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Truist Securities

Equity Research Report

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CONSUMER: Lodging

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Reasons for this report

✓ Deep dive analysis of recent U.S. hotel revenues and profits, a proxy for the Lodging REIT portfolios and within Lodging C-corps an excellent overview of franchisee health/fee generation of institutional hotel owners.

✓ The analysis is also a read-through on C-corp base and incentive management fees (IMFs) and owned/leased margins.

✓ Companies most impacted in this note include: HLT, H, MAR, the Lodging REITS, and secondarily PLYA as a leisure read-through.

April Hotel P&L Analyzer: Possible upside on 1Q C-corp fees/FY23 guides. Deep dive on trends.

As a follow-up to our "1Q Lodging Earnings Preview: At a minimum should be in-line but more likely ahead", we take a far deeper dive into revenue and expense big data on over 1,000 U.S. hotels (data source: HotStats). Our analysis is helpful for analyzing Lodging C-corps and REITS.

Our "Bottom Line": Our analysis suggests possible 1Q EBITDA beats/raises for REITS and strong 1Q U.S. C-corp base management fee generation. Absolute GOP margin in February was 34.8% (+150 bps vs. Feb 2019 / +70 bps y/y). January was -80 bps vs. Jan 2019. Margins have remained fairly steady since mid-2022 for full-service with modest improvement in select-service.

This note includes several deep dive multi-year and YTD trends of HotStats data complemented by discussions with public and private hotel owners, including:

- Revenue demand segmentation (subsegments within transient and group)
- C-corp base and incentive management fees (IMFs) and owned and leased EBITDA
- Operating expenses
- Gross Operating Profit (GOP) margin trends for full- and select-service
- Labor/union issues
- Food and beverage (F&B) customer pricing and costs
- Popular media talking points such as resort fees and U.S. hospitality hiring trends
- The rising headwind of insurance
- The above aggregated impact to hotel development pipelines

Major takeaways:

(First, please note our data set continues to skew slightly above the average Upper Upscale hotel and to institutionally-owned urban and resort hotels which may add some variance to STR data and individual public company results. ***Please view the PDF version of this note for superior quality of exhibits.****)*

A) YTD results, forecasts, and read through to earnings:

- We compared consensus estimates with January/February P&L results. Due to the recovery of group demand and conservative assumptions given limited visibility, we view opportunities for 1Q C-corp and EBITDA beats/guidance raises. Given macro uncertainty, we expect guidance raises more likely to be in-line with 1Q beats. For C-corps, we have more confidence in C-corp base management fee beats than IMFs and owned and leased profits but there is potential upside to consensus in all categories.
- **Rising insurance costs should dent C-corp IMFs and a multi-year hit to REIT margins** ex-hoteliers taking the risk to self-insure hotels.
- We see evidence that post-pandemic operating cost cuts are positively impactful to margins and REIT EBITDA but obfuscated by still depressed midweek occupancy.

B) Profit forecasting beyond 1Q23:

- Tricky with limited visibility. The biggest variable to 2Q23 and FY 2023 margins is how occupancy actualizes for groups/conventions and leisure travel. If there is weakness to demand, some of the fixed cost structures (in some cases rising much faster than room rates) may outweigh reductions in variable costs. **We view flattish to positive GOP margins for FY 2023 as not unreasonable if group and leisure trends hold.**
- GOP margin seasonality has largely returned to pre-pandemic norms. **Full-service margins are flattish to 2019 whereas select-service remains below but improving.**

C) Demand and segmentation trends:

- **Group:** Business and SMERF ADRs materially outperforming conventions (10-20 point spread) suggesting continued structural demand challenges in the latter.
- **High-end leisure:** Possible signs of slippage in U.S. luxury leisure/resort room rates.
- **Corporate transient:** Improving revenue mix but remaining depressed on demand with higher-rated hotel ADRs flattish to 2019.

D) Operations, labor, unions, and guest charges:

- **Labor cost growth is moderating**, driven partly by the rehiring of food and beverage/catering (F&B) staff in 2H22, which we view as material to overall U.S. hospitality hiring last year, the hiring slowdown YTD, and F&B margin deceleration. Moderating labor cost growth should lead to margin tailwinds during peak group months this year...
- ...**but union issues are increasingly evident** and may be a rising hotel profit threat.
- **Restaurant food and liquor prices have risen significantly for guests** but expenses are rising in similar fashion (up 20-40% versus 2019).
- **Resort fees/guest surprisingly do not appear to have risen** much since the pandemic.
- **Utility costs are up ~ 20% to 2019 and gas up as much as 55%.** If utility costs stay up ~20%, profit margins may be dragged down by 50 bps in 2023 relative to 2019 levels. We are cognizant that energy costs may start to decline.

E) Hotel development/pipeline:

- For hotel underwriting, **simple labor models** for prototypical new build and conversion brands **rule the day**.
- **New build hotel development appears challenged in corporate-focused higher-end select service** and urban full-service as ADRs and absolute profits are still well below cost growth.
- Given ADR growth in Economy/Midscale and resort markets post-2020, we view hotels within these segments likely to have superior feasibility and underwriting for new hotel development.
- **More C-corp conversions with attractive deal terms (key money/fee ramps/etc.) and M&A/brand launches of conversion friendly brands.** As a consequence of softer new construction in big urban and corporate suburban markets, **we expect a further push to develop new hotels in emerging markets beyond China such as India and a focus on global leisure destinations** at all price points.

Stock calls:

- **No changes to our ratings.** For hotel pipelines given our P&L analysis, we prefer **Hilton's** (HLT, Hold) presence in efficient new build and conversion brands at Midscale and Premium Economy price points such as Tru and Spark. We view **Wyndham** (WH, Buy) well-positioned for the underwriting/construction of Economy Extended-Stay ECHO Suites with lending support from local/community/neighborhood banks. **Marriott** (MAR, Hold) may benefit considerably if/when Midscale City Express is launched in the U.S. Within REITS, we view **Ryman** (RHP, Buy) best positioned due to operating efficiencies from high occupancy from groups. **We are more cautious on luxury hard brands that have stringent labor and operating standards; several Hold-rated REITS have bought luxury resorts in recent quarters.**

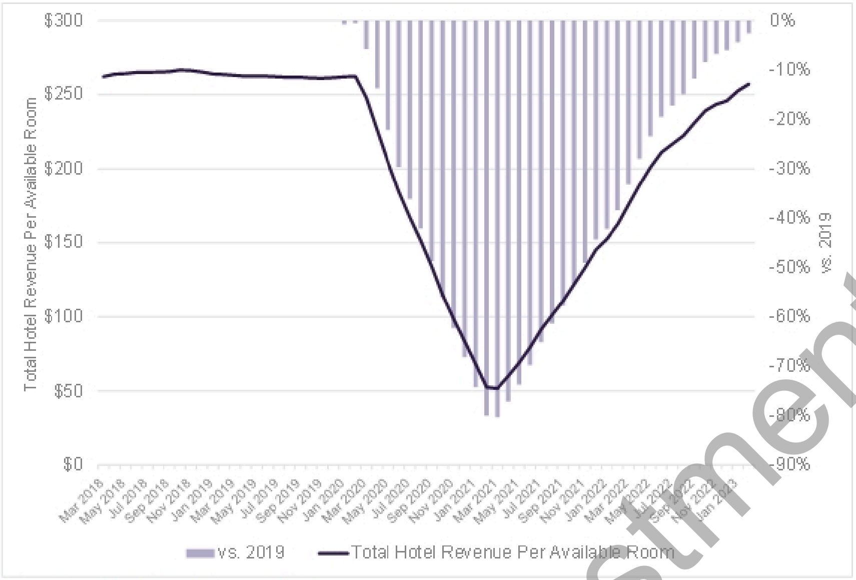
A) YTD results, forecasts, and readthrough to earnings:

We start with the Lodging C-corps and base management fees. We then shift to profits, focusing on C-corp incentive management fees (IMFs), C-corp owned and leased margins (O&L), and Lodging REIT Hotel EBITDA.

For the C-corps, the good news is the recovery of group demand is of particular benefit to U.S. base management fees given outside-of-room spend such as food and beverage (F&B)/catering flowing to greater total revenues. We have more confidence that revenue-driven base management fees may be an earnings beat than the difficult-to-forecast and profit driven IMFs.

We can see the trend of the recovery of U.S. total hotel revenues and gross operating profits in the following exhibits. We assume inflationary cost pressures to push room rates and outside-the-room price increases on F&B, recreation, and meetings combined with strong group demand are drivers to Total RevPAR growth and therefore higher base management fees despite below normal occupancy. Even though total revenues are finally recovering to nearly 2019 levels, the not-so-good news is total revenues remain well behind pre-pandemic levels when factoring inflation.

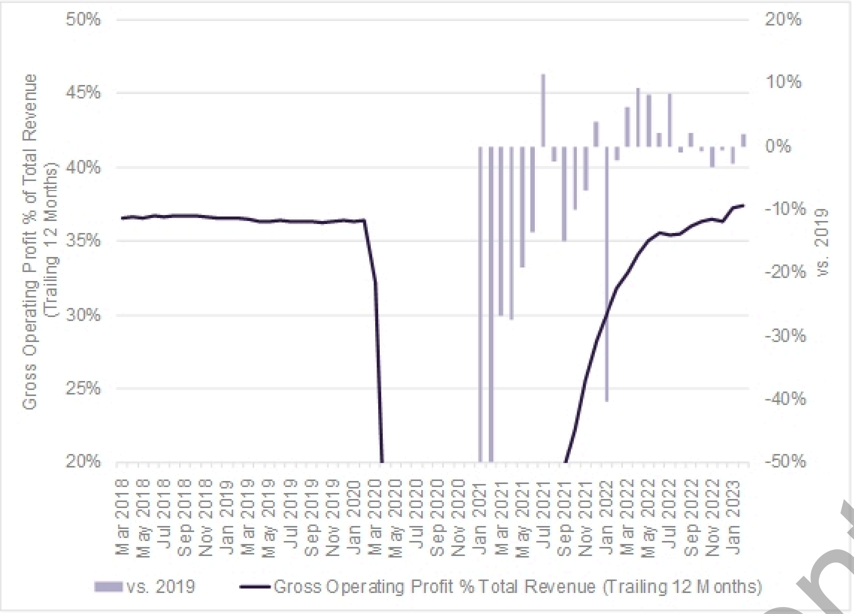
Exhibit 1: Total Hotel Revenue Per Available Room (Trailing 12 Months) and vs. 2019 Recovery



Source: Truist Securities Research, HotStats

In the following exhibit we can see that Gross Operating Profit margins were at times above 2019 levels in 2022 but we view part of the reason due to low staffing of the F&B department and in some cases closed restaurants. For investors asking why hoteliers should not continue the 2022 strategy, we note that abnormally low F&B staffing/operations for hotels is not long-term sustainable for many full-service hotels nor a good strategy given the need for diversified sources of lodging demand. As an example, we can see firsthand how important the recovery of midweek corporate group demand is today given weakness in individual corporate travel.

Exhibit 2: Gross Operating Profit % of Total Revenue (Trailing 12 Months) and vs. 2019 Recovery

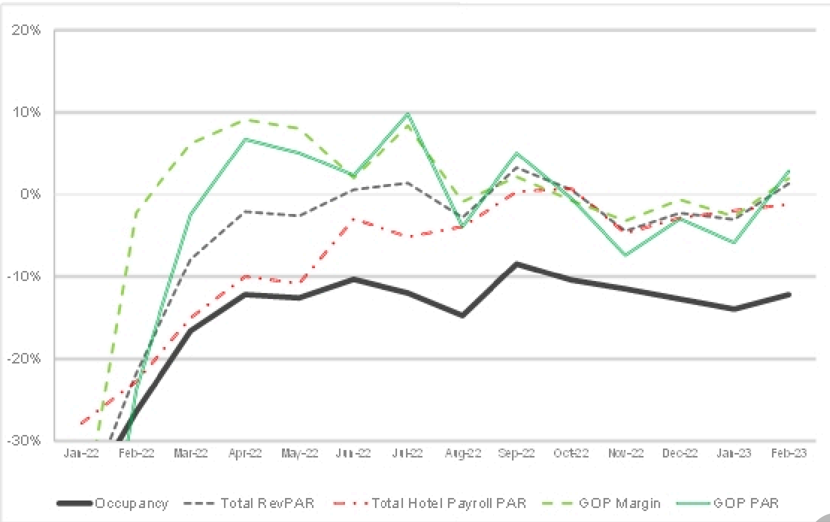


Source: Truist Securities Research, HotStats

While F&B is generally the second-largest revenue department in a hotel and important to efficient hotel operations especially given rising fixed costs (see the insurance discussion further in this note), F&B is labor-intensive and far lower margin than the rooms department. Note: lounges/bars are often higher margin than restaurants due to high liquor profits and some restaurant/F&B outlets operate at a loss even in the best of times. Catering/group events are often higher margin than hotel restaurants; given group demand strength, group-related revenues will be an important driver to C-corp base and incentive fees in 2023.

In the below summary chart, we can see that even though occupancy remains depressed, total RevPAR and profits have generally hovered in the -5% to +5% range versus 2019 for several months. We view the rehiring of staff in 2H22 evidenced in the red line below, particularly the many tipped and non-tipped roles in lower-margin F&B, as a contributing factor to the flattish profit trends. Despite some continued weakness in some major U.S. market performance and some leisure demand shifting outside of the U.S. due to high room rates, we anticipate March revenues and profits to improve versus February results driven by strong group results and the Easter holiday calendar shift that benefited March 2023 versus same periods in 2019 and 2022.

Exhibit 3: Occupancy, Total Revenue, Margins, and Labor Costs vs. Same Month 2019



Source: Truist Securities Research, HotStats

For international base management fees, we view the U.S., Caribbean, and Middle East best positioned, positive to **Hyatt** (H, Buy) and **Playa** (PLYA, Buy) and secondarily **MAR** with possible upside to guidance driven by international travel to Europe and Japan. Given the recent recovery of China travel and possible uncertainty built into 1Q guidance, we assume the robust recent recovery in March would benefit MAR, H, and HLT in that order.

Forecasting IMFs are incredibly challenging. We do not have strong conviction on how C-corp fees will actualize especially given the increasing mix of Asia-Pacific hotels without profit hurdles compared to the hurdles that exist in many U.S. contracts. Marriott's managed room mix presents an interesting example of how IMF generation may be shifting and where we expect less volatile fees over time assuming no more demand shocks or COVID-style country shutdowns:

- North America managed rooms in 1Q19: 242K rooms. 4Q22: 215K. **Percent change: -11.2%.**
- International managed rooms in 1Q19: 308K rooms. 4Q22: 345K. **Percent change: +12.0%.**
- We add that the lost rooms in Russia and in U.S. select-service managed contracts are probably less material to IMFs than the pickup in managed contracts elsewhere.

We note that versus 2019 IMF consensus for MAR and HLT are still below 2019 levels which may make sense given rising hotel-level costs such as labor/F&B/utilities/taxes/insurance, China only recently reopening, and some higher-end business and leisure travel remaining depressed. That said, U.S. absolute profit results may present favorably to IMF generation if March profit results follow the trends of February and given the recovery of group demand this year. In the following exhibit on IMF consensus, we excluded H as we did not have reliable consensus figures.

Exhibit 4: C-Corp Incentive Management Fee (IMF) Consensus for 1Q23 vs. 2019/2022

C-Corp IMF Consensus ($M)

	1Q23	1Q22	% change
HLT	54	34	59%
MAR	145	102	42%
		1Q19	**% change**
HLT		55	-2%
MAR		163	-11%

Source: Truist Securities Research, FactSet

U.S. incentive management fees are hard to forecast as contracts vary. We break out two general types of fee structures and impact to C-corps and REITS.

- For contracts where an IMF contribution cutoff is Gross Operating Profit or some equivalency, which includes some C-corp managed hotels, we focus on absolute GOP which the HotStats data tracks. GOP recovery would be a tailwind to the recovery of IMFs.
- Other management contracts use an IMF contribution based on Net Operating Income or some equivalency. Many REIT owned hotels including several managed by the C-corps and third-party operators reflect a profit line that includes fixed costs. In these scenarios, the IMF contribution to the hotel operator could be negatively impacted by rising taxes and insurance. **Effectively, hotel operators/C-corps that use NOI-based fee structures may see lower fees in part due to fast rising non-variable costs such as insurance which is rising well into the double digits y/y for many properties.** Taxes and insurance may represent ~3-6% of total revenues but a 10% y/y increase for example would cut into margins by 30-60 bps and would have to be made up for by considerable revenue growth and/or other cost savings. Some hotel level insurance costs are rising significantly above 20% and may remain sustainably higher unless hoteliers decide to risk and self-insure.

For C-corp owned and leased (O&L) margins and REIT Hotel EBITDA margins, we focus on portfolio-specific considerations.

C-corps: While highly difficult to forecast from our seat, O&L can be impactful to earnings beats/misses, where we receive investor questions, and worthy of discussion in this note despite reflecting a minority of overall EBITDA mix. We present where there may be puts/takes to results given geographic exposure. For **Choice** (CHH, Hold), we do not have great conviction on how the formerly Radisson-owned hotels in Minneapolis will perform under new CHH ownership although 1Q is low season and the city hosted the 2022 NCAA Division I Women's Final Four in early April making for possibly a tougher y/y comp in late March. **HLT's** leased portfolio is heavily in Europe and Japan including several "Regional UK" hotels that we assume would be in low season in 1Q. HLT pointed to limited COVID-related subsidies in 1Q23 on the 4Q22 earnings call. We assume **MAR's** owned exposure is materially influenced in the U.S. by the 1,073-room Westin Peachtree Plaza in Atlanta (far larger in room count than the W New York – Union Square and the three Las Vegas properties). While we do not know the performance of the Westin, 1Q23 Luxury/Upper Upscale Atlanta RevPAR was -16.2% versus 1Q19 and Group was -33.7%. Atlanta hosted the Super Bowl in February 2019. MAR should benefit from the Barbados properties which we presume performed well given Caribbean strength. We cannot as easily speak to the leased hotels which are diversified from U.S. Courtyards to major European and Japanese assets to a collection of South African hotels. For **H**, the owned portfolio is also quite diversified including 1,000+ room hotels in NYC, Chicago, and Orlando and the Miraval wellness-focused resorts. Group performance can be property specific. We assume the warm-weather Miraval resorts performed well given secular wellness demand strength. International owned and unconsolidated JV hotels are scattered across the world. While we assume a y/y recovery in margins, we do not have much conviction on 1Q23 H O&L results.

Exhibit 5: C-Corp Owned & Leased (O&L) Margin Consensus for 1Q23 vs. 2019/2022

C-corp Owned and Leased Margins Consensus

	1Q23	1Q22	y/y change (bps)
CHH	27%	32%	(558)
H	22%	23%	(88)
HLT	1%	-23%	2,393
MAR	18%	25%	(687)

		1Q19	4-yr change (bps)
CHH		N/A	N/A
H		24%	(242)
HLT		4%	(389)
MAR		13%	460

Source: Truist Securities Research, ConsensusMetrix

Shifting to the full-service Lodging REITS: it is possible that we may see EBITDA beats driven in part by conservative guidance, group strength, and the flow to margins. While we are concerned about rising fixed costs such as insurance, the combination of our review of HotStats data for January and February, March STR results that presented no clear decelerating trends on the macro, and consensus figures suggests possible 1Q EBITDA beats. If our assumptions hold true, we do not assume REITS will be aggressive on EBITDA guidance revisions for either 2Q23 or FY 2023 given uncertainty on the macro. FY 2023 guides may only be revised by the extent of the 1Q beat. While we do not have March P&L data yet, we compare the GOP margins for January and February y/y and versus 2019 against consensus. We focus particularly on the y/y and 4-yr change in GOP absolute dollars and margins. There are a number of noisy comparisons for 2022 given the easy Omicron comp especially in January to mid-February that was fading in March. On a 4-year basis, March 2019 reflects superior individual business travel and occupancy for many hotels compared to 2023 although the Easter holiday shift works in the favor of 2023. Net-net given February 2023 P&L results and March RevPAR data from STR, we are favorable about how 1Q Hotel EBITDA may actualize. *We present additional historical trends in the back pages/PDF of this note.*

Exhibit 6: January-February YTD Hotel Performance (Our Data Set)

Aggregated U.S. Hotel Operating Performance: Jan-Feb 2023 vs. Prior Years

	Jan-Feb 23	Jan-Feb 22	*y/y % change*	Jan-Feb 19	*4-yr % change*
Occupancy	61.2%	47.9%	*27.8%*	70.4%	*-13.1%*
ADR	$248	$230	*7.5%*	$217	*14.2%*
RevPAR	**$152**	**$110**	***37.4%***	**$153**	***-0.7%***
Total RevPAR	**$242**	**$170**	***41.8%***	**$244**	***-0.8%***
Room Margin	71.4%	70.2%	*1.7%*	71.4%	*0.0%*
F&B Margin	28.8%	17.3%	*66.5%*	29.3%	*-1.7%*
Operating Department Margin	59.1%	57.9%	*2.1%*	58.2%	*1.5%*
GOP Margin	**33.1%**	**27.7%**	***19.5%***	**33.0%**	***0.3%***
GOP Per Available Room	**$80**	**$47**	***69.4%***	**$80**	***-1.0%***
Total Hotel Payroll (% of Total Revenue)	37.5%	40.4%	*-7.2%*	37.8%	*-0.8%*
Total Hotel Payroll (Per Available Room)	$91	$69	*31.9%*	$92	*-1.6%*
Total Hotel Payroll (Per Occupied Room)	$148	$143	*3.1%*	$131	*13.1%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

Exhibit 7: REIT Hotel EBITDA Margin Consensus for 1Q23 vs. 2019/2022
(please note we could not determine proper consensus for Park (PK, Buy, Scholes) or RHP's Hospitality segment)

REIT Hotel EBITDA Margins Consensus

	1Q23	1Q22	y/y change (bps)
DiamondRock (DRH)	26%	25%	61
Host (HST)	31%	30%	126
Pebblebrook (PEB)	29%	32%	(391)
RLJ (RLJ)	36%	35%	184
Sunstone (SHO)	26%	20%	564
		1Q19	**4-yr change (bps)**
DiamondRock (DRH)		22%	411
Host (HST)		30%	92
Pebblebrook (PEB)		36%	(698)
RLJ (RLJ)		37%	(112)
Sunstone (SHO)		26%	(30)

Source: Truist Securities Research, ConsensusMetrix

Exhibit 8-9: Gross Operating Profit Margins as a Percentage of Revenues (top exhibit) and vs. 2019 (bottom exhibit)

GOP margin seasonality (% of revenue) has largely returned to pre-pandemic norms…

Full-service margins flattish to 2019 whereas select-service remains below 2019 but improving

Note: We have intentionally not presented the deeply negative margins in 2020 for easier visuals.

YTD results

February 2023: GOP margins of 36.7% compare to 35.2% in February 2022 and 36.0% in February 2019. Total Hotel RevPAR (which includes outside-the-room spending such as F&B, catering, and recreation) was $264 versus $261 in February 2019. Given the full-service and institutional-quality nature of the HotStats data set, we are not surprised to see occupancy still well below 2019 levels although ADR growth and operating efficiencies have helped profit performance. The below data provides evidence that post-pandemic operating cost cuts are positively impactful to margins and REIT EBITDA but obfuscated by still depressed midweek occupancy.

Exhibit 10: February Hotel Performance (Our Data Set)

Aggregated U.S. Hotel Operating Performance:
Feb 2023 vs. Prior Years

	Feb-23	Feb-22	*y/y % change*	Feb-19	*4-yr % change*
Occupancy	65.5%	54.9%	*19.3%*	74.6%	*-12.2%*
ADR	$254	$241	*5.2%*	$220	*15.4%*
RevPAR	**$166**	**$132**	***25.5%***	**$164**	***1.4%***
Total RevPAR	**$264**	**$204**	***29.4%***	**$261**	***1.3%***
Room Margin	73.1%	73.7%	*-0.8%*	72.8%	*0.4%*
F&B Margin	32.1%	26.7%	*20.2%*	32.3%	*-0.6%*
Operating Department Margin	61.3%	61.9%	*-1.0%*	60.1%	*2.0%*
GOP Margin	**36.7%**	**35.2%**	***4.3%***	**36.0%**	***1.9%***
GOP Per Available Room	**$96**	**$72**	***34.8%***	**$94**	***2.8%***
Total Hotel Payroll (% of Total Revenue)	34.8%	35.3%	*-1.4%*	35.6%	*-2.2%*
Total Hotel Payroll (Per Available Room)	$92	$72	*27.8%*	$93	*-1.2%*
Total Hotel Payroll (Per Occupied Room)	$140	$131	*7.0%*	$125	*12.3%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

January 2023: GOP margins of 29.2% compare to 17.9% in January 2022 and 30.0% in January 2019. January data reflects a very easy y/y Omicron comp and a tougher 2019 comp in some Top 25 markets such as San Francisco. January is the lowest occupancy month of the year for the HotStats sample.

Exhibit 11: January Hotel Performance (Our Data Set)

Aggregated U.S. Hotel Operating Performance: Jan 2023 vs. Prior Years

	Jan-23	Jan-22	*y/y % change*	Jan-19	*4-yr % change*
Occupancy	57.3%	41.5%	*38.1%*	66.6%	*-14.0%*
ADR	$241	$218	*10.8%*	$214	*12.8%*
RevPAR	**$138**	**$90**	***53.0%***	**$143**	***-3.0%***
Total RevPAR	**$222**	**$140**	***57.9%***	**$228**	***-3.0%***
Room Margin	69.5%	65.7%	*5.8%*	70.0%	*-0.7%*
F&B Margin	25.2%	3.7%	*581.1%*	26.3%	*-4.2%*
Operating Department Margin	56.7%	52.7%	*7.6%*	56.3%	*0.7%*
GOP Margin	**29.2%**	**17.9%**	***63.1%***	**30.0%**	***-2.7%***
GOP Per Available Room	**$64**	**$25**	***157.9%***	**$68**	***-5.9%***
Total Hotel Payroll (% of Total Revenue)	40.4%	47.1%	*-14.2%*	39.9%	*1.3%*
Total Hotel Payroll (Per Available Room)	$89	$66	*35.8%*	$91	*-2.0%*
Total Hotel Payroll (Per Occupied Room)	$156	$158	*-1.6%*	$137	*14.0%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

March forecast considerations

While we are not prepared to resume our quarterly margin forecasts, we forecast the following margins in March 2023, supported by an easier Easter calendar shift comp in 2023 (+ to March and - to April). We note that margin forecasting remains highly difficult and we do not have strong conviction in our ranges:

- Room margins: mid to upper 70s (vs. 74.8% in March 2019)
- F&B margins: 32-36% (vs. 32.9% in March 2019)
- Operating department margin: mid 60s (vs. 62.5% in March 2019)
- GOP margin: 39-44% (vs. 40.3% in March 2019)

B) Profit forecasting beyond 1Q23

Forecasting even 2Q23 is tricky. In our opinion, the biggest variable to 2Q23 and FY 2023 margins is how occupancy actualizes. If there is weakness to demand, some of the fixed cost structures (in some cases rising much faster than room rates) may outweigh reductions in variable costs. **We view flattish to positive GOP margins for FY 2023 as not unreasonable if group and leisure trends hold.** For REITS, we view in-house group strength and outside-the-room spend flowing to operating profits thus placing **RHP** best positioned due to high occupancy group efficiency especially given higher-end individual business travel remaining sluggish (weak on both fronts: San Francisco). The group tailwinds would also benefit C-corp management fees. Cost growth issues would be far more pressing if occupancy moderates especially from higher-rated leisure and group travel partly because staffing levels are closer to normalization today. We remain guarded on 2H23 margin trends given limited demand visibility.

Leisure resort performance may show signs of increasing diversion of results driven by the relative inflexibility of luxury brand standards/ staffing and a greater shift to groups. We can appreciate the long-term EBITDA benefits from resorts that saw large ADR growth since 2020 (a rationale why REITS "bought" EBITDA when urban was struggling) although short-term focused investors may be disappointed by margin deceleration at resorts that increase their group mixes due to weaker individual leisure demand. We generally prefer flexible operations for resorts and remain most cautious to luxury hard brands with operators that are less flexible.

- Our analysis presented further in this note suggests **modest weakening in U.S. leisure average room rates** which is supported by some American travelers taking vacations outside the U.S., supply growth of short-term rentals, and vacation value propositions elsewhere in a favorable FX environment (Europe/Caribbean/parts of Asia/cruising). **Weakening ADRs would be most negative to luxury resort top-line and margins.**

Our 2023 full-service GOP margin assumptions for now:

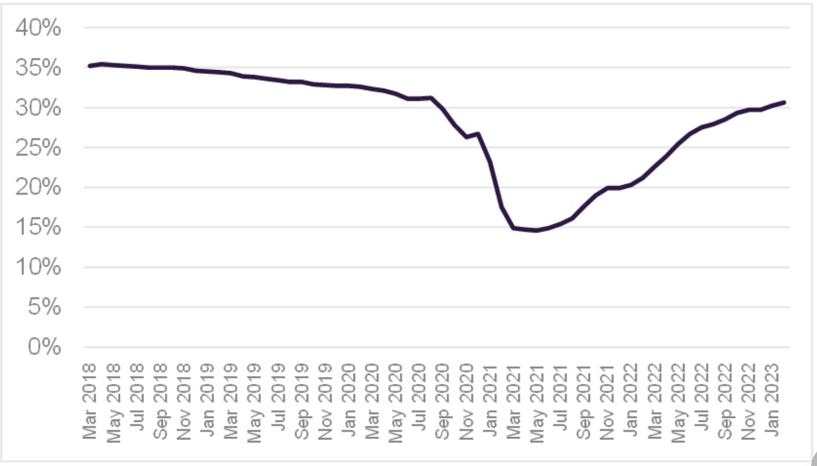
- **Base case:** Some softening on the macro but hoteliers can adapt through reductions in variable costs (staffing). Strength in group demand very meaningful.
- **Bull case:** If the macro holds, driven in part by strong group occupancy and recovering transient corporate, rising costs are kept somewhat in check. Hotel IMF contributions are more robust and REIT EBITDA guidances could rise materially through beat-and-raise scenarios. **We could assume flattish to positive y/y margin growth in this scenario.**
- **Bear case:** The biggest hit to many hotels' margins would be soft in-house group and leisure demand followed by declining ADR, leading to underutilization of rehired F&B staff.

C) Demand and segmentation trends:

We evaluated the “subsegments” within Transient and Group to better analyze strengths and weaknesses in the three customer segments of Group/Convention, Transient Leisure, and Transient Corporate (individual business travel). Given our HotStats data focuses on higher-rated hotels, we view this narrow look as additive for full-service hotels and not necessarily relevant for lower-priced hotels in the Economy and Midscale space.

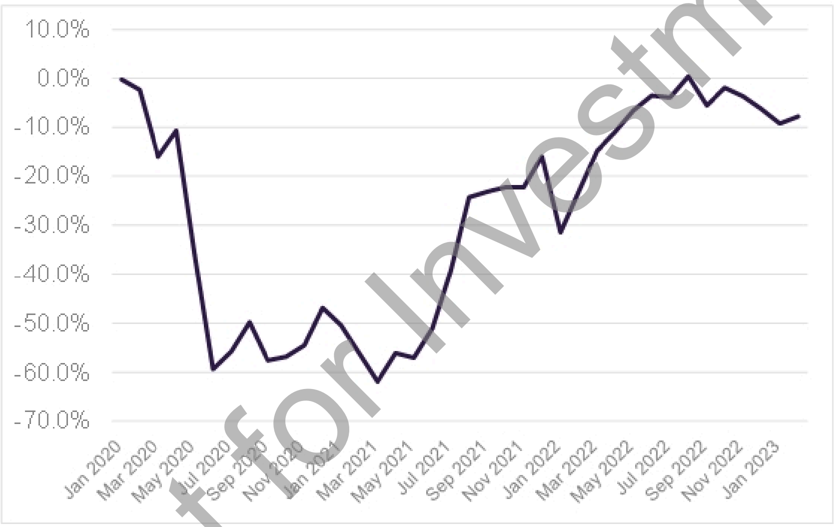
Group: We see clear evidence of the recovery of Group revenues in recent months although the group revenue mix is still ~3-5 points below 2018-2019 levels. We discuss why that may be the case below.

Exhibit 12: Group Rooms Revenue Mix - Trailing 12 Months (Group % of Rooms Revenue)



Source: Truist Securities Research, HotStats

Exhibit 13: Group Rooms Revenue Mix (Group % of Rooms Revenue) vs. 2019

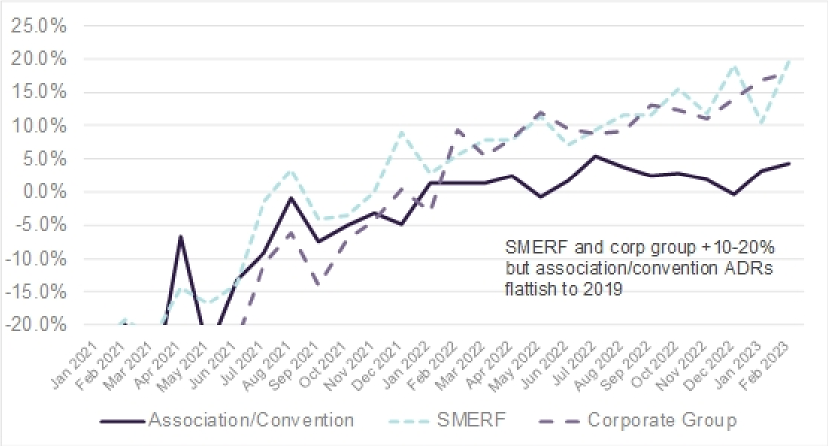


Source: Truist Securities Research, HotStats

Subsegment trends show corporate and SMERF group ADRs now +10-20% over 2019 levels and well ahead of association/ convention (flattish to 2019). We can interpret from ADR trends of the continued challenges in some large associations/ conventions due to hybrid and virtual meetings as well as lower attendance both from domestic and international travel. As a consequence, big cities have less opportunity for citywide hotel sellouts and pushing higher room rates. The pricing trends of corporate groups and SMERF or SMERFE (social/military/educational/religious/fraternal/ethnic group which is often lower-rated and weekend-led) continue to rise YTD.

The benefiting hotels cater to in-house groups. We view **RHP best positioned** within the REITS for large in-house corporate group.

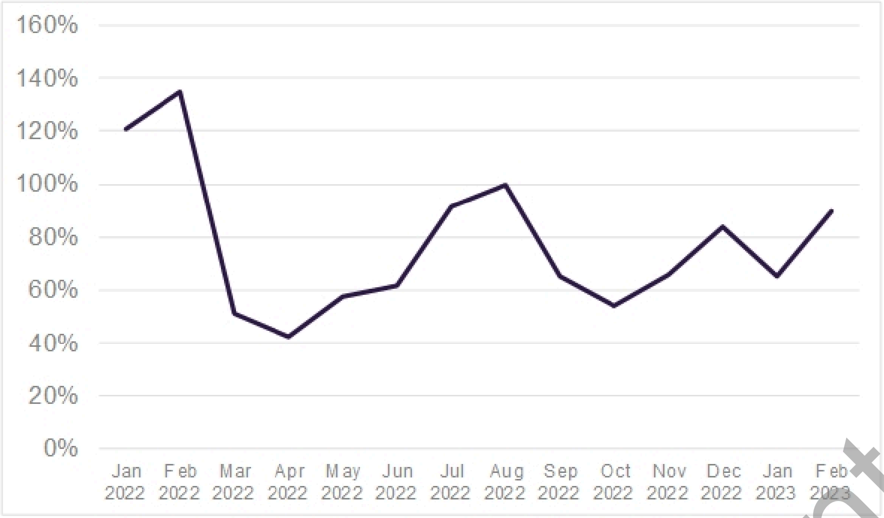
Exhibit 14: Subsegment Group ADR: % Recovery vs. 2019 Levels



Source: Truist Securities Research, HotStats

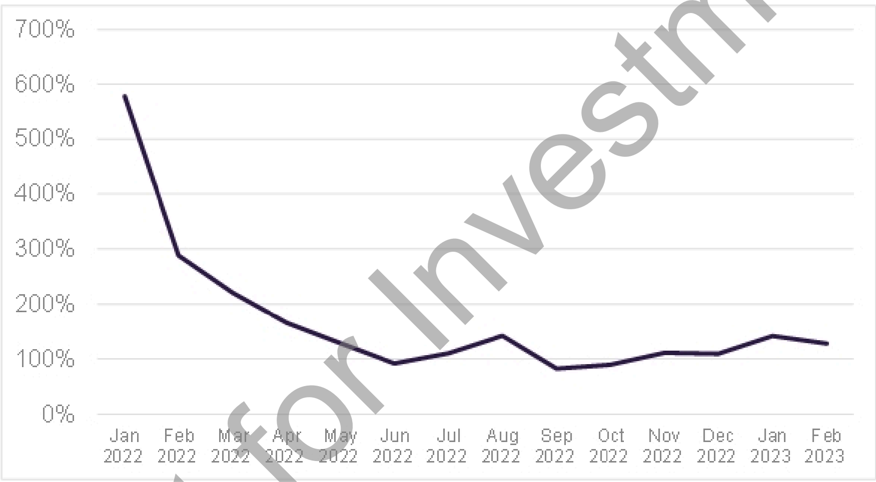
Further diving into the detail, we see that cancellation and attrition fees are still well above 2019 levels although we see cancellation fees stabilizing for the past several months whereas attrition fees have not. We are unsure what to make of the disconnect or if lower-than-expected attendance is a factor. According to a survey by the International Congress and Convention Association, more than half of associations (51%) are holding their largest 2023 meeting in person which compares to 41% in 2022 and 14% in 2021. However, virtual meetings are still backed by 37% of organizers (AMI Magazine). The survey results also show over 90% of associations incorporating hybrid/digital options in their RFPs. While event attendance varies with some events running well above pre-pandemic levels, it is possible that some association/convention attendance is below meeting planner expectations.

Exhibit 15: Attrition Fees Per Occupied Room (vs. 2019): Remaining Elevated



Source: Truist Securities Research, HotStats

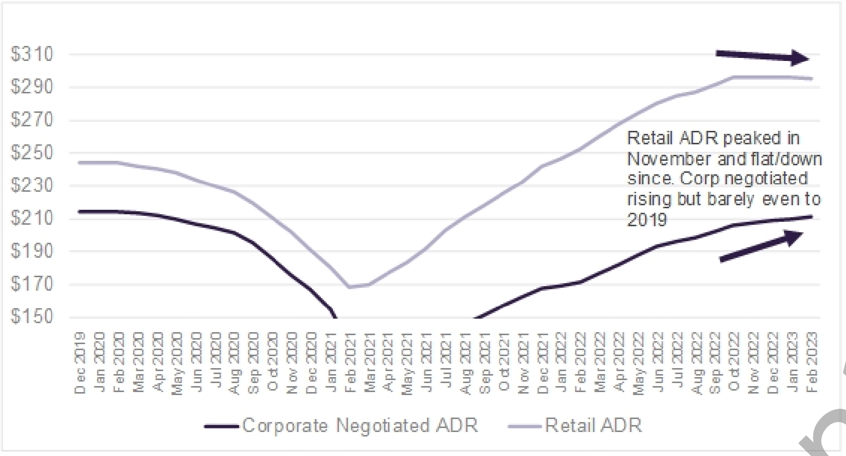
Exhibit 16: Cancellation Fees Per Occupied Room (vs. 2019): Elevated but Generally Stabilizing



Source: Truist Securities Research, HotStats

Transient leisure (high-end) and corporate negotiated (individual business travel): Retail ADR (proxy for high-rated leisure travel) and corporate negotiated ADR (individual business travel) are moving in opposite directions. We can see some evidence in the last few months of Retail ADR flat-to-declining on a trailing 12 month basis starting in November 2022. This trend seems quite supportable given the reopening of world travel for vacations discussed above. This trend could also indicate softness in higher-end U.S. leisure demand which is backed up by ARC data noting March passenger trips +3.5% y/y split +17.1% international and -3.7% domestic (Business Travel News). That said, we note that retail hotel ADR is still over $40 or 15-20% above 2019 levels. Conversely, corporate negotiated ADR is trending more positively but barely even to 2019 levels. In this data set, we see little to no evidence that higher corporate negotiated room rates for 2023 have materially impacted YTD results even though rates were reported to be up mid-to-high single digits y/y as discussed by public companies. Our distinct analysis of Tripbam data reflects ~ +5% growth. More analysis following the winter months could present better evidence of the impact of 2023 corporate room rate negotiations.

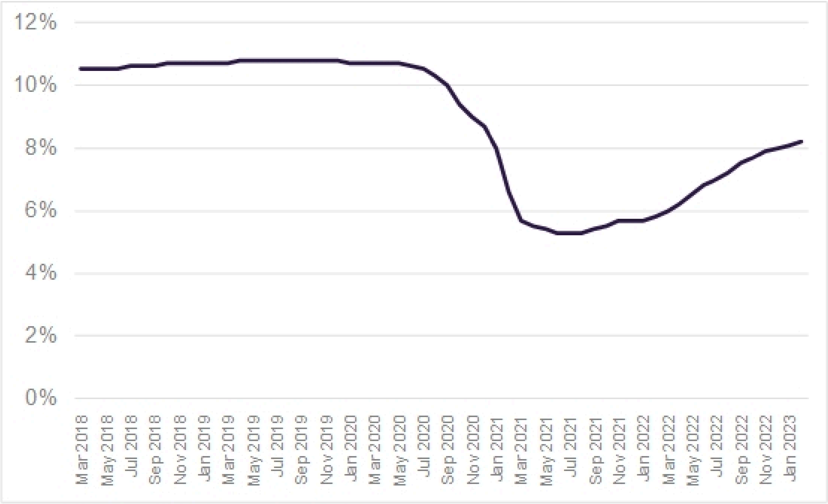
Exhibit 17: Retail and Corporate Negotiated ADR: Trailing 12 Months



Source: Truist Securities Research, HotStats

Similarly telling to the structural issues with individual corporate travel, the percentage of room revenue from corporate negotiated demand is more than 20% below 2019 levels. The good news is there continues to be a relative recovery of corporate negotiated revenues in 1Q23 which is very additive for hotel operating efficiency in the midweek and overall profits.

Exhibit 18: Corporate Negotiated Revenue Mix -- Trailing 12 Months (% of Rooms Revenue)



Source: Truist Securities Research, HotStats

Should hotels be pushing room rates? A recent push by one of the largest U.S. hotel owners: The CEO of one of the largest U.S. hotel owners (MCR, private) told hotel owners at the AAHOA conference a few days ago to push rate given inflationary cost pressures with the "media…doing our job" (Lodging Magazine). We note that ADR generally flows much more effectively to margins than occupancy gains although we appreciate greater profit efficiencies for group-oriented hotels with filled meeting space. The CEO also made comments about OTA commissions cutting into profitability and that MCR is removing many of its hotels from the OTAs. In an environment where corporate transient trends are still challenged, we can understand the CEO's points.

D) Operations, labor, unions, and guest charges:

We start with labor and a few of the key hourly and managerial roles at the hotels. Compared to a very difficult environment of fast rising costs and staffing shortages in 2022, we see somewhat less pressure today. **What has been less discussed by news media headlines about robust job hiring in hospitality in recent months (or the perception of a slowdown) is that job growth has likely been supported specifically by restaurant and meetings/events-related F&B roles** -- areas of the hotel that require a lot of employees, where margins are generally thinner, and where there was less business demand/greater health concerns pre-2022 (WSJ, CNBC, Skift). Concurrently, some of the moderation in wage growth to the +MSD/USD range y/y versus +10-15% in 2022 can be partly explained through the 2H22 hiring of low hourly waged roles in some tipped F&B positions.

- Hotels artificially keeping reduced occupancy due to labor shortages is likely a continuing trend for the foreseeable future. In theory the imbalance is "good" for room rate integrity heading into a possible macro softening given artificially reduced hotel supply. Cynically, we view this demand-supply balance may work until it does not work, or more specifically until a demand shock "un-artificially" impacts occupancy.

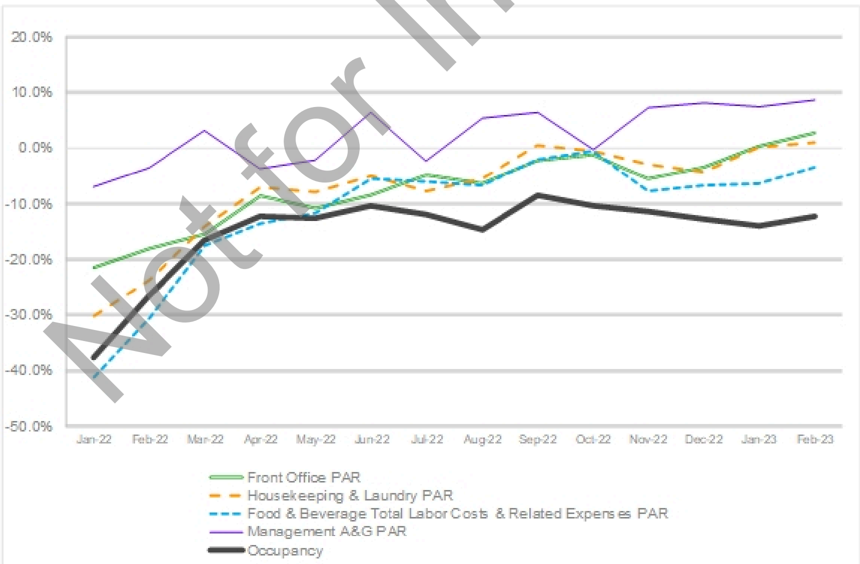
Union issues are increasingly evident and may be a rising hotel profit threat. We are watchful of activism that appear to be more prominent in recent months and may negatively impact hotel margins particularly for REIT-owned hotels and secondarily C-corp incentive management fees and O&L profits. The NYC suburbs' hotel union reached a deal in April to raise wages by $7.50/hour which according to the WSJ was the largest increase in the union's 100-year history. We see similar union action in Los Angeles and growing discussion in other major union markets (LA Times). We are not surprised to see activism as demand recovers and given cost of living increases. That said, in a possibly challenged macro demand environment, the potential ramifications of materially reduced hotel margins could rise especially if hotels cannot match cost increases with rising room rates.

- **Local ordinance issues: a triple whammy in the Los Angeles market.** In parts of L.A., ordinances have been passed that restrict the number of square feet a house cleaner can service in one day. Some hoteliers have noted to us tremendous challenges to build occupancy due to ordinances -- that it makes more sense to keep rooms vacant than occupied due to the higher variable costs. The consequence may end up being a double or triple whammy to these cities and the hourly workers: reducing tax proceeds due to lower revenues, fewer workers employed/hired, and perhaps less overall hotel development. Luxury hotels with suites and very large rooms (including hotels converted from apartment buildings) are particularly challenged by current rules.

Graphical representation of labor cost trends: Graphically, we present labor cost trends in two ways: on a per available room (PAR) basis and per occupied room (POR). As a reminder, some hotel roles exist regardless of demand (for example a general manager) and other roles are variable to travel demand. In general, we focus more on POR data but PAR data can be telling in a non-normalized operating environment. We focus on four particular labor departments that in totality represent ~20% of total hotel revenues or approximately 58% of hotel payroll (2019 comparisons). These departments are:

- **Front office salaries and wages** (non-managerial roles such as front desk): **1.2%** of total revenues in 2019
- **Housekeeping and laundry salaries and wages: 4.2%** of total revenues in 2019
- **Food and beverage (F&B) labor costs and related expenses: 13.3%** of total revenues in 2019
- **Management A&G** (managerial roles such as the General Manager, Director of Finance, Controller, Director of Human Resources, etc.): **1.4%** of total revenues in 2019.

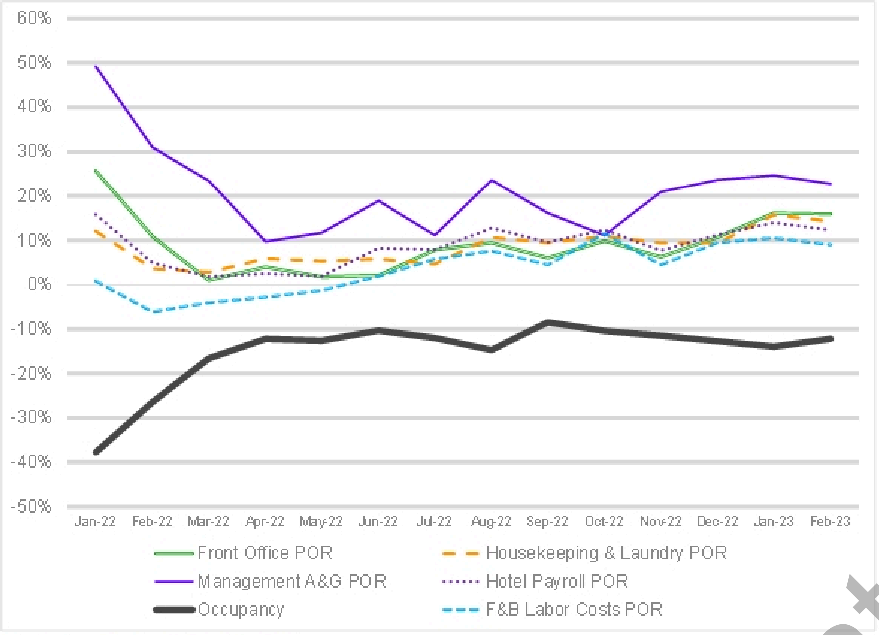
Exhibit 19: Occupancy Compared to Labor Costs by Hotel Department Per Available Room (PAR) vs. Same Month 2019



Source: Truist Securities Research, HotStats

On a POR basis, managerial costs are hovering around 20% over 2019 levels whereas many of the hourly roles are between 10-20%. We could explain some of the variance to staffing and operational efficiencies undertaken by hotel owners since the pandemic.

Exhibit 20: Occupancy Compared to Labor Costs by Hotel Department Per Occupied Room (POR) vs. Same Month 2019

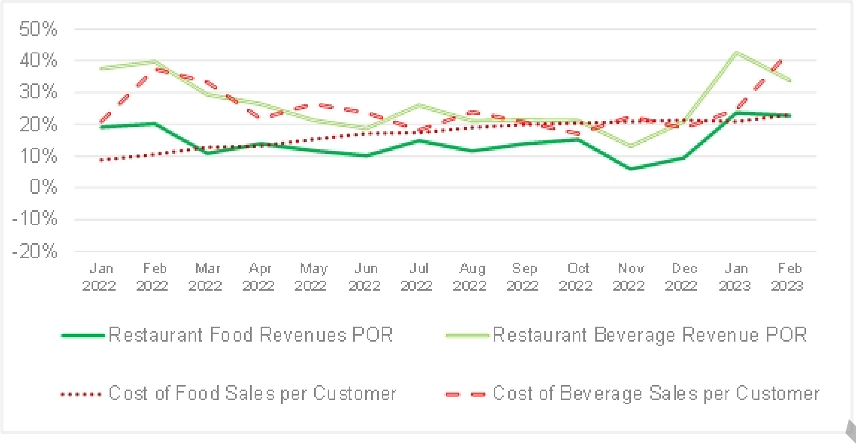


Source: Truist Securities Research, HotStats

Other P&L items

In food and beverage we see higher revenues in both food and liquor likely driven by material pricing increases. We focused on *restaurant* food and restaurant beverage (liquor) as a way to monitor both spend and cost increases -- both labor and the actual cost of consumed items. Given occupancy remains well below 2019 levels, we view clear evidence of higher pricing. Restaurant food revenues versus 2019 are trending +10-20% and beverages between +20-40%. **However, costs are up similarly. The trends suggest inflationary pressures and no great improvement to restaurant margins.**

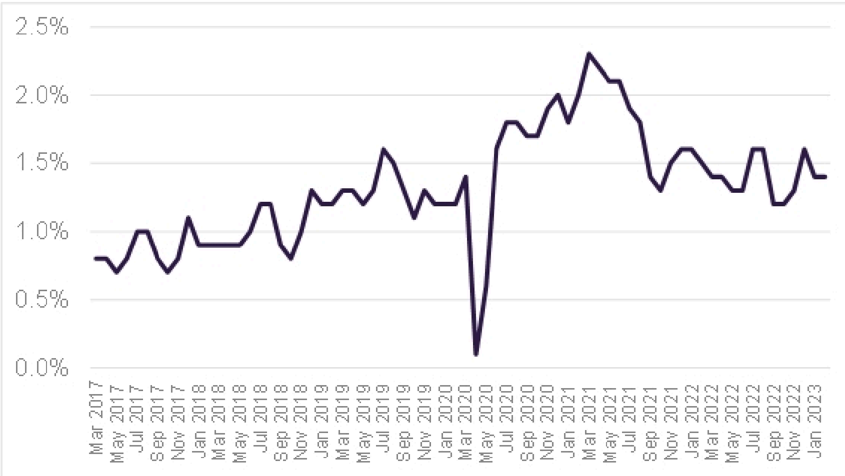
Exhibit 21: Restaurant Revenue and Expense Trends vs. 2019 Levels: Prices Up and So Are The Expenses (Not Customer Gauging)



Source: Truist Securities Research, HotStats

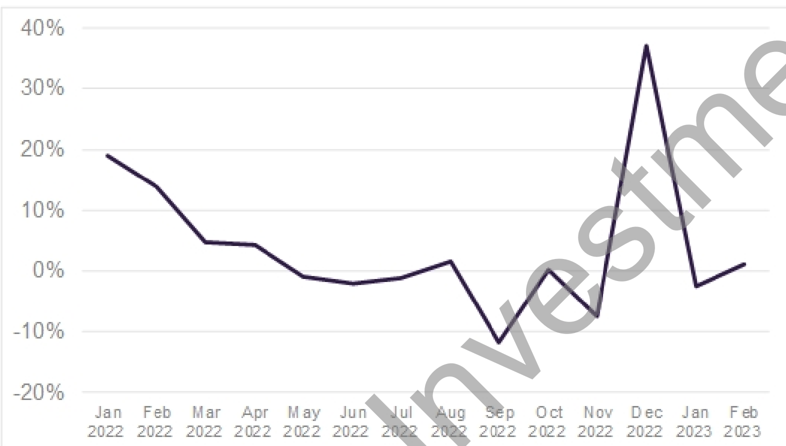
Resort fees remain a modest 1-2% of total revenues, although growing in importance. That said we see no clear evidence that the actual resort fees/guest have grown materially since 2019 — frankly this was very surprising to us. We recognize that resort fees are receiving considerable scrutiny from public officials although for the sake of evaluating actual pricing **we could argue that resort fees are *less profitable* than pre-pandemic** given inflationary and labor cost pressures.

Exhibit 22: Resort Fees (% of Revenues): Moderately Greater Importance to Hotel Revenues Post-Pandemic



Source: Truist Securities Research, HotStats

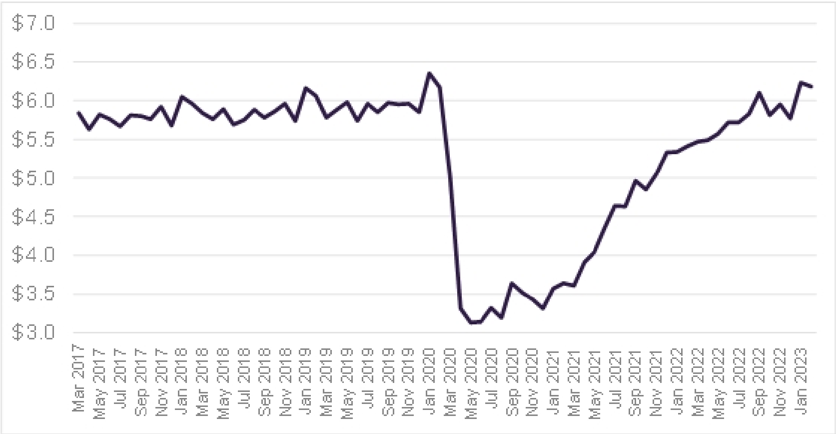
Exhibit 23: Resort Fees Per Occupied Room (vs. 2019): Not Growing Much, Surprisingly



Source: Truist Securities Research, HotStats

Repairs and maintenance is an important cost center for hotel upkeep and an area that hoteliers tell us is often understaffed, leading to more evidence of deferred upkeep of guest rooms and public spaces. We expected to find higher overall costs driven by labor but that has not been apparent in the HotStats data as of yet.

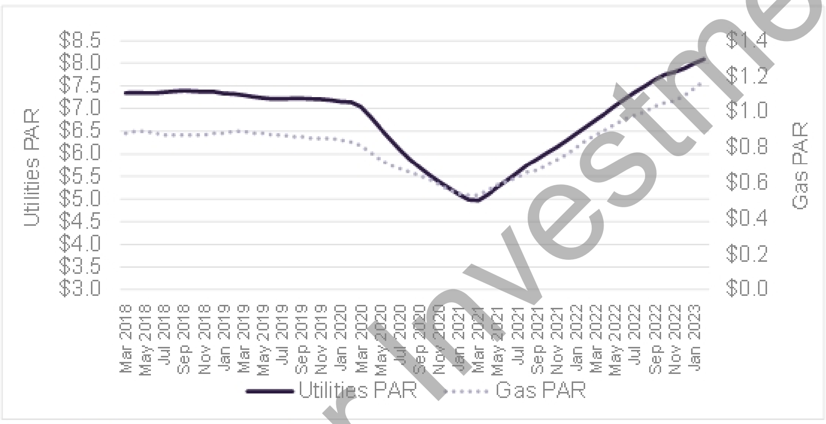
Exhibit 24: Repairs and Maintenance – Labor and Other Expenses Per Available Room (No Big Increases From Pre-2020)



Source: Truist Securities Research, HotStats

Utility costs which represent about 3% of total revenues have risen considerably since early 2022, particularly gas PAR which is up ~30% on a trailing 12 month basis relative to 2019 and was 55% higher than 2019 levels in February 2023. Overall utility costs are up nearly 20%. These costs alone may drag down margins by 50 bps or more in 2023. We are cognizant that energy costs may start to decline.

Exhibit 25: Utilities Costs Per Available Room – Spiking Costs Since Early 2022



Source: Truist Securities Research, HotStats

Fixed costs: We do not have HotStats data on taxes and insurance but informally we are aware of rising expenses in both areas. Insurance is more of the hot topic at the moment.

What is driving insurance premiums today for hotel owners:

- Hurricane impact from Ian and closures of big hotels in the Florida Keys and Naples/Ft. Myers (hundreds of $Ms of payouts)
- Often after a series of catastrophic natural disasters or terrorism, insurance rates rise
- Possible reduced supply of insurance funds from London
- Timing of when companies negotiate insurance – such as before or after hurricane season
- Higher interest rates
- Some REITS self-insure and/or do not partner with a franchisor who may have better terms due to the aggregation of hotels from Middle America to the coasts; REITS are highly concentrated in higher-risk markets

E) Hotel development/pipeline:

We wrap up the note with considerations to C-corp hotel pipelines as the feasibility of new hotel construction is directly impacted by P&L trends. When we put on our "feasibility/development hat" and factor the trends noted above we come to the following conclusions:

- **Simple labor models rule the day.** We focus on prototypical hotels and simple conversion brands. Outside of resorts and perhaps some group-focused hotels, we would not be surprised to see downscaling of new hotel development in the U.S. given both top-line and bottom-line trends.
- While U.S. individual business travel trends are improving, structurally we still see challenges to both demand recovery and ADR growth. Unless trends improve considerably, **we would expect to see reduced new hotel development in corporate-oriented urban and suburban markets – especially the higher-rated select-service brands that have been ankle-biters to full-service hotel occupancy and ADR in Top 25 markets for several years.**
- ADR growth since 2020 is a factor we consider for underwriting and we view higher ADR in leisure as a driver for development in resort markets and for Economy and Midscale (heavily in small towns/interstate and leisure destinations). Please see the below graphic for a visual representation of the disparity in 1Q23 vs. 1Q19 RevPAR performance by location, chain scale, and top markets.

Exhibit 26: 1Q23 RevPAR Change vs. 2019 by Chain Scale, Location, and Top Markets

	1Q23 RevPAR vs. 1Q19	*Chain scale/market QTD vs. national headline QTD (bps)*
US	13.1%	
Chain Scales		
Luxury	14.3%	*124*
Upper Upscale	3.9%	*(917)*
Upscale	5.8%	*(730)*
Upper Midscale	13.6%	*50*
Midscale	14.2%	*112*
Economy	13.7%	*62*
Independent	19.5%	*645*
Location		
Urban	1.3%	*(1,175)*
Suburban	11.7%	*(134)*
Airport	5.4%	*(769)*
Highway	20.5%	*744*
Resort	24.3%	*1,121*
Small Metro/Town	21.9%	*888*
The Big Six Markets		
Boston	4.3%	*(372)*
Chicago	2.5%	*(1,061)*
Los Angeles	5.0%	*(807)*
NYC	4.4%	*(862)*
San Francisco	-30.5%	*(4,352)*
Washington, D.C.	7.3%	*(581)*
Other Highly Relevant Markets		
Dallas	11.2%	*(188)*
Las Vegas	28.1%	*1,508*
Miami	16.4%	*335*
Nashville	13.3%	*23*
Oahu	8.7%	*(437)*
Orlando	18.3%	*520*
San Diego	16.6%	*355*
Seattle	-11.0%	*(2,403)*

Source: Truist Securities Research, STR

- Given construction costs, labor costs, and several other operating costs such as utilities and insurance have risen considerably more than RevPAR growth for some types of hotels, even without considering the lending environment, we view underwriting as structurally harder for new build hotels. **In order to shore up weaknesses in headline net rooms growth, we anticipate more C-corp conversions with attractive deal terms (key money/fee ramps/etc.) and M&A/brand launches of conversion-friendly brands such as HLT's Spark.** As a consequence of softer new construction in big urban and corporate suburban markets, we expect a further push to develop new hotels in **emerging markets beyond China such as India (given infrastructure spend) and SE Asia** and a focus on global leisure destinations at all price points and prototypical hotels.
- For U.S. pipelines given the aforementioned operating trends, **we view HLT far best positioned followed by WH.** MAR may benefit considerably if/when City Express is launched in the U.S.
  - We view HLT best positioned due to the still relatively new Midscale Tru brand and the recently launched premium Economy conversion Spark brand that are likely more economically feasible due to operating efficiencies and scale benefits.

- The major public C-corps have compelling extended-stay brands. Despite challenges to higher-rated corporate travel, we view quality extended-stay hotels with strong brand standards and efficient staffing as generally among the most profitable types of hotels. Extended-stay hotels are also very popular for guests given large rooms and amenities that sometimes include F&B. We are not surprised to see Hyatt enter the space recently with the Hyatt Studios concept that is positioned in Upper Midscale in the Americas. We are also very impressed with the growth of WH's ECHO Suites within the Economy space. Efficient labor costs, utilities, and relatively lower insurance costs may be additive for lender approval.

- We continue to like innovative operating brands overseas that could be replicated in the U.S. We still find properties in East Asia and parts of Europe to have minimalist approaches that do not take away from the guest experience and are operationally easier to maintain. While we remain guarded that robot-led front desks will be commonplace (we commonly point to a Japanese hotel that "fired" its robots), we have stayed at hotel brands by reputable companies abroad with innovative operations that could be acquisition or JV targets for the C-corps.

Exhibits 27-28: Additional Historical Hotel Performance Metrics (Our Data Set)

Aggregated U.S. Hotel Operating Performance:
Feb 2023 vs. Jan 2023

	Feb-23	Jan-23	*month % change*	*Abs, variance*	
Occupancy	65.5%	57.3%	*14.3%*	820	*bps*
ADR	$254	$241	*5.1%*	$12.31	
RevPAR	**$166**	**$138**	***20.2%***	**$27.90**	
Total RevPAR	**$264**	**$222**	***19.2%***	**$42.50**	
Room Margin	73.1%	69.5%	*5.2%*	360	*bps*
F&B Margin	32.1%	25.2%	*27.4%*	690	*bps*
Operating Department Margin	61.3%	56.7%	*8.1%*	460	*bps*
GOP Margin	**36.7%**	**29.2%**	***25.7%***	**750**	*bps*
GOP Per Available Room	**$96**	**$64**	***49.7%***	**$32.04**	
Total Hotel Payroll (% of Total Revenue)	34.8%	40.4%	*-13.9%*	-560	*bps*
Total Hotel Payroll (Per Available Room)	$92	$89	*2.7%*	$2.39	
Total Hotel Payroll (Per Occupied Room)	$140	$156	*-10.3%*	-$16.08	

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

Aggregated U.S. Hotel Operating Performance:
YE 2022 vs. Prior Years

	YE 2022	YE 2021	*y/y % change*	YE 2019	*3-yr % change*
Occupancy	65.1%	47.5%	*37.1%*	76.7%	*-15.1%*
ADR	$246	$206	*19.6%*	$220	*11.9%*
RevPAR	**$160**	**$98**	***64.0%***	**$169**	***-5.1%***
Total RevPAR	**$246**	**$145**	***69.7%***	**$261**	***-5.7%***
Room Margin	73.7%	72.8%	*1.2%*	73.2%	*0.7%*
F&B Margin	28.7%	21.4%	*34.1%*	29.2%	*-1.7%*
Operating Department Margin	61.8%	61.5%	*0.5%*	60.5%	*2.1%*
GOP Margin	**37.2%**	**31.3%**	***18.8%***	**36.6%**	***1.6%***
GOP Per Available Room	**$91**	**$45**	***102.3%***	**$96**	***-4.7%***
Total Hotel Payroll (% of Total Revenue)	34.0%	36.1%	*-5.8%*	34.9%	*-2.6%*
Total Hotel Payroll (Per Available Room)	$83	$52	*60.3%*	$91	*-8.6%*
Total Hotel Payroll (Per Occupied Room)	$128	$110	*16.9%*	$119	*7.7%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

Exhibit 29: Historical Hotel Performance on a Trailing 6 Month Basis (Our Data Set)

Aggregated U.S. Hotel Operating Performance: Trailing 6 Months vs. Prior Years

	Sep 22 - Feb 23	Sep 21 - Feb 22	*y/y % change*	Sep 18 - Feb 19	*4-yr % change*
Occupancy	64.7%	53.3%	*21.4%*	72.5%	*-10.8%*
ADR	$248	$225	*10.4%*	$222	*11.6%*
RevPAR	**$160**	**$120**	***34.0%***	**$161**	***-0.4%***
Total RevPAR	**$253**	**$183**	***38.1%***	**$255**	***-0.8%***
Room Margin	72.4%	71.8%	*0.8%*	72.7%	*-0.4%*
F&B Margin	28.9%	22.4%	*29.0%*	29.9%	*-3.3%*
Operating Department Margin	60.1%	59.8%	*0.5%*	59.3%	*1.3%*
GOP Margin	**35.1%**	**31.7%**	***10.7%***	**35.1%**	***0.0%***
GOP Per Available Room	**$88**	**$58**	***52.5%***	**$90**	***-1.6%***
Total Hotel Payroll (% of Total Revenue)	35.7%	37.2%	*-4.0%*	35.9%	*-0.6%*
Total Hotel Payroll (Per Available Room)	$90	$68	*32.6%*	$92	*-1.9%*
Total Hotel Payroll (Per Occupied Room)	$139	$128	*9.2%*	$127	*9.9%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.

Source: Truist Securities Research; HotStats

Companies Mentioned in This Note

Choice Hotels International, Inc. (CHH, $128.33, Hold, C. Patrick Scholes)
DiamondRock Hospitality Company (DRH, $8.10, Hold, C. Patrick Scholes)
Hyatt Hotels Corporation (H, $117.87, Buy, C. Patrick Scholes)
Hilton Worldwide Holdings Inc. (HLT, $148.45, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $174.33, Hold, C. Patrick Scholes)
Pebblebrook Hotel Trust (PEB, $14.15, Hold, Gregory Miller)
Park Hotels & Resorts Inc. (PK, $11.99, Buy, C. Patrick Scholes)
Playa Hotels & Resorts N.V. (PLYA, $9.34, Buy, C. Patrick Scholes)
Ryman Hospitality Properties, Inc. (RHP, $91.26, Buy, C. Patrick Scholes)
RLJ Lodging Trust (RLJ, $10.30, Buy, Gregory Miller)
Sunstone Hotel Investors, Inc. (SHO, $9.73, Hold, C. Patrick Scholes)
Wyndham Hotels & Resorts, Inc. (WH, $68.94, Buy, C. Patrick Scholes)
MCR Hotels (private)

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I, Gregory J. Miller , hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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Rating	**Count**	**Percent**	**Rating**	**Count**	**Percent**
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Hold	248	34.54%	Hold	37	14.92%
Sell	5	0.70%	Sell	1	20.00%

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