SunTrust Robinson Humphrey

How do hotels stay open? Questions from clients following our liquidity analysis note

Leanest operations ever in full-service; it's a family affair for budget hotels

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What's Inside

Questions on hotel operations from investors following today's liquidity analysis note

Following today's liquidity analysis note, we have a received a number of questions from investors on how is it possible that a large percentage of Choice's (CHH, Hold) hotels (and we assume Wyndham's (WH, Buy) as well) remain open. Last week CHH noted that 90% of its hotels remain open. We have also spoken to many private hotel owners who have told us about unprecedented hotel operating models to keep hotels open at *occupancies below 10%*. **Sub 10% occupancy does not mean hotels are profitable (or even close) but hoteliers are finding ways to keep the doors open with never-before-seen operating model adjustments with bare bones staffing.**

We provide additional insights below from our contacts on both full-service hotels and limited-service hotels:

- At a bare minimum, owner-operated economy hotels (run in many cases by entrepreneurial families that have no other hotels, businesses, or sources of income) can remain open with just 10% occupancy. By comparison, per STR, economy hotel occupancy in the US was 38.5% for the week ending April 4th. If conditions are dire, the family runs the hotel and other staff are let go.
    - This does not mean hotels are profitable at 10% occupancy, but pretty much any cash flow is better than no cash flow. **That being said, more upscale select- and full-service hotels financed by CMBS are at great risk of being taken over by special servicers as noted today in a New York Post piece.**
- **There is no great incentive for an economy CHH or WH franchisee to close a hotel.** Local and regional banks as lenders do not want to take back the assets – banks would rather have a 20-year relationship with a local entrepreneurial hotelier than take over and attempt to asset manage an economy hotel for 2 years. These banks generally do not have the skillset or resources to handle a complicated 24/7 operation much less sell a hotel for uncertain valuation in 2021/2022.
- **Many higher rated urban/resort hotels have closed and/or have little demand. Group demand (30-40% of full-service demand) is basically a zero, there is very limited corporate travel, and there is limited leisure travel.**
    - Conversely, small towns where a CHH/WH hotel is located may still have demand from people traveling across the country, in between full-time residences (very low rated long-term extended-stay), etc. It would not surprise us if the Suburban or WoodSpring Suites brands (CHH) are relative outperformers. For WH, we think of Hawthorn Suites in the same light.

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- **Importantly we want to dispel misinformation: rate cuts as exhibited in the STR results are presenting noisy/tricky trends as we do not see major rate cutting across the US -- at least not yet.** **The "who is traveling" matters especially in March/April** – if higher-rated demand is limited, the remaining travelers are lower rated (government, medical) so there is an implied loss of rate. **We have not seen wide scale intentional rate cutting / loss of rate integrity but that is likely to happen eventually.**
  - **For generalists new to lodging: please be aware that even if Economy hotels have a higher absolute RevPAR than Luxury today, this does not mean that Luxury hotels "become" Economy hotels.** Chain scale positioning is largely based on normalized room rates -- a Four Seasons running 5% occupancy will still be viewed by STR as a luxury hotel even if a Rodeway Inn has a higher absolute RevPAR.
- Private owners at the full-service level tell us they are adjusting labor on a week-by-week basis -- demand is in many respects one-time transient business.
- **One prominent private full- and select-service U.S. owner told us bluntly**:
  - ***Once taking into consideration fixed expenses, occupancy levels need to be 15-35% to break even at an NOI level.*** *At this point, we're simply managing cash flows, matching cash flow reserves to payroll and insurance. Property tax payments follow a schedule and we'll have to figure out a way to pay whenever the time arrives.*
  - ***The select-service operational break-even occupancy is less than what you think: ~8%.*** Staffing models: three shifts per day. *The general manager stays after for some administrative work. The second shift does a little bit of sales and responds to leads. The night auditor is also the security guard. Rooms get cleaned once a week, if it is not done by one of the three people mentioned above. Under these circumstances, the hotel is often left "open" for business.* ***We are encouraging full-service hotels to operate at this level as well. Unfortunately, it is harder for local operating teams to fathom the cutbacks.***

CHH: Valuation and Risks

Our price target of $91 for CHH is derived by applying a 14.0x target EV/EBITDA multiple (slightly above industry average) to our estimate for 2021 EBITDA.

Upside risks: conservative guidance, if the economy performs better than expected. Downside risks: slowdown in development opportunities, rising construction costs, and newly created brands grow slower than expectations. Coronavirus is a risk to the lodging industry although relatively limited for CHH due to limited existing China exposure (China hotels represent approx. 0.02% of annual CHH revenue; 7 hotels in China).

WH: Valuation and Risks

Our price target of $67 for WH is based on a 13.0x multiple (in line with portfolio quality/RevPAR relative to peers) of our 2021 EBITDA estimate.

Downside risk: slowdown in development opportunities. La Quinta integration takes longer than anticipated. Macro demand/pipeline headwinds. Coronavirus risk to demand and net unit growth.

Companies Mentioned in This Note

Choice Hotels International, Inc. (CHH, $70.05, Hold, C. Patrick Scholes)
Wyndham Hotels & Resorts, Inc. (WH, $32.06, Buy, C. Patrick Scholes)

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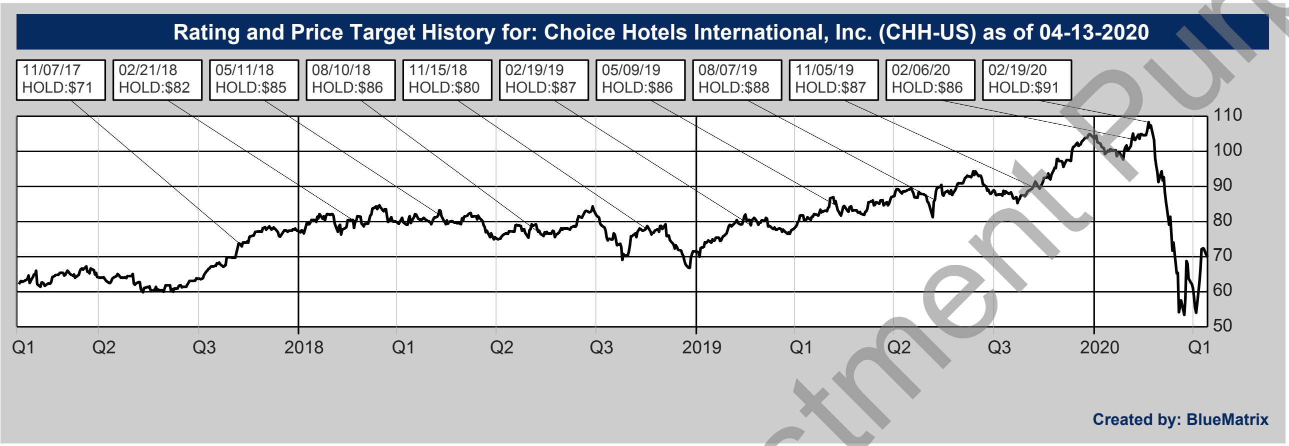

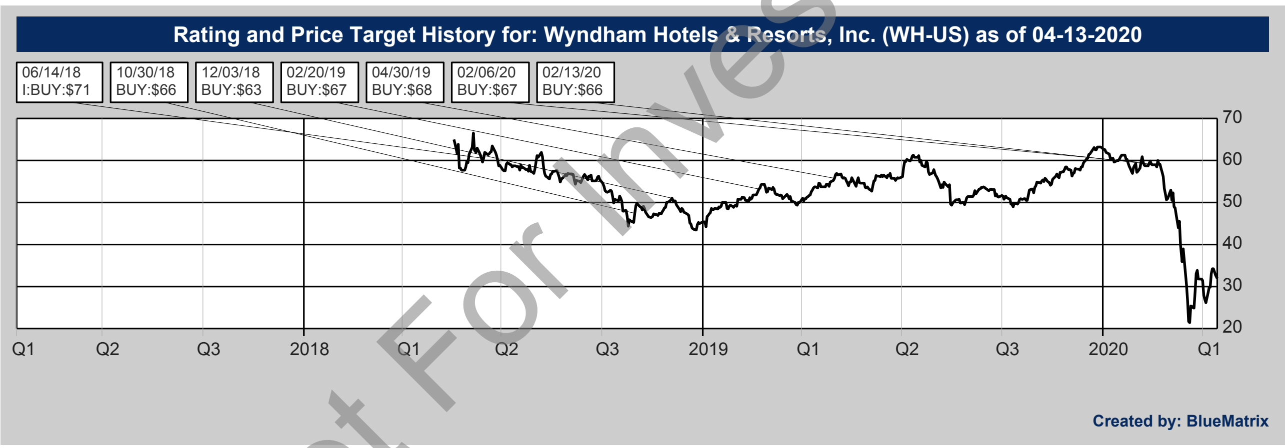

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