# December's Hotel P&L Analyzer -- How profitable were hotels in December and 4Q?

## Because headline RevPAR doesn't tell the whole story

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**What's Inside**

An analysis of recent hotel labor cost trends, one of the critical components impacting hotel EBITDA margins

### What's Incremental To Our View

**December: -40 bps of GOP margin "growth" on approx. +3.1% Total RevPAR.** This follows November, which had -150 bps of growth on approx. +0.3% Total RevPAR. In our monthly analysis of operational level P&L metrics of nearly a thousand U.S. upper-tier full service hotels (data source: HotStats), YE 2018 GOP margins ended +20 bps on Total RevPAR of +3.3%. For 2019, we see margins closer to flat to down -100 bps. We anticipate REITS with heavier San Francisco exposure will have more opportunities for margin expansion and REITS with heavier exposure to weak 2019 convention markets (e.g. Boston, Chicago, and Washington, D.C.) could have more measurable y/y margin declines.

**4Q: We estimate GOP margin loss of ~ 50 bps, largely driven by November's weak results (a very tough y/y comp). However, hotels with greater exposure to New Year's Eve leisure demand as well as luxury hotels more likely outperformed.** See our weekly STR note from January 9th for detail on New Year's performance.

- **4Q GOP margin results were at the low end of our forecast range (our prior forecast was -50 bps to +25 bps).** We believe a host of factors including weather events and the government shutdown contributed to a weak December margin result.
- We note that individual REIT portfolios can differ significantly from the aggregated results given market exposures, renovations, etc.

**We have analyzed monthly P&L metrics of nearly a thousand high-rated full-service hotels in the U.S. (Luxury and Upper Upscale hotels, both private and publicly owned) and have the following thoughts:**

While December is a less consequential month for many full-service hotels given relatively lower corporate and group travel towards the end of the year, a combination of one-time events contributed to a 40 bps y/y GOP margin contraction last month. This decline was despite Rooms RevPAR growth of 2.4% and Total RevPAR (includes F&B/catering) of +3.1%. REIT executives continue to suggest that Rooms RevPAR growth of ~ +2-3% is needed for EBITDA margins to remain flat, thus the December results were slightly weaker than our expectations.

- **How we view 4Q18:** We estimate 4Q GOP margin results were ~ -50 bps, at the low-end of our prior forecast range (-50 bps to +25 bps). Note: we assume December contribution to EBITDA is less than October and December for many hotels due to lower occupancy, thus we apply a weighted average to our



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estimates. The challenged 4Q results were largely driven by weakness in November (a tough y/y comp) and to a lesser extent the negative GOP margin results in December. However, we expect some degree of disparity in individual hotel results. For example, Luxury chain scale (branded) hotels had +2.0% Rooms RevPAR in December per STR, 120 bps above Upper Upscale. We believe leisure focused hotels were relative outperformers in December (Resort RevPAR was +2.9% in December per STR and this was driven by +3.9% ADR growth, thus a relatively stronger flow through to GOP margins). Given high ADR growth opportunities surrounding New Year's Eve with strong leisure demand for the holiday, we believe hotels that successfully cater to that holiday demand likely outperformed the average corporate-focused full-service hotel in December. As room rates and associated F&B can be very profitable around the holidays with good flow through to GOP margins, we believe strong New Year's results can measurably impact 4Q margins in aggregate.

**2018 GOP margins finished slightly positive at +20 bps.** While this sounds unimpressive from a headline result, we believe owners should take credit for pushing margins despite limited top-line growth and the very real pressures from rising labor costs. Hoteliers have been vigilant about cost containment measures, staffing efficiencies, time and motion studies, etc. and from what we can tell, these efforts are paying off. While limited EBITDA margin growth will not satisfy many investors, we believe it is not insignificant that GOP margins in the HotStats results finished at a very respectable 37.4% in 2018, a result that we believe contributes to stronger free cash flows and can contribute to a more sustainable Lodging REIT dividend.

- It is also not insignificant that hoteliers are making tough operating efficiency decisions in a period of very high occupancy. In 2018, the HotStats sample had an aggregated occupancy of 77.7%. Such a high occupancy suggests that hotels are full or close to it during many peak business travel days and on peak weekends as well. Thus cutting staffing when hotels are often full can be a challenge.
- The bad news here is that high occupancy is not leading to more accelerated room rate growth. This is a topic that we have addressed frequently in the last few months (see the January RevPAR Monitor for our latest take). If we saw more measurable improvements in ADR growth, we believe the flow to the bottom line would become very evident in the GOP margin results from the HotStats data. While we believe there has as of late been an ADR uptick in our forward bookings intelligence, this is coming at a give-back to occupancy, thus we believe EBITDA margins net out to no material change to profitability.
    - The hotels that may benefit more from the ADR pickup are group-focused hotels where a higher-paying guest is also paying more for their food and beverage and catering (generally there is some positive relationship between higher room rates and higher non-room revenues), but the GOP margin impact is likely marginal at best based on the forward bookings intelligence we see at this time.

**2019 margins...not looking so great.** The data (source: HotStats (high correlation to STR)) suggests marked increases in hotel labor costs through the end of 2018 are unlikely to slow in 2019, negatively influencing hotel margins. **Bottom line, we remain guarded about the ability for owned hotel EBITDA margins (barring any major self-help initiatives such as with Park (PK, Buy)) to materially grow in 2019 as RevPAR of +0.5-2.5% (our forecasts) in 2019 in an environment of property-level operating costs of 2.5%+ does not bode well for significant margin expansion for hotel owners.** *Again to keep it in perspective, the fact that we are discussing any margin improvement at all nine plus years into a cycle is certainly a positive.*

While we are very early into the year, the bad news for hotel REITS is rising labor costs will unfortunately likely result in margins flat at very best to more likely down 0 to 100 bps y/y.

- **The more likely relative margin outperformers (++):** hotels positively impacted by strong citywide markets in 2019. Unfortunately among the top markets, we believe only San Francisco and Las Vegas look promising from a group/citywide perspective (most Lodging REITS have no Las Vegas exposure). Most REITS in our coverage have at least modest exposure to the City of San Francisco (see below). However, these same REITS also are generally exposed to underperforming citywide markets such as Boston, Chicago, and Washington D.C.

| Est exposure to SF market | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | CHSP | DRH | HST | PEB | PK | RHP | RLJ | SHO |
| San Francisco | 23% | 1% | 10% | 20% | 12% | 0% | 11% | 8% |
| | | | | | | | | |
| Rank | 1 | 7 | 5 | 2 | 3 | 8 | 4 | 6 |
| | | | | | | | | |
| Note: Est. exposures include surrounding areas | | | | | | | | |
| | | | | | | | | |
| *Source: STRH Research, Company data* | | | | | | | | |

- **Also more likely relative margin outperformers (+):** new convention center hotels. There are very few of these hotels being built in the United States. According to Lodging Econometrics, the annual growth rate of hotels of over 500 rooms was ~ +0.6% in 2018 and is forecasted to be +1.0% in 2019.
- **Relative margin underperformers in 2019 (-):** hotels in challenged citywide markets (see above); hotels with revised union labor contracts and/or citywide living wage ordinances; markets with particularly low unemployment rates and pronounced staffing issues.

**December profitability: Modest RevPAR growth resulted in a slight decrease in y/y margin.**

- **4Q:** Operating Department margins were ~ -15 bps in 4Q and GOP margins were ~ -50 bps.

| Industry Metric | Dec 2018 y/y | YTD | | Dec 2018 | YTD | FY2018 | 2018 y/y | FY2017 |
|---|---|---|---|---|---|---|---|---|
| Occupancy | -50 | 30 | bps | 66.9% | 77.7% | 77.7% | 30 bps | 77.4% |
| ADR | 3.1% | 2.5% | % | $219 | $225 | $225 | 2.5% | $220 |
| RevPAR | 2.4% | 2.8% | % | $147 | $175 | $175 | 2.8% | $170 |
| Total Revenue PAR | 3.1% | 3.3% | % | $257 | $289 | $289 | 3.3% | $280 |
| Total Dept. Profit % Total Rev. | 40 | 10 | bps | 56.7% | 60.0% | 60.0% | 10 bps | 59.9% |
| Total Hotel Labor Costs % Total Rev. | 110 | 20 | bps | 38.3% | 35.5% | 35.5% | 20 bps | 35.3% |
| Total GOP PAR | 1.9% | 4.1% | % | $82 | $108 | $108 | 4.1% | $104 |
| Total GOP % of Total Rev. | -40 | 20 | bps | 32.0% | 37.4% | 37.4% | 20 bps | 37.2% |

Source: STRH Research, HotStats
All dollar figures are in USD. 2017 figures have been revised as of December 2018 to account for the updated sample set.

**November profitability: Flattish RevPAR growth resulted in y/y margin loss.**

| Industry Metric | Nov 2018 y/y | YTD | | Nov 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | -120 | 20 | bps | 74.2% | 78.6% | 77.2% | 50 bps |
| ADR | 1.6% | 2.2% | % | $221 | $225 | $219 | 1.1% |
| RevPAR | 0.1% | 2.5% | % | $164 | $177 | $169 | 1.9% |
| Total Revenue PAR | 0.3% | 3.1% | % | $279 | $292 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | -90 | 10 | bps | 57.2% | 60.0% | 59.6% | -10 bps |
| Total Hotel Labor Costs % Total Rev. | 120 | 10 | bps | 37.4% | 35.4% | 35.5% | 180 bps |
| Total GOP PAR | -3.9% | 3.8% | % | $95 | $110 | $103 | 3.0% |
| Total GOP % of Total Rev. | -150 | 20 | bps | 33.9% | 37.8% | 37.0% | 10 bps |

Source: STRH Research, HotStats
All dollar figures are in USD.

**October profitability: Moderate RevPAR growth contributed to a slight increase in margin.**

| Industry Metric | Oct 2018 y/y | YTD | | Oct 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | 90 | 30 | bps | 82.0% | 79.0% | 77.2% | 50 bps |
| ADR | 2.9% | 2.2% | % | $241 | $226 | $219 | 1.1% |
| RevPAR | 3.9% | 2.7% | % | $198 | $178 | $169 | 1.9% |
| Total Revenue PAR | 4.1% | 3.4% | % | $329 | $293 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | 40 | 10 | bps | 63.0% | 60.2% | 59.6% | -10 bps |
| Total Hotel Labor Costs % Total Rev. | 0 | 0 | bps | 32.2% | 35.2% | 35.5% | 180 bps |
| Total GOP PAR | 4.7% | 4.5% | % | $140 | $112 | $103 | 3.0% |
| Total GOP % of Total Rev. | 20 | 40 | bps | 42.5% | 38.2% | 37.0% | 10 bps |

Source: STRH Research, HotStats
All dollar figures are in USD.

**September profitability: Limited Rooms RevPAR growth; however, a decent increase in margin was likely driven by relative outperformance among Luxury hotels (we note that Total RevPAR was +4.1%, which indicates growth in non-rooms revenue departments such as food & beverage, catering/ conventions, and resort amenities.**

- **3Q:** Operating Department margins were ~ -10 bps in 3Q and GOP margins were ~ +15 bps.

| Industry Metric | Sept 2018 y/y | YTD | | Sept 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | -80 | 30 | bps | 76.3% | 78.7% | 77.2% | 50 bps |
| ADR | 2.2% | 2.1% | % | $224 | $224 | $219 | 1.1% |
| RevPAR | 1.2% | 2.6% | % | $171 | $176 | $169 | 1.9% |
| Total Revenue PAR | 4.1% | 3.3% | % | $280 | $289 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | 40 | 10 | bps | 59.7% | 59.9% | 59.6% | -10 bps |
| Total Hotel Labor Costs % Total Rev. | -40 | 0 | bps | 36.0% | 35.6% | 35.5% | 180 bps |
| Total GOP PAR | 7.3% | 4.4% | % | $105 | $109 | $103 | 3.0% |
| Total GOP % of Total Rev. | 110 | 40 | bps | 37.4% | 37.6% | 37.0% | 10 bps |

Source: STRH Research, HotStats
All dollar figures are in USD.

## August profitability: Moderate RevPAR growth contributed to a modest increase in margin.

| Industry Metric | Aug 2018 y/y | YTD | | Aug 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | 100 | 50 | bps | 78.4% | 79.0% | 77.2% | 50 bps |
| ADR | 1.6% | 2.1% | % | $203 | $224 | $219 | 1.1% |
| RevPAR | 2.9% | 2.7% | % | $159 | $177 | $169 | 1.9% |
| Total Revenue PAR | 3.9% | 3.2% | % | $249 | $290 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | -30 | 10 | bps | 57.0% | 59.9% | 59.6% | -10 bps |
| Total Hotel Labor Costs % Total Rev. | 40 | 10 | bps | 39.2% | 35.6% | 35.5% | 180 bps |
| Total GOP PAR | 4.9% | 4.1% | % | $80 | $109 | $103 | 3.0% |
| Total GOP % of Total Rev. | 30 | 30 | bps | 32.1% | 37.6% | 37.0% | 10 bps |

Source: STRH Research, HotStats
All dollar figures are in USD.

## July profitability: Relatively weak RevPAR growth resulted in a decline in margin (we believe this is in part due to the calendar shift of July 4th impacting Group demand).

| Industry Metric | Jul 2018 y/y | YTD | | Jul 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | -70 | 40 | bps | 80.4% | 79.1% | 77.2% | 50 bps |
| ADR | 2.1% | 2.2% | % | $212 | $227 | $219 | 1.1% |
| RevPAR | 1.2% | 2.7% | % | $171 | $179 | $169 | 1.9% |
| Total Revenue PAR | 0.4% | 3.1% | % | $261 | $296 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | -40 | 20 | bps | 58.2% | 60.2% | 59.6% | -10 bps |
| Total Hotel Labor Costs % Total Rev. | 90 | 10 | bps | 37.6% | 35.3% | 35.5% | 180 bps |
| Total GOP PAR | -2.5% | 4.0% | % | $88 | $113 | $103 | 3.0% |
| Total GOP % of Total Rev. | -100 | 30 | bps | 33.7% | 38.2% | 37.0% | 10 bps |

Source: STRH Research, HotStats
All dollar figures are in USD.

**June profitability: Relatively strong RevPAR growth contributed to a moderate increase in margin (the reverse impact from the July 4th shift positively benefiting group demand).**

- **2Q:** Operating Department margins were ~ +50 bps in 2Q and GOP margins were ~ +100 bps.

| Industry Metric | Jun 2018 y/y | YTD | | Jun 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | *110* | *60* | *bps* | 83.2% | 78.9% | 77.2% | *50 bps* |
| ADR | 3.0% | 2.2% | *%* | $226 | $230 | $219 | 1.1% |
| RevPAR | 4.4% | 2.9% | *%* | $188 | $181 | $169 | 1.9% |
| Total Revenue PAR | 4.7% | 3.5% | *%* | $305 | $302 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *90* | *20* | *bps* | 61.4% | 60.5% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *-80* | *0* | *bps* | 33.9% | 34.9% | 35.5% | *180 bps* |
| Total GOP PAR | *9.4%* | 4.9% | *%* | $121 | $117 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *170* | *60* | *bps* | *39.8%* | *38.9%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.

**May profitability: Low RevPAR growth contributed to a slight increase in margin.**

| Industry Metric | May 2018 y/y | YTD | | May 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | *-50* | *50* | *bps* | 79.5% | 78.0% | 77.2% | *50 bps* |
| ADR | 1.8% | 2.0% | *%* | $228 | $230 | $219 | 1.1% |
| RevPAR | 1.1% | 2.6% | *%* | $181 | $180 | $169 | 1.9% |
| Total Revenue PAR | 1.4% | 3.2% | *%* | $304 | $301 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *10* | *10* | *bps* | 61.0% | 60.3% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *60* | *10* | *bps* | 34.9% | 35.1% | 35.5% | *180 bps* |
| Total GOP PAR | *1.9%* | 4.0% | *%* | $121 | $117 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *20* | *30* | *bps* | *39.8%* | *38.7%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.

**April profitability: Relatively strong RevPAR growth contributed to a moderate increase in margin.**

| Industry Metric | Apr 2018 y/y | YTD | | Apr 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | *90* | *70* | *bps* | 82.3% | 77.6% | 77.2% | *50 bps* |
| ADR | 4.6% | 2.1% | *%* | $237 | $231 | $219 | 1.1% |
| RevPAR | 5.7% | 3.0% | *%* | $195 | $179 | $169 | 1.9% |
| Total Revenue PAR | 6.8% | 3.7% | *%* | $322 | $301 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *60* | *10* | *bps* | 62.1% | 60.1% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *-50* | *10* | *bps* | 32.6% | 35.2% | 35.5% | *180 bps* |
| Total GOP PAR | *9.6%* | 4.6% | *%* | $134 | $115 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *110* | *40* | *bps* | *41.5%* | *38.4%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.

**March profitability: Moderate RevPAR growth (although significantly better for Luxury hotels than Upper Upscale due largely to the Easter calendar shift) contributed to a slight increase in margin.**

- **1Q:** as evident in the table below, Operating Department and GOP Profit margins were flattish in 1Q.

| Industry Metric | Mar 2018 y/y | YTD | | Mar 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | *50* | *70* | *bps* | 82.6% | 76.1% | 77.2% | *50 bps* |
| ADR | 2.0% | 1.2% | *%* | $239 | $229 | $219 | 1.1% |
| RevPAR | 2.7% | 2.1% | *%* | $197 | $174 | $169 | 1.9% |
| Total Revenue PAR | 1.6% | 2.6% | *%* | $322 | $294 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *20* | *-20* | *bps* | 62.2% | 59.3% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *60* | *20* | *bps* | 33.4% | 36.1% | 35.5% | *180 bps* |
| Total GOP PAR | *2.1%* | 2.6% | *%* | $134 | $109 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *20* | *0* | *bps* | *41.7%* | *37.2%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.

**February profitability: Moderate RevPAR growth (in aggregate, although far better for Luxury hotels than Upper Upscale) contributed to a modest increase in margin.**

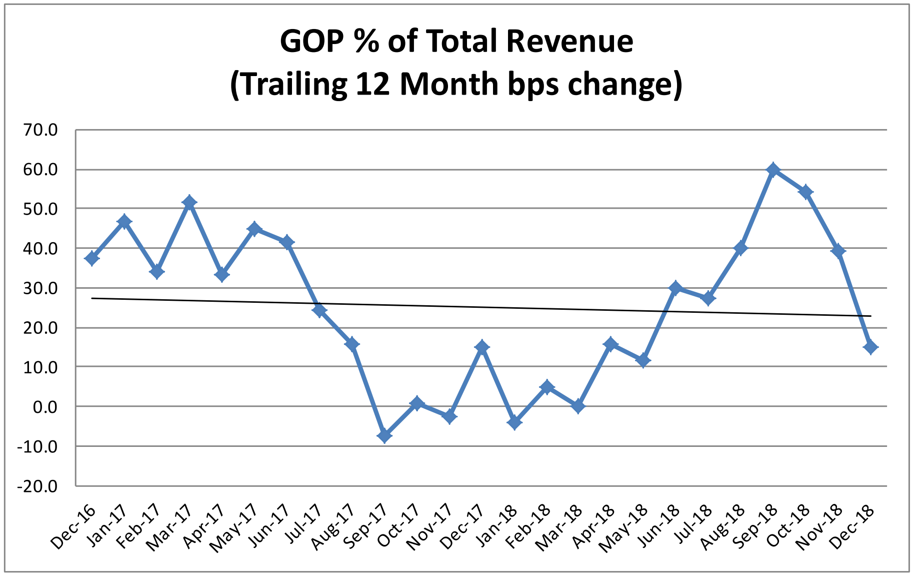
| Industry Metric | Feb 2018 y/y | YTD | | Feb 2018 | YTD | FY2017 | 2017 y/y |
|---|---|---|---|---|---|---|---|
| Occupancy | *80* | *60* | *bps* | 76.3% | 72.5% | 77.2% | *50 bps* |
| ADR | 1.3% | 0.7% | *%* | $225 | $222 | $219 | 1.1% |
| RevPAR | 2.4% | 1.5% | *%* | $171 | $161 | $169 | 1.9% |
| Total Revenue PAR | 4.2% | 3.2% | *%* | $295 | $277 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *-10* | *-40* | *bps* | 59.3% | 57.6% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *-10* | *0* | *bps* | 36.0% | 37.8% | 35.5% | *180 bps* |
| Total GOP PAR | *5.6%* | 3.0% | *%* | $109 | $96 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *50* | *0* | *bps* | *37.0%* | *34.5%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.

**January profitability: Low RevPAR growth, particularly among Upper Upscale hotels, contributed to a moderate reduction in margin.**

| Industry Metric | Jan 2018 y/y | | Jan 2018 | FY2017 | 2017 y/y |
|---|---|---|---|---|---|
| Occupancy | *40* | *bps* | 68.9% | 77.2% | *50 bps* |
| ADR | 0.1% | *%* | $219 | $219 | 1.1% |
| RevPAR | 0.7% | *%* | $151 | $169 | 1.9% |
| Total Revenue PAR | 2.1% | *%* | $259 | $278 | 2.5% |
| Total Dept. Profit % Total Rev. | *-70* | *bps* | 55.9% | 59.6% | *-10 bps* |
| Total Hotel Labor Costs % Total Rev. | *30* | *bps* | 39.7% | 35.5% | *180 bps* |
| Total GOP PAR | *0.0%* | *%* | $83 | $103 | *3.0%* |
| Total GOP % of Total Rev. | *-60* | *bps* | *31.9%* | *37.0%* | *10 bps* |

Source: STRH Research, HotStats
All dollar figures are in USD.



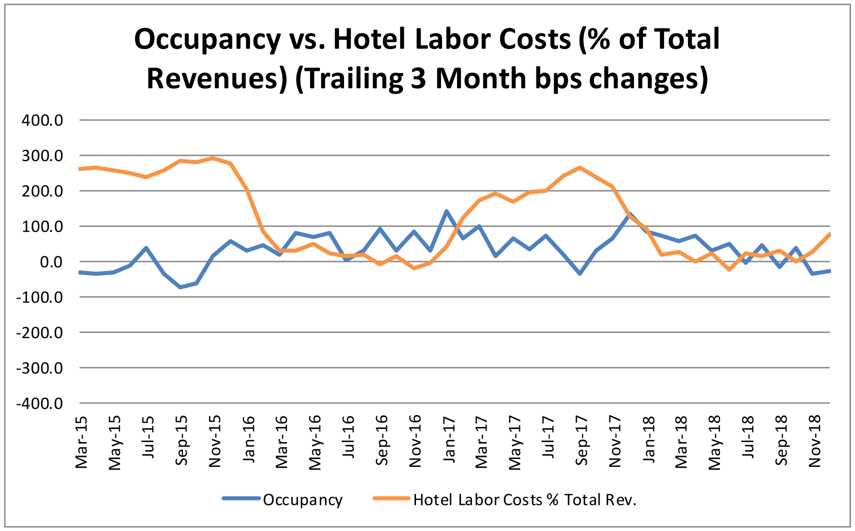

Source: STRH Research, HotStats

Source: STRH Research, HotStats

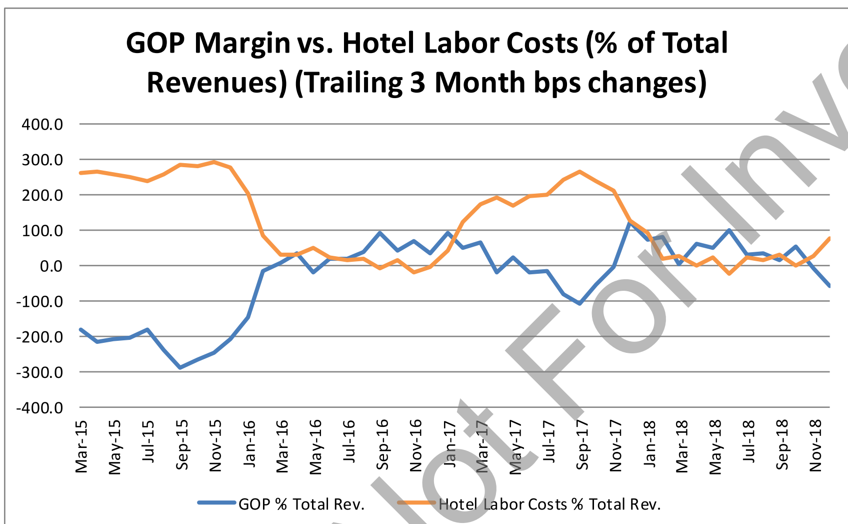
As we have previously noted, hotel labor is the primary operating cost for most hotels and is particularly significant for full-service hotels (food and beverage, catering/meetings, and resort facilities are labor intensive). Our general view is that higher room rates generally equate to greater service expectations by guests. **Being that most of the Lodging REITS focus on the highest-rated hotels, the recent trend of rising labor costs is especially impactful to EBITDA margins.** We analyzed HotStats' aggregated hotel P&L data to better grasp recent monthly trends in labor costs and margins. We note the following takeaways:

- While rising operating costs attributable to labor increased significantly in 2017, labor costs as a percentage of total revenue has fallen to more modest growth y/y (see the following charts below). This compares to flattish growth y/y in 2016, +150 bps y/y in mid-2017 and +190 bps by year-end 2017. Combined with just 2% RevPAR growth in 2017, GOP margins were flattish in 2017 y/y.
    - **How we interpret the recent trends:** Based on commentary from recent earnings calls, meetings with the REITS in recent months, and conversations with private hotel owners, we do not see labor cost growth abating in 2019. There may be some seasonality factors (including calendar shifts) and cost containment measures being undertaken (particularly around the end/start of the year) that have influenced the recent flattish trend in labor costs as a percentage of revenue. **Headwinds such as restrictive immigration policies, low unemployment, and recent minimum wage ordinances are contributing to rising hotel labor costs -- and we do not expect these increases to plateau in the near-term.** **For further discussion on labor costs and related headwinds, we encourage investors to review our takeaways from our December 2018 meetings with CBRE.**

- The following charts highlight trends in labor costs vs. occupancy and GOP margins.




Source: STRH Research, HotStats




Source: STRH Research, HotStats

**How we view property-level margins in the current low RevPAR growth environment:** Over the past few years, in a low RevPAR growth environment, hotel labor costs have had a highly significant influence on EBITDA margins. The correlation between labor costs as a percentage of hotel revenue and GOP as a percentage of total revenue is approximately -80%. **Thus, the ability for hotel owners and managers to keep labor cost increases as low as possible will be critical in 2019.**

- **Consideration for 4Q18 earnings:** Among our REIT coverage, our aggregated Adjusted EBITDA Margin estimate (weighted average by market cap.) is +25-75 bps y/y growth for 2018 (ex-San Francisco hotels it would be closer to -50 to -100 bps). Please note that there are anomalies for specific REITS due to portfolio changes and property renovations, hurricane impact, etc. thus we focus on the aggregate numbers. **Hotels owned by the REITS orient more heavily to Upper Upscale versus Luxury, thus our expectations for margin growth for REITS reflects that differential. We expect REITS with a greater proportion of Luxury hotels (ex-idiosyncratic factors as aforementioned) to have a greater opportunity for slight margin expansion in 4Q18.**

**One piece of good news for hotel owners is that lower margins can result in a slowdown of new hotel development, at least for full-service hotels.** However, we note that the highest-rated hotels often take the longest to go through the approval and development process, therefore we believe any warning signs on margins will likely play a factor for hoteliers that are very early in the development process and not necessarily for hotels that are well into the planning stages (thus, hotels that are scheduled to open in 2019 are still likely to open).

**How this cycle compares with the prior downturn:** One question we have raised to hotel owners (both public and private owners) is "how efficient are hotels today vs. the same time last cycle?". This is an important question as many full-service hotels were able to cut costs significantly during the last cycle downturn. Hotel owners admit that there is room to cut costs if occupancies take a more significant downward trend (we are not suggesting this will happen barring a demand shock). However, owners have also admitted to us that some operating costs (labor and otherwise) that were cut during the last lodging cycle were not added back, thus we believe that many hotels may be naturally leaner and more efficient today. If hotels are leaner today, the ability to cut costs in a high occupancy environment may be more difficult.

### PK: Valuation and Risks

Our $34 price target is based on an 12.5x multiple on our 2019 EBITDA estimate. This multiple is in-line with portfolio quality.

Risks to our rating and price target: Significant supply growth and macroeconomic challenges/shocks.

## Companies Mentioned in This Note

**Park Hotels & Resorts Inc.** (PK, $29.05, Buy, C. Patrick Scholes)

## Analyst Certification

I, C. Patrick Scholes , 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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· Reduce – total return ≤ negative 10% (5% for low Beta securities)
· Neutral – total return is within the bounds above
· NR – NOT RATED, STRH does not provide equity research coverage
· CS – Coverage Suspended

*Total return (price appreciation + dividends); **Price targets are within a 12-month period, unless otherwise noted; ***Low Beta defined as securities with an average Beta of 0.8 or less, using Bloomberg's 5-year average

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|---|---|---|---|---|---|
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