March's Hotel P&L Analyzer -- How profitable were hotels in March and 1Q?

1Q Margins: ~ +50 bps, in-line with our expectations. San Francisco helped.

C. Patrick Scholes
212-319-3915
patrick.scholes@suntrust.com

Brian Hollenden, CFA
212-303-1742
brian.hollenden@suntrust.com

Gregory J. Miller
212-303-4198
gregory.j.miller@suntrust.com

Kevin Robinson
617-345-6544
kevin.robinson@suntrust.com

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

March: 40 bps of GOP margin growth on approximately +2.3% Total RevPAR (Total RevPAR includes rooms RevPAR plus outside of the room spend). For 1Q: 50 bps of margin growth on approximately +2.9% Total RevPAR. This compares with 2018 GOP margins of +20 bps on Total RevPAR of +3.3%. **For 2019, we continue to see margins at flat to -75 bps.**

We have noticed a few months of relatively stronger profitability trends although we believe the tailwinds from San Francisco's strong 1Q ADR and a particularly profitable February contributed to the 1Q headline result.

Hotel owners are still managing to keep margins slightly in the black despite Total RevPAR growth hovering below +3% and labor costs rising 3-4% this year. As a reminder, this monthly analysis of P&L metrics (data source: HotStats) covers nearly a thousand high-rated full service hotels in the U.S. (Luxury and Upper Upscale hotels, both privately and publicly owned). Our latest takeaways post-March results are presented below:

March margins were a relatively respectable +40 bps given Rooms RevPAR growth of -0.8% and ADR growth of just +1.3%. March occupancy was 81.1%: unlike in January and February, we had relatively busier (higher occupancy levels) hotels in March which helps on operating efficiency. Still, with occupancy falling 160 bps and limited room rate growth, we believe the way to make EBITDA margins stay above zero continues to come partly from cost efficiencies and in some cases out-of-rooms spend (such as the high margin "daily activity fees" / "resort fees" that we highlighted in last month's note or improvements to F&B revenues.

For 1Q: GOP margins were +50 bps on Rooms RevPAR of +1.2% and Total RevPAR of +2.9%. The GOP margin result was in-line with our prior expectations. We believe GOP margins were bolstered by ADR-led strength in San Francisco (STR noted a 15.9% ADR gain for the quarter which we expect flowed very positively to margins), an easy comp in February (+120 bps on margins, one of the best results in years), and the various revenue and asset management improvements noted above.

- **Our weighted average of margin growth for the Lodging REITS in our coverage for 1Q is ~ +56 bps and we find the HotStats data was in-line with our 1Q margin projection for the REITS in our coverage of +25-75 bps.**

SEE PAGE 7 FOR REQUIRED DISCLOSURE INFORMATION

- **We still believe that in order for EBITDA margins to remain flat, Rooms RevPAR must rise ~ +2.5-3.5% for many full-service hotels.** This will remain difficult for most hotels (and most REITS) in 2019. We believe the cost efficiency matters are still helping although we expect a sequentially harder quarter in 2Q (as we discuss further in the note). As for 2020, we anticipate needing another 50 bps of Rooms RevPAR growth given steady labor cost growth y/y. We do not expect most markets will see +3% RevPAR growth in 2019 or 2020 (San Francisco being a major exception).
    - One disclaimer: each REIT has different dynamics particularly given market-specific considerations, renovations/portfolio changes, etc.

Our 2019 margin forecast holds at generally flat to -75 bps in 2019: We assume low single-digit RevPAR growth for this HotStats data set, although we still maintain a somewhat more positive bias on this data set for 2019 than our macro RevPAR projections in our RevPAR Monitor given that our margin analysis data set has a somewhat larger luxury exposure, where there is relatively limited new rooms growth (and limited impact from the growth of Upscale urban hotels, which we deem to "ankle-bite" the Upper Upscale hotels for price-sensitive demand). The lower supply growth and relatively stronger leisure demand should help on rate growth for 2019 which flows more positively to both Rooms and Total RevPAR growth and margin growth.

- As we have previously noted, Upper Upscale urban hotels in markets with challenged 2019 citywides (Boston, Chicago, and Washington, D.C. for example) are likely to underperform in aggregate while stronger 2019 citywide markets of San Francisco and Las Vegas amongst others are likely to see better results. **A number of hoteliers have anticipated weaker citywides and focused on in-house group demand and transient to replace the lost business.**
- **The Lodging REITS in our coverage appear to continue to be able to hold some expenses at more modest increases than we anticipated. We believe this bodes well for U.S. full-service hotels generally speaking.** Our forecasted weighted average Adjusted EBITDA margin y/y change in 2019 for the Lodging REITS in our coverage is -19 bps in 2019. We believe the REITS have guided somewhat conservatively and anticipate this weighted average will go up post-1Q earnings.

Monthly Profitability Metrics

March profitability: Slightly negative RevPAR growth although y/y margins were modestly positive.

- **1Q:** Operating Department margins were ~ + 40 bps and GOP margins were ~ +50 bps.

Industry Metric	Mar 2019 y/y	YTD		Mar 2019	YTD	FY2018	2018 y/y	FY2017
Occupancy	*-160*	*-110*	*bps*	81.1%	75.1%	77.7%	*30 bps*	77.4%
ADR	1.3%	2.7%	*%*	$245	$236	$225	2.5%	$220
RevPAR	-0.8%	1.2%	*%*	$198	$177	$175	2.8%	$170
Total Revenue PAR	2.3%	2.9%	*%*	$333	$304	$289	3.3%	$280
Total Dept. Profit % Total Rev.	*20*	*40*	*bps*	63.0%	60.2%	60.0%	*10 bps*	59.9%
Total Hotel Labor Costs % Total Rev.	*-30*	*-20*	*bps*	32.5%	35.6%	35.5%	*20 bps*	35.3%
Total GOP PAR	*3.2%*	4.3%	*%*	$142	$116	$108	*4.1%*	$104
Total GOP % of Total Rev.	*40*	*50*	*bps*	*42.7%*	*38.1%*	*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.

SunTrust Robinson Humphrey

February profitability: Decent RevPAR growth resulted in modest y/y margins.

Industry Metric	Feb 2019 y/y	YTD		Feb 2019	YTD	FY2018	2018 y/y	FY2017
Occupancy	-40	-70	bps	76.0%	72.0%	77.7%	30 bps	77.4%
ADR	4.4%	3.6%	%	$235	$231	$225	2.5%	$220
RevPAR	3.9%	2.5%	%	$179	$166	$175	2.8%	$170
Total Revenue PAR	3.6%	3.2%	%	$308	$288	$289	3.3%	$280
Total Dept. Profit % Total Rev.	100	60	bps	60.6%	58.5%	60.0%	10 bps	59.9%
Total Hotel Labor Costs % Total Rev.	-40	-10	bps	35.3%	37.5%	35.5%	20 bps	35.3%
Total GOP PAR	7.1%	5.0%	%	$118	$102	$108	4.1%	$104
Total GOP % of Total Rev.	120	60	bps	38.4%	35.2%	37.4%	20 bps	37.2%

Source: STRH Research, HotStats

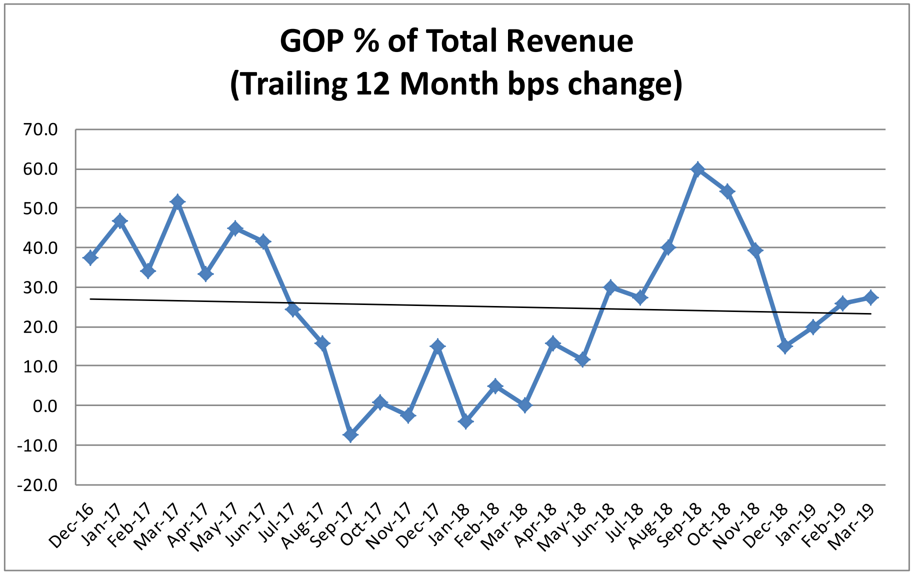
All dollar figures are in USD. 2017 figures have been revised as of December 2018 to account for the updated sample set.

January profitability: Limited RevPAR growth resulted in flat y/y margins.

Industry Metric	Jan 2019 y/y		Jan 2019	FY2018	2018 y/y	FY2017
Occupancy	-110	bps	68.3%	77.7%	30 bps	77.4%
ADR	2.6%	%	$226	$225	2.5%	$220
RevPAR	1.0%	%	$154	$175	2.8%	$170
Total Revenue PAR	2.8%	%	$271	$289	3.3%	$280
Total Dept. Profit % Total Rev.	20	bps	56.4%	60.0%	10 bps	59.9%
Total Hotel Labor Costs % Total Rev.	20	bps	39.7%	35.5%	20 bps	35.3%
Total GOP PAR	2.7%	%	$87	$108	4.1%	$104
Total GOP % of Total Rev.	0	bps	32.0%	37.4%	20 bps	37.2%

Source: STRH Research, HotStats

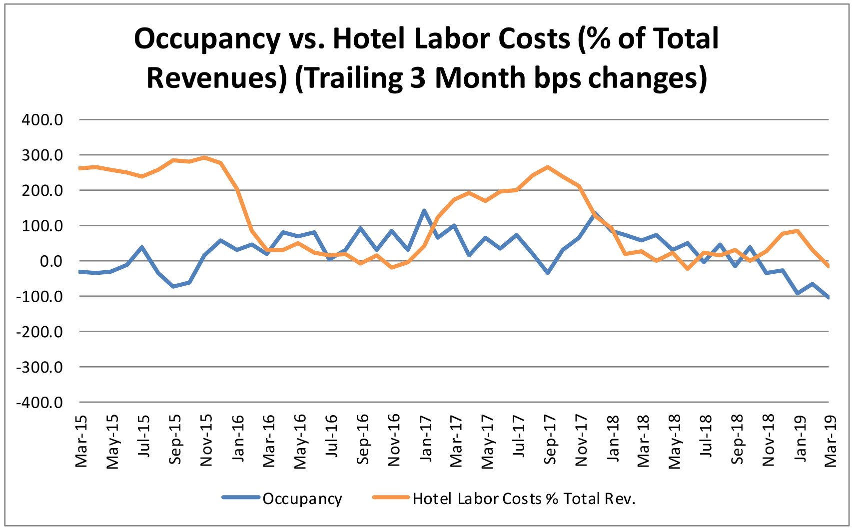
All dollar figures are in USD. 2017 figures have been revised as of December 2018 to account for the updated sample set.



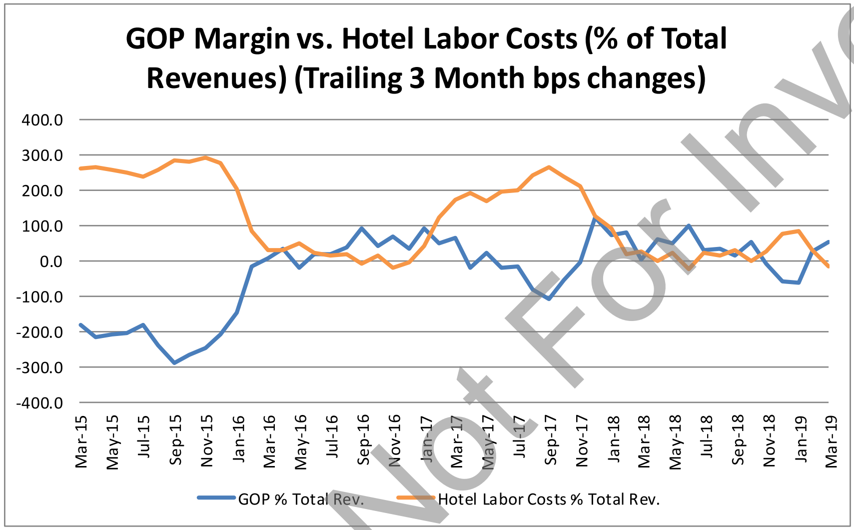
Source: STRH Research, HotStats

Source: STRH Research, HotStats

- 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 2Q19: Given the continued low RevPAR growth environment, hotel labor costs have had a highly significant influence on EBITDA margins. Labor costs are in many cases rising faster than hotel revenues and we expect this will be particularly relevant given what may be a tough April given the Easter/Passover calendar shift. **Thus, the ability for hotel owners and managers to keep labor cost increases as low as possible will continue to be critical in 2019.**

- **Consideration for 2Q19 earnings:** Among our REIT coverage, our aggregated Adjusted EBITDA Margin estimate (weighted average by market cap.) is -50 to -100 bps y/y. Our estimate is likely to be revised post-1Q earnings.
- 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 (or lower margin declines) in 2Q19 given the influence of the April holidays.**

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.

Required Disclosures

Analyst compensation is based upon stock price performance, quality of analysis, communication skills, and the overall revenue and profitability of the firm, including investment banking revenue.

As a matter of policy and practice, the firm prohibits the offering of favorable research, a specific research rating or a specific target price as consideration or inducement for the receipt of business or compensation. In addition, associated persons preparing research reports are prohibited from owning securities in the subject companies.

Charts indicating changes in ratings can be found in recent notes and/or reports at our website or by contacting SunTrust Robinson Humphrey. Please see our disclosures page for more complete information at https://suntrust.bluematrix.com/sellside/Disclosures.action.

STRH Ratings System for Equity Securities

Dissemination of Research

SunTrust Robinson Humphrey (STRH) seeks to make all reasonable efforts to provide research reports simultaneously to all eligible clients. Reports are available as published in the restricted access area of our website to all eligible clients who have requested a password. Institutional investors, corporates, and members of the Press may also receive our research via third party vendors including: Thomson Reuters, Bloomberg, FactSet, and S&P Capital IQ. Additional distribution may be done by sales personnel via email, fax, or other electronic means, or regular mail.

For access to third party vendors or our Research website: https://suntrustlibrary.bluematrix.com/client/library.jsp

Please email the Research Department at mailto:STRHEquityResearchDepartment@suntrust.com or contact your STRH sales representative.

The rating system effective as of Oct. 7, 2016:

STRH Rating System for Equity Securities

SunTrust Robinson Humphrey (STRH) rates individual equities using a three-tiered system. Each stock is rated relative to the broader market (generally the S&P 500) over the next 12-18 months (unless otherwise indicated).

Buy (B) – the stock's total return is expected to outperform the S&P 500 or relevant benchmark over the next 12-18 months (unless otherwise indicated)

Hold (H) – the stock's total return is expected to perform in line with the S&P 500 or relevant benchmark over the next 12-18 months (unless otherwise indicated)

Sell (S) – the stock's total return is expected to underperform the S&P 500 or relevant benchmark over the next 12-18 months (unless otherwise indicated)

Not Rated (NR) – STRH does not have an investment rating or opinion on the stock

Coverage Suspended (CS) – indicates that STRH's rating and/or target price have been temporarily suspended due to applicable regulations and/or STRH Management discretion. The previously published rating and target price should not be relied upon

STRH analysts have a price target on the stocks that they cover, unless otherwise indicated. The price target represents that analyst's expectation of where the stock will trade in the next 12-18 months (unless otherwise indicated). If an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of STRH Research Management not to assign a target price; likewise certain stocks that trade under $5 may exhibit volatility whereby assigning a price target would be unhelpful to making an investment decision. As such, with Research Management's approval, an analyst may refrain from assigning a target to a sub-$5 stock.

Legend for Rating and Price Target History Charts:
B = Buy
H = Hold
S = Sell
D = Drop Coverage
CS = Coverage Suspended
NR = Not Rated
I = Initiate Coverage
T = Transfer Coverage

<u>The prior rating system until Oct. 7, 2016:</u>

3 designations based on total returns* within a 12-month period**
· Buy – total return ≥ 15% (10% for low-Beta securities)***
· 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

SunTrust Robinson Humphrey ratings distribution (as of 04/30/2019):

Coverage Universe			Investment Banking Clients Past 12 Months		
Rating	**Count**	**Percent**	**Rating**	**Count**	**Percent**
Buy	431	63.76%	Buy	114	26.45%
Hold	242	35.80%	Hold	33	13.64%
Sell	3	0.44%	Sell	1	33.33%

Other Disclosures

Information contained herein has been derived from sources believed to be reliable but is not guaranteed as to accuracy and does not purport to be a complete analysis of the security, company or industry involved. This report is not to be construed as an offer to sell or a solicitation of an offer to buy any security. SunTrust Robinson Humphrey, Inc. and/or its officers or employees may have positions in any securities, options, rights or warrants. The firm and/or associated persons may sell to or buy from customers on a principal basis. Investors may be prohibited in certain states from purchasing some over-the-counter securities mentioned herein. Opinions expressed are subject to change without notice. The information herein is for persons residing in the United States only and is not intended for any person in any other jurisdiction.

SunTrust Robinson Humphrey, Inc.'s research is provided to and intended for use by Institutional Accounts as defined in FINRA Rule 4512(c). The term "Institutional Account" shall mean the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

SunTrust Robinson Humphrey, Inc. is a registered broker-dealer and a member of FINRA and SIPC. It is a service mark of SunTrust Banks, Inc. SunTrust Robinson Humphrey, Inc. is owned by SunTrust Banks, Inc. ("SunTrust") and affiliated with SunTrust Investment Services, Inc. Despite this affiliation, securities recommended, offered, sold by, or held at SunTrust Robinson Humphrey, Inc. and at SunTrust Investment Services, Inc. (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including SunTrust Bank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested. SunTrust Bank may have a lending relationship with companies mentioned herein.

Please see our Disclosure Database to search by ticker or company name for the current required disclosures, including valuation and risks, Link: https://suntrust.bluematrix.com/sellside/Disclosures.action

Please visit the STRH equity research library for current reports and the analyst roster with contact information, Link (password protected): STRH RESEARCH LIBRARY

SunTrust Robinson Humphrey, Inc., member FINRA and SIPC. SunTrust and SunTrust Robinson Humphrey are service marks of SunTrust Banks, Inc.

If you no longer wish to receive this type of communication, please request removal by sending an email to STRHEquityResearchDepartment@SunTrust.com

ADDITIONAL INFORMATION IS AVAILABLE at our website, www.suntrustrh.com, or by writing to:SunTrust Robinson Humphrey, Research Department, 3333 Peachtree Road N.E., Atlanta, GA 30326-1070