June Hotel P&L Analyzer: GOP margins +30bps. on Total RevPAR of +0.5%

Margins were surprisingly positive in June but 2Q margins still down ~ 40 bps

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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

Based on observations from ~1,000 higher-rated U.S. hotels (data source: HotStats) in our hotel data analytics lab: June: 30 bps of GOP margin gain on approximately +0.5% Total RevPAR (Total RevPAR includes Rooms RevPAR plus outside-of-the-room spend). June RevPAR results came in weak (as expected) but margin results were surprisingly slightly positive despite a tough y/y comp and paltry top-line growth. For 2Q, we estimate that margins were ~ -40 bps; this compares to our weighted-average estimate (by market cap) for our covered Lodging REITS of ~ -60 bps.

We maintain our general conservatism on Lodging REIT margin growth in 2019. Given RevPAR growth decelerating to near-flattish levels (+0.6% June YTD), we think the opportunities for REITS to keep margins flat or up are largely from 1) self-help factors (especially Park (PK, Buy)), 2) merger-related synergies, and 3) asset-management improvements (a focus today for all our covered Lodging REITS).

2Q19 margins for US full-service hotels came in largely within the range we previously forecasted (-25 bps to -100 bps); our GOP margin estimate for the HotStats data set is approximately -40 bps. We continue to maintain our position that Hotel REITS remain highly profitable, driven by low interest rates, relatively low debt levels, high nationwide occupancy and near-peak room rates, and proactive cost containment measures by owners. *If it were not for the proactiveness of management teams, margins could potentially be far worse in this low RevPAR growth / labor cost headwind environment, in our view.*

June results color: June RevPAR growth came in largely as expected although margins held in far better than expectations given the low RevPAR growth and the tough y/y GOP margin comp. Rooms RevPAR of -0.4% and Total RevPAR of +0.5% were unsurprisingly mediocre. (Total RevPAR was +4.7% in June 2018; the end of June last year saw a RevPAR bump from July 4th falling on a Wednesday.) Despite the tough comp and flattish RevPAR, GOP margins were +30 bps y/y. Our assumption is that the highly profitable other revenue segment (inclusive of daily destination/resort fees) contributed to the margin gain. We frankly consider June's results to be more of an anomaly and anticipate hotel owners will continue to have margin declines in light of rising labor costs that continue to grow faster than revenues.

- Please note that there are anomalies for specific REITS due to portfolio changes and property renovations, weather 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**

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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 positive leisure influence of the April holidays.

Our 2019 margin forecast continues to hold at flat to -50 bps. Per the HotStats data, YTD GOP margin growth is still basically flat and we do not anticipate the back half of the year to be an easier comp for most higher-rated hotels *and we certainly do not see a second half acceleration in our RevPAR data analytics lab*. The one major exception here are hotels that were materially negatively impacted by labor disruptions (strikes) in 2H18.

Our latest takeaways on hotel margins:

Over the last month, we have read a number of stories related to margin retention that we discuss below:

- **Resort fees under pressure with recent lawsuits to Marriott (MAR, Hold) and Hilton (HLT, Hold)**. We have spoken about resort and daily destination fees at length in our monthly notes. In the last few weeks, the DC Attorney General filed a lawsuit against MAR and Nebraska's AG has filed a similar lawsuit against HLT (Hotel Management). Part of the issue at hand stems from the disclosure or insufficient disclosure (per the briefs) of the total cost of a guest stay on hotel websites by keeping resort/daily destination fees separated from the room rate. We do not anticipate the REITS with MAR or HLT-operated properties to comment much until the lawsuits are settled. **We view the issue from a wider lens: daily fees as a distinct charge helps keep base room rates lower and more appealing for prospective guests, particularly in a late-cycle environment where room rates are plateauing in some markets. For hotel owners that have struggled to grow revenues and profitability (particularly the REITS under pressure), we view the fees as highly profitable ways to provide a fuller value for guests to use a hotel's operation beyond the room (greater usage of restaurants/lounges and other services).**
    - **What we find interesting is that these lawsuits focus on the daily fees even though quoted room rates on websites generally do not include taxes: state and local occupancy taxes are often more than 10% of the room rate and can be greater per night than the daily fees.** Tax charges have remained distinct from quoted room rates for years and yet tax disclosures do not appear to be the focus of the lawsuits.
    - **We remind investors of our bifurcated view on the sustainability of these daily fees:** Resort fees are somewhat more supportable in our view assuming a guest remains on property and uses bundled services (and assuming the resort fees have wide benefit -- one resort we stayed at offered "coconut husking" as part of the $50 resort fee -- some resorts offer more widely accepted amenities). **The sustainability of daily destination fees at urban hotels, a much newer phenomenon, remains more suspect to us** given that many services are often previously ones complementary to the guest and given that many guests may not use many if any of the bundled services. One item that may be more highly used is a food and beverage credit but a business traveler may still balk at any of these charges.
    - **When we speak with private and public hotel owners and managers, all suggest resort fees are here to stay.** MAR's CEO suggested similarly in an interview with LinkedIn. **We continue to contend that these fees are not necessarily permanent for urban hotels, particularly if hotel occupancy declines.** In Las Vegas, a number of properties have scaled back fees or are offering "no resort fee" periods during low occupancy periods (Las Vegas Review-Journal).
    - Complicating matters are how online travel agencies (OTAs) approach commissions -- if the daily fees are included (Travel Weekly). We view this topic as quite unresolved.
- **On our second topic: the transaction market is being impacted by labor cost increases. The linked article from Hotel News Now highlights how underwriting of labor costs is more on a pro forma basis vs. historic operating costs for some owners given limited resolution in labor cost stabilization.** We view this underwriting trend, where labor cost increases are likely to be part of the pro forma, to impact cap rate assumptions (making cap rates higher given lower NOI) and/or keep bid/ask spreads wide for some hotels.

- **Finally, a focus on F&B:** Given that food and beverage is a generally required albeit lower profit department for many higher-rated hotels, the linked article from Hotel News Now discusses ways that hoteliers have taken to reduce costs, including: reducing food waste, staff consolidation, using cheaper ingredients, buying local items and/or making more food from scratch, and taking out fine china from room service offerings.

Monthly Profitability Metrics

June profitability: Flattish RevPAR growth yet margins were slightly positive.

- **2Q:** Operating Department margins were ~ -20 bps and GOP margins were ~ -40 bps.

Industry Metric	June 2019 y/y	YTD		June 2019	YTD	FY2018	2018 y/y	FY2017
Occupancy	*-140*	*-90*	*bps*	81.9%	78.1%	77.7%	*30 bps*	77.4%
ADR	1.3%	1.7%	*%*	$229	$234	$225	2.5%	$220
RevPAR	-0.4%	0.6%	*%*	$188	$183	$175	2.8%	$170
Total Revenue PAR	0.5%	2.1%	*%*	$307	$310	$289	3.3%	$280
Total Dept. Profit % Total Rev.	*30*	*10*	*bps*	62.0%	61.0%	60.0%	*10 bps*	59.9%
Total Hotel Labor Costs % Total Rev.	*40*	*20*	*bps*	34.0%	34.8%	35.5%	*20 bps*	35.3%
Total GOP PAR	*1.2%*	2.1%	*%*	$123	$121	$108	*4.1%*	$104
Total GOP % of Total Rev.	*30*	*0*	*bps*	*40.2%*	*39.2%*	*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.

May profitability: Moderate RevPAR growth but modestly negative margins.

Industry Metric	May 2019 y/y	YTD		May 2019	YTD	FY2018	2018 y/y	FY2017
Occupancy	*30*	*-70*	*bps*	79.9%	77.4%	77.7%	*30 bps*	77.4%
ADR	2.0%	1.8%	*%*	$232	$236	$225	2.5%	$220
RevPAR	2.3%	0.8%	*%*	$186	$182	$175	2.8%	$170
Total Revenue PAR	3.8%	2.4%	*%*	$316	$310	$289	3.3%	$280
Total Dept. Profit % Total Rev.	*-40*	*10*	*bps*	60.9%	60.8%	60.0%	*10 bps*	59.9%
Total Hotel Labor Costs % Total R	*20*	*20*	*bps*	34.9%	35.0%	35.5%	*20 bps*	35.3%
Total GOP PAR	*2.7%*	2.3%	*%*	$125	$121	$108	*4.1%*	$104
Total GOP % of Total Rev.	*-40*	*0*	*bps*	*39.5%*	*39.0%*	*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.

April profitability: Flattish RevPAR and moderately negative margins.

Industry Metric	Apr 2019 y/y	YTD		Apr 2019	YTD	FY2018	2018 y/y	FY2017
Occupancy	-70	-100	bps	81.6%	76.7%	77.7%	30 bps	77.4%
ADR	-0.8%	1.7%	%	$238	$236	$225	2.5%	$220
RevPAR	-1.7%	0.4%	%	$194	$181	$175	2.8%	$170
Total Revenue PAR	-0.4%	2.0%	%	$324	$309	$289	3.3%	$280
Total Dept. Profit % Total Rev.	-40	20	bps	62.3%	60.8%	60.0%	10 bps	59.9%
Total Hotel Labor Costs % Total Rev.	100	20	bps	33.2%	35.0%	35.5%	20 bps	35.3%
Total GOP PAR	-3.0%	2.2%	%	$132	$120	$108	4.1%	$104
Total GOP % of Total Rev.	-110	0	bps	40.9%	38.8%	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.

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.

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

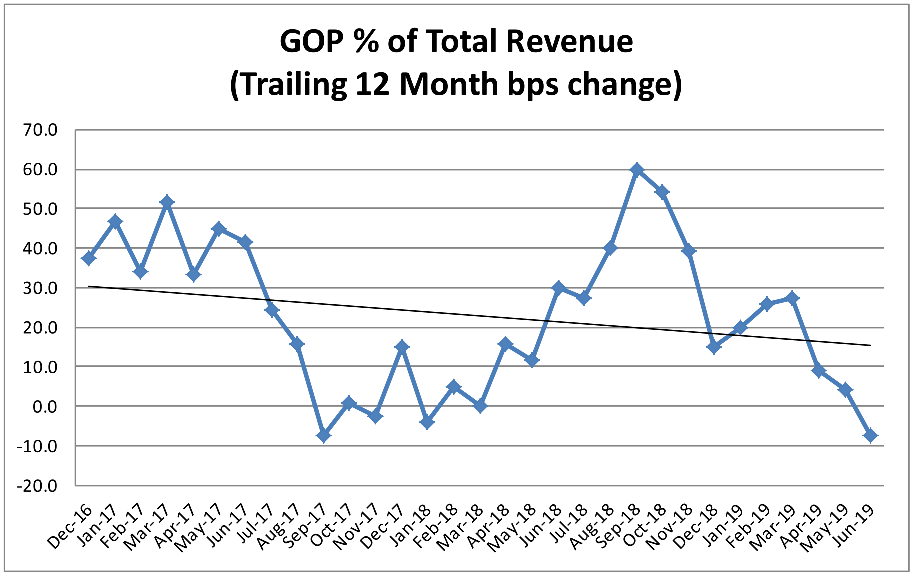
All dollar figures are in USD. 2017 figures have been revised as of December 2018 to account for the updated sample set.

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%

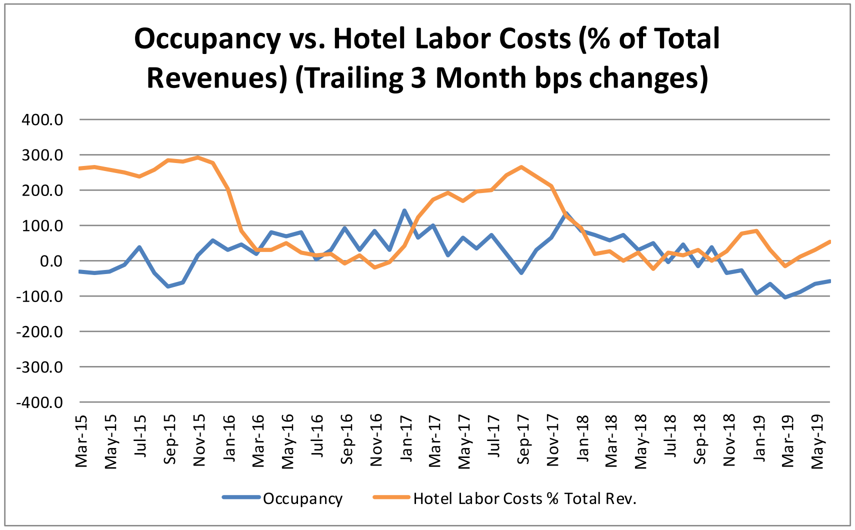
Source: STRH Research, HotStats

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

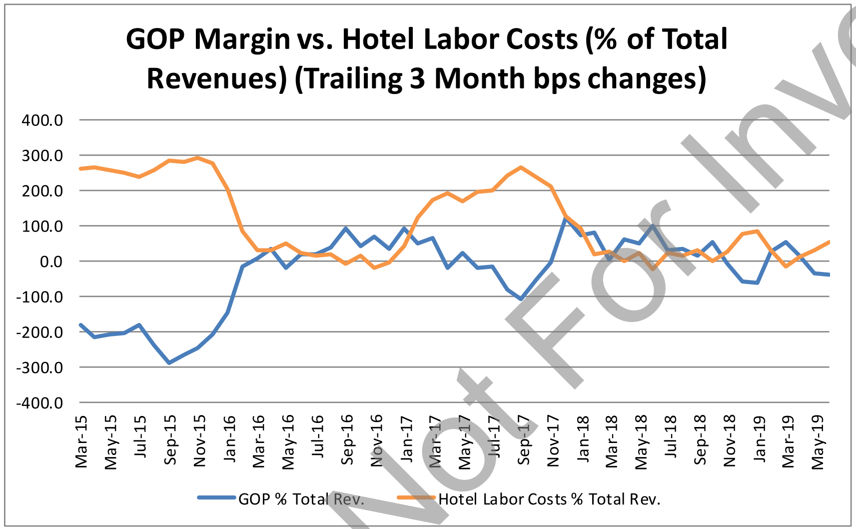


Source: STRH Research, HotStats

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



Source: STRH Research, HotStats



Source: STRH Research, HotStats

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REIT Margin Guidances*

		2Q Guide	2019 Guide	Margin Guidance Provided
Chesapeake	CHSP	guidance no longer updated due to proposed PK merger		
DiamondRock	DRH	none	none	
Host	HST	none	-25 to +35 bps	Comp Hotel EBITDA margins
Pebblebrook**	PEB	-100 to -75 bps	-50 to -40 bps	Same Property EBITDA margins
Park	PK	none	+20-80 bps	Comp Hotel Adjusted EBITDA Margins
Ryman	RHP	none	none	
RLJ	RLJ	none	-100 bps to -20 bps	Pro Forma Hotel EBITDA Margins (Implied guide from 32.8% YE 2018)
Sunstone	SHO	none	-25 to -75 bps	21 Hotel Comp Portfolio Adjusted EBITDAre Margin

*Note: We do not consider EBITDA margin guidances to be comparable across the Lodging REIT space as indicative of the type of margin guidance provided.

**Note: PEB reported earnings last week; for comparative purposes, we have listed the guidance as of 1Q earnings.

Source: Company filings, STRH Research

Companies Mentioned in This Note

Chesapeake Lodging Trust (CHSP, $27.82, Hold, C. Patrick Scholes)
DiamondRock Hospitality Company (DRH, $10.10, Hold, C. Patrick Scholes)
Hilton Worldwide Holdings Inc. (HLT, $97.40, Hold, C. Patrick Scholes)
Host Hotels & Resorts, Inc. (HST, $17.50, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $141.23, Hold, C. Patrick Scholes)
Pebblebrook Hotel Trust (PEB, $28.43, Hold, Gregory Miller)
Park Hotels & Resorts Inc. (PK, $26.41, Buy, C. Patrick Scholes)
Ryman Hospitality Properties, Inc. (RHP, $76.53, Hold, C. Patrick Scholes)
RLJ Lodging Trust (RLJ, $17.58, Sell, C. Patrick Scholes)
Sunstone Hotel Investors, Inc. (SHO, $13.29, Hold, C. Patrick Scholes)

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