Lodging REITs

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Hotel P&L Analyzer: Nov. GOP margins -4,030 bps y/y on -79.2% Total RevPAR

Absolute GOP turned negative again after briefly being positive in October

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 "big data" observations from higher-rated U.S. hotels (data source: HotStats): November: -4,030 bps of y/y GOP margin "growth" on -79.2% Total RevPAR (Rooms RevPAR + outside-of-the-room spend). By comparison, October margins were -3,190 bps y/y on -79.3% Total RevPAR. November results went in the wrong direction as absolute GOP turned negative (-5.7% GOP % of Total Revenue vs. +8.9% in October).

4Q: we forecast property-level EBITDA margins for full-service hotels of -3,500 bps to -4,500 bps y/y with "sun and ski" resorts as relative outperformers and big box urban largely very weak.

In this month's P&L Analyzer, we focus on two fronts:

1. Insight and forecasts for 4Q20 hotel profits (based on October/November HotStats results)
2. Additional commentary on 4Q for the Lodging REITS

<u>October/November HotStats results and our 4Q profit forecast:</u>

- **October: Rooms RevPAR of -77.9% and Total RevPAR of -79.3% compare with GOP margins of -3,190 bps y/y.**
- **November: Rooms RevPAR of -78.4% and Total RevPAR of -79.2% compare with GOP margins of -4,030 bps y/y.**
    - On an absolute basis, GOP as a percentage of total revenue was -12.8% in July, -13.5% in August, -16.6% in September, **+8.9%** in October, and -5.7% in November. Negative GOP margins effectively eliminates incentive management fees (IMFs) for most hotels, with possible exceptions to high occupancy resorts. **We caution investors that a material return of IMFs to Lodging C-corps from U.S. hotels (and most markets ex-China) is unlikely for several quarters.** The main saving grace for IMF contribution will come from hotels without an owners' priority or profit hurdle (largely in Asia-Pacific).

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- As of November, YTD occupancy for the HotStats' sample was just 30.5% with ADR down 17.8% y/y. Traditionally, we see full-service hotels' ability to break even at the property-level in the 40s+ percent occupancy. This figure has been lowered in the Spartan labor models post-COVID, but not really sustainable in our view with hotel managers running the front desk and in housekeeping roles.
- Departmental profit (reflective of the hotel operating departments) remains decently profitable with profit as a percentage of total revenue of 44.5% in October, 45.3% in November, and 49.3% YTD November. However, as evidenced by the unusual profit margins in each operating department (especially Rooms vs. Other Revenues in REIT earnings releases), we strongly suspect property managers acting in hourly roles as contributing to atypical margin results. If hotels were fully staffed at the hourly level on sub 30% occupancy, we would anticipate department profit being far lower than what the sample results indicate and what we find in REIT quarterly income statements.
- **We struggle to view the sequentially improved departmental profit in November as reflective of a potential positive surprise for December or 1Q21.** For one, November GOP re-shifted negative. Second, December MTD results from STR (we are missing the final five days of the year including the normally high occupancy/ADR 12/31) indicated Luxury/Upper Upscale occupancy at 24.1% (-60.2% y/y) and ADR -21.3% y/y. Even for the relatively outperforming resorts, RevPAR per STR for December MTD was -58.5% y/y. We have pointed out in our weekly STR notes that the traditionally low business travel period of early-mid December combined with the COVID demand impact resulted in some of the worst weekly lodging results since June.

• **4Q forecast: For now, we assume property-level EBITDA margins for full-service hotels of -3,500 bps to -4,500 bps y/y. As a reminder, normally our forecast range is 100 bps at most -- as we explain below, last minute bookings/cancellations for New Years Eve combined with weak December MTD demand and re-closing hotels add considerable volatility to our 4Q estimates.** As such, we would not be surprised to see some luxury resorts in "sun and snow" destinations significantly outperforming aggregated December results. Note, our assumption may not conform with HotStats December results due to the HotStats sample possible overweight to Luxury resort hotels.

- Where in normal times we might assign October with a higher weighting for 4Q forecasting given a normally robust business travel month (especially for groups), this year adds complications for precise estimates. The greatest complication for forecasting comes from New Years, a possible material overweight for some hotels and likely to show up in HotStats' December results. We will attempt to pinpoint what we can uncover looking at this Wednesday's STR results; we advise investors that market-level analysis for New Years (rather than headline results) may be especially material this year for 4Q forecasting.
- Given extremely short booking windows today, easy cancellation policies, recent reclosures of some REIT-owned hotels, rising COVID cases into Christmas week, and greater restrictions imposed by some local and state governments as of late, we view atypically material headwinds for New Years Eve demand.
- **While some hotels will likely benefit from a New Years' relative demand boost at high ADRs vs. an overall challenged 4Q, we expect outperforming hotels to be primarily in warm weather, drive-to markets with sun markets and snow resorts largely outpacing most city destinations.** We view Florida markets (Tampa, Orlando, Miami, and resort-destinations) and to an extent warm-weather destinations in the South and Southwest states, Southern California, and Hawaii as relative outperformers. For REITS, we view the sun and snow properties helpful but largely unable to balance out lower profitability/negative results from big-city, business/group focused, and cold-weather destinations, even net of some individual properties with robust high-rated Christmas/New Year's demand. A good headwind example for the REITS is NYC -- with a closed Times Square for the ball drop, no Broadway, and limited restaurant options, visitation from out-of-town guests would naturally be more limited -- and the normally high room rates less appealing. The challenge for us as forecasters is to balance out what could be some luxury hotels' $1,000 ADR rooms with high occupancies at select resorts with extreme weakness elsewhere. Net-net, we expect a very wide range of property-level profit results for December and 4Q.

4Q20 for the REITS: We suspect many management teams are trying to lower investor expectations vs. 3Q results, we view continued Spartan operations for many hotels and QTD HotStats results as indications that 4Q20 results may indeed not be a step-up from 3Q.

- While 3Q20 was a vastly better quarter on the bottom line for the REITS vs. 2Q20, driven by hotel reopenings and pent-up leisure demand, 4Q20 is more a menagerie of puts and takes. The biggest tailwind in our view was a modest rebound of corporate demand, WFH and virtual schooling driving vacations in non-holiday periods, and operating efficiencies as hotels continued to ramp up post-reopening. Importantly, the HotStats data that we analyze does not factor in corporate costs.
- **On the top line: we do not see 4Q reflecting major changes to 2020 fundamentals.** Large group/convention demand was virtually a zero in 4Q. Fly-to corporate travel remained limited and did not benefit many big city urban REIT-owned hotels. Leisure demand remains the relative outperforming customer segment for hotels.
- **On the bottom line: given our backgrounds in hotel operations, we are hard-pressed to believe that hotel-level profitability or the lack thereof has changed materially for the better.** Perhaps the most telling sign for us is that property-level managers are in many cases still handling hourly-wage functions, especially at big-city group-oriented hotels. If demand and profitability conditions were more favorable, we would see managers moving to their normal roles -- that dynamic remains mixed at best.
- **An additional headwind that is partly a late 2020 and 2021 story is the ability or desire for hourly hotel workers to resume prior roles.** Public and private hotel executives in our recent meetings noted the combination of stimulus checks and health fears as factors in some workers not resuming their prior roles. Essentially we would not be surprised to hear of hotels having to offer enhanced wages/benefits to entice some hourly workers back to work (less an issue at the annual salary roles as we do not expect a rebound of rehires for the $50K+ midlevel managers, sales and marketing, and catering positions until there is clear evidence of a corporate demand recovery). **A reduced stimulus check (the lack of the $2,000 stimulus passing) could lead to hotel workers applying to roles in greater numbers. An additional complication for hoteliers: city ordinances that require the rehiring of laid off employees (Restaurantdive.com). These ordinances in LA, Philadelphia, DC, and other markets can materially impact the Hotel REITS' profitability given portfolio concentrations in major urban and unionized markets.**

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