Lodging REITs

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What's Inside

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

Hotel P&L Analyzer: August GOP margins +4,640 bps y/y on +218% Total RevPAR. Leisure ADR a big help.

3Q read-through: July strength and Labor Day demand also profit tailwinds

What's Incremental To Our View

Based on "big data" observations from higher-rated U.S. hotels (data source: HotStats): August: +4,640 bps of y/y GOP margin growth on +217.5% Total RevPAR (Rooms RevPAR + outside-of-the-room spend). July: +5,060 bps of y/y GOP margin growth on +310.1% Total RevPAR.

Absolute GOP margins were very respectable in both months, over 30%, despite sub 60% occupancy. We view high ADR from pent-up leisure and continued tight operating controls (lighter staffing) will continue to help margins remain elevated for 3Q. September ought to be softer as leisure demand fades with back-to-school.

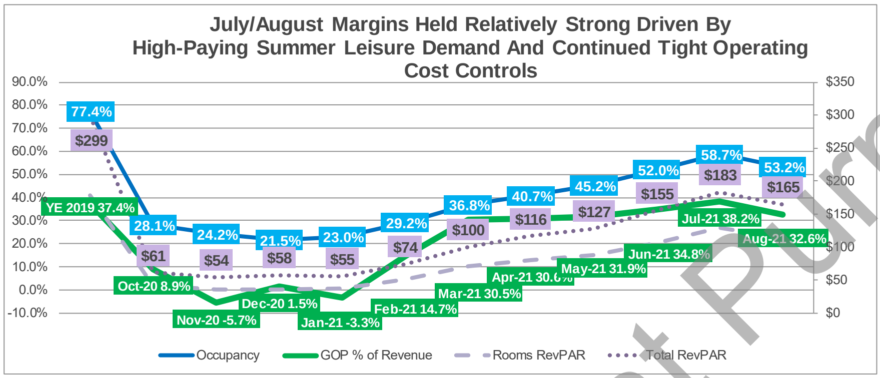
We suspect -- although we could be wrong -- that July will be a near-term peak of margins for possibly several months given the strength of summer leisure demand paying very high room rates. We remain more cautious into the fall. Leisure strength combined with tight operating controls have resulted in continued elevated margins on abnormal revenue and operating expense fundamentals.

Unfortunately, we are not hearing that labor issues have resolved even as pandemic insurance went away in some states several weeks ago -- despite some hope from corporates that September would be a turnaround story -- and partly as a result we are not as bullish on margin performance into the fall. Visibility remains very tough and we could be wrong on how margin trends progress, but service issues and staffing shortages appear to remain highly problematic for the greater service industry. There are many reasons for staffing issues that we have addressed in past notes: child care issues during COVID, health concerns, angry guest attitudes, competing wages from outside the service industry, etc.

- **A poll at the Lodging Conference in Phoenix this week (319 participants) suggested that the biggest challenge facing the hotel industry was workplace shortages (~70%), well ahead of the slow return of business travel (~21%)**, organized labor (~5%), and taxes/regulation (~4%).

We are not able to precisely forecast September/3Q margins at this time and await the HotStats September data for a better read-through to public lodging company performance, especially the asset-heavy REITS and Hyatt (H, Hold). **That said, we suspect generally strong Labor Day results (the continuation of pent-up leisure at high rates) may help stem lower margins for the rest of September.** We would not be surprised to see a relative improvement in top-line from corporate demand over the next several weeks but unlikely at the room rates of July/August. Beyond the flip to a heavier corporate mix are greater demands on lower-margin hotel operations, especially F&B and meeting space.

The perverse reality today is that hoteliers communicate contentness with lower occupancy because they can keep some rooms closed given light staffing. However, the rubber may meet the road on how long hoteliers can hold tight on cost controls. We still anticipate an eventual increase in hourly wages, whether driven from inflation and competitive wage pressure or the need to staff up in anticipation of higher overall demand. If/when that labor pressure reaches a precipice, that is another outstanding and impossible-to-forecast matter.



Notes: Comp sets may differ from month to month. We evaluate headline results for high-level comparisons.
Some properties have reopened over the course of recent months (including competitive properties), which may impact above.
Resort/leisure-oriented hotels may have an overweight influence on 2020/2021 results.

Source: HotStats, Truist Securities Research

<u>**3Q HotStats monthly results:**</u>

August:

- **Rooms RevPAR of +217.0% and Total RevPAR of +217.5% compared with GOP margins of +4,640 bps y/y.**
    - GOP margins as a percentage of total revenue of 32.6% compares to -13.8% in the prior year.

July:

- **Rooms RevPAR of +324.1% and Total RevPAR of +310.1% compared with GOP margins of +5,060 bps y/y.**
    - GOP margins as a percentage of total revenue of 38.2% compares to -12.4% in the prior year.

<u>**2Q HotStats results:**</u>

2Q estimates: We estimate GOP margins of approximately 32% for the HotStats sample, with relatively stronger results for many leisure hotels and resorts able to drive significant room rate growth. Given many closed and reopening hotels we are not making granular assumptions on other 2Q results.

June:

- **Rooms RevPAR of +361.7% and Total RevPAR of +357.0% compared with GOP margins of +9,630 bps y/y.**
    - GOP margins as a percentage of total revenue of 34.8% compares to -61.5% in the prior year.

May:

- **Rooms RevPAR of +539.0% and Total RevPAR of +540.9% compared with GOP margins of +12,490 bps y/y.**
    - GOP margins as a percentage of total revenue of 31.9% compares to -93.0% in the prior year.

April:

- **Rooms RevPAR of +867.2% and Total RevPAR of +752.6% compared with GOP margins of +22,340 bps y/y.**

- GOP margins as a percentage of total revenue of 30.6% compares to -192.8% in the prior year.

1Q HotStats results:

- **March: Rooms RevPAR of +4.0% and Total RevPAR of -11.0% compared with GOP margins of +4,240 bps y/y.** We add that ADR for March was $189 vs. $216 in the prior year. Occupancy was 36.8% vs. 31.0% in the prior year.
  - GOP margins as a percentage of total revenue of 30.5% compares to -11.9% in the prior year.

- **February: Rooms RevPAR of -70.3% and Total RevPAR of -73.6% compared with GOP margins of -2,220 bps y/y.**
  - GOP margins as a percentage of total revenue of 14.7% compares to 36.9% in the prior year.

- **January: Rooms RevPAR of -75.7% and Total RevPAR of -77.7% compare with GOP margins of -3,280 bps y/y.**
  - GOP margins of -3.3% compare to 29.5% in the prior year.

H: Valuation and Risks

Our price target of $76 for H is derived by applying a 14.2x target EV/EBITDA multiple (a blended average of the industry multiples for each business segment) to our estimate for 2023 EBITDA. Our valuation model for Hyatt assumes an owned-hotel 2023 EBITDA multiple of 12.5x and a franchise/management fee EBITDA multiple of 15.0x.

Upside risk: transient and group trends outperform expectations, stronger than expected supply growth, material disposition of real estate at attractive pricing, and improvements in market share for select-service brands.

Downside risk: lodging recovery takes longer than expected. Planned dispositions take longer than expected. Material labor issues to owned hotels. Pipeline growth slower than expected.

Companies Mentioned in This Note

Hyatt Hotels Corporation (H, $78.63, Hold, C. Patrick Scholes)

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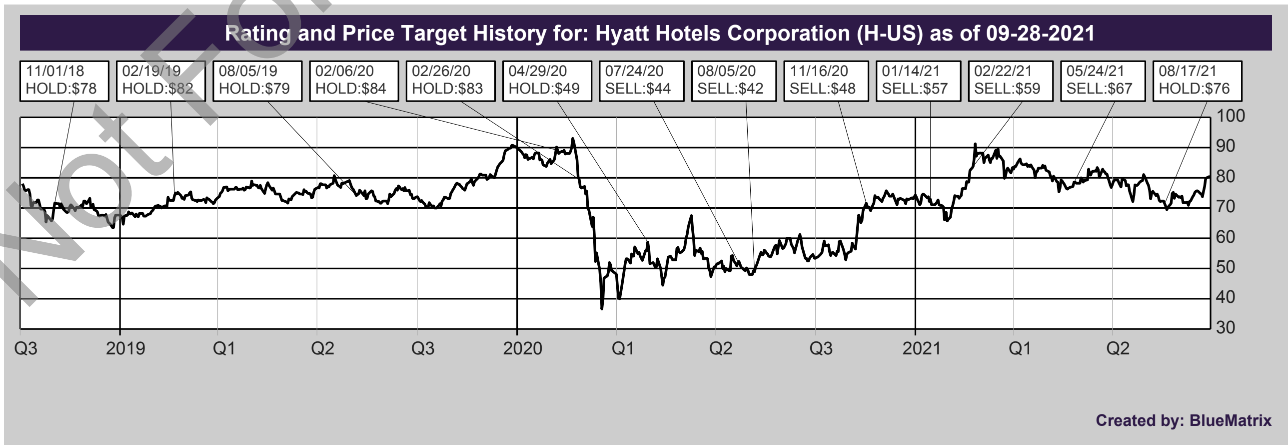

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