Equity Research

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CONSUMER: Lodging

May Hotel P&L Analyzer: GOP margin of 41.7% +330 bps vs 2019; sequentially -120 bps vs April.

Gregory J. Miller
212-303-4198
Gregory.J.Miller@truist.com

C. Patrick Scholes
212-319-3915
Patrick.Scholes@truist.com

Alexander Barenklau
212-303-4166
Alexander.Barenklau@truist.com

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Reasons for this report

✓ Deep dive analysis of recent U.S. hotel profits, a proxy for the Lodging REIT portfolios and within Lodging C-corps an excellent overview of franchisee health/ fee generation of institutional hotel owners as well as a read-through on incentive management fees (IMFs).

Companies most impacted in this note include: HLT, H, MAR, the Lodging REITS, and secondarily PLYA as a leisure read-through.

We analyze revenue and expense "big data" on over 3,000 U.S. hotels (data source: HotStats) and hold discussions with private hotel owners. HotStats data is helpful for analyzing both Lodging C-corps and REITS.

Our "Bottom Line": Absolute GOP margin in May was 41.7% (+330 bps vs. May 2019). April was 42.9% (+360 bps vs. 2019). Both months' Total RevPARs were 15% below 2019 levels. While May was a better reflection of a normal demand recovery month with less holiday impact/more corporate travel, sequential m/m profit changes were fairly modest. Regardless, labor shortages remain highly challenging.

Before we discuss the May profit results in detail, the macro issues impacting staffing shortages at hotels and the greater travel infrastructure still warrant primary attention as material to short- and longer-term revenue and profit forecasting. The issues: hotel demand is closer to normalization especially for summer travel, many hourly workers have permanently left the industry (exacerbating the material and oft forgotten labor shortage that existed pre-pandemic), and some hotel rooms are forced to stay unoccupied due to staffing shortages. Thus, the hotel industry is losing both revenue opportunities and theoretically higher margins given a hit to operating efficiencies and economies of scale (read-through: lower than optimal theoretical base and incentive fee revenues for C-corps; for REITS/C-corp owned U.S. hotels - lower than optimal hotel profits). Current 40%+ hotel margins are ahead of 2019 and very respectable to us (detail further in this note). **However, if the labor issues were less material, absolute revenues and profits could in theory be even better** and closer to 2019 levels.

Given the above dynamics heading into peak summer travel, labor remains topic #1 with industry executives: the vast majority of plenary sessions at the June NYU hospitality conference focused on labor. Last week, the American Hotel & Lodging Association (AHLA) released a survey noting 97% of hotels are experiencing a staffing shortage with 49% considering the situation "severe". In our view and supported by independent research, the most logical steps to attract staff are being implemented: 90% of hoteliers are increasing pay, 71% offer greater work hour flexibility, and 43% are expanding benefits. Relatedly, a June Boston Consulting Group-NYU report noted pay, then work flexibility, then benefits as top three considerations for prospective hotel industry workers.

- **The good news for now, despite recessionary concerns, is that our corporate travel agency and meeting organizer contacts note greater willingness to pay more for hotel rates and meeting expenses if service/staffing issues are improved -- not at all the normal tune we hear from these entities.** The above is relatively good news for hoteliers to push 2023 room rates for corporate rate negotiations although the backdrop of a potential recession is unfortunate timing given late-summer to fall negotiations. We cautiously view group-oriented hotels best positioned to push higher room/catering charges given the greater labor intensity of events followed by domestic-focused leisure hotels and resorts that have continued pricing power and strong 2023 occupancy fundamentals. This viewpoint may change depending on post-summer demand trends and the customer segments most impacted by a macroeconomic downturn.
- Please join us on Tuesday, July 12th as we discuss: *The Current State of Hotel Labor: Wage Growth, Staffing, and Challenges/Opportunities in Hotel Operations.* Please contact your Truist Securities salesperson or us for details and registration.

SEE PAGE 9 FOR REQUIRED DISCLOSURE INFORMATION

We next shift attention to ways that the labor cost growth and staffing shortages may eventually be rectified and how that translates to both quarterly earnings and lodging company guidance.

In terms of resolving the labor shortage issues: hotel industry leadership does not have its head in the sand. However, some structural challenges exist that we find hard to quickly resolve. Not often highlighted by public companies are the diffuse characteristics of the U.S. hotel industry: thousands of hotel owners and managers, differing and often intentionally distinctive operating and service standards and hotel/company culture, and over 100 major hotel brands make for a difficult calculus to solve the most pressing labor and operating issues in the near-term. While the hotel industry continues to take strides to improve the situation, some platitudes on labor issues and remedies at industry conferences seem to stay unchanged from pre-pandemic days. Some hoteliers have expressed surprise that furloughed employees would not "run back" (Hotel News Now). Recruitment efforts for hourly roles that we review in social media often focus on culture -- "great place to work" -- which seem rather similar to 2019 and insufficient messaging given long layoffs during the pandemic and property managers taking on hourly responsibilities during times of low occupancy. As we address further below, unless there is a major recession leading to higher entry-level unemployment/lower occupancy or a material change to immigration policies, we struggle with how quickly (and financially impactful) staffing shortages may impact 2H22/2023 hotel forecasts. Losing both potential occupied rooms and rehiring at higher wages may effectively become a double whammy. **Given the majority of hotel owners are experiencing labor shortages/rising wages (and we are somewhat cynical to public companies that suggest otherwise), forecasting profits beyond a few months out remains very difficult for many hoteliers.**

Some ways we see the labor crunch being ameliorated (outside of higher pay-benefits and worker flexibility noted in the aforementioned AHLA survey or another demand shock that lowers occupancy):

- **Industry specific:**
  - Further consolidation. We expect this trend to continue especially with third-party private operators. Consolidation of hotel managers should be of some benefit to C-corps and REITS for scale cost savings, a larger pool of workers under the same parent entity, and fewer industry partners. There may be some loss to the C-corp franchisor power from operator consolidation but less so than if hotel property ownership was far more consolidated (not likely).
  - Revised operating standards, amenities, and hotel design to decrease labor hours and allow for greater automation. **We continue to look to hotel markets such as in Scandinavia and Japan as examples of efficient interior design.**
  - Greater stability in pay and hours, especially for tipped roles.
  - Enhanced technology both for hoteliers to determine daily labor needs and to also pay staff closer to real-time.
  - Effectively highlighting career growth opportunities. We are seeing much needed efforts from brand CEO LinkedIn posts highlighting hourly workers that are now property/above-property managers and recruitment efforts by the AHLA Foundation. **We view more promotional "role models" from the most "labor shortaged" areas as additive -- especially highlighting how non-native English speakers and those without college degrees can advance from hourly roles.** Some major hotel employers have offered English language courses for years.
  - Enhanced pay/logistics for transportation to work, a real issue given hotel staff may reside a far distance from their employer and not always with easy/timely public transportation options.

- **Economic slowdown/stock market challenges/recession leads to more job applicants:**
  - A major rise of unemployment
  - Deteriorated savings of retirees

- **Health and related government and corporate policies:**
  - Resolved COVID situation that could bring back immunocompromised and older workers.
  - Improved medical treatment and employer support for both short-term COVID and "Long COVID" sufferers, particularly relevant for hourly workers that may view hotel employers as less forgiving than other industries when sick days occur. For example, a warehouse or healthcare employer may have hundreds of employees working at one time whereas the impact is greater when one of ten housekeepers on staff has a last-minute sick day. In the interim, hotel operator consolidation and technology can help outreach to a larger theoretical worker base that is available on-call and trained to several properties and reduce stress on a sick employee who either comes into work despite having COVID or worries about job security due to absence.
  - Enhanced benefits for childcare -- particularly relevant for roles with a greater percentage of female hourly staff such as housekeeping (Washington Post).

- **Immigration reform may be most impactful over the long-term and would have also likely been helpful pre-pandemic given the ~800K open accommodations/food service positions in early 2020. However, we struggle to see much political will to act today** even though last week the Supreme Court provided the Biden Administration the discretion to end an asylum policy set by the previous administration (Politico). Interestingly, Gallup polling on immigration suggests support for higher immigration at levels well above the last few decades (+30% in favor from prior single-digit levels).

Considerations for forecasting and guidance: While we find May data presented below as informative given fairly similar results to April, we cannot say that margins have normalized. **Given the lack of stabilization on both staffing and labor costs, irrespective of the potential macroeconomic uncertainty, projecting 2Q22 and FY22 profits remains very difficult.**

- **High-level for 2Q22 results: We look favorably on margin results given the continued positive spread between the recovery of profits and Total RevPAR (outperformance on lower demand).**
  - **2Q results for U.S. hotels will likely reflect a positive profit imbalance** due to: higher room rates driven by leisure/holiday demand (especially lower-end hotels and luxury resorts) combined with lower-than-normalized staffing; the aforementioned factors may for now

overweight the impact of rising labor costs, inefficiency from training new hires, and lower-than-optimal occupancy (including letting rooms stay vacant due to staffing shortages).

- While we are unsure the extent that higher inflation was considered in the forecasts for permanent margin expansion, **we remain confident that longer-term margin gains (peak cycle to peak cycle) discussed by Lodging C-corps and REITS are achievable if not beatable and most driven by theoretically permanently cut roles.** For C-corps, we focus on headquarter G&A and incentive management fees for managed hotels with lower permanent staffing. For REITS and C-corp owned hotels, we focus on cut property-level manager positions and labor/operating efficiencies in housekeeping, front desk, and food and beverage (F&B).

- Among the continued winners are likely resort profits, thus a benefit to companies such as Buy-rated and leisure-heavy Hyatt and Playa (H and PLYA, Scholes) even after winter high season. To a lesser extent, we anticipate Marriott (MAR, Hold, Scholes) to continue to benefit from its North America and Caribbean luxury leisure exposure. Both H and MAR should continue to see strong incentive management fees (IMFs) from properties seeing the flow of robust ADRs to margin results. Hilton (HLT, Hold, Scholes) should also benefit although their exposure is somewhat more select-service weighted in the U.S.

- The hotel companies that we view most able to publicly project EBITDA:
  - Fewer hotels to manage or own and can focus on demand forecasting (C-corp examples include HLT and Wyndham (WH, Buy, Scholes)
  - REITS that have greater visibility on group and resort bookings and perhaps fewer overall staffing shortages: DiamondRock (DRH, Hold, Scholes) and Pebblebrook (PEB, Hold) especially for their smaller leisure resorts and Ryman (RHP, Hold, Scholes) given the longer lead times and/or cancellation-attrition revenue generation for large in-house groups.

Shifting to May HotStats results:

HotStats data suggests April and May results were quite similar when comparing to the same month of 2019. There were modest margin declines in May relative to April despite a smaller impact from leisure/holiday demand and outside-the-room spend (reflecting in Total RevPAR).

Aggregated U.S. Hotel Operating Performance:
May 2022 vs. April 2022

	May-22	Apr-22	monnth % change	Abs, variance	
Occupancy	68.2%	68.9%	-1.0%	-70	bps
ADR	$224	$225	-0.2%	-$0.40	
RevPAR	**$153**	**$155**	**-1.3%**	**-$1.94**	
Total RevPAR	**$228**	**$227**	**0.5%**	**$1.11**	
Room Margin	75.5%	76.3%	-1.0%	-80	bps
F&B Margin	34.3%	34.5%	-0.6%	-20	bps
Operating Department Margin	64.7%	65.9%	-1.8%	-120	bps
GOP Margin	**41.7%**	**42.9%**	**-2.8%**	**-120**	bps
GOP Per Available Room	**$95**	**$96**	**-2.0%**	**-$1.89**	
Total Hotel Payroll (% of Total Revenue)	30.4%	29.6%	2.7%	80	bps
Total Hotel Payroll (Per Available Room)	$69	$67	3.6%	$2.42	
Total Hotel Payroll (Per Occupied Room)	$101	$96	4.8%	$4.63	

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.
We have not readjusted prior month reported data; differences are generally modest.

Source: Truist Securities Research; HotStats

Aggregated U.S. Hotel Operating Performance:
May 2022 vs. Prior Years

	May-22	May-21	y/y % change	May-19	3-yr % change
Occupancy	68.2%	49.6%	37.5%	78.9%	-13.6%
ADR	$224	$167	34.4%	$218	2.6%
RevPAR	**$153**	**$83**	**84.5%**	**$172**	**-11.3%**
Total RevPAR	**$228**	**$116**	**97.2%**	**$268**	**-14.9%**
Room Margin	75.5%	74.3%	1.6%	73.8%	2.3%
F&B Margin	34.3%	21.0%	63.3%	32.1%	6.9%
Operating Department Margin	64.7%	64.4%	0.5%	61.3%	5.5%
GOP Margin	**41.7%**	**33.1%**	**26.0%**	**38.4%**	**8.6%**
GOP Per Available Room	**$95**	**$38**	**149.7%**	**$103**	**-8.0%**
Total Hotel Payroll (% of Total Revenue)	30.4%	33.8%	-10.1%	33.9%	-10.3%
Total Hotel Payroll (Per Available Room)	$69	$39	76.9%	$91	-24.0%
Total Hotel Payroll (Per Occupied Room)	$101	$78	30.4%	$115	-12.2%

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.
We have not readjusted prior month reported data; differences are generally modest.

Source: Truist Securities Research; HotStats

When comparing April-May in aggregate versus 1Q22, there is understandably considerable improvement given the impact of Omicron on demand especially in January and the first half of February. **While it is premature to use the April and May results (vs. 2019) as a run-rate to forecast June profit results, we present QTD results versus 1Q22 and prior years for comparison.**

Aggregated U.S. Hotel Operating Performance:
April/May 2022 vs. 1Q22

	April-May 2022	1Q22	monnth % change	Abs, variance
Occupancy	68.7%	55.0%	*24.9%*	1,370 *bps*
ADR	$225	$209	*7.6%*	$15.82
RevPAR	**$155**	**$115**	***34.3%***	**$39.49**
Total RevPAR	**$229**	**$168**	***36.0%***	**$60.48**
Room Margin	75.8%	73.2%	*3.6%*	260 *bps*
F&B Margin	34.4%	24.2%	*42.1%*	1,020 *bps*
Operating Department Margin	65.2%	62.2%	*4.8%*	300 *bps*
GOP Margin	**42.1%**	**34.2%**	***23.1%***	**790** *bps*
GOP Per Available Room	**$96**	**$57**	***67.7%***	**$38.70**
Total Hotel Payroll (% of Total Revenue)	30.1%	34.8%	*-13.5%*	-470 *bps*
Total Hotel Payroll (Per Available Room)	$69	$58	*17.5%*	$10.21
Total Hotel Payroll (Per Occupied Room)	$100	$106	*-5.9%*	-$6.27

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.
We have not readjusted prior month reported data; differences are generally modest.

Source: Truist Securities Research; HotStats

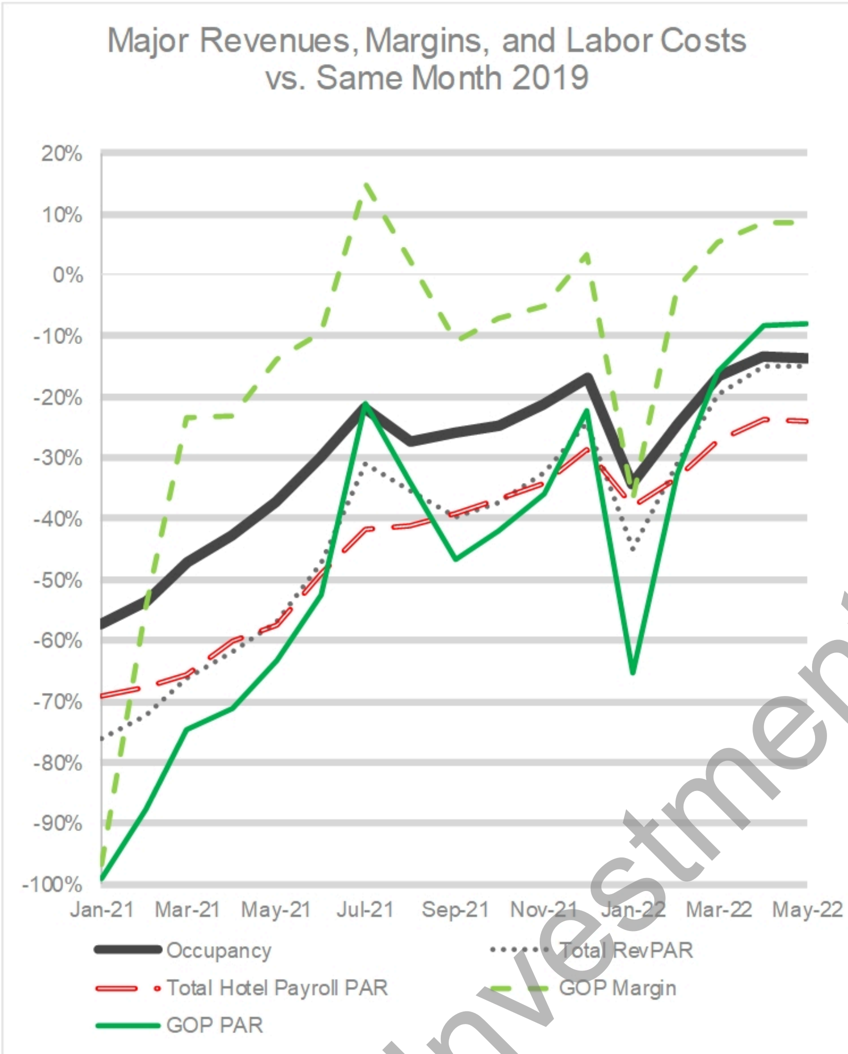
Aggregated U.S. Hotel Operating Performance:
April/May 2022 vs. Prior Years

	April-May 2022	April-May 2021	y/y % change	April-May 2019	3-yr % change
Occupancy	68.7%	47.7%	*44.0%*	79.3%	*-13.4%*
ADR	$225	$165	*36.4%*	$220	*2.5%*
RevPAR	**$155**	**$79**	***96.3%***	**$174**	***-11.3%***
Total RevPAR	**$229**	**$109**	***108.9%***	**$269**	***-15.0%***
Room Margin	75.8%	73.9%	*2.6%*	74.2%	*2.2%*
F&B Margin	34.4%	20.0%	*72.0%*	32.0%	*7.5%*
Operating Department Margin	65.2%	64.2%	*1.6%*	61.8%	*5.5%*
GOP Margin	**42.1%**	**31.7%**	***32.8%***	**38.8%**	***8.5%***
GOP Per Available Room	**$96**	**$34**	***179.3%***	**$104**	***-8.1%***
Total Hotel Payroll (% of Total Revenue)	30.1%	34.3%	*-12.2%*	33.4%	*-9.9%*
Total Hotel Payroll (Per Available Room)	$69	$37	*84.6%*	$67	*1.7%*
Total Hotel Payroll (Per Occupied Room)	$100	$78	*28.3%*	$113	*-12.1%*

Note: HotStats sample is somewhat skewed to U.S. full-service hotels although individual hotel results vary widely today by hotel location and customer base.
We have not readjusted prior month reported data; differences are generally modest.

Source: Truist Securities Research; HotStats

Below we present major top-line and bottom-line trends versus 2019. As we noted above, we cannot say that the sequentially similar April to May trends represent stabilized levels.

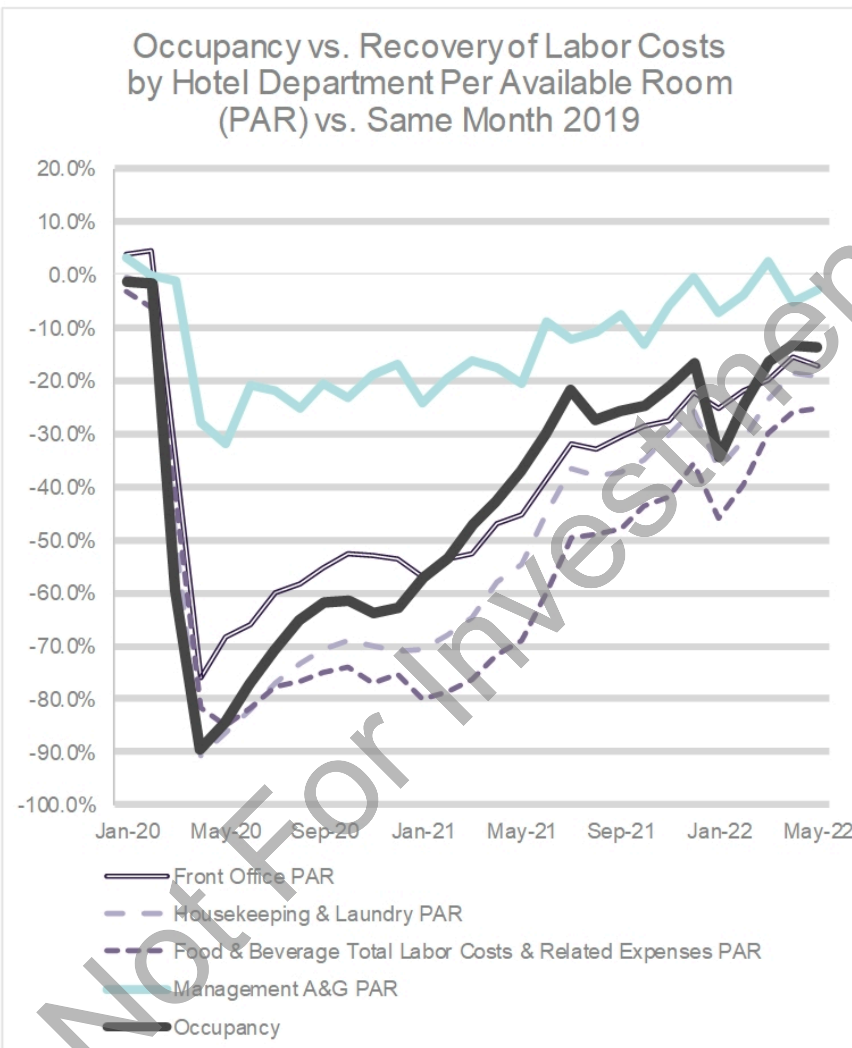


Source: Truist Securities Research, HotStats

Graphically, we present labor cost trends in two ways: on a per available room (PAR) basis and per occupied room (POR). As a reminder, some hotel roles exist regardless of demand (for example a general manager) and other roles are added back as demand recovers. In general, we focus more on POR data but PAR data can be telling in a non-normalized operating environment. We focus on four particular labor departments that in totality represent ~20% of total hotel revenues or approximately 58% of hotel payroll (2019 comparisons). These departments are:

- **Front office salaries and wages** (non-managerial roles such as front desk): **1.2%** of total revenues in 2019
- **Housekeeping and laundry salaries and wages: 4.2%** of total revenues in 2019
- **Food and beverage (F&B) labor costs and related expenses: 13.3%** of total revenues in 2019
- **Management A&G** (managerial roles such as the General Manager, Director of Finance, Controller, Director of Human Resources, etc.): **1.4%** of total revenues in 2019.

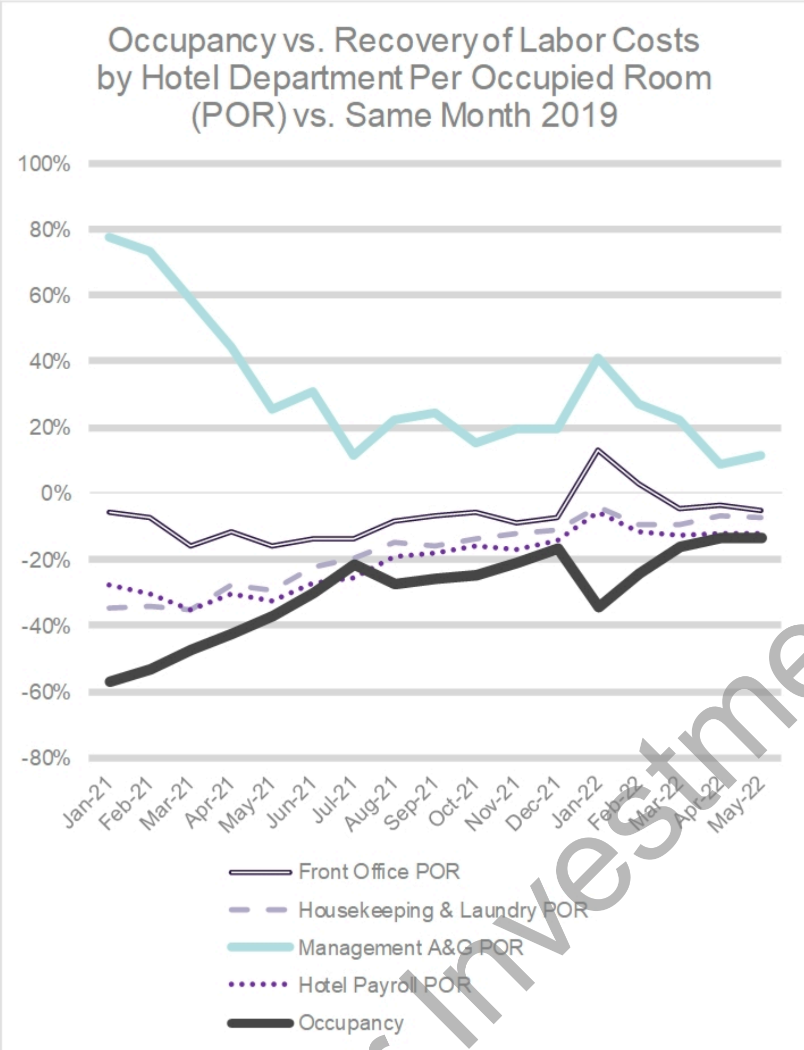
Labor Costs PAR: PAR data can provide some insights to staffing ahead of the full recovery of demand (especially lagging departments such as corporate groups - F&B as proxy).
- In May, we saw a slightly increasing spread of the recovery of occupancy and associated costs, a modest reversal from recent months.



Source: Truist Securities Research, HotStats

Labor Costs POR: In times of normalized hotel operations (including normalized business travel both individual and group/convention), POR data can often provide a good judge of operating efficiencies.

- Given May occupancy was very similar to April despite a shift of demand to more corporate in orientation, overall most of the labor departments we track showed similar trends to recent months.



Source: Truist Securities Research, HotStats

Companies Mentioned in This Note

DiamondRock Hospitality Company (DRH, $8.20, Hold, C. Patrick Scholes)
Hyatt Hotels Corporation (H, $75.17, Buy, C. Patrick Scholes)
Hilton Worldwide Holdings Inc. (HLT, $112.99, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $139.18, Hold, C. Patrick Scholes)
Pebblebrook Hotel Trust (PEB, $16.81, Hold, Gregory Miller)
Playa Hotels & Resorts N.V. (PLYA, $6.83, Buy, C. Patrick Scholes)
Ryman Hospitality Properties, Inc. (RHP, $76.36, Hold, C. Patrick Scholes)
Wyndham Hotels & Resorts, Inc. (WH, $67.25, Buy, C. Patrick Scholes)

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