March Hotel P&L Analyzer: down 5,280 bps y/y on 62% Total RevPAR decline

1Q20: GOP margins of -1,120 bps on -22.0% Total RevPAR growth

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

Based on “big data” observations from higher-rated U.S. hotels (data source: HotStats): March: -5,280 bps of GOP margin growth on -62.1% Total RevPAR (Rooms RevPAR + outside-of-the-room spend). Challenging March results resulted in 1Q GOP margin "growth" of -1,120 bps on Total RevPAR growth of -22.0%.

March results present a forward indicator to 2Q trends. April profits will likely be far worse for hotels staying open (much less the cash burn from closed hotels) as US RevPAR did not fall of a cliff until the second week of March.

We are removing our margin forecasts given the uncertainty of the current demand environment and temporary hotel closures.

This month's report focuses on the here and now of profit metrics as results pre-virus are largely irrelevant for Lodging REIT investors. While our custom HotStats data set of over 1,000 U.S. higher-rated hotels and resorts (Upper Upscale and Luxury) managed flat y/y EBITDA margins through YTD February, March results (representing a similar but all-inclusive U.S. HotStats sample) more than negated early 1Q results. **We assume the very negative results for March RevPAR and GOP margins will be far eclipsed by even more negative April results.**

Note that the HotStats data set for March is more expansive than our traditional custom set although still a strong indicator for 1Q20 U.S. hotel profitability of full-service hotels (as discussed below). March results reflect all U.S. hotels that HotStats has analyzed and for hotels that provided operating performance during the month (inclusive of closed hotel days). This presentation and reporting approach is likely to be followed by Lodging REITS for 1Q20 earnings.

1Q20 results color:

- **January** RevPAR growth was moderately positive, supported by luxury leisure strength around New Years; margins were moderately down. Rooms RevPAR of +2.5% and Total RevPAR of +3.4% compare with GOP margin growth of -50 bps y/y. There was a not atypically large 390 bps differential between Total RevPAR growth and GOP margin decline.

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- **February** RevPAR growth was more limited as headwinds from the coronavirus demand shock started to grow; margins were slightly positive despite the macro environment. Rooms RevPAR of +0.8% and Total RevPAR of +1.4% compare with GOP margin growth of +30 bps y/y. There was a slight 110 bps differential between Total RevPAR growth and GOP margin growth.
- **March results for the entire U.S. HotStats sample:** Rooms RevPAR growth was -64.4%; Total RevPAR growth was -62.1%. These results compare similarly to the Upper Upscale STR results of -62.6%. ADR of the HotStats sample was approximately $209 vs. STR Upper Upscale of $181. In both data sets and reflective of the normal early trajectory of a lodging demand shock, the RevPAR loss was ~ 75% occupancy driven.
    - **Given the March RevPAR loss was primarily occupancy driven, we view the corresponding slide to GOP margins (-5,280 bps) and absolute margins (-11.6% in March 2020 vs. +41.2% in March 2019) as representing only a partial picture of the negative results to come for hoteliers in 2Q20. What is to come: even lower occupancy for hotels that remain open, greater ADR loss, and what we assume will be the eventual loss to "rate integrity" as hoteliers slash room rates. <u>All these trends place an even greater headwind to hotel margins in 2Q20.</u>**
- **1Q20 results (total U.S. HotStats set):**
    - **Rooms RevPAR: -23.7%.**
    - **Total RevPAR: -22.0%.** We assume daily destination/resort/ancillary fees supports the 170 bps spread with Room RevPAR. While the daily fees represent a high profit margin source of revenue, we would not be surprised to see many of these fees going away as hoteliers fight for sources of demand. These fees may once again return if/when occupancy reaches the high levels pre-virus. **What may actually replace the ancillary fees are a la carte fees such as daily housekeeping services. A la carte pricing (similar to airline charges) had been proposed by some hoteliers well before the virus demand shock as a theoretical way to increase profitability.**
    - **Margins:** GOP margins declined 1,120 bps y/y with absolute GOP margins of 25.1% in 1Q20 vs. 36.3% in 1Q19.

<u>Impact to Lodging C-corps and REITS:</u>

C-corps: Outside of the declines to base management and franchise fees, the margin declines will have a great impact on incentive management fees (IMFs). In a negative GOP margin environment where IMFs are generally applied to U.S hotels after reaching a profit threshold, few hotels will be contributing incentive fees in the U.S. in March. The biggest Lodging C-corp recipient of IMFs from U.S. hotels is Marriott (MAR, Hold).

REITS: We assume profit results for the REITS will be somewhat disparate in 1Q20, depending in part on geographic exposure, portfolio focus (big box union hotels generally underperforming suburban select-service), and segmentation orientation. The initial virus demand shock to the U.S. lodging market was at airport hotels, in NYC, and in big West Coast markets (San Francisco had a very difficult y/y comp and the virus hit only added to the headwinds). Additionally, group demand started to struggle more rapidly than transient demand as corporate meetings and conventions were either cancelled outright or had significantly lower attendance. Warm weather leisure markets in some cases held up well into March given the timing of state shutdown ordinances (+ Florida).

There are at least three other important considerations that may soften the profit loss for hotel owners in 1Q20 vs. later in the year (although we assume modest-to-no positive benefit to 1Q20 Adjusted EBITDA/FFO):

1. **Group attrition and cancellation fees:** We assume the collection of fees will be case-by-case driven. Repeat groups and lucrative accounts that hotels do not wish to permanently lose to competition may not be forced to pay these fees or at least not at previously contracted rates (ruining a reputation with a meeting planner in today's environment is at one's peril). Other groups will have to pay these fees even though proceeds may not be received in 1Q20 and/or may be contested.
2. **Business interruption insurance:** Given the force majeure environment, it is unclear to us to what extent hoteliers will be able to secure proceeds.

3. **Government-related stimulus such as the Payment Protection Program (PPP).** While there has been some media attention to a few Lodging REITS as recipients of PPP funds, it is our understanding that hoteliers are still pushing for more government assistance. Similar to #1 and #2, it is likely that government support will be at the earliest a 2Q20 benefit.

2020 margin forecasts: Not surprisingly and in line with public companies dropping guidance, we are no longer providing margin forecasts for any 2020 quarters or the full year. However, we provide some current perspective below:

- **If we were to make a very high level estimate on margins, we point to Asia-Pacific hotel profits (also HotStats data) where we look at Japan and Australia RevPAR and margin declines as somewhat of a guide for U.S. Lodging REITS.** In that analysis of two markets with some similarities to the U.S. in terms of labor costs and staffing, GOP margins fell approximately 150-300% that of Total RevPAR, reflecting the profit hit from operating leverage. We find this range a good starting place for evaluating the potential profit loss for Upper Upscale and Luxury hotels in the U.S. given the unprecedented situation of hotels running very low occupancy.
- **We believe that it is impossible at this stage to forecast the length or severity of the demand shock.** Additionally, it is conceivable that we have not reached the peak of temporary hotel closures in the U.S. **Future hotel closures add an extra variable to forecasting Lodging REITS for 2020 and that includes even the REITS with the best balance sheets in our view** [HST (Hold) and SHO (Hold)]. We think it is still preliminary to assume that most hotels will reopen en masse in the next 30-90 days. There may be economic rationale to keep some hotels closed longer than others, especially for hotels undergoing major renovations or repositionings (we especially focus on HST's Marriott transformations, the many Legacy LaSalle hotels in the PEB portfolio, and the Wyndham conversions with RLJ). **Importantly, while April results will almost certainly reflect negative profitability for most full-service hotels in the U.S. that are open, the reality is hidden behind the headline results are the many closed hotels with a monthly cash burn in the hundreds of thousands of dollars per month to well in excess of $1M/month.**
- **One slight break we see for the Lodging REITS is that labor costs and the labor operational structure will likely be reset in today's environment.** Assuming no vaccine in the near term, testing insufficient to provide uniform confidence for business or leisure travel, and a weakening macroeconomic environment, we expect hotel operations to be lean given sub-optimal occupancy levels.

Monthly Profitability Metrics (for our custom data set)

February 2020 profitability: Limited RevPAR growth (rooms and total) driven in part by the start of the coronavirus impact although margins were modestly positive.

Industry Metric	Feb 2020 y/y	YTD		Feb 2020	YTD	FY2019	2019 y/y	FY2018	FY2017
Occupancy	*10*	*50*	*bps*	76.3%	72.6%	77.4%	*-30 bps*	77.7%	77.4%
ADR	0.7%	1.1%	*%*	$238	$234	$230	1.4%	$227	$220
RevPAR	0.8%	1.8%	*%*	$181	$170	$178	1.1%	$176	$170
Total Revenue PAR	1.4%	2.5%	*%*	$315	$299	$299	2.5%	$292	$280
Total Dept. Profit % Total Rev.	*0*	*-20*	*bps*	60.6%	58.3%	60.0%	*10 bps*	59.9%	59.9%
Total Hotel Labor Costs % Total Rev.	*-20*	*10*	*bps*	35.1%	37.6%	35.8%	*30 bps*	35.5%	35.3%
Total GOP PAR	*2.3%*	2.3%	*%*	$122	$105	$112	*2.4%*	$109	$104
Total GOP % of Total Rev.	*30*	*0*	*bps*	*38.7%*	*35.2%*	*37.4%*	*0 bps*	*37.4%*	*37.2%*

Source: STRH Research, HotStats

All dollar figures are in USD. 2017/18 figures have been revised as of December of the following year to account for the updated sample set.

January 2020 profitability: Moderate RevPAR growth driven in part by strong New Years' leisure demand (especially luxury); however, margins were slightly negative.

Industry Metric	Jan 2020 y/y	YTD		Jan 2020	YTD	FY2019	2019 y/y	FY2018	FY2017
Occupancy	*70*	*70*	*bps*	69.2%	69.2%	77.4%	*-30 bps*	77.7%	77.4%
ADR	1.4%	1.4%	*%*	$231	$231	$230	1.4%	$227	$220
RevPAR	2.5%	2.5%	*%*	$160	$160	$178	1.1%	$176	$170
Total Revenue PAR	3.4%	3.4%	*%*	$283	$283	$299	2.5%	$292	$280
Total Dept. Profit % Total Rev.	*-40*	*-40*	*bps*	55.9%	55.9%	60.0%	*10 bps*	59.9%	59.9%
Total Hotel Labor Costs % Total Rev.	*60*	*60*	*bps*	40.3%	40.3%	35.8%	*30 bps*	35.5%	35.3%
Total GOP PAR	*1.6%*	1.6%	*%*	$89	$89	$112	*2.4%*	$109	$104
Total GOP % of Total Rev.	*-50*	*-50*	*bps*	*31.5%*	*31.5%*	*37.4%*	*0 bps*	*37.4%*	*37.2%*

Source: STRH Research, HotStats

All dollar figures are in USD. 2017/18 figures have been revised as of December of the following year to account for the updated sample set.

Highlights in NYC (or Lowlights in NYC):

HotStats provided 1Q20 data to us for the NYC market: arguably one of the worst lodging markets in the country today.

Even pre-virus over the last few years, NYC was a very challenged hotel market. New supply growth, FX headwinds, shared-accommodation supply, and international demand falling in recent years all contributed to challenges to hotel profitability. The demand shock hit from the virus added material pressures to profits. **HotStats data noted Total RevPAR of -25.4% in 1Q20 with absolute GOP margins of -47.9%.** Comparatively, in 1Q19, GOP margins were already an unimpressive 14.0%.

We assume that with even worse financial results in April and likely at least May, many hoteliers will be in deep financial distress. Per the New York Post, there are a number of CMBS-funded hotels that could be at risk of moving to special servicers. **While we find the current NYC lodging environment still in a preliminary state of distress, we would not be surprised to see some hotels permanently removed from hotel supply.**

Companies Mentioned in This Note

Host Hotels & Resorts, Inc. (HST, $12.57, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $95.99, Hold, C. Patrick Scholes)
Pebblebrook Hotel Trust (PEB, $12.00, Hold, Gregory Miller)
RLJ Lodging Trust (RLJ, $9.91, Sell, Gregory Miller)
Sunstone Hotel Investors, Inc. (SHO, $9.60, Hold, C. Patrick Scholes)

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