

Real Estate Research

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Hotels Trends: Public Market Perspective

Meet the Money Conference 2017

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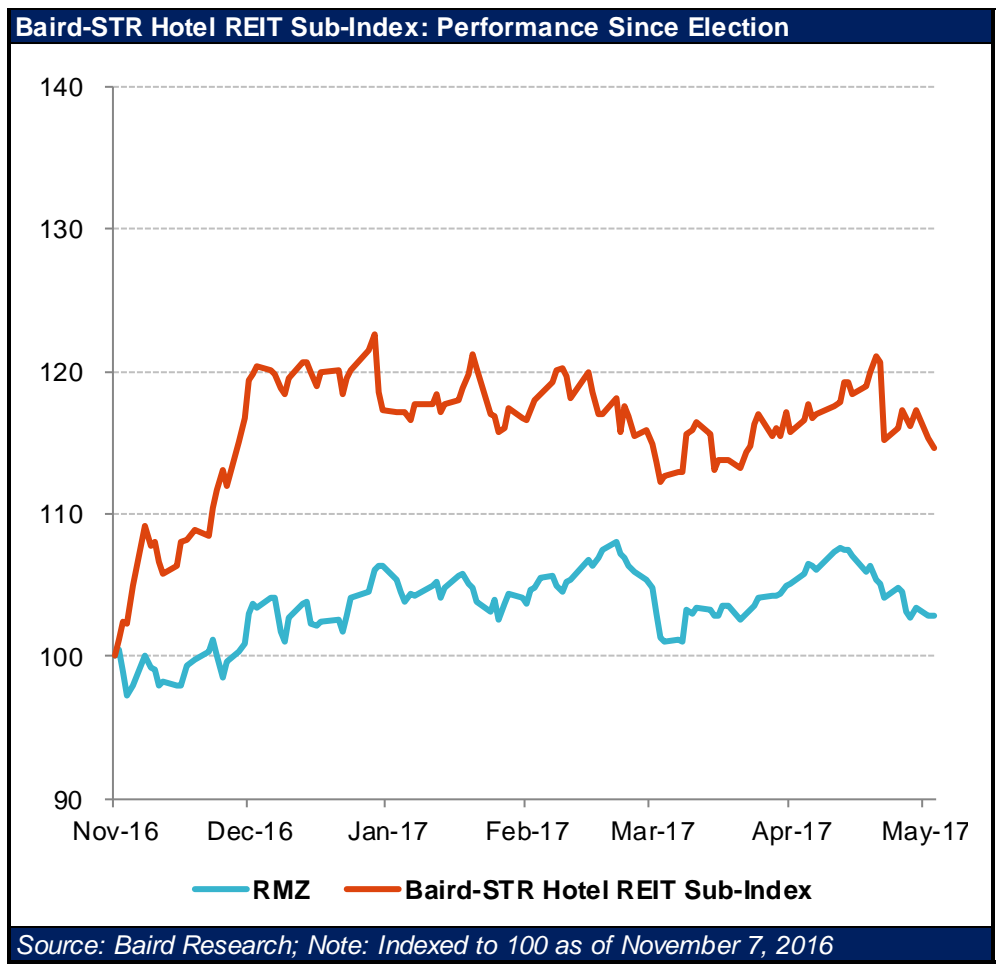
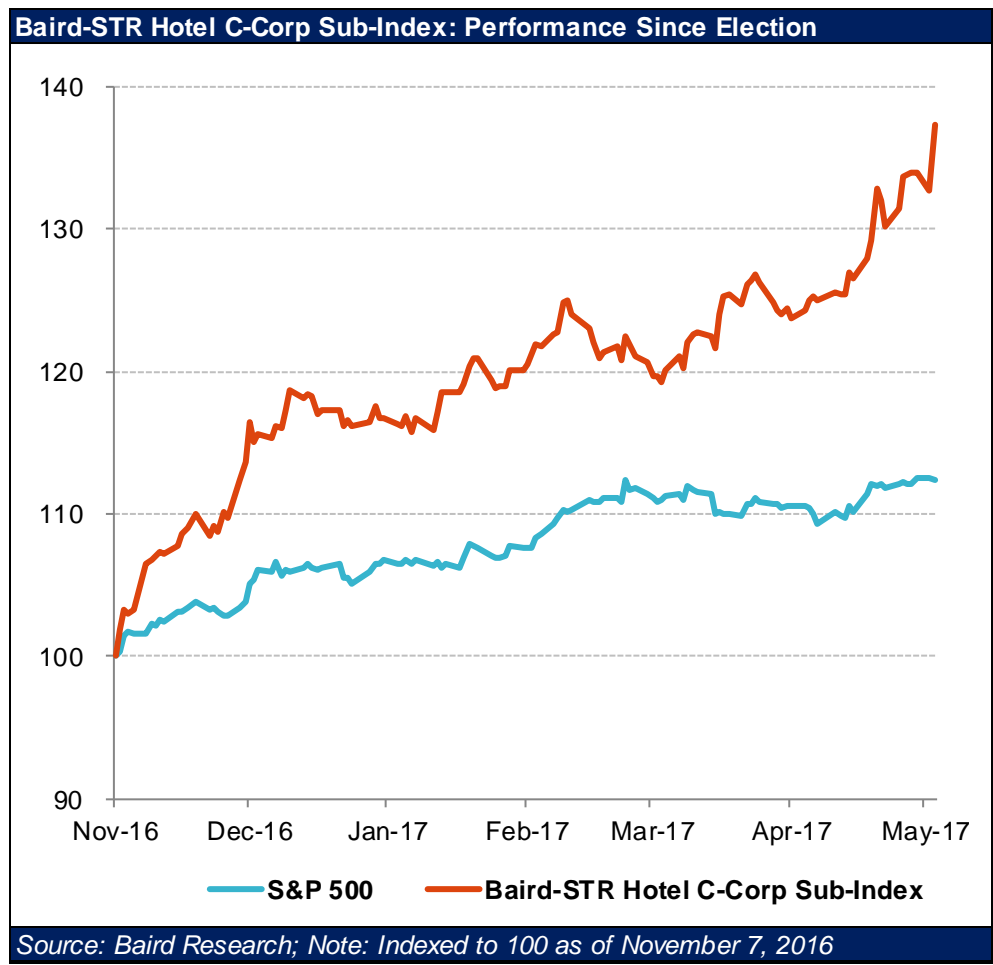
Please refer to Appendix - Important Disclosures and Analyst
Certification on pages 15-17

All information as of 05/09/17 unless otherwise noted.



Hotel Stock Performance Since the Election

- Hotel C-Corps and Hotel REITs have been relative outperformers



Stable Fundamentals Have Been Good Enough Lately

- **Waiting for growth to reaccelerate.** Investors appear to be in a wait-and-see mindset as potential fiscal policy changes should lead to improving hotel fundamentals, but recent demand trends have been relatively stable and hoteliers are not seeing any green shoots yet.
 - Stock valuations already reflect this better growth expectation though
 - Fundamentals have been stable recently, which is encouraging given the sequential slowing that the hotel industry experienced in 2015 and 2016
 - Broadly, investors appear to be relatively value-oriented
 - 1Q17 results were better than expected due to strong March results (Easter shift benefit), particularly for group-oriented hotels, which has led to improved investor sentiment

- **The expected 2H17 reacceleration is becoming a 2018 story.** Some management teams are pushing out their optimism until 2018 for stronger fundamentals; at the time of the election, the view was 2H17 would be an inflection point...that's looking less likely today.

Stable Fundamentals Have Been Good Enough Lately

- **It's all about the second derivative** – stable fundamentals have been good enough lately; decelerating RevPAR growth not a big topic of discussion recently
 - REIT-dedicated investors generally still maintain a somewhat cautious outlook
 - Consumer/generalist investors have a positive outlook for hotels, particularly the brands

- **Hotel REITs** – less bad than a lot of other real estate sectors today
 - Retail – bankruptcies, vacancies, tenant downsizing
 - Healthcare and triple-net – interest rate sensitive names hit hard lately
 - Storage – fundamentals still positive but slowing

- **Hotel C-Corps** – double-digit earnings growth, accelerating capital returns a winning combo
 - Energy – challenging with oil below \$50/barrel
 - Healthcare – legislative uncertainty negatively impacting sentiment
 - Retail – thanks a lot, Amazon...

Valuation Overview

▪ Hotel C-Corps

- Hilton and Marriott are trading at ~14x and ~15x NTM EBITDA, respectively
- Hyatt is trading at ~11.5x NTM EBITDA
- Investors favor the asset-light models (Hilton and Marriott) and love share repurchases

▪ Hotel REITs

- Select-service portfolios trading at premium multiples
 - Apple and Summit trading at ~12.5x and ~14x NTM EBITDA, respectively
- Full-service portfolios trading at 6.0% to 7.0% implied corporate cap rates
 - DiamondRock, Host, and LaSalle trading between 11.5x-12x NTM EBITDA
 - Chesapeake and Sunstone trading at ~12.5x NTM EBITDA
 - Pebblebrook is trading at ~14x NTM EBITDA

Capital Allocation Strategies Diverging (Hotel REITs)

- **Diverging views of the cycle could lead to M&A within the hotel REIT sector (finally), but we're not expecting much...**
 - Differing costs of capital and diverging capital allocation strategies are driving companies' acquisition and disposition activities.
 - '15-'16 playbook – sell assets, reduce debt, repurchase shares – is a thing of the past.
 - Today, low-levered companies are opportunistically looking to deploy capital – some took down leverage too much over the last 18-24 months

- **Selling assets to take advantage of the public-to-private valuation discrepancy:**
 - LaSalle and Pebblebrook

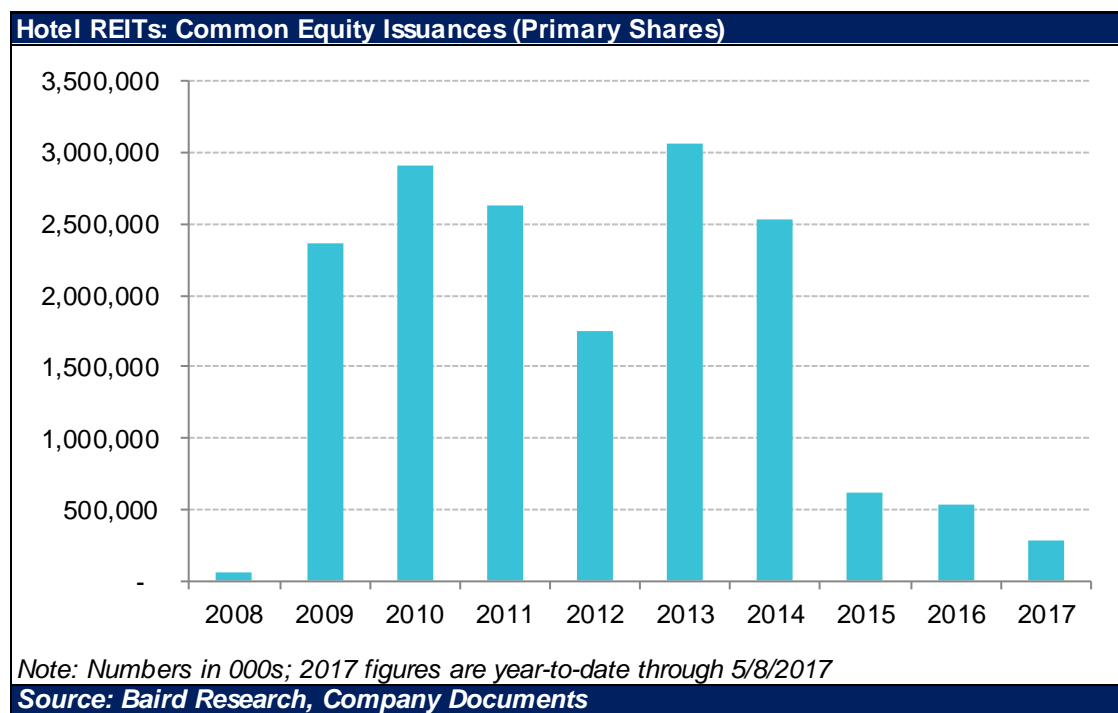
- **Looking to selectively buy assets, utilize under-levered balance sheets:**
 - DiamondRock, Host, Sunstone

- **Recycling capital to improve portfolio quality and growth rate:**
 - Hersha, Summit, Xenia

Capital Allocation Strategies Diverging (Hotel REITs)

- **Balance sheets are generally well positioned**
 - Most management teams targeting 3.0-4.0x net leverage, but some are much lower
 - While most management teams believe their shares are trading at discounts to NAV, share repurchases are generally not being considered

- **No recent or upcoming hotel IPOs:** pace of equity issuances has slowed materially



Recent Hotel REIT Transactions

- **Hotel REITs taking advantage of their well-capitalized balance sheets to invest dry powder, but cap rates are still low.**
 - *Ashford Prime (AHP)* – Hotel Yountville for \$96.5 million (6.2% TTM cap rate) and Park Hyatt Beaver Creek for \$145.5 million (6.0% TTM cap rate)
 - *DiamondRock (DRH)* – L'Auberge de Sedona and Orchards Inn Sedona for \$97.0 million (12.6x 2017E EBITDA).
 - *Hersha (HT)* – Ritz-Carlton, Coconut Grove for \$36.0 million and the Pan Pacific Hotel Seattle for \$79.0 million
 - *Host (HST)* – Don Cesar Hotel and the Beach House Suites (~6.6% NTM cap rate) and W Hollywood (~6.25% NTM cap rate)
- **Disposition activity is slowing but a few REITs remain sellers.**
 - *LaSalle (LHO)* – Lansdowne Resort for \$133.0 million (13.3x 2016 EBITDA) and the Alexis Hotel for \$71.6 million (15.9x 2016 EBITDA).
 - *Host (HST)* – JW Marriott Desert Springs for \$160 million (9.1x 2016 EBITDA); hotel in need of significant capex
 - *Sunstone (SHO)* – Fairmont Newport Beach for \$125 million (5.2% 2016 cap rate)

Details on RLJ–FelCor Merger Agreement

- **RLJ acquiring FelCor in an all-stock transaction**

- Implied deal value of \$8.24 per FCH share at announcement (16.7% premium)
- Premium declined to 9.4% after RLJ shares traded down the day of the announcement
- Premium is only 0.8% based on current prices
- The merger implied a 7.7% 2017 cap rate and 10.8x EBITDA for FCH (April 21 pricing)
 - Our analysis ascribes ~\$500,000/key of value to the NYC hotels and one JV asset
- Based on current prices, the merger implies an 8.3% 2017 cap rate and 10.1x EBITDA
- Conclusion: we have a negative view of the transaction, especially in the near term, given that RLJ's leverage increases materially and the merger creates uncertainties regarding strategy and portfolio composition as well as disposition risks

- **Key investor questions:**

- Leverage-neutral accretion – transaction appears to be per-share dilutive
- Timing and ability to reduce pro forma leverage post-closing
- Potential asset and revenue management upside opportunities within FCH portfolio

Hotel Technology Changes

- **Hotel brands don't know their customers well enough**
 - Booking direct campaigns will help
 - Need to convert the non-loyalty members / OTA users

- **Consumer booking behavior is changing rapidly...faster than the brands can update their technology**
 - Re-pricing software keeping a lid on ADR growth – TripBAM, Tingo, corporate travel management software → Baird has its own propriety technology with our travel agent
 - Baird's program, called ReSearch, led to a ~1% ADR savings in 2016
 - An app-friendly industry: Hotel Tonight, Recharge, Hotels.com

- **Inventory management is still difficult**
 - I can book 10 rooms for the same night, under the same loyalty number, and cancel 9 of these rooms with no consequence...why doesn't the brand or hotel operator ever call and ask why I have so many reservations?
 - Everyone wants to move toward the airline model but that's tough because the hotel industry is so fragmented

Conclusions

- RevPAR growth likely to remain in the low-single-digit range
- Urban markets will continue to underperform secondary/tertiary markets
- Stock selection: we favor the hotel brands over the hotel REITs
- Don't expect more hotel REIT M&A activity after the RLJ/FCH merger announcement...
- ...But, expect more REIT acquisition activity over the next 12 months
- The brands need to transition from behaving like a hotel company to becoming a global consumer branding company with a powerful distribution platform – just like an OTA



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Baird Hotel Coverage Universe

	Ticker	Market Cap (millions)	Rating	Risk Suitability	Price 5/9/17	Dividend Yield	(Discount) to 52- week high	Premium to 52- week low	Average Volume (000s)	Ent. Value/ EBITDA 2017E	Net debt + pref. / EBITDA 2017E	NAV NTM	(Discount) / Premium to NAV NTM
Company													
Apple Hospitality REIT	APLE	4,147	O	A	18.60	6.5%	-10%	7%	1,098	12.1x	2.9x	18.10	0%
Ashford Hospitality Trust	AHT	697	N	H	5.98	8.0%	-27%	25%	939	10.7x	9.1x	7.82	-31%
Ashford Hospitality Prime	AHP	379	N	H	10.26	6.2%	-42%	4%	432	11.4x	7.2x	14.69	-26%
Chesapeake Lodging Trust	CHSP	1,398	O	A	23.27	6.9%	-14%	12%	373	12.2x	4.8x	27.07	-7%
DiamondRock Hospitality	DRH	2,171	O	A	10.78	4.6%	-10%	31%	2,413	11.7x	3.2x	11.51	-1%
Hersha Hospitality Trust	HT	821	O	A	18.31	6.1%	-17%	19%	663	13.2x	7.5x	18.51	-7%
Hospitality Properties Trust	HPT	5,107	N	A	31.08	6.7%	-5%	26%	602	10.1x	4.5x	32.18	8%
Host Hotels & Resorts	HST	13,323	O	A	17.83	4.5%	-12%	25%	8,073	11.7x	2.6x	19.14	-1%
LaSalle Hotel Properties	LHO	3,226	N	A	28.46	6.3%	-11%	32%	1,468	11.8x	2.9x	32.00	-4%
Pebblebrook Hotel Trust	PEB	2,145	O	A	30.80	4.9%	-4%	31%	939	13.8x	5.1x	29.99	10%
RLJ Lodging Trust	RLJ	2,546	N	A	20.38	6.5%	-19%	8%	1,201	10.3x	3.1x	25.38	-17%
Summit Hotel Properties	INN	1,619	O	A	17.17	4.0%	-2%	51%	781	14.3x	4.7x	14.14	20%
Sunstone Hotel Investors	SHO	3,416	N	A	15.50	1.3%	-4%	38%	2,246	12.5x	2.1x	15.15	7%
REIT Median		2,171				6.2%	-11%	25%	939	11.8x	4.5x		-1%
Extended Stay America	STAY	3,443	O	A	17.74	4.7%	-5%	36%	411	9.6x	4.1x		
Hilton Inc.	HLT	20,493	O	A	62.33	1.0%	0%	13%	9,237	13.8x	3.0x		
Hyatt Hotels Corporation	H	7,275	O	A	57.99	0.0%	-2%	31%	316	11.3x	2.4x		
Marriott International	MAR	40,884	N	A	102.50	1.3%	-1%	68%	1,915	15.8x	2.5x		
C-Corp Median		13,884				1.1%	-1%	34%	1,163	12.6x	2.7x		
Peak Resorts	SKIS	83,059	O	H	5.60	5.0%	-10%	85%	55	7.8x			
Ski Median		83,059				5.0%	-10%	85%	55	7.8x			

Rating: O - Outperform; N - Neutral; U - Underperform

Risk Suitability: H - Higher Risk; A - Average Risk

Source: Baird Research, SNL Financial, FactSet

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Baird Hotel Coverage Universe

Baird Hotel Coverage Universe: Covered Companies	
	<u>Risks</u>
AHP	Execution of recently announced initiatives following strategic and financial review Potential conflicts of interest with its external manager Ashford Inc.
AHT	Higher-than-peer leverage and execution of potential asset sales (timing, pricing) Potential conflicts of interest with its external manager Ashford Inc.
APLE	Still-evolving capital allocation strategy Retail-focused shareholder base potentially looking for liquidity
CHSP	Outsized exposure to high-beta lodging markets Outsized exposure to the more volatile corporate transient business customer
DRH	Higher-than-peer concentration to Marriott-branded and -operated hotels Execution of potential asset sales (timing, pricing)
H	~80% common share ownership by founding family Sustainability of brand equity
HLT	Sustainability of brand equity Greater volatility from hotel ownership; execution of planned spin-offs
HPT	Higher-than-peer leverage Potential conflicts of interest with its external manager RMR
HST	Higher-than-peer concentration to Marriott-branded and -operated hotels Execution of potential asset sales (timing, pricing)

Source: Baird Research

Baird Hotel Coverage Universe: Covered Companies	
	<u>Risks</u>
HT	Potential conflicts with HHMLP, the affiliated operator of a majority of Hersha's rooms Geographically concentrated portfolio with significant exposure to New York City
INN	Ability to obtain debt and equity financing to fund acquisition/growth strategy Unexpected supply growth in secondary markets that could limit operating results
LHO	Outsized exposure to high-beta lodging markets and independent hotels Outsized exposure to the more volatile corporate transient business customer
MAR	Sustainability of brand equity Starwood integration- and merger-related risks, including potential asset sales
PEB	Outsized exposure to high-beta lodging markets and independent hotels Outsized exposure to the more volatile corporate transient business customer
RLJ	Significant concentration of hotel management by White Lodging Outsized exposure to weaker-performing markets like New York City and Houston
SHO	Higher-than-peer concentration to Marriott-branded and -operated hotels Ramp up of recently renovation and repositioned properties
SKIS	Adverse weather conditions Ability to obtain debt and equity financing to fund acquisition/growth strategy
STAY	Greater volatility from hotel ownership; development plans increase risk profile Competition from major global brand companies

Source: Baird Research

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