

Real Estate Research
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Hotel Capital Markets Update

David Loeb

Sr. Research Analyst
dloeb@rwbaird.com
414-765-7063

Michael Bellisario

Sr. Research Associate
mbellisario@rwbaird.com
414-298-6130

Amanda Frankwick

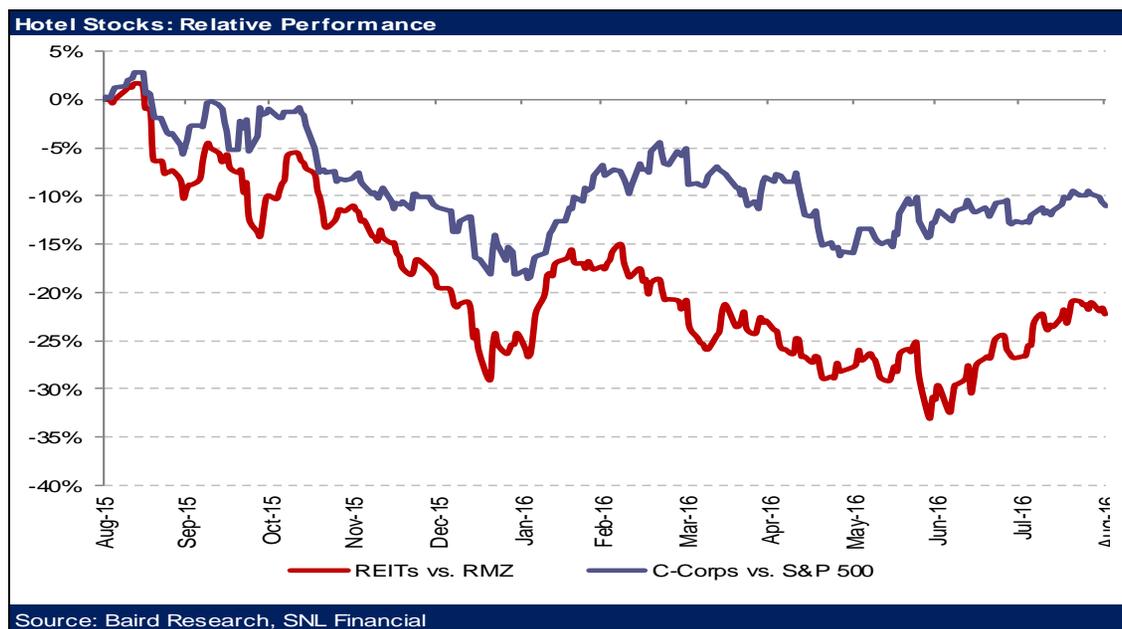
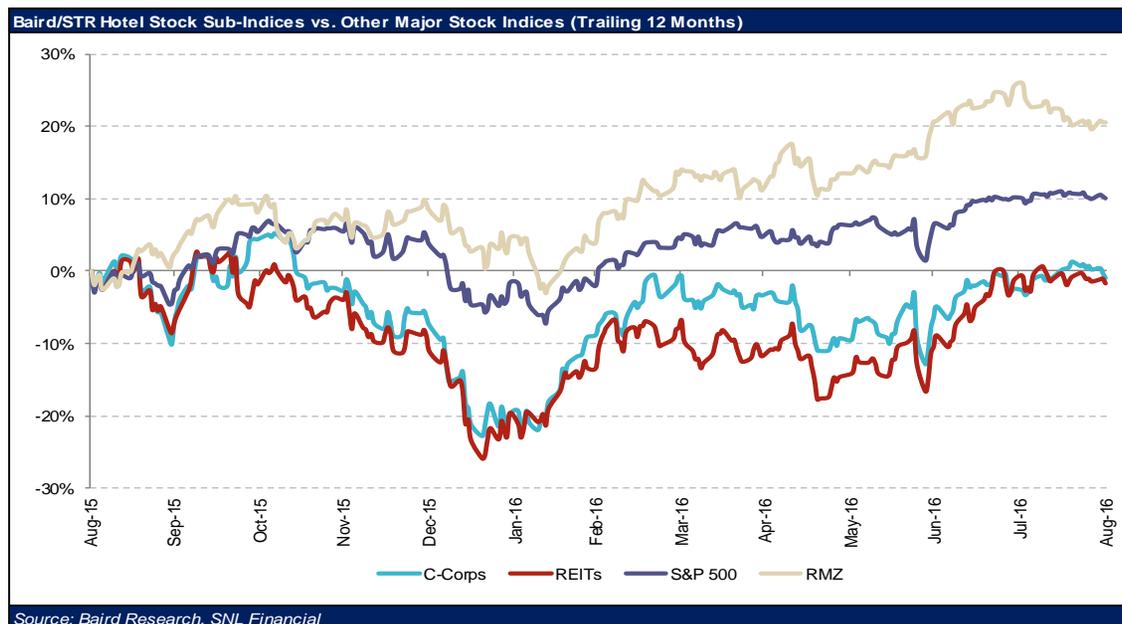
Research Associate
afrankwick@rwbaird.com
414-298-1706

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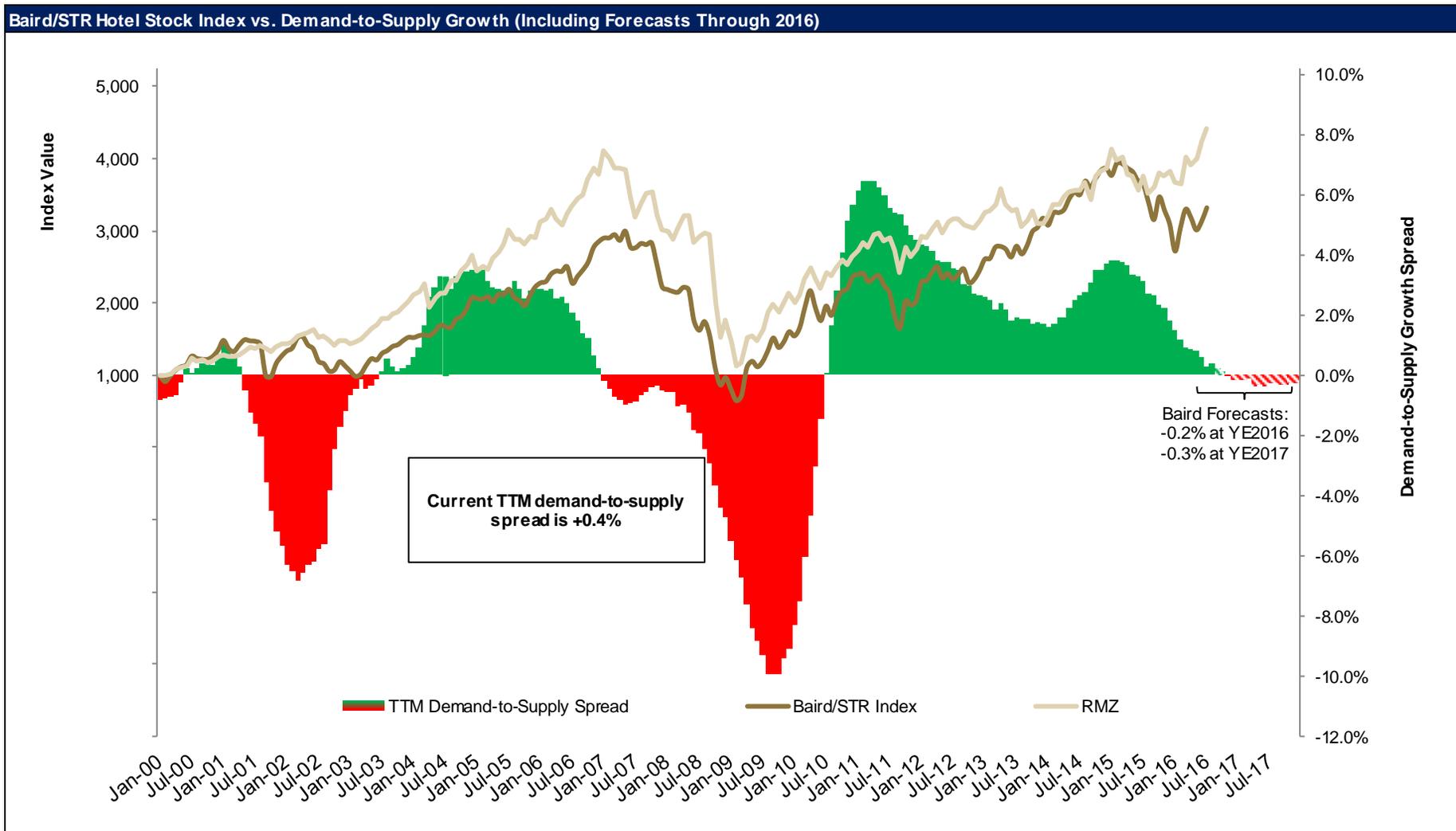


Stocks Have Rebounded Despite Slowing Growth

- RevPAR growth continues to underperform expectations on slowing corporate demand
- Stronger U.S. Dollar impacting Top 25 markets; Canada is in a recession, and Canada is about one-third of inbound international travel; Brexit impact unknown, but the U.K. is the third largest inbound international travel market
- Hotel stocks have rebounded off their lows as investors search for yield, but insider selling and still-slowing fundamentals will likely continue to pressure investor sentiment



TTM Demand-Supply Spread Nearing Equilibrium



Notes: Past performance is no guarantee of future results. The Baird/STR Hotel Stock Index was created on June 1, 2010, and characterizes stock performance since January 1, 2000. Performance for time periods prior to the creation date is hypothetical. The index is currently comprised of 20 of the largest domestically available hotel stocks and reviewed quarterly for composition adjustments by Baird Research. It is not possible to invest directly in the index; values indexed to 1,000 at January 1, 2000.



Forecasts Call for Growth to Remain Positive

2016 United States Hotel Industry Forecasts						2017 United States Hotel Industry Forecasts				
	Baird Research	CBRE	PwC	STR	YTD Actuals		Baird Research	CBRE	PwC	STR
Supply	1.6%	1.6%	1.7%	1.6%	1.5%	Supply	1.8%	2.0%	1.9%	2.0%
Demand	1.5%	1.7%	1.4%	1.6%	1.3%	Demand	1.4%	1.8%	1.5%	1.6%
Occupancy %	-0.2%	0.1%	-0.3%	0.0%	-0.2%	Occupancy %	-0.3%	-0.1%	-0.4%	-0.3%
Average Rate	3.3%	3.5%	3.4%	3.2%	3.1%	Average Rate	3.0%	4.1%	3.3%	3.1%
RevPAR	3.1%	3.6%	3.1%	3.2%	2.9%	RevPAR	2.7%	3.9%	2.9%	2.8%
<i>Updated:</i>	<i>Aug 2016</i>	<i>Sep 2016</i>	<i>Aug 2016</i>	<i>Aug 2016</i>	<i>Aug 2016</i>	<i>Updated:</i>	<i>Aug 2016</i>	<i>Sep 2016</i>	<i>Aug 2016</i>	<i>Aug 2016</i>
<i>Source: CBRE, PwC, STR</i>										

- Supply growth expectations likely to continue moderating (but rate of growth still expected to increase); occupancy expected to decline due to decelerating demand growth and an increase in alternative lodging options

Uncertainty Abounds; Mixed Signals for Hotel Stocks

Weekly/Monthly STR numbers not showing any signs of rebound

- Consumer confidence, employment still very strong...
- ...but corporate profits slowing, travel budgets shrinking (energy, financials)
- Domestic hotel fundamentals decelerating → monthly RevPAR growth has been in the low-single-digits range since November 2015
- Stocks trading between 10.0x and 11.0x NTM EV/EBITDA → lack of investor confidence in management teams' outlooks
- Urban- and transient-focused portfolios lagging the broader industry

Growth expected to remain positive in 2H16 though

- Group bookings still solid for 2H16; convention calendars stronger across the country
- RevPAR growth has remained in the low single digits in 3Q16, but has not yet accelerated as expected

Are management teams caught between a rock and a hard place?

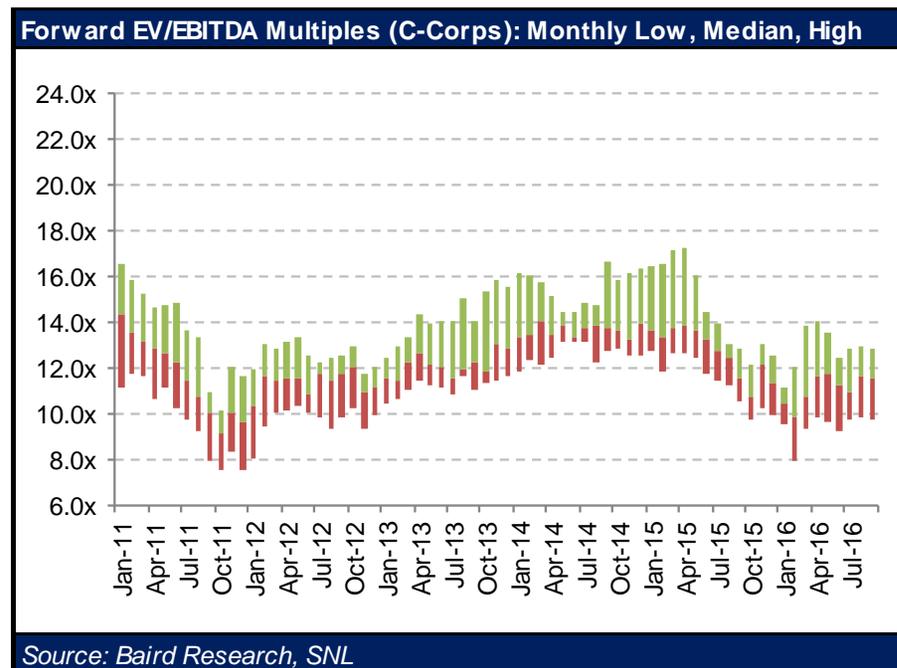
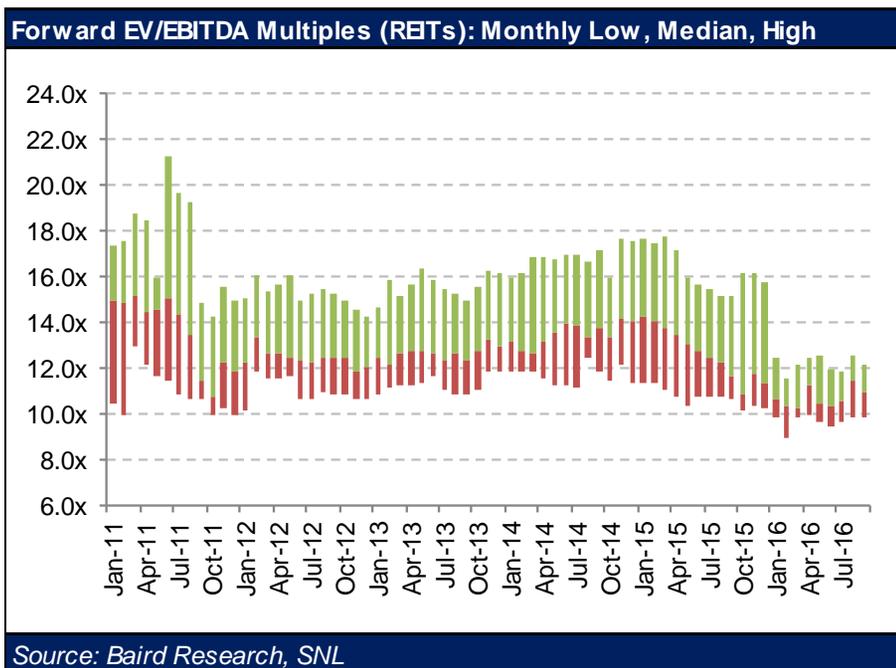
- Few recent insider buys; share repurchases have slowed/stopped; use of proceeds in focus as disposition activity increases (bias toward deleveraging)

Our View of Hotel Stocks and the Current Cycle

Many investors on the sidelines waiting for the next downturn

- We continue to believe RevPAR growth will remain positive into 2017
- Supply growth is steadily picking up and concentrated in a few major markets (Denver, Houston, Miami, New York City, and Seattle), which is becoming a bigger concern for owners and operators (and investors)
- Near- to intermediate-term demand outlook still positive, but managers' ability to forecast demand trends (and have enough confidence to increase ADR) becoming increasingly difficult due to today's short booking window and technology changes, including more price transparency for consumers and re-booking software
- Inbound international travel trends remain positive, but Brexit impact unknown; strengthening of the U.S. dollar could deter some foreign travelers
- Recession talk has subsided recently, but most investors believe we are in the latter stages of the lodging cycle and are on the sidelines
- The next downturn could be third consecutive disaster...or simply a soft landing with only modest RevPAR declines

Slowing Growth Pressuring Valuation Multiples



- Since the end of 2014, the median forward EV/EBITDA multiple has fallen 3.4x and 2.2x for the hotel REITs and hotel brands, respectively
- Given the pullback in valuations, acquisition activity has slowed as management teams are focused on potential opportunistic dispositions, share repurchases, and deleveraging
- The gap between private market value and stock prices has narrowed but continues to indicate that either estimates are too high, cap rates are too low, or public market investors are wrong

Cap Rate Changes Impact Exit Value

Hotel valuations likely less impacted given better NOI growth prospects

- Interest rates are one factor in determining cap rates, but not the only one
- Rising cap rates impact hotel values despite positive NOI growth; however, there could be more headline risk surrounding expectations about rising rates rather than a decline in values due to higher rates
- Most underwriting models assume low-single-digit NOI growth and modest cap rate expansion; if the opposite occurs, hotel values could fall substantially

Impact of Rising Rates on Hotel Values							Impact of Rising Rates and Leverage on Hotel Values											
							60% Leverage											
							NOI Growth											
							0%	10%	20%	30%	40%	50%	0%	10%	20%	30%	40%	50%
Cap Rate	6.00%	0%	10%	20%	30%	40%	50%	0%	25%	50%	75%	100%	125%					
	6.50%	-8%	2%	11%	20%	29%	38%	-19%	4%	27%	50%	73%	96%					
	7.00%	-14%	-6%	3%	11%	20%	29%	-36%	-14%	7%	29%	50%	71%					
	7.50%	-20%	-12%	-4%	4%	12%	20%	-50%	-30%	-10%	10%	30%	50%					
	8.00%	-25%	-18%	-10%	-3%	5%	13%	-63%	-44%	-25%	-6%	12%	31%					
	8.50%	-29%	-22%	-15%	-8%	-1%	6%	-74%	-56%	-38%	-21%	-3%	15%					
	9.00%	-33%	-27%	-20%	-13%	-7%	0%	-83%	-67%	-50%	-33%	-17%	0%					

Numbers represent cumulative change in value; base case = 6.00% cap rate

Numbers represent cumulative change in value from base case with 60% leverage

Source: Baird Research



Secondary/Tertiary Markets Outperforming

"Other" Market Performance Versus the Top 25													
	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16
Average Top 5 Market Performance ⁽¹⁾	2.2%	4.1%	5.8%	2.0%	1.8%	1.7%	2.5%	5.7%	2.9%	0.1%	2.5%	-0.2%	1.6%
Top 25 Markets	1.6%	6.0%	6.8%	3.6%	2.5%	2.2%	2.7%	3.2%	3.8%	1.2%	2.6%	1.2%	2.0%
All Other Markets	2.7%	9.7%	6.2%	5.0%	3.9%	2.6%	2.7%	2.3%	5.8%	2.3%	4.5%	3.4%	2.1%
"Other" Market Outperformance vs. Top 25	-110 bps	-370 bps	60 bps	-140 bps	-140 bps	-40 bps	0 bps	90 bps	-200 bps	-110 bps	-190 bps	-220 bps	-10 bps

⁽¹⁾ The top five markets by room count are Orlando, New York City, Chicago, D.C., and Los Angeles

Source: Baird Research, STR

Potential reasons for outperformance:

- Lower supply than urban markets (generally)
- Chicago and NYC market-specific weakness
- Less exposure to international travel and the stronger USD

Growing Select-Service Appeal; Trading at a Premium

- **Value/Income investors:**

- Strong free cash flow characteristics supporting high dividend payouts
- Lower stock volatility than full-service peers

- **Growth investors:**

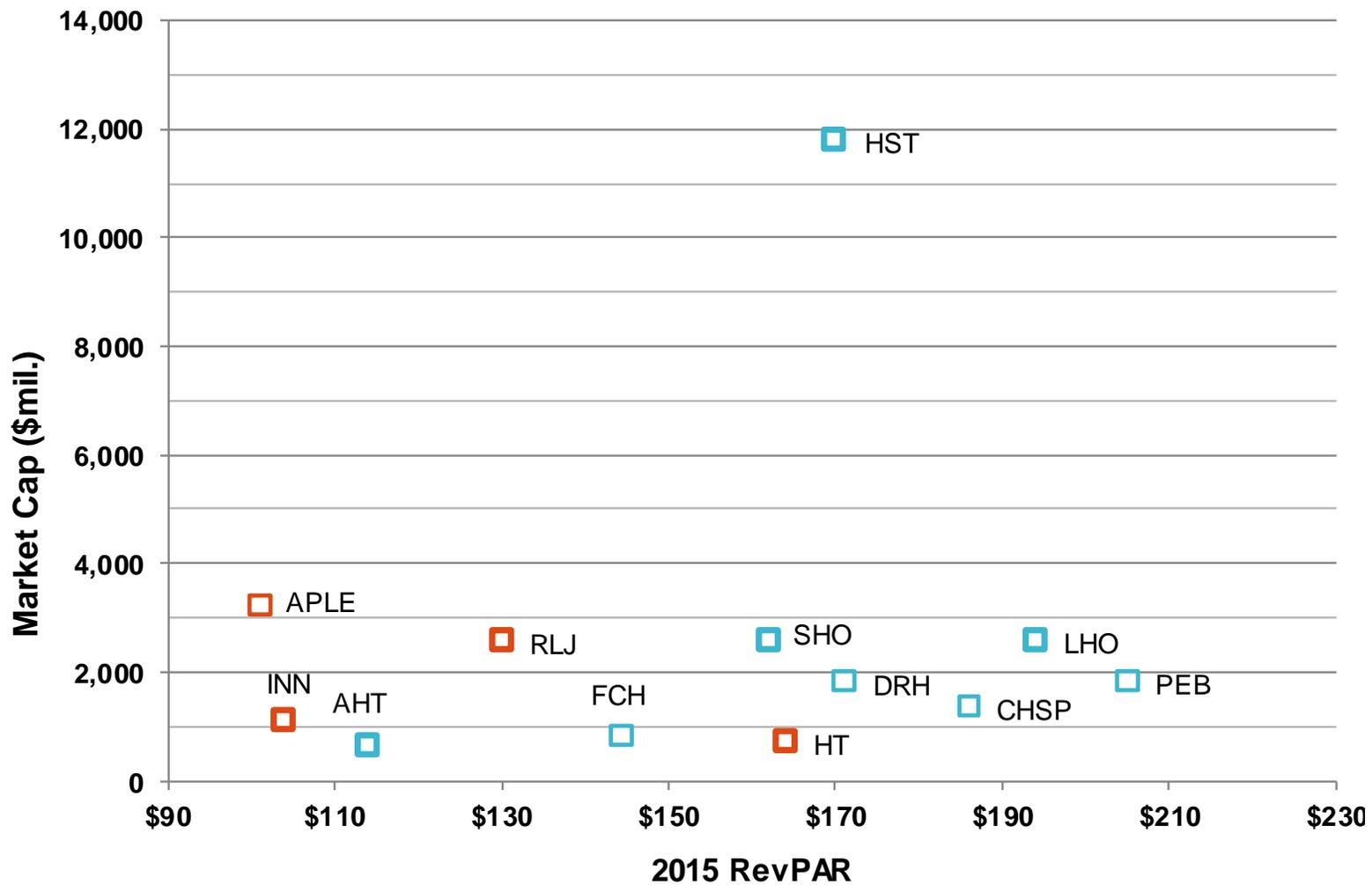
- More consistent growth in uncertain demand environment
- Desirable “Millennial” business travelers are increasingly receptive to well-located select-service hotels in urban CBDs; deemphasizing the need for full-service amenities
- Larger pipeline of acquisition opportunities with less bidding competition

- **Trading at Valuation Multiple Premium**

- RevPAR-EBITDA multiple correlation, which was strong in 2011-2014, has decoupled recently and select-service stocks are now trading at premiums

Hotel REITs: Host and the 14 Dwarfs

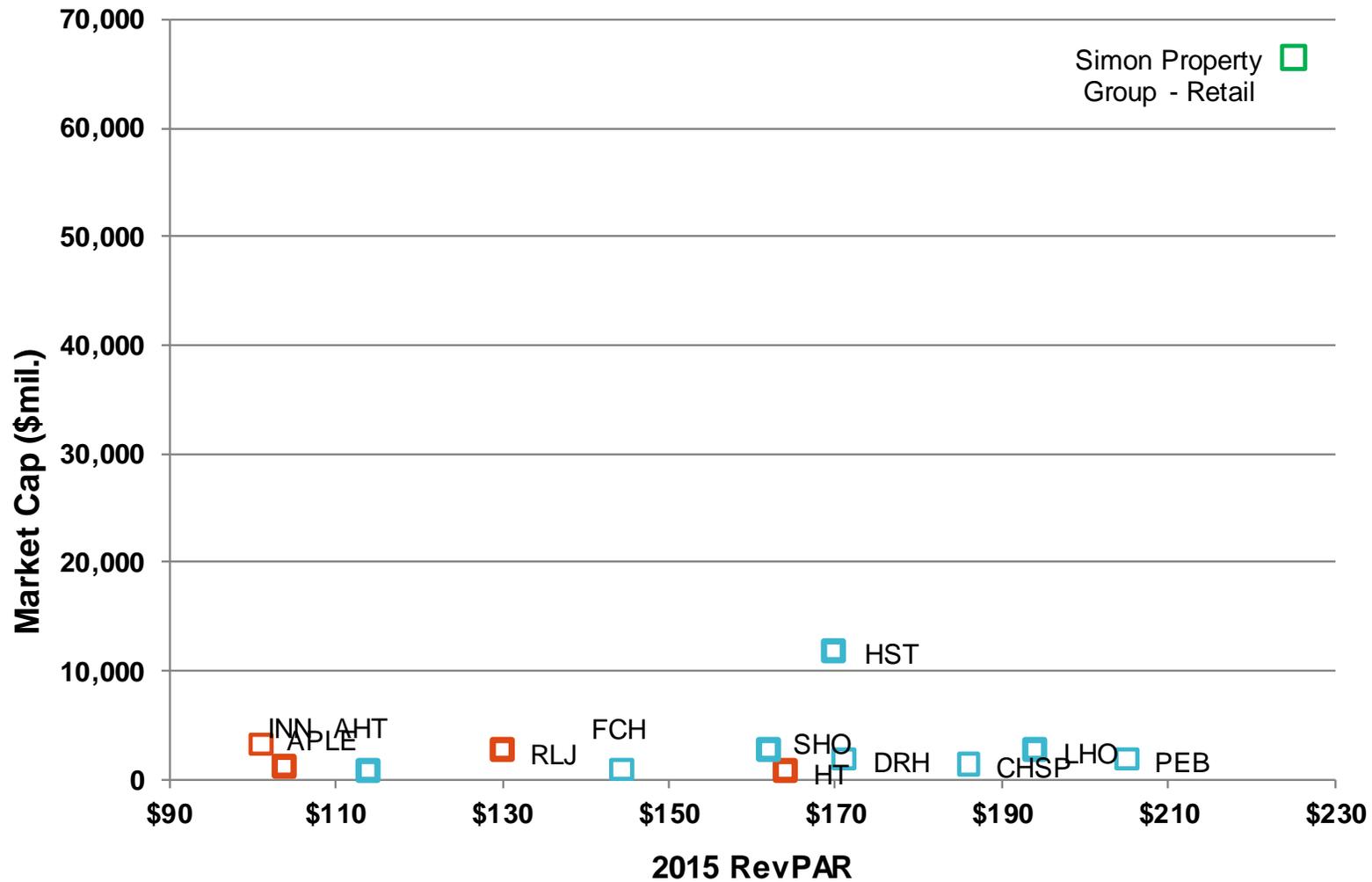
Minimal strategy differences among the Hotel REITs; no obvious industry aggregator



Source: Baird Research, Company Documents

Actually, Really 15 Dwarfs

The hotel industry is ripe for consolidation; scale has its benefits



Source: Baird Research, Company Documents

NYC Most Impacted by Airbnb

Most hoteliers have not noticed a significant impact from Airbnb

- Expected to mostly impact lower-end hotels
- Induces some amount of demand; not a 1-for-1 cannibalization of hotel rooms

However, Airbnb appears to be constraining ADR growth for certain events

- Large events (e.g., Super Bowl, Pope Francis's recent visit) have not generated as much compression as previously

New York City experiencing the largest impact

- Airbnb represents 12%-15% of supply and ~10% of demand
- Bill imposing fines for advertising short-term rentals recently passed the NY State Senate

Three factors for determining market impact (from CBRE Hotels research)

- How much Airbnb supply relative to hotel market
- Is Airbnb market average rate below hotel market average rate
- How fast is active Airbnb unit growth

Pricing Transparency: Short-Term and Long-Term Impact

Round One: Introduction of OTAs

- As hotels began to make inventory open to OTAs, rate integrity crumbled
- Post 9/11 downturn in 2001 and beyond saw sharp ADR drops

Round Two: New re-pricing software now rolling out

- TripBAM
- Tingo
- Corporate travel management software
- All designed to survey existing inventory to see if reservations can be rebooked at lower rates, at the same or similar hotels

Risk is that this software becomes widely used just as occupancy starts to fall

- Could make downturn sharper
- Rates could drop much more quickly following occupancy peak
- Weak nights and weak markets could see dramatic rate drops as operators “race to the bottom” to fill vacant rooms
- Brands working to combat repricing software

Baird Hotel Scout: Technology Is the Enemy of ADR Growth

BAIRD

Boston Omni:

~~\$249/night~~



\$207/night

-17%

Hyatt Times Square:

~~\$359/night~~



\$269/night

-25%

Le Méridien San Francisco:

~~\$427/night~~



\$299/night

-30%

The Lexington NYC:

~~\$289/night~~



\$219/night

-24%

- Proprietary software from Baird's travel management company expected to save \$40,000-\$45,000/year (gross) by rebooking at lower rates; Baird booked 18,500 room nights in 2015 implying \$2.30/night savings (0.9% of total cost)
- Looks at global distribution system (Apollo and Sabre) inventory; other commercially available websites (TripBAM and Tingo) use OTA inventory

Baird Hotel Coverage Universe

<i>REITs</i>	Price	Rating	Dividend	Payout (2016E)	EV/2016E EBITDA	Implied Cap Rate (2016)	(Net Debt+Pfd)/ 2016E EBITDA
AHP	\$14.38	Neutral	3.3%	28%	12.5x	8.0%	5.7x
AHT	\$5.87	Outperform	8.2%	29%	10.1x	7.9%	8.7x
APLE	\$18.36	Neutral	6.5%	68%	13.9x	7.5%	3.5x
CHSP	\$23.67	Outperform	6.8%	64%	11.3x	7.2%	4.4x
DRH	\$9.21	Outperform	5.4%	49%	9.7x	8.1%	2.7x
HPT	\$28.43	Neutral	7.2%	55%	9.8x	8.2%	4.5x
HST	\$16.00	Outperform	5.0%	48%	10.9x	7.5%	2.6x
HT	\$18.95	Outperform	5.9%	45%	12.4x	6.6%	5.7x
INN	\$13.44	Outperform	3.9%	39%	12.2x	7.3%	5.3x
LHO	\$24.65	Neutral	7.3%	62%	10.5x	7.4%	3.4x
PEB	\$27.11	Outperform	5.6%	55%	12.6x	7.1%	5.9x
RLJ	\$21.30	Neutral	6.2%	49%	10.4x	8.1%	3.6x
SHO	\$12.53	Outperform	1.6%	17%	10.9x	7.9%	2.4x
Median			5.9%	49%	10.9x	7.5%	4.4x
<i>C-Corps</i>							
H	\$50.19	Outperform	0.0%	0%	10.2x		2.2x
HLT	\$23.03	Outperform	1.2%	31%	11.0x		3.3x
HOT	\$75.45	Neutral	1.9%	46%	13.2x		1.1x
IHG	\$42.81	Neutral	2.4%	57%	13.6x		2.1x
MAR	\$68.69	Neutral	1.7%	32%	11.4x		2.1x
STAY	\$14.40	Outperform	5.3%	80%	9.2x		4.4x
Median			1.8%	39%	11.2x		2.1x

Source: Baird Research, SNL Financial; pricing as of 09/16/2016

Please refer to research notes for additional information



Baird Hotel Coverage Universe

Baird Hotel Coverage Universe: Covered Companies	
	Risks
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	Limited public market experience; capital allocation strategy still developing Retail-focused shareholder base
CHSP	Oversized exposure to high-beta lodging markets Oversized 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
HOT	Significant exposure to more volatile international markets Execution of potential asset sales (timing, pricing)
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	
	Risks
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
IHG	Execution of brand development (Crown Plaza NA relaunch, EVEN brand) Limited ADR share liquidity for investors that trade on the NYSE
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	Oversized exposure to high-beta lodging markets and independent hotels Oversized 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	Oversized exposure to high-beta lodging markets and independent hotels Oversized exposure to the more volatile corporate transient business customer
RLJ	Significant concentration of hotel management by White Lodging Oversized 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
STAY	Greater volatility from hotel ownership; development plans increase risk profile Competition from major global brand companies

Source: Baird Research

Please refer to research notes for additional information

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