TRUIST Truist Securities

Equity Research Report

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CONSUMER: Lodging

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Reasons for this report

✓ Deep dive analysis of recent U.S. hotel revenues and 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.

✓ The analysis is also a read-through on C-corp base and incentive management fees (IMFs) and owned/leased margins.

Hotel P&L Analyzer: Soft property-level profits in 1Q but we do not expect REIT FY EBITDA guide cuts, at least not yet.

In our analysis of over 1,000 U.S. hotels (data source HotStats), 1Q24 Gross Operating Profit (GOP) margins were 35.0%, -110 bps y/y and -90 bps versus same time 2019. These figures compare with 4Q23 (+50 bps y/y and -10 bps vs. 4Q19) and 3Q23 (-130 bps y/y and flat vs. 3Q19). 1Q was impacted by Easter timing. Full-service outperformed select-service.

Our "Bottom Line": Despite investor concerns about YTD results, we do not see enough justification *at this time* for FY24 REIT EBITDA guidances to be cut. That said, the actualization of strong 2H24 group paces into revenues will be material for REITS to maintain full-year guides after a soft 1Q.

Please note our full-service data set skews slightly above the average Upper Upscale hotel and to institutionally-owned urban and resort hotels which may add some variance to STR data and individual public company results. Our select-service data set also skews more institutional than the average U.S. select-service hotel. ***Please view the PDF version of this note for superior quality of exhibits.***

Please join us on May 30th for an expert conference call with HotStats on YTD demand, profit, and labor trends including on global markets. This call will be relevant for Lodging C-corp and REIT investors.

Our aggregated data set for 1Q24 reflected flattish y/y top-line results on mid-single digit labor cost growth leading to profits down about 3% y/y. These results are in-line to our/industry expectations of roughly 4% revenue growth needed for flattish profit margins. Despite ~23% inflationary growth since 1Q19, absolute gross operating profits for our data set rose just 1% over the same time frame.

Exhibit 1: 1Q24 Versus Prior Years Hotel Performance (Our Main Data Set)

Aggregated U.S. Hotel Operating Performance: 1Q24 vs. Prior Years

	1Q24	1Q23	*y/y % change*	1Q19	*5-yr % change*
Occupancy	65.8%	65.3%	*0.8%*	73.6%	*-10.6%*
ADR	$258	$258	*0.0%*	$223	*15.5%*
RevPAR	**$170**	**$168**	***0.7%***	**$164**	***3.3%***
Total RevPAR	**$270**	**$269**	***0.4%***	**$261**	***3.7%***
Room Margin	72.0%	72.8%	*-1.1%*	72.9%	*-1.2%*
F&B Margin	30.1%	30.9%	*-2.6%*	30.8%	*-2.3%*
Operating Department Margin	59.8%	60.5%	*-1.2%*	59.8%	*0.0%*
GOP Margin	**35.0%**	**36.1%**	***-3.0%***	**35.9%**	***-2.5%***
GOP Per Available Room	**$94**	**$97**	***-2.6%***	**$94**	***0.8%***
Total Hotel Payroll (% of Total Revenue)	36.9%	35.8%	*3.1%*	35.8%	*3.1%*
Total Hotel Payroll (Per Available Room)	$100	$96	*3.9%*	$93	*7.1%*
Total Hotel Payroll (Per Occupied Room)	$151	$147	*3.0%*	$127	*19.7%*

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.

Source: Truist Securities Research; HotStats

For earnings over the next two weeks, the above results would not suggest robust y/y Same Property Hotel EBITDA growth for most of the REITS or material step-ups in U.S. incentive management fees (IMFs) for the C-corps.

- As support for this view, Hilton (HLT, Hold, Scholes) global IMFs were +7.7% y/y in 1Q24 which we view supported in no small part by performance in regions outside the U.S. We expect a similar IMF setup for Marriott (MAR, Hold, Scholes) and Hyatt (H, Buy, Scholes).
- As for the Lodging REITS, we assume a wide spread of results due in part to idiosyncratic portfolio-specific factors such as renovations, relative outperformance in some Top 25 market Upper Upscale hotels, and relative underperformance for some select-service and resorts. While Park (PK, Buy, Scholes) did not provide 1Q EBITDA guidance, we view their +6.8% 1Q RevPAR guide at the midpoint as a positive outlier to y/y EBITDA growth compared to the rest of our covered Lodging REITS. For the average REIT-owned hotel, we view 1Q24 full-service +1-3% RevPAR growth y/y manifesting to Hotel EBITDA y/y declines in the low-single digits as the base case, supported by Exhibit 2.

Full- and select-service hotels performed quite distinctly in 1Q24 where full-service hotel revenues were modestly positive y/y and select-service hotels were modestly negative. As a result, absolute hotel profits (using Gross Operating Profit Per Available Room or GOPPAR as proxy) were relatively worse for select-service hotels though buttressed by a limited labor model. Even though March was not a strong group month y/y due to Easter and spring break timing, in absolute terms group demand still picks up annually in the springtime and where full-service hotels tend to be more operationally efficient given existent F&B-related staffing. As GOP margins exclude fixed costs, we add that EBITDA margins include continued headwinds from property insurance cost growth, particularly for coastal market hotels. Generally we assume property real estate taxes are also headwinds for now, but we are aware of owners contesting their raised taxes/property assessments.

Exhibit 2: 1Q24 Hotel Performance -- Full-Service vs. Select-Service

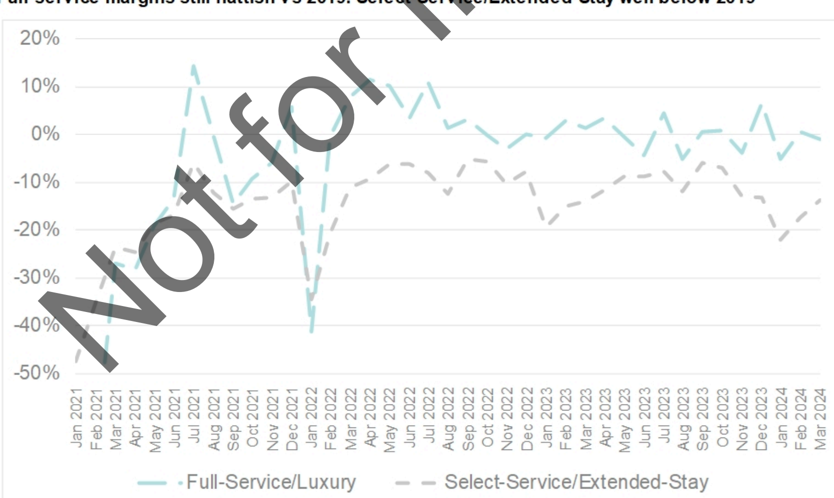
1Q24 U.S. Hotel Operating Performance: Full-Service/Luxury vs. Select-Service/Extended-Stay

	Full-Service	Select-Service	FS vs SS
RevPAR y/y	2.4%	-2.9%	5.3%
Total revenue y/y	2.5%	-2.4%	4.9%
GOP margin y/y (bps)	-110	-50	-60
GOPPAR y/y	-0.7%	-3.6%	2.9%

Source: Truist Securities Research; HotStats

Exhibit 3: Gross Operating Profit Margins vs. 2019

Full-service margins still flattish vs 2019. Select-Service/Extended-Stay well below 2019



Note: We have intentionally not presented the deeply negative margins in 2020 for easier visuals.
Source: Truist Securities Research, HotStats

March results were soft in part driven by Easter timing although some public company executives have suggested March was weaker than anticipated due in part to group and transient bookings that actualized below expectations. Rationale provided by Pebblebrook (PEB, Hold) included reduced group demand for the weeks surrounding holidays, a trend that raises concern to us if this trend is a permanent post-pandemic behavioral shift in travel, particularly as individual higher-rated business travel remains in some respects below pre-pandemic levels and the aggregated effect is less opportunity for urban hotels to have high occupancy to significantly push room rates. The relatively good news for March is that there was no material room rate reduction versus 2023. We strongly discourage hoteliers lower room rates to induce demand due to a still challenging operating cost growth environment.

Exhibit 4: March 2024 Versus Prior Years Hotel Performance (Our Main Data Set)

Aggregated U.S. Hotel Operating Performance:
Mar 2024 vs. Prior Years

	Mar-24	Mar-23	*y/y % change*	Mar-19	*5-yr % change*
Occupancy	71.7%	72.4%	*-1.0%*	79.5%	*-9.8%*
ADR	$267	$268	*-0.4%*	$229	*16.2%*
RevPAR	**$191**	**$194**	***-1.3%***	**$182**	***4.9%***
Total RevPAR	**$298**	**$304**	***-2.1%***	**$284**	***5.0%***
Room Margin	74.3%	74.9%	*-0.8%*	75.0%	*-0.9%*
F&B Margin	31.9%	33.8%	*-5.6%*	33.1%	*-3.6%*
Operating Department Margin	62.5%	63.0%	*-0.8%*	62.5%	*0.0%*
GOP Margin	**39.6%**	**40.5%**	***-2.2%***	**40.4%**	***-2.0%***
GOP Per Available Room	**$118**	**$123**	***-4.3%***	**$115**	***2.7%***
Total Hotel Payroll (% of Total Revenue)	33.7%	32.8%	*2.7%*	32.7%	*3.1%*
Total Hotel Payroll (Per Available Room)	$100	$100	*0.4%*	$93	*8.1%*
Total Hotel Payroll (Per Occupied Room)	$140	$138	*1.2%*	$116	*19.8%*

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.

Source: Truist Securities Research; HotStats

Looking ahead to 2Q24 and the rest of the year:

We have received a pickup in REIT investor questions about FY guidances in the last few weeks supported by cynicism that the high-end RevPAR ranges are already not achievable. While some investors are already suggesting that Lodging REITS should consider FY 2024 guidance cuts due to weak headline 1Q24 RevPAR results and downward 1Q sell-side EBITDA estimates for some names ahead of earnings, we are not at the stage yet to suggest material FY guide revisions. However, a big variable is the performance of group in 2H24 where public company expectations remain elevated on strong citywide performance for many major U.S. markets. Given REITS reported earnings only two months ago and under the presumption that public company expectations for 2H24 have not been significantly revised, we see little justification for REITS to cut guidance this early and then re-raise later this year if demand "re-accelerates".

- **Another rationale for FY guides to hold at least for this quarter is investor sentiment: We believe that it would not be a great look for management company forecasting for FY guides to be cut this quickly in the year unless there was some major demand shock -- which has not transpired.** That said, we also view REITS would be best suited to keep guidance expectations conservative given domestic summer leisure demand remains TBD and the back of the year includes elections which could also impact actual group attendance. In order to help manage investor concerns on full-year guides and the strength of 2H24, we recommend some management clarity in how RevPAR/EBITDA growth could manifest between 2Q and 4Q by quarter for REITS that have provided full-year guidance and how the high-end of ranges could actualize.
- **Organized labor activity ahead of contract negotiations may add another variable to 2024 EBITDA from theoretical protests/ strikes.** It is also not lost on us that anticipated hotel labor protests in cities such as San Francisco add another theoretical headwind for hotel owners (San Francisco Chronicle). Some travelers, particularly group travelers, do not want to cross picket lines. Strikes impacted convention demand to downtown Los Angeles last year although the impact to the REITS was limited (NPR; Los Angeles Times). Operational restrictions due to strikes do not make for great marketing of the U.S. tourism industry for international inbound travelers either (we think of Americans that avoid parts of Western Europe for vacations due to news on labor strikes). We have suggested multi-city hotel strikes as a "very bad look for the [hotel] union...given the still fragile nature of the U.S. urban lodging recovery".

The "upside case" for how the back of the year can manifest under strong group results is supported by absolute EBITDA growth -- more than from margins or RevPAR. A good example of this scenario is October 2023, one of the strongest group months of last year. (*We recognize there were a number of y/y comp considerations versus 2022 including the hiring of full-service workers in anticipation of more F&B activity, the timing of the High Holidays, and lapping Hurricane Ian, however for simplicity we focus on the headline stats.)* As presented below in Exhibit 5, in October 2023 for our full-service data set, given 4% RevPAR growth and 5% Total RevPAR growth, GOP margins grew just 40 bps but absolute GOPPAR grew 6.2%. **Given we anticipate aggregated REIT hotels to have positive +1-3% RevPAR growth in 1Q24 and where FY guidance at the midpoint is roughly +3.0-4.5%, this math may imply 2H24 RevPAR in the 4% range at the midpoint with somewhat similar dynamics to the precedent case we present in the following exhibit.**

Exhibit 5: October 2023 Results -- A Strong Group Month -- Provides Precedence of Strong Absolute EBITDA Growth Despite Flattish Profit Margins

October 2023 Full-Service/Luxury Results (y/y)	
Occupancy	+200 bps
ADR	1.3%
RevPAR	**4.2%**
Total RevPAR	**5.2%**
Room Margin	+10 bps
F&B Margin	+270 bps
Operating Department Margin	+70 bps
GOP Margin	**+40 bps**
GOP Per Available Room	**6.2%**

Source: Truist Securities Research; HotStats

- We add that October 2023 was a soft leisure month with Resort RevPAR -2% and Luxury -1% which negatively skews our HotStats profit results. Said differently, a Top 25 market urban hotel with strong group demand may have had RevPAR growth well north of 5% and commensurately strong absolute profit growth. A somewhat similar setup is possible for strong group months in 2H24.
- **On top of these theoretical tailwinds in 2H24 is a labor environment that is easing with less overtime pay and a more stable normalizing workforce -- which we assume would reflect in improved reported room and F&B margins versus 2023.**

Finally we consider one 2Q24 variable that may have been undermodeled by the Street for some REITS -- the impact of the solar eclipse.

We are unsure of the materiality of impact given such a short time frame (if any material impact) but there could be a modest upside surprise to 2Q EBITDA guidance from this likely high-ADR/high profit short-term event (San Antonio Express-News). For properties along the path, we note some came up with creative multi-day and non-overnight packages including on F&B (KDAF-TV highlighted several activities at the Gaylord Texan). From our sensitivity analysis, we estimate that based on QTD through April 20th Upper Upscale RevPAR of +9.4% y/y (STR data), 2Q24 Upper Upscale RevPAR would finish approximately +2.9% if the rest of the quarter RevPAR was +2%. The REITS may have a more concentrated impact given in some cases outsized exposure to the eclipse markets. *Of course, any benefit from the eclipse would be a one-time gain and not "sustainable demand" and will subsequently create a difficult y/y comparison in April 2025.*

We assume some on the sell-side (including us) did not model the eclipse in our 2Q projections. Most of the cities along the path are not Top 25 markets from STR and where many of us would not have QTD results by market to highlight any positive RevPAR impact in advance of earnings. Additionally, holiday timing and NCAA championship games complicated the y/y comparisons. However, several REIT markets were in or near the path, including:

- Texas: DFW Metroplex, Austin, and San Antonio
- Midwest: Indianapolis, Cincinnati, Detroit, and Cleveland
- U.S. Northeast / Eastern Canada: Buffalo, Northern Vermont (specifically Burlington for DiamondRock as highlighted by their hotel's "Total Eclipse of the Heart" package (DRH, Hold, Scholes), and Toronto

There are several REITS that could have had positive one-time impact reflect in 2Q guidance as a modest tailwind. While the Midwest and Northeast/Canada markets comprise a relatively small part of overall EBITDA for our coverage, the Texas markets are more significant. Within our coverage, we would especially view Ryman (RHP, Buy, Scholes) as a possible beneficiary given considerable Texas exposure in both the Hospitality and Entertainment segments followed distantly by Host (HST, Hold, Scholes) and RLJ (RLJ, Buy). We add some non-covered Lodging REITS also have representation along the path.

Companies Mentioned in This Note

DiamondRock Hospitality Company (DRH, $9.10, Hold, C. Patrick Scholes)
Hyatt Hotels Corporation (H, $152.21, Buy, C. Patrick Scholes)
Hilton Worldwide Holdings Inc. (HLT, $202.16, Hold, C. Patrick Scholes)
Host Hotels & Resorts, Inc. (HST, $19.19, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $240.49, Hold, C. Patrick Scholes)
Pebblebrook Hotel Trust (PEB, $15.00, Hold, Gregory Miller)
Park Hotels & Resorts Inc. (PK, $16.67, Buy, C. Patrick Scholes)
Ryman Hospitality Properties, Inc. (RHP, $107.13, Buy, C. Patrick Scholes)
RLJ Lodging Trust (RLJ, $11.11, Buy, Gregory Miller)

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