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# Sunstone Hotel Investors, Inc. (SHO)

Q4 2021 Earnings Call

## CORPORATE PARTICIPANTS

**Aaron Reyes**

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**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

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## OTHER PARTICIPANTS

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**William A. Crow**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Sunstone Hotel Investors Fourth Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. I'd like to remind everyone that this conference is being recorded today, February 23, 2022, at 12:00 PM Eastern Time.

I will now turn the presentation over to Mr. Aaron Reyes, Senior Vice President and Treasurer. Please go ahead, sir.

### Aaron Reyes

*Senior Vice President & Treasurer, Sunstone Hotel Investors, Inc.*

Thank you, operator, and good morning, everyone. By now, you should have all received a copy of our fourth quarter earnings release and supplemental, which were made available yesterday. If you do not yet have a copy, you can access them on our website.

Before we begin, I would like to remind everyone that this call contains forward-looking statements that are subject to risks and uncertainties, including those described in our prospectuses, 10-Qs, 10-Ks, and other filings with the SEC, which could cause actual results to differ materially from those projected. We caution you to consider these factors in evaluating our forward-looking statements.

We also note that this call may contain non-GAAP financial information, including adjusted EBITDAre, adjusted FFO, and property-level adjusted EBITDAre. We are providing that information as a supplement to information prepared in accordance with Generally Accepted Accounting Principles.

With us on the call today are Doug Pasquale, Chairman and Interim Chief Executive Officer; Bryan Giglia, Chief Financial Officer; Robert Springer, Chief Investment Officer; and Chris Ostapovicz, Chief Operating Officer. On today's call, Doug will discuss our recent value-enhancing hotel disposition and provide his thoughts on the company's near-term priorities and objectives, including an update on the CEO search process. Bryan will then discuss the operating environment and recent trends in our business. And finally, I'll provide a summary of our current liquidity position and a recap of our fourth quarter and full-year financial results. After our remarks, we will be available to answer your questions.

With that, I'd like to turn the call over to Doug. Please go ahead.

### Douglas M. Pasquale

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

Thank you, Aaron. Hello, everyone, and thank you for joining our call today. While the lodging industry continues to deal with a number of crosscurrents, I am pleased with our fourth quarter results and the enhanced pace of our transaction activity. During the quarter, we benefited from continued strong leisure demand, which led to record profitability at our resort hotels in Wailea and Key West.

While performance at our urban hotels remains challenged, we are encouraged by the pace of group bookings we saw in the fourth quarter and believe that a better backdrop for group meetings and events in the coming year,

combined with an increased amount of business travel, will allow for substantial growth in earnings and cash flow at these hotels as compared to 2021.

As I discussed during our call last quarter, we are redoubling our efforts to create value through a more active approach to capital recycling. To that end, we are pleased to announce our recent disposition of a Hyatt Centric Chicago. This hotel was no longer consistent with our strategy, and we believe it did not have the growth profile that justified our continued ownership and ongoing capital investment. Including this most recent sale, we have now completed nearly \$500 million of transactions in just the last few months.

Our balance sheet remains strong with significant investment capacity, and the team is actively working on opportunities to accretively deploy capital. While we have more work to do, overall, I am quite pleased with the progress we have made in recent months and I look forward to continuing to work with the management team to unlock further value for shareholders.

Before I turn the call over to Bryan, I want to provide an update on the CEO search process being conducted by the Board of Directors Search Committee. As I mentioned when we last spoke in November, the board's objective was to conduct an efficient, but thoughtful search. Since that time, the search committee has considered a significant number of potential candidates.

The committee, aided by Spencer Stuart, is carefully evaluating and vetting the best qualified of these individuals. We are confident that we have identified several candidates that have the skills, experience and track records to advance our strategy and accelerate value creation for our shareholders. As we establish our list of finalists, the search committee and the board are moving into the final stages of the process.

And with that, I will turn the call over to Bryan to cover some of the details of our fourth quarter operations.

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## Bryan Albert Giglia

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

Thank you, Doug, and good morning, everyone. I'll start with a review of our fourth quarter operating results, which managed to exceed our post-Delta revised expectations, even with some renewed pandemic-related headwinds that bookended the quarter. I will also provide an update on our current environment and our forward booking trends, which point to continued growth in 2022, despite a short term pause in the recovery due to the Omicron variant, which we believe is now subsiding.

So, let's begin with our fourth quarter results. While we were very encouraged by the performance of our resort assets and our non-resort properties that were able to pivot to take advantage of leisure-oriented demand, our group-centric city center properties were more challenged in the fourth quarter and more acutely felt the impact of Delta-driven cancellations in October and November.

Although these urban hotels remain well below pre-pandemic operating levels and weighed on our overall fourth quarter results, we expect them to become a tailwind moving into this year as group events and corporate travel rebound, and we are encouraged by the trends we are seeing in recent weeks. We will provide more details on our 2022 booking pace shortly.

Total revenue in the quarter was \$174 million, a 3.9% increase from the prior quarter and the highest quarterly revenue we have generated since the onset of the pandemic, an impressive feat given the headwinds we saw early in the quarter from Delta-related cancellations. The fourth quarter comparable portfolio occupancy was 55.6%, which represents 150 basis point increase from the prior quarter, despite fourth quarter seasonality.

The fourth quarter comparable portfolio ADR of \$246 was 50% higher than the fourth quarter of 2020 and also just above the fourth quarter of 2019, driven by very strong leisure demand at our resort properties. Wailea Beach Resort posted rate growth of 27% as compared to the same quarter in 2019, and Oceans Edge bested its pre-pandemic fourth quarter rate by nearly 80%.

As a result of this impressive rate performance, these two properties generated their best fourth quarter profitability on record. While our urban and group-oriented hotels are recovering more slowly as compared to our resort properties, we are encouraged by what we believe to be a much more promising outlook for these assets in 2022.

Overall, the combination of higher-than-expected occupancy, a comparable portfolio ADR that exceeded pre-pandemic levels contributed to fourth quarter RevPAR of nearly \$137, which is approximately 70% of 2019 actuals, and represents another quarter of continued indexed improvement relative to pre-pandemic run rate despite being negatively impacted by the Delta variant.

In addition to our comparable portfolio, our two recently acquired hotels, Montage Healdsburg and the Four Seasons Resort Napa Valley, continue to ramp up nicely and are getting great reception. In our first month of ownership, the Four Seasons Napa generated an impressive average daily rate of nearly \$1,600, which speaks to the quality and desirability of this new property. Across our portfolio, we have been pleased with our operators' ability to remain disciplined in their pricing approach since the onset of the pandemic, and believe this positions us well to capture outsized RevPAR growth going forward as business and group events make a more meaningful contribution to our hotel demand in the months to come.

We, once again, saw significant sequential growth in food and beverage revenue, which increased 33% from the third quarter of 2021. While our fourth quarter outlet spend on a per occupied room basis was above 2019, the primary driver of the higher out-of-room spend in the quarter was due to increased banquet contribution from group activity at our hotels. Banquet sales per group room was \$175 in Q4, a 45% increase from the prior quarter. While this level of spend remains approximately 10% below pre-pandemic levels, we have seen meaningful increases over the last two quarters and currently expect that group's spending patterns in the future will not be meaningfully different than historic trends.

While comparable RevPAR in the fourth quarter was similar to that of the third quarter, the growth in food and beverage revenue contributed to a quarterly comparable total RevPAR or TRevPAR of approximately \$200, a 5.3% increase from that achieved in the third quarter.

Turning to costs. Since the onset of the pandemic, we have been focused on working with our operators to deliver a safe and enjoyable guest experience, while looking for ways to achieve efficiencies and permanent expense reductions. We are pleased to report that we have eliminated nearly \$14 million of annual costs from our hotels, which we believe will be lasting savings that can be sustained even as business levels and occupancies increase.

While we have been successful in reducing certain operating expenses, our operators have not been immune from labor cost pressures that have been impacting our industry. While changes in hotel staffing composition over the last two years makes precise comparisons challenging, our data would suggest that from 2019 to 2021, average hourly wage rates have increased in annual rate of approximately 5%.

Looking ahead, we anticipate the growth in wage rates will moderate somewhat in 2022 and should be in the range of 4% to 5%. We recognize that there is a need to balance guests and associate satisfaction with optimal

service delivery, pricing, and hotel profitability. So, we are continuing to work with our operators to benchmark best practices and drive efficiencies wherever possible.

Despite some cost pressures, our comparable hotels generated a hotel EBITDA margin of 22.4% during the quarter. While this remains below the 30% range we have historically maintained in the fourth quarter, we again were very pleased with our operators' ability to deliver this level of profitability with a portfolio-wide occupancy in the mid-50% range.

Excluding the Renaissance Washington DC and the Hyatt Regency San Francisco, two of the most Delta variant impacted hotels, the fourth quarter margin would have been 27.8%, only a couple hundred basis points below the same time in 2019. This is a notable accomplishment and gives us confidence that we will be able to manage the cost pressures we are seeing and exceed prior peak margins as the operating environment returns to more normalized levels.

The combination of higher rates, increased occupancy, better out-of-room spend, along with ongoing stringent cost controls contributed to fourth quarter comparable hotel EBITDA of \$33 million, which exceeded our revised expectations and was similar to that of the prior quarter despite being a seasonally lower demand quarter and the incremental headwinds we saw in October and early November from Delta-related cancellations.

Now, shifting to segmentation, while transient room nights continue to make up a larger portion of our overall volume than it normally is the case, we saw some encouraging signs in the quarter from all segments which suggest future demand is becoming more widespread. Our comparable portfolio generated nearly 100,000 total group room nights in the quarter and the group segment comprised roughly 25% of our total demand. This volume represents a 32% increase in group room nights from Q3 at an average rate that was 6.7% higher.

While this is the largest number of quarterly group rooms we have actualized since the onset of the pandemic, it was negatively impacted by group cancellations from the Delta variant which lingered into October and early November. We estimate that these group cancellations, together with a delayed resumption of business travel that occurred as a result of the variant, resulted in approximately \$10 million to \$11 million of lower EBITDA in the quarter.

For the group events that did take place at our hotels, we were pleased to see them contribute greater levels of banquet and catering spend in addition to higher room rates. Looking forward, group production during the fourth quarter for all current and future periods was the highest it has been since the fourth quarter of 2019. We saw strength in group production at Hilton Bayfront, Boston Park Plaza, and Wailea Beach Resort had its best quarterly group production on record.

While the Delta variant had a meaningful impact on group activity in the fourth quarter, the Omicron variant, which emerged late in the year, had only a minimal effect on fourth quarter group activity; however, it has also led to some cancellations in early 2022. These cancellations primarily occurred in December and January and were generally for events slated to occur in January and February.

In total, approximately 25% of our first quarter group room nights cancelled, which is a milder impact than what we experienced with the Delta variant in 2021. Even with these cancellations, we still have more than 120,000 group room nights on the books for the first quarter, a nearly 20% increase sequentially from the prior quarter at an average comparable rate that is 18% higher.

Given the rapid decline in case counts in recent weeks and the additional lifting of restrictions, we are optimistic that we are moving beyond the short-term impact of the Omicron variant and will see acceleration in group activity.

In fact, as we look further into 2022, we anticipate that group demand will compose a much more meaningful component of our total room nights and that our overall segmentation will more closely resemble our pre-pandemic distribution where group events accounted for roughly a third of our total business.

Our group room nights for the second through fourth quarter of 2022 are pacing at approximately 80% of pre-pandemic levels at an average rate that is 6.5% higher than 2019. This would imply that our overall group revenue pace for this time period is down only 16% from the same time period in 2019.

Moving on to transient activity, which accounted for roughly 70% of our total room nights in the fourth quarter. Comparable transient rate for the fourth quarter came in at \$253 and reflected typical slowing from the prior quarter due to seasonal patterns, but was still 3.3% higher than pre-pandemic levels that we saw in the fourth quarter of 2019.

We continue to be encouraged by the increasing contribution of business travel to the overall transient demand. The number of special corporate rooms increased nearly 70% from the third quarter, with meaningful growth at our hotels in San Francisco, Boston, and New Orleans. Despite the continued quarterly growth, our overall special corporate volume remains only at 65% of pre-pandemic levels, and we expect demand from this channel to accelerate into 2022 as companies increasingly return to the office and business travel becomes more widespread.

Leisure demand continues to be very robust and allowed our operators to continue to push rates. We saw tremendous strength in average rates at our oceanfront resort properties with Wailea Beach Resort achieving a quarterly ADR that was 27% higher than the fourth quarter of 2019, and Oceans Edge turned in another record quarter with rates nearly 80% higher than pre-pandemic levels.

Full year EBITDA at Oceans Edge has nearly doubled from 2019 levels. While Hawaii had a slower start to the year while restrictions were being lifted, the EBITDA at the Wailea Beach Resort generated in the second half of 2021 was more than 27% higher than what was achieved in the same period in 2019. We are very pleased with what we are seeing at these two hotels already in 2022 and currently believe that we could see additional record-breaking profits for these two assets in the coming year.

We also saw strong rate performance at our two wine country resorts, with Montage Healdsburg achieving an average rate of \$1,085 in the quarter and the Four Seasons Napa Valley sustaining an average rate of \$1,578 in the first month of our ownership. These two most recent acquisitions have been very well received, and we look forward to their more meaningful contribution to operating results in the year ahead.

We expect that the early part of this year will be challenged by the lingering impacts from the Omicron variant and the shift to the seasonally lowest demand months. Our preliminary results for January are reflective of the short-term pause in the pace of the recovery as our index performance relative to the same time in 2019 is lower than where we had been pacing in the final months of 2021.

January 2022 comparable RevPAR of just under \$92 came in at 55% of 2019 actual, which is a step back from the 68% and 83% index levels we generated in November and December of last year, respectively. However,

given the improvements in COVID case counts around the country and the lifting of restrictions in more jurisdictions, we are seeing industry fundamentals reaccelerate.

Our transient booking activity, which declined sharply in December, has shown significant positive strength in January and, in the most recent weeks, is approaching pre-pandemic levels. In addition, the stronger citywide calendars, a better foundation of group room nights already on the books and an increasing amount of corporate travel as employees return to the office, all suggest that we could be on a path to a more widespread recovery in hotel demand over the coming year.

Based on what we see today, we expect our comparable portfolio RevPAR index to be in the mid-60s to 70% range relative to 2019 for February and March, and then increase to above 80% starting in the second quarter. These index gains will be primarily occupancy driven as pricing is already ahead of 2019 levels. We expect our portfolio's year-over-year percent growth in average daily rate for 2022 will be in the single digits with group and urban hotels growing more than leisure hotels.

Shifting to our capital projects, we invested \$64 million into our portfolio in 2021. As part of that work, we added new meeting space at Boston Park Plaza, completed a redesign of the food and beverage options at Hilton San Diego Bayfront and converted unused space at the hotel into a spectacular new meeting venue with views of the water. And we also made additional progress on the renovation of the soon-to-be rebranded Westin Washington DC.

While the portfolio remains in great condition, we have a number of exciting projects planned for 2022 and expect to invest between \$130 million and \$150 million into our hotels with a focus on enhancing the value and future earnings potential of the portfolio.

During the year, we will be working on the addition of a new serenity pool at the Wailea Beach Resort further elevate the guest experience, a rooms renovation at the Hyatt Regency San Francisco and we will also substantially complete the transformational work at our hotel in Washington DC, as we prepare to convert it to the Westin brand in order to capture higher rates and drive incremental profitability. We expect the incremental spend of \$30 million above the standard cyclical renovation to convert to a Westin will result in the low- to mid-teens return on our investment.

Moving to our transactions activity, as Doug noted earlier, yesterday, we announced the sale of a leasehold interest in the Hyatt Centric Chicago Magnificent Mile. This hotel was no longer consistent with our strategy and is located in a market that has been hampered by excess supply and an inability to drive meaningful rate growth. The hotel was sold for \$67.5 million, which represents a 13.3 times EBITDA multiple and a 5.6% cap rate on 2019 earnings.

In the last few months, we have completed nearly \$500 million of transactions, all of which have enhanced our portfolio quality and better position Sunstone for future growth. We have meaningful capacity for additional capital allocation and our teams are actively looking for ways to accretively deploy capital.

To sum things up, as we move into 2022, we are encouraged by what we believe will be a year of significant earnings growth across our portfolio as we are increasingly able to travel and meet together. The recent data would suggest that we are moving beyond the worst impacts of the omicron variant, and we are optimistic that we are headed into a period that will better support a sustained recovery in industry fundamentals.

Benefiting from a strong citywide calendar and group rooms on the books, we expect that our urban and group-oriented assets will see outsized growth this year as pent-up demand for business travel and corporate events began to catch up with the already robust leisure demand at our resort properties. Additionally, Sunstone is in the enviable position to use our strong balance sheet and debt capacity to grow the company and create value for our shareholders.

With that, I'll turn it over to Aaron. Aaron, please go ahead.

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## Aaron Reyes

*Senior Vice President & Treasurer, Sunstone Hotel Investors, Inc.*

Thank you, Bryan. During the quarter, we executed another set of favorable amendments to our unsecured debt agreements, which provide for increased flexibility to navigate the current operating environment and which should also help facilitate our ability to exit the covenant waiver period in the coming weeks. We continue to appreciate the ongoing support and partnership from our bank group and noteholders.

As of the end of 2021, we had approximately \$230 million of total cash and cash equivalents on a pro forma basis, including \$42 million of restricted cash and after adjusting for the proceeds received subsequent to the end of the year from the sale of the Hyatt Centric Chicago Magnificent Mile. We ended the quarter with \$611 million of total consolidated debt at a weighted average interest rate of 3.69%. All but two of our hotels are now unencumbered. And with full availability on our \$500 million revolving credit facility, our balance sheet has significant capacity.

Shifting to our financial results, the full details of which are provided in our earnings release and our supplemental, the quarterly results which surpassed our post-Delta revised expectations, reflect a sequential decline from the prior quarter, partly due to typical seasonal patterns, but also due to the lagging impact from the Delta variant, which led to group cancellations and lower business volumes for the fourth quarter. Adjusted EBITDA for the fourth quarter was \$31 million and adjusted FFO was \$0.08 per diluted share. For the full year, adjusted EBITDA was \$67 million and adjusted FFO was \$0.04 per diluted share.

Although these full-year results are far ahead of what we reported in 2020, they remain well below pre-pandemic levels. And while we expect to see significant sequential growth again this year, the operating environment remains too uncertain to provide earnings guidance at this time. As we shared with you last quarter, our two hotels in New Orleans were impacted to varying degrees by Hurricane Ida in August of 2021.

During the fourth quarter, we recognized \$2.6 million of restoration expense and an impairment charge of \$1.7 million as a result of damage incurred from the storm. The Hilton New Orleans St. Charles sustained the bulk of the damage and we are working with our insurers to identify and settle a property damage claim, and we expect that future losses from restoration work at this hotel will be mitigated by the property's insurance policy, subject to its deductible of approximately \$3 million. We currently anticipate that restoration work at these hotels should be completed by the third quarter and that both hotels to remain in operation while the work is performed.

Now, turning to dividend, our board has approved the quarterly distributions for our Series H and our Series I preferred securities.

And with that, we can now open the call to question. So that we are able to speak with as many participants as possible, we ask that you please limit yourself to one question. Operator, please go ahead.

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Your first question is from Rich Hightower with Evercore.

**Rich Allen Hightower**

*Analyst, Evercore Group LLC*

Hey. Good morning out there, guys.

Q

**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

Good morning, Rich.

A

**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

Good morning, Rich.

A

**Rich Allen Hightower**

*Analyst, Evercore Group LLC*

Let's just get it out of the way. So in terms of the CEO search process, Doug, are you able to provide any more specifics on the timing of the conclusion of that process? And then, more broadly, if the market's telling you in sort of a persistent fashion, as maybe it's doing right now in terms of the company's equity performance that Sunstone may have a cost of capital disadvantage for the foreseeable future, what sort of threshold, in the board's mind, would warrant formally evaluating strategic alternatives and maybe running a process along those lines?

Q

**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

Thank you for the questions, Rich. First of all, with respect to the CEO search, to embellish the opening remarks, we are entering into the final phases of the process. We have narrowed down to a final candidate list. And it's difficult to pinpoint exactly when we will be concluded, but I'd say it is certainly within the next two months and could be as soon as two weeks, depending on a number of factors that would influence that process. So within two months is my best estimate at this time. It could be much quicker than that.

A

With respect to evaluating our alternatives, any good board is aware of and should be evaluating on an ongoing basis how to best create shareholder value. It is clear to us at this time, while not yet as evident as we would like it to be to the broader marketplace, that we are on a very positive track. We think we have far more tailwinds than headwinds at this point in time, as I think Bryan very clearly and thoroughly described. And we have a very active transaction pipeline both for acquisitions and incremental dispositions that we're working very hard on.

The last five months – not quite five months – have been among the most productive in this company's history. And we see no reason why we can't extend and grow that. I'm very confident in the team, our strong balance sheet, our liquidity, the fact that we'll extricate ourselves from the covenants that have been restrictive. We see opportunities to, perhaps, buy in some of our stock. There's a lot of opportunities ahead of us that we believe we are best positioned to handle by staying on course. And so, that's our intent.

And you will continue to see execution. I understand why some people are skeptical. I embrace that. I have always been of show and tell. I've always thought show was far more important than tell. We told you what we were going to do from the beginning. We've materially done that. I'm telling you now that we're going to continue on that path and execute it, and I believe you're going to be pleased. And we come in every day with a focus on creating value for shareholders. I've never been involved in anything that fails and I don't intend to start now. This is a good group, and I think you're going to see continued momentum builds and execution of what we set out to do.

**Operator:** Okay. And your next question is from Thomas Allen with Morgan Stanley.

**Thomas G. Allen**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you. So, the Chicago asset sale was about – at a price about 30% higher than where we had it in our kind of price per key analysis. Any thoughts about getting more aggressive on the disposition front and kind of what are the puts and takes there? Thank you.

**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

Yeah. Let me take that and then my colleagues can join in on that. One of the very first things we did was to sit down and evaluate our portfolio asset by asset and determine an asset lifecycle plan for each of those assets. We've joined the board in that process. We are now expanding on that process. We've committed as a board to hold all of our meetings whenever possible at our hotels so we can better understand the markets, better understand our own hotels and evaluate what we believe is the best path for creating value in those hotels and making a determination when it's best to harvest that value and redeploy that capital in other ways.

So, we have several assets that we're currently considering for disposition. Some dispositions, I think, will manifest in the not-too-distant future and we have plans for, as I said, each asset based on what we believe that specific asset is in its life cycle.

**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

And just to add a little bit to that. I mean, we are always looking across the portfolio. And given the current environment, the spot market values for certain assets and resort assets have been very strong recently. Where a lot of our value is in the larger urban group centric hotels are later in the ramp or later to just start the ramp up coming out of the pandemic. And so, that's where we see a lot of our growth this year, but also a lot of time we will spend on the asset management front, making sure that those assets ramp up properly and make sure that the cash flows get back to or exceed the 2019 levels.

That will be very important to really maximize the values of those assets. This is set to– as Doug said, is to show that trajectory of cash flow as those assets have been trailing the resort assets and have weighed on our portfolio. But now, as we look into our group pace and citywides that those assets are really going to start to shine as we get into the second and third quarter, as we said in the prepared remarks that pace to those assets is in the low-teens, behind where 2019 was. So, you're going to see tremendous growth.

And then, as we have done in the past and as we've done with La Jolla, when we have an opportunity to demonstrate value in the portfolio and to harvest that value, we will look to do that, and then we will look to redeploy those assets in either value-add repositioning opportunities that we find. And then, as Doug said too, we

are at a point where, based on the fourth quarter numbers, we will clear our financial covenants and be able to exit covenant relief, which allows us to also utilize our balance sheet to acquire and repurchase our own equity.

**Operator:** Okay. And your next question is from Bill Crow with Raymond James.

**William A. Crow**

*Analyst, Raymond James & Associates, Inc.*

Q

Good morning. Appreciate the opportunity. I do want to follow-up on the first question that Rich asked, and I guess maybe from a different perspective. And that is, has the process of interviewing CEO candidates changed the way you're thinking about the future of the company? And just clarify it, I think you did maybe already, but if you do officially, formally name a new CEO, I assume any sort of board-driven strategic review would be then off the table. And finally, sorry about the compound question here. But finally, I appreciate the show-and-tell response, and you've been on the board for a long time. So from a relative outperformance perspective, have you been satisfied with the performance of Sunstone shares for that – your tenure period? I guess I'll leave it at that.

**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

So, let me tackle the last one first. We're absolutely unsatisfied with our relative performance for the last five months, but I'm not completely surprised by it. If you believe in the show component, then you have to acknowledge that there is some skepticism. Something hasn't been perfect leading up to that point in time. So, you have to change the trajectory of things and you have to get people to believe in you again. And so, that's what we're doing. We said that we were going to be more active in transacting, we have. We've done everything we can on the asset management front to improve the positioning of our hotels and maximize operations. The facts and indicators that, again, Bryan has shared suggests that that's on track.

To a large degree, it's been influenced by the variants, which everybody knows. But things are looking good for the future. We have not taken our foot off the accelerator. In fact, we're looking for a higher gear to move forward with other capital transactions. But we think it may take a little time for people to let us out of the penalty box. And different people require different degrees of show, so we're going to just keep showing and showing and showing, and eventually we believe that people will catch up to us.

I'm sorry, now I lost the other part of the question.

**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Strategic review.

**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

What's that?

**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Strategic review.

**Douglas M. Pasquale***Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

Strategic review. So the interview process with CEO candidates has mainly reinforced to us that we're precisely on the right track and that we've done a suboptimal job of execution in the past, but we think we are changing that. And so if anything, it's reinforced to us that we're on the right track. When you've come off of some times that are challenging, I mean that's not a good way to consider anything. You never want to be in a position in transacting unless you're in a position of strength. And that's not the position that we're in right now.

We fully expect that we will be at some point in time and the board will fulfill its duties to shareholders. We take that very seriously. It's a good board, as I mentioned before. They know what they're doing and we're fully committed to maximizing shareholder value, whatever that means. But, for now, staying the course, completing the execution, reinforcing everything we've done, demonstrating the show is the best way to position ourselves for any kind of success.

**Bryan Albert Giglia***Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Yeah. And just, Bill, to add to that, putting us in a position to execute and be in a position of strength, when you look at asset sales and you look at where hotels and resorts are trading right now, the resorts are trading at very high levels, at peak levels, and the urban group centric hotels are not at that point yet. And that's a function of cash flow and where they are in the cycle, coming out from the pandemic. And so, the best way that we can maximize the value of our portfolio is focusing and getting these hotels back to where they need to be. We have a great setup this year for that to happen, and we need to make sure that that's where our focus is. And once we have that and once those hotels get back to where they are, it opens up additional opportunities for us to proceed from a position of strength.

**Douglas M. Pasquale***Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

Did we get all your questions, Bill?

**Operator:** Yes. And your next question is from Anthony Powell with Barclays.

**Anthony F. Powell***Analyst, Barclays Capital, Inc.*

Q

Hey. Good morning out there. Just I guess, reading between the lines, it sounds like you guys are less optimistic on acquisitions at this time given the cost of capital and you've talked about buybacks, you talked about reinvesting in the portfolio. Is that a fair assumption? And I guess, when you do get a transaction, it sounds like you're looking more at redevelopment that may take longer to, I guess, actualize in terms of returns and just maybe comment on those questions would be great.

**Douglas M. Pasquale***Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

Well, let me take this, and then, Robert, if you could help out. But I'm not less optimistic at all. I have been to many cities with various members of the management team looking at assets, hotels that they have under scrutiny and study and underwriting. I'm highly confident that among the many things we're looking at, we'll find some good acquisitions and I think we have reason to be optimistic. Our cost of equity is higher than we would like it to be, but we also have a lot of cash and capacity on the balance sheet, we don't have to buy with

equity right now. And the best investment with our cash may be our own stock. So, we're not hurting for opportunities in our view. And I'll just reiterate, I'm optimistic that among the acquisition candidates that I've seen that I think our team is going to do a fine job in helping us get some things across the finish line.

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**Robert C. Springer**

*Executive Vice President & Chief Investment Officer, Sunstone Hotel Investors, Inc.*

A

Yeah. And I don't think, Anthony, there is any preconceived notion that a future acquisition would absolutely be a value-add or a deep turn. But in candor, we do think we do that well. So, that's something that speaks to our strengths and it's absolutely something that we have done in the past and we'll continue to look to do. So as I think about the deals that we've looked at in the last few months and are currently on our radar screen, there is absolutely some of that in the mix as well as some other assets. So no preconceived notion.

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**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Yeah. And Anthony, it's really a balancing of multiple things. The bottom line is that we have a fantastic portfolio with a lot of value in it, and we have a great balance sheet that gives us a lot of optionality. So when we look at allocating our capital, we have great internal investment opportunities. The DC conversion will be a fantastic return. The adult pool we're putting in at Wailea will allow us to further differentiate that hotel and be able to yield the rate to the luxury hotels that surround it. And we continue to look to mine value out of the existing portfolio. And that's a long-time process where there is – you're always in various stages of having the next thing to do. And so, hopefully, over the near term, we'll have a few things that we can move into implementation for next year. We'll continue to look at harvesting gains through our hotel in our existing portfolio and recycling that, as we did with La Jolla and as we'll do with others.

And then when we – we look to deploy those gains, as Robert and Doug said, acquisition opportunities, it's – value-add is something that we have done well in the past. And while you made an excellent point of it does create some near-term disruption and noise where – and we're no strangers to that. We experienced that through Wailea and Boston Park Plaza and Hyatt Regency San Francisco. We all know that the end of that and the finish line yields pretty good results. So, that's something that we will definitely not shy away from. And then, to your point, given where we are as a discount to NAV, share repurchases is absolutely something that is where we can deploy capital. We have the balance sheet to do that. And so, it really will be balancing all of those different capital allocation options. And then it will also depend on what the market has available at that time.

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**Operator:** Okay. And your next question is from David Katz with Jefferies.

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**David Katz**

*Analyst, Jefferies LLC*

Q

Hi. Morning or afternoon, everyone. I...

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**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Hey, David.

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**David Katz**

*Analyst, Jefferies LLC*

Q

Not to sort of overdo it on a couple of these issues. But my question is, have you actually put some bids in on some assets that are out there? Are you thinking more in terms of off market as a better avenue for success? And if we can fast forward ourselves toward the end of the calendar year, would it be fair of us to expect that there'll be a couple of multiple acquisitions on the board and/or maybe some share repurchases that are executed on by that point in time?

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**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

**A**

Yeah, I'll start, David. While we're not going to say right now what the outcomes of the year will be, I think when we look – when we fast forward and we look, we definitely know – what we're seeing right now there are a few things. One is that our portfolio and what has been lagging and weighing on our portfolio over the last year and a half is definitely going to be propelling our portfolio forward. So while resorts have been everything you wanted over the last year and a half, larger group hotels, business transient hotels are definitely going to lead growth going forward. So, we are excited about the way our portfolio is lined up for this next year.

Where we stand now and at a discount to where we are from where the value of the portfolio is and where we are from being able to now exit our covenant or near-term exit our covenant relief is that we have that option open that was not available to us previously. And so, having the balance sheet – the whole point of having a balance sheet with the capacity that we have is to be able to pull these different levers when they make sense. And so, assuming that that makes sense, then that is definitely something that is an option and something that, at the end of the year, you could see that we have done.

Now, things change and values move up and down. And so, there might not be that opportunity. But if there is that opportunity, we definitely have the ability, we have the authorization, we have the capacity we can go ahead and execute on that. And then, I think from the disposition and the acquisition standpoint, I'll let Robert get into more details on that. But that's something that is – if we feel that there is the opportunity to create value for our shareholders that we are going to execute on those. And I'll let Robert talk about where we are in that process. Go ahead.

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**Robert C. Springer**

*Executive Vice President & Chief Investment Officer, Sunstone Hotel Investors, Inc.*

**A**

Yeah. I mean, I think we spoke to already on the disposition side and our last two dispositions, specifically speaking to if there's a disconnect between private and public market values. On the acquisition side, I think you can look back to last year as an indicator. We bought an off-market transaction. We bought a marketed transaction. We are a active participant in the market right now. As Doug said, Doug and I have had the opportunity to travel to several markets together, and we have a full slate of things that we're looking at, some of which are on-market, some of which are off-market. And so, we're busy.

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**Operator:** And your next question is from Chris Woronka with Deutsche Bank.

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**Chris Woronka**

*Analyst, Deutsche Bank Securities, Inc.*

**Q**

Yeah. Hey. Good morning, guys. Bryan, I want to circle back – hey, good morning. You gave out a lot of data points about RevPAR versus 2019. And just want to ask, I think you said you got to 83% in December. You slid back to 55% in January, and I think you said 70-ish for February, March, and greater than 80% after that, 2Q and beyond.

I know you guys have historically liked to kind of under-promise and over-deliver, but I mean, even March, that sounds worse than December, sounds almost really like undoable. It should be, I would think, significantly better than that. So, I don't know if you can add any color, if there is anything we're missing in terms of resort pricing leveling off or going down, or what you're thinking about.

**Bryan Albert Giglia***Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Yeah, I think – and Chris, part of it is the majority of cancellations we saw were in the first – January and February of this year. When it comes to – but the second half of February on, we're seeing good acceleration. December – December was definitely driven by the resort hotels. As we get into March, we start to see more contribution coming from group hotels. And so, looking at Wailea – let's look at Wailea specifically as an example. Our expectation this year is that rate will be down a little bit to what it was, to 2021. And that's what is supposed to happen right now, because what we are doing is – the group customer is coming back. That group ancillary spend is coming back. The group rate is lower – slightly lower than the rate that the transient guest that was filling the hotel last year will be at. But our expectation is that EBITDA will be significantly higher this year than it was last year because of that group component. Oceans Edge is something that we think will be – actually rate will be up slightly to where it was last year and EBITDA will continue to drive as occupancy picks up there.

So, I think it's the natural progression that you see. And as we move into Q2 and Q3, the hotels start to ramp up. I will say that they're – not all markets are going at the same speed. But as we move throughout this year, we start to see pretty good growth throughout the portfolio.

**Operator:** Okay. And your next question is from Chris Darling with Green Street.

**Chris Darling***Analyst, Green Street Advisors, LLC*

Q

Thanks. Good morning. I want to go back to the detail you gave around wage costs, and inflationary pressures in general. To what extent do you think these costs can be passed through by pushing rates higher? And really, I'd be curious to understand how that view might differ across the portfolio.

**Bryan Albert Giglia***Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Good morning. So, the view on wages – and I'll just reiterate what we said is that from 2018 to 2019, wages increased about 6%, 6.5%. As we're in 2021 to 2022, the view is that they'll be about 4% to 5%. The ability to pass that on to guests will depend on the type of hotel, depend on our – and where that hotel is from its occupancy levels and how much we can really push the rate. That's something that will be a focus. And then other offset will be other efficiencies, technology, service levels, those are places where we can offset some of this also. But the good news is up to this point is rate has remained strong, and compared to previous downturns, it's at a much higher place than you would have ever imagined it to be. And so, hopefully, that bodes well for us as we go forward and be able to offset some of this. And in an inflationary environment where we have rents that reset on a nightly basis, we should be able to pass a portion of this on as we move forward.

**Operator:** Okay. And your next question is from Smedes Rose with Citi.

**Michael Jason Bilerman***Analyst, Citigroup Global Markets, Inc.*

Q

Hey. It's Michael Bilerman here with Smedes. Doug, I was wondering if you can maybe just walk us through the actual board decision to stay the course and, effectively, just hire a new CEO and continue. Because I think I've heard a lot on this call, you and Bryan have talked about the big discount to NAV. Obviously, pre-COVID, your NAV was \$16, and you look at where Street numbers are today, you can easily get to \$14, \$15, got a portfolio of 16 hotels, one of which makes up almost 40% of EBITDA. You're at a size where there's a lot of potential buyers in the universe. So, I just want to understand a little bit more, did the board actually engage with advisors, do a market check with the three most liquid potential buyers of the hotels to at least see what type of offer they would put down on the table.

To compare that to the execution, and I recognize you want to drive shareholder value, but comparing that to spending money, and I would assume the new CEO is not going to come cheap when you talk about the skill set, the experience level, and the track record, I imagine those people are going to be expensive. And so, how did the board look at that new capital commitment to the CEO waged against the potential of getting full value today? And what incentives – you've clearly made the decision that you're going to stay the course, how is that CEO going to be compensated so that shareholders – if shareholders don't make money, the CEO doesn't, because the board has made this determination that stay the course is the best avenue. So, just help me understand all of these dynamics and crosscurrents that are going on.

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**Douglas M. Pasquale**

*Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

**A**

Okay. I'll have a crack at that. We as a board and with the management team and I with the management team have done a lot of analysis with the aid of others that have some expertise in terms of asset valuation and other things. We have a good feel for what we believe the value of the company is and the value of our assets are. And based on that view, it is extraordinarily unlikely that a buyer would be willing to pay that price.

Most fundamentally, we are coming out of a 100-year pandemic that devastated the industry. We see multiple factors that's suggesting we are on the precipice of some very significant increases to earnings and cash, and we have other sales that are either in the works or we're contemplating. We have acquisitions. We had our hands tied behind our back. We couldn't buy back stock. We've got this terrific balance sheet, and we just see that it makes no sense at this point in time to not pursue and execute on our strategy. And we've talked to multiple candidates, and that's their view as well.

So, I'm going to modify just slightly what my colleague said here. I think they're doing the right thing by answering questions very thoughtfully, to an earlier question, I will be very surprised and highly disappointed if the number of things that were rattled off, more disposition, some acquisitions, buy back stock, if – the vast majority, if not all, of those things happens. I would not commit to we're going to buy one or three hotels. I have no idea.

But you're going to see us active in the marketplace. You're going to see more sales. You're going to see more harvesting of value. It's highly likely that we'll be in a position that we can buy back stock, if that makes sense. And we're going to build back value. And once we do that, we'll continue to evaluate what all our alternatives are at that time. To even consider extricating yourself from running this company when we have all these opportunities now, to me, would be irresponsible. And that's what the board believes. The company is not for sale. We believe that we have significant opportunities to create value there and that's exactly what we're going to do.

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**Bryan Albert Giglia**

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

**A**

And Michael, to your other question on alignment, we recently had an 8-K that was filed that details that our compensation is moving to a performance share program. And so, we, and assuming future CEO here, will be

highly aligned with shareholders with a – performance share programs are sometimes not always tied to shareholder returns, and there are other ways that the performance is measured. This, I can guarantee you, is a true performance program and that we are absolutely aligned that if management is not performing and providing shareholder returns, then management will suffer with the shareholders.

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**Douglas M. Pasquale***Chairman & Interim Chief Executive Officer, Sunstone Hotel Investors, Inc.*

A

And with respect to the CEO compensation, it's a good point. And again, thank you for the direct questions. We're very well aware that this company has spent a lot of money paying ex-CEOs. We're very thoughtful about how we're approaching this and thinking about this. And while it's too early to say exactly how that's going to play out, I think whatever actions we take, people will look at it and make the determination that we were very thoughtful about how we dealt with it and that we were as shareholder-friendly as we could possibly be.

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**Operator:** Thank you. And your next question is Michael Bellisario with Baird.

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**Michael J. Bellisario***Analyst, Robert W. Baird & Co., Inc.*

Q

Thanks. Good morning. Just want to go back to the Chicago transaction. You obviously sold one there and then there's reports that you're looking to sell the other two hotels in the market. I guess, my question is, why jump ship on Chicago today when that's a market that has plenty of room to recover, and especially given your optimism about urban markets and business travel recovering at some point this year? I just would like your thoughts on the rationale to exit the market?

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**Bryan Albert Giglia***Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

Hey, Mike. I'll start and then Robert can add to that. The view on Chicago is – and if you look at – you can go through our supplementals and you can look at the yield on our investment over an extended time period is Chicago has been a market where either through supply, other factors, real estate taxes, others, it's been a market where we really haven't been able to make a lot on those hotels or have much growth in there. And so while we are looking forward to invest in assets in markets where we can get strong growth, Chicago has been a market that's been tough for us. We feel that the pricing that we're getting today on the – that we got on the Hyatt was good pricing and it allows us to take those proceeds and do something more productive with them. And so, that's how we're looking at that market.

And Robert, do you have...

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**Robert C. Springer***Executive Vice President & Chief Investment Officer, Sunstone Hotel Investors, Inc.*

A

Yeah, I mean – and it speaks to Doug's comment from earlier on as we look at the entire portfolio and the lifecycle of the particular asset, if you look back at our timeline on the Hyatt and you do the count from – the year count from when we did the transformational renovation from Wyndham to the Hyatt Centric, we are coming up – or we were coming up right on a cyclical renovation in that hotel.

So, it was more than just holding the hotel for market recovery, which is a valid point. Bryan hit the point on – unfortunately, in Chicago, in a somewhat perverse way, you have a partner in the city with how aggressive property taxes have gotten in that city on the bottom line. Obviously, in this particular hotel, it was building lease.

So, you also have that factor, and you couple those two with the fact that you had a meaningful capital investment that was needed.

So when we looked at the totality of having those dollars deployed in Chicago and waiting for that market recovery, to the point of your question, it was more than that, right, because we would need to effectively double down, put more capital to work in the city. And so when we balanced those dollars, and speaking back to Doug's point on the life cycle of all of our investments, we made the decision that said, okay, it's better for us to take those money out of a market like Chicago and deploy it in a market where we're going to see faster growth and better ultimate recovery in fundamentals.

**Operator:** All right. And the last question is from Floris van Dijkum with Compass Point.

### Floris van Dijkum

*Analyst, Compass Point Research & Trading LLC*

Q

Thanks for taking my question, guys. I've heard you guys talk a little bit about you're trading at a discount to NAV. But every hotel company in the country trades at a discount to NAV at the moment. If I look at your consensus NAV, your discount is actually not as large. And maybe if you could comment on why you think your NAV is higher than where the market thinks your NAV should be, and also maybe on how aggressive, potentially when you emerge from the covenant waiver period, will you be to buy back – to potentially buy back stock and how would you weigh that with paying a more normalized dividend?

### Bryan Albert Giglia

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

A

I'll start with this. Morning, Floris. First, we are not specifically commenting on our NAV and where it is relative to the consensus. What we are saying is that repurchasing shares is a capital allocation tool that we have that when we decide how to allocate our capital, it is one of the different avenues that we have to invest in. And so when we look at discounts to NAV and whether that makes a good risk-adjusted return investment for us, we look at it multiple ways. We look at it – we know NAV is very difficult to – we're not good enough to come up with an exact number, so we recognize it's a range.

And then, we look at values of where are we on a – based on that price of where we're purchasing it, where is it on a cap rate to peak earnings, to trough earning, to multiple different ways to get comfortable with the discount that we're buying it at is a good return for our investors. And so, that's the way we will look at it. Again, it doesn't necessarily matter where we are, where consensus is. I think consensus is somewhere in the \$14 to \$15 range right now. And so, when we look at that discount on a risk-adjusted return, is that the best use of our capital to invest in.

**Operator:** All right. Thank you. That's the end of the Q&A session. We'll now turn it over to Bryan Giglia with closing remarks.

### Bryan Albert Giglia

*Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.*

We want to thank everyone for joining us on the call today, and we look forward to speaking with the majority of you over the upcoming conferences we have over the next few weeks. Thank you.

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