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Sunstone Hotel Investors, Inc. (SHO)

Q1 2022 Earnings Call

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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 First Quarter 2022 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 would like to remind everyone that this conference is being recorded today, May 5, 2022, at 12:00 PM Eastern.

I will now turn the presentation over to Mr. Aaron Reyes, Chief Financial Officer. Please go ahead, sir.

Aaron Reyes

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

Thank you, operator, and good morning, everyone. By now, you should have all received a copy of our first 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 EBITDA, adjusted FFO, and property-level adjusted EBITDA. 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, Executive Chairman; Bryan Giglia, Chief Executive Officer; Robert Springer, President and Chief Investment Officer; and Chris Ostapovich, Chief Operating Officer.

On today's call, Doug will start us off with some commentary on the industry and our company. Bryan will then discuss the current operating environment and recent trends in our business and provide information on our pending value-add acquisition of The Confidante Miami Beach that we announced yesterday afternoon. Finally, I'll provide a summary of our current liquidity position and a recap of our first quarter earnings results. After our remarks, the team will be available to answer your questions.

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

Douglas M. Pasquale

Executive Chairman, Sunstone Hotel Investors, Inc.

Thank you, Aaron. Hello, everyone, and thank you for joining our call. The first quarter marked a notable period of transition for our industry and our company. We are very pleased with the strong acceleration in lodging demand that started in mid-February and continues today. This quarter marks the most significant inflection since the onset of the pandemic. In particular, the return of business travel and corporate group events is encouraging given the composition of our portfolio. We expect that Sunstone will see outsized growth this year as demand strengthens and expands beyond leisure travel.

In addition to the positive improvements and industry fundamentals, we also implemented important leadership changes at Sunstone. As you know, in early March, the board of directors announced the appointments of Bryan as CEO, Robert as President and Aaron as CFO. These talented executives, complemented by an excellent team, will lead Sunstone in what I expect will be an extended period of significant value creation for our shareholders.

I am very pleased with the progress we have made with acquisitions, asset sales, and stock repurchases over the last several months. And I believe that our pending acquisition of The Confidante Miami Beach, as well as several other transactions we are currently evaluating will further position Sunstone for additional meaningful growth and value creation. I'm excited to facilitate the transition, which is going extremely well. The entire Sunstone team, the board of directors and I are all very excited and invigorated by the many opportunities that lie ahead.

And with that, I'll turn the call over to Bryan.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Thank you, Doug, and good morning, everyone. I'll start with a quick review of first quarter operations and then provide some commentary on the current trends we are seeing that point to continued growth for the remainder of 2022. Finally, I will highlight our pending acquisition of The Confidante Miami Beach and its transformation to the Andaz Miami Beach, a premier luxury lifestyle resort.

Despite getting off to a slow start in January and early February due to the lingering impacts of the Omicron variant, demand across our portfolio accelerated meaningfully in the back half of the quarter and contributed to

results that exceeded our initial expectations. While our resort properties continue to benefit from sustained high demand and a degree of price insensitivity, we are more encouraged by the resurgence we are seeing at our group-oriented and urban hotels as corporate and event travel is rebounding.

Portfolio occupancy increased from only 38% in January to nearly 68% in March, as hotel demand grew more widespread and diversified away from leisure. On the pricing side, our operators have remained disciplined in their revenue management approach and have maintained strong rates with the majority of our hotels at or above 2019 levels in the first quarter.

Our comparable portfolio achieved a first quarter average daily rate of \$280, a 9.8% increase as compared to 2019. This is the highest quarterly ADR ever achieved for these hotels, driven in part by meaningful growth at our resorts in Wailea in Key West. Our two recently acquired wine country assets generated a combined first quarter ADR of \$1,100, which is ahead of our underwriting and particularly impressive considering it is the seasonally lowest demand quarter for this market.

These hotels are positioned to generate significant ADR and EBITDA growth as they move into their high season in the second and third quarters and initial results are impressive with the Four Seasons Napa running an average rate of nearly \$1,900 in April. In total, our 14 hotel portfolio generated a first quarter RevPAR of \$160, made up of \$301 average daily rate at a 53% occupancy.

Non-room revenue continued to be a bright spot during the first quarter. We once again saw significant sequential growth in food and beverage revenue, which increased 16% from the fourth quarter of 2021. While our first 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 the group activity at our hotels.

Banquet and AV sales per group room was \$180 in Q1 and was approaching levels achieved prior to the pandemic. We also saw meaningful increases in destination and facility fee revenue as these programs have now been rolled out to most of our hotels. Including the out-of-room spend, our total portfolio generated an additional \$92 of revenue per available room in the quarter for a total RevPAR or TRevPAR of approximately \$252.

Turning to costs. While we have been successful in reducing certain operating expenses, including the reduction of \$14 million to \$15 million in annual permanent cost savings, our operators have not been immune from the labor cost pressures that have been impacting our industry. While changes in hotel staffing composition over the last two years make precise comparisons challenging, our data would suggest that from 2019 to 2021, average hourly wage rates have increased at an annual rate of approximately 5%.

Looking ahead, we anticipate that the growth in wage rates will moderate somewhat in 2022 and should be in the range of 4% to 5%. We recognize there's a need to balance guest 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 where possible.

We are also looking for additional areas where we can reduce costs through energy efficiency and waste reduction. The first phase of our solar farm is in place at the Wailea Beach Resort, and since installation, it has provided roughly 16% of the hotel's monthly electricity and has saved over \$260,000 in utility costs. We are evaluating other sustainability initiatives as projects like these are not only good for the environment, but they are also good for our returns.

Despite some cost pressures, our comparable hotels generated a hotel EBITDA margin of 25% during the quarter. While this remains shy of the low-30% range we have historically maintained in the first quarter, we are again very pleased with our operators' ability to deliver this level of profitability with a portfolio-wide occupancy in the low-50% range.

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.

Now shifting to segmentation, our comparable portfolio generated 123,000 total group room nights in the quarter, and the group segment comprised roughly 36% of our total demand. This group room night volume represents a 33% increase from the prior quarter, with average rates that were 7% higher than the same quarter in 2019.

Room production for all current and future periods in Q1 was up 152,000 room nights and was consistent with 2019 first quarter production. In terms of transient business, which accounted for roughly 55% of our total room nights in the quarter, comparable transient rate came in at \$314 and was 14% higher than the pre-pandemic levels that we saw in the same quarter of 2019.

The lingering impact of the Omicron variant in January and February led to lower levels of special corporate demand in the quarter, but we are seeing recent positive signs that should lead to acceleration into the remaining quarters of 2022 as companies increasingly return to the office and business travel becomes more widespread.

As I mentioned earlier, leisure demand continues to be very robust and we again saw tremendous strength in average rates at our oceanfront resort properties with both rate and RevPAR meaningfully higher than pre-pandemic levels.

Based on the strength of demand in March, which accelerated into April, we are more encouraged about the outlook for 2022. Our preliminary April results reflect comparable portfolio occupancy of 76% at an average rate of nearly \$300. This equates to a RevPAR for the month of \$225, down just 3% from 2019. When we add in the two recent wine country acquisitions, our total portfolio ADR and RevPAR increased to \$320 and \$241, respectively.

These are meaningfully improved results from where we were at the start of the year. We expect that continued healthy leisure demand during the spring and summer vacation seasons, increasing amounts of business travel, strong citywide calendars and the return of corporate group functions will support sustained growth as the year progresses.

Our recent booking trends are indicative of this as our group room nights for the second quarter through the fourth quarter of 2022 are pacing at approximately 80% of pre-pandemic levels at an average rate that is 4% higher than 2019.

This would imply that our overall group revenue pace for this time period is only down 18% from the same time in 2019. There's clear pent-up demand for corporate group events and we are seeing increased short-term booking activity.

At Boston Park Plaza, we hosted a 500 room night corporate event last week that booked only three weeks in advance. And in Orlando, we signed a large corporate training event booking just a few weeks out. In San Francisco, which has been one of the most challenged markets, lead volume in April was back to pre-pandemic levels. And in the year, for the year bookings were 13% higher than in 2019.

Our portfolio's forward transient booking patterns are improving and are nearing pre-pandemic levels. While the strength of recovery will not be uniform across all markets, we are seeing positive trends at each of our hotels.

Based on what we see today, we expect our comparable portfolio's year-over-year percent growth in average daily rate for 2022 could be in the mid to high-single digits with group and urban hotels growing more than leisure hotels. We anticipate that the demand levels for the comparable portfolio will rebound sharply starting with the second quarter, and that occupancy levels for the balance of the year could be down only 10% to 15% as compared to 2019.

Moving to our transaction activity. We were quite active in the first quarter with the sale of three lower growth hotels in a challenged market for combined gross proceeds of \$197 million. We redeployed \$48 million of these proceeds into the accretive repurchase of our own shares at an average price of \$11.16 per share, a meaningful discount to published estimates of NAV and that it implied 10.5 times multiple on our 2019 pro forma EBITDA.

In addition, as you saw in our release yesterday, we recycled the remaining proceeds into the purchase of The Confidante Miami Beach in an off-market transaction. We are excited about this value-add opportunity, which draws upon our significant in-house expertise and proven track record of creating value through successful renovations and repositioning.

As noted in our release, we are under contract to acquire the 339 room resort, which sits on 1.5 acres of well-located, fees simple, oceanfront real estate for a purchase price of \$232 million or \$684,000 per key. We also expect to invest approximately \$60 million to complete a full renovation of the hotel and reposition it as a premier beachfront resort under Hyatt's luxury lifestyle brand, Andaz. The renovation work is expected to begin in phases starting in the fourth quarter of this year with the completion currently expected to occur in the first half of 2024 when the resort will debut as the Andaz Miami Beach.

Post repositioning, we expect the hotel to generate a very attractive 8% to 9% yield on our total investment and we will own a fully-renovated, oceanfront luxury resort at an all-in basis of approximately \$900,000 per key in a market where per key valuations for similar assets are well in excess of \$1 million. The addition of this hotel will bring better balance to our portfolio composition, more prudently utilize our balance sheet capacity, and enhance our long-term growth profile upon completion of the repositioning.

This is a playbook we know well, and we have had great success in the past, and our team is eager to get to work when the deal closes next month. The hotel will remain in operation while the renovation work is completed, and we expect that continued growth across the remainder of our portfolio will offset any displacement in 2023 with the Andaz Miami Beach then contributing to outsized earnings growth starting in 2024.

To sum things up, as we move into the second quarter of 2022, we are encouraged by the recent trends we are seeing across our portfolio in March and April. We believe we have reached a significant inflection point in our business and barring any additional unforeseen circumstances, we are excited about the portfolio's growth trajectory going forward.

We expect that our well-located urban and group-oriented assets will see outsized growth in the coming quarters as pent-up demand for business travel and corporate events begins 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 continue to grow the company and to create value for our shareholders.

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

Aaron Reyes

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

As of the end of the first quarter, we had approximately \$254 million of total cash and cash equivalents, including \$39 million of restricted cash. We ended the quarter with \$576 million of total consolidated debt at a weighted average interest rate of 3.6%. We anticipate funding the purchase of The Confidante Miami Beach through a combination of existing cash and from proceeds received from our currently undrawn revolving credit facility. After adjusting for the purchase of the hotel, our pro forma leverage remains below the average of our peers and we retained incremental debt funded acquisition capacity that we can use to grow per share earnings and NAV in the coming quarters.

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 initial expectations, reflect lingering impacts from the Omicron variant in the initial weeks of the year, followed by significant demand acceleration in the back half of the quarter.

Adjusted EBITDA for the first quarter was \$27 million and adjusted FFO was \$0.08 per diluted share. As we indicated in our press release yesterday, beginning with the first quarter of 2022, we are modifying our presentation of adjusted FFO to exclude the non-cash depreciation expense associated with our deferred stock compensation. This change is intended to more closely align our reporting with that of most of our peers and resulted in a \$0.02 per share impact on our first quarter results. While we currently expect that the remaining quarters of the year will be more profitable than the first quarter, the changing operating environment remains too uncertain to provide guidance at this time.

Now turning to dividends, our board has approved the routine distribution for our Series G, H and I preferred securities.

And with that, we can now open the call to questions. 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] Our first question comes from Thomas Allen with Morgan Stanley. Your line is open.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. So I'll limit myself to one question. It may have a couple of parts. So, focusing on the Confidante. First, are you going to continue operating the property during the renovation and any thoughts on like with the performance during the renovation? And second, I remember when Hyatt bought it in 2016, there was a lot of optimism around the property. So, can you kind of just talk about what the opportunity is now? Thank you.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

A

Good morning, Thomas. So when we look at The Confidante, to first start, let's just look at the opportunity that we have in front of us. The Confidante has performed well, but we believe, based on its mid-beach location, proximity to other luxury assets, the footprint of the asset itself, which leads to a pretty exceptional pool area and pool experience that can be created, we believe that the way it is viewed by customers now and its ability to reach the luxury or go up into the luxury customer is somewhat limited. And it needs to have capital and branding to it to be able to do that.

And so when we look at – when you look at the Hyatt system and we have some experience with this from our neighbor in Wailea, we know that a really well done Andaz in a very strong market can do very, very well and attract that luxury customer. And so the opportunity we see here is by investing the capital into an asset where our – on our purchase price, the going in yield is a 5% yield on what the 2022 cash flow will be, which we think is pretty attractive for this market. But we have the ability to invest the capital, make it a true luxury product with a luxury pool experience that can rival other luxury hotels in the market.

And then similar to the game plan that we had in Wailea is we just need to then draft below that luxury – the luxury set and the luxury pricing. And if you look at The Confidante, it's expected to run roughly, call it, a \$280-ish rate this year. The luxury set will be somewhere in the \$800-plus range. Back in 2019, that luxury set ran high \$500- \$600 rate. So the business plan here isn't to achieve that, it is to achieve, call it, 60-ish-percent of that. So we're looking at – if we can get this to a somewhere in the \$500 rate - at stabilization, call it, 2025 – 2024 into 2025, then we have a very successful investment here.

The other thing, when you look at it and you look at our initial investment, you look at the capital, and then you look at \$900,000 a key all-in luxury, beachfront, mid beach, which has some of the higher rated luxury hotels in it with the Faena with the Edition, I believe there's another high-end luxury hotel that's under development or in the process of getting development there. It is in a strong area. And being \$900,000 a key all-in, we think it is a incredible long-term investment for us.

When we look at the cash flow cadence over the next couple years, one, yes, we will operate the hotel. Some of the work will start in the fourth quarter of this year. We don't believe it will be that disruptive of work. And the real disruptive work probably won't start until towards the end of the first quarter next year, which will allow for the high cash flow season in the first quarter to be able to get that.

The hotel should generate – assuming that we close in about a month, would generate \$3 million to \$4 million of EBITDA this year. And then as we look into next year with a displacement, it's probably down a couple million dollars depending on the ultimate timing and what the first quarter next year looks like and our ability to mitigate. I think when we first looked at Wailea, we had a much larger expectation of loss during that time period than what actually came to fruition.

But we want to be conservative on how we look at that and then it will start ramping up in 2024 and then reaching stabilization, 2025, 2026. We think – stabilization, we're looking at an 8% to 9% cash on cash yield, which again looking at this opportunity, based on a lot of things that we've seen recently, I don't think the team has been more excited about an opportunity than what we have in front of us.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Thank you.

Q

Operator: Your next question comes from the line of David Katz with Jefferies. Your line is open.

David Katz

Analyst, Jefferies LLC

Hi. Good morning, everyone, or afternoon, I should say, or morning where you are. Just looking at the balance sheet and thinking about kind of the magnitude of the opportunity, how do you think about updated leverage tolerance or a target leverage range for where you'd like to be? And should we look at that as another turn or so and therefore, few hundred million dollars or we take on a little bit of leverage with things that we buy? Like where would you like to wind up as we roll out longer term?

Q

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Good morning, David. So on the leverage front, as we've said in the past, we view leverage as a continuum throughout a cycle. And we want that to be as high as 4 or 5 times at the beginning, in early stages of the cycle and then moderating to somewhere in the 3 range as we get later in the cycle. Looking at The Confidante, looking where the leverage is now, including preferreds, that would put us at assuming a stabilized number or ramping number for Confidante, still well below 3 times now.

A

And so we have – definitely have additional capacity and it really depends on the opportunities we have in front of us whether that's one turn, two turns, but there is significant capacity left in the balance sheet. And when we look at our portfolio and we look at the balance sheet, we have a lot of optionality. And as you've seen recently, we've been able to capitalize on that, take advantage of our stock when it gets to a point where we believe it's a compelling investment relative to NAV, and then also having the ability to go out and do acquisitions like The Confidante where is there a little short-term noise in getting to the final product? Yes, we do believe that our portfolio does afford us the ability to do that now as our group hotels will continue to ramp up this year and next year, which will help cover that displacement.

The Napa hotel and then Sonoma hotel will also continue to ramp up, so that's additional growth next year and then The Confidante will then layer in growth in 2024 and beyond. And then we also have flexibility to invest in our own portfolio. As we are repositioning and rebranding the Westin – the Renaissance DC to Westin DC, and doing other investments throughout the portfolio, the adult pool complex in Wailea and having the flexibility to invest in all areas and be nimble and be able to go out and use that balance sheet to grow the company, to grow our earnings, to grow our value per share. So the answer – I guess, kind of long-

winded answer to your question is, yes, we have definite capacity left. And we will – I think the expectation is we will continue to take a balanced approach at deploying it.

Operator: Your next question comes from Michael Bellisario with Baird. Your line is open.

Michael J. Bellisario

Analyst, Robert W. Baird & Co., Inc.

Thanks. Good morning, everyone.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Good morning.

Aaron Reyes

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

Good morning.

Michael J. Bellisario

Analyst, Robert W. Baird & Co., Inc.

Bryan, just sort of want to go back to Miami but compare it to the deals you did last year in wine country. You underwrote those to 6% to 7% NOI yield, this Miami deal is 8% to 9%, so just kind of two-parter. How much of the differential is that fundamentals are better today than what you underwrote to call it a year ago? And then how much extra return are you embedding in your underwriting for the renovation risk that you're taking in Miami versus the simple ramp-up risk in wine country?

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Okay. I don't think that there's much different of an outlook. The leisure markets continue to do well. Miami continues to do well. The hotel – The Confidante in its current state is doing better this year and gaining some more share this year, but I don't think that that changed the way either we looked at the wine country assets or this asset. I think that our expectation over the coming years is relatively unchanged, part of it was there was expectation that things were going to continue to grow and continue to pick up.

As far as what is the right additional return on a risk adjusted basis necessary to compensate for the investment risk? That's a harder one to pinpoint. It could be 50 basis points or 100 basis points. It could even be wider than that if there's additional risk. When we look at The Confidante and we look at the positioning and we look at what we can do with the physical attributes and take advantage of that location. While there's always risk in these repositioning, I believe that we think that there is that this is as good of a bet you can make on this sort of transformation as you can. Because like we saw in Wailea, the customer is there, paying well in excess of what we need to do or what we need to achieve. And all we need to do then is work with Hyatt to make sure that the product level and the service level and the experience is what that customer wants.

And again, with the analogy in Wailea, it was the worst house on the best block. There are – we really like this location in Miami, and we believe that we can fix this house and really get the returns that we're looking for.

Operator: Our next question comes from Anthony Powell with Barclays. Your line is open.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Hi, good morning. There's been a lot of talk, I guess, this earnings season about leisure pricing and the sustainability of it. I'm just curious what you're seeing for upcoming holidays at your resorts and what's your view on the ability to at least hold current rates for the rest of the year?

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Good morning, Anthony. On the leisure front across all markets, we've seen incredible pricing increases. When we look at the specific holidays and different high demand leisure times, spring break was very strong across the board. Spring break was strong in the leisure market. Spring break was strong in the urban markets. There was a lot of leisure demand in Boston over spring break and marathon. And so, the view there is that will continue, but it is going to moderate and the rate of growth will definitely moderate and slow down. In Wailea, part of that is the mix shift, part of that is the group customer coming in that's at a slightly lower rate than the leisure customer, but they bring a tremendous amount of out-of-room spend that while the rate may flatten or even decline a little bit in certain instances, the EBITDA generation from that will increase significantly.

And so, when we look at our different leisure markets, part of it is the market itself and then part of it is what we have been able to do in that market. And when you look at a Wailea, Wailea is a market that has matured as a high-end leisure market over the last decade, the amount of flights coming into that market are greater than where we were in 2019. Remember part of that market is 89% Canadian travelers that just started coming back recently.

And so we – as we mix in the group customer and there we should be able to compress. Oceans Edge is partly the market which has – again has more airlift and has done very well during the last couple of years. But then also, our strategy at the hotel of taking the offerings, taking the experience and not just playing the occupancy gain, but lowering occupancy, pushing rate and competing with the other higher end resorts in Key West.

And so part of that, again, is the market. And then part is our business plan for that hotel. The wine country assets are extremely unique and will be highly sought after. We see rates continue to drive, be able to drive rates in those markets and those luxury assets build occupancy slower. So rate is where we need it to be now as they build the occupancy, bring in the right group customers and then yield those assets to the profitability that we need.

And then The Confidante is also a great example of a market that has really run. And again, we are targeting the ADRs and what we need to achieve our underwriting there is something that is a pricing that was achieved in 2019 and pricing that is well below where hotels are pricing today, roughly 60% below.

So I think that that is as we look at our different leisure markets and then the other important thing is that, through these acquisitions we have, we do have a more balanced portfolio. And so while leisure may taper off, our business transient and our group business will continue to grow throughout this year. Remember the Omicron impact in January and February, and so first quarter next year will be a relatively soft comp for those hotels. And so there's still a lot of growth in those hotels over the next 18 months that will help carry the portfolio.

Operator: Our next question comes from Chris Darling with Green Street. Your line is open.

Chris Darling

Analyst, Green Street Advisors, LLC

Q

Thanks. Good morning. I'm hoping you could give an update on the timing of the Renaissance DC rebrand to the Westin? I think you previously had said that might be complete this year, but it looks like it's a 2023 event now. And then given you have a couple other Renaissances, just any thoughts around maybe similar conversion opportunities down the line?

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

A

Good morning, Chris. Actually, I guess actually is morning to you, so good morning. On DC, DC was always going to be completed in 2023. The meeting space was done, just finished up, but was being done last year and into this year. The guestrooms are starting and the lobby is starting and those will be phased. So part of it, the meeting space is done. But that was always the expected cadence. Once we have guestrooms coming back online, we can then – since the meeting space will be done and guestrooms will be done, we can start bringing some group customers in there, starting next year. But the ramp will start next year and – or at the end of this year and into next year.

We are booking group business. That is at a rate that's roughly 10% above where we were booking at – as a Renaissance. So we're already starting to see some of the positive impact. And then remember when you look at the Westin brand from a business transient and leisure standpoint, that we – not only do we expect the higher group rates, but we also expect significant occupancy and rate power once we switch over to Westin and that customer that used to or the Westin customer will pay more than that Renaissance customer.

As far as the rest of our portfolio, this is part of our job is to go in and find ways to improve our real estate, whether that's through investing in the physical asset or looking at the brand affiliation and seeing if there's a better choice for that hotel. Sometimes there might be a better choice, it just might not be available. And so that's where we work with our brand partners, not dissimilar from acquiring The Confidante from Hyatt, where we sat with them and went back and forth and determined that the Andaz was the right brand for this asset. We do the same thing with our other partners, and that's on new assets and existing assets throughout the portfolio. So it's not just limited to Renaissance. It's really at all of our hotels at all times where we're trying to determine whether or not there's something else we can do.

Operator: Our next question comes from Bill Crow with Raymond James. Your line is open.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Hey, good morning. Thanks, Bryan.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

A

Good morning, Bill.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Good morning. This whole idea of kind of peak resort ADR was a big topic, I recall earlier today. Miami has been poster child of COVID success, right? It kind of stood alone as the market benefited the most. But now that other

markets are opening up in the US and globally. And I'm just curious, what do you think the odds are the ADR in Miami in that market, might be 20% lower in two years. I guess maybe a return to kind of 2018 sort of levels. And maybe if you could just tell us what the acquisition multiple and cap rate was if you use 2018 EBITDA instead of 2022 projected EBITDA.

Robert C. Springer

President & Chief Investment Officer, Sunstone Hotel Investors, Inc.

A

Yeah. Hey, Bill, it's Robert. On – this asset has gone through a number of changes of both ownership, branding and positioning over the years, so it's 2022 earnings multiple that we talked about is better than it was performing in 2018 and 2019 in that regard as it was going through a brand conversion at that time.

Backing to your question on do we see a possibility of a 20% decline in rate? Our view is, generally speaking, there has been a re-pricing of leisure and a re-pricing of luxury. We think the general consumer is putting a higher value on their leisure dollar than they did pre-COVID. COVID caused people to put a lot of things in perspective, and I think they're – generally speaking, they find and want to treasure those leisure experiences more because quite candidly, they were taken away from them.

That said, we would be naïve to not accept the fact that there are certain markets that have run very well. And is there a possibility there could be some downward pressure on rate? Yes, there is a possibility. We would not – we do not believe that it would be due to the magnitude of – that you said. And we think that we've underwritten appropriately when we look at The Confidante today where we think we can go with it, working with our partner in Hyatt. We think we've got plenty of room to run, even if there is some downward pressure on the high end of the market. But we definitely don't think it's to the magnitude that you indicated.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

A

And Bill, as Robert said, there is a lot of room between this hotel and the potential. I mean keep in mind that this hotel and while it's a good rate, it's run \$280 rate this year, still is on the beach in Miami. There might be secondary or tertiary markets that have outperformed or leisure markets that have outperformed just because the pent-up demand and the lack of other options. We feel that those markets will probably feel it a little bit more than your top destination areas.

And so Miami Beach, Napa, Wailea, Key West, those are markets that, will they hit a bump in the road eventually? Absolutely. We all know this industry and that always happens. But even at a 20% decline, you're talking about a \$600, \$700 rate in this market for the luxury set. Again, we need to get significantly lower than that. So there is always risk in all these investments. But we feel that there is a lot of room for this hotel to accrete up.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Yeah. Okay. If I could just follow up, I know we're trying to do one question, but – maybe, Robert, you can tell me what the supply picture looks like in Miami just over the next two years so that you can kind of think about where are you going to be reopening this hotel into?

Robert C. Springer

President & Chief Investment Officer, Sunstone Hotel Investors, Inc.

A

Yeah, there's absolutely projects in the market that are on the way, that are on the radar screen in various stages. There's actually a number of projects between South Beach and up that are a variation on what we're trying to do with The Confidante, take an older hotel and reposition it. So the Raleigh is a good example, that's a project that never reopened from Hurricane Irma back in 2017 and is being repositioned into a Rosewood and a few others. So, absolutely some new supply that we're cognizant of, but feel good that the market is in a position to absorb the new projects that are planning.

Operator: Our next question comes from Smedes Rose with Citi. Your line is open.

Michael Jason Bilerman

Analyst, Citigroup Global Markets, Inc.

Q

Hey, it's Michael Bilerman here for Smedes. Doug, I was just wondering if you could maybe just spend some time now that the CEO process is done, just taking us inside a little bit through the whole process in terms of, I can remember when the board terminated, John, one of the big things that you talked about was having someone with a CEO experience that I think you've said at one point on one of our calls that you didn't – you don't want to babysit a new CEO.

And Bryan, nothing against you at all, but just with that background, maybe Doug help us understand the decision to go with Bryan promote the CFO, which is effectively what the company did with Ken and with John and now with Bryan before. Just help us tie all that together and then tie to strategic alternatives and just in making a decision to stay internal versus getting someone from the outside which appeared to be what you originally wanted to do.

Douglas M. Pasquale

Executive Chairman, Sunstone Hotel Investors, Inc.

A

Okay. Good question. Let me try and address that as directly as I can. I think what I really said, Michael, was that we were looking for more transactional-related experience, more so than prior CEO experience, although frankly that would not have been a negative attribute. So the search committee took about six months to go through things and they spoke with an extensive list of candidates, primarily external candidates obviously. Some of which are names that would be very well-recognized in the industry and you would be familiar with that had prior CEO experience.

And as we had the chance to – I specifically had the chance to be inside of Sunstone, I came to the determination that what the team offered was really very substantial experience for the kinds of things that we were looking for. Specifically, our willingness to recycle assets to not at a time when we thought the future of that asset was not as bright, even if it was a terrific asset as a new investment that we could better deploy capital and create value, that we had a tremendous amount of transaction-related experience between Bryan and Robert and strong teams that both of them had built around them.

And that frankly, that the determination we made was in our best choice. And we think by a substantial margin, it was the best choice. And I don't think we could have canvassed the available candidates better than we did. We used a large national search firm. There were two, three dozen external candidates, again, people with experience. And we just believe that the experience level and attributes that available to us was right here in front of us and that there was significant transaction experience. And that if we really just charged ahead with the strategy which we have never wavered on, it would be the right choice. And so that's what we did.

Operator: Our next question comes from Floris van Dijkum with Compass Point. Your line is open.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

Q

Thanks guys for taking my question. Maybe, if you could just walk us through the typical group exposure that you have in your resort assets. And how does that compare to your urban hotels and where the – one of the things you've highlighted in the past is there significant you've under earned on the group side and that's bouncing back. So maybe talk about it – walk us through that and the upside that you see in your existing portfolio and compare maybe the resorts versus your urban hotels, please.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

A

Okay. Hey, Floris, so the overall balance of the portfolio is about 25% this is transient, about 31% leisure, about 38% group and the rest of that is contract. When you look at the resorts, the resorts are probably around 80-20, leisure to group, but some of – that group also, it also has a leisure component in there. They're at that leisure location because they tend to be higher end groups and that's where they want to be.

When you look at the bulk of our larger group boxes, the San Franciscos, the San Diegos, Orlando, Boston, those are where we see the biggest growth over the coming quarters because, remember, while our resorts are running in the mid-70s, up to 80s over the next last quarter and next quarter, our urban hotels and then the large group hotels in Q1 ran around 50% occupancy. And that's going to grow to 70s and then higher as we get into later quarters. So, that's really where the most growth comes. Wailea will have – will be able to bring in group customers, and we're seeing these group customers come in now and then that allows us to then also have a base of business that can compress the leisure guests there.

Operator: We have run out of time on today's call for Q&A. I'll turn the call back over to Bryan Giglia for closing remarks.

Bryan Albert Giglia

Chief Executive Officer, Sunstone Hotel Investors, Inc.

Thank you, everyone, for joining us today. We appreciate the interest in the company and look forward to meeting with you at upcoming meetings and conferences over the coming months. Thank you.

Operator: This concludes today's conference call. You may now disconnect.

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