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Sunstone Hotel Investors, Inc. (SHO)

Q1 2024 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 2024 Earnings Call. At this time, all participants are in 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 6, 2024, at 12:00 PM Eastern Time.

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

Aaron R. Reyes

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

Thank you, operator. 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 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 the commentary on this call will contain non-GAAP financial information, including adjusted EBITDAre, adjusted FFO, and property-level adjusted EBITDAre. We are providing this information as a supplement to information prepared in accordance with generally accepted accounting principles. Additional details on our quarterly results have been provided in our earnings release and supplemental, which are available in the Investor Relations section of our website.

With us on the call today are Bryan Giglia, Chief Executive Officer; Robert Springer, President and Chief Investment Officer; and Chris Ostapovicz, Chief Operating Officer. Bryan will start us off with some highlights from our first quarter, including commentary on operations and recent trends. Afterwards, Robert will discuss our capital investment activity. And finally, I will provide a summary of our first quarter earnings results and share the details of our updated outlook for 2024. After our remarks, the team will be available to answer your questions.

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

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Thank you, Aaron, and good morning, everyone. We knew coming into the year that Q1 was going to be the industry's most difficult year-over-year comparison. Despite this, our portfolio performed in line with expectations driven by solid out-of-room spend and strong cost controls, both at our hotels and at the corporate level. As the year progresses, we expect the quarterly comparisons to become more favorable and combined with our strong group pace for the remainder of the year, the first quarter headwinds should shift into a tailwind, especially the second half of the year.

During the quarter, we executed our strategy of recycling capital and announced the acquisition of the 630-room Hyatt Regency San Antonio Riverwalk, redeploying a portion of the proceeds from the sale of Boston Park Plaza into a more productive investment that will provide superior near-term growth without the disruption or capital costs we would have incurred with continued ownership of Park Plaza.

The Hyatt Regency is one of the best located hotels in the city, situated in the heart of the Riverwalk at the front door of the Alamo and steps away from the convention center. Our premier location allows the hotel to benefit from an attractive combination of group and transient demand in a market that continues to experience positive demographic shifts, increasing hotel demand and a business-friendly backdrop. The acquisition fits squarely within the investment parameters we had previously identified and will immediately contribute to our earnings, diversify our cash flow, and provide additional growth opportunities in the future.

The acquisition will add to the growth generated by the second component of our strategy, which is the internal investment we have made -- and continue to make -- in the portfolio. During the first quarter, we benefited from the ongoing ramp-up at the newly converted Westin Washington, DC Downtown. First quarter EBITDA at the hotel was over \$4 million higher than the same period in 2023, and we expect to see continued outsized growth for the remainder of the year, albeit at a more moderate pace, especially when the hotel comps over its conversion during the fourth quarter.

We are very pleased with our initial performance in DC. Our investment thesis was that the incremental spend to convert our former Renaissance to a Westin would generate positive returns by capturing a better share of transient customers and attracting higher quality groups. And this is exactly what we are seeing in the initial quarters and in our forward-booking patterns.

We are looking to replicate the same performance on the other coast where our latest conversion officially became the Marriott Long Beach Downtown at the end of March. Because of permitting and other delays, we incurred some incremental displacement. But this is behind us now and the project should be wrapped up next month. The hotel is receiving a positive response from travelers and meeting planners, which has added to our confidence that the Marriott flag will deliver superior returns by allowing the hotel to better compete in the market.

Looking to our next phase of internal growth, the transformation of Andaz Miami Beach remains on schedule to be delivered at the end of the year. As planned, we temporarily suspended operations at the resort in late March to facilitate the fastest construction schedule possible. Even at this accelerated pace, comprehensive value creating projects like these result in short-term earnings disruption. We are looking forward to having the disruption in our rearview mirror, which is now only a few short months away.

As we look forward, we believe the Andaz Miami Beach will provide a significant layer of incremental growth on top of the contribution from the recently acquired Hyatt Regency San Antonio, and the embedded earnings potential of our newly converted Westin in Washington DC, and our new Marriott in Long Beach. The combination of internal and external investment will provide additional layers of growth as we move into 2025 and beyond.

The last component of our strategy is the return of capital to our shareholders. Our board of directors declared a 29% increase in our quarterly dividend to \$0.09 per share. The increase reflects the incremental income generated by the acquisition of the Hyatt Regency San Antonio and the anticipated contribution from our repositioned hotels that should generate incremental funds for distribution over the coming quarters.

Now shifting to our quarterly results. As I noted at the top of the call, we were pleased with how the portfolio performed in the first quarter relative to our expectations, especially given the challenging industrywide comparison. Similar to what we saw in the last few quarters, group business performed well, corporate travel continued to recover, and leisure demand further moderated although our comparable resorts still generated profitability well ahead of pre-pandemic levels.

Our convention hotels led the portfolio with over 7% RevPAR growth in the quarter, driven by our newly converted Westin Washington, DC Downtown, which grew rooms RevPAR by 52% and total RevPAR by more than 77%. We continue to be encouraged by the trends at our urban hotels, which, excluding Long Beach due to its renovation, grew RevPAR by nearly 4% and benefited from occupancy gains as business travel continues to move higher.

Marriott Boston Long Wharf turned in another solid quarter, growing total RevPAR by nearly 15%, driven by strong corporate demand and a solid mix of group business. Leisure trends continued to moderate in the quarter, with comparable occupancy up marginally, but with rates down from the very robust levels seen in recent years. Our performance of Wailea also reflects the rotation of a large group event that was out of the market this year, but will be returning in 2025. Wine Country was also impacted by a particularly cold and wet first quarter, which contributed to further market-wide softness.

We are focused on driving group business and generating ancillary revenues at both Montage and Four Seasons, which is reflected in their total RevPAR performance in the quarter and that partially offset their lower rooms revenue resulting from weaker leisure demand in the market.

While we cannot control when leisure demand will accelerate, we can continue to work with the resorts to build a base of group business and control costs, so that we can maximize profitability when it does. Our efforts are showing in stronger bookings at these resorts, with group room nights pacing nearly 13% higher for the remaining quarters of 2024.

We knew coming into the year that the first few months would have challenged top line growth. And so we have been working with our managers to mitigate costs and offset inflationary pressures. Improved labor productivity in the first quarter relative to the prior year helped to offset the lower group mix and decline in average rates.

Our margin performance during the quarter was impacted by our renovation activity in Miami and Long Beach. Excluding these two hotels, our margin was down only 170 basis points even with minimal top line growth and the impact of our higher property insurance costs, which speaks to the efforts of our operators to be disciplined in their cost management efforts and to drive efficiencies where possible. As we look ahead into 2024, we are encouraged about the outlook for the year, which benefits from our recent investments and begins to pave the way for the next layer of growth in the portfolio.

Comparable portfolio group room revenue pace for the rest of the year is up approximately 9%, with broad-based strength across Boston, DC, Orlando, Long Beach, and Wailea. Transient booking patterns remain short term, but the recent week-over-week pickup from May and June is exceeding that of last year. While it remains early, we are encouraged by what we are seeing in our group booking activity for 2025 with improving convention and citywide calendars in many of our markets.

As Robert will elaborate on shortly, we were very pleased to close our acquisition in San Antonio last month. We continue to evaluate opportunities for the remaining proceeds from the sale of Boston Park Plaza, and we maintain significant additional investment capacity that we can use to create value through a combination of additional hotel acquisitions and the repurchase of our own stock on an opportunistic basis.

To sum things up, we continue to execute on our three strategic objectives: recycling capital, investing in our portfolio, and returning capital to shareholders, which has -- and should continue to -- result in multiple layers of embedded growth to drive incremental earnings and value over the next several years.

To put a finer point on this, as we move further into the year, we are putting the pieces in place to drive significant earnings growth into 2025 from a combination of our recent conversions in Washington, DC and Long Beach, the full year contribution from the Hyatt San Antonio and the debut of the Andaz Miami Beach, the combined impact of which, assuming a relatively steady macro backdrop, should drive double-digit EBITDA growth for the portfolio next year.

And with that, I'll turn the call over to Robert to give some additional thoughts on our recent acquisition activity and renovation progress. Robert, please go ahead.

Robert C. Springer

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

Thanks, Bryan. On April 23, we closed on our previously announced acquisition of the Hyatt Regency San Antonio Riverwalk for a gross purchase price of \$230 million before \$8 million of incentives offered by our operator. The transaction implies a current year yield of 8%, which we believe is very attractive for such a well-located, recently renovated hotel. Further, this yield is greater than what we were previously achieving at Boston Park Plaza and allows us to avoid significant defensive capital investments that would have led to further degradation in returns.

Instead, we now have the opportunity to grow this yield over time in San Antonio through near-term asset management initiatives and longer-term ROI projects. As it relates to investments in our existing portfolio, construction is in full swing in Miami with all parts of the hotel now under renovation. While this transformative renovation took some time to fully design and plan for, we are now just a couple of quarters away from the debut of the Andaz Miami Beach and from the benefit it will provide to earnings. The project remains on schedule and in line with budget.

In Long Beach, we converted our former Renaissance to the Marriott Long Beach Downtown in late March. While we experienced some delays and a longer-than-expected permitting process, the work should be wrapping up in the next month and the renovated product is being very well received. Elsewhere across the portfolio, we will be completing a few other projects, including a meeting space renovation at our JW New Orleans, which is underway now, and a soft goods renovation in Wailea that will start later this year. While we expect these projects to add to the earnings potential of the assets, they should not result in any meaningful disruption this year.

As we have shared with you before, capital recycling is a primary component of our strategy, and we are actively evaluating additional acquisition opportunities and remain focused on assets where we believe we can create value by redeploying capital at higher yields. We look forward to sharing additional information on our progress in the near term.

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

Aaron R. Reyes

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

Thanks, Robert. Our earnings results for the first quarter came in generally in line with expectations as better-than-expected operating margins and savings at the corporate level offset slightly lower RevPAR performance. Adjusted EBITDA for the first quarter was \$55 million and adjusted FFO was \$0.18 per diluted share. We estimate that we incurred \$3 million of earnings displacement at the Marriott Long Beach Downtown in the first quarter in connection with this conversion from a Renaissance.

While the project should wrap up next month, our 2024 displacement will be approximately \$2 million higher than our initial expectation, largely due to construction and permitting delays that were out of our control. Together with the \$10 million of year-over-year decrease in earnings at The Confidante as it undergoes its transformation to Andaz Miami Beach, we now estimate that we will incur \$13 million to \$15 million of total earnings disruption this year. We would expect to recoup all of this plus additional earnings at these hotels next year.

Included in our earnings release this morning was our revised outlook for the year. The midpoint of our guidance ranges remain unchanged, except to incorporate the impact of the Hyatt Regency San Antonio Riverwalk acquisition. As we noted in the transaction announcement last month, we expect the hotel to generate \$12 million to \$13 million of EBITDA during our ownership period in 2024. These incremental hotel earnings will be partially offset by lower-projected interest income as a result of deploying the excess cash. Taken together, at the midpoint, these would net to an expected adjusted EBITDA increase of \$10 million and \$0.05 of additional FFO per diluted share.

Based on our performance in the first quarter and what we see today for the balance of the year, we expect that our total portfolio full-year RevPAR growth remains from 2.25% to 5.25% as compared to 2023. This range includes all hotels in the portfolio. If we exclude The Confidante Miami Beach, which has suspended operations and will be under construction for most of the year, our full-year RevPAR growth is projected to range from 4.75% to 7.75%. Both of these ranges represent a 25-basis-point adjustment to incorporate the impact of the Hyatt Regency San Antonio acquisition.

We now estimate that full-year adjusted EBITDA will range from \$242 million to \$263 million, and our adjusted FFO per diluted share will range from \$0.84 to \$0.94. As I noted earlier, the midpoint of our guidance range remains unchanged from the outlook we provided in February, except to incorporate the partial year contribution from San Antonio. As is typical for our portfolio, the second quarter will be the largest contributor to our full-year

earnings. And based on the midpoint of our revised guidance range, we expect approximately 28% to 29% of our total full year earnings to be generated in the current quarter.

Our balance sheet remains strong, and as of the end of the year, on a pro forma basis, adjusted for the San Antonio acquisition, we had over \$240 million of total cash and cash equivalents, including our restricted cash. We retain full capacity on our credit facility, which together with cash on hand, equates to nearly \$740 million of total liquidity.

Following the partial redeployment of the Boston Park Plaza sale proceeds, our pro forma leverage has normalized, but it is still one of the lowest in the sector at 3.8 times net debt and preferred equity to trailing EBITDA, and only 2.6 times net debt to trailing EBITDA. We have one piece of secured debt coming due at the end of the year, and we expect that the modest principal balance of the maturing loan, combined with our low overall leverage and strong liquidity position, will give us sufficient optionality to address the refinancing before year-end.

Now shifting to our return of capital, our board of directors has increased our base quarterly common dividend to \$0.09 per share, representing an increase of 29% and consistent with our strategy of returning incremental capital to shareholders. The board has also declared the routine distributions 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: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And your first question comes from the line of Duane Pfennigwerth from Evercore ISI. Please go ahead.

Duane Pfennigwerth

Analyst, Evercore Group LLC

Hey. Good morning. Thank you. Sorry if I missed it in your prepared remarks, but I wonder if you could comment on April RevPAR trends and maybe any prospects for acceleration on top line that you see here in 2Q, specifically, as we get beyond some of the tougher weather.

Aaron R. Reyes

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

Sure, Duane. This is Aaron. I'll start there. So Q2 is expected to be a transition quarter for us. I think what you've heard broadly is that the comps do get easier as the year progresses, and that's certainly going to be the case for our portfolio. But what you'll see for April is that is largely the end of the period of the tougher comp from the highly compressed demand that we saw at the beginning of 2023.

And so our expectation was if you set Andaz side, is that we we're going to be down slightly for April on the RevPAR line, and that's so far what we've seen. And then April kind of ends up looking a little bit like Q1 where if you isolate both Andaz and Long Beach, we're slightly positive, but largely coming in line with

expectations. And then, we'd expect the quarter to get easier as we move into May and June and then go into the back half of the year, even greater growth.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Yeah. Good morning, Duane. Just to add to that a little bit, when we look into Q3 and Q4, unlike last year, when you look at where the group business and the pace was heavy, which was in Q1 and then moving into April a little bit, too. As we look into Q3 and Q4, our pace is up double-digits and looking at strength in the portfolio in DC, Orlando, Long Beach ramping will be significant growth. Boston and then New Orleans has a very strong second half.

Duane Pfennigwerth

Analyst, Evercore Group LLC

Q

Appreciate that commentary. And then, maybe just a pretty straightforward follow-up on longer-term CapEx beyond 2024, can you just tell us what is on deck beyond this year relative to the CapEx level you're taking on this year? Thanks for taking the questions.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

And looking forward, we'll move more to a much more normalized level of capital, which would include probably one or so cyclical rooms renovation on an annual basis. I mean, when you look at the back half of this year, Robert had mentioned that we'll be doing a soft goods renovation in Wailea, which given the transitioning from the impact of the fire in the market, it's proven to be a good time to do that. It's something like that which causes \$1 million or \$2 million of overall displacement is just sort of the run rate that the portfolio would have on an annual basis.

Duane Pfennigwerth

Analyst, Evercore Group LLC

Q

Thank you.

Operator: Our next question comes from the line of Smedes Rose from Citi. Please go ahead.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks. I was just hoping you could talk a little bit about what you saw in the transactions market as you were assessing opportunities. Obviously, you went back to Hyatt for a second acquisition directly from them. But I was just curious, what you saw out there and was it particularly competitive, were there interesting product, and maybe what led you back into the Hyatt arena.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Sure. Good morning, Smedes.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Hi.

Bryan Albert Giglia*Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.*

A

So when we were looking to potentially deploy and recycle capital from the Boston Park Plaza sale, we were in the third into fourth quarter of last year – fourth quarter, I guess, is when we had higher level of confidence that Boston was going to close. And so at that moment in time, there were not a lot of transactions happening. The debt markets were much more restrictive and difficult than they are today, even though we have had Treasury movements that have made things a little bit choppy.

And so at that point, there wasn't a lot on the market. And we were going to relationships, people we've done deals with before to see if there were deals possible. And being a cash buyer at that time made us a much more attractive and reliable counterparty.

The off-market process, direct deal process tends to take a longer time than a marketed process. And so we had the advantage of really being one of the only acquirers or looking to acquire at that time. So, we spent third, fourth quarter of last year really starting to build out that pipeline. And so as we get into or got into this year, the debt markets availability improved, CMBS market was much more conducive to transactions. And so as more things became marketed, we were able to supplement what we're looking at with marketed deals also. So, I think doing the deal with Hyatt was more of a necessity at the time we started that process. I think where we're looking now is there is more on the market. I think our direct deals pipeline that we developed is serving us well now and may continue to source our future deals. But we're also seeing additional assets out there being marketed and new opportunities are coming up every day.

Smedes Rose*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. Thank you. Appreciate it.

Operator: Our next question comes from the line of David Katz from Jefferies. Please go ahead.

David Katz*Analyst, Jefferies LLC*

Q

Hi. Good morning. I wanted to actually follow that up, Bryan, in particular, the very last part about marketed transactions coming back. We've certainly heard a mixed range of views about how quiet or active the marketed transaction market is. Has it started to re-accelerate? And what's driving that? And do we expect another quarter or two from now that it will continue to do that?

Bryan Albert Giglia*Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.*

A

Yes. Good morning, David.

David Katz*Analyst, Jefferies LLC*

Q

Good morning.

Bryan Albert Giglia*Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.*

A

It absolutely picked up at the beginning of the year. But to your point, with Treasury movements recently, it has slowed down a bit. This is why I think it was so vital that when we were out last year and building this pipeline to help supplement whether or not the marketed deals were going to be coming or not has served us really well.

I think the other thing to it right now is while, maybe the near-term deal flow has slowed down a bit, at the end of the day, we're still a cash buyer, which makes us a very attractive and reliable counterparty at this point, because we're not going to rely solely on the debt market. And that gets us a look at some other deals and maybe even some deals that might be looking or we're looking to refinance and now the debt's a little bit more expensive, maybe a little bit more restrictive. So I think it puts us in a pretty good position.

David Katz

Analyst, Jefferies LLC

Understood. Thank you for that.

Q

Operator: Our next question comes from the line of Michael Bellisario from Baird. Please go ahead.

Michael J. Bellisario

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

Thanks. Good morning, everyone.

Q

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Good morning, Mike.

A

Aaron R. Reyes

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

Good morning.

A

Michael J. Bellisario

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

Two-parter for you on San Antonio. Just first, it's not a market that a lot of us are really familiar with. So maybe help us understand the supply-demand dynamics there. And then, how have the hotel and the convention center both performed historically and what the outlook looks like for the next couple of years?

Q

And then the second part, just on return expectations. What sort of longer-term growth rates did you assume in your underwriting for the hotel and any levered or unlevered targets that you could share with us? Thank you.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Sure. Let me start and then I'll turn it over to Robert. When looking at the market, one, our overall view with when we're going to deploy capital, we want to make sure we're finding the best piece of real estate within that market. The location of the hotel is as good as you can get in that market. When you look at the demand drivers, you have the combination of leisure and convention are the two biggest. And then, you have a growing business transient demand also.

A

Our location is when you look at the leisure demand drivers, you have the Riverwalk, you have the Alamo, and we are situated right in the middle of the Riverwalk and at the entrance to the Alamo, the Alamo obviously having a massive redevelopment and expansion, which will open right up to our front door. We think that longer term, that's going to provide additional investment opportunity for us. We have a fair amount of retail. We have a relatively large parking structure that is right next to the Alamo education and information center that they are developing right now.

From the convention standpoint, convention center, that's 1.6 million square feet that recently had a multi-hundred-million-dollar upgrade. When you look at pace for the upcoming couple of years, it's positive and should also benefit from other regional convention centers going down, or partially down, or restricting some of their availability because of renovation, mainly in Austin and Dallas. Citywide pace is positive for 2025 and 2026.

And then, when you look the market also has a fair amount of government and military in there. The military tends to be more cyber-focused. So a much more dynamic and growing piece of business there. Overall, we are very pleased with our investment. We believe that going in, we're investing around an 8% cap rate on 2024. We think that there is some good near-term and medium-term growth year for us. And I will say, we've been very, very pleasantly surprised with the performance in our very short ownership period.

But the hotel is performing very well. The market is performing well. And while there is some supply, and Robert can talk to that a little bit more, coming into the market, our location, I think, is pretty insulated from that. We are absolutely what you want to be in that market. Robert?

Robert C. Springer

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

A

Yeah, I mean, just a couple of add-ons. So I think Bryan mostly covered all of your question, but a couple of details to add to that. So, Bryan mentioned the Alamo redevelopment. That's a \$0.5 billion state-funded project. If anybody's actually been to the Alamo before, it is a state park that is – no disrespect intended – it's a little bit underwhelming for the visitor experience and the state has allocated a significant amount of capital to build a proper museum and a significant visitation experience there, which we think will be very positive for what is already one of the most popular attractions in San Antonio.

The airport is kicking off on a multi-billion-dollar expansion, which should help drive additional visitation. Bryan mentioned or alluded to regional convention center impact – both Dallas and Austin are going under different, meaningful convention center renovations that ultimately should benefit a city like San Antonio as those convention centers come down for different state regional business that is looking to be in the Texas area but can't go to those markets. There is – you mentioned on the outlook. So I think we covered – I think we covered everything there.

Michael J. Bellisario

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

Q

And anything on return expectations from your underwriting?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Going into it is, as I said, it was an 8% cap. We hope to stabilize somewhere around kind of a 10% or so.

Operator, we'll take the next question.

Operator: Our next question comes from the line of Dany Asad from Bank of America. Please go ahead.

Dany Asad

Analyst, Bank of America Merrill Lynch

Hi. Good morning, everybody. Bryan, in your prepared remarks, you called out the first quarter headwinds should shift to tailwinds, especially when you look to the second half of the year. Are you guys able to quantify or bucket these easing comps, especially when you look at Q3 and Q4? So outside of The Confidante, how many points of tailwind should we expect out of Wailea, Long Beach, and so on, if you could?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Okay. Morning, Dany.

Dany Asad

Analyst, Bank of America Merrill Lynch

Morning.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

When looking at Q1, Q1 when comparing to 2023, 2023 had the compression of the pent-up demand of Omicron going into a lot of the markets, especially, some of the resort markets like Wailea, which then go and compress the transient rate.

So, when we look at the performance in Q1, we actually saw some very positive factors at play. One of them was our Q1 forward group production for current year and future years was basically second to 2018. It was a great year of production both in room nights and in rate. In transient, given that the comp of group was difficult, we were actually able to backfill with a lot of transient across the portfolio. And so that was definitely a positive. And then, on the group side, the group contribution was up year-over-year. So we're able to continue to get more out-of-room spend and our transient demand was backfilling.

When we look into the second half of the year, where you look at where the pace is the strongest and where you expect the most, DC for Q2, Q3, we'll continue to grow revenue for the full year, up almost 20% driven by the benefits that we're seeing not only on the group side and demand from the renovation but also where DC has been the strongest is really or has been the most refreshing to see is the expectation that's changing to the Westin flag, we would receive more transient demand.

And in the first quarter in DC, we saw all transient segments up both in occupancy and rates. And so we're seeing when we look forward, we see additional – the transient rate, the pace looking forward is up double-digits. So not only are we getting more transient guests, but they are also paying a higher rate and spending more.

Orlando has a better second half of the year and then Long Beach will start to ramp up in Q2 going through the rest of the year. New Orleans, which had a very strong first half of last year, has a very strong second half of this year.

Dany Asad*Analyst, Bank of America Merrill Lynch*

Got it. Thank you very much.

Q

Operator: Our next question comes from the line of Floris van Dijkum from Compass Point. Please go ahead.

Floris van Dijkum*Analyst, Compass Point Research & Trading LLC*

Thanks, guys, for taking my question. Obviously, it's always good to deploy excess capital. As you guys look at the basically \$240 million of cash that you have on the balance sheet today, how do you think about which segment would you like to target most? Is it group? Is it resorts, or is it urban hotels? And maybe if you could give your thoughts on those bits, that would be helpful.

Q

Bryan Albert Giglia*Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.*

Great. Good morning, Floris. The answer is kind of a mix of a little bit of everything you said. I mean, when we look at what we recently purchased, our focus for San Antonio was on a hotel that provided good immediate growth, immediate earnings to the portfolio to help balance the diversification of the portfolio after the Boston sale without having any of the needs of immediate capital going into it. So, I think we achieved that, and provided the ballast and the balance of the portfolio that we were looking for.

A

As we go forward, when you look at the types of hotels that we tend to do very well with, is that they have a group, a significant group component, And then, another component, whether it be leisure, or whether it be business transient, or whether if you're something like Long Wharf, you've got all of that.

So I think that that is the group base piece of it, whether it's 25% of the business, like some of our hotels, or in the 60%^s, like in Orlando, or DC, or San Diego, that that's something that we feel is important to add a good base of business, a piece of business that we know how to asset manage very well and then allows you to then compress the other segment, whether it be business transient or leisure.

When you look at the portfolio and you look at what we've done over the last couple of years, we've really been focused on providing layered growth. And it's not always painless to do that. But we're just at this stage now where some of these big repositionings, rebrandings are starting to really pay off as we saw with DC in Q1, which will help the portfolio for the remainder of the year and into next year.

We have Long Beach now coming online. Yes, was there a little additional displacement? Yes, but that's in the rearview mirror now. And we can focus on the growth. And we're very excited with Long Beach because what we've seen with DC is that in DC, the Westin flag really resonates with the transient customer, and we know that the Marriott flag does too. And we believe that like we're seeing in DC, it will give us additional lift. We then added San Antonio by recycling proceeds from Boston Park Plaza, providing a much better yield and less capital needed and less displacement that Boston would have had to go through in the future. Now that's on top of DC and Long Beach. And then, at the end of this year, the next leg of that growth will be Andaz.

And so we've built a great foundation. Our internal investments are delivering. Our external investments are now adding. And so when we look forward, do we need something like San Antonio that doesn't need any capital, that is more plug and play. Once we get Andaz done, could we do some more value-add? I think

that's where we add the most value. I think that's where we create. And so it opens that door, but right now, the focus is ramping San Antonio up and getting that to where we need it to be. And it's doing great so far. We have asset managers are all over it and they see a lot of opportunities. So we're very excited about that.

And then, watching DC perform, watching Long Beach perform, and then at the end of this year, being able to turn Andaz on and seeing how that can contribute to the portfolio.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

Thanks. Appreciate that.

Q

Operator: Our next question comes from the line of Chris Darling from Green Street. Please go ahead.

Christopher Lee Darling

Analyst, Green Street Advisors LLC

Thanks. Good morning, everybody.

Q

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Hi, Chris.

A

Christopher Lee Darling

Analyst, Green Street Advisors LLC

Bryan, I'd like to go back to the Hyatt Regency transaction for a minute. Can you help me understand how you thought about recycling capital in that fashion relative to more meaningful share repurchases? And I ask just from my perspective, anyway, your stock's been trading really at or below the multiple at which you bought the Hyatt, and presumably, your existing portfolio also benefits from a stronger growth profile for the next couple of years. I suppose to be fair, though, you mentioned on the call earlier, where you expect the Hyatt to stabilize at, so some fairly meaningful growth, but would be curious, your perspective kind of putting all that together.

Q

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Yeah. I mean, while San Antonio was a great yield going into it, there are factors in that market and hotel-specific factors that we think that there's quite a bit of growth that we'll be able to mine out of that. When the Alamo redevelopment is done, we have a good amount of retail that leads right into it that will be able to be upgraded to match what they've done with the Alamo and that should result in significantly more rents.

A

Our asset management team is very good at working with Hyatt as we've seen in San Francisco to be able to really get the performance and optimize the hotel. So we're pretty excited about it. Not only is it an immediate attractive yield, but there's near-term upside, medium-term upside without having to go and do a full rooms renovation, full bathroom renovation because that work is already done. And we get a benefit from that.

To your bigger question on thought process of deploying capital, maybe it's a little bit boring, and it's the answer we normally give, but it's a balanced approach, Chris. And so we took an asset in Boston that had done really well for us and was coming up to its next cyclical renovation, which will require significant guestroom

and bathroom work, which would result in a hotel that runs in the high-80s, low-90s occupancy, a lot of displacement, and a lot of capital in a 100-year-old building.

And so it's our job to find and comb through our portfolio, find instances where we can get a very attractive price and redeploy it into an opportunity that's going to have a better return on our invested capital than that. And that's exactly what I think we've done here with San Antonio.

And you always have the opportunity to buy back shares, and quite frankly, I think we have been very aggressive over the years with redeploying capital. When you look at our strategy, one of the tenants of our strategy is returning capital to shareholders. And we have done that through share repurchase. We continue to do that through right-sizing our dividend as our cash flow and earnings normalize.

And we also didn't deploy all of the proceeds from Boston Park Plaza. We still have some remaining which may go into hotel acquisitions if we find something attractive. It could go into share repurchase also. And so, again, it's keeping that balance. And at the same time, selling Boston was a large asset. And so we want to make sure that we also provide the right ballast and balance to the portfolio to make sure that we don't have any concentrations in any markets that could impact things.

So, at the end of the day, it's taking all of those things into account. It's being balanced in how we deploy, as we have done over the last several years. And it should be what you would continue to expect from us going forward.

Christopher Lee Darling

Analyst, Green Street Advisors LLC

All right. All helpful comments. I appreciate it.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Thanks, Chris.

Operator: That concludes our Q&A session. I will now turn the conference back over to Bryan Giglia for closing remarks.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

I want to thank everyone for the interest in the company. We look forward to meeting with many of you over the coming months at conferences and meetings, and look forward to providing you with updates and views on how our investment and especially how the progress on Andaz is coming, and how we look forward to having that displacement headwind like our other investments turn into a tailwind in the coming months. Thank you.

Operator: Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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