Sector

REIT ▪ United States

U.S. Hospitality Sector Outlook

Resilience underpinned by domestic consumption; Fears of trade war overplayed

Geraldine Wong / 65 6202 1193 / geraldine.wong@kgi.com
Amirah Yusoff / 65 6202 1195 / amirah.yusoff@kgi.com

- U.S. consumer expenditure remains largely unaffected by the U.S-China trade war, supported by a 50-year historical low unemployment rate and modest wage growth.
- The U.S. lodging sector continues to be underpinned by both domestic travellers, who made up c.97% of total U.S. trips taken in 2018, and their growing accommodation expenditure.
- We initiate coverage on ARA US Hospitality Trust and Eagle Hospitality Trust with an OUTPERFORM recommendation based on demonstrated resilience in the hospitality sector, and their attractive value propositions within the upscale and/or upper midscale hotel segment(s).

Investment Thesis

U.S. economy and lodging sector remain supported by strong consumer consumption. Consumer and business sentiments remained buoyant, fuelled by ease of credit and growing consumer disposable income through a record low level of unemployment and modest wage growth. With cost of funding expectations to remain low, consumption of big ticket items such as housing and expectations for business conditions and sales remain strong. The higher disposable income would directly fuel the U.S. lodging market. Leisure trips taken domestically made up 76% of total trips taken within the U.S., followed by domestic business trips (c.21%).

Forecasts for consumer expenditure on accommodation continues to outpace total expenditure. Forward growth for accommodation spending stood at a 4.6% CAGR, compared to overall spending (4.1% CAGR) for the period 2018 to 2022. Oxford Economics suggest that U.S. consumers will continue to allocate a higher share of their total spending on accommodation services, driven by millennials' penchant to spend on experiences, rather than physical goods.

Fears of trade war overplayed. Impact of trade war tensions with China's toll on international arrivals to the U.S. may be overstated. China was just the fifth international tourism market to the U.S. in 2018, making up 7.5% of total international tourist arrivals. This pales in comparison to the top two international markets, namely, Canada (20.2mn) and Mexico (17.8mn), which made up half of all international arrivals to the U.S. last year.

Hotel investment opportunities aplenty. Transaction activity remains robust with U.S. hotel transactions totalling $24 billion and $29.5 billion in 2017 and 2018, respectively. This was accompanied by the lower level of investment interest from cross-border investors in 1Q19 as attractive opportunities were offset by the strong U.S. dollar and currency hedging costs. We think that the current trend of single-asset transactions taking predominance over portfolio transactions would place portfolio deals in a better position when it comes to cap rate negotiations, especially with certain cross-border investors out of the picture. The sector continues to see strong interest from REITs which were the second biggest buyer group, accounting for 21% of quarterly volume.

Upscale segment(s) the best places to be. The upscale segment remains the most profitable value proposition segment within the U.S. lodging market, with gross operating margins expected at 45.7%, 360 bps above the sector average. This defensive operating model is built to weather future trends such as increasing labour costs and price competition and substitution by Airbnb listings. Neighbouring segments such as the upper upscale (GOP: 35.6%) and upper midscale (GOP: 39.3%) segments also sits well between the two ends of the spectrum – luxury and economy.

Valuation & Action

We initiate coverage on ARA US Hospitality Trust (ARA) and Eagles Hospitality Trust (EAGLEHT) with OUTPERFORM recommendations. ARA and EAGLEHT are capitalising on the full-service and select-service segment within the U.S. lodging sector respectively. Both portfolios are mostly within the upper segments, with a higher value proposition that is less susceptible to rising labour costs and price competition from Airbnb.

Our 12 month target price for ARA of US$0.96 represents a total upside of 16.7% (inclusive of a 12 month forward dividend yield of 8.1%). We like that ARA is able to maintain a higher GOP margin, due to lower labour requirements and less reliance on ancillary revenues. Its 38 hotels are also strategically diversified across economically stronger regions, allowing it to demand higher average daily room rates (ADR).

We give an OP recommendation to EAGLEHT with a 12 month target price of US$0.84, representing a total upside of 25.6% (inclusive of an annualised F19F dividend yield of 10.3%). EAGLEHT may appeal to more conservative investors with its 100% master lease structure. This gives greater visibility to future earnings which is further supported by a rental floor, while stability is further cushioned by diversification across (1) revenue streams segments, (2) brand affiliations and (3) both leisure and corporate demand drivers.

Key risks

A strong USD impacting international arrivals; forex risks; U.S. tax regulatory changes; U.S. recession fears becoming a reality (occupancy dropped to 55.1% in 2009 post GFC

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Eagle Hospitality Trust and ARA US Hospitality Trust

	EAGLE HOSPITALITY TRUST		ARA US HOSPITALITY TRUST	
VALUATION	*2019F*	*2020F*	*2019F*	*2020F*
12M Target price (US$)	0.84		0.96	
DPU (US cents)	4.3	6.6	7.0	7.2
DPU growth	2.4%	2.4%	2.3%	2.3%
Distribution yield	10.3%	9.8%	8.1%	8.2%
P/BV (x)	0.8		1.0	
FINANCIAL METRICS				
Interest coverage	4.1		6.0	
Gearing	37.5%		31.9%	
Fees in units	100%		50%	
Finance cost	3.90%		3.95%	
Fixed interest rate	93%		83%	
Debt maturity (years)	4.2		4.9	
OPERATING METRICS				
Occupancy (FY20)	76.8%		77.0%	
RevPAR (US$)	107		105	
ADR (US$)	131		126	
GOP margin	33.4%		42.8%	
PORTFOLIO STATISTICS				
Number of hotels	18		38	
Number of rooms	5420		4,950	
Number of states	8		21	
Brands	41% IHG 29% Marriott 24% Hilton 6% Independent		71% Hyatt Place 29% Hyatt House	
Portfolio valuation (US$mn)	1,270		720	
Freehold assets (% total valuation)	87.4%		94.3%	
Chain scale	100% Full-service (44% Upper Upscale, 28% Upscale, 29% Upper Midscale)		100% Select-service (100% Upscale)	
Revenue segments (FY20)	67% Room revenue 19% F&B revenue 8% Other revenue 6% Miscellaneous revenue		95% Room revenue 5% Other revenue	
% Fixed rent	68%		0%	
Capital Expenditure (US$mn)	174		55.2	
Years since last renovation (average)	1.5		3.5	
Demand driver segmentation	51% Leisure : 49% Corporate 92% Domestic : 8% International (Latest quarter statistics)		46% Transient corporate 36% Transient leisure 16% Group 2% Contract (Historical FY18 statistics)	

DPU in accordance to the respective IPO prospectus; Distribution yield annualised for FY19

U.S. Macro Picture

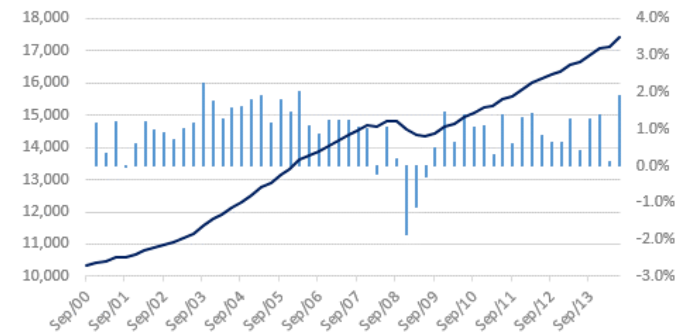
Steady growth within the US Hospitality Sector

The most recent forecast, as communicated at the Federal Open Market Committee meeting, projected a slowdown in U.S. GDP growth in 2019 and 2020 to 2.2% and 2.0%, a decline from 3.0% in 2018. This is on the back of lower interest rate assumptions priced in by the market. The Fed Committee lowered its policy interest rates to 1.75% - 2.0% in September 2019, and set expectations for a further rate cut in 4Q19. Consumer and business sentiments remained buoyant, in part fueled by ease of credit and growing consumer disposable income through a record level of unemployment (since 1969) and modest wage growth.

Low cost of funding helped with the consumption of big ticket items such as housing and forward expectations for business conditions and sales. Notably, 69% of GDP last year relied on personal consumption, followed by business investments (18%), government spending (17%) and net exports (-5%).

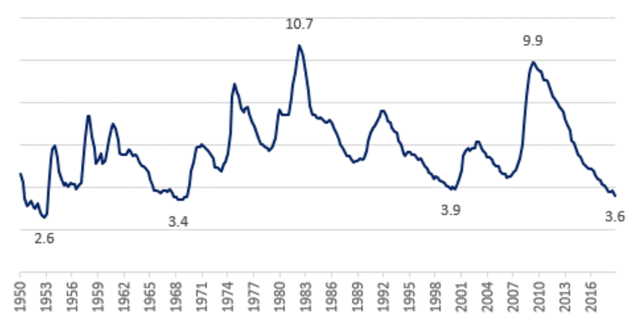
That being said, signs of recession fears continue to seep through. The ISM manufacturing index fell below 50 in Aug 2019 (49.1%), signaling a contraction for the first time since Aug 2016. The inversion of the 2-10 Treasury yield curve occurred last month, a phenomena witnessed before every U.S. recession since 1955. Consequently, the probability of a recession materializing in 2020 and 2021 is 30% and 40% respectively, peaking at 35% - 40% in 3Q19, according to a report by the fed.

Figure 1: U.S. nominal GDP, in US$ bn (% change QoQ)



Source: Bloomberg, KGI Research

Figure 2: U.S. unemployment index (% change YoY) – 50 year historical low

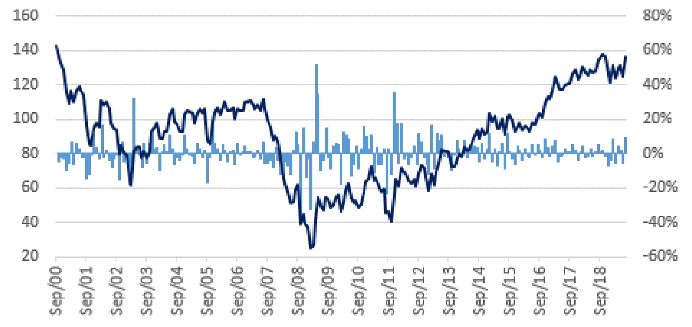


Source: Bureau of Labour Statistics, KGI Research

Consumer and business optimism continues to defy expectations

Expectations for business conditions, and real sales and expansion, posted solid gains. The sharp fall in market interest rates over the past 12 months is starting to support the economy, with activity growth in rate-sensitive sectors like durables consumption and housing rebounding in recent months. There have also been tentative signs that the sharp fall in mortgage rates to a near three-year low is supporting the housing sector.

Figure 3: Conference board consumer confidence index (% change MoM)



Source: Bloomberg, KGI Research

Figure 4: NFIB small business optimism index (% change MoM) – most supportive conditions in 46 years

Source: Bloomberg, KGI Research

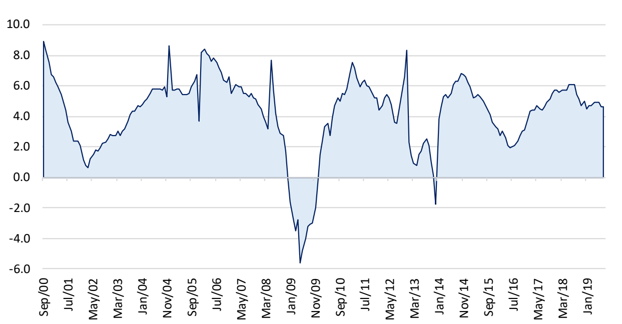
Consumer spending power continues to be on an upward trend fuelled by growing wages

U.S. wage growth (% change MoM) has nearly hit a 10 year historical high, since April 2009. Nominal average hourly earnings rose 3.2% over the past 12 months, marking the 13th straight month that year-over-year wage gains were at or above 3%.

Figure 5: U.S. personal consumption expenditure CPI (% change YoY)

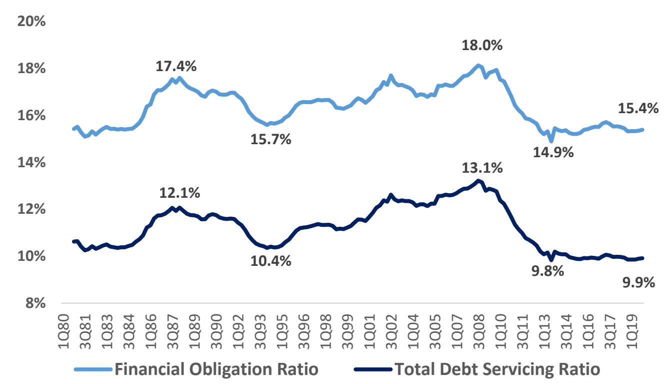
Source: Bloomberg, KGI Research

Figure 6: U.S. wage growth (% YoY)



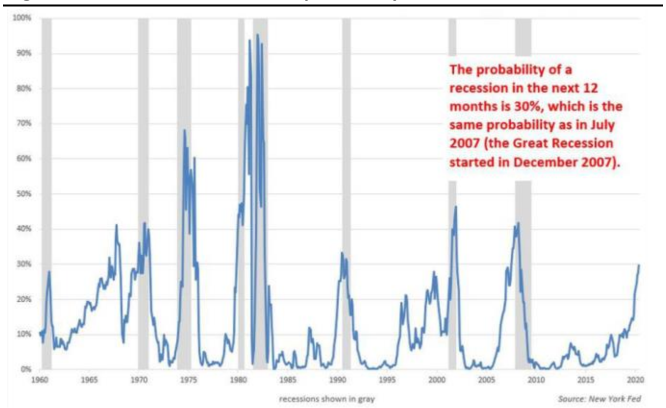
Source: Bloomberg, KGI Research

Figure 7: U.S. household debt obligation ratios (% disposable income)



Source: Bloomberg, KGI Research

Figure 8: New York Fed recession probability model



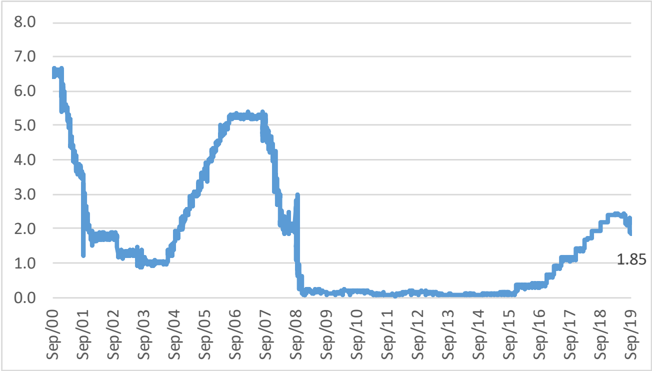
Source: New York Fed, KGI Research

U.S. household debt remains very healthy, at one of the lowest levels since 1993. Even then, risks of recession have risen over the past year (see Figure 8), and with the likelihood of a recession taking place in the next 12 months at 30%.

Dovish interest rate environment and a potentially overpriced U.S. equity market

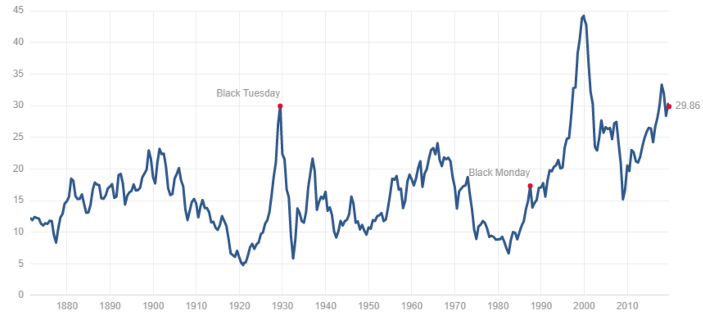
US interest rate will likely remain in a dovish environment for the next 12 months to reduce recession fears as long as trade war concerns remain in the forefront. Favourable credit environment boosts both big ticket items in consumption and support business credit needs.

Figure 9: US 10 year government bond



Source: IPO Prospectus, KGI Research

Figure 10: S&P500 Shiller Cape Ratio - near all time high since dot com bubble in 2000



Source: Robert Shiller, KGI Research

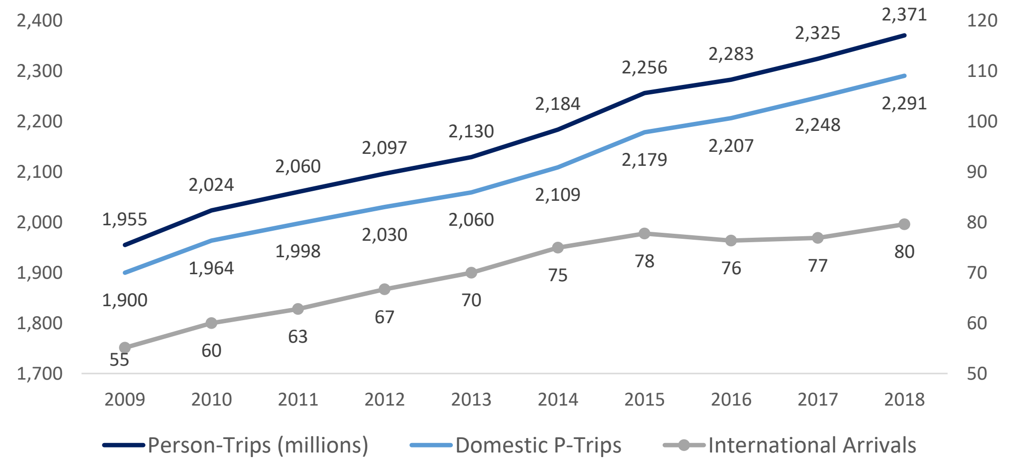
The S&P500 Shiller Cape Ratio measures the cyclically adjusted price-earnings ratio of the S&P500 Index. The last time this index breached 30x was back in 2000 during the dot com bubble crisis, suggesting the current high valuations, surpassing the 2000 levels, may not be supported by fundamental growth in corporate earnings. This was recently revisited in 2018 after a 10 year equities bull run following the 2008 global financial crisis, a potential signal of lower returns over the next couple of decades, with potential mean reversion trends in the coming few years.

What makes up the U.S. tourism industry?

Steady growth within the US Hospitality Sector

2018 saw a total of 2.3bn person-trips in 2018, an increase of 1.9% YoY, with domestic trips taking predominance. Leisure trips taken domestically made up the biggest slice of the pie at c. 1.8bn person-trips (c.76%), followed by domestic business trips (c.21%) and international tourist arrivals (c. 3.4%). From a historical 9 year standpoint, overall person-trips grew at a CAGR of 2.2%, with growth in international arrivals (9 year CAGR: 4.2%) far outpacing domestic trips (9 year CAGR: 2.1%).

Figure 11: U.S. person trips breakdown (in millions)



Source: U.S. Travel Association, KGI Research

Flattish expectations for the rest of 2020

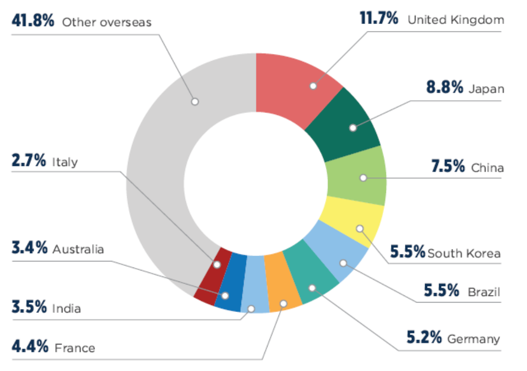
According to the U.S. Travel Association (UTA), trips taken to and within the U.S. grew only 2.4% YoY in June, travel's worst performance since September 2018. Although inbound travel grew in 2018, U.S. continues to lose global market share of long haul travel for a third consecutive from 13.7% in 2015 to 11.7% in 2018. This trend of declining global market travel is set to continue to fall to under 11% in 2022.

What stood out was the 0.8% contraction of international inbound travel, bringing the sector's six-month trend below zero for the first time since Sep 2015. UTA's Travel Trend Index projects that international inbound travel growth will remain just below zero over the next sixth months, settling around -0.2%.

Domestic travel and international travel

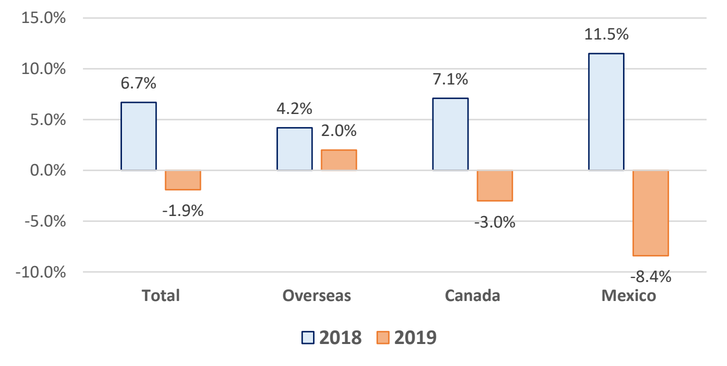
Impact of trade war tensions with China's toll on international arrivals to the U.S. may be disproportionately feared. China was just the fifth international tourism market to the U.S. in 2018, making up 7.5% of total international tourist arrivals. This pales in comparison to the top two international markets, namely, Canada (20.2mn) and Mexico (17.8mn), which make up half of all international arrivals to the U.S. last year.

Figure 12: Breakdown of overseas visitation to the U.S. (2018)



Source: U.S. Travel Association, KGI Research

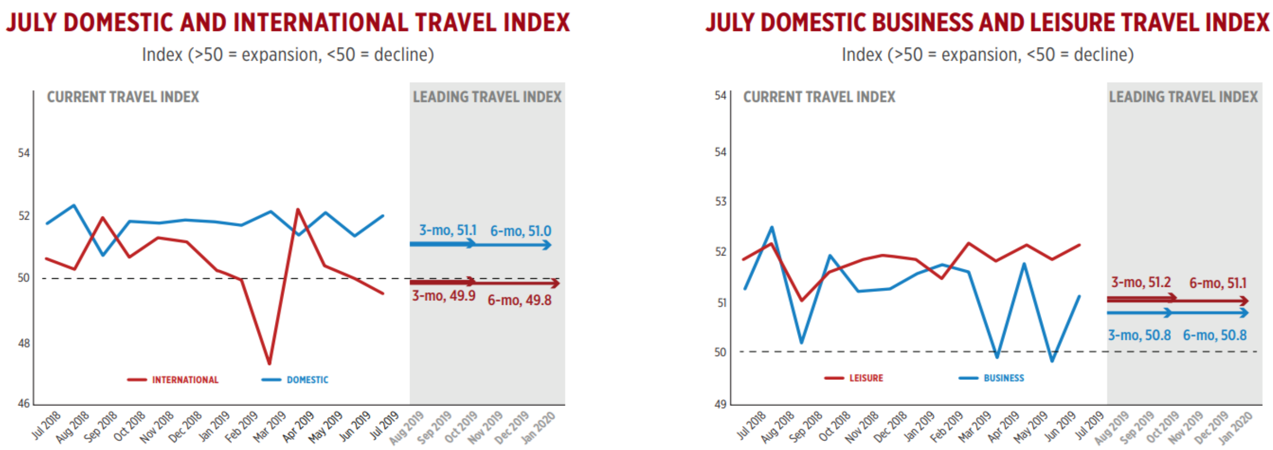
Figure 13: International visitation to the U.S. (5M19 % change YoY)



Source: U.S. Travel Association, KGI Research

Recent cooling business investment and ongoing trade conflicts has weighed on domestic business travel and will continue to do so through the rest of 2019. On a brighter note, domestic leisure, which made up 70% of overall domestic travel expenditure in 2018, fared better during the same period.

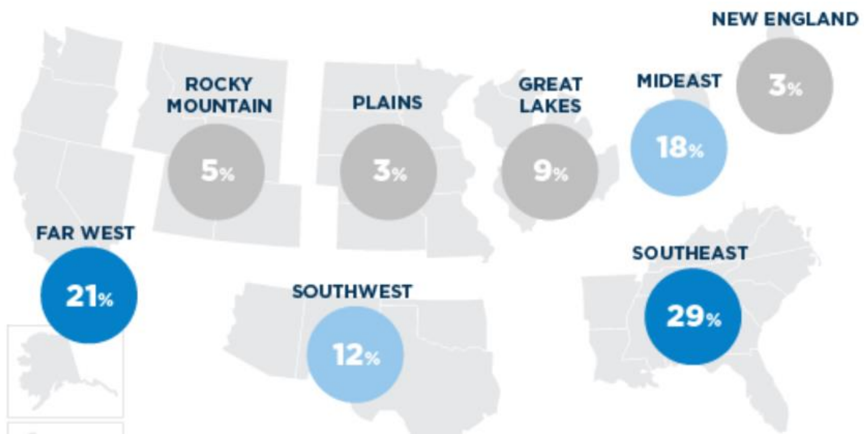
Figure 14: Guest profiles equally diversified across leisure and corporate travelers, while remaining well-shielded from international travelers



Source: U.S. Travel Association, KGI Research

Notably, the latest UTA Travel Barometer reported that American travel interest geared towards the Southeast region (29%) followed by the far west (21%).

Figure 15: Share of domestic search by U.S. region, July 2019



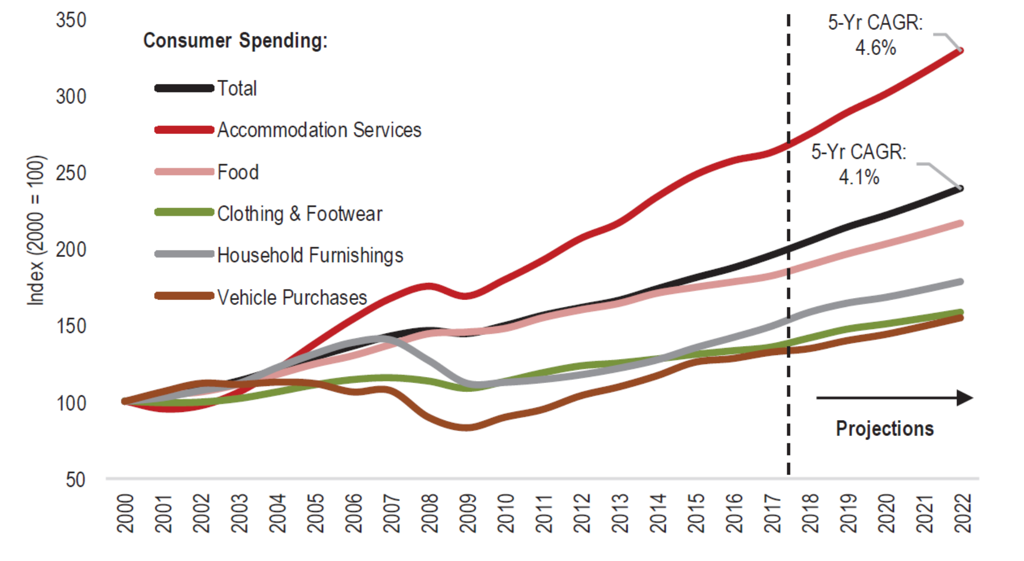
Source: U.S. Travel Association, KGI Research

Most immediate outlook: domestic consumption the key indicator in focus

Domestic leisure and corporate travel will remain the key indicator to focus on as a proxy for the outlook of the U.S. travel industry in the coming 1-2 years. International travel remains a small slice of the pie at just 3% of overall person-trips taken in the U.S. Fears of lacklustre Chinese tourist arrivals may be largely magnified as border travels from Canada and Mexico still take significant precedence over the Chinese travellers.

U.S. consumers are also allocating an increasing proportion of their spending to accommodation services during the last 20 years, and this trend is expected to continue to support the U.S. lodging market fundamentals. The share of consumer spending on accommodation services has increased significantly since 2000, disproportionately to consumer spending on other items, such as food, clothing, household goods, and vehicles. Projections from Oxford Economics suggest that U.S. consumers will continue to allocate a higher share of their total spending on accommodation services during the next few years as well, driven by millennials' well-documented penchant to spend on experiences, rather than physical goods.

Figure 16: U.S. consumer spending on select goods and services



Source: ARA US Hospitality Trust (ARA), U.S. Bureau of Economic Analysis, Oxford Economics, JLL, KGI Research

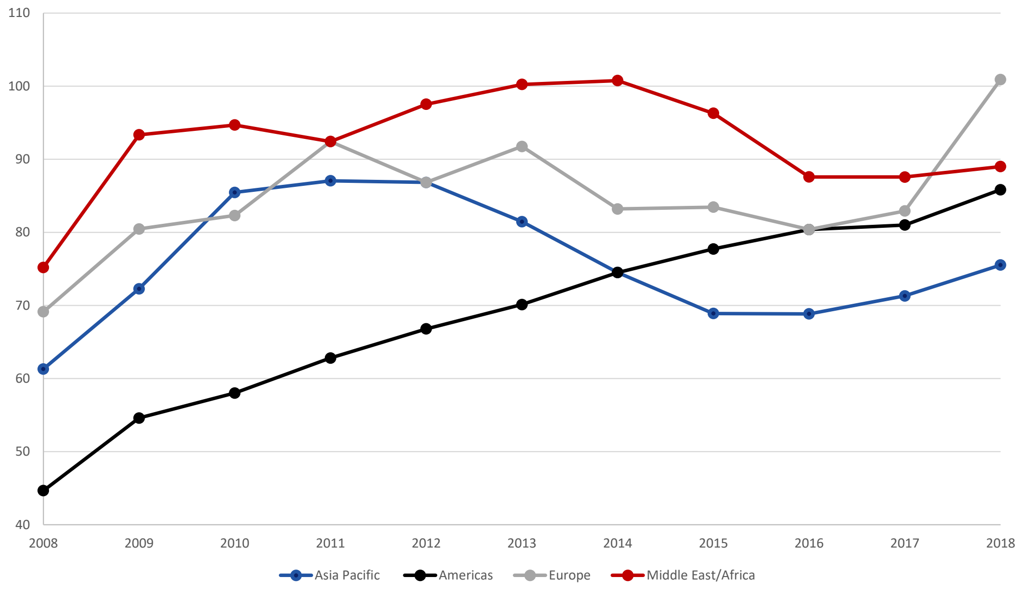
On the basis of higher consumer disposable income, healthy household debt levels and historically low unemployment rates, we think that demand will continue to be supported by domestic leisure travel. The lower than expected international arrivals to U.S. would not make a significant impact to the overall positive trend. Downside risks continue to be a volatile stock market, terrorists' fears causing a downswing in domestic travel sentiments and the impact of a strong USD on international arrivals.

Overview of industry operating statistics

Largest lodging market in the world

Through its recovery for almost a decade since the Global Financial Crisis, the U.S. lodging market has broken records with all-time highs of number of rooms available and sold, and room revenue in 2018. Across the globe, only revenue per available room (RevPAR) in the U.S. had been on a continuous upward trend since 2008.

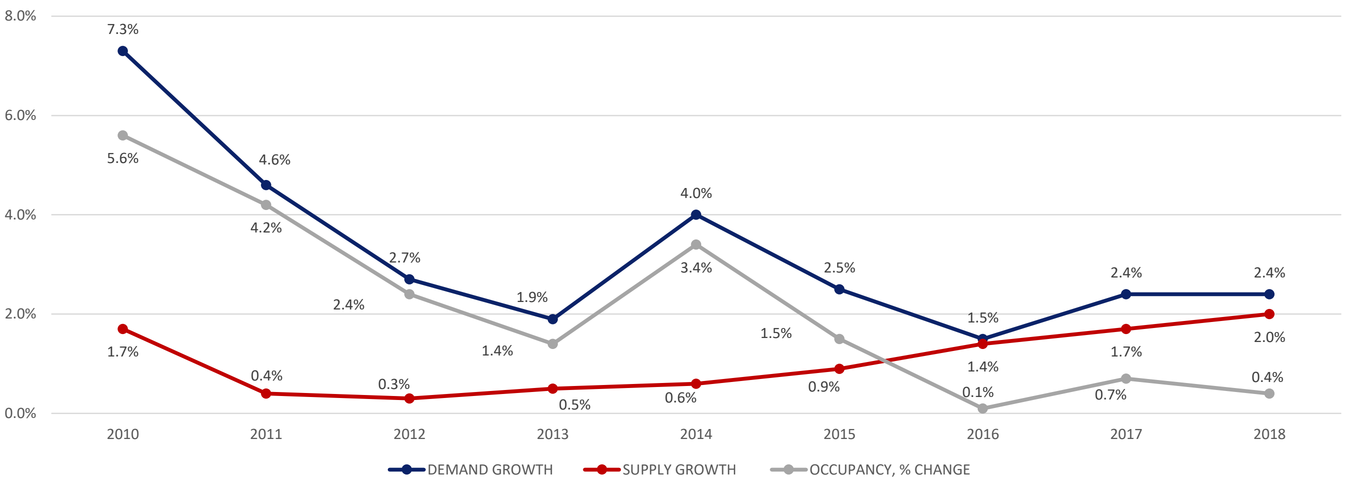
Figure 17: Global RevPAR trends in USD



Source: Statista, KGI Research

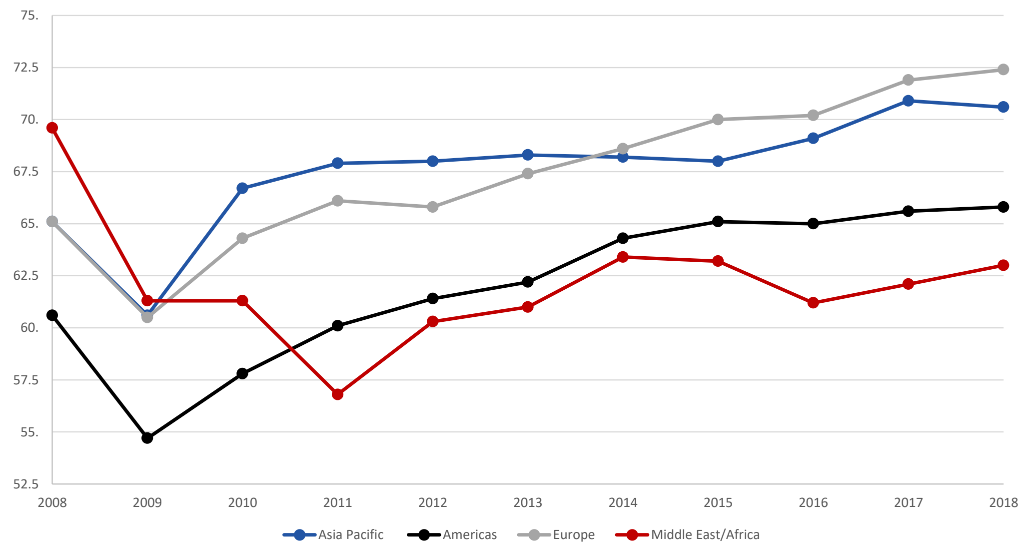
Demand, supply, and occupancy growth in the U.S. have also been on a continuous rise since 2010, attesting to the industry's revving performance. First quarter occupancy rates in 2019 had also hit a record high of 61.8% since 1988, as demand surpassed the net increase in supply by 0.4%.

Figure 18: Demand, supply and occupancy growth trends in the U.S.



Source: PwC, STR, IHC-Markit, KGI Research
Note: Figures in 2010 may seem unusually high due to the low base in 2009, post recession declines

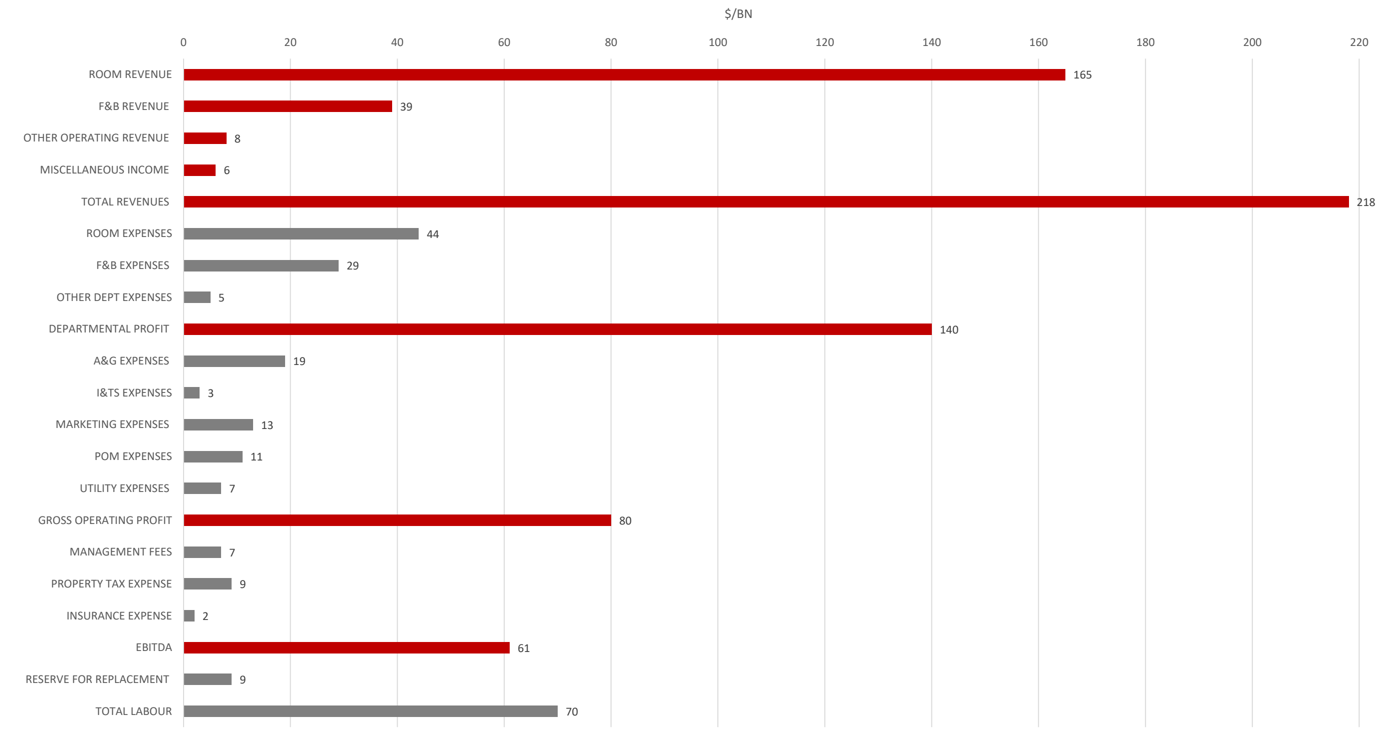
Figure 19: Global occupancy trends



Source: Statista, KGI Research

According to STR, U.S. hotels' industry-wide profit reached a record-breaking $80 billion in 2019, even as labor costs grew at a higher rate than revenues. Revenues totaled an estimated $218 billion in 2018, an increase of $10 billion from 2017.

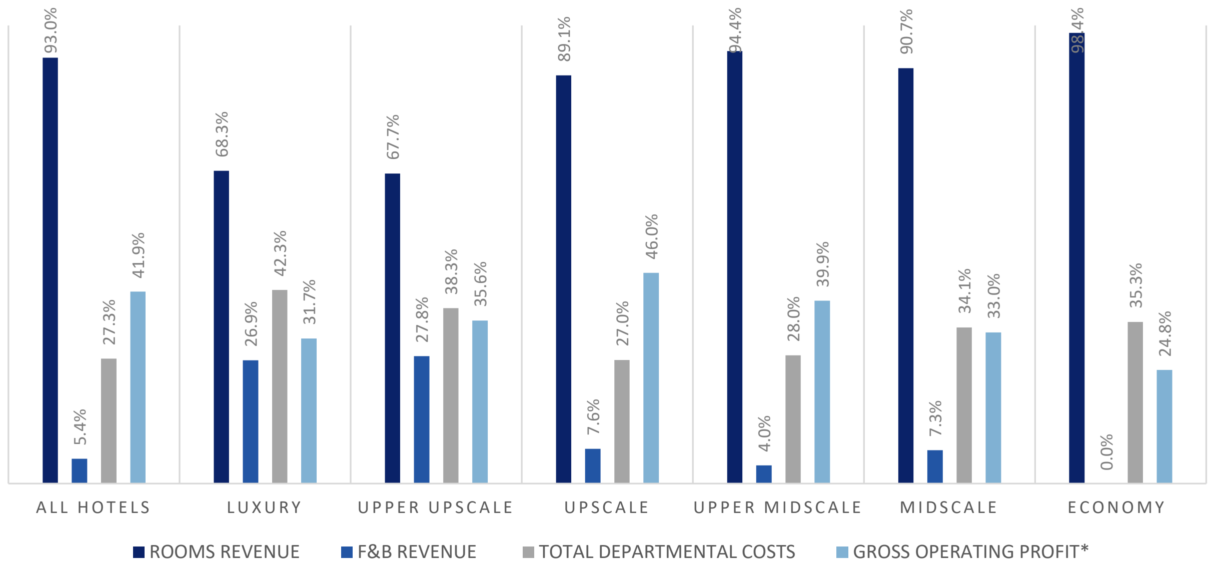
Figure 20: U.S. lodging industry revenues and profits from topline to bottom line, 2018



Source: STR, KGI Research

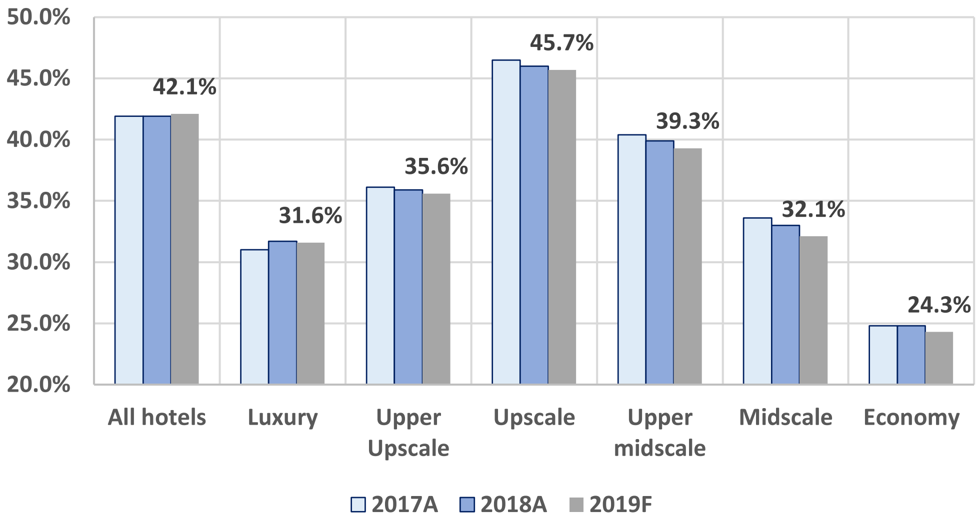
Gross operating profits (GOP) increased a proportionate 2.8% on a 2.9% total revenue growth: full-service hotels profits grew by 3.2%, while limited-service properties experienced a slight profit increase of 1.1% from levels achieved in 2017. Among chain segments, luxury hotels achieved the greatest profit increase of 5.3%, while the midscale/economy chain segments saw a profit decline of 0.5%.

Figure 21: U.S. hotels revenues and profits, as a percentage of total revenue, by value proposition, 2018



Source: CBRE, KGI Research

Figure 22: Historical and forecasted trends in gross operating profit ratio (%)



Source: CBRE, KGI Research

Figure 23: 2018 profit growth, by chain scale

2018 PROFIT GROWTH BY CHAIN SCALE	REVPAR	TOTAL REVPAR	DEPARTMENTAL PROFIT	GROSS OPERATING PROFIT (GOPPAR)	EBITDA	TOTAL LABOUR (LPAR)
LUXURY	3.8%	4.1%	4.9%	5.3%	8.2%	4.1%
UPPER UPSCALE	2.2%	2.6%	2.7%	2.8%	7.0%	3.7%
UPSCALE	1.9%	2.2%	1.8%	1.6%	3.0%	4.3%
UPPER MIDSCALE	1.5%	1.9%	1.6%	0.9%	3.6%	3.7%
MIDSCALE/ECONOMY	2.8%	2.9%	2.0%	-0.5%	-3.4%	6.7%

Source: STR, KGI Research

However, despite constant improvements in profitability in recent years, maintaining profitability will be a challenge moving forward, as uncertainties in the economy resulting in flattening demand and occupancy rates, while a tightening labour market and rising costs begin to stifle profits.

STR downgraded the forecasts for the sector on the basis of broader macro issues surrounding the U.S. China trade war, growing labor costs, and immigration policies. Overall performance growth for 2019 is now projected at 1.6%, downgraded from a previous 2.3% earlier in the year. Expectations for 2020 are equally disheartening with the first drop in occupancy rates in a decade projected for the year.

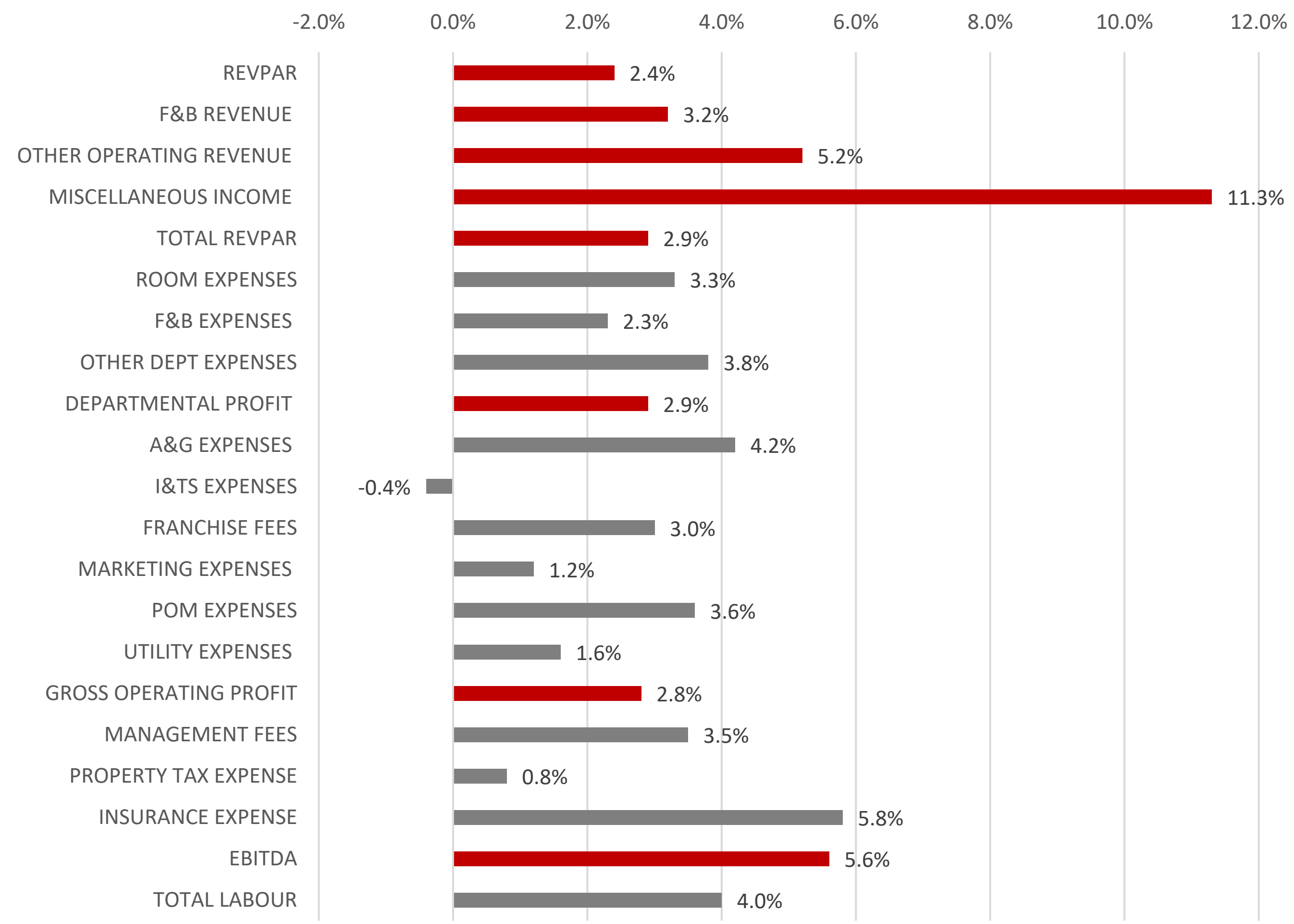
CBRE still expects occupancy to remain at least 200 bps above the long run average of 62.5% from 1988 to 2018 in the coming three years, providing a cushion should economic conditions go south.

Industry wide trends in revenue and expense changes

Based on STR industry profitability model that covers industry-wide revenues and expenses within the U.S. hospitality sector, non-room revenue led growth in underlying profits for 2018. STR estimated total U.S. F&B revenues of $40 billion (up $2 billion from 2017), other departmental revenues of $7 billion and miscellaneous income, which accounts for revenue from cancellation fees, of $6 billion.

Las Vegas led all markets with nearly $14 billion in total revenue (excluding gaming), while New York City ranked second at $12 billion. Los Angeles, Washington, D.C. and Orlando rounded out the top five with total revenue in excess of $6 billion.

Figure 24: U.S. HOST P&L Departmental revenues and expenses growth, 2018



Source: STR, KGI Research

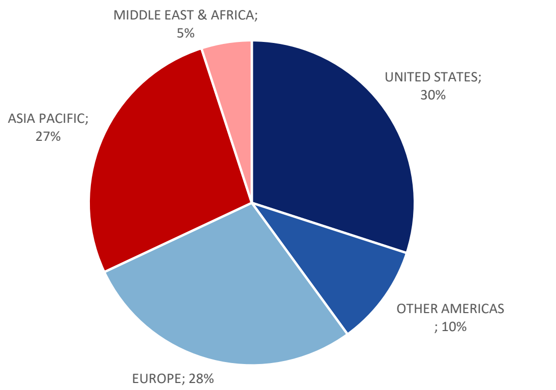
Breakdown of the U.S. hospitality sector

Largest lodging market in the world

As of December 2018, U.S. remains to be the largest lodging market in the world, and constitutes for 30%, or 5.3 million of 17.6 million hotel rooms globally (STR).

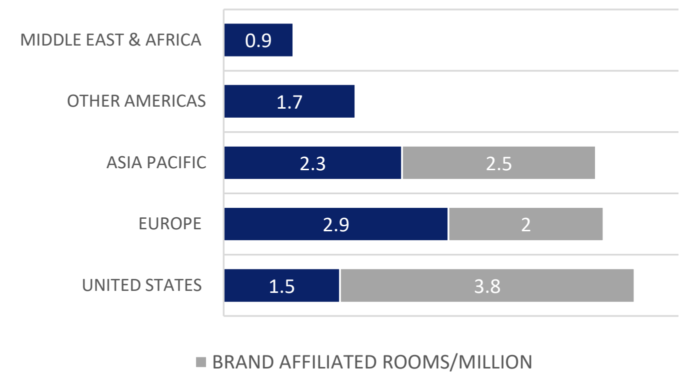
Notably, the U.S. also has the largest proportion of branded hotels - 71% of the 5.3 million rooms are affiliated with a brand. This pose as a stark contrast against Europe, which holds 28% of global hotel rooms inventory where only 40% have brand affiliations. In addition to truly reflecting the importance of brands' distribution channels in the U.S., this affirms that brand equity and image is critical in such a highly developed and competitive industry.

Figure 25: Global distribution of hotel rooms



Source: JLL, STR, Eagle Hospitality Trust (Eagle), KGI Research

Figure 26: International visitation to the U.S. (5M19 % change YoY)

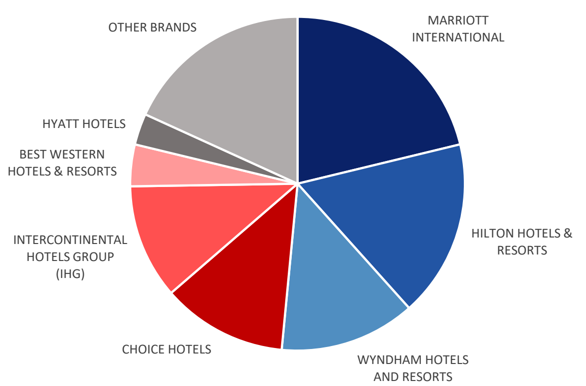


Source: STR, JLL, Eagle, KGI Research

Oligopolistic play among a few brand parent companies

The bulk of branded hotels in the U.S. is represented by several brand parent companies, mainly: Marriott International and Hilton Hotels & Resorts.

Figure 27: Distribution of U.S. hotel rooms by brand parent company (based on number of rooms)



Source: STR, JLL, ARA, KGI Research

Figure 28: Comparison of the largest hotel companies based on number of worldwide

Source: Marriott, Hilton, IHG, KGI Research

Each of these parent companies may then consist of multiple brands that further narrows their target focus within each segment of the market. These segments can generally be characterized by consumers' choice of service level desired, chain scale and location type.

Breakdown of U.S. hotel industry by segments

Breakdown by service level. The three main levels of service are categorized by: (1) full service; (2) select-service; and (3) limited service.

(1) Full service hotels offer wide varieties of services and onsite facilities such as restaurants, fitness facilities, retail and F&B outlets, and function spaces. Services for hotel guests often also include laundry, daily room service, and round the clock concierge staff that attend to any of the guests' requests. Examples of full service hotels include The Westin, Doubletree by Hilton, and Grand Hyatt.

(2) Limited service hotels on the other hand dedicate a much larger percentage of space to guest rooms, and usually space dedication to restaurants and other amenities. Since limited service hotels often cater to the budget-conscious travellers, they may include communal spaces instead – such as self-service communal kitchens or laundry spaces. Examples of limited service hotels include Holiday Inn Express, Comfort Inn by Choice Hotels, and Hampton Inn by Hilton.

(3) Between the two ends of the spectrum lies the select-service hotel – with some food and beverage options, some meeting spaces, and occasionally some retail outlets. Select-service hotels are usually preferred by cost conscious leisure travellers or mid-level corporate travellers. Average daily room rates (ADRs) may be just a third of that compared to full service hotels while still offering the necessary services and quality rooms. Due to the reduced labour requirements, select-service hotels often enjoy higher operating margins. Examples of select-service hotels are Hyatt Place, Hilton Garden Inn, and Courtyard by Marriott.

Figure 29: Example of Hilton hotels by service level and value proposition

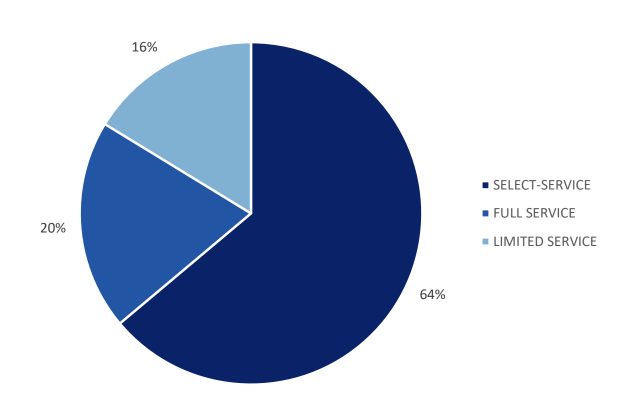
SERVICE LEVEL	CHAIN SCALE	HOTEL
FULL SERVICE	LUXURY	WALDORF ASTORIA™
	UPPER UPSCALE	HILTON
	UPSCALE	DOUBLETREE BY HILTON™
SELECT-SERVICE	UPSCALE	HILTON GARDEN INN™
	UPPER MIDSCALE	HAMPTON BY HILTON™
	MIDSCALE	HOME2 SUITES BY HILTON™

Source: Hilton, KGI Research

According to STR, approximately 2.4 million rooms in the U.S. are affiliated with select-service (incl. extended stay) brands, compared to 746,000 rooms affiliated with full service brands, and 611,000 rooms affiliated with limited service brands as of December 2018.

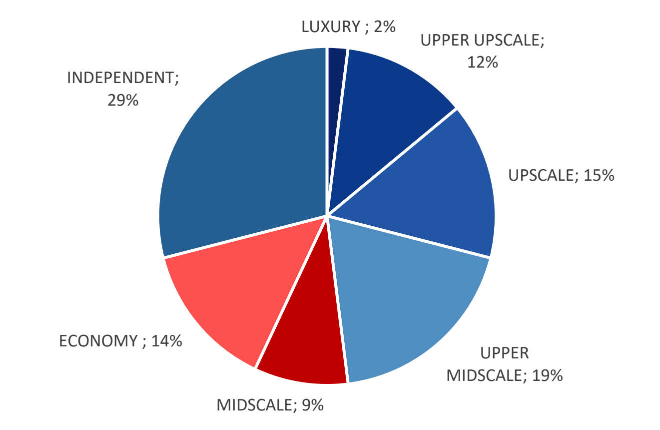
Breakdown by value proposition. STR also categorizes a hotels value proposition by the term chain scale. There are six specific segments within the chain scale classification based on a hotel's ADRs - luxury, upper upscale, upscale, upper midscale, midscale, economy and independent. Full service hotels tend to range from upscale to luxury, while select-service hotels range from midscale to upscale, and limited service hotels are in classified as economy.

Figure 30: Distribution of branded U.S. rooms by service level



Source: JLL, ARA, KGI Research

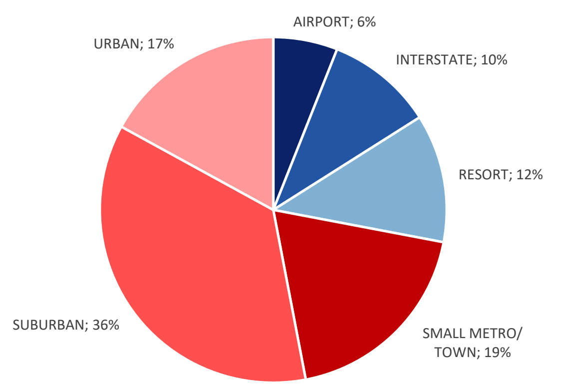
Figure 31: Distribution of U.S. hotel rooms by value proposition



Source: STR, JLL, ARA, KGI Research

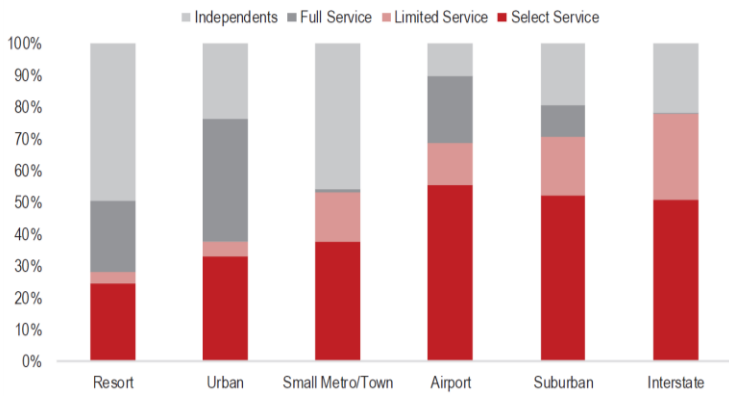
Breakdown by location type. Hotel rooms in the U.S. can also be categorized into location types- suburban, small town, urban, resort, interstate and airport. The large proportion of rooms in suburban and small metro/town areas correspond to the larger percentage of select-service rooms, as most full service hotels are usually located in the urban areas or resorts. Limited service hotels instead are more popular in the interstate areas (distinguished by their close proximity to major interstate highways), where travellers are simply looking to rest for a night or two before resuming on their trip.

Figure 32: Distribution of U.S. hotel rooms by location type



Source: STR, JLL, ARA, KGI Research

Figure 33: Share of different service level hotel rooms by location type



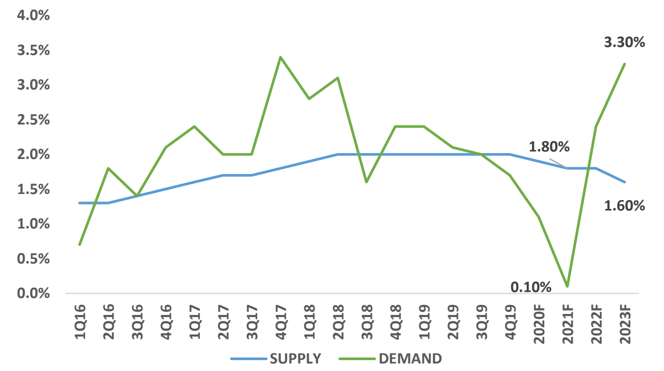
Source: STR, JLL, ARA, KGI Research

Operational performance by hotel segment

Industry wide hotel performance

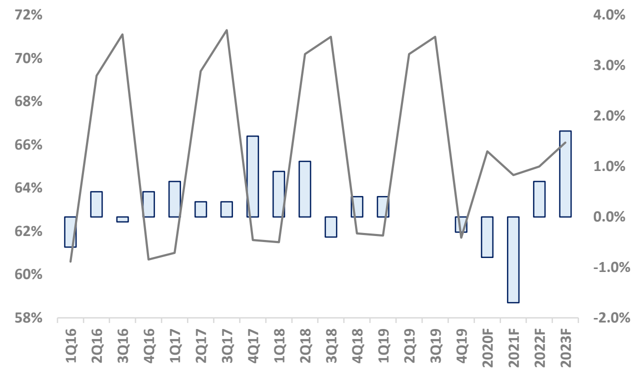
- **Demand and Supply:** We see an unfavourable industry-wide demand and supply mix for the coming two years, but our outlook improves from 2022 onwards. This is largely attributable to negative forecasted demand peaking within the midscale (-3.6%) and economy (-3.5%) chain scale segments in 2021F.
  A total of 191,800 rooms remain under construction as of end 2018, constituting 3.6% of total supply stock.
- **Occupancy**: Occupancies across all 6 segments is forecasted to record a dip in occupancy rates in 2021F, and recovery in 2022F – 2023F. The underperformance is expected to be led by the economy segment (-3.0%) in 2021F and to the least extend, the upscale (-0.6%) and the upper upscale segments (0.3%).
- **ADR and RevPAR:** ADR remains resilient in the coming three years, with RevPAR clocking in a dip in 2021F attributable to industry wide declines in occupancy for that year. Recovery of RevPAR is expected to come in strong in 2023F (+3.8%) led by both improvements in occupancy (+1.7%) and ADR (+2.1%).

Figure 34: Historical and forecasted demand and supply (% change YoY)



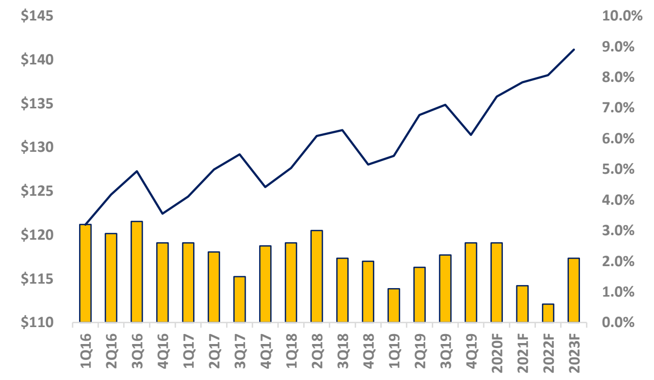
Source: CBRE, KGI Research

Figure 35: Historical and forecasted room occupancy (% change YoY)



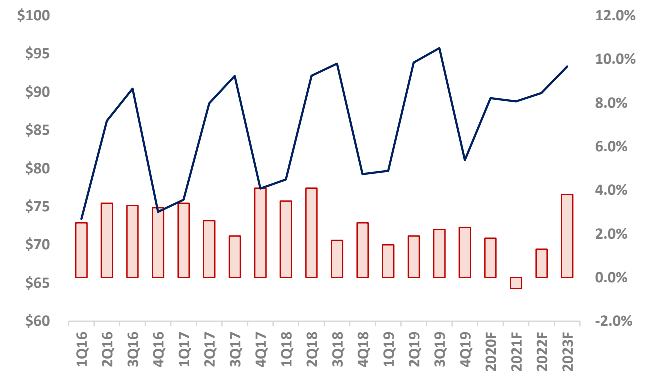
Source: CBRE, KGI Research

Figure 36: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 37: Historical and forecasted RevPAR (% change YoY)

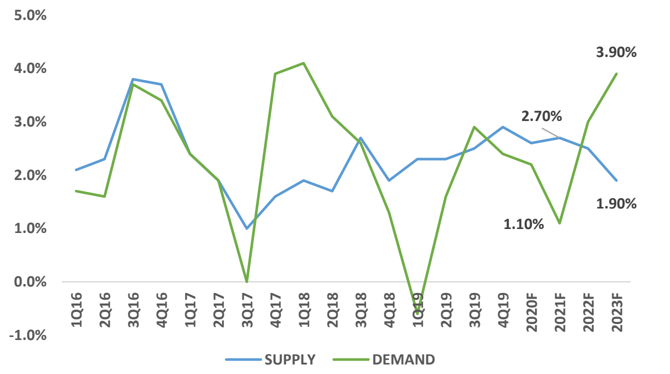


Source: CBRE, KGI Research

Luxury segment hotel performance

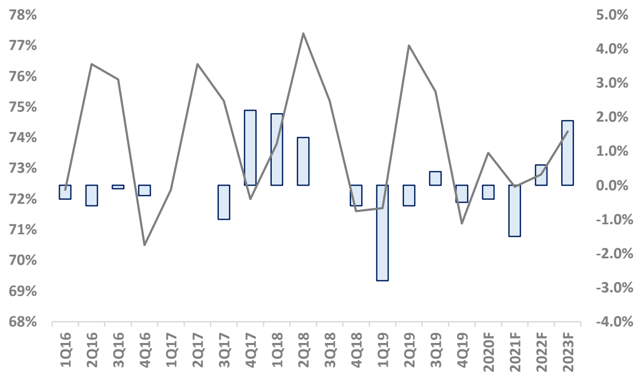
- **Demand and Supply:** Expectations are in line with the rising standard of living and a global trend benefiting the luxury hotel market (demand to grow at 4.7% across 2018 – 2023). Supply continues to dwindle due to the lack of location substitute, and the rising cost of construction that is pervasive in this segment of hotels. As of end 2018, a total of 11,152 luxury hotel rooms are under construction (30% YoY), representing 8.9% of existing stock.
- **Occupancy**: Occupancy is expected to remain rather flattish from 2020F – 2023F, averaging at 0.15%. On the back of resilient demand, occupancy is expected to improve from 71.2% as of year-end to 74.2% in 23F.
- **ADR and RevPAR:** ADR's growth (1.5%) is expected to trend below average (1.6%) over the next four years. ADR is expected to increase from $356.60 in 4Q19 to $364.16 in 23F.

Figure 38: Historical and forecasted demand and supply (% change YoY)



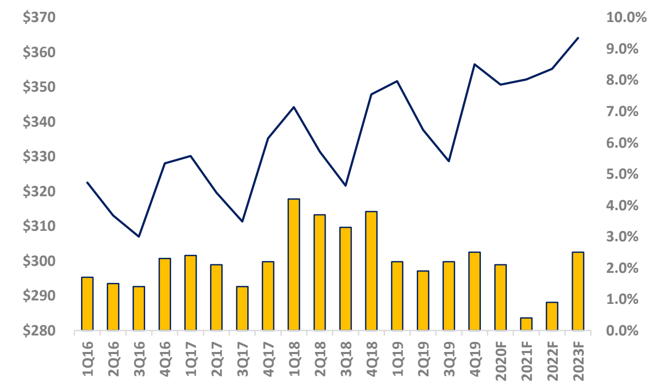
Source: CBRE, KGI Research

Figure 39: Historical and forecasted room occupancy (% change YoY)



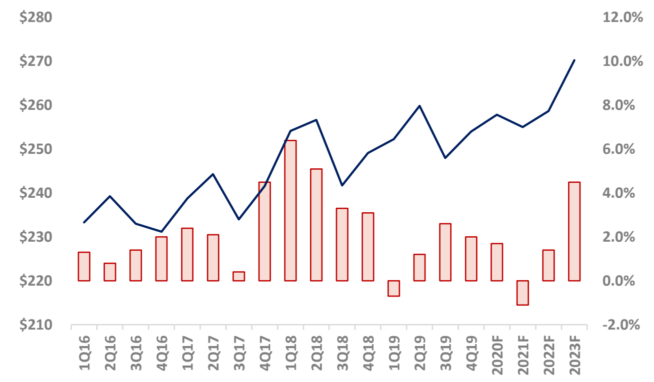
Source: CBRE, KGI Research

Figure 40: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 41: Historical and forecasted RevPAR (% change YoY)

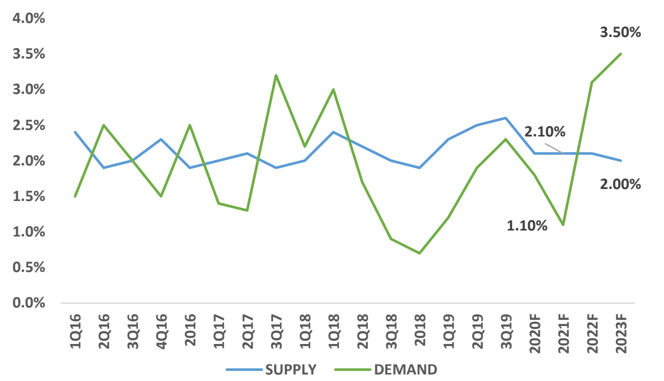


Source: CBRE, KGI Research

Upper upscale segment hotel performance

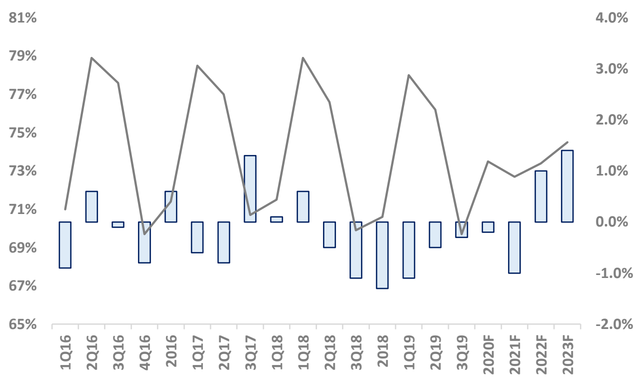
- **Demand and Supply**: Growth in this segment reflects a similar trend compared to the luxury segment, with the upside of lower supply coming in within the future four years, at an average of 2% yearly increment. A total of 24,286 hotel rooms remain within the upcoming supply pipeline, representing 3.9% of total existing room count.
- **Occupancy**: Occupancy growth is expected to be negative in 2021F at -1.0%, and is expected to recover to 1.4% in 2023F, and record an average growth of 0.3% across 2020F – 2023F. Occupancy will likely remain flattish between 73.6% in 4Q19 to 74.5% in 23F.
- **ADR and RevPAR:** RevPAR growth will continue to place higher reliance on increment in ADR, and clock in a growth (1.8%) above industry average (1.6%) for the same forecasted period.

Figure 42: Historical and forecasted demand and supply (% change YoY)



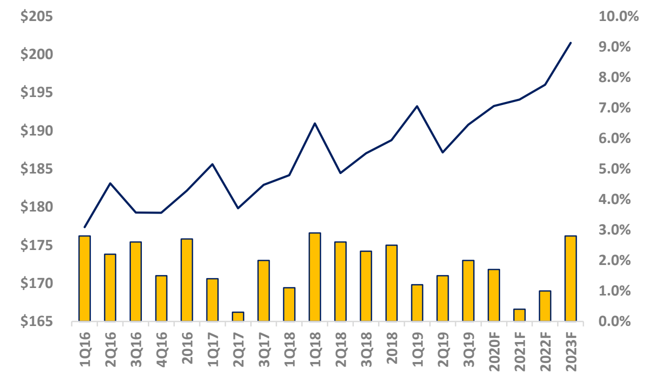
Source: CBRE, KGI Research

Figure 43: Historical and forecasted room occupancy (% change YoY)



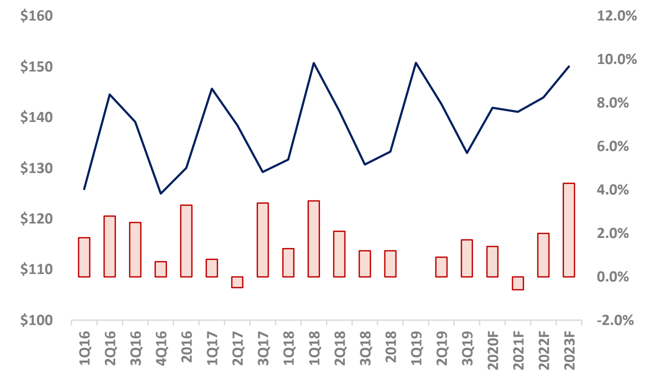
Source: CBRE, KGI Research

Figure 44: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 45: Historical and forecasted RevPAR (% change YoY)

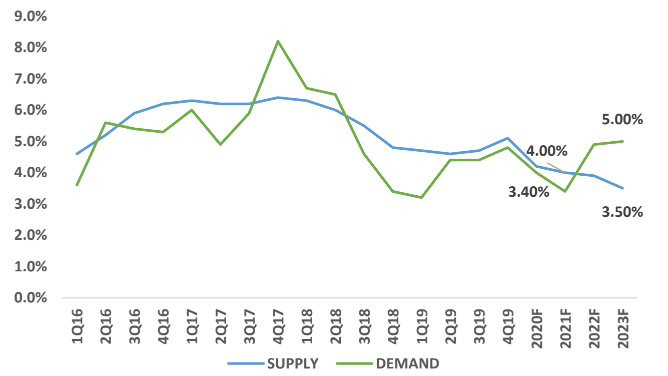


Source: CBRE, KGI Research

Upscale segment hotel performance

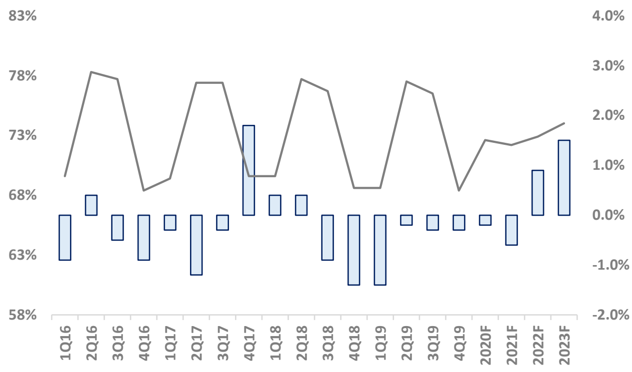
- **Demand and Supply**: Demand is expected to hold up well (4.33% across 2020F – 2023F) at the back of a large inventory stock entering the market in the coming years. A total of 24,286 hotel rooms remain within the upcoming supply pipeline, representing 3.9% of total existing room count. In terms of total construction count reported in 2018, the upscale and upper midscale dominates at over 61% of total new rooms across all segments.
- **Occupancy**: Occupancy is forecasted at 72.6% and 74.0% for 2020F / 2023F respectively, a decline from 2Q19 (77.5%).
- **ADR and RevPAR:** RevPAR to trend upwards in the next 4 years at a CAGR of 1.5% to $113.02 in 2023F, supported by both occupancy rates and ADR.

Figure 46: Historical and forecasted demand and supply (% change YoY)



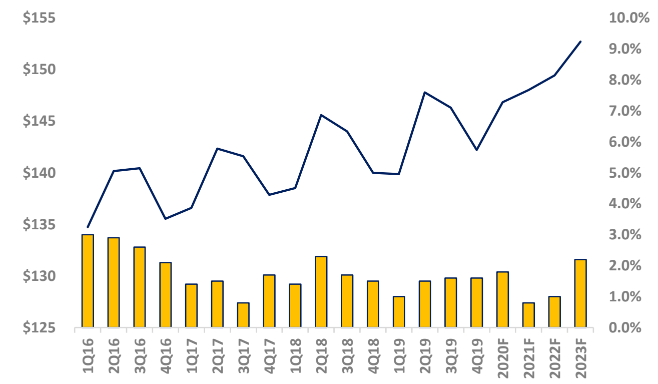
Source: CBRE, KGI Research

Figure 47: Historical and forecasted room occupancy (% change YoY)



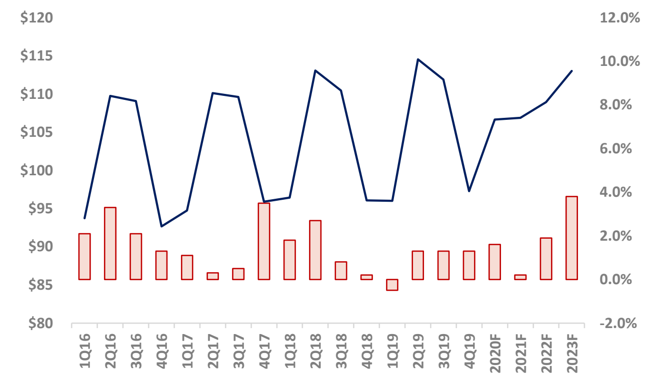
Source: CBRE, KGI Research

Figure 48: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 49: Historical and forecasted RevPAR (% change YoY)

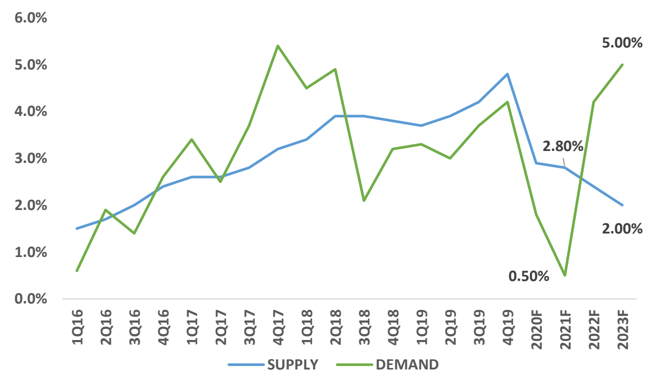


Source: CBRE, KGI Research

Upper midscale segment hotel performance

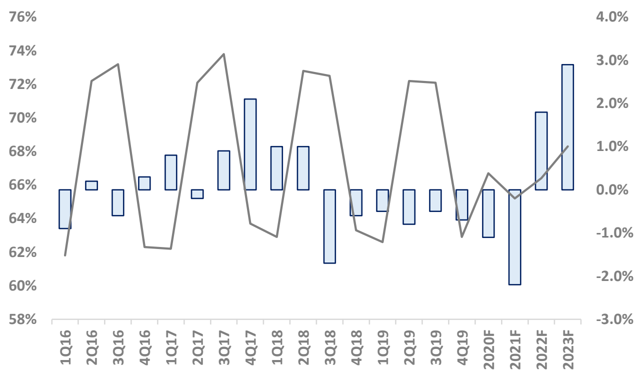
- **Demand and Supply**: Growth in demand to taper off until 2022F and 2023F according to CBRE. A total of 56,759 hotel rooms remain within the upcoming supply pipeline, representing 5.8% of total existing room count.
- **Occupancy**: We can expect occupancy rates to be near current levels in the coming years – 66.7% / 65.2% / 66.4% for 2020F / 2021F / 2022F.
- **ADR and RevPAR:** RevPAR remained flattish in the past four quarters at an average of 0.5%, but a sharp pick up is expected in 2021F where RevPAR is forecasted to increase 5.3% YoY, leading industry RevPAR growth for 2023F (3.8%).

Figure 50: Historical and forecasted demand and supply (% change YoY)



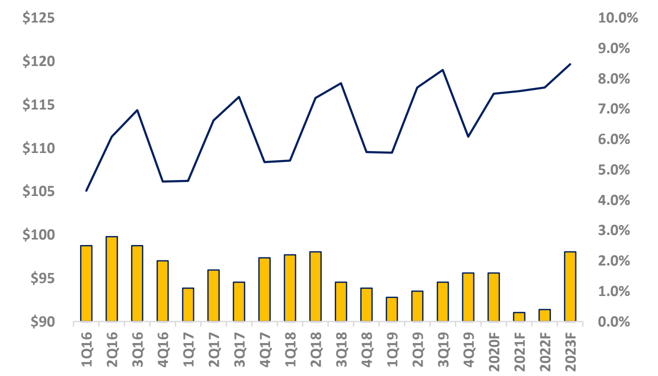
Source: CBRE, KGI Research

Figure 51: Historical and forecasted room occupancy (% change YoY)



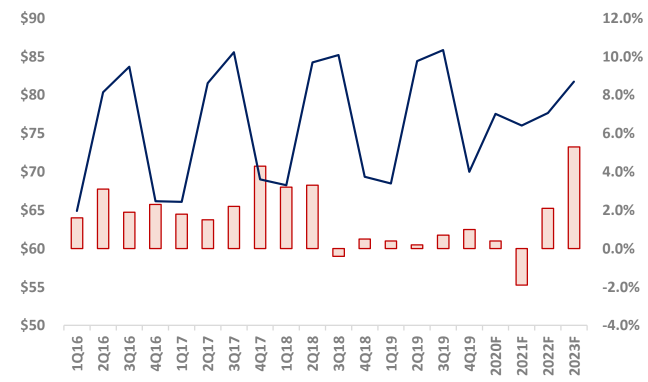
Source: CBRE, KGI Research

Figure 52: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 53: Historical and forecasted RevPAR (% change YoY)

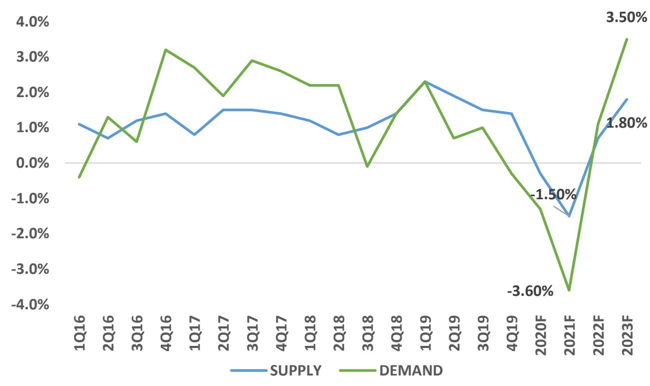


Source: CBRE, KGI Research

Midscale segment hotel performance

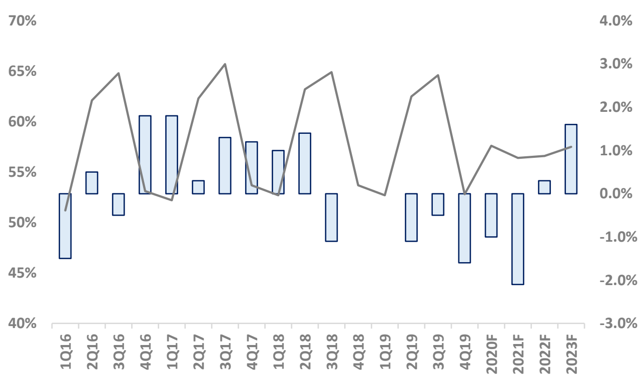
- **Demand and Supply**: The midscale segment is the only segment across the chain scale expected to see a noticeable dip in demand in the coming two years. Demand is forecasted to decrease 1.3% and 3.6% YoY in 2020F and 2021F. Demand for hotels in the midscale segment (1.1% and 3.5% YoY in 2022F and 2023F) continues to lag behind segments that may increasingly provide better value propositions to leisure and business travellers such as the upper midscale (4.2% and 5.0% YoY in 2022F and 2023F) and upscale segments (4.9% and 5.0% YoY in 2022F and 2023F).
  New rooms under construction boomed within the midscale segment, increasing 37% YoY to 15,871 rooms in construction as of end 2018, or 3.2% of existing room stock.
- **Occupancy**: Outlook for occupancy is flattish at best for the midscale segment in the range of 57.6% and 57.5% in the forecasted years 2020 and 2023 respectively. Occupancy range of 51% and 66% for the past quarters 1Q16 and 2Q19 shows an obvious step down compared to the above four chain scales that range between 62% and 80%.
- **ADR and RevPAR:** ADR growth (1.1%) a laggard as compared to industry average growth from 20F to 23F (1.6%).

Figure 54: Historical and forecasted demand and supply (% change YoY)



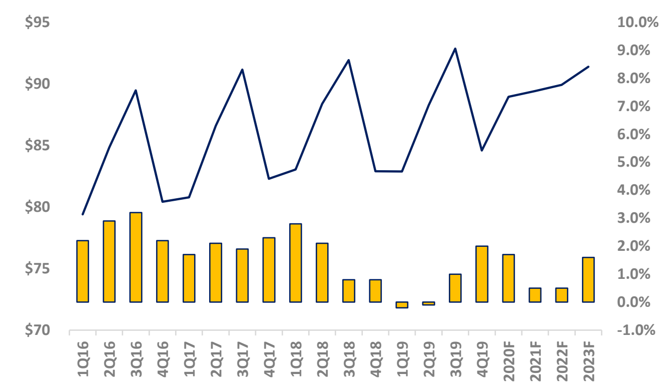
Source: CBRE, KGI Research

Figure 55: Historical and forecasted room occupancy (% change YoY)



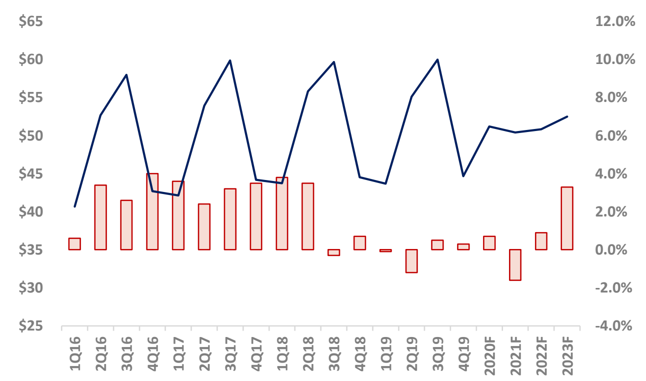
Source: CBRE, KGI Research

Figure 56: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 57: Historical and forecasted RevPAR (% change YoY)

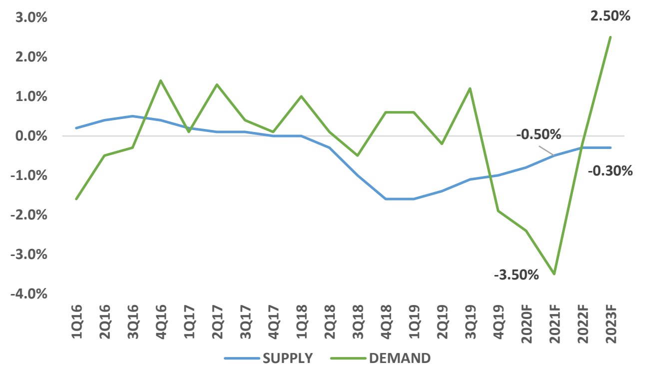


Source: CBRE, KGI Research

Economy segment hotel performance

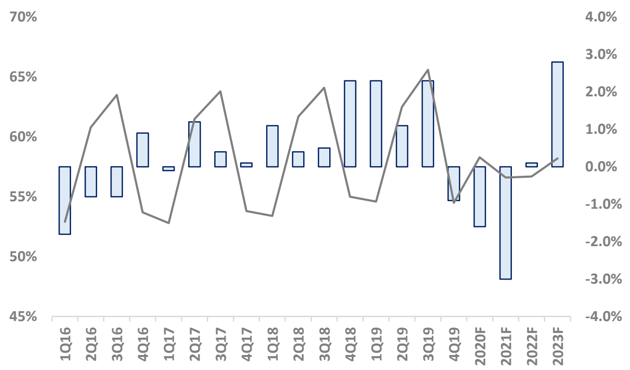
- **Demand and Supply**: The economy segment represents the only category with an obvious declining demand trend (-0.9% from 2020F to 2023F). Alongside the midscale and economy segments, the economy segment continue to face substitution by Airbnb.
  Rooms planned for construction doubled from 2017 to 2018 within the economy segment, increasing from 1,861 rooms to 3,729 rooms. This figures translates to just 0.5% of total room stock.
- **Occupancy**: Vacancy expectations remain the highest across all segments at -1.6% and -3.0% in the next two years, despite the having the lowest upcoming supply stock. Occupancy is expected to stay flattish between the years 2020F and 2023F at 58.3% and 58.2% respectively.
- **ADR and RevPAR:** A rebound in RevPARs is anticipated to materialise in 2023F, with low expectations between the years 2020F and 2023F. This was attributed primarily to a lacklustre occupancy outlook, as ADR growth is likely to remain stable at 1.8%, above industry average (1.6%).

Figure 58: Historical and forecasted demand and supply (% change YoY)



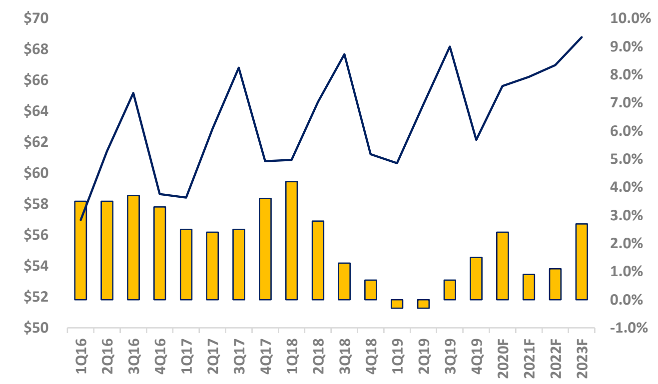
Source: CBRE, KGI Research

Figure 59: Historical and forecasted room occupancy (% change YoY)



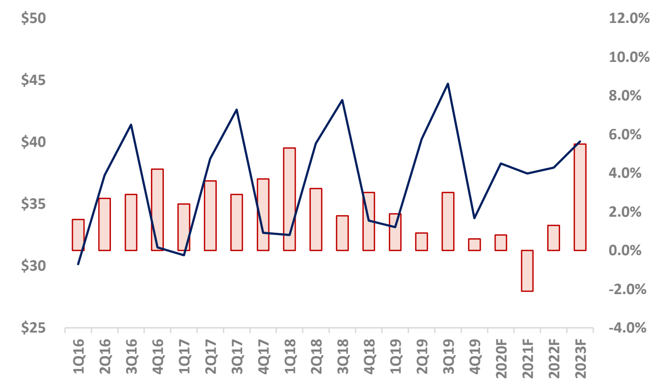
Source: CBRE, KGI Research

Figure 60: Historical and forecasted ave daily room rate (% change YoY)



Source: CBRE, KGI Research

Figure 61: Historical and forecasted RevPAR (% change YoY)



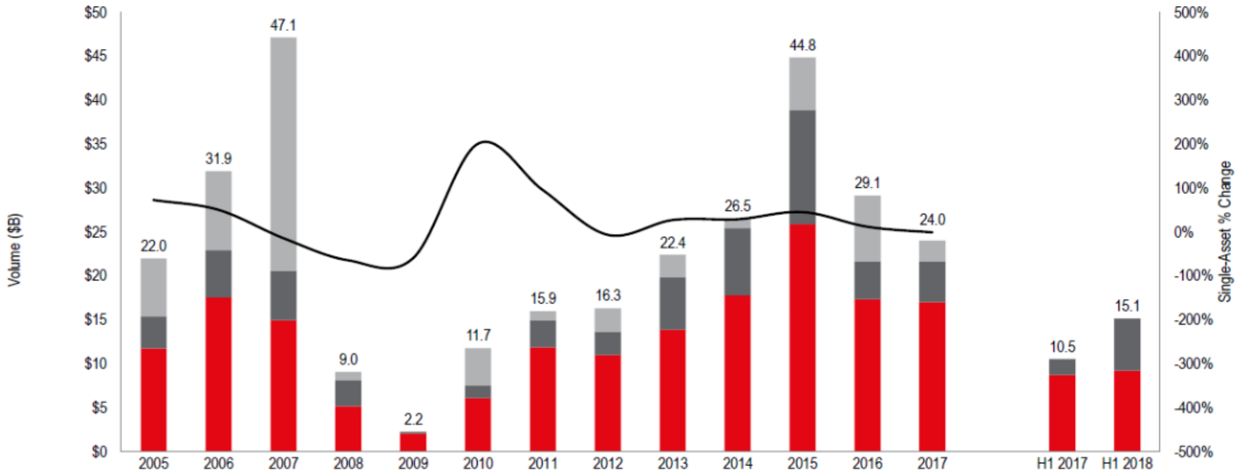
Source: CBRE, KGI Research

U.S. hotel investment outlook

Buoyant investor interest in U.S. hospitality assets

The volume of U.S. hotel investment sales increased dramatically between 2009 and 2015, when investment sales reached a cyclical peak of $44.8 billion. Single-asset sales reached an historic high of $25.9 billion in 2015. Since then, transaction activity has declined but remains robust with U.S. hotel transactions totalling $29.1 billion and $24.0 billion in 2016 and 2017, respectively. Most recently, year-to-date transactions in the first half of 2018 climbed 44% above the level recorded for the first half of 2017 due to significant portfolio transactions activity.

Figure 62: U.S. Hotel Transaction Volume



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	H1 2017	H1 2018
U.S. hotel transaction volume	22.0	31.9	47.1	9.0	2.2	11.7	15.9	16.3	22.4	26.5	44.8	29.1	24.0	10.5	15.1
Mega Portfolio M&A	6.6	9.0	26.6	0.9	0	4.3	1.0	2.7	2.5	1.1	6.0	7.5	2.4	0.0	0.0
All Other Portfolios	3.6	5.3	5.6	2.9	0.2	1.4	3.1	2.6	6.0	7.6	13.0	4.3	4.6	1.8	5.9
Single Assets	11.7	17.5	14.9	5.1	2.0	6.1	11.9	11.0	13.9	17.8	25.9	17.3	17.0	8.7	9.2
Single-Asset % Change	72%	50%	-15%	-66%	-61%	200%	95%	-8%	26%	28%	44%	11%	-2%	-19%	6%
Total Number of Transactions	302	431	434	218	97	161	247	324	404	486	585	414	391	92	131

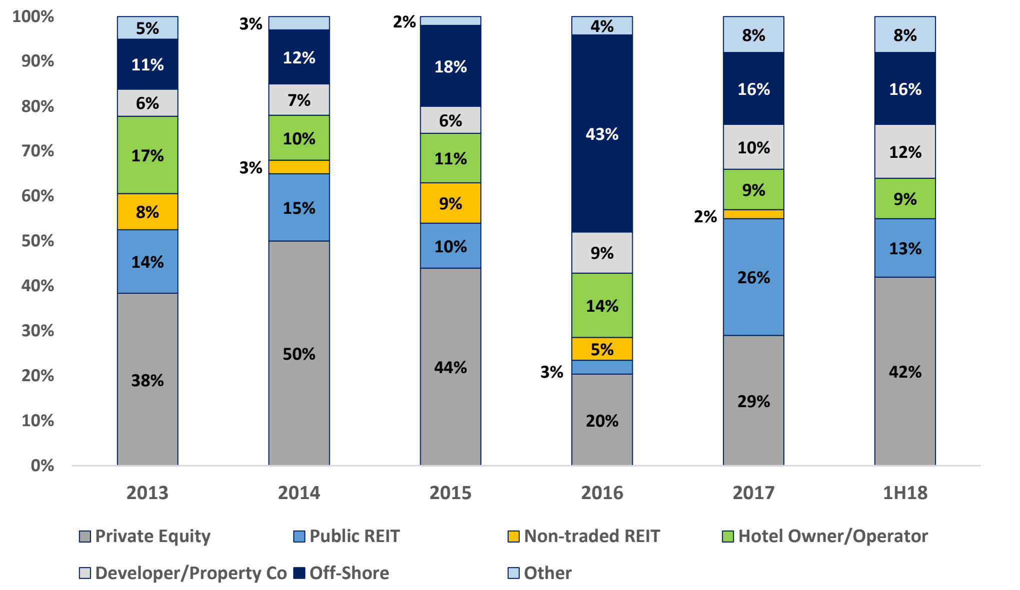
*Source: JLL, KGI Research *Mega portfolio pertains to deals $2bn and above*

Private equity and REITs account for nearly half of transaction volume

Private-equity buyers accounted for 27% of hotel purchases in 1Q19, with a focus on full-service single assets in top markets such as New York and California. REITs continued to pursue acquisition opportunities and accounted for 21% of quarterly volume. A lodging REIT also acquired the highest-value hotel asset on a per-room basis in the first quarter, the One Hotel South Beach.

Cross-border investment was lacklustre in 1Q19 as attractive opportunities were offset by the strong U.S. dollar and currency hedging costs.

Figure 63: U.S. hotel buyer composition



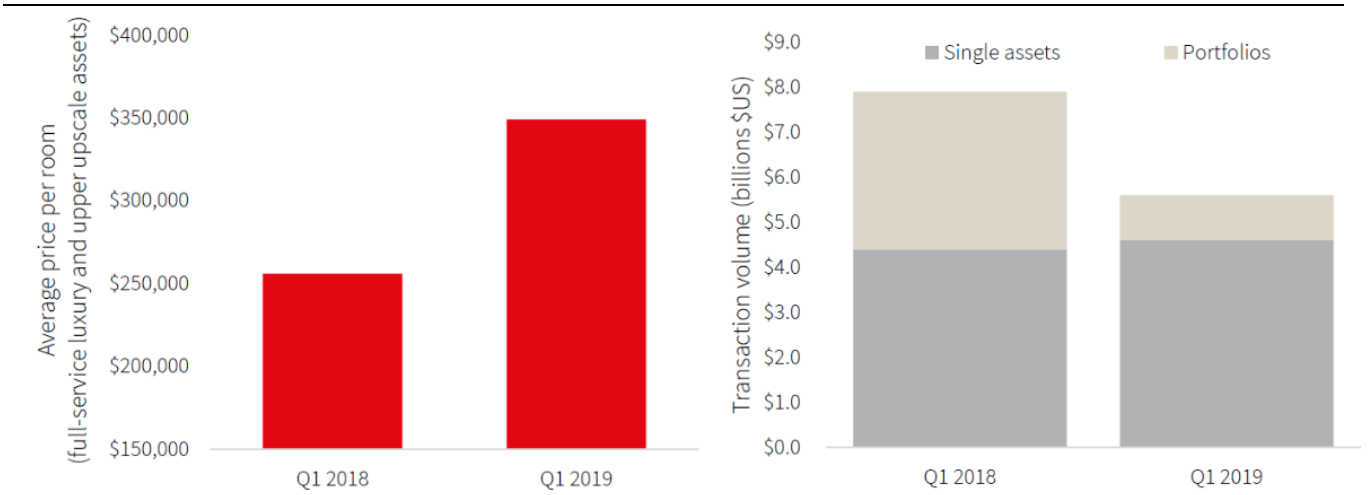
Source: JLL, KGI Research

Single asset sales taking predominance over portfolio purchase

U.S. hotel transaction volume of $5.6bn in 1Q19 represents a 30% dip YoY. Single-asset sales transaction volume took predominance in the first quarter, accounting for over 80% of activity.

Full-service luxury and upper upscale assets represented an increased amount of overall volume in 1Q19, rising from 33% of activity in 1Q18 to 59% of activity in 1Q19, evidencing investors' flight to quality. Investors focused on high-quality assets in urban markets as total transaction volume for these types of hotels more than doubled to $2.6bn in 1Q19.

Figure 64: Average price per room increased 36% in 1Q19 compared to 1Q18; portfolio purchase dipped in 1Q19 with investors approaching bulk acquisitions more purposefully



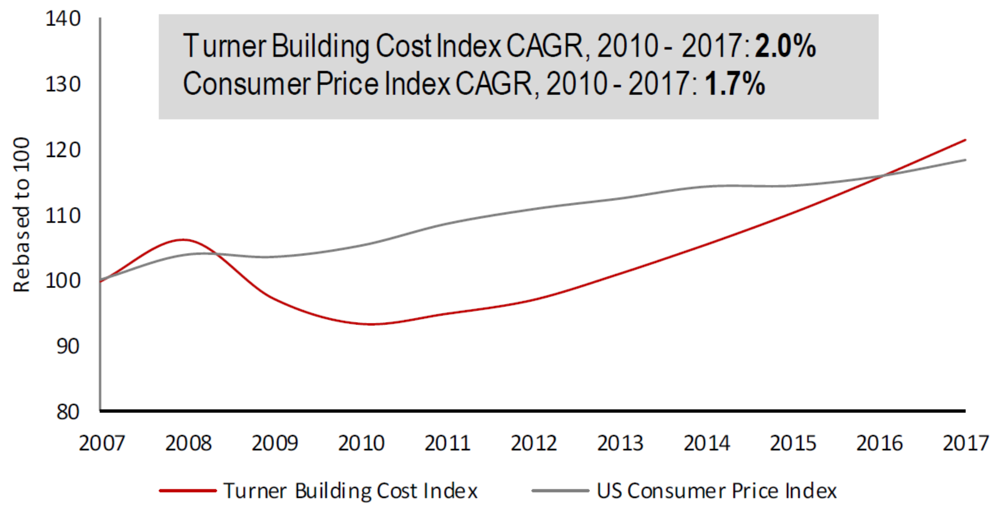
Source: JLL, KGI Research

Hotel construction costs

No slowdown was witnessed within the new hotel construction development cycle, supported by lower construction costs, smaller site requirements, fewer building amenities and efficient operating structure.

Rising cost of construction was driven primarily by higher labour costs and material pricing through a broader trend of wage increment in the U.S. and tariff on building materials (steel, aluminium etc) resulting from the U.S. China trade war. The lack of material pricing certainty remains an operational challenge for developers. The ENR materials cost index (as of April 2019) was up 4.4% from the prior year, driven by significant increases in cement prices (12%), and partly neutralised by dipping lumber prices (-2.7%).

Figure 65: Turner building cost index in comparison with the overall inflation rate



Source: Turner Construction, U.S. Bureau of Labor Statistics, JLL, KGI Research

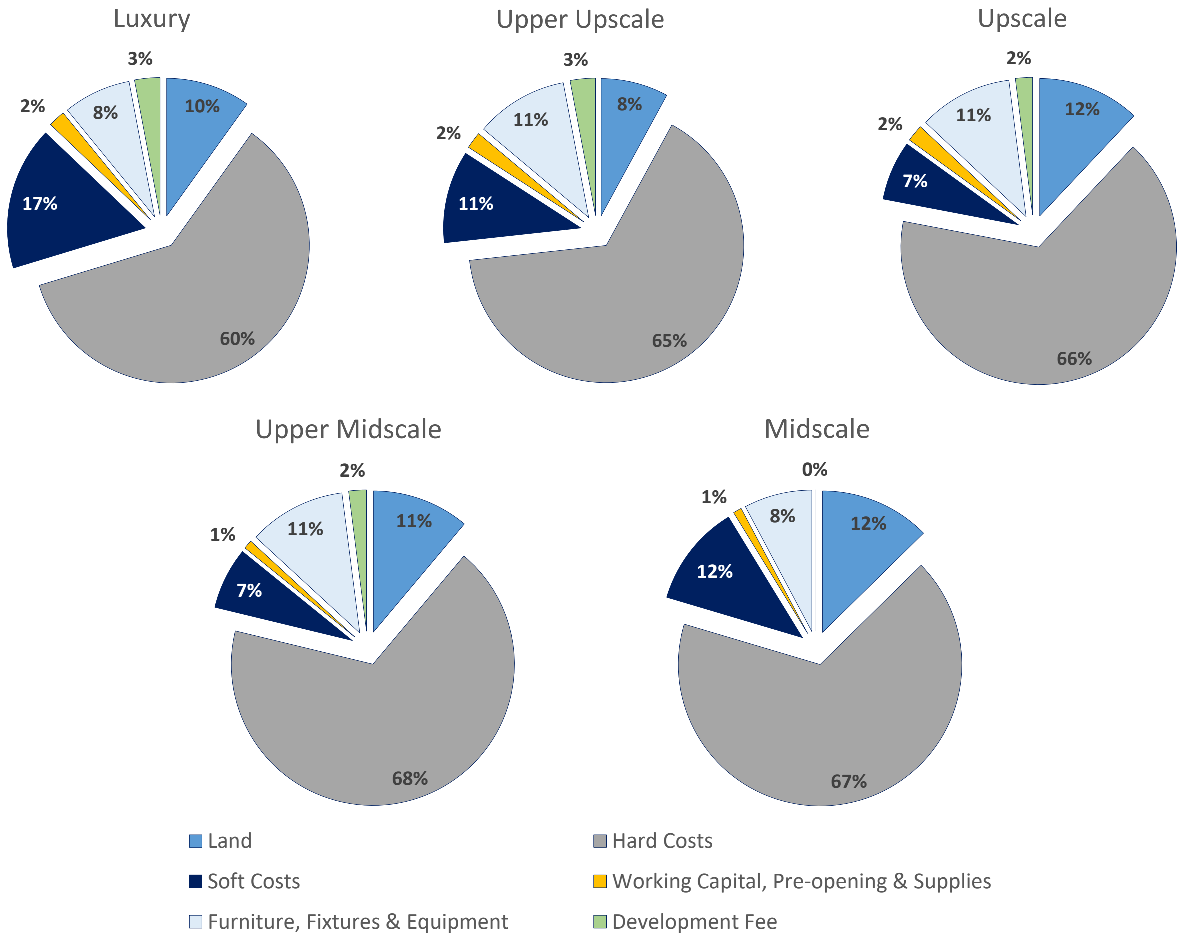
Hard costs remains the largest expense item within hotel development, marked by the Turner Construction index. The Turner Building Cost Index grew an annualised 6% for non-residential construction between 1Q18 and 1Q19, the highest growth since 2010.

Average hotel construction cost breakdown by segment

Last year, 150,169 hotel rooms opened across 1,203 projects, with the bulk (72.8%) belonging to the Midscale, Upper Midscale and Upscale segments. Rooms within the economy segment (2.5%) and luxury (3.3%) segment reflected the most challenging economic circumstances pertaining to feasible development, high land and construction costs. As of April 2019, there remains to be 1,575 projects within the pipeline accounting for 203,890 rooms in construction, a 9.9% YoY increase for the same period last year.

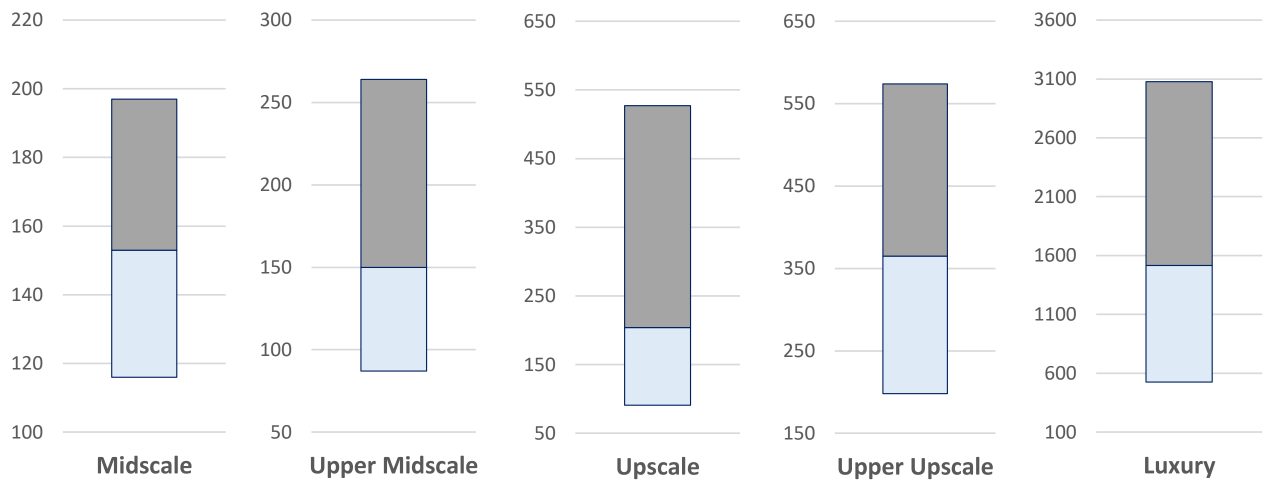
An ongoing shortage of skilled tradespeople continue to put pressure on development costs. Hard costs remain the largest portion of hotel development cost. This segment of cost remains to be volatile and higher than general inflation. Soft costs consist of financing costs, entitlement costs, legal, insurance and taxes etc.

Figure 66: Breakdown of construction costs by hotel segment



Source: Cushman & Wakefield, KGI Research
** Midscale developer fee excluded within statistics due to lack of data*

Figure 67: Average construction cost per room by segment (Min | Ave | Max)



Source: Cushman & Wakefield, KGI Research

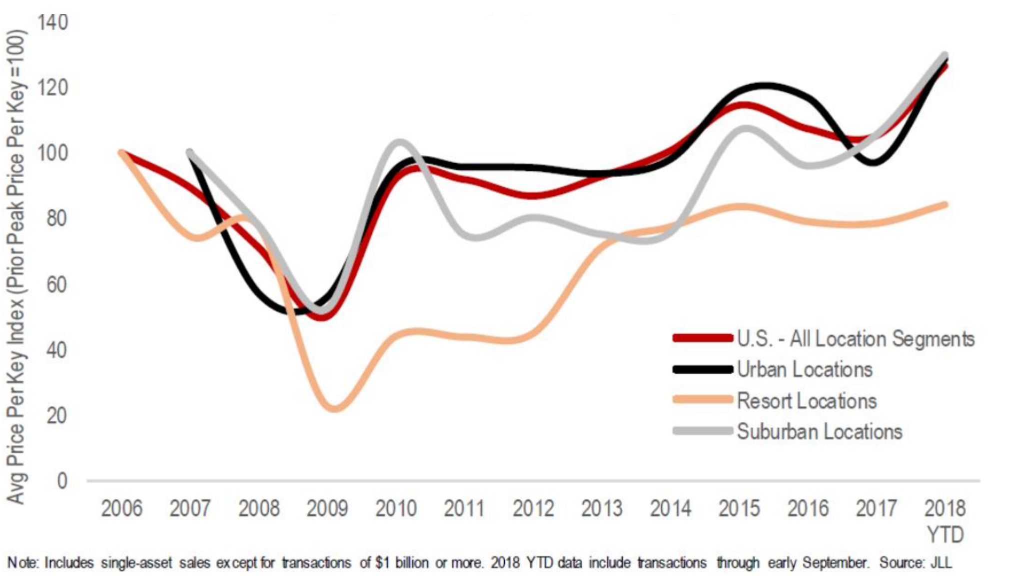
However, RevPAR growth expected to slow down, operating costs to increase, and construction costs to escalate, the actual completion of proposed hotels is likely to become more challenging.

Price per key

The average price per key for U.S. hotel sales has increased significantly from $99,000 in 2009 to $209,000 in 2017. The average price per key for 9M18 rose further to $251,000 per key. Appreciation relative to peak pricing before 2008 in the prior market cycle remains relatively modest. Average price appreciation will amount to only 2.0% per year during the last 12 years.

The average cap rate for U.S. hotel sales stood at 7.6% for 9M18, from 6.8% in 2014. Specifically, the average price per key for full-service assets led the growth trend, transacting at an average of $280,000 per key, compared to $175,000 per key across all segments. This trend was perhaps attributed to greater supply growth pressures in the select-service segment.

Figure 68: Average price per key by location segment



Source: JLL, KGI Research

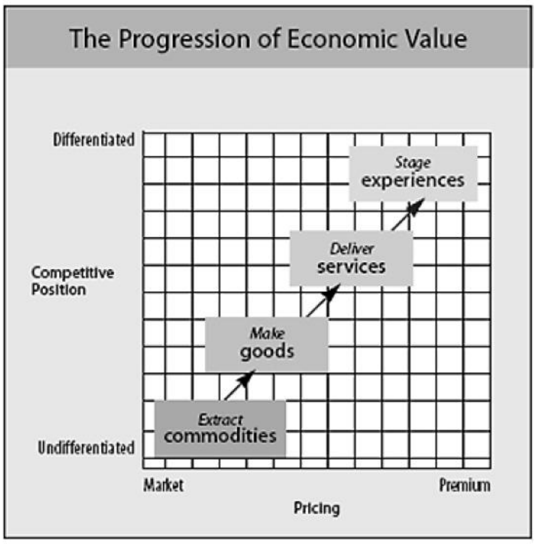
U.S. lodging industry trend – Airbnb, friend or foe?

Technology & the experience economy

Technological innovations in the last decade have metamorphosed the travel and hospitality industries, and will only continue to do all the more so.

The epitome of the 'Experience Economy', an idea first introduced by Pine II and Gilmore in an issue of the Harvard Business Review in 1998, is now. The 'Experience Economy' suggests that as services, like goods, become increasingly commoditized, experiences are the next step in the progression of economic value. And in a post-consumerist society where consumers today become more willing and able to seek out unique and authentic experiences that serve their self-actualisation needs, whether the simple physical offering of a hotel room will suffice, is questionable.

Figure 69: The Progression of Economic Value



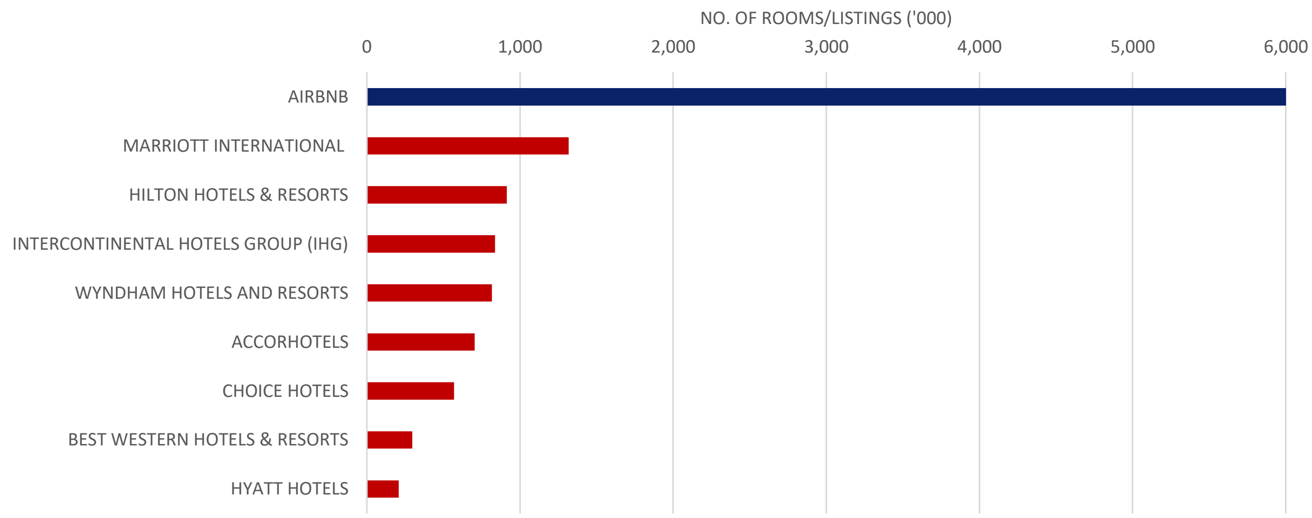
Source: Pine II & Gilmore, 1998, Jul-Aug Harvard Business Review, KGI Research

AIRBNB - one of the most significant entrants and an infamous disruptor of the hospitality industry. Since Airbnb's emergence in 2008, it has been revolutionizing the lodging market, offering much more than just accommodation – personalization, interaction, and experiences. Through Airbnb, travelers have a vast number of options to match their needs and preferences – an almost customizable stay.

Possibilities are endless: whether location, price, size, number of rooms, apartment, camper van, treehouse. Airbnb Experiences offers travelers an insight into their destination's highlights, hidden gems, and allows them to communicate with locals who have the best recommendations whether for food, sights, sports, theatre etc. Airbnb for Work also expanded in 2018 beyond just accommodating for business travel, to include team building experiences, hosting offsite meetings, and relocations. Finally, Airbnb Luxe goes above the top, offering grand properties – villas, designer homes, castles – with a designated trip advisor and designer, and tailored itineraries to go along.

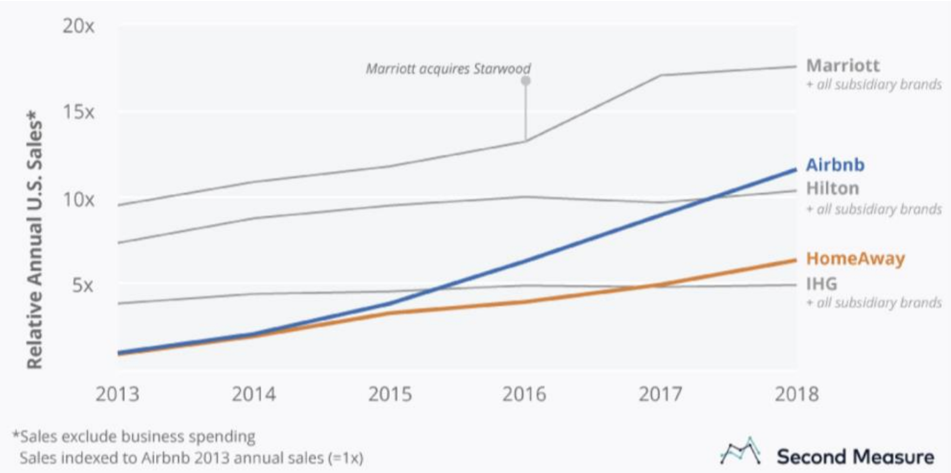
Today, Airbnb reports over 6 million listings worldwide, while according to Second Measure, a data analytics platform that analyses billions of U.S. consumer credit card transactions, Airbnb's annual sales also surpassed Hilton's in 2018.

Figure 70: Largest lodging companies by rooms/listings, 2018



Source: KGI Research

Figure 71: Airbnb U.S. sales against industry competitors



Source: Second Measure, KGI Research

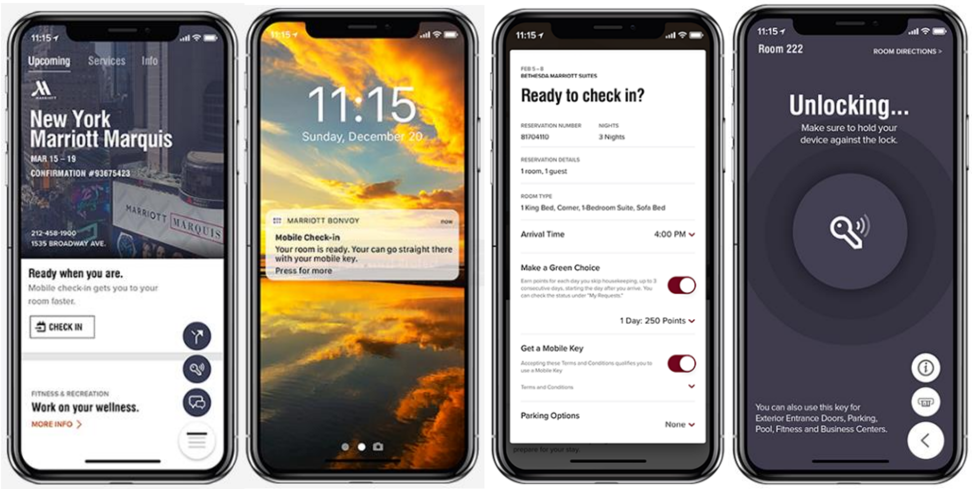
A formidable contender, not only would Airbnb's unique offerings affect hotels' occupancy rates, particularly select and limited-service hotels that share the same service level as Airbnb homes, but also potentially their ability to take advantage of and charge a premium during 'compression nights' (periods of peak demand), as the total number of rooms available would no longer be at fixed capacities with the availability of home-sharing.

Hospitality stepping up

While Airbnb fights off regulatory home-sharing laws in the 100,000+ cities it operates in, major hotel brands have been stepping up and innovating as quickly and extensively as possible, be it launching mobile applications that go beyond a room booking platform, entering new markets, or designing 'connected rooms' that may be voice or mobile controlled. Hilton has also been quick to emphasise the distinction between the lodging and hospitality markets, and differentiate themselves as being in the hospitality market where exceptional service delivers exceptional experiences.

Launched in February earlier this year, the latest Marriott's Mobile App allows users to check in before arrivals, unlock their rooms with their iPhones or Apple Watch, and instantly chat directly with a hotel host or submit mobile requests for service and amenities anytime during or up to 24 hours prior to their stay.

Figure 72: Marriott's new mobile application features



Source: Marriott Bonvoy, KGI Research

The World of Hyatt and Hilton Honors applications also offers similar functions with some added features. The World of Hyatt application has an added ability to access and stream personal content directly into the in-room TV through SONIFI's patent-pending Staycast™ powered by Google Chromecast. A first-of-its-kind integration, participating Hyatt hotels now offer guests simple, seamless and secure streaming of their favorite apps, such as Netflix®, Hulu®, YouTube® and 1,000+ others.

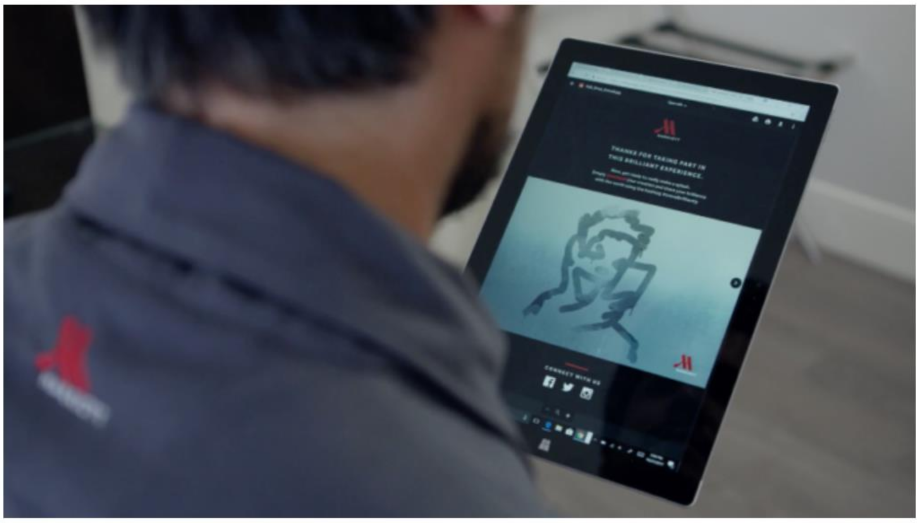
The Hilton Honors app on the other hand allows guests to choose their preferred room layout prior to check-in, then seamlessly control their room's lighting, temperature control, and entertainment options.

In 2018, Marriott explored the home-sharing business through partnering with Hostmaker, a home-rental management company, in a pilot program, and offered 340 properties for home-sharing stays in Paris, Rome, Lisbon and London. The properties came with a 24-hour support line and an in-person check-in through Hostmaker. Marriott has also said it guarantees hotel-like standards that are often overlooked in home-sharing, such as Wi-Fi, crisp white sheets, bath amenities, baby cribs and smoke alarms.

Following the success of its pilot program, Marriott became the first major hotel company to create a home-rental platform for the U.S. earlier this year. Marriott would allow guests using the platform to earn and redeem loyalty points as they do with other brands Marriott owns, including Sheraton, W hotels and Ritz-Carlton. Hyatt and Wyndham have also been exploring these options, in order to take on the home-sharing giant, Airbnb.

Marriott was also the first major hotel chain to offer Alexa for Hospitality, which is now available at select Marriott, Westin, St Regis, Aloft and Autograph Collection hotels. Its Internet of Things (IoT) Guestroom Lab in partnership with Samsung and Legrand also continues to explore concepts that aim to further elevate the guest experience, such as a technology that enables shower doors to record inspiration marked in condensation/steam.

Figure 73: Marriott's pilot technology that enables shower doors to record drawings/writings in condensation



Source: Marriott, Hotel Technology News

Hyatt is similarly keeping up with its technological innovations, as they collaborate with Google to pilot a new capability of the Google Assistant – Interpreter Mode. With this feature, guests and colleagues are able to receive translations for dozens of languages and conduct conversations in real time via a Google Home Hub.

Major hotel brands are also championing corporate responsibility and sustainability policies, such as IHG's Green Engage™ system, and most announcing global efforts to reduce single-use plastics, food waste, carbon emissions and water consumption. Hilton as an example, has pledged its commitment to the UN CEO Water Mandate, and partnered with World Wildlife Fund, while Hyatt is a signatory to the Hotel Owners for Tomorrow Coalition, which sets forth commitments and five actions to promote sustainability across hotel owners in Asia.

All of the above have been continuous innovation efforts by major hotel brands and chains to go the extra mile and increasingly appeal and adapt to the millennial mindset, and to keep themselves relevant in such a highly competitive sector. While Airbnb may offer experiences hosted by locals, and unique accommodation styles, hotel brands such as Marriott, Hilton, IHG and Hyatt offer first-rate hospitality services that continuously go beyond simply providing a roof and a bed to guests. Though easily overlooked, it is still important to distinguish the sheer convenience, comfort and luxury that those in the hospitality realm offer.

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Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.

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