# U.S. Hospitality Sector Outlook

## Winners to emerge stronger

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### Valuation and Action

**Maintain OUTPERFORM on ARA US Hospitality Trust (ARAUS SP) with revised 12M TP of US$0.67.** We remain optimistic on ARA's portfolio's ability to outperform its peers due to the quality of its assets. Our TP represents an 87% upside (incl. div) to the current price. We expect 2Q20 to bear the brunt of 'peak shutdown', then 2H20 to present a stunted recovery before a full recovery in 2H 2022. Read our 1Q company update for more details.

**Defensive portfolio with cost flexibility associated with the select-service and extended-stay sector to keep margins buoyant.** With 85-90% of variable costs, management has been diligent and proactive in implementing cost saving initiatives, saving up to US$143k per month as demand declines.

**Risks:**

- **Despite loan covenant waivers for the next 12 months, property values may not recover in time.** While demand may improve over the next year, we remain cautious as it may not be sufficient to support a RevPAR growth recovery – especially amid a recession, ongoing trade tensions, and a pending year-end election. Lodging property prices have also seen strong downward pressure in the last three months since the Covid-19 outbreak.

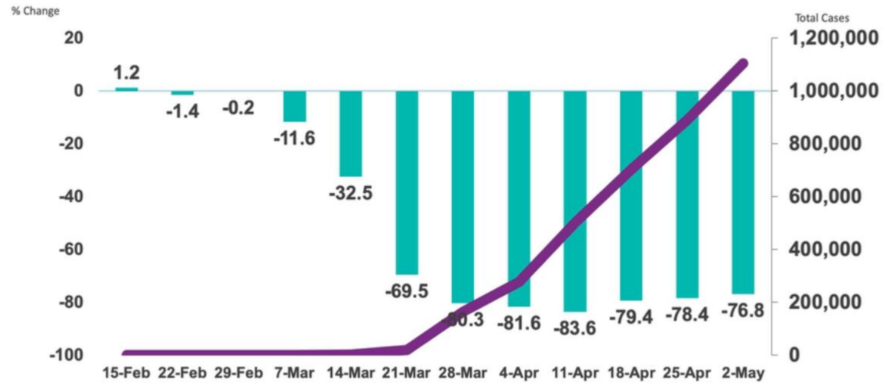
- **A second wave.** Critics have been quick to warn the US of opening up too quickly, as it may trigger a second wave of infections that will prove to be only more destructive.

### US Hospitality's 1Q in Review

**The worst is over. Maybe.**

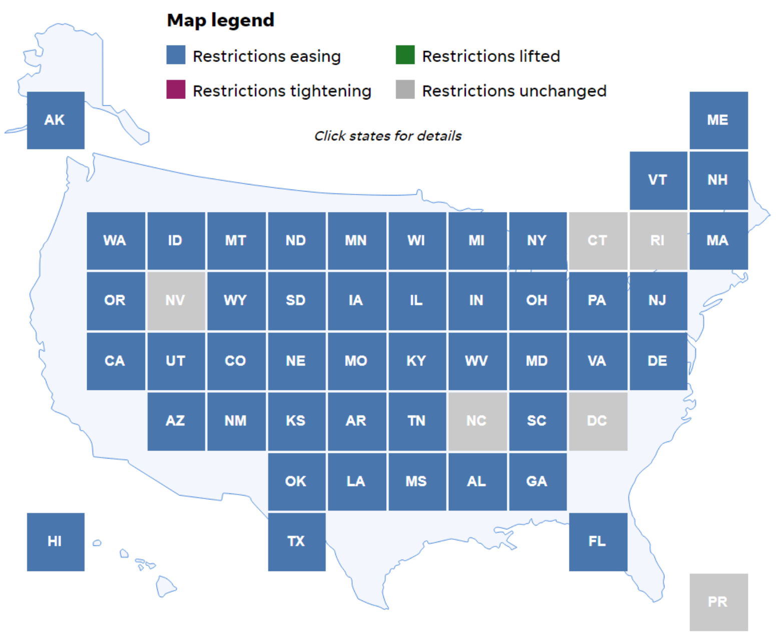
By the looks of improving RevPAR and occupancy rates, the US hospitality industry seems to have seen its worst in the week of April 11th, after eight weeks of consecutive declines. As of May 2nd, RevPAR has seen its third week in a row of less than -80% YoY declines, and the data shows, while sluggish, some improvements as most states begin emerging from lockdowns. According to USA Today, restrictions have been eased in almost 90% of the US with businesses, malls, and even some parks and beaches set to reopen, although social distancing measures are still in place.

**Figure 1: Total U.S. RevPAR % change and total Covid-19 cases, by week**




*Source: STR, KGI Research*

**Figure 2: Map of which US states' are reopening post Covid-19, as of 9 May 2020**




*Source: USA Today, KGI Research*

Occupancies have also hit an average of about 25% for the week ending May 2nd, from averages of about 15% in the week ending April 11th. Since the reopening of many states after lockdown expiries on 30th April, we have seen occupancy rates on weekends soaring, as pent-up demand for leisure travel emerges, much like the Chinese-termed 'revenge travel'.

**Figure 3: Weekend occupancy of opened up states hit highs of 50-60%, for the week ending May 2**

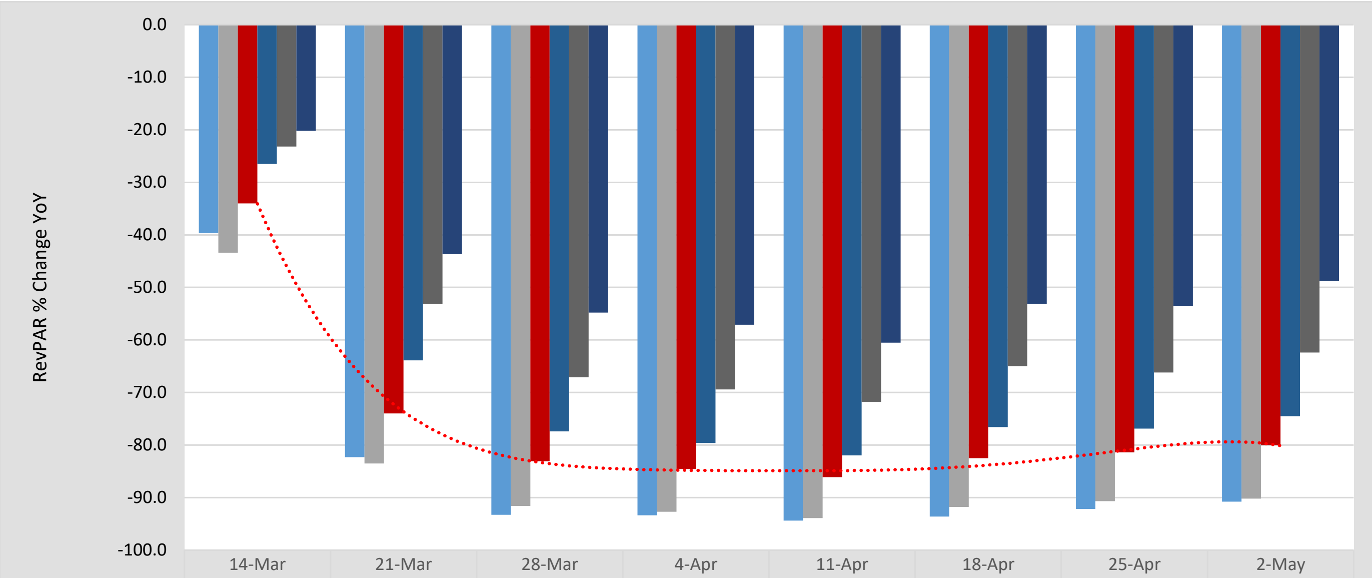
| Submarket | Weekday Occ % | Weekend Occ % | Point Difference |
|---|---|---|---|
| Galveston & Texas City, TX | 26.1 | 57.0 | 30.9 |
| Mobile, AL (Area) | 20.1 | 47.8 | 27.7 |
| Daytona Beach, FL | 21.5 | 45.6 | 24.1 |
| Corpus Christi, TX | 39.7 | 63.3 | 23.6 |
| Panama City, FL | 30.7 | 50.8 | 20.1 |

*Source: STR, KGI Research*

In California where beaches have reopened on 25th April, Americans have also wasted no time in chasing the sun and 'fresh air' despite the heat waves, and even as new coronavirus cases hit a record high in the United States the day before and deaths topped 200,000 worldwide, reports CNA.

**Upscale proving to be a good middle ground on the chain scale.** Magnifying the RevPAR and occupancy data, we see that while the economy class hotels are the most resilient given their affordability especially in such an uncertain economic outlook, the upscale class hotels have not seen the worst of the declines. Additionally, in the event of an eventual recovery of leisure and corporate transient travel, we see the upside in the upscale segment as it provides a balance between indulgence during travel, yet with a more reasonable and affordable price tag. The trend lines in the upscale segment also show an incredibly sluggish recovery since the week ending 11 April, but we note a recovery nonetheless.

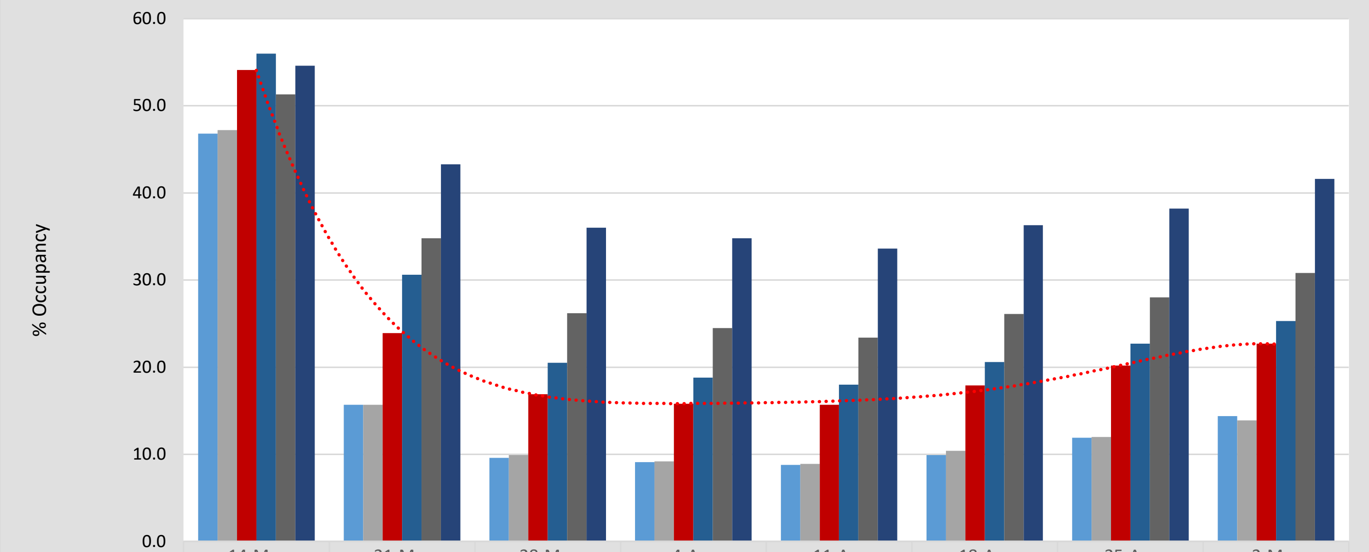
**Figure 4: Total US RevPAR % change, by week and chain scale, 14 Mar – 2 May**




| | 14-Mar | 21-Mar | 28-Mar | 4-Apr | 11-Apr | 18-Apr | 25-Apr | 2-May |
|---|---|---|---|---|---|---|---|---|
| Luxury | -39.7 | -82.3 | -93.3 | -93.4 | -94.4 | -93.6 | -92.2 | -90.8 |
| Upper Upscale | -43.4 | -83.5 | -91.6 | -92.7 | -93.9 | -91.8 | -90.7 | -90.2 |
| Upscale | -34.0 | -74.0 | -83.1 | -84.6 | -86.1 | -82.5 | -81.4 | -80.0 |
| Upper Midscale | -26.5 | -63.9 | -77.4 | -79.6 | -82.0 | -76.6 | -76.9 | -74.5 |
| Midscale | -23.2 | -53.1 | -67.1 | -69.4 | -71.8 | -65.0 | -66.2 | -62.4 |
| Economy | -20.2 | -43.7 | -54.8 | -57.1 | -60.5 | -53.1 | -53.5 | -48.8 |

*Source: STR, ARA, KGI Research*

**Figure 5: Total U.S. occupancy and total Covid-19 cases, by week, 14 Mar – 2 May**

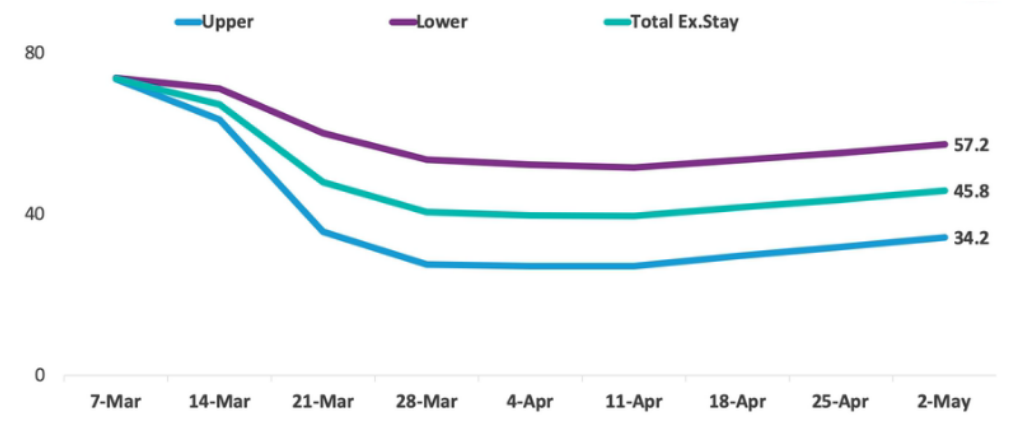



| | 14-Mar | 21-Mar | 28-Mar | 4-Apr | 11-Apr | 18-Apr | 25-Apr | 2-May |
|---|---|---|---|---|---|---|---|---|
| Luxury | 46.8 | 15.7 | 9.6 | 9.1 | 8.8 | 9.9 | 11.9 | 14.4 |
| Upper Upscale | 47.2 | 15.7 | 9.9 | 9.2 | 8.9 | 10.4 | 12.0 | 13.9 |
| Upscale | 54.1 | 23.9 | 16.9 | 15.8 | 15.7 | 17.9 | 20.2 | 22.7 |
| Upper Midscale | 56.0 | 30.6 | 20.5 | 18.8 | 18.0 | 20.6 | 22.7 | 25.3 |
| Midscale | 51.3 | 34.8 | 26.2 | 24.5 | 23.4 | 26.1 | 28.0 | 30.8 |
| Economy | 54.6 | 43.3 | 36.0 | 34.8 | 33.6 | 36.3 | 38.2 | 41.6 |

*Source: STR, ARA, KGI Research*

**Extended-stay hotels benefitting from lockdowns.** The branded extended-stay sector (i.e. Hyatt House by Hyatt, Residence Inn by Marriot) have been outperforming with occupancy lows hitting c.25-30% occupancy at the worst. Altogether, extended stay hotels have been able to maintain an average of 50% occupancy, with no steep declines nor exaggerated toughs. This is because extended-stay hotels are able to provide quality lodging for those who are unable to return home, e.g. airline, construction or air cargo crews.

**Figure 6: Branded extended-stay hotels performance – total US occupancy (%) for the weeks ending March 7 – May 2**

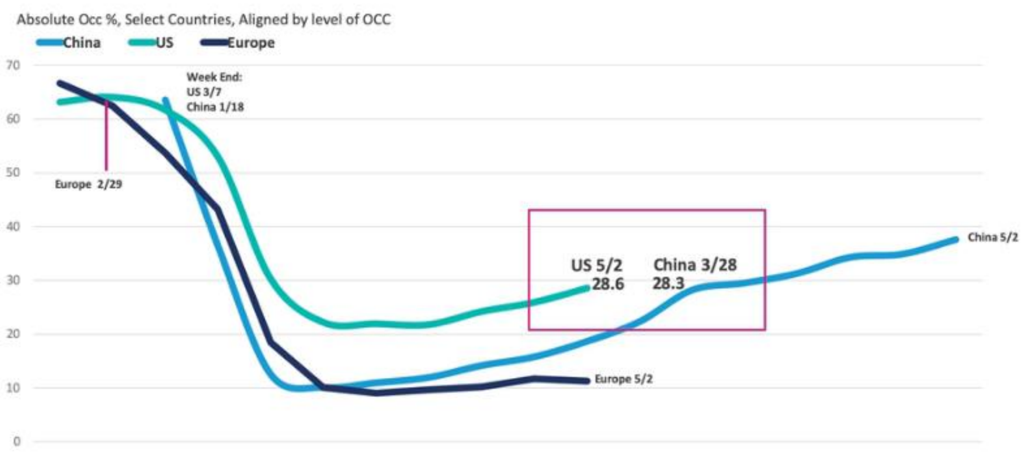



*Source: STR, KGI Research*

**Location, location, location.** However, it is not only extended-stay hotels that see the most stable occupancies, the economy-upscale select-service hotels in prime locations that are able to accommodate the above group of workers are also bound to benefit. For example, ARA's Hyatt Place Cincinnati Airport Florence – despite not being an extended-stay hotel--has been able to maintain a 45-50% occupancy level as it caters to air cargo crews servicing the Amazon logistics and distribution hub proximate to Cincinnati Airport.

***En route* to recovery?** US's occupancy data, unlike Europe's, has also been mimicking China's recovery trend, albeit 6 weeks apart. US occupancy for the week ending 2nd May was at the same level as China's six weeks before (week ending 28th March), providing an unusual sense of reassurance that we *could* be en route to recovery sooner than we think.

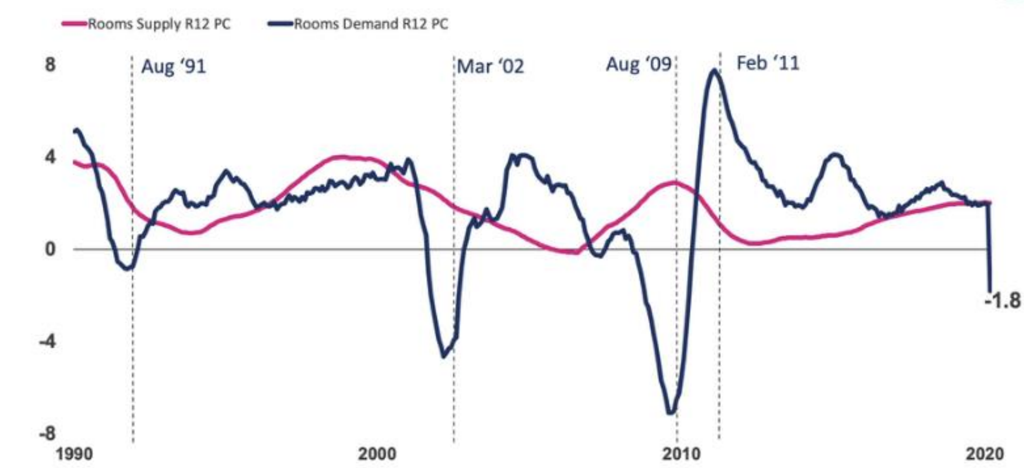
**Figure 7: US and China occupancy (%) at the same level – 6 weeks apart**




*Source: STR, KGI Research*

**Supply and demand not entirely divergent. Yet.** While supply and demand as of March 2020 have been unhinged, it also has not, yet, reached levels we've never seen before. The global financial crisis in 2010 brought about one of the worst drops in room demand of close to -8%, but it also brought about one of the largest rebounds in history. The V-shape trends in demand during recessions are apparent since the 1990s, and we may see a similar recovery post Covid-19.

**Figure 8: Annualised US supply & demand % growth, Jan 1990 – Mar 2020**

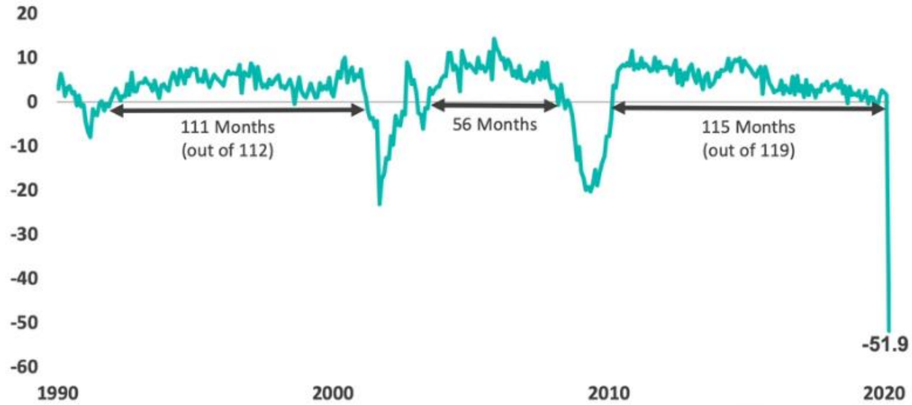



*Source: STR, KGI Research*

On the supply end, we see that supply growth tends to lag and drop off close to zero only after the recessions, due not only to the lead time in construction but also the disruptions that may impact construction projects – supply chain, labour, and financial challenges. This also in addition, amplifies demand growth as supply is temporarily stunted.

**But REALITY CHECK: RevPAR growth paints a gruesome picture.** In the same span of 30 years through the great recessions, MoM RevPAR growth has barely dipped into -20% territory; but as of March 2020, RevPAR has fallen steeper into the -50% range, the first in a 30-year history. And the bad news is that we expect it to only get worse in April. This unfortunately quantifies, clearly, the risk and the potential extent of deviation from past recovery trends.

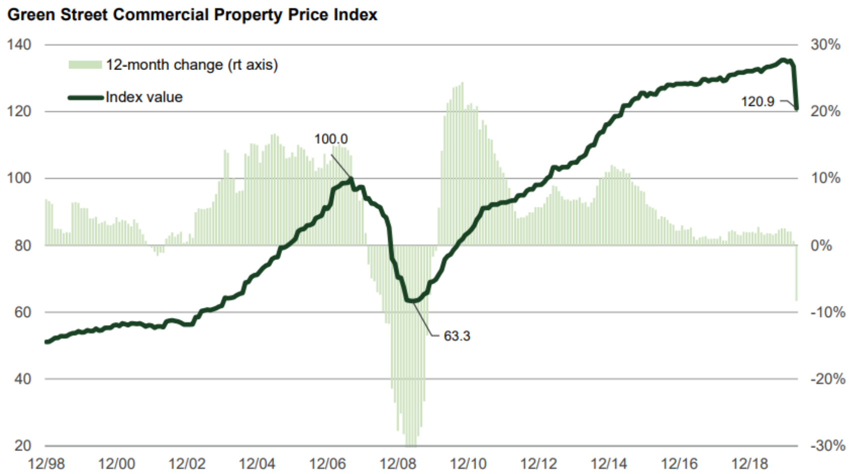
**Figure 9: Monthly US RevPAR growth, Jan 1990 – Mar 2020**




*Source: STR, KGI Research*

**Balance sheet disaster.** To add fuel to the fire, commercial property prices have already slipped an average of 10% as of May 2020, according to the Green Street Commercial Property Price Index (CPPI). More specifically, and more worryingly, the lodging sector has seen a 16% decline in values in the past 3 months. The effect on balance sheets can be dire if the lodging sector sees any further sharp declines in prices. As of May 2020, it holds second place from the bottom, only beating the declines in retail malls' property values.

**Figure 10: Green Street Commercial Property Price Index (CPPI)**




*Source: Green Street Advisors, KGI Research*
**Indexed to 100 in August 2007*

**Figure 11: Green Street CPPI: Sector-level indexes, May 2020**

| | Index Value | Change in Commercial Property Values | | |
|---|---|---|---|---|
| | | Past Month | Past 3 Mos | Past 12 Mos |
| All Property | 120.9 | -9% | -10% | -8% |
| Core Sector | 121.0 | -10% | -10% | -7% |
| Apartment | 140.1 | -10% | -8% | -3% |
| Industrial | 158.8 | -5% | -4% | 7% |
| Mall | 77.0 | -20% | -25% | -33% |
| Office | 107.2 | -9% | -8% | -6% |
| Strip Retail | 95.5 | -15% | -15% | -13% |
| Health Care | 132.8 | -5% | -7% | -5% |
| Lodging | 91.4 | -7% | -16% | -16% |

*Source: Green Street Advisors, KGI Research*

**Exercise caution, pick the winners.** Given the macro headwinds, we see the sun shining brighter on extended-stay hotels, and select service hotels, from the economy up to the upscale segments. With lockdowns in place, extended stay hotels have benefitted from the displacement of workers and homes. Post-lockdowns, pent-up leisure demand will put ARA US Hospitality Trust's portfolio in a relatively advantageous position as it appeals to those who intend to travel, but on somewhat of a budget given the economic outlook.

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|---|---|
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