THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FCH - Q2 2016 Felcor Lodging Trust Inc Earnings Call

EVENT DATE/TIME: JULY 26, 2016 / 3:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Steve Schafer *FelCor Lodging Trust Incorporated - SVP, Strategic Planning*

Rick Smith *FelCor Lodging Trust Incorporated - President and CEO*

Michael Hughes *FelCor Lodging Trust Incorporated - EVP and CFO*

CONFERENCE CALL PARTICIPANTS

Patrick Scholes *SunTrust - Analyst*

Joseph Greff *JPMorgan - Analyst*

Chris Woronka *Deutsche Bank - Analyst*

Shaun Kelley *Bank of America - Analyst*

Bryan Maher *FBR & Co. - Analyst*

Lukas Hartwich *Green Street Advisors - Analyst*

PRESENTATION

Operator

Good morning. My name is Joanna, and I will be your conference operator today. At this time, I would like to welcome everyone to the FelCor second-quarter earnings release call. (Operator Instructions)

Thank you. Steve Schafer, you may begin your conference.

Steve Schafer - *FelCor Lodging Trust Incorporated - SVP, Strategic Planning*

Thank you, and good morning to everyone joining us for FelCor's second-quarter earnings conference call. With me today is Rick Smith, President and CEO, and Michael Hughes, Executive Vice President and Chief Financial Officer. Following their remarks, we will be happy to take any questions.

Before I turn the call over to Rick, let me remind you that with the exception of historical information, the matters discussed on this conference call may include forward-looking statements within the meanings of the federal securities laws. These forward-looking statements are expressions of current expectations and are not guarantees of future performance. Numerous risks and uncertainties and the occurrence of future events may cause the actual results to differ materially from those currently expected.

These risks and uncertainties are described in FelCor's filings with the SEC. Although we believe our current expectations to be based on reasonable assumptions, we cannot assure you that our expectations will be attained or that actual results will not differ materially.

And with that, I will turn the call over to Rick.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Thanks, Steve, and good morning. We had RevPAR growth of 2.6% during the quarter. The quarter started off fairly strong in April, with 5.2% growth. May and June both had growth of 1.3%.

Corporate transient demand decreased 3% during the quarter, which affected primary areas, urban areas, and New York, Boston, Philadelphia, and San Francisco the most. However, the Southeast was temporarily affected as well, with storms in Myrtle Beach and the shootings in Orlando.

The good news is that outside of two hotels under significant renovation, our portfolio continued to gain market share during the quarter. Southern and central California, Austin, Napa, and Tampa performed very well, and overall, our airport and resort locations performed the best. Group business remained solid, with group room nights up 4% during the quarter.

And while the pace of new supply continues to move closer to the pace of demand, our portfolio remains fairly insulated except in New York. The diversity of our portfolio with the mix of urban, resort, airport, and suburban hotels in very strong submarkets, coupled with the Wyndham guaranty and The Knick ramping up, positions us well going forward.

To combat the decline in corporate transient business, we have two primary areas of focus moving forward: remixing our customer base as effectively as possible, and kicking off cost containment measures, both of which are underway.

The decline in corporate transient will have an overall impact on ADR due to mix changes, with our goal being to mitigate it as much as possible.

Generally, the US economy is demonstrating resilience, given greater global economic uncertainty, and analysts are expecting solid GDP growth in the second half of the year. Housing and unemployment remain strong, and oil prices have remained low, supporting leisure travel.

However, with increasingly short booking windows, visibility regarding corporate transient demand is limited, and corporate earnings ex-energy were flat in Q2. We feel very good about the strength of our portfolio and our ability to partially mitigate the decline in corporate transient demand through mixed management and cost containment measures. However, we believe the overall effect on ADR will persist in the second half of the year. While we still expect to outperform our peers, we are reducing guidance to account for this impact.

Operationally, The Knick is moving in the right direction relative to its competitors. RevPAR penetration index continues to improve each month as we ramp up. July month to date, the hotel is running at 92.2% against its set. However, with overall compression down in the city and less European travel, due primarily to Brexit, the market as a whole is feeling an ADR impact. While this impact will affect short-term profitability, we feel very good about the progress we are making to stabilize the hotel within the market and are still confident with our expected stabilized EBITDA.

One last note: The Knick was recently named the number three hotel in New York, number five hotel in the US, and number 92 hotel in the world by Travel + Leisure. This should be positive for future operations and in our discussions with potential buyers.

Our focus for the remainder of the year outside of operations remains asset sales and redevelopment projects. We are currently under contract on The Esmeralda and the National Holiday Inn. Both contracts are hard. The Esmeralda is set to close August 1, and Nashville is scheduled to close September 1. The combined 2015 cap rate is 5.6%, and the gross proceeds of $108 million will be used to pay down the line of credit.

While we are pleased with this progress, we continue to work very hard on the New York hotels that are currently on the market. JLL, who began marketing Morgans and Royalton in late May, is currently working with a number of interested parties, and we continue to work with the various interested parties related to The Knick. Morgans and Royalton are being marketed to very different groups, given the redevelopment play of Royalton, and we have had additional very recent inquiries regarding The Knick from European and Asian investors.

Given the inventory on the market in New York and current market sentiment, we will be disciplined and very diligent in our process. We will only do what makes most sense to drive long-term shareholder value, and we'll update the market as appropriate.

Now a quick update on redevelopment. As you're aware, a big portion of our plan is to continue generating better internal growth than the industry and our peers. Our portfolio's continued outperformance, in conjunction with the Wyndham guaranty and the Knick ramp-up, were part of that. The other aspect is the redevelopment projects we have available to continuously create value for shareholders going forward.

The first two projects got underway in April. Phase 1 of The Vinoy and Kingston Plantation are both progressing well and remain on schedule and under budget. Both projects will be completed in early 2017.

All projects will be staggered to control displacement and create a stream of above-market growth for the foreseeable future. Any project we undertake is expected to generate unlevered IRRs north of 15% and stabilized cash-on-cash yields of at least 11% on a risk-adjusted basis.

A couple of things before I turn the call over to Michael. We are in great position. We have created a balance sheet that allows us to continue executing our plan regardless of market or economic conditions. With our best-in-class maturity profile, strong FAD and the capacity we have now, we can execute our plan unimpeded. That, coupled with a strong-performing portfolio, less volatility due to the Wyndham guaranty, and additional internal growth that we will generate, positions us to create greater shareholder value moving forward than our peers. The remaining asset sales simply enhance that opportunity.

With that, I will turn the call over to Michael.

Michael Hughes - *FelCor Lodging Trust Incorporated - EVP and CFO*

Thanks, Rick. Good morning. As Rick mentioned, we have two hotels under contract with nonrefundable deposits, one scheduled to close in August and one in September. The sales will generate $108 million in gross proceeds, which we will use to repay our line of credit.

Our balance sheet is already in great shape, with long-dated debt maturities and low fixed interest rates, and selling these hotels only makes it stronger. These sale proceeds give us substantial incremental investment capacity and flexibility to operate our business and pursue opportunities that will generate long-term value for shareholders.

We are selling the two hotels for a 12.4 times EBITDA multiple and a 5.6% cap rate, based on 2015 earnings, illustrating the significant NAV disconnect between the private and public markets, which is reflected in where our shares trade today. We are taking advantage of this discrepancy by repurchasing shares of our common stock.

During the second quarter, we repurchased 1.2 million shares of common stock at an average price of $6.83. To date, we've purchased 6.1 million shares at an average price of $6.81. We intend to continue repurchasing our common stock while it trades significantly below our NAV.

The corporate transient segment, which accounts for 30% of our room nights, softened during the quarter. Our asset managers worked closely with the management companies throughout the quarter to remix customer revenue segments and implement cost controls, with good results. Portfolio RevPAR grew 2.6%, with 200 basis points of growth through ADR. And operating expenses increased 2.2%, allowing for 19 basis points of hotel EBITDA margin expansion.

Although growth in the group segment continues to show strength, we forecast weak corporate transient demand through the second half of this year. For the year, we forecast a 3% to 4% RevPAR increase at our same-store hotels. We forecast adjusted FFO per share between $0.87 and $0.92 and adjusted EBITDA between $237 million and $243 million.

Our forecast excludes $1.5 million of EBITDA from the Renaissance Esmeralda and Holiday Inn Nashville Airport from the time of sale to December 31, 2016. Additionally, our outlook assumes NOI from our Wyndham hotels equals 2016 guaranteed amount.

And with that, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Patrick Scholes, SunTrust.

Patrick Scholes - *SunTrust - Analyst*

I'm wondering if you are at liberty to say on the two asset sales what are the -- I guess the characteristics of the buyer? Are we talking private equity, international, domestic, REIT? If you can give any color on that, it would be great. Thank you.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, I can tell you Nashville is a private hotel investment company and Esmeralda is a private real estate company, both domestic, but that's really all I can get into.

Patrick Scholes - *SunTrust - Analyst*

Understood. Any -- and then additional color on the ramp-up of The Knick?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Well, like I was saying, we feel good about the progress. We've stepped up -- our RevPAR penetrations index has stepped up every single month. So we continue to put the hotel in the position it needs to be within its current market.

The issue right now, just being that the market overall is down, ADR is down. The market is down 6.4%. ADR has been down due to less compression overall in the market. And so short-term profitability is getting hit a little bit, but we are very excited about the trajectory within the market that the hotel is on, and we are hitting the things that we want to be hitting.

Patrick Scholes - *SunTrust - Analyst*

Okay, very good. Congratulations on those very impressive ratings in the Travel + Leisure; I hadn't seen that. Thank you.

Operator

Joseph Greff, JPMorgan.

Joseph Greff - *JPMorgan - Analyst*

Can you talk about the back half of the year in terms of RevPAR growth, how you see the difference between the third-quarter and fourth-quarter performance, at least directionally? Thank you.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, I think when we moved our numbers down, we basically took down third quarter a couple points. We took down fourth quarter 1 point. So if you look at kind of the -- our current being at 3% to 4%, third quarter looks to be between 2% and 3.5%, fourth quarter 3% to 5%.

Joseph Greff - *JPMorgan - Analyst*

And just sort of directionally, the reason for the fourth quarter being stronger than the third quarter, you would tell us it's because of the group business?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Group and comparisons. And so when I think you are just looking at it year over year, it's those two things. It's not that we think business is jumping up. And Philadelphia, Boston, San Diego look good from a group standpoint in the fourth quarter.

Joseph Greff - *JPMorgan - Analyst*

Great, thank you.

Operator

Chris Woronka, Deutsche Bank.

Chris Woronka - *Deutsche Bank - Analyst*

As for The Knick, how do you think the potential buyers you're looking at, how are they underwriting it kind of in a current operating environment versus maybe how you underwrite it? And then as you think about it longer term, how much do you guys think the current environment matters for them versus capital preservation or appreciation?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Right, I think the second question kind of answers the first. I think that you're talking about money that wants to be parked in the US, and the long-term view of New York is one that is a continuously increasing real estate value play. And so there are far less concerns, seemingly.

We haven't seen their underwriting yet. They haven't come back to us yet. We haven't talked about pricing yet other than kind of placeholders. But I think that the current operating environment is of far less concern to them than it is to would-be investors in the United States.

Chris Woronka - *Deutsche Bank - Analyst*

Okay, fair enough. And then, Rick, you guys have bought back some stock. You are delevering. Dividend seems to be in vogue again for a lot of investors. How do you balance the share repurchase, the delevering, and maybe some investors looking for more yield?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Well, I think that it's always an interesting question to talk about. But our philosophy on dividends is not going to change.

We are going to slowly ramp up the dividend to a place as a percentage of FAD that makes sense and that we think we can maintain on a long-term basis, and then we will stabilize it there. We're not quite there yet, but we're on our way.

And with everything that we have to do with our capacity, and whether that be share repurchase -- when you're buying back, it's such a huge discount to NAV -- or the redevelopments we have, they both add so much more value for shareholders than increasing a dividend at this time. So we won't be doing that.

If we ever got to the point to where we didn't have anything left to do with the capacity that could drive greater value, then obviously we'd take a look at it.

Chris Woronka - *Deutsche Bank - Analyst*

Okay, great. And just finally for me, as we think about the revised RevPAR guidance in light of EBITDA guidance, is there kind of more cost, I guess, containment initiatives baked in, or as you thought about guidance, how do you -- what are the opportunities there if the current environment doesn't get better?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Well, we're still looking. And it depends. If it doesn't get better, there's kind of step one, right? Cost containment measures. And Troy and his team started working with the managers in June on that. So things are getting rolled out.

If it were to get worse, then obviously there is a step two set of contingency plans. And so, we will gauge where we need to go, when we need to go there, and we will move quickly. I mean, the plans are on the shelf, so to speak. So it's just basically sitting down with the guys, going through them, and starting to implement.

So we'll be able to act fairly quickly as we go, just like we did back in 2008, at the end of 2007 and beginning of 2008, to make -- because we saw what we saw and we acted as quickly as we could. So will be in position to do that again this time, if need be.

Chris Woronka - *Deutsche Bank - Analyst*

Okay, very good. Thanks, Rick.

Operator

Shaun Kelley, Bank of America.

Shaun Kelley - *Bank of America - Analyst*

Rick, I think you mentioned that the underwriting -- or, sorry, the difference between group and transient in the quarter and the performance there. Can you talk a little bit about your pace stats as you look into the second half? Because some people that we've spoken with, even one of your peers this morning, was saying that the group in the year for the year, and in the quarter for the quarter, was not materializing quite like they thought it would. So I'm curious if you're seeing the same.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, it's interesting. I think that pace is down generally, but you can't read too much into that. It's improving, but it's not real strong. It looks better for September than we've seen it for a while.

But the thing that you have to keep in mind is that you're getting a lot of in-the-month, for-the-month group bookings because it is a very short window. So the pace report becomes not quite as helpful when you're seeing that.

And so that's what we are experiencing, at least. I don't know what everybody else is experiencing, but that's kind of been our experience over the past couple of months, that it's been a lot of very short window, in the month, for the month. So pace reports are not being what we're actually seeing. In some cases good, in some cases not, but that's what we're seeing.

Shaun Kelley - *Bank of America - Analyst*

Just sort of less indicative at this time, I guess, then.

So, then, second question, and just sort of specific one on The Knick. So I think at the beginning of the year, you guys outlined $13 million to $15 million of EBITDA contribution. Clearly, the market pressures -- I don't think anybody was underwriting negative $6 million for Q2.

So I mean, is the $13 million to $15 million, just to ask it explicitly, is that still on the table, or is that goal a lot harder, given just where the market is at the moment?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, the goal is a lot harder. Of the $3 million that we were below kind of our numbers in the second quarter, Knick was $1 million of that. And again, we are very happy with the progress. It is moving in the right direction. But the overall market being down and the pressure on ADR has driven that. So we were down about $1 million.

And on a go-forward basis for the second half, what we took down guidance, about $3 million of that, about $1.5 million a quarter, is for The Knick. So you're basically at about $10 million.

Shaun Kelley - *Bank of America - Analyst*

Got it, okay. And again, long-term stabilization is the plan, but probably should also be thinking about next year just needing a little bit more on the ramp side too for -- so 2017 may not be the full stabilization year. Is that fair?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, that's fair. I think that we are moving in the right direction. We certainly hope to be at 100% of market by the end of this year. We might be a little below that. And so there might be a little more ramp.

And then it will depend on what the market does in New York next year as far as getting to what we feel like, on a stabilized basis, meaning a stabilized market and a stabilized asset, where the rates will be.

Shaun Kelley - *Bank of America - Analyst*

That's helpful. I appreciate it, guys.

Operator

Bryan Maher, FBR & Co.

Bryan Maher - *FBR & Co. - Analyst*

Can you give us a little bit of an update -- I'm sorry if I missed this -- on kind of the progress with Morgans and Royalton?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, basically, you haven't missed any questions regarding that, Bryan. I touched on it a little bit during the prepared remarks.

But right now, as you are aware, JLL started marketing those at the end of May. And so, we're still working it. They are working with a number of -- and it's different groups for each asset because the Royalton is more of a redevelopment play.

And so there's different groups for each asset. They are working with various groups on each asset, but we're not there yet. So where they're going to come back at the end of the day, both from interest standpoint and from a pricing standpoint, we don't know yet.

Bryan Maher - *FBR & Co. - Analyst*

Okay. Can you talk a little bit about some of your markets? It really seems like there's a bit of a bifurcation here whereby the broadly diversified, mostly lodging C-corps and a handful of lodging REITs, seem to be holding up a little bit better as we start to talk about 2Q numbers versus some of the lodging REITs, which have more weightings toward certain specific MSAs.

To that extent, can you talk about a couple of your more profound MSAs and where you're seeing strength and where you're seeing weakness? And particularly as it relates to San Francisco maybe next year, with the Moscone Center being under redevelopment, how you're thinking about that?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Yes, we're -- well, first of all, on the first part of your question, as I mentioned, the more primary urban areas got hit a little bit harder from an expectation standpoint because of the decrease in corporate transient demand. That was 3% down for the quarter, and that drove the bigger MSAs more.

We certainly have -- we've had good pockets and bad pockets. But they got hit the most from an expectation standpoint. And so we had good growth in Austin, Napa, Tampa, and southern and central California. Myrtle Beach battled storms during the quarter; RevPAR climbed 4%. South Florida properties were down, and that was due a little bit to the strong dollar, and there were concerns over Zika. There were water concerns. There were a bunch of kind of odd, temporary things there.

Orlando was down 10.4%, partially because of renovation, partially because of the tragedy that occurred there and some cancellations. And New York, obviously, we know about; San Francisco, Boston, Philly we know about.

Our Houston property was flat to prior year due to flooding in April that caused some cancellations, softer-than-anticipated demand from the OTC conference in May. But the market was down 800 basis ; we were still flat. And San Diego was down $1.7 million due to citywide group business that didn't repeat this year.

So that's pretty much kind of the markets that we had. San Francisco did okay relative to prior year; it was just down a little bit from expectation.

For 2017, we're looking at going after more individual group, more corporate negotiated business. And hopefully -- well, we will have some reno, so we'll have less rooms available because of some displacement, but there will be less displacement because of what's going on with Moscone.

So it's going to be a tough couple of years from a group or citywide perspective in San Francisco. So what we've got to do is manage the mix as best we can. We've got a great property there, and it's incredibly well located. And so we should be able to steal some share as we go through 2017 and 2018. And that's the play.

Bryan Maher - *FBR & Co. - Analyst*

Thanks, Rick.

Operator

(Operator Instructions) Lukas Hartwich, Green Street Advisors.

Lukas Hartwich - *Green Street Advisors - Analyst*

Most of my questions have been answered. I just have one. Just looking back on your 10-K; I know we've had a quarter since that was filed. But there were 15 Hilton management contracts that were going to expire this year. And I'm just curious what the thought is with those contracts. Are you just going to extend them, or are you looking at switching out operators or even brands in some of those hotels?

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

We are currently in progress on that, so I can't really talk about it. Sorry, Lukas.

Lukas Hartwich - *Green Street Advisors - Analyst*

Okay.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

We'll definitely update the market once we're done.

Lukas Hartwich - *Green Street Advisors - Analyst*

Okay, we'll just save it for another quarter, then. That's it for me. Thanks a lot.

Operator

There are no further questions in the queue at this time.

Rick Smith - *FelCor Lodging Trust Incorporated - President and CEO*

Okay. Thank you all for joining us, and we'll talk to you next quarter.

Operator

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