THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FCH - Q3 2014 Felcor Lodging Trust Inc Earnings Call

EVENT DATE/TIME: OCTOBER 30, 2014 / 4:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Stephen Schafer *FelCor Lodging Trust - VP, Strategic Planning, IR*

Rick Smith *FelCor Lodging Trust - CEO, President*

Michael Hughes *FelCor Lodging Trust - SVP, CFO, Treasurer*

CONFERENCE CALL PARTICIPANTS

Anto Savarirajan *Goldman Sachs - Analyst*

Nikhil Bhalla *FBR & Company - Analyst*

Patrick Scholes *SunTrust Robinson Humphrey - Analyst*

Chris Woronka *Deutsche Bank - Analyst*

Lukas Hartwich *Green Street Advisors - Analyst*

PRESENTATION

Operator

Good afternoon. My name is Samantha and I will be your conference Operator today. At this time I'd like to welcome everyone to FelCor's Third Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question and answer session. (Operator Instructions) I would now to turn the call over to Mr. Stephen Schafer. You may begin.

Stephen Schafer - *FelCor Lodging Trust - VP, Strategic Planning, IR*

Thank you. On behalf of FelCor's management team I want to thank you for joining us on our third quarter earnings conference call. With me today are Rick Smith, our President and CEO, and Michael Hughes, our Chief Financial Officer. Following their remarks, we will take your questions.

Before I turn the call over to Rick, let me remind you that with the exception of historical information, the matters discussion on this conference call may include forward-looking statements within the meaning of the Federal securities laws. Those 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 actual results to differ materially from those currently expected.

These risks and uncertainties are described in our filings with the SEC. Although we believe our current expectations to be based upon 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 - CEO, President*

Thanks, Stephen. Good morning. We had a very strong from every perspective with significant progress on all of our goals for the year. We exceeded the high-end of our expectations for RevPAR and EBITDA growth and have increased our full year operational guidance by $2 million. Our comparable core portfolio, once again, outperformed the industry, with a 9.8% RevPAR increase. Same store RevPAR increased 12.3%. Our six acquired and recently redeveloped hotels, again, outperformed our expectations with a 50% increase in EBITDA and the Wyndham hotels grew RevPAR more than 31%.

We made great progress on asset sales including completing the swap with Hilton and we repaid all of our remaining near-term debt maturities. Our primary focus for the rest of the year is to finalize the first phase of the plan. That is to complete the nine remaining asset sales and use proceeds to repay debt; open the Knickerbocker, and most importantly, effectively position it in the market; focus on the continued ramp up of the acquired and recently redeveloped hotels; continue to aggressively attack ADR index and flow through; and complete the next phase of our Investor Relations program.

Let's start with the asset sales and balance sheet. At January 1st, we had 21 non-strategic hotels remaining to sell. We have sold seven hotels to date. We completed the swap of interest on ten hotels with our JV partner in July, retaining a 100% interest in five and disposing of five. That leaves nine hotels remaining. We have a contract with a $10 million non-refundable deposit on the Doubletree in Charlotte. The hotel is expected to close today. We are currently marketing seven of the eight remaining hotels. Two of those are under contract.

We are evaluating first round offers on four hotels and expect to receive second round offers in the next couple of weeks and we expect to have a call for offers on one hotel prior to Thanksgiving. The last hotel in the disposition program will be launched in January. Therefore we expect to have 20 of the 21 hotels sold or under contract by the end of the year. Pricing on transactions completed to date have met our high expectations. The transaction market continues to improve and we are seeing heightened interest from buyers as the year progresses.

So, we feel very good about wrapping up the final asset sales. I am very pleased with our progress this year and for all intents and purposes, we will have completed the portfolio repositioning program by the end of the year. As we sell the remaining hotels, we will use all the proceeds to repay the term loan and associated mortgage debt with the remaining applied to the line of credit. Following the debt repayment, our next significant debt maturity, other than the line of credit occurs in 2019 and we will have the best debt maturity profile of any hotel REIT. In addition, our weighted average cost of borrowing is now below 6% and we remain on track to achieve our target leverage in 2015.

Now let me update you on the Knick. First, we have made very good progress on the hotel, particularly since we took a more active role earlier this year. The hotel is shaping up very well. The rooms and the lobby look fantastic and we are making good progress on the fourth floor and rooftop public spaces. The hotel will not only be beautiful with very large, well appointed rooms, but will also offer very high-end service and command very high rates. Given the nature of the hotel, the most important aspect of opening is to open very well, with all amenities available to customers and all staff completely trained to provide the first-class service those customers will expect.

Due to the exquisite but very intricate design coupled with one specialty subcontractor who is responsible for certain work on the fourth floor and rooftop that has ceased operations, we have experienced a hiccup related to finishing those areas. The team has mitigated the schedule delays to a few weeks by replacing the problem sub. As such, we will miss Christmas season this year. While this is very disappointing to me, it is far more important to open well as I mentioned previously, than to open earlier but poorly. The hotel must be fully operational to open in the manner that we expect.

Although we will miss Christmas season, the end of December and all of January are not profitable timeframes in New York. Thus we will use the time to ensure that the hotel is complete, the staff is appropriately trained, and open strong in February. The website and booking engines are active and we are accepting reservations for that time period. This is going to be a tremendous hotel and we look forward to the opening and the long-term success of the asset.

As I mentioned earlier, our other six acquired and recently redeveloped hotels continue to pace ahead of expectations. Hotel EBITDA collectively increased 50% during the quarter with generally good performance from all hotels. The eight Wyndham hotels continue to perform very well. The hotels grew RevPAR 31% during the quarter, transition disruption is subsiding, and we will complete the renovation of the remaining hotel this month. We expect continued strong results going forward. Importantly, the guarantees stepped up more than 20% in 2014, and EBITDA at these hotels is expected to be about $43 million or about $8 million higher than 2013 and will step up another 20% plus in 2015. Please note as usual that our guidance reflects the guaranty level as to mitigate the risk of transition.

During the third quarter we began the next phase of investor meetings in addition to attending several conferences. We met with mostly perspective investors in the Midwest and Canada. After the Knick is open, the schedule will become more extensive with our focus shifting heavily to the second phase of the strategic plan and targeting new and existing investors. This will also entail an analyst day at the Knickerbocker.

And just a few final comments before I turn it over to Michael. When we began the first phase of the strategic plan, our central thesis was that we had an opportunity to create more value than any our peers if we executed our plan as presented to investors. We have done that. We have a high quality, well diversified portfolio and our same store RevPAR growth continues to outperform our peer group and the industry. We are achieving desired collective returns on our acquired and recently redeveloped hotels. By reducing our leverage and creating a best in class maturity profile, we have a much stronger and more flexible balance sheet. There is still more value to come, relatively speaking, as we complete the final piece and the Knick ramps up.

Additionally, as we embark on the second phase of the strategy, there is still a great deal of relative value to add given the many opportunities that remain available to us. Our portfolio is in excellent shape, is well insulated to new supply and is experiencing lower supply growth than the industry. As we finalize phase one and begin executing phase two of the plan, we have balance sheet flexibility that affords us the ability to seize strategic opportunities while providing a meaningful common dividend. As always and most importantly, we remain focused on delivering superior stockholder value.

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

Michael Hughes - *FelCor Lodging Trust - SVP, CFO, Treasurer*

Thanks, Rick. Good morning.

Our balance sheet restructuring is nearly complete. During the third quarter we closed a $140 million term loan, the loan bears interest at LIBOR, with no floor, plus 2.5% and is freely pre-payable. We used proceeds from the new term loan, line of credit borrowings, and cash on hand to redeem the remaining $234 million 10% senior secured notes. We repaid a $9.6 million single asset loan secured by the Indianapolis Embassy Suites, which was sold in September. The loan was scheduled to mature in 2016.

In connection with the unwinding of some of our joint ventures, we bifurcated a non-recourse unconsolidated term loan secured by eight hotels. We've consolidated our $64 million share of that loan, which is now secured by mortgages on four former joint venture hotels. The loan bears interest at LIBOR with no floor plus 3% and is freely pre-payable. We'll use free cash flow and the approximately $250 million of proceeds from selling the nine remaining non-strategic hotels to repay the $140 million and $64 million term loans and nearly all the outstanding line of credit borrowings, thus completing our multi-year balance sheet restructuring. We've already reduced our average borrowing costs to below 6% and by the end of next year, we expect our interest coverage to increase to three times and leverage to decrease to five times. We will continue to seek opportunities to further improve our balance sheet and create additional flexibility as we progress through lodging cycles.

As Rick mentioned, we had another great quarter. RevPAR at our 31 comparable core hotels increased 9.8% and RevPAR at our same-store hotels, which includes our eight Wyndhams and the remaining non-strategic hotels, increased 12.3%. Demand was strong across the board in terms of customer segments and markets and occupancy exceeded prior peak levels. We continued taking advantage of favorable demand trends by remixing our customer base. Room nights for premium corporate customers, with an average rate of $205, increased 7.7%, while room nights for the leisure and discount segments, with an average rate of $152, decreased 1%.

ADR increased 7% due to higher absolute rates and a continued shift to higher rated in corporate segments. Group pace was up 8.5% compared to the same time last year, which is the largest increase since the recession. Food and beverage revenues at our comparable hotels increased 9.4%, driven by better group demand and higher spend per occupied room. Our RevPAR gains, driven primarily by ADR growth, coupled with aggressive cost containment produced strong Hotel EBITDA margin growth of 238 basis points. We are increasing our guidance to reflect the better than expected hotel operating performance last quarter and updated asset sale timing.

We forecast RevPAR for our comparable hotels will increase between 8% and 8.25%, a midpoint increase of 38 basis points. We have increased the midpoint of our EBITDA guidance by $2.2 million for operational performance and $1.8 million for our updated asset sale timing. Our Adjusted EBITDA and FFO guidance reflects selling the Doubletree Charlotte South Park today and assumes we sell seven of eight remaining non-strategic hotels at year end. Our outlook continues to assume NOI for Wyndham hotels equals the 2014 guaranteed amount. We now forecast adjusted FFO per share between $0.60 and $0.62 and Adjusted EBITDA between $217.5 million and $219.5 million.

And with that, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Steve Kent.

Anto Savarirajan - *Goldman Sachs - Analyst*

Good afternoon. This is Anto Savarirajan in for Steve Kent. First, the Morgans and Royalton had a weak third quarter. You have previously noted some of the restrictions with management contracts and they have a few more years to go. What really are the options available with regard to either monetizing the assets or improving performance metrics?

Rick Smith - *FelCor Lodging Trust - CEO, President*

There's a number of alternatives related to these assets. We are evaluating every one of them and I can't -- because of the nature of things, I can't really go into more detail. I apologize for that. But it is what it is. We are working through that. We are evaluating that. We will -- once we have come to a final decision on that we will move forward with that.

And we will, as we are able, communicate that publically. But it depends on kind of the nature of how we're moving forward and things of that nature. So, we will keep you posted as best as we possibly can. But make no mistake, we are evaluating every conceivable option and will take the right steps that are in the best interest of the shareholders going forward.

Anto Savarirajan - *Goldman Sachs - Analyst*

Got it. Once the big gains and mix changes are made, where do you see occupancy levels move to, especially when you think about 2015 and beyond? How do you expect the skew between rate and occupancy to look? And separately, if you could also tell us where your current group and transient mix stands and if you could set that in context with prior peak, that would be pretty helpful.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Are you referring to Company-wide? Or are you still referring to -- ?

Anto Savarirajan - *Goldman Sachs - Analyst*

Company-wide. Company-wide.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Company-wide? I think we are nearing prior peak as far as occupancy goes. We've still got some room with the ramp up in ADR. We are working through that. There's a remixing kind of process as well as absolute rate increases. I think that when you look at the prior peak, you're looking at 77% occupancy. I think you'll be in that range again from an occupancy perspective going forward and margins are back to peak.

I think group is still 25%. And we'll probably be there. It's the mix of group is the important thing right now. It's really more about mix. I think we're seeing a lot of good dynamics from group this year. It's starting to pick up. And that's been very helpful. That's why the industry is looking as strong as it has. One big reason. So, we feel good about that. But I think we're headed in the right direction. There's still some more room in rate. And we are -- we'll probably peak in that 77% -ish range from an occupancy standpoint probably by the end of next year. Does that answer all -- there were a number of questions embedded in there. Did I pick up everything?

Anto Savarirajan - *Goldman Sachs - Analyst*

Yes. It did. Thank you.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Okay. Thanks, Anto.

Operator

Nikhil Bhalla.

Nikhil Bhalla - *FBR & Company - Analyst*

Good morning, everyone. The first question here is you talked about opening the Knick being delayed a little bit. As I recall, your expectations for EBITDA for next year from the Knick were about $16 million. How much has that changed because of the delay, if you could just give us some sense?

Rick Smith - *FelCor Lodging Trust - CEO, President*

There's a number -- Hey, Nikhil. How are you?

Nikhil Bhalla - *FBR & Company - Analyst*

Hey, good morning.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Thanks for the question. There are a number of factors involved. One thing about the delay is as far as getting our ducks in a row with regard to how we're affecting business once it does open, some of the ramp up is mitigated. Also, some of the -- January is a negative month. That helps from a mitigation standpoint. And the offsetting thing is that you're not going to have the ramp up time in '14 going into '15. So, we're working through that right now. I mean, it's fairly fluid. I talked about the one sub. It's a metal and glasswork related sub.

And as that occurred in the last few weeks and we've been kind of working through what the timing is, we're also working through the 2015 budget and taking that into account. We'll be finished with that budget in early '15. Right now we're assuming not much difference. Our rate expectations are rising. And certainly we're still on track from a stabilized long-term perspective as we get this asset stabilized. But we're working through the specifics of the 2015 budget which will be completed in early to mid-December and then we will certainly on our next call, we'll certainly outline that separately as a part of our guidance for 2015.

Nikhil Bhalla - *FBR & Company - Analyst*

Okay. Alright. And just a follow up question here, Rick. Most of the heavy lifting is kind of now behind you, hopefully this quarter, you'll have only one asset left to sell sometime early next year. If you can just update us on your thoughts for what you intend to do, the big pieces that you may want to address over the course of 2015 in terms of either redeem the series C shares, the preferred stock or maybe thinking about M&A or any of the big pieces that we should be thinking about more from a strategy standpoint?

Rick Smith - *FelCor Lodging Trust - CEO, President*

The great thing is as I mentioned a little bit on this night, and I talk about it a lot, is that we have such a huge opportunity to move the needle more than our peers by virtue of executing what has been in the first phase of the plan and we still have more pickup to come on that by finalizing the asset sales, finishing the repayment, and the Knick ramping up, and the finalization of the ramp up on the acquired and recently redeveloped. That's all been really good and there's more room to come on that, but the really great thing is after that is done, as we embark on the second phase of the plan which will start in 2015, we'll talk more about that in February and going forward on the road as we get beyond the earnings call next time.

But the great thing is we're going to be able to create through this process a lot of capacity and we no longer -- every dollar isn't earmarked as it was in the first phase of the strategic plan. Because in the first phase of the strategic plan, it was all defense and clean up. And so, everything had to be guided to a specific spot and so it was. And we executed that. But the great thing is going forward we have an opportunity to be opportunistic and so we are underwrite in our underwriting every single opportunity, all of the redevelopment opportunities that we have in Santa Monica, San Diego, Napa, Mandalay, Vinoy, Myrtle Beach, San Francisco, and going after the C's, calling the C's, as well as the potential to go after any of the A's on the market.

And going after the preferred stock and the redevelopment opportunities are two ways that we can continue to differentiate ourselves with regards to having some opportunities that some of our other peers may not have. So, now the other opportunities are, as you mentioned, M&A, acquisitions, going after the share count from a common stock standpoint.

Those are the other opportunities; all of our peers have those opportunities. And we won't underwrite all five buckets, every opportunity within those five buckets, look at the sources that we have to create capacity, and prioritize those uses in a way that will drive shareholder value the best. That's what it's all about. The things on that list that are going to drive shareholder value the most, given where the source is and what the cost of those sources are for the capacity will be the drivers.

And so, I look very much forward to the second phase of the plan and getting into '15, getting the Knick open, getting those last of the assets sold so that we can focus solely on the second phase and start really doing the next set of things that are really going to drive value. There will be a handful of additional asset sales. We will always look at the bottom performing assets in our portfolio and that will be one of the things that create capacity. We're going to be generating a ton of excess cash flow as we go forward given the balance sheet restructure, the debt pay down, and what will be coming going forward. So, there's lots of opportunity in the coming years, '15, '16 and beyond. So, I don't know if that answers your question, Nikhil, but that's something we're very focused on and very excited about going forward.

Nikhil Bhalla - *FBR & Company - Analyst*

Thanks for that and just one follow up question. Sitting here today, do you have a preference over redeeming the C's over redevelopment opportunities or is that something you're still evaluating?

Rick Smith - *FelCor Lodging Trust - CEO, President*

Sitting here today, we're still evaluating it. It depends on what the redevelopment -- when redevelopments are fully underwritten, what are the returns? And how does that measure versus taking out the preferred stock? And how does that affect shareholders? How does it affect their value?

Which one is going to drive more value? Now, they're not mutually exclusive. We're going to do some of both more than likely. But it just depends on -- it's a project by project underwriting and basis that will drive the decision making which is great because we do get to be opportunistic.

We do get to look at what's in front of us and make those decisions based on shareholder value versus saying a few years ago the balance sheet has to be here, the portfolio quality has to be here. So, these things have to be done and with the sources, these uses have to be done. It was all defensive in nature. So, we're looking forward to making those decisions and make no mistake, it will be -- everything will be risk adjusted and whatever the best risk adjusted return is for our shareholders is what we are going to do, pure and simple.

Nikhil Bhalla - *FBR & Company - Analyst*

Thanks, Rick. I appreciate it.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Thanks.

Operator

Patrick Scholes.

Patrick Scholes - *SunTrust Robinson Humphrey - Analyst*

Hi. I don't know if you talked about this already. There was a charge in here, an add back to FFO for contract dispute contingency of about $6 million. I'm wondering what that was. And secondly, do you have an estimate on the price per room that you expect to get from the remaining 2,500 rooms? And lastly, if you could give us your thoughts on dividend going into next year? Thank you.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Okay. First question first. I can't speak to that right now, Patrick. Rest assured that it is a dispute. And we feel very strongly that we will be taking some of that back in future quarters. But right now under GAAP it is what we had to do. But given what is going on with regard to that dispute currently we cannot speak to that at all. But trust me, kind of the full force of the Company is behind turning that around. The price per key is probably about $110. And what was the third question, Patrick? I'm sorry.

Patrick Scholes - *SunTrust Robinson Humphrey - Analyst*

Your thoughts on where dividend can go from here?

Rick Smith - *FelCor Lodging Trust - CEO, President*

Certainly as we move forward we're going to be increasing our FAD precipitously. I've also said philosophically from a dividend standpoint that what we would do is set the stabilized dividend at a place we felt throughout the cycles could be maintained and so it would be a lower payout percentage of that. However that does leave us a lot of room for us to move the dividend up. I would -- we are assessing and we will be speaking with the Board next week on the dividend for the fourth quarter which we will be announcing in December and we are evaluating either keeping it the same or taking it up at that time. And once we have that discussion we'll be announcing but I certainly look for an increase in 2015.

Patrick Scholes - *SunTrust Robinson Humphrey - Analyst*

Okay. Thank you. Are you at all able to say if that contract dispute has anything to do with the Morgans or the Royalton?

Rick Smith - *FelCor Lodging Trust - CEO, President*

It does not.

Patrick Scholes - *SunTrust Robinson Humphrey - Analyst*

Okay. Thank you.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Nor the Knick.

Operator

Chris Woronka.

Chris Woronka - *Deutsche Bank - Analyst*

Hey. Good morning, guys. Just a quick question on the Knick and certainly understand the seasonality here in New York and agree with your decision to hold off if you can't get it open before year end but I guess if you can talk maybe a little bit to the book of business you have and just I think we know that some of the corporate buyers probably will not book until they see the finished product. So, just any thoughts on whether that still kind of extends the ramp up a little bit.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Certainly the longer you wait to turn on the booking engine and the longer wait to open, it has some kind of an effect. But at the same time we're going to be, there's a couple of things. We're going to be opening in a pretty good period in February with the Fashion Week and NBA All Star game and there's something else that's going on there that week that I'm blanking on right now. But there's going to be a pretty good compression in Midtown.

The transient window, the booking window is very short and we have a lot of -- we've been doing a ton of sales activity across the world. South America, Europe, Asia, et cetera, as well as all over the United States and there's a lot of anticipation for this and a lot of high-end transient, high-end leisure as well as corporate transient and so we -- like for example we did 40 corporate sites through the building through the third quarter along. There's a lot of anticipation on the asset.

So, we feel very good about how things are stacking up and how we're going to be able to hit the ground running. I think bringing the folks on as early as we did, and building the team as early as we did, and working the process from a sales and marketing standpoint will pay off. And so we look forward to a pretty strong opening. Will there be some ramp? Of course. Absolutely there will be some ramp. No question about it. But we feel good about where that stands right now.

Chris Woronka - *Deutsche Bank - Analyst*

And then I think I heard Michael's commentary about getting out about five times leverage by the end of next year with your current plans. How do you think about potentially monetizing one of your -- one or more of your larger assets and kind of taking that leverage one step further and also taking advantage of the current pricing environment for hotels?

Rick Smith - *FelCor Lodging Trust - CEO, President*

Certainly there's some opportunity there because there's a number of assets -- I mean, well, not a number of assets, but a handful of assets that we look to be kind of next step asset sales that will create capacity because of what we think we can do with the money including leverage related items. But leverage preferred stock, et cetera, debt and redevelopment opportunities that we think will be able to generate a better return than what those assets are currently generating.

Additionally, we do hold/sell on every single in the portfolio twice a year and if and when it makes sense to sell a hotel because of what we think we can accomplish with the proceeds, we will definitely do that. One or two of the potential asset sales have an opportunity to be extremely high multiples and be very accretive depending on what we use them for, even if we were to use them to pay off debt which would be the lowest returning portion. Or use of the proceeds. So, there's a number of opportunities for us and will we look at that as part of it? Yes. We'll look at everything. Absolutely.

Chris Woronka - *Deutsche Bank - Analyst*

Okay. Understood. Very good. Thanks.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Thanks, Chris.

Operator

Lukas Hartwich.

Lukas Hartwich - *Green Street Advisors - Analyst*

Great. Thank you. Hey, guys. Quick question on the Hilton JV. With that unwinding, does that eliminate the unique structure where the unconsolidated hotels were showing up in consolidated results in the GAAP income statement?

Rick Smith - *FelCor Lodging Trust - CEO, President*

Yes.

Lukas Hartwich - *Green Street Advisors - Analyst*

Okay. So --

Rick Smith - *FelCor Lodging Trust - CEO, President*

There's one left with them that will never be unwound because of the nature of the ground lease underneath it but on the ten hotels that we did it, we now own five. They're consolidated. They own five consolidated for them. We have also the debt that was related to that that was bifurcated as part of the process is also consolidated on our balance sheet.

Lukas Hartwich - *Green Street Advisors - Analyst*

Okay. Great. All my other questions are answered. Thank you.

Rick Smith - *FelCor Lodging Trust - CEO, President*

Thanks.

Operator

(Operator Instructions)

Rick Smith - *FelCor Lodging Trust - CEO, President*

Looks like no more questions. Thank you, Operator. We'll talk to you next quarter.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.
