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LQ - La Quinta Holdings Inc Conference Call to Discuss its Planned Spin-Off of Real Estate Business

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CORPORATE PARTICIPANTS

James H. Forson *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Keith A. Cline *La Quinta Holdings Inc. - CEO, President and Director*

Kristin Hays

CONFERENCE CALL PARTICIPANTS

Chris Jon Woronka *Deutsche Bank AG, Research Division - Research Analyst*

Jared H. Shojaian *Wolfe Research, LLC - SVP*

Jeffrey John Donnelly *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Stephen White Grambling *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Thomas Glassbrooke Allen *Morgan Stanley, Research Division - Senior Analyst*

William Andrew Crow *Raymond James & Associates, Inc., Research Division - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to La Quinta's Analyst Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the call over to your host for today's conference, Ms. Kristin Hays. Ma'am, you may begin.

Kristin Hays

Thank you, Operator. Good morning, and welcome to La Quinta Holdings' Analyst Conference Call.

As a reminder, this presentation includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which reflects the company's current view of future events and financial performance. Words such as guidance, expect, will, plan, anticipate, believe and other similar expressions identify forward-looking statements. Any such forward-looking statements are subject to risks and uncertainties. And the company's future results of operations could differ materially from historical results or current expectations. For more details, please refer to the company's annual report on Form 10-K for the year ended December 31, 2016, and subsequent SEC filings.

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With that, I will now turn the call over to our President and CEO, Keith Cline.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Thank you, Kristin. Good morning, and welcome, everyone. Also joining me today is Jim Forson, our Chief Financial Officer. Thank you for making time to be on the call with us this morning. We plan to keep our prepared remarks relatively short to leave time for your questions at the end.

Let me start by saying that over the past 49 years, La Quinta has evolved into an amazing company, becoming one of the fastest-growing select service brands in the lodging industry. As we sit here today, our company continues to have tremendous opportunities.

Since announcing our key strategic initiatives almost 18 months ago, we have made significant progress to drive consistency in our product, to consistently deliver an outstanding guest experience and to drive engagement with the La Quinta brand. We believe we are now well positioned to consider the next evolution of our business.

Yesterday afternoon, we filed a Form 10 to begin the process of separating La Quinta's owned real estate business from its franchise and management businesses. This new real estate entity will be named CorePoint Lodging. As you review the Form 10, you may notice that the financial information is being presented in the form of a reverse spin. This presentation is driven by applicable accounting guidance and is primarily a result of the relative significance of CorePoint's business to La Quinta's business as measured in terms of revenues, profits and assets. However, to be clear, for legal, tax and all other purposes, CorePoint Lodging is being spun out of La Quinta Holdings Inc.

The Form 10 contains information about the strengths, strategies and opportunities we see for CorePoint's business as well as limited pro forma information presented in accordance with guidance provided by the SEC and generally accepted accounting principles.

In addition to the Form 10, we issued a separate press release with supplemental financial information and posted an updated investor presentation on our Investor Relation's website. The information included within the separate press release provides a supplemental look at the financial information, one that reflects our view on what the results of our businesses might have looked like had they operated on a standalone basis, inclusive of certain allocations and estimated additional recurring costs.

Following the spin transaction, La Quinta's franchise and management businesses will continue to operate within the current La Quinta Holdings Inc. entity and will maintain the NYSE ticker symbol LQ. This new La Quinta will be a market-leading, asset-light, fee-based franchise and management business that expects to capitalize on the growth opportunity of a large and growing pipeline, strong interest from developers to expand La Quinta brand into new market in a highly scalable property management platform. As a standalone company, the new La Quinta's total adjusted EBITDA for full year 2017 is estimated to be between $110 million and $115 million, including fee revenue under ongoing franchise and management agreements with CorePoint Lodging.

As part of the spin transaction, it is expected that the new La Quinta will enter into amended and restated franchise and management agreements with CorePoint Lodging. These agreements are expected to provide that CorePoint Lodging will pay fees to the new La Quinta, which will include a management fee of 5% of gross hotel revenues in return for day-to-day management of its hotels and a royalty fee of 5% of gross room revenues. The management agreements are expected to have an initial term of 20 years with two 5-year renewal options. And the franchise agreements are expected to have an initial term of 20 years with one 10-year renewal option.

Now turning to CorePoint. Following the spin transaction, CorePoint Lodging expects to qualify and elect to be treated as a real estate investment trust for federal income tax purposes. CorePoint Lodging anticipates that it will be the only publicly traded U.S. lodging REIT strategically focused on servicing the midscale and upper-midscale select-service segment, offering a geographically diverse portfolio of hotels with significant underlying real estate value and attractive cash flow characteristics. CorePoint plans to trade on the New York Stock Exchange under the ticker symbols CPLG.

CorePoint Lodging offers a strong portfolio consisting of 316 hotels with over 40,000 rooms located in attractive U.S. locations, including over 30% of its rooms located within the top 25 markets as defined by Smith Travel Research. The hotel portfolio contains assets that are well positioned competitively within their markets, located near major employment centers, airports and transportation corridors. In addition, CorePoint Lodging will benefit from the continuation of a longstanding and mutually beneficial relationship with La Quinta.

As a standalone public company, CorePoint's total adjusted EBITDA for the full year 2017 is estimated to be between $200 million and $215 million. CorePoint Lodging will have significant scale and plans to grow and enhance its portfolio, primarily within the highly desirable midscale and upper-midscale select-service lodging segments.

The filing of CorePoint's Form 10 is an important step towards realizing our goal with creating value by allowing each business to operate independently. We believe this separation will result in greater strategic clarity with distinct management teams that can fully activate and run their respective companies.

In addition, we expect the separation will allow us to unlock growth opportunities within each business and take advantage of capital market and tax efficiencies. We look forward to completing the spin transaction, realizing significant benefits for both companies and continuing to generate long-term value from La Quinta shareholders.

With that, we would like to open the line for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Chris Woronka with Deutsche Bank.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

I guess, the first thing I want to ask on the combined pro formas for '17, I guess, the total is $310 million to $330 million, but that would include the incremental public company costs. So does that still correlate to kind of the $320 million to $340 million combined company that you talked about in April?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes, Chris, you're absolutely right. So the guidance that we gave on the 2 individual companies was paid towards the midpoint. And then you take into account the estimated additional recurring cost, the public company cost and some of the shared services that would have to be replicated.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And I guess, just to kind of clarify that. Is the -- is $8 million the assumption for, I guess, the synergies or stand-alone public company costs at the new La Quinta?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

It's actually for both, the way we've presented it. We've captured everything in that call because we're adding back across to get back to the 10-K.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, got you. And then I guess, to the extent that CorePoint acquires outside of the La Quinta brand, would the -- would new La Quinta get the first look at a management contract on those assets? And then similarly, does the new La Quinta, will they be looking to acquire other brands?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Well, Chris, this is Keith. Those are 2 great questions. So as you think about CorePoint's growth strategy is, obviously, to diversify not only just in terms of geography, but in terms of brands and networks. So obviously, we've got a strong relationship with the management arm of La Quinta speaking from CorePoint's perspective. And they would certainly be under strong consideration for management of any new flag. But we would have to take a look at the market at that point of time and just pick an appropriate manager for that brand. From a new La Quinta perspective, once we are in a position, where we've got 2 management teams that are fully activated in both businesses, that is a potential strategy that new La Quinta could pursue. But I think it's just too early to go down that kind of a detail.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, sure. And then just finally for me, are there -- I know the initial franchise royalty rate looks like it's 5%. Is -- that's for kind of the -- all the in-place owned assets going to CorePoint. But is there -- and those are going to be under long-term -- I know franchise contracts. Are there going to be step-ups built into that royalty rate? Or is that kind of what's being charged to new franchisees today?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Today, new franchisees are charged that rate, so the rate on the CorePoint assets is consistent with the gross rate that are charged to franchisees.

Operator

Our next question comes from the line of Thomas Allen with Morgan Stanley.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

So first a couple of numbers questions. What do you think in terms of transaction costs?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes. So Thomas, each quarter, we're disclosing what we're incurring on a run rate. And in the first quarter it -- I think, it totaled up to about $4.6 million. We put in the back of the press release as a reconciling item to get to adjusted EBITDA.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

Okay. So -- but total, what should we be expecting?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

We don't have a total, yet. The run rate that you saw in Q1, that's going to continue for a few quarters, while we're working on this transaction. Then you're, of course, going to have debt issuance costs and advisory fees, which, at this point, I can't quantify.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

Okay. But when you gave your leverage targets, that has -- that includes what general assumptions are for advisory fees and debt issuance costs, right?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes. I mean, we've run different models that have assumptions, but they're pretty broad at this point.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

Just to be clear. You guys gave leveraged targets of 3.5 to 4.5 for the OpCo and 5.5 and 6.5 for the REIT. That -- that's inclusive of any -- of all the costs that are going to be -- and the tax leakage needed for this transaction, correct?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

So Thomas, as you think about the leverage -- that leverage ranges that we put out there, the 2 kind of real big components that what would be -- what would make up that debt are the -- is the refinance of our existing debt and any borrowing we'd have to make for an estimated tax payment on the leakage of the transaction, which, as you know, we don't know that number yet. That will be something that will be determined later on using the value of CorePoint on the first day of trading, minus the basis to get to some taxable figure and then, obviously, the net cash, right? So you have quite a bit of cash on the balance sheet. So we're using that kind of net-net cash number, less what we think a range of transaction costs may be. And I guess, I would just look at similar transactions in terms of refinancings and transaction costs for a deal this size to set your range. But we don't have a specific number that we're targeting.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

All right. And then the -- so just to clarify from the prior question, the implied incremental corporate expense is $10 million. And can you give us any clarity on how much of that is going to be at the OpCo versus the REIT?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes. I mean, the composition of those costs, it's going to be in that $8 million to $10 million range. Certainly, a significant chunk of that is going to be the duplicate cost of being a separate public company. You've got some executive management positions that you're going to duplicate in one spot or the other, CEO, CFO, probably being the most obvious of those, and then some shared services costs. I think we -- I can't specify which entity it manifests in because that sort of depends on where folks land at the end of the day, which we don't know yet.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

Okay. And that actually leads into the next question. How are you thinking about the management team? Any incremental color there?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Right. So obviously, the nominating and governance committee of the board is task with evaluating both entities and providing the recommendation to the board on how they would staff the executive teams of both entities. And that work has not yet completed. So once we've got something there announce, we'll absolutely be communicating the back out to the markets.

Thomas Glassbrooke Allen - *Morgan Stanley, Research Division - Senior Analyst*

Okay. And then just final question. Any update -- is it still $1.7 billion tax basis for the REIT and still, the tax, they could just come up in the air?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

That's correct, Thomas.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Yes. So it will all come down to what do you think the value of CorePoint is based on the financial information you have on the first day of trading less that basis to get to some taxable amount.

Operator

And our next question comes from the line of Bill Crow with Raymond James.

William Andrew Crow - *Raymond James & Associates, Inc., Research Division - Analyst*

Just -- again, on the tax basis, just walk us through us a scenario, if you could. I mean, just -- we've got the one point -- we've got the -- whatever the value is on the first day of trading less the $1.7 billion, what is the tax rate then that we about from a tax -- shareholder perspective?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Well, that is kind of one of the burning questions, right. So in the absence of any tax reform, it would be our current federal tax rate that's out there. If in fact, we get to -- or have the opportunity to take advantage of tax reform given that we would expect this spin to be effective sometime in early 2018, we would then use whatever the prevailing rate is at that time.

William Andrew Crow - *Raymond James & Associates, Inc., Research Division - Analyst*

How flexible is the timing of this? I mean, if there was tax legislation teed up, can you just kind of push it out until this gets done? Or until...

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

We would expect -- based on kind of standard SEC review times, which, obviously, we can't control, we would expect to have permission to make this spin effective sometime in very late fourth quarter. And at that point, the timing is pretty much in our control because we could simply not go effective and provide updated financial information if the financials and our documents go stale. So to your point, we do have some flexibility and control of the timing.

William Andrew Crow - *Raymond James & Associates, Inc., Research Division - Analyst*

Okay. And I know we're looking at this as an ongoing -- 2 ongoing businesses, but one of the questions we get a lot is the G&A at the C corp. How much of that is unique to the company versus how much could be eliminated if it was part of a larger enterprise? Is there any way to kind of quantify how much of that is -- you would be -- someone would be unable to eliminate. Is there any way to quantify that?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Well, really, under that hypothetical scenario, it really has so much dependency on who and what they already have and what types of significant structures are already in place at the other entity that it -- it's hard for me to give you a number that's really anything but speculation.

William Andrew Crow - *Raymond James & Associates, Inc., Research Division - Analyst*

In a best case scenario, worst case scenario, how much G&A would have to exist, period, even within the best scenario of integrating this into a fully developed company?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Yes, I think that's a great question, but once again, it really depends on -- in that kind of hypothetical scenario what the other entity looks like.

Operator

Our next question comes from the line of Jared Shojaian with Wolfe Research.

Jared H. Shojaian - *Wolfe Research, LLC - SVP*

Am I reading and hearing you correctly that your management compensation is just a percentage of revenue with no profitably component and no owner priority? So really from a P&L perspective, this is effectively like it's a 100% franchise. Is that correct?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Under the management agreement, is that what you were referring to?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

He's talking about the 5%, what's in the 5%.

Jared H. Shojaian - *Wolfe Research, LLC - SVP*

Right. That's correct.

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

I mean, we do show some, what we call, cost reimbursements coming through the C corp, which really largely relates to the field payroll that the management company would have at the hotel, so sort of GM and down that CorePoint would reimburse the C corp for pretty much dollar for dollar. The 5% covers your cost of running a management company business with a normal type of profitability built into it.

Jared H. Shojaian - *Wolfe Research, LLC - SVP*

Right. So I mean, my understanding with some of the more full service property is you're looking at sort of a 3% base revenue compensation and then some excess in -- on profitability. I mean, is there any sort of structure like that for you guys or are you entirely compensated on the revenue of the properties in the REIT?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes, your latter statement is correct. Our agreement is fairly simple in that it is a straight percentage of the revenue at the hotels. It doesn't have incentives and those types of things you're talking about built into it.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Yes, the 5% is kind of an all-in rate because there's so many different ways these management agreements are structured. This one, as to Jim's point, is very simple.

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Yes. Is the accounting fee in, is the revenue management fee in or out? This is all inclusive and simple.

Jared H. Shojaian - *Wolfe Research, LLC - SVP*

Okay. And then maybe you can just help me understand the timing of the Form 10 a little bit more. I mean, originally it was planned for early in the second quarter, so about 3 months later than expected. Is it correct that if you were to engage in any sort of M&A transaction, you would never have even needed to file the Form 10? And if so, is there anything to read into how long it took for this to be filed?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

So as we think about it, back in January, we announced the possible pursuit of this separation. And we said it would take probably 7 to 10 months to get the process rolling. And we're right in line with where we thought. We had thought potentially as early as June. So we're in July. One of the things that I do want to call out is as you're reading through the documents, you'll notice that the accounting treatment in the Form 10 is a reverse spin. And we did go through a preclearance process with the SEC to make sure that the Form 10 document has the right financial presentation so we didn't lose any time. And that actually did cost us several weeks. So the one thing that changed in the process was gaining preclearance on the reverse spin. Outside of that, everything else was 100% in line with our timing. Now in terms of anything transactional affecting what we're doing, as we had talked about, I believe, also kind of back in the January time frame, there's a lot of reasons why we would spin out our property and have the remaining entity be La Quinta Holdings Inc. It's very tax inefficient if you would do a transaction on OpCo and have remain-co hold all the assets because that remain-co would be La Quinta Holdings Inc. and would ultimately want to become a REIT. And upon reelection, the gain on the sale of the brand would then be taxed again. So it's a very inefficient structure to that type of transaction. So as we said before, regardless, we have to spin the properties out of La Quinta Holdings Inc. to get optimal tax efficiency given that we don't have a tax-free option available to us on spinning our assets into a REIT entity. So this is the right structure to follow.

Operator

Your next question comes from the line of Jeff Donnelly with Wells Fargo.

Jeffrey John Donnelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Just a follow-up on Bill's question. When you say the tax rate -- I think, he was talking about the incremental value over the $1.7 billion of asset value. Do you mean the ordinary income tax rate? Or are you referring to a capital gains tax rate?

James H. Forson - *La Quinta Holdings Inc. - CFO, EVP and Treasurer*

Jeff, so earlier when Keith was talking about that, he was talking tax at the corporate level that would be calculated. We really can't comment on how a shareholder might be impacted by this because there's lots of different factors that are in play depending on what your position is.

Jeffrey John Donnelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

So you mean, like, the tax the company would recognize in its statements then.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

Yes. The corporate level tax is the difference between the value of CorePoint Lodging and the basis on the first day of trading at the prevailing then corporate tax rate. At the individual level, we don't understand the position of every shareholder and how they hold the stock, so I can't really give guidance as to what that number would be.

Jeffrey John Donnelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay, that's helpful. And I know you've had certainly no shortage of initiatives on your plate. But when you think about the strategy that new La Quinta will pursue, have you guys given thought to whether new La Quinta might evolve into pure franchisor? Or perhaps, I recognize the management of the La Quinta assets is a significant piece of the business today. But -- or have you thought that, that might evolve into becoming a -- sort of a third-party manager of select-service assets? Just curious how you think about that down the road?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

That's a great question, right? As we were envisioning new La Quinta today, right, it's going to be the existing franchising brand and management business. Over time, that business could evolve into a -- 2 separate organizations potentially. But -- and as we talk about getting these 2 management teams stood up and activated, I think that kind of next iteration would be a strategy or discussion that would be undertaken by the management team that was put in place for new La Quinta.

Jeffrey John Donnelly - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And I guess, one last question. Do you folks have a preference yourselves for whether it's CorePoint or La Quinta? Or is that to be determined?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

As I mentioned earlier, the board and the non-gov committee are working through the process and putting together a recommendation. And the reality is this. As you look at both of these entities, CorePoint Lodging and new La Quinta both have, I think, amazing opportunities to grow and develop their businesses over time with new La Quinta continuing to have a strong and robust franchising business, an enormous amount of white space to continue growing their units. And then CorePoint Lodging, with, I think, a very unique opportunity and a lot of scale to be able to begin to consolidate in a very attractive space in our industry as base for the developers have all migrated for cash-on-cash returns and where consumers continue to migrate because of price value proposition. I think they're both very, very interesting opportunities and interesting businesses.

Operator

And our last question comes from Stephen Grambling with Goldman Sachs.

Stephen White Grambling - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I guess -- one -- I guess, have you all thought about actively shopping either entity as a potential acquisition target? And will the split create any limitations to selling off pieces of either entity?

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

So I'll answer your second question first. The spin transaction puts absolutely no limitations on any other kind of strategic activity. So -- and in fact, by spinning out the assets in the function -- in the fashion that we are planning to do, it actually increases optionality. Now in terms of selling the business, as you said before, we would consider any option that we believe would drive value for the business and the shareholders. So as we think about us and the board, it's really about what drives the optimal value. So I really can't comment on a theoretical transaction. But if there's something that really will drive a lot of returns and value for the business, then certainly, we'd have to give it a very hard look.

Stephen White Grambling - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And then, I guess, to be clear on Jeff's question as a follow-up. So fundamentally, you anticipate splitting the company should allow the growth rate of either of these 2 maybe accelerate relative to the entity as a whole as we look beyond 2017.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

That's our expectation.

Operator

And I'm not showing any further questions. I'll now turn the call back over to President and CEO, Keith Cline.

Keith A. Cline - *La Quinta Holdings Inc. - CEO, President and Director*

I just want to thank everyone for jumping on the call quickly this morning, and please enjoy your day. And thank you for support of our business.

Operator

Ladies and gentlemen, this does conclude the program. You may now disconnect. Everyone, have a great day.