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Sunstone Hotel Investors, Inc. (SHO)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day. Good morning, ladies and gentlemen and thank you for standing by. Welcome to the Sunstone Hotel Investors Second Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instruction will be given at that time. I would liketo remind everyone that this conference is being recorded today, August 4, 2021, at 12:00 PM Eastern Time.

I will now turn the presentation over to Mr. Aaron Reyes, Senior Vice President and Treasurer. Please go ahead, sir.

Aaron Reyes
Senior Vice President & Treasurer, Sunstone Hotel Investors, Inc.

Thank you, operator and good morning everyone. By now, you should have all received a copy of our second quarter earnings release and supplemental, which were made available yesterday. If you do not yet have a copy, you can access them on our website.

Before we begin, I would like to remind everyone that this call contains forward-looking statements that are subject to risks and uncertainties, including those described in our prospectuses, 10-Qs, 10-Ks and other filings with the SEC, which could cause actual results to differ materially from those projected. We caution you to consider these factors in evaluating our forward-looking statements. We also note that this call may contain non-GAAP financial information, including adjusted EBITDAre, adjusted FFO and property-level adjusted EBITDAre. We are providing that information as a supplement to information prepared in accordance with Generally Accepted Accounting Principles.

With us on the call today are John Arabia, President and Chief Executive Officer; Bryan Giglia, Chief FinancialOfficer; and Chris Ostapovicz, Chief Operating Officer. After our remarks, we will be available to answer your questions.

With that, I would like to turn the call over to John. Please go ahead.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

Thank you, Aaron. Hello, everyone, and thank you for joining the call today. I'll start with a review of our second quarter operating results, which materially exceeded our expectations and pushed the company back into profitability sooner than expected. I will also provide an update on the current operating environment and forward booking trends, which continue to provide strong signal of continued growth in the third and fourth quarters, despite the uncertainty surrounding COVID-19. Last, I'll provide an update on our most recent hotel investment, Montage Healdsburg, and the potential for additional acquisitions of Long-Term Relevant Real Estate. Bryan will later provide more details on our liquidity, earnings, and dividends as well as an update of our recent finance transactions, which have materially increasedour near-term investment capacity.

To begin, let's talk about our second quarter operating results. Building on the better than anticipated results of the first quarter, second quarter materially exceeded our expectations with comparable 17 Hotel Portfolio revenues of $104 million and RevPAR of $96. RevPAR at all of our Open Hotels, including Montage Healdsburg was $107, made up of an average daily rate of $235 and an occupancy of 45.6%. While the comparison to the second quarter of 2020 is of little value, the Open Hotel RevPAR of $107 in the second quarter was more than double the Open Hotel RevPAR of nearly $48 achieved in the first quarter of this year. Furthermore, our occupancy, ADR and RevPAR have each increased meaningfully on a sequential basis every month this year. And our June RevPAR of almost $130 was nearly 5 times that of the $27 comparable RevPAR achieved this past January. While we still have a ways to go, the trajectory of the recovery has been farsteeper than expected. As a result of the better than expected second quarter results, hotel EBITDA was positiveeach month of the quarter, which is the first time we achieved this important milestone since the fourth quarter of2019. This is a testament to the efficacy of zero basing expenses, the efficiencies in our operations, the diligence of our managers and the proactive investment and operating decisions made during the depths of the pandemic. When we last spoke on our first quarter earnings call, we shared that we expect a return to quarterly corporate profitability in the second half of the year. I'm happy to report we achieved this goal in the second quarter at least three months ahead of schedule.

So let's dig into some of the details of our quarter. While occupancy in all segments grew quarter-over-quarter, transient demand continues to be the shining star and transient room nights more than doubled compared to the first quarter. Leisure demand continues to be incredibly strong including in non-traditional leisure destinations andcommercial demand continues to demonstrate improvement as more people get back to business. While special corporate demand for the portfolio was still only around 20% of normal levels in the second quarter, several of our hotels including Hilton San Diego Bayfront, Embassy Suites La Jolla, Hyatt Regency San Francisco and Hyatt Centric Chicago witnessed a meaningful acceleration in special corporate room nights. Even more encouraging isthe strength of transient pricing with our second quarter transient rate at $253. Even after adjusting for the acquisition of Montage Healdsburg, our second quarter transient rate still approachedthat of the same period in 2019. Despite several urban markets still lagging compared to pre-pandemic levels, our resort hotels, specifically Wailea Beach Resort and Oceans Edge each achieved higher RevPAR than in the same time in 2019, up 4% and 79%, respectively. The performance of these hotels was driven by occupancy approaching pre-COVID levels with significantly higherroom rates compared to 2019, running 30% higher at Wailea Beach Resort and up a staggering 91% at Oceans Edge. The outsized rate growth at Oceans Edge is a direct result of our strategy to elevate the guest experience to match its superior physical offerings and then price the resort accordingly. Following our acquisition of the hotel in 2017 and the implementation of several asset management initiatives, therate growth at Oceans Edge has been more than twice that of the Duval Street adjacent resorts. Additionally, our recent acquisition, Montage Healdsburg, has performed favorably to our initial estimates running at an average rate over $1,000 in the second quarter. We continue to believe that our outstanding hotel product in these sought-after markets and a desire by travelers to spend time in special locations gives us a competitive advantage and further justifies our strategy of owning Long-Term Relevant Real Estate.

Now let's take a closer look at our quarterly group performance. Though presently a smaller percentage of occupancy than is normally the case, group business also experienced growth beyond our expectations. Group business contributed approximately 80,000 room nights in the second quarter, up from 51,000 room nights in the first quarter and the outlook for the third and fourth quarters indicates significant sequential improvement. Not onlyhas attendance at several recent group events across the portfolio exceeded projections, but short-term lead volumes and new group functions have increased significantly in recent months. For example, Hilton San Diego Bayfront, Boston Park Plaza and JW New Orleans each witnessed second quarter lead volumes approaching pre- pandemic levels. So over the last quarter we saw corporate and association groups holding their meetings as planned and group pickup was better than anticipated. Several of our larger group hotels including Hyatt San Francisco, Boston Park Plaza and Renaissance Orlando has several groups that picked up over 90% of the contracted blocks in the second quarter which was substantially higher than we forecasted. With these dynamics in place, we expect to see a steady acceleration in group meetings including citywide, corporate and association meetings for the remainder of the year, holding othervariables constant.

But rooms revenue was not alone in growing substantially on a sequential basis, food and beverage revenues increased by 2.5 times in the second quarter representing a 22% increase in food and beverage spend per occupied room and other revenues doubled as higher occupancy drove ancillary revenues such as parking. Catering revenue per group room night also increased by over 2.5 times as corporate group and associations returned. Not only are more guests staying in our hotels, but they are increasingly ready for the complete hotel experience and embracing our facilities and amenities as they reopen.

As a result of these factors, our comparable total revenue per available room or TRevPAR increased from nearly $60 in the first quarter to over $138 in the secondquarter. While we are pleased with our portfolio's financial improvement, we are equally pleased that our guest satisfaction scores remain very strong. For example, travelers on TripAdvisor recently ranked Oceans Edge as one of the top 10 hotels in Key West, up from 24 at the end of 2019, even with a massive increase in ADR. These factors give us confidence that the rate increase is sustainable, and additional growth is achievable. Again, we are seeing the benefits of the portfolio transformation completed in recent years as well as the operational investment decisions made during the depths of the pandemic.

As we look forward, we are mindful that, since early July, there has been a spike in COVID cases particularly amongst the unvaccinated in areas such as Florida and Texas. The recent spike in cases may result in reinstituting travel restrictions, mask mandates and vaccine mandates in certain locations which could postpone the eventual travel recovery. That said, we have not yet witnessed meaningful evidence that the spike in COVID cases has had a material impact on the trajectory of lodging recovery, rather, booking trends for all segments continue to accelerate despite increased COVID cases in numerous parts of the country. This is evident in our continued sequential monthly RevPAR improvement in July. Through July 29, our 17 Open Hotels generated RevPAR of approximately $165, made up of a 62% occupancy and a $266 average daily rate. July's occupancy, ADR and RevPAR all increased meaningfully over the prior month, continuing the trend that started last year. Our July RevPAR represents a $35 increase from June and is $138 higher than that experienced this past January.

As we evaluate expected group activity for the rest of the year, we anticipate increased demand for corporate and association meetings. The citywide calendars in many of our primary markets are very encouraging over the next several quarters and over 30% of our group room nights on the books for the fourth quarter are for citywide events. Citywide events are planned to resume in San Diego, Boston, New Orleans, DC and Orlando. That said, given the uncertainty around COVID, our operators have prudently assumed that the group room blocks will travel at significantly lower levels than has historically been the case. This assumes that attendees continue to make attendance decisions in relatively short timeframes and are influenced by evolving COVID data and trends. For example, in Orlando, a number of citywide groups relocated dates into the August to October timeframe from prior periods, but the team is forecasting higher than normal slippage on these programs and is anticipating softer performance for the larger conventions in the fourth quarter. However, based on early trends, there may be upside potential in some markets from taking this conservative approach.

As previously mentioned, several recent groups have picked up 90% to 100% of their room blocks which was well in excess of our forecast. While this will not be the case for every group, it is a far cry from the muted group attendance we initially feared. Examples of citywide group business for the remainder of the year include a scaleddown Comic-Con event over Thanksgiving at our Hilton San Diego Bayfront, several association meetings in Boston and various large association meetings in New Orleans which will be held in addition to several festivals that were rescheduled to the fall as a result of the pandemic. These are just a few instances of the evolving citywide and group landscape that gives us confidence that the positive trends established in the second quarter are likely to continue as pent-up group demand gets back on the road.

In-house group business has also witnessed positive trends. Increased vaccinations and the easing of travel and in-person meeting restrictions have given meeting planners a greater comfort level that their events will move forward. This has resulted in stronger group leads, more confirmed events and more participants planning to attend. In-house group demand has been broad based and includes incentive trips from technology and pharmaceutical groups at Wailea; retail, medical and financial services groups at the Hilton Bayfront; state and regional associations at the Renaissance Orlando; and a medical company at the Hyatt San Francisco.

With the number of vaccinated people growing every day, we are optimistic that group activity should continue on this trajectory. Based on these assumptions we expect group to make up an increasingly larger part of our room mix and revenues in the second half of 2021 and specifically in the fourth quarter. On average, group rates on the books for the remainder of 2021 are higher than the rates on the books for the same period in 2019. Furthermore, given the anticipated increase in corporate and association group business we also anticipate the banquet spend per occupied group room will increase substantially compared to the first half of the year when government and rooms-only group characterized most of the group room mix.

Supplementing the return of corporate and association travel, local social business should be robust in the third and fourth quarters including a record number of weddings expected in the second half of the year. From corporate events to social gatherings, people are motivated to get together and celebrate.

In addition to the more optimistic outlook for group business, transient trends have steadily improved. While our net transient reservations are still short of normal levels, bookings continue to accelerate. Our trailing six-week booking trends are now down only 10% to 15% compared to the same time in 2019 which marks a substantial improvement from the 80% to 90% declines we saw in the first of the year and the 40% to 50% declines we saw going into the second quarter. The booking window, though still relatively short-term, continues to expand. While leisure demand was the first to come out of the gates, business transient demand is expected to pick up in the third quarter and accelerate following Labor Day as companies continue to return to the office.

Moving to our recent investment activity, we are excited to discuss the strong performance of Montage

Healdsburg, which has exceeded our underwriting. While we were confident that this hotel would perform well, theramp-up in rate and occupancy has surpassed our expectations in each month of ownership. During the quarter the hotel ran an occupancy of 61% at an average rate over $1,000. And in July the hotel ran at over 70% occupancy at a rate of nearly $1,250. We're seeing broad based demand for the Wine Country and strong interestfrom transient and groups alike. In the second quarter we experienced transient compression on weekends and stronger than anticipated group demand during the week. Profitability also outperformed with the hotel achieving positive EBITDA ahead of schedule in the second quarter. Looking forward there's a lot to be excited about. The hotel has received extraordinary reviews, which has translated into strong group leads and is preparing for its second full property buyout since our acquisition. Layering in group with already strong transient will help drive additional success at this standout resort.

Since our last earnings call, we executed upon a number of balance sheet enhancing transactions including the issuance of two record-setting series of preferred equity and another favorable amendment to our unsecured debt agreements. Not only do these transactions provide us with an advantageous cost of capital that results in greater FFO growth, but they unlock meaningful debt capacity that we can use to pursue additional acquisitions of Long- Term Relevant Real Estate. We expect to be acquisitive and can do so without relying on the often fickle equity markets. This is a significant advantage that is not shared by many others and one we plan to take advantage of to enhance the quality, scale and earnings power of our portfolio, while increasing NAV per share.

To sum things up, performance in leisure and group segments in the second quarter set the stage for increased optimism in the second half of the year, despite the ongoing threat of COVID-19. Based on forward booking information, we believe the portfolio is on track for continued improvement as the year goes on. Furthermore, we are in the enviable position to use our strong balance sheet and debt capacity to grow the company and to createvalue for our shareholders.

With that, I'll turn it over to Bryan. Bryan, please go ahead.

Bryan A. Giglia

Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.

Thank you, John, and good morning everyone. As of the end of the quarter, we had approximately $210 million oftotal cash and cash equivalents, including $47 million of restricted cash. Adjusting for the issuance of our Series Ipreferred stock and the expected redemption of our Series F, our pro forma total cash balance at the end of the quarter would have been approximately $235 million. In addition to cash on hand, we also maintained full availability on our $500 million revolving credit facility.

During the quarter, we executed another favorable amendment to our unsecured debt agreements which removed the restrictions limiting the amount of unencumbered hotel acquisitions we could fund from existing liquidity during the covenant relief period. Even after deploying a portion of our excess liquidity in the second quarter, our balance sheet retains significant capacity and this most recent amendment better positions us to usethat capacity to grow the company through additional acquisition of Long-Term Relevant Real Estate. We appreciate the continued partnership and support from our longstanding lender and note-holder relationships.

As John mentioned since our last earnings call, we also executed upon two additional balance sheet enhancing transactions through the issuance of both our 6.125% Series H preferred and our 5.7% Series I preferred. Proceeds from these two transactions, both of which were record setting low coupons at the time of issuance, arebeing used to redeem higher cost existing preferred equity and will reduce our comparable preferred dividends by
$1.5 million per year. Given the attractive pricing and strong demand for our most recent offering, we elected to upsize the Series I transaction to take incremental proceeds. Preferred equity is an increasingly important part of our long-term capital structure and as a result of the acquisition and financing activity in the quarter, we have

increased our exposure and will have three attractively priced series of preferred stock outstanding.

Shifting to the second quarter financial results, the full details of which are provided in our earnings release and inour supplemental. Second quarter results reflect an improving operating environment driven by continued strong leisure demand and an increasing amount of commercial transient and group business. Second quarter adjusted EBITDAre was $15 million and second quarter adjusted FFO per diluted share was a loss of $0.01. These results far surpassed our previous expectations and marks the return to positive corporate EBITDA, a full quarter sooner than we had previously projected. While total FFO was marginally negative in the second quarter, we expect it to also resume quarterly profitability going forward.

Now turning to dividends, we have suspended our common dividend until we return to taxable income. Separately our board has approved thequarterly distributions for our Series H and I preferred securities.

With that, we can now open the call to questions. Operator, please go ahead.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Rich Hightower from Evercore. Your line is now open.

Rich Allen Hightower
Analyst, Evercore ISI Q

Hey, good morning guys.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc. A

Hey Rich.

Rich Allen Hightower
Analyst, Evercore ISI Q

I hate to ask academic questions on these calls because I'm sure it bores a lot of people, but I want to do that anyway. And it's the same question I asked on a competitor's call earlier, but when you think about ATM issuance relative to NAV, I just want to get a full understanding of how Sunstone thinks about, calculates what are the different inputs because there's obviously multiple ways of looking at it, so just help us understand the – really the cost of equity calculation there as we think – again as we think about issuance?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc. A

Sure. Actually thoughtful question, Rich. So, NAV is something that we look at. It's one of the inputs that we do look at as we spend a lot of time trying to understand, making sure we understand the value of our portfolio and as a result of that the value of our equity. When I take a look at consensus NAV of those that I think do a good job of calculating NAV and they're thoughtful knowing that it's a more difficult time now than I would say before in this type of environment to calculate NAV. But I'd say that those folks that spend a fair amount of time including, you Rich, consensus NAV is right around $13.25 and I think Green Street's at $13.25, you're at $13.50, Baird I think is at just below $13. And I think that that's in a fair area so to speak knowing that over time that NAV should continue to increase as a recovery increases.

How do we look at it? We take a look at a combination of cap rates, discounted cash flow, price per key and then we debate it internally knowing that cap rate right now is incredibly difficult. So we have shifted how we look at our own NAV a little bit and how we calculate it over time, probably using a little bit more discounted cash flow now than before. So hopefully that helps Rich.

Rich Allen Hightower
Analyst, Evercore ISI Q

That's helpful. Thanks John.

Operator: Your next question comes from the line of Anthony Powell from Barclays. Your line is now open.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Q

Hi. Just a follow-up to that question. So obviously you accessed the ATM and you issued a bit of extra preferred, I guess did you see an opportunity to do a deal in the quarter that spurred you to do those equity offerings or to raise extra equity and what are you seeing out there in terms of Long-Term Relevant Real Estate available for you to buy?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Yeah, so let's go back and talk about what we've said in terms of near-term tactics to fund external growth. One, we expect to be acquisitive and we've said that loud and clear. We've already completed $265 million of acquisition through the Montage Healdsburg which – the way we look at it was 100% leveraging and again Anthony we look at preferreds as leverage rather than equity. So then we have also disclosed that we are under contract for an asset on the West Coast of somewhere in the area of just below $200 million. It would be our expectation that that would be funded as well with debt, preferred and a very small portion of the ATM raise. So if you put both of those together and say we're in the $450 million, $460 million of acquisitions we're talking about an equity raise of about 8% or 9% of total proceeds which again is using our debt capacity and we think so wisely.

So – and following up to Rich's comment raising $38 million at right around what consensus NAV is, I don't think that hurts us long-term. I actually think it's pretty prudent as it will continue to increase the amount of – on a small basis and we're only talking about $38 million here, but on a small basis it increases our buying capacity, which, as earnings grow, that buying capacity should continue to grow as well as our debt capacity continues to increase.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Q

Got it. All right and just one more on the overall availability of deals, the – under contract acquisition is a positive sign, but what else are you seeing out there in terms of a transaction environment?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

We're active. As I've said on previous calls and at conferences, we've been active for now well over a year in sourcing transactions. Some of the transactions that we've been looking at take a long time. We're active in off-market transactions and in brokered transactions even though I will tell you it always seems that we do a little bit better in direct communication with potential sellers, but we are active. I'm pleased that we have seen an uptick in the quality of the potential dispositions or – excuse me, quality of the potential acquisition opportunities for us. Doesn't mean we're going get them all, as evidence some of our peers have acquired quality hotels as well, but we expect to be active over the next few years.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks Anthony.

Operator: Your next question comes from the line of Smedes Rose from Citi. Your line is now open.

Q

Hi. Good morning. This is Seth on for Smedes. Just wanted to know what are the gating issues to disclosing that hotel under acquisition?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

The gating issues to disclosure, we're just not ready to disclose it based on that we are not yet under hard contract and once we get to the position where we feel that we have a very high degree of certainty that it'll close then we will announce it. Typically, we actually don't even announce transactions until they're done, but given the preferred equity raise, we thought it was most prudent to disclose that we were under contract on asset of that size.

Q

And then just what are you seeing on the group side in terms of composition for 2022 in terms of corporate and social?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

So I'll turn it over to Chris for any color. But in general, what we're seeing is we are seeing a lot more activity in group activity starting in the third quarter. As I said on on our last call, we had a lot of non-traditional groups that were filling the hotels. And we've seen group business increase pretty meaningfully. Not only have we seen it increase, I think we did something like 50,000 or so rooms in the first quarter moving up to 80,000 rooms or so in the second quarter, we anticipate that to continue to increase, but there's going to be a – from what we see right now, there'll be a material shift in the number of citywides and the number of associations, et cetera, that will start coming back. And why is that important? That's important because it represents a pretty meaningful part of our business, but not only in addition to hotel rooms but out of room spend. And so we are very hopeful and we see evidence of that not only groups come back, but out of room spend continues to increase.

Chris, any color on types of groups we expect to see?

Chris Ostapovicz
Senior Vice President & Chief Operating Officer, Sunstone Hotel Investors, Inc.

A

Yeah. Thanks, John. I mean when we look at 2022 group pace, we're pretty pleased at where it is relative to where we thought it would be at this point. We're definitely seeing strong group lead production. Closure is not as fast as we'd like it to be but it never seems to be. But being down to 2019 for 2022 is encouraging. As far as the mix of business, it's across the board. We're seeing very good pickup from associations and corporate continues to be a little more short-term, but it's there as well. Speaking to John's comment about the ancillary revenue side of things, we're very encouraged.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

And just adding to that, when you take a look at the citywide calendars for 2022 several of our markets have very strong citywides relative to 2019 levels. So assuming this recovery continues, we're hopeful for next year.

Chris Ostapovicz
Senior Vice President & Chief Operating Officer, Sunstone Hotel Investors, Inc.
A

Yeah specifically San Diego is one of those markets John that, as you know, we're very bullish on San Diego looking at the citywide calendar. And what the meeting planners are telling us. More short-term, meeting planners – one of our brand partners just mentioned that 95% of 277 meeting planners that they spoke to plan to still hold their meeting between now and the end of 2021, so that's certainly leads to a very positive trend leadinginto 2022.

Q

Thanks.

Operator: Your next question comes from the line of Lukas Hartwich from Green Street. Your line is now open.

Lukas Hartwich
Analyst, Green Street Advisors, LLC
Q

Thanks. Good morning guys.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Hey Lukas.

Lukas Hartwich
Analyst, Green Street Advisors, LLC
Q

Hey. So in regard to inflation there seems to be a divide on whether that's transitory or not and obviously we're seeing pressure on the labor front for the hotel industry. I'm just curious do you think – where do you think labor cost pressure lands in that debate, do you kind of anticipate it will be more transitory or do you think this is kind of a new area of pressure we're going to be seeing for the foreseeable future?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Well, probably a question a little bit above my pay grade. But what we're seeing down on the ground is there is wage inflation now. It is difficult to hire, source quality employees. Our wage rates are moving up. In certain areas we are offering small sign-on bonuses, et cetera and we are limiting at several of our hotels we're limiting the number of services that we can provide as a result. However, based on what we've seen in some of those markets where they have cutoff the incremental unemployment benefits – the supplemental unemployment benefits, there seems to be an easing in the hiring process and that gives us some hope that following Labor Day, following the sunset of some of those benefits that we should start getting some relief on the labor side.

Lukas Hartwich
Analyst, Green Street Advisors, LLC

Q

Great. Thank you.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks, Lukas.

Operator: Your next question comes from the line of Bill Crow from Raymond James. Your line is now open.

William A. Crow
Analyst, Raymond James & Associates, Inc.

Q

Good morning, John and Bryan. Two questions here if you don't mind. John, on the labor discussion, as you go up in ADR I think guest expectations have to go up and it's one thing to have the availability of labor but it's another one to have the quality labor and workforce and just wondering whether you're running into challenges with people not showing up and higher turnover rates and that sort of thing?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Yeah. It's a great question. That's particularly for assets like Wailea, Oceans Edge, Healdsburg, et cetera. There's always a challenge in operations but at those types of hotels, we think that we brought back staff accordingly and just to make sure that we are servicing the guest and meeting their expectations. And as I just said to Lukas, there are a couple of areas in our hotels we're actually limiting the number of folks that we can accommodate. For example, in Healdsburg right now, we have so much demand for restaurant and spa that we are turning away outside guests for those services because we just don't yet have the full strength of or the full capacity so to speak of associates. And we want to make the experience, particularly at those price points, we need to make the experience right because that's what's going to build the loyalty back to those hotels.

William A. Crow
Analyst, Raymond James & Associates, Inc.

Q

Yeah. All right. And John you mentioned Wailea, so let me just pivot there real quick and ask if – we're starting to hear more pushback from politicians and residents on over tourism already. We just started again and they're pushing back. I'm just wondering what your thoughts are and whether that poses a risk to Hawaiian hotels?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

I don't think so long-term, Bill. Tourism represents such a major component of the economy there that I just don't see that being an issue long-term.

William A. Crow
Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. Thanks for the time.

Operator: Your next question comes from the line of Michael Bellisario from Baird. Your line is now open.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Good morning, everyone. John, I just want to go back to capital allocation. Has your view on M&A change at all given the fundamental improvement that's occurred and the divergent stock prices that we've seen recently or do you think that the pathto growth will be mostly through single asset transactions?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

I'm sorry. Can you ask that question again?

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Just has your view on M&A changed at all recently given the fundamental improvement that's occurred or do you think Sunstone's path to portfolio growth is really going to be driven mainly by single asset transactions?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

I'd say it's far more likely to be single asset transactions. Everything I see right now it's probably more likely to be single asset transactions. The more likely scenario is if the hotel REITs, which are now trading at discounts to NAV, if they stay at discounts to NAV for some time, there's so much capital out there that I actually think that the next transaction could be a privatization rather than M&A, should share prices stay where they are and should operating fundamentals continue to expand.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Got it and does that relative pricing to NAV change your view about how you think about dispositions and for pruning part of the portfolio going forward?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Not really, we're going down that path regardless. And I'm probably off by my numbers a little bit, but we've sold in mytime here some 22, 23, 24 hotels. I think we've sold 10 or so in the past 3-plus years, give or take. We've been very vocal that there are still a handful of hotels in our portfolio that are not long for our portfolio. And so we'll continue to do that.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Understood. Thank you.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks.

Operator: Your next question comes from the line of Floris van Dijkum from Compass Point. Your line is now open.

Floris van Dijkum
Analyst, Compass Point Research & Trading LLC

Q

Thanks. Thanks for taking my question guys. Just maybe if you can give us some perspective on your Oceans Edge acquisition and return. I mean obviously things are incredibly strong right now in Key West and in that property. For us to get more comfortable with some of the other higher priced acquisitions you've done, what is the return expectations for Oceans Edge based on your $1 million a key acquisition I think in 2017 today and can we expect something similar for some of the other higher end acquisitions that you've either doneor are contemplating and doing?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

So Oceans Edge, the hurricane set us back a little bit shortly after we acquired it. And – but this year we're probably looking at little bit more delayed than we had anticipated, but probably looking around a 6% yield on investment. So an asset like that we're in the money now. Although I will tell you the first couple years largely, because of hurricane and displacement in the market, it was a little bit bumpier than we thought. As evidenced by the significant rate increase, the repositioning of the asset, the asset management work that we've done, we believe that we are on path there. And as I said in my prepared remarks, consumers are really supporting the hotel given that we've moved rates so much, but at the same time we're now a top 10 resort in the Key West market.

When it comes to Montage Healdsburg, we've said loud and clear that we expect the stabilized yield on that asset to be in the 6% to 7% range. That was underwriting a rate of four, five years out of $1,250. Last month we did a rate of $1,250. Now that one month does not make a year because of seasonality, et cetera. But I feel very comfortable given what we've come to know that we will do just fine with that asset and create value. So there's been a lot of focus on price per key. But when you take a look at the economics of that hotel, the economics of that hotel will generate as much EBITDA as several 500 to 600 room hotels. So it needs to be taken into perspective.

Floris van Dijkum
Analyst, Compass Point Research & Trading LLC

Q

Appreciate that, John. Thanks.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks.

Operator: This concludes the Q&A session. I would like to turn the call over to Mr. John Arabia for closing remarks.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

Thanks everybody for your time. We're around today if there's any follow-up calls. And please, please, please if you have not been vaccinated yet, get your butt into the doctor and get vaccinated. Appreciate it. Have a good day.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.