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SOHO - Q3 2019 Sotherly Hotels Inc Earnings Call

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PRESENTATION

Operator

Hello, and welcome to the Sotherly Hotels Third Quarter 2019 Earnings Conference Call. (Operator Instructions) Please note that today's event is being recorded.

At this time, I would like to turn the conference over to Mac Sims. You may proceed, sir.

Unidentified Company Representative

Thank you, and good morning, everyone. Welcome to Sotherly Hotels' Third Quarter Earnings Call and Webcast. Dave Folsom, our COO, will begin today's call with a review of the company's quarterly activities and a review of portfolio performance. Tony Domalski, our CFO, will provide our key financial results for the quarter and update our 2019 guidance. Drew Sims, our Chairman and CEO, will conclude with an update of our strategic objectives. We will then take questions.

If you did not receive a copy of the earnings release, you may access it on our website at sotherlyhotels.com. In the release, the company has reconciled all non-GAAP financial measures to the most directly comparable GAAP measure in accordance with Reg G requirements. Any statements made during this conference call, which are not historical, may constitute forward-looking statements. Although we believe the expectations reflected that any forward-looking statements are based on reasonable assumptions, we can give no assurance that these expectations will be attained. Factors and risks that can cause actual results to differ materially from those expressed or implied by forward-looking statements are detailed in today's press release and from time to time in the company's filings with the SEC. The company does not undertake a duty to update or revise any forward-looking statements.

With that, I'll turn the call over to Dave.

David R. Folsom - Sotherly Hotels Inc. - President, COO & Director

Thank you, Mac, and good morning, everyone. I'll start off today's call with a review of our portfolio's key operating metrics in the quarter. Looking at results for the composite portfolio, which represents the company's wholly owned properties and the participating condominium hotel rooms from the Hyde Resort & Residences. For the quarter, portfolio RevPAR increased 0.3% over prior year to \$100.06 with a 1.1% increase in occupancy and a 0.7% decrease in ADR. Year-to-date, portfolio RevPAR increased 4.5% over prior year to \$116.57, with a 2.2% increase in occupancy and a 2.3% increase in ADR.

During the quarter, our portfolio was exposed to weather-related disruption resulting from Hurricane Dorian, a category 5 storm that struck the region from late August to early September. The storm threatened a substantial portion of the East Coast with governments declaring states of emergency in Florida, Georgia, South Carolina, North Carolina and Virginia.

As we mentioned in our press release on September 6, our portfolio sustained only minimal damage, and all properties remained open during the storm. The regional impact of Dorian, however, was more substantial from a business interruption standpoint. The storm was large, slow-moving and its track was uncertain for many days leading up to landfall. We experienced significant cancellations and minimal revenue pickup at our hotels along the coast, ranging from Hollywood, Florida to Arlington, Virginia, as a result. Travel throughout the Southeast region was disrupted from late August until the middle of September, and the lack of demand had a resounding impact across much of our portfolio. Unfortunately, we do not believe we'll be able to recover meaningful compensation from our business interruption policies due to the lack of physical damage and/or mandatory evacuation orders. However, we are still evaluating those claims.

Looking at some other highlights across the portfolio. At the Hotel Ballast in Wilmington, North Carolina, the hotel continues to ramp up following its conversion in 2018, growing RevPAR 13.6% in the quarter, which was fueled by a 4.6% increase in occupancy and an 8.6% increase in ADR. Despite headwinds from Hurricane Dorian, the Wilmington market continued its stellar performance in the quarter, with our comp set RevPAR up 9.1%. The Hyatt Centric in Arlington, Virginia grew RevPAR 3.5% in the quarter, reflecting a 2.8% decrease in occupancy and a 6.5% increase in rate. The Whitehall in Houston increased RevPAR 23.5% in the quarter, driven by a 27.3% increase in occupancy and a 3% decrease in rate. At the same time, the market was down 9.3% with our hotel taking over 3,600 basis points in share.

Looking at our recent corporate activity. In September, we announced that we entered into a master agreement with Newport Hospitality Group Inc. and Our Town Hospitality LLC for the management of 10 of the company's hotels, effective January 1, 2020. Our Town, which is a newly formed wholly-owned subsidiary of Newport Hospitality, will be headquartered in Williamsburg, Virginia and dedicated solely to the management of the company's hotels. Drew will provide more color on this change later in the call.

Also in September, we announced that we acquired 2 commercial condominium units in the Hyde Beach House Resort & Residences located in Hollywood, Florida. In connection with the closing, the company acquired the hotel commercial unit for \$5.35 million, which consists of the designated lobby and front desk area, offices and significant meeting facilities. The company also entered in a 20-year management agreement for the parking garage and poolside cabanas of the resort as well as an agreement to operate and manage the Condominium Association. Coincident with the closing on the hotel commercial unit, the company acquired a second 3,279 square foot commercial unit, which includes a ballroom and adjacent prefunction space as well as dedicated parking for 200 vehicles in the condominium's new 6-story parking garage. Conveyance of this ballroom commercial unit was required pursuant to an existing obligation on the part of the owner of the property as a condition to the development of the new Hyde Beach House. We look forward to incorporating the newly completed ballroom into our existing operations and realizing the increased potential for group bookings in the upcoming high season.

Finally, last month, we announced a quarterly dividend of \$0.13 per share representing an annualized dividend of \$0.52 per share and a yield of 7.9% based on yesterday's closing price.

With that, I will turn it over to our CFO, Tony Domalski.

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

Thank you, Dave. Reviewing performance for the quarter ended September 30, 2019. Total revenue for the quarter was approximately \$42.6 million, representing an increase of 2.7% over the same quarter a year ago. For the first 9 months, total revenue was \$141.5 million, representing an increase of 5% over the prior period.

For the quarter, hotel EBITDA was approximately \$8.9 million, representing a decrease of 3% over the same quarter a year ago. And for the first 9 months, hotel EBITDA was approximately \$37.7 million, representing a 0.6% increase over the prior period.

For the quarter, adjusted FFO was approximately \$4.3 million, representing an increase of almost 350% or \$3.3 million over the same quarter a year ago. For the first 9 months, adjusted FFO was approximately \$16.2 million, representing an increase of 15.4% over the prior period. Please note that our adjusted FFO excludes charges related to the early extinguishment of debt, gains and losses on derivative instruments, changes to the deferred portion of our income tax provision as well as other items.



Hotel EBITDA excludes these charges as well as interest expense, interest income, corporate G&A, the current portion of our income tax provision, the gain on the exercise of the development right as well as other items. Please refer to our earnings release for additional detail.

As Dave mentioned, during the quarter, we took title to the Ballroom Condominium unit and dedicated parking at the Hyde Beach House adjacent to our DoubleTree asset. Receipt of these assets resulted in a onetime gain of approximately \$3.9 million based upon their estimated fair value on the date of transfer.

During the quarter, the company sold approximately 200,000 shares of its 7.875% Series C Cumulative Redeemable Perpetual Preferred Stock through its aftermarket program for aggregate net proceeds of approximately \$4.9 million.

Looking at our balance sheet. As of September 30, the total book value of our assets was approximately \$498.6 million, which includes investment in hotel properties of approximately \$446.8 million. The company had total cash of approximately \$35.3 million, consisting of unrestricted cash and cash equivalents of approximately \$30.1 million as well as approximately \$5.2 million which was a reserve for real estate taxes, capital improvements and certain other expenses. As of the end of the quarter, the company had principal balances of approximately \$363 million in outstanding debt at a weighted average interest rate of 4.92%. Approximately 86% of the company's debt carries a fixed rate of interest.

Total stockholder and unitholder equity was approximately \$107.2 million at the end of the quarter, of which stockholder equity was approximately \$107.8 million and unitholder equity was a deficit of approximately \$0.6 million. At the end of the quarter, there were approximately 14.2 million common shares outstanding, of which approximately 600,000 shares are owned by the ESOP and approximately 1.8 million limited partnership units are outstanding as well. At the end of the quarter, the principal balances on our interest-bearing debt was approximately \$115,000 per room.

Turning to guidance. We're updating our previous guidance for 2019, accounting for current and expected performance within the portfolio, taking into account market conditions, the acquisition of the 2 commercial units at the Hyde Beach House Resort & Residences, and weather-related events, including Hurricane Dorian. The combined effect is almost no change in forecast RevPAR, a small increase in total revenue, a decrease in hotel EBITDA, a decrease in net income and an increase in FFO and adjusted FFO.

For the year, we're projecting total revenue in the range of \$184.3 million to \$185.8 million. At the midpoint of the range, this represents a 3.9% increase over last year's total revenue. Hotel EBITDA is expected in the range of \$47.4 million to \$47.8 million and at the midpoint of the range, this represents a 0.2% decrease over last year's hotel EBITDA. Lastly, adjusted FFO is projected in the range of \$17.6 million to \$18 million or \$1.14 to \$1.17 per share. At the midpoint of the range, this represents an 11.1% increase over last year's adjusted FFO per share. Additional details can be found in the outlook section of our earnings release.

And I will now turn the call over to Drew.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Thank you, Tony. As Dave mentioned, a number of our markets were challenged in the quarter. While our hotels survived Hurricane Dorian with minimal damage and operated continuously, the resulting demand destruction had a significant negative effect on the company's profitability. The declaration of a weather emergency in the Southern Atlantic states caused a number of large group cancellations.

On the transient side, the storm's unknown path caused hesitancy among leisure travelers over the traditionally profitable Labor Day weekend. While difficult to quantify the exact revenue impact of Dorian, we estimate an \$0.08 decline in adjusted FFO per share for the quarter. The loss of nearly 2 weeks of revenue for a significant portion of our portfolio caused a relatively weak third quarter operationally. We were having a successful quarter until Dorian arrived. Regardless, we believe we are generally on track to wrap up 2019 on a positive note and produce results in line with our revised guidance.

We were pleased to close on the acquisition of the Hyde Beach House Resort in the quarter after 30 months of effort. As Dave mentioned, part of the acquisition includes a new ballroom. The DoubleTree hotel previously lacked sufficient meeting space and should benefit significantly from

the addition of this premier waterfront event space. The completion of this transaction also signifies the culmination of a long-term complex development, which has presented construction-related challenges along the way, but now provides great upside going forward.

As Dave mentioned, in September, we announced that we entered into a master agreement with Newport Hospitality Group and Our Town Hospitality. With the management contracts for the majority of our portfolio expiring at year-end, we set out to formulate a structure that could develop and offer a customized management solution that would be solely dedicated to our portfolio and executing on our strategy. Our Town Hospitality is that solution. The team is uniquely equipped with the experience and expertise to implement our vision of expanding our boutique hotel collection. We believe this challenge will enhance the opportunity for future success and create value for our shareholders.

Looking at our strategic objectives. We continue to focus on maintaining a sound balance sheet by procuring fixed rate debt, extending maturities and ensuring we have sufficient cash reserves. We continue to monitor acquisition opportunities and remain steadfast to our conservative approach to underwriting as we believe the market is overheated in terms of pricing. We will focus on identifying long-term value creation opportunities for our shareholders and act if and when we find the right fit.

Looking at the industry as a whole. Although perceived risks to a positive outlook are evolving, the U.S. economy remains resilient. Despite these risks, we remain cautiously optimistic that the long upward cycle will continue without disruption for at least the next year as transient travel trends are steady in the aggregate and group booking pace is strong.

We will now open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Today's first question comes from Tyler Batory of Janney Capital Markets.

Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

Tyler. A couple of questions. I know it's difficult given the impact of Hurricane Dorian, but I was wondering if you could provide some color on leisure versus corporate versus group trends in the portfolio as a whole sans those markets?

David R. Folsom - *Sotherly Hotels Inc. - President, COO & Director*

I'm sorry, you broke up right at the end of there. Could you repeat just the end of your question?

Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

Yes, if you could provide some color on the leisure versus corporate versus group trends in the portfolio? I know it's difficult given Dorian and the impact to the southeast.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Yes, maybe I could give you a good example of what happened to us. In Jacksonville, we had scheduled for Labor Day weekend, the Boise State - Florida State game. Town was completely sold out. We're hosting Boise State, the team and the booster team. The booster group that promotes that. On Thursday, the Governor declares a state of emergency, moves the game to Tallahassee. Our hotels went from 100% occupancy for 3 days at very rich rates to basically no business, 0. So that's just 1 example. But that happened repeatedly. The following week, we still had a state of



emergency in several states. No group manager is going to put their folks at risk. And so as a result, all of our group business basically canceled from South Florida up to Wilmington, North Carolina. So it was a tough stretch. I mean, it lasted almost 2 weeks. And the anticipation of Dorian arriving. I think everyone's aware that it paused for quite a long time over the Bahamas. And was originally scheduled to be in South Florida a couple of days ahead of that. So they had warnings way out ahead of the storm. And then at the end, it paused and went north and ended up land falling in Eastern North Carolina. But that's kind of the story of what happened with our group business. And you can imagine the transient is the same story. No one is going to travel out to the coast for Labor Day weekend when there is a potential for a hurricane.

Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

Right. Okay, that's helpful. And then moving to kind of the broader industry. Some of your peers are experiencing issues with labor cost that comes up a lot. What are you guys seeing with respect to the labor market and other costs that are increasing?

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Well, it's -- it has been somewhat of a challenge. We are at basically full employment in the United States. Some of the markets that we're in, we are having to -- for line level employees, we're having to use a service -- an outside service, which gives us a fixed price. So we know what our costs are, and it gives us flexibility in terms of staffing, we can match our staff exactly to what our occupancy is. But it is a little more expensive. But we haven't seen a significant increase in our labor cost, Tony, you can opine in here, but I think it's only been at less than 2% this year.

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

Yes. We've been very fortunate. In addition, where we're seeing our hotels have to go out for contract labor are particularly markets that are very tight and also markets that had a lot of recent supply growth. This just caused a huge increase in demand for line level employees. And those are the more difficult markets to find those employees in.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Now being markets like Miami, Tampa, I think we're doing a little bit there.

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

Louisville, definitely.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Yes, Louisville, where they've had tremendous growth in the number of hotel rooms.

Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

Okay. Okay. And then moving into 2020, just wondering how we should think about capital allocation moving forward.

David R. Folsom - *Sotherly Hotels Inc. - President, COO & Director*

Tyler, it's Dave. So when you -- what are you referring to exactly?



Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

In terms of what you guys are looking for moving into 2020?

David R. Folsom - *Sotherly Hotels Inc. - President, COO & Director*

Yes. I think -- I mean, generally speaking, our hotels are in really good shape right now. Probably the -- our portfolio is in the best shape it's ever been in. We'll probably throttle it back a little bit on the spending. I think our goal is -- I think this year, we're going to spend upwards or close to \$8 million. It will probably come down a couple of million dollars to \$6 million, maybe in the high \$5 millions. We don't have any major nonrecurring renovation activity scheduled for next year relative to what you may have seen over the past few years, for instance, at our Tampa hotel, which we completed in the summer of this year. So we don't have this big outlying CapEx requirements, but we have our recurring CapEx. But as Drew mentioned, our portfolio is in pretty decent shape. So we shouldn't see any major outlying capital demands. I think -- does that answer your question?

Tyler Anton Batory - *Janney Montgomery Scott LLC, Research Division - Director of Travel, Lodging and Leisure*

Yes, that's helpful. It was -- In regards to the...

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

And for the next couple of years, the only rebranding that we really have scheduled is Raleigh, which is a relatively small hotel for us, it's 180 keys. And we've got an accordion on the existing loan there, so we've got that pretty much funded and it shouldn't affect our cash position.

Operator

(Operator Instructions) The next question comes from Daniel Santos of Sandler O'Neill.

Daniel Santos - *Sandler O'Neill + Partners, L.P., Research Division - VP*

Just -- I can appreciate that with the high transaction and the weather, there are some moving pieces. But as you sit today with the portfolio that you have, what do you think is a reasonable run rate from an FFO perspective, for the portfolio today on a quarterly basis?

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

FFO is seasonal, but I'm -- I'd say, as we look out through 2020, 2021, somewhere in that \$1 to \$1.10 range for FFO.

Daniel Santos - *Sandler O'Neill + Partners, L.P., Research Division - VP*

Okay. And then just specifically on the fees, do you see some of the fee income that you got in the quarter and that you've gotten this year, some of these sort of onetime items as sustainable in the future? Or should we expect that all of these onetime items will go away in 2020?

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Well, I would say -- I'll let Tony answer in a second. But obviously, the big pickup in AFFO due to the realized gain on the new ballroom, that's a onetime nonrecurring event that was equivalent to \$4 million, basically.

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

Yes. Let me -- in check here and give you a little color on that. 10 years ago, when we bought the DoubleTree, which was prior was the Courtyard, I mean the...

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Crowne Plaza.

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

Crowne Plaza, excuse me. The developer that sold us that hotel had the parcel next door, and he wanted to set up an opportunity for him to build another building there. So we negotiated a deal, which included us -- them having to build us a ballroom for the -- what is now the DoubleTree and provide a structured parking with 200 keys. So kind of a quid pro quo for that was the last 2.5 years, we've had to deal with a lot of construction mess, a lot of disruption at our hotel. But at the end of the day, our payment for that was the gifting of this ballroom and structured parking. So finally, all of that is behind us. And it's taken a very long time for this. It's a magnificent building. It's 50 -- almost 50 stories, and it's -- and so for us to have this complex of 3 hotels now located in Hollywood is a huge plus for us going forward. But as Dave said, this is a onetime deal, and it's really a fee to -- a disruption fee is the best way I would characterize it.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

The other thing I would add, Daniel, is when we mentioned the negative impact of the hurricane. I mean, we consider that a nonrecurring event. We really can't underwrite a hurricane for the next year or the following years. There are often hurricanes. Sometimes there are none. I think before Florence or the prior year, there hadn't been a major hurricane in the Miami market for nearly 20 years. So can you underwrite \$0.08 negative down? Next year, probably, won't do that, but there is a risk of a hurricane in the future. Hopefully, not as bad as this year. And I think other than that...

Anthony E. Domalski - *Sotherly Hotels Inc. - VP, Secretary & CFO*

But we've got some other noise in there. I think we've got the the extinguishment of the debt there on the baby bonds. We don't see anything like that recurring next year with the \$1 million or so hit to FFO. And I think we also have the change in value of our interest rate swap, which I don't see that dropping, that having the same effect on FFO next year as well. So I think, Daniel, I don't see those 3 items. I don't see those recurring next year.

Operator

At this time, I'm not showing any more questions in the queue. And this concludes our question-and-answer session. I would like to turn the conference back over to Drew Sims for any closing remarks.

Andrew M. Sims - *Sotherly Hotels Inc. - Chairman & CEO*

Thank you all for joining us this morning, and we look forward to reporting year-end numbers to you in January. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.



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