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SOHO - Q4 2019 Sotherly Hotels Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Sotherly Hotels Inc.'s Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Mack Sims, Vice President, Operations. Please go ahead.

Mack Sims - *Sotherly Hotels Inc. - VP of Operations & IR*

Thank you, and good morning, everyone. Welcome to Sotherly Hotels' fourth quarter earnings call and webcast. Scott Kucinski, 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 issue our 2020 guidance. Dave Folsom, our President and CEO, will conclude with an update of our strategic objectives. We'll 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 the conference call, which are not historical, may constitute forward-looking statements. Although we believe the expectations reflected in 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 Scott.

Scott M. Kucinski - *Sotherly Hotels Inc. - Executive VP & COO*

Thanks, Mack. Good morning, everyone. I'll start off today's call with a review of our portfolio's key operating metrics for the quarter and for year-end 2019, looking at results for the composite portfolio, which represents the company's wholly owned properties and the participating condominium hotel rooms for the Hyde Resort & Residences and Hyde Beach House.

For the quarter, portfolio RevPAR increased 2.2% over prior year to \$102.27, driven by a 1.6% increase in occupancy and a 0.6% increase in ADR. For comparison, the U.S. average RevPAR grew 0.7%, while our competitive sets in our markets grew 1%, a healthy outperformance for our portfolio over both.

For the year, portfolio RevPAR increased 3.4% over prior year to \$112.94 with a 1.4% increase in occupancy and a 2% increase in ADR. Again, for comparison, U.S. average RevPAR grew 0.9%, while our competitive sets in our markets grew 1.7% in the year. And again, a solid outperformance as our portfolio continues to take market share against our competitive sets, particularly at those properties that have been renovated and converted over the past few years.

The fourth quarter brought a number of changes for the company, both at the corporate and portfolio level. Over the past few months, we announced and executed on the promotion of several key members of the management team for an evolution of the company's senior leadership structure. Under the new structure, company veteran Dave Folsom will continue as President and succeed Drew Sims as Chief Executive Officer of the company, with Drew remaining as Executive Chairman.

Also, during the quarter, we transitioned the management of 10 of our hotels to Our Town Hospitality, a newly formed third-party management company located here in Williamsburg, Virginia, that is solely dedicated to managing Sotherly's collection of hotels. Our Town Hospitality's corporate offices are located adjacent to Sotherly's new corporate offices, a change we believe will accommodate improved workflow and managerial effectiveness. Dave will provide further comment on the management transition later in the call.

At the portfolio level, during the quarter, we saw the end of the impactful multiyear construction activities surrounding our Hollywood complex with the completion and opening of the new 40-story Hyde Beach House condo hotel building. Hyde Beach House's location adjacent to the DoubleTree Hollywood Beach Resort and across the street from the Hyde Resort & Residences provides for operational efficiencies and sales and marketing synergies, and it presents our team with a wide variety of product offerings and amenities to offer our guests. With several years construction impact behind us, we believe this complex is poised for success going forward.

This past week, we announced the purchase and sale agreement to sell the Sheraton Louisville Riverside Hotel. The sale of this property aligns with our strategy of recycling noncore assets. The company intends to use proceeds for the sale of the hotel to repay the existing mortgage on the property and for general corporate purposes.

Lastly, this month, we announced our quarterly dividend of \$0.13 per share, representing an annualized dividend of \$0.52 per share and a yield of approximately 9.9% based on yesterday's closing price.

I will now turn the call over to Tony.

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

Thank you, Scott. Reviewing performance for the period ended December 31, 2019. Total revenue for the quarter was approximately \$44.3 million, representing an increase of 1.9% over the same quarter a year ago. For the year, total revenue was approximately \$185.8 million, representing a 4.3% increase over the prior period. For the quarter, hotel EBITDA was approximately \$9.3 million, representing a decrease of 9.4% over the same quarter a year ago. And for the year, hotel EBITDA was approximately \$46.9 million, a decrease of 1.6% over the prior year.

For the quarter, adjusted FFO per share was approximately \$0.06, representing a decrease of 50% over the same quarter a year ago. And for the year, adjusted FFO per share was approximately \$1.11 or an increase of 6.7% over the prior year. Please note that our adjusted FFO excludes charges related to the early extinguishment of debt, gains and losses on derivative instruments, charges related to aborted or abandoned securities offerings, 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, general and administrative expenses; the current portion of our income tax provision and other items as well. Please refer to our earnings release for additional detail.

As previously mentioned, during the year, 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 during the year based upon their estimated fair value as of the date of transfer. Conveyance of this ballroom commercial units was required pursuant to an existing obligation on the part of the owner of the property as a condition to the development of the Hyde Beach House and acted as a construction impact fee for the 2 years of heavy construction directly adjacent to our property.

Looking at our balance sheet. As of December 31, 2019, the total book value of our assets was approximately \$487.2 million, which includes net investment in hotel properties of approximately \$443.3 million. The company had cash of approximately \$28 million, consisting of unrestricted cash and cash equivalents of approximately \$23.8 million as well as \$4.2 million, which was reserved for real estate taxes, capital improvements and certain other expenses.

As of the end of the quarter, the company had principal balances of approximately \$361 million in outstanding debt at a weighted average interest rate of 4.89%, and approximately 86% of the company's debt carries a fixed rate of interest.

As of December 31, there were approximately 14.3 million common shares outstanding, of which approximately 700,000 shares are owned by the ESOP and approximately 1.8 million limited partnership units are outstanding as well.

At the end of the year, the principal balance on our interest-bearing debt was approximately \$114,400 per room.

Turning to guidance. We're issuing initial guidance for 2020, which accounts for current and expected performance within our portfolio as well as other factors. For the year, we're projecting total revenue in the range of \$184.1 million to \$188.2 million. At the midpoint of the range, this represents a 0.2% increase over the last year's total revenue.

Hotel EBITDA is projected in the range of \$49.1 million to \$50.2 million, and at the midpoint of the range, this represents a 5.7% increase over last year's hotel EBITDA.

Adjusted FFO is projected in the range of \$15.4 million to \$16.4 million or \$1 to \$1.06 per share. At the midpoint of the range, this represents approximately a 7.3% decrease over last year's adjusted FFO per share. Additional details can be found in the Outlook section of our earnings release. And I'll now turn the call over to Dave.

David R. Folsom - *Sotherly Hotels Inc. - President & CEO*

Thank you, Tony. Good morning, everyone. In review of 2019, it was a year of significant operational achievement, but was also a major transitional year for the company. First and foremost, we remain steadfast in our commitment to our key strategic initiatives and goals over the course of the year. As a result, our portfolio experienced outsized performance compared to its peer sets. For our combined portfolio, RevPAR increased 3.4% as we took share from our competitors during the year. We produced top line revenue growth of 4.3% over 2018 and achieved AFFO above our initial guidance provided a year ago.

We remain committed to our shareholders as we once again offered and paid a dividend with a consistently competitive yield during the year. We maintained balance sheet discipline by executing a number of capital markets transactions during the year, including refinancing, mortgage debt at historically low levels while extending maturities.

In April, we closed on the offering of our Series D preferred stock, which provided flexibility and reduced risk by replacing short-term bonds with a permanent source of capital.

During the year, we delivered on key hotel repositioning projects, including the brand conversion of our Tampa asset in addition to the completion of the Hyde Beach House Resort and its commencement of operations. As part of the closing on the hotel commercial unit at the Hyde Beach House Resort, the company acquired a second commercial unit, as Tony mentioned in his remarks, which includes a ballroom and adjacent pre-function space as well as dedicated parking in the new condominium's 6-story parking garage. We believe that these key additions have poised our Hollywood portfolio to outperform the market going forward.

As Scott mentioned, last week, we entered into a purchase and sale agreement to sell our Louisville property. Due to constrained market dynamics, primarily resulting from an oversupply of Marriott flag properties, the Sheraton has remained an underperforming asset for several years and did not fit within the long-term vision of the company. Perhaps most significantly in the year, in September, we announced that we entered into a master agreement for the management of 10 of the company's hotels effective at the start of this year. The new manager, Our Town Hospitality,



offers Sotherly a management solution with improved oversight that is solely dedicated to our portfolio and the execution of our strategy. The Our Town team is uniquely equipped with the experience and expertise to implement the company's vision of expanding its hotel collection and achieving optimal operational performance. By the end of the year, we plan to expand Our Town's portfolio with the addition of the company's Hollywood, Florida properties. We are confident this transition will enhance the opportunity for the future success of our portfolio.

Looking ahead, we believe that 2020 will be another stable albeit not great year for the lodging industry, with industry experts projecting flat to nominally higher top line RevPAR growth of 0% to 1% and GDP growth ranging from 2% to 2.5%. Additionally, as is common in the later stages of an economic cycle, wages and benefits have been outpacing revenue growth. As a result, expense management and margin control will be a primary focus for the company, particularly with regards to insurance and health care costs. Despite these macroeconomic factors, we remain cautiously optimistic due to a strong group booking pace in our key markets and a refreshed portfolio that is positioned to, in our opinion, outperform the market.

Moving forward, we will maintain a disciplined investment strategy and remain steadfast to our conservative approach to underwriting as we focus on identifying long-term value creation opportunities for our shareholders.

With that, I will open the call up to any questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Tyler Batory of Janney Capital Markets.

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

This is the first question I had. I wanted to ask a little bit more about the management transition to Our Town. Can you talk a little bit more about how that has gone thus far? Any sort of disruption that we should be aware in the portfolio as well just from making that transition?

David R. Folsom - *Sotherly Hotels Inc. - President & CEO*

Yes, certainly. It's Dave here. So the transition has occurred, I think, fairly efficiently. I think we had a very good execution of the plan to transition the management of the bulk of the hotels to the new manager. Frankly, execution went very well. There are costs associated with that transition, as you can imagine. There are other things like employee transfers that we've had to deal with and just sort of the tail end of the year where the existing manager knew that they would no longer be managing the portfolio going forward. So I would say the execution of the transition went really well with some level of expected impact, but it's really going to be isolated, in our opinion, to last year. We're very excited about what we see so far going forward.

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

Okay. Great. That's helpful. And then just a question on guidance. Does your outlook include any impact from coronavirus? And then when you look at your markets across the portfolio, which have the most exposure to international inbound travel?

David R. Folsom - *Sotherly Hotels Inc. - President & CEO*

Yes. That's a very good question, and I figured that was going to be one of the first things that was asked, given what we've seen in the markets in the last few days. Our guidance has not baked in any of that impact. We actually -- without any loss of generality. We have a pretty decent booking



pace right now, and the hotels are doing well in the first quarter. That can change, however, with respect to our guidance. So I think that answers the first part of your question. What was the second part, Tyler?

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

Just which markets in your portfolio have the most international inbound travel?

David R. Folsom - Sotherly Hotels Inc. - President & CEO

So listen, I think this actually works in our favor, to some extent, not knowing how this will all play out generally across the United States. But we don't have hotel portfolio that's concentrated in the major top 10 gateway markets in the United States. We just don't. We don't have any West Coast properties. We would like to think that if international travel is disrupted, that travel may go regionally and that would benefit our Southeast portfolio to some extent. So we have an airport hotel in Philly. That's really not a major global gateway market. Other than that, we don't have any assets that I think would be part of some general, major global destination problem. That's not to say that this -- the events we've seen over the last few days could not escalate, but I think we're in pretty good shape, Tyler, with respect to our portfolio of hotels.

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

Okay. Great. I appreciate that. And from a property specific, when you look at the ramp at Hotel Alba and Hotel Ballast as well, can you talk a little bit more about performance at those 2 assets, how they've gone versus your expectations initially here?

David R. Folsom - Sotherly Hotels Inc. - President & CEO

Yes. I mean I think in 2019, we had a couple of false starts in Tampa. There are some things here when you do this, Tyler, that you can probably appreciate. One is the application of capital. It takes a lot of time to do this. It takes a lot of capital. Then you also have to change the service culture at the hotels. That is not an easy thing to do, but it's achievable with the right manager. And then you really have to change the revenue management picture. It's just not about charging more for the hotel, it's about finding a new customer base, a new customer mix. We're not trying to take the hotel to a new level and then simply charge a higher rate and expect the existing customer base to pay it. We have to go out and find a new customer base that exists in the marketplace that will recognize the value and who would otherwise already be willing to pay that rate. So it is a lengthy process. I think in Tampa we got off to a little bit of a slow start with respect to the last of those elements, just making sure that we were trying to focus on the correct customer base. And I think that's been solved in the fourth quarter. And we're seeing a lot of good results at that hotel in the first quarter. And in Hotel Ballast in Wilmington, I think the basic same message is true. It's the same process. Both of those hotels have their own identity, but they are also a part of the Hilton reservation system. So we sort of get the both -- the best of both worlds.

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

Okay. Great. And then from a CapEx perspective, any upcoming projects or renovations we should be aware of or are things going to be fairly quiet at least through 2020?

David R. Folsom - Sotherly Hotels Inc. - President & CEO

I think you'll see a more quiet application of nonrecurring CapEx this year. We are starting to look at our Raleigh asset for a major renovation and life cycle improvement to reposition that hotel, but that's more of a 2021 event. So beyond the initial stages of that, really, what we're looking at is our basic recurring CapEx that we have every year for all of the hotels.



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

Okay. And then just the last question for me on capital allocation. Can you comment on the dividend and how you're thinking about possible dividend growth going forward?

David R. Folsom - Sotherly Hotels Inc. - President & CEO

I think our message has to be consistent that we're focused on, as we've always been focused on, providing a competitive dividend. Our Board of Directors looks at dividend policy every quarter and that's when we make a decision. So really, beyond that, I can't provide you any forward-looking forecast about the dividend.

Operator

(Operator Instructions) The next question comes from Daniel Santos of Piper Sandler.

Daniel Santos - Piper Sandler & Co., Research Division - Research Analyst

Just a few quick ones for me. The first one is, could you give us a little bit more color on the \$750,000 guarantee tied to the Louisville transaction?

Scott M. Kucinski - Sotherly Hotels Inc. - Executive VP & COO

Yes. Sure, Dan. This is Scott Kucinski. That's simply just tied towards essentially any inconsistencies that pop up based on what we've represented and warranted in the purchase and sale agreement to the buyer versus what they discovered during their due diligence and a period post closing. So we wouldn't expect that to come into play necessarily, but it's essentially a backstop in case something material pops up that they view as differently compared to what we've represented.

Daniel Santos - Piper Sandler & Co., Research Division - Research Analyst

Fair enough. And then there was a press report earlier in the year about litigation at the Hyde Beach property. Could you give us an update there?

David R. Folsom - Sotherly Hotels Inc. - President & CEO

Yes. I could do that, Dan. We got into the Hyde Resort as a commercial unit owner back in 2017, and there's some ongoing litigation that probably is not -- probably I shouldn't comment too much on, but the litigation is between our company and the association -- the homeowners' association that involves typical tortious interference and some defamation charges. So we're working through that. This company has done this before at other locations. We've been involved in some of these condo projects. It was not looked for, not expected, but nonetheless it's just part of -- sometimes part of this business model when you get involved in the condo projects.

Daniel Santos - Piper Sandler & Co., Research Division - Research Analyst

Got it. That's helpful. And then just one last quick one for me. The \$300,000 manager termination fee, is -- should we expect that in the first quarter? And is that included in guidance?



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

That's included in the fourth quarter. That's part of the charges to hotel EBITDA. And it will be paid -- while it's paid in the first quarter, it's recognized in the fourth quarter of last year. So you won't see any effect on net income, FFO or adjusted FFO in the first quarter.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Dave Folsom for closing remarks.

David R. Folsom - *Sotherly Hotels Inc. - President & CEO*

Thank you, everyone, for joining us this morning, and we look forward to talking to you in the next quarter. Thanks.

Operator

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

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