RLH Corporation

Second Quarter Earnings Conference Call

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Operator: Greetings and welcome to the RLH Corporation's Second Quarter 2018 Earnings Conference Call. At this time all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference call, please press "*" "0" on your phone keypad.

It is now my pleasure to introduce your host, Nate Troup, Senior Vice President and Chief Accounting Officer.

Nate Troup: Thank you. Welcome to RLH Corporation's second quarter earnings call. With us today are President and Chief Executive Officer, Greg Mount and Executive Vice President and Chief Financial Officer, Doug Ludwig.

Before we get started I want to remind you that the company's remarks today contain forward-looking statements that are subject to a number of risk factors that may cause actual results to differ materially from those expressed or implied. For a discussion of important risk factors please see our most recent form 10K and subsequent reports filed with the SEC. Our form 10K and other filings are available on our website, RLHCO.com in the investor relations section or through the SEC website at SEC.gov.

These forward-looking statements speak as of today and we undertake no obligation to publicly update them to reflect subsequent events or circumstances. The company will also be referring to a number of non-GAAP measures. The reconciliation of these measures to their comparable GAAP measure is provided in the table to the press release today. That release is also available on the investor relations section of our website.

I will now turn the call over to Greg Mount.

Greg Mount: Hello, and thank you for joining the call today. We knew heading into 2018 it would be a vital year of transition and transformation for RLH. The key elements that we focused on were significant changes to our business model, our balance sheet, our technology advantage and our brands development. Our team has achieved a great deal on each of these key elements in the first half of the year.

Through July 2018 we have closed on sales of nine out of the 11 hotels we targeted for sale. These sales have resulted in eliminating joint venture debt of more than 73 million and allowed a distribution to us of 20 million from the joint venture. We are now positioned to use our cash reserves and capital capacity to grow our franchise business more aggressively through targeted acquisitions.

Our team has efficiently executed this strategy through the integration of Inner Circle's 10 upscale hotels earlier this year and the acquisition of Knights Inn in May. These acquisitions allow us to capitalize on our growth opportunities in the future. Selling the nine hotels significantly reduced the risk in our business model and repositioned our capital. This will, as planned, transform RLH Corporation into a high margin, non-capital-intensive franchise fee business model.

During this past quarter we have added new key diverse skill sets and business resources to further the leadership team that will help to drive and execute our aggressive growth strategy. In July two new Board members who represent over 55 years of business and industry experience joined our Board of Directors. Amy Humphreys is a financial expert with c-level experience and contributions around high-performance leadership and business model transformation. Ted Darnall is a 30-year veteran of hospitality industry and is recognized as one of the top innovators in lodging with experience at Starwood, Marriott, Interstate and currently with HEII.

Gary Sims joined RLH in June as our Chief Operating Officer with 30 years of experience with notable brands and extensive experience in franchise operations, sales, hotel management and human resources with Starwood, Hilton and La Costa resort. Paul Sacco was promoted in June to Executive Vice President of Global Development. With Paul's extensive franchise development background with large lodging companies like Starwood, he is making significant contributions to the expansion of our upscale and midscale brands.

Although we are currently an emerging franchise company we are fortunate to have the depth and breadth of experience and knowledge on our management team and Board of Directors. This has allowed us to put in place and execute aggressive plans to significantly grow the scale, profitability and value of the company in both the short and long-term.

With the Knights Inn acquisition and integration completed we have commenced a brand review to update the brand standards and signature moments to make Knights Inn more relevant to today's customer. Our technology and revenue management advantages will be meaningful to the Knights Inn owners, allowing them to improve their returns on invested capital as part of the RLH group. We also see significant potential to grow Knights Inn franchise base. Our team has identified over 600 markets where our economy brands are currently represented and where Knights Inn could expand and create significant value for that brand.

We are nearing the launch of our new groundbreaking website and related new initiatives that will allow us to improve the ease of taking reservations, to offer additional services to our customers and to improve our reservation revenue. The feedback from our testing of the new website has been extremely positive. Our talented team has brought our website development and operations in-house which has significantly reduced our cost. The new website is innovative and, in the industry, will create a strategic value for our franchise owners which should provide us with further competitive advantage and potential franchise contracts.

I would now like to turn the call over to Doug to discuss the financial performance and outlook for the company. Doug?

Doug Ludwig: Our net loss was 2.3 million for the three months ended June 30, 2018, compared to a net loss of $66,000 in the prior year. The increased loss was primary due to lost income from the hotels that have been sold during the quarter.

Important progress was realized with the July closing of the sales of our Spokane and Port Angeles hotels bringing us to nine completed hotel sales versus the 11 targeted in our announcement last fall. The adjusted EBITDA from the nine hotels sold through July 2018 was 2.3 million for the quarter ended June 30, 2018, and 3.1 million for the first six months of 2018.

We entered into new franchise agreement with the buyer of the Port Angeles hotel but not with the buyer of the Spokane hotel. These two closings realized aggregate gross proceeds of 54.5 million which allowed us to fully repay joint venture debt of 73 million as well as distribute over 20 million from the joint venture. The aggregate gross proceeds from the nine hotel sales to date were 116 million, placing them within the guidance range that we previously provided for the divestiture program. The nine hotel sales are expected to result in combined realized gains on sale reflected in our income statement in excess of $40 million.

With continued strong market conditions, we decided to market for sale our interest in Atlanta, Kalispell and Anaheim with the expectation that we would enter into new franchise agreements with the buyers of each. We believe the successful sale of those hotels accelerates our transition out of hotel ownership so that virtually all of our financial resources are targeted toward growing our franchise contract base.

In addition, by selling additional hotels we are further reducing the maintenance capital we need to spend on our asset base. There is no maintenance capital spending related to maintaining our franchise contract base. The successful sale of these three additional hotels should realize more than $40 million of gross proceeds to RLH and will further increase our cash reserves.

We are optimistic that we will close on the sales of additional hotels in the coming months and hope by the end of the year we will have realized proceeds to offset the majority of the Deutsche Bank loan that was used for the closing of the Knights Inn acquisition. The outstanding debt expected at year end will be our share of Washington DC and the Baltimore property loans.

We entered the second quarter aware that our largest shareholder, HNA, would be selling its ownership but unaware of the manner they would choose to sell its shares. This caused concern because they represented a significant overhang on our shares and we believe trading volumes during the second quarter were reduced significantly because of that.

Ultimately HNA sold all of its 3.8 million shares to Coliseum Capital Management and Vindico Capital in an overnight transaction on June 14, 2018. The closing share price on June 14, was

$11.65. The closing share price on June 15, was $12.20 so we are pleased that the entire HNA position was able to be transacted without a negative impact on our share price.

We have provided guidance of 150 to 200 franchise contracts excluding the Knights Inn acquisition. This represents a somewhat slower pace in the economy segments which has been more than offset by the Knights Inn acquisition and more production in the mid- and upscale segments.

We assess our development deals and pipeline on a net present value basis. Our current pipeline of upscale deals is pacing nearly 60% higher than where we were at this time in 2017. The estimated net present value of our upscale pipeline is currently about $20 million and we are making meaningful progress in achieving new deals with longer contract lives.

This concludes our formal comments and we would now be pleased to open the call to questions. Operator, please open the call to questions.

Operator: At this time, we will be conducting a question and answer session. If you would like to ask a question, please press "*" "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press "*" "2" if you would like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star keys.

One moment please while we poll for questions. Our first question comes from the line of Eric Wold from B. Riley & Co. Please proceed with your question.

Eric Wold: Thank you and good morning. Uh, a few questions if I may. I guess one, you mentioned, uh, for the three new hotels being marketed the, you know, 40 million+ in additional proceeds. Any way to kind of break that out between the owned and the leasehold interest to get a sense of valuation multiples received for both? And then kind of what is holding back the potential marketing of the other four hotels at this point and when do you think those will get to a point where you think it is, uh, appropriate to put them on the market?

Doug Ludwig: If you look at the, um, three that we have added, um, the largest contributor is going to be from Anaheim. That leasehold interest, the smallest contributor is going to be Kalispell again, a leasehold interest. And, um, you know, we are still, we are actively studying the issue on the remaining properties, um.

We don’t believe now is quite the right time to put them into the market but, um, won’t be surprised if by the end of the year one or two additional ones get added to that group, um. We clearly want to go from asset light to almost asset free, uh, through the execution of those real estate interests.

Greg Mount: Eric, this is Greg. Good morning and thanks for jumping on the call. Just to add to that I think that we have always been consistent in saying that we will, you know, we will monetize these assets when we believe they are stabilized and we can get the return that we and our partners, uh, and shareholders are looking for.

And so, I think more correctly to your question is that the remaining assets still need some additional seasoning., Uh, you know, we are, uh, we are confident that we are going to get them, uh, to that point but we are also not going to rush it, uh. We still feel that there is, uh, a good appetite for, uh, assets currently. Uh, I think you may have seen the recent announcement by Marriott, uh, where they are telling about $2 billion worth of assets, uh, give or take and so I think they talked about the marketplace right now.

And so, you know, we are confident that we will get there but we are just not going to push it or rush it, uh, you know. We want to make sure that we maximize the value, uh, but at the same time, you know, we're winding down our operations, um, and may see, you know, an opportunity to move those remaining few assets into a third-party operator which will allow us to completely unbuckle from that.

Eric Wold: Perfect, and then final question, um, kind of a larger one. You know, obviously you have now completed the Knights Inn transaction, you are looking at ways kind of improvement and grow that business. I guess take a step back kind of what are your thoughts now on the acquisition strategy? And I seem to recall from the past kind of a reluctance necessary to add a bunch of new brands to the portfolio.

If there is an opportunity to kind of go out with more of these Knights Inn type of opportunities and kind of grab portfolios of assets from other larger operators, you know, would you buy something of size that has a brand and force conversion in other brand, does it make sense to have now a portfolio of brands underneath one large corporate umbrella? What is your thought process behind that going forward?

Greg Mount: You know, the Knights Inn acquisition was very accretive for us and it was opportunistic, uh. We saw an opportunity and we ended up, you know, somewhere around about a five multiple, uh, in that acquisition and we are seeing, and we anticipate on a fully year, you know, very strong flow-through and the low to mid 90s because we didn't take on any cost from that acquisition whatsoever.

Uh, and is related to your more specific question with Knights Inn we are excited about the opportunity to grow that brand. To give you a good example of that, you know, out of the almost 900 America's Best Value Inn markets that we are in throughout North America, 600 markets do not have a Knights Inn, uh.

So, it allows us an opportunity to go into all of those markets, uh, with a fair amount of knowledge and insight and look for additional conversion opportunities. But the first thing we need to do which is critical to what we have done in the past and what we will continue to do is to make sure to, to reposition that brand, uh, so that it's meaningful. It mirrors what the consumers are looking for, uh, you know, it's relatable, something that we think is exciting. And I will tell you, uh, I think that as a brand it has some really great recognition in that brand itself and we plan to leverage that.

To your last part of your question as it relates to, you know, future acquisitions you know, we are constantly looking at opportunities and our focus is really in the midscale and upscale segment. Uh, you know, that is where we want to make those type of acquisitions and we can make them, uh, hopefully in, you know, a larger transaction if available if that opportunity exist but we also feel that we can aggregate that, uh, through smaller regional brands that may be available as well.

But to answer the specific question, with the right brand we would definitely add it. As you know this year we will be moving from 11 down to about nine brands, um, and we are not opposed to adding another brand, but we want to make sure that it strategically makes sense to do so and I think that that opportunity particularly in the midscale and upscale is one that we'll keep an eye on.

Eric Wold: Perfect. Thanks, Greg.

Greg Mount: You're welcome, Eric.

Operator: As a reminder, if you would like to ask a question please press "*" "1" on your telephone keypad. Our next question comes from the line of Alex Fuhrman from Craig-Hallum. Please proceed with your question.

Alex. Fuhrman: Hey, guys. Thanks for taking my question and congratulations on another strong quarter. Um, you know, Greg, I was particularly interested in what you mentioned in the prepared remarks about your, your pipeline of negotiations right now in midscale being up so significantly and particularly given that you, you know, it's not too long ago that you added the Inner Circle deals.

Um, I'm curious just what's in driving that increased interest in your midscale properties. Is it just as you are starting to hit a certain scale with the Red Lion brand there is becoming more interest, or do you think it's perhaps more broadly across the economy that there's just this renewed interest in the midscale price point? I'm curious what you think is driving that and how much room there could be to go there for your midscale brands.

Greg Mount: You know, we, you know, we keep a real close eye on the performance and what is happening in all of our segments and we have seen, you know, some great growth, uh, in our midscale performance and a lot of it has to do with the platform that we have made and created and we talked about it numerous times.

That platform is really starting to pay dividends and where it pays dividends is in the fact that we are able to deliver a room, uh, to our system. A fairly good discount for the owner and where that translates is it translates into additional dollars in their pocket and you're starting to see owners recognize that. You are also seeing owner start to recognize that technology, uh, and the innovations around where the industry is going and how the consumers are booking is changing at a very fast pace.

And while our competitors tend to continue to block and tackle the way they have for the last 20 years, we have really looked at how we can maximize our opportunity to become much more innovative and proficient in our e-commerce and digital marketing and that's paying significant dividends, uh, to our system. And, you know, right now we are able to compete, uh, in a meaningful way as it relates to the overall demand generated from our system, uh, versus kind of the more typical systems that you see in the industry.

Again, I think I would remind you that we tend to be more focused on the leisure traveler and that consumer that, you know, accounts for 80% of the rooms that are booked, uh, in the United States, uh, that travels, you know, 5-7 times a year, um. And so, we work very hard to drive that customer base, get the right shelf space as it relates to where that consumer is looking and how they are booking and making sure that we are pricing in real time to that particular channel. So.

Alex Fuhrman: Thanks, Greg. That's very, um, that's very helpful. And then if I could ask a financial question. I mean clearly there's a lot of moving pieces here with, you know, the first round of hotel sales and now the additional, um, properties being marketed, and you know, the Knights Inn acquisition and others but as you put all of the pieces together and presumably there can be some nice, uh, reductions going forward in interest expense and depreciation. Wondering if you think being net income positive is something you expect to see in the near future and when we might start to see that on an annualized basis?

Doug Ludwig: Yeah, it's very much a focus. I mean we are going to be that income positive this year because of the 40 million of gains that we're going to be accounting for from the nine asset sales. So, but that's just a stepping stone.

You know, as we look into next year, uh, significant reduction of interest cost, uh, significant improvement in interest income, uh, slashing depreciation and amortization to where it really won't be relevant beyond about the next year. So, um, net income is in the near future and, um, it's a key result of the strategy shift.

Alex Fuhrman: That's great. Thank you very much, both of you.

Greg Mount: Thanks, Alex.

Doug Ludwig: Thanks.

Operator: If anyone else would like to ask a question please press "*" "1" on your telephone keypad. With no more questions I will pass the call to Mr. Mount for his final words.

Greg Mount: Thank you, operator. Uh, folks, thank you for joining us today and, uh, we hope that you have a great week.

Operator: Thank you, ladies and gentlemen. This does conclude today's teleconference. A replay to the conference will be available until April 11, 2018-- I'm sorry, that is the wrong date. Uh, you may access the replay by dialing 877-660-6853 and entering ID 136748805 and with that you may disconnect your lines at this time and have a wonderful day.