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RLH - Q1 2018 Red Lion Hotels Corp Earnings Call

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Eric Christian Wold *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

PRESENTATION

Operator

Greetings, and welcome to the RLH Corporation First Quarter 2018 Earnings Conference Call. (Operator Instructions) It is now my pleasure to introduce your host, Nate Troup, Senior Vice President and Chief Accounting Officer.

Nathan M. Troup - *Red Lion Hotels Corporation - Senior VP & CAO*

Thank you. Welcome to our RLH Corporation earnings call. I wanted to introduce myself, as I am the new SVP and Chief Accounting Officer. With us today are; President and Chief Executive Officer, Greg Mount; and Executive Vice President and Chief Financial Officer, Doug Ludwig. Also joining the call for the question-and-answer period is Aaron Howard, Senior Vice President of Financial Planning and Analysis.

Before we get started, I want to remind you that the company's remarks today contain forward-looking information as defined by the SEC that is subject to a number of risk factors that may cause actual results to differ materially from those expressed or implied. These risks were disclosed in our annual report filed with the SEC on Form 10-K on April 2, 2018. Report is available on our website, rlhco.com in the Investor Relations section or through the SEC website at sec.gov.

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 issued today. That release is also available on the Investor Relations section of our website. For the purpose of the discussion today, the company will be referencing first quarter results on a comparable basis for all periods presented.

I will now turn the call over to Greg Mount.

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Good afternoon, and thank you for joining our first quarter 2018 earnings call. It's been an exciting and meaningful start to 2018. The first quarter was an important quarter for our strategic transformation, execution and accomplishment.

In November of last year, we announced that we will dispose of majority of our hotel investments and $2.5 million reduction in corporate labor expense, with the goal of focusing future earnings and cash flow of the company on high-margins less capital-intensive hotel franchise business. The key benefit of this decision was to take advantage of current favorable market conditions, which has proven timely based upon the prices for our hotels, that in turn is allowing us to significantly reduce long-term debt and to establish cash reserves that will be used to aggressively grow our franchise contract base.

So far this year, we have sold 6 of the hotels, which reduced our joint venture of long-term debt by 60% or $42 million. We also realized the gain on the sale of the 6 hotels for approximately $16 million.

In addition, we currently have 3 additional hotels under sales contract and just signed a letter of intent for our fourth. We expect the 3 sales to close over the next 2 months. Upon the closing of these 3 hotel sales, we expect to fully repay the RL Venture long-term debt and increase our cash reserves to approximately $40 million.

We have been pleased with our speed and timeliness to market on these divestures and the amount of proceeds being generated.

Just as important, we've been able to execute new franchise agreements for all 6 hotels that we have sold. These new franchise agreements will contribute fee revenues of $500,000 to $600,000 over the remainder of 2018.

As we communicated last quarter, with these hotel sales, we expect to see noteworthy decline in our Hotel Division adjusted EBITDA in 2018 and 2019. Our goal over the next 24 months or so will be to replace that Hotel Division profitability with additional franchise fees, combining aggressive organic growth and acquisitions of franchise contracts. We have set an organic growth target of adding 150 to 200 new franchise agreements this year.

We're are off to a strong start, having entered into 47 new franchise contracts in the first quarter and opening new franchise hotels including 10 full-service Inner Circle properties. Each of these are subject to 20-year contracts that represents significant net present value equal to more than 10% of our current market value. We will further enhance our Franchise Division adjusted EBITDA through the recently announced acquisition of the Knights Inn brand from Wyndham.

We expect to close on this transaction in just over a week, and it will increase our franchise contract base by more than 30%. We accomplished this acquisition at price of less than half the price as recently paid in other recent lodging industry acquisitions. This demonstrates our disciplined acquisition approach, which is critical to ensure that our deals will be immediately accretive within the first-year returns expected in the midteens.

We are not taking on any additional employees in this acquisition, and we are currently do not expect to add any materiality to our cost base to integrate this market -- the market of Knights Inn properties.

Our integration team is well prepared to bring the Knights Inn properties and to make sure that they are quickly operating on our technology platforms, giving the hotel owners significant benefits of our RevPAK, our industry-leading revenue management tools and our special e-commerce digital marketing capabilities.

Finally, we plan to better leverage this iconic brand as we have with other acquired brands by repositioning it to a relative brand for today's economy customer. I would like to turn the call over to Doug to discuss the financial performance and the outlook of the company. Doug?

Douglas L. Ludwig - *Red Lion Hotels Corporation - Executive VP, CFO & Treasurer*

Our consolidated net income was $7.3 million in the first quarter of 2018 as compared to a net loss of $5.1 million in the first quarter of 2017. Backing out the net income attributable to the noncontrolling interest of $4.7 million, we reduced the income attributable to RLHC to $2.6 million as compared to a loss of $3.6 million in the first quarter of 2017.

The income in the first quarter of 2018 included a gain of $14 million associated with the asset sales.

The company reported better-than-expected adjusted EBITDA of $421,000 in what is a typically seasonally slow quarter. This result exceeded our expectations by more than $900,000 as we expected a first quarter loss due to the lower adjusted EBITDA from our hotel division caused by the asset sales closed in the first quarter of 2018.

As we effect the transition of the company away from Hotel Division profits to Franchise Division profits, we continue to prioritize cost reductions and the efficiency of our Franchise Division's staffing structure. We started these efforts in November of last year when we implemented cost reductions that on a full-year basis represented, $2.5 million in reduced expenses.

The company expects to further reduce expenses by $4 million to $5 million in 2018. It's very important that we continue to demonstrate to our shareholders the strong profit and cash flow contribution from our new franchisees from the Inner Circle deal, the Knights Inn acquisition, and from strong organic growth with a growing contribution from contracts in more upscale properties.

A recent cost control decision was made to close a regional office in Florida, allowing us to concentrate those resources in Denver, which should allow us to improve productivity and our franchise profit margins.

We will soon be making a series of exciting announcements regarding our new and innovative website. As part of that decision, we have brought the development efforts in-house, allowing for more timely and effective changes to the website. We expect to save more than $2 million on an annual basis from that move alone. These estimated savings will be part of our targeted savings of $4 million to $5 million.

We have recently brought seasoned executives on board to fill vacancies in key human resources and accounting leadership roles. At this time, we believe that our team is complete and very capable to execute aggressive growth program that we have set out to replace Hotel Division profits with Franchise Division profits.

We have spent significant efforts this year to evolve our key banking relationships, so that we have adequate debt sources and capacity to allow us to fund a variety of future acquisitions. Given our year of transition, we spent considerable time to make sure the targeted banks understood our business model, our growth plans and our management team. We will soon announce the outcome of our efforts to source appropriate debt capacity for franchise acquisitions at significantly lower debt costs.

Because of the significant cash reserves we are realizing from our asset sales, we expect to finance future acquisitions from cash reserves and bank debt, rather than needing to use more costly equity while also avoiding equity dilution.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Eric Wold with B. Riley & Company.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

A few questions. I guess, one on the Knights Inn acquisition. Obviously, a significantly positive improvement from the kind of EBITDA talk in the 8-K/A that was filed of kind of more than $3 million contribution from the acquisition to the $5 million in today's press release. Maybe talk about major drivers between those 2 figures? And then on that same topic, how many other opportunities you see out there to be on the scoop up brands and chains from larger entities? And does the -- if this is focused on the economy side, does that change your plans of moving up into the kind of the upper middle scale segment? Or can you do both of those simultaneously?

(technical difficulty)

Operator

Ladies and gentlemen, please standby for technical difficulty one moment. Your line is now open for response.

Douglas L. Ludwig - *Red Lion Hotels Corporation - Executive VP, CFO & Treasurer*

So the difference between the $3 million and the $5 million was just refining timing and our expectations coming out of our transition plans relating to those assets, those hotels. So we feel good about the $5 million or more than $5 million number. So it's -- as you can see in terms of the purchase price paid for that EBITDA potential, it's an excellent transaction for Red Lion.

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Eric, this is Greg. Just kind of follow the second part of your questions there. We are going to continue to be focused on the midscale and upscale acquisitions. And we thought Knights Inn as a great opportunity for all the right reasons, which is why we have executed it. That being said, we think there are going to be more opportunities, both from what we've talked before about the smaller regional brands that are really becoming constricted and concerned based on consolidation. And we also think that consolidation is going to create opportunities down the road as well. And that we should see more opportunities in the midscale and, potentially upscale from some of the bigger systems as they look to pare down and focus and concentrate on where the bulk of the revenues are coming from. And I think that's going to be an advantage for us as we go forward, and we want to be prepared and ready to be able to act upon those as they become available.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

Perfect. And then just 2 quick follow-ups, if I may. With the 6 hotels that have been sold and now 3 under contract and 1 letter of intent, should we still look to that $165 million to $175 million guidance for all 11 as the right range?

Douglas L. Ludwig - *Red Lion Hotels Corporation - Executive VP, CFO & Treasurer*

Yes, that is correct. We're doing slightly better than that range, but we're still very comfortable with that range.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

Perfect. And then just final question. Obviously, I know when you acquire -- when you make some acquisitions, obviously there's lot of franchisees in there that may not be right for the brands or right for your system. And so you kind of churn some out, there has been just natural churn. If I look back the past 4 quarters, and correct me if I'm wrong, on the franchise side, there's been a net decline in franchised hotels for each of the past 4 quarters. When you think that switches to net gains? And maybe talk about the relative strength of those franchisees being added versus those being terminated or pulled out of system.

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Yes, I think there's 2 things there. I think as you look at kind of ins and outs, we also expected to have some as we acquire these brands and we work through hotel owners that probably shouldn't be in hotel but -- aren't conducive to the direction we are going. Or as some owners decided to make a change and those are all expected and we go through those. So those will start to slow down and they have pretty significantly. I think what's more important, Eric, and really where we would point to is it's really less about the number of hotels and really more about the revenue. And I don't think we've changed our guidance on our revenue growth, going forward or where we come historically, even through these acquisitions of like Vantage, and our revenues still grew pretty significantly quarter-after-quarter. And that's really the focus. So the focus is longer term, more valuable franchise agreements that really provide a strong net present value to the overall system. So I think that's what you're seeing and you're going to see the revenues continue to grow on historical pace that we've seen in past quarters.

Operator

(Operator Instructions) Our next question is from Alex Fuhrman with Craig-Hallum.

Alex Joseph Fuhrman - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

A couple of things I wanted to ask. But one was the hotels that are not for sale and the hotels that you have leasehold interest in. It looks like you're expecting pretty substantial growth in EBITDA this year, $7 million versus $5.9 million last year for those properties. Can you give us a sense of what's driving that? Is there 1 or 2 properties, perhaps within that, that has driven most of that growth? And as you think about potentially selling some of the hotels there that you have an ownership interest in, how long of a tail of maturity, do you think you have while those properties continue to scale up into what you think is a more mature EBITDA level for those properties?

Aaron Howard - *Red Lion Hotels Corporation - SVP of Financial Planning & Analysis*

Yes. This is Aaron. Great question. A couple of things that we can talk about with that. We do -- we are seeing some great growth in that set of assets. The assets themselves are doing very well. Also as in the Hotel Division, in addition to the properties, we have the overall management of 20 hotels that we had last year. We are expecting to save some of our cost control measures as we shift to franchise light we see in the Hotel Division. So there is some cost savings in those numbers as well that's also benefiting that. To your question about the maturing of those hotels, we like the very positive results that we've seen the recent history of those hotels and they continue to do well and we feel good about that option. We will look to monetize those assets when they're mature and seasoned.

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Yes. I think, Alex, this is Greg. Just to add to that. You've got a mix now. As you know, 3 that are fee simple, which will continue to season and look to monetize in some form. And then you have the leaseholds, which will do the same. But again it's really just a timing standpoint for us as we look at the best options and how to leverage those. Some of those leaseholds are 80 to 100 years, as we've gone through some recent renegotiations, which make them obviously, more valuable. And so we look to figure out the best way to kind of monetize those.

Alex Joseph Fuhrman - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

That's very helpful. And then I also just wanted to ask about the new Hello Rewards app that you launched a few months ago. I'm curious, what kind of adoption, you're seeing for that app amongst your Hello Rewards members? And then just more broadly, as you think about your loyalty program, has there been a big difference in adoption rates amongst your customers for the Red Lion branded properties versus the economy branded properties? And is there any thoughts to how Knights Inn is going to be rolled into the new loyalty program?

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Yes, I think, Alex, as we look at this, we continue to see a growth in that area. And as you know, we focus really on our one-to-one marketing. As we get loyalty members, really members that are looking for us to market to them and to interact with us. But we don't think that's where the long tail is going to be in the future. Long tail really is going to be a rewarding and recognizing affiliates that are helping us market rooms on social media basis. And I think, you'll see us start to use that, and Hello Rewards will really become more of the conduit and the communication device for consumers to really work with us. You're seeing in the industry and in some of the very biggest loyalty systems out there. You're starting to see surveys that are saying basically the 65% to 70% of the people that are in those loyalty systems are no longer in there for their points, which is an interesting shift if you start to think about it. And so as you know we've always been very focused on the fact that we need to look at the future and how consumers are going to interact and what they're going to see value in. And so for us -- we think it's leveraging our technology and having that app that allows people to book, to check in, to use their phone as the key to communicate with the hotel on many different levels, and request many different things. And as we roll out our new website, which will roll out here probably towards the middle of June, that would be another fundamental step towards kind of taking our system to the next level and really getting closer to what you see from more the online retailers. It'll have the capabilities that you haven't seen in industry before and those will mirror up nicely with our Hello Rewards.

Alex Joseph Fuhrman - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

That's really helpful. And without trying to scoop too much of the upcoming website relaunch, can you, I guess, give us a sense of what the goals of the relaunch are of the new website? Will it be to capture better conversion, to market some of your newer properties better? Just curious if you could give us a sense of what your team is hoping to accomplish?

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Yes, I think what you're going to see, you're going to see us do is, we're really going to focus on a couple of areas. One is really making it in the new website, for example in 2 clicks you can book a room. So it's really making it very user-friendly, providing technology where if a consumer is on a highway going from one location to another and they can pop that in. The app recognizes where they are and it can give them every hotel that we have between their current location and their destination, and provide them a rate to book. So it's really starting to look at really making it very easy for the consumer. The platform that's being written upon is really kind of what -- where the overall industry is going for website development to really be able to embrace some of the new technology that's out there. And I think you're going to see us move our content from less heavy, beautiful imagery to really more animated video content that's speaking really more directly to that location, that hotel and that consumer. So it really -- some really big changes and really building a platform that I would call more utilitarian in its aspect that's really focused on getting rooms booked.

Operator

With no more questions, I'll pass the call back to Mr. Mount for his final words.

Gregory T. Mount - *Red Lion Hotels Corporation - President, CEO & Director*

Great. Thank you, operator. I'd like to thank everyone for joining us today. We truly appreciate your time, and we look forward to speaking with you in the near future.

Operator

Thank you ladies and gentleman. This does conclude today's conference. A replay to the conference will be available until May 22, 2018. You may access the replay by dialing (877) 660-6853, and entering ID 13678805. Again (877) 660-6853, enter ID 13678805. And with that, you may disconnect your lines at this time. And have a wonderful day.
