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RLH - Q3 2017 Red Lion Hotels Corp Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the RLH Corporation Third Quarter 2017 Earnings Conference Call. (Operator Instructions)

It is now my pleasure to introduce your host, Mr. David Wright, Vice President of Accounting, Tax and External Reporting.

David Marshall Wright - *Red Lion Hotels Corporation - VP of Accounting, Tax & External Reporting*

Thank you. Welcome to RLH Corporation's earnings call.

With us today, our 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, Vice President of Financial Planning and Analysis; and myself.

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 are disclosed in our annual report filed with the SEC on Form 10-K on March 31, 2017. This report is available on rlhco.com, on the Investor Relations tab, or through the SEC website at sec.gov.

The company will also be referring to a number of non-GAAP measures. A 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 at our website.

For purposes of the discussion today, the company will be referencing third quarter 2017 results on a comparable basis for all periods presented.

I'll now turn over the call to Greg Mount.

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

Thank you, David.

Thank you for joining us today. Before I start, I want to take a brief moment to mention that we are committed to supporting our hotel owners and applaud their efforts in providing shelter for those in their community affected by the recent natural disasters.

Our team continued to focus on producing financial results that met or exceeded our business plans for the third quarter in 2017. It is critical that we consistently achieve our financial objectives and drive future growth.

On October 3, we closed on the sale of our entertainment business, allowing us to crystalize the value of this business and continue on our mission to simplify our business as we move closer to a fully asset-light business model.

On October 5, we also announced the listing for sale of the majority of our remaining owned hotels. Our ultimate goal through the sale of these assets is to significantly reduce our long-term debt, reduce our future maintenance capital spending, grow our cash balance to grow our franchising business, and optimize the market dynamics. The successful sale of these hotels should allow RLH to accelerate its evolutions towards operating primarily as a franchise company. Our franchise business requires less capital to grow our brand network, provides higher-profit margins and allows us to better leverage our excellent infrastructure and highly skilled employees over a larger franchise base.

Based on our review of the markets for the 11 hotels listed for sale, we estimate the aggregate value is between $165 million and $175 million. We are encouraged by the initial interest we have received in all 11 hotels. We expect to look for opportunities to market the remaining hotels we own in joint ventures as those properties stabilize to higher levels of profitability over next 12-to 18 months.

The remaining 4 hotels we control are leasehold interests.

With our strategic move away from hotel ownership, we expect to unlock the capital base of the company to finance future growth through franchising. Selling hotels also provides us the opportunity to reduce and rationalize our employee base. We have begun the efforts to execute these reductions and improvements to our organization.

We are confident that these organizational changes will allow us to further expand our franchise adjusted EBITDA margins. We expect that the disposition of our entertainment business and the anticipated sales of our hotels will reduce adjusted EBITDA in the near term over the next 12 to 24 months. But our intentions are to replace the adjusted EBITDA through a focus on the more aggressive growth franchise business.

We plan to strategically target upscale and mid-scale segments for growth because franchise agreements in these segments have longer durations and higher revenue base of royalty fees. We expect to further supplement our unit growth with more aggressive acquisitions through a targeted, strategic plan and careful due diligence process. We anticipate that our acquisitions will also focus on upscale and mid-scale hotel systems.

During the first 9 months of 2017, we have executed 120 franchise license agreements. We currently have approximately 50 properties, including 20 upscale properties contracted that will open over the next 18 months. Included in this total are our next 4 Hotel RL's.

Our 2017 guidance for executed franchise license agreements was 100 to 120. We are increasing that guidance to 130 contracts.

To support our unit growth efforts relating to the upscale and mid-scale segments, we recently added Paul Sacco as the Chief Development Officer. Paul is a highly respected industry executive with an excellent network and many years of mid-scale and upscale franchise development.

We are on track for another industry first by launching online sales of Country Hearth franchise agreements. We believe this innovative application process will provide hotel owners with a more tailored, comfortable and simplified experience that will be appealing with the standards and services built to flex to the needs of each individual hotel. This unique offering creates significant efficiencies for hotel owners and RLH Corporation while also providing us a future platform to be used anywhere in the world.

We are continuing our efforts to offer our franchise owners opportunities to convert to core RLH brands which, we think, will allow them to maximize returns on invested capital. These efforts will allow us to reduce our brand offerings from 15 to 9, while still providing excellent offerings in economy, mid-scale and upscale segments that give owners the freedom to move between brands as their business needs and or markets change.

For RLH Corporation, this reduction in the number of brands will let us optimize our marketing and brand promotion efforts in a more meaningful way for our current and future owners.

With the anticipated sales of many of our owned hotels, it is difficult to predict the timing and impact of those dispositions on our adjusted EBITDA for 2018. As such, we will focus our guidance for 2018 on our franchise operations and our anticipated reduction in long-term debt and the increase we expect to realize in our cash reserves from the asset disposals.

We will focus our efforts to achieve an improvement in our franchise business adjusted EBITDA of 15% to 17% by organic franchise growth, a reduction in our cost base and a productive deployment of our cash reserves and capital for the growth of our franchise base.

With higher profit margins in franchising and lower capital commitments associated with franchise growth, we hope to achieve an improvement in our market multiple as we execute the sale of our listed hotels.

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

Douglas L. Ludwig - *Red Lion Hotels Corporation - CFO, EVP and Treasurer*

Thank you, Greg.

We have continued to execute on our key business plan objectives and met market expectations.

Adjusted EBITDA from continuing operations increased by 34% for the 9 months ended September 30, 2017, as compared to the 9 months ended September 30, 2016.

Our franchise segment revenues were $12.7 million for the third quarter of 2017, representing an increase of 167% over the third quarter of 2016. The franchise segment profit for the third quarter of 2017 was $3.8 million for an improvement in excess of 140% over the third quarter of 2016.

Our gross profit margin on the franchise segment continues to improve throughout 2017, reaching 30% in the third quarter.

In the 9 months ended September 30, 2017, our franchise profits were $9.7 million, representing an improvement of 350% over the same period in 2016. The profit improvement was primarily driven by our brand acquisition completed on September 30, 2016.

Our franchise growth in the future will come from the 120 contracts signed through September 30, 2017, and the expected further growth in the franchise contract base.

These results confirm the importance of our strategic decision to focus on the franchise business for our future growth.

Our system-wide property count declined slightly during the third quarter. The decline was due to the economy franchise properties and the normal turnover realization. From the 12 months since the acquisition, the total attrition has been less than 10%. With the decline in the property count, which was anticipated as part of the original acquisition, the revenue for the acquired brands over the first 12 months essentially held as lower revenue properties dropped out of the system.

Despite the drop in the property count, we substantially met expected revenues from the acquisition due to a slight increase in the flat rate royalty fee.

We closed the sale of the entertainment business on October 3. GAAP requires that we disclose the entertainment business results as discontinued operations for the full year of 2017. We sold the business for $6 million before transaction costs. The purchaser assumes substantially all over the employment costs of the business, and so we had minimal severance cost related to the transaction.

Since the sales closed after the end of the third quarter, we will recognize the gain on the sale of the business, estimated at $1.1 million, in the fourth quarter.

In addition, as part of the sale, we sold the outstanding third-party ticketing obligation and the associated cash and receivables and trust totaling $8.2 million. Through the date of the sale of the entertainment business, it contributed $675,000 of adjusted EBITDA in 2017 as compared to its full year annual expectation of $1 million, as previously discussed.

As Greg mentioned, we have listed for sale 11 of our hotels, representing the majority of our real estate value. We expect to sell the 11 ownership positions while working to retain the franchise or management agreements on those properties.

Based on a review of the market, we estimate the aggregate value of the 11 hotels as between $165 million and $170 million (sic) [$175 million.] Based on the pricing, we anticipate there will be disposal gains on each of the 11 hotels. Company estimates that our tax loss carryforward and unused tax credits would largely offset any taxable gains from the sale of our listed hotels.

Once the hotel sales close, we will provide additional information on the discontinued operations.

We expect the sale of the 11 hotels should allow us to eliminate $73 million of consolidated debt associated with those assets and, thus, significantly reduce our long-term debt. We anticipate significantly increasing cash from the profits expected on the sale transactions.

Under GAAP, the company is required to consolidate 100% of the joint venture assets, liabilities and the results of operations. Although, the company is required to fully consolidate the joint venture, its economic share of the joint venture entities is 55%, with the exception of Baltimore, where its economic share is 73%.

For the 9 months ended September 30, 2017, our consolidated adjusted EBITDA from continuing and discontinued operations was $20.4 million. The company's joint venture partners' pro-rata share of this adjusted EBITDA was $6.1 million, and RLH's pro rata economic share of the adjusted EBITDA was $14.3 million.

As the company closes on the sales of the 11 hotels listed for sale and, ultimately, on the 3 remaining hotels in the joint ventures, there will no longer be a non-controlling interest on our balance sheet and our income statement.

Turning to our balance sheet liquidity. Eliminating our partner share of the joint venture, long-term debt and cash reserves, including restricted cash, leaves RLH, with its share of long-term debt, at $63.7 million and our share of the cash position was $32 million. Therefore, our pro forma net long-term debt position as at September 30, 2017, was $31.7 million.

This concludes our comments, and we'd now be pleased to respond to any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Eric Wold with B. Riley.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

A couple of questions. One, when you talk about the estimated $165 million to $175 million value for the 11 hotels that you currently have on the block, how much of that is based on kind of industry analysis, recent transactions versus current discussions with the potential buyers?

Douglas L. Ludwig - *Red Lion Hotels Corporation - CFO, EVP and Treasurer*

Yes, I mean, this is after an extensive review of the market conditions for each asset. We picked CBRE because they're very familiar with all 11 of these assets. So based on recent transactions and the detailed review of the market, we feel quite comfortable that this is a reasonable range of cash that should be realized from them.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

Okay. And then how would you -- I know it's early, as you haven't to put the 11 -- the other remaining 3 hotels in the block, you expect to do in the next 12 to 18 months. But how do you think about the average value of those 3 hotels versus the 11 in that $165 million to $175 million? Should we assume these a little better properties, same as those 11? How do you frame that?

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

Eric, this is Greg. I think it's really hard to interpret that at this point because they're such different markets and different set of business circumstances. So when we get to those and have those stabilized and ready for disposition, we'll surely kind of deploy the same type of metrics and looking at them and, hopefully providing some ranges on that as well. But at this point, I think, it will be hard to determine.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

Okay. And then just a couple more for me. Based on the executed franchise agreement that you currently have, the 120, and I guess, projected opening schedules and change over schedules of the franchisees, can you give us a sense or a range of where you expect to end the year in terms of number of hotels and rooms, what the initial pipeline might look like for to-be-opened hotels entering '18?

Aaron Howard

Yes. Eric, it's Aaron. Our -- we have the 50 properties approximately that are signed and are set to be opened. Those are set to be opened primarily in the next 6 months outside of the ones that -- we have a handful that are new-build constructions that will take longer. So we do anticipate that we'll see some openings associated with those properties here in the next 3 to 6 months. It's really difficult to say exactly the time frame by the end of the year what that number will be, but we anticipate continued growth, especially based on the expectation to raise our guidance from 100 to 120, up to 130 that we did today.

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

It's also interesting to see that 20 of them or 40% of those properties are from the upscale side, so it's in alignment with how we're trying to shift more assets into the upscale category. So it's a very encouraging outlook.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

All right, and just final question. With the consolidation of brands from 15 to 9, for those franchisees and the 6 that are going to be eliminated, are you going to be providing any assistance for them that want to switch over and need to switch over? Or is there a risk of losing some franchisees associated with that consolidation?

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

There's always some risk when you go through any type of transition, but we've been working diligently with those owners and are providing them opportunities to make the transition and help them with those expenses to do so. And so, we're seeing actually some really good movement. We have our conference coming up here in December, and I think you'll see a number of those people make the transition at that time, and we'll be scheduling meetings with them individually and working through that. But no doubt, it's a great opportunity for competitors who may want to try to reach in and take some deals away from us. That being said, the bulk of those are some of the heritage Vantage agreements that are very low revenue base for us. So the impact, if we do lose a few, would be, negligible in any case.

Operator

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

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

One thing I wanted to ask about was the increase in franchise agreements from 100 to 120, now 130. Obviously, that's a pretty significant, call it, 15% to 20% increase at the midpoint of the prior range. Can you give us a sense of where that is coming from? Are there any particular brands or geographies or real estate configurations where that has really exceeded your expectations?

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

Alex, no. I think it's really pretty spread out through the entire system and, really, through our geography. I don't think that there's any one area or brand, in particular. We have good momentum around a number of the brands. And we're working hard to kind of extend ourselves more deeply into markets like Canada, where we've been able to secure licensing to bring our franchises up there, past what has been up there historically from the Vantage Group. So from that standpoint, I don't think that there's any one area. I think one of the great indications that you may have gotten is what Doug was referring to. When you look at the 50-plus hotels that we have that are going to be opening here in the next 6 months, 40% of those are on the upscale, mid-scale side of things, which, again, as we've talked in the past really can be worth 3 to 5 economy segment -- franchise agreements just on their own.

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

That's really helpful. And then, another thing that I wanted to ask about is you mentioned in the prepared remarks that most of your hotels were able to stay open through the storm and serve the communities, which is obviously the most important thing, so we're certainly very happy to hear that. But we'll be remiss if we didn't ask about the financial impact. I think some of your competitors called out pretty significant financial impact from the storm. I know for you Florida and Texas are more franchise markets. Was there any material impact to your quarter, one way or another, from some of the weather events?

Aaron Howard

Yes, it's a great question, Alex. It's Aaron. As you said, the biggest impact is how it affects our franchise family, and we're very always concerned about that from a financial impact because most of those hotels -- the hotels that were impacted are flat fee schedule. It's a very immaterial impact to our financials for this quarter or for the year. It's very immaterial. So we continue to reach out and try to help and support those franchise in that -- in those communities as best as we can.

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

Yes. Just to add to that beyond the flat fees, we have worked with our franchisees who have been impacted in Florida and in Texas and helping them by deferring some of their fees as they get through this process. But those deferrals are only really just extending the agreements versus just eliminating the revenue. So we've tried to work hard with them, but the impacts have been fairly minimal for us.

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

Great. That's really helpful as well. And then I guess my last question, just thinking about the sale process of the 11 properties, can you give us a little bit of insight, I suppose, into what you're envisioning for the timing of this? Do you have a pace that you're hoping to complete the process by as you balance the potential trade-off between feet and price? Just curious more how you're thinking about this and if you expect -- based on your initial conversations, should we expect to see just a bunch of one-off sales and announcements as you go? Or is it possible that everything could be completed in a smaller number of transactions?

Douglas L. Ludwig - *Red Lion Hotels Corporation - CFO, EVP and Treasurer*

Yes, I think we're prudently planning that this will be 1 by 1. So it's going to naturally take a little bit longer than if we could find a couple of groups to take the assets. I don't think it'll be harmful to the overall value that we'd realize. And I actually think we've hit the market timing very well. I think there's a lot of interest that's being shown in these early stages. So that's very encouraging. And so I think we're going to see a prudent but not too slow a process, if I can put it that way. We -- I think we will hit our targets, which is most important at the end of the day. And as we said in the prepared comments, this will have a major impact on our EBITDA from operations next year. So there'll be a number of points of discontinued operations. So we're undertaking to keep the communication process open with the shareholders and let you know one by one, as we sell them what the impact is.

Operator

There's no more questions. I will pass the call to for Mr. Mount for his final words.

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

Great. Thank you, operator.

Again, thanks everyone for joining us today. We're very excited about our strategic steps and really the focus that continues around our future growth as we move to becoming primarily a franchising business, and we'll, of course, be speaking with you again early next year.

Operator

Thank you for joining us today. Thank you, ladies and gentlemen, this does conclude today's teleconference.

A replay to the conference will be available until November 16, 2017. You may access the replay by dialing (877) 660-6853 and entering ID 13669864.

And with that, you may disconnect your line at this time, and have a wonderful day.