Hilton split: Nassetta off to the races

By Jeff Weinstein on 2/22/2017

On January 4, Hilton Worldwide spun off into three separate and simplified publically traded companies – all motivated by goals to capitalize on growth opportunities, as well as create greater efficiencies and shareholder values. The results: remain-co., the fee-based management and franchise company now simply known as Hilton; a REIT, Park Hotels & Resorts, with 67 hotels at the time of the split and more than 35,000 rooms; and Hilton Grand Vacations, managers of 46 resorts for which it markets and sells vacation ownership intervals.

HOTELS' Investment Outlook talked to the CEOs of all three companies – Hilton's Chris Nassetta, Park's Tom Baltimore and HGV's Mark Wang – to learn more about their individual opportunities and challenges.

Today, HOTELS features the interview with Nassetta. In the following days, HOTELS will feature the interviews with Baltimore and Wang.

For Hilton's Chris Nassetta, a pure-play structure sets up a track meet among industry giants

In any battle to be the best, agility and efficiency are hallmarks of winners. By spinning off its real estate and vacation ownership businesses, the new Hilton gives competitive CEO Chris Nassetta more of just that – a pure play, fee-based management and franchise business with a mere 14 brands (and counting) that he thinks gives him the laser focus required to battle the likes of his Washington, D.C.-area neighbor, Marriott International (cue the music). While outwardly friendly rivals, this sets up a true clash of the titans for industry supremacy.

Nassetta, who speaks as though he is ready for the next leg of the race, says, “Being able to continue to focus even more on what we're doing with products, service delivery, innovation and technology, and driving relevance in each of those brands and market share, we ultimately think will continue to drive industry-leading organic growth.”

The architect of the spin-off of the REIT and timeshare businesses, Nassetta says he can do things better and faster, and with more dedication to the brand teams, adding that Park Hotels & Resorts and Hilton Grand Vacations (HGV) can fully activate their businesses, as well. “The truth is we weren't going out and buying real estate,” he says in reference to Park. “It's not what our core shareholder base wanted us to do.”

The same could be said for HGV, which Nassetta says requires more capital investment than Hilton Worldwide was willing to put in. Now the independent operator with its own shareholder base, it can more easily invest on its own.

There also are tax efficiencies to consider, he says. “It's not as efficient to finance these companies, any of them, as a combined company, when you can finance the individual pieces. And obviously, there's a significant amount of tax efficiency that comes as a consequence of the spin. Park was about 30% of the pre-spin business, and putting it in a tax-efficient REIT format matters. And so, those are all the reasons that we did it.”

Perhaps the best news remains in Hilton's revenue structure. Seventy percent of its fees are franchise-driven, 20% are management-driven, and the remaining 10% are from incentive fees. As a result, 90% of its revenue and EBITDA come from fees, and 90% of that is tied to the top line.

Brand builder

And no, Hilton is not acquisitive, Nassetta says, preferring organic growth, whereas main competitor Marriott is buying brands in addition to growing on its own. Time will tell which one delivers the best returns.

While Nassetta says he would never say never to a deal, he quickly adds, “I’ve been here nine years and we haven’t bought anything – and I grew up as an M&A person. But we think we have tremendous opportunities to continue to grow and lead growth in the industry and do it organically. I think that is ultimately better for our customer, our owners and our shareholders.”

In fact, during the Q3 2016 quarterly conference call, Nassetta alluded to the possibility of adding five new brands to the Hilton portfolio, including a few soft brands, a lifestyle brand and an urban micro-brand. In late January, he started making good on those promises by launching the upscale Tapestry Collection by Hilton with seven deals in the U.S. “There’s at least a reasonable possibility we’ll launch two new brands this year of the five that are in the incubation process. And that’s enough, as you know we’re just getting going,” he adds.

Perhaps the biggest growth vehicle for 2017 will be the opening of multiple Tru-branded hotels. “We’re going to open a bunch this year,” Nassetta says. “We like to give our brands a proper birth, which is to get it right, make sure it really resonates with customers. Whatever we need to tweak, we tweak. Ultimately, we need to make sure that we’re delivering commercially so that they’re successful for our owners, and so that they’ll want to continue to do more with us.”

Preferring the orderly approach, Nassetta says it’s clear over the next couple of years Hilton will launch at least three of the five in the lab. “Maybe even a couple this year,” he teases.

The other ace in Hilton’s pocket is its new partner from China, HNA, which at press time was set to acquire a 25% stake in the company for US$6.5 billion and become a strong ally in Hilton’s pursuit of growth in China. During Investor Day in December, Nassetta talked about how HNA carries 200 million passengers a year on its airlines, has tens of millions of loyalty members, and is the number two online travel agent and number one tour operator in China. “The idea is to connect all of our assets together,” he says.

Mr. Optimism

But not everyone is thrilled at the idea of more brands dotting the landscape and independent hoteliers have been, for selfish reasons, saying brand fatigue is setting in. “There probably are, in some ways, too many brands out there,” Nassetta says. “But when I think about it from our view, there are opportunities in our brand portfolio where if we offered consumers a new product, it’s something that they would use and, in fact, they would become even more loyal to our system… My guess is overall there are too many, and my guess is over time you’re going to see a continuation of more brands being launched and maybe then at some point some incremental consolidation.”

In the meantime, inventory is growing (Hilton has a 300,000 room pipeline) while demand is flattening out in North America. It is not a recipe for success, but Nassetta questions the suggestion that RevPAR headwinds are blowing harder. In fact, if fundamentals work out just right, he says, 2017 could be a very good year, especially when considering Hilton’s net unit growth, which will help drive a larger part of the company’s growth story.

“There has been a lot of discussion about policy initiatives in the tax and regulatory areas, in particular, that I think have boosted business confidence,” he says. “If that is maintained, that ultimately should translate into more jobs and capital spending, which would drive more demand for hotel rooms.”

And yes, there are concerns about labor costs, a strong dollar and geopolitics, among other issues, but overall Nassetta is optimistic.

“I get paid to worry, but I think that the basic setup for the industry right now is pretty good on things where we can really have impact and control. Certainly, we’ve seen higher growth rates, same store sales, but it’s not bad. It’s just a consequence of where the economy is. Our new unit growth rates are the best we’ve ever seen and if you put the two together, I think there’s reason for a lot of optimism.”