HOTELSMag.com

hotelsmag.com/Industry/News/Details/71772

Hilton split: Park REIT in Baltimore's wheelhouse

By Jeff Weinstein on 2/23/2017

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: Hilton, the fee-based management and franchise company; Park Hotels & Resorts, a REIT with 67 hotels 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 Baltimore; here's the interview with Nassetta, which ran yesterday. Stay tuned tomorrow for an interview with Wang.

Entering the market as the second-largest hotel REIT behind Host Hotels & Resorts and with a lower-than-peer supply growth outlook in key markets and the big-box/resort segments is not a bad way to step into a new office for Park Hotels & Resorts Chairman, President and CEO Thomas Baltimore Jr.

Following the spinoff of 67 owned assets from the former Hilton Worldwide, Baltimore says his priority is to prove operational excellence, rebuild a track record and increase street credibility. He wants to pursue larger one-off deals for upper-upscale and luxury assets in top 25 markets and premium resort destinations — or, over time, portfolio transactions. To do so, he might need to raise more investment capacity than US$100 million to $200 million in cash, a US$1 billion credit facility and a 4x leverage ratio. At the same time, management expects to grow via near-term ROI projects and asset churning, which, while unlikely, is not impossible. That's an equation that gives Baltimore confidence that Park's size, scale and quality will lead the newly minted REIT toward solid growth.

Longer term, M&A is not out of the question, but Baltimore is quick to point out, “You really have to have the currency. You've got to have the premium multiple and the lower cost of capital to really make the M&A work.”

M&A might also help Park reach its growth goal. “I would not be here if I did not passionately believe that there's an opportunity to at least double the size of this business over time, and that's in three to five years,” he says. “We're going to aggressively seek opportunities to have a significant portfolio of scale.”

Premium multiple

The former RLJ Lodging Trust president and CEO, who spent 16 years there raising three private equity funds and taking the company public five-plus years ago, says he found the new opportunity too compelling to pass up and started laying the groundwork and creating the all-important team for the new REIT when he joined Hilton last May. “I had worked at Hilton before (while starting RLJ with Robert Johnson on the side at night) and given the size and scale, it was just too attractive,” he says.

The biggest lesson Baltimore brings from RLJ, he says, is that no one succeeds alone. “We as a team really aspire to create the preeminent lodging REIT," he adds. "To do that you really must have an alignment of interests and the shared values."

To reach that goal, Baltimore says active asset management/operational excellence must improve margins, increase EBITDA and grow the top line to exceed guidance and consistently deliver superior results. "Hopefully, over time, we will earn a premium multiple," he says.

His second guiding principle is to be a prudent capital allocator because Park has to distribute at least 90% of its taxable income through dividends. And since Park must continually go back to the equity markets to raise capital, it must demonstrate to investors that it is a prudent user of that capital — or pay more for it.

The third leg of the stool, according to Baltimore, is having a low-levered balance sheet as it aspires to reach investment-grade.

"Tom is an extraordinary leader," says Hilton CEO Chris Nassetta, who recruited Baltimore away from RLJ. "He is the best of the best in the hotel REIT space, and he was my first and only choice when I had to go out and find a leader to help us out by running Park. We were incredibly fortunate that he was willing to join us."

Activate, maximize

Looking at the portfolio, Baltimore says it is anchored by irreplaceable assets representing a big chunk of EBITDA, such as the Hilton Hawaiian Village or Hiltons in markets such as Chicago, New York and San Francisco. In fact, he sees the first growth lever being able to take advantage of embedded growth within the portfolio. He points to a 40,000-square-foot ballroom going into an Orlando asset, parcels with development opportunities adjacent to hotels in Hawaii and New Orleans, and potential to convert some properties such as the DoubleTree in Santa Barbara, California, to higher-revenue generating Hiltons.

At the same time, Baltimore is interested in diversification with assets of scale in under-represented markets such as Washington, D.C., Boston and San Diego. "I love our partnership with Hilton but clearly over time we want to be adding Marriott, Hyatt and Four Seasons-branded product.

Park and Baltimore will also look to recycle capital. "Our top 25 or so assets account for about 82% of the EBITDA, and we have 67 assets. So, there clearly are some assets that are in slower growth markets and are non-core that we will look to recycle over time," he says.

More critically, analysts point to Park owning too many assets with longer-term management contracts. Baltimore responds by saying Hilton was not going to spin off top assets without having them encumbered. "We knew that going into this and I

accepted that constraint," Baltimore says. "And candidly, where Hilton should be spending its time are on these big, iconic portfolios, big convention center hotels where they have a core competency and a real strength. So, the long contracts didn't bother us at all."

Park did, however, make sure that it had appropriate management levers and approval over the general manager and the director of sales, and approval over the operating and capex budgets. "We're going to be exploring ways to activate the real estate and maximize the value," Baltimore adds.

These circumstances also require Baltimore to return to his roots and fundamental guiding principles as an asset manager. He points to opportunities in many assets to add more group business given the embedded advantage it has with large Hilton hotels with a lot of meeting space. "We welcome that challenge and I don't disagree that having these aggressive asset management strategies will be critical to our long-term success," he says.

Big picture

In late January, with a new administration in the White House, some observers were tempering expectations for the hotel business, while others saw the change as a net positive. Baltimore says that right after President Donald Trump's inauguration, the equity markets and consumer sentiment responded positively, and with potential tax reform and loosening of regulation, there may be renewed emphasis on infrastructure spending. "The combination of any and all of that is encouraging and could provide a nice tailwind for our industry," he adds. "And if you have rising corporate profits, I have to believe that's going to bode well for the lodging sector. So, I think there's certainly more optimism at this time."

Baltimore adds that interest rates rising closer to a more normalized state is also a net positive. "If we believe that rates are going to rise then perhaps there's going to be more economic activity, more economic growth," he says.

If these trends help lodging, or even if there are headwinds, running a new REIT like Park Hotels & Resorts is not new territory for Baltimore, who emphasizes his team will walk before it runs and focus on building credibility with the marketplace.

"I have built and grown a business from scratch before, so this is I think really in my wheelhouse," Baltimore concludes.