

07-Aug-2024

Sunstone Hotel Investors, Inc. (SHO)

Q2 2024 Earnings Call

CORPORATE PARTICIPANTS

Aaron R. Reyes

Executive Vice President & Chief Financial Officer, Sunstone Hotel Investors, Inc.

Robert C. Springer

President & Chief Investment Officer, Sunstone Hotel Investors, Inc.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

OTHER PARTICIPANTS

Michael J. Bellisario

Analyst, Robert W. Baird & Co., Inc.

David Katz

Analyst, Jefferies LLC

Dori Kesten

Analyst, Wells Fargo Securities LLC

Christopher Lee Darling

Analyst, Green Street Advisors LLC

Duane Pfennigwerth

Analyst, Evercore ISI

Chris Woronka

Analyst, Deutsche Bank Securities, Inc.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Sunstone Hotel Investors Second Quarter 2024 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. I would like to remind everyone that this conference is being recorded today, August 7, 2024, at 12:00 PM Eastern Time.

I will now turn the presentation over to Mr. Aaron Reyes, Chief Financial Officer. Please go ahead, sir.

Aaron R. Reyes

Executive Vice President & Chief Financial Officer, Sunstone Hotel Investors, Inc.

Thank you, operator. Before we begin, I would like to remind everyone that this call contains forward-looking statements that are subject to risks and uncertainties, including those described in our filings with the SEC, which could cause actual results to differ materially from those projected. We caution you to consider these factors in evaluating our forward-looking statements.

We also note that the commentary on this call will contain non-GAAP financial information, including adjusted EBITDAre, adjusted FFO and property-level adjusted EBITDAre. We are providing this information as a supplement to information prepared in accordance with Generally Accepted Accounting Principles. Additional details on our quarterly results have been provided in our earnings release and supplemental, which are available in the Investor Relations section of our website.

With us on the call today are Bryan Giglia, Chief Executive Officer; Robert Springer, President and Chief Investment Officer; and Chris Ostapovicz, Chief Operating Officer. Bryan will start us off with some highlights from our second quarter, including commentary on operations and recent trends. Afterward, Robert will discuss our capital investment activity. And finally, I will provide a summary of our second quarter earnings results and share the details of our updated outlook for 2024. After our remarks, the team will be available to answer your questions.

With that, I would like to turn the call over to Bryan. Please go ahead.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Thank you, Aaron, and good morning, everyone. Overall, it was a productive quarter at Sunstone as we executed on all aspects of our strategy, recycling capital and closing on the previously announced acquisition of the Hyatt Regency San Antonio Riverwalk, further investing in our portfolio, completing work on one value-creating brand conversion, and making further progress on the next, and returning capital to our shareholders through increased dividend and share repurchases.

Our second quarter earnings were in line with expectations as stronger ancillary revenues and successful cost controls offset softer leisure room revenue growth. While the near-term outlook for industry revenue growth has moderated, we believe that many of the primary drivers of the lowered expectations are isolated or short term in nature, and that the Sunstone growth story remains intact.

We continue to be optimistic about our earnings potential as we move into 2025, which is largely driven by the contribution of our recently completed and in-progress investment activity and less dependent on moving solely with market RevPAR trends. Later in the call, we will share some additional commentary on the various growth drivers we have across the portfolio. But before that, let's review some of the additional details on our second quarter performance.

During the quarter, we saw continued strength in group activity and further recovery in business transient demand. While the backdrop for leisure travel was more mixed, there has been some encouraging signs at our wine country resorts. These are the result of our work to redefine the cost model, while providing a world-class luxury experience and our efforts to increase the group mix to drive incremental business at both resorts. Our convention hotels once again led the portfolio this quarter, driven by the continued benefit from our newly converted Westin Washington, DC, Downtown, which grew RevPAR by 33% and total RevPAR by 42%.

The post conversion performance of this new flagship property continues to exceed our expectations as it is attracting higher-quality groups and appealing to a broader range of transient customers. The Westin Washington, DC increased total transient room nights by 28% year-over-year and at an average daily rate that was 34% higher than what was achieved as a Renaissance in 2019.

Our convention portfolio also benefited from the addition of the Hyatt Regency San Antonio Riverwalk, which exceeded our underwriting in the initial months of our ownership and grew total RevPAR by 20% in the quarter as a result of robust group and local food and beverage contribution.

The strong performance at these two hotels more than offset the challenged performance in the San Francisco and Orlando markets, which were expected to have tougher comps given their lighter convention calendars. In total, second quarter convention hotel RevPAR was nearly 7% higher as compared to the second quarter of last year.

As we look into the third quarter, we expect our convention hotels to once again lead in RevPAR growth, with further outsized increases in Washington, DC combined with more favorable booking patterns in Orlando, San Francisco and San Diego.

Our group pace for the second half of the year is up 17%. And while it remains early, we are encouraged by our group booking activity for 2025, which is trending up high-single digits. We continue to monitor trends in business travel and are encouraged by what we saw in the second quarter. The Marriott Boston Long Wharf exceeded our expectations, growing RevPAR by 8% from increases in both rate and occupancy. San Francisco also performed better, driven by higher midweek transient demand as the market benefits from growing commercial activity in the downtown area, driven not only by AI and other tech-related businesses, but also from increased bookings from legal and financial accounts.

As has been widely discussed, leisure demand continued to moderate in the second quarter although the trends varied across our markets. We have experienced some ongoing normalization in pricing, particularly in Key West where rates grew to very robust levels following the pandemic. During the quarter, Oceans Edge grew occupancy by nearly 4 points but at a lower rate than the prior year.

To be clear, pricing at our resorts remains very robust with comparable ADR up nearly 45% in the second quarter relative to the same period in 2019. The demand environment on Maui has been softer than expected, with both rates and occupancy lighter than projected in the second quarter, resulting from more subdued vacation travel to the island. While we expect some of these softer trends in Wailea to extend into the third quarter, which is reflected in our updated outlook, bookings for the festive period remain healthy and above last year.

There are incremental efforts underway or soon to be underway by local tourism authorities and other stakeholders, including the brands, to spur incremental travel to the area, which we anticipate will help bolster demand in the coming months. The island of Maui and Wailea in particular, is an unmatched and spectacular destination. We fully expect demand will rebound as we mark the first anniversary of the tragic fires last year and the island welcomes visitors to enjoy and celebrate all that the island and Wailea have to offer. Looking forward, Wailea's group pace is up 18% next year and we are currently renovating guestrooms and the lobby to provide an enhanced guest experience.

In other parts of our portfolio, the second quarter provided some more encouraging data points. In wine country, the Four Seasons Resort Napa Valley grew total RevPAR by over 22%, as our operator was able to more effectively leverage group business and drive out-of-room spend. The Four Seasons residences are also outperforming 2023, with revenue pace up 93%.

At Montage Healdsburg, we saw the benefit of productivity measures we have been implementing, which drove 470 basis points of margin expansion in the quarter. These two resorts remain a key focus area for us. And based on what we see today, we expect both properties to grow total revenue and earnings in 2024 relative to the prior year, which should continue into 2025, given the encouraging pace data we are seeing. Four Seasons has 2025 group room nights pacing up 11%, which will add additional out-of-room spend and help to compress transient rates.

Our second quarter results were impacted by the remaining renovation work at the recently converted Marriott Long Beach Downtown. As we noted on our last call, the project encountered some permitting delays that were out of our control and which lingered throughout the second quarter and into July. This extended our completion date and led to some incremental displacement.

While this resulted in lower expectations for the current year, the finished product looks great and the hotel is well-positioned to grow earnings from this point forward. Consistent with the success we have seen at our DC conversion, the Marriott Long Beach Downtown is already gaining transient share, with fourth quarter transient pace up 96%, relative to its performance as a Renaissance in the same period of 2019. Group pace for Q3 and Q4 are up over 100% to last year and 2025 pace is trending strong with rate and occupancy growth.

In Miami, the transformation of the Andaz Miami Beach remains on schedule to debut by the end of the year. We were recently on site and it's exciting to see the reimagined property starting to come together. The first phases of the construction will begin to wrap up in early fall and we are looking forward to the resort's earnings contribution that is now just a couple of quarters away.

While our outlook for 2024 has moderated, it is being impacted by some short-term factors and we remain encouraged about the growth potential we have embedded in our portfolio. The guidance that Aaron will discuss shortly assumes that RevPAR growth will be 300 basis points lower and adjusted EBITDA will be \$5.5 million lower at the midpoint than our prior estimates. What is important to note here is that nearly half of the RevPAR decline and nearly all of the EBITDA decline is associated with the permitting delays in Long Beach and the slower to recover Maui market. This means that apart from these two hotels, the profitability outlook for the balance of the portfolio remains solid, as our operators are able to drive incremental group and business transient demand while effectively managing costs.

As we look forward, we continue to believe that our setup for 2025 is among the most attractive in the sector. Our group production was healthy during the second quarter and up 2% to 2023. Layering on top of this are markets with better citywide calendars, the Super Bowl in New Orleans, strong group pace in wine country and growth at Andaz and Long Beach should all lead to an impressive 2025.

In the meantime, we continue to thoughtfully execute on our three strategic objectives: recycling capital, investing in our portfolio, and returning capital to shareholders. And we expect the combined impact of these to drive incremental earnings and value over the next several years.

And with that, I'll turn the call over to Robert to give some additional thoughts on our recent acquisition activity and renovation progress. Robert, please go ahead.

Robert C. Springer

President & Chief Investment Officer, Sunstone Hotel Investors, Inc.

Thanks, Bryan. Early in the quarter, we closed on our previously announced acquisition of the Hyatt Regency San Antonio Riverwalk, and we are very pleased with the hotel's initial performance. The market is healthy and we are already seeing the results of our asset management initiatives at the property. In fact, we now expect the first year yield on our net purchase price will be closer to 9%, which is incredibly attractive for an asset of this quality. This higher projection is 100 basis points ahead of our underwriting and represents meaningful accretion on the recycling of capital from the disposition of Boston Park Plaza. We retain the remaining proceeds from the sale that we can use to create further shareholder value, either through additional hotel acquisitions or the repurchase of our stock.

During the quarter, we also made additional progress on several other investments across the portfolio. As Bryan noted already, the renovation is in full swing at the soon to debut Andaz Miami Beach. As the first phases of the construction are nearing completion, we are now also working with the hotel team to prepare for the opening. We are pleased with the 2025 group booking activity we have completed to date and will soon be opening up

transient reservation channels for stays beginning in December. We continue to be pleased with the progress being made on what is a very comprehensive re-imagining of the resort.

While the recent softer demand environment in Wailea has been disappointing, we are using the opportunity to move more efficiently through the soft goods rooms renovation we have underway at the resort. As you can see from the property level data we make available, our upper upscale property achieves robust rates and competes very effectively with its nearby luxury peers. And so a refreshed room product will allow it to continue to do so. We will be performing the remaining work around peak periods and do not anticipate any meaningful disruption at the hotel.

Elsewhere across the portfolio, we will be completing a few other projects, including a meeting space renovation at our JW Marriott New Orleans, which is underway now and will be completed in October in order to take advantage of robust group business during the fourth quarter.

At Montage Healdsburg, we added a small event facility at the resort's showcase vineyard venue that will allow us to generate incremental sales, while also driving staffing efficiencies and contributing to higher margins. While these are smaller projects, they will add to the earnings potential and value of our portfolio.

As we have shared with you before, capital recycling is a primary component of our strategy. And while we are actively evaluating additional acquisition opportunities, we remain mindful of all capital allocation opportunities available to us and the relative returns offered from each at various points in time. We will be disciplined and balanced in our approach.

With that, I'll turn it over to Aaron. Please go ahead.

Aaron R. Reyes

Executive Vice President & Chief Financial Officer, Sunstone Hotel Investors, Inc.

Thanks, Robert. Our earnings results for the second quarter came in generally in line with expectations, as higher ancillary revenue and contribution from certain corporate-level items, offset lower RevPAR performance. Adjusted EBITDA for the second quarter was approximately \$74 million and adjusted FFO was \$0.28 per diluted share.

Our quarterly results reflect the impact of the extended completion of the renovation work at our hotel in Long Beach, which resulted in \$3 million of estimated EBITDA displacement in the quarter, approximately \$1.5 million higher than anticipated.

Together with approximately \$9.5 million of year-over-year decrease in earnings at The Confidante, as it undergoes a transformation to Andaz Miami Beach, we now estimate that we will incur \$15 million to \$16 million of total earnings disruption this year. Now that the work is completed in Long Beach and as we get closer to the debut of Andaz, we look forward to recouping all of this displacement, plus additional earnings at these hotels next year.

Included in our earnings release this morning, with our revised outlook for the year, as Brian noted earlier, we have lowered our full-year expectations for RevPAR growth and earnings. The change is primarily related to the extended timing of completion of the renovation in Long Beach and a softer leisure trends we have seen in Wailea, which together are impacting growth in full-year RevPAR by over 200 basis points.

Based on what we see today, we expect that our total portfolio of full year RevPAR growth, which includes all hotels in the portfolio, will range from a decline of 25 basis points to an increase of 1.75% as compared to 2023. If

we exclude The Confidante Miami Beach, RevPAR growth is projected to range from 2.25% to 4.25%. As a reference point for our updated guidance range, the full-year 2023 RevPAR metric for the total portfolio, including the Hyatt Regency San Antonio Riverwalk prior to our ownership, was \$219. And for the total portfolio excluding The Confidante Miami Beach, prior-year RevPAR was \$222.

Including our revised outlook for the balance of the year, we now estimate that full-year adjusted EBITDA will range from \$242 million to \$252 million and our adjusted FFO per diluted share will range from \$0.85 to \$0.90. While there is not as much of a seasonal variation between the quarterly earnings and the second half of the year as there is in the first, historically, the third quarter has contributed more to full-year earnings than the fourth. At the midpoint of our revised range, our EBITDA in the first half of the year would equate to 52% of our total projected full-year earnings. And we currently expect that an additional 24% to 25% will be generated in the third quarter with the remaining coming in Q4.

Our balance sheet continues to be one of the strongest in the sector. As of the end of the quarter, we had over \$230 million of total cash and cash equivalents, including our restricted cash. We retain full capacity on our credit facility, which, together with cash on hand, equates to nearly \$730 million of total liquidity.

We have one piece of secured debt coming due at the end of the year. We are finalizing our refinancing strategy for that loan now and will provide an update as part of our next earnings call. Our conservatively levered balance sheet and significant liquidity position continue to provide flexibility and be a source of strength for the company.

Now shifting to our return of capital. Our board of directors has authorized a base quarterly common dividend at our recently increased rate of \$0.09 per share. In addition to the dividend, we have also repurchased approximately \$7 million of shares since the start of the second quarter. We've retained ample authorization and liquidity for additional share repurchase activity. Separate from the return of capital to our common shareholders, the board has also authorized the routine distributions for our Series H and I preferred securities.

And with that, we can now open the call to question. So that we are able to speak with as many participants as possible, we ask that you please limit yourself to one question. Operator, please go ahead.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Michael Bellisario with Baird. Please go ahead.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks. Good morning, everyone.

Bryan Albert Giglia
Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Good morning, Michael.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Q

Bryan, kind of big picture question for you. Just can you remind us, review your view of value, what the board's view is, how they think about it, the path to get to that number, and then maybe how you're thinking both about the things you can and cannot control in order to close that valuation gap? Thanks.

Bryan Albert Giglia
Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Yeah. Well, we look at value and it's something that we spend a lot of time with the board at every board meeting on. And like any other hotel investor, we look at it from multiple ways. We look at it on a cash flow basis. We look at it on a relative multiple. We look at a replacement cost. And so, we use all those and we triangulate on our view of value.

And the way that that plays into our capital allocation strategy is at times when we see that deficit, we can do things such as what we did at Boston Park Plaza, where we monetize and then we can use that to get to the private market values and then go and either reinvest that into new growth opportunities or into our stock.

And if you look over the last couple of years, I think our approach has been very balanced in that. And that as we look forward, we have a great portfolio, we have great hotels and great markets. We have great internal growth that we've been able to build up on over the last couple of years. And they're now at a point where we have a cadence of hotels coming off of renovation and providing earnings like with DC and going to Long Beach and Andaz next year.

We have ramping hotels. San Antonio, one where we deployed that capital, has done really well for us and is a market that we're very excited about for several years to come. And we're very happy with this, as Robert said, almost a 9% yield on that investment in that first year. And then, of course, is also what we have done consistently over the last couple of years, is when the stock gets to a meaningful gap, is that we've been able to repurchase shares. And that's something that we did again in the quarter recently and have that balance sheet capacity and that flexibility to be able to pull on any of these levers at any time and they change depending on where our valuation and where that gap is.

Operator: Your next question comes from the line of Dori Kesten with Wells Fargo. Please go ahead.

Dori Kesten

Analyst, Wells Fargo Securities LLC

Q

Thanks. Good morning. During your prepared remarks, you described some leisure pricing as normalizing, but are there any hotels in your portfolio where you're seeing true price sensitivity at the margins?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

I'm sorry, Dori, what was the last part of that?

Robert C. Springer

President & Chief Investment Officer, Sunstone Hotel Investors, Inc.

A

What was the end of it?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

What was last part of that?

Dori Kesten

Analyst, Wells Fargo Securities LLC

Q

Where you're seeing just like true price sensitivity at the margin?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

One market we've talked about, Key West has been one where there has been more price sensitivity. We have been able to capture some more occupancy there, but that's one where maybe it's a little bit more sensitive and whether that's competing options for the traveler, whether it be cruises or other items, plays into that a little bit more.

Other markets, I don't think that we've seen that as much. One market where – not on the leisure side but on the group side, we've rationalized our pricing has been in Napa, which has been very successful, where we're bringing in additional group. And you'll see, when you go through the supplementals, you'll see that rates are lower, and that's because we're adding occupancy. We're taking the group at a more rational rate, which obviously fluctuates over the different demand periods, but then we're getting that ancillary spend where at Montage, it's \$700, \$800; at Four Seasons, it's \$900 to \$1,000 a day per group room. And that is between that and our productivity measures that we put in place, you're seeing the cash flow for both of those assets increase dramatically.

Operator: Your next question comes from the line of Duane Pfennigwerth with Evercore ISI. Please go ahead.

Duane Pfennigwerth

Analyst, Evercore ISI

Q

Hi. Thanks. Appreciate it. Just on Maui, given the asset level disclosure that you give us, the market doesn't really look that off or it's at least hard to tell in the disclosure that you've given. Can you talk specifically about how your assumptions have changed in the back half of the year, maybe 3Q versus 4Q and if there's specific groups or seasonal periods that really impacted the forecast? Thanks for taking the question.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Thanks, Duane. Good afternoon. So, with Maui, I mean, your point is exactly right. When you look at the supplemental and it's down, but it's not down a lot. At the end of the day, this is a hotel that's going to run around 70% occupancy at a mid- to high-\$600 rate. It is a meaningful hotel in our portfolio and we have a concentrated portfolio. And if you have a concentrated portfolio, you want to make sure that you have great real estate, you have a good market exposure and you have the ability to create value both internally with those assets and externally. And Maui is an asset that is an exceptional piece of real estate.

When you look at our position within the Wailea market, it is one of the better luxury resort markets in the world, and we're the value proposition there. We have an outstanding 22 acres, multiple pools, some of the closest rooms to the water that you can have, and we compete with some very high-end luxury product in that market.

What we started seeing in the second quarter, which tends to be a heavier leisure quarter than a group quarter is that some of the leisure demand did moderate a bit. And as we got into then looking at our projections going forward, the third quarter, the group business really starts in September and then runs through towards the festive season.

So from a group standpoint, group demand is still very good and our group pace is very good. It's just that that group kicks in in September. And when we look at the leisure and more of the summer traveler, whether it's a combination of still traveling abroad or other destinations, whether it be Mexico or Europe, is that there wasn't group to help insulate that weakness. And so when we look at the guidance and the change in the guidance, it really is that impact in the third quarter.

And while the tourism authorities and multiple stakeholders are doing promotions and other things to remind the traveler of what a wonderful experience Maui is, it still is a longer booking window buy. And so even with that going in, our assumption is that that's not going to kick in until maybe September and then into the fourth quarter. And September, we already have very good group base and not a lot of additional rooms to sell to take advantage of that.

And then probably the most important period of the year would be the festive period in December. Rate is down a couple percent for that, but occupancy is up over 10% right now. And so when we look at a hotel or a resort like Maui, you really look at total RevPAR. And when we look at occupancy going up that much on a pace basis, that should bode well for the back end of the year.

.....
Operator: Your next question comes from the line of Smedes Rose with Citi. Please go ahead.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thank you. I wanted to just ask you about, I guess, as the Andaz comes close to being back online and should be a pretty big contributor into next year, could you just talk about, I guess, how you're thinking about the mix of business there, group versus leisure? And just with that, I know you mentioned that it's on time. Does it remain on budget relative to what you've shared previously?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Yeah. Good afternoon, Smedes. So, Andaz is in full renovation right now. As we've told you before, the hotel was shut down to really expedite the renovation. The ultimate mix for that hotel is probably right around 25% group. Miami Beach is a very high transient leisure market. We did, through the renovation, add more suites to be able to accommodate groups.

And we also have some non-food and beverage group business that the hotels can do, too. And so our plan is to have renovation wrapping up for the most part in the fourth quarter. The reservation line isn't open quite yet but looking to book rooms into December, which is a good demand period, but use December as a time to fine tune the operation. So come the beginning of next year, I believe most of the investors are counting on the earnings from the hotel to really kick in as part of our 2025 growth to be in a great position for that. That's also a higher leisure time period, so transient bookings can fill the hotel at that point.

We do have the sales team that is fully engaged right now and they are booking business. That business is probably – you want to leave a little bit of time to get things running right so that business is probably looking to come in mid to late January into February. But we are putting business on the books right now. We are getting a great reception. The pools are coming into shape now. The backyard is coming into shape and you're starting to see the vision is becoming a little bit clearer, which is exciting for groups.

As far as timing, timing is still for the fourth quarter. And I would say that as far as the budget of it goes, our last update, were roughly around those numbers right now. So a lot of moving pieces, but we feel very confident with what is being completed and ready to go. And most importantly, creating EBITDA going into next year.

.....
Operator: Your next question comes from the line of David Katz with Jefferies. Please go ahead.

.....
David Katz

Analyst, Jefferies LLC

Q

All right. Thank you. Can you talk a bit about Napa and what you're seeing up there? And if that is encompassing the leisure trends that you cited earlier? And just how you're doing with those two assets, please? Thank you.

.....
Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Sure. Good afternoon, David. So in the second quarter, starting with Montage, and remember, from a group side, these are always going to be a little bit lumpy because you're going to have buyouts. You're going to have other, bigger pieces of business that kind of come and go. Montage group, it had some buyouts. It had a buyout wedding last year. Group was down a little bit, but we had good transient pickup for the quarter. I think transient was up about 14%. Group was down a couple percent.

And because that group was down, our total RevPAR was down a point or so. Even with that, with having the group base in there and also driving the ancillary revenues. And then also remember that the Montage is a little farther along in our productivity measures. The resort produced \$800,000 more in EBITDA than it did the prior year, even with RevPAR being down. So it's showing that we were able to work with the operator, get the efficiencies that we thought were appropriate. And then also maintaining the service levels of a true luxury hotel.

Looking forward for the rest of the year, group pace is very strong in Q3, and we're on track to be right around the group number that we thought we would be, call it 13,000 or 14,000 room nights. When we look into next year,

we're very excited about Montage because we are up \$3 million and in room revenue pace about 70%. And so, again, the cost model is there. We're starting to see some positives on the transient side and the group business and that ancillary spend, and most importantly, the total RevPAR is producing.

For Four Seasons, Four Seasons had a very good group in Q2. We are implementing some of our productivity measures there, so they're not fully realized. The Michelin Star restaurant is increasing its number of nights, has increased its revenue, is doing very well and bringing a lot of notoriety and people to the resort. And our profits were up again year-over-year about \$0.5 million at that asset. So again, doing very well.

As we look into next year, the group room nights pace is up about 11%. As I said earlier, rate is down a little bit, but that is by design to capture the ancillary spend which is almost \$1,000 a night per group room. So again, it's taken a little bit of time but as we saw this quarter, both of these hotels are absolutely moving in the right direction and producing the cash flow that we were counting on. And as we look into next year, both of them are lining up really well.

Operator: Your next question comes from the line of Chris Darling with Green Street. Please go ahead.

Christopher Lee Darling

Analyst, Green Street Advisors LLC

Q

Thanks. Good morning. Bryan, can you talk to your expectations for total RevPAR growth this year relative to RevPAR, and how that might have changed versus prior guidance? And then as you mentioned in your prepared remarks, out-of-room spend and cost reductions supporting results this quarter. Can you help me understand how each of those aspects plays into the updated full-year outlook?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Okay. Let me start on total RevPAR, it's probably about 40 basis points higher versus where rooms are.

Aaron R. Reyes

Executive Vice President & Chief Financial Officer, Sunstone Hotel Investors, Inc.

A

Yeah. I think if you look at how we've done through the first part of the year, total RevPAR growth exceeded rooms RevPAR growth in the second quarter. We saw that also in the first quarter. I think the magnitude of the disparity between rooms and total for this year I think will moderate a bit versus what we saw last year. But as Bryan noted, I think you'll expect that the total RevPAR growth should outpace rooms by around 40 to 50 bps.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

And you'll be able to see some of that in our supplemental. And remember, too, that a big piece of that will be the group side of things. And unlike last year where our group pace was heavy in the first half of the year, this year it's the second half of the year. And so there will be – from a quarter-to-quarter basis, there will be some lumpiness to that.

Operator: Your next question comes from the line of Chris Woronka with Deutsche Bank. Please go ahead.

Chris Woronka

Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys. Thanks for taking the question. I was hoping we could talk a little bit about Orlando. And I know, historically, it's been a pretty good asset for you guys, and this year pretty familiar with all the issues impacting the Orlando market. But for your asset there, specifically the Renaissance, do you think it's totally a market kind of specific issue or what's your outlook for that asset next year relative to the market? Is there anything you think you need to do? Is it still considered core on a longer term basis? Thanks.

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Yeah. Good morning, Chris. Longer term, we do have a lot of land there. And so there could be some opportunity longer term to enhance the asset and enhance its leisure offerings. Like our other and our past Renaissance hotels, it does very well from the group side. It doesn't do as well on an index basis on the transient side. And so when you look at what we've seen happen in DC, our transient index year-to-date is in the 130s. Prior to the repositioning, we were in the high-90s. And so the branding obviously makes a big impact.

From a leisure standpoint, the location kind of in between both parks was next to SeaWorld of course, but between the two major parks was never a primary leisure destination choice. With the new Universal gate opening much closer to the hotel, that should help going forward, too. So I think what we can do is we can look and especially when the new gate opens and see if there's additional demand shifting to our area. We definitely have the space to enhance the leisure amenities at the hotel.

Looking at the group side, the bread and butter of this hotel has always been group. It's been our space and the abundance of space, including the atrium area, which we use really well. And so that will always be appealing to groups because we can give them more space per guest or per guest room than some of the other competitors can or give them control of the house when, in maybe one of the larger resorts they're going to be group one, two or three in house at any time.

Operator: Your next question comes from the line of Floris van Dijkum with Compass Point. Please go ahead.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

Q

Hey. Thanks for taking my question. Bryan, maybe if you could talk a little bit about the transaction markets and also about potential because what we're hearing is that larger hotels are harder to transact in the current environment. Would you consider putting mortgage debt on one of your bigger assets, like, for example, the Hilton San Diego and using some of that capital to buy either another hotel or fund more share repurchases?

Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

A

Okay. Good afternoon Floris. From a capital standpoint, I don't know if we would need to put a mortgage on a hotel. We have a fully undrawn \$500 million line. We have cash on the balance sheet and we have a low-levered balance sheet. So as far as access to capital, whether we wanted to acquire something, whether it be an asset or stock, I think we have all the flexibility and firepower that we need to do that.

As far as the transaction market goes, when we sold Boston last year and started looking for acquisition targets, our expectation was that things were going to improve this year. And while part of it was that the CMBS market would improve and that would improve the pace of transactions, the CMBS market has definitely improved. It seems like it's improved in mainly facilitating refinancings more than a lot of purchases. And as rates come down and the cost of that debt comes down, then maybe we see some more private buyers become more active. But up until this point, it really – I would say we're disappointed with the pace because we thought that there would be

better opportunities to deploy the remaining proceeds from Boston Park Plaza.

Now, we did deploy a good portion of it in San Antonio, and we are very happy with that transaction. And I think if we could find another San Antonio right now, it would be more compelling. That said, we're not seeing a lot of that. And to your point, we're seeing maybe some of the smaller assets.

And then when it comes to actually deploying, it's the same thing that we always look at it. It's balancing deploying those proceeds into an asset and what are the return expectations of that asset, and then compare that to where are we trading, where is our stock, and is that a more compelling opportunity. And I think, over time, we've shown that we go back and forth between those pretty often and appropriately, and we try to remain balanced.

And that's something is we said we've already had some share repurchase that we announced in the release this morning. The lower the stock price goes and the bigger the discrepancy between that and our view of value makes a acquisition that much more difficult because we're going to need to make up for that difference. And so all these things ebb and flow. The good news is we have the portfolio, we have the balance sheet, we have all the flexibility we need to be able to be very nimble and to be able to go back and forth and make the right capital allocation decision.

.....
Operator: And that concludes our question-and-answer session. I will now turn the conference over to Bryan Giglia for closing remarks.

.....
Bryan Albert Giglia

Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Thank you, everyone, for your time and your interest, and we look forward to seeing many of you in the coming months, and we'll look forward to the grand opening of the Andaz in Miami Beach later this year. Thank you.

.....
Operator: This concludes today's conference call. Thank you for your participation and you may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2024 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.