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Sunstone Hotel Investors, Inc. (SHO)

Q3 2024 Earnings Call



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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Sunstone Hotel Investors Third 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 in that time. I would like to remind everyone that this conference is being recorded today, November 12, 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 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 third quarter, including commentary on operations and recent trends. Afterward, Robert will discuss our capital investment activity and provide an update on our Andaz Miami Beach Transformation. And finally, I will provide a summary of our third 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.

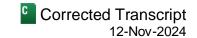
Bryan Albert Giglia

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

Thank you, Aaron, and good morning, everyone. During the quarter, we successfully navigated a number of challenges stemming from multiple weather events, labor disruption at one of our largest assets, and an evolving leisure backdrop, which particularly impacted demand across the market on Maui. Despite this, we still managed to deliver on multiple aspects of our strategy. As we noted in our update from early October, our operations in the third and fourth quarter have been impacted by labor activity at the Hilton San Diego Bayfront. While this resulted in some short-term disruption, we are pleased that this is now resolved and that normal operations have resumed at the property, which is one of the leading group hotels in the city.

After adjusting for the impact in San Diego, our third quarter earnings results came in generally in line with revised expectations as solid business transient demand at our urban assets, better ancillary spend across the portfolio, and solid cost controls both at the hotels and at the corporate level offset softer rooms revenue growth at our leisure properties. Despite a more muted near-term outlook, we continue to be optimistic about our earnings

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potential as we move into 2025, which is expected to benefit from recent acquisitions completed repositionings, stronger citywide, improved group pace, and an easier comparison related to disruption, specifically from the labor activity in San Diego.

Later in the call, we will share some additional commentary on these multiple drivers of growth. But before that, let's review some additional details on our third quarter performance. During the quarter, we saw sustained strength in group activity and further recovery in business travel. While leisure demand continued to moderate, we again saw encouraging signs at our wine country resorts.

Starting with the group segment, our portfolio was once again led by the newly converted Westin Washington, DC Downtown, which grew RevPAR by 33% and total RevPAR by 39%. The post conversion performance continues to exceed our expectations as it is attracting higher quality groups and appealing to a broader range of transient customers. The renovated hotel increased total transient room nights by 29% year-over-year at an average daily rate that was 31% higher than what it achieved as a Renaissance in 2019.

In the third quarter, the hotel led the comp set in ADR index, which speaks to the degree of transformation we have achieved at this property under the Westin flag. Other than San Diego, we saw strength across our convention hotel portfolio, which turned in a combined total RevPAR growth of nearly 15% in the quarter as robust performance in San Francisco, Orlando, and San Antonio added to the tailwinds from DC.

Our third quarter group production was robust, with room nights booked up 11% over last year at higher rates, translating into a healthy 15% growth in revenue. Even more encouraging is that we are seeing improved 2025 group pace across the portfolio, including Wailea, New Orleans, San Francisco, wine country, San Diego and Washington, DC. As we sit today, our group bookings for 2025 have improved since the last quarter, with revenue now pacing up in the low double-digit range.

Trends in business travel improved further in the third quarter, with strength in several markets, including Boston, San Francisco, and Portland. The Marriott Boston Long Wharf once again exceeded our expectations, with total RevPAR growth of 8.6%. The hotel increased occupancy by over 500 basis points on higher rates, as they took advantage of strong corporate demand on top of a solid base of group business.

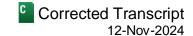
In San Francisco, midweek transient demand outperformed, driving occupancy higher by nearly 800 basis points despite a softer group backdrop in the market.

In Portland, we were pleased to see further recovery this quarter with occupancy jumping more than 16 points compared to last year on stronger short-term demand and growing amounts of activity from both transient and group events. This is an encouraging sign, as Portland has been our most challenged market in recent years.

In Long Beach, our newly converted Marriott is being well-received with strong early bookings, including group pace that is up more than 50% as compared to 2019 and transient rate index that is up more than 30% over the last month. We are seeing the benefit of our investment in this hotel in the fourth quarter as the hotel ramps up and gains share against its peers, especially with the highest rated corporate guest. We look forward to this tailwind continuing through 2025.

Excluding Long Beach, which was still ramping up during the quarter, our urban hotel portfolio grew RevPAR by a healthy 9%. Leisure demand further moderated in the third quarter, and we witnessed some ongoing normalization in pricing. This has been particularly true in Key West, where rates grew to very robust levels following the pandemic, but where we have seen incremental price sensitivity in recent quarters. As we discussed

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on our last call, the demand environment on Maui has been softer than expected, resulting from more subdued vacation travel to the island following the fires last year.

At Wailea Beach Resort, both rates and occupancy came in below expectations last quarter. While this more muted level of activity has carried into the start of the fourth quarter and is reflected in our updated guidance, we have begun to see an increase in bookings, and the upcoming festive period remained strong. In fact, total room nights are currently pacing 20% higher than last year. And while pricing has moderated, this still translates into 7% growth in room revenue for the festive period. Looking further ahead, the market shows signs of improvement in 2025 with a more constructive group event calendar driving strong group pace and with the added benefit of our rooms and lobby refresh, which is underway now.

In other parts of our resort portfolio, the third quarter provided some more encouraging data points. Our wine country resorts continued to season and are attracting more leisure customers and high quality group events. Montage Healdsburg grew total RevPAR by 27% in the third quarter and benefited from multiple resort buyouts, which translated into nearly 12 points of margin expansion. Four Seasons Napa Valley grew RevPAR by over 5%, despite comping over a significant buyout event that occurred in the prior year. Our focus at both of these resorts continues to be on driving more business volume, while managing expenses and we are making progress.

In Miami, work continues on the transformation of the Andaz Miami Beach. However, the multiple weather events that impacted Florida in recent months, combined with additional time needed for permitting and inspections, has extended our project timeline by several weeks. Despite this delay and some incremental investment for the project, we are confident that this will be a terrific asset and one that will result in meaningful value creation for our shareholders. As the renovation is now in the final stages, the property is coming together nicely and we are confident that the resort is well-positioned to deliver on our expectations.

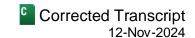
Robert will share some additional details shortly, but our full focus is on completing the renovation and positioning the resort to contribute to our 2025 earnings. During the quarter, we took advantage of market conditions and repurchased \$23 million of stock. This brings our year-to-date total to just over \$26 million at an average price of \$9.83 per share, a meaningful discount to estimates of NAV.

Since the start of 2022, we have repurchased nearly \$200 million of stock and we have the balance sheet capacity to return incremental capital to shareholders as market opportunities arise. While our outlook for 2024 has moderated, it has been impacted by short-term factors and we remain encouraged about the long-term growth potential we have embedded in our portfolio. The guidance that Aaron will discuss shortly reflects the confluence of several short-term impacts to the portfolio, including disruption from severe weather that impacted our Florida assets, lingering impacts from the labor activity in San Diego that have exceeded our initial estimates, and a more muted leisure backdrop.

Despite a softer near-term outlook for the current year, we remain very excited about our setup for 2025, which should be among the most attractive in the sector. Our group production remains healthy, and layering on top of that, many of our markets with better citywide calendars, strong group pace in wine country, San Francisco, New Orleans, and Wailea, 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 will drive incremental earnings and value in the years to come.

And with that, I'll turn the call over to Robert to give some additional thoughts on our renovation activity and updated expectations for the Andaz Miami Beach. Robert, please go ahead.

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Robert C. Springer

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

Thanks, Bryan. During the quarter, we made additional progress on several value-enhancing projects. As we noted earlier, we completed work at the recently rebranded Marriott Long Beach Downtown. We are quite pleased with the finished product and look forward to the hotel being one of several drivers of our growth next year.

In New Orleans, we put the finishing touches on a renovation of our meeting space at the JW Marriott, which is now hosting a busy calendar of meetings in the fourth quarter and set to take advantage of strong group pace for 2025 with the added benefit of the Super Bowl.

While the softer demand environment in Wailea has been disappointing, we are using the opportunity to move more efficiently through the soft goods rooms renovation and lobby refresh we have underway at the resort. We will be performing the remaining work around peak periods and do not anticipate any meaningful disruption.

While we have made substantial progress in the transformation of The Confidante to Andaz Miami Beach, it is a comprehensive and complex project with many moving pieces. Given some of the delays we experienced as a result of weather and an extended municipal permitting process that have impacted the pace of construction, we now anticipate debuting the repositioned resort in February of next year, about 60 days later than what we last shared with you.

In addition, we now expect the total renovation investment net of incentives will be approximately \$95 million. The incremental investment of \$15 million is primarily the result of cost inflation above our initial estimate, some scope enhancement, and some additional spend associated with a longer timeline. The entire team is working to complete the project and reopen the transformed resort as quickly as possible to ensure we are able to deliver solid growth in 2025. We look forward to bringing you news of the resort's opening on our next call.

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

Aaron R. Reyes

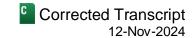
Executive Vice President & Chief Financial Officer, Sunstone Hotel Investors, Inc.

Thanks, Robert. Our results in the third quarter were impacted by labor activity in San Diego. As we noted in the operations update we provided in early October, the headwind from this activity weighed on revenue growth and earnings. After adjusting for this impact, our third quarter earnings came in generally consistent with our expectations, as a benefit of better cost control helped to offset lower rooms revenue.

Our quarterly results also reflect some headwinds from weather in Florida and from a more challenged operating environment in Maui. These were partially offset by stronger-than-expected performance in wine country and at most of our urban hotels. Comparable RevPAR growth, excluding The Confidante Miami Beach, was effectively flat. But excluding the Hilton San Diego Bayfront, was an increase of 2.4%.

Adjusted EBITDAre for the third quarter was approximately \$54 million and FFO was \$0.18 per diluted share. Included in our earnings release this morning with our revised outlook for the year. As we noted in our operations update last month, a new employment contract in San Diego was ratified in October. And while the hotel has resumed normal operations, there has been some lingering impact of bookings in the fourth quarter that have resulted in incremental earnings headwind above our initial estimate.

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Our updated outlook also reflects some impacts from the weather in Florida during the early part of the quarter and assumes a less robust leisure demand environment in Maui, leading up to the festive period. Taken together, we now expect that our total portfolio full year RevPAR change, which includes all hotels in the portfolio, will range from a decline of 3.25% to a decline of 1.75% as compared to 2023.

If we exclude The Confidante Miami Beach, RevPAR is expected to generally be flat to the prior year and vary in a range from a decline of 75 basis points to an increase of 75 basis points. As a reference point for our guidance, the full year 2023 RevPAR metrics for the total portfolio, including the Hyatt Regency San Antonio Riverwalk prior to our ownership, with \$219 million. 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 EBITDAre will range from \$220 million to \$230 million and adjusted FFO per diluted share will range from \$0.75 to \$0.80. Based on the revised timing for the opening of Andaz Miami Beach and our efforts to minimize costs, while the work is performed, we now anticipate that the resort will generate less of a loss in the current year, which is included in our revised earnings guidance ranges.

Our balance sheet continues to be one of the strongest in the sector. We retain full capacity on our credit facility, which, together with our cash balances, equates to nearly \$700 million of total liquidity. Subsequent to the end of the quarter, we entered into \$100 million delayed draw term loan agreement with a group of our existing lenders. We anticipate fully drawing the loan in early December and using most of the proceeds to pay off the maturing mortgage loan secured by the JW Marriott New Orleans.

Following this refinancing, we will have a fully unencumbered portfolio with a balance sheet that offers additional capacity and significant flexibility. After giving effect to extension options available to us, our next maturity will not be until 2026. We appreciate the continued support of our bank group on this new loan.

Now, shifting to our return of capital. In addition to the share repurchase activity that Bryan noted earlier, our board of directors has authorized a quarterly-based common dividend of \$0.09 per share for the fourth quarter. Based on our updated outlook, we anticipate that this dividend, together with our dividend in the first three quarters, should satisfy our expected distribution requirement for the year. In addition to the common dividend, the board has also authorized the routine distribution for our Series G, H and I preferred securities.

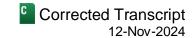
And with that, we can now open the call to question. So that we're able to speak with as many participants as possible, we ask that you please limit yourself to one question. Operator, please go ahead.



QUESTION AND ANSWER SECTION

Operator : Thank you. [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.	2
Thanks. Good morning, guys.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	4
Good morning, Mike.	
Michael J. Bellisario Analyst, Robert W. Baird & Co., Inc.	Q
just want to focus on 2025 impacts. Maybe first from San Diego, can you maybe quantify what transient, what group cancelled for early 2025? And then also on Miami, I think you had been talking about maybe \$12 million cositive EBITDA next year. Where does that shake out today? Obviously, directionally lower, presumably. But coyou quantify the delayed opening there in Miami and what that might do to 2025 numbers? Thank you.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	4
Sure. So, starting with San Diego, obviously, a lot of noise in the quarter, both third and fourth quarter. Again, the impact of cancellations and overall cost impact is confined to the fourth quarter. And so, we gave the update in October. The only thing that changed since then was a little bit more EBITDA impact; and that didn't come from additional cancellations, that was more of cost inefficiencies during the time period when books got fully closed and the expenses sorted out. The hotel, obviously, just doesn't run very efficiently during that time period. And there were some, also some concessions given to some of the groups that were in-house.	е
So, when we look at 2025, our view is that the hotel is back to normal operations at that time. So, there'll obviously be some expense normalization and we'll see some – we should see some positive swings that way at the hotel will be operating with full revenue and full staffing at that time. Pace is strong for next year. We're up about close to 6%. So, that, on top of the disruption this year should be a good year for San Diego.	ıS
On Miami, again, with the opening pushed back a few weeks, we were originally looking at about \$12 million of EBITDA compared to \$2 million to \$3 million loss this year. Beginning of the year is one of the high seasons there. And so, that impact is probably a couple million dollars of EBITDA. So, maybe going from \$12 million to about \$9 million for the full year. And then, on the loss this year, the GAAP loss of negative \$3 million still has a pretty meaningful pick up year-over-year. And then, the hotel will continue to ramp from that point.	
Michael J. Bellisario Analyst, Robert W. Baird & Co., Inc.	
Thank you.	

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

Dori Kesten

Analyst, Wells Fargo Securities LLC

Thanks. Good morning. Have your stabilized yield expectations changed at the Andaz with the new \$95 million cost? And then, just as a quick follow-up, the group revenue pace you cited up double-digits in 2025, was that including or excluding Andaz?

Bryan Albert Giglia

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

Good morning, Dori. So, originally we said that our yield expectations were at 8% to 9% on our total investment in the property. Obviously, with the capital going up a little – slightly from last quarter, which was a combination of some of the delays, which just results in more overhead costs staying with the property for that extended time period, some cost inflation, a little bit of scope. And then, also, in a building of – actually, multiple buildings with – done in different time periods or built in different time periods, there are some unforeseen things that come up with MEP and other items that have to be addressed to make sure that we have a world-class building to match the world-class asset that we are putting up.

So, our expectation is that our yield still stays in that range. I would assume that, with the additional capital, it moves down a little bit to that range, there within that range. And then, looking at 2025, our pace, it does exclude Andaz. We'll exclude that next year because that would create quite a bit of noise. And then, when we look at the different hotels next year that are driving the 2025 pace, we have very strong citywide in New Orleans; San Francisco has growth next year; Orlando is picking up; and then, on top of that, San Diego and Montage have really great pace for next year, and then Wailea also.

Dori Kesten

Analyst, Wells Fargo Securities LLC

Okay. Thank you.

Operator: All right. Our next question comes from Keegan Karl with Wolfe Research. Please go ahead.

Keegan Carl

Analyst, Wolfe Research, LLC

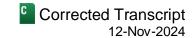
Yeah. Thanks for the time, guys. I guess, just want to dive into your Napa assets a bit. So, just wondering what the strategic opportunity is here and if it's actually a better opportunity to recycle the capital given the asset performance is improving?

Bryan Albert Giglia

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

Good morning, Keegan. No, great question. And in line with what we've said, our focus is to get these assets stabilized. It was a very productive quarter for both and it gives you – it gives us an opportunity to see both of them starting to fire on closer to all cylinders as they ramp up. Montage had a really strong group quarter. And for these assets, a strong group quarter means that there are several buyouts, and that obviously helps the performance.

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Four Seasons had buyouts last year that – the buyouts don't always repeat, but was able to backfill it both with a good amount of transient customers. Also in the Montage, we've had the residences come online this year. Of the 26 residences, 11 are participating. We expect to pick up one or more over the next 12 months. And so, that's also contributing to the performance. And as we look into next year, we have great pace. We have great pace at Montage. We have great pace in Four Seasons now. Our occupied rooms are up in Four Seasons, the rate is down. That is by design because of the ancillary spend that both of these hotels can generate.

So, while it's taken a while to get these both assets to where we want them to be, we are well on our way, and we believe that there is definitely more growth, and that next leg of growth is probably going to come as the market continues to get better and more transient demand comes into – back into the market. We have them set from a cost standpoint. And now, it's just working with the managers to get them to the right group mix, which, for Montage, is probably about 60%, we're around 50% today, Four Seasons closer to 45%, and we're probably around 30%, 35% today. So, everything moving in the right direction.

And then, just to answer the last part of your question is yes, is that it will ultimately result in the monetization of these assets. And we just need to weigh what the right time is and when we can realize and realize a good portion of that value and that upside to. So, that's what we're tasked with now is to determine when that point is. But as we said, at the acquisition of these hotels, that we would eventually look to recycle them and recycle them maybe sooner than some of our other holds.

Operator: Okay. We'll move on to the next question. Our next question comes from the line of Smedes Rose with Citi. Please go ahead.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Hi. I wanted to ask you. Well, actually, I want to kind of maybe do a two-fold question. Just to follow up quickly on your potential asset sale at the wine country assets. Do you think you could sell them for at or more than what you purchased them for? But the other question I wanted to ask you as well is, in San Antonio it looks like you're running ahead of your initial expectations for the 2024 contribution. Do you think that it's worth extrapolating that kind of run rate into 2025 where you could do more than I think you thought about maybe \$20 million of incremental – of EBITDA from that asset for next year?

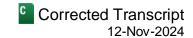
Bryan Albert Giglia

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

Good morning, Smedes. On Napa, both wine country assets, where we are and where – we're not quite where we want to be on a cash flow basis. We see a good path to get us there at this point. But whether we – whether a sale price would be – I think, right now, we're talking at probably slightly below to where our basis is in them. And that's going to depend on how much of the potential upside we get paid for today or do we need to wait a little bit more to realize that cash flow and then realize that value? So that's the give and take with evaluating the timing of sale for these assets.

On San Antonio, we're very happy with the acquisition. It's performing well in line with where we thought and as you said, a little ahead. The Alamo redevelopment is underway. I think that next year, our expectations are probably about the same we do have during the summertime of meeting rooms light renovation that's happening similar to what we did in the third quarter and JW, second and third quarter and JW in New Orleans that we were able to quickly get in there and update the meeting space.

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And so, I think, for next year, our expectation is, is San Antonio is in line. But when we have the full Alamo visitor center and historic site reopening in 2027 combined with the retail opportunities that we have on the ground floor and in our garage building that sits right next to the Alamo Center. We think that our long-term opportunities here are pretty meaningful and are very happy with where we sit right now in this investment.

Smedes Rose Analyst, Citigroup Global Markets, Inc.	C
Thank you. Appreciate it.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	Д
Thanks, Smedes.	
Operator: Our next question comes from Duane Pfennigwerth with Evercore ISI. Please go ahead.	
Duane Pfennigwerth Analyst, Evercore ISI	C

Hey. Thank you. So, you called out Maui as one of the items that drove the change since your guidance revision about one month ago. Maybe you could talk a little bit more about what shifted in Maui. And if you could remind us, did you have any relief business there that's in the comparisons, and when does that business – when did that relief business effectively roll off?

Bryan Albert Giglia

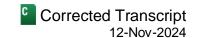
Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.

Good morning, Duane. Okay. So – and when we did the update in October, that was that was confined purely to the labor impact in San Diego. We didn't provide anything else in the portfolio at that time because we were still within closing up the quarter and not seeing where everything was at that point. But that was that update. And Maui did underperform in Q3, and it continued into Q4, and continues into Q4. And though it is, overall, just a general leisure pickup has been slower in this market than some of the other markets. And when you look across the portfolio, our group is firing on all cylinders. Our business transient is doing very well. Leisure is kind of hit and miss where, wine country, where we're seeing very promising results. And in other markets like Maui, Key West, occupancy is there. But it's a rate-sensitive – it's become a little bit more rate-sensitive of market, and Maui is – has struggled over the last couple of quarters.

There is no relief business in there and we fully lapped that over last year. And so, that's not impacting anything now. The positive that we've seen in Maui, a couple of things. One is that group picks up, and group picks up very strong next year. We have some decent group in the fourth quarter by 2025. And we've talked about this before, there's a large group that's on island for two years and then off island, and this was an off island year. So, our group pace is very strong next year. The State of Hawaii has been putting money into some promotional campaigns to promote Maui post-fire. We're looking for them to continue to do that. We're getting great help from the brands and other distribution channels, to help bring business back in there.

The biggest positive we've seen recently is we've seen airline flights and seats decline steadily over or been down for over a year now, for the month of December where we've actually seen that switch, and so seats and flights are up about 5%. And that is mainly coming from the West Coast, but that's the biggest feeder market for Maui. And so, that's a big positive where we've seen actually see more lift going into the island.

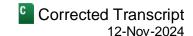
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And I think where that's – for the month of December, where that's translated to is we've seen festive very strong, festive is up. Room nights, significantly rate is down, but it does allow the hotel to fill and allow the hotel to fill and do a few things. One, it gives it upsell opportunities. It has ancillary spending that's very high at that hotel. And so, total revenue is up for festive, room nights are up. and layering on top of that our very strong pace for next year gives us a lot more optimism as we look at Maui going forward.

Duane Pfennigwerth Analyst, Evercore ISI	Q
Thank you.	
Operator: Our next question comes from David Katz with Jefferies. Please go ahead.	
David Katz Analyst, Jefferies LLC	Q
I think I may be double-clicking on the topic of Maui, but I'm really sort of curious whether we get to we go way back right to where it was and what the trajectory to that point really is. Or do we just find some new normal really with it? And what do you think that looks like if we can ask your crystal ball?	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	A
Yeah, okay. Good morning, David.	
David Katz Analyst, Jefferies LLC	Q
Good morning.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	A
I mean, this is – we'll look into the crystal ball here.	
David Katz Analyst, Jefferies LLC	Q
Okay, okay.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	А
Maui is a phenomenal leisure destination. Following the fire, call it, half of the leisure component of the iso your Kaanapali and Kapalua were impaired for a period of time. It was	island,
David Katz Analyst, Jefferies LLC	Q
Yeah.	
Bryan Albert Giglia Chief Executive Officer and Director, Sunstone Hotel Investors, Inc.	Α

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... difficult to get up there, groups were canceling. You had residents being put up in those hotels while other accommodations were being sourced. And so, it threw the island off kilter, and the normal cadence of travel and places to stay and the customer in Wailea is not exactly the same customer that stays up in Kaanapali.

And so, that's shifting back now and getting back to normal, with the airlift improving. The group demand is absolutely not an issue here. We continue to have a very strong funnel and the amount of production, not only from Maui specifically that we've seen in the second quarter and third quarter, but the rest of the portfolio, the group funnel and production levels are not only good compared to last year or 2019, but good over the last 10 years. And so that's for the entire portfolio and specifically Maui.

So, I think when we look out a year – and is it all going to snap back? No, it usually doesn't. But when we look out a year, two years from now, I'm expecting to see a Maui that's pretty similar to what we saw before. Because when you look at a different luxury leisure destinations that are domestic and have good airlift and have been highly desirable for decades, I don't see...

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Analyst, Jefferies LLC

Yeah.

Bryan Albert Giglia

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

...a major change in Maui. And the rest of the island is going through its rebuilding process. And that will only enhance the future experience as a traveler comes to the island.

David Katz

Analyst, Jefferies LLC

That's really helpful. Appreciate it. Thank you very much.

Operator: Our next question comes from Chris Darling with Green Street. Please go ahead.

Christopher Lee Darling

Analyst, Green Street Advisors LLC

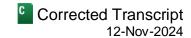
Yeah, thanks. Good morning. Bryan, as you think about capital allocation priorities for next year, do you think you'll be a net acquirer or a net seller? And then, to the extent you look at either new acquisitions or perhaps the next renovation project within your existing portfolio, what's your appetite these days to step out on the risk curve similar to what you did with the Andaz?

Bryan Albert Giglia

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

From an overall standpoint, I think our capital allocation strategy doesn't change, right. And I think we continue to employ a balanced approach where we've looked throughout our portfolio for opportunities to invest in, we've looked throughout our portfolio for opportunities to harvest. And once we have those, then we look for opportunities to either redeploy capital through acquisition or through share repurchase. And in our space, I think we've all become very accustomed to, is this is a very fluid process. And so, when we look at the different components, if you look at the renovation, our view is that we're doing – if we're investing in the portfolio, it should be kind of somewhere in the teens returns.

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If we're looking at an acquisition that's south of that, probably kind of a 10%, an 11% return is what we would be looking at on an acquisition. And then, repurchasing our shares is going to vary based on the price that we're trading at. And so, when we look for future deployment and allocation, it really just is us seeing what the landscape looks like, and then allocating based on that spectrum where we think the best returns are. And up to this point, I think we've been pretty balanced with it. I like the point in time that we acquired San Antonio for the price we did and the yield that it's providing. I like the investment opportunities that we made in DC that's producing meaningful EBITDA lift, and we changed the earnings power of that asset.

When you look at the – you look at it, its index that it's doing, and its RevPAR index is in the 130s now and it used to be 105 as a Renaissance. Okay. So, that's just not being able to be a Westin now and charge a higher rate, that's taking share from the market because you have a better product and a better distribution and a better brand on it now. And so, those are opportunities that we'll continue to look at to do. But we have to be mindful of the overall impact to the portfolio and the size of the portfolio as we allocate into those. But hopefully, we'll always have something like that in the portfolio to mine value. And if we don't, then it's time to recycle the asset and find one of the other sources to deploy.

Analyst, Green Street Advisors LLC

Appreciate the thoughts. Thank you.

Operator: Our next question comes from the line of Stephen Grambling with Morgan Stanley. Please go ahead.

Stephen W. Grambling

Analyst, Morgan Stanley & Co. LLC

Hey, thanks. Moving down the P&L a little bit. I may have missed this, but where do you think wage inflation, before considering any cost containment measures, is running next year. And are there any differences by market? And perhaps as a somewhat related follow up, but are there any policies being proposed by the new administration that could impact the business either as it as we think about wages or otherwise?

Bryan Albert Giglia

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

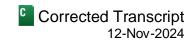
Good morning, Stephen. I think, for a while now, we've been saying our view on wages is kind of 4% to 6%. And I think that maybe over the last year, we started to move a little bit down that spectrum, but still well within that spectrum. My expectation is that it remains in that range for the near term at least. As far as, as policies and other changes, I think it's probably a little too early to know what sort of impact that might be. And so, we'll have to wait and see. But based on our Hilton which just finished with their employees at Hilton San Diego, and there are many other union contracts that are being in the process of being negotiated or being wrapped up. I think where we ended up is one well within that range that we're talking about. And so, I wouldn't expect anything to push higher over the near term.

Stephen W. Grambling

Analyst, Morgan Stanley & Co. LLC

And I guess, the follow up on the election, administration, anything that you've got your eye on there?

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Bryan Albert Giglia

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

No, I mean, we'll obviously be watching. There's a lot of difference from – ranging from SEC items to labor items, but we're going to have to actually see what happens before we can start to speculate or think about any changes.

Stephen W. Grambling

Analyst, Morgan Stanley & Co. LLC

Got it. Thanks so much. I'll jump back in gueue.

Operator: Great. Our next question comes from Chris Woronka with Deutsche Bank. Please go ahead.

Chris Woronka

Analyst, Deutsche Bank Securities, Inc.

Hey. Good morning, guys. Thanks for taking the questions. I guess, on Four Seasons, if we – it's good to see progress in the quarter and I know you said more is on the way and I understand the differences in buyouts and groups and everything like that. But if you look at the margin structure of the properties, it's very small, it's 85 rooms, it's much smaller than your average Four Seasons. Is there – do you guys feel like the brand – you've maxed out what the brand can do or is willing to do in terms of whether it's staffing or services that are offered or just kind of the unique nature of that property. Is there anything that can improve the structural margins or do you just have to get occ and rate and TRevPAR at a certain level?

Bryan Albert Giglia

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

Good morning, Chris. Yeah, it's a little bit of all of the above. But we definitely need more occupancy. I think the rate is strong enough. The rate will move, but I think we're happy with where the rate is and we've actually – we're happy that they've rationalized the rate at certain time periods to make sure that they get the occupancy in there to get the total spend in there. On the cost side, if you recall, we – last year, we went through a process with Montage and they made great strides, and you're seeing the impact of that on the P&L now. And that was that was phase one.

And then, we went over to our manager at Four Seasons and brought a lot of the same thoughts and other – some other changes, and had them go back and look at the cost structure and that was just recently implemented where they really work with us. And while there are certain components that have to remain to make sure that it is a luxury experience, there are other things that the guest doesn't really ever see or notice or value, and those are the things that we want to make sure that we maximize, and that the manager is doing things as efficiently as possible.

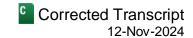
So, a lot of that went in and you should expect to start seeing that in the quarters moving forward. It was a little hard to see it in Q3, especially when you have the efficiency of a buyout, and that come out one quarter and not in the other. But going forward, those steps have already been taken and they've been implemented and they're in process now.

Chris Woronka

Analyst, Deutsche Bank Securities, Inc.

Okay. Very helpful. Thanks. Thanks, Bryan.

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Operator: Our final question for today comes from Floris van Dijkum with Compass Point. Please go ahead.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

Hey, thanks for taking my question. So, one of the things that you indicated that sort of caught my attention as well, Bryan, the ancillary revenue opportunity, I think you were referring to the San Antonio Riverwalk hotel. But how much of an opportunity is this in your portfolio, in particular, the billboards, potential retail? What do you have today in terms of ancillary revenues, and where do you think this could – you could drive this going forward?

Bryan Albert Giglia

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

Yeah. I think we've had experience with all of this in the past, and billboards is probably the most difficult in our portfolio just because of building type or certain regulations. And so, I don't know if there's really billboards. If there was a billboard opportunity, we would have taken advantage of it now because we know how lucrative that can be.

San Antonio is unique in the portfolio just because of the amount of retail. And again, for us, it's a lot. It's a – we have it – and for those that have been to the hotel, the lobby is on the second floor, which is street level. And then the bottom level, which is the Riverwalk level, there's a walk through that has some retail on each side. And then, at the end of that is the entrance to the, well, what is being redeveloped right now, but will be the entrance to the Alamo Center. And then, next to that is our parking structure that also has some ground floor retail. So, while it's an opportunity here, we're probably talking in the incremental hundreds of thousands of dollars of pickup, which for the hotel is meaningful and a good value creation.

Throughout the rest of our portfolio, I think we have mined this pretty well, but I wouldn't say that there are — there's nothing to this scale in the existing portfolio incremental. Now, it doesn't mean that there's not some development opportunities throughout our portfolio where we have excess land, which could be a combination of retail, lodging, and other. So, those are still things that we are mining throughout the portfolio. We built a ballroom in Orlando several years ago. There's the addition for the ability to put in additional keys in certain assets. So, that's stuff we're still working on. And when we have when we have updates on that, we'll — we will share it to with our investors.

Floris van Dijkum

Analyst, Compass Point Research & Trading LLC

Thanks.

Operator: All right. I will now turn the call back over to Bryan Giglia, Chief Executive Officer, for closing remarks.

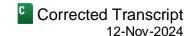
Bryan Albert Giglia

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

Thank you, everyone, for your interest. We look forward to meeting with many of you at the upcoming conferences. Thank you.

Operator: Thank you, everyone. That concludes today's call. You may now disconnect.

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