



## Final Transcript

### **RED LION: XBRL Red Lion Hotels 2nd Quarter 2011 Earnings Call**

August 4, 2011/2:00 p.m. PDT

#### **SPEAKERS**

Pam Scott – Director, Corporate Communications  
Jon Eliassen – President and CEO  
Dan Jackson – CFO

#### **ANALYSTS**

Smedes Rose – KBW  
David Loeb – Robert W. Baird  
Will Marks – JMP Securities

#### **PRESENTATION**

Moderator                      Ladies and gentlemen, thank you for standing by, and welcome to the Red Lion Hotels Second Quarter 2011 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. As a reminder, today's teleconference is being recorded. At this time, we will turn the conference call over to your host, Director of Corporate Communications, Ms. Pam Scott. Please go ahead.

P. Scott

Thank you, Tony. Hello, and welcome to Red Lion Hotels Corporation's Second Quarter 2011 Earnings Conference Call. With us today are Red Lion Hotels President and Chief Executive Officer, John Eliason, and Chief Financial Officer, Dan Jackson. Chief Operating Officer George Schweitzer will also be available to answer questions.

Before we get started, I want to remind you that our remarks today contain forward-looking information, as defined by the SEC, that is subject to a number of risk factors that may cause our actual results to differ materially from those expressed or implied. These risk factors are discussed in detail in our annual report filed with the SEC on form 10-K on March 16, 2011. Both reports are available at our Website [www.redlion.com](http://www.redlion.com), or through the SEC Website at [www.sec.gov](http://www.sec.gov). We will also be referring to a number of non-GAAP measures, the reconciliation of these measures to their comparable GAAP measures provided in the tables to the press release issued this afternoon. That release is also available in the Investor Relations section of our Website. I would like now to turn the call over to Mr. Eliassen.

J. Eliassen

Thank you, Pam, and welcome to our second quarter earnings call. I will provide a quick update on our corporate initiatives, recap results for the

period, and provide some perspective on the markets in which we operate. After that, Dan Jackson, our CFO, will give a more detailed review of our financial results. Then, we'll open up the call for Q&A.

In June, we closed the \$71 million sale of our Seattle, Fifth Avenue hotel to an affiliate of Lowe Enterprises. The sale price equates to \$239,000 per key. The completion of this transaction is an important first step for Red Lion, both in terms of unlocking significant real estate value and in beginning to restructure our balance sheet. The property will continue to be operated as a Red Lion franchise, managed by Destination Hotels & Resorts, which allows us to retain our brand presence in the downtown Seattle market. The buyers have planned a multi-year capital improvement process focusing on common areas and on both existing and expanded meeting space. The improvements will make the property better suited for group and higher-rated business—a move that is advantageous for all Red Lion hotels.

As we previously communicated, a portion of the sale proceeds was used to retire \$28 million of debt on our credit facility that was secured by that property. As reported in our 8-K filed on June 16<sup>th</sup>, the impact of the sale of Fifth Avenue, based on our 2010 results, would've been a net \$4.4 million reduction in EBITDA in that year. To offset this cash flow

reduction, a majority of the remaining proceeds are available to be used for a combination of retirement of lease obligations, reduction in debt, and for investments intended to improve our hotel guest experience and increase revenue.

Also it should be noted, the Red Lion Colonial Hotel in Helena, Montana, remains classified as an asset held for sale. The property is listed with CB Richard Ellis, the real estate firm that successfully marketed our hotel in Seattle. We are continuing the process to sell that property and hope to retain it as a franchised Red Lion.

As for our Denver Southeast Hotel, our contract has expired with Hospitality Real Estate Counselors. Due to market conditions there, we have not renewed the contract to sell the Denver property at this time. As we have previously communicated, we are evaluating opportunities to monetize selected assets that are not efficiently financed or are no longer a fit for Red Lion Hotels. This will unlock real estate value, making it possible to refinance and reposition our other owned hotels and to also pay down debt. These actions will further strengthen our balance sheet, the Red Lion brand, and our appeal and value to guests, employees,

franchisees, and our investors. We will continue to keep you updated as we progress on these initiatives.

Now, let's turn to performance during the second quarter. Results will be discussed on a comparable basis, which excludes the performance of the Red Lion Hotel on Fifth Avenue in Seattle for all the periods presented. Occupancy for our comparable owned and leased hotels increased 290 basis points year over year, while ADR was up 1.2%. Combined, these drove a 6.3% increase in rev par for the quarter. We saw some return in group business, which was better than we had expected.

We continued to generate strong transient results as well, driven by non-qualified retail and online travel agent demand. We used our business intelligence systems to selectively manage our preferred corporate rate offerings. As a result, we shifted some of the demand to a higher-rated, non-qualified retail segment. Moreover, we selectively offered discounted business through online travel agencies to fill lower occupancy periods. In effect, our investment in people and technology paid off, as we were able to counter an expected drop in government retail and government group business.

We are pleased that our hotel revenue performance compared favorably against the total U.S. mid-scale hotel segment. According to Smith Travel Research, mid-scale was the only segment to encounter a loss in ADR, experiencing a decline nationwide of one percent, while Red Lion saw an increase of 1.2% in ADR in our markets. Our owned and leased hotels continue to show improvement in occupancy, rev par, and ADR. In the majority of our markets, our hotels—as measured by rev par index—continue to exceed that of our competition.

Turning to franchise operation, in addition to the franchise agreement on the Seattle Fifth Avenue Hotel, during the second quarter we announced the opening of a new Red Lion franchise in Rancho Cordoba, near Sacramento, California. This property has been significantly upgraded and builds upon our presence in California. We are continuing our efforts to add hotels to the system through franchising, despite the very competitive nature of the franchise process.

As we look at our West Coast markets, many continue to suffer from more than ten percent unemployment and from rising consumer prices, two factors that can significantly impact the hospitality industry. In addition, energy and utility expenses are on the rise. While we cannot control these

variables, we are actively looking to drive revenues and further reduce our debt and other obligations, which will position us to take advantage of any upturn in our markets. And with that, I will turn the call over now to Dan Jackson.

D. Jackson

Thanks, John. I will walk through our second quarter results in more detail, and then provide you with an update on liquidity and guidance. Before I begin, I would like to note that any discussion of hotel operating results will be based on comparable hotels, which exclude the hotel operations of the Seattle Fifth Avenue property.

Hotel segment revenue of \$36.1 million increased \$1.3 million or 3.8% year over year. This was driven by an increase in rooms revenue due to improved rev par performance of 6.3% during the quarter. ADR increased 1.2% to \$82.20, accompanied by an occupancy increase of 290 basis points. We were encouraged by our solid performance in rooms revenue, which increased \$1.6 million in the second quarter. As John mentioned, we were able to grow revenue in our highest-rated transient segment, non-qualified retail, by 34% due to expanded oversight by our revenue management teams using our sensible pricing strategy. We also drove occupancy through selective use of online travel agencies. We saw a

slight pickup in group business, which increase 1.4% over prior year.

Food and beverage revenue declined 2.8% or \$250,000 due to a decrease in banquet business.

Turning to hotel segment expenses, we saw increases in labor, rooms promotions, utilities, repairs and maintenance, and food costs, which contributed to an overall increase of approximately 7% or \$1.9 million year over year. Labor costs were driven, in part, by a company-wide wage increase that was made effective at the beginning of the quarter. The increase follows two and a half years in which employee pay was frozen. We recognized the need to acknowledge our team's contributions and to provide market-rate wages needed to retain and attract valued employees. Rooms promotions expense grew 24% as we increased our efforts to drive transient business through new package offerings and increased online advertising. In addition, our utility costs increased 8% year over year due to inclement weather and utility rate increases.

Another driver of the growth in hotel segment expense was increased property maintenance cost, as we continue our efforts to improve our guests' experience at our hotels. Food costs, as a percentage of revenue, increased 200 basis points. In order to address the rise in food costs, we

are working to make our menu pricing and offerings more responsive to commodity price fluctuations. We also plan to add locally-sourced foods and wines to reengage our guests in the Red Lion dining experience. The resulting impact on hotel-direct operating margin was a decline to 22.2% from 24.6% in the prior year period. We will, as a result, be taking a number of actions to address the decline in operating margin and improve profitability going forward.

Turning to our other segments, franchise revenue grew 6% to \$945,000. Profitability in the segment was, however, negatively impacted by an increase in net lease expense of approximately \$300,000, related to our sub-leased and franchised Sacramento property. Entertainment revenue increased 98.3% to \$4.6 million, driven by a successful 11-day run of *Wicked*, in the Best of Broadway series. This drove a \$600,000 increase in profitability for West Coast entertainment, which was partially offset by lower sales in ticketing. The entertainment division contributed \$500,000 of profit to our overall performance in the quarter, an increase of \$150,000. On a comparable basis, EBITDA from continuing operations before special items was \$4.6 million for the quarter, compared to \$6.1 million in the prior year period.

In terms of capital spending, second quarter expenditures totaled \$2.7 million. We expect to invest approximately \$11 million to \$13 million in capital improvements over the course of the year. We are continuing with our guest room renovation program, which includes upgrades to flat-screen TVs and new bedding packages.

Now for an update on our liquidity, as of June 30<sup>th</sup> we had approximately \$51.5 million in cash and cash equivalents. At the end of the quarter, we had outstanding debt of \$106.3 million, which includes \$30.8 million of trust-preferred debentures. We are negotiating a new debt agreement secured by several of our properties, a portion of which will be used to pay off the \$24.6 million that is classified as current.

I would like to conclude with our outlook. We remain cautiously optimistic that revenue in the second half of the year will continue to improve over the prior year, so we are reaffirming the 2011 rev par guidance that we previously provided on our first quarter call. We project that our full-year rev par growth on a comparable basis for owned and leased hotels will increase 3% to 5%. We appreciate your interest in Red Lion, and with that we are ready to take questions. Operator?

Moderator Thank you, sir. And our first question in queue will come from the line of Smedes Rose with KBW. Please go ahead.

S. Rose Hi, thanks. I just wanted to ask you a couple of things on the Seattle property—so it closed for \$71 million of gross proceeds, can you just walk through what the taxes were on that, what the net proceeds to you were before paying down the credit line?

J. Eliassen Yes, Smedes. Let's see, I don't know if I have—the gross tax on the gain on the sale is about \$14 million. However, we are going to be paying much less than that currently because we did have loss carry-forward, so it could be applied against that. What I don't have in front of me right now is the net selling costs, which I think is probably part of the answer you want as well, correct?

S. Rose Well, yes. I guess I was just trying to think about just net proceeds of the 71. How much did you keep?

J. Eliassen Roughly—in round numbers—\$3 million of closing expense, so \$68 million net to the company. And so far, as I say, we have loss carry-

forward, so we've not had to make any federal income tax payments on the gain.

S. Rose                      Okay. And then the rooms at that property will shift into the franchise room count for the third quarter?

J. Eliassen                Yes, they will. It continues to be classed as an operating hotel, but now in the franchise group rather than the owned group. That transition took place on the 15<sup>th</sup> of June.

S. Rose                      Okay. And just any update on the ability to add properties to the franchising system over the next couple of quarters beyond the one that you just announced?

J. Eliassen                Yes. We continue to pursue franchising—in a very targeted way though, Smedes. We're very much interested in adding franchised hotels in probably a dozen or so larger markets, markets where we currently do not have owned property—and again, in the western 11 states. And we continue to have some very good conversations with hotel owners, either independents who we have not dealt with before, or independents who are in our system today. So we do have some positive discussions going

forward. We just don't have anything that we're able to announce at this point in time.

S. Rose                      Okay. Thank you.

Moderator                    Thank you very much. Our next question in queue, that will come from the line of Will Marks with JMP Securities. Please go ahead.

W. Marks                      Thank you and good afternoon, everyone. I just wanted to ask about what your strategy going forward in terms of owned properties. You mentioned a little bit about Denver, as well as the other—probably the Montana property you're selling. Are you considering any other asset sales at this point?

J. Eliassen                    Yes, it well depend. There are a few older properties that over the next one to two years, depending on whether they're owned today or whether they're leased properties that we could take control of, that we might look for either redevelopment with a third party or to exit that particular property. So there are a couple of others that we will certainly be looking at along with Helena. And we will again reassess Denver, even though

we're seeing a resurgence in that market, we believe that that's still a property that ultimately will be sold.

W. Marks                    Okay, thank you. And then in terms of the rev par guidance, can you help us out in terms of by quarter, and maybe if you care to reflect on July?

J. Eliassen                Well—and I'll let Dan answer this as well—but our problem, even internally, is quarter by quarter by not knowing exactly when a property is going to close, and not knowing which ones will get sold, and exactly where we're going with them, either on new franchises or on the sale of properties, it's very difficult to be very definitive on a quarterly basis. We're still comfortable with our annual outlook of the 3% to 5% that Dan mentioned, however.

D. Jackson                And we did finish July in that 3% to 5% range.

W. Marks                    Alright. That's all from me. Thank you.

Moderator                Thank you. And our next question in queue will come from David Loeb with Baird. Please go ahead.

D. Loeb

I came in a little bit late, so my apologies, and I do appreciate the brevity of your prepared remarks. It's been a long day. To follow up on Will's question, how asset-light are you thinking? Clearly, the concept of selling Fifth Avenue, it seemed like a little bit of an experiment to test asset values. Are you willing to shed a lot more owned assets as you look at the market and the appetite for hotel real estate?

J. Eliassen

David, I think we are willing to shed a few more. Obviously, Seattle was an ideal solution for us because we retain the flag through a franchise. We're very hopeful that when we complete the transaction in Helena, that too can remain as a Red Lion franchise. And while we've not specifically—when we had Denver listed, we didn't specifically list it that way. We would be interested, if we do sell other properties, to retain them.

For example, we've talked in the past about our commercial property in Kalispell. And at some point in time, depending on market conditions, that's a property that we would sell as well. That would probably end up then being a leased property for us. So we would either operate it as a leased property or as a franchise. There will be a net reduction in owned

properties, but we're not trying to exit ownership entirely. We'll still own hotels.

D. Loeb                      Okay. That's actually a very good answer. And what are you looking at in terms of the line of credit? What would you like a new line of credit to look like?

J. Eliassen                 Well first of all, we're going to maintain maximum flexibility going forward. We're going to be replacing the CMVS debt. We're in discussion with our banks about that right now. So that's \$22 million that would be replaced. And then other debt could be restructured as well, depending on timing and the interest of the banks. Having a line of credit of \$10 million to \$12 million would be ideal. That's been about our annual cap ex spend on a normal basis. And having the flexibility going into the beginning of the year, to draw against that kind of a line and do cap ex early in the year would be an ideal solution for us.

D. Loeb                      So that's really all you need is really enough for seasonal working capital to fund cap ex?

J. Eliassen                 Correct. Correct.

D. Loeb                      And would that likely be secured by a small pool of assets?

J. Eliassen                 It could be. We're not far enough along to know exactly how that would be, but I would expect that it would be secured by a pool.

D. Loeb                      Okay, great. That's all I had. Thank you.

Moderator                 Thank you, and at this time, we have no additional questions in queue, please continue.

J. Eliassen                 Okay. If there are no further questions, operator, I just want to thank all of you for—it has been an interesting day, to say the least, in the market. We've been monitoring that, and I do appreciate all of you taking the time to join us today for the call. And we look forward to talking to you again either next quarter or in between if you do have any questions in the interim. Thank you.

Moderator                 Thank you. Ladies and gentlemen, this conference will be available for replay after 4:00 Pacific time today through September 4, 2011, at midnight. You may access the AT&T TeleConference replay system at

any time by dialing (800) 475-6701 and entering the access code of 210796. International participants may dial (320) 365-3844. That does conclude your conference call for today. We do thank you for your participation and for using AT&T Executive TeleConference.