



Final Transcript

RED LION: 2011 Q1 Earnings Release

May 5, 2011/2:00 p.m. PDT

SPEAKERS

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

ANALYSTS

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

PRESENTATION

Moderator Welcome to the 2011 Q1 Earnings Release. At this time, all participants are in a listen-only mode. Later, there will be an opportunity for questions. As a reminder, this conference is being recorded. I'd now like to turn the conference over to your host, Ms. Pam Scott, Director of Corporate Communications.

P. Scott Hello. Welcome to Red Lion Hotel Corporation's First Quarter 2011 Earnings Conference Call. With us today are Red Lion Hotel's President and Chief Executive Officer, John Eliassen, 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, or through the SEC Website at www.sec.gov.

We will also be referring to a number of non-GAAP measures. The reconciliation of these measures to their comparable GAAP measure is provided in the table to the press release issued this afternoon. That release is also available on the investor relations section of our Website.

I would like to now turn the call over to Mr. Eliassen.

J. Eliassen

Thanks, Pam. Welcome to our first quarter earnings call. I'll provide a quick update on our previously announced asset sales and then I'll give you a recap of our first quarter results. I'll give some perspective on our markets, including an update on our outlook for 2011. After that, Dan Jackson, our CFO, will provide a more detailed review of our financial results. At that point we'll open the call up for Q&A after Dan finishes.

As you saw in our press release, we shared some good news on our asset sales initiatives. Following a short marketing period that began in mid-January, we just entered into an agreement to sell our Seattle Fifth Avenue property for \$71 million, which we believe is a very attractive price in light of market conditions. The new owner is an affiliate of Lowe Enterprises, a leading national real estate investment, development and management firm.

The buyer is also entering into a franchise agreement with Red Lion Hotels franchising. The agreement allows Seattle Fifth Avenue to continue to operate as a Red Lion hotel managed by Lowe's hospitality management subsidiary, Destination Hotels and Resorts. Both Lowe and DHR are highly regarded players in the lodging industry. We believe this demonstrates the strength of our brand in the Pacific Northwest region. Upon closing this transaction and consistent with our objectives, we will have successfully monetized a valuable asset in an important step to restructure our balance sheet. At the same time, we are maintaining our Red Lion brand presence in downtown Seattle. In addition, Red Lion and a subsidiary of Destination Hotels and Resorts will enter into a five-year affiliation agreement under which we will work together to cross-promote hotels.

We are moving through the sales process according to our original timeline. We anticipate closing late in the second quarter. We will use the proceeds from the sale to retire the credit facility secured by the Seattle Fifth Avenue property. As of March 31st, that facility had a balance of \$25 million outstanding. The remaining proceeds will be used to pay down additional debt or other securities or to reinvest in our hotels and brand.

As an update on our other properties listed for sale, we are evaluating offers on our Denver Southeast hotel while we are continuing to market the property. Additionally, in March we listed our Red Lion property in Helena, Montana for sale. With the debt on the Helena hotel coming due in October we have another opportunity to redeploy that equity. We believe prospective buyers will be interested in maintaining the Red Lion brand with management or franchise agreements.

Completing these sales will provide us with the financial flexibility to further restructure our balance sheet, including reducing debt. We will also be in a much better position to enhance our brand and refinance and reposition our other owned hotels in the coming months. This will strengthen Red Lion by increasing the brands appeal and value to both guests and franchisees.

Now turning to our first quarter results, as we had anticipated and we communicated in our last call, group demand softened in a number of our markets during the first quarter, resulting in a 16% decline in group occupancy year-over-year. This was primarily attributable to weakness compared to the prior year in citywide calendars in our convention market in Spokane coupled with reduced state and federal government travel in a number of our markets, including Denver.

That said, it is important to note that our sales and marketing and our revenue management teams worked very hard to proactively identify opportunities in the transient segment to counter this group decline, and they were very successful in these efforts. Our teams leveraged our business intelligence systems to forecast blocks of available room inventory. With that, we were able to partially fill the group void with increased transient business through the strategic use of our direct online marketing channels, e-mail, and other initiatives, including some online travel agencies.

As a result, occupancy in this segment was up 11%. This enabled us to maintain our RevPAR and rooms revenue of \$21.3 million year-over-year. Overall, ADR and occupancy were steady compared to the prior year. In addition, Red Lion distribution channels in the first quarter achieved a 12% increase in revenue contribution, largely driven by e-commerce.

I am very pleased with this performance, particularly given the challenge of replacing group business in the softer winter season. In fact, while ADR increased slightly during the quarter, in the first quarter Smith Travel Research data showed a decline of 30 basis points in ADR for total U.S. mid-scale segment.

Luxury and upscale continued to lead the way in terms of rate growth, so we are cautiously optimistic that pricing power is returning to the industry. We believe rate competition from these luxury and upscale hotels should begin to have less impact in our markets as we move through the second half of 2011.

We continue to focus on the strategy of growing the Red Lion brand through franchising. The previously announced Red Lion Inn Rancho Cordova near Sacramento is scheduled to open within the next few weeks. Unfortunately, the owner of the Red Lion Hotel Concord at Walnut Creek, that franchise unexpectedly closed the hotel this past week. While we currently have no further information on the Concord property, we are willing to consider future involvement and hope that it will be an option for us.

Turning to our outlook, we are affirming our 2011 guidance for RevPAR to increase 3% to 5% for the company's owned and leased hotels. While there may be a continued impact from the decline in group business in the second quarter, we believe these trends will reverse in the second half of the year based on the pace of group business already booked.

With that, I would now like to turn the call over to Dan Jackson to provide additional detail on our financial results.

D. Jackson

Thanks, John. I will provide more detail on our first quarter results followed by an update on our liquidity. In light of the challenging dynamics we faced in the first quarter, we are pleased with our top line performance in the hotel segment. Room revenue of \$21.3 million was in line with the prior year period as a result of a 0.2% increase in RevPAR driven primarily by a 0.3% increase in ADR during the quarter.

We saw a 6.8% decline in food and beverage revenue, primarily driven by the soft group results that John discussed and the associated decrease in banquet business. In addition to managing the modifications we have made to our offerings, we are also facing increasing food and labor costs that we were not able to offset with price increases due to competitive pressures. We are currently evaluating strategies to improve the profitability of this segment.

Hotel direct operating margin declined year-over-year to 9.9% during the first quarter and 13.2% in the prior year. This was primarily due to the decline in food and beverage revenues coupled with an increase in sales and marketing and utility costs resulting from severe winter weather in a number of our markets.

Turning to our other revenue drivers, franchise revenue was up 27% to approximately \$700,000. The primary cause of this increase was a marketing fee reduction that we offered during the first quarter of 2010 that was not repeated in the first quarter of 2011. Operating profit was negatively impacted by costs associated with the change in operators at our Sacramento franchise. Additionally, the investment in staff and travel costs to grow and support this segment had an impact on profitability.

Entertainment revenue increased about \$300,000 to \$2.8 million due to an increase in the number of shows in the quarter versus the prior year. Overall, segment profitability was negatively impacted by reduced ticketing revenue in Washington, Oregon and Colorado driven by the timing and mix of events year-over-year.

Moving down the income statement, we saw higher hotel and facility and land lease expense when comparing this quarter to the same quarter last year. Lower sublease income from the Sacramento franchise subtenant impacted the first quarter and will continue throughout 2011. First quarter net loss from continuing operations was \$4.8 million, or \$0.25 per share. This compares to \$4.2 million, or \$0.23 per share reported last year. In terms of capital spending, first quarter expenditures totaled \$0.4 million. We expect to invest approximately \$11 million in capital improvements over the course of the year.

Now turning to our balance sheet, you will note that we have presented the assets of the sale of Fifth Avenue and Helena, Montana properties as assets held for sale given their current status. The Denver Southeast

property did not meet all criteria for this classification, so it continues to be presented as a non-current asset in the property and equipment line. At March 31st we had approximately \$5.6 million in cash and cash equivalents and total debt outstanding was \$132.1 million, \$50 million of which is classified as current.

On March 25th, Key Bank acquired all of the interest of the other lenders under our \$30 million credit facility. Simultaneously, our covenants were amended. Our total leverage ratio threshold is now set at 6.5 times and our senior leverage ratio covenant is set at five times, levels that we are very comfortable with.

We have undertaken a number of initiatives to repay or refinance this facility as well as our other maturing debt obligations. As John mentioned, closing the sale of our Seattle Fifth Avenue property will be a significant first step in the recapitalization of our balance sheet as we'll use a portion of the proceeds to retire a credit facility. We also remain actively engaged in discussions with prospective lenders and other financing sources to evaluate alternative debt strategies. In the meantime, we have adequate financial resources to fund our ongoing operating activities.

Now let me conclude with our outlook. While macro economic indicators have been mixed with unemployment hovering around 9%, gas prices pushing \$4 per gallon, we continue to remain cautious on the economy. In addition to the potential negative impact on discretionary spending from increasing gas prices, many of our markets are drive-to destinations, which might see an impact. We will be monitoring the effect of gas prices closely this summer travel season. Group contracts and advanced bookings for the second half of the year, however, continue to look strong. We are therefore reaffirming our RevPAR growth projection of 3% to 5% for 2011.

We thank you for your interest in Red Lion. With that, we will now open up the call for questions.

Moderator

Your first question comes from the line of Smedes Rose of KBW.

S. Rose

I was just wondering if you could provide some additional metrics around the sale of your Seattle property, specifically what kind of trailing EBTIDA that property has or what it was forecast for this year. Maybe

you could give us the depreciation associated with it in terms of figuring out what your earnings are going to look like going forward.

- D. Jackson We have not elected to provide hotel-specific EBITDA in the past. On the Seattle Fifth Avenue property, we'll not be able to provide you that information at this time. However, pro forma financial information will be included in the 8-K when the sale closes.
- S. Rose When do you expect it to close?
- J. Eliassen We are targeting the end of May and certainly plan to have it closed by the end of the second quarter. Hopefully it will be the May date. Again, as Dan said, we're still working through a number of the things that will impact the total proceeds as well as the outlook going forward, including the timing of the close. There will be a taxable gain on this sale. Of course, there's all the expense of the sale itself. A number of these things are going to be dependent on the timing of the actual close before we know what they are.
- S. Rose On the franchise agreement, I might have misheard this, but is there a specific length of time that Lowe has agreed to carry the Red Lion franchise or is there a termination agreement or termination out for them at some point in the next couple of years? What is that agreement?
- J. Eliassen The franchise agreements normally run 10 to 20 years, but as you know, they all have economic outs. So with any franchise there is an economic out at various points in time during the agreement. This agreement basically follows the same pattern as our other franchise agreements.
- Moderator The next question comes from the line of David Loeb of Robert W. Baird.
- D. Loeb Just to go a little deeper, Dan, clearly, with the assets held for sale at a much, much lower number than what this one asset is going to be sold for, and they're listed as \$45 million, there will be a substantial gain. Do you expect that you'll have tax on all of that gain or are there some things that may reduce your tax liability? Can you give us an order of magnitude of what you think the net proceeds might be?
- D. Jackson Well, we do have some tax loss carry forwards that will be applied towards the sale of this property. At this time, we really aren't in a position to quantify. I know what you're looking for, but we're not in a position to quantify that yet until we're further down the road here.

- D. Loeb The tax loss carry forwards, you think that that will be enough for all of the tax or just a portion of it?
- D. Jackson It'll be a portion.
- Moderator The next question is from the line of Will Marks of JMP Securities.
- W. Marks In still talking about Seattle, you mentioned the out that they have based on economic circumstances. Are you guaranteed to have the flag flying for a year or is it not even that? I'm wondering.
- J. Eliassen With any of these things, as I say, there are always outs, but we would expect that it's going to be a period of years before the Red Lion flag could go away or would go away. We expect to have a long-term relationship with Lowe and with Destination Hotels and Resorts. Part of the reason is not only because of the sale and the franchise agreement – we think that's pretty positive, to keep our flag in Seattle – but we also have a separate affiliation agreement, which allows us to develop with them over time some cross-marketing of certain properties. Which we think is also indicative of the beginning of what could be a very good long-term relationship for us with them and vice versa.
- W. Marks On the other two assets for sale, if the asset are sold in the second quarter – just for modeling purposes – when will the EBITDA or the income from those assets be in discontinued operations?
- D. Jackson At this point we're not anticipating a sale to be completed in the second quarter for the other two properties. Our intent is to keep the flag on those hotels. If we are successful at that, they will not be put into discontinued operations.
- W. Marks That makes sense. On the RevPAR guidance, can you give us some indication of by quarter what we're looking at?
- D. Jackson We have stated that we expect to have a stronger second half of the year. We are seeing improvement in the second quarter. We still see most of the strength happening in the third and fourth quarters.
- W. Marks You would expect second quarter to be something positive?
- D. Jackson Yes, we would expect it to be more positive than the first quarter.

- W. Marks I have other questions, actually. Just update on the franchise. You talked a little bit about it. I see that the Concord Hotel has been shut down and I guess the text of the press release says it'll ... anything else of that nature, but are you working on some new agreements for the remainder of the year?
- J. Eliassen We continue to have dialog with a number of individual hotel operators of select properties but also operators of multiple properties. We're having, I would say, good conversations. It's just that we're not perhaps closing these as fast as we thought we might originally. We still would expect, though, to be able to add 30 franchises over the next three years or so. It's just been a much slower process than we would have liked, but we do have some very positive conversations with owners and/or operators of properties going forward.
- I will say, too, that on the Concord property, it's still really unclear as to what will happen with that. We are very interested in that market and we're interested in remaining the Red Lion flag in that market, so we are hopeful, depending on the bank and whoever they choose to operate that property going forward, that we would have a chance and the opportunity to keep the Red Lion flag there as well. That's just been a little bit awkward in the near-term here for our guests as much as anything.
- W. Marks So it's in the hands of the bank now?
- J. Eliassen Correct.
- W. Marks I had one final question. On the leases, over time you've talked about potentially using proceeds of your asset sales to buy out your leases. Is there any progress along those lines?
- J. Eliassen Those are discussions that are ongoing. They've been somewhat selective, as you know, over the past year with the Astoria lease and with other properties that are leased, but those are the kinds of financial instruments that we are looking to modify and take more control of if we can. It would be in our best interest to refinance and restructure the balance sheet to eliminate some of the leases that we currently carry.
- W. Marks How many total leases do you have right now?

- J. Eliassen Well, there's a combination of properties and then also land leases. I think here we're talking basically – we have 12 leased properties – some subset or a larger subset of that 12. Not all of them fall in this category, but probably nine or ten for sure are ones that we would be looking at. That's going to be an ongoing discussion over the next few months.
- Moderator We have a question from the line of Steven Abernathy of the Abernathy Group.
- S. Abernathy I think this question might be for Dan. Dan, could you describe the change in interest expense relative to the consolidated loan portfolio now at Key Bank?
- D. Jackson Are you talking specifically about the credit facility?
- S. Abernathy Yes. Terms – lower, higher?
- D. Jackson There was no change in the interest rate with the Key Bank transaction.
- Moderator There are no further questions in queue. Back to you, Mr. Eliassen.
- J. Eliassen Well, thank you very much, operator. I thank all of you for joining us on the call today. I look forward to speaking with all of you on the next earnings call. If any of you do have questions, of course in the interim, either through Pam Scott, through Dan Jackson or myself, we're always willing to have a conversation. Thank you again for today. We look forward to talking in the future.
- Moderator Ladies and gentlemen, this conference will be made available for replay after 4:00 p.m. today until June 5, 2011 at midnight. You may access AT&T Executive Playback Service at any time by dialing 1-800-475-6701, entering the access code 201843. International participants dial 1-320-365-3844, and again that access is 201843.
- That does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconferencing Service. You may now disconnect.