Global Hospitality/Gaming/Restaurant Prospective — 2022

I. Global Perspective

The global economy had great momentum until March 2022. Now with both global macroeconomic and geopolitical challenges upon us, we are entering a time of greater uncertainty. For example, Goldman Sachs is now forecasting a 35% chance of global recession. Some are calling for six rate hikes in 2022, but maybe inflationary pressures moderate this forecast. Conversely GDP growth and infrastructure investment are predicted to be robust, so there are mixed market messages. But uncertainty for now reigns supreme!

II. Property Markets

It is hard to gauge how these headwinds will impact disposable income and, as a consequence, property demand. The general feeling is that the transaction market is definitely going to pick up. It's been a fairly artificial environment for the last few years with government support, lender support, landlord support, and even brand support. All of those supports are now going away. Owners will be inclined to sell assets. The first six months of 2022 look good; there's a question mark as to what's going to happen in the second half of the year. Nonetheless, there is still a lot of liquidity in the system.

Many in the industry are paying close attention to how technology impacts hospitality overall. Other developments worth watching include the growth of Airbnb and its emerging competitors, the renaissance of the resort business, and the change in consumer behavior and consumer demand following the pandemic, including the evolving predilections of Gen Z and the younger Millennials. The consensus is that the U.S. will retain its status as a safe haven worldwide, so we will continue to see offshore capital coming into the country.

Now that people are increasingly getting back to work, there will be a greater focus on city center/urban, in the middle of the "great return"—return to work, return to school, return to city center. It's a segment that got completely overlooked for the last two years. It's receiving more attention from investors. Even if there's a bit of physical obsolescence, alternative redevelopment strategies should prevail.

III. Optimism Ahead? Technology's Contribution

On the technology front, the greatest surprise has been monitoring average daily rate and management's ability to build and grow rate in all segments during the pandemic. Clearly there is better yield management today. That's the data and business analytics that most of the sophisticated operators are leveraging.

There is also a focus on employee and guest safety and how technology has played a role in terms of cleaning practices and techniques, but also around assaulting employees which has become increasingly problematic. So owners and operators have come together with the AHLA to create initiatives around protecting guests and employees, leveraging technology to help the overall operation, and margins, and address labor issues. The pandemic has driven a lot of this behavior.

IV. Sectors

A. Hospitality

There's $2.7 trillion of pent-up savings in the United States. And clearly that's driven a lot of leisure activity. The borders are open, but nonetheless there has been just a modest uptick in business. Operating companies are excited and hopeful about this summer. In addition, the cruise industry is "stumbling back," but still at least another year away from any sort of return to normalcy (by 2019 standards). So collectively it speaks to the optimism around 2022.

When Covid hit, the brands stopped renovations. They also cut services and quality. By all accounts, the quality scores for the brands, are the lowest of all time. Furthermore, most smaller investors don't have any capital to renovate their hotels. Hence there is a massive disruption in industry equity values.

Finally, the timeshare business is interesting. If the guests don't show up, the HOAs still get paid. Profit margins continue to go up. The free cash flow is material and given the margins and the stickiness of their clients, this means profitability growth to the owner.

B. Gaming

2021 was the best year in the history of the casino business. That's without having meeting business or international business. The demand is overwhelming at times, especially with resorts. Furthermore, the consumer did not find a substitute during the pandemic. The regional casinos all had record years as well. The normalization of gambling in America through sports betting has opened the door of a younger customer who now is frequenting casinos as well.

The belief is that the ultimate winners of the sports betting are going to be MGM and Caesars because of their multi-channel ability to attract people.

Relative to sports betting, most believe that there are ultimately going to be two or three players — DraftKings and FanDuel at a minimum. Like Netflix and Uber, it's that same business model where they just invest incredibly, but they're playing for NPV. If they stopped expanding and managed costs, they would generate $2 billion of EBITDA by 2024.

C. Resorts

The best operators/owners are investing in infill locations and elevating quality, service, and member experience: golf, particularly the country club side of golf, below the tip of the pyramid (the 1,000 clubs below the 500-600 high end equity clubs). These renovated infill clubs now generate 30%/40% returns. There's an appetite in these infill locations for luxury experiences.

The driver is the profound appetite for belonging to a familiar environment; it's safe. For all aspects of the club experience, whether it's a city club or a golf and country club, demand is just incredible. And this business really is ripe for consolidation for the first time. It's just about having access to capital.

D. Restaurants

Branded restaurants are the big winners and have consolidated market share against chef-owned restaurants. Every branded restaurant is desperate to grow units. Replacement costs are up 30% to 40% over 2018/2019 levels; it is very expensive to add units. And a number of restaurant companies have reduced their headcount during Covid, in their growth departments, like real estate. Now they're back to grow, grow, grow, but costs are higher, and they don't have the people.

Some owners have raised private equity capital to try to buy empty restaurant properties. Many have found well located empty buildings, but at the price being asked, a potential buyer can't make any money. Having said this though, adding "Red State" properties has made a big difference to portfolio performance.

The "age of the drive through" has come of its own as well. The technology of the drive-through has become incredibly important. Quick service restaurants did 65% to 75% of their business in 2021 through drive-through facilities. Conceptually, it is more profitable to close the inside of the restaurant and do all delivery or curbside.

V. Talent Implications

The hospitality industry has lost more people than most other industries, especially those industries which flourished during the pandemic (logistics, residential real estate, etc.). So, the talent pool is shrinking and the war on talent has never been more competitive. The areas of momentum in hospitality and related adjacencies include investments, technology, ESG, and customer experience. Relative to technology, robust data systems now track consumer behavior and there's definitely a convergence between technology and the customer experience. The big focus in ESG has been more along the lines of DEI, which obviously impacts all hiring, retention, and development of people. And the carbon footprint of every asset is important, as is a proactive commitment to corporate responsibility.

VI. Stay Tuned.....

For the balance of 2022, are the following factors, challenges or opportunities?

- Cost of capital/shift from public to private capital for growth
- Tenants' health
- Economic pressures (interest rates, inflation, recession, etc.)
- Migration to the "Red States"
- Scaling growth
- Geopolitical risks

Look forward to revisiting these opportunities/challenges later in 2022!