Choice Hotels International, Inc. (CHH)
1Q20 Results and Management Commentary Relatively Encouraging

- No change in Neutral outlook – portfolio and balance sheet well positioned. Choice’s 1Q20 results were a bit better than expected, and we are encouraged by management's commentary that occupancy continues to trend higher (albeit slowly) as lower-priced segments continue to lead the industry's rebound, a trend that is likely to continue in the near term given the segment's predominantly leisure-focused customer, in our opinion. Shares of CHH have outperformed peers year-to-date given the company's best-in-class leverage profile and liquidity position, which tempers our enthusiasm modestly but generally aligns with our more positive relative stance recently (link to note).
  - RevPAR growth (domestic): -15%, which matched our -15% estimate and compares to midscale and economy RevPAR of -16.8% and -11.2%, respectively, per STR;
  - Adj. EPS: $0.76 vs. Baird/Street at $0.65/$0.70;
  - Adj. EBITDA (mil): $69.2 vs. Baird/Street at $65.8/$66.6; and
  - Effective royalty rate was 4.94%, which was 6 bps better than our estimate and a main driver of the earnings beat versus our modeling.

- Performance improving relative to the late March/early April lows. Choice’s domestic system-wide RevPAR declined 60% in April; however, management noted that occupancy began trending higher through April with trends improving into early May. We expect Choice's outperformance relative to the industry to continue in the near-to-intermediate term given the company's outsized exposure to suburban, small town, and interstate locations (~90% of domestic hotels); additionally, a greater proportion of Choice’s U.S. hotels have remained open with only ~3% of properties currently closed vs. ~17% for the broader industry. Less than 20% of the company's international hotels are temporarily closed.

- Dividends and share repurchases temporarily suspended. As previously announced, Choice has suspended both its dividend payment and share repurchase activity; the April dividend was paid, and the company repurchased 0.7 million shares for $54 million (~$77/share average price) during 1Q20. Overall, we expect Choice to remain highly opportunistic post-crisis, and we believe the company's strong balance sheet and expected near-term fundamental outperformance will position it well to capitalize on value-creating opportunities that may arise. Choice has over $725 million in cash and available borrowing capacity under its revolving credit facility.

- Additional conference call details:
  - Only 10% of hotels have enrolled in the company’s tailored fee deferral program;
  - Nearly 70% of hotels have applied for or received federal loan assistance;
  - The net working capital drag should only total $10-$20 million in the near term; make-whole payments from franchisees should occur over the next few years;
  - The monthly cash burn rate is approximately $30 million in a zero-occupancy environment; management noted cash burn was closer to $20 million at the lowest occupancy levels in late March/early April, which results in over 36 months of available liquidity.

Choice is a hotel brand franchisor with 7,000+ properties worldwide operated under 13 brands primarily focused in the economy, midscale, and upper midscale chain scales.

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Please refer to Appendix - Important Disclosures and Analyst Certification
Valuation Synopsis
Our $79 price target is based on our EV/EBITDA analysis, which applies a 14.5x multiple to our 2023 EBITDA estimate discounted back at 15% per annum. The applied multiple is 1.0x above the multiple we apply to Marriott given Choice's greater franchised exposure.

Risk Synopsis
Risks include competition from other major global brand companies, the sustainability of brand equity and customer loyalty, significant ongoing investments to jumpstart Cambria's growth, and liquidity risks related to the COVID-19 demand shock.
Appendix - Important Disclosures and Analyst Certification

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Covered Companies Mentioned
All stock prices below are the 5/8/2020 closing price.

Choice Hotels International, Inc. (CHH - $73.91 - Neutral)
(See recent research reports for more information)

Rating and Price Target History for: Choice Hotels International, Inc. (CHH) as of 05-08-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of CHH.

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