CorePoint Lodging REIT Stock Analysis

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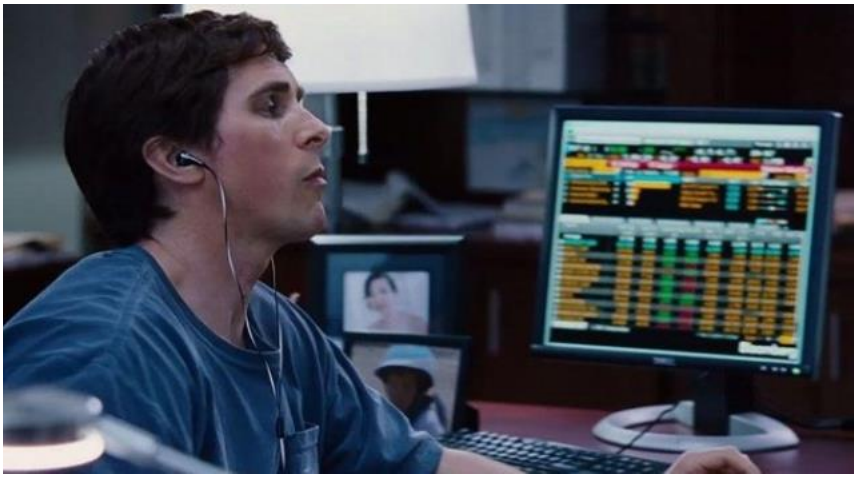
Introduction

The CorePoint Lodging REIT (CPLG) is a company that got the eye of the public when dr. Michael Burry, famous for being one of the big shorts in the movie The big short disclosed CPLG as his largest position.



CPLG is a real estate investment trust owning hotels that belong to the La Quinta brand. It is a spin-off from the La Quinta company and the stock hasn't been doing well since then.

Source: [CNN Money CPLG]()

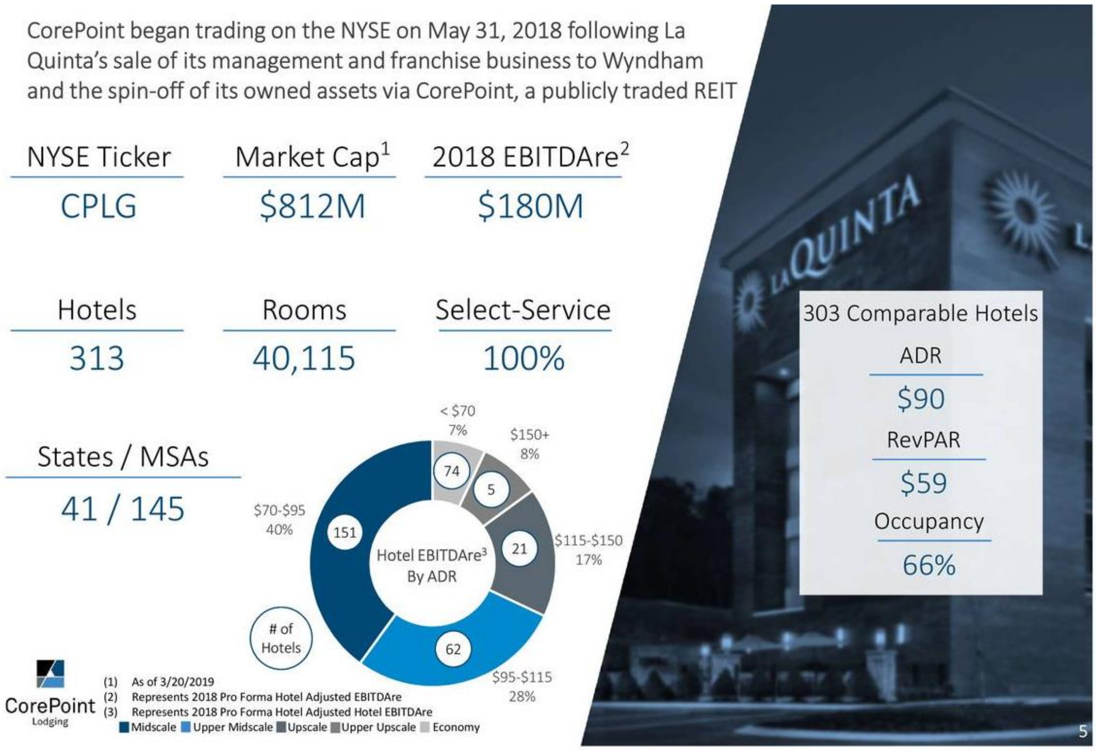
I have been reading a bit about the company because I find it interesting to dig into the reasons of why a person like Michael Burry would invest in a company like this. Since his exposure got disclosed the stock went up from the low teens to the mid teens but after the last earnings report it tumbled again.

Let's see whether there is value and a good investing opportunity or at least why would Michael own it.

CorePoint Lodging – Business analysis

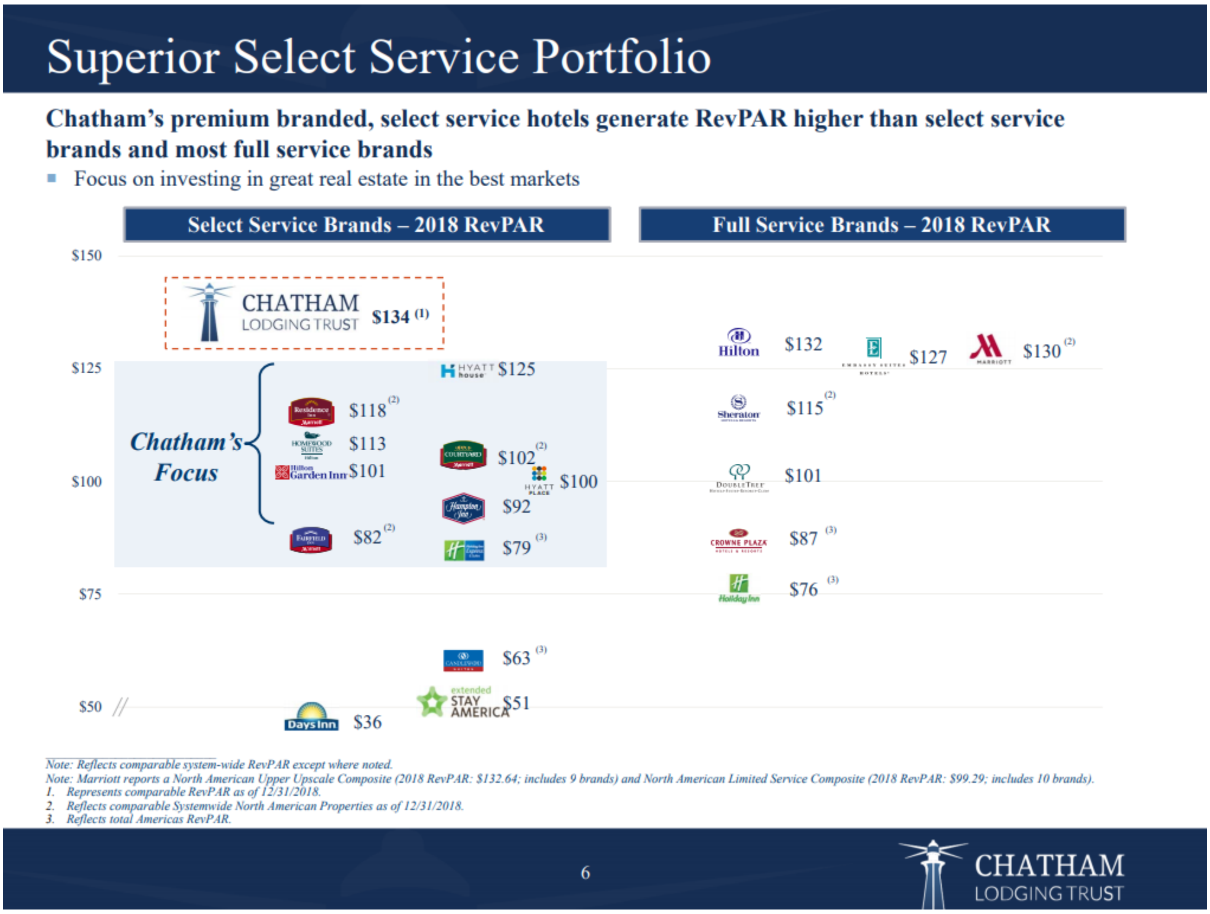
The hospitality industry is a complex one where it all goes around room values, revenue per available room (REVpar), occupancy but at the end for investors, it all boils down to cash flows, like with everything else.

CPLG has 40,115 rooms, a market capitalization of $665 million and debt of $1 billion. Therefore, the value per room should be $41,505 including the debt and market capitalization. ADR is $90 and REVpar is $59 due to the occupancy of 66%.



Source: CPLG

On the other hand, Chatham Lodging Trust (NYSE: CLDT) has a market cap of $900 million with $585 million in debt. RevPar $134, so double CPLG's but it has only 6000 rooms.

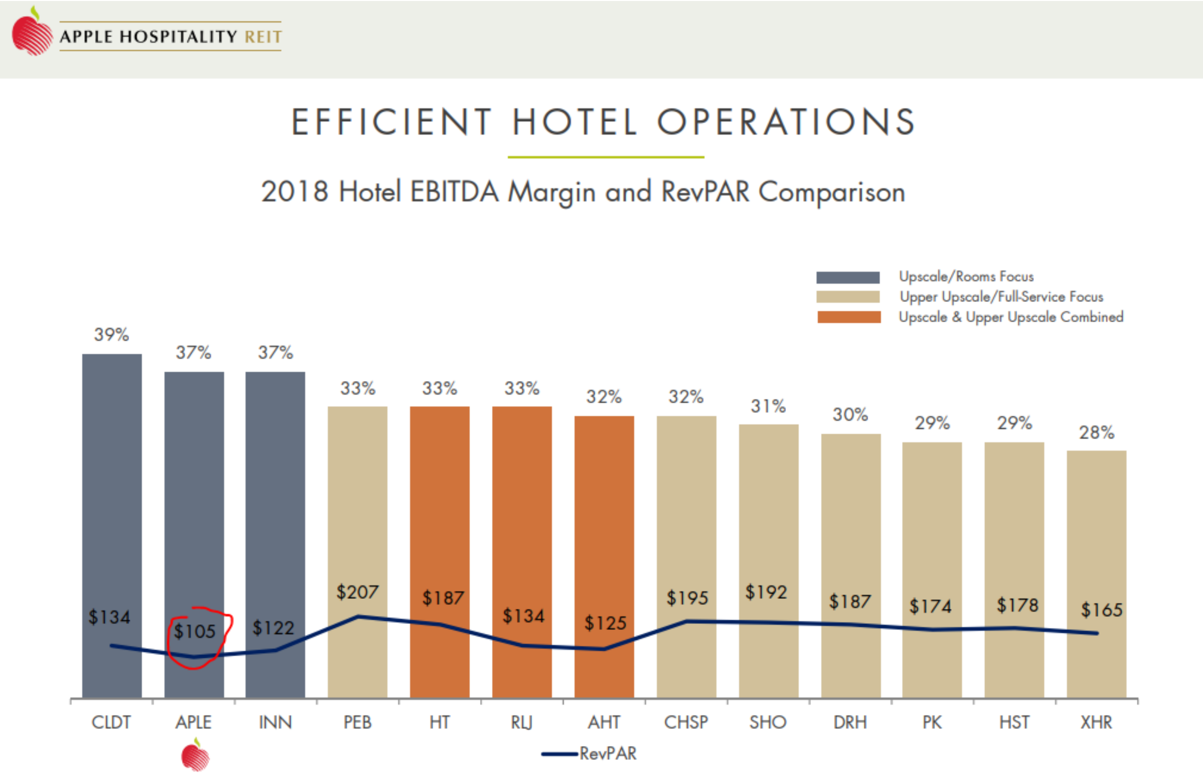


So, the value per room is $250k for Chatham.

Apple Hospitality REIT (APLE) has a market cap of $3.65 billion, debt of $1.4 billion and 30,000 rooms. The value of a room is $166k and RevPar is $105.

However, it all boils down to times funds from operations, Apple's is $400 million, Chatham $130 million with a bit more of debt, so the $900 million market cap.

$165 million for CPLG where the market cap is $665 million. So, it is cheap from this perspective.



Source: APLE

The point is that it will not go bust as interest costs are $50 million, it will hardly go lower but the upside is optional, plus you are buying a hotel room for $40k.

In private hands, with RevPar of $59, should give $21k in revenue per room per year. $40k for Apple and $50 for Chatham. This means CPLG has room for improvement and higher margins or the margins are much lower, where those actually are.

Portfolio Segmentation

	Core			
	> 30% Margin[6]	< 30% Margin[7]	Non-Core	Total Portfolio[8]
# Hotels	64	173	76	313
# Keys	8,450	22,402	9,263	40,115
Average Age[1]	20 y.o.	25 y.o.	33 y.o.	26 y.o.
$ Total Revenue[2]	$249M	$474M	$138M	$861M
$ ADR	$108	$89	$70	$90
$ EBITDAre[3]	$88M	$101M	$12M	$201M
% EBITDAre Margin[4]	35%	21%	8%	23%
$ NOI[4]	$78M	$83M	$6M	$167M

(1) Average age for repositioned properties based on completion date of renovation
(2) Represents 2018 Pro Forma Total Revenue
(3) Represents 2018 Pro Forma Hotel Adjusted EBITDAre
(4) Represents 2018 Pro Forma Hotel Adjusted EBITDAre margin
(5) Pro Forma Hotel Adjusted EBITDAre less capex reserve (4% of revenue)
(6) 30% or greater 2018 Pro Forma Hotel Adjusted EBITDAre margin hotels
(7) Less than 30% 2018 Pro Forma Hotel Adjusted EBITDAre margin hotels
(8) Excludes two sold assets

Two Recent Asset Sales:
Total Sales Price: $4.5M
FY 2018 PF Revenue: $2.7M
FY 2018 PF EBITDAre[2]: $0.2M
FY 2018 PF EBITDAre Margin: 7%

CorePoint Lodging

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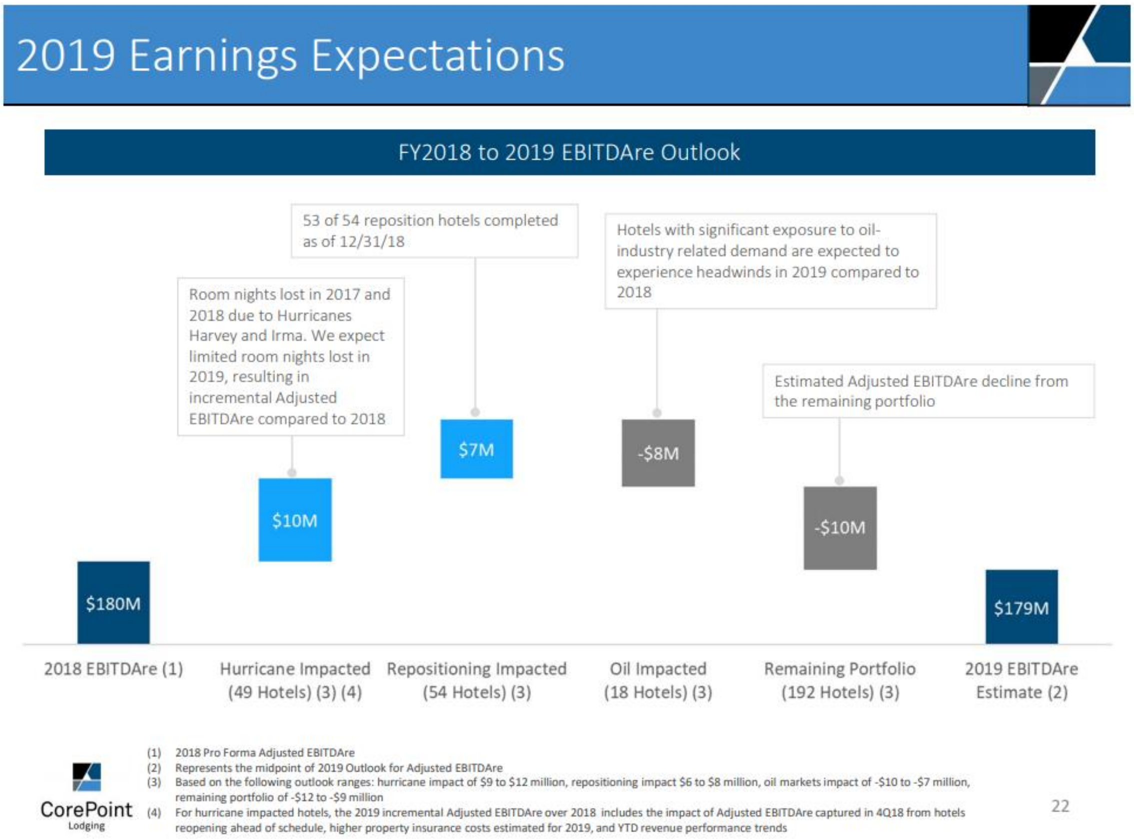
The core part of their business brings 94% of the EBITDA while 24% of the hotels bring in the rest. By disposing or changing the non-core hotels, CPLG can improve its ratios and make itself look better.

Cash flow calculations

This is the guidance for 2019:



8% to 9% of revenue goes for capital expenditures,

2.5% + libor = 5.5% interest rate = $60 million in interest payments.

$180 million in EBITDA minus $77 million in capex for 2019, minus $60 million in interest rates should give me cash flows of $43 million that on a market cap. of $700 million is a return of 6.1% which is in line with the dividend yield, just below it. The buybacks of another $50 million make this look attractive but this is not a business yielding 15% as the company without asset sales will not have an extra $50 million to do buybacks. However, value can be unlocked by selling the properties.

Selling properties to unlock value

The asset value is supposed to be $2.4 billion according to HVS. This is also what is on the books. Given the current market capitalization, there you have already a 50% discount. You are practically buying hotels across America with a 50% discount. Book value of assets $2.4 billion, debt $1 billion, value = $1.4 billion. Market cap is $700 million.

Overview

- In 2016, the La Quinta Predecessor Owner began a strategic repositioning of its owned and franchised properties in order to (i) upgrade select properties to a stronger upper-midscale product by improving amenities, such as breakfast offerings, (ii) create a more consistent product across the brand and (iii) enhance their loyalty program to attract repeat guests.
  - Starting in 2016, the La Quinta Predecessor Owner spent more than $200.0 million (approximately $27,000 per room) to begin the repositioning of 54 hotels upward within their respective markets in order to improve guest experience and to drive RevPAR growth.
    - As of April 2018, 40 of the 54 Property have completed renovations, with an additional 12 Properties expected to be completed by the second quarter of 2018.
    - 25 of the 54 Properties have been in service post-renovation for at least two months and have reported an increase in average net promoter score by approximately 42.7% and an increase in RevPAR and RevPAR penetration of approximately 12.9% and 11.1%, respectively.
- Since 2010, the Portfolio has undergone more than $700.0 million (approximately $18,000 per room) in capital expenditures. The Mortgage Loan is structured with a $15.0 million upfront reserve as well a monthly supplemental PIP reserve to collect an additional $5.1 million per year for brand mandated PIPs. The Loan Sponsor anticipates PIP work to be completed on a rolling basis over the term of the Mortgage Loan.
- The Mortgage Loan and Total Debt represent debt of $25,757 per room and $29,489 per room, respectively.
  - The cumulative "As-Is" appraised value of the individual Properties (with each Property appraised individually without regard to other Properties) as determined by HVS Consulting and Valuation Services ("HVS") as of February 15, 2018 is approximately $2.43 billion[1] (approximately $60,487 per room) (the "Cumulative Appraised Value"). Based on the Cumulative Appraised Value, the loan-to-value ratio ("LTV") of the Mortgage Loan and Total Debt is 42.6% and 48.8%, respectively.
    - Based on the property-by-property appraisal, the valuation of seven Properties that are not subject to a mortgage totaled $17,600,000. Excluding such Properties that are not subject to a mortgage, the Cumulative As-Is LTV of the Mortgage Loan and Total Debt would be 42.9% and 49.1%, respectively.
  - HVS also valued the Portfolio as a whole, as if sold in its entirety to a single buyer (the "Portfolio Appraised Value"). The Portfolio Appraised Value is $2.455 billion[1], which results in an LTV of 42.2% and 48.3% for the Mortgage Loan and Total Debt, respectively.
- The Borrowers and the Operating Lessee are indirectly owned by CorePoint Parent. According to the Loan Sponsor, CorePoint Parent is the only publically traded U.S. lodging REIT focused on mid-scale and upperscale, select-service properties.
  - In conjunction with the spin-off, the Borrowers and/or the Operating Lessee have entered into long-term management and franchise agreements with Wyndham.
  - Keith A. Cline, former President and Chief Executive Officer ("CEO") of the La Quinta Predecessor Owner, currently serves as President and CEO of CorePoint.

Source: CPLG - prospectus

I went to look at the list of what they could sell and found the following.

Victoria	TX	La Quinta Inn	1984	Feb-84	130	5,242
Waco (3)	TX	La Quinta Inn	1971	Sep-71	101	1,807
Wichita Falls	TX	La Quinta Inn	1973	Jun-73	139	2,938
Orem/Provo	UT	La Quinta Inn and Suites	1997	Jun-97	131	10,609
Salt Lake City	UT	La Quinta Inn	1978	Jul-78	122	2,594
Salt Lake City	UT	La Quinta Inn and Suites	1997	Jun-97	114	8,419
Salt Lake City	UT	La Quinta Inn and Suites	1983	Jun-83	100	3,572
Norfolk	VA	La Quinta Inn	1984	Jul-84	129	3,381
Norfolk	VA	La Quinta Inn and Suites	1987	Jul-07	136	15,260
South Burlington	VT	La Quinta Inn and Suites	1988	Mar-07	104	7,984
St. Albans	VT	La Quinta Inn and Suites	1996	Sep-06	81	5,137
Seattle/Tacoma	WA	La Quinta Inn and Suites	1986	Sep-86	143	10,614
Seattle/Tacoma	WA	La Quinta Inn and Suites	1986	Dec-86	121	13,218
Seattle/Tacoma	WA	La Quinta Inn and Suites	1985	Jun-85	155	13,446
Appleton	WI	La Quinta Inn and Suites	1988	Sep-04	99	2,835
Kenosha	WI	La Quinta Inn	1979	Sep-04	92	2,227
Madison	WI	La Quinta Inn and Suites	1997	Sep-04	120	7,208
Milwaukee	WI	La Quinta Inn	1991	Oct-04	98	4,325
Milwaukee	WI	La Quinta Inn	1988	Oct-04	99	4,211
Milwaukee	WI	La Quinta Inn	1982	Oct-04	103	3,706
Milwaukee	WI	La Quinta Inn and Suites	2001	Oct-04	88	5,525
Milwaukee	WI	La Quinta Inn and Suites	1997	Sep-04	97	6,039
Milwaukee	WI	La Quinta Inn and Suites	1994	Sep-04	109	8,660
Oshkosh	WI	La Quinta Inn	1973	Sep-04	96	1,805
Sheboygan	WI	La Quinta Inn	1975	Sep-04	96	828
Stevens Point	WI	La Quinta Inn and Suites	1989	Oct-04	73	2,371
Wausau	WI	La Quinta Inn	1979	Sep-04	93	2,405
Cheyenne	WY	La Quinta Inn	1981	Feb-81	105	2,931
Total						2,457,926

Source: CPLG

On top of the discount of 50% there might be more hidden value. For example, their hotel in Sheboygan is valued at $828k and was build in 1975, refurbished in 2004. However, with 73 rooms with a starting price of $75 I find it hard to believe the value of it is only $800k. So, there might be a few tens of millions in hidden assets lying around in these properties, probably just the land will be worth as much.

Source: Google

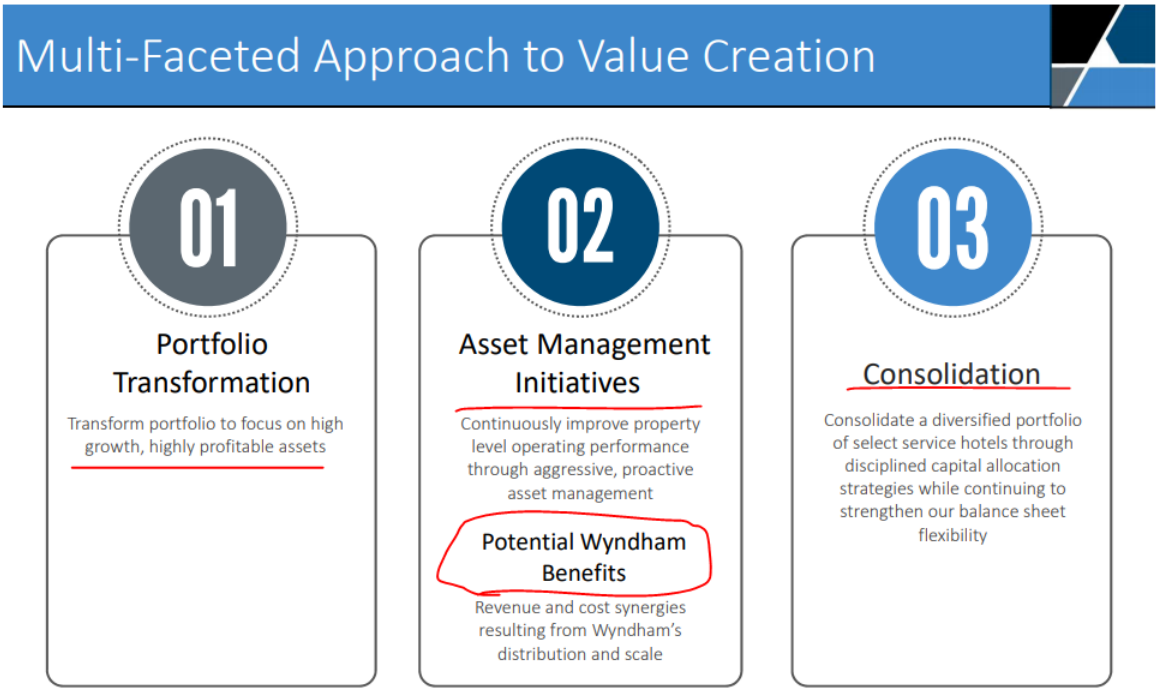
Or, if I go to Salt Lake City, they own 3 hotels where the value goes from $2.5 million to $8.4 million on a similar room number (100 to 122) and the price of the rooms is also close.

One of the hotels was built in 1997 while the other two are 20 years older, therefore the higher value. We must also not forget that many hotels were refurbished in the last two years that should also increase the book value.

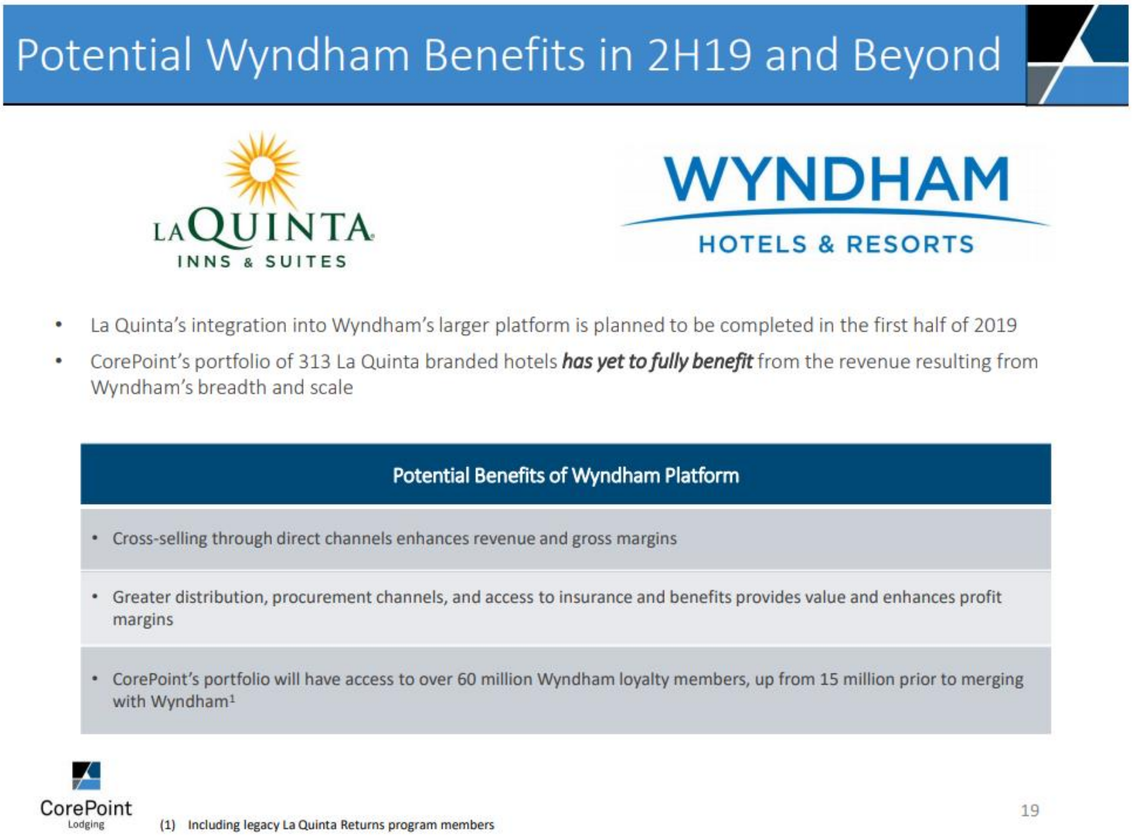
The point is that if the management manages to unlock value, transform the good properties and get rid of the bad for a good price, one could expect nice things to come from CPLG. If someone pays $2.4 billion for all the portfolio, that is a market cap of $1.4 billion or double the current level.

However, without going into a detailed value analysis of all the hotels, there are some potential catalysts lying in plain sight.

Stock catalysts already there



Since the La Quinta merger with Windham, the customer loyalty base will expand fourfold which could increase revenue and occupancy.

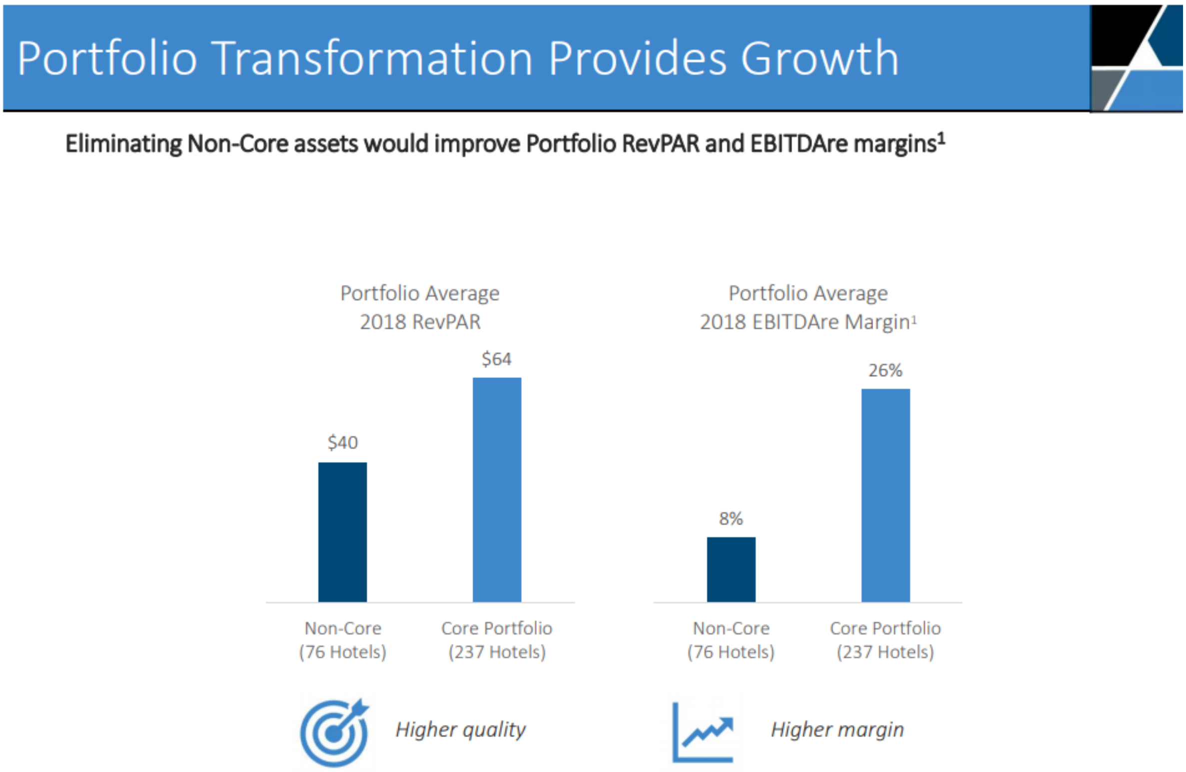


So, if CPLG improves revenues or EBITDA by just $20 million, those $20 million would improve cash flows from $43 million to $63 million, allow for a higher dividend or buybacks and therefore for a much higher stock price. Given the book value, there is a margin of safety with high upside situation here. That is in my opinion what dr. Burry has been buying.

Plus, it is a spin-off and if not performing immediately well, most previous owners ditch it. Only one analyst has been at the last conference call, so nobody is following what is going on which might make it go under the radar. If and when cash flows improve, it will get recognized.

The risks

The main risk for CPLG is an economic slowdown. Less travel, less business would lead to lower revenue and lower cash flows. However, higher margins offer some kind of resilience in case of a recession.



But, CPLG should get rid of the low margin hotels as those would produce losses in case of a slowdown.

I managed to find LaQuinta's annual report and in their risk description they tell how revenues declined 17% in 2009 and EBITDA 30%.

Contraction in the global economy or low levels of economic growth could adversely affect our revenues and profitability as well as limit or slow our future growth.

Consumer demand for our rooms is closely linked to the performance of the general economy and is sensitive to business and personal discretionary spending levels. Decreased demand can be especially pronounced during periods of economic contraction or low levels of economic growth, and the recovery period in our industry may lag overall economic improvement. Declines in consumer demand due to adverse general economic conditions could negatively impact our business by decreasing the revenues and profitability of our owned hotels and limiting the amount of franchising fee revenues we are able to generate from our franchised hotels. For example, for the year ended December 31, 2009, our revenues declined approximately $136 million, or 17%, from revenues of $816 million for the year December 31, 2008, and our Adjusted EBITDA declined approximately 30%. In addition, many of the expenses associated with our business, including personnel costs, interest, rent, property taxes, insurance and utilities, are relatively fixed. During a period of overall economic weakness, if we are unable to meaningfully decrease these costs as demand for our hotels decreases, our business operations and financial performance may be adversely affected.

Additionally, recent global economic conditions have significantly affected consumer confidence and behavior and, as a result, historical financial results may be less effective as a means of predicting future demand and operating results. Uncertainty regarding the rate and pace of recovery from the recent economic downturn and the impact any such recovery may have on different regions of the world makes it difficult to predict future profitability levels. Moreover, if further economic weakness in the markets in which we operate were to occur, it could have an adverse impact on our revenues and negatively affect our profitability.

As CPLG is a different business, a decline of 17% in revenue should hit it hard as the EBITDA would be gone practically.

Something that the investing community might have missed is the government shutdown that will certainly impact hotel revenue when those disclose them in Q1 2019.

However, as long as the situation with the economy remains as is, we can expect stability and slow managerial improvements for CPLG. The question is what will come first, recession or value unlocking?

Investment strategy

I am not going to invest in CPLG now as I look for a 15% return and CPLG offers a 7% return from the cash flows. When they improve their business, the cash flow yield might go to 10%, which would probably double the stock price, but stock price moves, especially short-term ones are not what I invest in.

From a dr. Burry perspective, this will probably not go bust, in case of a recession it will survive where the dividend will probably be cut and that is it. The value is there and over the next decade it will be unlocked given the management’s focus and freedom to do that after the spinoff. It is a value investment where over the long term you will hardly lose money, you are exposed to the American economy and if the value unlocking happens fast, you might also see higher stock prices in the next 12 months giving you great returns. If not, you still get the 6 or 7% yield.

To conclude, CPLG is a good investment offering value and a margin of safety with potential upside. It is a dull business so a perfect fit for value investors. See how it fits your portfolio, I am going to put it on my watch list to see where it goes and compare to other investments out there.