

Chatham Lodging (CLDT)

Updated June 15th, 2020 by Quinn Mohammed

Key Metrics

| | | | | | |
|----------------------|-------|-------------------------------------|--------|---------------------------|--------|
| Current Price: | \$7.0 | 5 Year CAGR Estimate: | 2.1% | Market Cap: | \$329M |
| Fair Value Price: | \$3.8 | 5 Year Growth Estimate: | 10.0% | Ex-Dividend Date: | N/A |
| % Fair Value: | 186% | 5 Year Valuation Multiple Estimate: | -11.6% | Dividend Payment Date: | N/A |
| Dividend Yield: | 3.0% | 5 Year Price Target | \$6 | Years of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Last Dividend Increase: | 0 |

Overview & Current Events

Chatham Lodging Trust manages and invests in upscale extended stay and premium branded hotel services. The company wholly owns 42 hotels with over 6,000 rooms across 15 states and the District of Columbia.

Chatham also has a roughly 10% noncontrolling interest in two joint ventures who own a combined 95 other hotels. The company looks to buy properties at a discount in large city centers. Chatham was formed as an REIT in October 2009 and has a market cap of \$329 million. Chatham operates under brand names like Hyatt, Marriot, and Hilton.

On May 11th, Chatham Lodging Trust announced first quarter results. Portfolio revenue per available room (RevPAR) declined by 21.8% to \$96, compared to last year. Average daily rate (ADR) decreased by 5.2% to \$153, and occupancy rate dropped 17.5% to 63%.

Adjusted EBITDA for the first quarter decreased \$10.5 million to \$16.5 million. Adjusted FFO declined \$9.9 million to \$6.3 million. Adjusted FFO per diluted share was \$0.13, down 63% from \$0.34 in 2019. Dividends paid for the quarter were \$0.22, down from \$0.33 paid in 1Q2019. Even with the lower dividend, adjusted FFO did not cover the payout, rising over 100% for first quarter.

Management took many actions to improve liquidity and mitigate financial impact of the coronavirus: suspending the monthly dividend entirely, reduced 2020 capex by 45%, drew down its credit facility and increased cash liquidity to roughly \$58 million, temporary reduced executive and board compensations, and has 6 unencumbered hotels available as collateral should additional liquidity be necessary. Chatham will pay any dividend necessary to maintain its REIT status in January 2021, by declaring it in December 2020.

The company is developing and has begun construction on a hotel in the Warner Center in Los Angeles, CA. This is the first ground-up development since the company's inception. Total development costs are expected to be about \$65 million. The surrounding area employs more than 50,000 people. To date, the company has spent \$27 million on this project. Development has slowed due to restrictions related to COVID-19.

Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| FFO/S | \$0.21 | \$0.28 | \$1.29 | \$1.26 | \$1.42 | \$2.26 | \$2.29 | \$2.14 | \$1.95 | \$1.85 | \$0.41 | \$0.66 |
| DPS | \$0.35 | \$0.70 | \$0.78 | \$0.84 | \$0.93 | \$1.20 | \$1.38 | \$1.32 | \$1.32 | \$1.32 | \$0.22 | \$0.44 |
| Shares ¹ | 9.21 | 13.8 | 13.9 | 26.3 | 34.0 | 38.3 | 38.4 | 45.4 | 46.5 | 47.5 | 48.0 | 52.5 |

In the past nine years, Chatham has been able to grow their funds from operations per share (FFO/S) dramatically, but in recent years this growth has slowed significantly and even decreased. FFO per share has declined by 4.9% since 2015 and this is largely due to decreased revenue and increased interest expense. The REIT has experienced difficulty due to increased competition from other hotels and home sharing services like Airbnb. While this is concerning for Chatham, they are dedicated to converting existing space into income producing assets. An example of this is the conversion of an underused meeting space into a sophisticated bar. The plan is to convert unused space into substantial revenue and profits. Chatham acquired two hotels to their portfolio in 2018 adding approximately \$70 million worth of assets. Once

¹ In millions

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completed, the Warner Center hotel should also provide a boost to EBITDA, however this is a long way out. These are long term assets that will take some time to produce income and boost FFO. Considering the beating that Chatham has taken due to its exposure to business-related travel, and considering all travel has been significantly cut, expected earnings for 2020 are extremely low, and so we expect that the company can grow earnings by 10% from here.

Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|-----------|------|------|-------|------|------|------|------|------|------|------|------|------|
| P/FFO | 82.1 | 38.5 | 12.02 | 16.5 | 20.6 | 9.2 | 9.0 | 10.6 | 9.1 | 9.9 | 17.1 | 9.2 |
| Avg. Yld. | N/A | 6.7% | 5.4% | 4.9% | 3.6% | 2.9% | 3.6% | 5.0% | 6.5% | 7.1% | 3.1% | 7.3% |

Chatham has historically traded at a price-to-funds from operations (P/FFO) multiple of 9.6 over the past 5 years and is currently grossly overvalued at 17 times 2020 earnings today. Chatham is expected to face difficulties of unknown proportions due to COVID-19 and is being brought down by increased interest expense. Hence, we expect Chatham's multiple will reset itself to 9.7 but may even drop lower. This decline in the multiple will lead to losses of 11.6%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

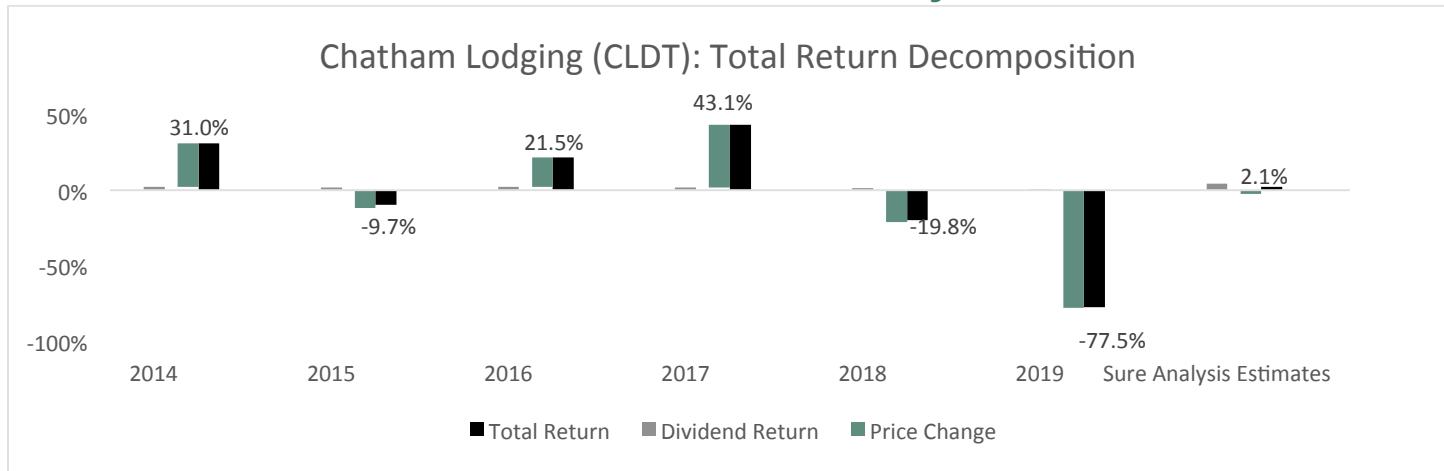
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 167% | 250% | 60% | 67% | 65% | 53% | 60% | 62% | 68% | 71% | 54% | 67% |

Chatham does not have any public information from the last recession. During recessionary periods, hotel REIT's experience difficulty because their revenue is linked to consumers discretionary income. This means that Chatham would not be very resistant to recessions. Considering the COVID-19 pandemic has caused an immense drop in travel, Chatham is very susceptible to the ongoing or upcoming recession. Chatham operates in large metropolitans which generally attract a lot of consumers; however, they have \$668 million worth of debt, the majority of which is at fixed interest rates with an average interest rate of 4.4%. As predicted, in light of the coronavirus pandemic, Chatham has slashed the distribution for 2020 and will only pay out what is necessary to hold its REIT status.

Final Thoughts & Recommendation

Overall, Chatham Lodging has a good reputation as an REIT with popular name brands, but the issues facing the hotel sector weighs heavily on the company. We expect Chatham to offer total returns of 2.1%, primarily focused on earnings growth from this low point, which is speculative. The company is overvalued on a PE basis, at 186% of fair value, so there is a negative margin of safety. We rate the stock a sell at this time.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 73 | 99 | 125 | 195 | 273 | 290 | 296 | 318 | 25 | 328 |
| Gross Profit | 31 | 44 | 56 | 94 | 136 | 141 | 140 | 148 | 10 | 148 |
| Gross Margin | 42% | 44.3% | 44.9% | 48.3% | 49.9% | 48.6% | 47.4% | 46.4% | 41.0% | 45.2% |
| SG&A Exp. | 6 | 8 | 8 | 10 | 12 | 11 | 13 | 14 | 4 | 14 |
| D&A Exp. | 12 | 14 | 18 | 35 | 49 | 49 | 46 | 48 | 3 | 51 |
| Operating Profit | 0 | 15 | 17 | 27 | 56 | 59 | 60 | 58 | 0 | 58 |
| Operating Margin | 0.2% | 14.8% | 13.9% | 13.7% | 20.3% | 20.3% | 20.2% | 18.3% | -1.8% | 17.7% |
| Net Profit | -9 | -1 | 3 | 67 | 33 | 31 | 29 | 31 | -1 | 19 |
| Net Margin | -13% | -1.5% | 2.4% | 34.3% | 12.1% | 10.9% | 10.0% | 9.6% | -4.8% | 5.7% |
| Free Cash Flow | 9 | 15 | 32 | 49 | 82 | 88 | 87 | 86 | 5 | 86 |
| Income Tax | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 459 | 457 | 674 | 1165 | 1337 | 1303 | 1392 | 1440 | 1440 | 1439 |
| Cash & Equivalents | 5 | 4 | 4 | 15 | 21 | 12 | 9 | 7 | 7 | 7 |
| Accounts Receivable | 2 | 2 | 2 | 4 | 4 | 4 | 4 | 4 | 4 | 5 |
| Total Liabilities | 242 | 251 | 288 | 573 | 640 | 621 | 582 | 632 | 632 | 664 |
| Accounts Payable | 10 | 8 | 13 | 20 | 25 | 28 | 32 | 34 | 34 | 33 |
| Long-Term Debt | 229 | 239 | 272 | 550 | 605 | 583 | 538 | 583 | 583 | 585 |
| Shareholder's Equity | 216 | 205 | 383 | 589 | 693 | 677 | 803 | 797 | 797 | 762 |
| D/E Ratio | 1.06 | 1.17 | 0.71 | 0.93 | 0.87 | 0.86 | 0.67 | 0.73 | 0.73 | 0.77 |

Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|
| Return on Assets | -2.7% | -0.3% | 0.5% | 7.3% | 2.6% | 2.4% | 2.2% | 2.2% | -1.0% | 1.3% |
| Return on Equity | -4.8% | -0.7% | 1.0% | 13.8% | 5.1% | 4.6% | 4.0% | 3.8% | -1.4% | 2.4% |
| ROIC | -2.8% | -0.3% | 0.5% | 7.4% | 2.7% | 2.5% | 2.3% | 2.2% | -1.1% | 1.4% |
| Shares Out. | 9.21 | 13.82 | 13.91 | 26.30 | 34.00 | 38.31 | 38.37 | 45.37 | 46.52 | 47.5 |
| Revenue/Share | 5.50 | 7.16 | 5.85 | 6.77 | 7.13 | 7.53 | 7.38 | 6.89 | 3.99 | 6.98 |
| FCF/Share | 0.67 | 1.08 | 1.48 | 1.71 | 2.14 | 2.28 | 2.16 | 1.86 | 0.83 | 1.83 |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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