Hospitality

Strategic Hotels' Plan for Growth

The Fairmont Princess Scottsdale, A Strategic Hotels & Resorts property

An Interview with Raymond L. "Rip" Gellein Jr., Chairman of the Board and Chief Executive Officer, Strategic Hotels & Resorts

Raymond L. "Rip" Gellein Jr.

EDITORS' NOTE *Previously, Rip Gellein was President of the Global Development Group for Starwood Hotels and Resorts Worldwide. Before this, he was the Director, Chairman, and Chief Executive Officer of Starwood Vacation Ownership, Inc. He also served as Chairman and co-Chief Executive Officer of Vistana, Inc. Gellein serves on the Board of Directors of Marriott Vacations Worldwide, the American Resort Development Association, and the Mind and Life Institute. He received a bachelor of arts in psychology from Denison University, as well as a master's of business administration in finance, accounting, and marketing from Northwestern University's Kellogg School of Management.*

COMPANY BRIEF *Strategic Hotels & Resorts, Inc. (strategichotels.com) is a real estate investment trust (REIT) that owns and provides value-enhancing asset management of high-end hotels and resorts in the United States and Europe. The company currently has ownership interests in 16 properties with an aggregate of 7,865 rooms and 835,000 square feet of meeting space under brands such as Four Seasons, Ritz-Carlton, Marriott, Fairmont, InterContinental, Westin, Hyatt, and Loews.*

Would you give a brief overview of how Strategic Hotels & Resorts has evolved?

Strategic Hotels & Resorts focuses on the higher end of the hotel spectrum – iconic hotels operated by world-class brands in great locations with multiple revenue streams beyond rooms. Our 16 properties are found in desirable, high-barrier-to-entry urban and resort markets in the U.S. We're the only REIT that purely focuses on the upper-upscale and luxury lodging market. Through disciplined execution of our proven strategy, we are continuing to build a leading hotel REIT that focuses on net profit, a strong balance sheet, superior performance, and an attractive return for our shareholders as measures of success.

We've come a long way over the years, especially as we worked to reverse the significant impact the downturn had on this industry. I joined the company's board during the recession, and became Chairman in 2010. We determined we had to pay down our debt, strengthen the balance sheet, refocus on core assets, and simplify our story. We focused on executing against this strategy and we have made dramatic improvements to our balance sheet, reducing our net debt to EBITDA from 14.3x in 2009 to about 5.3x in 2014. This provided us with improved flexibility to strengthen our portfolio through the selective acquisition of properties that contribute positively to earnings.

We have a terrific team. When I became Chairman, I made it a point to spend a significant amount of time with our senior management team so when the board asked me in 2012 to become CEO, it wasn't a major transition. While I knew that they were all talented, I didn't fully appreciate the depth of the skill and leadership of our team until I worked with them every day.

Today, we continue to execute our plan. Earlier this year, we sold our London hotel and our hotel in Punta Mita, Mexico for about $400 million combined. Then we bought our partners out of the Hotel del Coronado in San Diego and the Fairmont Scottsdale Princess for $650 million. We also raised a bit over $400 million in equity and paid off two of our preferred share classes. In total, we completed around $2.7 billion of transactions in 2014.

Our entire portfolio is now in the U.S. We are well diversified both from a geographic standpoint as well as from a mixture of urban assets and resorts. This diversification will continue to allow us to capitalize on strong operating trends within the industry.

Where does the story go from here?

There are three pillars to the story: the first is our iconic, irreplaceable assets: our soon-to-be-four Four Seasons, three Marriotts, two Ritz-Carltons, two InterContinentals, two Fairmonts, the iconic Hotel del Coronado, and more. They're located at some of the most iconic addresses, including Central Park, Michigan Avenue, and Union Square.

These are beautiful luxury and upper upscale assets, which at this part in the cycle have room to grow because it doesn't make sense to build properties like these today. So the supply of new competition coming into the market is muted.

Cycles have lasted as long as 10 years and we're in the middle of the current cycle. Group business is strong and the transient business at this quality level is strong, but we haven't reached peak levels – so there are good embedded growth opportunities in the portfolio.

The second pillar relates to the balance sheet, which is strong and allows us flexibility to add assets to our portfolio that further enhance shareholder value. Our stated objective is to further reduce our debt into the lower end of our target 3x-5x range.

Finally, we're prepared to smartly acquire assets, without much debt. The pipeline's strong and we're starting to see an increased amount of activity in the marketplace. We'd like to diversify our portfolio to the East Coast but will also selectively consider middle-of-the-country markets, ski destinations, and key West Coast markets like Seattle, San Francisco, and Southern California.

Is it important to build the brand awareness for Strategic or is it about the individual properties?

Both. For our shareholders and joint venture partners, we have distinguished ourselves by our performance. In every relevant metric, we outperform our peers and deliver one-, two- and three-year shareholder returns that lead the industry.

At our investor day at the Essex House Hotel, we put our asset management team on stage and had them provide several examples of what they do to create value for the company.

Their attention to detail and their staffing, procurement, and rate strategies lead to huge value generation for our company. Thanks to the asset management team, our margin enhancement over the past three years has been over 200 basis points per year, which significantly leads the market. We do $400 million a year in food and beverage with a margin of 30-plus percent. This past quarter, we saw a 6 percent increase in the amount of out of room spending by our group business, with food and beverage revenues up 10 percent.

Our culture is unique because there is a real passion for creating experiences that are best-in-class. For instance, we have Michael Mina's and Richard Sandoval's restaurants and skating rinks at the Del and in Scottsdale over the holiday periods – there are many cool experiences that appeal to the luxury traveler, generating incremental revenue, which is very important to the bottom line.

Looking ahead, our shareholders will see a continued focus on our plan, with an emphasis on revenue growth, margin enhancement, and consistent improvement to our properties. It's been a joy to witness how far we've come, and to see what new possibilities are within reach. ●