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Apr 13, 2020

Choice Hotels (CHH)

$72.40 (As of 04/10/20)

Price Target (6-12 Months): **$76.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/21/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:D
	Value: D | Growth: B | Momentum: F	

Summary

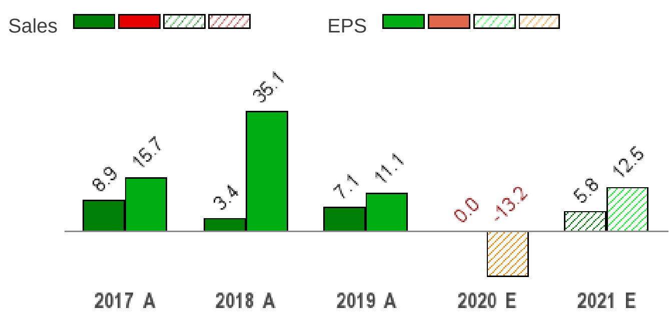
Although, shares of Choice Hotels have outperformed the industry in the past year, the coronavirus outbreak, which has taken the shape of a global pandemic is likely to hurt the company, going forward. Owing to the outbreak, the company has also suspended its dividend payouts. Moreover, stiff competition and high cost of operations are adding to the woes. Notably, earning estimates for 2020 have declined over the past 30 days. However, continuous enhancement of the mid-scale brand and the acquisition of the WoodSpring brand as well as transformation and advancement of the Comfort and Cambria brands, are likely to aid the company. Also, continual expansion strategies through acquisitions and franchise agreements are adding to the positives.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$109.26 - $46.25**
20 Day Average Volume (sh)	**814,388**
Market Cap	**$4.0 B**
YTD Price Change	**-30.0%**
Beta	**1.28**
Dividend / Div Yld	**$0.90 / 1.2%**
Industry	**Hotels and Motels**
Zacks Industry Rank	**Bottom 19% (206 out of 253)**
Last EPS Surprise	**9.5%**
Last Sales Surprise	**4.0%**
EPS F1 Est- 4 week change	**-12.9%**
Expected Report Date	**05/14/2020**
Earnings ESP	**-7.1%**
P/E TTM	**16.8**
P/E F1	**19.3**
PEG F1	**2.0**
P/S TTM	**3.6**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	239 E	342 E	335 E	294 E	1,180 E
2020	232 E	329 E	320 E	275 E	1,115 E
2019	218 A	318 A	311 A	268 A	1,115 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.78 E	$1.17 E	$1.36 E	$0.93 E	$4.22 E
2020	$0.77 E	$1.06 E	$1.28 E	$0.89 E	$3.75 E
2019	$0.84 A	$1.19 A	$1.37 A	$0.92 A	$4.32 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/10/2020. The reports text is as of 04/13/2020.

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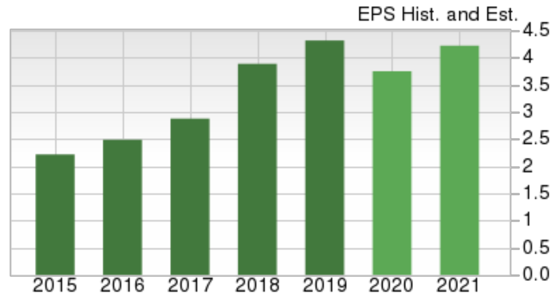
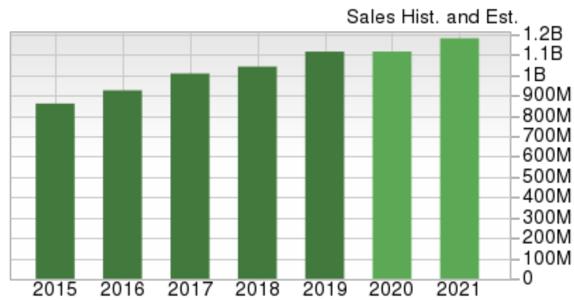
Overview

Choice Hotels International, Inc. (CHH) is one of the largest hotel franchisors globally. As of Dec 31, 2019, the company had more than 7,153 running hotels. This hotel chain is spread across 40 countries and territories internationally, and is present in 50 states domestically and the District of Columbia.

Comfort Inn, Comfort Suites, Quality, Clarion, Clarion Pointe, Sleep Inn, Econo Lodge, Rodeway Inn, MainStay Suites, Suburban Extended Stay Hotel, WoodSpring Suites, Everhome Suites, Cambria Hotels, and Ascend Hotel Collection (collectively, the "Choice brands") are the company's proprietary brand names.

Choice Hotel's primary business segment is hotel franchising, representing 97% of the total revenues. While domestic franchising operations are conducted through direct franchising relationships, international franchise operations are carried out via a combination of direct and master franchising relationships.





Reasons To Buy:

Continual expansion strategies through acquisitions and franchise agreements are major positives. The company's regular return of wealth to its shareholders is also commendable.

▲ **Strong Brand Recognition & Impressive Earnings Trend:** Choice Hotels' riveting growth potential depends on the continual expansion of its brands. In fact, the company's portfolio of well-segmented brands is getting evidently stronger. With continuous enhancement of the mid-scale brand and the acquisition of the WoodSpring brand as well as transformation and advancement of the Comfort and Cambria brands, Choice Hotels is poised for growth in 2020 and beyond. Notably, its earnings also surpassed analysts' expectations for 15 straight quarters. For 2020, Choice Hotels expects earnings per share in the range of $4.22-$4.33 per share.

▲ **Franchise Business Lends Economies of Scale:** The company's 97% of revenues are generated from the franchise business. Choice Hotels gains from economies of scale associated with the franchise business. Accordingly, higher fee from franchisees and transference of cost burden to franchises provide the company with operational advantages. Apart from royalty fees and procurement services revenues, Choice Hotels also collect marketing and reservation system fees to provide support activities for the franchise system. Franchising, as we believe, will facilitate ROE expansion and earnings growth over the long term. Meanwhile, the company's solid commitment toward franchisee profitability is driving incremental revenues. The number of domestic franchised hotels and rooms as of Dec 31, 2019, increased 1.6% and 2.9%, respectively, from the year-ago levels.

▲ **Continual Expansion Bodes Well:** Choice Hotels relies heavily on expansion in both domestic as well as international markets. During fourth-quarter 2019, the hotelier was awarded 307 domestic franchise agreements, increasing 7% year over year. Alongside domestic growth, the company continues to expand its international footprint in new countries. Key international operating markets include Spain, Colombia, Panama, the Caribbean and Canada. Relatively new to the midscale portfolio, Clarion Pointe - part of the popular Clarion brand, is experiencing great success. With more than 30 domestic franchise agreements in 2019, the company expects to open two dozen Clarion Pointe hotels in 2020. As Clarion Pointe brand is resonating with guests, the total number of Clarion Pointe hotels open or awaiting conversion since the brand launch has now surpassed 50 hotels. Meanwhile, in 2018, the company announced an alliance with Sercotel, a leading hotel operator and franchisor based in Spain. This alliance will enable the extension of Choice Hotels' global footprint in Spain and other markets, as well as the creation of opportunities for additional hotel development across Europe and Latin America.

The Cambria brand has been doing solid business. In 2019, the brand opened 11 new hotels, representing over 1,700 upscale rooms in major markets like Boston, Houston and Phoenix. It ended the year with the opening of its 50th Cambria hotel, the brand's largest property just outside Disneyland in Anaheim, CA. In 2020, the brand anticipates to open 13 hotels, across the country, taking the total Cambria system to over 60 hotels.

▲ **Woodspring Acquisition Adds Value:** Apart from constant franchise expansions, Choice Hotels has added 239 extended-stay hotels in 35 states to its portfolio through the acquisition of Woodspring Suites in 2018. In 2019, the extended stay domestic pipeline grew by 13% year over year to 315 hotels. This was primarily driven by the continued expansion of the Woodspring brand. In 2018, the company completed opening of additional 12 WoodSpring hotels in top markets like Chicago, Seattle, Charlotte and Detroit. Currently, Choice Hotels has 270 Woodspring hotels. By the end of 2020, it expects to see Woodspring operating 300 hotels. Additionally, in Jan, 2019, the company finalized an agreement with a developer to build more than 27 additional WoodSpring Suites over the next four years.

In January 2020, the company further strengthened its extended stay presence by introducing Everhome Suites, an all-new construction midscale brand in the extended stay segment. Multiple developers have already committed to build 13 Everhome Suites hotels in Austin, TX and Los Angeles market. Nonetheless, it expects to open its first Everhome Suite in 2021.

▲ **Returning Shareholder's Wealth:** Choice Hotels maintains a capital structure with high financial returns. The company has a historical record of returning value to its shareholders through share repurchases and dividends. During 2019, Choice Hotels paid cash dividends totaling approximately $48 million. Based on the current quarterly dividend rate of 22.5 cents per share, the company expects to pay out dividends worth approximately $50 million during 2020. Meanwhile, management repurchased roughly $0.6 million shares for nearly $50.6 million under the share repurchase program during the said period.

Reasons To Sell:

Cyclical nature of the industry, the coronavirus outbreak, stiff competition and high cost of operations remain concerns for Choice Hotels.

- **Coronavirus Likely to Hurt 2020 Results:** The Hotel and Motels industry is currently grappling with the coronavirus outbreak in China and Choice Hotels isn't immune to the trend. Owing to the outbreak, the company has already suspended its quarterly dividend payouts. The company has also taken certain actions to reduce operating expenses. Moreover, the CEO and the board of directors have agreed to a pay cut for 2020. The board has also decided to temporarily furlough part of its corporate workforce in Europe. Also, non-essential and discretionary capital expenditures have been eliminated. Notably, the company has withdrawn its 2020 guidance.

- **High Costs Hurt:** Despite the positive synergies to be realized from acquisitions and focus on franchising, Choice Hotels is shouldering high costs from operations. Total operating expenses in 2018 increased 20.1% year over year. Total operating expenses in 2019 increased 9% to $781.2 million.

- **Cutthroat Competition:** The hotel industry is highly competitive, as major hospitality chains with well-established and recognized brands are continuously expanding their global presence. Choice Hotels is continuously facing intense competition from both large hotel chains and smaller independent local hospitality providers. Increasingly, the company also faces competition from new channels of distribution in the travel industry. Additional sources of competition include large companies that offer online travel services as part of their business model such as Alibaba, search engines such as Google, and peer-to-peer inventory sources such as Airbnb and HomeAway that allow travelers to book stays on websites that facilitate the short-term rental homes and apartments from owners, thereby providing an alternative to hotel rooms. Unless the company counters these competitions with appropriate strategies, it may pose a concern for its future profitability.

- **Cyclical Nature of the Industry Poses Concern:** The hospitality industry is cyclical, and a worsening of global economic conditions might in turn dent Choice Hotels' revenues and profits. Consumer demand for services is closely linked to performance of the general economy, and is sensitive to business and personal discretionary spending levels. Decline in consumer demand due to adverse general economic conditions, poor travel patterns, lower consumer confidence and high unemployment can lower revenues as well as the profitability of the company. These factors can also reduce its management and franchise fee revenues.

- **Valuation Looks Stretched:** Looking at Choice Hotels' valuation, we find it stretched compared with its own range as well as the industry average. Looking at the company's EV/EBITDA ratio (Enterprise Value/ Earnings before Interest Tax Depreciation and Amortization), which is the best multiple for valuing gaming companies as those are highly capital intensive, investors might not want to pay any further premium. The stock has a trailing 12-month EV/EBITDA ratio of 12.65. On the contrary, the trailing 12-month EV/EBITDA ratio for the industry and the S&P 500 is 10.97 and 10.23, respectively.

Last Earnings Report

Choice Hotels Q4 Earnings & Revenues Beat Estimates

Quarter Ending	12/2019
Report Date	Feb 18, 2020
Sales Surprise	3.99%
EPS Surprise	9.52%
Quarterly EPS	0.92
Annual EPS (TTM)	4.32

Choice Hotels reported better-than-expected fourth-quarter 2019 results. The top and the bottom line surpassed their respective Zacks Consensus Estimate and increased on a year-over-year basis. The upside can be primarily attributed to increased domestic franchise agreements, solid progress on its flagship Comfort brand and continued expansion of its Cambria brand across the country.

The lodging franchisor reported adjusted earnings of 92 cents per share, which beat the consensus mark of 84 cents and rose 4.5% year over year. Notably, this marked the eighth straight quarter of earnings beat.

In the quarter under review, total revenues came in at $268.1 million. The figure increased 9% from the year-ago quarter's level and topped the consensus mark of $258 million.

Let's discuss the quarterly numbers.

Franchising & Royalties

Domestic royalty fees totaled $82.3 million, up 2.5% year over year. However, domestic system-wide RevPAR dropped 2.1% year over year. Average daily rate (ADR) inched down 0.4% and occupancy was down 100 basis points compared with the prior-year quarter's level.

The company's newly-executed domestic franchise agreements were 307 in the fourth quarter. As of Dec 31, 2019, the number of domestic hotels and rooms rose 1.6% and 2.9% year over year, respectively.

Operating Results

Total operating expenses increased 5.7% from fourth-quarter 2018 to $199.5 million. Adjusted EBITDA also increased 6.3% from the prior-year quarter's number to $81 million.

Balance Sheet

As of Dec 31, 2019, the company had cash and cash equivalents of $33.8 million compared with $26.6 million on Dec 31, 2018.

Long-term debt in the same period was $844.1 million, up from $753.5 million at 2018-end. Goodwill, as a percentage of total assets, was 11.5% at the end of the fourth quarter compared with 14.8% at 2018-end.

In 2019, Choice Hotels paid out cash dividends of $48 million. In 2020, the company expects to pay dividends worth approximately $50 million. Meanwhile, management repurchased roughly $0.6 million shares for nearly $50.6 million under the share repurchase program during 2019. As of Dec 31, 2019, the company had 3.9 million shares remaining under the current share repurchase authorization.

2019 Highlights

In 2019, total revenues amounted to $1.1 billion, up 7% year over year.

Adjusted earnings per share (EPS) for the year ended Dec 31, 2019 was reported at $4.32 compared with $3.89 in 2018.

Adjusted EBITDA amounted to $364.9 million, up 7% from 2018 levels.

Recent News

Choice Hotels Suspends Dividend on Coronavirus Concerns – Apr 8, 2020

Choice Hotels International have recently suspended dividend payout in an effort to preserve cash and maintain ample liquidity in case of a possible financial crisis triggered by the coronavirus outbreak. Notably, the CEO and the board of directors have agreed to a pay cut for 2020.

Choice Hotels Withdraws 2020 Outlook Due to Coronavirus Fear – Mar 17, 2020

Due to the unprecedented nature of the coronavirus outbreak situation on the global economy, Choice Hotels announced the withdrawal of its first quarter and full year 2020 guidance.

Choice Hotels' Cambria Line Sees Largest Opening in US - Feb 2, 2020

In a bid to expand its footprint in the United Sates, Choice Hotels International, Inc. announced the opening of Cambria Hotel Anaheim Resort Area — marking its 50th and the largest location opening. The 12-story, 352-room upscale hotel provides guests access to unique amenities, such as a waterpark, outdoor movie wall and putting green.

Choice Hotels' Ascend Hotel Collection Sets Record in 2019 - Jan 23, 2020

Choice Hotels International, Inc. continues to expand through franchise agreements. The Ascend Hotel Collection franchised by the company recently announced that 2019 was a record-breaking development year. The brand executed 96 total contracts and added 76 new properties to its portfolio of resort, historic and boutique hotels. This milestone fortifies Ascend Hotel's status as the industry's largest upscale soft brand.

Valuation

Choice Hotels' shares are down 30% year-to-date, and 11% in the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Consumer Discretionary sector is down by 41.2% and 24.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector were down by 34.3% and 19.2%, respectively.

The S&P 500 index is down 13.4% in the year-to-date period, and 4.4% in the past year.

The stock is currently trading at 3.38X forward 12-month sales, which compares to 1.61X for the Zacks sub-industry, 1.81X for the Zacks sector and 3.08X for the S&P 500 index.

Over the past five years, the stock has traded as high as 5.25X and as low as 2.54X, with a 5-year median of 3.74X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $76 price target reflects 3.55X forward 12-month sales.

The table below shows summary valuation data for CHH.

Valuation Multiples - CHH

		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	3.38	1.61	1.81	3.08
	5-Year High	5.25	2.25	3.19	3.44
	5-Year Low	2.54	1.13	1.68	2.54
	5-Year Median	3.74	1.64	2.52	3.01
P/E TTM	Current	16.76	14.47	19.51	17.39
	5-Year High	30.28	33.79	32.64	22.17
	5-Year Low	12.4	14.47	19.51	15.91
	5-Year Median	23.03	23.85	25.5	18.9
EV/EBITDA TTM	Current	12.65	10.97	9.32	10.23
	5-Year High	21.06	23.09	17.6	12.87
	5-Year Low	9.93	9.36	8.26	8.27
	5-Year Median	15.61	14.44	12.26	10.78

As of 04/09/2020

Industry Analysis Zacks Industry Rank: Bottom 19% (206 out of 253)

Top Peers

Hyatt Hotels Corporation **(H)**	Neutral
Hilton Grand Vacations Inc. **(HGV)**	Neutral
Hilton Worldwide Holdings Inc. **(HLT)**	Neutral
Extended Stay America, Inc. **(STAY)**	Neutral
Marriot Vacations Worldwide Corporation **(VAC)**	Neutral
WYNDHAM DESTINATIONS, INC. **(WYND)**	Neutral
Marriott International, Inc. **(MAR)**	Underperform
Wyndham Hotels & Resorts Inc. **(WH)**	Underperform

Industry Comparison Industry: Hotels And Motels

Industry Peers

	CHH Neutral	X Industry	S&P 500	H Neutral	HLT Neutral	MAR Underperform
VGM Score	D	-	-	F	D	F
Market Cap	4.04 B	3.00 B	19.66 B	5.39 B	18.99 B	26.36 B
# of Analysts	7	5.5	13	9	8	10
Dividend Yield	1.24%	1.24%	2.18%	1.50%	0.00%	2.36%
Value Score	D	-	-	C	D	D
Cash/Price	0.01	0.15	0.06	0.27	0.04	0.01
EV/EBITDA	13.39	12.36	11.72	4.18	13.35	15.43
PEG Ratio	1.87	3.87	2.04	562.20	2.75	3.52
Price/Book (P/B)	NA	1.40	2.66	1.36	NA	37.81
Price/Cash Flow (P/CF)	13.95	9.57	10.44	8.45	12.71	11.01
P/E (F1)	18.53	19.29	17.51	2,080.14	26.21	21.29
Price/Sales (P/S)	3.63	1.26	2.12	1.07	2.01	1.26
Earnings Yield	5.18%	4.90%	5.65%	-0.73%	3.81%	4.70%
Debt/Equity	-36.81	0.58	0.70	0.51	-19.05	15.43
Cash Flow ($/share)	5.19	3.11	7.01	6.29	5.39	7.39
Growth Score	B	-	-	F	B	D
Hist. EPS Growth (3-5 yrs)	19.12%	19.12%	10.92%	20.42%	10.73%	20.88%
Proj. EPS Growth (F1/F0)	-13.13%	-21.08%	-1.14%	-119.24%	-33.04%	-36.35%
Curr. Cash Flow Growth	7.52%	6.82%	5.93%	5.97%	24.59%	-2.82%
Hist. Cash Flow Growth (3-5 yrs)	17.19%	4.04%	8.55%	2.61%	2.71%	21.40%
Current Ratio	0.73	1.10	1.24	1.57	0.73	0.47
Debt/Capital	NA%	51.85%	42.36%	33.57%	NA	93.91%
Net Margin	19.99%	9.32%	11.64%	15.26%	9.32%	6.07%
Return on Equity	-249.37%	5.81%	16.74%	5.81%	-770.65%	181.84%
Sales/Assets	0.87	0.49	0.54	0.61	0.63	0.84
Proj. Sales Growth (F1/F0)	0.02%	-1.87%	0.45%	-20.33%	-17.21%	-23.69%
Momentum Score	F	-	-	F	F	D
Daily Price Chg	0.21%	0.25%	2.48%	3.42%	-2.34%	-1.48%
1 Week Price Chg	-15.15%	-16.46%	-4.40%	-18.76%	-19.10%	-25.07%
4 Week Price Chg	0.77%	-3.37%	11.26%	1.72%	-10.78%	-13.23%
12 Week Price Chg	-27.86%	-35.18%	-20.02%	-39.29%	-38.67%	-45.44%
52 Week Price Chg	-10.24%	-31.90%	-11.31%	-30.18%	-22.68%	-38.98%
20 Day Average Volume	814,388	814,388	3,931,994	2,570,084	8,841,999	10,980,553
(F1) EPS Est 1 week change	0.00%	0.00%	-0.12%	-203.20%	-22.76%	-19.06%
(F1) EPS Est 4 week change	-12.90%	-21.35%	-5.78%	-133.55%	-32.09%	-37.81%
(F1) EPS Est 12 week change	-14.37%	-30.48%	-7.64%	-122.38%	-32.04%	-41.61%
(Q1) EPS Est Mthly Chg	-14.90%	-40.42%	-10.13%	-142.74%	-40.42%	-52.02%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Value Score	D
Growth Score	B
Momentum Score	F
VGM Score	D

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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