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Hilton Worldwide Holdings, Inc. (HLT)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. My name is Sally, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Hilton Worldwide Third Quarter 2015 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I will now turn the call over to Mr. Christian Charnaux, Vice President-Investor Relations. Please go ahead, sir.

Christian Charnaux

Vice President-Investor Relations

Thank you, Sally. Welcome to the Hilton Worldwide third quarter 2015 earnings call. Before we begin, we would like to remind you that our discussions this morning will include forward-looking statements. Actual results could differ materially from those indicated in the forward-looking statements, and forward-looking statements made today are effective only as of today. We undertake no obligation to publicly update or revise these statements. For a discussion of some of the factors that could cause actual results to differ, please see the risk factors section of our most recently filed Form 10-K.

In addition, we will refer to certain non-GAAP financial measures on this call. You can find reconciliations of non-GAAP to GAAP financial measures discussed in today's call in our earnings press release and on our website at www.hiltonworldwide.com.

This morning, Chris Nassetta, our President and Chief Executive Officer, will provide an overview of our third quarter results and will describe the current operating environment, as well as the company's outlook. Kevin Jacobs, our Executive Vice President and Chief Financial Officer, will then provide greater detail on both our results and outlook. Following their remarks, we will be available to respond to your questions.

With that, I'm pleased to turn the call over to Chris.

Christopher J. Nassetta

President, Chief Executive Officer & Director

Thanks, Christian. Good morning, everyone, and thanks for joining us today. We're pleased to report another strong quarter with topline growth above the midpoint of our guidance and adjusted EBITDA above the high-end of our guidance. Healthy fundamentals should continue to drive solid performance for the rest of the year and into next, which we'll cover in a little bit more detail shortly.

In the quarter, system-wide comp RevPAR was at 5.8% on a currency-neutral basis. Transient growth was the primary driver of RevPAR growth in the quarter, as the expected holiday shift impacted group demand.

System-wide transient growth was up 6% in the quarter, strengthening significantly in September and with particular strength in leisure, which was up almost 10% in the quarter. System-wide group revenue increased nearly 4% in the quarter with strength in New York, Orlando and Los Angeles. Group revenue was strong in July with over 8% growth, but was tempered by the effect of calendar shifts in August and September. Americas owned and operated expected group revenue is up over 500 basis points in Q4 versus Q3 actuals, and is strengthening in pace.

On top of strong topline performance in the quarter and great cost discipline both corporately and in the hotels, it drove strong margin growth, we continue to benefit from significant and accelerating net unit growth. Our leading brands that can serve nearly every lodging need guests have anywhere in the world they want to be, drive loyalty to our system and result in our industry-leading market share premiums. Better topline results drive better returns for our hotel owners, and they in turn choose our brands.

In the quarter, our net unit growth was nearly 13,000 rooms on openings of 91 hotels and more than 14,000 gross rooms. Our net unit growth of nearly 30,000 rooms through September is more than 12% ahead of last year, and we're on track to meet our 2015 guidance of 40,000 rooms to 45,000 rooms. We're also on track to improve a record total of nearly 100,000 rooms this year, continuing to grow the largest hotel system in the world with the largest pipeline in the industry as measured by Star.

We continue to get a disproportionate share of new development with our portfolio of brands accounting for one out of every five rooms under construction in the world. That's four times our existing share of global rooms, and we remain number one in rooms under construction globally.

Our goal is to win everywhere, and having a diverse portfolio of brands enables growth as markets ebb and flow. In China, for example, we expect to sign more deals this year than last, because we strategically deployed focused-service brands there over the past couple of years, and these brands are now ramping up as full service and luxury development slows.

Our China pipeline now contains 31 Hilton Garden Inns and 13 Hamptons. The first of hundreds of focused-service hotels, we expect to open in China by the end of the decade. We expect the pace of openings in China to increase as more focused-service hotels enter the pipeline with a typical time to build less than half of full service and luxury projects.

While full service and luxury development has slowed, we still see great long-term growth potential in these segments. In fact, we expect to open nearly 20 of these hotels this year with an additional 125 projects in the pipeline. It's worth noting that nearly 30% of our gross openings year-to-date were through conversions, largely to our DoubleTree and Curio brands that grow our system, but do not add to overall lodging supply. These conversions average less than one year in our pipeline before opening and the average has been decreasing, as a Curio can convert to our system in a matter of months.

Our net unit growth is driven by what we believe is the best brand portfolio in the business. Every one of our brands has a growing pipeline and over half the pipeline of rooms are under construction. We have also organically launched three brands in the past few years to address incremental market segments and further our network effect. Home2, Canopy and Curio now account for over 420 hotels and nearly 55,000 rooms either open or in development.

Earlier this month at the Lodging Conference held at the Arizona Biltmore, we began introducing our new midscale brand to owners. The response was extraordinary. We expect to formally launch the brand early next year with a large number of signed deals and believe this could be our largest brand by number of hotels over time, as it serves the largest segment of customer demand.

All of our new brands are driving incremental fee growth at essentially 100% margin, and this has been achieved with no acquisitions and essentially no capital investment on our part. We believe that the scale of our high return organic brand growth leads the industry.

Now, let me take a minute to update you on our view of the cycle and our outlook for the rest of this year and into next. In the U.S., which drives nearly 80% of our earnings, we expect continuing strong fundamentals, driven by moderate demand growth coupled with historically low supply growth. With that setup, until that supply-demand balance meaningfully changes, we should continue delivering mid-single-digit RevPAR growth consistent with the cycle to date.

Supply growth is forecasted to be half of the 30 year average this year and only modestly growing next. There is good visibility into new capacity with years of lead time and annual estimates on supply growth during this cycle have tended to be higher than what was actually delivered. Overall development continues to be largely driven by economically rational projects in markets that can support the room growth.

We get a number of questions about Airbnb's potential impact on supply, so I thought I'd give you a sense of how we view it. As you would expect, we've done a lot of thinking and work on the topic, including having commissioned some independent analysis. The bottom line is we believe that a large portion of Airbnb's demand is incremental. The bulk of the demand is in higher-rated, high-occupancy urban markets. It is longer length of stay with a predominantly leisure and value focus, and stay occasions where customers are willing to accept inconsistent product with very limited services.

We do not believe there is a material impact on the bulk of our markets or with our core business and leisure customers. As we speak to our largest corporate clients, we're confident that Airbnb will not satisfy a meaningful piece of their demand. We'll obviously maintain a watchful eye on Airbnb as time goes on.

Now back to the fundamentals. On the demand side, there's a very high correlation between lodging demand and macroeconomic indicators such as GDP growth and non-residential fixed investment. Both of which are forecasted to modestly increase next year. So, a steady and intact business cycle bodes well for us. Specifically for the fourth quarter, we expect 4% to 6% system-wide RevPAR growth.

In the U.S. for the fourth quarter, we expect RevPAR growth to be consistent to modestly better than the past couple of quarters, driven by a consistent transient demand and improving group trends. Outside the U.S., we expect fourth quarter RevPAR growth to be meaningfully lower than the last couple of quarters in large part driven by the EMEA region after a third quarter that benefited from a tremendous summer season in Europe and a favorable holiday calendar in the Middle East.

Overall, system-wide trends for the fourth quarter are a bit lower than we had anticipated due to the difficult comps in EMEA that I just discussed and U.S. transient growth in October that has not accelerated as we anticipated against a difficult year-over-year comp.

For the full-year 2015, given results to-date and our fourth quarter outlook, we expect system-wide RevPAR growth between 5% to 6.5%. We're raising our full-year 2015 adjusted EBITDA guidance by \$10 million at the midpoint to \$2.84 billion to \$2.87 billion.

Looking ahead to 2016, our guidance reflects our view of continued strong fundamentals and is supported by a group position that continues to track up in the mid-single-digits with a strengthening pace of transient growth consistent with current trends.

As a result, we expect system-wide RevPAR to increase 4% to 6% in 2016, with 75% to 85% of that being driven by rate. We believe that RevPAR growth will be led by the Asia Pacific region and the U.S., both of which should be above the midpoint. We expect RevPAR growth in Europe near the midpoint and the Middle East/Africa region

below the midpoint. We also think that our strong development pipeline will support unit growth acceleration in 2016 translating into global net rooms' growth of 45,000 rooms to 50,000 rooms.

Lastly, we continue to work diligently on potential strategic alternatives for our timeshare and real estate businesses. We've made great progress assessing these complex opportunities and are hoping to be in a position to update you all when we report our year-end results.

With that, I'll turn the call over to Kevin for further details on the quarterly results and our outlook. Kevin?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

Thanks, Chris, and good morning, everyone. During the quarter, our RevPAR growth of 5.8% was driven by a 4.2% increase in average rate and a 1.2 percentage point increase in occupancy to nearly 80%. In actual dollars, system-wide RevPAR increased 3.3%. RevPAR growth year-to-date through September is 5.9%, roughly two-thirds driven by rate.

Diluted earnings per share adjusting for special items was \$0.23, an increase of 28% versus the prior-year period and at the high-end of our guidance range. Adjusted EBITDA was \$758 million for the quarter, an increase of 13% year-over-year, beating the high-end of our guidance by approximately \$8 million. Fee growth and timeshare outperformed expectations with the majority of the timeshare beat being timing driven, which should normalize in Q4.

For the quarter, enterprise-wide adjusted EBITDA margins were up 290 basis points year-over-year to 41.4%, driven by lower-than-expected corporate and other and higher-than-expected fee revenue.

Management franchise fees were \$438 million in the quarter, up 14% over the third quarter of 2014, driven by strong franchise fees, new unit growth and franchise sales.

As noted last quarter, we expect fee growth in the fourth quarter to moderate, owing to accelerated timing of fees booked earlier in the year than we initially anticipated and some one-time items that benefited prior-year results. However, solid comparable fee growth, outsize organic net unit growth, and rising royalty rates continue to provide a healthy setup for future fee growth. And as a result, we are increasing our 2015 management franchise fee growth guidance to between 12% and 14%, an increase of one percentage point at the midpoint.

In the ownership segment, RevPAR grew 6% in the quarter and adjusted EBITDA was \$281 million, up approximately 10% versus the prior-year, adjusted for the sale of Hilton Sydney. Results were boosted by better performance in our international portfolio, particularly our UK hotels, and lower utility prices which supported segment margin expansion of nearly 190 basis points, again adjusting for the Hilton Sydney sale. Adjusted EBITDA was adversely affected by softer demand related to holiday shifts. Hawaii was further affected by weaker transient business from Japan, although strong group position benefited one of our larger properties. Chicago had lower occupancy due to fewer city wides, and renovations at the Moscone Center were somewhat of a headwind in San Francisco.

Timeshare segment revenues increased 13% in the quarter, as a result of continued growth in our capital-light timeshare sales and favorable resort operations. Overall, timeshare sales volume was up 19% in the quarter, driven by tour flow increases of nearly 12% and VPG increases of over 6%. Adjusted EBITDA was \$99 million in the quarter, growing 24% versus the prior-year period. This exceeded our expectations by about \$8 million, which,

as I mentioned earlier, was largely driven by timing. We continue to expect strong tour flow and VPG growth and maintain our timeshare adjusted EBITDA forecast at \$335 million to \$350 million for full-year 2015.

Finally, our corporate expense and other was \$60 million for the quarter, slightly better-than-expectations; and as a result, we now expect growth in that segment to be flat to moderately down year-over-year.

Moving on to our regional results. In the U.S., RevPAR grew 5.1% year-over-year at comparable system-wide hotels, up slightly from 5.0% in Q2. Performance is driven by strong results in July with transient and group revenue both up in the high-single-digits. As we anticipated, growth in August and September was tempered by softer group business, largely attributable to holiday shifts and difficult year-over-year comps. International inbound revenue declined 1.7% during the quarter, owing primarily to weaker demand from Canada, Japan and Brazil; but mitigated by increases from China, Spain and the UK. Year-to-date, revenue from international inbound travel to the U.S. is up 40 basis points versus prior-year, while overall room nights are down 2.9%.

In the Americas outside the U.S., RevPAR grew 7.5%, driven largely by strength in Mexico, and somewhat hindered by softness in Brazil, where performance struggled due to economic weakness and was exacerbated by tough year-over-year comps as we lapped the 2014 World Cup. We expect Brazil to remain soft, but think positive momentum across other countries should continue supporting mid-single-digit RevPAR growth for the full-year.

RevPAR growth in Europe increased 8.8% in the quarter, driven by three consecutive months of robust growth in the region and continued market share gains, with our RevPAR index in Europe, up one point, two points for the quarter. Improving fundamentals were supported by a record breaking summer in Continental Europe, which benefited from tremendous leisure transient business. U.S. travel to Continental Europe increased 14% year-to-date. Results were modestly tempered by softer group volumes, given difficult 2014 comps from events such as the Commonwealth Games and the Ryder Cup.

While challenges in Eastern Europe, particularly in Russia, continue to pressure regional performance, we remain confident in our ability to deliver solid results, given increased inbound travel and local demand, coupled with rising market share. We maintain our mid-single-digit RevPAR growth forecast for 2015.

In the Middle East and Africa region, RevPAR grew a strong 9.1%, due to continued recovery in Egypt, which posted its strongest quarter since 2010. Additionally, Saudi Arabia benefited from stronger group performance owing to favorable calendar shifts in Ramadan and the Hajj, which will in turn weigh on fourth quarter results. We anticipate low-single-digit RevPAR growth forecast for the year.

In the Asia Pacific region, RevPAR increased a robust 10.2% versus prior-year, driven largely by a 23.9% gain in Japan, as the country continued to benefit from increased local demand and influx from Mainland China and strong transient rate. Additionally, easy comparisons aided performance in Thailand. Strong corporate transient leisure volumes coupled with market share gains supported 7.6% RevPAR growth in Mainland China.

We expect trends in China to remain favorable, in spite of broader economic deceleration. We think increased outbound demand from the UK and U.S. combined with our market mix and market share gains, position us to continue delivering solid growth. Our RevPAR growth forecast for China remains 6% to 8%, and we maintain our high-single-digit growth expectations for the Asia Pacific region.

Turning to capital allocation, we reduced long-term debt by \$350 million during the quarter, with a subsequent payment of \$100 million in October, bringing total debt reduction year-to-date to \$850 million. We ended the quarter with a net debt-to-trailing 12-month adjusted EBITDA ratio of 3.4 times. We paid our first quarterly dividend in September and expect to maintain a target payout ratio of 30% to 40% of recurring cash flow. We are

on track to achieve a low-grade investment grade credit profile by the second quarter or third quarter of next year. At which point, we would likely commence programmatic share buybacks.

In terms of our outlook for the full-year, as Chris mentioned, we are narrowing system-wide RevPAR growth guidance to between 5% and 6.5% on a comparable currency-neutral basis. We are raising our full-year adjusted EBITDA guidance range by \$10 million at the midpoint to \$2.84 billion to \$2.87 billion. Our full-year guidance continues to assume approximately \$60 million related to FX impacts for the year.

For the fourth quarter of 2015, we expect system-wide RevPAR to increase between 4% and 6% on a comp currency-neutral basis, adjusted EBITDA of between \$706 million and \$736 million and diluted EPS adjusted for special items of \$0.21 to \$0.23. Further detail on our third quarter results and updated guidance can be found in the earnings release we distributed earlier this morning.

This completes our prepared remarks. We would now like to open the line for any questions you may have. In order to speak to as many of you as possible, we ask that you limit yourself to one question and one follow-up.

Sally, can we have our first question, please?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Shaun Kelley with Bank of America Merrill Lynch. Your line is open.

Shaun Kelley

Bank of America Merrill Lynch

Hi. Good morning, everyone.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

Good morning, Shaun.

A

Shaun Kelley

Bank of America Merrill Lynch

Chris, thank you for the detailed kind of overview in the prepared remarks. One thing that I think is on people's minds is sort of what you're seeing so far into the 4Q. And you talked a little bit about a little bit softer transient growth in October than maybe you had expected.

Q

So, I was curious. I think coming into the quarter, most investors expected that 4Q is going to be better than 3Q. If you could just elaborate a little bit on sort of what you're seeing in the business right now, I think that would be helpful?

Christopher J. Nassetta

President, Chief Executive Officer & Director

Yeah. No, I assume somebody or many people would ask that question, because it's on everybody's mind, and we've obviously spent a lot of time looking at what's going on in the results.

A

Focusing on the U.S. for the moment, which is, my guess is, what you're more focused on in your question, I think what we're seeing is generally consistent with what we would have expected with one exception. I mean, the group side in the fourth quarter is getting better as we expected.

The transient side of the business is generally tracking consistent with what we saw over the last quarters, as I said in the prepared comments. And when you put those two together, that's how you get a U.S. fourth quarter that we said will be sort of similar to modestly better than what we've seen in the last couple of quarters.

I will say we had anticipated, forecasted, maybe hoped for, a transient pace that would pick up in the fourth quarter, and particularly in October, which is a very big transient month, and that has not materialized the way we had thought.

Now, I'm not one that likes to sort of give you there are 50 excuses or reasons, why. I mean, when we look at it, and we sort of still – trying to understand everything in a great amount of detail, it seems like it's a few things that's going on in October. One, you're in a month where you have very high levels of occupancy in the low-80%s. So, that is an issue.

The comps over last year, you had high-single-digit transient growth last year. So, you put those two things together, it makes it hard to sort of expect a lot. And so, in part, maybe we were a bit aggressive in our views of a pickup in transient business in October. What's really happening, as I said, is it's stable. It hasn't really ticked down. It hasn't ticked up. It's been relatively stable.

The other thing that's going on, and it's hard to perfectly scientifically quantify this, we had two hurricanes, and I know everybody sort of gets tired of weather, but weather has an impact, and we had two hurricanes that ended up, net-net on the East Coast and other parts of the country, cancelling thousands of flights, so people couldn't get places.

We do think that in October, in transient, that there was some impact in that regard. And I would say in the corporate business, which is what we expected to pick up, it has been a little bit choppier than we expected, meaning the net result is about where we've been. There have been weeks that have been better and worse, so a little bit choppier.

So, it's a whole bunch of stuff. I guess the primary theme that I would sort of glean from all that, and I would suggest is what we've gleaned from it all, is that what we're really seeing in the fourth quarter is strengthening of group the way you expect it, particularly in October, and transient that is clicking along pretty much like the second quarter and third quarter. And those things are combining to drive a reasonably good result, sort of where we've been or a little bit better in the U.S.

The rest of the world, which is why the fourth quarter number is 4% to 6%, is really a comp exercise. Particularly off of third quarter, you had massive leisure season in Europe with Europe on sale. In the Middle East, you had the hard shift from fourth quarter last year to the third quarter. When you put those two things together, our RevPAR growth in the rest of the world was just fine for the year and will be fine next year and everything is good. It's just that the comp issue will be less than half of what it was in Q3.

So, you put together a stable to modestly better U.S. story with the comp issues in the rest of the world, and that's sort of how you get there. But we're – the things are developing, as I said, pretty much what we thought with the exception of not seeing the pickup in transient demand in October that we forecasted.

Shaun Kelley
Bank of America Merrill Lynch

Q

Thank you very much.

Operator: And your next question comes from the line of Carlo Santarelli with Deutsche Bank. Your line is open.

Carlo Santarelli
Deutsche Bank Securities, Inc.

Q

Hey, everyone. Good morning. I had...

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

Good morning.

Carlo Santarelli
Deutsche Bank Securities, Inc.

Q

...two questions. One, Chris, if you wouldn't mind sharing kind of how your view around some of the strategic initiatives you've previously spoken about has changed. And secondly, if I could ask, as it pertains to your outlook, how much of the change and maybe the tone around 2016 and beyond stems from what you're seeing in your own business today versus maybe what you're seeing and hearing from commentary of complementary peer industries?

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

Yeah. Happy to cover both. On the strategic initiatives, I covered it, albeit, briefly in my prepared comments. And not to repeat it, we are making really good progress. They're massively complex sort of options that we're thinking through and with lots of different moving parts. And I would say, we don't really think about it any differently than any prior commentary that I've made.

But we're not in a position to really get into it at any level of detail, at this point, until we finish the process. And that's because, honestly, I think it's just unfair to piecemeal it and talk about one element of it without talking about all elements of it.

So, we're making progress. It's maybe taking us honestly a little bit longer. But, as you can imagine, there are lots of things going on that impact it. And we're, I think, rapidly getting there. And we'll be in a position to lay it all out for you, guys, whatever it is that we think makes sense and it's not too far out.

In terms of 2016 guidance, I'm glad you asked it because you may or may not like the answer. We obviously look at our performance on a forward-looking basis in a very granular way. We go through a very detailed budget by property and aggregate that altogether to determine, where we think we're going to be in the world. And we are not quite complete, but we're very, very close to complete.

And I think we're not going to share that budget. Obviously, we never do, but I think, it would be supportive of what I suggested in my commentary, which is we're still at a very healthy part of the cycle where we have moderate demand growth matched with very limited capacity additions and we're going to drive, I think very healthy RevPAR growth and that – so, the underpinning of that is that we feel good about things. We think that

the transient trends we see here and now that I just described supported our group position in the next year and the mid-single-digit supports it.

And so, that's how we've sort of determined it. As you can imagine, our budgets are likely more at the higher end than anywhere else. But, we're always – you don't get what you don't ask for at the property level, and we're always pushing.

There is a level, and I'll be perfectly honest and not in a sense, not perfectly scientific, there is sort of a overlay of a bit of conservatism that we've put in our guidance that we just described – that Kevin and I just described to you and that is just because we're out there, we're talking to all of you, we're talking to – I'm talking to a lot of contemporaries in lots of different industries, we read the papers, watch the news.

And I think vis-à-vis this summer even, the macroeconomic risk profile has gone up a little bit, right? I mean, we're very optimistic, you know that, you heard my description of what we think we can deliver and we're in a good healthy part of the cycle, but there are more, I think a little bit higher level of macro risk than might have existed three months, four months, five months, six months ago. And so, we have definitely sort of put an overlay, a bit of an overlay of conservatism into our guidance to take that into account.

Carlo Santarelli

Deutsche Bank Securities, Inc.

Great. Thanks very much, Chris.

Q

Operator: And your next question comes from the line of Robin Farley with UBS. Your line is open.

Robin M. Farley

UBS Securities LLC

Great. Thanks. Just looking at the guidance you gave by region, it sounded like each region was essentially unchanged in your guidance, but the overall guidance came down. Should we just think about it being lower in the range, I mean, I don't know if this transient comment is mostly a U.S. issue or is that something that you're seeing in those other regions as well?

And then maybe just as a quick follow-up and maybe this one's for Kevin. Your full-year EPS guidance was unchanged at the midpoint, but your EBITDA went up at the midpoint, and I guess maybe just some color about why we're not seeing more flow through from that, because I don't think your corporate expense is any higher. So, just some color on that...

Christopher J. Nassetta

President, Chief Executive Officer & Director

I'll take the first, leave Kevin the second. In terms of our guidance I mean, I was trying to really give you a super high level trajectory on, by the region. So, I don't think your math is necessarily wrong. And I think my last answer probably is the right answer, which is, what we've tried to do is look at what we think will happen by property, by region, and then we have – there's an overlay of a bit of conservatism.

Robin M. Farley

UBS Securities LLC

Is it more the U.S. where if we think about your guidance moving within the range unchanged, but where within the range it's moved, is that more of...

Q

A

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

I would say, Robin, to be honest, it's sort of across the board. Probably, our conservatism is – there are a lot of things going on in the world. I think the risk profile in the world is a little bit higher than it was. And so, I assume, it's sort of a general sort of risk overlay of conservatism. Not specific to U.S. Obviously the U.S. is the biggest part of the business. So, by the very nature of that overlay, it'll be predominantly a U.S. overlay.

Robin M. Farley

UBS Securities LLC

Q

Okay. Great. Thanks.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

And then, Robin, the full-year EPS is just in – and the outlook there is an incremental \$0.01 of FX translation in there that just kept us from moving the range up.

Robin M. Farley

UBS Securities LLC

Q

Okay. Great. Thank you very much.

Operator: And your next question comes from the line of Joe Greff of JPMorgan. Your line is open.

Joseph R. Greff

JPMorgan Securities LLC

Q

Hey. Good morning, everybody.

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Good morning.

Joseph R. Greff

JPMorgan Securities LLC

Q

Chris, not to beat the dead horse here about the trending commentary in October, but it sounded like it was a pretty broad statement for the U.S. But can you talk about what markets where, maybe things were not as bad or can you just talk about whether it was – how market-specific or how chain scale segment-specific the trends that you're seeing so far in October?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah, I'll maybe give it to Kevin by market. But I would say, it was – we had expected broadly an increase in transient. Again, we may have been wrong in expecting that, given the high occupancy months that we're in and the comps. We expected it broadly, and I'd say the trends have been – every market is a little different, but the trends have generally been consistent.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

Yeah. I think that's right. They've been pretty consistent. Obviously, Joe, every market has its own story, but – and the larger markets with larger hotels tend to have a bigger impact for us overall. But, I think they've been generally pretty consistent.

Joseph R. Greff

JPMorgan Securities LLC

Q

Great. And can you talk about your outlook for corporate negotiated rates? As we're kind of in the midst of that negotiation, what your expectations are broadly?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah. I think we – I just was with our team that is in the middle of those negotiations the end of last week, and I think we're probably in the mid-single-digits, maybe mid-single-digits plus.

Joseph R. Greff

JPMorgan Securities LLC

Q

Okay. Thanks, guys.

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yes.

Operator: And your next question comes from the line of Harry Curtis with Nomura. Your line is open.

Harry C. Curtis

Nomura Securities International, Inc.

Q

Thanks. Good morning.

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Good morning.

Harry C. Curtis

Nomura Securities International, Inc.

Q

First question is, if in October you're seeing record occupancy, what's keeping your property managers from pushing rate more?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

I think we are trying to push rate, I think as you will probably end up seeing in October that most of the RevPAR growth is going to be rate. So, we're having some success market-by-market, but I think you'll see the lion's share of the growth that came through rate. Because there's just not that much more occupancy to get particularly

during the week, so it should be all rate. And I think we're – I think we can always do better. I think we're having reasonable success there.

Harry C. Curtis

Nomura Securities International, Inc.

Q

And second question is turning to Airbnb. I think that Airbnb is working hard at addressing some of their weaknesses related to appealing to the corporate traveler. How likely in your view is it that they'll be able to overcome some of the more obvious issues of, for example, duty of care and the lack of amenities?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

I think it's relatively impossible. I mean, the way I think about Airbnb, is it – it's really, as I described, sort of largely urban – high-rated urban markets, where – and where their business thrives, as where there isn't enough capacity broadly in the market.

And it is generally for more extended stay. And with the leisure, even when it's business that has sort of a leisure component, bringing your family or part business, part leisure. And I view that as an evolving segment, if you will, that is satisfying maybe some of our customers. I'm sure some of our customers, but a lot of incremental customers that aren't our customers' needs in a way that haven't been satisfied before, which is why you see a very large component of Airbnb's business being incremental, meaning they're creating trip occasions that wouldn't have existed otherwise.

So, I think, as they sort of carve that niche, I think it becomes more of a segment onto itself. I do not believe strongly, do not believe that they are a major threat to the core value proposition we have, which is consistently high quality product and service delivery. And service delivery incorporates into it, a significant amenity package. Just simply, because I don't think that given the segment they've carved out in the model that there's a real ability to do the things that we do.

Again, it doesn't mean I think Airbnb is not a really good business. And that business is going to be around for a long time. I think it is a good business. It will be around. I just think it is serving a different kind of need. It's a different – it's a segment onto itself. And the segments that we are serving largely, I think, will remain separate and distinct from that. And I think it's very hard for us to do exactly what they're doing. I think it's extremely hard for them to be able to do – replicate what we're doing.

And I don't think customers suddenly woke up, our core customers, and said, we really don't care about consistently high-quality products and we don't need service and we don't need amenities. I just don't buy it. And by the way, scientifically, and the research that we've done and we've done an immense amount of it, that's not what customers are saying to us, quite to the contrary. They're saying they want – our core customers want more consistency, more quality, more service delivery, more of the amenities that they want and that they value.

Harry C. Curtis

Nomura Securities International, Inc.

Q

That's great. Thanks, Chris.

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yup.

Operator: And your next question comes from the line of Jeff Donnelly with Wells Fargo. Your line is open.

Jeff J. Donnelly
Wells Fargo Securities LLC

Q

Good morning, guys. Two questions, actually just continuing first with Airbnb. Chris, down the road, how do you think their platform evolved? Do you think it's maybe strategically combined with the major hotel brand and there's a reason for having a continual product from hotel rooms to Airbnb product? Or do you see it may be going the other way towards more of the reservations than like in Expedia?

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

It's hard to say. You should ask those guys. I mean, I might have an idea if I were running it, but I'm not. I don't think it becomes connected to hotel brands, not that I can see wrong. I don't see that, but it's possible. I mean, if you believe what I just said a few minutes ago that it's sort of developing into its own segment, one of the big hotel company could say that the segment we want to serve and we don't serve and we don't think it cannibalizes any of the rest of our business, which I'd happen to believe is true, and we want to have that segment.

But I wouldn't probably view that as a high probability. I think if you look at it, they're creating a very loyal customer base that wants to buy things through their system. So, I don't know. If I had to guess, it becomes through those loyal customers or broader platform to do other things.

But again, they don't have a call, I guess, since they are private. But they've lots of investors. So, I guess, I'd ask them. I do believe that strongly, as I said, that there is every ability for us to coexist. I know a lot of people are spending a lot of time. We're spending a lot of time on this call and for good reasons.

By the way, I told you in my prepared comments, we've thought about it a lot. We've done a lot of research independently in ourselves. So, you guys should care about it. But I suspect over time, the investors, everybody will see it for what it is, which is a really good business. But a business that is maybe not 100%, but largely distinct from what we do and that there is every opportunity for both of us to have really successful business models.

Jeff J. Donnelly
Wells Fargo Securities LLC

Q

And then, just as a follow-up. Obviously, there's lots of banter in the press about what's going on with Star, either with Hyatt or a Chinese buyer. How does the thread of a potential combination between whoever, Hyatt or a Chinese buyer, maybe affect your thinking on the strategic landscape. And maybe second to that, can we rule out Hilton's interest there?

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

The second first, you can rule out Hilton's interest. Okay. So, to be in abundance of clarity, we are not involved in the process in anyway. Secondly and the second, why I went that in that order is because it leads to the second and the reason that we're not is we feel – I'm not going to comment on who might do what. It's not my business, and I don't know other than the rumors and what I read like you.

The reason we're not involved in that process and the reason I'm not worried about what happens there is, we feel very good about the setup that we have. We feel like we've done an amazing job transforming this business over

the last eight years to create a real formidable network effect with both our scale, our geographic diversity, our chain scale diversity, the strength of our individual brands, every one of which is either a category killer or leads the industry.

And on average, the highest market share in the industry, having launched three new brands with an opportunity to launch more, one coming around the bend, and be able to do that in a way where we're leading the industry in organic growth and driving incredibly high returns, incrementally infinite return in IRRs and 100% margin business.

We don't feel – while we feel like there are always going to be gaps that we need to think about, they're relatively modest and those are opportunities. Those are not weaknesses for us, given the other attributes that we already have.

So, when we look at the world, I think we got to run the company well, we can't get complacent with just what happened to our company up until eight years ago. We sort of got at the top of the hill and became complacent. We are not going to get complacent, not while I'm here. We're going to stay on the balls of our feet. We have an amazing business, an amazing opportunity in front of us, and that's what we're focused on, optimizing for all of our benefits.

Jeff J. Donnelly
Wells Fargo Securities LLC

Thanks.

Q

Operator: And your next question comes from the line of Bill Crow with Raymond James. Your line is open.

Bill A. Crow
Raymond James & Associates, Inc.

Hey. Good morning, guys. Thanks.

Q

Christopher J. Nassetta
President, Chief Executive Officer & Director

Hey, Bill.

A

Bill A. Crow
Raymond James & Associates, Inc.

Chris, you did – hey. You did a great job in the introduction talking about the fundamentals and you paint it with kind of a broad brush. But if we take a little finer look and we kind of get beyond national supply and demand statistics and we start looking at the bigger gateway cities, it certainly seems like there is some underperformance there that might otherwise be masked.

Q

I don't know, whether it's international demand, I hate to mention Airbnb at this point or maybe increased supply where we're hearing 2%, 3%, 4% in many of these big markets. I guess the question is what do you see and with your pipeline, with your owned assets, turn many of these markets, what do you have to say about those kind of gateway cities?

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

Yeah. I mean, honestly, you're right. Every major city's got a different story. I would say broadly outside of New York, Bill, we don't see a lot of – I mean, people have been talking about Airbnb and other things in San Francisco. We're going to be double-digit RevPAR growth this year, and we think next year is going to be another really good year in San Francisco. New Orleans, a great story. We're having a great year in Chicago, maybe a little bit weaker there next year than this year.

I mean, outside of New York, I would say, we just don't see particularly significant issues. The way I'd look at it is, we've gone through all our major markets and sort of filtered it for our business, which is to say, where are the markets that maybe have a little bit more than the national average of supplies, but – and that don't – where we have a big presence or relatively big presence and that don't have demand that is exceeding that, meaning they have other things going on.

And that's sort of, I think, as we run the business, the right filter to look at it, because some markets are going to have excess supply more than the national average like a Seattle, but demand growth is phenomenal. And so the story goes.

So, it's not just supply. It's supply against demand, and then, for us, it's where do we have a presence. And when I do – when I put it through all those filters, New York is obviously sort of the one that continues to stand out. I would say probably the Texas markets, particularly Dallas and Houston, because there has been a bunch – a little bit more supply, and they have demand issues, given what's going on with oil and gas.

I would say beyond that, maybe a touch of Miami, but demand growth coming out of Latin America has been quite strong, because there's a little bit more supply growth, but there's also pretty good demand growth. I think we're going to be 7% growth this year in the Miami market.

Chicago, a little bit – which is a market that depends on McCormick, I would say, if you could look at next year and say maybe Chicago has a little bit more – is having a great year. This year, Chicago is probably having a little bit more supply than we've seen demand growth, because of the convention cycle next year coming out of McCormick. So, maybe Chicago will be sort of a little bit on that list, but that's sort of the list.

And when we look at the percentage other than New York, which is 4% of our EBITDA, I mean, you go to the Texas markets, that's one or one in change. Miami, which I don't think is an issue, is less than 1%. I mean, this is the benefit of diversification and having a very big broad portfolio that not only is sort of spread around the world, but spread around the United States.

So, I'm not trying to – there is definitely – there are some markets that have a little more supply than others. I just don't think – as we look at it through our filters, it's not wholesale by any means. They're just a few select places that we think about and where we'd have a little bit more concern. But generally, I think the story across the country is quite intact.

Bill A. Crow

Raymond James & Associates, Inc.

Q

I appreciate that. Very quickly, Kevin, I think in your prepared remarks you talked about achieving a low investment grade rating midpoint in next year, I think, or early to mid next year. Is it – it seems like that's pushed back a little bit from earlier expectations. Is that fair and why?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

No, I think it's on track, Bill. I think that it's – that's where we think the credit profile will get into the zone. We had originally said 3% to 4% when we came out, and we are in the 4% and then I think we said last quarter on our call that we had refined that range, just been thinking with – in discussions with the rating agencies and how they look at the business, because they think about the business differently as you get into different portions of the cycle. So, I'd say plus or minus on track.

Bill A. Crow

Raymond James & Associates, Inc.

Okay. Thank you.

Q

Operator: And your next question comes from the line of Felicia Hendrix with Barclays. Your line is open.

Felicia Hendrix

Barclays Capital, Inc.

Hi. Good morning.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

Good morning.

A

Felicia Hendrix

Barclays Capital, Inc.

Chris, just on – good morning. Just going back to your outlook for group next year. I believe I heard this correctly. You said that it was up in the mid-single-digits for 2016. Is that on rates or bookings, both?

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

That is both. I think, the best I remember, it's two-thirds rate – 60/40 rate spot.

A

Felicia Hendrix

Barclays Capital, Inc.

Okay. Great. And then, and can you just dig in further to what you're seeing in terms of the complexion of that demand? Are you seeing your different industries, industries switching to that? Are you seeing more or less sensitivity to rate or bookings, some color around – just any kind of detail you can give of what you're seeing?

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

Yeah. I mean, there are a few things that we've been looking at that I think are interesting, but not inconsistent with what you would think. I think in terms of the types of business, the growth is coming predominantly in corporate groups. But the big association groups are coming back. So, the average-sized group is getting a little bit bigger, not surprisingly, as you get into the group cycle coming back in a more fulsome way.

A

The length of the booking window has extended. And I actually ran the stats across all size groups last week with our guys and it's a month to a-month-and-a-half extension in the booking cycle, because you're having months which are big group months like October where we're running 83%. People get trained to think, wow, there's no capacity, so I better start booking a little further out.

So, I think that's a good trend, but a natural trend. I think in terms of spend, it depends on any quarter what's going on. But broadly, I think those trends are kind of following what we would expect. If we look at sort of the owned and operated hotels this year, and what kind of food and beverage catering growth we're going to see against the RevPAR growth. It's probably 60% to 70%.

Honestly, we had probably hoped for it to be a little bit better, a little bit more comparable, and that has to do with sort of partly the third quarter calendar shifts, with that impacting group in the quarter has a meaningful impact on the full-year.

But generally, I think the spend trends are headed in a good direction. As you get the bigger groups coming back, which we're seeing in corporate groups, I think you'll continue to see the food and beverage spend sort of tick up naturally. So, I guess those are a few things that may be fun facts that I think, again, are interesting. That's what you should expect to see as group comes back, and we are.

Felicia Hendrix

Barclays Capital, Inc.

Q

That's helpful. And then switching gears, Kevin, obviously, you guys are very clearly focused on driving shareholder value. And thank you all for the color in terms of just reminding us that we're going to get an update when you next report. But just thinking – how are you thinking about your strategic options, given the decline in REIT and timeshare multiples?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

Yeah. I think Chris said it before, Felicia, so I'm probably not going to say too much more, as you can probably imagine. But, we don't think about this really any differently than we've thought about it before. These are long-term decisions we're making to drive shareholder value, as you mentioned. And so, we're still thinking about it the same way.

Felicia Hendrix

Barclays Capital, Inc.

Q

Okay. Thank you.

Operator: And your next question comes from the line of Steven Kent with Goldman Sachs. Your line is open.

Steven E. Kent

Goldman Sachs & Co.

Q

Hi. Just a couple questions. You mentioned earlier that your time share sales were a little bit better in the quarter based on timing. And I just wanted to understand a little bit of what was going into that. Also just as an aside just because it's interesting, because a lot of your growth is coming in Asia, you announced the partnership with Plateno to build 400 Hampton in China over the next few years. You did that back in October 2014.

And now, Plateno has been acquired. So, does this change your ability to grow into that market? And then, just one final question, because I just think it's interesting. Occupancy is at very, very high levels right now. And as you noted, it's been a little bit hard to push rate. Is there anything, Chris or Kevin, you think changed structurally that makes it harder to push rate higher when the elasticity is pretty high?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah. I'll maybe take the second and third, and let Kevin take the timeshare on and in reverse order maybe. On occupancy, personally, I don't believe, I said, we're having a hard time. I said we can always do better, it's what I recall saying. And that we're driving the majority of our – in these high-occupancy periods, the majority of our growth is coming in rates.

So, I mean, I think we are achieving that. What I think it has to do with, Steve, honestly, more than anything is just sort of what it's been, how much areas in the balloon generally from a macroeconomic point of view. And that is to say, this has been – we've had reasonable demand growth, but not sort of skyrocketing demand growth. The reason that we've been able to deliver these mid-single-digits RevPAR number is, because we had such a dramatic decline in capacity.

So, I think there's obviously more transparency. We've had transparency for a while, maybe it's getting – of course, it's getting better, but we've had pretty good transparency for a while. I think it has to do more with the fact that this recovery has been a very tepid recovery. And as a result, if you look at what's going on in corporate America, there is always – there's not sort of a really robust feeling that exists out there that you would have had with a more robust recovery that would help you push rates even further.

So, as a percentage of our overall growth that's following a natural curve, in my opinion, relative to what the macro conditions are giving us. And I don't think, honestly, that there's any – I think it's over-thinking it to go a whole lot further than that, personally, based on experience.

On the Plateno/Jin Jiang, we've obviously had a good relationship with Plateno. We've been well aware long before this became public knowledge about what they were doing with Jin Jiang. And I think our attitude is that it makes them a better, stronger partner because they become bigger, better, stronger. They remain, as we do, committed to the things that we're trying to do together in China with Hampton.

So, I think, based on everything we've seen and talking with them throughout the process of their discussions with Jin Jiang, what we see in actual production on the development side, they're ahead of all their targets. They seem unbelievably focused on achieving success in this relationship, and I have every reason to believe that based on what they've said and what I see.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

Yeah. And then, Steve, on the timeshare question, it's interesting. Our full-year outlook, the timing differences is really not on the sales side. Our full-year outlook is still in the high-teens for overall sales for the year. As you know from covering the business, it's really earnings recognition that can have differences in timing. So, that's all it is.

Steven E. Kent

Goldman Sachs & Co.

Q

Okay. Thanks for your color.

Operator: Your next question comes from the line of Thomas Allen with Morgan Stanley. Your line is open.

Thomas G. Allen
Morgan Stanley & Co. LLC

Q

Hey. Good morning. Two questions on supply. The first one just around – is there – it's a simple question, so would it be able to take one adjust for your geographic and maybe chain scale exposure and get a supply forecast, maybe compare it or more qualitatively how would it compare to STR's forecast.

And then second question, that was an interesting article in The Wall Street Journal, I think it was last week about all the soft brands and highlighting potential risk to DoubleTree, you obviously have positive comments about unit growth there. Just wanted to hear your latest thinking about that potential risk? Thank you.

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

I seem to be doing everything in reverse order. I'll take the second one and get Kevin the first. On the soft brand actually, I think if you get into in detail what's going on with DoubleTree is that we've had an unbelievable success story for a whole bunch of reasons. When we got here new team eight years ago, we really viewed DoubleTree, particularly as the market started to go and decline, as a unique opportunity for growth, unique in the sense that none of the big global brands was out playing in the space, sort of below the core up or upscale space in full service, almost a bridge between limited service and full service.

And our view is as we reinvent DoubleTree from a product, service point of view, to sort of to get into that strata, we could really drive a great customer experience; but ultimately drive great market share and great unit growth and that's exactly what happened.

And thankfully, our competitors gave us a very wide berth. So, in that six years or whatever. We took market share from not being at fair share. We increased it, I would say, 700 basis points or 800 basis points. And even taking out 10% of the system at the bottom, that didn't meet the quality standards. We doubled the size of the brand and we continue to have great, amazing momentum. It has been and will continue to be a great engine of growth for conversions and new builds. I mean, doing plenty of new builds in other places around the world, obviously not much of any full service stuff getting done in the U.S.

We clearly – it sounds like Marriott has said they bought Delta to compete with it. That's what I hear and that's what I read in the papers, and others are doing other things. Clearly, we will have some competition. We're not afraid of competition. It makes us better. We don't – we think DoubleTree has been and continues to be unique. It has a huge global pipeline that is way ahead of what anybody else is doing and it's ultimately the best test is in market share.

So, a lot of these upstarts ultimately at the moment don't have the value – in my opinion, don't have the same value proposition to deliver for the ownership community, which is a premium market share that we have been able to deliver into the DoubleTree brand. So, we think there's good – there'll be more competition. It's a competitive world. We feel really good about what we'll be able to do in that world.

Kevin J. Jacobs
Executive Vice President and Chief Financial Officer

A

Yeah. And, Thomas, on the supply side, I mean and the short answer is, we have very broad diversification, as you know, particularly in the United States, if you're talking about that. And so, we tend to become pretty much an index.

And so, while I don't have the exact numbers in front of me, I'd say it really wouldn't be any different of a supply story in our markets, weighted for our markets. In places, where we would have more supply, obviously we're 20% plus or minus 20% of the rooms under construction in the U.S. versus 10% of the installed base.

So, we're getting more of our fair share, but I think as Chris has said before, we're getting more of our fair share in the places where there's more demand for the product and where our brand compete quite effectively. So, I don't think the story is any different on supply for us than it is for the industry overall.

Thomas G. Allen
Morgan Stanley & Co. LLC

Thank you.

Operator: And your next question comes from the line of Vince Ciepiel with Cleveland Research. Your line is open.

Vince Ciepiel
Cleveland Research Co. LLC

Hi. Thanks for taking my question. First question on unit growth, as you look at signings in the quarter and the positive reception to your new midscale brand and then the ramp of some of the newer products like Home2 and Homewood. What's the unit growth set up heading into next year versus this same time last year heading into 2015?

Christopher J. Nassetta
President, Chief Executive Officer & Director

I think accelerating in terms of signings and in actual deliveries. I mean, we're going to sign this year, as I've said in our prepared comments, hopefully 100,000 or close to 100,000 rooms. That's the biggest I think anybody has ever – and certainly, it's the biggest we've done. I think it's the biggest anybody's ever done in a year in the industry. And by the way, that's no midscale, that will be probably in that pipeline number that will probably be zero or maybe a de minimis number.

So, that will incrementally add to it and that will take a little bit of time to get that launched and ramped. But I think given the product and the price point and the shorter gestation period, you're going to see that be productive at a fairly rapid pace. So, I think we think things are accelerating modestly off a great year this year, they're accelerating modestly into next.

Vince Ciepiel
Cleveland Research Co. LLC

Great. Thanks. And then finally, looking at occupancy in the U.S., it looks like you're up 120 bps year-to-date, which puts you at 78%, which is one of the higher occupancy amongst the brands, I think, domestically. How is that compared to your initial expectations heading into the year? And maybe you could kind of comment on what you're seeing domestic group, domestic transient, and maybe the impact from inbound arrivals, how it's tracked versus that initial expectation?

Christopher J. Nassetta
President, Chief Executive Officer & Director

I think the short answer is, it's generally consistent with expectations for the year within minor rounding here. So, we think next year, as I described, a lot more of the growth is going to come to rate, so much more modest

occupancy gains overall. There are lots of factors sort of moving it one way or another. International has obviously been, from a volume point of view, a bit of a drag, but there are other things that have been sort of benefiting us. And most particularly, the group as – we've all been waiting for the group cycle to get more in full swing. We're starting to see that.

And that's a very healthy thing for the business, because it not only gives us more occupancy and build the base, but it allows us ultimately to leverage off of that base to drive more rates for us, which is part – in part, why you're seeing 75% to 80% of our RevPAR growth forecasted next year to be on the rate side. So, I think it's generally consistent with what we thought. And next year is consistent with what we would expect to see at this stage of the cycle.

Vince Ciepiel

Cleveland Research Co. LLC

Great. Thanks very much.

Christopher J. Nassetta

President, Chief Executive Officer & Director

Yup.

Operator: Your next question comes from the line of Joel Simkins with Credit Suisse. Your line is open.

Joel H. Simkins

Credit Suisse Securities (USA) LLC (Broker)

Yeah. Good morning and thanks for taking my call. Chris, as you think about your ability to take price over the next year or so, I mean, how much does the kind of the airline industries factor into the mix? Obviously, they have taken up price. And I have to imagine your corporate partners, do you think about kind of the total travel costs? So, does that in any way sort of crimp your ability to kind of continue to push through rate?

Christopher J. Nassetta

President, Chief Executive Officer & Director

I guess the answer would be, sort of logically, yes, it would at some point. I don't think the airlines are moving their rates so much that it's really – that we're seeing any impact and we'll watch it carefully. But, I ultimately think both of us are moving our rates because of underlying fundamentals of sort of the law of the supply and demand.

They're doing what they do to limit capacity to drive prices up. We have limited capacity because not a lot of people are adding. So, if the balloon is filled with air, meaning the broader economy continues to go, I think it gives us pricing power. So, I don't see, based on the current trajectory of what they're doing, what the economy is doing, that that crimps what we think we'll deliver.

Joel H. Simkins

Credit Suisse Securities (USA) LLC (Broker)

Sure. And one quick follow-up here, as we think about CapEx for 2016, is it a little too early to start commenting on that or should we expect to hear any sort of detail around specific hotel projects? Could you update us on the real estate?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah. We're going to – and Kevin could comment. We're going to give you obviously. Now we're just giving you sort of the high level like we always do this time of the year. We're not done with our budget process. We'll give you that on our next call. I would say as a leading indicator, because we're pretty far down the line, nothing unusual in CapEx, nothing out of the norm from what we've gotten this year.

Joel H. Simkins

Credit Suisse Securities (USA) LLC (Broker)

Q

Thank you.

Operator: Your next question comes from the line of Smedes Rose with Citigroup. Your line is open.

Smedes Rose

Citigroup Global Markets, Inc. (Broker)

Q

Hi. Thanks. I got something to ask. You spoke on supply a little bit and I was just curious if you're seeing anything kind of on the ground level on the development side on the ability to access financing either in kind of core U.S. markets, where it does seem like there's a little bit of an uptick in supply – you mentioned Chicago, and we see – and obviously, there's a lot coming in New York. So core markets, I guess, versus secondary markets. Is one remain easier than the other? Do you feel like overall developers can kind of get development loans, or kind of maybe what are you seeing...

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

So, I'd say, overall, it's still hard. I'd say only the best developers with the best brands are getting financed. And I know that sort of sounds like I'm being partial with our brands and I am, but it happens to be true. So, I don't think there's indiscriminate lending going on. I think it is heavily underwritten with the best of the best, both owner and brand.

I would say if you look at it statistically, more of it is getting financed in secondary and tertiary market. It's almost all limited service, okay, and it remains that. You haven't seen it creep up with lots of full service or any real luxury spattering and stuff, but it's almost all limited service.

And if you look at the bulk of the numbers, it's in secondary and tertiary markets, because – for a simple reason, that's where it has made the most economic sense; and in part, an issue that people don't talk about enough, because it's hard to scientifically sort of prove it out.

But there is more massive obsolescence issues in those secondary and tertiary markets, where what – you may not have a hotel that's going out of supply that a Hampton or a Garden Inn or a Homewood is replacing, but you have hotels that are sort of past their useful life. They're going to stay open. They're not going to bulldoze them, but they're going to go down the scale of sort of brands and price points. And so in reality, they're not truly in our competitive set.

That obsolescence issue is a much more of a secondary and tertiary market issue, which is why I think you see the bulk of that development going on there. There's obviously a spattering of it going on in the urban markets, still mostly limited service. But I think it's sort of been on a normal path. I haven't seen developer saying that the best

of offers with the best brands are able to selectively get money. That's the way it's been for the last six months, that's the way it is now.

Smedes Rose

Citigroup Global Markets, Inc. (Broker)

Q

That's helpful. Thanks. And then, I mean, just, I guess, kind of a similar question on China. I think we were pleasantly surprised by your very positive commentary on China, despite lowered economic expectations for that market. And I think you did mention that the luxury and the high-end maybe is a little bit slower on the development side versus the more midscale. Could you maybe just provide a little more color on what you're seeing there?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah. We've been trying to provide a little ton more color honestly. But then what I said – we've been saying this to everybody to you guys and everybody else that for the last two years or three years that we've been working for longer than that and sort of adapting our strategy, because it was obvious to us a few years ago that on the development side, a lot of what was going on at the high-end of the business may not have been totally economically rationale. Based on the hotel economics that was part of sort of a mass infrastructure build and huge investment going in sort of to real estate, which got a bit bubbly in China and the Chinese government has tried to sort of manage the deflation of that real estate balloon, without having it sparked sort of a contagion in the rest of the economy.

They've done a reasonably good job of doing that honestly. But in so doing, they've been sort of reallocating capital and lending out of that space and in other things. And the market is, by definition from a development point of view, and the hotel space becoming more economically rationale.

What's more economically rationale there over the long-term, just like it is and other markets as they mature like the U.S. or Europe is really the midmarket sort of opportunities, particularly in secondary and tertiary markets. So, sort of we anticipated that, because it's obvious that this was eventually going to happen. We're trying to – if you draw a line to it, it's a line that goes up, but it's not without ups and downs as it does it.

And it was obvious to us that long-term for us, it creates the same network effects that we have in other parts of the world, particularly in the U.S. and Europe that we needed broad distribution and that only over the long-term economically rational things were going to get done and those things were going to be really more in the mid-market with our limited service brands.

So, we, two years and three years ago, sort of repositioned our products for those markets, built out relationships with owners. In the case, our Hampton with Plateno over an extended period of time. And now, we're getting really good traction and we think that over time like the U.S., like Europe, that will be the bulk of the growth.

And what we're trying to also say is that, it doesn't mean that full service and luxury isn't going to happen in China. Over time, that's going to be a big, big growth business. It's just going to ebb and flow, where I think the limited service business is going to be more steady, because there's just more markets in China that are applicable.

So, it's not unlike what we did in Europe five years, six years ago when a lot of people sort of build out on Europe, when they had all troubles, we said, why would we bail out? What we ought to do is sort of change the trajectory and have a value strategy with conversions to DoubleTree. And then, if it's going to be new build, it's going to be a super-efficient Hampton or Garden Inn type of opportunity. We shifted the strategy there and we have – our

pipeline is twice as big as the next closest pipeline, and we've been delivering hotels in that market at a much more rapid pace.

So, the idea being China, Europe, U.S., you got the right brands and the right segments and you're quick on your feet, and you're really strategic about it, you should be able to grow in all the time and good times and bad, by deploying these brands and building the right relationships with the right partners in these various parts of the world, including China.

Smedes Rose

Citigroup Global Markets, Inc. (Broker)

Great. Thanks for that answer.

Q

Operator: Your next question comes from the line of Rich Hightower with Evercore ISI. Your line is open.

Richard Allen Hightower

Evercore ISI

Hi. Good morning, guys. A lot of ground covered today, so thanks for the commentary.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director

Yes.

A

Richard Allen Hightower

Evercore ISI

One very quick question regarding buybacks, I'm just curious if you can comment on any potential limitations or other sensitivities around potentially buying back Blackstone shares in addition to the ones that flow publicly?

Q

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

Yeah. Rich, I think that we would probably not do that. I mean, it's not that it's impossible but I think it's very difficult for them to sell the company shares. But I don't think it changes the dynamic and the way we think about capital allocation and its ability to have the desired effect.

A

Richard Allen Hightower

Evercore ISI

Okay. Perfect. Thanks, Kevin. That's it.

Q

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

Thanks, Rich.

A

Operator: And your next question comes from the line of Wes Golladay with RBC Capital Markets. Your line is open.

Wes Golladay

RBC Capital Markets LLC

Q

Hello, everyone. A quick question about the business transient customer, we've heard on other calls that there's been a lot of short-term cancellations. Are you seeing this trend as well? And are you going to look to lengthen – or I guess, strengthen your cancellation fee and maybe lengthen them?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

On the second first, since that's the trend today. Yes, we are looking at and testing a bunch of different options on lengthening and cancellation fees and other things to address – generally tying our inventory up for lengths of time without having people to have to pay for it, and that's just something we think is sensible. But that's for a whole bunch of reasons. It's not because we're seeing any short-term cancellation activity that's outside of the – outside of what we've been seeing.

Obviously, with all these new technologies and things over the last couple of years, there's been lots of different sort of ways people are trying to game all our systems with cancel and rebook and when there's no cost to it. The system has risks of gaming, and so, that's what we're really addressing.

But, in terms of what we've seen in October or whatever, there's nothing unusual – nothing new or unusual. That's business as usual. We should be looking at our canceled policies and whether we have fees and things, just because it's the right thing to do in the new world order.

Wes Golladay

RBC Capital Markets LLC

Q

Okay. And then, looking at some of these high occupancy, low ADR growth markets like New York, in particular, is the inability – we're talking about inability to push rate, but is ADR just dropping because of a mix shift issue? I'm wondering more specifically how your corporate negotiated rates are going in New York?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

I think our corporate negotiated rates in New York are consistent with what we're seeing everywhere else. Remember that's not – it's, kind of looking at Kevin, I think our corporate negotiated in New York is probably 20% maybe, 17%, 20% of the – maybe less, 15% to 20% of the business.

So in that arena, I think we will achieve those kinds of rates, because that we were pushing our core customers generally across the country pretty hard and whether they're in New York or wherever they might be. I think the inability to drive rates in New York had mostly to do even though it's high occupancy, there's been a lot of supply.

Wes Golladay

RBC Capital Markets LLC

Q

Yeah.

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

There's just a lot of – and there hasn't honestly been enough rate discipline and it doesn't take many to sort of not have discipline before everybody is forced to follow. So while it's high occupancy, there's still a lot of rooms that have been coming into that market that just sort of keep a lid on it.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

Yeah. I think New York is pretty unique in that regard as the market that runs that level of occupancy and has had impact from supply. Frankly, New York has needed the capacity. It hasn't been great for our business, but it's really been a lack of compression issue versus...

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

And it's a mix to your...

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer

A

[indiscernible] (75:09).

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

Yeah. To your question embedded in it, you're right. It's a mix thing. So, it's still running high occupancies even with all those rooms coming in, but it's with the mix that is not ideal, right? Yeah. You can run it, you fill it. Incrementally, you make more profit. But, if you add fewer rooms, you would have a better mix and you would have a higher paying customer, and you'd be able to leverage rates more. But, Kevin's right. New York is quite unique in the country.

Wes Golladay

RBC Capital Markets LLC

Q

Okay. And just a quick one on distribution. We've seen some of the OTAs consolidate. How are you doing on your negotiations on the commissions with them, and are you starting to get your customer to book more direct now? And how's the mobile front going?

Christopher J. Nassetta

President, Chief Executive Officer & Director

A

We are. That's quite a good last question, because it could take a while. But, the short version of that is, we can't, obviously for a whole lot of reasons, disclosed exactly what we've done in those negotiations. I said on the last call or maybe a couple of calls ago, we had three sort of pillars in our negotiations with all our OTAs. One was that we wanted to get rid of last room availability; two, we wanted to have the opportunity to have preferential pricing to our most loyal customers; and three, we wanted to continue to move our margins down to more reasonable level.

We are now done – while I can't be specific unfortunately contractually, we are now done with all of our OTA negotiations, and we achieved our goals in every one of those pillars. And we are definitely seeing more activity on direct booking. We're seeing the most growth in any of our segments coming through our direct channels, and we are very focused over the next year or two and making sure that our customer understands the value proposition that we offer them to drive even more of a direct relationship in terms of booking with us.

Wes Golladay
RBC Capital Markets LLC

Q

Okay. Thanks a lot for taking the question.

Christopher J. Nassetta
President, Chief Executive Officer & Director

A

You bet.

Operator: Thank you. I would now turn the call over to Chris Nassetta for closing remarks.

Christopher J. Nassetta
President, Chief Executive Officer & Director

Well, thank you, guys. We've taken too much of your time this morning, so I will end it just by saying we appreciate everybody participating. We had a good, healthy discussion about lots of different things that are going on in the industry. We feel great about things, and we look forward to catching up with you after the year is done. Have a great day.

Operator: Thank you, ladies and gentlemen, for your participation. This concludes today's conference call. You may now disconnect.

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