S&P Global
Market Intelligence

Hilton Worldwide Holdings Inc. NYSE:HLT

Q1 2023 Earnings Call Transcripts

Wednesday, April 26, 2023 10:00 AM ET

Table of Contents

Call Participants 2
Presentation 3
Question and Answer 6

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved
spglobal.com/marketintelligence

Call Participants

EXECUTIVES

Brian Kucaj
Senior Director, Investor Relations

Christopher Nassetta
President & CEO

Kevin J. Jacobs
CFO & President of Global Development

ANALYSTS

Brandt Antoine Montour
Barclays Bank PLC, Research Division

Carlo Santarelli
Deutsche Bank AG, Research Division

David Brian Katz
Jefferies LLC, Research Division

Joseph Richard Greff
JPMorgan Chase & Co, Research Division

Robin Margaret Farley
UBS Investment Bank, Research Division

Shaun Clisby Kelley
BofA Securities, Research Division

Smedes Rose
Citigroup Inc., Research Division

Stephen White Grambling
Morgan Stanley, Research Division

William Andrew Crow
Raymond James & Associates, Inc., Research Division

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

Presentation

Operator

Good morning, and welcome to the Hilton First Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Brian Kucaj, Senior Director, Investor Relations. You may begin.

Brian Kucaj
Senior Director, Investor Relations

Thank you, Chad. Welcome to Hilton's First Quarter 2023 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 speak only to our expectations as of today. We undertake no obligation to 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'll 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 ir.hilton.com. This morning, Chris Nassetta, our President and Chief Executive Officer, will provide an overview of the current operating environment and the company's outlook. Kevin Jacobs, our Chief Financial Officer and President, Global Development, will then review our first quarter results and discuss our expectations for the year. Following their remarks, we will be happy to take your questions. With that, I'm pleased to turn the call over to Chris.

Christopher Nassetta
President & CEO

Thanks, Brian. Good morning, everyone, and thanks for joining us today. We're pleased to report that demand for travel remains strong, maintaining the trend that we saw in the back half of last year, which led to both our top and bottom line results finishing the quarter above the high end of our guidance. As we move forward, fundamentals remain strong, and we're -- and we expect secular tailwinds to continue to support growth. Despite continued macroeconomic uncertainty, we're optimistic that the power of our network effect, our industry-leading RevPAR premiums and our fee-based capital-light business model will continue to drive strong operating performance, unit growth and meaningful cash flow, enabling us to return an increasing amount of capital to shareholders.

In the first quarter, system-wide RevPAR grew 30% year-over-year and 8% compared to 2019. Rate continued to drive growth, up 11% compared to 2019, and system-wide occupancy reached 68%, up from the prior quarter and just 2 points shy of peak levels. Globally, all segments outperformed expectations, and the lifting of COVID restrictions in China drove significant recovery in demand across Asia Pacific throughout the quarter. As a result, RevPAR in the month of March exceeded 2019 levels across all regions and segments for the first time since the pandemic began. Given our strong results and positive momentum, we're raising both top and bottom line guidance for the full year, which Kevin will cover in more detail in just a few minutes.

Turning to the segment details. Leisure trends remained strong throughout the quarter with RevPAR surpassing 2019 by approximately 15%, ahead of prior quarter performance. Strong leisure transient demand continue to drive rates up in the mid-teens above 2019 and occupancy fully recovered back to 2019 levels, driven by the surge in travel in Asia Pacific. Business transient also continued to improve with RevPAR up 4% from 2019, reflecting the resiliency of business travel, particularly for small and medium-sized businesses, which remained roughly 85% of our segment mix.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

Recovery in group remains robust with RevPAR finishing roughly in line with 2019 with steady improvement each month in the quarter and March exceeding 2019 by 5%. Demand for future bookings also remained strong with full year group position up 28% year-over-year and 3% versus 2019. Additionally, new group leads ended in the quarter 13% higher than 2019, an increase of 6 points compared to prior quarter.

Looking at the full year, based on the better-than-expected Q1 results, the accelerated demand across Asia and continued positive momentum in group, we now expect full year system-wide top line growth between 8% and 11% versus 2022, assuming some slowdown in the back half of the year due to macroeconomic uncertainty, particularly in the U.S.

Turning to development. In the first quarter, we opened 64 properties totaling over 9,000 rooms, celebrating several milestones, including the opening of our 500th hotel in China, our 100th addition to the Tapestry Collection and the opening of the Canopy Toronto Yorkville, the Lifestyle brand's debut in Canada. We also opened 2 new Embassy Suites resort properties in Virginia Beach and Aruba with the Aruba addition marking the brand's tenth international property. And after recently being ranked the #1 Hotel Franchise in Entrepreneur Magazine's Franchise 500 for a record-breaking 14th year in a row, Hampton by Hilton expanded its global presence to 37 countries with the brand's first property in Ecuador.

While we expect to see some impact from the current financing environment, we are encouraged by the progress on the signings and starts front. We signed approximately 25,000 rooms during the quarter, growing our pipeline to a record 428,000 rooms, more than half of which are currently under construction. Signings in the quarter outpaced prior year across all regions. And conversion signings in the quarter were 24% higher than prior year, benefiting in part from the rollout of our newly-launched brand, Spark by Hilton. The initial interest in Spark has been tremendous. We currently have more than 300 deals in various stages of negotiation, and our teams are working hard to deliver this exciting new premium economy conversion brand with hotels opening later this year.

Hilton Garden Inn also continues to be an engine of global growth with 14 new signings across 6 countries in the quarter and over 60 working deals in 22 countries. Additionally, in April, we announced the signing of the Waldorf Astoria Jaipur, marking the debut of the brand in India and further demonstrating our commitment to expanding our world-class luxury brands across the globe.

Construction starts for the quarter totaled over 19,000 rooms, up nearly 20% from prior year, and starts in the U.S. were up more than 50% year-over-year. Our global under construction pipeline is up 8% compared to March 2022. And per STR, we continue to lead the industry in total rooms under construction. Taking all this into account, we still expect to deliver net unit growth within our guidance range this year and remain confident in our ability to return to 6% to 7% net unit growth over the next couple of years.

On the loyalty front, Hilton Honors grew to more than 158 million members, a 19% increase year-over-year and remains the fastest-growing hotel loyalty program. In the quarter, Hilton Honors members accounted for 62% of occupancy, an increase of 200 basis points year-over-year. Additionally, in an effort to further provide our loyal guests with an elevated wellness experience, in April, we announced the international expansion of our partnership with Peloton, bringing Peloton bikes to properties across the U.K., Germany, Canada and Puerto Rico, building on our existing partnership to make Peloton bikes available in all U.S. hotels.

As one of the world's largest hospitality companies, we recognize Hilton has a responsibility to protect the planet and to support the communities we serve to ensure our hotel destinations remain vibrant and resilient for generations of travelers to come. In early April, we published our 2022 Travel With Purpose report, outlining our latest progress towards our 2030 environmental, social and governance goals, including our efforts to reduce our environmental impact while creating engines of opportunity within our communities and preserving the beautiful destinations where we live, work and travel.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

We remain committed to driving responsible travel and tourism globally while furthering positive environmental and social impact and sound governance across our operations and our communities. All of our success would not be possible without the dedicated efforts of our talented team, and we continue to be recognized for our remarkable workplace culture. Recently, Great Place to Work and Fortune ranked Hilton the #2 workplace in the U.S., our eighth consecutive year on the list, and once again, the top-ranked hospitality company, an accomplishment I'm truly proud of.

Overall, despite macroeconomic uncertainty, we believe that our world-class brands, dedicated team members and resilient business model have us incredibly well positioned for the future. Now I'll turn the call over to Kevin for a few more details on the quarter and our expectations for the full year.

Kevin J. Jacobs
CFO & President of Global Development

Thanks, Chris, and good morning, everyone. During the quarter, system-wide RevPAR grew 30% versus the prior year on a comparable and currency-neutral basis and increased 8% compared to 2019. Growth was driven by strong demand in APAC as well as continued strength in leisure and steady recovery in business transient and group travel. Adjusted EBITDA was $641 million in the first quarter, up 43% year-over-year and exceeding the high end of our guidance range.

Outperformance was driven by better-than-expected fee growth across all regions as well as strong performance in Europe and Japan benefiting our ownership portfolio. Management and franchise fees grew 30% year-over-year, driven by continued RevPAR improvement. Continued good cost discipline further benefited results. For the quarter, diluted earnings per share adjusted for special items was $1.24, increasing 75% year-over-year and exceeding the high end of our guidance range.

Turning to our regional performance. First quarter comparable U.S. RevPAR grew 21% year-over-year with performance continuing to be led by strong leisure demand. Both business transient and group RevPAR finished above 2019 peak levels for the second consecutive quarter, driven by strong rate growth. In the Americas outside the U.S., first quarter RevPAR increased 56% year-over-year and 35% versus 2019. Performance was driven by strong leisure demand at resort properties where RevPAR was up over 60% compared to peak levels. In Europe, RevPAR grew 68% year-over-year and was 13% higher than 2019. Performance benefited from continued strength in leisure demand and recovery in international inbound travel, particularly from the U.S.

In the Middle East and Africa region, RevPAR increased 32% year-over-year and 42% versus 2019, led by strong rate growth and group demand. In the Asia Pacific region, first quarter RevPAR was up 91% year-over-year and down only 4% versus 2019. RevPAR in China was down 5% compared to 2019, 32 points better than prior quarter as demand recovery accelerated due to the lifting of COVID restrictions. The rest of the Asia Pacific region also saw a significant improvement with RevPAR, excluding China, up 19% versus 2019, representing an 11-point improvement versus prior quarter.

Turning to development. Our pipeline grew year-over-year and sequentially and now totals 428,000 rooms with nearly 60% located outside the U.S. and over half under construction. Looking at the full year, despite the near-term macroeconomic uncertainty, we still expect net unit growth between 5% and 5.5%.

Moving to guidance. For the second quarter, we expect system-wide RevPAR growth to be between 10% and 12% year-over-year. We expect adjusted EBITDA of between $770 million and $790 million and diluted EPS adjusted for special items to be between $1.54 and $1.59. For full year 2023, we expect RevPAR growth of between 8% and 11%. We forecast adjusted EBITDA of between $2.875 billion and $2.95 billion. We forecast diluted EPS adjusted for special items of between $5.68 and $5.88. Please note that our guidance ranges do not incorporate future share repurchases. Moving on to capital return. We paid a cash dividend of 15% -- $0.15 per share during the first quarter for a total of $41

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

million. Our Board also authorized a quarterly dividend of $0.15 per share in the second quarter. Year-to-date, we have returned more than $600 million to shareholders in the form of buybacks and dividends, and we expect to return between $1.8 billion and $2.2 billion for the full year. Further details on our first quarter results can be found in the earnings release we issued earlier this morning. This completes our prepared remarks. We would now like to open the line for any questions you may have. We would like to speak with as many of you as possible, so we ask that you limit yourself to 1 question, please. Chad, can we have our first question?

Question and Answer

Operator

[Operator Instructions] And the first question is from Carlo Santarelli from Deutsche Bank.

Carlo Santarelli
Deutsche Bank AG, Research Division

Chris, just in terms of the way you guys are thinking about the year, your guidance, obviously, from a RevPAR perspective, up about 350 basis points at the midpoint. First quarter obviously contributes some of that lift. You guys spoke to a tougher macroeconomic situation in the second half of the year on your fourth quarter call. How much has your outlook on the second half changed as obviously you get some contribution from the first quarter, you have a lot of visibility in the second quarter? Just trying to understand within the context of that guidance, if you've had any kind of change or pushing out of when you guys believe or when you're interpreting the macroeconomic conditions will toughen?

Christopher Nassetta
President & CEO

Yes, a really good question. Obviously, I think I used the macroeconomic uncertainty 2 or 3 times for a reason because there is an uncertain environment. I mean, what we're seeing today is, as you heard in what you saw in our numbers and in the prepared comments is very good strength across all our segments. Leisure continues to be super strong. Business transient in the quarter, both demand and pricing, has returned to prior peak levels and group is motoring on its way. It's just longer in gestation to get there. But based on the trends, it's going to get there in the second half of the year, I think, with a great deal of certainty.

So we are not -- you didn't really ask it this way, but I think part of it is we're not seeing any cracks in terms of demand patterns. There is a lot of momentum. I sit at this very table every Monday morning with my entire executive committee representing every region of the world. And the first question I ask, are you seeing any cracks? Any issues with demand broadly? Any issues regionally? Any issues from a segment point of view? And the truth is we're just not seeing it.

Having said that, we know here in the U.S. and in many other places around the world, there's an inflation issue. Now it's being -- it is being managed. It's becoming -- it is in the process of normalizing, particularly here in the U.S., but it's not there. And the Fed has said it's going to deal with it. I believe that -- I take them at their word. And I think ultimately, that means you're going to continue to have a slowing of the broader economic environment that, at some point, has to have some impact on us.

It hasn't yet, for a bunch of reasons, I suggested: one, I still think we have a lot of pent-up demand; two, we are still benefiting from a secular shift in spending patterns broadly. So while people may have a little less to spend, they're spending more of it on experiences and a lot less of it on things. You see that throughout the economy. And international

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

travel is, finally, with China opening up, while it's not back anywhere near where it has been, international travel is really on a steep up-slope. And all of those things are keeping the momentum in demand in the business.

Recognizing also, by the way, that capacity additions are at historical lows and are probably going to stay there for a while. So when I said very quickly in my comments, fundamentals remain strong, I mean, fundamentals are supply and demand. Demand is good for the reasons I suggest that supply in the industry is anemic. Thankfully, we get a lot more than our fair share of the supply, so that's good for us. But the basic fundamentals in the business are good.

Having said all of that, we do expect things will slow down. You asked a question which I'm actually going to answer, which is, do I feel any differently than I did sitting here a quarter ago? And I would say, yes, I would say number one, the economy appears to be more resilient. Inflation is being tamed. I have a higher degree of confidence at this point. I'm not the right person to ask, but well, I'll tell you what I think. I have a higher degree of confidence that the Fed will land the plane reasonably well and that we're not going to have a deep dark kind of recession. We're going to have a slowdown, maybe a recession. It feels a lot more like it will be reasonably modest at this point. So I feel better about that.

And I definitely feel like things have been pushed out a little bit. One, just time has gone by. We have now a quarter under our belt. We're deep into understanding half of the year. I mean, we're not done. There's a bunch of the second quarter left, but we have pretty good sight lines at this point into Q2. And that feels like the momentum is continuing. So you get half a year sort of under your belt. It gives you more confidence. And so I feel better about, thus why we increased our guidance on the top line and bottom line because I feel like there's enough momentum in our business. The economy broadly is pretty resilient. There's more confidence in the Fed being able to sort of do this without wreaking too much havoc.

So I'd say net-net, yes, I feel a bit better. Having said that, we did and I said it intentionally in the prepared comments, we do assume because we are sentient and we know what's going on, that at some point, you will see some slowing. I think realistically, it's more late third quarter and into the fourth quarter. I honestly think there's a chance it kicks into next year, given the broader momentum and the strength of the consumer broadly.

But I don't know. And so what we've tried to do in our guidance is build in an expectation that this -- these efforts of the Fed here and in other parts of the world will eventually work and that we're going to see some, at least, modest slowdown. And so that's sort of what -- we feel better than we did. We still think there's a lot of uncertainty, and we've tried to factor for that in our guidance in the second half of the year.

Carlo Santarelli
Deutsche Bank AG, Research Division

Great. And then if I could, just 1 quick follow-up. In the period, obviously, I think managed franchise RevPAR was 29%. Unit growth on the franchise side was 4.4%. The fees -- franchise fees grew about 23%. I'm assuming that, that's a comp issue with some ancillary non-RevPAR fees in the 1Q of '22?

Christopher Nassetta
President & CEO

Correct. Yes. I mean, the way to think about those is those are normalizing in growth rates, above algorithm growth, above typical growth you would assume sort of on a same-store basis. But we're still, particularly because of Omicron, on the fee side, we have a supercharged fee growth rate in the first quarter. But I think the way to think about, over the intermediate, even longer term, is we think all of those ancillary license fees and otherwise, they're going to grow better than our typical algorithm growth. You're just -- yes, you have some year-over-year normalization going on in Omicron impact.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

Kevin J. Jacobs
CFO & President of Global Development

And a little bit of mix as well, so the franchise business is a little more concentrated in the U.S. where RevPAR growth has not been as robust as outside the U.S.

Operator

And the next question is from Joe Greff from JPMorgan.

Joseph Richard Greff
JPMorgan Chase & Co, Research Division

Chris, I'd love to hear your views on -- and your understanding of what developers are feeling right now, just given changes in the credit markets and the banking environment, particularly with maybe limited service developers that are more reliant on regional bank for financing. Are they requesting more capital help from you guys? Do you think maybe they're pulling forward some deals maybe in an effort to circumvent future tightening? Can you talk about what your expectation is for maybe pipeline growth for the balance of the year? And then I have a follow-up.

Christopher Nassetta
President & CEO

Yes. I mean, it's early. So we've obviously been talking to a lot of our ownership community as the banking issues have sort of taken hold. And I would say there's a broad range that anecdotally go from, we haven't seen much impact. We're still getting finance. As you can see in our numbers in starts in the U.S. being so far up. Now part of that was before the banking, the regional local banking set of issues, but part of it was after. They're still getting the best owners with the best relationships are getting their deals done, and our market share in a tougher environment goes up.

So proportionately relative to others in the industry, we typically do even better. But we also have folks that are saying very hard to find the money and some in the middle that are saying like they're talking to their banks and their banks are saying, "Hey, we're going to be there for you. Just give me like 90 days. Let me see how this all plays out." And so I think it's early to know. I think being objective about it, which I always am trying to be, I think the Fed seems to be managing through this reasonably well. There's some ongoing things today or this week going on, but I think the Fed, I think, is pretty committed to making sure there isn't sort of a run on regional banks broadly. So I think we're in reasonably good shape that way.

But I think that the net result is for a period of time, there'll be less credit available, okay? I still think we'll get more than our fair share of it because our brands are better performing, and we'll see our share go up as we historically do when times get tougher for financing, et cetera. But it's hard to believe that in the short to intermediate term, there's not going to be some impact. It hasn't shown up. It didn't show up in the first quarter. We haven't seen it yet, but I think in terms of pipeline, people, I think our expectation at this point for the year is the pipeline is going to keep growing.

The bigger question is going to be the conversion under construction. In the first quarter, it was very, very good, as you heard, in the data. I think that will get more challenging. I think it just stands to reason that will get more challenging. And so listen, the good news for us is we tend to get -- our share goes up. It's a big world. While China has been a little bit slower to sort of pick up steam on the development side, it is picking up steam. I think, particularly as we think about next year, I think it's going to be a big net contributor.

And conversions are -- have been and continue to be a big focus of ours. We think we'll do meaningfully more as a percentage of overall delivery this year as conversion somewhat aided by this year a little bit, but a lot, I think, next year by Spark, which is 100% conversion, very low cost of entry in a relative percent. Very, very lightly, if dependent at all, on

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

the banking community. So that's not why we did Spark. We did Spark for all the right reasons, to better serve, create a bigger and better network effect, but just in time management, the timing of it actually is quite good. As we said, it's not going to do a lot for this year, but I think over -- starting next year and beyond, it will add significantly.

But the net of all that, Joe, is, again, answering -- I'm trying to give a little bit of color across the board. We do expect that what's going on in the banking system, particularly for limited service, which is disproportionately financed by the regional and local banks, that they're going to pull in their horns. They're going to survive. Most of them are going to get through this, but there's going to be less credit available, and that's going to slow things down a bit.

Joseph Richard Greff
JPMorgan Chase & Co, Research Division

Great. And just -- my follow-up question is system-wide RevPAR is flat, which is sort of what's baked into the second half guidance. But if we just think about it for the intermediate term, not that you're guiding to anything beyond the second half, do you think fee growth can be in excess of RevPAR growth, just given the rooms growth in the last few years?

Christopher Nassetta
President & CEO

Should be, yes. It should be mathematically, yes. The algorithm is, as you know, so the same-store plus unit growth. And we've been delivering on average even through COVID, 5-ish, maybe a tick over even in an environment that is being impacted by some of the things I just described. We believe we'll continue to do that as we manage our way over the next couple of years back up to the 6% to 7%. And so even in a no growth same-store environment, which is not certainly what we're experiencing now for the record, as you can see, but even in that environment, fees would continue to grow with unit growth.

Operator

And the next question is from Shaun Kelley from Bank of America.

Shaun Clisby Kelley
BofA Securities, Research Division

Chris, I kind of wanted to stick with the development activity, but maybe let's just go out a little bit longer term. And if you could help us pull from a little bit of your experience of how this played out during the global financial crisis a little bit. Just help us think about, if we think about some of the -- there's kind of 3 drivers, I think, about domestic unit growth, obviously, decently reliant on the financial system; the conversion activity, where you've got a pretty interesting pipeline of brands that might even be stronger than back then and then the international side.

Can you help us think about sort of buckets 2 and 3? And as we get on to '24 and '25, how much could those help carry the weight? And how protected do you think, let's call it, a broad mid-single-digit net unit growth target should be in a variety of different scenarios as people are just trying to think about broader fallout here from financing and again, a more difficult macro broadly?

Christopher Nassetta
President & CEO

Yes. I mean, that's the right question to ask. And that's why I said, yes, we do expect to see some impact. But I also said, maybe I backed into it but I'll say it more directly, we feel good about being in that range you described. We've been around 5% through the toughest down cycle in recorded history. Through COVID, we've stayed sort of 5-ish or a tick above. And we think over the next period of time, as these things sort of work their way through the system, that

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

we'll be able to stay there.

How are we going to do it? Well, one, we're going to gain share because our products perform better, and we have the highest market share brands in the business. We're going to keep pushing market share higher. And so while there's going to be potentially less new build activity domestically, we will plan to work hard to get an even larger share of that.

Conversions, we do believe that we're uniquely suited certainly relative to The Great Recession by having not only more shots on goal in terms of brands. But Spark, again, there's -- long term, we think Spark is probably the most disruptive thing that we'll have ever done in terms of giving customers, at that price point, a really good product. But it's also, the timing of it is convenient and helpful because it depends very little on financing. Most of the other conversions still depend on financing. A lot of conversions, not all, but a lot of conversions do happen around asset transactions where people say I'm a buyer and a seller and I'm going to change brands and upgrade properties. We'll still convert a bunch of other types of properties that -- where they're not changing ownership, but no change -- lower change of ownership puts a little pressure on that.

But Spark is, I guess, that we'll keep giving in the sense of unit growth because, again, you're talking about 20,000 rooms. You're talking about a $2 million sort of bogey for somebody to convert and get into our system versus even at the lowest price point, newbuilds that require financing and/or writing checks of $10 million, $15 million or, in most cases, much higher than that. So conversions will play a big part in it.

And as I already said, it's a big world. So what's going on here in the U.S. is with the banking system, unlike The Great Recession where the whole financial system around the world was sort of imperiled in free fall, this really at the moment is more of a U.S. thing, obviously touched Europe a little bit and Switzerland, but it has largely been sort of continued to be a U.S. thing. And so you have the opportunities around the whole rest of the world.

Notably, as I said, China, in the sense that China is probably taking a quarter or 2 more. So I think China won't contribute what I would have hoped it would this year, but I think it will be made up for next in '24 and '25 because the engines are really cranking up. It's just a process. So it will be conversions, international growth and increased market share of what does get done in the U.S.

The other thing that is going on is we launched Spark. We're getting ready, and I'll maybe tickle the ivories a little bit. We're getting ready to launch another brand sort of at the -- in the extended-stay space at the lower end, mid-scale, very low end of mid-scale, below Home2 that we have -- we've been working with our ownership community and customers on that while it will be a newbuild product, it will be a very efficient build cost.

So again, the things -- my history of this living through The Great Recession, all that is your lower cost to build products that have -- that are very high margin because people make the most money doing it and they're the lowest risk and they're the easiest financed. Those are the ones that get going the fastest. And so again, we didn't develop this brand that we're getting ready to launch, hopefully, in the next 30 or 60 days because of this. We launched because customers want it, owners want to build it. But again, it won't have any effect this year but starting probably the latter part of '24, more likely '25 as people look at a brand that can deliver just astronomical margins on a very efficient per unit build cost, we think it will build a lot of excitement.

Home2 has been off the hooks in demand throughout all of COVID and otherwise because people make -- such customers love it, it's very high margin. We think customers are going to love this. It's something different. It's at a lower price point. But the margins are much even higher than that. And so again, it will take time to gestate that, but we think that is a mega brand opportunity for us that as we think about more likely '25, '26, even in an environment that's been more challenging -- is more challenging from a financing point of view, as the financing markets come back and they always do, it's those products that really get done fastest. And so we feel good about being around 5% and headed back to 6% to 7% over the next couple of years, and it will be a combo platter of all of those things that you said and that I just

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

spoke to.

Operator

And the next question is from Smedes Rose from Citi.

Smedes Rose
Citigroup Inc., Research Division

I just wanted to ask you quickly on that extended-stay launch. We've seen a lot of products from different brands being launched due to the extended-stay segment. And I was just curious, what do you think is driving so much interest from customers? And are they abandoning another segment of mid-scale? We don't get data or at least in our case, we don't get extended-stay data specifically. We just see the chain scale data. I'm just wondering what sort of shifts you're seeing within that, that it's leading so many people to launch into that sector?

Christopher Nassetta
President & CEO

We were already seeing it pre-COVID, where there was just a demand for workforce housing and people -- more mobility in their lives and they wanted to be places and work from different places. And they didn't -- they were going to be there long enough to commit. They're like, get an apartment and pay a one year's deposit and all that fun stuff. And so we are already seeing demand that was outstripping supply.

And then COVID hit. And while a lot of things have normalized, and I've talked about this on prior calls a bunch of times, the one thing that happened is it accelerated the idea of mobility. While the office environment is normalizing, a lot of people are going back. It's not exactly what it was. More people are going to be remote as a percentage of the workforce permanently. More are going to have flexibility and sort of different times of year, times of the week, Mondays and Fridays. And all of that is continuing to just -- as those patterns shift, it's building more and more demand against a limited amount of supply.

And so the fundamentals we think are just great. The way I think about the product that we're developing, and I'm getting ahead of myself, but it's coming really soon. I mean, down we have -- we've built it. We've done 99% of the work. It's almost a hybrid. It's like an apartment efficiency meets hotel. And I'd say it's almost like 60-40. It's more apartment efficiency. There's so many workforce housing needs that are just unmet with this kind of product for somebody who needs to be somewhere 30, 60, 90, 120 days.

So you're talking about average length of stay of probably 20 to 30 days on average versus most of the core extended-stay brands are like 5 to 10 maybe, somewhere in that range, if you look at the industry. So it's a different demand base, different types of locations, which is why we love it because we're not serving it, meaning it's not competitive with what we're doing with Home2 and certainly not competitive with Homewood because it's serving a totally different need, mostly in totally different markets. And as I said, we -- I didn't intend to go this far, sorry.

But this is hundreds and hundreds and hundreds of hotels over time. This is not like we're going to do 50 or 100 of these. I mean, you'll wake up over time in 10 years, and will -- it will be like Home2. We'll have 4, 5, 6. We'll have a lot of these because we think the need is there now and growing. And we -- while a lot of people are doing things in this arena, I think we've proven by launching brands that we do -- uniquely have done it pretty well to launch brands and get to scale and build network effect, not just broadly for the company but within brands. And we've done that, I think, as well or better than anybody. And I think we have an opportunity to do it here.

And our system delivers. The system delivers the highest market share in the business. So if you're an owner thinking about I'm going to build a similar product somewhere else, I mean, you're going to look at the system strength. And

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

ultimately, I think, historically, people vote with their feet. They vote with a product that they think will work better from a customer point of view, ultimately, higher margins and drive higher share. And so we got to do it again, but we've got a pretty good track record of doing this stuff. We've spent a lot of time on this. And hopefully, by the next time we talk, it will be out of the shoot and we'll be talking about how many deals we got lined up.

Smedes Rose
Citigroup Inc., Research Division

And can I just ask you a quick other question? The difference between the gross room additions in the first quarter and then that room just seemed kind of wider than what we've seen. Is that -- was that just -- is that sort of a seasonal thing or was there something in particular on the deletion side that you can call out or...

Kevin J. Jacobs
CFO & President of Global Development

Are you talking about the difference between Q -- if you do Q1 in the guidance, Smedes?

Smedes Rose
Citigroup Inc., Research Division

Well, just the first quarter gross room additions and then the net room additions that seem just...

Kevin J. Jacobs
CFO & President of Global Development

No, there's -- no. Removals is right in line with normal. We'll end up about 1%, 1% and change for the year. Just the gross rooms from a timing perspective, I mean, I think I don't want to repeat what Chris said earlier on the call, but I think from a timing perspective, for the full year, gross room additions were lower in the first quarter and deletions were about the same. So that's the difference.

Operator

And the next question is from Stephen Grambling from Morgan Stanley.

Stephen White Grambling
Morgan Stanley, Research Division

Maybe following up on some of your comments about the new brand launches, Spark and then it sounds like another 1 in the extended-stay. When you think about going into some of these lower-end chain scales, I think many of the peers often see higher attrition rates or deletion rates. What can you do to ensure that the attrition rates from your brands are more resilient long term? And have you seen any evidence of that from your current lower chain scale brands, which is true?

Christopher Nassetta
President & CEO

No. You mean, attrition meaning losing hotels out of the system? No, I mean, here's the -- listen, and not to be too simplistic about it. But what we do is really made much easier by delivering commercial performance. So having great brands that resonate with customers, loyalty that connects the dots that customers are engaged with, product and service in those particular brands that really resonates with customers. And ultimately, our commercial engines and commercial strategies that deliver the highest level of market share.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

And so if you look at our -- if you look at like Tru or Hampton almost, I would say, almost 100%, I don't know, 90% to 100% of the deals that exit the system within those brands. And I don't think any Trus have exited the system that I'm aware of. It's a relatively new brand. I'm probably -- probably none. But Hampton is by our choice, meaning that their time is up. They're in a location or they're in a physical state that we just don't think works anymore. And so that's by our choice. We have very little attrition.

And back to where I started, the reason we have very little attrition is our mega category brands are category killers. They drive incredibly high share. So as we think about Spark, as we think about our new extended-stay brand, we have to get it right, which we will. We have to drive really high share, which we will. The product has to really work for customers, which is what drives that. And people don't want to leave, right? So our history is super, super good in the mega categories. If you go through the whole list of all our extended -- Home2, Homewood, Hampton, Tru, the attrition there is almost all. The vast, vast majority of it is by our choice.

Stephen White Grambling
Morgan Stanley, Research Division

That's helpful context, and that's my 1 question.

Operator

The next question is from David Katz from Jefferies.

David Brian Katz
Jefferies LLC, Research Division

I wanted to just go back to Spark because obviously, a lot of enthusiasm and success and it's unlike things that you've done before. If we look at the makeup of the deals that you've put together, I'd love some color on what's in there. Are those independents that are looking for a brand? Are those switching from other brands for 1 reason or another? Are any of the hotels switching within your system into it that may have otherwise departed for 1 reason or another?

Christopher Nassetta
President & CEO

Yes. Of the 300 -- I'll get this direction. Of the 300 bang around, it's -- I would say it's almost all. It's very little of us. So there are a few Hamptons in -- of the 300, so a teeny number of Hamptons that we would probably otherwise say will exit the system that we think for Spark will work even though they wouldn't work for Hampton. But that's a teeny tiny amount. The rest of it is almost -- there's a little bit of independent on that data point, but it's almost all coming from other brands in that -- in the economy space and spread around what you would guess, but -- and I have some of that data but I'm not sharing it.

David Brian Katz
Jefferies LLC, Research Division

Fair enough and understood. My follow-up is when we look at the revenue intensity of adding in this category, how does that measure up with your other brands? Obviously, the upper upscale, a unit is generating more, right? But how does the fee structure and the revenue intensity of this measure up and add to your system?

Christopher Nassetta
President & CEO

Yes. The fee structure is quite similar to other fee structures. They are smaller and it is at a lower rate. We think the rate

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

here is probably $80 to $90 versus the net Tru, which is $120 -- in the $120s with Hampton being at like $140. So it's -- they're a similar size so a lot of the Trus and Hamptons, they're at a lower ADR by design. And so yes, per pound fees will be a little bit less and certainly versus upper upscale but the thing you have to remember in our world is we're trying to create a network effect. So this is a massive customer acquisition tool for us.

There's 70 million or 80 million people traveling in this segment, half of whom are younger people that travel and this is all they can afford. And while we serve some of them, we're not serving many of them. So the opportunity is for us to get them hooked on our system early by giving them the best product that they can find in the economy space because every single hotel, every customer-facing element of the hotel has to be done or it doesn't get our name. And we regulate the gate. Nobody comes in. Nobody passes through the gate until that's done.

And so the other thing to remember is it's an infinite yield. So we built -- we bring in tens of millions of new customers that are going to trade up. They're going to grow up and they're going to use our other products. They're going to trade in and around our products. And we built this brand with a lot of hard work and elbow grease from the standpoint of the deals that we're getting. While they may be per pound a little lighter, we're not paying for them. I mean, thus the infinite yield. There's no investment. We continue to build these incremental fee streams.

And when you add up what the potential, I mean, I suspect 30 years ago, somebody said that about Hampton. Well, I mean, Hampton at that time was a $50 rate, and it's 100-, 120-room hotel. How much money can that make you? Well, Hampton is a value well into the billions of dollars because it turns out when you do a few thousand of them, it adds up. And the ultimate potential of Spark is bigger than Hampton because it's a bigger slice of the pie. So we're very excited about it. We think it is going to add not just new unit growth, but it's going to add significantly to earnings as it ramps up and ultimately to the overall value of the company.

David Brian Katz
Jefferies LLC, Research Division

Sounds like no meaningful key money there either?

Christopher Nassetta
President & CEO

No.

Kevin J. Jacobs
CFO & President of Global Development

Yes, I think -- David, just to add just a little bit, and Chris covered it, yes. I mean, the capital intensity of our -- in our business is much higher at the upper end, right? So the higher you go in the chain scale, the more the deals are competitive and you're contributing capital. And the other thing I'd say is why I think -- sort of working with you for a while, I think where you were headed with that.

I think from a revenue intensity perspective, Chris described it. As you layer in these lower fee per room hotels, mathematically, of course, your fee per room does go down. But when we model it out over a long period of time, you'd be surprised the fees per room do not...

Christopher Nassetta
President & CEO

Keep going up.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

Kevin J. Jacobs
CFO & President of Global Development

They keep going up over time, and we continue to grow at what we often talk about as algorithm. So if you take same-store sales plus NUG, the fees per room and the fee growth continues at that pace. And part of that is because of the non-RevPAR-driven fees that Chris mentioned earlier in the call, which we think will continue to grow at a higher rate than algorithm. So you put that all in your model and it's relative -- it's surprisingly steady/continues growth.

Christopher Nassetta
President & CEO

There is no year where fees per room are going down just because the arithmetic. And we continue to have RevPAR growth on the existing pool of assets that continues to go up. And yes, fees per room as we model it 5, 10 years out, just keep going up.

Operator

The next question is from Robin Farley from UBS.

Robin Margaret Farley
UBS Investment Bank, Research Division

I wanted to ask a little bit about the business transient performance in the quarter. I know you talked about RevPAR being ahead of 2019 levels. But I wonder if you could give us a sense of where either occupancy or number of business transient nights in the quarter compared to Q1 of '19. It seemed like from kind of broader industry trends, that Q4 didn't show that much sequential improvement from Q3 in terms of that change versus 2019.

And maybe you'll say, of course, it may not matter at all when you have RevPAR performance as strong as what you have. So I'm certainly not saying it's not a strong quarter, but I'm kind of curious what's going on with that business transient night piece event.

Christopher Nassetta
President & CEO

Yes. On a global basis, business transient, actually fourth quarter to first quarter ticked up. So on a -- it was about -- in the fourth quarter, about 103 and it went to 104. But importantly, on an aggregate occupancy basis in the first quarter, for the first time, it actually got back or slightly above where it was at the prior peak. Now that's not a U.S., that's a global number.

So why is that happening in the face of everything you're reading? And it's really simple, which is why I said it in the comments, it's SME. It's like what we're all filtering through is big corporate America. Big corporate America is worried about the world, all the uncertainty and maybe curbing some of their appetite for travel. Having said that, I've met with -- we had a big customer event, and I didn't get that impression even at a big corporate America. I think incrementally year-over-year, they're all traveling more but maybe not as much as they would have thought.

But the SMEs continue, which are 85% of our business, continue to perform really, really well. And the big corporates weren't really back in any event. And so since they had not come back to prior levels, while they may recover more slowly, they're not, my impression from talking to a bunch of them, they're not really cutting because they already had cut so much and they hadn't built it back. They're just -- maybe it's flattening for them.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

But I said it many times over the last few years. We have, by choice -- we were always quite dependent 80% of our business was SMEs. It's 85% now by choice, meaning we have shifted our mix because it's higher rated business, it's more resilient in the sense that it's more fragmented by the very nature of what it is. So business transient is alive and well. And I'd say in the first quarter, both the price was above and volume was at or slightly above, and that trend continues into Q2 although we're early in Q2.

Robin Margaret Farley
UBS Investment Bank, Research Division

Okay, great. Very helpful. And then just the other question, kind of a small 1 is your distribution through OTAs, I have to imagine that as business transient is coming back, that your OTA distribution is moving down compared to last year, just given that leisure is not as big a percent of total?

Christopher Nassetta
President & CEO

It's normalizing. It's slightly elevated relative to pre-COVID but not much and has come down a bunch. And we expect probably by the end of the year, certainly into next, it will be normalized with where it was, which is where we want it to be.

Operator

The next question is from Brandt Montour from Barclays.

Brandt Antoine Montour
Barclays Bank PLC, Research Division

I was wondering if you could just dig in a little bit to the drivers of the conversion activity, taking Spark out of it. Chris, you mentioned potentially lower hotel transaction activity from financing headwinds putting pressure as well as financing being a headwind in and of itself for doing non-Spark hire and conversions. I guess, could you stack that up against some of the maybe positive tailwinds, perhaps enforcement of brand standards across the industry, foresee more trade down or even more independents getting more nervous looking for brands? How do you look at all those factors on a net basis later into the year?

Kevin J. Jacobs
CFO & President of Global Development

Yes, I'll take this one, Brandt. I think outside of Spark as we've covered that, I think you've got a couple of factors. One is yes, in sort of an environment where people are expecting demand to soften, they tend to seek out brands more often, and obviously, they tend to seek out the stronger brand. So it's being driven by somewhat of demand for independent hotels converting to brands.

And then I think the other factor is in an environment where credit's tighter, a cash-flowing hotel, right, so acquiring a hotel and that's already cash-flowing, it's easier to finance than new construction. So I think those are the two primary drivers. And then you think about some of the things that are going on around the world. But they're generally driven by transactions and generally in a softening demand environment, easier to finance and more demand for the branded systems.

Operator

The next question is from Bill Crow from Raymond James.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

William Andrew Crow
Raymond James & Associates, Inc., Research Division

As we think about the change to your guidance for 2023, how much of that is driven by areas outside the U.S.? And has there really been any change or any positive change to U.S. expectations?

Kevin J. Jacobs
CFO & President of Global Development

Yes. I think, Bill, what you're seeing is it's kind of -- it's across the board. It's positive change to all regions. Largely, I think Chris covered this earlier in the call, largely concentrated with the demand strength continuing into the second quarter and us taking the second quarter up a little bit, a little bit in the third quarter and then the -- and if you think about pushing out the anticipated slowdown in the back half of the year, but there is improvement in the outlook in all regions, including the U.S.

William Andrew Crow
Raymond James & Associates, Inc., Research Division

A follow-up. I'm going to actually switch my follow-up, and I want to actually address something you just said, Chris, which is that large corporates seem to be flat in their demand. And I'm just curious whether this early in the recovery, and I know there are issues going on in tech and financial services in particular, but does this give credence to that argument that business travel never fully recovers?

Christopher Nassetta
President & CEO

I mean, I don't think so. Well, the #1 prima facie evidence it has. So I mean, Bill, what I just finished on a couple of questions ago, in the data in the first quarter, business travel has already recovered. I think what it means for us is in the intermediate term, as you get more certainty in the environment, there's upside in business travel, meaning we've done a good job of shifting to SMEs. With that shift, we're sort of, on a volume basis, back to where we were. Rate base is higher.

The big corporates still have to travel. By the way, the big corporates are also not one size fits all. It's really where you see the impact is technology, bank and consulting. If you look at a lot of the other big corporate sectors, they're still growing, but those sectors weighed it down. As those sectors stabilize and start to think about the future and being competitive and getting their sales forces back out and get out of cost-cutting mode, which they will, they always do, I look at it as upside.

So I think when you wake up in a year or two and we're in a little -- whenever we get to a more certain environment, hopefully it's sooner than later, I think the opportunity will be that business travel, both volume and price, will be higher than the prior peak. I think the same thing for the group business. I think this has done -- what's happened in the last three years has done nothing but reinforced. I mean, we're definitely benefiting from a lot of pent-up demand, but it's done nothing but reinforce, as I talk to all of our group customers and the like, that the need for people to be congregating to do the things that they do in culture and collaboration and innovation and all of those fun things.

So I kind of famously said when we get through this in like April, May of 2020, I think it will look a lot more like it did than it does. And I think that's -- I still think that. And I think the data largely supports it. If you look at the business mix, like this quarter versus pre-COVID and the big segments of business transient, leisure transient and group, we're within a point. I mean, right now, the only difference is leisure is a point higher and group's a point lower. Otherwise, it's about where it was, right? And that's because group takes time to sort of -- to come back.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

spglobal.com/marketintelligence

And in the meantime, leisure has been strong. But ultimately, as we get strong high-rated groups back, we will continue to mix more of that in. So I do not personally believe there is credence to that argument. I think the data supports that argument at this moment.

William Andrew Crow
Raymond James & Associates, Inc., Research Division

Look forward to seeing you early next month.

Christopher Nassetta
President & CEO

Yes. Same.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the call back to Chris Nassetta for any additional or closing remarks.

Christopher Nassetta
President & CEO

Thank you, Chad. Thanks, everybody, for the time today. Interesting times with all -- the word of the day is uncertainty. But as you can see, we feel very good about what we delivered in the first quarter. We feel great about the second quarter. Frankly, we feel pretty good about the full year. We're making sure that we're keeping our eyes wide open about what's going on in the world. But we continue to do well and deliver, and most importantly, return more and more capital, which we'll continue to do. So thank you for the time, and we look forward to catching up with you after the quarter.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

COPYRIGHT © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

Copyright © 2023 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.
© 2023 S&P Global Market Intelligence.