Expect Hotels to Mimic the Airline Merger Playbook After the Last Recession

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It's a matter of when, not if, hotel companies begin a wave of mergers and acquisitions to beef up market share and survive coronavirus, according to industry experts.

Given the coronavirus economic downturn depleting revenue, business leaders across all industries today are focusing more on sheer survival than mergers and acquisitions. Global M&A activity was down nearly 36 percent in the first quarter of 2020, according to financial platform Dealogic. But on the rebound, analysts expect hotel companies to combine like airlines did after the last recession to survive.

"When you have an emergency like this and there's really no other alternative than to combine, the antitrust people in the government are a little more lenient," Boston-based Miller Tabak Chief Market Strategist Matt Maley said. "After pent-up travel demand gets spent, what happens then? Do people travel less or stay in hotels less? If that's the case, hotel owners won't have any choice but to consolidate, and the government won't have any choice to let them because they won't survive otherwise. That's what happened with the airlines."

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A wave of consolidation to the airline industry since the early 2000s reduced nine of the largest U.S. carriers to four — American, Delta, United and Southwest. While the hotel industry has its own mega-company equivalent with Marriott International following its $13 billion Starwood acquisition in 2016, there could soon be more like it as companies look to expand their presence to access whatever revenue trickles in during a travel recovery.

Smaller companies like Wyndham Hotels & Resorts, Choice Hotels, and Extended Stay America are ripe early M&A targets compared to bigger companies like Marriott, Hilton, and Hyatt, Maley said. But even bigger players could combine in a favorable regulatory environment.

"In any industry, the small to medium-sized guys, if they don't combine their resources, they get pushed out," he added. "One of the biggest problems when you have a major downturn like we have right now is the big guys win and the little guys lose."

Waiting in the Wings

In the lead-up to the coronavirus crisis, investors in U.S. real estate circles noted there was plenty of capital looking to invest in major markets but not enough property. In an interview with Skift earlier this week, LW Hospitality Advisors President and CEO Dan Lesser said that mindset also extended to businesses like a hotel.

Coronavirus and its accompanying catastrophic impact on hotel revenues are almost certain to eventually present investment opportunities. Many hotels have shut down around the world, and some of those may never reopen.

"The reality is most firms have their hands full right now handling struggling assets on their books. Cash is king right now and focusing on running one's own business takes precedent over going out and trying to effectuate new deals, but I think it's only a matter of time," Lesser said. "That said, there's a couple trillion dollars out there considered to be dry powder. Once things stabilize, you'll see that money deployed."

Economists have yet to rally around whether the coronavirus recovery will take on a rapid V-shape or the more prolonged L-shaped rebound, but a drawn out recovery is looking more likely as governments continue to extend shelter-in-place orders. Analysts tend to expect leisure travelers to return first when restrictions are lifted due to pent-up demand to get out of the house. There is also growing sentiment in the hospitality industry that travelers will initially stick to what they know best, often a bigger brand over something boutique.

“There is the simple logic that larger platforms can drive better economies of scale and better leverage operating costs,” EY Global Real Estate, Hospitality and Construction leader Mark Grinis said. “I think that will be a driving factor for consolidation. The players that have liquidity and staying power will see opportunities to acquire and consolidate other companies.”

Consolidate, but How Much?

It is still too early to determine exactly which hotel companies are going to pair off in an eventual merger environment.

Marriott and Hilton have both issued preliminary first quarter performance results and indicate they can’t issue a realistic financial forecast due to so many parts of the world having yet to stabilize from the spreading coronavirus. Hotel lending has essentially stopped because it is next to impossible to put a value on properties and underwrite. While he declined to say which companies would likely combine, Grinis said some level of industry consolidation is inevitable.

“The reality is if your value is down 30 percent, your capital structures are not going to hold up in that environment,” Grinis said. “As a result, M&A is certainly going to increase. That’s 100 percent. To what degree, we still need some time to see how the industry sorts itself out.”