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An Examination of Stock Performance: The Three Top-Performing Lodging Firms August 1987 - January 1990

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Abstract
A study published in the Fall 1988 issue of the FIU Hospitality Review revealed that the top three lodging stock performers during the period July 1982 to January 1988 were Prime Motor Inns, Inc., Marriott Corporation, and Hilton Hotels Corporation. The author has completed a follow-up study in an attempt to determine how selected lodging firms have fared since the summer rally of 1987 (which preceded the stock crash of October 19, 1987) until more recent times.

Keywords
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An Examination of Stock Performance: The Three Top-Performing Lodging Firms August 1987 to January 1990

by
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A study published in the Fall 1988 issue of the FIU Hospitality Review[1] revealed that the top three lodging stock performers during the period July 1982 to January 1988 were Prime Motor Inns, Inc., Marriott Corporation, and Hilton Hotels Corporation. The author has completed a follow-up study in an attempt to determine how selected lodging firms have fared since the summer rally of 1987 (which preceded the stock crash of October 19, 1987) until more recent times.

Over the period August 1987 to January 1990, an analysis of stock prices of hotel firms which were publicly-held, had over $100 million in annual lodging sales, were included in the Dow Jones lodging industry group, and were traded on the New York Stock Exchange resulted in the identification of three top performers: Holiday Corporation, Hilton Hotels Corporation, and La Quinta Motor Inns, Inc. Six companies were initially identified in this category; the other three were Marriott Corporation, Prime Motor Inns, Inc. and Ramada, Inc. However, Ramada, Inc. was not included in the final study since it sold its hotel business to New World Development Company of Hong Kong in December 1989.

Data were then collected on the closing stock prices for each company on the last day of each month for the period August 1987 to January 1990 (all amounts were rounded to the nearest dollar) to find the three top performers. More detailed analysis was thus limited to those firms.

Short-trend movements during selected time periods were observed both upward and downward; then appropriate percentage changes were obtained for each period. These percentage changes were matched against comparable percentage changes in the Dow Jones Industrial Average (DJIA) in order to determine whether the company outperformed or underperformed the Dow during that period and to provide a detailed review of the major contributing factors behind each company's stock performance. Useful parallels can be drawn between the previous study (1982-1988) and the current one (1987-1990), focusing on the recent developments affecting the hospitality industry economic and financial environment.

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Holiday Corporation

From a modest beginning when entrepreneur Kemmons Wilson opened the first Holiday Inn in his hometown, Memphis, Tennessee, in August 1952, Holiday Corp. grew into the world's largest lodging chain with over 300,000 rooms located in 51 countries or territories. In August 1957, Holiday Inns went public, trading stock in the over-the-counter market. In 1963 Holiday's stock began trading on the New York Stock Exchange. Over the years the Holiday Inn hotel system evolved from a chain of roadside motor courts to a network of hotels serving multiple markets. In 1970 the Holiday Inn hotel system became the first billion dollar food service and lodging chain in history when its estimated gross sales amounted to more than $1.2 billion.

"To maintain further growth, Holiday Inns attempted to diversify by purchasing Continental Trailways and Delta Steamships."[2] But, "the losses from Trailways and the reduced travel resulting from gasoline-price increases caused a 90 percent drop in the value of Holiday Inn's stock."[3] When Kemmons Wilson retired in 1979, a new management team "began to shift emphasis from an entrepreneurial approach toward more planned, professional management. As part of this strategy the company divested more than 30 businesses unrelated to the hospitality industry,"[4] including Delta and Trailways. During this time, Holiday Inn purchased the Perkins Restaurant chain and merged with Harrah's, the Nevada casino operator.

"In 1984 Holiday Inns, Inc. became a subsidiary of Holiday Corporation, holding company of its hotel/casino division, Harrah's and, all hotel and Embassy suites."[5]

In 1987 Holiday organized a plan of recapitalization after facing a potential takeover threat from developer Donald Trump. The $2.6 billion recapitalization plan caused the company to be highly leveraged. "At the end of 1987 there was a $770 million deficit in shareholders equity resulting from the payment of a special $65-per-share dividend in April 1987."[6] The company pursued "a strategy of asset dispositions that generated net after-tax proceeds of approximately $300 million in 1987 that were used to reduce debt or were escrowed for future debt reduction."[7] In 1988 long-term debt was reduced by $500 million through outstanding operations and aggressive asset sales.

In August 1989, Holiday Corporation entered into an agreement to sell its Holiday Inn hotel chain to Bass P.L.C., a British brewer with interests in the restaurant and lodging industries. "Bass will pay $125 million in Bass stock and assume $2.1 billion in debt."[8] Holiday stockholders were to receive a tax-free stock dividend from a new spin-off company (i.e., Promus) that represented interests in the company's gambling casinos and in three hotel chains, Embassy Suites, Hampton Inns, and Homewood Suites. In addition, Holiday shareholders were to receive a special dividend of $35 a share from the spin-off company.

In February 1990 the $2.23 billion deal was closed. "Holiday Inns entered the decade of the '90s with a new owner, Bass P.L.C. of London, the largest retailer in the United Kingdom."[9]

Stock Analysis Shows Exceptional Growth

There was a remarkable increase in Holiday's market prices from August 1987 to January 1990 of 114 percent, while the DJIA went down by 3 percent during the same period (See Exhibits 1 and 2). An analysis of specific periods in which Holiday outperformed and underperformed the Dow follows Exhibit 3.

Exhibit 1
Dow Jones Industrial Average

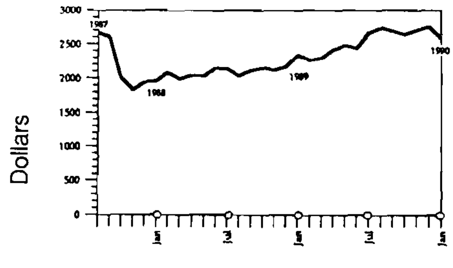

Exhibit 2
Holiday Corporation

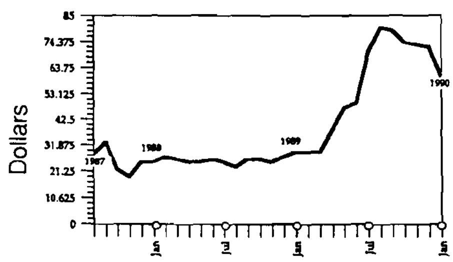

Exhibit 3
Holiday Outperforms the DJIA
August 1987 - January 1990

	DJIA Percentage Change	Holiday Percentage Change
November 1987 - June 1988	+17%	+ 37%
June 1988 - March 1989	+ 7%	+ 12%
March 1989 - August 1989	+19%	+176%

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• **November 1987 - June 1988:** In this period Holiday enjoyed an increase of 37 percent in its stock prices, or more than double the DJIA increase of percent, indicative of the strong recovery from the October 1987 market collapse.

By the end of 1987, Holiday was already well ahead of schedule in its asset disposition program to reduce the massive debt incurred as a result of the April 1987 $2.6 billion recapitalization plan. The steps taken by Holiday Corporation to cut its huge recapitalization debt included agreements "to sell certain Holiday Inn international and domestic assets to Bass PLC for approximately $475 million in cash and notes. Under the arrangement Bass will hold exclusive right to own, operate and license Holiday Inn hotels outside the United States, Canada and Mexico."[10] In addition, Holiday sold to Bass $100 million of 10-year 7.5% subordinated debentures convertible into Holiday's common stock at a price between $30 and $38 a share. The proceeds were used to reduce long-term debt. These measures renewed investors' confidence in Holiday Corporation.

"Although earnings comparisons were deemed highly erratic in 1987 and 1988, it was anticipated for Holiday to show strong earnings performance in the '90s as shrinking interest expense should lend substantial leverage to operating gains."[11] In May 1988, Holiday "announced the creation of its new Homewood Suites brand, thereby returning to the extended stay market it spurned when it sold 50% interest in the Residence Inn chain in 1987."[12]

Some analysts estimated "that the Holiday's stock, which was trading at $25 a share in May 1988, could have an underlying value of $40 a share."[13]

• **June 1988 - March 1989:** While the DJIA rose 7 percent from June 1988 to March 1989, Holiday's stock prices continued their steady growth by rising 12 percent, reaching the upper $20s.

Holiday Corporation reported a 4.1 percent decrease in revenues and a 19 percent decrease in net income for the year 1988, principally because Holiday owned a net of 28 fewer hotels and owed recapitalization charges and huge interests costs associated with the recapitalization plan. However, "income from continuing operations declined only one percent."[14] Michael D. Rose reported to Holiday's shareholders on March 15, 1989: "at year end our remaining debt stood $1.9 billion, net of $240 million in notes receivable, with no major principal repayments due until 1992."[15]

The May 1988 sale of domestic hotels and international assets to Bass for $450 million in cash and notes enabled Holiday to reduce its debt further and pay its huge interest costs. Fueling confidence in Holiday was its continued development and growth. A new casino/hotel, Harrah's del Rio, was opened in Laughlin, Nevada, in 1988. A two-phased expansion plan of the 991-room Holiday Inn/Holiday Casino in Las Vegas, Nevada, was also announced in December 1988. Together, "Holiday hotel brands added a total of 86 new properties in 1988, accounting for 15 percent of all new hotels opened in the United States,"[16] including the launching of a brand-new hotel product, Homewood Suites.

• **March 1989 - August 1989:** There was an astonishing 176 percent increase in Holiday's stock prices from March 1989 to August 1989 (prices jumped from the upper $20s to the $80s), compared to a 19 percent rise in DJIA during the same period.

"Hotel stocks performed well during the first half of 1989. Their strength was based in large part on asset speculation, spurred on by some well-publicized transactions, in which certain top-tier properties were sold for unexpectedly high prices."[17]

Since the recapitalization plan was undertaken in early 1987 "to the applause of Wall Street, Holiday's management has eliminated the company perquisites, including a collection of vintage cars and corporate jets; slashed jobs, scoured the company for undervalued assets, and gradually sold off much of the company's real estate at healthy prices."[18] That strategy enabled Holiday to pay off at least one-fifth of its massive recapitalization debt by mid-1989.

During May 1989, Holiday was already trading in the $40 range, fueled by the strong performance of hotel stocks and by Holiday's success in strengthening its financial position. On May 15, 1989, a $3.38 rise in Holiday's price, closing at $45.13, was attributed to "the higher than expected price on the possibility of selling its Harrah's Lake Tahoe hotel and casino with an earnings multiple that would translate into a sales price of about $400 million."[19]

Holiday's stock prices continued a rapid climb in July 1989 based on reports that the company was a takeover candidate. "On July 24, 1989, Holiday's stock jumped to $64 a share when a report published by Federal Filings appeared to indicate that a Japanese buyer might be attempting to buy the company."[20]

On August 23, 1989, Holiday's prices jumped $7.88 (to $77) in anticipation of an agreement to sell its hotel operations to Bass PLC for $2.23 billion. When the announcement was made on August 24, 1989, "Holiday's stock closed at $83 a share, up $6."[21] The planned sale was expected to provide payment to shareholders of $125 million in Bass stock and the assumption of about $1.2 billion in debt. Holiday would "break up the Holiday Inn, and it will borrow heavily against the assets of its remaining operations (later renamed Promus Companies) to pay each shareholder a $35 a share cash dividend."[22] The spin-off company will include four brands, Hampton Inns, Embassy suites, Homewood suites, and Harrah's. "Clear-cut winners in the Bass deal were perceived to be the stockholders of Holiday Corporation, its chairman and other top officers."[23]

• **August 1987 - November 1987:** Holiday's stock decline of 32 percent from August 1987 to November 1987 was slightly higher than the overall market decline in the DJIA of 31 percent, which reflected the market collapse of October 19, 1987. Overall, lodging stocks did not fare well during the month of October 1987. "Lodging and casino stocks fell in sympathy with the crashing market as the axiom of 'what goes up must come down' took on a new dimension. The lodging index plunged a record 631.71 or 30.58 percent."[24] Holiday's decline for October 1987 was 36.98 percent, closing at $19.58 a share.

During this period, Holiday was trying to reduce its massive debt resulting from the recapitalization plan of April 1987 by selling real estate assets and converting floating rate debts into fixed loans. Thus Holiday was perceived a highly leveraged and risky firm, thereby contributing to investors' hesitation to invest in the company.

On December 11, 1987, Value Line reported that "operations probably won't generate enough cash to meet interest payments until 1989. In the absence of substantial property sales gains in a given quarter, red ink will flow, as is likely in this case of a seasonally slow closing period."[25]

Exhibit 4
Holiday Outperformed by the Dow
August 1987 - January 1990

	DJIA percentage Change	Holiday percentage Change
August 1987 - November 1987	-31%	-32%
August 1989 - January 1990	- 5%	-25%

- **August 1989 - January 1990:** The second period of decline for Holiday occurred between August 1989 and January 1990. While the DJIA posted a slight decrease of 5 percent, Holiday dropped 25 percent during this period (from the $80 range down to the $60 range). In September 1989, some analysts felt "that Holiday seemed overpriced based on 3- to 5-year earnings prospects under the most favorable scenarios."[26] During the October 13, 1989, mini-crash, Holiday's price fell by 8 and 3/8 points to $71.50, since takeover stocks were hit hard at that time.

As indicated earlier, Holiday had agreed to sell its flagship Holiday Inn unit to Bass PLC of Britain for $2.23 billion in August 1989. In addition to a special dividend of $35 a share to be paid by Promus, Holiday shareholders were to receive shares of Bass stock in the new company. However, in mi-December 1989, "Holiday Corporation, citing market conditions, reduced to $30 a share the special cash dividend."[27]

Analyst said shareholders were unlikely to let the dividend reduction stop the deal since holders will still receive a total value of about $115 a share from the transaction, compared with the current price of $73."[28] Nonetheless, before the Bass transaction was consummated in early February 1990 by spinning off the Promus Companies and selling Holiday Inns to Bass, Holiday's stock prices declined further, closing at $60 on January 31, 1990.

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Hilton Hotels Corporation

Hilton Hotels Corporation, one of the leading lodging firms in the United States, "is the product of a merger between the old Hilton (started by Conrad Hilton's purchase of a small hotel in Texas early in the century), the Statler chain, and the spin-off of Hilton International in 1964."[29]

In 1947 Hilton Hotels Corporation became the first hotel company to be listed in the New York Stock Exchange. In the 1970s Hilton was the first publicly-held company to enter the gaming market. Hilton is primarily engaged in the ownership and management of hotels and hotel casinos in the United States. In 1985 Hilton reentered the international market with the opening of Conrad International Hotels and Jupiter's Casino in Queensland, Australia.

As of December 31, 1989, "the Hilton system consisted of 16 wholly owned properties, 15 partially owned and managed, 22 managed and 214 franchised hotels."[30] During 1989 Hilton entered the all-suites market segment with Hilton Suites and the mid-priced market segment with Crest-Hill by Hilton. The company also owns three Nevada hotel/casinos, two Nevada theme casinos and equity income and management fee income from a hotel casino joint venture in Queensland, Australia. "With the anticipated opening of the Flamingo Hilton-Laughlin in August 1990, Hilton will have five gaming facilities with a total of 10,000 rooms and 300,000 square feet of casino space."[31]

In 1989 gaming provided 44 percent of consolidated income. Gaming revenues and income contribution in 1989, however, "declined one percent and 20 percent, respectively, from 1988 levels due to an abnormally low win percentage at the Las Vegas Hilton and a loss on a sporting event promotion."[32] Hotel income contribution increased 12 percent in 1989 as compared to a 14 percent increase in 1988. The hotel segment performance has been affected by the renovation programs at many of its hotels in primary markets. During 1989, for instance, Waldorf-Astoria completed its renovation program, while major renovations at the San Francisco Hilton and the Hilton Hawaiian Village were completed in the spring of 1988.

Overall, Hilton's earnings per share before property transactions decreased 15 percent, from $2.72 per share in 1988 to $2.32 per share in 1989.

Stock Performance Shows Great Growth

Hilton's stock prices (adjusted for a 2-for-1 stock split in June 1988) reflected a significant increase of 44 percent from August 1987 to January 1990 in contrast to a 3 percent decline in the DJIA (see Exhibits 5 and 6). Most of this increase was fueled by speculative frenzy in the summer of 1989 (when stock prices peaked at $115.50) after the company was perceived as a takeover target, following Barron Hilton's settlement of a long-running dispute with the Conrad N. Hilton Foundation over control of Hilton's stock.

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Exhibit 5
Dow Jones Industrial Average

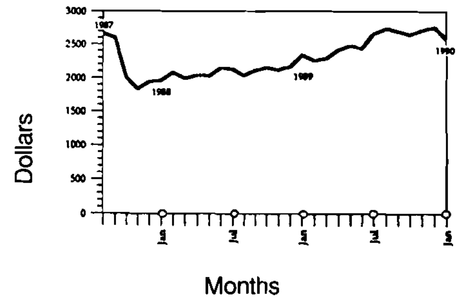
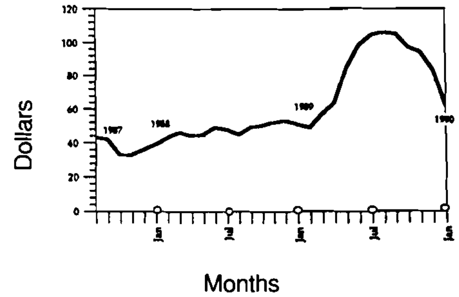


Exhibit 6
Hilton Hotels Corporation*



*Adjusted for a 2:1 stock split in June 1988

Exhibit 7
Hilton Outperforms the Dow
August 1987 - January 1990

	DJIA Percentage Change	Hilton's Percentage Change
August 1987 - November 1987	- 31%	- 23%
November 1987 - August 1988	+11%	+ 36%
February 1989 - August 1989	+21%	+116%

• **August 1987 - November 1987:** From August 1987 to November 1987 Hilton's stock analysis depicts a decrease of 23 percent, somewhat lower than the 31 percent decline in the DJIA. These downward trends reflect the stock market crash of October 19, 1987 (better known as Black Monday), at which time Hilton's stock was selling in the low $30s (adjusted for a 2-for-1 stock split). During October 1987 Hilton's stock decreased 22 percent. According to a study conducted by Professors Arbel and Carvell of the Cornell School of Hotel and Restaurant Administration, "the losses suffered by the hotel industry were greater than those sustained by 88

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percent of all industry sub-groups in the United States since the market perceives hotels as luxury items."[33]

Yet, Hilton's operating income rose 23 percent in the nine months ending September 30, 1987, while occupancy rates rose to 69 percent (as compared to the 65 percent industry average), prompting some observers to indicate that "the market crash has had almost no effect on advance booking for meetings and conventions."[34] Moreover, "high margins at the casino/hotels in Nevada (where occupancy rates averaged nearly 85 percent was a major factor for Hilton's profit margin at around 13 percent."[35]

In late 1987 a $43.8 million gain on the sale of interests in the Dallas Hilton and the Beverly Hills Hilton was announced. In both cases, Hilton retained a long-term contract to manage the hotels. These transactions freed capital for development of new projects like "all suites and Crest Hill and allowed the realization of the asset appreciation that management believes is not reflected in Hilton's stock prices."[36]

• **November 1987 - August 1988:** There was a very strong upward move by Hilton from November 1987 to August 1988; stock prices were up by 36 percent. The DJIA was also up at this time, but at a much lower rate, with an 11 percent increase, indicative of the recovery from the low prices of the October 1987 crash.

Hilton's earning per share for 1987 reached record highs, prompting Chairman Barron Hilton to state that "1987 was the best year in our history. We can truly be proud of that achievement because the results reflect the fruits of various programs. Adjusted for property transactions and a stock split, earnings per share were $2.25 in 1987 compared to $1.99 in 1986."[37]

In 1988 the company began another round of expansion and upgrade of the Las Vegas properties, adding a 750-room tower at the Flamingo Hilton and continued its record pace "with net income per share increasing 20 percent during the six months ended June 30, 1988, over comparable 1987 levels."[38]

"On May 12, 1988, the Board of Directors authorized a 2-for-1 split of Hilton's common stock and increased cash dividends by 11 percent. The board attributed these measures to the corporation's strong balance sheet and substantial cash flows, solid operating performance and the favorable outlook for the business."[39] On March 11, 1988, Value Line reported "that Hilton was a suitable long-term holding for conservative investors with excellent safety and financial strength and holding a significant amount of properties that were undervalued."[40]

Moreover, by mid-1988, some analysts began to speculate about Hilton's future following the ruling of a California Court of Appeals as a first step toward selling the company. "Once Barron Hilton's claims to the stock are resolved the most likely mechanism for maximizing the value of the shares would be selling the entire company to a foreign company."[41]

• **February 1989 - August 1989:** Hilton's astonishing increase of some 116 percent from February 1989 to August 1989 was six times that of the Dow of 21 percent. Hilton's stock prices more than doubled, going from $49 in February 1989 to $106 on August 31, 1989 (after peaking at $115 and 1/2 in mid-August).

The final settlement of the long-term dispute between Barron Hilton and the Conrad Hilton Foundation took place in May 1989. "As a result of the settlement Mr. Hilton has voting control over about 25 percent of Hilton stock and was precluded from selling off the six million shares placed under his discretion in charitable remainder trust for less than $75 a share."[42]

With the resolution of the long-standing dispute, there was a great deal of speculation in the investment community as to what would happen next. This speculation was ignited when in the May 1989 annual meeting Barron Hilton announced that "although the company is not actively seeking buyers, the board would consider any offers from interested parties."[43]

"Hilton's shares soared following his remarks closing at $72, up 6 and 1/2 on the New York Stock Exchange."[44] Analysts were estimating Hilton's value at $85 to $100, although some observers peg the company breakup value at $90 to $115 a share.

By early June 1989, Hilton's stock prices had risen more than 33 percent in the three weeks that followed Hilton's remarks at the annual meeting. Hilton's stock climbed to a 52-week high of $87.25, closing at $86.75 on June 2, 1989.[45] After Hilton's announcement that "it would retain New York-based brokerage house Shearson Lehman Hutton, Inc. and New York Real Estate Investment Bankers Eastdil Realty, Inc. as financial advisers as part of a plan to optimize shareholders value, Hilton's stock reached $100."[46] By mid-August, shares of Hilton continued to rise amid takeover speculation that the company was about to consider at least two formal buyout bids.

Exhibit 8
Hilton Outperformed by the Dow
August 1987 - January 1990

	DJIA Percentage Change	Hilton Percentage Change
August 1988 - February 1989	+11%	+ 9%
August 1989 - January 1990	- 5%	-42%

• **August 1988 - February 1989:** From August 1988 to February 1989, Hilton's stock performance experienced a 9 percent increase, two percentage points less than the Dow increase of 11 percent for the same period.

In the year 1988 Hilton achieved record revenues and earnings from operations. "Operating income from owned and partially owned

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properties increased 25 percent in 1988 over 1987 levels. The gaming segment enjoyed excellent growth in 1988, as revenue and income contribution increased 13 percent and 19 percent respectively."[47]

The company gaming operations passed their hotel income contribution for the first time in Hilton's history. However, Hilton's stock began to fluctuate when a tentative agreement was announced in November 1988 that Barron Hilton agreed to split the 27.9 percent Hilton Hotels stock with the Conrad N. Hilton Foundation. The possibilities of a final settlement of this dispute triggered deliberations as to what course of action the chairman of the board might take. Moreover, many observers felt that Hilton's price of $54 in January 1989 (20 times the 1988 earnings) was fairly valued despite the record pace in 1988, spurred by a 79 percent increase in gaming income during the nine months ending September 30, 1988, with Nevada gaming hotel occupancy reaching 88 percent and hotel occupancies showing an impressive 70 percent (despite an 8 percent rise in room rates). "While we do not believe the stock is particularly undervalued based on its underlying earnings stream, we do believe it is undervalued based on its assets,"[48] observes financial analyst Richard Simon of Goldman Sachs.

• **August 1989 - January 1990:** The last period of decline occurred between August 1989 and January 1990. While the DJIA posted a slight decrease of 5 percent, Hilton dropped some 42 percent during the period. The Dow decrease includes the impact of the mini-crash of October 1989 that was triggered by problems in financing a buyout proposal by the parent of United Airlines. The lodging industry was one of the worst performing industry groups in the last quarter of 1989, reflecting "soft occupancy levels and flat room rates providing one reason for the stock price weakness."[49] "Hilton Hotels Corporation earnings fell 14 percent in the fourth quarter and 18 percent for the year 1989."[50] Reduced profitability was mainly attributed to the $300 million expansion program which disrupted normal activities, to a low win percentage at the gaming division and start up costs at two new facilities. In addition, response was slow to the newly-developed Crest Hill and Hilton Suites.

Most importantly, after trading as high as $115 and 1/2 in August 1989 and declining 23 points (to 85) during the mini-crash of October 13, 1989, Hilton's stock fell in November 1989 following "speculation that the company was more likely to sell only its hotel group rather than the entire concern,"[51] a scenario that would lower the immediate payout to shareholders. Although "at least six bidders emerged as serious contenders for all or part of the assets of Hilton (including JMB Realty Corp. and two Japanese investors)"[52] by the end of the year 1989, Hilton's stock declined further, "following lower-than-expected bids for the hotel-casino concern and a statement by the company that it reserves the right to pull itself off the market."[53]

On January 23, 1990, "Hilton said that its board would meet next week to consider bids for the company as well as restructuring plans that would not involve a sale."[54] Investors interpreted the statement to mean that the bids were lower than expected and that the company was seriously considering not selling. "Hilton's shares fell sharply in active trading closing at $65,50, down $8.75."[55] On January 31, 1990, "takeover stocks rebounded from a two-day sell-off, including Hilton Hotels which climbed 4 to 61 and 3/4 after dropping to a low of $55 and 1/8 in early trading. Hilton's board continued to meet on the possible sale of the company, and the stock's upturn reflected speculation that the board would accept a bid, rather than pursue a recapitalization or take itself off the market."[56] Finally, on March 7, 1990, Hilton's board decided to take Hilton off the market. This action resulted in a further decline in Hilton's stock to the lower $50s.

La Quinta Motor Inns, Inc.

Since Sam Barshop opened La Quinta's first inn directly across from the World's Fair grounds in San Antonio, Texas, in 1968, the company has been involved in the development, ownership, and operation of motor inns, designed primarily to serve business travelers mainly in the Southwest, the South, and the Midwest. The major source of its customers are those business travelers who desire a high quality room, but whose needs do not include banquet and convention facilities, or on-premise restaurants and room service. As a result, La Quinta had been able to offer lower rates than comparable full-service hotels.

La Quinta has entered into joint venture agreements to enable the company to expand at a greater extent than would have been feasible using only company funds. The principal co-ventures are Prudential Insurance Company and Lincoln National Life Insurance Company. Prudential has been a joint venture partner since 1971. As of May 31, 1989, Prudential and La Quinta owned 27 La Quinta Inns and 16 free-standing restaurants.

The fiscal year ending May 31, 1982, marked the end of the first decade as a publicly-held company and La Quinta'a seventh successive record year of growth with revenues over $100 million and occupancy levels exceeding 80 percent.

Fiscal 1983, however, was not very rewarding for La Quinta. Sam Barshop, president and chairman of the board, began the address to the shareholders in the 1983 annual report by saying "Fiscal 1983 was a challenging year for La Quinta. Our management faced perhaps the most difficult time in our corporate history. Unlike other economic downturns, the 1982-1983 recession spread to our market area, the Southwest, triggered by declining oil prices."[57] As a result, La Quinta experienced a decline in its percent of occupancy of over 10 percent (to 71.1 percent) and a 10 percent increase in revenues (compared to the five-year compound growth rate of 23.71 percent previously reported). Nonetheless, La Quinta announced a commitment to its expansion program, regardless of the short-term shortcomings.

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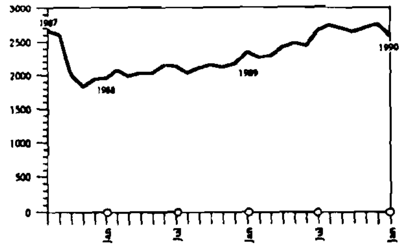
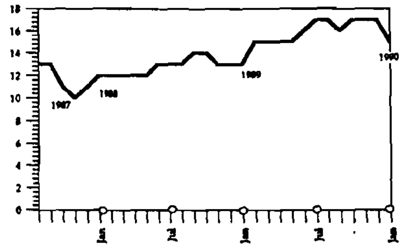
Exhibit 9
Dow Jones Industrial Average



Dollars

Months

Exhibit 10
La Quinta Motor Inns, Inc.



Dollars

Months

The company continued its planned expansion in 1984. However, the company's awareness of its vulnerability to the economic problems impacting Texas resulted in shifting its efforts to other states, including California, Florida, and others in the Sunbelt. Poor results continued in 1985 when La Quinta's third quarter became its first unprofitable quarter in a decade. This was attributed to declining occupancy percentages, new construction costs, and lower earnings resulting from a lower level of asset sales gains. "We believe the poor occupancy performance was due primarily to energy dependent areas of the country and an increased level of competition in our market segment."[58]

In October 1986, La Quinta sold 31 properties to a newly-formed publicly-traded La Quinta Motor Inns Master Limited Partnership. According to La Quinta, "This transaction provided an excellent opportunity for the company to realize returns for the real estate side of its business and maintain a control of those inns under long-term management agreements."[59] However, La Quinta decided to temporarily slow down construction of new inns.

In 1988 La Quinta continued to face operating difficulties. Although occupancies increased .9 percent to 61.3 percent, earnings per share went down to $.24 per share, while return on equity declined to a nominal 2.7 percent, However, in fiscal 1989 "La Quinta operating performance improved considerably."[60] The percent of occupancy increased 3.9 percentage points to 65 percent, with average room rates increasing to $37.29. Texas and its contiguous states led the improvement in occupancies. Earnings per share increased to $.36 per share (from $.24 per share in 1989).

La Quinta's Analysis Indicates Above Average Performance

While the DJIA experienced a 3 percent decline from August 1987 to January 1990, La Quinta's stock prices rose by 15 percent (See Exhibits 9 and 10). This was the result of renewed investor confidence in the company's ability to overcome the economic difficulties it had faced since 1983.

Exhibit 11
La Quinta Outperforms the Dow
August 1987 - January 1990

	DJIA Percentage Change	La Quinta Percentage Change
August 1987 - Nov. 1987	- 31%	- 23%
Nov. 1987 - June 1988	+17%	+30%
June 1988 - February 1989	+5%	+15%

• **August 1987 - November 1987:** From August 1987 to November 1987 La Quinta's stock price decreased by 23 percent, or 8 percentage points less than the DJIA decline of 31 percent, which was mainly attributed to the October 1987 market crash. La Quinta's decline during the October 1987 crash was the lowest among lodging firms. "While the lodging stock index plunged a record 631.71 points or 30.58 percent in October 1987, La Quinta's stock decline was 7 percent compared to a 15.95 percent decline in the Lodging Stock Index."[61]

During this period, La Quinta decided to control expansion in the wake of poor economic conditions in Texas and contiguous states. The company usually opened 15 new units a year. However, "it plans to add only five units in fiscal 1988."[62] Because of this decision to control growth, the company concentrated on renovating existing properties. These strategies were perceived as appropriate and timely.

Although operating results were likely to remain depressed in fiscal 1988 (ending May 31), the October 31, 1986, sale of 31 properties to La Quinta Master Limited Partnership realized $423.7 million sales gains that will continue to be recognized in fiscal 1988, resulting in estimated earnings per share of $.45."[63]

• **November 1987 - June 1988:** During the period, La Quinta's stock performance showed a remarkable increase of 30 percent, almost double than the 17 percent rise in the Dow, which was indicative of the stock market recovery from the October 1987 crash. La Quinta's bottom line continued to benefit from asset sales. In the third quarter of fiscal 1988, the company booked a $2.2 million gain on the sale of seven properties to a joint-venture formed with Cigna Investments, Inc.[64]

Meanwhile, over the next two years La Quinta continued to recognize gains of about $800,000 per month from the sale of 31 properties to the limited partnership on October 1987.[65] Operating results, however, remain weak with occupancy levels of 59 percent, still below the industry average. In addition, room revenues were running lower than in 1987 because heavy competition prompted a reduction in room rates of about 2 percent.

• **June 1988 - February 1989:** For the third consecutive period, La Quinta outperformed the DJIA increase of 5 percent from June 1988 to February 1989. La Quinta's prices went up three times as much, or 15 percent. La Quinta's emphasis on renovation of existing inns and the company's entrance into markets more prosperous than Texas (e.g., Florida and California) were major contributors to investor confidence in La Quinta's future.

In its annual report for the fiscal year ending May 31, 1988, La Quinta reported that its operations were benefiting from the increase in tourism in Texas. The opening of Sea World, an aquatic theme park in San Antonio, and the increase in the state's tourism budget "from approximately one million dollars in 1987 to approximately ten million dollars in 1988"[66] were expected to significantly and favorably impact occupancies. On September 19, 1988, Value Line reported that "La Quinta operations are beginning to perk up. Things look brighter, expecting earning per share record and occupancy levels increases of 3 percentage points."[67]

Exhibit 12
La Quinta Outperformed by the Dow
August 1987 - January 1990

	DJIA Percentage Change	La Quinta Percentage Change
February 1989 - July 1989	+18%	+13%
July 1989 - January 1990	- 3%	- 12%

• **February 1989 - July 1989:** During this period, La Quinta continued its upward trend by increasing 13 percent. However, the Dow experienced a higher increase of 18 percent for the same period. *The Wall Street Journal* reported that corporate earnings for first quarter 1989 were relatively modest for most hotel concerns, an indication of an industry slowdown. Indeed, La Quinta "reported a third quarter loss (for quarter ending February 28, 1989) of $2.5

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million (or 19 cents a share) compared to a loss of $505,000 (or 4 cents a share) in the same period in 1988."[68] Chairman Sam Barshop attributed the decline in operating results to a decrease in non-operating items (gain on sales of assets). Yet, "Average occupancy percentages for 3rd quarter of 1989 increased by 2.7 percent."[69]

• **July 1989 - January 1990:** La Quinta's stock prices fell 12 percent from July 1989 to January 1990, while the DJIA only fell 3 percentage points during the same period. The drop in stock prices was felt throughout the lodging industry. "Hotel and gaming stocks have generally been weak for the latter part of 1989 and early 1990. "Soft occupancy levels and flat room rates provide one reason for the stock price weakness."[70]

Although lodging occupancy increased to 65 percent for 1989 and the economy was recovering in Texas, a predicted softer U.S. economy and a "scheduled decrease in the advertising budget for tourism in Texas 1990"[71] was expected to negatively affect La Quinta. In addition, the gain on the sale of 31 properties to the master limited partnership in October 1986, which was recognized in 1987 and 1988 and, thus, had helped La Quinta's profitability, will drop to approximately $4 million in 1990. Accordingly, some analysts believe that "share earnings were going to be flat in 1990."[72]

Significant Observations Can Be Made

By focusing attention on the findings presented in this study pertaining to the stock performance of selected lodging firms between August 1987 and January 1990, some interesting observations can be made while establishing useful parallels with the 1982-1988 study and looking at future perspectives.

Strong revenue and earnings growth was a major contributing factor to the rise in stock market prices of the top lodging firms between 1982 and early 1988. Conversely, buyouts and takeover speculation, motivated largely by financial considerations, was the catalyst behind the rise in market prices of the top two lodging performers in the current study (1987-1990).

While most of the lodging stocks rebounded from the October 1987 market crash by early 1988, the recovery from the October 1989 mini-crash did not take place by January 1990. Conversely, "the lodging group was among the 10 worst performing groups for the 4th quarter of the 1989,"[73] and the worst performer in January 1990 (declining 22 percent). Certainly "in January 1990 the lodging group which led the market in 1989 is plagued with problems with the Hilton Hotels Corporation takeover and reports that industry profits will be hurt by overcapacity."[74]

The attractiveness of lodging stocks to Japanese and European investors who were seeking real estate investments in large U.S. cities was a dominant economic theme in the takeover speculation affecting the hospitality industry in 1989.

Overbuilding, operating cost increases, and fierce competition among major hotel chains have reversed the fast growth in revenues and earnings of the early 1980s.

Weakness in the real estate market, overcapacity, and the relatively high leverage (and risky) position of most lodging firms have turned investors away in the recent past. Investors fled to companies where economic risks were low. Accordingly, a report by Avner Arbel of the Cornell University School of Hotel and Restaurant Administration stated: "Hotel stocks have lost more value over the past half year (ending January 31, 1990) than did the average of all industries traded in the United States."[75]

Because of the slowdown in takeover activity and the collapse of the junk bond market, investors have become more disciplined in their decision-making process. They have returned to traditional fundamentals of research and stock valuation, whereas judgments are based on earnings and long-term performance. A strong balance sheet and cash flows are themes instead of the "break-up value" technique that prevailed in 1988 and 1989.

Subsequent to January 1990, the lodging industry group has continued to exhibit a very weak performance. In fact, the lodging group was the worst performer of all industry groups in March and April 1990. "All but 10 industry groups fell in April 1990 but the lodging group was the hardest hit. Three of the five component stocks were within 5 percent of their 52-week low."[76]

In spite of the gloomy outlook for the hospitality industry noted before, many experts believe that the current financial problems will result in the "consolidation already under way by forcing small chains to sell out to larger chains or combine with each other."[77] The survivors will go through a trying period but, ultimately, will have the market to themselves.

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