

Jane Elliott  
elliottj@rice.edu

**Starwood Hotels & Resorts** (NYSE: HOT)

**BUY**

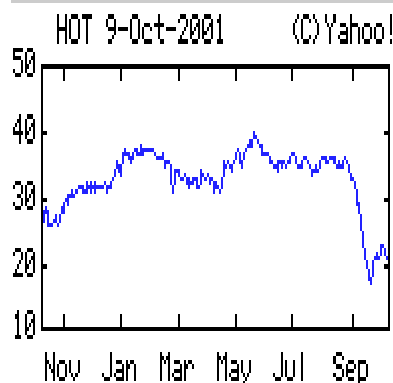
**October 17, 2001**

**Consumer Discretionary Sector**

**Lodging**

## MARKET DATA

Price	\$23.52
52 wk range	\$17.10-\$40.89
Price Target	\$62.00
Shares Out:	199.4 million
Market Cap:	\$4,425 billion
P/E Ratio	12.0
Book Value per share	\$19.69
Beta (from Yahoo! Finance)	0.50
Revenue FY2000	\$4,345 MM
Net Income FY2000	\$69.0 MM



## COMPANY OVERVIEW (FROM YAHOO! FINANCE)

Starwood Hotels & Resorts Worldwide, Inc. is one of the world's largest hotel and leisure companies. The Company conducts its hotel and leisure business both directly and through its subsidiaries. The Company's brand names include Sheraton, Westin, The Luxury Collection, St. Regis, W and Four Points by Sheraton. Through these brands, Starwood is well represented in most major markets around the world. The Company's revenue and earnings are derived primarily from hotel and leisure operations, which include the operation of its owned hotels; management fees earned from hotels the Company manages pursuant to long-term management contracts; the receipt of franchise fees; and the development, ownership and operation of vacation ownership resorts, marketing and selling vacation ownership interests (VOIs) in the resorts and providing financing to customers who purchase such interests.

## INVESTMENT CONCLUSION

- ☐ Recommending purchase of 200 shares of Starwood stock at current market price. Starwood's stock price has suffered from the recent terrorist attack and this is a great opportunity to pick up a high-quality company at bargain prices. The depressed share price makes this stock attractive because the lodging group will rebound as the broader economy improves.

## SUMMARY

- ☐ Starwood has managed its company accordingly to cope with the fall-off in demand—plans laid out for reducing costs and conserving cash through staff reduction, halting expansion plans, and shortening hours of operations in restaurants.
- ☐ Starwood shares trade at just 12X trailing earnings—a sharp discount to their median multiple of 18X trailing earnings over the past 4 years.
- ☐ Longer term, Starwood will benefit from customer loyalty programs and higher occupancy trends.
- ☐ Starwood owns real estate and will perform best coming out of a down cycle because they don't have to share sales or profits. According to a recent report, "lodging companies...that own real estate could offer 32%-75% upside."

## INDUSTRY INSIGHT

### News & Trends

- ☐ Lodging industry took hit after 9/11 attack.
- ☐ Near term outlook is pretty rough but will pickup long term. Lodging demand correlates extremely tightly with US GDP growth. Lodging stocks are well positioned for meaningful price appreciation.
- ☐ Near term uncertainty with US military action underway
- ☐ Lodging stocks are up 17% since attack, but that's still a long way from where they were before the attack
- ☐ Industry capacity has improved as a result of recent events. New room supply growth had been decelerating since 1998.
- ☐ RevPAR declines have mitigated. Still, growth in revenue per available room, has been negative since spring of this year
- ☐ Occupancy improved to about 60% in the week ending October 6.

## INVESTMENT HIGHLIGHTS

### Company Strategy or Company Discussion

Starwood Hotels is focusing on cutting back on spending in light of the recent tragedy to manage demand. They plan to lay off 10,000 people (23% of the hotel staff). They are leasing empty hotel space to businesses displaced by the attacks. They are also aggressively cutting costs by closing whole floors and wings of some hotels to reduce energy expenses. Staff have been cut in restaurants, health clubs, and business centers. They are thoroughly reviewing all their expenditures.

They expect their strong loyalty program to help them climb back when the economy picks up.

Strategy includes:

- maximizing earnings and cash flow by increasing the profitability of the Company's existing portfolio;
- selectively acquiring interests in additional assets;
- increasing the number of the Company's hotel management contracts and franchise agreements; acquiring, developing and selling vacation ownership interests;
- and maximizing the value of its owned real estate properties
- leveraging its global assets, broad customer base and other resources and by taking advantage of the Company's scale to reduce costs.

### Investment Risks

U.S. hotels stand to lose more than \$2 billion in room revenues and that more than a quarter of the business meetings scheduled this year have been canceled.

American Hotel & Lodging Association, which represents 13,000 member hotels, said that lost bookings in the 10 days after the attacks had cost \$700 million in lost revenue.

Earnings picture is risky. Military action may drive stock price back down.

Starwood Hotels is currently in discussion to seek government funding.

Combination of factors affect traveling concerns from consumers

We believe that over time demand for leisure and entertainment accommodations will return to its previous level and steady growth rate. The timing of this recovery is uncertain and we expect Starwood to face significantly reduced demand.

### Recent Results

## FINANCIAL RESULTS

- ☐ Starwood's stock has lost 43% of its value since May.
- ☐ Strong cash position with minimal working capital requirements
- ☐ Expenses are being controlled by management
- ☐ For the six months ended 6/30/01, revenues fell 1% to \$2.12 billion.
- ☐ Net income applicable to Common from continuing operations and before extraordinary items increased 6% to \$175 million. Results reflect decreased revenues per available room resulting from lower occupancy and industry-wide reduction in demand, offset by lower interest expenses.

**Financial Outlook**

Below are selected financial results (From MSN MONEY)

Earnings Estimates	Qtr(9/01)	Qtr(12/01)	FY(12/01)	FY(12/02)
Average Estimate	0.37	0.44	1.63	1.75
Number of Analysts	16	16	16	16
High Estimate	0.48	0.63	1.96	2.50
Low Estimate	0.01	-0.09	0.81	0.29
Year Ago EPS	0.50	0.64	1.96	1.63
Growth Rate	-26.63%	-31.54%	-16.87%	7.52%

Zacks Industry: HOTELS &amp; MOTEL

Earnings Growth Rates	Last 5 yrs.	FY 2001	FY 2002	Next 5 yrs.	01 P/E
Company	19.30%	-14.70%	8.90%	15.80%	14.60
Industry	14.10%	-4.00%	8.80%	14.50%	16.10
S&P 500	8.40%	-12.80%	15.80%	13.00%	22.60

Zacks Industry: HOTELS &amp; MOTEL

Zacks data updated daily.

## INVESTMENT HIGHLIGHTS

Based on the Bloomberg DDM model. No factors were altered in the pricing of Starwood's stock price.

We would like to slightly overweight the consumer discretionary sector. We recommend purchasing 200 shares with a target price of \$37.00. The sell stop should be place at the low of \$17.00 from the terrorist attack.

### Summary of Model

Current Price	\$24.10
Target Price	\$37.00
Stop Price	\$17.00
Growth Rate	11.26%

## CHARTS / TECHNICAL

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### DIVIDEND DISCOUNT MODEL

**HOT US** Starwood Hotels & Resorts Worldwide Inc

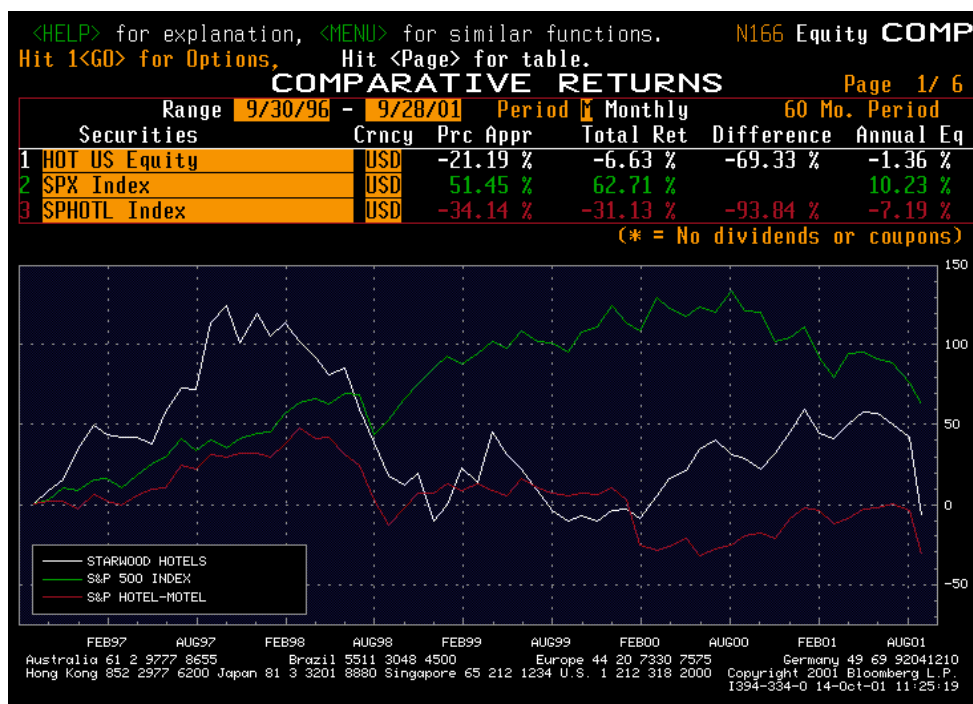
Current Year EPS	1.56	Bond Rate	5.42%
Next Year EPS	1.69	Country Premium	4.91
Indicated Annual Dividend	0.80	Applied Beta	1.10
Growth Years	7	1)Risk Premium	5.40%
Transitional Years	10	Payout at Maturity	45.00%
Long Term Growth Rate	16.67%	Growth Rate at Maturity	5.96%
Closing Price	24.09	Currency	USD

Computed values based on above assumptions

Theoretical Price	38.07
Percent Change from Close	58.01%
Internal Rate of Return	13.05%
Expected Return	37.91%
Implied Growth Rate	11.26%

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## CHARTS / TECHNICAL



### Potential Share Price Appreciation from Current Levels (From Merrill Lynch report)

Corporations	Stock Price	DCF Value	Potential Upside
Fairmont	\$16.75	\$22.13	32%
Hilton	\$8.85	\$13.74	55%
Orient Express	\$13.50	\$22.78	69%
Starwood	\$22.65	\$39.56	75%
Average			58%