Xenia Hotels & Resorts

Lots of Sellers, Who Will Buy?

Is Xenia set up to fall?

- Xenia’s risk profile reads: pent-up demand to sell, low liquidity, and trading price volatility.
- Long-time Inland American investors have seen their estimated share value plummet 30% from their buy-in price. The proposed offering is touted as a liquidity event for tens of thousands of mom & pop investors.
- With lots of sellers, how vulnerable will the stock be to price decline? It is unclear if Xenia will hire an underwriter.
- Preceded by a class action settlement, Inland’s last IPO was dubbed “disastrous.” Inland American has been the subject of a recently ongoing SEC investigation as well as shareholder litigation. Will history repeat itself?

The Xenia Hotels & Resorts ("Xenia") spin-off is being marketed as a liquidity event by Inland American Real Estate Trust ("Inland American"). After having their money locked up for many years, many of Inland American’s 183,000 investors are likely eager to get out. But, it is unclear who will buy in.

In the first of a series on the proposed Xenia listing (NYSE pending: XHR), this report takes a critical look at this seemingly-lopsided transaction and poses the following questions:

- Is Inland American setting up retail investors to take a bath?
- How much volatility and price pressure can Xenia’s stock handle?
- Will Xenia be underwritten by investment banks?
- Will institutional investors wait to buy?
- When will hedge funds see value?
- Will Xenia be vulnerable to shorting?
**Pent-up demand**

The average lifecycle for a non-traded REIT is approximately 10 years. Inland American was formed in 2004. Its latest estimated share value is 30% less than what most investors paid. It has charged stockholders over $1.4 billion in related party fees. In a limited buyback, Inland American offered investors a mere $6.50/share in April.¹

Significant pent-up demand to sell shares is outlined as one of the key risk factors for Xenia. To date, Inland American has not announced any special distributions of proceeds from nearly $2.5 billion in assets already sold, nor does it intend to distribute proceeds from the recently announced sale of its $1.1 billion select service hotel portfolio. The Xenia transaction is the only disclosed liquidity event for shareholders.

**Taxable event and sell pressure**

The offering will be structured as an in-kind distribution for existing Inland American stockholders. Mom & pop shareholders may be forced to sell some of their stock in an effort to meet the tax burden attached to the transaction. Xenia has disclosed that

> For U.S. federal income tax purposes, the separation will not be eligible for treatment as a tax deferred distribution by Inland American with respect to its stock. Accordingly, the separation will be treated as if Inland American had distributed to each Inland American stockholder in an amount equal to the fair market value of the Xenia common stock received by such stockholder...

Shareholders will generally have to pay tax on the Xenia stock they receive as if it were a cash distribution. Tax authorities could also ascribe a different valuation to the distributed Xenia stock leading to further tax consequences for existing stockholders.

The Company has also revealed implications for Xenia related to existing non-US investors. Non-US investors may not have the ability to hold all of their Xenia shares, because some of those shares may be redeemed to generate the amount Inland American must withhold in order to satisfy the IRS:

> If Inland American is required to withhold any amounts otherwise distributable to a non-U.S. stockholder in the separation, Inland American or other applicable withholding agents will collect the amount required to be withheld by reducing to cash for remittance to the IRS a sufficient portion of shares of Xenia common stock...

The tax consequences of the separation from Inland American will be affected by a number of facts that are yet to be determined, according to Xenia’s registration statement.
Where’s the underwriter?

Per its registration statement, it is not clear if the company will engage an underwriter. Employing an underwriter to line up commitments from large investors is a key component to the typical listing process. Because institutional investors have deeper pockets, hold for the long term, and have capacity to take risk, their commitments help create stability in the stock price.

We are unaware of any hotel IPO listed in the last decade without investment banks underwriting the deal. Below is a table of hotel IPOs and their long lists of underwriters.

<table>
<thead>
<tr>
<th>Company/Ticker</th>
<th>IPO Date</th>
<th>Underwriters</th>
<th>Shares sold at IPO</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHATHAM [CLDT]</td>
<td>Apr-10</td>
<td>Barclays Capital, FBR Capital Markets, Morgan Keegan &amp; Co, Stifel, Nicolaus &amp; Co, Credit Agricole Securities (USA), JMP Securities</td>
<td>7.5M</td>
</tr>
<tr>
<td>PEBBLEBROOK [PEB]</td>
<td>Dec-09</td>
<td>Raymond James &amp; Associates, Merrill Lynch, Pierce, Fenner &amp; Smith, Robert W. Baird, Credit Agricole Securities (USA), Janney Montgomery Scott, Piper Jaffray &amp; Co</td>
<td>17.5M</td>
</tr>
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Source: SEC filings
Warnings: Low liquidity and price volatility

Low trading volumes and higher trading price volatility are key risk factors identified in Xenia’s registration statement. Its retail investor base is not expected to change in the course of the transaction. “Non-institutional stockholders may not trade with the frequency and predictability of institutional stockholders, which may result in low liquidity and trading price volatility,” according to Xenia’s public filing.

Without the presence of institutional investors, typically counted on to hold up the buy-side of a stock listing, it is possible that a sell-off by the current investor base will dominate early trading. A high volume of sellers at one time could decrease the stock price and impair the company’s ability to raise capital down the road.

To make matters worse, Xenia’s registration statement revealed risks even in a best case scenario where substantial sales aren’t adversely affected:

[T]he mere perception of the possibility of these sales could depress the market price of our common stock and have a negative effect on our ability to raise capital in the future. In addition, anticipated downward pressure on our common stock price due to actual or anticipated sales of common stock from this market overhang could cause some institutions or individuals to engage in short sales of our common stock, which may itself cause the price of our common stock to decline.

Last IPO: “Disastrous”

Inland’s last listing of a non-traded REIT was dubbed “a disastrous Wall Street debut” by Crain’s Chicago Business. Prior to the Inland Western IPO in 2012, Inland settled a class-action lawsuit by returning $90 million worth of Inland Western shares to the REIT. When the shares were listed, existing investors who sold out received the equivalent of about $3.20 a share for stock most had paid $10 a share for—a 68% decline. Will the Xenia listing face a similar fate?

Inland American’s estimated share value dropped 30%, Inland affiliates have charged investors $1.4 billion in related-party fees, and Xenia is pursuing a spin-off that may lack a key component of success: underwriting. Inland American has been recently the subject of an ongoing SEC investigation and has a shareholder lawsuit pending. Given the current structure of the Xenia transaction, what is the exposure to litigation risk?

www.XeniaREITWatch.org
www.InlandInvestorAlert.org
(Endnotes)

1 Inland American Real Estate Trust 10-Ks 2006-2013, 10-Q filed 8/14/2014 & 8-K filed 5/13/2014