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Morgans' High Hopes For Vegas Hard Rock

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NEW YORK -

Hotel companies are basking in the sweet spot of a bull market driven by low supply and high demand, not only from consumers but also from investors.

According to New York-based Real Capital Analytics, buyers have been snapping up hotel properties at an ever-increasing rate (and an ever-decreasing cap rate): $9 billion in hotel acquisitions closed in the first quarter of 2006, versus $5 billion in the same period a year earlier, and $7 billion in the fourth quarter of 2005.

"It's out of control," says RCA Director of Market Research Dan Fasulo.

Equities investors should be happy, too: Six of the ten top-performing REITs and real estate operating companies in the first 120 days of 2006 were hotel companies like Diamond Rock Hospitality, Choice Hotels International and FelCor Lodging Trust.

So you'd think that buying a high-profile property in a superhot market would bring kudos for the management of Morgans Hotel Group, which last week announced its $770 million acquisition of the **Hard Rock Hotel & Casino** in Las Vegas. The all-cash deal will bring in approximately $50 million in adjusted cash flow after it closes in the next nine months, Morgans Chief Executive **Ed Scheetz** told Forbes.com. More importantly, the deal carries with it a range of possibilities that could bode well for the future of the fledgling public company.

So why have investors been dumping all over MHGC? The stock never stuck above its offering price of $20 per share after its February launch, and with the Hard Rock announcement, it has hit a new low, closing on May 15 at $15.70.

Morgans, which already has two long-term development deals at Boyd Gaming's Echelon project, has been scouring the Las Vegas market for a property that could start throwing off cash immediately. The Hard Rock "was the only property that fits what we do," Scheetz says. "Like our other properties, it's an operating asset with expansion possibilities and a well-known brand." He ticks off the amenities of this acquisition: "an operating hotel, gaming, development land and intellectual property rights."

Yes, but all the joy will not flow to Morgans. The real value of this acquisition will be in the company's ability to line up a sterling roster of joint-venture partners to take advantage of that expansion potential, including the 23 acres of condo development potential that are part of the 41-acre site. Hard Rock co-founder **Peter Morton** had already pre-sold hundreds of units of a planned condo project there, which he eventually scrapped in favor of simply selling the property.

The 647-room hotel and 30,000-square-foot casino, which sit on 17 acres with the Hard Rock Café on a parcel across the street, could be the springboard to growth for Morgans. But the company will take its time to evaluate how to reposition a brand that has possibly passed its peak.

"For now, we will operate the property with the Hard Rock brand," Scheetz says, "but that's on the table." Scheetz points out that the Hard Rock site is three times bigger than Boyd's Echelon site, and that another Las Vegas development, the Cosmopolitan, has packed 4 million square feet of space into its site. Compared with that, he notes, "Our site is not very dense at all."

The deal is being funded by $700 million in debt from Credit Suisse; Morgans' ownership will likely end up "south of 50%," says Scheetz. "Our goal is to be venture partners, as we are with Boyd, in our London properties, the Shore Club in Miami, while retaining significant ownership and management contracts."

Gaining control not only of the assets but also of the process of creating and implementing the partnerships will be key. First in line will be the 23-acre development parcel, followed quickly by an expansion of the hotel's capacity. "The hotel expansion component makes tremendous sense for gaming and food and beverage revenue," Scheetz says. "There's very significant profit potential."

The low stock price could entice some investors with a strong stomach and some patience back into Morgans; Green Street Advisors pegged the stock's warranted price at $17.50 per share in late March. Analysts say they are concerned about the additional debt Morgans is taking on, as well as the appetite for large-scale condo development in Las Vegas, which has likely cooled from the frenetic pace of a year ago.

Still, if Scheetz and company can deliver their deal with some solid joint-venture partners and come up with strong concepts to power the Hard Rock into life in the era of hip-hop and beyond, they may be able to deliver on the promise of all that potential.

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