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DOES WALL STREET TRULY UNDERSTAND THE LODGING VALUATION?

**Seoki Lee
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Arun Upneja**

ABSTRACT

Lodging stock undervaluation has been a longstanding issue in the hotel industry. Many market experts and industry educators and managers have participated in, or at least been exposed to, discussions and/or arguments over this issue. In summary, the proponent of lodging stock undervaluation contributes the occurrence to Wall Street's lack of comprehension of the lodging business. The opponent dismisses this claim by stating the unlikelihood of Wall Street having such extensive knowledge on all industries except this particular industry. As to which view is correct is an empirical question and therefore, it would be a safe assumption that empirical studies have been conducted investigating the issue when considering the importance of the issue.

Therefore, it is the main purpose of this study to investigate whether or not lodging stock is in fact undervalued. We used a sophisticated equity valuation method to examine the undervaluation issue by comparing lodging firms to firms in the rest of the industries. To empirically accomplish the main goal of the study, an equity valuation model, specifically the residual income (RI) model, was employed. By utilizing the RI model with historical financial data, estimated equity values were computed and compared to actual market values on both the lodging firms and non-lodging firms. We then compared the difference between these two final figures to identify if the lodging stock was undervalued, overvalued or fairly valued compared to the non-lodging stock.

The results are mixed in nature that yearly analyses show that the lodging stock is not consistently undervalued, but the pooled analysis shows that the lodging stock is undervalued. One major limitation is the small sample size of the lodging data. Therefore, collecting bigger sample size of the lodging firm may provide better insights on this issue.