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Marriott Vacations Worldwide Corp. (VAC)

Q1 2016 Earnings Call

CORPORATE PARTICIPANTS

Jeff Hansen
Vice President-Investor Relations

Stephen P. Weisz
President, Chief Executive Officer & Director

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer

OTHER PARTICIPANTS

Christopher Agnew
MKM Partners LLC

Steven Eric Kent
Goldman Sachs & Co.

Brad Dalinka
SunTrust Robinson Humphrey, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to Marriott Vacations Worldwide First Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host for today's call, Mr. Jeff Hansen, Vice President of Investor Relations. Thank you. You may begin.

Jeff Hansen

Vice President-Investor Relations

Thank you, Rob. And welcome, everyone, to the Marriott Vacations Worldwide first quarter 2016 earnings conference call. I'm joined today by Steve Weisz, President and CEO; and John Geller, Executive Vice President and CFO.

I do need to remind everyone that many of our comments today are not historical facts and are considered forward-looking statements under Federal Securities Laws. These statements are subject to numerous risks and uncertainties as described in our SEC filings, which could cause future results to differ materially from those expressed in or implied by our comments.

Forward-looking statements in the press release that we issued this morning, along with our comments on this call, are effective only today, April 28, 2016, and will not be updated as actual events unfold. Throughout the call, we'll make references to non-GAAP financial information. You can find a reconciliation of non-GAAP financial measures referred to in our remarks in the schedules attached to our press release, as well as the Investor Relations page on our website at ir.mvwc.com.

I will now turn the call over to Steve Weisz, President and CEO of Marriott Vacations Worldwide.

Stephen P. Weisz

President, Chief Executive Officer & Director

Thanks, Jeff. Good morning, everyone, and thank you for joining our first quarter earnings call.

This morning, I'll walk through our first quarter results and provide an update on our top line growth initiatives, which give us confidence that we will achieve our full year guidance. I will then turn the call over to John to provide a more detailed review of our first quarter and his thoughts on our full year before opening the call to your questions.

As we indicated on our year-end call at the end of February, first quarter contract sales in North America faced several challenges, stemming primarily from the tough comparison to last year's strong first quarter results, as well as the weakness we've experienced in our Latin American sales channels.

Remember, in our first quarter of 2015, we adjusted our owner recognition levels, or what we call ORLs, increasing the benefit at higher levels of ownership. This helped drive a 7% increase in owner tours and approximately 1.5 points of improvement in owner closing efficiency over the first quarter of 2014. As a result, first quarter vacation ownership contract sales last year were up almost $16 million or over 11%, driven mainly by the improved sales metrics to existing owners.

Shifting to the current year, in the first quarter of 2016, North America timeshare contract sales were approximately $140 million, down $16 million from the first quarter of 2015. $2.5 million of this decline occurred in our Latin America sales channels, as we continue to experience headwinds from the strong U.S. dollar.

This decrease, however, was less than the year-over-year declines we saw in the Latin American sales channels in the third and fourth quarters of last year. The remaining contract sales decline primarily resulted from almost 7% fewer owner tours in the quarter and lower owner closing efficiency, as we did not have the lift from the new changes to the ORL program as we did last year.

In the first quarter, we made significant progress on our plans to open new sales centers, which will grow our total number of site-based sales centers by over 30%. To provide the level of leadership needed at these locations, we obviously look first to our own internal pool of talent, as our existing leadership provides the best opportunity for each of our new sales centers to be successful as quickly as possible. The magnitude of these changes can create short-term disruptions to our existing sales centers.

Partially offsetting the decline in sales to existing owners, we began to gain traction generating more sales from first-time buyers, as our first-time buyer BPG was up almost 4.5% and first-time buyer tours were up 1% quarter-over-quarter. This highlights the improved performance in the quarter from our new marketing channels, namely our Call Transfer and Encore programs. And we're equally excited about their potential for the remainder of the year, as tour activations for the rest of 2016 are over 25% higher than at the same time last year.

In addition, our tour pipeline continues to ramp-up increasing more than 5,000 packages from the fourth quarter of last year. But this positive momentum in tours is just one part of our story for 2016 and beyond. The other side of our growth strategy relates to our six new sales centers opening throughout the year. On that note, I'm pleased to announce that we just recently launched our sales efforts at our Surfers Paradise property on the Gold Coast of Australia. We're excited about what that location can do in our Asia Pacific segment, as it ramps up its sales performance over the next several years.

In addition, we've just recently opened a temporary sales center in Washington, D.C., while we complete the construction for our permanent sales gallery. We've also launched a small sales operation in New York at our new property on 37th Street in Midtown Manhattan, while we complete our permanent on-site location early in the third quarter.

Further, we're also finalizing the plans for an additional larger New York City sales location, which will be in close proximity to our property and should be in operation by the end of the year. And in San Diego, we're on track to launch sales at our new onsite location early in the third quarter with the delivery of the first phase of renovated units there.

I'd like to provide an update on our transaction at the Waikoloa Marriott. We reached an agreement several weeks ago with the owner of the hotel for a capital efficient acquisition of 112 one and two bedroom timeshare units upon their conversion by the owner, which is targeted for July of 2017. In addition, we have begun construction on a permanent sales center at the property and expect to start sales on the Big Island in September of this year.

And, finally, as we announced in February, we have added a new location in South Beach to our portfolio. We're currently in the final stages of securing space for our sales center and expect to be in sales by the end of the year at this exciting new location. Now, allow me to shift gears just a bit as I'm excited to talk with you about a new brand extension to the Marriott Vacation Club family. As you may have seen us announce yesterday, we unveiled Marriott Vacation Club Pulse, a new type of product offering for our owners and a direct answer to the call from customers for more destinations in metropolitan areas.

Marriott Vacation Club Pulse is being launched at our new city destinations in New York, San Diego, Washington, D.C. and South Beach as well as the Custom House, our existing property in the center of Boston. At Marriott Vacation Club Pulse properties, the experience focuses on the destination itself. And all these properties are located in the heart of the action. To find out more, I encourage you to go to our website and follow the Marriott Vacation Club Pulse link to check the latest updates.

Now, let me take a moment to emphasize our confidence in our full year sales guidance. As I mentioned, our first quarter contract sales faced a tough comparison to 2015. However, underlying this performance were the signs that our new programs are working. First-time buyer tours improved, new tour package sales are ahead of expectations and tour activations are well-ahead of where we were at this point last year.

We've begun sales of our new properties in Australia, Washington, D.C. and New York and have three more locations beginning sales over the coming months. Lastly, while we expect to continue to face challenges in our Latin America sales channels in the second quarter, we began to lap this impact on a year-over-year basis at the beginning of the third quarter. Taking all of this into account, we expect a very strong second half to the year. And we remain confident we will achieve 4% to 8% contract sales growth for the full year.

Shifting to the bottom-line, our resort management and other services business was up $1.6 million, almost 7% over last year, and our financing business, which had been a headwind in the past, continued to improve as financing results were up $1 million to the prior year. When you consider these improvements, combined with our expectations for full year contract sales, we're equally confident that we remain on track to produce adjusted EBITDA of between $261 million and $276 million.

With that, I'll turn the call over to John to provide a more detailed look at our first quarter results and outlook for 2016. John?

John E. Geller, Jr.

Executive Vice President and Chief Financial Officer

Thank you, Steve, and good morning, everyone. Adjusted EBITDA totaled $51.6 million, $8.6 million below the first quarter of 2015. While we saw continued growth in our financing and resort management businesses, as expected, we did see a decline in our development business year-over-year.

For the first quarter, adjusted development margin was down roughly $10 million, of which nearly $9 million of the decline was in our North America segment as a result of lower contract sales to existing owners in the quarter. North America adjusted development margin was 20.6% in the quarter, down over 3 points from the prior year.

Product cost continues to be a great story for us, favorably impacting development margin by roughly 3 percentage points year-over-year, driven primarily from the continued strength of our inventory repurchase program. However, our product cost benefit was more than offset by higher marketing and sales costs as the lower contract sales impacted our ability to leverage our fixed marketing and sales costs.

In addition, our variable marketing and sales costs were impacted by higher spending related to our investment in future tours, primarily in our Call Transfer and Encore programs, as well as pre-opening costs associated with the start-up of new sales distributions. It's important to remember these higher variable costs will drive future contract sales growth for us in the second half of this year and beyond.

In the company's financing business, revenue, net of related expenses, was $19.2 million, up $1.1 million or 6% from the first quarter of last year. The program we launched last year to help drive financing propensity has continued to be successful, with our North America propensity up 15 basis points to 57%. And our purchasers remain very creditworthy, as we've seen a 16 point increase in FICO scores to 744 this quarter, as compared to 728 in the prior year.

With these higher financing propensity levels, as well as expected growth in contract sales in 2016, we expect year-over-year growth to continue to build in our financing business as we progress through the year.

Shifting to our rental business, excluding the results of operations for the portion of the Surfers Paradise Hotel that we expect to sell, total company rental revenues were $78 million, approximately $2 million higher than the prior year. This increase includes roughly $1.4 million from the properties we're operating prior to their conversion to timeshare, as well as higher plus point revenues.

Transient rate was up slightly. However, this increase was offset by a reduction in transient keys rented as we were making more keys available for preview room nights in support of our Call Transfer and Encore programs. Rental revenues, net of expenses, were relatively flat to the prior year as the revenue increase was offset by higher operating expenses in the quarter.

In our resort management and other services business, excluding the results of operations for the portion of the Surfers Paradise Hotel that we expect to sell, company results improved $1.6 million or 7% in the first quarter to nearly $24 million. Results reflected higher fees for managing our portfolio of resorts, higher ancillary profits and improved exchange company activity.

In our Asia Pacific segment, contract sales improved almost 9% quarter-over-quarter. Total adjusted results were $1 million, down $2.5 million from the prior year as first quarter results last year benefited from $1.1 million of favorable product cost true-up activity and our first quarter this year was negatively impacted by roughly $800,000 in pre-opening expenses associated with our new sales location in Australia. In addition, at the end of the first quarter, we opened our first ever sales location in Australia, representing our first new location in Asia Pacific in seven years.

General and administrative expenses were $25.3 million in the first quarter of 2016, a $2.5 million increase over last year. Roughly $2 million of this increase related to technology spend in the quarter as we continue to enhance our infrastructure. As we mentioned on our year-end call, we expect to have incremental spending related to enhancing our owner facing technology and updating our current web platforms through 2017. This incremental spend is included in our full year guidance.

Turning to our return of capital to shareholders, we returned nearly $91 million in the first quarter of 2016, including repurchasing nearly 1.3 million shares of our common stock for $73 million.

Shifting to our balance sheet, at the end of the quarter, cash and cash equivalents totaled nearly $107 million and we had approximately $102 million of gross vacation ownership notes receivable eligible for securitization in our warehouse credit facility.

The company's total gross debt outstanding at the end of the quarter totaled $699 million, all but roughly $11 million of which is non-recourse debt associated with securitized notes. In addition, $40 million of mandatorily redeemable preferred stock remains outstanding which we expect to redeem in October of this year.

Now let me spend just a moment on our contract sales outlook, more specifically the pace we're expecting for the remainder of 2016. The second quarter has continued to experience headwinds related to last year's owner recognition changes that we have discussed as the impact of that program ran through the end of April last year. And Latin America continues to sell against a strong U.S. dollar. As a result, we expect overall contract sales to be flat to up slightly in the second quarter as compared to last year.

As we move into the third quarter, we expect our Latin American headwinds to subside as we lap last year's declines. Additionally, we expect contract sales growth to ramp up as we move through the second half of the year from higher tour volumes and the impact of new sales distributions coming online. For this reason, we expect contract sales growth of 4% to 8% for the full year.

We expect development margin to follow a similar improvement track. As a result, our second quarter development margin percentage is expected to be lower than last year. As we move through the second half of the year, we expect development margin to continue to improve as higher contract sales allow us to leverage the fixed portion of our marketing and sales cost and lower product cost offset higher variable marketing and sales cost, similar to what we experienced in the first quarter.

With this improvement in development margin and the continued improvement in our other lines of business, we're reaffirming our adjusted EBITDA guidance of $261 million to $276 million. Turning to free cash flow, we maintain our expectations for adjusted free cash flow of between $135 million and $155 million. As we mentioned on our last earnings call, while slightly below normalized level, this range includes approximately $35 million of development capital spending deferred from last year. However, as we always do, we will continue to evaluate all of our capital needs as we progress through the year with the intent of delaying spending, wherever possible.

Also, while not included in our free cash flow calculation or guidance for 2016, we're well underway with negotiations regarding the sale of the downsized Surfers Paradise property as well as the bulk sale of our remaining units at the Ritz-Carlton Club and Residences in San Francisco. Combined, we expect these transactions could generate over $60 million of additional cash flow this year. I continue to be excited about the growth opportunities that lie ahead. And I look forward to sharing our achievements with you in future quarters. As always, we appreciate your interest in Marriott Vacations Worldwide.

And, with that, we'll open the call up for Q&A. Rob?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting the question-and-answer session. [Operator Instructions] One moment please while we poll for questions. Our first question is from Chris Agnew with MKM Partners. Please go ahead with your question.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Good morning, Chris.

Christopher Agnew
MKM Partners LLC

Q

Thanks very much. Good morning. Thank you for that color. Those express very strong – expecting very strong second half BOY sales and confidence in 4% to 8% growth. Can I ask – is your confidence, say, in the midpoint the same as when you initiated the guidance back in February given the first quarter that we just saw?

Stephen P. Weisz
President, Chief Executive Officer & Director

A

I would say so. I mean I'll be the first to tell you that the first quarter was maybe a little softer than we had originally anticipated. However, that's balanced out by the continued strength that we see in terms of booking and activating tours for the balance of the year, plus the progress we're making on the new sales centers. So, yeah, I wouldn't characterize our confidence in that 4% to 8% number as being markedly differently from when we first announced it.

Christopher Agnew
MKM Partners LLC

Q

Okay. Thanks. And then have – I think if I'm reading it right, there was no increase in your provision for loan loss from a year-over-year perspective. Have you seen any increase in default activity and any third-party sponsored defaults?

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer

A

Chris, this is John. To answer the second part of your question, no, we haven't seen any of that. First part of your question, as a percentage of finance sales, our bad debt allowance, I think, is down slightly – [ph] also (20:50) it's improved year-over-year. I mean, what you're seeing as I talked about is your actual finance sales is up about 15 percentage points year-over-year, but the rate we're actually providing is continuing to improve. Our core portfolio continues to perform very well. Where we're seeing a little bit on the edges, not surprisingly, would be with some of the Latin American paper just given some of the foreign currency, but that's in that overall number. So net-net, the overall portfolio continues to perform very well.

Christopher Agnew
MKM Partners LLC

Q

Got you. And the sales that you've talked about, that additional potential $60 million, are you more or less expecting that by the end of this year or is it just the timing around – or just give us a little bit more color on what needs to happen for those sales?

Stephen P. Weisz
President, Chief Executive Officer & Director

A

I'm assuming your reference is to the dispositions, correct?

Christopher Agnew
MKM Partners LLC

Q

Yes, sorry.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

On Surfers Paradise, we're very close. We have a few minor kind of conditions precedent that have to be satisfied before we can close that sale. So we're not prepared to announce that yet. But I expect you'll probably hear from us in the not-too-distant future that that sale has concluded. And we're well along the way about selling that – making that bulk sale at our Ritz-Carlton and Residence property in San Francisco. On a collective basis between the two, it's between $60 million and $70 million worth of proceeds.

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer

A

Yes. So, I mean, Chris, we feel good about it. I'd have to say I mean until they're done, they're not done, right?

Christopher Agnew
MKM Partners LLC

Q

Yeah.

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer

A

So there is always some risk, but we feel very good, to Steve's point.

Christopher Agnew
MKM Partners LLC

Q

Thanks. And one more question, sorry, to steal so much time.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Yes. Okay.

Christopher Agnew
MKM Partners LLC

Q

But in terms of thinking about how these new sales centers ramp, because obviously I think you've said some of the new temporary facility are moving to a larger facility. But did they ramp over a couple of years or is it six months? How do you think about sales centers and...

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Clearly for us, and I would argue probably for the rest of the industry, when you open up a new sales center, I mean, you're starting from a dead stop and you're trying to move forward further compounded by the fact that as I indicated that both in New York and in Washington we've got temporary sales centers that we've kind of put together and as the permanents are finished here in the next couple of months. It will take several years for any new sales center to reach its stabilized run rate. But that's all been factored into our guidance about how we think about the contract sales unfolding, as well as the EBITDA for the balance of the year.

Christopher Agnew
MKM Partners LLC

Q

Excellent. Thank you.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Thank you.

Operator: Our next question comes from Steven Kent with Goldman Sachs. Please proceed with your question.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Good morning, Steve.

Steven Eric Kent
Goldman Sachs & Co.

Q

Hi. Good morning. Just to follow on that last question about Washington and New York City. What are some of the early indicators that these markets will be robust for you? And, well, the reason I'm asking is because my recollection is the Boston property did very well and that was relatively new. And I think that was almost 10 years ago, I mean, when you rolled that out. So what are some of the early indicators that would say this city focus is moving in the right direction? And then, commentary on LatAm business, how that's holding up? That was an issue more last year, but I wanted to see if that was still an issue for this year.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Yes. Well, first of all, actually it's kind of hard for me to put this in perspective having been here 20 years, but actually Boston Custom House probably started sales 15 years ago even. And keep in mind at that point in time we were selling a site-based product. We weren't selling our points program, et cetera. The thing you gain by opening up a sales center that is in conjunction with inventory that you have in a marketplace is that you get the benefit of obviously any in-house marketing that you can do to those units or you can in fact talk to people that are either renting the unit or people that are there on either a usage or exchange about buying more points within our system. That's the first point.

The second point is also gives you an opportunity to talk to that people that live in that destination. New York City market as an example or Washington market both very vibrant, very wealthy markets that we can market too and we can get people to come take a presentation from us there. So I mean there is – nothing in life is guaranteed. Certainly, we can't guarantee that these will be homeruns. We have a reason to believe that they will be very successful. And that's the way we've underwritten these products. As far as LatAm, I'll let John talk about that.

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer
A

Sure. Yes. Obviously, Steve, the foreign currency hasn't necessarily improved much versus the U.S. dollar when you look at it from an overall basis from mid-year last year. I think what we're seeing is – and we talked about this even early on. Over time, some of those fluctuations become the new normal. And people within those markets, to the extent they want to travel and do things, yes, they're going to have to come to terms with what's happened with the foreign currency. We obviously target a more fluent buyer, probably people that have more means in terms of buying our product given our price point.

So, I think, we're seeing – as we said in the script, we're seeing the year-over-year decline notwithstanding not much improvement in the foreign currency exchange rates getting less which is positive, but it's obviously still a headwind, will be a headwind here in the second quarter in terms of EBITDA, I think, staying where they're at. It won't be till really the third quarter where we get some benefit from that easier comps for the balance of the year.

Steven Eric Kent
Goldman Sachs & Co.
Q

Okay. Thank you.

Stephen P. Weisz
President, Chief Executive Officer & Director
A

Thank you.

Operator: Our next question comes from Patrick Scholes with SunTrust. Please proceed with your question.

Stephen P. Weisz
President, Chief Executive Officer & Director
A

Hi, Patrick.

Brad Dalinka
SunTrust Robinson Humphrey, Inc.
Q

Hey. Good morning, guys.

John E. Geller, Jr.
Executive Vice President and Chief Financial Officer
A

Good morning.

Brad Dalinka
SunTrust Robinson Humphrey, Inc.
Q

It's actually Brad on for Pat. Just a quick one. With Marriott buying Starwood, is there any chance there's change to the way that sales leads are going to be distributed, any change against Starwood leads or any changes otherwise? I appreciate it.

Stephen P. Weisz
President, Chief Executive Officer & Director
A

Well, first of all, I guess, you would find it not uncommon for me to say that we really don't comment on third-party M&A kind of activity. However, I will also say that we look forward to dialog with Marriott about how the terms of our license agreement and that of what would be Vistana Signature Experiences lines up with them as the licensor and understand what the impact we'll have on loyalty programs.

Brad Dalinka
SunTrust Robinson Humphrey, Inc.
Q

Got it. Appreciate it.

Stephen P. Weisz
President, Chief Executive Officer & Director
A

Thank you.

Operator: There are no further questions at this time. At this point, I'd like to turn the call back over to Steven Weisz for closing comments.

Stephen P. Weisz
President, Chief Executive Officer & Director

First quarter of 2016 was the turning point of our growth strategy as we began opening new sales centers with more to come and we continue to ramp-up our first-time buyer tour production across all of our current sites. I'm excited about the remainder of the year and look forward to updating you on our performance on future calls. And, finally, to everyone on the call and your families, enjoy your next vacation. Thank you.

Operator: This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.