Company Name: Marriott Vacations Worldwide Corporation (VAC)
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<<David Katz, Analyst, Jefferies Group LLC>>

Good morning, everyone. Our next discussion is with Marriott Vacations, which is one of our favorites – our favorite in the timeshare space at the moment. It's been a core aspect of our research franchise for a number of years. We're fortunate to have the team; John Geller and Neal Goldner to talk to us this morning. I appreciate you making time for us. We're going to – this is a 25-minute meeting, so rapid fire, and we will try and leave a few minutes for questions at the end. Gentlemen, much appreciated having you on board with us this year, again.

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Thank you.

<<Neal Goldner, Investor Relations>>

Thank you.

<<David Katz, Analyst, Jefferies Group LLC>>

Look, I think that there's – if I can dive right in, there's a couple of drivers of growth from here, right? There's recovery in the business and there's progress, further progress on ILG. I do think it's appropriate to have just a quick update on where you are in the reopening, the recovery and what you're seeing so far.

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Sure. Thanks, David. And it's great to be here today, giving an update. So I won't go back through the history, which seems like a year ago when everything shut down, but obviously, we lost about half of our revenues midway through March with sales centers, our rentals being shut down, and then with resorts being closed, ancillary operations onsite, and we did see a huge reduction not surprisingly on the Interval business and people wanting to book exchanges in late March, early April.

The good news is more recently and it's really all been, call it, within the last month or so, where some of your Southern States, specifically South Carolina, Florida, where we have, call it, about 25% of our resorts started to come out of lockdown and in a lot of cases have completely reopened back up. So in South Carolina, for example, we've got 10 resorts that started to reopen, call it, just before Memorial Day week. And Hilton Head has eight of them, two in Myrtle Beach, we expect to see – and we've seen occupancies build, we expect on average those occupancies next week to be, call it, in the 75% to 80% range.

And as you work your way down into Florida, where we also have a significant number of resorts, specifically, our Florida Beach resorts on the East Coast, Key West and on the West Coast, similar where we're starting to see occupancies climb into that 75% to 80% range. Orlando's a little bit behind, but obviously, Disney doesn't open here for a couple of weeks. You've seen Universal and SeaWorld opened back up. We're starting to see build there. Even right now we should have – we'll see occupancy this week at our nine Orlando resorts at roughly 40%, and we expect that will build here over the next couple of weeks.

So when you look at it more holistically, by the end of June here, a big chunk of our resorts will be opened, the remaining ones most likely by the end of July, other than a handful. The caveat really being Hawaii, we've got about 15% of our rooms in Hawaii. Those resorts remain open. However, as you're probably aware, there's a 14-day self quarantine for arrivals into any of the Hawaiian Islands from outside of Hawaii that right now has been extended through July 31. So assuming that doesn't get extended further that will bode well. Hawaii is a big market for us, not only as I mentioned, about 15% of our rooms, but, call it, 20-plus percent of our annual normalized contract sales come out of Hawaii, so all very positive.

And another point I'll point out is we've got our two resorts, one in St. Thomas, one in St. John, obviously, fly to locations. And we expect to see occupancies there next week, call it, at roughly 50%. So all the other resorts I mentioned arguably are drive to. They're drivable on the – in the continental U.S., but I think that's a good sign early stages that a couple of your drive to are already going to be at 50% occupancy. And once again, when we look out what's on the books, while we're down from this time last year, call it, 10% give or take, it's still performing very well and we see increasing reservations get booked as we move, especially as you get into the August, September and latter in the year, people are starting to get their reservations booked.

The other thing I hit on is – are on the contract sales side. We've opened seven sales centers. We tried to do this in a, call it, slower methodical way, so we get a better understanding of our owners and guests propensity to take tours in this environment. They're closing efficiencies, i.e., are they willing to buy given the broader economic distress we've seen out there? So rather than bringing all our sales folks back day one, we're building it based on occupancy and some assumptions.

What I can say in early stages, these sales centers started to open a few weeks ago is we are seeing people wanting to take tours and we've obviously changed how we do a tour in terms of people wearing masks and having protection and things like that. We also because we launched a home sales program back in May, which has done very well before the sales centers open. We offer an in room sales for people that don't want to come over. And I think the good news is most people with a mask will come over and take the sales store. So we have – while we'll have a few that will opt for the in room sales pitch, most of them are willing to come. So that's a good early sign.

People's propensity to tour a little bit less, but very good. And then we are running some higher discounts right now, but VPGs are on a limited number, are early stages, looking very good. So it's all been very positive. We've got another, call it, 15 to 20 sales centers that will start to open up here July 1 as occupancy builds.

And so once again, we feel good. We're taking it slower than we probably need to based on early signs, but we want to make sure that we're bringing costs back in line with the revenues and doing it in a measured way, if you will.

So and then I should point out too, that obviously with resorts back open rental incomes started back up, which is great. As we've talked about when you look at our rental costs in any year 75% to 80% give or take are fixed, right. Those are your unsold maintenance fees that we pay on inventory we own, we haven't sold, which is paid at the beginning of the year, just like our owners pay our maintenance fees. And those are exchange costs, people that exchanged for Marriott Bonvoy points we pay for those big chunk of that's paid once again in the first quarter, early second quarter.

So all that cash is out the door. But with that, you have non-cash costs that get amortized in as that inventory is available for rent. Since rentals were shutdown for April through most of May, you're going to lose money in the second quarter on the rental business. No different than at the development margin level. And so we do expect overall for the second quarter, our adjusted EBITDA to be slightly negative, but given the reopening scenario, I just laid out, we that should really bottom out and assuming things continue to reopen at a good pace here, as we move through the second half of the year. We're very optimistic about performance returning. Albeit, we don't necessarily think we're going to get to our budgeted numbers by the fourth quarter, by any means, but it all is at least from an opening up perspective doing very well.

<<David Katz, Analyst, Jefferies Group LLC>>

I do want to circle back on what I think, whether you think concerns are fair around defaults, payments and maintenance. How should – I know you touched on it just a bit in your prior comment, but how should we think about what you're seeing in those areas so far? We're aware that you took a reserve in the first quarter?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah.

<<David Katz, Analyst, Jefferies Group LLC>>

How would you have us think about loan loss provision and some of the other metrics?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah. At this point, and we talked about this that additional loan loss we took in the first quarter above and beyond our normal loan loss provision cost just over $50 million. I think it was about $52 million. That represented really kind of what we saw happen to the loan portfolio coming out of the financial crisis, where we saw default rates go up about 50% for call it roughly 15 to 18-month period.

So given that was the most distressed environment we had seen and assuming not saying COVID is going to be exactly the same. There's obviously all different factors that go into your – the quality of your loans at any given point in time. But we applied a similar methodology. Assuming that we will see some higher stress. The good news is, if you think I'll add it just from a loan loss, we've seen just over 1% of our loan book qualify or take our deferred payment program.

So very much within our expectations and while some of those will go on to default, I do expect some of those will come back to current over time too. So there's always that question margin. And so I think we'll generally see some higher delinquencies here in the near-term, but we feel at this point, the reserve we took should be adequate based on how the loans continue to perform.

On the maintenance fee side, we've seen about a point give or take higher delinquencies. Our ultimate defaults for maintenance fees typically are in the low-single digit. And so you're not talking about that much more incrementally. Yeah, I do think as you get further into the collection process here, a lot of our owners have a tendency to pay and get back to current on the maintenance fee. It is a more manageable payment of $1,300, $1,400 on average. So but really nothing too unusual relative to what you're seeing in the broader macro environment.

<<David Katz, Analyst, Jefferies Group LLC>>

Got it. I do want to touch on how the business changes coming through this. And in particular items such as call forwarding and digital had become more important pre-COVID. What should we expect to see from you as we come out of this in terms of those two tools as a driver of the business going forward?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Sure. I think at this point, David, it's still early days. We'll see if our consumer or customer behavior changes. That's what will be interesting as we learn more here. Remember from a marketing perspective, we basically shutdown all marketing through the month of April. Any marketing was more inspirational, not direct marketing, we will vacation again, and those types of messaging, but we weren't actually trying to sell poor packages in April, just because it didn't seem like the right thing to be marketing at that point.

And quite frankly, not too many people were probably thinking about going on their next vacation in April. So the good news is we've started to open up some of that direct marketing with, when you look at Marriott is our biggest call transfer partner, obviously their occupancies and bookings are way down, but what we are starting to get the call transfer back up and running. And so we'll see how that goes, but and same thing on the digital side here as we go forward.

The good news is coming into the COVID-19, our tour pipeline was up roughly 20% over the same time last year. So the pipeline is strong. We basically while there were packages booked to show up in April and May most people only a 2% asked for a refund, most have rebooked to later in the year, or waiting to rebook. So the pipeline remains strong. We haven't lost any ground on that backlog of pipeline. And as sales start to come and people start to show up again on the packages, we'll start to sell out those packages again and keep that hopefully strong pipeline year-over-year growth as we go forward.

<<David Katz, Analyst, Jefferies Group LLC>>

Got it. So I do want to make sure that we have time to touch on the financing side and you expanded the size of the warehouse. I think it was to 531 million the time capacity was 310. Are you comfortable with where that is, as we sit today? And you had been talking about an ABS transaction pre-COVID, how were you thinking about the ABS market in the near-term and, call it now the rest of the year?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah. So, one of our competitors you probably saw got, I think kind of the first term deal done here a couple of weeks ago that, so that bodes well. We were in the process of looking at it. We're the rating agencies, obviously they've got to rate the different trenches of paper, they got to come up with the false scenarios. And so we were waiting to see how that played out that obviously impacts advance rates. But interest rates, I think, will normalize and continue to get lower over time. That capacity that we increased on the warehouse it just gave us a lot more flexibility to enter the market.

So, we're going to continue to monitor the market when we feel like, we can get the right advanced rate, as well as the right interest rates. And I think we're pretty close based on where we see the market going. We'll go ahead and do a term-deal here at some point. But we still got plenty of runway based on little sales, sales just reopened it really over the last month or so. We still got plenty of capacity there to kind of wait and make sure we're getting good terms.

<<David Katz, Analyst, Jefferies Group LLC>>

So, just to follow that up, that the presumption being that when you aren't doing a lot of selling, right, the need to go out and the need for more financing obviously goes down as well and those should ramp up together. But it is fair for us to assume that we'll probably see you, most likely see you in the market in the ABS market between now and the end of the year for sure.

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah. Absolutely. Yeah. I mean, we'll get back into the market. Like anything, I think our notes will continue to perform very well. At some level times our friend there in terms of the underlying collateral pool and better collateral pool gets you a better advance rates ultimately, and hopefully better cost to fund. So, our existing warehouse facility, which I think at the end of the first quarter, we said, based on the increased capacity, we could do, call it roughly $400 million in contract sales at a 50% financing propensity.

And so, like I said, just given the ramp up here, we've got, we've got some time here before we ever even come close to filling up the warehouse. But we get an 85% advance rate today and then all in costs to fund of less than 2%. And that warehouse, it goes well into next year before we look to it's a kind of a two-year revolving, we extend it. So, we've got maturity that is out a little bit and we've got capacity right now.

<<David Katz, Analyst, Jefferies Group LLC>>

Right. So look, I want to make sure we touch on the notion of construction and development of inventory. How much inventory do you have? Do you need to do some building this year or have some building occur this year in order to shape out your inventory?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah, no, I mean, we didn't have anything under development on our balance sheet, right, even plan for 2020. We were actively pre-COVID-19 looking for new deals to bring on new flags, et cetera. Obviously in the near-term, we've put a pause on that. Coming into the year to answer your question, David, we had over two years of inventory based on call it a $1.6 billion annual contract sales space, obviously that has slowed down. We'll see how that recovers, but that just extends out our need for inventory.

We've got some commitments still on our asset light deals first quarter of next year, assuming we don't look to push these out. If we don't need the inventory contractually, we have roughly $140 million do in the first quarter of next year, which would be taking down the remainder of New York, some more of our San Francisco asset light deal, as well as two smaller international deals, one in Costa Rica and some units out in Bali at a New Renaissance that's getting delivered there, which is just going to be a fabulous resort.

So with that, we'll still plan to open sales centers in Costa Rica and Bali as we open those new sites, if you will. But for now, we still have the ability to repurchase inventory on the secondary market and Waihekes and other one, but that was always slated to be built as a capital efficient deal and most likely not get delivered or pay anything until, call it end of 2022, 2023 timeframe. So, once we get a better sense and the other opportunity that could come out of this would be some distressed properties, right.

Specifically, if you look at some of the deals that we've done on the development side in some of our urban locations, like Washington, where we took a floor out of the Mayflower Hotel, there could be some opportunities where just given where owners are and maybe excess capacity that they'd want to potentially take some money off the table and we could co-locate if you will, at an existing resort somewhere.

So, we're going to continue to get back into development longer term. It's just right now, we're – we don't, we're not, I wouldn't say have too much inventory assuming sales start to ramp back up here, but we've got some time to given the near-term slow down before we start committing ourselves to new deals.

<<David Katz, Analyst, Jefferies Group LLC>>

If I can follow that up for a minute and just talk about geographies in particular by Hawaii is a discussion, frankly, that touches an awful lot of our coverage universe. And in many respects is arguably the ideal timeshare location, except when it's not, what is your strategy for Hawaii today? Do you look to be opportunistic with the expectation that it returns to normal or do you look elsewhere and just take a bit more of a wait and see, because there may be opportunities that show up that are compelling under the current circumstances, right?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yeah. Yeah. Clearly nothing, Dave – I mean, once I think we get past this, it might for Hawaii, it might take a little bit longer, but I think when we look at our owners and we've done some surveying of our owners and their propensity to fly on their next vacation and not surprisingly, like I mentioned in St. Thomas and St. John, where we have resorts that are open, owners are coming back, people want to go on vacation and I don't see Hawaii longer term losing that desirability of where our owners want to go.

So yes, there were – clearly there were opportunities in Hawaii, Maui those types of locations that absolutely those would be things that we'd be taking a hard look at. And that's where I go back to my earlier statement; some of those things, not necessarily Hawaii, but in other market the question becomes, yes, are there some interesting opportunities because of longer term issues with an existing property, et cetera. So we'll obviously keep an eye on it, but there's nothing that we're hearing or seeing that would lead us to believe that Hawaii as a destination isn't going to continue to be highly sought after.

<<David Katz, Analyst, Jefferies Group LLC>>

Right. I do want to come back to one of the earlier topics with a follow-up. On the subject of Vistara and that integration, which you've progressed nicely at a measured pace, is that – is that opportunity helpful as you rebound out of this or is it – does it become more challenging or all of the above? Where are you with respect to Vistara today?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Yes. Obviously we were making David, great headway in terms of closing that VPG gap. And as we talked about that strategy was over time to rationalize out maybe some of the lower yielding OPC, tour qualifications start to plug in more of our Marriott generated tours called transfer, some of the digital transfer, those types of things over time, which we know at least from a historical perspective provide a better VPG.

So the good news is like I talked about that pipeline still building, could there be a near-term opportunity as we open up tours at some of the standards to rationalize more of those tours more quickly because we are doing things a little bit on a slower measured pace, I guess so, at some level that'll be clearly stuff that we're looking at on the marketing and sales side, but everything in terms of that strategy remains intact and I do think, if anything maybe there could be a way to close that gap sooner and rationalize VPG faster. But there could be some trade off in terms of lower overall sales as you drive in that VPG to come back.

Now, when I say lower overall sales, you're starting from zero, right? So in terms of that, how quickly it returns, could we get sales returning at a higher VPG? I think that's possible. And clearly over time like I said, I think the strategy to close that gap is completely intact. We haven't seen anything yet to say that's going to change.

<<David Katz, Analyst, Jefferies Group LLC>>

Got it. I do want to just invite any of those who are tuned in to submit questions. We are at just about time, but we probably would have a minute for a quick question or two, if there are any. I don't see any in the queue. So what I will do John and Neil is just ask, is there any topic that we haven't really touched upon that you wanted to cover?

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

No. I think – I think we hit on all the, hopefully you can tell we're very optimistic about the reopening. We've always said that this business we're 100% leisure focused. We don't have meeting space. We don't focus on group travel, et cetera. So, and that what we're seeing is all else being equal and that was standing as you see COVID cases go up slightly around different parts.

People wanting to be safer, but actually get out and start to live their lives and get back on vacation early stages, but people were buying timeshare again not withstanding occupancies, aren't back to where we would expect that this time of the year, but assuming things continue to open up, we'll have in the Hawaii restrictions don't get extended, by early August we'll have a handful, mostly international resorts that except for San Francisco, our one resort in San Francisco probably won't open for the fall, but domestically, everything will be back-up and I would expect occupancies to continue to ramp. So we feel good.

Obviously there's still a lot of risks in the recovery here and what it looks like, but so far everything is opening up. I'd say a little bit better than we expected, if you would have clearly asked me, what did you think this would look like back in May? So we'll keep our fingers crossed. We continue to see that positive momentum.

<<David Katz, Analyst, Jefferies Group LLC>>

30 days is a long time in today's world. I do want to thank you for your time and your patience and for being with us and the transparency and the candor is all very, very helpful. And thank you for everyone who tuned in, we appreciate your time and attention also. I'm happy to follow up with anyone on anything after. Thanks very much.

<<John Geller, Executive Vice President and Chief Financial and Administrative Officer>>

Thanks, David. See you guys.