Corrected Transcript

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Marriott Vacations Worldwide Corp. *(VAC)*

Q1 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen and thank you for standing by. Welcome to Marriott Vacations Worldwide First Quarter 2012 Earnings Conference Call. At this time, all participants are in a listen-only mode. Following the presentation, we'll conduct the question-and-answer session and instructions will be provided at that time. [Operator Instructions] I would like to remind everyone that this conference call is being recorded today Thursday, May 3, 2012 at 10 A.M. Eastern time.

I'll now turn the conference over to Mr. Jeff Hansen, Vice President, Investor Relations. Go ahead, sir.

Jeff Hansen

Vice President-Investor Relations, Marriott Vacations Worldwide Corp.

Thank you, Ron. And welcome to the Marriott Vacations Worldwide first quarter 2012 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 May 3, 2012 and will not be updated as actual events unfold. Throughout the call, we will 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 www.mvwc.com.

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

Stephen P. Weisz

President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

Thanks, Jeff. Good morning, everyone, and thank you for joining our first quarter 2012 earnings call. This morning, I will provide an overview of our first quarter results and an update on the operational initiatives we are executing.

I'll then turn the call over to John to review our financial results in more detail. We'll then open the call for your questions.

This was our first full quarter as an independent company and we're very pleased with the exceptional results of both our top line contract sales and margin initiatives. In North America, 18% growth in both volume per guest or VPG and contract sales underscored solid marketing and sales execution.

We also made significant progress toward reducing our marketing and sales costs and are well on our way to meet or exceed our target of 12% development margin for the year which is 300 basis points or roughly 30% higher than our 2011 adjusted margins. This demonstrates the leverage in our business model and the progress we have made on our strategic goal of improving our development margins.

First quarter year-over-year development margins also improved after adjusting for revenue reportability, which John will speak to shortly. On our last earnings call, we discussed some sales initiatives including new purchase minimums and price increases we were testing within our North American points product, Marriott Vacation Club Destinations that it impacted our fourth quarter performance. With the insights of these initiatives provided, we made some adjustments which proved very successful in driving 18% contract sales growth in North America in the first quarter.

For the company, total gross contract sales increased 6% to $154 million during the first quarter, reflecting the strength in North America, partially offset by some softness in our other segments, which we anticipated given the current economic headwinds in the luxury markets and overseas.

North American contract sales growth was driven by improvements in closing efficiency, pricing and volume per contract resulting in strong VPG performance. As a reminder, VPG is calculated by dividing total onsite sales volume by the number of tours. This measures our effectiveness in selling to guests that tour at our resorts. It is a solid indicator of how efficient we are at selling as it combines how many guests actually buy or what we call closing efficiency with the sales volume per contract.

Following a 4% increase in VPG during 2011 in our North America segment, we drove further growth in the first quarter with VPG up 18% year over year to $2,942. These results clearly demonstrate the strength of our North America points program. With slightly more than 20 months since the launch, we are seeing the flexibility of the program resonate with both our existing owners and our new customers.

As of March 23, over 175,000 weeks have been enrolled in our points program. This represents almost one-third of our legacy weeks owned and we are continuing to see a trend of additional points purchases among these existing owners.

This generates a stable and recurring revenue stream from our internal exchange company, which was launched in June of 2010 with our Marriott Vacation Club Destinations program. Revenues from annual club dues have grown

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from $5 million in 2010 to $15 million in 2011 and are expected to be roughly $20 million in 2012. It is clear that our owners truly appreciate our new program.

In addition, we had outstanding performance from our rental business with revenues, net of expenses, exceeding the first quarter of 2011 by $6 million. This reflected stronger demand for our rental inventory as well as the benefit of lower unsold maintenance fees.

Finally, let me discuss some of our other segments and how they impacted our stated goals for the year. As I briefly discussed in our call last quarter, we are making headway in reducing our unsold maintenance fees in our Luxury segment, first through the sale last year of 17 units at our Ritz-Carlton Northstar, Lake Tahoe project, permanently reducing total unsold maintenance fees by almost $3 million annually.

Additionally, we are well underway with including inventory at our Ritz-Carlton project in Vail in our North America points program. We are also exploring this as an option for some of our remaining luxury inventory, allowing the sale of that inventory at a faster pace than we would expect in its current form. It is important to note, however, that this does not rebrand these luxury resorts, but instead adds a luxury vacation option in our current North America points program.

In our Asia-Pacific segment, we continue to believe that this region holds outstanding potential and our Asia points product provides us a long-term growth platform. As planned, we have closed into escrow on 18 units in Macau, which after release from escrow will be a wonderful addition to our portfolio of resorts, expanding our footprint in this vibrant region and adding an exciting new destination for our owners and guests.

In summary, our strong first quarter performance highlights the decisive actions we have taken to drive growth and improve our sales efficiency and overall cost structure. Contract sales continued to perform well underscoring the strong value proposition of our points program. We are encouraged by the outlook for the balance of 2012 and are reaffirming our guidance for the year.

Because our growth during the first quarter came from North America, our largest and most profitable segment, we believe it is more likely that we will perform toward the higher end of our 2012 guidance range. We will remain focused on delivering unparalleled vacation experiences for our customers, while maximizing the efficiency in our sales and marketing functions and continuing to right size our cost structure.

And with that, I'll turn the call over to John.

John E. Geller

Chief Financial Officer & Executive Vice President, Marriott Vacations Worldwide Corp.

Thank you, Steve, and good morning. The first quarter of 2012 is evidence we are making important strides toward achieving the goals we laid out prior to becoming a public company. As Steve mentioned, we are on track to improve our development margin by 300 basis points for the year. We plan to achieve this by leveraging our marketing and sales cost structure through growing North America contract sales and VPG, each of which grew by 18% in the first quarter, and by our continued focus on reducing our overall cost structure.

In addition, we have made significant progress in improving the results of our rental business and expect to see continued upside compared to previous years. Finally, we continue growing cash flow streams, like our annual club dues, in addition to our already established solid management fee stream. This morning, I will provide more granularity into our development margin, including the impact of revenue reportability, and discuss our rental,

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resort management and financing businesses as well as our segment results. Lastly, I will provide an update on our liquidity.

Starting with development margin, we have made solid progress this quarter. While this may not be easily understood from the face of our financial statements, recognize that the first quarters of both 2011 and 2012 were impacted by revenue reportability. You may recall reportability is generally an issue of when, not if we recognize the revenue. And with the strong growth in the first quarter contract sales, certain revenue for contracts that were in rescission periods was deferred at the end of the quarter. While this affects quarter-to-quarter earnings and related margins because of the impact of the seasonality on contract sales, over the course of the year, we will get the benefit from the impact of this deferred revenue, as we expect contracts in rescission period at year-end to be comparable year over year.

We have included schedules A-7 for the total company and A-8 for North America to illustrate the impact of revenue reportability on our development margins. I'm pleased to say after adjusting for the impact of this revenue reportability, development margins for the first quarter of 2012 were nearly 13% for the total company, and nearly 16% for North America.

Our increase in North America development margin is due to improvements in both cost of vacation ownership products and marketing and sales costs. The margins associated with the cost of vacation ownership products improved by 200 basis points, primarily from increased pricing implemented during the fourth quarter of 2011. In marketing and sales, our margins improved nearly 300 basis points showing our ability to manage the variable costs and leverage our fixed cost infrastructure. We believe our adjusted development margin for the first quarter is a better reflection of what we expect to achieve for the full year in our North America segment.

Therefore, this gives us confidence we can achieve our longer term development margin goals of high teens to 20%, as we work through the impact that our Luxury and Europe segments have on our total company development margin.

We have also seen significant improvements in our rental business with a year-over-year improvement of $6 million of revenue, net of expenses. This is primarily in our North America segment driven by a 4% increase in transient keys rented, higher revenue from our Plus Points program and increased utilization of our Explore program, which adds additional flexibility to an owner's usage options and increases our rental inventory.

Bottom line improvements also include reduced unsold maintenance fees in our Luxury segment. Finally, as our relatively new points program provides more data over time, we continue to improve our ability to analyze and forecast owner usage patterns, providing us confidence that our rental business will be a strong performer for the balance of 2012.

We have also seen favorable results in our resort management and other services operations through increases in annual club dues, enrollments and management fees. Lastly, as expected, financing revenue, net of operating expenses, declined $5 million year over year, as our notes receivable portfolio is burning off faster than we are originating new notes.

After including the impact of consumer financing interest expense, our overall financing business reflected a net decline of $2 million compared to the first quarter of 2011 on a pro forma adjusted basis. Again, this decline will continue, but will moderate over the next few years until our pace of new note originations matches the amortization of the existing note portfolio.

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Turning to our segment detail, as I previously mentioned, North America performed very well, an 18% increase in both contract sales and VPG year over year. Development margin as reported was nearly 12%; however, after adjusting for reportability, as I discussed earlier, it effectively increased nearly 500 basis points to almost 16%, a significant step toward our longer term company goal of 18% to 20%.

Adjusted North America segment results increased $6 million year over year primarily driven by $5 million of higher rental revenues, $4 million of higher resort management and other services revenues and $1 million of higher other revenues, all net of expenses. These increases were partially offset by $4 million of lower financing revenues.

Our Asia Pacific segment results declined $2 million year over year due primarily to reduced contract sales in the quarter from the closing of higher cost sales galleries.

Our on-site distribution locations are more efficient sales channels than off-site and therefore going forward, we are focusing our efforts on future inventory acquisitions with high volume onsite distribution potential. In our Luxury and Europe segments, as inventory continues to decline consistent with our stated segment strategies, gross contract sales declined to $11 million.

Adjusted segment results for both segments declined by $1 million to a loss of $4 million. Our strategies in these segments continues to be sell-out or sell-down of inventory in the case of Luxury and maximize our cash flows.

Turning to liquidity, at the end of the first quarter 2012, we had cash and cash equivalents of $77 million. Given our beginning cash balances on hand and cash generated from operating and investing activities, no cash fundings were required during the first quarter from either the warehouse facility or the corporate revolver.

At the end of the first quarter, we had approximately $79 million of notes available to securitize under our warehouse facility and $195 million of capacity available under our corporate revolver. Additionally, we have begun work on our first term securitization as a public company which we expect to complete this summer.

Turning to the balance sheet, we continue to make progress toward reducing our real estate inventory balance. Further, we are actively marketing our excess undeveloped land and inventory and have generated legitimate interest in multiple parcels, and are making progress toward disposing of these assets.

As we've previously guided, we expect to generate $85 million to $100 million of adjusted free cash flow during 2012 and any asset dispositions would be upside to this guidance. So as you have read in our release this morning, our first quarter was a strong start to the year. Our contract sales growth was at the top of our range. We exceeded expectations in our North America segment and made significant progress toward improving our development margins.

Looking ahead, we see the same economic uncertainties as you do, and consumer sentiment is a large driving force for our overall performance. However, we remain optimistic about the remainder of 2012 and we'll stay focused on delivering margin improvement and our overall company strategies. As always, we appreciate your interest in Marriott Vacations Worldwide.

And with that, we will now open the call up for Q&A. Ron?

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QUESTION AND ANSWER SECTION

Operator: Thank you, ladies and gentlemen. We will now conduct a question-and-answer session. [Operator Instructions] Your first question comes from Eli Hackel from Goldman Sachs. Please go ahead.

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Good morning, Eli.

Eli Hackel
Analyst, Goldman Sachs & Co.

Q

Good morning. Thanks. Just had a few questions I'll just say them all upfront here. Obviously, a big increase in North America VPG and gross contract sales, can you just talk about a few things there related to obviously the margin there, but more on the marketing side and the cost of goods side, what are the things that you learned maybe more specifically from 4Q to 1Q, where you had a big swing there that allowed for the growth in North America contract sales and the margins there, the big jump there? And the other thing on that is, what does that mean just in terms of going forward, obviously you kept the gross contract sales the same at 4% to 8%, really strong in North America in the quarter, as you look out to the balance of the year, are you expecting North America to kind of be above your prior guidance or your prior thoughts for maybe Luxury, Europe, Asia a little bit below?

And then finally, just on the land sales, you mentioned you're making progress there, where – can you just tell us we are in terms of timing, have you hired brokers to sell all the land you expect to sell? And then maybe are there additional thoughts in terms of, you know, you've given $150 million to $200 million of expected proceeds, is pricing coming in better or worse than you originally thought?

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Okay, Eli, this is Steve. I'll try to tackle these as best I can. On the sales front, as I mentioned and we talked about even at the end of the year call, we had done a number of things in the fourth quarter in terms of looking at the minimum number of points that needed to be purchased, in terms of looking at a fairly substantial price increase, etcetera. And as a result of all of that, our sales team was able to take the learnings from those kind of, I'll call them, experiments or tests that we did in the fourth quarter. And we refined our sales process to the point where we believe that what we saw in the first quarter was really the result of taking those great learnings, which arguably cost us a little bit in the fourth quarter, but we were able to take those great earnings and apply them consistently across the system.

And I believe as far as going forward, certainly those learnings are not going to be lost on us, we'll continue to – as we always do, every time we make a sale, we learn something more, but we believe that those things are things that will probably have a lot of traction for the balance of the year. So we feel very good about that.

As far as the, I'm sorry, I was going to – let me deal with the land thing very quickly. Yes, we've hired brokers on most of the parcels that we have. We've already gotten some expressions of interest, but a little early to tell about what the price point and contract terms would be on some of those things. Obviously as some of those things start to materialize and become more firm, we'll be happy to share them with you as that happens. But, at this point in time, we don't see anything that would cause us to feel any less optimistic about the $150 million to $200 million

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number that we have been using in the past. And I'm sorry, your question about the balance of the year, could you restate that for me, please.

Eli Hackel
Analyst, Goldman Sachs & Co.

Q

Sure, certainly. So, just obviously the growth was very strong in the first quarter, up 18%, and assuming that there wasn't really any pulling forward of demand from the second quarter, maybe what that just means in terms of North America growth for the balance of the year. I mean, you are only guiding 4% to 8%, obviously Europe, Luxury and Asia not doing that growth rate, but just given the strain in the first quarter, I was curious on your thoughts about North America for the balance of the year, just given that you are keeping that 4% to 8% range?

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Yeah. Well, clearly, we were very encouraged by what we saw in North America the first quarter. One thing, we had probably a little better set of easier comps in the first quarter of 2012 over 2011, not dramatic, but something that did give us a little boost there in terms of the percentage increase. As I've said in my comments, just trying to say, hey, listen, we think we are probably going to come in closer to the top end of our guidance than the bottom end. I mean, that's factoring in what we've seen in North America, what we kind of believe North America will look like going forward.

We do have the drag, as you pointed out, what's going on in Luxury, Europe and not quite the performance we've been looking for in Asia, although we expect that to pick up. So I think kind of when you do the arithmetic of blending all those things together and mixing it, that's where you see, hopefully us coming in towards the top end of the 4% to 8%, not towards the bottom end of the 4% to 8%.

Eli Hackel
Analyst, Goldman Sachs & Co.

Q

Okay, that's very helpful. Thank you.

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Thank you.

Operator: [Operator Instructions] Your next question comes from Bob LaFleur from Cantor Fitzgerald. Please go ahead.

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Hi, Bob.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Hi, good morning, guys. So you got about $1 billion worth, $926 million worth of inventory on the balance sheet. Can you talk a little bit longer term about inventory and where new inventory is going to come from, some of the things you are looking at, where it's joint ventures, greenfield developments, acquisitions, that sort of things? Just want to understand what the long-term inventory plan is.

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Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

Yes. Clearly, one of the things that, this is Steve, Bob. Clearly one of the things that we have and will have for sometime is the ability to add additional phases to our existing resorts, where the infrastructure is in place, all the central facilities, buildings and sales centers, all those things are in place, so you are literally stamping out units in new buildings. Having said that, if the right opportunities were to present to themselves to us in terms of JVs or opportunities that are a little less capital intensive, we would certainly look at that.

One of the advantages of having the real estate where we can develop phases is that if we have a nice drop-in product in a project in place where we might not have inventory today and put a new pin on the map, we can certainly push back the phasing of some of the existing resorts, and in fact, inject a new piece along the way. But we are going to look very carefully at all those things. But we've got several years' worth of buildable inventory already available to us, and we think that from a cash flow stand point, it'll look very attractive.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

When you look at the build-out of the existing resorts, how much more incremental revenue or I'm sorry, inventory, could you build as sort of your existing footprint without having to buy more dirt? Just ballpark, just to get a sense of the order of magnitude.

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

A

I don't have the exact number here, maybe John does. It is several thousand.

John E. Geller
Chief Financial Officer & Executive Vice President, Marriott Vacations Worldwide Corp.

A

Yeah, I think, Bob, call it $2 billion of additional investment in existing developments that would probably equate to $6 billion to $7 billion of contract sales, give or take. So that gives you, to Steve's point, we have a pretty long runway in terms of developing what we have. But clearly that's a balance against delivering the right customer experience, too, on the sales side, and make sure that we also are growing our portfolio and the experiences we provide to our customers.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Okay. And if I could ask one more question on a completely unrelated topic, could you sort of walk us through the Marriott rewards liability you have, sort of what the mechanics of that are burning off and sort of how it flows through your P&L? I think it's just an area that there is some still confusion about.

John E. Geller
Chief Financial Officer & Executive Vice President, Marriott Vacations Worldwide Corp.

A

Sure. And in terms of the liability that's on our books, that's already flown through the P&L historically. At the date of – and will give you a little bit of history here, but hopefully not too much, but when we were part of Marriott and we issued Marriott Rewards points, we actually paid for those Marriott Rewards points when those points were redeemed by the customers, so hence the liability. So as we issued those with accrued liability, as the points were redeemed by the customers, we would pay that to Marriott Rewards program.

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And that's different than how hotel owners and franchisees pay; they pay as they go. So post spin, what we do is, we pay as we go. So the expense hitting the current P&L for Marriott Rewards is actually hitting as we go, and there is no additional liability that's accruing. From a cash flow perspective, that liability essentially was frozen at the date of the spin or year-end. And so, it still works down the same way it did historically. So as those points are redeemed, you'll see that liability come down over time and contractually at the end of a, I think, five-year, four-year period that we have to clean up and pay off the remaining balance after factoring in some breakage and things like that.

So you'll continue to see that liability essentially, I think it came down about $10 million in the quarter. You'll continue to see that burn down here for the year and over the next four years.

Stephen P. Weisz — A
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

Go ahead, Bob. I'm sorry.

Robert A. LaFleur — Q
Analyst, Cantor Fitzgerald Securities

Is that $10 million reduction, did that through flow through the income statement or is that just adjustment to the cash flow statement?

John E. Geller — A
Chief Financial Officer & Executive Vice President, Marriott Vacations Worldwide Corp.

Net cash flow. So yeah, the liability coming down that's the liability that was existing at the date of the spin. Going forward, we are paying as we go for new point issuances. Remember, the liability that's on our books is for points, Marriott Rewards points that were issued previously.

Robert A. LaFleur — Q
Analyst, Cantor Fitzgerald Securities

Okay.

Operator: [Operator Instructions] There are no further questions at this time. Please continue.

Stephen P. Weisz
President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

Well, thank you for your questions and I trust you've heard that we are pleased with the momentum we have generated so far in 2012. And we look forward to reporting our progress on future calls. Thank you for your participation on our call today and your continued interest in Marriott Vacations Worldwide. And finally, to everyone on the call and your families, enjoy your next vacation. Thank you.

Operator: Ladies and gentlemen, this concludes the conference call for today. Thank you for participating. Please disconnect your lines.

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