07-Nov-2018

Marriott Vacations Worldwide Corp. (VAC)

Q3 2018 Earnings Call

CORPORATE PARTICIPANTS

Jeff Hansen
Vice President-Investor Relations, Marriott Vacations Worldwide Corp.

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

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

OTHER PARTICIPANTS

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC

Brian H. Dobson
Analyst, Instinet LLC

Jared Shojaian
Analyst, Wolfe Research LLC

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.

David Katz
Analyst, Jefferies LLC

Edward Engel
Analyst, Macquarie Capital (USA), Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to Marriott Vacations Worldwide Third Quarter 2018 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 turn the conference over to your host today, Jeff Hansen, Head of Investor Relations. Thank you. You may begin.

Jeff Hansen
Vice President-Investor Relations, Marriott Vacations Worldwide Corp.

Thank you, Rob, and welcome, everyone to the Marriott Vacations Worldwide third quarter 2018 earnings conference call. I'm joined today by Steve Weisz, President and Chief Executive Officer; and John Geller, Executive Vice President and Chief Financial and Administrative Officer.

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, November 7, 2018, 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 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, Marriott Vacations Worldwide Corp.

Thanks, Jeff. Good morning, everyone and thank you for joining our third quarter earnings call. Let me begin by taking this opportunity to publicly welcome the over 11,000 ILG associates to the MVW family. Everyone on both sides of the acquisition has worked tirelessly throughout the summer producing a virtually seamless closing on September 1st, a month earlier than initially targeted. Their efforts have continued through the fall, as we are now well in our integration and longer-term transformation efforts as one company. I am truly amazed every day at what our team of associates can do and I'm very excited about what this transaction means for our company.

Today, I'll walk through our performance in the third quarter before I spend a few minutes discussing more about where we stand, as it relates to the integration of ILG. I'll then hand the call over to John to provide more detail on our results, as well as our updated guidance for the full year before taking your questions.

With the acquisition of ILG, we have realigned our structure to manage the business through two operating segments, Vacation Ownership and Exchange & Third-Party Management. As a result, we have realigned our reportable segments from a geographic approach to reflect these changes. Vacation Ownership includes all functions related to our branded timeshare businesses across all geographic regions. This includes not only the selling and financing of our Vacation Ownership inventory, but the rental and management of our properties as well.

Exchange & Third-Party Management includes our world-class exchange company Interval International, as well as the third-party management companies of Trading Places International, Vacation Resorts International and Aqua-Aston.

ILG has only been part of MVW for the month of September. Therefore, we have included additional supplemental financial results, which we will refer to as the Legacy-MVW. These results exclude the month of ILG performance from the quarter for more apples-to-apples comparison to the prior year.

Overall, I couldn't be happier with our third quarter performance from our entire team, especially considering how much work has been happening surrounding the acquisition and integration work. Beginning with our consolidated company results, adjusted EBITDA totaled $100 million, an improvement of 36%. In our Vacation Ownership segment, consolidated contract sales for the company totaled $279 million, an increase of $75 million or 36% over the third quarter of 2017.

As it relates to Legacy-MVW, which was the primary contributor to our results in the quarter, contract sales increased $38 million or 18% to $242 million. Our Legacy-MVW results were driven by strong performance from our newer sales centers and marketing channels, which continue to drive top line growth.

Let me stay with the performance of Legacy-MVW for just a moment, as I feel it would be helpful to you as a reflection of how we perform versus expectations. VPG in our Legacy-MVW North America Vacation Ownership business was $3,781, up 9% over the third quarter of last year from improved closing efficiency. Related tour growth improved almost 7%, driven by our call transfer and Encore programs, as well as a very solid quarter from our newer destinations like Waikoloa, New York, and Washington DC.

In addition, our results were negatively impacted by the hurricanes which affected us in multiple locations in the third quarter. The first, Hurricane Lane affected the Hawaiian Islands, while the second Hurricane Florence affected the East Coast, primarily the Carolinas. We are very pleased to report that all of our impacted associates and guests made it through the storms safely. We did, however, experience some damage to several properties, as well as mandatory evacuations, shutdowns and cancellations, resulting in a loss of tours.

In total, we estimate that these two storms impacted contract sales in the third quarter by $6 million, including $5 million for Legacy-MVW. Adjusted EBITDA was negatively impacted by $5 million, including $3 million for Legacy-MVW. Adjusting for these impacts, our strong Legacy-MVW performance in the quarter would have been even better with contract sales growth of 21% and adjusted EBITDA growth of 15%. And as I'm sure you're aware, in October, the panhandle of Florida were severely impacted by Hurricane Michael and our hearts and prayers go out to those who were affected.

Legends Edge, our Marriott Vacation Club resort in Panama City was directly impacted. However, it does not have a sales center. The resort did sustain some damage, but thankfully, it was not to the degree of devastation that you may have seen in the Greater Panama City region.

In our Exchange & Third-Party Management segment, numerous resorts in the II and VRI family were impacted, some of which we believe will remain closed through the end of the year. Overall, we do not expect Hurricane Michael to have a material impact on our fourth quarter adjusted EBITDA results.

As it pertains to the acquisition of ILG within the quarter, as I have mentioned, we have only included their performance from the closing date of September 1. To that end, I'm pleased to say that while we only have metrics for one month in the quarter, consolidated contract sales in the ILG Vacation Ownership business performed well, growing 14% over September of last year. And in the Interval International exchange business, total membership remains steady at just over 1.8 million members.

Now, let me pivot to our continued integration, integration of ILG and its wonderful companies into the MVW family of brands and businesses. I am very pleased with how associates on both sides have embraced the acquisition. The more we work together and learn from one another, the more opportunity we see in the combination. I view the coming together of our brands and companies as a once-in-a-lifetime opportunity, and we are looking at the integration as just that, a chance to make a transformational change, the way we do business.

If you recall, we began this journey on April 30, announcing that our first look at this combination would provide a minimum of $75 million of cost synergies. About half of this comes from the natural savings that you would expect to achieve when you bring together two companies of our size, such as duplicate management structures, IT systems and public company costs.

We have stressed that this is a minimum target and as we have had more time and ability to work with the teams on both sides and asked our leadership to view this through a transformational lens. We now believe that there is potential to produce total cost synergies in excess of $100 million. I would like to stress that we are still in the review stage of many of these incremental savings opportunities and the costs associated with achieving them. We will endeavor to keep you up-to-date, as we continue to refine our longer term strategy.

Now let me shift to the top line growth opportunities, which over the longer-term should prove to be the most impactful rationale for the combination of our two companies. With all of the Marriott licensed Vacation Ownership brands under one umbrella, we have opportunities to grow in new directions and with new channels that weren't possible before. For instance, we are learning what makes a Westin Vacation Club buyer different from a Sheraton customer and how to enhance their loyalty across all of our Marriott brands.

We now have leadership throughout all of our Marriott brands focused on how to connect marketing channels and best practices to allow for improvements in tour production and closing efficiencies across the Vacation Ownership business. As an example, VPG in Vistana was just under $3,000 in September, well below the Legacy VPG of nearly $3,800 for the quarter. We view this as a great opportunity, as we look at offering promotions and programs that are successful in one particular channel, more broadly across the new expanded portfolio. This should improve VPG through efficiencies and best practices, driving a higher contract sales growth.

Perhaps what we are most looking forward to is our ability to tap into the digital marketing environment. By mid next year, we expect to launch our digital transfer program with Marriott International. Similar to our call transfer program today, digital transfer will allow users of marriott.com to receive fantastic offers and promotions linked to our products, driving higher tour flow at all of our Marriott branded locations.

In addition to the value we see in the digital arena with the Marriott linked programs, we see similar value in other social media and digital advertising platforms. Therefore, as part of our transformational view of our new company, we have created a new role reporting directly to me, the Chief Brand and Digital Strategy Officer designed to accelerate the building of our digital capabilities.

And within the Hyatt Vacation Ownership brand, we see a meaningful opportunity to grow the portfolio from the 16 resort destinations we have today by leveraging our Vacation Ownership development and sales strategies. We are working closely with the Hyatt senior executive team on a shared vision of the future and are excited about what this brand can accomplish under our leadership.

Let me walk you through our longer-term strategic view of the combination. Let me help set your expectations on how we will get there. As we saw, when we initially launched our call transfer program several years ago, a good portion of our tour package production does not materialize as a tour for up to 12 to 18 months after a package is sold. So, from a tour package perspective, you should expect us to begin seeing the growth from our future call transfer opportunities, our upcoming digital transfer program and other new programs like these to begin in early 2020.

Keep in mind too that 2019 will be a transitional year for us, as we will be rationalizing less efficient tour channels at Vistana in order to improve our combined VPG. By utilizing best practices from both companies and shifting our focus from lower VPG channels to more efficient channels, we should generate longer-term contract sales and adjusted EBITDA growth.

With that in mind, as I – while I reference 2019 as a transitional year, we also expect to see more immediate impacts from other opportunities, which come from applying best practices across our sales organization and across the brands. As an example, we see an opportunity to offer our financing incentive program to the Vistana buyers, something that could create a material improvement in their net financing propensity.

We also see the potential to enhance Vistana's VPG by utilizing MVW's pricing strategy that are designed to improve overall closing efficiency while enhancing the average contract value. Some of these changes are already underway, and others are being evaluated for rollout in the near-term, providing solid growth earlier in 2019.

As we look at the rest of 2018, we expect a solid fourth quarter with meaningful contract sales growth driven by our strong tour package programs and newer destinations with adjusted EBITDA within our updated guidance range of $395 million to $405 million. We are excited about the revenue opportunities which will position us well for the future and cost synergies above our initial expectations, including an annual run rate of roughly $25 million by the end of this year.

With that, let me have the call over to John to walk through the further detail on our third quarter results and our expectations going forward. John?

John E. Geller, Jr.

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

Thank you, Steve and good morning everyone. I'm very pleased with what we have accomplished this quarter, not only completing the ILG acquisition in an accelerated fashion, but also generating strong third quarter results. As Steve mentioned, as a result of the acquisition of ILG, we have reorganized the business and established two new reporting segments being Vacation Ownership and Exchange & Third-Party Management, as they represent how we will manage and discuss the combined business going forward.

With that as background let me shift to our third quarter financial results. Total company adjusted EBITDA totaled $100 million, an increase of $26 million or 36% from the prior year. As Steve mentioned, the recent 2018 hurricanes, both in Hawaii and the Carolinas impacted the company's financial results. After adjusting for the negative impact of the hurricanes, adjusted EBITDA would have totaled $105 million for the quarter.

Adjusted EBITDA for our Vacation Ownership segment totaled $123 million, an increase of $28 million or 29% from the prior year. Adjusted EBITDA for the Exchange & Third-Party Management segment totaled $19 million, all of which was driven by the ILG acquisition.

Turning to the Vacation Ownership segment in our development business, consolidated contract sales increased $75 million or over 36% to $279 million in the third quarter, including a $37 million increase related to the acquisition of ILG. Adjusting for the negative impact of the 2018 hurricanes and the contract sales related to the ILG business, Legacy-MVW contract sales would have grown by 21%.

Our total development margin in the first quarter was $57 million, up $14 million or 30% to the prior year. Legacy-MVW adjusted development margin was $52 million, an increase of $8 million or 17% over last year, and adjusted development margin percentage was 23.9% compared to 24.5% in the prior year.

In our financing business, revenues increased $14 million or 36% to $48 million in the third quarter of 2018. Financing revenue, net of expenses and consumer financing interest expense increased $6 million or 21%. Legacy-MVW financing revenue, net of expenses and consumer financing interest expense, was in line with the prior year. Legacy-MVW results include a $4 million increase in interest income from our growing notes receivable balance, offset by $1 million of additional costs from our financing incentive programs, $2 million of higher interest expense due to the accelerated timing of this year's securitization, and $1 million from slightly higher cost of funds.

Our notes receivable portfolio continues to perform very well. The average FICO score of buyers, who financed with us in the quarter was 736, while delinquency rates remained near historic lows and financing propensity remained strong at nearly 67%.

In August, prior to our acquisition of ILG, ILG successfully completed a $293 million note securitization at a blended interest rate of 3.63% and the 98% advance rate, generating $287 million of gross proceeds. As of September 30th, $71 million of the proceeds were included in restricted cash until we deliver the remaining notes receivable in accordance with the terms of the securitization. Subsequent to the end of the quarter, we sold an additional $23 million of notes to the Trust and we expect to sell the remaining notes and receive the remaining funds of roughly $48 million before the end of the year.

In our rental business, rental revenues increased $20 million or 30% to $86 million. Rental revenues net of expenses were $12 million, a 34% increase from the prior year. Legacy-MVW rental revenues net of expenses were $12 million, a 31% increase from the prior year. These adjusted results were driven by a 3% increase in transient rate and $2 million of higher plus points, partially offset by higher rental expenses.

In our resort management and other services business, revenues increased $21 million or 31% and the margin increased an $11 million or 38% to $43 million in the quarter. Legacy-MVW revenues increased $6 million or 9% and the margin increased $4 million or 16% to $36 million in the quarter. These adjusted results were driven by higher fees for managing our portfolio resorts and higher club activity.

G&A costs were $53 million in the quarter. Legacy-MVW G&A cost increased $4 million in the quarter, reflecting normal inflationary cost increases as well as higher technology spending and higher litigation related expenses. Royalty fees were $19 million in the quarter. Legacy-MVW royalty fees were $16 million, an increase of $1 million from the third quarter of 2017, mainly driven by higher contract sales and a higher mix of new inventory being sold.

Moving to our balance sheet at the end of the quarter, cash and cash equivalents totaled $441 million. We also had approximately $61 million of gross Vacation Ownership notes receivable eligible for securitization under our warehouse facility and roughly $594 million in available debt capacity under our $600 million revolving credit facility.

Our total debt outstanding at the end of the quarter was roughly $3.9 billion, consisting primarily of $2.2 billion of corporate debt, most of which resulted from the acquisition of ILG and $1.7 billion associated with our non-recourse securitized notes receivable. Subsequent to the end of the quarter, we paid down roughly $122 million related to the Legacy-ILG senior unsecured notes assumed as part of the ILG acquisition.

As a much larger and more diversified business, following the acquisition of ILG, these debt levels are hotter than we have historically experienced. However, on a pro forma basis, assuming the companies were combined for the last 12 months and including synergy savings of $100 million, we estimate that our current debt to adjusted EBITDA ratio of 2.6 times, only slightly higher than our longer term target of 2.5 times or less. With our new $900 million of floating rate corporate debt issued as part of the ILG acquisition, as well as higher non-recourse debt associated with our securitized notes receivable, we do recognize that we now have more exposure to interest rate risk in a rising interest rate environment.

However, we have already begun to take and make progress in mitigating this risk. For our variable rate corporate debt, we did swap $250 million of principal for a fixed rate of roughly 5.2% over five years to help manage a portion of this risk. And as it relates to our financing business, over the past year, we have been making programmatic changes that have resulted in a roughly 50 basis point increase in our weighted average coupon rate.

Given that our customers have historically been less interest rate sensitive, we have not seen any impact on our overall financing program with our financing propensity remaining above 60%. We will continue to identify opportunities to adjust our lending rates to help mitigate higher costs of funds.

As it relates to our return on capital, subsequent to the end of the quarter, we paid our third quarterly dividend of nearly $19 million and we repurchased 188,000 shares of our outstanding common stock for $17.5 million, leaving nearly 1.3 million shares available for repurchase under our existing share repurchase program.

Let me take a moment to update you on the status of our insurance claims related to Hurricanes Irma and Maria from 2017. For both Legacy-MVW and Legacy-ILG, the majority of the claims have been submitted related to both our business interruption losses, as well as property damage experienced by both us and our owners' associations from the hurricanes.

However, at this time, we do not know when the claims will be settled. As we've done in the past, our adjusted EBITDA and our adjusted free cash flow guidance do not reflect any insurance proceeds from settling these claims. We will continue to update you as these efforts progress.

Now, turning to our outlook for 2018, we have revised our overall full year guidance to reflect the results of the ILG acquisition, which includes Legacy-ILG's financial results from September 1 through the end of the year. As Steve mentioned, we expect a solid fourth quarter for the company, which when combined with our year-to-date results are expected to generate full-year contract sales between $1.07 billion and $1.09 billion and full year adjusted EBITDA between $395 million and $405 million.

While the majority of our synergy savings are expected to materialize through 2020, our current full year guidance does include roughly $4 million of synergy savings. For our adjusted free cash flow, we continue to manage overall inventory and other capital spending. As a result, for the combined company, we are targeting adjusted free cash flow between $235 million and $255 million for 2018. We have delivered strong contract sales growth from solid VPG and tour growth initiatives, giving us momentum as we finish out the year.

The momentum – or excuse me, this momentum coupled with top line growth opportunities as we integrate the acquisition of ILG, create a strong foundation to drive future revenue growth. We look forward to updating you on our progress. As always, we appreciate your interest in Marriott Vacations Worldwide.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Cameron McKnight with Credit Suisse. Please proceed with your question.

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

A

Good morning.

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning. Thanks very much. So, a question in terms of what's in and what's out of EBITDA? So, Legacy revenues were up 16% in the quarter, but EBITDA was up 10%. Was there something below the segment line that was impacting results at the adjusted EBITDA level?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

A

I mean from a Vacation Ownership perspective, you should get most of that flowing down, I think picking up the month of September, for the Exchange & Third-Party Management, you're not going to see that type of growth, so that's going to weight it down a little bit.

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Got it. So, a mix issue. Were there any, I guess, one-offs or items that we should be aware of in terms of third quarter EBITDA?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

A

No. I mean, I think the one thing we mentioned from a G&A perspective, just given some of our litigation that we've set, or we have been running, which we don't adjust out of the EBITDA, litigation defense costs, and those have been running higher year-over-year. The good news is, as we've settled some of these claims, we saw a few cases out there, but we hope that that will come down over time obviously.

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Got it. And then in terms of... Oh, sorry.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

A

Hey, just the other day, I mean, we called it out was the impact of the hurricanes obviously. But...

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

You don't adjust that back into the EBITDA what we gave you the $5 million impact.

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay, perfect. And was there any – in your opinion, was there any disruption to sales at the Legacy-ILG and Vistana sales centers in the quarter?

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

As a result of the hurricane?

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC
Q

Or as a result of the merger?

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

No. No, we haven't seen anything there of any meaningful nature and even on the hurricane front, there was – they had some loss of sales in Myrtle Beach. But that wasn't – it was included in our remarks, but – it was about $1 million.

Cameron McKnight
Analyst, Credit Suisse Securities (USA) LLC
Q

Got it. Thanks very much. I'll jump back in the queue.

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

Thank you.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Thanks.

Operator: Our next question is from Brian Dobson with Nomura. Please proceed with your question.

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

Hi, Brian.

Brian H. Dobson
Analyst, Instinet LLC
Q

Hey. Good morning. So, I'm just wondering if we can dig into some of those long-term strategic advantages from the acquisition particularly revenue synergies. I guess, first, could you give a little bit more color on the low and high VPG sales channels that you mentioned earlier? And then when do you expect to see a benefit from the digital transfer program? When does testing really begin in earnest on that and so you can get a better idea of how beneficial that will be?

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

A

Yeah. Let me try to take it reverse order, just because it's top of mind.

Brian H. Dobson
Analyst, Instinet LLC

Q

Great.

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

A

We expect the digital work with Marriott to be put into place by mid next year. You're probably very well aware of the fact that Marriott has been going through lots of integration between the Starwood reservation platform and the Marriott reservation platform. So, as you might expect, we're in the queue to get this work done. They're very committed to it. But we haven't started it yet. That's why we say, mid next year and we're optimistic about that.

With that said, once we started, as I mentioned in my remarks, once we have – once we're able to start the digital transfer, it will take 12 to 18 months for those tours to start to come through the house and materialize into contract sales.

On the question of what's going on with kind of rationalize the various channels to improve VPG in the Vistana businesses, they do some OPC work, off-premise contract work, which has a relatively low yield to it. And I think you can see us to try to move out of some of those things, enhancing linkage opportunities with the – you may recall that when we renegotiated our license agreement with Marriott International, we essentially preempted Vistana's ability to do linkage into the former Starwood branded, Sheraton and Westin properties. And so, we can now turn that back on.

And then, on a market-by-market basis, we'll be looking at every single thing in their tree to try to understand, as we have typically done. We look for highest yield, lowest cost, all the way down to lowest yield, highest cost and we trim the tree from the bottom up. So, that's what we'll be doing. It's not a simple process, nor is it one that you flip a switch and it happens overnight. But it's clearly something that we were experienced doing, and now we believe we have the talent and the team to be able to pull it off.

Brian H. Dobson
Analyst, Instinet LLC

Q

That's great. And when do you start implementing those changes?

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

A

Well, those changes are already afoot. I mean, where we've had teams working with the VSC sales leadership team and they're beginning to identify the opportunities. And then, once you get that done, then you have to go through some updated training for the sales teams that are on-site about how to approach it in the marketing side. But we didn't waste a lot of time after we closed on September 1st to get it going.

Brian H. Dobson
Analyst, Instinet LLC Q

So, the benefit could materialize in 2019 first half?

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

Well, that's as I tried to reference, there will be some things that will be a transitional, take a little longer, but everything we can try to get done to materialize in 2019, you can rest assure that we're already at it.

Brian H. Dobson
Analyst, Instinet LLC Q

Thank you very much.

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

Thank you.

Operator: Our next question comes from Jared Shojaian with Wolfe Research. Please proceed with your question.

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

Good morning.

Jared Shojaian
Analyst, Wolfe Research LLC Q

Good morning, everyone. Thanks for taking my question. So, I want to ask you first about the full year EBITDA guidance and just understand the assumptions a little bit better. I mean, it looks like you're guiding EBITDA about $80 million to $85 million higher than the prior standalone that guidance and I know you called up to $5 million for the hurricanes, you called out $4 million of synergy contribution, but is it right to assume that the difference between your prior guidance, the new guidance, call it, roughly $85 million or so that that's the ILG contribution in the four-month period, or are there other areas of puts and takes that we need to consider?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp. A

There's definitely other areas of puts and takes. So, you mentioned the hurricane, for example. Well, Michael, we said, it's not going to impact, we do have some continuing impact from Florence and Lane, which is probably another $2 million or $3 million in the fourth quarter, not part of the $5 million, which was the third quarter impact. We still are going to have pricing elevated litigation type expenses onto the defense side, as we are at trial – are going to trial on some of these cases soon. And then – but overall, the contribution, if you will, high level is slightly higher than that coming from the Legacy-ILG business for the four months.

If you annualize that, you got to remember that ILG had stronger first half of the year in terms of where their EBITDA is on an absolute basis, so the first and second quarters are better. As we move into the fourth quarter, obviously, it's a little bit more of a shoulder season on the timeshare side as it's always been for us in terms of the EBITDA contribution. And then, it's the same thing on the exchange in rental business, it's probably the weaker of the four quarters, if you will.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Okay. Thank you.

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

A

And of course, in the fourth quarter, also we have roughly $4 million worth of synergy savings that we will see in the fourth quarter.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

All right. Thank you. That's helpful. And Steve, you talked a couple of times about 2019 being a transition year. I imagine you're not prepared to give us any guidance. So, maybe you can just help us think about what that means exactly and specifically, I'm curious how much of the $100 million cost synergies do you think can be achieved next year? And if there's anything you can share. I'll be curious to know how you're thinking about contract sales growth or VPGs, tours, EBITDA and anything you'd be willing to share?

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

A

Sure. Well, thanks. First of all, the one question on your synergies. So, we believe by the end of this year we will have identified $25 million of run rate synergies. So, that's $25 million, for next year you should pretty much bake in. I would expect to see full run rate savings by the end of 2019 to be in the $50 million range, so roughly half of the $100 million that we've talked about.

As it relates to what we see on the top line, unfortunately, and the frustrating thing I'm sure for you and for us is that you'd like to think that when you've got some best practices that we've employed for years in MVW that they are immediately translatable into the Vistana business. Unfortunately, it doesn't quite work that way. You have to re-educate your sales force, you have to get them comfortable within our approach and everything else. So, I would not be in a good position today to give our guidance for next year.

Suffice it to say that while I referenced the transitional side that some things will take longer, some things will be more immediate. And you can certainly rest assure that we are going to be doing everything and our power to drive as much top line growth next year as we possibly can. But it's – while we've identified the opportunities, we still got to put a price to them, not in terms of prior cost to implement, but in terms of what their upside is, and then the timing to get it done.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Great. Thank you very much.

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

Hi, Patrick.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Hi. Good morning.

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

Good morning.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Two questions please. One, I just want to be absolutely clear on sort of the apples-to-apples EBITDA guidance. Your prior for the Legacy company for the year was $310 million to $325 million. What would that apples-to-apples be right now, if you were only giving the legacy guidance?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Well, Patrick, if you were to adjust for the hurricane impact both in the third quarter and the fourth quarter that I just mentioned, we would probably – obviously, a lot of moving parts here, we're not looking at it that way, but I would say we'd probably be towards the middle of that guidance range, kind of where we thought we'd be when we started the year.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Okay. Fair enough. I appreciate the clarification on that. And then, it looks like, you've started at least dabbling back in share purchases. How should we think about that trajectory going forward into next year?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Yeah. We don't obviously comment, Patrick, when we're in and out. I think as we go into next year and we give you guidance, we'll probably give you a little bit more guidance on how we're thinking about return on capital on a full-year basis. But look, like we've always done, and one of the things I wanted to point out on the call was that, from notwithstanding the new debt related to the acquisition, we're very comfortable with our leverage. We had said, we wanted to be in that kind of 2.5 times leverage ratio or less. As we sit here today, on a pro forma basis, yeah, we feel good about that. We've got a business that's going to generate a significant amount of free cash flow and we're going to be opportunistic when we see a good value in the stock price.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Okay, very good. That's it for me. Thank you.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Great.

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

Thank you.

Operator: Our next question comes from David Katz with Jefferies. Please proceed with your question.

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

Good morning.

David Katz
Analyst, Jefferies LLC
Q

Hi. Good morning, everyone. How are you doing?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Good morning.

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

Great. How are you?

David Katz
Analyst, Jefferies LLC
Q

I wanted to just – you've covered a lot of information, and I appreciate all the detail. But I wanted to just go back to the cost synergy side and essentially, follow it up. Within that cost [Technical Difficulty] (39:48) identified, how much would you say of that is labor driven versus sort of other? I don't know how much procurement there would be, but what kinds of different categories, what have you done so far to get to that $100 million number? And I'm essentially just trying to figure out what's left to do, and where you'll be looking?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.
A

Sure. David, it's John. In the near-term, a lot of the synergies are going to be redundancies at the senior management level, right, as you integrate and put the businesses together. Remember, this will take time. The size of this acquisition and integration takes a significant amount of time over the next couple of years, as we work through the different layers of the organization. So, the things we did originally and due diligence, obviously, we didn't have all the detailed information, because we didn't own the company, yet. We went through and made high level estimates, right.

Now that we own the company and we're digging in deeper, we see plenty of opportunities, especially around things like centralizing activities, automating activities, consolidating IT applications to get to cost that – both from a overhead perspective become much cheaper to operate. So, it's really just a lot of the same areas, but as we've gotten into it, we're sharpening the pencil.

We also see longer term additional ways, but without – it's going to include more investment to continue to automate, invest in technology. And so, we'll continue to explore those things. But as you might imagine with an undertaking of this size, there's plenty of opportunities, we're more excited than ever about the long-term value we can create here, but it is going to take some time to get to it.

David Katz
Analyst, Jefferies LLC

Q

Got it. I appreciate that. And I suppose – this may be a bit of a generic question, so I'll apologies for it. But has anything surprised you so far either positively or negatively?

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

A

This is Steve. I would say, if anything it's been – we've been pleased with how things have gone. I think the receptiveness on both sides of the transaction to putting these businesses together have been – has been very good. There's always going to be – as you go through any kind of a reorganization, there's going to be some job eliminations and things like that. I think, for the most part people certainly understand what we've done and why, and I believe we've been very appropriate in terms of how we've looked at severance packages and things of that nature.

And again, as the more time we spend the more opportunity we see here going forward, and I don't believe that discovery process is over. I believe it's – we're probably in the maybe third-inning of a nine-inning ball game in that. So, as we continue to kind of peel back the onion and understand what's here and go from there. And I want to make sure that it's clear. We're looking at this as a two-way street. There are some things that have been done in the ILG business that we think are very good and things of best practices that we can apply to the Legacy-MVW business. So, it goes both directions, and I'm excited about that as well. So, I'm very bullish about where we are.

David Katz
Analyst, Jefferies LLC

Q

Got it. Thank you very much.

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

A

Thank you.

Operator: Our next question comes from Edward Engel with Macquarie Group. Please proceed with your question.

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

Hi, there.

Edward Engel
Analyst, Macquarie Capital (USA), Inc. Q

Hi. How's it going? Thank you for taking the question. Certainly a lot of moving parts, but I was just wondering if you have any sense of what maybe pro forma 2018, or even trailing 12 months adjusted free cash flow, or maybe just your run rate adjusted free cash flow, if we kind of give you full credit for the synergies, and then a full year of ILG, at least some sort of ballpark?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp. A

Yeah. Since we didn't own the business, we didn't really have a calculation, if you will, for the period we didn't own it. But you can go back and look at what they put out as their guidance, probably give you a ballpark as to what the business was supposed to deliver for the year. And obviously, when you look at what we put out for the revised guidance of $235 million to $245 million – excuse me, $255 million, a lot of that is upside in our business in terms of the Legacy-MVW.

I can tell you that, as we've managed down our capital spend for the four months and once again, some of this is just timing as I mentioned on the EBITDA side and the way the cash comes into the Legacy-ILG business, they have better free cash flow in the beginning portion of the year that corresponds with the business. So, while there is some pickup in our full year guidance for ILG for the four months we own it, most of the upside that you're seeing here is really related to our Legacy-MVW, just given the timing of their cash flows.

Edward Engel
Analyst, Macquarie Capital (USA), Inc. Q

Okay. That's helpful. And then, for 2019, should we expect the Legacy-ILG tour flow to maybe slow down, and then be offset by VPG? And if so, should that improve your margin outlook, at least their margin outlook?

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

Well, [Technical Difficulty] (45:52) means, I think you've deduced appropriately what will happen. There will be some tour volume that will go down from these kind of high cost, low yield channels. As we transition to the lower cost, higher yield channels, there may be some timing difference, but that's clearly the goal. I think that's the essence of your question, right?

Edward Engel
Analyst, Macquarie Capital (USA), Inc. Q

Yeah.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp. A

And there was a second part of it, as VPGs go up, that should equate to, yes, more efficient sales and better margin.

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

A

Yeah. Sorry, I didn't answer the second part.

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

A

Yeah. But to Steve's point, there will be – as we talked about, there will be a little bit of a transition, it's hard to model that out. We'll do everything we can to manage through that with this little impact as possible. But once again, if you think about it over the long-term, it's huge opportunity when you look at where their VPGs are today and our ability – and our proven ability to get better tours.

Obviously, we have access to all the Legacy – or I should say the Marriott relationships on the call transfer, the digital transfer linkage that the Legacy Vistana business because of our agreement with Marriott didn't have. So, once again, this is a huge acquisition and there's going to be integration, but over the long-term, it's huge opportunity as we put the businesses together and execute best practices across it.

Edward Engel
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. And then, sorry, just one last one, in regards to that VPG bridge that you broke out earlier. Of that delta, how much is just because they have a higher mix of new owners versus just, I guess, pricing or efficiency?

John E. Geller, Jr.
Executive Vice President and Chief Financial and Administrative Officer, Marriott Vacations Worldwide Corp.

A

Yeah. It's really – it's not that much on the mix of new owners. It's probably a little bit on that. It really just has to do with some of the tour sourcing that they do off-property stuff that once again, they were probably, I won't say forced to do, but had to do relative to not having access to the better and higher efficient Marriott channels that we had access to. So, it's really a lot of the sourcing and where they got their tours. There could be a little bit in there on the first-time buyer too, but I don't think that's meaningful.

Edward Engel
Analyst, Macquarie Capital (USA), Inc.

Q

Great. And thank you, guys.

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

A

Thank you.

Operator: Ladies and gentlemen, we've reached the end of the question-and-answer session. At this time, I'd like to turn the call back to Steve Weisz for closing comments.

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

Thank you very much, Rob. We're still very early in the integration. But what I've seen so far has me excited about what lies ahead. With Marriott Vacation Club, Sheraton Vacation Club, Westin Vacation Club, Grand Residences by Marriott, the Ritz-Carlton Destination Club, St. Regis Residence Club, and the Hyatt Residence Club, we have the best brands in Vacation Ownership and the best exchange company in the industry with Interval International. I look forward to what we can do as a combined company and updating you on our results and direction on future calls. And finally, to everyone on the call and your families, enjoy your next vacation.

Operator: This concludes today's conference. You may disconnect your lines at this time. And we thank you for your participation.