Corrected Transcript

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Marriott Vacations Worldwide Corp. (VAC)

Q4 2015 Earnings Call

CORPORATE PARTICIPANTS

Jeff Hansen
Vice President-Investor Relations

John E. Geller
Chief Financial Officer & Executive Vice President

Stephen P. Weisz
President, Chief Executive Officer & Director

OTHER PARTICIPANTS

Christopher Agnew
MKM Partners LLC

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Patrick Scholes
SunTrust Robinson Humphrey, Inc.

Steven Eric Kent
Goldman Sachs & Co.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to Marriott Vacations Worldwide Fourth Quarter 2015 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.

I would now like to turn the conference over to your host, Mr. Jeff Hansen, Vice President, Investor Relations. Thank you. You may begin.

Jeff Hansen
Vice President-Investor Relations

Thank you, Rob. And welcome to the Marriott Vacations Worldwide Fourth Quarter 2015 Earnings Conference Call. I am 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, February 25, 2016, 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 and the schedules attached to our press release, as well as the Investor Relations page on our website at ir.mvwc.com.

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

Stephen P. Weisz
President, Chief Executive Officer & Director

Thanks, Jeff. Good morning, everyone, and thank you for joining our fourth quarter earnings call. This morning I'll spend some time on our 2015 full year results, highlighted by our strong adjusted EBITDA, which was driven by continued improvements in our diverse lines of business. I will then take some time to discuss our expectations for 2016 before returning the call over to John to provide a more detailed review of our fourth quarter performance, after which we will open up the call for your questions.

Adjusted EBITDA exceeded our expectations, ending the year at nearly $236 million, $4 million above the high end of our guidance range, and $36 million over 2014. These bottom line results highlight the strength of our diverse business model, as our adjusted EBITDA growth was driven by improvements in our rental business and continued solid results from our management and ancillary businesses, as well as improvement in the second half of the year from higher financing propensity. Adjusted fully diluted EPS was $3.70, and adjusted free cash flow, which John will speak to in a moment was $229 million, both exceeding the high end of our guidance. The company adjusted development margin was 20.9%, just below the lower end of our range of 21% to 22%.

Timeshare contract sales were roughly flat year-over-year, improving just $1 million to $700 million in 2015, where growth in our North America segment was offset by lower sales, and our Europe segment, where we remain in sellout mode. In our North America segment, timeshare contract sales were $631 million, up $12 million or 1.9% in 2014. Tours in North America improved by 2.5% over 2014, while VPG remained strong at $3,386, in line with 2013.

Not unexpectedly, we continued to see softness in our Latin American sales channels in the fourth quarter, stemming from the continued strength of the U.S. dollar. However, excluding this impact, North America full year contracts with sales grew almost $25 million or 4.4% year-over-year.

As we stated at our investor day last May, our long-term strategy is to drive profitable contract sales growth. Since our spinoff, this has primarily resulted from significant growth in VPG, up over 35% since 2011, which helped drive our adjusted development margin percentage from 7% to roughly 21% during that same period.

While VPG is an important metric, it is not the only driver of contract sales growth. Going forward, we expect our contract sales growth will come from a combination of increasing tours at our existing sales centers and adding new sales locations and exciting new destinations, all while targeting a 21% or better development margin.

Regarding increasing tours at our existing sales locations, tour bookings or activations on the books for 2014 from our call transfer and Encore programs have increased substantially over 2015. We are continuing to ramp up these programs, and our pipeline of new tours continues to grow. In fact, we have seen over a 40% improvement in tour package production from these programs over the same time last year, including another 5,000 new tours in our pipeline since the end of the third quarter. The growth in our new tour programs, coupled with our in-house and linkage channels should continue to drive incremental tour production.

As our tour production grows, it is important to remember that our focus with these new programs, as well as our in-house and linkage channels is to generate more first-time buyers. As we've talked in the past, this puts pressure on VPG, as first-time buyers typically have a lower VPG than owner reloads. While we are always focused on optimizing VPG, as I stated a moment ago, the majority of our contract sales growth will come from increasing tour production through our new and existing sales channels, as well as from new destinations.

Now let me take a moment to update you on our progress as it relates to our strategy to open new destinations with strong on-site sales distribution. We announced in January that through a capital efficient arrangement with a third party we began managing The Strand Hotel in New York City, with a commitment to begin purchasing units in early 2018. This 176-unit property in Midtown Manhattan is an exciting new addition to our portfolio, and will include a new onsite sales distribution which we expect to open toward the middle of the year. Once stabilized, this location should be a significant contributor to our contract sales growth in the years to come. As you know, Manhattan has been a top target of ours for some time, and I'm thrilled that we were able to find this location to carry our name in one of the most sought after travel destinations in the world.

In addition, just last week we purchased The Edgewater Hotel, a 49-unit ocean front art-deco design property in the heart of South Beach for $23.5 million. While this location will undergo some renovation, with its relatively small size we felt purchasing and operating the property while renovations occur similar to that, with what we are doing in San Diego, minimizes our cost of carrying the asset until it is sold as vacation ownership. We currently expect sales to start at this location in late 2016 or early 2017, and will keep you updated as the year progresses.

We are well underway with preparations at our new property in San Diego and at the Mayflower in Washington, D.C. with the expectation of opening a sales center in each location midyear. On the big island of Hawaii, capital efficient arrangements are well advanced, relative to our commitment to purchase units at the Waikoloa Marriott. Assuming we meet our expectations of completing the transaction early this year, we are planning to open a sales center in the third quarter.

In our Asia Pacific segment, we expect sales to start by the end of March at our location in Surfers Paradise, Australia. Discussions for the sale of the remaining portion of the hotel are well underway, and we look forward to sharing good news on that front by the middle of the year. In addition, I'm very pleased to announce that we have commitments to add two new destinations in Nusa Dua, Bali. The first of these two turnkey acquisitions that will be developed by third parties includes 51 purpose-built units collocated with an existing Marriott Courtyard Hotel. It is expected to be constructed over the next 18 months with delivery of units by the middle of 2017. Our second resort includes 88 units to be collocated with a new Renaissance Hotel, which has recently broken ground with an anticipated completion date in 2019. We expect our Bali sales operation will open with the completion of the units at the Courtyard in mid-2017, and are looking forward to welcoming these new additions in Bali to our Asia Pacific portfolio.

Now let me take a moment to discuss our full year guidance, and also provide some insight around how we see 2016 unfolding. We expect significant improvement in contract sales as we get into the second half of the year, from a combination of tour arrivals which are already trending well ahead of last year and incremental growth from our six sales centers at the new destinations which I just discussed. For that reason, we expect full year contract sales growth of 4% to 8%.

Although we don't provide quarterly guidance, I want to point out that we expect our first quarter contract sales performance to be down compared to the prior year. This is due to several reasons, the first of which is a tough comparison stemming from the owner recognition level changes that drove a 10% increase in contract sales in the first quarter of last year. Additionally, we are still facing headwinds in our Latin America sales channels in several of these markets.

Shifting to the bottom line, we expect significant bottom line improvement in the second half of 2016, generating full year adjusted EBITDA between $261 million and $276 million. Similar to our pace of contract sales growth, we do expect the first quarter adjusted EBITDA performance to be down to prior year as well. This is anticipated due to the lower contract sales, the startup costs associated with our new sales centers, as well as roughly $2 million of favorable revenue reportability in the first quarter of last year. For these reasons, we would expect development margins to be down earlier in the year as well.

Looking back, in 2015 we delivered adjusted EBITDA above our guidance range, even while facing a challenging contract sales environment. More importantly, looking ahead to 2016, we are executing our strategy to grow our top line sales as activations of our tour packages are up significantly and new sales centers begin coming online in March. I am confident that we can deliver even stronger results this year from top line growth, as well as continued contributions from our diverse lines of business. I look forward to reporting on our progress throughout the year.

With that, I'll turn the call over to John to provide a more detailed look at our 2015 results, and the outlook for 2016. John?

John E. Geller

Chief Financial Officer & Executive Vice President

Thank you, Steve, and good morning, everyone. I am pleased with our strong performance in the fourth quarter. Adjusted EBITDA totaled $69 million, $20 million higher than the fourth quarter of 2014. North America adjusted development margin was 22.1% and company adjusted development margin was 20.1%. And all of our business lines contributed to our year-over-year adjusted EBITDA growth this quarter. Our rental business continued to outperform, growing $12 million. Our development business contributed $5 million, benefiting as expected from the turnaround of the unfavorable third quarter revenue reportability. Our resort management business improved nearly $4 million, and while modest, our financing business also contributed to year-over-year growth for the first time since we spun off from Marriott International.

Turning to our North America segment, timeshare contract sales totaled $182 million, down 2% from the fourth quarter of last year. As Steve discussed, a strong U.S. dollar continued to unfavorably impact our sales, primarily in our Latin American sales channels. Excluding this impact, North America contract sales were up 1.4% in the quarter.

Tours in the fourth quarter were up 4.5%. VPG totaled $3,162, down 2.9% from the fourth quarter of 2014. In an effort to mitigate the impact to sales of the strong U.S. dollar in the fourth quarter, we ran a short-term marketing campaign during the fourth quarter that provided incremental incentives for in-house guests in North America to take a tour. While successful in driving increased tour volumes and contract sales, short-term programs like this do come with the risk of being less efficient and negatively impacting VPG, which is exactly what we experienced this past quarter.

North America adjusted development margin in the fourth quarter was $37 million. Fourth quarter adjusted development margin percentage was once again strong at 22.1%. These results reflected a 130 basis point reduction in our timeshare product cost driven by the continued success of our inventory repurchase program. As it relates to our marketing and sales cost, we saw a 270 basis point increase over the fourth quarter of last year. As we've discussed throughout the year, we've been ramping up our investment in new programs to help generate future incremental tour volumes, particularly as it relates to new buyer tours.

As Steve discussed, our pipeline of future tours continues to increase significantly, adding another 5,000 tour packages just since the end of the third quarter, and tour activations, the actual booking of the tour, had increased significantly as well. In the Company's financing business, revenues, net of related of expenses was $22.6 million, up slightly from the fourth quarter of last year. As you know, in the second quarter of 2015, we implemented a program to help drive increased financing propensity, and this program has continued to prove very successful. In fact, our North America propensity reached 56% in the fourth quarter, a full 13 percentage points or 30% higher than the fourth quarter of 2014. With our gross notes receivable balance increasing from these higher propensity levels, we expect to continue to see year-over-year growth in our financing business going forward.

Shifting to our rental business, excluding the results of operations for the portion of the Surfers Paradise Hotel that we expect to sell, total company rental revenues were up over $10 million. This was primarily driven by a 4% increase in transient rate, a 2% increase in transient keys rented, $4.4 million from higher revenue associated with operating hotels that we intend to convert to timeshare and higher plus points revenue. Rent true up produced net of expenses remained strong, totaling $13.6 million in the quarter, an increase of nearly $12 million year-over-year.

While results reflected the impact of the higher revenues, our rental margin also benefited over the fourth quarter of 2014 from lower Marriott rewards cost related to our pre-spin liability. In 2014, we recorded a charge of nearly $4 million due to higher redemption cost. However, with overall redemption cost declining throughout 2015, the fourth quarter of 2015 benefited from a favorable true up of roughly $2 million, driving a $6 million year-over-year benefit. As I will discuss in a moment, we repaid our remaining pre-spin Marriott rewards liability at the end of the year. So the puts and takes related to this liability are now behind us.

In our resort management and other services business, excluding the results of operations for the portion of the Surfers Paradise Hotel that we expect to sell, Company results improved $3.7 million in the fourth quarter to $34.4 million. Results reflected higher ancillary profits as well as higher fees for managing our portfolio of resorts and improved exchanged company activity.

In our Asia Pacific and Europe segments, total adjusted results were $6.7 million, up almost $1 million from the prior-year fourth quarter. I share Steve's excitement with the great strides we are making in growing our Asia Pacific portfolio, as we expect new sales distributions will drive strong contract sales growth. And in Europe, we remain focused on our strategy since the spin to sell through our remaining developer inventory as efficiently as possible.

Turning to our cash flow, we generated $229 million of adjusted free cash flow in 2015, $29 million higher than the top end of our guidance, as we were able to defer roughly $35 million of development spending to 2016. The $229 million of adjusted free cash flow excludes the final $66 million payment for our pre-spin Marriott Rewards liability that we accelerated into December of 2015. I should point out that we will continue to leverage the Marriott Rewards Program. Note however, that subsequent to the spin off, we paid Marriott International for rewards points at the time of issuance, which does not require future adjustment for actual redemption cost.

Turning to our return of capital to shareholders, we returned roughly $225 million in 2015, over $201 million of which is related to share repurchase activity, while the remainder related to our dividend payments. In the fourth quarter of 2015, we repurchased nearly 1.6 million shares and repurchased an additional 900,000 shares through yesterday for $45.6 million. Based on our current rate of repurchases and our confidence in the strength of our share buyback program, we announced on February 12 that our Board of Directors increased our share repurchase authorization by an additional 2 million shares, bringing our current remaining authorization to 3.1 million shares.

Shifting to our balance sheet, at the end of the year, cash and cash equivalents totaled $179 million, and we had approximately $110 million of gross vacation ownership notes receivable eligible for securitization at our warehouse credit facility. The Company's total gross debt outstanding decreased $23 million from the end of 2014 to $688 million, all but roughly $3 million of which is non-recourse debt associated with securitized notes. In addition, $40 million of mandatorily redeemable preferred stock remains outstanding, which we have the option to redeem beginning in October of this year. And based on the strength of our balance sheet, S&P upgraded us to a double B plus credit rating in December of 2015.

Before I get to the outlook for 2016, I want to highlight a change we are making to our adjusted EBITDA calculation. Beginning in 2016, we will also adjust for the impact of noncash share-based compensation expense, given that companies use share-based payment awards differently, both in the type and the quantity of awards granted. While this adjustment does not have a significant impact on our year-over-year adjusted EBITDA growth, it will align our calculation to be consistent with other lodging and timeshare companies who also exclude these noncash costs.

Looking ahead to 2016, as Steve mentioned, notwithstanding some of the challenges related to the stronger U.S. dollar and the other uncertain market conditions which are likely to continue this year, we remain confident that we will achieve our strategy, given the strength of our products and the new sales distributions that will be coming online later this year. With that said, we expect to achieve between $261 million and $276 million of adjusted EBITDA, which at the midpoint of this range reflects nearly a 7.5% increase over 2015's adjusted EBITDA on a comparable basis. We expect this growth to be driven by higher top line revenue from a 4% to 8% increase in contract sales coming from growth in same store volumes as well as from incremental sales from our new distributions. These new distributions will drive incremental sales beginning this year. However, recognize that there is a multi-year ramp up period until sales volumes from these locations are stabilized.

As it relates to development margin, we are targeting margins of 21% or better, similar to 2015. We expect product costs will continue to remain low, potentially down one to two additional percentage points from 2015 to below 27%, driven mainly from the continued success of our inventory repurchase program. We expect these lower product costs to more than offset higher marketing and sales spending associated with the ramp-up of our new sales distributions, which could negatively impact margins by over one percentage point in 2016, as well as higher costs related to the new marketing programs to drive incremental tour volumes.

Shifting to other lines of business, in our rental business, we expect to see year-over-year growth, however, not at the pace we've seen the past few years. While we will have incremental keys for rent, with our new properties coming online, a high percentage will be dedicated to preview rooms in support of driving incremental contract sales volumes on site.

Resort management will continue to grow from higher management fees and increased ancillary and exchange company activity and, as we saw in the fourth quarter of 2015, we expect our financing business to continue to growth year-over-year as we drive higher contract sales volumes and benefit from higher overall financing propensity levels. We expect adjusted free cash flow of between $135 million and $155 million. While slightly below normalized levels, recall that this range reflects approximately $35 million of development capital spending deferred from 2015, and as we've done in the past, we will continue to evaluate all of our capital needs as we progress through the year with the intent of delaying spending where possible.

We expect inventory levels to remain relatively flat through 2016, even after including the inventory spend deferred from 2015. This assumes that we will complete our Waikoloa transaction on a capital efficient basis, thereby deferring our capital investment. We will continue to report on progress throughout the year.

Lastly, while it will not be included in our adjusted free cash flow results, we anticipate selling the [ph] Downside (24:27) Surfers Paradise Hotel along with the bulk sale of the remaining units at our Ritz-Carlton Club and Residences in San Francisco later in the year. We expect this activity could generate an additional $60 million to $70 million of cash flow.

Turning to investment activities, we expect $36 million of other capital spending in 2016, roughly $15 million higher than our normalized spending, as we have new sales centers coming online this year as well as incremental spend for new technology. Regarding the technology spending, we are excited about these upcoming enhancements to our owner facing technology, as our increased investment in 2016 and 2017 will allow us to improve our owner experience and update our current web platforms.

We are proud of what we've accomplished over the last several years and are optimistic about the future. While we, like many others, continue to be faced with uncertain economic conditions, we maintain confidence in our products, our business model and our ability to deliver against our strategic goals.

I look forward to 2016, as we continue to grow our business model, and also look forward to sharing our accomplishments with you throughout the year. As always, we appreciate your interest in Marriott Vacations Worldwide.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] Our first question comes from Christopher Agnew with MKM Partners. Please proceed with your question.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Good morning, Chris.

John E. Geller
Chief Financial Officer & Executive Vice President

A

Hi, Chris.

Christopher Agnew
MKM Partners LLC

Q

Thanks very much. Good morning. First question, what's your appetite in the near term for additional locations in gateway cities? And maybe give us some idea of the opportunities you have. I'm wondering, would you look for additional locations in New York, and given the weaker performance of hotels and increased supply, is there maybe more opportunities presenting themselves to [ph] convert (26:51) into timeshare. Thank you.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Yeah. Let's kind of step back and think about the points model in general. We believe that there is advantage to having more flags in more cities, instead of having multiple flags in the same city. Having said that, under the right set of circumstances, conditions, financial arrangements, et cetera, if there was another right opportunity in New York as the example you used, we would certainly give it serious consideration. But by and large, I mean – we'd rather fly the flag someplace where we don't have a presence today which are well defined, well demanded vacation destinations.

Christopher Agnew
MKM Partners LLC

Q

Got it. Thanks. And maybe a couple of little detail model questions. When do you start lapping Latin American weakness? Should we expect that to be a headwind through the first quarter? Given that you're ramping some of these south locations, I think midyear, third quarter, should we expect the tour flow to be a little bit back-end loaded as those bring on additional tour flow? And then finally, when do you anticipate selling through in Europe?

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Okay. I'll – the Latin American piece; if you look at what – the currency fluctuation charts that happened in Latin America, largely the biggest impact was – started in Q3. So I would say, Q1 and Q2 will probably still be tough comparisons from that standpoint, assuming there's no meaningful change in the FX difference between ourselves and Latin America. As far as tour flow, I'm sorry, I lost the question there.

Christopher Agnew
MKM Partners LLC

Q

Just give...

John E. Geller
Chief Financial Officer & Executive Vice President

A

The tour flow, the timing is – I think, you kind of answered it.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Yes, two things. Number one, yes, I would say it's more towards the second half of the year than the first, for two reasons. Number one, as we've been activating these tour packages that we talked about, they seem to be skewing more towards the second half of the year than the first half of the year. Part of that, to be honest with you, is based somewhat on availability. Many of our resorts in the first half of the year are pretty full. So finding availability to house those tour packages is a little tougher. So it's more in the second half. And then, of course, as we have new sales centers coming online, that's when additional tours will be coming through the system.

John E. Geller
Chief Financial Officer & Executive Vice President

A

And then the final question, just on Europe and the wind down, I'll grab that real quick. We're getting close to selling out of our developed – the remaining developed inventory here over the next – call it a year to 18 months, maybe two years. But remember, we'll always have a resale program over there. We'll have a great management business with the resorts that we have. So it just – you'll continue to see our contract sales to come down, and then they'll kind of normalize once we get into that resale program of existing weeks.

Christopher Agnew
MKM Partners LLC

Q

Thanks. Maybe one follow-up. With the new sales centers, is there anything to bear in mind in terms of mix impact on VPG, whether it's closing efficiency or just the selling amount? Thanks.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Well, clearly as you bring on new sales centers, almost by definition you're going to get more first-time buyers. As we've discussed in the past, first-time buyers typically have a slightly lower VPG, although when you take everything through the sausage grinder in terms of the profitability of the business, a first-time buyer is every bit as valuable to us over the long-term as it is – an existing customer. So yes, as those sales centers come online, I would expect to see some continuing pressure in VPG. It's one of the reasons why I mentioned the fact that while heretofore, much of our improvement in development margin has been the result of improving VPG, the reality is as we go forward, it'll probably be less so VPG-driven, but more so by virtue of increasing tours and new sites.

Christopher Agnew
MKM Partners LLC
Q

Great. Thank you.

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

Thank you.

John E. Geller
Chief Financial Officer & Executive Vice President
A

Thanks.

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

Patrick Scholes
SunTrust Robinson Humphrey, Inc.
Q

Hi. Good morning.

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

Good morning, Patrick.

Patrick Scholes
SunTrust Robinson Humphrey, Inc.
Q

Good morning. First question, can you give a little bit more color on how your South American international customers did? Recall, obviously it was an issue in the previous quarter. Any noticeable changes in propensity to buy your product from them in the most recent quarter?

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

Yes, go ahead.

John E. Geller
Chief Financial Officer & Executive Vice President
A

Yes, I was just going to say I think – obviously, we were still down on that front year-over-year. I think the trends that we're seeing, Patrick in the third quarter, fourth quarter, then kind of moving into the first quarter this year is that we're down less. The trends are kind of going the right direction. We're still down significantly, but not as much year-over-year when you look at it that way. As Steve mentioned earlier that, we'll lap that year at the end of the second quarter. And the reality is, if you look at what the major currencies in Latin have done really sine the second quarter, beginning of the third quarter last year, they haven't dramatically improved. So as I think we had mentioned in the past, it becomes a little bit of the new normal in terms of that if – so, we're starting to see that a little bit at least in terms of some of the moderated decline, but it will continue to be a headwind through the end of the second quarter and then we're lapping some of that down.

Patrick Scholes
SunTrust Robinson Humphrey, Inc.

Q

Okay. Okay. And then on the Miami deal, which appears to be downsized from the previous property; did that – did you take into account sort of weakness in the South American customer in this new deal?

John E. Geller
Chief Financial Officer & Executive Vice President

A

That was not the primary driver of us making a shift. When – we had a commitment to purchase units at the larger project in South Beach that was subject to certain conditions. And when those conditions weren't met, we decided not to proceed and terminated the contract with no financial liability to us as a result of that. When we found this 49-unit property at the Edgewater with its great location, in addition to being an art deco project, et cetera, we decided that that was an acceptable alternative. Clearly, the Latin customer, we believe over time that this will rebound, but that was not the driving force to effectively downsize our presence in Miami.

Patrick Scholes
SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you for the color. That's all.

John E. Geller
Chief Financial Officer & Executive Vice President

A

Thank you.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Thanks.

Operator: Our next question is from Ben Chaiken with Credit Suisse. Please proceed with your question.

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

Hey, guys.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Hi, Ben.

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

Again, you mentioned down less impact from the LatAm customers. Is that consistent with what you've seen in the past basically outside of lapping easy comps – not easy comps, but lapping comps in 2H? When you look at previous movements in FX, is there a dynamic where the sticker shock wears off?

John E. Geller
Chief Financial Officer & Executive Vice President

A

Yes. I mean, obviously, the sticker shock we experienced here this past year is – from a historical perspective probably significantly higher than anything we've seen before. There's always fluctuations obviously in those currencies in Latin and exactly what you said, what typically happens is even if there's not a rebound in the currency, we're obviously targeting a consumer down there that meets our target market in terms of average household income, things like that. Those consumers like to travel, and over time if they want to continue to travel and do stuff, they've got to get their head around what the foreign currency translation looks like.

And so that's what we're really starting to see, a little bit of that in terms of it's now been almost three quarters, two-and-a-half quarters and there hasn't been much improvement. So the Latin's still down significantly, but it's starting to be down less here as we've seen it over the last couple quarters.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Ben, I'd add one other thing. Unlike where we used to be when we were selling a weeks-based product, selling a points-based product, you can – the purchaser can modulate how much money they want to put out of their pocket at any given point in time. So they might not purchase a full week's worth of vacation points. They could actually buy four or five days to help mitigate some of that impact. And then they can add some points later. So there's other advantages there, but I agree with John's point.

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

That's helpful. And then on the call you mentioned the lower margins from increased sales and marketing. Was that on a net basis? Because you also made a comment that it'd be a positive impact from lower product cost. I'm just trying to figure out is that..

John E. Geller
Chief Financial Officer & Executive Vice President

A

Yes. Net-net, we expect to kind of stay where we finished up 2015, which is – call it a 21% or better development margin is our target. So in 2016 it'll come from a little bit different places, is all we were pointing out. Our product cost continues to trend down, and so we expect that the better product cost we'll experience in 2016 – quite frankly I think those trends in product cost are staying lower should last for even past 2016 based on what we're seeing. And in the near term that will help offset some of the pre-opening costs we talked about. That's probably about a 1% headwind relative to 2015, just because you've got all these new sales centers that you have to get up and running, and you're expensing all those costs before you make your first sale. And then in addition, as we ramp up some of these tour packages, you could have some higher marketing and sales costs here in the near term, but net-net we expect that the product cost should offset or maybe even be a little bit more favorable back the other way.

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

That's helpful. And then I could have missed it, but do you guys provide a North American tour flow growth, excluding LATAM?

John E. Geller
Chief Financial Officer & Executive Vice President

A

No. We haven't.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

We haven't.

John E. Geller
Chief Financial Officer & Executive Vice President

A

We haven't historically provided any specific tour flow metrics.

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

And I assume you can't now?

John E. Geller
Chief Financial Officer & Executive Vice President

A

Yeah. We're not...

Ben N. Chaiken
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay All right. Thank you. Thanks a lot.

John E. Geller
Chief Financial Officer & Executive Vice President

A

Yes.

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Thank you.

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

Stephen P. Weisz
President, Chief Executive Officer & Director

A

Hi, Steve.

Steven Eric Kent
Goldman Sachs & Co.

Q

Hi. Good morning.

John E. Geller
Chief Financial Officer & Executive Vice President
A

Good morning.

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

Good morning.

Steven Eric Kent
Goldman Sachs & Co.
Q

I've got a couple questions for you. First, what's – I don't know if you mentioned it – what's the split between new and existing owners now? And where would you think they would be in let's say two years? Also just on that same theme, you said that there's a pickup in people taking financing. But are they also increasing the amount of the loan; meaning maybe they're putting a lower deposit down, and that's a way to facilitate some of these new customers to decide to buy timeshare for the very first time? And then just on an accounting issue, are you able to book sales from these new sales centers right away? Would they be deeded at that location or at another? I just want to understand how that's going to work.

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

All right, Steve. I'll take the first one, and I'm going to let John take the other two.

Steven Eric Kent
Goldman Sachs & Co.
Q

Okay.

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

On the first-time buyers versus existing customers, you've heard us say in the past that historically as a Company we've been roughly 50/50 mix of first-time buyers and existing customers. As 2008, 2009, 2010, 2011 rolled around, that number got to be 40% first-time buyers and 60% existing customers. We have said that we aspire to get back towards that 50/50 number. Exactly when that will happen, whether that will be in two years or three years or four years, I can't tell you, except to say that that is our goal. And the reason for that is – why do we want more first-time buyers? Obviously first-time buyers do a number of different things for us. A, they have a tendency to over time add more ownership during the course of their time. Secondly, they bring a new set of referrals to us that we have not heretofore seen, and we get another management fee, another exchange company fee, as a result of all that. And they have a slightly higher propensity to finance their purchase, which we make money off of financing.

What happened in 2015 was a little bit of a pleasant surprise to us, when we rolled out our new owner recognition levels in the first quarter of last year. The take-up rate from our existing owners was meaningful, driving that 10% increase in contract sales on a quarter-over-quarter basis, 2015 versus 2014. As a result, it kind of skewed that existing customer versus first-time buyer number by call it a point, point-and-a-half; something like that. So when you get all up to the end of the year, we didn't make as much progress in 2015 as to changing the mix of first-time buyers and existing customers. I'd say we moved it by maybe a point-and-a-half, two points. But we certainly have every intention and aspiration to do so further in the coming years.

John E. Geller
Chief Financial Officer & Executive Vice President

A

Great, and then on the financing side, Steve, a of couple things. Yes, we haven't changed any of our down payment requirements and we've never really increased our down payment requirements. We require kind of that minimum 10% of the purchase price. Some of our customers decide to put a little bit more down than that, but if you think about our default rates, I would argue we have probably the lowest default rates in the industry or pretty darn close. We've got great customers, and actually what you're seeing with the higher financing propensity and it's a little bit counterintuitive, you're actually seeing FICO scores go up.

So we've seen an average of about 9 to 10-point improvement in our average FICO score since we started this program, but what you're actually seeing is folks that might not have otherwise taken the financing are deciding to finance, and they actually have higher FICO scores than I think kind of where you were going – are we kind of loosening up our underwriting standards. We haven't changed those at all. And then on the sales accounting side, remember, we sell a points based product here in North America, and it's a Florida-based land trust. So people aren't buying deeded weeks at a specific property, they're buying a beneficial interest in all the properties in the trust. So what we're selling is the inventory that's in the trust.

When we announce these deals, they don't go into the trust immediately, and in the case of places like New York, we won't actually get that into the trust until call it a 2018-2019 timeframe, the first piece of that inventory. However, through our exchange company, that inventory will be available to owners on an exchange basis. So while it won't actually be owned by the trust for some period of time, the owners will have access to it until it actually gets deeded in there and sold through the trust. So that's the nice thing about our capital efficient model and how we source inventory is we're not selling that site specific, so we can open these new sale centers and we sell the portfolio.

Steven Eric Kent
Goldman Sachs & Co.

Q

Okay. Thank you.

John E. Geller
Chief Financial Officer & Executive Vice President

A

Thank you.

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

Stephen P. Weisz
President, Chief Executive Officer & Director

Thank you, Rob. I hope you're as pleased as we are with our 2015 results and your take away today is that we are executing our plan and are excited about what 2016 holds for our owners and for our shareholders. Thank you for your participation on our call today and your continuing interest in Marriott Vacations Worldwide. And finally to everyone on the call and your families, enjoy your next vacation. Thank you.

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