

Marriott Vacations Worldwide Corporation
Fourth Quarter 2020 Earnings Call
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Presenters

Stephen P. Weisz, CEO
John E. Geller, Jr., CFO
Neal Goldner, Investor Relations

Q&A Participants

David Katz – Jefferies
Patrick Scholes – Truist Securities
Jared Shojaian - Wolfe Research
Ben Chaiken - Credit Suisse
Brandt Montour - JP Morgan

Operator

Greetings, and welcome to Marriott Vacations Worldwide Fourth Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero, on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Neal Goldner. Thank you. You may begin.

Neal Goldner

Thank you, Rob, and welcome to the Marriott Vacations Worldwide fourth quarter 2020 earnings call. I am joined today by Steve Weisz, Chief Executive Officer, and John Geller, President and Chief Financial Officer. I need to remind everyone that many of our comments today are not historical facts and are considered forward-looking statements under the 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 last night and the presentation we added to our website this morning, as well as our comments on this call, are effective only when made 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 of our website at ir.mvwc.com.

It's now my pleasure to turn the call over to our CEO, Steve Weisz.

Stephen P. Weisz

Thanks, Neal. Good morning, everyone, and thank you for joining our fourth quarter call. Before we get started, I'd appreciate it if you would indulge me for a moment to reflect on the passing of Arne Sorenson last week. As many of you have noted, Arne was an outstanding businessperson with a keen understanding of not only where to take Marriott International but also what the future looked like for the hospitality industry.

I think it goes without saying that leaders with a combination of outstanding intellect, coupled with a passion for the business and a true ability to relate to associates at all levels of the company, are not easy to come by. Bill Marriott once again showed our industry his wisdom in selecting Arne to be the only person to be CEO that did not have Marriott as a last name. And he chose wisely.

But, I'd like to take just a moment to reflect on Arne the person. I had the good pleasure to be able to work as both a colleague of Arne's as well as having him as a boss for a short period of time before a spin-off in 2011. Not only was Arne a good friend of mine, but he was a good friend of our business. His unique understanding of the timeshare business and the connectedness that it had with the core lodging business helped to frame his recommendation to create two separate public companies as a way to unlock considerable value for the Marriott shareholders.

Now, almost 10 years later, I believe that history has shown that to be an outstanding decision for the shareholders of both of our companies. I ask you to join me and all the members of our team here at Marriott Vacations Worldwide when I say, thank you, Arne, God speed. You will be missed but surely not forgotten. Thank you for allowing me the opportunity to express my thoughts, and now I'll proceed onto our call.

What a difference a year makes. It was just one year ago when we reported double-digit fourth quarter year-over-year contract sales growth, and we were talking about the resiliency of our business model. One month later, we closed all of our sales centers and recommended that owners not come to our resorts due to the pandemic, even going so far as to cancel transient rental bookings.

But once government restrictions started to lift, occupancies quickly returned, beginning first in our drive-to markets, but expanding as the year went on, illustrating timeshare owners' desire to get back on vacation. As a result, we ended the fourth quarter at nearly 70 percent North America occupancy.

Our higher margin resort management, financing, and exchange membership businesses proved their resiliency last year, with that revenue declining only 2 percent, despite the global pandemic. We also ended the year with more liquidity than we had at the end of the second quarter, further illustrating the strength of our leisure-focused business model.

Sitting here today, I'm extremely optimistic about the continued recovery in our business. Occupancies in a number of our drive-to and fly markets are holding up well, and as more and more people get vaccinated, I expect some of the pent-up demand to continue to manifest itself. In fact, reservations on the books for the second half of the year are currently 8 percent higher than they were at the same time in 2019. So, while the recovery most likely won't be linear, and government actions could cause it in some markets, I do expect our business to continue to improve as we move throughout the year.

We announced in January the pending acquisition of Welk Resorts, one of the largest remaining independent timeshare operators, which we expect to close early in the second quarter. Welk operates a portfolio of eight upper upscale vacation ownership resorts primarily on the West Coast, with approximately 1,400 keys, more than 55,000 owners, and over 3 years of built inventory.

These resorts will be a great addition to our portfolio, and we intend to rebrand all of the Welk resorts as Hyatt Residence Club once we've obtained the necessary approvals. This will dramatically increase our Hyatt footprint, while providing us substantial future growth opportunities. Through a combination of margin improvement and sales growth, we expect the acquisition to generate between \$60 million and \$70 million in adjusted EBITDA by 2024, if not sooner, making this both a very attractive financial transaction as well as a great strategic one.

So, let's talk about our fourth quarter results, starting with our vacation ownership business. While 2020 was certainly challenging for the entire travel and hospitality industry, being completely leisure focused was certainly a better segment to be in. And being in the timeshare business with our much larger square footage units and amenities, coupled with the prepaid nature of our offering, was clearly a more attractive option for our owners and guests, as evidenced by our strong occupancies in many of our locations.

To give you a few examples, occupancy at our Florida beach resorts averaged in the mid-70 percent range during the quarter, including nearly 80 percent for the month of December. Our South Carolina resorts ran in the low 70 percent occupancy range during the quarter, our Colorado and Park City Mountain resorts averaged nearly 75 percent occupancy, and our Aruba resorts ran over 60 percent in November and December, while our U.S. Virgin Island resorts ran over 70 percent during the quarter.

Even some of our larger markets that had previously lagged the recovery continued to improve during the quarter. For example, Orlando, which represents more than 20 percent of our North America keys, averaged about 50 percent occupancy during the quarter, roughly double the

occupancy we ran in Quarter 3, including nearly 70 percent during the holiday break. Hawaii, which ran low single-digit occupancies in the third quarter, lifted its restrictions on October 15 and averaged nearly 50 percent occupancy during the fourth quarter, excluding Kauai, where the 14-day quarantine restrictions were re-instituted in early December.

VPGs were again very strong during the quarter, including 9 percent year-over-year growth, and North America VPG was up 17 percent, excluding Hawaii. We continue to benefit from a higher mix of existing owners as well as higher promotional activity. As a result, we increased contract sales by 27 percent sequentially from the third quarter, despite the increased government restrictions in California and Kauai in December.

Within the other parts of our vacation ownership business, our stickier management fees delivered 3 percent year-over-year revenue growth in the quarter. Our financing revenue declined slightly on a year-over-year basis in the quarter, despite significantly lower contract sales, reflecting the recurring nature of this high-margin revenue stream.

And rental revenue grew 29 percent sequentially in the third quarter, reflecting the broader travel recovery. Our Interval International business also continued its recovery during the fourth quarter, with interval exchange transactions increasing 17 percent on a year-over-year basis, reflecting members' desire to travel--as well as from pent-up demand.

Before turning the call over to John, I want to talk about synergies. As you might remember, we increased our synergy target to at least \$200 million back in November. These are permanent savings that will not return with volume and will help us drive substantial margin improvement going forward. We made a lot of progress in the fourth quarter, and by the end of 2020, approximately \$135 million of these synergies have been achieved on a run rate basis, getting us closer to our target.

So, let's talk about where we go from here. In late January, we reopened the California sales centers that we closed in December, so that still leaves Kauai and a handful of smaller sales centers that haven't reopened yet. But with most of our major locations up and running, we expect to continue to grow contract sales sequentially in the first quarter.

We ended the year with a tour pipeline of more than 165,000 sold packages, with more than 30 percent of those already activated. That means more than 50,000 customers have already booked their vacation and related tour for 2021, and we expect that number to grow as the year progresses. We're also ramping up our package pipeline engine after curtailing it last year, which will add future tours. We were very pleased with the sequential recovery at interval last year, with exchange transactions growing nicely in the second half of the year.

One of Interval's corporate customers has decided not to renew its affiliation going forward, choosing only to offer its owners' membership in its own internal exchange program instead. It's important to note that only a portion of these 165,000 members are active Interval users,

and we have been marketing to them since mid-last year. We've already retained a high percentage of those who have been active users, reflecting the breadth of Interval's offering. So, we expect the bottom-line impact on our business going forward will be largely immaterial.

Finally, a recent survey showed that one-third of American travelers have begun planning and booking trips specifically in anticipation of vaccines being available. Searches on the Marriott Vacation Club Owner website show a rising interest in getting back on vacation, with January searches for key words, such as "book" and "make a reservation", four times higher than the prior year, with a clear sign of increased demand for Orlando.

However, more than half of the people we've surveyed have also stated they will not travel until they get their vaccination. That's reflected on our first quarter bookings, which currently are holding below where they were last year. But looking further out, we have more reservations on the books for the second half of this year than at the same time in 2019, illustrating the pent-up demand for travel.

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

John E. Geller, Jr.

Thanks, Steve, and good morning, everyone. Today, I'm going to review our fourth quarter results, the recovery we've continued to experience across our business, the status of our synergy initiatives, and the overall strength of our balance sheet and liquidity position.

Our fourth quarter results reflect a strong sequential improvement from the third quarter, illustrating the resiliency of our business, with resort occupancies, contract sales, and exchange transactions all improving. As a result, we reported \$72 million of adjusted EBITDA for the fourth quarter, more than doubling our third quarter results, once again demonstrating the strength of our leisure-focused business model.

Looking first at our vacation ownership business, with the continued improvement in occupancies, contract sales improved 27 percent sequentially. We also saw a significant improvement in our development profit this quarter, with adjusted development margin increasing to \$14 million, compared to just \$6 million in the third quarter. And our stickier resort management and financing businesses again provided a strong contribution to our bottom line.

As a result, our vacation ownership segment delivered \$73 million of adjusted EBITDA in the quarter, a significant improvement from the \$28 million we reported in the third quarter. Our resort management business generated \$58 million of profit in the quarter, 10 percent lower than the prior year, due to reduced ancillary revenue resulting from lower year-over-year occupancies and limited operations at many of our outlets.

We did, however, see a 3 percent increase in our stickier high-margin management fee revenues. As I've mentioned in the past, the majority of the financing revenue we generate in any given year comes from prior year note originations. So even with lower contract sales, our financing business delivered \$39 million of profit in the quarter, only a \$1 million decline from the prior year, reflecting the stickier nature of this revenue stream and the benefits of our synergy and cost-saving initiatives.

We have continued to work closely with the owners who have temporarily lost their income due to the virus, deferring loan payments where we can. By the end of the quarter, roughly 1.5 percent of our borrowers had taken advantage of this program, speaking to the creditworthiness of our owners. In addition, more than 40 percent of these borrowers who had a payment due by the end of the quarter had made it.

We now expect to experience a slightly higher COVID-related default than we estimated back in Q1 and took a \$13 million net charge this quarter to increase our notes receivable reserve. Similar to our treatment in May, we have excluded this charge for adjusted EBITDA purposes. The great news is that by the end of the year, delinquency rates at all of our brands were in line with 2019 levels, and we've continued to see both sequential and year-over-year improvement thus far in 2021.

Finally, our rental business has also continued to improve. Transient keys rented were up 34 percent versus the third quarter, reflecting improved occupancies. Similarly, rate improved 1 percent from the third quarter. As a result, while our rental business generated a \$24 million loss in the fourth quarter, that represented more than a 40 percent sequential improvement.

Turning to the exchange and third-party management segment, exchange transactions at our Interval business were up 17 percent in the fourth quarter, compared to the prior year. Average revenue per member was down nearly 5 percent, primarily due to a decline in getaway rentals in other travel-related services. As a result, adjusted EBITDA was \$28 million in the fourth quarter, with margins in line with prior year, despite lower revenues, reflecting the benefit of our cost-saving initiatives.

G&A expense declined \$27 million, a 45 percent improvement from the prior year. We achieved this primarily through a combination of synergy savings, lower costs associated with furlough and reduced work week programs, lower overall spending across the business on technology, travel, and training, and \$4 million of savings due to the CARES Act retention tax credit we received in the quarter.

Moving to the balance sheet, our liquidity increased by roughly \$60 million in the second half of last year. We ended the year with nearly \$1.3 billion in liquidity, including \$524 million of unrestricted cash, \$147 million of gross notes receivable that were eligible for securitization, and \$597 million of availability under our revolving credit facility. We had \$4.3 billion in debt

outstanding at the end of the year, including \$2.7 billion of corporate debt and \$1.6 billion of non-recourse debt related to our securitized notes receivable.

Earlier this year, we issued \$575 million of zero percent convertible notes due 2026, reflecting the strong demand from investors. We used part of the proceeds to enter into a call spread transaction, increasing the conversion price to roughly \$214 per share, 70 percent higher than our stock price on the day we priced the offering. We plan to use a portion of the net proceeds to finance the Welk transaction, and we also used \$100 million of proceeds to pay down a portion of our term loan.

We still have no corporate debt maturities until September of 2022, which is our 2017 convertible notes, and that's only \$230 million. Given the uncertainty and the timing of the recovery, we also extended the suspension of our financial maintenance covenant and our revolving credit facility through the end of this year.

Before I move to 2021, let me touch briefly on our \$200 million-plus synergy goal. While the pandemic did cause us to temporarily pause some of the work on these initiatives, we made very good progress throughout the year. As Steve mentioned, by the end of 2020, our run rate savings was approximately \$135 million, of which roughly \$85 million of the program to date savings has been realized in our 2020 earnings.

That means there is roughly \$50 million of run rate savings achieved by the end of 2020 that haven't been fully realized yet, all of which will benefit this year's financial results. Looking forward, we continue to aggressively pursue additional synergy and cost savings on our way towards delivering at least \$200 million of total run rate savings by the end of 2021.

Looking ahead, we still have limited visibility on the trajectory of the recovery. And while we will not be providing full-year guidance this morning, I do want to help you think through what the first quarter could look like, as there are certain items that will impact our results. These include reinstating a portion of our variable compensation plans and bringing back associates to work to support the further recovery of the business.

In total, we expect the impact of these incremental costs in the first quarter to be roughly \$10 million, which will be spread throughout the business. In our vacation ownership segment, we have seen our business recover nicely and expect it to continue into the first quarter. From a development perspective, given that most of our sales centers have already reopened, we expect contract sales to grow sequentially to \$190 million to \$210 million in the first quarter, with a higher percentage of that amount coming in March.

As a result, we are expecting roughly \$15 million to \$20 million of negative EBITDA reportability in the first quarter, compared to the \$7 million benefit we had in the fourth quarter of 2020. It's important to remember that this is only timing. In addition, we are projecting higher marketing and sales costs in the first quarter as we ramp up tour production, which will

negatively impact our adjusted development margin in the quarter but will help drive future sales.

In our resort management business, we expect the recurring management fees to remain stable and ancillary margins to improve, compared to the fourth quarter, as occupancies continue to recover. However, given the timing of certain fee revenues, as well as the higher costs I mentioned earlier, we expect our VO management and exchange profit to be flat or down slightly on a sequential basis.

In our rental business, we expect occupancies and rate to grow sequentially, reflecting the continued recovery in leisure travel as well as normal seasonality. This will be partially offset by higher maintenance fee expense largely associated with higher inventory balances. As a result, we expect rental profit could improve by \$5 million to \$10 million compared to the fourth quarter. And for our financing business, we expect profit in the first quarter to be in line with the fourth quarter, as the benefits of lower costs and interest expense on a declining debt balance are offset by lower interest income from a declining notes receivable portfolio.

Turning to our exchange and third-party management business, we expect transactions at our Interval business to continue to improve a few percentage points year-over-year, reflecting the recovery. We also expect average revenue per member to be largely unchanged on a year-over-year basis. Finally, we expect G&A could be down roughly 20 percent on a year-over-year basis, reflecting the ongoing benefits of our synergy work and restructuring efforts, partially offset by reinstating our variable compensation incentive plans, associates returning back to work to support the further recovery of the business, and lower CARES Act retention tax credits.

Turning to cash flow, while we're not giving annual guidance at this time, I did want to highlight some timing aspects of our cash flow for the year as well as longer term benefits to our cash flow, given our current inventory position. As we've discussed before, the largest component of our rental expense is maintenance fees on unsold inventory. Like any other owner, these fees are typically due at the end of the year or early in the first quarter.

This causes our rental business to be a drag on cash flow in the first quarter. However, once we get past the first quarter, a disproportionate amount of our rental revenue tends to turn in to free cash flow, and as the business continues to recover, this year should be no different. In our vacation ownership business, we came into 2021 with more than \$900 million of completed inventory on our balance sheet and had commitments to purchase another \$165 million this year, with a large portion of this happening in the first quarter.

When you add in the excess inventory we were acquiring with the Welk acquisition, that brings our total inventory balance to more than \$1.1 billion today, or \$580 million of excess inventory at a normalized sales pace. So as our contract sales continue to ramp up, and with limited

inventory commitments going forward, we expect to generate significant free cash flow over the next few years as we monetize this excess inventory.

With that, Steve and I will be happy to answer your questions. Rob?

Operator

Thank you. At this time, we'll be conducting a question-and-answer session. If you'd like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

One moment, please, while we poll for questions. Our first question comes from David Katz with Jefferies. Please proceed with your question.

Stephen P. Weisz

Hi, David.

David Katz

Good morning, gentlemen, appreciate all of the detail. I wanted to go back on two things, if I may. You know, there's so much discussion about pent-up demand. And if we could maybe break that down just a little bit farther, right, we would expect that there's pent-up tours, right, you know, pent-up marketing packages, you know, pent-up visitation? But, can you maybe give us just a bit more detail as to, you know, how we would break down the notion of pent-up demand, which seems obvious and intuitive? But some more detail would help.

Stephen P. Weisz

Sure, so, if you look--I think I reported in my remarks that the second half of the year looks like we're 80 percent higher than we were at the same time in 2019. If you look at the first half of the year, it's actually down 16 percent on the same comparable basis to where we were in 2019. However, the bulk of that is largely in Q1. Q2 is down, you know, a couple of points, but-- when you average it all out for the full year, it's down about 8 percent.

I think it all stands to reason, if you sort through it. I mean, as I reported, people are anxious to travel, they're already looking to book travel, but they want to make sure that they have the benefit of the vaccine. You've heard about the rollout of vaccines and some prognostications that, the bulk of America will be vaccinated by the summer. so I think that all kind of syncs up well with how--and the other point, and I can't regurgitate the number, but there was a huge percentage of the population in 2020 that never took a vacation. That stands to reason, given the circumstances we all found ourselves in, so in addition to their normal inclination to take a vacation, I think it's been amplified by the fact that they haven't been able to get away in 2020. So, that's the best visibility we can give you right now. 80 percent of our sales in our resorts, come from people that are in residence at our resorts, 50 percent basically are in-house guests,

and another 30 percent are people that are on packages. So, as our resorts continue to fill up, we'll continue to see sales grow proportionately.

David Katz

Understood. And just a quick follow-up, if I may. The Welk opportunity I think highlights what, you know, may be some latent value with respect to Hyatt. Can you color us in a bit on, you know, what you--what we could reasonably expect that Hyatt brand to bring in terms of, you know, tour flow sales, visitation, you know, anything qualitative, because I think we--per your name, we usually think of you with Marriott? But there's this other thing there, too.

Stephen P. Weisz

Sure. I think probably the easiest way to think about it is that, when we acquired ILG, I would tell you that the Hyatt vacation residence business was basically relatively dormant in terms of what people were doing actively to try to grow the business. I think I've reported in previous calls that when ILG acquired Hyatt, they had 16 resorts, and when we acquired ILG, they had 16 resorts. That was, you know, four years later. So, we do believe that there is quite a bit of opportunity there.

In the Welk business, the way in which they typically source customers--because they didn't have kind of one of the major hospitality brands affiliated with it--they did a lot through sports marketing and OPC venues, where they generated customers. Typically speaking, those are, low-yield, high-cost kind of channels to source customers out of. We believe that we will start to strip out some of those costs as we replace them with things where we'll continue to obviously look to penetrate the world of Hyatt program, just as we have done in the Marriott Bonvoy program.

We will, continue to change practices about how sales are done at the site level, for instance, putting in the equivalent of our Encore program, which has proved to be very successful for us and has a very VPG number. We'll put that in. The only caveat I would throw into this is it's going to take us a little while for us to rebadge the Welk resorts as Hyatt. Call that the end of this year, first quarter next year.

But then, there's another impediment to being able to integrate all the inventory and that is the fact that Welk today is an RCI affiliate, not an Interval International affiliate. So, that makes putting the exchange program in place, much as we have done on the Marriott side, a little more problematic. That affiliation ends in 2022, and obviously we would look to, then, reaffiliate, Welk back with Interval International, from whence they used to be, by the way.

so, I think I reported that we said that, you know, we think by 2024, and hopefully sooner, it's going to mean somewhere in the neighborhood of \$60 million to \$70 million of adjusted EBITDA. I think we should look to take their development margin, which is today low single digits up into the 20 percent to 30 percent range. Contract sales, obviously we want to try to

grow substantially, and we think contract sales by 2024 could be, \$160 million to \$180 million, in that range roughly.

David Katz

Perfect.

John E. Geller, Jr.

And just a point of reference, David, I'd add there. I mean, that \$60 million, \$70 million Steve mentioned versus, call it Hyatt on a pre-COVID basis of EBITDA, I mean, it is a fraction of that \$60 million to \$70 million incremental, just to put it in relative size. All the improvements you're talking about are really going to drive, not only the top line but on a percentage basis, huge EBITDA growth over the next two to three years within the combined Hyatt, Welk business.

David Katz

Thank you very much.

Stephen P. Weisz

Thank you.

Operator

Our next question comes from Patrick Scholes with Truist Securities. Please proceed with your question.

Stephen P. Weisz

Good morning, Patrick.

Patrick Scholes

Hi, good morning, good morning. thoughts on timing of reopening the Hawaii sales centers, and can you give us a little bit of additional color on how some of those preliminary, reservations and bookings look for Hawaii going forward? Thank you.

Stephen P. Weisz

Yeah. As I think I reported, Hawaii, ex-Kauai, are running at roughly 50 percent occupancy. Now, there's still the requirement you have to have a negative COVID test before you arrive at the islands, etc. Kauai is the outlier. There's still a 14-day, quarantine, restriction in place, albeit, for instance at the Kauai Beach Club where we have kind of a broader--as long as you say, on campus, you don't have to actually stay in your room or in your villa. you can move around the resort.

But, it's relatively restrictive. I wish I had better visibility as to what the mayor of Kauai is thinking. Currently I think they're saying maybe the end of March. but, you know, we hear kind of informally that that may get extended further in Kauai. They want to make sure that

the vast majority of their population has received the vaccine. Now with that said, our sales centers in the rest of the islands are open. And as occupancy continues to build, I think you'll find that we'll continue to see a good thing. I'll give you a couple of statistics.

So just looking at this past week, Maui ran 75 percent occupancy, Oahu ran 85 percent occupancy, so that's contrasting to Kauai in the 20 percent range. So we feel reasonably good about how Hawaii will respond. Obviously, it's a very important market for us in terms of what percentage of our--not only our combinations but also our sales that are represented there. but we think it's starting to rebound. Clearly, Hawaii remains an aspirational destination for the vast majority of our owners.

David Katz

Yes, absolutely, and I aspire to be there in July of this coming summer.

Stephen P. Weisz

There you go.

David Katz

And then, a question--thank you. John, a question for you, expectations, thoughts around a securitization or securitizations for this year? Thank you.

John E. Geller, Jr.

Yeah, sure. We're targeting one here in the second quarter. Just from where rates are today, we see, potentially some significant improvement, even over the cost of funds we did last year of, call it, 2.5 percent. So, we've still got a few months here, obviously, before we execute that deal, but the demand is there. We've seen spreads continue to tighten since the deal we did last year.

So, the setup looks pretty good right now, and no different than we've done in the past. As recovery comes back, you know, we'll target, you know, in that, call it \$350 million, \$400 million type securitization, and, once again, similar to last year and what we've done historically, we expect probably in the 98 percent advance rate.

David Katz

Okay, good to hear. Thank you very much.

John E. Geller, Jr.

Yeah.

Stephen P. Weisz

Thanks.

Neal Goldner

Rob? Jared? Are you there?

Jared Shojaian

Hello, can you hear me?

Stephen P. Weisz

Yes, a little technical snafu there. Good morning.

Jared Shojaian

All right, good morning, everyone. Thanks for taking my question. So, you talked about reservations being up 8 percent in the back half of the year versus 2019. hypothetically, assuming that largely materializes, and reservations end up coming in pretty similar to 2019, and we assume the world is largely back to normal, can you help us think about what that translates into for contract sales and revenue relative to 2019 because obviously I know there's a little bit of a lag, you're not going to have the same level of new owner sales.

I think the financing portfolio is obviously smaller today than it was then. So, I think we're kind of struggling to understand what that revenue ramp is going to look like, assuming the forward bookings end up materializing. So, anything you can kind of share to help us think about those puts and takes would be helpful.

John E. Geller, Jr.

Sure. Hey, Jared, it's John. I'll kind of step through some different parts here of the business. Clearly, like we've always said, the majority of our sales come onsite, right? So, as occupancies come back in a combination of owners' packages, all the tours and all that, as well as, the rental side, that all bodes well when you're doing 80-plus percent of your sales from people, you know, if you will, staying at the resort, right?

So, I would expect if, to your point, you get back to those occupancies, that should be helpful. I think there will be a greater mix of owner usage in the second half of the year versus, being able--maybe the package tours, so we're working through all that. You know, there's pros and cons with that. Obviously, owner sales have higher VPGs, are more efficient, but they typically come at, you know, on average, a lower overall first-time purchase, right? And so, there's that mix there.

But we're continuing to build the pipelines back in market, and that includes reopening linkage that we have at a lot of our resorts. But, the one thing we're going to start to not bring back, if you will, and really look to focus more on our package pipeline to replace, was on the Sheraton side, some of the off-premise contact, mainly in Orlando and Myrtle Beach.

So that's, you know, not a huge percentage of the tours, but we're not looking to turn those low efficient, tours back on. It's going to be better cost going forward, but it's also going to help us with better VPGs. So I do think, if you kind of get back to that on a run rate basis in

fourth quarter, you know, you're going to get your contract sales closer, to where you were in 2019 and have a great opportunity to, obviously improve on that as you go into, 2022, right?

And the other parts of the business will recover with occupancies. I mean, the resort management, where we're missing a little bit right now is the onsite ancillary businesses, right? So once again, as those occupancies come back in the third and fourth quarters, we should be able to drive that ancillary profit and get that year-over-year growth going.

Financing, the good news is, notwithstanding the notes receivable balance has been coming down like we talked about here for the first quarter, given the timing of some of the interest expense as well as synergies and other costs we've continued to take out of the business, we expect financing profit in the first quarter to be relatively flat from the fourth quarter, right?

So, that's all, and then as sales start to go back up, and we start to grow that notes receivable balance later in the year, that hopefully will start getting us growing our financing profits as we move through the end of this year into next year. and so, the other big question mark is rentals. We'll continue to have, you know, some of that compression, if you will, of owners wanting to stay more in the second half of the year. We've got, as Steve mentioned, lower occupancy here in the first quarter, less nights on the books right now.

So with that compression of owner, that will impact our ability to do open-market rentals. But once again, the offset is you have more owners staying at the resort, and that's going to help you on the contract sales side so not necessarily a horrible trade-off, but rentals will take a little bit, more time to come back as you go through 2021. But once again, as you start to get into 2022, assuming more normalized occupancies, a lot of that shift in compression will start to make its way through the system.

and then on the exchange and third-party management side, we continue to see sequentially here some growth there in terms of the business coming back. So, hopefully from here, it's that kind of continued progression up. Obviously, that business was not impacted in terms of revenues going down as much as the VO business, so, very resilient. And then, our G&A, once again, and more broadly just the synergies that we're talking about, that's going to help, too, in the recovery here going forward.

Stephen P. Weisz

Yeah, Jared, let me just add one other thing. This is probably not a surprise to you. In 2019--I don't have the exact number here in front of me--but I think what we typically call linkage sales, which are people that are staying in hotels in markets where we have sales centers, etc., those were close to a couple hundred million worth of sales. Obviously as hotel occupancies continue to lag, the recovery that we're seeing--although it could be less people for us to be able to target and recruit tours from.

And so, that's another little bit of a headwind that we have to face. But, everything that John just articulated very well, in my opinion, should come into play. And I said in my remarks--I said I'm very optimistic about how this year is building and what it's going to deliver for us towards the end of the year.

Jared Shojaian

Okay. Thank you very much for that. And then, John, just going back to the first quarter, you gave a lot of really helpful commentary on a bunch of different line items, which I'm going to have to go back and aggregate. But at a high level, to summarize, you did \$72 million of adjusted EBITDA in the fourth quarter, do you think first quarter is higher or lower than that number, based on all the puts and takes you gave us?

John E. Geller, Jr.

Yeah, it will be lower, primarily due to the revenue reportability, right? We always have, just keep this in mind as the business recovers every quarter, right? In a normal year, we've got revenue reportability in the first quarter that's negative because end of February/March is typically higher contract sales than November, December, right?

And, as we've talked about in the past, that-- notwithstanding contract sales being higher--you don't get necessarily the benefit of that until the second quarter, right, when those contract sales close. What you have now in a recovery, right, is that's even more exaggerated, right? So not only do you have the normal seasonality of that November, December time frame, you have the acceleration of sales quarter to quarter, right? And that's why it's going to be a little bit more pronounced.

And arguably, right, if the recovery continues, you're going to see that kind of every quarter, right, and even on a full-year basis, just given where you ended up 2020, you're probably going to have higher negative reportability for the full year--once again, just timing, right? It's just the nuance of when we actually make the sale and when it actually comes through the P&L. But, that's going to be, as you think about the recovery--that's why we always report contract sales--it's a better leading indicator, right, in terms of what's happening in the business, people buying, etc. But, you know, the reporting lags that a bit.

So, that's your biggest thing. I mean, obviously we've got synergies that are helping offset cost increases, but we're bringing back, we paid no bonuses in 2020, right? We started to factor some of that back in here as we get back to a more normalized basis. We've got reduced--most likely, depending on what happens with any new--anything that the Biden Administration might do from a COVID relief package--we're expecting less tax credits from the retention tax credits and things that were in the previous package.

So, that's where you do have a little bit of just--as part of the recovery. And we still don't have all our people back to work, right? We've been managing that, bringing it back with the top-

line growth. So, on a pure cost perspective, yeah, you've got some things here that will continue to come back with the recovery.

Jared Shojaian

Okay. Thank you very much for all that color. I'll jump back in the queue.

John E. Geller, Jr.

Yeah.

Operator

Our next question comes from Ben Chaiken with Credit Suisse. Please proceed with your question.

Ben Chaiken

Hey, thanks for taking my question. How's it going?

Stephen P. Weisz

Good.

Ben Chaiken

Hey, just to clarify Jared's question. So, maybe looking just at the VOI business, should contract sales following bookings, which I think you said in the back half of the year was plus 8 percent--for the back half of the year, or higher or lower? Sorry, just maybe--I had a little bit of trouble following that.

Stephen P. Weisz

Well, I think it's--just to clarify. We said that our bookings for the second half of the year are 8 percent higher than they were at this time for 2019, which obviously gives you a sense of what the relative demand is for that period of time. Given the fact that 80 percent of our sales come from people that are in-house, then one should conclude that the velocity of sales growth will, in fact, continue to grow as we get into the subsequent quarters to the first quarter.

Ben Chaiken

Got you.

John E. Geller, Jr.

Yeah, I think just take--Ben, on the occupancy rate, just take fourth quarter North America occupancy, which I think was in 60 percent, 68 percent, right?

Stephen P. Weisz

North America was 70 percent.

John E. Geller, Jr.

Right. So, if occupancies get back to the 90-plus percent, right, we normally run--and what we're saying is what's on the books today is showing that trajectory, right, we still need to see how it recovers--your occupancy on a percentage basis is going up call it 40 percent, if you will, right? That's what's going to drive your contract sales on a relative basis. It's not the--the 8 points is just telling you where you're at today versus you were at the same time in 2019. But the bigger story is that recovery of occupancy from where we're at today, right, to something in that 90-plus percent range, which is, you know, what we would have run in 2019.

Ben Chaiken

I got you, makes sense. That's helpful. And then, just a quick clarification on the \$200 million in synergies. Can you give us maybe broad strokes, or I don't know how much granularity you have, but basically what would be--of that \$200 million, what would be incremental to 2019 because I think you've been working on this for a couple years now, so just trying to figure out what was maybe captured in 2019 versus what would be incremental to the reported 2019 EBITDA number.

John E. Geller, Jr.

Yeah, I mean, in 2019--I'm looking at Neal here--I want to say we had \$40 million to \$50 million of in the year savings of that \$200 million. We can get you the actual number, Ben. So, it would be that to the \$200 million, right, apples to apples, when you get a full-year run rate of the \$200 million. It would be something in that \$150 million plus or minus, I think, of incremental as you think about 2019 actuals.

Ben Chaiken

Great. No, ballpark is fine, appreciate it. Thank you.

John E. Geller, Jr.

Yeah.

Ben Chaiken

That's all for me.

Operator

Our next question comes from Brandt Montour with JP Morgan. Please proceed with your question.

Stephen P. Weisz

Hi, Brandt.

Brandt Montour

Hey. Good morning, everyone. Hey, how are you? Thanks for taking my questions. So just thinking about the sequential lift in the 1Q, or the sequential progression into 1Q versus the 4Q,

just wanted to understand if that is coming from one or two markets--one or two large markets that are improving, or if it's more broad-based. What did you sort of assume in that guidance?

Stephen P. Weisz

It's clearly more broad-based. as you will recall, we sell a portfolio product, so that each one of our sales centers is selling the same kind of--same product that we are elsewhere, and we're seeing the build in demand, to be across the waterfront. It's not focused on any one particular area. but, no, it's across the system. I guess the one area that is a little bit interesting for us will be to see how quickly Europe and Asia Pacific respond.

Europe, there are still cross-border, restrictions, that are in place. and we'll see how long that takes to sort itself out. And largely, everything in Asia Pacific is within country, so there's not much international travel, between countries in Asia Pacific. But again, as you well know, the vast majority of our sales are a function of what goes on here in North America, and we see that to be building very nicely.

Brandt Montour

Okay, that's great. Thanks for that. And then, on the consumer loan book--and, John, I think you sort of wrapped this up by giving us recent delinquency rates--but just wanted to maybe close the loop. It sounds like there's no sort of incremental reserves that would need to be taken unless something really bad happens. I guess the question is, what would you have to see in this year so far for, you know, the situation for you to take more excess reserves?

John E. Geller, Jr.

Yeah, I mean, clearly I think you'd have to see something more broadly from a, you know, economic impact. Remember, we took that reserve, back in May, end of April, right, with our first quarter with very limited visibility. We told you at the time that, you know, the reserve actually was based on not only what we saw but what the Vistana business saw, which we didn't own at the time, right? So, we didn't know all their marketing practices and what they were doing, but back--coming out of the financial crisis, obviously, you know, not the best comparison, but it was the best we had, right?

And we looked at what defaults did back then. And obviously the portfolio is different, our portfolio was different coming into COVID than what was coming out of the financial crisis. So, there were variables in there. and, you know, we took our best estimate, as we've looked at. I mean, we think this is what we need. Delinquencies, as we mentioned, were basically at the end of the year back to pre-COVID delinquency levels. And even over the last call it 30 to 45 days, we've seen delinquencies by brand come down another 30, 40 basis points, so in a lot of cases below, right, back where we were pre-COVID last year.

And, you know, the only other final point I'd make on that is which--is on a declining notes receivable balance, meaning that's a headwind, right? As you originate new notes--and you're growing the balance, your delinquency is apples to apples because you have more newer notes-

-generally would trend down, right? We're on a declining, and we continue to trend down. So, I think it all frames up. It's what we think we need here going forward, but yeah, we feel like we've got a little bit better sense as to how the notes have performed over the last eight or nine months obviously with the impact of COVID.

Brandt Montour

Makes sense. Thanks a lot, guys.

Stephen P. Weisz

Thank you.

Operator

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

Stephen P. Weisz

Welcome back.

Jared Shojaian

Thanks for taking my follow-up. So, you talked about the excess inventory you have on hand, the \$580 million, and that you expect significant free cash flow over the next few years. Can you help us frame a way to think about that in terms of maybe a historical conversion rate versus a new conversion rate over the next couple years? Or maybe it's an absolute number, and free cash flow should be, X million dollars greater than normal. Like how should we think about that excess inventory resulting in additional, above-normal free cash flow?

John E. Geller, Jr.

Sure. I mean, historically, Jared, I would say that if you think about our adjusted EBITDA on a more normalized cash flow, we've been converting roughly in that, call it 55 percent plus or minus. And what I mean by normalized free cash flow, right, that would assume that from an inventory perspective, you're replacing what your selling off the shelf from an inventory expense, so kind of a net neutral, right, as you think about free cash flow.

and if you look at, you know, the conversion, right, the pieces of that, interest expense is somewhat fixed, right? So, EBITDA needs to come back to kind of where you were in 2019 to get that kind of same conversion, if you will, on interest expense. Taxes, right, are going to be tied more to your EBITDA, more variable, so you'll have some flexibility in terms of how you think about cash taxes as a percentage of EBITDA.

And then, the other one that's in there, historically we've spent, you know, call it \$80 million to \$100 million of corporate CapEx. that \$80 million to \$100 million, obviously, as the business is recovering, we're going to manage lower, you know. And then, as the business comes back,

we'll get back to probably more normalized levels. So ,it's really--those are the different levers as you think about it.

The opportunity we're talking about is, as your EBITDA comes back, and you get to, call it a 2019 EBITDA, more of a 55 plus or minus conversion rate, that additional \$580 million, right, is going to help take that--all else being equal is going to help take that up over time. Now, the only thing I'll tell you is we'll continue to buy back inventory very favorably on the secondary market and do some of the things we do. So, it will be a multiyear recovery, but that potential of the \$580 million is what's kind of above, or going to help your conversion ratio.

Jared Shojaian

Got it. Okay, thank you for that.

John E. Geller, Jr.

Yeah.

Jared Shojaian

And then, I wanted to ask about the comment you made about one of the Interval customers chose not to renew. I know that's a largely immaterial bottom-line impact, which you were saying. But, can you help us understand and think about the risk of other customers choosing not to renew. And I guess what gives you confidence that, this was kind of an isolated event rather than a potential new trend?

Stephen P. Weisz

Yeah. First of all, we're not aware of any other significant affiliate of Interval's not choosing to renew or looking to do something alternatively. I think the other thing I'd point out, typically speaking in the exchange business, as you know, it's kind of a two-horse race. It's Interval, and it's RCI. and usually it's a share game. You know, if an affiliate was an RCI member, comes to Interval, or vice versa, it's just moving back and forth.

In this particular case, this affiliate chose not to be involved with any external exchange company. They have decided that they believe that the strength of their individual portfolio is strong enough to support the needs of what their owners are looking for in terms of being able to find alternative vacation experiences. I think that will remain to be seen.

Now with that said, you may recall that back in 2010 when we went to points, we put our own captive internal exchange system in place, for people to be able to, if they wanted to go from one Marriott branded resort to another, they didn't have to go through Interval in order to get there. So, this may be a page out of that same book that this other developer is choosing to go to. We'll wait and see.

We always maintained our affiliation with Interval only because there are locations in the world where we don't have product or vacation experiences that people want to go to, which I

think is one of the strengths of either of the two exchange companies. I happen to think that Interval is a higher quality exchange company. But be that as it may, this is a decision they've made. But again, we're not aware of anybody else that's contemplating a similar move.

Jared Shojaian

Great. Thank you so much for all the time.

Stephen P. Weisz

Thank you.

John E. Geller, Jr.

Thanks, Jared.

Operator

We have reached the end of the question-and-answer session. At this time, I'd like to turn the call back over to Steve Weisz for closing comments.

Stephen P. Weisz

Thank you, everyone, for joining our call today. 2020 was certainly a difficult year for the hospitality industry, but it also proved how strong our business model really is. People like to vacation, and when they own their vacations, they try to find a way to use it. You really don't need to look much further than fourth quarter results to see just how resilient our business really is.

Our North America resort occupancies averaged nearly 70 percent during the fourth quarter in the midst of a pandemic. Total contract sales increased 27 percent sequentially. Interval exchange transactions grew 17 percent on a year-over-year basis. Adjusted EBITDA margin improved nearly 650 basis points sequentially from the third quarter, and our run rate cost savings grew to roughly \$135 million in 2020, nearly double where we were at the end of 2019 and taking us even closer to our goal of at least \$200 million in savings.

Looking forward, our tour pipeline is now more than 165,000 packages sold, with more than 50,000 of those customers already booked for this year. And reservations on the books for the second half of this year are 8 percent higher than at the same time in 2019, illustrating the pent-up demand we think will start to manifest itself later this year.

As always, thank you for your interest in Marriott Vacations Worldwide. Take care of yourselves. And finally, to everyone on the call and your families, stay safe, and enjoy your next vacation.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.