Marriott Vacations Worldwide

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Stephen Grambling: All right. So, our next company has been busy over the past – I guess it's been maybe even a bit longer than a year here – having negotiated a contract with Marriott, renegotiated the contract with Marriott International following the Starwood acquisition, subsequently acquiring and integrating ILG.

To help us understand the moving parts and how all these position the company better from here, please join me in welcoming Steve Weisz, President and Chief Executive Officer, and John Geller, Executive Vice President and Chief Financial Officer, of Marriott Vacations Worldwide.

To start off, on the ILG acquisition, you aren't quite at the one-year mark from the closing. Perhaps just set the stage on what has been done with the integration and what's still being worked out.

Steve Weisz: Well, it's nine months and a day, by the way. The first things that we've tried to do, obviously, is to figure out how the management teams have all come together. And as you might imagine, you go through a process of identifying leaders in various parts of the organization from both sides of the business and put them in place, as well as their teams, below them. That's pretty much behind us at this point in time.

We started the process of integrating on the vacation ownership side, a lot of the sales and marketing techniques that we believe is in the best interest of the business, going forward. On the exchange and third-party management side of things, we've begun to work with them on things that we think can be helpful for them.

So, there's a lot of, as you said, moving parts. From a technology standpoint, lots of different platforms that we're on. So, we're in the midst of making changeovers, both in the human resource arena, with new human resource system, a new financial services system. Both of those will be done by the end of the year.

And then everything on down from identifying best practices in training, recruitment, getting a better matrix in place for sales executives to use so they make sure that everybody is singing kind of out of the same hymn book. It kind of goes on and on and on from there.

But that's what we've been about since September 1.

Stephen Grambling: Now, whenever you're doing these transactions you don't get a full look under the hood. What has maybe surprised you – upside, downside – and what have you maybe been able to learn from Vistana that you can implement in your legacy business?

Steve Weisz: There's a couple of things, one of which is what had been maybe not fully disclosed with us was the kind of lack of integration of the ILG businesses that had been acquired over the years. There was some level of integration, but it wasn't as deep as we would hope. So, you can look at that in one of two perspectives. One is, well, that's a challenge; the other is, it's an opportunity because now we have an opportunity to bring it all together in a fashion that we think makes sense. There's that.

There were some other things that came out that weren't really evident during due diligence in terms of some of the sourcing the tours and the vacation ownership business and where they were playing a lot more in the OPC channels, in channels that didn't have kind of the same yields that we're used to seeing. So, we've gone about and trying to figure out how we can discontinue some of that and replace it with some other things.

But there's some other things that we’re really positive on the other side. I mean, in the Vistana business – that's the vacation ownership side of ILG – they were more advanced on some of their digital personal apps than we were. So, we’re able to take that and apply it to us. They had a better in-house program in terms of acquiring tours from people that were staying in-house than we did. We thought we were pretty good, but they were better.

So, I think there's kind of some back and forth that you see across the waterfront, none of which are huge surprises, but some things that we obviously have to address.

Stephen Grambling: There seemed to be beforehand a little bit of a debate around the scale benefits in the industry. As you sit here today – and it's still, I would say nine months is still early in terms of trying to figure out exactly how that all plays out – how are you thinking about scale now as a competitive advantage? And does it change your mindset around potential acquisitions and consolidation, going forward?

Steve Weisz: My reaction to that is I think scale makes a lot of sense in the business. Better than 50% on the vacation ownership side, better than 50% of your costs are focused on sales and marketing. You can get better leverage, better gearing on sales and marketing costs. I think that's to everyone's benefit. And size matters in that business in terms of being able to negotiate with various partners, etc. So, we think that's all good.

I think on the exchange and third-party rental side, clearly, the profiles of these businesses are heavy cash flow generators, which are pretty attractive. We did take on some leverage as a result of this transaction. And over time, we think those cash flows are going to be very helpful in trying to bring those leverage levels down a little bit, although we're not uncomfortable with where we are today.

And so, we think scale works here. Obviously, it was one of the considerations that we looked into when we thought about acquiring this business. Having said that, does it take further acquisitions off the table? No. I'll be the first to tell you, though, I think right now our plate is a little full.

Stephen Grambling: Yes.

Steve Weisz: So, I think you probably wouldn't expect to see any significant announcements out of us in the fairly near term, unless it was truly, truly extraordinary and opportunistic.

Stephen Grambling: Great. Maybe you can describe to us how the average timeshare owner has changed over the last five years. And maybe the profile of your new owners that are coming into your system, how they might be evolving and kind of where you see that going forward.

Steve Weisz: Our average, first-time buyer is about 52 years old. That number hasn't changed materially over the last five years, or so. The reason for that is because of the way in which we target customers. We look at – our typical demographic is average household income $125,000, $150,000; married professional; couple of kids; own a home; etc.

Our average owner in the embedded base is about seven years older than that.

And about 15% of our first-time buyers are what would be classically considered millennials. About another 35% of our first-time buyers are Xs and Ys. So, about half of that are Xs and down, which gets you to the average age of 52.

Stephen Grambling: And have you had to shift your kind of sources and channels in which you source these new owners over the last couple of years?

Steve Weisz: Well, clearly, the more you can play in some of the more contemporaneous digital channels, I think the better off you are, particularly for the long term. With that said, 60% of our sales last year were to our existing owners. They wanted to buy more of our product, which we're very happy to accommodate. But over time, as there is more and more interest in people that are younger of age that have a higher proclivity to use the digital channels that they get access to, yes, that's where we have been experimenting and we're going further.

Stephen Grambling: How would you characterize the health of your consumer relative to sitting here at this time last year?

Steve Weisz: Maybe, John, you want to talk about things like default rates, or whatever?

John Geller: Well, I think generally we haven't seen much change at all. The consumer we're focused on of $125,000, $150,000 a year household income. While there's ups and downs in the broader market, we sell a prepaid vacation. Our folks, people that we sell to want to go on vacation and we present a sales opportunity that people see benefit and long-term value in. And so, that's what we're selling.

Through the course of the year you'll see ups and downs. It's interesting. You don't – you can never put your finger on one thing that could be impacting closing efficiency at any given point in time. But if you look at what we've delivered in contract sales growth last year, even in the first quarter of this year – notwithstanding you have some of those bumps; you go back to December or January where the broader stock market was going down 15% – we still delivered 8% growth in the fourth quarter and then on the legacy MVW business 10% in the first quarter. Right?

Now, is that a straight line through every quarter? No. And you're always constantly adjusting. But our consumer remains very healthy and strong.

Stephen Grambling: And so, would conversion rate be the primary place that you'd be watching to try and get a gauge of the sense of the consumer?

John Geller: I think you're always looking at it. It's really more on your first-time buyers. That's where – if there was some significant impact, you'd probably see it most likely on your first-time buyer closing efficiency. It's not as much on sales to existing owners. But yes, like I said, those can move around, and you just continue to work through it.

Stephen Grambling: So, the perennial question that we get is how to think about the cyclicality of timeshare and your business, in particular. Perhaps frame how the business has changed, and then give us a sense for how you think about sensitizing the model.

Steve Weisz: The last obviously significant recessionary environment was the '08-'09-'10 timeframe, which I don't think any of us want to go back through again. But if you think about it – if you take that aside, a largely consumer-led recession versus a business-led recession – and you look at what has happened – and it happened in our business just as it happened across the North American timeshare business – was even in recessions, actually timeshare sales grew. They didn't grow at quite the same pace, but they grew. Obviously, '09 and '10 were a very different kind of environment.

But how has our business changed? In '08 and '09, even before '10, we went to a points system in 2010, which is a very different model than a weeks-based model. It's a very – it's a much more efficient capital deployment profile, and it gives the consumer a lot more flexibility than they had before. What we were hearing and what caused us to go to points starting back in 2007 when we began the work was there was a lot of people that were saying, "Hey, listen. I own a week, but I can only go on vacation for five days." So, what happens? Well, they lost two days of use. And you've seen all the research that talks about people want a variety of experiences, they want to go different places, they want to go for shorter stays, and all that.

So we went to points, and in addition to points we also put our Destination Club in place, which gave them a lot more experiences: cruises, safaris, you-name-it. That was intended to enhance their vacation opportunities and go forward.

So, in addition, we're no longer selling in the high-end fractional space where we were in Ritz-Carlton. We've stopped doing that. We're no longer selling in Europe, which was a very low-margin kind of opportunity for us. So, we think that's different.

And we're using capital partners now from a development standpoint, where we heretofore were doing it all on our own balance sheet.

So, those are some of the fundamental differences. Most importantly – and I'll say this not only for us, but I think there are others in the business – we have the opportunity, or the need, I should say, to actually go through and rationalize every single channel we were in back in the '09-'10 time frame and understand really which channels provided the highest economic benefit and which didn't. And I think that was a lesson learned by many of us that's not going to be lost any time soon.

So, if we have to do some things – in '09 and '10, we closed eight sales centers, three call centers. We did a lot of that because of necessity. Hopefully, it wouldn't come to that again, but if we had to, we're – I think we understand how to do it.

Stephen Grambling: And I think you mentioned earlier about 40% of your sales are to new owners. How do you think about new owner growth and also net owner growth as important to long-term free cash flow and EBITDA growth of the business?

John Geller: I think everybody in the industry agrees that getting first-time buyers, new owners into the system – we've said it – that's what we need for the long-term health of our system, and that's what we've been focused on. If you go back over the last 24 months, if you look at where our tour growth is it's disproportionate to first-time buyer tours. And where we're leveraging that is through our call transfer program with Marriott International, and we'll be rolling that out to the legacy Starwood reservation centers. We just rolled that out here this quarter. So, those types of tour packages.

The marriott.com digital offering we've talked about, we'll be launching that on a pilot program here on marriott.com in a couple of weeks.

All these types of tour generation are disproportionate to first-time buyers. That's where we're looking to grow and we grew 9% in the first quarter. Last year, I think we grew 10% first-time buyer tours. So, that continues to be a big focus.

And if you look at it from a margin perspective, we've been able to grow those first-time buyer tours and sales and not give up the margin. And we've been able to do that by doing it by leveraging our fixed costs – Steve talked about our fixed costs – and reinvesting that into maybe some of the higher-cost tours that come through the first-time buyer.

So, the difference – and you mentioned the net owner growth. We obviously have a competitor out there that talks about net owner growth. Our model is different. When we sold a weeks-based product, we didn't buy back owners that had been – that wanted to sell. Right? So, all your sales to first-time buyers were generally net owner growth. Right?

In a system that we have where it's a portfolio system, we've got owners – we've been in the business now 35 years. So, we've had owners that have owned 30, 35 years, want to get out. And so, repurchasing those at a cost-effective rate and recycling that isn't a detriment to the health of the system. Those owners weren't going to buy more anyway.

And probably the other metric I can point to on that is if you go back over the last 10, 15 years, our average owner owned about 1.3, 1.4 weeks. That hasn't changed. Right? So, if we were overselling to our owners, you would expect each owner to own more. That really hasn't been the case because you're taking out owners that have owned a long time, not going to buy more, and you're replacing those with first-time buyers.

Last year, we added – on a combined basis between our legacy MVW and our acquired business with the Vistana business – 20,000 first-time buyers to the system. So, our goal is to continue to grow that, and we're doing it in a cost-effective way.

Stephen Grambling: And can you remind us the split between new inventory and maybe recovered or repurchased inventory that (inaudible)?

John Geller: Sure. For us, the cadence has been roughly one-third of the inventory we're repurchasing to support the sales each year, and roughly two-thirds of our inventory spend in any given year has been new development. Right? So, we're growing the system. We've added eight new flags, including a new property in San Francisco at Fisherman's Wharf that opened 10 days ago, over the last three or four years.

So, the system is growing. Right? And so, it's all very positive. And we're going to continue – the nice thing about how we add, too, is the capital-efficient model. We've been able to deliver normalized free cash flow over the last four or five years while adding those eight new resorts. Right? And that's the capital-efficient and the strength, I would say, of our points-based product.

Stephen Grambling: Can you remind us what the ongoing relationship is to your various brand partners, including Marriott, being the biggest? And how does the relaunch of the Bonvoy program impact your business?

Steve Weisz: Well, we have a – I think this is close – a 70-year license agreement remaining on our term with Marriott International, which, as you mentioned, was recently restructured, in January of 2018. And at the end of that 70 years, there's two 30-year renewal terms at our option. So, we think that's pretty strong, and I'm not going to worry about the expiration of it, if you get my drift.

The Bonvoy program, I don't think – if Arne were here, I think he'd be the first to tell you that it wasn't the smoothest transition that could have happened in terms of merging the Marriott Rewards and the Starwood Preferred Guest program. I think that's largely behind them. And we are very excited. It's 100 million members strong. The Marriott loyalty program has always been a very attractive source of tour generation for us. As that program gets to be even bigger and more vibrant, it's nothing but good news for us.

Stephen Grambling: And maybe, to a degree, a follow-up on that. I guess, what about the other brands? So, whether it's Hyatt?

Steve Weisz: I'm sorry. I should have mentioned. We are continuing discussions with Hyatt about the continuation of the license agreement there. You may recall that Hyatt sold the Hyatt Vacation Ownership business to ILG back in 2014. There was a change-of-control provision that was in place. It got triggered when we acquired ILG. We have been making great progress in terms of those negotiations. We hope to finalize those here in the very near term.

Stephen Grambling: You've mentioned your investments in digital recently. Just curious where you see the greatest opportunity right now with technology and maybe how you're partnering with people like Marriott to really get the most out of it.

Steve Weisz: So, in addition to things like apps and trying to make it easier for people to book their vacations online, etc. – that's kind of all a given – we've been spending a fair amount of time recently in some of the social media environment to try to do tour generation to figure out how it works. And the great news about digital is it's easily measurable. You can do something today and in short order you can understand the results you're getting and you can figure out what you want to tweak, where you need to make changes and everything else to continue to make it more effective over time.

In Marriott, as John mentioned, here in the next two weeks we will launch our digital version of call transfer. For those of you that are not too familiar with what that means, it's when someone attempts to make a reservation or makes a reservation through marriott.com, they'll get a prompt to ask if they'd like to understand a value vacation opportunity with Marriott Vacations Worldwide. In which case, if they do, then that will trigger a response from us, and we'll book them on a tour and go forward.

We're very excited about the potential for that. Obviously, from a commercial standpoint marriott.com is a very, very attractive website with a lot of traffic on it. And I would suspect most in this room, if not elsewhere, would agree with the statement that very few people call 800 numbers these days to make reservations. Most of them, in fact, use your device or your computer or whatever it is to try to do that. And we think the potential there is very significant.

Stephen Grambling: And when might you see – like, how significant of a channel can that be? And when might you start seeing, like, a margin impact, potentially?

Steve Weisz: Well, the test, as I said, will start here in a couple of weeks, and we'll start to see what kind of response we get. Now, with that, typically tour packages take anywhere from 12 to 18 months to come through the house. So, while you might see some tours start to show up, call it, in the fourth quarter, I would think that most of the impact would be in 2020 you'd start to see it. And even with that, it will continue to ramp.

As I said, this is a test. So, typically, even as we did the inbound call transfer, the physical telephone call transfer, we did some testing and we tweaked some things along the way to make sure that it was optimized. I would expect we'll see some of that same kind of behavior on the digital side. But we feel very encouraged by what it holds for us.

Stephen Grambling: Maybe one follow-up on that. Is there any regulatory limitations in terms of being able to sell timeshare through online channels?

Steve Weisz: Yes. Clearly, because it is a registered real estate product, you still have to have broker involvement, which means – it doesn't mean you have to buy from a broker; you have to buy from someone who is supervised by a broker.

Stephen Grambling: Right.

Steve Weisz: And I believe there will be a day when people will buy timeshare totally online and you'll never talk to a human being. I'm not saying that's going to be for everybody; that's going to be possible for many.

But in the short term, we're going to have to still facilitate some sort of personal interaction between a person who is supervised by a broker and a buyer. For instance, today we have a telesales group which sells incremental points to our existing owners. They do that over the phone. It doesn't require a tour. So, there will be some iterations of that, going forward.

But I think this is still something – the fact that it's got to be – I'm all for regulation in the timeshare business because we've seen many instances where people that haven't been regulated don't behave well. Right? But with that said, I think you'll see some changes in terms of the regulation over time that will make it easier for people to buy things without physically having to take a timeshare tour.

Stephen Grambling: Maybe turning to margins, what are the various things that investors should be considering as we think about both the integration and then focus on some of the new owners versus existing, as we think about margins?

John Geller: Sure. We like to break it down by the different parts of the business, starting with vacation ownership – our development margin, which is the sale of timeshare, if you will, and the profit on that. And the opportunities as we integrate is to leverage synergies or synergies coming out of the sales organization over time in terms of regional and corporate management teams. And so, there's going to be some cost savings as part of the $100 million-plus of synergies. That will continue to evolve.

The offset, as you mentioned and I talked about earlier, was generally first-time buyer tours have higher marketing costs. Right? And so, the nice thing with the digital, as we start to do more of that, there is a huge opportunity. Remember, digital will allow you to do things, especially as we've done some of the stuff with social media, to really leverage data – right? – and really laser focus in the offers to the people that you want to make the offers to. The name of the game is to get qualified tours to show up that are going to be more likely open to buying timeshare. Right?

And so, to the extent you can use data analytics to get better decision making – that's the interesting thing with our closing efficiency. The industry, call it, give or take is mid-teens closing efficiency. So, 100 people tour; roughly 15 buy. Right? If you get one more person to buy, it doesn't sound like a lot but as a percentage of your sales – and that all goes through to your bottom line because those marketing costs to get the person there – you're talking a 6%, 7% growth in your top line just by getting that one incremental. So, if you can use a lot of the data analytics to get better, that's your real opportunity I think over time to really leverage the cost effectiveness of driving that tour flow and hopefully drive higher VPGs over time.

As you walk through the rest of the business, I would say financing right now, very positive. We just did a securitization, close to a 1,000-basis-point excess spread, which is in line with one of the best ones we've ever done over the last five years. So, very favorable. That had been trending a little bit the other way with higher interest rates. So, that's trending back in the right direction as we think about that.

The rental side of the business, the management side of the business, we've continued to improve margins there over time.

And so, then you go over to the exchange business. I would say you're probably not going to see huge margin improvement, based on slower growth rates there, but we should be able to maintain margins we have in place today.

Stephen Grambling: And synergies?

John Geller: More broadly, a lot of synergies will come through G&A, but it will come through all parts of the business. But your biggest chunks are going to be through IT, in not only getting to one set of applications over time, those types of things.

HR, a lot of the things we're working on right now are to get to the same comp and benefit as well as payroll platforms.

Same thing on the financial reporting side. We've got multiple instances of PeopleSoft. Different versions and, with that, different reporting packages. We're working hard to and actually start to get to one instance here, here in the next month or two. And then with that, get to one reporting. And then that enhances across the business is a single process. You'd be more efficient, overall, in terms of people and all that.

So, that's all the work that we continue to drive.

And the real opportunity above the $100 million – which there might be a little bit in there as you think about it – we're taking a transformational approach in terms of looking at all new technologies out there. I mentioned data analytics, but things like artificial intelligence, chat bots, robotics and things where you can automate processes that have heretofore been done by people – right? – and where can you leverage that. Given the scale of our business now and how well those technologies have come along, there's some real opportunity over time to leverage digital and some of those technologies more and get more efficient.

Stephen Grambling: We have a couple of minutes left, if people want to raise their hands and ask questions.

Unidentified Audience Member: Just had a – how are you going to be managing the debt and also growing your dividend?

John Geller: I'm sorry. The first part was on debt?

Unidentified Audience Member: Yes, managing your debt.

John Geller: So, right now, if you look at our corporate debt – so, excluding the securitizations – our debt to EBITDA is just above, call it, 2.5x – so, 2.6x, 2.7x – on a pro forma basis. What we've said is that we'd like to operate within that 2x to 2.5x and we'd expect to get there with just normal EBITDA growth over the next year to 18 months. So, we have no near-term debt maturities, and we're not looking to pay down debt. We've got a significant amount of cash flow.

Historically, we've been growing our dividends. What we look at is, one, share repurchases. So, if we're buying back – which we have a significant amount of our shares – and at the same time EBITDA and cash flow growth. And so, we try to move dividends. And what we've done, if you look at it as a percentage of our EBITDA and our distributable cash, we've been raising our dividends double digits – 10%, 15% – a year since we launched our dividend. But our payout ratio is not going up because of the repurchases and the underlying growth in the EBITDA.

So, we'll continue to look at it that way. And after that, as I've talked about, we return capital to shareholders through share repurchases. We continue and we have historically gotten aggressive when our stock price we feel is really undervalued, and we'll continue to approach it that way.

Stephen Grambling: Maybe one quick follow-up on the financing business. Do you generally view that as a traffic sales driver or a profit center?

John Geller: So, for us, we don't sell a monthly payment, per se, to our customers. Right? People make the decision to purchase just given their household income. And before we did financing incentives, only, call it, roughly 40% of our sales took the financing. Right? They had other – they paid cash or had other means of financing that. And so, it is there to support sales. A lot of people ask why would anybody take 12.5%, 13% interest or pay that? I think for some people it's just the convenience factor.

But in terms of a profit center, we saw that opportunity to incent financing a little bit and align it with sales. And so, with that being said, our financing propensity with the incentive we offer has driven that up to roughly 62%, 63%. And basically, the incentive offer is giving the buyer, if they keep the debt outstanding for a minimum of 18 months, a single set of use points for that year, in Year 2.

And how does that help with sales? If somebody is buying 3,000 points, they're getting a first-day benefit of 3,000 points and then getting another 3,000 points in the second year. They now have 6,000 points, 6,000 points, and in the third year they're back to the 3,000 points they bought. Right? But they got to use the system at 6,000 points. They've enjoyed the system at 6,000 points. And that does help with reloads and owners wanting more, to get back up to where they were vacationing.

Stephen Grambling: Great. Well, we're just about out of time, but please join me in thanking Steve and John from Marriott Vacations Worldwide.

Steve Weisz: Thank you.

John Geller: Thanks.