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Marriott Vacations Worldwide Corp. *(VAC)*

Q3 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen. Thank you for standing by. Welcome to the Marriott Vacations Worldwide Third Quarter 2012 Earnings Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open for questions. [Operator Instructions] This conference is being recorded today October 18, 2012.

If you like to listen to a replay of today's conference, please dial 1-800-406-7325 or 303-590-3030 with the access code of 4564288.

I would now like to turn the conference over to Jeff Hansen, Vice President of Investor Relations. Please go ahead, sir.

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

Thank you, Ian, and welcome everyone to the Marriott Vacations Worldwide third quarter 2012 earnings conference call. I'm joined today by Steve Weisz, President and CEO, and John Geller, Executive Vice President and CFO.

I do need to remind everyone that many of our comments today are not historical facts and are considered forward-looking statements under Federal Securities Laws. These statements are subject to numerous risks and uncertainties as described in our SEC filings, which could cause future results to differ materially from those expressed in or implied by our comments.

Forward-looking statements in the press release that we issued this morning along with our comments on this call are effective only today October 18, 2012 and will not be updated as actual events unfold. Throughout the call, we

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will make references to non-GAAP financial information. You can find a reconciliation of non-GAAP financial measures referred to in our remarks in the schedules attached to our press release as well as the Investor Relations page on our website at www.mvwc.com.

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

Stephen P. Weisz

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

Thanks, Jeff. Good morning, everyone, and thank you for joining our third quarter 2012 earnings call. This morning, I'll share an overview of our third quarter results and provide an update on the strategies we continue to successfully execute again. I'll then turn the call over to John to review our financial results in more detail. We'll then open the call for your questions.

In tandem with the trend we saw in the first half of the year, total company-owned contract sales increased 4% to $171 million in the third quarter, primarily due to another strong quarter in our core North America vacation ownership business, where contract sales increased 13% and volume per guest or VPG was up 19% over the third quarter of last year.

Additionally, while our owner satisfaction scores have consistently been high for our weeks-based product and even somewhat higher for our points product, we are very pleased that in the third quarter we achieved a 97% owner services satisfaction score from our points owners underscoring the benefits of the program and its ability to meet our owners' needs.

We continue to reduce our reliance on less efficient and less profitable sales channels to improve marketing and sales efficiency. By reducing sales through accounts in these higher cost channels, we're able to focus our efforts on the locations that provide the best returns. As a result of these efforts, we drove a 2.4 percentage point improvement in closing efficiency during the third quarter. These improvements along with positive developments in our cost of vacation ownership products sold contributed to a nearly 12 percentage point increase in our adjusted development margins to 20.9% in the third quarter. This is the third consecutive quarter of margin expansion since our spin-off and with the year-to-date adjusted development margin of 15.4% we are well on our way to our longer-term goal of 18% to 20%.

It was another good quarter for our rental business. Rental revenues were up $4 million over the prior year driven by 11% higher transient keys rented resulting from more inventory available to rent as we continue to see increased popularity with our explorer program and other options for points usage. Rental revenues net of expenses were a loss of $1 million as higher than expected redemption costs associated with Marriott Rewards points issued prior to the spin-off partially offset the increase in revenues. However, we still saw a year-over-year improvement in rental results as they were $1 million higher than the third quarter last year. As we stated last quarter, we expect our rental business on a full year basis to significantly outperform last year.

Moving to our other segments, Asia Pacific revenues net of expenses were $1 million. As I mentioned on our last call, growth in this region will depend on our on-site sales distribution locations, which are much more efficient sales channels than off-site. Therefore, going forward we are focusing our efforts towards future inventory acquisitions with high volume on-site sales distribution potential. We continue to identify opportunities for development margin improvement and, with that in mind, we are closing our off-site sales locations in Hong Kong and Japan in the fourth quarter.

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We expect these actions to provide roughly 10 percentage points of marketing and sales margin improvement in this segment going forward. We anticipate the cost associated with these closures to be between $4 million and $5 million, the majority of which will be included in our fourth quarter reported results.

In Europe, we continue our strategy of selling out of our remaining developer inventory. We believe the flexibility of our new North America points exchange program option for our European weeks owners, which we implemented this summer, will enable us to continue to sell out developer inventory over the next two years despite the current economic headwinds in that region.

In our Luxury segment, we continue to make progress on the strategy we discussed on our last call of selling the remaining Luxury inventories through the North America points program, and we have converted several of our Luxury sales distribution centers to now sell our North America points program. Going forward, future sales of Luxury inventory that we contribute to our North America points program will be included in our North America financial results. However, we will continue to report on our progress as it relates to the sellout of our Luxury inventory and the related unsold maintenance fee impact given the significance of these items.

As an update on the Ritz-Carlton Club and Residences at Kapalua Bay, since our last call, we were able to work out an extension agreement with the owner associations to allow us to continue to manage the resort through the end of this month. Negotiations are continuing on another extension term and on a broader workout arrangement with the lenders and owners association.

Now I'd like to provide an update on initiatives we are working on at the corporate level. We have been working diligently on our organizational and separation efforts as it relates to reducing certain services provided by Marriott International. As we have stated before, we have service agreements for certain technology, human resources and other administrative services, which we put in place in conjunction with our spin-off. Our goal as these services agreements are replaced with either new in-house capabilities or third-party providers is to create the appropriate infrastructure for a company of our size. While work is underway and final estimates are still being refined, we anticipate annual savings associated with these efforts to be between $15 million and $20 million, with the full benefit being realized by the end of 2014.

To achieve the future savings, we anticipate spending between $30 million and $35 million, predominantly in 2013 and 2014. It is important to note that a significant amount of these costs are unavoidable as we are required to transition from our service agreements with Marriott International before the end of 2013. The remainder of the costs are being deployed to improve organizational efficiency.

Regarding our disposition of excess land and Luxury inventory, we continue to see high interest in several parcels and are working to have unlisted parcels out to market as soon as possible. Based on the indications of interest we have received thus far, we remain on target for the disposition of these assets over the next two to three years.

It's been another solid quarter, the third in a row, and our margin growth has continued to be the story to improve sales efficiencies and product cost. The rest of our business is on strategy and delivering the targeted results as well. Based on trends we've experienced thus far in 2012 and our expectations for the fourth quarter, we are increasing our 2012 adjusted EBITDA guidance to $130 million to $140 million from $115 million to $125 million.

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

John E. Geller

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

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Thank you, Steve, and good morning to everyone on the call. We are continuing to execute against the strategies outlined almost a year ago when we spun off from Marriott International. Our sales pace, VPG, and development margin in our North America segment have substantially improved over last year and we are taking steps in our other segments to move the needle there as well.

In the third quarter, total company-owned contract sales increased to $171 million, $7 million or 4% higher than the third quarter of last year. Results continue to reflect the strong performance of our North America segment where contract sales increased 13% year-over-year, partially offset by lower contract sales in our other segments, a good portion of which is a direct result of our margin expansion strategies in Luxury and Asia.

In North America, we had driven three consecutive quarters of double-digit contract sales and VPG growth, with VPG increasing in the third quarter by 19% over the last year to $3,051. But the highlight this quarter is improvement to our company development margin which has grown from 3.5% in the third quarter last year to nearly 17% this year on an as reported basis.

Consistent with the first half of the year, revenue reportability once again negatively impacted the third quarter margins. After adjusting for reportability, total company adjusted development margin improved to 20.9% from 9% in the third quarter of last year. We have provided supplemental information on schedules A12 through A15 in the earnings release that illustrate the impact of revenue reportability on the development margins for the total company as well as for North America.

Growth in the company's adjusted development margin continued to be driven by improvements in both the cost of vacation ownership products and marketing and sales execution. The margin associated with the cost of vacation ownership products improved more than 8 percentage points in the third quarter with nearly all the improvement or approximately $13 million resulting from favorable product cost true-up activity primarily in North America. Marketing and sales drove roughly 4 percentage points of improvement primarily from higher closing efficiency, from improved execution as well as higher pricing.

While product cost true-ups are a normal part of our business, given the significant impact they had on the third quarter results I'd like to spend a few minutes explaining how they arise. Accountings guidance requires us on a quarterly basis to estimate both the total cost to develop a project as well as the total revenues we expect to generate over the life of the project, including estimated pricing and sales pace assumptions. As we sell our vacation ownership products, we expense the cost of these products as a percentage of the revenue with the percentage being determined as the total projected cost for development divided by the total projected revenues. To the extent either the total cost or total revenues change from the most recent estimate, a non-cash adjustment either positive or negative is recorded in our statement of operations to true cost up to what would have been recorded historically if the revised estimates had always been used.

The true-up that we recorded in the third quarter related primarily to higher revenues we expect to generate over the life of the projects mainly from higher pricing assumptions as compared to previous estimates and to a lesser extent lower overall development cost. When we launched our North America points program two years ago, we estimated future price increases. However, because we had no historical program results, our assumptions turned out to be conservative. With two years of actual pricing performance, we have increased slightly our future point pricing assumptions to more closely align with our historical performance, which we believe reflects what we will achieve in the future.

Through the first three quarters of this year, our product cost rate is approximately 33% of revenues from the sale of vacation ownership products as compared to 40% last year. Given this performance and expectations for the fourth quarter, we expect our full year product cost rate to be roughly 34% of revenues from the sale of vacation

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ownership products and we expect them to remain at this level for the next few years. In addition to these updated pricing estimates, our future product cost assumptions also reflect our enhanced inventory repurchase program, where we are proactively buying back previously sold inventory at lower cost than it would take to develop new inventory.

As you might expect there are customers who for one reason or another desire to no longer under vacation ownership interest. By actively repurchasing this inventory we obtain lower cost inventory in desirable locations that we can subsequently resell to the North America points program. As a result of these improvements we have seen in marketing and sales and product cost, we expect our 2012 full year adjusted development to be between 14% and 15% versus our previous target of 12%. In North America, we expect 2012 full year adjusted development margin to be between 17% and 18%. Looking ahead to 2013, we expect to continue to grow these development margins further.

In our rental business our results have continued to improve for the third straight quarters as rental revenues totaled $57 million in the third quarter up 8% over 2011. This was primarily driven by an 11% increase in keys available to rent as again our owners are finding our explorer and Marriott rewards points programs to be very popular options for utilizing their vacation ownership points. However, we experienced higher than expected redemption costs associated with Marriott Rewards points issued prior to the spin-off and as a result total rental cost increased $3 million year-over-year. However, total rental revenues net of expenses improved $1 million over the third quarter last year.

We are again seeing positive results in our resort management and other services business with third quarter revenues net of expenses of $12 million, up $2 million from the same quarter last year. Margins continue to improve by 3 percentage points over the third quarter last year to 20%.

Turning to our financing business, revenues net of expenses decreased $3 million year-over-year due to our notes receivable balance from prior year's burning off faster than we are originating new notes. We expect financing revenues net of expenses to continue declining over the next few years until the origination of new notes offsets the impact of the declining portfolio.

In addition, as we discussed in our second quarter earnings call, early in the third quarter we completed a notes receivable securitization selling $250 million of loans at a 95% advance rate and a weighted average interest rate of 2.625%. Given the favorable deal terms from our recent securitization and our expectation for a continued low interest rate environment, we believe our financing profit after taking into account consumer financing interest expense has stabilized and should increase slightly beginning next year.

In our Asia-Pacific segment, we generated segment results of $1 million, down from $2 million in the third quarter of 2011. We have taken considerable steps toward aligning our performance with our strategy of on-site sales distribution locations versus off-site. And as Steve mentioned, in the fourth quarter we are closing our off-site sales distribution locations in Japan and Hong Kong. While this lowers the number of sales force and our ability to generate top line revenue in this segment in the near term it will allow us to materially improve our marketing and sales cost. Over the longer term, we expect to grow sales by adding new inventory locations with strong on-site sales distribution opportunities.

Our Europe segment continues to track towards sellout of developer inventory. The third quarter adjusted financial results were $5 million or $1 million lower than this time last year. We remain focused on being substantially sold out of developer inventory in the next two years and believe the ability for our owners to exchange their week for points in the North America system will provide some stability for sales despite the challenging European economic environment.

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In our Luxury segment, adjusted segment results for the third quarter were flat for last year at a loss of $5 million. It's important to note that during the third quarter we converted several of our Luxury sales centers to North America points as we continue preparing the remaining Luxury inventory to be sold to the North America points program. As such, going forward, revenue from the sale of this inventory will be reflected in North America results.

Steve briefly discussed the organizational and separation-related activities we have begun. However, I'd like to provide a little bit more color around the cost and the savings estimates. The $30 million to $35 million of total future spending, a portion of which will be capitalized, includes cost to complete our separation for Marriott International as we – as well as to establish a more appropriate infrastructure for a company of our size. Keep in mind that a significant portion of these costs are required to transition from services that will no longer be provided by Marriott International.

We anticipate that this spending will be incurred over the next 24 months with approximately $8 million being incurred during the fourth quarter of 2012, $15 million to $20 million in 2013 and the remainder in 2014. More importantly, however, are the long-term savings associated with these efforts. We expect the total annual savings to be approximately $15 million to $20 million with the full benefit being realized by the end of 2014. On a full year basis for 2012, we will see about $5 million in cost savings flow through, which is already reflected in our guidance. And for 2013, we expect to realize about $5 million to $7 million in additional savings.

Turning to our balance sheet and liquidity position, since the beginning of the year, real estate inventory balances declined $62 million to $891 million, and total debt outstanding declined $57 million to $793 million, nearly all of which is non-recourse debt associated with secured vacation ownership notes.

At the end of the third quarter, cash and cash equivalents totaled $212 million and the company had $195 million in available capacity under its revolving credit facility. In addition, we amended our warehouse credit facility to provide $250 million of borrowing capacity and to extend for a two-year term that takes us through September of 2014. The two-year term provides greater financial flexibility and the $250 million of borrowing capacity better aligns with our liquidity needs.

At the end of the quarter, we had no amounts outstanding under the warehouse and $47 million of vacation ownership notes receivable eligible for securitization. So three quarters through our first full year as a public company and each quarter we continue to make substantial progress towards the goals we laid out last year. North America results remained strong with solid contract sales, VPG and development margin performance, progress has been made toward repositioning our Luxury and European segments for sellout of developer inventory, and with strong cash flows and declining inventory and debt levels, our balance sheet remains strong.

Based on three quarters of performance and a positive outlook for the fourth quarter, we are raising our full year adjusted EBITDA guidance to a range of $130 million to $140 million and our EPS guidance to $1.17 to $1.31 per share. We are reiterating our adjusted free cash flow guidance of $130 million to $145 million. This cash flow guidance does reflect the cash outlay for organizational and separation related costs as well as other charges that will be incurred this year.

Hopefully your takeaway from today as we approach our one-year anniversary as a standalone public company is that Marriott Vacations Worldwide remains focused on delivering against our financial commitments, to improve development margins, drive company-wide cost savings through our seperational and organizational efforts, improve rental results, stabilize financing profits and provide strong cash flows long into the future.

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As always, we appreciate your interest in Marriott Vacations Worldwide. And with that, we'll now open the call up for Q&A. Ian?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question is from the line of Eli Hackel from Goldman Sachs. Please go ahead.

Eli Hackel
Analyst, Goldman Sachs & Co.
Q

Thank you.

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

Morning, Eli.

Eli Hackel
Analyst, Goldman Sachs & Co.
Q

Good morning. I have three questions. First, just a little bit more on the product true-up costs, can you just give us an idea what a like-for-like comparison of this year versus last year on North American development margins? Obviously, with the 23.8% had a lot of benefit from the true-up costs, is that directly comparable to the 9.3% or do you need to, should you really subtract $12 million there to get an apples-to-apples? Second question, just on Asia, just talk about your growth expectations there. Obviously, you're going to look to be a little bit more efficient, do you think you'll grow Asia contract sales next year? And finally just an update on your thought or the board's thought on capital allocation.

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

Sure. Hey, Eli, good morning. I'll start with the first one on product cost true-up. These are normal true-ups that we do changes and estimates. It's hard to say you should back out the number for comparison purposes because really a lot of the product cost true-up relates to profit you would have recognized in previous years on product that you sold.

So we had certain estimates when we recognized development margin last year. We've done better and our expectation is we'll continue to have those price increases. With that information, you're truing up through the previously sold inventory. So, said another way, the margin you're getting now would have been – some of that relates to previous period. So it's hard to go back and say, well, X amount of this year's is related to last and what it looks like on an apples-to-apples basis.

I think the important takeaway is really the fact that on a go forward basis, our product cost will be lower and our development margins – the full year company guidance now is 14% to 15%, even though you're getting some one-time pickup here in the third quarter, we're saying that's sustainable going forward with lower product cost and higher margins, and we expect to improve over those full year results this year, next year.

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Eli Hackel
Analyst, Goldman Sachs & Co.
Q

So that 14% to 15% should, there should be improvement from that 14% to 15%, there is no one-time anything?

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

That's right; we're saying that this is going to be sustainable going forward.

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

And, Eli, this is Steve, let me address your Asia question. I think it's important we kind of go back just a moment and talk about kind of how we've gotten to where we are. When we first started our new points-based program in Asia which was five or six years ago now, we anticipated starting with some off-site sales locations and filling in with on-site distribution which as we've already spoken about, the on-site is the much more efficient from a sales cost standpoint, having said, we also needed to generate some sales to begin, and it was easier to start up from off-site.

So we were well on that track until kind of the bottom fell out of the economic market, at which point in time Marriott asked us to stand down on any new development that we had in Asia. In fact we had a hotel that we were going to convert to timeshare in that region that we ended up, we owned it, we ended up having to sell it, et cetera. So what we were left with was an imbalance of too much off-site and not enough on-site.

So what we have been about for some time now is been out trying to identify new development opportunities where we will be able to establish an on-site sales presence in markets that we believe will generate substantial growth for the business. As you might imagine it takes little time to make that happen and we're not in the position to be able to announce something yet but I can tell you, I think we are, every time we have these calls we get increasingly closer to being able to do so.

So, whether 2013 will see a material increase in sales, in fact I would say it would probably go the other direction because, for the first three quarters of the year, we actually had both Hong Kong and Tokyo and as the revenue generators however they were not profit generators because of the high sales and marketing cost. So, I think 2013 you won't see a substantial increase in revenue, in fact you'll see a decrease but I think you will see some improvement in the margin of the business we do in Asia-Pacific.

On capital, on the allocation of capital, we spent the first year trying to figure out exactly where we are and we've already said that there are a number of opportunities that we think that we should be pursuing to kind of broaden our footprint in this industry. Some of the things that we could not have done under Marriott. And so our first and foremost priority will be to fuel those needs through cash that we have available. If however in 2013, we see ourselves in a situation where those needs have been met and we still have material amounts of capital available, we will be having meaningful discussions with the board about ways in which to we begin distributing that cash back to our shareholders. As you might imagine that typically takes the shape of either a dividend or share buybacks and like I said, when we have more to talk about there, we'll be happy to share it with you.

Eli Hackel
Analyst, Goldman Sachs & Co.
Q

Great, thank you very much.

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

A

Thank you.

Operator: Thank you, our next question is from the line of Bob Lafleur from Cantor Fitzgerald. Please go ahead.

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

A

Hey, Bob.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Hey, gentlemen.

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

A

Good morning.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

I want to stick with this true-up for a minute. The $13 million is that, is that just the amount that's attributable to prior periods or if not how much of it was prior period and how much of it was specific to the sales that were made in this quarter just so I can understand that.

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

A

Sure.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

And then I've got a second question after that.

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

A

Sure, Bob, it's John. Yes most of it would be related to prior quarters. Of the $13 million a portion of it was the pricing. A portion of it is we have actual cost of projects that are being completed coming in last than we had originally anticipated. So like I said, you recognize your product cost based on the best estimates you have at the time and as those estimates change that's when you would book this product cost true-up to essentially get to where you would have been if you were caught right from the beginning. And so it's really hard to go back and try and say well how much is related to any specific period but it is mostly for prior periods, there's very little pickup in the current period.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

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Okay. So then, is the right thing to do just to add $13 million back to the cost of sales and to get a true run rate cost of sales or...?

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

Well, if you're going to do that then you'd have to make assumptions about spreading that $13 million back to prior years for prior quarters.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

What – I mean, I understand the accounting there.

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

Yes.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

It's a one-time true-up and if you guys started doing this at the dawn of time you'd have to adjust back to the dawn of time. But from a go-forward standpoint

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

Yes.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

If all $13 million of that was attributable to periods other than this current quarter

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

Yes.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Then the run rate, large development margin you had in the quarter would basically just add $13 million back to the cost of goods and divide that by the revenue, right?

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

Sure.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay.

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

A

You can look at it that way. Like I said, I think on a go forward what we're also saying is because of now lower product cost that we're going to have on the projects we sell going forward, you're going to have a lower product cost related to that won't be as low as what you're seeing in the quarter because of what you're saying that one-time adjustment. And the other thing I mentioned was we are being a little bit more proactive in buying back inventory on the secondary market and in being opportunistic there where we can buy product at much less than what it would cost us to build new product. And so the impact of that will also help margins going forward.

So when we look ahead to next year, even on a full year basis, we have even with the adjustment this year, you have improvement in the development margin fairly significant off our targeted 12% and then what I'm saying is we'll be able to maintain and actually improve on those margins as we go into 2013.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Well, let me ask a question in another way then.

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

A

Yes.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

So how much on a go forward basis did your cost of sales go down, however you want to look at it, per unit of revenue? So before you were charging, let's just say, $35 or $100 of revenue, is that $35 now $34, $32, I'm just trying to get a sense of magnitude about how much the go forward assumption for cost of goods sold went down?

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

A

Yes, it's probably in that, on a companywide basis, Bob, it's in that, call it 34% here in the near term and obviously we're always going to look to try and get that even lower longer term.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Okay. Thank you. And then the other question I have on sort of an unrelated topic is what's going on with your tax rate, I mean it was 60 somewhat percent...

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

A

Yes.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

After backing out the adjustments. Why is it so high and what can you do going forward to mitigate that?

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

Yes, Yes. The – in the quarter, couple things, you say backing out the adjustments, there is one adjustment when you look at the income before taxes for those that are listening in related to interest on our preferred, which is a dividend it runs through interest expense. So in terms of getting your effective rate you have to add back that interest. But even with that that's probably a couple points. The impact that you're seeing is on the – on an international taxes and really relates in the quarter to the decision to shut down some of these off-site sales centers that we talked about in our Asia segment.

So, going into the third quarter, we were making money, add profit there. Because at some of these one-time charges now that we're going to have, we're now going to have some losses in areas where we're shutting down at least for the near term. As a result, there is, even if there is a tax benefit to those losses for GAAP you have to put a reserve on those. So you have a little bit of a true-up if you will in the quarter related to truing up that reserve on the NOL that you now need to look at because of our change in assumptions in Asia. We'll continue to see I think on an effective rate, we're going to be in the mid-40s. Now what we're doing as a new standalone public company is we are doing tax planning and we're looking at ways that we can utilize some of these international losses and make sure we get the benefit. If we're successful in doing that, that will benefit us with lower effective rates going forward, but a lot of work that still needs to get done in that area.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

You're not thinking about buying any synthetic oil plants or anything like that, are you?

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

Windmills.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay.

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

No, nothing, nothing like, nothing that exotic.

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

Been there. Done that. We got the t-shirt.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

All right. Thanks, guys.

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

Yes, thank you.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] And our next question is from the line of Chris Agnew from MKM Partners. Please go ahead.

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

A

Hi, Chris.

Chris Agnew
Analyst, MKM Partners LLC

Q

Thanks very much. Good morning. Hi.

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

A

Good morning.

Chris Agnew
Analyst, MKM Partners LLC

Q

First question if I can ask about, what do you think the appropriate level of long term or appropriate level long term for inventory to maintain say the current sales pace and maybe if just, what are your expectations for spend this year on inventory?

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

A

Okay. Well, generally speaking our goal is to get to about two times the product cost necessary to support the annual sales. We are higher than that number today. And one other thing that John mentioned in his remarks was that we continue to bring down the inventory balance. So, while I don't have a number right here in front of me. Generally speaking what we end up doing is we take more off the balance sheet than we spend in product cost. John, you have some more specific numbers.

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

A

Yes, just a little color, I mean if – if you're on our cash flow statement and you look at the change in inventory, up to this point that's the difference between the non-cash product cost coming off and your cash CapEx spend. So, if you look on the P&L, we had product cost year-to-date of – I'll get you the number, but that's your non-cash piece, the actual CapEx spend – we'll get you the difference. So for the full year, we'll probably spend on development around call it $125 million to $135 million versus what's coming off the P&L for product cost.

Chris Agnew
Analyst, MKM Partners LLC

Q

Got you. Got you, that makes sense. And do you have an idea in your head what that development spend will be sort of as you once you've got that inventory down to level that's more normalized?

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

Yes. The goal is in real estate never really gets a just-in-time delivery and in terms of that manufacturing sense, but the goal would be that even as we get to call it a stabilization that the amount of spend that we have will approximate our actual non-cash product cost when you get to that equalization. Right now our spend is less than the actual product cost, so the inventory balance is coming down. As you start to ramp up and you get to that equilibrium, it might be little bit more or less in any given year, but our goal is that that would approximate your product cost spend. So you're replacing your inventory as you sell it.

Chris Agnew
Analyst, MKM Partners LLC
Q

Got you. And then on consumer financing, you said that's stabilized and should reverse next year, actually to grow. I think that's a little sooner than you'd previously mentioned. Just wondered what is changed there, is it stronger sales pace or financing?

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

No, it's really the low interest rate environment. When we talk about our financing profit, you have on our P&L right, you have our financing revenues, you have the direct cost of the servicing, et cetera. Cost to service those loans. On that revenue, less expense, you'll continue to see some margin loss there, like we've talked about, because the notes receivable balance will continue to come down.

The big difference is if when you look at the actual securitized interest expense related to those securitizations, historically, we're probably at about a 5% on the outstanding securitizations in terms of the interest rate that we pay. The deal we just did for $250 million was at call it 2.6%, and just given some of our next securitization, some clean up of some of our existing securitizations that will hit a 10% threshold here over the next six to eight months that will be able to securitize, we think that we're going to be replacing a lot of that call it 5% interest rate at something south of 3%. And so that interest rate pick up is going to more than offset our expectations previously about the financing business, and that's where you'll start to see after interest expense a little bit of a pickup I would say next year.

Chris Agnew
Analyst, MKM Partners LLC
Q

Okay. Okay. But then like the notes receivable balance will continue to sort of come down for next couple years or so.

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

Yes, exactly.

Chris Agnew
Analyst, MKM Partners LLC
Q

Yes, Yes, okay

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

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It's driven by the cost side.

Chris Agnew
Analyst, MKM Partners LLC

Q

And then final question on expectations for excess land sales. I'm trying to remember what you'd said previously, but did you sort of extend the timeframe? I think you mentioned two to three years, has there been any change there?

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

A

Not any material change at all, Chris. I mean as you might imagine, when we said what we said, which was when we were doing a kind of a road show before we went out last fall, there were certain assumptions about what the economy was going to do in 2012 and everything else. We still feel very comfortable with the windows that we talked about. In fact, one of the largest parcels that we have is a parcel of land that exists in Hawaii. That got listed just this past week. Some of the remaining stuff we have listed are just a little more complex; it takes us a little more time to get them done before we put them out in the market. But I feel very encouraged by what we've seen thus far in terms of some interest levels that we've seen, and so we don't believe that we're making any material changes to what we've said all along.

Chris Agnew
Analyst, MKM Partners LLC

Q

Okay, thanks. That's very clear. Thanks very much, guys.

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

A

Thank you.

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

A

Thanks, Chris.

Operator: Thank you. And we have no further questions at this time.

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

Okay, great. Well, in sum-up hopefully you took away from all of this that we're very pleased with the momentum we've generated so far in 2012. We look forward to reporting our progress on future calls and want to thank you again for your participation on the call today, your continued interest in Marriott Vacations Worldwide. And finally to everyone on the call and your families, enjoy your next vacation. Thank you.

Operator: Ladies and gentlemen, this does conclude our conference for today. Thank you for using ACT and you may now disconnect.

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