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Marriott Vacations Worldwide Corp. (VAC)

Q3 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Marriott Vacations Worldwide Third Quarter 2013 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]

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

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

Thank you, Danielle, and welcome to the Marriott Vacations Worldwide Third Quarter 2013 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 10, 2013 and will not be updated as actual events unfold. Throughout the call, we will make references to non-GAAP financial information. You can find a reconciliation of non-GAAP financial measures referred to in our remarks in the schedules attached to our press release, as well as the Investor Relations page on our website at ir.mvwc.com.

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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 earnings call. This morning, I'll discuss our results for the third quarter of 2013, which include continued growth in adjusted EBITDA and solid development margin performance. Given our strong year-to-date results as well as our outlook for the fourth quarter, we've increased our full year 2013 adjusted development margin, free cash flow and EBITDA guidance. I am also pleased to announce the beginning of our capital return strategy which I will discuss more in a moment. I will then return the call over to John who will provide additional detail on our financial results after which we'll open the call for your questions.

Today's announcement of our share repurchase program shows our confidence in this business model and the company's ability to generate robust cash flows. Our balance sheet is strong and is naturally deleveraging as our EBITDA grows and our non-recourse securitized debt is paid down through collections from the notes receivable. Further, the company has virtually no recourse debt other than the $40 million of our subsidiary's mandatorily redeemable preferred stock, which is now not callable until October 2016. In addition, we anticipate generating over $150 million in cash proceeds over the next several years as we execute against our strategy of disposing of excess land and inventory.

From an investment perspective, we see strong organic growth opportunities in both our North America and Asia-Pacific segments where we are targeting to add great new destinations that will provide additional sales distributions to grow our top-line. Our capital-efficient points model allows us to fund these new investments from our operating cash flows. Further, we plan to explore arrangements with partners for some of these new investments which would provide asset-light opportunities to further improve cash flows.

Our free cash flow and strong balance sheet also allows us the flexibility to opportunistically pursue acquisitions of timeshare related businesses, if we determine an acquisition is a strategic fit and provides appropriate returns to our shareholders. We expect this overall capital allocation strategy will result in excess capital, which we would intend to return to shareholders.

Given our confidence in our long-term growth outlook and cash flow generation potential, our board has authorized us to repurchase up to 3.5 million of our outstanding shares. We are committed to our top line growth and margin expansion strategies in addition to a disciplined and balanced capital allocation strategy.

Turning to our third quarter results, we're pleased with our strong performance with adjusted EBITDA up $17 million over the third quarter of last year to $50 million. This was primarily achieved through stronger development margin, higher resort management and other services margin, and improved bottom-line rental results.

Total company contract sales were down less than 2% to $168 million in the quarter reflecting improved performance in North America. This improvement was more than offset by the impact of the closure of underperforming offsite sales distributions in our Asia-Pacific segment late last year, as well as declining sales in Europe, as we continue our strategy to sell out our remaining inventory in that segment. In our key North America segment, contract sales were up $10 million or 6% over the third quarter of 2012, driven by better performance in our traditional vacation ownership business and higher sales from the disposition of excess residential units.

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We generated $7 million of residential sales in the quarter, mainly at our resort near Panama City, Florida. While these sales flow through our North America development revenue, they are part of our broader strategy to dispose off excess land and inventory. With only seven more units left to be sold in this resort, we expect to sell through the remaining inventory by early next year.

In addition to these residences, we recently completed the necessary steps to begin selling 10 residences at our Ritz-Carlton property in San Francisco. We expect to dispose off these units over the next six to nine months beginning in the fourth quarter, which when combined with the sales of remaining Panama City units, should generate up to $20 million of net cash proceeds.

Excluding these residential sales, North America contract sales were up 2% in the quarter on a 6.6% increase in VPG to $3,252. The improved VPG was driven by a mix of increased pricing and nearly one point improvement in closing efficiency. This was partially offset by tour flow, which was down 4% in the quarter, but represented an improvement from last quarter when tour flow was down 6%.

As I mentioned before, we are focusing on growing our tour flow cost effectively, as we pivot to more first-time buyer tours and our longer-term goal of a 50-50 mix of new buyers to existing buyers. You should keep in mind, however, that many tours we book today will not recur until the next time a potential buyer stays at one of our resorts, which may not happen for another 10 months on average.

As we look ahead to the fourth quarter, we expect tour flow excluding the 53rd week to be down roughly 4% year-over-year. As a result, we have lowered full-year contract sales growth guidance for North America to 4% to 8%. Excluding the impact of residential sales, we expect contract sales growth for North America timeshare to be between 3% to 5% for the full year.

As we move into next year, we expect tour flow to continue to improve sequentially with our 2014 full year goal of year-over-year tour growth.

In terms of development margin, we achieved strong performance during the third quarter with a total company adjusted development margin of 20.3%, down slightly from the third quarter last year, which benefited from favorable product cost true-up activity.

Our third quarter product cost rate was higher than the 33% we have been targeting, mainly as a result of the higher cost residential sales that we made in the quarter. Excluding those sales, our 34.7% product cost rate would have been closer to 32%. Looking at the full year, including the impact of further residential sales, we still expect our full year product cost rate to approximate 33%.

Our rental business contributed an additional $9 million to the bottom line in the third quarter. This was a result of two points of higher occupancy on 11% more transient keys rented, and 10% higher transient rate. We continue to expect full year rental results to be materially higher than last year, but we remind you that the fourth quarter is typically the softest due to seasonality.

Our resort management and other services business continues to steadily improve, up $4 million over the third quarter of 2012 to $17 million, and as has been true throughout 2013, this improvement was driven by increases in club dues and management fees, as well as improvements in our ancillary operations.

Shifting to G&A, cost increased $3 million over the third quarter of 2012. Our third quarter results benefited from $1 million of incremental savings related to our organizational and separation related efforts. However, our G&A

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cost also reflected normal inflationary growth, higher legal cost, and incremental standalone public company costs.

For the full year, we anticipate our G&A cost will increase year-over-year, driven mainly by inflation, the impact of the 53rd week of cost due to our fiscal reporting calendar, and higher legal and public company costs. However, we expect these increased costs to be partially offset by roughly $5 million of savings related to our organizational and separation related efforts.

In closing, we had a very solid third quarter and expect our performance to continue through the remainder of the year. For that reason, we are increasing our adjusted EBITDA guidance by $10 million to $165 million to $175 million, and raising our adjusted development margin guidance by one point to 18% to 19%. We are also increasing our net income and cash flow guidance, which we'll speak to momentarily.

With that, I'll turn the call over to John to provide a more detailed look at our results and cash flow projections. John?

John E. Geller

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

Thank you, Steve, and good morning to everyone on the call this morning. Strong EBITDA growth and improved business results highlighted another great quarter this year. Our North America segment, key to our growth throughout this year, saw a $23 million increase in revenue from the sale of vacation ownership products. This was driven by higher contract sales and favorable revenue reportability year-over-year. Contract sales improved by $10 million over the same quarter last year to $152 million.

As Steve mentioned previously, approximately $7 million of this increase was due to the sale of residential product, primarily at our property in the Florida Panhandle. The sale of this inventory was part of our excess land and inventory disposition plan, so we were pleased to be able to capitalize on improving real estate markets. Excluding the impact of these residential sales, contract sales in North America improved $3 million from the third quarter of last year.

The favorable revenue reportability in the third quarter of this year had a $1 million positive effect on North America reported development margin, increasing the margin by 50 basis points to 22.7%. Reportability had the opposite effect on the third quarter of 2012, negatively impacting reported development margin by $7 million and reducing the margin percentage by 3.6 percentage points.

Excluding the impact of reportability in both years, development margin in the quarter was 22.2%, 60 basis points lower than the third quarter of last year. Similar to our first three quarters of this year, we do not expect revenue reportability to have a meaningful impact on our reported fourth quarter development margin. However, remember that favorable revenue reportability in the fourth quarter of last year had a $13 million positive effect on reported North America development margin. The 60 basis point decline in North America adjusted development margin reflects the impact of higher product cost offset partially by improved marketing and sales cost.

The impact of higher product cost true-ups in the prior year improved development margin last year by more than 8 percentage points. Our product cost rate this year continues to benefit from our inventory repurchase program. However, as Steve mentioned, our product cost rate in the quarter was negatively impacted by higher cost residential sales, which raised our North America product cost rate by 3 percentage points.

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Marketing and sales costs which improved 3.2 percentage points over last year benefited from higher VPG as well as the impact of the residential inventory sold in the quarter, which carries lower marketing and sales cost. Excluding the impact of the residential sales, marketing and sales margin improved by 1.7 percentage points.

Rental results for the company improved by $9 million in the third quarter compared to the prior period as we continued to better understand and estimate owner usage behavior. As we mentioned on the last call, the fourth quarter is generally a softer rental period, so our expectations for full-year rental results are in the $14 million to $17 million range, a substantial improvement over the full-year 2012. This range does not include any additional charges related to our pre-spin Marriott Rewards liability which, depending on actual redemption cost, could have a negative impact in the fourth quarter.

In our resort management and other services business, revenue net of expenses improved $4 million to $17 million in the fourth quarter. These results reflect higher annual club dues earned in connection with our points product, higher management fees and improved ancillary results from the disposition of a golf course and related assets at one of our Ritz-Carlton branded resorts late in 2012.

In our Asia-Pacific segment, results were down $1 million from the third quarter of last year, while contract sales were down by $8 million as a result of the closure of underperforming offsite sale centers late in 2012. These declines were offset by corresponding reductions in marketing and sales and product cost.

Turning to Europe, adjusted segment results were $6 million, flat to last year as we continue our strategy of selling out remaining inventory in that region. Our financing business continues to improve. Revenue net of financing expenses and consumer financing interest expense was flat to the third quarter of last year, as default activity trends downward and interest rates in the ABS markets remain at historic lows.

As we announced in August, we completed a $263 million securitization with a 95% advance rate and a blended interest rate of 2.21%, almost 0.5 point better than the securitization we completed last summer, which had been the strongest deal to date. As of the end of the third quarter, our securitization portfolio had an average interest rate of 3.5%.

Turning to our balance sheet and liquidity position, since the end of 2012, real estate inventory balances declined $28 million to $853 million, which is comprised of $390 million of finished goods, $193 million of work-in-process, and $270 million of land and infrastructure. The company's debt outstanding increased $73 million from the end of 2012 to $751 million, including $747 million in non-recourse debt associated with the securitized notes. In addition, $40 million of mandatorily redeemable preferred stock of a subsidiary was outstanding at the end of the third quarter of 2013.

Cash and cash equivalents totaled $288 million and we also had $17 million of notes receivable eligible for securitization and $196 million in available capacity under our revolving credit facility.

Our full year adjusted free cash flow outlook continues to improve, primarily from roughly $10 million of higher projected net income, $10 million from the deferral of development CapEx and other capital spending, and $30 million of favorable working capital changes as we continue to fine tune the timing of our working capital activity as a standalone public company. As a result of these changes, we are raising our outlook for adjusted free cash flow for the year, excluding the impact of organization and separation-related charges and litigation settlements by $50 million to $170 million to $185 million.

This guidance is approximately $40 million higher than what our free cash flow would be on a – would it be on a normalized basis because of the impact of certain items. These items, which will continue to impact our free cash

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flow over the next few years, include the pay down of the Marriott Rewards pre-spin liability, the timing of inventory spend and organizational and separation-related costs. Our 2013 free cash flow on a more normalized basis could be between $135 million and $140 million.

In addition to our adjusted free cash flow guidance, as a result of improved business results, we're also raising the range of our adjusted net income guidance to $81 million to $87 million, and our fully diluted earnings per share guidance to $2.21 to $2.37 for the full year.

Additionally, we are raising the range of our full year adjusted EBITDA guidance to $165 million to $175 million, and our adjusted development margin guidance to 18% to 19%.

With all that, let me close by saying we had another very strong quarter of EBITDA and development margin performance and remain optimistic about the longer term growth potential of our business. As always, we appreciate your interest in Marriott Vacations Worldwide.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] Our first question is from Robert Higginbotham from SunTrust. Please go ahead sir.

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

A

Good morning, Rob.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

Good morning, guys. My first question is really around your sales and marketing dynamic, meaning your kind of VPG tour flow equation and your VPG number continues to be impressive in high single-digits. You still have the [ph] challenges throughout your (20:24) tour flow down, I guess what I'm wondering is two-fold, what are you doing differently now versus what you had been doing up to last quarter to drive tour flow. And then as you look forward to 2014, and targeting positive tour flow growth, how should we think about the VPG opportunity. In other words, do you expect to be able to continue to improve VPG with – and tour flow given the new paradigm, if you will?

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

A

Well, thanks Rob. This is Steve. Let me try to take it on a couple of different fronts. As we've mentioned in previous calls, one of the things, the dynamic that has been in place is that tours that we have generated from our existing owner base have seen a decline over the past almost six months to nine months kind of thing, basically because the bulk of the people, the bulk of the owners that we had when we converted to a points based program in June of 2010, we've spoken to, they've taken a tour, we've helped explain to them what the new – whole new points based program is all about.

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And so, by definition they don't need to come talk to us again, and so that has started to decline. At the same token – same time we started to kind of turn towards selectively turning on channels to generate new customers. You may recall that in the 2008-2009 timeframe, we as well as many of the others in our space very deliberately got out of a number of channels that were targeted at more first-time buyers largely because they were relatively inefficient to talking to your existing ownership base. So, as we continue to dial those up, we've done that very selectively and we'll continue to do so, taking the learnings that we had when we went through the turn-off of those programs and applying them proactively going forward.

The second thing that will happen is that as we add new flags on the map, we will do so which will generate new distribution centers for us in markets that are obviously good vacation destinations. So we believe we will get additional tour generation out of that.

Relative to your question about what's going to happen with VPG growth on a percentage basis, I mean, obviously comps get to be a little bit more challenging. We've had a great run in terms of driving this up. I think most would suggest the VPG range that we're in now in the $3,200, $3,300 range is pretty attractive. We will continue to try to drive that. We will drive that hopefully through two different methods, one of which is continuing to focus on increasing closing efficiency.

The second is, there should hopefully be some natural benefit that we would get if the economy continues to improve. Obviously, as we've talked before, there is a fairly tight correlation between closing efficiency and consumer confidence if that consumer confidence number can somehow find a way to get some traction and move north that would benefit us as well. Hopefully that's answered your question.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

It does, but to maybe follow-up on the last piece of that in terms of close rate improvement. From this point going forward, could you give us a little more color on what the drivers of that improvement could be going forward to the extent that, that's going to be your bigger margin driver?

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

A

Well, clearly some of it is – as we continue to have more and more experience selling the product, understanding what the really salient points of how customers view this new product that is relatively new to us and the points based product, what are the main drivers of that and we'll continue to try to accentuate that every time we have a sales tour. I would say there are some headwinds with that because, as you move from existing owners to first time buyers, first time buyers have a generally lower closing rate than existing owners have. So you have to balance those two things out. We still think there is room to grow in closing rates. I think I've reported before that we've historically, kind of pre-downturn, we enjoyed closing rates in the mid-teens. I see no reason why that's not infinitely achievable and hopefully higher. So, we'll continue to do where we can to try to drive closing rates that has an enormous impact on the leverage you get with your fixed sales and marketing cost; every close that you have it's over and above what you maybe experienced before, helps in your financially reported sales and marketing metric. But that's how we're going to keep working.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

Great. Let me close out by asking a larger industry question. There's been some indications of new development picking up over the recent months. What are you seeing out there in the industry and what do you think it means

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to you? I mean is it a healthy thing and maybe just a reflection of a directionally improving economy? Is the demand there to absorb it or do you expect to see pricing pressure as those properties come online?

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

Well, we certainly see some of the same things that you see. I would say it's very positive for the industry. You got to put it in perspective, many developers were – when things turned south rather quickly, were left with a lot of built inventory that they needed to sell through before they thought about adding new inventory to their system. We find ourselves in exactly the same place. We are [ph] out (26:29) stopping short of making any announcements. We are active looking at new places to put a flag in the ground in markets that we are not currently represented. And I believe others are doing the same. So, I think there is a general confidence that the industry has come off the bottom. It's starting on its way back up. Having said that, I think it's not going to be a quick rise back to the pre-2008 levels, but hopefully a gradual improvement moving ahead.

Robert Higginbotham — Q
Analyst, SunTrust Robinson Humphrey

Great. And [ph] I actually sort of lied (27:02), let me ask you one more. Your sales was below trend at least over the past few quarters and below a longer-term average, the third quarter being about 4.8%. Any color you can give there, any one-time items we should consider and how should we think about that going forward?

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

No. I think we've spoken to it. Obviously the reduced tour flow being 4% down has a fairly significant impact on your overall sales. Having said that, North America was generally pretty good.

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

Yeah. We're up about 2% this quarter, last quarter in North America, timeshare sales were down slightly, if you remember, the lower tours hit the VPG. So, actually the trend sequentially is a little bit better in terms of North America sales because the tour flow wasn't down as much.

Robert Higginbotham — Q
Analyst, SunTrust Robinson Humphrey

I was asking about your sales reserve, your best...

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

All right. We missed the reserve question.

Robert Higginbotham — Q
Analyst, SunTrust Robinson Humphrey

Yeah.

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

No. On the bad debt allowance side...

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Robert Higginbotham
Analyst, SunTrust Robinson Humphrey Q

Yeah.

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

... the trends have continued to get better. I would say I mean while they – you never want to say they could get better than where we're at today, Robert, I think from a historical standpoint, we're back down to where we've been probably at, than some of our lowest points in time if you will. So obviously, we'll do everything we can to see if we can drive it lower, but I don't think there's a huge amount of opportunity for us to improve from where we're at today.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey Q

Great. I'll leave it there. Thanks a lot.

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

Thanks.

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

Thanks, Rob.

Operator: Our next question is from Steven Kent with Goldman Sachs. Please go ahead.

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

Hi, Steve.

Steven E. Kent
Analyst, Goldman Sachs & Co. Q

Hi. Good morning. Just a couple of questions actually following on Robert's questions. First off just a little bit more on international and the opportunity there and how we should think about it for 2014 and beyond? And then, just more broadly on cost containment, how much opportunity is truly left there over the next few quarters?

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

Okay. Let me kind of break international down into couple of different buckets. We've already told you that Europe is not a place that we plan to do anything other than sell through our remaining inventory. So I wouldn't think about Europe as a great growth engine for us, completely counter that would be Asia-Pacific. We believe that there are very, very positive dynamics in Asia-Pacific.

Now, the real question comes down to is, how do we try to make sure that we take the best advantage of those? And I guess, I would say to you that what we did was we've kind of moved from a lot of offsite distribution stuff.

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Now we are moving towards trying to get new resort locations that would have onsite distribution with it. Now that takes a while to get those deals done and particularly doing business outside the United States because there are few more wrinkles and complications to it, but I think we're moving forward rather nicely in this space. So I think we actually think Asia Pacific has got a great growth potential for us.

Then I would kind of go towards Latin America. We've said before and we have no presence in Mexico, as an example, and there are certainly some opportunities in Mexico that would present themselves. As we get further down into the Caribbean, I think there is other places where we can look to grow. So I think internationally, aside from Europe, things look relatively rosy. It's just going to take us a while to get there.

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

A

Yes. On the cost containment, Steve, [ph] I assume you're (31:02) talking just the cost savings of $15 million to $20 million, we've achieved to-date since the spin-off about $8 million or so. Now some of that runs through G&A, but some of that, I think as we've talked about in the past, actually hits off in the different parts of the business. So you see that through some of the margin improvement and development margin, et cetera. We should get another, call it, $2 million to $3 million over the balance of this year with the remaining piece really hitting next year. In terms of our separation efforts related to the spinoff from MI, we're pretty far along. The last big piece here is just some of the IT items and we're working through that here as we go through the fourth quarter and also the other piece on the IT side is just how we source resources going forward and doing things more cost effectively, so that's where we'll get some of the other upside going forward. Though, I will say once we get through this, obviously we're always going to look for ways to drive improvements and efficiencies in the business and hopefully you've seen that in terms of what we've done over the last couple of years.

Steven E. Kent
Analyst, Goldman Sachs & Co.

Q

And just one final question, maybe if you could just talk to how the board thought about share buyback versus dividends, Steve?

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

A

Yes, we began dialog with the board early this year kind of looking forward as to what we saw unfolding from a cash flow perspective and what was the needs of the cash balances we had on the balance sheet, et cetera. And we talked through various alternatives, the two most obvious being should we go to an annual dividend, should we go to a share buyback. Our analysis and the conversation with the board finally got further dialog about it in September at our board meeting and then we had a subsequent board meeting just recently where we concluded that at least for now the right answer is to go to a share buyback. It doesn't preclude us going to an annual dividend at some point in time, but we thought that the highest and best use of the cash and the greatest return to the shareholders for now was in the share buyback space.

Steven E. Kent
Analyst, Goldman Sachs & Co.

Q

Okay. Thank you.

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

A

Thank you.

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

Thanks Steve.

Operator: Our next question is from Chris Agnew with MKM Partners. Please go ahead.

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

Good morning, Chris.

Chris Agnew
Analyst, MKM Partners LLC
Q

Thanks very much. Good morning. Maybe start off with your free cash flow. I think you mentioned there were a couple of things, deferred CapEx and working capital, which benefited. How much of that is pulled forward from next year and, therefore, maybe an extension to that, how do we think about free cash flow for heading into next year versus your – if your normalized pace is what [ph] $135 million (34:04), if some of it has been pulled forward? Thank you.

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

Yes, in terms of pulled forward, it's really, as we've talked about in the past, more on the timing of our CapEx spend related inventory. And as we think about that, we still have excess inventory that over the next couple of years our target is to get to kind of two times cost of goods sold. So timing in terms of just the impact for 2014 or 2015, I think you have to look at it towards that longer-term goal rather than necessarily just the impact of what it might be on next year. So, if we took it up, like I said, for CapEx say $10 million, that means we're getting to that two times inventory over the next couple of years a little bit quicker. It doesn't change the end game. It's just we're getting there faster by deferring some of that inventory.

And as you think about normalized cash flow, I think the only real change we made there was on the working capital with our spin off from Marriot and still working through kind of what our working capital balances are once you kind of peel back some of the spin-off related items, there was a little bit of upside we saw this year. We did on a more normalized basis say that we expect our working capital to essentially be breakeven where before we thought it might be a use of cash by call it $8 million to $10 million. So, on a more normalized basis I think that's where you'll see hopefully a little bit more recurring cash flow in terms of our working capital needs.

Chris Agnew
Analyst, MKM Partners LLC
Q

Okay. So, if I think of your normalized cash flow next year, this working capital benefit to what you're guiding to doesn't necessarily come out of next year's cash.

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

No.

Chris Agnew
Analyst, MKM Partners LLC
Q

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Okay, okay.

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

Yes, the working capital doesn't, like I said the impact of the three items still, as you think about next year, Chris, are the pay down of the Marriott Rewards liability, which will still happen over the next couple of years, the timing of inventory spend, and so like I said that, it's hard to pinpoint that to one year, because we're trying to get to that target in two years and then the last piece is, yes, little bit on the tax side, but that should normalize out, so...

Chris Agnew
Analyst, MKM Partners LLC
Q

Okay.

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

And this is Steve. Let me just add one other thing to you. The CapEx piece of this, we have a fairly detailed review of our CapEx expenses that goes on every single quarter, and when we see an opportunity to defer CapEx even from one quarter to another, we certainly are very much inclined to do so. So you make [ph] it a little relative (36:56) quarter four to quarter one and everything else, but it's not going to be dramatic. But obviously every dollar of cash to us is important and if we can delay spending it, we're certainly going to do that.

Chris Agnew
Analyst, MKM Partners LLC
Q

Absolutely. And so given your stronger free cash flow and the cash building up on your balance sheet, should you not have some recourse debt? I mean what are your thoughts on that, because both your peers and I know there's different things going on there to have recourse debt. I mean what are the impediments to thinking about that in the near-term? Thanks.

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

Sure. We look at our overall corporate credit rating. We're BB minus and that's where we think is – where we want to be. I think some of our competitors' credit ratings – their overall credit rating is lower. Now that being said, I think as Steve motioned in his comments, we are creating going forward, as our EBITDA continues to grow and our securitized debt gets paid down, additional capacity potentially. So it will be something we'll continue to evaluate in terms of our target leverage, but today we feel pretty good where we are at, but as the business continues to grow, there is definitely an opportunity that we'd have some dry powder there.

Chris Agnew
Analyst, MKM Partners LLC
Q

Got you. And then final question if I may. How should we think about the pace of share repurchases and maybe I'll ask it another way, are there any – what's the amount of cash that you want to have on your balance sheet at any one time and are there any working capital needs or seasonality of cash flow that would cause you to think about the pace of the potential share buybacks? Thanks.

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

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I'll start and let John finish. There's an old saying that every long journey begins with a first step. Well, this is our first step. And it's – 3.5 million shares is roughly 10% of our outstanding shares. So we thought that was a good place to start. I think as we continue to – I mean we believe we have a strong cash flow model. We don't believe that this will be a one-and-done kind of exercise. Having said that, we're not going to be able to commit anything beyond that to what we've already announced. But I would have an expectation is that, as I said in my remarks, that to what degree we have met the needs of the business in terms of being able to fuel our growth and we still have excess cash on hand, there is no sense carrying it around on our balance sheet, so we would certainly look to return that to shareholders. John, I'll let you add any different color on that.

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

No, I think you hit on most of that. I think just in terms of working capital, we do have kind of peaks and valleys in terms of our quarterly cash flows. We look at kind of working capital from pure cash perspective in that on average $50 million to $75 million. But I would say obviously we've got a $200 million revolver that we haven't pulled down. We have capacity. So, it's not – from a cash flow, it's not as much of an issue, and given the amount of the buyback, Chris, we've got close to $300 million in cash on the balance sheet today and obviously expect to continue to generate significant cash flow going forward, so I don't think there is any impediments in terms of the timing or how we buy the stock back.

Chris Agnew
Analyst, MKM Partners LLC
Q

Great, thank you. And congratulations.

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

Thank you.

Operator: Our next question is from Carlo Santarelli with Deutsche Bank. Please go ahead, sir.

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

Good morning, Carlo.

Carlo Santarelli
Analyst, Deutsche Bank Securities, Inc.
Q

Hey, guys, how are you?

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

Great.

Carlo Santarelli
Analyst, Deutsche Bank Securities, Inc.
Q

I was just hoping and I know you touched on it a little bit earlier, but the $35 million change in the other working capital line.

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

A

Yes.

Carlo Santarelli
Analyst, Deutsche Bank Securities, Inc.

Q

I know you mentioned some of the pull forward aspects, et cetera, but would you be able to provide a little color on what that is or how we should think about that number, what's in that basket.

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

A

Sure, yes. It's just the way we are targeting what our AP – excuse me, accounts payable, receivable balances on a normalized basis are at yearend. The one unusual item with the separation from Marriott this quarter, one of the last items we have to do is get off our accounts payable system. And so given the timing of that at yearend, we did know the timing of – as we went through the year, we weren't sure of the timing of when that split was going to occur and if it could impact our accounts payable balance at yearend. Now that we're further along, there will be a minimal impact year-over-year. So that's where most of that upside comes from, but even with the spin-off there was – just given the timing of the spin-off over the last – from the first year as well as last year, there were just some items that impacted the timing of cash flows at yearend. I think we're kind of past all those at this point. This is probably the last piece with the separation of the accounts payable system. So we were more comfortable in terms of kind of what that year end net working capital balance looks like.

Carlo Santarelli
Analyst, Deutsche Bank Securities, Inc.

Q

That's great. That's very helpful. Thank you.

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

A

Good.

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

A

Thank you.

Operator: Our next question is from Steve Altebrando with Sidoti & Company. Please go ahead.

Steve T. Altebrando
Analyst, Sidoti & Co. LLC

Q

Good morning.

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

A

Good morning.

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Steve T. Altebrando
Analyst, Sidoti & Co. LLC

Q

Can you expand a little bit on the rental revenue, just a couple items specifically? You had mentioned mix playing part of the strength and if you could go over a little bit what the ebbs and flows of that mix is? And then second is, and maybe if you can educate me, is the strength fueled by members or through the Marriott [ph] side (42:40)?

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

A

Let me answer the second part of your question first. Any available rental inventory we have, we've put out through all of the Marriott distribution systems, including Marriott's reservation system, all the GDS systems and everything else, so that's where it comes from. I mean yes, some of our owners do rent our product just for additional vacation break or a couple of days or something like that, but the bulk of it is from non-owner rental. Let me...

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

A

In terms of – let me address on the mix side.

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

A

Yes.

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

A

The nature or type of inventory we have year-over-year is always changing, right, because we get inventory from newly developed inventory that hasn't been sold yet, we can rent that. And then based on also how people exchange their weeks for Marriott Rewards, things like that. So there is always a certain amount of mix in terms of – it's not apples-to-apples year-over-year. This year I think we had some [ph] Ko Olina (43:43) inventory that came online that we didn't have last year, which is obviously Hawaii you can get a little bit of rates on some of that unsold inventory.

So there is always going to be a little bit of the mix. I think what drove rental revenue better for the most part, though, was we have seen some of our owners taking advantage of our Explorer program, which allows them to use and go on non-traditional lodging-type stays, and with that we get that inventory to rent. So we actually saw our rental – inventory available to rent go up 10%, and then we turn around, we offset the cost of providing that vacation and make a little bit of money on top of it. So that's where you're seeing the growth and obviously rates were better a little bit because of the mix.

Steve T. Altebrando
Analyst, Sidoti & Co. LLC

Q

Okay. That's helpful. And then if you could talk a little bit about as the customer base kind of shifts towards going out towards new owners versus existing, maybe one to two years out how you see that impacting development margins?

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

A

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Well, if we do it right, which we certainly have every intention of doing, we will make this a gradual shift, not one that is dramatic in nature and move from what historically has been the last several years the more 60/40 existing buyers, the first-time buyers back down to that 50/50 mix. Typically the way this works is that you run a higher sales and marketing cost on a first time buyer than you do on an existing owner, obviously because you don't have to incur a marketing expense to any great degree to get the people on tour, et cetera.

The flipside of that is a first time buyer traditionally has a higher average contract price, because existing owners are kind of topping off the tank; they're buying some additional points, but may not be buying the equivalent of a [ph] full week's interest in (45:39) points. So when you kind of mix those two things together, hopefully you will not – we'll not see a dramatic increase in sales and marketing cost. And arguably, if we can drive more first-time buyer sales and keep our sales and marketing costs on a fixed basis relatively flat, you start to see some more leverage, because you get higher sales on the top line and you get better leverage on the fixed cost.

Steve T. Altebrando
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you. It's helpful.

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

A

Thank you.

Operator: And there are no further questions at this time. Please continue with any closing statements.

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

Okay. Well, as you've heard, we're very pleased with our year-to-date performance, and we look forward to a strong finish in 2013. We thank you once again for your participation on our call today and your continued interest in Marriott Vacations Worldwide. And, finally, to everyone on the call and to your families, enjoy your next vacation. Thank you very much.

Operator: Ladies and gentlemen, this concludes the conference for today. Thank you for your participation and you may now disconnect.

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