25-Apr-2013

Marriott Vacations Worldwide Corp. *(VAC)*

Q1 2013 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 First Quarter 2013 Earnings Call. During today's presentation, all participants will be in a listen-only mode. Following the presentation, the conference will be open for questions. [Operator Instructions]

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

Jeff Hansen

Vice President-Investor Relations, Marriott Vacations Worldwide Corp.

Thank you, Bruno. Welcome to the Marriott Vacations Worldwide first quarter 2013 earnings conference call. I am joined today by Steve Weisz, President and CEO; and John Geller, Executive Vice President and CFO.

I do need to remind everyone that many of our comments today are not historical facts and are considered forward-looking statements under Federal Securities Laws. These statements are subject to numerous risks and uncertainties as described in our SEC filings, which could cause future results to differ materially from those expressed in or implied by our comments. Forward-looking statements in the press release that we issued this morning, along with our comments on this call, are effective only today, April 25, 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.

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

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Stephen P. Weisz

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

Thanks, Jeff. Good morning, everyone, and thank you for joining our first quarter call. This morning, I'll discuss our results for the first quarter of 2013, which continue to deliver on our strategies of improving development margin and driving adjusted EBITDA growth. I'll also provide color on our updated 2013 guidance and will then turn the call over to John, who will provide additional performance detail before we open the call for your questions.

We posted another quarter of strong growth. Adjusted EBITDA increased almost 35% year-over-year to $39 million, reflecting our ability to further reduce product cost and hold marketing and sales spending flat, while generating higher contract sales during the quarter.

On a company-wide basis, adjusted development margin increased to 560 basis points to 17.7%. And in North America, we continue to drive higher margins, improving our adjusted development margin from 15.3% in the first quarter of last year to 18.8% in the first quarter of 2013.

Marketing and sales cost contributed nearly 1.5 of development margin improvement driven by 11% improvement in North American VPG to $3,266. As you've heard me say many times, VPG is a key metric as it continues to highlight our efforts to improve our sales process through higher closing efficiency, which was up more than a point year-over-year. Again, our strategy in North America is to continue to focus on our most cost-effective marketing channels to generate the most profitable results.

In our rental business, it continues to – the improvement we saw in 2012, with total rental revenues increasing by roughly 13% year-over-year. However, revenues, net of expenses were down $1 million to $7 million in the first quarter of 2013, primarily due to the timing of rental expenses associated with owners banking their inventories for usage next year.

We continue to improve our ability to forecast our points owners' behaviors and are confident that our full-year rental business result in 2013 will show substantial improvement over 2012.

Our resort management and other services businesses also – has also seen continued strong performance in the first quarter with results up by $4 million over 2012 to $14 million. These improvements were driven by increases in club dues revenues, additional management fee revenue and improvement in our ancillary operations.

In our Asia-Pacific segment, we were able to increase development margin due to the closing of underperforming off-site sales centers late last year. While top line revenue was down from $12 million in the first quarter of 2012 to $8 million in the first quarter of this year, cost decreased by $5 million, improving the development margin to nearly 27%. This resulted in segment financial results of $3 million in the first quarter from $1 million last year. Our strategy here remains unchanged: drive development margin improvements while seeking new destinations that will provide strong on-site sales distribution.

For our Ritz-Carlton product, we continue to focus on our members' changing vacation needs and desires from expanded vacation experiences, as well as ways to operate more efficiently in the current financial environment. We're in the process of establishing a platform of expanded vacation offerings for our members that include options that deliver the highest standards for service and quality that has always been associated with this iconic brand.

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As it pertains to our excess land and luxury inventory, I want to reiterate that we are actively working to dispose of these assets. I'm pleased to announce that we closed on the sale of a multi-family parcel and several lots in St. Thomas for approximately $3 million, posting a small gain.

Allow me to reemphasize our strategy as we understand that these positions are extending beyond our initial two-year estimate. We do not intend to firesale these assets, and much of the initial work has been positioning these parcels in the best possible manner for sale to a third party. We have made some headway selling several listed parcels and have been in active negotiations on others and have confidence that we will work through these assets in the next couple of years at the best possible price.

Moving on to our G&A, costs increased $2 million in the first quarter of 2013 as compared to the first quarter of 2012. Our first quarter results benefited from $1 million of incremental savings related to our organization and separation efforts as well as $1 million from a favorable resolution of an international non-income tax matter. Our G&A costs also reflected normal inflationary growth, higher legal costs and the timing impact as it relates to uncertain standalone public company costs came on line throughout 2012.

For the full-year of 2013, we anticipate our G&A costs will increase year-over-year driven mainly by inflation, the impact of a 53rd week of cost due to our fiscal reporting calendar and higher legal cost. However, we expect these increased costs to be partially offset by roughly $5 million of savings related to our organization and separation-related efforts, which we expect to realize throughout the full-year.

Now, I'd like to talk about our capital allocation strategy, a topic which we know continues to be top of the mind for our shareholders. In our last quarter call, I spent some considerable time answering your questions concerning M&A opportunities in the industry. I walked through my thoughts on those opportunities and discussed our current efforts to find low-cost, asset-light inventory as well as to seek out management fee businesses and other timeshare businesses. This might have been interpreted by some, but this is our sole focus as it pertains to capital utilization. Let me reassure you, we understand the need for a well-rounded strategy that includes growing our business through investment, as well as returning capital to shareholders.

As we previously discussed, over the next several quarters, our cash flow will be impacted by certain spin-related items. However, longer term, I expect that we will provide meaningful free cash flow that we will use to both grow our business and return capital to shareholders. We will continue our dialogue with our board as the year progresses to develop a balanced allocation plan.

I'm very pleased that the first quarter performance was solid top-line growth and continued development margin improvement. There are still three quarters remaining in the year, and as you know, visibility through the balance of this year remains somewhat cloudy. As consumer confidence has made headlines as it remains lower than we would like to see. I should point out that we've not seen any direct impacts to our sales results thus far. However, we must be mindful of the macroeconomic environment and the continued challenges it may bring for the rest of the year.

That being said, given our solid performance through the first quarter and our expectation that we can carry these improvements throughout 2013, we are raising the lower end of our 2013 full-year adjusted EBITDA guidance from $150 million to $155 million, while maintaining the high end at $165 million at this time.

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

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John E. Geller

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

Thank you, Steve, and good morning, everyone. I'm pleased to say we are off to a great start to the year, especially in our key North America business. We are making further strides on development margin improvement and we remain highly focused on our separation and cost-saving initiatives.

North America contract sales grew $9 million or nearly 7% to $143 million in the first quarter of 2013. This reflects continued improvement in closing efficiency and higher pricing, yielding VPG growth of 11% at $3,266 in the quarter. Overall company contract sales were up 2%, with North America growth offset by the closure of underperforming off-site sales distributions in Asia-Pacific and slightly lower sales in Europe.

In our Luxury segment, we continue our focus on our members' changing vacation need and given the ongoing changes in scope and strategy related to the segment, we are now including Luxury results in North America. To ensure comparability, we have also recast our prior-year North America results to include Luxury.

We saw significant improvement in our development margin throughout 2012, and we are targeting continued improvement in 2013 as well. Reported development margins improved by nearly seven percentage points to 15.8% in the first quarter of 2013. Adjusted development margin improved 5.6 percentage points to 17.7% in the first quarter, reflecting improvements in both cost of vacation ownership products and marketing and sales expenses.

Revenue reportability negatively impacted development margin by almost two percentage points in the first quarter, primarily from contracts that were still in the statutory rescission period at the end of the quarter. This compares to almost three points of negative reportability impact last year when we were running certain incentives. As a result of changes to the incentive structure this year, we expect the impact of revenue reportability to be less pronounced on a quarterly basis during 2013 as compared to 2012. Remember, revenue reportability will impact quarter-to-quarter earnings. However, on an annual basis, we do not expect revenue reportability to have a significant impact on our development margins.

Improvement in the cost of vacation ownership products grew roughly four percentage points of the adjusted development margin improvement in the quarter. These results include a three-point benefit from product cost true-ups and a one-point benefit from a favorable mix of inventory being sold. The product cost true-ups in the quarter were driven primarily by lower than expected construction costs and the impact of our successful program to re-acquire previously sold inventories.

As you may recall, in the fourth quarter earnings call, we indicated that we anticipated our cost of vacation ownership products to approximate 33% for 2013. While we achieved 31% during the first quarter, we are still projecting full-year cost to be approximately 33% given the mix of higher cost inventory expected to be sold in Asia-Pacific later this year, offset partially by the favorable product cost true-up in the first quarter.

Marketing and sales costs, which drove the remaining 1.5 percentage points of margin improvement reflected more efficient sales in North America and the impact of closing underperforming sales centers in Asia-Pacific, which allowed us to substantially reduce lower margin sales in the region.

In our rental business, as Steve mentioned, results declined by $1 million in the first quarter, mainly due to the timing of rental costs year-over-year. We estimate a certain portion of these costs at the beginning of each year based on a forecast of how many owners will bank current year points or opt to use the Explorer program. These estimates get trued up during the year based on actual owner activity.

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In 2012, more owners than we originally estimated chose to bank their points, so we increased our accrual based on actual banking later in the year. For 2013, we have forecasted slightly higher banking activity, so the related cost is being recognized over the full-year resulting in higher cost in the first quarter compared to last year. With each year, we gain more insight and have more data which aids our ability to forecast owner usage patterns, and as a result, improve our overall rental results which, for the full year, we expect will improve significantly over 2012.

Shifting to our Resort Management and Other Services business, we were able to generate $14 million of revenue net of expenses in the quarter, a $4 million improvement over the prior year quarter. Results were driven by higher management fees, higher annual club dues earned in connection with the North America points program, and higher ancillary profits driven primarily by the disposition of the golf course and related assets at our Jupiter, Florida property late in 2012.

In our financing business, revenues net of expenses were down $2 million in the quarter, driven mainly by $3 million of lower interest income year-over-year, offset partially by reduced expenses from lower foreclosure activity. Interest income continues to decrease due to the balance of our notes receivable from prior years declining faster than we're originating new notes. However, financing profit, after subtracting interest expense on our securitized debt was flat the prior year. We benefited not only from a decline in debt balance but also from lower borrowing cost on the portfolio resulting from the continued paydown of older securitizations that carried higher overall interest rates as well as the benefit of lower interest rates achieved in the securitization we completed last year.

We're very happy to see that the current securitization market remains strong, and we are optimistic that our planned 2013 note securitization will be on even more favorable terms than the transaction we completed just last year.

In our segments, we saw dramatic improvements in our Asia-Pacific development margin driven by the closure of our underperforming off-site sales galleries and lower product costs. This drove revenue net of expenses higher by $2 million over the first quarter of 2012 to $3 million in spite of $4 million of lower sales volume. We expect this trend to continue through 2013 as we search for additional inventory opportunities in this region with strong on-site sales distribution.

In Europe, adjusted segment results improved by $1 million in the quarter from breakeven in the first quarter of 2012 due to reduced product costs primarily from a favorable mix of sales in the region.

Turning to our balance sheet and liquidity position, since the end of 2012, real estate inventory balances have declined $8 million to $866 million and total debt outstanding increased $8 million to $726 million, including $682 million in non-recourse debt associated with securitization ownership notes and $40 million of mandatorily redeemable preferred stock of a subsidiary.

At the end of the first quarter, cash and cash equivalents totaled $119 million and we had $89 million of vacation ownership notes receivable available for securitization through our warehouse facility. We also had $194 million in available capacity under our revolving credit facility at the end of the quarter.

With respect to our free cash flow, we have updated our 2013 guidance to reflect improvement to our outlook for cash, income taxes, inventory spend, and consumer financing activity.

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With the continued strength of our inventory repurchase program, we've reduced our forecasted inventory spend for 2013 by approximately $10 million. In addition, higher cash sales than we had forecasted is also improving current year cash flow by approximately $10 million. Based on this, we have raised our outlook for free cash flow for the year excluding the impact of organizational and separation charges and litigation settlements by $20 million to $55 million to $70 million. Remember, the $55 million to $70 million guidance includes near-term puts and takes, which are affecting our free cash flow in 2013.

We expect the Marriott Rewards pre-spin liability paydown to be approximately $45 million with higher cash income taxes adding another $5 million to $10 million of headwind. These puts were offset by $10 million to $20 million of expected full-year inventory benefit, which reflects the additional $10 million of reduced inventory spend I just discussed. As a result, 2013 free cash flow on a more normalized basis could be between $105 million to $150 million.

Looking ahead to 2014 and 2015, we expect our cash taxes to approximate our tax provision and the paydown of the Marriott Rewards pre-spin liability to approximate $30 million to $40 million a year with the benefit from reduced inventory spend offsetting much of this higher paydown. As a result, 2014 and 2015 actual free cash flow should approximate amounts that we can generate on a more normalized annual basis.

As you have heard, the first quarter was very positive and a great building block for the rest of the year. It is for that reason we have increased the low end of our adjusted EBITDA guidance from $150 million to $155 million. Additionally, we have increased the low end of our adjusted net income guidance from $66 million to $69 million.

Finally, with the continued improvements we have achieved in our adjusted development margin, we are increasing our guidance range by 50 basis points to 17% to 18%. While we have not seen anything to-date that gives us pause on a more optimistic full-year outlook, we are mindful of the macro environment and read the same newspapers as you. And for that reason, we did not increase the upper end of our guidance at this time. However, we remain optimistic that 2013 will be another great year and we look forward to speaking with you in future quarters. As always, we appreciate your interest in Marriott Vacations Worldwide.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] And our first question comes from Robert Higginbotham with SunTrust. Please go ahead.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

Good morning. Thanks for the question.

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

A

Good morning.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

So I was hoping you guys could give us a little more color on what's driving your close rate improvement, continues to go higher by over a point based on what you said. So I'm curious if you could give us any incremental details on that. I mean, what are the drivers during the quarter and where do you see further opportunity?

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

A

Yeah. This is probably not anything different than what you've heard me say before. And that is that – as we continue to get more and more experience with our points program which, as you know, we launched in the summer of 2010, we continue to build upon that. And as I'm sure you may remember me saying, the – in an effort to try to improve closing rate, whether we were in the old weeks environment or in the points environment, you're constantly looking for new tools and techniques to be able to do it. There's nothing specifically I could point to and say – this one thing equated to one-point improvement. And what you're looking for is incremental change and incremental improvement in every one of your distribution facilities during the course of the year. And what that has resulted in is a one-point improvement.

Having said that, when we see something that's having an impact on closing rates and cause the things to get better, we share that broadly throughout the organization on a best-practices basis so that others can take those same approaches and move forward.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey

Q

Got it. So it – have you done any changes recently to your targeting methodology in terms of – how you flow customers through your resorts? Your tour flow had been down for the – kind of mid-single digits – in 2012, kind of flattened out this year. Is there any improvements you can make on that front?

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

A

Well, just so that we're clear.

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Robert Higginbotham
Analyst, SunTrust Robinson Humphrey
Q

Yeah.

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

Actual tour flow in the first quarter of 2013 is actually down from the first quarter of 2012. But that is as to be expected given the fact that we closed two sales centers in Asia-Pacific that were open in the first quarter of last year. And as we moved into our Marriott Vacation Club Destinations programs, aka North America points, what we did was we made a very specific effort to try and get in front of as many of our legacy owners as we possibly could to help them understand the benefits of points. Over time, you have talked to that community. So the number of people that you would normally talk to – have talked to in the first quarter of last year is actually less this year. As we are pivoting to more first-time buyers, you pick up new tour flow. So if you take out all the noise, I would say our tour flow is roughly static to what it was last year, maybe up a little bit.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey
Q

Got it. So on your cost of products, it sounds like you're getting higher activity on the resale front, which caused you to make this true-up. But I'm trying to understand what is making you maintain your 33% ongoing run rate? If resale activity is higher than you expected, why is that now pushing that run rate higher? Is there some sort of – sorry, offset? It sounds like – is Asia maybe running higher than you expected?

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

Well, we always knew that in 2013, towards the latter half of the year, our Asia product costs would go up little bit because we've got our products in Macau that comes through at a higher price point than some of the other products that we have in the system. But we had anticipated at the end of 2013 that we would have a meaningful amount of inventory that was pre-owned that we would be putting through the system. What you saw was, in the first quarter, the product cost true-up, which was roughly three points of product costs, if you were to basically take that out over the full-year for that impact, it comes out to be six or seven-tenths. And really why we're still staying at 33% is more a rounding thing. We were a little bit higher than 33%. Call it 33% point something or other. We now maybe a little lower than 33% but still around the 33%. So I don't think you should read anything more into that other than the fact to say that we were happy with what's going on and we'll continue to pursue reacquiring some of this inventory to attractive prices and hopefully that will have a continuing positive effect on the product costs going forward.

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

And just to add on, and so what you saw, we did take the development margin up half a point...

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey
Q

Right.

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

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...to reflect quite a little bit of that in terms of that rounding.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey
Q

Got it. Okay, understood. And then lastly, on the Luxury front, you officially combined those segments but just to be clear – I think the answer is no, but does that mean that those properties are now in the North American trust?

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

No. I think you know that Vail is in and has already been sold through the trust. Each one of these projects has various hurdles for us to overcome to get it into the trust in terms of getting through some of the – as we've talked before, some of the kind of tight controls we put on it when we established these to begin with. We're on track. We're moving ahead as we – as each property clears those hurdles and goes in the trust, it'll come in and come out very quickly. But there's nothing that – is any more significant than that.

Robert Higginbotham
Analyst, SunTrust Robinson Humphrey
Q

Okay, great. I'll let someone else on. Thank you.

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

Thank you very much.

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

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

Hi, Chris.

Operator: I'm sorry. It looks like the next question is from Bob LaFleur with Cantor. Please go ahead.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Hi. I guess I'll ask Chris' question too. I want to dig more deeply into the reacquired inventory, and just want to get a sense of the relative economics of that versus new development or selling things that are already in inventory. And then also get a sense of how big a potential market is that and what are the governors that keep you from pursuing that inventory more or less aggressively when obviously there's a huge cost benefit to more of that inventory. So is there a limit to how much of that you can buy or just maybe walk us through your thinking on that?

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

Yes. Well, at the 30,000-foot level, obviously, the advantages of taking previously owned inventory and reacquiring it and then selling it back out through the trust is that if you can acquire it at a cost that is less than what it cost you to develop new units, then that, obviously, helps your margin and delays the amount of additional capital it would take to build the new units. We – as I think we've explained before, we have what we call our blue

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book, where we put a value on each piece of inventory that we have sold and we say, if we can acquire a piece of inventory at or below the blue book price, we'll pull the trigger and buy it.

As far as the depth of that market, it changes based on time of year, based on the economic environment, et cetera, as you might imagine. In distressed economic times, when people are pressed for – because of employment issues and everything else of not being able to pay their mortgage and put their kids through college and everything else as well as pay their annual maintenance fee, some people are more inclined to sell than others. But we have never been a – in a position yet where we have seen that pool dry up. People's lives changes. People own something for 15 years to 20 years and all of a sudden they say, either for health reasons or something else, they want to move on in their lives.

So I've always said that the timeshare business is one that needs an active, for lack of a better word, used car lot. And so, we've always been in the resale business and we're just taking advantage of the arbitrage that you get in terms of being able to buy it and what we could sell it for.

The downside or one of the things that just to keep in mind is that if you don't do any new development, you don't have an opportunity to put new flags on the map and your system gets a little stale. So I think we need to balance those two things together to make sure that people continue to want to join our club and want to go to those new destinations that have been on their bucket list of places they want to travel to.

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

And the only thing I'd add on to that from the downside with adding the new flags also comes other revenue streams, Bob, management fee streams, things like that. That will grow as you grow the map and have more property. So it's a balance.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

I guess what I'm trying to get at is, is there a surplus of this inventory? Are you buying as much as you possibly can, or is it sort of you buy as much as you want because there is plenty of it available? That's, I think, what I'm trying to get to.

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

Yeah, I think there's – I mean, today, because we just started to ramp this up obviously second half of last year, arguably, there is probably a little bit of a surplus. We always had a resale program, Bob, and worked with our owners to resale. Now, we're just being more proactive to going to some of those members on the resale list with offers to buy that inventory back.

So that said, we're working through the list and we're doing it in a diligent manner. And I think I've talked in the past that we see, at least for the foreseeable future here, that there's probably enough out there that we should be able to support about a third of our North American sales here on an annual basis with just some of the people that are looking to get out of their week. And as we said, though we haven't disclosed the actual product costs, obviously very favorable, significantly less than what will cost us to build the next phase.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay. Thanks.

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Operator: Our next question comes from Chris Agnew with MKM Partners. Please go head.

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

A

Hi, Chris.

Christopher Agnew
Analyst, MKM Partners LLC

Q

Hi. Good morning. Can you hear me? I'm not sure what happened.

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

A

We can now.

Christopher Agnew
Analyst, MKM Partners LLC

Q

Thanks very much. I wanted to just revisit what was happening with the rental income net of expenses, maybe expand upon that a little bit? And I'm not sure I understood exactly what's driving the decline in profits earnings this quarter. And then also maybe two more specific questions. Is there anything in particular driving transient keys growth up so much in the quarter? And is there – why did the number of owners banking points, I guess, surprise you last year? And are you estimating the banking points at the same pace that you saw last year?

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

A

Let me take your last question first, Chris, and simply say – we've been at our points program now for – ever since the summer of 2010. And so, really, the first time people had any meaningful banking activity was in 2012. As you might imagine, when you do market research and everything else before the launch, you anticipate a certain number of people will bank, et cetera. As I think I reported to you last year, we were actually very pleasantly surprised about the percentage of our owners that were taking advantage in some of our Explorer options as well as the ones that were banking for the kind of bigger or longer vacations. So that was a surprise last year.

So this year, what we tried to do is we tried to be a little bit more optimistic and more aggressive about assuming what kind of banking results were going to take place in 2013. And when that happens we then said, all right, let's take those costs that we largely loaded into the second half of 2012 and let's start to reflect those in 2013. And as a result of that, when you anticipate that people are going to give you back a week in 2013 to delay their vacations in 2014, you actually now have that inventory to rent and sell, which drives more keys. With that, I'm going to turn it to and John and he can provide any additional color.

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

A

Yeah. Well, I think Steve hit on most of it. Chris, we've talked about – we get inventory to rent from four primary areas, right, unsold developer inventory where we pay our cost as the maintenance fee, Marriott Rewards where people exchange for rewards where we pay for those Marriott Rewards, the banking where people want to put their usage into a future year, we get their current year usage, and then as Steve mentioned, the Explorer program.

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The first two, those elections get made by our owners prior to the beginning of the year. So we know how much inventory we're going to get to rent to offset those costs. So that's not – that doesn't impact our full-year cost in terms of the timing. The second two, as Steve pointed out, those elections actually can be made during, for example, 2013 on your 2013 usage. So at the beginning of the year we make an estimate of how many of our owners are going to actually elect one of those two usage. As Steve mentioned, 2012 being our second year that the program was smaller, we gave it our best estimate. As a result, first quarter rentals last year, we had less cost, but to Steve's point, we also made less inventory available for rent because we didn't know we were going to have that much inventory.

Now, another year under our belt, we understand better how banking's going to work out, Explorer's going work. So we're – while we don't think net-net, the number of people banking year-over-year is going to be that much higher. We've estimated it a little bit higher. We're doing that at the beginning of the year so the costs, which for the full-year should be about the same for all of our usage costs. But as it relates to the banking specifically, we're going to have a little bit more of that cost in the first quarter.

And to your question on transient keys rented and actually keys available, that's why we have so much more keys available and we're able to rent those more effectively in the first quarter. But when you look at it over the full-year, our costs for the total for year-over-year, for all those four usage options, should be flat, maybe up a little.

Christopher Agnew
Analyst, MKM Partners LLC **Q**

Got you. I mean, I guess where I'm maybe a little bit confused is I think that renting out and getting people to the Explorer program is very good for you. And I guess is it just that as you see upside from renting activity through later through the year, that that's when you would see the upside in the income segment?

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

That's right. Well, you're going to have apple-to-apples, we'll probably have – because we took more of those rental keys in the first quarter, you're going to have – your rental keys compared to last year will be a little bit less. But with that, your costs are less and that should also – with less rental, we can drive rate and be able to really get some compression there in terms of renting. And that's where we said, when you think about it on a full-year basis, we're going to be able to drive more revenues like you saw in the first quarter, but our costs should be flat to relatively up in terms of those costs – for those – yeah.

Christopher Agnew
Analyst, MKM Partners LLC **Q**

Got it, got it. That makes sense. And then one more question on – just any update on the Las Vegas project and sort of inventory spending plans there?

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

Yeah, the third tower in Las Vegas is under construction, moving along nicely. Nothing out of the ordinary to report in terms of how that is going. We expect the delivery to be on schedule and on budget.

Christopher Agnew
Analyst, MKM Partners LLC **Q**

Excellent. And when do you – when is that delivery?

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

I knew you're going to ask me that question. Call it, second quarter of next year. I don't have the exact date in front of me. We can certainly get it to you.

Christopher Agnew
Analyst, MKM Partners LLC
Q

Okay. No, that's perfect. Perfect. Thanks very much.

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.

Operator: And our next question comes from Eli Hackel with Goldman Sachs. Please go ahead, sir.

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

Hi, Eli.

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

Actually, it's Steve Kent...

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

Hi, Steve.

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

...pinch-hitting for Mr. Hackel.

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

Okay.

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

So, a couple of questions. One, could you just talk about for the next couple of years if there's any sort of must build or required inventory build? I think it was Las Vegas that had that component where you had to build a certain amount. And then separately you did talk a little bit about your cash returns and the balanced approach.

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What about the modest dividend initiation? I'm not sure if anybody else has asked that, yet, but it's obviously a favorite.

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

Well, let me try to take a stab with both. The only other required construction that we're going to have is there is the next phase at our Shadow Ridge project in Palm Desert, California that you got to start a phase every three years or you'll lose the entitlement. It's not anywhere near as meaningful as our third tower in Las Vegas. So that's the only that comes to mind.

As far as dividend, clearly, as you think about returning cash to shareholders, a dividend is certainly one way to do it, buying back stock is another. As I reported, because of some of the ways in which the cash flow is working in 2013, we will continue – we've already had begun a discussion with our Board. We will continue to have that discussion with our Board towards the latter half of this year to try to find out what the right balance is of allocating capital for future growth as well as returning to shareholders of which a dividend would certainly be one of the options.

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

Any issue with the net debt-to-EBITDA that a ratio there that you need to – we need to keep in mind as those discussions go?

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

No. Not on the – in terms of limiting distribution?

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

Right. Or where the Board feels uncomfortable having you at some level too levered since you're relatively unlevered.

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

Yeah. I'm not going to get into specific discussions with the Board, but yeah, in terms of our debt covenants and overall debt ratios, when we look at it from an S&P, no, there's no issues there.

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

Okay. Thank you.

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

Yes. Thank you.

Operator: I'm showing no further questions in the queue at this time.

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Stephen P. Weisz

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

Okay. Well, as you've heard, we were very pleased with how we started 2013, and we look forward to reporting our progress throughout the year. Thanks again for your participation on our call today, and your continued interest in Marriott Vacations Worldwide. And finally, to everyone on the call and your families, enjoy your next vacation. Thanks.

Operator: Ladies and gentlemen, this concludes the conference call. We would like to thank you for your participation. You may now disconnect.

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