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Marriott Vacations Worldwide Corp. (VAC)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to Marriott Vacations Worldwide First Quarter 2017 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is my pleasure to turn the conference over to your host today Mr. Jeff Hansen, Vice President, Investor Relations. Thank you, you may begin.

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

Thank you, Rob and welcome to the Marriott Vacations Worldwide first quarter 2017 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 filing, 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, May 4, 2017, 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 the call 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 first quarter earnings call. This morning, I'll walk through our 2017 first quarter results highlighted by our continued growth and contract sales and adjusted EBITDA. I'll provide an update on growth from new sales distributions and new marketing programs, as well as some brief thoughts on our outlook for the full year. I'll then hand the call over to John to provide a more detailed view of our performance.

In the first quarter, company contract sales were almost $194 million, up over 26% and adjusted EBITDA was over $62 million, up $10.5 million from the first quarter of 2016. Remember, that with our change this year to a 12-month reporting calendar, the first three quarters will each include roughly one additional week, so our year-over-year growth will not be comparable as reported.

Adjusting, our prior year contract sales for the estimated impact of the additional week, contract sales were up nearly 16% in the quarter. This was driven by our North America segment, which on the same adjusted basis was up almost 17% in the quarter, including a 6% improvement in VPG to $3,691.

Staying in North America, nearly 7 percentage points of our strong growth was produced by our five new destinations. This was the first full quarter in which we had all of our new sales distributions open, including the larger sales location in New York City and our location in South Beach, which just opened its sales center at the end of 2016 and I'm very pleased with how these new centers have performed.

We are particularly pleased that the VPG from our new destinations in the first quarter has reached a level similar to our other locations, a positive signal that they're already performing well. It is important to remember that our sale centers in North America normally take about three years to fully ramp-up tour flow and we are still in the first year at all of our new locations.

Our same-store sales distributions drove over 10% percentage points of our growth in North America through VPG improvement as well as growth in tours. Both tour flow and VPG benefited from increased demand from our large base of owners. This demand was driven by excitement about our new destinations, in addition to our evolving marketing programs geared both toward new and existing buyers.

All of this has helped us drive increased tour flow, as well as improved closing efficiency by 50 basis points in the first quarter. As it relates to our call transfer and Encore programs, at the end of the first quarter, same year activations are up 28% over this time last year as the overall tour pipeline continues to grow. Longer term, we still have room to increase our pipeline of tours.

Our call transfer program was recently expanded and is now in all six major Marriott branded call centers in North America and we are piloting programs internationally to continue this growth. We've also signed an agreement for a call transfer program with an airline partner, expanding our reach outside of the Marriott umbrella, providing opportunities for additional future tour growth. The performance from all of these programs has continued to propel our first time buyer growth, as contract sales to first time buyers improved over 6% in the first quarter.

As it relates to our capital efficient inventory model, we have just acquired the first 36 two and three bedroom units in the newly constructed tower at our property on Marco Island, with the remaining 112 units coming online later this year. We are contracted by the developer to manage the new units and will purchase them over the next few years, similar to our agreement at our property in Manhattan. We are also in the process of closing on 112 one and two bedroom units at the Waikoloa Marriott on the Big Island of Hawaii.

We agreed to purchase these units almost a year ago from the new owner of the hotel upon completion of the converted units. When we make our first installment payment in the next few days, we will take ownership of all the units and we'll make the remaining payments over the next several years. This asset-light transaction has enabled us to begin sales, prior to completion of the units and delay the timing of the capital payments over multiple years.

In our Asia-Pacific segment, adjusting for the estimated impact of the financial reporting calendar change this year, contract sales grew $1.7 million or 16%. This growth was due to contract sales at our Surfers Paradise resort in Australia, which opened in late March of last year. Since this new destination is our first in Australia, sales have been heavily weighted towards first time buyers, negatively impacting our VPG in the quarter.

As we have just completed our first full year of sales at this location, we should point out that our ramp-up of sales has been slower than average when compared to our North America sales centers. Some of this stems from the new and unique and selling environment in Australia, as well as the size of the segment itself which currently lacks the scale of our North America marketing distributions. While the sales ramp-up has been below our initial expectations, we're excited about the potential for continued growth from both our Surfers Paradise property this year and our new Bali property which we expect to open later in the fourth quarter.

Before I turn to our outlook for the year, I'd like to take a moment to provide some thoughts about our industry in general, especially in light of the recent ARDA Global Timeshare Conference, which was held in New Orleans at the end of March. As my two-year term as Chairman of ARDA came to an end at this year's conference, I look back with a perspective that our industry has gone through many changes in its decades-long history and through those changes. With the obvious exception of the Great Recession, we have always continued to grow and thrive. Industry contract sales in North America have grown almost 50% since 2009, topping $9 billion in 2016.

And ARDA has continued to provide tremendous support to its members and to timeshare owners to strengthen the environment in which we all operate. Hearing at the conference about all of the wonderful things happening throughout our industry, I feel confident that we are poised to do great things and our best days are still ahead.

Now, let me take a moment to provide my thoughts on our first quarter performance and the solid foundation it's provided for the rest of the year. We have performed very well to start 2017, continuing the trend that began towards the end of the third quarter last year. Contract sales in the first quarter grew double-digits and adjusted EBITDA was right in line with our expectations to meet our full-year target. We are reaffirming our 2017 guidance, however, if the trends that we have seen today continue, we would expect to be towards the higher-end of our guidance range for the full year.

With that, I'll turn the call over to John to provide a more detailed look at our first quarter results.

John E. Geller, Jr.

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

Thank you, Steve and good morning, everyone. I am very pleased with our strong first quarter results. Contract sales, after adjusting for the estimated impact of the change in our financial reporting calendar, were up nearly 16% to almost $194 million, and adjusted EBITDA totaled $62.1 million, $10.5 million higher than the first quarter of 2016. While these results are not adjusted for the timing of revenue reportability, it is important to highlight that our adjusted EBITDA was unfavorably impacted in the quarter by roughly $3 million of revenue reportability. Without that reportability impact, our first quarter adjusted EBITDA would have approached $65 million.

As expected, our development, resort management and financing businesses, all contributed to our improvement in adjusted EBITDA. With our strong contract sales performance, development margin grew $4.5 million, our resort management business grew by $8.8 million and financing margin was higher by $1.7 million.

In our development business, company adjusted development margin increased 33% to $31.6 million and adjusted development margin percentage grew 60 basis points to 17.9%. As a remainder for the full year, we continue to expect company development margin of 21% or better. In our North America segment, adjusted development margin increased 30% to $33.3 million in the first quarter and adjusted development margin percentage was 20.7%, slightly higher than the prior year first quarter. Development margin benefited from roughly 60 basis points of lower product cost, offset by just over 50 basis points of higher marketing and sales cost, as we continue to ramp-up our new sales distributions.

In our financing business, revenues were up $2.9 million, or nearly 10%, to $32.1 million in the first quarter of 2017. These results reflect $5.1 million from higher interest income from our growing notes receivable balance, partially offset by additional cost from our financing incentives. Our notes receivable portfolio continues to perform very well, as we have we've seen our financing propensity rise 8 points to 66% in the first quarter, with the average FICO scores of our buyers at 740, and delinquency rates remaining near historic lows. Financing revenues, net of related expenses, were up 9% to $21 million from the first quarter of last year.

In our rental business, excluding the impact of the Surfers Paradise hotel we sold last year, rental revenues increased $7 million to $85.3 million over the first quarter of 2016. Rental revenues net of expenses were $14.8 million, down slightly from the prior year. These results reflect a nearly 12% increase in transient keys rented which was offset by higher unsold maintenance fees from inventory at our new locations. Results also reflect a nearly 21% increase in preview room nights.

Remember, as we utilize more of our rental availability for preview room nights to support our call transfer and universal Encore tour arrivals, the revenue typically comes through at a lower rate than from our transient rentals. For our strategy, we expect higher preview keys to be a headwind to rental margins throughout the year as we focus on driving contract sales growth.

In our resort management and other services business, excluding the impact of the Surfers Paradise hotel, results improved $8.8 million, or 37.1%, to $32.5 million in the quarter.

These results reflected higher fees for managing our portfolio of resorts and an improved exchange company activity from the addition of our new managed destinations, as well as a cumulative increase in owners enrolled in our points program.

In addition, the first quarter benefited from approximately $2.2 million, mainly from favorable timing of refurbishment income and lien fee activity.

General and administrative costs were up $2.2 million in the quarter, however, costs were relatively flat year-over-year, excluding the additional week of cost resulting from the change in our financial reporting calendar. Royalty fees were up $2.7 million from the prior year first quarter. This was driven primarily by higher contract sales, as well as the additional week from the change in our financial reporting calendar.

Furthermore, as it relates to our insurance claim associated with Hurricane Matthew, we continue to work through the process with our insurance provider. And we will provide you further updates as we move through the year.

Moving to our balance sheet at the end of the quarter, cash and cash equivalents totaled $101.8 million. We also had approximately $201.5 million of gross vacation ownership notes receivable eligible for securitization and $199 million in available debt capacity under our $200 million revolving credit facility. Our total gross debt outstanding at the end of the quarter was $692.1 million, all but $8 million of which is non-recourse debt associated with securitized notes.

Now, let me spend just a moment on the outlook for the year. As Steve mentioned, we are reaffirming our 2017 full year guidance. Speaking to our contract sales growth, even with the more difficult comparison in the second half of this year with respect to our new sales distributions, we do expect continued strong sales performance at our existing sites. This is primarily due to the increased tour flow we expect from our various marketing programs.

And finally, we continue to focus on maximizing our adjusted free cash flow. Our capital efficient business model allows us to drive this top-line growth, while still delivering adjusted free cash flow between $160 million to $180 million. We started the year with a very strong first quarter with our new sales distributions open and growing, and our marketing programs continuing to ramp-up very nicely.

VPG remains solid as we begin the year and tour activations are well ahead of the same point in 2016, all of which gives us confidence that 2017 will be a tremendous year for us. As always, we appreciate your interest in Marriott Vacations Worldwide. And with that, we'll open up the call for Q&A. Rob?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Chris Agnew with MKM Partners. Please proceed with your question.

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

A

Good morning, Chris.

Christopher Agnew
Analyst, MKM Partners LLC

Q

Thanks very much. Good morning. I just want to think a little bit about the balance sheet and ask why no share repurchases in the quarter, I mean, given your net cash position, you're arguably under-levered for business with really predictable, stable cash flows. So, what are the sort of strategic options you're thinking about with respect to the balance sheet and why no buybacks this quarter? Thanks.

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

A

Sure. Thanks, Chris. This is John. Look, in terms of buybacks, obviously, there's a lot of factors that go into when we're buying back shares in and out of the market. And I'm sure, as you can appreciate, we don't comment specifically on those factors. But what I will say is, our strategy to return capital to shareholders including share purchases has been a big part of what we do and continues to be a big part of our strategy going forward. So, I would expect us to continue that strategy here in the future. And so, in terms of the balance sheet, I agree, we have a lot of capacity on the balance sheet and as we've said in the past, we'll continue to evaluate with our board how we deploy that capital in the future.

Christopher Agnew
Analyst, MKM Partners LLC

Q

Thank you. And then, given the success with your new sales centers, what's the pipeline or what are your thoughts about expanding into, acquiring additional new resorts or adding additional new sales centers over the next several years? Thanks.

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

A

Yeah, thank you. Chris, this is Steve. The simple answer is, we have a very active development group that is out looking for new sites. I mentioned obviously that we are going to be opening our new sales gallery and new resort in Bali, here towards the end of the year. We continue to look for additional growth in the Asia-Pacific region and there are some specific areas that we are very focused on there. And also in North America, I mean, while we have great distribution in North America and many of the very popular vacation destinations, there are still some places where we don't have a significant presence. And so we continue to look there.

So, while not being able to disclose anything in particular to you right now, let me simply reiterate that we believe that we're going to be in a fairly consistent cadence of adding new resorts, new sales distributions in the years to come.

Christopher Agnew
Analyst, MKM Partners LLC

Q

Excellent. Thank you.

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

A

Thank you.

Operator: Our next question comes from Tyler Batory with Janney Capital Markets. Please proceed with your question.

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

A

Good morning.

Tyler Batory
Analyst, Janney Montgomery Scott LLC

Q

Great. Good morning, thanks for taking my questions. So maybe first on the cost side, just related to the new sales centers. Can you just talk about how marketing and sales came in for the quarter versus your expectations and then, how you're thinking about that line item going forward here, as you're [ph] confident (19:47) over some of the opening of the new sales centers?

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

A

Sure. On the cost side for the new sales centers, I would say, all in all, in line with our expectations. The key there is ramping those sales to leverage the fixed cost, obviously. In places like New York city, you have rent and other costs that are higher. And so, as a percentage of sales, you start out, they're high and as you get to a more normalized level, you start to get to more of that system-wide average. So, as we continue to ramp going through this year and into next year, we'll continue to get closer to that which will help the overall margins as we go forward when you think about development.

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

And Tyler, if I might add, this is one of things that I spoke to in my remarks was, obviously the VPG performance at these sales centers, which quite frankly is pretty close to what we're running at a system-wide average. Now, admittedly, this is an average of five sales centers versus all the remaining in our system, but I would say to you that we are very pleased by what we've seen thus far in the first quarter and we think it provides optimism, for as we continue a little more tours into these centers on how we'll be able to perform.

Tyler Batory
Analyst, Janney Montgomery Scott LLC
Q

Okay. Great. And then on inventory, can you talk about how much inventory you have access to right now and how much of that you would consider to be asset-light?

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

Sure. So, rough numbers, I would say, we probably have about a year and half of completed inventory given our sales base on our books today. And then, our asset-light deal, so this is inventory that we don't own, but are committed to, we probably got another two years there. And then, when you think about the amount of inventory that we have and landed infrastructure at existing resorts that we could build-out in that zone, and we could build-out units there, that's probably another four years worth of inventory.

And then the other thing, which we don't necessarily control, but obviously part of our program is to repurchase weeks on the secondary market, and given the pace there, that's probably another couple of years worth of inventory. Just if you think about it here over the next three or four years, that we'll active buying back, always a lever that we can increase or decrease as we need inventory. So, you're probably talking ballpark, 8 years to 10 years when you add-up all that.

Tyler Batory
Analyst, Janney Montgomery Scott LLC
Q

Okay. That's great. And then last, can you comment on growth for reloads versus first time buyers, I'm just wondering, what you're seeing in those two segments?

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

Yeah. Actually, we have said all along that our goal is to add more first time buyers. I think you heard me say that our first time buyers were up 6% over the first quarter of last year. Having said that, we were very pleasantly surprised to see the amount of existing owner or reload growth in the quarter. Lot of that's attributable to the fact that as we added new destinations to the portfolio last year, there were people that were excited about those locations and they wanted to add to their amount of interest that they hold within our company.

And so, we're at the luxury of being able to add first time buyers for the long-term perspective of being able to get more referrals and all the other things that come along with those. But also enjoy adding more existing ownership to people that are already our members and we're very pleased with how that works.

Tyler Batory
Analyst, Janney Montgomery Scott LLC
Q

Great. That's all from me. Thank you.

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

Thank you.

Operator: Our next question comes from Brad Dalinka with SunTrust. Please proceed with your question.

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

Hi, Brad.

Brad Dalinka
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Hi, guys. On for Patrick Scholes, Thanks for taking my question.

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

Yeah.

Brad Dalinka
Analyst, SunTrust Robinson Humphrey, Inc.
Q

First, I just wanted to close the loop on something someone asked about before, were you guys blacked out from repurchases in the quarter?

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

Hey, Brad, it's John. Yeah. Once again, we're not going to comment specifically on the factors that we may or may not be in the market for. So, like I said in my previous answer, there is a lot of factors we consider at any time we're repurchasing shares. So I'm not going to add anymore color than that at this point.

Brad Dalinka
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Understood. And then, just wanted to ask you guys a broader question about your thoughts on timeshare M&A environment today, we're seeing a lot of investor questions on that lately and that's it for us? Thank you.

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

Well, at kind of a 20,000-foot level, you look at this industry, which obviously because of the increased number of publicly traded companies in this space, I think has attracted more investor interest than, say, when we first became public five and a half years ago. And typically, in any industry when you see increased investor interest, then that rises to the occasion of increased levels of M&A. And as you've seen, some companies have become public, some public companies have gone private. So, I think that's a normal, logical iteration of how any industry moves and I don't think the timeshare industry space is any different from that.

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

Hello? Rob?

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

Rob?

Operator: Yeah. I'm right here. Okay. Our next question comes from David Katz with Telsey Group. Please proceed with your question.

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

Good morning, David.

David Brian Katz
Analyst, Telsey Advisory Group LLC Q

Hi. Good morning, everyone.

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

Good morning.

David Brian Katz
Analyst, Telsey Advisory Group LLC Q

Nice quarter.

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

Thank you.

David Brian Katz
Analyst, Telsey Advisory Group LLC Q

Nice stock price. I wanted to ask about, go back to the balance sheet, and if you could, John, update us on sort of what your leverage tolerance would be if – if of course hypothetically there was something that were of interest you and productive for you to buy, how much leverage do you think you could tolerate?

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

A

Sure. Well strategically, like we said, we're not trying to be an investment grade company in terms of our cost of capital. We like to play in that BB range David and within the BB, you're probably talking comfortably up to, call it 3 times leverage of EBITDA. And so the question would be obviously, if you are acquiring a company how much EBITDA is that bringing to your existing EBITDA and you're probably in that 2.5 times to 3 times. Clearly depending on the opportunity there is, we could go higher than that and that would be something we have to talk to our board about. But that's generally how we think about our long-term capital structure.

David Brian Katz
Analyst, Telsey Advisory Group LLC

Q

Got it. And more of a kind of a big picture strategic question, as you grow and get bigger, through whatever avenues you do, can you talk about the benefits of scale in the timeshare business? I think, for us and probably the Street in general, we're still in an education curve in terms of what scale benefits and how the business evolves as it grows and you are really out ahead of the pack in that regard?

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

A

Yeah. I mean, generally if you think about – I mean, the single largest cost in the timeshare business is in the sales and marketing arena. And obviously, to what degree by adding additional scale to the business allows you to leverage your fixed marketing and sales costs, obviously, you get a nice gearing effect to the bottom-line, in terms of your sales and marketing costs.

There, I think, is a general misnomer, however, that some believe that if you add additional scale, all incremental sales and marketing costs go away which certainly wouldn't be the case. You still got to run a sales and marketing operation, add existing resorts which has its own inherent cost. So, I think that's the biggest area, obviously, there are other corporate fixed cost that we have in our overhead basis that you get some leverage out of, which would obviously contribute to growth in your bottom-line margins. But those are the two areas, in particular, that I think really kind of jump out of the page at you.

David Brian Katz
Analyst, Telsey Advisory Group LLC

Q

Got it. And one of the, I guess, issues or complexities that you usually provide us with an update on is the joining of the loyalty programs under the Marriott Umbrella between SPG and Marriott Reward. Is there any update that you can provide us this quarter as to how those discussions maybe going?

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

A

Basically, you probably have seen what we have seen in the public press, where Marriott has indicated a continuing desire to try to put the two programs together. But there's not been any real increase in dialog between ourselves and Marriott in that regard.

David Brian Katz
Analyst, Telsey Advisory Group LLC

Q

No dialog. Okay. Perfect. Thanks very much.

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

A

Yes.

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

A

Thank you.

Operator: Ladies and gentlemen, we have reached the end of the question-and-answer session. I'd like to turn the call back to Steve Weisz for closing comments.

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

Thank you, Rob. We're off to a great start this year with contract sales growth exceeding our record fourth quarter and adjusted EBITDA laying the foundation for a solid earnings year. I'm excited about what our destinations and enhanced marketing programs can do and look forward to discussing our results with you on future calls. And finally, to everyone on the call and your families, enjoy your next vacation. Thank you.

Operator: This concludes today's teleconference. You may disconnect your lines at this time. We thank you for your participation and have a wonderful day.