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Marriott Vacations Worldwide Corp. *(VAC)*

Q4 2011 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Marriott Vacations Worldwide Fourth Quarter and Full Year 2011 Earnings Conference Call. At this time, all lines are in a listen-only mode. Later we will conduct a question-and-answer session with instructions provided. [Operator Instructions] I would like to remind everyone this conference is being recorded today, Thursday, March 15, 2012, at 10 AM Eastern Time.

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

Jeff Hansen

Vice President-Investor Relations, Marriott Vacations Worldwide Corp.

Thank you, and welcome to the Marriott Vacations Worldwide fourth quarter 2011 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, March 15, 2012, 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

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measures referred to in our remarks in the schedules attached to our press release as well as the Investor Relations page on our website at www.mvwc.com.

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

Stephen P. Weisz

President & Chief Executive Officer, Marriott Vacations Worldwide Corp.

Thanks, Jeff. Good morning, everyone, and thank you for joining our fourth quarter and full year 2011 earnings call, our first as an independent company. This morning, I'll provide a brief review of our 2011 results and an update on the initiatives we discussed during our Analyst Day and Investor Road Show late last fall. I'll then turn the call over to John to review our detailed 2011 financial results and our full year 2012 outlook. We'll then open the call for your questions.

For those of you who may not be familiar with Marriott Vacations Worldwide, we are the leading and largest pure-play vacation ownership company in the world with a loyal and highly satisfied owner and member base. With exclusive rights to the Marriott and Ritz-Carlton brands, we manage a total of 64 resorts in the U.S., the Caribbean, Europe, and Asia, and have roughly 420,000 owners and members who entrust their vacations to us every year.

To start off, I think it's important that I review our strategy. Number one, we expect to drive profitable sales growth by reducing our marketing and sales and overhead costs and improving top-line sales and other revenue streams. As we institutionalize our standalone company capabilities, we believe we will realize associated cost savings as we continue to transition certain support services from Marriott International by the end of 2013, if not sooner.

Second, we are focused on accelerating cash flow through the disposition of excess plan as well as reducing our inventory levels, primarily in the luxury segment. Both of these measures are also expected to reduce our operating cost. Lastly, we will seek our growth opportunities to expand and diversify our other recurring revenue stream. 2011 was a transformational year, as Marriott Vacations Worldwide became a separate public company through our spin-off from Marriott International in November.

I would like to take this opportunity to thank our incredibly talented associates for their hard work and dedication to completing this transaction while maintaining an unwavering focus on our owners and on our operations. It was a monumental company-wide effort, and I'm deeply appreciative to our team for their exceptional accomplishment.

During 2011, we drove revenue growth and improved our sales efficiency while continuing to improve our cost structure. We also were successful in monetizing excess inventory, which reduced our unsold maintenance fees and related carrying costs. And 2012 will our first full year of independence after having been a division of Marriott since 1984. We're very much looking forward to taking advantage of the new opportunities the spin-off affords us.

We have diversified revenue streams comprised of four distinct components of our business, including sales of vacation ownership products, resort management, rentals and financing. In 2011, just under 50% of our $1.3 billion in revenue, excluding cost reimbursement, was generated from the sale of vacation ownership product. Our other revenue streams, including $63 million in recurring management fees as well as other services, financing, and rentals, made up the balance of our revenue last year.

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Our business is grouped into four segments; North America, Luxury, Europe, and Asia-Pacific. I'm going to focus on our North American segment and John will provide more detail on this and our other segments in just a moment.

In North America, we introduced our point space vacation ownership product, Marriott Vacation Club Destinations, in mid-2010 to provide owners with greater flexibility in vacation choices throughout our network of destinations and exchange options. This transition has materially enhanced the owner experience and allows us to more efficiently deploy our capital to develop resorts going forward. By example, we expect to have only three or four projects under construction in any given year to fulfill sales versus 15 to 20 under the former weeks-based model. In addition to this, we firmly believe we offer one the most flexible and competitive points programs in the industry.

When we launch Marriott Vacation Club Destinations, we initially focused our sales efforts on existing owners to educate them on the benefits of the new points product and to encourage their enrollment into the new program. We did this not only to encourage their annual contribution of their weeks into the point system, but also to allow them to build on their current ownership by purchasing points to supplement their existing usage.

Additionally, as we have continually stated, our owners are historically some of our best salespeople through referrals of their family and friends. The response has been overwhelmingly positive. As of the end of 2011, almost 92,000 or nearly 25% of our weeks-based owners have enrolled in the points program representing more than 167,000 weeks. The fourth quarter also represented a shift of focus from existing owners back to new buyers, as evidenced by a 4 percentage point increase in new buyers versus existing owners over the fourth quarter of 2010.

An important metric we will call out today and we expected to continue to report on is volume per guest or VPG. VPG is calculated by dividing total onsite sales volume by the number of sales tours. This measures our effectiveness in selling to guest the tour at our resorts. It is a solid indicator of how efficient we are at selling as it combines how many guests actually buy or what we call closing efficiency with the sales volume per contract.

As we expected, the launch of points in mid-2010 saw a decline in VPG, as sales were focused on existing owners with a lower minimum purchase requirement. However, during 2011, VPG began to increase, up 4% to over $2,500, underscoring the improvement on our sales efficiency and shift of focus to new buyers. However, while VPG increased in 2011, the company's total gross contract sales of $676 million came in shy of our original guidance range of $685 million to $695 million.

This was primarily due to the fourth quarter 2011 North America contract sales coming in flat year-over-year, which was below our expectations due to weaker than anticipated holiday season sales. In addition, during that quarter, we were testing a number of sales initiatives, including new purchase minimums and price adjustments that impacted our fourth quarter performance.

With the insights these fourth quarter initiatives provided, I'm pleased to report that we expect first quarter contract sales to be up 4% to 6% year-over-year even with some softness in our international segments, as you can imagine with the current economic state overseas. In North America, contract sales and VPG are up over 10% thus far this year in the first quarter compared to last year at this time. While we believe these encouraging trends are positive indicators for the balance of 2012, please understand that we do not have any better knowledge of future macroeconomic conditions than you do. So let's call it cautiously optimistic.

In addition to driving top-line growth, we continue to put great focus on improving our cost structure. We instituted a significant restructuring in 2008 and we continue today to take cost out of the business to support our long-term margin expansion goals. At the corporate level, we are focused on optimizing our cost structure for a

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business of our size and are in the process of realigning business processes to support this critical objective. The work is already underway and we expect to see meaningful cost reductions in these areas starting in 2013. We ended 2011 within our guidance range, generating adjusted EBITDA on a pro forma basis of $96 million assuming we were a standalone public company for the entire year.

With strong momentum and contract sales in VPG so far in the first quarter coupled with the progress we are making on the cost reduction front, we believe we are well positioned to generate 4% to 8% annual growth in total contract sales and 20% to 30% growth in adjusted EBITDA resulting in 2012 adjusted EBITDA of $115 million to $125 million.

And with that said, I'll turn the call over to John.

John E. Geller

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

Thanks, Steve, and good morning, everyone. As you are able to see this morning in our release, we have provided our 2010 and 2011 results on an adjusted pro forma basis. Remember, for 2010 and 2011, our actual results are as a division of Marriott International until our spin-off on November 21, 2011. Therefore, our pro forma results for both years reflect full-year royalty fees to Marriott International, full-year interest payments on our warehouse and revolving credit facilities, and a full year of dividends on the preferred stock, as if we were a standalone company since January 1, 2010.

In addition, we also adjusted for certain non-cash impairment and other charges, including costs related to the spinoff, severance charges related to optimizing our cost structure, and legal charges for a more meaningful comparison of our year-over-year operating results. Therefore, my focus today will be on these adjusted pro forma results. Both our 2011 top line and pro forma adjusted EBITDA results were in line with the guidance we provided at our Analyst Day in October.

Total revenues were $1.6 billion, including $331 million in cost reimbursements. Our gross full-year contract sales of $676 million were short of guidance of $685 million to $695 million. However, we were able to mitigate some of the impact from lower sales, as we outperformed in our rental business, and G&A costs came in lower, as we continued to drive costs out of the business. As a result, we generated $96 million in pro forma adjusted EBITDA in 2011, which was within the range of $95 million to $105 million that we shared back in October. And our adjusted EBITDA margin of 7.2% was also in line with our expected range.

We discussed a number of strategic initiatives at our Analyst Day, one of which was margin improvement, primarily in our sales vacation ownership products, net of related product costs and marketing and sales expenses. We refer to this as our development margin. Our development margin, adjusted for the charges I described earlier, was 9.3%, within our guided targets of 9% to 13%. And we are committed to returning to a development margin in the 18% to 20% range over the next several years.

Adjusted development margin in 2011 was $59 million or $10 million higher than 2010, with the revenue impact from lower contract sales offset by lower cost of vacation ownership products as well as $10 million of favorable revenue reportability. This relates to revenue associated with contract sales that were made late in 2010 that, due to GAAP down payment requirements, were not able to be reported until 2011. As we mentioned at our Analyst Day, this revenue is not a matter of if it will be recognized, only a matter of when, but it can make year-over-year comparisons challenging.

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We also laid out opportunities to improve rental margin, as rental revenue after rental expenses was a loss of $8 million in 2011 compared to a loss of $7 million in 2010. These losses are primarily related to our unsold maintenance fees in the luxury segment, which are negatively impacting the profitability of our consolidated rental business. We normally monetize our unsold maintenance fee obligation through rentals. In our North American segment, rental revenue net of expenses was $12 million in 2011.

Our luxury product, however, has limited rental ability on a side-by-side basis. Unsold luxury maintenance fees in 2011 totaled $16 million. Our goal in the next one to two years is to reduce our luxury inventory in an effort to significantly lower the unsold maintenance fees. We've already taken several steps in that direction. First, do the bulk sale of 17 units in remaining parcels of land at our Lake Tahoe project generating gross sales proceeds of $18 million while reducing annual unsold maintenance fees by $3 million.

Additionally, we are in the process of getting a substantial amount of inventory in one of our Luxury resorts into the North America points program. This supports our North America points owners a luxury offering previously unavailable to them due to the points program. This will not change the brand or operations of the resort itself, but once sold, will reduce unsold luxury maintenance fees in the future.

Resort management and other services net of expenses was $40 million or $5 million higher than 2010. Resort management fees are more stable and recurring cash flow totaled $63 million in 2011. This continues to be a growing and profitable business that we will build upon as an independent company. The balance of the resort management and other service revenues totaled $175 million. In aggregate, this revenue stream increased 5% over 2010. We continue to see opportunities to drive additional revenue growth, as we increase our exchange club fee revenue with every new and existing owner we enroll into the points program. We will also look for additional ways to grow our exchange business through our Explore program and other affiliations.

Turning to financing, revenues net of expenses declined $21 million or 10% year-over-year to $141 million, primarily due to lower interest income on a declining notes receivable portfolio. In turn, interest expense related to note securitizations decreased $9 million. As a reminder, we've seen a run-off of the portfolio as loans continue to amortize from prior years faster than the pace at which we are originating new loans. We expect this trend to level off in the next two to three years. We continue to expect financing propensity in the 40% to 45% range, consistent with what we experienced in 2011. Our adjusted G&A was $75 million or $6 million lower than 2010 because of lower management bonuses and lower expenses from our continued focus on improving margins.

Turning to our segment results, let me dive a little bit deeper into North America, where overall adjusted segment results were lower by $18 million. This was primarily due to $19 million of lower financing revenue and $7 million in lower revenues from the sale of vacation ownership products net of expenses. These declines were partially offset by $8 million of additional resort management and other services revenue net of expenses due to $6 million of higher fees related to our new exchange business and $2 million of higher management fees.

In our Asia Pacific segment, contract sales increased $2 million year-over-year. However, adjusted segment results were $21 million lower in 2011. This is a direct result of a $21 million gain on the sale of an operating hotel during 2010. Taking this into account, adjusted segment results were flat year-over-year.

In the Luxury and Europe segments, we saw 14% decline in combined contract sales year-over-year. However, despite this decline, we were able to drive a combined $26 million improvement in these segments adjusted financial results due to $60 million of higher development margin, which benefited from $9 million of lower sales and marketing costs and $10 million from lower sales reserve and favorable revenue reportability. In addition, we had $4 million of higher combined rental revenues net of expenses and a $2 million gain in the fourth quarter of 2011 from the sale of the 17 units and remaining undeveloped parcels of land at our Lake Tahoe project.

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I should note our strategies from these segments have not changed. We intend to sell out of the existing European inventory and sell down the luxury inventory to a more stabilized level, and we will continue to focus on further improvements in their overall performance in 2012.

Turning to our liquidity position, with the timing of the spin-off, we did not complete a securitization in 2011, but instead entered into a $300 million non-recourse warehouse credit facility in the third quarter. At the end of 2011, we had $118 million drawn on the facility. We have seen very positive trends in the ABS markets so far in 2012, and our team has been actively preparing to meet with investors with the expectation of executing a securitization later this year.

In terms of our other liquidity, we started 2012 with $110 million of cash and cash equivalents and $200 million in available capacity under our revolver. In addition, at the end of 2011, we had sellable notes receivable of $41 million, which could have generated another $30 million of cash flow to the extent we needed to draw down from the warehouse facility.

For 2012, we expect adjusted free cash flow of $85 million to $100 million, taking into account net activity related to our securitizations in our warehouse facility. In addition, we are focused on our strategy to accelerate cash flow due to monetization of excess undeveloped land and inventory over the next three years with total estimated proceeds of $150 million to $200 million. Any dispositions in 2012 would be upside to our adjusted free cash flow guidance.

To answer the inevitable question of our priorities as it relates to how we intend to use our cash, let me reiterate our strategy as we laid it out in October. As we are now towards the end of our first full quarter as an independent company, we will look for opportunities to grow our business that will provide appropriate returns to our shareholders. I want to stress that we are focused on increasing our return on invested capital in creating shareholder value and that will drive our capital allocation decisions.

Now turning to our guidance for 2012, on February 8, we published our 2012 adjusted EBITDA guidance of $115 million to $125 million. While we recognize that many of you may have drawn a comparison to our Analyst Day scenarios and assumed flattish sales growth from 2011, we thought it would be important to highlight that our 2012 expectations assume growth of 4% to 8% in total gross contract sales and further improvements in our other revenue streams.

Lastly, as Steve mentioned, our year-to-date first quarter contract sales in our North America segment are very encouraging in terms of the progress we are making toward achieving the goals we have laid out.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now conduct a question-and-answer session. [Operator Instructions] Your first question comes from the line of Chris Agnew of MKM Partners. Please go ahead.

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

Good morning, Chris.

Chris Agnew Q
Analyst, MKM Partners LLC

Thank you very much. Good morning.

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

Good morning.

Chris Agnew Q
Analyst, MKM Partners LLC

I was just wondering if you could comment on the expectations for the pace of contract sales through 2012, any sort of particular variance we should watch out for on a quarterly basis. And then I guess linked to that, are there any quarters – trying to think about the impact from reportability issues next year – sorry, this year, whether there's anything we should be sensitive to, and is that just difficult to forecast?

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

Chris, this is Steve. Let me take – I'll take the kind of seasonality question, which I think is the first part of your question. I'll let John talk about reportability. Typically speaking, in the timeshare business, at least as we've experienced it, the second and third quarter are generally stronger than the first and fourth quarter. This is in the – all the years we've been out, that's just pretty much what we've seen, largely based on the distribution of physically where you find the resorts and where we talk to customers.

As you might imagine, as you get into kind of the Easter season or things like that in the second quarter, you've got a lot of people who are travelling in the Sunbelt and the like and you're also kind of in the heart of the ski season in our mountain resorts. And of course, then you have the traditional vacation period when people are on vacation and particularly in North America here during the summertime.

John, do you want to talk about reportability?

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

Sure. This is John Geller. Yes, couple things to consider on reportability. One, what historically has been the most significant impact was our percentage of complete. So now we're selling completed projects so that that should not be impactful at all going forward. For us, it's really about our financed sales, and that has to do with the GAAP down payment. And I know we've talked about this a little bit in the past. We would expect on a quarter-to-quarter

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basis, there could be some variability and it is difficult just given some of the financing promotions or things that we might be running at the end of any given quarter. But – so it's difficult to predict, but I would say on an annual basis, it should kind of work its way out with some variability within the quarters.

Chris Agnew
Analyst, MKM Partners LLC

Q

Got you. Thanks. And then, can I ask about the excess land? I mean, can you give us some color on what you're doing – currently doing to monetize that at sort of the level of interest and can you give us an idea of where the majority of the land is located?

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

A

Sure. Again, this is Steve. The bulk of the land that we have available for sale is either beachfront here, either in North America or in the Caribbean. There is also some land available in Hawaii. And those are the – and quite frankly, it's pretty great real estate. We have engaged in conversations, and in some cases, already under contract for certain brokers to help represent us on these sales and we have a fairly high confidence level that we'll be able to get some transactions done here in the next couple of years.

As you might imagine, there is not a lot of great comps out there over the last couple of years because it's certainly not been a seller's market for real estate. However, we've already kicked up some interest on a few things that we'll see if it ultimately translates into a purchase agreement, but we feel pretty good about where things are.

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

A

Yes. The only thing I'd add is, where in the past we've probably seen a lot of folks more low borrowing on some of the offers, we're starting to see some serious buyers out there and some better value. So, to Steve's point, we're optimistic we'll be able to start to move some of this. As we said all along, we are not in a buy or sell mode. We are going to make sure we maximize the cash proceeds we get out of all this land.

Chris Agnew
Analyst, MKM Partners LLC

Q

Thanks. And could I ask one last question on your financing propensity? I mean, given the favorable spreads at the moment, why would you not look to raise that higher?

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

A

Sure. The short answer is we typically securitize about once a year based on our current volumes. Historically, that's been a couple of times a year, but based on where we're at, we're looking at probably in annual securitization. So if I knew today every note I originated, I could securitize a year from now – at the spreads and the rates where the market is today, I absolutely would do financing all day long. I think the balance is just from managing your balance sheet and potential risks. So we think, for us, given us as a new company here in that 40% to 45%, maybe a 50% financing propensity, is right for us, just given the managing the profit side and the balance sheet side, but we will – we always are evaluating that and we'll be opportunistic where we can.

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

A

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And Chris, this is Steve. Let me just add to that if I may. It's important that you understand that unless someone's FICO score is below our underwriting threshold, we don't – we don't decline financing to any customer. The fact of the matter is, if you look at kind of the demographic profile of our customer, they generally come into a sales presentation with numerous means to be able to, in fact, pay for their purchase. Where we have in the past have higher financing propensity is when we've actually done things to kind of artificially stimulate people to take our financing. That's the one thing we haven't gotten back into. I think, as John mentioned, if all of a sudden you start to see the securitization market being very stable for a very long term with high advance rates and everything else, we might contemplate a little bit more of that. We certainly are attracted to the returns on the financing business. It's just we don't want to get stuck with a lot of papers on our balance sheet.

Chris Agnew Q
Analyst, MKM Partners LLC

Great. Thank you.

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

Thank you.

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

Thanks.

Operator: Your next question comes from the line of Eli Hackel of Goldman Sachs. Please go ahead.

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

Good morning, Eli.

Eli Hackel Q
Analyst, Goldman Sachs & Co.

Good morning. Thank you. So just three questions. Just going back to the land sales -- and I'm going to ask them all upfront -- can you just give us an up-to-date on the net of what you expect to sell. I think late last year it was $150 million to $200 million? Is it still in that range? Second question is just on the development margins, clearly there's a lot of room to run here. Do you think that's going to be more – is it going to be a straight-line up from that 9% to 18% or 20% or it will take a little bit to ramp as you get – it takes a while to get the points inventory through the system or the weeks inventory through the system hence you get that cheaper point inventory? And then just on the contract sales growth for 2012, is it possible to break out a little bit the growth by segment? Clearly, if you're winding down Luxury and Europe a little bit, I do expect floor growth there or do you think the pace will be the same? Just a little bit of more color on contract sales by segment will be great. Thank you.

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

Okay. Hey, Eli, it's John Geller. Good morning.

Eli Hackel Q
Analyst, Goldman Sachs & Co.

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Good morning.

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

A

In terms of the land sales, yes, what we said I think in the fall was $150 million to $200 million. That's still the case. So we expect over the next couple of years to generate somewhere in that range. Secondly, your question on development margin, yes, I think the way to think about this a little bit is you have to think about this by segment. We finished up at the low end of our guidance, as I mentioned, down in the 9% and it's clearly not going to be just a straight line up.

I think in terms of the development margin, we are seeing improvement and we're really driving North America, and that's obviously helping with the points program. Steve mentioned we're off to a terrific start year-to-date first quarter. We're up over 10% year-over-year. So we're starting to see some good traction there. Obviously that's the biggest part of our business. So, as we improve the margins there, it clearly is going to help the overall company margin. There is some downside, as you touched on, we're winding down Europe in terms of sales. So, because of that, that's going to put some downward pressure here over the next couple of years from a Europe perspective. Same thing on the Luxury side. There is still some noise in there. So, once we work through some of that on, call it, the next couple of years and with the improvement on the North America side, that's where we'll get back to that high-teen, the 18% to 20% I mentioned.

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

A

And Eli, on the contract sales question, if you look at our 2011 results, I mean, more than three-quarters of our sales came out of North America, which obviously that's kind of the mother lode, so to speak, of where the bulk of our activity is. As John mentioned and reminded everybody that both in Europe and at Luxury, we in fact are winding ourselves down from previous sales levels just because we're trying to sell out of that inventory. So I think you'll see the kind of growth in those two segments.

And Asia-Pacific is one where we think it's an outstanding market for the future. We're a little bit – it's kind of a conundrum because we have very limited distribution of our physical resort product in Asia-Pacific. It's largely in Thailand only. We're about to add some product in Macau, which will help that. As we continue to add more product over time, we would open up new distribution locations and therefore you would see new organic sales growth. But I think what you should really focus on would be that three-quarters of our sales coming out of North America with the kind of guidance that we've already given you.

Eli Hackel
Analyst, Goldman Sachs & Co.

Q

Okay. That's very helpful. Thank you very much.

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

A

Thank you.

Operator: And your next question comes from the line of Fred Lowrance of Avondale Partners. Please go ahead.

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

A

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Hi, Fred.

Fred T. Lowrance
Analyst, Avondale Partners LLC

Q

Hi, good morning. Thank you for taking my call. I know you said it, John, but I missed it. I'm just looking to walk through from contract sales down to the revenue line on the sales vacation ownership product. So if you could just walk me back through what your reportability was and obviously then walk in back into what your sales reserve was? I don't think that was in the release.

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

A

Yes. Overall the 2011 contract sales of $658 million was the company owned. We had $36 million of sales reserve and then favorable reportability across the company of about $12 million. That gets you to the $634 million.

Fred T. Lowrance
Analyst, Avondale Partners LLC

Q

Okay. And then the second question, I know what you guys presented back at your Investor Day was not guidance for 2012, but if I would look at those sensitivities on a 4% to 8% contract sales growth base, I come up with a little bit higher range for EBITDA. So I'm wondering if you could just sort of walk us through maybe why we end up towards the lower end or just below what those sensitivities would have told us.

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

A

Yes. So if you go back to the Analyst Day, we had given that zero, kind of flat sales, up 5%, up 10%. So we today guided up 4%, up 8%. So if you just extrapolate that, that's probably more – up 4% would be, call it, $125 million of adjusted EBITDA, and up 8% would be $134 million, give or take, just to kind of put it on apples-to-apples. And so we, on that 4% to 8% right, said $115 million to $125 million. So, at both the high end and low end, there is about a $10 million gap. There is really two things driving that. One, as we mentioned, we missed the contract sales for 2011. We came in under our forecast. That's about a $15 million difference in terms of revenue. And if you put the product cost and then the variable portion of marketing and sales cost, you're probably losing $6 million to $7 million of margin there, just on – you're starting at a lower point to begin with. And then from a G&A perspective, as we fine-tuned G&A as a standalone public company, there is probably $2 million to $3 million of additional G&A cost that when we pulled that together, we hadn't identified.

Fred T. Lowrance
Analyst, Avondale Partners LLC

Q

All right. Thank you. That's it for me.

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

A

Thank you.

Operator: Your next question comes from the line of Bob LaFleur of Cantor Fitzgerald. Please go ahead.

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

A

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Hey, Bob.

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

A

Hey, Bob.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Hey, good morning, guys. Couple of questions. One, you talked about the developer paid maintenance fees for the Luxury segment. Can you give us that number for the overall company and then maybe walk us through how that draws down over the next couple of years? And then I've got another question on reportability afterwards.

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

A

Yes. For 2011, that number for the whole company was about $65 million. I think the way to think about that, we told you $60 million of that was for Luxury. It's probably going to take a couple of years to kind of bring that down, and lot of that is how successful we are on obviously selling that Luxury inventory. We talked about what we are doing with one of the projects and making it available through our native points program. And so we're going to be active to try and get that down as much as possible.

There's probably a little bit more, and if you think about Europe and Asia, we're at a pretty low point anyway in terms of inventories. So the maintenance fees there aren't as significant. So it's really North America. There is a little bit more rundown of excess inventory in our North America that will continue to bring that down. I think the big difference there is, as we mentioned, in North America, we typically are able to rent that inventory and make some money. So it's not a direct, hey, this cost went down. In some cases, you potentially could lose a little margin on that on sold maintenance fees in North America. So it's not a direct correlation.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

So it sounds like if it was $65 million overall, $16 million for Luxury and you've got excess inventory there, it sounds like that sort of the run rate on that is about $50 million a year in sort of a steady state, given the normal load of inventory you cover or is that overstating that?

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

A

I would probably – Bob, this is Steve. I would probably call in the $40 million to $50 million range.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities

Q

Okay.

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

A

But again, back to John's point, while we have unsold maintenance fees, in many cases, except in Luxury, as an example, we can monetize that inventory and so we get rental income as an offset.

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Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay. And then on the sales reserve, it looks like there was about 5.5% of contract sales. Is that a pretty decent number to use going forward or is that going to continue to come down as the consumer sort of settles out and the default rates and delinquency rates come in?

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

Yes, it's probably still directionally pretty good. The – we are – we continue to see improvement in our delinquencies year-over-year and defaults. Some of that gets baked into the curves as that performance improves, and you look at what you expect to happen into the future. So, that's probably still a pretty good run rate for now. If things were to get considerably better, we could maybe bring it down. And obviously if the things go the other way, it could go up a little bit.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay. And forgive me, I just thought of one extra one I wanted to ask you guys. On the management fees, how does that grow over time? I mean, obviously you have some incentives to keep costs down, to keep maintenance fees down for your customers, but that obviously would keep your maintenance fees down. Well, but you also have unit growth. So what sort of a realistic growth rate to think of your management fee business growing over time?

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

I think the best way to think about it, Bob, is if you – I mean, every time we sell a new timeshare owner or even an existing timeshare owner more inventory or more points, it comes with an initial maintenance fee. And to your point, yes, we have a fiduciary responsibility to our condominium associations and ergo to the owners to make sure that we are operating these resorts as efficiently as possible, but because you get normal inflation, we pass through things like higher utility costs, higher insurance costs, and things like that. You're going to get it – our maintenance fee, generally speaking, is 10% of the annual maintenance fee. And so every time we sell a new interest, we get more management fees.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

So it sort of sounds like it's kind of sales volume plus inflation is a good proxy, right?

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

That's right.

Robert A. LaFleur
Analyst, Cantor Fitzgerald Securities
Q

Okay. Thanks, guys.

Stephen P. Weisz
President & Chief Executive Officer, 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.

Operator: [Operator Instructions] And your next question comes from the line of Tim Wengerd of Deutsche Bank. Please go ahead.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

Hi, good morning.

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

Good morning, Tim.

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

Good morning.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

I was just trying to think about the long-term level of inventory that you need now as you switch to the points program. And I guess what's the right amount of inventory? I know you had close to $1 billion at the end of the third quarter. Long-term, what's the right level for, say, $700 million of contract sales?

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

Probably the way – probably the way to think about it instead of an actual dollar volume, although you can do the arithmetic, is the number of years inventory. And let me give you – it's a little bit of inside baseball here -- but let me try to walk you through it. For our North American points program, we can only put completed inventory with the certificate of occupancy into the Florida-based land trust, which is the fundamental underlying element of this points-based program. It takes a while once you complete building it to get it through a registration process, to get notice of use rights, and ultimately get it into a saleable position within the trust. So our working kind of assumption is that somewhere between a year to a year-and-a-half of inventory is probably what we're going to be needing on a continual basis. And that's kind of what we plan for.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. And then, is the year to year-and-a-half completed and – in the trust and ready to go? Is that -

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

Year to year-and-a-half completed, some of which will get into the trust. I'll give you one other element – into the trust, ready to go, 100% registered and everything else, our ultimate goal is six to nine months. Right? And what I was trying to get to was, you've got some completed inventory that is going through the registration process,

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getting into the trust before it's available for sale. So, on average, you're about a year to year-and-a-half, in the trust, ready to go, registered, everything else, six to nine months is the ultimate goal.

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

A

Yes. So I think just to kind of add on, in total, in work-in process and all that because you have stuff coming in and out, probably 1.5 to two times of inventory is probably a good way to think about it on a little bit higher level.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. All right. That's helpful. And then, for your cash flow guidance for 2012, how much – I guess, how much real estate inventory spending does that include?

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

A

It's about $150 million or so, a little bit more than what we actually spent in 2011. Now our product costs will be higher, so the non-cash piece, that runs through your EBITDA that gets added back, net-net you'll generate fairly close to the same amount of positive development inventory cash flow year-over-year.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And then thinking about 2013 and beyond and what we talked about for inventory levels, should that $150 million, that should go down?

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

A

It will – what will drive as we get into, say, 2013 and 2014, obviously it will be sales pace and -

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Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.

Q

Okay.

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

A

We're selling more and sales pace is going up. I would expect that to go up and continue to go up over time. The goal, if you remember, if you think about EBITDA is running through your EBITDA or your net income is your product cost, which is non-cash. That's the amount that's coming off your books. And what we've talked about is the actual cash we're going to spend versus what's coming off of our balance sheet will continue to go down here over the next couple of years. We saw that a little over $100 million for 2011. We probably see a similar pace here for 2012, and then I think as you get further in the out-years, once again depending on pace and how sales are going, you'll continue to see that come down. But at some point over the next few years, it will get fairly close, and the idea is because of the point space model and the capital efficiency where we're only going to have a handful of resorts under active development, is we'll be able to manage that cash outflow with the non-cash product cost coming off of the books on a more normalized basis in the future.

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Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

Okay.

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

Does that make sense?

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

Yes, that makes sense. And then also, does your cash flow guidance include reduction of the Marriott Rewards liability?

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

Yes.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

In the year?

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

Yes.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

I guess how much of a reduction would you expect to pay on that in 2012?

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

The way that works is the actuals are based on actual redemptions. So we have obviously a lot of history based on people and how they redeem their points. We probably expect $60 million to $70 million or maybe a little bit more of actual net redemptions. And then remember, the cash flow also assumes that any new point issuances, beginning here in 2012, we pay for as we go and that's in the cash flow too.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. Okay. Yes, that's helpful. And I know you talked a little bit about – putting some luxury into the points program and that would help reduce the owner-funded maintenance fees. What sort of – I mean, how much of a reduction do you think you can create this year?

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

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Well, we're not going to -- given what Steve just talked about, by the time you actually deeded into the trust and get it registered, there is a run rate. So -

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Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.

Q

Okay.

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

A

So, to the extent we're successful getting it in this year, we'll start to see the benefit next year. We're still doing a lot of diligence around all the projects in what we want to put in. So we'll know more on that and will be able to talk a little bit better in the future, but you won't see any real significant benefit on that this year.

Timothy Wengerd
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. All right. That's all from me. Thank you.

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

A

Thank you.

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

A

Thanks.

Operator: And Mr. Weisz, there are no further questions at this time. Please continue.

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

Thank you, Luke. We were thrilled to have completed our spin-off and we're very excited about the opportunities that lie ahead now that we are an independent company. As you've heard, we're optimistic about the outlook for 2012. We look forward to reporting our progress on the future call. So, thank you for your participation on our call today and your continued interest in Marriott Vacations Worldwide. And finally, to everybody on the call and your families, enjoy your next vacation. Thank you.

Operator: Thank you. Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation, and you may now disconnect your lines.

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