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Marriott Vacations Worldwide Corp. (VAC)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to Marriott Vacations Worldwide Second Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-answer-session will follow the formal presentation. [Operator Instructions] As a reminder, this conference call is being recorded.

It is now my pleasure to turn the call over to your host, Mr. Neal Goldner, Vice President, Investor Relations. Thank you, you may begin.

Neal H. Goldner
Vice President-Investor Relations, Marriott Vacations Worldwide Corporation

Thank you, Rob, and welcome to the Marriott Vacations Worldwide second quarter earnings conference call. I'm joined today by Steve Weisz, President and Chief Executive Officer; and John Geller, Executive Vice President and Chief Financial and Administrative Officer.

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, August 1, 2019, 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 and the Financial Information page on our website at ir.mvwc.com.

It's now my pleasure to turn the call over to Steve Weisz, President and Chief Executive of Marriott Vacations Worldwide.

Stephen P. Weisz

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

Thanks, Neal. Good morning everyone and thank you for joining our second quarter earnings call. I'm very pleased with our performance this quarter with contract sales growth being driven by both our Legacy-MVW and Legacy-ILG vacation ownership businesses contributing to our 17% adjusted EBITDA growth on a combined basis.

Starting with our Vacation Ownership business, we previously told you that we expect that our Legacy-MVW business to deliver relatively consistent sales growth throughout 2019. And that the Vistana and Hyatt businesses would accelerate as the year progressed. That's exactly what we delivered this quarter. Driving 6% higher consolidated contract sales on a combined basis with growth coming from both our Legacy-MVW business and the acquired Vistana and Hyatt vacation ownership businesses.

Our Legacy-MVW segment increased contract sales 6% in the quarter compared to the prior year. North American tours grew 3% and VPG increased 1% to $3,700. First time buyer tours increased 6% representing approximately 45% of the total tours taken in the quarter, highlighting our focus to grow new owners. We also saw continued growth at our newer sales distributions, including the most recent addition to our portfolio, the Marriott Vacation Club Pulse near Fisherman's Wharf, San Francisco, which we opened in late May.

Moving to Legacy-ILG vacation ownership, sales accelerated meaningfully compared to our first quarter. We've been working very hard integrating the business, leveraging best practices in sales and marketing, and shifting to more efficient marketing channels with a longer term goal to increase Vistana's VPG to levels closer to that of our Legacy-MVW business. And this quarter was a great example of the progress we made with tours increasing 2%, VPG expanding more than 4%, and total contract sales growing more than 6%.

The tour package pipeline increased 8% on a combined basis, including 15% growth at Vistana. This was driven by double-digit Encore and Bounce Back package growth.

While our Vacation Ownership business certainly had a solid performance in the second quarter, we believe we still have substantial opportunities ahead of us. For example, even with the strong improvement in the quarter, VPG of Legacy-ILG still remains roughly 20% lower than Legacy-MVW, illustrating just one of the long-term opportunities that lie ahead of us.

But what I'm most excited about is our continued focus on digital transformation. Through our customer centric and data driven approach, we continue to deploy innovative pilot programs across multiple digital marketing channels, with a longer term goal to drive more efficient tours and higher profitability. Utilizing this methodology, we can increase the number of impactful programs while minimizing the risks and time associated with unproven large-scale rollouts.

During the second quarter, we launched a digital marketing pilot on Marriott.com and a deeper integration with the Marriott Bonvoy traveler partnership. While still relatively small in scale, we believe digital marketing on Marriott.com and other online channels holds tremendous promise over time.

Our longer term vision is to be able to make differentiated offers digitally to the customers during their booking journey when it's most appropriate for them, enabling them to buy their package and make their reservation completely online.

As we continue to evolve and enhance our product offering, in the second quarter we also announced an exciting new relationship with PlacePass, a digital concierge service bringing over 200,000 additional leisure experiences to our owners and members through an online marketplace. We also continued our work on enhancing our product offerings across our multiple Marriott brands. As we shared with you previously, we continue to evaluate the various options and our current plan is to add new enhancements in stages, each building on the strong foundation that we offer customers today.

Over time, our goal is to develop an integrated product that leverages all of our Marriott family of brands, providing owners and potential owners an even greater array of vacation destinations and experiences from which to choose. We remain extremely optimistic about its potential and we'll have more to say about this in our upcoming Investor Day on October 4.

Our Exchange & Third-Party Management segment also had a good quarter with Exchange membership stabilizing compared to Q1 and average revenue per member increasing 3% compared to the prior year. Interval International announced an exciting new agreement with Planet Fitness, taking a meaningful step in its strategic initiative to diversify beyond its traditional time share customer base. Under the agreement, Interval will leverage its technology to enable more than 8 million Planet Fitness Black Card members access to hotel, cruise, and condominium vacations at preferential rates.

We've also added more features to the Interval app to enhance our members' abilities on their mobile experience, including the ability for members to deposit their weeks and enable an improved vacation planning experience. In our Third-Party Management business, Aqua-Aston welcomed CopperWynd Resort & Club in Scottsdale to its portfolio, making it their first managed resort in Arizona.

Moving to synergies. The integration of ILG is progressing well. We are making excellent progress, not only achieving the savings we promised, but in fundamentally transforming how we do business. We now expect our run rate savings to approach $60 million by year end including $45 million to $50 million of synergies we expect to benefit our 2019 results. We've made real progress since closing the acquisition only 11 months ago and we continue to target total annual run rate savings in excess of $100 million by the end of 2021. With that said, we continue to work hard to find additional opportunities to surpass this target.

Before I turn the call over to John, let me touch upon our full-year outlook. With the first half of the year behind us, we've narrowed our full-year contract sales growth guidance to 6% to 9%, implying more than 9% growth at the midpoint for the second half of the year. This is consistent with our original guidance that growth would accelerate in the second half of the year. We've also narrowed our full-year adjusted EBITDA guidance to reflect the updated contract sales growth and higher synergy attainment we expect this year.

Since the end of the first quarter, we've repurchased an additional 1.5 million of our shares, bringing the total amount since closing the ILG acquisition on September 1 last year to roughly 4 million shares. This represents more than 8% of the shares we had outstanding at the time of the acquisition. In addition, the board recently increased our authorization by 4.5 million shares, bringing our current authorization to 4.7 million shares or roughly 10% of our outstanding shares.

Looking forward, the fundamentals of our industry remain strong. The integration of ILG is progressing well. And we remain very excited about the unique opportunity we have to fundamentally change how we go to market.

With that, let me hand the call over to John.

John E. Geller, Jr.

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

Thank you, Steve, and good morning, everyone. I too am very pleased with our second quarter results and how we are progressing through the year. As we did last quarter to better highlight how the business performed, we have included additional supplemental financial results in our earnings release. This supplemental information includes 2018 financial information that combines Legacy-ILG second quarter 2018 results with Legacy-MVW's results to be comparable to our current year presentation. My comments today about growth and year-over-year changes refer to our results on a combined basis.

Total company adjusted EBITDA increased 17% in the quarter and grew 20% after excluding the impact of VRI Europe which we disposed of last December. While we are very pleased with these results, we are even more excited with the drivers of the year-over-year growth with roughly two-thirds of the improvement coming from our core businesses and the balance coming from synergy savings.

Looking first at our Vacation Ownership segment, adjusted EBITDA increased 16% year-over-year to $208 million in the second quarter, with growth coming from all lines of business. In our development business, consolidated contract sales increased 6% to $386 million in the second quarter. Adjusted development margin, which is adjusted for revenue reportability and other charges, increased 17% over last year to $86 million. Adjusted development margin percentage was 24.2% reflecting 170 basis point improvement due to both lower inventory costs and more efficient marketing and sales spending.

In our financing business, revenues increased 18% to $68 million in the second quarter. And financing revenue, net of expenses and consumer financing interest expense, increased $3 million or 7%. These results reflect increased revenue primarily from our growing notes receivable balance partially offset by higher interest expense due to a higher outstanding debt balance and a slightly higher average cost of funds. Our notes receivable portfolio continues to perform very well. The average FICO score of buyers who financed with us in the quarter was 736 while delinquency rates remain near historic lows, and financing propensity remains strong at 62%.

In our rental business, revenues increased 6% to $141 million, and rental revenues, net of expenses, increased 43% to $42 million. These results were driven by an increase in transient rate, higher plus point revenues and lower inventory costs. In our resort management and other services business, revenues increased 2% while revenues net of expenses increased 1% to $64 million. This growth reflects higher year-over-year fees for managing our portfolio resorts partially offset by higher fees earned last year for managing our asset light inventory arrangements in San Francisco and Marco Island.

Turning to the Exchange & Third-Party Management segment, adjusted EBITDA was down $2 million year-over-year after adjusting the prior year to exclude VRI Europe. The year-over-year decline was due, as expected, to the nonrenewal of certain contracts last year. The core exchange company business was relatively flat year-over-year and average revenue per member in the quarter was up 3%. As Steve mentioned, we continue to work to identify new incremental revenue streams for these businesses and are encouraged about the progress to-date.

G&A cost declined $15 million year-over-year driven primarily by synergy savings, as well as the timing of technology and other spending, partially offset by normal inflationary cost increases.

As it relates to our synergy savings, as Steve mentioned, we are making great progress. In the second quarter, we generated $13 million of synergies, bringing total savings for the first half of 2019 to over $20 million. With the savings achieved to-date as well as what we have projected for the remainder of the year, we are increasing our target of in-the-year savings for 2019 to $45 million to $50 million, up roughly $10 million from our previous estimate.

Moving to the balance sheet, at the end of the quarter, cash and cash equivalents totaled $179 million. We also had approximately $104 million of gross vacation ownership notes receivable eligible for securitization. Further, we had roughly $516 million in available capacity under our $600 million revolving credit facility.

Our total corporate debt outstanding at the end of the quarter totaled $2.2 billion. This excludes $1.8 billion associated with our non-recourse securitized notes receivable. From a leverage perspective, assuming the companies were combined for the last four quarters and including $100 million of total synergy savings, our combined debt to adjusted EBITDA ratio at the end of the quarter was 2.7 times, slightly higher than our longer term target of 2 to 2.5 times.

During the quarter, we successfully completed a $450 million note securitization at a blended rate of 2.9% and a 98% advance rate. This is the first securitization we've completed that included the Marriott, Westin and Sheraton brands and we are very pleased with the high demand for our paper as well as the favorable terms of the securitization.

Regarding our return of capital, in the second quarter, we repurchased 1.1 million shares for $109 million at an average price per share of $96.36 and we also paid dividends of $20 million. Subsequent to the end of the second quarter, we repurchased an additional 400,000 shares for nearly $40 million, bringing our total capital returns year-to-date to more than $315 million.

Before I turn to our outlook for the year, I want to provide an update on a few items. First, as you may recall, last quarter, I mentioned that we were undertaking a comprehensive review of our vacation ownership assets to determine the best strategic direction for the business. While work to quantify the impact continues, we do expect to generate incremental cash flows over the next few years. We will provide further details around the results of this review as part of our Investor Day on October 4th.

As it relates to business interruption insurance proceeds, we received another $6.5 million in the second quarter associated with the 2017 hurricanes. For our Westin St. John property, which is the largest claim outstanding related to the 2017 hurricanes as well as for minor claims related to the 2018 storms, we continue to work with our insurance providers and expect to finalize the majority of the claims over the next several months. This includes both our business interruption losses, as well as the property damage experienced by both us and our owners' associations. While we expect to receive a good portion of the proceeds this year, our adjusted EBITDA and adjusted free cash flow guidance do not reflect the receipt of any insurance proceeds for our business interruption losses. We will continue to update you as these efforts progress.

Now let's turn to the outlook for the year. As Steve mentioned, we expect contract sales to grow 6% to 9% this year, with year-over-year sales growth continuing to improve as we progress through the year, as our new sales center in San Francisco ramps up and we lap the impact of last year's hurricanes and soft December. With this top line growth, we are projecting adjusted EBITDA of $750 million to $780 million, or roughly 15% year-over-year growth, reflecting our revised full-year contract sales guidance but also incremental synergy savings we expect to materialize this year.

For our Vacation Ownership segment, we are projecting continued growth from all lines of business. We expect continued strong sales growth from both our Legacy-MVW and Legacy-ILG brands, coming from a combination of higher tours as well as from VPG growth. And development margin is expected to benefit from the turnaround of unfavorable revenue reportability that we experienced in the first half of the year.

At this time, we are projecting our reported development margin for the second half of the year to be between 24% and 26% resulting in a full-year development margin of between 21% and 22%. Financing is expected to continue to benefit from higher sales volumes as well as a relatively low interest costs on the securitized debt. We expect that growth in our financing results for the second half of the year will be in line with what we experienced in the first half of the year. We are planning to execute a second-term securitization later this year with the expectation that the terms of the deal will continue to be favorable.

Rentals is expected to perform well with higher transient keys rented and higher transient rate, as well as continued growth in plus point revenues.

Resort management is expected to grow from higher management fees, exchange company activity, and ancillary results. And G&A is expected to continue to benefit from the acceleration of some of the savings from our synergy initiatives.

For the Exchange & Third-Party Management segment, active members are projected to remain relatively stable compared to the first half of the year. Average revenue per member for the Exchange company is projected to increase at slightly higher than inflation as results of programs being implemented or enhanced to expand membership benefits.

Lastly, we're now targeting adjusted free cash flow of between $440 million and $490 million for 2019, more than $25 million higher than our previous guidance using the midpoint of the range. As we've done in the past, we will continue to identify ways to enhance our cash flow generation while ensuring our spending continues to support future sales growth.

We started the year with a solid first half. Our integration of the business continues, and we are excited about the changes that have already been implemented and the results they are beginning to generate, particularly around technology and processes. I look forward to updating you on our continued progress as we move throughout the year. As always, we appreciate your interest in Marriott Vacations Worldwide. And with that, we will open the call up 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 Jared Shojaian with Wolfe Research. Please proceed with your question.

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

A

Good morning, Jared.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Good morning, everyone. Good morning. Thanks for taking my question. Can you just elaborate a little bit more on what drove the reduction to the contract sales growth guidance for the year? And maybe specifically is it coming from Legacy-Marriott or Vistana? I mean is this the new run rate norm as we think about looking forward to 2020 and beyond? And was this more of an intentional decision to slow down some of the growth and drive higher development margins? Or was there some other onetime things that you would call out?

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

A

Sure. I certainly understand your question. I mean through the second quarter, we were at 6% year-over-year growth. So, if you were to do the arithmetic, if we were going to achieve the top end of our original guidance, which you may recall was 12%, we would have needed to have run 18% year-over-year for the second half of the year. That would be pretty sporty from our perspective. We made a lot of changes in our sales and marketing organization over the last six to nine months. And it takes some time to manifest these changes into higher efficiencies.

We know that these are best practices. We're comfortable that we will see improvement over time. You saw some of that evidenced and what happened in the VSE businesses in the second quarter where we saw very substantial improvement of what you may recall with a 2% down year-over-year in the first quarter to 6% up in the second quarter. And it takes some time to put these things in place. I would also say to you that part of that is driven by our sales leadership which has predominantly remained from the MVC business. They spent a disproportionate amount of time in the VSE properties trying to drive some of these changes.

So, in some respect, I think you'll see some of the slight dip between the 10% growth we had in the first quarter for MVC down to 6% growth in the second quarter in the MVC business. That was partly because they were spending more time there. We took our eye off the ball a little bit on the MVC side.

So, when you simply do the arithmetic, that 9% growth which is what the midpoint of the guidance going forward to get to where we see between 6% to 9% for the full year, we think that's very achievable and we're very confident in that. We thought it would be appropriate to make sure that everybody understood what our expectations were.

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

A

And just to – you had asked, Jared, on the longer term opportunities 2020 and beyond, obviously we're going to be doing our Analyst Day here on October 4. But as we've talked about, the longer term opportunities to grow are very much intact and that's really leveraging a lot of the Marriott branded tour channels through the legacy Vistana business and that gap in VPG. So, we'll provide an update on the 4th about how we think about the longer term growth opportunities.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Okay. Great. And just a follow-up on that. I guess if you had to single out and call out like the biggest delta between what you're thinking now versus what you were thinking three months ago. Like I understand like the prior guidance would imply a much bigger ramp in the second half. It's probably not realistic. But three months ago, I think kind of the assumption was that second quarter maybe a little bit better and then second half I think still even a little bit better than what you're assuming now on contract sales. What would you say, if you isolate it, the biggest delta between what you were thinking three months ago and what you're thinking now?

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

A

I think it was the growth of the MVC sales in the second quarter. As I said, we did 10% in the first quarter. To be honest with you, we thought there would be a similar kind of cadence in the second quarter. It was down to 6%. But again, we don't attribute that to anything on the demand side per se. I think it's more of an executional thing and that's what drove the change.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Great. Thank you. And then, one other question for you. Just on the synergies, the $10 million higher in-the-year savings for this year, do you think that's a pull forward from future years and just accelerating the timeline of the synergies or do you feel like you found an extra $10 million that you didn't have before?

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

A

Yeah. I mean, for now, it's an acceleration of the $100 million or more target, if you will. As Steve said though, we're looking real hard. We see a lot of other potential opportunities. Hopefully, you can appreciate the size of this integration and transaction that we're undertaking here, so there's a lot of moving parts. We see lots of opportunities and on October 4th, we'll provide a little bit more detail around that in kind of what we see going forward. But, for now, yes, it's really getting after stuff faster and seeing things happen a little bit quicker than we had originally drawn up.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Okay. Great. Thank you very much. I'll jump back in the queue.

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

A

Thank you.

Operator: Our next question comes from David Katz with Jefferies. Please proceed with your question.

David Katz
Analyst, Jefferies LLC

Q

Hi. Good morning.

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

A

Hi, Dave.

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

A

Good morning.

David Katz
Analyst, Jefferies LLC

Q

Good morning. So, look, I want to pile on to that matter, if you don't mind, with respect to the synergies since we're so focused on it. And just think about how you arc that synergy progress, looking out beyond this year, is this something that we should think about taking two to three years? And obviously improvements are always ongoing, but when you've sort of mapped out what you underwrote in buying, making this acquisition, how long is that curve?

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

A

Yeah. I mean, David, when we did our plan originally, we're trying to get everything within the first three years. Obviously we're making great progress. We expect to kind of exit the first year here or just a little over a year at the end of 2019 at $60 million. So versus our original expectations, we're moving quicker than we had originally anticipated, and that's why we have that $10 million benefit here.

I think the hard part when you start and you're looking at all the different things you don't know all the pieces it's going to take until you get into it. And so, I'm very happy with where we're at. As I said before, we are looking hard, and as Steve said, we're going to do everything we can to continue to look for other opportunities over the next couple of years and we'll do everything we can to pull those forward and get them in place sooner.

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

A

And as we have more visibility on any of the incremental savings over the minimum $100 million, we'll certainly share that with you. It's simply a matter of going through the process, and some of these are some fairly significant technology implementation projects that for the most part are going in place this year. But there is other things that are on the horizon that as we get a finer point on it we'll certainly share.

David Katz
Analyst, Jefferies LLC

Q

Got it. And if I can just ask one more about that, and I'll apologize as we're all doing a few things this morning if you already spoke about it, but the degree to which Marriott's integration, which has had some challenges and bumps in the road, to the degree that their integration is a gating factor in you achieving what you set out for yourself. How much of a gating factor is that?

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

A

I would say the only thing that we can point to in terms of some of the Marriott's activities and given, again, the magnitude of that acquisition, which I think you can certainly appreciate was pretty substantial. I think the only thing that we saw was, as they were transitioning on to one reservations platform between the two, there were some – we took a bit of a hit in some of the call transfer stuff that we were enjoying prior to on the MVC side of things. But that, from a synergy standpoint, there's nothing of any material nature there. I would just – that's more on the tour flow and revenue side for us. But, again, I don't think there's any read through from Marriott's challenges to where we find ourselves in what we're trying to do.

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

A

And the good news there is that, that's behind us now on the call transfer stuff, so we're getting back to more normalized. Even with that, as we talked about tour pipeline grew 8% year-over-year. So there's a lot of levers to pull with the business. But we're excited to get that ramped – getting ramped up again.

David Katz
Analyst, Jefferies LLC

Q

Got it. That question comes up. I appreciate the answer. Thanks so much.

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

A

Yeah.

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

A

Thank you.

Operator: Our next question comes from Patrick Scholes with SunTrust Robinson. Please proceed with your question.

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

A

Hi, Patrick.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hi. Good morning. Good morning, Steve and John. A couple questions here for you. This morning, we saw your big competitor, Hilton Grand Vacations, drastically take down their back half guidance really due to lack of inventory at one single property. What would you say to investors to comfort them that one property lack of inventory is less of an issue for your organization to sort of soothe some nerves in that sense? Thank you.

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

A

Yeah. Hey, Patrick. You got to remember our product form is different. We sell a system product, so we sell Florida based land trust in North America and people are buying into the system, not specific resorts. And so, with that, as we've always talked about, it's a much more capital-efficient model. We're going to deliver normalized free cash flow of over $400 million this year and allows us to return that capital to shareholders. So we're always looking to add inventory, but that location issue, since you sell the system of resorts, is not a factor in terms of our business model.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great. Thank you for reminding us on that. And then, my second question, with this pilot program and perhaps it's too early to get some statistics on it, I know Wyndham has talked about seeing a 25% higher VPG from customers who come from their guest rewards program. Do you have any early indications of sort of how VPGs compare for a Marriott Bonvoy customer versus sort of your traditional customer?

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

A

Well, clearly, the Bonvoy customer, previously Marriott Rewards customer or Starwood Preferred Guest customer, they have very strong VPGs and we're very happy with that. Obviously, putting those two programs together into one, I don't think you'll see a material change in the VPG that we'll get from the one combined program from the two that were separate. But back to your – the other part of your question is on the whole digital side of things. I mean the pilot that we put in place literally in June to begin to do some work on Marriott.com, it is very early stages. We are reasonably encouraged by the pilot. It's a small pilot. Our intent would be that this fall, as we get some of the learnings from the pilot, we'll roll it out more broadly to the former MVC properties. And then in the next year, we'll roll it out to both the Sheraton and the Westin properties.

But again, to your point, I think relative to where Wyndham finds itself, I certainly don't know a lot about their business, except to say that I think they were slow to come to the game in terms of trying to penetrate the Wyndham loyalty program, and obviously that was a centerpiece of our program for a whole lot of years.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you. And then just last question. I believe you have an Investor Day coming up in October. Is it possible we could get some sort of initial financial metrics about possible additional incremental revenues from this digital marketing? Certainly, most of us on the Street believe there is revenues but nobody is quite sure how to model that upside at this point.

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

A

Sure. Hey, Patrick. Yeah. I mean we obviously expect at the Analyst Day to take you through the high level strategy. A cornerstone of future growth, as we've talked about, is around the digital opportunities. We'll have our Head of Digital and Brand there presenting and talking about those opportunities, and obviously we'll frame that up in terms of how we think about the longer term growth of the business and how that's going to contribute. So, hopefully you'll walk away from the day with a good sense of what the opportunity is in that area.

Patrick Scholes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great. Thanks. Thanks gentlemen. Looking forward to that Investor Day. That's all for me.

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

A

Thank you.

Operator: Our next question is from Brandt Montour with JPMorgan. Please proceed with your question.

Brandt Montour
Analyst, JPMorgan Securities LLC

Q

Good morning. Thanks for taking my questions. Can you talk a little bit more about the strong quarter you guys had with ILG? How much of that is kind of owing to getting those brands up on the call transfer system and how did that business kind of come in versus your internal expectations?

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

A

It was primarily because of some better execution on the VPG side of things. Keep in mind, call transfer or even any of the Encore or Bounce Back programs, they typically manifest in tour flow that comes in later on in time, anywhere from 12 to 18 months later. So anything that we've done there probably won't see much in terms of until 2020 or something like that.

So, it was largely about VPG. You may recall that we've said over time that when we talked about this, that we were going to make some changes and get out of some of the high cost, low yield distribution channels that Vistana was in, some of the OPC places they were in. They were doing a lot of tour not required kind of packages. So we've moved those things and I think that's where you'll see the bulk of it. You may recall from my remarks, I said that VPG in Vistana was up 4% and that's really where most of it came from.

Brandt Montour
Analyst, JPMorgan Securities LLC

Q

Got it. That's helpful. And then on Exchange, you guys gave us a fair amount of color and we did see a nice bounce back in the revenue [indiscernible] (00:37:30) number. Just curious what you guys did to drive that sort of sequential turnaround? I know you had slightly easier comps there, but if you could just talk a little bit more about that but then also member count stabilized, you said, but it was still down year-over-year. So, I guess what happened within the quarter on the member count side that gives you some confidence that that's truly kind of moving in the right direction.

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

A

Yeah. The member count in Interval International was roughly consistent with what we saw in the first quarter. These were accounts that had transitioned out in 2018, towards the end of 2018. I mean one of them was Shell Vacations which actually was acquired by Wyndham back in 2012 and they eventually moved over to RCI for obvious reasons because that's a Wyndham asset. And then, there were two others, SunSwap and I forgot the name of the other one. Anyway, these were – but that's where the accounts of members has remained relatively stable. The increase of the 3% is largely about the fact of trying to find some incremental wallet share out of the existing members by offering some additional services and some enhancements to the membership and as well as some price increases.

Brandt Montour
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks, guys.

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

A

Thank you.

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

A

Thank you.

Operator: Our next question comes from Chris Woronka with Deutsche Bank. Please proceed with your question.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys.

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

A

Good morning.

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

A

Good morning.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning. I want to see if you could maybe – you mentioned 45% of your buyers were first time buyers in the quarter, maybe can you break that down a little bit between your Legacy-ILG and Legacy-MVC. And maybe what do you think that can get to? And how do you get there?

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

A

Well, first of all, it's 45% of our tour growth, it's about a third of our contract sales, so just to put that number in correct perspective. As far as the breakdown between the businesses, I don't have that number...

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

A

We don't have the numbers. What I can tell you directionally Chris is that the mix is more first time buyers on the Legacy-ILG Vistana business and slightly less on the Marriott side, but not overly meaningful, I don't think in terms of the differences.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, great. That's helpful. And then just kind of following up on that in terms of getting that VPG, closing that VPG gap on the Vistana side, is that more to do with some of your marketing efforts? And – or does it have more to do with kind of you're bringing a new customer into the fold? I'm just trying to get a better understanding of how the cadence of that might look depending on what drives it.

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

A

Well, the way you should expect us to try to attack the VPG issue on the Vistana business is really three-fold. Number one is, as I mentioned earlier, kind of rationalizing the distribution channels where we are sourcing customers from. They were in a number of channels that quite frankly weren't delivering a very good VPG, which by definition means that you have a relatively high marketing and sales cost. So we moved out of that. One of the other areas that you should see improvement is better execution at the sales center or when the sales executive is speaking with an owner about making a purchase, and we've done a lot to try to align our first day benefit grid, our pricing grid, everything else to do much the same as we do on the MVC side of things. So that's where you should.

And then the third piece is to continue to try to do a better job of trying to penetrate kind of the richer vein of distribution channels where we've had a lot of success in the MVC side. I mean, the linkage stuff, as an example, where we source customers that are staying in adjacent Marriott branded, or in this case, a Vistana, Sheraton or Westin branded property to incent people to take tours, and hopefully, become buyers, that also carries a fairly high VPG. So, those are some combination of the things that we are in the midst of doing. And we're starting to yield some pretty good success.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Very helpful. Thanks, guys.

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

A

Thank you.

Operator: Our next question is from Jared Shojaian with Wolfe Research. Please proceed with your question.

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

A

Welcome back.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Hi. Thanks for – yeah. Thanks for taking my follow-up. So, as we look forward to next year, can you just help us understand the free cash flow guidance this year. Is there any reason why free cash flow next year shouldn't be growing probably similar to your EBITDA growth next year or are there some one-time impacts to this year? And then on that same front, do you think you'll have more capacity to return capital next year than you do this year?

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

A

Yeah. So, a couple of things. We took the guidance up at the midpoint as we talked about. A lot of that really relates to the ability to push off development spend which flows through our inventory spend, if you will, flows through our free cash flow. So, if you look at our original guidance, Jared, I mean the midpoint of that was probably around a normalized free cash flow with the EBITDA, because we're always budgeting in or putting dollars in there to replace inventory that's being sold off the shelf.

So, now your comment around growth, yeah. I mean – but it wouldn't be – your EBITDA growth number wouldn't be off the higher development spend or less development spend that's generating the higher free cash flow. This year it would be more off the normalized, if you will. The other thing we've talked about is we'll continue to leverage excess inventory. We got some excess inventory in the ILG acquisition, so that that always can help like it is this year in a tailwind but those are kind of the different levers or things you should consider in terms of year-over-year growth.

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

A

The only thing I would add to that is and we'll talk about more of this at the Investor Day, is as you know, we're going through an assessment of the various assets that we acquired when we bought the ILG business and there will be probably some things that we will agree that probably are not strategic for us in the long-term in terms of selling off individual parcels or things of that nature. And so, you might get some bump next year from that.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Okay. Thank you. So, it sounds like we should assume CapEx picks up a little bit next year and then your inventory spending picks up a little bit next year. Correct me if I'm hearing that incorrectly. And then in terms of the second part of the question, just the capacity to return capital next year, I mean if I just look at what you've done in the first half of the year and just assume that continues in the back half, do you think next year is a bigger capital return year or kind of similar? Or how would you think about that?

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

A

Yeah. Go back to the development spend. Once again, we'll look to budget kind of what we're selling off the shelf. That's always the opportunity. And a lot of the timing stuff on free cash flow from development comes from our ability to do capital efficient transactions which we've been very successful at and we expect we'll continue to do it that way which allows us to add multiple new sites, flags, and take that inventory down over time.

So, I'm not sure. I don't want to say now – we'll work on our plan – that development spend is going to be higher next year at this point. So, I don't want you to walk away with that. We're going to do our best to manage from that perspective.

So, to Steve's point, I mean our free cash flow wouldn't include proceeds from dispositions, but that number, and we'll update you in October as we continue to refine our strategy there, that would be above and beyond our free cash flow number to the extent that we dispose the stuff, and we can execute those dispositions in the next year.

Those proceeds would just run back to our normal funnel of excess capital which more recently obviously other than the ILG acquisition has been returned back to shareholders. So I think there is much capacity if not more, given some of those moving factors to continue to return capital like we've done this year.

Jared Shojaian
Analyst, Wolfe Research LLC

Q

Okay great. Thank you very much.

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

A

Thank you.

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

A

Thank you.

Operator: Ladies and gentlemen, we've reached the end of the question-and-answer session. At this time, 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.

Thanks very much, Rob. I'm very excited with our first half performance with a strong contract sales and double digit adjusted EBITDA growth. But what I'm even more excited about are the opportunities we have in digital marketing and other transformational changes that will enable us to drive solid performance for many years to come. Thank you very much for your time today. I look forward to seeing many of you on our October 4th Investor Day. And, finally, to everyone on the call and your families, Enjoy your next vacation.

Operator: This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.