Hilton Grand Vacations

Q2 2019 Earnings Call

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CORPORATE PARTICIPANTS

Charles Corbin - *General Counsel and Chief Development Officer*

Mark Wang - *President and Chief Executive Officer*

Dan Matthews – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to the Hilton Grand Vacations' Second Quarter 2019 Earnings Conference Call. A telephone replay will be available for seven days following the call. The dial-in number is 888-203-1112, and enter PIN 2114602. At this time all participants have been placed in a listen-only mode. The floor will be open for questions following the presentation.

If you'd like to ask a question, please press star one on your telephone keypad. If at any point your question has been answered, you may remove yourself from the queue by pressing star two. If you should require operator assistance, please press star one. If you're using a speakerphone, please lift your handset to allow your signal to reach our equipment.

I would now like to turn the call over to Charles Corbin, General Counsel and Chief Development Officer. Please go ahead, sir.

Charles Corbin
Thank you, Operator, and welcome to the Hilton Grand Vacations' Second Quarter 2019 Earnings Call. Before we get started, please be reminded that our discussions this morning will include forward-looking statements. Actual results could differ materially from those indicated by these forward-looking statements, and the forward-looking statements made today are effective only as of today. We undertake no obligation to publicly update or revise these statements.

For a discussion of some of the factors that could cause actual results to differ, please see the Risk Factors section of our previously filed 10-K or our 10-Q, which we expect to file later today. We will also be referring to certain non-GAAP financial measures. You can find definitions and components of such non-GAAP numbers, as well as reconciliations of non-GAAP and GAAP financial measures discussed today in our earnings press release, and on our website: investors.hgv.com.

As a reminder, our reported results for both periods in 2019 and 2018 reflect accounting rules under ASC 606, which we adopted last year. Under ASC 606, we are required to defer certain revenues and expenses related to sales made in the period when a project is under construction, and then hold off on recognizing those revenues and expenses until the period when construction is completed.

To help you make more meaningful period-to-period comparisons, you can find details of our current and historical deferrals and recognitions in Table T1 in our earnings release. Also for ease of comparability and to simplify our discussion today, our comments on adjusted EBITDA and our real estate results will refer to results excluding the net impact of construction-related deferrals and our recognitions for all reporting periods. Finally, unless otherwise noted, results discussed today refer to second quarter 2019 and all comparisons are accordingly against the second quarter of 2018.

In a moment, Mark Wang, our President and Chief Executive Officer, will provide highlights from the quarter in addition to an update of our current operations and company strategy. After Mark's comments, our Chief Financial Officer, Dan Matthews, will go through the financial details for the quarter and our expectations for the balance of the year. After that, Mark and Dan will make themselves available for your questions.

With those preliminary comments out of the way, let me turn the call over to our CEO and President, Mark Wang. Mark?

Mark Wang
Thank you, Charles, and welcome, everyone. This morning we released our second quarter results. Adjusted EBITDA was $108 million, total contract sales were up 1.7% and total revenues were up 3%. Our consolidated margins remain steady at 22%. These results did not meet our expectations, and we're again adjusting our full-year guidance.

We're disappointed by this guidance reduction, but we believe that the underlying drivers of the business remain in place and are committed to our goals of driving Net Owner Growth and maximizing customer engagement.

Today, I would like to talk about what we saw in the quarter and what we expect for the year and the steps we're taking to address the issues that we see. There were two main sources of weakness in the quarter, namely a reduction in our average transaction price and, to a lesser extent, pressure on our close rate. Both of these were mainly driven by limited inventory in key locations.

While we recognized this issue at the beginning of the year and discussed it last quarter, we underestimated the impact of our current inventory levels and mix would have on our sales trajectory in the second quarter and over the remainder of the year.

Let me give you a few examples. In our APAC region we have seen lower average transaction prices as we continue to lack the optimal mix of new and upgradable inventory. In Hawaii, for instance, we sold 9 million of Ocean Tower inventory in the second quarter compared to 57 million in the same period last year. We've also seen lower close rates in our Las Vegas and Orlando sales centers due to a lack of desirable upgrade inventory.

We believe that the lower average transaction prices and close rates will continue to be a headwind of VPG and we've updated our guidance accordingly, which Dan will cover in more detail. We don't take this lightly. While we clearly have some near-term challenges, we have a significant level of new inventory coming online in 2020 and 2021 and are confident that we can return to contract sales growth next year and beyond.

In the short-term, we're moving with a sense of urgency to adapt to this environment and regain the sales growth momentum we've produced throughout our history, all while continuing to drive NOG in contract sales in the coming years.

I'd like to share a few of the initiatives we put in place to adjust to current conditions and regain our momentum. Across our sales centers we're adjusting our sales process to better segment our tours and improve yields. We're more effectively using pre-tour intelligence to provide our customers with the best sales experience and adapting to the recent pickup in tour flow increases that we've experienced.

Ahead of our new project launches in 2020 and 2021, we're taking steps to optimize the inventory mix that we have available. We're offering a wider array of financing options to meet the needs of our customers and we've expanded our owner exclusive program to help stimulate owner occupancy during off-peak times, creating additional touch points to drive sales growth in our engagement.

We've also further focused on cost disciplines to maintain our margins and reinforce our position as the most efficient operator in the industry. We have a flexible cost structure and will adjust to changes in the business to maintain our strong margin profile.

Over the mid- to longer-term, we have initiatives in place that will enable us to return to growth. First,

we're just ahead of a significant amount of inventory coming available for sale in 2020 and 2021. In 2020, we have a second phase of Ocean Tower and our new properties in Waikiki, Maui, and Los Cabos, followed by Okinawa in 2021, which will support our sales growth for multiple years to come. These projects should provide meaningful additions to support our average transaction price and should align our available inventory mix with customer demand.

We're undertaking marketing initiatives across both existing and new channels to bring new members into HGV, reflecting the increased breadth of Hilton's expanded Honors program. This includes Millennials and Gen Xers, who have a longer runway to grow with us during their lifetime and become powerful NOG contributors.

Our expanded multichannel marketing strategy has also evolved to target new customers through digital marketing programs. This digital initiative has had a very successful ramp, representing over 80% of the year-over-year growth in package sales during the quarter. While we are excited about the potential of this initiative to expand our customer reach over time, this is an area of learning for us.

The guests we've sourced under this program have initially converted at a lower rate and will remain a VPG mix headwind in the near-term. However, we know the cost to acquire customers via digital channels is lower, and while still early, we expect to seek better margins from this initiative versus our traditional channels.

We also continue to tailor the mix of our inventory and layer in capital efficient deals with attractive offerings across our expanded consumer base. One new fee-for-service project we can announce today is in the Smoky Mountains of Tennessee, which complements our growing regional portfolio of new offerings that cater to the full breadth of our buyers' spectrum.

And as we look out to 2020 and 2021, we'll take a thoughtful approach to the staging of our new inventory to support steady demand over multiple years. We have stress tested our assumptions around these investments and remain confident in the returns that they will generate.

Next, I would like to share with you why, despite the challenges in the quarter, we saw that the underlying drivers of the business remain intact, and will continue to focus on driving NOG, which stands at the core of our strategy of embedding more value into the business than we take out each year.

To that end, we're still growing our customer reach. Tour flow is the primary driver of success in the industry, and our tours increased 8%, with more than 100,000 guests visiting our sales centers in the quarter.

In markets where we did introduce new inventory we saw improved trends, particularly in New York, where we saw contract sales growth of 30% and South Carolina, where sales improved 8% versus last year. Net transactions to both new and existing owners exceeded any Q2 in our history, meaning more people committed to vacationing with HGV over their lifetime, and those commitments will drive future fees and sales.

Our vacation package sales, which represents future tour flow, were up 11% in the quarter. Our relationship with Hilton has never been stronger, and our access to the Hilton brand and its over 90 million Hilton Honors customers remains a valuable asset. We also continue to have strong owner engagement, with owner arrivals up 8% year-to-date. And most importantly, net owner growth was a healthy 6%.

Consumers continue to bias their spend of vacation and travel, and they continue to see the value in prepaying their vacation experience with us. Our Club and Resort teams do an incredible job engaging with them through multiple channels both in person and digitally. The result is our owners continue to be highly satisfied. We continue growing the base of our new owners along with upgrading our existing owners, driving NOG and improving the resiliency of the annuities streams that it generates. You can see this reflected in our non-real estate businesses propelled by NOG, Club and Resort combined steady growth and robust cost controls, driving EBITDA up 14% for the quarter. Financing EBITDA was also strong with 15% growth.

In addition, our rental and ancillary business continues to perform well with EBITDA up 10%. In total, these high-margin non-real estate businesses contributed two-thirds of our adjusted EBITDA and provide us with a stable source of consistent cash flow generation.

Beyond our operational drivers, management and the board remain focused on shareholder value and maximizing our returns on capital. We continue to hold the industry-leading position in capital efficiency. Roughly 70% of our contract sales in the last 12 months were asset light, with over half being fee-for-service. And we expect that range to remain about 50% for the rest of the year.

That thoughtful approach extends through our recently announced capital allocation framework. We've returned $343 million to shareholders in the form of share repurchases since December 2018, representing nearly 12% of our market cap. We have $57 million remaining under our existing authorization and we remain committed to executing under this framework going forward.

In closing, let me be very clear, we're not satisfied with these results and are laser focused on overcoming these near-term challenges. I am confident in our ability to adapt to remain focused on our long-term strategy.

I'll now turn things over to Dan to walk you through our financial results.

Dan Matthews
Thank you, Mark, and good morning, everyone. Before getting into the numbers, just a quick reminder that last year's second quarter results reflect $60 million of net construction-related recognitions, $91 million in revenues, and $31 million in expenses. And that this year's second quarter results reflect $18 million in net construction-related deferrals, $34 million in revenues and $16 million in expenses. You can see the details in Table T1 in the earnings' release.

Because construction-related deferrals and recognitions create meaningful distortions to year-over-year comparisons, my comments today on net income, adjusted EBITDA and real estate results will exclude the net impact of construction-related deferrals and recognitions. This is the way we manage the business, and it provides better perspective on period-over-period trends.

After considering the impact of construction-related recognitions in 2018 and construction-related deferrals in 2019, revenue and adjusted EBITDA for the respective periods are as follows: Q2, 2018 reported revenues and adjusted EBITDA would be reduced by construction-related recognitions. As a result, reported revenues in Q2 2018 would be reduced by $91 million and $563 million to $472 million, and adjusted EBITDA of $175 million would be reduced by $60 million to $115 million.

In Q2 of 2019, there were construction-related deferrals impacting reported revenues by $34 million and adjusted EBITDA by $18 million. Accordingly, both reported revenues and adjusted EBITDA would increase. Reported revenues would increase from $454 million to $488 million and adjusted EBITDA of $90 million increases to $108 million. Net deferrals and recognitions only impact our real estate results,

financing, resort, club, and rental are not affected by the deferrals.

Now let's turn to the results, total second quarter revenue increased 3.4% to $488 million, reflecting growth in the resort, club, rental, and finance businesses partially offset by a modest decline in real estate revenues. Driven by a decline in our real estate business, adjusted EBITDA came in at a $108 million, or year-over-year decrease of 6%.

Net income was $57 million and diluted EPS was $0.63. This compares to net income of $47 million and diluted EPS of $0.49 in 2018. Although we achieved improvement in contract sales with growth in Q2 of 1.7% over the prior-year, our results still fell short of expectations. Despite a solid increase in tour growth of 7.9%, an overall reduction in our average transaction price coupled with pressure on our close rates drove the shortfall in our expectations for contract sales growth.

Our fee-for-service mix for the quarter was 51%, down from 59% in Q1. For the balance of the year we expect the fee-for-service contract sales growth be approximately 50%, well within the range of our original guidance of 48% to 54%.

In our real estate business, Q2 revenues declined 4% to $261 million. Our increase in contract sales was more than offset by $11 million associated with the timing of revenues and decisions year-over-year as well as an increase in our loan loss provision of $6 million.

Although we have some degree of variability in our real estate expense structure, the increase in tour growth coupled with lower VPGs resulted in sales and marketing expenses increasing 20 basis points. As a percentage of owned sales, product costs increased 210 basis points to 27.9%, driven by a shift in product mix sold. As a result, real estate margin was compressed by $16 million to $74 million with margins of 28.4%.

Although we anticipate that SG&A as a percentage of contract sales to be consistent in the back half of the year, a focus on selling lower cost of product inventory will result in modest decrease in cost of product as a percentage of owned contract sales.

Turning to the financing business. Q2 margins increased $4 million to $31 million, as the benefits of a larger receivables portfolio, higher average interest rates, and increased servicing revenues offset the incremental interest expense from our 2018 ABS deal. Our financing margin percentage increased 290 basis points to 72.1%. We anticipate that this margin percentage will contract in the back half of the year due to the timing of our 2019 ABS transaction, which we anticipate closing in the next few weeks.

Looking at the consumer portfolio at the end of the quarter, gross financing receivables were consistent with year-end at $1.3 billion. Our average down payment remained strong at 12.7%. Our average interest rate increased to 12.4% from 12.2% last year as the rate increases we put in place late last year continue to work their way through the broader portfolio. And finally, our long-term allowance was 13.4% compared to 13.2% last quarter.

Turning to resort and club business, NOG was 6.1%, which helped drive a 16.2% revenue increase in the quarter to $43 million. The majority of the growth was driven by new members. Margin increased 19% to $31 million and margin percentage expanded 180 basis points to 72.1%. Q2 rental and ancillary revenues increased 13% to $60 million and margin remained flat at $23 million. Margin percentage contracted 510 basis points to 38.3%.

The revenue increase was driven by transit revenues from The Quin, which we acquired at the end of Q2 of 2018. Rental expenses increased due to the cost of operating plan as well as additional

developer subsidy expense at newly opened properties. While The Quin did positively contribute to the bottom line, it is a lower margin business and negatively impacted our margin percentage.

With the conversion of The Quin to timeshare in the back half of the year and larger subsidy requirements, we anticipate that the rental and ancillary business margin will modestly contract compared to last year. Bridging the gap for Q2 segment-adjusted EBITDA to total-adjusted EBITDA G&A increased $2 million, license fees increased $1 million and our JVs generated an additional 4 million of adjusted EBITDA.

As Mark touched on, we are in the process of executing our second $200 million share repurchase authorization that we started in early May of 2019. In Q2, we purchased 5.9 million shares for $174 million at an average price of $29.74. Since initiating the share repurchase plan in Q4 of 2018 we have repurchased 11.4 million shares for $343 million at an average price of $30. This represents roughly 12% of what our market cap was at the time we announced the program back in Q4 of 2018.

We continue to view return of capital as an important component of improving shareholder returns and have roughly $57 million available under our current program. At the end of Q2, our net leverage stood at 1.9 times at the top end of our target range of 1.5 times to 2 times. Although we are currently at the high end of our target leverage levels, the timing of cash flows and expectations surrounding our 2019 ABS transaction will allow for material repurchases of shares in the back half of the year while staying within our leverage targets.

Looking at liquidity position, we ended the quarter with $120 million in unrestricted cash, $374 million of capacity on the revolver and $315 million of capacity on the warehouse. On the debt front, we have corporate debt of $944 million. Our non-recourse debt balance was $702 million. Driven by lower inventory spend, our Q2 adjusted free cash flow was $16 million compared to a negative $111 million last year.

As Mark discussed, our Q2 results were characterized by continuation of inventory availability issues that we identified in Q1. Unlike Q1, however, the pressure we experience with close rates was coupled with the deterioration in average transaction price, further impacting growth in contract sales, although we have experienced solid growth in markets where ample inventory mix is available or where we introduce new product, a prime example being New York, which was up 30% in Q2. We anticipate that this trend will continue for the balance of the year.

As a result, we are reducing our guidance. We’re now projecting contract sales to be flat to down 3% for the year. Driven by this change, we're also reducing adjusted EBITDA guidance from $445 million to $465 million to $415 million to $435 million.

Walking through a few other line items in our guidance, we are increasing interest expense by $5 million to reflect incremental borrowings used to fund share repurchases through August 1. We are increasing depreciation and amortization expense by $5 million.

The guidance reflects no additional share repurchases, and is based on 89 million fully diluted shares outstanding. Driven by the decrease in adjusted EBITDA and the expectation that construction-related deferrals associated with The Central will not be recognized until 2020, our revised earnings per share guidance range is now $2.04 to $2.21 compared to our prior range of $2.61 to $2.77. Excluding the impact of deferrals, our EPS range would be $2.44 to $2.61.

Our adjusted free cash flow guidance is being reduced by $10 million to $50 million to $110 million. The decrease is driven by lower adjusted EBITDA, partially offset by the postponement acquisition cost

associated with The Central from Q4 of 2019 to 2020.

From a cadence perspective, we estimate the adjusted EBITDA for the balance of the year will be weighted towards Q4, with roughly 55% materializing then.

Before turning the call over to the operator, we also wanted to let you know that Bob LaFleur, our Head of Investor Relations, has moved on to pursue other opportunities. We thank him for his contributions over the last three years and wish him the best of luck with his future endeavors. In his absence, please feel free to call me with follow-up questions to this morning's call.

This completes our prepared remarks. We will now turn the call over to the operator, and we look forward to your questions. Operator?

QUESTIONS AND ANSWERS

Operator
Thank you. As a reminder, if you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is switched off to allow your signal to reach our equipment. Again, please press star one to ask a question.

We'll now take our first question from Stephen Grambling from Goldman Sachs. Please go ahead.

Stephen Grambling
I wanted to make sure I understood some of the puts and takes on the guidance here. You've been consistent in describing the inventory availability as the headwind, but you also said that the new inventory coming online is selling well, so is the shortfall in guide down just a mis-modeling of guidance or is it lower conversion that you referenced a single view of either a macro or industry issue that you didn't see coming? And then as a follow up, how did trends during the quarter progress and how might that underscore your back half guidance?

Mark Wang
Yes, Stephen, it's Mark. As far as the inventory I think that you were referencing, Central came on board earlier this year and we're having great success there. I think we mentioned we're up 30% last quarter.

The other properties Charleston and Chicago, neither one of those properties will have much of a material impact in improving our sales this year, because they're just small and they are new. As far as Chicago goes, we only took down 16 units there. In Charleston, we're actually not open in Charleston yet. We just started selling Charleston inventory out of our Washington, D.C. sales center.

So as it relates to inventory, really the benefit of the impact in front of us is our properties at Ocean Tower, the second phase. We've got Maui, which we're going to be starting to sell next year, and we have our sequel Waikiki along with Cabo. So the impact in the benefit of the inventory and the value that we placed in that inventory does not really start coming into effect until next year.

And now around the consumer side, we look at consumer trends and in leisure still remaining strong and so we're pleased, we had 7% new buyer tour flow, which was an uptick. If you look at our owner arrivals to our properties are up 8%. And our package sales, which is a great indicator for future tour flow, are double-digits. So we are seeing really good demand there.

And then as Hilton continues to expand their base at a rapid pace, it's really providing more

opportunities for us. But we have seen some softening with our new buyers, in particular and that I think is more related to the mix of customers coming in versus the overall customer or consumer environment out there.

So overall, I think the consumer is in a good place. Our net owner growth continues strong. The prepaid nature of our product has our owners coming back and, if anything to more resilient. And we saw record sales to our owners in the second quarter. So our owners are behaving extremely well. But you know concerns around headwinds in the macro are not lost on us, we watch those very closely. So, again I think it's really inventory driven. The inventory effect will not start really benefiting us other than New York until early next year.

Stephen Grambling
The guidance since then, the new inventory is it just having an impact later or when you were thinking about the guidance before was the assumption that you will have a bigger impact from that, or did just the core business revert back to the prior trend faster than you thought?

Mark Wang
Yes, look, I think at the end of the day we underestimated the impact of the inventory and after we reported Q1, we went back, we looked at Q1. And average transaction price wasn't an issue at that time. It was all in closing percentage and we thought it was all inventory–related. So as we re-forecasted for the year, we took down closing percentage but we did not take down average transaction price.

But as the quarter materializes, Q2 started materializing, we saw a strong impact in average transaction price and it all came out of our APAC region. And just to remind everybody APAC is Hawaii, and our Japan business, we have a little bit of business in Korea. So all of the average transaction price impact was really focused in that region, and as I just outlined with Waikiki, Maui, Ocean Tower, that's where we're really impacted most from a high-end upgradable and also entry-level. We have a lot of mid-tier product in the region, which is supporting our current sales but we're missing inventory on both ends of that spectrum, on the entry and upgrade side.

Operator
The next question comes from Brandt Montour with JPMorgan. Please go ahead.

Brandt Montour
Mark, that is very helpful color and if you could even just dive-down a little more. The APAC region is Hawaii and obviously, your Japanese customers coming to Hawaii, so is it a lack of inventory in Hawaii and so you have a mix issue of just lower price of inventory available or is it something else like something that would make us think that you already are lowering prices to try and juice sales or something else entirely?

Mark Wang
We haven't done anything on pricing or in lowering pricing. It's just something that we have historically never done. The impact, interesting enough, if you look at just sales within Japan, so that's 100% of sales to Japanese nationals, that was impacted the most. So I think our average transaction price went down 19% there, so it was a good percentage of average transaction price that we just did not materialize.

Now, when you look at the actual business within Japan, transactions were up 21%. So the business and our teams I think pivoted and did a really good job adjusting, and what we found, which was something we did not forecast in, is we knew coming in the quarter that we were light on inventory and

our mix was off, but we assumed that the Japanese, we would be able still push them and steer them into some of our other Hawaii product. What ended up happening is they ended up shifting a lot of their sales into Las Vegas, which is something new for us. We haven't seen that before.

And so, consequently we saw I think 12% of our sales in Japan were Las Vegas product, which significantly reduced our average transaction price. So all in all transactions were good, NOG is really strong, because 85% of our sales in Japan are our new customers. So that creates really good strong NOG business. So again, I feel confident once we get the inventory back into the system we'll start shifting and we'll start seeing average transaction prices go back up to where they were before.

Mark Wang
And then, just to follow-up on one of your comments about softening of new buyer demand and that potentially could be a mix issue. Which types of new customers that came through the system were not buying and which types of new customers were buying? Maybe just to flesh that out for us?

Mark Wang
Look, what we saw was we saw some softening. And we saw some softening in our conversion rate and it was mainly on the mainland. In fact, APAC had a flat year-over-year closing percentage, and the impact was really focused on the mainland. And so it really at the end of the day was a mix as we look at it. We started seeing a younger demographic customer coming in. As Hilton continues to widen their customer mix so do the leads that we're receiving from Hilton.

So we just saw the growth of what I would call the younger customer, which are typically under 100,000 versus above 100,000 there is a higher ratio of 100,000 family income customers, we saw that mix grow quicker. And so, it's not a bad customer, that customer be in our system longer, but historically with that customer we have converted lower with lower average transaction prices, which has created a headwind on our VPG there.

Operator
The next question comes from Patrick Scholes from SunTrust. Please go ahead.

Patrick Scholes
I have a very high level question for you folks. How difficult would it be to shift your business model at this point to emphasizing selling points as opposed to deeded real estate? Certainly, the selling deeded real estate obviously has created volatility quarter-to-quarter in earnings. I think back to quite a while ago, I believe Marriott and Wyndham were originally deeded, but over time they shifted mostly to points. Is that possible at all and something you think about? Thanks for some color.

Mark Wang
Patrick, I appreciate the question on that. Obviously as we look at our product form today it's been really well accepted from our customers, which I think on an apples-to-apples basis has provided for us to drive premium of VPGs. But and I think the current headwinds really are not related to the form but to really the mix of the inventory that we have sellable today.

That said, we do realize the benefits to a trust product. It does have benefits on reducing some of the variability. And we're exploring not only a trust product for certain markets but we're also exploring other prepaid vacation forums. We really want to figure out how we can continue to capture even more new buyers to bring into our system.

But I would say though even if we did introduce an additional product form there is no plans to a full discontinuation of what we're currently doing, because we don't think our trust product would service us

well in markets like Hawaii and New York with these premium prices, especially with our Japanese. Because they want the certainty that a lot of times you don't get out of the trust product meaning a home resort, window for reservation.

But again, we're looking at it. We think it could be done on a regional basis and it could reduce some of the variability in the business. But we also have to cognizant around the fact that we have a robust fee-for-service business. And it would be really, really difficult to have a trust product with multiple fee-for-service partners like we have now. We have half a dozen fee-for-service partners, and I just don't know how you negotiate whose product goes in to the trust first. Whereas today, we can sell multiple fee-for-service deals simultaneous.

So we understand some of the benefits. We also understand some of the challenges. We are actively working and looking at new product forums going forward, with the idea of really not necessarily to make it simpler but take some of the variability out. But also most importantly adjust to what our customers want and our ability to capture more customers more rapidly.

Patrick Scholes
And then just a very quick question here. I remembered last quarter the Cabo project shifting into 2020, any update or changes on that expectation?

Mark Wang
No, none at all. We have progressed very well since the last call and we're getting closer and closer as we get through the regulatory process, and the project from a renovation standpoint has just started the conversion. We plan to have that done later this year, and we expect that we'll be able to start sales sometime in the first half of 2020.

Operator
The next question comes from Jared Shojaian from Wolfe Research. Please go ahead.

Jared Shojaian
Mark, I think you said in your prepared remarks you were confident you would return to contract sales growth next year. Can you flesh out some color on what that means exactly? Is it sort of a normal year like the past couple years we've been in sort of the high single low double-digit kind of range? And how should we be thinking about just for 2020 and longer-term ramp? Are you still confident in some of those longer term targets that you outlined at the Analyst Day last year or do you feel like you kind of lost a year of growth this year with the numbers being what they are?

Mark Wang
Yes, so clearly, we've been challenged in 2019 and we're not pleased with our results. But I think with the adjustments we talked through today we're going to be coming off a lower base than we anticipated when we set those targets originally. And we are actively revisiting the long-term targets, based on the dynamics that we're seeing in the business, though I have to say I am very optimistic about 2020, especially with the inventory coming online. And I think we will definitely be back into a sales growth mode in the 2020, and that momentum will carry us into 2021.

Jared Shojaian
And if I look at your contract sales in the quarter, the growth rate, and I look at the year-over-year comps from last on the surface if I didn't know anything else the second quarter kind of did about what you would have expected, just looking at 1Q-to-2Q from last year. But now the back half comps starts to get a little bit easier, particularly in the fourth quarter, but your guidance seems to imply things getting a little bit worse in the second half then what you did in the first half. So maybe help me understand

how you're thinking about that guidance. Are you assuming that the current trends that you've been seeing in the most recent weeks and months are just extrapolated into the back half, or have you assumed somewhat of an incremental step-down maybe in VBG or just average transactions or whatever in the back half?

Dan Matthews
Jared, it's Dan. When we took a step back and looked at Q2, we did a very deep dive on a granular basis, we looked at the forecast, examined the close rates, average transaction price etc., and took those trends and carried them forward through the balance of the year, obviously with what we know about different inventories coming online etc. To your point, the comps definitely become easier in the back half, and that's definitely in Q4. Q3 last year was still double-digit growth. So you still have a tough comp there. But that's really what we're doing. And clearly we're disappointed in having to take down the guidance earlier this year, the second time we're not going to be doing it going forward. So that's the motivation there.

Jared Shojaian
And one more if I may, Dan, just to go back to your comment on the buyback, I think you talked about a material amount of capacity in the back half of the year for the buyback. Can you help me understand what material means? Because if I look at your free cash flow guidance, you're, I think assuming around somewhere around $100 million give or take of free cash in the back half. But if I look at where you stand on leverage today and kind of normalized for the deferrals, it looks like you're a little bit outside of your target range. So maybe help me understand how you're thinking about the buyback? Are you comfortable going above that 2x high end of your range, a leverage range with your stock trading down where it is right now? How are you thinking about that?

Dan Matthews
When we look at the target range, we're cognizant of that high end 2x, because of various covenants that kick in on our senior notes as well as our credit facility. And it's mostly restricted payment issues, more so than anything else. But what I mean is right now we're at 1.9x. We will have an influx of cash here shortly, once we complete our ABS transaction. And that will delever that 1.9x to probably 1.5x, maybe 1.4x. So there'll be plenty of room to build right back up into that leverage range of 1.5x to 2x. And that's with an ABS transaction that's in the range of about 235 to 325, somewhere in that range.

Jared Shojaian
One more, just a quick housekeeping. Correct me if I'm wrong, EBITDA guidance would be $36 million higher if it wasn't for that incremental deferral issue this year? And do you have any sense on how we should be thinking about deferrals for next year?

Dan Matthews
No update on deferrals for next year, but you're correct on the deferrals for this year. We'll update you probably next conference call.

Operator
Once again as a reminder, please star one to ask a question. The next question comes from David Katz from Jefferies. Please go ahead.

David Katz
I wanted to just focus on the notion of guidance in general, because I think that going later in the queue, so much of the questioning has been around quarterly cadence and dynamics for the remainder of the year. And I just wonder what thoughts you might have about positioning a little longer-term earnings power for the company? And kind of refreshing people's view on the horizon rather than sort of what

you're going to do this year, because there is obviously some transition going on, there's obviously some inherent in the business volatility quarter-to-quarter. I just wondered what your thoughts on that and that maybe sort of a Dan question.

Dan Matthews
Yes, I mean, I think, and we've reiterated some of these points already, David. But it's a good question to talk about again. When you look at how we performed in Q2 and how the inventory that came online performed specifically, just underscores our confidence in the need to bring on that inventory. And when you look to 2020, and I know Mark has mentioned it several times now, but you've got very key prospects coming online; Maui, the Waikiki sequel, Cabos, Ocean Tower Phase 2, which as I think everybody on the line knows, performed extremely well in 2018, and all of that gives us a great bit of confidence going into 2020.

Now the dynamics with what we've seen this year, obviously cause us to pause a little bit. But what we're seeing where inventory comes online, plus 30% New York, plus 8% in South Carolina is clearly very encouraging and we're very confident that those investments are still the right investments.

Now when it comes to addressing long-term targets; will we see an increase from where we are today, a hockey stick effect as you will, absolutely, but commenting on long-term, just a little bit early to talk to that at this particular time. The next data point, I think, you're going to see from us is probably on our Q4 call when we give guidance specifically for 2020.

David Katz
And then can we just talk about the balance or the capital allocation philosophy? Balance is what happens to be available in your capital structure for growth. And clearly, there is some access beyond that and how you think about the decision to buy back stock, rather than sort of let the cash pile up and perhaps wait for another day or another time. How do you think about that challenge?

Dan Matthews
Yes, absolutely. When it comes to capital allocation, I think generally, you can look at it in three different perspectives, right? You could do M&A; you could buy inventory; you could repurchase shares. We have—in 2018 we committed a large investment to inventory spend. And we have a lot of inventory coming online.

We've checked that box, we have no inclination approaches in the inventory in 2019, 2020, and 2021, beyond what we've already talked about. If it comes in 2021, it would be back half. When it comes to M&A, look, we clearly haven't done anything, that's not really on our agenda right now. So when it comes to uses of cash, share repurchases are number one on our list.

Despite where the stock is trading today, I think, if we look at our discounted cash flow, we know our intrinsic value is well above where we're trading today. So it's a good investment for us. We were buyers of stock at $30, we're clearly going to be buyers of stock at where we are today. And at this point in time that is the best use of our cash. That's how we think about it.

CONCLUSION

Operator
Ladies and gentlemen, at this time we will conclude the question-and-answer session. I would now like to turn the call back to Mr. Mark Wang, for any additional comments and closing remarks.

Mark Wang

Thanks again, everyone, for joining us this morning. We will continue to focus on our key drivers and long-term strategy. And we look forward to sharing the results of those efforts with you in the coming quarters. Have a good day.

Operator
That will conclude today's call. Thank you for your participation. You may now disconnect.