Hilton Grand Vacations Inc.

Q3 2019 Earnings Call

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CORPORATE PARTICIPANTS

Mark Melnyk – *Vice President of Investor Relations*

Mark Wang – *President and Chief Executive Officer*

Daniel J. Mathewes – *Executive Vice President and Chief Financial Officer*

PRESENTATION

Operator:

Good morning, and welcome to Hilton Grand Vacations' Third Quarter 2019 Earnings Conference Call. A telephone replay will be available for seven days following the call. The dial-in number is 844-512-2921, and enter PIN number 13695690.

At this time all participants have been placed in a listen-only mode and the floor will be opened for your questions following the presentation. If you would like to ask a question, please press star, one on your touchtone phone to enter the queue. If at any point your question has been answered, you may remove yourself from the queue by pressing the star, two. If you should require Operator assistance, please press star, zero. If using a speakerphone, please lift your handset to allow the signal to reach our equipment. Please limit yourself to one question and one follow-up to allow the opportunity for everyone to ask questions. You may then re-enter the queue to ask additional questions.

I would now like to turn the call over to Mark Melnyk, Vice President of Investor Relations. Please go ahead, sir.

Mark Melnyk:

Thank you, Operator. Welcome to the Hilton Grand Vacations Third 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 these statements 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 at 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 in 2018. 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 T-1 of our earnings release.

Also, for ease of comparability and to simplify our discussion today, our comments on Adjusted EBITDA in our real estate results will refer to results excluding the net impact of construction-related deferrals and recognitions for all reporting periods.

Finally, unless otherwise noted, results discussed today refer to third quarter 2019, and all comparisons are accordingly against third 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 Mathewes, will go through the financial results for the quarter and our forward expectations. After that, Mark and Dan will make themselves available for your questions.

With that, let me turn the call over to our President and CEO, Mark Wang. Mark?

Mark Wang:

Welcome everyone. This morning, we released our third quarter results. Total revenues were up 2%, despite a slight decline in contract sales, Adjusted EBITDA grew 13% year-over-year to $119 million, and our consolidated margins improved to nearly 25%. These results were slightly ahead of our expectations and continue to reflect the trends we noted in Q2, with strong tour flow offset by weaker VPG. While we're seeing the initial benefits of our operational cost improvements we announced last quarter, we're not yet satisfied. However, we'll push to drive further improvements as we exit this year and prepare to ramp sales of our new inventory in 2020, and that's why we're very excited about the path ahead over the coming quarters.

Let's start by talking about what we saw in the quarter. In our Real Estate segment, we saw notable improvements, with tour flow growth accelerating to 8.5%, against a tough comparison to Q3 last year. Owners and new buyers from both our mainland and APAC regions were equal contributors to this growth, and this performance was in spite of losing several days of business in key sales centers due to the hurricane. VPG was lower year-over-year, but still within the range of expectations. Transactions were up in both the mainland and APAC, although those transactions occurred at lower prices. Owner engagement, remained strong with arrivals up 8%, which is a continued vote of confidence from our members about the quality of our offerings and experiences Hilton Grand Vacation provides. Regionally, we saw strength in our sales centers, where we opened new properties, such as Myrtle Beach, and we saw a nice pickup in Las Vegas after making some operational improvements, which I'll talk more about here in a minute. Overall, we remain focused on the capital efficiency strategy, with fee-for-service sales of 54% and total capital efficiency sales at 68%.

Moving to our non-real estate business, we continue to leverage NOG to drive consistent high-margin performance. Our Club and Resort business combined strong top line growth with solid cost controls to drive segmented operating profits up 17%, with a margin of over 75%, our highest since 2017. We benefited from strong NOG of over 5.5%, as well from additional management fees associated with the opening of Ocean Enclave, and we just completed our annual Hilton corporate quality assurance test, with everyone of our properties receiving the highest possible score, a testament to our team's ability to develop and maintain great product. Over the last five years, this segment has grown its operating profits at nearly a 10% CAGR, providing us with a growing stream of high-margin fees.

Finally, in our Finance business, we completed our 2019 ABS offering, with very strong demand, achieving a 98.5% advanced rate and one of the lowest interest rates we've obtained, reflecting the appreciation that credit markets have for the fundamental strength of our portfolio and owner base.

Now, I'd like to share some of the progress we've made on our near-term strategic initiatives.

Last quarter, we detailed efforts underway to address the short-term challenges we were facing in the business. We acted swiftly and decisively to enact process improvements and cost controls, and we've already begun to see some meaningful results from these initiatives. In Las Vegas, for example, we implemented changes to better segment our owners and new buyers and streamline the sales process. Our efforts drove meaningful improvements in our largest and most mature market, and these positive trends have continued into October.

We also took action with our existing product portfolio to address inventory availability challenges that we saw in the second quarter. In Q3, we registered additional inventory from Chicago, South Carolina and Barbados for sales at our largest sales centers. We're also preparing for the introduction of additional high-value point packages at our Elara property in Las Vegas, which proved to be very popular with our customers and sold through faster than we initially anticipated. We continue to see good uptake on our owner exclusive program, which incentivizes our owners to visit during off-peak periods and drive incremental visitations in the quarter.

Additionally, we made efforts to right-size our overhead and operating costs, with corporate G&A down 23% in the quarter. Combining our top line efforts and adjustments to our overhead enabled us to enhance our industry-leading efficiency and drive consolidated margins of over 24.5%, the highest since 2016.

Now, let's shift to some of our longer-term initiatives. We remain excited about commencing sales of our new resorts in 2020. Currently, we are on schedule to begin selling Phase 2 of Ocean Tower, Maui and Cabo in the first half of the year, followed by our new property in Waikiki in the second half. We've also taken steps to further optimize this inventory for the right mix of unit types of point packages that will appeal to the full spectrum of buyers that we're seeing. We're confident that the introduction of this new inventory, combined with these optimization efforts, will support average transaction prices and drive growth for the years to come.

Next, a quick update on our new marketing efforts. We've continued to see growth from our digital channels, which now represents over 5% of new buyer tours. We've leveraged demographic data and propensity intelligence to target our most profitable prospects and optimized package sales through this channel, and as we work through additional refinements, we believe this will become one of our highest-margin tour channels. Not only will these efforts yield efficient customers, but, over time, it will also meaningfully expand our reach throughout the Hilton network. While we're still early in the stages of developing this channel, the initial results have been promising and we're focused on building out our infrastructure and further refining our targeting efforts.

In closing, we're confident that our strategy will deliver substantial long-term value to our shareholders, we continue to maintain industry-leading margins, our owner engagement is at record highs, NOG is healthy, adding to our base of customers in the prime of their upgrade cycle, and our marketing package pipeline continues to expand, giving us great visibility into our tour flow going forward. All of this, combined with our exciting upcoming inventory launches, provides confidence as we look out to 2020, and beyond.

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

Daniel Mathewes:

Thank you, Mark, and good morning, everyone. Before getting into the results, I'd like to cover a quick refresher on deferrals.

As you will recall, our models allow us to presell new projects up to two years in advance of opening. GAAP ASC 606 requires that we differ the revenue, cost of product and direct SG&A associated with these presales until we open the property for occupancy. Put simply, this requirement creates deferral items on our balance sheet that grow during the presale phase and, consequently, there's an artificial reduction to Adjusted EBITDA during this period. Once we obtain the temporary certificate of occupancy for a project, we reverse those items in their entirety, creating a large positive income statement recognition that inflates EBITDA in that area.

As these adjustments create misleading volatility in our revenues and EBITDA, and the sales booked during these presale periods generate cash flow, we manage our business internally by focusing on earnings excluding deferrals and recognitions. Hence, all references to net income, Adjusted EBITDA and real estate results on this call for current, prior and future periods excludes the impact of deferrals and recognitions.

Further details can be found in Tables T-1 and T-15 in our press release, and a complete accounting of our historical deferral and recognition activity can be found in Excel format on the Financial Reporting section of our Investor Relations site. We would encourage you to reach out to Mark Melnyk for additional help in understanding deferrals in your modeling and valuation work.

Now, let's turn to the results for the third quarter of 2019. Total third quarter revenue increased 1.9% to $481 million, reflecting growth in the Resort, Club, Rental and Finance businesses, with a slight decline in Real Estate revenue. Adjusted EBITDA came in at $119 million, versus $105 million last year, a year-over-year increase of 13.3%, driven by slight growth in revenue and strong cost performance. Net income was $58 million and diluted earnings per share was $0.68, compared to net income of $66 million and diluted earnings per share of $0.68 in the third quarter of 2018. Contract sales during the quarter fell 1.1%, as an acceleration in tour growth to 8.5% was more than offset by a decline in VPG, and the impact from Hurricane Dorian, which we estimated lowered contract sales by approximately $8 million versus our expectations.

As we have mentioned on prior calls, Q3 was also the final quarter of lapping the strong VPG generated from sales of the very successful first phase of Ocean Tower. Similar to last quarter, we continue to see pressure on both close rate and average transaction price, though average transaction price compression outweighed the close rate impact this quarter. The provision for bad debt was stable at 13.3% of owned contract sales. Fee-for-service mix for the quarter was 54%, up from 51% last quarter. For the year, we anticipate being near the high end of our guidance of 48% to 54% of contract sales.

Looking at expenses, the strong growth in tours, combined with lower VPGs, drove an increase in our sales and marketing expense percentage, which was 40.8% of the total contract sales versus 39% last year. This was offset by product costs that came in well below last year, at 17.5% of owned contract sales versus 27.5% in the third quarter of 2018.

As we discussed last quarter, we focused on selling lower-cost inventory to reduce product costs. However, this quarter, we also experienced a larger than expected benefit from cumulative adjustments of roughly $9 million, which made up the majority of the $14 million of product costs favorability during the quarter.

For context, you can see from our filings that these adjustments have historically averaged a few million dollars per quarter. The cumulative adjustment was driven by a change in our assumptions around the sell-out dates for some projects in the portfolio. Going forward, we anticipate that our cost of product will trend within a range of 27% to 30%.

As I mentioned, the trend of strong tour growth, combined with VPG declines, has continued to drive deleverage on the SG&A line. While we do expect some improvement in the fourth quarter, for the year, we continue to anticipate that SG&A as a percentage of contract sales will increase versus 2018.

These factors all contributed to real estate margin of $86 million, up $5 million versus last year, with margins of 32.8%, up 226 basis points.

Moving to our Financing business, Q3 margins increased $1 million to $29 million, with a margin percentage of 67%, versus 70% last year. As we mentioned last quarter, the additional interest expense associated with our 2019 ABS transaction drove contraction in margins. Overall credit trends remain stable, our allowance for bad debt remains under 14%, and has recently begun to show some positive signs from underwriting changes implemented in the last 12 months.

Looking at the portfolio balance, at quarter end, gross receivables stood at just over $1.3 billion. Our average down-payment year to date is 12.4% and our average interest income rate increased to 12.4% from 12.2% last year.

Turning to our Resort and Club business, NOG was 5.6% for the quarter, which contributed to a 12.5% increase in revenue to $45 million. Both Club and Resort revenues were strong in the quarter and revenue per member was strongest it has ever been for a Q3 in our history. Margin for Q3 was up 17% at $34 million, and our margin percentage was 75.6%, up 310 basis points, against a strong performance last year.

Q3 Rental and Ancillary revenues decreased 10% to $54 million, with the majority of the decline coming from our Rental segment. As we mentioned last quarter, the conversion of the Quin from a rental property into a timeshare was a drag on Rental income. This is entirely related to a lower supply of rental rooms at Quin as it transitions to timeshare product. It is also important to note that we continue to dramatically outperform the comparable STR RevPAR metrics in every major market that we participate in. That being said, the lower supply will cause Rental revenues to decline until we lap the Quin conversion in the back half of next year.

On the expense side, larger subsidy requirements at newly opened properties also continue to weigh on the results, with margin coming in at $18 million and margin percentage contracting 500 basis points to 33.3%. Bridging the gap between segment Adjusted EBITDA and total Adjusted EBITDA, G&A decreased $6 million or 23%. License fees were up $1 million and EBITDA from JVs was down $1 million. As we spoke about on our last call, we implemented efficiency initiatives and our G&A performance this quarter is a direct result of those initiatives.

In Q3, we purchased 470,000 shares for $12.2 million at an average price of $25.90. At the end of Q3, our net leverage stood at 1.6 times versus our target range of 1.5 to 2 times. In August, we announced the completion of a $300 million securitization. We continue to see strong support from capital markets, which allowed us to complete and oversubscribe securitization at the lowest weighted average interest rate since our 2014-A deal, 2.43%.

Looking at our liquidity position, we ended the quarter with $113 million of unrestricted cash, $494 million of capacity on the revolver and $450 million of capacity on the warehouse. On the debt front, we had $815 million of corporate debt and non-recourse debt of $795 million.

Driven by lower inventory spend, Q3 adjusted free cash flow was $162 million, compared to $124 million last year. We are maintaining our Adjusted EBITDA guidance of $415 million to $435 million, with contract sales of flat to down 3%. However, given Q3 results, we now expect to be at the high end of the range for both of these metrics.

Walking through the additional items in our guidance, adjusted free cash flow is still expected to be $50 million to $110 million. Net income is now expected to be $214 million to $229 million or $2.40 to $2.57 on a per share basis. This is roughly $4 million lower than our last guidance, due to expenses associated with our restructuring and slightly higher tax rate. Again, both of these are excluding all deferral and recognition activity. As a reminder, our guidance assumes no further share repurchases and is based on 89 million shares outstanding.

Before we turn to Q&A, I'm sure many of you are aware of the media speculation in recent months regarding interest from potential acquirers. I'm sure you can appreciate we do not comment on market speculation or rumors and will not be addressing this matter on this call.

We will now turn the call over to the Operator and look forward to your questions.

Operator:

Thank you. Ladies and gentlemen, if you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it maybe necessary to pick up the handset before pressing the star keys. One moment, please, while we poll for questions.

Our first question comes from the line of David Katz with Jefferies. Please proceed with your question.

David Katz:

Hi, good morning, everyone, and thanks for all of the detail. I wanted to sort of ask a—I wanted to ask a bigger picture, longer term question. As I thought about HGV and the opportunities that are out there, how much have you done, and how much can you talk about the potential geographic expansion opportunities that are out there and your ability to put resorts and put your flag down in new markets, and what that could mean for the long-term opportunity for growing this Company?

Mark Wang:

Good morning. Dave, this is Mark.

David Katz:

Good morning.

Mark Wang:

Yes, no, great question. We've done a lot of thinking and a lot of work around it. I think if you look at just this year, we started sales in Charleston, which is a new market for us. Chicago, which we're really excited about, we just opened there a few months ago. We've got a great—as we look at Chicago, we've got a great database that supports that market, and Hilton has 20 hotels in that market, so we have a lot of potential from a ground game standpoint. We also have announced and are expanding into Mexico for the first time, so that's something we're excited about launching next year. On top of that, we recently announced a new project in Pigeon Forge, another new market for us. Then, we've also committed to opening up our first purpose-built project, with a partnership with Mori Trust in Okinawa in 2021.

So, as you can see, we have already made some really good progress in a very short period of time, looking at ways to geographically expand the business, which we think is really important for us, because we have been fairly narrow in our distribution and in our product offerings, and we think all of these are going to create value to the business. Not only are we going to be able to add distribution, but we're going to be able to add to the value proposition for our members.

Now, that being said, we think there's additional opportunity that just sits right here in front of us, especially in the U.S. Our largest member base resides in California and our third-largest member base resides in Texas. California is a market that we still haven't been able to penetrate, but we are actively looking at opportunities there, as well as Texas, we think that's another potentially great market for us in the future. It would allow us to, number one, reach states that have strong economies and large populations, but also provide some regional access to the member base that I just mentioned before. Other markets that we're looking at are Arizona, and there are a handful of other markets that we see as great opportunity.

We think that our strategy and our path forward is strong, because, again, we've been very, very focused on big distribution markets and we've had great success in recent years opening new markets. Myrtle Beach is a great example of a market that we opened a few years back. That has ramped up now close to—it's just under $100 million, and we've added some great product there. I think one market I missed mentioning is Hilton Head, that's another new market we wanted, too. So, you can see we've been very active and we have a lot of opportunity in front of us.

David Katz:

If I can just follow that up, I hope you don't mind. I assume that there is a strategic plan that includes—and I don't know if you'd be willing to go there—more than 10, more than 20 market opportunities for the Company to enter. Is that an order of magnitude that makes sense? I assume that there’s some present value of all those future market opportunities that's being executed.

Mark Wang:

Yes, look, I think, for us, it's important that we're really smart in how we manage our growth going forward and how we're going to deploy our capital to ensure that we're generating the best results for our overall shareholders. We have a plan, it's a strategic plan. As I just mentioned—I just outlined a lot of new markets that we've already committed to—we've got a plan over the next five years on how we're going to deploy our capital, and we've announced and provided a lot of guidance on that previously. This additional market expansion will take time. We're going to be really smart and disciplined about how we do this, because every time

you open a new market, you've got a lot of expense related to start-up and it takes time for these markets to mature and become efficient. So, I think we're on the right path and I think we've got the right cadence.

David Katz:

Perfect. Thank you very much.

Mark Wang:

Thank you.

Operator:

Thank you. Our next question comes from the line of Patrick Scholes with SunTrust Robinson Humphrey. Please proceed with your question.

Patrick Scholes:

Hi, good morning, Mark and Dan.

Mark Wang:

Good morning.

Patrick Scholes:

My question has to do with the out-year guidance or outlook that you gave in last fall's Investor Day, and, certainly, coming out of the prior earnings call, there seemed to be some uncertainty whether those ranges and guidances were still valid. Do you have an updated thought on that?

Mark Wang:

Patrick, we—I think we mentioned this last quarter—we're actively revisiting our long-term targets based on new dynamics that we're seeing in the business. We're very optimistic about 2020, especially as we start bringing in the new inventory and bringing that product online. We think this momentum is going to carry over very well into 2021. With that being said, as far as any further guidance, long-term guidance, we're going to provide 2020 guidance early next year on our Q4 and full year call. So, yes, I guess that's what we would say on that question.

Patrick Scholes:

Okay, look forward to that in February, and then just a quick follow-up question. Any further thoughts around shifting to a hybrid points system?

Mark Wang:

I think I mentioned again on the last call that we are actively looking at other product forms, though our dated product resonates very well with our new buyers and our owners alike. In fact, our customers, as we've gone out and reached out to them, have told us that they value the transparency and the certainty of our product form, especially in the key markets like Hawaii and

New York, and I think it's reflective in just how we're yielding. I mean, if you look at how we're yielding with owners and just average revenue per owner in any given year, I think we're outpacing our closest competitor by 40%. So, the current product form is working very well, but it does—we all understand that it creates a little bit more variability, with the reportability on a dated product, so we're looking for ways to enhance our product offerings, we're looking for ways to incrementally improve and complement our core product, and we think those product forms will be something that we will be talking about in a more definitive way as we move into, probably, the latter part of next year.

Patrick Scholes:

Okay, very good, looking forward to hearing about that. That's it, thank you.

Mark Wang:

Thank you.

Operator:

Thank you. Our next question comes from the line of Stephen Grambling with Goldman Sachs. Please proceed with your question.

Stephen Grambling:

Hey, thanks. I guess one quick one to start. It looks like the buyback slowed down from the run rate last quarter, and I know you don't include it in your guidance, but can you just remind us the thought process for how you think about the buyback?

Daniel Mathewes:

Hey, Stephen, it's Dan. How are you this morning? Good question. I think the way we think about it is exactly how we came out on Investor Day. When we look at our capital allocation strategy, the first use of cash has always been organic growth. As you and I think everyone on the call realizes, we have a very large investment in inventory coming online and we to see that—we'll start to fully appreciate that in Q1 of 2020, and then obviously evolve over next year. The second use of cash was return to shareholders via share repurchases. Since we've started our initial buyback program in December of last year, over the last 10 months we've repurchased in excess of $350 million worth of shares. We were active in the market in Q3 and we repurchased $12 million, lower than Q1 and Q2, but still a new market, and I think what you'll see going forward is that's still our number two use of free cash flow.

Stephen Grambling:

Great, and I appreciate you can't comment on the reports out there on M&A, takeover stuff specifically, but how do you generically think about the positive and negatives of consolidation in the space, and perhaps tying in anything that's specific to HGV?

Mark Wang:

Yes, Stephen, it's Mark. I think we recognize the value proposition of consolidation in our industry and other industries. I think, from our perspective, some of the key reasons for

consolidation is you want to improve your asset base, you want to strengthen your brand, and in this industry's case, you want to have the access to a pipeline of incremental new customers. So, I'd say, look, we've got a great set of assets and we have this great brand and relationship with Hilton, and we've talked about the tour pipeline that they provide us, and we've had a long and strong history of execution and growth. So, look, I think consolidation has been positive in the industry and we understand the rational behind it.

Stephen Grambling:

Great, thanks. I will jump back in the queue.

Mark Wang:

Thank you.

Operator:

Thank you. Our next question comes from the line of Brian Dobson with Nomura. Please proceed with your question.

Brian Dobson:

Hi, good morning. I have two quick questions for you. First, do you think that you could speak a little bit about the technology initiatives that you're developing with Hilton to drive tour flow kind of outside of the traditional call transfer setup? Then, second, just to follow up on that share repurchase question, was there anything that restricted you from purchasing more shares during the third quarter and are you free to repurchase shares going forward outside of normal blackout periods? Thank you.

Mark Wang:

Okay, hey, Brian, I'll take the first part of that question, then I'll let Dan take the second part of that. So, look, we're really excited about the work we're doing with Hilton and, clearly, that relationship benefits us in a number of ways. It's something that we're really focused on with Hilton right now, especially on the digital side. As you know, their Honor base continues to grow, their loyalty base, I think they just announced they reached over 100 million loyalty members this year, and one of the things that's been very, very positive is that their Honor base has been responsive to our offers on a digital basis. We have been successfully reaching out through e-mail and through placement of offers on hilton.com and within the Hilton app. This is a build, build test, build exercise.

We're very, very pleased with our new Chief Marketing Officer, Sherri Silver, and the team that she's built and brought onboard over the last 24 months. We're expanding not only our skill set, but we're expanding our capabilities, and the progress is starting to show. We expect that 5% of our new buyer tours this year will originate through this channel. But, importantly, package sales are accelerating in this channel. We expect to sell 30,000 packages this year. To put that into a relationship to call transfer, this is more packages that we're going to sell on a digital basis this year than we did with call transfer our first year. What does that mean? Well, that means that this should translate to about 9% of our new buyer tour flow next year, so we're excited.

We're learning, there's a lot to learn around this. We're learning about the qualifications and the parameters that we have to put. We're building our data, we're building our systems. We're working to improve, and we're adjusting. The nice thing about digital, and one of the benefits, is we can measure success sooner and we're able to adjust quicker.

Anyways, very pleased with early results, and we're excited to be able to talk to you about how we're proceeding in this very important channel expansion with Hilton as we move forward.

Brian Dobson:

Great,. that's very helpful.

Daniel Mathewes:

Hey, Brian, it's Dan. With regards to the share repurchases, as I'm sure you can imagine, there's a number of factors that we internally discuss and take into consideration. We just have a policy, we clearly do not forecast share repurchases, nor do we talk about restrictions, etc., so all I can do is re-emphasize that the use of free cash flow outside of organic growth, the primary use is still share repurchases. So, I think I'll just leave it at that.

Brian Dobson:

Great, thank you very much.

Mark Wang:

Thank you.

Operator:

Thank you. Our next question comes from the line of Jared Shojaian with Wolfe Research. Please proceed with your question.

Jared Shojaian:

Hi, everybody. Thanks for taking my questions. Just on the contract sales, the comp gets a lot easier going into the fourth quarter. You're not really assuming any sequential improvement to the year-over-year growth rate if we exclude the Hurricane Dorian impact that you called out here today. So, can you just talk about how you're thinking about the fourth quarter given that dynamic? I appreciate the conservatism, but I'd love to just hear some of your perspective on that.

Mark Wang:

Yes, no, look, I think, as I've said in my prepared remarks, we're dealing with some of the same trends around inventory mix availability as we look at Q4, and this really starts to correct itself early in 2020. It improves as we begin to layer in inventory and register properties throughout our distribution centers. I think what you're going to see is you're going to see a momentum build.

When you look at this year, VPG for the last quarter came in consistent with our expectations and really similar to the trends we saw last quarter. When you look at the components of VPG, closing percentage and average transaction price, we experienced a slight reduction in closing percentage. The predominant impact for the quarter was related to transaction price. I talked about it this last quarter. The primary impact on transaction price was felt out of APAC, our APAC region, and, again, we expect that that will correct itself, but the APAC impact was really related to just not having the optimal mix of inventory in that market, especially for first-time buyers, and so our Japan sales lines, both in Oahu and in Japan, continued to push some of our mainland product. I think the positive for that is, as we start bringing new product into the system, in Hawaii and in Japan, these new customers that we're bringing in will upgrade into those products. But I have to—I'm very pleased though with the way our teams have reacted, they're doing a really good job of pivoting, because transactions continue to be strong, and they're adapting to the inventory that we have available.

So, I guess a long way of saying that we see some of the same trends we saw earlier in the year playing out in the fourth quarter.

Jared Shojaian:

Great, thank you. Then, just along those lines, as we look out to next year, obviously a lot of inventory coming online, can you just help us think about contract sales growth, I guess the cadence as the year progresses? Should we be assuming that there's going to be a ramp-up from 1Q to 2Q to 3Q to 4Q in terms of how the growth rate is trending, or with the inventory that you have coming on immediately in the first quarter, is this just kind of right out of the gate, you're back to growing contract sales, how you've been going in the past? Then, I guess along those lines, as well, is there any reason why in 2020, you can't get back to the record VPG you were doing in 2018, now that you get the same quality of inventory that's coming back online? And that's it for me. Thank you.

Mark Wang:

Okay. I think, again, 2020 guidance, we're going to provide a lot of detail around that in our Q4 call, but I would say that your example of a progressive ramp into 2020 is a logical way to look at this. First of all, we're not going to get all of these projects registered on day one, so starting January 1, and so we believe the earliest project that will be registered will be Ocean Tower Phase 2, and then later in the second half—or the first half of the year, we'll start to see Maui and Cabo come online, and then the back half of the year, we'll see our new property in Waikiki come online.

With any new property that we bring onboard, with the way our distribution works, it requires us to not only, first, obtain registration and approval within the jurisdiction or state that the project resides in, but then we have to then move that approval out through multiple, multiple marketing states and then other distribution states, so it takes time for the registration. A great example we're seeing now is we just recently got Chicago and Charleston registered in Nevada. We're able to start selling those earlier in the year, but they're now starting to move into new markets. So, I think you should expect it to be a ramp, but we will definitely provide better insight as we talk to the numbers in early next year.

Jared Shojaian:

Okay, thank you.

Mark Wang:

Thank you.

Operator:

Thank you. Our next question comes from the line of Brandt Montour with JPMorgan. Please proceed with your question.

Brandt Montour:

Hello, good morning, everybody. Thanks for taking my questions. The first one is just on NOG, which, obviously, again you had this very strong quarter, industry-leading NOG, but it was a little bit of a decal, and you have had a little bit of a decel over the past sort of three quarters. Is that a purposeful shift in strategy or is that just sort of tough comps?

Mark Wang:

Yes, no, look, I think that, number one, any positive NOG is beneficial to business, right, it's embedding that future value into the business, and so we're within our long-term ranges. You're seeing the benefit in our Club and Resort businesses, as I talked about earlier. We do have industry-low attrition, we believe, when you look at the fact that our base is over 315,000 customers now. There's nothing strategic about bringing it back down, but we are definitely working on initiatives to make sure that we stay within that range. We think that's a healthy range that will allow us to continue to drive sustainable growth going forward.

Brandt Montour:

Got it, thank you, and just a quick follow-up on taxes and free cash flow. Given you're in an elevated cap ex period, what is the flexibility you have with regards to sort of accelerated depreciation or any ability you have to find upside to cash generation from that potential tax shield?

Daniel Mathewes:

Well, from a tax perspective, what you saw this quarter was, to be perfectly honestly with you, a slight increase in taxes, primarily a function of—as you can imagine, different states have different tax rates. Where we ended up on the high end of our range of 26% to 28% this quarter, being closer to 28%, was really driven by where we actually sold inventory. We're taking advantage of all aspects from a tax perspective, and we continually pursue and re-evaluate methodologies, etc., but long term, we still expect to be in that 26% to 28% range.

Brandt Montour:

Very helpful. Thank you very much, guys.

Mark Wang:

Thank you.

Operator:

Ladies and gentlemen, at this time, there are no further questions. Before we end, I would like to turn the floor back to Mark Wang for any closing remarks. Mr. Wang?

Mark Wang:

All right. Well, before we close, on behalf of the Management Team, I'd like to thank our HGV team members for providing great vacation experiences to our over 320,000 owners. Thanks again for joining us this morning. We look forward to speaking with you over the coming weeks and updating you on our next call. Thank you.

Operator:

Thank you. Ladies and gentlemen, this concludes today's teleconference, you may disconnect your lines at this time. Thank you for your participation.