Hilton Grand Vacations Inc.

Q4 2022 Earnings Call

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CORPORATE PARTICIPANTS

Mark Melnyk – *Senior Vice President, Investor Relations and G&A*

Mark Wang – *President and Chief Executive Officer*

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

PRESENTATION

Operator
Good morning, and welcome to the Hilton Grand Vacations' Fourth Quarter 2022 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 13735178.

I would now like to turn the call over to Mark Melnyk, Senior Vice President of IR and G&A. Please go ahead, sir.

Mark Melnyk
Thank you, Operator, and welcome to the Hilton Grand Vacations' fourth quarter 2022 earnings call.

As a reminder, our discussions this morning will include forward-looking statements. Actual results could differ materially from those indicated by these forward-looking statements. Any 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 Factor section of our 10-K or other applicable SEC filings.

We'll 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.

Our reported results for all periods reflect accounting rules under ASC 606 which we adopted in 2018. Under ASC 606, we're 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 of our earnings release.

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 recognitions for all reporting periods. 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 website.

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 details for the quarter. Mark and Dan will then make themselves available for your questions.

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

Mark Wang
Morning, everyone, and welcome to our fourth quarter earnings call.

This past quarter was a great finish to a standout year. Contract sales of $634 million remained nicely ahead of 2019, and EBITDA of $253 million was nearly 25% higher than our pro forma 2019, with margins nearly 300 basis points higher. We had a solid contribution from new buyer channels, which has been a key area of focus and investment. With continued strength in leisure demand and good execution from our teams, we've been successful at activating our packaged sales pipeline to drive tour growth, which generates NOG, and importantly, embeds future value into the business.

I'm extremely proud of our entire team and what they accomplished in the past year. We laid the groundwork for our combined organization through the launch of major programs and integration initiatives, and due to their efforts, we hit several milestones faster than we initially modeled, while outperforming our initial underwriting expectations.

We've also continued to benefit from consumers' pivot toward experiences, in leisure travel in particular, and while we're monitoring the macro environment, our leisure focus and strong value proposition leaves us well-positioned for these ongoing shifts in consumer spending preferences.

Earlier this quarter, we wrapped up another successful LPGA Tournament of Champions, which was the second held under the HGV brand. We had great attendance during the week, and our media exposure was up dramatically across all channels this year, with social media impressions tripling to over 750 million and active engagements up six fold to 1.2 million, on top of expanded international television and media coverage. The tournament also serves as our Marquee Ultimate Access event of the year, and we kicked off this calendar with exclusive programming set up for our members throughout the week. As a result, we generated 40% more tours from the tournament this year, with new buyer tours more than doubling versus last year.

During the tournament, I spent a lot of time with our owners and guests, and I can say that the energy around our brand and the engagement of our member base is really high, which leaves us optimistic about '23 and beyond. We're confident in our business, as evidenced by our guidance, and we're committed to enhancing shareholder value through continued capital returns.

Now, before I get into the details of the quarter, I'll start by taking a quick look at what we've accomplished over the past 12 months.

It was around this time last year that I said 2022 would be a transformational year for HGV, and that certainly proved to be the case. We launched HGV Max, our new membership offering that links our resort collections and was also the first major club redesign in our history.

We launched HGV Ultimate Access, our exclusive experiential platform, and hosted over 100,000 members and guests and over 3,000 events, including private concerts, culinary experiences, shows, excursions, and sporting events.

We rebranded our sales center to provide a dramatically improved experience to our marketing guests and trained our sales staff to uphold HGV's rigorous standards of integrity.

We also rebranded Diamond's largest properties, adding nearly 5,700 keys in new markets like Sedona, Lake Tahoe, Palm Desert, and Virginia Beach, and we also merged our financial and HR systems and integrated the former DRI teams to unify the organization under our HGV culture and values.

From a financial perspective, we produced record cash flow and EBITDA exceeding our initial underwriting expectations. We built the largest new buyer pipeline in our history, which will provide a source of tour flow in coming years and embed additional value into the business for years to come, and we achieved an upsized cost synergy goal several quarters ahead of schedule, but equally, as important for our shareholders, however, is that the Diamond acquisition has created real economic value. Dan will get into the details here in a minute, but our cash flow, returns on capital, and member base are all well ahead of pro forma combined entity pre-acquisition metrics, and these improvements were the results of longer-term value creation initiatives like cost efficiencies, process improvement, and enhancing our product offerings rather than just taking outsized pricing. So after a year of hard work, we've laid a strong foundation to continue growing the long-term value of the business.

Looking forward, 2023 will be a year for further execution of our integration plans, and we'll build upon the successful launch of both Ultimate Access and HGV Max with new programming and features. We'll re-brand nearly a dozen additional Diamond properties to add to the Hilton Vacation Club collection, and, as we've done throughout our history, we'll maintain our focus on driving new buyer sales and net owner growth.

Now, let me take you through a more detailed look at our performance in the fourth quarter.

Contract sales strength was driven by the continued improvement in tour flow, which more than offset the expected normalization of VPG. Tours were nearly 85% of 2019, demonstrating continued progress in our pace of recovery. New buyer tours drove the improvement, showing the positive results from our investment efforts. Additionally, transaction volumes were exceptional this quarter, driven by the tour flow improvements and a close rate that remains near all-time highs. That close rate drove VPGs of $4,350, which remains well ahead of 2019 and decelerated only modestly from the recovery pace we saw in Q3.

Turning to the demand indicators, our system occupancy was 79%, seasonally lower than Q3 and in line with fourth quarter of last year. We saw some softening of occupancy at the end of the quarter that coincided with the holiday airline disruption and unusual storm activity in some markets, but believe that those were isolated issues.

Looking forward, on-the-book arrivals are nicely ahead of 2019 through the entire first half of '23, with particular strength in our rental arrivals. I'm encouraged that our marketing package

pipeline ticked up slightly from Q3, but more importantly, our number of packages with set travel dates also grew, which will drive additional new buyer tour flow in the months ahead and support net owner growth.

We ended the year with 519,000 members and NOG of 3.9% on a combined basis, having grown our member base at both HGV and Diamond throughout the year. This is the highest NOG we've generated since we reopened our properties in mid-2020, and I'm really pleased with the results of the investments we've made to drive new buyer channel. This combination of new buyer growth and increased member activity drove club and resort revenue to a record $155 million, and finally, our rental business produced solid revenue results owing to the strong leisure travel environment.

To summarize, we feel great about how we closed out a transformational year for HGV. The teams executed against an ambitious and complex plan that involved a lot of heavy lifting, and I'm proud to say we accomplished even more than we anticipated at the close of the acquisition.

We've built a strong foundation to build upon in 2023 and beyond. With our new membership, new programming, new destinations, and rebranded resorts, we think that our value proposition is the strongest that it's ever been, which is why we're seeing such a great response from our owners and new buyers, and we're continuously focused on creating value for our shareholders through operational improvements of the business, as well as a commitment to capital returns.

With that, I'll turn it over to Dan to talk you through the numbers. Dan?

Daniel J. Mathewes
Thank you, Mark, and good morning, everyone.

Before we start, note that our reported results for this quarter included $3 million of sale deferrals, reducing reported GAAP revenue associated with presales of the next phase of our Maui project. We also recorded an associated $2 million of direct expense deferrals, resulting in a net benefit of $1 million to our reported EBITDA for the quarter. In my prepared remarks, I'll only refer to metrics excluding the impact of deferrals, which more accurately reflects the cash flow dynamics of our financial performance during the period.

We had a very strong 2022 in the midst of a material amount of integration work and major initiative launches, so we're very proud of everything that the team’s accomplished.

Contract sales for the year were a record $2.4 billion and EBITDA of $1 billion was nearly 40% ahead of pro forma 2019, with a margin improvement of nearly 600 basis points to 28%, and, as Mark mentioned, we're extremely proud of the progress we've made on our integration and we've created real shareholder value with the acquisition.

Our 2022 adjusted free cash flow of $563 million was significantly ahead of the pro forma 2019 cash flow. We've maintained our exceptional return on invested capital of over 20% on a much

higher capital base, creating additional value annually, and despite several years of the pandemic, we still drove net owner growth, ending 2022 with a member base roughly 25,000 members higher than in pro forma 2019, which will drive additional future value creation.

Now, let's review the results for the quarter.

Total revenue in the fourth quarter was just under $1 billion. We saw year-over-year revenue growth in all of our segments, led by strength in real estate and financing segments.

Q4 reported Adjusted EBITDA was $253 million, with margins of 25%.

Turning to our segments.

Within real estate, total contract sales were $634 million. Sales momentum in our owner channel has remained strong and ahead of 2019 levels, and we also saw a nice jump in the recovery pace of our new buyer channel, with sales quickly approaching 2019. We're pleased with the initial results of the recent investments in our new buyer channel. From the first half of the year, prior to our investment, to the second half of the year, we saw strong improvements in new buyer tour flow and contract sales pace against 2019 that well exceeded the growth from our owner channel and helped to drive solid NOG growth of 3.9%.

We've been monetizing our package pipeline and our activated packages are at the highest level since 2019, and our investments should continue paying dividends. As Mark mentioned, we're seeing very strong arrival growth in our marketing channel as we look out over the coming months.

VPG was $4,350 for the quarter, which grew against prior year and 2019, and for the year, VPG finished 31% ahead of 2019.

Looking at 2023, as we've said for a number of quarters, we expect to see continued normalization of VPG performance against 2019 as we move through the year. For your modeling purposes, it's important to note that in the first quarter of ‘23, we're lapping the highest VPG in the history of the Company, and thus, we anticipate that while VPG will be ahead of 2019, it will decline against that record from Q1 of last year.

Cost of product was 19% of net VOI sales for the quarter. Real estate S&M expense of $243 million for the quarter was 38% of gross contract sales, similar to third quarter levels and reflecting our investments in the new buyer channel. Real estate profit was $172 million for the quarter, with margins of 36%.

In our financing business, fourth quarter revenue was $71 million and segment profit was $34 million. I'd note that financing expenses this quarter included a one-time non-cash true-up adjustment to the premium amortization associated with the acquired Diamond portfolio of approximately $9 million.

Combined gross receivables for the quarter were $2.5 billion or $1.8 billion net of allowance, and our interest income was $65 million.

Our originated portfolio weighted average interest rate was 14.3%, while our acquired portfolio had a weighted average interest rate of 15.6%, and includes a $6 million contra revenue with the amortization of non-cash premium associated with the portfolio of receivables that we acquired from Diamond during the acquisition.

Our allowance for bad debt was $742 million on that $2.5 billion receivable balance. Of these amounts, the acquired Diamond portfolio, which used Diamond's underwriting standards, was $338 million on a portfolio balance of $709 million.

Our annualized default rate for our consolidated portfolios, including the Diamond acquired and underwritten portfolios, was 7.9%. This is over 100 basis points lower than last year, with both the acquired and originated portfolios continuing to demonstrate substantial outperformance from our initial underwriting assumptions.

Our provision for bad debt was $39 million or 9% of owned contract sales, which remains below our steady-state expectations of a normalized provision, driven by higher down payments and continued levels of elevated prepayments.

In our resort and club business, our consolidated member count was 519,000. Our consolidated NOG was 3.9% at the end of the quarter, which I note now includes both HGV and Diamond members.

Revenue was $155 million for the quarter and segment profit was $112 million, with margins of 72%. Rental and ancillary revenues were $160 million in the quarter, with segment profit of $7 million.

Fourth quarter margins reflect additional expenses associated with the seasonal effect of member point conversion activity, along with the continued elevated developer maintenance fees associated with the unsold inventory from our recently opened projects.

For your modeling, it is important to note that due to the changes made to unify the reporting of HGV and Diamond, there is a timing shift associated with Diamond's member benefit expense that will cause rental and ancillary expenses in the first half to be up materially versus the first half of 2022. For Q1 specifically, we expect that this will result in a year-over-year impact of roughly $14 million, which will impact our reported rental and ancillary profit, as well as our overall Adjusted EBITDA. I'd emphasize that this adjustment is only timing and reflects a change in the seasonality of expenses in the rental and ancillary segment. This year-over-year impact will reverse through the year to become a fully offsetting benefit in the back half and will not itself have any impact to rental and ancillary profit or Adjusted EBITDA for the year.

Bridging the gap between segment Adjusted EBITDA and total Adjusted EBITDA, corporate G&A was $47 million, license fees were $34 million, and JV income was $3 million.

Our adjusted free cash flow in the quarter was a use of $92 million, which included inventory spending of $73 million and excludes acquisition-related costs of $40 million.

As we mentioned on our prior call, in Q4, we had additional contractual inventory spending for our Sesoko project, along with the payment of our cash taxes, which drove the negative adjusted free cash flow in the quarter. For the year, I'm really happy to say we generated adjusted free cash flow of $563 million, which is a record for the Company. We converted 54% of our economic EBITDA into adjusted free cash flow, which was nicely inside of our 50% to 60% target range, and we expect to maintain this conversion range in the years ahead.

It is important to note, however, that in 2023 specifically, we do have an additional just-in-time inventory payment for the Central in New York of roughly $140 million, which includes a payment that was deferred during the pandemic. Considering this additional payment, total inventory spend for 2023 is expected to be approximately $400 million versus $175 million in 2022. Despite that, however, we still anticipate achieving the low end of our 50% to 60% target EBITDA conversion range.

During the quarter, the Company repurchased 2.5 million shares of common stock for $100 million at an average price of $39.88. For the year, we repurchased seven million shares of stock for $272 million, so on top of spending on our integration, funding our growth, and paying down our debt, we returned nearly half of our adjusted free cash flow to our investors through share repurchases, and we're continuing that trend thus far in 2023. Through February 24, the Company has repurchased an additional 1.8 million shares for $80 million. We currently have $148 million remaining of the $500 million repurchase plan approved by the Board in May of 2022, and we remain committed to enhancing the total return for our shareholders by returning capital.

Turning to our outlook.

We are setting our 2023 Adjusted EBITDA guidance to a range of $1.09 billion to $1.12 billion. Excluding the special reserve release that benefited our third quarter, our guidance implies EBITDA growth of 4% to 7%, which is a great result on top of the strong EBITDA growth we produced this year. For your modeling, I would note that from a seasonal perspective, Q1 EBITDA is typically lower than the preceding fourth quarter and is also typically the lowest EBITDA quarter for the year. Q1 of 2023 will also have the timing impact of the $14 million expense impact in our rental and ancillary segment that I mentioned earlier.

As of December 31, our liquidity position consisted of $223 million of unrestricted cash and $959 million of availability under our revolving credit facility.

Our debt balance at quarter end was comprised of corporate debt of $2.7 billion and a non-recourse debt balance of $1.1 billion.

At quarter end, we had $652 million of remaining capacity on our warehouse facility, of which we had $279 million of notes available to securitize and another $338 million of mortgage notes we anticipate being eligible following the certain customary milestones, such as first payment, deeding and recording.

Turning to our credit metrics.

At the end of Q4, the Company's total net leverage was 2.4 times.

Finally, before we wrap up our prepared remarks, I wanted to address an item that you will be seeing in our 10-K once it is filed later today.

We have identified a material weakness related to Diamond. These items did not impact our business operations or reported processes in any way. They also did not impact our current financial results or our historical results, nor will they result in any revision or restatement of historical financials. We already have a remediation plan in place and we'll provide additional updates through the year, but we fully expect to have these items resolved expeditiously.

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

QUESTIONS AND ANSWERS

Operator
Thank you. Our first question is from Ben Chaiken with Credit Suisse. Please proceed.

Ben Chaiken
Hey, Good morning.

If I'm not mistaken, I think there's two initiatives underway with the rebrand. One is updating and rebranding the sales centers, which I think you noted on the last call was completed towards the end of ‘22, and then second is updating and rebranding the Diamond properties themselves. On this first part, the sales centers, is there any type of feedback, whether anecdotal or otherwise, to help us understand the benefit so far? Then on part two, the property rebrand, have you started to market those properties to Hilton Honors members or is this further down the line? I have one follow-up. Thanks.

Mark Wang
Yes. Sure, Ben, so on the rebranding front, we basically have rebranded all the legacy Diamond sales centers and implemented our HGV selling technology, our sales approach, our new training, and, of course, we've now introduced HGV Max in those sales centers, so a lot of heavy lifting, great work by the teams to get all that done.

As far as marketing into the sales centers utilizing the Hilton database or Hilton's customer base, we've sold 72,000 packages to these locations, and we're starting to see those tourists now arrive to the property. As you recall, these packages—these vacation packages we sell have a—they have a 12 to 18-month window for travel, so we started selling these probably at the beginning of the second quarter of last year, so we're starting to see those guests travel, so we're starting to see some revenue synergies there, and I think some of the benefits that we've seen in our outsized VPGs last year have come through the work we've done in repositioning these sales centers and lifting up this new membership program.

Ben Chaiken
Got it. That's very helpful, and then switching gears a little bit, fee-for-service mix moved higher in the quarter sequentially. I think you called out the pipeline is 85% owned, if I'm not mistaken, in the press release. How do we think about the mix in '23, and '24, for that matter?

Daniel J. Mathewes
Hey, Ben. Dan here.

Just the easy way to think about it, to your point, most of the inventory that's coming online is owned. Most of the pipeline is owned, so I would look for the fee-for-service to decrease in 2023 to be more in that range of 20% to 25%, with ebbs and flows, because obviously when a consumer comes in the door, we take the time to really get to know them, and some people are just interested in a deeded product that happens to be fee-for-service, so there is a bit of that play, but with the dynamic of the pipeline being primarily owned inventory, it should decrease to that 20% to 25% range.

Ben Chaiken
Got it. Thank you very much.

Operator
Our next question is from Patrick Scholes with Truist Securities. Please proceed.

C. Patrick Scholes
Hi. Great. Thank you. Good morning, everyone.

A couple of questions here. You had used the adverb on some of your forward trends, the adverb being nicely ahead, or nicely, the adverb. Can you give more granularity, perhaps some percentages, on some of those metrics that you brought up?

Daniel J. Mathewes
Hey Patrick, it's Dan. Any particular metrics we…

C. Patrick Scholes
I think you were referring to—I think it was owner visitation and tour packages.

Daniel J. Mathewes
Sure.

C. Patrick Scholes
I think those were the ones you were referring to?

Mark Wang
Yes, so Patrick, this is Mark, so as it relates to tour flow, so ‘23 is going to be really the year for tour flow growth, and we've had some really good tour flow growth last year. We continue to see strong demand from a leisure travel standpoint. Our owners and rental guests on the books are above what we saw in ‘19, but the real growth is going to come from our new buyer—from a new buyer perspective. Total packages and activated packages are at record high, and just to give you kind of a sense of how that's been trending, if you look at our new buyer tour flow compared to ’19, in Q1, we're at 60%; Q2, 68%; Q3, 74%; Q4, 78%, and our expectations is that that trend is going to continue building because our activations have really picked up, and our package pipeline is well over 0.5 million packages that we have in the pipeline. Importantly, the note is our new buyer sales are actually back up to 94% of where they were in ‘19 because of the better closing percentages and better VPGs we're seeing out there, so all in all, our expectation is strong tour flow growth this coming year.

I should note, though, that, if you remember, coming out of pandemic, our owners came back first with elevated tour flow transactions and close rates. The pent-up demand for travel from our most committed owners really led this high VPG, especially in Q1 of ‘22, which I think Dan noted in his prepared remarks was our—a record VPG for us, so important to note we're coming up against a tough VPG comp in Q1, so as we've indicated for several quarters, we think the mix shift as we shift into more new buyers will moderate our VPG from these ’22 highs more on a glide path to what we've been saying for a number of quarters now to about 10% to 15% above what we saw in 2019.

Daniel J. Mathewes
Patrick, just to add to that, just to give you another nicely adverb, as Mark was talking about the package sales, we're well over half a million. Year-over-year, that's increased 18%, but the investment we've made to activating those packages I think is really underscored by the fact that the percent activated has grown 80% year-over-year, so I think that just speaks to that, but it also talks to that moderation in VPG. As new buyers come on, as Mark just went over, obviously, VPG's will moderate, and that will ultimately have an impact on the margins—the EBITDA margins that we see for the overall business. Now, this is the same story we've been talking about for a number of quarters, so it’s no surprise. That moderation should ultimately fall out to be ahead of where the pro forma was in 2019.

Obviously, we've capitalized on a lot of cost synergies. Will that moderate, normalize in 2023? It'll probably carry into 2024, but that's 100 to 200 basis points, something of that nature, where it ultimately falls out, but to avoid any confusion, that's a percentage moderation from an

absolute dollar earning. You combine new buyers, we sell new buyers at a profit, so we're not talking about lack of earnings growth. It's just a margin percentage moderation.

C. Patrick Scholes
Okay. I do have some follow-up questions regarding all that. Certainly, it sounds like new buyers in the packages and pipeline, a very high percentage. Is the target actually—is the target still 40% for new buyers actually buying by the end of '23? It sounds like it might be ahead of that.

Mark Wang
Yes. Look, I think that's our targeted goal. You have to remember, new buyer sales are growing and tour flows are growing, accelerating faster than we're seeing owner tour flow grow, but you have to remember, the VPG and close rate is considerably less than owners, so our goal is to get back up to 40%. I'm not sure if we'll get to that level by the end of the year, but that's our ultimate goal.

Look, at the end of the day, NOG is core to our strategy. We know that the lifetime value to customer is so important, and we know since 2016, that every new buyer that we generate, we generate an additional 1.7 additional transactions, so not only is it embedding recurring revenue from management and club fees and any mortgages that we may initiate, but it's also embedding future high-margin sales, so very core to our strategy, early on when the pandemic began, we really focused on our owners, because that made the most sense from a standpoint of generating as much cash and margin as possible, but we are now back on course, and this year will be the year of tour flow growth, in particular around new buyers.

C. Patrick Scholes
Okay. Thank you. I've got more questions, but I will go to the end of the queue and let some other people ask questions. Thank you.

Operator
Our next question is from David Katz with Jefferies. Please proceed.

David Katz
Hi. Good morning, everyone. Thanks for taking my questions, and given I have a couple going on this morning, I hope I'm not asking something twice, but my most important issue is just figuring out how you think about the contingencies and sensitivities and leverages as we get through this year and potentially get into a recession that still has yet to be defined as to what that would look like. Help us walk through a range of scenarios, if you can.

Mark Wang
Well, look, David, I think obviously, we're aware and mindful of the potential impacts of macro environment, and clearly, there's a lot of cross currents on the consumers out there, but what we're seeing right now is consumers continue to prioritize travel, and we're seeing more owners and rental guests on our books than we saw in '19, and so that's a great indicator. We just answered a question earlier around new buyer tour flow. New buyer tour flow is really outpacing

all of our other channels, and we continue to activate those tours at a very healthy pace, so all in all, the activity—all of this activity's increasing traffic in our sales centers and it's going to drive transactions, and so I do think we have some distinct advantages in our model, our direct sales approach, which allows us to engage with our owners and prospects in pretty much any environment.

You saw how fast our industry, in particular, HGV's, come back from the pandemic. We've got this high-quality pool of customers from Hilton through their Hilton Honors member base who have a high affinity to travel, and so, again, packages remained strong. We drove increases in tour flow. I just gave out some numbers. If you go back and you listen to the transcript, I gave out some detailed numbers on the sequential growth of our new buyer tour flow. Our inventory position is really good, and while—look, we're certainly not immune from macro pressures, we do believe we'll hold up well even if we face some incremental headwinds on VPG and margin.

David Katz
Understood, and can I just ask for a quick comment with respect to the balance sheet and how you think about—not that leverage is a challenge for you in any way, but how do you think about managing your leverage levels as you progress through this year as well?

Daniel J. Mathewes
Hey, David. It's Dan. Thanks.

Look, great question. We are right now 2.4 times levered. I think, when we worked our way through COVID, we've proven that we tend to be a little bit conservative on the balance sheet in preparation for macroeconomic events. That being said, I think COVID also proved out that ourselves, as well as the vast majority of time share, can operate at significantly higher leverage if necessary. I think ultimately what you would see us do, barring some kind of material, call it, great financial crisis type recession, you'd see us continue down the path that we're on right now, and that's actively returning capital to shareholders, continuing to do that, and maintaining a leverage ratio sometime—some place in the range of two to three times. We've been able to pull back on inventory spend where necessary, and if something material were to happen, we'd probably look at pulling that lever again as well.

David Katz
Understood. Thanks very much.

Operator
We have a follow-up question from Patrick Scholes with Truist Securities. Please proceed.

C. Patrick Scholes
Okay, great. Thank you. I definitely have some more questions here.

At the end of the prepared, Mark through a little curveball there with talking about material weakness. I'm wondering if you could give us any more color whatsoever that might mean or what it might refer to at all. Thank you.

Daniel J. Mathewes
Hey, Patrick. It's Dan. Thanks. That's a great question. Was a little bit vague. The disclosure in our Form-K under Item 9 today will be a little bit more transparent, but just to give you an example or maybe some background, as you know, Diamond was taken private in 2016, and to be perfectly honest, there was a lack of investment in infrastructure associated with internal controls, as you would expect. That's very typical of any private organization.

One of the items, just to give an example, was a shortfall in user access controls associated with their property management system, as well as their tour system, etc., so you—what we had to do was literally go in and clean up every single user that had access, define the roles and responsibility of every single users, and those controls need to be in place for a specific amount of time in order to avoid a material weakness, if you will, and they were not in place for the specified amount of time, and we're working through a remediation plan, but this in no way impacts the financials, no way impacts the processes of selling a contract.

There's no restatements. Don't confuse me. I'm not trying to be dismissive. No one wants to have a material weakness, but this is the one that you would take, especially since it has no financial impact, but it should be—we fully expect to be on track with regard to internal controls at both HGV—keep in mind, no material weakness on the legacy HGV side. This was strictly Diamond, and we believe both entities will be in a solid position for this year's audit that progresses—starts to progress in Q2.

C. Patrick Scholes
Okay. Would a way of maybe summing that up would be they didn't follow the required best practices where you folks do have the best practices. You identified it and you are working on rectifying it. Is that a good summary?

Daniel J. Mathewes
That would be a nice summary, yes.

C. Patrick Scholes
Okay. Okay. Good. Okay. Then, just a couple of other follow-up questions.

You had, in our conversation earlier, had mentioned close rates. Can you tell us what the close rates were either year-over-year and/or versus 2019? Thank you.

Mark Wang
Yes, so look, we're—what we can tell you is that our close rates have been running approximately 400 bps ahead of where they were in ‘19, and that's been pretty—that was pretty consistent. It happened pretty quickly right after the reopening, again—and it's interesting,

because our close rates, if you go back over multiple decades, have been pretty stable, and for us, clearly, we benefited from the pent-up demand. I don't know if you want to really call it revenge travel or what.

Clearly, the consumers' balance sheets were in really good shape, and so—but at the end of the day, our expectations is those close rates would moderate that down just like our VPG, and VPG's really an outcome of close rate an average transaction price, so at the end of the day, our expectations is close rates will moderate back down, especially as we shift our mix back to more new buyer tours, so all-in-all, our expectation's it won't go back to where it was in '19. It'll still hover above that, as we think our overall value proposition has improved. We've added new product in new markets, and we continue to really enhance our precision around finding the best customer that fits our product.

C. Patrick Scholes
Okay. Thank you, and then one last question, I promise, here.

The provision, did you say you're trying to take it sub-10%, but I remember in my notes you said targeting 15% to 16%. Can you clarify where you are and where you want to be with that? Thank you.

Daniel J. Mathewes
Yes. Hey, Patrick, so the provision in 2022 was—we had, as you may recall, a benefit in Q3. All in, it was right around that 10% level. With regards to where is it going, at some point in time, you're going to have a more normalization in credit trends. Now, we haven't seen that to date, and what I—what we're very happy about is if we look at our default rate on the legacy Diamond side and the delinquency rate on the legacy Diamond side pre our acquisition to post our acquisition where our underwriting and sales practicing standards have kicked in, it is materially down. Our underwrite anticipated that provision on a consolidated basis to be north of 15%. Not ready to ring the bell that we've changed things permanently, but it's significantly outperforming the underwriting.

On the HGV side, we see the delinquency rates and the default rates very consistent with 2019, which we're also pleased with. Ultimately, you're going to see that provision as a percent of contract sales increase this year. We anticipate it to increase this year. Don't think it will fully get to 16% or 15%, but it will begin to normalize, we believe.

C. Patrick Scholes
Okay. Thank you. Actually, I have one last question here, a modeling question. Anything we should think about with quarter-to-quarter volatility and expected recognition of net deferrals when we're modeling the deferral—excuse me, Adjusted EBITDA by quarter? Thank you.

Mark Wang
Yes, Patrick. I think we may have discussed this before. We've actually shied away from giving specifics, because it all associate—it's all associated with the timing of specific deeded projects

that are sold, and as I mentioned earlier, we do allow the consumer to choose exactly where they want to buy, so I would assume just zero by quarter and we'll (inaudible) as it plays out.

C. Patrick Scholes
Okay. No, that's great. I recall a number of years ago that definitely created a lot of volatility, so it's great to hear that. I am all set. Thank you.

Daniel J. Mathewes
Thank you.

Mark Wang
Thanks, Patrick.

Operator
This will conclude our question-and-answer session, but before we end, I will turn the call back over to Mark Wang for any closing remarks. Mr. Wang?

Mark Wang
Well, thanks, everyone, for joining us today. I want to give a special thanks to our team members for going above and beyond to deliver outstanding vacation experiences to our members and guests. We look forward to speaking with you again soon. Have a great day. Thanks.

Operator
Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.