

Diamond Resorts First Quarter 2021 Earnings Teleconference Company Transcript

Operator

Good morning. My name is Lori and I will be your conference operator today. At this time, I would like to welcome everyone to the Diamond Resorts first quarter 2021 earnings conference call. Our speakers for today's call are Mike Flaskey, Chief Executive Officer, and Jim Mikolaichik, Executive Vice President and Chief Financial Officer.

Today's call is being recorded and will be available for replay beginning at approximately 4:00 p.m. Eastern Time. The replay dial in number is 404-537-3406, and the PIN# is 4847855.

At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following the presentation.

If you would like to ask a question at that time, please press *1 on your touch tone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. If you should require operator assistance, please press *0. We ask that you please pick up your handset to allow optimal sound quality.

I will now turn the call over to Sean Silva of Prosek Partners for preliminary remarks.

Sean Silva, Prosek Partners

Thank you, Lori. Before we begin, I would like to remind everyone that this call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about the company's expected financial performance.

The statements may be affected by many factors including those listed in the company's annual report, which is hosted on Intralinks. As a result, actual results may differ materially from the results discussed or projected today.

Forward-looking statements will not be publicly updated, whether as a result of new information, future events or any other reason.

During this call, references will be made to the 2021 first quarter earnings summary which was posted to Intralinks this morning. The earnings summary contains full reconciliations to GAAP metrics. We reconcile each non-GAAP measure to the most comparable GAAP measure. Please also refer to our discussion of non-GAAP financial measures in our annual statement.

I will now turn the call over to Mike Flaskey, Chief Executive Officer. Mike?

Mike Flaskey, Chief Executive Officer, Diamond Resorts

Thank you, Sean, and good morning everyone. We appreciate you joining us today to review Diamond Resort's first quarter 2021 results.

I'll start with a business update of our first quarter operations and then Jim will then walk us through our financial results in more detail. After that, we will open the call for questions. As with our call last month, we will not be taking questions regarding our merger with Hilton Grand Vacations. Please route those questions to HGV's IR team directly. We appreciate your understanding.

Today, I will discuss our most recent results relative to the comparable period in 2019, which we believe provides a better sense of how close we are to reaching pre-Covid activity and performance.

Q1 VOI sales were 79 percent of our 2020 Q1 levels, and 65 percent of our Q1 2019 levels, showing strong signs of recovery.

Key regions such as Orlando, Las Vegas and Hawaii continue to recover nicely. Our California, Virginia and Arizona regions were temporarily impacted by government-mandated closures in January. As a result, January sales volume was 51 percent of 2019 levels. Once those closures were lifted, sales

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dramatically improved. From February through the end of March, sales volume recovered to 78 percent of 2019 levels, and April is currently tracking to achieve close to full 2019 results.

We experienced a similar trend in our rental operations, as rental revenue was at 60 percent in January compared to 2019, before reaching 88 percent of 2019's volume in March. And while occupancy has sequentially improved, so has monthly ADR. In fact, ADR for March exceeds its comparable 2019 rate and Q1 of this year is at par with 2019. Early indications point towards a continuation of this upward trend with our April results.

Maintaining an active approach to member engagement has been a key to this success. For example, a remote environment limits our ability to execute high-VPG campaigns such as our Diamond Dream Holiday program, yet our first quarter VPG growth of 25 percent set a new first-quarter company record. Among the key drivers were our digital, promotional and marketing efforts. These include member webinars, our Destination Xchange promotional offer, and social media engagement. We have seen strong results through using social media as a way to provide customer service, having resolved 10,000 inquiries digitally during Q1 alone.

Our mix shift strategy is another key to our success. You'll recall that in response to the pandemic, we had less off-premise marketing initiatives, choosing to focus on arrivals of leisure travelers and our loyal existing members. This is reflected in the efficiency of our sales and marketing organization. Our Q1 close rate for existing members was 25 percent, and their average transaction size grew by almost 5 percent compared to 2019 levels. Our new member transaction mix was at 36.5 percent with a close rate of 12.4 percent. Additionally, we continued to experience record level VPG's across our sales lines.

Most importantly, we were able to increase sales volume while maintaining a disciplined cost approach. The rates for first day incentives as well as Advertising, Sales and Marketing expenses came in below Q1 2019 levels, and we are also seeing encouraging trends in our loan loss provision.

As we move forward, we remain optimistic about the pace of the recovery as more people get vaccinated across the country. The CDC has authorized fully vaccinated people to travel within the United States, without the need for self-quarantining or testing. While we mostly employ a drive-to model at Diamond Resorts, where we are not totally reliant on air travel, we still certainly stand to benefit from the increased mobility of people throughout the United States.

Third Party Exit activity, while still present, has trended lower during the past few quarters. This shows the success of our rigorous visibility-raising campaigns and continued work with legislators to eliminate these unethical third-party exit companies from our industry. In fact, during Q1, we recorded the lowest third-party exit-driven defaults of the past three years. While there remains much work to be done on this front, we are pleased to be able to report the success and we continue our commitments to our stakeholders by mitigating this issue.

We are also proud of our commitment to maintaining the Diamond Standard of Clean. We believe we have built a strong level of trust with our members, which has supported our strong engagement levels. All of our interactions illustrate that our members are very comfortable returning to our resorts, and are eager to vacation again, particularly as we enter the spring and summer popular travel seasons.

The normalcy that comes at Diamond Resorts – a living room, kitchen and amenities – is something that our members have identified as a value-add relative to hotels and other more standardized forms of lodging. When combined with our drive-to model and our experiential-driven offerings, we anticipate arrivals and occupancies will continue improving.

We are very encouraged by the pace of the current recovery. Looking ahead, our forward indicators, strong member engagement and proven ability of our teams to execute leave us well positioned to capitalize on the continued strengthening of the economy. Thus, we maintain a very positive outlook for leisure travel and our business.

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I will now turn the call over to Jim Mikolaichik, our Chief Financial Officer, for a review of our financial performance. Jim?

Jim Mikolaichik – Chief Financial Officer

Thank you, Mike, and good morning everyone.

My comments today should be taken in conjunction with the 2021 first quarter Earnings Summary and quarterly statement that was posted this morning.

Please see the Earnings Summary and quarterly statement for reconciliations between our GAAP as Reported and Pro Forma presentation.

On this call, and for comparison purposes, I will predominantly discuss our Pro Forma revenue and Pro Forma Adjusted EBITDA as governed by our Senior Credit Facility.

[First quarter pro forma revenue of \\$247 million decreased year over year by \\$47 million, or 16 percent.](#)

Contract sales decreased by \$37 million and reportability was \$19 million unfavorable, partially offset by \$27 million in favorable loan loss provision.

Management and Member Services revenue decreased by \$8 million, consumer finance interest decreased by \$4 million, and other revenue decreased by \$6 million.

[First quarter Pro Forma Adjusted EBITDA decreased year over year by \\$13 million, or 16 percent.](#)

This was primarily attributable to a decrease of \$20 million in our Vacation Interest Sales and Financing segment, partially offset by a \$3 million improvement in our HAMS segment as well as \$5 million in favorable Corporate and Other expenses as a result of our continued focus on cost discipline.

[I'll now address our segment results in more detail, starting with VOI and Consumer Finance.](#)

Net vacation interest sales decreased by \$28 million, driven by contract sales of \$138 million, a decrease of 22 percent.

Proforma adjusted EBITDA for VOI & Consumer Finance decreased by 35 percent to \$36 million, driven by a decrease of \$63 million in vacation interest revenues coupled with a \$9 million increase in Vacation Interest Carrying Costs, or VICC. The decrease was partially offset by three items:

- First, a \$1 million increase in our net Consumer Finance Interest margin
- Second, \$24 million in favorable Advertising, Sales and Marketing expense
- And third, \$27 million in favorable Loan Loss Provision

And as Mike mentioned in his remarks, we are seeing a steady rebound in our sales following some softness in December and January that were the result of government mandated shutdowns and other restrictions. This sequential improvement is fueled by increasing tours coupled with VPGs that continue to be at record levels, despite residual limitations in our Diamond Dream Holiday channel and a gradual focus shift back to new member business.

Turning now to Hospitality and Management Services, or HAMS

Hospitality and Management Services proforma-adjusted revenue decreased by 8 percent to \$102 million.

And proforma-adjusted EBITDA for the HAMS segment increased by 5 percent to \$57 million.

I'll now discuss our Balance Sheet and Free Cash Flow

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Total liquidity as of March 31, 2021 was \$374 million, including \$187 million of unrestricted cash and \$157 million of unpledged receivables, assuming an advance rate ranging from 80 to 86 percent.

Total net debt during the quarter increased to \$1.8 billion during Q1 compared to \$1.7 billion in Q4.

Our net debt leverage ratio was 8.3x last 12 months proforma adjusted EBITDA, or 7.6x including the benefit of unpledged receivables. This compares to 7.7x and 7.1x, respectively, at the end of Q4.

At the end of the first quarter, we had \$541 million of total undrawn warehouse capacity to support the monetization of current and future consumer loans and were undrawn on our corporate revolver.

Excluding non-recurring expenses, adjusted free cash flow was \$46 million, compared to \$128 million in Q1 of 2020.

And with that, I'll now turn the call over to the operator for questions. Lori?

Operator Instructions

Thank you. At this time I would like to remind everyone that if you would like to ask a question please press *, then the number 1, on your telephone keypad. If your question has been answered and you wish to remove yourself from the queue, please press the pound key. Once again, if you would like to ask a question, please press *1. We'll pause for just a moment to compile the Q&A roster.

Once again, if you would like to ask a question, please press *1. Your first question comes from the line of Chris Gaines of Signal Peak.

Chris Gaines, Signal Peak

Hey guys can you hear me ok?

Mike Flaskey, Chief Executive Officer, Diamond Resorts

We do

Jim Mikolaichik, Chief Financial Officer, Diamond Resorts

Sure can.

Chris Gaines, Signal Peak

Fantastic. Thanks for having the call. I've just got a quick one here. You broke up, Mike, during your prepared remarks and I was just wondering, could you just repeat what you were saying about the new member mix? There was a little section there, a couple of sentences, where it was like "new member mix" and kind of what your average transaction size is. Is there a way you could just repeat that for me real quick? I just missed that.

Mike Flaskey, Chief Executive Officer, Diamond Resorts

Yeah, happy to do that, Chris. For Q1 we had a mix on a transaction basis of about 36.5 percent of our overall sales were to new members. That trend has continued to go north as we move into April, that number is actually closer to 38 percent and we're very very pleased with the VPG and the close rates. The close rates have maintained themselves in the 12.5 percent range, and the average transaction sizes are in and around \$16,000 to \$17,000 on the new member. So our short term 10-year product has really moved the needle for us to capitalize on improving on our new member business.

Chris Gaines, Signal Peak

Great. And then do you have any sales centers that are closed right now or are they all open?

Mike Flaskey, Chief Executive Officer, Diamond Resorts

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We are 100 percent open in North America. We shut down most of our sales centers in Europe last year so the answer to the question is we are all open

Chris Gaines, Signal Peak

Ok got it. I don't know if you can give color but we're approaching the end of school here, and getting to summertime, do you have any high-level color on what booking trends and occupancy trends kind of look like as we get into the busy season?

Mike Fliskey, Chief Executive Officer, Diamond Resorts

Sure. What I can tell you is for seven weeks in a row now at our resorts our occupancy levels have been at or above 2019 levels. And we have had record number of calls coming into our booking centers for people booking in the summer and out into the fourth quarter. When we look at our bookings, our bookings are actually running about 25 percent ahead of 2019 bookings as we look at what we have coming in the pipe.

I can also tell you, because we alluded to it in the prepared remarks, from a VOI sales standpoint we are actually through 29 days in April we are at 102 percent of 2019. So all of our indicators are pointing very positive that we are working ourselves nicely out of this pandemic as it relates to leisure travel and we are extremely optimistic as I said in my remarks as we move into Q3 and q4. The recovery has been robust.

Chris Gaines, Signal Peak

Great. Thanks for your time, guys, I appreciate it.

Mike Fliskey, Chief Executive Officer, Diamond Resorts

You're welcome.

Operator

Once again if you would like to ask a question, please press * then the number 1 on your telephone keypad. Your next question comes from Richard Schoenfeld of KKR.

Richard Schoenfeld, KKR

Hi good morning guys thanks for taking the question.

Jim Mikolaichik, Chief Financial Officer, Diamond Resorts

Good morning.

Mike Fliskey, Chief Executive Officer, Diamond Resorts

Good morning.

Richard Schoenfeld, KKR

Was hoping you could comment a bit on performance and the ramp in VOI sales that you're seeing in April by market. I'd be particularly curious as to how Vegas and Orlando are tracking. Thanks very much.

Mike Fliskey, Chief Executive Officer, Diamond Resorts

Yes sure, happy to do it Richard. This is Mike.

Well we're start with what you asked for. We have seen a robust recovery in Las Vegas and we've seen a robust recovery in Orlando. Both markets are tracking over 100 percent of budget and over 100 percent of 2019 April levels. As I indicated on the question prior, for seven weeks in a row now, we have seen continual ramp on the arrivals that put us ahead on an aggregated basis of 2019, and I can tell you over

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the last 4 weeks that has been the case as it relates to the 2 markets that you asked relative to Las Vegas and Orlando.

I also want to point out that we are seeing and have seen an extremely strong recovery in the Virginia market, which is a big market for us, the mid-Atlantic, that is a drive-to market and one of the first that has bounced back and has continued a northward trajectory.

The southwest – Arizona, Sedona, Scottsdale, over 100 percent of what we saw for April in 2019, both in the arrival front and the VPG front.

And surprisingly, really really happy to report Hawaii. Most of our, really all, of our Diamond customers that go to the islands of Hawaii are North American customers and they are traveling back now at record numbers and as of yesterday we were about 95 percent of our budget in Hawaii and we are slowly approaching 2019 levels there as well. We are not quite at 2019 levels in the Hawaii market but we're incredibly optimistic with the bookings and where we see sales going in the Hawaiian islands.

Jim Mikolaichik, Chief Financial Officer, Diamond Resorts

And one other thing I'd add, Mike, too, just to top it off, the other encouraging aspect to this is a lot of this comes without full force on Diamond Dream Holiday trips and our Events of a Lifetime being up and running at full force. So we still have I think more wind at our back as the pent up demand with people not traveling and us not being able to do events coming through the end of last year really starting into this year, I think also should continue to propel us forward. So, it's very encouraging that we're getting these results without a couple of the important tools.

Mike Flaskey, Chief Executive Officer, Diamond Resorts

I was just going to add one last significant soundbite that I believe is important and that is our volume per guest which is they key metric that we use on the VOI sales side to kind of measure everything as it culminates is in the mid-\$4,800 range, \$4,850 net-net of recissions through 29 days of April. That just like we reported in the first quarter is by far a company record. So, all positive.

Richard Schoenfeld, KKR

That's great to hear. And I guess, the only other question I had, I saw that you all completed a securitization earlier this month. Would love just if there's any commentary that you can offer on that. It looked like the advanced rate was a little bit lower and I guess some color I'd heard is that that's driven by S&P's methodology at the moment being a little bit more conservative, but any color there would be helpful as well.

Jim Mikolaichik, Chief Financial Officer, Diamond Resorts

Yeah, hey it's Jim. The advance rate was lower probably than historical, but it was actually in excess of what we went into the market expecting. We expected to come in maybe around the 90 percent range, we ended up at 94 percent, which we thought was a really good print. We did have a little bit of headwind from S&P's remarks, I think they are still very cautious I think in how they're doing their ratings, but we got 4 percent above what we were expecting, and we had about 100 basis points better on the interest rate side. We were expecting over 3 percent and we printed about 2.17 or 2.18 percent. So, we thought it was a great print overall and we're very happy with the execution.

Richard Schoenfeld, KKR

Perfect well congrats on the great performance guys. Thank you.

Jim Mikolaichik, Chief Financial Officer, Diamond Resorts

Thank you.

Operator

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Thank you. At this time I would like to return the call to management for any closing remarks.

Mike Flaskey, Chief Executive Officer, Diamond Resorts

Thank you, operator, and thank you everyone for attending our 2021 earnings call today we appreciate that. We are very pleased with the results and we continue to be very optimistic about the recovery as you've heard throughout the call. And we look forward to speaking with you in July to report our Q2 2021 results. Have a great day.

Operator

Thank you. That does conclude the Diamond Resorts first quarter 2021 earnings conference call, you may now disconnect.