Hilton Grand Vacations: GARP Investors Should Take A Serious Look

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Apr. 24, 2017 8:12 AM ET About: Hilton Grand Vacations Inc. (HGV), Includes: HLT

Long/short equity, contrarian, medium-term horizon, long-term horizon

Summary

As a newly independent company, Hilton Grand Vacations is poised to accelerate its growth going forward.

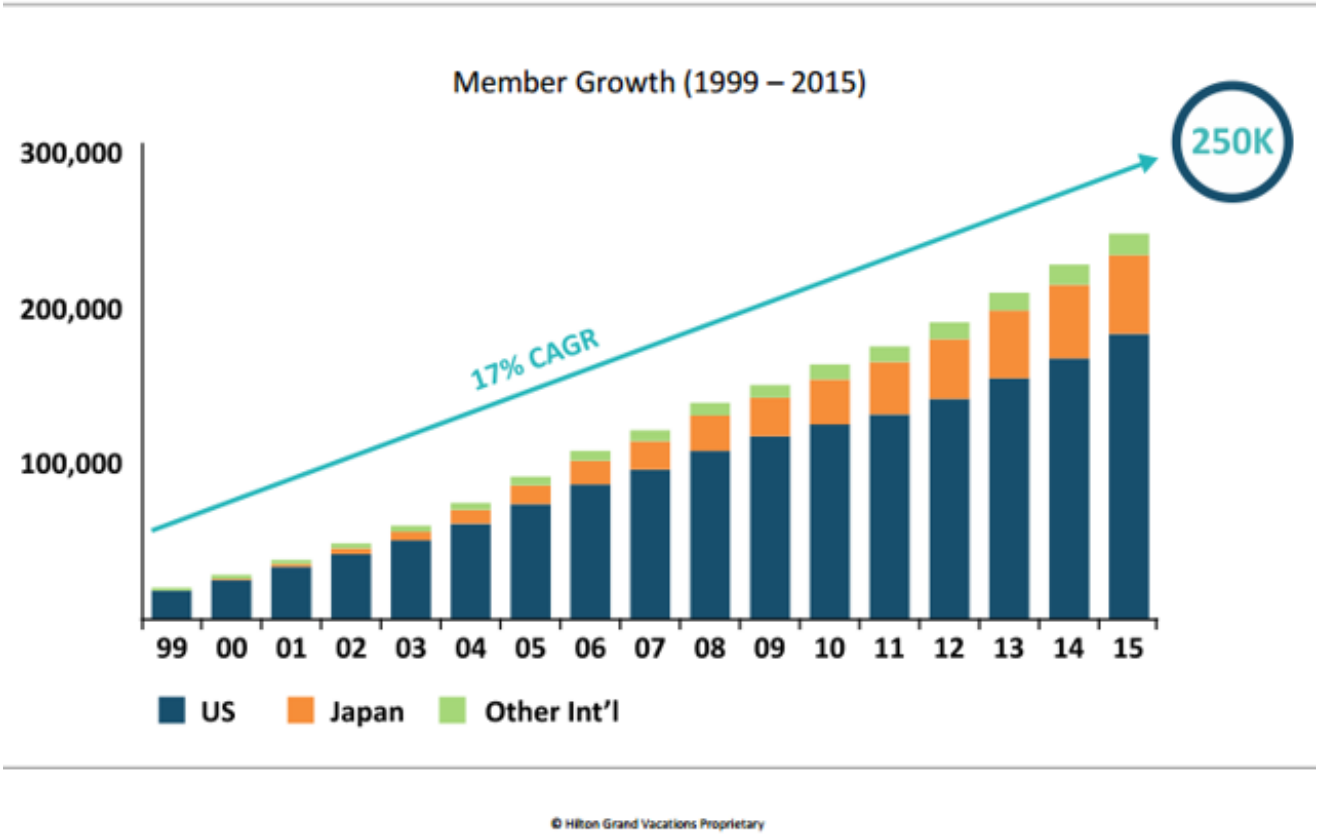
Growth is being fueled by economic tailwinds and its continued relationship with Hilton Worldwide.

Best in class growth, capital efficiency and operating performance make the stock extremely attractive to growth investors.

When Hilton Grand Vacations (NYSE:HGV) spun off from Hilton Worldwide (NYSE:HLT) in early January it finally lost its shackles - allowing it to now act in the best interest of its business and its business only. When HGV was part of HLT, it had to compete for capital, investment and management attention with the hotel chain. On HGV's first earnings call, the CEO and CFO specifically called out the underinvestment in the business the past few years and their intention to reinvest all of the company's free-cash-flow back into the company for at least the next few years. This is great news for HGV investors as the company is the leading time share brand in the U.S. - besting its competitors by a country mile in many key metrics (more on this later). Reinvesting its earnings back into the business will only lengthen this lead. Let's take a look at how HGV is performing and what is allowing it to outperform its peers.

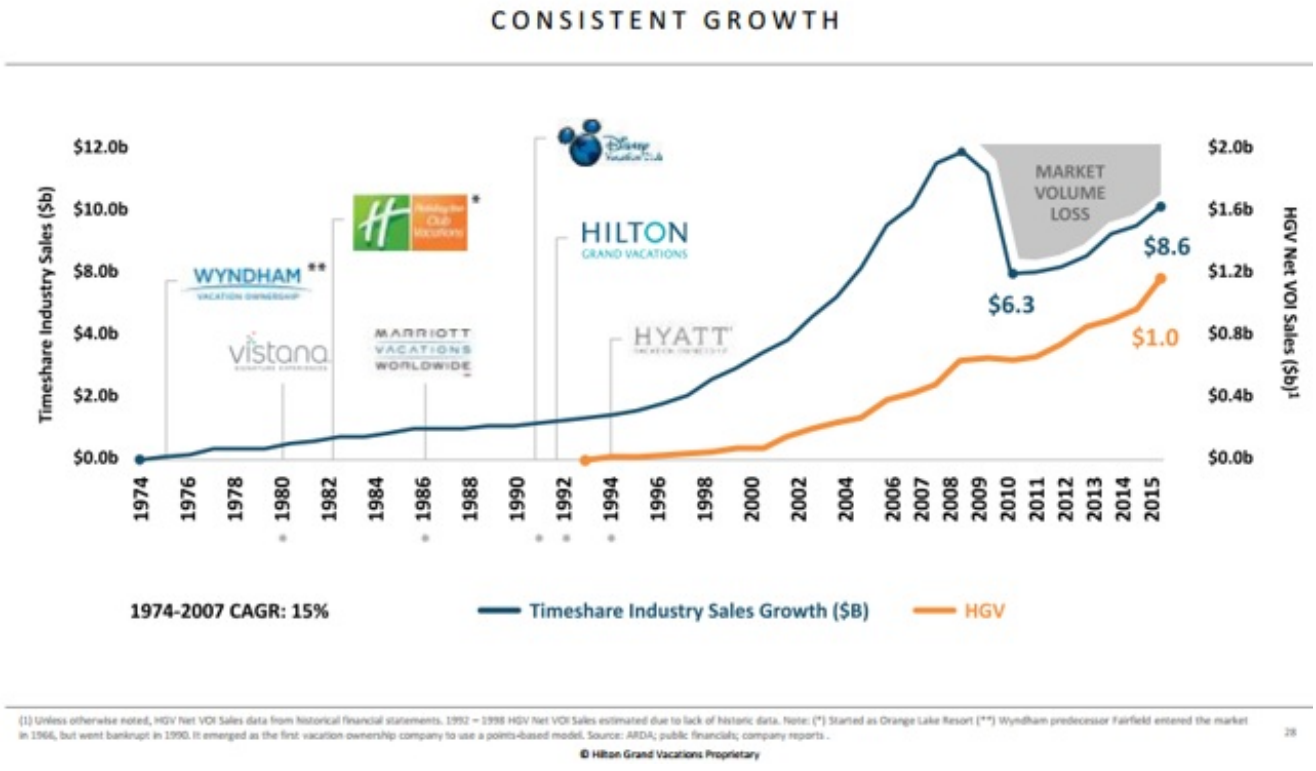
Key Business Metrics

The most impressive statistic that HGV can point to over the last decade is Net Owner Growth (NYSEMKT:NOG). One would think that a cyclical business like timeshare sales would have gotten slammed during the financial crisis, with a significant loss of owners in 2008-09. That was not the case for HGV. It has managed to grow NOG every year for the past 18 years, including during the financial crisis.



Source: HGV Corporate Presentation

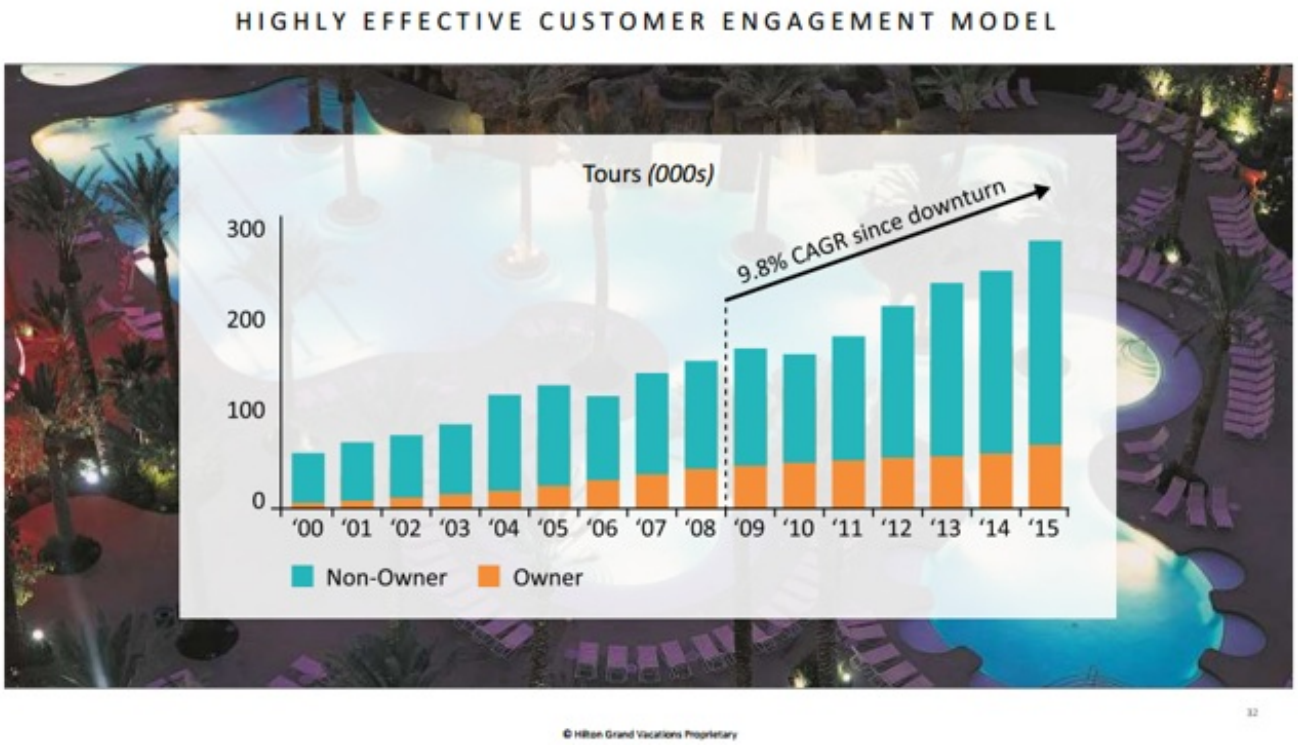
The competition did not fare so well during the great recession.



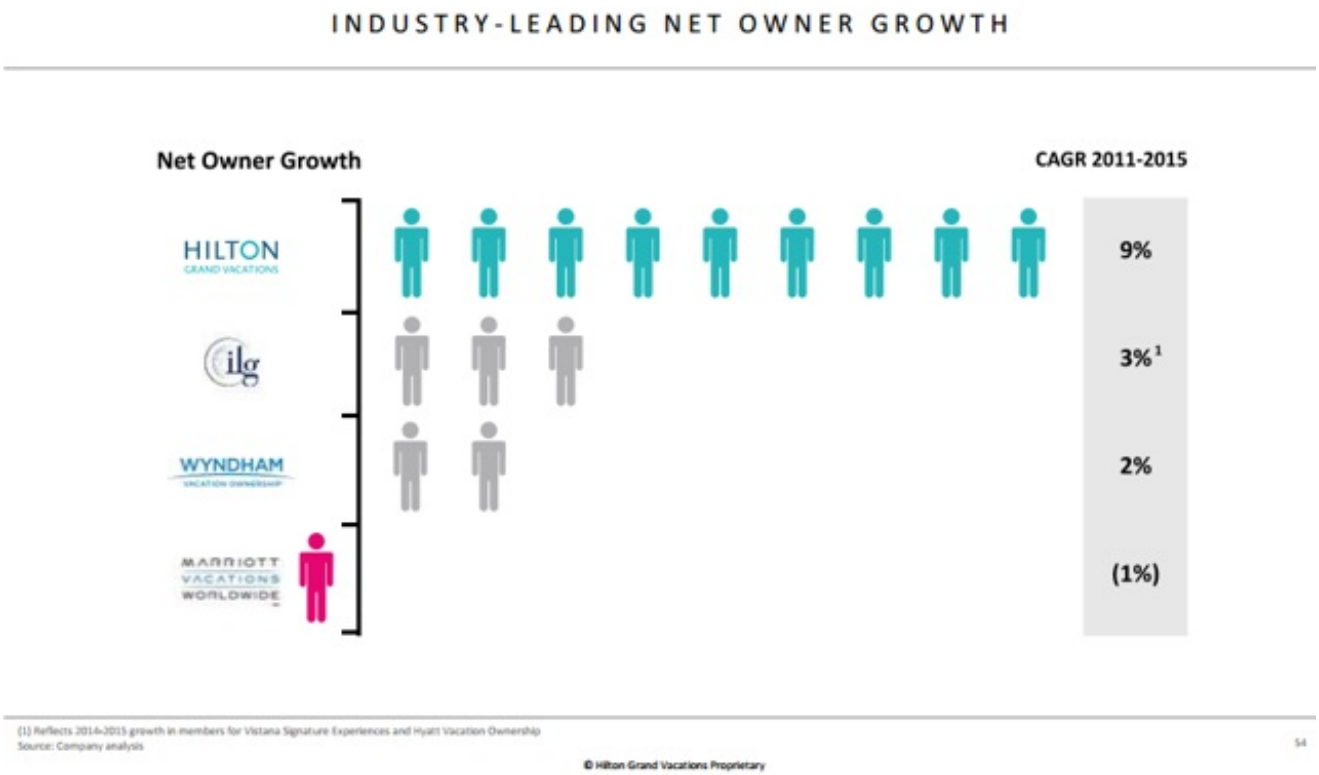
Here you can see just how poorly the industry overall performed during that period. So how did HGV manage to outpace the industry over the last decade? It turns out there are many reasons for HGV's success. Let's take a look at several of them.

First, HGV greatly benefits from both the Hilton Brand and its relationship with HLT, even after the spin-off. HLT created a very successful loyalty program, Hilton Honors. Through a combination of smart marketing and the latest technology, Hilton has created a very powerful loyalty program, with over 58M members. HGV has access to those members for marketing opportunities. I recently stayed in a Hampton Inn and joined the Hilton Honors program. A few weeks later I received a call from HGV offering me an opportunity to stay in one of its Orlando Resorts for 3 nights for only $100 (I talked them down from $150). I just happened to be headed to Orlando soon, so I said sure I will try it out. I was able to book a stay at Parc Soleil in Orlando. The rub was that I had to sit through a two hour sales presentation for a timeshare unit. Long story short I did not end up buying a timeshare, however I did come away from the process quite impressed with both the value proposition and the company as a whole. The resort I stayed in was top notch. From the rooms, to the amenities, to the service - I enjoyed all of it and would certainly consider buying a timeshare from HGV in the future.

I was told that 25% of the people that come through the sales pitch at that resort end up making a purchase. I believe it. The diverse set of luxury properties and partners offer tremendous value. The same sales pitch/tour I received is repeated hundreds of thousands of times a year at HGV.



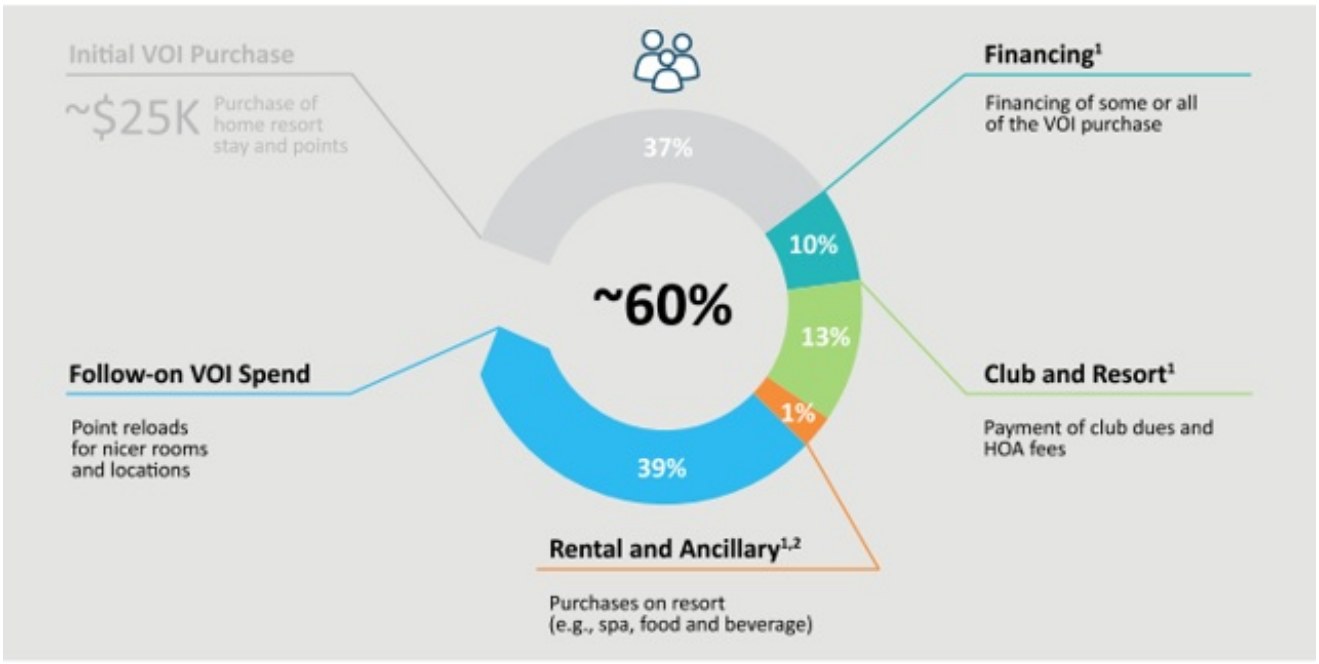
The fact that HGV still has access to HLT's customer data after the spin-off is incredibly powerful. This is a huge source of tour flow for the company. It is able to curate a list of potential owners that provide a very high success rate.



This has led to HGV outpacing its nearest competitor in NOG by a 3 to 1 margin. Its members are affluent, have good credit, love travel and adventure, and span generations.

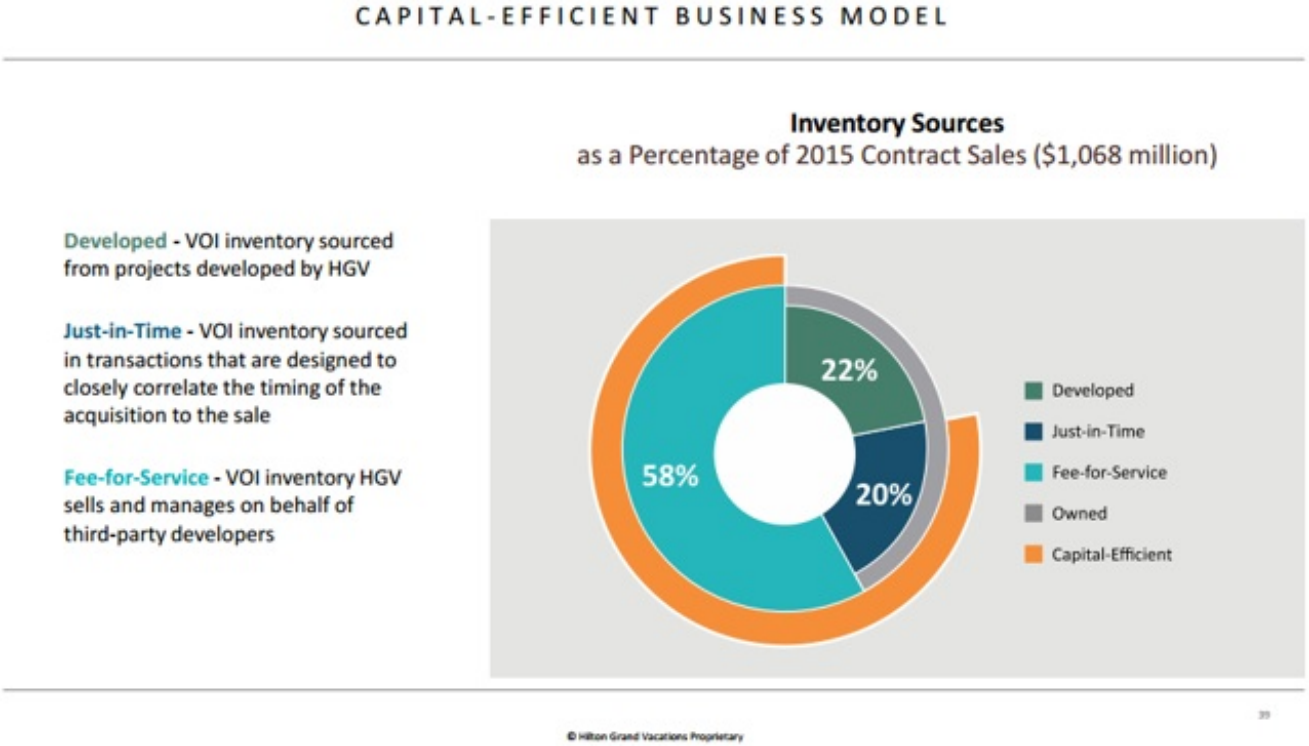


The proof of HGV's success lines in its satisfied owners. Anecdotally, I spoke with several owners at the pool during my visit. Each one had nothing but good things to say about HGV. One gentleman had been an owner at other national competitors and could say hands down that HGV was the best.

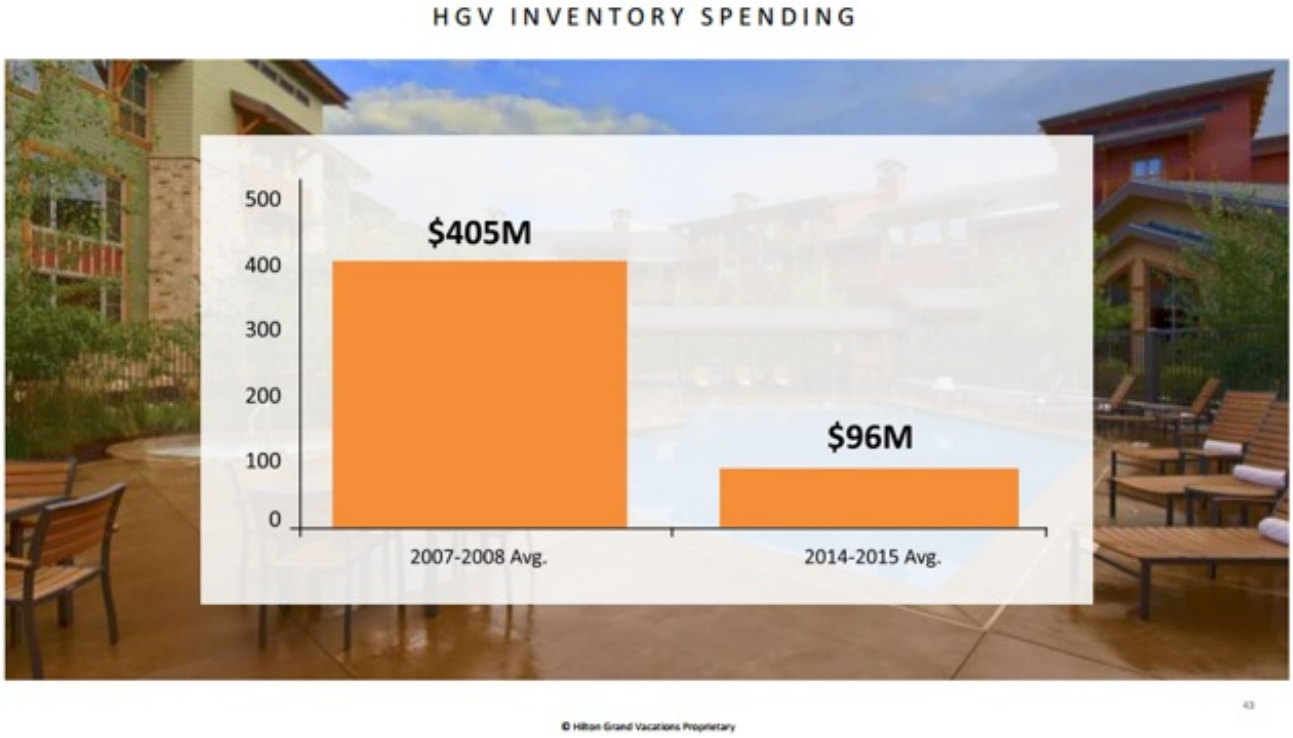


The above graphic is very powerful. Existing owners buying additional points for longer stays, high season travel or larger suites represents a very healthy 39% of a customer's lifetime value to HGV. That shows just how loyal and happy the company's customers are with the value they are receiving.

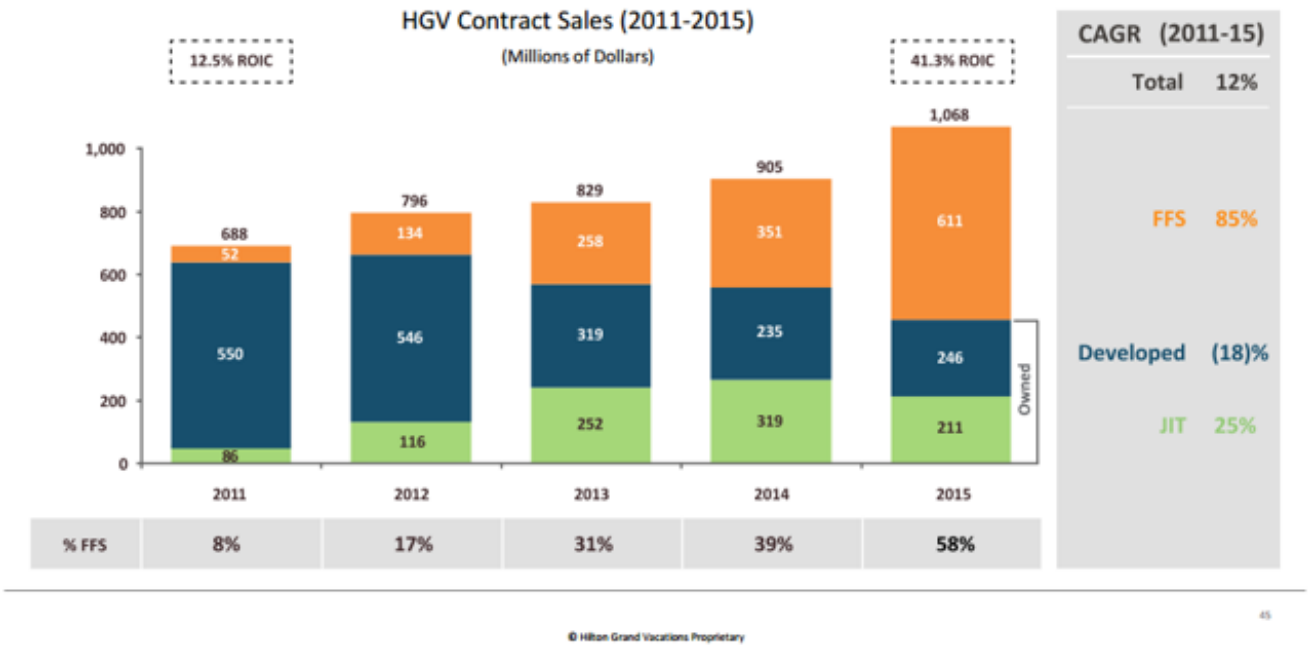
Capital Efficient Business Model



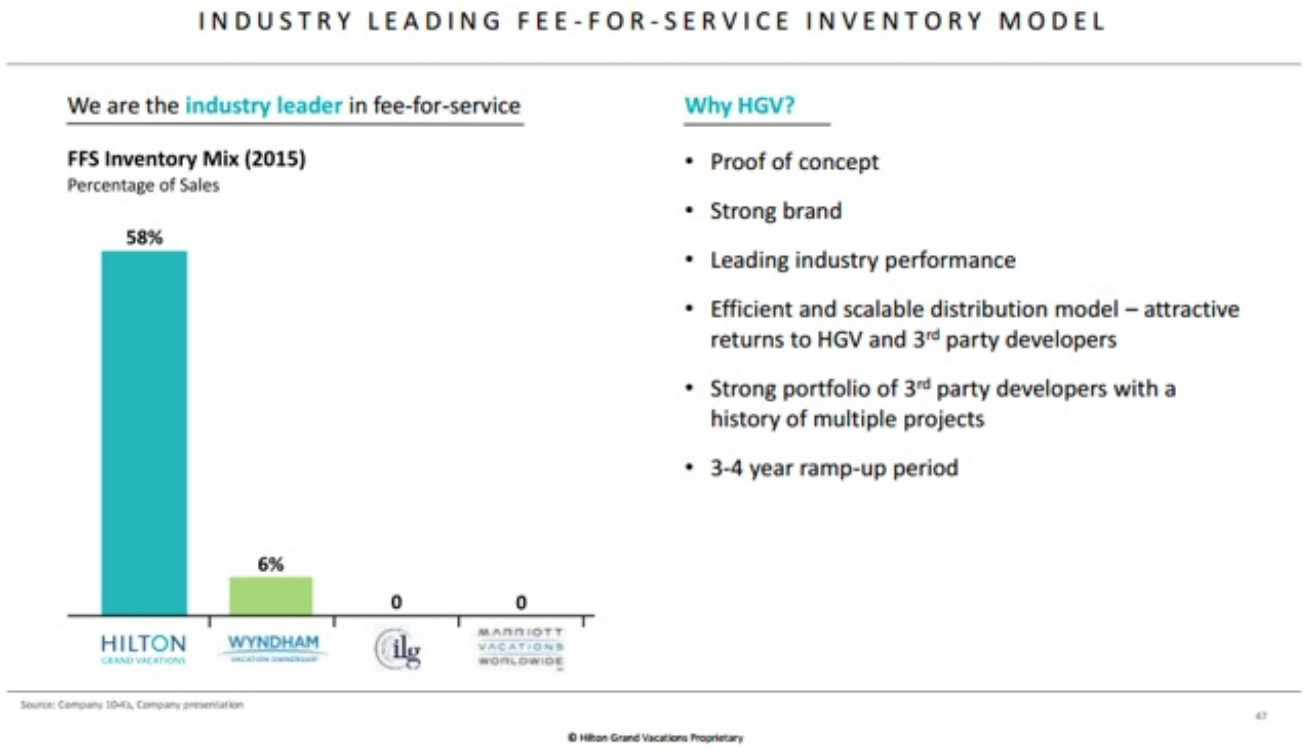
Similar to its former parent company HLT, HGV has the vast majority of its inventory under development coming from highly capital efficient sources. 58% of its inventory sold in 2015 was developed and funded by third-party partners. This means that HGV did not have to use its own capital to develop the property. It simply operates under a fee-for-service model for those properties. It sells the inventory and manages the property for fee income. Another 20% of its inventory is just-in-time - meaning it only takes ownership of units right before they are sold - a third-party develops the units and takes the development risk. Only 22% of units sold in 2015 required HGV capital.



This is a relatively new phenomenon. Pre-financial crisis HGV was tying up a lot of capital in development. Since then inventory spend has dropped by three-quarters, allowing the company to generate a very high Return on Invested Capital (NASDAQ:ROIC).



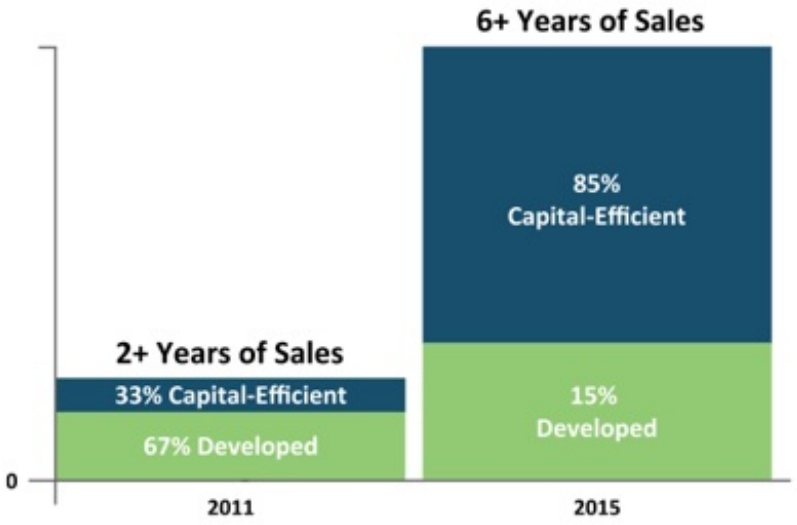
Apparently HGV's competitors have not yet discovered this capital light business model.



HGV's business model allows it to efficiently grow at a much faster rate.

HGV INVENTORY POSITION

We have **dramatically increased inventory**, 81% capital-efficient as of 9/30/16[1]

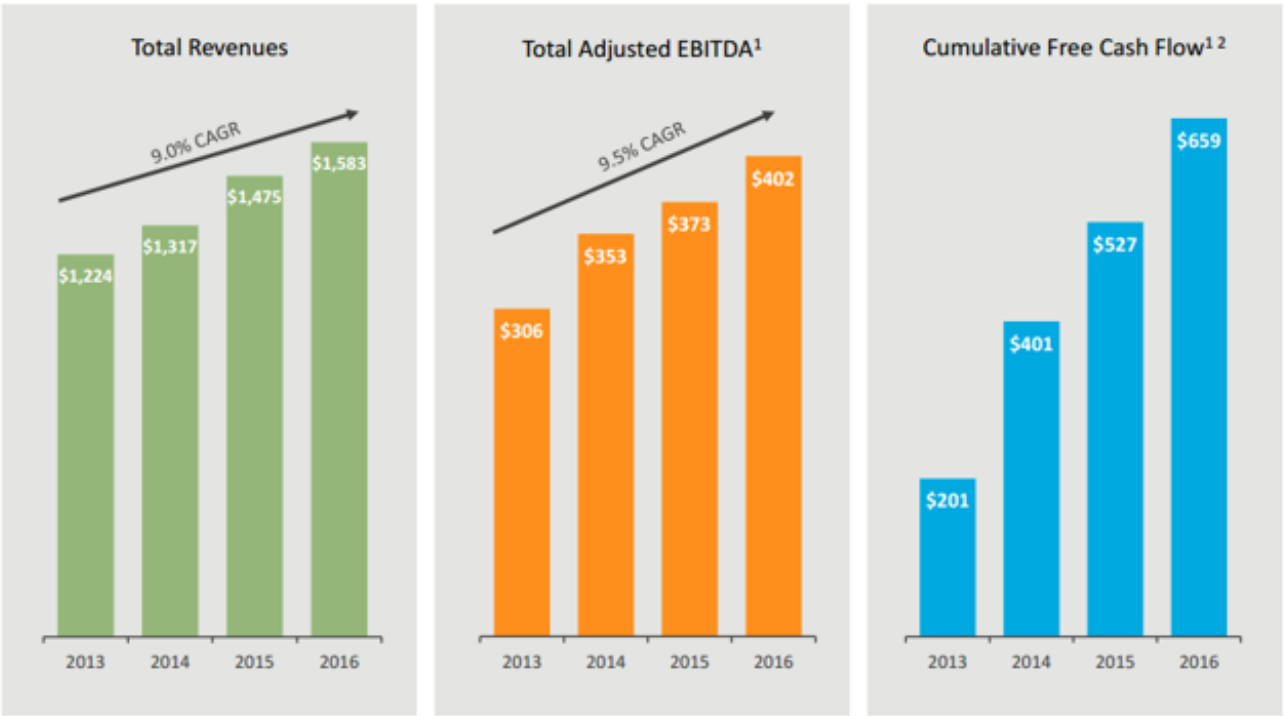


(1) As of September 30, 2016, supply of inventory equaled 5.5+ years of sales up from 2.7 years in 2011
Source: Company 10-Ks, Company presentation

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Financials/Valuation

REVENUE, ADJUSTED EBITDA AND FREE CASH FLOW



(1) See appendix for a reconciliation of Adjusted EBITDA and Free Cash Flow.
(2) Free cash flow calculated as cash flow from operations (adjusted for non-cash stock compensation) less non-inventory capex.

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Over the last four years HGV is compounding revenues and adj. EBITDA near double digits thanks to 8% member growth and 12% contract sales growth. The company is levered less than 1x, net. It is committed to reinvesting its FCF for the next few years back into the business to drive growth. Given the company's past success, proven ability to grow NOG throughout the cycle, the continued relationship with HLT, and current economic tailwinds, today's valuation of 17.3x (lower than the current S&P forward multiple of 18.25x) at the midpoint of this is year's EPS guidance seems quite reasonable. The company expects to maintain high single digit growth in EPS for the next three years. If you believe the company's past success will continue, the stock looks quite reasonable priced today for the long term growth investor. Shares could rise between 25-30% over the next three years if the stock continues to trade at this earnings multiple and expectations for growth are maintained.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

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