PARTICIPANTS

Corporate Participants

Christian Charnaux – SVP, Investor Relations, Hilton Worldwide Holdings, Inc.
Christopher J. Nassetta – President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.
Kevin J. Jacobs – Chief Financial Officer & Executive Vice President, Hilton Worldwide Holdings, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone. Thank you for standing by. This is the conference operator and we apologize for the technical difficulties in this call getting started. We would like to welcome you to the Hilton Worldwide Holdings Second Quarter 2016 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Christian Charnaux, Senior Vice President of Investor Relations. Please go ahead, sir.

Christian Charnaux, SVP, Investor Relations

Thank you, Denise, and again our apologies for the technical issues with our conference call provider this morning. Welcome to the Hilton's second quarter 2016 earnings call.

Before we begin, we would like to remind you that our discussions this morning will include forward-looking statements. Actual results could differ materially from those indicated in the forward-looking statements. And forward-looking statements made today are effective only as of today. We undertake no obligation to publicly update or revise these statements.

For a discussion of some of the factors that could cause actual results to differ, please see the Risk Factors section of our most recently filed Form 10-K. In addition, we will refer to certain non-GAAP financial measures on this call. You can find reconciliations of non-GAAP to GAAP financial measures discussed in today's call in our earnings press release and on our website at www.hiltonworldwide.com.

This morning, Chris Nassetta, our President and Chief Executive Officer, will provide an overview of the current operating environment and the company's outlook. Kevin Jacobs, our Executive Vice President and Chief Financial Officer, will then review our second quarter results and provide details on our expectations for the remainder of the year. Following their remarks, we will be available to respond to your questions.

With that, I'm pleased to turn the call over to Chris.

Christopher J. Nassetta, President, Chief Executive Officer & Director

Thank you, Christian, and thanks, everyone, for joining us today. Sorry for the delay in getting started. Continued disciplined execution of our strategy and a clear focus on delivering long-term value for shareholders has resulted in another solid quarter results for the company with adjusted EBITDA towards the high end of our guidance range and our global share of development activity increasing.

First, let's talk more specifically about second quarter results. Our system-wide comparable RevPAR growth for the quarter was 2.9% on a currency-neutral basis primarily driven by rate gains. Top line growth improved quarter-over-quarter, but a softer macro environment continued to weigh on performance particularly on corporate transient growth.

Overall transient revenue grew 2.1% system-wide in the quarter with weakness in corporate as noted, but supported by continued strength in leisure business. We continue to see positive trends in Group revenue which increased 4.9% in the quarter, and Group remains on track to deliver solid revenue growth for the full year as expected.

We continue to increase our global RevPAR index, gaining market share across all brand segments and all regions during the first half of the year. On top of same-store growth, our performance continues to benefit from accelerating organic net unit growth helping to drive fee growth in the quarter of nearly 9% and to increase our adjusted EBITDA margin by 100 basis points year-over-year.

Looking forward, comps are getting more favorable, and most forecasts indicate strong U.S. job gains in the coming months, and for GDP growth to pick up in the second half of the year. As a result, we do expect growth to pick up.

However, given that system-wide RevPAR growth for the first half of the year was 2.5%, that we continue to see weakness in corporate transient demand, and that uncertainty in regions outside the United States has increased, we're tempering our expectations for the full year. We now expect 2016 comp system-wide RevPAR growth on a currency neutral basis of 2% to 4%, and would highlight that growth above the midpoint would require pickup in corporate transient demand from what we've seen.

Turning to development, we remain on track to add 45,000 to 50,000 net units to our management and franchise system this year, an increase of nearly 7% and a year-over-year growth rate of nearly 11% at the midpoint. We think our system offers the most consistent, high-quality products and services as demonstrated by our industry-leading RevPAR index.

Each of our brands is a segment leader, and not one of our 13 brands is subpar or subscale. We believe this makes us a preferred choice of owners and developers, leading to our rapidly expanding portfolio and pipeline and to our disproportionate share of global growth.

In the U.S., for example, Hilton accounts for nearly 25% of U.S. rooms under construction, well above our 11% U.S. market share. We expect net unit growth of over 6% for our U.S. managed and franchised portfolio in 2016, which is more than three times greater than forecasted U.S. supply growth.

Our growth story is also compelling, because it typically lags the broader economic cycle. Our lowest level of net unit growth in the last down cycle occurred in 2010 with growth of 3.6%. That was with a total freezing of the capital markets and without the benefit of our international growth strategies and new brand launches. To add a little bit of color to that, 45% of our growing pipeline and nearly 30% of our net unit growth over the last five years has been from the layering of existing brands internationally and from new brands like Curio and Home2.

We're particularly proud of our new brands and believe we lead the industry in organically creating brands that resonate with both guests and owners alike, successfully bringing incremental growth platforms to market at essentially infinite returns on invested capital.

With Home2, we celebrated our 100th opening last week in La Crosse, Wisconsin. Only 13 months ago, we celebrated our 50th opening. Only five years after its launch, Home2 is now the third largest hotel brand under development in the United States with over 150 signings in the last 12 months and 340 hotels in the pipeline. That's over 40,000 Home2 rooms open or in the pipeline, which we believe is an industry record ramp-up for a new brand since the launch of Hampton, a record that will likely not last very long thanks to our latest brand, Tru by Hilton.

Tru continues to exceed even our most optimistic growth expectations, and we expect Tru to be our largest brand over time. Just launched in quarter one, as of today, there are 120 Tru hotels in the pipeline totaling over 11,000 rooms, with another 200 hotels or over 18,000 rooms in process. In the quarter, we averaged five Tru approvals per week and we're just getting started opening up deals to owners outside of our system. We expect the first Tru to open early next year.

This month, we opened our first Canopy in the heart of Reykjavik, Iceland. The hotel features 112 rooms and suites designed to fit with the culture of its neighborhood along with 24-hour fitness center, complementary bicycles for guest use, artisanal breakfast in the morning, and wine and beer tastings in the evening. Canopy is defining the accessible lifestyle segment, and we currently have 33 Canopys in various stages of development.

The Curio brand launched two years ago, and we have now nearly 90 Curios open or under development. Curio is another growth platform targeting conversions which have been a meaningful and attractive driver of our growth. Since 2010, over 65,000 rooms have joined our system through conversions, representing nearly 1/3 of our total net unit growth. Conversions tend to contribute more to net unit growth during softer operating environments as high-quality independent hotels or hotels in lower performing systems seek the strength and efficiency of our commercial engines. Conversions especially to a soft brand like Curio can move through the pipeline very quickly and enable us to grow our system without growing overall industry capacity.

Our four new brands launched in the last five years are supercharging our growth, and we believe that there are more brand opportunities out there. Our brand teams are hard at work on new potential brands that we plan to bring to market over time.

As for growth year-to-date through Q2, we opened over 21,000 gross rooms or approximately 17,000 net rooms, bringing our system size to nearly 780,000 rooms across more than 4,700 properties, all while continuing to grow our pipeline. Globally year-to-date through Q2, our system averaged one hotel construction start per day and more than two approvals per day. We're on track to surpass 2015's record 100,000 room approvals this year. According to STR, Hilton holds the lead in both U.S. and global pipeline as well as global room supply and rooms under construction.

When we went public, our pipeline was about 28% of our supply. Now, it's close to 38% off of a base that's 15% larger, and we did this with minimal capital investment on our part. Our total pipeline of nearly 300,000 rooms has a total of $126 million of our capital committed to it.

While expanding our geographic and chain scale reach, we're also focused on enhancing our direct relationship with customers. Industry-leading innovation focused on our Hilton Honors Loyalty Club has been at the heart of this strategy, essentially giving our guests an even better experience and value through membership in the Hilton Honors.

Since the launch of preferential Honors pricing in February, the program has generated significant incremental revenue to the system and is meaningfully increasing Honors enrollments and share of system occupancy.

In the quarter, the pace of Honors enrollments was up nearly 80% year-over-year, adding 2.4 million new members for a total membership of over 55 million. Honors' share of occupancy was nearly 56% in the quarter, up over 400 basis points year-over-year.

Guests are also responding by shifting business to our direct channels with revenue growth from our web channels outpacing OTAs by a factor of nearly five in the quarter, and our share of mix meaningfully increasing while OTA share is decreasing. Our fastest-growing channel, the HHonors app, is also our lowest cost channel. The HHonors app now accounts for 23% of all of our direct web traffic, and the pace of HHonors app downloads continues to increase, up 66% year-over-year in the quarter to nearly 1 million downloads, almost doubling our growth rate from Q1.

Lastly, our focus remains on delivering long-term value for shareholders. The pending spins of our timeshare and real estate businesses are the latest and arguably the most complex value creation efforts we've undertaken to date. We filed our initial Form 10 Registration Statements for both Hilton Grand Vacations and Park Hotels & Resorts in early June and filed updated statements earlier this month. We think all three companies will be uniquely positioned to capitalize on value-enhancing opportunities in their respective businesses and to complete the spins by the end of the year.

As the purest large-cap lodging brand company, the new Hilton will have a simpler, highly resilient fee-based business model with significantly lower operating leverage, and therefore, lower bottom line volatility. We expect Hilton's fee business will generate over 90% of its total pro forma adjusted EBITDA, of which more than 90% will come from top line-driven franchise and base management fees.

Incentive management fees, which represent approximately 10% of our fee mix, are also expected to be meaningfully less volatile as the vast majority are structured to pay on the first dollar of profitability and do not sit behind an owner's priority return.

On top of same-store growth driven by a brand portfolio with the highest RevPAR index in the business, we expect continued industry-leading organic net unit growth requiring essentially none of our capital.

In closing, we're optimistic about our growth prospects and are especially optimistic on the value creation opportunity for all three independent companies and think Hilton's portfolio of clearly defined, industry-leading brands and a record 1 million rooms open or in development is uniquely positioned to further drive shareholder value.

With that, I'll now turn the call over to Kevin for further details on the quarter.

Kevin J. Jacobs, Chief Financial Officer & Executive Vice President

Thanks, Chris, and good morning, everyone. On the bottom line, diluted earnings per share adjusted for special items was $0.25 in the quarter, including $0.02 of non-cash drag from FX, driven by volatility caused by the Brexit vote.

Adjusted EBITDA grew 4% to $806 million in the quarter. System-wide adjusted EBITDA margins increased a solid 100 basis points to 42.8% versus the prior period due to fee growth, favorable timeshare sales and cost discipline. Management and franchise fees grew 9% year-over-year to $471 million, in line with expectations.

Our fee segment benefited from especially strong performance in our franchise portfolio, which grew revenue 11% in the quarter due to new unit ramps, solid franchise sales, and a 10 basis-point increase in royalty rates, which increased our effective franchise rate to 4.8%.

New application volume, particularly from Tru, drove better-than-expected franchise sales, which was offset by a slowing pace of change of ownership fees from lower deal activity. In the ownership segment, adjusted EBITDA was $299 million, down 4% in the quarter versus the prior year when adjusted for the sale of the Hilton Sydney.

Ownership RevPAR grew 70 basis points in the quarter pressured by corporate trends and weakness in the U.S. particularly in New York and Chicago, challenges in Europe from a weak London and terror events on the continent, and a strengthening yen which affected business in Japan. Weaker transient was partially offset by solid F&B growth in the quarter particularly from Group-driven business which drove Americas' banqueting revenue up nearly 5% year-over-year.

Ownership segment adjusted EBITDA margins were down 100 basis points for the quarter, but still up 10 basis points for the first half of the year, and we expect adjusted EBITDA ownership margin growth of around 40 basis points for the full year.

Timeshare adjusted EBITDA increased 14% to $98 million in the quarter, driven by higher sales and greater resort operations revenue due to growth in club members and resort fees. Tour flow and net volume per guest each rose more than 6% versus the prior year period which led to sales growth of 13% for the quarter. Third-party developed intervals accounted for 61% of intervals sold in the second quarter and 81% of inventory as of quarter end. At our current sales pace, we have nearly six years of inventory or 132,000 intervals.

Turning to regional performance and outlook, in the U.S., comparable RevPAR grew 2.9% in the quarter. Results were helped by strength in California with our hotels in Los Angeles increasing RevPAR 16%. The Midwest and South Central regions, however, remained under pressure given weakness in Chicago and continued challenges in oil and gas markets such as Houston and New Orleans. We saw continued improvement in the U.S. inbound revenue in the quarter which declined less than 2% year-over-year compared to a 6% decline in Q1 on the same basis, with growth from China, the U.K. and Japan offsetting weakness from Canada and Brazil.

For full year 2016, we forecast U.S. RevPAR growth to be in the low single digits to mid-single digits. In the Americas, outside the U.S., RevPAR rose 2.1% in the quarter, driven by solid 4.3% growth in Canada.

Brazil remained under pressure, given political and economic instability, while Zika virus fears also weighed on regional results, meaningfully affecting leisure demand in Latin America and Puerto Rico. For full year 2016, we expect RevPAR growth in the region to be in the low single-digit to mid-single-digit range, supported by increased travel to Brazil for the Olympics against declines in the back half of last year.

RevPAR in Europe increased 1.3% in the quarter, as geopolitical concerns and terrorist attacks led to declines in travels to Turkey and Belgium and soft corporate transient demand weighed on performance in London. Pockets of strength included Germany and the Netherlands, where RevPAR increased 9% and 6%, respectively, giving good Group business and strong rate gains.

Going forward, we expect Brexit and other recent events in Europe to increase uncertainty and potentially hurt demand across the broader region. For full year 2016, we expect low single-digit RevPAR growth for the European region.

The Middle East and Africa regions grew RevPAR 8.1% in the quarter, largely driven by the earlier timing of Ramadan. Egypt, however, continued to struggle with weak leisure demand due to regional instability. We are forecasting a low-single-digit decline in full year 2016 RevPAR in the region.

In the Asia Pacific region, RevPAR increased 3.6% in the quarter. Disruption from earthquakes and broader weakness in transient business slowed performance in Japan, but RevPAR growth in China finished nearly 4% ahead of the prior year period, as strong ramps of new hotel openings continued to drive results. We also saw strength in Thailand as positive momentum over the last few quarters continued. We expect RevPAR growth in the Asia Pacific region to increase in the mid-single digits for the full year with RevPAR in China up 5% to 6%.

Moving on to capital allocation, during the quarter, we paid a quarterly cash dividend of $0.07 per share, bringing year-to-date cash dividends to $138 million. Our board has authorized a quarterly cash dividend of $0.07 per share to be paid in the third quarter of 2016.

Although, we expect the spins to increase our leverage modestly in the near-term, we remain focused on achieving an investment-grade credit rating. We also expect increased cash flow generation given Hilton's simplified business model and the tax efficiency of the spun REIT, which should drive greater capital return to shareholders. We remain committed to initiating a share repurchase program at Hilton post spins.

As Chris mentioned, we are lowering our full year 2016 system-wide RevPAR guidance to 2% to 4% given performance to-date and weakness in corporate transient demand and are reducing our ownership RevPAR growth guidance to 1% to 3% on the same basis. This reduction will flow through to lower our full year adjusted EBITDA and diluted EPS after special items guidance ranges which are now $2.98 billion to $3.04 billion (sic) [$980 million to $3,040 million] and $0.87 to $0.91, respectively.

As with prior guidance, please note that these full year ranges do not incorporate the impact of our intended real estate and timeshare spins. For the third quarter of 2016, we expect 2% to 4% system-wide RevPAR growth supported by continued strength in Group business and a favorable holiday calendar in September. We expect adjusted EBITDA of between $760 million and $780 million and diluted EPS adjusted for special items of $0.21 to $0.23.

Further details on our second quarter results and updated guidance can be found in the earnings release we published earlier this morning, including updates to the 2016 pro forma adjusted EBITDA estimates for Park, HGV, and Hilton standalone.

This completes our prepared remarks. We would now like to open the line for any questions you might have.

Christian Charnaux, SVP, Investor Relations

Actually, it's Christian here again. Due to ongoing issues that we're having with our conference call provider, apparently we're unable to do Q&A at this time. Our plan right now is putting out a press release where we can reconvene later today and complete the Q&A component of the call. Again, our sincere apologies on this, and we look forward to continue the conversation a little bit later today. Thank you all.

Operator: Ladies and gentlemen, the conference has now concluded. Thank you for attending the presentation. We look forward to reconvening later today. You may disconnect your lines at this time.