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Wyndham Hotels & Resorts, Inc. (WH)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Wyndham Hotels & Resorts Second Quarter 2018 Earnings Conference Call. 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. [Operator Instructions]

I would now like to turn the call over to Matt Capuzzi, Vice President of Investor Relations. Please go ahead.

Matt Capuzzi

Vice President, Investor Relations, Wyndham Hotels & Resorts, Inc.

Good morning, and thank you for joining us. With me today are Geoff Ballotti, our CEO, and David Wyshner, our CFO. Before we get started, I want to remind you that our remarks today contain forward-looking statements. These statements are subject to risk factors that may cause our actual results to differ materially from those expressed or implied. These risk factors are discussed in detail in our Form 10 and other filings with the SEC.

We will also be referring to a number of non-GAAP measures, corresponding GAAP measures, and a reconciliation of non-GAAP measures to GAAP metrics are provided in our earnings release, which is available on our Investor Relations website at www.investor.wyndhamhotels.com.

Consistent with the information that we share with you in May, our further adjusted metrics reflect what our results would have looked like if we had completed our spin-off and the acquisition and integration of La Quinta on January 1.

With that, I'd like to turn the call over to Geoff.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Thanks, Matt. Good morning, and thanks, everyone, for joining us today on Wyndham Hotels & Resorts first earnings call as an independent public company. Before getting into the quarter, we'd like to recognize and sincerely thank our over 16,000 team members who have been working harder than ever to deliver the results we announced this morning. It's been a very exciting time for us since spinning off two months ago, and we couldn't be more excited about what we've been able to achieve and for the opportunities that lie ahead.

We reported a solid second quarter in line with our guidance with adjusted EBITDA of \$125 million and further adjusted EBITDA of \$159 million. Our system size grew 12%. And excluding the acquisition of La Quinta and the sale of Knights Inn, our system size grew 3%, as our RevPAR increased 4% in constant currency. David, in a moment, will discuss our financial results in much more detail.

From a strategic perspective, we announced that we would be extending the by Wyndham endorsement to all of our brands in over 7,000 hotels worldwide that we completed our nearly \$2 billion acquisition of La Quinta and that we completed our spin-off from Wyndham Worldwide. It's been a very busy and very productive 13 weeks.

Today we'd like to talk about Wyndham Hotels & Resorts' identity and what we do best about some of the principal messages we've been out sharing with investors and all of you and about the progress we've made on several key initiatives. Here's how we like to think about our business. We franchised more hotels than any other company in the world, and we are the market leader in both the economy and the mid-scale segments of the global lodging industry.

We license our 20 well-known brands to hotel owners in virtually every market at a range of price points. And in doing so, we help them attract 0.5 million guests to our hotels each and every night. More than a third of our rooms are outside of the United States and nearly 20% of our royalty fees come from international properties.

Going forward, we see significant opportunities to continue to grow our business, both organically and through acquisitions, both in the United States and internationally. Our focus is not only on maintaining our strong industry position but also, of course, on growing it.

I want to reiterate four key points about our business, our growth strategy and our value proposition to investors. First, our business model is simple and efficient. We are an asset-light fee-based business that drives consistent earnings and cash flow growth. We delivered nearly \$0.5 billion of royalty and license fee revenue that flows through to earnings at roughly 90%, generating more than \$450 million of adjusted EBITDA.

Second, chain scale is not a proxy for quality. They are two entirely different things. Our brand promises to make hotel travel possible for all, elevating experiences for the everyday traveler regardless of price point, and in doing so, developing brands that attract and retain franchise owners. According to the most recent J.D. Power Guest Satisfaction survey, we operate three of the top four economy brands.

Microtel by Wyndham, our fastest-growing new construction economy brand, finished number one for the 15th time in the past 17 years; and Days Inn, our largest economy brand in the United State, finished number three, up from sixth place three years ago.

We also operate three of the top-four mid-scale brands as ranked by J.D. Power, including for the fourth consecutive year the number one ranked Wingate by Wyndham, along with the recently integrated La Quinta at

number two, and the AmericInn brand now by Wyndham, illustrating our ability to acquire brands that further enhance the quality and enhance the growth potential of our portfolio moving forward.

Next, we are laser-focused on the quality of our system, and we routinely explore ways to strengthen and differentiate our brands. A great example of this is the recent refresh called Innovate that owners have embraced at our Super 8 brand. We developed a renovation package for about \$1,500 a room that is completely transformed and elevated the experience of staying at a Super 8, including new furniture and fixtures and featuring high-impact, custom-selected art for each hotel's locale to give guests the true sense of place when they check in.

Over the last three years, over 90% of our domestic Super 8 owners have adopted the Innovate package, which has helped them drive their brand perception and meaningful market share increases in their RevPAR indices in their markets.

And finally, our Wyndham Rewards loyalty program with its 58 million enrolled members is consistently recognized as the most generous loyalty program in the industry. And it's viewed depending on the year as just ahead of or just behind Marriott's loyalty program as the top hotel rewards program according to U.S. News & World Report. You can't serve 0.5 million guests a night without a lot of repeat customers, and Wyndham Rewards is a very important component of driving that loyalty and direct business.

Through all of the investor outreach we're doing, we continue to communicate the strength of our business model, the quality of our brands, and our very unique position to serve the everyday traveler in cities and towns throughout the United States and across the over 80 countries in which we serve. We also made important progress on several key initiatives in the second quarter, particularly in the areas of technology, branding, system size, delivering benefits to Wyndham destinations with the integration of La Quinta, and I'd like to discuss each of these in a bit more detail.

Our industry-leading state-of-the-art technology platform provides our franchisees with cloud-based central reservation and property management systems that are easy to use, stable and cost-effective. In the second quarter, we completed the implementation of our central reservation systems for our 16th, 17th, 18th and 19th brands, and we have now completed a three-year journey of rolling out our central reservation system globally to all of our brands aside from La Quinta, which we will add next year.

We believe our ability to provide hotel owners with technology solutions that are easy to install, easy to maintain and easy to use is a tremendous competitive advantage for us going forward. Our franchisees are pleased with the plug-and-play nature of the systems we provide, the technology and training support we offer, and the functionality we make available. The work our incredible technology and operations teams have done over the last three years to get us to this point has been nothing short of monumental.

Separately, we continue to be excited about our strategic decision announced in April to connect all of our brands under the by Wyndham banner. This seemingly simple and yet very meaningful by Wyndham endorsement will be displayed on signage all around the world and be reflected in all of our marketing efforts, advertising and digital presence from our brand.com sites to all online searches. This cross-branding will help our guests better understand which brands belong to Wyndham Rewards and increase overall brand awareness.

At the same time, we expect the halo effect of by Wyndham to elevate our economy brands and drive more direct bookings to our franchisees. And since our launch of by Wyndham, online searches for Wyndham have increased over 10%, and we are seeing increased conversion rates in many channels.

Building our franchisee base is a key priority for us. Our total room count at June 30 is up 12% from a year earlier and is up 3%, excluding La Quinta and Knights Inn. In the United States, the upscale trademark brand that we introduced last year has grown to 98 hotels, with another 60 in our pipeline, making it what we believe to be one of the fastest-growing and fastest-scaling newly created brands in the history of the lodging industry.

Outside of the United States, our system grew 3% organically. And while this is below our typical experience and longer-term objective, our direct franchisee international room count grew 8% from a year earlier, and the slower growth was caused by a 3% decline in master franchise international room count, largely due to decisions made by one of our master franchisees in China following our lead to terminate sub-par properties. While this China master still has some work to do, we expect fewer terminations and net room growth from them in the back half of the year.

We continue to expect organic room growth of 2% to 4% this year, driven by a 6% to 8% international room growth and relatively steady domestic room count. As many of you know, we refer to our ongoing efforts to generate cross-marketing benefits with Wyndham Destination/Vacation Ownership as the blue thread between our operations. We continue to strengthen the blue thread in the second quarter, and our initiatives helped to increase Wyndham-affiliated tour volume and therefore supported meaningful growth in Vacation Ownership sales and rental room nights at Wyndham Destinations.

For instance, we know that offering Wyndham Rewards points can drive tour flow and can help land new timeshare owners, and we sold nearly twice as many reward points to Wyndham Destinations for this purpose than we did in the second quarter of last year. These points not only drive Vacation Ownership sales on which we are paid a royalty, they will most likely also be used for a stay at one of our hotels in our system, generating incremental revenue for our franchisees.

And last but certainly not least among the initiatives, I'd like to cover today the acquisition and integration of La Quinta and just how well that's going. The transaction closed in late May, and we have welcomed into our [audio gap] (12:18) nearly 8,000 La Quinta employees, most of whom at La Quinta hotels that we now manage. We have had great discussions with franchisees about our intent to maintain, to grow, and to strengthen the La Quinta brand.

Along those lines, we have reignited La Quinta's franchise sales and La Quinta's pipeline efforts. Since the announcement of the acquisition, we have signed 15 new La Quinta construction deals. We have broken ground on 10 new La Quinta pipeline projects. And the La Quinta pipeline has grown to 24,000 rooms, or from 250 hotels to 266 hotels, which is at an all-time record for this pipeline.

We have laid out a technology road map that will migrate La Quinta franchisees on to our central reservation system next year, providing them with significantly expanded distribution at a lower cost. We are, of course, streamlining La Quinta's corporate functions where there is overlap with ours.

Most importantly, we've begun leveraging the capabilities that La Quinta has in areas like designing construction services, hotel management, and global sales to provide benefits to our other brands. And we will soon be making La Quinta available for sale by our franchise sales and development teams across the United States and across Canada. Most importantly, La Quinta's franchisee retention rate is running 99.5% year-to-date, as is our retention rate at AmericInn.

In short, we feel very good about our progress to date. We continue to expect that we will achieve \$55 million to \$70 million in annual synergies throughout the integration, as David will discuss. And we are thrilled that the La Quinta franchise advisory board has already decided that they want the brand to be known as La Quinta by Wyndham as soon as possible.

In summary, we remain incredibly enthusiastic about the opportunities in front of us. We believe we are continuing to deliver on our winning proposition where the quality of our brands does three things. It allows us to offer great value and excellent experiences to our guests; it enhances the returns generated by our franchisees; and it delivers attractive percentage of room revenue royalties to us as the franchisor. As we like to say, wherever people go, Wyndham will be there to welcome them.

And with that, we'll turn the call over to David.

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

Thanks, Geoff, and good morning, everyone. Today I'd like to discuss our second quarter results, which were solid and in line with our expectations, as well as the La Quinta integration, our balance sheet and our 2018 outlook.

My comments will be primarily focused on our adjusted metrics. You can find our complete results in our earnings release, including reconciliations of adjusted amounts to GAAP numbers and walk downs of adjusted amounts to further adjusted metrics that reflect what our business would look like if our spin-off and the acquisition and integration of La Quinta had all occurred on January 1.

As Geoff mentioned, our mid-quarter acquisition of La Quinta and our mid-quarter spin-off from Wyndham Worldwide make our results and year-over-year comparisons somewhat challenging to interpret this quarter. We believe that the adjusted figures we're providing will be helpful in understanding how our business performed and how it will look on a go-forward basis.

Our total revenues grew 31% in the second quarter, including \$77 million of incremental revenues from La Quinta. Excluding the acquisition, revenues grew 8%, primarily due to 8% higher royalties and franchise fees, as well as a 17% increase in marketing reservation and loyalty fees that in 2018 included global franchisee conference revenues that were fully offset in EBITDA by conference-related expenses.

Adjusted EBITDA increased 19%, primarily reflecting the growth in revenues, partially offset by the timing of marketing expenses. We estimate that if we had completed the spin-off and had acquired and fully integrated La Quinta prior to April, our adjusted EBITDA in the second quarter would have been \$159 million, near the high end of our prior projection of \$150 million to \$160 million.

Royalty and franchise fee revenues increased \$18 million or 19%, including a 10-point contribution from La Quinta, a 3-point contribution from AmeriInn, and a 1-point reduction from the divestiture of Knights Inn. Marketing and reservation expenses were in line with marketing and reservation revenues in the quarter, but revenues exceeded expenses by \$3 million in second quarter 2017. So that timing difference worked against us this year.

Domestic RevPAR grew 9% in the quarter. Since La Quinta added 4 points and the divestiture of Knights Inn contributed about 1 point, our RevPAR growth, excluding those brands, was 4% in the U.S. This growth reflected increases in both occupancy and average rate. It was right in line with the industry at 4%, with strong performance

across many of our brands, particularly Microtel, Wyndham, Baymont and Days Inn; growth in nearly every region of the country; and the double-digit year-over-year increase in Texas. Excluding La Quinta and Knights Inn, our U.S. RevPAR growth has been 5% in the first six months of the year.

International RevPAR increased 5% in constant currency, all of which was organic, reflecting strong performance in Canada, Germany, Turkey and Spain. Our global RevPAR grew 8% in constant currency, including 3 points from La Quinta, and is up 7% in constant currency so far this year.

Net system size was up 12% year-over-year, primarily reflecting 14 points of growth from acquisitions, partially offset by a reduction of more than 3 points due to the divestiture of Knights Inn. Our total pipeline now stands at 171,000 rooms, of which 51% are international and 70% are new construction.

La Quinta added 24,000 rooms to our global pipeline, 90% of which are new construction. Excluding our 2018 acquisition and divestiture – acquisitions and divestitures, our global pipeline was unchanged year-over-year, but was up 1% sequentially compared to the first quarter. As a percentage of total system size, our pipeline, including La Quinta, grew from 21% in the second quarter of 2017 to 22% in the second quarter of 2018. We've seen good growth in the pipeline for Trademark, Hawthorn and Wingate, as well as La Quinta and AmericInn since their acquisitions.

As Geoff mentioned, we continue to expect to achieve \$55 million to \$70 million in total synergies from the La Quinta acquisition. We are on target with our expected timing of synergy realization since we were able to begin communicating human resources related decisions to La Quinta employees in April before the acquisition even closed. The amount of salary and benefits savings we expect to achieve is also right in line with our acquisition model.

As a reminder, virtually all of the synergies we projected are cost savings. More than a third of the savings will come from eliminating La Quinta's public company infrastructure, including certain executive positions, directors' fees, listing fees, stand-alone insurance costs, and professional services expenses such as auditing fees.

A third will come from leveraging the operational support, franchisee training, franchise sales and relations, billing and collections, procurement and shared services functions we have and that already support 19 brands so that adding an additional brand, even one with 900 hotels, is highly efficient.

And about a third of the synergies will come from leveraging our contact centers, data centers, existing IT licenses, advertising agency relationships, e-commerce tools and loyalty platform, as well as migrating La Quinta to our technology platform and central reservation system. There should be no doubt in anyone's mind it is far more efficient to be operating a family of brands as we do than to be operating a single brand as AmericInn and La Quinta were doing.

For the month of June, we realized \$2 million of synergies at La Quinta, which puts a run rate of annual synergies at \$24 million. We expect this to increase to \$35 million to \$40 million at year-end. The half-year math associated with this is that it will allow us to deliver \$15 million to \$20 million of actual benefits over the balance of the year. We are aiming to complete substantially all of our integration work during the first half of 2019, as we add La Quinta onto our technology platforms and loyalty programs, positioning us to reach full run rate synergies in the second half of 2019.

In total, you should expect La Quinta to contribute about \$9 million to \$11 million of EBITDA per month during 2018 subject to some seasonality, growing to around \$13 million or \$14 million per month by late 2019 as the business is fully integrated.

At June 30, we had \$416 million of cash on our balance sheet, which included \$240 million of cash that we expect to pay out in Q3 to tax authorities incorporating lodging in conjunction with our acquisition of La Quinta. Our debt balance was approximately \$2.1 billion, carrying a weighted average interest rate of 4.8%. There were no borrowings outstanding under our revolving credit facility.

Excluding the \$240 million of temporary cash related to the La Quinta acquisition, our net leverage was 3.3 times the midpoint of our 2018 further adjusted EBITDA forecast, which would put it in the lower half of our 3 to 4 times net leverage target.

Our free cash flow through the first six months of the year would have been \$100 million if not for transaction and separation related costs and insurance-reimbursed CapEx compared to \$63 million in the first six months of 2017. As Geoff and I have said before, our primary goal is to grow our business organically, and we will deploy a portion of our cash flow for development advances and similar opportunities as they present themselves.

We will also continue to deploy free cash to pay dividends. Beyond that, we will allocate free cash flow to tuck-in acquisitions that are both strategic and accretive and to share repurchases, with the amount going to each depending largely on the acquisition opportunities that are available. In the second quarter, we paid our first quarterly dividend of \$0.25 per share and we repurchased 246,000 shares of common stock for \$15 million in June.

Now let me turn to our outlook, the details of which are in our earnings release. Our further adjusted 2018 forecast, which assumes that our spinoff in the acquisition and integration of La Quinta had all been completed on January 1, is largely unchanged from what we have previously provided. It calls for further adjusted revenues of \$1.99 billion to \$2.04 billion; further adjusted net income of \$300 million to \$320 million; further adjusted EBITDA of \$590 million to \$610 million; and rooms growth of 11% to 13%, including organic growth of 2% to 4%.

The only two tweaks to our prior forecast are in the area of RevPAR growth, which we now expect will be 7% to 8% this year in total, and approximately 3% excluding our 2018 acquisitions and divestitures compared to our prior forecast of 2% to 3% RevPAR growth. And in the area of further adjusted diluted EPS, which is now forecasted to be \$2.98 to \$3.18, \$0.03 higher than before due to share repurchases by us and by Wyndham Worldwide in the second quarter.

The increase in our outlook for RevPAR growth reflects the favorable results we've had so far this year as well as our continued expectation that year-over-year RevPAR comparisons will be tougher in the second half of 2018 due to the positive impact that hurricanes had on RevPAR in the last four months of 2017. At the same time, adjusted EBITDA comparisons will benefit from the negative impact that the hurricanes had on our adjusted EBITDA in the second half of 2017, primarily at our owned hotel in Puerto Rico.

In conclusion, while there are a lot of moving parts and strategic accomplishments associated with our second quarter, I want to underscore three things. Our results were solid and in line with our expectations; our full-year further adjusted EBITDA outlook is unchanged from what we shared with you at our Investor Day in May; and we remain highly enthusiastic about the opportunities in front of us as a newly public company that is the global leader in economy and midscale lodging.

With that, I would like to turn the call back over to Geoff.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Thanks, David, and thanks again, everyone, for joining us today. We hope you all come away from the call sharing our excitement and enthusiasm for what lies ahead. Our business model, our recent results, our outlook including the integration of La Quinta, and our growth potential, all make us very optimistic about our team's future as an independent public company.

Finally, we again want to thank all of our team members for their help and commitment in executing on our spin and on the acquisition and integration of La Quinta, all while delivering Wyndham's legacy, count-on-me service to customers, which continues to be so very central to our culture.

And with that, operator, David and I welcome any questions.

QUESTION AND ANSWER SECTION

Operator: And the floor is now open for questions. [Operator Instructions] We'll take our first question from Joe Greff with JPMorgan. Please go ahead. Your line is open.

Joseph R. Greff

Analyst, JPMorgan Securities LLC

Good morning, guys.

Q

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Good morning.

A

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

Good morning.

A

Joseph R. Greff

Analyst, JPMorgan Securities LLC

I have a few questions here. The first question relates to La Quinta. Thank you for the commentary about the development pipeline. You're hitting that 24,000 rooms mark. Can you talk about how La Quinta did in terms of year-over-year RevPAR growth and net rooms growth?

Q

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Sure. Thanks, Joe. They are having a great year. We're looking now at their entire system. And in the first quarter, they were up 3.6%. In the second quarter, their RevPAR finished significantly ahead of that at up 5.7%. In our first month that we had them on our platform, which was June, we saw a 6% RevPAR growth. And we're seeing really

A

solid gains, good gains in their web.com traffic and in the central contribution. And I'd say most importantly their RevPAR index, which is up system-wide 100 basis points in the quarter.

Joseph R. Greff

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you. I just want to talk about the topic of rooms [ph] churns, removals (29:03), franchisee retention. I know you've talked that it's currently in that 6% range per annum. Can you talk about some of the specific steps that you guys are doing to bring that lower? How much of any potential future improvement is tied to the system being cleaned up historically and more recently? How much of it is related to a better appreciation of where the platform is today versus the past? And what's the timetable to maybe bring that down and to kind of get it to, say, more in that 3% to 4% range?

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

Sure. Thanks, Joe. We have been talking for the last three years about our manic focus on quality, and we've removed roughly 80,000 substandard rooms domestically from our system, which were not meeting our brand standards. And you look at Table 4, you certainly see that year-to-date in terms of the first six months, our terminations are still very quality-focused. 90% of those are substandard. We are seeing growth in our domestic system size. I think we're up about 1,000 rooms for the quarter.

We continue to be very focused on quality in our economy brands and very focused on trying to raise our quality scores, which we've been doing from our internal ratings with our Medallia scores and external social media scores. And we're seeing great progress and feeling really good about that. And it's great to see internationally as well our master franchisees following our lead, as I touched briefly on, in markets like China to raise those quality standards.

Joseph R. Greff

Analyst, JPMorgan Securities LLC

Q

And then a question for David, and this will be my last question. You have further adjusted EBITDA in the 2Q coming in at \$159 million. What would be the corresponding net revenue number on that basis, the royalty and franchise fee that correspond to that? And what would be the corporate expense that corresponds to that, just so we can have a sense of those items with respect to how you disclose that further adjusted EBITDA? And that's it for me. Thank you.

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Joe, I don't have those numbers in front of me right now, but we'll grab those and get back – we'll get back to you.

Joseph R. Greff

Analyst, JPMorgan Securities LLC

Q

Okay. Thanks, guys.

Operator: Thank you. We'll go next to David Katz with Jefferies. Please go ahead. Your line is open.

David Katz

Analyst, Jefferies LLC

Q

Hi. Good morning, everyone.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

Good morning.

David Katz

Analyst, Jefferies LLC

Q

I wanted to just focus on – I know, David, you went through some of the capital allocation avenues. And obviously priorities will change over time. But if you can elaborate just a bit on what the priorities, at least for the remainder of this year, look like in terms of where you'll be allocating capital, and specifically around the degree to which you would be using capital for key money and other inducements in the development side of the business.

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Sure. With respect to the allocation of capital, it's something we spend a lot of time thinking and talking about. Our game plan would continue to be to find good opportunities to deploy \$20 million or \$25 million-ish of capital for development advances and key money.

And I think our run rate so far this year and where our pipeline is running for that sort of activity puts us in a good position to end up somewhere around that range this year. And that's consistent with what we've been targeting. As we think about other uses of cash, as I mentioned, the dividend will – we expect will be the same over the remainder of this year at \$0.25 a quarter or about \$50 million in total in the back half.

And then it's hard to know or to model exactly what acquisition opportunities are available. We are always looking at tuck-ins that could be attractive to us from both a strategic and financial perspective. And in that context, I think we'd also like to be able to execute some share repurchases, consistent with what we did in June with the repurchase of \$15 million of stock.

If I had to pick a range, it would probably be in the \$75 million to \$100 million range for the year as a whole, really the June through December period. But I would caveat that by saying that that number will depend on what tuck-in acquisition opportunities are available to us.

David Katz

Analyst, Jefferies LLC

Q

If I can just follow that up two ways, one is, if we think about a maximum balance of capital that you would have out in the field for development at any point in time, do you think of it that way, and is there some – an amount or a ceiling on how much that would be? And then, secondarily, if you could just give us the boundaries around what you consider a tuck-in to be, is that a eight-figure, nine-figure? Where do you consider the top end of size for that?

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Sure. Let me work backward through those. I think the prototypical tuck-in acquisition for us is the purchase of AmericInn last year. That was a \$140 million transaction that added about 200 properties to our system. It's a great brand from a quality perspective. We think it has significant growth potential. And as a result, it's a prototype for what we'd like to do. I think a transaction of that size, of that order of magnitude could be double that size, half that size, but in that range, could all fit into the tuck-in category. And that's – that's how we think about that.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

And David, there's still several single brand companies as well as many regional players out there that fit that. As David just went through sort of prototypical fit for us and established well-perceived brands with growth opportunities in markets, like La Quinta, that we know we could grow with great synergies that are immediately accretive without any own real estate, that would be a strong strategic fit for us and something that we can integrate I think...

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Yeah.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

... [ph] per se (36:28).

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Yeah. And then on the development advance front, typically the development advances are forgiven over an extended period of time. And if we assumed a sort of five-year average life at \$25 million a year, that could have us with – somewhere in the range of \$125 million of capital expended – extended for those purposes.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

Especially with our new construction brands, David, we have inherited such a phenomenal capability with the new construction – the new construction development franchise sales team with La Quinta and the new construction architecture design and construction team. They're here today in New Jersey meeting.

And these folks are really end-to-end professionals, and they're looking at our new construction brands, which is where our focus is from a pipeline add standpoint. And we've built five new prototype construction rooms downstairs. It's our Microtel by Wyndham. It's our Wingate by Wyndham, which is now number one in the J.D. Power rankings. These are the brands that we would use that type of key money for the right market.

David Katz

Analyst, Jefferies LLC

Q

Got it. And if I can just be clear about one last thing. David, from your comments, I think you may have said \$15 million to \$20 million of EBITDA per month from La Quinta by mid-2019, which if I annualize, that is a decent return on the investment so far, but we should expect that that would accelerate beyond that level over time. Correct?

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

We certainly we do expect La Quinta to grow over time. I believe the number was at \$13 million to \$14 million in the back half of 2019. And that would be consistent with the – with sort of the – where La Quinta was running at, at nearly \$100 million of standalone EBITDA plus synergies of \$55 million to \$70 million.

David Katz

Analyst, Jefferies LLC

Got it. Okay. Thank you very much.

Q

Operator: We'll take our next question from Patrick Scholes with SunTrust. Please go ahead. Your line is open.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Hi. Good morning. Thank you. Now that you have a couple months of La Quinta in the system, how are you feeling about upside to that original synergy range at this point?

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David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

I think it's a little early for us to say. We feel very good about how the integration has been going. This is a range we really want to stick with. And at this point in time, as we look at the various components, I feel good about what we're able to deliver on the fixed cost side. I feel good about what we're delivering on the variable side in terms of our ability to reduce the rate that various volume-related activities are costing us.

A

And the area where it's just going to take a little bit longer to be confident about where we're landing or about whether we have any upside associated with the forecast is in the semi-variable cost area where it – where I – I think we just need some more time with the business to know exactly where we're going to land on various semi-variable costs.

And then the one area that really does continue to be a significant upside for us is on the revenue side. The only revenue synergy we built into the \$55 million to \$70 million forecast is tied to adding La Quinta on to our existing credit card program. And when we look at our ability to grow the business and expand into – expand the La Quinta brand significantly into international markets and to grow it in some parts of the country, the parts of the U.S. where it's underrepresented, I think that represents upside that's not part of our synergy model.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Okay. Thank you. And then my second question, and perhaps this might be a better question for offline, but it has to do with Table 4, the system size, certainly a lot of moving parts to think about what's the true organic growth rate. The question I have in there, you have in your headline of 3% looks like net room growth or – but does that – or excuse me – since June 30, 2017, did you not also add 11,000 AmericInn rooms in there? And if so, doesn't sort of that organic growth rate be closer to like 1% to 2%? Am I thinking about that correctly?

Q

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Yeah, that's fair. That's fair, Patrick. This is Geoff. Excluding La Quinta and Knights Inn, as you say, our domestic system size was up 3% year-over-year. Reflecting the acquisition of AmericInn and excluding AmericInn, to your point, our domestic system size is up about 1,000 rooms through 6/30.

A

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Right. And when you look at the 3% growth that we've had year-over-year, about half of that comes from the AmeriInn acquisition and half of it is organic. And as we look at this, we continue to feel good about our pipeline and its ability to convert in the second half, and that's why we're projecting 2% to 4% rooms growth this year.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. So, just to be clear, you're expecting an acceleration due to seasonality, timing, in the second half versus that first half number.

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

That's right. And there does always tend to be some seasonality associated with this, and you could see that in terms of the strong results we had in the fourth quarter of last year.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. So ...

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

The other thing on Table 4 that folks have pointed out is, we are happy with what's happening with our China franchise master license who has taken quality to heart. They have grown over – we acquired this master back in 2004. And they've grown to about 100,000 rooms, or they acquired the license from us.

And they're targeting the bottom 10% of their portfolio. And we talked about the 5,000 rooms that they terminated for quality in Q1. That number was about 3,000 in Q2. We expect that number in Q3 and Q4 to come down and for them to have net room growth in the back, which helps.

So we're seeing – we're seeing good growth from China, especially in our direct business, which is – the team is doing a great job over there. They're up I think quarter-on-quarter from 25,000 to nearly 30,000 rooms. We've added five brands in that market. And we're seeing growth internationally as well in Southeast Asia and Latin America.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you. So we should expect again a pretty material uptick in organic room growth in the back half of the year?

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

Yeah.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Great. Thank you.

Operator: Thank you. We'll take our next question from Stephen Grambling with Goldman Sachs. Please go ahead.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Thanks for taking the question. I guess I've got two follow-ups. First, La Quinta looks like the EBITDA did grow – I want to say it's about 10% year-over-year. I think your prior guidance had included just the 2017 EBITDA, if you can really guide to another public company's numbers. So I guess, how are you thinking about growth and the contribution from that business the rest of the year, and specifically how that maybe factors into the reiterated full-year EBITDA guidance?

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

Sure. On La Quinta, as I mentioned, we're really – we're expecting that to contribute about \$9 million to \$11 million of EBITDA a month, give or take a little bit for seasonality as we work through the back half of the year. And that includes the system growth as well as the strong RevPAR that La Quinta has been delivering so far this year. So I would say that that's factored in to the numbers that we – that we're providing. And as Geoff mentioned, we've been excited about the RevPAR growth we're seeing on the – seeing in the La Quinta brand.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

And then I guess a follow-up on M&A. How important is an established pipeline versus maybe being able to plug into your sales force as you think about potential acquisition opportunities?

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

I think it's very important. And it gives us great comfort and great credibility with the team that we've inherited from La Quinta that's joining our sales force when you look at just how strong that pipeline is. As David mentioned, 90% of it is new construction. It's established. It's with the developers that want to do more. It's with developers that are building our other brands. And to look at a new construction pipeline now of – that's 70% of our pipe, especially as we continue to focus on new construction and focus on bringing in higher quality deals, it's very important.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Yeah. And one last one, if I can sneak it in. I think you alluded to this. But on the revenue synergy side, which is not included, I guess any kind of timing we should be thinking about and milestones or things that you would need to implement before being able to capture those? Thanks.

David B. Wyshner

Chief Financial Officer, Wyndham Hotels & Resorts, Inc.

A

I think with respect to La Quinta, as I mentioned, the longest poles in the tent are really the integration of technology and the loyalty program. And I think that's fairly typical in terms of what we see in transactions. But our hope in La Quinta is to have that done within a 12 to 13-month period. And as a result, that puts – it should put us in good position to deliver full run rate synergies as we move into the second half of 2019.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

That's right. Our teams are really focused now and working with the La Quinta team on the technology side. And we expect, David, I believe, our central reservation system cutover to be happening towards the end of the first quarter. And the heavy lifting and the work that's going on through the back half of this year and the first two months of 2019 will create for these franchisees a central reservation system that's more distributed and more connected than they've ever had. It's what – what the La Quinta franchisees are most excited about is getting off of legacy technology and onto our platform.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

That's helpful...

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

A

... in which [indiscernible] (47:38) will come the loyalty benefits, which are also so important. While we've matched their loyalty program, the La Quinta Return program, which has 13 million members, with our award winning program, the ability to earn and burn points and drive more business direct, which has been our strongest probably win this quarter in terms of driving more business direct to our franchisees through the Wyndham Rewards program, will also begin to accrue to them towards the end of the first quarter of next year.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Great. That's helpful color. Thanks so much.

Operator: And it appears we have no further questions. I would like to return the floor to Geoff Ballotti for closing remarks.

Geoffrey A. Ballotti

President, Chief Executive Officer & Director, Wyndham Hotels & Resorts, Inc.

Well, again, thanks, everybody, for joining us today. And Matt and David and I will certainly be available after the call for any follow-up questions. I know we've got one to get back on. But again, we're really excited and we hope everybody will join us in watching the Wyndham Championship coming up on the Golf Channel in CBS in a few short weeks, August 16 to the 19. And again, thanks for the time today. Thanks, operator.

Operator: Thank you. And this does conclude today's Wyndham Hotels & Resorts second quarter 2018 earnings conference call. We ask that you disconnect your lines at this time and have a wonderful day.

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