Marriott International, Inc.
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Shaun Kelley - BofA Securities, Research Division: Good morning, everyone. Thanks for staying with us. So go ahead and lead into our next fireside chat with Tony Capuano, President and Chief Executive Officer of Marriott International. So, Tony, welcome. Nice to see you.

Tony Capuano - Marriott International, Inc.: Thanks, good to be back.

QUESTIONS AND ANSWER SESSION:

Shaun Kelley: So, a lot of places we can go, but one place I just want to start. Obviously, it's just past the summer. When I get to speak to the global CEOs like yourself, I kind of want to know like, where were you this summer? So, give us a quick highlight because I can only imagine… Every time I talk to you, it's just back from Saudi Arabia, just landed from here. So just give us a quick spotlight on what the summer looked like for your travels.

Tony Capuano: So, I was all over, but we're lucky enough to have a little home in Italy. And so often, I try to concentrate a lot of my EMEA travel while we're there and use that as a base. So, I was in London a bit, I was in Italy. And then probably the most interesting trip I took, I spent about eight days in East Africa. And so, I went to Rwanda, Ethiopia and Kenya. Got to meet the leaders of each of those countries, which was amazing. Got to see some of our new projects there. And probably highlighted, I stayed in our first safari launch, the JW Masai Mara, which is right on the Kenyan-Tanzanian border. Spectacular. And that's a pretty exciting, vibrant growth segment for us. We've got a couple dozen in-flight projects across Africa in that space.

Shaun Kelley: Incredible. So, what wasn't included in there, though, was the, I believe it was just the maiden voyage of the second Ritz-Carlton Yacht. Is that right?

Tony Capuano: That is correct. So, the Ilma launched in Europe in the mid…I think it's this week is the first paid voyage. And a little different ship. I think about these ships a little like the iPhone, right? The iPhone 1 was great until you got the iPhone 2. You learn a great deal with each iteration. And so, this ship is a little larger. The original ship was 149 cabins, Ilma is 224 cabins. A little more varied food and beverage. And then Ship 3 is under construction and a launch similar time frame next year.

Shaun Kelley: Interesting. Even larger or --

Tony Capuano: No, that one will be the same as --

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[1] Not a verbatim transcript; extraneous material omitted and edited for clarity and misstatements.

Shaun Kelley: The same. Looking forward to my invite.

Tony Capuano: So, I've not actually sailed. I've toured the ship. I've done some media there. And then we have a big sponsorship with Mercedes-AMG PETRONAS F1 team. And so, for the Monaco race, Mercedes actually chartered the ship and anchored it there and did all their events there. So, I got to spend a night on it, which was spectacular. I think that's been one of the real pleasant surprises of that business, is the amount of private charter business we've seen.

Shaun Kelley: Fascinating. Definitely not in the BofA price range here.

So, another interesting lens for you and this is where I want to kind of start the conversation is, obviously, you're located right around the D.C. Metro area. This is a big year in Washington, D.C. So, I want to open with sort of the broad kind of question around both politics and economics. Talk to us a little bit about what's the election environment right now in Washington, D.C., kind of how are things feeling? And then much more importantly, what are some of the implications here for the hospitality business and possibly, to the extent you want to enter into it, Wall Street?

Tony Capuano: Yes. The political landscape is all consuming as it is every election season in Washington. It's all that's on the news. It's all that's in the papers. It appears that the race for the White House is going to be a toss-up. I've given up looking at the polls because you can find a pole that says anything you want to say. But it's also looking increasingly unlikely that one party will get control of the White House, the Senate and the House of Representatives.

And so, I suppose, unfortunately, we may end up with more of the same, which means a bit of gridlock in the federal government and not a great deal of change going forward. I'll leave it to political scientists to talk about the implications. Obviously, there is a view, whether you believe it or not, that if the Republicans take the White House, it will be more favorable on tax policy, maybe a little more pro-business. If the Democrats win the White House, you'll see stronger labor unions, you'll see higher tax structure being tried to push through.

So, it will be interesting to watch. But again, I think the fact that you likely won't see a unified federal government means you won't see, I think, particularly dramatic change.

Shaun Kelley: And then how do things feel out there right now? Obviously, Wall Street is obsessed with soft landing, hard landing, no landing, whatever kind of landing but how do things actually feel for you as you think about it?

Tony Capuano: I think broadly, we're feeling really positive about how the business is performing. To be sure, there are lots of economic uncertainties and headwinds out there, whether that's softening economy. You saw one of the jobs reports come out this morning about 1/3 lower than anticipated. Inflation is still impacting some sectors. Household savings rates are lower than we might hope.

But I think that the travel and tourism sector broadly, Marriott specifically, seems to be floating above it a little bit because even pre-pandemic, we'd started to see this shift where consumers were prioritizing travel and experiences. So, it doesn't feel like our sector is as impacted as some of the other consumable sectors.

Shaun Kelley: So we kind of weigh that experiences and that moment coming out of COVID with the "we just have to live for now", coupled with every piece of the consumer has seen some normalization curve, right? Coming out of the second quarter, I think it was the first time certainly, and I can recall since 2015, but maybe even earlier that 100 percent of our lodging companies reduce the RevPAR outlooks. So, what's that really mean? Let's get to the bottom of it? Is it just normalizing? Are there hints of softness? I mean, you're covering such a broad range of products and price points of Marriott, help us uncode what it all means.

Tony Capuano: So, I'll talk globally, but then we can go deeper on individual markets like China, for instance. But I think most of what you're seeing, I would characterize as normalization and lots of focus on the leisure sector, for instance. And I think it's really important we remind ourselves, leisure was the fastest segment of our business to recover. And in fact, the one that grew most quickly. If you look at the five years since 2019, leisure RevPAR actually grew on a global basis, 40 percent. And so, it's not unreasonable to expect that, that wouldn't continue forever, and you'd start to see it normalize.

But even on the heels of 40 percent RevPAR growth over the last five years, in Q2, we saw global leisure growth of 2 percent. We just got July numbers. In July, we saw 2 percent leisure growth as well. And so, it's not as if we're seeing leisure fall off the cliff, quite the opposite. We continue to see good, steady growth in the leisure segment. it's just normalizing relative to that 40 percent explosion that we saw.

Shaun Kelley: And then what can some of the other opportunities that be for you? In September starting to turn the corner to group to -- again, we talked about some of the big things going on in New York right now. And also, some tailwinds in corporate. I mean, I think we've all glossed over the fact having been so focused on leisure for so long that the majority of your business has generally been on the corporate and group side.

Tony Capuano: Yes. So, on the business transient side, the last few earnings calls, I've characterized it as the tortoise in this tortoise and hare of recovery. But we're really encouraged. We're seeing steady quarter-over-quarter improvement in business transient. And again, you've got to go one layer deeper. Several years ago, we saw small and medium-sized business go far ahead of where it was pre-pandemic. The big corporates, the big multinationals have been slower to recover, but we're seeing steady growth quarter-over-quarter.

And then group has been really the bright shining star. We talked in the second quarter about the fact that based on forward bookings, if you look at full year 2024 and forward-looking into full-year 2025, we expect high single-digit revenue growth for the group segment in both of those years.

Shaun Kelley: And maybe group is part of the answer here, but can you just kind of think about how the whole pandemic played out and kind of where we sit today, what is kind of your big observation structurally, be it kind of one thing that surprised you on the positive side. It's been a little bit more better than you would have thought? And one thing that hasn't quite maybe lived up to what you kind of thought it would have.

Tony Capuano: So I would say on the positive side, surprising to the upside. One, I mentioned earlier, just this continued trend of consumers prioritizing their discretionary spending on travel and experiences. I would say group would be the other big surprise to the upside. There had been a lot of conventional wisdom in the early days of the recovery that group might be the last sector to kind of limp across the threshold, and it's been quite the opposite.

And I was just out in Colorado meeting with a bunch of association meeting planners. And you talk to them anecdotally about their budgets going forward, and they're planning on meaningful increases year-over-year.

I would say on the surprise to the downside, it would probably be the pace with which we've seen the greater China market soften.

Shaun Kelley: Hold that thought because China is literally my next question. So, this was an area that was called out a little bit on the earnings call. I think we've even probably given a precursor back in the first quarter just sort of knowing, hey, this isn't quite what we thought it would be, but obviously a lot more acute by the time we kind of rolled around in the second quarter. You have that, again, this incredible global lens. You've probably been over there, certainly much more recently than me.

So, what's the broad backdrop? Help us kind of think about demand broadly because what we're hearing and many people in this room bring this out to me a lot, Nike, Starbucks, major U.S. international companies have struggled with the demand side over there. And at this point, probably for a year plus, travel Zero COVID had longer recovery, but now we're feeling it RevPARs, and it just doesn't quite do what we thought it would do.

Tony Capuano: I'm going to probably ramble a bit because I'm going to bifurcate my answer on the performance of the existing core lodging business. But then I want to pivot the growth side of China as well because I think there's some instructive data there as well.

To state the obvious, you see meaningful macroeconomic weakness in China. You've seen real challenges in the housing sector, in the commercial real estate sector. You throw all of that into the mix, and there is a real crisis of consumer confidence in China.

That is compounded by the fact that just like in the U.S., where you've seen a bit of a bifurcation of the consumer, the lower-income consumer really feeling the stress of economic headwinds. But the higher-end consumer continuing to be quite stable and have a strong appetite for travel. You've seen the same thing in China, but the distinction is that that high-income traveler in China is going outside of China and traveling across the balance of Asia. And that's why we saw such outsized RevPAR performance in the second quarter across APEC, highlighted by Japan, where I think we had north of 20 percent RevPAR growth.

We just got, again, July numbers. RevPAR was down in Greater China, 10 percent in July. And barring some sort of dramatic policy change from the central government, we think in the short term, that's a market that will continue to be weak. However, we believe deeply in the long-term potential of that market. And I think that the real estate development community shares that view, and that's why we're seeing such contrast on the growth side of our business.

In the first half of 2024, we signed more deals in China than in any six-month period in the company's 97-year history. And so, the development side of the business in China is going gangbusters. And we already had a well-established footprint in the luxury and upper upscale tiers. What we're really excited about now is the pace at which we're seeing select brands like Courtyard, Fairfield, Four Points really start to accelerate their growth.

Shaun Kelley: I mean, this is a big disconnect, right? Like if we think about it, historically, supply follows demand. So over here, for sure, you spent your career in this on the development side, right? Once RevPAR rolled, projects that were slated were being there, but all of a sudden, the pro forma start to change and then everything pulls back, usually on a lag. But China made a decision -- actually, the decisions are bifurcated I felt.

Tony Capuano: Yes, I think that's probably right. But I also just think it's a view. So many of the real estate partners that we have, have some involvement of state-owned enterprises. And there is a long-term view about the vibrancy and the vitality of the travel sector in China. And where there is some similarity, though, I mean, I think about our U.S. owners.

The vast majority of them are long-term investors in the sector. And so, they're not necessarily saying I'm going to try to time putting a shovel on the ground just right, whether it be because of the construction cost environment or the interest rate environment. They're often holding these assets for decades. And so, they believe in the long-term return horizons for these assets. And I think we're seeing the same thing in China.

Shaun Kelley: And back to the demand side, not to put you on the spot too much about individual markets, but I know Hainan is a huge amount of supply. It was also a massive COVID winner because within China, this was the one place you could go domestically. How much of the normalization or the down 10, if you will, is just a market or a selection of submarkets like that? Or are you seeing this across Tier 1 to Tier 4 cities.

Tony Capuano: Yes, so great question. I mean there is a deceleration across all markets. But I think we mentioned this in the Q2 call. When you look at the Tier 1 cities, they actually had positive RevPAR in Q2. And where we saw a much more significant weakness was in secondary and tertiary markets and Hainan, obviously, had some real challenges as well.

Shaun Kelley: And then a number of people have also talked about the outbound coupled with the lack of inbound. Putting your global hat on, and obviously, geopolitics gets in the way here a little bit but we said structural things like flight capacity. Any signs of life that China inbound, because especially for Western hotel brands, this is not insignificant for filling up those big assets in China?

Tony Capuano: Well, and what's interesting is so much of the challenge we have in performance in China is around rate, right? Demand is largely there. It looks different than it did pre-pandemic because it's much more heavily concentrated in domestic Chinese demand than it is, as you point out, in inbound international.

But the other big challenge we're having from a rate perspective is the current booking window in Greater China is as short as I've ever seen. I mean, you're talking under three days, all right? And so, your ability to really build in creative and aggressive pricing strategy is impacted pretty significantly. We are starting to see inbound international, but we still have a long hike to get back to where we were back in 2019.

Shaun Kelley: And on the supply side, you mentioned a little bit about being some popularity of products in that select service. Remind us of Marriott's go-to-market here, in terms of are these all are you able to do direct franchising? Do you need to do any kind of broader partnership deals with brands on master licensing or master franchising agreement, what's the right way to get those brands out there into that market?

Tony Capuano: So today, the bulk of our 500-plus hotels in Greater China are managed but we are doing some selective franchising. Our strategic point of view is, we're not sure we want to limit our growth perspectives by entering into, sort of, singular countrywide exclusive relationships. Just like we've done here in the U.S., our model works best when we grow with large multi-unit partners, and we're having good success identifying multiple multi-unit partners across China across quality tiers.

Shaun Kelley: So, let's take the development discussion and zoom out a little bit. We're thinking that Wall Street is now 100 percent conviction in a rate cut here in September. We know we're looking out to December already for possibly one or more. One thing that, that is very different from than a year ago was obviously trying to put the brakes on inflation and what this can mean for development. So, if we have cooling inflation coupled with lower rates, it would seem like the domestic side of the supply equation could start to improve. How are those conversations going?

Tony Capuano: Yes. And I think you're already seeing some of that improvement in anticipation of some of the factors that you've described. We talked on the Q2 call about the fact that for U.S. & Canada, our construction starts were up 40 percent. Now they're still not back to where we were pre-pandemic, but we're encouraged because the prior quarter, we were up 20 or 25 percent, I think. So, we are seeing some acceleration. Cuts in rates, stabilization of construction costs, all of those are going to be impactful in terms of shovels going into the ground.

But the new build activity is not mutually exclusive with our conversion activity, which continues to be a really terrific part of the story around our growth in the quarter. If you exclude MGM about 1/3 of both our signings and openings were conversions, some in the individual asset conversion, some in the portfolio conversion.

Shaun Kelley: And what are ROIs like for the development community. I mean are they optimistic and again, maybe able to look just a little bit beyond the horizon of that slowing

RevPAR curve? Because when we talk to a number of owners, obviously, things have basically recovered from the pandemic across portfolios of assets. But what you see is 2 percent RevPAR coupled with 3 or 4 percent unit inflation, cost inflation so it's not that easy. So, can they look out a little bit, but are they more optimistic than that? Can they say, "Hey, we've got this stuff to do. We've been sitting for four years, we're ready to go”?

Tony Capuano: Well, I think they're doing more comparative analysis than they might have been doing a year ago. Build versus buy, right? They are hoping that the gap between the bid and the ask on asset sales will continue to narrow. I think if interest rate cuts come in the back half of this year, that should be a bit of a catalyst for more asset transactions. So, there should be more and more product out there for the equity that's sitting on the sidelines.

But I think those that are developers or developer operators, they are now starting to get to a place where they say, if interest rates are coming down, if construction costs are stabilizing, do we have the ability to gear back up our construction engines. And they weren't necessarily having those conversations even a year ago.

Shaun Kelley: A lot of stuff that's worked in development, particularly where the deals have been signed has been in select service, particularly extended stay select service become that specific asset type that I think it works because it works for this operating environment, right, in terms of the four-wall cost structure, what it means or that's the way that people are making their ROIs work. But Marriott, in particular, over the years has been particularly good at full service, more complex, complicated cash structures, all of which probably come back to this interest rate equation. So, any sign of life from a full-service side?

Tony Capuano: It's a more modest absolute number, but I'll give you two examples. I was down in Longboat Key on the West Coast of Florida two weeks ago, opening our 9,000th hotel, which is a new construction St. Regis Resort on Longboat Key, which got financed in sort of the depths of the challenge of the limited availability of construction debt. And it is a spectacular hotel. And I think a lot of our owners put themselves in the mindset of that developer who struggled might a way to get the project financed and built. But look at it now, he's opening into the teeth of this amazing recovery and really able to command pretty extraordinary rates because he's got this shiny new beautiful hotel.

Similarly, we talked earlier about the strength in the group segment. I think second quarter next year, we'll open the Gaylord Pacific in San Diego. And it's probably the biggest hotel under construction in America. I'll have to confirm that. But I think it probably is. And we're so excited about that because when we look at the strength of group demand, having a new asset like that on the West Coast just gives us the opportunity to lengthen our lead in the group segment.

Shaun Kelley: A lot of this dovetails into capex. And I'm thinking of this a little bit from the owner's perspective, but it matters a lot for the brands, right? Obviously, the code of conduct during the pandemic was we just need to survive, right? And whether that meant giving some flexibility to owners to do what they need to do to get their capital structures kind of okay to make it through. We're past that period, but one of the handful of ways we've seen more inflation than in our normal course of life is probably in construction.

So, what are the implications of that sort of capital or capex inflation in terms of your business? Does this lead to an increased M&A environment? Does it lead to some bigger refreshes and some bigger priorities? How are you working with owners to make this tougher capital environment work?

Tony Capuano: So there's a lot in there. Let me try to deconstruct it. I think in the early days of the pandemic, you're exactly right. We were in partnership with our owner and franchise community focused on survival. And in a lot of ways, we set aside the sort of normal daily disagreements we might have, came to the same side of the table to slay this common foe of the pandemic.

We were very focused on helping our owners survive, including going as far in some cases, of going to their lenders and helping them negotiate release of FF&E reserves, for instance, to help them survive. We did that all eyes wide open, both on the owner side and the brand side, understanding that bill would come due at some point.

About a year ago, we restarted all of our quality metrics, brand standard audits, quality assurance audits and the like. And because we are so aligned with the owner community, as you might expect, the vast majority, and I mean the vast majority of that owner community, they applauded us putting it back in place. And think about it, in many cases, they've invested hundreds of millions, if not billions of dollars in our portfolio of brands. We are very much aligned in wanting to make sure that the owner community is investing in those assets and continuing to build equity in each of those brand platforms.

At the same time, certainly for my team, one of the things we talk about all the time, it's terrific that in 2022 and in 2023, Marriott achieved all-time record EBITDA but we can't spend a lot of time celebrating that because we've got to recognize, as you point out, our owners and franchisees are often in a very different place. They saw billions of dollars of asset and enterprise value evaporate during the pandemic. The expense side of the P&L didn't stop growing during the pandemic. And so, I think we've got to, and we have been, using a bit of a bespoke approach, if you will.

So, for instance, we have renovation requirements. But if the service scores are at or above a certain level, if the product has been well maintained, we might give a year grace period on that renovation. Similarly, in certain instances, owners and franchisees will come to us, and they say, I understand I need to put capital in the hotel, but I'm still under a fair amount of duress. Help me prioritize where I invest that capital for it to be most impactful in the individual asset.

Shaun Kelley: Really interesting. So, I want to go back to the other part of the development conversation, which was conversions and you alluded to this. This has obviously been a major kind of like way to plug the gap that has occurred with the much lower development environment that's been out there.

Let's just start with the high level. What are you doing differently? I think we've talked in the past about multi-brand deals. But what's come up much more recently and certainly over the last year, it was basically a year ago at this conference that you were just out with the announcement on MGM. So, let's talk about both those veins, pure conversions and then partnership deals help us think about these opportunity sets as we sit here today for Marriott.

Tony Capuano: Sure. So, on the pure conversions, I would say, on individual asset conversions, it's really just focus. It's streamlining our PIP[2] process. It's just like we're doing with existing assets, saying, in order for the deal to be economical, can we narrow the PIP focus on the most impactful parts of the asset or tranche the PIP into multiple tranches to get the asset in. Similarly focus on identifying multi-hotel portfolios and trying to bring those in on conversions.

And then I think on deals like MGM, I mean, MGM in some ways is a rainbow painted unicorn, right? It checks so many boxes for us. First of all, a terrific partner, kind of similar scale in the gaming space that we enjoy in the lodging space. When you think about our dominance in the group segment to be able to add that many properties, 5 million square feet of state-of-the-art meeting space in 1.5 miles strip, 500 food and beverage outlets, access to all of the entertainment and content that they have.

You may have seen we did an event just last week where one of our Bonvoy members got to take, I don't know if it was his wife or is fiancée, lakeside at Bellagio and program the Fountain Show with his wife's favorite music. And so, there's all these great Bonvoy tie-ins as well. And so, the combination of all the appealing facets of MGM led us to do a creative deal.

Then you look at a deal like Sonder, which we did most recently, that's structurally much more of a franchise deal. The fees are quite similar to a franchise deal. The Sonder properties are paying all the above-property charges of a regular franchise hotel. The only reason that we don't call it a franchise is they're going to control the development side of the equation.

Shaun Kelley: Sticking with MGM, you did talk about a rainbow-painted unicorn. My daughter would be so happy. It seems you have heard you said that, she's 6. But does that also imply a -- there are not a lot of these. Because there are some pros and cons in these partnership style deals in terms of these aren't necessarily the same economic structures. So, what is your, kind of, flexibility desire? Are there portfolios like this that could fit in? Or is it truly a unicorn in the sense of no, that's kind of one and done.

Tony Capuano: I mean if you've watched us over the years. We'll look at anything that we think makes sense to either fill a gap in our brand architecture, fill a gap in our geographic footprint where we're not getting the speed of growth organically that we might like or that can enhance the attributes of the Bonvoy program and MGM sort of ticked all those boxes. My guess is going forward might another deal like that present itself? Perhaps. But the very large majority of transactions that drive net unit growth will be traditional management agreements and franchise agreements. MGM in no way reflects some sort of strategic shift to how we think about net unit growth.

Shaun Kelley: And then maybe not to put you on the spot about it, but thinking about 2025 and 2026 some of the goals you laid out at your own Analyst Day, just confidence level on those unit

[2] Property Improvement Plan

growth targets as we sit here today, right? Sonder is, and again, economically sounds very comparable and rate structure that's probably actually a pretty decent relative portfolio. But like what confidence level interval sitting here today about hitting some of those longer-term objectives for Marriott?

Tony Capuano: So at the Analyst Day, we talked about a multiyear CAGR of 5 to 5.5 percent net unit growth, and we continue to feel good about that pace. A couple of years ago, in the early days of the recovery from the pandemic, we talked about our aspiration to get back to consistent mid-single-digit net unit growth. And I think that multi-year view continues to reflect that confidence.

Shaun Kelley: One last area that I want to touch on a little bit here was technology. So obviously, I don't want to get into like an AI buzzword bingo contest. So, we're going to try and do this without some AI.

But what you have been doing is you're actually investing, I think, behind the scenes, but this is an actual capex number from area at the moment. In a pretty material overhaul. So, can you talk a little bit about what's going on there? And then what are some of the features or opportunity set that, that may allow you to unlock?

Tony Capuano: So really, the principal project we're doing is the re-platforming of our three most important technology platforms, reservations, property management system and the loyalty platform. And it's not necessarily this notion of we'll go dark for a couple of years and then have the big reveal. We've already started to roll out some functionality, and we'll continue to roll that functionality through the back half of this year and into 2025.

When I think about the benefits, I really think about it through the lens of the three constituents we serve. So, when I think about our guests, our guests are by the hour becoming more and more discerning and sophisticated. And I think these new technology platforms give them and give us the opportunity to really help them curate and customize their travel experience in a way that we've not been able to do previously. For our associates, we will continue to be in a war for talent and this next generation of prospective hotel workforce is a generation that grew up very comfortable opening an Apple box with no instructions because the technology was intuitive.

Our on-property systems will be that same sort of single-pane-of-glass intuitive technology. And the thing that's most exciting to me about that, is the capacity that it creates for our associates to more deeply engage with guests at the hotel.

And then for the owners, obviously, there is some margin enhancement opportunity from more efficient technology. But I think one of the pieces that's not talked about as much as it should be is the revenue enhancement opportunities.

And so, if you think about as a Marriott guest, all the products and services, we'd like to make available to you, rooms, food and beverage, spa, golf, retail, residential. If you go to marriott.com today on the old platform, very easy and efficient to book a room, less easy and efficient to purchase all of those products. And this is a consumer that is accustomed to whether it's Amazon or some other retail site, plucking from multiple categories and dropping them in a shopping part and this new central reservation system will provide that sort of functionality, which I think is a really underrecognized and underappreciated revenue enhancement opportunity for the portfolio.

Shaun Kelley: Perfect. Tony, that's what we have time for. Thank you so much for joining us here.

Tony Capuano: Thanks for having me.

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