Operator: Welcome to the Marriott International second quarter 2009 earnings conference call. At this time for opening remarks and introductions I would like to turn the call over to President and Chief Financial Officer, Mr. Arne Sorenson. Please go ahead sir.

Arne Sorenson: Thank you. Good morning, everyone. Welcome to our second quarter 2009 earnings conference call. Joining me again today to discuss the quarter are Carl Berquist, our executive vice president and chief financial officer, Laura Paugh, senior vice president, investor relations and Betsy Dahm, senior director of investor relations.

As always, before we get into the discussion of our results, let me first remind everyone that many of our comments today are not historical facts and are considered forward looking statements under federal securities laws. These statements are subject to numerous risks and uncertainties, as described in our SEC filings, which could cause future results to differ materially from those expressed in or implied by our comments. Forward looking statements in the press release that we issued earlier this morning, along with our comments today, are effective only today, July 16, 2009, and will not be updated as actual events unfold. You can find a reconciliation of non-GAAP financial measures referred to in our remarks on our web site at www.marriott.com/investor.

We were pleased with our results in the second quarter. North American RevPAR came in a bit better than our guidance and adjusted earnings per share was at the high end of our expectations.

In North American lodging, we continue to see signs of stabilization in occupancy levels. It’s still too soon to say that we’re seeing “green shoots,” but to take the analogy a bit farther, at least we have some evidence that the planting season is not too far off.

Unfortunately, we aren’t yet seeing more corporate travelers and business meetings returning to our hotels. Instead, our mix of business remains skewed toward price sensitive leisure travelers. For the Marriott brand, roomnights sold to corporate travelers, defined as those paying corporate or above rates, declined 18 percent year-over-year in the second quarter.

1 Not a verbatim transcript; extraneous material omitted.
In contrast, leisure roomnights in the Marriott brand increased 12 percent in the second quarter, and on the group side, room nights from weddings, sports teams, family reunions and the like rose 7 percent. Marriott Hotels & Resorts’ weekend occupancy was actually higher than weekday occupancy, a very surprising statistic in the peak spring business travel season. Our sales and marketing teams have done a terrific job driving the demand that is out there into our hotels.

However, with occupancy levels stabilizing in the low to mid 60s, pricing has become a greater challenge. Everyone is price sensitive today, not just vacationers. We expect pricing power to return only as occupancy recovers. For now, with rates declining, we are seeing customers increasingly recognizing the great values available and, starting with leisure customers, jumping at them. We expect business transient and group customers to follow, as they see both the need to get back to work and the tremendous values available today.

Outside North America, we are starting to see more significant RevPAR declines with the economic downturn affecting most markets. In addition, the H1N1 virus is having a profound impact on our 17 hotels in Mexico and in some markets in Asia. Political uncertainty has also dampened demand in several countries.

Obviously, the environment for lodging is challenging worldwide. Still, there is much that we can do. Our lodging marketing teams continue to roll out new programs to gain market share; our sales organization is focused on closing business; and our properties are aggressively controlling costs.

For the timeshare business, we rolled out a 25th Anniversary marketing program in the second quarter. We offered discounts on our Marriott Vacation Club product for a limited time, 15 percent discounts for new owners and 25 percent discounts for existing owners. Of the 4,500 buyers who took advantage of our offer, more than half were existing owners buying another week. We were delighted with the results of the program. Adjusted contract sales totaled $212 million during the quarter, roughly $55 million more than we sold in the first quarter.

Given the success of the timeshare discount plan in the second quarter, we may consider becoming more aggressive on timeshare, fractional or residential pricing in the future. If so, pricing changes could have a material impact on the carrying value of certain projects in our inventory, which could result in impairment or other non-cash charges. Our priority is to drive cash flow in this business.

Company-wide our general and administrative expenses declined over 20 percent in the second quarter and we intend to keep those costs in check. We continue to aggressively manage our balance sheet and we are committed to our investment grade credit rating. With $1.4 billion available under our bank revolver we have excellent liquidity. Year-to-date, net debt is down nearly $240 million and we expect it to decline $600 to $650 million for the full year 2009. Through continued reductions in our investment spending and substantial cash flow from our fee-based model, we expect to be able to continue to reduce debt in 2010, improving our
leverage ratios further. We have no meaningful debt maturities until 2012 when our revolver matures, but we expect our revolver balance to be minimal at that time.

For our owners and franchisees, we remain focused on property-level cost control and driving the top line. We have eased brand standards where it makes sense and deferred scheduled renovations to help owners. For franchisees, we are communicating more than ever, focusing our advice and assistance on revenue generation, marketing and cost controls. We’ve received considerable favorable feedback from both owners and franchisees.

On the development front, we opened over 8,000 rooms during the quarter and have 110,000 rooms in the pipeline, including a new hotel in Hanoi we’re announcing in Vietnam tomorrow. Over half of the hotels in our pipeline are under construction and another 6 percent are awaiting conversion.

Our lower development pipeline reveals an important truth. The long term North American supply outlook has rarely been so favorable. At the same time, our development organization remains successful in signing new deals. While 4,500 rooms were cancelled from the pipeline in the second quarter, nearly 7,000 rooms were added, largely international deals in Asia and the Middle East as well as a few limited service hotels in secondary and tertiary markets in the U.S. As credit markets improve, we expect greater unit growth in the U.S. will come from conversions. All of this is possible because of the high value of our brands for owners and franchises.

We’re grateful every day for our business model, strong brands, owner and franchisee preference and guest loyalty. But we recognize the key to our success is our associates. They have been responsive and creative in dealing with the economic challenges while still taking care of our guests every day, and we thank them for their great efforts. We can’t tell you when the economy will recover; but we know with near certainty that the economy will improve and that when it does the earnings potential of Marriott will be impressive. We should see that dynamic play out in an environment where Marriott flags will fly over more than 600,000 hotel and timeshare rooms globally, and where demand growth should exceed anemic supply growth by a substantial margin.

Now I’d like to turn it over to Carl to talk about our results for the quarter and our outlook. Carl?

Carl Berquist: Thanks, Arne.

As you saw this morning, we reported adjusted diluted earnings per share from continuing operations for the quarter of 23 cents. Compared to the midpoint of our guidance, fee revenue was about a penny better, largely due to better than expected RevPAR in North America and solid cost controls that drove both house profit margins and incentive fees.

The “owned, leased, corporate housing and other” line gave us about 1 cent from better than expected house profit margins and better than expected branding fees.
We picked up about 1 cent from our adjusted timeshare sales and services, net, line. In April and May, our stimulus promotion increased contract sales and profits ahead of expectations. While some of the strong sales were undoubtedly pulled from future periods, we were nevertheless encouraged by the demand for our products.

Unfortunately, our tax line cost us about 2 cents, largely due to our 2009 marginal rate moving to 39 percent compared to about 35.7 in the first quarter. As the recession has continued to spread around the world, our income from “low tax-rate countries” has declined substantially. The second quarter provision reflects this higher rate.

The changing mix of customers in our lodging business reflects both market realities and our aggressive response to this business climate. In North America, Marriott Hotels and Resorts’ transient customers generated roughly 60 percent of the brand’s roomnights during the quarter. Encouragingly, transient roomnights declined only 4 percent in the second quarter as we replaced weak corporate business with leisure, government and other discounted transient business while the change in mix and price sensitivity drove transient average daily rates down 19 percent.

In contrast, groups made up about 40 percent of the brand’s customers in the second quarter. Here, roomnights declined 19 percent reflecting cancellations from months ago, lower participant turnout at meetings and fewer new group bookings. While cancellations have subsided in recent months, deteriorating attendance at group meetings, commonly referred to as attrition, continues to worsen. All in all, group RevPAR declined 25 percent during the quarter.

On the upside, we have seen a remarkable improvement in moving tentative group bookings to signed contracts by offering a variety of incentives to our sales staff and meeting planners. In addition, our revamped sales teams are putting us in front of dramatically more meeting planners. For transient business, a new weekend promotion during the second quarter yielded record-breaking booking activity on Marriott.com.

While roomnight bookings for the rest of the year are down 18 percent, today’s hesitant meeting planners tell us that they are held back more by the economy rather than any negative rhetoric from Washington. So, when the economy improves we would expect more favorable near term bookings and stronger occupancy, all of which should help transient pricing.

House profit margins in the North American company-operated hotels declined 5.3 percentage points during the second quarter, despite RevPAR declining 23 percent, as our teams continue to control costs. Labor-hours per occupied room have improved nearly 7 percent and management wages are down 16 percent.

And as Arne noted, our second quarter showed that the recession is global. Our International company-operated RevPAR was off 22 percent in constant dollars. The outbreak of the H1N1 flu had a dramatic effect on the results in Mexico. Occupancies at our 17 hotels there in May were as low as the mid-teens, with RevPAR down 80 percent. China and other countries in Asia were also impacted as groups canceled and bookings slowed due to quarantine concerns. But, despite the difficult conditions, at properties around the world operators have done an excellent job in controlling costs.
While RevPAR across our Ritz-Carlton brand in North America was off most significantly, down 31 percent, Ritz-Carlton’s leisure packages were up 59 percent. Recognizing that leisure business typically is less affected by the downturn, Ritz-Carlton launched a promotion focused on delivering high-perceived value to guests who may be traveling less but still want a vacation to remember.

Let’s talk a little bit about timeshare. Adjusted contract sales totaled $212 million during the quarter, exceeding expectations due to our 25th anniversary promotion. With costs in check, a lot of that upside revenue dropped to the bottom line. Adjusted timeshare sales and services, net of costs, totaled $16 million.

For a couple of quarters now, we have discussed the steps we are taking to right-size our timeshare business given a weaker demand environment. We have significantly reduced our investment spending and are committed to our objective of delivering positive cash flow for the business in 2009.

Turning to timeshare financing, the delinquency rate on financed timeshare loans was 10 percent in June, down a bit from the 10.2 percent we reported in May. Given the economic environment, seven timeshare loan pools have hit default triggers year-to-date, which, as you may recall from our discussion last quarter, results in a redirection of cash flow to investors. We estimate that the net cash flow reduction associated with these triggers will total about $20 million in 2009. Assuming current delinquency rates and typical receivable aging, we anticipate these triggers will cure in about six months.

As I am sure you are aware, recently released Financial Accounting Standards 166 and 167 will impact the way we account for securitized loans beginning in 2010. Under the new rules, it is likely we will have to consolidate previously securitized loans. We are still determining how the new rules will specifically affect the balance sheet and the income statement. But what we do know is that the underlying economics of the deals will not change and the timeshare loan pools will remain non-recourse to us. Our revolver covenant calculation does not include nonrecourse debt, so we don’t expect it to change. Further, based on our discussions with rating agencies, we do not expect any changes in how they look at timeshare securitization as a result of this accounting change.

For Marriott overall, our adjusted G&A totaled $136 million in the second quarter, down 26 percent from the prior year. We are continuing to review our organizational structure, our systems, and business processes to improve our efficiency further and right-size our overhead as appropriate.

Let’s talk about the third quarter.

In the earnings release, we have shared with you a range of top-line assumptions that we are using internally to manage our business. We are sharing these assumptions to help you model the business, but we are not guiding you to any particular earnings number. Unfortunately, the level of visibility simply remains too low for us to have much confidence in predicting results.
For hotels outside North America, we assume third quarter RevPAR declines 22 to 24 percent. International lodging markets have significantly weakened as the economies in many countries have been impacted by the global downturn. In addition, we’ve seen significant impact from the H1N1 virus in many markets. Political unrest in Thailand and the terrorist incident in Mumbai last year continue to reduce travel to those areas.

For hotels in North America, we expect RevPAR to continue the trends seen in the second quarter with RevPAR down 20 to 23 percent. Here, much of the RevPAR decline will likely come from lower room rates, due to a mix shift to lower-rated business, and discounting to keep pace with competitors and weaker group business.

Given these assumptions, we assume total fee revenue of $210 to $220 million in the third quarter. While unit expansion should help our fees, tougher comparables will likely also impact our results, since contingency cost cutting for North American hotels began in the second quarter of 2008. Given the likely RevPAR decline, margin compression and seasonality of the third quarter, incentive management fees could total zero to $10 million. With fewer hotels earning incentive fees, the incentive fee impact of resort and convention seasonality is likely to be more pronounced in the third quarter.

We expect owned, leased, corporate housing and other revenue, net of direct expenses, to total approximately $0 to $5 million in the third quarter. While we own or lease 43 hotels, seasonally softer performance combined with the weak economy, particularly in the international markets, will continue to constrain profits.

For the timeshare business, while we had good consumer response to our discount plan in the second quarter, we believe it may have accelerated sales that would have occurred later in the year. As a result, we expect timeshare contract sales to total $165 to $175 million in the third quarter and timeshare sales and services, net of direct costs, is expected to total about $15 million in the quarter.

The G&A line reflects savings we’ve taken at our corporate headquarters, throughout our lodging organization, as well as in our timeshare business. We estimate third quarter G&A will decline from $167 million in 2008 to $135 to $145 million in 2009, a decline of roughly 15 percent from the prior year. Quarter-over-quarter comparisons are getting tougher.

Including the benefits from lower interest rates, offset by the impact of the 39 percent tax rate, we estimate adjusted third quarter EPS at about $0.09 to $0.14 per share.

For the full year 2009, we are operating our business assuming RevPAR will decline 17 to 20 percent on a constant dollar basis for systemwide hotels both inside and outside North America.

Given these RevPAR assumptions and the more than 30,000 rooms expected to open in 2009, we anticipate our fee revenue could total $1.03 to $1.06 billion. Owned, leased, corporate housing and other revenue, net of direct expenses, could total $55 to $60 million.
For our timeshare business, we continue to assume a weak economic climate and adjusted contract sales of approximately $800 million, consistent with our prior outlook.

However, services revenue has weakened a bit as lower room rates have reduced timeshare rental revenue. In addition, with growing timeshare inventory, maintenance fees from unsold inventory also depresses results as projects are completed. Further, an $8 million charge for a state tax matter taken in the second quarter will flow through the full year numbers. In total, adjusted timeshare sales and services revenue, net of the direct costs, could total approximately $45 million in 2009 and the adjusted timeshare segment results could total roughly $25 million. We are confident that the timeshare business will have positive cash flow in 2009.

We expect Marriott’s hotel investment spending to total about $325 to $375 million in 2009, a roughly $450 million decline from 2008 spending levels and down slightly from what we expected last quarter. Compared to 2008, this includes cuts in the net timeshare spending, new capital expenditures and other investing activities.

Compared to the midpoint of our prior 2009 scenario, we reduced total fees by approximately $0.05 per share largely related to slowing RevPAR in international markets and weaker incentive fees. Adjusted timeshare sales and services, net of direct costs, is assumed about $0.02 cents per share lower due to a penny from a state tax reserve I just talked about, and a penny from lower services income.

The higher tax rate reduces our outlook by about $0.04 cents

In addition, below the line items, including a higher diluted share count as the result of a higher stock price, cost us about $0.02.

All of this implies adjusted 2009 earnings per share of about $0.76 to $0.86 per share.

Despite this very challenging environment, as we look ahead, we’re optimistic, not just because we believe business will come back but also because we have been strengthening our company. We’re confident in the future.

As always, keep traveling. We’ll take questions now.

Question and Answer Session

Jeffrey Donnelly, Wells Fargo: Good morning guys. A few questions, Arne, I guess Arne and Carl, I have to imagine that between the fourth quarter of 2008 and I guess I’d say the second quarter of 2009 there has been some significant portion of demand that vanished perhaps I guess I’d say due to non-economic reasons, whether it was just companies being conservative or fear of attention from politicians or the press, and it may well return in the coming six to nine months, similarly for non-economic reasons. Do you have a sense for where that demand was or sort of where and when it could reappear and how material it could be?

Arne Sorenson: Not really, no…
Jeffrey Donnelly, Wells Fargo: [Laughter] That’s an honest answer…

Arne Sorenson: Obviously you have got enormous economic forces that have had an impact on demand in our industry and demand in virtually every other industry that we can think of. Those economic forces were further fueled, certainly around the financial world, and particularly the impact on group and transient travel in the financial business by a toxic political rhetoric which we think largely is gone. There may be a few remaining vestiges of that but by and large you don’t hear politicians any more talking about evils of travel. In fact just the reverse. I think you hear increasingly from the White House and from the hill a due recognition of the significance of this industry to the U.S. economy and the advantages of travel.

So, I think that bit is gone. We are though clearly not out of the environment where the economic pressures on our customers have lessened significantly. And so as a consequence we wouldn’t see that there would be a powerful rebound from the non-economic rhetoric, if you will, until such time as we see the economic forces justify a bit more demand.

Jeffrey Donnelly, Wells Fargo: It’s a good thing they are not scrutinizing my industry. [laughter] I’m curious on the cost side, we had recently done a survey of GM’s where I think about 70 percent of them said they felt there was really no further ability to reduce costs at the hotel level. I suspect that view pertains more to, I’ll call it non-occupancy related costs. Do you think that is an accurate view or do you think there really is more that can be done from this point?

Carl Berquist: I think obviously our folks out in the field have done a tremendous job managing costs if you think about how far RevPar has dropped yet holding margins at 450 basis points down globally. It is just a tremendous job. I think they continue to look for opportunities. Going forward obviously as we discussed about pricing and how there is a lot of pressure on pricing it gets harder and harder to maintain those margins because it is a rate driven drop. In addition, comps get more difficult because we started actually in the second quarter but more so in the third quarter cutting costs and controlling costs out in the field. So, I wouldn’t give up and say there is nothing there but it is going to get more difficult going forward. But our folks are continuing looking at different opportunities.

Jeffrey Donnelly, Wells Fargo: Just one more question, clearly your organization is hunkering down operationally and I guess balance sheet wise, but it also seems to be a good time you could be taking share or at least positioning yourself to take share in the future. Recognizing we are not going to probably see rampant new room construction at least here in the U.S. are there areas of your firm that either you are ramping up or at least not cutting back as dramatically such as teams that would focus on conversions or maybe asset management areas that could enhance profitability or group or public sales teams so that you are well positioned for 2010 and 2011?

Arne Sorenson: We think in a number of different areas we are in fact focused on positioning ourselves for the growth opportunities that are going to be present here soon. And while we are obviously focused on both the balance sheet and managing costs we are doing that in part so that we have maximum flexibility to seize the opportunities as they come in. In terms of transactions,
we are all reading the same stuff. We are all hearing the same stories. I think we know that there is a substantial increase in loans that are either in default or nearing default in our industry. But there has not been much yet that has traded. Until they start to trade both the opportunities directly to invest in real estate but also more importantly to us the trading of assets which drives conversions, that volume I think will stay down a bit. And so we are ready to pounce. You can look across our departments. I think we have cut relatively less in international focused development, for example, because that is still relatively stronger and presents more opportunities. Not surprisingly we have cut basically nothing at all in terms of the efforts and dollars we spend around work outs and working with our owners and franchisees with troubled hotels. Obviously that will be a substantial industry for the foreseeable future and in other areas where we have tended to cut more. We are very much trying to be set up to seize the opportunities as they come forward.

Jeffrey Donnelly, Wells Fargo: Ok. Thanks you guys.

Janet Brashear, Sanford Bernstein: Good morning. I have a question about the rate environment but I’m wondering if I could follow-up on your last discussion a minute first relative to the margins. The hotel GM’s said they didn’t see many more areas where they could cut. How do you feel about the corporate environment and your operating margins? Do you see many more areas you can cut?

Carl Berquist: Well we continue to look at our business and look at our overhead costs mostly above property as well as the corporate costs. As we look out and look at the business we are going to continue to right-size our overhead to meet the demands of the business. Obviously we started the process in the second half of last year so the comps gets a little harder to do that but we will continue to look for areas and continue to reduce our costs as the business continues to develop.

Janet Brashear, Sanford Bernstein: Thanks Carl. If I can switch back to rates for just one second, the industry trends we are seeing from Smith Travel and others show that in some segments transient rates are falling below the group rates. I’m wondering if that is true for your brands and if so how do you manage that since then the group rates start to collapse?

Arne Sorenson: There are certainly marrying and I’m sure in some individual instances we have some transient rates that are lower than some of the group rates that are on the books. Rate is obviously the risk here. When you look at both our results in the quarter and what is implicit in our forecast or guidance assumptions going forward and you look at the industry data you see the lines crossing at this point. You see greater relative performance of occupancy, it is still obviously down year-over-year but looking back over our last six periods the rate of decline in occupancy has been flat or improved six straight periods. If you look at rate, and I think we are 10-11 periods in a row where the pace of decline of rate has accelerated.

That is what we are watching as we go forward. I think as optimistic and positive as we are about the bottoming of demand we are concerned about pricing.

Janet Brashear, Sanford Bernstein: Thank you Arne.
Chris Woronka, Deutsche Bank: Good morning guys. I am curious as to whether you have seen any impact yet from the airline capacity reductions and whether you expect to see any impact in the future? I know yesterday American announced more cuts, I think primarily domestically. Is that something you look at? Do you track it? What kind of impact might there be?

Carl Berquist: We look at that along with a lot of other indicators to look at the indicators out there that show who is traveling and the level of travel. Clearly the airlines have announced that although they have dropped capacity they also are having pricing problems in their business. The planes are full because they have dropped the capacity but it is what they are getting per passenger mile. I think one of the things we are seeing is the corporate customer is not traveling. And that is the big driver. Our people are doing a great job of replacing that business with government and other mix shift types of business, leisure, but as we mentioned earlier it is a pricing issue relative to that mix shift.

Chris Woronka, Deutsche Bank: Is it your view that you can incentivize any additional corporate or group travel with price? We know you can on leisure but can you do that on corporate or group or is that more reliant on the airlines to and everybody else?

Arne Sorenson: Clearly leisure is more responsive to price discounting immediately but I think the group business particularly, so those folks who know they are going to hold their meetings, and this is maybe a bit of wishful thinking, but the business is on sale and the values that are out there today are wonderful. So if I am looking at booking a piece of group business that I know with a high probability I am going to have next year or I am going to have in 2011, this is a pretty tempting time to book it because of those rates and to get them available. Again, none of us knows when we are going to see a real recovery in economic activity which is the thing that is going to drive occupancy and demand. But we all can be pretty certain that it is going to come. And as it comes, the values that are available in this industry today will become less available. So it is a great time to buy for not just leisure travelers but for others as well.

Chris Woronka, Deutsche Bank: Right, great. That’s helpful, thanks.

Smedes Rose, Keefe, Bruyette & Wood: Good morning. I just had a couple of questions on timeshare. I just want to understand it, it looks like contract sales you are still estimating I think around $800 million, which has been the number for awhile, but the profitability continues to decline. Is that primarily a function of these default triggers take place, and your interest income gets subordinated, that is driving down the profits there through the financing area or is it more to do with reportability? What is kind of the main driver there?

Carl Berquist: Well, I think on your question relative to the default triggers, if you look what that affects is the value of your residual. And we made an adjustment for that $12 million in the second quarter for the drop in the value of the residuals so we kind of took that out of the adjusted column relative to the effect of that. I think what you are seeing is a couple of things. One, we had our incentive program in the second quarter and some of those profits or some of those sales we pulled from the third and fourth quarter that probably would have occurred. The
other thing is our services profits or services activity, which is renting the unsold weeks so to speak as transient rooms, that has dropped because RevPar has dropped and those revenues offset unsold maintenance fee costs. Unsold maintenance fees are what we pay on the unsold weeks and so those together with the increased weeks are putting pressure on our services profit.

So I think you see both of those things are driving some of that. And finally, we have this $8-9 million tax item that is depressing the earnings for the full year.

**Smedes Rose, Keefe, Bruyette & Wood:** Ok. And then just the other thing on that one, you talked about the rating agencies. Did they currently assume Marriott’s potential liability is around 20 percent of the securitized notes? Does that change if delinquencies continue to rise? How do you think they are kind of thinking about that particularly now that you have to consolidate these notes?

**Carl Berquist:** Each rating agency looks at our timeshare securitizations a little differently. I think they looked at them consistently over time and they obviously watch the delinquencies as we do as well.

**Smedes Rose, Keefe, Bruyette & Wood:** Ok. And then Arne just one last one, on the international outlook, you have clearly reduced expectations. It seems like the developing world, China, Singapore or Asia is kind of doing better than many people had thought. Is it mostly, is Europe just doing really badly? Maybe could you talk a little bit more about the segments besides the areas where there has been political unrest?

**Arne Sorenson:** It is everywhere and there is a somewhat different dynamic. So in China, for example, their economy obviously is better performing and forecasted to be better performing than much of the rest of the world but you have got still a tough travel environment which is compounded by meaningfully higher supply growth in China than we have seen probably anywhere else. So you look at the RevPar numbers actually for that market and they are not meaningfully better and in fact in many respects are worse in many months than we have seen in the United States.

India is a much smaller market from a hotel perspective both for us and for the industry as a whole. But maybe a few remaining impacts of the Mumbai bombing. I think probably more than that though it is an impact on global travel in the tech business. Very weak RevPar. So I think that the stories are a little different as we talked about a quarter ago. In the U.S., Washington, D.C. is still one of the relatively best markets. I think as a region we would say that maybe excluding Dubai the Middle East is a relatively strong performer. Saudi is strong. Egypt is relatively strong. And those are good markets. Europe is actually about average for performance across the globe.

**Smedes Rose, Keefe, Bruyette & Wood:** Thank you.

**Arne Sorenson:** It’s a big world out there.
**Steve Kent, Goldman Sachs:** Good morning. Two questions for you. One, I thought that you mentioned, I think it was Carl who mentioned about incentive fees, going forward that in the third quarter because these were in resort locations maybe they would be a little bit softer. Maybe you could just review that. But maybe in a broader sense, if RevPar stays negative for the next several quarters do you expect to get no or very, very low incentive fees? Does RevPar have to turn positive for you to start to get incentive fees at this point? If you could explain those two issues.

And then, just more broadly Arne, it feels to me like the last time we went through a downturn in the cycle there was a build up of leisure travel and all the people you are tapping right now, the sports teams and some of the meetings on weekends, and that created a lift of occupancy which then gave some of your hotel owners and managers some comfort of pushing price a little bit as they got further along. This seems worse than the last time but is that sort of the normal trajectory for how this industry recovers or your experience of recovery?

**Arne Sorenson:** Let me take that one first and then Carl can jump in and talk about the incentive fee performance. I think there are bits of this which are normal. I use that word with some caution because there is a lot about this downturn that doesn’t feel very normal. It is not unusual for leisure customers to be more loved by higher end hotels in weaker markets and pursued more aggressively. It is not unusual for leisure travelers to respond more quickly to discounting and therefore to fill in some of these lower demand periods. Obviously the better leisure performs the more that will drive relatively improved confidence both in terms of pricing for the rest of the hotel and among our teams out there in the hotels and the like.

Having said that, we are probably not going to be able to drive significant pricing growth on leisure customers only. I think as we get into the fall we are going to need to see business travelers and group rebook and get back on the road. And until we start to see demand grow in that space I think we will continue to have pressure on rate. Carl you want to talk about incentive fees?

**Carl Berquist:** On the incentive fees Steve, your question about the resorts, we use that as an example, but when you report incentive fees you do it on a cumulative basis throughout the year. We do a kind of catch up adjustment, so to speak, each quarter on a cumulative basis so you take a resort that earned a lot of money in the first quarter, records an incentive fee and then in the third quarter which is a very slow period you will have an adjustment to bring that to a cumulative number. What you are seeing is that a number of hotels that used to pay incentive fees aren’t paying incentive fees now because they are now below the owner’s priority. And so this is becoming more pronounced as these cumulative adjustments take hold.

And that is the phenomenon we are seeing. And then as the international markets get soft, even in those cases where we are earning the fee right off the first dollars of operating profit, operating profit is dropping internationally as well as RevPar drops internationally despite the efforts made by our folks to hold margins. What will we need to keep things flat? I guess it would be margins would have to stay flat to hold the incentive fees flat at this point.
Arne Sorenson: But you know we don’t need, Steve you asked…I think you asked do you need positive RevPar to see incentive fees. We think we will do $100 million plus of incentive fees this year with obviously massively negative RevPar. We don’t need for RevPar to be positive next year in order to have the first dollar obviously of incentive fees. We can still make $100 million plus of incentive fees. Again, it depends obviously on the cost environment and exactly where RevPar is. We have got still the possibility of making good incentive fees going forward.

Steve Kent, Goldman Sachs: To carry that forward, if RevPAR negatives…the negative growth trajectory gets less worse or less bad or whatever people talk about or the second derivative improves, the same thing can happen on incentive fees that they can start to tick up?

Arne Sorenson: Generally negative RevPar is going to be a negative influence on incentive fees. It doesn’t take it to zero.

Steve Kent, Goldman Sachs: Right.

Arne Sorenson: But it would likely continue to reduce until such time as RevPar is positive and then you will start to see the increases.

Laura Paugh: Also remember that with fewer hotels earning incentive fees, the incentive fees are going to be dependent on performance at those particular hotels. So it is not necessarily the case that a system wide number represents what is going on in those particular hotels.

Steve Kent, Goldman Sachs: Ok. Thanks.

William Marks, JMP Securities: Good morning everyone. A couple of questions, one, can you remind us what international is as a percentage of total these days? Revenues or however you want to describe it?

Carl Berquist: It’s about 25-30 percent of fees.

William Marks, JMP Securities: It seems as if, based on the guidance that is where really the only surprise is versus April in terms of your hotel business but you are also saying you are seeing a shift in rate versus occupancy. Maybe can you help me understand that?

Arne Sorenson: I think I understand your question. Obviously our RevPar, our assumption for RevPar for the full year we have not changed. Our second quarter numbers were about what we anticipated, maybe on the positive side, the optimistic side of what we anticipated for the second quarter. So you look at that and say why then does the assumption about total fees for the full year change? Assuming that is what you are asking?

William Marks, JMP Securities: Yes.

Arne Sorenson: There are obviously a number of factors that go into that but the two most significant ones you have just referred to. So you’ve got international RevPar which we now expect to be meaningfully worse than we did a quarter ago, order of magnitude 5 points I
suppose, something like that. And on incentive fees, we have got basically while RevPar is about the same we have got relatively stronger performance in occupancy and relatively weaker performance in rate with therefore greater pressure on margins and a greater impact on incentive fees.

**William Marks, JMP Securities:** Ok.

**Arne Sorenson:** Those would be the two most significant pieces I think driving that full year fee number. Is that what you were asking?

**William Marks, JMP Securities:** Yes it was. I know you were repeating yourself or I was making you repeat yourself but I just wanted to make sure I was clear. Also on the big issue these days is certainly the trading of ADR for occupancy and can you discuss along different segment levels where obviously at the luxury end we are definitely seeing it. Are you seeing it all the way down?

**Arne Sorenson:** We are seeing rate declines in every brand. Yes, in every segment.

**William Marks, JMP Securities:** I’m sorry, actually what I meant was has there been a change in the last few months where…because it seems like if you look at the weekly Smith Travel numbers the rate of RevPar decline hasn’t changed that much and the trade off of rate versus occupancy is happening much more at the high end, meaning it has gotten much worse, but at the lower end it doesn’t seem as if the ADR has shifted that much.

**Carl Berquist:** Occupancy is starting to level off. But what you are seeing is that the price sensitivity continues to put pressure on RevPar. So what has happened is that over the last several months or several periods you’ve seen occupancy leveling off in the mid 60’s but continued rate pressure and because the occupancy has leveled off at a lower rate you don’t have pricing power yet.

**William Marks, JMP Securities:** Ok.

**Arne Sorenson:** You look at our quarterly results by brand and you can see rate at double-digit declines for all full service and worst in the luxury Ritz-Carlton. In the limited service brands, Courtyard is about in the same area because it is 100 percent transient and mostly business travelers. And the other limited service brands the rate declines are a bit less at high single digits. And that may be what is behind your question. But we are still talking about in limited service brands rate declines in our second quarter nearly 10 percent, 8 or 9 percent. And when you look at either our data or you look at the Smith Travel Industry wide data, you can plot from November or the first of December 2007 until today by month, you have to adjust a little bit for some funkiness in holidays, but by month a shifting. Initially the weakening in RevPar growth was driven by occupancy declines. Rate was still very, very strong. But in every period since then the rate growth, and now declines, have gotten worse month by month. I think that is true for every segment.

**William Marks, JMP Securities:** Ok. That answers the question. Thank you.
**Joseph Greff, JP Morgan:** I had a follow-up question on some of your earlier comments Arne about group business for 2010 and 2011 and now an opportune time to do it from a pricing perspective. For the 2010/2011 corporate group business that you have on the books how does that basket of pricing compare to 2009 pricing on group?

**Arne Sorenson:** I think it is flattish. Maybe down a bit. The bigger impact is in occupancy. We have got business on the books for next year compared to the same time last year for this year is down significantly, high teen’s year-over-year. About 20 percent. But as we talked about a quarter ago that is not a very meaningful number because a lot of the business that was on the books last year for this year has already been cancelled or attrited down. So we don’t have a very meaningful statistic on pace which is really the occupancy equivalent.

On the group, the pricing it’s not been terribly impacted yet in part because there is a higher percentage of the group business that is on the books for next year which was booked really prior to when the wheels came off last fall.

**Joseph Greff, JP Morgan:** Ok. Do you think though that this time next year that pace is a more relevant metric just given the narrowing in rate between transient and group that there is maybe less of a booking out of the block from a corporate rate or a group rate into a transient rate? Or is that sort of an optimistic way of…

**Arne Sorenson:** I’m not really sure I understand. I think Pace is going to lead us out.

**Laura Paugh:** Eventually.

**Joseph Greff, JP Morgan:** Ok.

**Carl Berquist:** Right now we have a very short booking window. The meeting planners and bookers, they’re sitting on the sidelines waiting to see if they can get a better deal, looking for better pricing, and so you have a very short window right now. I guess part of your question is do we think as we move out of this volatility or out of the recession part will we see that booking window lengthen? And probably. I mean you would expect it to do that. As occupancy moves up then there will be a need to book further and further out so that booking window will expand. But right now it is pretty short.

**Joseph Greff, JP Morgan:** And then a question on the composition of the development pipeline. How much of that is under construction right now? How much of that is international? How much of that is domestic, limited service?

**Carl Berquist:** About 50 percent of it is under construction. We have another 6-7 percent that is conversions. If you put those two together probably 57-58 percent is the equivalent of under construction or conversions. What was the second question you had there?

**Laura Paugh:** International…
Carl Berquist: Oh, how much is international? I think 30 percent is international and if you think of it in terms of full service probably 60 percent of our total pipeline is limited service in North America, predominately franchise. The other 40 percent being full service and the majority of that would be outside of the United States.

Joseph Greff, JP Morgan: Ok. I know you don’t want to talk about 2010 in any great detail but based on those numbers and those statistics do you feel confident you can add 30,000 gross rooms in 2010?

Carl Berquist: I don’t think we have given a number yet for 2010. We think that we feel good we will continue to add rooms in 2010 in a healthy way just given the pipeline and what is under construction and what’s in it.

Joseph Greff, JP Morgan: Good enough. Thank you guys.

Felicia Hendrix, Barclays: Hi guys. Laura, good to hear your voice.

Laura Paugh: Thank you. It’s nice to be back.

Felicia Hendrix, Barclays: Yeah, I’m sure. A few questions. Arne, awhile back in this call you had talked about workouts and how you are spending some time with I guess managers and particularly managed guys on that. I was just wondering what percentage of your managed and franchised hotels are in some kind state of payment default on their debt service? And to the extent that you are engaged in workout discussions I am just wondering if there is any way you could give us the magnitude of where that is maybe relative to prior similar periods.

Arne Sorenson: Those are all great questions. I think in terms of cash defaults on debt service we think the number of hotels that are in that situation are very, very few. The hotels which are under the most pressure from a long-term perspective probably were financed in 2005, 2006, 2007 or something like that, towards the end of the cycle, and if they were financed aggressively there are questions about how much debt those things can support long-term. A positive piece though is much of that financing was done floating rate and if it is floating rate those owners have gotten the benefit of very low current interest rates.

And so as a consequence, the cash defaults are really not that high. It is more a question of longer term how do those deals get structured in a way that makes sure that they are stable. We are in communication with our owners and franchisees a lot but we don’t have direct data in our system about the details necessarily of their financing. So there are many statistics we really can’t give you. I think though that if you compare this to 2001, 2002 and 2003, we are still...right now we are in...the wheels changed dramatically in the fall of 2008 so we are really three quarters into a tough RevPar environment. If you really look at 2009 where it has been the most severe, we have been through two quarters. I think the big questions we are really going to have to watch is how long does it continue and if we can hopefully see some kind of recovery that is meaningful in 2010 that will have a profound impact into the way both owners and lenders view these projects.
Felicia Hendrix, Barclays: Right.

Arne Sorenson: So I think we are all as an industry collectively working to get a few more quarters down the road in the hopes that we are going to see some recovery and that is going to have an impact on the way these deals get dealt with.

Felicia Hendrix, Barclays: And then in terms of when you used the terms workouts, we have been hearing…all brands have been offering those owners who are having difficulties certain concessions and deferrals and that sort of thing. When you are having these discussions even though they are few, what sort of discussions are they? What sort of path are they taking?

Arne Sorenson: I think the word workouts sort of implies a conclusion of some set of negotiations. We are not at the stage where workouts are being completed. So maybe I used that word inadvisably. But what we are doing is working with our owners and franchisees to be prepared to ultimately see how those things can get restructured if they can get restructured.

Felicia Hendrix, Barclays: Ok.

Arne Sorenson: Because we know that that pressure is already there but again that pressure has not been there long enough, usually, in the overwhelming majority of cases to ripen into something definitive yet.

Felicia Hendrix, Barclays: Gotcha.

Arne Sorenson: I think in the meantime we have a lot of structural benefits in our business model. We have management contracts that overwhelmingly include non-disturbance agreements from the lenders. We are usually in the position in the managed hotels to control the cash and to make sure that we are not letting receivables run up or in some other way financing the system. So we are doing everything we can to protect our situation and not become a lender to hotels that are under pressure but at the same time the owners and franchisees are hugely important customers and partners of ours and we’ve got to make sure we are working with them to do everything we can consistent with our needs to make sure that they can survive.

Felicia Hendrix, Barclays: Ok. And then just switching gears, I was wondering can you give us the metric in the quarter for your pipeline around just your conversions versus new hotels and maybe how that compared to last…to second quarter 2008?

Carl Berquist: We had two hotel conversions in the second quarter. So of our total hotels it wasn’t a material number of the total. I think we are expecting somewhere between 7 and 10 percent of our hotels added in 2009 to be conversions.

Felicia Hendrix, Barclays: And then is that, I know I could look it up but how does that compare to 2008 second quarter?

Carl Berquist: I don’t have that with me. We’ll have to get back to you on that one.
Laura Paugh: We’ll get it for you…

Felicia Hendrix, Barclays: Yeah, I could look that…you have that in your factbook.

Carl Berquist: And one other thing, as Arne mentioned when he was talking, right now we haven’t seen a lot of activity relative to the lenders or properties going back to banks and all that. Lenders are working with owners. We would suspect that when and if that does start happening within the industry we will get more than our fair share of conversions as portfolios start changing hands.

Felicia Hendrix, Barclays: Ok. And then just…

Arne Sorenson: Felicia, thank you very much. I think we are at our time. Thank you all very much for participating in this morning’s call. As always, we encourage you to get back out on the road there. There are great values out there. Snap them up before they disappear. Thanks for your time.

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