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WESTPEAK RESEARCH ASSOCIATION

Hilton Grand Vacation (NYSE: HGV)

Hotels, Resorts, and Cruise Lines

Buy Your Next Vacation

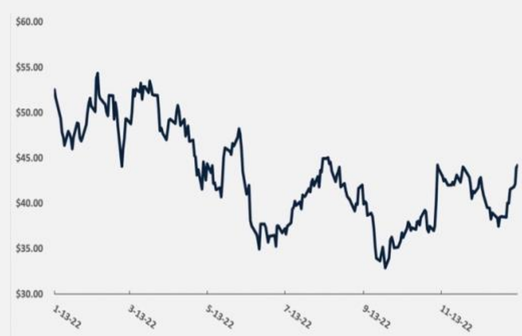
March 30h, 2023

Equity Research	US
Price Target	**USD$ 50.30**
Rating	Buy
Share Price (April 17 Close)	USD $45.91
Total Return	9.56%

Key Statistics	
52 Week H/L	$52.69/$32.12
Market Capitalization	$5,160M
Average Daily Trading Volume	1.39M
Net Debt	$3,561M
Enterprise Value	$8821M
Net Debt/EBITDA	3.24x
Diluted Shares Outstanding	112M
Free Float	55.5%
Dividend Yield	0%

WestPeak's Forecast	2018E	2019E	2020E
Revenue	$3.83B	$4.51B	$4.71B
EBITDA	$862M	$903M	$948M
Net Income	$397M	$571M	$602M
EPS	$3.27	$4.98	4.98
P/E	13.0x	8.9x	8.4x
EV/EBITDA	9.8x	8.6x	7.6x

1-Year Price Performance



Hilton Grand Vacation is a timeshare company that allows travelers to advance purchase vacation time at various travel destinations within the Hilton network. Travelers join one of Hilton's points-based Clubs and become one of 300,000 members to enjoy exclusive leisure travel services.

Thesis

Hilton Grand Vacations is one of the largest timeshare companies worldwide and delivers high-quality products to over 725,000 owners. Company performance was heavily impacted by the COVID-19 pandemic – however, the rapid distribution of vaccines worldwide along with the diversified offerings and synergies from Hilton's acquisition of Diamond Resort position the company favorably in the industry as it continues to capture a larger market share, capture acquisitive and organic growth in the years to come.

Drivers

The rapid distribution of COVID-19 vaccines worldwide along with Hilton's acquisition of Diamond Resort position the company to see top-line growth in the next few years as synergies are realized. Hilton is also expected to benefit from the steady growth of the hotels, resorts, cruiselines industry, as the next decade anticipates globalization, international business activities, and sports tourism, driving the occupancy rate of hotels and resorts. Furthermore, the loosening of government travel mandates and pent-up demand for traveling will drive Hilton's revenue as the economy recovers.

Valuation

Our target price of $50.30 USD is based on the perpetuity growth and EV/EBITDA exit multiple in the DCF, as well as the EV/EBITDA and P/E in our comparable company analysis, weighted at 25% each. We believe Hilton Grand Vacations is currently undervalued and has a **BUY** rating with an implied upside of 9.56%.

Business Overview/Fundamentals

Company Overview

Founded in 1992, Hilton Grand Vacation Inc. (NYSE: HGV) is a global timeshare company that is headquartered in Orlando, Florida, United States. Hilton develops, sells, and markets timeshare products and resorts, serving customers worldwide. Top-line growth is driven through selling vacation ownership intervals (“VOI's"), managing resorts based on fee-for-service and just-in- time management contracts, financing loans for customers' VOI purchases, and managing the points-based Hilton Grand Vacation Clubs. As of December 31st, 2021, Hilton has approximately 330,000 Club members who have the flexibility to exchange their VOIs at any of the 6,500 properties in the Hilton system, at locations in the US, Europe, Mexico, the Caribbean, Canada, and Japan. In 2021, Hilton acquired Diamond Resorts of $1.4 billion, and is expecting significant cost savings and $125 million in cost synergies.

Source: Hilton Grand Vacations

History

Hilton Grand Vacations (HGV) became an independent publicly traded company after Hilton Worldwide Holdings Inc. completed a spin-off in 2017. Upon completion of the spin-off, Hilton entered into an agreement with Hilton Worldwide Holdings Inc. to use the Hilton Grand Vacations brand, which is an essential part of its current business strategy. In August 2021, Hilton completed the acquisition of Dakota Holdings, Inc. (“Diamond"), the biggest timeshare operator with no previous brand affiliation which owned a portfolio of resort properties, by exchanging 28% of Hilton Grand Vacation’s common shares for 100% of Diamond's outstanding equity.

Revenue Segments

VOI Sales and Financing Segment

Hilton's vacation ownership interest product (“VOI”) allows customers to advance-purchase the vacation time they intend to use each year. This business segment has traditionally approximately 40% of Hilton’s revenue in the last few years. This product allows Hilton customers to split the full cost of a vacation with other VOI owners while benefiting from a wide array of amenities and services. Through fee-for-service agreements, the company collects a fee based on a percentage of total VOI sales on behalf of third-party developers. Additionally, Hilton provides clients with financing services for their purchase of VOIs, collecting interest income from the origination of consumer loans provided by itself or by third-party developers.

VOI Inventory Sourcing Model

Hilton sources VOIs through a capital-efficient model comprised of fee-for-service and just-in-time agreements with developers. These agreements make up 40% of the total inventory sourced and provide the company with predictable revenue while minimizing exposure to real estate market’s cyclicality.

Under fee-for-service agreements with third parties, Hilton earns commission as a percentage of total VOI sales. The fee-for-service arrangements are capital-efficient because they generate revenue from the sales and marketing of the VOIs without requiring the company to fund the acquisition and construction of the resorts, which reduces inventory holding costs and increases the inventory turnover rate. Additionally, the just-in-time arrangements enable the company to correlate the timing of the inventory acquisition with the sale of the VOI inventory. The resulting EBITDA contributions from such inventory sourcing strategy are typically higher due to the lack of initial capital investments required to drive revenue growth.

Financing VOI Purchases

Approximately 15% of Hilton's revenue comes from its financing receivables from loan origination to customers who wish to finance their purchase of VOI products. In FY 2020 and 2021, the company's financing propensity was 67% and 74%, which is calculated as sales volume of financed contracts divided by total contract sales originated in the period. The loans Hilton originates range from 2.5% - 25% interest annually for a duration of up to 10 years.

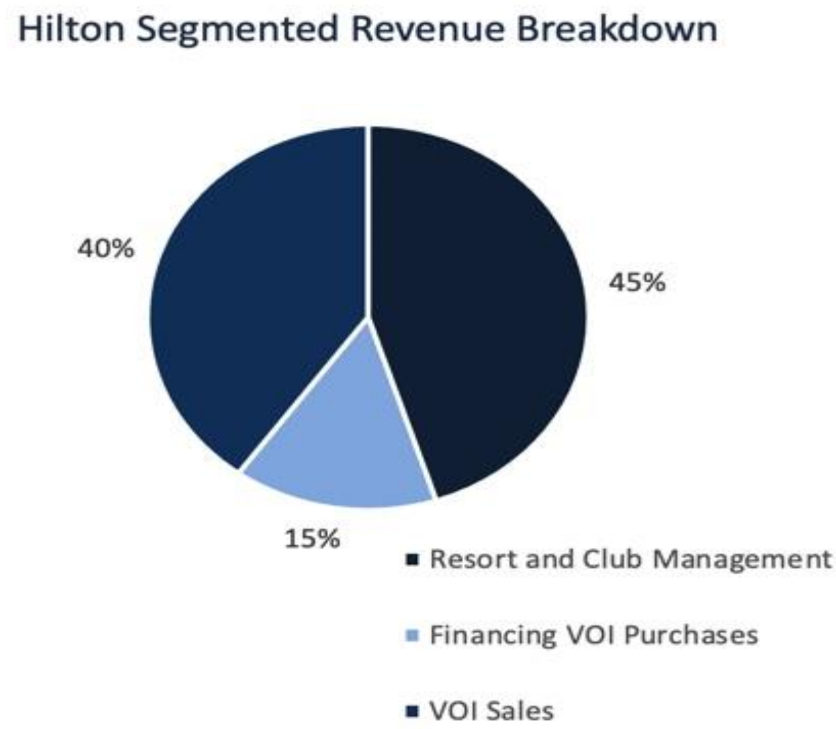
Resort Operations and Club Management Segment

Resort Management

Approximately 45% of Hilton's revenue comes from resort management and club management fees. Through management agreements, Hilton provides management services including day-to-day resort operations, maintenance, budgeting, and employee training. The company collects a fee that is 10-15% of the resort operation costs as well as cost reimbursements for the expenses incurred during management activities. The fees provide the company with a predictable revenue stream, as resort operating costs are relatively unaffected by the occupancy rate and thus remained a constant level during the COVID-19 pandemic.

Club Memberships

Hilton offers two types of club memberships, the Legacy-HGV Club membership, and the Legacy-Diamond Club membership. When customers purchase VOIs, they are enrolled as one of Hilton's 330,000 Club members. The points-based system gives customers the flexibility to exchange timeshare at any of its properties, adapting to their changing vacation needs. Through the Diamond Resort acquisition, Hilton seeks to add value to its Clubs' product offerings by adopting Diamond's Club features and welcoming its members to the Hilton clubs.



Diamond Resorts Acquisition

The company's acquisition of Diamond Resorts plays an important role in its plan to grow its customer segment, broaden product offerings, and consolidate its position as a key player in the global industry. Through the acquisition, the company plans to capture consumers' loyalty by offering high levels of flexibility through enhanced product offerings and broader exchange networks.

Benefits

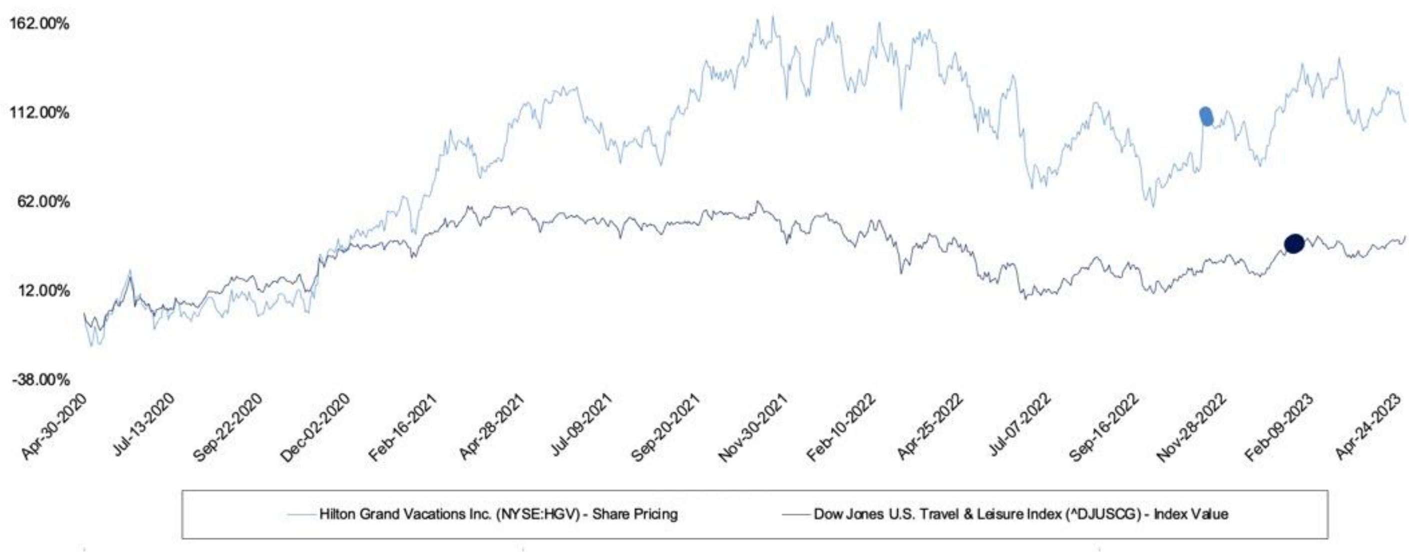
The acquisition of Diamond Resorts in August 2021 seeks to strengthen Hilton as an industry leader, by bringing cost savings of $125 million in the first 2 years and adding more than 380,000 members to its Club system. With an expanded network of resorts over 20 new markets and 710,000 total owners across an expanded customer demographic, Hilton anticipates significant value creation for its shareholders and clients through enhanced operational efficiencies and scale. Prior to the acquisition, Diamond was the largest timeshare operator with no brand affiliation, with its operations primarily consisting of VOI sales and marketing, management of resort properties, and points-based vacation clubs. Diamond, an industry leader in the timeshare industry, focused on the infusion of hospitality and experiences through an entire life cycle of client experience. The strategic acquisition expands Hilton's offerings, by leveraging its existing brand recognition with Diamond's diverse network of locations and strong experiential offerings. Ultimately, Hilton is expected to be positioned as a stronger industry leader with an expanded customer demographic and a wider array of product offerings. As of December 31st, 2021, 92 of Hilton's 154 properties are Legacy-Diamond properties. The acquisition was completed by trading 0.32 shares of Hilton's common stock with 1 share of Diamond common stock, which cost approximately 28% of Hilton's total common shares outstanding. Furthermore, the accretive acquisition of Diamond contributed $322 million to the $957 million in additional sales of VOIs in FY 2021 in comparison to FY 2020, as well as contribute to a spike in its EPS.

Risks

In 2021, Hilton Grand Vacations acquired Diamond Resorts, the largest timeshare operator with no brand affiliation before the acquisition. Despite the successful acquisition of Diamond Resorts, Hilton acknowledges that successful integration of the Diamond business will take sustained amounts of resources and face certain risks. Risks identified include a prolonged integration period due to delays in converting Diamond resorts into HGV-strategy-suited resorts, difficult compensation arrangements between the two parties, along with other uncertainties about the effects of the acquisition with stakeholders. Additionally, the acquisition of Diamond Resorts brings a substantial amount of recurring and non-recurring expenses in the long term, which are not guaranteed to be offset by the anticipated cost synergies and benefits. Thus, any such unexpected expenses may negatively impact Hilton's financial condition and operating results.

Performance Graph

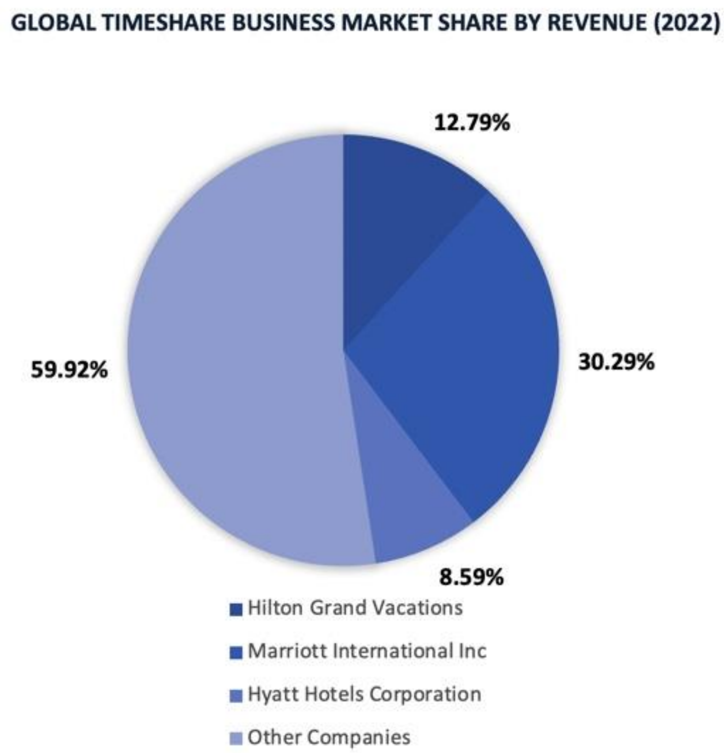
This graph exhibits a comparison of Hilton's share price performance with the Dow Jones US Travel & Leisure Index from 2020 - 2023. The graph shows a close correlation of Hilton's common stock pricewith the two indices in recent years, signifying that Hilton shares' performance matches industry performance standard.



Industry Analysis

Hilton Grand Vacations belongs to the global timeshare industry, with a market size that is projected to reach 29 billion USD by 2028, from the 18 billion USD valuation in 2021, at a CAGR of 7.3% during 2022-2028. The industry is highly competitive and is dominated by a few national and regional companies that develop, finance, and operate timeshare properties, such as Hilton Grand Vacations, Wyndham, Marriott Vacations Worldwide, and Hyatt. Most of the industry activity is concentrated in the US, with the top three businesses owning 44.57% of revenue share in

2017 - Hilton Grand Vacations being the third largest player dominating 12.69% of the global market share, following Wyndham and Marriott Vacations Worldwide.



External Competition

The industry is segmented yet competitive - players stand out by being innovative in meeting rising consumer expectations for high-quality leisure in the post-pandemic era. Timeshare businesses compete based on location and quality of resorts, prices of VOIs, financing terms, flexibility to exchange timeshare at different properties, and brand recognition. In terms of sales and marketing of timeshare VOIs, the industry players engage in holding unique trademarks and logos to gain a competitive edge. Lastly, property acquisitions and talent acquisitions are important for the business to stand out. As for Hilton, it competes for the sale of VOIs based on the quality of resorts, prices of timeshare intervals, terms of use, flexibility to exchange time at various properties, as well as brand recognition.

Covid-19 Impact

The industry had taken a significant toll due to the COVID-19 pandemic and ongoing travel restrictions over the last three years. Despite Hilton having all its resorts and VOI sales centers open and operating as of Dec 31st, 2021, some resorts are operating in markets with capacity restraints, which negatively impacts consumer demand for the business's products and services. While Hilton plans to operate at its full capacity, the pandemic's unknown duration and uncertainty of regulatory restrictions continue to weigh on its expansion capacity.

Catalysts

Globalization and Tourism

Hilton Grand Vacations is expected to benefit from the expansion of the hotels, resorts, and cruise lines industry. The next decade anticipates globalization, especially in areas of internal business, travelling, and sports tourism, driving the occupancy rate of hotels and resorts. The growing international relations among numerous countries result in a high tourism rate eventually resulting in increased usage of hotels, resorts, & cruise lines which is strengthening their presence thus propelling the growth of the industry. The trend of sustainable consumerism and expectations for hygiene creates growth potential for the hotels, resorts, and cruise lines industry.

Post-Covid Economy Stablization

The global timeshare industry is closely correlated with the travel, leisure, and tourism industries. Since the start of the pandemic, the number of international tourists and cruise line passengers in the US fell by 80%. Fast forward to the post-pandemic economy in 2022, the rising revenge spending phenomenon drives consumers to splurge on experiences and leisure that they had missed out on during the COVID-19 pandemic. With an estimated $1.5 trillion of excess savings in US consumers' pockets from 2021, "revenge spending" is widespread - consumers are seeking to regain a sense of normalcy by spending more on traveling and high-quality leisure experiences. Furthermore, the macro trend of increased globalization, international business trips, increased tourism, and a higher number of travelers will contribute to a boom in the demand for timeshares worldwide.

Company Strategy

Hilton competes with other timeshare companies for the sales of VOIs based on the flexibility of financing terms, location, quality of resort locations, and brand recognition. In addition, Hilton primarily competes for property acquisitions of other entities that share a similar objective, such as Diamond Resorts. Timeshare companies can also gain a competitive edge by differentiating their marketing strategies, broadening their customer segments, and offering a diversified range of products and Club membership flexibility. New entrants are unlikely to overtake Hilton’s current market position or pose a threat. However, Hilton must guard against rival companies such as Wyndham, Marriott Vacations Worldwide, and Disney Vacation Club, by enhancing its inventory mix, and technology-based marketing, as well as continue seeking out timeshare development opportunities at new properties.

Expanding Operations Post-Diamond Acquisition

Following the Diamond acquisition, the size of Hilton’s business is projected to grow significantly, both in terms of product offerings and customer demographic. With expansion into non-US jurisdictions to which Hilton did not have prior access, it plans to obtain approvals from developers to include additional resorts in the multi-resorts that were previously managed by the Diamond Resort. With additional resort locations under Hilton’s umbrella of properties, it hopes to see increased margins, scale, and profitability in the years to come after the full consolidation of the increased operations.

Product Expansion into Japan

Hilton currently operates timeshare properties globally, mainly within the United States, Europe, Mexico, the Caribbean, and Canada. Despite currently marketing its VOI products and other services in the Asia Pacific region, it still seeks to expand its operations in these regions, specifically Japan. Hilton plans to develop properties in Japan and explore opportunities to develop properties within neighboring countries in the Asia Pacific region. The main activities part of this strategy includes acquiring, developing, and marketing new timeshare properties, and selling and financing timeshare properties within these regions. The main reason for expanding into Japan is the country's steady growth of disposable income, which had reached its second-highest level in the past 10 years. Furthermore, although real wages in Japan have declined due to recent inflation, Japanese households' spending increased in 2022. The increase in spending indicates the pent-up demand from the COVID-19 quarantine. Furthermore, the country's recent offering of travel subsidies supports the tourism industry, increasing household spending on leisure and other activities.

Technology-Based Marketing Strategy

With the newly implemented technology-based marketing strategy, Hilton plans to engage with a broader market of potential VOI purchasers. Hilton plans to execute a digital marketing strategy, capitalizing on the trend where consumers become more reliant on digital tools. The technology-based marketing also includes targeted direct marketing to reach potential customers who have the financial capacity to pay for Hilton's timeshare products, as well as frequent leisure travelers. In addition to the digitalized marketing channels, Hilton plans to continue selling its timeshare VOI products through its 50 sales distribution centers across the United States, Mexico, Canada, Europe, and Japan. At the sales centers, Hilton plans to increase in-person sales tours as COVID-19 restrictions ease. The sales tours provide potential clients with customized presentations using sales techniques to create a transparent and trust-building purchase experience for clients.

Management Team

Hilton Grand Vacations prides itself on its strong leadership team that drives the company's future to be a champion in every part of its business. Its executive team has an extensive history of working in the timeshare industry, and most of the team has been in management positions for some of the largest timeshare companies worldwide.

Mr Mark Wang – Chief Executive Officer

Mr. Mark Wang has 35 years of industry experience and currently serves as Hilton's President, CEO, and a member of the Board of Directors. Before joining Hilton, he co-founded three independent timeshare companies. During his presidency, he has led the company to grow consecutively each year and helped adopt the current capital-efficient model. Mr. Wang is an innovator who brings in new, highly effective sales and marketing techniques to the industry. In 1987, he introduced the US timeshare product to Japan.

His total compensation for FY 2021 was $17.5 million. This breaks down into a salary of $950,000, $8.7 million in stock awards, $5.5 million in option awards, $2.3 in non-equity incentive plan compensation, and $26,066 in other forms of compensation. Non-equity incentives allow the CEO to share the success of the business without complicating the company's capital structure. Additionally, stock option benefit is determined as the difference in fair market value in the shares at the date of exercise and the exercise price, which is a compensation strategy we believe effectively aligns management's incentive with shareholders' benefits.

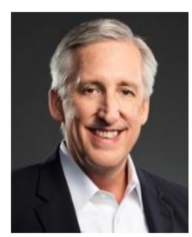
Mr Daniel J. Matthewes – Chief Finance Officer

Mr Daniel J. Matthewes is the Executive Vice President and CFO at Hilton Grand Vacations. Mr Matthewe served as CFO since 2018 and is responsible for leading a team of highly skilled finance professionals in developing and implementing corporate and financial strategies. He has more than 10 years of global finance experience in both public and private multinational companies.

Mr Daniel J. Matthewes' total compensation is for FY 2021 $6.9 million, broken down into $571,192 as base salary, $1.4 million as bonus and non-equity incentive compensation, $1.6 as stock options, and $3.3 awarded as stock and $27,389 as other types of compensation. The non-equity incentive compensation is designed to allow top executivesto share in the success of the business without changing the capitalization structure of the company. Additionally, stock option benefit is determined as the difference in fair market value in the shares at the date of exercise and the exercise price, which is a compensation strategy we believe effectively aligns management's incentive with shareholders' benefits.

Mr Gordon S. Gurnik – Senior Executive Vice President

Mr Gordon S. Gurnik is the Senior Executive VP at Hilton Grand Vacations since 2021 and was Executive VP and Chief Operating Officer prior to his current position. He joined Hilton in 2018, where he led Business Operations, Global Sales and Marketing, Sales Support, Resort Operations and Club, as well as Brand and Digital. His current responsibilities include leading sales and business development, improving Hilton's brand and products, and overseeing resort operations and Club programs. Additionally, his qualification is strengthened bymembership in the American Resort Development Association's board of directors, as well as a bachelor's degree in management from Purdue University.



Mr Gordon S. Gurnik's total compensation in FY 2021 was $ 6.1 million USD, of which $566,923 was received as salary, $1.1 million as a bonus and non-equity incentive compensation, $1.3 million as stock options, and $3.1 awarded as stock and $10,000 from other forms of compensation. The non-equity incentive compensation is designed to allow top executives to share in the success of the business without changing the capitalization structure of the company. Additionally, stock option benefit is determined as the difference in fair market value in the shares at the date of exercise and the exercise price, which is a compensation strategy we believe effectively aligns management's incentive with shareholders' benefits.

Mr. Dennis A. DeLorenzo – Chief Sales Office

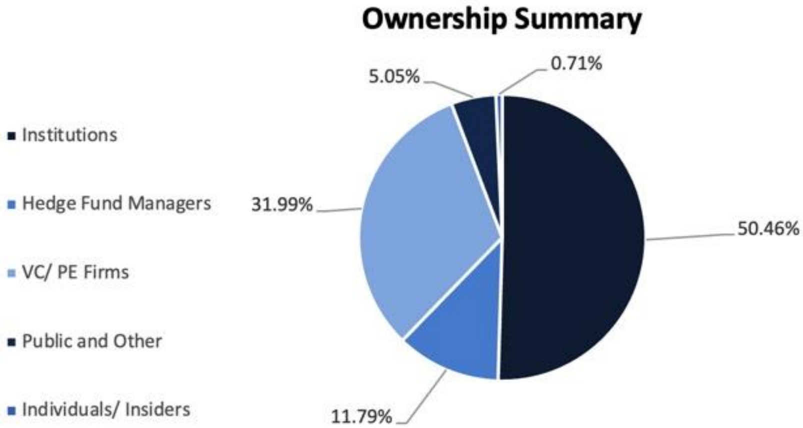
Mr. Dennis A. DeLorenzo serves as the Executive VP and Chief Sales Officer at Hilton Grand Vacations. As the CSO, he oversees sales and marketing strategies across North America and Europe. Before serving as CSO, he served as VP of Sales in 2015, and currently also serves as the executive sponsor of the company's Women's Team Member Resource Group. Mr. DeLorenzo has been a leader in the timeshare industry for over 30 years and holds a strong commitment to operational excellence and a passion for diversity and inclusion.

Mr. Dennis A. DeLorenzo's total compensation in FY 2021 was $4.7 million, broken down into $437.091 as salary, $1.4 million as a bonus and non-equity incentive compensation, $1.2 million as a stock option, $1.7 million as stock, and $17,729 as other forms of compensation. The non-equity incentive compensation is designed to allow top executives to share in the success of the business without changing the capitalization structure of the company. Additionally, stock option benefit is determined as the difference in fair market value in the shares at the date of exercise and the exercise price, which is a compensation strategy we believe effectively aligns management's incentive with shareholders' benefits.

Shareholder Base, Liquidity, Market Depth

Out of the outstanding 115 million shares, 55.5% are free float. Its stock price is currently trading at $44.40 USD, making its market capitalization $5.05 billion USD. Hilton's shareholder base is primarily made up of institutions that own 94.18% of outstanding common shares, 5.09% owned by the public, and 0.72% owned by individuals and insiders.

Type	Common Stock Equivalent Held	% of Total Shares Outstanding	Market Value (USD in mm)
Institutions	58,061,345	50.46%	2,551
Hedge Fund Managers	13,561,145	11.79%	596
VC/ PE Firms	36,805,738	31.99%	1617
Public and Other	5,805,517	5.05%	255.1
Individuals/ Insiders	824,024	0.71%	36.2
Total	115,057,769	100.00%	5,055



Valuation

Our target price of $50.30 is based on the perpetuity growth and EV/EBITDA exit multiple in the DCF, as well as the EV/EBITDA and P/E in our comparable company analysis, weighted at 25% each. We believe Hilton Grand Vacations is currently undervalued and has a **BUY** rating with an implied upside of 20.2%.

Comparable Company Analysis

The companies listed below have a comparable business model, similar market capitalization range below $10 billion USD, and similar operating activities including selling timeshare products and managing Club systems. Most of the following companies are listed on the NYSE and are also dominating players in the North American market.

Hyatt Hotels Corporation (NYSE: H): Hyatt Hotels Corporation is an American multinational hospitality business that manages luxury resorts and vacation properties. Hyatt's growth drivers primarily include the acquisition and development of other resort operators such as AmeriSuites and Summerfield Suites.

Travel + Leisure Co. (NYSE: TNL): Travel + Leisure Co. is a timeshare company based in the United States that shares similar business activities as Hilton, including the development, sale, and management of timeshare resorts, as well as the management of vacation ownership clubs. Similarly, Travel + Leisure Co. also provides timeshare exchange services through its Club system.

Marriott Vacations Worldwide Corporation (NYSE: VAC): Marriott Vacations Worldwide Corporation is an American timeshare business that was formerly a division of Marriott International. It is a separate entity that focuses selling and advertising vacation ownership products, much like Hilton. With a market capitalization of $6 billion USD, it runs more than 70 resorts worldwide and operates the Marriott Vacation Club.

Wyndham Hotels & Resorts Inc (NYSE: WH): Wyndham Hotels & Resorts Inc is a hotel franchisor, with the greatest number of properties worldwide. It has approximately 9,000 hotels and 23 hotel brands across over 90 counties. It has a market capitalization of $ 6.7 billion USD. Its main business operations include owning a portfolio of hotel brands and operating a loyalty program.

Choice Hotels International Inc (NYSE: CHH): Choice Hotels International Inc is a multinational hospitality company based in the United States. It is a hotel chain that owns several upscale and economy hotel brands.

Playa Hotels & Resorts (NASDAQ: PLYA)

Playa Hotels & Resorts is a U.S. based business that owns, operates, and develops all-inclusice resorts in Mexico, Jamaica, and the Dominican Republic. With a portfolio of 23 resorts, the company manages 7 resort brands such as Hyatt Zilara and Wyndham Alltra.

Discounted Cash Flow

Business Segment 1 – VOI Sales and Marketing Revenue: With a strong revenue recovery as seen in 2021 and 2022 of 161% and 64% growth respectively, we expect Hilton to increase revenue at 18% over the next fiscal year and taper off to a 5% growth as Diamond Resort acquisition synergies gradually become realized in the following years. Hilton's main revenue stream is through the sale and marketing of its timeshare products, which is driven by technology-based marketing and the re-opening of in-person sales distribution centres. We expect this segment's revenue to increase by 20% in the next year and taper off to 5% in the following years. This growth rate was calculated based on an average of FY 2017, FY 2018, and FY 2021 as FY 2019 and FY 2020 are outliers due to COVID-19 impacts.

Business Segment 2 – Resort and Club Management Revenue: Hilton's second largest revenue stream is through its resort operations through fee-for-service and just-in-time agreements with third parties, and through management of its Club system. Our revenue forecast for this segment shows a positive and consistent growth rate of 20% in 2023 and 5% onwards. This estimate is based on Hilton's expanded network of resorts it will be managing due to the acquisition of Diamond Resort's network, and a steadily growing forecast after 2023.

Capital Expenditures: Due to Hilton's acquisitive-growth mindset and the acquisition of Diamond Resort in 2021, we believe that Hilton will continue making acquisitions in later years after the synergies and cost savings from the recent acquisition have materialized. Therefore, we predict that Hilton's CAPEX as a % of beginning PP&E will be 12% - an average of FY 2017, FY 2018, and FY 2021 as FY 2019 and FY 2020 are outliers due to COVID-19 impacts.

Weighted Average Cost of Capital: Hilton's WACC was calculated to be 7.3%. The risk of debt is from Bloomberg data, which is 3.9%. The risk-free rate is the US 10-year Treasury rate of 3.1%, and the cost of equity is calculated to be 10% after computing 2.01 as the company's relative volatility beta.

Weighted Price Target: Our target price of $50.30 is based on the perpetuity growth and EV/EBITDA exit multiple in the DCF, as well as the EV/EBITDA and P/E in our comparable company analysis, weighted at 25% each. We believe Hilton Grand Vacations is currently undervalued and has a **BUY** rating with an implied upside of 20.2%.

Recommendation

Hilton has made a strong recovery from the pandemic. Despite a low occupancy rate in its timeshare properties in FY 2019 and FY 2020, it has made a strong comeback in FY 2021 and FY 2022. Hilton is positioned well in the timeshare industry and is adopting a technology-based marketing strategy as well as realizing synergies from the FY 2021 acquisition of Diamond Resort. Hilton is also planning to expand its product offerings and develop properties in Japan and neighboring countries in the Asian Pacific. Many of the in-person sales distribution centers witnessed decreased foot traffic in FY 2019 and 2020. However, with most of the world reopening and strong demand in the leisure industry, Hilton is positioned to see growth in its main revenue segment – VOI sales and marketing. Therefore, we are issuing a buy rating on Hilton Grand Vacations.

Investment Thesis

Market View

The current view the market has on Hilton is a steadily growing company that has established itself as a key player in the global timeshare industry. However, consumer skepticism to the recovery of the leisure and travel industry and depressed prices for real estate due to high interest convince the market to hold a skeptical view about Hilton's ability for growth and recovery.

Investment Thesis 1 – Significant Synergies to Be Realized

Acquisition of Diamond Resorts

Hilton's acquisition of Diamond Resorts presents a transformative opportunity for Hilton, as it will generate significant value by combining the largest independent timeshare company with the strength of its Hilton Grand Vacations brand. This strategic acquisition will bring cost savings, and synergies, as well as a wider variety of product offerings and resort destinations, which Hilton will leverage to penetrate the broader customer base. By rebranding Diamond's properties and existing products to fit into Hilton's brand and culture, the business is predicted to see revenue growth in new customer segments. The acquisition is expected to generate $150 million USD in cost synergies in the first 24 months to close the deal. Furthermore, the company is positioned to see an increase in recurring EBITDA streams by adopting Diamond Resort's operations, which will increase overall cash flow.

Hilton's acquisition of Diamond Resorts, the broad chain-scale offering of its globally recognized brand, cost-efficient arrangements for inventory sourcing, combined with the strong recovery of the post-pandemic vacation demand, will all contribute to years of growth for the company with minimal exposure to the cyclicality of the real estate market. We believe that with the realization of the acquisition and the ability to manage inventory to meet predicted sales, Hilton will see material revenue generation and the creation of cost synergies, which positions Hilton as a great investment opportunity at the current price. Despite post-pandemic tailwinds of high rates and regulatory complexities, Hilton's proven track record and value proposition of a diverse inventory mix positions the company strongly among its competitors.

Investment Thesis 2 – Lower Costs Contribute to Expanded Margins

Hilton's inventory sourcing strategy is highly capital efficient, as 40% of its inventory is sourced using either just-in-time agreements or fee-for-service strategies. Hilton can monetize its unutilized assets, generating rental income that offsets the costs of carrying inventory as well as generating additional tours. We believe that in a high interest-rate environment, Hilton has the unique advantage of using its capital-efficient inventory sourcing strategy to generate predictable long-term cash flows that do not acquire long-term capital expenditures that may otherwise be a significant expense that will push down its operating margins. Additionally, 6-9% of its revenue from the financing segment is relatively unaffected by the high-interest rates as its variability allows it to have a stably increasing interest income.

Risks

Macroeconomic Conditions

Consumer demand and macroeconomic factors in the vacation and resort industry have a high impact on the growth of Hilton's revenue and ability to sell its products and services. In recessionary environments, lower consumer confidence, higher unemployment, and lower real estate prices may negatively impact the demand for leisure travel, decreasing Hilton's tour flow and sales of VOIs. Furthermore, in the post-pandemic era, high-interest rates may decrease disposable income and increase the cost of borrowing, suppressing spending demand. This is a risk factor that causes volatility in the sales of VOIs in upcoming years, impacting a major stream of Hilton's revenue. High-interest rates in the post-pandemic economy also directly impact Hilton's ability to generate interest income from originating consumer loans - as interest rate rises, consumers are less incentivized to take on loans to finance their purchase of VOIs as they become more expensive.

Regulation and COVID-19 Pandemic

The timeshare and resort industry is highly regulated, and Hilton is subject to a wide range of complex international, federal, and local policies. These regulations and policies affect main areas of business: rea estate development, marketing and sales, lending activities, and resort management activities. In addition, Hilton faces risks inherent to the timeshare and hospitality industry, such as strong reliance on tourism and the surrounding regulations. Hilton's performance is also subject to government statements related to travel that may result in the negative perception of travel. The COVID-19 pandemic outbreak has caused and may continue to bring regulatory changesthat limit the capacity of Hilton's tour flow and sale of VOIs, therefore impacting Hilton's revenue growth in the coming years.

Interest Rate Risk

Hilton's financing and loans origination revenue is exposed to changing interest rates. Hilton's loans are variable-rate loans, and therefore is most vulnerable to rising rates. To manage this risk, Hilton plans to introduce fixed rate timeshare loans and secure fixed-rate funding to match the funding of the loans.

Dependence on Brand Recognition and Third-Party Relationships

The success of Hilton's business strongly depends on the quality and reputation of the Hilton brand name, as the business is prohibited to operate any properties that are not under the Hilton brand name. Such dependence of business activity on the brand may expose Hilton to risks of brand deterioration or reputational decline. Thus, any failure to protect the Hilton trademarks and brand, may materially affect the business' market share, reputation, and results o operations.

Relationships with third-party developers heavily impacts Hilton's revenue from sales of VOIs as they determine the success of its capital-efficient business model consisting of fee-for-service and just-in-time agreements. Hilton's ability to maintain good relationships with developers can stimulate revenue growth by providing opportunities for property development and continued capital-efficient arrangements. Failure to maintain a healthy relationship with VOI suppliers may cause a decline in VOI inventory, or a decline in fee-for-service agreements, both resulting in decreased VOI sales revenue.

Shifting Consumer Preferences

Consumer preferences for vacations and leisure activities impact Hilton's revenues. The business relies on vacation traffic at specific locations, and critical marketing strategies to increase tour flow and thus VOI sales. Thus, any changes for consumer behavior and preference for vacations may cause declines in tour flow volume and can material materially impact Hilton's revenue.

Appendix 1 – Model Summary

Summary Page

(Figures in mm USD)	Dec-17 FY2018	Dec-18 FY2019	Dec-19 FY2020	Dec-20 FY2021	Dec-21 FY2022	Dec-22 FY2023	Dec-23 FY2024	Dec-24 FY2025	Dec-25 FY2026	Dec-26 FY2027	Dec-27 FY2028
Income Statement											
Revenue	1,711.0	1,999.0	1,838.0	894.0	2,335.0	3,829.6	4,513.8	4,739.5	4,976.5	5,225.3	5,486.6
EBITDA	366.0	470.0	366.0	(200.0)	516.0	862.3	902.8	947.9	995.3	1,045.1	1,097.3
Net Income	327.0	298.0	216.0	(201.0)	176.0	397.0	571.2	602.5	635.1	669.4	705.4
Earnings Per Share	$ 3.27	$ 3.04	$ 2.16	$ (2.36)	$ 1.74	$ 3.27	$ 4.72	$ 4.98	$ 5.25	$ 5.53	$ 5.83
Cash Flow Statement											
Capital Expenditures	(35.0)	(44.0)	(37.0)	(8.0)	(18.0)	(48.3)	(93.6)	(94.2)	(95.0)	(95.8)	(96.7)
Acquisitions	-	-	-	-	(1,592.0)	-	-	-	-	-	-
Divestitures	-	-	-	-	-	-	-	-	-	-	-
Balance Sheet											
Current Assets	1,989.0	1,980.0	2,040.0	2,321.0	3,984.0	3,904.9	4,600.7	5,211.8	5,883.9	6,592.3	7,339.0
Non-Current Assets	395.0	773.0	1,039.0	813.0	4,024.0	4,017.7	4,024.7	4,031.6	4,038.7	4,045.8	4,052.9
Assets	2,384.0	2,753.0	3,079.0	3,134.0	8,008.0	7,922.7	8,625.4	9,243.5	9,922.5	10,638.1	11,392.0
Current Liabilities	801.0	774.0	858.0	768.0	1,692.0	1,795.6	1,927.1	1,942.7	1,986.6	2,032.8	2,081.2
Non-Current Liabilities	1,065.0	1,363.0	1,651.0	1,992.0	4,328.0	3,847.0	3,847.0	3,847.0	3,847.0	3,847.0	3,847.0
Liabilities	1,866.0	2,137.0	2,509.0	2,760.0	6,020.0	5,642.6	5,774.1	5,789.7	5,833.6	5,879.8	5,928.2
Shareholders' Equity	518.0	616.0	570.0	374.0	1,988.0	2,280.0	2,851.3	3,453.8	4,088.9	4,758.3	5,463.8
Cash	297.0	180.0	152.0	526.0	695.0	701.8	1,135.2	1,715.2	2,299.6	2,916.0	3,566.0
Debt	1,065.0	1,363.0	1,651.0	1,992.0	4,328.0	3,847.0	3,847.0	3,847.0	3,847.0	3,847.0	3,847.0
Net Debt	768.0	1,183.0	1,499.0	1,466.0	3,633.0	3,145.2	2,711.8	2,131.8	1,547.4	931.0	281.0
Minority Interests	-	-	-	-	-	-	-	-	-	-	-
Debt/EBITDA	2.1 x	2.5 x	4.1 x	n/a	7.0 x	3.6 x	3.0 x	2.2 x	1.6 x	0.9 x	0.3 x
Operating Metrics											
Return on Equity (ROE)	95.5%	0.5%	36.4%	-42.6%	14.9%						
Return on Assets (ROA)	9.4%	10.1%	7.2%	-0.2%	6.0%						
Return on Invested Capital (ROIC)											
Valuation Metrics											
Stock Price (High)	$ 42.69	$ 46.10	$ 35.60	$ 34.60	$ 54.68	$ 54.35	$ 45.91	$ 45.91	$ 45.91	$ 45.91	$ 45.91
Stock Price (Low)	$ 24.99	$ 25.68	$ 25.86	$ 10.53	$ 38.36	$ 32.80	$ 45.91	$ 45.91	$ 45.91	$ 45.91	$ 45.91
Stock Price (Average)	$ 33.84	$ 35.89	$ 30.73	$ 22.57	$ 46.52	$ 43.58	$ 45.91	$ 45.91	$ 45.91	$ 45.91	$ 45.91
Diluted Shares Outstanding (Average)	100.0	98.0	100.0	85.0	101.0	121.5	121.0	121.0	121.0	121.0	121.0
Market Capitalization (Average)	3,384.0	3,517.2	3,073.0	1,918.0	4,698.5	5,294.4	5,555.1	5,555.1	5,555.1	5,555.1	5,555.1
Enterprise Value (Average)	4,152.0	4,700.2	4,572.0	3,384.0	8,331.5	8,439.5	8,266.9	7,686.9	7,102.5	6,486.1	5,836.1
P/E	10.3 x	11.8 x	14.2 x	n/a	26.7 x	13.3 x	9.7 x	9.2 x	8.7 x	8.3 x	7.9 x
EV/EBITDA	11.3 x	10.0 x	12.5 x	n/a	16.1 x	9.8 x	9.2 x	8.1 x	7.1 x	6.2 x	5.3 x
FCF Yield to Market Capitalization	11.8%	-8.2%	1.4%	-4.3%	-0.1%	11.2%	7.8%	10.4%	10.5%	11.1%	11.7%
FCF Yield to Enterprise Value	9.6%	-6.1%	0.9%	-2.4%	-0.0%	7.0%	5.2%	7.5%	8.2%	9.5%	11.1%
Free Cash Flow											
EBIT	337.0	434.0	315.0	(245.0)	390.0	659.8	816.1	860.7	907.3	956.3	1,007.8
Tax Expense	16.0	(105.0)	(57.0)	79.0	(93.0)	(197.9)	(244.8)	(258.2)	(272.2)	(286.9)	(302.3)
D&A	29.0	36.0	51.0	45.0	126.0	202.6	86.7	87.2	88.0	88.7	89.5
Capital Expenditures	(35.0)	(44.0)	(37.0)	(8.0)	(18.0)	(48.3)	(93.6)	(94.2)	(95.0)	(95.8)	(96.7)
Changes in NWC	52.0	(608.0)	(230.0)	47.0	(408.0)	(23.5)	(130.9)	(15.5)	(43.7)	(45.9)	(48.2)
Unlevered Free Cash Flow	399.0	(287.0)	42.0	(82.0)	(3.0)	592.6	433.4	580.0	584.4	616.4	650.1

Valuation Summary

Current Price	**$ 45.91**
Target Price	$ 50.26
Total Return	9.5%
Recommendation	**BUY**

DCF Valuation	
Perpetuity Growth Implied Price	$ 61.77
Exit Multiple Implied Price	$ 51.25
Comps Valuation	
Comps - EV/EBITDA Implied Price	$ 33.74
Comps - P/E Implied Price	$ 48.43

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Appendix 2 – DCF Analysis

Discounted Cash Flow Analysis

(Figures in mm USD)	Dec-18	Dec-19	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Dec-21
	FY2019	FY2020	FY2021	Q1-2022	Q2-2022	Q3-2022	Q4-2022	FY2022
Free Cash Flow								
EBIT	434.0	315.0	(245.0)	1.0	26.0	209.0	154.0	390.0
Less: Tax expense	(105.0)	(57.0)	79.0	6.0	(3.0)	(49.0)	(47.0)	(93.0)
Add: Depreciation and amortization	36.0	51.0	45.0	11.0	12.0	48.0	55.0	126.0
Less: Capital expenditures	(44.0)	(37.0)	(8.0)	(1.0)	(3.0)	(7.0)	(7.0)	(18.0)
Less: Change in net working capital	(608.0)	(230.0)	47.0	53.0	(48.0)	(282.0)	(131.0)	(408.0)
Unlevered Free Cash Flow	**(287.0)**	**42.0**	**(82.0)**	**70.0**	**(16.0)**	**(81.0)**	**24.0**	**(3.0)**
Discount factor								
Present Value of Unlevered Free Cash Flow								

(Figures in mm USD)	Mar-22	Jun-22	Sep-22	Dec-22	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27
	Q1-2023	Q2-2023	Q3-2023	Q4-2023	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Free Cash Flow										
EBIT	100.0	147.0	237.0	175.8	659.8	816.1	860.7	907.3	956.3	1,007.8
Less: Tax expense	(20.0)	(44.1)	(71.1)	(52.7)	(197.9)	(244.8)	(258.2)	(272.2)	(286.9)	(302.3)
Add: Depreciation and amortization	60.0	64.0	57.0	21.6	202.6	86.7	87.2	88.0	88.7	89.5
Less: Capital expenditures	(8.0)	(11.0)	(6.0)	(23.3)	(48.3)	(93.6)	(94.2)	(95.0)	(95.8)	(96.7)
Less: Change in net working capital	105.0	60.0	(25.0)	(163.5)	(23.5)	(130.9)	(15.5)	(43.7)	(45.9)	(48.2)
Unlevered Free Cash Flow	**237.0**	**215.9**	**191.9**	**(42.2)**	**592.6**	**433.4**	**580.0**	**584.4**	**616.4**	**650.1**
Discount factor	-	0.25	0.50	0.75	0.75	1.75	2.75	3.75	4.75	5.75
Present Value of Unlevered Free Cash Flow	**-**	**212.1**	**185.2**	**(40.0)**	**357.3**	**390.4**	**476.5**	**446.9**	**438.9**	**431.0**

Discounted Cash Flow Valuations

Perpetuity Growth Method		
Perpetuity Growth Rate		2.0%
PV sum of unlevered FCF		2,541.0
Terminal value		8,124.1
Enterprise Value		**10,665.0**
Add: Cash		286.0
Less: Debt		3,847.0
Less: Other EV adjustments		
Equity Value		**7,104.0**
Shares outstanding		115.0
Implied Share Price	$	**61.77**
Current Price	$	45.91
Implied Price	$	**61.77**
Total Return		**34.6%**

Exit Multiple Method		
Terminal EV/EBITDA Multiple		9.5 x
PV sum of unlevered FCF		2,541.0
Terminal value		6914.1496
Enterprise Value		**9,455.1**
Add: Cash		286.0
Less: Debt		3,847.0
Less: Other EV adjustments		-
Equity Value		**5,894.1**
Shares outstanding		115.0
Implied Share Price	$	**51.25**
Current Price	$	45.91
Implied Price	$	**51.25**
Total Return		**11.6%**

Perpetuity Growth Rate	WACC 8.30%	7.80%	7.30%	6.80%	6.30%
1.00%	$ 40.00	$ 45.39	$ 51.64	$ 58.97	$ 67.70
1.50%	$ 43.90	$ 50.00	$ 57.17	$ 65.70	$ 76.01
2.00%	$ 48.41	$ 55.42	$ 63.75	$ 73.83	$ 86.26
2.50%	$ 53.71	$ 61.85	$ 71.70	$ 83.85	$ 99.20
3.00%	$ 60.00	$ 69.63	$ 81.50	$ 96.50	$ 116.06

Terminal EV/EBITDA Multiple	WACC 8.30%	7.80%	7.30%	6.80%	6.30%
7.5 x	$ 35.80	$ 37.34	$ 38.93	$ 40.57	$ 42.26
8.5 x	$ 41.83	$ 43.53	$ 45.29	$ 47.10	$ 48.97
9.5 x	$ 47.86	$ 49.73	$ 51.66	$ 53.64	$ 55.69
10.5 x	$ 53.89	$ 55.93	$ 58.02	$ 60.18	$ 62.40
11.5 x	$ 59.93	$ 62.12	$ 64.38	$ 66.71	$ 69.12

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Appendix 3- Comparable Company Analysis

Comparable Company Analysis

(Figures in mm USD)				EV/EBITDA Multiple			P/E Multiple					
Marriott Vacations Wor	(NYSE:VAC)	5,708.6	10,098.6	16.6 x	11.3 x	10.0 x	1.1	$ 8.01	$ 11.79	131.9 x	18.6 x	12.6 x
Wyndham Hotels & Re	(NYSE: WH)	6,469.7	8,263.0	15.0 x	13.6 x	12.9 x	2.6	$ 3.77	$ 3.95	28.2 x	19.4 x	18.5 x
Choice Hotels Internat	(NYSE: CHH)	6,253.3	7,429.5	15.9 x	13.1 x	14.4 x	5.2	$ 6.09	$ 5.80	23.0 x	19.4 x	20.4 x
Playa Hotels & Resort	(NASDAQ:PLYA)	1,088.1	1,829.8	22.5 x	8.8 x	7.7 x	(0.6)	$ 0.37	$ 0.47	(12.2 x)	18.1 x	14.3 x
Hilton Grand Vacatio	**(NYSE HGV)**	**5,279.7**	**8,840.7**	**13.4 x**	**9.0 x**	**8.1 x**	**1.8**	**$ 2.86**	**$ 3.93**	**26.2 x**	**16.1 x**	**11.7 x**
Median					**9.5 x**	**8.5 x**					**13.5 x**	**10.2 x**
Mean					**7.6 x**	**6.8 x**					**16.9 x**	**11.2 x**
High					**18.8 x**	**14.4 x**					**84.8 x**	**38.8 x**
Low					**8.8 x**	**7.7 x**					**9.0 x**	**7.7 x**

	EV/EBITDA Implied Price		P/E Implied Price	
Median	$ 50.11	$ 49.26	$ 38.72	$ 39.94
Mean	**$ 33.74**	**$ 32.82**	**$ 48.43**	**$ 44.15**
High	$ 129.20	$ 104.66	$ 242.57	$ 152.56
Low	$ 44.48	$ 41.70	$ 25.65	$ 30.20

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