MARRIOTT INTERNATIONAL INC /MD/
Form 10-Q
May 10, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File No. 1-13881

MARRIOTT INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware	52-2055918
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
10400 Fernwood Road, Bethesda, Maryland	20817
(Address of principal executive offices)	(Zip Code)

(301) 380-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 353,355,376 shares of Class A Common Stock, par value $0.01 per share, outstanding at April 26, 2018.

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements

MARRIOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
($ in millions, except per share amounts)
(Unaudited)

	Three Months Ended	
	March 31, 2018	March 31, 2017
REVENUES		
Base management fees	$273	$ 264
Franchise fees	417	355
Incentive management fees	155	140
Gross fee revenues	845	759
Contract investment amortization	(18)	(11)
Net fee revenues	827	748
Owned, leased, and other revenue	406	428
Cost reimbursement revenue	3,773	3,736
	5,006	4,912
OPERATING COSTS AND EXPENSES		
Owned, leased, and other-direct	336	356
Depreciation, amortization, and other	54	51
General, administrative, and other	247	212
Merger-related costs and charges	34	51
Reimbursed expenses	3,835	3,696
	4,506	4,366
OPERATING INCOME	500	546
Gains and other income, net	59	—
Interest expense	(75)	(70)
Interest income	5	7
Equity in earnings	13	11
INCOME BEFORE INCOME TAXES	502	494
Provision for income taxes	(104)	(123)
NET INCOME	$398	$ 371
EARNINGS PER SHARE		
Earnings per share - basic	$1.11	$ 0.96
Earnings per share - diluted	$1.09	$ 0.95
CASH DIVIDENDS DECLARED PER SHARE	$0.33	$ 0.30

See Notes to Condensed Consolidated Financial Statements.

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MARRIOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
($ in millions)
(Unaudited)

	Three Months Ended	
	March 31, 2018	March 31, 2017
Net income	$398	$ 371
Other comprehensive income:		
Foreign currency translation adjustments	152	188
Derivative instrument adjustments, net of tax	(3)	(2)
Unrealized gain (loss) on available-for-sale securities, net of tax	—	(1)
Pension and postretirement adjustments, net of tax	—	—
Reclassification of losses (gains), net of tax	13	—
Total other comprehensive income, net of tax	162	185
Comprehensive income	$560	$ 556

See Notes to Condensed Consolidated Financial Statements.

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MARRIOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
($ in millions)
(Unaudited)

	March 31, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and equivalents	$ 701	$ 383
Accounts and notes receivable, net	2,098	1,973
Prepaid expenses and other	232	235
Assets held for sale	121	149
	3,152	2,740
Property and equipment, net	1,791	1,793
Intangible assets		
Brands	5,972	5,922
Contract acquisition costs and other	2,622	2,622
Goodwill	9,270	9,207
	17,864	17,751
Equity method investments	754	734
Notes receivable, net	147	142
Deferred tax assets	172	93
Other noncurrent assets	604	593
	$ 24,484	$ 23,846
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	$ 988	$ 398
Accounts payable	766	783
Accrued payroll and benefits	1,163	1,214
Liability for guest loyalty programs	2,238	2,121
Accrued expenses and other	1,314	1,291
	6,469	5,807
Long-term debt	7,858	7,840
Liability for guest loyalty programs	3,029	2,819
Deferred tax liabilities	634	605
Deferred revenue	645	583
Other noncurrent liabilities	2,283	2,610
Shareholders' equity		
Class A Common Stock	5	5
Additional paid-in-capital	5,685	5,770
Retained earnings	7,898	7,242
Treasury stock, at cost	(10,163)	(9,418)
Accumulated other comprehensive income (loss)	141	(17)
	3,566	3,582
	$ 24,484	$ 23,846

See Notes to Condensed Consolidated Financial Statements.

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MARRIOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in millions)
(Unaudited)

	Three Months Ended	
	March 31, 2018	March 31, 2017
OPERATING ACTIVITIES		
Net income	$398	$ 371
Adjustments to reconcile to cash provided by operating activities:		
Depreciation, amortization, and other	73	62
Share-based compensation	42	48
Income taxes	16	86
Liability for guest loyalty programs	325	69
Contract acquisition costs	(29)	(53)
Merger-related charges	(16)	(36)
Working capital changes	(185)	(135)
(Gain) loss on asset dispositions	(60)	1
Other	111	49
Net cash provided by operating activities	675	462
INVESTING ACTIVITIES		
Capital expenditures	(64)	(48)
Dispositions	108	311
Loan advances	(12)	(28)
Loan collections	5	7
Other	12	1
Net cash provided by investing activities	49	243
FINANCING ACTIVITIES		
Commercial paper/Credit Facility, net	627	(26)
Issuance of long-term debt	—	1
Repayment of long-term debt	(13)	(4)
Issuance of Class A Common Stock	4	2
Dividends paid	(118)	(115)
Purchase of treasury stock	(815)	(582)
Share-based compensation withholding taxes	(95)	(99)
Net cash used in financing activities	(410)	(823)
INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	314	(118)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, beginning of period [1]	429	887
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, end of period [1]	$743	$ 769

[1] The 2018 first quarter amounts include restricted cash of $46 million at December 31, 2017, and $42 million at March 31, 2018, which we present in the "Prepaid expenses and other" and "Other noncurrent assets" captions of our Balance Sheets.

See Notes to Condensed Consolidated Financial Statements.

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MARRIOTT INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements present the results of operations, financial position, and cash flows of Marriott International, Inc. and subsidiaries (referred to in this report as "we," "us," "Marriott," or "the Company"). In order to make this report easier to read, we also refer throughout to (i) our Condensed Consolidated Financial Statements as our "Financial Statements," (ii) our Condensed Consolidated Statements of Income as our "Income Statements," (iii) our Condensed Consolidated Balance Sheets as our "Balance Sheets," (iv) our Condensed Consolidated Statements of Cash Flows as our "Statements of Cash Flows," (v) our properties, brands, or markets in the United States ("U.S.") and Canada as "North America" or "North American," and (vi) our properties, brands, or markets in our Caribbean and Latin America, Europe, and Middle East and Africa regions as "Other International," and together with those in our Asia Pacific segment, as "International." In addition, references throughout to numbered "Footnotes" refer to the numbered Notes in these Notes to Condensed Consolidated Financial Statements, unless otherwise noted.

These Financial Statements have not been audited. We have condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with U.S. generally accepted accounting principles ("GAAP"). The financial statements in this report should be read in conjunction with the consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 ("2017 Form 10-K"). Certain terms not otherwise defined in this Form 10-Q have the meanings specified in our 2017 Form 10-K.

Preparation of financial statements that conform with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements, the reported amounts of revenues and expenses during the reporting periods, and the disclosures of contingent liabilities. Accordingly, ultimate results could differ from those estimates.

The accompanying Financial Statements reflect all normal and recurring adjustments necessary to present fairly our financial position as of March 31, 2018 and December 31, 2017, and the results of our operations and cash flows for the three months ended March 31, 2018 and March 31, 2017. Interim results may not be indicative of fiscal year performance because of seasonal and short-term variations. We have eliminated all material intercompany transactions and balances between entities consolidated in these Financial Statements.

The accompanying Financial Statements also reflect our adoption of several new accounting standards. See the "New Accounting Standards Adopted" caption below for additional information.

New Accounting Standards Not Yet Adopted

Accounting Standards Update ("ASU") 2016-02 "Leases" (Topic 842). ASU 2016-02 introduces a lessee model that brings substantially all leases onto the balance sheet. Under the new standard, a lessee will recognize on its balance sheet a lease liability and a right-of-use asset for most leases, including operating leases. The new standard will also distinguish leases as either finance leases or operating leases. This distinction will affect how leases are measured and presented in the income statement and statement of cash flows. The standard is effective for us beginning in our 2019 first quarter and requires the use of a modified retrospective transition method. We are still assessing the potential impact that ASU 2016-02 will have on our financial statements and disclosures, but we expect that it will have a material effect on our Balance Sheets.

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New Accounting Standards Adopted

ASU 2016-18 "Restricted Cash" (Topic 230). ASU 2016-18 requires companies to include restricted cash with cash and cash equivalents when reconciling beginning and ending amounts shown on the statement of cash flows. We adopted ASU 2016-18 in the 2018 first quarter using the retrospective transition method, and accordingly, we revised prior period amounts, as shown in the "Statements of Cash Flows" table below.

ASU 2016-16 "Accounting for Income Taxes: Intra-Entity Transfers of Assets Other than Inventory" (Topic 740). ASU 2016-16 requires companies to recognize the income tax effects of intercompany sales of assets other than inventory when the transfer occurs. We adopted ASU 2016-16 in the 2018 first quarter using the modified retrospective transition method and recorded an adjustment of $372 million for the cumulative effect to retained earnings at January 1, 2018.

ASU 2016-15 "Classification of Certain Cash Receipts and Cash Payments" (Topic 230). ASU 2016-15 specifies how certain cash receipts and payments are to be classified in the statement of cash flows and primarily impacts our presentation of cash outflows for commercial paper. Under ASU 2016-15, we are required to attribute a portion of the payments to accreted interest and classify that portion as cash outflows for operating activities. We adopted ASU 2016-15 in the 2018 first quarter using the retrospective transition method, and accordingly, we revised prior period amounts, as shown in the "Statements of Cash Flows" table below.

ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" (Topic 825). ASU 2016-01 eliminates the available-for-sale classification for equity investments and requires companies to measure equity investments at fair value and recognize any changes in the fair value in net income. We adopted ASU 2016-01 in the 2018 first quarter using the modified retrospective transition method and recorded a cumulative-effect adjustment of $4 million to retained earnings at January 1, 2018.

ASU 2014-09 "Revenue from Contracts with Customers" (Topic 606). ASU 2014-09 and several related ASUs (collectively referred to as "ASU 2014-09") supersede the revenue recognition requirements in Topic 605, Revenue Recognition, as well as most industry-specific guidance, and provide a principles-based, comprehensive framework in Topic 606, Revenue Recognition. ASU 2014-09 also specifies the accounting for certain costs to obtain or fulfill a contract with a customer and provides enhanced disclosure requirements. We adopted ASU 2014-09 in the 2018 first quarter using the full retrospective transition method. See Footnote 2. Revenues for disclosures required by ASU 2014-09, including our revenue recognition accounting policies.

When we adopted ASU 2014-09, we applied the following expedients and exemptions, which are allowed by the standard, to our prior period Financial Statements and disclosures:

- We used the transaction price at the date of contract completion for our contracts that had variable consideration and were completed before January 1, 2018.
- We considered the aggregate effect of all contract modifications that occurred before January 1, 2016 when: (1) identifying satisfied and unsatisfied performance obligations; (2) determining the transaction price; and (3) allocating the transaction price to the satisfied and unsatisfied performance obligations.
- We did not: (1) disclose the amount of the transaction price that we allocated to remaining performance obligations; or (2) include an explanation of when we expect to recognize the revenue allocated to remaining performance obligations.

The cumulative effect of adopting ASU 2014-09 was a decrease in 2016 retained earnings of approximately $264 million.

The following tables present the effect of the adoption of ASUs 2014-09, 2016-15, and 2016-18 on our Financial Statements included in this report.

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Income Statements

($ in millions, except per share amounts)	Three Months Ended March 31, 2017 (As Previously Reported)	Adoption of ASU 2014-09	Three Months Ended March 31, 2017 (As Adjusted)
REVENUES			
Base management fees	$ 264	$ —	$ 264
Franchise fees	365	(10)	355
Incentive management fees	153	(13)	140
Gross fee revenues	782	(23)	759
Contract investment amortization	—	(11)	(11)
Net fee revenues	782	(34)	748
Owned, leased, and other revenue	439	(11)	428
Cost reimbursement revenue	4,340	(604)	3,736
	5,561	(649)	4,912
OPERATING COSTS AND EXPENSES			
Owned, leased, and other-direct	358	(2)	356
Depreciation, amortization, and other	65	(14)	51
General, administrative, and other	210	2	212
Merger-related costs and charges	51	—	51
Reimbursed expenses	4,340	(644)	3,696
	5,024	(658)	4,366
OPERATING INCOME	537	9	546
Gains and other income, net	—	—	—
Interest expense	(70)	—	(70)
Interest income	7	—	7
Equity in earnings	11	—	11
INCOME BEFORE INCOME TAXES	485	9	494
Provision for income taxes	(120)	(3)	(123)
NET INCOME	$ 365	$ 6	$ 371
EARNINGS PER SHARE			
Earnings per share - basic	$ 0.95	$ 0.01	$ 0.96
Earnings per share - diluted	$ 0.94	$ 0.01	$ 0.95

Statements of Comprehensive Income

($ in millions)	Three Months Ended March 31, 2017 (As Previously Reported)	Adoption of ASU 2014-09	Three Months Ended March 31, 2017 (As Adjusted)
Net income	$ 365	$ 6	$ 371
Other comprehensive income (loss):			
Foreign currency translation adjustments	188	—	188

Derivative instrument adjustments, net of tax	(2)	—	(2)
Unrealized (loss) gain on available-for-sale securities, net of tax	(1)	—	(1)
Pension and postretirement adjustments, net of tax	—	—	—
Reclassification of losses, net of tax	—	—	—
Total other comprehensive income, net of tax	185	—	185
Comprehensive income	$ 550	$ 6	$ 556

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Balance Sheets

($ in millions)	December 31, 2017 (As Previously Reported) [1]	Adoption of ASU 2014-09	December 31, 2017 (As Adjusted)
ASSETS			
Current assets			
Cash and equivalents	$ 383	$ —	$ 383
Accounts and notes receivable, net	1,999	(26)	1,973
Prepaid expenses and other	216	19	235
Assets held for sale	149	—	149
	2,747	(7)	2,740
Property and equipment, net	1,793	—	1,793
Intangible assets			
Brands	5,922	—	5,922
Contract acquisition costs and other	2,884	(262)	2,622
Goodwill	9,207	—	9,207
	18,013	(262)	17,751
Equity method investments	735	(1)	734
Notes receivable, net	142	—	142
Deferred tax assets	93	—	93
Other noncurrent assets	426	167	593
	$ 23,949	$ (103)	$ 23,846
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
Current liabilities			
Current portion of long-term debt	$ 398	$ —	$ 398
Accounts payable	783	—	783
Accrued payroll and benefits	1,214	—	1,214
Liability for guest loyalty programs	2,064	57	2,121
Accrued expenses and other	1,541	(250)	1,291
	6,000	(193)	5,807
Long-term debt	7,840	—	7,840
Liability for guest loyalty programs	2,876	(57)	2,819
Deferred tax liabilities	604	1	605
Deferred revenue	145	438	583
Other noncurrent liabilities	2,753	(143)	2,610
Shareholders' equity			
Class A Common Stock	5	—	5
Additional paid-in-capital	5,770	—	5,770
Retained earnings	7,391	(149)	7,242
Treasury stock, at cost	(9,418)	—	(9,418)
Accumulated other comprehensive loss	(17)	—	(17)
	3,731	(149)	3,582
	$ 23,949	$ (103)	$ 23,846

(1) Includes reclassifications among various captions, including Deferred revenue and Other noncurrent liabilities, to conform to current period presentation.

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Statements of Cash Flows

($ in millions)	Three Months Ended March 31, 2017 (As Previously Reported)	Adoption of ASU 2014-09	Adoption of ASUs 2016-18 and 2016-15	Three Months Ended March 31, 2017 (As Adjusted)
OPERATING ACTIVITIES				
Net income	$ 365	$ 6	$ —	$ 371
Adjustments to reconcile to cash provided by operating activities:				
Depreciation, amortization, and other	65	(3)	—	62
Share-based compensation	48	—	—	48
Income taxes	82	4	—	86
Liability for guest loyalty program	60	9	—	69
Contract acquisition costs	—	(53)	—	(53)
Merger-related charges	(36)	—	—	(36)
Working capital changes	(108)	(28)	1	(135)
(Gain) loss on asset dispositions	1	—	—	1
Other	49	7	(7)	49
Net cash provided by (used in) operating activities	526	(58)	(6)	462
INVESTING ACTIVITIES				
Capital expenditures	(48)	—	—	(48)
Dispositions	311	—	—	311
Loan advances	(28)	—	—	(28)
Loan collections	7	—	—	7
Contract acquisition costs	(54)	54	—	—
Other	(4)	4	1	1
Net cash provided by investing activities	184	58	1	243
FINANCING ACTIVITIES				
Commercial paper/Credit Facility, net	(33)	—	7	(26)
Issuance of long-term debt	1	—	—	1
Repayment of long-term debt	(4)	—	—	(4)
Issuance of Class A Common Stock	2	—	—	2
Dividends paid	(115)	—	—	(115)
Purchase of treasury stock	(582)	—	—	(582)
Share-based compensation withholding taxes	(99)	—	—	(99)
Net cash provided by (used in) financing activities	(830)	—	7	(823)
(DECREASE) INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	(120)	—	2	(118)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, beginning of period	858	—	29	887
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, end of period	$ 738	$ —	$ 31	$ 769

See Footnote 10. Other Comprehensive Income (Loss) and Shareholders' Equity for the impact of the adoption of new accounting standards on our shareholders' equity.

2. REVENUES

Disaggregation of Revenues

The following tables present our revenues disaggregated by major revenue stream for the 2018 first quarter and the 2017 first quarter.

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($ in millions)	Three Months Ended March 31, 2018 North American Full Service	North American Limited Service	Asia Pacific	Other International	Total
Gross fee revenues	$299	$ 196	$ 117	$ 122	$734
Contract investment amortization	(11)	(3)	—	(4)	(18)
Net fee revenues	288	193	117	118	716
Owned, leased, and other revenue	155	33	47	158	393
Cost reimbursement revenue	2,856	535	111	251	3,753
Total segment revenue	$3,299	$ 761	$ 275	$ 527	$4,862
Unallocated corporate					144
Total revenue					$5,006

($ in millions)	Three Months Ended March 31, 2017 North American Full Service	North American Limited Service	Asia Pacific	Other International	Total
Gross fee revenues	$289	$ 181	$ 97	$ 112	$679
Contract investment amortization	(6)	(3)	—	(2)	(11)
Net fee revenues	283	178	97	110	668
Owned, leased, and other revenue	197	31	41	149	418
Cost reimbursement revenue	2,760	532	103	253	3,648
Total segment revenue	$3,240	$ 741	$ 241	$ 512	$4,734
Unallocated corporate					178
Total revenue					$4,912

Performance Obligations

For our managed hotels, we have performance obligations to provide hotel management services and a license to our hotel system intellectual property for the use of our brand names. As compensation for such services, we are generally entitled to receive base fees, which are a percentage of the revenues of hotels, and incentives fees, which are generally based on a measure of hotel profitability. Both the base and incentive management fees are variable consideration, as the transaction price is based on a percentage of revenue or profit, as defined in each contract. We recognize base management fees on a monthly basis over the term of the agreement as those amounts become payable. We recognize incentive management fees on a monthly basis over the term of the agreement based on each property's financial results, as long as we do not expect a significant reversal due to projected future hotel performance or cash flows in future periods.

For our franchised hotels, we have a performance obligation to provide franchisees and operators a license to our hotel system intellectual property for use of certain of our brand names. As compensation for such services, we are typically entitled to initial application fees and ongoing royalty fees. Our ongoing royalty fees represent variable consideration, as the transaction price is based on a percentage of certain revenues of the hotels, as defined in each contract. We recognize royalty fees on a monthly basis over the term of the agreement as those amounts become payable. Initial application and relicensing fees are fixed consideration payable upon submission of a franchise application or renewal and are recognized on a straight-line basis over the initial or renewal term of the franchise agreements.

Under our management and franchise agreements, we are entitled to be reimbursed for certain costs we incur on behalf of the managed, franchised, and licensed properties, with no added mark-up. These costs primarily consist of payroll and related expenses at managed properties where we are the employer of the employees at the properties, and include certain operational and administrative costs as provided for in our contracts with the owners. We are entitled to reimbursement in the period we incur the related reimbursable costs, which we recognize within the “Cost reimbursement revenue” caption of our Income Statements.

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Under our management and franchise agreements, hotel owners and franchisees participate in certain centralized programs and services, such as marketing, sales, reservations, and insurance programs. We operate these programs and services for the benefit of our hotel owners. We do not operate these programs and services to generate a profit over the contract term, and accordingly, when we recover the costs that we incur for these programs and services from our hotel owners, we do not seek a mark-up. The amounts we charge for these programs and services are generally based on sales or other variable metrics and are payable on a monthly basis. We recognize revenue within the “Cost reimbursement revenue” caption of our Income Statements when the amounts may be billed to hotel owners, and we recognize expenses within the “Reimbursed expenses” caption as they are incurred. This pattern of recognition results in temporary timing differences between the costs incurred for centralized programs and services and the related reimbursement from hotel owners in our operating and net income. Over the long term, these programs and services are not designed to impact our economics, either positively or negatively. In addition, proceeds from the sale of our interest in Avendra that we expend for the benefit of our hotel owners are included in “Reimbursed expenses”.

We provide hotel design and construction review quality assurance (“Global Design”) services to our managed and franchised hotel owners, generally during the period prior to a hotel’s opening or during the period a hotel is converting to a Marriott brand (the “pre-opening period”). As compensation for such services, we may be entitled to receive a one-time fixed fee that is payable during the pre-opening period of the hotel. As these services are not a distinct performance obligation, we recognize the fees on a straight-line basis over the initial term of the management or franchise agreement within the “Owned, leased, and other revenue” caption of our Income Statements.

At our owned and leased hotels, we have performance obligations to provide accommodations and other ancillary services to hotel guests. As compensation for such goods and services, we are typically entitled to a fixed nightly fee for an agreed upon period and additional fixed fees for any ancillary services purchased. These fees are generally payable at the time the hotel guest checks out of the hotel. We generally satisfy the performance obligations over time, and we recognize the revenue from room sales and from other ancillary guest services on a daily basis, as the rooms are occupied and we have rendered the services.

Under our Loyalty Programs, we have a performance obligation to provide or arrange for the provision of goods or services for free or at a discount to Loyalty Program members in exchange for the redemption of points earned from past activities. We operate our Loyalty Programs as cross-brand marketing programs to participating properties. Our management and franchise agreements require that properties reimburse us for a portion of the costs of operating the Loyalty Programs, including costs for marketing, promotion, communication with, and performing member services for Loyalty Program members, with no added mark-up. We receive contributions on a monthly basis from managed, franchised, owned, and leased hotels based on a portion of qualified spend by Loyalty Program members. We recognize these contributions into revenue as the points are redeemed and we provide the related service. The amount of revenue we recognize upon point redemption is impacted by our estimate of the “breakage” for points that members will never redeem. We estimate such amounts based on our historical experience and expectations of future member behavior. We recognize revenue net of the redemption cost within our “Cost reimbursement revenue” caption on our Income Statements, as our performance obligation is to facilitate the transaction between the Loyalty Program member and the managed or franchised property or program partner. We recognize all other Loyalty Program costs as incurred in our “Reimbursed expenses” caption.

We have multi-year agreements for our co-brand credit cards associated with our Loyalty Programs. Under these agreements, we have performance obligations to provide a license to the intellectual property associated with our brands and marketing lists (“Licensed IP”) to the financial institution that issues the credit cards, to arrange for the redemption of Loyalty Program points as discussed in the preceding paragraph, and to provide free night certificates to cardholders. We receive fees from these agreements, including fixed amounts that are primarily payable at contract inception, and variable amounts that are paid to us monthly over the term of the agreements, based on: (1) the number of free night certificates issued and redeemed; (2) the number of Loyalty Program points purchased; and (3) the volume of cardholder spend. We allocate those fees among the performance obligations, including the Licensed IP, our Loyalty Program points, and free night certificates provided to cardholders based on their estimated standalone selling prices. The estimation of the standalone selling prices requires significant judgments based upon generally accepted valuation methodologies regarding the value of our Licensed IP, the

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amount of funding we will receive, and the number of Loyalty Program points and free night certificates we will issue over the term of the agreements. We base our estimates of these amounts on our historical experience and expectation of future cardholder behavior. We recognize the portion of the Licensed IP revenue that meets the sales-based royalty criteria as the credit cards are used and the remaining portion of the Licensed IP revenue on a straight-line basis over the contract term. In our Income Statements, we primarily recognize Licensed IP revenue in the “Franchise fees” caption, and we recognize a portion in the “Cost reimbursement revenue” caption. We recognize the revenue related to the Loyalty Program points as discussed in the preceding paragraph. We recognize the revenue related to the free night certificates when the related service is provided. If the free night certificate redemption involves a managed or franchised property, we recognize revenue net of the redemption cost, as our performance obligation is to facilitate the transaction between the Loyalty Program member and the managed or franchised property.

Contract Balances

We generally receive payments from customers as we satisfy our performance obligations. We record a receivable when we have an unconditional right to receive payment and only the passage of time is required before payment is due. We record deferred revenue when we receive payment, or have the unconditional right to receive payment, in advance of the satisfaction of our performance obligations related to franchise application and relicensing fees, Global Design fees, credit card branding license fees, and our Loyalty Programs.

Current and noncurrent deferred revenue increased by $85 million, from $685 million at December 31, 2017 to $770 million at March 31, 2018, primarily as a result of our revenue recognition activity described above in the “Performance Obligations” caption. The increase was primarily attributed to a $96 million increase related to our credit card branding licenses and a $9 million increase related to franchise application and relicensing fees, partially offset by an $8 million decrease related to Global Design activity.

Our current and noncurrent Loyalty Program liability increased by $327 million, from $4,940 million at December 31, 2017 to $5,267 million at March 31, 2018, primarily reflecting an increase in points earned and consideration from our credit card agreements, partially offset by revenue recognized of $425 million that we had deferred at December 31, 2017.

Costs incurred to obtain and fulfill contracts with customers

We incur certain costs to obtain and fulfill contracts with customers, which we capitalize and amortize on a straight-line basis over the initial, non-cancellable term of the contract. We classify incremental costs of obtaining a contract with a customer in the “Contract acquisition costs and other” caption of our Balance Sheets, the related amortization in the “Contract investment amortization” caption of our Income Statements, and the cash flow impact in the “Contract acquisition costs” caption of our Statements of Cash Flows. We classify certain direct costs to fulfill a contract with a customer in the “Other noncurrent assets” caption of our Balance Sheets, and the related amortization in the “Owned, leased, and other-direct” caption of our Income Statements.

We had capitalized costs to fulfill contracts with customers of $301 million at March 31, 2018 and $295 million at December 31, 2017.

Practical Expedients and Exemptions

We do not disclose the amount of variable consideration that we expect to recognize in future periods in the following circumstances:

(1) if we recognize the revenue based on the amount invoiced or services performed;

(2) for sales-based or usage-based royalty promised in exchange for a license of intellectual property; or

(3) if the consideration is allocated entirely to a wholly unsatisfied promise to transfer a distinct service that forms part of a single performance obligation, and the terms of the consideration relate specifically to our efforts to transfer, or to a specific outcome from transferring the service.

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We are required to collect certain taxes and fees from customers on behalf of governmental agencies and remit these back to the applicable governmental agencies on a periodic basis. We do not include these taxes in determining the transaction price.

3. DISPOSITIONS

In the 2018 first quarter, we sold The Sheraton Buenos Aires Hotel & Convention Center and Park Tower, A Luxury Collection Hotel, Buenos Aires, both Caribbean and Latin America properties, and received $100 million in cash. We recognized a $53 million gain in the “Gains and other income, net” caption of our Income Statements.

Planned Dispositions

At the end of the 2018 first quarter, we held $121 million of assets classified as “Assets held for sale” on our Balance Sheets related to two Asia Pacific properties, one North American Full-Service property, and the remaining Miami Beach EDITION residences.

4. EARNINGS PER SHARE

The table below presents the reconciliation of the earnings and number of shares used in our calculations of basic and diluted earnings per share:

	Three Months Ended	
(in millions, except per share amounts)	March 31, 2018	March 31, 2017
Computation of Basic Earnings Per Share		
Net income	$ 398	$ 371
Shares for basic earnings per share	358.4	384.9
Basic earnings per share	$ 1.11	$ 0.96
Computation of Diluted Earnings Per Share		
Net income	$ 398	$ 371
Shares for basic earnings per share	358.4	384.9
Effect of dilutive securities		
Share-based compensation	4.9	5.1
Shares for diluted earnings per share	363.3	390.0
Diluted earnings per share	$ 1.09	$ 0.95

5. SHARE-BASED COMPENSATION

We recorded share-based compensation expense of $42 million in the 2018 first quarter and $48 million in the 2017 first quarter. Deferred compensation costs for unvested awards totaled $318 million at March 31, 2018 and $168 million at December 31, 2017.

RSUs and PSUs

We granted 1.3 million RSUs during the 2018 first quarter to certain officers, key employees, and non-employee directors, and those units vest generally over four years in equal annual installments commencing one year after the grant date. We granted 0.1 million PSUs in the 2018 first quarter to certain executive officers, subject to continued employment and the satisfaction of certain performance conditions based on achievement of pre-established targets for Adjusted EBITDA, RevPAR Index, room openings, and/or net administrative expense over, or at the end of, a three-year performance period. RSUs, including PSUs, granted in the 2018 first quarter had a weighted average grant-date fair value of $133.

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6. INCOME TAXES

Our effective tax rate decreased to 20.8 percent for the 2018 first quarter from 25.0 percent for the 2017 first quarter, primarily due to the reduction of the U.S. federal tax rate under the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act"), the release of tax reserves due to the completion of certain examinations, increased earnings in jurisdictions with lower tax rates, increases in excess tax deductions related to the vesting and exercise of share-based awards, and a reduction of the provisional Deemed Repatriation Transition Tax ("Transition Tax") estimate due to the impact of a 2018 first quarter audit settlement. The decrease was partially offset by tax expense incurred for uncertain tax positions relating to legacy-Starwood operations, increased state income tax due to a change in our position regarding the future remittance of a portion of the accumulated earnings of non-U.S. subsidiaries, tax expense related to the gain on the sale of two properties in the 2018 first quarter, and the current period's provisional estimate of tax for global intangible low-taxed income ("GILTI") under the 2017 Tax Act.

We paid cash for income taxes, net of refunds, of $88 million in the 2018 first quarter and $37 million in the 2017 first quarter.

Tax Cuts and Jobs Act of 2017

Although we have not completed our accounting for the effects of the 2017 Tax Act, we have where possible made reasonable estimates of the 2017 Tax Act's effects on our existing deferred tax balances and the Transition Tax, as described below. In cases where we have not been able to make reasonable estimates of the impact of the 2017 Tax Act, as described below, we continue to account for those items based on our existing accounting under ASC 740, Income Taxes, and the provisions of the tax laws that were in effect immediately before enactment of the 2017 Tax Act. In all cases, we will continue to refine our calculations as we complete additional analyses on the application of the law. As we complete our analysis, collect and prepare necessary data, and interpret any additional regulatory guidance, we may adjust the provisional amounts that we have recorded during a measurement period of up to one year from the enactment of the 2017 Tax Act that could materially impact our provision for income taxes, which could in turn materially affect our tax obligations and effective tax rate, in the periods in which we make such adjustments.

Reduction of U.S. federal corporate tax rate. The 2017 Tax Act reduced the U.S. federal corporate tax rate from 35 percent to 21 percent, effective January 1, 2018. In 2017, we made a reasonable estimate of the net impact of the corporate tax rate reduction on our deferred tax assets and liabilities, which did not change in the 2018 first quarter. However, our estimate could change as we complete our analyses of all impacts of the 2017 Tax Act, including, but not limited to, the state tax effect of adjustments made to federal temporary differences.

Deemed Repatriation Transition Tax. The Transition Tax is a new one-time tax on previously untaxed earnings and profits ("E&P") of certain of our foreign subsidiaries accumulated post-1986 through year-end 2017. In addition to U.S. federal income taxes, the deemed repatriation of such E&P may result in additional state income taxes in some of the U.S. states in which we operate. In the 2018 first quarter, we reduced our Transition Tax provisional estimate and recorded a benefit of $5 million, resulting in a net provisional estimated federal and state Transition Tax of $740 million. This adjustment resulted from changes to E&P as a result of completing an IRS audit. Our total Transition Tax estimate could continue to change as we finalize our analysis of untaxed post-1986 E&P, amounts held in cash or other specified assets, and as audits of federal income taxes are completed.

The 2017 Tax Act does not provide for additional income taxes for any remaining undistributed foreign earnings not subject to the Transition Tax, or for any additional outside basis differences inherent in foreign entities, as these amounts continue to be indefinitely reinvested in those foreign operations. Substantially all our unremitted foreign earnings that have not been previously taxed have now been subjected to U.S. taxation under the Transition Tax. In the 2018 first quarter, we recorded a state tax expense of $27 million relating to our plan to remit a portion of the accumulated earnings of non-U.S. subsidiaries in the future. This estimate could change as we complete additional analyses of the impacts of the 2017 Tax Act.

State net operating losses and valuation allowances. We must assess whether our state net operating loss valuation allowances are affected by various aspects of the 2017 Tax Act. As discussed above, we have recorded provisional amounts related to state income taxes for certain portions of the 2017 Tax Act, but we have not

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completed our analysis for the states where we have net operating loss carryovers and valuation allowances. Because we have not yet completed our determination of the need for, or any change in, any valuation allowance, we have not yet recorded any change to valuation allowances.

Other provisions. The 2017 Tax Act also included a new provision designed to tax GILTI. Under GAAP, we may make an accounting policy election to either (1) treat any taxes on GILTI inclusions as a current-period expense when incurred (the "period cost method") or (2) factor such amounts into our measurement of our deferred taxes (the "deferred method"). We have not yet adopted either accounting policy because we have not completed our analysis of this provision. We recorded a provision for GILTI tax related to current-year operations in our estimated annual effective tax rate. Because we are still evaluating the GILTI provisions and performing our analysis of future taxable income that is subject GILTI, we have not provided for additional GILTI tax on deferred items.

7. COMMITMENTS AND CONTINGENCIES

Guarantees

We present the maximum potential amount of our future guarantee fundings and the carrying amount of our liability for our debt service, operating profit, and other guarantees for which we are the primary obligor at March 31, 2018 in the following table:

($ in millions) Guarantee Type	Maximum Potential Amount of Future Fundings	Recorded Liability for Guarantees
Debt service	$ 131	$ 76
Operating profit	232	108
Other	10	2
	$ 373	$ 186

Contingent Purchase Obligations

Times Square EDITION. In the 2018 second quarter, the owner of the Times Square EDITION sold the property, and the lenders terminated our contingent purchase agreement.

Sheraton Grand Chicago. We granted the owner a one-time right, exercisable in 2022, to require us to purchase the leasehold interest in the land and the hotel for $300 million in cash (the "put option"). If the owner exercises the put option, we have the option to purchase, at the same time the put transaction closes, the underlying fee simple interest in the land for an additional $200 million in cash. We accounted for the put option as a guarantee, and our recorded liability at March 31, 2018 was $57 million.

Other Contingencies

In connection with our acquisition of Starwood and our assessment of various regulatory compliance matters at certain foreign legacy-Starwood locations, including compliance with the U.S. Foreign Corrupt Practices Act, we have determined that we do not need to establish reserves, or accrue expenses, based on the results of this assessment and the steps we have taken to integrate Starwood into Marriott's compliance program.

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8. LONG-TERM DEBT

We provide detail on our long-term debt balances, net of discounts, premiums, and debt issuance costs, in the following table at the end of the 2018 first quarter and year-end 2017:

($ in millions)	At Period End March 31, 2018	December 31, 2017
Senior Notes:		
Series K Notes, interest rate of 3.0%, face amount of $600, maturing March 1, 2019 (effective interest rate of 4.4%)	$598	$ 598
Series L Notes, interest rate of 3.3%, face amount of $350, maturing September 15, 2022 (effective interest rate of 3.4%)	348	348
Series M Notes, interest rate of 3.4%, face amount of $350, maturing October 15, 2020 (effective interest rate of 3.6%)	348	348
Series N Notes, interest rate of 3.1%, face amount of $400, maturing October 15, 2021 (effective interest rate of 3.4%)	397	397
Series O Notes, interest rate of 2.9%, face amount of $450, maturing March 1, 2021 (effective interest rate of 3.1%)	448	447
Series P Notes, interest rate of 3.8%, face amount of $350, maturing October 1, 2025 (effective interest rate of 4.0%)	345	345
Series Q Notes, interest rate of 2.3%, face amount of $750, maturing January 15, 2022 (effective interest rate of 2.5%)	744	744
Series R Notes, interest rate of 3.1%, face amount of $750, maturing June 15, 2026 (effective interest rate of 3.3%)	743	743
Series S Notes, interest rate of 6.8%, face amount of $324, maturing May 15, 2018 (effective interest rate of 1.7%)	326	330
Series T Notes, interest rate of 7.2%, face amount of $181, maturing December 1, 2019 (effective interest rate of 2.3%)	194	197
Series U Notes, interest rate of 3.1%, face amount of $291, maturing February 15, 2023 (effective interest rate of 3.1%)	291	291
Series V Notes, interest rate of 3.8%, face amount of $318, maturing March 15, 2025 (effective interest rate of 2.8%)	337	337
Series W Notes, interest rate of 4.5%, face amount of $278, maturing October 1, 2034 (effective interest rate of 4.1%)	292	292
Commercial paper	2,998	2,371
Credit Facility	—	—
Capital lease obligations		