Marriott Corporation (A)

Over the next few years we will place special emphasis on enhancing our strong customer preference, increasing operating cash flow and reducing debt.

—Chairman's letter to shareholders,
Marriott Corporation *1990 Annual Report,* p. 3

Priorities for the next few years: Reduce our long-term debt to about $2 billion by the end of 1994, by maximizing cash flow and selling assets.

—Chairman's letter to shareholders,
Marriott Corporation *1991 Annual Report,* p. 5
[Third in a list of four priorities.]

J.W. Marriott, Jr., chairman of the board and president of Marriott Corporation (MC), had weathered difficult times in the last few years. The company his father had founded in 1927 had grown explosively during the 1980s, developing hotel properties around the world and selling them to outside investors while retaining lucrative long-term management contracts. However, the economic slowdown in the late 1980s and the 1990 real estate market crash left MC owning many newly developed properties for which there were no buyers, together with a massive burden of debt. As Marriott had promised in successive annual reports in recent years, the company was working to sell properties and reduce that burden, but progress was slow. Looking ahead to the end of 1992, three months away, financial results promised to be only slightly better than for 1991, although still a significant improvement over the low point reached in 1990. For the foreseeable future, MC's ability to raise funds in the capital markets would be severely limited.

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Harvard Business School case 394–085.

But Marriott now faced a decision that had the potential to change this situation completely. He was considering a radical restructuring of the company proposed by Stephen Bollenbach, the new chief financial officer (CFO), under which the bulk of MC's service businesses would be split off from its property holdings—and debt. A new company would be created for the service businesses, with existing shareowners of MC receiving a share of stock in the new company to match each share they owned in the old one. The new company would have the financial strength to raise capital to take advantage of investment opportunities. The old one, valued for the chance of appreciation in its property holdings when the real estate market recovered, and not on the basis of earnings, would be under less pressure to sell properties at depressed prices.

Bollenbach had served as treasurer of MC in the early 1980s at the beginning of its period of rapid growth. After leaving in the middle of the decade, he had built a reputation for creating innovative financial structures in the hotel industry with the 1987 recapitalization of Holiday Corporation (later named Promus Companies, Inc.), and then with his rescue of Donald Trump's heavily indebted real estate holdings. Bollenbach returned to MC as CFO in February 1992. His proposed restructuring, called Project Chariot, reflected the imaginative and innovative thinking characteristic of the financial advisors who had contributed so much to MC's growth in the 1980s.

Project Chariot seemed like the perfect solution to the company's problems. Was it the right step to take now? MC's board of directors would be meeting soon, and Marriott needed to decide what to recommend.

Company and Industry Background[1]

Founding and Early Years

With 202,000 employees at the end of 1991, MC was ranked as the twelfth-largest employer in the United States.[2] The company traced its beginnings to 1927, when J.W. Marriott Sr. opened a small root beer stand in Washington, D.C. The business soon began to sell food and was renamed the Hot Shoppe restaurant. Working with his wife, Alice, Marriott Sr. saw the business grow throughout the 1930s and 1940s into a family-owned chain of 45 restaurants in nine states. The Marriotts also acquired contracts to run cafeterias and company kitchens, as well as to supply food to the airline industry. Growth and success were based upon a policy of careful attention to details and centralized and standardized operating procedures.

Initial Public Offering

MC went public in 1953, selling one-third of its shares. Although the company continued to sell stock to the public over the years, in 1992 the Marriott family still owned 25% of the company. In the first 5 years after the initial stock offering, it had doubled in size. In 1956 it opened its first hotel, in Washington, and in the next 8 years had grown to 120 Hot Shoppes and 12 hotels. J.W. Marriott Sr. resigned the position of president in 1964, passing it to his son J.W. Marriott Jr., then only 32. Under the son's leadership, MC abandoned the father's conservative financial policies. It turned to major borrowing to finance expansion that would maintain its historical 20% annual

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1. Much of the material in this section is based upon Keith F. Girard's, "What the Hell Happened to Marriott?" *Regardies,* April–May 1991, pp. 71–91.

2. *Dun's Business Rankings,* 1993.

revenue growth rate. In the 1970s, MC began to use bank credit and unsecured debt instead of mortgages to finance development. According to new financial thinking developing in the company, borrowing was acceptable as long as cash flow was maintained at a sufficient multiple of interest charges. The company acquired restaurant chains and entered new businesses, such as theme park development and operation.

Joint Ventures

In 1978, MC embarked upon its first joint venture, constructing a group of hotels and then selling them to the Equitable Life Assurance Society, a major insurance company. Thus began a powerful growth strategy in which the company would plan and develop hotels, sell the properties to investors, and retain long-term management contracts. By 1980, following a 5-year period of 30% annual growth, 70% of MC's hotel rooms were owned by outside investors. MC possessed an enviable reputation for quality and reliability in service, and together with careful site selection procedures and hotel sizing, this reputation translated into occupancy rates 4–6% above industry averages. This gap had widened to more than 10% by 1992; when the industry average was only around 65%, MC's rate was 76–80%.[3]

The Economic Recovery Tax Act of 1981 created new incentives for the ownership of real estate, which further fueled MC's hotel-developing activities. Its first real estate limited partnership, offered in that year, gave investors $9 in tax writeoffs for every $1 invested. Beginning in 1983, MC also branched out into the mid-price lodging market with "Courtyard" hotels, which were bundled into groups of 50 or more for limited partnership offerings. In 1985 scaled-down but full-service "compact hotels" for smaller city markets, as well as all-suite hotels and longer-term residence inns were introduced; MC entered the budget hotel market with "Fairfield Inns" in 1987. MC also continued to acquire restaurant chains, including Gino's in 1982 and Howard Johnson's in 1985, although its success in establishing a national business in this area was limited. In 1984 the company discontinued its theme park operations.

End of the Boom

In 1986 the Tax Reform Act ended most of the tax incentives for real estate investment, but MC, relying on the strong economy and its own reputation, continued its high-paced development activities. However, the market for its limited partnerships was drying up, and in 1989 the company experienced a sharp drop in income. It froze capital expenditures, which had increased threefold over the previous 6 years, sold off its airline in-flight catering business, and discontinued its restaurant operations. In 1990 the real estate market collapsed. MC's income plummeted and its year-end stock price fell by more than two-thirds, a drop of over $2 billion in market capitalization. For the first time, investor-owned Marriott hotels went bankrupt.

MC was saddled with large interest payments on properties it was unable to sell. Industry excess capacity led to low occupancy rates and deep discounting on room rates, resulting in large losses for many of MC's competitors and even bankruptcies in some cases. In 1991, MC intensified its focus on contract and management opportunities that required less capital outlay. These included captive food service markets such as hospitals, office buildings, and turnpike service plazas, as well as management of golf courses. The development and management of "life-care" community facilities

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3. Joseph J. Doyle, CFA, *Marriott Corporation,* Smithy Barney Research Report (released December 18, 1992).

TABLE A
Market Statistics on Marriott Corporation, September 1992

Recent market price	$16.00
Estimated earnings per share	.75
Stock beta	1.30
Price/earnings ratio	
Marriott Corporation	21.30
S&P 500 Industrials (close of 3Q1992)	26.00
S&P Hotel/Motel (close of 3Q1992)	22.70

Sources: Value Line reports (September 4, 1992); MC annual statement; *S&P Analysts' Handbook.*

for senior citizens was also a high-growth market that MC had entered, but capital constraints forced it to cut back on planned new construction.

Thus, the MC of September 1992 was a far cry from the real estate development engine of the 1980s. Capital spending had been reduced to an annual level of $350 million, only the amount necessary to maintain and refurbish the existing properties. While the company had improved its position from the low point in 1990, investors still regarded it at best as a company beset by the problems of a severely depressed industry, with several years of slow recovery ahead before it could begin to grow again. (See Table A for market statistics on MC.)

Corporate Culture

However, MC remained a company with many strengths, not least of which was a unique corporate culture built around the personality and values of the Marriott family, and especially of J.W. Marriott Sr., the founder. In every Marriott hotel lobby hung a painting of the two J.W. Marriotts; every Marriott hotel room contained a Gideon Bible, the Book of Mormon, and an authorized biography of J.W. Marriott Sr., a book commissioned and written in the 1970s and published in 1977.[4] The biography detailed the life of the founder, beginning with his roots in the Mormon frontier communities in Utah, his childhood and early struggles in difficult economic circumstances, and his work for several years as a missionary for his church. It described the source of his lifelong aversion to borrowing: the burden of debt on his family's sheep farm in Utah and the resulting foreclosure during the depression following World War I. The book closed with the picture of a wealthy and respected man, a leader in his church and active in politics and philanthropy.

In describing the growth of the MC, the book stressed the themes of careful attention to detail and organization, and above all of service to customers. But the organization itself was focused on the employees. On his retirement in 1964, in a letter to his son and successor, J.W. Marriott Sr. listed a number of "guideposts" in his management philosophy, including the principle that "People are No. 1—their development, loyalty, interest, team spirit."[5] And 9 years later, in introducing J.W. Marriott Sr. as a speaker to the employees at the opening of the Los Angeles Marriott, a company senior executive remarked, "Marriott believes that the customer is great, but you come first. Mr. Marriott knows that if he takes care of his employees, they'll take care of the customers."[6]

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4. Robert O'Brien, *Marriott: The J. Willard Marriott Story* (Salt Lake City: Desert Book Company, 1977).

5. Ibid., p. 266.

6. Ibid., p. 8.

Project Chariot[7]

Under Project Chariot, MC would become two separate companies. The division would be effected by a special stock dividend, giving stockholders of MC a share of stock in the new company to match each share they held of MC. The new company, to be called Marriott International, Inc. (MII), would comprise MC's lodging, food, and facilities management businesses, as well as the management of its life-care facilities. Food management had become a major segment of MC's business. With nearly 3,000 accounts, it included as clients some of the largest corporations and educational institutions in the United States. The existing company, to be renamed Host Marriott Corporation (HMC), would retain MC's real estate holdings and its concessions on tollroads and in airports (see Exhibit 1 for details). The transaction would be conditioned upon a ruling from the International Revenue Service that the special dividend would be tax free to shareholders, and upon ratification by a majority of MC stockholders. The plan called for the distribution of the dividend by mid-1993.

Under the plan, MII and HMC would have separate management teams. J.W. Marriott Jr. would be chairman, president, and chief executive officer of MII; his brother Richard Marriott (currently vice chairman of MC) would be chairman of HMC; and Stephen Bollenbach (the current MC chief financial officer) would be HMC's president and chief executive officer. The two companies would also have separate boards of directors, except that the two brothers would each serve on both boards. MII would have an ongoing contractual relationship with HMC similar to the current relationship between MC and owners of hotel properties managed by MC. Such contracts typically involved the payment by the property owners of an annual management fee of 2–3% of revenues. Similarly, MII would have the right to lease and operate the senior living facilities owned by HMC.

Under the spin-off, MII would have the right to purchase up to 20% of HMC's voting stock at market value in the event of a change in control of HMC. MII would also have right of first refusal if HMC offered its toll road and airport concessions for sale.

In the past several years, MC had reduced its work force significantly in response to its difficult economic situation. It was not expected that Project Chariot would lead to further cuts in the work force. After the division, MII would have 182,000 employees, and in 1992, on a projected pro forma basis, would have had $7.9 billion in sales and operating cash flow before corporate expenses, interest expense, and taxes of $408 million. HMC would have 23,000 employees, and 1992 projected pro forma sales of $1.8 billion, with operating cash flow before corporate expenses, interest expense, and taxes of $363 million. Under the plan, HMC would retain nearly all of MC's long-term debt of nearly $3 billion, although it would have access to a revolving line of credit of $600 million from MII through December 1997. However, MII itself would have very little long-term debt (see Exhibit 1).

Management Perspectives

Pure Plays. Dividing MC into two companies was consistent with the company's general strategy of separating property ownership from management operations. The theory was that added value came from finding investment opportunities and develop-

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7. Much of the material in this section is taken from Marriott Corporation Press Release, October 5, 1992, and from Mitch Hara, James Kirby, and Renee Noto, "Analysis of the Marriott Restructuring," a paper dated May 5, 1993, and written for the Harvard Business School class on Corporate Restructuring.

ing and managing hotels, not from the ownership of real estate. MC management had long felt that the financial markets undervalued the company's stock because of the difficulty investors had in distinguishing and separately valuing property ownership and management. Project Chariot offered investors the opportunity to participate in "pure plays" in the hotel management business and in hotel real estate investment business for longer-term appreciation.

Career Opportunities. In many ways, Project Chariot would offer attractive possibilities to Marriott's management. In the downsizing of the previous few years, many executive positions had been lost. MC had also seen the departure of fast-track executives who decided that their chances of rapid ascent in the organization and wealth accumulation were not as good as elsewhere. With two separate companies, there would now be twice as many top-level positions, and with MII poised for rapid growth, ambitious managers would be more likely to stay. Managers with stock holdings and options would also benefit personally from the expected increase in the value of the company's stock after the Project Chariot restructuring.[8]

Opportunities for HMC and MII. Because HMC would be valued more on the basis of the chance of appreciation in its property holdings than on expected income, the company would be under less pressure from investors to sell off hotels at distress prices. To the extent that HMC operated at a loss, the combined after-tax earnings of the two separate companies would be smaller than that of MC as a single entity, for HMC's losses would no longer offset MII's positive earnings. On the other hand, unburdened by debt, MII would have the ability to raise additional capital to finance growth, perhaps to participate in the consolidation of the hotel industry by purchasing the assets of competitors in financial difficulty. These new acquisitions would strengthen MII from a customer-service point of view.

Implications for Bondholders

While Project Chariot would very likely benefit stockholders in MC, the situation was quite different for bondholders. (See Exhibit 2 for a summary of MC's long-term debt.) Although MC management was confident that HMC would have the financial strength to make all payments of interest and principal on long-term obligations when due, the separation of the two companies would affect the security of MC debt holders. Bond rating agencies such as Moody's Investors Services (Moody's) and Standard and Poor's Corporation (S&P) were likely to lower the ratings on MC's long-term bonds to a level below investment grade. (See the Appendix for a discussion of bond ratings.) This development could force some institutional holders of MC debt to sell their holdings, since banks, insurance companies, and pension funds often operated under legal restrictions that limited the amount of non-investment-grade securities they could own. Fiduciaries managing such funds were also typically required by law to follow the "prudent person" rule in making investment decisions.

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8. According to the MC March 1992 proxy statement, the Marriott family was deemed to control 25.75% (approximately 25.6 million shares) of common stock of MC. The holdings of all other directors, nominees, and executive officers amounted to approximately 300,000 shares. An additional 800,000 shares were set aside for executive officers under a restricted stock plan and deferred stock agreements, as well as approximately 2.8 million stock options (of which 1.1 million were currently exercisable) under a stock option plan.

In the LBO situation, the tests of solvency and capitalization were the critical factors in determining constructive fraud.[11] Since courts excluded from consideration both intangible value created by a transaction and tangible value received by anyone other than the debtor (the corporation), LBOs failed the "reasonably equivalent value test" by their very nature.

LBO lawsuits were rarely successful. In large cases, plaintiffs almost always agreed to settlements averaging less than ten cents for each dollar of their claims.[12] A review of two dozen decisions found only five with a verdict for the plaintiffs, and federal appeals courts ruled for the defendants in virtually every key case considered between 1986 and 1992. Among the most favored defendants were "public shareholders who received most of the funds, but did not control the deal."[13]

Duties to Bondholders. U.S. courts had held that corporations have no responsibilities to safeguard the interests of bondholders other than those spelled out by the terms of the bond indenture. For example, in 1986 the Delaware Court of Chancery stated in *Katz v. Oak Industries:*

> Arrangements among a corporation, the underwriters of its debt, trustees under its indentures, and sometimes ultimate investors, are typically thoroughly negotiated and massively documented. The rights and obligations of the various parties are, or should be, spelled out in that documentation. The terms of the contractual relationship agreed to, and not broad concepts such as fairness, define the corporation's duty to bondholders.[14]

However, a more recent Delaware Chancery Court decision took the position that the duties of corporate boards of directors toward holders of corporate debt could be more extensive than simply to observe indenture provisions, particularly when the corporation was facing serious economic difficulties or bankruptcy. In such cases, very risky courses of action could be beneficial to stockholders yet injurious to the interests of debt holders. In *Credit Lyonnais Bank N.V. v. Pathe Communications* (1991 WL 277613), the court imposed a duty on the board to respect "the community of interest that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity."[15] A commentator noted that this decision altered the traditional approach in which "the board's duties to the company ran primarily to the stockholders, unless the company became insolvent, in which case the board's duty in some sense 'flipped' to creditors." In contrast, the new decision

> recognizes that there is no magic point at which duties should shift from stockholders to creditors. Instead, there is a continuum approaching insolvency in which the board's incentives become increasingly distorted and the creditor-stockholder conflict increases.[16]

The Delaware Chancery Court's decision in the *Credit Lyonnais* case was not based upon completely novel ideas about the legal responsibility of corporate leaders.

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11. Ibid., pp. 106–107.
12. Jack Friedman, "LBO Lawsuits Don't Pick Deep Pockets," *The Wall Street Journal,* January 27, 1993.
13. Ibid.
14. Cited in Lehn and Poulsen, p. 646.
15. Richard P. Swanson, Esq., "Directors' Duties to Creditors," p. 16.
16. Ibid., p. 16.

As far back as 1932, E. Merrick Dodd Jr., in an article in the *Harvard Law Review,* noted that

> Despite many attempts to dissolve the corporation into an aggregate of stockholders, our legal tradition is rather in favor of treating it as an institution directed by persons who are primarily fiduciaries for the institution rather than for its members.[17]

However, Professor Dodd's view was far from the orthodox position of most financial economists and lawyers in 1990, who regarded managers as agents for the shareholders with responsibility primarily to protect and promote shareholders' interests.

Social and Economic Climate

As the junk bond market collapsed and many of its high-risk issues headed towards bankruptcy or renegotiation, public opinion regarding the acceptability of massive wealth transfers through financial engineering shifted. Although there were still defenders of such transactions, they were viewed with suspicion by large segments of the public who condemned them as paper transactions that contributed no real value to the economy. Junk bonds and real estate investments had left many financial intermediaries, such as commercial banks, pension funds, and life insurance companies, in financially shaky positions. Although commercial bank profits were starting to improve, the real estate market continued to languish as financial institutions shed nonperforming real estate loans, and residual fears dampened the enthusiasm of potential investors.

The Decision

Marriott wondered what he should recommend to the board of directors regarding Project Chariot. (See Exhibits 3–7 for relevant financial data.) He had been assured by legal counsel that the corporation was within its rights as a debtor to restructure itself in this way. Investment advisors had given him an opinion that the transaction was in the best interests of shareholders. His CFO, Bollenbach, was convinced that cash flows for HMC were more than adequate to cover debt service requirements. And surely, if public reaction were extremely negative, or if other difficulties arose, Project Chariot could be abandoned without significant loss. But with this transaction the company was entering new territory.

The board would be meeting soon, and Marriott needed to decide.

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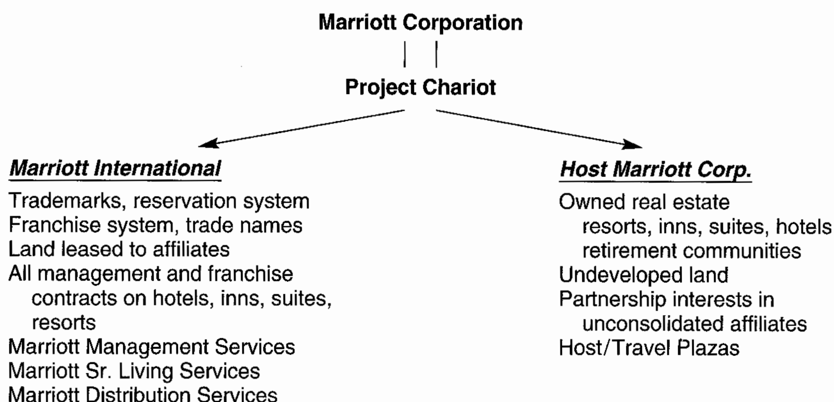
17. E. Merrick Dodd, Jr., "For Whom are Corporate Managers Trustees?" *Harvard Law Review* XLV, no. 7 (May 8, 1932): 1162–1163.

EXHIBIT 1
Project Chariot: Division of Marriott Corporation into Marriott International, Inc. and Host Marriott Corporation (amounts are projected)



1992 Statistics[a]

	Marriott International	*Host Marriott Corp.*
EBIT	$259	$123
Interest	25	210
Net income	134	(49)
Preferred dividend	0	$ 17
Net income, common	$134	($66)
EPS	1.40	($0.69)
Total assets	$2,600	$4,600
Debt	400	2,000
Preferred stock	0	200
Common equity	800	600
Times interest	10.4	.59
Debt % book capital	67%	76%

a. Millions of dollars, except per share data.

EXHIBIT 2
Marriott Corporation Long-Term Debt (millions of dollars)

	1990	1991	Moody's	S&P
Secured notes, with an average rate of 8.6% at January 3, 1992, maturing through 2010	$ 175	$ 527	Baa3	BBB
Unsecured debt				
Senior notes, with an average rate of 9.3% at January 3, 1992, maturing through 2001[a]	1,198	1,323	Baa3[c]	BBB[c]
Debentures, 9.4%, due 2007	250	250	Baa3	BBB
Revolving loans, with an average rate of 5.3% at January 3, 1992, maturing through 1995[b]	1,780	676		
Other notes, with an average rate of 7.8% at January 3, 1992, maturing through 2015	209	193	Baa3	BBB
Capital lease obligations	61	62		
	3,673	3,031		
Less current portion	(75)	(52)		
	$3,598	$2,979		

Sources: MC Annual Statement; Moody's and S&P reports.

a. Includes approximately $230 million (current valuation) of 8.25% Liquid Yield Option Notes, maturing in June 2006 for the face amount of $675 million and rated Ba1 (Moody's) and not rated by S&P.

b. By year-end 1992, MC expected to have reduced its revolving loan borrowings by $500 million and its other debt by approximately $150 million.

c. On April 29, 1992, MC issued $200 million of 10% 20-year senior notes, and on May 5, 1992, $200 million of 9.5% 10-year senior notes. Both issues were rated as Baa3 (Moody's) and BBB (S&P) and sold at yields in line with other Baa3 issues at the date of issue (see Exhibit A1 in Appendix).

EXHIBIT 3
Marriott Corporation Consolidated Statements of Income
(millions of dollars except per share data)

	1989	*1990*	*1991*
Sales			
Lodging			
Rooms	$2,093	$2,374	$2,699
Food and beverages	1,082	1,146	1,194
Other	371	422	486
	3,546	3,942	4,379
Contract services	3,990	3,704	3,952
	7,536	7,646	8,331
Operating costs and expenses			
Lodging			
Departmental direct costs			
Rooms	481	554	628
Food and beverages	816	870	915
Other, including payments to hotel owners and net restructuring charges of $65 million in 1990 and $194 million in 1989	2,117	2,279	2,511
Contract services, including restructuring charges of $57 million in 1990 and $51 million in 1989	3,818	3,590	3,799
	7,232	7,293	7,853
Operating profit			
Lodging	132	239	325
Contract services, including $231 million gain on divestiture of airline catering business in 1989	403	114	153
Operating profits before corporate expenses and taxes	535	353	478
Corporate expenses, including restructuring charges of $31 million in 1990 and $11 million in 1989	(107)	(137)	(111)
Interest expense	(185)	(183)	(265)
Interest income	55	47	43
Income from continuing operations before income taxes	298	80	145
Provision for income taxes	117	33	63
Income from continuing operations	181	47	82
Discontinued operations, net of income taxes			
Income from discontinued operations	35	—	—
Provision for loss on disposal	(39)	—	—
	(4)	—	—
Net income	$ 117	$ 47	$ 82
Earnings (loss) per common share			
Continuing operations	$ 1.62	$ .46	$ .80
Discontinued operations	(.04)	—	—
	$ 1.58	$ .46	$ .80

Source: MC Annual Report.

EXHIBIT 4
Marriott Corporation Consolidated Balance Sheets (millions of dollars)

	1990	1991
Assets		
Current assets		
Cash and equivalents	$ 283	$ 36
Accounts receivable	654	524
Inventories, at lower of average cost or market	261	243
Other current assets	230	220
	1,428	1,023
Property and equipment	2,774	2,485
Assets held for sale	1,274	1,524
Investments in affiliates	462	455
Intangibles	494	476
Notes receivable and other	494	437
	$6,926	$6,400
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$ 675	$ 579
Accrued payroll and benefits	305	313
Other payables and accruals	582	391
Notes payable and capital leases	75	53
	1,637	1,335
Long-term debt	3,598	2,979
Other long-term liabilities	388	351
Deferred income	312	232
Deferred income taxes	584	614
Convertible subordinated debt	—	210
Shareholders' equity		
Convertible preferred stock	—	200
Common stock, issued 105.0 million shares	105	105
Additional paid-in capital	69	35
Retained earnings	528	583
Treasury stock, 9.5 million and 11.4 million common shares, respectively, at cost	(295)	(244)
Total shareholders' equity	407	679
	$6,926	$6,400

Source: MC Annual Report.

EXHIBIT 5
Marriott Corporation Consolidated Statements of Cash Flows (millions of dollars)

	1989	1990	1991
Operating Activities			
Income from continuing operations	$ 181	$ 47	$ 82
Adjustments to reconcile to cash from operations			
Depreciation and amortization	186	208	272
Income taxes	41	18	27
Net restructuring charges	256	153	—
Proceeds from sale of timeshare notes receivable	—	—	83
Amortization of deferred income	(31)	(50)	(38)
Losses (gains) on sales of assets	(273)	(1)	3
Other	98	50	3
Working capital changes			
Accounts receivable	(100)	(76)	88
Inventories	(39)	(22)	63
Other current assets	(19)	(5)	13
Accounts payable and accruals	123	63	(47)
Cash from continuing operations	423	385	549
Cash from discontinued operations	86	(10)	3
Cash from operations	$ 509	$ 375	$ 552
Investing Activities			
Proceeds from sales of assets	$1,648	$ 990	$ 84
Less noncash proceeds	(258)	(15)	—
Cash received from sales of assets	1,390	975	84
Capital expenditures	(1,368)	(1,094)	(427)
Acquisitions	(242)	(118)	—
Other	(223)	(129)	(126)
Cash used in investing activities	(443)	(366)	(469)
Financing Activities			
Issuance of convertible preferred stock	—	—	$ 195
Issuances of long-term and convertible subordinated debt	873	1,317	815
Issuances of common stock	41	24	3
Repayments of long-term debt	(581)	(846)	(1,316)
Purchases of treasury stock	(280)	(294)	—
Dividends payments	(26)	(27)	(27)
Cash from (used in) financing activities	$ 27	$ 174	$ (330)
Increase (decrease) in cash and equivalents	93	183	(247)
Cash and equivalents, beginning of year	7	100	283
Cash and equivalents, end of year	$ 100	$ 283	$ 36

Source: MC Annual Report.

EXHIBIT 6
Marriott Corporation 10-Year Financial Summary (millions of dollars except per share data)

	1982	1983	1984	1985	1986	1987	1988	1989	1990[a]	1991
Reported sales growth		19%	21%	26%	29%	26%	13%	14%	1%	9%
Rate of general inflation		5	4	3	2	3	4	4	3	3
Real growth		14	17	23	27	23	9	10	(2%)	6
Increase in Marriott hotel rooms		11	11	10	16	32	14	14	12	7
Capital expenditures		$462	$627	$911	$821	$1,053	$1,359	$1,368	$1,094	$ 427
Asset Management										
Sales/total assets	.97	.95	.99	.99	1.02	1.09	1.11	1.16	1.10	1.30
Profitability										
Earnings per share	$ .41	$ .56	$ .74	$ .96	$ 1.16	$ 1.40	$ 1.59	$ 1.62	$ .46	$ .80
EBIT as % of sales	8.2%	8.2%	8.2%	8.4%	7.7%	7.3%	6.8%	6.4%	3.4%	4.9%
Net income as % of sales	4.7	4.8	4.9	4.6	4.1	3.8	3.5	2.4	0.6	1.0
Return on equity	20.0	20.0	22.1	22.1	20.6	22.2	30.4	23.8	9.7	18.3
Return on invested capital	8.5	7.6	7.5	7.4	6.3	6.4	6.7	5.7	3.9	6.5
Financial Leverage										
Long-term debt as % capital	54%	53%	48%	42%	47%	59%	61%	60%	68%	59%
Times interest earned	2.3	3.1	3.8	4.0	6.0	4.7	3.3	2.6	1.4	1.5
Senior debt rating	A2	A2	A2	A2	A2	A2	A3	A3	Baa2	Baa3
Valuation										
Share price	$11.70	$ 14.25	$ 14.70	$ 21.58	$ 29.75	$ 30.00	$ 31.63	$ 33.38	$ 10.50	$ 16.50
Earnings per share	.41	.56	.74	.96	1.16	1.40	1.59	1.62	.46	.80
Dividends per share	.06	.08	.09	.11	.14	.17	.21	.25	.28	.28
Price/earnings ratio	29	25	20	22	26	21	20	21	23	21
Market/book ratio	3.0	3.1	2.8	3.3	3.9	4.4	4.8	5.5	2.4	3.3

a. Operating results in 1990 included pretax restructuring charges and writeoffs, net of certain nonrecurring gains, of $153 million related to continuing operations. Operating results in 1989 included pretax restructuring charges and writeoffs of $256 million related to continuing operations, a $231 million pretax gain on the transfer of the airline catering division, and a $39 million after-tax charge recorded in conjunction with the planned disposal of the restaurant division.

EXHIBIT 7
Unconsolidated Affiliates

Marriott Corporation held ownership positions ranging from 1% to 50% in 267 hotels. This financial interest was reported as a $445 million "Investment in Affiliates," under either the cost or equity method of accounting (depending on the percent ownership). Marriott held management contracts and ground leases on these properties, and it provided limited guarantees on the debt of some of the properties in the form of a commitment to advance additional amounts to affiliates, if necessary, to cover certain debt requirements. Such commitments were limited to $349 million. Marriott Corporation's pretax income from affiliates was $97 million in 1991 and included management fees, net of direct costs, $81 million; ground rental income, $18 million; interest income, $19 million; and equity in net losses, ($21 million). Pretax income from affiliates was $47 million in 1986.

In 1991 the affiliates reported sales of $1,855 million, down slightly from the $1,900 million reported in 1990. Operating expense before interest totaled $2,076 million in 1991 versus $2,082 million in 1990.

Operating Results of Unconsolidated Affiliates (millions of dollars)

	1986	1990	1991	1992
Sales	$889	$1,801	$1,855	$1,900
Cash operating expenses		1,709	1,729	1,735
Depreciation	811	344	347	347
EBIT	$ 78	($252)	($221)	($182)
Interest expenses	213			
Net loss	($135)			

Balance Sheets of Unconsolidated Affiliates at December 31 (millions of dollars)

Assets	1986	1991	1992	Liabilities & Equity	1986	1991	1992
Current	$ 194	$ 158	$ 204	Current liabilities	$ 154	$ 445	$1,464
Noncurrent	2,721	4,842	4,589	Long-term debt	2,377	4,233	3,162
Total	$2,915	$5,000	$4,793	Other liabilities	242	565	694
				Equity	142	(243)	(527)
				Total	$2,915	$5,000	$4,793

Marriott Corporation Pretax Income from Unconsolidated Affiliates (millions of dollars)

	1986	1990	1991	1992
Management fees, net of cost	$63	$76	$81	$82
Ground rents		17	18	19
Interest income		21	19	16
Equity in net loss	(16)	(16)	(21)	(24)
Total	$47	$98	$97	$93

Appendix
Explanation of Bond Ratings[18]

Since the early 1900s, bonds have been assigned quality ratings that reflect their probability of going into default. The two major rating agencies are Moody's Investors Service (Moody's) and Standard & Poor's Corporation (S&P). These agencies' rating designations are shown in Exhibit A1. The AAA and AA bonds are extremely safe. A and BBB bonds are strong enough to be called investment grade bonds, and they are the lowest-rated bonds that many banks and other institutional investors are permitted by law to hold. BB and lower bonds are speculations, or junk bonds; they have a significant probability of going into default, and many financial institutions are prohibited from buying them.

Bond Rating Criteria

Although the rating assignments are judgmental, they are based on both qualitative and quantitative factors, some of which are listed below:

1. Debt ratio.
2. Times-interest-earned ratio.
3. Fixed charge coverage ratio.
4. Current ratio.
5. Mortgage provisions: Is the bond secured by a mortgage?
6. Subordination provisions: Is the bond subordinated to other debt?
7. Guarantee provisions: Some bonds are guaranteed by other firms.
8. Sinking fund: Does the bond have a sinking fund to ensure systematic repayment?
9. Maturity: Other things the same, a bond with a shorter maturity will be judged less risky than a longer-term bond.
10. Stability: Are the issuer's sales and earnings stable?
11. Regulation: Is the issuer regulated, and could an adverse regulatory climate cause the company's economic position to decline?
12. Antitrust and legal: Are any antitrust actions or lawsuits pending against the firm that could erode its position?
13. Overseas operations: What percentage of the firm's sales, assets, and profits are from overseas operations, and what is the political climate in the host countries?
14. Environmental factors: Is the firm likely to face heavy expenditures for pollution-control equipment?
15. Pension liabilities: Does the firm have unfunded pension liabilities that could pose a future problem?
16. Labor unrest: Are there potential labor problems on the horizon that could weaken the firm's position?

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18. Based on Eugene F. Brigham and Louis C. Gapenski, *Financial Management,* 5th ed. (New York: The Dryden Press, 1988), pp. 545–547. Data on bond yield have been added.

17. Resource availability: Is the firm likely to face supply shortages that could force it to curtail operations?
18. Accounting policies: Conservative accounting policies are a plus factor in bond ratings.

Representatives of the rating agencies have consistently stated that no precise formula is used to set a firm's rating—all the factors listed, plus others, are taken into account, but not in a mathematically precise manner. Statistical studies have borne out this contention, for researchers who have tried to predict bond ratings on the basis of quantitative data have had only limited success, indicating that the agencies do indeed use a good deal of subjective judgment when establishing a firm's rating.

EXHIBIT A1
Comparison of Bond Ratings

	Moody's	***S&P***	***Yields[a]***
High quality	Aaa	AAA	7.80%
	Aa	AA	8.07
Investment grade	A	A	8.26
	Baa	BBB	8.72
Junk bonds substandard	Ba	BB	9.04
	B	B	10.81
Speculative	Caa	CCC	—
	C	D	—

Note: Moody's and S&P use "modifiers" for bonds rated below AAA. S&P uses a plus and minus system; thus, A+ designates the strongest A-rated bonds, and A– the weakest. Moody's uses a 1, 2, or 3 designation, with 1 denoting the strongest and 3 the weakest; thus, within the AA category, Aa1 is the best, Aa2 is average, and Aa3 is the weakest.

a. Yields of corporate bonds with 10-year maturities as of September 28, 1992.

EXHIBIT A2
Bond Ratings of Industrial Corporations (1987–1989 Medians)

	AAA	***AA***	***A***	***BBB***	***BB***	***B***	***CCC***
Times interest earned	12.0	9.1	5.5	3.6	2.3	1.0	.8
Long-term debt as percent of capital	12%	19%	30%	38%	51%	66%	62%