

HILTON HOTELS CORP
Form 10-Q
November 02, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-3427

HILTON HOTELS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

9336 Civic Center Drive, Beverly Hills, California

(Address of principal executive offices)

36-2058176

(I.R.S. Employer
Identification No.)

90210

(Zip code)

(310) 278-4321

(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 twelve 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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of October 31, 2005: Common Stock, \$2.50 par value 381,453,201 shares.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Company or group of companies for which report is filed:

HILTON HOTELS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Income

	Three Months Ended September 30, 2004 (unaudited) (in millions, except per share amounts)		Nine Months Ended September 30, 2004 (unaudited) (in millions, except per share amounts)	
	2004	2005	2004	2005
Revenue				
Owned hotels	\$ 492	489	1,520	1,559
Leased hotels	30	28	85	87
Management and franchise fees	102	119	288	338
Timeshare and other income	119	155	346	457
	743	791	2,239	2,441
Other revenue from managed and franchised properties	290	311	853	913
	1,033	1,102	3,092	3,354
Expenses				
Owned hotels	365	350	1,116	1,117
Leased hotels	26	24	76	77
Depreciation and amortization	81	70	247	228
Impairment loss and related costs				7
Other operating expenses	101	128	291	366
Corporate expense	19	25	63	75
	592	597	1,793	1,870
Other expenses from managed and franchised properties	290	311	849	907
	882	908	2,642	2,777
Operating income from unconsolidated affiliates	20	9	40	35
Operating Income	171	203	490	612
Interest and dividend income	2	6	19	14
Interest expense	(67)	(66)	(209)	(196)
Net interest from unconsolidated affiliates and non-controlled interests	(6)	(6)	(20)	(19)
Net (loss) gain on asset dispositions and other	(1)	4	(2)	76
Loss from non-operating affiliates	(3)	(4)	(3)	(13)
	96	137	275	474
Income Before Taxes and Minority and Non-Controlled Interests	96	137	275	474
Provision for income taxes	(35)	(47)	(96)	(108)
Minority and non-controlled interests, net		(1)	(6)	(11)
Net Income	\$ 61	89	173	355
Basic Earnings Per Share	\$.16	.23	.45	.93
Diluted Earnings Per Share	\$.15	.22	.44	.87

See notes to consolidated financial statements

Hilton Hotels Corporation and Subsidiaries
Consolidated Balance Sheets

	December 31, 2004	September 30, 2005 (unaudited)
	(in millions)	
ASSETS		
Current Assets		
Cash and equivalents	\$ 303	554
Restricted cash	163	404
Accounts receivable, net	269	367
Inventories	144	191
Deferred income taxes	85	90
Current portion of notes receivable, net	68	46
Other current assets	74	123
Total current assets	1,106	1,775
Investments, Property and Other Assets		
Investments and notes receivable, net	635	680
Property and equipment, net	3,510	3,248
Management and franchise contracts, net	336	314
Leases, net	111	108
Brands	970	970
Goodwill	1,240	1,224
Other assets	334	349
Total investments, property and other assets	7,136	6,893
Total Assets	\$ 8,242	8,668
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$ 611	743
Current maturities of long-term debt	14	14
Income taxes payable	4	5
Total current liabilities	629	762
Long-term debt	3,633	3,601
Non-recourse debt of non-controlled entity	100	100
Deferred income taxes and other liabilities	1,312	1,492
Stockholders equity	2,568	2,713
Total Liabilities and Stockholders Equity	\$ 8,242	8,668

See notes to consolidated financial statements

Hilton Hotels Corporation and Subsidiaries
Consolidated Statements of Cash Flow

	Nine Months Ended	
	September 30,	
	2004	2005
	(unaudited)	
	(in millions)	
Operating Activities		
Net income	\$ 173	355
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	247	228
Amortization of loan costs	7	6
Net loss (gain) on asset dispositions	2	(76)
Loss from non-operating affiliates	3	13
Impairment loss and related costs		7
Change in working capital components:		
Inventories	47	(49)
Accounts receivable	(55)	(91)
Other current assets	(5)	(48)
Accounts payable and accrued expenses	74	130
Income taxes payable	26	1
Restricted cash	(73)	(10)
Change in deferred income taxes	19	73
Change in other liabilities	42	(36)
Unconsolidated affiliates distributions in excess of earnings	15	
Change in timeshare notes receivable	(82)	(79)
Other	(1)	(15)
Net cash provided by operating activities	439	409
Investing Activities		
Capital expenditures	(106)	(322)
Additional investments	(67)	(30)
Proceeds from asset dispositions	51	629
Asset disposition proceeds held in escrow as restricted cash		(231)
Payments received on notes and other	34	39
Net cash (used in) provided by investing activities	(88)	85
Financing Activities		
Change in revolving loans	(160)	
Long-term borrowings		14
Reduction of long-term debt	(10)	(11)
Issuance of common stock	52	56
Repurchase of common stock		(271)
Cash dividends	(23)	(31)
Net cash used in financing activities	(141)	(243)
Increase in Cash and Equivalents	210	251
Cash and Equivalents at Beginning of Year	9	303
Cash and Equivalents at End of Period	\$ 219	554

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1: General

The consolidated financial statements presented herein have been prepared by Hilton Hotels Corporation in accordance with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2004 and should be read in conjunction with the Notes to Consolidated Financial Statements which appear in that report.

The consolidated financial statements for the three and nine months ended September 30, 2004 and 2005 are unaudited; however, in the opinion of management, all adjustments (which include normal recurring accruals) have been made which are considered necessary to present fairly the operating results and financial position for the unaudited periods.

Note 2: Earnings Per Share

Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. The weighted average number of common shares outstanding totaled 385 million and 383 million for the three and nine months ended September 30, 2004 and 381 million and 383 million for the three and nine months ended September 30, 2005, respectively. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The dilutive effect of stock-based compensation and convertible securities increased the weighted average number of common shares by 34 million for both the three and nine months ended September 30, 2004 and 2005. In addition, the increase to net income resulting from interest on convertible securities assumed to have not been paid was \$3 million for both of the three month periods ended September 30, 2004 and 2005, and \$9 million for both of the nine month periods ended September 30, 2004 and 2005. The sum of EPS for the first three quarters of 2004 differs from the year to date EPS due to the required method of computing EPS in the respective periods.

Note 3: Stock-Based Compensation

We apply Accounting Principles Board (APB) Opinion 25 and related interpretations in accounting for our stock-based compensation plans. Prior to 2004, our stock-based compensation consisted primarily of stock options. No compensation cost is reflected in our net income related to our stock option awards for the periods presented, as all stock options had an exercise price greater than or equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, we will account for our stock-based compensation in accordance with Financial Accounting Standard (FAS) 123R (see Note 7).

We granted 400,000 stock options with an exercise price of \$22.19 per share and an estimated fair value of approximately \$13.12 per share in 2005. No stock options were granted in 2004. For disclosure purposes, we estimated the fair value of each stock option grant on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2005: dividend yield of one percent; expected volatility of 55 percent; risk-free interest rate of 4.1 percent and expected life of 8 years.

During the first quarter of 2005, we granted 1,272,000 stock units and 811,000 performance units, both with a grant date fair value of approximately \$22.19 per share. Stock units and performance units settle for shares of our common stock on a one-for-one basis. The stock units vest annually in a straight-line manner over four years. The performance units vest in full at the end of a three-year period, and vest at a level between 0% and 150% of the target amount based on the extent that pre-determined performance measures are achieved. In accordance with APB 25, compensation expense for the stock units is measured

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at the fair value of the underlying stock at the date of grant, and compensation expense associated with performance units is subject to adjustment for changes in the underlying stock price over the vesting period, as well as changes in estimates relating to whether the performance objectives will be achieved. Compensation expense for both stock units and performance units is amortized over the respective vesting periods. Consolidated compensation expense related to stock units and performance units was approximately \$2 million and \$5 million for the three and nine months ended September 30, 2004, respectively, and \$4 million and \$15 million for the three and nine months ended September 30, 2005, respectively.

We also provide supplemental retirement benefits to eligible senior officers in the form of stock units that settle for shares of our common stock on a one-for-one basis. The compensation expense associated with the benefits is expensed over the four-year vesting period. The pre-tax expense under these plans was less than \$1 million and approximately \$3 million for the three and nine months ended September 30, 2004, respectively. The expense for the three and nine months ended September 30, 2005 was less than \$1 million.

Had the expense for all forms of our stock-based compensation been determined using the fair value based method defined in FAS 123,

Accounting for Stock-Based Compensation, our net income and net income per share would have been reduced to the pro forma amounts indicated below. These pro forma results may not be indicative of the future results for the full fiscal year due to potential grants, vesting and other factors:

	Three months ended September 30, 2004		Nine months ended September 30, 2004	
	2005	2005	2004	2005
	(in millions, except per share amounts)			
Net income:				
As reported	\$ 61	89	173	355
Add back: Compensation expense included in reported net income, net of tax	1	3	5	10
Deduct: Fair-value compensation expense for all awards, net of tax	(4)	(5)	(14)	(17)
As adjusted	\$ 58	87	164	348
Basic earnings per share:				
As reported	\$.16	.23	.45	.93
As adjusted	\$.15	.23	.43	.91
Diluted earnings per share:				
As reported	\$.15	.22	.44	.87
As adjusted				