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Avis Budget Group, Inc. (CAR)

Q1 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Avis Budget Group First Quarter Earnings Conference Call. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the meeting over to Mr. Neal Goldner, Vice President of Investor Relations. Please go ahead, sir.

Neal H. Goldner
Vice President-Investor Relations

Good morning, everyone, and thank you for joining us. On the call with me are Larry De Shon, our Chief Executive Officer; and David Wyshner, our President and Chief Financial Officer.

Before we begin, I would like to remind everyone that the company will be discussing forward-looking information that involves risks, uncertainties, and assumptions that could cause actual results to differ materially from the forward-looking information. Important risks, assumptions, and other factors that could cause future results to differ materially from those expressed in the forward-looking statements are specified in the company's earnings release and other periodic filings with the SEC, which are available on the Investor Relations' section of our website at avisbudgetgroup.com.

We have provided slides to accompany this morning's conference call, which can also be accessed on our website as well. Our comments will focus on adjusted results and other non-GAAP financial measures that are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

Now, I'd like to turn the call over to Avis Budget Group's Chief Executive Officer, Larry De Shon.

Larry D. De Shon

Chief Executive Officer & Director

Thank you, Neal, and good morning. Our business is about connecting people with what's important to them and I believe Avis Budget Group is as well positioned today around the world to meet this critical need as ever.

Yes, we faced some headwinds in the first quarter, but we also made meaningful progress on our strategic initiatives to drive revenue growth and position us to improve margins longer-term. And importantly, as you saw in our earnings release last night, our full-year earnings expectations are unchanged and we remain committed to delivering shareholder value over time.

The first quarter was full of challenges. Some of which we expected and others that wound up being more difficult than we anticipated. Softness in commercial volume continued, while in-bound travel to major leisure destinations in the United States was lower than normal. The lack of a major winter storms also meant that rental cars that would normally be utilized to meet insurance replacement needs, found themselves at airports instead.

With half of the quarter being a seasonally low demand period for used cars and therefore being a difficult time to de-fleet, we saw elevated fleet levels across the industry resulting in unusually tough pricing environment.

In the face of these headwinds our teams pulled together and aggressively managed those things that are under our control. We took advantage of our fleet flexibility, aggressively managed our inventory and delivered increased utilization both in the Americas and in our international segment.

We made substantial progress in our shuttling and manpower planning initiatives as well as expanding our self-service offering to more locations and more customers. We took steps to streamline our operations and lower our cost structure, which will provide benefits for the remainder of the year. And we took advantage of our stock price by repurchasing \$80 million of our own shares in the quarter.

We made a lot of progress in a short amount of time and I believe we are well placed to take full advantage of the substantial opportunities still ahead of us; but before that, there are a few key things I want to highlight.

First the answer to a question that some of you have on your minds this morning is; yes, pricing in the first quarter was tougher than we thought it would be. We now know that our soft President's week, particularly in markets like Florida and Arizona was the start of what turned out to be an unusually weak spring break. Coupled with the soft commercial demand, weak inbound volume and a mild winter, fleet was abundant across the industry and pricing finished down 5% year-over-year in the quarter.

Second, our view is that this unusually soft pricing event we experienced in the first quarter is an anomaly, not a trend or a new normal. Our year-over-year comparisons have been improving fairly significantly over the last few months. March was better than February, April was better than March, and May bookings are indicating a continuation of the favorable pricing trend. We're running our fleet tight relative to demand, and based on what we're seeing in the marketplace, it appears that the industry seems to be shifting to a better alignment of fleets with traveler demand.

Third, we have revised our full-year Americas pricing forecast to be down around a point this year. This revision primarily reflects the challenges we faced in the first quarter and our expectation that the remainder of the year will be better than Q1 due to our actions and better aligned industry fleet levels.

We are going to continue to work to optimize our pricing strategies through the use of demand fleet pricing yield management tool and running our fleet tight to demand. But with the first quarter having been down five points, the math tells you that we're forecasting progressive improvement, so that the last nine months of the year in aggregate have roughly flat pricing year-over-year.

We also had a number of positive trends in the Americas in the first quarter. We achieved 7% growth in leisure volumes, our seventh straight quarter in excess of 6%. Our prepaid volumes grew 28% and now represent more than a quarter of our total dotcom reservations.

Our ancillary revenues from satellite radio rentals were up double-digits. Our fleet utilization was up 100 basis points from first quarter 2015. Our customer satisfaction scores increased significantly. And on the technology front, we continue to make good progress on the modernization of our core Wizard system, which will help us reduce costs and be more technologically nimble. We migrated Payless onto Wizard and we are investing in our brands' mobile sites in the United States to make them more user friendly and more effective.

Moving to our international segment, as many of you know, we've been working very hard over the past few years to improve our international operations. Since acquiring Avis Europe in 2011, we've reduced hundreds of overlapping and outdated IT systems. We've expanded our low cost shared service center in Budapest and driven out substantial costs, while also making the business more nimble.

We put a renewed emphasis on growing ancillary sales, improving fleet utilization and expanding the presence and growth of our Budget brand. And we've also followed a well-executed acquisition program. And with the European economy starting to feel better, we expect the benefit from all this hard work to begin to come through in our financial results this year.

In the first quarter, revenue in our international operations grew 14% in constant currency. We saw significant growth in leisure demand, while double-digit growth in the UK, France, Portugal and Spain. And in Italy, we saw leisure volumes grow more than 30%, even excluding Maggiore.

In-bound volumes were strong with inter-European inbound increasing double-digits and inbound rentals from outside Europe growing almost as much. Our customer satisfaction scores in Europe improved significantly. We laid the groundwork for incremental marketing spend in Q1, and launched our new Avis brand campaign in April. And we made further progress on the integration of Maggiore by concluding our union negotiations and social plans, and have begun tri-branding some stores in Italy with the Avis, Budget and Maggiore brands where it makes sense to do so. It would be easy for our solid international results in the first quarter to get lost amid currency effects and pricing challenges. But, it's something we do want to highlight.

Moving to our outlook, as I mentioned in my opening remarks, our full-year EBITDA guidance remains unchanged. We have reduced our full-year pricing outlook in the Americas to reflect our first quarter results and more gradual improvement over the remainder of the year.

We're also projecting lower per-unit fleet costs in our international segment compared to our previous guidance, as well as higher global fleet utilization, less foreign currency headwinds and improved labor productivity based on actions we took in the first quarter.

In the Americas, we expect volume growth to be driven primarily by leisure demands. As I mentioned, pricing has already begun to improve. In addition with fleet costs for our entire industry likely to be up this year, we continue to believe there should soon be a tailwind pushing pricing to strengthen in order to offset margin pressures.

In our international segment, summer bookings are just starting to come in. While it's still early days, our reservations are building nicely. And we are optimistic about this trend. We think currency exchange rates are going to have Europeans traveling within the Eurozone that inbound volumes to Continental Europe will be strong, and that the threat of terrorism will have limited effects on travel volume.

On the pricing side, we continue to anticipate a highly competitive environment and expect to see a decline in constant currency international pricing in 2016. And as I mentioned, our second quarter results will reflect our additional investment in brand marketing.

And we're looking to deliver incremental benefits from our key initiatives for the year: robust ancillary revenues; reduced shuttling expenses; increased productivity; effective sales and marketing; strong customer retention; and excellent fleet management, including higher fleet utilization and increased use of alternative disposition channels.

We continue to expect to invest \$50 million or more through the income statement this year to help deliver savings and growth in 2016 and beyond. We see a significant opportunity in the near-term as well as the long-term to reshape our business in meaningful ways and that means leveraging technology.

So, before turning the call over to David, I'd like to take a minute to update you on the progress we've made since our last earnings call to enhance our service offering and drive long-term margins. We serve a lot of customers at our locations and it takes a lot of hard work to make each rental experience a great one. The customers don't always come to us in a steady flow. We have peak months during the year, peak weeks during the month, peak days during the week, and even peak hours during the day.

To drive higher margins, our staff needs to be as variable as our volume. Our manpower planning initiative will help us sharpen our deployment of our people to more efficiently service the different demand patterns at our various locations. When you consider that we spend nearly three quarters of a billion dollars annually on field manpower, a small improvement in productivity can have a big impact on our profitability.

Since our last call, we've assembled a team and have begun the work to deploy sophisticated manpower planning tools in our business and we are confident that the savings from this initiative will be substantial.

We also move a lot of vehicles every day, which is expensive. We shuttle cars within our airport operations, we shuttle cars between our airport and off-airport locations and we even move cars between brands. And when you consider that we spend over a quarter billion shuttling vehicles, even a little bit of incremental efficiency can save a lot of money.

Improving a driver's route, making sure we are shuttling the best car for the rental or making a better decision regarding whether the shuttle should occur at all. We believe that we can reduce our shuttling costs per transaction over time through investment in technology and people.

To that end, we are piloting a shuttling technology tool and repurpose an important resource in our organization to sit over the top of that cost line with new data analytics that can evaluate every shuttle move we might make. The early indications have been encouraging.

We are also investing in our brands as planned. At our Avis brand, we are deploying ambassadors at the busiest times for our busiest locations to help our customers through the checkout stage of the rental process, particularly on our lots and in our garages.

At Budget, we have launched a new series of direct-to-response commercials, featuring Jessica Simpson both to drive volume through proprietary channels and to build brand awareness and brand preference. And in Europe, we completed the rollout of new Avis website and mobile apps in 12 countries over the last six months and are seeing the benefits and improved conversion rates.

And finally, we continue to make significant progress on our self-service initiative. We've expanded our test to encompass nearly 20,000 commercial customers and 50 airports in the United States. When their flight lands, enrolled customers can see the vehicle assignment on their smartphone as well as other vehicles they can select without going to the rental counter.

Our app-enabled customers to exchange or upgrade their vehicle, extend their rental period, end their transaction upon returning the vehicle and obtain a receipt right on their mobile device. In other words, we're giving customers the control over their car rental experience that they've been asking for.

To sum up, while the first quarter was challenging, I believe we've turned the corner and are headed in the right direction. The hard work we started this quarter to drive efficiencies and strengthen our service offering will go a long way to improve our margins long-term.

Leisure demand around the world continues to be good. Pointing towards a robust summer, when pricing tends to firm up. We signed a number of large commercial accounts recently, which are already starting to drive incremental volume.

Our international segments had a strong first quarter, giving us optimism that the economy there continues to rebound. We will continue to push for higher pricing where we can get it and to manage our costs as tightly as we can, while also making the investments in our business that capture the opportunities that lie ahead of us.

With that, I'll turn the call over to David.

David B. Wyshner

President & Chief Financial Officer

Thanks, Larry, and good morning, everyone. Today, I'd like to discuss our first quarter results, our fleet, Zipcar, currency effects, our balance sheet and our outlook. My comments will focus on our adjusted results, which are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

Total revenue increased 2% in the quarter and grew 3% in constant currency to \$1.9 billion, which is a record first quarter for us. However, due to a \$33 million negative impact from currency movements, lower year-over-year pricing and higher per-unit fleet costs, adjusted EBITDA declined to \$44 million in the quarter.

Currency gave rise to a significant year-over-year variance, not because of earnings translation, but rather because our earnings hedges generated mark-to-market gains in the first three months of 2015 and mark-to-market losses in this year's first quarter. Even aside from currency effects, it was a tough quarter for us but we don't think it's indicative of how other quarters this year will play out.

Our trailing 12 months adjusted EBITDA is now \$830 million and for those analysts who compare company margins and valuations based on EBITDA before deferred financing fees and stock-based compensation. Our 12 month adjusted EBITDA would be \$886 million.

Revenue in our Americas segment declined 1% in the first quarter. Volume increased 3%, driven by 7% growth in leisure rental days, partially offset by a three point decline in commercial volume. As Larry mentioned, pricing in the Americas was below our expectations, with rate per day declining 4.7% in constant currency. Commercial pricing declined around 3%, while leisure pricing declined 6%.

The acquisition of our licensee in Brazil had a 50 basis point negative impact on our reported pricing, and the mix effect of lower commercial volume negatively impacted our pricing by another 50 basis points. While we knew pricing would be challenging in the quarter, we did not expect the severity of the weakness. The strength of the U.S. dollar negatively impacted international in-bound travel in the geographies like Florida and Arizona that are typically quite important to our first quarter results.

We believe that currency exchange rates simply made it cost-prohibitive for many Canadians and Latin Americans to travel to the United States and our operations team worked all quarter to get our fleet in Florida and Arizona right-sized to demand.

Having a significant number of program cars certainly helped us manage our fleet size. To be clear though, while Florida and Arizona exacerbated the challenges we faced, pricing was tough throughout North America. In this environment, we pushed for higher pricing where and when we could.

Our international segment had a strong start to the year. Revenue increased 9% in the first quarter on a reported basis and was up 14% in constant currency. Growth was driven by a 21% increase in volume, with the acquisition of Maggiore contributing nine points of that growth. Pricing was soft in the quarter, declining 3% in constant currency, excluding Maggiore. International adjusted EBITDA decreased \$15 million on a reported basis, but grew \$14 million in constant currency, reflecting the strong volume growth, lower per-unit fleet costs and synergies from our acquisitions.

Turning to our fleet, per-unit fleet costs in the Americas increased 6% in the first quarter to \$312 per month, we achieved 3% growth in rental days with less than 1% fleet growth. We saw elevated inventories at many used car auction sites in the first quarter. Nonetheless, through the end of April we have been able to complete nearly half of our planned U.S. risk car dispositions for the year, at values near what we had planned for, including selling about a third of our U.S. risk vehicles through alternative channels.

We've also seen some increased pressure on risk vehicle residual values this year, which is reflected in our full-year fleet cost guidance. In particular, we now expect that fleet residual values in the marketplace will be about two points lower as a percentage of cap costs than they were a year earlier, which is about a point below our prior expectations. We have actively re-optimized our fleet plans to help mitigate residual value pressures.

In addition, we expected industry-wide fleet cost pressures will be an impetus for pricing to strengthen over the course of the year. With us having turned back more program vehicles early in the year to keep our fleet in line with demand, we now expect risk vehicles to represent roughly 65% of our Americas fleet this year compared to 55% last year and an initial expectation of 60% for 2016.

Our Zipcar brand continues to play a major role in the broad mobility market. In the first quarter, we took significant strides to expand Zipcar's service offering. We successfully completed our test of instant drive which

enables a new customer to sign up, become a Zipster and initiate his or her first transaction in minutes instead of days all via smartphone. We plan to rollout instant drive nationwide starting later this quarter.

As part of the incremental \$50 million investment we are making in our business this year, we launched Zipcar's one-way offering in Los Angeles in March and expect to expand one-way into additional markets over the remainder of the year. The future of Zipcar's mobility solution is not just round-trip, it's enabling members to transact in whatever form suits their needs. It's truly wheels when you want them and how you want them.

And finally, we continue to get closer to the one million member milestone with solid membership growth in the Americas and double-digit growth internationally. Zipcar is the clear leader in the global car sharing industry. It continues to be in the forefront of technological innovation and the urban mobility landscape and we are enthusiastic about the growth opportunities Zipcar has as consumer preferences, vehicle technologies and our service offerings all evolve.

One of our principal objectives over the last year-and-a-half has been to drive incremental efficiency by consolidating, standardizing and strengthening our non-field operations, everything from reservations and customer care to legal and human resources.

Our transformation initiative has been delivering significant progress and the benefits are both lower cost and higher quality. We are re-engineering many of our human resources processes to move from practices that often varied by country, didn't provide scale benefits and required dispersed infrastructure, to a consistent approach that will leverage a common system and global service providers.

We've brought increased procurement discipline to our third-party legal spending, allowing us to reduce the rates we pay without sacrificing quality, including by in-sourcing certain activities where we have enough volume to make it cost effective to do so.

We have restructured the claims processing area that deals with the more than 100,000 accidents and incidents that our customers have each year in the United States in order to take advantage of third-party systems and expertise in that area. And we have re-optimized how we handle reservation and customer care calls to increase conversion rates, strengthen our customer service, leverage self-help technology and reduce costs.

Despite its name, Transformation 2015 is an extended initiative that is providing incremental benefits each year as we execute on existing plans and tackle additional areas. Also to be clear, our T15 efforts are in addition to our performance excellence team's ongoing and valuable work on process improvement throughout the organization.

Moving to our balance sheet, our liquidity position remains strong with nearly \$5 billion of available liquidity worldwide. We ended the quarter with \$876 million of cash, no borrowings under our corporate revolver, and more than \$900 million of availability under that facility.

We had unused capacity of more than \$3 billion under various vehicle-backed funding programs. A ratio of net corporate debt-to-EBITDA was 3.57 times. And later this month, when we use \$300 million of cash on our balance sheet to pay off corporate debt that we have called for redemption, we will have only \$250 million of corporate debt maturities through year-end 2018.

Our access to capital to fund our business needs is solid. In the first quarter, we issued \$450 million of five-year vehicle-backed term notes with an average interest rate of 3.25% and advance rates above 80%. Proceeds will be used to repay maturing ABS debt. We also issued \$350 million of eight-year corporate bonds in order to fund the corporate debt redemption I mentioned.

We continued to repurchase our stock in the first quarter, buying back 3 million shares or 3% of our shares outstanding at a cost of \$80 million. Looking forward, while we continue to look for creative tuck-in acquisitions, we expect to use our free cash flow primarily for share repurchases.

As you can imagine, with our stock trading at more than a 20% free cash flow yield, share repurchases remain particularly attractive right now. We continue to expect that we will buy back \$300 million to \$400 million of stock this year. And our first quarter repurchases therefore represent about one quarter of our anticipated buybacks this year.

As we think about our full-year 2016 expectations, we've tweaked a few of our estimates to reflect our first quarter experience and changes in currency exchange rates. But, our adjusted EBITDA and earnings per share projections remain unchanged.

As we announced last night, we now expect our revenues to increase 3% to 5% this year compared with 2015. And our revised revenue range reflects both our revised pricing expectation and currency movements.

In the Americas, we expect our rental base to increase 2% to 4% this year, with that growth skewed more toward leisure travelers. We've adjusted our full-year pricing to account for the year-to-date softness. We now expect Americas pricing to decline approximately 1% in constant currency this year and we expect pricing trends to improve as the year progresses.

In our international segment, we expect revenue to increase 7% to 10% in constant currency. Total company fleet costs this year are expected to be \$280 to \$290 per-unit per month, reflecting low to mid single-digit constant currency cost increases in both of our operating segments.

We continue to expect our adjusted EBITDA in 2016 will be \$820 million to \$900 million. We expect adjusted EPS to be \$2.70 to \$3.30 per share, which includes the benefit of our continued share repurchase activity. We still expect our cash taxes to be \$40 million to \$60 million and that our non-fleet capital expenditures will be roughly \$210 million this year.

As a result, we continue to expect our free cash flow to be \$450 million to \$500 million in 2016, absent any significant timing differences, our fifth straight year with free cash flow of more than \$450 million. This works out to roughly \$5 per share, giving our stock a free cash flow yield of more than 20%.

We now estimate that currency will have a roughly \$20 million negative effect on adjusted EBITDA this year. With currency having had a \$33 million negative impact on our first quarter results, the forward curve now implies that currency will have a modest positive impact on our results for the remainder of the year. We have again provided a slide that lays out our estimate of the effects that currency movements will have for the year, by quarter based on recent rates.

In closing, while the first quarter was challenging, we do not expect the unusually soft pricing we experienced in Q1 to continue. In fact, while pricing is not yet back to flat, it has improved dramatically. Our goal is to have better pricing comparisons in the remaining quarters of the year to manage our costs assiduously and to invest for the future carefully in order to achieve the targets we laid out in February.

The summer travel season both in North America and in Europe will be key to our success. We continue to be aggressive in areas that we can control, opportunistic in areas that we can influence, attuned to real and potential risks and focused on enhancing shareholder value.

With that, Larry and I would be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Chris Woronka with Deutsche Bank. You may ask your question.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys. Wanted to drill down a little bit more on pricing obviously. I know you've talked in the past about how putting in some pricing increases, there's I guess so-called the decay curve as time approaches. Has there been a change in that through the, I guess, March and the second quarter so far? Are you seeing actually different dynamics as far as that's concerned?

Larry D. De Shon

Chief Executive Officer & Director

A

Yeah. So, in the first quarter, there were a number of rate increases that were put in the industry, which is a positive thing. But, I think with the pressure of the fleet position that the industry had, it makes holding onto those rates as it gets into the booking curve very, very difficult.

And I think the rate the rate increases started from also was at kind of a lower point. So, even where some of them may be held closer end it started from a lower point. So, I think the good news is that rate increases were attempted.

In many of them, there were some good matching as they went out, but then as you go t closer into the booking curve with the fleet position they started to erode and particularly started to erode from the kind of third tier parties and then kind of on up.

So, we haven't seen that number of attempts of rate increases so far as we look into the second quarter yet. But as fleets tighten up, I would expect that as rate increases go in that there's an opportunity for that to hold closer into the booking curve as fleets are tighter as we go through the second quarter and into the summer.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Okay. Great. And then I guess more from an industry perspective or anything you'd care to share about your own fleet? But, are you seeing more, I guess, harmonized action with all the players in terms of fleet? Because it seems like it's been a little bit erratic throughout last year. Do you think everyone's kind of on the same page now?

David B. Wyshner

President & Chief Financial Officer

A

Hi, Chris. I'm not going to touch that language, but I think the thing to look at is the utilization that we experienced in the first quarter growing our volumes about 3% on a fleet that was up just over 0.5%. We're running our fleet relatively tight and as we've moved through the first four months of the year, we've actually tightened up the extent to which we're planning on running the fleet over the course of the year.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Great. And just finally for me, you mentioned you sold over or about half of the planned risk dispositions through April. How does that compare against last year? Are you kind of selling more in the first half this year than you did last year?

Larry D. De Shon

Chief Executive Officer & Director

A

It's actually fairly similar to last year. Last year was the first time we really accelerated into the early part of the year as much of our fleet – risk fleet dispositions as we did. We've continued that this year. And we were able to do that even in a somewhat softer residual value environment, with no significant gain or loss on our vehicle dispositions. So, we feel good about how we manage that. And then we obviously had the advantage of having some program cars in our fleet that we could use to de-fleet in areas like Florida and Arizona where we had to adjust our fleet plans based on the volumes we saw.

Operator: Thank you. Our next question comes from John Healy with Northcoast Research. You may ask your question.

John Healy

Northcoast Research Partners LLC

Q

Thank you, Larry, I wanted to ask a little bit about pricing to start. In the February call, clearly you'd indicated the year started off difficult and the expectation was for flat pricing for the year. Now we know that through March things were a bit more difficult and the pricing expectation is for down one point.

If you look at that period of April through December, have your expectations for pricing in that timeframe changed relative to what they were in the February call? And then additionally I wanted to ask, you mentioned the month-on-month improvements, but I just wanted to confirm, has pricing gone positive? Or at least gotten better than flat at this point in the year in terms of a month-over – year-over-year on a monthly basis?

Larry D. De Shon

Chief Executive Officer & Director

A

Yes. So the way I would characterize it is, you start with February ended worse than what we had thought. And then as we went into March, although March improved over February, March was still not what we had planned for it to be. Then as you go from March into April, April improved again over March. And then as we're looking at May bookings, May is also improving over April. So, we haven't turned positive as of yet, but we're getting very close to it at this point. And we're very optimistic about what we're seeing for June and summer bookings are looking strong and rate is looking significantly better.

So, I think it was just the kind of the curve of the pricing trends just delayed a bit and started to improve later than what we had hoped. So fell a little bit harder than we thought at the beginning and then delayed a little bit more than what we had hoped when we went out of the declines in February. But the good news is, every month is getting stronger and we're seeing that in the advance bookings going into summer.

John Healy

Northcoast Research Partners LLC

Q

Okay. And then relative to just kind of your expectations compared to earlier in the February timeframe. Is that April through December expectation much different than it was back in February?

Larry D. De Shon

Chief Executive Officer & Director

A

What I would just say is that the – we're calling the pricing overall down a point for the year, so that incorporates the first quarter results, and then just a slower, a more gradual ramp up to better pricing as we go through the remainder of the year. So, we're going to have some down months, and then we'll have some positive months later in the year to kind of net out the last nine months as flat, which then brings the year down about a point.

David B. Wyshner

President & Chief Financial Officer

A

That's right. I think everything is a little bit, just a little bit softer than we had anticipated in January and February. And I think it's important to remember that what we saw in January and February was so weak and so anomalous compared to what we typically experienced. It really was a difficult time to be projecting out for the remainder of the year. So, we have tweaked those estimates as well.

Operator: Thank you. Our next question comes from Chris Agnew with MKM Partners. You may ask your question.

Christopher Agnew

MKM Partners LLC

Q

Thanks very much. Good morning. I was wondering if you could first reconcile your comments on strong leisure travel, but weak summer break. And if I remember, sometimes spring breaks are a good harbinger for summer demand. And then slightly related, on international in-bound it was weak in the first quarter that you talked about. Are you assuming a continuation of those trends into the summer? And what are the risks that international in-bound continues to negatively surprise? Thank you.

Larry D. De Shon

Chief Executive Officer & Director

A

Yeah. I think the way to think about it is, as you go through the year the impact that in-bound into North American from particularly Canada and South America, starts to have less impact as a percent of the total volume. It's a big percent of our volume in the winter months, in the first quarter. But as that continues on, our reliance on that volume declines over time.

So, yeah, I think as people are looking to go in-bound into the U.S. from those markets, it's going to be a challenge with the currency impacts that have happened. But we don't depend on it as much as we go through the rest of the year.

Christopher Agnew

MKM Partners LLC

Q

And any thoughts on like you've got strong leisure travel, but why was spring break so weak if it's predominantly were relied on more leisure travel?

David B. Wyshner

President & Chief Financial Officer

A

That's where the international in-bound seem to have a – much more in effect this year than last year, and that's why we call it out. And as Larry said, the markets like Florida and Arizona in February and March probably drive is much international in-bound business as a percentage of their overall business as any areas that we have at any point during the year. So, the in-bound issue becomes smaller just as a percentage of our business as we move into other parts of the year.

Operator: Thank you. Your next question comes from Adam Jonas with Morgan Stanley. You may ask your question.

Adam Michael Jonas

Morgan Stanley & Co. LLC

Q

Thanks. Hi, Larry. So, there's been a few announcements by some OEMs who are ostensibly entering the car rental and car sharing business in some form, examples like GM's Maven and some of the car sharing efforts within Ford Smart Mobility LLC, a separate legal entity, and some others. How does senior management at Avis Budget view these moves? Is this a sign of validation for your core rental business? Or is it new competition that you need to consider maybe not very near-term but over time? Or is it both? Thanks.

Larry D. De Shon

Chief Executive Officer & Director

A

There's a lot of people that are getting into the mobility space and car share space. And I'm not surprised by the OEMs that are looking at it as well. And I think the answer to your question is really both.

I think that as you take a look at the logistics that are involved in managing car share and car rental are extremely complicated, and we have 15 years of experience on the Zipcar side of managing car share, and we have 70 years of experience on the rental car side of managing this. I mean there's a whole infrastructure and talent skill set that's required; people, systems, equipment. And it's quite complicated.

And so, there have been a number of people that have gotten into car share globally, and many have left. There are some that are in car share globally and aren't making any money. We continue to grow Zipcar. We're going to cross the million member, paying member mark this year.

We continue to grow locations. We continue to grow use case offerings. So, we're pretty pleased with how we have been able to grow the business and we're growing it internationally. And I just think that the logistics that are involved are – it's in our wheelhouse. It's what we do. And we've got a lot of experience doing it. So, I'm not worried about it. I think it's something we watch, but we're pretty confident about how we can manage that business.

Adam Michael Jonas

Morgan Stanley & Co. LLC

Q

Thanks, Larry. Can I ask a follow-up on your IT budget? I don't know if you've ever disclosed the size of your annual IT spend. Is that something you could give an order of magnitude or disclosed?

Larry D. De Shon

Chief Executive Officer & Director

A

Yeah, from an expense perspective, it's in the \$100 million range, Adam.

Adam Michael Jonas

Morgan Stanley & Co. LLC

\$100 million range?

Q

Larry D. De Shon

Chief Executive Officer & Director

Yes.

A

Adam Michael Jonas

Morgan Stanley & Co. LLC

Okay. Thank you very much.

Q

Operator: Thank you. Our next question comes from Brian Johnson with Barclays. You may ask your question.

Dan M. Levy

Barclays Capital, Inc.

Hi. Good morning. This is Dan Levy on for Brian. Thanks for taking the question. Just a couple of questions on fleet cost guidance and just overall on industry fleet levels. First, just wondering on the fleet cost guidance, I know, in the prior call, you assumed residuals as a percent of cap costs would decline by around a point. I assume that that's down. Could you just disclose what the magnitude of that is? And if residual as a percent of cap cost is down, what is it that's allowing you to maintain your fleet cost guidance? Is it better cap costs? Is it a longer holding period? Are you seeing better benefits on your disposals through alternative channels?

Q

Larry D. De Shon

Chief Executive Officer & Director

Sure, Dan. Our expectation is now that fleet residual values will be down around two points as a percentage of cap cost and we had gone into the year expecting it to be down around one point. So, we've seen about a point of softening there in our expectations and we've done a number of things to mitigate that. It actually starts with the fact that in markets where we were a little bit heavily fleet relative to demand in the first quarter. We used program cars fairly aggressively to de-fleet to the right levels. Program cars on average tend to be a little bit more expensive than risk vehicles and so that's one of the things that is helping us.

A

And then we're working through our fleet optimization opportunities as we see different cars having different values as the year plays out, larger cars and SUVs doing better than smaller ones and we've re-optimized both risk and program cars, hold periods and our mix of vehicles really down to the make and model level to help mitigate the impact of residual values. So far, this year, being a bit softer than we had expected and the possibility that that will continue to some extent going forward.

Dan M. Levy

Barclays Capital, Inc.

Okay. And is it safe to say that if we see the rental risk auction data under-performing to the magnitude that it did, in the past couple months it was down 6%, I believe. Is it safe to say that there would be incremental risk to that fleet cost guidance?

Q

Larry D. De Shon

Chief Executive Officer & Director

A

Clearly, if the market softens relative to where it is now there would be incremental – there could be risk there. On the flipside, if the market strengthens a bit that would be helpful to us. I think it's important to know one of the things I mentioned, and that is that auction sites really had a lot of cars at the start of the year. They were backed up a bit. And I think we've worked through a significant amount of that backlog. It was both program cars and risk cars from a variety of sources. January and the first half of February is not a great time to work that backlog down.

And I think what we saw in February and March and even to an extent in April was that backlog being worked down, which had an impact on residual values. And that phenomenon shouldn't exist to quite the same level that it did at the start of the year.

Operator: Thank you. Our next question comes from Hamzah Mazari with Sterne Agee. You may ask your question.

Hamzah Mazari

Sterne Agee CRT

Q

Hey. Good morning. Just a question on European margins; I know you guys don't disclose that. But any color as to how those are trending? And maybe an update on some of the initiatives you may have in place to improve the concentration of the European network? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

Yes. As you know, we've been working for a number of years to – on a strategy to improve our European margins. We've put in a number of initiatives to drive efficiencies across the operations as well as into our back office administrative work as well.

And this has all been with an eye that when the economy starts to recover in Europe that we would be repositioned in a better place to be able to improve our margins over time. So, those strategies are continuing. We've been updating our IT systems, which has caused a lot of headaches by having a lot of outdated overlapping systems that varied by country. We've been consolidating all those, putting everyone on the standard systems, reducing our IT expense.

We moved all of our back office work into Budapest and eliminated those functions in the countries. We consolidated the countries down into regions. So, we've improved our performance. Our operational performance as it relates to Net Promoter Score as well as our utilization. We've been growing ancillary revenue and expanding our Budget brand.

So, there's a number of initiatives that are going. And I think what you'll start to see as the economy recovers there and volume starts to rebound, that's what will have a bigger impact on our profit margins as we go forward. So, I think all the hard work that's been going on there for the last four years is starting to come together and new initiatives being put in place to continue to drive that over time.

Hamzah Mazari

Sterne Agee CRT

Q

Thank you. Just a quick follow-up. Just wanted to confirm the cadence of pricing. You made a lot of comments around pricing. Is it fair to say that Q2 is going to be down still low single-digits, Q3 flattish, and then Q4 up low

single-digits? Is that the right way to think about pricing in your guidance? Or is there some flexibility around how that moves around? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

I would say yes to both. It's not a crazy way to think about things at all, and could very well be the way it plays out. We really don't want to get into quarter-by-quarter guidance, and that's why we really spoke about the first quarter and then the subsequent nine months in aggregate.

The path you're laying out could very well be the way things play out, but I think it's also quite possible, there'll be a little bit of delays around that as we see some seasonal effects. The other thing that's worth noting is that I do think we have an easier comp in the fourth quarter than any other point this year.

Operator: Thank you. Our next question comes from Anj Singh with Credit Suisse. You may ask your question.

Zachary Bakal

Credit Suisse Securities (USA) LLC (Broker)

Q

Good morning. This is actually Zack in for Anj. So, given the number of headwinds you've talked about in terms of pricing, whether it's Brazil or FX or international in-bound being down. It seems like your expectations for the next nine months is not flattish core pricing, but core pricing actually being positive. Can you give us some sense of how that has trended and whether or not you're seeing improved strength there? And what your expectations for that are over the next nine months?

David B. Wyshner

President & Chief Financial Officer

A

Yeah. You know the acquisition of Brazil I think closed in April of last year, so the Brazil impact that we had in the first quarter really shouldn't be a continuing impact now that we've anniversaried that transaction. And I would – while the commercial leisure mix as I pointed out, had a 50 basis point impact, I consider that mix to be part of what's going on in our core.

So, I would actually be inclined to view the comments that we made about pricing going forward as being applicable to the core, if you will. And not distinguish between the core and something else as we look out over the remaining nine months.

Zachary Bakal

Credit Suisse Securities (USA) LLC (Broker)

Q

Got it. Thanks for clarifying. And then you talked a little bit more about the free cash flow yield. I think one of the things you've sort of mentioned there is that time can have a significant issue there. But in addition, you've sort of given out sensitivities to EBITDA, for example in relation to some of your operating drivers. Given that some investors do have some concerns about how wide that range is and whether or not that's sort of a safe range, could you speak to whether or not the sensitivities to EBITDA should be roughly similar to the sensitivities that you'll see to movements in relation to your free cash flow?

David B. Wyshner

President & Chief Financial Officer

A

Yes. I think EBITDA and free cash flow will generally tend to move in line with one another. So, there's always some differences between them; but generally speaking, if our EBITDA were toward the higher end of our range, I'd expect free cash flow to be toward the higher end of the range. And similarly at the lower end of both ranges.

Operator: Thank you. Our next question comes from Kevin Milota with JPMorgan. You may ask your question.

Kevin M. Milota

JPMorgan Securities LLC

Q

Hey. Good morning, guys. I was hoping you could give us some color on how much of your May business is booked at this point, and how much of the June to September businesses booked as of now? And then follow on to that would be how confident are you in that business follow-through, given that first quarter surprised to the downside?

And then secondly on the holding periods for fleet, could you give us a sense for what or how much you're extending your holding periods on the risk fleet? And why not just take a mark on those assets now and move on? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

You know we're obviously in the month of May, so bookings are, as far as our percentage of our total volume for the month of May bookings are strong. I don't know the exact percent that we've taken for the month, but we're in the booking curve now.

And the pricing that we're seeing, we're encouraged by, significantly encouraged by for the month of May. When you take a look at over summer, at this point probably 15%, I'm going to estimate, of our bookings are probably taken at this point. And once again, the indications from those bookings are that both volume is coming in strong as well as rate continues to improve. So, there's nothing in what we're seeing at this point for May or for summer, although summer is still pretty early, that gives us any cause for concern.

Larry D. De Shon

Chief Executive Officer & Director

A

And then on the fleet side, I think we'll probably end up extending lives of vehicles slightly, which I put more in the matter of in weeks. It could be anywhere from two weeks to eight weeks as we work through our optimization. But not significant or drastic changes in how long we're holding cars.

We still like to sell the significant majority of vehicles that we sell on a risk basis in the 30,000 mile to 40,000 mile range and that really hasn't changed. I just want to emphasize that in the first quarter, as we sold a lot of vehicles, we did not have any significant gains or losses on disposition. And so, we feel good about the rates at which we've been depreciating vehicles. I think we would have liked to have some gains in the first quarter, but where we ended up was really right in line with where we've been depreciating to.

Kevin M. Milota

JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: Thank you. And final question comes from Afua Ahwoi with Goldman Sachs. You may ask your question.

Afua Ahwoi

Goldman Sachs & Co.

Q

Thank you. Just two quick questions from me. First, the \$50 million incremental investment you talked to in the – on the fourth quarter call. How much of that was in Q1, if at all? And how should we think about the spread over the next few quarters? And then on the other side of that, are there any savings we can expect to offset some of that spend?

And then the second question I have, and it's something I continue to struggle with is on your comments on the industry being right-sized or fleet being right-sized. How should we think about that? Because I think I believe on the fourth quarter, we were expecting the industry to be right-sized going into Q1 and obviously, given the soft spring break that through us off a little bit. So, as we think about the balance of the year, is the plan to grow your fleet less than demand? In line with demand? How is the best way to think about when you say the industry is right-sized, what exactly that means? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

Sure. Afua, it's David. I'll tackle the first part and Larry will tackle the second. With respect to the \$50 million investment, I would say that some – a small portion of it occurred in the first quarter, but probably less than 25%.

Some of the areas that we're investing in such as our investment in incremental marketing will be more concentrated in the second quarter both in the U.S. where we have new commercials running for Budget. And particularly, in Europe, where we're going to be doing a fair amount of brand advertising in the second quarter, which is a key part of the booking curve for the summer peak and we want to make sure we take advantage of marketing during that period for that time.

Some of the other initiatives are ramping up over time. And so, I think the impact that they'll have will actually grow a little bit as the year moves on. And I think the right way to think about the \$50 million incremental investment is really as the net number. So, some of the areas that we're investing in, such as our shuttling pilot and manpower planning, we are getting benefits from. But I would think of the \$50 million as being the net number, spending a little bit more than \$50 million gross generating some benefits this year so that the impact is – the net impact is in the \$50 million range.

Larry D. De Shon

Chief Executive Officer & Director

A

As far as the fleet question is concerned. As you know in the first quarter, the industry was extremely over fleeted. We managed very hard to get our fleet down and to keep our fleet below volume, so that we can continue to improve our utilization. And that will be our plan as we go through the rest of the year as the fleet underneath with the expected volume that we're planning to get.

And as you look to the first quarter and you saw what's happening with de-fleeting and the number of cars that were being sold at auctions, the number of cars that were at the auctions, and working through that inventory. And now, then you see a series of storms that happened in Texas and other surrounding countries have soaked up a lot of fleet as we've sent cars down to support insurance replacement needs down there, and then backfill those Airports and so forth. We have moved a lot of cars, as the industry has moved a lot of cars into that territory.

And what you start to see, and we see at our locations is you see where we go on length of rental restrictions or our competitors start to go on length of rental restrictions, or we start to see suspend actions put in place. And that gives us a sign of how the industry is actually fleeting in those markets.

So, we're kind of heading to the normal period of time that we would see, where people are getting their fleets down, getting ready for summer. And as far as we're concerned, we'll be trying to fleet basically underneath the demand for the summer and keep our utilization improving.

Larry D. De Shon

Chief Executive Officer & Director

Okay. Before we close, I think it would be a mistake to judge our full-year and long-term potential based on what we believe was a first quarter anomaly. Pricing has already started to turn the corner with fairly substantial improvements seen over the last few months.

We continue to see significant opportunity to reshape our business by leveraging technology, and I hope we've given you a flavor of the progress we've already made. And our full-year adjusted EBITDA and free cash flow guidance remains unchanged.

We have a full Investor calendar this quarter and we look forward to seeing many of you during our travels. With that, I want to thank you for your time and your interest in our company.

Operator: This concludes today's conference call. You may disconnect at this time.

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