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EDITED TRANSCRIPT

CAR - Q1 2017 Avis Budget Group Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 revenues of \$1.8b and adjusted loss per share of \$0.94. Expects 2017 revenue to grow 2-3% and adjusted EPS to be \$2.85-3.50.



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PRESENTATION

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 - *Avis Budget Group, Inc. - VP of IR*

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 be accessed on our website as well. Our comments will focus on our 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.



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Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

Thank you, Neal, and good morning. We expected the first quarter would be challenging with many of the issues that affected us toward the end of 2016 persisting into the first quarter of this year, but we didn't expect it to be as difficult as it turned out. Volume did increase both in the Americas and internationally, but industry fleet levels remained elevated relative to the available demand, which put pressure on pricing. And with Easter falling in April this year compared to March in 2016, the pressure was even more pronounced.

At the same time, used car values in the Americas were weaker than expected, causing our per-unit fleet costs to increase considerably. As reported by the National Automobile Dealers Association, the typical seasonal upswing in used car values did not occur in February this year as is usually the case but was delayed into March, further impacting our results for the quarter.

The good news is that many of these factors appear transitory. Volume trends improved in March and demand and pricing for Easter were both solid, creating a record April for global revenue and rental days. We're seeing indications that industry fleets have begun to firm up and used car values have stabilized above their February lows.

So looking forward, we feel optimistic that the industry dislocation we've seen over the past few months could largely be behind us by the time we get to the summer.

Meanwhile, in the face of higher fleet costs, we took a number of actions to reduce expenses in our field operations, shared services and general and administrative functions around the world.

We expect these restructuring actions including a voluntary termination program to produce more than \$50 million of cost savings this year without impacting our ability to deliver the high-quality service our customers expect from our brands. Looking beyond the first quarter, I think it's important to reiterate our goal of achieving 300 to 500 basis points of improvement in our adjusted EBITDA margins by 2021 and to touch on some of the initiatives that will take us there.

Let me start with profitable revenue growth. As we've discussed previously, 2 of our key initiatives to drive profitable revenue are the continued development of our demand-fleet-pricing yield management system and our enhanced websites and mobile apps. In the Americas, we are already delivering benefits from the pricing robotic component of our Demand-Fleet-Pricing system. Over the last few weeks, we have begun to pilot the use of all 3 phases of our fully integrated fleet and pricing optimization modules in the United States. We're still learning how best to use this system to drive day-to-day decision-making, but the teams have gotten their hands on it and are incredibly enthusiastic about its potential.

As a reminder, we expect that this system will be able to analyze billions of pieces of data and inform our pricing and fleet decisions by market, by day, by fleet class, based on the available demand. In addition, the rollout of the pricing robotic is scheduled for mid-year in Europe, where we expect the additional pricing capability to position us well in the competitive market place.

We launched our new avis.com platform late last year including the ability to offer our Pay Now feature for customers on mobile devices. The results of the new platform have exceeded our expectations, driving more than 10% increase in prepaid reservations in the quarter compared to first quarter 2016 and 100-basis-point year-over-year improvement in conversion. And we recently launched our new budget website in the Americas. These new websites provide a more intuitive user experience, and we expect them to drive more customers to book directly with us.

Operational efficiency initiatives have the potential to have a significant impact on our cost structure. Our manpower planning initiative generated an 8% increase in productivity improvement in the first quarter while still being reliant on spreadsheets and manual processes. In the next few months, we will have a sophisticated new scheduling tool deployed at our 25 largest locations in the United States, with all locations expected to be up and running by the end of 2017. This technology will help our airport managers further align their workforce with customer demand patterns enabling them to more effectively calibrate our manpower needs with the peaks of our business. When you consider that we spend more than \$0.75 billion a year on field manpower globally, you can see why we're so excited about our ability to apply sophisticated technology to drive substantial savings from this initiative.



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Our shuttling initiative has also continued to produce impressive results. Shuttling cost per transaction decreased 8% in the first quarter, and we believe we've hardly scratched the surface of this potential. Implementing a dedicated fleet strategy in 400 local market locations and putting in heuristics to determine when a car should be moved has reduced shuttling cost without sacrificing profitable revenue. We expect our manpower planning and shuttling initiatives will together generate \$50 million of year-over-year savings in 2017.

Pressures on residual values have only highlighted the importance of selling more of our used cars through alternative disposition channels and to operationalize more of the data than we've ever had at our disposal to inform us what cars to sell where and when. As David will discuss in a minute, we sold 45% of our risk vehicles this quarter in the Americas through alternative channels, saving us millions of dollars, and we still have a lot of opportunity ahead of us.

And our capabilities as a technology-enabled mobility services provider have continued to grow, it's been less than a year since we launched Avis Now, and we've seen more than 450,000 customers enrolled and have completed more than 430,000 transactions, cementing our position as the industry leader in self-service rentals.

In addition to the customer benefits, we believe our significant operational benefits to be realized with a fleet of connected cars. We are preparing to pilot our first connected city later this year with the fleet comprised entirely of connected cars. This will allow for a better understanding of the efficiencies of a fully connected fleet and will help identify specific areas where investments may be worthwhile.

Some examples of the potential advantages include automated maintenance notification, real-time inventory counts and mileage management. Having this data at our fingertips will facilitate the enhancement and optimization of our fleet management capabilities and provide scalable benefits based on the number of connected cars moving forward. Not only will this test help to reinvent our operational model, but it will also provide an excellent forum for customer feedback about how to modify and personalize our self-service product to satisfy our customers.

We have continued to make progress in our efforts to drive profitable revenue growth and deliver efficiencies throughout our operations. The significant strides we've made in technological advancement will better position us to meet consumers mobility needs and allows to meaningfully expand our margins over time. And while we remain enthusiastic about the longer-term opportunities we're working toward, we're also being aggressive about making tough decisions to drive near-term performance.

In summary, the first quarter saw 2 key challenges that we had to navigate. Pricing and the used car market were unusually weak to an extent that we did not expect and to a level that fortunately we do not expect will continue over the balance of the year. Industry fleet levels were tight in key leisure markets around Easter, suggesting that the over-fleeting issues are slowly getting resolved. We're seeing more cities with fleet tightness than earlier in the year but it's still not at levels we saw at this time last year, which is why we think it could take a few more months before industry fleet levels are more aligned with demand. For this reason, we expect pricing to be down in the second quarter but we also expect to see opportunities to yield up in the key summer months.

Leisure demand remained solid and airline capacity is increasing which bodes well for demand for car rental services, and we expect volume to strengthen. We have a strong team of dedicated people in place who are focused on what they can control. What they can control adds up to hundreds of millions of dollars of increased profitability over the next 5 years. We're now testing our sophisticated new revenue management system that we believe is the first in the industry that can make both dynamic pricing and fleet recommendations based on the available demand.

We've restructured our sales effort to focus on the most profitable customer segments, increasing -- increase our emphasis on cross-border sales and are more aggressively calling on customers and segments that are disproportionately profitable.

We're using more data than ever to gain insights on residual values refining and utilizing our analytics to drive our fleet actions and increasing our use of alternative disposition channels to dispose of our risk vehicles to manage our fleet cost. We're deploying sophisticated technology to increase our sales productivity and building procurement capabilities to drive efficiencies globally. And we're modernizing the car rental experience we offer to meet evolving customer needs and have a team of people solely focused on building and harnessing the power of connected cars. It's this and more that makes me enthusiastic about our future.



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

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

Thanks, Larry, and good morning, everyone. Today I'd like to discuss our first quarter results, our fleet, our balance sheet and our outlook for the remainder of 2017. 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.

As we reported last night, our quarterly revenue declined 2% from the prior year to \$1.8 billion, driven by a challenging pricing environment in many parts of the world, soft commercial travel demand and the effect of having 1 fewer day in the first quarter due to last year having been a leap year.

Adjusted EBITDA declined to a loss of \$27 million in the quarter, primarily due to global pricing pressures coupled with higher per-unit fleet costs in the Americas. Our adjusted loss per share during the seasonally slower and lower margin first quarter was \$0.94.

Revenue in our Americas segment declined 4% year-over-year in the first quarter driven by lower pricing. Volume increased 1% with leisure rental days up 1.5 points and commercial volume consistent with last year.

Pricing in the Americas declined 4%. We saw pricing pressure throughout the quarter which we believe reflected industry fleet levels that continue to be high relative to demand. Both leisure and commercial pricing saw similar declines. We kept our fleet in line with our volume as our fleet utilization was virtually unchanged year-over-year.

Adjusted EBITDA in the Americas declined to a loss of \$20 million in the first quarter, primarily as a result of soft pricing in higher per-unit fleet cost.

Revenue in our international segment grew 2% in the first quarter or 3% excluding currency effects, despite the Easter holiday moving into the second quarter. Volume grew 7%, offset by a decline in pricing of nearly 4 points in constant currency.

Excluding our acquisition of France Cars, volume in our international segment was unchanged, reflecting temporary pressure from the calendar effects of leap year and Easter. Growth in leisure rentals was particularly robust in Austria, the Czech Republic and Scandinavia, and commercial demand in Germany and the United Kingdom began to pick up. Inbound demand to Europe was strong in the quarter, bolstered by a healthy ski season, and we saw a good demand in Europe surrounding Easter, which has historically been a good indicator for the summer.

International adjusted EBITDA grew to \$7 million including a \$16 million favorable impact from currency. We estimate that the shift in Easter from the first quarter in 2016 to the second quarter this year reduced our adjusted EBITDA in Q1 by more than \$10 million, with a majority of this impact occurring in our international segment.

Per-unit fleet costs in the Americas increased 7% in the first quarter to \$333 per month. While we had projected continued residual value pressure coming into 2017, used car values were weaker than we had expected in the first quarter. As Larry mentioned, the normal seasonal increase in used car values that we typically see following Presidents' Day was delayed in coming. In fact, 2017 was only the second time ever in which February used car prices declined sequentially from January. We believe this decline was driven by a number of factors, including an increased supply of late-model used cars coming from heightened off lease and off rental sales, higher incentives on new vehicles, and federal tax refunds arriving later than usual this year. It was the combination of these factors that had first quarter used vehicle residual values about 3.5 points below where they were a year earlier versus our expectation of a roughly 2-point decline. The good news is that we did see selling prices improve noticeably from the start of March to the end and prices remained relatively firm in April.

In the context of weak residual values in Q1, each week we had to make a decision about whether to keep our fleet in line with demand or to hold cars in hopes that residual values would improve. Sometimes the first loss is the best loss, and we took our medicine, selling cars to keep our fleet levels where we felt they needed to be. In particular, we went into the quarter planning to sell 51,000 cars, and in the quarter, we sold 51,000 cars. We actually set a new record in the quarter for the number of used cars we sold.



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In addition, we benefited from selling more of our used cars through alternative disposition channels. Our sales through alternative channels increased to 45% of our risk car disposals in the quarter compared to 30% in first quarter 2016. We have extended our direct-to-dealer and direct-to-consumer networks, including bringing more dealers onto our proprietary platform, displaying our used car inventory on select third-party sites like TrueCar, opening used car lots in select markets, and beginning to sell used vehicles to ride hailing drivers.

Nonetheless, the 1-month delay in the seasonal uptick in used car values and the muted volume of the uptick when it arrived in mid-March negatively impacted our per-unit per month fleet cost by approximately \$20 in the first quarter or about 6% percent. The impact on our adjusted EBITDA was roughly \$20 million.

Looking forward, we think the elevated levels of risk cars -- of rental risk cars sold at auction and the limited amount of new deliveries to car rental companies in the first quarter compared to a year earlier, should help enable industry fleet levels to normalize relative to available demand. This should help us achieve better pricing than the down 4% we reported in the first quarter.

At the same time, we expect that used vehicle values will remain under pressure by historical standards. We now expect residual values for the late-model used cars will decline 3 to 4 points from 2016 compared to our initial expectation of a 2 to 3-point decline. As a result, we now expect our per-unit fleet costs in the Americas will increase 2% to 5% compared to 2016. At the end of March, we had already completed a third of our planned risk car sales for the year, and at the end of April, we were 45% done.

We continue to believe that the investment we've made in fleet optimization capabilities will help us make the best possible decisions about how, when and where to dispose the vehicles, and will help us limit the effect of weaker residual values this year to a per-unit fleet cost increase of 2% to 5%.

Moving to our balance sheet. Our liquidity position remains strong with \$5 billion of available liquidity worldwide, and our net corporate leverage was 4x, which is at the high end of our targeted net leverage range. For covenant purposes, our leverage was 3.8x, nearly a full turn below our current maximum leverage ratio of 4.75x. We expect our leverage ratios to decrease as the year progresses, and we remain committed to our 3 to 4x net leverage target.

In March, we completed a EUR 250 million offering of 8-year notes with an interest rate of 4.5%, and we amended our senior credit facility to provide a \$188 million increase in outstanding term loans. Proceeds from these borrowings have been used to redeem all of our outstanding euro-denominated senior notes due 2021 and will be used to redeem all of our outstanding floating rate senior notes due 2017.

As a result of these financings occurring in the first quarter but the debt redemptions being in the second quarter, our March 31 corporate debt and cash balances were both temporarily inflated by around \$450 million, with no effect on our net debt. More importantly, the refinancings completed in Q1 mean that we will now have no significant corporate debt maturities until 2022.

We continue to repurchase stock in the first quarter, buying back 1.5 million shares or 2% percent of our shares outstanding at a cost of \$50 million. We continue to look for accretive tuck-in acquisition opportunities to create shareholder value. But with an adjusted free cash flow yield in the high teens, share repurchases are particularly attractive. We continue to expect to repurchase at least \$300 million of our shares this year.

As we think about 2017 as a whole, we do not expect first quarter performance to be indicative of full year results. Our Q1 was significantly impacted by the competitive environment in which we operate. The first quarter is a difficult time for an over-fleeted competitor to get its fleet in line with demand, and the softness we saw in the used car market made that particularly true this year. We were, however, encouraged to see that industry fleet levels tightened up around the Easter mini-peak in April.

So we have updated our estimates in light of year-to-date trends. Our revised projections reflect our expectation that our strategic initiatives will have a significant positive effect on our 2017 earnings, that the cost reduction actions we've taken over the last 2 months will help to offset our first quarter EBITDA decline, and that the overall pricing and operating environment will improve as we head into the summer.



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As we announced last night, we expect our revenues to grow 2% to 3% this year, and we expect our 2017 adjusted EBITDA to be between \$800 million and \$880 million. We expect our revenue growth to come primarily from increased rental volumes, with Americas' pricing now expected to decline 1 to 2 points. We see international revenue growth of 4% to 7%, including a 3% negative impact from currency. This growth is being driven by roughly 5% to 6% organic volume growth plus 5 to 6 points from the tuck-in acquisitions we've done, offset by a 1% organic decline in constant currency pricing and a 2-point decline in pricing due to the tuck-ins.

We expect our full year adjusted EPS to be between \$2.85 and \$3.50 per share. This includes the benefit of our continued share repurchase activity and represents EPS growth of 8% at the midpoint. Our forecast includes the benefit of having recently taken more than \$50 million of operating, marketing and administrative costs out of the business.

We expect our cash taxes to be \$55 million to \$75 million and that our non-fleet capital expenditures will be roughly \$210 million this year. As a result, we expect our adjusted free cash flow to be \$450 million to \$500 million, absent any significant timing differences.

That would make 2017 the sixth straight year with adjusted pre-cash flow of more than \$450 million and would give us adjusted free cash flow of more than \$5 per share.

With our projected EBITDA range coming down by \$40 million, we still believe we can deliver \$450 million or more of adjusted free cash flow by offsetting the EBITDA reduction with the combination of corporate interest savings, managing our capital expenditures and working capital carefully, and finding ways to free up a few million dollars of equity tied up in our fleet.

We estimate the currency will have a roughly \$15 million positive effect on adjusted EBITDA this year, with the majority of this benefit realized in the first quarter. We have again provided a slide that lays out our projection of the effects that currency movements will have for the year by quarter based on recent rates.

In closing, the first quarter was softer than we had anticipated, and our updated projections for the full year reflect this.

Looking forward, we do not expect these unusually soft market conditions to persist. We will continue to manage our fleet efficiently and our costs aggressively in order to produce stronger earnings in the remaining quarters of the year. Our strategic initiatives are generating benefits and should generate incremental benefits that will translate into earnings, margin growth and free cash flow, that we will use to enhance shareholder value.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) For our first question, coming from Mr. John Healy from Northcoast Research.

John Michael Healy - *Northcoast Research Partners, LLC - MD and Equity Research Analyst*

David, I want to ask a little bit about the \$50 million cost reduction plan. I was hoping maybe you could give us some color in terms of how kind of how the plan came about, the pace at which that happened, the timing in terms which of those costs will come out, and maybe the facets of the business that those costs are coming from.



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Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

John, it's Larry. I'll take that question. I think as we started to see the residual values and the pricing unfold in the first quarter, we got onto where we could go in the business to reduce costs and drive a little more revenue in different areas. So we started really jumping on this at the very beginning of the year, at the end of January, beginning of February. And it's really across a number of different initiatives. I think, if you look at the organization, we really worked hard with our leadership team here to really think of ways that we could streamline the organization to take some costs out. Also, maybe do away with some of the work that we were doing that wasn't really the value-added that we were looking for and not really focused on the areas that we're really pushing for our strategic initiatives going forward. We implemented a voluntary program -- voluntary termination program, with people that were over 15 years of seniority to elect to -- receive an enhanced severance to leave the company. We were able to choose which ones of those we accepted. So what we really did was look for opportunities where we would streamline the organization to not replace that position or replace that position with a lower cost position in the organization. Or to redistribute that work in another way. We literally combed through hundreds of expense lines to make sure that we really understood what we were spending where and when and make sure that, that was appropriate. And really, just reviewing our suppliers performance and making appropriate adjustments there, our procurement department has been reorganized and is now global and is finding new opportunities moving forward. So it was a whole host of different things that really -- that we've really been working on hard since the first and kind of in the middle of the first quarter.

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

And then John, in terms of how that plays out over the course of the year, I would see us getting a partial quarter benefit this quarter and full benefits in the third and fourth quarters. So ballpark, think of it as \$10 million, \$20 million, \$20 million over the last 3 quarters of the year. And the one thing I'd add is, as we went through this process, the only sacred cow, if there was one, was the customer experience. We're dedicated to saving money in ways that will not negatively affect the customer experience. Beyond that, I would say virtually everything was on the table.

John Michael Healy - *Northcoast Research Partners, LLC - MD and Equity Research Analyst*

Got you. And then Larry, I was hoping you could kind of talk a little bit more about a comment that you made about the industry fleet levels. I feel like there's always a tension on industry fleet levels that maybe not a lot of discussion on what the industry is buying. And I think you mentioned that in 1Q you actually saw the industry reduce its buy for the manufacturers on fleet. Can you talk a little bit more to kind of what you're specifically looking at there? And if you have any color on maybe what you're hearing from the manufacturers of what maybe 2Q or what April looked like?

Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

Yes. I think when you take a look at how the industry's de-fleeted over the first quarter and what's been going on at the auctions, obviously, there's been a lot of cars in the auction. The auctions were up significantly year-over-year with rental fleet that their -- that everyone was trying to push through. And I think as that works through and we take a look at fleet tightness as we're in the second quarter now, although there are markets that are starting to tighten up, it's not at the levels that you would want it to be kind of this time of year. So our expectation is that it's going to take a few more months before the fleet levels really get a line to the demands, so we're really thinking more summer as we go into summer. But you couple that with the fact that all the data points that we have tell us that the industry overall registered fewer cars in the first quarter compared to last year. The data we have for January and February really put the industry down almost 10 points, cars being registered in those 2 months. And then reports we've read since then about March, there's even a larger decline year-over-year. So I think the combination of the 2 things where we see cars been pushed into auctions, they are having record number of rental vehicles going to the auctions in the first quarter going in the second quarter, combined with the fact that registrations are down, should bode well for a good level -- the right level of fleet to demand as we go to the summer.

Operator

Our next question comes from Mr. Chris Woronka from Deutsche Bank.



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Chris Jon Woronka - Deutsche Bank AG, Research Division - Research Analyst

I want to ask you, as first quarter unfolded and residual values continued to weaken relative to your, I guess, initial expectations, does that make you change when you start thinking about next year? Does it make you change anything in terms of risk mix or make and model mix?

Larry D. De Shon - Avis Budget Group, Inc. - CEO, COO and Director

That's really the beauty of having a fleet optimization tool, because you can run several different scenarios with that tool that will really give you the best recommendations as far as what you should have, as far as risk mix -- on the risk mix or buybacks. So even though fleet cost increased, we would run that increased cost through the module as we look at our future demand, and that will tell us whether we have an opportunity to take advantage of more program cars or less program cars, more risk cars, based on how those negotiations start to unfold, which we're in the middle of now. So we don't really know yet. So that's the beauty of having this tool that you keep plugging in the data points that you know that really tells you how to rotate your fleet, what type of fleet to buy, what car classes to buy to meet the demand, and how to rotate them in and out. So it's just a constant iteration, and our team has been doing this for a very long time and the expertise that they built up, helps us really analyze all the data points to really get to the best answer that we can. So, of course, over time, if the output is bad we should change the mix, then that's what we'll do.

Chris Jon Woronka - Deutsche Bank AG, Research Division - Research Analyst

Okay, great. And I'll just -- quickly a follow-up on that prior question. Appreciate the data points about the new registrations and the level of volume received at the auctions. I mean, I guess, when I added that up on the spot realtime, it would suggest the industry would be less fleeted than, I guess, it still is. How long do you think that takes to kind of -- those accumulate effects to kind of take effect going forward?

Larry D. De Shon - Avis Budget Group, Inc. - CEO, COO and Director

It's hard to tell. I mean the data point that we really use is just whether we see as it relates to fleet tightness in the market place by our competitors, and that's really the benchmark that we can work on. And we look at that every single solitary week to understand where we're starting to see fleets tightened up, and are they routinely tightened up. So are we seeing week after week after week. And as I mentioned, at this point in time, although we are seeing markets start to tighten up, are we seeing them tighten up to the degree that we -- that we'd like to see them? And of course, the issue that your -- that we're in now is that we're in May, and May is always a difficult month because it's -- Easter is over, and we're waiting for summer. And there's just not a lot that people will do with fleet that they need to hold in for the summer. So as we're still trying to sell cars, obviously, for cars that we intended to de-fleet at this point. May is just a very tough month, and we just have to kind of get through that, and then get into the summer period where we can start -- to really start to see fleets really kind of equalize up to demand.

Operator

Our next question comes from Chris Agnew from MKM Partners.

Christopher James Wallace Agnew - MKM Partners LLC, Research Division - MD and Senior Analyst

I was hoping to get a little more color on the pricing outlook and how you thought about providing the revised outlook. And I'm trying to square away your optimism for the summer with the outlook. And does that -- for the second quarter, are you now implying that pricing will be or could be down in the similar magnitude for the first quarter?



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David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

I think, with respect to the quarter, what we're saying at this point is that we expect pricing to be down. I don't think we're going to -- we typically have stayed away from particular point estimates for the quarter, and I think we're going to stick with that approach here. But based on what we're seeing now, we do expect it to be down. What we're -- in many ways, what we're looking for as the year plays out is some similarity to last year where the first quarter was particularly difficult and the environment improved and particularly -- and was strongest in the summer months, which are the most important ones for us from an earnings perspective. And as we look at the various data points about fleet and the experience we've seen in the industry over the last year, those all suggest that summer should be a better time in terms of fleet tightness and ability to get pricing and yield up. And as we move into June in the summer, we think that will have the greatest impact. So while we do expect Q2 to be down, in many ways the overall trends that we're looking at are somewhat similar to what we experienced last year.

Christopher James Wallace Agnew - *MKM Partners LLC, Research Division - MD and Senior Analyst*

Then can I confirm -- you're talking about your residuals down 2.5% first year going into first quarter. Can I confirm if that's as a percentage of cap costs? And you talked about an improvement in April which has been sustained. So what was -- can you provide what you saw in April? And then why -- what's baked into your assumption that, that will worsen at some point for the rest of the year?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

When we talk about 3- to 4-point decline or 3.5 in the first quarter, that is as a percentage of cap costs. And that is the way we look at things. In terms of our experience in April, when we look at our results for the cars that we sold, the gain or loss associated with our dispositions in April were -- was very close to what we experienced in March. And that's what drives the -- drives our commentary about relative stability in the used car market in April compared to how things were operating in March.

Operator

Our next question comes from Mr. David Tamberrino from Goldman Sachs.

David J. Tamberrino - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

Just following up on that pricing question. As we progress through the first quarter and you saw de-fleeting, did the negative pricing environment improve, so to speak? Say go from the negative 5, negative 4, negative 3, or was it deteriorating as the first quarter progressed?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

I would describe it as relatively consistent over the course of the quarter. And coupled -- and part of that, certainly is the effect of Easter moving around which made some of the weeks particularly in March not really comparable or easily comparable to the prior year period.

David J. Tamberrino - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

And then following up on that. We did have the Easter shift and we're through April, did you see any positive sequential pricing movement as a result of that Easter demand? Or is it still been just the industry over-fleeting as...



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David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

Certainly, as we moved into the period right around Easter and the mini-peak that was helpful on a year-over-year basis. And then some of the other weeks in the month looked fairly similar to March, which we'd expect since the fleeting situation in the industry wouldn't be all that different in the non-Easter weeks of April than it was in March.

David J. Tamberrino - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

Understood. And then the second question as it relates to as you start thinking about your 2018 fleet purchases and your negotiations with OEMs. I know it's very early, but the OEMs have a growing problem on their captive finco balance sheets with the amount of leasing that they did up and through the first half of 2016. It came to a peak so we should continue to see off-leased vehicles coming back to them over the next 3 years. As a result, we've seen them conscientiously pull back on selling vehicles into the daily rental channel. My question to you is, as used values are expected to continue to decline, do you expect to be able to get price breaks or lower prices from the OEMs on an upfront that helps you manage that spread? Or as a result of what the OEMs are currently employing as a pullback from the daily rental channel, that those prices may stay flat and the used residuals will still continue to be a headwind as we go forward into '18 and '19?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

David, you've done a good job of laying out the range of important dynamics that are going on in the marketplace. And those are informing how we approach the negotiations that are going on right now. And certainly -- I'm sure are informing how the manufacturers are going about those discussions with us. I think we -- it's early. We feel reasonably good about how things are going in those discussions so far. In particular, I think we'll be able to get the cars that we need. But it's really just too early in the process to know exactly how it's going to sort out in terms of cost increases or decreases among the various manufacturers. As you point out, it's pretty fluid situation right now and a lot of important dynamics going on. And in that context, I think we're going to want to wait to see how things play out for a few more months before we provide some more detailed commentary.

David J. Tamberrino - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

That's fair. But is there anything right now that you're seeing in your purchases that would indicate that the OEMs are firming on their prices and kind of holding the line given the amount of again off-lease vehicles and supply that's going to be coming back to the market?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

All I'd say right now is that there's nothing unusual about where we are in negotiations at this point in the year.

Operator

Our next question comes from Mr. Brian Johnson from Barclays.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD and Senior Equity Analyst*

I've got a couple questions on -- just following up on buy-side and the another about the demand forecasting and just airport trends. On the fleet side, are you getting opportunities to do tactical purchases, it's not lost on us that that I think SAR has been weak for a couple of months and you have some aggressive OEMs out there who are more and more optimistic for the year? Is that presenting even as you model negotiations that were fairly firm, some tactical opportunities and if so, is that creating risk that's some of the competitors may wind up with too many cars?



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Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

Like every year, Brian, we take a look at opportunities as they come up through the year. Obviously, you're going to want the cars. If they come to you and offer cars, you're going to want them. If you're going to take them, it means that you really need them into your fleet. So at this point, we're not in the market to really be taking anything additional, but we'll be looking at opportunities as the rest of the year plays out, and they usually present themselves year after year, so we'll just have to wait and see how it plays.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD and Senior Equity Analyst*

Okay. Second question. When you look at the airport reservation, cancellations, just all the number of people passing, deplaning at airports. Are you seeing anything that'll help you better forecast demand and other fluctuations in demand from people, say, landing in an airport and deciding to Uber a lift to their destination instead of renting a car?

Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

I wouldn't say that there's anything out of the extraordinary that we would normally look at as we look at how deplanements are happening. We look at volumes by airport. We look at our share every month by airport and how we do. We continue to try to get our fleet rightsized to what that demand is that we're forecasting by market. We go through those reviews with the locations every single week. So nothing has really changed as we take a look at that. There's no big surprises in no-shows or any of those type of things that are already built into our model.

Brian Arthur Johnson - *Barclays PLC, Research Division - MD and Senior Equity Analyst*

And if you look at the metric of deplanements to rental volumes, maybe for those airports that give you total rentals for your competitors? Any trends there?

Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

No. I think as you look at deplanements and what the mix is of the customers on those deplanements as leisure grows, obviously that gets less opportunity for us than commercial. But once again, we build these into the models. We look at how we perform against the models. We adjust them as we go, and this is really nothing of any significance that's really changing that we need to be concerned about at this point.

Operator

Our next question comes from Mr. Anj Singh from Credit Suisse.

Jeffrey Lee - *Credit Suisse Securites (USA) LLC - Analyst*

This is Jeff Lee for Anj. As we look at your guidance, what sort of impact is being baked in as a result of your strategic initiatives? Is there any lift to EBITDA in 2017 from these efforts that we should be looking in 2018 for a bit more tangibility? And we'd appreciate any more color you can offer on your progress, perhaps what's going better than expected and what may be a bit [upward from an extract needs stand].

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

As we built our 2017 plan and we talked about this a fair amount on the last call, we built in significant benefits from our initiatives, the strategic initiatives that we talked about in detail in November. Some of the big benefits are coming from our manpower and shuttling initiatives. We went into the year expecting about a \$40 million benefit from those. We've continued to push to generate more and we now see it -- we now have about \$50 million improvement from those initiatives alone coming through our numbers this year. We're spending in some areas, particularly with



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respect to connected car and Avis Now self-service capabilities, and those are investments we're making in the P&L this year that offset that a little bit. But we've continued to deliver significant benefits from our strategic initiatives, and in fact, those have grown a bit as we've worked through things so far this year.

Operator

Our next question comes from Mr. James Albertine from Consumer Edge.

James Joseph Albertine - *Consumer Edge Research, LLC - Senior Analyst*

A lot of the questions that have been asked sort of on our list. But one maybe in sort of a different vein, ask a more strategic long-term question as it relates to pricing. And I'm wondering if you were to take maybe a 5-year outlook, how can pricing work higher from here? And if you can help us to delineate, it sounds like a lot of what you've described in the first quarter, cyclical, maybe some issues with respect to inventory competitors or what have you. But I'm wondering if there's something bigger structurally or that's more permanent of a shift that you're working against? Or any data to support that there's a more permanent shift of pressuring pricing as well that we should be aware of?

Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

I think there's a couple of things in there. One of all, I think in the short term, what really needs to happen is for the industry to really get its fleet rightsized to demand. And I think everyone's working to do that based on what we're seeing as far as car sales are concerned and registrations are happening. We haven't really seen a period of time here for a while where that rightsizing of fleet industry-wide to demand has really been there and has been sustained. So I think that's the first challenge, and I think that that is something that will play out and get there. I think, the second thing is that for a while, we've not seen pricing offset fleet cost. And all the car rental companies are buying the same cars from the same OEMs and selling them into the same marketplace and obviously encountering the same fleet cost. And so I think that there would be a strong motivation for everyone to try to recover that fleet cost. And we saw -- we put in a few price increases over the first quarter. And one in particular did pretty well and lasted actually for a couple of weeks. And that was a price increase we put in March for April. Obviously, April being a busier month, fleets will be tighter. There was more matching of that price increase that we put in place in March. So I think that there is a desire by the industry to want to recover fleet cost. And then I think strategically, as you look at the long-term, the work that we've been doing with our demand-fleet-pricing system to be able to allow us to be able to forecast further out and optimize both our demand and our fleet to try to yield to the best pricing opportunity that we possibly can. So if you can get -- if the industry is in an environment where fleets are more aligned with demand and then you've got technology that allows you further out to be able to assess how that demand and fleet will play out, it gives you an opportunity to make decisions earlier on about where you want to set pricing to really optimize for those opportunities where you can yield higher and get higher price for the demand. So I think those things playing all together gives us an opportunity over time to be able to start to see price improve and be able to do more strategic and plan for how we get it in an environment where fleets are more aligned to demand.

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

And James, to your question about some of the analysis and data we've done around this -- this is certainly an important question and one that we've done a fair amount of work on all of which supports the points that Larry just made. And in particular, when we look back over the last 5 and 10 years, we see a strong correlation between pricing and per-unit fleet costs changes. And what's interesting about that, as we work through the analysis, the strongest correlation tends to exist with pricing following fleet cost increases on a 6- to 9-month lag. And those correlations are fairly solid, but they're stronger with either 6- or 9- month lag built in there on pricing. So, I think, the other point to make is that some of those historical periods had a larger number of players in the car rental industry who were -- who had different mixes of fleet split between risk and program and very different mixes by manufacturer. And as we look at the industry now, not only are there fewer players, but as Larry pointed out, everyone is buying cars from the same folks in somewhat similar proportions. And as a result, we see more similarity of fleet acquisition among the various players in the industry. And in that context, my expectation would be that the correlation that existed in the past would be, could be even stronger



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than it has been, and that's part of the reason why we do expect pricing to benefit or help offset some of the pressures that we've seen on the fleet cost side over time.

James Joseph Albertine - *Consumer Edge Research, LLC - Senior Analyst*

That's certainly very helpful color and I appreciate it. If I may just ask another strategic one while I have you. From an acquisition standpoint, or maybe better way to ask it is, build it versus buy it, right? As you think about your strategy of developing initiatives to help grow your sort of addressable market over time, improved pricing, improved cost controls and so forth. There's been some movement, it seems, in the Ubers and Lifts of the world share shifting perhaps. Do you see in the 2- or 3-year horizon a potential to buy into other segments of the sort of broader shared mobility or ride-hailing sector? And how should we think about acquisitions sort of ranking in your schedule of capital allocation priorities?

Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

You know if you go back to our acquisition of Zipcar, it was really the first place that we -- we were the first ones to really look at this as an example of getting into a broader mobility of the world and then rental car. So obviously, we are open to any acquisition or partnership that would make sense in the broader mobility landscape. And we constantly talk to the folks that are in that area to see where we can align, where we can partner, what synergies we may have between the two of us, and whether that includes an acquisition or not. So of course we're really open to those opportunities going forward. As far as the acquisition pipeline, I would say it's pretty small at this point. We still look for tuck-in opportunities where they make sense. There's still some licensees out there that when those are available would make sense. But right now, I would say the acquisition pipeline is not large at this point.

Operator

Our next question comes from Mr. Michael Millman from Millman Research Associates.

Michael Millman - *Millman Research Associates - Founder*

Could you talk about what you're seeing in the what I call the energy markets in terms of demand, in terms of price, and how that affects the totality of what you're doing? And sort of related to that, can you talk about what you're seeing in the corporate markets in terms of loss of demand and price? And then one of the sort of unrelated question, given your tax status, what would be -- assuming the corporate tax goes down 15% what kind of benefit, if any, would you receive?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

You snuck in a four-parter on us. Let me try to tackle it. With respect to the energy portion of our business, energy and energy-related customers represent 10% to 15% of our overall business. And I think what we've seen there is certainly that part of the economy, that part of the travel sector has stabilized compared to where it was 18-or-so-months ago. But we would describe it as having stabilized at a reduced or depressed level compared to where it's been over a longer period of time. So it's not really a drag on our growth. But when we look at things over a longer period of time, we're not seeing as much business from that sector as we would have a few years ago. On the corporate side, I think demand has been okay, but a little bit soft at the same time. We have the sense that there are pressures on corporate travel budgets from a variety of sectors, including the financial services sector, number one. And number two, as we saw the GDP report come out for the first quarter where growth was a little bit less than people had expected and less than we had seen in the second half of last year, that seemed to us to be consistent with the -- with what we were seeing and feeling in terms of commercial travel demand. That it was okay but not as robust as it might have been. On the commercial side, I would break it into 2 components. One being the contracted commercial pricing for large commercial accounts. As we've discussed in the past, that has been extremely competitive and it remains that way. And then on the uncontracted side of the commercial -- the commercial business, that tends to be spot or by definition it's uncontracted. And as a result, it tends to move with leisure pricing. So it was impacted in the first quarter by the over-fleeting that existed in the industry. And when leisure pricing is soft, we'll typically see that uncontracted commercial pricing and it



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faces some of the same pressures. And then lastly, on the tax front, I think there are a number of different proposals out there, so it's hard to know exactly where things would land. But if we look at a reduction in the corporate tax rate on a stand-alone basis, I think the impact would be a positive in terms of our effective tax rate, so it would be helpful to our adjusted EPS numbers. I don't think it would have any significant near-term impact on our cash taxes, because we're not a federal cash tax payer currently.

Operator

And for final question coming from Mr. Yilma Abebe from JP Morgan.

Yilma Abebe - *JP Morgan Chase & Co, Research Division - Executive Director and Senior High Yield Analyst*

My question is on your fleet debt. With the volatility and residual values, are you seeing any -- an increase in enhancements required at the fleet debt level? Or even higher rates that you may be paying at the fleet debt level? And if the answer there is no, could there be any sort of, I guess, triggers to require you to pay higher enhancement levels as some residuals will move around?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

The answer is no. There have not been any significant changes in how our fleet debt is working. We issued asset-backed debt at an average rate of around 3% in the first quarter. We saw a good demand for that paper. Advance rates continue to be strong and haven't really changed. And no, there haven't been any significant pressures on us to make adjustments to any of our enhancement levels. And I think the key issue to be aware of is that our fleet depreciation, which is running through our P&L, is effectively a cash cost for us. So as we depreciate cars at a higher rate to take into account, softer fleet residual values or have any losses on disposition, those actually end up operating effectively as cash cost where the lease payment we pay to our fleet financing structure increases. So it doesn't necessarily change the -- it doesn't change the advanced rate, but it does create a situation where we're -- where the effects that you see running through our P&L in a quarter like the first quarter where fleet costs were up, a lot of those are felt in the fleet financing facility as well. And that tends to keep things stable with respect to the fleet financing facilities over time. And doesn't require dramatic changes in enhancements.

Yilma Abebe - *JP Morgan Chase & Co, Research Division - Executive Director and Senior High Yield Analyst*

That's helpful. And then my follow-up is as you sort of see the volatility both on the pricing and the cost side, and as you sort of look at your leverage targets, 3 to 4x. Any thoughts on sort of revisiting the appropriate level of leverage for this business given the current environment? And specifically, with expectations of \$30 million cash use for share repurchases, any thoughts around perhaps reducing that in this current environment?

David B. Wyshner - *Avis Budget Group, Inc. - President and CFO*

As I mentioned, we remain committed to keeping that leverage in the 3 to 4x range. We prefer to be in the lower half of that range. And the key for us is to delivering EBITDA that allows us to move back down towards the middle of that range as the year progresses. We started the year at around 3.6x, and I think as we deliver better LTM EBITDA than where we are right now, we have the opportunity for our net leverage to come down while still using a significant portion of our free cash flow for share repurchases.

Operator

For closing remarks, the call is being turned back to Mr. Larry De Shon. Please go ahead, sir.



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Larry D. De Shon - *Avis Budget Group, Inc. - CEO, COO and Director*

Thank you. So before we close, I think it's important to reiterate the key takeaways from today's call. While the first quarter was certainly more difficult than we anticipated, we do not expect this quarter's performance to be indicative of our full year results. Used car values have relatively stabilized, and we're seeing indications that industry fleets are beginning to firm up, giving us optimism that the industry over-fleeting we've seen over the past few months could largely be behind us by the time we get into summer.

We expect to generate \$450 million to \$500 million of adjusted free cash flow this year and to repurchase at least \$300 million of our shares. And we've already started work on many of the initiatives we discussed during our Investor Day to transform our business through the use of technology, and we expect this work to enable us to expand our margins by 300 to 500 basis points over the next 5 years.

We have a full calendar of Investor Relations activities planned this quarter, and we hope to see 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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