Avis Budget Group, Inc.

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SPEAKER 1: Good morning, everyone. Happy to have Ron Nelson, chairman and CEO of the Avis Budget here, front row we have Neal Goldner, our expert IR professional, and we're doing a format similar to what you guys have seen this morning. This is also webcast. So, maybe we just get started.

QUESTION: Obviously, the industry has seen some nice consolidation and obviously the key theme here is pricing. So maybe you just talk a little bit about what you're seeing in the current pricing environment where the opportunities are maybe like customer segment.

ANSWER: Sure. Well, actually, for the first 10 weeks of this year, pricing has been very firm. We're up-- we're hold-- through February, we're up 2% on a composite basis across our entire book of business. It's carried forward into the first half of March. We'll give back a little in the last 2 weeks of March because Easter is moved out of a-- moved out of the first quarter and into the second quarter, and Easter obviously has a higher yielding time, but we're fairly confident we're gonna end up the quarter with positive pricing. And that's on top of actually a fairly robust pricing period a year ago. If you recall, we were up 4% on a composite basis. In the first quarter of '13, leisure was up 8, commercial was flat and so, you know, getting incremental pricing against comps that were fairly difficult I think is a good sign. Commercial pricing nationally seems to have gotten a little better. It's still not where it needs to be and it still is the challenge I think we all face in the market, but it's leisure pricing that's actually pulling the average of up to 2%, so I'm encouraged by the environment particularly in light of one of our competitors professing sort of an over fleet situation that obviously tends to dampen price.

QUESTION: Just from a competition standpoint, I mean, have you seen anything, you know, out of the realm of a normal [inaudible] as it relates to Hertz or Enterprise and kind of, you know, how that plays into the greater pricing picture, is there someone that's--

SPEAKER 2: Yeah.

QUESTION: holding the pricing dynamic back?

ANSWER: Well, I think if you-- I think if you look back over the longer term and by that I mean back to say October of 12 and we got fairly aggressive about-- talking about pricing, I think the real shift in strategy occurred with Enterprise. They had historically been the spoiler on pricing and they've now flipped rolls and become the fast follower on most of the pricing increases. I think Hertz's pricing actions have been somewhat erratic, but they're understandable. I think when you think about them in the context of what was going on last year with the FTC in terms of what was going on with their de-fleeting issues with the Dollar Thrifty merger. And ultimately, they probably had a window on what was going with advantage that the rest in the industry didn't have. And so, it's-- you know to me it would be entirely reasonable again in those circumstances to not be very aggressive about moving pricing. But having said that, I mean, they still participated and probably a third to a half of the price increases and, you know, the industry came out, at least we came out. We had four quarters of positive pricing last year. You know, that's-- that is unusual. So, you know, I do think that I-- that there is a different view on pricing in the industry and I-- and I-- and I suspect that they'll be more uniformity as we get out towards the middle of the year and the back half of the year when the over fleeting issues that seemed to be with one of our competitors get put aside.

QUESTION: And digging into the commercial part of the business, obviously, that's been the [inaudible], a more challenging place to push for price compared with like the hotel business where, you know, in the corporate basis, the corporate rates are going up kind of in single digits, where is--how have you change your process of how you are either going through the RP process with commercial accounts, you know, kind of what are the opportunities to offset the weak--

SPEAKER 2: Yeah.

QUESTION: commercial pricing with small business?

ANSWER: Well, I think that really is the most imminent opportunity is changing the mix of our commercial book of business. We're able to be-- we have a little more leverage in terms of our midmarket, our smaller contracted players, and we've been relatively successful in withholding price if not increasing it on a thousand or so contracts that we renegotiated since the third quarter. Small business is actually priced off of leisure, so as leisure improves, your small business improves, and small business has an RPD that's probably $5 to $7 higher than our average commercial RPD, so to the extent you can change your mix of business, you can actually average up the composite rating in your commercial business. You know, we were-- we were pretty clear about 8 months ago, about we are gonna approach the large commercial business. We've walked away from a fairly big account over the past 6 months. We just didn't see any way that is was remunerative. It was an account we have had for 20 years. There were no service issues. You just couldn't make any money. And I think in a lot of the RFPs where there are no service issues. You know, playing in that game just-- you're just getting used as a stocking horse and I think that's what's unfortunately driven some of the commercial rates down. And I think we're in an environment now where-- you know, over the last 2 or 3 years, everyone had used car premiums that were available to offset the impact of non-remunerative commercial pricing and I think that's no longer the case. And so I think that my sense is everybody has the same kinds of cost pressures in terms of declining residual values and, you know, we've been able to move leisure rates pretty well. The problem really isn't commercial and I think that's where the next beachhead is gonna be for everyone.

QUESTION: And how long is that process? Obviously, a lot of the accounts are 2 to 3 year in length, renegotiated 1,400 accounts or so, you know, as a population of the total commercial mix, what, you know, what does that represent and how long is the process gonna take?

ANSWER: Yeah, our large-- our largest commercial accounts probably account for 15% of our total contracted, or our total business, maybe 30% of our contracted business. They tend to be 3 years some are as long as 5 years. You know, I think, the challenge is with very large accounts, the $10 million, $20 million, $30 million car rental accounts is that they're hard to walk away from. I mean it is-- it's a lot of guaranteed volume, it tends to be concentrated at maybe a dozen or so airports. There's a lot of operating leverage in a particular airport when you can put a lot of volume through it. And so, I mean understand the competitive nature of it. I don't understand not making money at it. But I do think that, you know, one scenario that could play itself out is that the industry will continue to be very competitive on these big accounts and what you'll do is you'll be more aggressive on your smaller accounts, on your small business accounts where you have more leverage, and ultimately it'll be a mix shift that ultimately get your composite commercial book of business, but having said that, I do think that when you look at the commercial rates on the-- on the $20 and $30 million accounts that are in the market right now, it's hard to see them going into lower. They just don't drop enough margin contribution to absorb any overhead at the-- at the rates they're-- they're currently have.

QUESTION: Great, kind of shifting gears here. Looking at fleet cost, obviously another-- one of the key drivers for the-- for your story. Maybe you could refresh us with what your views are for residuals for this year and then you know, looking out to '15 and '16 and how you see residuals playing through?

ANSWER: Well, we've built our plan around the view that residuals are gonna drop about 2 points as a percentage of Cap cost, that's how we tend to look at the residuals. So, our plan is built around recovering 80% of our Cap cost from residual values. The long term average is actually 79%, the lowest that's ever been I think it's in 2008 somewhere in the 73% range, and I suspect the highest it's ever been was 2 years ago at 93% when we had the tsunami and the sort of the perfect storm of things that draw residual values. But, you know, I'm feeling very comfortable with our forecast. The used car market which we are in everyday selling cars is behaving exactly as we expected it. Volumes are increasing every week. Prices are increasing every week. We've seen nothing that would suggest that our plan is built around a number that we can achieve. And all of us, and certainly us, tend to sell the majority of res cars in the-- in the March through July period when prices are the strongest. And so, it's important that the market behave as we hope it will during that period because that is the period of biggest res car disposition for us.

QUESTION: And just from a-- that it's kind of offset the softening residuals, maybe talk a little bit about your-- the different channels which you're using to dispose--

SPEAKER 2: Yeah.

QUESTION: of the cars?

ANSWER: I mean, I think, all of us have pretty-- very much the same sort of channel strategy. Traditional auctions are the largest part of the mix, online wholesale auctions are the second largest, direct to dealer is the third, and our retail channel, the automation ventures, obviously the smallest. Now everybody goes after those channels in different proportions, so these are our numbers, but we probably still sell about 60% of our res cars through traditional auction, 30% to 35% through online wholesale auctions. And then the balance is in direct-to-dealer and through automation, there are different realization rates out of-- out of those channels. Obviously, the retail channel's the best-- the best part of it, and direct-to-dealer we're seeing probably a $300 to $400 pickup from that net of-- net of commissions and the net of fees. Online auction is a little less. You end up-- the auction fee is lower, and you usually get some transportation benefit because you're bound to have a car that a dealer wants closer to where his lot is than closer to where the auction is. I think overtime, you'll probably see the traditional auctions go down 10 to 15 points as a percentage. The online auctions will pick up some of that slack, and at least in our mix, direct-to-dealer and retail, we'll pick up the balance and so, you know, in a couple of years, it wouldn't surprise me to see 15% go through-- excuse me-- retail and direct-to-dealer, and then 45 or so percent through traditional and then the balance through online wholesale. Selling, you know, 200,000 plus a year is a-- is a big task and so it's not likely that we're ever going to foreclose the traditional auctions as a method of selling cars.

QUESTION: And then-- I've got plenty of questions here, but if anybody has any questions to add in, feel free.

SPEAKER 1: Yeah.

SPEAKER 2: Yeah.

QUESTION: Since you're been with the [inaudible]-- of your business going forward given the amount of [inaudible]-- what do you think will become of [inaudible] in terms of relative to what will be increase consolidation pricing [inaudible]--?

ANSWER: Well, I think-- I think we're already seen to that. I think with the increase consolidation, 3 of us have 95% of the market and so it doesn't make a lot of sense to play a price game, right? I mean, you wouldn't re-price your whole book just to go after 5 share points, and most of those share points are in places where you get $22 and $23 a day RPD. So once you stop-- once you reach that conclusion that I think everybody sort of asks, you know, formally and thinks about how they recover their cost increases, and obviously, the quickest way is through price, we'll have process improvement initiatives and productivity initiatives, but pricing is ultimately the best way and look, I think that the reality of our business is that the returns on capital are insufficient, and the demand is fairly inelastic in our business, and the kinds of price increases that you need to drive an acceptable return on capital and grow your business is not a lot. I mean we're not talking about $10 a day, I mean, if we got a dollar a day across our entire book of business, globally, that drops over $100 million of EBITDA, and in North America alone, a dollar a day would drop close to 75 million to 80 million, and so it's-- these are not numbers that as a consumer you look at and oh boy, are they really taking advantage of the consumers. So, I really think it's the uniformity of business mix, the fact that we have so much in the market and the fact that we all have the same sorts of issues driving our P&L that's gonna allow pricing and cost efficiencies to act-- drive us in the same direction.

QUESTION: [inaudible]--

ANSWER: Well, you know, it's not clear to me exactly what the extent of their over fleeting is, you know, it's-- you know, I understand that maybe they have cancelled some orders in terms of new cars and so that tends to balance it out. And I will say to their credit, well, at least as I understand it, when they-- when they tried to move as many cars as they did in April and May of last year and saw that they were affecting the whole market, they pulled cars back. And for the most part, I'm told that they've, you know, park these cars. They're not trying to get-- move them and try and upset market pricing. They probably move some into the opaque channel because that doesn't really affect sort of market place pricing. So, it doesn't concern me a lot. My guess is that they're-- they obviously waited until the first and second quarter when prices were better to move cars, and what we're seeing in the auctions at least through the first 10 weeks of this year would suggest that there's not any real disruption to the market place. And to a certain extent, I don't know the mix of these cars, but to the extent, these are higher mileage cars, that they've been around for a while and they're 45, 40, 50,000 mile cars, that's really not the sweet spot for where we sell cars. I mean, we're generally in the below 30s and it's a-- it's a-- it's a different customer and a different buyer, different market, so. But there's 3 months left to go, and so--

QUESTION: And shifting gears, looking at-- looking at Europe, obviously you've done a ton to pull cost out of that business and still have a lot of-- a lot of room to run, but maybe just talk a little bit about your expectations for the budget brand, how you see that growing, you've slowed down the growth a bit, but, you know, with the more of a focus on attaining price, but can you talk a little bit about where you see that brand going in?

ANSWER: Yeah, well, 150% a year isn't sustainable. Okay, and so-- no, we've been absolutely thrilled with the initiative to expand the budget brand. We're up 250% in the 2 years that we've been going after it. That's obviously gonna start to slow down. Our forecast for this year is that budget is gonna grow somewhere in the 25% to 30% area. I think there's probably 3 to 4 more years of 20% plus growth in the budget area. We've gotten much smarter over 2 years about how we yield budget, I mean the manner in which we increase the volume obviously was to cut price. We didn't think budget should compete with Avis or Hertz or Europe car. But in June, July, and August, there is absolutely no reason to cut price on budget because you can rent every car you have and at least in the southern regions of Europe, so we got much smarter, much quicker last summer with the yielding budget, and as a result, we had the best third quarter even in the history of Avis Europe, even with the economic challenges that exist in the-- in the market place. So, we're continuing to grow budget, we've invested very heavily in the new eCommerce site. We rolled out the first iteration of the new site over the last 3 or 4 months. Conversion's up in the mid teens, so it's doing exactly what we hope it would do. And I'll say in the-- in the first quarter, which is generally a soft quarter in Europe, one of the softer shoulder periods, budget's performing nicely-- price is up, volume's up pretty significantly. So, it continues to be an important asset for us.

QUESTION: Also looking at ancillary, obviously that you were structured how you sell the ancillary products for the European business. Maybe talk a little bit about what you did, how you improve the process for selling ancillary products, and then also what your expectations are for '14 and how you see that part of the story playing out?

ANSWER: Well, we started this about 5 years ago in North America and realize that a lot of our business model is dependent on how well we sell GPS's and XM radios and insurance and up sell car categories. And we engaged a sales training company, we went around, we're now-- we're now really through the top 150 airports, we've retrained all the customer service reps to be sales people not order takers. They have quotas that they have to deliver in terms of ancillary sales per rental day, and we change the spec for how we hire. There's very much about the nature of the personality of the person in terms of how well they sell. Over the course of those 5 years, you know, we enjoy double digit guids and ancillary revenues were-- they're sort of flattening out now because we pretty well trained everybody, but we're still growing ancillaries at 5% to 6% today in North America. So, we started the same thing last year in Europe. We're at the early stages of it, but the ancillary revenues last year in Europe grew 15% to 16%, I'm not sure which one it was, and I think we'll probably have an equally strong year this year. So, and I would see Europe playing out much the same way than North America do. It'll be on the declining curve, but it will continue to grow for sure for the next 4 to 5 years.

QUESTION: And then how does competition feel? Obviously you've had great success with the grow in the budget brand, but have you seen any pick up in competition from any other of the value brands in Europe?

ANSWER: No, the value brands are actually relatively well distributed, let's say that I mean, they're independents, they tend to be concentrated in a-- in a particular country. There's not many pan-European value renters. Europe car started or resurrected in a rent over the-- over the course of last year, but we haven't seen much in a way of significant competition from them. Hertz continues to, I believe, the advantage brand in Europe, but it's not as anywhere near as well distributed as the budget brand, 'cause in the budget it actually has greater awareness across the European continent. So, you know, our view longer term was that we're ultimately the car rental space globally is gonna be down to 3 global companies and that we had a window of opportunity here to grow the budget brand in a space that wasn't particularly well populated. And so, we've been moving very aggressively to get the budget brand distributed and get its footprint bigger and, you know, I think the results bear that out.

QUESTION: Any takers from the crowd? Looking to Australia, obviously a small area but, you know, big contribution for you with the Apex brand, maybe talk a little bit about what, you know, what you saw last year, how you see '14 playing out, obviously, it feels a little bit better than it did last year [inaudible]?

ANSWER: A little bit, but, you know Australia was significantly more- well, the business was better, the mining industry clearly declined over the course of the last 2 years, and that had fairly significant impact on the-- on the car rental business. I think it did catch everybody a little flat footed, they were tended to be over fleeted for most of the year, pricing was down pretty significantly in Australia, and it did impact our profits [inaudible], between our two brands, we have a fairly significant market share in Australia, and we make a lot of money. So, it hurt to see pricing go down 6 points, so you know, we tried to do all the things that you do to offset it. I think pricing has gotten a little better as we move through the summer season there. Pricing on a year-over-year basis at least in the fourth quarter was flat. It seems to be flat this year in the first quarter, but the things that drive the Australian economy, the mining business still haven't gotten a lot better, and so, you know, I think for us, we're looking in all those things that we did in North America when the economy got tough in terms of how we position our Australian business. I've never been a big fan of going after share, and so I've, you know, I'm talking to the guy that runs the Asia Pacific region for us, I said, "Look, let's keep pricing up to where we-- where we can make our margins and make money and even if we have to give up a few share points," and that's exactly what we're doing. Apex is actually, is a-- is a little acquisition we did almost 2 years ago now. It has a business model that we would all covet. They pay absolutely no commissions. It's the Southwest Airlines of car rental. It tends to be a lower end business. They cater to long term travelers. They hold on to cars 4 or 5 years, and they actually have a fairly significant market position in New Zealand, they are the largest player in what I would call the discount or value into the market. Over the course of 2 years, we moved it to Australia, we're present in the Gold Coast camps, Melbourne and Sidney. It's growing 20%, 25% a year, and our next stop, which we will do this year at least didn't-- in terms of capital markets, is we think it's become a franchise asset. And so between Apex and Payless, we think we've got two brands that are capable of being franchised around the world where there are dark spots. So, we're pretty high on them and neither one is an outcome driver, quite honestly, they're both relatively small businesses, but at the margin they can-- they can actually drive some good EBITDA and great returns on capital.

QUESTION: And then shifting gears to free cash flow, obviously that's, you know, one of the key aspects of your story that I like and I think folks in this room are attracted to. Looking at roughly $400 million in free cash in '14, $500 plus in '15, you stated in that leverage target of 3 to 4 times-- do, okay, I'll do the math, but gives you significant ability to put more debt on the balance sheet and do things with that-- with that liquidity. What are your principal uses for that free cash and you know, is it principally buy-back, are there acquisitions that could be interesting to you?

ANSWER: Sure. Well, I think-- I think this year there's probably 3 buckets where we're gonna-- where we're gonna put cash and I'll go from largest to probably the smallest, but I could be wrong. I think the first is gonna be share repurchase, so I think the majority of our free cash flow this year will go to share repurchase. The second bucket is tuck-in acquisitions. I would be happy if that moved up to be the first bucket. Most of tuck-in acquisitions are either brand extensions for budget or licensees that we're reacquiring. We tend to buy these businesses at 5 times EBITDA and we get at least a multiple turn of synergies and efficiencies and the likes of the return and most of the EBITDA that they drive is all free cash, so, you know, you're looking at Europe from 25% to 30% returns on capital so we'd like to put as much money to-- or Payless is a good example of that by the way. We paid $50 million for Payless. We're gonna earn over $50 million of EBITDA this year, so we're gonna own that almost 3 times, little over 3 times EBITDA. You know, I think they're-- a big tuck-in acquisition is 50 million. Most of them are around 30. We just reacquired the budget franchise in Edmonton for $30 million. We took over operation of budget for [inaudible]. A couple of weeks ago, I think the investment was $10 million of-- it's hard sitting here today to see how we put $100 million or so to work in tuck-ins, but if they're there and they have the return on capital, I think that's, you know, obviously they alter the growth trajectory in terms of generate good returns on capital. So, you know, that's gonna be worth of cash. The third bucket is fairly small. We've got $800 million of high coupon debt, 6 in a quarter of-- 625 million of 8 in a quarter and 200 million and 9 in three quarters. So, our goal is to obviously bring that debt in house as quickly as we can. And they'll be some debt extinguishment costs, which is to the $200 million Euro dollar offering last week. We took the proceeds worth $280 million. We're gonna buy back the 8 in the quarters, we did the Euro dollar offering at 485, so we're gonna pick up 300 basis points on the-- on the trade, P&L-- 300 million of P&L basis. We'll have 20 million or so debt extinguishment costs. But that still is a little less than $600 million of high coupon debt out there that over the course of the next year we'll be able to retire and as long as rates stay and the-- and the range that they're out, I mean 485 was a little better than we thought it was gonna be. But even if it takes up to a 5-1/2 or so, there are still 250 basis points that we're gonna be able to grab out of-- out of that. So, it's an opportunity. But that's where some of the cash will go, but I-- just

INAUDIBLE: I think most of it is gonna go to share repurchase.

QUESTION: [inaudible]--

ANSWER: Yeah. Our relationships with the OTAs are good. We-- they're probably not as good as they would them to be because we pulled out of the opaque channels pretty significantly last year, Hotwire. And we've recovered most of the volume through Priceline, but Priceline is a little different than Hotwire and that we set the retail rate, not somebody else. So, it's kind of a bit of a detrimental, but our opaque volume is down 40% to 50% on a year-over-year basis. And we do not put Avis into the-- into the opaque channel, so-- but I-- you know, we have good relationships, we have presence on all of the-- all of the OTAs. There are about 8% of our total volume, it's not a-- you know, it's not-- and certainly, don't wanna lose it, but it's not huge. We're up on all the mobile platforms in North America. We'd actually just launched a new version of our mobile platforms running Android, Microsoft, to iPhone-- there's one other-- iPad [inaudible], it's still early days. I mean, mobile reservations are obviously growing like a weed, but it's small in terms of the absolute numbers. And our European team actually is launching new mobile apps this year as well and I got a preview up when I was in Europe last month, it's pretty amazing what they've done and obviously mobile

QUESTION: [inaudible]--

ANSWER: Yeah, I mean, I don't know. I think our cost capital is probably somewhere on a-- on a normalize basis 10% to 11%. Our return on capital depends obviously how you wanna measure it, but I tend to look at free cash flow, on levered free cash flow return on capital which is in the 8% range. You know, I think-- I think we need to get it up 3 or 4 more points. We do have a finance company balance sheets so it's not gonna be-- it's not gonna look like the rest of industrial America. But, you know, I think through a combination of-- you know, if you look at the things that are sort of ripening in our income statement over the next 2 years, we've got Zipcar and Payless synergies, which should deliver another 70 million. We've got the annualizing of Avis Europe, synergy is which another 70 million. And then the whole area of fleet optimization yield management and process improvement, we think that it had over $100 million of efficiencies so, you know-- and I think there is just a lot of-- lot of opportunity to improve our return on capital through things that we actually control, you know, we're not really reliant on the market to drive most of those, and some of the Avis Europe synergies are budget expansion, but I'm pretty comfortable with how that's going. And, but for the most part the rest of them are all things that are in our control to either succeed or succeed mightily or not succeed as great.

QUESTION: Can you talk a little bit-- touch upon the Zipcar? We haven't talked about that piece of the business at all.

ANSWER: Yeah.

QUESTION: A couple things, one, fleet optima-- or fleet utilization, so kind of the car sharing, if you will, between your brands, can you talk a little bit about that and how that can improve-- utilization, but then also customer experience for Zipcar?

ANSWER: Sure. Well, I'll deal with the last one first and then we'll go-- Decision that we made early on when we bought the company was to leave it in Boston. Let them continue to run their own customer experience, their own marketing, and their own technology. I think that is the core of the brand, I mean that's-- that's what allowed them to develop a really a globally recognized brand that far exceeds their financial significance, and that is--that is the way we're operating the business now. In terms of fleet sharing, I think it's a little more complicated than we thought it was gonna be. And I think one of the-- one of the pathways that we've realized is core to getting the most out of fleet sharing is get in to the one-way business. The issue of fleet sharing is, one is that it cost you to be able to move those cars from one location to another and the cost of shuttling can really impact the incremental yield you expect to get from delivering that car to pick the incremental demand. But if you have one-way capability, then you can actually have customers pay you to shuttle your car either into Manhattan or into downtown Boston or into downtown San Francisco, so it's-- so it's a revenue item and on a cost item. We're in beta testing now with one-way technology. It should be available by the third or fourth quarter and then we'll be able to really get-- optimize the fleet sharing paradigm. We haven't been sharing fleet over the course of the last year. We've sort of been of hard wiring it and doing it in a way that it wasn't optimally profitable. But, we had to get a sense in these markets of what unconstrained demand was. So, that we really knew how many cars that we have to share in order to-- in order to get the most out of what we have. So, I think we know that now and with the one-way capability, we'll be able to get the most out of fleet sharing as we get into the end of next-- end of this year, and end of 2015.

SPEAKER 1: Okay, great. Anyone else from the crowd? All right. Thank you very much--

SPEAKER 2: Right. Thank you all.

SPEAKER 1: Ron. I appreciate--

SPEAKER 2: My pleasure.
