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## CAR - Q3 2017 Avis Budget Group Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 07, 2017 / 1:30PM GMT

**OVERVIEW:**

CAR reported 3Q17 results. Expects 2017 adjusted EPS to be $2.45-2.65.

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## PRESENTATION

**Operator**

Good morning, and welcome to the Avis Budget Group Third 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.

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**Neal H. Goldner** *- Avis Budget Group, Inc. - VP of IR*

Good morning, everyone, and thank you for joining us. On the call with me this morning are Larry De Shon, our Chief Executive Officer; and Martyn Smith, our Interim 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.

Risks, assumptions and other factors that could cause future results to differ materially from those expressed in the forward-looking statements are identified in the company's earnings release and other periodic filings with the SEC. It can also be found on the Investor Relations section of our website.

Our comments today will focus on our adjusted results. We believe that our financial performance is better demonstrating using these non-GAAP financial measures. All non-GAAP measures are reconciled to the GAAP numbers in our press release and in the earnings call presentation, which is also available on our website.

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

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Thanks, Neal, and good morning. Before we discuss the quarter, I want to acknowledge the devastation caused by hurricanes Harvey, Irma and Maria. And to express our deepest sympathies to all that were affected by these terrible events. The impacts from these powerful storms were felt throughout our operations, and I'm proud of our teams who worked tirelessly to ensure the safety of our employees and their families as well as their work to move vehicles to the affected areas to support our customers and the relief agencies.

Now to the quarter. As we announced last evening, we had a record third quarter with our seasonal peak being driven by strong global volume growth, increased pricing in the Americas and better-than-expected used car values, partially offset by soft pricing in our International segment. We achieved this despite the effect of the hurricanes, which negatively impacted our adjusted EBITDA by approximately $15 million in the quarter. This impact included lost revenue and lower utilization due to airport closures, incremental shuttling costs we incurred to move vehicles to the impacted area and property damage.

I'll let Martyn take you through the results, but first, I'd like to spend a few minutes to review our few -- a few of our key initiatives that drive long-term profitability and margins as we grow and adapt into the evolving mobility services industry as well as what we've been able to achieve in the year since we laid out our plan. I'll also take a few minutes to talk about our Waymo partnership and the progress we have made since our last earnings call.

Starting with profitable revenue growth. Our plan has been developing quite nicely. The fully integrated Demand-Fleet-Pricing yield management system is now live in 6 markets in the Americas, and we are seeing positive results in these test markets in both utilization and in being more selective in the types of business we take. And in Europe, we also launched the first phase of the system, the pricing robotic, in 25 cities with many more to come. In addition, our new websites and mobile apps continue to generate strong direct bookings. In the third quarter alone, more than 1/3 of the reservations that came through our proprietary platform in the Americas were prepaid and the investments we have made in our websites contributed to a 70 basis point increase in conversions. We also drove good performance from our EMEA websites and achieved a 30 basis point improvement in conversion in the third quarter. We have also simplified the process for people to register with us, thereby enabling us to provide our customers a more personalized experience when they book directly on our websites. Leveraging the benefits of our own platforms will enable us to grow our lower-cost distribution channels and increase our profitability.

We're also making good progress on our initiatives to improve our revenue mix, leading to the first quarter of flat commercial pricing since early 2015. We also renewed and expanded our multi-year partnership with IAG, the largest airline group in Europe, making Avis and Budget the only car rental brands available for booking through British Airways, Iberia and their low-cost subsidiary, Iberia Express, with Aer Lingus to follow.

In terms of new customer offerings, we are now piloting the bundling of products online in Europe, where we are offering a combination of damage and theft coverage as well as roadside assistance at a bundled price. Currently testing in 8 countries, this initiative is showing attachment rate similar to our strongest sellers at the counter, and we plan to expand this test to more countries, including in the United States starting this month.

Looking forward, with the growing middle class in both China and India and a high propensity to travel internationally, and us being the only rental car company with a corporate presence in both markets, we are well positioned for the future as these economies expand. Chinese tourists spent more in the United States than tourists from any other country in 2016 and inbound travelers from China into Australia are expected to overtake those from New Zealand for the first time next year.

To capitalize on this trend, we recently launched prepay for outbound customers from China, enabling Chinese travelers the convenience of paying ahead when they travel. And for our India customers, in addition to the traditional self-drive service we offer customers, we recently launched International Chauffeur Drive, benefiting those traveling abroad who prefer to have a driver. These are just 2 of the ways that we are positioning ourselves to capitalize on the growth of these important markets.

As the mobility landscape continues to change, we are leading and evolving by finding innovative ways to interact with our customers. During the third quarter, we grew Zipcar's presence by opening licensee locations in Costa Rica and Iceland, and by launching its floating product in the U.K. under the name Zipcar Flex. This new offering allows members access to a vehicle as needed with the flexibility to pay by the minute and the added convenience to drop the car off at any approved location. And in October, Zipcar rolled out a new cost-effective mobility option in select U.S. cities for members who commute to and from work, but don't want to bear the cost of car ownership and inconvenience of finding parking. This new program, which offers members a recurring weekly rental, including insurance and a parking spot for a monthly fee plus mileage, is just another example of how we are providing innovative solutions for our members.

We also continued to improve our customers rental experiences, leveraging the Avis' mobile app powered with new customer requested features. These features solve every day problems that make renting a car easier, while eliminating pain points for travelers. The major updates, which include enhancing the selection of vehicles for exchange and upgrade as well as realtime tracking of our airport shuttle buses, to name just a few, are showing early returns. We are seeing substantial improvements in our Net Promoter Scores, signaling that we are meeting or exceeding our customers' expectations. With that in mind, we continue to expand the reach of the new Avis mobile app, experienced by making it available in more countries, including recent launches in Canada and Australia.

These expansions have helped us exceed 825,000 transactions utilizing the new rental experience and every week, even more of our Avis preferred customers are using the app and this is just the beginning. This new and improved customer experience truly differentiates our brand and puts us at the forefront of self-service rentals.

I'm also pleased to say that our Connected City pilot has been progressing smoothly and early learnings are extremely positive. Having a fleet of connected cars enables more sophisticated tracking of idle vehicles, and soon the cars will be able to inform us when they are ready to be rented. This in turn allows us to employ more dynamic planning and makes our inventory process that much more effective. We are performing automated inventories in our Connected City and we plan to implement this feature in all connected cars in the near future. We also continue to realize benefits from the more accurate fuel reading capability. Completely accurate fuel measurements have provided additional transparency around the billing process, ultimately leading to a greater customer satisfaction as well as better gas collection. The opportunity for learning and leveraging this new technology will let us better serve our customers as well as drive substantial operational efficiencies.

Our ability to utilize technology to better serve our customers also allows us to create new service offerings, such as our partnership with Waymo, the autonomous driving division of Google parent company, Alphabet. Since our original announcement in June, our teams have worked together to prepare facilities, processes and people to support Waymo's self-driving vehicles, which are currently being used for the program in Phoenix. As a reminder, we announced our multi-year partnership in June to provide fleet management services to all of Waymo's self-driving vehicles with the intent of expanding our support as Waymo expands its fleet beyond Phoenix and into new markets. We have already renovated our initial locations specifically to support the custom needs of Waymo's vehicles, including dedicated space and secured 24/7 access for the Waymo team. We are committed to expanding both our services and our locations to meet Waymo's needs and growth plans across North America and elsewhere. Equally important, we continue to learn new and valuable lessons about what it takes to support and maintain a fleet of self-driving vehicles, lessons that will help us deliver new mobility service offerings to our customers in the future.

We've also made progress with our partnership with RocketSpace, a leading accelerator for start-ups. Through this first of a kind mobility technology accelerator program, we have begun to work together with start-ups that have a product in market or are ready to launch. As the only rental car provider in the program, our participation in the RocketSpace accelerator positions us at the forefront of innovative and potentially industry-changing advancements. The initial group of early-stage companies has successfully executed pilots and we are now interviewing a new pool of promising start-ups from around the globe for the second cohort. These companies range from new connected car technology and services providers to others offering new platforms and products for electric vehicles, automotive data analytics and insights, improved user experiences and other critical segments of the new mobility ecosystem. We look forward to working with these companies as we look to expand and accelerate our own capabilities.

With that, I'd like to turn the call over to Martyn.

**Martyn Smith** - *Avis Budget Group, Inc. - Interim CFO*

Thanks, Larry, and good morning, everyone. This morning, I'm going to discuss our third quarter results together with our fleet, cash flow, liquidity and our outlook for the full year 2017. My comments will focus on our adjusted results. As Neal mentioned, these are reconciled to our GAAP numbers both in our press release and the earnings call presentation.

First, starting with an overview of our third quarter. Strong volume growth globally led to total company revenue, increasing 4% with both pricing and utilization improving in the Americas. And in our International region, strong volume growth being partially offset by lower rate per day. This revenue growth and benefits from our continuing cost mitigating actions net of a 3% increase in overall fleet cost, led towards increasing our third quarter adjusted EBITDA by $13 million to $482 million.

Now to get into the detail, starting first with the Americas. We increased revenue in the third quarter year-over-year as we executed on our revenue management initiatives and despite some impact of the hurricanes. This enabled us to drive around 1.5% higher pricing in local currency and a 1% increase in volume as well as a utilization improvement of 80 basis points. Leisure volume was strong, picking up more than 3% in the quarter, while commercial remained -- commercial volume remained relatively soft, down 3% year-over-year. Inbound rental days increased 3% with good growth coming from both our International leisure and commercial customers. Leisure rate per day also increased 3% and commercial pricing was unchanged year-over-year, which as Larry mentioned, is the first quarter of flat commercial pricing since Q1 2015. In terms of full year 2017 for the Americas, we now expect a 1.5% to 2% increase of rental volumes, with rates per day expected to be lower by 1 to 1.5 percentage points. These are just slightly changed from our previous projections.

Now turning to America's fleet. In the quarter, we managed our average fleet levels to achieve the utilization improvement, while also providing our revenue management team more opportunities to realize higher pricing. Per-unit fleet cost increased 5% in the third quarter, a substantial improvement compared to the second quarter and the first half of the year. Used car values began to stabilize at the beginning of the summer and then were helped towards the end of the quarter as the hurricanes created incremental short-term demand.

Now moving to our initiative to sell more used cars through alternative distribution channels, where we benefit between $250 and $400 for every car we sell to a wholesale buyer and substantially more when selling retail. We are pleased with the progress we have made this year. By the end of September, we had sold more than 85% of our planned risk cars with more than 90% disposed by the end of October. Half of the risk cars we sold year-to-date were made through alternative channels compared to 37% in the prior period, including a significant year-over-year improvement in the third quarter.

We intend to develop these channels further as we continue to invest in our vehicle remarketing strategies. Looking forward, we now expect our Americas per-unit fleet cost to increase between 6.5% and 7% for the full year, but improved on our previous guidance due to the short-term post-hurricane effect on the used car prices. And as we mentioned on our last earnings call, we plan to run our fleet slightly tighter into 2018 to achieve a further benefit from improvement in utilization.

Turning to other costs. We continue to realize benefits from our manpower planning initiative. We've now rolled out this technology across all of our top U.S. airports, driving another 4% increase in year-over-year productivity. Likewise, shuttling per transaction improved 4% in the quarter and despite incremental costs related to the hurricanes, as we remain focused on minimizing the number of times we move our vehicles.

We also continued to push on cost reduction actions throughout the business. We estimate that the hurricanes negatively impacted revenue and adjusted EBITDA by approximately $5 million and $15 million, respectively, in the quarter, as the incremental volume from relief agencies could not offset the lost revenue from the business disruption, property damage incurred and the utilization impact.

This is net of the benefit we experienced in the quarter from better-than-expected used car values, which is reflected in our updated 2017 full year guidance. Our guidance also presumes that there'll be no material impact from the hurricanes over the balance of the year.

Now turning to our International segment. Revenue growth -- revenue grew 9% in the third quarter or 5% in local currency, reflecting a 13% increase in rental days of which the FranceCars acquisitions generated 6%. Our European region grew volume by 14%, including the acquisition and our Asia-Pacific region increased volume by 5%. Leisure was up a strong 7% in the quarter, benefiting from robust demand in Spain, Italy, Germany and France, including a 17% increase in our Budget brand across Europe. We also benefited from good corporate demand with volume up 8% internationally, including an impressive 20% increase in Australia. Inbound volume was also good in the quarter, up 4% year-over-year. However, the strong volume was partially offset by 5% lower pricing in local currency, reflecting competitive European market conditions.

International adjusted EBITDA increased 4% in local currency and 8% as reported. This performance was achieved through the strong revenue growth, produced local currency per-unit fleet cost, our cost-reduction initiatives and a $9 million currency exchange benefit. For the full year, we now expect International volume to grow between 11.5% and 12.5%, with approximately half coming from organic growth and the balance from acquisitions.

International rate per day is expected to be 1.7% to 2.2% lower on a reported basis, while fleet costs are expected to be in the range of down 0.5 point to up 0.5 point. On a local currency basis, pricing is expected to be lower by 3.7% to 4.2% and fleet costs are expected to be better by 1.5% to 2.5%. These are all broadly similar to our previous guidance.

Moving onto cash flow and our funding position. We generated $473 million of adjusted free cash flow through the first 3 quarters of the year, comparable to a year ago, while also increasing our non-fleet CapEx on strategic growth initiatives, such as mobility. The timing of vehicle programs, which had a significantly positive impact on the first half free cash flow partially reversed in the third quarter with a further reduction expected to occur by year-end.

For the full year, we now expect our cash taxes to be $55 million to $65 million and cash restructuring costs will be approximately $50 million.

We expect our non-fleet CapEx to be around $200 million this year, with more than half of this being spent on technology, including growth initiatives, such as connected car, our integrated Demand-Fleet-Pricing yield management system and our various mobility initiatives. As a result, we now expect adjusted free cash flow to be approximately $325 million this year, absent any further significant timing differences.

We bought back 783,000 shares at a cost of $27 million in the third quarter at an average price of $34.13 per share. Through the first 9 months of the year, we repurchased 4.2 million shares at a cost of a $127 million, at an average price of $29.93 per share. Based on our updated earnings and free cash flow guidance today, we now intend to repurchase approximately $200 million of our shares this year, which represents 6% from our current market cap.

Our financial position remains strong with some $4 billion of available liquidity. This comprised ending the quarter with $814 million of cash and having more than $700 million of available capacity on our revolving credit facility, plus $2.6 billion of capacity under our vehicle programs.

None of our corporate debts matures before 2022. Our net corporate leverage of 3.9x remains toward the high end of our targeted range of 3 to 4x and with 3.7x for covenant purposes, a full turn below our maximum leverage ratio.

As we look at the remainder of the year, we have updated our estimates to reflect our year-to-date performance as well as our expectations for the fourth quarter. For the year, we now expect our overall revenue to grow 2 to 3 percentage and adjusted EBITDA to grow between $725 million and $745 million, including the $15 million negative effect of the hurricanes. Absent this impact of the hurricanes, the midpoint of our adjusted EBITDA guidance would have been similar to what we discussed in August. We estimate that currency will have a roughly $65 million to $70 million positive effect on revenue and a $25 million to $30 million positive effect on adjusted EBITDA this year, largely due to the strength of the euro. We have provided a slide in today's presentation that sets out the effects of currency movements will have for the year and the fourth quarter based on recent rates.

Our estimates for non-vehicle depreciation and amortization, excluding acquisition-related amortization, remains at approximately $205 million for 2017. We expect non-vehicle interest expense to be approximately $195 million this year.

We now estimate our adjusted effective tax rate to be approximately 35% in 2017. And as a result, our full year adjusted EPS will be between $2.45 and $2.65 per share. And while we're working on our 2018 budget right now, it's important to note that we are likely to see an increase in interest costs in the coming year, given the current rate environment, as some of our less expensive U.S. vehicle-backed debt rolls off and is replaced by new debt. And we anticipate our other variable U.S. dollar borrowings to cost us more next year.

We will provide the outlook for 2018 through our February earnings call. In summary, we had a good record third quarter despite a lot of noise. In the Americas, we saw tighter fleet throughout the quarter contributing to the pricing improvement. The 3 severe hurricanes created significant additional obstacles for our teams to overcome and the used-car market stabilized compared to the first half of the year. And our International segments saw strong demand growth, partially offset by the difficult pricing environment.

We remain focused on controlling costs and finding efficiency opportunities to help mitigate some of the challenges we face this year. At the same time, we continue to invest in our business, our work toward margin expansion by aggressively managing our costs, while remaining focused on the longer-term growth strategy.

With that, I'd like to turn the call back to Larry.

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Thank you, Martyn. Before moving to Q&A, I think, it's important to reiterate the key takeaways from today's call. We had a record quarter with pricing improving in the Americas, as industry fleet levels returned to normal and strong International volume growth, driven by both commercial and leisure demand, partially offset by lower pricing. Our initiatives to drive profitable revenue growth are proving successful. Our manpower and shuttling initiatives continue to drive efficiencies and lower our costs and we are leading and evolving as the mobility landscape changes.

As I look towards the future, I can't help, but feel optimistic about where we're heading. We still have tremendous opportunities ahead of us to leverage technology to improve our customer experience and lower our cost. We operate in a global industry, benefiting from trends towards lower car ownership and greater car sharing and the growth of middle-class travelers in both China and India where we should particularly benefit from being the only global car rental company operating corporately in these countries.

As one of the largest mobility companies globally with world-class brands and a presence in approximately 180 countries, we are uniquely positioned to capitalize from these secular trends.

With that, we'd be happy to take your questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Chris Woronka with Deutsche Bank.

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

Wanted to ask, maybe if you can give us a little -- maybe a little deconstruction of the quarter and whether things were tracking in line or maybe better than you thought prior to the hurricanes. And then maybe just a little color on the net impact of the pluses and minuses in terms of demand ahead of and immediately following the hurricanes.

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. I think the quarter was actually tracking pretty well. We were having a good summer. Residual values had really stabilized. We started seeing improvements in residual values in July going into August prior to the first hurricane. Obviously, we saw a spike on residual values after the hurricane happened as there was a lot of demand on those cars. But overall, I would say that the quarter was tracking pretty well. Since then, obviously, we've had some residual value improvements that were above and beyond what the marketplace would have endured otherwise. That has kind of -- that has already started to pretty much -- start to wind down, if you will. It's hard to know exactly the inflection point where we're kind of back to normal, but based on the number of cars that we're seeing out there and how fast they're moving in lot of the auctions, we think that, that initial demand has pretty much dissipated by now. And so as we kind of go into the -- I think we're kind of getting back more into a normal period as we're going now into the fourth quarter. What I am encouraged about is the fleet position of the industry. I think is really kind of back to what you would normally see. Obviously, coming out of the summer, you would normally see a fairly large de-fleet in September as people are trying to get out of their summer peak fleet. That didn't happen as the hurricanes caused a lot of those cars to be needed in hurricane environments. So now what you're seeing is that's kind of winding down, you're now seeing more cars being sold at auctions in this month kind of at the end of October and November than what you would normally see just because I think it was delayed 30, 45, 60 days from when the hurricane events happened.

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**Operator**

Our next question is from John Healy with Northcoast Research.

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

Larry, I wanted to talk a little bit more about the data point on the corporate pricing. I was hoping maybe you could kind of talk about the contributors to kind of the stabilization there. And if you think that is kind of reflective of a trend we'll start seeing kind of on a multi-quarter basis? Or was this just a function of kind of the leisure pricing being strong and maybe that raising some of the flipping that happens on the corporate side?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

John, definitely. As leisure pricing, spot pricing raises, those corporate segments that are working off of spot pricing, that obviously raises with it. So that's had a nice impact as we continue to work on the mix of corporate business that we're taking. And so as that continues to be strong, then that will benefit from that. So it wasn't really -- it was a good quarter from a perspective that we finally kind of hit flat year-over-year pricing. The other thing to think about, too, is our length of rental was fairly strong in the quarter. And as you also look in October, length of rental was also very strong. That usually has a negative impact on pricing because the longer the length the lower the rate is per day. So even with that increase in longer length, we ended up with flat pricing. So we've been working really hard on the mix of business that we've been taking and trying to really leverage those customer segments where we might be able to get a better rate per day. Whether that will stand the test of time into the fourth quarter, I don't know. October, I think, commercial is probably going to be down a little bit, but once again, that's -- a lot of that's being driven by the fact that we had very, very strong length of rental in the month of October.

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

Got you. Along those same lines, I wanted to ask about the agency business you had in September with, I imagine the FEMAs and the Red Cross' of the world. Did that weigh down reported pricing in the Americas? As I kind of imagine that's a longer length of rental and kind of works against the RPD metric. And just kind of curious if you could kind of give some color on that.

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

John, it definitely does. It is a longer length of rental business and some of it is -- some of that business is pre-negotiated rates. So that does have -- that will have a drag effect on rate. And I think that the important thing to note about the relief agency rentals this go-around on hurricanes is that the -- the initial business you get from them, obviously, is strong, but it's been winding down fairly rapidly. So you do get a good length of rental, a month at a time. But we're not seeing the 4, 5, 6, 7 month demand that we've seen in other hurricanes or other types of disaster events in the past. And I think a lot of it is the fact that relief workers pretty much got dispersed to multiple disasters across the country and everywhere that those happen, obviously, we lose a lot of our demand early on and we're not seeing the length of the disaster relief staying in those locations for extended periods of time. So already, we're seeing that business kind of wind down.

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**Operator**

Our next question is from Chris Agnew with MKM Partners.

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

Wanted to ask about non-rental revenue in Americas. And if I look at it on a per rental day, it looks like it's been declining this year and in the quarter, it declined about 3% to 4%. I'm assuming that's ancillary revenues and/or Zipcar. So I was wondering if you could shed a little light on that. And maybe in general talk about how that's tracking versus your expectations this year?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. Ancillary revenue has been down this year. You take a look at some of the products like GPS, that just continues to unwind as we go through the year and we've been having that problem for a while. We put new leadership in place around our ancillary revenue and we're working really hard on trying to improve some of the other channels of which we sell it, which is in the script we talked a little bit about the bundling projects that we're doing with insurance products and so forth in Europe, and we'll be starting that this month in the U.S. And the early signs in Europe have been really favorable as far as how much penetration we've been able to get online where we've never offered bundled packages before. So we're seeing more take rate of insurance products in the test markets that we launched in Europe than what we had seen just offering individual products by themselves. So we've got to get more creative as people move to mobile apps and to more online booking, we've got to be more creative about how we get the product offerings out to consumers in a way that they really understand them and that they can take advantage of them for their needs. So that's what we're working on that. Early signs are pretty positive. So we're really hoping that as we roll that out, that we'll start to see some growth in ancillary revenue.

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

And if I could ask you a quick follow-up on prepay. Obviously, you gave some numbers, good growth and prepay in general is good, sort of cancellation fee. But is that, it's obviously at a discount to headline rate. Is that impacting your headline RPD growth? And, do you know what that impact is?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Well, we move our discounts with -- they'll move along with the rates that we're offering in the marketplace. So as spot prices go up when demand is strong and fleets are tight, that will raise the tide of the prepaid as well. But obviously, if more people take advantage of the 5% to 10% discount over sometimes in the year, maybe even a 15% discount, that, obviously, would have a negative impact on rate. But we also save a lot of distribution costs when they come in to us direct and we also save on the fact that these customers are going to show. So we have very, very low no-show rates on this customer base. So we want to grow our prepaid and we just gotten our digital teams, have just done a fantastic job of, not only have we launched these new platforms and improved our conversions so significantly, 70 basis points in the U.S. and in International, the conversion continues to improve on the sites that we've actually launched a couple of years ago. But they've done a lot of work to make the whole prepay process a lot easier and a lot more transparent and clear for our customers. So we want to continue to drive that business and I think net-net, it's just a very profitable business for us.

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**Operator**

Our next question is from Michael Millman with Millman Research Associates.

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**Michael Millman** - *Millman Research Associates - Founder*

Splitting up the commercial into, I guess, corporate and other. Can you talk about the trends in the corporate piece, particularly what National may be continuing to do? And secondly, AutoNation just announced that they have this U.S. deal with Google, seeming in competition or seeming similar to what yours is. Could you discuss what seems to be happening there?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Sure, Michael. So your first question on corporate commercial or commercial business, I think the large commercial accounts will just continue to be very competitive. There has been really no change in the pricing environment there. Those continue to be very competitive and we're going to be aggressive on those accounts, make sure we keep our accounts. But there is other types of business that rolls up into the Commercial segment and there is areas where we just think that we can do better in how we offer our products and how we market to these consumers and how we price our products and so forth. And so we have mobilized more of our sales efforts around those kind of customer segments, and still wanting to protect our large corporate accounts but we are seeing progress in some of the other areas as well as we continue to focus on those segments of the business that can help our profitability. As far as our Waymo arrangement and AutoNation, this is very complementary to what we're offering. We're very excited about the Waymo partnership. We actually launched this month in the locations that we've been preparing. We have been doing some work already early on, registrations and titles and things like that. But now, we start the maintenance activity. Look, they're really looking for AutoNation is to -- they have a desire to want to run their vehicles 200,000, 300,000 miles. So they're looking for someone who could actually provide that other types of services like body repairs to keep the bodies in shape to go that kind of length of life. And so that's very complementary to the type of work that we're doing where it's registration, titling, servicing, maintenance, oil changes, cleaning, positioning, protecting, securing, all the different things that we're doing for them. So it's an extension to those services, and I think they'll be a great partner for them.

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**Operator**

Our next question is from Samik Chatterjee with JPMorgan.

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**Samik Chatterjee** - *JP Morgan Chase & Co, Research Division - Analyst*

I wanted to start off with the International segment and you had somewhat softer pricing there this quarter, or if you can sort of discuss what led to that pricing pressure. Is it sort of a multi-quarter thing that we're looking at? Or is it more something one-off that you saw in this quarter that you expect to sort of moderate in the coming quarters?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Sure thing [Dominic] (sic) [Samik]. So International pricing has been under pressure pretty much all year. And a lot of it has to do with the third tier players that are in most of the markets that have just been aggressive on fleeting this year and have been very aggressive on price. We've seen some higher registrations of new fleet in a number of our countries this year where we've seen the opposite impact in the United States. And so I think that's part of the problem. I also think that just the industry overall hasn't found the right balance of how they're pricing their individual brands, and I think there is just more work to be done there to -- when we look at our brands, we try to make sure that we position our brands in the kind of customer segments that we think they can perform really well in and not try to use our brands into other segments as much as we possibly can. And so I think this is just an industry balancing of how to manage multiple brands in the portfolio that over time hopefully will improve. But I think the third tier companies and there is significant numbers of them, as you know, in International, have been -- have really caused some pricing pressure this year with the amount of fleet that they put in place and then the resulting pricing that they've got in the market. I would say that October, that trend seems to be improving, although still negative pricing in the month of October, it is better than what we did see over the third quarter.

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**Samik Chatterjee** - *JP Morgan Chase & Co, Research Division - Analyst*

Got it. And just a final question, as you were mentioning sort of October trends in International looking good for pricing. What was the -- any color on what the exit 3Q pricing looked like? Or what early sort of 4Q pricing looks like in the U.S. relative to the average for the third quarter?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

I think it's too early yet to really talk about fourth quarter pricing. So as I did mention, October was probably it was down just a tad, probably not -- maybe about 0.5 point. But I think a lot of that was driven by length of rental as leisure on airport pricing was up almost 3 points in the month of October. So still strong demands. Volume was still strong and still good leisure pricing and then I think there is some length of rental and kind of relief activity effects on the rate overall.

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**Operator**

Our next question is from Hamzah Mazari with Macquarie Capital.

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**Hamzah Mazari** - *Macquarie Research - Senior Analyst*

You mentioned competitive dynamics in International and smaller players being more aggressive. Could you maybe frame for us, is there a consolidation opportunity internationally similar to what we've seen in the U.S? Or are there antitrust concerns and maybe the market just is not as right for consolidation? Any thoughts there would be great.

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

No, I do think there is a consolidation opportunity. And we have -- we've tried to help that with the acquisition of Maggiore in Italy and the acquisition of FranceCars in France and recently, Europcar has bought Goldcar and also Buchbinder in Germany. So you start to see it happening and -- but there is obviously, long ways to go before these acquisitions I just mentioned. I think that the other category of car rental companies was about 30%, 35% of the marketplace. So that's quite significantly different than what we have going in the U.S. So there is more opportunity for consolidation and I think you will see that play out over time.

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**Hamzah Mazari** - *Macquarie Research - Senior Analyst*

Great. And just a follow-up question. If we back out the hurricane and we forget about the impact going forward and currently in your business. Are you seeing any structural change or any change in the rental car business from a fundamental standpoint when you look at the fleet, you mentioned the tighter fleet. Is the sector being more disciplined? I mean, it's a very consolidated space that historically has had choppy pricing track record. So just frame for us, do you see things changing on a go-forward basis? Forget about the hurricane, just fundamentally.

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. Putting the hurricane aside, I would have to say the most exciting thing for me is that fleets look to be back to normal, and it's been a long time since we've been able to say that. And that's a fundamental change. We are working hard, as we mentioned before, we're working hard to keep our fleet below our demands. We had a really good utilization improvement in the third quarter of 80 basis points and that's with the effects of the hurricane where we had a lot of our fleet sitting for several days unrented as Florida basically shut down for a number of days. So even with that impact, we had an 80 basis point improvement in utilization. I think it was the best utilization quarter we've had since 2010. And next year, we're going to push for even more utilization. We pulled some cars up from the first quarter into the fourth quarter to sell, trying to tighten up our first quarter even more. And I'm thinking that based on what I'm seeing in the industry that the fleet levels, you got a little noise because of the hurricane and when it hit, when we'd be normally de-fleeting, but I would say the fleet levels are kind of where you would typically see them coming out of the summer peak. And that's really encouraging for me, for us, here as we look at how we manage our fleet and try to get it very tight as well.

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**Operator**

Our next question is from David Tamberrino with Goldman Sachs.

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

Just following up on your 4Q pricing comments. It sounds like you said that October was down 0.5 percentage point in Americas, but leisure is up 3%. Your guidance for the year is down 1% to down 1.5%, Larry. Just trying to understand some of the variability that you could be seeing that would push, I think, fourth quarter pricing between a range of down 1.5% to positive 1%?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. Based on -- just based on our forecast of where we think the business is headed and what we've been seeing, we are encouraged that we'll have a positive overall fourth quarter pricing. I think to kind of hit our guidance, we needed to be somewhere between probably about 0.5 point to up a couple of points. So we think that's doable based on year-over-year impacts, what we were doing in the fourth quarter last year, how those comparisons look this year and the trends that we've been seeing. So yes, we feel pretty good about the fourth quarter and kind of how the rest of the year will end up.

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

Got it. And then just switching gears. You think about your connected car test fleets that you have going on. So when do you think the company can get the full fleet of cars out on rent or within the fleet in a connected status? Is that something that you could aspire to for the end of 2018? Or is that beyond?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes, I think that's going to be more 2019. We expect to have about half our fleet automated with the connectivity next year. We start taking delivery of another 50,000 units towards the end of this year and into the first quarter of next year. But we're also -- we're looking at multiple kind of solutions for this, so that as some of those kind of come to fruition then that would help us go at a faster pace as well. So we are learning a lot. The key was to get a lab going were everything was connected so we could really start changing our processes behind the scenes. And that's finally -- we finally were able to get there this summer. So we have a team on the ground, working every day to look at how do we change kind of everything we do and how we manage our fleet through the technology by having the automation and being able to keep track of our fleet and be able to maximize the utilization of our fleet, the best that we possibly can with this data. So I would say, that by next year, we'll have half the fleet and hopefully by the time we get into '19 and 2020, we'll be able to get most of our fleet done.

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

Okay. And do you have a rule of thumb or a way for us to think about what type of cost savings you can get per car at this point? Or is that something maybe down the road you can share with us?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. I mean, we have lots of ideas and we've got a road map that the team has laid out of the first initiatives that they'll be working on and then managing all the way through it. And, of course, as you get into it, new things come up all the time of new opportunities. And this is kind of an endless road map at this point, which is pretty exciting. So we don't have a number right now because we're just in the discovery stages, but as we put some of these initiatives in place and start to see the benefits, then we'll -- we will have a number that we'll be targeting. We have seen the gas revenue impact as far as the incremental revenue per transaction, and that we've been testing now for a number of years. And we feel pretty good about that number. But now, there is a lot of efficiencies we think we can drive into the fleet and also in how we manage miles across our fleet. And so those will be some of the initiatives we'll be working on in 2018. So it's pretty exciting. Some of the new things we've already started have been really great. There is customer benefits in it as well, some of the initiatives that they've been working on. And I think we just have to kind of let this thing play out and let the team do their work and then we can start to get to numbers as we look into next year.

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**Operator**

Our next question is from James Albertine with Consumer Edge.

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

If I missed it, I apologize. I think I heard you say you're shifting to run slightly tighter into 2018. Can you talk a little bit about the fleet mix, the balance of risk versus program cars and then also sort of cars versus utility vehicles as we think about that running slightly tighter into the new year?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. So we still have a lot of the optimization work going on, on the fleet for next year and how we'll rotate fleet in and out of the different markets and we'll continue to work that through the balance of the year. But overall, I'd say that our acquisition, our buy for the -- 2018 buy did move more -- did move up several percentage points on program versus risk, so we're still buying more risk, but not to the degree that we bought in '17. And now net-net over next year with the risk cars we already have in the fleet, we'll probably move our mix a couple points more towards program, but the purchase was more than a couple points more. It's just how the math works out when you put it over the entire fleet. And we did -- we did move our mix more on some of, what we call, our noncore fleet. So some of the bigger SUVs and more specialty types of vehicles where we can drive a higher revenue per unit as well as residual values tend to be stronger. So the fleet cost may be higher, but the RPU is stronger and the residual value seem to be stronger as well. So we have moved a little bit more towards more of the noncore than the traditional sedans, the core cars that we have in the fleet.

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

Understood. And if I may as a follow-up, if you'll indulge me on more of a strategic longer term question. I guess can you help us understand sort of 2 factors. One, the elevated sort of capital spending levels, you're running about $200 million or so I believe for this year was your guidance. And how many more years of that sort of elevated spending on these initiatives do you anticipate? Or are we on the downslope now? And then if you were to sort of indulge a thought experiment, 5 to 10 years, maybe 10 years down the road, what does your revenue mix look like? Is it something like a Zipcar, maybe a one-way rental people commuting to work sort of opportunity? Is that a 10% to 15% sort of revenue opportunity in the longer term? Or how do you see that sort of shaking out over time if you were to sort of run that hypothetical?

**Martyn Smith** - *Avis Budget Group, Inc. - Interim CFO*

James, it's Martyn. I'll take the CapEx part of that question and hand it over to Larry. So CapEx is running about in line with our depreciation and I think, if anything, it will rise a little in 2018 and into '19, partly for the point Larry was saying earlier about connected fleet. So we've got a large program to bring those cars or to a connected state and that will lift that plus some of the other investments from the technology as well. But expect some CapEx to rise to an extent and then hold around there '18 and '19. Now I hand over to Larry on the second part of the question.

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

It's interesting. As we look at all of our new mobility opportunities, this one that you referred to, I think is a really creative solution that our Zipcar team came up. And it's actually doing already quite well in just the test markets that we put it in. Where we've come up with a product for those people that just don't want to bear the cost of a car, the insurance, the gas, the damage, the maintenance, the parking and particularly in the cities that we've tested and where parking is quite difficult. When they only really need it to drive to work and back and they don't really use their car in the weekend. So we're now offering this product where from 5:00 in the morning on Monday till 7:00 in the evening on Friday, this car is dedicated to you, this spot is dedicated to you, and you pay a monthly fee plus a mileage fee, and you have your insurance and gas included and the parking is guaranteed. We're seeing a really nice response to that product. So it's interesting as we look at new mobility types of products whether it's across the Zipcar space and the car sharing space or whether it's on the rental car side, new mobility is really an important area that we need to get into. How do we offer new mobility solutions beyond the traditional rental car by the day, by the week, by the month, and as well by the traditional hour rental that we see on the Zipcar side? In Zipcar, we launched in London, Zipcar Flex, which is a -- you can take the car, you pick up the car, and you pay by the minute, not by the hour but by the minute, and you can drop the car in any parking spot that the municipality authorizes. That is seeing a big uptick in London. We're seeing a huge growth in members because of it. We've had some of our largest month growth of new memories that we've ever had in Zipcar in London and a lot of that has to do with people really aligning with that product and really wanting it. So these are just a couple of examples of new mobility solutions that we'll continue to take a look at across all of our brands as we go forward. What percentage it is of the total revenue in 10 years? I don't know, but I think we're at the really early stages, so that would just be a guess, but I think it's an exciting opportunity for us, and we're really thinking in those ways of how do we drive more mobility opportunities and solutions for people who now are starting to look for more mobility solutions as they've given up on their own car ownership.

**Operator**

Our next question comes from Yilma Abebe with JPMorgan.

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

Couple of questions from me. My first question is, if you can perhaps touch on your -- both your volume and pricing performance relative to the industry both in Americas and internationally, are the trend lines relative to industry better, worse or in line with the industry on both those fronts, please?

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

I'm sorry, was your question on market share or pricing?

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

Well, both on volume and pricing, which, I guess, the implication being sort of the market share trends. If your volume and your pricing experience in the quarter -- how does that compare with overall industry?

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Yes. Our market share trends, if you go back a number of years, have not really changed. We've been on a constant trend of around 27 -- I think about 27%, 27.5%. And, we may go down a half a point or up a half a point here or there kind of from month-to-month, but our trends really haven't changed. Our pricing I think has been kind of it's hard because everyone has a different year-over-year comparison. But obviously, we're not pricing to gain share and we certainly don't want to price to lose share. We did, in the fourth quarter last year, we did try to hold our prices higher and we did lose a little bit of share and we had to recover that back at the beginning of this year. So -- but other than that, our market share has been basically the same really for a number of years.

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

Okay. So it sounds like there's nothing of note on the market share front this quarter. The second question I had is, you called out in the better fleet cost than expected. Do you attribute that to sort of your company-specific disposal channels or is it mostly driven by, you think, the overall used car marketplace?

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

I think, as Martyn said in his section, that we've been able to grow our alternative channels quite significantly, which does have a positive impact on our fleet cost. I think we moved at least 13 points for the first 9 months of the year and we're about 50% of our fleet that we're selling. We're selling through alternative channels. And we still have a long ways to go there. So they're still -- every month, we just continue to do better as our fleet remarketing team continues to expand our capabilities there and work with our field operations team to do that. We did see a benefit, obviously. Short term, we did see a benefit from the hurricanes. But before that, pricing -- the residual values were improving before even the hurricanes happened. So we felt really good about how things were starting to look in July and going into August. And as I said, I think, pretty much the demand has really plateaued now caused by the hurricanes. And so what we're seeing now is still improvement from what we experienced in the first half of the year. So I think it's a combination of just the market improving. I think a lot of the volume of rental cars that were going to the market in the first half of the year obviously has now worked its way through. We're more into a normal -- a more normal environment than we were in the first half of the year. Not that we don't have other pressures like off-lease vehicles and those types of things that continue to increase as we go forward. But I think all these things together is what's really kind of helped this quarter on fleet cost.

**Operator**

Our final question comes from Dan Levy with Barclays.

**Dan Meir Levy** - *Barclays PLC, Research Division - Research Analyst*

Wanted to follow up on an earlier question. In the Americas, if we take the quarterly price delta and the quarterly fleet cost delta, you applied EBITDA and sensitivities to those, it implies year-over-year headwind roughly a negative $20 million delta. I know that the quarterly relationship is lumpy and it's not perfect, but we've seen this trend for a number of quarters now. So with fleets a bit tighter now, you mentioned they're more normalized and residual showing some stabilization. Any sense on when you think that relationship of price versus fleet cost may flip to being a positive? And given the lag that we've seen between fleet-cost pricing, any sense on the magnitude of pricing recovery because we've now seen a long stretch of sort of heavy fleet cost increases without much price. Wondering if there is a snapback of price that you think can occur? Or if that's just not possible?

**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Well, we certainly hope it's possible at some point in the future. It's hard to tell when that's going to -- when those 2 will cross over and pricing will start recovering fleet cost. We've had as you said 2 years of fleet cost going up and pricing be negative. So -- but as I said, we did see improvement in price in the third quarter. Fleet cost starting to improve. Tight fleets, tightening up and I think that's really the key because I think fleets have to really stay tight to demand for that pricing to be able to continue to increase and continue to grow. But I think also the hurricane has put a little bit of confusion in kind of what was happening in the quarter, and we just have to let that kind of noise settle out and then see how we turn the year as far as how fleets are to demand next year. But if the fleets stay tight, there is no reason why we haven't seen anything going on in the industry that would say that pricing would still be challenged. There was a price increase that went in by one of our competitors a little over a month ago. That price increase was matched pretty well by the industry, and so there seemed to be a response to that in a way that people want to offset fleet cost. So as we go forward, fleet cost continues to be pressured and fleets are tight, then there's, I would think that those yielding opportunities will continue to manifest itself. And that's what Demand-Fleet-Pricing is all about. It is making sure that we find those opportunities and that we can plan for them further out of when our fleets will be tight to demand and how we can then yield our pricing earlier than what we do today so that we can take advantage of that with more of our fleet than what we end up doing today when we're trying to look at it more in a manual environment. And so we're really excited about the 6 markets we've already rolled out with the fully integrated DFP, Demand-Fleet-Pricing, where it is playing off of our -- our new forecasting model on volume as well as in leveraging the forecast of the fleet against that and then doing the appropriate pricing and having us make decisions much earlier in the process so that we have more fleet closer in for a higher volume business, and that's the way it works. And so as long as fleets stay tight to demand, we should be able to recover fleet cost.

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**Dan Meir Levy** - *Barclays PLC, Research Division - Research Analyst*

Okay. And just one quick follow-up. We're now about a year since your Investor Day and you outlined a number of initiatives to grow EBITDA margin, revenue growth fleet optimization, efficiencies. Any sense on the early scorecard on those initiatives, the cadence and the timing to extract those benefits? You think that the challenging environment in used car pricing has changed your approach around those initiatives, whether accelerating them or shifting priorities?

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**Larry D. De Shon** - *Avis Budget Group, Inc. - C.E.O., President & Director*

Well, we have accelerated a number of them and that's how we were able to mitigate some of the impacts of the pricing and residual value pressure that we've had this year. But what we keep everyone focused on is don't worry about fleet cost and pricing. We said at the Investor Day that we thought we could reach those kinds of levels of margin improvement if pricing offset fleet cost. So net-net, it was neutral. Obviously, that hasn't happened this whole year, so that has put pressure on us. While all that's happening, we're working on all the things we said we were going to work on and examples like alternative disposition channels, which have improved significantly in providing us very good return. Our manpower and shuttling initiatives are good examples of that. Our connected car initiatives are good examples of a longer term play of how to drive efficiencies in the fleet and reduce our cost. So we're going to stay focused on all those things we committed to and, obviously, if something were to happen that fleet costs were not offset by pricing, that would be a drag on that goal. But hoping that, that eventually turns its way around, we believe these other initiatives can help us drive those kinds of impact. So we have accelerated some of those this year just out of the -- just with the environment that was going on, the team pulled together and said, we got to move faster in some of these, and we took some risks and did that, and we'll continue to play off those initiatives as we go into 2018.

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**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. - C.E.O., President & Director*

Well, thank you for your time this morning. I hope the enthusiasm we have for our business and the opportunities to lower our cost and drive efficiencies across our business. And further, our leading position in the mobility market were apparent from our comments today. We again have a full calendar of Investor Relations activities planned this quarter starting tomorrow at Deutsche Bank Leisure Conference in New York, 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.