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Avis Budget Group, Inc. (CAR)

Q3 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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.

Neal H. Goldner
Vice President-Investor Relations

Thank you. Good morning, everyone, and thank you for joining us. On the call with me are Ron Nelson, our Chairman and Chief Executive Officer; and David Wyshner, our Senior Executive Vice President and Chief Financial Officer.

Before we discuss our third quarter results, I would like to remind everyone that the company will be discussing forward-looking information that involves risks, uncertainties, and assumptions that could cause actual results to differ materially from the forward-looking information.

Important risks, assumptions, and other factors that could cause future results to differ materially from those expressed in the forward-looking statements are specified in the company's earnings release and other periodic filings with the SEC, which are available on the Investor Relations section of our website at avisbudgetgroup.com. We have provided slides to accompany this morning's conference call, which can also be accessed on our website.

Our comments will also focus on our results, excluding certain items and other non-GAAP financial measures that are reconciled to our GAAP numbers in our press release and in the earnings call presentation.

Now, I would like to turn the call over to Avis Budget Group's Chairman and Chief Executive Officer, Ron Nelson.

Ronald L. Nelson*Chairman and Chief Executive Officer*

Thank you, Neal and good morning to all of you on the call. So let me begin with the headlines. Operationally we had a great record third quarter, both in North America and international driven by strong demand in pricing trends in North America. We had continued growth of the Budget brand in Europe. We realized benefits from phase one of our integrated demand fleet pricing system and we harvested incremental synergies from our Avis Europe, Payless and Zipcar acquisitions.

On the capital allocation front, we repurchased \$60 million of our shares in the third quarter \$70 million more in the month of October bringing our total purchases this year to \$280 million. We increased our share repurchase authorization by an additional \$200 million, not only to give us the capacity we need, but also to highlight the confidence we have in our company, and the long-term prospects for our business. And as important, we announced a significant tuck-in acquisition of our largest Budget licensee holding rights to all of Southern California and Las Vegas. A busy and productive quarter indeed.

So those are the headlines and David will give you more detail in a few minutes. But this morning, I'd like to spend some time talking about the trends that we're seeing in our business, and how they influence, and are influenced by our strategic initiatives. These trends include pricing, demand growth, and fleet cost in North America, record results in our European operations, continued expansion of our Zipcar brand, and our use of free cash flow for both bolt-on acquisitions and share repurchases.

So starting with pricing, on the pricing front, the positive trends that we'd experienced since late 2012 continued in the third quarter. North American pricing increased 3% year-over-year in constant currency with the peak months of July and August up 4%. We again achieved price increases across all of our brands both on and off airport, and in both leisure and commercial rentals. Increased pricing has been and will continue to be a principal objective for us and with seven quarters now behind us, we believe we have demonstrated our company's ability to achieve pricing growth in the market environment that has developed over the last few years.

Our success in growing revenue per day continues to be driven by our efforts to accelerate growth in the most profitable sales channels, customer segments and car classes, as well as the continuation of what we started 24 months ago, consistently leading price increases across our entire book of business.

We are achieving price increases that are highly meaningful to our bottom line, but have a de minimis impact on the overall cost of customers' business trips or vacations. As a result, we have been growing our pricing, while maintaining our share on-airport rental revenues. The critical element in this work has been the first phase of our demand fleet pricing tool, which we have highlighted in previous calls.

Over the summer, we rolled out the first phase of this tool, our yield manager to additional locations including eight of our largest local markets, where we saw immediate benefits. When you consider all the different car classes, and length of the rentals we offer and then multiply that by the number of our locations in days in the quarter, there are literally millions of opportunities to optimize competitive pricing, and our pricing tool accelerates, and streamlines the decision-making process well beyond the capability of manual action.

As a result, our pricing has become more nimble and dynamic and we are now better able to optimize our pricing through the entire product portfolio. The results speak for themselves with leisure rising up 3% in the third quarter, on top of a 2% increase in last year's third quarter. And while this tool focuses primarily on pricing on our leisure segment, our commercial segment also continued the trend we saw in the first half of the year with overall commercial pricing increasing 2% in the third quarter. Possibly the most positive sign of success in our strategy to

drive higher achieved pricing came in our large commercial segment, where we reported year-over-year pricing growth for the first time since 2009.

And while one quarter does not make a trend, I'm encouraged that our efforts to improve returns in our large commercial segment are beginning to bear fruit. Our work is far from done. We continue to believe that the pricing we receive today does not adequately reflect the value we offer to customers or the capital we deploy in our business. With the continued rollout of our yield management system, our ongoing focus on more profitability segments and the industry facing the reality of rising fleet costs, we continue to believe the positive pricing trends that we've been able to deliver in our North America segment still have a ways to go.

Let's move to volume. Another favorable trend has been demand. Over the summer, we saw a robust demand environment both on and off-airport. We grew our rental volumes 6% in North America with commercial rental volume of 5%, and leisure up 6%. To break it down a bit further, international-inbound revenue, our single most profitable customer segment increased 21%. Small business revenue grew 8% with pricing that was more than \$10 a day higher than our average large commercial rates.

Revenue from our higher margins specialty and premium vehicles increased 6% on top of the double digit increase in last year's third quarter, as we continue to expand the size of our non-core and signature fleet. And finally revenue on our local market operations rose 10% led by a 7% increase in volume. Clearly our strategy to focus on growing our volume of general use rentals in the off-airport market is paying off.

We also continued our initiative to move reservation activity toward our higher margin proprietary websites and shifted over 200 basis points more volume towards our proprietary sites in the third quarter alone. This includes not only our websites, but also our mobility apps where revenues generated from this channel have grown over 50% year-to-date. With the growing consumer trends towards mobility, these channels are increasingly important to us and we are focused on staying in tune with these lifestyle changes.

Turning to EMEA, in Europe, we generally experienced what most economists are talking about, macroeconomic conditions that appear to be going sideways. It resulted in softer summer demand than we expected, in turn generating some industry-wide over fleetings, and what followed was not a surprise, the pricing environment that was not terribly constructive. But here is the punch line. We had record results.

Our international EBITDA, which is always paced by Europe in the third quarter, grew 7% to a record \$160 million. Our revenues in Europe increased 3% driven by growth in total revenue per rental day. Our focus on ancillary revenues drove a 12% per rental day increase led by higher insurance in GPS sales. Our continuing initiative to aggressively grow the Budget brand in Europe led to a revenue gain of 17% year-over-year and more than tripled what they were in 2011.

And we're generally starting to see the benefits of the integration synergies we've been achieving. They manifested themselves in a number of ways, a more efficient operation with greater operational readiness every day, incremental synergies from performance excellence, and reduced customer waits by effective use of low cost line-busting technology. As a result of these actions, the contributions from our European operations increased significantly even after we made an incremental \$5 million investment in brand marketing in the quarter, as well as continued investment in new digital platforms. So not quite the quarter we had hoped in Europe, but not one I'm losing any sleep over.

Fleet costs, as we highlighted at a recent investor conference, vehicle residual values weakened in August and September more than typical seasonality would explain. This trend obviously impacted the prices we realized on the 25,000 risk cars we needed to sell in those months and also caused us to adjust the depreciation rates on

vehicles remained in our fleet. Part of the issue was an unprecedented number of vehicle recalls this year. It is our policy to ground a car immediately when we receive a safety recall. So, we found ourselves holding on to more fleet than we normally would have throughout the summer to meet customer demand. This not only impacted our utilization, which was down 160 basis points in the quarter, but also affected the timing of our fleet dispositions.

Certain cars earmarked to sell in the spring when prices are traditionally higher will end up being sold in the late summer and early fall, which is a period when used car pricing always tends to be seasonally lower. These adjustments to our fleet plan were pushing us toward the higher end of our per unit fleet cost guidance for the year at the time of our last earnings call.

The other part of the residual value equation has been the surprisingly strong SAR, along with pent up de-fleeting by our competitors. In a market largely influenced by supply, this has had an impact on used car values as well as trade-ins reduced dealer demand for late model used cars at the same time that the auctions were flushed with off-rental volumes. That phenomenon began to affect used car values over the summer reaching the bottom in September and seem to be stabilizing at September levels throughout October.

David will talk about our preliminary [ph] 2000 fleet cost views (10:42) in a minute, but I think it's important to remember two things. Fleet cost pressures are an industry-wide issue and we have far fewer risk cars than any of our competitors. However, in light of the strong pricing that we've been able to achieve this year, you should expect us to move aggressively to offset somewhat higher input costs.

Let's talk about Zipcar. Let me get back to the record breaking theme for a minute. Zipcar generated more revenue in the third quarter than any quarter in its history. We saw increases in both, usage revenue and pricing, as well as membership, which now stands at over 900,000 members worldwide. We took several steps in the quarter to expand the brand to new markets and to offer more services to our members.

Let me tick some of them off. We began pooling of cars between Zipcar and Avis Budget at over 80 locations with plans to expand over 150 locations nationwide. By adding this flexibility, we're now able to further satisfy more members' needs for wheels when they want them. We launched an innovative program that initially targets some of the world's most frequent travelers the 45,000 members of Southwest Airlines flight crews. We're adding Zipcars at airports and at hotels where crew typically stay and have begun to sign up thousands of new Zipcar members this year due to this affiliation. In September, we made one way transactions available to the more than 80,000 Zipsters in Boston. We're excited to bring this new service to our members and look forward to the learnings that it will provide us as we expand the rollout in 2015.

We also signed an agreement with the GSA to serve government employees in Washington, New York, Boston, and Chicago. We leveraged existing Avis Budget relationships by signing additional corporate accounts to Zipcar to serve their mobility needs. We added Zipcar to 21 additional universities in four new markets domestically including Zipcar in Dallas. And finally, we continued the global expansion of the Zipcar brand opening in Paris in the third quarter in Madrid this month. There is no question, our enthusiasm for the opportunity that Zipcar has to be an ongoing leader in providing safe, cost effective, and convenient mobility solutions to city dwellers, and others continues to grow.

Acquisitions and share repurchases, the last important trend I want to discuss is our use of our free cash flow for bolt-on acquisitions and share repurchases. Earlier this week, we announced that we will be acquiring our largest licensee in North America holding rights for the operation in sublicensing of the Budget brand in Southern California and Las Vegas. This asset has been on our acquisition target list for a long time and is one of the Budget's founding families had held on to royalty free rights to these important markets for decades.

It's a strategic target for us, because LA access one of the largest airports in North America and Southern California as a significant gateway market for a value-oriented brand like Budget, as well as for inbound travelers. As part of this transaction, we will take over and expand Budget's operations at LAX, significantly increase Budget's local market presence in Southern California, and reduce overhead cost, so that we own this asset at accretive EPS and EBITDA multiples. In addition, because SoCal sub-licensees will now be our licensees, this transaction should unlock incremental tuck-in acquisitions opportunities over time although they will be much smaller in size than this one.

This transaction has not significantly reduced our appetite for returning cash to stockholders through share repurchases. We took advantage of the market [ph] and reduced (14:16) pullback in our stock price to step up share repurchases. We bought back more stock in October than in the whole of the third quarter, and more than in any single month in our history in Avis Budget Group.

In the first nine months of the year, we repurchased \$210 million of stock. Earlier this month, we added \$200 million to our existing share repurchase authorization, getting us roughly \$375 million of capacity. In October, we repurchased \$70 million of stock at prices generally below our 200-day moving average. We now expect that our share repurchases this year will total between \$300 million and \$330 million.

Our targeted net leverage ratio remains 3 times to 4 times EBITDA with a focus on the lower portion of that range. Our plans for cash flow deployment continued to be a combination of share repurchases and tuck-in acquisition. The mix will depend on the opportunities available to us, but I do consider us fortunate to have a couple of deals in our pipeline for the first half of 2015 that are both strategically important and financially attractive, and at the same time we have increased our share repurchase forecast for 2014.

Outlook, our progress in all these fronts from North America pricing to a record summer for us in Europe leaves me feeling good about what we've accomplished in 2014 and enthusiastic about 2015. As we announced last night, we now expect North America pricing to increase 2% to 3% this year in constant currency inclusive of a half a point or so headwind from Payless. The positive demand and pricing trends we experienced through the first nine months of the year continued in October with pricing up 3% in the month, excluding currency and rates up across both our commercial and leisure books of business. Pricing on our November res build is also holding positive although we expect demand maybe a little wider in view of the midterm elections and the fact that Halloween following on a Friday effectively gave us another commercial week in October. The December holiday season will clearly be an important period for us as it is every year.

Regarding North America fleet cost, we're fortunate to have sold nearly three quarters of our planned risk car dispositions by the end of July, which insulated a somewhat. We have less than 6,000 cars left to sell in November and December. And since we attended the fleet in November and December primarily with program cars, we're pretty comfortable that the fleet cost guidance we provided last night is about where we're going to wind up for the full year. And at the risk of stealing of some of David's thunder, we do think fleet cost increases we're currently expecting for 2015 are manageable.

So our macroeconomic conditions outside North America and vehicle residual values here at home are presenting us some headwinds. We've considered them in projecting roughly \$100 million of EBITDA growth this year compared to 2013. Across our business, we've continued to drive efficiencies, manage our cost, and focus on more profitable rentals to help mitigate challenges, and to put us in position to deliver record results in 2014.

In addition, we do continue to target \$1 billion of EBITDA in 2015. Now to be sure the path to get there has had its ups and downs since we set this target a couple of years ago, including the absence of an economic rebound materializing in Europe, but we've pushed pricing, managed cost, invested in our business, and relied on our

people to put ourselves in a good position to achieve our \$ 1 billion goal next year, all the things you expect your management team to do. We continue to view pricing as the easiest way to protect and improve margins particularly when there are fleet cost pressures and we think it makes sense to look for both increased pricing, and an increased efficiency in our operations as we turn our attention to 2015.

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

David B. Wyshner

Chief Financial Officer & Senior Executive VP

Thanks, Ron, and good morning, everyone. Today, I'd like to discuss our third quarter results, our fleet costs, our balance sheet, and our outlook. My comments will focus on our results excluding certain items. As Neal mentioned, these results are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

Revenue increased 6% in the third quarter, and adjusted EBITDA grew 9% to a record \$417 million. Margins expanded by 40 basis points, and diluted earnings per share increased by 29% to \$1.91. At the risk of being immodest, we consider our 29% EPS growth in the quarter and 33% EPS growth year-to-date to be significant achievements. Our trailing 12 months adjusted EBITDA now stands at \$862 million, and for those analysts, who compare company margins and valuations based on adjusted EBITDA before deferred financing fees and stock-based compensation, our trailing 12 months adjusted EBITDA would be \$911 million.

Revenue in our North America segment grew 8% to \$1.6 billion making it the strongest revenue quarter ever for North America. Total volume grew 6% in the third quarter, while pricing was up 3% in constant currency.

Ancillary revenue per day increased 7% driven by higher damage waiver and insurance product penetration and our in-car SiriusXM satellite radio service. For the third consecutive quarter, we saw positive volume and pricing in both our leisure and commercial segments. Leisure revenue increased 9% in the quarter, with volume up 6% and pricing up 3%. Commercial revenue grew 7% in the quarter, including a 5% increase in volume and a 2% increase in pricing. And as Ron mentioned, large commercial pricing increased, a trend we hope will continue going forward.

North America adjusted EBITDA grew 13% year-over-year, primarily due to increased pricing in higher volume, partially offset by a 7% rise in per unit fleet cost and a 160 basis point reduction in utilization, primarily due to vehicle recalls. Despite the increasing fleet cost, margins improved in North America for the fourth straight quarter driven by lower direct operating cost as a percent of revenue.

In our international segment, revenue grew 4% in the third quarter principally as a result of the increased ancillary revenues. Excluding currency, revenue was up 2%. International adjusted EBITDA grew \$11 million to a record \$160 million.

Ron already discussed our results in Europe, the Middle East and Africa. In our Latin America, Asia Pacific region, the story is consistent with prior quarters. Revenue increased 4% in constant currency, driven by higher pricing and ancillary revenue gains, partially offset by a 4% decline in volumes.

The main culprit continues to be Australia where economic weakness is suppressing car rental demand. In the third quarter, we elected to remain firm on pricing with our Avis brand and that clearly had an impact on volumes. However, since we've remained focused on profitable rentals growing ancillary sales and managing our costs, our

bottom-line results for the quarter were in line with our expectations. Looking forward, we're going to continue to optimize pricing, fleet and volumes with a focus on profitability.

We're also excited about exporting a copy of our successful new yield management system to Australia. We've already begun the implementation work and look to launch the pricing robotic early next year in both Australia and New Zealand.

In our truck rental segment, revenue declined 5% in the quarter due to the planned decline in our average fleet size. Adjusted EBITDA declined \$1 million in the third quarter driven by higher per unit fleet cost as we refreshed a portion of our fleet. We expect these newly acquired trucks to improve the customer experience we offer and lower our operating costs. More importantly in the quarter, we reached our goal of rightsizing our fleet to approximately 20,000 trucks and while the reduction of our fleet over time has impacted our volumes which were down 5% in the quarter. We've been able to yield up nicely with pricing up 2% and utilization up over 130 basis points and we expect our truck rental segment to again deliver positive earnings growth in the future. I'm particularly enthusiastic about how our packaged delivery bookings are shaping up for the fourth quarter.

Next, I'd like to take a few moments to talk about fleet costs. North America per unit fleet cost increased approximately 7% in the quarter. And as we announced last night, we now expect our full year North America per unit cost to be approximately \$312 to \$315 a month, an increase of 4% to 5% year-over-year. We've experienced incremental cost related to recalls and higher than expected new vehicle sales this year, as well as a greater supply of off-lease vehicles [indiscernible] (22:51) used car market than in the recent past. Against this backdrop, we continued to execute on our plans to mitigate potential pressure from lower used car values. First, we've been increasing our use of alternative disposition channels such as online auctions, direct to dealer sales and our direct to consumer partnership with AutoNation.

So far this year a quarter of our risk dispositions have been through these channels, an increase of approximately 50% compared to 2013 with close to 30% of our cars sold through these channels in the third quarter alone. The benefits of selling cars through alternative dispositions channels can be \$250 per vehicle or more and we expect alternative channels to represent a still higher percentage of our risk car sales in 2015.

Second, we've been cascading fleet to Payless throughout the year. At this point, a majority of Payless's fleet is comprised of cars from Avis and Budget locations enabling us to lower the monthly depreciation on a portion of our overall fleet while still meeting the expectations of our Avis Budget and Zipcar customers. In addition, we're finding some good opportunities to source low mileage used cars for Payless at wholesale auctions.

And finally, we're using our fleet optimization system to enable us to make better decisions about our fleet purchases, rotation and dispositions. The good news is that in the face of record levels of vehicle recalls that required us to re-optimize our fleet to accommodate a significant number of surprises, our fleet management systems have been more valuable than ever. The bad news is that due to the recalls, it's not easy to see the benefits in our P&L in 2014.

Looking forward, while we are smack in the middle of our 2015 planning process, I do want to give you some early thoughts about next year's fleet cost. We've now completed most of our model year 2015 negotiations and we feel good about our ability to source the vehicles we need at prices that are up only modestly.

Generally speaking, we saw better value in program cars relative to risk cars for model year 2015. At this point, we anticipate that risk cars will represent only about half of our North America fleet in 2015 compared to around 64% this year. We realized that the number of off-lease vehicles is going to increase the supply of late model used cars

again next year and we've been working to offset as much of that through fleet optimization and cascading as possible.

So while we're still building our 2015 plan, refining our fleet forecast and evaluating residual value trends, the completion of the substantial majority of our model year 2015 negotiations allows us to know that program car costs are going to increase only a point or two. That allows us to estimate that our aggregate per unit fleet cost will increase 3% to 6% in North America next year, which translates into a 9% to 12% increase from 2013 levels. We'll certainly have better visibility on this topic and more to say about it in February when we report our full year results.

Turning to the balance sheet, our liquidity position remained strong with \$4.3 billion of available liquidity worldwide. We ended the quarter with \$713 million of cash, no borrowings under our corporate revolver, and roughly \$865 million of availability under that facility. We had unused capacity of \$2.7 billion, under various vehicle backed funding programs.

Our quarter end debt balance benefited by \$50 million from the decision we made in 2013 to issue Euro - denominated corporate debt to better match our assets and liabilities. And our ratio of net corporate debt -to-LTM adjusted EBITDA at the end of quarter was 3.0 times. We again took advantage of attractive financing available to us extending our revolving credit facility by \$150 million and extending its maturity earlier this month.

Before I wrap up, I'd like to discuss our expectations for the remainder of this year. As we announced last night, we now expect our 2014 revenues to be approximately \$8.5 billion, a roughly 7% increase compared to 2013, including a 2% to 3% constant currency increase in North America pricing. We now expect total company per unit fleet cost to be \$305 to \$310 per month this year.

In North America, as I mentioned per unit fleet cost are now expected to increase 4% to 5% compared to 2013. We now expect full year adjusted EBITDA to be approximately \$860 million to \$885 million, a year-over-year increase of 12% to 15%. Our 2014 pre-tax income excluding items is expected to be \$500 million to \$525 million. We expect our effective tax rate in 2014 will be approximately 37% and our diluted share count will be \$110 million to \$111 million, including the effect of repurchasing \$300 million to \$330 million of outstanding shares this year.

Based on these expectations, we now estimate that our 2014 diluted earnings per share will be \$2.82 to \$3, an increase of 28% to 36% compared to 2013. We're still expecting our performance excellence efforts to contribute \$40 million to \$50 million of incremental benefits again this year. We expect our cash taxes to be approximately \$60 million to \$70 million. We estimate that our non-fleet capital expenditures will total around \$190 million this year as we take advantage of strong ROI opportunities to reinvest in our business, particularly in the area of technology.

And finally, we expect our free cash flow to be approximately \$415 million this year, absent any significant timing differences. So, to wrap up, we had a record third quarter and overcame some headwinds to deliver this result. North America reported its strongest revenue quarter ever due to growth in volume and pricing. Our international operations achieved their largest quarterly profit despite economic challenges and we increased our total company EBITDA margin by 40 basis points year-over-year.

On the capital allocation front, we see the acquisition of our Southern California licensee and its pro-forma EBITDA contribution is creating incremental debt capacity for us, so does our retirement of \$65 million of outstanding corporate debt on October 1st with the maturity of our convert. We're pleased to have returned \$280 million of free cash flow to our stockholders so far this year in the form of share repurchases and we expect to

repurchase a total of \$300 million and \$330 million of stock this year. We've reduced our diluted shares outstanding by more than 24 million shares since April 2012 through our convertible debt in common share repurchases. And finally, we narrowed our full year 2014 estimates and continued to target \$1 billion of adjusted EBITDA next year.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instruction] Our first question comes from John Healy from Northcoast Research. You may ask your question.

John M. Healy

Northcoast Research Partners LLC

Q

Hi, good morning guys. I wanted to ask a big picture question Ron. In your prepared remarks you continued to indicate that you don't feel like yourself or the industry is getting enough further value that you provide to the customer. I was hoping that you could kind of help us shape that a little bit. I mean ultimately from a return points or from a price point standpoint. I imagine there is a way you think about what the appropriate return on your services should be. And I was hoping you could give us some bigger picture thoughts of what you think that is?

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Well, there is a couple of ways to answer that, John. One is sort of the market – or the customer approach is what I like to think about. And I think people get to an airport and they make decisions based on convenience and price. And when you think about the alternatives, when you get to an airport, it's either a limousine service, or a taxi. The limousine service is far more expensive and a taxi is far less convenient. And it seems to me that when you look at the value that car rental provides and the prices at which we provide it, there should be a significant amount of upside in terms of the pricing that we actually realize for the service.

Secondly just in terms of return on capital, I've said this many times before. It just feels to me like we're a couple of hundred basis points shy in terms of what our return on capital should be given the investments that we make and the amount of capital that takes to drive our business. Everybody measures return on capital in a different way. I tend to look at it what's our free cash flow return on our market equity plus our debt, and it's still a number that's in the mid single-digits and I think it needs to get higher, and we should be 100 basis points or 200 basis points over our cost of capital. And then, maybe a third way to think about it is, look at what's happened to other people in the travel sector. I mean airlines and hotels have increased their pricing significantly over the last few years. There's absolutely no reason why car rental, which is the smallest component of anybody's travel budget shouldn't be able to realize some incremental pricing just solely on the basis of what's going on in the travel sector, so that's my view.

John M. Healy

Northcoast Research Partners LLC

Q

Great and I appreciate that. And just wanted to ask one follow up operational question. You talked about the de-fleeting that the industry had a little bit later in the year this year. How do you feel about that de-fleeting process? Do you think you consider yourself right fledged? Do you think your competitors are right fledged? Just a little color around where you think the environment is today?

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Yeah. It's – I think throughout the third quarter and even through October and looking forward to November, I think everybody is right fleeted. We tend to monitor the number of locations that go on LOR restrictions on a daily and weekly basis, so we know what percentage of locations are shut down or restricted based upon and that only happens based upon fleet levels. And so looking at October and even into the third quarter, all the shut downs would suggest that everybody was right fleeted. And I think it begs the question about the excess fleet that Hertz is rumored to have and I think the conclusion that you can draw from it is that they probably parked a lot of these cars and are really managing their airport fleet with the cars that are simply available to them.

John M. Healy

Northcoast Research Partners LLC

Q

Great. Thank you, guys.

Operator: Our next question comes from Chris Woronka from Deutsche Bank. You may ask your question.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Hey, good morning guys. I wanted to ask you about as we think about recalls this year and then into next year, I mean obviously it was a huge jump this year. Is there any fundamental shift in -- maybe if you look back a long ways and what the typical recall rate has been, I mean is there something going on there where we might expect higher recall levels kind of on an ongoing basis, maybe not this year's level, but versus the long-term historical average. Do you think that rate is trending up?

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Well, I think there is two things, Chris. One is you're right. I mean we had over 140,000 vehicles recalled this year through the end of the third quarter and that's twice the rate at which we had them in last and the year before and the year before was higher than the year before that. So I do think it was out of the ordinary. I think there has been a structural shift in what is a safety recall. A number of the things that we're part of the 140,000 this year would have been campaigns last year, but didn't necessitate grounding of the vehicle.

And I do think going forward that the OEMs will be quicker to pull the trigger on a safety recall just based upon the scrutiny that this is all had over the course for the last eight months or nine months. That being said, I think what we're hoping is that there is some perception that this is – we're in an amnesty period here and everybody is cleaning out their closet for all the things that can possibly be recalls and that next year's level of recalls won't be anywhere quite as significant. I think when you add up all the cars that had been recalled over the past year, there may not be many left out there that haven't been recalled. So the opportunity maybe smaller, but I think we all believe that recalls will be down next year and that this is really just sort of a one-time event, but obviously we can't guarantee that.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Sure. Just a quick follow-up if I can on pricing. Do you see more of an – you talked about some of the large commercial pricing being up for the first time. As we think about next year in the opportunities, is that a much bigger opportunity than leisure, if we kind of try to break down the portfolio on the whole?

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Well, I think in the abstract, yes, it is a much bigger opportunity, because it's gone from being our best business to our worst business, and I think it's at levels that existed in large commercial marketplace now that going much lower is just basically taking on unprofitable business. But I do think it's always going to be competitive. And I don't – we're sort of bouncing around the zero to up a half, down a half place in the pricing scheme in large commercial. So I don't want to get too carried away with it. But my feeling is it just can't go any lower unless you want to lose money on a contribution basis. So look we're going to continue to push for increased pricing. We're not participating in RFPs where there is no service issue. And I think the number as we've reduced we've renewed something like 70% of the contracts this year at flat or better rates. So I'm mildly optimistic and hopeful that we're going to continue that trend.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Okay, very good. Thanks, Ron.

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

Christopher James Wallace Agnew

MKM Partners LLC

Q

Thanks very much. Good morning. Given the fleet cost headwinds in general and from the recall in particular, have you seen any change in behavior of your peers in terms of greater willingness to follow your lead on pricing? What are the sorts of adoption rates you're seeing to your initiatives? Thanks.

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Chris it's still inconsistent. The tone of the market right now is that we're leading with price and enterprise seems eager and anxious to follow, and – but they're generally not following unless Hertz comes along. And from time-to-time, we see Hertz coming along and other times we don't. And look I think all of this plays into the sort of the fleet bubble that's kind of working its way through the system by virtue of recalls and excess fleet. I continue to believe it's transitory that throughout the course of the fourth quarter and the people work their way through and then we'll get some normalization of the fleet market. I think it will normalize at a lower level, because it is a supply driven market and you can't deny that the supply is up, but you know this industry has always been best at getting price, when it had cost driven pressures. So I think that that in combination with the fact that both of our competitors have far more risk cars than we do and a far greater need to get price would suggest to me that pricing will hopefully be more consistent as we go forward.

Christopher James Wallace Agnew

MKM Partners LLC

Q

Thanks. And as a follow up, I just confirm you're not planning on breaking out Payless going forward in terms of, but it's still likely to be a mix drag, and I guess as you add grow Payless and add tuck-ins, is it fair to think that mix drag will kind of be half a point next year? Thanks.

David B. Wyshner

Chief Financial Officer & Senior Executive VP

A

Good morning, Chris. It's right. We anniversaried the Payless acquisition this quarter and we felt it was the right time to re-simplify our disclosures. The Payless effect this quarter is that it added about 1.5 points to our volume. It reduced our pricing by just under 1 point, and I think the volume impact was a little bit greater than it typically would be because last year we had Payless for a 10 weeks in the quarter, not all 12 weeks, so that's what's giving rise to it. I think there will continue to be mix adjustments depending on the acquisitions that we're holding in. Generally speaking though I think they're going to be relatively small and that's why we took the approach we did with respect to the Payless disclosure, but those are the numbers that we have them.

Christopher James Wallace Agnew

MKM Partners LLC

Q

Thank you.

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

Kevin M. Milota

JPMorgan Securities LLC

Q

Hey, good morning guys. I appreciate your commentary on 2015 fleet cost and the reiteration of the \$1 billion target for EBITDA. With the fleet cost in line and the EBITDA target, what's kind of your early view on pricing for 2015? Is it still kind of expected to grow in the 1% to 3% range on a normalized basis? And then secondly, on the yield management systems, what are your expectations and kind of talk about timeline and rollout for phase two and phase three and what the potential benefit could be to the overall operations? Thank you.

David B. Wyshner

Chief Financial Officer & Senior Executive VP

A

Hey, good morning, Kevin. With respect to more details on 2015 and pricing in particular, I think we're going to wait until February when we have our full year results and go through our 2015 projections in detail to go into that. We are clearly enthusiastic about the continuation of the trend we have been seeing of price up 2% to 3%. And we do – as Ron alluded to, we do view fleet cost pressures as being a reason for us to continue to try to push pricing in the future. Beyond that and with respect to any particular numbers, we're going to wait until February.

Kevin M. Milota

JPMorgan Securities LLC

Q

Okay. And then on the yield management system benefit?

David B. Wyshner

Chief Financial Officer & Senior Executive VP

A

Sure. And then, on the DFP system and yield management, we ramped up from a very small number of markets using the pricing robotic to about 110 markets currently over the course of the first nine months of the year. And so we'll have the benefit of starting 2015 with a 110 markets, or more. And so we'll get an anniversary benefit solely from the robotic in the first half of next year, which we think will be helpful.

We're making progress toward our forecaster and expect to be able to combine that with the integrated demand fleet pricing module in the second half of next year. I think it will be helpful in the second half of next year, but I'm not expecting it to have a large impact on our results in the second half of the year.

I do think with respect to the pricing robotic and the yield management tool, the benefits that we'll get in 2015 aren't just the anniversary of the rollout in the ramp up. It's also that using the tool as much as we have this

year and getting more experience with it is making us better able to derive value from it. And so I do think it will have an incremental benefit in 2015 even after we anniversary being at a 110 markets.

And the last element I want to mention is that given the success we've had with the pricing tool, we are accelerating the rollout of it in Australia and New Zealand and into Europe. And I think, as I mentioned earlier, the rollout to Australia and New Zealand should have a positive impact beginning in the spring, and we're looking to get Europe up and running as soon as possible in 2015 as well.

Kevin M. Milota

JPMorgan Securities LLC

Okay. Thanks a lot, guys.

Q

Operator: Our next question comes from Afua Ahwoi from Goldman Sachs. You may ask your question.

Afua A. Ahwoi

Goldman Sachs & Co.

Thank you. Good morning. So, first on the pricing front. Can you remind us what is the as-reported pricing number, especially North America given the Canadian dollar has been a headwind and probably will be again in 4Q? So, how does the 2% to 3% number you've mentioned on the constant look on an as a reported number?

And then separately in international, I guess, I think I was at least frankly a little surprised that maybe the volume didn't grow, at least wasn't flat given some other gains in market share that you indicated in the past the Budget has been making. So does that imply that the core has softened materially more? And what do you expect in the out years, or is the Budget gains more moderate now, given it's been around for a while now? Thank you.

David B. Wyshner

Chief Financial Officer & Senior Executive VP

Sure, Afua. The foreign exchange impact in North America was around a half a point in the third quarter and that's really a half point negative and that's really where it's been running throughout the year in each of the first two quarters and probably will have a similar impact in the fourth quarter as well. So that's where the impact there.

With respect to Europe, I think the way you're looking at it makes sense. We are continuing to grow Budget volumes. They were up in the high-teens in the third quarter. And where the economic weakness and some industry-wide over-fleeting showed up is in our overall volumes. And so you could see that Avis gave up a little bit of volume to get to our overall numbers, and we really attribute that based on what we're seeing to economic weakness that was there in Europe in the third quarter.

Ronald L. Nelson

Chairman and Chief Executive Officer

Yes. This is Ron. There are couple other considerations too to take into account. You shouldn't judge the ability of Budget to grow by the third quarter. We yield Budget up fairly significantly in the Southern region during the third quarter, so it's not going to have the same capability to grow in the 20% to 30% range and actually into the 40% that it grew in the first half of the year.

A

But we continue to believe at least for the next three to four years that Budget is going to grow in the 20% to 30% range. We're actually adding a fairly big block of Budget licensees in one of our bigger territories over the course of the next couple months. They will drive the volume fairly significantly.

And then the other thing is that there are few things that affected volume over the summer months. One clearly was the World Cup. There is no question that it had an impact on volumes, but I think the other thing that affected it, volumes were short in Italy and Spain and markets where you didn't actually think they were, and our sense is that our competitors – it wasn't lost on our competitors how well we did last year in those markets. And I think they all flocked up to try and grab some of the business that we took last year in those markets.

And so, I think the combination of the World Cup and the increased fleet drove what manifested itself as fairly tepid volume in those markets, but we still did quite well in those markets over the course of the summer, so I don't want you to take away that there was some sort of serious economic issue that affected the ability to harvest the summer peak in those markets.

David B. Wyshner

Chief Financial Officer & Senior Executive VP

A

That's exactly right. We're bringing some of the tools that we've used in North America to focus on profitable transactions to Europe as well. And so, what you're seeing is in some areas some submarkets we may have given up some volume and I think that was all part of our strategy to focus on profitability, and it's how we were able to achieve the record results that we did in Europe.

Operator: Our next question comes from Fred Lowrance from Avondale Partners. You may ask your question.

Fred T. Lowrance

Avondale Partners LLC

Q

Hey, good morning, guys. Just wondering and looking at fleet cost, what you can tell us about the 2014 fleet cost guidance? If you can sort of parse out the impact of recalls versus just maybe normal market changes in terms of what's happening to residuals here lately. How many points or whatever are related to recalls?

And then, sort of along those lines, when I look at the 3% to 6% increased target guidance for fleet cost in next year, have you done anything to maybe put in a little bit of a cushion for maybe after this year having more historically elevated levels of recalls? Obviously nothing like this year, but maybe taken a little bit more conservative approach to what that normalized recall run rate might look for you?

David B. Wyshner

Chief Financial Officer & Senior Executive VP

A

Sure, Fred. As we think about fleet cost this year, we really do view the increase in our fleet cost guidance range, which had been \$300 to \$310 and now it's \$312 to \$315 as being essentially all due to recalls and the disruption they've created both in the used car market and our ability to adhere to the optimized fleet plan we've started with this year. And as a result, we do think the recalls had a significant impact in the movement upward from, call it, the midpoint of the range where we started to the midpoint of the current range. So we attribute that to recalls.

As Ron mentioned and I agree, I think recalls should moderate a bit in 2015 because of the pent-up elements that were released in 2014, but I also expect that recalls will be at a higher level in 2015 than they were historically, because of the sensitivity and scrutiny in this area. So to put together 2015, I think one of the biggest best buffer that we could put in place would be to increase the percentage of program cars we have in our mix, and I think the

plans we've been able to adopt, the ability to make a fairly sizable shift for us of north of 10 points in the program component of our fleet does provide us with some buffer to be able to manage fleet cost in an environment that's had a bit more volatility than over the prior 18 months. So that's sort of the thinking that goes into the forecast of a 3% to 6% increase [indiscernible] (55:25) fleet cost in 2015.

Fred T. Lowrance

Avondale Partners LLC

Q

Okay. And with that fleet cost guidance in mind, can you just, either one of guys, Ron and David, just give us a sense for how the path to your \$1 billion-plus in EBITDA for 2015 has changed since you first introduced that target. Obviously, it seems like pricing running a little bit hotter, fleet costs are obviously a little bit higher, and also curious to know how these tuck-in acquisitions like your Southern California licensee purchase, how maybe that pipeline has changed and given you more confidence in that \$1 billion target over the last few months?

Ronald L. Nelson

Chairman and Chief Executive Officer

A

Yes, well, Fred, I think that historically we've used somewhere around a 2% to 4% fleet cost accelerator when we built the model to get to \$1 billion of EBITDA. So, obviously, if we're at 3% to 6%, we've got some headwind there that we've got to make up somehow. I think the components of what's going to get us there are still the same. It's the continue to harvest the synergies from the acquisitions. It's the continued benefit that we're going to get from demand fleet pricing.

I think overall pricing is going to play a greater role in it now than it would have before, largely because we've got to overcome some cost pressures. And the \$1 billion was made without the impact of considering the Budget acquisition, so it will be disingenuous for me to tell you that that's part of the \$1 billion target, but nonetheless we will go a long way towards hitting our revenue and EBITDA targets in Budget. It's a property we know well and it should integrate fairly smoothly I think. So, I'd like to see it add to the \$1 billion target that we get, but we'll issue guidance in February and you will get a better sense of where all this fits together.

Fred T. Lowrance

Avondale Partners LLC

Q

All right. Thank you.

Operator: Okay. And we're running out of time, so that will be our final question. And for closing remarks, the call is being turned back to Mr. Ronald Nelson. Please go ahead, sir.

Ronald L. Nelson

Chairman and Chief Executive Officer

So, before we close, I just think it's important to reiterate what I believe were the key points from today's call: one, we expect 2014 to be a record year driven by healthy industry dynamics as evidenced by strong volume and pricing in North America; two, we continue to focus on pricing as a key lever in our business, whether it's to offset input cost increases or to drive margin improvement or both. three, we're achieving the incremental synergies from our acquisitions of Avis Europe, Zipcar and Payless; and lastly, we continue to return cash to our shareholders through share repurchases.

We do have a full investor calendar this quarter beginning with the Northcoast Best Ideas Conference next week in New York. I hope to see many of you during our travels. With that, I want to thank you for your time and interest in our company.

Operator: And this concludes our conference. You may disconnect at this time. Thank you.

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