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CAR - Q2 2017 Avis Budget Group Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 results. Expects 2017 revenue growth to be 2-3% and adjusted EPS to be $2.40-2.85.

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

Hamzah Mazari *Macquarie Research - Senior Analyst*

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

Michael Millman *Millman Research Associates - Founder*

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

PRESENTATION

Operator

Good morning, and welcome to the Avis Budget Group Second Quarter Earnings Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the meeting over to Mr. Neal Goldner, Vice President of Investor Relations. Please go ahead, sir.

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

Thank you, Sean. Good morning, everyone, and thank you for joining us. On the call with me 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.

Important risks, assumptions and other factors that could cause future results to differ materially from those expressed in the forward-looking statements are specified in the company's earnings release and other periodic filings with the SEC, which are available on the Investor Relations section of our website at avisbudgetgroup.com.

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

We believe that our financial performance is better demonstrated using these non-GAAP financial measures. And now 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. Last time we spoke, the industry was over-fleeted and the pricing environment, difficult, but that finally started to change in June. In fact, as we look back at the second quarter, I'm hopeful it will be recognized as the time when industry fleet levels normalized and pricing began to improve.

As you know, the second quarter is normally a period where industry fleet levels are seasonally elevated relative to demand. But that effect was much more pronounced this year as one of our competitors worked to rectify their over-fleeted situation. This imbalance created a difficult pricing environment for much of the second quarter and added additional pressure on fleet cost. However, we started to see an inflection in pricing in June as industry fleet levels began to tighten up, enabling us to take advantage of more yielding opportunities than we've experienced earlier in the year. This drove a significant improvement in pricing starting in the middle of June, and that improvement continued through July and into early August.

In July, pricing increased more than 1 percentage point in the Americas with leisure pricing up just over 2.5%. But the story on fleet cost is a little bit different. While used car values did stabilize moving into the second quarter, the market became more challenging as the quarter progressed. This was exasperated by a higher-than-normal volume of rental cars being disposed in the quarter putting further pressure on fleet cost. And with us selling 35% of our total risk-car sales for the second quarter, this had an amplified effect on our per-unit fleet cost. However, in July, our car sales performed better than expected, and we were able to sell a few more cars in the month than we planned for, leaving us with relatively few cars to dispose of over the balance of the year. Martyn will talk more about all of this in a few minutes.

Meanwhile, in the face of these near-term headwinds, I'm really proud of how our team pulled together and identified additional cost savings opportunities of $25 million to improve operational efficiencies, bringing our 2017 savings to $75 million that will help offset some of the margin pressures that we are facing this year.

Before I turn the call over to Martyn, to discuss the quarter and our updated guidance, I wanted to point out how excited I am about all of the new innovative growth initiatives we've announced already this year. From launching Zipcar Flex and expanding our leading car sharing brand into Taipei, to enabling Avis customers to transact with us through Amazon Alexa and Google Home, to the new features and functions we've added to the Avis mobile app and to our partnerships with RocketSpace and Waymo, which significantly boosted our mobility efforts. I'll have more to say about these initiatives in a few minutes, but first, let me turn the call over to Martyn, to discuss our second quarter results and full year guidance.

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

Thanks, Larry, and good morning, everyone. It's a pleasure to be here in my new role as the Interim CFO. Just by way of background, I was previously the Finance Director of Avis Europe, a U.K. publically traded entity, that before its acquisition, had licensed the Avis brand outside of the Americas. And then worked for Larry for a number of years as CFO of what became the International region of Avis Budget Group. I started here on the 4th of June.

This morning, I'm going to discuss our second quarter results together with our fleet, cash flow, liquidity and our outlook for 2017. My focus will be on adjusted results, which are reconciled to our GAAP numbers both in our press release and in the earnings call presentation slide deck available on our website.

As we reported last night, significantly higher fleet costs of Americas and lower pricing, net of early benefits from cost-reduction initiatives, were the main cause of our second quarter adjusted EBITDA being $64 million lower than the prior year at $140 million. Revenue for the total company was essentially unchanged from the prior year as a 5% increase in global volume was offset by correspondingly lower rates per day.

So turning first to the Americas. Revenue was down in the second quarter year-over-year due to 4% lower pricing mitigated by a 2% increase in volume. Inbound rental days increased 5% and leisure volume was strong, being up more than 6% in the quarter, while commercial volume decreased nearly 4% year-over-year on more muted levels of activity. Rate per day for our leisure and commercial rentals were each lower by similar amounts.

Utilization was largely unchanged, as we kept our fleet in line with demand in the quarter as we prepared for the summer peak.

As Larry mentioned, we saw industry fleet levels begin to tighten during June, leading to an improved pricing environment, and that improvement has continued into the summer.

In terms of the full year 2017, for the Americas, we now expect a 1.5% to 2.5% increase in rental days with rate per day lower by 1 to 2 percentage points. We have realized considerable gains through the early stages of our manpower planning initiative with another 8% increase year-over-year productivity.

Likewise, shuttling is another initiative that has continued to produce impressive results with the key metric of shuttling cost per transaction being 4% improved in the quarter.

Turning now to fleet. In the Americas, fleet costs increased nearly 10% in the quarter to $344 per unit per month, reducing adjusted EBITDA by $40 million. While we did see the used car market begin to stabilize at the end of the first quarter, the underlying pressures from both increased used vehicle supply and higher new car incentives continued to impact used car values in the second quarter.

This dynamic, coupled with the significant increase in used rental cars hitting the market, put additional stress on prices achieved. Our exposure to these factors was magnified in both the first and second quarters due to the large proportion of risk cars we disposed in that period.

By the end of June, we had sold nearly 70% of the risk cars we planned on selling this year compared to 65% last year, and we had sold more than 75% by the end of July with the recent disposals at slightly better values than we had anticipated.

Being [well advanced] clearly lowers our exposure to any further potential adverse movements in used car values. Across the whole year, we, therefore, now expect per-unit fleet cost in the Americas to increase between 7% and 8%.

We plan to continue our aggressive push to dispose of all vehicles through alternative wholesale channels such as direct to dealer where we can achieve $250 to $400 benefit for every car we sell in addition to reducing the time [for loss] rental for sale by about a half. We are also selling more cars directly to consumers where the benefit is at least $1,000 per vehicle.

We sold 48% of our risk cars through alternative channels in the second quarter compared to 39% in last year 's second quarter. And across the whole of the first half, achieved more direct-to-dealer sales than all of 2016. We intend to drive this trend further as we continue to invest in our vehicle remarketing strategies.

Our fleet team now has better than ever decision-making support processes, and we've taken advantage of this by selling a few model-year '17 cars early again with better-than-expected results. While used car market conditions have clearly been difficult, our team is utilizing more and more science, data and analytics than ever in their decision-making. Such developments have helped inform this year's purchases.

Our negotiations for the model-year '18 buy are now substantially complete, and we expect the model-year '18 purchase prices to be a couple of percentage points lower than the prior model year. Also, we presently intend to purchase fewer vehicles compared to model-year '17 and as a consequence, plan to run our Americas fleet a bit tighter in the second half of this year as well as into 2018, benefiting from the utilization improvement.

Now turning to our International segment where we benefit from our broad geographic spread of business. Revenue grew 4% in the second quarter or 6% in local currency, reflecting an 11% increase in rental days, of which the France Car acquisition generated 6%.

Our European and Asia Pacific regions each grew underlying volume by about 5%. The benefits of this strong volume was partially offset by 3% lower local currency rate per day, reflecting both the prevailing competitive market conditions and France Car having a slightly lower rate per day.

We achieved strong leisure volume growth in both Spain and Scandinavia and a rebound in corporate demand in Australia and the U.K. In France and Germany, there was pricing pressure throughout the quarter, but our rate per day improved in the U.K. as we exited some of our less profitable businesses.

Inbound volume was also strong in the quarter growing some 6%.

International adjusted EBITDA, up 14% in local currency and 4% as reported, was driven by the organic revenue growth, the acquisition and integration of France Cars, strong cost initiatives and the benefits from Easter falling in the second quarter this year, partially offset by a 3% increase in local currency per-unit fleet costs, given that we had fewer gains on disposal in the quarter compared to the prior year. The adverse exchange translation effect was $6 million.

For the full year, we now expect International volume to grow between 10% and 12%, with roughly half coming from organic growth and the balance from the acquisition of France Cars.

International rate per day is expected to be 1% to 2% lower on a reported basis or down 3.5% to 4.5% in local currency, while fleet costs are expected to be in the range of 1% to up 2% on a reported basis and 3% lower to flat year-on-year in local currency.

Moving now to cash flow and our funding position. We generated $397 million of adjusted free cash flow in the first half of the year. The timing of our vehicle programs had a significantly positive impact from this free cash flow and which is expected to reverse in the third quarter. This is further reinforced by a strong focus on working capital management in the second quarter and resulted on a relatively high cash position at the quarter end of $776 million.

Just as a reminder, we also had very high cash at 31st of March of $923 million. In that case, due to the timing of note offerings in quarter 1 that we used to redeem other notes early in quarter 2.

Looking forward, we expect spending on [normal fleet] cash CapEx and cash restructuring costs both to be proportionately higher in the second half of the year. The cash generated by our seasonally stronger earnings in the second half is, therefore, expected to be offset by all these timing effects.

Over the full year, we expect our cash taxes to be $55 million to $75 million, and cash restructuring costs will be approximately $50 million. We expect our non-fleet CapEx to be around $200 million this year.

Consequently, for the full year, we now expect adjusted free cash flow to be approximately $350 million, absent any further significant timing differences and reflecting our updated earnings projections.

In terms of CapEx, more than half of this will be spent on technology including growth initiatives, such as connected car, our integrated Demand-Fleet-Pricing revenue management system and the momentum we are now gaining with mobility.

Moving now to our funding. Our liquidity remains strong with some $3 billion of available liquidity after meeting our funding needs for the seasonal peak, and with none of our $3.6 billion of corporate debts maturing before the year 2022. The lower earnings, our net corporate leverage of 4x remained at the high-end of our targeted range of 3 to 4x, but our leverage for covenant purposes was lower at 3.8x, nearly a full-term below our current maximum leverage ratio of 4.75x.

We bought back 3.4 million shares being 4% of our shares outstanding with an average price of $29 per share, and that's a cost of $100 million in the first half of 2017. And we now intend to repurchase $200 million to $250 million of shares across the whole of the year.

And now to the outlook. And as we look at the remainder of the year, we have updated our estimates to reflect year-to-date performance as well as our current expectations for the balance of the year. These revised estimates reflect the difficult market for used cars in the Americas through the second quarter together with our updated expectations for Americas fleet cost for the balance of the year. The impact of the poor international pricing environment is broadly offset by the benefit of additional cost reduction actions we've taken to mitigate this effect.

So to pull this all together, we expect our overall revenue growth to grow 2% to 3% this year, and we expect our 2017 adjusted EBITDA to be between $725 million and $775 million. This reflects our plan to now take $75 million of operating and administrative costs out of the business in the year.

We estimate that currency will have a $15 million to $25 million positive effect on revenue and a $20 million to $25 million positive effect on adjusted EBITDA this year.

We have provided a slide in today's presentation that sets out the effects of currency movements with the half -- for the year by quarter based on recent rates. We estimate that normal fleet depreciation and amortization, excluding acquisition-related amortization, will be in between approximately $205 million in 2017. We expect normal fleet interest expense to be in between $195 million and $200 million this year.

We estimate our non-GAAP effective tax rate to be approximately 36% in 2017, and as a result, our full year adjusted EPS will be between $2.40 and $2.85 per share.

In summary, second quarter fleet costs and pricing, both more difficult than we expected, and our updated projections for the full year reflect this. But we don't think the second quarter performance was indicative of a long-term potential for our company. Our results were impacted by continuing over-fleeting of industry in the first half, which appears substantially reduced by the end of June. We have recently seen an improvement in pricing in the Americas. And with more than 75% of our risk-car sales completed by the end of July and our strategy to sell even more of our cars through alternative disposition channels going forward, we have limited our exposure to further changes in the used car market in the second half of the year.

In the midst of a difficult operating environment, our people stayed focused on what they could control, while also finding an additional $25 million of cost savings and efficiency opportunities that will help offset lower international pricing.

We will continue to aggressively manage our expense lines, while still investing in longer-term growth opportunities. Our strategic initiatives are generating benefits that would translate in higher margins, earnings and free cash flow in the years ahead of us, which we will use to enhance shareholder value.

And like Larry, I'm very excited by the strategic partnerships we signed during the quarter with RocketSpace and Waymo.

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

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

Thanks, Martyn. Before we move to Q&A, I think, it's important to reemphasize the steps we are taking to transform the profitability of our organization for the long-run. Pricing and fleet costs will do what they're going to do month-to-month, and we're certainly working hard to manage through them. But despite the short-term difficulties, I am particularly proud of the progress our team has made on many of the initiatives that will help us to reach our goal of getting to 13% to 15% adjusted EBITDA margins.

Starting with profitable revenue growth. We've achieved significant advancements in our key initiatives to drive profitable revenue, specifically with regard to our industry-leading Demand-Fleet-Pricing revenue management system and the continued enhancements of our websites and mobile platforms.

We have already realized benefits from the earlier phases of our new revenue management system, particularly the pricing robotic. The fully integrated system is now live in a few select markets, and we will roll it out across the Americas throughout the remainder of the year and into 2018.

We previously talked with you about the success of our new Avis web and mobile platforms, which launched in late 2016 and we have realized similar results from the new budget platform. Conversion improved by more than 100 basis points on the new Avis website in the quarter, and the new budget website, which launched in March, is experiencing similar improvements. The streamlined user experience and the Pay Now function on our new sites has driven a double-digit increase in prepaid rentals. These enhancements have created an easier, more customer-friendly reservation experience and we expect they will continue to drive an increase in direct bookings.

Turning to mobility. As we discussed during last November's Investor Day, the mobility landscape is changing, and our strategy to remain a leading provider of diverse mobility solutions to meet customers needs is evolving with it. We've been working towards that strategy with quiet intensity since that presentation. Initially, we have been assessing the areas in next-generation mobility where we can find new business opportunities and model for growth and value. Within those areas, we have been identifying initiatives to begin testing and exploring, all with a focus on meeting 4-key innovation objectives.

The first objective is significantly improving and differentiating our customers' digital user experience by embracing new technologies, platforms and consumer behaviors, which is what the Avis mobile app is all about. Self-service functionality in our new Avis mobile app has now been enabled in more than 175 locations globally to date, and we have completed more than 600,000 transactions with more than half of customers that have used the app using it multiple times, cementing our position as the industry leader in next-generation car rental experiences.

And just last month, we added major updates fueled by customer feedback that provide renters with even more options and more resources while on the road. Enhancements such as a larger variety of vehicles to choose from, being able to identify nearby fuel and parking locations, the ability for customers to track the closest Avis shuttle bus right on the app as well as the estimated time of arrival of the bus and the new Find My Car feature that works with connected cars to show our customers the exact location of their car should they forget where they parked.

We also introduced Zipcar to Taipei in the quarter, our first Asian location. And we went live with Zipcar's Flex product, which is currently available in select markets in the U.K., allowing us to offer Zipsters a full suite of products, be it round-trip or floating, depending on their needs. And we're expanding our pilot with Uber in Boston to supply Uber drivers with cars through Zipcar. And just last month, we announced that Avis is now integrated with Amazon Alexa and Google Home, allowing travelers to book and manage car rental reservations through these popular voice platforms. With our mobile apps and now Alexa and Google Home, we are providing customers with yet another way to engage with us seamlessly.

Our second objective focuses on finding new and innovative ways to leverage our global presence, capabilities and assets as the owner and operator of a multi-branded and multimodal mega fleet. In my opinion, nothing illustrates our progress better than our recently announced partnership with Waymo, the autonomous driving division of Google parent company, Alphabet, to offer fleet support and maintenance services for their self-driving car program in Phoenix, Arizona.

Under the multiyear agreement, we will enhance select rental facilities to offer automotive services, including interior and exterior cleaning, oil changes, tire rotations and the checking, ordering and installation of automotive parts as well as other necessary fleet support and maintenance. This collaboration also furthers our strategy of being the premier provider of fleet support and supply chain services globally for the whole range of today's and tomorrow's mobility solutions.

The third objective is clarifying the immediate and long-term operational economic benefits gained from utilizing connected cars and for managing truly connected fleets. That's why I'm so excited about the launch of our first connected city this month. Completely outfitted with connected cars, we will use this as a sort of lab to help us better understand the efficiencies of a fully connected fleet and help identify additional opportunities. This information will help to evolve our fleet management capabilities and provide scalable economic benefits and efficiencies based on the number of connected cars moving forward. Understanding the intricacies of the technology and how to effectively manage a fleet of connected cars will position us very nicely for the future of mobility.

And our fourth objective is creating new partnerships that accelerate our knowledge, insights and early opportunities in the emerging and disruptive new mobility products. We've made progress on this front with our recently announced partnership with RocketSpace, a leading accelerator for startups. Through this first of its kind mobility tech accelerator program, we will get to work together with mobility startups to have a product end-market or are ready to launch. As the only rental car provider in the program, we are accompanied by BP, Magna, Allstate and IBM. Our participation in the RocketSpace Accelerator, positions us at the forefront of innovative and potentially industry-changing advancements in mobility tech, enhancing our strategic initiatives and maintain our competitive advantage in our industry.

In summary, the second quarter saw similar challenges to that of the first. Pricing was unusually weak due to industry fleet levels, and used car values remained relatively soft in the Americas. However, we were encouraged by the data we were seeing as the quarter progressed, showing new car registrations by the car rental industry down more than 15% year-to-date. Coupled with the strong leisure demand we've seen since the beginning of the summer season, this led to higher year-over-year pricing in July in the Americas with August showing a continuation of this trend. This has given me optimism that the industry issues we've been contending with over the past few years, should finally be behind us.

Meanwhile, our teams around the world are focusing on the multiple transformative cost savings initiatives that will lead us to sustainably higher margins in the long run. We have begun to rollout the final phase of our new integrated revenue management system that we believe is the first in the industry that can make both dynamic pricing and fleet recommendations based on the available demand. We've restructured our sales team to focus on our most profitable customer segments, increased our emphasis on cross-border sales and are more aggressively calling on customers and segments that are disproportionately more profitable.

We're utilizing larger amounts of data to become even more meticulous in our approach to buying and selling vehicles, we started to deploy sophisticated technology to increase our field productivity to drive efficiencies globally. We're focusing intently on building our connected car fleet and employing the many operational benefits, this technology has to offer, and we're modernizing the car rental experience to meet customer needs as well as leveraging our existing core competencies to play a major role in the future mobility. It's this and more that makes me enthusiastic about our future.

With that, Martyn and I will be happy to take your questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris Agnew from MKM Partners.

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

To what extent are you seeing length of rental restrictions being put in place at the moment relative to your expectations? And if different, do you think it's more on the demand or the supply side that...

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

Thanks, Chris. I think, the length of rental restrictions that we would normally see at this time of the year are about normal. We started seeing them expand kind of in the back half of June, as we've gone into July, the lengths of rental restrictions, as far as the number of airports putting those in place, have been fairly robust, which has been a very, very good sign for fleet levels as we've gone through the summer. So I think, I would say that July is kind of where we would normally be.

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

And on fleet cost, thanks for the color on the model-year '18 buy, does that benefit second half fleet costs? And if so, how much of that is baked into guidance? And given that you've got some color on the fleet buy, are you able to provide any outlook for fleet costs heading into 2018?

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

I think, we've got a lot more work to do as it relates to model year or to full '18 fleet cost. There'll be minimal impact really in the '17 model year as we're not taking deliveries of that many '18s in the back half of the year. So really, the fleet cost for '17 really reflects the losses that we've taken so far for the year in the first half. And then the depreciation adjustments that we felt that we needed to make on the '17 model year fleet as it goes out throughout the rest of the '17 and goes into '18.

Operator

Our next question is coming from Hamzah Mazari for Macquarie Capital.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

The first question is just on pricing. Is there any reason to think that pricing would decelerate in the second half? I know you didn't change your price guidance, so the down 2% basically implies that pricing is flat and not sort of up as you've seen in July and August. It also implies commercial pricing doesn't follow if you are down 2%. So just trying to get a sense of, is this just conservatism or is this just -- you have low visibility there? Any color would be great.

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

Thanks. As we've said, our July leisure pricing was strong at about 2.5%. As we look into August, we see some strong weeks in the month of August with positive pricing leisure still being strong. Corporate improving a bit in August so far in reservations holding. So if you take a look at our pricing guidance overall for the year, it really comes out to be positive, almost a point in the back half of the year. So there is some positive improvements that we have baked into our assumptions. I think, what's important is that we want us to see fleet levels come down as we go into the fourth quarter and make sure that we get back to a normal de-fleeting process that the industry will go through after the summer peak is over with and to see those levels come down nicely as they should going into the fourth quarter.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Great. That's very helpful. And just second question. Just around industry structure, are you guys seeing any change in behavior from the other 2 competitors versus history? I know in this sector, the fleet is sort of 100% variable and you de-fleet and refleet and investors have to worry about capacity in line with demand every year. But just curious if there's any structural change you see in the marketplace as you look at your 2 largest competitors.

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

I think, the structural change really happened in the second quarter with the massive de-fleet that occurred throughout the second quarter by the industry, particularly 1 competitor who worked very hard, it appears, to get their fleet in line by June. So, that to me, was a structural change from what we had been experiencing. So now we're into the summer and the summer fleets are tight. We're seeing length of rental restrictions in many, many markets as you would normally see in the summer, where we used to be years ago. And then hopefully, we will look for a normal de-fleeting activity as we go into the fourth quarter. So no, I'm not seeing anything other than the de-fleeting that had to happen in the second quarter that looks like it got really right-sized by the mid-part of June. Otherwise, I think, things look normal. As we said, as we look at our '18 buy, we're actually going to buy fewer cars going into '18, as we're going to push drive utilization up. And also, reflecting the fact that we're a higher risk-car fleet now than we were a year ago, and therefore, those cars have longer holding periods, so we don't have as much churn of fleet in the -- overall. So that means we'll be buying less overall. So combination of higher risk percentage and also trying to push utilization as we go into 2018.

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Operator

We're showing no further questions in queue at this time (Operator Instructions) Our next question is coming from David Tamberrino from Goldman Sachs.

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

So couple of questions related to fleet in the back half of the year and then into next year. Judging by your comments, it sounds like your competitor de-fleeted in the second quarter and looking at your average fleet, you're still up, I think, 2.6%, 2.7% year-over-year. Should we read your comments to believe that [2 8 17] fleet for Avis should be flat to down year-over-year? And then further into 2018, should we be expecting some de-fleeting in order to keep utilization tight?

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

Yes, our utilization in the second quarter was flat with last year. As you take a look at where we're positioning our fleet as we're going through the rest -- the remainder of the year, it's basically really flat to slightly up just a couple maybe 10 or 20 basis points or 30 basis points, not much at all. And so then as we push for next year, as we go into next year, our goal will be to try to drive higher utilization year-over-year. We also have some flex in our fleet as we go through the remainder of this year, so we always try to look at how much flexibility we have upside and downside, though the volumes don't materialize to the point we'd like them to. We want to make sure we keep our utilization improving as we go through the balance of the year, though we have some downside opportunity as well if we need to take more fleet out.

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

Okay. Got it. And then for your model-year '18 purchase prices, I think I heard during the prepared remarks that you said it's going to be lower year-over-year. How much of that is a function of just lower like-for-like purchase prices? How much of it is a lower potentially ASP mix? And how much it is from -- moving from a program car to a risk-car?

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

It's overall like-for-like, is the metric that we gave of being down 2 points is really the like-for-like models.

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

And is that just from the excess inventory that OEMs have on the dealer lots today? What's kind of driving that 200 basis points lower year-over-year? Is it a switch from the D3 to Japanese brands? Maybe you should provide a little more color as to how you're achieving that.

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

I'd say, basically, the program costs were down compared to the 2017 models.

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

Okay. And just lastly from me with your digital strategy, as you think about continuing to get that in the consumer's pocket and onto their phone, you think about some of the, maybe, competing, I know it's only 1-day rentals and 75 miles or less, but when you think about an Uber, they've rolled out basically a cancellation fee if you cancel that ride within, I think, it's 5 minutes or so. Do you think that over time, you might put in a cancellation fee within the digital app if someone were to show up at a location and decide not to ultimately rent through you? Maybe it's $5, maybe it's $15, what it is, but at least it gives the consumer a little bit more of an incentive to not walk away from that rental?

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

I think, what we're really focused on is pushing our prepay, which has very low no-show rates. And we've grown our prepaid rentals on our dot-coms fairly significantly this year. We're up about 13 points, I think, year-over-year. So that's a huge movement. And it's the work that our team has done developing the new platforms, both on the mobile apps as well as on the dot-com. As far as non-cancellation rates are concerned, I think, that's something that we would address based on kind of where the industry might go in the future. We've looked at it in the past, but it was -- moving forward with it, would not have ended up being competitive in the market place. We do have them in Europe and that's -- it works in Europe, but we'll just have to watch how the industry looks at that in the future.

Operator

Our next question is coming from Mr. Chris Woronka from Deutsche Bank.

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

I appreciate all the data points you've given out. I want to ask you, you mentioned pricing starting to get better towards the end of June, better in July. That kind of overlaps with the industry and your competitor fleeting changes. Is there, in your kind of experience, is that kind of the normal trajectory of when you might begin to see pricing? Or do you think, there's a little bit more of a lagged effect? And, maybe, as we begin to think about fourth quarter, it plays out as you expect from a capacity standpoint? Do you think that there's more pricing gains to be had?

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

Chris, as you know, it all depends on fleet levels. So as we look at what pricing opportunities there might be in the fourth quarter, it will really depend upon how the fleets are managed going into the fourth quarter. So we've been prudent as we've looked at what we are forecasting our pricing to be in the fourth quarter. And if fleets tighten up more than that, more than what we're assuming, then there could be some pricing opportunity. I would say that as we looked at June going into July and August, maybe a bit delayed than normal, but not much. And I think, in the July, August period, we're kind of seeing the normal activities. We have kind of a strange event this year, which is driving higher pricing in one specific week, in the week of August, and that's all around the solar eclipse. And those markets were -- is driving quite a bit of rental activity that week, and so the pricing was very strong in that week. But otherwise, I would say the trajectory is pretty normal, maybe, just a bit delayed getting going.

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

Okay. Great. And then on the shuttling and manpower initiatives, I know those are kind of long-term things, but as we think about OpEx for next year, do you think we see a discernible kind of flow through on those two?

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

Yes, I would say, we'll continue to build on our success with both of those initiatives. We've been working really hard, the teams have been working really hard on this, and the field is really organized around this. We've had some good benefits this year already between the 2, about $40 million of benefits between manpower and shuttling combined. So we'll continue to try to build on top of that. What will help a lot is that we're just now rolling out the new technology that we have been working on for about the last year or 1.5 years as it relates to how we plan our manpower, really down by the minute, if you will, 15-minute increments throughout the day and days of the week. That's now going out at all of our major airports, and that's providing a lot of insight for our management teams in the field to really be able to move their manpower to where we most need it and not have it in places when we have valets and we don't need the resources there. So that will also help as we go forward.

Operator

Our next question is coming from Dan Levy from Barclays Capital.

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

I think, we can appreciate the commentary that the pricing trends and fleet levels are improving. But if I just take the implied back half guidance for fleet cost and pricing, I think, it implies your fleet cost is up roughly 7 points give or take: price up 1.5, both at the midpoint. And if I apply the EBITDA sensitivities to that, let's say just run that run rate for the year, it still tells us that the net of fleet costs less pricing is still a net negative. Now I know that's just a limited period, but to your comments from earlier, which I suppose one may be able to interpret that fleet cost and price over time will be a net loss, what piece of this dynamic do you see changing that will ultimately help to create more of a net neutral between the variables?

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

Yes, thank you for the question. I think, this is such an anomaly year with so much fleet that went into the marketplace to be sold, particularly, in the second quarter. And then as we went through the second quarter and had the results that we had on lost on sale, then our models will tell us then that we need to make adjustments in our depreciation rates on the fleets that we're holding and the inventory of fleet as we hold it throughout the rest of the year and into next year. So what you're seeing, I think -- you're absolutely right. Fleet does not -- or pricing is not offsetting fleet costs in the back half of the year. Those depreciation rates have been changed going forward. But I think what will change it over time, and this is always delayed, in particularly, it's going to be more delayed after kind of the events that we have been facing with how fleets have been oversupplied in the marketplace. So, I think, it will, overtime when fleets return to kind of normal levels, normal seasonal demands, normal shoulders, normal peaks that we've had prior to last 3 or 4 years. And that just all depends on everyone getting their rotations right by market, rotating out their fleets, peaking up when they peak up, coming back down when they come down, getting back to the normal routine of how our market has always conducted over the years, always operated. So, I think, as we turn the chapter on this and we get into the normal periods, then I think that's when pricing will start to really catch up with fleet because fleets will be tighter to demands more often throughout the year, which will cause fleet or cause pricing opportunities to manifest itself.

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

Okay. It's appreciated. And just a follow-up. You're sitting at 4x net debt at the end of the second quarter and then you mentioned that it's the upper end of the historical guided range. And then in the past, I think, you can appreciate that earnings have seen a nice boost from M&A and buybacks that I see in the guidance that you've reduced your buyback range. Could you just comment on how to think of the M&A and share buyback activity on a go-forward basis? Is it possible you may take a slightly more conservative approach on this given leverage levels or concerns around cycle risks or any of those things?

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

Yes. It's Martyn, Dan. They kind of fit hand-in-hand. It's difficult in my first -- as you know, I've only been here 2 months or so, but that's the main area of focus. I'm just trying to ensure we have a really balance and line of sight into the relationship, as you rightly say, in free cash flow, the share buyback program and then leaving some -- essentially, space for tuck-in acquisitions and then working that through in terms the way it fits with the maximum leverage debts as well. So I feel pretty comfortable with where we are in this guidance, and I think, it sets quite a good tone going forward as well. So, I think, it looks pretty good at the moment in terms of the balance between the various moving parts we've been through our guidance today.

Operator

Our next question is coming from Yilma Abebe from JP Morgan.

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

My first question is on the fleet debt on ABS side. Given the current environment of the fleet costs, are you seeing any increase in required enhancement levels?

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

No, we're not at all.

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

Okay. And then my second question is on sort of pricing. Can you comment on some of the drivers of, the weaker commercial pricing, as you compare that to leisure, what are the puts and takes there?

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

As you know, our significant amount of our commercial business, our corporate business, is contracted. So those contracted rates are what they are as you go through the year. I think, about 60% and maybe, more. It's about 60% of our commercial business is contracted. And then into the second quarter, if you take a look at the non-contracted commercial business, it's going to work off of the spot rates of what we're offering in the marketplace. And, of course, pricing was down fairly significantly in the second quarter, which then caused those corporate noncontracted pricing to be down as well. So -- but then that started to improve as we went into July, so the corporate contracted is going to stay the same, but the noncontracted started to improve fairly significantly. And actually, I think, in July only down about 7/10 of a point. So as fleets once again tighten up and we start yielding up noncontracted commercial business will yield up along with that as leisure does as well.

Operator

Our next question is coming from James Albertine from Consumer Edge Research.

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

I wanted to ask, if I may, on your disposal channel -- the alternative channels of disposal that you've talked about in the past. If you could provide, and I apologize if this was in the prepared remarks, I got disconnected for a moment. But if you could provide an update on sort of where you stand as a percentage of your disposals, but which part -- what percentage is going through alternative channels? And then to the extent you can quantify the benefit of the alternative versus traditional channels of disposal, that would be great.

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

Yes, we've made a lot of headway this year on trying to increase the percentage of our fleets that's disposed through alternative channels, and this is basically our internet sales to dealers or direct-to-dealer sales and then also work that we do with other fleet sellers in the marketplace that are online like TrueCar, Vroom for example. And also, we sold a number of cars to Uber this past quarter. And so we've increased it in the first half, I think, about 13 points from last year to this year, and we'll continue to try to grow that. The good thing about the back half, now that we've got probably close to 78% of our risk cars sold for the year, that gives us a lot of flexibility as we look at trying to drive more across the alternative channels than -- and increasing that percentage versus the auctions. In the first half, where you have a lot being sold, you're going to sell in the auctions as well as sell in the alternative channels. But in the back half, we have a lot less to sell now, just about 22% from August on and that allows us to be a little bit more selective in how we're selling the cars through the remainder. So we should continue to drive our alternative channel sales higher. On the direct-to-dealer, we benefit anywhere from about $250 to $400 benefit, and that's primarily saving auction fees and other disposal costs, shuttling cost and so forth. And then when we get to direct-to-consumer, which is still a very small percentage for us, but growing, we've sold actually a lot more cars in the first half this year than we did last year on the direct-to-consumer side. And that's about at least $1,000 benefit for every one of those cars we sold direct-to-consumer.

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

Okay. Very good. I appreciate that color. If I may, just ask a strategic question. With every quarter, we appreciate the details that you provide in the prepared remarks on the slides and release, on your digital initiatives. As we think about specifically the partnerships potentially with -- growing partnerships with Waymo and some of these sort of ride-sharing, ride-hailing autonomous technology service fleets, should we think about this more from a fleet management perspective as being the key contributor to your P&L over time? Or is this something more with respect to you providing vehicles for their fleets? I'm just trying to understand kind of where the monetization is going to come from ultimately. And if you're willing to put -- at this point, I understand you might not be, but a broad range of when these digital strategies will be sort of manifested in your bottom line EPS from a material contribution perspective? Is it the 2020 or 2025 sort of outlook, that would be helpful.

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

Yes. I think, it's early yet to be talking about kind of how much contribution fleet management as a service will make for our company over time. It's certainly an area that we're focused on, an opportunity that we've been able to successfully conclude with Waymo. We're at the very beginning stages of our Waymo partnership. They've been terrific to work with, and we're looking forward to what we're going be doing for them in Arizona. And it is on the fleet management services side, if you will, so we'll be doing interior cleaning, exterior clinic, oil changes, managing defective parts for them, replacing parts and so forth, storage of the vehicles, protecting the vehicles and host of other things. And as that partnership hopefully grows, we're certainly open to discuss anything else from a fleet management perspective that they would like for us to do. And we're also taking a look at other opportunities to provide fleet management as a services going forward. As we talked about many times in the past, that as the industry moves closer towards autonomous vehicles, one of the things that's our core competency, and we're one of the very few companies in the world that can do this and we do it in 180 countries, is manage mega fleets. And whether the car is autonomous or driven, someone has to buy these cars and in-fleet these cars, register these cars, fix them, maintain them and dispose of the cars and make sure that they're everywhere they need to be at the right time and ready for the customer. And we do that at massive scale. And so that is a true core competency of this organization and something we're going to look to leverage as we go forward. So, I think, still early stages, and as we get more opportunities to do this for more companies going forward, I think, then we'll have a better feel for its overall contributions to the company as we go forward.

Operator

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

Michael Millman - *Millman Research Associates - Founder*

Could you give us an idea of your conversion rate compared to, say, hotels, airlines? Kind of looking for what kind of upside you might have and when you might start achieving more of it.

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

Yes. Michael, we don't really compare conversion rates to other companies, because I found that trying to do that, everyone measures it slightly differently. And so we just focus on our own base and trying to improve our own base. On our own base, 100-point improvement is quite remarkable actually, and Avis was actually slightly higher than that in the first half. And so that's pretty exciting for us to have a conversion improvement like that, and there's still a lot of upside for us to go forward as well. There's still many enhancements we'll be making to the website. There's a whole long list of new innovations that our digital team are looking to put onto the website, and onto the mobile apps as well. So those will just continue to evolve to get better and better as we listen to what customers tell us. They really want to see more in these apps and on our dot-com. So we're real pleased with the conversions, but it's really almost impossible to try to compare it to any other companies.

Michael Millman - *Millman Research Associates - Founder*

Would you say it's in the very early days of starting to use more AI to improve conversion and we can look for a lot of upside in 2 years, 5 years?

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

Yes. I would agree that there's good upside in the next 2 to 5 years as technology improves and there's other opportunities to bring enhanced technology into it. And, like I said, we've got a team that's focused on that with a long list of things they want to do, most of which are either to just improve the experience overall, but many will also improve conversion. It's something that our team is really focused on. We've got all sorts of ways to test through multivariate testing, ways in which to improve it to see what happens to conversion. So we're constantly running those tests all the time. So yes, we've got a lot of upside in it. We're excited about it. And I think, as technology develops, it will bring more opportunities as we go forward.

Operator

Our final question comes from Yilma Abebe from JP Morgan.

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

One quick follow-up from me. You obviously talked a lot about sort of the industry fleet levels in this call here. Can you talk about perhaps the risk that even if fleet levels are aligned, that you may still see above-average competition on the pricing side, any 1 or 2 competitors being aggressive on the pricing side even if the fleet levels are more aligned with demand?

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

Yes. I just haven't seen that. What we tend to find is price increases in the industry seemed to hold when fleets are aligned, and they do don't hold when fleets are not aligned. And I've said over and over again, that in this industry, it's really hard to get price increases when the industry is overfleeted. But when the industry is fleeted properly to demand, then the yielding opportunities, particularly, as you get close in to our booking window, really start to manifest themselves. So I would say that I've not seen anything that would tell me that there's anything different happening from what I can watch in the marketplace. We're in a tight fleeted situation now, normal fleeted situation for summer, we're in the summer peak and we're getting improvement in pricing, and I suspect that will continue as we go through the summer. And then as we -- as the industry right sizes, hopefully, in the fourth quarter, to where they would normally do, then that will give us opportunities in those peak periods throughout the fourth quarter as they hit. So no, there's really nothing different that I can see.

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

Okay. Before we close, I think, it's important to reiterate the key takeaways from today's call. Second quarter was more difficult than we anticipated, driven by higher fleet costs in the Americas and lower pricing, and we've updated our full year projections to reflect this. Pricing started to improve in June in the Americas and has continued into the summer with July pricing in the Americas up more than 1% year-over-year. We have identified additional cost-saving opportunities. We now expect these actions to generate $75 million of benefits in this year alone, and we're making good progress on our long-term strategic initiatives highlighted by our partnership with Waymo to provide fleet management services for their autonomous vehicles in Arizona. We have a full calendar of Investor Relations activities planned this quarter starting tomorrow at the JPMorgan Auto 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

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

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

Those have been concluded, so thanks, everyone.

Operator

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