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Avis Budget Group, Inc. (CAR)

Q3 2015 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, Rhea. Good morning, everyone, and thank you for joining us. On the call with me are Ron Nelson, our Chairman and Chief Executive Officer; Larry De Shon, our Chief Operating Officer; and David Wyshner, our Senior Executive Vice President and Chief Financial Officer.

Before we begin, I'd 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 adjusted results, which excludes 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 on our website.

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

Ronald L. Nelson
Chairman & Chief Executive Officer

Thanks, Neal, and good morning. Well, it wasn't easy, but we delivered record earnings in the third quarter with both our Americas and International segments contributing to our growth. We were up against a tough year-over-year pricing comp and significant headwinds from currency exchange rates, but we took advantage of a reasonably good leisure demand environment, particularly in Continental Europe, and leveraged the stable and supported used-car market in North America to deliver the highest quarterly earnings in our company's history.

And at the same time that our teams throughout the world were working feverishly to serve customers, accommodate our summer peak, and intelligently manage our cost structure, we used $161 million of cash to repurchase 4% of our outstanding shares in the quarter at an average price of $43 a share. We would like to think we worked both hard and smart this quarter, and our results give me confidence that 2015 will turn out to be the most profitable year in our company's history.

If one wants to search for the soft spots in our record earnings, let me help you. Commercial demand in North America and the overall pricing environment globally continued to be a bit softer than we would've hoped. Pricing in the Americas rounded to flat in constant currency; so did our commercial growth. With most of the fourth quarter being driven by commercial travel and recent pricing trends likely to continue, we've adjusted our range to $900 million to $925 million of adjusted EBITDA. David will go through all of the details of the quarter in a few minutes.

Despite this, I do think that there is a lingering underestimation of the attractiveness of our industry. To my way of thinking, first, we offer an essential service that is difficult to displace and largely price inelastic, particularly on airport; and, second, ours is an industry where demand is reasonably predictable, volume typically outpaces economic growth, and where we have inventory flexibility that few other industries offer.

And as it relates to our company, three things to consider: absent currency issues, our earnings would handily be in the $950 million to $975 million range, some 10% to 11% greater than 2014, even with the volume and pricing challenges we've encountered this year; we do generate substantial free cash flow well above our annual capital needs; and finally, we have only begun to harvest the significant opportunities in front of us to improve all aspects of our business through the use of technology. I firmly believe that our best years lie ahead of us.

As I'm sure you read, in January, I will become the company's Executive Chairman and Larry De Shon will take over the responsibilities of CEO. Having announced that decision, I felt that this was an appropriate time to look back at how far our company has come over the past several years, where I believe it's going, and introduce you to the person who will lead our team there. My goals when the board appointed me CEO back in 2006 were three-fold: to build a world-class management team; create a sustainable long-term strategy for profitable growth; and deliver strong returns to our shareholders.

These goals were interrupted in the first 24 months when we found ourselves in the middle of the worst economic crisis that we and our industry had ever faced. To be sure, that was a difficult time, but we emerged from it much leaner and stronger with a four-pronged strategy which became the foundation for operational excellence, continuous improvement, investment, and growth. Our four pillars, as we call them, have driven our actions since 2010.

First pillar is to strategically accelerate growth. It's not enough for us just to grow the topline; we have to do it intelligently. You've heard us speak many times about the areas of the business that drive outsized profitability, such as International-inbound and non-core car classes. Over the past several years, we've focused our efforts on several areas where we have been able to identify above-average opportunities for profitability and the results have been impressive. For example, revenues from International inbound customers have grown more than 50% since 2010; revenue from non-core vehicles have more than doubled over that time; and ancillary revenues, which drive very significant incremental margin, have grown 45%. Yet we still see significant upside opportunity for the foreseeable future as we remain the only company with two truly global brands.

The second pillar of our strategic plan is to expand our global footprint. We continue to believe there are significant opportunities for growth and attractive returns on capital in geographies that are less concentrated than our home market. You've seen us execute against this strategy through a combination of large, medium, and small acquisitions over the past few years, the centerpiece of which was our 2011 acquisition of Avis Europe. That acquisition immediately transformed us from a regional car rental company to a global player of significant scale, and we've continued to grow our European reach through various tuck-in acquisitions, including this year's acquisitions of Maggiore and our Scandinavian licensee, while organically expanding the Budget brand across Europe.

In the process, we've realized significant synergies by taking costs out of the business and we believe there are further opportunities to strengthen our operating margins in Europe as the economy begins to show some improvement. Our acquisition of Zipcar, which made us the clear leader in car sharing, also expanded both our footprint and our business model, giving us a substantial presence in meeting the evolving mobility needs in cities and on college campuses, providing us with a new set of future growth opportunities.

The third pillar of our strategic plan is to put the customer first. In both the B2C and the B2B2C components of our business, winning and retaining loyal customers is critical. So among the various initiatives we have launched are: investing in a broad range of vehicles to meet customers' needs; consistently offering a low mileage well-maintained rental fleet; training our counter agents to help identify and satisfy customer needs for ancillary products and services; and vehicle choice for customers who want it.

We continuously ask our customers for feedback about what we're doing well and where we need to do better. Just this past summer, we launched a completely new Avis loyalty program. And future actions will be even more impactful. We are investing in self-service technology that we believe will transform how many of our car rental customers transact with us. This same technology will also deliver the efficiency of having a connected car infrastructure, driving millions of dollars of utilization and maintenance benefits.

Our final pillar is to drive efficiency throughout the organization. We have leveraged our cultural tendency to control spending carefully into a strategic asset to drive margin expansion. As part of that initiative, we've generated tremendous benefits from our Performance Excellence process improvement initiative, identifying and replicating best practices across our entire global organization. And while Apex has already made a nine-figure contribution to our annual earnings, it's still driving tens of millions of dollars in incremental savings each year.

Since we developed and implemented our four-pillar strategy in 2010, our revenues have grown by $3 billion, our adjusted EBITDA has more than doubled, our margins have expanded more than 250 basis points, and our adjusted earnings per share more than tripled. We believe we are on the right track with more work for us to do and more opportunity for us to seize.

In that context, I, along with our board, think now is the appropriate time for a group of seasoned executives that have been groomed to lead this company in the future to take hold of the reins. As I mentioned, Larry De Shon will become our new CEO effective January. Larry is the former head of our U.S. operations, former President of our International segment, and our current Chief Operating Officer. Between his time at United Airlines and with us, he has more than 35 years' experience in transportation services and he brings a world-class understanding of our operations to his new role. We are fortunate to have such a strong internal candidate to serve as our next CEO.

As Larry moves into his new role, David will become the company's President while continuing to serve as Chief Financial Officer. Company veterans Joe Ferraro and Mark Servodidio will head our Americas and International segments, respectively, and Scott Deaver will serve as our global Chief Marketing Officer, which represents an intentional shift from approaching marketing from a regional perspective. I'm convinced that this is the right team to help drive our company to new levels of prosperities.

With that, it's my pleasure to introduce Larry De Shon.

Larry D. De Shon

President, Chief Operating Officer & Director

Thank you, Ron, and good morning, everyone. Let me begin by saying how excited I am for this new opportunity and for the future of Avis Budget Group. I have been fortunate during my time with the company to have responsibilities that have allowed me to meet our employees from all corners of the world, and I can tell you with absolute certainty that we have an amazing team. From the experience of our senior management team, many of whom have been with the company for more than 20 years, to the passion of our employees in the field, one thing remains consistent around the globe: our employees' commitment to excellence. And it's an honor to be chosen to lead them.

I echo Ron's sentiments about the significance and sustainability of our strategic plan. I was one of the architects of the plan back in 2010 and have had the opportunity to see its applications, both in the United States and across our international operations. It was the right plan five years ago and it's the right plan now as we look to the future.

I firmly believe there are substantial opportunities that lie ahead of us for continued growth. While the next 5 years to 10 years will have new challenges, there will also be exciting opportunities for us. I, for one, am particularly excited about the impact that emerging technologies will have on our business. We have been making significant investments over the past several years, including in our demand/fleet/pricing tool in connected car and self-service technology, and at Zipcar in order to ensure that Avis Budget Group remains a technological leader in our industry.

I also believe we still have substantial opportunities to lower our costs to deliver the high-quality service our customers expect of us. We've made significant strides over the past few years in the acquired Avis Europe business and I know Joe has been just as focused in the Americas segment. And under David's leadership, we launched our Transformation 2015 project last year and it is delivering significant benefits. Nonetheless, I think we still have substantial opportunities to optimize our global cost structure and drive incremental efficiency.

I'll have more to say about our strategies and tactics and focus in coming months, but you should expect to hear the following themes emerge. First, our strategy is not changing. We will continue to execute against our strategic plan with the same energy and determination as ever, particularly as it relates to technology initiatives, which I believe are the future opportunities for our business, both in improving the customer experience and reducing our operating costs.

Second, we will fight for increased realized pricing in both rate per day and higher ancillary revenues and fees, all the while focusing on the opportunities we can control. We will ensure we capture every yielding opportunity, shifting the mix of business across more profitable channels, managing the mix of our fleet to capture revenue per unit opportunities, improve our production capabilities to deliver right car to the right customer. Third, we will strive for operational excellence and providing an outstanding customer experience, which are interdependent, not mutually exclusive. And fourth, we will continue to generate cash and deploy capital for the benefit of our shareholders.

Finally, and importantly, I want to thank Ron for his many years of service and leadership. He has successfully guided this company from spin-off through the Great Recession to what is poised to be another year of record earnings and cash flow, and I'm very excited and honored to be chosen to succeed Ron to lead this company into the future.

With that, it's my pleasure to turn the call over to David.

David B. Wyshner

Senior Executive Vice President and Global Chief Financial Officer

Thanks, Larry, and good morning, everyone. Today, I'd like to discuss our third quarter results, our fleet, our balance sheet and cash flow, and our outlook. My comments will focus on our adjusted results, which exclude certain items and which are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

We had a record third quarter with the highest reported quarterly revenue and adjusted EBITDA in our company's history. Revenue grew 1% in the quarter and was up 8% in constant currency, reflecting both organic growth and our acquisitions. Adjusted EBITDA increased 3% on a reported basis and 13% in constant currency. Our trailing 12 months' adjusted EBITDA is $904 million, and for those analysts who compare company margins and valuations based on adjusted EBITDA before deferred financing fees and stock-based compensation, our 12-month adjusted EBITDA would be $56 million higher, or $960 million.

In our Americas segment, trends in the quarter were generally consistent with our first-half results. Revenue grew 2% with rental days up 4%. Leisure volumes were solid, increasing 6% overall. Commercial volumes were unchanged. Adjusted EBITDA increased 1% and 4% in constant currency. Margins in our Americas segment declined 10 basis points in the quarter, due in part to the cost of our newest marketing partnerships. The margins benefited from 6% lower per-unit fleet costs and remained strong overall at over 15%.

Our strategic initiatives to grow disproportionately in our most profitable customer segments and channels continued to deliver results. In particular, International inbound volume remained resilient, increasing 6% in the quarter despite the strength of the U.S. dollar. Demand for our non-core and Signature fleet, including BMWs, Mercedes, Cadillacs, and other premium vehicles, grew 10%. High-margin ancillary revenues increased 6% in the quarter in constant currency and we continue to shift reservations to higher-margin channels, including our mobile apps, which saw volumes grow 47% at Avis and over 85% at Budget.

Pricing in the Americas rounded to flat in constant currency and rate per day at our flagship Avis and Budget brands in the U.S. increased a fraction of a point year-over-year. This small increase represented a sequential improvement from the second quarter and emerged despite a difficult comparison with last year, when pricing for Avis and Budget in U.S. was up 3%.

Overall, leisure pricing increased 1%, while commercial pricing declined 2% in constant currency. Our local market operations continued to perform well. Importantly, industry fleet levels were generally in line with demand during the summer, indicating that the industry over-fleetedness that characterized late 2014 and the first half of 2015 may be subsiding. And in September, one of our competitors initiated a price increase effective for the fourth quarter, which means that each of the three largest competitors in our industry has initiated at least one price increase over the last six months.

In our International segment, revenue was unchanged on a reported basis in the third quarter, but it grew 17% in constant currency. Volume was up 23% with the acquisition of Maggiore contributing 11 points of that growth. International pricing declined 3% in constant currency, partly due to the inclusion of Maggiore this year, but total revenue per day increased 1% in the quarter, excluding Maggiore. Adjusted EBITDA grew 6% on a reported basis, but was up 27%, excluding a $33 million negative impact from currency movements. Just over half of our International EBITDA growth was organic and just under half came from acquisitions.

As we mentioned previously, we had a good summer across Continental Europe, consistent with our expectations. We saw strong growth in Portugal, Spain, and Germany in the quarter, driven by a combination of commercial and leisure demand. We also saw robust leisure demand in France and Italy with volumes up double digits in both of those markets.

Our Maggiore operations exceeded the expectations embedded in our acquisition model, and as you know, we've been intensely focused on strengthening the European business we acquired in 2011: changing internal processes, containing costs, optimizing sales channels, and driving ancillary revenue growth. As a result, International margins expanded more than 100 basis points in the quarter. We did have several million dollars of year-over-year timing differences that helped our third-quarter comparison, but will make our fourth-quarter International comp difficult.

Turning to our fleet, per-unit fleet costs in the Americas declined 6% to $304 per month in the third quarter. The strength in the used-car market we've seen this year continued throughout the summer and we took advantage of that strength to sell some more cars ahead of the traditional September de-fleeting season. This not only helped our per-unit fleet costs, but also boosted our utilization, which increased 210 basis points in the quarter.

We continue to benefit from growth in vehicle sales through alternative disposition channels, which had a record quarter. We sold more than 40% of our risk vehicles through alternative channels such as online and dealer-direct sales, compared to what was then a record-high 28% in third quarter 2014. These channels drive two important cost savings: shorter-time from last revenue to sale and lower transaction costs.

Given the timing of our fleet dispositions this year, our 2015 fleet composition will turn out to be approximately 55% risk and 45% program and our per-unit fleet costs should be around 3% lower than in 2014, or 2% lower in constant currency. Looking forward, while we still have not finalized all of our model-year 2016 vehicle purchases, I do want to give you some color related to our Americas fleet planning for next year.

As I mentioned previously, we have seen that vehicle availability is somewhat tighter for model-year 2016 than in prior years. We do expect to be able to source the vehicles we need to meet demand, but we are seeing some pressure on model-year 2016 program car costs. As a result, we anticipate that the risk vehicle component of our fleet in 2016 will be at or above 2015 levels.

We expect risk car purchase prices to have only nominal inflationary increases. But as we work through our residual value assumptions for 2016, we are inclined to expect that residuals will decline a bit next year, whether it's as a result of the increased supply of off-lease vehicles in 2016 or a give back of some of the used-car market strength that surprised us this year or both. So with that being said, we are still building our plan for next year and we'll give you a specific estimate of our 2016 per-unit fleet costs on our next earnings call.

Just a brief update on Zipcar, which continues to be the clear leader in car sharing, we added a record number of new members in the third quarter, including significant growth in established markets like New York and San Francisco, and total Zipcar membership now exceeds 950,000. Zipcar has already launched at 100 new colleges and universities this year, compared to around 40 in each of the last two years. And in September, Stevens Institute of Technology became the 500th campus where Zipcars are available.

We recently launched our Instant Join program nationwide, reducing the time it takes to become a Zipcar member from up to a week to as little as 2.5 minutes. And ONE > WAY transactions are now fully launched in Boston and we have expanded our ONE > WAY tests in Seattle, Los Angeles, Denver, and Philadelphia. In short, our Zipcar team continues to innovate to maintain its leadership in the fast-growing car sharing industry and we remain enthusiastic about the role that Zipcar is playing in emerging mobility solutions.

Moving to our balance sheet, our liquidity position remains strong with more than $4 billion of available liquidity worldwide. We ended the quarter with $585 million of cash, no borrowings under our corporate revolver, and more than $1 billion of availability under that facility. We had unused capacity of $3 billion under various vehicle-backed funding programs and our ratio of net corporate debt to EBITDA was 3.3 times. We have no corporate debt maturities until fourth quarter 2017.

As Ron mentioned, we increased our share repurchase activity significantly in the third quarter, buying back more than $160 million of stock, twice what we spent in the second quarter and more than five times what we spent in the first quarter. And with our average repurchase price of $43 per share in the third quarter, we actually repurchased more than seven times the number of shares we bought back in the first quarter. Our repurchase activity in Q3 brings our year-to-date total to just over $275 million. In this quarter, we expect to pass a significant milestone, having distributed more than $1 billion of cash to our shareholders through stock buybacks and convertible note repurchases. Looking forward, we expect to repurchase meaningfully more than $300 million of stock this year, reflecting our confidence in our business and our ongoing focus on returning cash to shareholders through share buybacks.

Before I wrap up, I'd like to discuss our expectations for the remainder of the year. As we announced last night, we expect our revenues to increase around 1% this year compared with 2014, including a five-point negative impact related to exchange rates. In the Americas, we expect our rental base to increase approximately 4% and our pricing to be largely unchanged in constant currency. Generally speaking, we expect the pricing trends that were evident in the third quarter to continue into the fourth quarter.

In our International segment, despite a good summer, economic challenges remain and pricing is competitive, particularly as we move out of the seasonal peak in Europe. Total company fleet costs this year are now expected to be $280 to $285 per unit per month, or down 6% to 8% after a four-point currency benefit. Per-unit fleet costs in the Americas are expected to be around $300 a month or down approximately 3% year-over-year. International per-unit fleet costs are expected to decline 8% to 9% in constant currency.

Our Transformation 2015 initiative to increase global process consolidation is progressing well. We continue to believe that it will contribute more than $30 million in savings this year and now expect it to provide a further $40 million benefit next year as we transform our support structure to take advantage of our worldwide scale.

We now expect our adjusted EBITDA in 2015 will be $900 million to $925 million after a roughly $50 million currency headwind this year. The narrowing of our projected EBITDA range to the lower half of our prior estimate primarily reflects $7 million of incremental currency impacts and our updated revenue outlook.

We expect that our effective tax rate in 2015 will be around 39%, which is higher than we previously estimated, principally due to a change in the U.K. corporate tax rate that has no cash impact, but negatively impacts the value of our deferred tax asset there. We now expect our full-year diluted share count to be approximately 105 million reflecting the increase in our share repurchase activity in Q3.

We still expect our cash taxes to be approximately $25 million to $50 million. We estimate that our non-fleet capital expenditures will be no more than $200 million this year. And, finally, we expect our free cash flow to be approximately $500 million this year, absent any significant timing differences. This works out to roughly $4.75 per share, giving our stock a free cash flow yield of more than 9%.

In closing, we had a record third quarter driven by strong summer demand in Europe, better-than-expected fleet costs, and rigorous cost management throughout the organization. As we look forward, we remain enthusiastic about the multiple avenues we have to grow our earnings in the future and drive shareholder value. Industry fleet levels appear to have stabilized, which should provide us an opportunity for increased realized rates and expanded margins.

We still have opportunities to lower costs and drive efficiency around the world, including with our demand fleet pricing tool, our Transformation 2015 and Performance Excellence initiatives, and synergies from the integration of Maggiore, each of which is expected to provide incremental benefits in 2016 and beyond. And we continue to be focused on returning cash to our shareholders in the form of stock repurchases and on identifying attractive tuck-in acquisitions.

On a personal note, I'm looking forward to stepping into the role of company President in January and to taking on responsibility for our global strategy and brand licensing functions in addition to our finance and IT functions. And I loudly echo Larry's comments about Ron's service and leadership to our company. We've been lucky to have Ron as our CEO.

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

QUESTION AND ANSWER SECTION

Operator: [Operating Instruction] Our first question comes from Chris Agnew of MKM Partners. You may ask your question.

Christopher Agnew
MKM Partners LLC

Q

Thanks very much. Good morning. First question is on your volume guidance. Did you see a deceleration in demand in fourth quarter or was third quarter weaker? And can you share some more color on what's happening in commercial demand, any color geographically or end markets. Thanks.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Good morning, Chris. Thanks. What we saw in demand, particularly on the commercial side, was a little bit of softening or really more of a continuation of softness in the second quarter. You really see it in Europe where the third quarter was very strong because that's driven by leisure, whereas the second and fourth quarters that are more of a commercial period are just softer.

And I think in the Americas we've been, I would say, consistently just a little bit disappointed with where commercial volumes have been for us and based on what we see across the industry. We've heard some noise from GBTA and others in the travel industry that suggests it's not unique to us or the car rental industry, but it has been just a little bit of a softness 0.5 point here, 0.5 point there relative to our expectations and we saw it play out in the third quarter and we're expecting it to continue in the fourth quarter.

Christopher Agnew
MKM Partners LLC

Q

Thank you. And if I could have a follow-up on free cash flow, was there anything unusual in 2015 in terms of the cadence of free cash flow which is backend-loaded? And how would you describe sort of [indiscernible] (30:22) tuck-in opportunities that you see out there? Thank you.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Sure. Cash flow I think we've been pleased with. We're at $456 million free cash flow already, which is 90% of our expectation for the year. So we feel good about where free cash flow has been running. I think the inclusion of Maggiore may push a little bit more cash flow into the fourth quarter due to the timing of some VAT taxes in Europe and Italy in particular. But I think the cadence is one that we feel good about and should get us to right around $500 million for the year, which is consistent generally with our pre-tax income.

On the tuck-in acquisition front, I think we continue to look for deals and a lot of what we're seeing in the pipeline looks like the deal that we mentioned in the earnings release, which is the acquisition of Avis Poland. It's about a $25 million deal. It's in a geography that's contiguous to where we operate. We think we have significant synergies there and it's going to be an attractive transaction. But a lot of the tuck-ins that we're looking at are in this, call it, $10 million to $60 million range. And I expect that to be the case a majority of the time over the next several quarters.

Christopher Agnew
MKM Partners LLC
Q

Thank you.

Operator: Thank you. Our next question is from John Healey of Northcoast Research. You may ask your question.

John Healy
Northcoast Research Partners LLC
Q

Thank you. Good morning and congratulations, Ron, David, and Larry, on the changes in roles and responsibilities. The first question I kind of wanted to ask was focusing on the commercial business again. As you look at that business primarily here in the U.S, are you seeing any – I guess maybe if you could comment on trends that you're seeing in major metropolitan cities, the Bostons, the San Franciscos, the New Yorks, the Chicagos, in terms of your commercial demand and try to give us some color on maybe how you're seeing companies like Uber and Lyft impact you directly in those markets and if that's really contributing to any of the kind of plateauing of growth on the commercial side.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer
A

Thanks, John. We talked about this fairly significantly on the last earnings call and, no, we're not seeing a significant impact. We've looked at this a number of ways, particularly in markets like San Francisco and Chicago and Boston and New York that would be more likely to see an impact, and if there is one, it's very slight. We continue to be growing in those markets. Our volumes are up year-over-year and we continue to believe that Uber and Lyft have a very significant impact on taxi replacement on that market.

The impact on rental car has not been as significant, and based on a number of analyses we do, we would estimate the impact to be somewhere between zero and a few tenths of a point of volume this year. And it really gets to the fact that the core product offering that Uber and Lyft have is taxi replacement at a much higher cost per minute or per hour than car rental, and that makes a lot of sense for trips around Manhattan, trips that people typically aren't using car rental for anyway.

And I think we are continuing to look at the impact on Zipcar where the use cases for Uber and Zipcar are much closer to one another and we do see there being a potential for some impact, but we continue to be excited about the possibility that public transportation and Zipcar and Uber and taxis and car rental, in combination, will provide a range of transportation options to city dwellers and people living on college campuses that can allow those people to put off buying a car and take advantage of Zipcar and the other things that are out there to be utilized. We do think that's an important growth opportunity for the future, even as some of the use cases in that space overlap with one another.

John Healy
Northcoast Research Partners LLC
Q

Great, thank you. And just one follow-up question. I wanted to ask about maybe some preliminary expectations for how we should think about free cash flow for the next couple years. And I know you guys have been able to really take advantage of tax planning to help free cash flow. And just your thoughts on maybe cash taxes for the next couple of years in terms of how you're planning those?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer
A

Sure. We've spoken for a while about the fact that our adjusted pre-tax income is a pretty good proxy for free cash flow and I expect that will continue to be the case. We're not a federal cash taxpayer in the U.S. I don't expect to be for the next several years and cash taxes for us would be state and international taxes, which will probably continue to be, going forward, in the $50 million to $70 million range, give or take a little bit. And that should allow us to continue to have free cash flow that's generally in line or in the neighborhood of our adjusted pre-tax income.

John Healy
Northcoast Research Partners LLC
Q

Thank you.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer
A

So in short, no real change in our outlook for free cash flow compared to where it's been running. It should continue to grow with our adjusted EBITDA.

John Healy
Northcoast Research Partners LLC
Q

Great. Thank you.

Operator: Thank you. Our next question is from Chris Woronka of Deutsche Bank. You may ask your question.

Chris J. Woronka
Deutsche Bank Securities, Inc.
Q

Hey, good morning, guys. Want to ask if you saw any maybe changes in any booking behaviors, either throughout the year or even more recently in terms of maybe the length of booking or the channels they're being booked through. And then also if maybe you could give us a little bit of an idea of the cadence of your demand in the third quarter and if you care to talk about October at all? Thanks.

Larry D. De Shon
President, Chief Operating Officer & Director
A

This is Larry. There's really been no, I think, no change in the segments of how our bookings come through or the – we watch as far as how far out bookings come in and how far out they come out two months out, four weeks out, three weeks out, two weeks out. We continue to monitor that. We continue to monitor it by market and we really haven't seen much shift in that at all I would say in this quarter or really looking forward.

As far as it relates to how October looked and how the rest of the year is looking, I can comment a little bit about international bookings are looking still pretty good. We're still booking year-over-year up pretty healthy and so that's I think a good opportunity for us as we look into the fourth quarter. We're expecting our fourth quarter to be up over last year as fleets continue to really normalize against demand versus last year where we were pretty much over-fleeted in the industry internationally. So things are looking pretty good there.

Chris J. Woronka
Deutsche Bank Securities, Inc.
Q

Okay. Thanks. Just a question on the pricing increase you mentioned from the competitor. How should we think about that in terms of that supposedly went in for the fourth quarter and we would think you guys probably matched? Is that something we see more of an effect of in 2016 or are you potentially being a little bit conservative on the pricing outlook or any color there? Thanks.

Ronald L. Nelson
Chairman & Chief Executive Officer
A

Chris, it's Ron. The pricing increase that was put in in October, I think you're correct. We matched as did everyone else. But, as you know, these things all tend to have a decay curve that ranges from anywhere from four days to three weeks. And so I think the pricing that we expect for the balance of the year is going to be pretty much like the pricing that we saw in the third quarter. I don't expect much change and it would be unusual for a price increase that took effect in November to have some impact in 2016.

I think the things that are going to impact 2016 are the things that always impact it: margin pressure from increasing fleet costs and cost pressure from inflation. And I think the good news on that front is that I think for the first time in a long time we've moved into what I would call is a fairly stable environment and everybody seems to have their fleets in sync with demand. Everybody has cost pressures probably relating to residual values over the course of the next few months, and everybody is going to have inflation affecting their P&Ls.

And so historically this industry has always gotten price increase when there's been cost push and I don't think any of us expect that to change. But I think in terms of the near-term price increases, the impact they're going to have on the entirety of the year in terms of pricing is not going to be terribly significant. Most of our opportunities will come from [ph] yielding (40:31) as we go into the last two months where we have two holiday periods that tend to pump up demand and give us an opportunity to yield.

Chris J. Woronka
Deutsche Bank Securities, Inc.
Q

Okay, very good. Thanks, guys.

Operator: Thank you. Our next question is from Kevin Milota of JPMorgan. You may ask your question.

Kevin M. Milota
JPMorgan Securities LLC
Q

Hey, good morning, guys. Two questions for you. First on the pricing side of things. If you could give us some color on what happened in October in the Americas and then also if it's possible to give us the monthly year-over-year comparisons for the fourth quarter, so October, November, December? And then, secondly, appreciate the color on the fleet costs for next year. With what you've said and kind of what your view is on negotiations, should we be modeling kind of a low single-digit increase in fleet cost or is it more of a mid- to high-single digit increase? Appreciate it.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer
A

Sure, Kevin. As we look at pricing, we're not going to get into a month-by-month discussion. Obviously the way calendar falls can impact that. But when we look at the fourth quarter overall, we really are expecting the trends to be consistent with what we saw in the third quarter. Ron walked through the fact that there are two holiday periods that will be particularly interesting to watch, [ph] if (42:08) the rest of the quarter ends up being dominated by commercial travel and that's really what should drive a lot of the consistency with what we saw in the third quarter. On fleet costs, as I mentioned in my comments, we're continuing to work through it right now, and I do expect that we'll be looking at fleet costs that are probably at or above 2014 levels next year, but we're not ready to go out with a specific range yet. We still have some work to do and we'd like to see how the used car market plays out over the next two or three months before we pin down our assumption on residual values as a percentage of cap costs in 2016.

Kevin M. Milota
JPMorgan Securities LLC

Q

Okay, so the comments on 2014 levels is looking at percent of cap costs in the similar range?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

No, that's on a per-unit basis and this year obviously we're down 3% and down 2% in constant currency. So we were at $310 per unit per month last year and this year, as I mentioned and we mentioned in the earnings release, we're going to be closer to around $300 with about $3 of the decrease due to currency.

Kevin M. Milota
JPMorgan Securities LLC

Q

Okay. Thank you very much. Appreciate it.

Operator: Thank you. Our next question is from Anj Singh of Credit Suisse. You may ask your question.

Mark Wallach
Credit Suisse Securities (USA) LLC (Broker)

Q

Hi. This is Mark in for Anj. Just a question on the Americas fleet growth. If you can comment on some of the moving parts there, I know it was less than 1% growth this quarter. I know you mentioned that the timing of dispositions played into that, but can you also comment on how much of that and the utilization improvements are due to your robotics and analytics tools versus a concerted effort to rein fleet in? And also, how should we think about that going forward?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Sure. Utilization improved by a little over 200 basis points this quarter compared to third quarter 2014. About three-quarters of that was due to the recall issues that we had last year and the need to hold on to additional fleet to accommodate the recalls. The remaining 50 or 60 basis points was really due to the combination of our demand fleet pricing tool and our rigorous management of the fleet from location to location.

I really view those two initiatives as being part and parcel of each other in terms of managing the fleet to be in line with demand. But when you look at the utilization improvement we had in Q3, it was larger than we would typically see because of the recall issue last year. But even when you back out the recalls, there was more than 0.5 point of utilization improvement from DFP and fleet management in the Americas.

Mark Wallach
Credit Suisse Securities (USA) LLC (Broker)

Q

Got it, thanks for that. And also wondering if you can comment on the competitive environment. I know you spoke about price increases that were implemented, but from our channel checks it seems that in general your competitors are behaving pretty rationally. So just curious if you are seeing that as well and if there are any significant share shifts you are seeing that you would call out.

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Yes, Mark. As I think I said in my earlier answer, it does feel like we've moved into a period of relative stability here and to use the word rational behavior I think is probably true. I think that the markets remain competitive. They remain particularly competitive in the commercial space. And I think that from a share standpoint, the share shifts that have gone on have been going on – have gone on for about a year and I think that they have essentially stabilized right now over the last couple, three months. We've basically maintained our share and Enterprise has gained share at the expense of Hertz.

I think a lot of that has to do with the shift in insurance replacement business and not in terms of actual account losses. But I think it's going to be an interesting year ahead of us, because I feel like we all now have got in a period of stability. We are all playing on the same field in the same way and we will see what sort of business unfolds from that.

Mark Wallach
Credit Suisse Securities (USA) LLC (Broker)

Q

Got it, thanks a lot.

Operator: Thank you. The next question is from Afua Ahwoi of Goldman Sachs. You may ask your question.

Afua A. Ahwoi
Goldman Sachs & Co.

Q

Thank you. Two questions from me. First, maybe following up on the question that was asked earlier, and I'm actually curious; given fleets are rational – as you said competitors are behaving rationally, you and your peers are taking price increases, you saw utilization improvement, why do you think we are only seeing 1% or so increase on prices, if that? And I know you talked about this at the K curve [ph] and you raised it in the Ks (27:28), but to some extent the industry controls at the K, so what will it take to see maybe a little more than 1% or 2%?

And then my second question was actually on the marketing expenses and the commission's increase that you talked about in the press release. Given the guidance you have for the full year, it suggests there is still some cost pressures in 4Q. And what's driving that? Is that a one-time impact? Will it go away after this year? Maybe you can walk through that a little bit.

Larry D. De Shon
President, Chief Operating Officer & Director

A

Sure, Afua. On the first front, Ron talked about the emergence of stability in the third quarter. Fleets being in line for really the first time in 9 months or 10 months and there being not the recall issues that we had, no significant movements of major accounts and as a result, I think the emergence of stability across the industry in the third quarter was a new phenomenon compared to what we have been going through over the prior quarters.

And I for one don't think that that stability gives rise to pricing overnight. Rather, I think it takes some time for that to play out. I happen to believe that this stability is really helpful to the pricing environment, but it's not like turning on a light switch.

And as a result, as we talked about, we are enthusiastic about how the next several quarters will play out, particularly if we are in a more stable environment. And certainly if there is a push from increased fleet costs, I think that will have a cost push impact on the pricing environment as well.

But at the same time I think that people who expect the change to be immediate and sharp and extremely discernible should really rather be expecting things to evolve and develop over periods of time and, in particular, to be focused on peak periods or near-peak periods where the impacts are likely to be greatest. So the next times we'll see that are Thanksgiving in parts of the country and Christmas and New Year's in other parts of the country, and we're working to manage those peaks to optimize it as much as we can.

On the commission's front, we have made a decision to invest in certain partnerships to generate volume and there are costs associated with that. I think the third quarter probably was the toughest quarter where we had ramp-up costs associated with some of those transactions, so we actually had more costs and less revenue in the third quarter than we would typically see because we were in a ramp-up phase. And as we go forward, I do think there will be some small impact associated with the investment we're making to generate revenue, but I don't expect it to be quite as dramatic as it was in the third quarter.

Afua A. Ahwoi
Goldman Sachs & Co.
Q

Okay. Thank you.

Operator: Thank you. And our final question is from Brian Johnson with Barclays. You may ask your question.

Brian Arthur Johnson
Barclays Capital, Inc.
Q

Yes. First want to congratulate Larry. Wanted to drill in a little bit on pricing versus what in other product categories we might call mix within the Americas. So your leisure pricing down 1% – excuse me up 1%. Within that, though, you flag International inbound up 6%; Signature, which I assume is largely leisure, correct me on that, up 10%. So it seems like within that 1% you're actually getting a mix benefit from these product lines. Give us a sense of how important that mix benefit is? And if we were just to take a Fusion-to-Fusion, Camry-to-Camry kind of base pricing, what's the real trend there?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer
A

Sure. The International inbound on a rate basis isn't a big driver of mix. It helps from a profitability standpoint, but it tends to be longer length of rental, and as a result the average rate associated with it doesn't drive a particular mix benefit. It does help with our ancillary growth.

On the Signature and the non-core fleet, yes, we have had a mix benefit over the last several years. I think it was more significant this year – more significant last year, sorry. This year it's several basis points, but it's not the principal driver of our pricing. I would put it in the fraction of a point category overall because our non-core car class growth was much greater in 2013 and 2014. This year we're tweaking around the edges. We've been able to add a few new high-end manufacturers, which is helpful, but it's not the driver of pricing that it was in 2013 and 2014.

Brian Arthur Johnson
Barclays Capital, Inc.

Q

Okay. So that sounds like there's about 75 basis points of real kind of hedonically adjusted, if you will, price in leisure. Second question is just around some of the franchisee income coming through international. Is there any way to quantify that and the types of currencies that's exposed to because it does look like the incremental margin on your currency movements was greater than the average in that sector?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Yeah, currency movements have some timing issues and, in particular, the UK pound, euro rate has moved a fair amount, which has an impact on us. Particularly since we have a disproportionate amount of our European cost in the UK, and a little bit less in Continental Europe, so we see some noise associated with that expense mismatch that we're partially hedged for, but not fully hedged for. And so that's some of what's driving the movement from a $43 million headwind the last time we spoke to about a $50 million aggregate headwind on EBITDA.

And I think the licensee income is exposed to almost every currency imaginable, so as a result, we're fairly well diversified. We've seen our licensee income up very slightly year-over-year in our European business, which obviously has licensees in the Middle East and Africa as well. So, I don't see currency impacts having a new impact there, but clearly the strength of the U.S. dollar relative to most currencies is part of what's creating pressure year-over-year.

Brian Arthur Johnson
Barclays Capital, Inc.

Q

Okay. And then you sort of mentioned earlier that sort of pricing discipline isn't going to materialize overnight. I mean, what are the things we can look for in the marketplace or in competitive behavior and announcements, especially within investment day coming forward that might give some indication that there might be, especially on the corporate side, pricing improvement?

David B. Wyshner
Senior Executive Vice President and Global Chief Financial Officer

A

Yeah, I expect the commercial side, the large commercial and midsize commercial accounts to continue to remain very competitive. And I think what you'll continue to see is a lot of this will play out in the uncontracted – the push for increased pricing will play out nearer term in the uncontracted space, so the 50% of our business that's leisure, and the additional 20% of our business that's uncontracted commercial business.

I think those spot market transactions are where we'll see the most action. And as I mentioned, I think the best times to follow that will actually be when demand is relatively strong compared to fleet levels. And you'll see that in holiday periods and we'll see it in various markets from time-to-time, depending on which football teams are in town and what events are going on.

And we're going to play for the big peaks and the mini peaks and the local peaks as aggressively as we can to get the pricing we deserve, particularly when demand is strong relative to the supply vehicles.

Brian Arthur Johnson
Barclays Capital, Inc.

Q

Okay. Thanks.

Operator: For closing remarks, the call is being turned back to Mr. Ronald Nelson. Please go ahead, sir.

Ronald L. Nelson
Chairman & Chief Executive Officer

Thank you. So before we close I think it's important to reiterate what I believe are the key points from today's call. First, we delivered record quarterly results despite facing a tough year-over-year pricing comp and significant headwinds from currency exchange rates. Second, we do expect 2015 to be our most profitable year ever. And third, we repurchased more than $160 million of our shares in the quarter and now anticipate repurchasing meaningfully more than $300 million this year.

And finally, as I plan to turn over the CEO reins to Larry in the coming weeks, I want to thank all of you for your support over the years. I firmly believe the company's best years still lie ahead of us and look forward to watching Larry, David, and our entire senior leadership team, take our company to even greater heights.

With that, I want to thank you for your time and interest in our company and wish you all the best to the holiday season.

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