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CAR - Q1 2015 Avis Budget Group Inc Earnings Call

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OVERVIEW:

Co. reported 1Q15 revenue decline of 1%. Expects 2015 revenue to be approx. $8.8b and diluted EPS to be $3.15-3.75.

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PRESENTATION

Operator

Good morning and welcome to the Avis Budget Group first-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 Goldner - *Avis Budget Group Inc. - IR*

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

Before we discuss our first-quarter results, I would like to remind everyone that the Company will be discussing forward-looking information that involves risks, uncertainties, and assumptions that could cause actual results to differ materially from the forward-looking information. Important risks, assumptions, and other factors that could cause future results to differ materially from those expressed in the forward-looking statement 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 the website as well. Our comments will focus on our results excluding certain items and other non-GAAP financial measures that are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

In addition, as we announced in April, due to changes in our corporate management structure, we now have two reportable segments instead of the three previously. Our Americas segment consists of our operations in North and South America and the Caribbean, including Budget Truck Rental. Our International segment represents our operations outside of the Americas.

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

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Thanks, Neal, and good morning. All things considered we had a solid start to the year, highlighted by continued domestic pricing momentum in our flagship Avis and Budget brands, despite challenging weather conditions. Our overall results, while in line with our expectations and prior years' results, were affected by a number of items, both positive and negative.

The three headlines that I would summarize the first quarter with are: one, weather played a significant role in the Americas results. The challenged growth in commercial volumes, which inevitably resulted in a cascade effect. Lower volume, excess fleet, more difficult pricing. Two, used car values were stronger than expected and, three, timing-related currency benefits allowed us to report results in line with last year's earnings.

It is not a lot more complicated than that, but against this backdrop we not only achieved forward operating momentum but made some important strategic progress as well. Some of the elements of that progress include revenue increased 3% in the Americas despite weather-related challenges. We took advantage of a better-than-expected used car market in the US to reduce our fleet costs and position our fleet for the upcoming summer peak.

We made significant progress not only in defining, but also in executing on the mobility innovations that will have applicability to our Zipcar operations, as well as our traditional car-rental operations. And we extended our global footprint by acquiring our Scandinavian licensee in January and Maggiore car rental in April. And just last week, we consolidated our Brazilian operation by acquiring the remaining 50% we didn't own. These three operations alone should add over $300 million of revenue annually.

But top-of-mind for most of you, I'm sure, is pricing, so let me start there. Overall pricing in the Americas was unchanged in the quarter. Currency movements and the mix effect associated with the rapid growth of our Payless brand reduced our reported pricing by more than 1 point in aggregate.

In the US we saw price increases in both our Avis and Budget brands, both on- and off-airport, and in both our commercial and leisure segments. Pricing across both brands, which represent over 95% of the US revenue, was up 1%.

But at the same time, the winter storms and their generally early in the week timing pulled pricing down in two ways. First, commercial volume was negatively impacted and, second, demand for high-priced one-way business was lower than last year, when more of the storms occurred midweek. As a result, with lower-than-expected volume, industry fleet levels, particularly on-airport, ended up being elevated relative to the available demand.

The combination of these weather effects, multiplied by the five times they occurred in the quarter, made it difficult to achieve more than modest pricing gains this quarter. But even with that, US leisure pricing increased 2%, excluding the mix effect of Payless, and US commercial pricing was up about 0.5 point in the quarter. And within commercial, modest pricing declines in our contracted commercial business offset increases in the other 40% of our commercial segment.

We continue to drive benefits from our initiatives to focus on those channels, segments, and car classes that are disproportionately profitable. In the first quarter we were encouraged by the pricing we achieved in areas not affected by weather issues. For instance, pricing in Florida was up 5% in the quarter.

We continue to see significant benefits from the first phase of our demand fleet pricing yield management tool, which David will discuss more in detail a little later. Finally, we continue to be proactive in our efforts to raise our overall realized pricing. We have implemented five domestic price increases this year.

And while the market response can best be described as mixed, I would be hard-pressed to say that the pattern of matching by our competitors was much different than has been the case over the past two years. At some level, it was arguably a little better. To be sure, the weather-related overfleeting didn't help.

We also continue to make progress on the commercial account front with approximately 75% of the accounts we renewed this quarter done at either flat or increased rates.

Volume in the Americas increased 5% in the quarter, driven by an 8% increase in leisure volume and a 1% increase in commercial volume, with the acquisition of our licensee in Budget Southern California representing approximately 2 point of our total growth and more than 2 points of the leisure growth. Once again, there were several areas that showed strength, leaving us optimistic for the rest of the year.

In particular, International inbound revenue increased 9% in the quarter despite the continued strength of the dollar. Revenue from our higher-margin specialty and premium vehicles increased 6%. Local market revenue increased 7% in the quarter, driven by general use commercial and leisure demand and positive year-over-year pricing. And ancillary revenue increased 7% due to the strength of our Sirius XM offering, which increased more than 25% year-over-year.

But not only is the type of volume we get important, so is how we get it. Our efforts to shift more reservations toward our proprietary website continues to grow impressively. In the first quarter alone we shifted almost 150 basis points of volume toward our proprietary channels, resulting in a superior customer experience while reducing commissions. This includes not only our proprietary websites but also our mobile apps, which saw volumes increase 70% at Avis and over 150% at Budget.

We also continued to drive incremental revenue from our current portfolio marketing partnerships, which includes long-standing relationships with AARP, USAA, and Costco. Looking forward, a number of items will generate additional revenue over the next 12 months. In no particular order, we expanded our retail relationship with the Expedia group of websites, which should drive profitable revenue growth for years to come.

We signed three airline relationships that will contribute meaningfully to our growth. First, we've expanded our strategic partnership with the new American Airlines that will further improve our brand presence within American's e-commerce channels and loyalty program. Second, we inked a new partnership with JetBlue Airways, giving us exclusivity in all of its e-commerce channels and preferred status in the TrueBlue loyalty program. And, third, we signed a new multiyear agreement with Southwest Airlines that includes Southwest's highest-producing channels for car rental bookings.

These three airline relationships alone will allow us to capture both leisure and commercial volumes, and we expect them to contribute over $100 million of incremental revenue over the next 12 months.

Moving on to Zipcar. Demand for Zipcar has never been higher as we signed up more members than in any other first quarter in its history. And while we have more members than ever before, we are also highly focused on giving them the state-of-the-art experience they expect and providing them with more services every day.

For example, we added Zipcar to 15 additional universities in the quarter, putting the total number of campuses where Zipcar is available at more than 425 and growing. The importance of this channel can't be underestimated. College is when many consumer buying habits are formed. As a result, our on-campus operations have a high propensity for developing lifetime customer relationships.

We expanded our Zipcar for Business program, signing two major global accounts during the quarter with several more in the pipeline. We expanded Zipcar to four new cities, including Jacksonville and Las Vegas, and launched Zipcar in Istanbul, marking Zipcar's sixth metropolitan area in Europe. Our global rollout plan for 2015 includes several more international sites, as well as additional cities in North America.

We continue to believe that there are many additional markets in Europe, Asia, and Australia where car sharing is an even greater natural fit. In April, we introduced Zipcar into our exclusive partnership with the French National Railway, making Zipcar available at 27 railway locations across France. And we continued to generate incremental synergies from fleet sharing and from leveraging Avis and Budget's physical infrastructure, shared services, and fleet buying.

As we look at the broad mobility landscape, innovation is having a significant impact on shaping consumer preferences. That's why we're investing so much time and effort on digital initiatives in our core car rental offering and why everything that Zipcar does is done to ensure they maintain, and even expand, their position as the clear technology leader in car sharing.

And Zipcar is making great strides. For example, Zipcar's mobile app is now available for Google's android and Apple watch owners, providing members all the features of Zipcar's mobile app on their wrist. Zipcar content can now be found on Google's new predictive search software known as Google Now, and we will be introducing our instant join and instant drive programs later this year, enabling new members to enroll and drive almost instantaneously as compared to the current practice, which requires a waiting period.

Looking forward, our continuing investment in Zipcar is of critical importance as the sharing economy gains more traction around the world. More importantly, we believe what we learn today at Zipcar informs what we need to do with our traditional brands in the future. Our goal is for Zipcar to continue to be on the forefront of the expansion of the sharing economy and remain the most recognizable brand in the global car sharing industry.

In our International segment, the macroeconomic headwinds and industry overfleeting we faced in 2014 continued throughout much of the first quarter, though we did see some signs of improvement across portions of Europe in March. Revenue declined 11% in the quarter on a reported basis, but increased 4% in constant currency. International volumes rose 5% in the quarter, due primarily to the continued double-digit growth of the Budget brand in Europe.

As we have been noting for some time now, demand trends across our international regions remain mixed and inconsistent. For example, we saw strong leisure volume in both France and Germany and the quarter, but it was largely offset by weakness in commercial volume in January and February, particularly after the terrorism incident in Paris. On the other hand, volumes in Italy and Spain increased nearly 5% in the quarter and strengthened as the quarter progressed.

Our volume in the UK declined, though all of that was self-inflicted as we continue to exit unprofitable legacy insurance and leasing contracts where we do not see a path to profitability. And volume in Australia increased approximately 3%. Pricing there continues to be challenging because what struck us as extremely aggressive competitor behavior. The good news is that Australian pricing stabilized in April and the tough Q1 pricing environment was partially offset by a very strong used car market in the region.

Meanwhile, our International team continues to focus on what they can control. For example, our sales training initiatives continue to pay dividends as high-margin ancillary revenue was up 12% per rental day in constant currency. Utilization improved 40 basis points to 70% in the quarter. In a market where cars do not move freely from one territory to another, this is an impressive accomplishment. And we closed the acquisition of our Scandinavian licensee in January and successfully transitioned many of its back-office functions during the quarter.

In addition, as we announced in April, we completed the acquisition of Maggiore Group, the fourth-largest car rental brand in Italy. This is a company we've admired for some time. While the Maggiore brand may not be well known in the United States, it is a well-regarded and powerful brand in its home market with a strong reputation among both commercial and leisure travelers, as well as having a strong van rental business operating under the trade name AmicoBlu.

We intend to preserve these brand values while also achieving significant infrastructure synergies. We see dual-branding of locations as a revenue growth opportunity and plan to add to the Budget brand to Maggiore's existing network of more than 140 locations. We also expect to expand Maggiore's van rental business. And, most importantly, this acquisition represents more summer peak inbound revenue in one of our most profitable markets, putting us in an even stronger position in a year where the decline of the euro would suggest a strong tourist season.

In South America, we are pleased to be moving to full control and ownership of our licensee in Brazil, which had previously been a 50/50 joint venture. This is a long-term attractive market for commercial and leisure car rental as well as fleet leasing, and a significant opportunity for meaningful growth as our current share is significantly below levels than our other corporate-owned operations typically have.

Moving to our full-year outlook. We have tweaked our full-year fleet cost and pricing guidance. To be clear, this is primarily to reflect the first-quarter actuals, rather than to suggest any meaningful change in our expectations for the remaining nine months of the year. Accordingly, our estimates now call for 1% to 2% constant currency pricing growth.

Pricing April continued to be challenging as it was negatively impacted by the shift to an earlier Easter, as well as some lingering overfleeting. May pricing thus far, however, has reversed course and is trending up. Looking forward, increases in airline capacity and historically low fuel prices bode well for continued volume growth in the spring and the upcoming summer months. And we expect that the entire industry, like us, has taken and will continue to take advantage of the favorable used car market to align fleet levels with expected demand.

Residual values were clearly better than we anticipated in the first quarter and have continued to be strong throughout April, which makes us optimistic that our full-year fleet costs could be modestly better than originally planned. This is important as we sell almost 70% of our risk cars in the first six months of the year.

Finally, the volume of manufacturer recalls has decreased, and since the second quarter of 2014 was the peak of last year's recalls, we would expect to see a little tailwind over the remainder of 2015 in the form of better utilization.

In our International segment, we expect rental days to increase more than 15% this year, primarily due to the acquisitions of Maggiore and our Scandinavian licensee as well as the continued growth of the Budget brand in Europe. Summer bookings are just starting to come in, but we are cautiously optimistic about how they're going to shape up. We have several factors working in our favor.

Inbound volume should benefit from the movement in currency exchange rates. The World Cup negatively impacted volumes last year. We have refined the tactics we are using to build our book of reservations and early booking trends, combined with Easter results, are positive on both volume and rate.

On the pricing side, we do expect to see a modest decline in constant currency international pricing in 2015 and we currently expect that currency movements will have about a 16 point impact on revenue and more than a $35 million negative impact on International adjusted EBITDA this year.

Finally, as you saw last night, our full-year adjusted EBITDA projection remains unchanged and we kept our $1 billion target at the high end of our range. However, our first-quarter operating results, which reflected the weather affects of the Americas and a disappointing peak season in Australia, have us playing a bit of catch-up rather than going into Q2 with a lead. As a result, attaining the high end of our EBITDA guidance is beginning to feel more like a stretch goal that would require pricing to be stronger than we are currently projecting.

Taking a step back, the tailwinds we are seeing from better-than-expected fleet costs thus far have been valuable. Further, the potential for stronger European demand this summer is also encouraging and we still expect to achieve 1% to 2% constant currency pricing growth in the Americas, including modestly better growth for flagship brands in the US.

So to sum up, we expect 2015 will be another record year for both revenue and earnings. We are happy to have delivered all three of the important acquisitions -- Budget Southern California, our Scandinavian licensee, and Maggiore -- that we said in October we were working towards. We're making good progress in the integration of those businesses and even begun to apply a best practice from an acquired business to our existing operations. And now our focus on generating significant free cash flow and using it for a combination of tuck-in acquisitions and share repurchases is unchanged.

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

David Wyshner - *Avis Budget Group Inc. - Senior EVP & CFO*

Thanks, Ron, and good morning, everyone. Today I would like to discuss our first-quarter results, our yield management efforts, our fleet, currency effects, our balance sheet and cash flow, and our outlook. My comments will focus on our results excluding certain items, which are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

As Ron mentioned, we had a solid beginning to 2015. Revenue declined 1% in the quarter and adjusted EBITDA was unchanged. Revenue increased 4% in constant currency, reflecting both organic growth and acquisition effects. Our trailing 12 months adjusted EBITDA continues to stand at $876 million. And for those analysts who compare company margins and valuation, based on adjusted EBITDA before deferred financing fees and stock-based compensation, our 12-month adjusted EBITDA would be $53 million higher or $929 million.

As we mentioned in our earnings release, we were required to recast our segment results to reflect our new two-region management structure. This moved $19 million of first-quarter revenue and $3 million of first-quarter adjusted EBITDA from our International segment to our Americas segment in 2014 with no effect on our consolidated results.

We know that the combination of the segment recast, much larger than usual currency effects, and normal operating variances can make it a bit more difficult to understand our results this quarter. Really, though, there were three key items impacting our first-quarter 2015 EBITDA compared to first quarter 2014.

First, we had a $17 million benefit from currency effects, primarily because we hedged a significant portion of our full-year currency exposure at the start of the year and rates continued to move during Q1. Second, we recorded a $7 million expense in the Americas, because we now expect to settle rather than litigate our two long-standing employee classification cases, which were at their core similar to cases that many retailers have faced.

And, third, we had negative $10 million of net operating variances, principally driven by industry overfleeting and soft pricing in Europe and Australia. Given the size and scope of our company, there were other puts and takes, but these three items are the short answer as to what occurred in the first quarter.

Turning to our segments, revenue in the Americas grew 3% to $1.4 billion. Volume increased 5% in the quarter. Reported pricing was unchanged while pricing increased 1%, excluding Payless and currency effects. Ancillary revenue per day grew 4% in constant currency, driven by higher damage waiver and insurance product penetration, as well as our in-car Sirius XM satellite radio offering.

For the fifth straight quarter we saw positive volume and pricing in both our domestic leisure and commercial segments. Adjusted EBITDA in the Americas was unchanged year-over-year, but would have increased 6% excluding the $7 million legal accrual in the quarter.

Revenue in our International segment declined 11% in the first quarter, entirely due to currency effects. Revenue grew 4% in constant currency, driven by 5% volume growth and a 12% increase in constant currency ancillary revenue per day, partially offset by a 3% decline in constant currency pricing. Total revenue per rental day was unchanged in constant currency, with Europe up 1% and Australia and New Zealand down 3%.

International adjusted EBITDA increased $2 million, reflecting a $15 million year-over-year benefit from currency hedging gains, offset by a challenging operating environment in Europe and Australia. Pricing in both of these regions was stronger in March than in January and February, so we are hopeful that the trendlines are turning in our favor.

Next, I want to provide an update on our demand fleet pricing yield management initiative. Phase one, the pricing robotic, is now live in more than 125 markets across the United States and Canada. The benefits we're seeing from this phase have significantly exceeded our original expectations and are still growing.

This first phase looks to optimize pricing in an environment where the size of our fleet is a given, not a variable that can be optimized. Once we have an automated demand forecaster and a fleet optimization module that will change. We will be performing a more sophisticated optimization every day from which we expect to derive substantial incremental benefit.

Our timeline calls for a lot of progress this year. The rollout of phase two, the demand forecaster, began in April. And while the financial benefits from this phase alone are minimal, it does lay the groundwork for the implementation of phase three, the fleet optimization module, later this year. Once all three are integrated into a single demand fleet pricing system, this state-of-the-art tool will give us the flexibility to maximize profitability in ways not possible today, given the billions of data points we need to analyze each year.

Importantly, we also expect to start rolling out the pricing robotic later this month in Australia and New Zealand and have kicked off work on the European robotic, with the goal to launch the first market there around year-end. Demand fleet pricing is an example of how we are increasingly using data analytics in our business and we believe it is quite powerful.

Moving to our fleet. For the quarter, fleet costs declined 1% to $294 per unit per month in the Americas. We saw a strong used-car market in the first quarter, enabling us to sell more than 45,000 risk cars in the US, a more than 50% increase from last year, at prices that were generally favorable to our original expectations. We sold an additional 20,000 risk cars in April, again with favorable residual value. As a result, we are now a third of the way through the year, but have completed almost half of our planned risk car disposition.

While our results at used car auctions have been strong, we are also benefiting from a significant increase in our vehicle sales through alternative disposition channels. Specifically, we sold more than 30% of our risk vehicles through alternative channels, such as online and dealer direct sales, compared to 25% in the first quarter of 2014. As we've mentioned in the past, the principal benefit from selling through these channels is the savings on disposition costs, such as transportation and auction fees, as well as reducing the time from last rental to disposition.

The sale of a vehicle through one of these alternative wholesale channels can save us between $250 and $400 in expenses and in some cases cars can even be presold while still on rent. With the investment required to set up these channels having been minimal, the return on these efforts is quite attractive.

Looking forward, while we believe there will always be a significant role for traditional auctions in our disposition mix, we plan to continue to expand our use of alternative channels to take full advantage of this cost-saving opportunity.

Like most multinational companies, we are seeing some unusually large impact on our results from foreign exchange. At the beginning of each year we typically hedge a majority of our expected full-year pretax currency exposure, and this year was no different. But the mark-to-market accounting for these hedges has no doubt made the effects of exchange rate movements somewhat confusing.

For instance, in the first quarter after we entered into our earnings hedges, the dollar continued to strengthen relative to the euro. The primary effect of this will be to reduce the dollar value of our euro-denominated earnings over the course of the year. Because we hedged a majority of this exposure, though, our hedging instruments increased in value during the first quarter and we had to recognize these gains in our first-quarter P&L.

Because this can be difficult to model, we've tried to lay out in the slides accompanying this call the expected quarterly impact of exchange rate movements on our revenue and EBITDA based on recent exchange rate levels. The full-year effects are what we highlighted in our earnings release, the $470 million impact on revenue and a $40 million impact on EBITDA. The effects by quarter, including the positive effect of currency on EBITDA in the first quarter, are less intuitive and are still subject to future movements and exchange rates.

I should also note that our euro-denominated senior notes serve as a partial long-term hedge of our foreign earnings and our efforts to issue these notes before exchange rates move so dramatically have served us well. More generally, our liquidity position remains strong with $6 billion of available liquidity worldwide. We ended the quarter with $854 million of cash, no borrowings under our corporate revolver, and more than $1 billion of availability under that facility.

We had unused capacity of $4 billion under various vehicle-backed funding programs and our ratio of net corporate debt to LTM adjusted EBITDA at the end of the quarter was 3.3 times. In March we issued $375 million of 10-year senior notes at a rate of 5.25%. We used proceeds from that offering in April to redeem the remaining $223 million of 9.75% notes outstanding and to help fund the Maggiore acquisition.

In fact, as a result of this refinancing, combined with the actions we have taken over the past few years, our roughly $3.5 billion of corporate debt has a weighted average interest rate below 5% and a remaining average life of more than five years.

Between the Maggiore acquisition and the redemption of our 9.75% senior notes, we used more than $400 million of cash in the month of April. As a result, our adjusted or pro forma cash balance is really more like $450 million, not $850 million.

Moving to our full-year outlook, we've updated a few of our numbers for our first-quarter results for currency effects and for the Maggiore acquisition, but our adjusted EBITDA and earnings-per-share forecast is unchanged. Maggiore, by the way, is expected to contribute around $110 million of revenue and just over $10 million of adjusted EBITDA this year as most of the integration savings will benefit our 2016 results, not 2015.

As we announced last night, we expect our 2015 revenues to be approximately $8.8 billion, a roughly 4% increase compared with 2014, including what is now a 6 point negative impact related to exchange rate. In the Americas, we expect our rental days to increase 5% to 7% and our pricing to increase 1% to 2% in constant currency.

Total company fleet costs this year are expected to be $290 to $300 per unit per month, or down 2% to 5% after a 5 point currency benefit. Per unit fleet costs in the Americas are expected to be in the $310 to $320 a month range, a zero to 3% increase. International per unit fleet costs are expected to decline in constant currency.

We are making progress on our transformation 2015 initiative to reduce costs and consolidate certain activities on a global basis, as we announced last quarter, and we think this work will contribute $20 million or more in savings this year. We expect our adjusted EBITDA in 2015 will be $900 million to $1 billion, and this should translate into pretax income, excluding items, of $535 million to $635 million. We expect that our effective tax rate in 2015 will be 37% to 38% and our diluted share count will be approximately 106 million.

Based on these expectations, we continue to estimate that our 2015 diluted earnings per share will be $3.15 to $3.75, an increase of 6% to 27% compared to 2014. We expect our cash taxes to be approximately $50 million to $75 million. We estimate that our non-fleet capital expenditures will total around $200 million this year as we continue to invest in technology and facilities in 2015. Finally, we continue to expect our free cash flow to be approximately $450 million to $525 million this year, absent any significant timing differences.

We will generate the substantial majority of our free cash flow in the second half of the year due to the seasonality of our business. Our priorities for free cash flow continue to be a combination of share repurchases and tuck-in acquisitions.

In the first quarter we repurchased 509,000 shares of common stock at a cost of just over $30 million. The amount of share repurchases was below our recent run rate, in part because of the impending closing of the Maggiore transaction. You may remember that we highlighted in February that our share repurchases were likely to be weighted toward the back half of the year. Nonetheless, we continue to expect that over the course of 2015 we will use all of the $285 million of share repurchase authorization that we started the year with.

So to wrap up, we remain enthusiastic about opportunities ahead of us this year. We expect to continue to grow our business, both as a result of the acquisitions we have completed and through organic growth. We are expanding our use of alternative disposition channels for fleet to help offset any decline in residual values.

We are expanding Zipcar to additional cities and locations. We have begun rolling out the second phase of our demand fleet pricing system in the Americas and we will begin using the pricing robotic internationally this quarter. We closed the acquisitions of Scandinavia and Maggiore and expect to realize significant synergies from these transactions.

We continue to return cash to our shareholders in the form of share repurchases. And while the first quarter had its headwinds, we were able to overcome them and continue to believe the 2015 will be a record year for our company.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Healy, Northcoast Research.

John Healy - *Northcoast Research - Analyst*

Good morning. Ron, wanted to ask a question about your view on pricing trends as we move into 2Q. I think you mentioned that May has reversed trend and showed some improvements. Was curious to get your thoughts whether it has been more of a behavioral change improvement in the market or if it appears just to be a function of fleet and demand more aligning with one another.

I think you also mentioned the five price increases that you implemented in the market year-to-date. Was hoping you could give us some color on -- in terms of how maybe some of your competitors responded to those movements.

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

John, I think it's a number of things. I don't think it's any one discrete variable.

Clearly, I think there's a little bit of overhang of excess fleet with one of our competitors that is affecting the pricing. I think, secondly, the calendar had an impact. If you remember last year, because of the late Easter, we had a fairly long Spring Break/Easter period where we got good pricing in April for almost all of the month. Actually if you remember, our second quarter last year had fairly good pricing and it will be a tough comp this year.

This year, with the calendar, Easter came somewhat early. It merged into Spring Break and some of the Easter business got booked into the first quarter and, therefore, fell out of the second quarter. So I think that had an impact on April pricing. I think as fleets start to tighten up a little bit and people are selling more cars to take advantage of the used cars we're starting to see pricing turnaround in May.

I don't think the competitor behavior has been any different, quite honestly, in this year than it has been. As I said in the script, I think it's been a little bit better.

The challenge with this is that it's not just a competitor moving prices. You got to have some harmony in terms of moving prices, and what we have seen in a couple of the price increases is that one competitor will move and another one won't. Then you do another one and the other competitor will move and the other one won't. And so it does take some harmony in order to get some water level in pricing.

But, look, we are continuing to push. We think that pricing should move over the course of the second quarter and should be good in the third quarter. The things that we see going on at the auctions in terms of deflating by competitors give us some encouragement that fleet levels are going to get in line with demand, which will speak well for increased pricing.

Operator

Christopher Agnew, MKM Partners.

Christopher Agnew - *MKM Partners - Analyst*

Thanks very much, good morning. I was wondering if I could ask for a little more color on Payless and the mix impact, and why it's such a large impact, given that you've lapped that acquisition. Can you give us any color on volume growth and how different price point is? Thank you.

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Sure. The simple answer, Chris, is that when we acquired Payless we had 12 corporate markets. Over the course of the summer, between the markets we acquired from Advantage and the markets we acquired from Ace and markets we opened, by the end of the year, actually, Payless was up to 61 markets. So you got 61 markets lapping 12 and that's what's creating the volume impact.

It's not -- same-store volume is up and revenue is up, but aggregate revenue is up significantly, largely because of the increased markets. We should lap that by September, I'm going to guess, the 61 markets and so you'll start to see a more normalized impact from Payless. And, frankly, the ability and our ambition to grow Payless is much more constrained over 2015. If we grow another 15 markets in Payless I would be surprised.

Operator

Brian Johnson, Barclays.

Brian Johnson - *Barclays Capital - Analyst*

Good morning. I've got both a guidance question and then sort of a midterm strategic question.

On the guidance question, could you just give us some context on maintaining your guidance range of $900 million to $1 billion? I just want to kind of go through the various puts and takes.

Your fleet drag cost looks to us it would add about $45 million. The Maggiore deal should add $10 million, so that's a $55 million benefit. If we use the update of pricing, that's about a $20 million headwind; say $7 million for legal. Let's just round up and call that maybe a $30 million headwind.

So it kind of seems like net-net you could be slightly up, so that is still positive. Are there other negative factors that you considered, particularly that you said the upper end of the guidance would be a stretch?

David Wyshner - *Avis Budget Group Inc. - Senior EVP & CFO*

Brian, I think those are really the right items that you have identified. And clearly the couple of -- the key ones in there are what we saw in the first quarter in terms of pricing being a little bit softer than we had expected and the used car market being a bit stronger. And so, as you highlighted in your walk-through, those are the key ones that driving what we are seeing and feeling.

We've got a few million dollars of additional impact from currency effects, although that's still rounding to around $40 million. And you're right to point out the legal accrual of $7 million in the first quarter, because that was not part of our expectation going into the year.

Operator

Kevin Milota, JPMorgan.

Kevin Milota - *JPMorgan - Analyst*

Appreciate it. Trying to get a sense for cadence on how you are looking at pricing for the year. Obviously North America down 40 bps in first quarter; International down close to 18%. How should we think about how pricing plays through in the second, third, and fourth quarters for both regions?

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

I am sitting here today, Kevin, I don't see any reason why the cadence on pricing would do anything other than follow the pattern that it has followed over the last couple, three years. Pricing has historically been a challenge in the second quarter, although last year would dispel that notion, so I don't think the second quarter will see significant pricing gains.

I think the third quarter is largely dependent on travel. The economy is good. Airlines are at capacity. They are projecting greater employment growth than they have over the years. And I think in Europe the decline in euro actually should do well for our southern regions -- Italy, France, and Spain. We are encouraged by what we see in the early booking patterns.

Then, as I mentioned, we got hit with the World Cup last year. We didn't really see any summer pick up until late July, when usually it's late June/early July when you see that. And Easter season was good in Europe and Easter tends to be a good predictor of where the summer is coming out.

So I think the only thing that I would just keep in mind, thinking about cadence, is that Q2 from last year is a tough comp and has a lot to do with the change in the calendaring between Easter year-over-year.

Operator

Chris Woronka, Deutsche Bank.

Chris Woronka - *Deutsche Bank - Analyst*

Good morning. Want to ask you a little bit about visibility on the business and whether maybe relative to last year -- and I'm kind of referring to peak season -- you think you have maybe a little bit more visibility and is any of that being driven by some of the shift in the channels, booking channels. Are you seeing any different behavior in terms of length of rental or anything like that for the peak season?

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

In the Americas, Chris, we have no greater visibility this year than we did in other years. As you know, we get 50% of our bookings within the last seven days prior to the rental and within 14 days we get an even bigger percentage, obviously. So I don't see any change in visibility.

I think that in Europe the same level of booking patterns has continued. I don't think they have any greater visibility. Although Europe does tend to book earlier, and that's why early booking patterns are more significant in Europe than they are in North America.

But I think the thing that we will look at, quite honestly, is the hotel business; particularly Marriott tends to be a fairly good predictor of where volumes are going and the economy overall. I think everybody -- the pundits are looking for somewhere between a 2% to 3% growth in the domestic economy in the second quarter and with fuel prices down that should suggest a much greater propensity to travel. So I really think it is more the macro issues that are -- that would give you more visibility than our res build.

Operator

Anjaneya Singh, Credit Suisse.

Anjaneya Singh - *Credit Suisse - Analyst*

Thanks for taking my questions. Appreciate the comments earlier on the weaker euro for the southern Europe region. Just wondering if you can discuss how FX is affecting demand trends in your business, perhaps with some additional detail on International inbound. It looks I grew decently by a really tough comp and likely faced some of the same weather disruptions.

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Sure. The effects so far on demand have been relatively muted. I think we were pleasantly surprised over the first three or four months of the year to see volumes into the Americas continue to be strong, and we haven't seen much of an impact there.

Then as we look ahead to the summer, we have to expect that we're going to see some incremental benefit in terms of demand in Europe from inbound travelers. It is early in the booking curve to be able to tell that right now, but everything we are hearing suggests that that is a reasonable expectation. So we are hopeful that that will be helpful to the summer in Europe and obviously that represents a much more significant portion of European travel than it does in the Americas.

Operator

Afua Ahwoi, Goldman Sachs.

Afua Ahwoi - *Goldman Sachs - Analyst*

Good morning, just two quick questions from me. First, on the first one on the fleet costs, is there anything specific you can point to that you're seeing that are driving better fleet costs? Whether it's higher new car prices, better supply demand in the market, is there anything specific you can point to?

Then the second one, I guess I am still trying to understand why the fleet -- why you and the industry should have been so overfleeted in 1Q. Did you come in planning for fleet levels in line with the norm and then, because of how the winter storms shaped up, that had an impact? Or did you assume there would be some growth from last year, even just by the fact that last Q1 benefited from I guess better, tighter fleet because of the way the winter storms shaped up?

I guess just some more color there would be helpful. Thank you.

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Sure, Afua. With respect to what we are seeing in terms of fleet costs, there is not any one particular driver or big surprise there. Demand has been good throughout. I think we may be benefiting a little bit from the fact that we are selling -- we are continuing to sell cars in what we continue -- what we consider to be the sweet spot for used vehicle sales, somewhere typically between 28,000 and 40,000 miles. And that has been helpful to us. And, generally speaking, I think the demand patterns have been good in the used car markets.

With respect to the second question regarding our utilization, I don't think that we came into the quarter overfleeted. I do think one of our competitors was, by their own admission, and that issue got compounded by the weather effects that we referred to.

Having a number of storms fall at the beginning of the week reduced the length of rental for transactions we got and caused some transactions to go away. What is interesting is that you only need one out of every 50 transactions to go away to create a 2% overfleeting and to have this sort of utilization impact that we had. And that's why the timing of weather had a larger impact than might normally be expected.

And those weather impacts really were felt in a variety of ways. One, it reduced the amount of volume we had. Second, it reduced the utilization that we got out of the fleet that we had. And, third, the combination of those two things made the pricing environment or the realized pricing that we achieved a bit more difficult.

So as we look ahead to the remaining eight or nine months of the year, the weather effects should be significantly less and ideally nonexistent. So those issues should go away. We have our fleet in line with where we want it to be and feel good about that. We are expecting the competitor that has had the biggest challenges with fleet levels to have made a fair amount of progress by June or July in getting its fleet in line with its demand.

Operator

Brian Johnson, Barclays.

Brian Johnson - *Barclays Capital - Analyst*

Thank you very much. Just wanted to follow-up on the fleet sizing, fleet utilization issue, just kind of up on that. To what extent does the fleet get back into shape? And if they do get back into shape, what does that imply about your guide?

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

As I was saying, Brian, I do think fleets are going to be in line with demand, based on what we are seeing. We feel good about our fleet levels and I expect our competitors' fleets will be even more in line with demand over the remainder of the year than they were in the first quarter.

What that means for our projections is that I think it's built into or assumed in the projections that we have. We are not assuming a significant underfleeting or overfleeting by us or by our competitors over the remainder of the year.

Brian Johnson - *Barclays Capital - Analyst*

Well, you mentioned weather, which presumably January/February. Can you give us a sense, if you look at March, how the utilization shaped up there, especially as that is beginning to be when fleets are beginning to be expanded for spring travel?

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Sure. Utilization strengthened in March, as you would expect, for those reasons and I think, as we highlighted in the call, we saw strong pricing, up 5% in Florida over the course of the quarter.

And the reason we included that data point is that Florida is an area that largely was not impacted by weather and so we ended up with, generally speaking, the amount of demand that we had fleeted for. And we were able to get pricing in that sort of environment. And so that is an important data point for why we feel good about the industry's ability to be right-fleeted and about what that would mean for our realized pricing as we go out into a less weather-impacted portion of the year.

Operator

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

Ron Nelson - *Avis Budget Group Inc. - Chairman & CEO*

Thanks, everyone. Before I close, I think it important to reiterate what we believe are the key points from today's call.

We had a solid beginning to the year, despite the effect of winter storms. Pricing in our US Avis and Budget brands did increase through the first quarter and we are cautiously optimistic that as industry fleets get in line with demand we will be able to achieve better pricing. Fleet costs continued to be better than expected and we have moved aggressively to take advantage of the strength of the used car market. And early indications are that Europe could have a very good summer, while pricing in Australia appears to be normalizing.

We do have a full investor calendar this quarter, starting with the Baird Growth Conference later this week, and we look forward to seeing many of you during our travels. With that, I would like to thank you for your time and interest in our company.

Operator

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