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Avis Budget Group, Inc. (CAR)

Q4 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Avis Budget Group Fourth 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, Eunice. Good morning, everyone, and thank you for joining us. On the call with me are Larry De Shon, our Chief Executive Officer and David Wyshner, our 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 Chief Executive Officer, Larry De Shon.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

Thank you, Neal and good morning. As you saw on last night's release, we had a record 2015 with the highest reported revenue and adjusted EBITDA in our company's history. Achieving record results in the year when industry fleet levels were elevated for much of the time, commercial volume was weaker than expected, and international pricing remained difficult, reflects the resilience of our business model and the hard work of our team.

As I look back on 2015, we achieved several significant accomplishments that strengthen our company's global position. We acquired Maggiore, making us the largest car rental operator in Italy and also acquired our Avis and Budget licensee in Scandinavia and our Avis licensee in Poland. We completed the integration of our former licensee for Budget Southern California. We generated millions of dollars of what will be recurring savings through our Performance Excellence and Transformation 2015 initiatives.

We generated more than \$500 million of free cash flow, which is our fourth consecutive year exceeding \$450 million. And we used the majority of that free cash flow to repurchase nearly \$400 million of our own shares, representing 8% of our outstanding shares. Even with all of these achievements, I believe there is much more that we can accomplish. We have significant opportunities to leverage technology both to enhance how we interact with our customers and to streamline our operations as well as drive higher margins. As you saw in the outlook we issued last night, we will be investing in those technologies that will put us in the best position to capture those opportunities in the years that follow.

Our 2016 outlook reflects more than \$50 million of incremental investments we are making in our business. Investments that are expensed rather than capitalized. The areas we're targeting for higher spending include: development and testing of our self-service technology; new information technology; and data analytics to drive cost reductions; expanding Zipcar's very successful ONE > WAY offering into new cities; accelerating the growth of our joint venture in China; as well as incremental brand marketing; enhancements to our Avis loyalty program; and new and expanded marketing partnerships.

We believe that now is the right time to make these investments, not only to improve our growth prospects for the years to come, but also to expand our long-term margins by capitalizing on a number of opportunities that various new technologies provide us.

But before I get ahead of myself, I know you have questions about our 2015 results and our plans for capital deployment. So for that, it's my pleasure to turn the call over to our CFO, David Wyshner.

David B. Wyshner

President & Chief Financial Officer

Thanks, Larry, and good morning, everyone. Today, I'd like to discuss our fourth quarter results, fleet costs, our balance sheet and cash flow, our 2016 outlook, and how we think about capital deployment. Along the way, I also want to discuss our current thinking around ride hailing and card sharing. My comments will focus on our adjusted results, which exclude certain items and are reconciled to our GAAP numbers in our press release and in the earnings call presentation on our website.

Even though Larry already mentioned it, I think it's worth repeating. We had a record year in 2015. This is true from a number of perspectives. We serve more customers than we ever have. We generated record levels of

revenue and adjusted EBITDA despite major exchange rate headwinds. We again grew our margins. We bought one of the largest independent car rental companies in Europe. We invested more in technology than ever before. We expanded our efforts to drive productivity and global consolidation of various functions. And we generated more than \$0.5 billion of free cash flow and used much of it to buy back more stock than ever before.

In this context, the decline in our stock price in 2015 was disappointing. But our team remains focused on what we can control. And we know the companies that consistently generate \$5 of free cash flow per share don't have stock prices below \$30 for very long, even in a choppy market.

As we reported last night, our adjusted EBITDA for 2015 was \$903 million, and for those analysts who compare company margins and valuations based on adjusted EBITDA before deferred financing fees and stock-based compensation, our 2015 adjusted EBITDA would be \$959 million. And most importantly, our constant-currency adjusted EBITDA growth last year was 9% and our constant-currency adjusted EPS growth was 15%.

In the fourth quarter, revenue in our Americas segment grew 1% and rental days grew 3%. And while our revenue increased, so did our fleet utilization, which improved by 100 basis points in the quarter, reflecting some dissipation in manufacturer recalls, as well as benefits from our demand fleet pricing yield management initiative. We grew our adjusted EBITDA margin by 110 basis points to the highest fourth quarter margins in our history. Leisure volumes increased 7% in the quarter despite a shorter December holiday period compared to last year. Leisure growth was driven by our new airline partnerships and bookings through our websites.

Commercial volumes, however, continued to be challenging in the quarter, declining 3% including a 2% drop in the United States. Our analysis of broader travel patterns suggests that our results reflect overall commercial travel demand, not any significant shift in demand for car rental services among commercial travelers. Not surprisingly, our customers in the energy sector have curtailed their travel most, but the softness certainly extended beyond just oil and energy.

Still, we continue to have success in our strategic initiative to grow disproportionately in our most profitable customer segments and channels. In particular, international-inbound volume continued to grow, increasing 4% in the quarter in spite of the strength of the dollar. Demand for our non-core and Signature fleet grew 10%. High-margin ancillary revenue increased 5% in the quarter, including 18% growth in satellite radio revenues, and we continue to shift reservations to our proprietary channels including our mobile apps, which saw volumes increase more than 30% at Avis and nearly 60% at Budget.

Pricing in the quarter was challenging as the trends that we experienced in the third quarter continued into the fourth quarter. Rate per day in the Americas declined 1.5 points in constant currency. Faster growth in our Payless brand had a 30-basis-point negative impact on our reported pricing, while the mix effect of lower commercial volumes negatively impacted our pricing by another 40 basis points. Commercial pricing in our core domestic Avis and Budget brands was down less than 1 point, while leisure pricing was unchanged.

The fourth quarter is typically commercially dominated outside of the two holiday periods. As a result, the softness in commercial demand made it particularly difficult to drive higher realized rates in the quarter. The trend of lower year-over-year pricing has continued thus far in 2016. We continue to push for higher realized pricing wherever and whenever possible. But as you could see in our press release, we're not building pricing growth into our 2016 projections. I'll talk more about those in a bit.

In our International segment, for the fourth quarter, revenue is unchanged on a reported basis, and grew 12% in constant currency. Volume was up 21% with the acquisition of Maggiore contributing 11 points of that increase. We saw strong growth in Italy and Portugal in the quarter, driven by a combination of both commercial and

leisure demand. We also saw strong commercial demand in Spain and Germany. In France, demand declined but was relatively resilient with the terrorist incidents in Paris having the most pronounced impact on inbound travel.

The pricing pressures that we have experienced all year in our International segment continued into the fourth quarter. Pricing declined 4% in constant currency, excluding the acquisition of Maggiore, reflecting a highly competitive pricing environment in both Europe and Australia. Adjusted EBITDA decreased to \$32 million in the quarter due to currency effects, soft pricing and timing differences with the third quarter that we mentioned during our last call. Because of the timing differences, we think it's helpful to look at our second half 2015 International results in total and in the second half, adjusted EBITDA in our International segment grew 13% in constant currency.

Turning to our fleet, per unit fleet costs in the Americas declined 7% in the fourth quarter. For the year, Americas per unit fleet costs declined 4% and we sold a one-third of our risk vehicles through alternative channels, more than double the number from two years ago. Looking forward, we're not expecting the decline in fleet costs that we achieved in 2015 to repeat in 2016, but we've been working hard to limit the impact of higher program car costs and the effect of lower vehicle residual values. As we announced last night, we expect our 2016 Americas per unit fleet cost will increase 3% to 5%.

Let me provide a little bit more detail. As I mentioned previously, vehicle availability was somewhat tighter from [ph] earlier year 2016 (11:15) than in prior years. This created pressure on our program fleet cost, which we expect will increase 6% to 8% this year. We anticipate that residual values for risk cars will decline 1 point or so to approximately 77% of cap costs, which is slightly below our long-term average. We expect that risk cars will represent about 60% of our fleet this year compared to 55% in 2015. We will continue to aggressively manage our fleet and expect to increase our utilization slightly in 2016. And our increased use of alternative disposition channels has been a win for us, so we plan to sell even more of our risk cars through such channels in 2016.

Moving to our balance sheet, our liquidity position remained strong with nearly \$5 billion of available liquidity worldwide. We ended the year with \$452 million of cash, no borrowings under our corporate revolver, and more than \$1 billion of availability under that facility. We had unused capacity of more than \$3 billion under various vehicle-backed funding programs.

Our ratio of net corporate debt to EBITDA was 3.3 times, or 3.4 times excluding the effect of a fourth quarter change in the accounting for deferred financing fees. And we have no corporate debt maturities until fourth quarter 2017. We expect to issue vehicle-backed debt this year, as we do every year, primarily to refinance our ABS maturities which, this year, have an average interest rate of 3.5%. Based on current conditions in the ABS market, we expect that replacement debt will carry an interest rate at or below that level.

Our free cash flow in 2015 totaled \$525 million. We continued our heightened share repurchase activity in the fourth quarter buying back more than \$117 million of stock. For the full year, we spent a record \$394 million to repurchase approximately 8.8 million shares or 8% of our shares outstanding. We also passed a significant milestone in the quarter, having now spent more than \$1 billion of cash on a combination of stock buybacks and convertible note repurchases which together have reduced our diluted share count by 22% from its peak in 2011. We continued to repurchase stock in the first six weeks of 2016, but we were required to operate under a 10b5-1 plan, which doesn't provide as much flexibility as if we'd been able to control our repurchases day by day.

Looking forward, while we will continue to look for accretive tuck-in acquisitions, we expect to use our free cash flow primarily for share repurchases. With our stock trading at a 17% free cash flow yield, share repurchases are particularly attractive right now. We currently expect to do a significant amount of repurchases in the first half of the year even though our cash flow generation is typically weighted towards the back half of the year. With our

board having increased our authorization by \$300 million in January, we are estimating that we will repurchase \$300 million to \$400 million or more of stock this year.

I want to take a moment to talk about ride-hailing. The question of whether this is impacting us comes up in our discussions with many of you and we've now had the chance to analyze our full year 2015 volumes and compare them to the prior year in order to look at whether the rapid growth of ride-hailing is having any material impact on our business. We've looked at our one-day rentals, all rentals with less than 50 miles or 75 miles or 100 miles driven, volumes in cities where Uber and Lyft are well established and growing, where corporate travel managers are seeing, and even what we hear about or from ride-hailing companies.

For starters, while short-length rentals would appear to be the ones most susceptible to replacement by taxi, radio car, or ride-hailing services, our volume of one-day rentals actually increased in 2015. Similarly, while low-mileage rentals would appear to be most susceptible to alternatives, the percentage of our volume that comes from customers driving less than 50 miles during the rental was unchanged year-over-year, same for less than 75 miles, same for less than 100 miles.

One-day rentals represent only 3% of our rental day volume and under 50-mile transactions also represent only 3% of our rental days. These statistics are part of why we view the use cases for car rental and ride-hailing to have minimal overlap. We looked at our volumes in Boston, Chicago, New York, San Francisco, and Washington, the biggest cities for ride-hailing and saw that our rental day volumes increased 2% there, consistent with our overall organic volume growth in the United States.

And lastly, we spoke with close to 100 corporate travel managers on this topic. They consistently see room for ride-hailing to replace taxi or radio car use, but they continue to view car rental as the best value to meet their traveler's non-taxi needs. The reality is that the use cases for car rental and ride-hailing are very different. Our average renter drives our cars more than 450 miles over the course of four days. That's an average of more than 110 miles per rental day. When you look at shorter-length rentals such as one-day or two-day transactions, the mileage per day actually increases. These are clearly not trips where ride-hailing, often at a cost of around \$4 a mile, is going to be economic.

Another way of looking at this is that 97% of our renters drive our cars more than 50 miles over the course of a transaction, making substitution with a ride-hailing service prohibitively expensive. The net result is that the data simply don't support the argument that the growth in ride-hailing is coming at the expense of car rental. At the same time, we don't ignore the fact that new companies in spaces adjacent to ours are growing rapidly and have significant access to capital. As Larry will discuss, we're investing in technology and capabilities to ensure that we continue to be well positioned to be a leading provider of ground transportation services even as mobility solutions evolve.

In that context, Zipcar is an important part of our strategy. It continues to be the established leader in the growing car-sharing market, and 2015 was a record year for Zipcar. We grew our membership in established markets such as Boston and New York, as well as completely new markets. Zipcar can now be found at more than 500 colleges and universities. Zipcar launched ONE > WAY service in Boston, and ONE > WAY pilots in Seattle, Los Angeles, Philadelphia, and Denver. We also introduced Instant Join, which allows consumers to sign-up and become Zipsters in minutes instead of days.

And looking forward, 2016 looks to be just as busy. Zipcar will continue to expand into new markets and universities to serve more members. We expect to launch Instant Drive in the first half of the year, which will allow many new members to sign up and actually begin driving within minutes using only their smartphone. We

will continue to expand ONE > WAY into new markets, and we expect Zipcar will pass a major milestone this year, crossing the 1 million-member mark.

In short, Zipcar remains the clear leader in the car-sharing industry. We see car-sharing and ride-hailing as occasionally competing with each other, but they generally represent complementary solutions for people in cities and on campuses who don't own their own car. We see Zipcar evolving from historically offering only roundtrip transactions to providing roundtrips, booked-in-advance one-way transactions, and eventually unreserved floating availability. In this way, Zipcar will continue to play a growing role in the mobility industry as the trend away from car ownership in cities continues to accelerate.

Finally, I'd like to discuss our expectations for the upcoming year. We have, again, gone through a rigorous and detailed annual planning process with our focus on cost saving and revenue-enhancing initiatives we can drive. In today's uncertain economic climate, key inputs such as demand growth, the industry pricing environment, and fleet residual values proved to be particularly challenging to get comfortable with this year. Nonetheless, I think we built a realistic plan for 2016 that requires execution on a number of important initiatives throughout the year, throughout the world.

As Larry noted, our 2016 outlook reflects more than \$50 million of incremental investments we're making in our business this year, investments that are expensed rather than capitalized, in addition to the more than \$100 million we are investing in technology as part of our capital expenditures this year. As we announced last night, we expect our revenues to increase 2% to 4% this year compared with 2015 including what is currently about a point-and-a-half negative impact related to exchange rates. In the Americas, we expect our rental days to increase 2% to 4% and our pricing to be unchanged in constant currency.

In our International segment, the macroeconomic climate appears to have stabilized, but we remain cautious about the competitive environment as it relates to pricing. We expect international revenue to increase 7% to 10% in constant currency. Total company fleet costs this year are expected to be \$280 per unit per month to \$290 per unit per month, reflecting low-to-mid single-digit constant currency cost increases in both of our operating segments.

Our Transformation 2015 initiative to increase global process consolidation is expected to contribute around \$70 million of savings in 2016, roughly half of which is incremental to the initiatives benefit in 2015. We expect our adjusted EBITDA in 2016 will be \$820 million to \$900 million inclusive of a roughly \$30 million currency headwind. And our forecast of adjusted EPS is centered around \$3 per share, which includes a benefit of our continued share repurchase activity. We also expect our cash taxes to be \$40 million to \$60 million, and that our non-fleet capital expenditures will be roughly \$210 million this year. As a result, we expect our free cash flow to be \$450 million to \$500 million in 2016, absent any significant timing differences. This works out to roughly \$5 per share, giving our stock a free cash flow yield of 17%.

The year-over-year pricing softness we've seen so far this year, as well as continued soft commercial demand is a headwind for us in Q1 in the Americas. We're also expecting our International EBITDA to be down in the first quarter, but that's entirely driven by exchange rate movements. So as you build out the quarters in your models, please know that we currently expect to generate a higher percentage of our full year earnings in the third quarter this year compared to last year, and a lower percentage of our full year earnings in the first quarter.

Currency effects were significant for us in 2015, negatively impacting our adjusted EBITDA by \$49 million. We are estimating that currency will be an approximately \$30 million incremental EBITDA headwind this year, with the majority of that occurring in the first quarter. We have provided a slide that lays out our estimate of the effects that currency movements will have on our revenues and adjusted EBITDA this year by quarter. The ultimate

impact of exchange rates on revenues will depend on where exchange rates go this year. But the impact of future currency movements on our full-year 2016 EBITDA should be more limited as a result of the beginning of year hedging that we do.

In closing, I'm proud of our worldwide team for having delivered record earnings in 2015 despite nearly \$50 million of currency headwinds. I'm proud of having grown our margins by 90 basis points over the last two years and by 270 basis points over the last five years. I'm enthusiastic about the investments we're making in our business, particularly in technology.

At the same time, recent trends have made us more cautious in our outlook for 2016. Projected per unit fleet cost increases are eating up the benefit of our projected volume growth. And with pricing currently projected to be unchanged in constant currency, the outstanding difficult work being done to drive efficiency throughout our organization, including acquisition integration, is offsetting inflationary pressures in our \$6 billion of non-fleet costs rather than driving significant margin growth this year. What this means for us is two things. First, we need to continue to push for realized pricing growth even if it's not built into our forecast. And second, meeting and exceeding our plans to drive incremental efficiency in our business is more important than ever.

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

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

Thanks, David. In just a few months since I returned from Europe, I've had the chance to review most aspects of our business and I'm excited for the opportunities that are in front of us. A year ago, the industry was still dealing with an oversupply of cars, which we don't expect to recur this year.

In terms of demand, while we expect the softness in commercial volumes to persist due to macroeconomic conditions, the addition of our new and expanded airline partnership should translate into strong leisure volumes this year.

In terms of pricing, while we haven't assumed price growth in our 2016 forecast, I do think the environment is more constructive this year compared to last year. All major industry participants have implemented price increases in the last several months. With tighter industry fleets, we should be in a position to capture higher-yielding business, particularly during our peak periods. But it's the future that I'm really excited about. I believe, we have tremendous opportunities to change many things we do today to simplify the business, to change how our customers transact with us, and ultimately drive higher margins.

Over the past few years, we've improved the customer experience through new websites and apps and driven incremental revenue through our Demand-Fleet-Pricing initiative. But we've only just begun the journey. By investing in new technology, such as self-service car rental and taking advantage of connected cars, nearly every process we do today has the opportunity to be improved.

First, let me start with how we'll be using technology in the near term to impact our results. As David mentioned, our Transformation 2015 initiative is providing substantial benefits by strengthening, standardizing, and globalizing some of our non-field functions. In addition, opportunity exists to leverage technology to improve some of our largest non-vehicle cost items. By putting people in charge of these large cost centers, investing in the tools and the resources they need to help them identify opportunities to drive efficiencies and making them accountable to improve these metrics, we should be able to drive substantial cost out of our business over time.

One example is fleet shuttling, to ensure we're driving the highest profitability possible from our shuttling decisions. Another example is our field labor force to better match our manpower with our daily, weekly and seasonal demand peaks. And there are other areas where we can drive substantial cost savings. And when you consider that we spend more than \$1 billion in aggregate on items such as these, the multiplier effect of only a small percentage change can mean significant savings.

We will also continue to expand our Demand-Fleet-Pricing yield management capabilities. Phase I, the pricing manager, has been implemented in most of North America's largest airports and local stores as well as in Australia and New Zealand, and we plan to begin implementing it in Europe later this year. We are rolling out Phase II, the new demand forecaster, in the Americas, which will give us enhanced visibility into our demand with more accuracy and further into the future. And Phase III, which is expected to begin rolling out later this year and into 2017 in the Americas, will integrate the fleet optimizer with our price manager and our demand forecaster.

Once implemented, this system will allow us to optimize each day the millions of decisions inherent in our business that are impossible to look at manually, enabling us to drive incremental earnings. We will continue to enhance our websites, our mobile apps and our electronic communications with customers. We launched completely new websites in France, Germany, Italy, Spain and the Netherlands in 2015 and overall conversion rates improved in the year. Already in 2016, we have launched new websites in Austria, Belgium, Luxembourg and Portugal, and we are planning further enhancements that will enable us to more effectively sell ancillaries, including the bundling of products, to increase our average revenue per transaction.

Looking further out, you can start to see how we can use technology, some of which exists today, to have a positive impact on our business. We will realize incremental benefits each year as we roll out our Demand-Fleet-Pricing technology across our international locations. You will also begin to see a significant change in the experience we offer customers as we ramp up our self-service car rental offerings to more consumers where their entire interaction is done through their mobile device. Customers will be able to make a reservation on their Avis app, and when they land, their phone will tell them the location of their car and show pictures of other vehicles they can choose from. When they arrive at their car, they will use their phone to unlock the door and then simply drive away. And when they return, they will simply walk away from their car and receive a receipt instantly on their phone. It's that easy.

And while it's clearly enhancing the premium experience for our customers, it's also a significant source of cost savings and incremental revenue. Knowing the customer has arrived and is coming for the car allows us to manage our inventory in real-time, significantly eliminating unused assets. And when customers simply use their Avis app to make their reservation, they are less likely to go to other places to price shop. And this technology isn't a long way off. We're currently testing self-service car rentals with a few thousand cars and are looking to expand it into more markets throughout the year.

Finally, looking longer term, we have already started to plan and prepare for the intersection of self-service, connected car, and new vehicle technologies. Think of all the things that we do every day to manage our fleet. We have hundreds of manual processes supporting the purchasing, in-fleeting, servicing, maintaining, renting, shuttling, and finally selling or turning back our vehicles. We rent tens of thousands of cars to all types of customers throughout the day every day. Even something as simple as assigning a car to a customer can be enhanced. There are a number of choices of cars that are available to be assigned, but there is only one that is the very best one for that customer. With better information through technology, that choice can be the right one more often than it is today.

Now think of all the possibilities when technology allows two-way communication between our fleet and our systems, allowing us to dynamically optimize the available fleet to demand at a location level at every turn, not

allowing a car to end its rental life away from a disposition location saving us shuttling cost, on a low-utilization day not burning miles on a risk car when you have a better option. There are hundreds of processes like these that are at the core of what we do at every location every day where we know inefficiencies exist, but can't improve what we do without taking advantage of new and emerging technologies.

Now while connected cars exist today, this technology and others will clearly become more pervasive in the years to come. But we're not sitting around waiting for that time. The combination of connected cars and self-service rentals, and ultimately autonomous vehicles opens up tangible opportunities to enhance customer service, lower operating costs, improve fleet utilization and more. And because the financial implications at each of these are substantial, we are investing today so we can reap the rewards in the future.

So I hope I've given you a glimpse of our vision of where we need to go and what we are doing today to drive us there. And while a lot of this sounds like it could be a few years away, we've already assembled a cross-functional team who have mapped out all of the things that we do from in-fleeting to de-fleeting and everything in between, with the goal of determining what are the early wins that we can begin to attack now.

In the short term, though, here is what you should expect from us: we're going to devote our time and energy on those items we can control; we're going to strengthen our data analytics to help us be more granular in running our business more efficiently; we're going to make investments in new technologies to further enhance our service offering and drive higher earnings; and we'll continue to allocate our free cash flow to drive shareholder value, including the deployment of most of our free cash flow this year towards share repurchase.

The broad mobility space is changing and I for one am extremely excited about what this means for us. Whether it's at Zipcar or our car rental business, our customers are telling us they want a personalized, tech-enabled experience, and we plan to deliver that.

With that, David and I will be happy to answer any questions that you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Chris Woronka of Deutsche Bank. You may now ask your question.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Hey, good morning, guys. Larry, maybe I could start off with a big picture question, kind of ask you how you see your relationship with the OEMs evolving over time? They've, obviously, in some cases tried to get into a small part of our business, I guess, for various reasons. But how do you see it evolving over the next several years?

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

Thanks, Chris. We have an excellent relationship with our OEMs, and we talk to them frequently about matters of today and matters in the future. It's not a surprise that, I think, that you see OEMs getting into things like the car-sharing business. Obviously, they're all trying to sort out where they see themselves for the future of mobility.

I think there's a lot of things that we can do together. We have talked to OEMs about strategies that we can look at in the future as it relates to technology that enables us to partner together to provide a better service outcome for our customer. So I just see the partnerships getting stronger as we go forward. Sure, they are testing certain car sharing, for example, as we're in the car-sharing business. But, overall, I think the partnerships are good. I think they'll continue to be good going forward. We're obviously a big purchaser of their vehicles. So I don't really see any issues there.

Chris J. Woronka

Deutsche Bank Securities, Inc.

Q

Okay, great. And maybe just an update on where you are, your thinking in terms of the prepaid options and also maybe some policy changes on cancellations, length of rental, that kind of thing?

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

Prepaid is an important part of the product offering that we have. We continue to try to push our prepaid, and our prepaid continues to grow globally. It's very strong internationally, and it's growing in the Americas as well. We have tried non-cancellation fees in the past. We've taken a look at it. We're obviously prepared to be able to do it, to execute on it. But when we tried it in the past in the U.S., we just didn't see the traction in the industry. So, therefore, it's something that we are not considering at the moment. But we do have it in Europe and we instituted it a few years ago in Europe, and it works well for us in Europe. And customers don't seem to really have an issue with it. In fact, I rarely see a customer complain as it relates to the cancellation fees. So I don't know. We'll see. We'll watch the marketplace and see how things progress.

Operator: Thank you. Our next question came from the line of Anj Singh of Credit Suisse. You may now ask your question

Anjaneya K. Singh

Credit Suisse Securities (USA) LLC (Broker)

Q

Hi. Good morning. Thanks for taking my questions. I was hoping first if you could just discuss what your guidance assumes for maybe the commercial volume outlook versus the leisure volume outlook. And I would be interested to hear what your perspective is on the commercial volume weakness you're experiencing ex-O&G. It seems like from other travel-related companies the outlook on commercial demand is relatively more optimistic. So just any thoughts around those factors. Thanks.

David B. Wyshner

President & Chief Financial Officer

A

Sure. With respect to our expectations for 2016 in volume growth, we don't provide separate numbers for commercial and leisure, but I think it's fair to say that we expect leisure to be stronger than commercial, and certainly you can see that trend over the last six months of the year.

In terms of what we're – I think the strength that we're having on the leisure side is a big part of the equation as well. And I think we're seeing some shift in terms of the mix of folks who are getting our planes and arriving. And as a result, it's helping on the leisure side and hurting us a little bit on the commercial side. And as I mentioned in my remarks, I think commercial softness that we're seeing is certainly most pronounced among oil and energy-related accounts, but there seems to be a bit of it pockets of other softness outside of those areas as well.

When we look at some of the data that are out there, including some of the USTA data, we believe what we're seeing is consistent with what's going on in the marketplace, but I do understand that there have been a few other folks who are somewhat more optimistic or somewhat more bullish about recent trends in commercial travel. But I think the mix issue between leisure and commercial is impacting car rental and impacting us.

Anjaneya K. Singh

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. I appreciate it. And then as a follow-up, in light of your guidance and commentary on investments, could you help us with your thoughts on how you view margin expansion over time? It seems one of your competitors has a view of significantly increasing margins from a level that's currently about flat with yours in the Americas despite investments. And I realize there's many mix differences contributing to this. But where do you think your margins can go from here? And how long may it take to see the return on the investments that you're making? Thanks.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

We know that there's margin expansion opportunities globally. We're very focused on it in international and there's a number of initiatives that are being put in place to continue to grow our margins there as well as there is in Americas. And what you see in these investments, I think, if you can think of them as building blocks to help us grow our margins over time. So as we won't necessarily see that much margin expansion in 2016, but we are putting in place the resources, the initiatives, the data analytics to get more granular, and particularly in our large cost center items to make sure that we can grow our business and grow it more efficiently. So I would think of this year as kind of building up to the opportunities that we can start to see margin expansion in the 2017, 2018 and beyond years. So we know there's opportunity, and the team is focused on margin growth. And these are initiatives that are really put in place to help us do that.

Operator: Thank you. Our next question comes from the line of Christopher Agnew of MKM Partners. Your line is now open.

Christopher Agnew

MKM Partners LLC

Q

Thanks very much. Good morning, Larry, David. First question; I know you touched on why you're not giving price guidance this year, but maybe just to be clear, are you seeing anything that would lead you to believe the industry can't or even has less ability to recover fleet cost inflation? And do any of your competitors have any cost advantages that would sort of allow them to take a different path in 2016? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

Good morning, Chris. On the pricing projection front, let me be clear, we are and have provided pricing guidance in the Americas and it's at zero percent or unchanged year-over-year. So I think there may be a little bit of confusion out there on that topic, but we haven't changed our approach. We're providing our thinking about pricing. It happens to be at flat year-over-year. And I think, clearly, we expect some cost pressures from fleet over the course of this year. And unfortunately, I think we are experiencing a lag between when we're starting to see those pressures impact us and when we're able to realize higher pricing.

I think one way to look at what we've been talking about this morning is that we did see pricing that was down in fourth quarter and we've seen that so far this year. And so in order to get to the full-year pricing of flat, we are going to need some amount of price increase later in the year. And that is part of what's built in to our forecast of relatively unchanged pricing year-over-year in constant currency.

Christopher Agnew

MKM Partners LLC

Q

Thanks. And then a follow-up on – maybe a question on your approach to corporate leverage, I think at the low end of your guidance, it moves up to around 3.6 times. So how do you think about where leverage should be over the cycle and then your approach to share repurchases if it were to creep up? Thank you.

David B. Wyshner

President & Chief Financial Officer

A

Sure. I think our thinking around leverage continues to be consistent and that is that our targeted range is three times to four times and that we'd prefer to be operating in the lower half of that range, unless we've recently completed a transaction that temporarily takes it up into the second half of that range.

So we are aware that we've moved up a 0.2 point over the last year. We're down to 0.1 point compared to where we were two years ago, and we will continue to watch how that develops based on our EBITDA, cash flow and our share repurchases. But we are comfortable with the lower half of the range of three times to 3.5 times and a movement of a 0.1 turn or 0.2 turn in either direction is something that will happen from time to time.

Operator: Thank you. Next question comes from the line of Brian Johnson of Barclays. You may now ask your question.

Brian A. Johnson

Barclays Capital, Inc.

Q

[audio gap] (44:48-44:58) ...your predecessor talked about a kind of 12%, 13% EBITDA margin, long-term target. This year we're looking at kind of 9% to 10%-ish or this upcoming year with the investments you are making. Can you give us a few things, kind of one, how much of this investment, the \$50 million has come about since you took over [ph] as CFO – CEO (45:24) versus things that were in process for a couple of years? And second, how would you kind of all other things being equal around pricing and fleet cost, see the payoff on these investments in terms of moving you back towards that target?

David B. Wyshner

President & Chief Financial Officer

A

Hi, Brian. So, the way I would really think about it is that these investments are kind of ripe for the company at this time. So, every year we have a series of initiatives that are built up through a very thorough business plan, process and review. And we look at the resources we have in the organization, the number of initiatives that we have, and how much bandwidth we think that we have to really go out and tackle it.

So, this year is just an evolution of those initiatives. So, if you think of self-service, this is something we've been looking at for a number of years, it's not something brand new this year. We were actually testing kind of early versions of self-service technology for rental car back in 2009, but it just wasn't right. The technology hadn't really advanced at this point. But now, we're taking a look at the technology that's out there and the number of providers that have this kind of technology, and we felt like this is the year to really start pushing forward on that initiative and making that kind of investment.

Once again, just the better analytics and the better tools that we have to really soar over the top of our large expense lines. We've been working many initiatives, for example, in manpower and also many initiatives in shoveling through our PEx, our performance excellence team. And I think we've driven the efficiencies as well as we can without putting some additional technology on top of it that helps us get a lot more granular at a location level to really understand these costs at a deeper level and therefore, drive more efficiency. So, once again, the technology is right, the time is right, the evolution of our initiatives as a company is right. And we've got resources that we can put on top of this to own these cost lines and to really work the technology and use the data analytics properly to get more granular.

When you take a look at ONE > WAY, this is something we've been working on for a couple of years now, and we've been testing it in Boston and other locations and we've rolled it out in Boston, and it's had very good positive impacts for us. So, once again, we're going to now make that investment and roll that out into more locations as we go forward.

So, as you look at all of these, I think, it's just the right time for where we are. And all of these initiatives – there are investments we're making now, we'll be making next year as well, but we think that they will help us get to a longer term margin that we can be pretty proud of. And so, we are going to drive our margins forward. That is what we're focused on. These are building blocks, as I said earlier, to help us get there and make the investments over the next few years to get there and there's no reason why we can't get our margins into the teams over the longer term.

Brian A. Johnson

Barclays Capital, Inc.

Q

Okay. And second question, kind of more shorter term, you mentioned that the OEMs were less than accommodating on some of the cap costs, you expect residuals to be down 1% to 2%, as we look within the car sales data in the new car market, we consistently see weakness in small and mid-sedans which, a) maybe you could remind us what percent of your U.S. fleet those typically compose, both in terms of the sales pace and the

pricing trends? So, what, couple of questions, a) how much of your fleet U.S. fleet are those small to mid sedans and does it differ between risk and program, and b) why do you think the OEMs are holding the line when this is a category at least in the new car showrooms [ph] and which (49:22) consumers seem to be avoiding? And three, when you think about your fleet cost assumption, how are you kind of factoring this disconnect between OEMs wanting price on new sedans and the used market not supporting pricing on new sedans?

David B. Wyshner

President & Chief Financial Officer

A

Sure. With respect to the mix of cars, we do have a broad mix, and smaller and mid-sized sedans represent a significant portion of that. We'll get the exact percentage for you. I don't have it in front of me right now. As we think about the issues with the OEMs and the acquisition of fleet, it is typically a discussion about purchasing a range of fleet. And we'll go through in a situation such as the one we're in, where gas prices are quite low by historical standards. We're seeing, as you'd expect, more of a willingness to sell smaller, more fuel-efficient vehicles to us.

We're seeing on the flipside, the residual values associated with those vehicles tend to be a little bit lower as well. So, our desire to change our mix as a result of purchase prices being lower isn't necessarily there.

And on the flipside, we have been growing the amount of non-core cars, and the amount of signature fleet in our mix to try to meet customer demand in that area and also, because that tends to be a more profitable portion of our fleet. And as a result, we end up having a discussion about wanting some vehicles that the manufacturers are doing really well, selling on a retail basis right now. And in that context, it's a multi-point – multi-part negotiation for us to get the types of vehicles we want because we're not going to be in a situation where we're really happy just taking the sort of vehicles that manufacturers most want to give to us. We have to consider the residual values that are out there, and we have to really consider meeting our customers' needs, and the various profitability associated with various vehicles.

Operator: Thank you. Next question comes from the line of Afua Ahwoi of Goldman Sachs. Your line is now open.

Afua A. Ahwoi

Goldman Sachs & Co.

Q

Thank you. Good morning, team. Just a question from me and then I'll have my follow-up right away. First of all, on the pricing front, I think you mentioned earlier, I can't remember if it was Larry or David on that, you're seeing competitor price increases over the last few months, so I'm just curious if you can give some views or color as to why maybe those haven't stuck and why we're still seeing year-on-year declines through the fourth quarter and to-date?

And then the second question on the – as we think about the \$50 million investment or more than \$50 million investment you're going to make, for modeling perspective, will that show up more on the SG&A line or on the operating – on the direct operating expense line? And how should we think about those going forward? Is it one-time? How many years, or is this just a new rate of investment we're going to have to get used to over the next few years? Thank you.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

Sure. Good morning. So, on the price increases, the good news is that there have been a number of price increases that have gone in in the fourth quarter and into the first quarter. I think the difficulty is in the fourth quarter and first quarter, other than the two holiday periods in November and December, the industry is usually over fleeted in that period and was certainly over fleeted in the fourth quarter this year. And as you turn the quarter into the first quarter, that over fleeting continues as people look to try to get out of their fleet and sell cars and so forth. So, when you put the price increases in, I think there was pretty good matching by the industry of those price increases. But once you get into the core of the booking pattern, really [ph] the timing of the (53:59) reservations are really coming in close in to the rental date, it just starts to fall apart because people are sitting on a lot of fleet.

So, I think it will be easier as the year goes through, if there are price increases that are put through and fleets are tighter which we are expecting overall for this year compared to last year, you have a better opportunity to be able to yield your rates up and keep your rates up as you get closer into the booking pattern during those tighter fleet moments. But when you're in the fourth quarter going into the first quarter, there's a lot of available fleet, it's pretty difficult for those rates to hang in there as you get close into the booking pattern.

David B. Wyshner

President & Chief Financial Officer

A

And then, hi Afua. On your second question, I think a significant – a portion of the cost will show up in SG&A, particularly things like incremental brand marketing, the enhancements to our loyalty program and new and expanded marketing partnerships will all be in that area. But I'd expect the majority to show up in our operating expenses, whether it's related to the self-service technology. The other technology investments we're making to drive cost reductions, the spending at Zipcar to expand ONE > WAY, and even the acceleration of growth in China, all those should impact direct operating costs.

Afua A. Ahwoi

Goldman Sachs & Co.

Q

Okay. Thanks. And I just asked about how long the investments would continue for.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

It's pretty early yet to take a look at what investments we're going to have for 2017 and 2018, but I would expect that the investment level will be consistent with this year or perhaps slightly less than this year. That's the way I would think about it.

Operator: Thank you. Our final question comes from Kevin Milota of JPMorgan. You may now ask your question.

Kevin M. Milota

JPMorgan Securities LLC

Q

Hey. Good morning, everyone. Just have a question on the commercial side of the business here, what it feels like has been a challenging period for commercial over the last few years. What's the kind of immediate term to intermediate term strategy on how to make that business a healthier business, and actually get price from your commercial accounts? I mean, you see the hotel companies able to get pricing, airline companies able to get pricing from corporate accounts. So, what strategies are you planning to take to perhaps change that dynamic.

And then, secondly, David, you mentioned 6 weeks and 16 year of stock buybacks, I'm sorry if I missed it, but what was the number of shares you bought back and the average price? Thank you.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

A

Hi, Kevin. So, I would talk about commercial pricing increase in this way, if you take a look at the commercial accounts that we renewed in 2015, we renewed 70% approximately, 70% of our renewals were at flat rate or higher. So, we do push very hard to work with the accounts, to find those opportunities where we can get rate improvement overall for the business, overall for the year. And our sales teams continue to really work with our marketing teams to focus on ways to find those opportunities to do that. So, we'll continue to do that. We're taking a look at how we're using our resources as well as far as how we have them allocated to the different customer segments that we sell to.

So, the teams are very focused on that and that renewal rate of 70% was similar in the year before that. So, there are some that are very competitive and will continue to always be very competitive, and we're going to work hard to maintain those accounts, but there's also opportunities as we take a look at how we grow our small business accounts and other non-contracted commercial accounts but we know that the rate per day there is higher. So, we'll be focusing in those customer segments and helping the organization with additional resources to really kind of grow in those segments as well, which will help overall the rate per day for commercial.

David B. Wyshner

President & Chief Financial Officer

A

And on share repurchases so far this quarter, I would describe the repurchases in dollar terms as being fairly consistent with the fourth quarter and clearly the price at which we are repurchasing in the first six weeks of the year was lower than in the fourth quarter.

Kevin M. Milota

JPMorgan Securities LLC

Q

Okay. So, consistent, meaning do you have a dollar amount?

David B. Wyshner

President & Chief Financial Officer

A

We'll disclose our first quarter share repurchases when we announce our first quarter results.

Larry D. De Shon

Chief Executive Officer and Chief Operating Officer

Okay. Before we close, I think it's important to reiterate why I'm still excited about our future. We're a leading participant in a large and growing industry offering essential service to travelers. We had record results in 2015 and have improved our margins by nearly 300 basis points over the past five years. We see tremendous opportunity to invest in and embrace technology to both improve the service we offer to our customers and substantially reduce our cost structure over time. And we'll be investing this year to begin to capture these opportunities, while at the same time, deploying most of the nearly \$500 million of free cash flow we will generate this year in share repurchase. We have an active investor calendar this quarter, with several events planned, and we look forward to seeing many of you during our travels.

With that, I want to thank you for your time and your interest in our company.

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

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