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Hertz Global Holdings, Inc. (HTZ)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Hertz Global Holdings Second Quarter 2019 Earnings Conference Call. Currently, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. I would like to remind you that today's call is being recorded by the company.

I would now like to turn the call over to your host, Leslie Hunziker.

Leslie M. Hunziker
Senior Vice President-Investor Relations, Corporate Communications & Corporate Social Responsibility, Hertz Global Holdings, Inc.

Good morning, everyone. By now you should have our press release and associated financial information. We've also provided slides to accompany our conference call that can be accessed on our website.

I want to remind you that certain statements made on this call contain forward-looking information. Forward-looking statements are not guarantees of performance and by their nature are subject to inherent uncertainties. Actual results may differ materially. Any forward-looking information relayed on this call speaks only as of this date and the company undertakes no obligation to update that information to reflect changed circumstances.

Additional information concerning these statements is contained in our earnings press release and the risk factors and forward-looking statements section of our 2018 Form 10-K and our second quarter 2019 form 10-Q when filed. Copies of these filings are or will be available from the SEC and on the Hertz's website.

Today, we'll use certain non-GAAP financial measures, all of which are reconciled with our GAAP numbers in our press release, which is posted on our website. We believe that our profitability and performance is better demonstrated using these non-GAAP metrics. Our call today focuses on Hertz Global Holdings, Inc., the publicly-traded company. Results for the Hertz Corporation are materially the same as Hertz Global Holdings.

On the call this morning, we have Kathy Marinello, our CEO; and Jamere Jackson, Hertz's Chief Financial Officer. Now, I'll turn the call over to Kathy.

Kathryn V. Marinello

President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

Thank you, Leslie, and good morning, everyone. It's been a busy couple of months since we last spoke and good progress continues on all fronts. We delivered improved U.S. rental car volume, pricing and utilization again in the second quarter. In addition to a market-leading vehicle offering, enhanced service and improved processes are driving NPS scores higher. And value-added service revenue is trending positive year-over-year across all major categories after we put new sales training programs in place and made enhancements to key products.

Machine learning revenue management tools continue to help us find strategic pricing opportunities and marketing initiatives are raising the visibility and value of all three of our major brands, each of which generated price and volume growth in the latest period. This resulted in 3% higher U.S. RPD and a 10% revenue improvement, which extends a quarterly string of high single-digit low double-digit growth. Admittedly, year-over-year U.S. comps get tougher as we move forward, but our commitment to balanced top line growth remains a priority.

Our International segment reported revenue in line with last year on a constant currency basis and a 1% higher pricing. To generate sustainable momentum in Europe, our team is taking a page from the U.S. turnaround and prioritizing a richer fleet mix configuration to better reflect country-specific customer preferences for quality and premium brands, while launching AI pricing and demand forecasting tools across the regions.

At the same time that we're delivering record second quarter revenues, we'll also focus on cost optimization. We have a companywide productivity initiative underway that's paid early dividends, with the second quarter results exceeding our internal plan and giving us increased confidence in the opportunities we have identified to work smarter, leverage our scale and streamline processes. Right now, a portion of these savings are being used to offset technology investments, but next year, these efficiencies will make a more notable margin contribution.

As it relates to depreciation expense, as you saw, the reduction was significant in the quarter. While residual values remain stronger than expected going into the year, multiple factors are contributing to the favorability, including our vehicle acquisition strategy, asset efficiency through transaction growth and extended life TNC fleets and the effective use of our highest return retail sales channel.

So far we haven't seen much softening in the used car market. However, we're being prudent with internal planning and decision-making through disciplined fleet management and cost controls. Our focus on fleet procurement, dispositions through higher earning channels and the opportunistic rotations are capabilities that drive better outcomes on depreciation through all of the cycles.

We're also grounded and thoughtful in how we're managing our technology transformation and we've made significant progress through the first half of the year. We've already rolled out the advanced features and functions of our now cloud-based CRM program, launched our fast and more flexible mobile app, and just last week completed the launch of our new financial systems.

This month, we started user acceptance testing of our core rental and reservation systems. And our plan is to launch our integrated cloud-based platform in a couple of markets in North America this fall. We have exceptional leadership and world-class partners to help ensure the success of the launch and cutover activities. The technology transformation will put us on a path to delivering faster growth and incremental productivity in the years to come, and we're confident in our ability to fully execute our plan.

And as we strengthen our presence and leadership in our markets around the world, improving our capital structure to support growth is also top of mind. In the second quarter, we launched the Rights Offering to retire $700 million of corporate debt, which reduces interest expense and increases financial flexibility. We completed the highly successful transaction last month and at the same time refinanced our 2021 bonds at a lower rate with a new seven year maturity.

It was overwhelming demand to participate in both transactions and I think that reflects the consistent progress we've made in delivering quality top line growth, the margin opportunities from productivity optimization and the revenue and earnings growth potential that the technology upgrade creates. The combination of profit expansion and the recent accelerated debt repayment will deliver greater future value to our shareholders.

Before I turn it over to Jamere, I'll just reiterate that the second quarter was very strong by Hertz by any measure. By aligning ourselves with our customers and through disciplined execution and investments in new revenue opportunities, we are strategically positioned for significant future growth.

The combination of our core rental competencies, car sales infrastructure, Donlen's large fleet management expertise, our ridesharing initiative, delivery services program and telematics and AI capabilities give us a pipeline for future revenue growth that transcends anything we've seen in the past. We've got a great team of dedicated employees in place working hard and working smart every day to elevate Hertz to the next level. It's an exciting time to be in rental car.

Now, I'll let Jamere walk you through more details on the second quarter. Jamere?

Jamere Jackson

Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

Thank you, Kathy, and good morning, everyone. Overall, we had a great second quarter and our results exceeded our previous estimates. The momentum from our growth initiatives, disciplined fleet management, residual value strength and our laser focus on productivity drove significant improvements in revenue and adjusted corporate EBITDA for the quarter.

In addition, we have taken the necessary steps to delever and derisk the balance sheet, which will provide us with tremendous opportunities to grow the business and improve profitability and free cash flows.

Before I get into the details, there is one housekeeping item. In accordance with ASC Topic 260, the company has adjusted the share counts used for both basic and diluted EPS for the second quarter 2019 and 2018 to give effects of the Rights Offering that we launched in June.

Now, let me provide an overview of our total company results, slide 6 – slide 6 shows our consolidated results on a U.S. GAAP basis and our non-GAAP measures for the second quarter. Total revenue of $2.5 billion was up 5%

on a reported basis and up 7% on a constant currency basis versus second quarter 2018, driven by 10% growth in our U.S. RAC segment, partially offset by a 6 point drag due to foreign currency in our International RAC segment.

Revenue results marked eight quarters of consecutive quarterly growth for our business. Net income for Hertz Global was $38 million during the quarter compared to a loss of $63 million in the second quarter of 2018. And net income per diluted share was $0.40 compared to a per share loss of $0.66.

On a non-GAAP basis, adjusted corporate EBITDA improved 124% to $207 million, and our adjusted corporate EBITDA margin expanded by 440 basis points. Our results were driven by higher revenue from increased volume and pricing, combined with lower vehicle depreciation expense in our RAC business and the impact of our productivity initiatives. Adjusted net income for the quarter was $71 million or $0.74 per share compared to an adjusted net loss of $16 million or $0.17 per share in the prior year quarter.

Now, let me provide some additional color on the quarter, starting with our U.S. RAC segment, and I'll start with revenue. Our U.S. RAC business set a second quarter record with total revenues of $1.8 billion up 10% versus prior year. Our TNC business grew 73% and contributed 3 percentage points of revenue growth for the segment driven by robust demand.

The U.S. RAC segment saw strong volume and pricing growth with a 6% increase in transaction days driven by TNC and retail leisure, and time and mileage rate up 3%. Total RPD was up 3% versus the prior year quarter, and ex-TNC, total RPD grew 4% fueled by growth in both business and leisure both on and off airport.

In addition, high margin revenue from value added services were a positive contributor to top line growth in the quarter.

U.S. RAC adjusted EBITDA was $156 million, a $138 million improvement versus the prior year quarter. Our results were driven by the tremendous top line growth, a 13% decrease in monthly per unit vehicle depreciation and solid productivity. Our teams continue to execute on our growth initiatives, disciplined fleet management, service excellence, brand building marketing and productivity, resulting in solid growth and profitability improvements in our U.S. RAC segment.

Now turning to fleet, we continue to manage our fleet capacity with rigor and discipline. Fleet capacity was up 6% and up 3% ex-TNC fleet. Vehicle utilization rose to 82% as we manage a tight fleet and drive segment profitability.

Moving to depreciation, monthly vehicle depreciation expense is up $247 million per unit, decreased 13% versus the prior year quarter. The decrease was a result of disciplined fleet acquisitions, residual value strength and solid execution. In addition, we continue to increase unit sales through a higher returning retail channel to drive solid outcomes and depreciations.

Moving to our fleet sales initiative, our non-program vehicle dispositions were up 5% in the quarter. Dispositions through our retail channel grew 11% compared to the second quarter of 2018, while same-store unit sales grew 4%. We continue to expand our retail footprint through Hertz car sales and we had 84 stores at the end of the second quarter with more to come. Retail car sales is a core capability and represents an important component of our future growth and profitability.

Moving to our International RAC segment, total revenues were $560 million, down 5%, but were up 50 basis points on a constant currency basis as volumes declines offset higher pricing. RPD grew just over 1% and transaction days were down just under 1%. Our business in Asia-Pacific continue to see solid volume growth, while our European business saw some pricing improvements, partially offset by weaker volume.

We have expanded our revenue and fleet management capabilities to our International segment and we launched new growth and service initiatives, which we expect will deliver benefits for the segment similar to what we have seen in the U.S. The International RAC segment reported adjusted EBITDA of $56 million, down $23 million on a constant currency basis due primarily to a favorable expense item in the second quarter of 2018 that did not repeat in the second quarter of 2019.

Now I'll move to the balance sheet and cash flow and I like to provide an update on some of our financing activities and free cash flow. As Kathy mentioned, we announced the stock Rights Offering, which concluded in July. This efficient equity offering raised $750 million, with over 96% of the basic rights [ph] validly (00:13:17) subscribed for and substantial oversubscription requests. The proceeds from this transaction, combined with the issuance of $500 million of unsecured senior notes completed in August, will allow us to redeem the $700 million 2020 corporate debt maturities and refinance the $500 million 2021 loan maturities.

More importantly, this enables us to accelerate the delevering of our balance sheet and provide us with increased flexibility to grow our business and improve free cash flow.

Turning to cash, our cash usage in the quarter is driven by the seasonal fleet ramp up to meet summer demand. However, the strength and residual values and the improvements in operating cash flow has improved our cash outlook for the year. If residual values hold up over the back half of the year as anticipated, then we would expect to generate positive free cash flow in 2019.

So to wrap up, the strong results in the second quarter and early momentum in our summer peak season position us for a solid 2019. Despite tougher comparisons in the third and fourth quarter on revenue and vehicle depreciation, we still expect to drive revenue growth and improvement in adjusted corporate EBITDA in the back half of the year.

Longer term, our growth initiatives will continue to deliver solid top line results, while the focus on productivity and efficiency will contribute to our margin expansion objectives. These dynamics along with a stronger balance sheet give us confidence in our ability to drive long-term shareholder value.

And with that, I'll turn it back over to the operator for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Chris Woronka from Deutsche Bank. Please go ahead.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, everyone, and congratulations to you all on a really terrific quarter. I wanted to ask – it's pretty clear that you're gaining market share on the core business. And is it possible to kind of talk about what inning you think that might be in, if you go back to kind of when this turnaround started, where you were and where you're going, just the trajectory of the market share gains and what you think is possible?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

Well, look, I think there is still more room to gain share for Hertz at a fairly steady pace, not anything really significant. There's a lot of business to go around. If you also look at the macroeconomic environment and the opportunities with ridesharing, last mile delivery, there's a ton of opportunities there to provide vehicles and services to support those efforts. The demand far outweighs the vehicles and the capacity out there. And no one's better at managing, financing and delivering fleets out into the marketplace wherever and whenever you need than Hertz.

And so I think we have a brand and a reputation in the space and we're building that every day. We've seen enormous growth in our ridesharing business. And I think we have more potential off-airport to gain share for those reasons in addition to just probably more of our fair share. As you're aware, we dropped our share over the last several years based on kind of taken our eye off the price, and frankly, I think we're just winning our fair share back. So I think there is plenty of growth for everybody right now and it's a matter of just ramping up and taking what we do well and putting it out there.

And then, if you – one of the gems we have and gifts we have is Donlen. And we were up – our whole team was up in Chicago a week ago, looking at driver point and the capabilities they have to manage all sizes of fleets: fleets of one or two, right up to fleets of tens of thousands. And so with the work they have been doing on telematics and connected car, the work we've been doing, what we have over in Europe that we've developed, and then what we're doing and consistently putting place in technology. Our ability to offer a wider variety of services and capabilities is limitless at this point.

So, yes, we're laser-focused and intently focused on getting our foundation solid. So where we've gotten our balance sheet position and our leverage by the end of the year, I think we'll be in a very good place there, but we're well on our way there by getting productivity and expense management in place in addition to world-class marketing and pricing capabilities. And then, you look at our utilization rate at 82%, I mean, I could not be prouder of the efforts that the entire team has put in and the results.

And then, if you add into it, I was out on the road on the West Coast and watching people incredibly dedicated to delivering world-class service to our customers, cleaning cars in a 110 degree temperatures with a smile on their face is incredible. But if you add in a world-class group of employees that we really value and I think make a difference in this space, there's plenty of room to grow and there's plenty of room to get price for that growth. And we are working it hard. It's not – there is no magic wand here, but I think the things we're doing are progressing slowly and surely and I think there's more to come.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Appreciate all that color, Kathy. And follow-up question is, you've always said that there will come a time when kind of the incremental spending on a lot of these initiatives would kind of inflect partially because of the revenue growth. And it really feels like this past quarter was a big step there. I think the direct OpEx was only up a few percentage points, big margin expansion. Do you think that time has come? And you talked about some of the productivity initiatives. There is going to be a payoff next year. I mean, do you think this was kind of the quarter where you inflected or is there something that would make you go back in the other way?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

Well, look, I think what we have to do is be really diligent and being world-class in our operations. And clearly, the real secret sauce there is technology. And so the work we're doing has taken time, but we're doing it right. We're fixing all of the backbone systems, not just coming up with some add-on stuff that works nice, but what's more important is that our core enterprise systems work flawlessly, have the technology in our employees hands that they need to deliver the right service to the customers, as well as seamlessly enable us with our connected car capabilities.

So this is something that will make a huge difference. So if we are honest, there will continue to be some technology investment down the road probably well through 2020. That work still has to get done and brought to completion. But as I mentioned, we are in user acceptance testing on the really lion's share of it. But I think we are very intent on – we have a good cycle now with the cost of cars being down. And I think you're going to see a different residual market given the macroeconomic conditions around the cost of cars. The population is growing in the space that demands a lower-cost used car. The OEMs are much more rational around how they're producing and what they're producing. The bankruptcy did a beautiful thing for them, took – allowed them to get out capacity and refinance their balance sheets.

But I think looking at SARs at [ph] 17 million (00:21:33) an all-time high was [ph] 20 million, (00:21:37) but that [ph] 17 million (00:21:38) is driven by population growth and a consistent population growth in the United States. I don't – however, given all of that, we're managing our business to be profitable and succeed and continue investments through a down-cycle in residual values, right. So I am not assuming that we're going to be sitting at [ph] 250 (00:21:59) for the next 10 years. We're building an operations and a capability that can weather us through [ph] 350 (00:22:06) or whatever residual values come out at.

So long answer to a short question, but I think we have more work to do on productivity and process and a lot of that is around our technology. But we have to manage, and everybody here knows, we're managing our business to a much higher residual rate. And so I think that will – that discipline will drive overall a higher margin over time.

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

Yeah. The only thing I'll add is that we said coming in the year that we were focused on becoming both a faster growing and a higher margin business. And to do so, we've been focused on growing our direct operating expenses and our SG&A at a slower rate than revenue growth, which we achieved in the second quarter. Revenue grew over 5%, 7% on a constant currency basis, and our DOE and SG&A grew just under 2%.

So there are opportunities, as Kathy mentioned, to get leaner and drive efficiency really across every line item in the P&L. And we're going after them in a disciplined and sustainable way, and you're starting to see the benefits of those things flow through our P&L.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.
A

And I'd add what I really love about our results is that I think we really put strong results on the table for the quarter, but we were also heavily investing in the technology, and the brands, and the marketing, and the people, and the company all along the way. So to be able to deliver that and invest back in the value creation of future opportunities is really how we – our employee base, our leadership is motivated by, look, if we waste a single dollar, that's $1 less we can invest in the future and future opportunities.

So the motivation is very positive. Even if you look at – I think the greatest motivation we've had for the general employee base out in operations is, we have a world-class fleet out there, significantly higher quality than it was two years ago at $100 less than it was at the peak per unit, per vehicle, per month. And I think that's how you got to run the business.

Operator: Your next question comes from the line of Brian Johnson from Barclays. Please go ahead. Brian Johnson, your line is open.

Brian A. Johnson
Analyst, Barclays Capital, Inc.
Q

Thank you. Just took it off mute. Kathy, two questions, well, one for you Jamere around OpEx and second around kind of broader strategy. Around OpEx, it improved as a percent of sales, would you [ph] prescribe (00:24:47) that to the cost reduction initiatives you're growing, just better expense management while the revenue grow, or as you mentioned earlier, some of the technology enabled cost saves?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.
A

It's both. So the most efficient way for us to grow our earnings in the business is through top line. I think that's true for most businesses. But as I've mentioned before, I mean, we are laser-focused on driving productivity and efficiency across our company. So we have literally hundreds of productivity initiatives in every area of our business. Every function has a productivity goal, every area of operation has a productivity goal, and we're driving that with rigor and discipline. And I think those capabilities combined with a growing business where we're getting operating leverage is what's contributing to the acceleration in EBITDA that you see.

And this isn't short of a one hit wonder, the discipline that we put in place around productivity. These are sustained things. So it's not a cut and chase program. It's making sustained structural improvements in our business and putting that discipline in the business going forward.

The technology is really early innings. And so we think the benefits that we're going to see from technology, whether it's through the back end financial systems or the improvement in our reservation and rental systems or our fleet management systems or our customer service systems, those are all things there are yet in front of us, and we think that will add an incremental opportunity for us to grow our margin.

So, again, we're focused on building a faster growing, higher margin business. We do that with disciplined growth on the top line getting both volume and price, and then you do it with really managing your direct operating expenses and your SG&A, and we're running that play with intensity inside the company.

Brian A. Johnson
Analyst, Barclays Capital, Inc.

Q

Okay, second question, it's kind of got two parts, but the same topic. So it's announced that Europcar is acquiring a small company Fox rental car. So kind of two questions. One, before you comment on the merger itself, which probably you won't say much about, but just as we go to – as the airports move to more and more common rental car facilities – I happen to be renting one of your cars at O'Hare the other week [indiscernible] (00:27:16)

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

Beautiful sight. Isn't it?

Brian A. Johnson
Analyst, Barclays Capital, Inc.

Q

What's that? [indiscernible] (00:27:23)

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

It's a beautiful sight. We were just there last week.

Brian A. Johnson
Analyst, Barclays Capital, Inc.

Q

I know, I know. I sent Leslie a note saying, next time give me a call. But my question is, as you look at a facility like that, I'm always struck by how the – kind of what I used to think as the off-airport minor brands are right there on the same footing. And I think Fox was literally between Dollar Thrifty and Hertz or Sixt with the major brands.

So before you comment on Fox, Europcar, what are you seeing in terms of market share trends in those facilities? Do you wind up leaving more – I saw actually a lengthy line. I don't know if that's good news or bad news to Dollar Thrifty that day. So do you see any kind of market share or premium brand erosion when you do to that? When you – airport's new to that type of facility? And then second, what do you think about Europcar, Fox combination?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

Well, actually, what we've done with Dollar Thrifty as we've invested back in those brands, it's actually elevated the Hertz brand. So the Hertz brand is not looking for the Fox clientele. The Hertz brand is more focused on speed, service and reliability, whereas when we get into the value brands, Dollar and Thrifty compete down with those brands. And I would say Dollar more competes with the budget brands and Thrifty more with somebody who is looking for a bargain, which is who is going to go to Fox. And so our fleet, our service reflect that. And what we've seen actually, as our Dollar and Thrifty brands have gotten stronger, our Hertz price continues to grow and be elevated.

So we have – with the artificial intelligence and the machine learning, we've gotten through that capability over the last year and a half since we've had it in place. We continue – as you saw, we got 3% price in the second quarter. And I think it's not an easy environment with the cost of cars going down to do that and the competition.

As far as acquisitions and Europcar doing the Fox acquisition, as I talked about earlier, we think we have competencies to grow our share within the rental space with the three brands we have. And we think we had lost some traction a few years ago and now we're getting it back. And we think we can grow those brands and the capacity they have without having to do acquisitions with companies like Fox.

When we look at growth, as I mentioned before, I think our off-airport locations have a lot of opportunity to expand and grow as well as ridesharing and last mile delivery and those services and capabilities. So I think there is more profit – well, if I step back, there's – when there's great demand and you have a great capacity to meet that demand, that's where you maximize profit. We don't see our future competing down at kind of the ankle biters, low end of the business. We see it providing value services and leveraging the brands we have and the investments we've made in technology in those brands.

Operator: Your next question comes from the line of John Healy from Northcoast Research. Please go ahead.

John Healy
Analyst, Northcoast Research Holdings, LLC
Q

Thank you. I was hoping to talk a little bit more about the TNC business and the exciting growth there. Can you give us a little bit color on what's driving the step up there? Where you ultimately think this business can get to over the next year or two in terms of size, and any early indications on how the profitability of this business might compare to the normal airport rental business?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.
A

So the best way to explain it is, I had a conversation with one of the COO's of one of the ridesharing companies and what they explained in the Chicago metropolitan area, the demand that is there for rides. In order to meet that demand, you would have to sign up all of the licensed drivers in the metropolitan area to really consistently meet the demands of the rides that consumers want.

So it's probably a bit of an exaggeration, but frankly, there's just an enormous demand for drivers. And the greatest challenge, obviously, in that space is you have a car and cars are expensive. And so, when you find a solution like leveraging the depreciation curve of our cars and not selling them into the rent used car space at a time where they're really not at their best peak from a residual value perspective, instead putting them out to these drivers and being able to do it at double-digit margins. It's been a great win for the ridesharing companies, for the drivers and ourselves. And whenever you find a need and demand and a solution where everybody wins, the profitability and the growth is – frankly, we're going to grow this business sensibly and rationally. We're not going to over expand. We're going to leverage the distribution network we have, our ability to buy these assets and sell them, and continue to grow what a – I mean the growth has been huge obviously. And our projections, we have – our projections continue to be well north of 50%, 60%, 70% a year as far as what we're able to add. We will come close to $0.5 billion by the end of the year.

The other thing we're doing, though, is these fleets, we have connected them. So we are able to now and have been building services and capabilities from those learnings. And then, we're leveraging our Donlen business to manage with DriverPoint, the platform that we have for logistics and fleet management, so really learn and go well beyond just putting a – renting a car to a driver.

So I think expanding the services, signing on the DSPs, the delivery service providers that back up some of these larger companies to last mile deliveries, and then expanding it into a real platform of service offerings is where we're heading.

So the growth – we've got – the question before was, are we going to buy low end providers? No. We're probably going to focus in on this space where we've had success. We have a great brand. And there's more than enough business to go around for anybody and everybody in this space.

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.
A

Yeah. And just in terms of profitability, I mean, we're pleased with the profitability of the TNC business. It's a strong contributor to both growth and profitability of our U.S. RAC business.

In the second quarter, our vehicles were up 68%, our pricing was better, our operating costs are improving, and we're obviously benefiting from the lower cost of cars. And when we look at the business in totality, it's actually EBITDA accretive when factoring the benefits of length to keep and the lower vehicle costs offsetting somewhat higher maintenance costs on an older fleet. So we're pleased with the profitability there.

And as Kathy said, the demand has been robust and we expect this business to grow double digits really for us as far as the eye can see just based on the demand and the marketplace.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.
A

And we have started discussions on the process of launching these services with our partners over in Europe as well. So with the global footprint we have, there's enormous opportunity. We already have worked down in Brazil with our partner, Localiza, but we've just started to expand and grow this business.

John Healy
Analyst, Northcoast Research Holdings, LLC
Q

Great. And then just a follow-up, I feel like you guys have mentioned last mile delivery five or six times in this call. And I feel like that's a little bit different than in the past. And I just immediately think of those blue Amazon van's driver around my neighborhood dropping things off. So I'm trying to think about that type of opportunity. Are companies like Amazon – are those potential partners for the Donlen business? And maybe what an offering in the last mile space would look like that's brought to the market by Hertz.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.
A

We already have literally hundreds of contracts with DSPs for – to support Amazon deliveries. So our Donlen business has literally been signing dozens of contracts every month with these companies to provide our fleet management services, which include maintenance and our DriverPoint platform to support Amazon deliveries. And then, off-airport locations, we are loading up vans and cars in our off-airport locations to make sure that we're well positioned to support last mile delivery needs. And again, we can't get enough vans to meet those needs. We're running north of 90% on all of the deliveries out in our off-airport locations of these types of vans. But in addition to leveraging our distribution network directly out to drivers who are seeking employment in that regard, we have a great offering. We've been certified and we are supporting those Amazon trucks that you see driving around in a sense that the DSPs that are signed up with Amazon to find drivers and trucks, we're supporting with our fleet management services out of Donlen, and obviously, leveraging our distribution of our rental car business to do that.

Operator: Your next question comes from the line of Michael Millman from Millman Research. Please go ahead.

Michael Millman
Analyst, Millman Research

Q

Yeah. Thank you. Could you talk about the percentage and changes of growth and the revenues you keep? By that, I mean, the amounts that go to OTA's and deals you have with AAA and such. Where does that stand and where it's going? And secondly, could you talk about the corporate end of the business, which I think you noted in your press release was strong, but I'm not sure that meant pricing. So the question is about what's happening with corporate pricing.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

We are seeing a firming up in corporate pricing and that's a favorable trend. We do see – as far as our – the partners that you just talked about, we highly value – we have a world-class, best-in-class group of partners. We have United and Marriott. From a travel perspective, number one in their space. We have a great partner in AAA, clearly a highly valuable partnership there. Our State Farm partnership is solid and growing. We saw in the replacement space fairly stable volumes and price. A little bit – it was fairly flat the first half, but we saw volumes picking up in July. There were hailstorms, et cetera. So we're seeing transaction growth in the replacement business. I think when you look at those targets, we picked the right partners and we work very successfully with those partners to maximize the value and the price and the growth that those brands and those partnerships drive for us.

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

Yeah. And I would say, to the first part of your question on where we're seeing the volume growth, I mean, we're seeing volume, as I said, in business and in leisure. And one of the things that we've been really focused on as we drive price is finding yield opportunities within individual segment. So while we've seen growth across all of the segments, the performance that we've had in retail and our ability to get price in retail has been outstanding through the first half of the year. And so as we're looking at our business across the segments, we're finding opportunities to drive price within those individual markets, and that's important. And I think as Kathy mentioned, corporate has always been a really competitive segment in the marketplace. And the investments that we've made in fleet, the investments that we've made in our service capabilities are enabling us to get price there. And that's really, really important for us to drive pricing opportunities within our business.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

Yeah. And I think, Michael, to that point, look, there is a lot of talk around ridesharing and last mile delivery and all that goodness, but we have a massive distribution network that has been supported over the years by great partners like United, like Marriott, the corporate business, what we're doing with State Farm and replacement. And so the heart of this business, we're not going to take our eyes off of what the heart and soul of this business is, which is corporate travel, leisure travel, the off-airport needs, and we see a rational growth from last mile deliveries and ridesharing. It is not going to dominate our business. We – part of the $207 million in EBITDA and record revenue growth has been somewhat – that's been somewhat a part of it, but clearly, our ability to get price and grow overall is all about our core businesses and not about ride-hailing and the last mile delivery. That's purely a leveraging and adjacency, that there's a lot of demand and need and we can help meet it.

Michael Millman
Analyst, Millman Research

Q

Could you put some numbers on what you're seeing in corporate pricing, some numbers on how much of the revenue you keep, how much goes to third parties and others that you just talk about?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

Obviously, that's pretty competitively sensitive information, but what I can tell you directionally is that we have – based on the improvements that we've made in service, based on the improvements that we've made in terms of the fleet, as Kathy says, we have a beautiful fleet out there, those are the things that enable you to win business and to win price. And that's that Bob Stuart and our sales team have been focused on

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Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

And as our brand gets stronger, we have more people coming direct to our websites and our apps.

Operator: Your next question comes from the line of Derek Glynn from Consumer Edge Research. Please go ahead.

Derek J. Glynn
Analyst, Consumer Edge Research LLC

Q

Yes, good morning. Thanks for taking my questions. Just had a follow-up on some previous comments on M&A and the space. There's been a history of consolidation in the U.S rental market over the years, but each of the big three still has multiple brands under its umbrella. Do you think there's too many brands in the marketplace? And as you look across the competitive landscape, do you feel there is a distinct value proposition to the consumer for each of those brands?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

We do have very good distinct value propositions for each of those brands. And as I mentioned, all three of those brands grow revenue and price. So, there's clearly upside and opportunity and are maintaining and growing three brands. And in fact, being able to differentiate has elevated the Hertz brand from a value proposition and a price. And I do think as we drive more specific services and target markets with very specific value propositions for all three of those brands, we will see more price potentially and more volume as we get better at that.

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

From our perspective, the competitive landscape has been cleaned up and expanded multiple times over the years. I think our perspective, as Kathy said, it's about focusing on the customer segments and making sure that you have the brand and the product and the service that sort of meets the needs of the marketplace. And so we're more focused on that and driving value through that equation as opposed to figuring out whether or not there are consolidation or roll-up opportunities in the industry.

Derek J. Glynn
Analyst, Consumer Edge Research LLC

Q

Got it. And then, following the rate and the notes offering, could you just expand how you're thinking about – expand upon how you're thinking about capital allocation and where does reducing leverage even further rank in the order of your priorities?

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

It has been from the day I joined the company a top priority, creating cash and getting leverage into the 3 zone is where I'm hell bent. And I do think I've been pretty clear in guiding that by 2020, we should see our company in a much better place. And the productivity improvements I think have – I'm pleased to say the distance that we put on productivity very quickly. The team has done an amazing job. We have a great group of financial professionals here working with a great group of leaders and engaged employees, and getting our cost down, at the same time, growing our company, and then, being able to pay down the debt that we did with the Rights Offering, really puts us in a very sweet place to have to be spot on where our leverage needs to be.

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

And from this point forward, I mean, obviously, the Rights Offering gave us the opportunity to accelerate the deleveraging activities, and the operating capabilities that we built inside the business will enable us to naturally delever. We're really comfortable running the business in the sweet spot that Kathy talked about and we'll be in a pretty good trajectory as we enter into an exit 2020.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

As we get the debt down and our EBITDA up where it needs to be, the passion around that is also around the cost of debt. I mean, having high leverage and the risk assessment around that is very costly to this company. And as we take that out, obviously, from a capital perspective, we can return more to the shareholders. We can – we have more to invest back into the company as well. And I think getting our leverage down has been a key contributor to ensuring that we create future value as well as manage through any cycle that hits us.

Operator: Your next question comes from the line of Ryan Brinkman from JPMorgan. Please go ahead,

Rajat Gupta
Analyst, JPMorgan India Pvt Ltd.

Q

Hey. Thanks for taking my questions. This is Rajat on for Ryan. Just had a question on the exit rate in 2Q and then into 3Q. You raised guidance twice over the last month and a half. I mean, could you help us understand what really got that much better towards the end of June? Was there any particular metric you could point to, whether U.S. International or within U.S., with the pricing or the transaction? Is there anything you can point to that got materially better or exceeded your expectations? And then, how did that flow through into July? Just want to clarify that. Thanks.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

A

I think with the Rights Offering, we did have to give a range for guidance and it was before, obviously, June had closed. And we – the guidance that we gave originally, we had to have surety that we weren't going to miss. So it's somewhat conservative on purpose. As we closed June, and from a price, volume and a depreciation perspective, and cost actually, our cost really came in better than we had expected, depreciation held. And as a result of that – and we didn't see a – we didn't have a price issue or volume issue. So things came through better than we expected.

So price and volume held our expectations. Productivity and residual values were better. And as a result, we came in at $207 million, and we had to before we came in at that, say, we were going to be somewhat better, as we knew we were going to be – we had to guide in that direction. As far as the third and fourth quarters, we have tough comps, but the capabilities that we put in place, we've been really diligent on managing our fleet by – and our volume and our price associated with that fleet to maximize value to the company. And the capabilities we've put in place with our revenue management and our fleet management systems, along with discipline, we've progressed the business. But again, the comps are going to be tough in the second half, but we believe we will continue to progress as we have in the past.

So, we're working the same systems that have delivered and we assume they will continue to deliver in the second half, but we do have tougher comps.

Rajat Gupta
Analyst, JPMorgan India Pvt Ltd.

Q

Got it. And just to expand on the tougher comps comment. You had 3% pricing here in the U.S. And with the comps getting tougher, I mean, could that – I mean, can we still see pricing growth in the second half or – I don't know if that meant to indicate that to be flattish or – I mean, just could you give a little bit more – or could you just bracket that a little bit as to what kind of pricing you're seeing, especially based on what you've seen in July so far?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.

A

Yeah. So just to remind you, I mean, in the back half of last year, our U.S. RAC revenues grew 9% and 10% through a combination of both volume and price, and both volume and price were strong in the back half of the year. So, as we look at the year-over-year comps, those are the things that we're referring to. I think the most important thing for us to focus on is the capabilities that we've built, revenue management systems, the things that we're doing around fleet management, the marketing initiatives that we have in place, the service capabilities, none of those things are changing and those are the things that has enabled us to earn price.

So, over time, to the extent that we continue to execute on the strategy, those are the things that enable you to get price through the cycles. There are always quarters where competitive dynamics can be different, market dynamics can be different, but the strategy has not changed. And we are really focused on driving both volume growth and pricing growth in our business.

Operator: Your next question comes from the line of David Tamberrino from Goldman Sachs. Please go ahead.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Great. I wanted to follow up on, Jamere, your comments about possibly getting the positive free cash flow this year. I think that's much more positive than you were earlier in the year where you were thinking it was going to be negative? What assumptions – or what do we need to see from residual values in the back half in order for you to achieve that?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.
A

We came into the year saying that we were expecting residual values to decline sort of low single digits. We obviously haven't seen that in the first half of the year. So if we sort of continue along the trajectory that we're on, that was the big swing factor in deciding – in determining whether or not we get positive free cash flow.

I mean, from an operating standpoint, our operating cash flows are improving. Our execution in the marketplace is very strong. Residuals have been the swing factor. And based on what we're seeing, if these kind of trends continue, then we'll get to positive free cash flow for the end of the year.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Okay. And just within that, have you seen any change in the cadence of used vehicle values throughout the first half of the year for yourself or is it somewhat tracked in line with the public indices that we're able to track?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.
A

We've been tracking sort of in line with the public indices. There are pockets and there are times where we outperform and we've seen a little bit of that in the first half of year. But generally speaking, those numbers that you see from sort of the public indices are directionally in the right direction. Obviously, our own individual experience varies from time to time just based on the nuances associated with our business. The mix of the fleet, the markets that we're in, the demands in those marketplaces, sometimes gives us an opportunity to outperform. But generally speaking, directionally, we've been in line with what you're seeing.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Okay. And then, your competitor yesterday made some comments about they're seeing on peak season shipping up so far. Understanding the conversation about tougher comps, are you seeing fleets being tight into July, and now the early August period, they're getting a little bit looser? Just what are you guys seeing from a market perspective being the number two player in the U.S.?

Jamere Jackson
Executive Vice President and Chief Financial Officer, Hertz Global Holdings, Inc.
A

Generally speaking, the fleets are about right. I wouldn't necessarily say that they're overly tight or they're loose. I would say, generally speaking, the fleets are about right. But what's most important is that when you're operating in this industry and there is discipline around fleet capacity and pricing, then generally speaking, that's a good dynamic for our business. And through the first half of the year, we saw an industry that had fleets capacity and about the right place and you've seen us be able to get pricing in those environments. And again, you'll have pockets of underperformance in certain markets from time to time, but I think generally speaking, the fleet sizes are about right.

Kathryn V. Marinello
President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.
A

Yeah. And if you look at our fleet, we've gotten more volume and lower price than we've added in fleet. And I think that kind of discipline ensures that you don't have over capacity. So I can't control what everybody else does, but right now, by having a disciplined fleet for ourselves, we've seen a 3% increase in price, we've seen more than that in volume, and the methodologies, the pricing and the utilization efforts are playing out with a $207 million EBITDA for the quarter. And so we will continue to do what we've been doing because it seems to work.

Operator: And at this time, there are no further questions.

Kathryn V. Marinello

President, Chief Executive Officer & Director, Hertz Global Holdings, Inc.

Thank you.

Operator: Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.