Hertz Global Holdings, Inc. [HTZ]
First Quarter 2018 Financial Results
Tuesday, May 8, 2018, 8:00 AM ET

Company Participants:
Leslie M. Hunziker, Staff Vice President, Investor Relations
Kathryn V. Marinello, President and Chief Executive Officer
Tom Kennedy, Senior Executive Vice President and Chief Financial Officer

Analyst Participants:
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James J. Albertine, Consumer Edge Research, LLC
Michael Millman, Millman Research
Dan Levy, Barclays
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Justine Fisher, Goldman Sachs & Co.
Trent Porter, Guggenheim Securities, LLC
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Presentation

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Hertz Global Holdings First Quarter 2018 Earnings Call. At this time, 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 conference over to your host, Leslie Hunziker. Please go ahead.

Leslie M. Hunziker: Good morning, everyone. By now you should all 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 within the meaning of the Private Securities Litigation Reform Act of 1995. 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 is 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 in the risk factors and forward-looking statement section of our 2017 Form 10-K and our first quarter 2018 Form 10-Q. Copies of these filings are available from the SEC and on the Hertz website.

Today, we'll use certain non-GAAP financial measures, all of which are reconciled with GAAP numbers in our press release and related Form 8K, which are 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. It's a publicly traded company. Results for Hertz Corporation are materially the same as Hertz Global Holdings. On the call this morning, we have Kathy Marinello, Hertz's CEO, and Tom Kennedy, our Chief Financial Officer.

Now, I'll turn the call over to Kathy.

Kathryn V. Marinello: Thank you, Leslie, and good morning, everyone. We entered 2018 a much stronger company than one year ago, with positive underlying revenue momentum. Our investments and initiatives in the U.S. operational turnaround are gaining traction. In each of the last three quarters, worldwide revenue has increased year-over-year.

In the U.S., in the fourth quarter, we reversed a declining trend and continued that progress into the recent first quarter, where we increased revenue by 5% versus a year ago. Add a 430 basis point increase in utilization to the top line growth, and you've got a strong improvement in revenue per unit, a measure of how effectively we're managing our assets. The favorable RPU reflects disciplined fleet capacity, more robust demand for our brand and better base rental rates.

These positive trends are testimony that we're on the right track with our strategies to enhance fleet, service, brands and technologies. The early progress is motivating for our employees and being recognized by our customers. Clearly this is only a start. There are significant opportunities that we're pursuing through well-placed investments, stronger execution, better processes and a fortified leadership team.

As you know, this is an end-to-end revitalization plan in the U.S. Our priority was getting our product right. By midyear last year, we had right sized the fleet, rebalanced the car class mix and upgraded trim as appropriate. The efforts of an experienced team in fleet procurement, fleet operations and fleet remarketing ensured we were positioning ourselves to optimally address rising fleet costs and more effectively shape consumers' impressions of our product line. Nearly 80% of our operating fleet is made up of model year 2017 and 2018 vehicles that include the most popular makes, models and car class mixes based on consumer preferences.

In revenue management, the team is collaborating closely with fleet operations and leveraging smarter systems to continue to drive top line growth. Our new revenue platform, combined with a new fleet allocation system, is giving us greater capabilities to forecast demand, deploy fleet and better accuracy, capture pricing and target the right mix of segments. It's an iterative process, but we're consistently improving, and I'm pleased with what I'm seeing.

We also started work on customer service improvements last year, hiring field training and recruiting leaders, rebuilding our continuous improvement quality program, introducing our Ultimate Choice airport model and undertaking a site optimization initiative to enhance efficiency through process remapping. We're only partway through these initiatives, but customer satisfaction scores have been consistently rising.

When we last spoke, we had just hired Paul Stone as Chief Retail Operations Officer to lead the

U.S. field operations revitalization. With more than 20 years of applicable experience, Paul hit the ground running with site visits, evaluations and analysis and already has identified incremental revenue and efficiency opportunities.

In marketing, under the new leadership of Jodi Allen, another 20-year consumer products veteran, and her team, we've launched our initial campaigns to reenergize the brands and have refreshed our value-added products and services. These campaigns highlight the higher quality fleet and services our customers are experiencing and are already driving newer and higher-frequency rentals.

Better visual merchandising online is a priority this year to drive more sales of value-added services. We're seeing some early progress there as well, so we'll continue to test, analyze and scale our marketing approach with a focus on high-leverage opportunities.

Under the leadership of Bob Stuart, a Hertz veteran, and his tenured sales team, we're leveraging our better fleet, improving service, new Ultimate Choice model and Hertz brand marketing initiatives to drive a higher penetration of share of wallet in dual source corporate accounts. Couple that with some strong new account wins, and we've got an improving trend.

The corporate market is important not only because of the predictability and scale of these business transactions, but also because these are premium customers who, when satisfied, will choose Hertz for their less price-sensitive leisure travels. Satisfaction scores across corporate accounts are higher today than they've been in the last three years. Similarly, improving satisfaction trends with partner and affiliated accounts are correlating favorably with an increasing number of repeat rentals.

As we're gaining momentum from both an operational and financial perspective and with a fortified group of high-performing executives now leading the growth initiatives, I'm turning more of my attention to supporting our innovation and technology plan. Prior to my joining the company, the bulk of our IT resources were spent outsourcing the legacy technology and working to increase the productivity of that architecture.

Mike Fischer, our Chief Digitization Officer, who has more than 25 years of strategic technology experience, supported by an experienced team, is currently overseeing the existing infrastructure. In parallel, innovative partners are helping us design and modernize our core technologies, the fleet reservation and rental systems. I'm working closely with our IT leaders and these partners on the project enhancements, which will allow us to adapt processes through web-based interfaces, leverage data science, make applications usable and mobile in other digital formats and ensure a fast, flexible user experience.

An upgrade of this magnitude is incredibly hard work. As with any technology overhaul, along the journey we've modified projects' goals based on learnings and have identified new, valuable opportunities to incorporate even greater benefits. The rollout of our modernized platforms begins this year and continues through next year. Likewise, investments in the systems will continue next year as we've discussed previously.

Based on recent financial results and the marketing and sales momentum we're seeing, we expect to continue to generate top line growth that should translate into steadily improving adjusted EBITDA, despite the incremental investments. These investments will ensure that we have the right fleet, the best brands, leading technologies and the best people driving sustainable growth for the long-term.

With that, I'll turn it over to Tom to share the details of our progress.

Thomas C. Kennedy: Thank you, Kathy. Good morning, everyone. As Kathy mentioned, we continue to make progress on our initiatives to improve the operating performance of our U.S. RAC segment. Evidence of this is reflected in growth in the top line of unit revenues, increased transaction days, improved vehicle utilization and reduced unit vehicle depreciation expense. As a result, we saw a significant improvement in our consolidated adjusted corporate EBITDA versus the prior year, our second consecutive quarter of improved results versus the comparable prior year quarter.

While we still have much work ahead of us, we will continue to be in a period of elevated investments, which I'll address in a moment. We are pleased with the progress we are making on the top and bottom lines. Given this overview, I will now turn to more specific updates on our U.S. and International RAC segments and an update on our first quarter financing activities and balance sheet and liquidity position.

Our focus continues to be on delivering profitable, sustainable growth. To that end, in the U.S. RAC segment in the first quarter, total and unit revenues as measured by RPU both increased 5% versus first quarter 2017. The 5% growth in total revenues in the first quarter was a result of a 6% increase in transaction days, slightly offset by a 1% decline in total RPD. The 6% transaction day growth was largely a result of the growth in nearly all categories of our off-airport business as well as modest growth in the airport volumes, despite a 3% decline in our core vehicle fleet.

The improved airport volume refers to clients we experienced in the third and fourth orders last year. Total RPD decreased 1% in the quarter, but increased 3%, excluding value-added service revenue and the impact of a growth in ride-hailing rentals. While we still experienced a decline in our value-added service revenues in the first quarter, the rate of decline moderated as we worked on initiatives to turn this trend.

The majority of our value-added service revenues are in four products: upgrades, loss damage waiver, or LDW, liability insurance supplement, or LIS, and fuel. Navigation products are only approximately 2% of the total value-added service revenue, and while we experienced a decline in this product category, it does comprise a small percentage of our overall revenues. Furthermore, we did not experience declines in our fuel or LIS products, so largely the decline was in upgrades and LDWs, but also relative to prior year in navigation products, which, again, only comprised 2% of our value-added service revenues.

Our recovery focus has been on driving improvements in the upgrade and LDW products through targeted merchandising, branding and digital sales delivery strategies, and we have seen some favorable early results with our efforts. In fact, our first quarter results exceeded our internal projections. Despite the value-added service headwinds, total RPD for the airport business was flat and off-airport business off-airport increased 2%, but, again, overall U.S. RAC segment total RPD declined 1% as a result of the off-airport transaction days growing faster than the airport.

So to recap from a pricing standpoint, we believe the market conditions in the demand and supply side were constructive for the favorable pricing results.

Total average fleet capacity was flat to prior year and declined nearly 3%, excluding vehicles dedicated to ride-hailing rentals. At quarter-end, we had approximately 24,000 vehicles dedicated to ride-hailing rentals versus 22,000 vehicles at year-end 2017. Total vehicle utilization of 79% increased 430 basis points versus the prior year. As we continue to maintain discipline in our overall fleet levels, [adure] absolute vehicles in various remarketing channels versus the prior year quarter and continue to make progress on better positioning fleet supply with demand.

Monthly vehicle depreciation expense of $302 per unit decreased 13% versus the prior year quarter and were largely in line with the second half of 2017. The decrease in unit vehicle depreciation was a result of a number of factors, including the following. Based on the Manheim Rental Index, used vehicle residuals were stronger in the first quarter, and we experienced a sequential strengthening in the market during the quarter as well.

The 2018 first quarter market environment compared favorably to what we experienced last year where residuals declined each month versus the prior year and the normal sequential strengthening quarter did not occur. As a result, last year we incurred significantly higher losses and sold approximately 50% more fleet in what was a weaker residual market versus this year.

We increased the penetration of remarketing vehicles through higher-yielding alternative channels, with 78% of our vehicles remarketed through dealer-direct and retail this year versus 65% last year. Model year 2018 and model year 2017 vehicles comprised approximately 80% of our fleet at quarter end versus approximately 72% at year-end, which had lower like-to-like pricing than prior year models. And finally, we opportunistically sold some vehicles in the first quarter that marginally contributed to the favorable results.

We are still depreciating our risk vehicles, assuming an approximate 2% decline in residuals for the year, but this may moderate based on the first quarter performance and if that trend continues in the second quarter. In fact, the Manheim Rental Index came out yesterday [indiscernible] and reflected a nearly 9% increase, so early signs are that the market environment entering the second quarter is continuing this trend.

Total U.S. vehicle interest expense increased $16 million and cash interest expense increased $11 million. The increase in cash interest expense was largely rate driven, associated with higher benchmark rates and wider spreads in our VFNs related to last year's two bank amendments. In addition, the blended rate on our term ABS notes increased slightly as we have increased our mix of term ABS debt to mitigate the impact of further interest rate increases.

We now have approximately a 2/3-1/3 split of fixed and floating rate debt on our U.S. RAC vehicle debt. Nonetheless, given our mix of debt along with the forward curve, we would expect mixed RAC vehicle interest expense to now increase approximately $45 million in calendar 2018 versus calendar 2017 on a volume-neutral basis.

We continued to make necessary investments in fleet, operations, sales and marketing and IT to deliver sustainable, profitable growth in the first quarter. Recall that we indicated we would be making approximately $300 million in investments impacting adjusted corporate EBITDA in calendar 2018, an incremental increase of approximately $40 million versus calendar 2017. During the first quarter, we invested approximately $80 million that impacted adjusted corporate EBITDA, which was an incremental $10 million versus the prior year.

As a result, our elevated investment spending, total U.S. RAC direct vehicle and operating, or DOE, and SG&A expense as a percentage of revenue increased 129 basis points versus the prior year. We expect DOE and SG&A as a percentage of revenue to remain elevated in 2018 as compared to 2017 for each calendar quarter and the full year. Despite the higher levels of investment spending and higher vehicle interest expense, U.S. RAC adjusted corporate EBITDA improved $56 million versus the prior year quarter, primarily as a result of improved unit revenues and reduced multiunit vehicle depreciation expense.

Now, let me turn to International RAC segment. International RAC total revenues increased 14% to $468 million, and excluding $45 million of favorable currency impact, total revenues increased 3%, driven by a 5% increase in total RPD, partially offset by a 2% decrease in transaction days.

Recall that we sold our Brazil operations to our partner, Localiza, in August last year. Excluding the Brazil operating results in 2017, total RPD increased by 2% and transaction days increased by 4%. The increase in transaction days was largely attributable to the strong commercial and multi-month volumes. The 2% increase in RPD ex-Brazil was due to stronger pricing in our Asia Pacific markets during their summer peak. Pricing in Europe also improved versus prior year as a result of strong leisure demand.

International net vehicle depreciation per unit per month of $222 million reflected a 9% increase versus prior year. Excluding the Brazil operating results in 2017, net vehicle depreciation expense per unit increased 5% or approximately $4 million. Approximately $0.5 million of the increase is the result of the declining residual values of vehicles with diesel engines in Europe.

We reduced risk purchases of diesel engine vehicles from 12% to 7% of model year 2017 and 2018 purchases respectively. Of the 7% risk diesels we are purchasing in model year 2018, 4.5 percentage points are vans and SVUs that are not under the diesel residual pressures that other model types are experiencing.

International vehicle interest expense increased $4 million. Foreign exchange accounted for $2 million of the increase, and the remaining $2 million was split almost evenly between rate and volume.

Looking forward, the higher rate on the refinanced euro vehicle bond and higher bank facility spread is expected to result in full calendar year international vehicle interest spreads to increase approximately $9 million due to rate, excluding any volume or foreign exchange impacts.

Vehicle utilization of 75% was 70 basis points worse than prior year as a result of higher fleet entering the quarter and the pursuit of moderate volume growth in exchange for higher pricing that resulted in lower utilization but higher revenue quality, especially in our Spanish and Asia Pacific businesses.

Overall, the International segment reported adjusted corporate EBITDA that was breakeven, a decline of $3 million versus 2017, largely as a result of higher unit vehicle costs.

Now, I'd like to provide an update on our financing activities, corporate liquidity and free cash flow. Year-to-date, we continue to be active in the debt capital markets. As I discussed on our year-end earnings call at the end of February, we executed a $1 billion, five year term ABS transaction for U.S. RAC. This issuance covered the $929 million in term ABS maturities we have this year and extended our vehicle debt maturity profile.

Additionally, we executed a €500 million European vehicle note in March to refinance our €425 million notes due in January of next year and to support vehicle growth. Because the issuance and subsequent note redemption straddled the quarter end, our restricted vehicle cash and vehicle debt balances were elevated as of quarter end by approximately $520 million.

In April, we increased our U.S. RAC VFN, and in May, we executed a term ABS transaction for Donlen. The $250 million increase to our U.S. RAC revolving VFN facility replaced and extended a portion of the vehicle debt capacity lost when we voluntarily terminated a standalone $500 million VFN facility in March. The $550 million Donlen issuance was well received by the market, and the proceeds created incremental liquidity for Donlen by refinancing amounts outstanding on the revolving VFN.

Overall, we continue to maintain our focus on extending Hertz' liability structure. Regarding our nonvehicle book of debt, we will continue to be proactive in assessing opportunities to refinance pending maturities, but I'd also remind you that the nearest debt maturity for our book of non-vehicle debt is not until October 2020.

On the liquidity front, we ended Q1 with no drawings on our corporate senior revolving credit facility, almost $1.6 billion in corporate liquidity and our first-lien covenant ratio of 1.76x was well inside the required 3.0x.

Turning to cash flow, free cash flow for the three months ended March 30 was breakeven. We expect free cash flow to be negative through the first half of the year as we go through the normal summer seasonal peak and add fleet and then be positive in the second half of the year as we seasonally de-fleet off the summer peak. Overall, we still expect free cash flow to improve year-over-year, but likely be negative for the full year due primarily to a heightened investments.

In closing, we believe the first quarter results continue the trend we experienced in the second half of 27 (sic) [2017] of improving total unit revenues, moderating improving unit vehicle costs, which ultimately results in improved results.

With that, I will now turn it back over to the operator for questions. Operator?

Question-and-Answer

Operator: [Operator Instructions] Your first question comes from the line of Chris Woronka from Deutsche Bank.

Chris J. Woronka: Wanted to ask about your corporate or commercial account strategy in the first quarter and kind of what you're -- if you're seeing any improvement in corporate volumes and maybe what your strategy is on the market share and pricing front there.

Kathryn V. Marinello: What we're seeing is what I mentioned earlier, which is as we've improved the quality of our cars, the service and with the support of a really strong commercial team, we're winning back more corporate share over the last several months. And basically we've gotten really great feedback around the Ultimate Choice rollout combined with better cars and better service from our employees, and our corporate sales teams have been leveraging all the work we did around that throughout last year. And we continue to -- we have really motivated, pumped up employees that are responding as much as our customers are responding to the better fleet and the investments we're making. Our employees are really pumped up about it. And then we backed it with branding and marketing and a lot of solid work from our marketing team, and it's showing results. It's a business I believe is very important to the strength of the Hertz brand as well as carries over into the retail space.

Chris J. Woronka: Okay. Great. Appreciate that. And just wanted to ask on the incremental spend, I think you mentioned $40 million this year over -- incremental over last year, and I think last year might've been, if I remember, maybe $110 million over '16. As you kind of look out to '19, and understanding it's a moving target and I'm not asking for guidance, but directionally, do you think the incremental spend has a chance to level off or decrease next year?

Kathryn V. Marinello: I think one of the things I've found over the years is what somewhat manages investment spending is just the ability of your management team and your organization to handle an incredible amount of change. And so I think we are getting to a point of leveling off on how much our teams can handle and implement given we've done a pretty phenomenal job this first quarter in growing the U.S. as well as the overall company in addition to doing a ton of work on technology and our operations. And so I do think we'll probably stay at about the same level of spending next year. I don't see a significant drop off given the bulk of what we're launching in our technology will be launched next year.

Operator: Your next question comes from the line of James Albertine from Consumer Edge.

James J. Albertine: Wanted to talk a little bit about on the ride sort of hailing side as we look further out. It implies that you're going to be managing residuals of vehicles that are quite a bit older than your corporate average today. Just want to understand how you're thinking about that and how we should sort of think about the risk associated with managing those residuals for your customers and participants in that program.

Kathryn V. Marinello: Well, what we have found so far, if you look at the used car market and you think about residual value curves, if you ask any new car dealership or used car dealership, the sweet spot for cars is around 70,000 miles or $8,000, $9,000 in the sales price. We find, and if you go out to any dealership, those cars generally fly off the lots. So what we've found is, we're managing double-digit returns on this business in how we bend the curve and the value that these renters see in being able to rent a car for a week or a month. And so when we look at maintenance costs, etc., the incremental cost between 40,000 miles and 70,000 miles or 35,000 miles and 40,000 miles and 70,000 miles from a maintenance perspective is fairly nominal, and we bend the return on that asset, from a residual value perspective, significantly. And our leader Jeff Adams in the used car arena is far exceeding our expectations on what we're able to book as gains on these cars when we sell them at 70,000 miles. So we don't run them beyond their natural life, and we don't run them to the point of where we're replacing a transmission or an engine.

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

Michael Millman: Following up on the first question, the corporate -- for corporate airport, can you tell us what you're seeing in pricing and be more -- a little more specific on volume? Then I have one on technology.

Kathryn V. Marinello: I think what we see from a pricing perspective is always companies are shooting for productivity saves, so we're constantly fighting the pricing efforts of these companies to get productivity through lower pricing. What I would say is we're holding our own, but there's clearly pressure downward on pricing. And I think everybody's seeing that right now. What was the second part of that question?

Thomas C. Kennedy: Volume. I think volume.

Kathryn V. Marinello: Volume is up, so we're winning. As I mentioned earlier, we are winning more of our share in growing from a -- when it's a dual account, we're winning back a lot of customers, and we're seeing our share increase where we have -- where the companies have a dual relationship.

Thomas C. Kennedy: Yes. We believe the Hertz brand is the preferred brand by the commercial traveler. With the investments we've made in fleet, the Choice service delivery model last year and now putting service quality in the field as well with additional resources, our NPS scores and the feedback we're getting is very favorable by commercial accounts, and they're starting to see and take notice of that and come back to the Hertz brand, for which we had multi-years of lost share.

Kathryn V. Marinello: And I do think just the value that is being perceived is somewhat offsetting what could be a much more significant decline in price.

Michael Millman: Okay. And on your technology, assuming that you were complete -- I guess you never complete -- what would we be seeing in this year and to what -- how long do you think it'll take before you have your systems where you want them and the impact you'd expect at that point?

Kathryn V. Marinello: Well, what we -- prior to my joining in the initial, I would say, half of my first year here, the bulk of the work was finishing Dollar Thrifty conversions and offloading our legacy systems to one of our valued partners. And over the last -- the second half of the year a lot of work was spent on building requirements and starting to move into the developing and coding phase with our partners. And this year we'll be doing a bulk of that work, as well, continuing on on building forward the coding and the development.

We see next year as the bulk of the launch of the systems that will make a big impact, and that's really with our rent and our fleet systems. We're pretty close to closure on our reservation systems, but where the real value comes in when we can see the full process right down to where we went and management of our fleet.

So we really see a lot of the development work this year, the launching next year, probably more towards the third quarter. And we should start to see a decline in our investment cost as well as some benefits of all the work we've been doing in 2020.

And I would say we have fantastic partners. We're working with three or four great, leading-edge technology partners, IBM, Infor, Deloitte, and as well as Salesforce.com. We've done a lot of work with Salesforce around data already. We're in the process of building out a data lake, which will give us a lot more speed and value around our pricing.

So there's a lot of great work being done. And it's hard work, but I think what I think is phenomenal over the organization is despite all of the effort and the resources, having to focus in on requirements and the technology work, we still managed to pull out almost 8% growth in the first quarter, in reverse of declining revenue trends. So I think we've got a team that can pull this off, and so far pretty darn impressive.

Thomas C. Kennedy: And, Michael, to add some additional, as we said previously our OpEx on IT spending has been running in the range of $400 million a year, and it's been basically an albatross around the Company. It's been a tax on our ability to innovate and speed to market and to deploy technology to improve the service and how we sell our products.

So we have said previously that we believe once our technology kind of transformation is complete the OpEx should decline by over $100 million, and that's just the hard dollar benefit. The real benefits is what Kathy's talking about is what we can do from a revenue, service and a customer relationship standpoint that we cannot do today with our legacy systems.

Kathryn V. Marinello: Yes, we have a team that's really focused on saying we're not going to let the technology and the tools (inaudible) and maybe (inaudible) right now get in the way of growth. We know we've got a lot of opportunity out there around process improvements and marketing and customer service that we can make an impact with while we're building out the technology and tools, and, to their credit, we drove I would say significant growth despite the work and the resources being drained into other areas in the first quarter.

And everybody is really pumped up by those positive results to continue that through the year, and we did improve EBITDA quarter over quarter. We made strides around the fleet as well as we continued to improve our ability to sell cars through more effective channels along with buying better cars at a lower price. And overall we see the utilization improving, as well. So a lot of the key metrics -- price, utilization, the cost of the fleet, and how well we buy and sell cars -- are all moving in the right direction.

Operator: Your next question comes from the line of Dan Levy, from Barclays. Please go ahead.

Dan Levy: Hi. Good morning, and thank you for taking the questions. First, just wanted to ask about your ride-hailing business. I can appreciate the comments you gave on the impact of ride-hailing and ancillary price, but could you just quantify for us the impact in the quarter of ride-hailing on your U.S. transaction days, the utilization, and per unit fleet cost? I imagine that it was a boost to utilization volume and certainly a tailwind to the fleet cost side. I'm just trying to get a sense on those.

Thomas C. Kennedy: Yes, roughly our total revenue ex-TNC and U.S. RAC segment would have increased 3% as opposed to 5%. Our RPU would have relatively been about the same. And our transaction day growth would have been about 3% excluding TNC as well.

Dan Levy: And the per unit fleet costs, how much of --

Thomas C. Kennedy: Per unit fleet cost, it's a marginal benefit because it represents only about 4.8% of our fleet. It is a lower (inaudible) rate than the average, so there is some benefit, but it's still a very clearly insignificant percentage of our overall fleet.

Dan Levy: Okay. So we're not talking about something like you're depreciating these cars at $150 per month versus the fleet --

Thomas C. Kennedy: That would be significantly lower than we are, but they are lower than the average.

Dan Levy: Okay.

Thomas C. Kennedy: (Inaudible) cars. And, as Kathy mentioned, I believe that we have experienced very favorable results on when we've gone to remarket these vehicles at 70,000 miles. It does create a price point of a vehicle which we historically have not had in our retail segment. And we're kind of tapping into an entire new customer segment that we didn't have a product to sell. So it is actually a win-win from an operating standpoint as well as from a remarketing standpoint of our fleet.

Dan Levy: Understood. And then my follow-up is I want to continue in the same thread of questions that are being asked on the corporate side, but a little differently. I appreciate that a lot of the EBITDA recovery that you've talked to for the coming years ahead, at least on the price side, will be more a function of mix than, say, pure industry pricing. Is that mix purely just changing your corporate business, or is there a leisure component?

And then on the corporate side, as you've won this new business, what's typically the turnaround time before we start to see that reflected in the RPD? Is that a matter of there's a lag behind that? Just trying to get a sense of the timing on when those benefits start to become more visible if you're winning share today.

Kathryn V. Marinello: It's a lot of question. Let me see if I can break it down.

Dan Levy: Sorry for the long question.

Kathryn V. Marinello: Oh, no. That's okay. As far as I think what you're trying to get to is price. Right? And how are we going to manage overall price, which obviously impacts RPU, as well as how do we manage the type of business we take, which impacts RPD? And where we're looking at is we've identified the segments that we believe we're not getting our fair share. We have a really strong marketing team around our different brands and we have a very thoughtful and, I would say, aggressive strategy around how we're going to gain more price and gain more days in different segments that we believe are attractive to our three different brands. And so we started the work there and that's what started to reverse the trend of decline in the U.S. and actually an increase in days, an increase in price, as well as an increase in overall revenue.

At the same time, we have a growing replacement business, and we have great partnerships with different travel partners as well as AAA. And so when you put all these together, how we manage the demand and the fleet that we have makes a difference. And the AI team that we have working on this, along with the great fleet management capabilities we've been building and learning around, continues to drive improved pricing as well as understanding where the demand is going to be and making sure our cars are there.

So I know people think rental cars and mobility are one and the same, but cars are pretty expensive to move around. And as we get better and better at predicting demand and making sure our cars go there we see a greater ability to capture price. So we have a fairly extensive strategy around all the different segments with the different brands along with the fleet that we buy, where we put the fleet and how well we predict demand.

Operator: Your next question comes from the line of Hamzah Mazari, from Macquarie. Please go ahead.

Mario Cortellacci: Hi. Good morning. This is Mario Cortellacci filling in for Hamzah. Could you walk us through how you think about the impact of higher interest rates to your business, both qualitatively as well as quantitatively?

Thomas C. Kennedy: Yes, so from a vehicle standpoint, U.S. RAC, as I mentioned in my script, approximately 75%, or two -- I'm sorry, two-thirds of our vehicle debt is fixed. We've been moving towards that in anticipation of rising rates, as I had mentioned in my remarks as well. We now expect the impact on rate for the full year to be approximately $45 million on vehicle interest expense for U.S. RAC. Recall on the last call we indicated it was roughly going to be $35 million to $40 million, so that's a slight increase given where forward curves has gone and some of the refinancings that we anticipate. So that's roughly the impact on U.S. RAC.

On International RAC vehicle interest expense we indicated we expect about a $9 million increase year over year on vehicle interest expense. That's primarily made up of the refinancing we already did on the Eurobond in the first quarter. That's about a $4.8 million of the $9 million impact, that refinancing this year, and the balance is just there's going to be some increase, but it's not as susceptible to increases in Europe as we are in the U.S.

On the non-vehicle side, about 75% of our debt is fixed. So we don't expect to have any significant changes, roughly the same amount we expect, and non-vehicle interest expense year over year to be approximately $280 million, which was compared to last year's $278 million. So, not a lot of change in the non-vehicle side.

Mario Cortellacci: Thank you. And could you update us on any behavioral changes you may be seeing in the marketplace among competitors this cycle that could be different versus past cycles with regard to size of the fleets or following or leading in price increases?

Thomas C. Kennedy: Yes, I mean, we don't -- we kind of focus on what Hertz controls, and we've been very careful about, as you've probably noticed by our numbers, a flat fleet overall, 3% decline in fleet in the first quarter ex-TNC. So as a result, we've been very -- we believe very disciplined in kind of how we deploy fleet in the marketplace relative to market demand. We believe the travel market is very robust right now, and I think that's positive for leisure as well as commercial travel. So we see good overall market conditions from a demand standpoint. And from a Hertz standpoint, we're obviously being very cautious on our fleet supply strategy.

Mario Cortellacci: All right. Thank you so much.

Operator: Your next question comes from the line of Justine Fisher, from Goldman Sachs. Please go ahead.

Justine Fisher: Good morning. Sorry, good morning. The first question that I have is on the OpEx and SG&A as a percent of sales. So when you guys say that that's going to be elevated for the next couple of years, does that mean that as a percent of revenues we should expect those percentages to be relatively flat year over year for 2018 and 2019, so in the first and fourth quarters, like low 70s and then other quarters high 60s?

Thomas C. Kennedy: Yes, Justine, thanks. Thanks for your question. Yes, we added a slide in the deck, as well, because the seasonality is pretty important. And so we said, as you probably noticed, we were up a little over 100 basis points in the first quarter, around 71-ish percent. For the overall year we've been running 66%, 67%. That's elevated to where the Company ultimately we believe can get to and where our public comp is. So, we said this is primarily a reflection of our elevated investment spending.

So we expect 2018 to be around where the 2017 levels were, if not slightly higher, and actually would expect 2019 to be somewhat consistent with that depending upon the rate of revenue growth. Obviously, as the revenue growth accelerates that might moderate to some degree, but if you assume kind of neutral revenue we expect the percentage of sales seasonally to be consistent with 2017, if not slightly elevated in 2018, and 2019 should be similar.

Justine Fisher: Okay.

Kathryn V. Marinello: Yes, I would also add to it what makes it particularly tough is right now we're doing all of the work on requirements as well as a lot of the work on how does -- with our continuous improvement efforts, how to get our process out at the sites, choose the most efficient and productive process. And as we're just doing all that work, we have yet to reap the benefits of it, and we're doing the technology investment on top of it, and we're growing and growth tends to be expensive.

So, I think as we get through a lot of the development work around better process out at the sites, as well as a lot of the development work around technology and we start implementing these systems, we will start to reap the benefits of it and not have the impact that we have. So ultimately based on what we're doing, we should have better than industry average percentages out into -- once we start hitting our stride in 2020 and as we start going through 2019 and see some of the benefits.

Justine Fisher: Okay, thanks. And then my follow-up question is regarding the D&A, on the U.S. vehicle D&A. You mentioned that one of the drivers of it being lower was some opportunistic sales during the quarter. And if ride-hailing had a negligible impact on that D&A number because it's still a small percent of the fleet, I was wondering if you could tell us, and maybe it's hard to do this, but if there was a percent of the change or a dollar amount impact of those opportunistic sales, or is that you guys just saying, look, we've got these cars on hand, turns out that the sale prices have been pretty good, so I guess we might as well sell them. Is that what that was?

Kathryn V. Marinello: One of the things we are developing and are doing better at all the time around with some of our analytic capabilities that we're adding is figuring out when the best -- doing a better job of figuring out the best time to sell cars. We were holding cars in some cases probably longer than we should have if we had in place the tools that we now have in place, and so we have seen the benefit. Tom, I think it was about 4%.

Thomas C. Kennedy: $4 million.

Kathryn V. Marinello: I'm sorry, $4 million.

Thomas C. Kennedy: Yes. So, Justine, the dollar value of this opportunistic sales was about $4 million in the quarter, that's why I mentioned it's kind of marginal benefit.

Kathryn V. Marinello: And I do think it's something we're going to continue to move on, where we do a better job at understanding the best time to sell those cars and take less of a hit on depreciation and actually get some gains as well, so more to come on that.

Operator: Your next question comes from the line of Trent Porter, from Guggenheim. Please go ahead.

Trent Porter: Hi, guys. Thanks for taking the question. My first question you mostly took care of. I just want to make sure that I understood. On the vehicle interest, the increase from your previous $35 million to $40 million headwind to the $45 million, I think you said it was the forward curve and something else and I was hoping that you can clarify. But then what would it cost to swap or otherwise hedge the remaining 35% of vehicle debt that is floating rate? And then I had one more, if we've got the time.

Thomas C. Kennedy: Yes, so from a vehicle interest expense what I indicated is that we had estimated the impact for the year would be $35 million to $40 million at the last call in February. We've updated that slightly to approximately $45 million given the forward curve and just our estimates of what we might do with an additional refinancing. So we are focused on terming out some of this data and getting a better balance of fixed and floating.

We benefited the last couple of years by having a greater percentage of floating. But now we're working towards terming that out. So that's why we're in the two-thirds to one-third. We haven't looked at a swap per se, so because we do like to have flexibility of some variable funding and variable rates. But nonetheless we're obviously opportunistic and we'll look at that. But we haven't recently looked at the cost of swapping, so I don't have the answer to that question.

Trent Porter: Oh, okay. All right. Thank you. And then just, I guess, actually I had two more, the next one is there was a recent article in one of the trade magazines warning that residual values -- I mean, this is notwithstanding the strength in the quarter, but residual values could take another hit from heightened manufacturer incentives to offset rising interest rates. And I'm not sure how real that is.

But I wonder, you've made so much progress offsetting residual values, shifting to alternative disposition channels, negotiating new vehicle buys. So if this becomes a problem or a challenge later this year or next year, do you still have a toolbox to offset the headwind? Is it -- how much room, for example, is there to shift from, say, direct to dealer to retail and how material of an impact would that be?

And then maybe I'll knock out the next one. The next one is a simple one, something you had said on the last call, the fleet investment component of your incremental spending this year is stepping down from $130 million to $100 million, but then you said that there's likely to be an ongoing expense. And I wonder once you've completed your rightsizing and upgrading the fleet and everything you've got it, what drives the ongoing investment and how much are we talking about?

Kathryn V. Marinello: Let me -- I'll address the first part of it and I'll toss the second part, last part, to Tom. I think, to answer your question, is if we get into an issue around residual values declining, very honestly I'm not seeing any real factors to make me believe that's imminent. I spent 10 years on the GM board, before that I spent five years managing 1.5 million cars. And so

I've got more years than I care to admit on tracking residual values.

And I actually look pretty closely at what the OEMs are doing from a sales perspective, what production looks like, inventories, building, and I haven't seen irrational behaviors. In fact, I've seen the opposite. I've seen the OEMs becoming more disciplined, more rationalized in what they're doing. I'm not seeing upticks in what they're putting out into the rental market.

So I think there is the belief that if they're going to get price for cars they have to manage all of those things more effectively, and they're doing a much better job at it. So when I look at that and then I look at what Manheim is talking about right now and then I look at what we're able to get in opportunistic sales and what we're -- from a depreciation and residual values what our retail operations are seeing, I'm not seeing imminent risk.

However, that being said, one of the best ways you manage through that is maximizing the asset value that you have, so managing price. With the cost up making sure that we have those valuable assets out there we get price for. But also as importantly, I think we're off to being the seventh largest seller of used cars through retail operations. And continuing to open up lots there at a very disciplined pace in markets that we're seeing demand, moving more of our shares to those retail lots and through dealer direct and away from the auctions.

And then the final piece is managing that curve of residual values through what we're doing with ride-sharing and getting more for those assets during the life where we're minimizing the impact of how much of a loss you take upfront and carrying those through a point that we're not incurring great cost around maintenance and expenses around it and selling them really at their peak value.

So the best way to manage through a downturn in residual values is with a great offense. And finally we have a really great team on negotiating what we pay for those cars and we absolutely -- if we see a decline in residuals, we negotiate that decline and any cars that we're purchasing going forward.

And then the final thing is making sure we're buying the right cars with the right type of trim in them, so we get maximum value when we go to sell them. So long answer, but there's a lot that we do to make that happen. We understand creating the right long-term value in this company does also involve and maybe most importantly maximizing the value of those assets, which is how we buy and sell those cars. And now maybe if you want to talk about the second part of it.

Thomas C. Kennedy: Sure. So the investment spending we've been making in fleet is relative to the 2016 baseline. So, as we said previously, we invested approximately $130 million in calendar 2017, of which $20 million to $25 million of that was kind of one time related to the fleet rotation we went through last year. with the rest reflective of increased mix, so investing in better quality fleet of full-size and SUVs and better trim. And so that's kind of versus 2016, the baseline.

That's $100 million kind of ongoing. What we expect is that as we continue to iterate around the right optimal mix of full-size and premium and SUVs, we will continue to have a higher level of fleet cost relative to 2016. So that's a relative basis to the baseline of 2016 of being roughly $100 million a year ongoing investment related to the fleet cost relative to 2016.

Kathryn V. Marinello: And the good news is we are starting to get price for that better fleet and win more of our fair share of business back as a result. And so as we roll out and manage our revenue management and our finance forecasting and continue to learn and get better at that, we are offsetting -- part of that I think was just we didn't have the right fleet, that we ended up losing business in the past couple of years because we didn't have the type of fleet that people wanted.

Now what we're seeing is we're winning back more price, we're able to sell the cars for more and we're able to buy the cars at a lower price and continually driving down that incremental cost.

Operator: Your next question comes from the line of Brian Sponheimer, from Gabelli. Please go ahead.

Brian Sponheimer: Hi. Good morning, everyone.

Kathryn V. Marinello: Hi, Brian.

Brian Sponheimer: Just one question kind of looking down the road, Kathy. When you're making these IT investments, I'm curious your thoughts on just how much of what you're doing is not only setting up your core rental business to operate in a much more efficient fashion and to drive revenue, but also set up next-gen mobility solutions around fleet management and service.

Kathryn V. Marinello: I love that question, Brian. We are -- probably one of the things I'm most excited about is how what we're doing does set us up to be the best fleet management company in the world. And my background a few years ago, four or five years, was managing the largest corporate fleet.

And back during that time, we developed a lot of logistics and telematics capability to manage the corporate fleets that we did business with. We have a corporate fleet business (inaudible). In fact the gentleman who runs it ran my Australian division when I was at that fleet management company, and he's done a great job with his team to build out great connected car telematics capabilities, and we do have, right now, multiple tests and pilots around some of those capabilities, and we're pretty excited about the results we're seeing.

As we put in our new capabilities within the work that we're doing, it's, obviously, reservations and rentals on what we call two really business lines that we're going after and then that's around our retail rental operations, but then there's another focus that does impact that, which is our fleet management, fleet accounting, and Treasury capabilities.

So the work we're doing with Deloitte and Infor and IBM around that integrates telematics capabilities as well as all the financing that goes along with managing the fleet and car placement, all sorts of great asset management capability, so it's really taking a step back and saying if we become the best fleet management company in the world and our capabilities around fleet management accounting, treasury and financing around that, that's probably our best asset as mobility, autonomy and some of these other gig economy things come into place.

So we're very much focused on making sure that we have technology that enables not just our rental business, but then is already translating and transferring into great fleet management for a large delivery in gig and corporate fleets around the world. And the good news is it is global. The work we are doing is in tandem with our European, even South American operations. So we're taking a pretty aggressive approach along with what we're doing to support the rental operations.

Brian Sponheimer: Outstanding. Well, thank you very much and good luck.

Kathryn V. Marinello: 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.