

AVIS BUDGET GROUP, INC.

Form 10-Q

November 03, 2016

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
^x 1934

For the quarterly period ended September 30, 2016

OR
^o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
^o 1934

For the transition period from _____ to _____

Commission File No. 001-10308

Avis Budget Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

6 Sylvan Way

Parsippany, NJ

(Address of principal executive offices)

06-0918165

(I.R.S. Employer
Identification Number)

07054

(Zip Code)

(973) 496-4700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90

days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of the issuer's common stock was 87,889,621 shares as of October 31, 2016.

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q may be considered “forward-looking statements” as that term is defined in the Private Securities Litigation Reform Act of 1995. The forward-looking statements contained herein are subject to known and unknown risks, uncertainties, assumptions and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by any such forward-looking statements. Forward-looking statements include information concerning our future financial performance, business strategy, projected plans and objectives. These statements may be identified by the fact that they do not relate to historical or current facts and may use words such as “believes,” “expects,” “anticipates,” “will,” “should,” “could,” “may,” “would,” “intends,” “projects,” “estimates,” “plans,” and similar words, expressions or phrases. The following important factors and assumptions could affect our future results and could cause actual results to differ materially from those expressed in such forward-looking statements:

- the high level of competition in the vehicle rental industry and the impact such competition may have on pricing and rental volume;

- a change in travel demand, including changes in airline passenger traffic;

- a change in our fleet costs as a result of a change in the cost of new vehicles, manufacturer recalls, disruption in the supply of new vehicles, and/or a change in the price at which we dispose of used vehicles either in the used vehicle market or under repurchase or guaranteed depreciation programs;

- the results of operations or financial condition of the manufacturers of our cars, which could impact their ability to perform their payment obligations under our agreements with them, including repurchase and/or guaranteed depreciation arrangements, and/or their willingness or ability to make cars available to us or the rental car industry as a whole on commercially reasonable terms or at all;

- any change in economic conditions generally, particularly during our peak season or in key market segments;

- our ability to continue to achieve and maintain cost savings and successfully implement our business strategies;

- our ability to obtain financing for our global operations, including the funding of our vehicle fleet through the issuance of asset-backed securities and use of the global lending markets;

- an occurrence or threat of terrorism, pandemic disease, natural disasters, military conflict or civil unrest in the locations in which we operate;

- our dependence on third-party distribution channels, third-party suppliers of other services and co-marketing arrangements with third parties;

- our ability to utilize derivative instruments, and the impact of derivative instruments we utilize, which can be affected by fluctuations in interest rates, gasoline prices and exchange rates, changes in government regulations and other factors;

- our ability to accurately estimate our future results;

- any major disruptions in our communication networks or information systems;

our exposure to uninsured or unpaid claims in excess of historical levels;

risks associated with litigation, governmental or regulatory inquiries, or any failure or inability to comply with laws, regulations or contractual obligations or any changes in laws, regulations or contractual obligations, including with respect to personally identifiable information and taxes;

any impact on us from the actions of our licensees, dealers and independent contractors;

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any substantial changes in the cost or supply of fuel, vehicle parts, energy, labor or other resources on which we depend to operate our business;

risks related to our indebtedness, including our substantial outstanding debt obligations and our ability to incur substantially more debt;

our ability to meet the financial and other covenants contained in the agreements governing our indebtedness;

risks related to tax obligations and the effect of future changes in accounting standards;

risks related to completed or future acquisitions or investments that we may pursue, including any incurrence of incremental indebtedness to help fund such transactions and our ability to promptly and effectively integrate any acquired businesses;

risks related to protecting the integrity of our information technology systems and the confidential information of our employees and customers against security breaches, including cyber-security breaches; and

other business, economic, competitive, governmental, regulatory, political or technological factors affecting our operations, pricing or services, including uncertainty and instability in Europe related to the potential withdrawal of countries from the European Union.

We operate in a continuously changing business environment and new risk factors emerge from time to time. New risk factors, factors beyond our control, or changes in the impact of identified risk factors may cause actual results to differ materially from those set forth in any forward-looking statements. Accordingly, forward-looking statements should not be relied upon as a prediction of actual results. Moreover, we do not assume responsibility for the accuracy and completeness of those statements. Other factors and assumptions not identified above, including those discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Risk Factors” and other portions of our 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 24, 2016 (the “2015 Form 10-K”), could cause actual results to differ materially from those projected in any forward-looking statements.

Although we believe that our assumptions are reasonable, any or all of our forward-looking statements may prove to be inaccurate and we can make no guarantees about our future performance. Should unknown risks or uncertainties materialize or underlying assumptions prove inaccurate, actual results could differ materially from past results and/or those anticipated, estimated or projected. Except to the extent of our obligations under the federal securities laws, we undertake no obligation to release any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events. For any forward-looking statements contained in any document, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Avis Budget Group, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(In millions, except per share data)

(Unaudited)

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
	2015	2016	2015	2016
Revenues				
Vehicle rental	\$1,871	\$1,832	\$4,772	\$4,684
Other	785	745	2,008	1,916
Net revenues	2,656	2,577	6,780	6,600
Expenses				
Operating	1,219	1,202	3,381	3,279
Vehicle depreciation and lease charges, net	576	555	1,571	1,485
Selling, general and administrative	315	314	896	843
Vehicle interest, net	77	75	215	218
Non-vehicle related depreciation and amortization	63	56	189	161
Interest expense related to corporate debt, net:				
Interest expense	51	49	157	146
Early extinguishment of debt	—	—	10	23
Restructuring expense	6	6	26	10
Transaction-related costs, net	4	8	13	57
Total expenses	2,311	2,265	6,458	6,222
Income before income taxes	345	312	322	378
Provision for income taxes	136	128	128	60
Net income	\$209	\$184	\$194	\$318

Comprehensive income	\$235	\$150	\$294	\$198
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Earnings per share

Basic	\$2.32	\$1.80	\$2.07	\$3.04
Diluted	\$2.28	\$1.77	\$2.05	\$3.00

See Notes to Consolidated Condensed Financial Statements (Unaudited).

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Avis Budget Group, Inc.

CONSOLIDATED CONDENSED BALANCE SHEETS

(In millions, except par value)

(Unaudited)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 985	\$ 452
Receivables, net	822	668
Other current assets	635	507
Total current assets	2,442	1,627
Property and equipment, net	671	681
Deferred income taxes	1,443	1,488
Goodwill	1,013	973
Other intangibles, net	885	917
Other non-current assets	224	232
Total assets exclusive of assets under vehicle programs	6,678	5,918
Assets under vehicle programs:		
Program cash	126	258
Vehicles, net	11,724	10,658
Receivables from vehicle manufacturers and other	586	438
Investment in Avis Budget Rental Car Funding (AESOP) LLC—related party	361	362
	12,797	11,716
Total assets	\$ 19,475	\$ 17,634
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and other current liabilities	\$ 1,713	\$ 1,485
Short-term debt and current portion of long-term debt	338	26
Total current liabilities	2,051	1,511
Long-term debt	3,528	3,435
Other non-current liabilities	763	734
Total liabilities exclusive of liabilities under vehicle programs	6,342	5,680
Liabilities under vehicle programs:		
Debt	2,966	2,064
Debt due to Avis Budget Rental Car Funding (AESOP) LLC—related party	7,134	6,796
Deferred income taxes	2,370	2,367
Other	189	288
	12,659	11,515
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$0.01 par value—authorized 10 shares; none issued and outstanding	—	—

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Common stock, \$0.01 par value—authorized 250 shares; issued 137 shares, at each date	1	
Additional paid-in capital	6,940	7,010
Accumulated deficit	(1,608)	(1,802)
Accumulated other comprehensive loss	(47)	(147)
Treasury stock, at cost—48 and 39 shares, respectively	(4,812)	(4,623)
Total stockholders' equity	474	439
Total liabilities and stockholders' equity	\$ 19,475	\$ 17,634
See Notes to Consolidated Condensed Financial Statements (Unaudited).		

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Avis Budget Group, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Nine Months Ended September 30, 2016 2015	
Operating activities		
Net income	\$ 194	\$ 318
Adjustments to reconcile net income to net cash provided by operating activities:		
Vehicle depreciation	1,453	1,423
Gain on sale of vehicles, net	(15)	(58)
Non-vehicle related depreciation and amortization	189	161
Stock-based compensation	21	22
Amortization of debt financing fees	29	31
Early extinguishment of debt costs	10	23
Net change in assets and liabilities, excluding the impact of acquisitions and dispositions:		
Receivables	(149)	(131)
Income taxes and deferred income taxes	80	43
Accounts payable and other current liabilities	33	(28)
Other, net	256	234
Net cash provided by operating activities	2,101	2,038
Investing activities		
Property and equipment additions	(125)	(126)
Proceeds received on asset sales	10	8
Net assets acquired (net of cash acquired)	(4)	(225)
Other, net	4	3
Net cash used in investing activities exclusive of vehicle programs	(115)	(340)
Vehicle programs:		
Decrease (increase) in program cash	138	(71)
Investment in vehicles	(10,151)	(9,762)
Proceeds received on disposition of vehicles	7,373	6,756
	(2,640)	(3,077)
Net cash used in investing activities	(2,755)	(3,417)

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Avis Budget Group, Inc.
**CONSOLIDATED CONDENSED
 STATEMENTS OF CASH FLOWS**
 (Continued)
 (In millions)
 (Unaudited)

	Nine Months Ended September 30, 2016 2015	
Financing activities		
Proceeds from long-term borrowings	896	377
Payments on long-term borrowings	(527)	(290)
Net change in short-term borrowings	1	(23)
Repurchases of common stock	(289)	(270)
Debt financing fees	(15)	(7)
Net cash provided by (used in) financing activities exclusive of vehicle programs	66	(213)
Vehicle programs:		
Proceeds from borrowings	11,879	11,532
Payments on borrowings	(10,752)	(9,933)
Debt financing fees	(20)	(17)
	1,107	1,582
Net cash provided by financing activities	1,173	1,369
Effect of changes in exchange rates on cash and cash equivalents	14	(29)
Net increase (decrease) in cash and cash equivalents	533	(39)
Cash and cash equivalents, beginning of period	452	624
Cash and cash equivalents, end of period	\$985	\$585
See Notes to Consolidated Condensed Financial Statements (Unaudited).		

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Avis Budget Group, Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)

(Unless otherwise noted, all dollar amounts in tables are in millions, except per share amounts)

1. Basis of Presentation

Avis Budget Group, Inc. provides car and truck rentals, car sharing services and ancillary services to businesses and consumers worldwide. The accompanying unaudited Consolidated Condensed Financial Statements include the accounts and transactions of Avis Budget Group, Inc. and its subsidiaries, as well as entities in which Avis Budget Group, Inc. directly or indirectly has a controlling financial interest (collectively, the “Company”), and have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission for interim financial reporting.

The Company operates the following reportable business segments:

Americas—provides and licenses the Company’s brands to third parties for vehicle rentals and ancillary products and services in North America, South America, Central America and the Caribbean, and operates the Company’s car sharing business in certain of these markets.

International—provides and licenses the Company’s brands to third parties for vehicle rentals and ancillary products and services in Europe, the Middle East, Africa, Asia, Australia and New Zealand, and operates the Company’s car sharing business in certain of these markets.

The operating results of acquired businesses are included in the accompanying Consolidated Condensed Financial Statements from the dates of acquisition. During the nine months ended September 30, 2016, the Company completed the purchase price allocation for the acquisition of its Avis and Budget licensees in Norway, Sweden and Denmark, its Avis and Budget licensee in Brazil and Maggiore Group. There were no material adjustments to the preliminary allocation. The fair value of the assets acquired and liabilities assumed in connection with the Company’s fourth quarter 2015 acquisition of its Avis licensee in Poland has not yet been finalized; however, there have been no significant changes to the preliminary allocation of the purchase price during the nine months ended September 30, 2016.

In presenting the Consolidated Condensed Financial Statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”), management makes estimates and assumptions that affect the amounts reported and related disclosures. Estimates, by their nature, are based on judgment and available information. Accordingly, actual results could differ from those estimates. In management’s opinion, the Consolidated Condensed Financial Statements contain all adjustments necessary for a fair presentation of interim results reported. The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. These financial statements should be read in conjunction with the Company’s 2015 Form 10-K.

Vehicle Programs. The Company presents separately the financial data of its vehicle programs. These programs are distinct from the Company’s other activities since the assets under vehicle programs are generally funded through the issuance of debt that is collateralized by such assets. The income generated by these assets is used, in part, to repay the principal and interest associated with the debt. Cash inflows and outflows relating to the acquisition of such assets and the principal debt repayment or financing of such assets are classified as activities of the Company’s vehicle programs. The Company believes it is appropriate to segregate the financial data of its vehicle programs because, ultimately, the source of repayment of such debt is the realization of such assets.

Transaction-related costs, net. Transaction-related costs, net are classified separately in the Consolidated Condensed Statements of Comprehensive Income. These costs are comprised of expenses related to acquisition-related activities such as due-diligence and other advisory costs, expenses related to the integration of the acquiree's operations with those of the Company, including the implementation of best practices and process improvements, non-cash gains and losses related to re-acquired rights, expenses related to pre-acquisition contingencies and contingent consideration related to acquisitions.

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Currency Transactions. The Company records the gain or loss on foreign-currency transactions on certain intercompany loans and the gain or loss on intercompany loan hedges within interest expense related to corporate debt, net. During the three months ended September 30, 2016 and 2015, the Company recorded losses on such items of \$1 million in each period, and during the nine months ended September 30, 2016 and 2015, the Company recorded losses of \$8 million and \$10 million, respectively.

Adoption of New Accounting Standards

On January 1, 2016, as a result of the issuance of a new accounting pronouncement, the Company adopted Accounting Standards Update (“ASU”) 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments,” which eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination at the acquisition date. Instead, the cumulative impact of any adjustment will be recognized in the reporting period in which the adjustment is identified. The adoption of this accounting pronouncement did not have a material impact on the Company’s Consolidated Financial Statements.

On January 1, 2016, as a result of the issuance of a new accounting pronouncement, the Company adopted ASU 2015-05, “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” which provides guidance for determining whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software, rather than as a service contract. The adoption of this accounting pronouncement did not have a material impact on the Company’s Consolidated Financial Statements.

On January 1, 2016, as a result of the issuance of a new accounting pronouncement, the Company adopted ASU 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern,” which requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued and to provide related footnote disclosures in certain circumstances. The adoption of this accounting pronouncement did not have an impact on the Company’s Consolidated Financial Statements.

Recently Issued Accounting Standards

In August 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-15, “Classification of Certain Cash Receipts and Cash Payments,” which clarifies guidance on the classification of certain cash receipts and cash payments in the statement of cash flow. ASU 2016-15 becomes effective for the Company on January 1, 2018. The adoption of this accounting pronouncement is not expected to have a material impact on the Company’s Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, minimum statutory withholding requirements and classification in the statement of cash flow. ASU 2016-09 becomes effective for the Company on January 1, 2017. The Company is currently evaluating the effect of this accounting pronouncement on its Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, “Leases,” which requires a lessee to recognize all long-term leases on its balance sheet as a liability for its lease obligation, measured at the present value of lease payments not yet paid, and a corresponding asset representing its right to use the underlying asset over the lease term. ASU 2016-02 becomes effective for the Company on January 1, 2019. Early adoption is permitted. The Company is currently evaluating the effect of this accounting pronouncement on its Consolidated Financial Statements.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities," which makes limited amendments to the classification and measurement of financial instruments. The new standard amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 becomes effective for the Company on January 1, 2018. The adoption of this accounting pronouncement is not expected to have a material impact on the Company's Consolidated Financial Statements.

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In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” which outlines a single model for entities to use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance. ASU 2014-09 becomes effective for the Company on January 1, 2018. The Company is currently evaluating the effect of this accounting pronouncement on its Consolidated Financial Statements.

2. Restructuring

In 2014, the Company committed to various strategic initiatives to identify best practices and drive efficiency throughout its organization, by reducing headcount, improving processes and consolidating functions (the “T15 restructuring”). In first quarter 2016, the Company expanded the T15 restructuring to take advantage of additional efficiency opportunities. The expanded T15 restructuring fits within the initiative’s focus areas to identify best practices and drive efficiency throughout the organization, including the consolidation of rental locations. During the nine months ended September 30, 2016, as part of this process, the Company formally communicated the termination of employment to approximately 565 employees, and as of September 30, 2016, the Company had terminated approximately 425 of these employees. The costs associated with this initiative primarily represent severance, outplacement services and other costs associated with employee terminations, the majority of which have been or are expected to be settled in cash. The Company expects further restructuring expense of approximately \$2 million related to this initiative to be incurred in 2016.

In conjunction with previous acquisitions, the Company identified opportunities to integrate and streamline its operations, primarily in Europe (the “Acquisition integration”). During the nine months ended September 30, 2016, as part of this process, the Company formally communicated the termination of employment to approximately 125 employees, and as of September 30, 2016, the Company had terminated approximately 110 of these employees. The Company expects further restructuring expense of approximately \$2 million related to this initiative to be incurred in 2016.

The following tables summarize the activity related to our restructuring liabilities:

	Americas	International	Total
Balance as of January 1, 2016	\$ 1	\$ 10	\$ 11
T15 restructuring expense	10	8	18
Acquisition integration expense	—	9	9
Avis Europe restructuring expense	—	(1)	(1)
T15 restructuring payment/utilization	(9)	(4)	(13)
Acquisition integration payment	(1)	(13)	(14)
Avis Europe restructuring payment	—	(1)	(1)
Balance as of September 30, 2016	\$ 1	\$ 8	\$ 9

	Personnel Related	Facility Related	Other ^(a)	Total
Balance as of January 1, 2016	\$ 10	\$ 1	\$ —	\$ 11
T15 restructuring expense	13	1	4	18
Acquisition integration expense	9	—	—	9
Avis Europe restructuring expense	—	(1)	—	(1)
T15 restructuring payment/utilization	(9)	—	(4)	(13)
Acquisition integration payment	(14)	—	—	(14)
Avis Europe restructuring payment	(1)	—	—	(1)
Balance as of September 30, 2016	\$ 8	\$ 1	\$ —	\$ 9

(a) Includes expense related primarily to the write-down of certain vehicle assets.

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3. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share ("EPS") (shares in millions):

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
Net income for basic and diluted EPS	\$209	\$184	\$194	\$318				
Basic weighted average shares outstanding	90.4	102.7	93.5	104.7				
Options and non-vested stock ^(a)	1.4	1.3	1.3	1.4				
Diluted weighted average shares outstanding	91.8	104.0	94.8	106.1				
Earnings per share:								
Basic	\$2.32	\$1.80	\$2.07	\$3.04				
Diluted	\$2.28	\$1.77	\$2.05	\$3.00				