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Hertz Global Holdings, Inc. (HTZ)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Hertz Global Holdings Second Quarter 2018 Earnings Conference Call. At this time, all lines are in 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 our host, Leslie Hunziker. Please go ahead.

Leslie M. Hunziker

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

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 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 in the Risk Factors and Forward-looking Statements section of our 2017 Form 10-K and our second quarter 2018 Form 10-Q. Copies of this filing is available at the SEC and on the Hertz website.

Today, we'll use certain non-GAAP financial measures, all of which are reconciled with our GAAP numbers in our press release and related Form 8-K, 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., the 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

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

Thank you, Leslie, and good morning, everyone. In the second quarter, we generated growth across every business segment with higher year-over-year revenue and adjusted EBITDA. In particular, our U.S. turnaround initiatives are gaining traction and we delivered our third consecutive quarter of growth in the latest period as a result of effective strategies, experienced leaders, and critical investments in fleet, marketing, and retail operations. U.S. revenue is growing again across all brands. It was up 7% in the latest quarter driven by both increased volumes and higher time and mileage rates. Asset utilization is improving as new machine learning, forecasting tools better match fleet with demand all the way down to the local site level.

Fleet costs are significantly lower as we've negotiated better new car economics, bought vehicles with the most favorable residual outcomes, instituted new processes for opportunistic fleet rotation, leveraged our higher return retail sales channels, and bent the curve on depreciation through our expanded ride-hailing fleet. With revenue per unit in the U.S. up year-over-year and our fleet management initiatives pushing utilization higher and supporting lower depreciation per unit, we've been able to increase the revenue cost spread for the fourth consecutive quarter.

Since the beginning of 2017, we've been working on a four-tiered plan to ensure that the foundation of our business is strong, resilient, and adaptable to support growth and innovation, and successfully navigate any economic cycle. Our plan encompasses initiatives to enhance product, service, brands and technology. At the same time, we're bolstering our leadership team and investing in employee skills and capabilities. It's a lot of work across the organization, but success in these areas is fundamental to creating recurring revenue and productivity improvements. We know that the most sustainable path to creating value is to continually invest in our capabilities. A successful turnaround is not the result of quick-fixes or short-term cost-cutting. It's a deliberate process to drive sustainable improvement across all key metrics.

We also know that the significant investments we're making in operations and technology are putting a lot of pressure on earnings, but if we don't get it right, deficiencies in any one area can derail long-term growth, and getting it right takes time. However, early performance trends are encouraging and we're cautiously optimistic about the pace of progress throughout the rest of 2018. For the turnaround to have the most successful outcomes and the fastest returns, our approach has required adding resources, prioritizing higher return opportunities, and learning from each experience to make subsequent efforts more effective. Additional resources result in some short-term efficiencies, until the transformative actions are complete and productivity benefits take hold.

A significant portion of our incremental spending is related to additional personnel as well as consulting resources primarily in field operations and technology support. In those areas, spending will remain elevated through 2019 as we continue the operations improvement program and update our 30-year old technology platform. On the other hand, investments in sales and marketing are what I would categorize as catch-up on ongoing investment to reenergize the brands. Marketing has suffered from under investment for a long time, so this area's spending reflects a new base level to continue to leverage brand value.

Finally, the investment we made last year to fix the fleet is paying off and we're now benefiting from better processes and strategies in fleet management to keep depreciation expense in a more reasonable range. So what about the benefits? It's those investments that we made in 2017 that are driving our progress today. Better management of fleet capacity, our car-class mix that our customers prefer, broad coverage of our Ultimate Choice vehicle delivery model, training and incentives for improving customer service scores, a defined brand segmentation strategy, corporate account win-back initiatives, our more intuitive revenue management system and an AI-powered constant management platform that combines fleet and demand forecasting into one system.

All of those 2017 investments along with additional support from new leaders in HR, marketing and retail operations are the catalyst to the improving trends we're seeing in 2018. But there is still a lot of work to do. This year, we're re-launching all three brands targeted at distinct consumer segments. Hertz, our iconic category leading brand, launched new digital marketing introducing the brand promise of Hertz: We're here to get you there, to underscore our positioning as the number one choice for frequent business travelers in the premium leisure market. The message is to highlight the key areas that drive consumer consideration, great products with choice, either pickup and return, and an industry-leading royalty program, all delivered with consistency and reliability.

Innovative partnerships with Chevrolet where specifically targeted Hertz customers were upgraded to the just launched Traverse, and Hendrick Motorsports where we sponsored 20-year-old NASCAR phenomenon William Byron have further increased brand visibility and relevance for a whole new generation of drivers. The Dollar brand focuses on families on a budget and is this year's lead sponsor of national KIDZ BOP tour. Dollar's brand re-launch has targeted our top [ph] store (07:43) cities like Chicago and Miami. For Thrifty, we just started rolling out online ads with the slogan As Thrifty As You Are. We have a very granular tracking in place to gauge the performance of each campaign.

So far, conversions are up and volumes across all brands are trending higher. At the same time, we're driving growth to our higher engagement, higher margin dotcom channel. In addition to marketing campaigns this year, we're stepping up field recruiting and training, centralizing maintenance later this fall to reduce out-of-service fleet, and investing in our Lean Six Sigma site optimization initiative to add oversight and improve and standardize processes across the location. When you get the process right, you not only become more productive, but you also deliver the best customer service, and that's our experience. Of course, to see this program at even just the top 50 airports, it is quite an undertaking, but we're making good progress.

We're also investing in our used car business, which is a key asset for us. We're opening a handful of retail lots this year to improve our geographic coverage, and we recently upgraded our car sales website to power online digital retailing capability. As we've grown in our higher return alternative channels, auction sales now represent less than 25% of total disposition.

Finally, as I mentioned, while benefits are coming from fleet marketing and field operations, heavy IT spending continues. As is always the case, but especially when it comes to technology, the benefits lag the investments. For those of you who are new to the story, we're in the midst of a major end-to-end technology upgrade that included outsourcing our legacy systems and designing and building a cloud-based infrastructure for our five core platforms: digital, CRM fleet management and fleet accounting, reservation, and rental.

As we begin pilot testing and get closer to launching the new platforms in 2019, we've been transitioning IT leadership for that next phase. Over the last three months, I've held the Interim CIO position in addition to my day job, dedicating there time, afforded me an opportunity to go really deep into the project to get a better understanding of vendor performance, spending controls, data flow strategy, and the timeline and accountability for each initiative. While we've made a few adjustments and done a little bit of re-sequencing as a result, we're on track for our fall 2019 delivery date.

We're targeting the fall because we wanted to be through the summer peak before we launch the new technologies. To-date, our sales force and cloud CRM applications are substantially complete. The New Hertz digital app has been created and testing is well underway. Development of our redesigned reservation system is 90% realized and our fleet management and fleet accounting system build-out is about 60% done. The platform's engine, the rental system is roughly 25% through its development.

So again, we're making good progress. Our plan is for the fleet reservation and rental systems to be rolled out as one cohesive integrated global system next year. Being so close to the technology transformation gave me great insights as we conducted our CIO search. It also gave me great confidence in choosing Opal Perry for this job. Opal will lead our IT strategy development and operations as well as the prioritization and delivery of our cloud-based systems upgrade. Most recently from Allstate, she brings more than 25 years of experience as a global leader, developing, integrating and capitalizing on end-to-end digital innovations and cloud-native applications and microservices. I feel very confident in handing over the reins to Opal when she comes on board later this month.

With 2018 being Hertz's centennial anniversary, we like to think of it as year one of our next 100 years. That means that as we're designing and building our new technology platforms, we're doing so with the future in mind. Incorporating the work that's already underway to support connected, touchless and autonomous vehicles into our new systems, will mean better data analytics, more intuitive fleet management and incremental new revenue streams, all being driven by a faster, more agile architecture. These are the advantages that compel technology leaders and future mobility to partner with Hertz. You probably saw that Aptiv is our latest development partner. They recognize our fleet management capabilities as best-in-class, and our new platform will only further enhance our mobility interface resources.

We look to shape Hertz's future as a more efficient progressive, fleet management company that drives operational growth, leverages Hertz's iconic brands, leads through technology and unlock asset value. Those are our priorities. In 2019, the contributions from our 2017 and 2018 initiatives will further accelerate, which will have more of an offsetting benefit on the investments in technology and operations that will continue through the end of next year. In 2020, with the systems' rollout completed and the field operations leveraging the new technology tools, the turnaround investments fall away, revenue continues to grow and productivity steps up.

So far, everything tells us we're on the right track. An early read on July's revenue looks very encouraging with U.S. Rental Car up roughly 11% and we still have a few weeks left of the summer peak before we start transitioning through the September shoulder period. With our enhanced fleet management tools and expanding car sales capabilities, our goal is to be well positioned from a capacity standpoint heading into the fall. We expect the revenue and adjusted corporate EBITDA improvement trends over the last three quarters to continue.

With that, I'll turn it over to Tom to walk you through the financial metrics in detail.

Thomas C. Kennedy

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

Thank you, Kathy, and good morning, everyone. Second quarter results reflect continued year-over-year improvement in nearly all of our key operating metrics in U.S. RAC segment, and reflect the third consecutive quarter of year-over-year improvement in consolidated adjusted corporate EBITDA.

As Kathy mentioned, these results reflect that the four key areas of focus, improve fleet and product, enhance operational service, investments in technology, and investments in sales and marketing of our brands are driving a trend of improving results from quarter to quarter. While we still have a period of elevated investment spending ahead of us, we expect to continue to see consolidated year-over-year revenue growth, expense productivity improvements, margin expansion and positive earnings growth and improving cash flow into 2019 and 2020.

Now, I'd like to move into an update of our U.S., International RAC segment's results and an update of the financing activities, liquidity, cash flows and look at our preliminary July revenue results in U.S. RAC. In the second quarter, total U.S. RAC revenues grew 7% versus the prior year with 2 percentage points sequential improvement from the first quarter of 2018 despite a more difficult comparison due to the timing of the Easter holiday this year.

The revenue growth was driven primarily by 7% increase in transaction days on flat total revenue per day or RPD. The transaction day increase reflected strong volume growth in both our airport and off-airport businesses in nearly all customer segments. Excluding the growth in our TNC business, total transaction days grew 5%. We believe the volume growth is a function of a strong market demand and our company-specific investments.

For example, the rental car industry has experienced a 4% to 6% revenue growth in top 100 airport markets in the first half of 2018 and off-airport market demand appears strong. Our company's specific investments such as better mix of vehicles, improved service and the rollout of our Ultimate Choice products, and increased personnel in field operations also seem to be contributing to our improving volume growth.

Total RPD was flat versus prior year despite an unfavorable comparable with timing of the Easter holiday demand benefiting the first quarter of this year. The flat total RPD also reflected a sequential improvement from the first quarter. Also, each month sequentially improved during the second quarter, and we exited the quarter with June reporting a 2% increase in total RPD and nearly a 5% increase in time and mileage rates, which includes value-added service revenues. The favorable trend in total RPD during the quarter was achieved despite value-added service revenues still being a headwind on overall pricing.

However, as we discussed on last quarter's call, we have initiatives in place to improve our performance in this area. We're seeing progress through the second quarter as compared to the first quarter of this year as the rate of decline in value-added service revenue per day excluding TNC improved 390 basis points versus the first quarter, and we have turned positive in two of the four key products that make up nearly 80% of the overall value-added service revenues.

Now turning to fleet, excluding fleet dedicated to ride-hailing, or TNC fleet, our core fleet capacity increased 3% responding to strong market demand as evidenced by the 5% growth in transaction days. Also recall that we've reduced core fleet capacity last year in the second quarter of 2017 by 3%. So, our 2018 core fleet capacity is essentially flat to our core fleet capacity in 2016. At quarter end, we had approximately 29,000 vehicles in our dedicated TNC fleet compared to 24,000 at the end of the first quarter and 22,000 at the end of year 2017. All these rentals have lower RPD, but they're profitable as we use higher mileage vehicles and lower monthly depreciation rate and achieve longer length of rents.

Total vehicle utilization excluding TNC improved 150 basis points and total utilization of the entire fleet including our TNC business reached 81%, an increase of 100 basis points versus the prior year. The lower TNC utilization is largely the result of [ph] higher-end fleeting (17:46) volumes that incur retitling and maintenance checks before being put into TNC service. Monthly vehicle depreciation expense of $285 per unit decreased 19% versus the prior year quarter. The decrease in unit vehicle depreciation expense is a result of continued favorable market residual values we spoke about in the first quarter call as reflected in the Manheim rental index, which posted increases of 79% per month in the quarter.

Continued increase of model year 2018 and 2017 vehicles as a percentage of the total fleet, which comprise nearly 90% of the fleet at the end of the second quarter versus 80% at the end of the first quarter and has lower like-for-like prices, a 16-percentage-point increase in dispositions through higher-yielding dealer direct and retail sales channels, and opportunistic sales of certain models reflecting favorable market conditions and ongoing systematic reviews of optimizing our fleet holding costs.

No net losses on dispositions were recorded for U.S. RAC in the second quarter 2018 compared to $33 million net loss reported in the prior year quarter when we sold approximately 51% more fleet in what was a weaker market as we're finalizing the rebalancing of the fleet, the lower volumes and a richer mix of vehicles.

Our retail car sales operation continues to be a strength of the organization and we're investing in its growth. In addition to adding new physical locations in 2018, we launched an upgraded web-based selling platform in the second quarter. This new platform is a key step in the development of our digital retail experience and we're excited about the potential growth in our online sales channels for retail.

Total U.S. RAC vehicle interest expense increased [ph] $16 million (19:22) and cash expense increased $50 million relative to the second quarter of 2017. Both rate and volume contributed to increase in vehicle interest expense. The increase in rate was due to higher floating benchmark rates, wider spreads in our Variable Funding

Notes related to last fall's bank commitment, and an approximate quarter-of-a-percentage increase in blended rate in our term ABS notes. An increase in fleet debt relative to last year also contributed to higher interest expense levels, reflecting the higher average fleet levels versus prior year commensurate with demand as well as the impact of our investment in higher fleet mix.

Our current mix of the U.S. RAC ABS debt is approximately two-third fixed and one-third floating. For the full year, we expect U.S. RAC vehicle interest expense to increase about $40 million due to rates and about $30 million due to higher fleet debt levels. Despite the negative impact on higher vehicle interest expense and elevated investment spending, U.S. RAC posted a $40 million improvement in adjusted corporate EBITDA versus prior year due primarily to the contribution of revenue growth and improved unit multi-vehicle depreciation expense.

Moving on to our International RAC segment, total revenues increased 8% to $589 million. Excluding $35 million of favorable currency impact, total revenues increased 2% driven by 2% increase in total RPD on flat transaction days. Excluding the Brazil operation results in 2017, total revenues increased 4% in constant currency and total RPD was flat, driven by rate pressure in our commercial business offset by stronger leisure pricing and transaction days increased by 4%. Consistent with the first quarter of 2018, the increase in transaction days is largely attributable to strong commercial, multi-month and light commercial vehicle volumes in Europe.

While still an increase versus prior year, leisure travel was dampened during the quarter due to the shift of Easter in 2018 to the first quarter versus 2017 and lower demand in leisure travels during the tournament period of 2018 Football World Cup, which also impacted vehicle utilization. International net vehicle depreciation per unit per month of $199, reflected a 4% increase versus prior year, which is a 5-percentage-point sequential improvement compared to the year-over-year increase in the first quarter. Excluding the Brazil operating results of 2017, net depreciation expense per unit increased just 1%, which equates to less than $1 million.

In the quarter, International RAC segment vehicle interest expense increased by $26 million and cash vehicle interest expense increased by $24 million. Of the $24 million cash vehicle interest expense increase, $19 million of the increase is attributable to premium associated with the [ph] April redemption (21:57) of over €425 million Eurobond

Higher vehicle interest expense rates reflecting increased spreads of our international fleet facilities and higher coupon on the new issue Eurobond further impacted the increase by about $3 million. Foreign exchange with somewhat higher debt levels made up the remaining difference. The quarter results also reflect an approximate $20 million net year-over-year decrease in insurance liability expense, resulting from our improving customer mix and claims management expertise. In summary, International RAC segment adjusted corporate EBITDA of $81 million, a 29% improvement versus the prior-year quarter.

Now, I'd like to provide an update on our financing activities, corporate liquidity and free cash flow. In April, as I mentioned earlier, we redeemed €425 million notes due in January 2019 with proceeds from our March issuance of €500 million European Vehicle Notes. In addition, we issued €550 million of term ABS under balanced commercial fleet lease ABS program. And in June, we again tapped U.S. RAC ABS market for $400 million of term notes for rental car structured entity, HVF II. The transaction consisted of two series of notes, one with three-year maturity and one with five-year maturity with an aggregate principal amount of $200 million each.

Finally, we utilized standalone letter of credit facility set up last fall for the first time. We were able to access this facility by terminating up to $400 million of outstanding letter of credits from our Senior RCF facility and [ph] reissuing credit (23:29) under the standalone letter of credit facility. During the quarter, we issued approximately $302 million stated amount of letters of credit. The corresponding $302 million of commitments were permanently reduced under the Senior RCF and moved to the standalone letter of credit facility. This had no impact on our liquidity. But by reducing the size of the Senior RCF facility, we increased our debt incurrence capacity for debt junior to the first lien debt by $302 million.

Overall, we continue to maintain our focus on extending Hertz's liability structure. Regarding our non-vehicle book of debt, we will continue to assess opportunities to refinance pending maturities, but our nearest dated maturity is not until October of 2020. We will not wait until the last minute to refinance these notes, but we'll evaluate the trade-off between waiting to benefit from continued improvement in our financial performance and opportunities available in the marketplace. On the liquidity front, we ended the quarter with no drawings under our corporate senior revolving credit facility and almost $1.2 billion in corporate liquidity and our first lien covenant ratio of 1.6 times was well inside the required 3.0 times.

Turning to cash flow, I discussed in our last call, 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. Year-to-date through June, adjusted free cash flow is negative $326 million, a $240 million improvement relative to the first half of 2017. Overall, we expect strong free cash flow in the second half while we continue to expect that the full year will be negative albeit significantly better than last year.

Finally, as I mentioned in our first quarter call, industry fundamentals appear to be favorable and positive contributing to our results. However, investments we have made, and will continue to make, also are contributing to top-line revenue growth and year-over-year improvement in adjusted corporate EBITDA. We expect these trends in quarterly year-over-year revenue growth and improving adjusted corporate EBITDA to continue despite being in a period of elevated investment spending.

In fact, our preliminary revenue results in U.S. RAC in July versus prior year were very encouraging as evidenced by the following. Total revenues grew 11% as a result of 4% increase in total RPD and 7% increase in transaction days with both rate and volume growth at the airport and off-airport operations. Total revenue per unit per month or RPU increased nearly 5% as we continued to maintain discipline in our fleet growth relative to demand and excluding TNC, average core fleet grew approximately 3% and vehicle utilization increased by approximately 70 basis points.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we do have a question from the line of Brian Sponheimer with Gabelli. Please go ahead.

Brian C. Sponheimer
Analyst, Gabelli Funds LLC

Q

Well, number one. Good morning and congratulations on good momentum here, Kathy and Tom. I guess my question is more strategic [ph] in line (26:33) with so much focus on the U.S. business, we've heard a lot about your optionality. How are you thinking about maybe servicing value of the Donlen business or the international operations? Is there something strategic that could potentially be done there that you're thinking about?

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

A

I think what we're thinking about strategically is particularly in the future as you look to autonomous fleet management and more global fleet management, having a very broad global reach with distribution pretty much around the world between both our franchise and our corporate-owned locations, we think that's invaluable on a go-forward basis.

And then if we look at some of the deals that we've entered into, like with Aptiv, which we announced recently, having the corporate fleet business and the capabilities that they bring to the table around managing corporate fleets of size, not just 20 or 30, but tens of thousands of vehicles. When we combine their telematics capability, fleet management capabilities, our global reach and our brand, again we think we have a real future going forward regardless of where things go from an autonomy and a mobility perspective. So, we think that that's really the strategic advantage.

Brian C. Sponheimer
Analyst, Gabelli Funds LLC

Q

Okay, great. And just regarding the Aptiv and your other arrangements, none of these are exclusive by nature. You're free to partner as you will with the entire spectrum of developers?

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

A

Aptiv is exclusive with us, but obviously as we look to other corporate fleets, we have thousands of corporate fleets now that we support, so we're really not in a position to do anything on a purely, it's only our space is proprietary basis. So, we're pretty much open to manage like we do in our corporate fleet business, multiple, both connected car or autonomous and just regular large fleet.

Brian C. Sponheimer
Analyst, Gabelli Funds LLC

Q

All right, terrific. Well, best of luck for a great second half.

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

A

We're working hard for you. Thank you.

Operator: And we do have a question from the line of Chris Woronka with Deutsche Bank. Please go ahead.

Chris J. Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, good morning, everyone. Also thanks for providing the kind of the EBITDA bridge for the next couple of years. I know that there is not hard numbers in there, but I think directionally, it's helpful. So, the question is just kind of on the revenue front, is it possible to kind of bucket what you're, I guess, underwriting from an industry perspective versus how much growth you expect to get from your own investment initiatives?

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

A

So, are you saying what is just the underlying economic growth right now, and then what do we think we've been [ph] using (29:33) that growth with? Is that the question?

Chris J. Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, exactly right. Yeah.

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

A

Well, we think obviously now with – in July having an 11% number, we're assuming economic stability going forward, and I think [indiscernible] (29:50) wouldn't be all that wise. I think our investments are right now more than doubling what we're seeing economically.

So clearly what we've been doing around multiple fronts to drive improved revenue is working. So we have a much more accurate sense of demand, where the demand is going to be, as well as pricing and those things are coming into play. We're moving a lot more business to our .com which is very helpful from a rate perspective, and as we strengthen the brand and investment in the brand, it's amazing what a strong brand Hertz is in particular. With very little investment initially we've seen strong growth there and as we're doing more things across multiple channels, we continue to see very strong growth.

So our near term, we're seeing all the different investments we've put in place on the top half of the P&L paying off. I also think we have an amazing tens of thousands of great employees that are really charged up. We've done some things investment wise between a much better fleet that customers prefer, they got real charged up over that, something as simple as but important is uniforms from a pride perspective, they've gone a long way, and just in general we see a really charged up employee base that's driving incredibly strong growth on our service capability. So we've seen a lot of customers return and we've seen a lot of new customers come into play, and we're seeing really strong growth over the economic positives.

Chris J. Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's very helpful Kathy. And just on the U.S. fleet costs, is this $285? Could we view that as something of a run rate or – and how does the increased mix of TNC fleet – what's the kind of net impact, is that – could that drive $285 lower going forward?

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

A

It's – from a – what percentage the fleet is, it's 29,000 vehicles over obviously a much larger fleet, so it has somewhat of a minimal impact on the overall cost, but if you add up all the really smart things we are doing to manage fleet costs, as we've mentioned earlier between an amazingly strong and resilient used car business, along with what we're doing around demand forecast and utilization, even things like centralizing maintenance to make sure that we get cars, out of service very quickly. All these things are driving down the cost, and then we're working with our different OEMs to buy the right kind of cars with the right equipment that people would actually prefer, but then when we go to sell them, they sell at a better price. And then probably if you look at, well under 25% in what goes to auction now, it's been very powerful. But even what we're doing from an auction perspective, we're working with Manheim and we leverage them to take care of some of the maintenance, the titling things as well, which gets these cars out of service and/or sold quicker. So maybe Manheim doesn't have as much auction business, we're giving them business in other ways that we win and they win as well. So all these things and the strategies that we're driving are really making a big difference on the individual cost of a car for us.

Operator: And we do have a question from the line of Michael Millman with Millman Research. Please go ahead.

Michael Millman
Analyst, Millman Research

Q

Thank you. Regarding July, could you break that 11% down between retail or between leisure and corporate in terms of both price and volume, also can you talk about, at least may be roughly talk about 2020, What kind of EBITDA generally we should be looking at for the company? Thank you.

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

A

I'll start with your last question. I know it's frustrating to everybody but we don't give guidance. However, what I can say is, if you look at what we've been doing every month, every quarter, we've been improving our contribution for the bottom line. We've been improving cash and we've been improving the level of EBITDA, and we based on the strategies we have in place, those trends will continue.

And our goal is to be cash positive in 2019 and do that through earnings. So as we continue to drive improvements from a growth and a quality of earnings perspective, in July during our peak period we got both rate and days and that will continue to be our goal to get quality revenue.

At the same time we're working hard on productivity and the efficiency of our expenses and though we're making investments, we will continue to drive – we've had a retail operations leader now in place for about a half a year, he is a very seasoned, experienced executive out of Walmart, and he's making contributions already. So things like centralizing maintenance will have an impact, but as we get the tools in place out of our systems in 2019, we expect right benefits there, but in between we're doing things like the Six Sigma efforts to get processes right at all major airports.

So, I would say from a guidance perspective you can kind of figure out where we're going that we will have the continued improvement in EBITDA that will grow us up to a cash positive and industry competitive margins.

On your other question, we don't talk about price and we don't break out how we get our different prices and how we get that rate and volume.

Operator: And we do have a question from the line of John Healy with Northcoast Research. Please go ahead.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Thank you. And congrats on the progress made this quarter. I wanted to just ask a question kind of in the rearview on 2017, the impact of the hurricanes last year. Is there a way to think about kind of what the hurdle is, I guess in September and October from just how the storms again impacted revenues both on price and volume, and maybe the impact on the car cost? Just how we should be thinking those as kind of the – maybe the headwind that you guys will encounter in that time period coming up?

Thomas C. Kennedy
Chief Financial Officer & Senior Executive Vice President, Hertz Global Holdings, Inc.

A

Yeah, John, so it's Tom. We estimated that the favorable impact, transitory impact on fleet because of the hurricanes were somewhere in the range around $12 million, so that's roughly the expense benefit. From a revenue standpoint is, if we talk about, you go back to our releases in 3Q, there were some impact, negative impact and some favorable impact, so it was kind of a wash as we saw over the course of the year. But yes, it's clear that there was a little bit of an uptick as we all saw in the [ph] Rental Index (37:17) Manheim in residuals plus the hurricanes and we estimated that was about $12 million impact.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Great. And then just a big picture question for you Kathy, I know, you've laid out the pillars of fleet service technology and marketing and, I feel like we spend most of the calls talking about fleet and technology. But was hoping you could spend a little bit more time on the marketing side. I know you've made some additions to the marketing team there. I was kind of curious how you see, may be the brands of Hertz, Dollar and Thrifty, maybe how you see them positioned long term and maybe how we should be expecting the company to be marketing over the next two or three years compared to how you've done it in the past and maybe just a little bit more color on what that strategy is?

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

A

Well, I guess, I would say I probably felt it's the most from day one on growing the top-line of the business. It is a math exercise and the more you grow the top-line, the more you have to invest in your business as well as expand margins. So one of the solid hires I made in the areas that we made immediate changes around and clearly with a number like 11% in July, we've made enormous progress there with that team. And that team has gone out on multiple fronts between social media, corporate win-back programs, having a very focused fleet that customers want, the service experience, all of those things are adding up to the growth we've seen.

And if you are tracking turnaround, it's rare that you have a fix and build scenario where you are actually intensively fixing the operations and the technology, but you also grow your top-line double-digits. So I think if I was most proud of what this company has done and its employees, it's the people out in the field, the effort and the energy they put into representing our brands and the service they deliver that gets more and more people coming back and attracts more people in addition to all the hard work our revenue management team has done around pricing and demand, the marketing team has done around social media channels, driving business back to .com, the branding we've done. If you go to Miami, we've wrapped the airport for Dollar, we've wrapped the airport in Chicago as well. So we're out there making sure that we get the brands out there.

From a focus perspective, we do and we are – we have a concerted effort on how we're segmenting. We're segmenting Dollar for the family, Thrifty for that value conscious group of people and then again, Hertz, that premium brand for the frequent traveler, for the higher retail end market and so all the marketing and the pricing we're doing around that has been effective, and seeing in July a number where we've improved both price and volume is exactly what we're marketing towards.

And we do with the better fleet and with a tighter fleet and with the efforts we've made around branding and segmentation, we're seeing positive results and we have very sophisticated testing and analytics to make sure that if something doesn't work we stop doing it and if something works, we do more of it. So I think all in all what's most impressive about the team here is that in very short order they have returned growth and consistently returned growth and consistently improved that level of growth. And we have very clear line of sight for the levers that are driving that and we're going to continue to add levers and manage those ones stronger that are working.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Great and then just one housekeeping question for Tom. In the quarter there was a $29 million add back on technology and transformation cost. I know you had some done in the first quarter along those lines there, but I was just trying to understand, what is in that line item? If that's like an implementation cost, or kind of what's going on there when you add that back to EBITDA?

Thomas C. Kennedy
Chief Financial Officer & Senior Executive Vice President, Hertz Global Holdings, Inc.

A

Yes, so where our investments are impacting our financials is in adjusted corporate EBITDA like we talked about last quarter, and as part of some of the investments are being recorded below the line, so they are an add back to EBITDA, so some of the [indiscernible] (41:59) development costs are related to that aspect, so you'll continue to see those elevated. So as you think about our overall investment spending, EBITDA impacting [ph] plus global line (42:10) kind of gives you a summation plus some of the non-vehicle CapEx. Those are the three areas in our financials that the investment spending shows up, so that would be primarily related, John, to the investment spending that we're making.

Operator: And we do have a question from the line of Brian Johnson with Barclays. Please go ahead

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Brian A. Johnson
Analyst, Barclays Capital, Inc.

Q

Yes, you talked a bit about making sure you have the right fleet for right demand and at least when we look at the [ph] auto fleet data which are not in (42:41) your purchases, but there is pretty sharp rotation from cars into CUVs. Could you give us some sense of how you've evolved your fleet away from sedans toward CUVs, what those percentages roughly might be? And then if the RPU on those compensates for the increased carry costs, if there are increased carry costs?

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

A

Actually we have a really sophisticated approach to the cars we buy, how we price and how we continuously reevaluate. So we look at RPU by car model on a monthly basis with actual results, and as we see less demand based on price and the margin we get on the cars, we will buy less of those cars, for example. If we see great margin on certain cars, we will buy more of them. And so as we're constantly adding cars and deleting cars into the fleet, we actually manage revenue per unit on a monthly real-time basis.

In addition to that though, we look at opportunistic sales. If we see a great environment for a certain car at a certain mileage, we'll rotate that car out. So we've developed a great dealer network and good relationships with the OEMs where we're able to add cars and delete cars pretty effectively. So when we're evaluating what cars we buy in our next buy, we're clearly taking into account what we're seeing in an RPU buy model. We're seeing – we still see demand for cars like the Malibu, and we still see great margin on those cars. So they are still – we've a fairly large corporate business and those are cars they consistently want to drive, at the same time, we have a mix of all different sized SUVs, and we manage the buying and selling of those based on demand. So we see the mix obviously moving more towards SUVs, but we continue to buy cars at somewhat of a lesser rate, but the need is still there.

Brian A. Johnson
Analyst, Barclays Capital, Inc.

Q

Okay. And is there any way to quantify the move away from opaque channels and the impact it's had on pricing it in terms of percent of bookings coming directly through the .com channel or it just impact on price?

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

A

We don't break that out publicly, but we do – obviously opaque drives prices down and the more that we attract people directly to Hertz, Dollar and Thrifty.com the better price. I'll also say though what we advise customers to do, going directly to us is going to improve your service experience and our ability to get you the car you want at the price you want.

So we encourage customers to come directly to us and get value that way as well, not when there are service issues – opaques are very valued customer as well, but at the same time there is value going directly to our websites and getting that level of service also, and the guarantees around that.

Operator: And we do have a question from the line of Hamzah Mazari with Macquarie. Please go ahead

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Hamzah Mazari
Analyst, Macquarie Capital (USA), Inc.

Q

Good morning, thank you. The first question is just on investment spend, if you could just help us think about execution risk in the second half of 2019 as the new systems roll out, that's sort of one piece. And then the second piece of investment spend is in your bridge on Page 10, it feels like reinvestment is offsetting maybe half of the tech spend fall-off. So, I guess, is the way to think about it, you are spending $300 million in 2018 a mix of $80 million sales/marketing, $120 million IT, $100 million fleet and then half of that rolls off in second half 2019 and Kathryn, I know you gave some color on the call on this but if you could just flush that out? Thank you.

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

A

Hamzah, you're asking multiple questions there, so I'm just thinking through it. I think going back to your question around, are we going to continue to reinvest and what level. What we've seen obviously is the investments we're making in the business, the operations and the marketing and the growth of the business are paying off in a big way. And they are more than offsetting the investment we're spending already.

And if you think about it, we're still working with both hands tied behind our back and that all of our core systems are being upgraded and yet our team, our people, we're finding growth in getting it done despite not having 30-year old legacy tools, despite having to spend time and energy on the requirements and training around that, we're still growing EBITDA every month, every quarter. And I think it's much to the credit of the employees here who want to win, want to grow and want to drive the next 100 years forward.

So, right now, we're getting it done without those sourcing and price and if next year for some reason which we don't see happening based on the talent we have and what we have in place to manage the rollout of these systems, we've been doing it without the systems then we'll get through it, we'll continue to get through whatever we have to get through.

I'll also say that we have really great partners in the work we're doing, in Infor, IBM and in Deloitte and we have actually the attention and support right up to their CEOs of those companies to make sure we're successful. And I am really pleased with the level of engagement these three partners work together. We've already gotten through the bulk of the sales force conversion. We've basically completed 90% of that very successfully and are getting the benefits in what you're seeing in marketing and some of the pricing and the marketing programs that we have. So I have every confidence in that we will get it done.

We will have contingency plans in place and that we have fantastic partners that at very senior levels are really rooting for us but more than rooting for us, they are putting the resources and the energy behind these efforts to make sure we're successful. So I believe we're in a very good place.

So, as far as ongoing investments, we will continue to invest in the sales and marketing when we see things like July of 11% growth, that says we're doing the right thing and making that incremental investment makes sense.

Hamzah Mazari
Analyst, Macquarie Capital (USA), Inc.

Q

That's very helpful. I appreciate it. I'll just ask a follow-up and I'll turn it over. Just on the ancillary business value-added services, I think you said two out of four products turned positive and that's the majority of the revenue base. Could you remind us how big the ancillary revenue base is? And then does this mean that investors can view that business as potentially turning positive next year?

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

A

We don't break it out. Does it have an impact? Yes, at the same time we've narrowed the gap on almost all the products now and we do see that turning positive next year as we've reconfigured those products, we've reconfigured how we sell them out in the marketplace and we're driving more training and capabilities and incentives through our employees, we do see that going positive going forward.

Hamzah Mazari
Analyst, Macquarie Capital (USA), Inc.

Q

Great. Thank you.

Operator: And we do have a question from the line of David Tamberrino with Goldman Sachs. Please go ahead.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Great. Couple of questions. Liquidity levels came down by approximately $400 million sequentially. Tom, what target cash balance are you looking to end the year at, and what levers can you pull to enhance that if the market backdrop doesn't materialize as positively as July has?

Thomas C. Kennedy
Chief Financial Officer & Senior Executive Vice President, Hertz Global Holdings, Inc.

A

We haven't provided guidance for cash for the year. We said we'd be slightly – we'd be cash flow negative, but significantly better than prior-year. We said we'd turn cash flow positive in 2019 we believe. So, yeah, we have levers we could pull if there's any downturn, obviously the second half of the year is always seasonally stronger from cash flow as you deplete after the summer peak and the first half of the year is always cash flow negative just because of the seasonality of the business, so we expect the second half to be much stronger, both U.S., internationally and globally.

As we think about levers we can pull, clearly, we have elevated investment spending and elevated fleet right now where the fleet is up 3%. Fleet is a big, big source of cash. We continue to work on improving utilization of the fleet and optimizing the deployment of the fleet, so that's clearly an opportunity. And then as we go through the investment spending, we always have the ability to toggle up or down on our investment spending depending on the cash in the business and what we're getting in return on that. So there's some fairly significant levers. As you know, fleet is the biggest lever and we're managing that I think very, very closely.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then maybe following up on that, the ride hailing fleet grew again to about 29,000 units I think heard, what was the size of the fleet last year in 2Q 2017 and how many of those 29,000 vehicles are Hertz owned versus 767 Auto's assets?

Thomas C. Kennedy
Chief Financial Officer & Senior Executive Vice President, Hertz Global Holdings, Inc.

A

Yeah, I mean, fleet last year was around 12,000 to 13,000 if I recall correctly at the end of the second quarter. So, yeah, we've been growing that sequentially and that is an important component of our business, and as we said, it's profitable longer length of rent, lower depreciation cost, with more [ph] liquidity (53:08) in the quarter than we had in the first quarter, so there was some drag [indiscernible] (53:11) because you're doing – re-titling those cars and extensive maintenance checks before they go into dedicated TNC service. And 767 is very small, I think it's in our financials in one of the footnotes you'll see, I think it's 500 some cars, so it's a very small component.

Operator: And we do have a question from the line of Doug Karson with Bank of America. Please go ahead.

Douglas Karson
Analyst, Bank of America Merrill Lynch

Q

Great, guys, thanks so much. Good quarter. My question kind of focuses on some of the recent partnerships. I think you announced a partnership with Aptiv that was focused on fleet management, and I want to just see kind of of what the game plan, initial kind of read on that is? And then if I look to the relationship with Uber, how has the kind of the profitability been, I think that program has been in place for about a year now, is that kind of hitting some of the targets that you had hoped.

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

A

So look I'm very bullish on fleet management. My background is actually way more years than I care to admit but not that many years ago I managed 1 million car plus of corporate fleet business with GE, and corporate fleet is a very nice margin, solid business, financing of that business is something our Treasurer Scott enjoys doing it you can say, enjoys the financing process. But it's a really solid business.

And I see relationships with companies like Aptiv, and we do have multiple relationships in the area of connected cars and mobility. Those relationships will grow over time as they grow their fleets and what they're doing in that space.

And we're uniquely positioned with our corporate fleet business to leverage the tools that have already been in place for large fleets along with our distribution, our maintenance and the capabilities we have, and our ability to serve direct-to-consumers and manage those cars in between that it's a great opportunity for us.

And we're seeing with the ride hailing business that the win-win we create for those drivers is a good thing for them, but it's reducing the overall cost of their business, but it's also been a positive for us. We're making competitive margins on those businesses. We're growing it wisely, we've been in it since 2016 and we've been growing those relationships successfully.

We're going to do it in a metered, intelligent way, but so far between the corporate or autonomous and mobility fleets that we have partnerships with which are growing, the numbers of them are growing and the numbers of cars in them are growing.

We have connected car pilots out with some of these partners as well as we have connected cars running in Europe on an accelerated basis with companies there. We continue to see that to be a good business for us as well as on the ride hailing business.

So again the more solid businesses that we offer based on our core competency of fleet management, the more avenues we have to grow our top line and the price metrics, the volumes, but also the price and the quality of earnings.

Douglas Karson
Analyst, Bank of America Merrill Lynch

Q

That's very helpful. Thank you for that. And I just maybe want to direct towards the balance sheet for a quick moment. It looked from the early stage of the call, you had commented that liquidity was kind of solid enough that the 2020 maturity, there's like really no rush to refinance that based on the cash you had and the kind of outlook of the business. What is the kind of the right cash balance for you to have kind of through 2019, and what would kind of trigger you want to prefund the 2020 and maybe 2021 notes given market conditions if there was a scenario for such?

Thomas C. Kennedy
Chief Financial Officer & Senior Executive Vice President, Hertz Global Holdings, Inc.

A

What we're looking at as far as the refinancing of the 2020s in October and 2021s in January, we kind of look at those like I said about $1.2 billion total. As we look and think about that, we believe our continuing operating performance is a key precursor to us tapping the market, so the market conditions are one factor but also demonstrating consistency of our improving trend and trajectory will obviously result in a better spread and better execution.

And so we don't want to go to market too quickly until we have enough of this momentum that people are convicted in and believe in that will help on the execution and spread of that transaction. So that's how we're thinking about it and balancing it, so that when I said we have time, that's how we're looking at it.

As far as the cash balances, we're always looking to maintain certain levels of cash in the business. Clearly, we have in our perspective what minimum cash is, we're significantly above where we think that is from an operating standpoint. We haven't really guided to that as far as what our minimum expectations and what our target is, but as I said, I think what is important to note is the cash flow from the business is approaching breakeven this year, but will still likely be cash flow negative and that's despite kind of we're just in the early stages in our third quarter of kind of turning the corner, and I think now accelerating into the third quarter as evidence of that, and I think as we said in 2019, we expect and we'll plan to [ph] and finally deliver (59:14) to be cash flow positive, and as the market sees those factors, I think those two factors combined will help determine kind of the timing relative to where the market is with us tapping the markets to refinance the 2020s and 2021s.

Operator: And we do have a question from the line of Trent Porter with Guggenheim Securities. Please go ahead.

Trent Porter
Analyst, Guggenheim Securities LLC
Q

Hi. Just a quick question. Kathryn, I think you had addressed my question, but I wanted to dig in a little bit more with regard to the segmenting. This is something you've talked about in the past as sort of an ability to lever sort of core pricing improvement by improving the mix, and so I wonder, T&M increasing 3% excluding value-added services, was mix improvement a big part of that or is there still – are you in early innings and there's still a lot more leverage to come or legs to this opportunity?

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

So, the great news that we're seeing is that we're seeing growth in all three brands. So we're figuring out how to drive profitable growth across all three of those brands. And we've just started and launched the brand segmentation this year. So we're really early stages, and as we get a very targeted in the different media that we used to attract that volume, how we attract the segment with the types of products and services and even the types of cars we offer. For example, our Thrifty brand, they love Subarus. So we over-subscribed Subarus to that space because it's very attractive.

There's different markets that we're stronger in for the Dollar and Thrifty brand, so we're very focused on, I gave the example, in-bound for Dollar is a very strong segment and we're very focused on Miami and we wrapped that airport with the Dollar brand. So, we're very early stage in growing those brands, but we've already had success and all three brands are delivering and delivering both on price as well as volume.

Trent Porter
Analyst, Guggenheim Securities LLC
Q

Okay. That's encouraging, thank you. And then forgive me, I might have missed this discussion, but on the value-added services I was wondering if you could talk – I think you said two categories have turned positive and I think we can assume that maybe it'll become a tailwind next year versus a headwind, but I was wondering if you could talk qualitatively just about how you are making – what you're doing to make that improvement, what's left to go or further opportunities and which categories turned positive. And then I had a third question just on the standalone letter of credit facility, am I understanding correctly that that's just sort of to enhance your flexibility with respect to the refi, but you haven't yet [ph] decided (1:02:32) whether you'd do a senior secured or an unsecured depending on market conditions and your performance?

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

A

Yeah. So, again, where we're focused on is out in the field, we move to ultimate choice, which meant you went right to your car and you pick. So where we're making progress is on how to revisit things like upsell, which we still need to get the benefits of up-selling cars, the better fleets and some of the options people have when they go into the lot to upgrade the car they have.

So simple things like I've observed at the counter, a family showing up with car seats and kids and they were renting a mid-sized car and I was saying, hey, look, for x amount more, you can have an SUV and a much better obviously vacation out of that with your family and they right away said, yep, we'll take that.

Things like I was at one of the lots and stood at the gate with one of the employees, and I actually sold the prepaid gas which is, hey, if you get in line, there is probably 15 Lyft and Uber guys right outside the airport waiting in front of you, it's market rate, it's $2.80 a gallon and for $9.99, you don't have to worry about it. The guy bought the gas.

So, as we're training our employees in understanding that we can't sell pre-sell now because they are not at the counter, but we've got people now at the gate. We used to have security guards at the gate that we hired from outside agencies, now we staff it with our full-time employees and they take that opportunity to do things like, do you want the gas presale option.

So training, incentives and the quality of the products we have are much simpler insurance product now for people to buy and that's been working, gas has been working and now we're working on our LDW as well as our upsell product. So we see that potentially being a tailwind next year for us.

R. Scott Massengill
Treasurer & Senior Vice President, Hertz Global Holdings, Inc.

A

On your letter of credit facility question, on that one...

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

A

This is Scott, our Treasurer here...

R. Scott Massengill
Treasurer & Senior Vice President, Hertz Global Holdings, Inc.

A

Scott Massengill, Treasurer. On that one, it was just for optionality at this stage, but what it did do is it increased our debt incurrence capacity and our lien capacity under our financing arrangements, but again just optionality at this stage.

Operator: And at this time, I'll turn it back over to the host for closing remarks.

Kathryn V. Marinello

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

Thank you and have a great day everybody.

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