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CAR.OQ - Q2 2021 Avis Budget Group Inc Earnings Call

EVENT DATE/TIME: AUGUST 04, 2021 / 12:30PM GMT

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PRESENTATION

Operator

Greetings, and welcome to Avis Budget Group Second Quarter 2021 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, David Calabria, Treasurer and Senior Vice President of Corporate Finance. Thank you. You may begin.

David T. Calabria - *Avis Budget Group, Inc. - Treasurer & Senior VP of Corporate Finance*

Good morning, everyone, and thank you for joining us. On the call with me are Joe Ferraro, our Chief Executive Officer; and Brian Choi, our Chief Financial Officer.

Before we begin, I would like to remind everyone that we will be discussing forward-looking information including potential future financial performance, which is subject to risks, uncertainties and assumptions that could cause actual results to differ materially from such forward-looking statements and information. Such risks and assumptions, uncertainties and other factors are identified in our earnings release and other periodic filings with the SEC as well as the Investor Relations section of our website. Accordingly, forward-looking statements should not be relied upon as a prediction of actual results and any or all of our forward-looking statements may prove to be inaccurate, and we can make no guarantees about our future performance. We undertake no obligation to update or revise our forward-looking statements.

On this call, we will discuss certain non-GAAP financial measures. Please refer to our earnings press release, which is available on our website for how we define these measures and reconciliations to the closest comparable GAAP measures.

With that, I'd like to turn the call over to Joe.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Thank you, David. Good morning, everyone, and thank you for joining us today.

Let me start this call by stating the obvious: what a difference a year makes. 12 months ago, I had the unenviable job of coming on this call and reporting that our revenues were down 67% compared to 2019, and that in the second quarter of 2020, we unfortunately posted our largest adjusted EBITDA loss ever. Today, I get to tell you that in the second quarter of 2021, we delivered the best revenue, the best adjusted EBITDA and the best margin in our company's 75-year history.

Since the pandemic began, we've been consistent with our message that Avis Budget Group would come out of this disruption, a transformed company, and our focus on cost discipline and operational efficiencies would position us to take maximum advantage of a rebound in travel.

The results we posted yesterday prove that this just was an empty rhetoric. Despite being in the early innings of a travel recovery, we are already demonstrating the operating leverage that our post-pandemic business is capable of. Today, I will go over the results of a historic quarter and why this is just the introduction to a new chapter in the Avis Budget Group story.

Let's start with the Americas segment. As you recall, last quarter, we said the demand for travel in the U.S. started to materialize in late February and in March, we started to see the convergence of pent-up demand, tight fleets and stronger pricing. This positive momentum continued throughout the second quarter with each month showing sequential improvement in rental days, pricing and revenue, with June being the strongest as it led up to the July 4 holiday and the busy summer travel season.

We saw demand patterns change from previously mostly close-in bookings to a more balanced display of both close-in and further out reservations. Demand increased at the traditional seasonal locations surrounding beach, mountains, golf and other outdoor venues. During the quarter, restrictions were lifted in the West Coast locations, such as California and Hawaii, which helped volume and fleet utilization.

Our team was ready using both reservation data, a proprietary demand fleet pricing system combined with years of on-the-ground experience to drive this opportunity. Now although we are still down roughly 15% in rental days versus 2019, our fleet utilization is actually higher than it was in the second quarter of 2019. This reflects a shortage in vehicles relative to demand that was prevalent across the entire rental car industry.

As Brian laid out on our last call, the simple laws of economics state that a supply/demand imbalance will invariably lead to change in price. We saw this reflected in our revenue per day this quarter. RPD was up 32% sequentially and 42% versus the second quarter of 2019. I'm sure RPD will be the focus of many questions given the magnitude of this change, but I'd like to shift gears and talk about something that hasn't changed, which is our focus on cost control.

Throughout the pandemic, we had the benefit of focusing 100% of our efforts on becoming the best version of ourselves operationally. We're able to rethink how we do things and implement new processes that allowed us to do more with less. During the downturn, the results of these efforts were reflected in our resiliency. We were able to withstand never before scenes in demand shocks. However, this quarter, when demand was on an upswing, the results of these efforts were reflected in our operating leverage.

In the Americas, revenue increased by $1.4 billion year-over-year. Americas adjusted EBITDA during the same period increased by approximately $870 million for an incremental margin of 62%. On a 2-year basis, if you compare our most recent results to the second quarter of 2019, Americas revenue increased by roughly $350 million, while adjusted EBITDA increased by $490 million. Our maniacal cost discipline is what gets us through the environment this tough and enables us to maximize profitability when the environment is in our favor.

It's an easy concept to understand, but very difficult to execute. The Americas team has demonstrated that they can deliver on this quarter after quarter, both during the challenging times this pandemic presented and now as demand levels increased.

With that, let's move over to our International segment. While we've reached an inflection point in the Americas, the macroeconomic environment remains largely unchanged from the last quarter internationally. On a percentage basis, rental days for the last 4 quarters have been down in the mid-40s versus the comparable quarters in 2019. However, because of the fleet and cost rationalization that the international team has executed on, adjusted EBITDA has gone from $140 million loss in quarter 2 of 2020 to an $8 million gain in the most recent quarter. That's nearly $150 million improvement in adjusted EBITDA on $200 million of revenue gains.

Perhaps a more impressive way to look at it is comparing to the second quarter of 2019. Despite revenue being over $300 million lower, the International segment was able to mitigate adjusted EBITDA decline to roughly $30 million. We're able to deliver these results without the benefit of substantial RPD gains or vehicle depreciation tailwinds versus 2019. What changed was the structural cost base of international operations, which gives me the confidence to say whenever travel restrictions are lifted in EMEA, our International segment will see a similar step change in profitability that we're seeing in the Americas.

Through shopping trends and forward bookings, we can say that the underlying travel demand in Europe is improving and there is a clear customer intent to travel whenever it is possible. Our battle-tested international team is eagerly awaiting the chance to service that demand.

Moving on to fleet. We'll focus more in the Americas segment due to the relatively stable dynamics of the International segment. Let me direct you to the sequential growth in average fleet size for the Americas. During the first quarter of 2021, we had an average fleet size of 295,000 vehicles. In the second quarter, we had an average fleet size of 378,000 vehicles. That reflects an 83,000 increase in vehicles on an absolute basis and a 28% increase on a percentage basis from quarter 1 2021 average fleet size. By comparison, the sequential period of quarter 1 2019 to quarter 2 of 2019, we only had a 58,000 increase in vehicles on an absolute basis and a 15% increase on a percentage basis.

Our fleet size increased sequentially every month with June being the highest as new fleet arrived to our locations. So how did we add more vehicles this quarter despite the ongoing semiconductor shortage? 2 main factors. One, we worked hand-in-hand with our OEM partners to make sure we receive the deliveries that were slated for the ramp-up to the summer period. This required flexibility and creative solutions from both our side and from the manufacturers. The deep relationships we have allowed us to mitigate potential cancellations and capitalize on unforeseen production opportunities. I want to thank our OEM partners for their efforts and reiterate our commitment to doing everything we can to be their partner of choice.

Separately, we continue to do this self-help required to maximize our existing fleet. Despite record breaking used car values, we sold fewer vehicles in the first quarter to help serve the spike in consumer demand. We also invested heavily in reconditioning our vehicles and with diligent in our preventive maintenance. This allowed us to increase the amount of usable fleet due to less out-of-service cars as compared to 2019 and improved our overall fleet utilization. We were able to have fleet available in those cities that had the most demand to capitalize on both rate and volume. I've always said that fleet management is at the heart of what we do. It touches every part of our organization, operations, supply chain, shared services, corporate, everyone working together. I'm proud of how our team delivered on maximizing the availability of fleet this quarter and expect us to continue this area of excellence going forward.

I'd like to wrap up this section by commenting briefly on the model 2022 year buys. In a normal year, we'd be almost complete with our annual fleet purchase by now. However, we're not in a normal year, and this is still a fluid situation. We believe that conversations will continue late into the third quarter as the manufacturers get more clarity on their production forecast.

Finally, I'd like to close with Avis' commitment to safety on our latest views around the Delta variant. We've been closely tracking the reported COVID cases on a local market basis since this pandemic began. What we're following is no different from what you've been reading, an increase in COVID cases in certain geographies. However, at this time, we are seeing no impact from the Delta variant to our current bookings. Bookings for the third quarter continued the positive momentum we saw throughout the second quarter with the summer looking strong. While this may change in the future, currently our upward demand trajectory remains stable.

The travel industry has been normalizing over the past few months, but our company has been just as vigilant around our Avis Safety Pledge and our Budget Worry-Free Promise. We will continue to offer best-in-class safety measures, providing peace of mind to our customers and our workforce.

So let me wrap this up where I began, what a difference a year makes? We've gone from losing nearly $400 million in adjusted EBITDA in the second quarter of 2020 to making over $600 million in adjusted EBITDA in the second quarter of 2021. That's a $1 billion turnaround in just 1 year. This wouldn't have been possible without the tireless effort of our entire team, and I want to take this moment to thank all our employees for delivering a record quarter.

With that, I'll turn it over to Brian to discuss our leverage and liquidity.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Thank you, Joe, and good morning, everyone. I will now discuss our leverage and liquidity. My comments today will focus on our adjusted results, which are reconciled from our GAAP numbers in both our press release and earnings call presentation.

I'd like to start off by addressing the same topic I kicked off with last call, domestic revenue per day. As I made clear last quarter, we at Avis do not set rental car prices. We discover price as determined by consumer demand and the availability of supply in the industry. Those increasing demand and tight supply dynamics we discussed on the last call, clearly continued throughout the second quarter. The result being that Americas RPD strengthened again sequentially.

RPD clearly had a significant impact in the turnaround of our profitability in the second quarter. As Joe mentioned, it was a $1 billion swing from our $382 million loss in the second quarter of 2020 to our $624 million gain in the second quarter of 2021. But another way to look at it is that our combined second quarter adjusted EBITDA over the past 2 years is only $250 million. Compare that to the average 2-year stack of second quarter adjusted EBITDA between the years of 2011 and 2019 of roughly $385 million.

We went through a near-death experience last year. We received no federal bailout, and we were able to honor our obligations to our business and financial counterparties by withstanding substantial losses. I don't know how sustainable this elevated level of RPD is, but I view what's happening now as simply a catch-up in profitability. Given the value of the asset we deliver and the mission-critical nature of the service we provide to travelers, in my opinion, our customers are receiving a great value proposition. I think the demand we're seeing even at these elevated RPD levels substantiates this view.

Let's move on to liquidity and financing. As of June 30, we had available liquidity of $1.8 billion, comprised of approximately $1.3 billion in cash and cash equivalents and approximately $530 million in availability on our revolving credit facility. Additionally, we had cash and available borrowing capacity of $3.4 billion in our ABS facilities. We took advantage of favorable debt markets, and we're proactive with refinancing and optimizing our capital structure.

In May, we issued $800 million of asset-backed notes with a maturity of 5 years at a blended interest rate of 1.73%. That is the best interest rate on any multi-tiered asset-backed note we have done in our company's history.

In June, we issued approximately $300 million of de-tranche asset-backed notes, adding on to our 2018-2, 2019-2 and 2020-1 series, bringing our advance rate on those notes to approximately 90%. Additionally, we also extended the maturity date of our AESOP variable funding notes until March of 2023, continuing to demonstrate our strong relationships with our banks to efficiently fund our summer peaks.

Finally, in July, we renewed our credit facility with a maturity date of 2026 and eliminated our relief period. As a result, our corporate debt is well laddered with no meaningful corporate debt maturities until 2024 and no need to refinance any of our ABS tranches this year. We are in compliance with all of our secured financing facilities around the world with significant headroom on our maintenance covenant tests as of the end of June.

I've been following Avis closely for well over a decade. And in my opinion, our capital structure is in the strongest position I've ever seen it. This balance sheet strength, combined with our robust earnings trajectory, leave us in the privileged position of considering how best to deploy our free cash flow. As always, when considering the optimal use of free cash flow, it's important to address and benefit all stakeholders of Avis Budget Group.

Yesterday, we announced our intention to retire the outstanding 5.25% senior notes due 2025 with cash on hand in order to address the incremental debt we took on during the pandemic. We also announced a new share buyback authorization of $1 billion that will be used opportunistically to return value to shareholders.

Finally, we will also be investing in ourselves. Our employees have been asked to do more with less during the pandemic. As we rebuild our business, we must provide our workforce the systems and tools necessary to keep driving productivity, enhancing operational efficiencies and delivering a better rental experience. We believe the use of free cash flow in these key areas will benefit our debt investors, our equity investors, our employee base and our customers.

Now during the pandemic, we stated that when revenues normalize back to 2019 levels, our structurally leaner cost base would also -- would deliver over $1 billion in adjusted EBITDA. Revenues have come back, but I wouldn't call this environment normal, and we are not building our go-forward model with this level of RPD.

As I mentioned earlier, though, this increased pricing, combined with our continued cost discipline, is allowing for a catch-up in profitability, which is why at this time, Joe is pushing our entire organization to deliver $1.5 billion in adjusted EBITDA, which would be close to 2x what we achieved in 2019.

With that, let's open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Chris Woronka with Deutsche Bank.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

Congratulations on some fantastic results. Wanted to maybe talk a little bit about fleet going forward and kind of -- look, the question is around how you're underwriting fleet acquisitions heading into next year? But also just your world view of used car market, understanding in the second quarter, you didn't have the benefit of gains, you didn't sell any cars. But as you bring more fleet in, in the back half and into next year, obviously, you have to make an assumption. So maybe just a world view of what fleet costs could directionally trend towards over the next year or 2?

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Okay. Chris, this is Joe. So this quarter was a bit unusual for us as far as our fleet planning. We had mentioned that on the previous call that it was a very fluid situation, and it turned out to be. The thing that I like most about it is that we were able to work with our OEM partners and come up with a strategy. We were getting insight probably late February of what fleet deliveries would look like. And you guys heard publicly about as they closed plants down, and unfortunately, we were all affected, but we managed.

And one of the core competencies that we have in this organization is to be able to align fleet with demand, and that didn't change in this quarter, even at the elevated levels of demand that we saw. As we go forward right now, we're still getting new model -- new cars in, model year '21s in right now. So you could see the delay in the manufacturing because we are already at this point in time, on a normal year, would be starting to talk about early model '22s. And as I said in my prepared remarks, we're still having conversations with the OEMs as they look at their production schedules, and that's going to continue on in the coming weeks and the coming months.

As far as our ability to sell cars, as you know, we sold a whole lot of them last year. And we made a choice this quarter not to do that to deal with the spike in demand that we saw early on. My opinion on the used car market, if you look at it now, new cars are -- inventories are kind of like -- used cars that are kind of getting back to where they were in '20, but it wasn't a normal year, and are still below the levels they were in '19. We are the predominant supplier of 1-year old vehicles. And seeing as the industry in '20 -- in 2020 and again in '21, did not get the full complement of vehicles that we had normally received those other years, I still think the used car market has legs. If you look at the prices in the market, although it's gone down in the last couple of weeks, it's still running quite a bit higher than it was in '20 and in '19. And I think that continues. How long that goes? I'm not totally sure. But I do think that there is some tailwinds on that.

Chris Jon Woronka - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. Very helpful. And then the follow-up is, as we think about RPD, and I agree with you that this industry is historically underpriced relative to value. But is there any way you guys come through all the data you get to maybe triangulate some -- sort out some of the unusual transactions, some of the highest price things that are beyond your wild streams and kind of say, if that goes away, we're back to here and a fleet is here and obviously, that involves predicting industry fleet levels, which I know you can't do with perfection. But just any way to sense what a new normal RPD is? If it is 79, that would be great. If it's 70 or something else? Just any thoughts on that.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. Chris, it's Brian here. Let me take the first crack at this and Joe is going to jump in. And I know this is going to sound repetitive, but I'm going to state it again. We at Avis do not set rental car prices. We discover price as determined by consumer demand and the availability of supply in the industry, right? So with that disclaimer out of the way, let's just break down those 2 components, right?

First is consumer demand and within consumer demand, let's just start with leisure demand. So domestically, like people have been cooped up for a year, savings are high, International travel is largely unavailable, so it's natural that in the Americas, we're seeing outsized consumer demand from the leisure segment. Now is that going to remain elevated in perpetuity? Of course, not, right? But could it last for some time? I think so. So we see like, I think, continued strength in the consumer segment currently. But conversely, commercial demand right now is pretty depressed. So while we will be seeing increases in that segment, the commercial, especially large commercial comes with lower rates. So that normalization of business mix is going to cause some downward pressure on RPD.

Now switching to the supply side. Just like you said, like from our perspective, we're working with our OEM partners to secure fleet. We're doing it in a very disciplined manner, but we're just 1 player, and I can't comment on what our competitors do -- will do. So it's tough to say what will happen to industry supply. And because that's an unknown, like we at Avis are going to keep doing what we've been doing for the last 18 months. We're going to minimize costs. We're going to maximize operational efficiency. We're just going to be a structurally leaner and more bulletproof business.

So going back to your question, what does that all mean for the sustainability of RPD? It's just tough to say right now, Chris, but we're not going to be building our business models assuming this level of RPD sustains.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. I think Brian -- this is Joe. I think Brian hit it on the head. There -- if you look at this quarter, it was an explosion of leisure demand and it happened early on. It happened in April and in May. And then in June, it was kind of more like the summer, which, in my opinion, started earlier because people were out of school and the weather was more certain. But if you look at it, we'd say there's a business mix opportunity here of a lot more leisure demand.

And I think when you look at rate, it's -- we have a demand fleet pricing system that allows us to look at contribution of vehicles and the best position to place those vehicles to drive at that opportunity. And this is like a third or fourth year in, and we've gotten really good at it. And so we were well aware of where the price points were in certain geographies and how to position our fleet in that area to maximize the benefit. And then you have to add the fact that we haven't talked about ancillary but -- since there's been predominantly a leisure-driven quarter here, there's a lot of ancillary opportunity in that and when you unpack the RPD, that's probably a large component of it as well.

Operator

Our next question comes from the line of John Healy with Northcoast Research.

John Michael Healy - *Northcoast Research Partners, LLC - MD & Equity Research Analyst*

Congrats to everyone at Avis, truly a remarkable turnaround in 12 months. Wanted to ask a little bit about the cost side of things. Brian, I was hoping maybe we could get a little bit deeper on where are you really seeing the cost kind of revisited in the business? Maybe some examples of where this reduction has actually taken place? Clearly, we can see it in the P&L. But just operationally, what's different? And I think going forward, one of the questions we've been getting frequently is just a view of OpEx, the percentage that's kind of fixed, the percentage that's kind of variable. And as transaction base come back, what sort of relationship should OpEx have with transaction base in terms of growth?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Sure. So John, that's exactly how we look at the business right now in terms of what is fixed and what is variable. But for competitive reasons, we're not going to give guidance on what that will be going forward. As we look at like the cost base of our business, the biggest buckets are people and vehicle, right? And what we're seeing right now in terms of labor shortage is prevalent across our business. So there is some savings on the people side, but there's a flip side to that. I don't think that we're anywhere near running at full operating efficiency there. Yes, we've been running more productively. But given the fact that we can't hire the optimal mix, like our -- like part-time versus full-time mix is off, we've been relying more on third parties for shuttling and things like that. So I think that there's still room to benefit there.

On the vehicle side of things, we've also been investing a lot in resources, having a lot more visibility into where we spend our dollars there. And given the fact that like maintaining our vehicles is probably our single biggest cost outside of people. That's an area that we've been focusing a lot on, and I think there's still a lot of potential operating leverage there.

John Michael Healy - *Northcoast Research Partners, LLC - MD & Equity Research Analyst*

Great. And just 1 big picture question for you guys. Obviously, there's been a fair amount of news recently in Europe regarding EW and Europcar. I would just love to get your reaction to how that -- how you feel about that combination kind of impacting the competitive structure internationally? And do you view it as a game changer in terms of kind of how that business kind of reemerges?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

No, it's -- I think it's early to say. And I wasn't involved with the business back when the OEMs all owned the rental car companies. I've had a chance to go through kind of what Europcar has said. And I think what they're saying makes a lot of sense given the platform that Europcar offers them. But it's still an open-ended question in terms of how that plays out. We're controlling the things within our control. And as you see in the numbers, like our international team has delivered spectacular results in terms of the cost takeout that they've done. So I think that whatever does happen, we'll be in a position to compete effectively.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. Listen, I'll jump in here. This is Joe. I confirm with Brian. I think we spend our time worrying about what we do. And over the years, we've looked at our European business, and we looked at ways to operationalize and improve our overall margins there. And I think we're well on that path. I was incredibly pleased with the overall effort that the team has displayed this last quarter. When you think about it, the Americas came out, business came back and it was about, are we ready and can we handle it? And can we keep the cost down and keep the fleet aligned? In Europe, it's still the grind of 40% down in business. Yet, there are some countries that were able to overachieve as far as EBITDA compared to 2019.

So I think like I say, when we talk about competitors, I think we get our act together and we do the things that we do really well, manage fleet, manage costs, drive the sequential improvement in revenue that we see every day. I think that takes care of itself, and that's how we'll position our business going forward.

Operator

Our next question comes from the line of Jason Stuhldreher with Barclays.

Jason Flynn Stuhldreher - *Barclays Bank PLC, Research Division - Research Analyst*

Just first off, I was hoping we could get a little more specific on what we're seeing into Q3. You mentioned that July, and I guess the cadence into Q3 is still pretty strong right now. We're seeing a continuation of volume recovery in the Americas, and I think you said Europe is improving a little bit. Maybe just on pricing, too, what are you guys seeing in July, both internationally and in the U.S.? I think it would be helpful.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Okay. This is Joe. As I mentioned earlier, June was started what I thought the summer season a bit earlier than it normally does, as I said, largely because of certainty of weather and maybe kids out of school. But the end of June was really when we started to see our July 4 holiday bookings, right? It was -- July 4 was kind of -- it was like a Monday, I think or so this year, or Sunday holiday, but Monday off, and the week before it was actually pretty prevalent. And July 4 is a precursor too, in my opinion, to the summer season, and it was strong. And what I would say about what we're seeing as far as demand and price is that it's a continuation of what we saw we exited June, which was the best rental days, the best price that we had in the quarter. And we haven't seen any signs of that slowing down.

Jason Flynn Stuhldreher - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Helpful. And then just following up on the target, Brian, that you mentioned around when you return to 2019 levels, I think I heard correctly, it's -- you're now thinking it's going to -- EBITDA could be more in the $1.5 billion range when volumes return to 2019 levels. Can you just sort of clarify what sort of -- are there any changes to RPD or fleet cost assumptions in that number? Or is it really just the business potentially operating like the mid- to high-teens margins?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Sorry, I should have been a little more clear on that one, Jason. The target that Joe is pushing us for and that $1.5 billion, that's for this year. So we think that given the pricing dynamics that we're seeing, combined with our cost discipline for this year, we're going to be at this $1.5 billion level in 2021. We're not getting kind of updated guidance on like outer years just given that there's still a lot of macro unknowns and also internal things that we're working through in terms of operational efficiencies. So that $1.5 billion has to do with 2021.

Jason Flynn Stuhldreher - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. And then we shouldn't think about any changes right now to kind of your longer-term $1 billion target?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. I think that $1 billion target was predicated on kind of our first pass at what the business could look like at 2019 volume and RPD. We're still working through that. What I will say is that as we've gotten more granular in terms of the cost takeouts, we're just finding more opportunities. So I wouldn't anchor to that at this point. And also some of the macro uncertainties on kind of what happens with industry supply, what happens with pricing, like where do we shake out. That's still a little bit unknown. So we're not commenting on that going forward. But hopefully, that color is helpful.

Operator

Our next question comes from the line of Billy Kovanis with Morgan Stanley.

Billy Kovanis - *Morgan Stanley, Research Division - Research Associate*

Simple question, and it's, where to from here? So not next month, not next quarter, but more over the medium term. You flagged the $1.5 billion adjusted EBITDA in '21, which, I mean, definitely is possible, almost double that of 2019. But if I think about the tailwinds, it looks like volumes have some room to go, pricing will become an incremental headwind just of this record high in the U.S. and fleet costs were raised, but International looks like it can improve overall. So I just want to make sure, does this match up with the way you guys are thinking about it internally? And just your views around how the business can be a bit less cyclical, medium to longer term?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Sure. Well, Billy, I don't blame you for asking, but like we're not going to get into kind of next year guidance or midterm guidance at this time. There's just still a lot of unknowns, a few of them which you pointed out. We don't know exactly what the COVID impact will be. Its effect on travel demand. We still have this ongoing chip shortage that Joe mentioned on the fleet side, that clouds vehicle availability and the outlook on the used car market. I think what I will say is that our game plan for next year and go forward is not going to change from what we laid out for this year. So we're going to take a cost-first approach to our business. That way, we'll be resilient in a weak demand environment, and we'll have very high drop-through in a strong demand environment.

Operator

Our next question comes from the line of Michael Millman with Millman Research Associates.

Michael Millman - *Millman Research Associates - Research Analyst*

So I guess from a standpoint, obviously, of us, analysts, to some extent, next year might be in terms of numbers of a (expletive) shoot. But is it fair to start with a $1.5 billion base and kind of put some numbers around that? Or would you suggest some other approach for us to do that? And my second question is on Hertz. Are you thinking that Hertz has got to make an effort now to get back a lot of it's lost business, I guess, much to you, and they're going to be stabilized? Maybe that's a little strong pricing.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. Let me start with your first question, and then Joe will answer the second. But Michael, I agree 100% with you. It's not an easy year to forecast for the analyst community for 2022. If it helps at all, it's not super easy for the CFOs of the world either. So I feel your pain. We're working through that ourselves. But I think what you laid out in terms of starting with the $1.5 billion and going from there, I mean that seems like it makes sense. Joe, you want to answer the...

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. I'll give you a little color on the competitors. I've been in this business for a long time now, and I've learned not to take any competitor for granted, and I won't do that going forward. It's very early to tell about what happens with that company as they reorganize and come out of bankruptcy. I prefer always, and I tout this to our team is to worry about ourselves. I think we run a really rational business here. We've never really inflated our fleet to go after marginal cost business. We always run our fleet to be slightly below demand, which is something we've been doing for a long time now. So we believe we'll have a rational approach to our demand side of the business.

As Brian talked about, I think we've really got good at looking at how we manage costs. We all talk the same language. So you could talk to an operator in Italy or an operator in Orlando airport, and they will all talk to you about what they're doing to manage the cost base of their business. And those guys are on the ground, and that's really where it matters. So I think you'll see a maniacal approach to cost removal. You don't go through 2020, the way we did, and then say everything is back to normal. We won't allow that. I won't allow that. We have a great way of looking at our overall performance. So fleet in line, cost in line and then it comes to how we manage supply and demand.

And I think we have a proprietary demand fleet pricing system. As I said before, that gives us tremendous insight on how to price our cars down to the location level for various different length of rentals and different contribution rates. So I think that gave us a big -- provided a huge opportunity here this past quarter because not all places or not all vehicles are the same. So I think we concentrate on that, and that will take care of ourselves.

Operator

Our next question comes from the line of Hamzah Mazari with Jefferies.

Mario J. Cortellacci - *Jefferies LLC, Research Division - Equity Analyst*

This is Mario Cortellacci filling in for Hamzah. I guess my first question, could you just comment on what you're seeing on airport? You touched a little on business, obviously, that's not coming back. But maybe you can just speak specifically about what kind of demand you are seeing there and then what you're seeing on the pricing side? And then any comment on just what your conversations are like with your customer base on expectations for people getting back on the road.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Okay. So let me start off with -- this is Joe. Let me start off with what we're seeing on the airport We -- you guys -- we track the TSA volume and it's been -- there's about 2 million passengers a day or thereabouts. And that's been kind of steady. It's down around, I think, 19% compared to 2019. But I have to tell you, the airplanes are pretty full. The airlines scheduled increased destinations, so whether it be Mountain or beach resorts, and we've seen increases in that environment.

Our on-airport business has been more robust than it has been in the past. And you heard me last year maybe talking about how our local market business was providing the spark that we needed during the pandemic. Seems like air travel has come back. I heard one of the airline CEOs the other day saying that this past weekend, airplane capacity was at 90%. We're seeing that at our locations. And the key is, are we ready for it? And we think we were in the places that matter the most. So our on-airport business has been pretty solid. And that continues. I'll give you anecdotally. I haven't been on the road because of the pandemic, and I've been around a fair amount of late, and the airports are very busy and the airlines are crowded, and our business is busy as well.

The second part of your question, Mario, was on -- please, can you go back to that?

Mario J. Cortellacci - *Jefferies LLC, Research Division - Equity Analyst*

Yes, yes, yes. It was just, I guess, related to on-airport, I guess, traditionally, the business travel has been related to more of the on-airport. We're just looking for some -- an update there? Obviously, it doesn't come back. But what you're hearing from customers on timing? And then any update on kind of the price there?

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Sure. We have seen in this past quarter a sequential improvement in our commercial demand, if that's what you're referring to. It's not back to where it was in 2019, of course. And I think when you look at the TSA stats, a good portion of the decline that you see versus '19 is commercial and probably inbound, right? So those are the 2 areas. So it hasn't come back yet.

I mean when we talk to our commercial accounts, there's mix. They got to get back to the office first and they got to be able to get on the road and see people. I was talking to a trade organization, and I think that's going to occur maybe in the latter part of this year, maybe towards the end of the third quarter, beginning of the fourth. What we have seen is that there are certain groups that are traveling commercially. Those are logistic companies, defense contracting, entertainment, health care. We've seen some of that. And so where we participate with those companies, we've seen -- and maybe a little bit of technology, we've seen some growth. But I think that has to be more predicated on when they get back to the offices wholeheartedly and when they're allowed to travel.

Mario J. Cortellacci - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And then if I could just sneak one in on fleet utilization expectations. I guess what are you guys looking at in the second half of '21, I think, the Americas was like 72% in Q2. Should we expect a further increase in the back half? Or are these levels more or less stable?

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. I think when you look at our utilization, say, 72%, you're really tight. We look at ours on a 24-hour day, if you convert that to way others look, it's in the 90s. Our fleet utilization has been strong. And the reason why it's been strong are for 2 reasons. One is the cars are in the right place. And two, we had tremendous out-of-service control. We invested in our fleet going back to February, seeing this coming, and that is giving us more usable fleet to provide utilization benefits. So as I said, the summer is the summer, and utilization will be very solid there. And then we'll -- the rest of the year, it's about what's full travel like. We're a seasonal business. So you come out of the summer, you're going to have a situation where you go into the September, October for all travel and then it's about holidays. So we think as long as we continue doing what we're doing, use the technology that we have, keeping the fleet fresh, we'll be able to maintain some level of improved utilization.

Operator

Our next question comes from the line of Ryan Brinkman with JPMorgan.

Rajat Gupta - *JPMorgan Chase & Co, Research Division - Research Analyst*

Congrats on the results. This is Rajat Gupta on for Ryan Brinkman. Just had a question on the $1.5 billion, presumably that would imply somewhere close to $800 million to maybe $900 million free cash flow. So with that kind of run rate of free cash flow going forward, could you give us a sense of how the capital allocation priorities are going to look like or change going forward versus M&A or buyback versus CapEx, et cetera? Like any color on that would be really helpful.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes, sure. Roger, let me actually clarify one thing. You said that, that would be a run rate going forward. Like I think it's tough to say that that's a run rate at this point, right? The $1.5 billion, and we've talked about this is a catch-up in profitability, right? So we think that, that's what can happen this year. But like I said, it would be irresponsible of us to assume this level of RPD increases going forward. So what that run rate is going to be, like we're still working through that, but I think like the $1.5 billion as I could go forward and the drop-through of $1 billion would be like premature at this point to say that that's what's sustainable. So let me start with that.

But you're right, this year, there will be a substantial amount of free cash flow generating. You can see what's happened with free cash flow generation in the second quarter. There's just not a lot of M&A to be had out there at this point. So as things come up, we're going to be looking at that. There are certain tuck-in acquisitions that we do, and those are highly accretive. So we'll continue to keep our eye out for that.

But then after that, I think kind of what we laid out in the press release before or last night, I should say, is we're going to take care of our debt investors. We took on some incremental leverage during the pandemic to get through. We're going to be addressing that opportunistically. We're going to be investing in ourselves, like I said. There's a lot of capital expenditures that we have that maybe we didn't get to in 2020, and additional things that we're going to be investing in to make sure that our cost base stays at this -- at the structurally lower level, so there's that. And then the buyback as well, like we've always been consistent that in terms of returning value to shareholders that way. And at this point, like we still view that that's a very -- it's a great place to kind of deploy our capital as well. So we're going to take a holistic approach to how we deploy our free cash flow. But yes, those are the main areas.

Rajat Gupta - *JPMorgan Chase & Co, Research Division - Research Analyst*

Got it. Got it. That's helpful color. And just on the pricing stuff, just a drop-through of that pricing through the EBITDA. I mean, historically, like the rule of thumb, employed is like more like 90% drop-through of that incremental pricing revenue. Does that like in anyway change going forward, just in terms of like how you're incentivizing the staff, with that extra pricing and just with the changes you have made to like the cost structure in the business? Is that still like a good rule of thumb to use just for a forward models? That will be all.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Sure. Let me take that part, and then I'll hand it over to Joe for the incentives. But I think the 90% is actually high, right? It depends on what channel it goes through, right? Both for -- on-airport, like the rough -- I think you get to 90% because you know that the airport fees are roughly 10%. But like it depends on where we acquired that customer. We have partnerships, commissions from that, credit card fees. So like the 90% is high. I would imagine if you take a look at like the incremental margin in the Americas this quarter and given that it was like driven sequentially like a lot by price, that might be a good place to start. But yes, 90% seems high for that just given that there's leakage in other areas. And Joe, on the...

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes, just to add, we -- price -- when you unpack price, there's a lot of variables that have to do with that. And whether it's airport or off-airport, length of rental, ancillary revenue, which had very accretive, which has high drop-throughs, type of vehicle rented, et cetera, and those are more or less aligned with the business mix, and we've seen a lot of that this quarter. As far as incentives and how we do, most of our incentive base compensation for the team is about what they sell. And we have -- and our employee base is very responsive to that.

Operator

Our next question comes from the line of Aileen Smith with Bank of America.

Aileen Elizabeth Smith - *BofA Securities, Research Division - Analyst*

Following up on Rajat's cash flow question, but maybe thinking about it in a different way. If we assume that the production environment is going to remain constrained through year-end, dealer inventory is probably not going to be restocked until next year, then I think a more significant level of fleet deliveries for you guys is also going to be a 2022 event. But that could set up for a pretty significant investment requirement for you guys of not only refreshing your fleet, but also increasing the size substantially, at the same time that you may be divesting older vehicles with more mileage next year just based on the way you had to use them this year. So how do you think about that possible imbalance between cash outflow versus inflow on an operating basis with vehicle programs into next year?

And just as a clarification for folks, is there any corporate cash that you thought -- that you think you might need to allocate towards fleet into next year that you may hold on to this year? Or is your equity in the ABS structures and advanced rates sufficient to really do everything you think you need to do?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Sure. Let me take that one. I think you're thinking about it exactly the right way, Aileen, but we obsess over this as well. And given the amount of equity that we put back into our ABS structures in the first quarter and in the fourth quarter of last year, combined with all the work that we've been doing around kind of the de-tranche and to really optimize our advance rate, I think that we're pretty good in terms of the amount of equity that we need in that structure. So at least for the foreseeable future, I think we're in a good position.

Aileen Elizabeth Smith - *BofA Securities, Research Division - Analyst*

Okay. So when we think about the significant excess cash that is going to be generated this year, if you guys are going to do north of $1.5 billion in EBITDA or somewhere around there, is there -- beyond M&A, is there any thought process internally on how to capitalize on the near-term strength and allocate excess cash to accretive business initiatives? I mean is the only output share repurchases? Or are there some other areas in which you guys could get more aggressive, whether it's you further rolling out touchless store rentals or other things?

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. No, we're absolutely -- actually, Joe, why don't you take that one?

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. Listen, I think that's a great concept, and that's what we're looking at. There were many things that we were in the process of completing in 2020 that we didn't get really up our hands around in a big way. And we're going to do that this year. We rolled out last year the ability to bypass the counter, pick a car that you want on a wrap, exchange it if you'd like or even -- and leave the gate without having to talk to an individual, just use your phone to -- and a QR code that exits the gate. Admittedly, we rolled that out, and we couldn't support it because we were uncertain about what was going to come. There are many of those solutions that we're working on right now.

And I think if you think about how we would deploy some of that cash in the environment, the 2 things that come to mind for me is how do we create a more efficient business, give the leaders the tools necessary to make on-the-ground decisions and differentiate themselves from what we've done in the past. And the second would be, how do we enhance the experience? And those are things that we're working on and we'll have more to come and talk about that on future calls. But I think technology and our ability to understand how we can get the customer through our process quicker and more efficiently is really where you're going to see us operationalize some of the capital.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. And actually, just to add to that. So it's actually in 2 segments, right, that Joe mentioned. So definitely investing in how do we just make this a better customer experience and will lead some of the pressure that we had kind of on our employee base, delivering vehicles to customers. So that's one big area. And the second big area is internally, how do we become a more data-driven organization? How do we hold ourselves more accountable? How do we make sure that we're operating as efficiently and at the lowest cost structure possible? That is going to require investment. So a significant amount of capital is going to go towards that as well.

Aileen Elizabeth Smith - *BofA Securities, Research Division - Analyst*

Okay. Great. That's helpful commentary. And 1 follow-up, if I may. Touching base on some of the fleeting activity in the quarter and to follow up on one of Joe's prepared remarks. Last quarter, I think I asked a question on some reports that the rental car companies were stepping up purchases in the used vehicle market in a pretty significant way. When we look at the -- I think at the 80,000 vehicle increase in fleet size in the Americas in the quarter, is it possible for you guys to bracket percentage-wise where those vehicles were coming from, meaning new vehicles from automaker programs versus used vehicles from other channels? And perhaps where you think that normalizes to over the course of the year?

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. Okay. I'll take that. I would say the large majority of those are new vehicles. And that doesn't mean that we don't support our specific cities or locations with used vehicles. We are opportunistic when it comes to that. I think the underlying decisions that we make about fleet involve 3 things, and I continue to talk to the team about it. One is how you buy the car. So we make sure we run our car buy through our modeling that would suggest, is this the right car to buy, number one, to get the rental rates that we need? But two, to hold the residual value so when you sell them?

The second is how you go ahead and use the car? What's your mileage accretion like? Where are you going to use it? How long are you going to hold the car? And third is how you delete the vehicle? And we spent a lot of time in the past number of years talking about our car exiting strategy, concentrating more on direct-to-consumer. As long as the vehicles that we purchase fit into that model, we're open to anything, right? So -- but I have to say in this quarter, it was -- a larger majority was new, and that doesn't mean we haven't bought used because we have.

Brian J. Choi - *Avis Budget Group, Inc. - Executive VP & CFO*

Yes. And just -- I mean like Joe said, we're not opposed to the used car, but as you know, how strong the used car market has been, we run every buy that we have on an -- what is the return on invested capital for us. And sometimes, it doesn't make sense and we need to stay rational in terms of our fleet purchases.

Operator

That concludes our question-and-answer session. I'd like to hand it back to Mr. Ferraro for closing remarks.

Joseph A. Ferraro - *Avis Budget Group, Inc. - CEO & President*

Yes. Thank you. So to recap, the momentum we saw at the end of the first quarter continued into the second quarter. The Americas delivered record-breaking adjusted EBITDA and International was cost disciplined, resulting in second quarter results being at historic levels for Avis Budget Group. I personally want to thank all our employees for all their hard work they put in over this past year. With their dedication and believing the Avis Budget Group way, we're able to achieve these results as a team. And as always, thank you for your interest in our company.

Operator

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.
