

AVIS BUDGET GROUP, INC.
Form 10-K
March 01, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

COMMISSION FILE NO. 1-10308

AVIS BUDGET GROUP, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

6 SYLVAN WAY

PARSIPPANY, NJ

(Address of principal executive offices)

06-0918165

(I.R.S. Employer Identification Number)

07054

(Zip Code)

973-496-4700

(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

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TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, Par Value \$.01	New York Stock Exchange
Preferred Stock Repurchase Rights	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant on June 30, 2006 was \$16,150,271,336, or \$2,149,205,537, as adjusted for the one-for-ten reverse stock split and Cendant Separation described herein. All executive officers and directors of the registrant have been deemed, solely for the purpose of the foregoing calculation, to be affiliates of the registrant.

The number of shares outstanding of the Registrant's common stock was 101,272,628 as of January 31, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be mailed to stockholders in connection with our annual stockholders meeting to be held on May 21, 2007 (the Annual Proxy Statement) are incorporated by reference into Part III hereof.

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FORWARD-LOOKING STATEMENTS

The forward-looking statements contained herein are subject to known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are based on various facts and were derived utilizing numerous important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements. Forward-looking statements include the information concerning our future financial performance, business strategy, projected plans and objectives. Statements preceded by, followed by or that otherwise include the words believes , expects , anticipates , intends , projects , estimates , plans , may increase , may fluctuate and similar expressions or future or conditional verbs such as will , should , would , may are generally forward-looking in nature and not historical facts. You should understand that the following important factors and assumptions could affect our future results and could cause actual results to differ materially from those expressed in such forward-looking statements:

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

an increase in the cost of new vehicles;

a decrease in our ability to acquire or dispose of cars generally through repurchase or guaranteed depreciation programs and/or dispose of vehicles through sales of vehicles in the used car market;

a decline in the results of operations or financial condition of the manufacturers of our cars;

a downturn in airline passenger traffic in the United States or in the other international locations in which we operate;

an occurrence or threat of terrorism, pandemic disease, natural disasters or military conflict in the markets in which we operate;

our dependence on third-party distribution channels;

a disruption or decline in rental activity, particularly during our peak season or in key market segments;

a disruption in our ability to obtain financing for our operations, including the funding of our vehicle fleet via the asset-backed securities and lending market;

a significant increase in interest rates or in borrowing costs;

our failure to increase or decrease appropriately the size of our fleet due to the seasonal nature of our business;

our ability to accurately estimate our future results;

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our ability to implement our strategy for growth;

a major disruption in our communication or centralized information networks;

our failure or inability to comply with regulations or any changes in regulations;

our failure or inability to make the changes necessary to operate effectively now that we operate independently from the former real estate, hospitality and travel distribution businesses following the separation of those businesses from us during third quarter 2006, when we were known as Cendant Corporation;

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other business, economic, competitive, governmental, regulatory, political or technological factors affecting our operations, pricing or services;

risks inherent in the restructuring of the operations of Budget Truck Rental;

risks inherent in the separation and related transactions, including risks related to our new borrowings, and costs of the separation; and

the terms of agreements among the separated companies, including the allocations of assets and liabilities, including contingent liabilities and guarantees, commercial arrangements and the performance of each of the separated companies' obligations under these agreements.

Other factors and assumptions not identified above, including those described under "Risk Factors" set forth in Item 1A herein, were also involved in the derivation of these forward-looking statements, and the failure of such other assumptions to be realized, as well as other factors, may also cause actual results to differ materially from those projected. Most of these factors are difficult to predict accurately and are generally beyond our control.

You should consider the areas of risk described above, as well as those described under "Risk Factors" set forth in Item 1A herein, in connection with any forward-looking statements that may be made by us and our businesses generally. Except for our ongoing obligations to disclose material information under the federal securities laws, we undertake no obligation to release any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events unless required by law. For any forward-looking statements contained in any document, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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PART I

ITEM 1. BUSINESS

Except as expressly indicated or unless the context otherwise requires, the Company, Avis Budget, we, our or us means Avis Budget Group, Inc., a Delaware corporation, and its subsidiaries and Avis Budget Car Rental or ABCR means Avis Budget Car Rental, LLC, a Delaware limited liability company and its subsidiaries, the companies that comprise our vehicle rental operations. Avis and Budget refer to our Avis and Budget operations, respectively, and exclude the operations of Avis Europe and its affiliates, as further discussed below.

We operate two of the most recognized brands in the global vehicle rental industry through Avis and Budget. Avis is a leading rental car supplier to the premium commercial and leisure segments of the travel industry and Budget is a leading rental car supplier to the price-conscious segments of the industry. We believe we are the largest general-use vehicle rental operator in each of North America, Australia, New Zealand and certain other regions we serve, based on total revenue. We maintain the leading share of airport car rental revenue and we believe we operate the second largest consumer truck rental business in the United States based on available information.

Our car rental operations generate significant benefits from operating two distinctive brands that target different industry segments but share the same fleet, maintenance facilities, systems, technology and administrative infrastructure. We believe that Avis and Budget both enjoy complementary demand patterns with mid-week commercial demand balanced by weekend leisure demand. For 2006, our vehicle rental operations generated revenues of \$5,628 million. The Avis, Budget and Budget Truck brands accounted for approximately 61%, 31% and 8% of our vehicle rental revenue, respectively, in 2006.

Our operations have an extended global reach that includes approximately 6,700 car and truck rental locations in the United States, Canada, Australia, New Zealand, Latin America, the Caribbean and parts of the Pacific region. On average, our rental fleet totaled more than 410,000 vehicles, and we completed more than 28 million vehicle rental transactions worldwide in 2006. Domestically, we derived approximately 81% of our nearly \$4.0 billion in car rental revenue from on-airport locations in 2006 and approximately 19% of our domestic car rental revenue from off-airport locations, which we refer to as the local rental segment. In 2006, we significantly expanded our presence in the local segment and plan to continue this expansion in 2007. We rent our fleet of approximately 30,500 Budget trucks through a network of approximately 2,400 dealer operated, 210 company operated and 100 franchisee operated locations throughout the continental United States. We also license the use of the Avis and Budget trademarks to multiple licensees in areas in which we do not operate. The Avis and/or Budget vehicle rental systems in Europe, Africa, the Middle East and parts of Asia are operated at approximately 3,700 locations by subsidiaries and sub-licensees of an independent third party primarily under virtually royalty-free trademark license agreements.

Following the completion of the Cendant Separation, discussed in detail below, we categorize our operations in three operating segments: domestic car rental, consisting of our Avis and Budget U.S. car rental operations; international car rental, consisting of our international Avis and Budget car rental operations; and truck rental, consisting of our Budget truck rental operations. In 2006:

our domestic car rental business generated approximately 89 million rental days and time and mileage revenue per day of \$40.01 with an average rental fleet of approximately 329,350 vehicles;

our international car rental business generated approximately 14 million rental days and time and mileage revenue per day of \$39.61 with an average rental fleet of approximately 53,310 vehicles; and

our truck rental business generated approximately 4.6 million rental days and time and mileage revenue per day of \$86.28 with an average rental fleet of approximately 30,500 trucks.

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For 2007, our objective is to enhance growth, profitability and our position as a leader in the vehicle rental industry. We expect to achieve our goals by focusing our efforts on the following core strategic initiatives:

Optimizing Our Two-Brand Strategy. We plan to continue to position our two distinct and well-recognized brands to capture different segments of customer demand. With Avis as a premium brand preferred by corporate and upscale leisure travelers and Budget as a value brand preferred by cost-conscious travelers, we believe we are able to target a broad range of demand, particularly since the two brands share the same operational and administrative infrastructure while providing differentiated though consistently high levels of customer service. We aim to provide products, service and pricing, and to maintain marketing affiliations and corporate account contracts, which complement each brand's positioning. In addition, we use various marketing channels as appropriate to each of our brands and seek to continue to grow the volume of reservations that we generate through our avis.com and budget.com websites, which are among our least-expensive sources of advance bookings.

Expanding Our Revenue Sources. We plan to expand the revenues we generate from sources beyond on-airport time and mileage rental fees. We seek to grow off-airport revenue for Avis and Budget by opening new locations and continuing our effort to identify and attract local demand. In particular, we plan to increase our revenues in the insurance replacement sector, in which we have historically had a more limited presence, and we have formed a dedicated local sales team to expand our insurance replacement, local truck rental and off-airport general-use rental volumes. Separately, we look to expand our revenue sources by offering additional products and services to existing on- and off-airport customers, including additional insurance coverages and insurance-related and ancillary products and services, such as our recently launched *Where2* GPS navigation product.

Capturing Incremental Profit Opportunities. We plan to continue our focus on yield management and pricing optimization, rigorous cost controls and fleet diversification. We are developing technology that will allow us to strengthen our yield management and we have put in place technology to tailor our product/price offerings to specific customer segments. Specifically, we plan to continue to expand our technology that allows Avis and Budget to target customers with rates and prices based on past shopping and rental behavior. With respect to fleet diversification, in an effort to mitigate expected increases in fleet costs, we are seeking to adjust our relationships with vehicle manufacturers by moving to a more balanced multi-supplier model, increasing the risk-vehicle portion of our fleet, lengthening the average hold period, and reducing the average vehicle size and number of options. In addition, we believe the expansion of our revenue sources (discussed above) will permit us to generate incremental profits from our customer base, while at the same time enhancing their vehicle rental experience.

In 2006, we made considerable progress vis-à-vis our strategic objectives. We retained approximately 98% of our commercial contracts at Avis and Budget and, we believe, generated more U.S. rental car reservations through our own websites than any other company. Budget entered into marketing alliances with USAA and AARP, which are long-time Avis marketing partners, and grew its award-winning small business program. We opened approximately 200 new off-airport locations in 2006, and off-airport revenues represented 19% of our domestic car rental revenues. We are now an approved or preferred provider for customers of a majority of the largest auto insurance companies in the United States. In 2006, we began offering *Where2* GPS navigation system units. In the area of cost management, we have reduced our reliance on individual suppliers, such that our largest fleet supplier in 2007 is expected to represent only 38% of our vehicle purchases, versus 53% in 2005. We are utilizing sophisticated yield-management technology to optimize our pricing, and we continue to analyze and streamline our operations to gain efficiencies. And, most importantly, our more than 30,000 employees continue to provide reliable, high-quality vehicle rental services that foster customer satisfaction and customer loyalty.

* * *

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Company Information

Our principal executive office is located at 6 Sylvan Way, Parsippany, New Jersey (telephone number: (973) 496-4700). We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, and in accordance therewith, we file reports, proxy and information statements and other information with the Commission and certain of our officers and directors file statements of changes in beneficial ownership on Form 4 with the Commission. Such reports (including our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and any amendments to such reports), proxy statements and other information and such Form 4s can be accessed on our website at www.avisbudget.com as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Commission. A copy of our Codes of Conduct and Ethics, as defined under Item 406 of Regulation S-K, including any amendments thereto or waivers thereof, Corporate Governance Guidelines, Director Independence Criteria and Board Committee Charters can also be accessed on our website. We will provide, free of charge, a copy of our Codes of Conduct and Ethics, Corporate Governance Guidelines and Board Committee Charters upon request by phone or in writing at the above phone number or address, attention: Investor Relations. In accordance with New York Stock Exchange (NYSE) Rules, on September 22, 2006, we filed the annual certification by our Chief Executive Officer certifying that he was unaware of any violation by us of the NYSE's corporate governance listing standards at the time of the certification.

Company History Cendant Separation

We were created through a merger with HFS Incorporated in December 1997 with the resultant corporation being renamed Cendant Corporation. On August 23, 2006, Cendant completed the separation (the Cendant Separation) into four separate companies, one for each of its former Real Estate Services businesses (Realogy Corporation), its former Hospitality Services (including Timeshare Resorts) businesses (Wyndham Worldwide Corporation), its former Travel Distribution Services businesses (Travelport) and its Vehicle Rental businesses (Cendant, now Avis Budget Group). The separation was effected through the pro rata distributions of all of the shares of common stock of Realogy Corporation and Wyndham Worldwide Corporation and the sale of Travelport to an affiliate of The Blackstone Group. In connection with the Cendant Separation, we entered into certain agreements with Realogy, Wyndham and Travelport governing our relationships following the separation, including the assumption by Realogy and Wyndham of 62.5% and 37.5%, respectively, of certain contingent and other liabilities of Cendant. In connection with the Cendant Separation, we also entered into various commercial arrangements with Realogy, Wyndham and Travelport. Following completion of the Cendant Separation, Cendant changed its name to Avis Budget Group, Inc. and our common stock began to trade on the New York Stock Exchange under the symbol CAR. With the completion of the Cendant Separation, Avis Budget Group's operations consist of two of the most recognized brands in the global vehicle rental industry through Avis Budget Car Rental, LLC, the parent of Avis Rent A Car System, LLC, Budget Rent A Car System, Inc. and Budget Truck Rental, LLC.

Founded in 1946, Avis is believed to be the first company to rent cars from airport locations. Avis expanded its geographic reach throughout the United States in the 1950s and 1960s. In 1963, Avis introduced its award winning "We try harder" advertising campaign, which is considered one of the top ten advertising campaigns of all time by Advertising Age magazine. Budget was founded in 1958. The company name was chosen to appeal to the budget-minded or value-conscious vehicle rental customer. Avis possesses a long history of using proprietary information technology systems in its business, and its established, but continually updated Wizard System remains the backbone of our operations. Cendant acquired the Avis brand in 1996, Avis' capital stock in 2001, and the Budget brand and substantially all of the domestic and certain international assets of Budget's predecessor in 2002.

In addition to our vehicle rental operations, we continue to manage the transition of certain legacy items which remain following the completion of the Cendant Separation. Management of these items, which includes certain Cendant corporate contingent liabilities and assets and provision of certain transition services such as payroll, accounts receivable, telecommunications and information technology, is conducted through our subsidiary, Cendant Finance Holding Company, LLC and Avis Budget.

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The following diagram reflects the current ownership structure of our company.

Car rental business

Operations Avis

We operate or franchise approximately 2,100 of the approximately 5,000 rental locations that comprise the Avis car rental system (the Avis System), which represents one of the largest car rental systems in the world, based on total revenue and number of locations, and encompasses locations at most of the largest airports and cities in the United States and internationally. The Avis System in Europe, Africa, the Middle East and parts of Asia is primarily operated under royalty-free license agreements with Avis Europe Holdings, Limited (Avis Europe), an independent third party, and is comprised of approximately 2,900 company operated and sub-licensee locations.

We own and operate approximately 1,300 Avis car rental locations in both the on-airport and local rental segments in North America, Australia, New Zealand, Latin America and the Caribbean. For 2006, Avis generated total revenue of approximately \$3.4 billion, of which approximately 85% (or \$2.9 billion) was derived from U.S. operations. In addition, we franchise the Avis System to independent business owners in approximately 850 locations throughout the United States, Canada, Latin America, Australia, New Zealand and parts of the Pacific region. In 2006, approximately 95% of the Avis System total domestic revenue was generated by our locations and the remainder was generated by locations operated by franchisees. Franchisees generally pay royalty fees to us based either on total time and mileage charges or total revenue.

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In 2006, Avis derived approximately 60% and 40% of its domestic time and mileage revenue from commercial and leisure customers, respectively, and 82% and 18% of its domestic revenue from customers renting at airports and locally, respectively. Customers who rent locally often rent in order to temporarily replace their cars when their own cars are not available either due to accidents or otherwise. We are focused on increasing the amount of revenue we generate locally for both Avis and Budget.

The Avis brand provides high-quality car rental services at price points generally above non-branded and value-branded national car rental companies. We offer Avis customers a variety of premium services, including:

Avis Preferred, a counter bypass program, which is available at major airport locations;

Avis Where2, a navigation system with real-time traffic alerts, including weather delays, construction tie-ups and traffic snarls, which suggests alternative routes and features Bluetooth hands-free calling, MP3 playback capability as well as directions in multiple languages;

Avis Cool Cars, a new line of fun-to-drive vehicles, which include the Cadillac CTS, Volvo S60 and Hummer H3;

Roving Rapid Return program, which permits customers who are returning vehicles to obtain a printed charge record at the vehicle as it is being returned;

Avis Cares, a program which provides customers with area-specific driver safety information, the latest child safety seats (available for rent), local information and driving maps;

Avis Access, a full range of special products and services for drivers and passengers with disabilities; and

Avis Interactive, a proprietary management tool that allows select corporate clients to easily view and analyze their rental activity via the Internet through account analysis and activity reports, allowing these clients to better manage their travel budgets and monitor employee compliance with applicable travel procedures.

Operations Budget

The Budget vehicle rental system (the Budget System) is one of the largest car rental systems in the world, based on total revenue and number of locations. We operate or franchise approximately 1,900 of the approximately 2,700 car rental locations in the Budget System, including locations at most of the largest airports and cities in the United States and certain other regions. The Budget System in Europe, Africa and the Middle East is operated under a royalty-free trademark license agreement with an independent third party, which is an affiliate of Avis Europe and is comprised of approximately 800 additional company operated and sub-licensee locations.

We own and operate approximately 700 Budget car rental locations in the United States, Canada, Puerto Rico, Australia and New Zealand. For the year ending December 31, 2006, our Budget car rental operations generated total revenue of approximately \$1.7 billion, of which 88% (or \$1.5 billion) was derived from U.S. operations. We also franchise the Budget System to independent business owners who operate approximately 1,100 locations throughout the United States, Canada, Latin America, the Caribbean and parts of the Asia Pacific region. In 2006, approximately 88% of the Budget System domestic total revenue was generated by our locations with the remainder generated by locations operated by independent franchisees. Independent franchisees generally pay royalty fees to us based on gross rental revenue. In 2006, Budget derived 28% and 72% of its domestic time and mileage car rental revenue from commercial and leisure customers, respectively, and 79% and 21% of its domestic car rental revenue from customers renting at airports and locally, respectively.

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Budget is a leading rental car supplier to the price-conscious segments of the industry. Budget offers Fastbreak, an expedited rental service for frequent travelers. Budget also offers the Budget Small Business Program, a program targeting the needs of small businesses. The Budget Small Business Program was named Best Car Rental Value by *Entrepreneur* Magazine in their 2006 Business Travel Awards. Budget also offers its own branded version of the Avis Where2 GPS navigation product described above.

Reservations

Customers can make Avis and Budget reservations through our Avis and Budget websites at avis.com and budget.com, through our reservation centers toll-free at 1-888-777-AVIS and 1-800-BUDGET7, respectively, through online travel portals, through selected partners including many major airlines utilizing direct connect technology, through their travel agent or by calling a location directly. Travel agents can access our reservation systems through all major global distribution systems and can obtain information with respect to rental locations, vehicle availability and applicable rate structures through these systems.

Marketing

Avis and Budget support their premium and value brand positions through a range of marketing channels and campaigns, including traditional media, such as television, radio and print advertising, as well as Internet and direct marketing. Avis focuses its marketing around its industry-leading customer loyalty and its award-winning "We try harder" campaign. Budget builds its marketing around retail advertising, key partnerships and new media, including extensive online advertising and its second-annual Internet-only "blog" campaign recognized by Yahoo! Finance, Adrants and Brandweek.

We maintain strong links to the travel industry. Avis and Budget offer customers the ability to earn frequent traveler points with most major airlines frequent traveler programs. Avis and Budget are also affiliated with the frequency programs of major hotel companies, including Hilton Hotels Corporation, Hyatt Corporation, Starwood Hotels and Resorts Worldwide, Inc. and Wyndham Worldwide. These arrangements provide incentives to program participants and cooperative marketing opportunities including call transfer programs and online links with various partners' websites. Avis has an agreement with Wyndham's lodging brands whereby lodging customers making reservations by telephone may be transferred to Avis if they desire to rent a vehicle.

In 2006, approximately 79% of domestic vehicle rental transactions from our owned and operated Avis locations in the United States were generated by travelers who rented from Avis under contracts between Avis and the travelers' employers or through membership in an organization with whom Avis has a contractual affiliation (such as AARP). Avis also has marketing relationships with American Express Company and Sears, Roebuck and Co., through which we are able to provide customers of these companies with incentives to rent from Avis. Avis licensees also have the option to participate in these affiliations. For commercial and leisure travelers that are unaffiliated with any of the employers or organizations that we contract with, Avis solicits business through media, direct mail, email and Internet advertising. Avis conducts various loyalty programs through direct marketing campaigns, including Avis Preferred, which allows customers to bypass the counter, and Preferred Select, which offers upgrades and other incentives to our best customers. As a result of these programs, Avis has been ranked as the top rental car brand for customer loyalty for eight consecutive years by a leading third party research firm. Travel agents are also able to participate in the Avis travel agent reward program, Club Red.

Similarly, Budget offers "Unlimited Budget", a loyalty incentive program for travel agents which had approximately 17,600 travel agents actively enrolled as of December 31, 2006. Budget also has contractual arrangements with American Express Company and other organizations which offer members of these groups incentives to rent from Budget. In connection with its focus on price-conscious customers, Budget primarily relies on retail advertising, including Internet advertising, and on value pricing to drive customers to our Budget website, Budget call centers and other distribution channels. Budget also offers proprietary marketing programs such as Fastbreak, an expedited rental service for frequent renters.

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Our international Avis and Budget operations maintain close relationships with the travel industry through participation in several non-U.S. based airline frequent traveler programs, such as those operated by Air Canada and Qantas Airways Limited, as well as participation in Avis Europe's programs with British Airways Plc, Deutsche Lufthansa AG and other carriers.

Franchising

Of the approximately 2,100 Avis and approximately 1,900 Budget car rental locations we operated and/or franchised at December 31, 2006, approximately 40% and 60%, respectively, were owned and operated by franchisees. Revenue derived from our car rental franchisees in 2006 totaled approximately \$36 million. Franchised locations range from large operations at major airport locations to franchise territories encompassing an entire country to relatively small operations in suburban locations. Fleets of our franchisees range from fleets in excess of 3,000 vehicles to fleets of fewer than 50 vehicles. Franchisees provide us with a source of high margin revenue as there are relatively limited additional fixed costs associated with fees paid by franchisees to us. Although franchisees represent approximately half of the locations that we own and franchise, they represent only approximately 7% of total domestic revenue generated by the Avis and Budget Systems, as the average franchise operation is significantly smaller than the average owned location.

We enjoy good relationships with our franchisees and meet regularly with them at regional, national and international meetings. Our relationships with Avis and/or Budget franchisees are governed by franchise agreements that grant the franchisees the right to operate Avis and/or Budget vehicle rental businesses in certain exclusive territories. These franchise agreements impose obligations on the franchisee regarding the operations of each franchise and restrict the franchisee's ability to transfer its franchise agreement and the franchisee's capital stock. Each franchisee is required to adhere to our system standards for each brand as updated and supplemented by our policy bulletins, brand manuals and service programs. We maintain the right to monitor the operations of franchisees and, when applicable, can declare a franchisee to be in default under its franchise agreements, which may or may not be curable. We can terminate these franchise agreements for certain defaults, including failure to pay franchise fees and failure to adhere to our operational standards.

In general, the franchise agreements grant the franchisees the exclusive right to operate an Avis and/or Budget car and truck rental business in a particular geographic area. Under agreements that predate our ownership of Avis or Budget, a limited number of franchisees in the United States are also separately franchised exclusively to sell used cars under the Avis and/or Budget brand. Our current franchise agreements provide for a 20-year term. Certain existing franchise agreements provide for renewal terms for no additional fee so long as the franchisee is not in default. Upon renewal, the terms and conditions of the franchise agreement may generally be amended from those contained in the expiring franchise agreements, while language in certain older franchise agreements may limit our ability to do so. The car rental royalty fee payable to us under franchise agreements is generally 5% to 7.5% of gross rental revenue but certain franchisees of each brand, both internationally and domestically, have franchise agreements with different royalty fee structures.

Pursuant to their franchise agreements, some franchisees must meet certain requirements relating to the number of rental offices in their franchised territory, the number of vehicles available for rental and the amount of their advertising and promotional expenditures. In general, each franchise agreement provides that the franchisee must not engage in any other vehicle rental business within the franchised territory during the term of such agreement and, in the Budget franchise agreement, for 12 months thereafter. Upon termination of a franchise, the franchisee is also prohibited from using the Avis or Budget name and related marks in any business.

Other revenue

In addition to revenue from vehicle rentals and franchisee royalties, we generate revenue from Avis and Budget customers through the sale and/or rental of optional products and services such as supplemental equipment (for example, child seats and ski racks), loss damage waivers, additional/supplemental liability insurance, personal accident/effects insurance, fuel service options, fuel service charges, and products and services as described

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above, such as rentals of Where2 GPS navigation units. In 2006, approximately 4% of our vehicle operations revenue was generated by the sale of loss damage waivers, by which we agree to relieve a customer from financial responsibility arising from vehicle damage incurred during the rental period, if the customer has not breached the rental agreement.

Websites

Avis and Budget have strong brand presence on the Internet through their websites, avis.com and budget.com, as well as third party websites. A steadily increasing number of Avis and Budget vehicle rental customers obtain rate, location and fleet information and then reserve their rentals directly on these websites. Direct bookings via our websites incur less cost per transaction than bookings made through our voice reservation agents or through third party distribution systems. Therefore, the trend toward Internet bookings is generating cost savings for us. In addition, both Avis and Budget have agreements to promote their car rental services with major Internet portals and have a strong advertising presence on various search engines. Over 49% of Budget's 2006 domestic reservations were derived from bookings over the Internet, with 30% of reservations derived from bookings on budget.com. Over 28% of Avis' domestic reservations were derived from bookings over the Internet, with 22% derived from bookings on avis.com. In 2006, avis.com reservations grew by 11% and budget.com reservations grew by 8% over the prior year.

The Wizard System

We own the Wizard System, our worldwide reservations, rentals, data processing and information management system. The Wizard System enables us to process over a million incoming customer inquiries each day, providing our customers with accurate and timely information about our locations, rental rates and vehicle availability, as well as the ability to place or modify reservations. Additionally, the Wizard System is linked to all major travel distribution networks worldwide and provides real-time processing for travel agents, travel industry partners (such as airlines), corporate travel departments and individual consumers through our websites or calls to our reservation agents. The Wizard System also provides personal profile information to our reservation and rental agents to better service our customers. Among the principal features of the Wizard System are:

Roving Rapid Return , which permits customers who are returning vehicles to obtain completed charge records from wireless-connected Roving Rapid Return agents who complete and deliver the charge record at the vehicle as it is being returned;

Preferred Service , Avis' expedited rental service that provides enrolled customers with a printed Preferred Service rental record in their pre-assigned vehicle and a fast, convenient check-out;

Fastbreak , Budget's expedited rental service which allows for a faster processing of rentals and service for enrolled customers;

Wizard on Wheels , which enables us to assign vehicles and complete rental agreements while customers are being transported to the rental vehicle;

Flight Arrival Notification , a system that alerts rental locations when flights have arrived so that vehicles can be assigned and paperwork prepared automatically;

Avis Link , which automatically identifies when a customer with a profile on record is entitled to special rental rates and conditions, and therefore sharply reduces the number of instances in which we inadvertently fail to give Avis renters the benefits of negotiated rate arrangements to which they are entitled;

Credit Card Link , which allows both brands to verify all major credit cards in a real-time connection during the rental processing;

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interactive interfaces through third party computerized reservation systems such as Galileo and Sabre;

Avis Interactive , which allows select corporate clients to easily view and analyze their rental activity via the Internet through account analysis and activity reports, allowing these clients to better manage their travel budgets and monitor employee compliance with applicable travel policies;

Direct Connect , a service offered to business to business partners that allows them to easily connect their electronic systems to the Wizard System, for either brand, and to obtain rate, location and fleet information as well as book reservations for their customers; and

operations management programs that, among other things, enable field personnel to manage which vehicles will be rented next. We also use data supplied from the Wizard System and airline reservation systems in certain proprietary information management systems to maintain centralized control of major business processes such as fleet acquisition and logistics, sales to corporate accounts and determination of rental rates. The principal components of the systems we employ include:

Fleet planning model. We have created a comprehensive decision tool to develop fleet plans and schedules for the acquisition and disposition of our fleet, along with fleet age, mix, mileage and cost reports based upon these plans and schedules. This tool allows management to monitor and change fleet volume and composition on a daily basis and to optimize our fleet plan based on estimated business levels and available repurchase and guaranteed depreciation programs.

Yield management. We have created a yield management system which is designed to enhance profits by providing greater control of vehicle availability and rate availability changes at our rental locations. The system monitors and forecasts supply and demand to support our efforts to optimize volume and rate at each location. Integrated into this yield management system is a fleet distribution module that takes into consideration the costs as well as the potential benefits associated with distributing vehicles to various rental locations within a geographic area to accommodate rental demand at these locations. The fleet distribution module makes specific recommendations for movement of vehicles between locations.

Pricing decision support system. Pricing in the vehicle rental industry is highly competitive and complex. To improve our ability to respond to rental rate changes in the marketplace, we have developed sophisticated systems to gather and report competitive industry rental rate changes every day. The system, using data from third party reservation systems as its source of information, automatically scans rate movements and reports significant changes to a staff of pricing analysts for evaluation. The system greatly enhances our ability to gather and respond to rate changes in the marketplace.

Business mix model. We have developed a strategic planning model to evaluate the discrete segments of our business relative to each other. The model considers revenue and costs to determine the potential margin contribution of each discrete segment. The model develops business mix and fleet optimization recommendations by using data from our financial systems, the Wizard System and the fleet and revenue management systems along with management's objectives and targets.

Customer profitability model. We have developed a sophisticated model which analyzes a corporate customer's rental pattern to estimate the fleet costs, operations costs and division overhead expenses associated with that customer's vehicle rentals. We use this profitability model to determine the financial merit of individual corporate contracts.

Enterprise data warehouse. We have developed a sophisticated and comprehensive electronic data storage and retrieval system which retains information related to various aspects of our business. This

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data warehouse allows us to take advantage of comprehensive management reports, query capability and easy access to data for strategic decision making for both brands.

Sales and marketing systems. We have developed a sophisticated system of online data screens which enables our sales force to analyze key account information of our corporate customers including historical and current rental activity, revenue and booking sources, top renting locations, rate usage categories and customer satisfaction data. We use this information, which is updated weekly and captured on a country-by-country basis, to determine opportunities for revenue growth, profitability and improvement.

Interactive adjustments. We have developed a multi-linked customer data system which allows us to easily retrieve pertinent customer information and make needed adjustments online for superior customer service. This data system links with other accounting systems to handle any charge card transactions automatically.

Fleet

General. We maintain a single fleet of vehicles for Avis and Budget. We rent a wide variety of vehicles, including luxury and specialty vehicles. Our fleet consists primarily of vehicles from the current and immediately preceding model year. Rentals are generally made on a daily, weekly or monthly basis. Rental charges are computed on the basis of the length of the rental or, in some cases, on the length of the rental plus a mileage charge. Rates vary at different locations depending on the type of vehicle rented, the local marketplace and competitive and cost factors. Most rentals are made utilizing rate plans under which the customer is responsible for gasoline used during the rental. We also generally offer our customers the convenience of leaving a rented vehicle at a location in a city other than the one in which it was rented, although, consistent with industry practices, a drop-off charge or special intercity rate may be imposed. We facilitate one-way car rentals between corporate-owned and franchised locations in the United States that enable us to operate as an integrated network of locations.

Vehicle purchasing. We participate in a variety of vehicle purchase programs with major domestic and foreign vehicle manufacturers. General Motors is the featured supplier for Avis, and Ford is the featured supplier for Budget. During 2006, approximately 42%, 32% and 12% of the cars acquired for our U.S. car rental fleet were manufactured by General Motors, Ford and Chrysler, respectively, compared to 53%, 28% and 8%, respectively, in 2005. During 2006, we also purchased Toyota, Hyundai, Suzuki, Nissan, Kia and Subaru vehicles. The decrease in the portion of our fleet sourced from General Motors, and the number of other vehicle manufacturers from which we purchased vehicles in 2006 is reflective of our efforts to diversify our fleet, which we expect to continue in 2007. The substantial majority of vehicles used in our rental car business are purchased through our principal U.S. vehicle financing, which is an asset-backed facility.

Vehicle disposition. We generally hold a vehicle in our domestic fleet for a term of four to twelve months. For 2006 and 2005, approximately 88% and 95%, respectively, of the rental cars purchased for our domestic car fleet were the subject of agreements requiring automobile manufacturers to repurchase them or guarantee our rate of depreciation during a specified period of time. Cars subject to these agreements are sometimes referred to as program vehicles or program cars and cars not subject to these agreements are sometimes referred to as risk cars or risk vehicles. The programs in which we participate currently require that the program vehicles be maintained in our fleet for a minimum number of months (typically four to twelve months) and impose return conditions, including those related to mileage and condition. At the time of return to the manufacturer, we receive the price guaranteed at the time of purchase and are thus protected from fluctuations in the prices of previously-owned vehicles in the wholesale market at the time of disposition. The future percentages of program vehicles in our fleet will be dependent on the availability and attractiveness of manufacturers' repurchase and guaranteed depreciation programs, over which we have no control, and we expect percentages for 2007 to be lower than 2006 as we acquire more risk vehicles in order to mitigate the anticipated increased cost of program vehicles. We dispose of our risk vehicles largely through automobile auctions.

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Of the approximately 445,000 cars from our rental car fleet that we sold in 2006, we sold approximately 88% back to the manufacturers pursuant to repurchase or guaranteed depreciation programs and the rest through third party channels such as wholesale auctions. In 2007, we expect the percentage of cars sold back to the manufacturers to decrease as we acquire more risk vehicles.

Utilization and seasonality. Our car rental business is subject to seasonal variations in customer demand, with the summer vacation period representing the peak season. The general seasonal variation in demand, along with more localized changes in demand at each of our locations, causes us to vary our fleet size over the course of the year. For 2006, our average monthly fleet size in the U.S. ranged from a low of approximately 297,000 vehicles in December to a high of approximately 366,000 vehicles in July. Domestic fleet utilization for 2006, which is based on the number of rental days (or portion thereof) that vehicles are rented compared to the total amount of time that vehicles are available for rent, ranged from 67% in December to 78% in August and averaged 75% for 2006. Our calculation of utilization may not be comparable to other companies' calculation of similarly titled statistics.

Maintenance. We place a strong emphasis on vehicle maintenance since quick and proper repairs are critical to fleet utilization. To accomplish this task we employ a full-time National Institute for Automotive Service Excellence (ASE) fully certified technician instructor at our headquarters. This instructor has developed a specialized training program for our 410 technicians who operate in approximately 100 maintenance and damage repair centers for both Avis and Budget. The technicians/instructors also maintain strong relationships with General Motors and Ford. We use advanced diagnostic equipment, including General Motors Techline and Tech 2 diagnostic computers and Ford's PDS diagnostic system. Our technician training department also prepares its own technical service bulletins that can be retrieved electronically at all of our repair locations. Approximately 89% of our technicians are ASE certified.

Customer service

Our commitment to delivering a consistently high level of customer service is a critical element of our success and strategy. Each year, our internal quality auditors conduct approximately 1,000 unannounced reviews of locations to measure service levels by location. We identify specific areas of achievement and opportunity from these assessments. We address areas of improvement on a system-wide level and develop standard methods and measures. The major focus areas of these assessments include (i) vehicle condition and availability; (ii) customer interaction, including helpfulness and courtesy; and (iii) location image. In addition, we utilize a toll-free 800 number and a dedicated customer service email address to allow customers of both Avis and Budget to report problems directly to our customer relations department. Location associates and managers also receive training and are empowered to resolve virtually all customer issues at the location level. We prepare weekly and monthly reports on the types and number of complaints received for use in conjunction with the customer satisfaction reports by location management as feedback of customer service delivery. Finally, we conduct daily location-specific customer satisfaction tracking by sending web-based surveys to recent customers of our top volume locations.

Airport concession fees

In general, concession fees for on-airport locations are based on a percentage of total commissionable revenue (as defined by each airport authority), subject to minimum annual guaranteed amounts. Concessions are typically awarded by airport authorities every three to five years based upon competitive bids. Our concession agreements with the various airport authorities generally impose certain minimum operating requirements, provide for relocation in the event of future construction and provide for abatement of the minimum annual guarantee in the event of extended low passenger volume.

Competition

The car rental industry is characterized by intense price and service competition. Competition in the U.S. vehicle rental operations business is based primarily upon price, reliability, vehicle availability, national distribution,

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usability of booking systems, ease of rental and return and other elements of customer service. In addition, competition is influenced strongly by advertising, marketing and brand reputation. We compete primarily with the following car rental companies: Hertz Global Holdings, Inc., Vanguard Car Rental USA Group, which operates the National Car Rental and Alamo brands, Dollar Thrifty Automotive Group and Enterprise Rent-A-Car Company.

Truck rental business

Operations

Budget's truck rental business is one of the largest local and one-way truck rental businesses in the United States. The Budget truck rental business has a combined fleet of approximately 30,500 trucks, with a median truck age of less than two years old, which are rented through a network of approximately 2,400 dealers, 210 company operated and 100 licensee operated locations throughout the continental United States. The Budget truck rental business serves both the consumer and light commercial sectors. The consumer sector consists primarily of individuals who rent trucks to move household goods on either a one-way or local basis. The light commercial sector consists of a wide range of businesses that rent light- to medium-duty trucks, which we define as trucks having a gross vehicle weight of less than 26,000 pounds, for a variety of commercial applications. In 2006, the Budget truck rental business generated total revenue of approximately \$472 million.

We primarily advertise in yellow pages telephone directories to promote our truck rental business to potential customers. Budget truck rental customers can make reservations through the Budget truck rental reservation center toll-free at 1-800-GO-BUDGET, through our Budget truck rental website at budgettruck.com or by calling a location directly. In addition, we have established online affiliations with websites like moving.com to reach our targeted audience. Budget truck rental reservations may also be made through the budget.com website.

During 2006, we announced plans to close the headquarters of our truck rental operations in Denver and integrate Denver-based operations into existing car rental facilities during first quarter 2007. In connection with this restructuring, we eliminated certain positions and significantly reduced separate senior management for our truck rental operations.

Distribution

Budget's truck rental business is offered through a national network, which included approximately 2,400 dealers as of December 31, 2006. These independent dealers are primarily self-storage facilities, rental centers, hardware stores, service stations and other similar service retailers. In addition to the dealers' principal businesses, the dealers rent our light- and medium-duty trucks to consumers and to our commercial accounts and are responsible for collecting payments on our behalf. The dealers receive a commission on all truck rentals and ancillary equipment rentals. Generally, dealership agreements may be terminated by either party upon 30 to 90 days' prior written notice.

Competition

The truck rental industry is characterized by intense price and service competition. We compete with a large number of truck rental companies throughout the country, including U-Haul International, Inc., Penske Truck Leasing Corporation, Ryder System, Inc., Enterprise Rent-A-Car Company and many others.

Seasonality

Our truck rental operations are subject to seasonal demand patterns, with generally higher levels of demand occurring during the late spring and summer months when most self moves occur, with the third quarter typically being our busiest quarter. Generally, December is also a strong month due to increased retail sales activity and package deliveries.

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Ancillary products and insurance coverage

We supplement our daily truck rental revenue by offering customers a range of ancillary optional products. We rent automobile towing equipment and other moving accessories such as hand trucks, furniture pads and moving supplies. We also make available to customers a range of optional liability-limiting products and coverages such as physical damage waivers, automobile towing protection, personal accident and cargo insurance and supplemental liability insurance. These ancillary products enhance our appeal to consumers by offering customers one-stop moving services.

Insurance coverage

We generally assume the risk of our liability to third parties arising from vehicle rental services in the United States, Canada, Puerto Rico and the U.S. Virgin Islands, for up to \$1 million per occurrence, through a combination of self-insurance, insurance coverage provided by one of our domestic subsidiaries and insurance coverage secured from one or more unaffiliated domestic insurance carriers. We retain the exposure for up to \$9 million per occurrence, in excess of the previously described \$1 million level, through an unaffiliated fronting carrier who is reinsured by our offshore captive insurance company, Constellation Reinsurance Co., Ltd. We also purchase additional excess insurance coverage from a combination of unaffiliated excess carriers.

We insure the risk of liability to third parties in Argentina, Australia and New Zealand through a combination of unaffiliated carriers and our affiliates. These carriers provide coverage supplemental to minimum local requirements.

Trademarks and intellectual property

The service marks *Avis* and *Budget*, related marks incorporating the words *Avis* or *Budget*, and related logos and marks such as *We try harder* are material to our vehicle rental business. Our subsidiaries and franchisees actively use these marks. All of the material marks used by the *Avis* and *Budget* Systems are registered (or have applications pending for registration) with the United States Patent and Trademark Office as well as all countries worldwide where *Avis* and *Budget* have operations. Our subsidiaries own the marks, patents and other intellectual property, including the *Wizard* System, used in our business.

Discontinued Operations

Following the formal approval by our Board of Directors of a disposition plan for the former *Cendant Travel Distribution Services* businesses and completion of the *Cendant Separation*, we classified the former *Real Estate Services*, *Hospitality Services*, *Timeshare Resorts* and *Travel Distribution Services* businesses as discontinued operations. Set forth below is a brief description of the businesses that were classified as discontinued operations during 2006. The former mortgage business, which was distributed in 2005, was also classified as a discontinued operation in 2006 following completion of the *Cendant Separation* as such business could not be classified as a discontinued operation in 2005 when originally distributed due to participation by the former *Real Estate Services* business in a mortgage origination venture established with *PHH* in connection with the distribution of that business.

Real Estate Services Businesses. *Realogy* Corporation, which holds the assets and liabilities associated with the former *Real Estate Services* businesses, is one of the preeminent providers of real estate and relocation services in the world. *Realogy* is a franchisor of five of the most recognized brands in the real estate industry; owns and operates a full-service real estate brokerage business; offers a broad range of employee relocation services; and offers title and settlement services, assisting with the closing of real estate transactions. In the first quarter of 2006 (prior to the completion of the *Cendant Separation*), we changed the name of our *Real Estate Services* segment to *Realogy*.

Hospitality Services and Timeshare Resorts Businesses. *Wyndham Worldwide* Corporation, which holds the assets and liabilities associated with the former *Hospitality Services* and *Timeshare Resorts* businesses, is one of

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the preeminent providers of hospitality products and services in the world. Wyndham franchises hotels and provides property management services; provides vacation exchange products and services to developers, managers and owners of intervals of vacation ownership interests and markets vacation rental properties; and markets and sells vacation ownership interests and provides consumer financing in connection with the purchase by individuals of vacation ownership interests.

Both Realogy and Wyndham were distributed to our stockholders on July 31, 2006 as part of the Cendant Separation through a pro rata dividend of all of the common stock of each company to Cendant stockholders at the close of business on the record date of the distributions.

Travel Distribution Services Businesses. Travelport, which holds the assets and liabilities associated with the former Travel Distribution Services businesses, provides a highly effective worldwide system for the distribution of travel and travel-related products and services. Travelport focuses on electronic travel distribution services that connect travel suppliers to travel agencies, and it owns and operates several industry-leading online travel agencies. On August 23, 2006, we completed the sale of Travelport.

FINANCIAL DATA OF SEGMENTS AND GEOGRAPHIC AREAS

Financial data for our segments and geographic areas are reported in Note 21 Segment Information to our Consolidated Financial Statements included in Item 8 of this Form 10-K.

REGULATION

We are subject to federal, state and local laws and regulations, including those relating to taxing and licensing of vehicles, franchising, consumer credit, environmental protection, insurance, privacy and labor matters.

Environmental

The principal environmental regulatory requirements applicable to our vehicle rental operations relate to the ownership or use of tanks for the storage of petroleum products, such as gasoline, diesel fuel and waste oils; the treatment or discharge of waste waters; and the generation, storage, transportation and off-site treatment or disposal of solid or liquid wastes. We operate approximately 440 Avis and Budget locations at which petroleum products are stored in underground or above ground tanks. We have instituted an environmental compliance program des