

Operating and Financial Review



Mark McCafferty Chief Executive



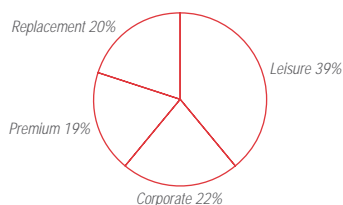
Martyn Smith Group Finance Director

REVENUE OVERVIEW

Our balanced geographical and segmental portfolio provides some protection in times such as these, by enabling us to focus revenue development activity in less affected areas. In 2002 overall Group revenues were 5.3% lower at €1,189.2 million.

Although volume declined by 5.6%, primarily due to cutbacks in corporate-related spend, we continued to create yield gains with revenue per rental up 1.7% versus prior year.

REVENUE BY CUSTOMER TYPE



	Change versus 2001	
	Half 2 %	Full year %
Leisure	2	-
Replacement	(8)	(7)
Corporate	(13)	(14)
Premium	(4)	(5)

Leisure recovered steadily

The major segment for the Group in 2002 was Leisure, accounting for 39% of revenue. Leisure activity continued to recover, returning to growth in the second half and achieving full year revenue in line with 2001.

Intra-European Leisure revenue, which is 40% of the Leisure segment, was only marginally lower than 2001. A reduction in tour operator referred business was offset by targeted investments to increase the number of customers booking direct through the internet, our call centres and travel agents. This change in mix contributed to an increase in revenue per rental of 2.8%.

Domestic Leisure revenue, which is 29% of the segment, was up 2% versus prior year, with particularly strong performances in France and the UK from promotional activities.

International Leisure revenue, which is 31% of the segment, recovered gradually during the year, supported by new products and sales investment in the US retail market. Full year revenue was 2% below prior year.

Corporate customers reduce travel expenditure

Corporate business accounted for 22% of revenue in 2002. This segment was impacted from the second quarter onwards when companies further reduced their discretionary expenditure. Full year revenue was 14% lower than prior year, with only marginal improvement in the second half even with the benefit of the weak comparative of the fourth quarter in 2001.

The market was particularly difficult in Northern Europe although we again achieved yield gains in this segment. Investment in sales and marketing activity enabled us to grow elements of the Corporate segment in certain markets, for example Spain, by increasing sales efforts in the small and medium sized enterprise market.

Replacement impacted by reduced corporate spend

Replacement represented 20% of revenue in 2002 and includes business originating from three sources – corporate longer term, which was 45% of revenue, leasing-related 26% and insurance-related 29%.

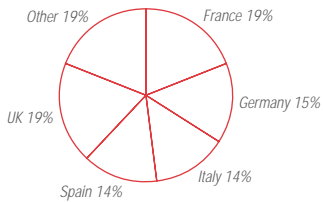
Overall Replacement revenue was 7% lower than 2002 with corporate longer term down 14% in line with the overall trend in the Corporate segment.

Premium in line with overall revenue trends

The Premium sector accounted for the remaining 19% of revenue and includes customers who do not pre-book their car rental and business from some partnerships. Revenue in this segment was 4.9% lower than 2001, broadly in line with the overall Group.

REVENUE BY GEOGRAPHIC AREA

After re-allocation of tour operator and insurance revenue.



	Change versus 2001	
	Half 2 %	Full year %
France	(5)	(5)
Germany	(11)	(14)
Italy	(5)	(7)
Spain	8	7
UK (£)	(9)	(11)
Group	(5)	(5)

The major markets of France, Germany, Italy, Spain and the UK generated 81% of Group revenues during 2002. Full year revenue in Germany and the UK was down 14% and 11% respectively as these markets were significantly impacted from the second quarter onwards by cut backs in corporate travel spend. This also impacted Italy and France to a lesser extent where total revenue was 7% and 5% lower respectively. Targeted revenue activities were developed in each market to help mitigate this reduction in corporate-related travel and to underpin revenue development for the future.

Spain, which grew by 7%, was the strongest of the country markets, not only in its core Leisure business but also in the successful development of more than 50 new domestic corporate accounts in the small and medium enterprise segment. Development of corporate activity reduces dependence on peak leisure periods and eases fleet planning. A number of important agreements were renewed during 2002, including the three-year partnerships with Iberia and the Sol Melia hotel group. We also secured our position across all key Spanish airports for the next five years.

In Germany, where trading conditions remained particularly difficult, we continued to operate a yield strategy, with revenue per rental increases in Corporate and transatlantic business. New initiatives were launched at the end of the year to develop the insurance-related element of Replacement segment. Our Lufthansa partnership was successfully renewed and extended to include joint marketing activities to develop both domestic and international business.

In addition to the economic downturn, Corporate revenue in the UK was impacted by the withdrawal from certain Government contracts. Initiatives focused on stimulating domestic Leisure activity underpinned a year on year increase in Leisure revenues. Despite the difficulties of the airline market and reductions in passenger capacity, we marginally increased the number of rentals from British Airways customers through marketing and database promotions.

In France, domestic promotional activity generated a 5% growth in Leisure. During 2002 we launched Caraway, an internet-based prepaid rental product, to develop future domestic and outbound leisure business.

Italy successfully implemented new loyalty programmes and stimulated double-digit rental growth in the premium segment. A number of new UK inbound tour operator contracts were secured in the latter part of 2002 to generate leisure business in 2003.

Partnership developments

During 2002 we renewed some key partnerships and secured new arrangements with a number of airlines, travel companies and international rail companies. Renewed arrangements were completed with Iberia, Lufthansa, Olympic Airways, JAL and All Nippon and a new three-year exclusive partnership was secured with FlyBE, Europe's leading independent regional carrier.

New pan-European arrangements were secured with Thomas Cook and new partnerships with two of Europe's largest internet-based travel companies, e-bookers and Expedia, commenced during the year.

Our penetration of the high-speed rail customer base was further enhanced with a new exclusive partnership with Eurostar and new marketing programmes with SNCF in France and RENFE in Spain.

Centrus implements new operating guidelines

Centrus is the UK's second largest car replacement service to non-fault accident insurance claimants providing claim management services and generating rental volume for the Avis UK business. In 2002 revenues were down 2.3% to €34.6 million with completed hires of some 21,000.

Although industry guidelines for reimbursement of claims were previously agreed with the Association of British Insurers, we have continued to experience difficulties with the settlement process, resulting in an exceptional charge of €6.9 million.

Operating and Financial Review continued

To ensure more timely settlement of claims we are working with insurers to introduce new processes for more effective data capture and exchange and we have significantly strengthened our claims collection team.

As a result of these actions we expect improvements to the speed of settlement during 2003, which should then provide a base for an expansion of the business in 2004.

STRATEGIC DEVELOPMENT

Budget acquisition will provide further opportunities for growth

In February 2003 we reached a binding acquisition agreement for certain assets of the Budget Group, including the royalty-free rights to the Budget brand throughout Europe, Middle East and Africa. Completion of the acquisition is subject to certain closing conditions, which we expect to complete during March.

The purchase consideration is approximately €30 million, plus €8 million of assumed debt relating to fleet assets. We expect the acquisition to be marginally earnings dilutive in the first full year following completion.

Budget is at present predominantly a franchised business with a limited number of corporate owned operations in France, Switzerland and Austria. It currently operates in over 60 countries through 1,000 locations and generates licence fee income of some €11 million per annum.

This year we will focus on the integration and stabilisation of the business prior to more significant investment towards the end of 2003. The brand has very limited presence in some key territories such as Spain, Italy and Scandinavia. This provides the opportunity to deploy our operational experience and resources to regenerate the brand. In addition there will be cost efficiencies from simplifying existing systems infrastructure as well as developing joint service and support functions.

Avis France extends corporate network

In January 2003 we acquired the rental network of a major Avis licensee in France for €17.8 million including assumed debt relating to fleet assets of approximately €11.6 million. This is the leading car rental company in the South East and has been part of the Avis licensee network for over 30 years. The business generated €18.5 million of revenue in 2002 and is expected to be earnings enhancing in 2003.

Avis branded joint venture in China commences trading

In addition to investing in our core European markets we continue to develop our presence in Asia which we see as a

key long term growth region for the Group. Our joint venture in China with Shanghai Automotive Industry Corporation received regulatory approval and started trading in January 2003 with 1,000 cars operating from nine locations. We plan to extend the network to 70 locations in 26 cities over the next five years, leading up to the Beijing Olympics in 2008.

OPERATING PROFIT OVERVIEW

Operating profit before exceptional items and goodwill amortisation was €186.5 million, down 13.5% on prior year. Operating margin of 15.7% was 1.5% points lower than the prior year largely resulting from the impact of lower revenue on fixed costs which mainly relate to the short term inflexibility of support staff levels across the Group and the rent and depreciation of our rental station network.

	2002 % revenue	2001 % revenue	Margin movement
Selling costs	6.8	6.6	(0.2)
Revenue related	8.2	8.2	–
Rental related	2.1	2.1	–
Fleet costs	33.2	33.1	(0.1)
Staff costs	21.1	20.5	(0.6)
Overheads	12.9	12.3	(0.6)
Operating margin*	15.7	17.2	(1.5)

*Before goodwill amortisation and exceptional items.

Rapid adjustment of fleet and staff to lower demand

The relative flexibility of our operating cost base allows us to minimise the impact of reduced revenues on margin.

Average fleet was 5% (some 6,000 units) lower than 2001, resulting in our key fleet efficiency measure of vehicle utilisation being 68.1% (2001: 68.5%). Our other key operational efficiency measure is staff productivity, which was just 1.7% lower, compared to the reduction in rentals of 7%. Operational and call centre staffing levels were reduced in line with demand, sales teams were tactically increased for business development and a process of restructuring to adjust management and support positions across the Group, resulted in a reduction of 100 positions in the last quarter of 2002.

Continued success with fleet strategies

Fleet costs as a percentage of revenue were very similar to prior year, reflecting the success of key initiatives in vehicle sourcing, damage recovery and our used car re-marketing programmes.

During the second half of the year a new hand-held vehicle check-out and check-in device was piloted at selected airports in Germany and the UK. In addition to improving customer service, this initiative is designed to substantially improve damage management and increase delivery and collection efficiencies. With positive consumer acceptance and the process efficiency results achieved in the pilot, we are investing in a two-year €16 million roll out programme of the new device to all major rental locations across the Group.

Other operating costs

Overhead costs of €153.2 million included €73.0 million of non-property costs, which were reduced by 9% through intensive cost management actions. Property costs of €80.2 million increased by €5.8 million as we continued to invest in improving our network facilities. As a result overheads increased 0.6% points of revenue.

Net interest payable

	2002 € million	2001 € million
Adjusted interest payable*	59.9	66.8
Average net debt*	1,129	1,281
Average interest rate	5.3%	5.2%

*Excludes deferred consideration.

Adjusted interest payable has reduced because of the level of average net debt required to fund the lower fleet level. Average interest rates have increased from 5.2% to 5.3% as the Group increased financing through longer term facilities and also increased the proportion of fixed rate debt.

Exceptional charges

Exceptional charges of €16.4 million have been incurred in the year. These are detailed as follows:

As a result of business conditions following 11 September 2001, action has been taken to reduce a number of management and support positions across Europe, incurring severance costs of €6.2 million.

A charge of €6.9 million has been made to reduce Centrus credit hire receivables to their recoverable amount. This reflects experience in collections to date, particularly due to the transition to an industry-wide protocol.

A dispute has arisen as to the recoverability of certain prior year re-insured amounts from the Group's former principal re-insurer which is now in run off under the supervision of the Financial Services Authority. Accordingly, a charge of €3.3 million has been made.

Taxation

	2002 € million	2001 € million
Taxation pre-exceptional charges	26.0	30.0
Taxation on exceptional charges	(5.2)	-
Total taxation	20.8	30.0

The effective tax rate for 2002 pre-exceptional items was 22% and post-exceptional items was 20.5%. The tax rate continues to be less than the rate of UK corporation tax largely because of the utilisation of UK tax losses brought forward and adjustments in respect of prior years.

Pensions

The Group has a number of pension schemes of a defined benefit and defined contribution nature. The material defined benefit pension schemes in the Group are in the UK, which is a funded scheme, and Germany, which is unfunded.

On a SSAP 24, Accounting for pension costs, basis there was a deficit at 31 December 2002 in respect of the UK scheme of €14.5 million. On a FRS 17, Retirement benefits, basis the deficit between the market value of the assets in the UK scheme and the actuarial value of its liabilities was €37.2 million.

The charge in the profit and loss account for the Group's defined benefit schemes is €10.9 million, based on the requirements of SSAP 24. The Group has chosen not to adopt FRS 17 early, but had it done so, the profit and loss account charge for the same schemes would have been €10.0 million.

Following the actuarial valuation of the Avis UK Pension Plan at 30 June 2002, it was decided to introduce a new defined benefit scheme for UK employees who join the Company from 1 July 2003. This is a contributory scheme, which provides a defined capital sum at retirement, based on an annual accrual plus interest. The contributions are used to provide a pension based upon open market rates. The Company retains responsibility for the investment but not the annuity risk.

Shareholders' funds

At the end of the year, shareholders' funds were €109.5 million compared with €84.5 million at the start of the year. Principal movements were the retained profit of €27.3 million, the issue of new shares (resulting from the exercise of options) at €1.6 million and exchange movements of €(3.9) million.

Operating and Financial Review continued

Goodwill

Capitalised goodwill of €64.4 million relates primarily to the acquisitions in previous years of Centrus, former licensees Holland and Greece and a sub-licensee in Germany. The reduction in carrying value from €70.6 million in the prior year is attributable to the amortisation of goodwill brought forward and exchange movements. Goodwill arising before 28 February 1998, of €1,080.4 million, has been written off against the profit and loss reserve.

Fixed assets

Fleet fixed assets book amount is 1.2% lower at €1,312.4 million, relating to 102,000 vehicles. This reflects the lower level of business partially offset by an increase in prepaid but not yet registered fleet in Germany.

Non-fleet fixed asset additions of €27.4 million increased the closing net book amount to €79.7 million. This was a consequence of the acquisition of a new head office building in Madrid, land for parking in Barcelona, the Faro rental station and further development of the back office reservation system "Wizard".

Cash flow

	2002 € million	2001 € million
Net cash inflow from operating activities	518.6	528.1
Fleet capital expenditure	(323.7)	(271.6)
Non fleet capex	(25.3)	(17.3)
Taxation	(2.0)	(25.0)
Interest and dividends	(119.2)	(126.7)
Acquisitions and other	1.7	12.8
Movement in net debt	50.1	100.3
Movement in fleet net book amount	16.1	(36.3)
Movement in fleet working capital	(50.0)	70.4
Depreciation and adjustments on disposal	(284.7)	(307.8)
Exchange and acquisitions	(5.1)	2.1
Fleet capital expenditure	(323.7)	(271.6)

Overall the level of net debt has reduced during the year by €50.1 million. This is largely due to cash generated from operations. Despite the difficult trading conditions, the Group has been profitable and cash generative.

Despite lower average fleet levels, fleet capital expenditure has risen. This is largely a consequence of movements in net vehicle working capital, which increased by €50.0 million in 2002 (compared to a decrease of €70.4 million in 2001). This increase arises primarily because of the timing of vehicle

purchases and sales at the year end leading to the partial reversal of the timing benefit experienced at the end of 2001.

In addition, the Group has particularly benefited from reduced tax payments because of the changed timing of payments related to current year tax and repayments received relating to prior years.

Net debt

	2002 € million	2001 € million
Current asset investments	113.2	0.5
Cash	41.5	21.5
Debt due within one year	(181.7)	(264.1)
Debt due after one year	(742.6)	(572.7)
Finance leases	(310.6)	(315.5)
	(1,080.2)	(1,130.3)

Overall net debt has decreased during the year, but both gross debt and gross cash have increased. The gross cash position significantly increased by €132.7 million to €154.7 million, principally due to the introduction of cash collateral used to secure competitive finance leases in France and additional investments by the Group's captive insurance company.

The gross debt position increased by only €82.7 million to €1,234.9 million largely due to a net increase in long term debt, primarily due to the issue of some €171.8 million of unsecured loan notes, partially offset by a consequent decrease in short term debt.

TREASURY

Policies and controls

The Group's treasury policy is structured to reduce the financial risks and exposures facing the business, particularly to changes in interest rates and foreign exchange rates and to ensure constant access to sufficient liquidity. To achieve this, the Group undertakes an active hedging policy, including the use of derivatives (interest rate and foreign exchange swaps, forward rate agreements and caps and collars) which are only entered into under policies approved and monitored by a sub-committee of the Board, chaired by the Group Finance Director. These transactions are only undertaken to reduce exposures arising from underlying commercial activities and at no time are any transactions undertaken for speculative reasons.

Foreign currency

From a transactional perspective the nature of our operations generally provides a natural currency hedge as each country's

operations broadly generate revenue and incur costs in local currency. Regarding translation, Group policy is to match average liabilities of the Group in each major currency to the equivalent average assets (including goodwill) and thus minimise any impact on the Group. To the extent that this does not naturally occur, both foreign currency borrowings and forward exchange contracts are used. The balance sheet position is as follows:

Balance sheet currency analysis at 31 December 2002

	Assets %	Liabilities %
Euro	71	71
Sterling	27	28
Other	2	1
Total	100	100

Interest rates

The Group finances its operations through a combination of fixed and floating rate facilities and uses derivatives to fix a proportion of its debt so as to reduce exposure to any rise in interest rates. At 31 December 2002, the Group had fixed 66% of debt, this being analysed below:

	Floating € million	Fixed € million	Fixed %	Weighted average fixed interest rate %	Weighted average period for which rate is fixed (years)
Euro	334.7	769.1	70	5.9	3.0
Sterling	67.4	46.7	41	6.8	1.7
Other	17.0	–	–	–	–
Total	419.1	815.8	66	5.9	2.9

The above table excludes deferred consideration and forward start swaps as detailed in Note 24 to the Financial Statements.

Liquidity and funding maturity

The seasonal nature of the business necessitates higher fleet levels in the summer months and hence higher debt requirements. The peak debt required in 2002 was €1,273.2 million at the end of June. Consequently the Group ensures that it has a core level of long term funding in place supplemented by shorter term facilities to cover seasonal requirements.

During the year, the Group achieved a considerable increase in the amount of committed long term funding available. A new multi-currency facility was agreed with a syndicate

of banks, comprising a €385.0 million five year tranche, together with a €165.0 million 364 day tranche, with a one year term out option. In addition medium term notes totalling €171.8 million maturing between 2007 and 2012 were issued.

These facilities are in addition to local bilateral banking and leasing facilities, a domestic Belgian commercial paper programme, US\$300.0 million of senior unsecured notes and €25.0 million of senior unsecured notes. There have been no other changes to the principal facilities during the year and, in total, the Group has available committed financing amounting to some €2.0 billion, of which nearly €800.0 million matures in 2005 or later, and in addition, €0.9 billion of uncommitted facilities. The weighted average remaining life of committed facilities (excluding finance leases) has improved from 2.5 years at the end of 2001 to 3.8 years at the end of 2002.

Counter party risk

The Group controls this risk from a Treasury perspective by only entering into transactions involving financial instruments with authorised counter parties of strong credit quality, and such positions are monitored regularly.

EXCHANGE RATES

The average euro/sterling exchange rate used for the year was 1.594 (2001: 1.612) and the rate at the year end was 1.555 (2001: 1.615). The profits earned in the year by operations in the UK were naturally hedged by net costs in the headquarters such that there was a minimal impact of this change in exchange rates on the consolidated euro results.

ACCOUNTING STANDARDS AND POLICIES

The Group's accounting policies are set out in the Financial Statements and are consistent with the prior year, except with regard to deferred taxation and unregistered cars. During the year, the Group adopted FRS 19, Deferred tax, and there was no material impact on the Financial Statements. The Group has also changed the classification of unregistered vehicles from prepayments to fixed assets to ensure a consistent treatment with vehicles in use by the business. The impact of this change on the comparative balances is set out in Note 13 to the Financial Statements.