

Financial Review

**Phase I
investment
underway**



Martyn Smith

Revenue € **1,276m**

Avis € **1,234m**

Budget € **42m**

Revenue overview

€ million	2005	2004	% change
Corporate	1,209	1,196	1
Licensees	25	22	14
Avis	1,234	1,218	1
Corporate	34	27	26
Licensees	8	7	14
Budget	42	34	24
Centrus	-	1	-
Revenue	1,276	1,253	2

Avis Corporate revenue

Avis Corporate revenue was 1% ahead of prior year at €1,209 million. Volume, in terms of billed days, was up 2.8%, with all customer groups other than replacement ahead of prior year and a particularly strong performance in leisure. Although the pricing environment remained difficult with revenue per day 1.5% lower, there was some easing in the second half, largely resulting from a reduction in longer rental length replacement business.

As a proportion of revenues, the leisure customer group represented 37%, corporate 22%, replacement 22% and premium 19%, largely unchanged on the prior year.

Leisure

Overall leisure revenues were 5% ahead of prior year, with a particularly good second half performance, especially in domestic and intra-Europe. Domestic leisure (30% of the customer group) was up 6% with good volume growth in France and the UK and virtually flat pricing. Intra-European leisure revenue (45% of the customer group) grew by 7%, with double-digit revenue growth in Italy, Germany and the UK. Although pricing was 1% lower, this performance was assisted by tactical yielding initiatives. Overall growth in long-haul leisure (25% of the customer group) was 1% up on the prior year, with weakness in US inbound offset by continued growth in the

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With the customer at the heart of our on-line strategy, we have continued to develop the usability and functionality of our websites.



rest of the world. Long-haul price overall was 1% lower, with some recovery in yields achieved in the second half.

Corporate

Corporate revenue was flat year-on-year. Growth in the number of rentals was offset by weaker price, partly on increased rental length. A particularly strong revenue performance was achieved in Spain, but limited growth was seen in France. However, revenue in the other main markets was lower than prior year.

Replacement

Replacement revenues were 4% lower than prior year. Total volume was slightly down, with a significant increase in rental length offsetting a reduced number of rentals. Pricing was correspondingly lower. Replacement revenues in all main markets, except Germany, were down.

Premium

Overall revenue in premium was flat year-on-year. Volume growth of 4%, partly on higher rental length, was offset by lower rate. The pricing environment remains tough and yielding in the segment was further impacted in Italy by a transport strike early in the year.

Avis Licensee revenue

Overall revenue from licensee countries grew by 14%, with above average growth trends across the Middle East and the emerging markets in Asia.

Budget Corporate revenue

Budget Corporate revenues of €34 million were up 26%, mainly as a result of the opening of a station at Heathrow Airport, an improved performance in France and increased walk-up business in Switzerland.

Budget Licensee revenue

Budget Licensee revenues of €8 million were up 14%, on new licensee openings and improved network revenue.

Operating profit overview

€ million	2005	2004	% change
Corporate	130.8	154.6	(15)
Licensees	23.1	20.2	14
Avis	153.9	174.8	(12)
Corporate	(8.4)	(9.0)	7
Licensees	1.5	0.9	67
Budget	(6.9)	(8.1)	15
Unallocated	(47.1)	(52.5)	10
Group underlying operating profit	99.9	114.2	(13)
Underlying adjustments	(18.5)	(74.4)	75
Total Group operating profit	81.4	39.8	105

Underlying operating profit was €99.9 million (2004: €114.2 million), including a €6.9 million loss from Budget (2004: loss €8.1 million). Currency translation effects were immaterial. After adjusting for €13.2 million of net exceptional charges and €5.3 million of losses on foreign exchange derivatives, total operating profit was €81.4 million (2004: €39.8 million).

Avis operating result

Underlying Avis operating profit of €153.9 million compared to €174.8 million in the prior year. This when combined with a reduction in unallocated costs of €5.4 million, to €47.1 million, resulted in an underlying operating profit of €106.8 million, compared to €122.3 million in the prior year.

Underlying operating margin after deducting unallocated costs at 8.7% was 1.3% lower as anticipated. The weaker pricing environment, together with the investment in recovery strategy initiatives was partially mitigated by volume growth and a good utilisation performance. Operating costs increased by €32 million or 2.9% to €1,128 million.

A €5 million increase in selling costs was due to recovery strategy initiative expenditure, offset by lower travel agency fees following the successful change of terms on pre-contracted corporate rentals.

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Strong operational cost focus



Rental related costs increased by €7 million. This was due to increased road taxes in Germany and higher fuel costs, which impacted both transportation costs and the cost of providing fuel to customers, although the latter was largely offset by increased fuel revenues.

Fleet costs were €18 million higher, an increase of 4.6%, of which some 1.6% was a consequence of higher volumes. Fleet cost per car month was 2.8% higher due to a tightening of terms and richer fleet mix, partly offset by the good utilisation performance. Fleet running costs increased as a result of higher insurance premiums and costs associated with a general transportation strike in Italy in the early part of the year.

Staff costs were €11 million higher including a €1 million increase in pension expenses. Staff costs per rental were up 2.4% due to: inflationary increases; investment in additional staff to implement yield management and fleet re-marketing initiatives; and the continued parallel running on the transfer of back-office activities to the shared service centre in Budapest.

Overheads were €10 million lower, benefiting from profits arising on the disposal of certain properties in Belgium and Spain in the first half and cost reductions in Germany, Italy, France and the UK. Recovery strategy initiative expenditure during the year was higher than prior year project spend, which included certain costs associated with cancelled IT projects.

Avis Licensee operating profit of €23.1 million was 14% ahead of the prior year, with drivers of the performance being in line with revenue.

Budget operating result

The underlying operating loss of €6.9 million was as anticipated, being €1.2 million lower than the prior year. Licensee underlying operating profits of €1.5 million contrasted favourably to €0.9 million in the comparative period, in line with the improvement in revenue trends. The Corporate underlying operating loss of €8.4 million was only marginally improved,

reflecting planned investment in additional sales and marketing activities and after a goodwill impairment charge of €0.4 million.

Financial review Net finance costs

€ million	2005	2004
Underlying net finance costs*	62.1	62.0
Average net debt	1,096	1,117
Average finance rate	5.5%	5.3%

* Excludes certain re-measurement items and economic hedges.

Underlying net finance costs increased marginally year-on-year due to the full year impact from the higher cost of the loan notes issued in the summer of 2004 offset by slightly lower average debt, benefiting from the receipt of the rights issue proceeds. The annualised effect of the interest cost of the loan notes was mitigated by maturing interest rate swaps and lower cash deposits held as collateral against finance leases in France during the year.

Net exceptional charges

Net exceptional charges before taxation of €13.2 million have been incurred in the year, summarised as follows:

	€ million
Restructuring	(8.4)
Project termination costs	(3.6)
Centrus receivables provision	3.2
Capital restructuring and rights issue	(4.4)
Total	(13.2)

Restructuring costs of €2.0 million were incurred in the year in connection with the transfer of back-office functions to the shared service centre in Budapest. A further €6.4 million was incurred in relation to a restructuring project commenced in late 2005 covering the roles of the Group's European headquarters, corporate operations, shared service centre and call centres.

Now leveraging shared service centre in Budapest

In 2006, we will accelerate the transfer of back-office activities into the shared service centre in Budapest, which is presently supporting four corporate countries and Group headquarters.



Following the Group's decision in 2004 to terminate the agreement with the principal contractor on the IT back-office project, additional termination costs of €3.6 million have been recognised in 2005, primarily arising from the mitigating action being taken against the termination costs, which may lead to a net credit in future accounting periods.

During the year, the collection of credit hire receivable balances in the Centrus business was more successful than previously anticipated. Exceptional income of €3.2 million has been recognised reflecting a partial reversal of the receivable write-off and reorganisation provisions made in previous years.

Additionally, various professional, legal and consultancy costs have been incurred in the year in conjunction with the Company's capital restructuring and the rights issue. Where such costs are not directly attributable to the issue of new shares, or the drawing down of new debt facilities, they have been recognised as exceptional items.

Certain re-measurement items and economic hedges

The following items have been incurred in the year and are excluded from underlying profit before tax:

€ million	Operating profit	Finance items	Profit before tax
Re-measurement losses on financial instruments	(4.1)	(1.2)	(5.3)
Economic hedge adjustments	(1.2)	2.1	0.9
Foreign exchange gain on borrowings	–	9.6	9.6
Total	(5.3)	10.5	5.2

Net re-measurement losses on financial instruments arise from the recognition in the income statement of movements in the fair value of certain derivatives following the implementation of IAS 39, Financial Instruments: Recognition and Measurement. The Group uses these derivatives to hedge its underlying economic positions, but only applies hedge accounting to

those relationships where it is permissible and practical to do so. Where re-measurement gains and losses on financial instruments are excluded from underlying profit, movements in any economically hedged underlying items are also excluded.

Accounting standards as applied also restrict the recognition of intra-group borrowings as part of a net investment in foreign operations. Foreign exchange on certain intra-group borrowings is therefore recognised in the income statement even though the Group is economically hedged. Changes to these standards that remove these restrictions have been made, but have yet to be adopted by the European Commission. Had these changes been applied, the foreign exchange gain on borrowings could then have been recognised in the statement of recognised income and expense to offset exchange losses of €9.3m arising on translation of foreign operations.

Taxation

€ million	2005	2004
Underlying taxation	10.2	13.0
Taxation charge/(credit) on exceptional items	(1.3)	(16.0)
Taxation credit on certain re-measurement items and economic hedges	2.0	–
Total taxation charge/(credit)	10.9	(3.0)

The effective rate of taxation on underlying profit was 27% compared to 25% in 2004. The increase in the effective rate was primarily a consequence of the mix of profits and losses in different jurisdictions, and restrictions on the ability to recognise deferred tax assets in loss making subsidiaries.

Shareholders' funds

At the end of the year, shareholders' equity was €85.8 million compared with a deficit at the start of the year of €(58.0) million. The principal movement in the year was the €166.2 million net proceeds from the rights issue. This was partially offset by the total recognised loss of €(12.0) million (being the net of a profit attributable to equity holders and the loss recognised in the

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statement of recognised income and expense). The latter was mainly a consequence of the increased pension fund deficit arising on the change in actuarial assumptions.

Cash flow/net debt movement

€ million	2005	2004
Net cash generated from operating activities before taxation	177.8	390.1
Manufacturer re-purchase contracts:		
Payments	1,469.5	1,308.7
Receipts	(1,190.6)	(1,244.5)
Other working capital movements	4.0	–
Adjusted cash flow from operating activities before taxation	460.7	454.3
Net fleet expenditure*	(504.0)	(197.2)
Net non-fleet capital expenditure	(17.6)	(46.9)
Interest and dividends	(60.0)	(94.2)
Taxation	(3.1)	(30.2)
Acquisitions and other	159.0	(5.9)
Reduction in net debt	35.0	79.9
Net fleet expenditure is analysed as follows:		
Net charge to the income statement	(319.4)	(308.1)
Change in closing fleet	(55.0)	10.3
Movement in fleet working capital	(132.3)	98.2
Exchange and other acquisitions	2.7	2.4
	(504.0)	(197.2)

* Net fleet expenditure includes cash flows relating to both vehicles subject to re-purchase agreements and risk vehicles and includes new finance leases of €95.4 million (2004: €69.7 million).

Net debt has reduced at the year end by €35.0 million. Adjusted cash flow from operating activities has marginally increased to €460.7 million, despite cash outflows in the year of €40.0 million relating to exceptional items. A further exceptional item, cash outflow of circa €10 million in respect of current year charges, is anticipated in future periods, primarily in 2006, which will be in addition to cash flows arising from the restructuring programme announced on 15 February 2006.

Total net fleet cash expenditure in 2005 is €504.0 million, €306.8 million above prior year. This is largely a consequence of the reversal of the fleet working capital from 2004, arising from both vehicle manufacturer terms and timing of purchases and sales at the year end, mitigated in part by lower year-on-year average owned fleet levels.

Lower non-fleet capital expenditure was mainly a consequence of significant expenditure in the prior year on the re-engineering back-office activity and hand-held check-in projects.

Interest and dividend payments have reduced on the previous period as a consequence of the prior year including the final dividend of 2003. Taxation cash outflows are reduced as a consequence of the offset or recovery during the year of overpayments made in previous years.

Net debt

€ million	31 December 2005	1 January 2005
Interest bearing assets	113.8	114.3
Debt due within one year	(114.1)	(143.9)
Debt due after one year	(611.6)	(579.2)
Finance leases	(278.1)	(270.6)
Derivative debt instruments	(55.6)	(101.2)
Total net debt	(945.6)	(980.6)

Interest bearing assets were reduced during the year as lower levels of collateral were required in respect of finance lease obligations in France. However, at 31 December a material cash balance was held in anticipation of settling a fleet creditor balance on the first working day of 2006. Debt and finance lease outstandings were broadly unchanged on the prior year, reflecting the benefit from the proceeds of the rights issue during the year offset by the reversal of working capital benefits as described above.

During late 2005, the Group began discussions with its senior banks to examine the opportunities to extend the maturity of its current syndicated revolving credit facility. On 20 February 2006 the Group signed a new five-year facility of €580 million.

Fleet

The majority of vehicles continue to be subject to manufacturer re-purchase arrangements, which guarantee a disposal value at the end of the holding period, thereby reducing the Group's residual value risk exposure. The split between risk and re-purchase vehicles is set out below:

€ million (net book amount)	2005	2004
Risk vehicles on fleet	464.0	423.6
Risk vehicles held for resale	11.1	5.0
Total risk vehicles	475.1	428.6
Manufacturer re-purchase vehicles	882.8	874.3
Total fleet	1,357.9	1,302.9

In addition to the above, there were a further 9,832 vehicles held at the year end under non re-purchase operating leases (2004: 9,227). These leased-in vehicles represent 8.9% of the total fleet (2004: 8.6%).

Pensions

The Group operates both funded and unfunded defined benefit pension and statutory termination schemes, as well as defined contribution schemes.

Funded defined benefit schemes

The principal funded scheme is that in the United Kingdom. The deficit between the market value of all funded scheme assets and the actuarial value of the funded scheme liabilities was €82.1 million (2004: €50.6 million).

The fair value of funded scheme assets has increased €21.7 million (2004: €16.5 million) in the year, primarily as a result of an experience gain on scheme assets of €13.4 million (2004: €2.6 million). The present value of funded scheme obligations has increased €53.2 million (2004: €20.5 million) primarily as a result of actuarial losses of €37.5 million (2004: €3.1 million) arising on changes of actuarial assumptions in the year. The most significant change in assumption is the reduction in the average discount rate to 4.7% (2004: 5.2%) largely reflecting movements in long-term corporate bond yields. Given the increased deficit, the level of the Group's contributions to be paid into the funded schemes in 2006 is expected to increase to €12.9 million (2005: €7.9 million).

Unfunded defined benefit schemes

The principal unfunded scheme is held in Germany. The actuarial value of all unfunded scheme liabilities was €47.2 million (2004: €36.0 million). The increase in deficit is primarily due to an actuarial loss of €8.6 million (2004: €3.4 million), reflecting a reduction in the average discount rate to 4.0% (2004: 4.8%).

The charge in the income statement for defined benefit schemes is €13.2 million (2004: €12.8 million).

Insurance

The Group is legally obliged to provide all customers with insurance against accidents caused to third parties, and cover is also offered against theft and personal accident. Additionally, the Group covers various risks arising in the normal course of its business, including damage to property and general liability. Cover is arranged with a number of major insurance companies of strong credit quality to help spread the risk cost effectively and access the global reinsurance markets.

Accounting standards and policies

From 1 January 2005, the Group is required to prepare Consolidated Financial Statements in accordance with International Financial Reporting Standards ("IFRSs") endorsed for use in the European Union. The Group previously prepared Consolidated Financial Statements in accordance with UK GAAP until 31 December 2004, and the Company continues to do so.

The Group's accounting policies are set out in the Consolidated Financial Statements.

These policies have been consistently applied to both the 2005 and comparative 2004 results, except for those policies relating to the classification and measurement of financial instruments. The Group has made use of the exemption under IFRS 1, First Time Adoption of International Financial Reporting Standards, to only apply IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement, with effect from 1 January 2005.

Martyn Smith
Group Finance Director