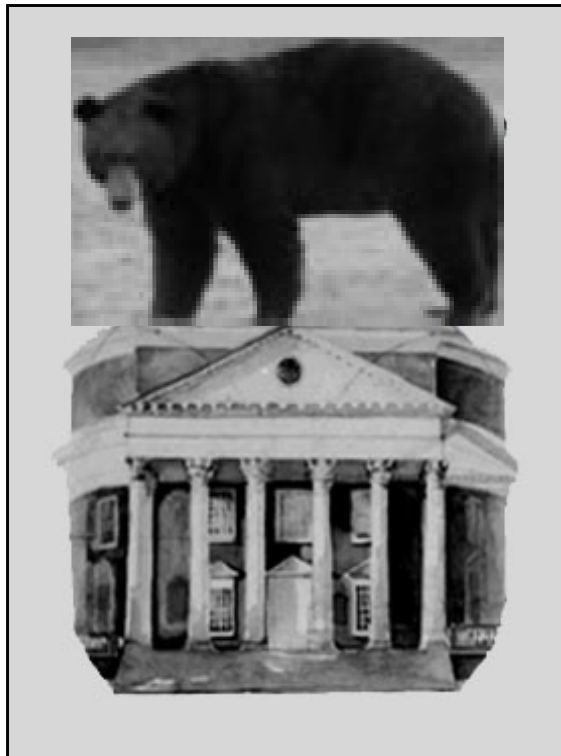


# McIntire Investment Institute

At the University of Virginia



## Short Pitch: Dollar Thrifty Automotive Group (NYSE: DTG)



Prepared by Jon Haas | September 24, 2009

# Outline

- Company Overview
- Stock Analysis
- Thesis Points
- Catalysts
- Risks
- Recommendation
- Q&A



# Overview: Who is Dollar Thrifty?

- Dollar Thrifty Automotive Group rents and leases cars, primarily in the US and Canada
- Two brands: Dollar and Thrifty
- Successor to Chrysler-owned Pentastar Transportation Group – incorporated Nov. 1997
- Locations either company-owned or franchised
- 2 of top 8 brands in rental car industry
- $\approx 12\%$  market share (Hertz, ABG = 30% each)
- Headquartered in Tulsa, OK



# DTG: The Fundamentals

- Price (9/24): \$23.15
- 52 wk: \$0.60 - \$26.38
- Market Cap: \$545.4M
- Beta: 4.48
- P/E: -10.03\*
- EPS: -2.36
- ROE: -19.1%
- Quick Ratio: 0.9
- D/E: 8.07
- Operating CF: \$524.37M
- Levered Free CF: -\$1.04B
- Short Ratio: 4.3
- % $\Delta$  YTD: 2,270%
  - Outperformed S&P 500 and Industry by  $\approx$ 2,200%

→Data from Scottrade



# 52-Week Chart



# Thesis Points

- Little value can be found in the value brand
- DTG-Chrysler: Inferior product from inferior supplier
- Rising expenses, uncollectible revenue, and financing worries plague future operation



# Result:

- Dollar Thrifty experiences further difficulties in a bearish market correction and fails to capitalize on a recovering economy, to the dismay of investors, bringing down this castle in the air



# Thesis Point 1

- Dollar Thrifty lacks a competitive advantage as the value brand
  - Pricing
  - Promotions
  - Customer service





# Dollar Thrifty's Niche

- Value brands in industry
- Bare-bones car rental
  - Cheap nav-systems, no Satellite Radio, no “Fun” cars
- *“Customers who rent from Dollar and Thrifty are cost-conscious leisure, government and business travelers who want to save money on car rentals without compromising fundamental car rental products or services.” (10-K)*
- Company locations focus on air travelers in largest hubs
- Franchise locations capture smaller markets (APO and non-APO, international)







# Pricing

- Dollar and Thrifty prices more or less the same
- Smaller, non-airport locations (franchises) often 0-30% cheaper – less demand
- Weekdays cost more than weekends
- Prices compared at multiple locations through company websites
- **Is DTG really the best choice for cost-conscious individuals and businesses?**



# Dulles Intl Airport, 10/17-10/24

	Economy	Full-Size	Premium	SUV	Minivan
	\$371.60	\$389.92	<b>\$380.74</b>	<b>\$395.88</b>	<b>\$373.20</b>
	<b>\$460.49</b>	<b>\$490.49</b>	<b>\$525.49</b>	<b>\$510.49</b>	<b>\$510.49</b>
	<b>\$232.05</b>	<b>\$248.85</b>	\$496.65	\$504	\$432.24
	\$395.09	\$414.81	\$404.91	\$509.99	\$396.81



# So, You Have Your Heart Set on Dollar-Thrifty...

- What will get you the best price -
- Right before you travel?
  - Less planning, not locked into anything
  - Risk top preferences being unavailable
- Or
- Weeks in advance?
  - Everything is set and ready
  - Risk locking into higher price
- Remember, pseudo-perishable pricing – car can still be rented to someone else tomorrow, but every idle day is a waste



# What Makes Sense for DTG...

- Looking to maximize profits
  - As value brand, some price penetration
- Long-term (1 month+), keep prices “below retail”
  - lock in profit early
  - Forecast demand, available cars, allocation of fleet
- Short-term, adjust based on current demand
  - Lower price to increase demand
  - Incrementally raise to promote advance reservations, feeling that cars are “going fast”



# ...And What They are Actually Doing

Dollar/Thrifty Prices, Washington Dulles Intl APO					
Class	Car (Chrysler)	Price 9/19-9/26	Price 10/17-10/24		Difference (%)
Economy	Aveo	\$ 324.89	\$ 395.09	↑	21.61%
Full Size	Charger	\$ 334.79	\$ 414.81	↑	23.90%
Premium	300	\$ 408.80	\$ 404.91	↓	-0.95%
SUV	Grand Cherokee	\$ 481.47	\$ 509.99	↑	5.92%
Minivan	Caravan	\$ 400.49	\$ 396.81	↓	-0.92%
Convertible	Sebring	\$ 640.90	\$ 899.00	↑	40.27%

\*Prices obtained 9/14/2009



# What the Numbers Mean

- DTG is having significant trouble renting cars
  - Every day a car is not used, it generates no revenue, but just sits in a lot and depreciates
- Customers have a disincentive to plan in advance
- Advance planning very important for vacations, business travel
  - Flying, hotels, itineraries, etc...
- Either plan in advance at higher price or take lower price and risk having something get screwed up
- Pricing policy conflicts with customer's best interest



# Promotions

- All firms – similar pricing promotions
- Hertz – “Green” “Fun” “Prestige” Collections
  - Toyota, Mercedes, Ford Mustangs
- Avis – “Cool Cars” Collection
  - Mustangs, Mitsubishi, Infiniti
- More on cars later...
- Dollar-Thrifty – “Lock Low and Go” “Wild Car”





# Lock Low and Go / Wild Car

- Pay rate slightly lower than Midsize
  - \$381.32 at Dulles, October 17-24
- Dollar/Thrifty picks Midsize or larger vehicle for you
- *“When you arrive to pick up your car, we will pick the vehicle for you: you might get a Mid-size car, a minivan, or an SUV... it's a smart bet!”* -(Thrifty.com)



# Pros and Cons of Wild Car

## PROS

- Better fleet utilization
- Less “I’m sorry, that’s sold out”
- Pay lower fee
- Chance of getting bigger/better vehicle

**Smart Bet. Wild Car™**



## CONS

- Consumers like to know what they’re getting, esp. when vacation planning
- Most likely to get worst car available
- Longer checkout
- Not helpful for specialty needs (ski trips, road trips)
- Positive for DTG is negative for consumers, vice versa
- No “special” vehicles like competitors



# VAR – The Customer Experience

- Suzanne O’Hara – PwC employee, vacationer
- “Loyal Hertz customer”
- Travelled to Chicago (O’Hare) for business – one day rental, not driving clients
- Used DTG not by price, but because all others sold out
- “Industry standard fees”
- Bussed over to rental location
- 5 people in front of her – took 40 minutes – only one employee
- Car “nothing special” “not pristinely clean” “definitely thrifty”
- Again, “took forever” to turn in car



# VAR Cont.

- Customer service “awful”
- “The employees were dumber than tree stumps”
  - No people skills
  - Didn’t seem to know what their job entailed
- Car picked, paperwork at the desk – takes time
- In comparison, Hertz – sign paper, get key, look at board in parking lot, get in car and go
- **“Not the Hertz experience”**



# VAR - Comparison

- **\*\*Let's count out premium Hertz\*\***
- Ms. O'Hara used Enterprise through Geico after fender-bender
  - Spoke to Marion Brakefield @ Progressive – use Enterprise for number of locations and **PRICE**
  - Auto insurance companies are huge customers not using DTG
- Car ready immediately, quick paperwork
- Told her no fees for minor scratches on bumper – “bound to happen”
- “It was a relief” to not worry about this



# Thesis 1 Conclusion

- Dollar-Thrifty fails as the value brand
- Pricing, promotions hold no advantage
  - Work against vacation/business planning
- Unable to present attractive product/service for customers
- Losing out on business with large auto insurance companies, corporations
- Little to no competitive advantage within niche



## Thesis 2

- Dollar Thrifty's binding relationship with Chrysler severely dulls their competitive edge

CHRYSLER



# Chrysler

- We all know what happened to the auto industry
- Bailed out by government
- Declared Chapter 11 in April
- Fiat holds 20%, can up to 35% and eventually 51%
- Very little free cash (obviously)
- Were not producing cars that appealed to consumers (unlike Toyota, for example)





# Dollar-Thrifty and Chrysler

- At least 75% of fleet through 2011
- Historically 75-90%
- Currently  $\approx 76\%$
- As of most recent 10-Q, unsure of when Chrysler will restart production
- Value of Chrysler vehicles impaired
- At year end, DTG owed \$41.3M by Chrysler



# The Fleet

## Cars

- Economy: **Chevy Aveo**
- Compact: **Dodge Caliber**
- Midsize: **Chevy Sebring**
- Specialty: **Chevy PT Cruiser**
- Full-size: **Dodge Charger**
- Premium: **Chevy 300**



## Minivans/SUVS

- Minivan: **Dodge Caravan**
- Mid-Size SUV: **Jeep Liberty**
- SUV: **Jeep Grand Cherokee**
- All-Terrain: **Jeep Wrangler**
- Premium SUV: **Dodge Durango**
- “...or similar”



# Fleet Comparison: DTG v. Enterprise

	Dollar/Thrifty	Enterprise
<b>Economy</b>	Chevy Aveo	Chevy Aveo
<b>Compact</b>	Dodge Caliber	Nissan Versa, Toyota Yaris
<b>Midsize</b>	Chevy Sebring	Pontiac G5/Toyota Corolla/Ford Fusion
<b>Fullsize</b>	Dodge Charger	Chevy Impala, Nissan Ultima, Dodge Charger
<b>Specialty</b>	PT Cruiser	N/A
<b>Premium</b>	Chevy 300	Nissan Maxima, Toyota Avalon
<b>Luxury</b>	N/A	Cadillac DTS, Lincoln Towncar

	Dollar/Thrifty	Enterprise
<b>Minivan</b>	Dodge Caravan	Chrysler T&C, Dodge Grand Caravan
<b>Midsize SUV</b>	Jeep Liberty	Ford Escape, Jeep Liberty
<b>All-Terrain</b>	Jeep Wrangler	N/A
<b>SUV</b>	Jeep Grand Cherokee	Chevy Trailblazer
<b>Premium SUV</b>	Dodge Durango	GMC Yukon, Chevy Tahoe, Ford Expedition



VAR – You!!!



# Round 1 - Compact



- \$417.04/week
- Dollar-Thrifty
- Dodge Caliber



- \$232.05/week
- Avis
- Chevy Cobalt



# Round 2 - Premium



- \$380.74/week
- Enterprise
- Toyota Avalon



- \$404.91/week
- Dollar-Thrifty
- Chevy 300



## Round 3 - SUV



- \$449.90/week
- National
- Chevy Trailblazer



- \$509.99/week
- Dollar-Thrifty
- Jeep Grand Cherokee  
Laredo



# More Issues With Chrysler

- Auto market has shown the lack of appeal of Chrysler vehicles
- Compare: Toyota, Honda, Volkswagen
- Resulted in crash of company, restructuring
- Ignoring this, DTG has only 1 main supplier – bad position to be in
- ABG, Hertz, etc... have multiple suppliers





# Thesis 2 Conclusion

- DTG's relationship with Chrysler debilitates future value creation
- Inferior product (and price) v. competitors
- Unstable and uncertain supply
- Impaired value of fleet
- Tied down to only one supplier
  - No tangible results from announced deals with Ford, Hyundai



# Thesis 3

- Rising expenses and uncollectible revenue counteract growth from recovering economy



# What's a Program Vehicle?

- Pay higher price, manufacturer promises guaranteed buyback after one year
- Non-program – lower price, rental co. puts fleet on auction, in used car market
- DTG has approx. 35% Program w/ Chrysler (10-K)



# Program Cars

## Benefits

- Low selling risk
- Predictable depreciation
- Easier forecasting

## Drawbacks

- Higher upfront investment
- Must deal with receivables
- Can get better price in seller's market

# Non-Program Cars

## Benefits

- Lower purchase cost
- Easy to sell in good market
- Not restricted by time constraints

## Drawbacks

- Bad selling market means cars depreciate longer
- High selling risk
- Harder to forecast expenses



# Chrysler...Again

- Recent reductions of program vehicles
- Chrysler already owes around \$41.3M
  - Remember – Program cars involve receivables
- Value of vehicles impaired as uncertainty about Chrysler continues
- Depreciation is largest expense for DTG, industry



# Revenue

- Effects of down economy are obvious
  - Less travel, but more value-consciousness
- Several factors will impede DTG in recovery
- Little gain from increased business travel
- Higher consumer confidence, leisure travelers “treat themselves”, use Avis, Hertz, etc...
- Used car buyers upgrade to new cars
- Closed locations/franchises don't generate revenue, need capital investment to reopen
- XL Leisure Group PLC, large UK tour company and DTG customer, now bankrupt
  - \$5.5M bad debt expense
  - DTG has little presence with business, auto insurers – focuses on leisure travel



# Writeoffs, Impairments, and Other Stuff That Made You Hate 201

- Recorded goodwill/impairment charges of \$363.1M
  - Goodwill impairment  $\approx$  280M
  - Reacquired franchise rights impairment = 69M
  - IT initiative writeoff = 10.5M
  - Impairment of Canadian assets = 6.1M
- Bad debt from XL Leisure
- How much more from Chrysler?
- Almost doubled Allowance for Uncollectables



# Expenses

- Expenses actually increased last year
  - “higher transaction costs, offset by less transactions”
- Where are cost-cutting initiatives?
  - Less advertising, workforce, outsourcing
- Depreciation expense, impairment of Chrysler vehicles
- Restocking fleet for recovering economy requires lots of capital, debt





# Liquidity and Financing

- Required to maintain >\$100M cash → not free
- \$1.84B in debt
  - Remember fundamental numbers from before...
- Huge interest payments on this debt
- Need financing (through debt) to increase fleet in preparation for upturn, re-expand business
  - “access to cost-effective financing will continue to be limited” (10-Q)



# Thesis 3 Conclusion

- DTG unable to take advantage of recovery, revenue fails to meet expectations
  - Further impairments and uncollectables
- Further issues with Chrysler, failure to implement long-term cost-cutting raise expenses
- Both further affected by precarious financial/liquidity situation
- Profitability, ratios, etc... hurt – scares the Street



# Catalysts

- Short-term - bearish correction scares investors
  - Negatively affects performance, hurts 3Q results
- Long-term – recovering economy
  - Further complications with Chrysler surface
  - Leisure travel increases, but remain value-conscious
  - Depreciation expenses rise
  - Limited access to financing hinders re-expansion
- 3Q (and 4Q) reports don't impress the Street



# Risks

- Chrysler steps up its game, pays receivables, buys program cars, offers competitive fleet
- Leisure travelers continue to perceive DTG as value brand, (cost-conscious) travel increases
- Used car market stays stable – upgrades and downgrades
- Depreciation expenses kept to minimum
- Improved access to financing



# Risks – Contrarian VAR

- David Crowther – VP, Investor Relations at Avis Budget Group\*\*\*
- New management team (most <1 year) doing the right things
- Looking to increase profitability, not necessarily market share
- Maintaining strong position in niche of leisure, small business travel
- Large amounts of cash ( $\approx \$8$ /share)
- Stable used car market – in bull, 2- and 3-year used buyers upgrade to 1 as 1-years go to new
- Thinks DTG was incredibly undervalued before its huge jump
  - ...but so was everyone else in March



# Risk #1 – Macro

- Despite the multiple highlighted flaws and incredibly inflated stock price, a national or global economic recovery will lead to more travel, especially leisure
- People who skipped their annual family vacations are sure as hell going to do it this year
  - Higher consumer confidence, job security
- More business for industry means improving results for DTG, no matter the issues at hand
- Could raise stock prices of industry even higher



# Recommendation

- Depends on MII's macro outlook, risk propensity
- 3 alternatives to consider:
  - Short
  - Pair trade
  - Straddle



# Equity Investments

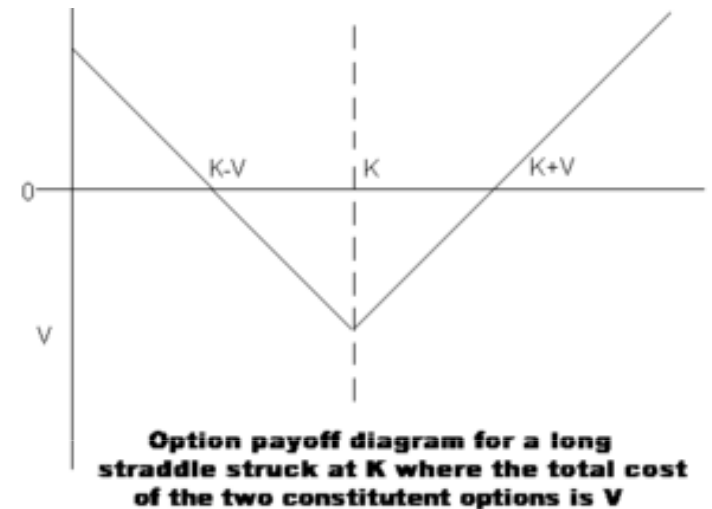
- Short
  - Get in now, scale up or down after observing market
  - No hedge against macro
- Pair Trade
  - Hedges out industry risk
  - Who do you pair with?
  - Would make for a good pitch, Analysts...





# Other Options...

- Quick derivative lesson
- Straddle
  - Buy both call and put, same strike price
  - Upside unlimited (bull), 100% (bear)
  - Downside is sum of premiums, at strike price
- DTG flaws win out, price drops, we profit (exercise call)
- Macro wins out, price rises, we profit (exercise put)
- Profit if change in stock price is greater value than premiums
- Good choice if we expect volatility, unsure of direction
  - Beta = 4.48



# Final Recommendation

- Short makes sense from analysis, but recovering economy makes this very risky
- I would recommend a pair trade – hedges industry risk and doesn't involve options
- Depending on MII's ability/willingness to trade options and current option prices, the straddle is certainly something we should consider
  - I would be very surprised if DTG suddenly stabilizes



# Disclosure

- I do not own DTG (no margin account)
- I interned at Avis Budget Group this summer doing accounting
- I do own Avis Budget Group (CAR) as a long, which I invested in prior to interning



# Questions?

Thank you for being a great audience!

