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HTZ.OQ - Q4 2021 Hertz Global Holdings Inc Earnings Call

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PRESENTATION

Operator

Welcome to Hertz Global Holdings Fourth Quarter and Full Year 2021 Earnings Call. (Operator Instructions) I would like to remind you that this afternoon's call is being recorded by the company.

I would now like to turn the call over to our host, Johann Rawlinson, Vice President of Investor Relations. Please go ahead.

Johann Rawlinson

Good afternoon, everyone, and thank you for joining us. By now, you should have our press release and associated financial information. We've also provided slides to accompany our conference call that can be accessed on our website.

I want to remind you that certain statements made on this call contain forward-looking information. Forward-looking statements are not guarantees of performance and, by their nature, are subject to inherent uncertainties. Actual results may differ materially. Any forward-looking information relayed on this call speaks only as of this date, and the company undertakes no obligation to update that information to reflect changed circumstances. Additional information concerning these statements is contained in our earnings press release and in the Risk Factors and Forward-Looking Statements section of our 2021 Form 10-K available from the SEC and on the Hertz website.

Today, we'll use certain non-GAAP financial measures, which are reconciled with GAAP numbers in our press release. We believe that our profitability and performance is better demonstrated using these non-GAAP metrics. All comparisons discussed will be against 2019, unless stated otherwise because we believe it provides a more relevant benchmark given the unusual impact of COVID-19 on our business in 2020. For comparisons to our 2020 results, please refer to our press release and 2021 Form 10-K. Comparisons will also exclude the effects of the Donlen Fleet Leasing and Management business we sold in March 2021.

Our call today focuses on Hertz Global Holdings, Inc., a publicly traded company. On the call this afternoon, we have Mark Fields, our Interim Chief Executive Officer; and Kenny Cheung, our Chief Financial Officer. I'll now turn the call over to Mark.

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Thanks, Johann. Good afternoon, everyone, and welcome to our fourth quarter 2021 earnings call. I'm very excited to speak with you today as we reflect on a very transformative year and contemplate an exciting road ahead for Hertz.

On today's call, I'll be providing a high-level review of our business initiatives and an update on our strategic initiatives. Kenny will then provide a review of our financials before we open up the call for Q&A.

Before I begin, I'd like to take a moment to recognize some exciting news around our search for a world-class permanent CEO. As we announced a few weeks ago, we're pleased to welcome Stephen Scherr to the Hertz family as CEO effective February 28. We're thrilled to have someone of his caliber taking the reins and to continue Hertz' commitment to being at the center of the modern mobility ecosystem. Stephen was Chief Financial Officer of Goldman Sachs. And in that role, he developed and led Goldman's all-digital consumer banking business, which was built to enable customers to save, borrow and spend on a clean digital platform.

I plan to work closely with Stephen to ensure a smooth transition, and I very much look forward to staying involved with Hertz in my capacity as a member of the Board of Directors.

I would also like to start off by recognizing the very hard work and efforts of the entire Hertz team that enabled us to report these results to you today.

Now turning to our results. Sustained structural improvements on both the top and bottom line contributed to a strong performance. Monthly revenue per unit rose 31% from the fourth quarter of 2019, driven by a 35% increase in revenue per day. We maintained discipline in our fleet planning and our pricing. We aligned our fleet below demand, and we did not chase unprofitable business.

Our fourth quarter adjusted corporate EBITDA exceeded guidance. We achieved a record first -- record fiscal year of adjusted corporate EBITDA of $2.1 billion and a margin of 29%, which resulted in adjusted earnings per share of $4.39. Our leaner cost structure also contributed meaningfully to our results.

We previously mentioned that we've realized $300 million in annual cost savings, and our results this quarter reflect just that. We're becoming more efficient and agile. And as a result, we're a healthier, stronger business.

During the quarter, we unveiled how Hertz is positioning itself at the center of the modern mobility ecosystem, announcing transformative initiatives with Tesla, Uber and Carvana. We also completed a listing through a secondary offering of our common stock that now publicly trades on the NASDAQ Global Select market, as do our warrants. We redeemed $1.5 billion of preferred shares for less than the 30% premium originally contracted and are currently executing on a Board-approved $2 billion share repurchase program which is incremental to the $300 million repurchase in conjunction with the NASDAQ listing.

As you can see, it was a busy but exciting quarter for our business.

Last fall, we did lay out 5 key priorities that would serve as the foundation behind everything we do to position Hertz for long-term success. And as noted on Slide 7, these priorities include excellence in executing on the fundamentals, committing to a customer-first mentality, innovating relentlessly, leading in the adoption of electric vehicles and investing in our future. Our teams around the world are guided by these priorities, and they act as a driving force behind the execution of our key strategic initiatives, which are summarized on Slide 8.

Now bottom line is we're positioning ourselves at the center of the modern mobility ecosystem and discuss this in the context of our recent partnership with Tesla, Uber and Carvana. So let me take you through a few highlights on the progress that we're making with these partnerships.

First, Hertz customers can now rent Teslas in multiple major markets across the United States including, but not limited to, Atlanta, Fort Lauderdale, Los Angeles, Orlando, San Francisco and Washington, D.C. Initial learnings from this rollout have been invaluable, and we're already starting implementing them into our standard operating procedures. For instance, on-site customer training is proving to be very important. Our website and app have an expedited EV rental booking process and include digitized guidance to educate customers about the EV to get them on their way quickly.

We're currently ahead of plan in building out our charging infrastructure. We have over 700 Level 2 chargers installed across 65 markets globally. Our purpose-built infrastructure consists of charging stations across airport, suburban locations and shared mobility rental locations. And we are accelerating our plans to install Level 3 DC fast chargers into our top markets in 2022.

As we've explained, a significant number of our Tesla electric vehicles are dedicated to our strategic initiative with Uber. We're seeing strong driver interest, and participating drivers are generating higher earnings. The program has launched in over 30 markets including, but not limited to, Los Angeles, San Francisco, Chicago and Atlanta. As we grow the EV fleet and continue to build out our infrastructure, we're committed to being an agile and always-learning team. These learnings will improve our operations and, in my view, will give us a huge competitive advantage in the industry. We've seen several of our OEM partners announce EV launches in the coming year, and we're having active ongoing discussions with our OEM partners and evaluating all available models for inclusion into our fleet.

Our partnership with Carvana is exceeding initial expectations as we work to revolutionize fleet management. Leveraging Carvana's customer dedication, technology and nationwide first-party network allows for a more efficient direct-to-consumer sales channel, providing Hertz the opportunity to increase its retail-focused disposition channels. We are ramping up the program with several thousand vehicles listed on the Carvana platform which are converting very well into sales. As we mentioned in conjunction with our listing, all of these initiatives that I just went through remain margin accretive relative to our view of our normalized earnings power.

Our ability to execute effectively on each of these initiatives is, of course, highly dependent on a skilled and motivated workforce. Given the current challenges in the U.S. labor market, this has never been more important. And recognizing this, we recently began implementing a series of further enhancements to our workforce hiring and retention practices to ensure we have the right people in the right place at the right time. These include the use of analytics for local pay and competitive benchmarking, leveraging technology to improve the candidate experience during the interview and communication process and more closely aligning workforce planning to fleet fluctuations.

In addition to supporting employees, Hertz is prioritizing being environmentally conscious on our path to lead the future of mobility. We're actively working towards establishing short- and long-term science-based greenhouse gas emission reduction targets. Ongoing investments in growing our global EV fleet and robust charging infrastructure will be critical to achieving future targets and improving customers' access to zero emissions transportation options.

Last quarter, we emphasized our focus on modernizing our technological offerings, delivering innovation and growth and connecting our entire fleet. We originally anticipated having a substantial portion of our fleet connected by the end of 2022. However, we're now partnering with a leading telematics supplier and continue to work with various OEM partners where select vehicle models are telematics-enabled from the factory. These developments have accelerated our telematics rollout timing, and we now expect to have a majority of our U.S. fleet connected before the end of the summer. To make that data then work for us, we've also developed and implemented a technology platform that ingests data from these connected cars to promote fleet and operational efficiencies. Amongst others, this data can tell us where a car is, if it moves to a location it should not be in, the charge level of the vehicle's battery or triggering of the engine service indicator. We expect this data to further improve fleet efficiency and reduce our operating costs.

On the international side of the business, we recently invested in an early-stage company with a customer-centric platform built around a fully digital EV rental experience. The technology is supported by a fleet management system to assist in the deployment and management of our EV fleet, which, combined with Hertz' in-house initiatives, could ultimately be scaled globally. These efforts will further our capabilities to leverage the best of transportation and logistics management alongside a strong digital backbone.

We're also busy with several initiatives that we believe will enhance the customer experience and streamline the car rental process. These include a touchless experience for renting vehicles and enhancements to the Hertz mobile app. Hertz customers will start to see improvement with the app by next month, and an iterative series of enhancements will follow through the rest of the year. This will allow us to deliver more personalized customer experience to help us attract and retain new customers and drive loyalty. We've expanded our customer experience team to better coordinate and oversee these activities. And as I mentioned earlier, taking a customer-first approach is central to how we run the business.

Finally, before turning things over to Kenny, I want to update you on what we're seeing thus far in 2022. The Omicron variant brought a new wave of cases and had a near-term impact on the travel industry. Throughout this period, the industry has remained fairly disciplined. The weakness we saw was localized to January and the first half of February. Industry pricing for the remainder of the quarter is significantly stronger than the first half of the quarter. As a result of this relative industry discipline, the recovery has been swift. And Kenny will provide more specifics on this in a few minutes.

As a reminder, our 2021 results were heavily driven by leisure travel demand in the U.S. The rebound for international leisure inbound and business travel has yet to take shape, but we stand ready. Business travel tends to be more concentrated towards the beginning and middle of the week, which is where our utilization rates are currently at their lowest. The return of business travel is expected to improve revenue per unit as midweek utilization rates improve.

On the fleet side, we're still experiencing a constrained supply of new vehicles, and the Manheim data for December showed that units of inventory were still down over 20% compared with 2019. We expect that the vehicle shortage will persist for several quarters to come. We believe we're getting our fair share of new vehicles, and we continue to supplement the fleet with good quality preowned vehicles. In light of these conditions, we've maintained strict discipline on fleet size management and pricing. Historically, there was a tendency in Hertz to chase utilization and fleet size, which led to excess fleet and lower monthly revenue per vehicle. Today, we're managing this business differently, and I believe we're a healthier and a more sustainable business as a result.

Looking ahead, in addition to focusing on our key priorities, we will continue to build on our brand strength and global fleet management expertise, combining it with new investments in technology, electrification, shared mobility and a digital-first customer experience. Our key fleet management capabilities will allow us to diversify and profitably grow in new areas of the mobility sector. Bottom line, we have a view on where mobility is headed, and we're very excited on executing on a strategy to put us firmly in the middle of that.

So with that, I'll turn it over to Kenny.

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Thank you, Mark, and good afternoon, everyone. During our last call, I talked about our strategy to deliver profitable growth, including, first, optimizing our market segment and network distribution to drive business improvement; second, managing our fleet capacity with rigor and discipline; and third, continued execution on productivity.

As we discussed around the time of our listing last year, our focus on enhancing the top line, combined with the cost discipline, has had a positive impact on our earnings. Structural revenue improvement in RPU and $300 million in considerable cost reductions are management actions which have resulted in a healthier, more profitable business. We have significantly transformed our business since 2019.

Turning to Slide 11. In Q4, we remained focused on our plan and delivered strong results. We recorded $0.91 adjusted diluted EPS, $628 million in adjusted corporate EBITDA, and EBITDA margin of 32% and adjusted free cash flow of $509 million. RPU was a fourth quarter record and increased 31% from the fourth quarter of 2019. The key driver for the RPU increase was RPD, which increased 35% from the fourth quarter of 2019. Monthly depreciation per unit came in slightly better than guidance at $57. We ended the year with liquidity of $3.2 billion, which was ahead of our guidance after adjusting for the redemption of our preferred share and common share repurchases, both which I'll cover in more detail shortly.

Adjusted operating cash flow for the quarter was $573 million or 91% of adjusted corporate EBITDA, and we expect that ratio to be around 90% going forward.

In the fourth quarter, we continue to demonstrate how management actions such as corporate contract changes, segment mix optimization and furthering the sale of ancillary products contributed to increasing RPU. Our total RPU for Q4 was $326 higher than the same period in 2019, driven by a combination of management actions and market forces. As I mentioned, monthly depreciation per unit was $57 during the quarter, slightly better than our guidance range of $60 to $70. This is a result of today's strong market for used cars, which has 2 principal effects on our income statement: first, lower growth depreciation expense on our vehicles; and second, gains on vehicle disposition.

Let me take you through this in a bit more detail. Gross depreciation is simply the recorded depreciation of our vehicles while they are in our fleet. Broadly speaking, the gross depreciation rate at any given time is the difference between our book value and expected disposition value, divided by our anticipated hold period. The starting vehicle value is our acquisition cost, and book values reflect periodic depreciation as the vehicle is utilized in our fleet. When used vehicle price rises, so do our expected disposition values. When this happens, the gap between our book value and disposition value closes, and our anticipated gross depreciation falls. We have seen this trend reflected in our results over the past few quarters. Lastly, when we sell a vehicle above its depreciated book value, we recognize a gain, which offsets the gross depreciation expense in our income statement.

Given the continued strong residual values, there are vehicles for which our current book values are below expected selling prices. We call these fully depreciated vehicles. Because we do not record any further depreciation on these vehicles, their presence and the presence of near fully depreciated vehicles as well reduces our average depreciation rate and skews the fact that there are many cars within our fleet on which we are experiencing more normal growth depreciation. When these vehicles are sold, the resulting gains on sale further net depreciation, amplifying this effect.

In Q4, we booked $224 million of gross depreciation expense and $146 million of net gain on sale, resulting in the $78 million that you see on our income statement. Keep in mind that we rotate more vehicles out of the fleet in our Q4 and Q1 trough period. Thus far, in 2022, we are continuing to see residual value strength and generating exceptional gains. Given these dynamics, again, the strong residual environment and the heightened frequency of outsized gains on sale, we expect Q1 depreciation to actually be a gain or a negative expense of $40 to $50 per vehicle per month.

Looking beyond Q1, we expect these factors to abate. As we fleet up for our spring and summer peak seasons, we will be rotating more expensive cars into the fleet, and both our number and proportion of the fully depreciated vehicles will decrease. As such, we expect monthly depreciation per unit to increase sequentially throughout the remainder of 2022, normalizing towards the end of the year.

Given how strong the used car market is, investors are rightly focused on sensitivity to falling residual values over time. First, from a cash flow perspective, the ABS is well funded and has an equity cushion of over $2.5 billion, which would insulate the ABS from a 25% drop in residuals. Second and critically, we do not think that falling vehicle residuals need to put deflationary pressure on rental pricing. Pricing is fundamentally reflective of supply and demand for rental cars. And as Mark mentioned, we are keeping the fleet supply slightly below expected demand.

Although it is only one single case study, the industry pricing behavior around Omicron is indicative of responsible growth, which is reflecting the world's recovery from the pandemic, but not outpacing it. We continue to expect that Hertz will realize strong RPU, enabled partly by these industry factors, but also evolution in our technology, fleet, ancillary offerings and segment mix. We will continue to be disciplined on pricing.

Turning now to our operating expenses. Continued execution on productivity drove an improvement of DOE, SG&A as a percent of revenue of more than 600 basis points when compared to 2019. As previously disclosed, we implemented a cost reduction in the business which, on a comparable basis, would have enhanced full year 2019 adjusted corporate EBITDA by approximately $500 million if you were to include the impact of lower interest rate on vehicle debt. We expect $300 million of cost reduction to be permanent. Our journey to improve the bottom line is continuous as we seek to optimize business processes and drive operational efficiencies.

In terms of our capital structure and liquidity, our balance sheet remains extremely healthy, and we are well positioned to fund our strategic initiatives, including the share repurchase program, and grow the business as demand fully recovers. During the fourth quarter, we issued $1.5 billion of senior notes in a private offering. We used the proceeds plus cash on hand to redeem all of the preferred shares outstanding at a reduced premium of 25%, achieving a $75 million savings. Redeeming the preferred shares eliminate the 9% dividend and will save the company over $90 million annually -- $60 million annually on a net basis.

At December 31, our corporate net debt position was approximately $550 million, and we have no material corporate debt maturities until 2026. At December 31, our liquidity was $3.2 billion or $4.3 billion when you exclude the capital structure activities. Liquidity is made up of $2.3 billion of unrestricted cash and $925 million under the available first lien RCF. The company established a 10b5 repurchase plan, which allowed us to continue share repurchases within specific parameters during our restricted period. As of February 17, we have executed repurchases amounting to $1.1 billion or 48 million shares. Consequently, we have about $1.2 billion remaining under the $2 billion repurchase plan. We continue to believe the share repurchase plan is an excellent way to return cash to shareholders and simultaneously capitalize on what we consider to be a very attractive buying opportunity.

We believe Hertz' share price is below fundamental value, and that view is based on our high quality of earnings, our strong earnings to cash conversion, our low corporate leverage, the sustainability of underlying fundamentals driving our earnings, pricing discipline and our growth strategy in the context of the EV mobility ecosystem.

Turning now to what we are seeing for the first quarter. Historically, we tend to see a decrease from Q4 to Q1 revenue of about 10% to 15% due to normal seasonality. Based on what we are seeing so far, we expect the quarter to be towards the favorable end of this range. As Mark mentioned, the industry has remained fairly disciplined throughout this period, and pricing for the remainder of the quarter is trending upwards based on our forward bookings.

All indications are the effects of Omicron are behind us, and we feel confident about the remainder of the quarter. As countries reduce travel restrictions, we believe our international inbound segment results will continue to recover. As this is a high-value segment, it will continue to rising global RPU -- contribute to global rising RPU. We expect to continue rebound in business travel to contribute to rising RPU as well.

With that, I'll turn it back to Mark.

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Thanks, Kenny. So I hope from this afternoon's call, it's clear that Hertz has made great strides and that the company is well positioned for profitable growth. Hertz has established strong momentum since its restructuring and listing, successfully executing on the fundamentals and starting to execute on the strategic partnership we have forged with mobility leaders.

Hertz is poised to play a central role in the evolution of the modern mobility ecosystem, leading the electric vehicle fleet transition and creating a digital-first experience for business and leisure travelers around the world. I've been thrilled to have been part of Hertz at such a pivotal time for an iconic brand like ours, and I look forward to staying close to the business as a Board member.

I can tell you that Hertz teams around the world are energized about the future. And together, we look forward to capitalizing on the significant opportunities ahead.

So with that, why don't we open up the session for Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Chris Woronka with Deutsche Bank.

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

Maybe we can talk just for a second about fleet and drill down a little bit into how you think the fleet normalizes in the sense of your typical kind of buying and disposition cadence. Because I know you're a little bit off pace right now in terms of seasonality. Is there any way for us to think about as we get towards the end of the year, can you get back to more of a normal seasonal pattern? And does that allow you to possibly take fewer used cars into the fleet and buy on a more normalized schedule?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Yes. Thanks, Chris. So let me take that first. So just as we've said in the past, from a fleet standpoint, our strategy around fleet, as we mentioned, is to match it to our view of demand going forward. So our approach, maybe in the past has been to have the biggest fleet. Our approach now is to have the most profitable fleet and match it: match capacity to demand.

In terms of the kind of the seasonal pattern, as you know, the industry -- the car industry is still having a lot of significant challenges with the supply chain and making their production schedules. And as usual, just like we do with every OEM, we work with them on that. So part of your question of getting back to seasonality, part of that will also obviously be very dependent on the ability for the OEMs to get back to a normal operating pattern in their plants.

But again, we're going to -- in terms of the fleet, we're going to match the demand. So we can have a lot of pricing discipline. And in the time being, we're taking new vehicles. But also, as Kenny mentioned, we're being very active in high-quality -- purchasing high-quality preowned vehicles to ensure that we have the right fleet for the right level of demand.

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

Okay. Great. Thanks, Mark. Follow-up kind of related to that, which is, obviously, since this whole process began, call it, 2 years ago, you guys had several iterations of what you might look like in the future. But kind of on the demand side, how do you think you look at the world now versus 18 months ago, 12 months ago or 6 months ago? Do you think there's more of an opportunity? Is the size of the pie growing? Or do you think Hertz is just going to take more market share than you might have originally thought?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Well, first off, I would also just -- on your question on market share, our view is making sure we have healthy market share, which means profitable market share. I think in the near to medium term, we're seeing a lot of pent-up demand that was -- it's only exacerbated by Omicron. And I think that's going to bode well for our business because in the short to medium term, I think consumers are in a traveling mood, and that's good for our business.

When we think about the business aspect of our travel in our business, obviously, pre-COVID, it's still down substantially. Importantly, we're starting to see green shoots. We're starting to see -- every quarter last year, we saw a sequential improvement year-over-year in terms of its comparison to 2019 -- was improving. So businesses were starting to travel again. Of course, Omicron put a crimp on that.

But as Kenny mentioned, any increase in business travel is going to be good for our business because that tends to be in the early part of the week where our utilization rates are the lowest. Even if businesses decide to travel less than they did pre-COVID, I think we're well positioned, not only because of what I just mentioned, but also we renegotiated and actually exited a number of unprofitable contracts. And so our actual -- if you look at our business part of our travel, not only was volume up versus 2021, but our rates were up, not only versus 2021, but also versus 2019 because of those actions.

So bottom line is I think in the short to medium term, we're going to see, I think, a bigger pie just because of the pent-up demand. And then going forward, we'll be best positioned no matter where the market goes, given some of the operational improvements that we went through today and also our discipline around fleet planning.

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Yes. Chris, it's Kenny. Just to add to Mark's point, as Mark mentioned, as we implemented structural improvement to our business, we did deliberately walk away from businesses that were not profitable or margin accretive. And so if you think about our fleet versus 2019, on paper, it's down about 30%, but half of that was business that we walked away from. So as a result, because of that, we are now a much stronger business with sustainable earnings, higher margins and stronger cash conversion.

Operator

Our next question comes from Billy Kovanis with Morgan Stanley.

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

Mark, you say Hertz is positioned for the future of mobility. And I don't doubt that, but the truth is, today, Hertz still generates 100% of revenues from car rental, and that's got its own cyclical drivers. Question is, when will some of these long-term initiatives play out in the financials? And on that point, can you point us to that, when we're in a more normalized environment on pricing and fleet cost, what will the new Hertz look like in terms of EBITDA with all the positive actions you guys have taken? Is it closer to $1 billion? Or is it closer to $2 billion? Because I think that's the key debate on the stock, and it's really hard for investors to look past some of these cyclical near-term drivers to focus on the long term. And I'm very excited over the long-term initiatives. I just want to make sure that the short-term normalized EBITDA is under [RT].

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Yes. Great. Thanks, Billy. So on your question around when are these initiatives going to start to bear fruit, I would tell you that they already are, when you look at our initiatives around leading in EVs. Our Tesla business, it's still early days. We've launched in 9 markets here in the U.S. for retail customers to rent vehicles. We're in over 30 markets now with what we call our TNC business, which is basically our business offering the Tesla vehicles to Uber drivers.

And the bottom line is the early -- again, early innings, the demand is very healthy. Retail customers are willing to pay a premium versus the same size as another ICE vehicle. And the customer satisfaction levels are very good. And in the case of Uber, there's strong demand for that. And the good news is, if you recall, we said one of the benefits we thought that would accrue to the Uber drivers is that they would be able to make more money and that is the case. But on both of those, if you recall, when we were going through the road show on the relisting, we said that all of these actions would be margin accretive to the company and be profitable for us and they are, and we plan to build on that going forward. So the simple answer is it's starting now. We're going to build on that going forward.

In terms of what the business is going to look like, on a normalized basis, Kenny, you want to take that?

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Yes. So I think the easiest way to think about this, Billy, is let's take 2019 EBITDA as a "normal year." And so we had $649 million of EBITDA. And to be fair, let's back out Donlen, just to be fair, about $100 million of EBITDA. So you're left with about $550 million of EBITDA. And let's factor in the $300 million of structural cost reduction that we made to our business. And let's also factor in the $95 of RPU benefit and structural improvement for our business as well, right?

So if you do the math, it's $649 minus $100 million for Donlen, plus $300 million plus roughly 600 for the RPU side, you get to a roughly $1.5 billion EBITDA number. And if you do the math, it's roughly a 17% margin business.

I'll say this though. This excludes any of the mobility play that we have with Tesla, Uber and Carvana. This excludes the favorable residual environment that we're currently operating in right now. This excludes any of the favorable market forces that we believe some will actually stick going forward from a pricing standpoint. So again, think of this as right now as the floor and not the ceiling.

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

That's really helpful. Just one quick follow-up. What's the assumption that is used for per unit fleet cost to get to that $1.5 billion in the U.S.? Is it around $250? Or is it based on current market rates?

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

No. Yes, you're spot on. It's based on our historical dep rate was roughly around $300.

Operator

Our next question comes from John Healy with Northcoast Research.

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

I wanted to ask a question or 2 about fleet cost. I would love to get your view on the value of the fleet that you see today versus what it's on the books for. My guess is the gain you'll take in Q1 is probably going to be north of $200 million. So I was just kind of wondering how much more gains are left in the system? And when do those fall off? And when you look at the fleet today, I got to imagine it's a pretty diverse mix of model year vehicles. I guess there's '18s, '19s, '20s, '21s, '22s all in there. So I would love to kind of get your thoughts as you look at '23, how much more will your acquisition costs of your fleet in '23 be compared to maybe what you've seen historically?

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Okay. So let me try to decouple the question and answer it in a few pieces. So I think your first question was, how do you think about the fair market value versus the value of the vehicles on our books. And as I mentioned, right now, the ABS is roughly a $2.5 billion equity cushion. So said differently, if residuals fell on us by 25%, we still wouldn't have any ABS collateral requirement on these vehicles, right?

So -- and that leads me to, I guess, to your second question around the gains. I think -- so John, let me try to answer it this way. And I think this may help you think through our gains going forward, right? So let me take Q4 as an example and bifurcate and dig a bit deeper on the $57 of dep rate. And I think that would -- I think, John, that would help you think through the remainder of the year.

So as you think about the $57, there is the gross depreciation piece of it, right? That's roughly blended right now as of Q4, $160 per month per car. And if you split up the $160, you have a meaningful amount of cars that are fully depreciated, right? So they're deping at almost 0 at this moment. The rest of the vehicles are actually depreciating closer to historical norms of roughly $300. So again, $0, $300, blended, $160. That's a gross line of the house.

The second piece is the gains line, which you asked about. Right now, per vehicle, we have roughly $103 per car of gains per month. So $160 minus the $103, that's the $57. Most of the $103 per car gains are driven by the fact that we have these fully depreciated assets on our books. So as these cars rotate out of our fleet, the gains will surely decrease, right? And then the gross depreciation line will normalize towards that $300 of monthly depreciation, which we've seen in the past, call it, 5 years.

One caveat, though, right? The $300 is on a like-for-like basis. There are factors that will impact depreciation such as fleet cost, such as hold period, fleet mix and market residual values. So you can expect the gains to narrow throughout the rest of the year, especially as these 0-dep cars are out of our fleet and then you expect to normalize gross depreciation to be close to $300.

And I think the other piece is thinking about the relationship between residual value gains and then purchase price, right? I think we all know versus 2019, residual value has risen 25% to 30%. But right now, my other vehicles that are not fully depreciating are still deping at $300. So the reason why is because, usually, purchase price and residual have a direct correlation. Therefore, the glide path of depreciation doesn't get impacted.

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

No, that's helpful. And I guess just a follow-up on that. Is there a way to think about how much different the '23s might cost you versus what you've had in the past? As you look at just retail prices, what the dealers are putting up, it seems like those prices wouldn't necessarily compare to what you've seen historically and what you've purchased cars for. I guess my question is, is that $300 a month number, is that still a relevant number as we look to '23 and beyond?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Well, I think -- I wish I had a good crystal ball on this, but this is -- it's going to be market driven. And so we'll work with our OEM partners. I would just say whatever that market price is that we would be offered would be offered to our competitors as well. So it would be relatively not a big impact on the industry, at least between competitors. But tough to -- and as you know, it's tough to predict the market pricing, particularly in this environment as the OEMs kind of work through their supply chain issues and then have to, first and foremost, restock their retail network before they get to us.

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Yes. I won't comment on (inaudible) depreciation of 1.25% to 1.5% is kind of how we've modeled it ourselves.

Operator

Our next question comes from Ryan Brinkman with JPMorgan.

Ryan J. Brinkman - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

First, I wanted to ask on the partnership with Tesla, including how many vehicles you may have purchased from Tesla so far, how many you hope to or expect to take delivery of this year or in total by the end of this year. And also, are you able to comment at all on like the trend in revenue per day or per unit so far for your Tesla vehicles relative to your fleet average? Are you seeing maybe any trends in demand for renting electric versus ICE vehicles from leisure versus commercial customers, for example? I'm not sure if maybe corporate customers might like to see their employees rent EVs when possible to better pursue their ESG initiatives? Or just anything else to keep in mind.

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Yes. Thanks, Ryan, for that question. So I won't get into specific numbers on Tesla, just like we don't get into specific numbers with any of our OEM partners. Suffice it to say that, as I mentioned, the launch is going very well. I mentioned we were in 9 markets here in the U.S. where -- for retail rental. We're in a couple of markets like Germany, Italy and France in Europe. And the demand is good. There is a premium that customers are paying versus, as I mentioned, a comparably sized ICE vehicle, and the satisfaction is really good. Combine that with the demand we're seeing from the Uber drivers and the fact that they're making more money, we're very bullish on our ability to grow this business as the vehicles are delivered to us.

And the bottom line is vehicles are flowing. We -- I think I mentioned in my remarks, we're actually kind of front-loading our charging infrastructure rollout. We're now in 65 markets with, as I mentioned, 700 Level 2 chargers so we're anticipating to further rollout as we continue to get vehicles delivered from Tesla. But we're quite pleased with the rollout.

And to your question around kind of leisure and business travelers, the simple answer is yes. We're seeing that there's -- customers are very excited and happy about their experience renting a Tesla from Hertz, and they're willing to pay for it. And encouragingly, in the early stages of the recovery of business travel, we're seeing corporate business travelers actually take a lot of interest in having their business travelers rent an EV from us.

Ryan J. Brinkman - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Very interesting. And I heard you mentioned a very strong 90% conversion of EBITDA into FCF, at least for this year. Can you maybe talk about some of the puts and takes there? I imagine you may be benefiting from the improved loan to value of the existing fleet given the strong used car price environment, thereby allowing you to perhaps grow the fleet in unit terms without additional dollar investment, right, sort of benefiting FCF. Is that the case? And for how long would you expect that dynamic to persist? And how should we maybe think about FCF conversion thereafter?

Kenny K. Cheung - *Hertz Global Holdings, Inc. - CFO & Executive VP*

Yes. So just a correction, it's 90% to OCF, so it's operating cash flow, right? So that's the stat that we're referencing. So that walk is EBITDA. And then you have a bit of working capital, which again, given the fact that we're healthier from an infrastructure standpoint and a footprint standpoint as well as the fact that we are generating high RPU, the drag from working cap is just less, right? So that drives the 90% OCF conversion.

On FCF, I won't give a lot of details in terms of the -- how many cars we're buying, selling, et cetera. But I will say this, right, the net fleet growth line on a single core unit economics, right, the [buying and purposing is self-funded,] given the fact that we have equity, that gets [on track] with several vehicles. However, as I mentioned in my prepared remarks, we are rotating our fleet right now, and that will have a cash need from a net rebill standpoint. So obviously, it will impact us, yes.

Ryan J. Brinkman - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Okay. Perfect. And then just my last question is on the allocation of that cash flow, of which I expect share repurchases to take up by far the lion's share, including for all the reasons that you mentioned towards the end of the prepared remarks there. But I saw the UFODRIVE announcement and while small in the context of your ample FCF, I'm just curious, are there many other similar opportunities for investment? Or what other M&A opportunities could be out there?

Of course, car rental itself is already highly consolidated, but I'm not sure if there are maybe certain currently outsourced functions you could insource or maybe you might look to grow via organic or inorganic investment to maybe offer for third-party certain functions you do today, like fleet management or, for example, selling -- would you ever sell vehicles in your retail stores that are not coming out of your fleet? Or capitalize upon your already vertically integrated direct to dealer auctions to maybe stand between buyers and sellers of auction vehicles? Or just anything else? Maybe it would all make sense to just keep hammering away at the repurchase given where the share price is, but just curious what other priorities or opportunities you feel might be out there.

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Thanks, Ryan. So first off, I would just characterize our growth strategy as not dependent on significant M&A. We think we have lots of ample opportunity to grow, given our strategic initiatives that we've outlined. That being said, we're always going to be looking for interesting tuck-in types of M&A that could further our strategy and give us opportunities to further grow.

I do think other things we're doing in the business that we've talked about in the past, we're investing a significant amount of money in our IT infrastructure. We're doing it in a different way than we've done in the past, different tasks. We tried to boil the ocean all at once. Now we're being very targeted and have business owners for each one of these investments. But I think the good news is given our business performance and given Kenny's comment around what we see as the free cash flow conversion, it's going to give us lots of opportunities to look at many of the things that you just mentioned, and that will be an ongoing process.

Operator

Our next question comes from Brian Johnson with Barclays.

Brian Arthur Johnson - *Barclays Bank PLC, Research Division - MD & Senior Equity Analyst*

I just want to talk a little bit about the corporate travel. You talked about the trends, the impact on midweek utilization that would clearly help the RPU metric, which we appreciate.

But in Avis' results, they talked about a bit of a headwind from corporate. And drilling down, it seems in particular that there are large corporate travel accounts that have rates that were negotiated pre-COVID, pre chip shortage, so hence, are significantly under the retail market more so than the typical arbitrage. Can you give us a sense -- you do talk about that roll-off of unprofitable contracts during the restructuring -- about whether you face the similar kind of issues vis-a-vis those large contracts?

And then just as a follow-on, how the Amex Global GBT relationship would play into that? Particularly, do you have more pricing leverage with SMEs? And the large corporates that -- did note that 75% of the big 4 or big 3 accounting firms, however many left, are using GBT. My impression is they would still have the contract rates as opposed to the Global Business Travel rate. So maybe talk about that aspect of corporate pricing.

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Yes. Thanks, Brian. Good set of questions. So on our corporate contracts, I can't speak to what our competitors are facing. I can just kind of speak to what we're seeing. And as we mentioned, obviously, we -- during our restructuring, we were able to either exit or renegotiate almost all of our contracts. So at the highest level, we view as corporate and business travel returns, that's going to be a favorable tailwind for us because, as you know, and as we mentioned, they tend to travel in the beginning of the week where our utilization is low, so that will improve our revenue per unit quite substantially.

In terms of what's going on with SME and large corporates and Amex, first off, as you know, our partnership with Amex is extremely important to us. And we expect to grow our share versus historical levels, and we're starting to see that. When it comes down to kind of SME and large corporates, I won't get into too much details, but on SMEs, the rates are more attractive, which is good as they start coming back to the market and traveling. And on the large corporates, what they provide us is not only volume but also stability. And then when you combine that with the fact we've renegotiated all those contracts, I think we're quite pleased with that business coming back as it comes back over time. And even if it doesn't come back to the levels that it was pre-COVID, we're still going to be in pretty good shape.

Brian Arthur Johnson - *Barclays Bank PLC, Research Division - MD & Senior Equity Analyst*

And just a quick follow-on. I get the utilization point in terms of overall days, but as our business travels often took us to the Hartfords, the Indianapolis, the Columbus, Ohios, which are not Miami, Los Angeles, Denver, Phoenix or other vacation spots, so how does the utilization impact of corporate change when you need more cars at those kind of mid-tier business airports?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Well, that's normal course of business for us, right, as we manage our fleet. And to that end, I think when you look at some of the examples, and I think I mentioned this in my prepared remarks around better managing our fleet to demand, things like telematics that we're putting into our business, I mean that gives us a lot better data in terms of availability of our vehicles and be able to match that to forward bookings and manage our fleet to where the customers are. So -- and that's also part of the investments, as you know, Brian, we've mentioned in the past that we're making in our IT infrastructure to continue to improve our fleet and revenue management.

Operator

Our next question comes from Stephen Grambling with Goldman Sachs.

Stephen White Grambling - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I'm sure that Stephen Scherr will want to provide his own thoughts on the strategy and financials of the company and what drove him to the role next quarter. But I'm curious from a Board standpoint, what aspects stood him apart from others you looked at, recognizing maybe his reputation precedes him, and how that might impact the strategic direction, if at all, for the company?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Great. Well, first off, as I mentioned, we're very excited to get Stephen on board. Listen, what Stephen brings is not only great kind of strategic skills because he ran Goldman's strategy for quite some time. He's also an operator as well, having basically started up and led the consumer banking business for them in markets. So we think both of those things are quite important skills as we look at navigating the future here at Hertz. And as I mentioned, he's very supportive of the strategy. And as I said, like every CEO, they're going to come and bring their perspective, but it's not going to be a student body left, it's going to be about building on the momentum that we have going forward.

Stephen White Grambling - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Great. And then there's an unrelated follow-up. You mentioned that you want to be the most profitable fleet, not the largest fleet. How do we think about how that plays out from a competitive standpoint if peers are more willing to add supply faster? And are there scale benefits that could theoretically drive more aggressive pricing? Or perhaps asked another way, what dictates pricing more, macro or competitive dynamics?

Mark Fields - *Hertz Global Holdings, Inc. - Interim CEO & Director*

Great. Well, I think from what you're seeing in the marketplace right now, the pricing is really delivered -- being driven by supply and demand. And to your point around, let's say -- again, I can't speak to any of my competitors, this is really about our strategy of matching capacity to demand. I do think that for the foreseeable future, it's going to be very difficult for any rental car company to fleet up substantially. And that's driven by the production issues you're seeing at OEMs, et cetera. So I think that's a bull case, if you will, around the pricing environment going forward, at least in the near to medium term.

Operator

This concludes the Hertz Global Holdings Fourth Quarter and Full Year 2021 Earnings Conference Call.

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