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HTZ.OQ - Q2 2023 Hertz Global Holdings Inc Earnings Call

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OVERVIEW:

Company reported EBITDA of $347 million, margin of 14%, SG&A of $500 million, debt of $2.6 billion, available liquidity of $1.4 billion, cash of $682 million.

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PRESENTATION

Operator

Welcome to Hertz Global Holdings Second Quarter 2023 Earnings Call. (Operator Instructions) Following management's commentary, we will conduct a question-and-answer session. I would like to remind you that this morning'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 - *Hertz Global Holdings, Inc. - VP of IR*

Good morning, everyone, and thank you for joining us. By now, you should have our earnings press release and associated financial information. We've also provided slides to accompany our conference call, which 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 a guarantee 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 today's 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 2022 Form 10-K and our second quarter 2023 Form 10-Q filed with the SEC. These documents are available on the Investor Relations section of the Hertz website.

Today, we'll use certain non-GAAP financial measures, which are reconciled with GAAP numbers in our earnings press release available on our website. We believe that these non-GAAP measures provide additional information about our operations allowing better evaluation of our profitability and performance. Unless otherwise noted, our discussion today focuses on our global business. On the call this morning, we have Stephen Scherr, our Chief Executive Officer; and Alex Brooks, our Chief Financial Officer. I'll now turn the call over to Stephen.

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Thank you, Johann. Good morning, and thank you all for joining us on this second quarter earnings call. Before turning to our Q2 results, let me first acknowledge the appointment of Alex Brooks to the position of Chief Financial Officer, having served as our interim CFO for the past several months. Given her talents, I look forward to a continued partnership with Alex as we execute on the priorities of Hertz, I congratulate Alex on her permanent appointment. With that, let me address our second quarter results, which reflect another impressive performance by the team and a successful start to the key summer season.

Our results for the second quarter were strong, reflecting the ongoing strength of our business, continued high demand for our services and lower fleet carrying costs. Revenue was $2.4 billion, up 19% sequentially, and adjusted corporate EBITDA was $347 million. Our results were a product of higher transaction days and a stable rate environment that remains well above pre-pandemic levels, and we believe no longer reflects a momentary surge of travel but a more stable baseline of demand growth being witnessed across the travel industry. Our results also reflect our fleet being deployed at very elevated utilization throughout the quarter as we captured customer demand across multiple channels and continue to opportunistically harvest available gains on the sale of vehicles, consistent with our ROA-driven strategy.

Volume across our business in the quarter was up 18% sequentially and 12% versus Q2 of last year. Demand was strong in the U.S., Canada and Europe, as each of leisure, corporate and ride-share continued to demonstrate momentum with international travel benefiting both our U.S. and European businesses. Our sequential growth in transaction days in the U.S. outpaced TSA airport traffic and other indicators of broader growth in travel and was generated with only 11% growth in fleet.

While share of airport volumes remained constant, we experienced increasing volume across our other customer channels, including rideshare, suggesting broader growth in the business. As they mature, we expect these initiatives to grow top line and to be accretive to margins in 2024 and beyond. In Europe, we are realizing results from our restructuring with improvements seen in the second quarter as volumes and rate showed strength and our delivery costs improved.

In all, travel held up in the quarter and has continued to demonstrate strength early into Q3. On the forward, we will look to benefit from a continuing tailwind in U.S. inbound travel and further recovery in business travel. On pricing, RPD in Q2 was $61.14 up versus Q1, reflecting typical seasonality and aligning with our expectations. Although Q2 RPD was down year-over-year, you will recall that last year's second quarter RPD benefited from very tight fleet levels matched against surging travel coming out of Omicron, as OEM supply was limited and car sales accelerated into an exceptionally strong residual market. Like many of our competitors, we were impacted by sellout conditions across a significant number of markets in Q2 of last year, as demand for cars outstripped excessively tight supply.

In Q2 of this year, while fleet was not as tight as last, we nonetheless ran at even higher levels of utilization. Benefiting from operational productivity, including materially lower out-of-service, which provided opportunity for more cars to be profitably on rent. Our expectation on rate for the balance of 2023 is for year-over-year comparisons to improve from here. Looking forward, we expect to see a sequential uptick in both rate and demand into Q3 with rate holding at a material premium to pre-pandemic levels. With an early view into July to date, we have seen rates move higher versus Q2 by more than 5%.

While OEMs have had more cars on offer this year, which historically would have given way to rate pressure, we have not seen such a dynamic to date. For Hertz, we are thinking about our fleet differently than the company did in the past. As we have said previously, we believe a dynamic approach to managing the fleet and adherence to an ROA mindset has contributed to our ability to keep RPD attractive, more stable and capable of yielding healthy returns.

To be clear, utilization is driving price and not the other way around, as it often been the case historically. Maintaining high utilization allows us to command better pricing and therefore produce higher revenue per unit and higher margin in the business. Operationally, we achieved fleet utilization of 82% in the quarter, 400 points higher than Q1 and 230 points better than year-over-year, and we anticipate further improvement from here. Benefited by lower out of service, our monthly revenue per unit came in at $1,516, up 8% sequentially and reflecting both price and utilization as key components of financial return. As we continue to take cost out of the business, drive higher utilization of our assets, grow rideshare and our value-driven customer channels, we are confident that we will produce increasing margins for the business.

As I noted, the company produced adjusted corporate EBITDA for the quarter of $347 million. Let me reflect on the components. Depreciation per unit came in at $195 favorable to the range laid out on our last call. As Alex will expand upon, we view depreciation as an output of many fleet plan decisions that we are making on a day-to-day basis throughout each quarter, including whether to add EVs or ICE vehicles or new versus used cars, as well as vehicle cap cost, vehicle length of keep, vehicle condition and mileage and vehicle rotation.

In Q2, each of these factors influence depreciation and our decisions ultimately resulted in a lower depreciation expense versus prior expectations. This is about careful management of the fleet. On expenses, we took actions on both our direct operating expenses and SG&A in the quarter. DOE per transaction day improved $2 sequentially, notwithstanding continuing inflationary influences on operational costs like labor and transportation. On SG&A, we took steps in the quarter to reduce corporate overhead. With a reduction of about $30 million on an annualized basis through attrition and reduction in force.

Despite these reductions, we have work to do on cost. Going forward, we will continue to focus on key controllable cost items, both DOE and SG&A in an effort to drive productivity, offset inflationary cost pressures and fund growth-related investments. We have been strategically replacing more expensive third-party labor in the field with Hertz employees. We have deployed telematics across the fleet to bring fuel costs down, reduce vehicle theft and improve the speed and cost of car recovery. These cost initiatives will be supplemented by further actions taken over the next year as we migrate our business to the cloud and thereby reduce significant third-party spend that currently burdens our results.

As in prior years, cash outflow in the first half of the year was driven primarily by the build of our fleet to meet the summer peak demand. Cash flow generation in the back half of the year is expected to improve materially as a result of the expected pace of business and the seasonal reduction in fleet following the summer surge. Staying with fleet for a moment, we are benefiting from increased operational productivity as evidenced by a material reduction in out-of-service and more efficient maintenance turns. But simply, we are making more fleet available for more revenue earning activities, which better enables us to serve base demand as well as demand across our new ventures, including rideshare and our revitalized value brands.

Think of lower out of service is helping to fund growth in the business. As we open the third quarter, there is no current evidence of softening demand. Nevertheless, the risk of a weaker economy, albeit lessening is to be acknowledged. And as such, we have changed our bias on fleet versus our thinking at the start of the fiscal year. Our objective is to always deliver profitable volume through high utilization. As demand is driven by many factors, we do not use core RAC pricing as a tool for demand creation nor do we use price to chase market share.

Risk of economic slowdown notwithstanding, we expect to benefit from a supportive business environment for the balance of Q3. As we said a year ago, travel trends are prevailing over the risks of an economic slowdown. Until that equation changes, we will continue to benefit from the former and will be ready for the latter. Now let me turn to progress on strategic initiatives where we've made significant progress across a wide range of opportunities. These initiatives, when taken together, will supplement the work we are doing to build a more robust baseline RAC business with an expectation of driving additional EBITDA generation in 2024 and beyond, further enhancing the earnings power of the business overall.

Let me begin with Dollar. In June, we launched our new website for Dollar as part of the revitalization of the brand. We are bringing forward new digital properties for Dollar designed to pursue profitable mid-market growth across both leisure and business segments. We believe that the new Dollar, when fully operational, will enable us to better access customer segments that we are not fully tapping today, including a younger value-driven consumer that comes to us directly or through online travel agencies, consolidators, tour operators, select airlines and other partners. We also believe that our work on Dollar will enable us to deploy a higher number of lower depreciating vehicles, driving higher margin revenue to the business.

While very early, the data since launch is positive. In the first 3 weeks of July and admittedly off a low base, the new Dollar website saw a pickup of 14% in conversion, a growth of 15% in revenue per visitor and a jump of 12% in value-added service revenue per booking. The Rideshare business continued its growth in Q2 as revenue grew by 84% year-over-year and 14% sequentially, primarily on volume. Transaction days in the Rideshare business grew by 69% year-over-year and 17% sequentially.

We believe that bringing greater scale to the Rideshare business and creating what is, in essence, a subscription business for drivers will better position us to moderate the quarterly peak to trough typically experienced in the leisure business and to flatten the depreciation curve on our vehicles. While the multi-week rental may generate lower RPD, when coupled with lower transactional expense, the business produces accretive EBITDA margins. Let me next spend a moment on EVs, where we are creating long-term value through our first-mover advantage in electrification. As you are aware, we are investing in the largest EV rental fleet in North America and one of the largest in the world. These are early days in a transition that hasn't happened in the automotive industry in a century.

We are readying ourselves for an electric future and are pleased with our progress on this strategy. First, the economic opportunities of EVs are compelling. EV maintenance is better than ICE vehicles. And while at present, EV damage repair is stubbornly more difficult and expensive, we expect that the entry of multiple fleet-oriented OEMs to the EV space will bring the supply of parts and EV technicians up and cost down.

Second, running a large EV fleet brings unique operational demands that we believe are not easily turned on overnight. We are building an embedded first-mover advantage in the area of EV fleet management from charging stations, both proprietary and through partnerships to training employees around EVs, hertz will be better positioned longer term to pursue adjacent fleet management opportunities, whether in the form of managing electric fleets for others or even adapting to the growing prospect of autonomous vehicles now in early commercial development.

And third, we are positioning Hertz as the unique provider of EVs across multiple customer segments, leisure, corporate and rideshare, all that, while providing choice for our customers. To assist those who might be trying an EV for the first time, we provide robust digital and other educational content, and we have deployed EV ambassadors at key airport locations, and last week, we held one of the nation's largest EV test drives at LAX, the first in this series where hundreds of people came to Hertz for an introduction to EVs of various makes and models. Taken together, what you are seeing at Hertz is an evolution of readiness and smart investments that are not easy to replicate quickly.

Finally, we are creating value through our investments in technology. Customers want more seamless experiences, and we are leveraging leading-edge technology and partners with industry leaders to deliver. At the same time, we are rebuilding the foundational elements of the technology on which we run. I'm pleased to share a few updates on our progress. First, we are just past the midway point of our migration to the Cloud. We are moving our reservations, fleet, finance and other systems to the Cloud and expect to demise our European data center by the end of 2023 and our U.S. data center to follow in early 2025. Once complete, we expect to benefit from all that comes with being in the Cloud, including, as I mentioned, a significant reduction in the cost of third-party service providers that we have been using to support our systems.

Second, we are progressing more agile pricing tools, modernization of our revenue management system and the build of a broader fleet control tower, all with an eye to capturing the most profitable demand available in the market at any given time. We will optimize VIN-level fleet decisions to maximize ROA across the portfolio, including whether to rent, move, buy, sell or repair a car.

For context, a modest price improvement of $1 in a daily rate brought about by better fleet allocation and/or more dynamic pricing would boost revenue by $150 million across an equal number of transaction days per year with our current levels of margin pull-through to EBITDA. Third, on the customer-facing side, we've made improvements to the Hertz mobile app. For iOS users, Q2 saw us take in 42% more reservations versus last year with an uptick attributable to a revamped booking experience and broader customer engagement. In Q2, we saw an 84% increase in downloads of the Hertz app versus last year, as improved customer experience elevated the app's standing in the Apple store. We have also launched new functionality for Android users.

Fourth, with respect to the deployment of AI, we intend to use natural language AI in our operations starting with customer care and at the front end of our digital customer engagement. On customer care, we are working on an initiative to deploy natural language AI for call center and reservation queries. We believe that a significant majority of our call center and reservation inquiries can ultimately be handled through AI, freeing our call center agents to focus their time more productively on the needs of customers whose requests are more complex.

On the front end of commerce, there is also opportunity to embed natural language AI into our digital properties, enabling a customer to ask simple questions about an upcoming reservation or rental and being more efficiently directed to the most relevant information, giving rise to higher transaction conversion and improved customer experience.

Fifth and final on technology and further the customer experience, we are excited to work with Apple across a range of initiatives, starting with payments. We are on track to begin accepting ApplePay on our U.S. e-commerce and mobile platforms by year-end, making Hertz one of the first major companies in the travel industry to do so. While more details are to come later this year, we're looking forward to working with Apple to deliver a better customer experience by enabling a convenient and secure way for our customers to pay online and in the app.

What is clear across these initiatives is that our ROA mindset is producing tangible results and becoming part of the fabric of Hertz. Moving into the second half of this year and beyond, I'm confident in our ability to build on this progress and continue forging a new way of doing business at

Hertz with a perspective that is both grounded in risk management and motivated by the expansive possibilities that lay before us. With that, let me turn the call to Alex.

Alexandra Dawn Brooks - *Hertz Global Holdings, Inc. - Senior VP, Interim CFO & CAO*

Thank you, Stephen, and good morning, everyone. As Stephen noted, we had a strong second quarter that reflected continued positive momentum in demand for our services. Revenue was up in both the Americas and International segments and totaled $2.4 billion, an increase of 19% sequentially, both volume and rate and our expectations for the quarter, as we laid out on our last call, with volume up 18% and rate up 1% versus Q1.

International inbound volume continued to improve and was at 78% of 2019 levels for the quarter. We also experienced growth in rideshare rental volumes, which were 69% above Q2 2022. We expect our rideshare margins to be accretive as the business benefits from longer length of keep and reduce direct costs, not withstanding lower RPD. We believe that progress here will demonstrate that revenue per unit or RPU, when coupled with lower direct operating cost is a better measure of margin creation than is RPD and a better reflection of our focus on ROA.

Adjusted corporate EBITDA was $347 million in the second quarter, a margin of 14%. Growth in global travel and rideshare were large contributors with continued strength in leisure. Americas and International generated impressive margins of 16% and 23%, respectively, while maintaining a tight fleet. In terms of fleet, we held an average in Q2 of 560,000 vehicles, which was managed to be inside the demand curve as demonstrated by utilization of 82% for the quarter, thereby enabling us to hold rate and generate healthy returns.

Depreciation per unit for Q2 was $195 and was below the range we laid out on our last call, primarily due to an increase in the number of fully depreciated vehicles in our fleet as well as favorable fleet mix. Turning to our operating costs. As Stephen noted, we continue to focus on key controllable cost segments in the quarter, driving productivity and mitigating inflationary cost pressures. Our DOE per transaction day in Q2 was $34, a $2 improvement sequentially. About half of this improvement was the result of improved internal labor productivity and reduced third-party labor costs.

As we have noted on prior calls, we expect DOE per transaction day to continue to improve through the back half of the year. SG&A expenses were $285 million in the second quarter, reflecting slightly higher marketing spend on a sequential basis ahead of the summer surge. We expect SG&A in the back half of the year to fall below $500 million as actions taken in Q2 take hold.

Let me turn to our capital structure and liquidity. With respect to our balance sheet, net corporate debt at the end of the quarter was $2.6 billion, and net corporate leverage for Q2 was 1.7x, modestly above our target of 1.5x and in line with expected seasonality mainly as a result of our net fleet CapEx during the quarter. We expect net corporate leverage to come down over the second half of the year, given anticipated performance and projected fleet reduction. At June 30, our available liquidity was $1.4 billion which includes $682 million of unrestricted cash. During the quarter, we took a variety of actions in the normal course of business to extend the maturities and increase the aggregate commitments related to our ABS facilities globally. In June and as planned, we drew $500 million on our revolving credit facility, which funded vehicle purchases and seasonal working capital as we fleet it up for peak demand.

We expect to pay this down in the second half of the year as cash flow turns meaningfully positive. We also amended our first lien term loans B and C to transition from LIBOR to SOFR as the primary underlying benchmark index. At June 30, we had capacity under our ABS of $773 million globally, and our vehicle debt portfolio was approximately 67% fixed rate, which mitigates the impact of a rising rate environment. We also maintained sufficient equity cushion in our EDF at quarter end. Overall, we continue to maintain a well-structured debt maturity ladder. We have no material corporate debt maturities until 2026.

Turning to our cash flow and capital allocation. For the second quarter, we recorded adjusted operating cash flow of $91 million, fleet CapEx of $437 million and non-fleet CapEx of $77 million, resulting in free cash outflow of $423 million. As we begin our de-fleeting cycle in the third quarter, we expect free cash flow generation to turn meaningfully positive for the second half of the year. In addition to our investments in fleet and non-fleet CapEx in Q2, we repurchased 6.3 million shares of our common stock for $100 million.

At quarter end, we had approximately $950 million remaining under the Board's authorization. Finally, let me give some color around our forward-looking expectations. On Q3 revenue, we expect a sequential uptick from Q2, consistent with seasonal patterns with continued growth in demand, seasonally improved RPD and continued improvement in utilization. On our global fleet, we will begin a reduction in fleet in Q3 off of a July peak with the current intention of bringing our fleet size at year-end to stand modestly higher than where we began the year, subjected as always to demand indicators, but with a tighter bias as we see some risk to residual prices into the back half of the year. On fleet carrying costs, we expect a Q3 depreciation rate per unit of $275 to $300 reflecting current market conditions.

We expect global fleet interest not limited to the U.S. to be about $140 million in the third quarter, reflecting both fleet size and the rate curve. On operating expenses, we expect DOE per transaction day to continue to decline and for the back half SG&A to total less than $500 million. In closing, we believe the strong results in the second quarter and the early momentum in July position us for a strong second half of the year. Longer term, we expect our growth initiatives to continue to mature as contributors to both the top and bottom lines as Stephen noted.

All the while we stay focused on driving productivity and efficiency to contribute to our margin expansion objectives. We're confident that these dynamics, along with a strong balance sheet, will contribute to long-term shareholder value. With that, let's open up the call for Q&A.

QUESTIONS AND ANSWERS

Operator

We will now open the line for questions. Please limit your questions to 1 question per speaker and 1 follow-up, if needed. (Operator Instructions) Our first question comes from the line of Chris Woronka of Deutsche Bank.

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

I appreciate all the color so far. And congratulations to Alex on the permanent employment. So as we look to 2024, and if we -- I guess, kind of assume that demand stays relatively constant, maybe pricing is similar to 2023. And then you talked about initiatives around Dollar thrifty and maybe there's a longer tail to the European recovery and further growth in rideshare. I guess do you think it's possible that year-over-year EBITDA would be positive next year?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Thanks for the question, Chris. I appreciate it. The short answer is yes. We do see opportunity for growth into 2024. And I would sort of put our confidence on a number of different sort of factors. First of all, we're seeing no abatement in baseline fundamentals that is demand for our product is there. You saw demand grow at 18%, 19%. And we're seeing that and expecting that to continue. And I would say that demand is both in our core RAC business, but equally, we will experience increasing demand and opportunity in Europe, in Rideshare and in Dollar, and I'll come back to those.

I would also say as a general matter that the demand function, I think, is also going to come from continued opportunity in the RAC business. So international inbound travel, which is a very positive force for us is added about, call it, 60% of where it was pre-pandemic. And we have yet to see kind of the full throated benefit, if you will, of what comes from Asia.

If you look at business travel, there have been various analyses done by third parties that point to business travel back at about 60% of pre-pandemic returning to about 95% in the next 2 years. So baseline demand fundamentals in the Core RAC business, along with incremental demand that is still not yet present and then demand across the various sort of growth components of the business. On rates, and as we said, we expect that rate over the balance of this year to improve in terms of year-over-year comparison.

So Q2 year-over-year rate was down 7%. I would venture to say that Q2, as we suggested, was a bit of an anomaly last year in that you had excessively high demand coming out of COVID, and you had all of the rental car companies selling cars, decreasing supply into an extraordinary bid on the residual value base of used cars, so wild asymmetry in supply demand. We think that the year-over-year comparison is going to improve Q3 perhaps appreciably less than the 7% that Q2 was down and Q4 exhibiting progress from there.

The next thing I would say about 2024 is that, the history in this industry, obviously, is to the extent that there is meaningful supply of cars coming into the market, the temptation was to in-fleet big and price would follow. Obviously, it's not consistent with the strategy that we have around ROA, but I don't think the temptation is even going to be there across the industry. When you look at analyses of 2024 in terms of OEM production, it's marked to be only about 2% higher than 2023.

So yes, cars will be freer, if you will, than where they were in the depths of COVID but not nearly back to where pre-pandemic levels are. Then I think the biggest component of optimism around '24 and why growth can happen is around our rideshare business around Europe and around Dollar. Dollar obviously plays to us taking more of a very big addressable market, lower depreciating vehicles reflected in depreciation and putting those to use at higher margin. TNC is showing growth and improvement. We've expanded what we're doing with Uber into Europe, we're in 60 markets around the U.S. And then in Europe, all of our countries are proving profitable, and we're seeing rate and volume extend through to this summer such that summer would appear now to end from a rental car point of view in kind of October. And so that's another vector of continued growth.

I would say on the expense side, again, just apply to margin and the work we have to do, it's important to remember that while we are working on DOE and SG&A, we are running side-by-side IT platforms as we move from the data center into the Cloud. That will start to converge more than where we have been. We will demise a single component of that, and we will see material benefit in terms of costs, particularly in through 2024 and beyond.

Last thing I would say, again, playing to margin, playing to EBITDA generation is we continue to try to pull our way ourselves away and we'll do more in from the vagaries of the wholesale market into which we sell cars and look to rely more heavily on our retail sort of component, which is both our stores and Carvana. That's a good mitigant to risk to residual decline, it does harvest greater gain on sale for us. I think we're unique in the context of pursuing that. So taking all of that and driving to a higher EBITDA level, a higher margin in 2024, those are the various components that I think feed kind of a level of optimism on the forward.

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

Okay. Stephen. Super helpful. And then I did have a follow-up, which maybe we can drill down on where you are on EVs a little bit. And I know you mentioned earlier that the might change your pivot a little bit in terms of what you're in-fleeting when and where? And maybe just a view of the economics of that business so far, where you're at on in-fleeting, the kind of puts and takes you're seeing from pricing changes at the OEMs on EVs? And just again, kind of the economics of how that impacts the business in '24 and beyond in terms of RPD difference and margin difference with DOE and things like that?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Sure, sure. Okay. So EVs are now 11%, 12% of our overall fleet. It still skews to a dominant presence of Tesla in the fleet. But I think we're encouraged that we are now taking delivery on the first EVs out of GM as part of the 175,000 that we agreed to purchase over the next 5 years. They are all coming at more attractive price points than where we thought they would originally that only benefits the economics in terms of the margin to be had and the returns to be had on these cars. I would also say that as we take in more General Motors EVs, one, it mitigates the sort of single supplier risk, just in terms of recall and operations. But equally, I think we're encouraged at working more aggressively with GM, by virtue of their parts supply, their network and the like because I think that the ability on those cars at various price points to sort of see parts more readily available at lower price points is an important element in the overall economics of running the EV platform.

From a straightway maintenance point of view, EVs are still what they promised to be, which is lower maintenance, obviously, subject to sort of tires and brakes. And I think we're quite encouraged at the longer length of keep that we'll be able to have, flattening the depreciation curve, buying more EVs at lower price points than where we bought them in the past.

And I think we find ourselves in a really interesting opportunity particularly as cities are requiring rideshare companies like Uber and Lyft to be 100% electric by 2030, only kind of 6 years or more from where we are and we become the viable path for that to happen. And so again, having lower price points on EVs, longer length of keep, lower depreciating sort of components, and having sort of an embedded base of demand for them in the context of ride share is just another added component of why we think the economics and the first mover edge is there.

And again, none of this relies on what I had mentioned in our prepared remarks, which is that the whole undertaking around EVs puts us in a position longer term to think about fleet management, to think about autonomous vehicles and the like. Again, all of that is an add-on to some of the baseline business that we're putting EVs to.

Operator

Our next question comes from the line of Ian Zaffino of Oppenheimer & Company.

Ian Alton Zaffino - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Great. Very good color. Can you maybe touch upon Manheim residuals have been pretty volatile recently. How are you now thinking about that impact as you manage the business going forward?

Alexandra Dawn Brooks - *Hertz Global Holdings, Inc. - Senior VP, Interim CFO & CAO*

Hey Ian, it's Alex. I'll take that question. Yes, you're right. We have seen decreases in the Manheim Rental Index published over the last few weeks about a 4% decline for the month of June, and we've seen diminished pricing in the spot market. But when you think about that Manheim Rental Index, I think it's important to put it in the context of where we started the year.

So it's pretty much a round trip on that in terms of where we started January, and even compared to the beginning of Q1, we increased and then came back down in the last month of the quarter. So just to put that in perspective. In terms of how we think about managing residual risk in the business, I mean, as you know, driving to a profitable disposition of the vehicle as it exits our fleet, is an important component of return on asset and how we manage to return on assets.

So in a declining residual environment, it's more important than ever that we divert volume away from auctions and a baseline wholesale price to more profitable channels. This includes Dealer Direct. And right now, we have more of our volume going through our Dealer Direct channel than we do at auction. And we also really feel like our differentiator is our retail channel and our car sales operations.

So our car sales operations includes our partnership with Carvana and we're yielding much better returns than what we would otherwise realize by disposing of these vehicles through auction. Our Carvana volume is growing and contributes to us in a meaningful way. So that being said, in the current residual environment, we're even more focused on disciplined fleet management and managing our fleet size within the demand curve. And as we mentioned in our prepared remarks, we are going to reduce our fleet size towards the end of the year.

So it stands modestly higher than where we started the year. And this is a function of managing to the downside risk understanding that if demand indicators weren't, we can pivot quickly to the upside and manage that through spot market purchases. So with that context, and as we look forward to Q3, as I mentioned, we're expecting net depreciation of $275 to $300 per unit. And this is a view on the gains that we expect to realize in car sales, given the current residual environment as well as the impact of the current spot market on the forward.

In other words, on the forward of the fleet in terms of how long our holding period and future dispositions at future dates.

Ian Alton Zaffino - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Okay. That's really good color. And I guess just listening to the prepared comments that you made, it seems like you guys or the business is performing -- or the outlook is better than expected or at least what you thought initially? There seems to be a nice growth component here. You're talking about a lot of free cash flow coming in, in the second half of the year. So how are we thinking about buybacks here?

I know you bought back about 6 million shares this past quarter. But what should we really be expecting? And how are you now thinking about kind of the value of your stock and the purchase of shares, just given your seemingly improved outlook?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Well, I think -- look, obviously, we generate appreciably more cash flow in the back half of the year. The back half would be the point in the year to sort of give consideration to sort of take up in share repurchase. But our strategy has always been looking at fleet and non-fleet CapEx and then looking at share repurchase as an option. We have considerable capacity under our existing authorization to do that. We'll continue to sort of look at where value sits in the stock. We share, obviously a rather bullish view on what the forward looks like.

And so the opportunity will present itself in the second half, and you should think of us as a continued buyer of stock as we move through the back half of the year.

Operator

Our next question comes from the line of John Healy of Northcoast Research.

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

I hate to try to get in the weeds on this, but I just kind of wanted to spend a little time on the depreciation line for the quarter. Obviously, a nice benefit Q2 over Q1. Your fleet went up, say, 40,000 cars, and I can imagine those cars are coming in at higher depreciation than previous. So I was just trying to kind of back into the gain that you had this quarter on the fleet disposition. And I don't know, my guess is it's probably $125 million or so? So if the used car market was softer in Q2 that we can see that versus Q1, you had that big gain. Why would you not have another big gain in Q3?

Is it just the age of the cars you're moving through? I'm just trying to understand kind of why they snapped from 280 down to 198 and then back to 280 again.

Alexandra Dawn Brooks - *Hertz Global Holdings, Inc. - Senior VP, Interim CFO & CAO*

Yes. Sure, John. This is Alex. You're right. So for Q2, we had about $110 million gains on car sales in the quarter. And as we look ahead to Q3, we've got -- again, we obviously have a dynamic fleet. Our fleet consists of different vehicles, different ages. And as we look ahead, there's some fleet mix impact there in terms of what we expect to see. And again, we're managing also, I think, to a residual environment in which we see some downside risk versus some upside risk.

So when thinking about that forward depreciation rate of $275 to $300 , we tried to incorporate to the best of our knowledge, what we see happening in terms of fleet plan dynamics as well as our view on the spot market and the market in which those car sales will happen.

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

Okay. That makes sense. And then just on your...

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

John, just -- John, it's Stephen. Just before we move off that. So let's talk about the different channels that we have, okay? The wholesale market is a spot market, right? Now it is, as you see in the Manheim Rental Index down quite considerably over the latter part of June into July. All consistent with the comments that Alex made earlier about it being a round trip on the year. As we look to use kind of what I would describe as more proprietary channels, the likes of Carvana or for that matter, our own retail network, there's a longer sale period there than there is in the spot market.

And so right now, for example, those proprietary channels can yield $2,000 to $3,000 more per car than what we see in the wholesale market, okay? But they require a 30 or 40 days sort process to get through. And so what you're seeing in the reflection, as Alex said, is a realization of where the wholesale market is trading, the time to be able to sort of sell the cars that we have with a very clear view that we are bringing fleet down off of the early Q3 peak as we get back down into the back or the end of the year.

And so -- that's just to give you a bit of a flavor for it. I would say also in the context of Q2, there's obviously a rise in 0 debt cars that we're holding because they have greater utility to us in the context of the business that we're growing around Dollar, for example, or in [TMC], so these are the dynamics around depreciation. It is not the sort of -- here's a given output. Instead, it is an output of a series of actions that we take which include choice of car we buy, choice of car we keep, length of keep, what we sell, whether we advance the sale, what cars we advance in the context of those that carry elevated equity and equally the ability to sort of capture an equal or better price around a car that may have a lower depreciation [to the] feature than not.

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

That's helpful. And I want to bring up Carvana there. I mean, clearly, the company has gone through a lot over the last 18 months or so and appears to be maybe on the other side of things to some degree. Is the relationship that you guys entered into with them kind of structure the same way?

Are they as excited about being in this business with you guys as they had been. Just kind of curious like if we could get some visibility on kind of where that stands and the durability of it? Because to me, that probably is a big part of the '24 changeover in distribution, how you get out of fleet.

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Yes. I would say the commercial relationship with Carvana is better now than it's been. You may remember that when they first ran into challenges with creditors and the like, they had pivoted on their own business model to move away from smaller, more bespoke providers or dealers of cars to larger-scale operations, of which Hertz is clearly one. So we've seen growth in volume that we can put through Carvana, a very engaged partner with us in the context of car sales. And so I would say that things have improved in the context of where we are.

By the way, I should also say, John, that -- just back to the Manheim question, there is spot risk when you look at it. What I would say to you, though, is that there's some interesting dynamics about these car market, which I think we're looking at and considering to put ourselves marginally more optimistic about it, which is that structurally speaking, the used car market is now into a point of being short used cars that are attractive to rental car companies, namely off lease.

If you think about it, the supply that would come or start right now into the used car market would have gone on lease 3 years ago. They didn't go on lease because they weren't manufactured because we were in the froze of COVID. So we're entering a period of structural shortage in terms of supply of attractive cars. That should have some upward lift, if not stability to sort of where the Manheim Rental Index shifts. Now corresponding negative view on it, of course, would be that interest rates are higher, so borrowing on the part of the consumer is -- puts them in a more reluctant sort of position.

But I think we shouldn't lose sight of the structural element there. I don't mean to make a pattern of the last 2 weeks, but the last 2 weeks have shown more stability than what we saw and, as Alex put it, a 4% decline over latter part of June into early July.

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

Okay. Great -- and Alex, congrats on the promotion.

Alexandra Dawn Brooks - *Hertz Global Holdings, Inc. - Senior VP, Interim CFO & CAO*

Thank you.

Operator

Our next question comes from the line of Stephanie Moore of Jefferies.

Stephanie Lynn Benjamin Moore - *Jefferies LLC, Research Division - Equity Analyst*

Hi, good morning. Thank you. I think you gave a little bit of color of the trends that you were seeing in July, but maybe if we could just flesh that out a little bit. If you could just touch on the demand trends you've seen in July and how that's compared to maybe normal seasonality? And at the same time, if you could discuss what you're seeing from a competitive standpoint through this kind of busy peak season as well? That might be helpful.

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Sure. Well, I would say that the trend in July that I took note of in the prepared remarks was looking at rate in July as being in or around 5% or slightly better relative to where we were in Q2 and July being higher than June kind of on a month-over-month sequential basis. Typically in Q2 to Q3, you would see a 10% uptick in rate. And you would see a more modest 5% uptick in volume, I think that we are forecasting here perhaps an inverse of the two, which is we're expecting and are experiencing materially better volume than what is otherwise seasonal, maybe breaking with the seasonal sort of nature of it all.

And we're seeing rate sort of continue higher but again, off of a higher base, right, than where we otherwise would have been. And as I mentioned, equally looking away just from the sequential quarter-on-quarter, if you look at year-over-year, Q2 was 7% lower year-over-year. We envision Q3 to be lower than it was last year, but lower than that, meaning down, call it, 5-ish percent relative to where it was and improving throughout the year as there's a better comparable set moving away from kind of the extremity of what was Q2 of 2022.

But I think overall, very strong demand, of which we're going to find other channels to feed it even more and continued strength in price, again, in a very stable rate environment relative to what we otherwise might have seen or cynically thought would come, again, with a slightly looser availability of cars and so forth.

Stephanie Lynn Benjamin Moore - *Jefferies LLC, Research Division - Equity Analyst*

Great. Absolutely. No, that's helpful. And then maybe switching gears on the expense management side. I think you called out clearly continuing to place a lot of focus on whether it's SG&A or direct costs. And I think you highlighted that there were some (inaudible) costs right now as you kind of migrate into the Cloud, migrate further into the Cloud. Can you maybe quantify what you're seeing or the impact that was there in the quarter?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Well, I would say, without putting precise numbers to it, I would simply tell you that there's a material amount of expense that we incur in the course of a transition from operating to data centers to where we will ultimately be for the end of next year into '25 up into the Cloud with various instances on a global basis. We will shed ourselves of a meaningful number of outside consultants and other service providers that have for probably the better part of 2 decades stood up older platforms that sit in physical data center. And so the savings we will get is not just simply the kind of more conventional savings that comes with simply being in the Cloud, it is the ability to move away from a reliance on third-party providers.

Now we're not there yet in its entirety because, this is a gradual sort of move, where, as I've mentioned, finance, for example, is up in the Cloud. There are other elements or platforms that will be migrated in due course. And as we do that, we're reducing down our reliance on third parties. Obviously, there's the cost of the Cloud, there's cost of our own employees, but this will be quite a material number in the context of what we will realize as it bleeds forward in through the latter part of 2024.

Stephanie Lynn Benjamin Moore - *Jefferies LLC, Research Division - Equity Analyst*

Great. And then lastly for me, I was hoping you could maybe give a little bit of an update on the Hertz and Uber partnership in Europe that was launched earlier this year, particularly with EVs and the availability that you're providing for Uber drivers in certain European cities.

So -- any difference in outcomes or learnings or anything thus far comparing to the European market and then maybe the U.S. market? Just curious what you see a so far?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Sure, sure. Well, first of all, it's early days in Europe to draw the comparison but our venture is starting off in London and Amsterdam and will next be in France. And these are areas where, there's a very professional cadre of drivers that drive, there are licensed that are required, to take and pass certain exams and so forth. What that will bring to us, I suspect, is a more uniform professional group of drivers on which we can rely kind of more readily on risks that we take in terms of risk of collision and so forth.

I would say that in certain of the European jurisdictions, the insurance and the risk-bearing relative to what it is in the U.S. will shift, meaning we can put risk on third parties, whether it's obligatory insurance programs or otherwise. And so the economics all in, if you will, so put aside rate and volume as the key components, but the ancillary costs of collision, damage, salvage, all keyed off of quality of driver and equally kind of insurance and risk-bearing, I think could possibly be better in Europe than it would be in the U.S., although the U.S. business will be larger for us for a while, but I think the European business holds sort of considerable promise.

Operator

Our next question comes from Christopher Stathoulopoulos of Susquehanna International Group.

Christopher Nicholas Stathoulopoulos - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Stephen, a lot of good detail here in your prepared remarks as it relates to demand in some of the Q&A. But if we look at the airlines here for a minute, and I mentioned the airlines given the correlation to rental volumes, domestically here, we are seeing some signs of slowing, but perhaps bigger declines in pricing and concerns on some elevated inventory here in North America? Long-haul travel, as you said, and with what the airlines are seeing is very strong. So given that in your global footprint, I was wondering if you could perhaps put a little bit more sort of a nuanced view here with respect to how you're seeing demand here domestically if you're able to parse that out regionally most on the coast? And of course, your thoughts with how you see what looks to be a lot of pent-up demand, but certainly, the last segment to recover with respect to travel playing out into the back half?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Sure. Great. So just as a baseline, okay? It's important to realize that we've been -- we ran in Q2 at an 82% utilization. And we are signaling to you that we will take that even higher in the context of our fleet. And that's not price driven, as I said, that's fleet driven. So we calibrate the fleet, and we'll take it down to sort of maintain very high levels of utilization, so as to maintain price and the like. I raised that because across the whole of the business, all geographies are contributing to an elevated level of view.

Let me start domestic. I'll just decompose it as in your question. Domestically, we continue to see strength across all of our regions. I would say the regions behave on a seasonal basis. So quite strong in the Northeast in the summer. Will be quite strong, and we'll see bookings in through the winter in the Southern clients like Florida and Arizona. I would say that the West is picking up and this factors into inbound travel, which is Asian inbound travel has been kind of the last of the three, meaning European travel back strong, Latin American travel back strong. Asian travel was late, but we're seeing more and more travel, particularly among Japanese and Korean tourists into the California markets and also into Hawaii.

I would say, an interesting twist is that we're seeing Chinese tourists not in the United States by virtue of visa issues, but rather in our European markets in places like Paris and elsewhere and so growing that. On the European side, we're seeing certainly this summer, a considerably elevated level of Americans that are traveling to Europe. Obviously, the places that you know like the southern part of France, into Spain and into Italy. The business has been really quite strong and strong in demand at a moment where we have made very material changes to our cost base in certain parts and certain countries of Europe, France, in particular.

And so the margin throw-off of that business is quite enticing. And so what we see in this is quite strong. But I would point out, we're not done, meaning we're not yet back to where international inbound was. I think the airlines would tell you that they would redeploy capacity as and if they had it to feed that. We would like that because this international inbound business, going both ways is very attractive to us. It carries very high rate, very high pickup in VAS, very attractive margins. And so we'd like to see and expect to see that continue.

Christopher Nicholas Stathoulopoulos - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Great. Great color. A follow-up. So in your prepared remarks, you touched on what is your view of -- or how you approach fleet management and what is certainly, I would say, a different approach today? If you could expand on that a little bit more, that's just about how every conversation with investors for me at least starts off as how has fleet management changed for Hertz?

How does Stephen think about managing the fleet through a cycle to date versus how it used to be done?

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Thanks a lot. Look, the core of the strategy, as we have said on all the calls in which I've been a participant is that ROA drives this, okay? And we're targeting a marginal ROA on fleet at 15% to 20% in terms of what the ROA ought to be on the cars that we hold. We're dynamic all the time, okay, which is why depreciation and fleet size could move and will move depending on where demand is but you're always looking to optimize your return.

By the way, that may be as it was in various portions of last year, selling the car over renting the car, but as prices have come off, the rental proposition has obviously become more attractive at a very stable base rate that we are at. So yes, it is down year-over-year. But I think it's explainable in the context of where we're coming from and now sitting sequentially at what we view to be a relatively stable rate environment that sustains adequate and attractive marginal returns on our assets.

If you think about fleet, okay, and you think about utilization and fleet being the key component of what drives utilization, not taking price down to beef up against a static fleet number, we started off the year at kind of 475,000 to 500,000 cars. We surged into the summer, challenging ourselves to ensure that what we were getting at appropriate levels of utilization was adequate return. And as Alex pointed out, we will be back down to something that's slightly higher than where we began the year, again, in the context of being mindful of where demand sits maintaining better than 82% utilization on the fleet, maintaining high ROA on the cars and all the while serving a diverse set of customers that have different RPD, but very attractive expressions of margin.

So in other words, the fixation on rate in and of itself, I think, starts to skew because as we've said, what we do in rideshare will be a lower RPD, but longer length of keep and lower expense and better and more accretive margin. What we do in insurance replacement may be dilutive to RPD, but again, big length of keep, lower expression of cost, better margin. So each of these channels will express different levels of margin potential, all that feeds into the ROA. By the way, even in the context of what we're planning on doing with Dollar. Right now, Dollar has been an inferior product. The customer experience has been a poor one. When you go on to Expedia, because the rating on Dollar is much lower than budget at [Avis], we have no choice but to keep a low rate.

As we improve the customer experience on Dollar, we will have room to take that rate up, okay? As we take that rate up, just know that we will be using lower depreciating vehicles in the to create margin. So I'm just giving you kind of a walk around the business plan, all with a central focus on ROA, all with a central focus on returns, all with a central focus on managing this fleet, as you would expect an asset manager to do and generating increasing returns for our shareholders.

Operator

Thank you. This concludes today's Q&A session. I would now like to hand the call over to Stephen Scherr, Chief Executive Officer. Please go ahead.

Stephen M. Scherr - *Hertz Global Holdings, Inc. - CEO & Chairman*

Thank you all for your participation today. Before we close the call, I want to thank the more than 20,000 employees of Hertz for their continued service and their attention to our customers, particularly as we're in the busy summer season. We look forward to sharing further updates with you on our next call. And with that, I'll hand it back to the operator.

Operator

This concludes the Hertz Global Holdings Second Quarter 2023 Earnings Conference Call. Thank you for your participation.
