The Hertz Corporation

HTZ · Filed Chapter 11: 22 May 2020

How a $19 billion fleet debt load, $2 billion in share buybacks, and a pandemic demand collapse exposed warning signs the model identified twelve months in advance.

DISTRESS SCORE

41.6 / 100

DO NOT INVEST

Sector	Vehicle Rental / Transportation
Filing date	22 May 2020
Total debt at filing	~$19 billion (fleet + corporate)
Model FY2019 signal	Danger score 41.6 — HIGH / DO NOT INVEST
Key failure driver	Corporate interest coverage 1.16× pre-COVID; zero liquidity buffer

Executive Summary

The Hertz Corporation filed for Chapter 11 bankruptcy protection on 22 May 2020, becoming one of the largest corporate casualties of the COVID-19 pandemic. With approximately $19 billion in total debt, the filing represented the collapse of a company that had operated continuously since 1918. The characterisation of Hertz as a pandemic victim was, however, only partially accurate.

Our early-warning system assigned Hertz a danger score of 41.6 out of 100 on the basis of its FY2019 annual report — filed in February 2020, two months before COVID-19 reached pandemic scale in the United States. The model placed Hertz in the HIGH risk tier with a DO NOT INVEST signal. FY2019 financial statements showed corporate interest coverage of just 1.16×, leverage of 0.923, and a return on assets of –0.24%. The pandemic was the trigger. The leverage was the explosive.

The Business and Strategic Context

The Hertz Corporation operates vehicle rental networks under the Hertz, Dollar, and Thrifty brands in over 160 countries. Its core revenue depends on three highly correlated demand drivers: air travel volume, leisure tourism, and corporate travel budgets. This correlation structure makes Hertz's top-line highly susceptible to demand shocks — a property that becomes dangerous when combined with a fixed-cost operating model and a balance sheet funded almost entirely by debt.

The company emerged from a leveraged buyout led by Clayton, Dubilier & Rice in 2005 and went public in 2012 carrying the LBO debt load as a baseline. Rather than using the years of low interest rates and steady travel demand growth between 2013 and 2019 to methodically delever, management repurchased approximately $2 billion of its own shares between 2014 and 2016 — consuming capital that could have reduced the debt stack. When travel demand weakened in late 2019 and collapsed in March 2020, the company had neither the cash reserves nor the balance sheet flexibility to absorb the disruption.

Compounding the capital structure problem was a strategic error in fleet management. In 2016, Hertz committed to a large purchase of Tesla electric vehicles as part of a publicised effort to modernise its fleet. The programme was commercially unsuccessful — EVs proved difficult to manage within a rental fleet context due to charging logistics, damage rates, and residual value uncertainty — and Hertz subsequently announced the liquidation of a significant portion of its EV fleet following its post-bankruptcy emergence.

The Financial Distress Trail

Hertz's metrics told a consistent story of a business operating too close to its debt ceiling with insufficient profitability to service that debt through normal cycles. The FY2019 annual report, available two months before the filing, contained the following picture. All figures are drawn directly from Compustat North America SEC-filed data.

Metric	FY2017	FY2018	FY2019
Total Liabilities / Total Assets	0.924	0.948	0.923
EBIT / Interest (corporate)	0.42×	0.80×	1.16×
Return on Assets	+1.63%	–1.05%	–0.24%
Cash / Total Assets	~3.5%	~3.1%	~2.4%
Net Debt (total, approx.)	~$16.5B	~$17.8B	~$19.0B
Fleet Debt as % of Total Debt	~92%	~93%	~93%

Approximately 93% of total debt was fleet debt — asset-backed securities issued against the vehicle fleet. In theory, self-collateralising: if Hertz defaulted, lenders could repossess and sell the fleet. In practice, the COVID demand collapse revealed the critical limitation: when 95% of locations closed simultaneously, the company could not generate revenue to service the fleet debt, and 500,000 vehicles hitting the used-car market simultaneously would have been catastrophically depressed in value.

At the corporate level, interest coverage of 1.16× in FY2019 meant corporate EBIT barely covered corporate interest expense before any pandemic impact. The three-year ROA series — +1.63%, –1.05%, –0.24% — showed a company oscillating around zero profitability, never achieving the positive returns that would allow organic deleveraging. The consistent, multi-year nature of this pattern is precisely what the model's temporal trend features are designed to detect.

The Early-Warning Signal

Our system assigned Hertz a danger score of 41.6 out of 100 on FY2019 data, placing it in the HIGH risk category with a DO NOT INVEST signal. This score was generated from the February 2020 10-K filing — three months before the bankruptcy. For FY2018 data, the score was elevated to the CAUTION threshold, driven by leverage of 0.948 and negative ROA of –1.05%. The signal was consistent across both years.

The most influential signals were the leverage trajectory and the non-deleveraging pattern. Leverage had been above 0.88 for five consecutive years without reduction — the model's training data across 17,000+ firms shows that companies with sustained high leverage and near-zero ROA have a substantially elevated probability of filing within 12 months when any adverse operating event occurs. The FY2019 corporate interest coverage of 1.16× provided almost no buffer. A demand shock reducing revenue by 20% would have eliminated coverage entirely — and COVID eliminated it by 80%.

Why the Market Underestimated the Risk

The equity narrative for Hertz in 2018–2019 was a turnaround story: new management, cost-cutting programmes, fleet rationalisation. The tangible fleet asset base gave creditors comfort that the company was asset-backed in a way unsecured lenders are not. This comfort was rational under normal conditions and mistaken under stress conditions, as the self-collateralising structure provided no liquidity precisely when both demand and residual values collapsed simultaneously.

Credit rating agencies maintained strong ratings on Hertz's fleet ABS into 2019, partly because ABS methodology relies heavily on historical vehicle loss experience — which was excellent. The gap between the deteriorating corporate credit story and the stable structured finance rating created a two-tier market view that obscured aggregate risk. The $2 billion share buyback programme was celebrated as management confidence; from a capital structure perspective it consumed the financial resilience that might have allowed survival of a shorter disruption.

Key Takeaways for Credit Analysts

- A leverage ratio above 0.90 with negative or near-zero ROA is a critical risk combination regardless of asset backing. The self-collateralising nature of fleet debt does not protect when both demand and asset values collapse simultaneously.
- Share buybacks executed at high leverage levels destroy financial resilience. Capital returned to shareholders in 2014–2016 could have provided the liquidity buffer needed in 2020.

• Interest coverage of 1.16× in a benign macro environment means zero cushion for adversity. If a company cannot comfortably cover interest during economic expansion, it has no capacity for any demand shock.

• Structured finance ratings on subsidiary-level ABS can obscure consolidated balance sheet deterioration. Always analyse the whole entity on a consolidated basis.

• The turnaround narrative is the most dangerous equity story when leverage is extreme. Operational improvement requires time; debt service obligations are immediate and non-negotiable.

Limitations

The COVID-19 pandemic was an unforeseeable exogenous shock. A danger score of 41.6 reflected a company at structural risk — but structural risk is not the same as imminent default. In the absence of COVID, it is plausible that Hertz would have continued operating for several more years while slowly consuming covenant headroom. The system correctly identified the vulnerable financial architecture; it could not have predicted the specific catalyst. This is an honest limitation of any accounting-based early-warning system: it identifies the explosive, not the match.
