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How Hertz's bet on Teslas went horribly sideways

25–32 minutes

LIKE anyone habituated to the excesses of Wall Street, Tom Wagner and Greg O'Hara knew how to throw a party.

On the night of Nov 9, 2021, guests emerging from the oversize elevator at Zero Bond, the members-only Manhattan social club frequented by Kim Kardashian and New York City Mayor Eric Adams, were greeted with flutes of Champagne. Offerings of sliced raw tuna on crispy rice and roasted maitake mushrooms awaited them as heads turned to admire an Andy Warhol and a Keith Haring, while New Order throbbed in the background. On every cocktail napkin, emblazoned with Hertz's familiar yellow and black, was "Let's Go!"—the slogan for its splashy new ad campaign starring seven-time Super Bowl champion Tom Brady.

Earlier that day, Hertz Global Holdings, the rental-car giant that careened into bankruptcy during the first two months of Covid-19 burdened with a bad balance sheet and generations of even worse management, had raised US\$1.3 billion in an initial public offering (IPO). Somehow, in slightly more than five months, Wagner and O'Hara had pulled off one of the greatest turnarounds in corporate history.

By the time Wagner's hedge fund, Knighthead Capital Management, and O'Hara's private equity firm, Certares Management, bought Hertz in a June 2021 bankruptcy auction, the company had slashed its debt and cut 15,000 jobs. Neither Wagner nor O'Hara had any experience in the industry, but to the self-styled disrupters in an archaic business, that was a virtue. They would run financial analyses that clearly showed the future of rental cars was in electric vehicles (EVs). "We felt we could position Hertz in a completely different way," Wagner told Bloomberg Businessweek in an interview just before the IPO.

Hertz's new owners were making a fully charged bet to swap Hertz's petrol-powered rental-car fleet for EVs. The company announced an unprecedented order for 100,000 Teslas and struck an exclusive deal to supply EVs to Uber drivers. It planned to build out a national, and eventually global, charging network at Hertz's thousands of locations, with ambitions to become the service manager for the autonomous-driving era.

Wagner was also ski buddies with Brady, then quarterback of the Tampa Bay Buccaneers, and persuaded him to be its new celebrity frontman. Brady, who in his prime joked that he was the slowest man in the NFL, would show, in Hertz's words, that the company "is making EV rentals fast"—a play on the company's 1970s commercials, with OJ Simpson vaulting down staircases touting "The superstar in rent-a-car."

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It was a pitch-perfect strategy for an economy just rebounding from the pandemic, seizing on America's newfound love for travel, the public's fascination with Elon Musk and the stock market's willingness to throw money at anything with an EV story. The November IPO valued Hertz at US\$15.3 billion, more than two-and-a-half times the US\$5.9 billion Wagner and O'Hara had paid to buy it out of bankruptcy.

With demand for car rentals surging and cash flowing in, the company authorised a US\$2 billion stock buyback. Soon, Hertz would announce that Stephen Scherr, the recently retired chief financial officer at Goldman Sachs Group, was joining to lead its EV transformation as chief executive officer.

By early 2024 it was clear the massive bet on electrification was a catastrophe. Musk had slashed Tesla prices by as much as 30 per cent, sending the value of Hertz's EVs plummeting. Wagner and O'Hara's plan was filled with countless other miscalculations that only deepened the wound.

All that talk of a radical makeover for a tired industry has gone silent, and the company is now doubling down on gas guzzlers. Hertz shares have fallen 74 per cent since the IPO festivities at Zero Bond, there's finger-pointing in the boardroom over who bears responsibility, and Scherr, who never saw himself as a fix-it guy, is gone. Gil West, a seasoned operations executive, on Apr 1 became Hertz's sixth CEO in 10 years. It is his turn to try to clean

up the mess.

While most people were in lockdown in the summer of 2020, Wagner and O'Hara were on the prowl. Wagner specialised in taking chances on troubled companies. Since quitting Goldman Sachs in 2008 to co-found Knighthead, he'd scored big on several high-profile bankruptcies, including Puerto Rico's main power producer; PG&E, the electric utility whose equipment sparked some of California's worst wildfires; and Lehman Brothers.

Among his peers, Wagner was known not only for a cocksureness common to ex-traders but also for a fierce work ethic and meticulous attention to detail. O'Hara, who started his career in information technology, eventually jumped to JPMorgan Chase & Co to help arrange multibillion-dollar buyouts. In 2012 he started Certares to invest in travel, tourism and hospitality and made a name for himself buying a 50 per cent stake in American Express Global Business Travel as well as part of Tripadvisor.

Together they raised a US\$1.5 billion fund to snap up travel and leisure companies such as Hertz that had been crushed by the pandemic and might eventually soar once the economy reopened. It was a binary bet: If Covid could be tamed or beaten, there was, potentially, a huge upside in any industry that had ground to a halt because of shelter-in-place orders. Plus, because Hertz was bankrupt, the company stood a good chance of restructuring much of its debt, renegotiating contracts and slashing costs.

This was not the first time investors had spotted a moneymaking opportunity in Hertz. In 2014, Carl Icahn, the billionaire activist, saw so much potential that he waged a proxy battle for control of the company. Automakers once saw it as a great side business,

too. General Motors owned it through the 1930s and '40s. Ford Motor bought it in 1987 and moved its offices from Manhattan to Park Ridge, New Jersey, before unloading it to a group of private equity buyers in 2005.

Ever since Hertz returned to the public markets in 2006, a parade of CEOs had tried—and mostly failed—to solve its problems. In 2012, while Mark Frissora was in charge, Hertz successfully waged a bidding war against Avis Budget Group for rival Dollar Thrifty Automotive Group. The purchase gave Hertz key budget brands, but it also added to the company's large and expensive debt, a bedeviling legacy of the 2005 buyout. Frissora tried to save money by keeping old, tired-looking cars in service rather than refresh the fleet. US regulators fined Hertz for, among other things, failing to disclose the impact of that tactic on maintenance costs and on its premium brand.

Icahn forced out Frissora, but over the next six years, no matter who was running the company, the stock kept sliding. Then-CEO John Tague's bet on compacts and family sedans coincided with a 2016 plunge in fuel prices, which revived demand for SUVs and left Hertz with an inventory of used vehicles few people wanted to buy.

Tague, who was replaced by Kathy Marinello the following year, initiated a US\$1 billion overhaul of its car-tracking, reservation and scheduling systems that was so ineffective Hertz is still working to replace it. By the time Icahn sold his position in May 2020, days after the company filed for bankruptcy protection, he'd lost almost US\$1.6 billion.

Wagner and O'Hara arrived with a far more ambitious plan for the

century-old company: electrification. A few years earlier, Knighthead had studied the disruptive potential of EVs and autonomous driving.

Now, Wagner was fully geeking out on the future of mobility, convinced it was inevitable that batteries would displace petrol and self-driving would eliminate the need for single-family cars. At the time, Tesla was selling every car it could make, and global EV sales were about to double after growing by almost 50 per cent in 2020. Musk predicted that Teslas were on the verge of being able to drive themselves and that eventually they could earn money for their owners as robotaxis for hire instead of sitting idle in a garage or parking lot.

If Hertz went all-in on EVs, it could gain a yearslong advantage over Enterprise Holdings and Avis by positioning itself for exclusive deals with ride-hailing services and automakers. It would be more profitable, too, because EVs were so much cheaper to operate, easier to maintain and safer, they figured. Meanwhile, O'Hara was touting the synergies with Certares' network of travel agencies and its expertise in technology. He boasted of being able to solve the chronic software issues, and he even forecast the company would make an additional US\$150 million a year in profit, thanks to the rental business it'd get from his Amex GBT.

If Hertz could get the software engineering right, renting might actually be a pleasure rather than a necessary evil. When booking a Tesla, you would get an app notification with a handy map showing where exactly to find it. The car would automatically unlock as you approached, recognise you by name, adjust the seats, mirrors and temperature to your preferred settings, upload your favourite playlist on, say, Spotify and display your destination

as well as the expected battery consumption and charging options along the way. Returning the vehicle would be a similarly painless experience.

When Hertz finally held an auction to sell itself in May 2021, Wagner and O'Hara, backed by Apollo Global Management, beat the runner-up with an offer that was some US\$200 million higher. "They had a huge embedded advantage in the bidding process, because they saw so much more value than a mere turnaround," Jim Millstein, the investment banker who represented Wagner and O'Hara at the auction, told Businessweek at the time.

Mark Fields, a former Ford CEO whom Wagner and O'Hara recruited as a Hertz director, agreed to serve as the company's interim chief, but they needed a leader for the long term. Days after Scherr announced his retirement as CFO of Goldman in September 2021, he received a call from a former colleague at the firm. Jeff Nedelman, by then a partner of O'Hara's, wanted to know if Scherr would be interested in taking the job at Hertz, where he would be working for Wagner, another Goldman alum.

Scherr was apprehensive. Most of his 28 years at Goldman had been in investment banking. He knew finance, how to structure deals and raise capital. Running a nuts-and-bolts company such as Hertz was altogether different, but Wagner and O'Hara were offering the chance to lead an industry transformation. Plus, he could make a killing. If he stayed four years and Hertz shares hit the most aggressive targets in his incentive plan, he'd have about US\$325 million to play with and still be under 65. He took the job.

To those around him, Scherr was a surprising choice. At Goldman, he would always been considered smart, logical, level-headed and

articulate, if loquacious at times. One former colleague said he had off-the-charts “EQ and IQ”. Aside from a career at Wall Street’s most prestigious firm, there was little on his résumé to suggest he’d do well at Hertz.

By the time Scherr started his new job on Feb 28, 2022, the key pieces of Hertz’s strategy were in place. The Tesla deal had come together in part because of another Goldman player, CEO David Solomon. Solomon had connected Wagner and O’Hara to some of the world’s biggest carmakers in the hope of finding one or two that might be able to supply EVs. But it was clear only Tesla was making enough at the time to sell in volume.

The order for 100,000 Tesla Model 3’s and Model Y’s, hammered out in secret negotiations over nine months, often with Musk himself, seemed like a coup for both companies. Hertz got a jump on Enterprise and Avis, the latter of which was just running small experiments renting out EVs. On the day of the announcement in October 2021, shares of Tesla surged 13 per cent, and its market value topped US\$1 trillion for the first time.

The Uber relationship, unveiled 48 hours later, solved a different problem. By renting as many as 50,000 of its Model 3’s to Uber drivers at a fixed weekly rate, Hertz would not only develop a new market but also increase the utilization—and thus profitability—of each vehicle. The third critical deal was with Carvana, the car retailer that operates vehicular vending machines. It enabled Hertz to sell cars directly to consumers and fetch better prices than the company typically got at dealer auctions, potentially saving tens of millions a year. “Our approach is very strategic and very deliberate in terms of how we want to disrupt ourselves,” said Fields at the time, “and, hopefully, disrupt the industry”.

Scherr did not want to give up his New York existence and move to Florida, where Hertz was based, and the board agreed that was fine. Back in 2013, Frissora had relocated the headquarters from New Jersey to Estero, Florida, a pricey playground for wealthy retirees where he had a vacation home.

The locale had become a problem for a succession of Hertz leaders who did not want to move there, and the company had a hard time wooing the transportation industry talent it needed. While Scherr was in Estero most days and sometimes stayed over weekends, he would also open a new Hertz office in Manhattan, a short drive from his Upper East Side apartment. Looking back, some members of the board now wonder if they should have insisted he live in Florida full time, especially as challenges began piling up.

During Scherr's first year on the job, the rental-car business boomed. Yet Hertz, which was never known for efficiency, kept reporting lower margins than Avis. Over the course of 2022, directors began pressing Scherr, according to a person with knowledge of the situation who, like several others in this story, asked not to be named discussing private matters. Why, they asked, was Hertz not squeezing more revenue from its available cars or making more progress on its technology upgrades? Why were Uber drivers falling behind on payments? Scherr, they noted, had also ditched a practice Fields brought over from Ford to grade management performance.

The science of car rentals is predicting where demand will be greatest and making sure that is where the vehicles are. In the race to staff up quickly coming out of the pandemic, Hertz hired contract workers to haul cars to markets that experienced surges

in rental demand, such as Miami and Los Angeles. But the contractors were expensive, and Hertz took a long time to replace them with less costly full-time hires.

The company's perpetual IT troubles also compounded inefficiencies. Because Hertz typically has hundreds of thousands of vehicles on the road, it needs to know in real time when and where they will be returned, cleaned and gassed up and ready to be rented again. Similarly, its desk agents and customer service staff need to know if a car's been damaged and when it is likely to be back in service. If any of that gets lost in translation, it can quickly devolve into a headache for the customer.

Over the years, Hertz invested in plenty of software and cloud services, but it ended up with a jumbled mess of technology for different parts of the business and chronically failed to get those programmes working in tandem. As a result, too often travellers showed up to find that the cars they'd booked were unavailable.

Sometimes the kludgy system erroneously showed cars as missing, resulting in hundreds of innocent Hertz customers getting arrested on charges of stealing rentals they would actually return. (In 2022, Hertz paid US\$168 million to settle 364 of those claims.) Avis, which operates a fleet 25 per cent bigger than Hertz's and generates 28 per cent more revenue, has 2,500 fewer employees. Hertz had promised shareholders at the time of the IPO that US\$300 million of the cost cuts it had modelled would be permanent. The board wanted results from Scherr.

At about the same time in late 2022, the first fissures in the EV strategy began showing. Internally, some longtime Hertz managers who would experienced the ups and downs of used-car prices over

the years warned against making such a huge wager on Teslas. They knew that betting wrong on which models to buy is a profit killer for rental companies, which rely on strong returns when they eventually sell the cars into the used-vehicle market.

Wagner and O'Hara pressed ahead with their plan anyway. EVs were hot with consumers and investors, and the calculations showed that Hertz would not just make money renting them at higher rates but also save on maintenance costs. The company followed the mammoth Tesla order with five-year agreements in 2022 to buy as many as 65,000 EVs from Polestar, the venture between Volvo Car and China's Geely Automobile Holdings, and 175,000 from GM.

In the field, everything started looking different from what was on the spreadsheets. Unlike EV owners comfortable with the idea of charging a car battery at home and on the road, business travellers and vacationers suffered from range anxiety and did not want the hassle or worry of having to find a charger in the wild.

Rudy Gardner, who as president of Teamsters Local 922 represents Hertz workers at Washington, DC's Dulles and Reagan National airports, says travellers after a long flight would arrive at those Hertz locations to find that Teslas were the only vehicles available. "People did not want to charge them," he said. "At the end of the night that is all we had left, so they would go to Avis."

Lack of demand was such a problem that Scherr started a programme where Hertz agreed to share certain data on EV rentals with cities such as Atlanta, Denver and New York so they would install more charging stations. Other deals gave customers who rented Teslas for three days an extra day free or offered free

charging to anyone who returned an EV with at least a 30 per cent full battery. The company even made symbolic efforts, like donating an EV to a New York technical school for mechanics to learn how to repair it. None of it made a difference.

There were other charging issues, too. While the company had installed its own charging network as part of the electrification push that started in 2021, some older airports, such as New Jersey's Newark, do not get enough power from the electricity grid or lack the infrastructure to support the number of so-called Superchargers that Hertz needed to get EVs back on the road in a half-hour or less. Once a Tesla was returned to those locations, Hertz employees often had to drive them for miles to find a Supercharger, which added yet more expense.

Early in 2023, another warning light flashed. Delays due to repair were increasing across Hertz's entire fleet, and collision costs were jumping, too, but initially neither Scherr nor anyone else could explain why. It was not for at least another quarter that his team broke down the aggregate data and showed the board that the culprit in both cases were Teslas.

With electric motors and drivetrains, Teslas were indeed cheaper to maintain than a traditional car, as Wagner and O'Hara predicted in their financial models. The problem was how often they crashed. Newbie Tesla drivers who were not used to the car's instantaneous acceleration and immediate braking were running into obstacles or getting rear-ended, sometimes even before they left the rental lot. Hertz's Teslas got into accidents four times more often than the company's other vehicles.

Unlike major automakers, Tesla does not have an extensive

network of franchised dealers to help with service and repair, leaving owners subject to the company's availability and schedule. Some of Hertz's Teslas were idled for extended periods as a result. "They couldn't get parts, even simple things like an outside mirror," says Alex Rojas, the business agent representing Hertz workers for Teamsters Local 222 in Salt Lake City. "They just sat there for weeks not getting rented and not making money."

When Hertz was able to get its Teslas fixed, the costs were exorbitant compared with those of repairing other makes. A radar assembly for the Autopilot driver-assist system can cost US\$1,500 to replace and as much as US\$3,000 to calibrate. Many Teslas had to be junked altogether, because a crash could result in a permanent misalignment of the body panels or because the risk of battery damage made them uninsurable. That, combined with the higher rate of accidents than on Hertz's other vehicles, led to a spike in repair bills. In 2023, Hertz reported the cost of operating its vehicles was US\$5.5 billion, up 13 per cent from the previous year and 39 per cent from 2021, partly because of collision and damage.

If Wagner and O'Hara were caught off guard by setbacks with the Teslas, they certainly did not imagine that Musk would wage a price war. Hertz management had always been wary of its relationship with the unpredictable Tesla CEO, but he would cause embarrassment only once, in 2021, when he tweeted, accurately, that Hertz would pay full price for the cars it bought, rather than get a fleet discount as it often did from other automakers.

Then, late in the evening on Jan 12, 2023, Tesla published a new price list on its website. There were discounts on every car in the

lineup— Model Y crossovers were selling for US\$53,000, a drop of 20 per cent. Scherr at the time planned to increase Hertz's EV allotment from 10 per cent of the fleet to 25 per cent by the end of 2024. That implied buying tens of thousands more vehicles, whether Teslas, Polestars or Chevy Bolts. "I'm obviously a happier and a better buyer at a lower price point than not," he said on an April 2023 conference call. The cuts would benefit his ride-hailing business, too. "Our EV fleet is the most affordable entry point for drivers to get into those EVs and use them," Scherr said.

But what initially seemed like a boon exploded like a bomb. By October 2023, Musk, intent on defending Tesla's share of an increasingly competitive EV market, had slashed prices multiple times. The warnings Wagner and O'Hara had brushed off were proving all too prescient. Musk's price cuts forced Hertz to revalue all of its Teslas and played a major role in a tripling of Hertz's depreciation costs to US\$2 billion last year.

In the boardroom, frustration was mounting. Scherr started each meeting with a two- and sometimes three-hour discourse about the state of the company, with no slide presentation. By the third quarter of 2023, directors were asking one another if Scherr's background in finance left him ill-prepared for the immense challenges he faced with Hertz's EV fleet and with the performance improvements they'd demanded. As the situation deteriorated, some wanted less of an overview from Scherr and more time to grill members of the company's operations team on how they were tackling specific problems.

Meanwhile, little of the US\$150 million in profit O'Hara forecast from rentals through Amex GBT had materialised, and O'Hara himself had moved to Italy and stepped down as Hertz chairman in

January 2023. (He returned to the board a year later.) Scherr, according to people with knowledge of the situation, called Paul Abbott, the CEO of GBT, multiple times to find out what happened and got nowhere. (Abbott declined to comment.)

The pressure that had been building for months finally came to a head over how to address the EV debacle. Scherr, drawing on his Goldman schooling in risk management, had come to see the Teslas as nothing more than a bad trade and wanted to dump them quickly. Wagner, who champions EVs almost as loudly as Musk does, disagreed.

As one of Hertz's two controlling shareholders, he demanded that the company look at every alternative to "defleeting" the Teslas. For two months the sides debated until Wagner finally conceded that getting rid of the Teslas was the only option. In December, Hertz reversed course on electrification and began unloading 20,000 EVs, many on its own used-car website. Buyers who previously could only dream of owning a Model 3 could now purchase one with 85,000 miles for as little as US\$18,000 thanks to the Hertz sell-off.

Scherr had had enough. He would joined Hertz to lead a revolution, not deal with one crisis after another. On Jan 8 he walked through the revolving doors of Manhattan's 280 Park Ave. and rode an elevator to Knighthead's 22nd-floor offices for a 10 am appointment with Wagner, who was still unhappy with Hertz's new direction. After spending the Christmas break contemplating his life and prospects, according to people familiar with the exchange, Scherr had come to deliver a message: He wanted out. "This isn't the job I signed up for," he said.

Turning around Hertz now falls to Gil West, an operations specialist who's worked in the trenches of transportation companies and is definitely not a banker. West, formerly chief operating officer at Delta Air Lines during the carrier's merger with Northwest Airlines, was originally Wagner and O'Hara's first choice for the Hertz top job, but at the time he was tied up as COO of Cruise, GM's self-driving car division. In December, GM dismissed him along with eight other executives in the struggling unit, and he was suddenly available.

Meantime, a couple of Wagner and O'Hara's strategies are working. Uber drivers have put more than one billion miles on EVs rented from Hertz. Carvana has helped the company recover more value from used vehicles. Now that Hertz has written down its Teslas and is replacing EVs with gas-powered cars, damage and depreciation costs should not be as big of a problem. But the company West inherits is no longer the herald of humanity's mobile future. If anything, it resembles the one Icahn hoped to fix—with bloated costs, vexing IT issues and a misguided bet on the wrong vehicles.

Brady, Hertz's human embodiment of a Tesla, is still on the payroll. After retiring from football, he extended his contract with the company and also joined Wagner to buy a UK soccer club. In his most recent Hertz ad from May, Brady is still pitching EVs, only this time there's none of Musk's cars in sight. Since the IPO, Knighthead and Certares have not sold any Hertz shares, even as the company bought back US\$3 billion of stock to 2023. As a result, Wagner and O'Hara—and the investors in their funds—are sitting on a loss of about US\$220 million, or 11 per cent, on the investment.

By piling into EVs as car prices were peaking, a fact visible at every showroom in the country, the two had made the most classic of Wall Street errors, buying high and selling low. In many respects, they are no different from any of the hapless investors in Tesla, or Rivian Automotive, or Lucid Group, or Polestar, who are now licking their wounds as global EV demand slows and the prospects grow dimmer for full electrification of the auto industry. Wagner has made controversial bets before and stuck through them. To him, Hertz is no different. With the confidence of a born trader, he still believes his bet will be proven right in the end. “My strong suspicion,” he says, “is that in the not-too-distant future we will have figured all this stuff out”. BLOOMBERG