HollAnd
Advisors

Holland Views – Ashtead – Price: 1681p; MCap: £7.6bn

Plant Higher

This piece recommends buying the shares of a cyclical company that has debt during what looks like the onset of a sizable US recession. Are we mad? We looked at Ashtead this January (Pre coronavirus) and found a business with a strong track record of compounding capital at high rates of return. We also found it to be a consolidator of the US Plant hire industry and an excellent capital allocator. In January we liked the quality of the business model we found. Today we like the price it is offered at too.

We are doing lots of stress testing these days at Holland (including on each other!). We should say up front that our eyes are wide open here. This is a cyclical business with debt. Some might ask shouldn't it get weeded out via our new stress test flow chart? Actually, our pre-crisis views on this being a well-run business (albeit one that uses debt financing to partly fund its growth), still look sound. We think Ashtead is a survivor that will not need new equity and will be very well placed for a recovery. Trading might well suffer for a while, but its smaller competitors will feel even greater pressure

Before we lose the sceptics, we might add that Ashtead now trades on **9x PE** and **6.5x 'owner earnings'** to March 2019 figures (and these earnings, for now, are still <u>above</u> 3/2021 forecasts). It also has a plausible 8-year equity investor **IRR of 17-23% we estimate**!

What originally attracted us to Ashtead is:

- **A classic compounder**. It grew revenues at 15% cagr 2009-19 with a consistent high teens ROE. Tangible book value per share has compounded at 27% since 2009!
- **Has a long runway of Growth**. Ashtead's 9% market share and the fragmented nature of the US rental market offer strong growth opportunities. Scale begets scale.
- **A strong Capital Allocation track record**. By definition, rental businesses depend on capital to grow. Ashtead has a good track record of allocating excess capital astutely to grow organically and by acquisition (also dividend+buybacks). Its track record suggests a strong awareness of how to use debt prudently (2x net debt/EBITDA currently).

<u>Fig.1: A very depressed valuation multiple considering the earnings power of its assets</u>

March year-end ¦ GBPm	2015	2016	2017	2018	2019
reported adj EBITDA* (<u>before movement in rental inventory</u>	**908.4**	**1177.6**	**1504.4**	**1733.1**	**2106**
less amortisation (for prudence re acquiring fleet)		-28.6	-28.3	-43.5	-50.7
add back exceptionals?				25.2	0
less STATED rental *replacement* capex as reported		-452.6	-413.9	-375.8	-472.9
less STATED *overhead* capex				-141.2	-168.7
less interest				-110	-143
less cash tax				-98	-100
Owner Earnings				**990**	**1171**
OE margin				27%	26%
reported adj NI margin				26%	18%
Price to Owner-Earnings P/OE					**6.5x**

Source: Holland Advisors

We structure this note in two sections:

1. **Stress Test**. First and foremost, we apply a stress test to the business' balance sheet and cashflows for a period of steep revenue declines.
2. **Ashtead as a compounder**. We then look at the track record and prospects for the business with "pre-February 2020 eyes" – i.e. when we were in a calmer state of mind!

The pandemic has put us on a 'war footing' of sorts here at Holland. We have spent the last few weeks intensely assessing balance sheets and reading banking covenants for a myriad of businesses that are suddenly facing collapsing revenues of unknown duration. Inevitably, there are over reactions by Mr Market. Part of our job is to avoid the torpedoes (some businesses will get hit) but also to identify the survivors. I.e. the great businesses that we know well that will survive and thrive post Covid-19. In early 2020 we undertook a lot of research on Ashtead and identified it as a great business, a compounder. This note serves to promote that work, to highlight an excellent business whose shares now look very cheap against many scenarios.

Section 1: The Ashtead Stress Test (Pass)

As of January 2020, Ashtead had c.£4.4bn of Net Debt (before IFRS16 capitalised leases) secured against c£6.5bn of depreciated equipment assets. Its Market Cap is c.£8bn (vs. an all-time peak of £13bn on Feb 27th 2020) and its 2019 EBITDA was c.£2.1bn. Additionally, as of January 2020, stated Net Debt/EBITDA was 1.9x, at the high end of its 1.5-2.0x guided range. None of the £4.4bn debt matures for another four years (see Fig.2) and the company has been pro-active in refinancing throughout the last year. This is company that has been on the front foot in prudently managing and communicating its debt structure.

> *"In November, the Group took advantage of good debt markets and refinanced its debt facilities by issuing $600m 4.0% senior notes maturing in May 2028 and $600m 4.25% senior notes maturing in November 2029. The net proceeds of the issues were used to repurchase the Group's $500m 5.625% senior notes which would have matured in 2024, pay related fees and expenses and repay an element of the amount outstanding under the ABL facility. These actions ensure the Group's debt package continues to be well structured and flexible, enabling us to optimise the opportunity presented by end market conditions. The Group's borrowing facilities are now committed for an average of six years at a weighted average cost of 4%"* – **Ashtead January 2020 update**

Disclaimer

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.