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. Ie 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**

Fig.2: Ashtead debt maturity (as of April 2019, i.e. prior to the refinancing above)

Contractual maturity analysis

Trade receivables, the principal class of non-derivative financial asset held by the Group, are settled gross by customers.

The following table presents the Group's outstanding contractual maturity profile for its non-derivative financial liabilities, excluding trade and other payables which fall due within one year. The analysis presented is based on the undiscounted contractual maturities of the Group's financial liabilities, including any interest that will accrue, except where the Group is entitled and intends to repay a financial liability, or part of a financial liability, before its contractual maturity. The undiscounted cash flows have been calculated using foreign currency exchange rates and interest rates ruling at the balance sheet date.

At 30 April 2019

	Undiscounted cash flows – year to 30 April						
	2020 £m	2021 £m	2022 £m	2023 £m	2024 £m	Thereafter £m	Total £m
Bank and other debt	–	–	–	–	2,010.7	–	2,010.7
Finance leases	2.3	1.5	0.9	0.3	–	–	5.0
5.625% senior secured notes	–	–	–	–	–	383.5	383.5
4.125% senior secured notes	–	–	–	–	–	460.3	460.3
5.250% senior secured notes	–	–	–	–	–	460.3	460.3
4.375% senior secured notes	–	–	–	–	–	460.3	460.3
	2.3	1.5	0.9	0.3	2,010.7	1,764.4	3,780.1
Interest payments	158.8	158.7	158.6	158.5	89.5	154.2	878.3
	161.1	160.2	159.5	158.8	2,100.2	1,918.6	4,658.4

Letters of credit of £38m (2018: £33m) are provided and guaranteed under the ABL facility which expires in December 2023.

Source: Ashtead 2019 Annual Report

For context, readers would do well to recap on the January fiscal Q3 results reported by Ashtead. You will note that, well before this crisis hit, this company was very transparent on its debt financing, its liquidity profile, maturity and specific covenants. The Q3 20 presentation link is here[1] (start, as we have been doing lately, at the last slide and work backwards!).

Trying to break it

What follows is our attempt to break the Ashtead business or least determine how far the business is from running out of money or indeed out of favour with its lenders. What we are really assessing is the chances that the company might need to raise and thus dilute equity shareholders. As per other companies for which we have made similar stress tests, we take a six-month window in our assessment and assume a fairly drastic Covid-19 related revenue shock. From knowing the specifics of the business (its variable costs, capital commitments etc.), we then combine the resulting P&L and cashflow impact to assess the possible hit to debt gearing ratios and covenants.

In short, Ashtead has a lot of cost and cash levers to play with, so even in a scenario where rental revenues fell -50% in the next six months, we suggest that net debt might rise by just £200m to £4,537m. That is even after it spending c.£600m on fleet CAPEX which was committed to in January 2020 (half of its then full year gross capex budget).

Such a scenario would inevitably mean a temporarily higher Net Debt to EBITDA ratio (c.4x?), but crucially the company would still have access to another $707m bank funding BEFORE its sole bank covenant would need to be measured.

Fig.3: Holland stress test on Ashtead

£m	31/10/2019 H1 FY20	31/01/2020 Q3	30/10/2020 H1 FY21	FY21
Revenues	2447		1223.5	
Used sales	234		0	
Group Revs	**2681**		1223.5	
Revenue decline est YoY			-50%	
Staff	591		531.9	-10%
Used sales	119		0	
Other opex	644		120 fuel etc	
Group OPEX	**1354**		**651.9**	
EBITDA	**1327**		**571.6**	
Depreciation	526		526	
Amortisation	29.7		29.7	
op profit	**801**		**15.9**	
interest	111		87 lower int rate	
	5.2%	4.0%		
PBT	**690**		**-71.3**	
tax	173		0	
	25%			
Net Income	517		-71	
net debt (ex IFRS 16 leases)	4242	4359	4537	
statutory net debt		5443		
undrawn debt facility		**$ 1,446**		
undrawn debt - covenant trigger Level		$ 410		
ie headroom in US$		$ 1,036		
headroom in GBP		£ 885.5	£ 707	
Holland calculated Net Debt/EBITDA	2x		4.0x	
reported figure ("*on constant currency*")	2x			

Group Opex fixed/variable:
25% easily variable
25% fairly fixed
50% headcount

Source: Holland Advisors

[1] http://www.ashtead-group.com/lib/docs/181743-q319-20resultspresentation.pdf

Thus, even in such a bleak six-month scenario for revenue declines, the company would still have bank liquidity headroom should our scenario not prove bearish enough. Fig.3 shows the detail of this scenario.

Someone else's money

Covenants are the next potential phase of stress. As shown in Fig.3 above, Ashtead had undrawn debt of $1,036 (£885m in sterling) at the end of October. This undrawn facility would need to fall (i.e. debt would need to rise) an additional +£707m before its covenant trigger is reached. Specifically, this trigger is activated only when available undrawn debt headroom falls to $410m) and thus needs to be measured.

For completeness, Ashtead's only covenant is the ratio of:

> "[**EBITDA less net cash capex**] to [**interest paid, tax paid, dividends paid and debt amortisation**] must equal or exceed 1.0x"

For what it's worth, on a last 12 months basis, this calculation was c.2x according to the company who this week were keen to point out to us that it: *"will manage the situation so as never to come close to dropping below the $410m of availability so the actual covenant calculation is irrelevant"*.

What is crucial to understand here is that this 2x multiple is calculated *after* the company spent almost £1bn on growth capital expenditure![2] Thus the company's ability to turn off CAPEX at its discretion is crucial to bear in mind here as to its creditworthiness and cash generating abilities.

Why Such generous covenants?

Stress testing requires one to use one's imagination but with Fig.3 implying a six-month EBITDA of £571m vs. Interest of £87m there would be a long way further to fall before any breach.

As an aside: It is worth considering why a bank would agree to such seemingly light covenants in the first place? We suggest it is because they see the strong market positioning and importantly, the flexibility of the Ashtead model. ie its ability to generate cash from the assets that its owns

Continuing in our imaginative way, how low would EBITDA need to go for a covenant breach? With the current annual interest of c.£180m (£4500 x 4%) plus if the remaining debt facility headroom of $1bn needed to be utilised, it would add another c£45m of interest i.e. c.£225m interest payments in total. The last time that Ashtead earned an EBITDA close to that level was the £255m earned ten years ago in 2010. A recessionary period many will be quick to note. However, we also note that in that year, it had £1,701m of un-depreciated rental equipment on its balance sheet (see Appendix) or about 1/5th of today's fleet!

So, on this basis, a covenant breach is a seriously bleak scenario, one which we are prepared to say that we think is highly unlikely

We might also add, what bank would repossess used plant equipment from a company that enjoys 9% US market share and has shown excellent cash generation abilities from the plant it owns outright? Would a bank really think that they could maximise the cashflows from such assets at a time presumably when demand and thus used resale prices are massively depressed?

We thus think it very unlikely that Ashtead needs to raise equity, which we think is an important, if to some obvious conclusion.

Section 2: Ashtead as a compounder

[2] For 9m to 31 Jan 2020: [interest + tax + dividends + debt amortisation] = [154+239+25] = 418m ¦
2x418m = 836m ¦ EBITDA was 1911m implying a 9m capex figure in the covenant ratio of [1911-838] = 1075m ¦

Just as it is useful to look back on a diary to revive opinions at a time since forgotten, we present our views on Ashtead, written at the end of January 2020 largely unedited. The point is that it is easy after the last few weeks of craziness to over-adjust our version of what we ascribe as normality. What follows is our assessment of Ashtead analysed and written under what were more ‘normal’ times. By the way, we are not suggesting that we expect the economy and life to snap back to January 2020 normality levels any time soon, but we suggest there is value today in appraising companies through such a lens to assess its longer-term potential.

This section has three parts

a) A recap on how our approach to compounders has evolved

b) We apply the Holland compounding model to Ashtead

c) A focus on Ashtead’s allocation of capital

a) A recap on how our thinking has evolved on Compounders

Measuring the historical compounding of share price returns is simple, in retrospect. *Predicting* such returns in the future is a completely different matter. Most observers focus on a company’s profitability prospects, making judgements on revenue, earnings growth, margins and a P/E multiple. As a short cut, this is an understandable approach but it misses a key component – the use of retained capital. If we have learned anything in a few decades assessing the best businesses, it is that return on capital (not return on sales) and how that capital is reinvested is *really* what matters in identifying great businesses. The good news is that because this is not easy to do, great companies can often be priced like OK ones.

To identify companies which offer superior per-share compounding we realised that we needed to think more critically about how excess capital returns are reinvested and whether returns are maintained. Mathematically, compounding is non-linear which is precisely why it is so powerful in investing but also why it is so hard to recognise. We suspect the master investors like Buffett and Munger can do this all in their head but for the rest of us, we need a little excel horsepower.

This brings us back to our old friend; the ‘**Holland Compounding Model**’.

Beautifully maturing models (…think Cindy Crawford!)
We use this opportunity to explain how our model has evolved over the last 10 years as we have tried to better analyse the per share likely compounding of different types of businesses.

1. We developed the model initially to *methodically* estimate the positive impact that good capital allocation (mostly buybacks) had on companies’ per-share equity returns. This proved helpful in understanding capital light businesses like **Next** or **Moody’s**.

2. Then we progressed using the same model and approach to assess other good quality capital allocators (**Ryanair** and **JD Wetherspoon**). This work concluded that even lower ROE companies (15-20%) with excellent cash generation (via working capital) and ample opportunity to invest can be phenomenal compounders. We also realised that the market was often missing this point, hence there was an opportunity for investors

   Using the model in assessing JD Wetherspoon threw up a further angle; ie that using prudent constant financial gearing (against rising but predictable profits) could provide another layer of ‘excess cash’ to be reinvested or used to distribute to shareholders. Again, the kicker that such capital provides to returns was not captured in the headline P/E valuation on offer and thus missed by most.

3. Most recently, we found a business with pretty much all of the above characteristics – **American Tower**. Telecom Tower businesses offer high growth, good returns and have

high reinvestment opportunities. They are also in a position to use gearing to generate additional capital for deployment in their business. On a P&L (earnings) basis, they look expensive but our model emphasised that was not the full story due to the powerful compounding this combination of factors can result in.

4. This research journey has had a profound impact on our view of valuing businesses with re-deployment opportunities. As value investors we started out trying to remain disciplined in thinking of the margin of safety that comes from modest starting valuation levels of say 10x EV/EBIT or 15x PE. However, in assessing great businesses through such a compounding lens, we can now easily see why a company like American Tower can justify the higher multiples often enjoyed by a **Mastercard** or **Moody's**.

In conclusion, we now get excited when:

- We see companies that enjoy these attributes of growth, returns and capital reinvestment opportunities
- and especially when their management demonstrate a clear awareness of the Operate, Generate and Allocate factors that we look for

In **Ashtead**, we think we might have one such company.

b) Applying the Holland Compounding Model to Ashtead

Ashtead has an excellent Annual Report that is very informative and easy to read. We highly recommend it[3]. In this section we highlight supportive evidence from our extensive readings, summarised via a chart book, that underpin our assessment of Ashtead as a superior compounding business. We walk through our model input assumptions and what they reveal about Ashtead's business and its potential compounding power for equity owners.

A summary of our Ashtead Holland Compounding Model (shown in its entirety in the Appendix) has key input variables – none of which are surprising in their own right but their combined effects are powerful. The point here is not to over-state the fact that we think Ashtead will say, grow revenues precisely at 10% cagr. Indeed, that will be unlikely in calendar 2020! Rather it is to show the **cumulative effect** of the various levers in determining Ashtead's ultimate per-share compounding prospects.

The model shows that Ashtead is a business that can offer superb per share equity compounding thanks to its ability to reinvest lots of capital at high rates of return due to the market opportunity in front of it. We make simple assumptions of:

1. Core business **Revenue and Profit growth**
2. Start and end period **P/E valuation multiples**
3. The ability to deploy its **retained earnings** at good rates of return.
4. Shareholder capital **payout ratios** (dividend and buybacks),
5. The use of prudent, **constant leverage for reinvestment**

1. we assume that Ashtead's revenues and profits grow together at 10% cagr. Importantly, Ashtead has a track record of market share gains and has a stated target (plausible we assess) to increase its US market share from 9% to 15%. Growing profits at the same rate would imply a steady 28% EBITA margin (we can see why this might look lofty to most – especially for a cyclical business. But this should not detract from the purpose of the analysis).

   We then assume that Net Tangible Assets also grow by 10% cagr to fund this revenue growth via fleet asset growth. Note that the resulting Asset Turnover at 0.7x is stable and consistent

[3] http://www.ashtead-group.com/investorcentre/annualreports.aspx

with the last 5 years. As you would expect this leads to a causal Net Income cagr growth of c.10% also. So far so simplistic!

2. For prudence we assume no PE valuation re-rating - Start and end multiples static at 9x PE (this is a P/E based on *reported* earnings as opposed to 'owner earnings' referenced on page 1 and compares with 15x PE that the group traded on in January).
3. For the next layer, based on the excess cash derived from the model, we assume that 25% and 15% of Net Income are distributed as dividends and used for repurchasing shares respectively. The reminder being retained earnings for reinvestment and/or acquisitions.
4. Finally, we postulate how Net Debt is likely to grow within a constant leverage level (we use 3x EBITA as a proxy for c.2x EBITDA). Additionally, how that incremental debt capital can be treated as available cash for reinvestment in addition to the core business' excess cash post distributions.

   We assume, rationally based on our knowledge of the company, that some of this excess cash is allocated to acquisitions (a key part of the Ashtead story is 'rolling-up' the fragmented US plant rental market where it is the #2 player). We use a lower than group level RoTE (in this case 20%) on acquired businesses.

In conclusion, with these four key assumptions over 8 years:

1. Net Income compounds at a rate = 9.8%.

But

2. Per-share compounded returns of core business before reinvestment benefit =14.5%pa
3. **Per-share compounded equity returns, including prudent gearing and reinvestment**
4. **=17.2%** **8 year IRR** with no P/E re-rating at 9x
5. **=23.3%** **8 year IRR** with a P/E re-rating back to 15x

c) Ashtead Chart Book: a compounder in action

In this section we highlight our findings after trawling through Ashtead's investor presentations, annual reports and transcripts wearing our compounder hat. We assess the company on three fronts:

1. Growth, margins and returns
2. Capital allocation
3. Gearing

1. Growth, profit margins (and marginal returns)

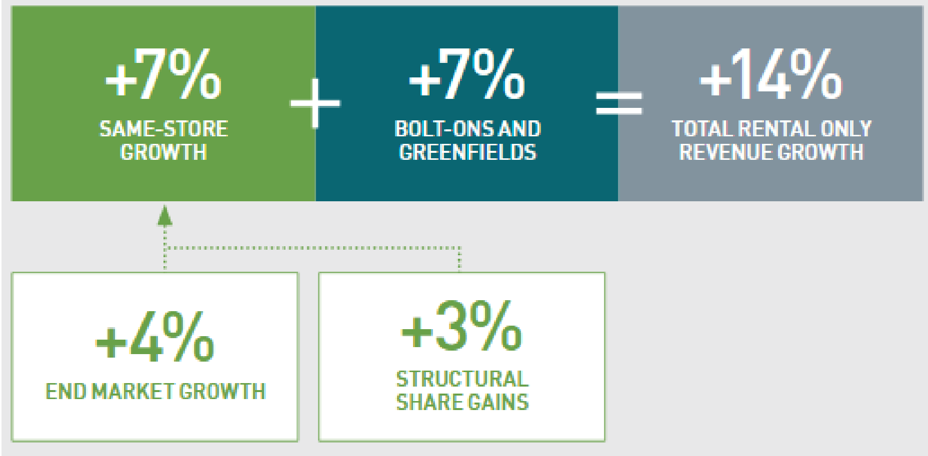
Organic revenue growth and compounding often go hand in hand, but we have always been wary of acquired growth when it assumes to generate shareholder-value compounding. That said we do see the attraction of well-run 'roll-up' businesses but only when there is a strong rationale for such consolidation. Ashtead, we observe, offers investors both organic growth and roll-up rationale.

Fig.4 below warrants careful study. It reminds investors of the 3 pillars of growth that Ashtead enjoys

- Its end market growth, ie that GDP and construction activity (in most years!) grows
- Structural share gain is the move by more and more builders to use rented as opposed to owned equipment (with the US still lagging markets like the UK on plant rental usage)
- Bolt-on acquisitions and expansion of Ashtead's network with greenfield developments

Having exceeded its growth targets laid out in 2017 and earlier years, Ashtead management have credibility in achieving past targets. As a reminder, the latest target is to increase US market share from 9% to 15% over a ten year period.

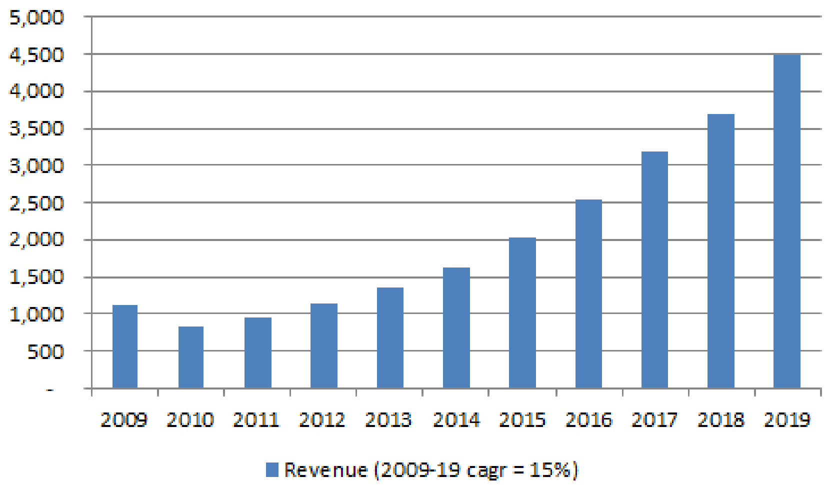
Fig.4. Doing what they said they would do in 2017. Actual 2016-19 revenue cagr was 21%



Source: Ashtead 2017 Annual Report

This targeted growth puts our model assumptions earlier (10% organic growth assumption) into context. Bolt-ons are effectively part of our modelled acquired growth. The chart below (Fig.5) shows group revenues (in £m) which have compounded at 15% since 2009.

Fig.5: Actual revenue growth

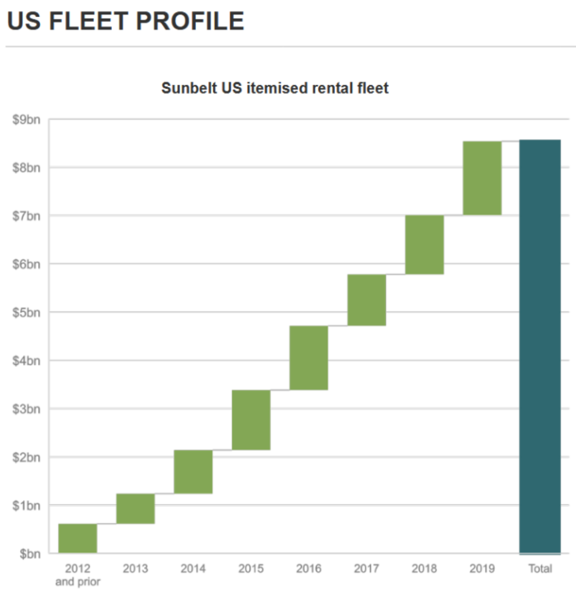


Source: Holland Advisors

Fig.6. is a clear reminder that this is a 'put up more to make more' business-model. Any rental business can clearly only sustainably grow if its fleet capital grows also. Said plainly, the earnings power of an equipment rental business is determined by the magnitude (+ quality and availability) of its fleet. Fig.6. also gives us a feeling for the company's recent scale of reinvestment in its fleet.

The stability of ROI over this period (shown in Fig.7) speaks to the company's past ability to have generated strong marginal rates of return on each new year of additional capital that has been deployed. Given fleet size and revenues grow hand in hand over the medium term, that is why our model discussed earlier, assumes tangible capital grows at the same rate as sales growth, as it has in the company's past.

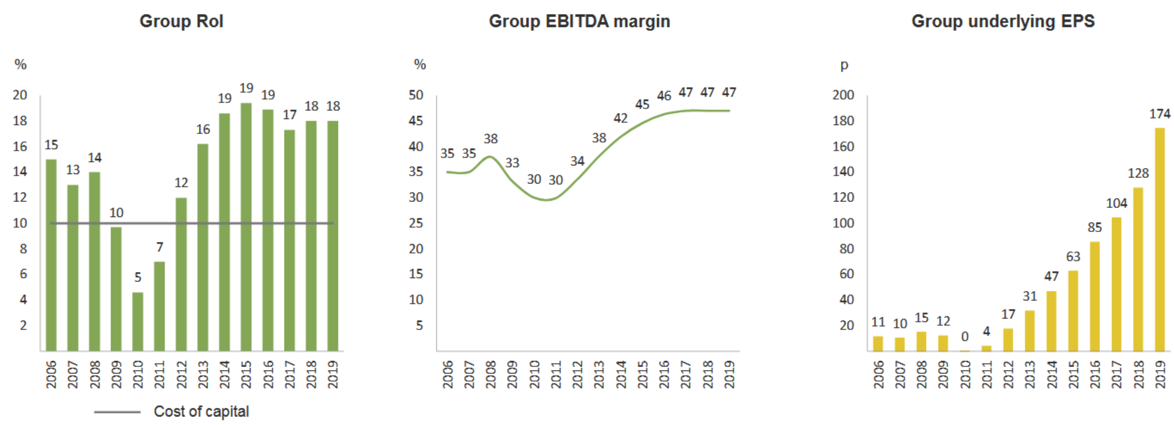
Fig.6: This is what compounders do; they reinvest capital



Source: Ashtead Annual Report

Fig 7 charts show the stability of ROI on the enlarged capital base. They also show a no-nonsense approach to cost of capital with a simplistic 10% rate being used. That recent rates of ROI and EBITDA margins are higher than the past cycle some might say point towards a business or sector overearning...? Whilst we cannot dismiss this theory, we think it logical for returns to be a little higher than the past due to the greater scale in market share now being enjoyed by Ashtead and its closest peer.

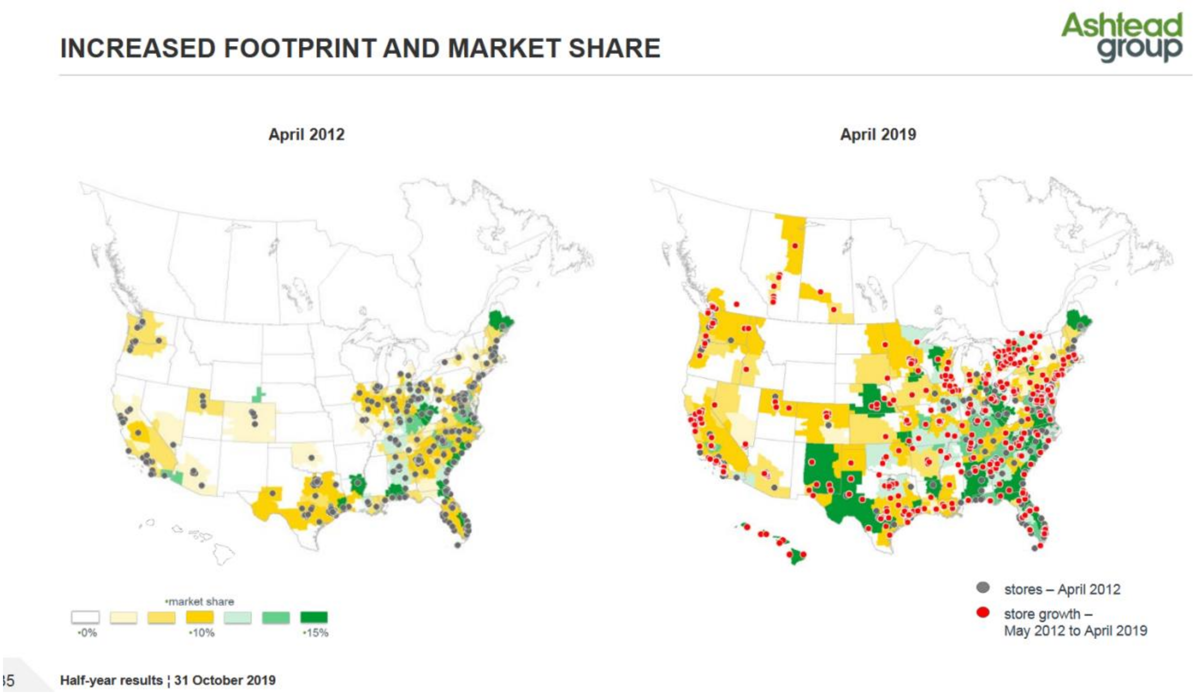
<u>Fig.7: But crucially, that reinvestment ought to be at consistent rates of return</u>



Source: Ashtead Annual Report

We also highlight the prominent point that this stability in higher returns have only been achieved since 2010. That this company experienced a cyclical downturn in 2009 is not lost on us. Indeed, our initial work in January caused us to pause on the idea that the group despite our attraction to it could be ‘overearning’. With the shares now discounting that fact we find ourselves comforted.

<u>Fig.8: This is the opportunity for market share growth</u>

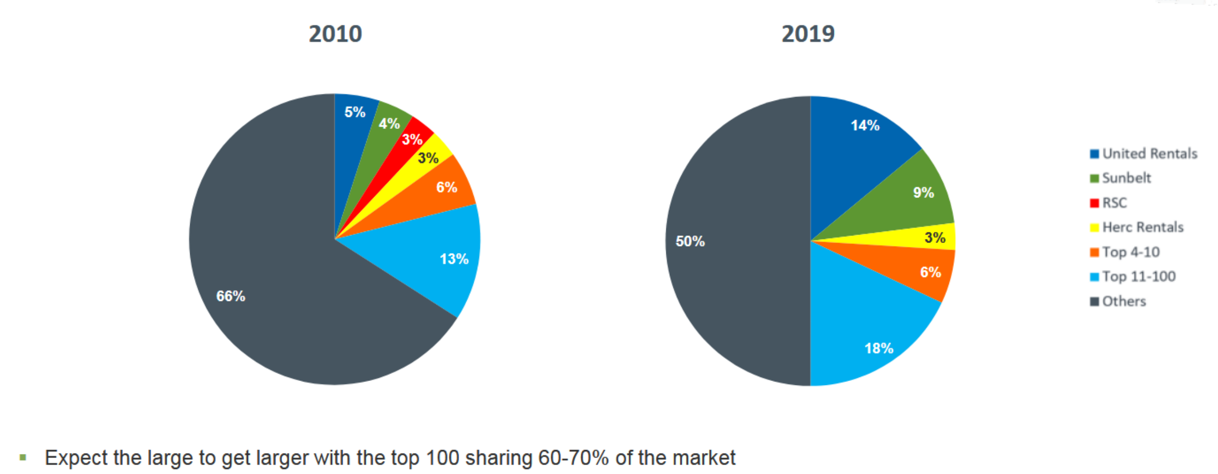


Source: Ashtead Annual Report
(please see Appendix for an enlarged version of this excellent chart)

Fig.8 shows how retained capital was deployed across the US in the last 5 years to establish a more dominant distribution, and ultimately, market share footprint. Additionally, Fig.9 demonstrates the market share growth that has resulted for those businesses building such unmatched industry scale (Ashtead's Sunbelt division and United Rentals). Two competitive facts stand out we suggest:

1. That Ashtead competitors are mostly all less profitable and more highly geared than it
2. That whilst a near term US recession can hurt profitability this network will not be replicated by others easily

Fig.9: For context, Market share gain targets are on track and still low at 9%



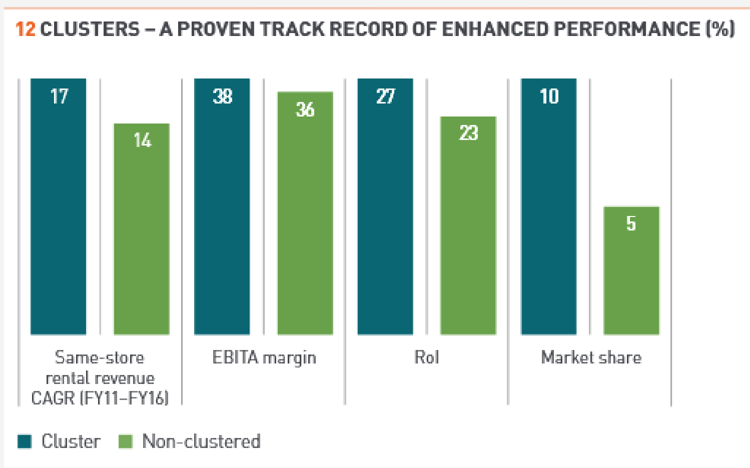
Source: Ashtead

The group has a long-term target of a US market share of 15%. Its position of scale, proven history and strength in a broadly unconsolidated market indicate to us these targets are plausible. This in turn suggests the group has potential long runway of growth ahead of it.

How is it doing this?

Ashtead's returns are being maintained in new capital expansion via a 'cluster' distribution strategy driving local and *regional scale* advantages ("clusters" of distribution centres and thus market power). This we suggest is a little granular evidence of Ashtead being a good business 'operator' as they identify why they will win vs competitors rather than it just being an aspiration

Fig.10: Cluster strategy



Source: Ashtead Annual Report

Fig.11: Cluster approach drives higher for longer ROI

Profile	Non-Construction	EBITA	ROI
Mature	+60%	41%	29%
Mid-Term	40%	35%	22%
Early	20%	32%	19%

Source: Ashtead Annual Report

Through the use of this cluster strategy, management look to have a clear understanding of how much local scale can drive superior longer term returns on investment. This we suggest is a thoughtful and well-planned approach to deploying capital in a manner that over time should sustain premium returns.

A side note on management and their thinking

Sadly we lack a true owner manager at Ashtead. But, **rarely outside Next plc or the John Malone Liberty companies have we seen a company explain its capital allocation and usage of debt as well as Ashtead does**.

Fig.12 and Fig.13 below offers some insights into management thinking on the competitive advantages of being essentially one of the just two market leaders in this rental market segment.

- Scale matters in this business. It is very hard for independent operators to offer the same fleet breadth and availability.
- The market is under-served. Ashtead is creating new markets - Floor scrubbers are a good example with CEO recently citing a 32% ROI on a $100m business that didn't exist just a few years ago.

- Along with its peer, United Rentals, Ashtead (via its US business Sunbelt) is arguably a duopoly of those with sufficient scale. This in turn enabling them to make higher returns and to be able to deploy further capital profitably. This is against a wider industry that might be typified by local competitors with older equipment, lower utilisation rates, lower customer service capabilities and ultimately lower return levels.

Fig.12: Management quotes (on scale etc.)

Analyst (how are you winning all this business?): *If you are competing on price, what actually are you kind of winning on? It sounds like a really naïve question or is it the pricing is competitive, but this is still good pricing– I'm just interested as to how you describe why you are winning.*

CEO (via scale – we're effectively in a duopoly): *All these big projects, I mentioned or even the one-off at lots of sites like the light towers. How many companies can spend GBP20 million in CapEx for a project where it takes to have 3,000 light towers around the country.* ***I'll give you the answer. Two.*** *So those two are both responsible and looking to over time to independently just nudge rates up. We don't need 4% in a year. I mean, I'll take it. I wouldn't give it back to you, but you just don't – you just don't need that. But the real key is this, not just because we can, it's becauase of the breadth of products and services we have.*

All of these customers we talk about – the one for instance around the light towers, they, in their full operations have nothing to do with construction. But inside the last six weeks they had a fire event which we had to deploy all of our speciality businesses into. So our remediation, our Climate Control, our power generation clients - they are looking for partners who can actually solve multiple solutions.

Source: Ashtead analyst call

Fig.13: And some commentary on the cycle

Traditionally, rental companies have only generated cash in a downturn when they reduce capital expnditure and age their fleet. In the upturn, they consume cash as they replace their fleets and then seek to grow. We are in a highly cash genreative phase as we continue to grow the business in a cyclical upturn.

As a consequence, our leverage would trend natually towards the lower end of our target range of 1.5 to 2.0 times net debt to EBITDA which provides the Group with significant flexibility and security. However, we believe that the current cycle will likely be lengthened by current policy proposals in the US, if enacted, and therefore we do not need to be towards the lower end of our leverage range at this stage. This give us even more flexibility to invest in growth.

Source: Ashtead annual report

Allocate, Allocate

Fig.15 below is a very revealing table and will pique the interest of anyone who has read our work on American Tower. **Notably, Ashtead is allocating capital that is 2-3x the size of its Net Income that is being reported in the company's Income Statement.** It is doing so, with full awareness of how this drive returns. Our extensive reading of management discussions from its annual reports and call transcripts show a very clear understanding of capital allocation.

We repeat something alluded to above: to find this powerful driver of compounding laid out so clearly by a management team is as impressive as it is rare. There lies the opportunity.

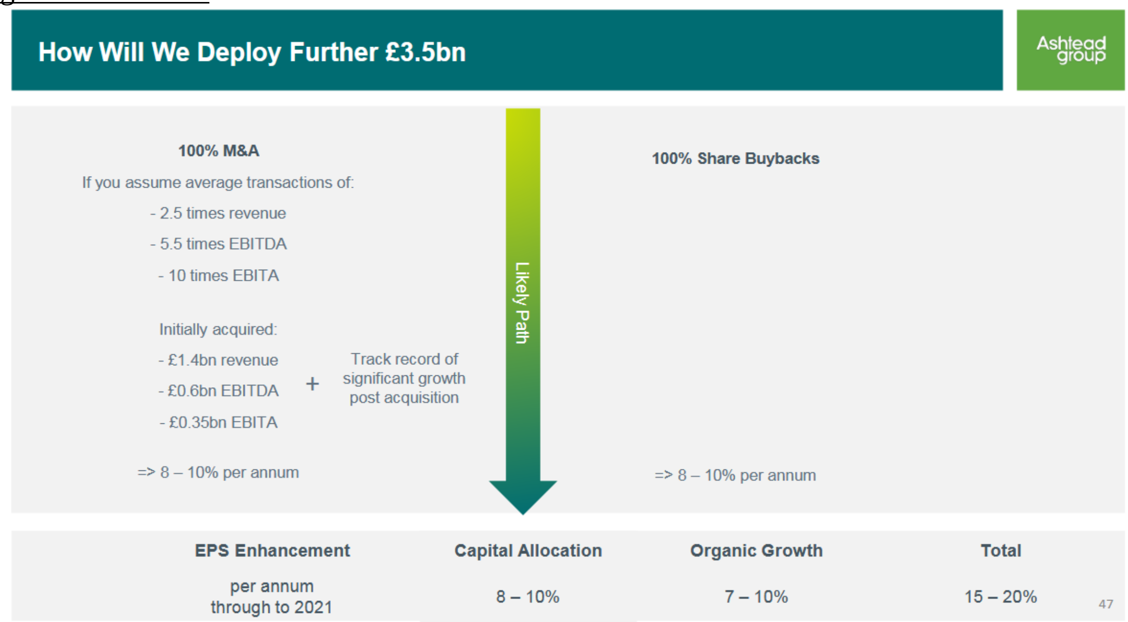
Fig.15: Ashtead Capital Allocation

CAPITAL ALLOCATION	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	last 12m
value of acquisitions	0.7	34.8	21.9	33.8	103.3	241.5	68.4	**437.0**	**359.0**	**591.3**	
replacement capex									375.8	472.9	706
non-rental capex									141.2	168.7	
growth capex									705.9	1030.6	945
total capex	42.8	202.6	406.0	581.5	740.5	936.8	1,234.2	1,123.5	**1222.9**	**1672.2**	
Dividends	12.8	14.6	15.3	20	41.3	61.4	81.5	116.1	140.5	164.2	185
Buyback						20.3	12.0	50.0	158.2	460.4	518.0
Total shareholder Payout						**81.7**	**93.5**	**166.1**	**298.7**	**624.6**	
as % of Net Income						27%	23%	33%	31%	78%	
TOTAL ALLOCATION	43.5	237.4	427.9	615.3	843.8	1260	1396.1	1726.6	1880.6	2888.1	
Reported Net Income	2.1	0.9	88.5	137.8	231.2	303.4	407.6	501	968.8	796.9	

Source: Holland Advisors

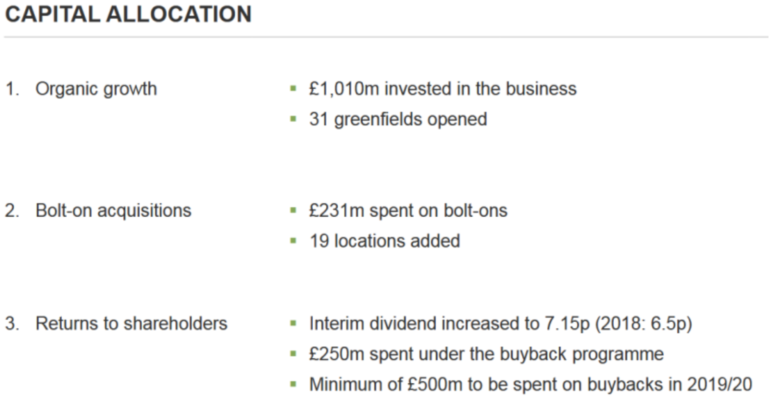
The following two charts Fig.16a and Fig.16b are important also. Firstly, because they give a clear demonstration that management understand the various constituencies of capital allocation and how it impacts per-share earnings. Not many companies demonstrate such clarity. Subtly, the second chart is from the newly promoted CEO Brendan Horgan (former COO) suggesting that past management culture is continuing.

Fig.16a: From 2017



Source: Ashtead 2017 CMD

Fig.16b: From 2019 (via the newly promoted CEO)

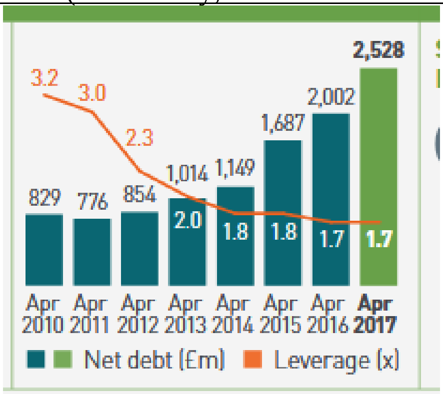


Source: Ashtead 2019 Interims

Using debt financing (again, written in January!)

We have addressed Ashtead's debt levels early on in this note but the chart in Fig.18 is important showing the de-leveraging of the business in a time of exceptional growth. Remember this is a business that compounded sales at 15% over this time. As mentioned earlier, net debt/EBITDA is c.1.9x. that management understand how to sensibly use leverage to boost returns is clearly demonstrated in the quote in Figure 19

Fig.18: Gearing looks prudent (and notably, has fleet asset backing)



Source: Ashtead

Fig.19: Speaking our language – clarity of purpose

> *"if we were to grow 7 to 10% per annum and let's say we have 47% to 48% EBITDA margins and let's say 29% to 30% EBITA margin, we're going to have to spend broadly £3bn on capex….*
>
> *…Now, if we then fix our leverage towards the upper end of our – at or around 2 times, what that means is we would have £3.5 billion left over to spend to further enhance value to shareholders.*
>
> *I think one of the most commonly missed part of our business model is absent extreme growth, this is an incredibly cash generative business and increasingly how we apply that cash and how we use it is going to become an important part of our messaging and probably a shift forward in only the two years since we did our last presentation in 2016."*

The Key Remains The Cash & The Opportunity For Further EPS Enhancement Ashtead group

(£m)	Forecast Assumption
Based on three year organic growth	7-10%
Group EBITDA margin	47-48%
Group EBITA margin	29-30%
Three year capital expenditure spend	c. £3bn
Amount available for M&A and share buybacks	c. £3.5bn[1]

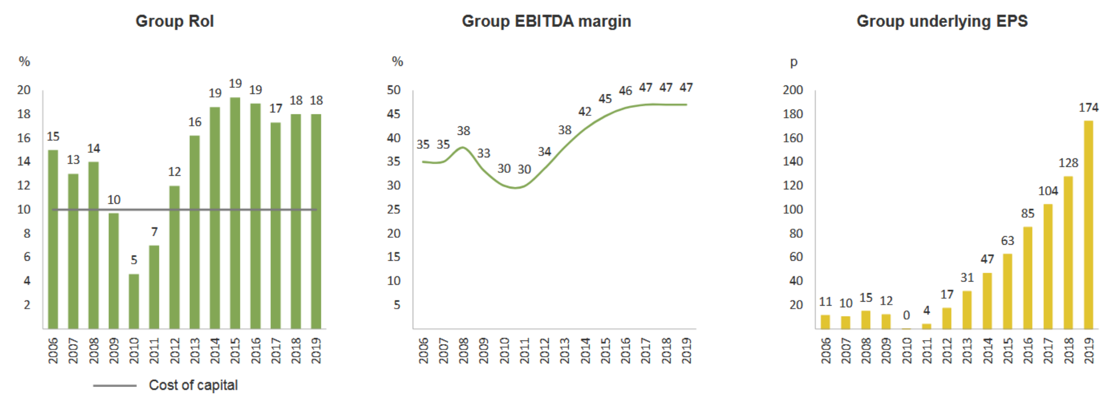
[1]Assuming EBITDA to net debt ratio of 2.0 times

Sources: All from Ashtead 2017 Capital Markets day

A compounder dressed up as a cyclical….?

Ashtead is a classic 'put up more to make more' business dressed up as a levered cyclical. It earns strong returns on capital and reinvests its excess capital whilst also using debt prudently to add to the snowball. There are many rental businesses that look great in times of economic prosperity only to suffer greatly when the cycle turns. Ashtead, we opine is not one of those companies. That its profits may fall this year we cannot deny is now looking probable. But it has a track record (shown again in Fig.20) that suggests a management culture of how to carefully deploy shareholder capital.

Fig.20: The key chart revisited



Source: Ashtead Annual Report

We don't know how severe this pandemic-triggered recession will be. What we can say is that Ashtead will survive it and then thrive in a likely fiscal expansionist recovery. Demand for building construction and plant will one day soon return strongly and when it does Ashtead will most likely start to again make the sort of ROI's and EBITDA margins outlined above. Indeed, with its starting US market share position readers we would hope would conclude this is the '*most likely*" option

All out work in studying its capital allocation is designed just to show the *most likely* compounded growth such a continuation will result in. The best way to summarise this outside of excel models is that it will "*most likely"* look like a similar gradient of the growth in past EPS, shown above

Its shares today trade on c.9x earnings and only 6.5x Owner earnings when we adjust for growth capex. We suggest some phenomenal IRRs could be achieved by investors from today's starting share price (our best guess is 17-23% pa return for 8 years!). That looks to us a steal. Our Models are attached

Buy Ashtead.

Andrew & Mark **firstname@hollandadvisors.co.uk**

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as advisors to.

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Appendix

Holland Advisors Compunding Model

Compan) **Ashtead Plc** Mar-2020 **8-year IRR 17.2%**

Year	cagr Growth Rates	Mar-19 0	Mar-20 1	Mar-21 2	Mar-22 3	Mar-23 4	Mar-24 5	Mar-25 6	Mar-26 7	Mar-27 8	CAGR
Asset/Turns		0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	
Revenue	10%	**4,499**	**4,949**	**5,444**	**5,988**	**6,587**	**7,246**	**7,970**	**8,767**	**9,644**	10.0%
Clean EBITA	10%	1,263	1,389	1,528	1,681	1,849	2,034	2,237	2,461	2,707	10.0%
EBITA Margin		28.1%	28.1%	28.1%	28.1%	28.1%	28.1%	28.1%	28.1%	28.1%	
Fixed Assets	10%	**6,486**	**7,135**	**7,848**	**8,633**	**9,496**	**10,446**	**11,490**	**12,639**	**13,903**	10.0%
Working Capital	10%	200	220	242	266	293	322	354	390	429	10.0%
% sales		4%	4%	4%	4%	4%	4%	4%	4%	4%	
Interest		-153	-171	-197	-227	-250	-275	-302	-332	-365	
Other											
PBT		**1,110**	**1,218**	**1,331**	**1,454**	**1,600**	**1,759**	**1,935**	**2,129**	**2,342**	
Margin		25%	25%	24%	24%	24%	24%	24%	24%	24%	
Tax	25%	**-275**	**-305**	-333	-364	-400	-440	-484	-532	-585	
PAT		**835**	**914**	**998**	**1,091**	**1,200**	**1,320**	**1,452**	**1,597**	**1,756**	9.7%
PAT Margin			18%	18%	18%	18%	18%	18%	18%	18%	
NTA		**6,686**	**7,355**	**8,090**	**8,899**	**9,789**	**10,768**	**11,845**	**13,029**	**14,332**	10.0%
Returns: PAT/NTA		12%	12%	12%	12%	12%	12%	12%	12%	12%	
Starting PE Multiple	9.0x			9x	9x	9x	9x	9x	9x	9x	
Ending PE Multiple	9.0x										
Company Equity Value		**7,515**	8,224	8,985	9,815	10,797	11,876	13,064	14,371	15,808	9.7%
PAT		**835**	**914**	**998**	**1,091**	**1,200**	**1,320**	**1,452**	**1,597**	**1,756**	
Organic/Re-investment in business			669	735	809	890	979	1077	1184	1303	
Current year Excess Cash post Organic Investment			**245**	**263**	**282**	**310**	**341**	**375**	**412**	**453**	
+ Cash Benefit from stable leverage			468	417	458	504	555	610	671	738	
Dividend Paid % of Net Income	25%		228	250	273	300	330	363	399	439	
SBB Cash (Q. % of Net Income)	20%		183	200	218	240	264	290	319	351	
Remaining Free Cash- Re invested in Acquisitions for consolidation			302	230	249	274	302	332	365	401	
Number of shares		**482**									
Number of shares bought			12	11	11	11	11	10	10	10	
Start of yr no. of shares			482	470	459	448	437	426	416	406	
End of year no. of shares		**482**	470	459	448	437	426	416	406	396	-2.4%
End of Year value per share (£)		**15.59**	17.49	19.58	21.92	24.72	27.87	31.43	35.44	39.96	£24.37
DPS			0.49	0.54	0.61	0.69	0.77	0.87	0.98	1.11	£6.07
Divi yield			2.8%		2.8%						
						Total Return from Self Funded Investment - A					£30.43
		Year 1 P/E	8x					% return			195.2%
						prospective 8-year IRR					14.5%

Leverage Assumptions		Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27
Debt (at April 2019)		3,700								
Cash		-								
Net Debt		**3,700**	**4,168**	**4,585**	**5,043**	**5,547**	**6,102**	**6,712**	**7,384**	**8,122**
DEBT/EBITA	3.00	2.9x	3.0x	3.0x	3.0x	3.0x	3.0x	3.0x	3.0x	3.0x
Int rate assumed	5%	4.1%	4.1%	4.3%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Interest paid			170.9	197.1	226.9	249.6	274.6	302.1	332.3	365.5
Interets Cover vs EBIT			8.1	7.8	7.4	7.4	7.4	7.4	7.4	7.4

Marginal Investment		Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	
Cash Reinvested			302	230	249	274	302	332	365	401	
assumed ROTE(after tax)	20%		20%	20%	20%	20%	20%	20%	20%	20%	
Cumulative new Profits				60	106	156	211	271	338	411	
Additional Coroprate value created at terminal PE										3,698	
Per share						**Total Return from debt-funded reinvestment - B**					£9.35
						Total return (A+B)					£39.78
								% return(A+B)			255.1%
						prospective 8-year IRR					17.2%

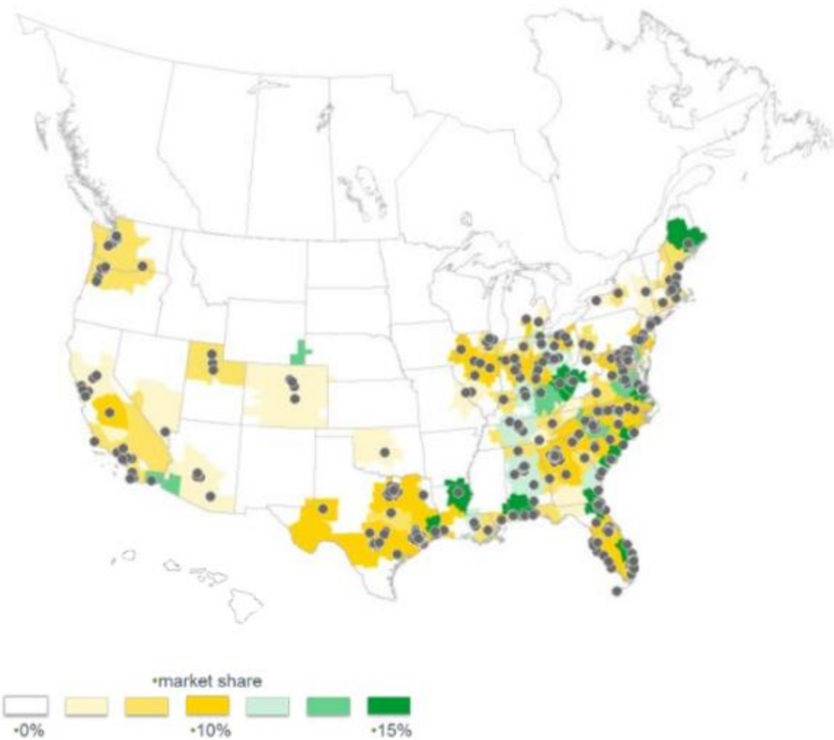
Ashtead Historical Data

share price= £ 15.88	M Cap= £ 7,649	N Debt= 3744		EV= £ 11,393	
P/E= 9.1x	P/OE= 8.4x	p/book= 2.7x		EV/EBIT= 9.4x	

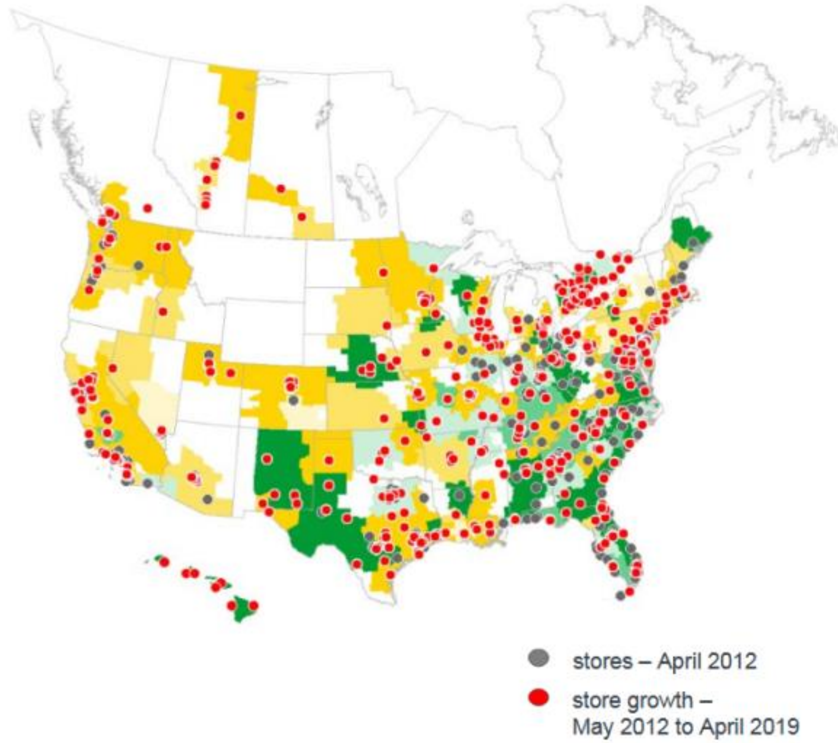
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	last 12m
revenue	836	949	1135	1362	1635	2039	2546	3187	3706	4499	21%
adj op costs	582	582	754	843	950	1131	1368	1682	1973	2393	
EBITDA	255	284	381	519	685	908	1178	1504	1733	2106	2335
depreciation	187	185	200	229	276	352	449	607	696	843	
adj op profit	68	99	181	290	409	557	728	898	1038	1263	
interest	64	68	51	45	47	67	83	104	110	153	
adj pre-tax profit	5	31	131	245	362	490	645	793	927	1110	
op profit	66	97	178	284	44	541	700	869	994	1212	
pre-tax	5	2	135	214	357	474	617	765	862	1060	
CFO pre ex and chg in rental fleet	266	280	365	501	646	841	1071	1444	1681	2043	
FCF	199	66	-9	-34	-49	-88	-68	319	386	368	
Capex	63	225	476	580	741	1063	1240	1086	1239	1587	
Book cost of rental eq	1701	1622	1854	2187	2576	3638	4481	5844	6567	8282	21%
Shareholder funds	500	481	555	683	824	1112	1480	1970	2527	2800	
Div per share	2.9	3.0	3.5	7.5	11.5	15.3	22.5	27.5	33.0	40.0	
EPS	0.4	0.2	17.8	27.6	46.1	60.5	813	100.5	195.3	166.1	
adj EPS	0.2	4	17.3	31.4	46.6	62.6	85.1	104.3	127.5	174.2	
				82%	48%	34%	36%	23%	22%	37%	
adj EBITDA marin	30.5%	29.9%	33.6%	38.1%	41.9%	44.6%	46.3%	47.2%	46.8%	46.8%	
adj op margin	8.2%	10.4%	16.0%	21.3%	25.0%	27.3%	28.6%	28.2%	28.0%	28.1%	
adj pre-tax margin	0.6%	3.3%	11.5%	18.0%	22.2%	24.0%	25.3%	24.9%	25.0%	24.7%	
adj ROI	4.6%	7.0%	12.0%	16.2%	18.6%	19.4%	18.9%	17.3%	17.6%	17.8%	
employees	7218	8163	8555	9085	9934	11928	13106	14220	15996	17803	
stores	498	462	485	494	556	640	715	808	899	1036	

INCREASED FOOTPRINT AND MARKET SHARE

April 2012



April 2019



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