HollAnd Advisors

Holland Views: Ashtead Price: £46.50; Mcap: £20.7bn

A Fresh Start

Stock markets are funny places were little changes for years, then a lot inside a few weeks. We will leave the Cathie Wood/NASDAQ reversal commentary to others, our role in this game has always been that of Captain Sensible. We have only ever analysed the shares we look at for their long-term potential and done so against the absolute price we are being asked to pay for part ownership of such businesses. To use the phrase 'absolute price' implies to some we only look at low PE or 'cheap' companies. Whilst that might have been a route we pursued many years back, for a good while now we been focused on businesses priced attractively vs their most likely future compounding rate.

Business model building blocks

In our work there is lots of looking back to assess the resilience and how proven a business model is and how it has been able to grow and with what capital. The looking forward bit is always a guesstimate but hopefully a well-reasoned one. We have spent the best part of 15 years developing the building blocks that give us the understanding of different attractive businesses models today. Our journey took us via Buffett's description of the Dream, Compounder and Gruesome models working hard to understand all the drivers of each. This led to our own requirement for companies we were attracted to excel at the hurdles of 'Operate', 'Generate' and 'Allocate'. Along the way we looked at organic vs acquired growth, negative working capital and of course the important roles played by aligned owner managers. A few years ago, as we spent time on each of these qualitative drivers an important but simple quantitative driver maybe sometimes slipped our mind. This being growth and the right price to pay for it. The NASDAQ boom has always been about growth and more often than not the price many were willing to pay for growth became seemingly unlimited. Low interest rates were used to justify such behaviour and to a point we could see this rationale, but only when looking at highly predictable future cashflow streams, not uncertain ones.

Enter Ashtead

All of this thinking brings us to Ashtead. We are proud of our Ashtead work (*Holland Views: Plant Hire – March 2020, 1681p*). Whilst the publication of that piece was well timed, what was more important was the approach we used to help our (and we hope others) understanding of this business model. The retention of capital and use of constant leverage against it can be a powerful driver of intrinsic value growth for a company. But it can only work successfully if there is ample opportunity to deploy such future capital at good rates of return. Ashtead's strong US market position (12% share + more in clusters) drives high returns. Its potential to increase its scale further with greenfield sites, organic growth and accretive M+A creates a capital deployment opportunity. The final requirement is a management team that can marry the two effectively, i.e. drive the business to grow at speed and sourcing and deploying the capital to do so. Whilst Brendan Horgan is no owner manager, Ashtead's articulation and execution of their expansion plan is meticulous and we think sound.

Many investors understand well the Dream businesses model and pursue it with zeal, but this arena is competitive resulting in higher prices. For those without our business model building blocks maybe Ashtead's growth is harder to see. Perhaps we could think about Ashtead or companies like it as Lollapaloozas as they require the coming together of multiple factors to produce an outsized result i.e. the deployment of capital, a market opportunity and management needing a high level of competence. What is interesting is how the Ashtead model as we describe it has been articulated by this company for many years now and is largely unchanged. Yet during that time the multiples placed on the business have moved considerably as the chart below shows. This suggests to us that a deep understanding of the company is appreciated by some investors, but not by all.

Fig.1: Ashtead PE Ratio – Falling to 18x on March 2023 forecasts

Source: Bloomberg

Dispassionately assessing value

When distributing a few reflections on Ashtead in December we made the following comments:

> *"Our original 2020 piece is not just re-attached for bragging rights, but mostly because we think it explains how the parts of the financial model of this company importantly come together. Today the powerful interaction of the drivers we observed continue. Organic growth + opening of greenfield sites + acquiring infill businesses combine to result in strong revenue growth. This being executed in a constant leverage model is what is driving such fast growth in earnings and the capacity for share buy backs in addition to the above levers of growth.*
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> *It is interesting to look back on the compounding model we distributed with that summer 2020 piece (re-attached). Whilst we then knew a constant PE multiple of 9x would be too low it was a useful way to demonstrate the compounding power of the business without confusing the effect of any PE re-rating. Readers today that open that same model and opt for an end period PE of 30x, rather than 9x will find we hope an interesting conclusion in the protected share price that is implied. In March 2021 it implied a price of £69 and in March 2022 £76…i.e. very close to where we are today.*

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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