Vp plc

Business is humming

27th November 2018

Is the UK 'construction glass' half full or half empty? Listening to the Brexit mood music, then one could presume the wheels had fallen off. However, in reality this political hot potato has not on its own yet materially impacted GDP. **Grass roots demand remains robust**, especially across new build housing and infrastructure. And only 3 weeks ago the Office for National Statistics said the construction industry had enjoyed an 'Indian summer', with Q3 output expanding at a 2.1% clip, after experiencing a -1.6% Q1 decline (cold winter) and a 0.8% rebound in Q2 (wet spring).

Likewise, equipment rental specialist Vp is showing few signs of a slowing-down - this morning reporting "***another excellent set of results with revenues, profits and EPS all significantly ahead***".

Comfortably on track to hit FY19 expectations

H1'19 turnover, adjusted PBTA, EPS and dividends (see below) all climbed by double-digits to £193.2m (+42%, Est LFL 13%), £25.9m (+22%), 52.3p (+18%) and 8.2p (+21%) respectively. Beating **our H1 PBTA estimates by 3%**, and providing a comfortable cushion in the event of a future hard-Brexit.

Divisionally, trading at Torrent Trackside (£48bn CP6 rail), TPA (transmission) and Groundforce (AMP6, water infrastructure) was strong, augmented by supportive conditions at Hire Station, UK Forks and Brandon Hire (acquired in Nov'17 for £69.2m). UK adjusted EBITA jumped 21% to £26.9m (95.5% of group vs 97.7% FY18) on revenues 46% higher at £175.3m (margin 15.3%).

Impressive H1'19 numbers

£'000s March yearend	Act H1'18	Act H1'19 6M BH	%	Act H2'18 5M BH	Est H2'19 6M BH	%	Act FY18 5M BH	Est FY19 12M BH	%
Est prev Vp UK	120,299	135,938	13.0%	119,847	119,554	-0.2%	240,146	255,492	6.4%
Est Brandon Hire (BH)		39,400		31,843	36,800		31,843	76,200	
Total UK sales	120,299	175,338	45.8%	151,690	156,354	3.1%	271,989	331,692	22.0%
International sales	15,693	17,873	13.9%	15,957	16,635	4.2%	31,650	34,508	9.0%
Group revenues	**135,992**	**193,211**	**42.1%**	**167,647**	**172,989**	**3.2%**	**303,639**	**366,200**	**20.6%**
UK	22,178	26,912	21.3%	20,823	22,449	7.8%	43,001	49,361	14.8%
International	261	1,266	385.1%	756	1,073	41.9%	1,017	2,339	130.0%
Group EBITA	**22,439**	**28,178**	**25.6%**	**21,579**	**23,522**	**9.0%**	**44,018**	**51,700**	**17.5%**
UK	18.4%	15.3%		13.7%	14.4%		15.8%	14.9%	
International	1.7%	7.1%		4.7%	6.4%		3.2%	6.8%	
Group EBIT % margin	**16.5%**	**14.6%**		**12.9%**	**13.6%**		**14.5%**	**14.1%**	
PBTA	**21,155**	**25,853**	**22.2%**	**19,442**	**21,147**	**8.8%**	**40,597**	**47,000**	**15.8%**
Adjusted EPS (p)	44.2	52.3	18.3%	37.6	43.7	16.3%	81.8	96.0	17.4%
Dividend (p)	**6.8**	**8.2**	**20.6%**	**19.2**	**22.3**	**16.3%**	**26.0**	**30.5**	**17.4%**
Net debt	-115,391	-188,236	63.1%	-179,172	-174,000	-2.9%	-179,172	-174,000	-2.9%
Net debt : EBITDA		1.9		2.0	1.8		2.0	1.8	
ROCE Vp (ex Brandon)	16.0%	16.0%			16.0%		16.0%	16.0%	
Group ROCE	**16.0%**	**14.5%**			**14.5%**		**14.8%**	**14.5%**	

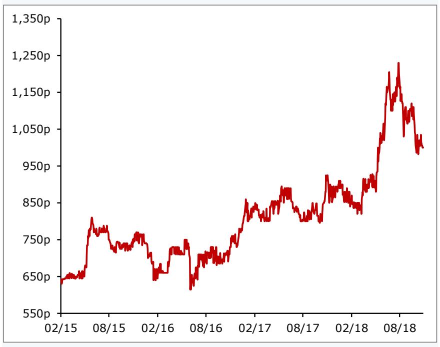
Source: Equity Development

Elsewhere, there were also **encouraging performances abroad**. EBIT rising to £1.3m (vs £0.3m LY) on sales of £17.9m (+14%), reflecting good progress at TR's (Australian test & measurement firm) depots in Malaysia & Singapore, complemented by "***marginally improved activity***" in oil & gas (Airpac Bukom).

Company Data

EPIC	LSE: VP.
Price (last close)	1,000p
52 week Hi/Lo	1,230p/820p
Market cap	£402m
ED valuation/share	1,100p
Daily volume	10,000

Share Price, p



Source: Web Financial

Description

Vp is a specialist rental business providing equipment and services to a wide range of markets including civil engineering, rail, oil/gas exploration, construction, outdoor events and industry, primarily within the UK, but also from overseas.

In terms of sector split, 37% FY18 sales came from infrastructure, 33% construction, 11% housing building, 8% oil & gas and 10% other.

Member of FTSE SmallCap Index.

Next news: Trading update Apr'19

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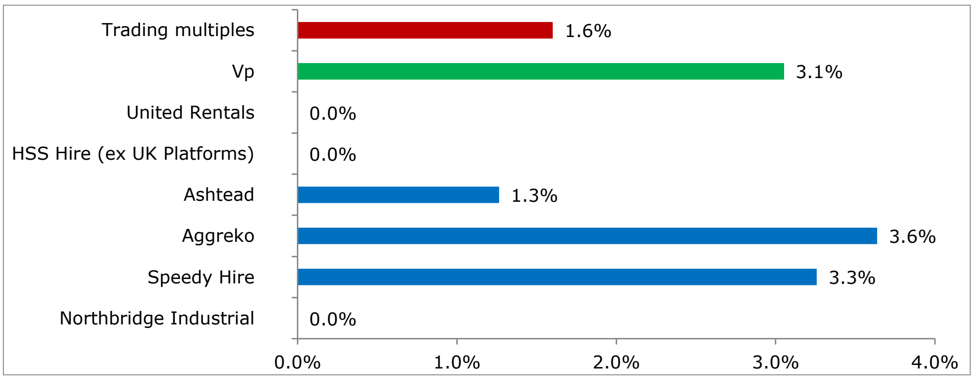
The latter chiming with cautiously upbeat commentaries from other E&P related tool-hire providers, such as Northbridge Industrial and Aggreko. On top, we reckon OPEC will cut production at its next meeting in Vienna on 6th December to stem the decline in crude prices.

Dividend hiked 21% as sign of confidence

Shareholders are set to receive a welcome boost too, with the interim dividend lifted 21% to 8.2p - payable on 11 January 2019 (ex-div Thursday 6 December). Offering a prospective yield of 3.1%, or almost twice the sector average (see below).

Current year (CY) dividend yield vs peers

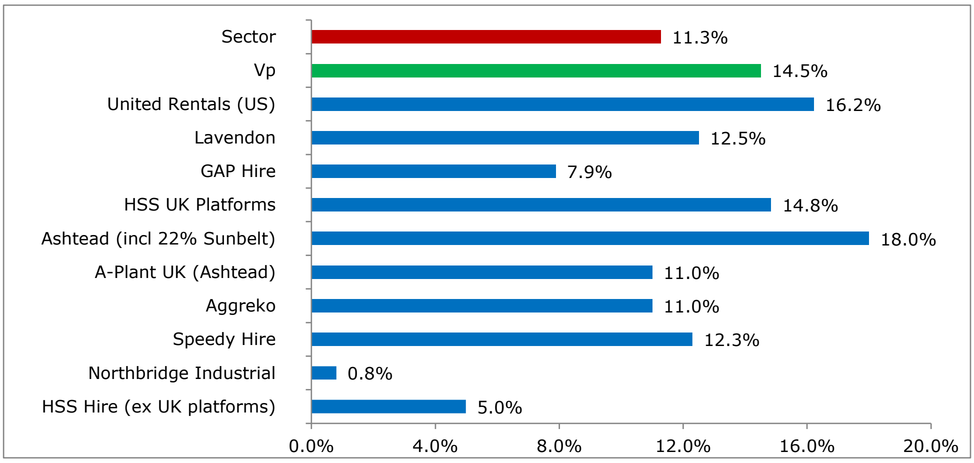


Source: Equity Development. Closing prices as per 26th November 2019

Attractive ROCE maintained and set to improve

What's more, **capital efficiency continues to be Vp's forte**, as evidenced by the **14.5% H1 ROCE** (see below). Granted this was lower than the Board's own stretching 15% target, yet the gap was simply a function of the expected mix effect of combining the £69.2m Brandon acquisition (Est 10% ROCE) with the existing business (16%).

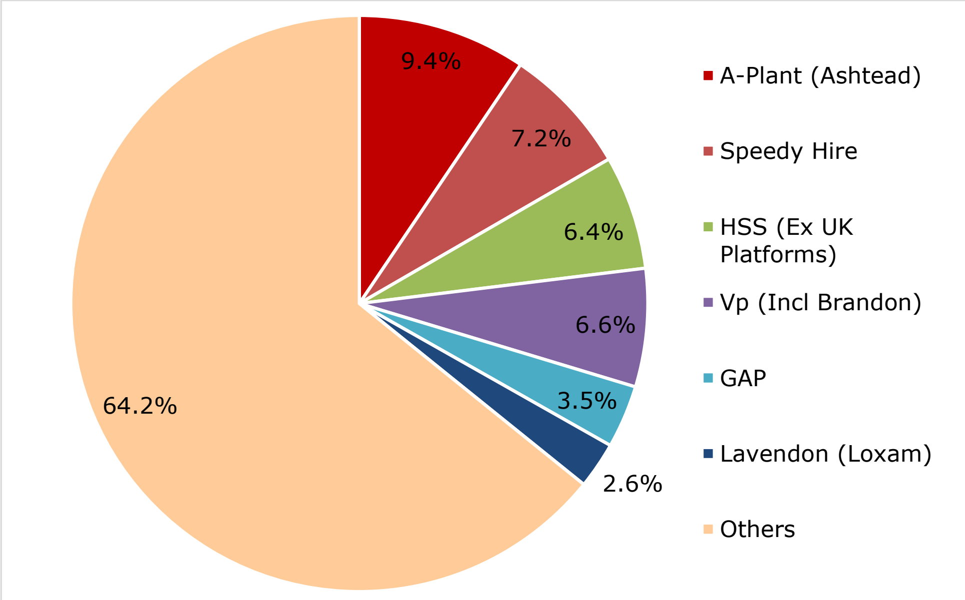
CY ROCE across sector



Source: Equity Development

Plus, the 14.5% exceeds most of Vp's rivals anyway across the £5bn UK tool/plant hire & related services market (see below).

UK equipment hire market shares

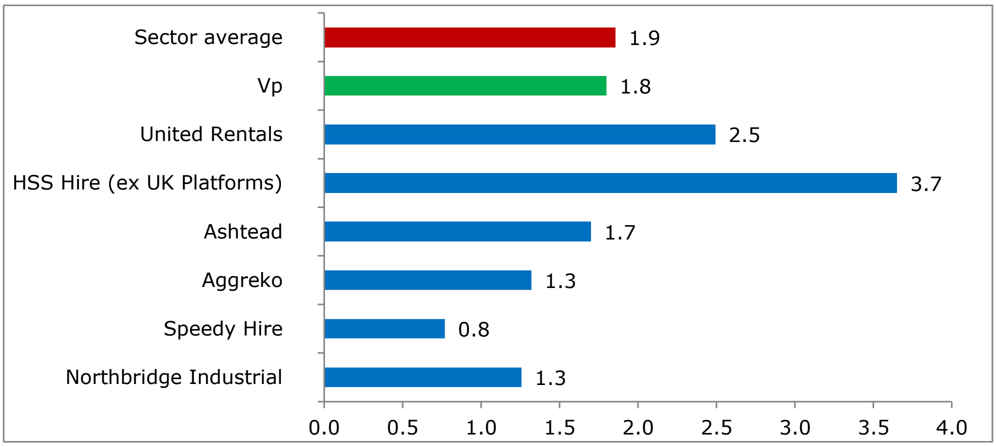


Source: Equity Development

Prudently geared & generating healthy cashflows

In terms of the balance sheet, net debt closed Sept'18 at £188.2m, up £9.0m from March (£179.2m), after absorbing £7.6m of dividend payments and £36.7m (+13%) in rental fleet capex. Debtor days in Sept'18 were steady at 58 vs 57 in March. Going forward, **net debt : EBITDA is predicted to drop to 1.8x by yearend** (vs 2.0x FY18) on the back of positive H2 cashflows.

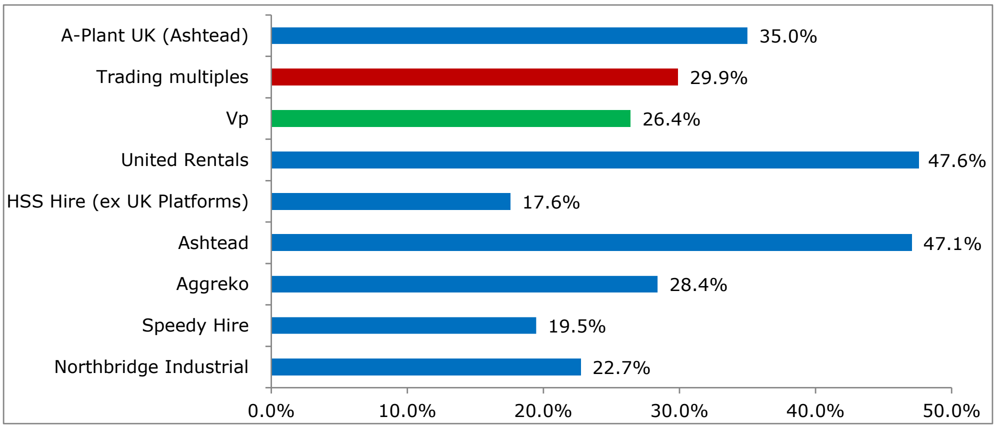
CY Net debt : EBITDA



Source: Equity Development (arithmetic average for sector).

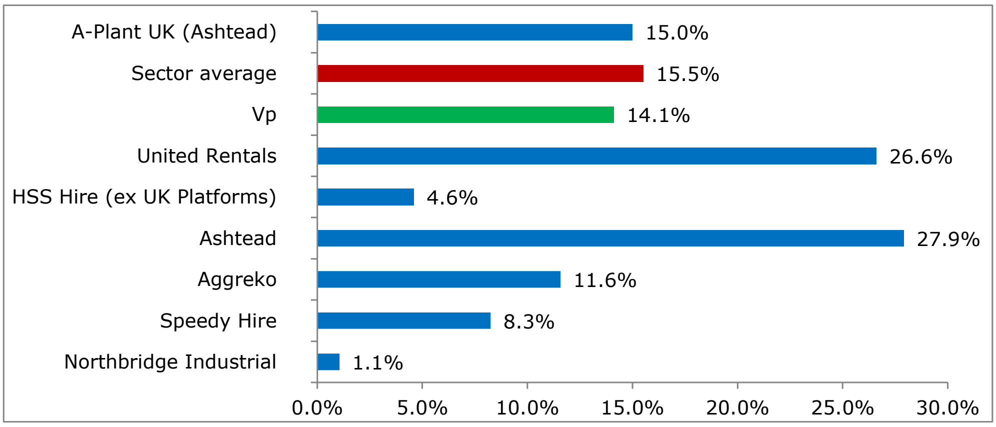
Similarly, as synergies from the Brandon acquisition (ED Est of >£2.5m annualised) are fully realised over the forthcoming 12 months, both EBITDA & EBIT margins (see below) are set to expand - further reducing leverage, along with nudging up ROCE.

CY % EBITDA margins vs peers



Source: Equity Development (arithmetic average for sector) Vp based on proforma numbers

CY % EBIT margins vs peers



Source: Equity Development (arithmetic average for sector) Vp based on proforma numbers

Ok, but what about the next 12 months?

Well, overall **we are broadly optimistic**, but do envisage a slightly less buoyant UK economic backdrop, as corporates/consumers potentially pull-back the reins because of the uncertainty. Consequently, **we have held our FY19 turnover, PBTA & EPS numbers at £366.2m, £47.0m & 96.0p respectively**, whilst recognising the de-risked H2 targets after the impressive 1st half.

Indeed we believe this upwardly biased 'wait & see' approach is sensible and consistent with views held at other bell-weather UK construction/housebuilding stocks, who are also sounding watchful tones (see below). The overwhelming message though being that despite the softer property market (eg London), things are definitely not falling off a cliff, regardless of the negative sentiment.

Sure, equity markets are often a useful gauge of the economic road ahead, yet equally we suspect the November correction has closer parallels with what happened immediately following the original Brexit vote in June 2016. Ultimately proving to be a good time to buy, rather than sell.

Equity sell-off seems to have over-shot economic reality

Outlook for UK Construction remains broadly favourable

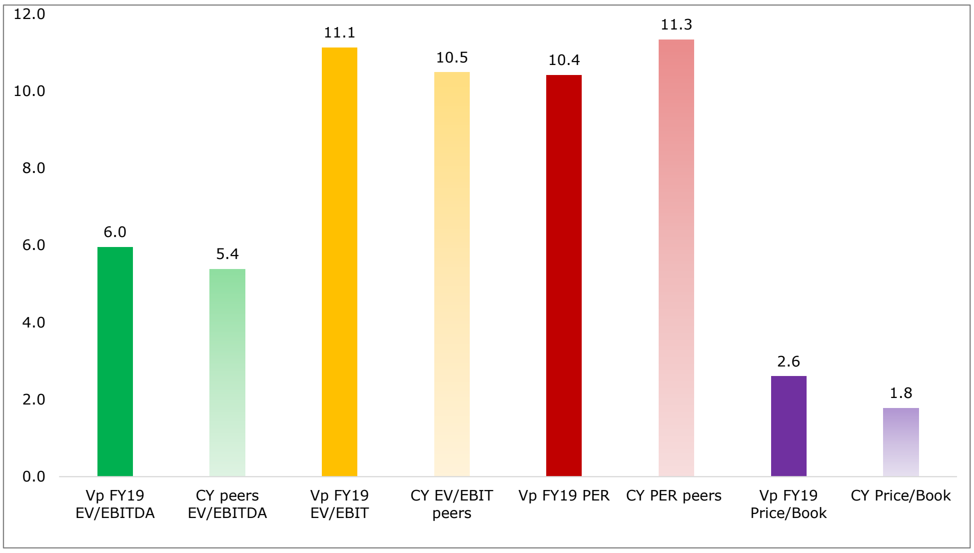
- Ibstock (Brick-maker) 23rd Nov - "*Whilst the uncertainty around the ongoing negotiations for the UK's withdrawal from the EU persists, the* ***market backdrop in the new build housing sector remains positive****.*"
- Bovis Homes (Housebuilder) 15thNov - "The ***group continues to target profits for the year to be at a record level****, in-line with the Board's expectations*."
- Breedon (Aggregates) 21st Nov - "*Whilst we are mindful of the unpredictability of the Brexit negotiations,* ***we continue to commit substantial investment across our business****, which brings us ongoing benefits in terms of enhanced performance and improved productivity.* "
- Speedy Hire (Plant hire) 8th Nov - "***Strong H1 performance****; significant improvement in profitability. Confident of delivering FY results in line with expectations*."
- HSS (Plant hire) 21st Nov - "*Trading momentum has continued into the first 7 weeks of Q418.* ***Expect FY EBITDA to be marginally ahead of expectations****.*"
- On the other hand, Ashtead's UK A-Plant division is trimming its FY19 fleet investment in order to increase ROCE, and offset margin/price compression

Source: Equity Development

Reiterate our £11.00/share valuation

So, how much is the stock worth? Well, **we make no change to our £11.00 valuation**, but see upside in the event either our forecasts prove to be too conservative, and/or the sector re-rates upwards - say once the fog has lifted post Brexit on the 29th March 2019.

Vp FY19 multiples vs peers



Source: Equity Development – closing prices as at 26th November 2018

Chairman Jeremy Pilkington commenting "*The Group has produced yet another* ***excellent set of results with revenues, profits and earnings per share all significantly ahead****. Both our UK and International Divisions have performed strongly with most of our business units busy supporting stable end markets.* ***In the UK Division, whilst Brexit continues to be a distraction, day to day activity seems to be continuing largely unaffected****.*

*With the benefit of a strong first half, which includes an in line contribution from Brandon Hire, **we look forward to the remainder of the year, and beyond, with every confidence**."*

Forecasts (£'000s)

Vp (March year end)	**2015 Act £'000s**	**2016 Act £'000s**	**2017 Act £'000s**	**2018 Act £'000s**	**2019 Est £'000s**	**2020 Est £'000s**	**2021 Est £'000s**
Turnover							
UK	*184,142*	*193,555*	*220,015*	*271,989*	*331,692*	*341,760*	*352,147*
International	*21,460*	*15,191*	*28,725*	*31,650*	*34,508*	*36,001*	*37,560*
Total	**205,602**	**208,746**	**248,740**	**303,639**	**366,200**	**377,761**	**389,706**
% growth	*12.3%*	*1.5%*	*19.2%*	*22.1%*	*20.6%*	*3.2%*	*3.2%*
UK		*5.1%*	*13.7%*	*23.6%*	*22.0%*	*3.0%*	*3.0%*
International		*-29.2%*	*89.1%*	*10.2%*	*9.0%*	*4.3%*	*4.3%*
EBITDA	**53,803**	**59,266**	**71,238**	**84,337**	**96,728**	**100,616**	**103,974**
% Margin	*26.2%*	*28.4%*	*28.6%*	*27.8%*	*26.4%*	*26.6%*	*26.7%*
Adjusted EBIT							
UK	*26,027*	*30,659*	*35,871*	*43,001*	*49,361*	*51,613*	*53,022*
International	*2,753*	*1,232*	*1,886*	*1,017*	*2,339*	*2,553*	*3,033*
Total	**28,780**	**31,891**	**37,757**	**44,018**	**51,700**	**54,166**	**56,055**
% Margin	***14.0%***	***15.3%***	***15.2%***	***14.5%***	***14.1%***	***14.3%***	***14.4%***
UK	*14.1%*	*15.8%*	*16.3%*	*15.8%*	*14.9%*	*15.1%*	*15.1%*
International	*12.8%*	*8.1%*	*6.6%*	*3.2%*	*6.8%*	*7.1%*	*8.1%*
Underlying Interest charge	-2,023	-2,093	-2,906	-3,421	-4,700	-4,600	-4,400
Adjusted PBT (pre amortisation)	**26,757**	**29,798**	**34,851**	**40,597**	**47,000**	**49,566**	**51,655**
Adjusted earnings	**21,201**	**24,226**	**27,262**	**32,290**	**38,070**	**40,149**	**42,874**
Adjusted Basic EPS (p)	**54.4**	**62.2**	**69.5**	**81.8**	**96.0**	**100.8**	**107.1**
EPS growth rate	*29.7%*	*14.3%*	*11.7%*	*17.7%*	*17.4%*	*4.9%*	*6.3%*
Dividend (pence)	***16.5***	***18.9***	***22.0***	***26.0***	***30.5***	***32.0***	***34.0***
Valuation benchmarks							
P/E ratio	*18.4*	*16.1*	*14.4*	*12.2*	*10.4*	*9.9*	*9.3*
EV/Sales	*2.8*	*2.8*	*2.3*	*1.9*	*1.6*	*1.5*	*1.5*
EV/EBITDA	*10.7*	*9.7*	*8.1*	*6.8*	*6.0*	*5.7*	*5.5*
EV/EBITA	*20.0*	*18.0*	*15.2*	*13.1*	*11.1*	*10.6*	*10.3*
PEG ratio	*0.6*	*1.1*	*1.2*	*0.7*	*0.6*	*2.0*	*1.5*
Dividend yield	*1.7%*	*1.9%*	*2.2%*	*2.6%*	*3.1%*	*3.2%*	*3.4%*
Dividend cover	*3.3*	*3.3*	*3.2*	*3.1*	*3.1*	*3.1*	*3.1*
Corporate tax rate	*-20.8%*	*-18.7%*	*-21.8%*	*-20.5%*	*-19.0%*	*-19.0%*	*-17.0%*
Net debt / EBITDA (proforma)	*1.2*	*1.5*	*1.4*	*2.0*	*1.8*	*1.6*	*1.5*
Return on average capital employed	*16.2%*	*16.3%*	*16.0%*	*14.8%*	*14.5%*	*14.8%*	*15.0%*
Net cash/(debt)	**-66,764**	**-86,134**	**-98,933**	**-179,172**	**-174,000**	**-163,537**	**-152,620**
Fleet capital expenditure (gross)	49,300	45,900	57,600	64,900	70,000	65,000	68,000
Investment as % sales	*24.0%*	*22.0%*	*23.2%*	*21.4%*	*19.1%*	*17.2%*	*17.4%*
Reported sharecount Ks (net Treasury)	*38,940*	*38,942*	*39,215*	*39,476*	*39,649*	*39,847*	*40,046*
Shareprice (p)	**1,000**						

Source: Company historic data, ED estimates

Key risks

- In light of Vp's operational gearing, if the economy stalled then this could impact earnings as costs are predominantly fixed. That said, investment in the hire fleet can be flexed as conditions change as occurred during the 2008/9 recession.
- Competitive pricing pressures and higher interest rates that could lift funding costs, albeit 40% of gross debt is fixed.
- Acquisition integration, albeit the management’s track record to date has been good.
- 50.26% of the equity is owned by a number of trusts connected to Exec-Chairman Jeremy Pilkington (re possible hypothetical impact on minority interests), although this should also help ensure the group is run to maximise shareholder value.

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