Vp plc

The strong get stronger

29th November 2022

Technicals and fundamentals are often deemed as two sides of the same investment coin. The former typically acting as a leading indicator of future performance. However, for many small/midcaps, where liquidity tends to be thinner compared to the FTSE100, then price can be a poor reflection of intrinsic worth. We think this is the case for specialist equipment rental firm Vp. Why?

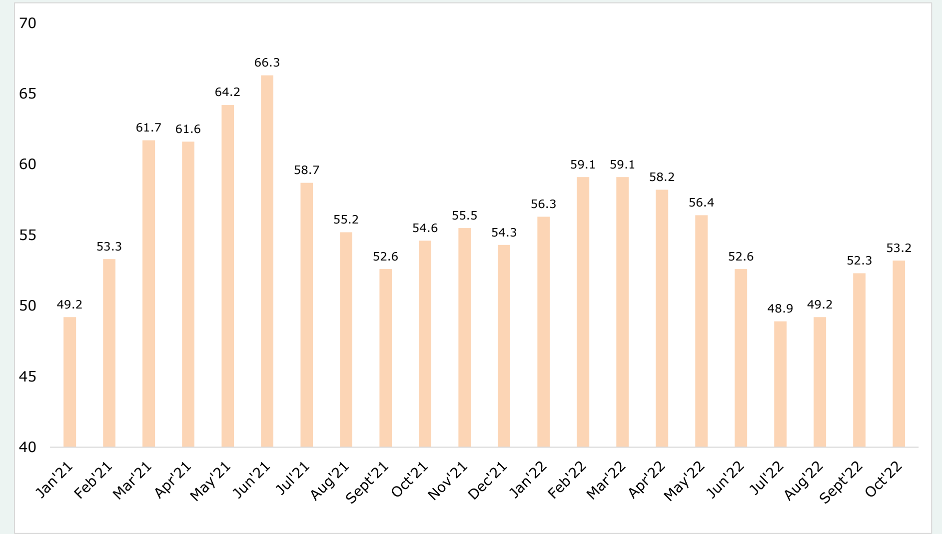
Long term secular growth markets

Well after a slight dip over the summer (re extreme hot weather), the **UK construction market** (see PMIs below) **is now recovering** on the back of a **substantial backlog of future infrastructure work**, especially in regulated areas such as roads, rail (CP6), water (AMP7) and electricity.

Sure there's been some softness caused by subdued new build commercial development (eg offices, hotels, shops, etc), delays transitioning to Phase 2 of HS2 and the recent rail strikes. Yet equally going forward, this should be more than compensated by Hinkley Point C, the Lower Thames Crossing & offshore wind (re Transmission).

Similarly, don't write off housing either. Yes, the homebuilders have witnessed a temporary air-pocket in buyer demand after the spike in mortgage rates triggered by September's Gilt/LDI pension crisis. Yet even here, borrowing costs are now declining in line with the UK swaps curve.

UK Construction Managers PMI improves (>50 indicates expansion)



Source: Chartered Institute of Purchasing and Supply (CIPS) Construction Purchasing Manager's Index (PMI)

Trading in line with FY'23 EBIT expectations

So where does this leave Vp?

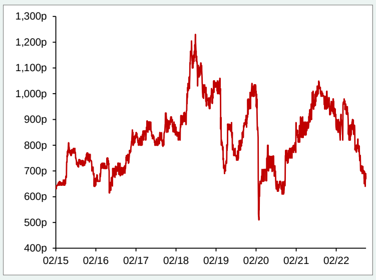
Today the company posted a **"solid" set of H1'23 results**, that was also **in line with our FY'23 adjusted EBIT forecast of £45.75m**. H1 sales rose +5.9% to £186.5m (vs £176.1m LY) - which alongside measured prices increases and internal efficiencies - drove **ROCE up to 14.4% vs 13.5% LY**, despite absorbing further input cost inflation.

Likewise, **H1 adjusted PBT** (see overleaf) **came in +6% higher at £21.5m (**£20.2m LY), even after incurring higher interest charges, as **net debt climbed 13% to £148.9m** due to slightly longer debtor days and top line growth.

Company Data

EPIC	LSE: VP.
Price (last close)	£6.80
52 week Hi/Lo	£10.10/£6.40
Market cap	£273m
Est Mar23 net debt (ex IFRS16)	£138m
Share count	40.154m
ED valuation	1,130p/share

Share Price, p



Source: Yahoo Finance

Description

Vp is a specialist equipment 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 (91% of pre-covid turnover), but also overseas.

In terms of sector split: circa 36% sales is derived from infrastructure, 41% construction, 7% housing building, 9% Energy and 7% other.

Member of FTSE SmallCap Index.

Next news: Interims 29th Nov'22

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5.9% revenue growth helps drive ROCE back to pre-pandemic levels

£'000s March yearend	Act H1'23	Act H1'22	%	Est H2'23	Act H2'22	%	Est FY23	Act FY22	%
UK sales	166,932	160,761	*3.8%*	166,079	159,442	*4.2%*	333,011	320,203	*4.0%*
International	19,555	15,342	*27.5%*	13,000	15,370	*-15.4%*	32,555	30,712	*6.0%*
Group revenues	**186,487**	**176,103**	***5.9%***	**179,079**	**174,812**	***2.4%***	**365,566**	**350,915**	***4.2%***
Group EBITDA pre IFRS16	**47,791**	**44,546**	***7.3%***	**44,450**	**47,791**	***-7.0%***	**92,241**	**88,868**	***3.8%***
EBITDA % margin	*25.6%*	*25.3%*		*24.8%*	*27.3%*		*25.2%*	*25.3%*	
UK	22,457	21,810	*3.0%*	21,378	20,019	*6.8%*	43,835	41,829	*4.8%*
International	1,503	700	*114.7%*	417	804	*-48.2%*	1,920	1,504	*27.6%*
Group EBITA	**23,960**	**22,510**	***6.4%***	**21,795**	**20,823**	***4.7%***	**45,755**	**43,333**	***5.6%***
UK	*13.5%*	*13.6%*		*12.9%*	*12.6%*		*13.2%*	*13.1%*	
International	*7.7%*	*4.6%*		*3.2%*	*5.2%*		*5.9%*	*4.9%*	
EBIT % margin	***12.8%***	***12.8%***		***12.2%***	***11.9%***		***12.5%***	***12.3%***	
Interest	-2,503	-2,298	*8.9%*	-2,997	-2,130	*40.7%*	-5,500	-4,428	*24.2%*
PBTA	**21,457**	**20,212**	***6.2%***	**18,798**	**18,693**	***0.6%***	**40,255**	**38,905**	***3.5%***
Adj EPS - pre IFRS16	**42.3p**	**37.6p**	***12.5%***	**33.5p**	**33.6p**	***-0.2%***	**75.9p**	**71.2p**	***6.5%***
Dividend	**11.0p**	**10.5p**		**26.5p**	**25.5p**		**37.5p**	**36.0p**	
Net debt (pre IFRS 16)	-148,942	-131,721	*13.1%*	-138,000	-130,604	*5.7%*	-138,000	-130,604	*5.7%*
Net debt : EBITDA							1.5	1.5	
Group ROCE	***14.4%***	***13.5%***		***15.6%***	***14.5%***		***15.0%***	***14.5%***	

Source: Equity Development. Note: excludes £1.8m of exceptional 'Formal Sale Process' fees in H1'23

Nonetheless, **there's still ample liquidity for both fleet investment in H2** (£33.8m H1'23) and paying a **11p/share interim dividend** (+5%).

UK to suffer a mild recession next year, but not a hard landing

Additionally, from a macro perspective we believe the **UK will experience a mild recession in 2023**, with the **Bank of England only having to lift interest rates to 4.0%** (3.0% currently) in order to bring CPI back down to below 3% by 2024 (11.1% Oct'22).

Granted we suspect this will push unemployment up to 5.5% (3.6% Sept'22) and lead to a peak-to-trough decline in house prices of 10%. Yet in the grand scheme of things, **we view this as simply rebalancing the economy to pre the Great Financial Crisis norms**.

Equally creating a 'neutral playing field', where the best operators like Vp should continue to thrive - as opposed to those poor performers, who've been able to limp along on cheap debt for far too long.

Plus, Vp isn't just a domestic group. Its overseas interests are starting to flourish too. Indeed **TR** (Australia) **has returned to pre covid levels**, whilst **Airpac Rentals has benefitted from increased oil and gas demand** and is diversifying into more downstream areas.

65% potential upside vs our £11.30/share fair

Fine but what's the potential upside? Well, this is where it gets really interesting.

You see at 680p, Vp trades on modest CY EV/EBITDA and EV/EBIT multiples of 4.5x and 9.0x respectively. Falling to 4.3x and 8.3x in the following year vs typical peer ratings of 6.0x & 10.4x respectively. Moreover, **Vp is economically more resilient and possesses greater pricing power than the sector average**.

Consequently, **we reiterate our FY23 numbers** and **fair value of £11.30/share**, albeit have nudged down the adjusted EPS & PBTA estimates, reflecting higher borrowing costs.

Ultimately, we suspect Vp may even be able to surpass its own stretching 15% ROCE target (re operating leverage), thanks a leaner cost base, dovetailed with **best-of-breed ESG, carbon footprint and digital solutions** to take advantage of the post-pandemic world.

Ideally placed to execute both organic & acquisitive growth

Exec Chairman Jeremy Pilkington commenting: ***"****The period has seen inflationary pressure on higher fleet capital costs, transport, fuel, wages, utilities and interest costs, but we have largely mitigated these with agreed price increases combined with a diligent focus on efficiencies within our business.*

Water (AMP7) and rail (CP6) are now coming on stream more strongly *and in line with our expectations, although* ***recent strike actions have disrupted some rail workstreams****. Transmission demand has been good, but HS2 work has been quieter than anticipated, as we transition to phase 2.*

New non-residential construction has remained soft, ***however commercial re-purposing of property has emerged as a buoyant alternative****. Housebuilding, despite popular commentaries, remains a resilient and important market for us with good long-term prospects.*

We remain confident of delivering a full year outcome in line with the Board's expectations*.*"

Finally in terms of management changes, existing Group Finance Director Allison Bainbridge plans to retire on 31st Dec'22, and will be succeeded by Anna Bielby, who was previously interim CFO at Lookers plc, and before that was KCOM's CFO and a PwC Audit/Consulting director.

Summary projections (£'000s)

Vp (March year end)	2018 Act £'000s	2019 Act £'000s	2020 Act £'000s	2021 Act £'000s	2022 Act £'000s	2023 Est £'000s	2024 Est £'000s
Turnover							
UK	*271,989*	*350,330*	*331,005*	*281,309*	*320,203*	*333,011*	*343,001*
International	*31,650*	*32,500*	*31,922*	*26,688*	*30,712*	*32,555*	*33,531*
Total	**303,639**	**382,830**	**362,927**	**307,997**	**350,915**	**365,566**	**376,533**
% growth	***22.1%***	***26.1%***	***-5.2%***	***-15.1%***	***13.9%***	***4.2%***	***3.0%***
UK	*23.6%*	*28.8%*	*-5.5%*	*-15.0%*	*13.8%*	*4.0%*	*3.0%*
International	*10.2%*	*2.7%*	*-1.8%*	*-16.4%*	*15.1%*	*6.0%*	*3.0%*
EBITDA	**84,337**	**101,339**	**98,050**	**72,701**	**88,868**	**92,241**	**96,532**
% Margin	*27.8%*	*26.5%*	*27.0%*	*23.6%*	*25.3%*	*25.2%*	*25.6%*
EBITDA (post IFRS16)			*123,817*	*96,660*	*112,827*	*116,200*	*120,491*
Adjusted EBIT							
UK	*43,001*	*49,838*	*50,190*	*27,156*	*41,829*	*43,835*	*47,037*
International	*1,017*	*1,733*	*1,700*	*565*	*1,504*	*1,920*	*2,313*
Total	**44,018**	**51,571**	**51,890**	**27,721**	**43,333**	**45,755**	**49,349**
EBIT (post IFRS16)			55,480	30,928	45,601	47,607	50,809
% Margin	***14.5%***	***13.5%***	***14.3%***	***9.0%***	***12.3%***	***12.5%***	***13.1%***
UK	*15.8%*	*14.2%*	*15.2%*	*9.7%*	*13.1%*	*13.2%*	*13.7%*
International	*3.2%*	*5.3%*	*5.3%*	*2.1%*	*4.9%*	*5.9%*	*6.9%*
Interest charge (pre IFRS 16)	-3,421	-4,742	-4,791	-4,448	-4,428	-5,500	-6,000
Adjusted PBT (pre amortisation)	**40,597**	**46,829**	**47,099**	**23,273**	**38,905**	**40,255**	**43,349**
PBT (post IFRS16)			46,640	23,176	38,808	40,158	43,252
Adjusted earnings	**33,520**	**37,677**	**35,740**	**18,435**	**28,210**	**30,191**	**32,512**
Adjusted Basic EPS (p) - pre IFRS 16	**84.9**	**95.1**	**90.2**	**46.6**	**71.2**	**75.9**	**81.3**
EPS growth rate	*22.1%*	*12.0%*	*-5.2%*	*-48.4%*	*53.0%*	*6.5%*	*7.2%*
Adjusted EPS diluted	***83.9***	***92.9***	***88.8***	***45.8***	***70.5***	***75.1***	***80.5***
Basic EPS (post IFRS16)			*88.9*	*46.2*	*72.5*	*75.7*	*81.1*
Dividend (pence)	**26.0**	**30.2**	**8.5**	**47.0**	**36.0**	**37.5**	**40.2**
Dividend growth	*18.2%*	*16.2%*	*-72.0%*	*456.2%*	*-23.4%*	*4.3%*	*7.2%*
Valuation benchmarks							
P/E ratio (pre IFRS 16)	*8.0*	*7.1*	*7.5*	*14.6*	*9.5*	*9.0*	*8.4*
P/E ratio (post IFRS 16)			*7.6*	*14.7*	*9.4*	*9.0*	*8.4*
EV/Sales	*1.4*	*1.1*	*1.1*	*1.3*	*1.2*	*1.1*	*1.1*
EV/EBITDA (pre IFRS 16)	*4.9*	*4.1*	*4.2*	*5.7*	*4.6*	*4.5*	*4.3*
EV/EBITDA (post IFRS 16)			*3.8*	*4.8*	*4.1*	*4.0*	*3.9*
EV/EBITA (pre IFRS 16)	*9.3*	*8.0*	*7.9*	*14.8*	*9.5*	*9.0*	*8.3*
EV/EBITA (post IFRS 16)			*8.4*	*15.1*	*10.3*	*9.8*	*9.2*
PEG ratio	*0.4*	*0.6*	*-1.5*	*-0.3*	*0.2*	*1.4*	*1.2*
Dividend yield	*3.8%*	*4.4%*	*1.2%*	*6.9%*	*5.3%*	*5.5%*	*5.9%*
Dividend cover	*3.3*	*3.2*	*10.7*	*1.0*	*2.0*	*2.0*	*2.0*
EBIT drop through rate (%)		*9.5%*	*-1.6%*	*44.0%*	*36.4%*	*16.5%*	*32.8%*
Corporate tax rate	*-17.4%*	*-19.5%*	*-20.0%*	*-21.1%*	*-26.0%*	*-25.0%*	*-25.0%*
Net debt / EBITDA (pre IFRS 16)	*2.0*	*1.7*	*1.6*	*1.7*	*1.5*	*1.5*	*1.3*
Return on average capital employed	*14.8%*	*14.5%*	*14.5%*	*9.2%*	*14.5%*	*15.0%*	*15.0%*
Net cash/(debt) - pre IFRS16	**-179,172**	**-168,100**	**-159,806**	**-121,906**	**-130,604**	**-138,000**	**-129,492**
Fleet capital expenditure (gross)	64,900	63,800	49,100	40,200	59,800	60,000	60,000
Investment as % sales	*21.4%*	*16.7%*	*13.5%*	*13.1%*	*17.0%*	*16.4%*	*15.9%*
Reported sharecount Ks (net Treasury)	*39,476*	*39,603*	*39,618*	*39,595*	*39,597*	*39,795*	*39,994*
Shareprice (p)	**680**						

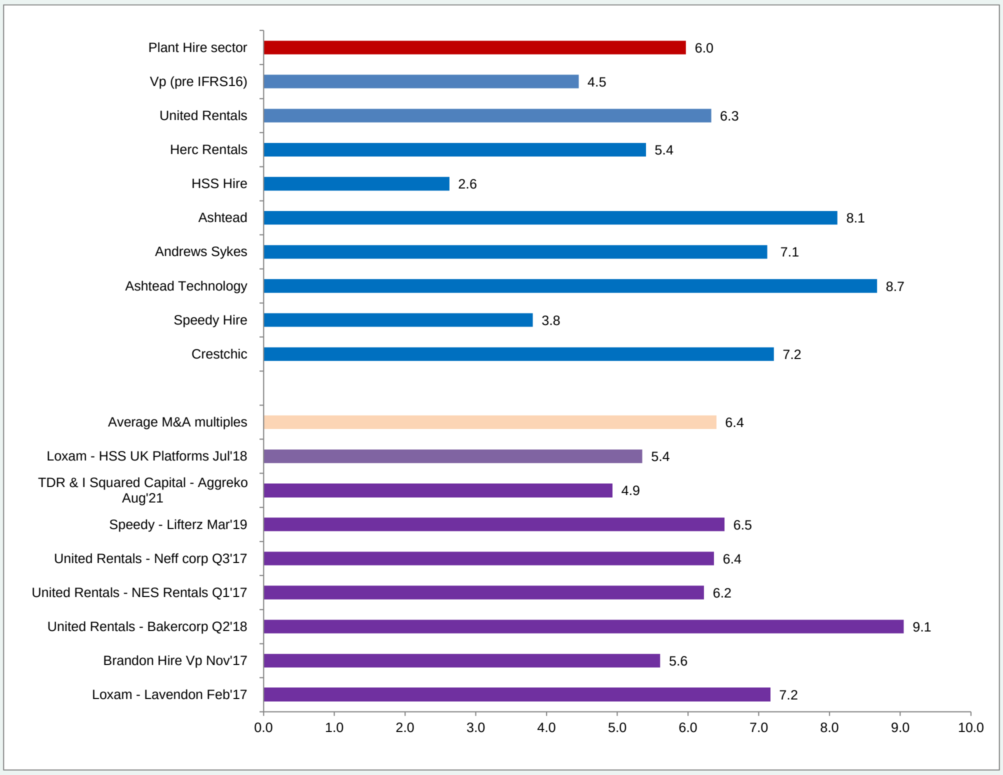
Source: Equity Development – FY21 includes special dividend of 22p/share

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.
- Competitive pricing pressures and higher interest rates that could lift funding costs.
- 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.

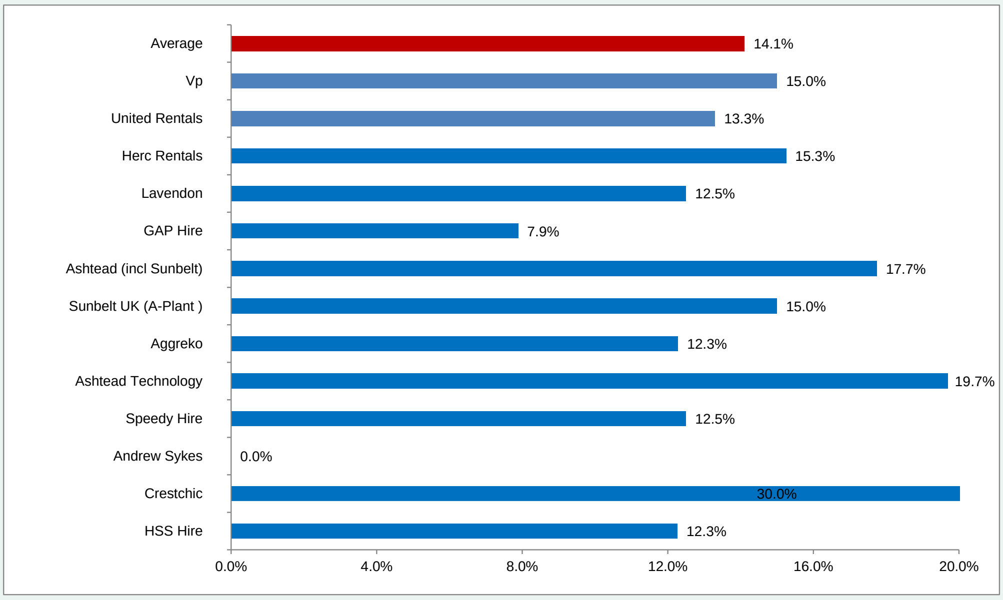
Appendices - sector valuation metrics and KPIs

Current Year (CY) EV / EBITDA multiples vs peers



Source: Equity Development

CY % ROCE vs peers



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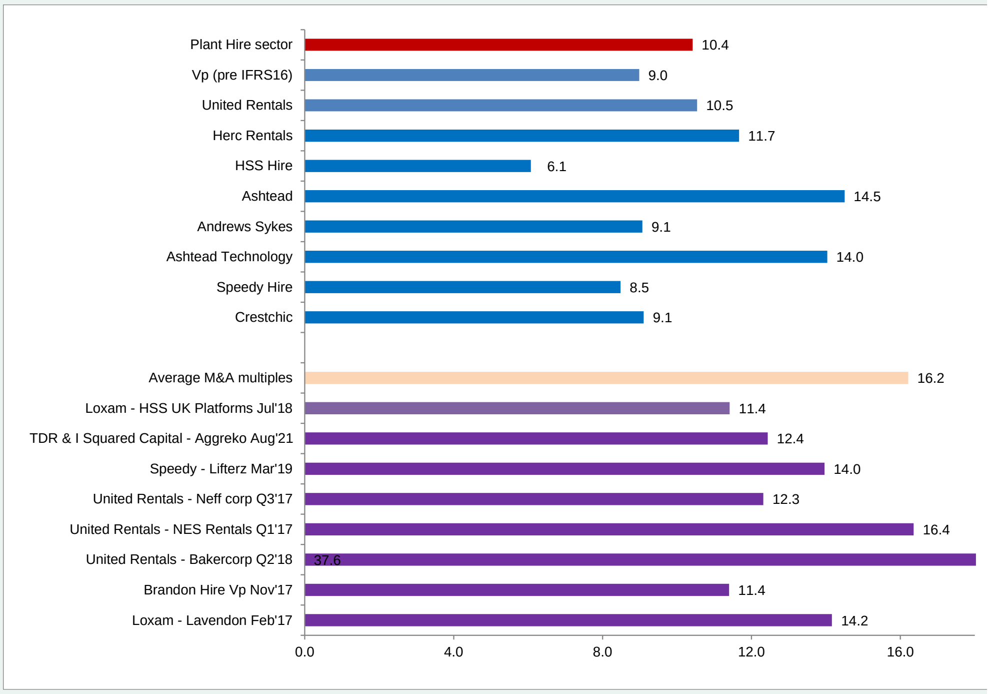
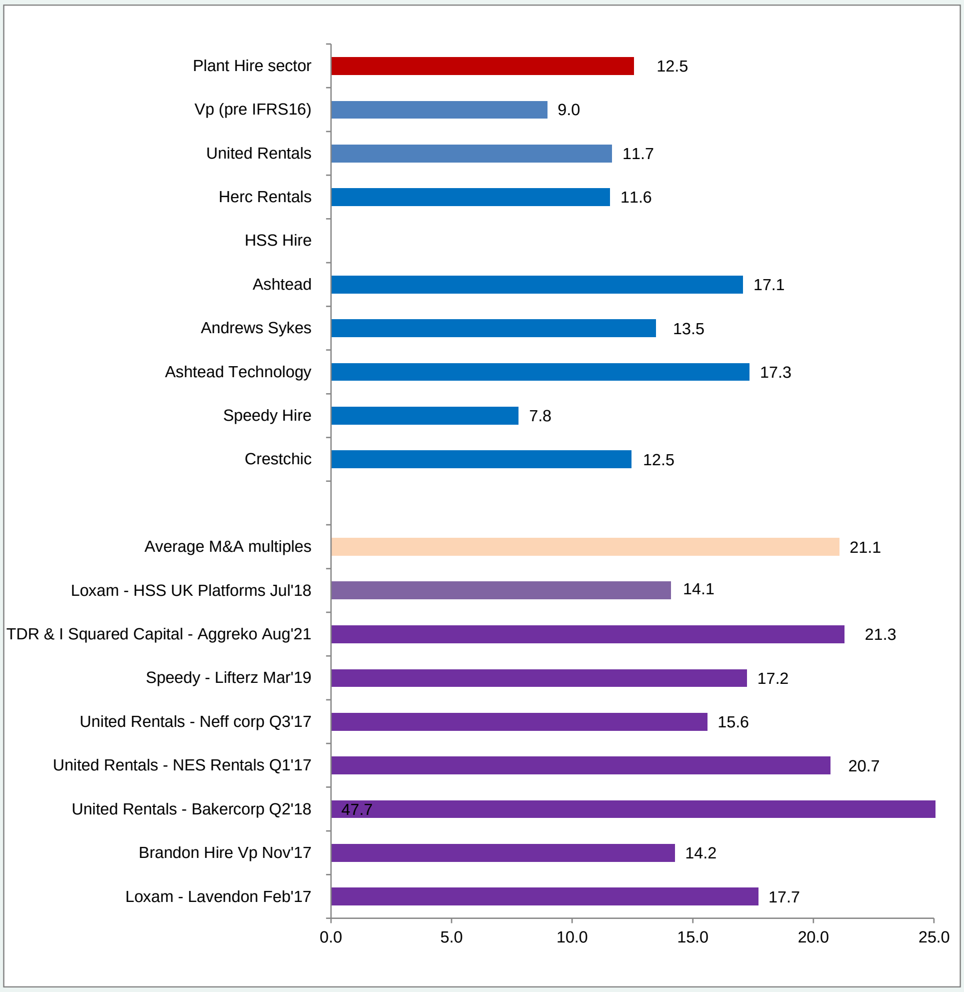


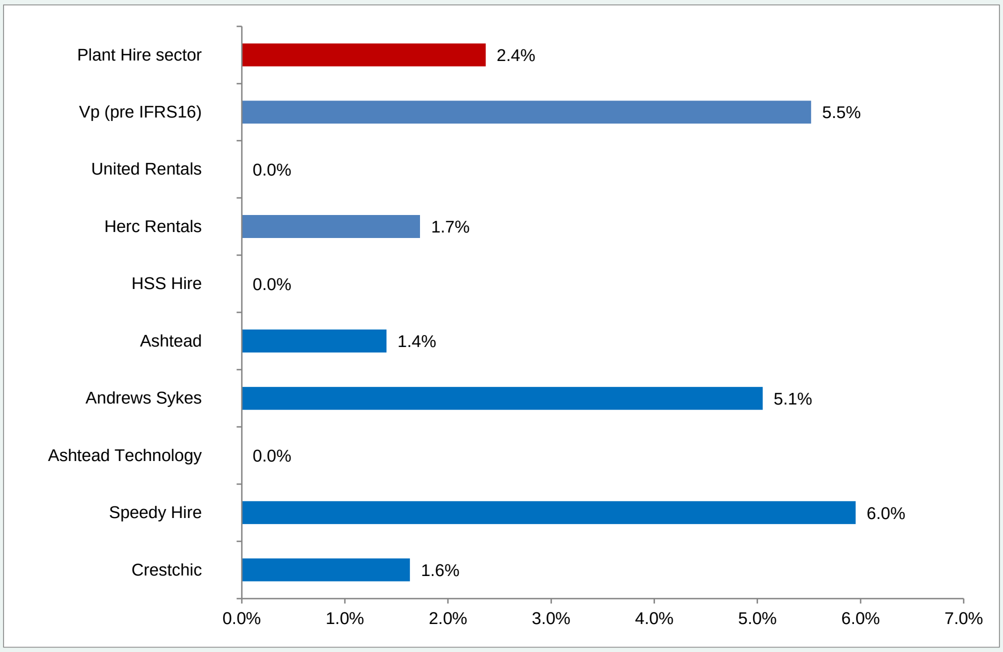
Source: Equity Development

CY PERs vs peers



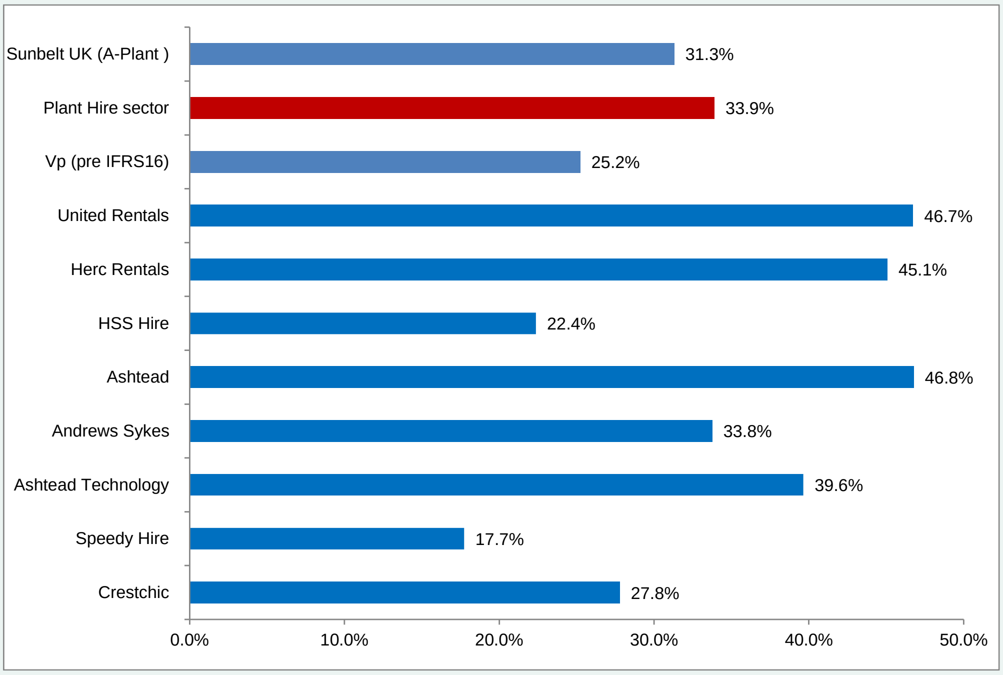
Source: Equity Development

CY dividend yield vs peers



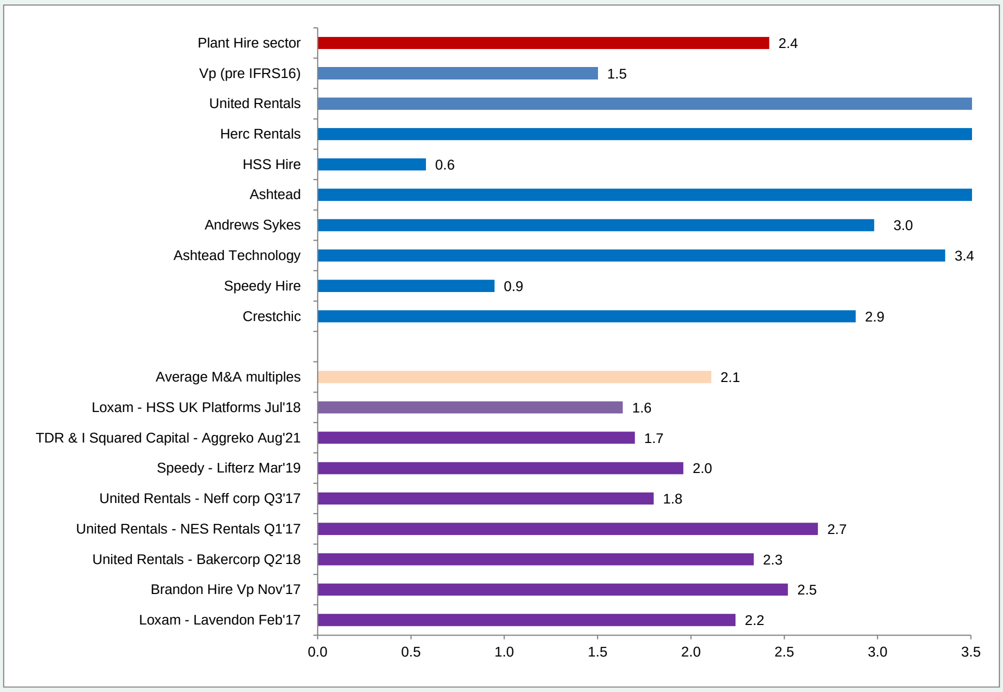
Source: Equity Development

CY % EBITDA margins vs peers



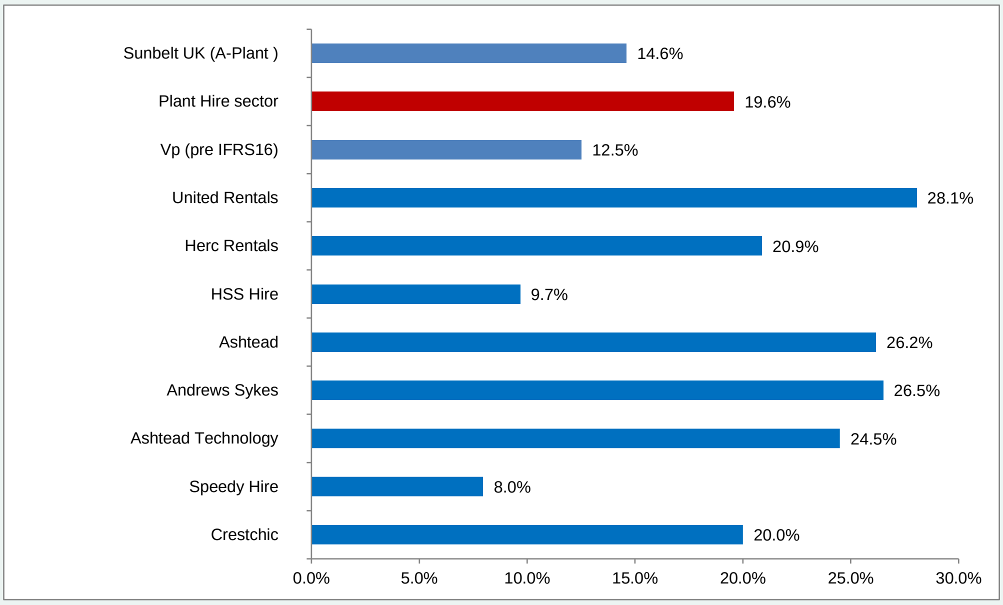
Source: Equity Development

CY Price: Book



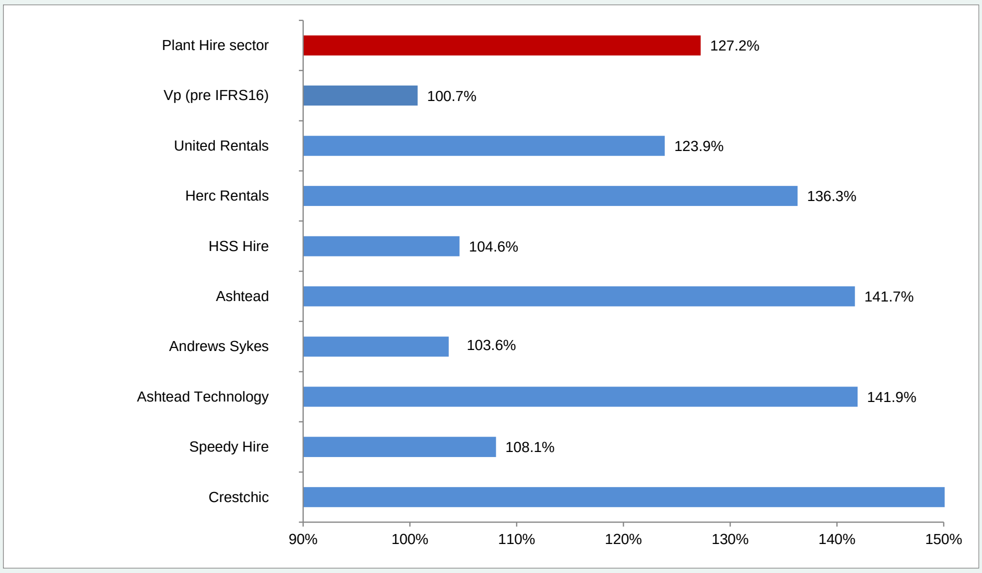
Source: Equity Development

CY % EBIT margins vs peers



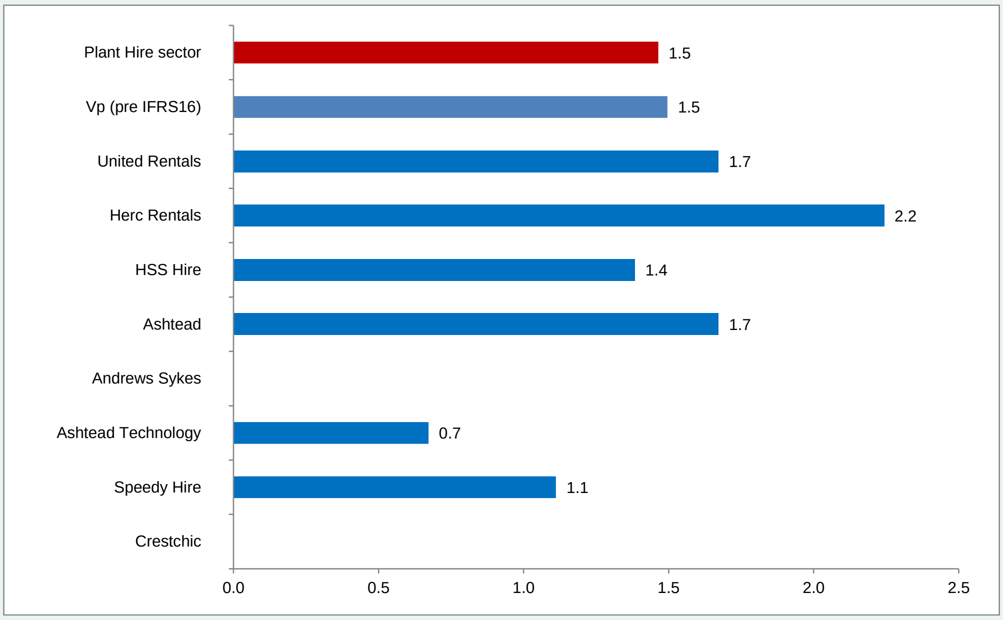
Source: Equity Development

Current year sales as a % of pre Covid levels



Source: Equity Development.

CY Net debt : EBITDA



Source: Equity Development

Market capitalisation of peers

	Shareprice	Mrk Cap (Ms)	CY net cash / (debt) Ms	Enterprise Value (Ms)
Crestchic	325.0p	£96.3	£2.5	£93.8
Speedy Hire	42.0p	£210	-£87	£297
Ashtead Technology	314.0p	£251	-£21	£272
Andrews Sykes	495p	£209	£17	£192
Ashtead	$6,096.0	$27,310	-$7,088	$34,398
HSS Hire	13.5p	£94.0	-£104.6	£198.6
Herc Rentals	$133.0	$3,884	-$2,754	$6,638
United Rentals	$360.0	$25,200	-$9,048	$34,248
Vp	680p	£273	-£138	£411

Source: Equity Development

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