

Beats on both top and bottom lines

5th June 2018

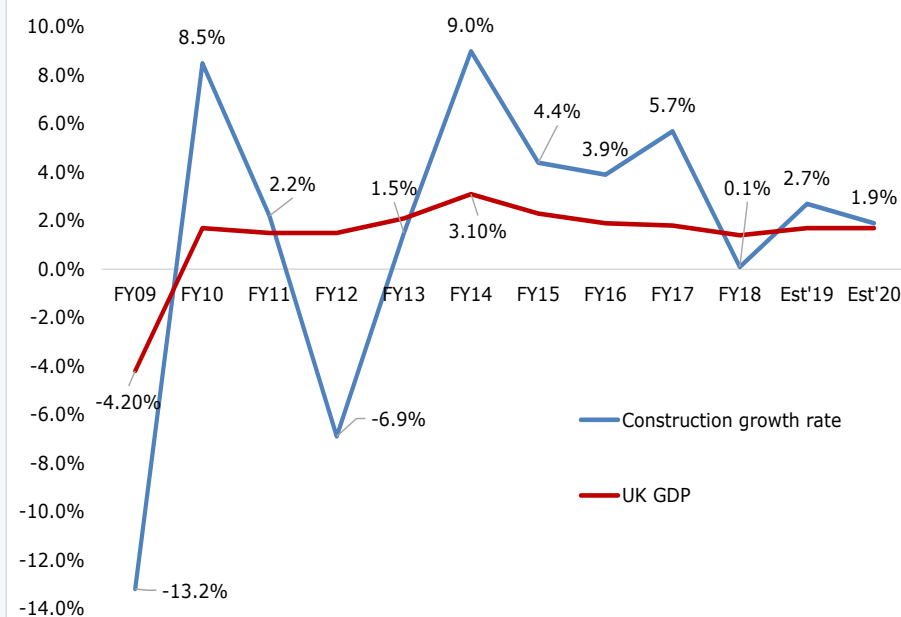
Like it or not, but in 10 months' time the UK will leave the EU. Critics have warned about the challenges, yet being inside Europe isn't exactly risk-free either. As evidenced by the resurgence last week of anti-establishment rhetoric in Italy/Spain, and worries of another Eurozone crisis.

Either way, the UK construction industry ploughs ahead unabated. Building the 100ks of new homes the country desperately needs, together with updating often capacity constrained & dilapidated infrastructure (eg rail, power, water, airports, etc). Secular trends that should endure irrespective of Brexit.

Vp's growth is unlikely to be derailed by Brexit

Indeed, the Construction Products Association (CPA) reckon that, despite a weak Q1'18 (-2.7%), UK building output will expand on average at 1.0% for the following 3 quarters (0.1% FY), before accelerating to 2.7% and 1.9% in 2019 and 2020 (see below) - compared to 2018 GDP of 1.4% and 1.7% thereafter.

Projected UK construction activity



Source: ONS, Bank of England and Construction Products Association (CPA)

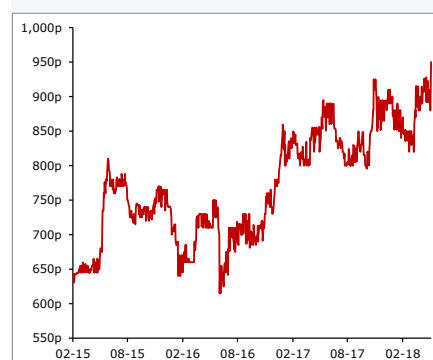
Infrastructure & housing remain bright spots

Within this, **infrastructure** (37% of Vp's FY18 turnover) **is set to be the standout**, motoring along at a 6.4% clip this year and 13.1% next, as several giant civil engineering projects kick-off – not least HS2, the Thames Tideway Tunnel, Crossrail 2 and Hinkley Point.

Company Data

EPIC	LSE: VP.
Price (last close)	940p
52 week Hi/Lo	945p/792p
Market cap	£377m
ED valuation/share	1,070p
Daily volume	13,000

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

Member of FTSE SmallCap Index.

Next news: AGM early August 2018.

Paul Hill (Analyst)

0207 065 2690
paul.hill@equitydevelopment.co.uk

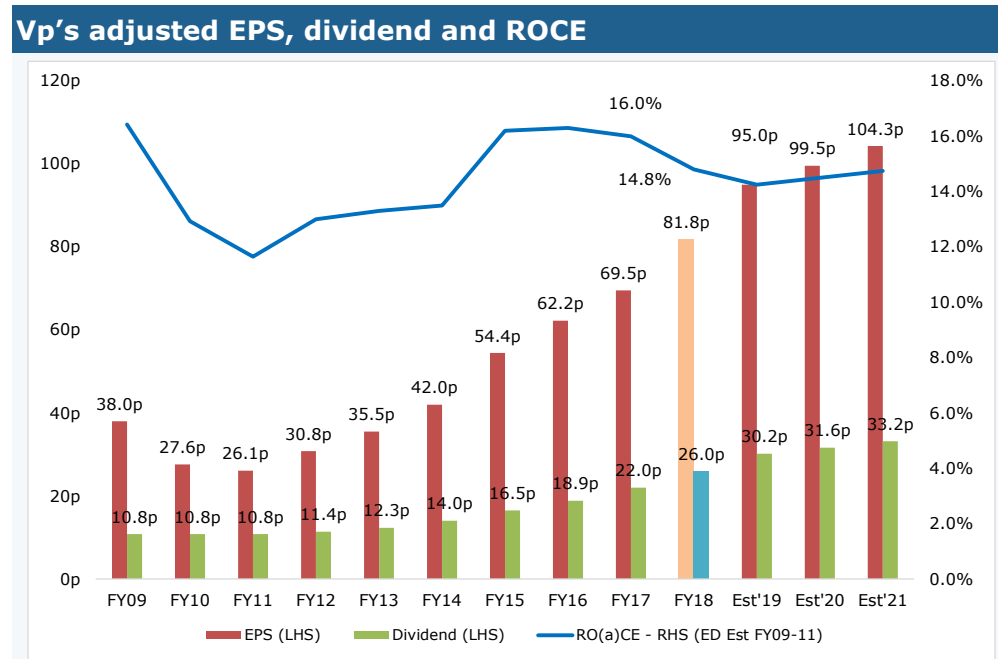
Hannah Crowe

0207 065 2692
hannah@equitydevelopment.co.uk

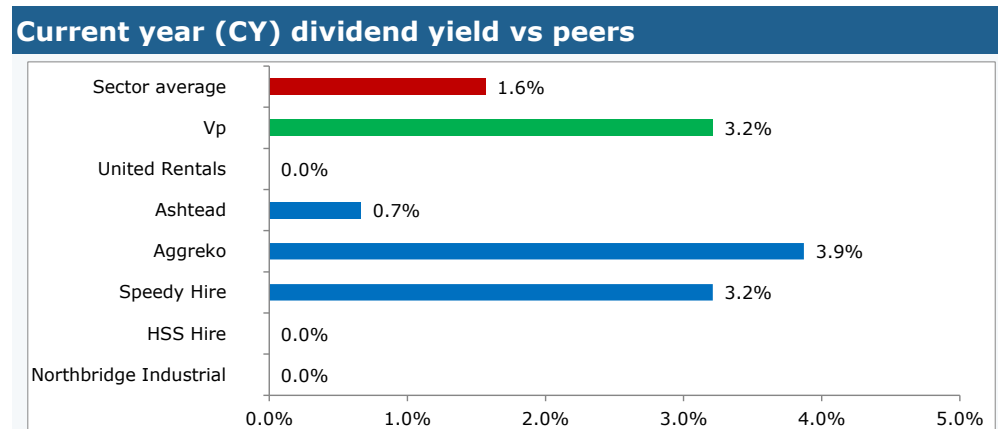
Metronomic earnings and dividend expansion

Therefore, whichever 'way the EU pendulum ultimately swings', we're confident **Vp will continue to outperform over the cycle**. Indeed the firm's '**tried & tested**' approach of focusing on renting specialist equipment, complemented by flawless execution and synergistic M&A - enabled it to post **exemplary results once again** (see below) this morning.

FY18 revenues, adjusted PBT, EPS and dividends all climbed to £303.6m (+22.1%), £40.6m (+16%, ED £39.2m), 81.8p (+18%) and 26p (+18%) respectively. Propelled by an "**excellent**" performance in the UK, where EBIT rose 20% to £43m – representing almost 98% (95% LY) of the business – on revenues 24% up at £272.0m (margin 15.8%).



Source: Equity Development



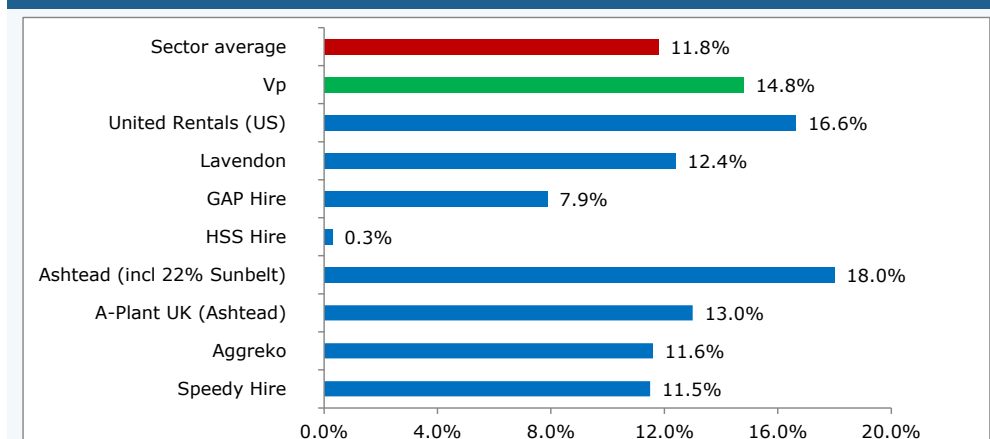
Source: Equity Development. Closing prices as per 4th June 2018

Leading the pack

Similarly, ROCE came in at a healthy 14.8%. Sure, this was slightly lower than the Board's own stretching 15% target, but masks the fact that the **existing business** (excluding Brandon at Est 10%) **achieved a 16% return**.

What's more, the 14.8% is superior anyway to most of Vp's rivals (see below) within the £4.5bn UK tool/plant hire & related services market. Plus last year, the group was forced to wait 4 months before being able to begin integrating Brandon (re CMA review), experienced little rebound in oil/gas demand (Re Airpac Bukom) and had to navigate the industry-wide disruption caused by the Carillion bankruptcy (Jan'18) and severe winter weather. A period too, that is traditionally much quieter for Brandon compared to the rest of the year.

ROCE across sector



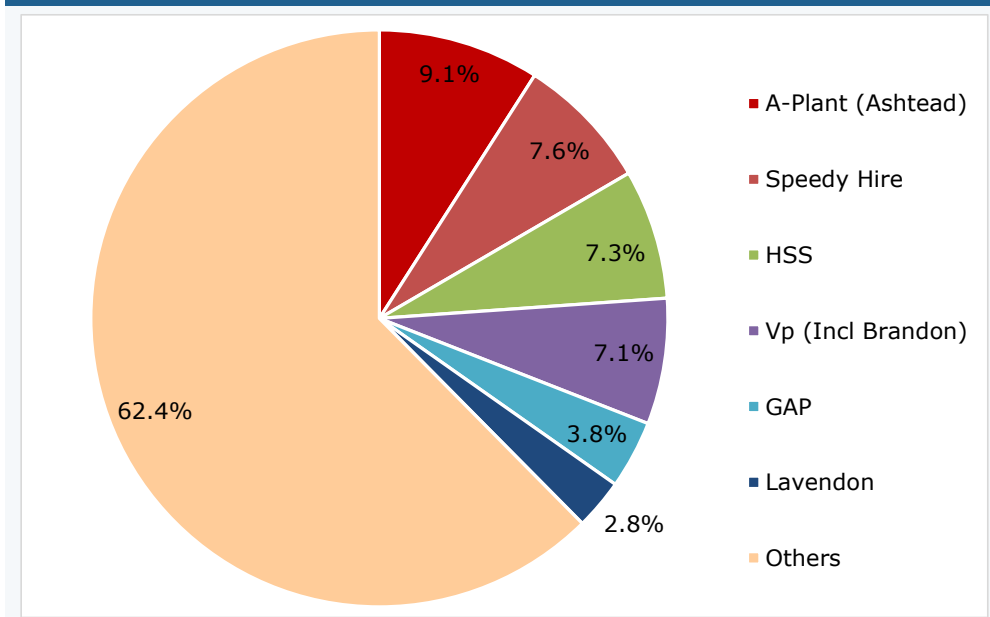
Source: Equity Development

Largest players winning market share

Furthermore from a macro perspective, the **leading operators seem to be expanding faster than the pack**. Here the top 5 groups, who possess an approx 31% share (see below), generate greater economies of scale. Hence enabling them to not only invest in the latest equipment/technology (eg remote diagnostic, safety enhancements), but also provide 24-7 national, same-day breakdown cover. Widening their 'moats', and facilitating consolidation as smaller players are faced with the long term decision of either bulking up or selling out.

In fact, A-Plant (owned by Ashtead) is aiming to lift its 9.1% (see below) by 50% to >13.5% over the next 5-7 years. We see no reason why Vp can't (at least) do the same – **supplementing organic growth with selective M&A**.

Estimated UK construction rental market shares



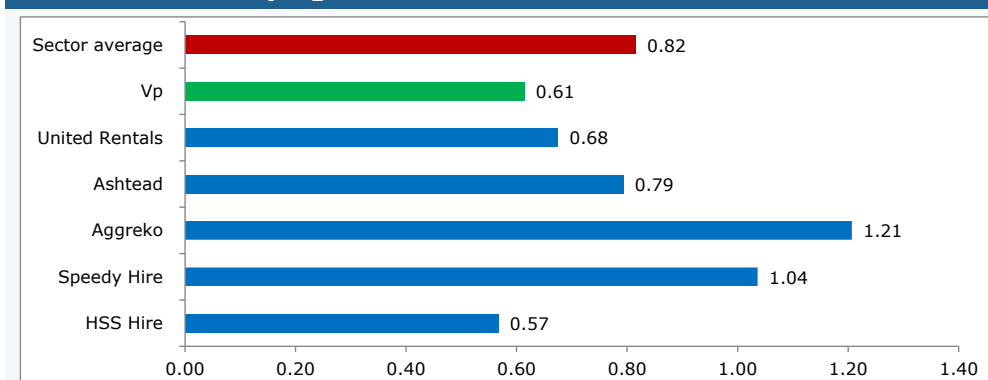
Source: Equity Development based on AMA Research, Ashtead and IHS Markit data

Stock trades on a PEG of only 0.6x

A 2-pronged strategy which paid off handsomely in FY18, as **Vp was able to purchase Brandon Hire in November for £68.8m** (biggest ever acquisition) at reasonable 2016 EV/EBITDA, EV/EBIT and EV/Book (debt/cash free) multiples of 5.6x, 11.5x and 1.9x. Whilst spending a further £11.2m on 3 bolt-ons: namely, Zenith Survey Equipment, Jackson Mechanical Services and First National.

Better still at 940p, **investors can access this double digit growth at a current year (CY) PEG of 0.6x** (see below).

Estimated underlying PEG ratios

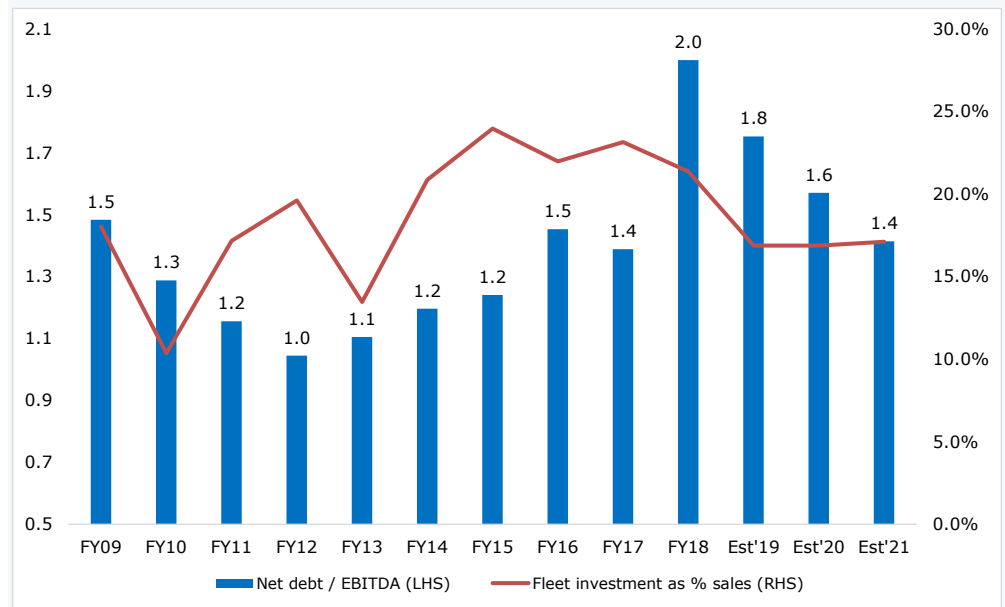


Source: Equity Development. Closing prices as per 4th June 2018

Taking advantage of cheap credit, but not over-gearing

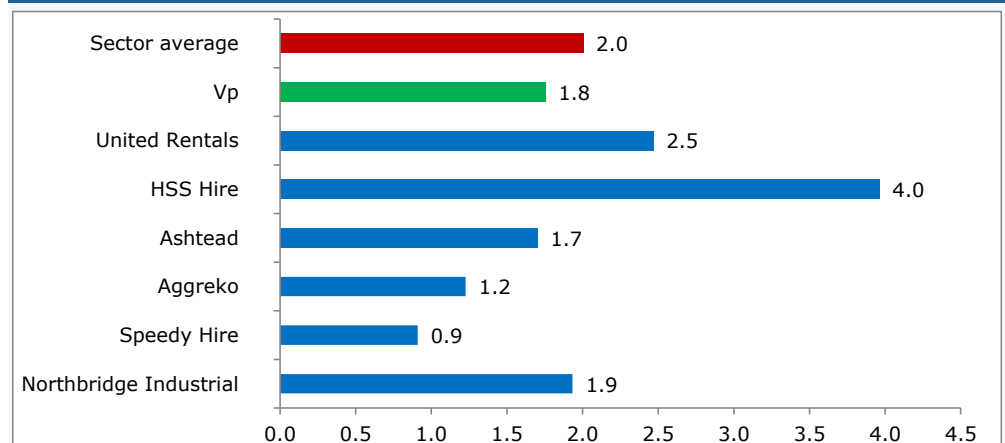
In terms of the balance sheet, net debt closed Mar'18 at £179.2m (£98.9m LY). Equivalent to an **adjusted net debt:EBITDA of <2.0x** (see below), falling to 1.8x 12 months later. All told, £64.9m (or 21.9% sales - £57.6m LY) was invested in the fleet in FY18, and another £80.2m on M&A.

Prudent balance sheet



Source: Equity Development (arithmetic average for sector). FY18 proforma figures.

Current year (CY) net debt to EBITDA ratios vs peers



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

Was there anything to quibble about?

As always there were a few swings and roundabouts – albeit it's frankly 'clutching at straws'. Demand within some corners of the commercial property world remains subdued (eg retail parks and basement digging in the South East). Meanwhile, Vp incurred a minor bad debt from Carillion - yet this might actually turn out to be a net positive, since the rebid work is tending to land in the laps of the most financially stable providers.

Elsewhere, conditions at Airpac Bukom (ie oil & gas) got tougher, although of late there has been a **noticeable improvement in enquiry levels** thanks to the bounce in crude prices. Likewise Network Rail postponed and/or cancelled a few notable 'new build' contracts (eg electrification) under CP5. However going forward Torrent Trackside should benefit from the 2019-24 £48bn CP6 programme, which is tilted more towards its sweet-spot of maintenance, repairs and upgrades.

Finally, there was £1.7m of one-offs from the Brandon deal – split £1,141k professional/legal fees (advisor & associated CMA review) and £541k restructuring (severance and depot closure costs).

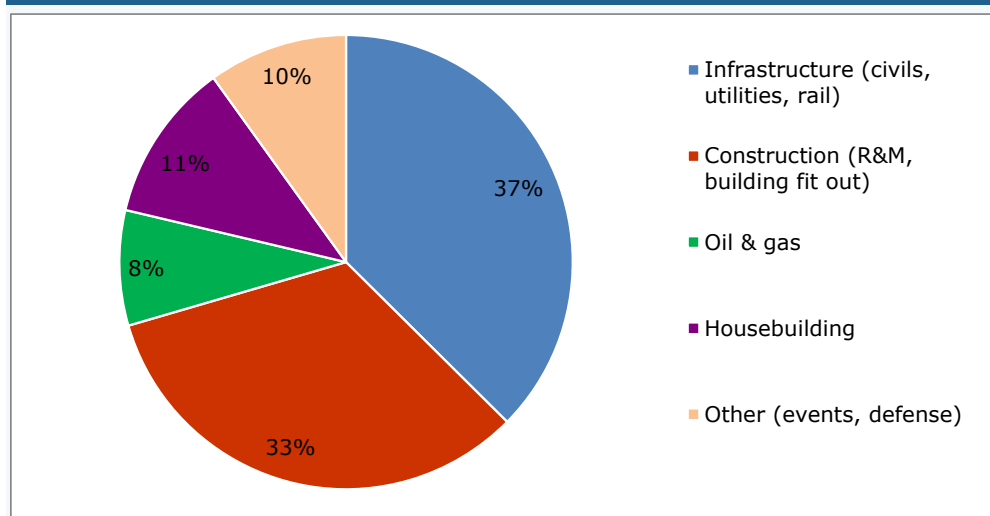
Brandon to deliver a “step change”

That said, in the grand scheme of things these were relatively small beer. The **housebuilding, construction and infrastructure verticals** (see below - contributing 81% turnover) **deliver the vast majority of profits**. And in our opinion should continue to do so in light of the >£100bn being ploughed into HS2, the Thames Tideway Tunnel, 3rd runway at Heathrow and Hinkley Point C, alongside the government’s stated aim of building 300k homes pa vs circa 200k today.

Additionally, once fully integrated in 2 years’ time, we suspect Brandon’s ROCE will shift closer towards Hire Station’s (Est 15%), reflecting fleet capex, x-selling, procurement, geographic and overhead synergies. The Board is not hanging around either, with a single management ‘tool hire’ team already appointed, and trading said to be “*in line with expectations*”.

Importantly, Brandon enhances Hire Station’s branch network to >200 locations and raises its presence in the valuable SME sector. Together creating a **much stronger organisation** that should be able to better serve customers - ultimately operating under a single unified brand once common systems are implemented.

FY18 sales breakdown (£303.6m)



Source: Equity Development

Outside of the UK, there are opportunities in Europe (eg Germany) where Vp’s fledgling “enterprises are starting to gain traction”. While TR had a “successful year with good progress being made in the Australia and New Zealand”, and prospects described as “promising”. Nevertheless, FY18 International EBIT tumbled to £1.0m from £1.9m (margin 3.2% vs 6.6% LY), mirroring losses at Airpac Bukom in spite of TR’s profit progression.

So where do we end up?

With regards to the numbers, **we have nudged up both our forecasts and valuation to 1,070p/share (vs 970p before)** – on the back of the “outstanding” FY18 out-turn and enhanced competitive position within tool hire.

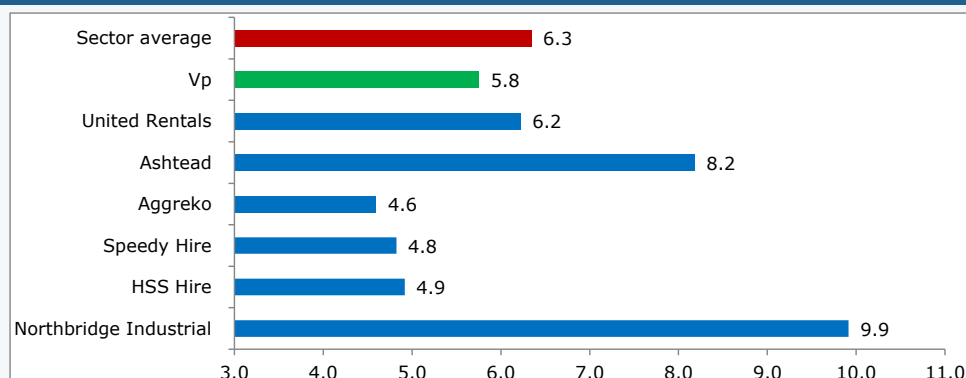
Chairman Jeremy Pilkington commenting ***"The Group is focussed on delivering sustainable long term value for shareholders by leveraging our proven expertise in the specialist rental sector. We remain committed to being first choice provider, first choice employer and to aspire to lead our markets in terms of service & customer satisfaction. The past is always easier to predict than the future but we look forward to the new financial year with confidence"***.

CEO Neil Stothard adding ***"The start to the new financial year has been positive. We anticipate that our core UK markets of infrastructure, housebuilding and construction will continue to provide a strong platform for future growth. Our European activities have a busy year ahead and we look forward to further progress in that region. International growth will be driven by further development of our TR business and some modest recovery in our offshore oil and gas support services business."***

What about the peer comparison?

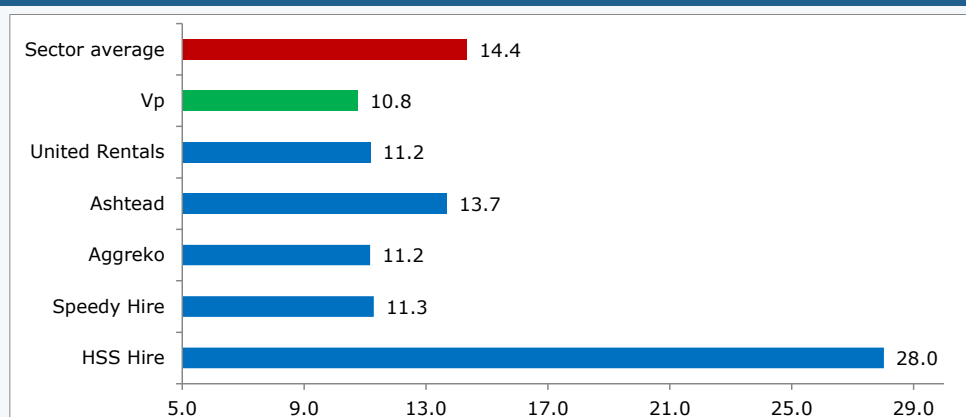
Based on our revised porjections, at 940p we think Vp trades at an undeserved discount to the equipment hire sector, implying current year (CY) EV/EBITDA, EV/EBIT and PER multiples of 5.8x, 10.8x and 9.9x respectively (see below). In our view, **this offers good value for such a quality GARP stock** - especially bearing in mind its **positive flight path, high-teens earnings growth and PEG of 0.6x**.

Current year (CY) EV/EBITDA multiples



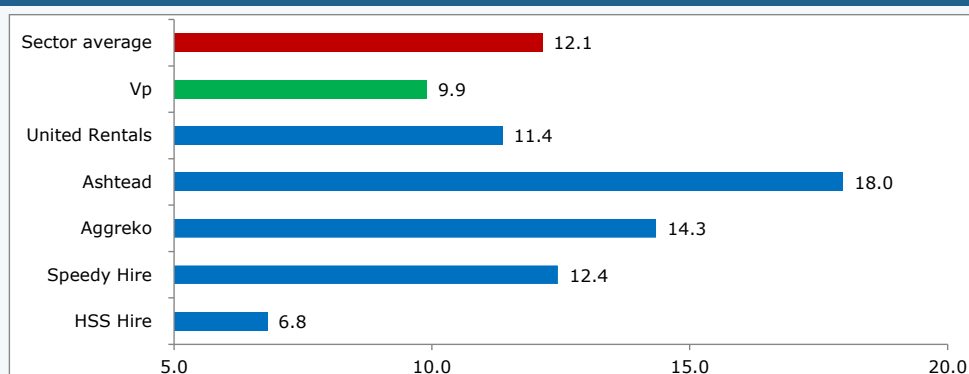
Source: Equity Development. Closing prices as per 4th June 2018

CY EV/EBIT multiples



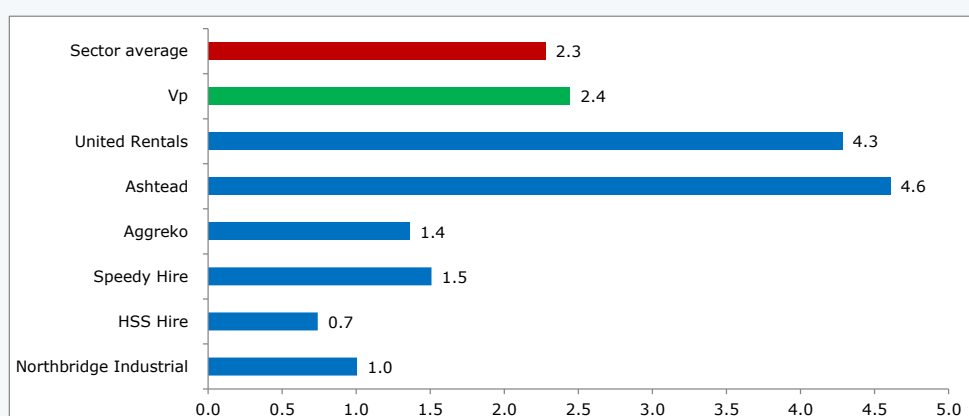
Source: Equity Development. Closing prices as per 4th June 2018

CY PERs



Source: Equity Development. Closing prices as per 4th June 2018

CY Price to Book



Source: Equity Development. Closing prices as per 4th June 2018

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	333,184	343,723	354,621
International	21,460	15,191	28,725	31,650	33,018	34,445	35,934
Total	205,602	208,746	248,740	303,639	366,201	378,168	390,556
% growth	12.3%	1.5%	19.2%	22.1%	20.6%	3.3%	3.3%
UK		5.1%	13.7%	23.6%	22.5%	3.2%	3.2%
International		-29.2%	89.1%	10.2%	4.3%	4.3%	4.3%
EBITDA	53,803	59,266	71,238	84,337	96,729	101,100	104,420
% Margin	26.2%	28.4%	28.6%	27.8%	26.4%	26.7%	26.7%
Adjusted EBIT							
UK	26,027	30,659	35,871	43,001	50,131	52,299	53,765
International	2,753	1,232	1,886	1,017	1,570	2,301	2,631
Total	28,780	31,891	37,757	44,018	51,700	54,600	56,397
% Margin	14.0%	15.3%	15.2%	14.5%	14.1%	14.4%	14.4%
UK	14.1%	15.8%	16.3%	15.8%	15.0%	15.2%	15.2%
International	12.8%	8.1%	6.6%	3.2%	4.8%	6.7%	7.3%
Underlying Interest charge	-2,023	-2,093	-2,906	-3,421	-4,700	-4,600	-4,500
Adjusted PBT (pre amortisation)	26,757	29,798	34,851	40,597	47,000	50,000	51,897
Adjusted earnings	21,201	24,226	27,262	32,290	38,070	40,500	43,074
Adjusted Basic EPS (p)	54.4	62.2	69.5	81.8	95.0	99.5	104.3
EPS growth rate	29.7%	14.3%	11.7%	17.7%	16.1%	4.8%	4.8%
Dividend (pence)	16.5	18.9	22.0	26.0	30.2	31.6	33.2
Valuation benchmarks							
P/E ratio	17.3	15.1	13.5	11.5	9.9	9.4	9.0
EV/Sales	2.7	2.7	2.2	1.8	1.5	1.5	1.4
EV/EBITDA	10.3	9.4	7.8	6.6	5.8	5.5	5.3
EV/EBITA	19.3	17.5	14.7	12.6	10.8	10.2	9.9
PEG ratio	0.6	1.1	1.2	0.7	0.6	2.0	1.9
Dividend yield	1.8%	2.0%	2.3%	2.8%	3.2%	3.4%	3.5%
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	1.4
Return on average capital employed	16.2%	16.3%	16.0%	14.8%	14.3%	14.5%	14.8%
Net cash/(debt)	-66,764	-86,134	-98,933	-179,172	-169,567	-158,815	-147,674
Fleet capital expenditure	49,300	45,900	57,600	64,900	61,847	63,847	66,847
Investment as % sales	24.0%	22.0%	23.2%	21.4%	16.9%	16.9%	17.1%
Reported sharecount Ks (net Treasur	38,940	38,942	39,215	39,476	40,082	40,688	41,294
Shareprice (p)	940						

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.
- 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.



Head of Corporate

Gilbert Ellacombe

Direct: 0207 065 2698

Tel: 0207 065 2690

gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Felix Grant-Rennick

Direct: 0207 065 2693

Tel: 0207 065 2690

justin@equitydevelopment.co.uk

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