UK Market Conditions

Introduction

In the back half of 2017 continuing into 2018 Rouse has seen hire companies and OEMs report measured but positive results. This, combined with sustained value retention, has Rouse optimistic about the hire industry.

2017 equipment sales in the UK Grew by 7.6% compared to 2016 according to the Construction Equipment Association (CEA) accounting for 30,000 units sold in 2017. Growing capital spending in hire fleets is said to be a major driver as the hire industry accounts for over 60% of equipment supply in the UK. Consistent with this trend, recent reports from original equipment manufacturers (OEMs) of equipment have been positive.

The positive tones across the hire industry and the equipment sales environment are balanced against some of the cautionary signals seen across the broader construction environment.

Despite construction performance and equipment sales improving between 2016 and 2017, the latter half of 2017 continuing into early 2018 showed month over month declines in construction spend. This sustained decline combined with the recent, notable construction company bankruptcy has led to some caution in the overall construction industry. Q2 2018 has seen construction output rise each month, but total construction new orders are down for the third consecutive quarter and sit at the lowest level in over five years.

Hire Industry

Despite the challenging economic scenario that included elections in the United States, France, Germany and the Netherlands, as well as Brexit, the ERA Market Report 2017 released by European Rental Association (ERA) shows growth in the equipment rental market for all fifteen countries incorporated within the research. The report showed a 2.5% increase compared to 2016 and forecasted a 2.8% increase for 2018 for the European market.

UK National Hire Company Performance

Many of the major hire and equipment companies posted improved revenue in their latest public disclosures including A-Plant, Vp plc, Speedy, and Aggreko. HSS Hire Group, the one exception, showed some meaningful declines in the first half of 2017. The majority of these topline improvements are in the low double digits. Improvements seem rooted in fleet growth, as utilization growth has been flat to modest (low single digits).[1]

Company	Period	% Revenue Change	% EBITDA Change	Physical Utilization	Other Notes
A-Plant	TTM 4/30/18	21%	21%	68% -> 69%	UK growth driven by same-store improvements, bolt-on acquisitions
Aggreko	T6M 6/30/18	26%	-7%	52% -> 61%	Increased utilization, focus on specialty products, and new e-commerce platform boosted revenue
Gap Group	TTM 3/31/17	11%	13%		Move from utilities to focus on being a “Hire Solutions” provider has driven positive results
HSS Hire	T6M 6/30/18	5.8%	74.7%	49% ->52%	Implemented new hire business model in 2017. Savings realized in H1 2018 with EBITDA margins increasing from 10.6% to 17.6%
Speedy Hire	TTM (as of 3/31/18)	6%	19%	51% -> 55%**	Growing revenue from value-added services businesses; Improved utilization also contributed to increased revenue
Vp plc	TTM 3/31/18	22%	17%*		Revenue growth driven by R&M/fit out

***PBITA**

One major avenue to fleet growth has been through acquisitions. Loxam acquired Lavendon to become the third largest global player in the aerial market. A-Plant has acquired Clyde Security Containers, Plantfinder, and Chanton Hire Survey. Vp plc has purchased JMS M&E, Zenith survey equipment, Brandon Hire, and First National. With Brandon Hire folded in to Hire Station, Vp now owns the largest specialty tool hire firm in the UK. Speedy has acquired cherry picker hire firms Prolift Access Limited and Platform Sales & Hire Limited. Most of the acquired companies specialize in small to mid-size equipment in the access and tool space. The transaction multiples paid for the larger acquisitions have shown a vigor to get into the space and improve footprint. This is a positive sign for the construction industry as a whole, and specifically the hire market.

[1] *All data sourced from the public filings of the listed companies*

ROUSE APPRAISALS

Deal (Acquirer/Seller)	Acq price (000)	Revenue (000)	EBITDA (000)
A-plant/Chanton Hire	£1,000		
A-plant/Plantfinder & Clyde Security Containers	£24,000	£10,500	
Loxam/Lavendon	£727,000		£106,390
Speedy/Platform Sales & Hire	£10,700	£9,300	£2,400
Speedy/Prolift	£12,700	£7,880	£2,400
Vp plc/Brandon Hire	£68,800	£79,800	£6,000
Vp plc/First National	£1,700		
Vp plc/JMS M&E	£3,600		
Vp plc/Zenith Survey Equipment	£6,150		

Secondary Market Values – Plant and Equipment

Rouse regularly tracks local market equipment values as part of the process for creating accurate, up-to-date fleet appraisals. In addition to collecting disposal data across its vast client base, Rouse accumulates all of the publicly available auction data from Ritchie Bros., Euro Auctions, Iron Planet, and Thimbleby and Shorland totaling over £260m in UK auction sales in 2017. Rouse is able to track value retention by comparing current auction returns against the forced liquidation value ascribed in the previous period. When looking at YTD 2018 auction returns compared against fourth quarter 2017 appraised values, sales results were within 3% of the prior quarter appraised values. There was an observed consistency across equipment groupings with Q1 aerial (including telehandlers) and earthmoving equipment reflecting 98% and 95% of prior appraised values respectively and support equipment reflecting 99% of prior appraised values. If one were to consider an approximate 10%-12% depreciation of equipment per year, this could lead to the assumption that values are holding strong with very little value degradation over this period (Given that this comparison is for Q1 2018 sales against Q4 2017 thru Q1-2018 appraised values, there is an approximate 1 to 6-month lag).

Select Categories

Category	Sale Price/ FLV
Telehandlers	98%
Excavators	95%
Wheel Dumpers	96%
Air Compressors	110%
Track Loaders	85%
Backhoe Loaders	102%
Double Drum Rollers	106%
Articulating Booms	100%
Light Compaction	98%
Grand Total	97%

New Equipment Sales

According to the CEA, growth in sales of construction equipment was driven by mini and medium excavator sales up 16% from 2016. As the sales are seasonal, they peaked in Q2 and bottomed in Q4. Exports of equipment increased by 22% while imports grew by 16%. This resulted in a £1.42 billion trade surplus – a 30% year-on-year increase. Exports nearly doubled from 2016 with the USA being the top destination accounting for 24% of total exports. Japan topped the list of importers accounting for 20% of all imports.

The first half of 2018 has seen similar growth, albeit at a slowing pace. Equipment sales in the first half of 2018 have increased 5% over the first half of 217, according to the CEA. Given the softer construction market between January and March, this increase is all the more encouraging. The CEA said that much of the growth is attributable to the homebuilding market, which has stimulated demand for smaller equipment.

In response to these positive export trends, both Haulotte and JCB have posted optimistic results in. Haulotte, a Paris-based European leader in the aerial work platform manufacturing, saw revenue growth of 11% in 2017 to £510 million. Despite rising raw material pricing, operating income increased by 56%. At a constant exchange rate, equipment sales sector sales grew 13% and hire sector sales grew 16%.

JCB, a UK-based construction equipment manufacturer, has responded to a healthy order book with the addition of 200 employees immediately and 400 more expected over the next 12 months.

Construction Activity

According to the Office of National Statistics[2], construction output during calendar year 2017 increased in comparison to output in 2016. This growth was driven by strength in new work within the housing and private commercial sectors, which saw increases of ~13% and ~8% respectively. Activity in the construction repair and maintenance sector also increased compared with the same period in 2016, with growth of ~5%. On balance, there was a 5.1% increase in construction output for 2017. March 2017 represented a five-year peak for construction output in the UK, with output up 31% over the lowest point of the last five years, January 2013. Total new orders increased by 5.4% in 2017 as well, representing the highest total since 2008; this, however, was largely due to the awarding of the HS2 contracts.

Despite the increase in output for 2017 vs 2016, there are indicators of headwinds when looking at the more recent trends. Viewed on a trailing three-month vs prior three-month basis, construction output in the UK declined for most periods in 2017. This construction market stagnation was spread across all sectors (housing, infrastructure, commercial, and repair and maintenance). Though the 2017 output ended up increasing on aggregate, including two consecutive months of output growth to close out the year, the more recent downward trend of 2018 may be more indicative of the current state of the UK construction market.

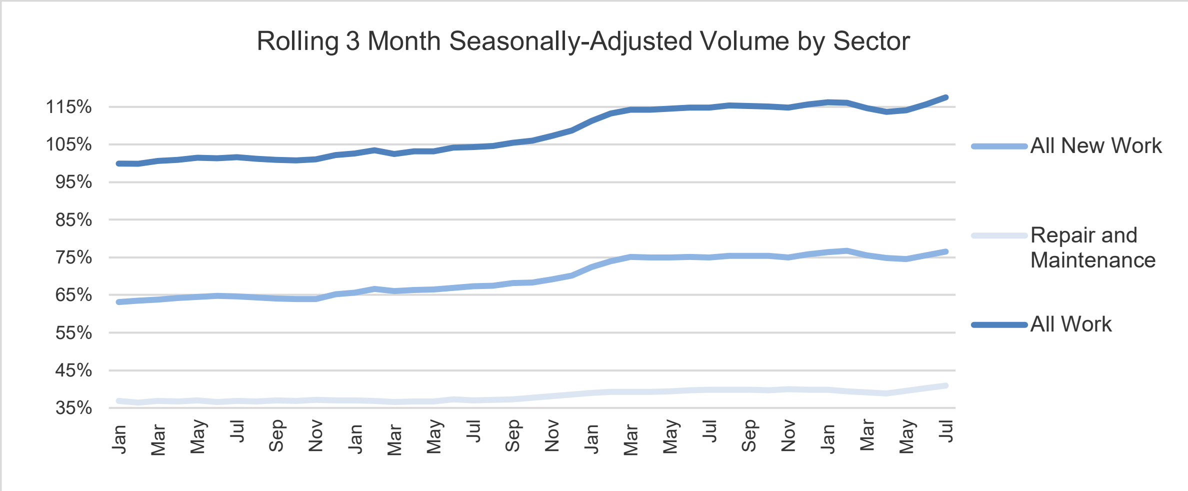
2018 started off very slowly, with adverse weather conditions contributing to a 0.8% decrease in output on a quarter-on-quarter basis. Q2 2018, however, saw an increase of 0.9% in output. This has been attributed largely to the improvement in weather, which allowed for a rebound effect. However, Q1 and Q2 saw a divergence in the type of work. According to Rebecca Larkin, senior economist at the CPA, “New build activity in the public housing, infrastructure, and industrial output were offset by falls in private housing and public sector work. However, all R&M activity rose 2.7% in Q2, and sits 0.8% higher than at the end of 2017.” Most recently, construction output in July increased by 0.5% month-over-month, driven predominantly by a 4.0% increase in new private housing work.

The recent increase in output is likely due to a rebound effect after the cold weather of Q1 2018, as opposed to a sustainable improvement in the UK construction market. Total construction new orders declined 6.5% in Q2, which is the third consecutive quarter that new orders have decreased. New orders currently sit at their lowest level since Q1 2013. The quarter-on-quarter decrease in construction new orders in Q2 is largely due to a 17.6% fall in new housing orders.

2018 has shown some other bright spots as well. The Q1 2018 (RICS) UK Market Survey found a net balance of 23% of surveyors reporting their workloads to have risen in the first three months of the year. Both new work and repair and maintenance were reported to have risen steadily. Private housing reported the sharpest increase in workloads, with 36% more respondents citing an increase rather than a decrease. Further, private housing output is expected to rise 5% in 2019, largely supported by the Help to Buy program, a government sponsored mortgage assistance program. This is the most positive response since the beginning of 2016. However, a shortage of skilled workers continues to be an obstacle for many businesses, with 60% of respondents citing it as an impediment to growth.

Looking forward, there are several government infrastructure projects that should continue to support the construction environment throughout the UK such as Hinkley Point C nuclear power station, Thames Tideway Tunnel, and High-speed 2 rails. According to the Q1 2018 (RICS) Market Survey, Infrastructure output is expected to grow 6.4% this year and 13.1% in 2019. Still, the market is weary of rising inflation and the result of less government income from taxes, which could potentially delay or deter some of the government infrastructure projects. Contractors cited the threat of higher interest rates and rising labour costs as deterrents from starting new projects. Commercial spending is predicted to decline as investors are still cautious about the unrealized effects that Brexit may have going forward. For this reason, it is predicted there will be a decrease in the demand for contractors who typically depend on work for commercial projects. All that said, the Construction Products Association (CPA) projects construction work to bounce back next year, forecasting a 2.7% increase in output in 2019 and a 1.9% increase in 2020.

2 *All quoted statistics are from the Office for National Statistics, and have been seasonally adjusted*



Notes from Major Construction Contractors

- 2017 saw mostly improved revenues for many of the major UK contractors.
    - Infrastructure projects in the UK appear to be a common driver of improved revenues.
- Forward looking, order books appear to be flat to down.
    - There looks to be some strategic initiative around the bidding process with the emphasis on improved margins.

Contractor	Notes
Amey UK	Order book down 17% year-over-year as of 12/31/17, due to a more strategic bidding process with an emphasis on improved margin.
Balfour Beatty	Pre-tax profit from continuing operations jumped from £12m to £50m in H1 2018. Order book increased from £11.4bn to £12.6bn, not including HS2 JV.
Galliford Try	Construction Revenue up 10.5% YoY, from £1,527m to £1,687m. Gross margin improved from 0.0% to 0.9%. Order book is down from £3.6bn to £3.3bn due to more rigorous project selection.
Interserve	Order book down from £1.5b at midyear 2016 to £1.0b at midyear 2017 due to increased selectivity on bidding.
Keller	"We have seen a notable slowdown in orders in recent months and expect 2018 to be a challenging year. However, the major infrastructure projects coming up in the UK, most notably HS2, should mean that the market for geotechnical work picks up noticeably in 2019 and 2020" - Preliminary FY 2017 results announcement on 26 Feb 2018.
Kier Group	Kier reported a 5% organic growth in revenue for Fiscal Year 2017 (7/1/16 to 6/30/17). As of 6/30/17, the construction order book was at £4.2b compared to £3.2b the year before.
Morgan Sindall	Revenue up 9%, Profit before tax up 46% as of TTM 12/31/17. Construction & Infrastructure increased operating margin from 0.7% to 1.5% and operating profit from £8.9m to £20.4m. Infrastructure drove most of the growth with large-scale projects being awarded (M62 and M27 highways among others). However, order book for C&I was down 2% Y0Y.

Carillion Disposition

There has been some major trepidation in the market as the second largest contractor, Carillion, went into liquidation. Although it seemed to happen suddenly, there were clear signs that Carillion was in a perilous situation.

In 2017 Carillion gave multiple profit warnings stating that profits would be materially lower than current market expectations. There was also an overhaul of their executive team, going so far as to appoint a new CEO in October. The board admitted that they expected to breach on loan covenants due at the end of 2017.

The fallout has shown signs that it is not all doom and gloom for the market. If the projects were currently a part of a joint venture, the previous partners have thus far been able to continue operations. While JV partners such as Galliford Try Balfour Beatty have released statements regarding the costs they will have to bear in the wake of Carillion' collapse, there have been no project cancellations to date, and there will be less competition going forward.

As of 6 August 2018, agreements to transfer the last remaining Carillion contracts to other service providers were in place, signaling the end of the trading period. According to the Official Receiver, "83 per cent of the original workforce have either transferred with the contracts or resigned with another job to go to." In the end, 13,945 jobs were saved while 2,787 jobs were made redundant. Further, some Carillion suppliers including Grand Equipment and Serco have seen increased business. There is still some concern for insolvency among smaller suppliers dependent upon the Carillion relationship. Additionally, an investigation has revealed that Carillion had over £6.9 billion in liabilities upon entering receivership. This is significantly higher than the £2 billion that was initially reported.

To date, Rouse has seen no direct impact observed on used equipment values but will continue to keep a close eye on the fallout from Carillion's collapse.