UK Market Conditions

Introduction

In 2018 Rouse has seen hire companies and OEMs report measured but positive results. This, along with sustained value retention, bodes well for the UK construction market. However, some notable headwinds going into 2019 have potential to hinder the growth the industry has enjoyed recently.

Reports from original equipment manufacturers (OEMs) have been positive. The first three quarters of 2018 saw a 4.2% increase in equipment sales versus the same period in 2017. However, 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.

The latter half of 2017 through into early 2018 showed month over month declines in construction spend. This sustained decline was exacerbated by the harsh winter of 2018 and the Carillion administration. Q2 2018 saw construction output rebound with total output increasing each month. Q3 2018 saw strong growth in construction output, increasing 2.1%.

Most recently, construction output in Q4 2018 declined 0.3% compared to Q3. January 2019 reversed the downward trend, with all work increasing 2.8% in January after dropping 2.8% in December. However, total new orders in Q2, Q3, and Q4 2018 were the lowest they've been in over 5 years. This puts the UK construction market in a tenuous position heading into the rest of 2019.

UK National Hire Company Performance

Many of the major hire and equipment companies posted improved revenue in their latest public filings. 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	T9M 31/1/19	2%	3%	69% -> ~71%	Physical utilization increased but was offset by lower rates. EBITDA margin increased from 36% to 37%
Aggreko	TTM 31/12/18	19%*	-7%	52% -> 61%	Increased utilization, focus on specialty products, and new e-commerce platform boosted revenue
Gap Group	TTM 31/3/18	6.6%	13%		Particularly strong performances by GAP's Non-Mechanical and Lifting equipment divisions
HSS Hire	T3M 29/9/18	4.5%	24%	49% -> 52%	Implemented new hire business model in 2017. Savings realized in Q3 2018 with Adjusted EBITDA margins increasing from 20.0% to 23.7%
Speedy Hire	T6M 30/9/18	6.5%	9.5%	55% -> 56%	Strong growth in SME customer numbers and revenues
Vp plc	T6M 30/9/18	42%	25%		Revenue growth driven by strong demand from UK rail, transmission, and water infrastructure markets

*Rental Solutions Division

One avenue to fleet growth has been through acquisitions. A-Plant has acquired Clyde Security Containers, Plantfinder, Chanton Hire Survey, and recently Hoist-It. Morris Leslie acquired Chertsey Plant Hire, adding over 500 units to its 5,000-strong fleet. Foreign companies have made inroads into the UK by way of acquisition as well. Loxam entered the UK in 2017 by purchasing Lavendon, the parent company of Nationwide Platforms. Dutch firm Boels also entered the UK in 2017 with its purchase of Supply UK. In 2018, Boels has added Already Hire, Artisan Hire Centre, and its sister company SAS to its portfolio. With 38 depots throughout the UK already, Boels aims to have at least 50 branches in the UK by 2020.

Though most hire firms have reported positive results, the administration of Hawk Plant Hire gives reason for caution. Low utilization was reported to be a problem for Hawk. However, late payments resulting from the Carillion fallout have been cited as the primary reason for Hawk's insolvency. Given Carillion's size, other plant hire firms have almost certainly been impacted in a similar manner. The true extent of Carillion's collapse may not be known for some time.

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

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

ROUSE APPRAISALS

Ritchie Bros., Euro Auctions, Iron Planet, and Thimbleby and Shorland totaling over £223m in UK auction sales in 2018. Rouse is able to track value retention by comparing current auction returns against the forced liquidation value ascribed in the previous period.

Select Categories

Category	Sale Price/ FLV
Excavators	94%
Wheel Dumpers	95%
Scissor Lifts	110%
Telehandlers	105%
Double Drum Rollers	105%
Articulating Booms	119%
Air Compressors	105%
Lighting Equipment	85%
Backhoe Loaders	101%
Generators	104%
Telescopic Booms	128%
Grand Total	98%

New Equipment Sales

The first half of 2018 saw solid growth in new equipment sales, albeit at a slowing pace when compared to 2017. Equipment sales in the first half of 2018 increased 5% over the first half of 2017, according to the CEA. The CEA stated that much of the growth was attributable to the homebuilding market, which has stimulated demand for smaller equipment.

Q3 2018 sales increased just 1% over Q3 2017, leaving sales up 4.2% in the first three quarters of 2018 over the same period in 2017. Q4 saw sales decrease by 8% compared to Q4 2017, leaving 2018 total growth at 2% with approximately 31,000 units sold in the UK retail market. Large crawler excavators showed the strongest growth, with sales up 16% over 2017 levels. Telehandlers showed the weakest performance, with sales to the construction industry specifically down 10%.

Though sales slowed in 2018, the 2.2% increase looks better when viewed alongside the 0.7% growth in construction output. The CEA cited sustained demand from the rental sector as a strong factor. Additionally, HM Revenue & Customs reported that exports of construction equipment increased 19% over 2017.

In response to the positive export trends, both Haulotte and JCB have posted optimistic results. Haulotte, a Paris-based European leader in the aerial work platform manufacturing, saw revenue growth of 14% for YTD September 2018 to €413.9 million. JCB, a UK-based construction equipment manufacturer, reported a 73-year high in machine production and added 1,500 new jobs in 2018. JCB also began work on a new £50 million factory in Staffordshire to build cabs for its machines.

Construction Activity

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 saw an increase of 0.9% in output. 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.”

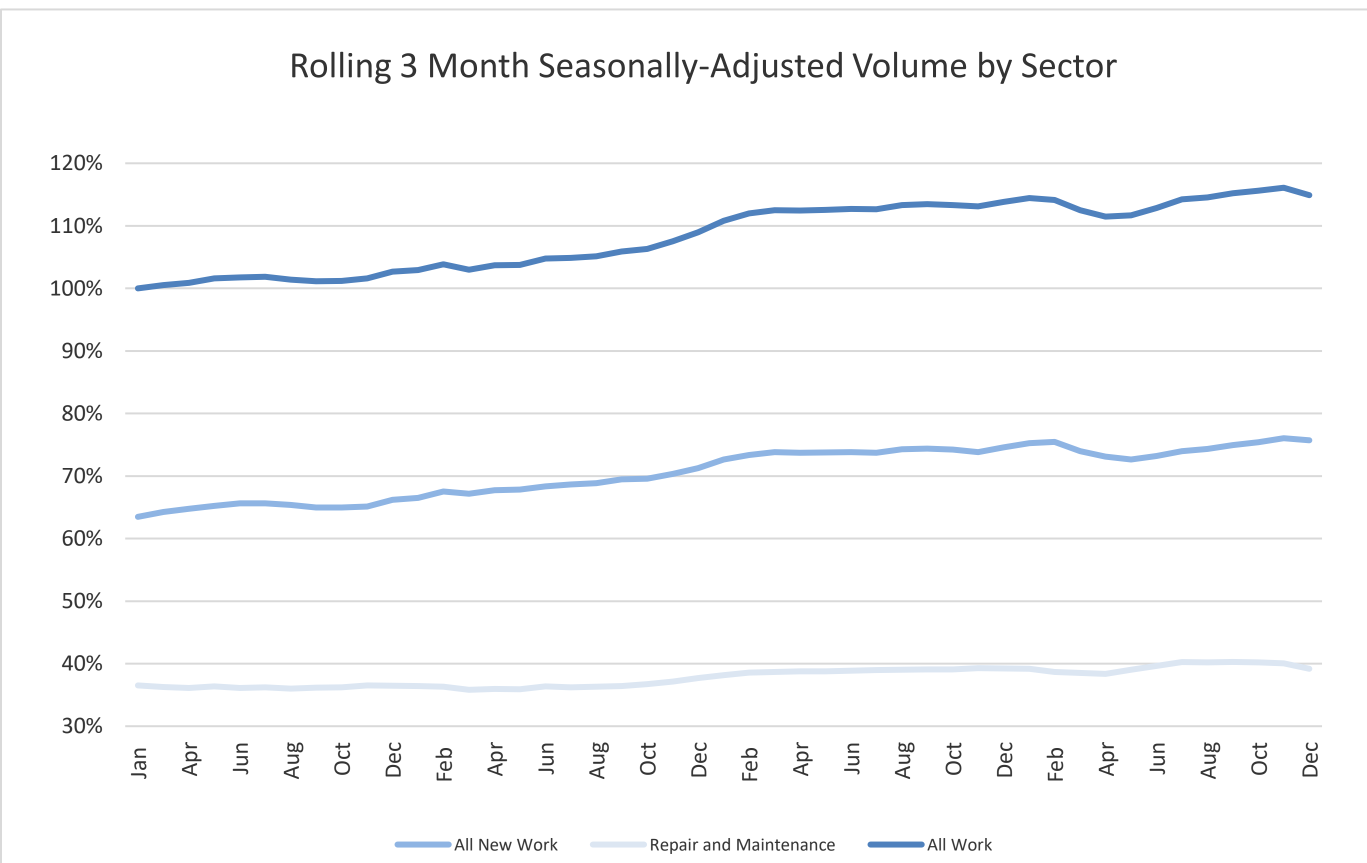
The Q2 2018 increase in output was likely due to a rebound effect after the cold weather of Q1 2018, however. Total construction new orders declined 7.3% in Q2, which was the third consecutive quarter that new orders decreased. This decline in construction new orders in Q2 was primarily due to a 17.9% fall in new housing orders.

Q3 saw the trend reverse with a modest 3.4% increase in new work orders quarter-over-quarter, though it should be noted that Q3 2018 new work orders sat 30.7% below Q3 2017 and 12.1% below 2016. Total Q3 output increased 2.1% over Q2, with new housing, infrastructure, and non-housing repair & maintenance increasing by 5.9%, 3.7%, and 4.0% respectively. Output in October and November decreased 0.4% and grew 0.1%, respectively.

Month-on-month construction output declined 2.8% in December. This was the largest month-on-month decline in output since June 2012. The softness in December contributed to a quarter-over-quarter decrease in output of 0.3%. 2018 ended up having the lowest annual growth rate since 2012, with 2018 output increasing only 0.7% over 2017. However, certain individual sectors exhibited strong growth. Private housing new work, infrastructure, and non-housing repair and maintenance grew by 6.1%, 5.7% and 3.9% respectively. Most recently, January's construction output reversed the 2.8% decline of December with a 2.8% increase in all work. However, Q4 new orders declined 1.9% from Q3 and sit 10.5% below 2017 Q4 new orders.

With regards to the future, key industry figures have been increasingly cautious. Federation of Master Builders (FMB) director of external affairs Sarah McMonagle warned: "A growing and prosperous construction sector will be a distant memory if the government allows the UK to crash out of the EU without a deal in place."Ms McMonagle added "In the immigration white paper, published at the end of last year, the government revealed that they will make few allowances for low-skilled workers to enter the UK post-Brexit. Most tradespeople will be defined as low-skilled and therefore will not be permitted to enter the UK, regardless of whether they are from the EU or further afield. It is crucial that the government introduces a post-Brexit immigration system that continues to allow us to draw on essential migrant workers or else their house building and infrastructure targets will be totally unachievable." Chartered Institute of Procurement and Supply (CIPS) director Duncan Brock, referring to the decline in the December CIPS/HIS construction Managers' Index, said "Employment rose at the slowest rate since July 2016 and with optimism also in short supply, the sector only needs a small nudge to tip it closer to recession."

Brexit uncertainty and infrastructure delays were cited as reasons for a downgrade in construction forecasts in the Construction Product Association's (CPA) Autumn 2018 report. The CPA had initially forecasted a 2.3% increase in construction output for 2019, but revised the forecast down to 0.6%. Additionally, the CPA revised its forecast for infrastructure growth in 2019 from 13% to 8.7% amid concerns about the government's ability to avoid the similar delays and cost overruns currently plaguing Crossrail in future projects. Though government infrastructure projects should continue to support the construction environment throughout the UK, including Hinkley Point C nuclear power station, Thames Tideway Tunnel, and High-speed 2 (HS2) rails, Hinkley Point C and HS2 are already delayed.



Notes from Major Construction Contractors

- Looking ahead, order books appear to be flat or down. There seems to be some strategic initiative around the bidding process with the emphasis on improved margins.
- Contractors have struggled under heavy debt loads, with Carillion collapsing and Interserve struggling to remain solvent

Contractor	Notes
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. Balfour Beatty predicts the year end order book will be £12 billion, up from the 2017 year-end of £11.4 billion.
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	Declining revenue and mounting debt have forced a crunch shareholder vote on 15/3/2019. EY has been appointed administrator in the event of the shareholders do not approve the rescue deal.
Keller	"The UK, which represents 3% of overall group revenue, is having a quiet year in a more difficult market. 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" – Interim Results, July 2018
Kier Group	Revenue up 5%, operating profit up 10% in H12018 vs H1 2017. Order book up from £8.9 billion to £10.2 billion as of 30/6/2018.
Morgan Sindall	Revenue up 6%, Profit before tax up 24% year-over-year for 2018. Construction & Infrastructure increased operating margin to an industry-leading 2.0%, and operating profit up 32% to £27.0m.