TM CAPITAL

EQUIPMENT RENTAL & DEALER REPORT

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Q & A

WITH DAVID FELTS

We recently sat down with David Felts, a Managing Director at TM Capital Corporation to gain insight into the merger and acquisitions activity in the equipment dealer market.

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Q: DAVID, WE APPRECIATE YOU AGREEING TO SHARE YOUR THOUGHTS AS AN INVESTMENT BANKER REGARDING INVESTMENT AND MERGER &ACQUISITION ACTIVITY IN THE EQUIPMENT DEALER MARKET. CAN YOU SHARE A BIT ABOUT YOUR FIRM?

A: TM Capital is a middle-market-focused investment bank with approximately fifty professionals operating nationally and internationally from three offices in Boston, New York, and Atlanta. Over the last 15 years, TM Capital has established a market-leading equipment rental and dealer sector practice, advising a broad range of privately-owned and financial-backed clients. With an emphasis on M&A transactions (both sell-side and buy-side), TM's sector activity is accelerating; we've completed 11 transactions since January 1, 2021, totaling over $2.1 billion in aggregate enterprise value. Our substantial experience across a wide range of transactions reinforces recurring relationships with an expanding universe of domestic and foreign strategic buyers, as well as a growing roster of private equity and family office investors that are increasingly focused on these categories. Regarding Associated Equipment Distributors (AED), I have enjoyed the opportunity over the years to speak on the M&A topic at various executive summits.

Q: EARLIER THIS YEAR, TM CAPITAL CAME OUT WITH ITS 2023 EQUIPMENT RENTAL AND DEALER REPORT—WHAT WAS THE MOTIVATION FOR THAT EFFORT?

A: In July 2020, we published our inaugural "TM Capital Equipment Rental and Dealer Report" seeking to leverage our unique understanding and deep sector expertise to bring clarity to these largely misunderstood sectors of the economy, particularly for financial investors. We witnessed financial investors continually pass on or misvalue these sectors (often concerned with "CapEx" or OEM control), and we titled a section of that prior report "Missing the Math," in an admittedly provocative attempt to challenge and educate financial investor market participants. Expanding financial investor participation in these dynamic sectors influences the title of this 2023 Equipment Rental and Dealer Report: "M&A Merging into the Mainstream," where our goal remains to put a spotlight on this attractive, dynamic dealer sector.

Q: LOOKING AT OUR INDUSTRY TODAY, HOW HAS THE SECTOR EVOLVED?

A: After the Great Recession, many OEMs shifted their perspective to acknowledging that equipment dealers with both the scale and the financial strength to drive growth and weather downturns may be better positioned to support OEMs' own growth objectives. Recognizing that many dealers are multi-generational family businesses with owners nearing retirement, topics of succession planning and/or business transitions are continually topics of high interest with OEMs to drive growth and stability. These evolutions in the sector are continuing to create opportunities for financial investors, including family-office investors who typically have longer investment horizons, to enter this sector with greater frequency and confidence.

Further, since the Great Recession, many dealers have invested in rental fleets to participate in the trend of increased rental penetration. Rental fleet investment enables dealers to grow their "wallet share" with existing customers, win new customer relationships and provide growth opportunities beyond their OEM-related new equipment sales, which are territory-constrained.

These trends have led to a new norm of "hybrid dealer-rental" companies that reflect a growing convergence of what were previously viewed as much more distinct sectors. Growth of rental operations requires an investment in fleet which changes the financial profile and internal reinvestment requirements of the traditional equipment dealer.

Q: AS TM LOOKS AT THE EQUIPMENT INDUSTRY MORE BROADLY, WHAT TAILWINDS OR OTHER INFLUENCES CURRENTLY AFFECT INVESTOR INTEREST?

A: Equipment rentals and sales are closely tied to the performance of downstream markets, including residential, commercial, industrial and infrastructure construction and maintenance. In recent years, robust activity and capital deployment in downstream markets have supported strong organic growth in these sectors. Some of these downstream markets are currently facing headwinds in the form of input material shortages and interest rate increases that are slowing the pace of construction (residential construction in particular), but long-term demand fundamentals remain robust. The growing shortage of residential housing, shifting demands for commercial space in an evolving economy and significant public investment in national infrastructure will support meaningful organic growth for construction equipment rentals and sales for years to come. In fact, recent commentary from equipment rental and dealer public company executives continues to express sector optimism for 2023 and throughout the next decade.

Regarding housing, long-term residential housing development fundamentals remain robust, driven by the rapid approach of millennial / Gen Z homebuyers, overlaid with an expanding shortage of single-family housing units. Despite the recent wave of homebuying, single-family starts have not yet reached pre-Great Recession levels, which has led to an expanding deficit of single-family housing – currently estimated by Realtor.com at nearly six million units short of demand.

The single-family housing unit shortage, combined with rising mortgage rates, has forced many potential homebuyers into rental markets. Thus, the multifamily market experienced strong activity throughout 2022 and into 2023.

Shifts in the modern economy, combined with the economic shock of the COVID-19 pandemic, have permanently altered the mix of commercial space demanded by the market. While typical "core" asset classes – particularly retail and office – have seen demand plummet, commercial / industrial spaces including warehouses, cold storage facilities, data centers and life science facilities have seen demand skyrocket, with no slowdown in sight given tightening supply-demand dynamics for these building types.

A huge tailwind stems from the 2021 Bipartisan Infrastructure Law, which commits $550 billion in federal funding to physical infrastructure projects and will support strong growth in construction equipment spending over the next 5-10 years. The bill targets projects in downstream markets such as roads, bridges, passenger rails, drinking water and wastewater systems, as well as expanded high-speed internet infrastructure, power infrastructure and climate-related infrastructure. These projects require equipment – either newly purchased or rented – and will provide attractive recurring cash flows for operators for years to come.

Further, the CHIPS and Science Act, signed into law in August 2022, supports strong growth in industrial spending, and therefore

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associated equipment purchase and rental demand, in the near-term. The law provides nearly $250 billion in investment for semiconductor manufacturing and scientific R&D over the next five years. The legislation comes amid a broader trend of domestic supply chain reshoring. This onshoring trend, combined with federal funding, will continue to drive industrial construction spending throughout the remainder of the decade. These macro influences combine to create a supportive, attractive environment for investment and consolidation.

Q: TAKING THIS ALL INTO CONSIDERATION, HOW DOES M&A ACTIVITY IN THE EQUIPMENT DEALER SEGMENT STACK UP AGAINST OTHER SEGMENTS, FOR INSTANCE THE EQUIPMENT RENTAL SEGMENT?

A: Compared to the traditional equipment rental house sector, which has evolved into an investment/acquisition ecosystem with strategic and financial buyers active at almost every size range, we believe the equipment dealer sector remains in the earliest innings of consolidation and the landscape remains highly fragmented. We believe that continued further consolidation trends, rental fleet expansion and succession influences will generate an increasing number of control and minority-investment opportunities in the equipment dealer sector over at least the next decade. Evidencing this shift, we have recently worked with or currently are engaged with four AED members (and one dealer in another asset class) regarding sale/recapitalization transactions, which have garnered the expanded family office and private equity investor interest we are referencing. So, as you can see, the increase in sector activity is quite real!

Look for part 2 of this interview next month when we will delve into business model elements that influence a dealer's valuation. •