

Herc Holdings Inc

Trimming the outlook catches us by surprise....more to come this earnings?

Reiterate Rating: UNDERPERFORM | PO: 105.00 USD | Price: 107.21 USD

Trimming the high-end unlikely to satiate investors

We reiterate our Underperform post Q3 results. There were some bright spots: Q3 EBITDA of \$410mn in line with cons even with higher disposals to auction, rate growth of 6.9% YoY, improvement in REBITDA flow through (76%). That said, HRI trimmed the high end of its EBITDA & net capex guide (partly on higher equipment disposals), dollar ute declined 320bps YoY (Hollywood strike ~200bps), and FCF remains negative. We continue to believe leverage and FCF are key differentiators in the rental equipment space as the cycle becomes more uncertain – we prefer Buy-rated URI to U/P-rated HRI.

Sector read across: rates positive, capex nearing plateau?

So far this earnings season, TEX barely raised its FY guide and HRI trimmed the high end – not inspiring as some risks creep into the [construction space \(see note\)](#). To be clear, HRI still delivered strong double-digit growth and rental metrics were positive: rates 6.9% YoY in Q3 (vs 2H guide of MSD). We sensed a high degree of messaging around ‘fleet rotation’ and fleet management. After all, the average fleet age was 45 months (vs 49 months a year ago). We look to the call (8:30 EST) around the outlook for 2024, particularly around fleet growth. We remain cautious on rental suppliers (U/P OSK, Neutral TEX). Higher disposals through auction – flagged in the release – supportive to Neutral-rated RBA.

The movie biz isn’t what it used to be, exit stage left

Herc announced it is exploring strategic alternatives for their studio business given changing industry dynamics which require significant capital investments. The studio business has been a significant headwind. While the writers’ strike has ended, the actors strike is ongoing, and Herc does not expect a meaningful recovery this year.

Underperform: lowering estimates, PO to \$105

We trim our 2023E estimates, while maintaining our 2024E on updated guide. We now model \$1,475mn/\$1,560mn in EBITDA for 2023/24 respectively, and assume higher rental rate of 6.7% (6% prior) for 2023. We decrease our PO to \$105 (from \$130) on 4.0x 24E (4.5x 24E prior) as ongoing entertainment disruption, negative FCF, and slowing construction starts leave us more cautious. We look to Herc’s Nov 2nd Investor Day for renewed three-year targets/medium term outlook.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	7.52	11.26	12.22	14.25	15.18
GAAP EPS	7.37	10.92	12.08	14.25	15.18
EPS Change (YoY)	149.8%	49.7%	8.5%	16.6%	6.5%
Consensus EPS (Bloomberg)			13.31	14.77	16.28
DPS	0.50	2.30	2.53	2.66	2.79
Valuation (Dec)					
P/E	14.3x	9.5x	8.8x	7.5x	7.1x
GAAP P/E	14.5x	9.8x	8.9x	7.5x	7.1x
Dividend Yield	0.5%	2.1%	2.4%	2.5%	2.6%
EV / EBITDA*	5.5x	4.0x	3.4x	3.2x	3.1x
Free Cash Flow Yield*	6.8%	-7.7%	-4.0%	20.1%	21.6%

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 24 October 2023 05:00AM EDT

24 October 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	130.00	105.00
2023E Rev (m)	3,300.3	3,317.6
2024E Rev (m)	3,485.2	3,451.4
2025E Rev (m)	3,583.0	3,560.8
2023E EBITDA (m)	1,480.0	1,475.0

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Stock Data

Price	107.21 USD
Price Objective	105.00 USD
Date Established	24-Oct-2023
Investment Opinion	C-3-7
52-Week Range	93.97 USD - 162.47 USD
Mkt Val (mn) / Shares Out (mn)	3,055 USD / 28.5
Average Daily Value (mn)	22.88 USD
BofA Ticker / Exchange	HRI / NYS
Bloomberg / Reuters	HRI US / HRI.N
ROE (2023E)	31.8%
Net Dbt to Eqty (Dec-2022A)	260.2%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

Ute: Utilization; U/P = Underperform, OSK = Oshkosh, TEX = Terex, RB = Ritchie Bros

iQprofileSM Herc Holdings Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	8.1%	9.2%	9.0%	8.7%	9.0%
Return on Equity	26.6%	32.6%	31.8%	32.8%	28.1%
Operating Margin	18.3%	20.5%	20.5%	20.9%	20.5%
Free Cash Flow	209	(234)	(124)	613	661

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	3.3x	2.7x	3.0x	2.8x	2.4x
Asset Replacement Ratio	1.1x	1.9x	1.6x	0.6x	0.5x
Tax Rate	22.4%	23.1%	23.9%	25.0%	25.0%
Net Debt-to-Equity Ratio	194.1%	260.2%	334.4%	235.8%	160.8%
Interest Cover	4.4x	4.6x	3.0x	4.1x	4.9x

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	2,073	2,739	3,318	3,451	3,561
% Change	16.4%	32.1%	21.1%	4.0%	3.2%
Gross Profit	689	969	1,130	1,222	1,247
% Change	48.4%	40.8%	16.6%	8.2%	2.0%
EBITDA	895	1,227	1,475	1,560	1,600
% Change	29.8%	37.2%	20.2%	5.8%	2.6%
Net Interest & Other Income	(86)	(122)	(224)	(175)	(150)
Net Income (Adjusted)	229	340	353	409	434
% Change	158.5%	48.9%	3.8%	15.7%	6.2%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	230	344	353	409	434
Depreciation & Amortization	476	599	762	810	841
Change in Working Capital	(126)	(360)	(139)	(242)	(509)
Deferred Taxation Charge	53	84	0	0	0
Other Adjustments, Net	110	249	98	161	295
Capital Expenditure	(535)	(1,151)	(1,198)	(525)	(400)
Free Cash Flow	209	-234	-124	613	661
% Change	-50.0%	NM	47.2%	NM	7.8%

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	35	54	19	223	247
Trade Receivables	388	523	700	775	858
Other Current Assets	47	68	68	68	68
Property, Plant & Equipment	308	392	380	375	370
Other Non-Current Assets	3,712	4,921	5,701	5,404	4,951
Total Assets	4,490	5,957	6,868	6,845	6,493
Short-Term Debt	15	16	16	16	16
Other Current Liabilities	515	588	696	651	479
Long-Term Debt	1,916	2,922	3,722	3,472	2,972
Other Non-Current Liabilities	1,068	1,322	1,322	1,322	1,322
Total Liabilities	3,514	4,848	5,756	5,461	4,789
Total Equity	977	1,109	1,112	1,385	1,704
Total Equity & Liabilities	4,490	5,957	6,868	6,845	6,493

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Industrial Services/Equipment Rental

Company Description

Formed in 2016 through a spinout from parent Hertz Global Holdings, Herc Rentals is one of the largest equipment service companies in the US. Herc rents, sells, and provides parts and support service for general rental categories as well as specialty equipment through its ProContractor and ProSolutions segments. Nearly 100% of sales are derived from the US & Canada.

Investment Rationale

We rate Herc at Underperform. Herc has enjoyed a somewhat successful turnaround in recent years and remains a strong number three in the equipment rental space behind United Rentals and Ashtead. Herc has demonstrated vastly improved financial and operating performance since its IPO, however Herc has become more of an execution story, and we expect the idiosyncratic exposure to entertainment will drive a near-term headwind in otherwise constructive rental markets.

Stock Data

Average Daily Volume 213,389

Quarterly Earnings Estimates

	2022	2023
Q1	1.95A	2.35A
Q2	2.47A	2.69A
Q3	3.42A	4.00A
Q4	3.44A	3.20E

Exhibit 1: Stocks mentioned

Prices and ratings for stocks mentioned in this report.

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
HRI	HRI US	Herc Holdings	US\$ 107.21	C-3-7
OSK	OSK US	Oshkosh	US\$ 88.51	B-3-7
RBA	RBA US	Ritchie Bros	US\$ 62.6	B-2-7
TEX	TEX US	Terex Corp.	US\$ 47.38	C-2-7
URI	URI US	United Rentals	US\$ 408.88	C-1-7

Source: BofA Global Research

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Price objective basis & risks

Herc Holdings Inc (HRI)

Our price objective for Herc is \$105 per share, or 4.0x 2024E EV/EBITDA, a turn below the historical average. We assume no multiple benefit vs prior trading history given the rising rate environment and a slowing macroeconomic backdrop.

Downside risks to our PO are a recession, disorderly spike in interest rates, renewed weakness in the energy markets, slower-than-expected rental rates, and turmoil in the debt markets.

Upside risks come from a sharper-than-expected economic recovery, a bounce in oil prices, increase in infrastructure work, and the company being taken over eventually in a consolidating US equipment rental market.

Analyst Certification

I, Sherif El-Sabbahy, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
NEUTRAL				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	Ritchie Bros	RBA	RBA US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
UNDERPERFORM				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	XOS Inc.	XOS	XOS US	Sherif El-Sabbahy
RVW	Fluor	FLR	FLR US	Michael Feniger

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology; Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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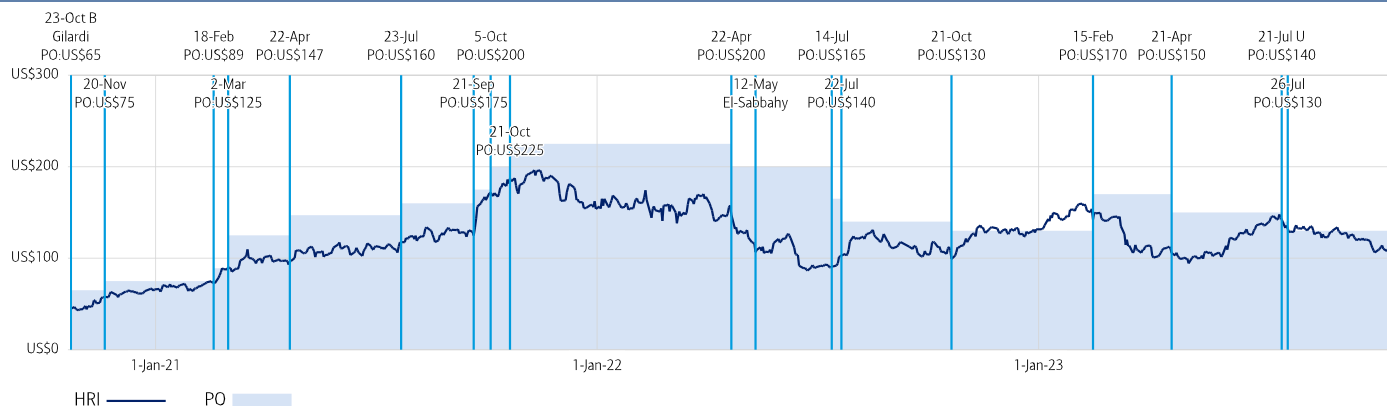
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Important Disclosures

Herc Holdings (HRI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	43	48.86%	Buy	22	51.16%
Hold	26	29.55%	Hold	17	65.38%
Sell	19	21.59%	Sell	10	52.63%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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