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Keep selling it

When the July 15 issue of *Grant's* climbed into bed, shares of United Rentals, Inc. changed hands at $70.29. Today, they fetch $76.49. Would that the two prices were reversed: We were, beginning on July 15—and remain today—bearish on the big industrial- and construction-equipment rental company.

We contended that United was over-leveraged and vulnerable to margin pressures. We cited weakening prices in the market value for used equipment and a softening in U.S. building activity. We cited the risk of falling rental rates. With respect to the company's BB-minus-rated public-debt securities, we opined that they were overvalued. In one case—the 7⅝s of 2022—they were priced to yield only 2.5%.

We were correct about contracting margins and sales: In the third quarter, rental revenue fell 0.3% year over year to just over $1.3 billion, while rental gross margin declined by 145 basis points to 44.3%. In United's general rentals segment, the top line decreased by 2.1% to just under $1.1 billion and rental gross margin fell 189 basis points to 42.8%. And we were correct about continued softness in used-equipment prices and in United's segment of America's macro economy.

What we did not anticipate was the warmth of the credit market's hospitality. Since the first quarter, United has replaced debt issues with coupons ranging between 7.375% and 8.25% (an aggregate principal value of $1.9 billion) with short-term asset-backed borrowings and longer-term bonds carrying coupons below 6%. On Oct. 24, United announced the retirement of the aforementioned 7⅝s at a make-whole price of 106 and change plus accrued interest, a 2½-point premium to the contractual call price. It's a credit-markets love fest.

Nor did we reckon with the standout results of United's trench, power and pump segment, the largest element of its "specialty" operations (which also includes tool rentals). Trench, power and pump accounted for 17% of United's third-quarter rental revenue, equal to $225 million and up 9.2% year over year. Writing on Oct. 21, Vicki Bryan, high-yield analyst at Gimme Credit, holds up the recent quarter as evidence of United's financial resiliency: "While business conditions remain challenging, United still generates strong operating margins and free cash flow."

Whether management can continue to deliver is another matter. In August, nonresidential construction put in place dropped by 1.3% year over year, the first monthly decline since 2013. The most recent reading for the Architectural Billings Index came in at 48.4, the lowest figure in more than four years.

Nor have concerns about oversupply abated. Ashtead Group plc (AHT on the London Stock Exchange), owner of United's biggest competitor, Sunbelt Rentals, appears especially keen to grow. Ashtead says it plans to increase the number of Sunbelt locations to nearly 900 by 2021, a more than 50% jump from current levels. (*Grant's* remains bearish on Ashtead, too.)

"The specialty space has softened what we thought was going to be an

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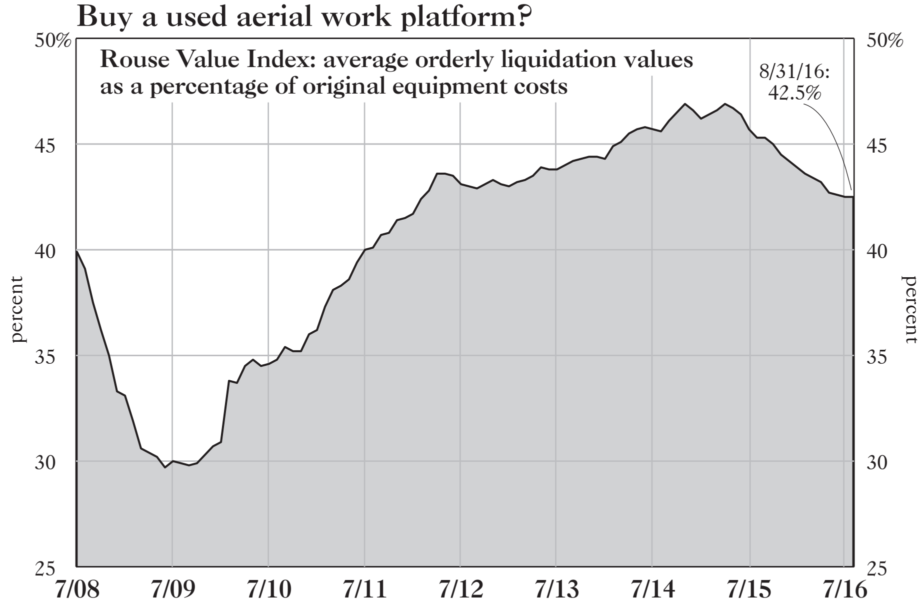

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imminent hard landing," says Gordon Johnson, senior analyst at broker-dealer Axiom Capital (he rates United a sell.) Scan recent competitor conference materials and earnings calls, says Johnson, and it becomes clear that "people are pumping excessive amounts of capex to buy a lot of specialty equipment." At Sunbelt, the specialty sector (excluding oil and gas) grew by 11% year over year in its latest quarter. Herc Holdings, Inc. (HRI on the New York Stock Exchange), the third-largest equipment rental firm, has announced plans to expand the share of its fleet dedicated to specialty and tool rentals to at least 25%, from 16%. "We don't think that sustainable, tangible demand is there. You're going to get margin pressure inevitably," Johnson predicts.

Short interest totals 10.1% of the United float, up from 9.2% as of July 15. Insiders, too, seem disenchanted. In the 12 months prior to our report on that same date, they had sold 96,507 shares for $6.89 million. Since we went to press, they have dumped 111,145 shares for $8.70 million.

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