United Rentals, Inc. (URI) CEO Matthew Flannery on Q3 2019 Results - Earnings Call Transcript

Oct. 17, 2019 3:45 PM ET
by: SA Transcripts

Q3: 10-16-19 Earnings Summary

Press Release *Slides*

EPS of $5.96 beats by $0.30 | Revenue of $2.49B (17.58% Y/Y) beats by $33.17M

Earning Call Audio

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United Rentals, Inc. (NYSE:URI) Q3 2019 Earnings Conference Call October 17, 2019 11:00 AM ET

Company Participants

Matthew Flannery - President & CEO

Jessica Graziano - EVP & CFO

Conference Call Participants

David Raso - Evercore ISI

Robert Wertheimer - Melius Research

Ross Gilardi - Bank of America Merrill Lynch

Timothy Thein - Citigroup

Jerry Revich - Goldman Sachs Group

Steven Fisher - UBS Investment Bank

Joseph O'Dea - Vertical Research Partners

Courtney Yakavonis - Morgan Stanley

Seth Weber - RBC Capital Markets

Stanley Elliott - Stifel, Nicolaus & Company

Scott Schneeberger - Oppenheimer

Operator

Good morning, and welcome to the United Rentals Investor Conference Call. Please be advised that this call is being recorded. Before we begin, note that the company's press release, comments made on today's call and responses to your questions contain forward-looking statements.

The company's business and operations are subject to a variety of risks and uncertainties, many of which are beyond its control, and consequently, actual results may differ materially from those projected. A summary of these uncertainties included in the safe harbor statement contained in the company's press release. For a more complete description of these and other possible risks, please refer to the company's Annual Report on Form 10-K for the year ended December 31, 2018, as well as to subsequent filings with the SEC. You can access these filings on the company's website at www.unitedrentals.com.

Please note that United Rentals has no obligation and makes no commitment to update or publicly release any revisions to forward-looking statements in order to reflect new information or subsequent events, circumstances or changes in expectations. You should also note that the company's press release and today's call include references to non-GAAP terms such as free cash flow, adjusted EPS, EBITDA and adjusted EBITDA. Please refer to the back of the company's recent investor presentations to see the reconciliation from each non-GAAP financial measure to the most comparable GAAP financial measure.

Speaking today for United Rentals is Matt Flannery, President and Chief Executive Officer; and Jessica Graziano, Chief Financial Officer. I will now turn the call over to Mr. Flannery. Mr. Flannery, you may begin.

Matthew Flannery

Thank you, operator, and good morning, everyone. Thanks for joining us. I'll start by commenting on the quarter and the state of the operating environment, and then Jess will cover the financial results. And after that, we'll take your questions. So as you saw in our release, we reported a solid third quarter, but not a perfect one. We're pleased that we delivered substantial growth while wrapping up the integrations, and that's an important achievement because it speaks to the long-term potential of leveraging our larger platform.

Yesterday, we reported the best revenue numbers of any quarter in our history, $2.5 billion of total revenue and $2.2 billion of rental revenue. And to put that into perspective, our total revenue was up more than 5% pro forma. That took a lot of focus on the part of our field organization. Their efforts drove an improvement in our fleet productivity metric both sequentially and year-over-year. And Jess will talk more about that in a minute.

Now here's what we could have done better. Our adjusted EBITDA was a record $1.2 billion, and that's good, but not as good as we expected. And it created some pressure on margin and flow-through. Now part of that relates to a more moderate build with the OEC on rent due to a slower growth in some of our industrial end markets. This, coupled with the acquisitions, resulted in some excess fleet, and we've been working through that. And when it makes sense, we service these assets and relocate them to markets of higher demand. This increases R&M and delivery costs in the near-term, but it drives capital-efficient growth over time. And we also sold some older assets with high operating hours, and this includes some equipment from the oil patch where upstream declined. Sales like this are generally dilutive to our used equipment margin. So the parts of the quarter that weren't perfect are largely tied to positioning, and that will continue to play out to a lesser degree in the fourth quarter. It will absorb the near-term impacts because the benefits will last well beyond that. And we're confident that we're making the right long-term decisions for the business. Our job now is to take this powerful engine that we've built and extract increasing value from it over time.

As we discussed in July, in the first half of the year, we were focused internally on the structural phase of the BlueLine integration as well as some smaller deals. Now we've pivoted to an external focus. Our sales territories are finalized. We've added more sales talent in the field to expand our coverage. And we've enhanced our outreach program to reactivate dormant customers.

We've also been making significant investments in our fleet mix, including continued investment in our specialty solutions. Having the right fleet in the right markets delivers on two fronts: It helps us solve more challenges for our customers, and it's also key to our strategy for improving return on capital.

And moving on to the operating environment, the construction landscape has remained strong across the board, and our customer survey suggests this trend should remain intact. All three construction sectors are showing good growth: nonresidential, infrastructure and residential. In fact, the rental revenue for nonres, our core market, was up almost 9% pro forma in the quarter. And our focus on infrastructure continues to pay dividends as it now accounts for double-digit percentage of our total rental revenue. This positive environment was partially offset by headwinds in some of the industrial verticals, as I mentioned earlier. The further deceleration in upstream oil and gas is reflected by the rig count data. By contrast, downstream grew in high single digits, and there were some other puts and takes in the industrial verticals. So in general, industrial was more of a mixed bag than it was in the first half of the year.

So for the first time in a while, construction and industrial activity appeared to be on somewhat different paths, and we've taken this into account in making the updates to our 2019 guidance. Our new ranges assume a more modest rate of growth in the near-term impacts on flow-through that I mentioned earlier, as well as our expectation for higher free cash flow. And Jess will address these in more detail.

Now looking at it geographically. The majority of our regions were up in the quarter. Only a few were down and those were small single-digit declines. And our Specialty segment continues to deliver strong growth. Trench, power and fluids solutions combined generated a 21% increase in rental revenue as reported compared to a year ago. And organic revenue accounted for about half of that gain. And a shout out to our European team, fluid solutions. They delivered 17% pro forma growth in the quarter in local currency. In North America, we opened another 8 specialty cold-starts in the last 3 months, bringing that network total to 361 locations against our target of 363 by year-end.

Before I wrap it up, I want to give you a safety update, and it's a really good one. Heading into September, we challenged the team with an aggressive target for a recordable rate well below 1. And our team responded with an incredible performance. They did better than target, resulting in 12 of our regions and 99% of our branches reporting zero injuries. September was the safest month for United Rentals in our 22-year history. And I'm personally inspired by the way our 19,000 employees have come together as one and embraced our safety culture.

Now, the one final comment before I turn the call over to Jess. I want to reiterate our confidence in our position in going into 2020. We appreciate that economic and political uncertainty is a concern for a lot of people. And while we don't have a crystal ball, we do have a lot of experience in planning for different end market scenarios. We can shift gears quickly when we need to. Most important, we remain strongly committed to our strategy of driving profitable growth and to the capital discipline, cost management and execution required to do that. These are the attributes to drive returns in every area of our business under all types of operating conditions.

So with that, I'll ask Jess to walk you through the quarter and then we'll go to Q&A. Jess, over to you.

Jessica Graziano

Thanks, Matt, and good morning, everyone. As with past quarters, I'll walk you through our as reported results, but I'll pivot at times to speak to our performance on a pro forma basis. That includes BlueLine and also includes a month of Baker as we lapse the acquisition on July 31. Let's get into the Q3 results.

Rental revenue on an as-reported basis grew 15% or $286 million to $2.147 billion. That's a record for us. The increase is primarily related to the impact of both BlueLine and Baker. But on a pro forma basis, rental revenue was up a solid 4.2% for the quarter.

Within rental revenue, as reported OER growth contributed approximately $242 million of the increase, ancillary added $44 million and re-rent was flat. Here's the breakdown of that $242 million or 15% OER growth. We had growth in our fleet of 18%. That's about $287 million of additional revenue. Fleet inflation cost us the usual 1.5% or $24 million. And fleet productivity on an as-reported basis was down 1.3% or $21 million. A more helpful way to consider fleet productivity is on a pro forma basis, which was up 1.7%. And within that number, rental rates and mix were positive for the quarter, partially offset by lower time utilization.

That's rental revenue. Let's move on used sales. Used sales revenue was up 41% or $58 million year-over-year. The used sales environment continues to be healthy, and we sold $132 million more fleet at OEC than last year. This included a significant increase in sales through our retail channel, which made up 60% of our overall sales. The pricing on those retail sales was down slightly around 1.5%.

Adjusted gross margin on used sales was 46%, down from 50%. That decline is due mainly to the mix of equipments sold and channel mix, which included some auction sales of some tired fleet from the oil patch. Taking a look at EBITDA. Adjusted EBITDA for the quarter was $1.207 billion, another record for us, and an increase of $148 million or 14% versus prior year. Here's a bridge on the as reported changes.

The improvement in OER added approximately $140 million. Ancillary and re-rent together contributed $4 million. Used sales added $21 million to adjusted EBITDA. SG&A expenses were a headwind of $24 million, mostly due to adding the BlueLine and Baker cost basis. And that leaves $7 million of adjusted EBITDA benefit in the quarter, which is primarily coming from better performance in our other lines of business.

Our adjusted EBITDA margin was 48.5%, which is down 150 basis points year-over-year due mainly to the impact of bringing in BlueLine and Baker. On a pro forma basis, our adjusted EBITDA margin declined 40 basis points. That is in part coming from a shift in revenue mix with higher used sales in the quarter. It's also due to higher operating costs, primarily in repair, maintenance and delivery. These costs were associated with getting excess fleet rent ready and into higher growth end markets. As reported adjusted EBITDA flow-through was approximately 40%. Now if I reconcile flow-through similar to what we've shared in the past, which is to adjust for the impact of our acquisitions, including synergies as well as the impact of new and used sales, adjusted EBITDA flow-through is still about 40%. The biggest drag on that adjusted flow-through this quarter comes from the higher operating cost I mentioned. However, that calculation is very sensitive. So I'll add that the GAAP this quarter from 40% to a flow-through of close to 60% is around $12 million, which on its own is the cost associated with the investment we've made in repairing and repositioning the fleet this quarter.

As for adjusted EPS, a robust $5.96 in the quarter compared with $4.74 in Q3 of '18. That's an increase of 26% primarily from better operating performance across the business and includes the impact of our acquisitions. Adjusted EPS was also helped this quarter from lower shares outstanding.

Let's move to CapEx and free cash flow. Year-to-date, we've brought in $1.97 billion in gross CapEx with $845 million of that having come in during Q3. We're on pace to purchase between $2.05 billion and $2.15 billion of CapEx for the year. And we've adjusted our view of net rental CapEx down for the year by $50 million as we anticipate selling more used equipment than originally expected. That will refresh more of our fleet in a strong used market and position us well going into 2020.

Free cash flow, very strong as we generated $1.1 billion through the end of September. We are on track to deliver our full year expectations, which we increased in our guidance update. Our tax-adjusted ROIC remains strong coming in at 10.6% for the third quarter, and that continues to meaningfully exceed our weighted average cost of capital. Year-over-year, tax adjusted ROIC was down 40 basis points primarily as a result of the expected drag from our acquisitions, and we believe that impact will moderate over time.

Taking a look at the balance sheet. Net debt at September 30 was $11.7 billion, which is up $1.6 billion from last year. The biggest driver there was the financing of the BlueLine deal, offset in part by our reducing debt through the year. Our total liquidity at September 30 was a very strong $2.16 billion that's comprised mainly of ABL capacity.

Leverage at the end of the quarter was 2.7x net debt to adjusted EBITDA. That's down 10 basis points versus where we were at the end of the second quarter. And as we've updated our forecast for the remainder of the year, we expect to finish 2019 at 2.6x, which is a 50 basis point decline from the end of last year.

Here's a quick update on our share repurchase program. We purchased $210 million of stock in the third quarter on our current $1.25 billion program, which puts us at $1.05 billion purchased to date. We still expect to complete this program by year-end, and I'll also note that our total share count at the end of the third quarter was down about 7% year-over-year.

I'll wrap up with a few comments on guidance. Our update was impacted primarily by our third quarter results and trends. Some of which we expect will continue through the end of the year. First, we still expect to deliver mid-single-digit growth in total revenue, but the revenue mix has shifted between slightly lower rental revenue and slightly higher used sales. That shift in revenue mix is reflected in our total revenue range and its impact on adjusted EBITDA.

Second, cost management remains a focus for us. We are balancing that with the need to repair and reposition excess fleet, putting that fleet into strong end markets, which we believe is the right choice for the business. As a result, some of those higher repair, maintenance and delivery costs will play out through the fourth quarter. That change is reflected in our updated adjusted EBITDA range as well.

Third, and as I mentioned earlier, we expect to generate better free cash flow than originally expected. So we brought up the bottom of the free cash flow range such that we expect to generate between $1.45 billion and $1.55 billion in free cash flow this year. That compares to a little over $1.3 billion last year.

And with that, let's move on to your questions. So operator, would you open the line, please?

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from the line of David Raso from Evercore ISI.

David Raso

Given the way the rest of the year guidance played out where mix obviously was fairly significant as well as some of the cost obviously to repair and maintain and move some of the equipment out of the softer industrial markets, can you help us a bit -- we're trying to think about 2020 margin sensitivity to mix. Can you give us a little education on exactly how we should think about if the industrial markets start the year a little bit weaker, but construction a bit better? How to think about some of the geographic issues of equipment -- let's say equipments coming out of Texas and going to the Southeast? Can you just give us a little ladle in to how to think about the sensitivity to mix going into next year?

Matthew Flannery

Sure, Dave. This is Matt. So first off, I think one of our opportunities, especially if we know it ahead of time, right? So if we feel comfortable that the work we're going to do throughout this quarter and our planning process for 2020, and the field validation and customer information that we're going gives us a better view. The sooner we can reposition stuff appropriate to where the opportunities are, the better the outcome's going to be. There will be some nuance not just between oil and gas and other markets, some nuance as to markets that bring higher returns than other or a different mix than other. But I think in the balance of a full year planning area, the most important part is getting the fleet in the right area so we can maximize the usage of that fleet and therefore, our fleet efficiency. So that's how we view it. Acknowledging there can be some moves. All that work will be done in detail from the ground up, and then reviewed top-down to get us ready for 2020 guidance in January.

David Raso

Would you say the fleet movement that occurred in the third quarter is the bulk of the moves you expect to make through the end of the year? I mean I'm just trying to get a read on how you view some of the industrial markets in '20 by the actions you're taking in '19. Is there still more to do? Or do you feel you've made all the moves already.

Matthew Flannery

I think by really probably midway through this quarter, but certainly by the end of fourth quarter, that answer will be a yes. To be fair to the question, oil and gas accelerated -- the downside of oil and gas accelerated faster than we thought in Q3. It's only 4% of our business now. Rig counts are down at the end of the -- as we sit here today, 17%. And our revenue's down 20%. So does that get worse? I don't know how far you can fall from this low level, but that will be the only wild card. And to be fair, that is what created our challenge here in the back half on movement and extra investment we need to make to pull that fleet out because it is a unique market. Other than that, our movements are usually just part of our regular business because we have those very fungible assets in such a broad, broad network. So long -- short answer, yes, understanding that oil and gas part to be the only variable. And I don't pretend to know where oil and gas is going, but I got to imagine it's pretty close to the bottom.

David Raso

And lastly, the fleet productivity, be it pro forma or year-over-year, however you want to think about it, report it. Can you help us a bit with just some sense of movement from the third quarter to fourth quarter? What we should generally expect? Does the fleet productivity improve on a year-over-year basis pro forma reported? Just if you can help us with some framing it?

Matthew Flannery

Yes. As we've discussed before, as much as I'd love to be able to predict this, just like we would love to predict rate and time that precisely. Those are the 2 biggest variables along with mix in these numbers. We're not trying to predict that. It's an output that we are utilizing to discuss what happened. And really not getting into -- even for the fourth quarter, forget about 2020. The predictability of it or our ability to forecast it, we still peg 1.5 point overall throughout the year is what we want to do and what we want to achieve because we want to achieve our inflation. That will change in some years and maybe our inflation will change in some years depending on what the macro is. But we're really using it as postmortem on how to explain how our revenue acted than a predictive metric, to be fair. So it's a long no, but I'm just trying to give you color on why.

David Raso

Yes. Not to push you to an exact number, but just the idea of the fleet will be bigger year-over-year in the fourth quarter than the implied revenue growth. And especially given used equipment sales will be up year-over-year in the fourth quarter, I'm just trying to make sure we don't get off the phone thinking that fleet productivity year-over-year degrades, deteriorates, from what we just saw, at least not materially, because it's sort of what's implied in the guide if we use the revenue midpoint. So I just wanted to give you the opportunity to address that.

Matthew Flannery

Yes. No, I understand the viewpoint and the position there. As always, we'll do the obligatory don't anchor of the midpoint. But to be fair, we give you -- we create the midpoint for you. It really is a number that's going to move compared to where we end up within that pretty tight range that we gave you. So -- and part of that range, you will be very pleased with it. And if we end up in a different part of that range, maybe less pleased. But I would just say it is a way that we talk about the output and not to be predicted. So I get your point though. So thanks for that.

Operator

Our next question comes from the line of Rob Wertheimer from Melius.

Robert Wertheimer

So I just wanted to ask about outside of oil and gas, it seems -- I mean, you guys have a really good insight to what's happening, sort of a finger on the pulse of the construction and other economy. And it seems like it's pretty good still. So I wonder if you could talk just a bit about how much visibility you have into next year. Not your forecast, but just like how far your customers -- you can see -- you can see some starts, you can see some cancellations, et cetera. And then just as a management team, how are you thinking about -- philosophically, the market's obviously very worried about recession and different things, or as you're seeing strong trends. How do you sort of think about balancing those to go into guidance?

Matthew Flannery

Yes. Thanks, Rob. So as we're into the planning process, and we'll be doing reviews here and within the next 30 days, in detail at the field level, we'll -- a couple of data sets that we look at. In addition to everything that all of you have access to, our additional information, as we've said before, is our customer confidence index, which remains strong. I referred to that in my prepared remarks. Whereas we have still 60% of our customers survey believe next -- 2020 will be better than 2019. So admittedly, that subset is more large customers. So as we've said before, strategically why we focus on large customers is they're the ones that are going to do better in a slower growth environment. So yes, you could say if you want to jade that at all. But 97% of the customers say it will be flat to better. Only 3% of the customers are looking at their business as 2020 being down, so that's a good indicator for us.

We then need to test that with our field representatives, whether it be sales folks or the managers, in what they're seeing in their business in the competitive landscape, in a volume landscape, in a jobs landscape. So all that work will be done throughout Q4, and we'll inform what we guide to for 2020. And the industrial part, I mean, the other part of it I'd say is I think some of the headwinds we have absorbed internally in the first half of the year won't be there next year. So I think we'll be better prepared to position the fleet more accurately. We'll be more externally focused. So I'm looking forward to that after the team did a lot of work internally in the first half of this year and is moving past that.

Robert Wertheimer

That's helpful. You've outgrown the market for a number of years via acquisition and just your own investments. And then obviously, you're skewed towards the bigger customers that ought to outgrow the construction market. So in a flatter market, you would continue to expect to continue that trend?

Matthew Flannery

It's always our goal to outperform the end market, right? I mean, that is always our goal. We've got a lot of resources. We got a lot of breadth and depth. And we serve a lot of end markets. So for this quarter, for example, if we are overly reliant on oil and gas or a flattish industrial sector, this would have been a different outcome for us, right? We wouldn't have record revenue, record EBITDA. The fungibility of the assets and the diversification of the portfolio gives us a lot of confidence that we have the opportunity to outperform the end market, and that is our goal.

Operator

Our next question comes from the line of Ross Gilardi from Bank of America Merrill Lynch.

Ross Gilardi

You guys are acknowledging that the demand in the industrial side is a little slower. I mean, you sold of some excess fleet. I'm just curious to hear. Why didn't you cut the gross CapEx guide again? And is it fair to say that you're more likely to trend towards the lower end of the gross CapEx guide as you finish out the year?

Matthew Flannery

No. Ross, I wouldn't say. I'll only answer the first part of your question, which is why. We had the opportunity to take some older assets that were at the end of their rental useful life, and sell them into a strong end market. And when we think about some of the stats that Jess reported in her prepared remarks, think about that used sales market still throwing up higher margin. We're still recovering $0.53 on the original OEC dollar per fleet that's over 86 months old. So over 7 years old. And we had the ability -- after cutting CapEx in July, we had the decision to make, do we cut further if we've got, let's say, a 100 million extra capacity. Or we take an opportunity to refresh the fleet. The other issue is we generate higher free cash flow. So there was no reason for us to cut the gross versus the net, and we think that positions our fleet better. As we've always said, we want to keep that fleet age at the appropriate time so when there is a downturn, we can age it, and that's part of our resiliency. So we view that as part of that strategy -- continuing that part of the strategy.

Ross Gilardi

And you went through this, a similar dynamic in the industrial recession a few years ago where you redeployed fleet out of the oil patch into some of these other markets, and you managed to pull it off. Can you give us a little more color as to where in terms of geography or end markets you are going to move that fleet? And what gives you confidence that you won't create an oversupply situation elsewhere in doing so?

Matthew Flannery

In the relative scale of our $15 billion of fleet, we're not going to move it. It's still a pretty small number, right? We're not going to move it to any end market that it's enough to overwhelm, right? I guess, we move all of it to one market. Technically, that could be. We're not doing that. We're moving it to the markets where nonres is strong. And to be fair, even close by, downstream's still strong. So just for clarity. We talked about industrial being choppy. They're not all down. Downstream is still a good part of our business. Upstream and midstream are negative. And the rest of them are just kind of a little bit up, a little bit down, leading to a flattish industrial overall end market. But that -- those in markets that we have and the customers that we can serve outside of those verticals is where we're moving that fleet.

And it's not a single enough, large enough number to any one of those verticals or geographies that's just going to create a supply glut in our opinion. I'd say the other difference between -- because I know a lot of people will tie this dialogue of oil and gas to back what happened between '14 and '15, right? When oil and gas was at a peak then, it was a much bigger part of our business. But even for the industry overall, that knock on impact of what happened with oil and gas in '15, of the infrastructure to build -- to help serve the area around it of improved -- or additional hotels, retail, right? Shopping centers, even schools, all that's built out already. That was not part of this oil and gas run the past couple of years. So therefore, you won't have the knock-on effect that you had back then. And that's the way we're viewing this. We're viewing this as a temporary issue that we had to work through, but nowhere near the impact that we had back in '15.

Ross Gilardi

Got it. And just lastly, how much momentum do you feel like you have in the tank for specialty in the next year? I mean, it's got 20% of your business. Still growing 10% organically. Does it feel sustainable even if nonres does have sort of a notch lower. And what are the areas you're most excited about in the specialty portfolio?

Matthew Flannery

We absolutely feel good it, and that team continues to generate not only good returns, but good growth. And I think fluid solution, right. Sometimes, it gets lost in the conversation of the bigger integration. Fluid solutions is a new go-to-market strategy where we had to integrate the Baker and the old pump team. And so they've worked through that in the past 12 months. I think they've got great opportunity to get externally focused and run with the ball a little faster. So we like the prospects.

Operator

Our next question comes from the line of Tin Thein from Citigroup.

Timothy Thein

Matt, you touched earlier on mix. And I wanted to see if you could give any sort of help in terms of, again, high-level of thoughts on rate for 2020. And specifically, if the remaining couple of months here played out with whatever normal sea patterns would suggest. What would that imply in terms of the rate carryover for '20?

Matthew Flannery

Yes, Tim, I wish I could help you. We're committed to not giving that level of detail. The way that we're going to talk about rate, time and mix in the future is exactly how we're talking about it this quarter. We're going to give it in arrears. We're going to give it all in year-over-year. And we're going to talk about in fleet productivity, and we'll give you that numerical value. And then what we're going to do qualitatively is say, "As we did this quarter, rate's a good guy. Mix has been a good guy overcoming some headwinds that we've had in time utilization." As we look forward, I mean, the mix of those 3 will be impacted by the demand environment certainly, right, all 3 of them, and our decisions on where we invest our capital and what our customers rent. So that's how we look at it. So I want to stay true to that. We want to stay true to that, because we think isolating any one of them belies the interaction between the 3 of them in our business going forward. And that's really why we made the change. Our business has changed. If this was back 2006, it was very simple. We knew our fleet mix have changed much, and it was a direct correlation. The interplay of the 3 is much more relevant for today, which is why we made the pivot.

Timothy Thein

Okay. And I guess old habits die hard, I guess. But maybe just a second one was coming back to I think you said your nonres -- or just maybe it was construction in total, up almost 9% in a backdrop where depending on what statistics you're using, I mean, there's not much by way of overall construction spending growth. So just curious in terms of -- I mean, this whole notion of outgrowth and kind of the magnitude, is that -- basically what's contributing to that? Is it pretty big number, and I don't know if that's -- is there any tangible share -- or not share, but kind of penetration gains you think are contributing to that? Or maybe just touch on that in terms of if we are in an environment where nonres spending is flat to maybe up a little bit next year, just what sort of outgrowth could we potentially be looking at?

Matthew Flannery

Sure. So first of all, I think it's a little bit of share gain, right? And when we think about the bigs getting bigger, which is something we've talked about, I mean, it's why the consolidation plays work. We think the opportunity of that density and diversity gives you the opportunity to over-index in places that are growing, and therefore, dampen the impact or mitigate the impact to places that aren't. So that's the overarching reason why we think we can swim upstream so to speak in different end markets, and we continue to feel that way. I would say that every time we look in arrears or what some of the end market data says, it's maybe too self-serving to say we outperform it. So maybe sometimes, they're just wrong. But at the end of the day, the macro data is a good framing for us to look at. But that deep dive on what our customers are telling us and their backlogs are, and what our managers and sales teams are telling us of the work that they foresee needing to serve is our single largest barometer to how we're able to build the plan. I'm not saying we're going to over perform by 30% of what the end market forecast say because they're just not reliable enough to build business plan around that. So we're going to do all that hard work, as I said, throughout Q4, throughout our planning process, and I'll inform where we guide for 2020.

Operator

Our next question comes from the line of Jerry Revich from Goldman Sachs.

Jerry Revich

I'm wondering if you could talk about the demand cadence over the course of the quarter. Your fleet in the quarter grew about 3%, which is 1 point better than normal seasonality. So it looks like you're able to put more equipment to work this third quarter sequentially compared to normal seasonality. Can you comment on that? Is that what's playing out in the field? And it looks like by the improvement in fleet productivity, I would imagine utilization improved at least in line with normal seasonality in the quarter. Can you just comment on that, because in the prepared remarks, you spoke about oil and gas headwinds, et cetera. But you folks were able to pool a lot of the equipment work this quarter, and I'm just trying to square up those 2 points.

Matthew Flannery

I really just think it was that level of demand in our core end markets and with our key customers. And frankly, we would have liked than done a lot better. And had we not done some of that choppiness, that's why we pointed to it, we -- when you look at the year and break it in 2 halves, we talked in July about the internal focus maybe not getting that build that we wanted in the first half. When you look at the back half of the year, we're pretty dead on as to what our original thoughts for how much OEC on rent fleet you build in the back half. Our hope was that we backfill some of that hole. And as we got into some of the end markets not giving us that, specifically oil and gas, midstream; and maybe flattish, let's say, manufacturing down a little bit, we just didn't get that opportunity in some of those to offset what the team did do by backfilling the hole in a lot of the nonres markets. And that's the way to look at it. So I'd say the demand trend was, back-half, probably as expected originally. Would have -- the progress, I wish we'd done better. I wish we could have backfilled that hole a little bit more. And therefore, we would've drove a little bit more volume. We're talking on 1% area so we're talking on the margins here. When you look about year-over-year, what we reported in January versus what we did here. But I think demand allowed us to have that growth throughout Q3.

Jerry Revich

Okay. And Matt, earlier in the discussion, you spoke about how pricing played out in the oil and gas downturn and the fact it's a smaller equipment sized market today. Can you just expand on other differences you see in the market. So talk about the impact of data availability we're hearing from construction equipment dealers with rental fleets, that the supply demand data has been really helpful? Are you seeing that in your market in terms of better ability to match the supply with demand for the industry. Because the concern is, in the last cycle, utilization moved down, and then pricing moved down. And I just want to make sure we ask the question of what's playing out. They're pooling in mid cycles. So I'm wondering if you can expand on any other drivers there.

Matthew Flannery

Sure. First and foremost, I think the discipline at the industry -- and we've been talking about this for a few. I think the discipline in the industry is showing, in the last 10 years of my career compared to the first 18 years of my career, is night and day, right? So that's #1. And I think data has been a big help on that and I think history has been a teacher on that too, right, going through '09, and that's scar tissue. I think you can't underestimate the impact that may have had on folks being much more responsible for that. There will be times throughout any cycle where it will get ahead and pull back. And I think the industry overall is responding appropriately. But to be clear, I also don't think the end of demand is here.

So we have the opportunity to continue to complete the work. I think our actions of consolidating capacity to drive growth as opposed to just adding capacity to drive growth is a significant difference, right, when you think about last 10 years. I think some of our competitors are doing the same. I think that's good news. So I think when you think about all those issues, the availability, right, that those of us, which is about half the industry now, get from the Rouse information, is helpful. Technology in general, the professionalization of the industry, which consolidates and help bring having analytics, having data as a resource to think through investments and timing. All those are part of why I think we'll see a better -- why we've been seeing a better outcome in supply demand.

Jerry Revich

Okay. And lastly, on the cold-starts within specialty. Can you just talk about what the learning curve has been as you've ramped up the cold-starts over the course of this year? And as you look at the opportunity in terms of the potential new locations over the next couple of years, what that opportunity set for expanded cold-starts looks like on a multi-year basis based on everything we've learned with the rollout this year?

Matthew Flannery

Yes. Not terribly different than what we've been doing, right? So we don't really communicate it that way. The year 1, the year 2, the year 3 communication. That's not our -- that's not the way we do it. And mostly because many of our cold-starts are growing on the border of another one. So there's a lot of efficiency that's built-in when 1 store doesn't -- especially in our specialty network. As we build it out, that network doesn't have to travel out as far as to serve the market. We could be more responsive. We get growth out of that. But then we also get better value in the existing store that's no longer going there. So there's a couple of different calls to look at it. I think we're going to have a specialty day that maybe we could talk about that, and Paul will leaving that in more detail, that, that would be more helpful as opposed to trying to get to that level of specificity on this call. But you know what, we'll follow-up with Ted, make sure that we get that on your calendar. I think that would be a great opportunity to learn about how specialty cold-starts, especially growth, play out.

Operator

Our next question comes from the line of Steven Fisher from UBS.

Steven Fisher

Just a follow-up on Ross' question. Just really, if you could characterize how tight are the markets from a supply/demand basis in those construction areas where you see the better opportunities to move fleet. To what extent are you seeing others sending equipment into those same places at the moment?

Matthew Flannery

I wouldn't say less or more competitive than they've been, right? So I'd say -- we're not seeing an extra competitiveness, and we're not seeing any easy roads either, right? We have to earn our customer's business every day. I would say that there's only a few companies, and this is why I think the bigs are getting bigger. There's only a few companies that have that flexibility and fungibility to do that. So it's not the whole market. It's only a subset of the market that can make those pivots in a quarter-to-quarter or within an annual cycle because other companies that don't have stores, they aren't -- they're just not going to have the ability to go ramp-up and open up an x location because all of a sudden, there seems to be better opportunity there than where they reside. They may do it on the fringes, right? They may travel a little further. But that's a little bit different than the broader footprints that a couple of companies in the industry have. So I think that's a big differentiation and why you're not seeing a rush to any individual market, quite frankly. I hope that answers your question.

Steven Fisher

Yes. That's helpful. And then any change you can give us some color on how the fleet productivity metric trended over the course of the quarter. Did your upside to the 1.5% target, did that outcome more later in the quarter or kind of stay throughout?

Matthew Flannery

Yes, no. We're not pulling -- actually, we don't even calculate it that way. But we're not pulling that apart that way. This is a quarter and year-over-year result that we look out and prep for earnings to help communicate what happened in the quarter, but not sequentially or not trying to use it as a trend line or anything like that. So no, I don't have that color for you.

Operator

Our next question comes from the line of Joe O'Dea from Vertical Research.

Joseph O'Dea

Can you quantify how much fleet you've taken out of the oil patch? And then Jess, I think you touched on this but just to confirm, what the related repositioning and repair costs are that are attached to that.

Jessica Graziano

So I'll start there, Joe. So we called out about $12 million of cost that we incurred this quarter. Going forward into Q4, we think it will be something less than that as we do have a little bit to work through, but something less. I don't have a number right now, but--

Matthew Flannery

Yes. And when you think about the fleet, it's a portion of, and it will be in Q4, say, 1% or 4% of your business, right? So somewhere in the $100 million range, let's say we moved about half of it out of there, we got another half to go, depending on how it turns. That could accelerate or decelerate if we get in different news there, but it's in that realm of impact from an OEC perspective.

Steven Fisher

And then just the related kind of EBITDA bridge sequentially, you're implying margin's up. Seasonally, they're typically down 3Q to 4Q. You're still going to have some of these carryover costs. Just any other factors to consider as we move from 3Q to 4Q EBITDA margins and see that improvement.

Jessica Graziano

So there will be the impact -- in addition to the acquisition impact, there will be the impact of the flow-through margin of -- as I mentioned, we'll have a little bit higher used sales, and so that's going to come in at a lower margin than the rental would. The other caution, and I know Matt mentioned it earlier, but I will caution against using the midpoint.

Joseph O'Dea

Yes. I think whether you use the low end, high end or midpoint, it's implying a 48.8% EBITDA margin in 4Q versus 48.5% in Q3. And so I was just curious about what some of the good guys are in terms of the sequential move.

Jessica Graziano

Yes. The two drivers are the ones that we mentioned. The BlueLine impact, which we'll anniversary that on November 1. And then the -- that shift, that mixed shift between used and rental.

Joseph O'Dea

Okay. And then Matt, just on replacement CapEx. As you do a little bit more this year, does that mean that you're positioned to do a little bit less next year? And then just bigger picture, as you think about the backdrop of the market, are you seeing anything that's leading you to think we're gonna pause a little bit on some of this replacement spend?

Matthew Flannery

No. I wouldn't -- definitely, we're not planning on doing any less, right? The used sales end market, as we've talked about, are still strong. We still want to keep that fleet age as fresh as we can as we're still in a growth cycle. So I wouldn't -- I would say if anything, we plan to be maybe 5%, even 10% more.

Jessica Graziano

For the replacement.

Matthew Flannery

For replacement in 2020. So that's the way we're thinking about it. If the market changes, if the outputs, right, change, which we're not seeing even as recently as the last month. The used sales channels are still good, and we're going to utilize them to keep the fleet freshened a little bit. And what we did here in Q3, it's a good way to re-profile, too, right?

So as you try and continue to get your mix right, you could sell off some of the older assets and use those funds as a net -- in net CapEx to help re-profile your fleet versus only using growth, which is a much smaller number to re-profile.

Jessica Graziano

So Joe, to be a little bit helpful. One step further, we're still pulling the plan together so obviously, we're still landing on what we think the growth capital could be for next year. But as far as the replacement, as Matt mentioned, that will be up next year. And if you think about something in the neighborhood of selling kind of $1.6 billion to $1.7 billion at OEC inflation-adjusted, that's going to look like something, call it, $1.8 billion to $1.9 billion.

Operator

Our next question comes from the line of Courtney Yakavonis from Morgan Stanley.

Courtney Yakavonis

Just wanted to go back just on the comment about the $12 million of cost incurred. Was that $12 million incremental? Or kind of what was that versus your baseline expectation for fleet repair and maintenance? And then I think you had called out in the press release increases of 27% and 19% for repair and maintenance versus delivery. So just wanted to understand if that was included in that number. And then if you could also just help us understand for the gen rent gross margin impact, how much was in gen rent versus specialty?

Jessica Graziano

Sure. So Courtney, it's Jess. So from the -- for that $12 million, that was incremental for the quarter in terms of isolating what we leaned into to repair and reposition the fleet. Some of that excess fleet that Matt talked about and getting that into strong end markets. As far as what you're seeing as the increase is R&M versus delivery, the mix impact of that is we saw a little bit more of the repair and maintenance and delivery cost in the -- together in the gen rent segment. There was a bit more on the repair and maintenance side on the Specialty segment, a little less delivery. So that's the dynamic there.

Courtney Yakavonis

Okay. Got you. And then can you help us understand when you do the repair and maintenance for something like this, does it extend the fleet age? Do you consider it getting reset at all? But how do we think about how much this kind of extends the fleet age?

Jessica Graziano

Yes. There's no real extension of the fleet age per se. It's just making sure that it's in rent-ready mode to get into those markets. We did spend a little bit more on some of the repair of the fleet that came out of the oil patch because that's going to be kind of worn down a little bit more than across some of the other end markets. So there's a lean into the repair and maintenance as a result of that.

Matthew Flannery

Yes. And we don't account for it in any way if capitalizing or extending or anything like that either. So that's the difference.

Operator

Our next question comes from the line of Seth Weber from RBC Capital.

Seth Weber

Most of the questions have been asked. But just on the $50 million-or-so of fleet that was moved and the $100 million that may be in aggregate, is most of that -- is it fair to assume that most of that is gen rent versus specialty? And can you just talk about what you're seeing in the specialty side in some of these oil and gas markets?

Matthew Flannery

Sure. Certainly most, but there's some pump in gen sets that we have some work there, as you know, in the specialty. But I would say it's primarily gen rent, say 70 -- you want to just -- we don't have it. I don't have it broken down for you here. But we can maybe give you that data. But primarily gen rent. Think about our fleet overall, and it follows fleet profile.

Seth Weber

Yes, no. I mean, just some of this specialty is just harder to move, obviously, so I was just trying to get an understanding. I think in -- during the last downturn, you gave us a number that's something like 80% of the revenue from -- in Texas was from nonenergy stuff. Is that still kind of a good framework to use? So I know the energy business -- the upstream business is smaller today than it was back in 5 years ago. So is it -- maybe is it less than 20% of your business in Texas at this point?

Matthew Flannery

Yes. I actually don't have that answer for you. I think we've talked about it in whole. I actually don't recall. I've been here a while. I just can't remember. I was talking about it as far as what percentage of the Texas business as a whole. Somebody must have slipped that by me, because I would certainly stop that conversation just from a competitive perspective. But I actually don't recall that number.

Seth Weber

Okay. Fair enough. And then just given the potential for caution around the macro. Clearly, it's not manifesting yet, but just on the broader macro on the construction business, et cetera. Are you thinking about changing your cadence of discussions with the OEMs? This is kind of around the time of year you would start to plan for 2020. Your discussions with the OEMs. I mean, are you thinking about maybe going a little bit more slowly this year versus prior years?

Matthew Flannery

Yes, no. I think we'll keep the spend pretty successful for us. I think we'll keep that similar cadence. I think it helps them, right? And it helps us. So we make sure we understand what pipe -- once we build the plan, we understand what pipeline we think we need, with flexibility, right, which we always have, as you know. And we try to be reasonable. We don't overuse that flexibility for no value. And it gives them the opportunity to build in their plant. And we need good suppliers. So we need them to get their supply chain in order. So it's a partnership. And I think the way we've been doing it, we're comfortable with the outputs, and we're going to stay on cadence.

Operator

Our next question comes from the line of Stanley Elliott from Stifel.

Stanley Elliott

A quick question back on the outgrowth piece. How much of that is -- well, when you look across the portfolio in international account profile, are you over-indexed, under-indexed to any verticals necessarily? Or is it pretty much consistent with the rest of the portfolio?

Matthew Flannery

From an asset cap perspective?

Stanley Elliott

Yes.

Matthew Flannery

I wouldn't say over-indexed. Is there a percentage points of movement in certain verticals that's more primarily -- and I would segregate it as key accounts not just National Accounts. As we've talked to you all before, our National Accounts use our national footprint. But we have strategic accounts and key accounts that are equally as important, just use maybe regional marketplaces, right? So I would say the combination of those is -- no, I wouldn't call them heavily more influenced by any specific vertical. I think that's a pretty broad portfolio as well.

Stanley Elliott

Yes. No, I appreciate that. I was just curious about the 9% construction growth, which is much better than what we're seeing. And then Jess, thanks for the slide on the free cash flow conversion. Anything or any reason out of the ordinary why those numbers shouldn't carry forward as we look into 2020 and beyond?

Jessica Graziano

So we're still planning 2020, which includes what we believe our view of free cash flow is going to be, not just from an operating perspective, but also taxes and interest and some of the other lines. So that's still to come, Stanley. What I will tell you is we are planning for another robust year of free cash flow. Exactly how much, I don't know yet. But it will be robust.

Operator

Our next question comes from the line of Scott Schneeberger from our Oppenheimer.

Scott Schneeberger

Matt, you covered in the beginning in the prepared remarks, a bid on the integration in BlueLine. But that was a bit of a hiccup last quarter. So just looking for a second, what were some of the actions that were taken this summer to enhance that integration process? And maybe some lessons learned since obviously URI is well experienced an acquisition integration. But what were some things that you took out at that process and would apply going forward?

Matthew Flannery

Great question, Scott. So we do have a robust playbook, and it's -- every deal makes it better. And that's one of, what I think the values of learning, that gives us. And I want to focus specifically on BlueLine, because the real thing that we learned is BlueLine was the third deal in many markets in 18 months. It was the first deal, and we've been talking about a different deal that had the challenges, and it would probably still be third deal. So that's the part of it. And if I had to do it all over again, I'd spend much more time making sure the external portion of it, that customer outreach, was -- which we haven't had to spend extra energy on in the past. So that's something in this deal. Whether it was just because it was the third, which I think plays a lot, or whether it was the largest of the 3. I don't even care which 1 of those of the two it is because I don't really know, but that's what I would change.

We would learn -- we would have a much stronger external focus on the front-end of it versus what is a very aggressive internal focus as we get everybody on the same system in 9 days and try to get all the brands consolidations done. So we're working as 1 unit and people know what they're doing in the first 3 months. So we got to bounce that aggressiveness internally with equal aggressiveness externally. That would be my learning and I think what we'd integrate into the playbook. The good news is I don't think we're going to -- I don't think there's 3 big deals to get done in a row again in the near-term. So I don't think that, that's parts going to be an issue. But the external focus is a good learning.

Scott Schneeberger

Appreciate that. And here at the end of the call, I guess a question I can't help but ask. You are generating a lot of cash a lot of flexibility there. And there's been a lot of talk this year more than in years past of M&A in the specialty rental space. So as we head into next year and everything you've been working on to integrate will now be in the rearview mirror having anniversary-ed, just could you address the use of capital again. I know, Jess, you have the new lower leverage objective. But just please put that in perspective for us here at this part of the year.

Matthew Flannery

I think you hit on it. As we've been saying, that our lean, at a time where we're a little more focused on absorbing and leveraging, we still look at deals. We are still on a pipeline that we do work on. But the lean would be more on additional products and services customers versus our overlapping products and services. And the second would be filling out any gaps in distribution and footprint. So by definition, that leans towards specialty. And on top of that, they're good return business. The 3 criteria of cultural, strategic and then financial still needs to be met, and that's a high bar for us. So -- but there's deals out there, and we'll see. If any of them meet those 3 deals, we have a flexibility. Jess and the team have given us the balance sheet and the flexibility that we could still do stuff that's accretive to the business. But we certainly also have the opportunity to absorb and leverage what we bought. So it's that balance right now, with a lean towards specialty.

Operator

And this does conclude the question-and-answer session of today's program. I like to hand the program back to management for any further remarks.

Matthew Flannery

Great. And thank you, operator. And everyone, thanks for joining us. And just a reminder that our Q3 investor deck is available online. As always, you can reach out to Ted with questions in Stamford. And we look forward to have a great holiday season, and we look forward to talking to you all in the New Year and sharing our thoughts on 2020. And looking forward to that. Be safe and thanks for joining. Operator, you can end the call.

Operator

Thank you. And thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.