

United Rentals and Herc Rentals replace Triton International in the CUSP industrials holdings

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The Industrials sector returned – 8.57% in 2022, according to Morningstar, compared to the S&P 500 Index's performance for 2022 of –19.44%. The Industrial sector has long been thought of as a defensive sector, and it was just that in the year 2022. With rising interest rates and economic uncertainty, investors have shifted toward more defensive sectors and companies. This has provided both complexities and opportunities within the sector. One of the CUSP Fund holdings, Triton International, was acquired by the Canadian asset management firm Brookfield in March 2023. This deal caused Triton's stock price to jump 30% on the day of the acquisition. CUSP Fund managers decided to exit the position given the level of the premium offered and the fact that the offer price was fully priced in by investors. This merger is expected to close in Q4 of 2023.

From a portfolio management perspective, CUSP managers want to remain slightly overweight in the Industrial sector. To fill the hole that Triton left in the Industrial sector, CUSP managers decided to add United Rentals Inc. (URI) and Herc Holdings Inc. (HRI) to the portfolio.

United Rentals is the largest rental company in the United States, capturing 16% of the rental market according to Statista. The company's rentals include general construction and industrial equipment, such as backhoes, skid-steer loaders, forklifts, earthmoving equipment and material handling equipment, among others. Customers include construction and industrial companies, manufacturers, utilities, municipalities, homeowners and government entities. Even though United Rentals is the market leader, overall, the rental market is an extremely fragmented market. United Rentals has used this to its advantage, using its strong balance sheet to acquire firms to expand its physical footprint. One such example is United Rentals' acquisition of Ahern Rentals Inc. for \$2 billion in Q4 of 2022. This was one of United Rentals' largest acquisitions in the last 20 years.

CUSP Fund managers deemed United Rentals attractive because of its recent pullback in valuation despite perceived growth potential. United Rentals' stock price dropped approximately 20% during to the regional banking crisis of early 2023. Since many construction projects are financed by regional banks, recent worries about bank runs and constricted lending caused investors to pull back on investments in firms such as United Rentals. In our view, nothing in the underlying business of United Rentals had changed, and CUSP managers viewed the price drop as providing for a more attractive entry point into a profitable and growing company. With an industry median P/E ratio of 16.71x, United Rentals looks attractive at a P/E ratio of 14.67x. United Rentals' EV/EBITDA ratio of 7.12x is exactly the sector median at 7.12x as well. Additionally, United Rentals boasts an attractive five-year revenue CAGR of 11.88% and a decade high return on invested capital of 13.43%. It also appears URI is poised to capitalize from a forthcoming significant uptick in spending on infrastructure as a result of several recent

spending bills that were signed into law. The impressive double-digit growth combined with the recent pullback in valuation led CUSP managers to vote to buy URI for the portfolio in April 2023.

In addition to URI, the CUSP managers voted to add Herc Holdings Inc. to the industrials sector. Herc Holdings Inc. operates through a subsidiary, Herc Rentals, as an equipment rental supplier, offering a large portfolio of industrial equipment for rent. Herc Rentals' classic fleet includes equipment such as aerial, trucks and trailers, material handling, air compressors, earthmoving, compaction and lighting. Its industry-specific services include power generation, climate control, remediation and restoration, pumps, trench shoring and studio and production equipment. According to the firm's 10k, Herc Rentals has approximately 6,700 employees in 364 locations in North America and generates about 90% of revenues from the U.S., with another 10% coming from Canada. The firm has grown significantly over the past two years, mostly by acquiring smaller specialty equipment firms.

CUSP managers considered Herc Rentals a good investment due to its attractive valuation and aggressive growth strategy. Herc Rentals has had significant growth in revenues of 16.4% in 2021 and 32.10% in 2022. Similar to URI, HRI's stock price has been discounted during the period of instability in regional banks in early 2023. The CUSP managers view the drop in price as providing a good entry point for the stock. For example, Herc Rentals' P/E ratio of 9.98x compares favorably to the rental industries median P/E ratio of 16.71x. Like URI, HRI stands to benefit tremendously from the Build Back Better Act, giving the company ample opportunity for growth in the near term. Finally, it is worth noting that Herc Rentals is the third largest player in the equipment rental space. Given the firm's profitability, strong balance sheet and reasonable valuation, the stock was added to the portfolio in April 2023.

The surplus of funds provided by the acquisition of Triton provided CUSP managers with the ability to alter some of the other holdings within the CUSP industrials sector. These funds were strategically allocated to Acuity Brands and Snap-on, two existing holdings. CUSP managers decided on this due to the recent drawback in Acuity's stock price and the strong Q1 performance from Snap-On, with 10.2% organic sales increase from FY 2022. Both are solid names within the sector, and we believe they continue to provide meaningful return potential for the portfolio. All these transactions were completed in April 2023.

Sources:

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