

Northgate PLC

Results for the year ended 30 April
2018

26 June 2018

Transcript



Andrew: Well, good morning, everybody, and welcome to Northgate's full year presentation for the 12 months ending the 30th of April, 2018. And welcome, too, to those joining on the webcast. The format for this morning, very short introduction from me, then you'll hear from both Kevin and David. And after that, there'll be an opportunity to ask questions.

So 2018 has been a very active year for Northgate. New UK management team. I'm pleased to see we have Frank sitting here in the front row, and Frank has brought with him alongside some very able people, and the results of this are already starting to show through. We revisited our strategy and revised and refined that, and that was led by Kevin, obviously with help from Fernando and his team in Spain and Frank in the UK, plus some outside consultants who know their way around our sector. So we now have a very clear pathway to driving the business forward and to delivering long term shareholder value.

And the results for last year are very much in line with market expectations. 5% increase in revenues, earnings per share coming in a shade under 35p and a full year dividend of 17.7p, so covered a couple of times, representing a small increase on last year. That should be seen very much a sign and a symbol of our confidence in the ongoing ability of this business to generate good levels of cash flow and return.

In terms of the geographic breakdown, fantastic performance from Spain, very strong rental growth, and particularly encouraging to see this new leg of the business, the minimum term rental, taking off. Kevin will talk about that in some detail. But equally pleasing, certainly from my perspective, is to see the momentum that is now building in the UK. It's a delight to be able to stand up here and talk about that business being in growth, and some very good metrics coming off that.

As always, there are a number of moving parts. Kevin and David will take you through that, but the key message here is that we've taken decisions for the long term. We may have slightly depressed short term reported profits, but what we're doing is taking steps to build long term shareholder value and on a sustainable basis. That includes our drive into the minimum term market alongside flex, but it also, of course, takes into account maximizing the returns from our investments in vehicles, fleet optimization strategy.

So we have a very good team now at the top. Kevin's been on board for 18 months. I'd like to thank David, too, for his fantastic contribution. He came in at very short notice last autumn, and has done some sterling work. You'll have seen this morning, we've announced the appointment of Philip Vincent. Philip comes on board in a few weeks' time. Great pedigree, comes out of South African Breweries. He was the CFO of their Asia-Pacific business, and prior to that he was the CFO of BBC Worldwide. So some very interesting experience, and I think a complementary skill set to Kevin. I think he'll be a very good wing man.

What about the way forward? Well, I feel optimistic about this, because we now have strong operational teams in place in both Spain and the UK, a great top team. We have real momentum building in the business. We have a landscape that is very attractive with the minimum term rental business sitting alongside flex. And we have a clear and well-understood strategy, and everybody in Northgate is signed up to that. So clear strategy, strong teams, lots of potential ... What's not to like?

Over to you, Kevin.

Kevin: Thanks, Andrew.

Right. Good morning, everyone, and welcome to the 2018 Results Presentation for Northgate. I wanted to start, if I may, just with a brief overview of the key messages that we've got for you today, before handing over to David to take you through the financials.

2018 and my first full year in the business has been a critical year of transition for Northgate, where we've developed and begun implementation of a new growth strategy for the group. We restructured the UK business, overhauling sales and marketing in particular, and reversed a multi-year decline in VOH. In addition, we took advantage of a failed competitor at the end of the year by acquiring fleet through three separate asset deals, to add a further 3,400 vehicles to the UK's operational fleet. The implementation of the new strategy was executed really well in Spain, driving strong growth in VOH, and in both markets, the addition of new, minimum term product has delivered profitable growth and increased the quality and the stability of earnings as we look forwards.

In February, as Andrew alluded to, we took the difficult decision to implement a fleet optimization strategy, ending the core practice of recent years. Now whilst this creates short term headwinds on earnings, as the fleet's aged, it delivers a structural improvement in steady state cash production through extending the replacement cycle, and reducing net replacement capex. Our debt facilities have been extended, leverage covenants increased to support growth. So, in short, this has been a key year of building the foundations for strong and sustainable growth in shareholder value.

Let me hand you over to David, who can take you through the detailed financials.

David: Thank you, Kevin, and good morning, everyone. I'd like to run you through the key numbers before Kevin provides more background to the underlying trading dynamics.

If we start with the income statement, we can see this is a story of higher revenue and EBITDA, but low operating profit, which then obviously impacts profits before tax and earnings per share. Before I start, can I mention that where we refer to underlying performance metrics, we exclude exceptional items and amortization of intangible assets.

Total revenue increased 5.1% to just over £700 million. Behind this, vehicle hire revenue increased 3.3%, to £471 million, and revenue from vehicle sales increased 9.1%, to £230 million. Underlying EBITDA increased 4% to £251 million, due to the increase in higher revenue.

Underlying operating profit fell 19.2%, predominantly due to disposals, and this largely explains the 24% reduction in underlying profit before tax, to £57 million, although interest costs also increased due to higher net debt levels. I will go into more detail about operating profit in a moment.

Underlying earnings per share consequently declined 26.4%, to 34.8p. The Board is proposing to maintain the full year dividend, resulting in an increase in the dividend for the year to 2.3%, to 17.7p, which reflects our confidence in the outlook for the group.

We have started to see the benefits of our strategy in the fourth quarter, and Kevin will take you through this shortly.

Here, we take a look at the components of the operating profit decline. We can see that of the £16.3 million decline, some £13.9 million is explained by the reduction in disposal profits at our two main businesses, as we implement our fleet optimization strategy. In comparison, only £3.1 million related to lower rental profits. UK rental profits declined 22%, to £23 million, with margins down by 2.2 percentage points as we prioritize getting VOH back into growth, and incurred the cost of doing so. In comparison, Spain rental profit grew by 14%, to 29 million, driven by VOH growth, with the rental margins there broadly flat. Please note that all margins quoted are calculated as rental profit over rental revenue. Kevin will give you more insight into the rental margin movements in both markets a little later on.

Disposal profits declined 47% in the UK and 42% in Spain, largely as a result of lower PPU's, down by around 45% in both territories. As we explained when we announced our fleet optimization strategy at the start of the fourth quarter, this falling PPU resulted from the previous policy of selling vehicles at younger ages, i.e., when they still have high net book values. There was also a £4.2 million negative impact of depreciation rate changes in previous years. Please note that underlying operating profits benefited by £1.7 million due to foreign exchange effects from a weak sterling.

Moving on to cash flow, we see underlying operating cash generation increased by £2.2 million on 2017, reflecting the growth in rental revenue, and increase in underlying EBITDA. New vehicle purchases were up sharply, by £141 million, driven mainly by the strong VOH growth in Spain, and the resumption of VOH growth in the UK, as well as some OEM price inflation. This increase in vehicle purchase expenditure was by far the most significant feature of the group's cash flow during the year, and I'll come back to this in a moment.

Vehicle disposal proceeds increased £10 million, to £187 million, with the proceeds in both 2017 and 2018 reflecting the disposal of a high volume of vehicles at younger ages. Other non-fleet net capital expenditure increased by £6.2 million, to £11 million, mainly due to property and IT software investments.

Tax and interest cash costs were broadly similar to last year, and this led to an outflow of £96 million as we invested to pursue our growth opportunities. We see this very clearly on the next slide.

We are disclosing cash flow before and after growth capex for the first time. We calculate growth capex by taking the increase in the size of the fleet in the year, and multiplying it by the average cost of the new vehicles. Clearly, this does not reflect changes in the mix of vehicles purchased, but we believe it is a good, straightforward way to articulate growth capex. Everything else is defined as replacement capex, with vehicle disposal proceeds being added back to derive a net replacement capex number. Net replacement capex was up 7.5%, to £186 million, reflecting a variety of factors including OEM price inflation and foreign exchange impacts.

EBITDA less net replacement capex, which we believe to be a good indicator of the steady state cash flow of the business, before investing for growth, was £3 million down on 2017, but still a very healthy £65 million. This illustrates well the cash generative characteristics of our business.

We also undertook a very significant investment to grow our hire business. Growth capex was almost zero in 2017, with fleet growth in Spain offset by a decline in the UK fleet. But in 2018, we invested 125 million pounds to expand the business. This

expenditure comprised 72 million in Spain, as we grew the fleet by nearly 15%, and £54 million in the UK, as we returned to VOH growth. The UK number includes £13 million for the acquisition of vehicles formerly managed by a competitor that went into administration close to the year end.

As previously announced, we have extended the maturity date of the majority of our bank facilities by one year to July, 2021. You can see here the component parts of our loans under our median term facilities, of £442 million, and the costs of these, with our total borrowing costs being 2.27%. Net debt, after taking account of the borrowings on the short term facilities and cash balances, was £439.4 million. At the same time, we agreed to increase our leverage covenant in the bank documentation to 2.75 times to give ourselves greater financial flexibility. This compares to a year end leverage level of 1.76 times, up from 1.31 times last year, as we have invested for the growth, and net debt levels are therefore higher.

Following this amendment, we have announced a change to our targets. We plan to operate with leverage in the 1.5 to 2.5 times range with higher levels of leverage during periods of significant growth. We believe this gives us the ability to finance our growth plans, and is efficient whilst at the same time protecting our balance sheet through economic cycles.

Thanks. With that, I'd like to hand you back to Kevin.

Kevin: Thanks, David. Okay. Let me start with a recap of our rental market opportunity. We operate in markets that are undergoing a clear structural change, with customers moving away from outright ownership of vehicles into rental and minimum term hire models instead. Penetration of rental and term hires continue to increase, now standing at 14.3% in the UK market, and this continues to drive around 6% volume growth per annum in our segments, independent of any underlying growth in the LCV market.

Against this, we're focused on three core opportunities in rental. So, defending and growing our share of flex, particularly in the UK where that share's been lost in recent years. Second, gaining share in minimum term markets, which are a natural adjacency to our core business, and where we've got deep competitive advantages. And third, to pursue opportunities presented by the shift from ownership into rental with products such as WeBuyYouRent, where we purchase customer's legacy fleet, dispose of it, and then supply them with new fleet based on minimum term contracts instead.

In the fourth quarter, we returned the UK business to positive volume growth, with average fleet rising 3.2% versus the prior year. And this marked the culmination of significant efforts through the year, and the application of self-help measures that I set down to last year's results. The executive team was largely overhauled with strong leadership installed now in all key positions. Sales and marketing have had particular focus. In sales, significant changes to leadership, to sales talent, coupled with stronger pipeline management and more agile decision making, and more competitive pricing all contributing to the result. The marketing team equally was entirely replaced, the website overhauled and relaunched, customer contact data cleansed and increased, and a brand strategy developed for launch later this year.

The new minimum term product, 12months+, was launched last September, and has sold very successfully into a growing market, gaining substantial share. Vehicles on minimum term contracts now account for about 11% of closing vehicles on hire in the UK, a significant growth, and with an average contract duration of three years, it

provides far higher quality of earnings and stability of future revenue streams than the core flex business. Critically, and in line with our strategic objectives, we also saw flex volumes return to growth in the fourth quarter.

At the end of the year, TOM Vehicle Hire went into administration, and we secured deals with three of its lenders to acquire fleet, the majority of which was already on rent to customers. For a total consideration of £36 million pounds, 3,400 vehicles were purchased. Our sales account management and operational teams have since focused on inspecting these vehicles, administering the change in ownership, and bringing the customers on to Northgate contracts at improved commercial terms. We expect that by the end of the first quarter, 2,000 of these vehicles will remain on hire, mostly to ex-TOM customers, and 1,400 will have been sold profitably or be awaiting sale or redeployment to further customers.

Now, rental margins in the UK. Well, these have really reflected our growth strategy through the year. Since FY17, margins have reduced by 1% as a result of pricing becoming more competitive, in the flex market in particular. We've simply not been prepared to let competition take business from us based on price, and there's been a further 0.5% reduction as a result of increasing our mix in minimum term at a lower rate today than flex. Finally, we've seen a further 0.6% reduction through increased costs, such as OEM terms which have not been passed through historically, plus investments in marketing to drive growth, and a modest reduction in leverage, as rental revenues declined slightly in the year.

The UK fleet increased by six and a half thousand units through the year, driven by strong growth in closing VOH which was up 6.9%, coupled with the acquisition of fleet at the end of the year. Disposals reduced slightly, as fleet optimization was implemented as of February, and there was a slight offsetting increase in third party disposals. Van Monster sales accounted for 48% of units sold, a strong increase on the prior year, and the average age of the UK fleet reduced over the year by one month, really reflecting the strong growth in closing VOH.

Turning to Spain, the implementation of the new growth strategy, combined with favourable macro conditions has driven a significant step in rental volumes with average VOH in the fourth quarter trading up 14.1% versus the prior year. While the underlying economy and the service sector in particular is growing in Spain, we continue to see a marked shift out of ownership and into rental. And our Spanish businesses outperform the market with the addition of new minimum term products presenting a really compelling breadth of offer to customers, especially large accounts who wish to satisfy a blend of short term, variable needs through flex, with the longer term efficiency afforded by the minimum term rental.

Spanish margins have been broadly flat year over year. We saw a one and a half percentage point reduction due to taking a more competitive stance on pricing, both to defend the core business in flex, but also to gain strong market share in minimum term. Mix drove a further 0.9 percentage points reduction, primarily, again, as lower priced minimum term business increased. However, operational leverage over the fixed cost base increased and cost efficiencies mainly within our workshops were driven through. The cost of network expansion was deferred until FY19, and the effect of these cost impacts was positive on margins, mostly offsetting the contraction in pricing and mix.

The Spanish fleet increased by 6,200 units through the year, again driven by strong growth in closing VOH which was up 13.3%. De-fleets reduced slightly, as fleet

optimization was implemented. And, again, the average age of the fleet reduced over the year by one month, again reflecting strong growth in closing VOH.

In February, we announced the implementation of the new fleet optimization policy, which marked a significant evolution of the strategy that we set out in October. While its implementation generated short term earnings headwinds, the objectives of the policy were focused on improving cash returns from the investment in fleet, reducing debt, and improving the return on capital employed in order to drive shareholder value.

Actions have now been taken to age the fleet by three to nine months across the UK and Spain, unless for specific vehicles operational constraints prevent this. For a minority of vehicles, cash returns can be further maximized by faster rotation, and a clear framework exists to manage this. So consequently, we've now started to see a lower volume of sales and replacement purchases as the fleet ages, and this in turn is leading to lower net replacement capex, which we define, as David said, as replacement purchases less disposal proceeds. It also leads to structurally higher, steady state cash flow, defined as EBITDA less net replacement capex. Lower capex clearly has a positive impact on our net debt, and return on capital employed is supported as a result of the average net book value of these older vehicles being lower.

How this translates into specific guidance is that we're stating that net replacement capex in FY19 will be 25-35% lower, so that's £50-70 million lower than in FY18. And beyond FY19, with the longer replacement cycle, there will of course be an ongoing structural benefit to net replacement capex, and therefore the steady state cash flow.

Let's go on to our outlook for the UK and Ireland. Clearly there have been some significant steps to evolve our strategy, particularly with regard to having managed cash within the business since the capital markets day in October. The outlook that I'm presenting now reflects these changes, the update to depreciation rates commenced in May, and the recent acquisition of fleet in the UK. It also reflects a combined view for the UK and Ireland which will be managed under Frank Hayes in the UK executive team moving forwards. It's also worth stating that following the update to our depreciation rates, future disposal profits, by design, will be a far smaller component of our guidance as we aim in line with accounting standards to manage the net book value of the fleet to be in line with sale proceeds at end of life.

So the growth that we saw in VOH last year has continued, and in the UK and Ireland rental business, we expect high single digit percentage growth in VOH this year, including the impact of the TOM vehicles acquired, returning to mid to high single digit growth in FY20. We expect rental margins to be broadly flat this year, due to the further costs of investing to drive sustainable growth with rental margins then expanding in FY20, as the benefits of these investments come through. Disposal profits are expected to reduce both this year and next as a function of both the fleet optimization strategy and the unwind associated with recent depreciation rate changes.

In Spain, again, we've continued to see really strong growth in VOH in recent months, and expect continued double digit percentage growth in average VOH this year and in FY20. Rental margins will expand significantly this year, primarily driven by the depreciation rate change, and we expect rental margins to then remain broadly flat in FY20. Disposal profits will decline this year, as a result of the fleet aging, but are expected to increase in FY20, as the business returns to normalized sales volumes.

So rolling that up for the group, in FY19, we expect rental profits to grow strongly, driven by continued VOH growth and expanding margins in Spain. Disposal profits will be significantly lower, driven by fleet optimization and the extension of holding periods. Interest charges will be higher, both due to the increase net debt of the fleet grows, but also by some increased margins with leverage increases. Net replacement capex, as I mentioned earlier, will be 25-35% lower, so 50-70 million pounds increase in steady state cash flow. We expect organic growth capex to be at a range of £90-120 million, and we'll continue to apply disciplined controls to ensure that the marginal contribution from this capex is substantially ahead of the weighted average cost of capital.

While rental profits will grow strongly, the return on capital employed this year will be impacted by both the reduction in disposal profits as the fleets age, and also by the significant investment to support VOH growth. And we expect leverage, as David outlined, to remain within a range of one and a half to two and a half times net debt to EBITDA. Beyond FY19, we expect further growth in rental profits, higher disposal profits for the group, and higher return on capital employed for the group.

So let me just conclude by recapping the equity story for Northgate. We're the market leader in large, growing, profitable markets with future growth underpinned by a clear structural shift away from ownership and into rental. Northgate has been historically under-managed, and has substantial self-help upside which we've demonstrated this year. We have a new compelling growth strategy. We have a new strengthened UK management team to supplement our already strong Spanish team. We've delivered a clear turnaround of volumes in the UK, and are pursuing opportunities to improve rental margins in the median term, and this continued substantial profitable growth available in Spain as we execute the strategy. But, most importantly, we've taken decisive actions to optimize our fleet and we expect to see strong and structural benefits in cash generation as a result of that move moving forwards.

Okay? So maybe at that point we can pause there and hand over to you for questions.

Andrew: So, have we got a roving **microphone**? I can ask people to put their hands up. I see Jane's first out of the box. And if you would give your name and your organization and then your questions, please. Jane?

Jane S.: Jane Sparrow from Barclays. Just a couple on pricing. You referenced in the statement about the price competition in flex in Spain. We're just wondering, is that your sort of traditional, smaller, flexible players, or is that the larger car rental companies flexing their muscles a bit in the van market?

And on pricing in the UK, at the beginning of FY19, you've obviously put the prices up 5% and not noticed much churn in reaction to that. Just wondering where on the price curve in the UK that leaves you, given you cut prices last year. How far back are you to reclaiming what you cut by?

And then one final one on the impact on margin from the growth in minimum term? I thought the understanding of minimum term was that it was fairly margin neutral, given the transaction cost is up, just a timing issue on the margin? That it initially impacts the margin, but longer term is neutral. Thank you.

Andrew: Yeah. Kevin?

Kevin: That's fine. Thanks, Jane. Let me take those in turn.

So first, competition in flex in Spain. This is not about small players competing against the flex proposition. Frankly, there are few of them, and our service standards and brand are sufficiently strong to be able to deal with those sorts of threats. The main price pressure on the flex business in Spain comes from one or two of the larger, traditionally fixed term players, one of whom in particular has a small network across the country, much less significant than ours, but where, in regions, they can introduce some price pressure. And that's where we're seeing the majority of it.

Your question on pricing in the UK and where are we on the curve, and you're right that we put 4.8%, and that was on the majority of the flex base. We are indeed seeing that stick. What's pleasing is that we were very vocal about that change with the customers in the market, and some of our recent indications suggest that competition is following that sort of price move, which certainly helps. We will look at opportunities to move up minimum term pricing in addition, through the course of this year, and that's something that the team are actively exploring. But where we are on the curve, clearly we will seek to continue to push pricing, certainly recovering costs as we move forwards and aiming to widen pricing as a lever to driving margins.

. Final question on minimum term. To be clear on this, we had previously drawn analogies on marginal return on capital between flex and minimum term, and we believe that moving forwards that, yes, there is broad parity there when the three different components of rate per day, utilization, and direct costs are weighed up. There is a little bit of timing impact, so whilst rates comes down straightaway, utilization comes up straightaway, there's a little bit of timing around those direct costs from lower touch points on the vehicle for that to come through. But I think net we do see a little bit of dilution as you see on the chart, primarily as a result of the lower priced minimum term coming in. But we believe firmly that this is fantastic business to grow in, as a combination of its marginal returns and the stability it provides on forward earnings and revenues.

Andrew: Julian? The guy with the hand up.

Julian C.: Good morning. It's Julian Cater from Numis. Two questions, please.

The first is in terms of the guidance, Kevin, that you provided on the UK rental margins for this year. You obviously alluded to the 4.8% price increase on the flex backed book. That's sticking. And I just wonder whether you could talk about the sort of off-setting factors that you're anticipating this year, perhaps how much incremental investment's going to sales and marketing that you alluded to, which brings it back to flat.

And then my second question is just in terms of UK Van Monster. You obviously see a big step up in terms of the penetration for the full year. But given that two-thirds of the vehicles were disposed of in the first half, the implied penetration rate for the second half, it looks like it's about 65-70%, so I wonder if you could say is it just the mix of the vehicles, or is there another dynamic at work there, please?

Kevin: Sure. Let me take both of those. So on your first question, just on FY19 UK margin guidance, let me just put some colour around the tail winds and the head winds that result in that broadly flat outlook.

In terms of tail winds, you highlight the 4.8%, and that's absolutely right, and I've commented around that sticking. We also say that, as I mentioned to Jane, we're exploring some rate increases, potentially around minimum term product, so there

could be some opportunity there. We will see, with revenue growth this year in the UK, some benefit on leverage over fixed costs, and that's a further tailwind. And, of course, we've got the depreciation rate change more modest in the UK, but driving £4.1 million increase in rental profits.

Offsetting that in terms of headwinds, we have OEM pricing, which is really a fact of life in our business. It will always be there, as you'd expect, but you should be thinking in terms of low single digits pressure on OEM pricing. The market remains competitive, and so we're yet to see the extent again to which we can manage price in the face of that competition, whilst maintaining top line growth. Minimum term mix we expect to see that increase again, so potentially a bit of drag coming from minimum term mix increasing. And then, finally, yes, some investment and transformations. More investment in marketing, a little bit more investment in sales. We want to make sure that the growth that we're seeing in the UK isn't a flash in the pan. It's sustainable, long term growth in terms of top line, so thus the investment around that.

Does that help?

Andrew: Comment on the penetration second half.

Kevin: So on your Van Monster question, clearly part of this, Julian, is affected by the disposals decisions that we took in the second half of the year and as of February, we were into a fleet optimization plan. And naturally that started to reduce the level of disposals overall that we are making, because we're focused on disposals in de-fleet to get a mature fleet. And I can only imagine that if there's a change in mix on your observations between first and second half, it will be driven by that, as opposed to any underlying performance within the business. But I'm happy to pick up more detail at a later stage of duration.

Andrew: This chap.

Andrew N.: Morning. Andrew Nussey from Peel Hunt. Again, a couple of questions. Just wonder if you'd give us any insight to the trends you've experienced in May and June. I'm just wondering if there'd be any sort of issues with commercial teams obviously having to take on all the TOM customers.

And, secondly, just any thoughts on any potential cannibalization between the fixed and flex product both in Spain and in the UK? I may be a cheeky sir, just in terms of the IT system, the choices made, and any thoughts in terms of what can be realized from fleet management and workshop efficiencies.

Andrew: They're all for you.

Kevin: Trends in May and June as regards to TOM. We maintain that these deals were attractive ones for the UK to do, and there has certainly been work to identify the vehicles, examine the vehicles, negotiate with customers, and bring those vehicles on board. You saw from the slides that our expectation is that 2,000 of those vehicles will be on hire by the end of the first quarter, so that's a good indication of the progress that we've made. We have seen some profitable sales of the balance of those vehicles so far this year, and for the remaining vehicles, as I said, we'll expect to either redeploy them to hire customers, or trade them out profitably over the course of the coming months.

To cannibalization between flex and fixed, it's something that we monitor and we track hard. The short answer is, there may be some, but it is minimal. And typically, it's in cases where customers have been on legacy flex contracts but really haven't required the optionality of putting that fleet back to the supplier, because their business is stable and they're not experiencing volatility. In those few cases, we see pressure to switch that into minimum term contracts, and we're happy to if that's the case.

On the IT system, I think the message is no change, Andrew, since our last update. The team in the UK along with Infor, as the supplier, have been working really deeply through an elaboration phase of that implementation, defining the target operating model and making sure that the workflow and the processes that the system will support on its implementation are exactly those that are best in class for the UK business. But there's no change in terms of cash or benefits outlook relative to the guidance we've given before.

Andrew N.: Thank you.

Andrew: Any more questions?

Greg P.: Good morning. Greg Poulton from N+1 Singer. How important is pricing flexibility in your sales strategy? And now that you're pricing up, how are you adapting that? And then, the second one, could you give us the VOH growth guidance, excluding Ireland and TOM?

Andrew: Okay. Kevin?

Kevin: Pricing and the sales strategy. The answer is, it varies by customer. At the more strategic, larger customer end of the spectrum, typically pricing is a bigger component in the decision making. At the smaller end, serving SMEs or regional accounts, there's a huge emphasis on service and keeping the customer on the road and well-maintained and well-served. So there is a spectrum. As we have driven both pricing up, we're also seeking to drive service levels up across the UK, so that we can justify a premium into the market. That would be the SMEs and with the regional players, so I think we're very comfortable, Greg, with our matching of service levels and prices, because we see it.

In terms of the VOH growth, I don't have those numbers immediately to hand, but again we're very happy just to follow up after the Q&A.

Andrew: Okay. There's a question here.

Speaker 9: Thank you. I was slightly intrigued by the strategic comment that effectively you're going to age your vehicles longer, and then your returns will be higher. You mentioned you have a lower capital employed. But if depreciation changes, your capital employed will increase. You would expect that in the older end of the market, there'd be more mom and pop type competition, lower barriers to entry. Just talk a little bit at the high level, helicopter view, why this is the right way forward.

Kevin: Yes, be happy to. It's a great question.

The decision wasn't taken lightly, and it was taken on the basis of some very detailed work in all of our core markets. The teams looked at all cash flows associated with running the vehicle, and then putting it out on rent, including an increase in service and

maintenance profile as the vehicle ages. In our business, and even in the flex term business, we operate vehicles that are of rentable standard, and if a vehicle is of a rentable standard, we charge the same price, irrespective of whether it's three months old or eighteen months old. So there's no degradation on pricing, and that's part of the input into that equation.

We find that in competition with local players, it's Northgate's service standards that stand out in the relationships that we build with local customers through our workshops and our depots, and that's the basis of competition, is that service differentiation to the small customer. That's really the basis of the logic and the thinking. It was very clear from the work that we did that the NPV of an investment in a vehicle was maximized by lengthening the holding period. And, in fact, in Spain in particular, we'd be happy to further lengthen that holding period if acceptable to customers. And in the Spanish market, the vehicle park industry is substantially older, so it doesn't present us with a problem in doing so.

Andrew: Any more questions for the guys? What?

Joe S.: Thank you. Joe Spooner from Jefferies. Can you just talk a little bit about opportunities to make more acquisitions to accelerate the scale of the business? Obviously, you've bought in TOM. I guess that was a little bit of a one-off situation, but you did mention talking to others about their fleets, and maybe just a little bit of colour on the pipeline around that?

And then, just to be clear on the depreciation policy. Did you say that is now targeting a zero disposal profit at the extended holding period that you now intend for the vehicles? Thank you.

Andrew: Should we let David answer the second one and you deal with the first?

Kevin: Acquisitions. As I mentioned at our previous announcement, we keep an active pipeline and view of potential acquisitions in both territories. I think we have more opportunity in the UK market to consider small bolt-ons, and the team I think now are certainly of a calibre to be able to evaluate, assess, and execute those if we wish them to, which is certainly a good step forward from where the business has been in prior years.

In terms of then moving forwards with acquisitions, our view on capital allocation hasn't changed. So our first call on additional capital really is in to fleet and into growing the core fleet. Because as we've mentioned before, we can see marginal returns on capital in a range of 20-25% against the capital deployed in additional vehicles on our core fleet. And beyond that, of course, dividends, and beyond that, we would consider either ... If we were in a position of having excess capital, we'd then be at a point we would actively pursue and consider M&A, or alternative approaches toward dividends or buy-back.

Andrew: On depreciation, David?

David: On depreciation, we're targeting sort of slightly above zero, rather than bang on zero, Joe, just to be clear on that, we make our profit in the group from hiring vehicles. When we sell a vehicle, effectively what we're doing is recycling cash back into replenishing the fleet. And so, we don't really make profit on the sale of vehicles from the way that other people might think of it, it is an adjustment to depreciation rates.

So I think as the depreciation rate policy rolls through, in time, whereas we have seen disposals profits as being a sort of high-ish proportion of our overall level of profitability, we'd expect over the course of a three or four year period for that to decline to less than 10%. And the focus very much for us is on how do we maximize our profit from hiring vehicles, which is very clearly our core business.

Andrew: Any other questions?

Right. Well, thank you all very much indeed for your attendance this morning. It's much appreciated. And the guys will be around for another 15 or 20 minutes if there's anything that you'd like to ask them, please feel free to stick around. Thank you very much.