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TRANSCRIPT

Q1 2022 Earnings Conference Call

WillScot Mobile Mini Holdings Corp. (Nasdaq: WSC)

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TRANSCRIPT

Operator

Welcome to the First Quarter 2022 WillScot Mobile Mini Earnings Conference Call. My name is Vanessa, and I will be your operator for today. Please note that this conference is being recorded.

I will now turn the call over to Nick Girardi, Senior Director of Treasury and Investor Relations. Nick, you may begin.

Nick Girardi

Good morning and welcome to the WillScot Mobile Mini First Quarter 2022 Earnings Call. Participants on today's call include Brad Soultz, Chief Executive Officer; and Tim Boswell, President and Chief Financial Officer. Today's presentation material may be found on the Investor Relations section of the WillScot Mobile Mini website.

Slide 2 contains our safe harbor statement. We will be making forward-looking statements during the presentation and our Q&A session. Our business and operations are subject to a variety of risks and uncertainties, many of which are beyond our control. As a result, our actual results may differ materially from today's comments. For a more complete description of the factors that could cause actual results to differ and other possible risks, please refer to the safe harbor statement in our presentation and our filings with the SEC.

With that, I'll turn the call over to Brad Soultz.

Brad Soultz

Thanks, Nick. Good morning, everyone. Thank you for joining us today. I'm Brad Soultz, CEO of WillScot Mobile Mini. This quarter is an excellent example of how growth compounds across our platform. We recently laid out a portfolio of largely idiosyncratic growth levers, which collectively represent about $1 billion of top line growth.

Starting on Page 13, I'll talk through how each of these growth levers contributed to our strong performance in Q1, in which we delivered $509 million in revenue and $192 million of Adjusted EBITDA, both up 20% and 17%, respectively, year-over-year.

Starting with the largest growth lever at the top, value-added products and services, or VAPS, represents approximately $0.5 billion of the $1 billion top line growth potential. We continue to deliver ever more value to our customers with our differentiated and compelling offering as we take care of a supply chain node that's an inconvenience for our customers.

In North America Modular, we achieved average VAPS rate per month of $407, up 21% year-over-year, on all units delivered over the last 12 months. When we went public in late 2017, we set what most felt an ambitious target of $400 of VAPS per unit per month. We eclipsed that milestone this quarter. If we simply hold these already achieved penetration levels for 3 years, while the on-rent fleet rolls from its average 3-year lease durations, we'll realize $160 million of annual top line growth or approximately 1/3 of the $0.5 billion VAPS-related potential.

We're incrementally introducing new offerings that will help even more of our customers be Ready to Work day one. We are leveraging our proven processes and tools to optimize rates. We are continuously enhancing our training and market collateral to improve the performance of the lower quartile of our sales reps and to accelerate the onboarding of new reps and customers alike. All of which makes us confident that we will achieve our next new milestone of $600 of VAPS per unit per month, which would yield approximately another $200 million of additional annualized growth.

In North America Storage, now 80% of our ground level office fleet can be delivered with our VAPS offering, and penetrating our Mobile Mini ground level office fleet at the same level already achieved on life-size units in the Modular segment would yield another $50 million of incremental VAPS-related top line growth. In addition, we are piloting our new Storage VAPS program to select branches starting in May, with a full assortment of locks, lighting, and basic shelving. We expect our premium offering to follow in early 2023.This is a differentiator relative to peers and is based on an established playbook that we developed and have been executing for years in Modular. While we don't expect a significant financial contribution until 2023, we are excited by initial discussions with customers and confident that this initiative will be very well received.

We identified up to $200 million of top line growth potential associated with further lease rate optimization. Q1 lease rates accelerated across all segments, driven by our processes team and technology, further underpinned by the current inflationary backdrop. I was particularly pleased with our continued progress in North America Storage, where rates on portable Storage units were up 12% year-over-year, marking our first quarter with a double-digit rate increase.

North America Modular has now sustained double-digit Modular rate growth, inclusive of VAPS for over 4 years now, such that rates on new Modular deliveries are greater than 30% above the average of all units currently on rent. As I've emphasized previously, we are a net inflation winner, and this quarter was no exception.

Our cross-functional quarterly reviews help us stay disciplined and focused on further rate optimization. Given 4 years of history in North America Modular, wherein VAPS penetration has delivered just over half of the sustained double-digit rate growth and lease rate optimization has driven the balance, there's certainly further potential upside in this powerful and proven lever.

One last note on rates. Please recall that our solutions provide a relatively high-value, low-cost, first on-last off critical service for our customers, representing only about 50 basis points of their average total project cost. As additional context, our average Modular rental rate is equivalent to $1 to $2 per square foot per month, which compares quite favorably to the national average of about $3 to $5 per square foot per month for lease commercial office space to the extent it's even available directly adjacent to their project. These are comparative unfurnished rates. Our fully furnished Ready to Work solutions delivered and installed directly on the customer site and then taken away and redeployed to another customer whenever their project ends further widens the relative value spread.

Market penetration initiatives are also progressing well as units on rent in Q1 were up sequentially across all segments.

Looking across both North America Storage and Modular segments, average portable Storage units on rent increased by about 32,000 units, driven both equally by organic growth and acquisitions. As expected, our North America Modular segment average units on rent inflected positive as the end of the quarter unit on rent increased sequentially from December 31, 2021, by approximately 1,800 units or 2%. Again, driven by organic volume increases and acquisitions.

In North America Storage, our strong volume growth of about 47,000 units year-over-year was supported by organic growth, acquisitions and the transfer of the legacy WillScot containers from North America Modular. While I'll expand further on the robust end market demand that we're experiencing in a moment, suffice it to say, we expect further sequential improvement through at least Q3.

Our efforts in logistics are another example of how we are a net inflationary winner. Logistics services are where we are most immediately exposed with respect to inflation. Our delivery and installation margins actually expanded by about 300 bps year-over-year, which is indicative of our ability to manage through inflationary pressures. Our team vigilantly focuses on rates, fuel surcharges where appropriate, as well as operating efficiencies. Both North America Modular and North America Storage realized logistics margin expansion in the quarter.

And we've now closed 3 more M&A transactions in 2022 for a total of 10 tuck-in acquisitions over the last 8 months. All of these are fully integrated onto our operating platform, but for the one we announced this week, which is in process and expected to be fully integrated by the end of the day. The M&A pipeline is robust. You should expect us to continue our momentum with smart, disciplined acquisitions followed by seamless integrations.

We deliver more value, more efficiently than anyone else in our space, and we're thrilled to have the opportunity to provide that value proposition to our new and existing customers. While we do not expect meaningful additional cost synergies with respect to these tuck-in acquisitions, they certainly compound through our VAPS, lease rate and market penetration growth levers.

This portfolio of idiosyncratic growth levers underpinned by ambitious, but achievable, milestones laid out at our Investor Day in November, notably achieving $1 billion of EBITDA milestone within 3 years, and along the way achieving $500 million of free cash flow annualized run rate as we exit 2022.

Given our significant progress in Q1, we're raising our guidance by $50 million to $860 million to $900 million of Adjusted EBITDA for 2022. The predictable and reoccurring nature of the portfolio, supported by our long duration leases and our current commercial momentum, will translate into growth for years to come.

Circling back to our end market outlook on Page 9. While the macroeconomic uncertainties exist, we are experiencing extremely robust and broad-based end market demand, and we are investing accordingly. Our current order book is the largest we've ever experienced. The relative strength of the order book affords us great visibility into the demand for new units over the next 90 days.

Non-residential construction leading indicators remain bullish in the near and medium term, as indicated by the 14th consecutive month of ABI holding above $50. This is an objectively strong leading indicator for core markets heading into 2023. The customer and field leadership feedback has been supportive, with some of our largest general contractors already booked out through the end of the year. And the strength largely extends across all end markets and geographies.

Just a few examples. In Texas, we have a customer that's building a $17 billion semiconductor facility that we're supporting by providing 225 floors, totaling over 100,000 square feet of Ready to Work Modular and Storage solutions on their project site. This is a long-duration lease with additional opportunities to supply subcontractors over the course of the project, all enabled by the heavy involvement of our construction services team.

We are unique in our capability of delivering such a large complex solution set to customers with such high standards. Data centers continue to be a source of ongoing strength, typically requiring 20,000 square feet or more of Modular and Storage place per solution set, and we see that across the Midwest and the Plains regions of the U.S. In many cities, such as Des Moines and Fargo as examples are benefiting from population shifts away from larger metropolitan centers, creating demand from customers in construction, schools, retail, warehouses, frankly, across all of our end markets.

And across most geographies, infrastructure spending on roads and bridges continues to remain robust. Keep in mind, all of this is before any tangible benefit associated with the potential multitrillion-dollar infrastructure bill currently under consideration. While end market demand is the one element of the growth recipe we do not control, the current demand environment is as robust as I've ever experienced, certainly over the last 10 years, with all leading indicators pointing towards sustained strength into 2023 and the potential of significant incremental infrastructure spending to further extend that robust demand well beyond that.

With that, I'll turn the call over to Tim.

Tim Boswell

Thank you, Brad, and to everyone on the call, good morning, good afternoon. Page 20 reflects a high-level summary of the quarter. We're very excited about the outstanding commercial performance in all of our businesses and the implications for our guidance.

Our team is exceeding our own high expectations. We're investing accordingly to support demand across all product lines, end markets and geographies, as Brad mentioned. But I think the implications for our trajectory into 2023 and 2024 are quite compelling, irrespective of recession concerns, of which we're perfectly cognizant and to which we can easily adjust. But we simply don't see any areas of concern in our leading indicators.

On the contrary, we operate a highly predictable and slow-churning portfolio, with powerful idiosyncratic growth drivers. And both the lagging results on this page and the leading indicators in Q1, tell us that we need to prepare to scale up and scale up meaningfully.

Page 21 breaks out revenue and EBITDA performance by segment for the quarter. Our commercial KPI performance drove a 20% increase year-over-year in total revenues to $509 million and a 17% increase year-over-year in Adjusted EBITDA to $192 million. Through our normal quarterly reforecasting process, we're getting a very good feel for how inflationary impacts in both our revenue streams and cost structure are rolling through the portfolio. And this is one of the key factors causing us to increase our guidance meaningfully, which I'll come back to.

Overall gross profit margin expanded year-over-year by 227 basis points, which is the first indicator that our pricing is already outpacing cost pressures. Delivery and installation margins, in particular, expanded 270 basis points across our portfolio. These margins are interesting because transportation is the portion of our business where both our spot price increases and our cost increases impact the P&L immediately. And the net result of these increases is 270 basis points of margin expansion.

Rental rate increases, on the other hand, build gradually in our P&L as the portfolio churns. Average rental rates in North America Modular have already increased significantly, and we continue to see powerful spot rate increases for unit rental rates exclusive of value-added products, up 20% to 30% year-over-year in both North America Modular and North America Storage.

As these are sustained, those increases will roll through the lease portfolio in future periods very predictably. So expansion of our leasing margin will lag due to the duration of our leases and yet overall gross profit margin still expanded by 227 basis points despite increased maintenance and labor costs, as well as elevated activity levels, especially in our Modular segment, where work order completions were up 11% year-over-year in Q1 to support our growing order backlog in Q2.

So in our guidance, we are quite confident in continued year-over-year gross margin expansion given the continued acceleration of rental spot rates and the predictable lag with which they roll through the portfolio, combined with unit on rent volumes tracking ahead or in line with our expectations in all segments.

Below gross profit, selling, general and administrative expenses were up both sequentially and year-over-year. Similar to what we discussed in Q4, this is partly due to the inflationary environment and partly due to conscious resource additions to support growth that is ahead of our expectations. On the inflationary side of the ledger, we pulled forward our annual merit increases from Q2 into Q1, along with other benefits to support our employees. This is the right thing to do and for obvious reasons. And we're seeing inflation in other areas like travel and real estate.

More impactful on the growth side of the ledger, we've increased sales headcount by 14% year-over-year. We've executed and integrated 10 acquisitions since September that are not yet fully optimized, and we have resourced numerous functional initiatives across the company in the areas of inventory management, product management, branch network optimization, national accounts and marketing, and information technology, all of which will allow us to scale efficiently in 2023 and 2024 based on the obvious growth that we need to support in those years.

I recognize that's more detail on costs than I would normally share, but I think it's appropriate given the macroeconomic backdrop. And I would stress 2 points. First, the growth-related additions I've referenced for the past 2 quarters can be removed just as easily as they were added if we don't see the growth and don't see the results that we expect. So I see no particular risk with those, although we are building ahead.

Second, we're not forecasting significant SG&A additions after Q1, and our SG&A forecast is pretty much flat sequentially for the remainder of the year. This means that we are quite confident expecting significant leverage of our SG&A as revenue builds predictably through the course of the year.

Together with the gross margin trends I discussed, we expect Adjusted EBITDA margins could expand 500 to 600 basis points linearly from Q1 to Q4 this year. And our guidance reconfirms our expectation for approximately 200 basis points of Adjusted EBITDA margin expansion in 2022 for the year relative to 2021.

So while the macroeconomic backdrop evolves rapidly, we've taken a hard look at our revenue and our cost drivers as we always do in our forecast process. We're calling up our top line revenue and EBITDA significantly. We're reconfirming our margin expansion expectations. Our run rate heading into 2023 is likely to continue increasing as long as this inflationary environment persists. And we expect that the spot pricing environment that we're in today, will materialize predictably in our reported average rental rate in future periods as it always has.

These are clearly unfortunate times geopolitically, interesting times from a macroeconomic standpoint, and exciting times if you own a piece of WillScot Mobile Mini's earnings run rate.

Turning to Page 22. Cash from operations increased 20% year-over-year to $146 million, in line with our revenue growth rate. Given the order backlog, we invested to meet expected demand in the coming months with $91 million of net capital expenditures focused on Modular refurbishments, organic container purchases, and value-added products. Those discretionary investments left $55 million of free cash flow during the quarter.

As we discussed in prior calls, we expect free cash flow generation to be back-half loaded, such that we achieve our $500 million run rate free cash flow milestone in the second half of this year. We shared that expectation with you over 2 years ago, before we all contemplated a global pandemic, or the Russian attack on Ukraine, or an upward interest rate cycle. We know how recessions work, both in the economy and in our business. Our guidance is up and our longer-term milestones are unchanged.

Turning to Page 23. We used our free cash flow to close 3 transactions year-to-date, as Brad mentioned, and I expect a consistent cadence of acquisitions through the remainder of 2022. And we repurchased 2.1 million shares of our common stock at highly attractive valuations relative to our prospective earnings growth, irrespective of near-term macroeconomic conditions. We have ample liquidity to execute on our strategic initiatives. We're effectively at the top end of our 3 to 3.5x leverage range and growing EBITDA rapidly. And we have compelling investment opportunities, both in M&A and in our own stock, and we're investing with confidence in our outlook.

Turning to Page 24, perhaps my favorite page in the deck. Our capital allocation framework is clear and unchanged. Our investment behavior over the last 12 months is consistent with this framework. Our outlook implies that our capacity for capital deployment will increase significantly, having deployed nearly $1 billion of capital in the last 12 months. And we see highly attractive opportunities to continue reinvesting organically in acquisitions and in our common stock.

Our updated outlook is on Page 26. I already talked about most of the underlying mechanics here, but these are important. Our revenue run rate is well ahead of our expectations from just 5 months ago. This is driven by increases to price, volume, and delivery and installation revenues in all segments. Value-added products in Modular continues to perform outstanding. And while we've kicked off various value-added initiatives in Storage that are incredibly exciting, that's not really a contributor yet to the guidance raise and is a tailwind more for 2023 and beyond.

And on pricing, it's important to understand that the current rental spot rate increases that we are realizing today will flow through the P&L well into 2023 and 2024. So the pricing tailwinds that we discussed back in November are larger today. We expect that Adjusted EBITDA will grow between 16% and 22% this year, with margins expanding by approximately 200 basis points. Remember, those margins are lagging, both due to the timing of inflation impacts in our P&L as well as discrete SG&A investments that we've made, and we've made those investments because we have a higher confidence in our growth outlook.

Our CapEx guidance is up for all the same reasons, and approximately 10% of the increase is based purely on material and labor inflation. That's okay. These investments are demand-driven. We have internal initiatives underway to improve CapEx efficiency, and we have an extraordinary capital advantage in our markets relative to any competitor. This is an area where scale matters tremendously.

Lastly, included in this guidance is about $25 million of EBITDA from acquisitions that closed in the second half of 2021 and the first 4 months of 2022. About $17 million of that contribution was included in the prior outlook, and approximately $8 million of contribution is incremental based on acquisitions that have recently closed. All of this is consistent with a $500 million free cash flow run rate in the second half of this year, an exciting run rate headed into 2023, and the realization of the longer-term milestones that we shared in November.

I think all of the commitments on Page 26 we've discussed before and are unchanged. So with that, Brad, I'll hand it back to you.

Brad Soultz

Thanks, Tim. I'd like to express appreciation to both our team for their contributions and our customers for their trust as we continue generating undeniable and accelerating commercial momentum and financial returns. 2022 is off to a great start, and I speak for the entire team when I say we're excited to continue to deliver on our commitments to all stakeholders. I wish all of you listening today continued safety and good health.

This concludes our prepared remarks. Operator, would you please open the line for questions.

Operator

And we have our first question from Manav Patnaik with Barclays.

Manav Patnaik – Barclays Bank PLC

I just wanted to hopefully have you elaborate on -- in the press release, you talked about the order backlog. And I just wanted to help understand how sticky that order backlog is in the event things do start slowing down. So just trying to appreciate the resiliency there in that comment. And also, I think you mentioned national account conversations, just curious what you're hearing there.

Brad Soultz

Yes. Manav, this is Brad. It's quite sticky. Those are firm orders aligned with projects that are well into initiation stages. So no risk. We're not seeing any deviation in the behavior of the orders once they're booked. And as I mentioned, it's the strongest we've seen, certainly looking back 10 years, even on a pro forma basis.

Tim Boswell

And Manav, this is Tim. It's a run rate business, right? So what we're seeing today is if you just take North America Modular, for example, continued sequential unit on rent gains into April, a very significant order backlog. And as Brad said in his comments, that gives us a very high degree of confidence that volume continues to build sequentially into Q3. Which means along with the pricing trends and value-added product trends, that leasing run rate is going to continue to compound meaningfully over those periods.

And that order backlog, you can think of it as looking about one quarter ahead in terms of the hard orders that are in the pipeline, and it tends to replenish through the course of the subsequent quarter. So it doesn't go out 12 months necessarily for the most part, but it's highly reliable for the upcoming 90 days. And that's why we have the zero-based 90-day capital planning cycle that we redo every forecast period.

Manav Patnaik – Barclays Bank PLC

Okay. Got it. That's helpful. And Tim, maybe just on the M&A front. I mean these tuck-ins that you've been doing, I mean, the pace is quite impressive and you said it should continue. So just wondering, is it the new kind of insights from your technology systems? Or can this pace really continue for multi years?

Tim Boswell

I believe it can, right? I think we'll continue this cadence through the remainder of the year, is my expectation. We're tracking a universe of potential targets that would support a multiyear consolidation strategy of this nature. The nature of M&A as it is difficult to predict the timing and the probability of certain transactions, but the volume that we're tracking today certainly supports this cadence through the end of 2022.

Operator

We have our next question from Scott Schneeberger with Oppenheimer.

Scott Schneeberger – Oppenheimer & Co. Inc.

I want to think about North American Portable Storage container segment and just the strong acceleration in pricing. Could you speak to the kind of the components of that? Is this a lot of the inflationary-based pricing improvement? Or is this a little bit of VAPS penetration rate increase? And kind of -- what I'm looking for is where is that going to go to? Are we going to continue to see this accelerate? Or are you kind of pushing the limits here?

Brad Soultz

There's no VAPS penetration effectively in that. And you've seen that build, Scott, well ahead over the last several quarters before we've really experienced this current inflationary environment. I would think of that more as sustaining that position on a go-forward basis. And as we mentioned, over the course of 2023, we should start to see some benefits from VAPS. We'll continue to deploy the processes and eventually some of the tools we have on the Modular side to continue to optimize lease rates as well.

So those have been building well ahead of the inflationary environment. It just kind of backstops, if you will, the progress and gives us potential further upside.

Tim Boswell

Scott, this is Tim. I'd just add, there are numerous reasons to be, I think, enthusiastic here, VAPS is an obvious one. We talked a little bit last quarter about product positioning within the Storage portfolio. As you know, under our Mobile Mini brand, we've got a truly differentiated Tri-Cam product, specialty product, that doesn't exist anywhere else in the North American market.

Through acquisition and some of our organic purchases, we are building out a larger standard container fleet with which we can compete very effectively given our customer service and logistics capabilities. But we also have a significant opportunity to realize a premium then in the segment of the market that truly values all the other highly differentiated Mobile Mini capabilities. So that is a new thought process for the business here, and it's working extremely well.

And then as you look into 2023, once we consolidate our CRM systems, we've talked about the application of pricing technology and further customer segmentation in Storage, that's not happening yet. And underlying all of that, you do have the underlying inflation of container assets themselves and the cost basis by which new supply is going to come into the market is going to further support pricing increases over the medium and, frankly, the long term.

Scott Schneeberger – Oppenheimer & Co. Inc.

Excellent. I appreciate the color from both of you. Tim, for my follow-up, it's kind of a 2-parter, it's on the expense side. You did a nice job in the prepared remarks discussing kind of on logistics how you're covering inflationary pressures. And you all have alluded to a lot of optimization, internal optimization in logistics. Could you give us a progress report on how that's going?

And then the second part of this is just an update on Mobile Mini synergies. Don't talk about that much anymore, but I know that's a powerful driver of margin this year. So if you could just talk about how that's progressing.

Tim Boswell

Yes, on the logistics side, I'd say the area where we're seeing the most immediate traction right now is on the revenue side of that equation, actually. On the Modular side of our business, we have gone through a pretty thoughtful exercise over the last 6 months or so to standardize a lot of our delivery and setup activities across the network, so that we can more consistently predict the margin that's going to come out of those services as well as the pricing that we're charging.

We've implemented fuel surcharges across all of our divisions, and that's contributing to the margin expansion that we're seeing in that area. And yes, we do also have more operational-oriented initiatives underway, some technology-based route optimization and things of that nature, that I think will be supportive in future periods, but not a cause of the underlying strength that you're seeing in the margin right now. That's more revenue and pricing process driven, I would say.

In terms of Mobile Mini synergies, this is an interesting one, because we're obviously adding SG&A at the moment. And we've just added SG&A in Q4 and Q1. And I think about this as a redeployment of some of the duplicative redundancies that were obvious when WillScot and Mobile Mini came together. We're redeploying those resources into places like sales. And then it's new functional capabilities that, frankly, neither company had before.

I do think there is a significant opportunity in installation if this business were to go into a more contractionary GDP environment to realize substantial efficiencies based on the platform that we have today. But this is really more about positioning the portfolio for growth to support a top line expectation that's well in excess of what we would have contemplated 2 years ago.

Scott Schneeberger – Oppenheimer & Co. Inc.

Just to clarify that. So are we not really going to speak in terms of Mini cost synergies anymore because a lot of the benefit is being redeployed into top line initiatives and a strong demand environment? And most importantly, underlying, you've talked about this potential of 200 basis points of margin expansion. So just curious how we're thinking about that going forward and how we should approach it?

Tim Boswell

Scott, it's going to be difficult to dissect prospectively. What I can say with confidence is SG&A is not going to grow sequentially from where it is today. And that means that the base that we have in place at the moment is highly scalable going into the remainder of the year and into 2023. There is absolutely an opportunity to continue realizing efficiencies from our back office functions, in particular, as we get onto a single CRM. But it is going to be difficult to dissect, okay, this cost reduction is related to the Mobile Mini merger per se. We're over 2 years out from when those were all formulated.

Brad Soultz

Well, and given the pace of tuck-ins, it's almost nonsensical.

Tim Boswell

Right.

Operator

We have our next question from Kevin McVeigh with Credit Suisse.

Kevin McVeigh – Credit Suisse

Congrats. You folks are not seeing any slowdown. We keep getting the question if things slow, Tim or Brad, it might be helpful just -- you've brought so much more flexibility in the cost structure, the capital structure of the business, maybe talk about it relative to kind of the taper tantrum and then COVID a little bit, because it's a fundamentally different company.

So maybe just higher level, some of the puts and takes, whether it's capital structure. Just because, clearly, you're much better positioned to the extent there is any macro air pockets, if you would. But maybe just talk to that for a minute, if you would.

Tim Boswell

Kevin, this is Tim. I'll start, and I'm sure Brad can talk at length on this topic. Most important thing to say initially is we don't see any concerns in the leading indicators. We do watch all the same headlines everybody else does, so we'll be prepared if and when there is an air pocket, as you suggest.

The #1 thing we can do in this business to prepare for an economic contraction is to continue to drive our leasing revenue run rate. And it is going to compound powerfully through the remainder of this year, such that the run rate we carry into any contraction is going to be substantially higher than it was 2, 3 years ago. And that means that the cash generation in the business going into a period, where, to your point, we can take costs both out of the variable cost structure. Some of the SG&A that I was just referencing can easily be pared back where necessary. And then also the capital spending in the business is highly discretionary. Such that if and when we see a period like that, the countercyclical free cash generation in this business will be profound and give us an awful lot of capital allocation flexibility.

And just to help kind of give you order of magnitude, an idea of how to understand the acceleration of the lease revenue run rate, if we look at contracts in Modular delivered in the last 12 months inclusive of pricing and VAPS, we're tracking over 30% above the average rental rate in the portfolio, right? So all we have to do is hold that level of performance that we've achieved in the last 12 months. And mind you, spot rates continue to accelerate. And you've got 10% plus pricing and value-added products insulation in the portfolio already today that you would carry into any macroeconomic contraction.

So just like you saw in COVID, that's exactly the dynamic that allowed us to grow lease revenue year-over-year every quarter through 2020, despite a 20% contraction in our delivery volumes in Q2 and Q3. These are very powerful top line tailwinds, and that's the best thing we can do to position this business for a contraction.

Kevin McVeigh – Credit Suisse

That's super, super helpful. And then it sounds like you had really good progress on the transportation margin, 300 basis points. Is there any way to frame what the headwind was? Was it -- if not for fuel and kind of labor, what was that 200 basis points, maybe clearly powered through it. But any sense to kind of frame what labor and fuel was from, I guess, across the organization in the quarter from a headwind perspective?

Tim Boswell

Yes. I can give you that. Now I'll tell you what our cost per move was, and it was up about 14% year-over-year in Q1, and that's across the entire business. And that's going to be a blend of our fuel costs as well as drivers and trucks and third-party trucking that we use. But on a blended basis, if you take all those costs, divided by the number of movements that we were making, trucking was up about 14% year-over-year. And obviously, our pricing was up over 20% to more than compensate for that.

Operator

Our next question is from Stanley Elliott with Stifel.

Stanley Elliott – Stifel, Nicolaus, & Company

With the demand backdrop that you're seeing in the inflationary environment for new units, I mean, do you think we could get into a situation where utilization rates are running higher than they've normally run historically? So maybe low 70s on the Modular maybe mid-70s on Storage?

Brad Soultz

This is Brad. We're high 60s now on Modular. We know we can run this fleet as tight as 82%. So no concerns with respect to utilization being a constraint on the Modular side. And as you mentioned, it's all net-net quite supportive of continued rate progress. The Storage fleet obviously runs about 10% tighter than that. We are still landing containers. We have about 8,000 containers we're dropping into the fleet, in addition to all the very attractive M&A purchases, if you will.

Tim Boswell

Stanley, this is Tim. This is a critical point because our utilization level in Modular is actually a huge advantage now heading into the next several periods. Because we have all of the idle capacity that we need in order to grow that business organically, and we control the supply chain around direct labor and materials.

If you're trying to source a Modular unit new today into our market, you're going to be paying 40-plus percent more than you would have paid just 2 years ago. Container prices, if you're sourcing them today, have roughly doubled versus where we were in 2017 and 2018, for example. So any new supply coming into this market is going to be at a much higher basis and going to require higher pricing than, frankly, we probably see today.

So I think this business and this portfolio is extremely well positioned, both to grow volumes more competitively than anybody else in the market and also to drive incrementally higher ROIC as the pricing that we're seeing today flows through the portfolio.

Stanley Elliott – Stifel, Nicolaus, & Company

Yes. No, it certainly sets up well from all of those standpoints. And kind of piggybacking off of that, when you all kind of retrofit or refurbish a unit, have you thought any more about pushing up into some of the higher price or like A level versus B versus C, in an attempt to capture even more rate than what you would historically just because the units available for rent are fairly tight amongst your peers?

Brad Soultz

Yes. I would note on the Modular side, the new fleet we're acquiring is almost exclusively this premium product like you'd see on the cover of our investor deck, we refer to as our Flex product. It's very suitable particularly in dense environments. You can stack it up to 3 stories high, network them together and create tens of thousands of square foots of Ready to Work solutions for our customers. Those are at a pretty significant premium even to the rates I quoted on a per dollar per square foot basis, but still very attractive and compelling versus commercial real estate alternatives.

Operator

We have our next question from Steven Ramsey with Thompson Research Group.

Steven Ramsey – Thompson Research Group, LLC

I wanted to start with the run rate free cash flow hitting $500 million in the next few months even with the higher CapEx levels, and then an incremental $150 million to reach the 3- to 5-year target. This now seems just more and more conservative with such robust demand and an infrastructure bill laid on top of that and then the acquisitions. So I guess, do you view this as fairly conservative at this point? Or if not, why?

Tim Boswell

Steven, this is Tim. The way we operate is we put together plans that we believe we can execute. We quantify those plans and we give you the best sense of the targets that we think we're going to hit. I think the only question here is timing rather than whether or not the ranges that we put out there are achievable. So that's probably the bigger variable here to consider.

Steven Ramsey – Thompson Research Group, LLC

Okay. Helpful. And then thinking about kind of the change in guidance just a couple of months away, where a quarter ago, you were seeing the high end of revenue and the midpoint of the EBITDA range. It appears this dynamic is now not in play, yet the midpoint of the new guidance implies margins that are about 100 bps below maybe the old guidance. How much of that is SG&A? How much of that is new acquisitions having lower margins? Or any other inputs to consider there?

Tim Boswell

Well, the change in the guidance from late February, I guess, when we last spoke, was a combination of us knowing at the time that the leading indicators for demand were very strong. In our normal seasonal patterns, the Q2 delivery period is really the critical seasonal build in our Modular business. So that's why we typically wait for this point in the year to really formulate our views for the remainder of the year. And that's -- we had a sense for it back in February, we've got a very clear sense for that sitting here today, hence, the increase in the revenue range.

I think back to our discussion in November, and my thought at the time was maybe 300 basis points of margin expansion at the midpoint of our guidance. We think that's more like 200 basis points today. I'd say that's almost entirely SG&A driven based on some of the build as we went into Q1. And certainly, the acquisition component will normalize over the course of this year and get back to kind of profitability levels that are consistent with the rest of our portfolio. But I think that's really the bigger change relative to where we were in November.

Operator

We have our next question from Faiza Alwy.

Faiza Alwy – Deutsche Bank

I wanted to zoom out a little bit and just follow up on the $1 billion of Adjusted EBITDA that you've talked about in 3 to 5 years. I mean it looks like you're going to get at least close to the $900 million this year. And I guess I'm curious like how do you think about the business as you reach that $1 billion of EBITDA, because it sounds like you're going to get there a lot earlier than 3 to 5 years?

Brad Soultz

Yes. And we did characterize the $1 billion, even back in November, it's not an if it's when. It's a milestone that we actually felt we could achieve within 3 years. And then the framework of kind of the 7 other longer-term targets that we set out, we continue to track well towards.

Tim Boswell

And Faiza, the implications of that are really in the areas of capital accumulation and deployment, which was a key theme of our discussion back in November. So to the extent we accelerate the growth of the business and achieve that cash generation target sooner, the capital available for redeployment then grows as well. And the business just compounds faster in that scenario, whether you're looking at free cash flow per share, whatever other earnings metric you deem appropriate.

So that's really the fundamental implication. We've already deployed $1 billion, when you consider a leverage-neutral philosophy and balance sheet in the last 12 months, and those numbers will grow as the business grows.

Operator

We have our next question from Phil Ng with Jefferies.

Phil Ng – Jefferies LLC

I guess for a question for you, Tim, you raised the top line guide, and certainly it makes sense just given the momentum you're seeing in AMR growth. But embedded in that, what are you assuming on units on rent shaking out for Modular and Storage? And just given the momentum you're seeing in this business heading into 2023, is there a good way to think about it more on a medium-term basis? I've always kind of thought of it as a low single-digit volume grower. But certainly, the momentum you're seeing in Storage is quite impressive and you've seen that inflection in Modular as well.

Tim Boswell

Yes, we've seen the inflection in Modular. I think that low single-digit rate is still a good place to be just given the 3-year lease duration in the portfolio, and we're very pleased to see the inflection in Q1 and the momentum going into Q2. So I'm still comfortable at that level. As Brad mentioned, we intend to add approximately 8,000 units organically this year in the Storage business. So you can do the percentage growth math, assuming all of that is deployed at average utilization levels.

And then the tuck-in and cadence, I think, will continue, probably a bit more weighted towards the Storage side of the business, although we see opportunities across all asset classes. And if you consider our CapEx investment, even at the midpoint of the ranges that we've given you, it's still basically in line with rental fleet depreciation and PP&E

depreciation just as a proxy. So we're not really expanding the fleet organically. So some of that inorganic tuck-in activity is in lieu of introducing fleet organically into our markets.

Phil Ng – Jefferies LLC

Okay. That's helpful. And then, Tim, a question for you again. On the free cash flow side, certainly some puts and takes. EBITDA looks good. CapEx a little higher. But how should we think about free cash flow this year? I think in the past, you talked about a free cash flow margin probably get to like $430 of free cash flow [in 2022]. Is that still a good way to think about it this year? And can you remind us how much firepower you have this year for buybacks and M&A? Certainly, it seems like you got good runway on the M&A side.

Tim Boswell

Yes. It's a good question. So I mean our view of run rate free cash flow in the second half of the year hasn't really changed. Now if we execute the plan that we're talking about today, we'd enter 2023 with a much higher revenue run rate than we expected maybe 6 months ago, that will have higher EBITDA generation this year, higher CapEx generation this year, such that second half free cash flow is not materially changed based on this forecast.

So that would actually imply a lower free cash flow margin in the second half of the year, but it's a heavier growth scenario. That's kind of the beauty of how this business works. You can hit targets like that, both in growth cycles like we're in right now. And frankly, we could blow that target away in a contractionary cycle, where you're pulling back on CapEx. That's easy to do. We're not going to do that as long as we've got organic growth opportunities in the business.

And I would just direct you back to Page 24 on the investor deck. It shows you how we've allocated our capital over the course of the last year. I will say, given we're at the top end of our leverage target, there is no need to continue paying down an ABL at LIBOR plus 2.125% at the moment. So that gives us, frankly, a lot of flexibility for both M&A and repurchases.

Operator

We have our next question from Andy Wittmann with Baird.

Andrew Wittmann – Robert W. Baird & Co. Incorporated

Great. Essentially all my questions have been asked and answered, but I thought, Tim, I would give you an opportunity to talk about interest expense in a rising rate environment. What are you thinking for that line for guidance this year? Just help us understand how your ABL is adjusting to this? Because it looks like besides that, everything else is fixed.

Tim Boswell

Yes, that's correct. Our ABL is priced currently at LIBOR plus 2.125%. We typically manage around a 1-month LIBOR, which is north of 50 basis points now and likely to increase. We do have a swap of about $400 million for a portion of the ABL balance that's actually at 3%. So that is going to unwind here in the next couple of months, such that we're going to get an immediate interest savings on that portion of the ABL drawn balance.

However, that does mean that more of the ABL balance will be floating. So that is something we're actively working on and thinking about. But the immediate implication is we're going to get a little bit of an interest -- cash interest reduction. How we structure the ABL and the debt balance for a longer-term rising rate environment is something else that we're working on. But in terms of cash interest expectations at current leverage levels for the year, I think we're around about $115 million.

Operator

We have our next question from Courtney Yakavonis with Morgan Stanley.

Courtney Yakavonis – Morgan Stanley

So I just wanted to go back again to the conversation about the CapEx increase. Obviously, you increased the sales and EBITDA guidance because of the stronger environment, but it seemed like the CapEx increase was pretty 1:1 for the increase in EBITDA growth. So should we be expecting, if you do continue to have a stronger environment, see additional upside to EBITDA? Should we be expecting more of that to be flowing down into CapEx? Or was that just kind of a coincidence this quarter?

And then I also just wanted to fully understand, Tim, I think you mentioned earlier that the CapEx was primarily replacement CapEx, not growth CapEx. But it is going to be spent on that Flex product. So just trying to understand how -- what the impact of that CapEx increase can be on the fleet? Because I think that Flex product commands a much higher rate than the legacy product.

Tim Boswell

It's an astute observation, Courtney, because the CapEx that we're deploying today is more capital efficient than that which was deployed 5, 10 years ago, which tends to drive the depreciation in the business. So when I draw a parallel between the 2, I'm saying that we're replacing our net book value effectively on an organic basis. Those investments, whether it's Flex or value-added products or targeted refurbishments across our network, they are very capital-efficient investment. So a portion of that is going to drive growth and a portion of that is replacement. I can't give you a precise breakdown.

The other thing I would just remind you of in the CapEx number itself, there is an inflation component there. If you think about traditional building materials and direct labor that are used in the refurbishment of Modular asset, I mentioned that container prices have roughly doubled since 2017 to 2018 periods, so there's an inflation component there that's above, frankly, that we would have talked about in November. I think those are the types of inputs, however, that can stabilize and in some cases, come down with building materials. So I don't see that as necessarily a permanent change in the overall capital requirements of the business.

Courtney Yakavonis – Morgan Stanley

Okay. Got you. And then, Brad, you alluded to the plans to pilot the Storage VAPS in May, and your customers sound very excited about it from your initial discussions. I think you guys rolled out the GLO product end of last year. So can you just help us, any early reads just based on the rollout of that product or how quickly you'd expect the uptake of the Storage VAPS product?

Brad Soultz

First of all, back to the ground level office rollout. So you're right, we began rolling that out late last year. Just a few pilot branches, if you will. As I mentioned in my prepared commentary, we now have about 80% of the ground level office volume capable of being supplied with the kind of Ready to Work furniture solution we've got on the Modular side. The uptake there is tracking along with our expectations. And frankly, the uptake is a bit faster than we saw in the same transition several years back on the Modular side.

We're super excited, as I mentioned, with respect to the Storage container side of the VAPS opportunity. We're not expecting much in terms of contribution this year. But think of kind of 2 phases. In May, we'll roll out kind of a basic bundled offering, if you will, lights, basic shelving, ramps to get in, et cetera, locking systems. And then we'll follow that with the kind of the premium proprietary racking system and offering that I mentioned actually in the prior call, in 2023.

Operator

Our next question is from Brent Thielman with D.A. Davidson.

Brent Thielman – D.A. Davidson & Co.

Most of my questions have been asked as well. I guess just a couple. One, your fleet sales both new and used were down pretty considerably this quarter from last year, and I recognize that's a strategic focus. But is there anything more to it, I guess, in this first quarter, whether it's association with certain markets or customers you're deemphasizing, anything like that?

Tim Boswell

No, Brent. Sales by their nature can be a bit lumpy period to period. To your point, it's not a core focus commercially for us. And given the utilization levels that we're running at in Storage and in the U.K., we have effectively said don't sell anything, for example, just given how well that business is performing. Same thing in Tank & Pump. We're running at 77% OEC utilization as of this morning, which is record levels. Business is performing great.

And on the Modular side, we're obviously heading into a period of unit on rent build, where we're much less likely to want to sell an idle viable Modular building. So I'd expect it to remain at fairly depressed levels for the foreseeable future.

Brent Thielman – D.A. Davidson & Co.

Perfect. And then just a follow-up. In the U.K., trying to reconcile the different trends or I guess KPIs you're seeing in Modular versus Storage, I guess, specifically units on rent. Can you say anything at all about the economy? Is it just a nuance specific to your business?

Tim Boswell

That's a good observation because there's been a unit on rent mix shift in favor of containers and a little bit of runoff in the ground level office Modular fleet there. There was some COVID-related demand on the Modular side of the business that began tapering in Q4 of last year. We've actually seen that start to rebuild a bit here to start 2022, albeit in other end markets. That was really the only notable change in the U.K. business was a little bit of COVID-related runoff in the Modular unit on rent. Offset, frankly -- more than offset by core demand in the container side of the business. And frankly, both assets are performing quite well as we enter 2022.

Operator

Thank you. We have now reached the end of today's call. I will now turn the call back over to Nick.

Nick Girardi

Thank you, Vanessa. Thank you all for your interest in WillScot Mobile Mini. If you have additional questions after today's call, please contact me. Thank you.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect.