TRANSCRIPT

Q3 2022 Earnings Conference Call

WillScot Mobile Mini Holdings Corp. (Nasdaq: WSC)

November 3, 2022, at 10 AM ET

WILLSCOT MOBILE MINI PARTICIPANTS

Brad Soultz, Chief Executive Officer

Tim Boswell, President & Chief Financial Officer

Nick Girardi, Sr. Director of Treasury and Investor Relations

MEETING PARTICIPANTS

Andrew Wittmann, Robert W. Baird & Co. Incorporated

Brent Thielman, D.A. Davidson & Co.

Faiza Alwy, Deutsche Bank

Ronan Kennedy, Barclays Bank PLC

Philip Ng, Jefferies LLC

Scott Schneeberger, Oppenheimer & Co. Inc.

Sean Wondrack, Deutsche Bank

Stanley Elliott, Stifel, Nicolaus, & Company

Steven Ramsey, Thompson Research Group, LLC

TRANSCRIPT

Operator

Welcome to the Third Quarter 2022 WillScot Mobile Mini Earnings Conference Call. My name is Michelle, and I will be your operator for today's call.

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 Third 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. First, I'd like to take a second to thank our colleagues that supported the successful divestiture of the Tank & Pump segment during this quarter. Following the divestiture, we are a unique pure-play Modular and Storage solutions provider of unparalleled scale with a higher quality revenue mix.

The consistent compounding growth of our core segments and the successful divestiture of the Tank & Pump segment during the quarter, together, reduced leverage from 3.7x in Q2 to 3.4x in Q3 and comfortably within our target leverage range of 3 to 3.5x net debt to EBITDA. The capital from the divestiture is already being redeployed, consistent with our capital allocation framework, including reinvestment to Modular and Storage segments, continued M&A and returns to shareholders.

Shifting to our third quarter 2022 performance, which was again stellar and demonstrates our team's commitment to delivering value to our customers and our shareholders. Our strong commercial performance continued as volumes, pricing, and value-added products or VAPS, were all up year-over-year. To that end, value-added products average monthly rate in our North America Modular segment increased 24%. Modular units on rent in the North America Modular segment increased 4% and prices were up 19%, inclusive of VAPS and storage units on rent in the North America segment increased 28% and prices were up 27%.

We offer a differentiated value proposition, which has continued to drive our rate performance and capture volume in 2022 and will continue to do so going forward. Given the resulting 31% in year-over-year revenue growth and the sequential stabilization in SG&A, we generated $251 million of adjusted EBITDA from continuing operations in Q3. Adjusted EBITDA margin was 41.6%, which expanded 270 basis points year-over-year and 140 bps sequentially. As such, we're tracking towards about 200 basis points of margin expansion for the full year 2022 relative to the prior year. We remain convicted as ever in our ability to continue to compound growth and deliver outsized returns.

Switching gears to demand, which continues to be broad-based and robust across our end markets other than some softening in Canada as well as U.S. residential builders and developers, both of which were discussed during our Q2 call. Other aspects of the diverse portfolio are effectively mitigating these 2 more minor contributors. The Architectural Billing Index has remained positive since February of '21, which combined with our customer sentiment, supports our confidence in continued robust nonresidential demand well into 2023.

We are already actively servicing major reshoring and onshoring mega projects. These are large complex long-duration projects which require a correspondingly complex, Modular and Storage solutions. With our scale and sophistication, we're uniquely positioned to compete for these projects, which began even before the CHIPS or Inflation Reduction Acts were passed.

Infrastructure spending will also continue to be a tailwind. We're just now beginning to see project activity that we can trace back to the federal investment. For example, we're supporting offshore wind projects along the Atlantic Coast, partnering with our customers to provide office, break room, storage, and operational space as they develop wind turbines. We are uniquely positioned to support these projects, which typically have a broader geographical requirement for ‘Ready to Work’ Modular and Storage solutions.

And internally, we'll be focused on improving our cross-selling capabilities to drive volumes into 2023. Our CRM harmonization, which upgrades our 2 existing instances of Salesforce.com into a single instance and is on track to be completed in Q1 of 2023. This project will enable automated lead sharing, enhanced digital marketing and customer targeting, and improved sales rep productivity taking our industry-leading data and technology advantage 1 step further and giving us yet another lever with which to drive volumes irrespective of end market conditions.

We continued to progress the deployment of value-added products across our Mobile Mini branded fleet. Our commercial and product management team is actively transforming how we go to market in the storage business, transitioning our mindset from just delivering a box to supplying portable, secure workspace and warehouse solutions. As a point of reference, our current North America storage average rental rates equal less than $1 per square foot per month for a portable secure workspace or warehouse that’s dropped where you want when you need it with our best-in-class logistics capabilities.

Our ground level offices in the third quarter were already delivered with over $100 of average VAPS value per month with customer adoption increasing towards that which we see in comparably sized units in the Modular segment. And early feedback with respect to our VAPS initiative for portable storage units is extremely encouraging with locks, lighting, and basic shelving, all beginning to increase in penetration. Given our scale every $1 of VAPS value per month on portable storage units represents approximately $2 million of incremental annual revenue.

Based upon this unique storage value proposition, which is further enhanced as we extend and expand VAPS penetration, we're confident in continued storage rate growth for years to come as we've been experiencing in our Modular business.

So all in, we're confident in the trajectory upon which we enter 2023, and we continue to invest aggressively given, first, we see objective sources of strength in our end markets as evidenced by the ABI, customer sentiment, onshoring and reshoring of industrial manufacturing, and tailwinds from infrastructure spending. Second, we have the strongest leasing run rate in our history with rapidly accelerating free cash flow. Third, we're demonstrating undeniable progress executing across our $1 billion of idiosyncratic growth levers. And finally, we are methodically executing our programmatic tuck-in acquisition strategy to further compound growth.

Now while our current outlook demand remains robust, as Tim discussed during the Q&A during our Q2 call, we have an established playbook to grow our resilient portfolio through any macroeconomic environment. We effectively execute that playbook every 90 days across all geographies and major products as per our zero-based CapEx and operations planning process.

Finally, I'll touch on guidance before Tim takes over. The midpoint of our prior adjusted EBITDA full year guidance range was $920 million, including the expected contributions from the recently divested Tank & Pump division. The midpoint of our revised full year guidance for adjusted EBITDA from continuing operation is still $920 million. In other words, 2 quarters of outperformance in our Modular and Storage segments is offsetting the full year of earnings from our former Tank & Pump division.

As such, implied Q4 adjusted EBITDA from continuing operations is $257 million to $277 million, which, along with the $251 million of adjusted EBITDA from continuing operations in Q3 indicates that we're already at the $1 billion adjusted EBITDA run rate that we set in our November 2021 Investor Day with a superior revenue mix and a laser-like focus by our team on the Modular and Storage operations.

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

Tim Boswell

Thank you, Brad, and good morning, everyone. Page 20 shows a high-level summary of the quarter. Before I jump in, I'll remind everyone that the results from the divested Tank & Pump segment are reported as discontinued operations in Q3 and all prior periods. Where appropriate for purposes of comparability, we added back Tank & Pump results for certain non-GAAP metrics and footnoted those adjustments accordingly. But our goal is to be as transparent as possible about the run rate of our continuing operations and we're incredibly excited about where we're headed.

The business is compounding predictably and ahead of our expectations. We are achieving strong growth across all of our leasing KPIs of volume, rate, and value-added products and supplementing that organic growth with accretive high-volume tuck-in acquisitions to drive leasing revenue up 31% year-over-year. The powerful compounding of lease revenue growth, coupled with sequential stabilization of selling, general and administrative expenses is creating sustainable upward pressure on margins with adjusted EBITDA margin of 42%, up 270 basis points year-over-year and rapidly accelerating profitability at the net income and EPS levels. This is translating into predictable cash flow growth with free cash flow of $83 million in Q3, up 20% sequentially from Q2, while supporting a record level of organic reinvestment.

We closed 4 acquisitions during the quarter, continuing our programmatic tuck-in strategy while building our pipeline for 2023. And we are using our balance sheet to support our strategy, reducing leverage to 3.4x net debt to adjusted

EBITDA, while reducing our economic share count by 6.4% over the last 12 months. All of our initiatives are working in concert to drive growth, return on invested capital, and free cash flow per share.

Return on invested capital increased 360 basis points to 16% in Q3 and 14% over the last 12 months. And given the undeniable progress executing our $1 billion of growth levers as well as our programmatic tuck-in strategy, we see multiple pathways to more than triple free cash flow per share over the next 2 to 4 years. We are a serial compounder, we are compounding at scale, and our pace of compounding is accelerating into 2023.

Page 21 lays out revenue and adjusted EBITDA for the quarter. From continuing operations, revenue increased 31% to $604 million and adjusted EBITDA increased 40% to $251 million, with margins expanding 270 basis points. A few points quickly on the margin expansion, as I think Q3 sets the stage for what we can expect in the near term.

First, Q3 was our strongest quarter for modular deliveries since 2019, which, combined with inflationary pressures created a variable cost headwind in the business at the gross margin level. That said, variable leasing costs were more than offset by very strong execution across our logistics function with delivery and installation margins up 870 basis points year-over-year, driven by our ability to pass through transportation costs, in-source more transport activity, and optimize costs.

At Investor Day, we talked about our logistics value driver, and you are seeing those results in real time. And lastly, we stabilized selling, general, and administrative expenses in the third quarter as we said we would. We front-loaded certain SG&A investments in Q4 2021 and the first quarter of 2022 to support a strong growth year, which we have delivered. And now with our ERP reporting and analytics, all in place and with a full year of tuck-in acquisition activity under our belt, we're in a place now where SG&A from continuing operations, excluding stock comp and other discrete expenses actually declined sequentially from approximately $140 million in Q2, to $135 million in Q3. And I would expect just normal inflationary increases from here.

So while our results have been largely top line driven since the merger, heading into 2023, we are seeing opportunities to be more efficient with our variable costs and our capital expenditures. We see opportunity to build upon or at least sustain the gains in our logistics function and we see SG&A efficiencies, all of which will support margin and free cash flow expansion in 2023 and in which we are quite confident.

Turning to Page 22. Net cash provided by operating activities grew by 61% year-over-year, grew by 12% sequentially from Q2 and are compounding predictably. Organic capital expenditures remained elevated, driven primarily by modular refurbishments and additional portable storage units that we landed and rented in Q3. While higher than we forecasted, these investments are demand-driven, supporting the strongest modular delivery volumes since 2019 and nearly 15,000 new storage units this year that are all being absorbed immediately by our customer base and we're operating at nearly 90% utilization in that product class.

That said, capital spending is tapering rapidly as we head into Q4, the vast majority of our seasonal storage volume has been delivered, and this is a seasonally slower time for modular deliveries. So I expect net capital expenditures will drop meaningfully into Q4 and then remain at lower levels into Q1 until we assess the seasonal ramp-up of our nonresidential construction markets in 2023. This isn't a commentary on our demand expectation for next year. Rather, it simply reflects the fact that we have the fleet we need to operate for the next 6 months or so.

Free cash flow and free cash flow margin have increased steadily each quarter since Q4 of 2021 despite the elevated demand environment this year. And I expect these metrics will inflect towards our $500 million free cash flow run rate as capital expenditures normalize entering 2023.

And while it's premature to give guidance, we will reassess the demand outlook as we enter 2023. Our base case is that capital expenditures will likely revert from approximately 30% of available capital in the last 12 months back closer to our longer-term target of 25% for purposes of 2023, which would suggest a meaningful reduction next year in dollar terms.

Turning to Page 23. The continued compounding of our cash flows and the proceeds from the Tank & Pump divestiture combined to reduce leverage to 3.4x net debt to adjusted EBITDA, comfortably within our target range of 3x to 3.5x. I will note, this is the lowest leverage with which we have ever operated our company. With the predictability and forward visibility into our reoccurring cash flows and over $1 billion of capacity available in our ABL revolver, we are operating from an exceptional position of strength to execute our strategy and we can invest aggressively wherever we see compelling opportunities in our business.

In Q3, we invested $127 million in net CapEx, $105 million in acquisitions and $197 million of repurchases of our common stock. As of September 30, our weighted average interest rate was 4.75% and our annual cash interest run rate was approximately $142 million.

Interest costs will obviously be a headwind through the course of 2023, though are manageable. And while our weighted cost of capital and hurdle rates are higher, they have not changed our view of relative capital allocation priorities given the rates of return that we can achieve in our business.

Page 24 lays out those priorities and our performance over the last 12 months. We generated $1.4 billion of capital to deploy on a leverage-neutral basis over the last 12 months and inclusive of the divestiture proceeds. And we continue to allocate that capital consistent with the framework we laid out at our 2021 Investor Day. In the right-hand chart, organic capital expenditures are running at 31% of total capital, so higher than target given the strong demand environment this year.

As I mentioned earlier, it's easy to see CapEx reverting back to target in 2023, and we can, of course, go lower than that target if demand moderates. We have invested $300 million on regional modular and storage tuck-in acquisitions, which is in line with target and aligns neatly with the $323 million in proceeds that we received from the Tank & Pump divestiture. So we effectively reinvested all of those divestiture proceeds at a comparable blended multiple back into our North America Modular and Storage segments where we have superior lease durations, better unit economics, more diversified industry exposures and greater opportunities for growth.

And lastly, we utilized our $1 billion repurchase authorization to deploy the remaining $562 million of surplus capital which reduced our economic share count by 6.4% over the last 12 months. This is exactly the right formula to drive sustainable growth and compound returns over time.

Turning to Page 25. We have raised our full year 2022 guidance for our continuing operations to $2.22 billion to $2.27 billion of revenue and $910 million to $930 million of adjusted EBITDA. If we hadn't divested the Tank & Pump segment, adjusted EBITDA guidance would be $955 million to $980 million, which would be approximately a 5% increase to our prior guidance at the midpoint. This represents a $40 million to $55 million raise to our adjusted

EBITDA for our continuing operations and it is attributable to outperformance just in the second half of the year. So it's really a $100 million increase to our expected run rate. This obviously more than offsets the divested Tank & Pump EBITDA and suggests that the pace of compounding in North America Modular and Storage has accelerated significantly.

The midpoints of our range is implying an adjusted EBITDA margin of 41% for the year, which would be up approximately 200 basis points for the full year, which is consistent with what we have said since February. And this implies a margin in excess of 43% in the fourth quarter, which makes sense and is driven by the normal seasonal slowdown of modular work order activity and the normal seasonal increase of storage demand in our retail end market.

Finally, turning to Page 26. Heading into 2023, our run rate is accelerating, and we have a superior revenue mix in a streamlined portfolio. For purposes of Q4, total revenue is likely up just modestly on a sequential basis as steady compounding of rental revenues is offset by seasonally slower transportation revenues. As I mentioned, net CapEx and variable costs will moderate with the seasonal slowing of modular deliveries, which will result in sequential margin expansion with EBITDA margins up approximately 200 basis points for the year, in achieving a $500 million free cash flow run rate as we enter 2023. All of this is consistent with what we discussed a year ago at our Investor Day. And given the track record of execution by our team, I believe that we have upside across all of the key value drivers. We're growing the business. We're driving margins and return on invested capital, and we are deploying capital productively, all of which will drive consistent compounding returns over time.

With that, Brad, I'll hand it back to you.

Brad Soultz

Thanks, Tim. Our team is dedicated and excited to finish 2022 on strong footing as we shift our focus to 2023. I wish all of you listening today continued safety and good health. This concludes our prepared remarks. Michelle, would you please open the line for questions?

Operator

Our first question will come from Andrew Wittmann with Baird.

Andrew Wittmann – Robert W. Baird & Co. Incorporated

Great. I was just wondering if we could get the latest sense that you guys are having out of the order book. It's either at the end of the quarter or maybe at the end of October, what you're seeing there just in terms of some of your more cyclical end markets, recognizing that spring season is kind of where the better information is, but I thought having some intel about what you're seeing kind of real time on the order book would be helpful.

Brad Soultz

Yes, Andy, this is Brad. I'm happy to start that. Storage effectively we're sold out. As Tim mentioned, we're running 90% utilization in that segment running into the hot season. So -- we've got all the orders we could possibly handle.

And the constraint there is really our fleet. On the Modular side, the order book is in line today with that of prior year, which, again, I think is -- as a reminder, last year, we saw strong demand actually heading into what's been a very productive 2022. So is by that in line with last year. But as you noted, it's really going to be February of next year, which is when we begin to see that Modular order book begin to grow from a kind of normal seasonal practice.

Operator

Our next question will come from Scott Schneeberger with Oppenheimer.

Scott Schneeberger – Oppenheimer & Co. Inc.

Guys, with regard to CapEx, I understand the seasonal slowdown and you've been very active this year to fuel the demand. Just curious, high level, how you approach, and this is particularly on containers because you had the seasonal pick up here and Brad, you just mentioned being sold out. How are you viewing having capacity going forward? It's not a bad thing to have excess capacity even if a portable storage container just sits on the yard. But curious about as we get to 2023, how active might you become again? Is it really just, hey, we'll play it by year in in February, or it sounds like you've added a lot of containers here this year. Is that something that is just get as many as we can. And are you sourcing China? Or are you sourcing from ports?

Brad Soultz

Yes. This is Brad and Tim will jump in. We're at 90%. We're a little higher in utilization certainly than we've been historically this time of year. It's okay, heading into the seasonal peak, we can push ourselves towards 100% for that short duration, right? We'll see those units start to come back right after the New Year's.

My expectation is demand is robust and will continue, and we'll be expanding the storage fleet next year accordingly. We just are in a place where we don't have to do it in the next month or 2. As a reminder, we've expanded the fleet through all the legacy WillScot containers that have rolled over, all the acquisitions and then significant purchases at record levels this year of fleet, which has primarily been one-trippers from China, Scott.

Scott Schneeberger – Oppenheimer & Co. Inc.

Great. Appreciate that. And just as a follow-up, the D&I margin was quite impressive in the quarter. Just harkening back to Investor Day, you talked about the logistics optimization as a, I think, $25 million to $50 million long-term EBITDA opportunity. Where are you along that journey? And just I think you mentioned earlier, you're seeing upside to a lot of your objectives. Just on that 1 specifically, if you could address where you are.

Tim Boswell

Yes, Scott, this is Tim. And I think one of the things I'm most proud about the team as it relates to the delivery and installation margins is it's not like we're in a stable cost environment, right? I mean our cost per move across both the Storage and Modular businesses, it's up almost 30%, and that's consistent across both of those. So we're doing a couple of things on the cost side. We are definitely in-sourcing more of that activity on the Modular side. We're still north of 50% of our moves in Modular are third party, but it is gradually coming down as we can in-source more trucks and drivers.

We've also executed a couple of different acquisitions of transportation and setup crews with whom we already did a significant amount of business. So that is another manner in which we are in-sourcing activity. We have consolidated fuel cards and things of that nature coming out of the merger. But obviously, fuel costs are up and costs in general are up. That said, we are clearly passing that through a more standardized approach to delivery and installation pricing. And this is something that we're looking at religiously, week by week across every branch in the network. And you can tell by the margin expansion that the revenue side of the equation is up much more than the cost side of the equation. So it's really a multifaceted effort. And I would just say that we've got more attention on that revenue stream and the underlying cost structure than we've ever had in the past. And we're absolutely well on our way to eclipsing those targets that we set for the Logistics value driver at Investor Day.

Operator

Our next question comes from Manav Patnaik with Barclays.

Ronan Kennedy – Barclays Bank PLC

Kennedy on for Manav. Obviously, strong results in some have expectations when you're at exceeded the $1 million laid out a year ago today. What was – and cognizant that it may be everything, what where the key drivers of that? And was it a function of an element of conservation or not having the visibility that you typically have at the half year into the order book and the remainder of the year. If you can just comment on those drivers. And any changes to the other targets from the Investor Day.

Tim Boswell

Ronan, this is Tim, and you're a bit muffled in terms of your question, but I think you were generally getting at where are we kind of in line with our expectations that we had to start the year versus where we may be quite clearly ahead. So I'll just start with the fundamental leasing KPIs of volume, price and value-added products.

So in Modular, volume, very much in line, low single-digit organic growth for the year, supplemented with some tuck-in acquisitions with a comparable order book going into next year. So we kind of check the box. We're at expectation there. Ahead of expectations, certainly on pricing and value-added products and services. I am extremely excited by the product management organization that we have today and the pipeline of opportunity that we see in value-added products not just for 2023, but we are phasing product introductions into 2024.

So I'd say, ahead of expectations there in modular VAPS and ahead of expectations, I think, across the board in the storage segment. Certainly, organic and acquisition-based volume growth in storage is ahead of where we thought we would be. Pricing, I think we're still trying to figure out where the ceiling is in storage. And we have -- are kind of in line with our VAPS rollout expectations for storage and are seeing very encouraging results there in ground level offices. Brad mentioned, we're already delivering those units north of $100 per unit per month that could double as we roll forward into 2023 and 2024.

And we're starting to move the needle a bit in storage container value-added products as well. So really, if you look at our 3- to 5-year operating ranges on Slide 15 of the investor deck, you net all that together, we're running well ahead of the revenue CAGR that we put forth as we go into Q4, we'll be at the upper end of the EBITDA margin range that we talked about. We've eclipsed the return on invested capital range, at least in the most recent quarter. We're comfortably within the leverage range. We're growing into the free cash flow range as we get to that $500 million free cash flow run rate, the free cash flow margin is down, right? And that's just a function of a heavy investment year this year, but no concerns about getting back into that range over time. And as I said in my prepared remarks, multiple pathways to triple free cash flow per share in 2 to 4 years.

So I'd say across the board, we're feeling quite good. I already talked about the logistics value driver. We're on our way to eclipsing that one as well. And all of this means that the business is compounding at a pace that's faster than we thought a year ago and means our run rate going into 2023 is well ahead of where we thought we would be.

Ronan Kennedy – Barclays Bank PLC

That's very helpful and apologies for the bad connection here. You've previously articulated a clear articulation of the recession and the levers that form a very strong downturn playbook. It sounds like aside from the softening in Canada, U.S. resi builders and you're not really seeing much weakness. But can you just remind us what happens in terms of pricing and other key metrics as a downturn or weakness materialize and what they would look like in varying recession?

Tim Boswell

Look, we're sitting here today as we have now for over a year, with spot rates inclusive of VAPS in our Modular business that are over 30% higher than the portfolio average. And we have maintained that 30% spread since I believe it was Q1 of 2020 -- 2020, when I think we first disclosed that to the public. So we have grown the absolute average rental rate that we're reporting in our financial statements, and we've maintained that 30% spread, which means all we have to do from a pricing standpoint is maintain the spot rates that we've already achieved. If we just maintain those rates, the average rental rate in the portfolio in Modular will converge roughly 10% a year to that plus 30% level.

We have a similar dynamic in terms of pricing in the Storage business. So that gives the portfolio an awful lot of insulation. And as you know, the volume side of our business just does not move quickly up and it doesn't really move quickly down either by virtue of that 34-month lease duration in Modular and 30-month duration in Storage. And to the extent you do get a softening of demand, that's when the business is at its most cash-generative posture, right?

So if I say -- if you just think back to 2021, we were still in a relatively conservative growth mode, given that we were coming out of COVID and not investing at -- certainly not the level today. CapEx was at $250 million, right, versus pushing $375 million to $400 million in the current guidance. So there is a very significant capacity in this business to moderate capital spending and it's entirely demand-driven and we start from zero with that capital allocation process every 90 days. That frees up a lot of capital allocation flexibility to de-lever, to be more aggressive with acquisitions, to repurchase the stock, and we revisit those alternatives quarterly.

Operator

Our next question comes from Faiza Alwy with Deutsche Bank.

Faiza Alwy – Deutsche Bank

Great. I wanted to talk about the new sort of commercial approach to storage that you talked about. And sort of what's the early result related to that? And maybe how your cross-selling initiatives are part of playing into that new approach?

Brad Soultz

Yes. I think it's most evident in both the rate and the volume performance in the storage segment. If you look at the year-over-year volume growth, certainly, that's supported about half from M&A, but the other half is significant organic growth. And that's certainly more than markets have expanded. So we've been gaining share through cross-selling, modular wins over to storage certainly.

We've seen the rate progress in storage effectively with no VAPS yet right, other than the GLO performance I mentioned before. So you've got very, very strong pricing, which is based upon applying the practices we've always applied in Modular. It's leveraging our unique logistics capability and associated value prop. And there's certainly an aspect of product positioning where we've shifted from a good, better and best.

Looking forward, we're going to further extend that from, hey, we've just delivered a container or a box to this is a turnkey storage solution with lights, lock, shelving and all of the above, if you will. And that's when you really realize effectively what we have on the Modular side in place is a turnkey ‘Ready-to-work’ solution for the customer.

So maybe we're well along the journey. You can see it in rate in Storage, which is driven exclusively by core DSR. And what we're excited about as we look 3 to 5 years ahead, is really seeing that further compounded with the addition and expansion of VAPS.

Faiza Alwy – Deutsche Bank

Great. And Tim, just on SG&A, those -- this SG&A as a percentage of sales improved quite significantly and you had sequential improvement there also -- and just in terms of dollars, like how should we think about that as we look ahead to 2023, it's been impressive. I'm curious what's the -- how sustainable that level is.

Tim Boswell

Right. I think there's always going to be what I'd call a normal level of inflation impacting SG&A. And I think that's probably the best assumption using today's base as a starting point. We obviously had more significant SG&A additions in Q4 and Q1 in particular, Q4 of last year and Q1 of 2022. I don't expect those types of step changes in the future. So I think we're at a good base right now.

The sequential gains or reductions in SG&A from Q2 to Q3 were kind of the expected runoff of largely third-party expenses. As you can imagine, coming out of the integration, we've had some consultants, we've had contractors, and we've also had duplicative third-party spend in the business, which, over time, naturally -- we naturally shed. And that's really what drove the sequential change in Q3.

I do think we have additional variable cost opportunities, both in the cost of leasing side of the business as well as in SG&A as we go into 2023. So I do think there are some opportunities there to mitigate inflationary pressures as we go into 2023. But I don't expect anywhere near the increase that we put in place intentionally to start 2022, just given that we were positioning the business for a much more substantial growth trajectory than we had previously.

Operator

Our next question comes from Steven Ramsey with Thompson Research.

Steven Ramsey – Thompson Research Group, LLC

Maybe to think about North America units on rent and utilization there. How many of those units that are not on rent are project ready and are prepared to go on projects with the value-enhancing features from previously done CapEx this year?

Tim Boswell

Steven, this is Tim. We, as a general rule, try to keep roughly 10% of the idle fleet in rentable condition. This isn't a hard and fast rule, but as we go through the 90-day capital allocation process, that's roughly the buffer that we think we need in modular to meet immediate demand. Right? We go through that 90-day capital allocation process where we look at our branches' forward demand over the next 90 days, based on the nature of that demand, we try to find the most cash-efficient way to service that using our supply base.

So in general, that's -- we're allocating capital to kind of maintain that 10% buffer. The rest of the fleet is perfectly fine. It's just that there's no point in investing in it until utilization gets to the point where you need to dig into it, right? And so that's exactly the process that we go through every 90 days. And that's what drives the modular refurbishment capital in the business. And because we've been growing the business organically this year, that refurbishment spend has gone up.

Steven Ramsey – Thompson Research Group, LLC

Okay. Helpful. And then to follow on the CapEx line of thought with the run rate free cash flow hitting $500 million in the midst of elevated CapEx this year. Can you maybe clarify the CapEx dollar commentary moderating next year and with the excess free cash flow, do you expect more buybacks or is the pipeline still sizable enough for both?

Tim Boswell

Okay. In dollar terms, guidance is $370 million to $410 million for this year, right? So I kind of mentioned 2021 was down below the $250 million level. So I think there are 2 kind of guideposts that you can kind of have in mind. One is a very heavy growth year in terms of the 2022 number. The 2021 was a moderate growth year coming out of COVID. So those are 2 recent goalposts, I guess, that we have.

Now going into Q4 and Q1, these are seasonally slower periods of time in the modular business. So going back to the comment about the 90-day process, there is less need to invest in that refurbishment activity in Q4 and Q1. When we see the order backlog and the demand outlook as we get into second half of January and first half of February, that's when we'll start allocating refurbishment capital in the modular business for the seasonally stronger Q2 and Q3 period. So that's very much in line with kind of the $500 million free cash flow run rate to go into next year. You've already eclipsed $1 billion EBITDA run rate as Brad talked about. And as you kind of taper CapEx into the next 2 quarters and likely moderate for the purposes of 2023, I think you're very much in that ZIP code.

Operator

Our next question comes from Philip Ng with Jefferies.

Philip Ng – Jefferies LLC

Brad, I guess, volumes have been really strong in storage. Part of the pitch, I think, when you made the merger with MINI, there was an opportunity to kind of really cross-sell and gain share. And to kind of get there just given how you're constrained from a capacity standpoint, you had to do M&A. Just give us an update on how to think about the progress you're making on that front and the opportunity going forward?

Brad Soultz

Yes. Thanks, Phil. Yes, as I mentioned on a prior question, if you look at the year-over-year volume growth in storage, that's about half underpinned by M&A, which is just smart on all dimensions. And the other half is organic. That's certainly been supported by what I've kind of referred to as the manual phone-a-friend cross-selling. So it's literally the Mobile Mini storage rep and the WillScot rep collaborating within each territory that they operate. And again, that's certainly been effective, but it's only most effective with largest customers and largest projects. What we're excited about as we look into next year is we'll harmonize the two Salesforce.com CRM instances into one, and we'll be able to automate all of that.

So at a transactional level, if we receive an immediate inbound request for a modular unit or storage, our general assumption is whatever that lead it has initiated with respect to, both products are needed, right? And we kind of use that 1 to 3 ratio that we mentioned in our Investor Day, if there's 1 modular unit there's somehow probably 3 storage units around it.

So we look through in 2023, in first quarter, we'll get the combination behind us, and then we'll really be able to leverage the power of the tool to really automate all of that lead generation, if you will. So I think that will really begin to pay further dividends later in 2023. And as I mentioned in my commentary, it's another lever, if you will, looking into 2024 and beyond that would let us grow share irrespective of end market environment that we find ourselves in.

Philip Ng – Jefferies LLC

And have supply chain loosen enough where you're able to get units to kind of meet that demand if you need to?

Brad Soultz

Sure. Yes, we've been able to source containers throughout this, costs us a little bit more money to acquire them and move them, but we've had no issues with that. And certainly, as Tim mentioned, we've got adequate idle fleet on the Modular side to grow for several years coming.

Philip Ng – Jefferies LLC

Got you. And then from a capital deployment standpoint, I mean, it's great the balance sheet is in a great spot today, cash flow coming through. But the macro backdrop are actually getting a little murkier here. So Brad, Tim, how are you guys thinking about capital deployment? I mean your comfort level in doing more deals in this backdrop, how you're thinking about paying down debt versus returning cash to shareholders? Any color would be helpful.

Brad Soultz

Yes. It's really not an either/or, right? With this cash flow, it's all of the above. If you think of the framework, I kind of think of it as a clock dial you started at 12:00. The first thing we'll do is fund all the organic CapEx the business needs and the markets present. You move on around. When you're acquiring these tuck-in storage and modular businesses at the levels we are, you've got an immediate spread to where we trade. You take out a turn or 2 of cost synergies and then you've got significant commercial synergies beyond that. You'll do that all day long. That pipeline looks robust. We've done 15 to 20 deals since the ERP cut over, we'll keep doing that. And then the balance kind of that other half goes back to shareholders. So again, no change in that regard. And certainly, no change with respect to our outlook.

Operator

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

Brent Thielman – D.A. Davidson & Co.

Great. Brad or Tim, just wondering how dilutive all the acquisition activity you've done here over the last 12 months is on the reported rental rate increases you're showing today?

Tim Boswell

Brent, this is Tim. It's a hard one to estimate. And in the grand scheme of the portfolio, I mean, the acquisitions aren't contributing a lot. If you think about just the guidance increase since Q2, maybe $5 million of that EBITDA increase is coming from our recent M&A and the rest is just organic compounding of the core businesses. So I wouldn't point to a significant embedded increase from the tuck-in acquisition. You certainly have an embedded increase just by virtue of where spot rates are today across the entire portfolio. That's really the powerful tailwind that's in the business today.

And thinking back to Q4 and Q1, you did have some margin dilution in the business attributable to M&A and some of the resources we put in place to support that, but we've been at it for a year now, right? And so we've kind of eclipsed that, and we have no such margin pressure resulting from M&A going forward. And I think that supports kind of our margin expansion thesis going into 2023 and beyond.

Brent Thielman – D.A. Davidson & Co.

Okay. And then just the second question back on storage. And I don't want to take anything away from you in terms of the initiatives you're putting in place to take the business to new levels. But look, I mean, the KPIs this quarter are just extraordinary. And I'm just wondering if you can comment on any sort of specific supply side or demand side dynamics, in particular, in that asset class that sort of amplify the returns you've been able to achieve here?

Brad Soultz

Probably the 1 aspect I'd point to, Brent, is the effect of the seasonal container pricing that you were starting to see late in the quarter, which historically has been dilutive and it's really no longer so. In fact, it's shifting to the other side of the ledger. Other than that it's a continuation of what started almost 3 or 4 quarters ago.

Operator

Our next question comes from Stanley Elliott with Stifel.

Stanley Elliott – Stifel, Nicolaus, & Company

A quick question on the storage. I mean you mentioned seasonally kind of slowing down after the holiday period. Do you think we're in a different dynamic heading into '23 to where utilization could still be as strong as it is and not really seeing a seasonal drop off given some of the inventory challenges that you're seeing at some of the retailers.

Tim Boswell

Yes. Stanley, this is Tim. I think that's absolutely a scenario we're thinking about. Seasonal -- we started getting seasonal orders in the middle of Q2 this year and started seeing those deliveries much earlier than would be historically typical. It would not be a huge shock if they stayed on rent longer. And we're having exactly those types of conversations with our customers such that the retail sector really shouldn't necessarily be a seasonal business for us, right? There is a customer need all year long. We see that in the store renovation side of the business.

But look, they have space requirement needs from the moment a good hits the port all the way to the store and the end consumer, right? So that's a situation where our national accounts team is sitting down with the larger nonmall-based retailers and having those conversations and think about, okay, how can we go deeper into that relationship and have this be kind of core reoccurring annual business rather than seasonal. And that is going to be an interesting transition I would expect over the next couple of years.

Stanley Elliott – Stifel, Nicolaus, & Company

And then kind of switching gears. You haven't really talked too much about the U.K. business. It's holding up quite well. But we continue to hear concerns more so about Europe and the market conditions over there. Has the successful divestiture of Tank & Pump made you think any differently about this asset within the portfolio? Or just kind of how you're thinking about it and maybe even expectations for it going forward on the operations side?

Tim Boswell

Yes. This is Tim. Operationally, you look at the KPIs, stated in local currency terms and the business is performing extremely well. So I've been very happy with delivery activity in the division, units on rent are up mid-single digits. Pricing on the container product has been pretty consistent this year.

And I think we've got meaningful growth opportunities in that business, both in the storage and the accommodations fleet going into 2023, recognizing the macroeconomic backdrop is tougher in Europe than certainly we have here. So we're keeping that in mind in terms of not getting too far over our skis from a CapEx standpoint. But fundamentally, it's an incredible business, #1 competitor in the Storage business over there and with room to grow.

Operator

Our next question comes from Sean Wondrack with Deutsche Bank.

Sean Wondrack – Deutsche Bank

Nice to see that you step down in net leverage this quarter to 3.4x. Just start with a couple of housekeeping items. Can you tell us -- and I'm sorry if it's in the packet, what is pro forma revenue and EBITDA for Q4 '21?

Tim Boswell

Sean, let's see if we can pull that up for you. I am going to say that pro forma, excluding Tank & Pump for 2021 was approximately $488 million of revenue and EBITDA was $199.5 million of revenue.

Sean Wondrack – Deutsche Bank

I appreciate that. And then can you just remind us again, what is maintenance CapEx now pro forma the divestiture of the Tank & Pump segment?

Tim Boswell

Well, remember, we reinvested those proceeds in the core business. I still stick to that $175 million range. To the extent maintenance CapEx related to Tank & Pump has been divested, we've certainly replaced that in the Modular and the Storage fleet.

Sean Wondrack – Deutsche Bank

Right. You're certainly getting the returns to support that. Just my next question has to do with the infrastructure bill itself. It also kind of rolls into the recent Inflation Reduction Act. But what is the company doing commercially to best position itself to capitalize on the infrastructure spending?

Brad Soultz

I'd just point to the example I mentioned in my prepared commentary, Sean, with respect to that specific chip manufacturing facility where we're supporting with a very unique capability, both the construction of the chip plant as well as kind of the early engineering team, if you will, from the manufacturer itself.

And you can take that same example and apply it to data centers, which we've been servicing for 3 to 5 years in a row. Solar, wind turbine, power, et cetera. So I mean those projects were already materializing. The way I think about the CHIPS Act, the Inflationary Reduction Bill, any further stimulus, all it really will do is extend the robust demand we're already seeing.

Tim Boswell

So Sean, keep in mind, if you look at Page 10, our industry exposures, we're already doing business with all of the customers that are going to benefit from those types of spending bills. So any general contractor in North America is already a customer. We don't have to do anything differently. When they get pulled into an infrastructure project, we're going to get pulled into that project. Manufacturing, we've talked about for like the last several quarters, we're already being pulled into those types of projects, either directly from the owner of the project like a Samsung or the general contractor who's working on that project on behalf of the project owner.

Think about energy and natural resources, any utility in the country in the U.S. or Canada, already a customer. We're seeing wind farm and solar projects across the country. So we're getting pulled in there. And then certainly, anything on the institutional side, education, government, health care, those could be sectors that are benefiting from the spending as well. So we don't really have to do anything differently other than be in constant contact with our largest customers, which we're already doing.

Sean Wondrack – Deutsche Bank

Great. That's helpful. And then it's actually -- it's funny you pointed this out. Just on that same slide, it shows exposure to homebuilders and developers at about 9%. I know that's a broad term. It could be single-family and multifamily. I was just kind of curious if you could comment on sort of how that segment has been going and what your outlook is kind of there?

Brad Soultz

Yes, it's down moderately. Our exposure there is more to multifamily and large track homebuilders. Again, it's a very small percentage of what we do. It's already baked into our outlook and not expecting any recovery and acceleration soon nor do we need it.

Sean Wondrack – Deutsche Bank

Right. That makes a lot of sense. Thank you very much. I appreciate your help.

Operator

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

Nick Girardi

Thank you, Michelle. 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

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