Alta Equipment Group (NYSE: ALTG)

Overview

ALTG is a heavy construction & material handling equipment distributor. It has 5 main revenue streams: new and used equipment sales (51.5%), parts sales (16%), service revenues (13.6%), rental revenues (11%), and rental equipment sales (7.9%).

The company operates in different geographic regions, in each of which it has an effective monopoly protected by the manufacturer who authorizes them to distribute their product. As noted by Scott Miller of Greenhaven Road Capital, the company operates a razor blade business model; it sells equipment at low gross margins for the benefit of its parts & service businesses, which are able to capitalize on wear-and-tear on this equipment years later.

My investment thesis centers around the companies ability to generate far greater cash flow, distorted financial data making ALTG seem over indebted/masking its true potential for cash generation, and the stock being misunderstood as cyclical. It is my belief that at the current price (~$6.57), ALTG represents a base upside of over 59% as it reverts to a ~8.5x EBITDA multiple.

Investment Thesis

(1) Distorted cash flows in its rental business mask its true cash generation potential.

Alta's 2023 financial statements regarding the rental business states that sales totalled to $130M and that expenses were $62M, suggesting that the rental business provided ~$68M. However, the "Net transfer of assets from inventory to rental fleet within property and equipment" is labeled $180M. Since Alta takes in rental equipment from inventory, this means that the rental segment took in almost $123M in cash. It is clear from ALTG's price (down 47% YTD) that the effect of this cash has not been considered by the market; over the next few quarters, the cash should start showing up on the company's cash flow statements, providing significant downside protection.

The current rental rate market dynamics and the company's history with the rental business also mask its positioning within ALTG's larger business model. Alta has spent upwards of $198M on acquisitions post-COVID - this makes it harder to see the rental business' cash generation potential. Currently, utilization rates throughout the rental segment are low. How? I mean, rental revenues are increasing, right? Well, it's because rental rates remain high right now, and while management would usually be selling equipment at a loss to maximize utilization, they are taking advantage of current rates While this is a good move by management, this makes it seem as if the company (which also appears to be heavily indebted) is very cash flow negative. As rates wear off, rental sales will only contribute to higher cash flow (which will help improve the company's perception as it screens as being *extremely* indebted). Also, as discussed in the next paragraph, ALTG is currently in the midst of moving to a more service/parts revenue mix. The value of the acquisitions will become more and more clear as they will allow the company to pursue organic growth, only further adding to (3).

ALTG's power to generate cash is overlooked as a whole - as mentioned previously, there are essentially 5 businesses under the Alta name. The company runs a razor blade business model - the new/rental equipment sales are lower margin businesses which act as razors, while the service & parts sale segments are the higher margin business. There's also a rental segment which also helps prop up the parts sale business. Since ALTG only went public a bit over 4 years ago, the interlinked nature of these product lines isn't too visible in the balance sheets, masking the true cash generation power which Alta has but hasn't really revealed yet. Lastly, the equipment distribution industry as a whole is pretty consolidated. Most manufacturers set a cap on the number of distributors by area, and have previously shown distaste for PE backed companies - this gives Alta a pretty big runway to operate & consolidate as it has been over the last 5 years. The lack of competition here is another possible boon to cash generation.

(2) Alta's debt is overstated leading it to screen poorly.

ALTG screens poorly as more indebted than it actually is on trading screening services like FactSet & CapIQ, all because of its floor plan facility. The impact of the facility also shows up in the invested capital, deflating its ROIC. These floor plans exist to finance new inventory and are provided primarily by manufacturers. As of Q2 '24, upwards of $298M was listed as debt in the new equipment section under this facility. I do not view this "debt" as equivalent to actual debt for two reasons: for one, it does not have a contractual maturity date in case the equipment is not sold, and the loans are non-recourse to Alta, so (if the company is unable to sell the new equipment) it can be returned (at cost) to the manufacturer (lender).

My view on this is pretty straightforward, but regardless of whether you view floor plan facilities as debt or not, you can probably agree that it's better than "normal" debt.

(3) Alta is less cyclical than it is perceived to be and is more closely tied to non-residential construction volumes than it is to interest rates.

As interest rates were raised in July 2024, ALTG declined ~35% over the following days. While interest expense and residential construction would benefit from lower rates, I believe that Alta's success is more clearly tied to manufacturing & infrastructure spending. The Infrastructure Investment & Jobs Act (IIJA), which provides $1.2 trillion for transport & commercial infrastructure spending, will be a more relevant driver of future growth. The business is also linked to e-commerce trends through their exposure to warehouses. Contrary to seeming market perception, Alta has pretty much no exposure to residential construction on a direct level; as the fed raised rates in late 2022/early 2023, revenues stayed flat/grew at expected levels, while the decrease in non-residential construction volume had a more adverse effect on the business as it plateaued in mid-current 2024.

Even though the company has been around for ~40 years, most data starts off from when it went public (2020). However, in 2009, ALTG's service business was down only 10% as its two largest customers (both auto companies) were facing bankruptcy. There isn't a *lot* of information about this out there, but it only shows how ALTG is less cyclical than it seems.

Also, as discussed in (2), its equipment sales segment only exists to prop up the higher-margin service & parts businesses, which are the main drivers of earnings and are far less cyclical (as they are *not* discretionary).

Catalysts

(1) Continued earnings beats & increased cash flows.

This pretty much speaks for itself. As investors see cash from thesis point (1) begin to pile up on the cash flow statement, more investors will see the truth behind ALTG's cash generation power. Also, as ALTG continues to show stability in this high interest rate environment, investors will review their perceptions of the company as cyclical, which could drive a multiple rerating.

(2) Increased analyst coverage.

ALTG has a market cap of just over $215M and so it's pretty expectedly undercovered by analysts. As previously mentioned, it screens poorly on platforms like FactSet & CapIQ so increased cash on its balance sheet will help improve optics which could lead to investors taking a closer look at its debt and leading the stock to stop screening like it's depressed (management's focus on deleveraging also adds to this). The extremely limited analyst coverage (all of which being neutral to negative) means that even slight improvements in ratings & additional coverage can greatly boost visibility.

(3) Higher margins resulting from the changed revenue mix.

After Q1 '24 results, the stock fell as 30% largely due to comments about gross margin reversion in the new equipment sales segment (which in itself is only 15% of gross profit). Increases in parts & service revenues are likely in the near future (equipment sales have been progressing rapidly over the past few years with an almost 40% CAGR) meaning that the business is due for higher margins and more recession-resilience (which seems to be a key reason why the stock is currently priced so low).