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TRANSCRIPT

Q2 2021 Earnings Conference Call

WillScot Mobile Mini Holdings Corp. (Nasdaq: WSC)

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Phil Ng, Jefferies LLC

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TRANSCRIPT

Operator

Welcome to the Second Quarter 2021 WillScot Mobile Mini Earnings Conference Call. My name is Kathleen, 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, Director of Treasury and Investor Relations. Nick, you may begin.

Nick Girardi

Good morning, and welcome to the WillScot Mobile Mini Second Quarter 2021 Earnings Call. Participants on today's call include Brad Soultz, Chief Executive Officer; and Tim Boswell, 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 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, and thank you for joining us today. I'm Brad Soultz, CEO of WillScot Mobile Mini. I want to start by extending my gratitude to our entire team for their strong performance in yet another quarter. I also want to thank our customers for their continued support. We appreciate and value your business, and take pride in delivering on our commitments to you.

Before I get into this quarter's outstanding results, I'm excited to announce that we'll be holding an Investor Day on November 8 in NASDAQ in Times Square. We look forward to seeing many of you there.

Our second quarter results demonstrate accelerating trends across our diversified portfolio and corresponding superb outcomes. Delivery volumes improved in all of our segments, while rates improved at record pace. We also achieved a major step in the WillScot Mobile Mini's maturation process by successfully migrating the legacy WillScot business on to Mobile Mini's SAP platform in May. In turn, I'm pleased to raise guidance again this quarter after our increase last quarter.

Our latest outlook indicates a 9% to 12% revenue growth and a 10% to 13% adjusted EBITDA growth relative to 2020 on a pro forma basis, which again is a function of accelerating KPIs across our business and implies a stronger run rate for 2022. Our strong free cash flow continued with a margin of 20% over the last 12 months and supports continued execution of our capital deployment strategy as we've repurchased 251 million of our shares over the last 3 quarters.

Starting on Page 8. The progress that we saw in March for deliveries continued throughout the second quarter. We increased deliveries across all 4 products and across most of our end markets on a year-over-year basis. In construction, a strong Architectural Billing Index, or ABI, of greater than 50, which began in February and has continued each month since, confirms a significant rebound in activity since March 2020 and indicates growth in nonresidential starts. This is a 9- to 12-month positive leading indicator, and we expect this trend to continue in the near and medium term. I'll note that where we go, our customers go and our customers are building everything from warehouses to data centers to the Virgin Hyperloop in Las Vegas.

Commercial and industrial had the largest increase in deliveries this quarter, up 49% year-over-year. There's certainly more opportunity than risk in this segment. The biggest mover in the bucket was arts, media, hotels and entertainment, which we increased deliveries to by over 40 -- 80%. Retail store remodels returned to more normal levels as evident in the storage deliveries. This activity is augmented by the return of special events as COVID restrictions relax. You can see great examples of these contracts on Page 14 with units for media at a Major League Baseball All-Star game in Denver and temporary complexes for production of an upcoming miniseries in HBO. Other customers include Facebook, where we're helping to build data centers, and Amazon where we provide flexible warehousing for inventory, distribution and infrastructure.

Energy and natural resources, which is a smaller component of our customer base, also saw rising deliveries. This segment correlates with both GDP and energy prices, both of which were strong throughout the quarter. And we'll continue to monitor the passage of infrastructure bill in the United States. However, for our 2021 outlook, we do not assume any significant impact from incremental spending by Congress. As I've stated previously, the current draft of the infrastructure bill would provide tailwinds across almost all of our end markets. And keep in mind, it will take roughly 12 to 18 months following passage before shovels hit the ground on any of these infrastructure-related projects. So we'd expect any associated tailwinds to occur in 2022 and beyond. Regardless with or without further stimulus, we expect a continuation of strong market demand.

Page 15 breaks out deliveries by segment. Modular space deliveries in our North America Modular segment increased in the quarter at a rate of 12%. As we expected in our outlook beginning earlier this year, deliveries accelerated in the second quarter, as the economy improved and what are typically stronger seasonal months for project starts. We expect this trend to continue in the third quarter.

Deliveries in our North America Storage segment increased 42% year-over-year and now exceeded 2019 levels. This rebound reflects strong demand across all of our end markets that I previously discussed. In the second quarter, following our successful ERP migration, the North America Storage segment begin delivering all container deliveries. So the North America Storage segment is managed in both legacy Mobile Mini portable storage as it previously had as well as the legacy WillScot portable storage units in most of our geographic markets. Consolidating all of our container rental activity into the legacy Mobile Mini branch network will have numerous benefits in the form of improved customer service, operating efficiencies, logistics and utilization, among others.

Turning to Slide 16. In our North America Modular segment, the increase in deliveries resulted in stable modular space units on rent sequentially from the first quarter. As a function of our long-duration leases, which average 34 months, in North America Modular, unit on rent growth will lag delivery volume. So stabilization is the first step on the path towards volume growth, and I'm highly encouraged by the order and delivery activity in this segment. And at 68% utilization, we have ample inventory with which to grow without thinking of any near-term fleet expansion.

Portable storage and modular units on the bottom left in the North America segment increased 6% sequentially from the first quarter, 10% year-over-year and compared to 2019 average unit on rent increased 6.5%. A testament to the strength we're seeing across end markets. North America Storage recovered faster than North America Modular. Thanks in part to the return of the store renovation in our retail, wholesale and trade end market. You can see an example of these types of remodels on page -- back on Page 14, where we delivered 17 storage containers for a major retailer remodel, which is representative of the services we provide to most major non-mall-based retailers.

Shifting gears to rates on Slide 17. North America Modular average monthly rental rates increased nearly 20% year-over-year in the second quarter, smashing the previous record of 15%. Roughly half of the $132 year-over-year increase was driven by continued VAPS penetration on newly delivered units in the last 12 months. The remainder of the increase came from core pricing with a larger-than-normal impact from the return of shorter-duration events relative to Q2 2020.

Looking back on the last 18 months, our markets and pricing were expanded rapidly heading into the pandemic. As discussed in prior quarters, the growth trajectory for both pricing and VAPS on new deliveries slowed a bit in Q2 and Q3 of last year, largely mix related. We're now seeing a continuation and further acceleration of the pre-pandemic trajectories as price and VAPS performance has been phenomenal. Our VAPS monthly rate on new units delivered in the last 12 months, as depicted on Page 10, is up 31% to $360 per unit per month. So we're now setting our sights higher in this area.

Rates also increased dramatically in our North America Storage segment up 10% year-over-year in the second quarter. Our team is very focused on optimizing rate for new storage activation and the focus is evident in our results. In parallel, we're starting to provide value-added products in our ground-level office fleet, and we've identified a VAPS offering for containers, which is now under development.

Our U.K. segment continued its brilliant progress with another tremendous quarter. Rates are up 40%. Units on rent are up 13%, and adjusted EBITDA is up nearly 80% year-over-year. We're thrilled with our progress. And our Tank & Pump segment is also inflected strongly as end markets recovered. However, we're clearly outperforming the market and capturing share here.

Our OEC utilization is into the mid-70s, which is now above 2019 levels. Revenue and EBITDA are up year-over-year in Q2. So while outperforming our peers in Q2 2021, our Tank & Pump business is now also contributing to our increased run rate, which is fantastic. We have very exciting technology road map coming together, which will further [underpin] and support these results in all segments for coming years.

And before I pass the call over to Tim, I want to spend some time on our ERP migration. As I mentioned previously, we migrated the legacy WillScot business on to Mobile Mini's world-class SAP platform on time earlier this quarter. We went live in SAP across the entire company the first week of May. So we've now been operating on a single ERP platform for 3 months, a year of planning, several months of intensive training, change management led up to that successful cutover.

Many of our colleagues worked days, nights and weekends to make this transition a success. And for that, we have our gratitude and appreciation. No ERP transition is easy, but our team's dedication, meticulous attention to detail and collaboration across the various segments resulted in a minimally disruptive implementation. There's really been no change for the legacy Mobile Mini branch as we've been operating SAP there for years, but it's been a massive change for our legacy WillScot branches. And while we're still learning how to efficiently navigate the new system, refining our reporting and analytics, it hasn't distracted us from serving our customers, as you can see from our delivery, pricing, and value-added product trends.

This successful system migration is a critical enabler on 4 fronts. First, it enables the $50 million cost synergy premise in the merger between WillScot and Mobile Mini. But frankly, this is pretty straightforward. Second, it enables us to mark up on the next phase of our technology road map, which in the near term will include refinement of inventory management, harmonization of our CRM platform, development of stronger business intelligence and data science capabilities.

Third, now that the migration is complete, I'm excited to redirect the team to our host of multiyear growth levers that continue to expand. Price optimization, value-added products, cross-selling, operation efficiencies, each and together represent opportunities in all 4 of our operating segments. And fourth, we'll be able to even more seamlessly integrate any acquisitions going forward, continuing our strategy to compound robust organic growth with highly accretive M&A.

We executed the cutover flawlessly, and I'm humbled to be associated with such an outstanding team. We are one a very small group of few great companies that can use the terms on time, success and SAP in the same sentence.

With that, I'll hand it over to Tim.

Tim Boswell

Thank you, Brad, and good morning, everyone. Jumping to Page 19, it presents a high-level summary of the quarter. While it is last on the page, our top priority in the quarter, as Brad mentioned, was to successfully migrate the legacy WillScot operations into Mobile Mini's SAP platform. We accomplished that consistent with the time line we established about 17 months ago when we announced the merger. I won't repeat Brad's observations other than to say thank you again to the team. This was the highest risk undertaking related to the merger, so to have it largely behind us clearly increases our confidence in the outlook.

More importantly, the ability to execute a project of this complexity across all functions, both in the field and in our shared service centers, proves the capability of this organization when we collaborate. And frankly, it creates a huge competitive advantage as we redeploy these resources to other commercial and operational value drivers.

While all of that was going on, our operating results were outstanding. Leasing revenues increased 18% year-over-year, with acceleration across all leasing KPIs and in all segments. And I'll remind everyone that this is on top of growing our lease revenues every quarter last year on a pro forma basis. So our platform is not simply recovering from the pandemic, we are compounding growth through the pandemic, and not many companies in our space can say that.

On a pro forma basis, adjusted EBITDA increased 14% over the prior year to $176 million. Adjusted EBITDA margin contracted 130 basis points to 38.1% versus prior year on a pro forma basis as we expected and discussed on the prior 2 quarterly calls. Accelerating deliveries drove a higher mix of lower-margin transportation revenues and increased variable maintenance costs, which is playing out pretty much as we expected. And we still expect margins will expand approximately 200 basis points year-over-year as we get to Q4 and head into 2022.

We generated $82 million of free cash flow during the quarter. In the 12 months since the merger, we've generated a 20% free cash flow margin despite the integration cost headwinds. The completion of our ERP migration will bring integration costs down and allow us to start realizing other cost savings. So our free cash flow trajectory is very much on track.

We maintained the leverage at 3.7x this quarter, as we repurchased $135 million of common stock and warrants, mostly in conjunction with the secondary offering from TDR Capital. Our confidence in the outlook as well as the ERP migration obviously impact our view of capital allocation. Since closing the merger last year, we've reduced our economic share count by 2%, including the elimination of the 2015 warrants, which we announced in May, simplifying our capital structure.

And the outlook itself continues to improve, both as the markets pick up and as we gain traction from all of the organic initiatives that we've been organizing over the past 12 months. EBITDA will be between $710 million and $730 million for the year, up 10% to 13% versus 2020 and putting us on an exciting trajectory heading into 2022. Altogether, it was a fantastic quarter with a lot of reasons to be excited about the future.

Page 20 details some of the other financial metrics from the quarter. We delivered $461 million of revenue, up 18% on a pro forma basis. Again, revenues were up in all segments. So the run rates across the board heading into the second half of the year are quite strong. We generated $176 million of adjusted EBITDA, which is a 14% year-over-year increase, again with growth in all segments.

We ended up with approximately a $23 million increase in our variable leasing costs impacting gross margin this quarter relative to prior year due to the increase in delivery volumes. About half of that increase was in the modular segment, but we saw the same dynamic in all segments, and it's a normal mechanic of the business in periods with significant volume fluctuations. And we, of course, benefited from this variability in our cost structure last year when volumes were down.

Normalizing for these cost fluctuations, flow-through to EBITDA would have been north of 60%. So it's easy to see that the long-term margin expansion trend is on track. This dynamic will continue in Q3. Adjusted EBITDA margins should be down year-over-year and flat sequentially as delivery volumes accelerate into Q3. Then as deliveries normalize in Q4, we still expect 150 to 200 basis points of margin expansion in the fourth quarter headed into 2022, which is consistent with our commentary for the past 6 months. So the business performed exactly as we expected, actually a little better relative to our original outlook with continued acceleration of commercial KPIs and strong cash generation, which you can see on Page 21.

Cash from operations grew both year-over-year and sequentially, in line with our lease revenue and EBITDA trends. I think this was a company record actually. Net CapEx increased sequentially to support the normal seasonal increase in delivery activity. You can see free cash flow margin in the bottom right has been in a predictable range for the last 12 months and average 20% over that period. So while the metric will fluctuate a bit mostly due to CapEx timing, we have long-term upside here through growth, synergy realization and the completion of the integration.

Turning to Page 22. We maintained leverage at 3.7x while repurchasing $135 million of share equivalents. The largest driver of the repurchase activity was the secondary offering by TDR Capital. Over the last 12 months, we've reduced our economic share count by about 2% to just over 230 million shares as of June 30 using the treasury stock method. I'll note that had we redirected funds used for share repurchases in Q2 towards deleveraging, our leverage ratio would have been 3.5x, which is consistent with our leverage target for year-end and readily achievable.

As a reminder, we have $249 million remaining in our share repurchase authorization. We also executed some tactical refinancing in the quarter, which reduced our weighted average interest rate to 3.8%, and our annualized cash interest to $98 million. Given our predictable growth trajectory, the balance sheet is in great shape, and I don't see any constraints from a capital allocation standpoint.

Speaking of the strong growth trajectory, Page 23 shows the revised outlook for 2021. We now expect revenue between $1.8 billion and $1.85 billion, with adjusted EBITDA between $710 million and $730 million. This is a 2% increase at the midpoint relative to our previous outlook, driven simply by the improving leasing fundamentals. Again, margins are on track to expand 150 to 200 basis points in Q4 as variable costs normalize and should expand again meaningfully in 2022. So no change to those expectations. Our CapEx range increased slightly to reflect the strong market environment and fleet constraints in certain markets. We are planning to increase the spend sequentially into Q3 and our guidance assumes that Q4 will be above prior year levels.

And lastly, I'll point out that tax expense in Q2 implied a 54% effective tax rate compared to the 25% to 27% range that we would typically expect. This was driven by an $8 million noncash expense due to the statutory rate increase in the United Kingdom, which went from 19% to 25%. So we had to revalue our deferred tax liability in the U.K. and recognizing additional $8 million of noncash expense. Again, no material cash impact from that over the next couple of years. For the 2021 fiscal year, we expect our effective GAAP tax rate will normalize to the 27% to 28% range. So this had no material change to our long-term cash tax outlook, although it created some noise in Q2.

As I stated on previous calls, on Slide 24, our capital allocation framework is unchanged. We have excellent visibility in our business and numerous organic growth levers which we are completely focused on now that the ERP migration is complete. We are on track to deliver to less than 3.5x by the end of 2021 and could have easily achieved that target ahead of schedule in Q2. Completion of the ERP integration de-risks our outlook and unlock synergy opportunities, bringing us an important step closer to the $500 million free cash flow milestone, which we envisioned 17 months ago. And that, in turn, gives us more confidence to use the balance sheet for M&A and repurchases.

On the 1-year anniversary of our merger, I am more excited than ever about the progress that we've made as well as the portfolio of commercial and operational value drivers that we are beginning to execute. I and our team look forward to seeing you all at our Investor Day in New York on November 8 and discuss in all of that in more detail.

Brad, back to you.

Brad Soultz

Thanks, Tim. We're frugal and smart with the capital we employ. We can transact quickly on M&A. And now that the ERP system is up and running, we can add other businesses to our platform with ever-increasing efficiency. I expect our continued execution to support shareholder value creation for years to come. 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

Your first question comes from the line of Scott Schneeberger from Oppenheimer.

Scott Schneeberger – Oppenheimer

I guess, guys, I noticed a big step-up in North American portable storage container pricing. And just curious, rationale and the road map for that going forward. And if you could speak to the core containers versus GLOs in that category?

Brad Soultz

Yes. Scott, this is Brad. I mean what you're seeing there is, if you remember, historically, Mobile Mini has been driving 3% to 3.5% rate CAGR. As we've discussed before, that was almost exclusively driven by GLOs. So what you're seeing now is continuation of that GLO performance with a step-up and also now continued improvement in new rates on all containers themselves. So we're simply deploying the playbook we've used for years.

As far as the road map, as we've noted before, we're still yet to deploy all the rate optimization goals that we have on the modular and VAPS side to that portfolio nor have we really significantly begin to see traction from VAPS with either ground-level offices or the storage units. As I mentioned in my remarks, we have now started to deliver the GLOs with the furniture bundling that WillScot had in place, and that's starting quite well as well as we've architected, if you will, a VAPS portfolio for storage containers themselves, which is now under development, and I expect we'll be rolling out in 2022.

Scott Schneeberger – Oppenheimer

Excellent. And then I'm just going to stay from my follow-up on the pricing theme and swing it over to North America Modular. And 19.7%, obviously, the biggest increase we've seen in a while. And then Tim mentioned earlier on, maybe in a different context, but this wasn't necessarily against an easy comp. That was a very robust number. So just -- I think you've said in the past, Brad, hey, we can go out a few more years with the double-digit increases with regard to rate and VAPS contribution, but we seem to have achieved a new tier here. So just if we could speak to what would be reasonable expectations for the coming quarters in this category?

Tim Boswell

Scott, this is Tim. I'll give that a shot. I'm not sure I would extrapolate 20% too far out into the future, but we're extremely pleased with how rates and value-added products are progressing in North America Modular and in the U.K. as well. I think they're actually leading the charge from a year-over-year rate growth perspective.

In value-added products and services, I don't know if we called it out, but on Page 10, our delivered rates so to the contracts in the last 12 months, the value-added products reoccurring revenue is up 31% year-over-year. So we have clearly seen an acceleration of adoption, both with our sales force and our customers. And we've maintained that $130 million plus organic revenue growth opportunity that we've been talking about for some time now, meanwhile growing those delivered rates.

So that's a big contributor. It's driving about 45% of the year-over-year increase in AMR in North America Modular. The remainder of the AMR increase in North America Modular is coming from core rate increases, which we continue to push. There is a mix element last year. We had virtually 0 short-term special events in our portfolio just due to COVID. And we are seeing some of those start to come back. So I think there is a bit of a mixed component this year that's contributing to that 19.7% number. But fundamentally, under the hood, we've got very good underlying trends, and we expect to continue pushing it.

Scott Schneeberger – Oppenheimer

Just a quick follow-up on the short term. Is that anything that's going to disrupt your 34-month average? Could that pull it down? Or that's just -- it's just a little above normal trend and nothing to get concerned about there?

Tim Boswell

No, it's not that it's an above normal trend. It's that they didn't happen last year, right? This is normal reoccurring business that we would service every year mostly in Q2 and Q3. Think about PGA golf tournaments anywhere in the country, NASCAR races, music festivals, community fares, those types of things. It's a normal part of our business, just typically shorter duration. And we do have duration-based pricing at least in the modular side of the business. That's a technique that we may have opportunity to test and pilot in other segments, just as one example of the kind of cross-pollination of commercial best practices that we're looking at.

Operator

Your next question comes from the line of Kevin McVeigh from Credit Suisse.

Kevin McVeigh – Credit Suisse

Congratulations as well. Brad, Tim, you spent a lot of time on SAP. Is there incremental potential synergies as you work through that process? And then more importantly, I guess, as it relates to M&A, does it give you more opportunity on the M&A side? Just any thoughts, I guess, on the M&A strategy given that you've worked through SAP. And then just sort of related to existing synergies as well.

Brad Soultz

Yes. I mean we've been pretty successful with M&A over the last 4 years and seamlessly integrating acquisitions. This will just make it quicker and easier, right? We now have the SAP platform. A lot of the companies that we would be interested in will have both storage and office. So it really allows us to be even more swift, if you will, on that front.

The ERP, as far as cost synergies, yes, we definitely expect incremental operating efficiencies. I pointed out on previous calls, Mobile Mini had been expanding EBITDA margins with not a lot of growth, frankly, and that was largely due to synergies they were realizing efficiencies as they really refine their model with SAP. So we expect the continuation of that as we refine our reporting and analytics, as I mentioned in our prepared remarks.

Tim Boswell

Kevin, the only other thing I would add, this is Tim, is that the completion of the SAP migration is really an enabler that then allows us to get on with the rest of our technology road map, which is really the most exciting part of this journey, I think, from the perspective of our team and call out 2 big ones. The harmonization of our CRM and the harmonization of our customer data, all of our transaction data historically, we have got the biggest repository of transaction data in North America for the markets that we serve. And that is a huge competitive advantage. And we are actively recruiting business intelligence capabilities, data science capabilities, pricing capabilities, on our team to take advantage of that.

And the other thing I'm very excited about is virtually overnight by virtue of moving into SAP, we've started a journey down the path of a more sophisticated perpetual inventory management system for the modular side of the business. So if you think about cost containment, being more efficient with our inventory, being more efficient with our value-added products, that's something that we're going to be spending a fair amount of time on going into 2022. So those are just 2, I think, very tangible examples about where we can now focus our time with the SAP migration complete.

Kevin McVeigh – Credit Suisse

And just to follow up on that point, does that give you an opportunity to maybe increase the utilization overall? Or would you still expect kind of peak utilizations to be in that [normal to high]?

Tim Boswell

I think both of those projects are opportunities for us to drive returns. So whether it's utilization or pricing or being more efficient with the balance sheet, we're focused on driving growth and returns.

Kevin McVeigh – Credit Suisse

Got it. And then just one quick follow-up, if I could. It seems like the seasonal business has been flexing up nice. How about some of the more COVID-related demand you had? Has that kind of been as expected, extending out a little bit? Or any thoughts on that? Because it seems like last year, there's a little bit of a hedge on that. But given the revenue trends, is it like maybe the seasonal or it's coming back and the COVID-related work is kind of the same? Is that a fair way to think about it?

Brad Soultz

Yes, it's fair. I think as we've mentioned on previous calls, as demand for COVID testing and vaccine dissemination ebbs, we're just seeing recovery across the other end markets.

Operator

Your next question comes from the line of Justin Hauke from Baird.

Justin Hauke - Baird

So there was a question earlier on the pricing in portable storage. I guess I wanted to drill into that a little bit more because you guys talked about how the VAPS on the GLOs have driven a lot of that. But if you strip that out, 10.3% in portable storage here, it looks like on the base units that they were up 5%, 6% as well, and that had been kind of flattish. So is there anything that's changed in the way that you're pricing the core units without the VAPS on the GLOs? Or just how should we think about pricing there?

Brad Soultz

Yes. And I apologize if I confused in my prior response. This 10.3% exclusively core pricing. We've started to implement VAPS for the ground-level office, but you're just beginning to see that in the numbers. You've got the 3.5% CAGR that Mini has been delivering for years. That was almost exclusively driven by ground-level offices, that's continued and accelerated. And now you're seeing new rates for containers also start to pull that up.

So I shouldn't say exclusively core pricing, but this is predominantly a core pricing play thus far is simply doing what we've been doing and what we always do and that's optimized rates on new deliveries. And what excites us going forward is we will, over time, see further benefits from expanding penetration of VAPS on ground-level offices. And then as I mentioned before, we've engineered a VAPS portfolio, if you will, for containers which is just under initial development. And as I mentioned before, think of that as a 2022 benefit. And this is an opportunity, I think we'll talk about more when we're together at the Investor Day in November.

Justin Hauke - Baird

Okay. I appreciate the clarification on that. I guess my second question is just on the margins in the modular space area specifically. I know you guys have talked about how there'd be some pressure from putting more deliveries out here in 2Q and 3Q. But the volumes were actually kind of flattish, and you got so much pricing. So I guess, were there a lot of returns to or other things that were kind of variable cost increases that weighed on the margins there as an offset? Anything that we should think about for 3Q and 4Q on the margin trajectory for modular space as well?

Tim Boswell

Justin, it's Tim. So units on rent in North America Modular were sequentially flat from Q1 to Q2. So by definition, delivery volume equaled return volume for the most part. Deliveries did accelerate 12% year-over-year, although not to 2019 levels, and we expect them to sequentially increase again going into Q3. So you always have to think of unit on rent as very much a lagging indicator.

In our original guidance for the year, we expected modest modular volume growth by the end of the year, and that requires several quarters of year-over-year delivery growth in order to then have the entire portfolio turnover to drive unit on rent growth. So that's all you're seeing here is the impact of 3-year lease duration on the portfolio, and it turns over very predictably. So there really were no surprises in Q2 from our perspective. Delivery volumes picked up. It's the delivery volume that will drive the variable maintenance cost and some selling costs. We saw that margin compression as we expected on a pro forma basis in Q2.

I'd expect EBITDA margins to stay sequentially flat into Q3, which will still be down year-over-year. And then when you get to Q4, our Q4 delivery volumes last year were getting pretty close to normal. And so if we're at normal again this year, that means there's no year-over-year noise. And you'll see that margin expansion again in the range of 150 to 200 basis points. So this is a very predictable portfolio. It's rolling forward really as we predicted with a little more pricing upside than we originally forecasted for North America Modular.

Operator

Your next question comes from the line of Ross Gilardi from Bank of America.

Ross Gilardi – Bank of America

Tim, you just answered the question. So I don't know if there's any more nuance to my question, but I'm still scratching my head on this, too. I mean you just got 20% pricing in your core business. You got material acceleration. Demand is picking up, and your margins are down year-on-year. It's just -- I don't know. I still don't totally get these buckets of costs that are coming back into the business. I mean if volume is improving, I get that there's variable costs associated with that, but why are margins down?

Brad Soultz

Ross, keep in mind, last year, we took massive costs -- variable costs out of the business, right, post-COVID, right? We stripped almost all of the variable cost out in the second quarter, both on the Mini platform and the legacy WillScot platform. So we've been foreshadowing and talking about and expecting those costs to come back in. So you had kind of resumption to normal cost plus this kind of incremental demand. So I mean that's to me, as expected and pretty straightforward.

Tim Boswell

Ross, in terms of the process that we run, we're talking about direct labor in the branch network, and we're talking about materials that are used in maintaining not just modular equipment but also storage equipment, right? So we saw this in every segment. And we assumed at the outset of the year that delivery volumes were going to pick up meaningfully across the business, which is what we saw. And in our guidance for the year going back to Q4, we talked about how margins will contract sequentially and year-over-year for Q2 start to stabilize in Q3. And then pop again heading into 2022 as we get to Q4. So this is, again, as I described in my remarks, kind of the normal mechanics of how the business turns over. It's usually not this pronounced and that's just a function of what Brad mentioned a lot of costs coming out in Q2 last year and what was a bit of an anomaly and then that coming back pretty strongly here in Q2 this year.

Ross Gilardi – Bank of America

Okay. Maybe I'll follow-up afterwards. Can you talk a little bit more about the -- just the relationship between fleet utilization and rate improvement? I mean it's great to see the rates up so much, but at least in the Modular space side of the business, rate's been -- sorry, utilization has been just kind of range bound at 67% to 68% for the last 3 or 4 quarters, if I'm interpreting your slides correctly. I mean I would -- I guess I would expect utilization to be going up sharply along with the rate acceleration, but I'm clearly missing something. So can you talk about that a little bit?

Tim Boswell

Remember, 45% of the AMR increase year-over-year is coming from value-added products. So regardless of whether utilization is moving up or down, we're going to get AMR growth just as units that were rented years ago come back to our branches, and then turnover and rent it to new customers with $360 per unit per month of recurring rental revenue from value-added products and services. So in a volume-neutral environment, you look at that. You know you've got over $130 million of revenue growth just from the value-added products component. And we do test price volume elasticity all the time. And it's not as pronounced as you might think. So utilization is interesting to look at, but it's not the only variable we're looking at when we're deciding what to do with rates.

Brad Soultz

The only thing I would add to that is, I mean, if you look at delivery and rates together in the quarter, right, you saw significant improvements in delivery rates on both modular and storage as well as rates. And as Tim pointed out, the big step between modular and storage is really VAPS.

Ross Gilardi – Bank of America

Now that the costs are coming back in the business and things kind of normalize from here, I guess, what sort of incremental EBITDA margin or however you want to slice it, should we expect on VAPS-related pricing versus core pricing?

Tim Boswell

Well, so I think in Q3, Ross, as I said in my remarks, we probably have the same or a similar dynamic, maybe not as pronounced, just because volumes were starting to come back last year. And then I think we get to that north of 60 percent flow-through in Q4 heading into 2022. And as you kind of break it down in a normal environment if volumes are not fluctuating as much as they are currently, you get kind of 90 percent flow-through from pricing, 75-ish percent flow-through from value-added products and services and then kind of 60-ish percent from volume, at least in the modular side of the business, those can be a bit higher on the storage side of the business.

Operator

Your next question comes from the line of Steven Ramsey from Thompson Research.

Steven Ramsey – Thompson Research

It's maybe what's been discussed, but to clarify it further on modular stabilization, I guess how long do you expect this period to last the stabilization and this lag to getting better volumes and to getting to the growth stage again? Is this taking longer than normal? Or is this something you would expect in this environment?

Brad Soultz

No, I think as we looked into this year initially, right, we had expected to see modular volumes recover at the end of the year. And that's just the simple function of long lease duration. So as you increase deliveries, it takes time to get there. So -- and keep in mind, unit lease revenues, as I mentioned in our prepared remarks, are slightly ahead of our expectation right now. And that combination, simple combination of volume, rate and VAPS, puts us into a pretty interesting position where we are today and where we expect to head into 2022. So no, it takes time to turn a large portfolio that's on rent for 34 months.

Steven Ramsey – Thompson Research

Okay. And to follow up on that, given the dynamics of labor and material shortages on the residential side that's driving a longer time of starting a project to finishing home, are you seeing that dynamic at all in commercial projects? Trying to get a sense of going forward, there could be longer lease time frames over the next 1 to 3 years as these factors continue to impact the market.

Brad Soultz

I don't expect anything material there. I mean, we'll keep our eye on this. Across our diversified portfolio, we're not seeing any significant impacts now. So whether that means in the future, some projects start earlier and some later. We'll see how it plays out. But these lease durations have been pretty stable over time. As we mentioned before, we're kind of the critical first on last off these projects. Very small percentage of the project costs, like 50 basis points of any one of these large projects. So I think it's been stable over time. I don't expect anything significant or material here.

Operator

Your next question comes from the line of Sam England from Berenberg.

Samuel England - Berenberg

First one, I was just wondering what the time line is in your minds on delivering on the revenue synergies from the Mini deal, now the ERP integration is done? And I'm thinking particularly around the sort of national account overlap and some of the cross-selling you've talked about in the past, given that you've already sort of touched on perhaps earlier in the call.

Brad Soultz

Yes. I think this is another we'll talk about more when we're together in November. But if you remember, at the time of the merger, the only revenue synergy we quantified was that associated with putting the WillScot Furniture portfolio into Mobile Mini's ground-level office fleet. We've started that. That's happening in more than a dozen branches already and expanding pretty rapidly. So that is beginning. That was a $50 million revenue opportunity across, frankly, both North America and the U.K. ground-level office fleet. That falls through it like $35 million of EBITDA, as we've characterized before.

So that's well under our way, and we're going to do our work now. As we mentioned, we've had massive human capital focus only on the ERP cutover. And that's what's the most exciting now. And we can turn all that towards our expanding ESG opportunities, unlocking all this value in terms of cross-selling lifting the storage market share along with storage, rate optimization across the portfolio. VAPS into storage containers, etcetera. So we'll do some work, and I think that's something we really look forward to sharing in a bit more detail when we're together in November.

Samuel England - Berenberg

Okay. Great. And then you're getting quite close now to that internal $400 a unit VAPS target that you talked about in the past on an LTM basis at least. Is $400 still the longer-term target? Is that moving up in your minds over time, do you think? And do you plan to sort of talk to another target at some point in time?

Brad Soultz

Yes, it's moving up. We -- I think when we were marketing the company back in 2017, we set our sights on the $400 level. And clearly, at $360, we're kissing that with many areas, sustaining that $400 level. So yes, that's another one I'm sure we'll talk about in November, but we usually set these milestones with intentions to eclipse them.

Samuel England - Berenberg

Okay. Great. And then maybe just one more. I just wondered what you're seeing in terms of replacement unit cost inflation at the moment. And is it something you're largely just sort of delaying incurring by -- [I suppose] buying units sort of what are the dynamics going on there?

Tim Boswell

Certainly, on the container side of the business, there's been some -- what we think is temporary pressure on new and used container pricing, whether it's on tripper coming from China or a unit we're buying from the ports. Shipping costs and shipping time lines are certainly up. There are some modular units that we bring in flat path from China. But other than that, we're really not buying any other modulars right now given where utilization is.

We're just going to refurbish the equipment that we've already got, and that is a real luxury looking out through the rest of this year heading into next year. There's plenty of capacity there in the modular fleet that's totally within our control, and we handle all of that refurbishment in-house at scale in our larger branches, which is another point of competitive differentiation, I think, out in the market. So yes, there are supply constraints everywhere, but I think we have the luxury of controlling our destiny a bit more than perhaps others in the market.

Operator

Your next question comes from the line of Phil Ng from Jefferies.

Phil Ng - Jefferies

Congrats on another great quarter. I hop off the Q&A portion earlier for a little bit, so I apologize if you've answered this question. M&A has always been a very big part of your strategy, your growth strategy. There's been a few deals in the space for both modular and portable. So I'm curious, are you seeing a little more competition on the M&A front? And how are multiples kind of shaking out? And any color on the pipeline would be super helpful.

Bradley Soultz

Yes. I think as we've characterized before, the pipeline's robust. While we've been laser-focused on the ERP, we've also said we weren't going to miss any smart deals nor were we compelled to do anything that we didn't think was the right play for our shareholders. So I don't think we've missed anything we should. Pipeline is robust. It's been a core part of our strategy, right, continue to compound just outstanding organic opportunities with accretive M&A. So it's been part of our DNA, and I expect it will continue to be.

Phil Ng - Jefferies

And how is the valuation just the competition for assets? I mean, it's a great business. So what's the valuation profile these days?

Tim Boswell

It's hard to say. I can point to maybe 1 or 2 transactions that they're out there. So I don't want to draw any conclusions from those. And market valuations generally have been up over the last 12 months. So we're still seeing a very interesting, very accretive opportunities out there, and I expect we will be active here in the next 6 to 12 months.

Phil Ng - Jefferies

Got it. And then, Brad and Tim, you guys, just from your background, you've always kind of really hunker down on core businesses and maybe seeing less value of having an international presence, but this U.K. portable business has been a home run for you guys, really strong growth. Is this a business you want to get behind more and invest more capital, whether it's organic or inorganic, just because it seems to fit pretty nicely for you guys?

Brad Soultz

Yes. I would comment that it's more than storage, although that's how it's labeled, right? So it's really a nice blend of what we call modular and storage in the U.S. So great alignment with what we do, outstanding performance by the team there. So I'm quite pleased with that. And we are deploying capital to support their growth. So we're quite pleased with the business. What we said before is I wouldn't go buy a business in another geography as this kind of stand-alone business prior to this merger. But now that we have that business, it's great.

Operator

Your next question comes from the line of Stanley Elliott from Stifel.

Stanley Elliott - Stifel

Question on VAPS as it relates to some of the opportunity you have on some of the legacy Mini products. The VAPS business has historically grown at a pretty decent but consistent clip. As you're moving into that market, is it -- is that the opportunity, so it's on rent on a go-forward basis were these items can get rented? Or is there a chance to go out to the existing field? Just curious to try to see how quickly this can ramp and maybe this is kind of what you want to talk about in November.

Tim Boswell

It's our expectation, Stanley, this is Tim, is that we begin to penetrate both the ground-level offices and eventually the containers on new deliveries. There's a very limited opportunity to go out to a unit that's already in the field and try to sell the customer on furniture. After a few days, they've probably already figured out where to sit and shelving and work benches inside the containers, for example, they've already solved that problem on their own. So the opportunity here is really upfront and making that transaction simple for the customer so that they can be ready to work day 1 when our assets arrive on the job site. So I expect that it will continue to build at that consistent 20% CAGR that you saw on North America Modular over the last 9 years or so.

Stanley Elliott - Stifel

Great. And then when you're talking about incrementals, you mentioned kind of a 60 percent flow-through for kind of the core business. Looking at, I think it was what, $23 million in variable costs here. Probably something similar. When you look into next year, is there a reason why the incrementals wouldn't be better than the 60 percent given kind of a more normalized operating environment plus lower diesel costs and maybe better logistics?

Tim Boswell

Certainly north of 60 percent seems like the right ZIP code, and I absolutely see margins expanding meaningfully into 2022. What the exact flow-through will be in any given quarter, that's not really how we look at it, just because of the variable cost fluctuation. But it sure feels like we're having a pretty solid delivery season heading into Q3. The seasonality in the business seems like it's taking shape as it would in a normal year. And if all that remains the same going into next year, yes, you would not have this level of flow-through variation that you see in Q2 and probably again here in Q3.

Operator

Your last question comes from the line of Brent Thielman from D.A. Davidson.

Brent Thielman – D.A. Davidson

I guess one more on North America Modular volume. I think we're all trying to figure out kind of the velocity of the rebound here. I understand the explanation you'll have returns to go with deliveries. I guess if we were to theoretically see another couple of quarters of, call it, 10 percent plus delivery growth, when we think about your average lease duration, 30-plus months, I mean, can we extract at least your units on rent can grow by 1/3 of that into 2022? Or is that just too simple math?

Tim Boswell

Heading into 2022, assuming we're back to call it neutral in Q4, which was always kind of the original expectation up a little bit year-over-year, getting into that low single-digit volume growth range in 2022 and beyond is a good target.

Brent Thielman – D.A. Davidson

Okay. Great. I guess bigger picture question, just wondering about all of these supply chain constraints and things we hear about in the market, is that actually helping your business from a delivery or new orders perspective?

Brad Soultz

On a net basis, it's helping returns, right, because we're able to -- any friction we're encountering, we're clearly able to pass it through in rate. It's not -- they haven't been constraining to us, as Tim mentioned. And part of that is just the benefit of our scale, right? If we've got a particular shortage in one geography, be it fleet or people or material, we can take care of it from another and make sure we're never letting our customers down.

Tim Boswell

I would only add that we are the largest marginal supplier of all of this equipment. So whether it's supplier relationships or just the existing capacity that we have in the fleet, we are more likely to be able to respond with -- to the customer with the right asset in the right place at the right time than I think anyone else in the market. So all else equal, I see supply constraints as a benefit to the business certainly supporting pricing and should be -- allow us to be more competitive on the volume side as well.

Brent Thielman – D.A. Davidson

Okay. And then my last one, I know you guys had sort of been de-emphasizing unit sales. I'm just wondering if this sort of the difficulty of acquiring new units right now is actually causing some customers to -- that would traditionally buy the unit to convert to leasing. Is that a trend you're seeing at all?

Brad Soultz

The way I would characterize our kind of strategy with respect to sales, as you say, it runs around 10 percent of our revenues. And with about half of that being used sales, that's typically either just maintenance of fleet or more typically accommodation to the current customers. So when we're more constrained in fleet as we are in storage right now, we'll dial that back. And anything we're selling, we're selling at a great return because we need to replace that unit with another new one.

And new sales are more, again, that exception, if you think of the Modular side where a customer, they want something that's a little more unique or they really know they need it for 5 or 6 years and the economics are such that they do it. So I think across our various end markets as demand and utilization ebb and flow, we tweak those dials a little bit. But you never should expect like a material shift in our strategy in that regard. I think of it more as a fleet and customer maintenance than anything else.

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, Kathleen. 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.