McGrath RentCorp (MGRC)

Updated April 24th, 2018 by Nate Parsh

Key Metrics

Current Price:	$59	**5 Year CAGR Estimate:**	-3.0%	**Quality Percentile:**	N/A
Fair Value Price:	$40	**5 Year Growth Estimate:**	2.1%	**Momentum Percentile:**	N/A
% Fair Value:	148%	**5 Year Valuation Multiple Estimate:**	-7.3%	**Total Return Percentile:**	N/A
Dividend Yield:	2.2%	**5 Year Price Target**	$45	**Valuation Percentile:**	N/A

Overview & Current Events

McGrath RectCorp is a leading business-to-business rental and sales company that provides portable buildings for use as classrooms, office space and places to test electronic equipment. The company's products can also be used as secure storage for both hazardous and non-hazardous materials, restrooms, health care and child care facilities. Many of McGrath's portable buildings are used to meet a variety of demands and can be moved easily from one location to another. The company has a current market cap of $1.4 billion and had sales of $462 million in 2017.

McGrath reported 4th quarter 2017 earnings on 2/27/2018. The company reported earnings per share of $0.62, $0.13 above estimates and 55% above Q4 2016's total. Revenue grew 16.1% to $122.22 million. Revenue totals were $12.5 million above analysts' expectations. Each of the company's divisions posted growth in the quarter, driven primarily by higher rental rates. McGrath will be a beneficiary of recent tax reform legislation as the company's tax rate will drop from 35% to 21% in 2018. The has seen an uptick in salary and benefits for employees due to low unemployment rates.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.72	$1.40	$1.50	$2.00	$1.78	$1.67	$1.73	$1.59	$1.60	$2.12	***$2.30***	***$2.55***
DPS	$0.80	$0.88	$0.90	$0.92	$0.94	$0.96	$0.98	$1.00	$1.02	$1.04	***$1.28***	***$1.56***

McGrath has experienced volatility in its earnings per share over the past decade. EPS dropped almost 19% in 2009 and it wasn't until 2011 that earnings recovered above 2008's total. Earnings trended down from 2011-2015. McGrath had a strong 2017, as demand for products drove higher rental rates across the company's portfolio of offerings. McGrath has increased earnings at a rate of 2.1% per year over the past 10 years. McGrath expects an EPS midpoint of $2.30 per share for 2018, though the company said this estimate will be revisited at the next conference call. Applying the growth rate to 2018's estimate, McGrath could earn $2.55 by 2023.

McGrath has increased its dividend for the past 25 years. Though dividend growth has averaged just 4% per year over the past ten years, McGrath raised its dividend by 30.8% on 4/12/2018. This type of dividend growth is most likely unsustainable going forward, but it is a sign that management believes the company is going to grow going forward. Based off of the average growth rate over the past 10 years, shareholders of McGrath could receive $1.56 in dividends per year by 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14	14.2	16	13.2	15.7	20.1	20.5	18.6	18.4	25.4	***25.7***	***17.6***
Avg. Yld.	3.3%	4.4%	3.7%	3.5%	3.4%	2.9%	2.8%	3.4%	3.5%	1.9%	***2.2%***	***3.5%***

As earnings growth has returned to the company, McGrath's stock has seen its average price to earnings multiple rise as investors find the stock attractive. Last year, the multiple expanded significantly, but McGrath's EPS had strong growth. Shares might deserve that type of multiple today, but the stock has a 10-year average multiple of 17.6. If shares were to revert to this P/E, shareholders would see the multiple contract 7.3% per year through 2023. If earnings were to continue to grow at an accelerated rate going forward, the multiple might not compress to this degree.

Share of McGrath have traded with a very generous dividend yield for much of the past 10 years, often in the 3.5% to 4.5% range. The stock price has increased in recent years and the company has continued to raise its dividend by $0.02 per year up until the most recent increase.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	17.3%	16%	16.1%	18.2%	17.3%	16.4%	16.3%	15.3%	16.3%	18%	***17.7%***	***16.7%***
Debt/A	68.1%	64.7%	63.7%	63.7%	62.5%	61%	62%	67.1%	65.1%	54.3%	***56.1%***	***63.2%***
Int. Cov.	7.8	8.6	10.5	11.7	9	9.2	9.3	7.6	6.5	8.2	***8.3***	***8.8***
Payout	46.5%	62.9%	60%	46%	52.8%	57.5%	56.6%	62.9%	63.8%	49.1%	***55.7%***	***61.1%***
Std. Dev.	65.6%	71.1%	39.6%	40%	27.3%	22.9%	26.5%	25.1%	27%	27.3%	***29.3%***	***37.2%***

McGrath showed in the last recession that its earnings are at risk during a recession. The company's rental business would most likely see earnings decline in the next recession as customers might not be willing to add additional classroom or office space and would make do with current facilities. Even when the economy strengthened, McGrath had difficulty growing earnings until very recently.

One area McGrath has succeeded in is lowering its debt over the past decade. The amount of debt as a percentage of asset has gone done almost every year since 2008. This is not an overleveraged company. Gross profit, while not up all that much from 2008, has been fairly stable, even as earnings struggled to grow. McGrath's payout ratio is rather low for 2017, but the company did increase its dividend almost 31% for 2018. With this much higher than average increase, shareholders could take this to mean that management believes earnings will grow at a higher than usual rate. With an aggressive recent raise and a long track record of growing dividends, shareholders should feel confident that McGrath will continue to increase dividends.

Final Thoughts & Recommendation

Shareholders of McGrath RentCorp can expect to see a return of (-3.0%) per year through 2023. This total return is a combination of earnings growth (2.1%), dividends (2.2%) and multiple reversion (7.3%). The stock's current multiple is well above its average. While earnings grew in 2017 and are expected to grow in 2018, McGrath has had a difficult time delivering consistent EPS over the last ten years. If the company was to show consistent growth, then shares would deserve a higher multiple. Until that, it is recommended that investors stay away from shares of McGrath.

Total Return Breakdown by Year