McGrath RentCorp (MGRC)

Updated November 1st, 2018 by Nate Parsh

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	4.3%	**Volatility Percentile:**	77.3%
Fair Value Price:	$52	**5 Year Growth Estimate:**	2.1%	**Momentum Percentile:**	83.7%
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.3%	**Growth Percentile:**	7.5%
Dividend Yield:	2.5%	**5 Year Price Target**	$58	**Valuation Percentile:**	47.3%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	16.2%

Overview & Current Events

McGrath RentCorp 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 location to location.

McGrath reported 3rd quarter earnings on October 30th. The company earned $1.01 per share, $0.11 above estimates and a year over year improvement of 46.4%. Due to tax reform, McGrath's tax rate dropped to 21% for the quarter compared to 35% for the same period last year. This added $0.19 to the company's earnings-per-share result. Without this benefit, EPS still grew almost 19%. Revenue grew 5.7% to $143.3 million, topping estimates by $3.3 million.

Rental rates revenues improved 11% while operating profit grew 18% during the quarter. Mobile Modular reported a 14% increase in revenues and a 21% growth in operating profit due to a 9% increase in rental rates and strong demand for products in commercial, education and portable storage. RenTelco, which provides general purpose equipment as well as communication test equipment for 5G networks, had a 6% increase in sales and 8% rise in operating profit. Infrastructure products saw an increase in demand due to future 5G rollout. Adler Tanks, which provides products for the energy sector, saw a 13% rise in sales and a 30% increase in operating profit as the majority of its business divisions increased rental revenues due to a higher upstream oil and gas exploration. McGrath now estimates that its operating profits will increase 18%-21% in 2018, up from a range of 11%-15% previously. The average analysts' estimate for EPS is $2.96, up from $2.30 previously. Share of McGrath closed higher by 11.5% the day after the earnings release.

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	***$2.96***	***$3.28***
DPS	$0.80	$0.88	$0.90	$0.92	$0.94	$0.96	$0.98	$1.00	$1.02	$1.04	***$1.36***	***$1.65***
Shares	23.7	23.8	24.2	24.6	24.9	25.8	26.1	23.9	24	24.1	***24***	***24***

McGrath has experienced volatility in its earnings per share over the past decade. Earnings-per-share dropped almost 19% in 2009 and it wasn't until 2011 that earnings recovered above 2008's total. McGrath has increased earnings at a rate of 2.1% per year over the past 10 years.

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 31% on April 12th. This type of dividend growth is likely unsustainable going forward. McGrath's annualized dividend of $1.34 gives the stock a 2.5% yield.

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	***17.9***	***17.6***
Avg. Yld.	3.3%	4.4%	3.7%	3.5%	3.4%	2.9%	2.8%	3.4%	3.5%	1.9%	***2.5%***	***2.8%***

Shares of McGrath have decreased $5, or 8.6%, in price since our August 14th update. Based off of update earnings guidance for the year, McGrath's stock currently has a P/E of 17.9, down from 25.1 earlier. 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 just 0.3% per year through 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

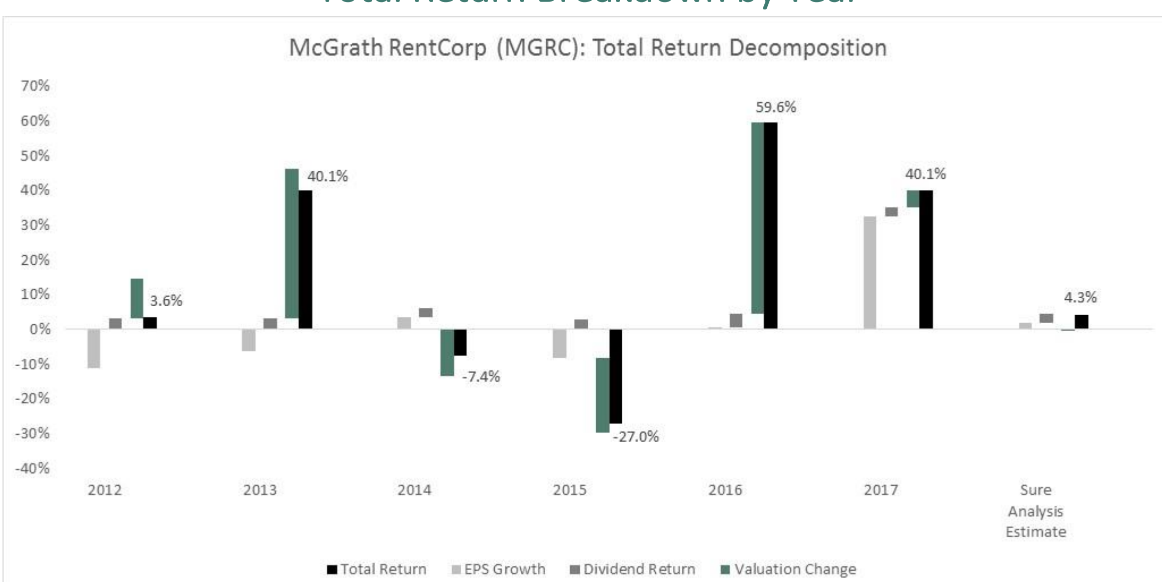
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	17.3%	16%	16.1%	18.2%	17.3%	16.4%	16.3%	15.3%	16.3%	18%	***17.7%***	***16.7%***
Debt/A	68.1%	64.7%	63.7%	63.7%	62.5%	61%	62%	67.1%	65.1%	54.3%	***56.1%***	***63.2%***
Int. Cov.	7.8	8.6	10.5	11.7	9	9.2	9.3	7.6	6.5	8.2	***8.3***	***8.8***
Payout	46.5%	62.9%	60%	46%	52.8%	57.5%	56.6%	62.9%	63.8%	49.1%	***45.9%***	***50.3%***
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 down 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. 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.

Final Thoughts & Recommendation

After the release of 3rd quarter earnings and an uptick in EPS guidance for 2018, we now forecast that shares of McGrath RentCorp can offer total annual returns of 4.3% through 2023, up from an annual loss of 2.4% earlier. McGrath had a strong 3rd quarter. Though a lower tax rate provided a large boast to earnings, McGrath still showed impressive growth companywide. Revenues and operating profits were up significantly. We have raised our 2023 price target $7 to $58 and move shares from a sell to a hold. The market responded with a significant share price increase following the earnings release, so we suggest investors interested in McGrath to wait for a pullback before purchasing.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	304	276	291	343	364	380	408	405	424	462
Gross Profit	136	121	131	167	168	169	182	177	184	206
Gross Margin	44.6%	44.0%	44.9%	48.7%	46.2%	44.5%	44.6%	43.7%	43.4%	44.7%
SG&A Exp.	58	60	66	78	86	89	97	100	105	112
D&A Exp.	60	63	63	67	72	77	81	84	81	78
Operating Profit	78	61	65	89	82	80	85	77	79	95
Operating Margin	25.5%	22.2%	22.4%	25.9%	22.5%	21.1%	20.9%	19.0%	18.7%	20.5%
Net Profit	41	33	36	50	45	43	46	40	38	154
Net Margin	13.5%	12.1%	12.5%	14.5%	12.3%	11.4%	11.2%	10.0%	9.0%	33.3%
Free Cash Flow	-11	50	-34	-43	-20	-11	-42	4	51	13
Income Tax	26	21	23	31	28	28	31	26	29	-70

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	784	758	814	919	972	1028	1116	1153	1128	1148
Cash & Equivalents	1	1	1	1	2	2	1	1	1	3
Accounts Receivable	86	71	76	93	92	88	101	95	97	106
Goodwill & Int. Ass.	42	41	41	40	39	38	38	37	36	36
Total Liabilities	535	491	519	586	608	627	692	773	734	624
Accounts Payable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	72	78	86
Long-Term Debt	306	247	266	297	302	290	322	381	326	303
Shareholder's Equity	250	267	295	333	365	401	425	380	394	524
D/E Ratio	1.22	0.92	0.90	0.89	0.83	0.72	0.76	1.00	0.83	0.58

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	5.8%	4.3%	4.6%	5.7%	4.7%	4.3%	4.3%	3.6%	3.4%	13.5%
Return on Equity	16.7%	12.9%	13.0%	15.8%	12.8%	11.3%	11.1%	10.1%	9.9%	33.5%
ROIC	8.3%	6.2%	6.8%	8.3%	6.9%	6.4%	6.4%	5.4%	5.2%	19.9%
Shares Out.	23.7	23.8	24.2	24.6	24.9	25.8	26.1	23.9	24	24.1
Revenue/Share	12.70	11.55	12.00	13.84	14.47	14.64	15.59	15.89	17.69	19.04
FCF/Share	-0.44	2.09	-1.41	-1.73	-0.78	-0.42	-1.60	0.15	2.13	0.54

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.