McGrath RentCorp (MGRC)

Updated October 30th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$78	**5 Year CAGR Estimate:**	0.6%	**Volatility Percentile:**	66.8%
Fair Value Price:	$62	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	94.7%
% Fair Value:	126%	**5 Year Valuation Multiple Estimate:**	-4.4%	**Growth Percentile:**	17.6%
Dividend Yield:	1.9%	**5 Year Price Target**	$72	**Valuation Percentile:**	34.4%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	11.9%

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. The company has a market capitalization of $1.9 billion and generates more than $500 million in annual revenues.

McGrath reported earnings for Q3 on 10/29/2019. The company earned $1.32 per share, beating estimates by $0.29 and improving 31% year-over-year. Revenue grew 21% to $174 million, $23 million higher than expected.

Rental revenues increased 11% from the previous year. Mobile Modular, the company's largest division, grew 13% due to higher average rental rates and a large fleet. Commercial and education markets continue to be healthy and portable storage revenues grew 11%. Rental revenues for TRS-RenTelco increased 21% on higher average rental equipment and improved utilization. The company saw improved demand for general purpose and communications test equipment. Adler Tanks sales were down 8% as higher rental rates only partially offset lower utilization.

McGrath RentCorp now sees operating profit increasing 15% to 19% for the year, up from the company's previous estimate of 9% to 14% growth. We are raising our earnings-per-share estimate to $3.53 due to third quarter results. Shares increased more than 10% following the earnings release.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.40	$1.50	$2.00	$1.78	$1.67	$1.73	$1.59	$1.60	$2.12	$3.24	***$3.53***	***$4.09***
DPS	$0.88	$0.90	$0.92	$0.94	$0.96	$0.98	$1.00	$1.02	$1.04	$1.28	***$1.50***	***$1.74***
Shares[1]	24	24	25	25	26	26	24	24	24	24	***25***	***25***

McGrath RentCorp 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. We now expect earnings-per-share to grow at a rate of 3% per year through 2024. A combination of revenue growth and a lower tax rate (expected 27% for 2019 compared to 35% prior to tax reform) should allow the company to grow earnings-per-share above its historical rate of 2.1%. McGrath RentCorp announced a 10% dividend increase, double its 10-year average increase, for the 4/30/2019 payment. This will give the company 27 consecutive years of dividend growth. Shares offer an annualized yield 2.3% presently, slightly higher than the average yield of the S&P 500. Despite McGrath RentCorp's variance in earnings-per-share over the last decade, the company has been able to raise its dividend each year for almost three decades. This is an impressive feat for a company that can be very cyclical.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.2	16	13.2	15.7	20.1	20.5	18.6	18.4	25.4	15.8	***22.1***	***17.6***
Avg. Yld.	4.4%	3.7%	3.5%	3.4%	2.9%	2.8%	3.4%	3.5%	1.9%	2.5%	***1.9%***	***2.4%***

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[1] Share count in millions

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Shares of McGrath RentCorp have increased $11, or 16.4%, in price since our 7/31/2019 update. Based off of updated earnings expectations for 2019, McGrath RentCorp's stock currently has a price-to-earnings ratio of 22.1. The stock has a 10-year average multiple of 17.6. If shares were to revert to this multiple by 2024, then valuation would be a 4.4% headwind to annual returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	63%	60%	46%	53%	58%	57%	63%	64%	49%	40%	***43%***	***43%***

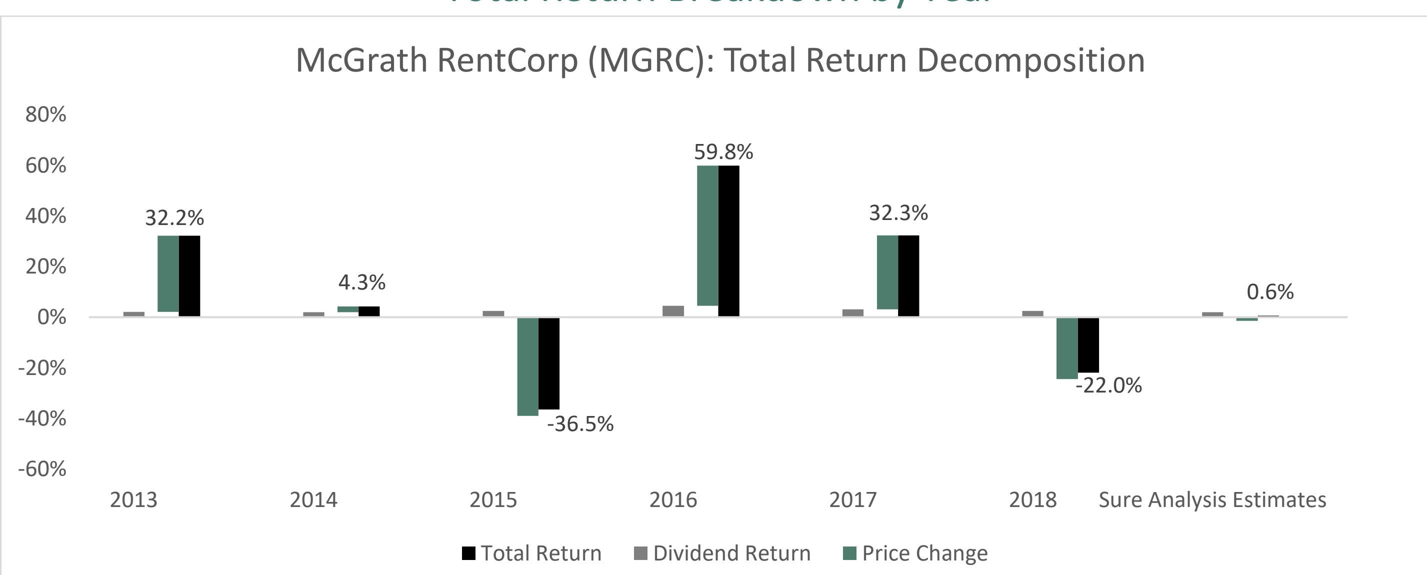
McGrath RentCorp showed in the last recession that its earnings are at risk during a downturn. The company's rental business would most likely see earnings decline in the next recession as customers might not be willing to add additional classroom or office space, and would make do with current facilities. Even when the economy strengthened, McGrath RentCorp had difficulty growing earnings until very recently. One area McGrath RentCorp has succeeded in is lowering its debt over the past decade. The amount of debt as a percentage of assets has gone down almost every year since 2008. McGrath RentCorp's payout ratio was rather low for 2017, but the company did increase its dividend almost 31% for 2018, prior to this year's 10% increase. With two consecutive higher-than-average increases, shareholders could take this to mean that management believes earnings will grow at a higher than usual rate.

McGrath RentCorp's key competitive advantage is that company's rental portfolio is fairly diverse. The company's products are used for office space, school classrooms, telecommunications and energy purposes. While still sensitive to the state of the economy, this product diversity does give McGrath RentCorp some cushion against weakness in any one area of its business.

Final Thoughts & Recommendation

After third quarter results, McGrath RentCorp is expected to return 0.6% per year through 2024, down from our previous forecast of 3.3%. McGrath RentCorp had another solid quarter, with all three divisions seeing higher rental rates. The company's two largest segments also posted strong year-over-year growth rates. We have raised our 2024 price target $2 to $72 to account for updated earnings forecast, but note that the stock currently trades well above this level. Shares are expensive against their own history and we recommend investors consider selling McGrath RentCorp.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	276	291	343	364	380	408	405	424	462	498
Gross Profit	121	131	167	168	169	182	177	184	206	233
Gross Margin	44.0%	44.9%	48.7%	46.2%	44.5%	44.6%	43.7%	43.4%	44.7%	46.8%
SG&A Exp.	60	66	78	86	89	97	100	105	112	116
D&A Exp.	63	63	67	72	77	81	84	81	78	82
Operating Profit	61	65	89	82	80	85	77	79	95	117
Operating Margin	22.2%	22.4%	25.9%	22.5%	21.1%	20.9%	19.0%	18.7%	20.5%	23.6%
Net Profit	33	36	50	45	43	46	40	38	154	79
Net Margin	12.1%	12.5%	14.5%	12.3%	11.4%	11.2%	10.0%	9.0%	33.3%	15.9%
Free Cash Flow	50	-34	-43	-20	-11	-42	4	51	13	4
Income Tax	21	23	31	28	28	31	26	29	-70	25

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	758	814	919	972	1028	1116	1153	1128	1148	1217
Cash & Equivalents	1	1	1	2	2	1	1	1	3	2
Accounts Receivable	71	76	93	92	88	101	95	97	106	121
Goodwill & Int. Ass.	41	41	40	39	38	38	37	36	36	35
Total Liabilities	491	519	586	608	627	692	773	734	624	646
Long-Term Debt	247	266	297	302	290	322	381	326	303	299
Shareholder's Equity	267	295	333	365	401	425	380	394	524	572
D/E Ratio	0.92	0.90	0.89	0.83	0.72	0.76	1.00	0.83	0.58	0.52

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.3%	4.6%	5.7%	4.7%	4.3%	4.3%	3.6%	3.4%	13.5%	6.7%
Return on Equity	12.9%	13.0%	15.8%	12.8%	11.3%	11.1%	10.1%	9.9%	33.5%	14.5%
ROIC	6.2%	6.8%	8.3%	6.9%	6.4%	6.4%	5.4%	5.2%	19.9%	9.4%
Shares Out.	23.8	24.2	24.6	24.9	25.8	26.1	23.9	24	24.1	24
Revenue/Share	11.55	12.00	13.84	14.47	14.64	15.59	15.89	17.69	19.04	20.31
FCF/Share	2.09	-1.41	-1.73	-0.78	-0.42	-1.60	0.15	2.13	0.54	0.16

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