McGrath RentCorp (MGRC)

Updated April 29th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	6.4%	**Market Cap:**	$1.47 billion
Fair Value Price:	$63	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	4/14/2020
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.9%	**Dividend Payment Date:**	4/30/2020
Dividend Yield:	2.8%	**5 Year Price Target**	$73	**Years Of Dividend Growth:**	29
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	12%

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 RentCorp released earnings results for the first quarter on 4/29/2020. The company earned $0.81 per share in the quarter, which was $0.10 higher than expected and an 8% increase from Q1 2019. Revenue grew 6.1% to $129.5 million, slightly ahead of estimates.

Rental revenues increased 8% in the quarter. Rental revenues for Mobile Modular, the company's largest division, were higher by 12% due to demand from commercial and education markets. These end markets have been strong for several quarters now. Rental revenues for TRS-RenTelco increased 17% as demand for general purpose and communications test equipment remains high. Adler Tanks revenues declined 13% due to weakness in five out of six end markets. McGrath RentCorp withdrew its previously issued guidance for 2020 due to the impact of the COVID-19 pandemic. Analysts now expect earnings-per-share of $3.56 for the year, down from $4.01 previously.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.50	$2.00	$1.78	$1.67	$1.73	$1.59	$1.60	$2.12	$3.24	$3.93	***$3.56***	***$4.13***
DPS	$0.90	$0.92	$0.94	$0.96	$0.98	$1.00	$1.02	$1.04	$1.28	$1.50	***$1.68***	***$1.95***
Shares[1]	24	25	25	26	26	24	24	24	24	25	***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 continue to expect earnings-per-share to grow at a rate of 3% per year through 2025. McGrath RentCorp announced a 12% dividend increase, more than double its 10-year average increase, for the 4/30/2020 payment. This will give the company 29 consecutive years of dividend growth. Shares offer an annualized yield 2.8% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16	13.2	15.7	20.1	20.5	18.6	18.4	25.4	15.8	19.5	***16.9***	***17.6***
Avg. Yld.	3.7%	3.5%	3.4%	2.9%	2.8%	3.4%	3.5%	1.9%	2.5%	2.0%	***2.8%***	***2.7%***

Shares of McGrath RentCorp have decreased $16, or 21%, in price since our 2/25/2020 update. Based off of earnings expectations for 2020, McGrath RentCorp's stock currently has a price-to-earnings ratio of 16.9. The stock has a 10-year

[1] Share count in millions

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.

average multiple of 17.6. If shares were to revert to this multiple by 2025, then valuation would add 0.9% to annual returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	60%	46%	53%	58%	57%	63%	64%	49%	40%	38%	***47%***	***47%***

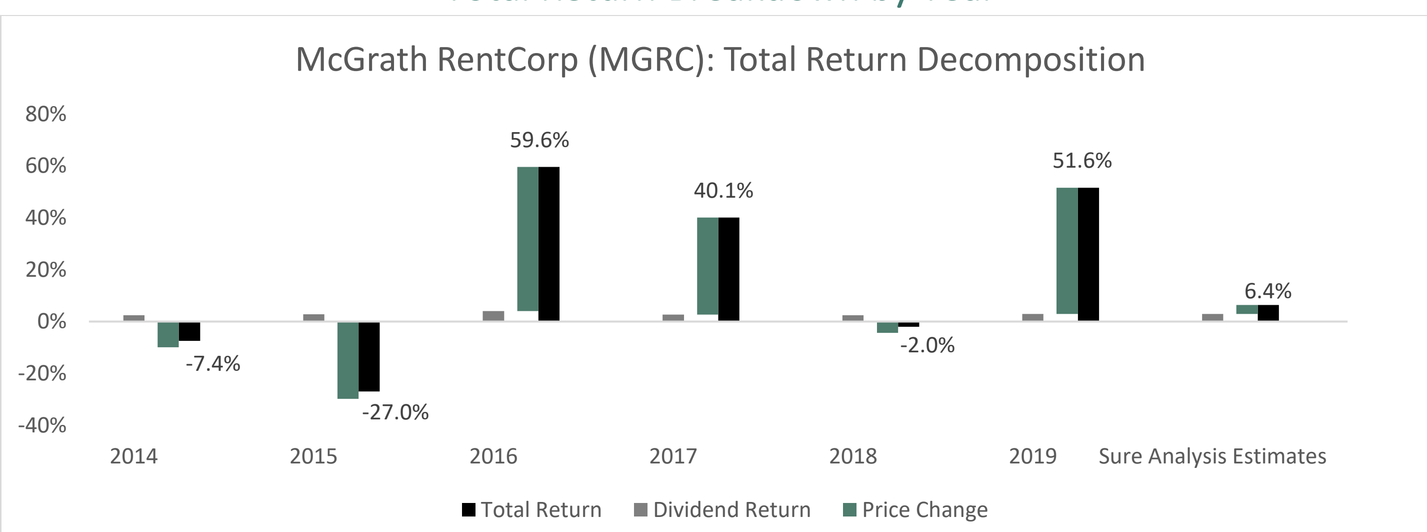
McGrath RentCorp showed in the last recession that its earnings are at risk during a downturn. The company's rental business would most likely see earnings decline in the next recession as customers might not be willing to add additional classroom or office space, and would make do with current facilities. 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 is in a healthy range and the company has increased its dividend by at least 10% for the past three years. With three 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

Following first quarter results, McGrath RentCorp is projected to return 6.4% per year through 2025, up from our previous estimate of 3.7%. The company had double-digit growth in its Mobile Modular and TRS-RenTelco segments as demand for products remains strong. Adler Tanks has been a headwind to the company, but this is the smallest segment within McGrath RentCorp. The company did pull its guidance as the duration and impact of COVID-19 on the economy remains unknown. We have lowered our 2025 price target $9 to $73 as a result of lowered earnings-per-share estimates. That said, McGrath RentCorp has increased its dividend for nearly three decades and offers a yield that is above that of the S&P 500. Due to higher projected returns compared to our previous update, Sure Dividend has raised its rating on McGrath RentCorp to hold from sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	291	343	364	380	408	405	424	462	498	570
Gross Profit	131	167	168	169	182	177	184	206	233	266
Gross Margin	44.9%	48.7%	46.2%	44.5%	44.6%	43.7%	43.4%	44.7%	46.8%	46.7%
SG&A Exp.	66	78	86	89	97	100	105	112	116	125
D&A Exp.	63	67	72	77	81	84	81	78	82	89
Operating Profit	65	89	82	80	85	77	79	95	117	141
Operating Margin	22.4%	25.9%	22.5%	21.1%	20.9%	19.0%	18.7%	20.5%	23.6%	24.8%
Net Profit	36	50	45	43	46	40	38	154	79	97
Net Margin	12.5%	14.5%	12.3%	11.4%	11.2%	10.0%	9.0%	33.3%	15.9%	17.0%
Free Cash Flow	88	112	112	122	110	135	130	108	127	176
Income Tax	23	31	28	28	31	26	29	(70)	25	32

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	814	919	972	1,028	1,116	1,153	1,128	1,148	1,217	1,310
Cash & Equivalents	1	1	2	2	1	1	1	3	2	2
Accounts Receivable	76	93	92	88	101	95	97	106	121	128
Goodwill & Int. Ass.	41	40	39	38	38	37	36	36	35	36
Total Liabilities	519	586	608	627	692	773	734	624	646	676
Long-Term Debt	266	297	302	290	322	381	326	303	299	293
Shareholder's Equity	295	333	365	401	425	380	394	524	572	634
D/E Ratio	0.90	0.89	0.83	0.72	0.76	1.00	0.83	0.58	0.52	0.46

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	4.6%	5.7%	4.7%	4.3%	4.3%	3.6%	3.4%	13.5%	6.7%	7.7%
Return on Equity	13.0%	15.8%	12.8%	11.3%	11.1%	10.1%	9.9%	33.5%	14.5%	16.1%
ROIC	6.8%	8.3%	6.9%	6.4%	6.4%	5.4%	5.2%	19.9%	9.4%	10.8%
Shares Out.	24	25	25	26	26	24	24	24	24	25
Revenue/Share	12.00	13.84	14.47	14.64	15.59	15.89	17.69	19.04	20.31	23.16
FCF/Share	3.64	4.53	4.46	4.69	4.21	5.30	5.43	4.44	5.18	7.14

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