McGrath RentCorp (MGRC)

Updated November 1st, 2020 by Nathan Parsh

Key Metrics

Current Price:	$57	**5 Year CAGR Estimate:**	8.4%	**Market Cap:**	$1.38 billion
Fair Value Price:	$66	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	1/15/2021[1]
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.9%	**Dividend Payment Date:**	1/29/2021[2]
Dividend Yield:	2.9%	**5 Year Price Target**	$76	**Years Of Dividend Growth:**	29
Dividend Risk Score:	B	**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 announced third quarter earnings results on 10/29/2020. Revenue was lower by 9.9% to $156.5 million, but was $4.8 million ahead of expectations. Earnings-per-share was lower by $0.13, or 12.9%, to $1.15. this topped estimates by $0.13.

Rental revenues declined 3% to $88.1 million. The company faced a tough comparison from the prior year due to a large concentration of completed equipment sales in Q3 2019. Revenues for Mobile Modular, the company's largest division, were up 12%, but this was mostly due to a decrease in costs and depreciation expense. Rental revenues improved just 1% on higher demand from education customers. TRS-RenTelco rental revenues increased 3% due to demand for general purpose test equipment. Adler Tanks rental revenues were down 22% due to continued weakness in oil and gas end-markets due to disruptions related to COVID-19.

McGrath RentCorp withdrew its guidance for the year previously, but expects fourth quarter revenue to be in-line with the previous year's result of $147 million. Analysts have raised EPS estimates to $3.74 from $3.04 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	***$3.74***	***$4.34***
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[3]	24	25	25	26	26	24	24	24	24	25	***24***	***24***

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 2.9% presently, ~100 basis points 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.

[1] Estimated ex-dividend date
[2] Dividend payment date
[3] Share count in millions

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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	***15.2***	***17.6***
Avg. Yld.	3.7%	3.5%	3.4%	2.9%	2.8%	3.4%	3.5%	1.9%	2.5%	2.0%	***2.9%***	***2.6%***

Shares of McGrath RentCorp have decreased $1, or 1.7%, in price since our 7/29/2020 update. Based off of revised earnings expectations for 2020, McGrath RentCorp's stock currently has a price-to-earnings ratio of 15.2. The stock has a 10-year average multiple of 17.6. If shares were to revert to this multiple by 2025, then valuation be a 2.9% tailwind to annual results 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%	***45%***	***45%***

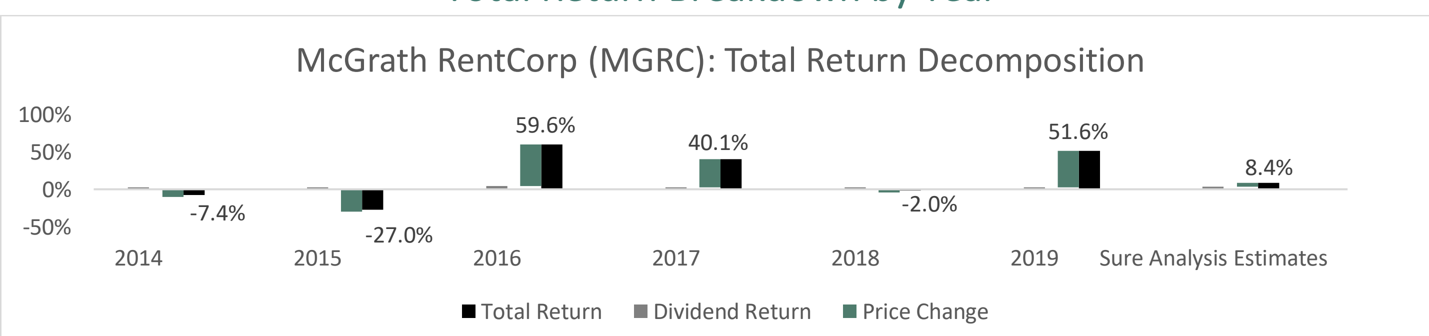
McGrath RentCorp showed in the last recession that its earnings are at risk during a downturn. The company's rental business would most likely see earnings decline in the next recession as customers might not be willing to add additional classroom or office space, and would make do with current facilities. 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 third quarter results, McGrath RentCorp is projected to return 8.4% per year through 2025, up from our previous estimate of 4.2%. McGrath RentCorp saw some headwinds related to the COVID-19 pandemic, particularly in its Adler Tanks business, but showed resiliency elsewhere. The declining price of oil also weighed on this division. Mobile Modular had solid growth overall, but rental rates were up slightly from the previous year. We have raised our 2025 price target $14 to $76 due to revised EPS estimates for 2020, but maintain our hold rating on the stock. Interested investors are encouraged to wait for a further pullback before buying shares of McGrath RentCorp.

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.