McGrath RentCorp (MGRC)

Updated October 29th, 2023 by Nathan Parsh

Key Metrics

Current Price:	$102	**5 Year CAGR Estimate:**	1.9%	**Market Cap:**	$2.4 B
Fair Value Price:	$88	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/16/23
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Dividend Payment Date:**	10/31/23
Dividend Yield:	1.8%	**5 Year Price Target**	$102	**Years Of Dividend Growth:**	31
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Rating:**	Sell

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 completed the divestiture of its Adler Tanks during the first quarter of 2023.

On October 26th, 2023, McGrath RentCorp announced third quarter results for the period ending September 30th, 2023. For the quarter, revenue grew 21.4% to $243.5 million, which was $28.9 million more than expected. Earnings-per-share of $1.65 compared favorably to $1.25 in the previous year and was $0.48 above estimates.

For the quarter, rental revenues grew 22% to $122.7 million. Rental revenues for Mobile Modular, the company's largest division, increased 36%, largely due to an acquisition completed during the prior quarter. Service revenues grew 45% due to higher delivery and pick up activities as well as an increase in site related services. TRS-RenTelco rental revenues fell 10% to $28.7 million, due to lower average rental equipment rent compared to the prior year.

McGrath RentCorp now expects revenue in a range of $820 million to $830 million for 2023, compared to $805 million to $830, $790 million to $820 million, and $780 million to $810 million previously. At the midpoint, this would be an 12.4% increase compared to the prior year. We now project that the company will be earn $4.88 in 2023, up from $4.63, $4.71, and $4.60 previously. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.67	$1.73	$1.59	$1.60	$2.12	$3.24	$3.93	$4.16	$3.66	$4.70	***$4.88***	***$5.66***
DPS	$0.96	$0.98	$1.00	$1.02	$1.04	$1.28	$1.50	$1.64	$1.73	$1.80	***$1.86***	***$2.16***
Shares[1]	26	26	24	24	24	24	25	24	24	24	***25***	***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 was not 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 2028.

On February 22nd, 2023, McGrath RentCorp raised its dividend by 2.2% for the April 28th, 2023 payment. This marks 31 consecutive years of dividend growth. Shares offer an annualized yield 1.8% 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 more than three decades. This is an impressive feat for a company in an industry that can be very cyclical.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	20.1	20.5	18.6	18.4	6.1	17.0	16.0	20.1	21.9	21.0	***20.9***	***18.0***
Avg. Yld.	2.9%	2.8%	3.4%	3.5%	1.9%	2.5%	2.0%	2.5%	2.2%	1.8%	***1.8%***	***2.1%***

[1] Share count in millions

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Shares of McGrath RentCorp have increased $6, or 6.3%, since our July 28th, 2023 update. Based off updated earnings expectations for 2023, McGrath RentCorp's stock currently has a price-to-earnings ratio of 20.9. We have a valuation target of 18 times earnings, in-line with the long-term average for the stock. If shares were to revert to this multiple by 2028, then valuation be a 2.9% headwind to annual results over this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	58%	57%	63%	64%	49%	40%	38%	39%	47%	38%	***38%***	***38%***

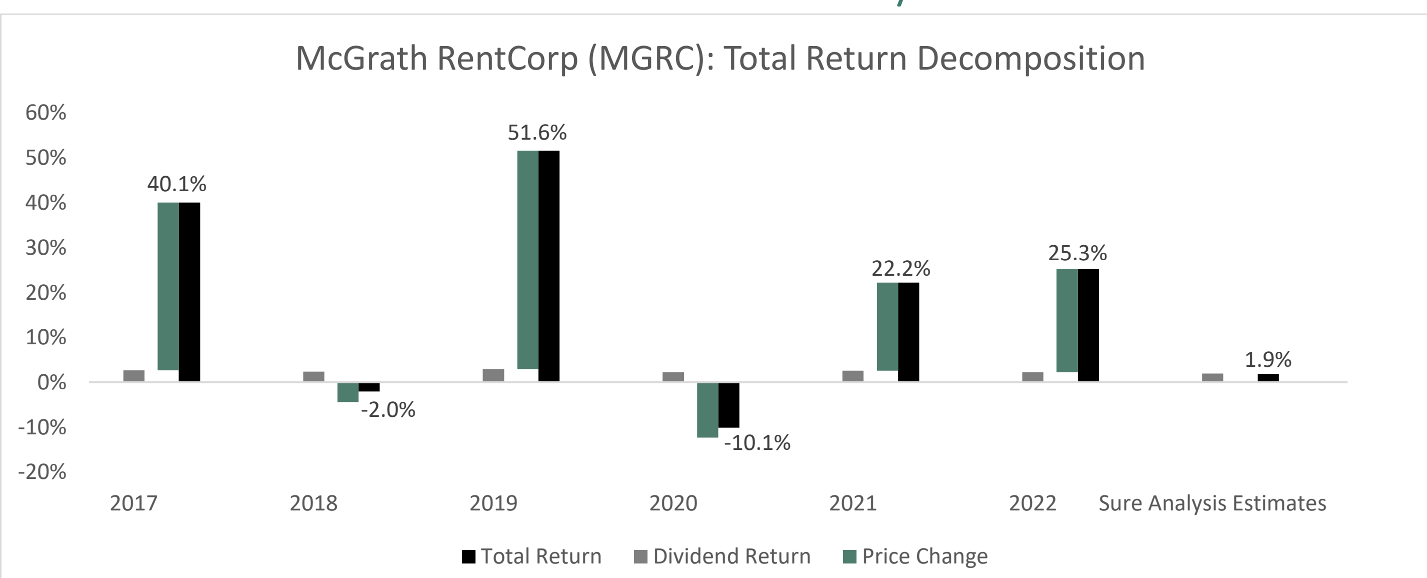
McGrath RentCorp showed in the last recession that its earnings are at risk during a downturn. The company's rental business would most likely see earnings decline in the next recession as customers might not be willing to add additional classroom or office space, and would make do with current facilities. 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 9% for the three years prior to 2020, though the last two raises have been below this range. Higher-than-average increases could 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 diverse. The company's products are used for office space, school classrooms, and telecommunications 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 1.9% per year through 2028, down from our previous estimate of 2.2%. Our projected return stems from a 3% earnings growth rate and 1.8% starting yield that are partially offset by a low single-digit headwind from multiple compression. McGrath RentCorp's segments continue to show strong growth rates in its most recent quarter. We have raised our five-year price target $5 to $102 to reflect estimates for the year, but we reiterate our sell rating on shares of McGrath RentCorp due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	380	408	405	424	462	498	570	573	617	734
Gross Profit	169	182	177	184	206	233	266	264	281	337
Gross Margin	44.5%	44.6%	43.7%	43.4%	44.7%	46.8%	46.7%	46.1%	45.6%	45.9%
SG&A Exp.	89	97	100	105	112	116	125	123	149	171
D&A Exp.	77	81	84	81	78	82	89	95	107	111
Operating Profit	80	85	77	79	95	117	141	141	132	166
Operating Margin	21.1%	20.9%	19.0%	18.7%	20.5%	23.6%	24.8%	24.6%	21.5%	22.6%
Net Profit	43	46	40	38	154	79	97	102	90	115
Net Margin	11.4%	11.2%	10.0%	9.0%	33.3%	15.9%	17.0%	17.8%	14.5%	15.7%
Free Cash Flow	(11)	(42)	4	51	13	4	8	80	79	(11)
Income Tax	28	31	26	29	(70)	25	32	30	32	35

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,028	1,116	1,153	1,128	1,148	1,217	1,310	1,276	1,596	1,708
Cash & Equivalents	2	1	1	1	3	2	2	1	1	1
Accounts Receivable	88	101	95	97	106	121	128	123	159	190
Goodwill & Int. Ass.	38	38	37	36	36	35	36	35	179	173
Total Liabilities	627	692	773	734	624	646	676	593	864	904
Long-Term Debt	290	322	381	326	303	299	293	223	426	414
Shareholder's Equity	401	425	380	394	524	572	634	683	732	804
LTD/E Ratio	0.72	0.76	1.00	0.83	0.58	0.52	0.46	0.33	0.58	0.51

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.3%	4.3%	3.6%	3.4%	13.5%	6.7%	7.7%	7.9%	6.2%	7.0%
Return on Equity	11.3%	11.1%	10.1%	9.9%	33.5%	14.5%	16.1%	15.5%	12.7%	15.0%
ROIC	6.4%	6.4%	5.4%	5.2%	19.9%	9.4%	10.8%	11.1%	8.7%	9.7%
Shares Out.	26	26	24	24	24	24	25	24	24	24
Revenue/Share	14.64	15.59	15.89	17.69	19.04	20.31	23.16	23.34	25.16	29.93
FCF/Share	(0.42)	(1.60)	0.15	2.13	0.54	0.16	0.33	3.28	3.22	(0.44)

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