

MCGRATH RENTCORP
Form 10-Q
August 07, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

Commission file number 0-13292

McGRATH RENTCORP

(Exact name of registrant as specified in its Charter)

| | |
|--|--|
| California (State or other jurisdiction of incorporation or organization) | 94-2579843 (I.R.S. Employer Identification No.) |
| 5700 Las Positas Road, Livermore, CA 94551-7800 (Address of principal executive offices) | |
| Registrant's telephone number: (925) 606-9200 | |

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or a smaller reporting company. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of August 7, 2008, 23,657,318 shares of Registrant's Common Stock were outstanding.

FORWARD LOOKING STATEMENTS

Statements contained in this Quarterly Report on Form 10-Q which are not historical facts are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts regarding McGrath RentCorp's (the Company's) business strategy, future operations, financial position, estimated revenues or losses, projected costs, prospects, plans and objectives are forward looking statements. These forward-looking statements appear in a number of places and can be identified by the use of forward-looking terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, future, intend, hopes or certain or the negative of these terms or other variations or comparable terminology.

Management cautions that forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected in such forward-looking statements including, without limitation, the following: the future prospects for and growth of the Company and the industries in which it operates, the level of the Company's future rentals and sales, customer demand and cost of raw materials, the Company's ability to maintain its business model; the Company's ability to retain and recruit key personnel; the Company's ability to maintain its competitive strengths and to effectively compete against its competitors; the Company's short-term decisions and long-term strategies for the future and its ability to implement and maintain such decisions and strategies, including its strategies: (i) to focus on rental revenue growth from an increasing base of rental assets, (ii) to actively maintain, repair, redeploy, manage and anticipate the need for various models of rental equipment cost-effectively and to maximize the level of proceeds from the sale of such products, and (iii) to create internal facilities and infrastructure capabilities that can provide prompt and efficient customer service, experienced assistance, rapid delivery and timely maintenance of the Company's equipment; the demand by the educational market (and the K-12 market in particular) for the Company's modular products; the effect of delays or interruptions in the passage of statewide and local facility bond measures on the Company's operations; the effect of changes in applicable law, and policies relating to the use of temporary buildings on the Company's modular rental and sales revenues, including with respect to class size and building standards; the effects of changes in the level of state funding to public schools and the use of classrooms that meet the Department of Housing requirements; the Company's ability to maintain and upgrade modular equipment to comply with changes in applicable law and customer preference; the Company's strategy to effectively implement its expansion into Florida, North Carolina, Georgia and other new markets in the U.S.; the Company's expectation that the first phase of its ERP upgrade project will be completed in late 2008 and the Company's reliance on its information technology systems; the Company's engaging in and ability to consummate future acquisitions; manufacturers' ability to produce products to the Company's specification on a timely basis; the Company's ability to maintain good relationships with school districts, manufacturers, and other suppliers; the impact of debt covenants on the Company's flexibility in running its business and the effect of an event of default on the Company's results of operations; the effect of interest rate fluctuations; the Company's ability to manage its credit risk and accounts receivable; the timing and amounts of future capital expenditures and the Company's ability to meet its needs for working capital including its ability to negotiate lines of credit; the Company's ability to track technology trends to make good buy-sell decisions with respect to electronic test equipment; the effect of changes to the Company's accounting policies and impact of evolving interpretation and implementation of such policies; the risk of litigation and claims against the Company; the impact of a change in the Company's overall effective tax rate as a result of the Company's mix of business levels in various tax jurisdictions in which it does business; the adequacy of the Company's insurance coverage; the impact of a failure by third parties to manufacture our products timely or properly; the level of future warranty costs of modular equipment that we sell; the effect of seasonality on the Company's business; the growth of the Company's business in international markets and the Company's ability to succeed in those markets; and the Company's ability to pass on increases in its costs of rental equipment, including manufacturing costs, operating expenses and interest expense through increases in rental rates and selling prices. Further, our future business, financial condition and results of operations could differ materially from those anticipated by such forward-looking statements and are subject to risks and uncertainties including the risks set forth above and the Risk Factors set forth in this Form 10-Q. Moreover, neither we assume nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements.

Forward-looking statements are made only as of the date of this Form 10-Q and are based on management's reasonable assumptions, however these assumptions can be wrong or affected by known or unknown risks and uncertainties. No forward-looking statement can be guaranteed and subsequent facts or circumstances may contradict, obviate, undermine or otherwise fail to support or substantiate such statements. Readers should not place undue reliance on these forward-looking statements and are cautioned that any such forward-looking statements are not guarantees of future performance. We are under no duty to update any of the forward-looking statements after the date of this Form 10-Q to conform such statements to actual results or to changes in our expectations.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of McGrath RentCorp and Subsidiaries:

We have reviewed the accompanying consolidated balance sheet of McGrath RentCorp and Subsidiaries as of June 30, 2008, and the related statements of income for the three-month periods ended June 30, 2008 and 2007 and the statements of income and cash flows for the six-month periods ended June 30, 2008 and 2007. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the United States Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of McGrath RentCorp and Subsidiaries as of December 31, 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 25, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Grant Thornton LLP

San Francisco, California

August 5, 2008

McGRATH RENTCORP

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

| <i>(in thousands, except per share amounts)</i> | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|------------------|
| | June 30, 2008 | June 30, 2007 | June 30, 2008 | June 30, 2007 |
| REVENUES | | | | |
| Rental | \$ 48,846 | \$ 44,995 | \$ 97,082 | \$ 88,303 |
| Rental Related Services | 7,490 | 8,598 | 14,832 | 16,020 |
| Rental Operations | 56,336 | 53,593 | 111,914 | 104,323 |
| Sales | 17,001 | 13,224 | 26,174 | 22,567 |
| Other | 616 | 630 | 1,280 | 1,310 |
| Total Revenues | 73,953 | 67,447 | 139,368 | 128,200 |
| COSTS AND EXPENSES | | | | |
| Direct Costs of Rental Operations | | | | |
| Depreciation of Rental Equipment | 14,044 | 12,730 | 27,462 | 24,749 |
| Rental Related Services | 5,536 | 6,166 | 10,751 | 11,259 |
| Other | 9,591 | 8,996 | 17,681 | 16,594 |
| Total Direct Costs of Rental Operations | 29,171 | 27,892 | 55,894 | 52,602 |
| Costs of Sales | 11,667 | 9,203 | 17,465 | 15,729 |
| Total Costs | 40,838 | 37,095 | 73,359 | 68,331 |
| Gross Profit | 33,115 | 30,352 | 66,009 | 59,869 |
| Selling and Administrative Expenses | 14,230 | 12,607 | 27,774 | 24,255 |
| Income from Operations | 18,885 | 17,745 | 38,235 | 35,614 |
| Interest Expense | 2,291 | 2,832 | 4,758 | 5,453 |
| Income Before Provision for Income Taxes | 16,594 | 14,913 | 33,477 | 30,161 |
| Provision for Income Taxes | 6,505 | 5,816 | 13,123 | 11,763 |
| Income Before Minority Interest | 10,089 | 9,097 | 20,354 | 18,398 |
| Minority Interest in Income (Loss) of Subsidiary | | 12 | | (15) |
| Net Income | \$ 10,089 | \$ 9,085 | \$ 20,354 | \$ 18,413 |
| Earnings Per Share: | | | | |
| Basic | \$ 0.43 | \$ 0.36 | \$ 0.85 | \$ 0.73 |
| Diluted | \$ 0.42 | \$ 0.36 | \$ 0.85 | \$ 0.72 |
| Shares Used in Per Share Calculation: | | | | |
| Basic | 23,641 | 25,233 | 23,810 | 25,174 |
| Diluted | 23,890 | 25,491 | 23,977 | 25,431 |
| Cash Dividends Declared Per Share | \$ 0.20 | \$ 0.18 | \$ 0.40 | \$ 0.36 |

The accompanying notes are an integral part of these consolidated financial statements

McGRATH RENTCORP
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| <i>(in thousands)</i> | June 30, 2008 | December 31, 2007 |
|--|--------------------------|------------------------------|
| <u>Assets</u> | | |
| Cash | \$ 1,302 | \$ 5,090 |
| Accounts Receivable, net of allowance for doubtful accounts of \$1,300 in 2008 and \$1,400 in 2007 | 68,717 | 67,061 |
| Rental Equipment, at cost: | | |
| Relocatable Modular Buildings | 492,774 | 475,077 |
| Electronic Test Equipment | 256,267 | 232,349 |
| | 749,041 | 707,426 |
| Less Accumulated Depreciation | (240,529) | (221,412) |
| Rental Equipment, net | 508,512 | 486,014 |
| Property, Plant and Equipment, net | 76,501 | 66,480 |
| Prepaid Expenses and Other Assets | 19,698 | 17,591 |
| Total Assets | \$ 674,730 | \$ 642,236 |
| <u>Liabilities and Shareholders' Equity</u> | | |
| Liabilities: | | |
| Notes Payable | \$ 234,725 | \$ 197,729 |
| Accounts Payable and Accrued Liabilities | 53,784 | 55,642 |
| Deferred Income | 24,021 | 28,948 |
| Deferred Income Taxes, net | 126,462 | 115,886 |
| Total Liabilities | 438,992 | 398,205 |
| Shareholders' Equity: | | |
| Common Stock, no par value - Authorized 40,000 shares | | |
| Issued and Outstanding 23,657 shares in 2008 and 24,578 shares in 2007 | 42,968 | 41,917 |
| Retained Earnings | 192,770 | 202,114 |
| Total Shareholders' Equity | 235,738 | 244,031 |
| Total Liabilities and Shareholders' Equity | \$ 674,730 | \$ 642,236 |

The accompanying notes are an integral part of these consolidated financial statements

McGRATH RENTCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

| <i>(in thousands)</i> | Six Months Ended June 30, | |
|---|------------------------------|-----------|
| | 2008 | 2007 |
| <u>CASH FLOWS FROM OPERATING ACTIVITIES:</u> | | |
| Net Income | \$ 20,354 | \$ 18,413 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Depreciation | 28,749 | 25,902 |
| Provision for Doubtful Accounts | 654 | 430 |
| Non-Cash Stock-Based Compensation | 1,919 | 1,704 |
| Gain on Sale of Rental Equipment | (4,824) | (4,350) |
| Change In: | | |
| Accounts Receivable | (2,312) | (4,755) |
| Prepaid Expenses and Other Assets | (2,107) | (1,047) |
| Accounts Payable and Accrued Liabilities | (2,725) | (4,434) |
| Deferred Income | (4,927) | (7,391) |
| Deferred Income Taxes | 10,576 | 4,303 |
| Net Cash Provided by Operating Activities | 45,357 | 28,775 |
| <u>CASH FLOWS FROM INVESTING ACTIVITIES:</u> | | |
| Purchase of Rental Equipment | (54,665) | (54,965) |
| Purchase of Property, Plant and Equipment | (11,308) | (1,511) |
| Proceeds from Sale of Rental Equipment | 12,558 | 11,040 |
| Net Cash Used in Investing Activities | (53,415) | (45,436) |
| <u>CASH FLOWS FROM FINANCING ACTIVITIES:</u> | | |
| Net Borrowings Under Bank Lines of Credit | 36,996 | 20,424 |
| Proceeds from the Exercise of Stock Options | 663 | 3,374 |
| Excess Tax Benefit from Exercise and Disqualifying Disposition of Stock Options | 133 | 1,385 |
| Repurchase of Common Stock | (24,418) | |
| Payment of Dividends | (9,104) | (8,550) |
| Net Cash Provided by Financing Activities | 4,270 | 16,633 |
| Net Decrease in Cash | (3,788) | (28) |
| Cash Balance, beginning of period | 5,090 | 349 |
| Cash Balance, end of period | \$ 1,302 | \$ 321 |
| Interest Paid, during the period | \$ 5,059 | \$ 5,632 |
| Income Taxes Paid, during the period | \$ 2,415 | \$ 6,076 |
| Dividends Declared, not yet paid | \$ 4,713 | \$ 4,558 |
| Rental Equipment Acquisitions, not yet paid | \$ 10,432 | \$ 8,970 |

The accompanying notes are an integral part of these consolidated financial statements

McGRATH RENTCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

NOTE 1. CONSOLIDATED FINANCIAL INFORMATION

The consolidated financial information for the six months ended June 30, 2008 and 2007 have not been audited, but in the opinion of management, all adjustments (consisting of normal recurring accruals, consolidation and eliminating entries) necessary for the fair presentation of the consolidated results of operations, financial position, and cash flows of McGrath RentCorp (the Company) have been made. The consolidated results for the six months ended June 30, 2008 should not be considered as necessarily indicative of the consolidated results for the entire year. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's latest Form 10-K.

NOTE 2. NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement (SFAS No. 157) on January 1, 2008. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure about fair value measurements. The adoption of SFAS No. 157 did not have any significant impact on the Company's financial condition, or results of operations.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) became effective on January 1, 2008. SFAS No. 159 permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The Company did not choose to measure any financial instruments or other items in accordance with the provisions of SFAS 159.

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141(R), Business Combinations, and SFAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin (ARB) No. 51. These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS Nos. 141(R) and 160 are effective for financial statements issued for fiscal years beginning on or after December 15, 2008. SFAS No. 141(R) will be applied by the Company to business combinations occurring on or after January 1, 2009. The Company is currently evaluating the impact of the pending adoption of SFAS No. 141(R) on its consolidated financial statements. The Company does not currently have any noncontrolling interest in subsidiaries and does not believe the adoption of SFAS No. 160 will materially impact the presentation of the financial results of the Company.

NOTE 3. EARNINGS PER SHARE

Basic earnings per share (EPS) is computed as net income divided by the weighted average number of shares of common stock outstanding for the period. Diluted EPS is computed as net income divided by the weighted average number of shares outstanding of common stock and common stock equivalents for the period, including the dilutive effects of stock options and other potentially dilutive securities. Common stock equivalents result from dilutive stock options computed using the treasury stock method and the average share price for the reported period. The effect of dilutive options on the weighted average number of shares for the three and six months ended June 30, 2008 and 2007 was 248,143 and 257,498 and 166,637 and 257,925 shares, respectively. As of June 30, 2008 and 2007, stock options to purchase 1,105,000 and 500,000 shares, respectively, of the Company's common stock were not included in the computation of diluted EPS because the exercise price exceeded the average market price for the quarter and the effect would have been anti-dilutive.

On May 14, 2008, the Company's Board of Directors authorized the Company to repurchase an aggregate of 2,000,000 shares of the Company's outstanding common stock. In connection with this authorization, the Board of Directors terminated its previous share repurchase authorization announced on March 21, 2003. These purchases are made in the over-the-counter market (NASDAQ) and/or through privately negotiated, large block transactions at such repurchase price as the officers of the Company deem appropriate and desirable on behalf of the Company. All shares repurchased by the Company are canceled and returned to the status of authorized but

unissued shares of common stock. There were no repurchases of common stock during the three months ended June 30, 2008. During the six months ended June 30, 2008, the Company repurchased 968,746 shares of common stock for an aggregate repurchase price of \$21.9 million, or an average price of \$22.61 per share. There were no repurchases of common stock during the three and six months ended June 30, 2007. As of June 30, 2008, 2,000,000 shares remain authorized for repurchase.

NOTE 4. NOTES PAYABLE

In May 2008, the Company entered into a credit facility with a syndicate of banks (the New Credit Facility). The five-year facility matures on May 14, 2013 and replaces the Company's prior \$190.0 million line of credit. The New Credit Facility provides for a \$350.0 million unsecured revolving credit facility, which includes a \$25.0 million sub-limit for the issuance of standby letters of credit and a \$10.0 million sub-limit for swing-line loans. The New Credit Facility requires the Company to pay interest determined by reference to the Consolidated Leverage ratio (as defined). In addition, the Company pays a commitment fee on the daily unused portion of the available facility. The New Credit Facility contains financial covenants requiring the Company to not: (1) permit the Consolidated Fixed Charge Coverage Ratio (as defined) as of the end of any fiscal quarter to be less than 2.00 to 1.00; (2) permit the Consolidated Asset Coverage Ratio (as defined) as of the end of any fiscal quarter to be less than 1.50 to 1.00; and (3) permit the Consolidated Leverage Ratio (as defined) at any time during any period of four consecutive fiscal quarters to be greater than 2.50 to 1.00 (provided that, for the three fiscal quarters immediately following the occurrence of a Material Transaction (as defined), the Consolidated Leverage Ratio (calculated on a pro forma basis giving effect to such Material Transaction) shall not exceed 3.00 to 1.00).

In June 2008, the Company entered into a Credit Facility Letter Agreement with Union Bank of California, N.A. and a Credit Line Note in favor of Union Bank of California, N.A., extending its \$5.0 million line of credit facility related to its cash management services (Sweep Service Facility). The Sweep Service Facility matures on the earlier of May 14, 2013, or the date the Company ceases to utilize Union Bank of California, N.A. for its cash management services.

At June 30, 2008, the Company was in compliance with all covenants related to the New Credit Facility and had the capacity to borrow an additional \$156.3 million under its lines of credit.

NOTE 5. SEGMENT REPORTING

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. In accordance with SFAS No. 131, the Company's three reportable segments are Mobile Modular, TRS-RenTelco, and Enviroplex. The operations of each of these segments are described in Note 1 - Organization and Business, and the accounting policies of the segments are described in Note 2 - Significant Accounting Policies in the Company's latest Form 10-K. Management focuses on se