MCGRATH RENTCORP
Form 10-Q
August 02, 2017

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, 2017

Commission file number 0-13292

McGRATH RENTCORP

(Exact name of registrant as specified in its Charter)

California	94-2579843
(State or other jurisdiction	(I.R.S. Employer
of incorporation or organization)	Identification No.)

5700 Las Positas Road, Livermore, CA 94551-7800

(Address of principal executive offices)

Registrant's telephone number: (925) 606-9200

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period of complying with any new or revised financial accounting standards provided pursuant to section 13(a) of the Exchange Act.

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 1, 2017, 23,993,801 shares of Registrant’s Common Stock were outstanding.

FORWARD LOOKING STATEMENTS

Statements contained in this Quarterly Report on Form 10-Q (this "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 not guarantees of future performance and are subject to risks and uncertainties that could cause our actual results to differ materially from those projected in such forward-looking statements. 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 as set forth under "Risk Factors" in this form 10-Q.

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. Except as otherwise required by law, 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

Board of Directors and Shareholders

McGrath RentCorp

We have reviewed the accompanying condensed consolidated balance sheet of McGrath RentCorp and subsidiaries (the "Company") and the related condensed consolidated statements of income, comprehensive income and cash flows as of June 30, 2017 and for the three month and six month periods ended June 30, 2017 and 2016. 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 Public Company Accounting Oversight Board (United States), 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 condensed consolidated interim financial statements referred to above 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 the Company as of December 31, 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unqualified opinion on those consolidated financial statements in our report dated February 28, 2017. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2016, 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 Jose, California

August 2, 2017

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Revenues				
Rental	$ 69,953	$ 66,747	$ 137,931	$ 133,279
Rental related services	18,796	19,315	36,731	36,906
Rental operations	88,749	86,062	174,662	170,185
Sales	20,187	16,396	28,482	25,430
Other	646	647	1,275	1,189
Total revenues	109,582	103,105	204,419	196,804
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	17,242	18,231	34,621	36,771
Rental related services	14,312	14,677	28,145	28,402
Other	16,039	16,020	31,398	31,302
Total direct costs of rental operations	47,593	48,928	94,164	96,475
Costs of sales	12,778	10,421	17,374	15,918
Total costs of revenues	60,371	59,349	111,538	112,393
Gross profit	49,211	43,756	92,881	84,411
Selling and administrative expenses	27,365	25,683	55,213	52,080
Income from operations	21,846	18,073	37,668	32,331
Other income (expense):				
Interest expense	(2,949)	(2,990)	(5,738)	(6,546)
Foreign currency exchange gain (loss)	11	(77)	237	74
Income before provision for income taxes	18,908	15,006	32,167	25,859
Provision for income taxes	7,447	5,927	12,733	10,214
Net income	$ 11,461	$ 9,079	$ 19,434	$ 15,645
Earnings per share:				
Basic	$ 0.48	$ 0.38	$ 0.81	$ 0.66
Diluted	$ 0.48	$ 0.38	$ 0.80	$ 0.65
Shares used in per share calculation:				
Basic	23,985	23,900	23,968	23,881
Diluted	24,092	23,949	24,164	23,931
Cash dividends declared per share	$ 0.260	$ 0.255	$ 0.520	$ 0.510

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

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McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2017	2016	2017	2016
Net income	$ 11,461	$ 9,079	$ 19,434	$ 15,645
Other comprehensive income (loss):				
Foreign currency translation adjustment	(30)	5	(108)	(87)
Tax benefit (provision)	11	(1)	36	33
Comprehensive income	$ 11,442	$ 9,083	$ 19,362	$ 15,591

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

McGrath RentCorp

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)	June 30, 2017	December 31, 2016
Assets		
Cash	$1,871	$852
Accounts receivable, net of allowance for doubtful accounts of $1,987 in 2017 and $2,087 in 2016	96,539	96,877
Rental equipment, at cost:		
Relocatable modular buildings	782,503	769,190
Electronic test equipment	249,935	246,325
Liquid and solid containment tanks and boxes	309,784	308,542
	1,342,222	1,324,057
Less accumulated depreciation	(479,015)	(467,686)
Rental equipment, net	863,207	856,371
Property, plant and equipment, net	118,117	112,190
Prepaid expenses and other assets	34,422	25,583
Intangible assets, net	8,159	8,595
Goodwill	27,808	27,808
Total assets	$1,150,123	$1,128,276
Liabilities and Shareholders' Equity		
Liabilities:		
Notes payable	$330,287	$326,266
Accounts payable and accrued liabilities	82,332	78,205
Deferred income	42,533	37,499
Deferred income taxes, net	292,606	292,019
Total liabilities	747,758	733,989
Shareholders’ equity:		
Common stock, no par value - Authorized 40,000 shares		
Issued and outstanding - 23,992 shares as of June 30, 2017 and 23,948 shares as of December 31, 2016	103,040	101,821
Retained earnings	299,452	292,521
Accumulated other comprehensive loss	(127)	(55)
Total shareholders’ equity	402,365	394,287
Total liabilities and shareholders’ equity	$1,150,123	$1,128,276

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

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McGrath RentCorp

CONDENSED Consolidated Statements of Cash Flows

(unaudited)

(in thousands)	Six Months Ended June 30, 2017	2016
Cash Flows from Operating Activities :		
Net income	$19,434	$15,645
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	38,752	41,417
Provision for doubtful accounts	597	987
Share-based compensation	1,538	1,586
Gain on sale of used rental equipment	(7,914)	(6,282)
Foreign currency exchange gain	(237)	(74)
Amortization of debt issuance costs	25	26
Change in:		
Accounts receivable	(259)	(1,584)
Income taxes receivable	—	11,000
Prepaid expenses and other assets	(8,839)	(2,863)
Accounts payable and accrued liabilities	680	4,361
Deferred income	5,034	2,061
Deferred income taxes	587	6,105
Net cash provided by operating activities	49,398	72,385
Cash Flows from Investing Activities:		
Purchases of rental equipment	(46,118)	(45,715)
Purchases of property, plant and equipment	(9,623)	(8,698)
Proceeds from sales of used rental equipment	16,057	13,059
Net cash used in investing activities	(39,684)	(41,354)
Cash Flows from Financing Activities:		
Net borrowings under bank lines of credit	23,996	1,814
Principal payments on Series A senior notes	(20,000)	(20,000)
Proceeds from the exercise of stock options	—	37
Taxes paid related to net share settlement of stock awards	(319)	(486)
Payment of dividends	(12,390)	(12,253)
Net cash used in financing activities	(8,713)	(30,888)
Effect of foreign currency exchange rate changes on cash	18	(8)
Net increase in cash	1,019	135
Cash balance, beginning of period	852	1,103
Cash balance, end of period	$1,871	$1,238
Supplemental Disclosure of Cash Flow Information:		
Interest paid, during the period	$5,817	$6,646
Net income taxes paid, during the period	$18,141	$5,679
Dividends accrued during the period, not yet paid	$6,214	$6,135
Rental equipment acquisitions, not yet paid	$6,359	$3,935

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

McGRATH RENTCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

NOTE 1. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The condensed consolidated financial statements for the three and six months ended June 30, 2017 and 2016 have not been audited, but in the opinion of management, all adjustments (consisting of normal recurring accruals, consolidating and eliminating entries) necessary for the fair presentation of the consolidated financial position, results of operations and cash flows of McGrath RentCorp (the "Company") have been made. The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to those rules and regulations. The consolidated results for the six months ended June 30, 2017 should not be considered as necessarily indicative of the consolidated results for the entire fiscal year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's latest Annual Report on Form 10-K filed with the SEC on February 28, 2017 for the year ended December 31, 2016 (the "2016 Annual Report").

In order to conform to our current year presentation, certain amounts were reclassified from other to rental related services within the direct costs of rental operations on the Condensed Consolidated Statements of Income. These reclassifications had no impact on net income, earnings per share or operating cash flows.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. The objective of this guidance is to establish the principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue from contracts with customers. The FASB has continued to issue ASUs to clarify and provide implementation guidance related to Revenue from Contracts with Customers, including ASU 2016-08, Revenue from Contract with Customers: Principal versus Agent Considerations, ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients and ASU 2016-20, Revenue from Contracts with Customers: Technical Correction and Improvements. These amendments address a number of areas, including the entity's identification of its performance obligations in a contract, collectability, non-cash consideration, presentation of sales tax and an entity's evaluation of the nature of its promise to grant a license of intellectual property and whether or not that revenue is recognized over time or at a point in time. These standards are effective for the interim and annual reporting periods beginning after December 31, 2017. The new standard permits two methods of adoption: retrospectively to each prior period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). While the Company is still evaluating the potential impact of this guidance, including the method of adoption, the Company believes the majority of its revenue, as such revenue relates to rental contractual revenue, is excluded from the scope of this standard, and the remaining revenue streams will not be materially affected. The Company's Enviroplex division currently recognizes the sale of its manufactured modular buildings to customers following the completed contract method which, under the new guidance, may change to occur over time. The Company currently does not anticipate the adoption of this guidance will have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Subtopic 842-10). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) on the commencement date: a) lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and b) right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. While the Company is still evaluating the potential impact of this guidance, as a lessor, the Company does not believe the accounting for operating lease revenues will be materially affected by this standard. The Company anticipates its lessee accounting to increase its total assets and liabilities; however, the Company is currently evaluating the magnitude of the impact the adoption of this guidance will have on the Company's consolidated financial statements.

During the first quarter 2017, the Company adopted ASU No. 2016-09 Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). As a result of the adoption, the Company recognized $116,000 and $134,000 of excess tax benefits related to share-based payments as a reduction to the provision for income taxes for the three and six months ended June 30, 2017, respectively. These tax benefits, or shortfalls, were historically recorded in equity. In addition, cash flows related to excess tax benefits, or shortfalls, are now classified as an operating activity with the prior period adjusted accordingly. Cash paid on employees' behalf related to shares withheld for tax purposes is classified as a financing activity, consistent with prior year's presentation. Retrospective application of the cash flow presentation requirements resulted in decreases to both net cash provided by operations and net cash used in financing activities of $871,000 for the six months ended June 30, 2016. The Company's compensation expense for each period continues to reflect forfeitures as they occur, rather than based upon estimated expected forfeitures.

In May 2017, the FASB issued ASU No. 2017-09, Compensation, Stock Compensation (Topic 718). The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all of the following are met: 1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification; 2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified and; 3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments of this update are effective for the interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

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 assuming conversion of all potentially dilutive securities including the dilutive effect of stock options, unvested restricted stock awards and other potentially dilutive securities. The table below presents the weighted-average number of shares of common stock used to calculate basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(in thousands)	2017	2016	2017	2016
Weighted-average number of shares of common stock for calculating basic earnings per share	23,985	23,900	23,968	23,881
Effect of potentially dilutive securities from equity-based compensation	107	49	196	50
Weighted-average number of shares of common stock for calculating diluted earnings per share	24,092	23,949	24,164	23,931

The following securities were not included in the computation of diluted earnings per share as their effect would have been anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2017	2016	2017	2016
Options to purchase shares of common stock	306	989	10	989

NOTE 4. INTANGIBLE ASSETS

Intangible assets consist of the following:

(dollar amounts in thousands)	Estimated useful life in years	June 30, 2017	December 31, 2016
Trade name	Indefinite	$5,700	$ 5,700
Customer relationships	11	9,611	9,611
		15,311	15,311
Less accumulated amortization		(7,152)	(6,716)
		$8,159	$ 8,595

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The Company assesses potential impairment of its goodwill and intangible assets when there is evidence that events or circumstances have occurred that would indicate the recovery of an asset's carrying value is unlikely. The Company also assesses potential impairment of its goodwill and intangible assets with indefinite lives on an annual basis regardless of whether there is evidence of impairment. If indicators of impairment were to be present in intangible assets used in operations and future discounted cash flows were not expected to be sufficient to recover the assets' carrying amount, an impairment loss would be charged to expense in the period identified. The amount of an impairment loss that would be recognized is the excess of the asset's carrying value over its fair value. Factors the Company considers important, which may cause impairment include, among others, significant changes in the manner of use of the acquired asset, negative industry or economic trends, and significant underperformance relative to historical or projected operating results.

The Company conducts its annual impairment analysis in the fourth quarter of its fiscal year. The impairment analysis did not result in an impairment charge for the fiscal year ended December 31, 2016. Determining the fair value of a reporting unit is judgmental and involves the use of significant estimates and assumptions. The Company bases its fair value estimates on assumptions that it believes are reasonable but are uncertain and subject to changes in market conditions.

Intangible assets with finite useful lives are amortized over their respective useful lives. Based on the carrying values at June 30, 2017 and assuming no subsequent impairment of the underlying assets, the amortization expense is expected to be $0.5 million for the remainder of fiscal year 2017, $0.9 million in each of the fiscal years 2018 and 2019 and $0.2 million in 2020.

NOTE 5. SEGMENT REPORTING

The Company's four reportable segments are (1) its modular building and portable storage segment ("Mobile Modular"); (2) its electronic test equipment segment ("TRS-RenTelco"); (3) its containment solutions for the storage of hazardous and non-hazardous liquids and solids segment ("Adler Tanks"); and (4) its classroom manufacturing segment selling modular buildings used primarily as classrooms in California ("Enviroplex"). The operations of each of these segments are described in Part I – Item 1, "Business," and the accounting policies of the segments are described in "Note 2 – Significant Accounting Policies" in the Company's annual report on Form 10-K for the year ended December 31, 2016. Management focuses on several key measures to evaluate and assess each segment's performance, including rental revenue growth, gross profit, income from operations and income before provision for income taxes. Excluding interest expense, allocations of revenue and expense not directly associated with one of these segments are generally allocated to Mobile Modular, TRS-RenTelco and Adler Tanks based on their pro-rata share of direct revenues. Interest expense is allocated among Mobile Modular, TRS-RenTelco and Adler Tanks based on their pro-rata share of average rental equipment at cost, intangible assets, accounts receivable, deferred income and customer security deposits. The Company does not report total assets by business segment. Summarized financial information for the six months ended June 30, 2017 and 2016 for the Company's reportable segments is shown in the following table:

(dollar amounts in thousands)	Mobile Modular	TRS-RenTelco	Adler Tanks	Enviroplex [1]	Consolidated
Six Months Ended June 30,					
2017					
Rental revenues	$68,684	$39,551	$29,696	$ —	$137,931
Rental related services revenues	23,554	1,312	11,865	—	36,731
Sales and other revenues	12,703	10,990	1,153	4,911	29,757
Total revenues	104,941	51,853	42,714	4,911	204,419
Depreciation of rental equipment	10,666	16,071	7,884	—	34,621
Gross profit	47,578	23,847	19,832	1,624	92,881
Selling and administrative expenses	27,617	11,019	14,528	2,049	55,213
Income (loss) from operations	19,961	12,828	5,304	(425)	37,668
Interest (expense) income allocation	(3,289)	(1,126)	(1,515)	192	(5,738)
Income (loss) before provision for income taxes	16,672	11,939	3,789	(233)	32,167
Rental equipment acquisitions	21,531	25,510	2,558	—	49,599
Accounts receivable, net (period end)	57,268	18,443	15,918	4,910	96,539
Rental equipment, at cost (period end)	782,503	249,935	309,784		1,342,222
Rental equipment, net book value (period end)	551,101	96,547	215,559		863,207
Utilization (period end) [2]	75.7%	61.6%	55.4%		
Average utilization [2]	76.7%	62.3%	53.4%		
2016					
Rental revenues	$62,792	$41,197	$29,290	$ —	$133,279
Rental related services revenues	23,337	1,501	12,068	—	36,906
Sales and other revenues	8,634	13,194	644	4,147	26,619
Total revenues	94,763	55,892	42,002	4,147	196,804
Depreciation of rental equipment	10,347	18,386	8,038	—	36,771
Gross profit	41,287	22,558	19,077	1,489	84,411
Selling and administrative expenses	24,798	11,343	14,155	1,784	52,080
Income (loss) from operations	16,489	11,215	4,922	(295)	32,331
Interest (expense) income allocation	(3,602)	(1,340)	(1,719)	115	(6,546)
Income (loss) before provision for income taxes	12,887	9,949	3,203	(180)	25,859

Rental equipment acquisitions	26,448	15,373	550	—	42,371
Accounts receivable, net (period end)	52,362	23,098	15,757	4,643	95,860
Rental equipment, at cost (period end)	761,125	251,080	310,089		1,322,294
Rental equipment, net book value (period end)	544,132	94,320	229,970		868,422
Utilization (period end) [2]	75.7 %	59.7 %	46.8 %		
Average utilization [2]	76.0 %	59.5 %	49.7 %		

1. Gross Enviroplex sales revenues were $4,911 and $4,147 for the six months ended June 30, 2017 and 2016, respectively, with no inter-segment sales to Mobile Modular requiring elimination in consolidation.
2. Utilization is calculated each month by dividing the cost of rental equipment on rent by the total cost of rental equipment excluding accessory equipment and for Mobile Modular and Adler Tanks excluding new equipment inventory. The Average Utilization for the period is calculated using the average costs of rental equipment.

No single customer accounted for more than 10% of total revenues for the six months ended June 30, 2017 and 2016. Revenues from foreign country customers accounted for 5% of the Company's total revenues for the same periods.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q, including the following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), contains forward-looking statements under federal securities laws. Forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Our actual results could differ materially from those indicated by forward-looking statements as a result of various factors. These factors include, but are not limited to, those set forth under this Item, those discussed in Part II—Item 1A, "Risk Factors" and elsewhere in this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC on February 28, 2017 (the "2016 Annual Report") and those that may be identified from time to time in our reports and registration statements filed with the SEC.

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes included in Part I—Item 1 of this Form 10-Q and the Consolidated Financial Statements and related Notes and the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2016 Annual Report. In preparing the following MD&A, we presume that readers have access to and have read the MD&A in our 2016 Annual Report, pursuant to Instruction 2 to paragraph (b) of Item 303 of Regulation S-K. We undertake no duty to update any of these forward-looking statements after the date of filing of this Form 10-Q to conform such forward-looking statements to actual results or revised expectations, except as otherwise required by law.

General

The Company, incorporated in 1979, is a leading rental provider of relocatable modular buildings for classroom and office space, electronic test equipment for general purpose and communications needs, and liquid and solid containment tanks and boxes. The Company's primary emphasis is on equipment rentals. The Company is comprised of four reportable business segments: (1) its modular building and portable storage container rental segment ("Mobile Modular"); (2) its electronic test equipment segment ("TRS-RenTelco"); (3) its containment solutions for the storage of hazardous and non-hazardous liquids and solids segment ("Adler Tanks"); and (4) its classroom manufacturing segment selling modular buildings used primarily as classrooms in California ("Enviroplex").

The Mobile Modular business segment includes the results of operations of Mobile Modular Portable Storage division, which represented approximately 8% of the Company's total revenues in the six months ended June 30, 2017. Mobile Modular Portable Storage offers portable storage units and high security portable office units for rent, lease and purchase.

In the six months ended June 30, 2017, Mobile Modular, TRS-RenTelco, Adler Tanks and Enviroplex contributed 52%, 37%, 12% and negative 1% of the Company's income before provision for taxes (the equivalent of "pretax income"), respectively, compared to 50%, 39%, 12% and negative 1% for the same period in 2016. Although managed as a separate business unit, Enviroplex's revenues, pretax income contribution and total assets are not significant relative to the Company's consolidated financial position. Accordingly, we have not presented a separate discussion of Enviroplex's results of operations in this MD&A.

The Company generates its revenues primarily from the rental of its equipment on operating leases and from sales of equipment occurring in the normal course of business. The Company requires significant capital outlay to purchase its rental inventory and recovers its investment through rental and sales revenues. Rental revenues and certain other service revenues negotiated as part of lease agreements with customers and related costs are recognized on a straight-line basis over the terms of the leases. Sales revenues and related costs are recognized upon delivery and installation of the equipment to customers. Sales revenues are less predictable and can fluctuate from quarter to quarter and year to year depending on customer demands and requirements. Generally, rental revenues less cash operating costs recover the equipment's capitalized cost in a short period of time relative to the equipment's potential rental life and when sold, sale proceeds are usually above its net book value.

The Company’s modular revenues (consisting of revenues from Mobile Modular, Mobile Modular Portable Storage and Enviroplex) are derived from rentals and sales to education and commercial customers, with a majority of revenues generated by education customers. Modular revenues are primarily affected by demand for classrooms, which in turn is affected by shifting and fluctuating school populations, the levels of state funding to public schools, the need for temporary classroom space during reconstruction of older schools and changes in policies regarding class size. As a result of any reduced funding, lower expenditures by these schools may result in certain planned programs to increase the number of classrooms, such as those that the Company provides, to be postponed or terminated. However, reduced expenditures may also result in schools reducing their long-term facility construction projects in favor of using the Company’s modular classroom solutions. At this time, the Company can provide no assurances as to whether public schools will either reduce or increase their demand for the Company's modular classrooms as a result of fluctuations in state funding of public schools. Looking forward, the Company believes that any interruption in the passage of facility bonds or contraction of class size reduction programs by public schools may have a material adverse effect on both rental and sales revenues of the Company. (For more information, see “Item 1. Business – Relocatable Modular Buildings – Classroom Rentals and Sales to Public Schools (K-12)” in the Company’s 2016 Annual Report and “Item 1A. Risk Factors – Significant reductions of, or delays in, funding to public schools have caused the demand and pricing for our modular classroom units to decline, which has in the past caused, and may cause in the future, a reduction in our revenues and profitability" in Part II – Other Information of this Form 10-Q.)

Revenues of TRS-RenTelco are derived from the rental and sale of general purpose and communications test equipment to a broad range of companies, from Fortune 500 to middle and smaller market companies primarily in the aerospace, defense, communications, manufacturing and semiconductor industries. Electronic test equipment revenues are primarily affected by the business activity within these industries related to research and development, manufacturing, and communication infrastructure installation and maintenance.

Revenues of Adler Tanks are derived from the rental and sale of fixed axle tanks ("tanks") and vacuum containers, dewatering containers and roll-off containers (collectively referred to as "boxes"). These tanks and boxes are rented to a broad range of industries and applications including oil and gas exploration and field services, refinery, chemical and industrial plant maintenance, environmental remediation and field services, infrastructure building construction, marine services, pipeline construction and maintenance, tank terminals services, wastewater treatment, and waste management and landfill services for the containment of hazardous and non-hazardous liquids and solids.

The Company's rental operations include rental and rental related service revenues which comprised approximately 85% and 86% of consolidated revenues in the six months ended June 30, 2017 and 2016, respectively. Of the total rental operations revenues for the six months ended June 30, 2017, Mobile Modular, TRS-RenTelco and Adler Tanks comprised 53%, 23% and 24%, respectively, compared to 51%, 25% and 24%, respectively, in the same period of 2016. The Company's direct costs of rental operations include depreciation of rental equipment, rental related service costs, impairment of rental equipment (if any), and other direct costs of rental operations (which include direct labor, supplies, repairs, insurance, property taxes, license fees, cost of sub-rentals and amortization of certain lease costs).

The Company's Mobile Modular, TRS-RenTelco and Adler Tanks business segments sell modular units, electronic test equipment and liquid and solid containment tanks and boxes, respectively, which are either new or previously rented. In addition, Enviroplex sells new modular buildings used primarily as classrooms in California. For the six months ended June 30, 2017 and 2016, sales and other revenues of modular, electronic test equipment and liquid and solid containment tanks and boxes comprised approximately 15% and 14% of the Company's consolidated revenues, respectively. Of the total sales and other revenues for the six months ended June 30, 2017 and 2016, Mobile Modular and Enviroplex together comprised 59% and 48%, respectively, TRS-RenTelco comprised 37% and 50%, respectively, and Adler Tanks comprised 4% and 2%, respectively. The Company's cost of sales includes the carrying value of the equipment sold and the direct costs associated with the equipment sold, such as delivery, installation, modifications and related site work.

Selling and administrative expenses primarily include personnel and benefit costs, which include share-based compensation, depreciation and amortization, bad debt expense, advertising costs, and professional service fees. The Company believes that sharing of common facilities, financing, senior management, and operating and accounting systems by all of the Company's operations results in an efficient use of overhead. Historically, the Company's operating margins have been impacted favorably to the extent its costs and expenses are leveraged over a large installed customer base. However, there can be no assurance as to the Company's ability to maintain a large installed customer base or ability to sustain its historical operating margins.

Adjusted EBITDA

To supplement the Company's financial data presented on a basis consistent with accounting principles generally accepted in the United States of America ("GAAP"), the Company presents "Adjusted EBITDA", which is defined by the Company as net income before interest expense, provision for income taxes, depreciation, amortization, and share-based compensation. The Company presents Adjusted EBITDA as a financial measure as management believes it provides useful information to investors regarding the Company's liquidity and financial condition and because management, as well as the Company's lenders, use this measure in evaluating the performance of the Company.

Management uses Adjusted EBITDA as a supplement to GAAP measures to further evaluate period-to-period operating performance, compliance with financial covenants in the Company's revolving lines of credit and senior notes and the Company's ability to meet future capital expenditure and working capital requirements. Management believes the exclusion of non-cash charges, including share-based compensation, is useful in measuring the Company's cash available for operations and performance of the Company. Because management finds Adjusted EBITDA useful, the Company believes its investors will also find Adjusted EBITDA useful in evaluating the Company's performance.

Adjusted EBITDA should not be considered in isolation or as a substitute for net income, cash flows, or other consolidated income or cash flow data prepared in accordance with GAAP or as a measure of the Company's profitability or liquidity. Adjusted EBITDA is not in accordance with or an alternative for GAAP, and may be different from non–GAAP measures used by other companies. Unlike EBITDA, which may be used by other companies or investors, Adjusted EBITDA does not include share-based compensation charges. The Company believes that Adjusted EBITDA is of limited use in that it does not reflect all of the amounts associated with the Company's results of operations as determined in accordance with GAAP and does not accurately reflect real cash flow. In addition, other companies may not use Adjusted EBITDA or may use other non-GAAP measures, limiting the usefulness of Adjusted EBITDA for purposes of comparison. The Company's presentation of Adjusted EBITDA should not be construed as an inference that the Company will not incur expenses that are the same as or similar to the adjustments in this presentation. Therefore, Adjusted EBITDA should only be used to evaluate the Company's results of operations in conjunction with the corresponding GAAP measures. The Company compensates for the limitations of Adjusted EBITDA by relying upon GAAP results to gain a complete picture of the Company's performance. Because Adjusted EBITDA is a non-GAAP financial measure, as defined by the SEC, the Company includes in the tables below reconciliations of Adjusted EBITDA to the most directly comparable financial measures calculated and presented in accordance with GAAP.

Reconciliation of Net Income to Adjusted EBITDA

	Three Months Ended		Six Months Ended		Twelve Months Ended	
(dollar amounts in thousands)	June 30, 2017	2016	June 30, 2017	2016	June 30, 2017	2016
Net income	$11,461	$9,079	$19,434	$15,645	$42,040	$40,779
Provision for income taxes	7,447	5,927	12,733	10,214	31,199	26,108
Interest	2,949	2,990	5,738	6,546	11,399	11,900
Depreciation and amortization	19,348	20,557	38,752	41,417	78,514	83,526
EBITDA	41,205	38,553	76,657	73,822	163,152	162,313
Share-based compensation	732	730	1,538	1,586	3,043	3,032
Adjusted EBITDA [1]	$41,937	$39,283	$78,195	$75,408	$166,195	$165,345
Adjusted EBITDA margin [2]	38 %	38 %	38 %	38 %	38 %	40 %

Reconciliation of Adjusted EBITDA to Net Cash Provided by Operating Activities

	Three Months Ended		Six Months Ended		Twelve Months Ended	
(dollar amounts in thousands)	June 30, 2017	2016	June 30, 2017	2016	June 30, 2017	2016
Adjusted EBITDA [1]	$41,937	$39,283	$78,195	$75,408	$166,195	$165,345
Interest paid	(3,397)	(3,660)	(5,817)	(6,646)	(11,607)	(11,791)
Net income taxes paid	(12,576)	(4,973)	(18,141)	(5,679)	(28,017)	(6,687)
Gain on sale of used rental equipment	(4,971)	(3,316)	(7,914)	(6,282)	(15,371)	(12,619)
Foreign currency exchange loss (gain)	(11)	77	(237)	(74)	(42)	161
Amortization of debt financing cost	12	13	25	26	51	51
Change in certain assets and liabilities:						
Accounts receivable, net	(3,987)	(3,977)	338	(597)	(925)	(2,140)
Income taxes receivable	—	—	—	11,000	—	—

Prepaid expenses and other assets	(7,303)	(4,812)	(8,839)	(2,863)	(4,027)	2,066
Accounts payable and other liabilities	11,218	13,451	6,754	6,031	7,943	9,515
Deferred income	2,646	1,525	5,034	2,061	3,509	8,623
Net cash provided by operating activities	$23,568	$33,611	$49,398	$72,385	$117,709	$152,524

1. Adjusted EBITDA is defined as net income before interest expense, provision for income taxes, depreciation, amortization, and share-based compensation.
2. Adjusted EBITDA margin is calculated as Adjusted EBITDA divided by total revenues for the period.

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Adjusted EBITDA is a component of two restrictive financial covenants for the Company's unsecured Credit Facility, and Series A Senior Notes, Series B Senior Notes and Series C Senior Notes (as defined and more fully described under the heading "Liquidity and Capital Resources" in this MD&A). These instruments contain financial covenants requiring the Company to not:

- Permit the Consolidated Fixed Charge Coverage Ratio (as defined in the Credit Facility and the Note Purchase Agreement (as defined and more fully described under the heading "Liquidity and Capital Resources" in this MD&A)) of Adjusted EBITDA (as defined in the Credit Facility and the Note Purchase Agreement) to fixed charges as of the end of any fiscal quarter to be less than 2.50 to 1. At June 30, 2017, the actual ratio was 3.75 to 1.
- Permit the Consolidated Leverage Ratio of funded debt (as defined in the Credit Facility and the Note Purchase Agreement) to Adjusted EBITDA at any time during any period of four consecutive quarters to be greater than 2.75 to 1. At June 30, 2017, the actual ratio was 1.99 to 1.

At June 30, 2017, the Company was in compliance with each of the aforementioned covenants. There are no anticipated trends that the Company is aware of that would indicate non-compliance with these covenants, although, significant deterioration in our financial performance could impact the Company's ability to comply with these covenants.

Recent Developments

On June 7, 2017, the Company announced that the Board of Directors declared a quarterly cash dividend of $0.26 per common share for the quarter ended June 30, 2017, an increase of 2% over the prior year's comparable quarter.

Results of Operations

Three Months Ended June 30, 2017 Compared to

Three Months Ended June 30, 2016

Overview

Consolidated revenues for the three months ended June 30, 2017 increased 6% to $109.6 million from $103.1 million in the same period in 2016. Consolidated net income for the three months ended June 30, 2017 increased 26% to $11.5 million, from $9.1 million for the same period in 2016. Earnings per diluted share for the three months ended June 30, 2017 increased 26% to $0.48 from $0.38 for the same period in 2016.

For the three months ended June 30, 2017, on a consolidated basis:

- Gross profit increased $5.5 million, or 12%, to $49.2 million in 2017. Mobile Modular's gross profit increased $4.5 million, or 22%, due to higher gross profit on rental and sales revenues, partly offset by lower gross profit on rental related services revenues. TRS-RenTelco's gross profit increased $0.9 million, or 8%, primarily due to higher gross profit on rental and sales revenues. Enviroplex's gross profit decreased $0.1 million, or 7%. Adler Tanks' gross profit increased $0.1 million, or 1%, primarily due to higher gross profit on sales revenues.
- Selling and administrative expenses increased $1.7 million, or 7%, to $27.4 million, primarily due to increased employee headcount, salaries and employee benefit costs.
- Interest expense decreased $0.1 million, or 1%, to $2.9 million in 2017 compared to the same period in 2016, due to 9% lower average debt levels of the Company and 9% higher net average interest rates of 3.56% in 2017 compared to 3.27% in 2016.
- Pre-tax income contribution by Mobile Modular, TRS-RenTelco and Adler Tanks was 51%, 35% and 12%, respectively, compared to 44%, 35% and 16%, respectively, for the comparable 2016 period. These results are discussed on a segment basis below. Enviroplex pre-tax income contribution was 2% in 2017 compared to 5% in 2016.
- Adjusted EBITDA increased $2.7 million, or 7%, to $41.9 million in 2017.

Mobile Modular

For the three months ended June 30, 2017, Mobile Modular's total revenues increased $7.0 million, or 14%, to $56.6 million compared to the same period in 2016, primarily due to higher sales and rental revenues, partly offset by lower rental related services revenues. The revenue increase, together with higher gross profit on rental and sales revenues, partly offset by higher selling and administrative expenses and lower gross profit on rental related services revenues, resulted in a 45% increase in pre-tax income to $9.6 million for the three months ended June 30, 2017, from $6.6 million for the same period in 2016.

The following table summarizes quarterly results for each revenue and gross profit category, income from operations, pre-tax income and other selected information.

Mobile Modular – Three Months Ended 6/30/17 compared to Three Months Ended 6/30/16 (Unaudited)

	Three Months Ended		Increase	
(dollar amounts in thousands)	June 30,		(Decrease)	
	2017	2016	$	%
Revenues				
Rental	$35,030	$31,637	$3,393	11%
Rental related services	11,966	12,132	(166)	-1%
Rental operations	46,996	43,769	3,227	7%
Sales	9,504	5,785	3,719	64%
Other	138	125	13	10%
Total revenues	56,638	49,679	6,959	14%
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	5,333	5,221	112	2%
Rental related services	8,930	9,024	(94)	-1%
Other	10,247	10,536	(289)	-3%
Total direct costs of rental operations	24,510	24,781	(271)	-1%
Costs of sales	6,994	4,264	2,730	64%
Total costs of revenues	31,504	29,045	2,459	8%
Gross Profit				
Rental	19,451	15,881	3,570	22%
Rental related services	3,036	3,108	(72)	-2%
Rental operations	22,487	18,989	3,498	18%
Sales	2,509	1,520	989	65%
Other	138	125	13	10%
Total gross profit	25,134	20,634	4,500	22%
Selling and administrative expenses	13,817	12,336	1,481	12%
Income from operations	11,317	8,298	3,019	36%
Interest expense allocation	(1,698)	(1,655)	43	3%
Pre-tax income	$9,619	$6,643	$2,976	45%
Other Selected Information				
Average rental equipment [1]	$746,358	$717,755	$28,603	4%
Average rental equipment on rent	$570,728	$543,761	$26,967	5%
Average monthly total yield [2]	1.56%	1.47%		6%
Average utilization [3]	76.5%	75.8%		1%

Average monthly rental rate [4]	2.05	%	1.94	%		6	%
Period end rental equipment [1]	$747,351		$722,237		$25,114	3	%
Period end utilization [3]	75.7	%	75.7	%		0	%

1. Average and Period end rental equipment represents the cost of rental equipment excluding new equipment inventory and accessory equipment.
2. Average monthly total yield is calculated by dividing the averages of monthly rental revenues by the cost of rental equipment, for the period.
3. Period end utilization is calculated by dividing the cost of rental equipment on rent by the total cost of rental equipment excluding new equipment inventory and accessory equipment. Average utilization for the period is calculated using the average month end costs of rental equipment.
4. Average monthly rental rate is calculated by dividing the averages of monthly rental revenues by the cost of rental equipment on rent, for the period.

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Mobile Modular's gross profit for the three months ended June 30, 2017 increased $4.5 million, or 22%, to $25.1 million. For the three months ended June 30, 2017 compared to the same period in 2016:

- Gross Profit on Rental Revenues – Rental revenues increased $3.4 million, or 11%, primarily due to 5% higher average rental equipment on rent and 6% higher average monthly rental rates in 2017. As a percentage of rental revenues, depreciation was 15% in 2017 compared to 17% in 2016, and other direct costs were 29% in 2017 compared to 33% in 2016, which resulted in gross margin percentages of 56% in 2017 compared to 50% in 2016. The higher rental revenues, together with higher rental margins, resulted in gross profit on rental revenues increasing $3.6 million, or 22%, to $19.5 million in 2017.
- Gross Profit on Rental Related Services – Rental related services revenues decreased $0.2 million, or 1%, compared to 2016. Most of these service revenues are negotiated with the initial modular building lease and are recognized on a straight-line basis with the associated costs over the initial term of the lease. The decrease in rental related services revenues was primarily attributable to lower amortization of delivery and return delivery and dismantle revenues, partly offset by higher delivery and return delivery revenues at Mobile Modular Portable Storage. The lower revenues and lower gross margin percentage of 25% in 2017 compared to 26% in 2016, resulted in rental related services gross profit decreasing $0.1 million, or 2%, to $3.0 million in 2017.
- Gross Profit on Sales – Sales revenues increased $3.7 million, or 64%, compared to 2016, primarily due to higher used equipment sales. Higher sales revenues, and a flat gross margin percentage of 26% in 2017 and 2016, resulted in gross profit on sales increasing $1.0 million, or 65%, to $2.5 million. Sales occur routinely as a normal part of Mobile Modular's rental business; however, these sales and related gross margins can fluctuate from quarter to quarter and year to year depending on customer requirements, equipment availability and funding.

For the three months ended June 30, 2017, selling and administrative expenses increased $1.5 million, or 12%, to $13.8 million, primarily due to increased salaries and employee benefit costs and higher allocated corporate expenses.

TRS-RenTelco

For the three months ended June 30, 2017, TRS-RenTelco's total revenues decreased $1.4 million, or 5% to $26.5 million compared to the same period in 2016, primarily due to lower sales and rental revenues. Pre-tax income increased $1.2 million, or 23%, to $6.6 million for the three months ended June 30, 2017 compared to the same period in 2016, due to higher gross profit on rental and sales revenues and lower selling and administrative expenses.

The following table summarizes quarterly results for each revenue and gross profit category, income from operations, pre-tax income and other selected information.

TRS-RenTelco – Three Months Ended 6/30/17 compared to Three Months Ended 6/30/16 (Unaudited)

	Three Months Ended			
			Increase	
(dollar amounts in thousands)	June 30,		(Decrease)	
	2017	2016	$	%
Revenues				
Rental	$19,805	$20,269	$(464)	-2%
Rental related services	654			