

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 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 October 29, 2018, 24,175,940 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 the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, regarding McGrath RentCorp’s (the “Company’s”) expectations, strategies, prospects or targets are forward looking statements. These forward-looking statements also can be identified by the use of forward-looking terminology such as “believes,” “expects,” “will,” or “anticipates” or the negative of these terms or other 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

Results of review of interim financial statements

We have reviewed the accompanying condensed consolidated balance sheet of McGrath RentCorp and subsidiaries (the “Company”) as of September 30, 2018, and the related condensed consolidated statements of income and comprehensive income for the three- and nine-month periods ended September 30, 2018 and 2017, cash flows for the nine-month periods ended September 30, 2018 and 2017, and the related notes (collectively referred to as the “interim financial statements”). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim 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) (“PCAOB”), the consolidated balance sheet of the Company as of December 31, 2017, 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 in our report dated February 27, 2018, 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, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for review results

These interim financial statements are the responsibility of the Company’s management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our reviews in accordance with the standards of the PCAOB. 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 PCAOB, 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.

/s/ GRANT THORNTON LLP

San Jose, California

October 30, 2018

3

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
Rental	\$ 82,155	\$ 73,781	\$ 233,683	\$ 211,712
Rental related services	23,880	21,856	60,797	58,587
Rental operations	106,035	95,637	294,480	270,299
Sales	36,085	38,684	67,722	67,166
Other	1,027	1,067	3,013	2,342
Total revenues	143,147	135,388	365,215	339,807
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	18,407	17,492	54,287	52,113
Rental related services	18,618	16,611	47,404	44,756
Other	17,674	15,396	52,696	46,794
Total direct costs of rental operations	54,699	49,499	154,387	143,663
Costs of sales	24,398	27,114	42,680	44,488
Total costs of revenues	79,097	76,613	197,067	188,151
Gross profit	64,050	58,775	168,148	151,656
Selling and administrative expenses	28,226	28,489	85,833	83,702
Income from operations	35,824	30,286	82,315	67,954
Other income (expense):				
Interest expense	(3,142)	(2,986)	(9,133)	(8,724)
Foreign currency exchange gain (loss)	(129)	36	(505)	273
Income before provision for income taxes	32,553	27,336	72,677	59,503
Provision for income taxes	7,774	10,574	17,520	23,307
Net income	\$ 24,779	\$ 16,762	\$ 55,157	\$ 36,196
Earnings per share:				
Basic	\$ 1.03	\$ 0.70	\$ 2.29	\$ 1.51
Diluted	\$ 1.01	\$ 0.69	\$ 2.25	\$ 1.50
Shares used in per share calculation:				
Basic	24,172	24,015	24,128	23,984
Diluted	24,563	24,228	24,550	24,201
Cash dividends declared per share	\$ 0.340	\$ 0.260	\$ 1.020	\$ 0.780

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

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(in thousands)	Three Months Ended September		Nine Months Ended September	
	30, 2018	2017	30, 2018	2017
Net income	\$ 24,779	\$ 16,762	\$ 55,157	\$ 36,196
Other comprehensive income (loss):				
Foreign currency translation adjustment	82	(11)	222	(119)
Tax benefit (provision)	(15)	7	(54)	43
Comprehensive income	\$ 24,846	\$ 16,758	\$ 55,325	\$ 36,120

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

McGrath RentCorp

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)	September 30, 2018	December 31, 2017
Assets		
Cash	\$4,399	\$2,501
Accounts receivable, net of allowance for doubtful accounts of \$1,883 in 2018 and \$1,987 in 2017	115,089	105,872
Rental equipment, at cost:		
Relocatable modular buildings	801,129	775,400
Electronic test equipment	284,647	262,325
Liquid and solid containment tanks and boxes	312,487	309,808
	1,398,263	1,347,533
Less accumulated depreciation	(509,656)	(485,213)
Rental equipment, net	888,607	862,320
Property, plant and equipment, net	125,756	119,170
Prepaid expenses and other assets	32,660	22,459
Intangible assets, net	7,480	7,724
Goodwill	27,808	27,808
Total assets	\$1,201,799	\$1,147,854
Liabilities and Shareholders' Equity		
Liabilities:		
Notes payable	\$309,006	\$303,414
Accounts payable and accrued liabilities	92,443	86,408
Deferred income	48,192	39,219
Deferred income taxes, net	197,611	194,629
Total liabilities	647,252	623,670
Shareholders' equity:		
Common stock, no par value - Authorized 40,000 shares Issued and outstanding - 24,176 shares as of September 30, 2018 and 24,052 shares as of December 31, 2017	102,753	102,947
Retained earnings	451,794	421,405
Accumulated other comprehensive income (loss)	—	(168)
Total shareholders' equity	554,547	524,184
Total liabilities and shareholders' equity	\$1,201,799	\$1,147,854

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

McGrath RentCorp

CONDENSED Consolidated Statements of Cash Flows

(unaudited)

(in thousands)	Nine Months Ended September 30,	
	2018	2017
Cash Flows from Operating Activities:		
Net income	\$55,157	\$36,196
Adjustments to reconcile net income to net cash provided by		
operating activities:		
Depreciation and amortization	60,896	58,425
Impairment of rental assets	39	—
Provision for doubtful accounts	297	1,155
Share-based compensation	2,810	2,245
Gain on sale of used rental equipment	(15,044)	(13,006)
Foreign currency exchange (gain) loss	505	(273)
Amortization of debt issuance costs	18	38
Change in:		
Accounts receivable	(9,514)	(11,691)
Prepaid expenses and other assets	(10,195)	(1,261)
Accounts payable and accrued liabilities	148	80
Deferred income	8,741	4,689
Deferred income taxes	2,982	4,544
Net cash provided by operating activities	96,840	81,141
Cash Flows from Investing Activities:		
Purchases of rental equipment	(84,658)	(73,193)
Purchases of property, plant and equipment	(12,521)	(12,784)
Cash paid for business acquisition	(7,543)	—
Proceeds from sales of used rental equipment	30,067	28,478
Net cash used in investing activities	(74,655)	(57,499)
Cash Flows from Financing Activities:		
Net borrowings under bank lines of credit	25,575	16,813
Principal payments on Series A senior notes	(20,000)	(20,000)
Taxes paid related to net share settlement of stock awards	(3,004)	(1,363)
Payment of dividends	(22,719)	(18,628)
Net cash used in financing activities	(20,148)	(23,178)
Effect of foreign currency exchange rate changes on cash	(139)	53
Net increase in cash	1,898	517
Cash balance, beginning of period	2,501	852
Cash balance, end of period	\$4,399	\$1,369
Supplemental Disclosure of Cash Flow Information:		
Interest paid, during the period	\$9,193	\$8,563
Net income taxes paid, during the period	\$16,055	\$23,510
Dividends accrued during the period, not yet paid	\$8,349	\$5,979
Rental equipment acquisitions, not yet paid	\$9,643	\$6,622

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

7

McGRATH RENTCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

NOTE 1. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The condensed consolidated financial statements for the three and nine months ended September 30, 2018 and 2017 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 nine months ended September 30, 2018 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 27, 2018 for the year ended December 31, 2017 (the “2017 Annual Report”).

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. Under this ASU, entities should account for costs associated with implementing a cloud computing arrangements that is considered a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company is evaluating the impact of this guidance on its consolidated financial statements.

In February 2016, 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 the 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. We expect to use the transition method that allows us to initially apply this guidance at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, financial information will not be updated and the financial disclosures requirement under the new standard will not be provided for periods prior to January 1, 2019. The standard contains additional optional transition practical expedients intended to simplify adoption that the Company is still evaluating. The Company is currently implementing processes and systems to assist in the ongoing lease data collection and analysis and evaluating the impact on its accounting policies and internal controls.

NOTE 3. IMPLEMENTED ACCOUNTING PRONOUNCEMENTS

Revenue from Contracts with Customers

The Company's accounting for revenues is governed by two accounting standards. The majority of the Company's revenues are considered lease related and are accounted for in accordance with Topic 840, Leases. Revenues determined to be non-lease related are accounted for in accordance with ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which was adopted by the Company on January 1, 2018. The Company utilized the modified retrospective method of adoption and there was no impact on its condensed consolidated financial statements, nor was there a cumulative effect of initially applying the new standard. The Company accounts for revenues when approval and commitment from both parties have been obtained, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. The Company typically recognizes non-lease related revenues at a point in time because the customer does not simultaneously consume the benefits of the Company's promised goods and services, or performance obligations, and obtain control when delivery and installation is complete. For contracts that have multiple performance obligations, the transaction price is allocated to each performance obligation in the contract based on the Company's best estimate of the standalone selling prices of each distinct

performance obligation in the contract. The standalone selling price is typically determined based upon the expected cost plus an estimated margin of each performance obligation.

The Company generally rents and sells to customers on 30 day payment terms. The Company does not typically offer variable payment terms, or accept non-monetary consideration. Amounts billed and due from the Company's customers are classified as Accounts receivable on the Company's consolidated balance sheet. For certain sales of modular buildings, progress payments from the customer are received during the manufacturing of new equipment, or the preparation of used equipment. The advance payments are not considered a significant financing component because the payments are used to meet working capital needs during the contract and to protect the Company from the customer failing to adequately complete their obligations under the contract. These contract liabilities are included in Deferred income on the Company's consolidated balance sheet and totaled \$11.0 million and \$6.8 million at September 30, 2018 and December 31, 2017, respectively. Sales revenues totaling \$2.1 million and \$5.6 million were recognized during the three and nine months ended September 30, 2018, respectively, which were included in the contract liability balance at December 31, 2017. For certain modular building sales, the customer retains a small portion of the contract price until full completion of the contract, which results in revenue earned in excess of billings. These unbilled contract assets are included in Accounts receivable on the Company's consolidated balance sheet and totaled \$0.3 million and \$2.0 million at September 30, 2018 and December 31, 2017, respectively.

Lease Revenues

Rental revenues from operating leases are recognized on a straight-line basis over the term of the lease for all operating segments. Rental billings for periods extending beyond period end are recorded as deferred income and are recognized in the period earned. Rental related services revenues are primarily associated with relocatable modular building and liquid and solid containment tanks and boxes leases. For modular building leases, rental related services revenues for modifications, delivery, installation, dismantle and return delivery are lease related because the payments are considered minimum lease payments that are an integral part of the negotiated lease agreement with the customer. These revenues are recognized on a straight-line basis over the term of the lease. Certain leases are accounted for as sales-type leases. For these leases, sales revenue and the related accounts receivable are recognized upon delivery and installation of the equipment and the unearned interest is recognized over the lease term on a basis which results in a constant rate of return on the unrecovered lease investment. Other revenues include interest income on sales-type leases and rental income on facility leases.

Non-Lease Revenues

Non-lease revenues are recognized in the period when control of the performance obligation is transferred, in an amount that reflects the consideration the Company expects to be entitled to receive in exchange for those goods or services. For liquid and solid containment solutions, portable storage containers and electronic test equipment, rental related services revenues for delivery and return delivery are considered non-lease revenues.

Sales revenues are typically recognized at a point in time, which occurs upon the completion of delivery, installation and acceptance of the equipment by the customer. Accounting for non-lease revenues requires judgment in determining the point in time the customer gains control of the equipment and the appropriate accounting period to recognize revenue.

Sales taxes charged to customers are reported on a net basis and are excluded from revenues and expenses.

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

The following table disaggregates the Company's revenues by lease (within the scope of Topic 840) and non-lease revenues (within the scope of Topic 606) and the underlying service provided for the three and nine months ended September 30, 2018 and 2017:

	Mobile	TRS-	Adler		
(in thousands)	Modular	RenTelco	Tanks	Enviroplex	Consolidated
Three Months Ended September 30, 2018					
Leasing	\$52,036	\$ 23,206	\$ 18,942	\$ —	\$ 94,184
Non-lease:					
Rental related services	5,697	642	6,781	—	13,120
Sales	17,140	3,828	294	14,102	35,364
Other	18	461	—	—	479
Total non-lease	22,855	4,931	7,075	14,102	48,963
Total revenues	\$74,891	\$ 28,137	\$ 26,017	\$ 14,102	\$ 143,147
2017					
Leasing	\$45,824	\$ 22,033	\$ 16,700	\$ —	\$ 84,557
Non-lease:					
Rental related services	5,528	623	6,255	—	12,406
Sales	17,533	4,186	461	15,781	37,961
Other	2	462	—	—	464
Total non-lease	23,063	5,271	6,716	15,781	50,831
Total revenues	\$68,887	\$ 27,304	\$ 23,416	\$ 15,781	\$ 135,388
Nine Months Ended September 30, 2018					
Leasing	\$ 146,672	\$ 69,183	\$ 51,889	\$ —	\$ 267,744
Non-lease:					
Rental related services	11,226	1,816	17,674	—	30,716
Sales	30,694	14,179	629	19,831	65,333
Other	21	1,349	52	—	1,422
Total non-lease	41,941	17,344	18,355	19,831	97,471
Total revenues	\$ 188,613	\$ 86,527	\$ 70,244	\$ 19,831	\$ 365,215
2017					
Leasing	\$ 133,184	\$ 63,106	\$ 46,629	\$ —	\$ 242,919
Non-lease:					
Rental related services	10,634	1,666	17,929	—	30,229
Sales	30,001	13,080	1,572	20,692	65,345
Other	9	1,305	—	—	1,314
Total non-lease	40,644	16,051	19,501	20,692	96,888
Total revenues	\$ 173,828	\$ 79,157	\$ 66,130	\$ 20,692	\$ 339,807

Customer returns of rental equipment prior to the end of the rental contract term are typically billed a cancellation fee, which is recorded as rental revenue in the period billed. Sales of new relocatable modular buildings, portable storage

containers, electronic test equipment and related accessories and liquid and solid containment tanks and boxes not manufactured by the Company are typically covered by warranties provided by the manufacturer of the products sold. The Company typically provides limited 90-day warranties for certain sales of used rental equipment and one-year warranties on equipment manufactured by Enviroplex. Although the Company's policy is to provide reserves for warranties when required for specific circumstances, the Company has not found it necessary to establish such reserves to date as warranty costs have not been significant.

The Company's incremental cost of obtaining lease contracts, which consists of salesperson commissions, are deferred and amortized over the initial lease term for modular building leases. Incremental costs for obtaining a contract for all other operating segments are expensed in the period incurred because the lease term is typically less than 12 months.

Modifications to Share-based Payments

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 became effective for the interim and annual periods beginning after December 15, 2017. The Company adopted the provisions of this guidance on January 1, 2018, which had no impact on the Company's consolidated financial statements.

NOTE 4. 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:

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Weighted-average number of shares of common stock for				
calculating basic earnings per share	24,172	24,015	24,128	23,984
Effect of potentially dilutive securities from equity-based				
compensation	391	213	422	217
Weighted-average number of shares of common stock for				
calculating diluted earnings per share	24,563	24,228	24,550	24,201

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

Three Months	Nine Months Ended
-----------------	----------------------

	Ended	September
	September	30,
(in thousands)	30,	2018 2017
Options to purchase shares of common stock	—	14 — 14

NOTE 5. INTANGIBLE ASSETS

Intangible assets consist of the following:

	Estimated	September	December
	useful life	30,	31,
(dollar amounts in thousands)	in years	2018	2017
Trade name	Indefinite	\$ 5,871	\$ 5,700
Customer relationships	11	9,849	9,611
		15,720	15,311
Less accumulated amortization		(8,240)	(7,587)
		\$ 7,480	\$ 7,724

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 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 typically 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, 2017. 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 September 30, 2018 and assuming no subsequent impairment of the underlying assets, the amortization expense is expected to be \$0.2 million for the remainder of fiscal year 2018, \$0.9 million in the year 2019 and \$0.2 million in 2020.

NOTE 6. ACQUISITION

On August 1, 2018, the Company completed the purchase of the blast resistant module rental business of DropBox, Inc. ("DropBox") for \$7.9 million. The Company accounted for this transaction as a business combination and the fair value of the purchased assets was allocated primarily to rental equipment totaling \$7.7 million. The remaining purchase price was allocated to trade name and customer relationships valued at \$0.2 million, respectively, and deferred revenue of \$0.2 million. At September 30, 2018, \$0.4 million related to the purchase price was included in accounts payable and accrued liabilities.

The DropBox operating results are included in the Mobile Modular segment results since the date of acquisition. Supplemental pro forma prior year information has not been provided as the historical financial results of DropBox were not significant. Incremental transaction costs associated with the acquisition were not significant.

NOTE 7. 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, 2017. 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 nine months ended September 30, 2018 and 2017 for the Company's reportable segments is shown in the following table:

	Mobile Modular	TRS- RenTelco	Adler Tanks	Enviroplex ¹	Consolidated
(dollar amounts in thousands)					
Nine Months Ended September 30, 2018					
Rental revenues	\$ 116,436	\$ 65,919	\$ 51,328	\$ —	\$ 233,683
Rental related services revenues	40,510	2,287	18,000	—	60,797
Sales and other revenues	31,667	18,321	916	19,831	70,735
Total revenues	188,613	86,527	70,244	19,831	365,215
Depreciation of rental equipment	15,841	26,536	11,910	—	54,287
Gross profit	86,515	40,155	35,031	6,447	168,148
Selling and administrative expenses	43,191	16,780	22,245	3,617	85,833
Income from operations	43,324	23,375	12,786	2,830	82,315
Interest (expense) income allocation	(5,256)	(1,999)	(2,409)	531	(9,133)
Income before provision for income taxes	38,068	20,871	10,377	3,361	72,677
Rental equipment acquisitions	40,704	51,744	3,187	—	95,635
Accounts receivable, net (period end)	69,419	18,991	19,876	6,803	115,089
Rental equipment, at cost (period end)	801,129	284,647	312,487	—	1,398,263
Rental equipment, net book value (period end)	558,790	129,816	200,001	—	888,607
Utilization (period end) ²	79.2 %	61.5 %	64.0 %		
Average utilization ²	77.8 %	62.4 %	59.8 %		
2017					
Rental revenues	\$ 104,923	\$ 60,569	\$ 46,220	\$ —	\$ 211,712
Rental related services revenues	38,283	2,095	18,209	—	58,587
Sales and other revenues	30,622	16,493	1,701	20,692	69,508
Total revenues	173,828	79,157	66,130	20,692	339,807
Depreciation of rental equipment	15,951	24,335	11,827	—	52,113
Gross profit	77,939	36,420	31,407	5,890	151,656
Selling and administrative expenses	42,157	16,475	21,855	3,215	83,702
Income from operations	35,782	19,945	9,552	2,675	67,954

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Interest (expense) income allocation	(5,008)	(1,726)	(2,301)	311	(8,724)
Income before provision for income taxes	30,774	18,492	7,251	2,986	59,503
Rental equipment acquisitions	28,107	45,700	3,130	—	76,937
Accounts receivable, net (period end)	66,126	16,253	18,118	6,916	107,413
Rental equipment, at cost (period end)	781,791	258,877	309,825	—	1,350,493
Rental equipment, net book value (period end)	547,115	106,728	211,881	—	865,724
Utilization (period end) ²	76.8 %	64.3 %	59.7 %		
Average utilization ²	76.6 %	62.8 %	54.7 %		

1. Gross Enviroplex sales revenues were \$21,191 and \$20,692 for the nine months ended September 30, 2018 and 2017, respectively. There were \$1,360 inter-segment sales to Mobile Modular in the nine months ended September 30, 2018, which required elimination in consolidation. There were no inter-segment sales in the nine months ended September 30, 2017.

13

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 nine months ended September 30, 2018 and 2017. Revenues from foreign country customers accounted for 4% 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, 2017, as filed with the SEC on February 27, 2018 (the "2017 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 2017 Annual Report. In preparing the following MD&A, we presume that readers have access to and have read the MD&A in our 2017 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 nine months ended September 30, 2018. Mobile Modular Portable Storage offers portable storage units and high security portable office units for rent, lease and purchase.

In the nine months ended September 30, 2018, Mobile Modular, TRS-RenTelco, Adler Tanks and Enviroplex contributed 52%, 29%, 14% and 5% of the Company's income before provision for taxes (the equivalent of "pretax income"), respectively, compared to 52%, 31%, 12% and 5% for the same period in 2017. 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 2017 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 81% and 80% of consolidated revenues in the nine months ended September 30, 2018 and 2017, respectively. Of the total rental operations revenues for the nine months ended September 30, 2018, Mobile Modular, TRS-RenTelco and Adler Tanks comprised 53%, 23% and 24%, respectively, compared to 53%, 23% and 24%, respectively, in the same period of 2017. The Company’s direct costs of rental operations include depreciation of rental equipment, rental related service costs, impairment of rental equipment (if applicable), 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 nine months ended September 30, 2018 and 2017, sales and other revenues of modular, electronic test equipment and liquid and solid containment tanks and boxes comprised approximately 19% and 20% of the Company’s consolidated revenues, respectively. Of the total sales and other revenues for the nine months ended September 30, 2018 and 2017, Mobile Modular and Enviroplex together comprised 73% and 74%, respectively, TRS-RenTelco comprised 26% and 24%, respectively, and Adler Tanks comprised 1% 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, non-cash impairment costs 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

(dollar amounts in thousands)	Three Months Ended		Nine Months Ended		Twelve Months Ended	
	September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017
Net income	\$24,779	\$16,762	\$55,157	\$36,196	\$172,881	\$45,930
Provision (benefit) for income taxes	7,774	10,574	17,520	23,307	(76,255)	33,368
Interest	3,142	2,986	9,133	8,724	12,031	11,445
Depreciation and amortization	20,608	19,673	60,896	58,425	80,887	78,076
EBITDA	56,303	49,995	142,706	126,652	189,544	168,819
Impairment of rental assets	—	—	39	—	1,678	—
Share-based compensation	982	707	2,810	2,245	3,763	3,009
Adjusted EBITDA ¹	\$57,285	\$50,702	\$145,555	\$128,897	\$194,985	\$171,828
Adjusted EBITDA margin ²	40	% 37	% 40	% 38	% 40	% 39

Reconciliation of Adjusted EBITDA to Net Cash Provided by Operating Activities

(dollar amounts in thousands)	Three Months Ended		Nine Months Ended		Twelve Months Ended	
	September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017
Adjusted EBITDA ¹	\$57,285	\$50,702	\$145,555	\$128,897	\$194,985	\$171,828
Interest paid	(3,070)	(2,746)	(9,193)	(8,563)	(12,455)	(11,957)
Income taxes paid, net of refunds received	(4,380)	(5,369)	(16,055)	(23,510)	(22,049)	(31,314)
Gain on sale of used rental equipment	(5,169)	(5,092)	(15,044)	(13,006)	(19,771)	(15,947)
Foreign currency exchange loss (gain)	129	(36)	505	(273)	444	(93)
Amortization of debt financing cost	3	13	18	38	30	51
Change in certain assets and liabilities:						
Accounts receivable, net	(9,994)	(10,874)	(9,217)	(10,536)	(7,676)	(3,655)

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Prepaid expenses and other assets	4,743	7,578	(10,195)	(1,261)	(5,810)	(686)
Accounts payable and other liabilities	(359)	(2,089)	1,725	4,666	4,618	8,298
Deferred income	3,887	(345)	8,741	4,689	5,772	34
Net cash provided by operating activities	\$43,075	\$31,742	\$96,840	\$81,141	\$138,088	\$116,559

1. Adjusted EBITDA is defined as net income before interest expense, provision for income taxes, depreciation, amortization, non-cash impairment costs and share-based compensation.

2. Adjusted EBITDA margin is calculated as Adjusted EBITDA divided by total revenues for the period.

17

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 September 30, 2018, the actual ratio was 6.62 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 September 30, 2018, the actual ratio was 1.58 to 1.

At September 30, 2018, 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 September 20, 2018, the Company announced that the Board of Directors declared a quarterly cash dividend of \$0.34 per common share for the quarter ended September 30, 2018, an increase of 31% over the prior year's comparable quarter.

Results of Operations

Three Months Ended September 30, 2018 Compared to

Three Months Ended September 30, 2017

Overview

Consolidated revenues for the three months ended September 30, 2018 increased 6% to \$143.1 million from \$135.4 million in the same period in 2017. Consolidated net income for the three months ended September 30, 2018 increased 48% to \$24.8 million, from \$16.8 million for the same period in 2017. Earnings per diluted share for the three months ended September 30, 2018 increased 46% to \$1.01 from \$0.69 for the same period in 2017.

For the three months ended September 30, 2018, on a consolidated basis:

- Gross profit increased \$5.3 million, or 9%, to \$64.1 million in 2018. Mobile Modular's gross profit increased \$3.1 million, or 10%, primarily due to higher gross profit on rental and rental related services revenues, partly offset by lower gross profit on sales revenues. Adler Tanks' gross profit increased \$1.5 million, or 13%, primarily due to higher gross profit on rental revenues. TRS-RenTelco's gross profit increased \$0.3 million, or 3%, primarily due to higher gross profit on sales revenues. Enviroplex's gross profit increased \$0.4 million, primarily due to higher gross margin on sales revenues.
- Selling and administrative expenses decreased \$0.3 million, or 1%, to \$28.2 million, primarily due to lower bad debt expense.
- Interest expense increased \$0.2 million, or 5%, to \$3.1 million in 2018 compared to the same period in 2017, due to 9% higher net average interest rates of 3.96% in 2018 compared to 3.63% in 2017, partly offset by 4% lower average debt levels of the Company.
- The provision for income taxes resulted in an effective tax rate of 23.9% and 38.7% for the quarters ended September 30, 2018 and 2017, respectively. The lower effective tax rate in 2018 was primarily due to the enactment of the Tax Cut and Jobs Act on December 22, 2017, which among other things reduced the federal income tax rate from 35% to 21% effective January 1, 2018.
- Pre-tax income contribution by Mobile Modular, TRS-RenTelco and Adler Tanks was 53%, 21% and 14%, respectively, compared to 52%, 24% and 13%, respectively, for the comparable 2017 period. These results are discussed on a segment basis below. Enviroplex pre-tax income contribution was 12% and 11% in 2018 and 2017.
- Adjusted EBITDA increased \$6.6 million, or 13%, to \$57.3 million in 2018.

Mobile Modular

For the three months ended September 30, 2018, Mobile Modular's total revenues increased \$6.0 million, or 9%, to \$74.9 million compared to the same period in 2017, primarily due to higher rental and rental related services revenues, partly offset by lower sales revenues. The revenue increase, together with higher gross profit on rental and rental related services revenues and lower selling and administrative expense, partly offset by lower gross profit on sales revenues, resulted in a 23% increase in pre-tax income to \$17.4 million for the three months ended September 30, 2018, from \$14.1 million for the same period in 2017.

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 9/30/18 compared to Three Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Three Months Ended		Increase	
	September 30, 2018	2017	(Decrease) \$	%
Revenues				
Rental	\$41,205	\$36,239	\$4,966	14 %
Rental related services	16,188	14,729	1,459	10 %
Rental operations	57,393	50,968	6,425	13 %
Sales	17,140	17,533	(393)	-2 %
Other	358	386	(28)	-7 %
Total revenues	74,891	68,887	6,004	9 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	5,320	5,285	35	1 %
Rental related services	12,457	11,075	1,382	12 %
Other	10,662	9,396	1,266	13 %
Total direct costs of rental operations	28,439	25,756	2,683	10 %
Costs of sales	12,987	12,770	217	2 %
Total costs of revenues	41,426	38,526	2,900	8 %
Gross Profit				
Rental	25,223	21,558	3,665	17 %
Rental related services	3,731	3,654	77	2 %
Rental operations	28,954	25,212	3,742	15 %
Sales	4,153	4,763	(610)	-13 %
Other	358	386	(28)	-7 %
Total gross profit	33,465	30,361	3,104	10 %
Selling and administrative expenses	14,261	14,540	(279)	-2 %
Income from operations	19,204	15,821	3,383	21 %
Interest expense allocation	(1,834)	(1,719)	115	7 %
Pre-tax income	\$17,370	\$14,102	\$3,268	23 %
Other Selected Information				
Average rental equipment ¹	\$759,542	\$748,779	\$10,763	1 %
Average rental equipment on rent	\$596,950	\$571,595	\$25,355	4 %
Average monthly total yield ²	1.81 %	1.61 %		12 %
Average utilization ³	78.6 %	76.3 %		3 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Average monthly rental rate ⁴	2.30	%	2.11	%	9	%
Period end rental equipment ¹	\$767,522		\$750,798		\$16,724	2 %
Period end utilization ³	79.2	%	76.8	%	3	%

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.

20

Mobile Modular's gross profit for the three months ended September 30, 2018 increased \$3.1 million, or 10%, to \$33.5 million. For the three months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** – Rental revenues increased \$5.0 million, or 14%, primarily due to 9% higher average monthly rental rates and 4% higher average rental equipment on rent in 2018. As a percentage of rental revenues, depreciation was 13% in 2018 compared to 15% in 2017, and other direct costs were 26% in 2018 and 2017, which resulted in gross margin percentages of 61% in 2018 compared to 59% in 2017. The higher rental revenues and higher rental margins, resulted in gross profit on rental revenues increasing \$3.7 million, or 17%, to \$25.2 million in 2018.

• **Gross Profit on Rental Related Services** – Rental related services revenues increased \$1.5 million, or 10%, compared to 2017. 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 increase in rental related services revenues was primarily attributable to higher modular building repair revenues and higher amortization of modular building delivery and return delivery and dismantle revenues. The higher revenues, partly offset by lower gross margin percentage of 23% in 2018 compared to 25% in 2017, resulted in rental related services gross profit increasing \$0.1 million, or 2%, to \$3.7 million in 2018.

• **Gross Profit on Sales** – Sales revenues decreased \$0.4 million, or 2%, compared to 2017, primarily due to lower used equipment sales. The lower sales revenues and lower gross margin percentage of 24% in 2018 compared to 27% in 2017, resulted in gross profit on sales decreasing \$0.6 million, or 13%, to \$4.2 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 September 30, 2018, selling and administrative expenses decreased \$0.3 million, or 2%, to \$14.3 million.

TRS-RenTelco

For the three months ended September 30, 2018, TRS-RenTelco's total revenues increased \$0.8 million, or 3% to \$28.1 million compared to the same period in 2017, primarily due to higher rental revenues, partly offset by lower sales revenues. Pre-tax income increased \$0.3 million, or 5%, to \$6.9 million for the three months ended September 30, 2018 compared to the same period in 2017, primarily due to higher gross profit on 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 9/30/18 compared to Three Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Three Months Ended		Increase	
	September 30, 2018	2017	\$(Decrease)	%
Revenues				
Rental	\$22,225	\$21,018	\$1,207	6 %
Rental related services	773	783	(10)	-1 %
Rental operations	22,998	21,801	1,197	5 %
Sales	4,549	4,909	(360)	-7 %
Other	590	594	(4)	-1 %
Total revenues	28,137	27,304	833	3 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	9,093	8,264	829	10 %
Rental related services	697	683	14	2 %
Other	3,767	3,352	415	12 %
Total direct costs of rental operations	13,557	12,299	1,258	10 %
Costs of sales	1,667	2,432	(765)	-31 %
Total costs of revenues	15,224	14,731	493	3 %
Gross Profit				
Rental	9,365	9,402	(37)	0 %
Rental related services	76	100	(24)	-24 %
Rental operations	9,441	9,502	(61)	-1 %
Sales	2,882	2,477	405	16 %
Other	590	594	(4)	-1 %
Total gross profit	12,913	12,573	340	3 %
Selling and administrative expenses	5,220	5,456	(236)	-4 %
Income from operations	7,693	7,117	576	8 %
Interest expense allocation	(686)	(600)	86	14 %
Foreign currency exchange gain (loss)	(129)	36	(165)	nm
Pre-tax income	\$6,878	\$6,553	\$325	5 %
Other Selected Information				
Average rental equipment ¹	\$280,377	\$254,369	\$26,008	10 %
Average rental equipment on rent	\$173,402	\$161,184	\$12,218	8 %
Average monthly total yield ²	2.64 %	2.75 %		-4 %
Average utilization ³	61.9 %	63.4 %		-2 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Average monthly rental rate ⁴	4.27	%	4.35	%	-2	%
Period end rental equipment ¹	\$284,674		\$258,391		\$26,283	10 %
Period end utilization ³	61.5	%	64.3	%	-4	%

1. Average and Period end rental equipment represents the cost of rental equipment excluding 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 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.

nmNot meaningful.

22

TRS-RenTelco's gross profit for the three months ended September 30, 2018 increased \$0.3 million, or 3%, to \$12.9 million. For the three months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** – Rental revenues increased \$1.2 million, or 6%, and depreciation expense increased \$0.8 million, or 10%, resulting in a comparable gross profit on rental revenues of \$9.4 million. As a percentage of rental revenues, depreciation was 41% and 39% in 2018 and 2017, respectively, and other direct costs were 17% in 2018 and 16% in 2017, which resulted in a gross margin percentage of 42% in 2018 compared to 45% in 2017. The rental revenues increase was due to 8% higher average rental equipment on rent in 2018 as compared to 2017, partly offset by 2% lower average monthly rental rates.

• **Gross Profit on Sales** – Sales revenues decreased \$0.4 million, or 7%, to \$4.5 million in 2018. Gross profit on sales increased \$0.4 million, or 16%, to \$2.9 million with gross margin percentage increasing to 63% from 51% in 2017, due to higher gross margins on used equipment sales. Sales occur as a normal part of TRS-RenTelco's rental business; however, these sales and related gross margins can fluctuate from quarter to quarter depending on customer requirements and related mix of equipment sold, equipment availability and funding.

For the three months ended September 30, 2018, selling and administrative expenses decreased \$0.2 million, or 4%, to \$5.2 million, primarily due to lower bad debt expense.

Adler Tanks

For the three months ended September 30, 2018, Adler Tanks' total revenues increased \$2.6 million, or 11%, to \$26.0 million compared to the same period in 2017, primarily due to higher rental and rental related services revenues, partly offset by lower sales revenues in 2018. Higher gross profit on rental and sales revenues, partly offset by lower gross profit on rental related services revenues and higher selling and administrative expenses resulted in a \$1.2 million, or 36%, increase in pre-tax income to \$4.7 million for the three months ended September 30, 2018, compared to the same period in 2017.

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

Adler Tanks – Three Months Ended 9/30/18 compared to Three Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Three Months Ended		Increase	
	September 30, 2018	2017	(Decrease) \$	%
Revenues				
Rental	\$ 18,725	\$ 16,524	\$ 2,201	13 %
Rental related services	6,919	6,344	575	9 %
Rental operations	25,644	22,868	2,776	12 %
Sales	294	461	(167)	-36 %
Other	79	87	(8)	-9 %
Total revenues	26,017	23,416	2,601	11 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	3,994	3,943	51	1 %
Rental related services	5,464	4,853	611	13 %
Other	3,245	2,648	597	23 %
Total direct costs of rental operations	12,703	11,444	1,259	11 %
Costs of sales	195	397	(202)	-51 %
Total costs of revenues	12,898	11,841	1,057	9 %
Gross Profit				
Rental	11,486	9,933	1,553	16 %
Rental related services	1,455	1,491	(36)	-2 %
Rental operations	12,941	11,424	1,517	13 %
Sales	99	64	35	55 %
Other	79	87	(8)	-9 %
Total gross profit	13,119	11,575	1,544	13 %
Selling and administrative expenses	7,587	7,327	260	4 %
Income from operations	5,532	4,248	1,284	30 %
Interest expense allocation	(833)	(786)	47	6 %
Pre-tax income	\$ 4,699	\$ 3,462	\$ 1,237	36 %
Other Selected Information				
Average rental equipment ¹	\$ 311,086	\$ 307,790	\$ 3,296	1 %
Average rental equipment on rent	\$ 194,525	\$ 175,656	\$ 18,869	11 %
Average monthly total yield ²	2.01 %	1.79 %		12 %
Average utilization ³	62.5 %	57.1 %		9 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Average monthly rental rate ⁴	3.21	%	3.14	%	2	%
Period end rental equipment ¹	\$311,481		\$308,099		\$3,382	1 %
Period end utilization ³	64.0	%	59.7	%	7	%

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.

24

Adler Tanks' gross profit for the three months ended September 30, 2018 increased 13%, to \$13.1 million. For the three months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** – Rental revenues increased \$2.2 million, or 13%, due to 11% higher average rental equipment on rent and 2% higher average rental rates in 2018 compared to 2017. As a percentage of rental revenues, depreciation was 21% and 24% in 2018 and 2017, respectively, and other direct costs were 17% and 16% in 2018 and 2017, respectively, which resulted in gross margin percentages of 61% and 60% in 2018 and 2017, respectively. The higher rental revenues and higher rental margins resulted in an 16% increase in gross profit on rental revenues to \$11.5 million in 2018.

• **Gross Profit on Rental Related Services** – Rental related services revenues increased \$0.6 million, or 9%, to \$6.9 million compared to 2017. Higher rental related services revenues, offset by lower gross margin percentage of 21% in 2018 compared to 24% in 2017 resulted in rental related services gross profit decreasing 2% to \$1.5 million in 2018.

For the three months ended September 30, 2018, selling and administrative expenses increased 4% to \$7.6 million compared to the same period in 2017, primarily due to increased employee headcount, salaries and employee benefit costs.

Nine Months Ended September 30, 2018 Compared to

Nine Months Ended September 30, 2017

Overview

Consolidated revenues for the nine months ended September 30, 2018 increased 7% to \$365.2 million from \$339.8 million for the same period in 2017. Consolidated net income for the nine months ended September 30, 2018 increased 52% to \$55.2 million, from \$36.2 million for the same period in 2017. Earnings per diluted share for the nine months ended September 30, 2018 increased 50% to \$2.25 from \$1.50 for the same period in 2017.

For the nine months ended September 30, 2018, on a consolidated basis:

• Gross profit increased \$16.5 million, or 11%, to \$168.1 million in 2018. Mobile Modular's gross profit increased \$8.6 million, or 11%, primarily due to higher gross profit on rental and sales revenues. TRS-RenTelco's gross profit increased \$3.7 million, or 10%, due to higher gross profit on rental, sales and rental related services revenues. Adler Tanks' gross profit increased \$3.6 million, or 12%, primarily due to higher gross profit on rental revenues, partly offset by lower gross profit on rental related services and sales revenues. Enviroplex's gross profit increased \$0.6 million, primarily due to higher gross margin on sales revenues.

• Selling and administrative expenses increased 3% to \$85.8 million from \$83.7 million for the same period in 2017, primarily due to increased employee headcount, salaries and employee benefit costs.

• Interest expense increased 5% to \$9.1 million, due to 11% higher net average interest rates of 3.91% in 2018 compared to 3.54% in 2017, partly offset by 5% lower debt levels of the Company.

• The provision for income taxes resulted in an effective tax rate of 24.1% and 39.2% for the nine months ended September 30, 2018 and 2017, respectively. The lower effective tax rate in 2018 was primarily due to the enactment of the Tax Cut and Jobs Act on December 22, 2017, which among other things reduced the federal income tax rate from 35% to 21% effective January 1, 2018.

• Pre-tax income contribution by Mobile Modular, TRS-RenTelco and Adler Tanks was 52%, 29 and 14%, respectively, compared to 52%, 31% and 12%, respectively, for the comparable 2017 period. These results are discussed on a segment basis below. Pre-tax income contribution by Enviroplex was 5% in 2018 and 2017.

• Adjusted EBITDA increased \$16.7 million, or 13%, to \$145.6 million in 2018.

Mobile Modular

For the nine months ended September 30, 2018, Mobile Modular's total revenues increased \$14.8 million, or 9%, to \$188.6 million compared to the same period in 2017, primarily due to higher rental, rental related services and sales revenues during the period. The revenue increase, together with higher gross profit on rental and sales revenues, partly offset by higher selling and administrative expenses, resulted in a 24% increase in pre-tax income to \$38.1 million for the nine months ended September 30, 2018, from \$30.8 million for the same period in 2017.

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 – Nine Months Ended 9/30/18 compared to Nine Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Nine Months Ended		Increase (Decrease)	
	September 30, 2018	2017	\$	%
Revenues				
Rental	\$116,436	\$104,923	\$11,513	11 %
Rental related services	40,510	38,283	2,227	6 %
Rental operations	156,946	143,206	13,740	10 %
Sales	30,694	30,001	693	2 %
Other	973	621	352	57 %
Total revenues	188,613	173,828	14,785	9 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	15,841	15,951	(110)	-1 %
Rental related services	31,031	28,802	2,229	8 %
Other	33,460	29,290	4,170	14 %
Total direct costs of rental operations	80,332	74,043	6,289	8 %
Costs of sales	21,766	21,846	(80)	0 %
Total costs of revenues	102,098	95,889	6,209	6 %
Gross Profit				
Rental	67,134	59,683	7,451	12 %
Rental related services	9,479	9,481	(2)	0 %
Rental operations	76,613	69,164	7,449	11 %
Sales	8,929	8,154	775	10 %
Other	973	621	352	57 %
Total gross profit	86,515	77,939	8,576	11 %
Selling and administrative expenses	43,191	42,157	1,034	2 %
Income from operations	43,324	35,782	7,542	21 %
Interest expense allocation	(5,256)	(5,008)	248	5 %
Pre-tax income	\$38,068	\$30,774	\$7,294	24 %
Other Selected Information				
Average rental equipment ¹	\$752,076	\$746,632	\$5,444	1 %
Average rental equipment on rent	\$585,216	\$572,196	\$13,020	2 %
Average monthly total yield ²	1.72 %	1.56 %		10 %
Average utilization ³	77.8 %	76.6 %		2 %
Average monthly rental rate ⁴	2.21 %	2.04 %		8 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Period end rental equipment ¹	\$767,522	\$750,798	\$16,724	2 %
Period end utilization ³	79.2 %	76.8 %		3 %

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.

27

Mobile Modular's gross profit for the nine months ended September 30, 2018 increased 11% to \$86.5 million from \$77.9 million for the same period in 2017. For the nine months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** - Rental revenues increased \$11.5 million, or 11%, primarily due to 8% higher average monthly rental rates and 2% higher average rental equipment on rent in 2018 as compared to 2017. As a percentage of rental revenues, depreciation was 14% and 15% in 2018 and 2017, respectively, and other direct costs were 29% in 2018 and 28% in 2017, which resulted in gross margin percentage of 58% and 57% in 2018 and 2017, respectively. The higher rental revenues and higher gross margin percentages resulted in gross profit on rental revenues increasing \$7.5 million, or 12%, to \$67.1 million in 2018.

• **Gross Profit on Rental Related Services** – Rental related services revenues increased \$2.2 million, or 6%, compared to 2017. Most of these service revenues are negotiated with the initial lease and are recognized on a straight-line basis with the associated costs over the initial term of the lease. The increase in rental related services revenues was primarily attributable to higher repair revenues, increased services performed during the lease and higher delivery and return delivery revenues at Mobile Modular Portable Storage. The lower gross margin percentage of 23% in 2018 compared to 25% in 2017, offset by higher revenues, resulted in comparable rental related services gross profit of \$9.5 million in 2018 and 2017.

• **Gross Profit on Sales** – Sales revenues increased \$0.7 million, or 2%, primarily due to higher used equipment sales compared to 2017. The higher sales revenues, together with higher gross margin percentage of 29% in 2018 compared to 27% in 2017 resulted in sales gross profit increasing 10% to \$8.9 million from \$8.2 million in 2017. 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 nine months ended September 30, 2018, selling and administrative expenses increased \$1.0 million, or 2%, to \$43.2 million, primarily due to increased employee salaries and benefit costs and higher allocated corporate expenses.

TRS-RenTelco

For the nine months ended September 30, 2018, TRS-RenTelco's total revenues increased \$7.4 million, or 9%, to \$86.5 million compared to the same period in 2017, due to higher rental, sales and rental related services revenues. Pre-tax income increased 13%, to \$20.9 million for the nine months ended September 30, 2018 compared to \$18.5 million for the same period in 2017, primarily due to higher gross profit on rental, sales and rental related services revenues.

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 – Nine Months Ended 9/30/18 compared to Nine Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Nine Months Ended		Increase (Decrease)	
	September 30, 2018	2017	\$	%
Revenues				
Rental	\$65,919	\$60,569	\$5,350	9 %
Rental related services	2,287	2,095	192	9 %
Rental operations	68,206	62,664	5,542	9 %
Sales	16,568	14,897	1,671	11 %
Other	1,753	1,596	157	10 %
Total revenues	86,527	79,157	7,370	9 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	26,536	24,335	2,201	9 %
Rental related services	1,956	1,937	19	1 %
Other	10,834	9,957	877	9 %
Total direct costs of rental operations	39,326	36,229	3,097	9 %
Costs of sales	7,046	6,508	538	8 %
Total costs of revenues	46,372	42,737	3,635	9 %
Gross Profit				
Rental	28,549	26,277	2,272	9 %
Rental related services	331	158	173	109 %
Rental operations	28,880	26,435	2,445	9 %
Sales	9,522	8,389	1,133	14 %
Other	1,753	1,596	157	10 %
Total gross profit	40,155	36,420	3,735	10 %
Selling and administrative expenses	16,780	16,475	305	2 %
Income from operations	23,375	19,945	3,430	17 %
Interest expense allocation	(1,999)	(1,726)	(273)	16 %
Foreign currency exchange gain (loss)	(505)	273	(778)	nm
Pre-tax income	\$20,871	\$18,492	\$2,379	13 %
Other Selected Information				
Average rental equipment ¹	\$273,142	\$249,740	\$23,402	9 %
Average rental equipment on rent	\$170,535	\$156,856	\$13,679	9 %
Average monthly total yield ²	2.68 %	2.69 %	0	0 %
Average utilization ³	62.4 %	62.8 %	-1	1 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Average monthly rental rate ⁴	4.29	%	4.29	%	0	%
Period end rental equipment ¹	\$284,674		\$258,391		\$26,283	10 %
Period end utilization ³	61.5	%	64.3	%	-4	%

1. Average and Period end rental equipment represents the cost of rental equipment excluding 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 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.

29

TRS-RenTelco's gross profit for the nine months ended September 30, 2018 increased 10% to \$40.2 million from \$36.4 million for the same period in 2017. For the nine months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** – Rental revenues increased \$5.4 million, or 9%, with depreciation expense increasing \$2.2 million, or 9%, to \$26.5 million and other direct costs increasing \$0.9 million, or 9%, to \$10.8 million, resulting in increased gross profit on rental revenues of \$2.3 million, or 9%, to \$28.5 million. As a percentage of rental revenues, depreciation was 40% in 2018 and 2017, and other direct costs were 16% in 2018 and 2017, which resulted in a gross margin percentage of 43% in 2018 and 2017. The rental revenues increase was due to 9% higher average rental equipment on rent compared to 2017.

• **Gross Profit on Sales** – Sales revenues increased \$1.7 million, or 11%, to \$16.6 million in 2018, compared to \$14.9 million in 2017. Higher sales revenues, and higher gross margin percentage of 58% in 2018 compared to 56% in 2017, primarily due to higher gross margins on used equipment sales, resulted in gross profit on sales increasing 14%, to \$9.5 million from \$8.4 million in 2017. Sales occur routinely as a normal part of TRS-RenTelco's rental business; however, these sales and related gross margins can fluctuate from quarter to quarter depending on customer requirements, equipment availability and funding.

For the nine months ended September 30, 2018, selling and administrative expenses increased \$0.3 million, or 2%, to \$16.8 million compared to the same period in 2017, primarily due to higher allocated corporate expenses.

Adler Tanks

For the nine months ended September 30, 2018, Adler Tanks' total revenues increased \$4.1 million, or 6%, to \$70.2 million compared to the same period in 2017, primarily due to higher rental revenues, partly offset by lower sales and rental related services revenues during the period. The revenue increase, partly offset by higher selling and administrative expenses resulted in 43% increase in pre-tax income to \$10.4 million for the nine months ended September 30, 2018, from \$7.3 million for the same period in 2017.

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

Adler Tanks – Nine Months Ended 9/30/18 compared to Nine Months Ended 9/30/17 (Unaudited)

(dollar amounts in thousands)	Nine Months Ended		Increase (Decrease)	
	September 30, 2018	2017	\$	%
Revenues				
Rental	\$51,328	\$46,220	\$5,108	11 %
Rental related services	18,000	18,209	(209)	-1 %
Rental operations	69,328	64,429	4,899	8 %
Sales	629	1,576	(947)	-60 %
Other	287	125	162	130 %
Total revenues	70,244	66,130	4,114	6 %
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	11,910	11,827	83	1 %
Rental related services	14,417	14,017	400	3 %
Other	8,402	7,547	855	11 %
Total direct costs of rental operations	34,729	33,391	1,338	4 %
Costs of sales	484	1,332	(848)	-64 %
Total costs of revenues	35,213	34,723	490	1 %
Gross Profit				
Rental	31,017	26,846	4,171	16 %
Rental related services	3,583	4,191	(608)	-15 %
Rental operations	34,600	31,037	3,563	11 %
Sales	144	245	(101)	-41 %
Other	287	125	162	130 %
Total gross profit	35,031	31,407	3,624	12 %
Selling and administrative expenses	22,245	21,855	390	2 %
Income from operations	12,786	9,552	3,234	34 %
Interest expense allocation	(2,409)	(2,301)	108	5 %
Pre-tax income	\$10,377	\$7,251	\$3,126	43 %
Other Selected Information				
Average rental equipment ¹	\$309,943	\$307,322	\$2,621	1 %
Average rental equipment on rent	\$185,391	\$167,949	\$17,442	10 %
Average monthly total yield ²	1.84 %	1.67 %		10 %
Average utilization ³	59.8 %	54.7 %		9 %
Average monthly rental rate ⁴	3.08 %	3.06 %		1 %

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Period end rental equipment ¹	\$311,481	\$308,099	\$3,382	1	%
Period end utilization ³	64.0	%	59.7	%	7

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 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.

31

Adler Tanks' gross profit for the nine months ended September 30, 2018 increased 12% to \$35.0 million from \$31.4 million for the same period in 2017. For the nine months ended September 30, 2018 compared to the same period in 2017:

• **Gross Profit on Rental Revenues** – Rental revenues increased \$5.1 million, or 11%, primarily due to 10% higher average rental equipment on rent, and 1% higher average monthly rental rates in 2018 as compared to 2017. As a percentage of rental revenues, depreciation was 23% in 2018 and 26% in 2017, and other direct costs were 16% in 2018 and 2017, which resulted in gross margin percentages of 60% and 58% in 2018 and 2017, respectively. The higher rental revenues and higher rental margins resulted in gross profit on rental revenues increasing \$4.2 million, or 16%, to \$31.0 million in 2018.

• **Gross Profit on Rental Related Services** – Rental related services revenues decreased \$0.2 million, or 1%, compared to 2017. The lower revenues and lower gross margin percentage of 20% in 2018 compared to 23% in 2017, resulted in rental related services gross profit decreasing \$0.6 million, or 15%, to \$3.6 million in 2018.

For the nine months ended September 30, 2018, selling and administrative expenses increased \$0.4 million, or 2%, to \$22.2 million compared to the same period in 2017, primarily due to increased employee headcount, salaries and benefit costs.

Liquidity and Capital Resources

The Company's rental businesses are capital intensive and generate significant cash flows. Cash flows for the Company for the nine months ended September 30, 2018 compared to the same period in 2017 are summarized as follows:

Cash Flows from Operating Activities: The Company's operations provided net cash of \$96.8 million in 2018 compared to \$81.1 million in 2017. The 19% increase in net cash provided by operating activities was primarily attributable to improved income from operations, partly offset by a higher increase in prepaid expenses and other assets.

Cash Flows from Investing Activities: Net cash used in investing activities was \$74.7 million in 2018, compared to \$57.5 million in 2017. The \$17.2 million increase was primarily due to \$11.5 million higher purchases of rental equipment of \$84.7 million in 2018, compared to \$73.2 million in 2017, primarily at TRS-RenTelco and \$7.5 million cash payment for the acquisition of DropBox, partly offset by \$1.6 million higher proceeds from sales of used rental equipment.

Cash Flows from Financing Activities: Net cash used in financing activities was \$20.1 million in 2018, compared to \$23.2 million in 2017. The \$3.0 million decrease was primarily due to \$8.8 million higher borrowings under bank lines of credit, partly offset by \$1.6 million higher taxes paid related to net share settlement of stock awards and \$4.1 million higher dividend payments.

Significant capital expenditures are required to maintain and grow the Company's rental assets. During the last three years, the Company has financed its working capital and capital expenditure requirements through cash flow from operations, proceeds from the sale of rental equipment and from borrowings. Sales occur routinely as a normal part of the Company's rental business. However, these sales can fluctuate from period to period depending on customer requirements and funding. Although the net proceeds received from sales may fluctuate from period to period, the Company believes its liquidity will not be adversely impacted from lower sales in any given year because it believes it has the ability to increase its bank borrowings and conserve its cash in the future by reducing the amount of cash it uses to purchase rental equipment, pay dividends, or repurchase the Company's common stock.

Unsecured Revolving Lines of Credit

In March 2016, the Company renewed its credit agreement with a syndicate of banks (the "Credit Facility"). The five-year facility matures on March 31, 2021 and replaced the Company's prior \$420.0 million unsecured revolving credit facility. The Credit Facility provides for a \$420.0 million unsecured revolving credit facility (which may be increased to \$620.0 million with \$200.0 million of additional commitments), which includes a \$25.0 million sublimit for the issuance of standby letters of credit and a \$10.0 million sublimit for swingline loans.

In March 2016, the Company entered into a Credit Facility Letter Agreement and a Credit Line Note in favor of MUFG Union Bank, N.A., extending its line of credit facility related to its cash management services ("Sweep Service Facility") and increasing the facility size from \$10.0 million to \$12.0 million. The Sweep Service Facility matures on the earlier of March 31, 2021, or the date the Company ceases to utilize MUFG Union Bank, N.A. for its cash management services.

At September 30, 2018, under the Credit Facility and Sweep Service Facility, the Company had unsecured lines of credit that permit it to borrow up to \$432.0 million of which \$209.0 million was outstanding, and had capacity to borrow up to an additional \$223.0 million. The Credit Facility contains financial covenants requiring the Company to not (all defined terms used below not otherwise defined herein have the meaning assigned to such terms in the Credit Facility):

Permit the Consolidated Fixed Charge Coverage Ratio as of the end of any fiscal quarter to be less than 2.50 to 1. At September 30, 2018, the actual ratio was 6.62 to 1.

Permit the Consolidated Leverage Ratio at any time during any period of four consecutive fiscal quarters to be greater than 2.75 to 1. At September 30, 2018, the actual ratio was 1.58 to 1.

Permit Tangible Net Worth as of the end of any fiscal quarter of the Company to be less than the sum of (i) \$246.1 million plus (ii) 25% of the Company's Consolidated Net Income (but only if a positive number) for each fiscal quarter ended subsequent to December 31, 2011 plus (iii) 90% of the net cash proceeds from the issuance of the Company's capital stock after December 31, 2011. At September 30, 2018, such sum was \$361.0 million and the actual Tangible Net Worth of the Company was \$519.3 million.

At September 30, 2018, 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.

4.03% Senior Notes Due in 2018

On April 21, 2011, the Company entered into a Note Purchase and Private Shelf Agreement (the “Note Purchase Agreement”) with Prudential Investment Management, Inc. (“PIM”), The Prudential Insurance Company of America and Prudential Retirement Insurance and Annuity Company (collectively, the “Purchaser”), pursuant to which the Company agreed to sell an aggregate principal amount of \$100.0 million of its 4.03% Series A Senior Notes (the “Series A Senior Notes”) to the Purchaser. The Series A Senior Notes are an unsecured obligation of the Company, due on April 21, 2018. Interest on these notes is due semi-annually in arrears and the principal is due in five equal annual installments, with the first payment due on April 21, 2014. In addition, the Note Purchase Agreement allows for the issuance and sale of additional senior notes to the Purchaser (the “Shelf Notes”) in the aggregate principal amount of \$100.0 million, to mature no more than 12 years after the date of original issuance thereof, to have an average life of no more than 10 years and to bear interest on the unpaid balance. The final \$20.0 million principal payment under the Series A Senior Notes was made in April 2018 with no amount remaining outstanding as of September 30, 2018.

3.68% Senior Notes Due in 2021

On March 17, 2014, the Company issued and sold to the Purchaser a \$40.0 million aggregate principal amount of its 3.68% Series B Senior Notes (the “Series B Senior Notes”) pursuant to the terms of the Note Purchase Agreement, as amended. The Series B Senior Notes are an unsecured obligation of the Company and bear interest at a rate of 3.68% per annum and mature on March 17, 2021. Interest on the Series B Senior Notes is payable semi-annually beginning on September 17, 2014 and continuing thereafter on March 17 and September 17 of each year until maturity. The full net proceeds from the Series B Senior Notes were used for working capital and other general corporate purposes. At September 30, 2018, the principal balance outstanding under the Series B Senior Notes was \$40.0 million.

3.84% Senior Notes Due in 2022

On November 5, 2015, the Company issued and sold to the Purchaser a \$60.0 million aggregate principal amount of its 3.84% Series C Senior Notes (the “Series C Senior Notes”) pursuant to the terms of the Note Purchase Agreement, as amended. The Series C Senior Notes are an unsecured obligation of the Company and bear interest at a rate of 3.84% per annum and mature on November 5, 2022. Interest on the Series C Senior Notes is payable semi-annually beginning on May 5, 2016 and continuing thereafter on November 5 and May 5 of each year until maturity. The principal balance is due when the notes mature in 2022. The full net proceeds from the Series C Senior Notes were used to reduce the outstanding balance on the Company’s revolving credit line. At September 30, 2018, the principal balance outstanding under the Series C Senior Notes was \$60.0 million.

Among other restrictions, the Note Purchase Agreement, under which the Series A Senior Notes, Series B Senior Notes and Series C Senior Notes were sold, contains financial covenants requiring the Company to not (all defined terms used below not otherwise defined herein have the meaning assigned to such terms in the Note Purchase Agreement):

• Permit the Consolidated Fixed Charge Coverage Ratio of EBITDA to fixed charges as of the end of any fiscal quarter to be less than 2.50 to 1. At September 30, 2018, the actual ratio was 6.62 to 1.

• Permit the Consolidated Leverage Ratio of funded debt to EBITDA at any time during any period of four consecutive quarters to be greater than 2.75 to 1. At September 30, 2018, the actual ratio was 1.58 to 1.

• Permit Tangible Net Worth, calculated as of the last day of each fiscal quarter, to be less than the sum of (i) \$229.0 million, plus (ii) 25% of net income for such fiscal quarter subsequent to December 31, 2010, plus (iii) 90% of the net cash proceeds from the issuance of the Company’s capital stock after December 31, 2010. At September 30, 2018, such sum was \$361.0 million and the actual Tangible Net Worth of the Company was \$519.3 million.

At September 30, 2018, 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.

On February 9, 2016, the Company entered into an amendment to the Note Purchase Agreement (“2016 Amendment”) with the Purchaser. Pursuant to the 2016 Amendment, (i) the issuance period for the shelf notes to be issued and sold pursuant to the Note Purchase Agreement is extended until the earlier of February 9, 2019 or the termination of the issuance and sale of the shelf notes upon the 30 days’ prior notice of either PIM or the Company, and (ii) the definition of the “Available Facility Amount,” which is the aggregate amount of the shelf notes that may be authorized for purchase pursuant to the Note Purchase Agreement was amended to equal a formula based on: \$250 million, minus the aggregate principal amount of the shelf notes then outstanding and purchased pursuant to the Note Purchase Agreement, minus the shelf notes accepted by the Company for purchase, but not yet purchased, by the Purchaser pursuant to the Note Purchase Agreement; provided, however, the aggregate amount of the shelf notes purchased by any corporation or other entity controlling, controlled by, or under common control with, PIM shall not exceed \$200 million.

34

Although no assurance can be given, the Company believes it will continue to be able to negotiate general bank lines of credit and issue senior notes adequate to meet capital requirements not otherwise met by operational cash flows and proceeds from sales of rental equipment.

Common Stock Purchase

In May 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. The Company has in the past made purchases of shares of its common stock from time to time in over-the-counter market (NASDAQ) transactions, through privately negotiated, large block transactions and through a share repurchase plan, in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934. In August 2015, the Company's Board of Directors authorized the Company to repurchase an additional 2,000,000 shares of the Company's outstanding common stock. The amount and time of the specific repurchases are subject to prevailing market conditions, applicable legal requirements and other factors, including management's discretion. All shares repurchased by the Company are canceled and returned to the status of authorized but unissued shares of common stock. There can be no assurance that any authorized shares will be repurchased and the repurchase program may be modified, extended or terminated by the board of directors at any time. There were no repurchases of common stock during the nine months ended September 30, 2018 and 2017. As of September 30, 2018, 1,592,026 shares remained authorized for repurchase.

Contractual Obligations

We believe that our contractual obligations have not changed materially from those included in our 2017 Annual Report.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements as of September 30, 2018.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the Company's market risk exposures from those reported in our 2017 Annual Report.

Item 4. Controls and Procedures

The Company's management, under the supervision and with the participation of the Company's Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), the Company's principal executive officer and principal financial officer, respectively, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2018. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective. There have been no significant changes in the Company's internal controls or in other factors that have materially affected, or would reasonably be likely to materially affect, the Company's internal control over financial reporting.

Part II -Other Information

Item 1. Legal Proceedings

The Company is subject to various legal proceedings and claims arising in the ordinary course of business. The Company's management does not expect that the outcome in the current proceedings, individually or collectively, will have a material adverse effect on the Company's financial condition, operating results or cash flows.

ITEM 1A. RISK FACTORS

You should carefully consider the following discussion of various risks and uncertainties. We believe these risk factors are the most relevant to our business and could cause our results to differ materially from the forward-looking statements made by us. Our business, financial condition, and results of operations could be seriously harmed if any of these risks or uncertainties actually occur or materialize. In that event, the market price for our common stock could decline, and you may lose all or part of your investment.

The effects of a recession and tightened credit markets in the U.S. and other countries may adversely impact our business and financial condition and may negatively impact our ability to access financing.

Demand for our rental products depends on continued industrial and business activity and state government funding. The effects of the most recent credit crisis and economic recession in the U.S. and general global economic downturn had an adverse effect on our customers, including local school districts that are subject to budgetary constraints, which resulted in decreased demand for the products we rent. While the U.S. economy has emerged from the recession, if the economy experiences another recession, reduced demand for our rental products and deflation could increase price competition and could have a material adverse effect on our revenue and profitability.

Instability in the global financial system may also have an impact on our business and our financial condition. In the past, general economic conditions and the tightening credit markets have affected the ability of many companies to raise new capital or refinance existing indebtedness. While we intend to finance expansion with cash flow from operations and borrowing under our unsecured revolving line of credit under our Credit Facility (as defined and more fully described under the heading "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources – Unsecured Revolving Lines of Credit"), we may require additional financing to support our continued growth. Constriction in the capital markets, should we need to access the market for additional funds or to refinance our existing indebtedness, could limit our ability to obtain such additional funds on terms acceptable to the Company or at all. All of these factors could impact our business, resulting in lower revenues and lower levels of earnings in future periods. At the current time we are uncertain as to the magnitude, or duration, of such changes in our business.

Our stock price has fluctuated and may continue to fluctuate in the future, which may result in a decline in the value of your investment in our common stock.

The market price of our common stock fluctuates on the NASDAQ Global Select Market and is likely to be affected by a number of factors including but not limited to:

our operating performance and the performance of our competitors, and in particular any variations in our operating results or dividend rate from our stated guidance or from investors' expectations;

any changes in general conditions in the global economy, the industries in which we operate or the global financial markets;

investors' reaction to our press releases, public announcements or filings with the SEC;

the stock price performance of our competitors or other comparable companies;

any changes in research analysts' coverage, recommendations or earnings estimates for us or for the stocks of other companies in our industry;

any sales of common stock by our directors, executive officers and our other large shareholders, particularly in light of the limited trading volume of our stock;

any merger and acquisition activity that involves us or our competitors; and

other announcements or developments affecting us, our industry, customers, suppliers or competitors.

In addition, in recent years the U.S. stock market has experienced significant price and volume fluctuations. These fluctuations are often unrelated to the operating performance of particular companies. Additionally, the most recent global credit crisis adversely affected the prices of most publicly traded stocks as many stockholders became more willing to divest their stock holdings at lower values to increase their cash flow and reduce exposure to such fluctuations. These broad market fluctuations and any other negative economic trends may cause declines in the market price of our common stock and may be based upon factors that have little or nothing to do with our Company or its performance, and these fluctuations and trends could materially reduce our stock price.

Our future operating results may fluctuate, fail to match past performance or fail to meet expectations, which may result in a decrease in our stock price.

Our operating results may fluctuate in the future, may fail to match our past performance or fail to meet the expectations of analysts and investors. Our results and related ratios, such as gross margin, operating income percentage and effective tax rate may fluctuate as a result of a number of factors, some of which are beyond our control including but not limited to:

- general economic conditions in the geographies and industries where we rent and sell our products;
- legislative and educational policies where we rent and sell our products;
- the budgetary constraints of our customers;
- seasonality of our rental businesses and our end-markets;
- success of our strategic growth initiatives;
- costs associated with the launching or integration of new or acquired businesses;
- the timing and type of equipment purchases, rentals and sales;
- the nature and duration of the equipment needs of our customers;
- the timing of new product introductions by us, our suppliers and our competitors;
- the volume, timing and mix of maintenance and repair work on our rental equipment;
- our equipment mix, availability, utilization and pricing;
- the mix, by state and country, of our revenues, personnel and assets;
- rental equipment impairment from excess, obsolete or damaged equipment;
- movements in interest rates or tax rates;
- changes in, and application of, accounting rules;
- changes in the regulations applicable to us; and
- litigation matters.

As a result of these factors, our historical financial results are not necessarily indicative of our future results or stock price.

Our ability to retain our executive management and to recruit, retain and motivate key employees is critical to the success of our business.

If we cannot successfully recruit and retain qualified personnel, our operating results and stock price may suffer. We believe that our success is directly linked to the competent people in our organization, including our executive officers, senior managers and other key personnel, and in particular, Joe Hanna, our Chief Executive Officer. Personnel turnover can be costly and could materially and adversely impact our operating results and can potentially jeopardize the success of our current strategic initiatives. We need to attract and retain highly qualified personnel to replace personnel when turnover occurs, as well as add to our staff levels as growth occurs. Our business and stock price likely will suffer if we are unable to fill, or experience delays in filling open positions, or fail to retain key personnel.

Failure by third parties to manufacture and deliver our products to our specifications or on a timely basis may harm our reputation and financial condition.

We depend on third parties to manufacture our products even though we are able to purchase products from a variety of third-party suppliers. In the future, we may be limited as to the number of third-party suppliers for some of our products. Although in general we make advance purchases of some products to help ensure an adequate supply, currently we do not have any long-term purchase contracts with any third-party supplier. We may experience supply problems as a result of financial or operating difficulties or failure of our suppliers, or shortages and discontinuations resulting from product obsolescence or other shortages or allocations by our suppliers. Unfavorable economic conditions may also adversely affect our suppliers or the terms on which we purchase products. In the future, we may not be able to negotiate arrangements with third parties to secure products that we require in sufficient quantities or on reasonable terms. If we cannot negotiate arrangements with third parties to produce our products or if the third parties fail to produce our products to our specifications or in a timely manner, our reputation and financial condition could be harmed.

A breach of our information technology systems could subject us to liability, reputational damage or interrupt the operation of our business.

We rely upon our information technology systems and infrastructure for our business. We could experience theft of confidential information or reputational damage from industrial espionage attacks, malware or other cyber-attacks, which may compromise our system infrastructure or lead to data leakage, either internally or at our third-party providers. Similarly, data privacy breaches by those who access our systems may pose a risk that sensitive data, including intellectual property, trade secrets or personal information belonging to us, our employees, customers or other business partners, may be exposed to unauthorized persons or to the public. Cyber-attacks are increasing in their frequency, sophistication and intensity, and have become increasingly difficult to detect. There can be no assurance that our efforts to protect our data and information technology systems will prevent breaches in our systems (or that of our third-party providers) that could adversely affect our business and result in financial and reputational harm to us, theft of trade secrets and other proprietary information, legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties.

Disruptions in our information technology systems could adversely affect our business and results of operations. Additionally, if these systems fail, become unavailable for any period of time or are not upgraded, this could limit our ability to effectively monitor and control our operations and adversely affect our operations.

Our information technology systems facilitate our ability to transact business, monitor and control our operations and adjust to changing market conditions. Any disruption in our information technology systems or the failure of these systems to operate as expected could, depending on the magnitude of the problem, adversely affect our operating results by limiting our capacity to effectively transact business, monitor and control our operations and adjust to changing market conditions in a timely manner.

Further, the delay or failure to implement information system upgrades and new systems effectively could disrupt our business, distract management's focus and attention from our business operations and growth initiatives, and increase our implementation and operating costs, any of which could negatively impact our operations and operating results.

We have engaged in acquisitions and may engage in future acquisitions that could negatively impact our results of operations, financial condition and business.

In 2004, we acquired Technology Rentals & Services ("TRS"), an electronic test equipment rental business and in 2008 we acquired Adler Tanks, a liquid and solid containment rental business. We anticipate that we will continue to

consider acquisitions in the future that meet our strategic growth plans. We are unable to predict whether or when any prospective acquisition will be completed. Acquisitions involve numerous risks, including the following:

- difficulties in integrating the operations, technologies, products and personnel of the acquired companies;
 - diversion of management's attention from normal daily operations of our business;

- difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets may have stronger market positions;

- difficulties in complying with regulations applicable to any acquired business, such as environmental regulations, and managing risks related to an acquired business;

- timely completion of necessary financing and required amendments, if any, to existing agreements;

- an inability to implement uniform standards, controls, procedures and policies;

38

- undiscovered and unknown problems, defects, damaged assets liabilities, or other issues related to any acquisition that become known to us only after the acquisition;
- negative reactions from our customers to an acquisition;
- disruptions among employees related to any acquisition which may erode employee morale;
- loss of key employees, including costly litigation resulting from the termination of those employees;
- an inability to realize cost efficiencies or synergies that we may anticipate when selecting acquisition candidates;
- recording of goodwill and non-amortizable intangible assets that will be subject to future impairment testing and potential periodic impairment charges;
- incurring amortization expenses related to certain intangible assets; and
- becoming subject to litigation.

Acquisitions are inherently risky, and no assurance can be given that our future acquisitions will be successful or will not adversely affect our business, operating results, or financial condition. The success of our acquisition strategy depends upon our ability to successfully complete acquisitions and integrate any businesses that we acquire into our existing business. The difficulties of integration could be increased by the necessity of coordinating geographically dispersed organizations; maintaining acceptable standards, controls, procedures and policies; integrating personnel with disparate business backgrounds; combining different corporate cultures; and the impairment of relationships with employees and customers as a result of any integration of new management and other personnel. In addition, if we consummate one or more significant future acquisitions in which the consideration consists of stock or other securities, our existing shareholders' ownership could be diluted significantly. If we were to proceed with one or more significant future acquisitions in which the consideration included cash, we could be required to use, to the extent available, a substantial portion of our Credit Facility. If we increase the amount borrowed against our available credit line, we would increase the risk of breaching the covenants under our credit facilities with our lenders. In addition, it would limit our ability to make other investments, or we may be required to seek additional debt or equity financing. Any of these items could adversely affect our results of operations.

If we determine that our goodwill and intangible assets have become impaired, we may incur impairment charges, which would negatively impact our operating results.

At September 30, 2018, we had \$35.3 million of goodwill and intangible assets, net, on our consolidated balance sheets. Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations. Under accounting principles generally accepted in the United States of America, we assess potential impairment of our goodwill and intangible assets at least annually, as well as on an interim basis to the extent that factors or indicators become apparent that could reduce the fair value of any of our businesses below book value. Impairment may result from significant changes in the manner of use of the acquired asset, negative industry or economic trends and significant underperformance relative to historic or projected operating results.

Our rental equipment is subject to residual value risk upon disposition, and may not sell at the prices or in the quantities we expect.

The market value of any given piece of rental equipment could be less than its depreciated value at the time it is sold. The market value of used rental equipment depends on several factors, including:

- the market price for new equipment of a like kind;
- the age of the equipment at the time it is sold, as well as wear and tear on the equipment relative to its age;
- the supply of used equipment on the market;
- technological advances relating to the equipment;
- worldwide and domestic demand for used equipment; and
- general economic conditions.

We include in income from operations the difference between the sales price and the depreciated value of an item of equipment sold. Changes in our assumptions regarding depreciation could change our depreciation expense, as well as the gain or loss realized upon disposal of equipment. Sales of our used rental equipment at prices that fall

significantly below our projections or in lesser quantities than we anticipate will have a negative impact on our results of operations and cash flows.

39

If we do not effectively manage our credit risk, collect on our accounts receivable or recover our rental equipment from our customers' sites, it could have a material adverse effect on our operating results.

We generally rent and sell to customers on 30 day payment terms, individually perform credit evaluation procedures on our customers for each transaction and require security deposits or other forms of security from our customers when a significant credit risk is identified. Historically, accounts receivable write-offs and write-offs related to equipment not returned by customers have not been significant and have averaged less than 1% of total revenues over the last five years. If economic conditions deteriorate, we may see an increase in bad debt relative to historical levels, which may materially and adversely affect our operations. Business segments that experience significant market disruptions or declines may experience increased customer credit risk and higher bad debt expense. Failure to manage our credit risk and receive timely payments on our customer accounts receivable may result in write-offs and/or loss of equipment, particularly electronic test equipment. If we are not able to effectively manage credit risk issues, or if a large number of our customers should have financial difficulties at the same time, our receivables and equipment losses could increase above historical levels. If this should occur, our results of operations may be materially and adversely affected.

Effective management of our rental assets is vital to our business. If we are not successful in these efforts, it could have a material adverse impact on our result of operations.

Our modular, electronics and liquid and solid containment rental products have long useful lives and managing those assets is a critical element to each of our rental businesses. Generally, we design units and find manufacturers to build them to our specifications for our modular and liquid and solid containment tanks and boxes. Modular asset management requires designing and building the product for a long life that anticipates the needs of our customers, including anticipating potential changes in legislation, regulations, building codes and local permitting in the various markets in which the Company operates. Electronic test equipment asset management requires understanding, selecting and investing in equipment technologies that support market demand, including anticipating technological advances and changes in manufacturers' selling prices. Liquid and solid containment asset management requires designing and building the product for a long life, using quality components and repairing and maintaining the products to prevent leaks. For each of our modular, electronic test equipment and liquid and solid containment assets, we must successfully maintain and repair this equipment cost-effectively to maximize the useful life of the products and the level of proceeds from the sale of such products. To the extent that we are unable to do so, our result of operations could be materially adversely affected.

The nature of our businesses, including the ownership of industrial property, exposes us to the risk of litigation and liability under environmental, health and safety and products liability laws. Violations of environmental or health and safety related laws or associated liability could have a material adverse effect on our business, financial condition and results of operations.

We are subject to national, state, provincial and local environmental laws and regulations concerning, among other things, solid and liquid waste and hazardous substances handling, storage and disposal and employee health and safety. These laws and regulations are complex and frequently change. We could incur unexpected costs, penalties and other civil and criminal liability if we fail to comply with applicable environmental or health and safety laws. We also could incur costs or liabilities related to waste disposal or remediating soil or groundwater contamination at our properties, at our customers' properties or at third party landfill and disposal sites. These liabilities can be imposed on the parties generating, transporting or disposing of such substances or on the owner or operator of any affected property, often without regard to whether the owner or operator knew of, or was responsible for, the presence of hazardous substances.

Several aspects of our businesses involve risks of environmental and health and safety liability. For example, our operations involve the use of petroleum products, solvents and other hazardous substances in the construction and maintaining of modular buildings and for fueling and maintaining our delivery trucks and vehicles. We also own,

transport and rent tanks and boxes in which waste materials are placed by our customers. The historical operations at some of our previously or currently owned or leased and newly acquired or leased properties may have resulted in undiscovered soil or groundwater contamination or historical non-compliance by third parties for which we could be held liable. Future events, such as changes in existing laws or policies or their enforcement, or the discovery of currently unknown contamination or non-compliance, may also give rise to liabilities or other claims based on these operations that may be material. In addition, compliance with future environmental or health and safety laws and regulations may require significant capital or operational expenditures or changes to our operations.

Accordingly, in addition to potential penalties for non-compliance, we may become liable, either contractually or by operation of law, for investigation, remediation and monitoring costs even if the contaminated property is not presently owned or operated by us, or if the contamination was caused by third parties during or prior to our ownership or operation of the property. In addition, certain parties may be held liable for more than their “fair” share of environmental investigation and cleanup costs. Contamination and exposure to hazardous substances or other contaminants such as mold can also result in claims for remediation or damages, including personal injury, property damage, and natural resources damage claims. Although expenses related to environmental compliance, health and safety issues, and related matters have not been material to date, we cannot assure that we will not have to make significant

expenditures in the future in order to comply with applicable laws and regulations. Violations of environmental or health and safety related laws or associated liability could have a material adverse effect on our business, financial condition and results of operations.

In general, litigation in the industries in which we operate, including class actions that seek substantial damages, arises with increasing frequency. Enforcement of environmental and health and safety requirements is also frequent. Such proceedings are invariably expensive, regardless of the merit of the plaintiffs' or prosecutors' claims. We may be named as a defendant in the future, and there can be no assurance, irrespective of the merit of such future actions, that we will not be required to make substantial settlement payments in the future. Further, a significant portion of our business is conducted in California which is one of the most highly regulated and litigious states in the country. Therefore, our potential exposure to losses and expenses due to new laws, regulations or litigation may be greater than companies with a less significant California presence.

The nature of our business also subjects us to property damage and product liability claims, especially in connection with our modular buildings and tank and box rental businesses. Although we maintain liability coverage that we believe is commercially reasonable, an unusually large property damage or product liability claim or a series of claims could exceed our insurance coverage or result in damage to our reputation.

Our routine business activities expose us to risk of litigation from employees, vendors and other third parties, which could have a material adverse effect on our results of operations.

We may be subject to claims arising from disputes with employees, vendors and other third parties in the normal course of our business; these risks may be difficult to assess or quantify and their existence and magnitude may remain unknown for substantial periods of time. If the plaintiffs in any suits against us were to successfully prosecute their claims, or if we were to settle any such suits by making significant payments to the plaintiffs, our operating results and financial condition would be harmed. Even if the outcome of a claim proves favorable to us, litigation can be time consuming and costly and may divert management resources. In addition, our organizational documents require us to indemnify our senior executives to the maximum extent permitted by California law. We maintain directors' and officers' liability insurance that we believe is commercially reasonable in connection with such obligations, but if our senior executives were named in any lawsuit, our indemnification obligations could magnify the costs of these suits and/or exceed the coverage of such policies.

If we suffer loss to our facilities, equipment or distribution system due to catastrophe, our insurance policies could be inadequate or depleted, our operations could be seriously harmed, which could negatively affect our operating results.

Our facilities, rental equipment and distribution systems may be subject to catastrophic loss due to fire, flood, hurricane, earthquake, terrorism or other natural or man-made disasters. In particular, our headquarters, three operating facilities, and certain of our rental equipment are located in areas of California, with above average seismic activity and could be subject to catastrophic loss caused by an earthquake. Our rental equipment and facilities in Texas, Florida, North Carolina and Georgia are located in areas subject to hurricanes and other tropical storms. In addition to customers' insurance on rented equipment, we carry property insurance on our rental equipment in inventory and operating facilities as well as business interruption insurance. We believe our insurance policies have adequate limits and deductibles to mitigate the potential loss exposure of our business. We do not maintain financial reserves for policy deductibles and our insurance policies contain exclusions that are customary for our industry, including exclusions for earthquakes, flood and terrorism. If any of our facilities or a significant amount of our rental equipment were to experience a catastrophic loss, it could disrupt our operations, delay orders, shipments and revenue recognition and result in expenses to repair or replace the damaged rental equipment and facility not covered by insurance, which could have a material adverse effect on our results of operations.

Our debt instruments contain covenants that restrict or prohibit our ability to enter into a variety of transactions and may limit our ability to finance future operations or capital needs. If we have an event of default under these

instruments, our indebtedness could be accelerated and we may not be able to refinance such indebtedness or make the required accelerated payments.

The agreements governing our Series A, Series B and Series C Senior Notes (as defined and more fully described under the heading “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources”) and our Credit Facility contain various covenants that limit our discretion in operating our business. In particular, we are limited in our ability to merge, consolidate, reorganize or transfer substantially all of our assets, make investments, pay dividends or distributions, redeem or repurchase stock, change the nature of our business, enter into transactions with affiliates, incur indebtedness and create liens on our assets to secure debt. In addition, we are required to meet certain financial covenants under these instruments. These restrictions could limit our ability to obtain future financing, make strategic acquisitions or needed capital expenditures, withstand economic downturns in our business or the economy in general, conduct operations or otherwise take advantage of business opportunities that may arise.

A failure to comply with the restrictions contained in these agreements could lead to an event of default, which could result in an acceleration of our indebtedness. In the event of an acceleration, we may not have or be able to obtain sufficient funds to refinance our indebtedness or make any required accelerated payments. If we default on our indebtedness, our business financial condition and results of operations could be materially and adversely affected.

The majority of our indebtedness is subject to variable interest rates, which makes us vulnerable to increases in interest rates, which could negatively affect our net income.

Our indebtedness exposes us to interest rate increases because the majority of our indebtedness is subject to variable rates. At present, we do not have any derivative financial instruments such as interest rate swaps or hedges to mitigate interest rate variability. The interest rates under our credit facilities are reset at varying periods. These interest rate adjustments could cause periodic fluctuations in our operating results and cash flows. Our annual debt service obligations increase by approximately \$2.1 million per year for each 1% increase in the average interest rate we pay based on the \$209.0 million balance of variable rate debt outstanding at September 30, 2018. If interest rates rise in the future, and, particularly if they rise significantly, interest expense will increase and our net income will be negatively affected.

Our effective tax rate may change and become less predictable as our business expands, making our future earnings less predictable.

We continue to consider expansion opportunities domestically and internationally for our rental businesses, such as the organic expansion of our modular business in North Carolina, Georgia, Maryland, Virginia and Washington, D.C., expansion into the portable storage business and our expansion in 2008 into the liquid and solid containment business. Since the Company's effective tax rate depends on business levels, personnel and assets located in various jurisdictions, further expansion into new markets or acquisitions may change the effective tax rate in the future and may make it, and consequently our earnings, less predictable going forward. In addition, the enactment of future tax law changes by federal and state taxing authorities may impact the Company's current period tax provision and its deferred tax liabilities.

Changes in applicable tax regulations could negatively affect our financial results.

We are subject to taxation in the United States, as well as a number of foreign jurisdictions. On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The changes included in the Tax Act are both broad and complex. The final transitional impact of the Tax Act may differ from the estimates provided in the Company's 2017 Annual Report, due to, among other things, changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates we utilized to calculate the transitional impacts, including impacts related to changes to current year earnings estimates and the amount of the repatriation tax. Given the unpredictability of these and other tax laws and related regulations, and their potential interdependency, it continues to be difficult to assess the overall effect of such changes. Nonetheless, any material negative effect of such changes to our earnings and cash flow could adversely impact our financial results.

Changes in financial accounting standards may cause lower than expected operating results and affect our reported results of operations.

Changes in accounting standards and their application may have a significant effect on our reported results on a going-forward basis and may also affect the recording and disclosure of previously reported transactions. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred in the past and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

Failure to comply with internal control attestation requirements could lead to loss of public confidence in our financial statements and negatively impact our stock price.

As a public reporting company, we are required to comply with the Sarbanes-Oxley Act of 2002, including Section 404, and the related rules and regulations of the SEC, including expanded disclosures and accelerated reporting requirements. Compliance with Section 404 and other related requirements has increased our costs and will continue to require additional management resources. We may need to continue to implement additional finance and accounting systems, procedures and controls to satisfy new reporting requirements. While our management concluded that our internal control over financial reporting as of December 31, 2017 was effective, there is no assurance that future assessments of the adequacy of our internal controls over financial reporting will be favorable. If we are unable to obtain future unqualified reports as to the effectiveness of our internal control over financial reporting, investors could lose confidence in the reliability of our internal control over financial reporting, which could adversely affect our stock price.

SPECIFIC RISKS RELATED TO OUR RELOCATABLE MODULAR BUILDINGS BUSINESS SEGMENT:

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.

Rentals and sales of modular buildings to public school districts for use as classrooms, restroom buildings, and administrative offices for K-12 represent a significant portion of Mobile Modular's rental and sales revenues. Funding for public school facilities is derived from a variety of sources including the passage of both statewide and local facility bond measures, developer fees and various taxes levied to support school operating budgets. Many of these funding sources are subject to financial and political considerations, which vary from district to district and are not tied to demand. Historically, we have benefited from the passage of statewide and local facility bond measures and believe these are essential to our business.

The state of California is our largest market for classroom rentals. The strength of this market depends heavily on public funding from voter passage of both state and local facility bond measures, and the ability of the state to sell such bonds in the public market. A lack of passage of state and local facility bond measures, or the inability to sell bonds in the public markets in the future could reduce our revenues and operating income, and consequently have a material adverse effect on the Company's financial condition. Furthermore, even if voters have approved facility bond measures and the state has raised bond funds, there is no guarantee that individual school projects will be funded in a timely manner.

As a consequence of the most recent economic recession, many states and local governments experienced large budget deficits resulting in severe budgetary constraints among public school districts. To the extent public school districts' funding is reduced for the rental and purchase of modular buildings, our business could be harmed and our results of operations negatively impacted. We believe that interruptions or delays in the passage of facility bond measures or completion of state budgets, an insufficient amount of state funding, a significant reduction of funding to public schools, or changes negatively impacting enrollment may reduce the rental and sale demand for our educational products. Any reductions in funding available to the school districts from the states in which we do business may cause school districts to experience budget shortfalls and to reduce their demand for our products despite growing student populations, class size reduction initiatives and modernization and reconstruction project needs, which could reduce our revenues and operating income and consequently have a material adverse effect on the Company's financial condition.

Public policies that create demand for our products and services may change, resulting in decreased demand for or the pricing of our products and services, which could negatively affect our revenues and operating income.

In California a law was enacted in 1996 to provide funding for school districts for the reduction of class sizes for kindergarten through third grade. In Florida, a state constitutional amendment was passed in 2002 to limit the number of students that may be grouped in a single classroom for pre-kindergarten through grade twelve. School districts with class sizes in excess of state limits have been and continue to be a significant source of our demand for modular classrooms. Further, in California, efforts to address aging infrastructure and deferred maintenance have resulted in modernization and reconstruction projects by public school districts including seismic retrofitting, asbestos abatement and various building repairs and upgrades, which has been another source of demand for our modular classrooms. The most recent economic recession caused state and local budget shortfalls, which reduced school districts' funding and their ability to comply with state class size reduction requirements in California and Florida. If educational priorities and policies shift away from class-size reduction or modernization and reconstruction projects, demand and pricing for our products and services may decline, not grow as quickly as, or not reach the levels that we anticipate. Significant equipment returns may result in lower utilization until equipment can be redeployed or sold, which may cause rental rates to decline and negatively affect our revenues and operating income.

Failure to comply with applicable regulations could harm our business and financial condition, resulting in lower operating results and cash flows.

Similar to conventionally constructed buildings, the modular building industry, including the manufacturers and lessors of portable classrooms, are subject to regulations by multiple governmental agencies at the federal, state and local level relating to environmental, zoning, health, safety, labor and transportation matters, among other matters. Failure to comply with these laws or regulations could impact our business or harm our reputation and result in higher capital or operating expenditures or the imposition of penalties or restrictions on our operations.

As with conventional construction, typically new codes and regulations are not retroactively applied. Nonetheless, new governmental regulations in these or other areas may increase our acquisition cost of new rental equipment, limit the use of or make obsolete some of our existing equipment, or increase our costs of rental operations.

Building codes are generally reviewed every three years. All aspects of a given code are subject to change including, but not limited to, such items as structural specifications for earthquake safety, energy efficiency and environmental standards, fire and life safety, transportation, lighting and noise limits. On occasion, state agencies have undertaken studies of indoor air quality and noise levels with a focus on permanent and modular classrooms. These results could impact our existing modular equipment and affect the future construction of our modular product.

Compliance with building codes and regulations entails a certain amount of risk as state and local government authorities do not necessarily interpret building codes and regulations in a consistent manner, particularly where applicable regulations may be unclear and subject to interpretation. These regulations often provide broad discretion to governmental authorities that oversee these matters, which can result in unanticipated delays or increases in the cost of compliance in particular markets. The construction and modular industries have developed many “best practices” which are constantly evolving. Some of our peers and competitors may adopt practices that are more or less stringent than the Company’s. When, and if, regulatory standards are clarified, the effect of the clarification may be to impose rules on our business and practices retroactively, at which time, we may not be in compliance with such regulations and we may be required to incur costly remediation. If we are unable to pass these increased costs on to our customers, our profitability, operating cash flows and financial condition could be negatively impacted.

Expansions of our modular operations into new markets may negatively affect our operating results.

In the past, we have expanded our modular operations in Texas, North Carolina, Georgia, Maryland, Virginia and Washington, D.C. There are risks inherent in the undertaking of such expansion, including the risk of revenue from the business in any new markets not meeting our expectations, higher than expected costs in entering these new markets, risk associated with compliance with applicable state and local laws and regulations, response by competitors and unanticipated consequences of expansion. In addition, expansion into new markets may be affected by local economic and market conditions. Expansion of our operations into new markets will require a significant amount of attention from our management, a commitment of financial resources and will require us to add qualified management in these markets, which may negatively impact our operating results.

We are subject to laws and regulations governing government contracts. These laws and regulations make these government contracts more favorable to government entities than other third parties and any changes in these laws and regulations, or our failure to comply with these laws and regulations could harm our business.

We have agreements relating to the sale of our products to government entities and, as a result, we are subject to various statutes and regulations that apply to companies doing business with the government. The laws governing government contracts differ from the laws governing private contracts. For example, many government contracts contain pricing terms and conditions that are not applicable to private contracts such as clauses that allow government entities not to perform on contractual obligations in the case of a lack of fiscal funding. Also, in the educational markets we serve, we are able to utilize “piggyback” contracts in marketing our products and services and ultimately to book business. The term “piggyback” contract refers to contracts for portable classrooms or other products entered into by public school districts following a formal bid process that allows for the use of the same contract terms and conditions with the successful vendor by other public school districts. As a result, “piggyback” contracts allow us to more readily book orders from our government customers, primarily public school districts, and to reduce the administrative expense associated with booking these orders. The governmental statutes and regulations that allow for use of “piggyback” contracts are subject to change or elimination in their entirety. A change in the manner of use or the elimination of “piggyback” contracts would likely negatively impact our ability to book new business from these government customers and could cause our administrative expenses related to processing these orders to increase significantly. In addition, any failure to comply with these laws and regulations might result in administrative penalties or even in the suspension of these contracts and as a result, the loss of the related revenues which would harm our business and results from operations.

Seasonality of our educational business may have adverse consequences for our business.

A significant portion of the modular sale and rental revenues is derived from the educational market. Typically, during each calendar year, our highest numbers of classrooms are shipped for rental and sale orders during the second and third quarters for delivery and installation prior to the start of the upcoming school year. The majority of classrooms shipped in the second and third quarters have rental start dates during the third quarter, thereby making the fourth quarter the first full quarter of rental revenues recognized for these transactions. Although this is the historical seasonality of our business, it is subject to change or may not meet our expectations, which may have adverse consequences for our business.

We face strong competition in our modular building markets and we may not be able to effectively compete.

The modular building leasing industry is highly competitive in our states of operation and we expect it to remain so. The competitive market in which we operate may prevent us from raising rental fees or sales prices to pass any increased costs on to our customers. We compete on the basis of a number of factors, including equipment availability, quality, price, service, reliability,

appearance, functionality and delivery terms. We may experience pricing pressures in our areas of operation in the future as some of our competitors seek to obtain market share by reducing prices.

Some of our larger national competitors in the modular building leasing industry, notably WillScot Corporation and Modspace, have a greater range of products and services, greater financial and marketing resources, larger customer bases, and greater name recognition than we have. In August 2018, WillScot Corporation completed the acquisition of Modspace. These combined competitors may be better able to respond to changes in the relocatable modular building market, to finance acquisitions, to fund internal growth and to compete for market share, any of which could harm our business.

We may not be able to quickly redeploy modular units returning from leases, which could negatively affect our financial performance and our ability to expand, or utilize, our rental fleet.

As of September 30, 2018, 53% of our modular portfolio had equipment on rent for periods exceeding the original committed term. Generally, when a customer continues to rent the modular units beyond the contractual term, the equipment rents on a month-to-month basis. If a significant number of our rented modular units were returned during a short period of time, particularly those units that are rented on a month-to-month basis, a large supply of units would need to be remarketed. Our failure to effectively remarket a large influx of units returning from leases could negatively affect our financial performance and our ability to continue expanding our rental fleet. In addition, if returned units stay off rent for an extended period of time, we may incur additional costs to securely store and maintain them.

Significant increases in raw material and labor costs could increase our acquisition cost of new modular rental units and repair and maintenance costs of our fleet, which would increase our operating costs and harm our profitability.

We incur labor costs and purchase raw materials, including lumber, siding and roofing and other products to perform periodic repairs, modifications and refurbishments to maintain physical conditions of our modular units. The volume, timing and mix of maintenance and repair work on our rental equipment may vary quarter-to-quarter and year-to-year. Generally, increases in labor and raw material costs will also increase the acquisition cost of new modular units and increase the repair and maintenance costs of our fleet. We also maintain a fleet of service trucks and use subcontractor companies for the delivery, set-up, return delivery and dismantle of modulars for our customers. We rely on our subcontractor service companies to meet customer demands for timely shipment and return, and the loss or inadequate number of subcontractor service companies may cause prices to increase, while negatively impacting our reputation and operating performance. During periods of rising prices for labor, raw materials or fuel, and in particular, when the prices increase rapidly or to levels significantly higher than normal, we may incur significant increases in our acquisition costs for new modular units and incur higher operating costs that we may not be able to recoup from our customers, which would reduce our profitability.

Failure by third parties to manufacture our products timely or properly may harm our reputation and financial condition.

We are dependent on third parties to manufacture our products even though we are able to purchase products from a variety of third-party suppliers. Mobile Modular purchases new modulars from various manufacturers who build to Mobile Modular's design specifications. With the exception of Enviroplex, none of the principal suppliers are affiliated with the Company. During 2017, Mobile Modular purchased 36% of its modular product from one manufacturer. The Company believes that the loss of any of its primary manufacturers of modulars could have an adverse effect on its operations since Mobile Modular could experience higher prices and longer delivery lead times for modular product until other manufacturers were able to increase their production capacity.

Failure to properly design, manufacture, repair and maintain the modular product may result in impairment charges, potential litigation and reduction of our operating results and cash flows.

We estimate the useful life of the modular product to be 18 years with a residual value of 50%. However, proper design, manufacture, repairs and maintenance of the modular product during our ownership is required for the product to reach the estimated useful life of 18 years with a residual value of 50%. If we do not appropriately manage the design, manufacture, repair and maintenance of our modular product, or otherwise delay or defer such repair or maintenance, we may be required to incur impairment charges for equipment that is beyond economic repair costs or incur significant capital expenditures to acquire new modular product to serve demand. In addition, such failures may result in personal injury or property damage claims, including claims based on presence of mold, and termination of leases or contracts by customers. Costs of contract performance, potential litigation, and profits lost from termination could accordingly reduce our future operating results and cash flows.

Our warranty costs may increase and warranty claims could damage our reputation and negatively impact our revenues and operating income.

Sales of new relocatable modular buildings not manufactured by us are typically covered by warranties provided by the manufacturer of the products sold. We provide ninety-day warranties on certain modular sales of used rental units and one-year warranties on equipment manufactured by our Enviroplex subsidiary. Historically, our warranty costs have not been significant, and we monitor the quality of our products closely. If a defect were to arise in the installation of our equipment at the customer's facilities or in the equipment acquired from our suppliers or by our Enviroplex subsidiary, we may experience increased warranty claims. Such claims could disrupt our sales operations, damage our reputation and require costly repairs or other remedies, negatively impacting revenues and operating income.

SPECIFIC RISKS RELATED TO OUR ELECTRONIC TEST EQUIPMENT BUSINESS SEGMENT:

Market risk and cyclical downturns in the industries using test equipment may result in periods of low demand for our product resulting in excess inventory, impairment charges and reduction of our operating results and cash flows.

TRS-RenTelco's revenues 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, in the aerospace, defense, communications, manufacturing and semiconductor industries. Electronic test equipment rental and sales revenues are primarily affected by the business activity within these industries related to research and development, manufacturing, and communication infrastructure installation and maintenance. Historically, these industries have been cyclical and have experienced periodic downturns, which can have a material adverse impact on the industry's demand for equipment, including our rental electronic test equipment. In addition, the severity and length of any downturn in an industry may also affect overall access to capital, which could adversely affect our customers and result in excess inventory and impairment charges. During periods of reduced and declining demand for test equipment, we are exposed to additional receivable risk from non-payment and may need to rapidly align our cost structure with prevailing market conditions, which may negatively impact our operating results and cash flows.

Seasonality of our electronic test equipment business may impact quarterly results.

Generally, rental activity declines in the fourth quarter month of December and the first quarter months of January and February. These months may have lower rental activity due to holiday closures, particularly by larger companies, inclement weather and its impact on various field related communications equipment rentals, and companies' operational recovery from holiday closures which may impact the start-up of new projects coming online in the first quarter. These seasonal factors historically have impacted quarterly results in each year's first and fourth quarter, but we are unable to predict how such factors may impact future periods.

Our rental test equipment may become obsolete or may no longer be supported by a manufacturer, which could result in an impairment charge.

Electronic test equipment is characterized by changing technology and evolving industry standards that may render our existing equipment obsolete through new product introductions, or enhancements, before the end of its anticipated useful life, causing us to incur impairment charges. We must anticipate and keep pace with the introduction of new hardware, software and networking technologies and acquire equipment that will be marketable to our current and prospective customers.

Additionally, some manufacturers of our equipment may be acquired or cease to exist, resulting in a future lack of support for equipment purchased from those manufacturers. This could result in the remaining useful life becoming shorter, causing us to incur an impairment charge. We monitor our manufacturers' capacity to support their products and the introduction of new technologies, and we acquire equipment that will be marketable to our current and

prospective customers. However, any prolonged economic downturn could result in unexpected bankruptcies or reduced support from our manufacturers. Failure to properly select, manage and respond to the technological needs of our customers and changes to our products through their technology life cycle may cause certain electronic test equipment to become obsolete, resulting in impairment charges, which may negatively impact operating results and cash flows.

If we do not effectively compete in the rental equipment market, our operating results will be materially and adversely affected.

The electronic test equipment rental business is characterized by intense competition from several competitors, including Electro Rent Corporation, Continental Resources and TestEquity, some of which may have access to greater financial and other resources than we do. Although no single competitor holds a dominant market share, we face competition from these established entities and new entrants in the market. We believe that we anticipate and keep pace with the introduction of new products and acquire equipment that will be marketable to our current and prospective customers. We compete on the basis of a number of factors, including product availability, price, service and reliability. Some of our competitors may offer similar equipment for lease, rental or sale at lower prices

and may offer more extensive servicing, or financing options. Failure to adequately forecast the adoption of, and demand for, new or existing products may cause us not to meet our customers' equipment requirements and may materially and adversely affect our operating results.

If we are not able to obtain equipment at favorable rates, there could be a material adverse effect on our operating results and reputation.

The majority of our rental equipment portfolio is comprised of general purpose test and measurement instruments purchased from leading manufacturers such as Keysight Technologies (formerly Agilent Technologies) and Tektronix, a division of Fortive Corporation. We depend on purchasing equipment from these manufacturers and suppliers for use as our rental equipment. If, in the future, we are not able to purchase necessary equipment from one or more of these suppliers on favorable terms, we may not be able to meet our customers' demands in a timely manner or for a rental rate that generates a profit. If this should occur, we may not be able to secure necessary equipment from an alternative source on acceptable terms and our business and reputation may be materially and adversely affected.

If we are not able to anticipate and mitigate the risks associated with operating internationally, there could be a material adverse effect on our operating results.

Currently, total foreign country customers and operations account for less than 10% of the Company's revenues. In recent years some of our customers have expanded their international operations faster than domestic operations, and this trend may continue. Over time, we anticipate the amount of our international business may increase if our focus on international market opportunities continues. Operating in foreign countries subjects the Company to additional risks, any of which may adversely impact our future operating results, including:

- international political, economic and legal conditions including tariffs and trade barriers;
- our ability to comply with customs, anti-corruption, import/export and other trade compliance regulations, together with any unexpected changes in such regulations;
- greater difficulty in our ability to recover rental equipment and obtain payment of the related trade receivables;
- additional costs to establish and maintain international subsidiaries and related operations;
- difficulties in attracting and retaining staff and business partners to operate internationally;
- language and cultural barriers;
- seasonal reductions in business activities in the countries where our international customers are located;
- difficulty with the integration of foreign operations;
- longer payment cycles;
- currency fluctuations; and
- potential adverse tax consequences.

Unfavorable currency exchange rates may negatively impact our financial results in U.S. dollar terms.

We receive revenues in Canadian dollars from our business activities in Canada. Conducting business in currencies other than U.S. dollars subjects us to fluctuations in currency exchange rates. If the currency exchange rates change unfavorably, the value of net receivables we receive in foreign currencies and later convert to U.S. dollars after the unfavorable change would be diminished. This could have a negative impact on our reported operating results. We currently do not engage in hedging strategies to mitigate this risk.

SPECIFIC RISKS RELATED TO OUR LIQUID AND SOLID CONTAINMENT TANKS AND BOXES BUSINESS SEGMENT:

We may be brought into tort or environmental litigation or held responsible for cleanup of spills if the customer fails to perform, or an accident occurs in the use of our rental products, which could materially adversely affect our business, future operating results or financial position.

Our rental tanks and boxes are used by our customers to store non-hazardous and certain hazardous liquids and solids on the customer's site. Our customers are generally responsible for proper operation of our tank and box rental equipment while on rent and returning a cleaned and undamaged container upon completion of use, but exceptions may be granted and we cannot always assure that these responsibilities are fully met in all cases. Although we require the customer to carry commercial general liability insurance

in a minimum amount of \$5,000,000, such policies often contain pollution exclusions and other exceptions. Furthermore, we cannot be certain our liability insurance will always be sufficient. In addition, if an accident were to occur involving our rental equipment or a spill of substances were to occur when the tank or box was in transport or on rent with our customer, a claim could be made against us as owner of the rental equipment.

In the event of a spill or accident, we may be brought into a lawsuit or enforcement action by either our customer or a third party on numerous potential grounds, including an allegation that an inherent flaw in a tank or box contributed to an accident or that the tank had suffered some undiscovered harm from a previous customer's prior use. In the event of a spill caused by our customers, we may be held responsible for cleanup under environmental laws and regulations concerning obligations of suppliers of rental products to effect remediation. In addition, applicable environmental laws and regulations may impose liability on us for the conduct of third parties, or for actions that complied with applicable regulations when taken, regardless of negligence or fault. Substantial damage awards have also been made in certain jurisdictions against lessors of industrial equipment based upon claims of personal injury, property damage, and resource damage caused by the use of various products. While we take what we believe are reasonable precautions that our rental equipment is in good and safe condition prior to rental and carry insurance to protect against certain risks of loss or accidents, such liability could adversely impact our profitability.

The liquid and solid containment rental industry is highly competitive, and competitive pressures could lead to a decrease in our market share or in rental rates and our ability to rent, or sell, equipment at favorable prices, which could adversely affect our operating results.

The liquid and solid containment rental industry is highly competitive. We compete against national, regional and local companies, including BakerCorp, Rain For Rent and Mobile Mini, all of which may be larger than we are and may have greater financial and marketing resources than we have. Some of our competitors also have longer operating histories, lower cost basis of rental equipment, lower cost structures and more established relationships with equipment manufacturers than we have. In addition, certain of our competitors are more geographically diverse than we are and have greater name recognition among customers than we do. As a result, our competitors that have these advantages may be better able to attract customers and provide their products and services at lower rental rates. Some competitors offer different approaches to liquid storage, such as large-volume modular tanks that may have better economics and compete with conventional frac tanks in certain oil and gas field applications. We may in the future encounter increased competition in the markets that we serve from existing competitors or from new market entrants. In July 2018, United Rentals, Inc. completed the acquisition of BakerCorp. This acquisition may create additional competition for customers and provide the combined entity access to greater financial resources than we have.

We believe that equipment quality, service levels, rental rates and fleet size are key competitive factors in the liquid and solid containment rental industry. From time to time, we or our competitors may attempt to compete aggressively by lowering rental rates or prices. Competitive pressures could adversely affect our revenues and operating results by decreasing our market share or depressing rental rates. To the extent we lower rental rates or increase our fleet in order to retain or increase market share, our operating margins would be adversely impacted. In addition, we may not be able to match a larger competitor's price reductions or fleet investment because of its greater financial resources, all of which could adversely impact our operating results through a combination of a decrease in our market share, revenues and operating income.

Market risk, commodity price volatility, regulatory changes or interruptions and cyclical downturns in the industries using tanks and boxes may result in periods of low demand for our products resulting in excess inventory, impairment charges and reduction of our operating results and cash flows.

Adler Tanks' revenues are derived from the rental of tanks and boxes to companies involved in oil and gas exploration, extraction and refinement, environmental remediation and wastewater/groundwater treatment, infrastructure and building construction and various industrial services, among others. We expect tank and box rental revenues will

primarily be affected by the business activity within these industries. Historically, these industries have been cyclical and have experienced periodic downturns, which have a material adverse impact on the industry's demand for equipment, including the tanks and boxes rented by us. Lower oil or gas prices may have an adverse effect on our liquid and solid containment tanks and boxes business. Any steep decline in both domestic and international oil prices driven by materially higher supply levels and weak demand could have a significant negative impact on the industry's demand for equipment, especially if such market conditions continue for an extended period of time. If the price reduction causes customers to limit or stop exploration, extraction or refinement activities, resulting in lower demand and pricing for renting Adler Tank's products, our financial results could be adversely impacted. Also, a weak U.S. economy may negatively impact infrastructure construction and industrial activity. Any of these factors may result in excess inventory or impairment charges and reduce our operating results and cash flows.

Changes in regulatory, or governmental, oversight of hydraulic fracturing could materially adversely affect the demand for our rental products and reduce our operating results and cash flows.

We believe that demand related to hydraulic fracturing has increased the total rental revenues and market size in recent years. Oil and gas exploration and extraction (including use of tanks for hydraulic fracturing to obtain shale oil and shale gas) are subject to numerous local, state and federal regulations. In the three and nine months ended September 30, 2018, oil and gas exploration and production accounted for approximately 10% of Adler Tanks' rental revenues, and approximately 2% of the Company's total revenues. The hydraulic fracturing method of extraction has come under scrutiny in several states and by the Federal government due to the potential adverse effects that hydraulic fracturing, and the liquids and chemicals used, may have on water quality and public health. In addition, the disposal of wastewater from the hydraulic fracturing process into injection wells may increase the rate of seismic activity near drill sites and could result in regulatory changes, delays or interruption of future activity. Changes in these regulations could limit, interrupt, or stop exploration and extraction activities, which would negatively impact the demand for our rental products. Finally, it is possible that changes in the technology utilized in hydraulic fracturing could make it less dependent on liquids and therefore lower the related requirements for the use of our rental products, which would reduce our operating results and cash flows.

Seasonality of the liquid and solid containment rental industry may impact quarterly results.

Rental activity may decline in the fourth quarter month of December and the first quarter months of January and February. These months may have lower rental activity in parts of the country where inclement weather may delay, or suspend, a company's project. The impact of these delays may be to decrease the number of tanks, or boxes, on rent until companies are able to resume their projects when weather improves. These seasonal factors historically have impacted quarterly results in each year's first and fourth quarter, but we are unable to predict how such factors may impact future periods.

Significant increases in raw material, fuel and labor costs could increase our acquisition and operating costs of rental equipment, which would increase operating costs and decrease profitability.

Increases in raw material costs such as steel and labor to manufacture liquid and solid containment tanks and boxes would increase the cost of acquiring new equipment. These price increases could materially and adversely impact our financial condition and results of operations if we are not able to recoup these increases through higher rental revenues. In addition, a significant amount of revenues are generated from the transport of rental equipment to and from customers. We own delivery trucks, employ drivers and utilize subcontractors to provide these services. The price of fuel can be unpredictable and beyond our control. During periods of rising fuel and labor costs, and in particular when prices increase rapidly, we may not be able to recoup these costs from our customers, which would reduce our profitability.

Failure by third parties to manufacture our products timely or properly may harm our ability to meet customer demand and harm our financial condition.

We are dependent on a variety of third party companies to manufacture equipment to be used in our rental fleet. In some cases, we may not be able to procure equipment on a timely basis to the extent that manufacturers for the quantities of equipment we need are not able to produce sufficient inventory on schedules that meet our delivery requirements. If demand for new equipment increases significantly, especially during a seasonal manufacturing slowdown, manufacturers may not be able to meet customer orders on a timely basis. As a result, we at times may experience long lead-times for certain types of new equipment and we cannot assure that we will be able to acquire the types or sufficient numbers of the equipment we need to grow our rental fleet as quickly as we would like and this could harm our ability to meet customer demand and harm our financial condition.

We derive a meaningful amount of our revenue in our liquid and solid containment tank and boxes business from a limited number of customers, the loss of one or more of which could have an adverse effect on our business.

Periodically, a meaningful portion of our revenue in our liquid and solid containment tank and boxes business may be generated from a few major customers. Although we have some long-term relationships with our major customers, we cannot be assured that our customers will continue to use our products or services or that they will continue to do so at historical levels. The loss of any meaningful customer, the failure to collect a material receivable from a meaningful customer, any material reduction in orders by a meaningful customer or the cancellation of a meaningful customer order could significantly reduce our revenues and consequently harm our financial condition and our ability to fund our operations.

We may not be able to quickly redeploy equipment returning from leases at equivalent prices.

Many of our rental transactions are short-term in nature with pricing established on a daily basis. The length of time that a customer needs equipment can often be difficult to determine and can be impacted by a number of factors such as weather, customer

funding and project delays. In addition, our equipment is primarily used in the oil and gas, industrial plant services, environmental remediation and infrastructure and building construction industries. Changes in the economic conditions facing any of those industries could result in a significant number of units returning off rent, both for us and our competitors.

If the supply of rental equipment available on the market significantly increases due to units coming off rent, demand for and pricing of our rental products could be adversely impacted. We may experience delays in remarketing our off-rent units to new customers and incur cost to move the units to other regions where demand is stronger. Actions in these circumstances by our competitors may also depress the market price for rental units. These delays and price pressures would adversely affect equipment utilization levels and total revenues, which would reduce our profitability.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. MINE SAFETY DISCLOSURES

None.

Item 5. Other Information

None.

Item 6. Exhibits

15.1 Awareness Letter From Grant Thornton LLP.

31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Title 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Title 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from McGrath RentCorp's Quarterly report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Statement of Income, (ii) the Condensed Consolidated Balance Sheet, (iii) the Condensed Consolidated Statement of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: October 30, 2018 McGrath RentCorp

By: /s/ Keith E. Pratt
Keith E. Pratt
Executive Vice President and Chief Financial Officer

By: /s/ David M. Whitney
David M. Whitney
Vice President, Controller and Principal Accounting Officer