

MCGRATH RENTCORP
Form 10-Q
May 04, 2006

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

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

For the quarter ended March 31, 2006

Commission file number 0-13292

McGRATH RENTCORP

(Exact name of registrant as specified in its Charter)

California
(State or other jurisdiction
of incorporation or organization)

5700 Las Positas Road, Livermore, CA 94551-7800

94-2579843
(I.R.S. Employer
Identification No.)

(Address of principal executive offices)

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

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

Edgar Filing: MCGRATH RENTCORP - Form 10-Q

Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

At May 4, 2006, 24,949,682 shares of Registrant's Common Stock were outstanding.

FORWARD LOOKING STATEMENTS

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

Management cautions that forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected in such forward-looking statements including, without limitation, the following: the future prospects for and growth of the Company and the industries in which it operates, the level of the Company's future rentals and sales and customer demand, the Company's ability to maintain its business model, the Company's ability to maintain its competitive strengths and to effectively compete against its competitors, the Company's short-term decisions and long-term strategies for the future and its ability to implement and maintain such decisions and strategies, including its strategies (i) to actively maintain and repair rental equipment cost effectively and to maximize the level of proceeds from the sale of such products and (ii) to create internal facilities and infrastructure capabilities that can provide prompt and efficient customer service, experienced assistance, rapid delivery and timely maintenance of the Company's equipment; utilization rates for the Company's rental equipment, the level of future warranty costs on sales of modular equipment, the effect of interruptions in the passage of statewide and local facility bond measures and the effect of such interruptions on the Company's operations, the effect of changes in legislation on the Company's modular rental and sales revenues, including legislation with respect to policies regarding class size, the level of state funding to public schools and the use of classrooms that meet the Department of Housing requirements, the Company's ability to maintain and upgrade modular equipment to comply with changes in applicable legislation, the timing and amounts of future capital expenditures and the Company's ability to meet its needs for working capital and capital expenditures through 2006 and beyond; the effect of changes to the Company's accounting policies (including our critical accounting policies) and future implementation of these policies, including policies with respect to stock option expensing under SFAS No. 123(R), depreciation, maintenance and refurbishment and impairment; the impact of a change in the Company's overall effective tax rate as a result of the Company's mix of business levels in various tax jurisdictions in which it does business, and the Company's ability to pass on increases in its costs of rental equipment, including manufacturing costs, operating expenses and interest expense through increases in rental rates and selling prices. Further, our future business, financial condition and results of operations could differ materially from those anticipated by such forward-looking statements and are subject to risks and uncertainties including the risks set forth above and the Risk Factors set forth in this Form 10-Q. Moreover, neither we assume nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements.

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

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have reviewed the accompanying consolidated balance sheet of McGrath RentCorp and Subsidiaries as of March 31, 2006, and the related statements of income and cash flows for the three-month periods ended March 31, 2006 and 2005. These interim financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2005, and the related consolidated statements of earnings, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 8, 2006, 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, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Grant Thornton LLP

San Francisco, CA

May 2, 2006

McGRATH RENTCORP
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

<i>(in thousands, except per share amounts)</i>	Three Months Ended March 31,	
	2006	2005
REVENUES		
Rental	\$ 39,671	\$ 35,959
Rental Related Services	7,067	5,275
Rental Operations	46,738	41,234
Sales	10,498	10,972
Other	620	732
Total Revenues	57,856	52,938
COSTS AND EXPENSES		
Direct Costs of Rental Operations:		
Depreciation of Rental Equipment	10,858	11,565
Rental Related Services	4,960	3,571
Other	8,006	7,245
Total Direct Costs of Rental Operations	23,824	22,381
Costs of Sales	7,329	7,564
Total Costs	31,153	29,945
Gross Profit	26,703	22,993
Selling and Administrative	11,554	9,561
Income from Operations	15,149	13,432
Interest	2,353	1,719
Income Before Provision for Income Taxes	12,796	11,713
Provision for Income Taxes	4,991	4,451
Income Before Minority Interest	7,805	7,262
Minority Interest in Income (Loss) of Subsidiary	(32)	85
Net Income	\$ 7,837	\$ 7,177
Earnings Per Share:		
Basic	\$ 0.32	\$ 0.29
Diluted	\$ 0.31	\$ 0.29
Shares Used in Per Share Calculation:		
Basic	24,866	24,572
Diluted	25,604	25,147

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

McGRATH RENTCORP
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

<i>(in thousands)</i>	March 31, 2006	December 31, 2005
ASSETS		
Cash	\$ 723	\$ 276
Accounts Receivable, net of allowance for doubtful accounts of \$1,000 in 2006 and 2005	51,084	63,702
Rental Equipment, at cost:		
Relocatable Modular Buildings	428,197	408,227
Electronic Test Equipment	161,053	154,708
	589,250	562,935
Less Accumulated Depreciation	(163,762)	(156,502)
Rental Equipment, net	425,488	406,433
Property, Plant and Equipment, net	56,042	56,008
Prepaid Expenses and Other Assets	15,276	16,019
Total Assets	\$ 548,613	\$ 542,438
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Notes Payable	\$ 176,500	\$ 163,222
Accounts Payable and Accrued Liabilities	44,005	51,690
Deferred Income	20,460	27,410
Minority Interest in Subsidiary	3,168	3,199
Deferred Income Taxes, net	99,497	98,438
Total Liabilities	343,630	343,969
Shareholders' Equity:		
Common Stock, no par value -		
Authorized 40,000 shares		
Issued and Outstanding 24,950 shares in 2006 and 24,832 shares in 2005	28,892	26,224
Retained Earnings	176,091	172,245
Total Shareholders' Equity	204,983	198,469
Total Liabilities and Shareholders' Equity	\$ 548,613	\$ 542,438

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

McGRATH RENTCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

<i>(in thousands)</i>	Three Months Ended March 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 7,837	\$ 7,177
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	11,384	12,139
Provision for Doubtful Accounts	70	43
Non-Cash Stock Compensation	830	
Gain on Sale of Rental Equipment	(2,489)	(1,760)
Change In:		
Accounts Receivable	12,548	2,692
Prepaid Expenses and Other Assets	743	281
Accounts Payable and Accrued Liabilities	(1,293)	(400)
Deferred Income	(6,950)	(5,187)
Deferred Income Taxes	1,059	3,796
Net Cash Provided by Operating Activities	23,739	18,781
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Rental Equipment	(39,855)	(27,877)
Purchase of Property, Plant and Equipment	(560)	(307)
Proceeds from Sale of Rental Equipment	5,497	6,807
Net Cash Used in Investing Activities	(34,918)	(21,377)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net Borrowings Under Bank Lines of Credit	13,268	4,788
Proceeds from the Exercise of Stock Options	1,256	771
Excess Tax Benefit from Exercise and Disqualifying Disposition of Stock Options	582	187
Payment of Dividends	(3,480)	(2,700)
Net Cash Provided by Financing Activities	11,626	3,046
Net Increase in Cash	447	450
Cash Balance, beginning of period	276	189
Cash Balance, end of period	\$ 723	\$ 639
Interest Paid, during the period	\$ 1,502	\$ 1,033
Income Taxes Paid, during the period	\$ 3,349	\$ 570
Dividends Declared, not yet paid	\$ 3,992	\$ 3,446
Rental Equipment Acquisitions, not yet paid	\$ 7,758	\$ 7,429

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

McGRATH RENTCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2006

NOTE 1. CONSOLIDATED FINANCIAL INFORMATION

The consolidated financial information for the three months ended March 31, 2006 and 2005 have not been audited, but in the opinion of management, all adjustments (consisting of only normal recurring accruals, consolidation and eliminating entries) necessary for the fair presentation of the consolidated results of operations, financial position, and cash flows of McGrath RentCorp (the Company) have been made. The consolidated results of the three months ended March 31, 2006 should not be considered as necessarily indicative of the consolidated results for the entire year. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's latest Form 10-K.

NOTE 2. STOCK-BASED COMPENSATION

The Company maintains a stock option plan under which it has granted options to purchase common stock to directors, officers and employees of McGrath RentCorp. The plan provides for the award of options at a price not less than the fair market value of the stock as determined by the Board of Directors on the date the options are granted. Most options vest over 5 years and expire 10 years after grant.

Beginning on January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R) under the modified prospective method, which requires the expensing of employee stock options at fair value. Under the modified prospective method, compensation expense recognized included the estimated expense for stock options granted on and subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R, and the estimated expense for the portion vesting in the period for options granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. Results for prior periods have not been restated, as provided for under the modified prospective method. Prior to the adoption of SFAS No. 123R, the Company used the intrinsic method of valuing share-based payment transactions allowed under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). Accordingly, because the stock option grant price equaled the market price on the date of grant, no compensation expense was recognized by the Company for stock-based compensation. As permitted by SFAS No. 123, Accounting for Stock-Based Compensation, stock-based compensation was historically included as a pro forma disclosure in the notes to the consolidated financial statements.

The Company utilizes the Black-Scholes option pricing model to estimate the fair value of employee stock-based compensation at the date of grant, which requires the use of accounting judgement and financial estimates, including estimates of the expected term option holders will retain their vested stock options before exercising them, the estimated volatility of the Company's stock price over the expected term and the number of options that will be forfeited prior to the completion of their vesting requirements. Application of alternative assumptions could produce significantly different estimates of the fair value of stock-based compensation and consequently, the related amounts recognized in the Consolidated Statements of Income.

For the three months ended March 31, 2006, the non-cash stock-based compensation expense included in Selling and Administrative Expenses in the Consolidated Statements of Income was \$0.8 million, before provision for income taxes. The Company recorded a tax benefit of approximately \$0.3 million related to the aforementioned stock-based compensation expense. The stock-based compensation expense, net of taxes, reduced net income by \$0.5 million, or \$0.02 per diluted share. Tax benefits resulting from the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options were \$0.6 million and \$0.2 million for the three months ended March 31, 2006 and 2005, respectively, and are included as a financing cash inflow in the Consolidated Statements of Cash Flows.

The following table shows on a pro forma basis the effect on net income and earnings per share for the three months ended March 31, 2005 had compensation cost for the stock-based compensation plans been determined based upon the fair value at grant in accordance with SFAS No. 123R:

	Three Months Ended March 31, 2005
<i>(in thousands, except per share amounts)</i>	
Net Income, as reported	\$ 7,177
Pro Forma Compensation Charge	(394)
Pro Forma Net Income	\$ 6,783
Earnings Per Share:	
Basic as reported	\$ 0.29
Basic pro forma	\$ 0.28
Diluted as reported	\$ 0.29
Diluted pro forma	\$ 0.27

The following table summarizes stock option activity for the three months ended March 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Aggregate Intrinsic Value
Options outstanding at December 31, 2005	1,852,054	\$ 17.30		
Options granted	428,500	29.56		
Options exercised	(117,454)	10.69		
Options terminated	(32,850)	22.24		
Options outstanding at March 31, 2006	2,130,250	20.05	8.24	\$ 13,190,000
Options exercisable at March 31, 2006	655,250	15.40	7.05	\$ 3,134,000

The following table indicates the options outstanding and options exercisable by exercise price with the weighted average remaining contractual life for the options outstanding and the weighted average exercise price at March 31, 2006:

Exercise Price	Options Outstanding		Options Exercisable		
	Number Outstanding at March 31, 2006	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at March 31, 2006	Weighted Average Exercise Price
\$ 5 - 10	111,550	4.17	\$ 8.79	111,550	\$ 8.79
10 - 15	411,100	6.58	11.80	213,000	11.95
15 - 20	437,500	8.02	15.74	120,200	15.67
20 - 25	629,600	8.84	22.27	210,500	22.30
25 - 30	540,500	9.80	29.56		
5 - 30	2,130,250	8.24	20.05	655,250	15.40

The fair value of each option award granted was estimated at the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions: