MCGRATH RENTCORP
Form 10-Q
October 30, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

QUARTERLY REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2018

Commission file number 0-13292

McGRATH RENTCORP

(Exact name of registrant as specified in its Charter)

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

5700 Las Positas Road, Livermore, CA 94551-7800

(Address of principal executive offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically 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 an 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

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 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 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 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.

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.

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:

(in thousands)	Mobile Modular	TRS-RenTelco	Adler 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:

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

NOTE 5. INTANGIBLE ASSETS

Intangible assets consist of the following:

(dollar amounts in thousands)	Estimated useful life in years	September 30, 2018	December 31, 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

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The Company assesses potential impairment of its goodwill and intangible assets when there is evidence that events or circumstances have occurred that would indicate the recovery of an asset's carrying value is unlikely. The Company also assesses potential impairment of its goodwill and intangible assets 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:

(dollar amounts in thousands)	Mobile Modular	TRS-RenTelco	Adler Tanks	Enviroplex [1]	Consolidated
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

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.

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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

	Three Months Ended		Nine Months Ended		Twelve Months Ended	
(dollar amounts in thousands)	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

	Three Months Ended		Nine Months Ended		Twelve Months Ended	
(dollar amounts in thousands)	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)

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.

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

- Permit the Consolidated Fixed Charge Coverage Ratio (as defined in the Credit Facility and the Note Purchase Agreement (as defined and more fully described under the heading "Liquidity and Capital Resources" in this MD&A)) of Adjusted EBITDA (as defined in the Credit Facility and the Note Purchase Agreement) to fixed charges as of the end of any fiscal quarter to be less than 2.50 to 1. At 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 September 30, 2018	2017	Increase (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			