MCGRATH RENTCORP
Form 10-Q
July 31, 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 June 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 30, 2018, 24,169,551 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 June 30, 2018, and the related condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2018 and 2017, cash flows for the six-month periods ended June 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

July 31, 2018

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Revenues				
Rental	$ 77,267	$ 69,953	$ 151,528	$ 137,931
Rental related services	19,086	18,796	36,917	36,731
Rental operations	96,353	88,749	188,445	174,662
Sales	19,546	20,187	31,637	28,482
Other	1,084	646	1,986	1,275
Total revenues	116,983	109,582	222,068	204,419
Costs and Expenses				
Direct costs of rental operations:				
Depreciation of rental equipment	18,103	17,242	35,880	34,621
Rental related services	15,018	14,312	28,786	28,145
Other	18,753	16,039	35,022	31,398
Total direct costs of rental operations	51,874	47,593	99,688	94,164
Costs of sales	11,181	12,778	18,282	17,374
Total costs of revenues	63,055	60,371	117,970	111,538
Gross profit	53,928	49,211	104,098	92,881
Selling and administrative expenses	29,479	27,365	57,607	55,213
Income from operations	24,449	21,846	46,491	37,668
Other income (expense):				
Interest expense	(2,999)	(2,949)	(5,991)	(5,738)
Foreign currency exchange gain (loss)	(344)	11	(376)	237
Income before provision for income taxes	21,106	18,908	40,124	32,167
Provision for income taxes	5,194	7,447	9,746	12,733
Net income	$ 15,912	$ 11,461	$ 30,378	$ 19,434
Earnings per share:				
Basic	$ 0.66	$ 0.48	$ 1.26	$ 0.81
Diluted	$ 0.65	$ 0.48	$ 1.24	$ 0.80
Shares used in per share calculation:				
Basic	24,145	23,985	24,106	23,968
Diluted	24,584	24,092	24,549	24,164
Cash dividends declared per share	$ 0.340	$ 0.260	$ 0.680	$ 0.520

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

McGRATH RENTCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2018	2017	2018	2017
Net income	$ 15,912	$ 11,461	$ 30,378	$ 19,434
Other comprehensive income (loss):				
Foreign currency translation adjustment	167	(30)	141	(108)
Tax benefit (provision)	(44)	11	(40)	36
Comprehensive income	$ 16,035	$ 11,442	$ 30,479	$ 19,362

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

McGrath RentCorp

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)	June 30, 2018	December 31, 2017
Assets		
Cash	$4,484	$2,501
Accounts receivable, net of allowance for doubtful accounts of $1,883 in 2018 and $1,920 in 2017	105,095	105,872
Rental equipment, at cost:		
Relocatable modular buildings	789,158	775,400
Electronic test equipment	278,253	262,325
Liquid and solid containment tanks and boxes	312,168	309,808
	1,379,579	1,347,533
Less accumulated depreciation	(503,057)	(485,213)
Rental equipment, net	876,522	862,320
Property, plant and equipment, net	121,614	119,170
Prepaid expenses and other assets	37,397	22,459
Intangible assets, net	7,289	7,724
Goodwill	27,808	27,808
Total assets	$1,180,209	$1,147,854
Liabilities and Shareholders' Equity		
Liabilities:		
Notes payable	$314,860	$303,414
Accounts payable and accrued liabilities	89,064	86,408
Deferred income	44,073	39,219
Deferred income taxes, net	195,017	194,629
Total liabilities	643,014	623,670
Shareholders’ equity:		
Common stock, no par value - Authorized 40,000 shares		
Issued and outstanding - 24,170 shares as of June 30, 2018 and 24,052 shares as of December 31, 2017	101,983	102,947
Retained earnings	435,279	421,405
Accumulated other comprehensive loss	(67)	(168)
Total shareholders’ equity	537,195	524,184
Total liabilities and shareholders’ equity	$1,180,209	$1,147,854

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

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McGrath RentCorp

CONDENSED Consolidated Statements of Cash Flows

(unaudited)

(in thousands)	Six Months Ended June 30, 2018	2017
Cash Flows from Operating Activities:		
Net income	$30,378	$19,434
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40,288	38,752
Impairment of rental assets	39	—
Provision for doubtful accounts	181	597
Share-based compensation	1,828	1,538
Gain on sale of used rental equipment	(9,875)	(7,914)
Foreign currency exchange (gain) loss	376	(237)
Amortization of debt issuance costs	15	25
Change in:		
Accounts receivable	596	(259)
Prepaid expenses and other assets	(14,938)	(8,839)
Accounts payable and accrued liabilities	(365)	680
Deferred income	4,854	5,034
Deferred income taxes	388	587
Net cash provided by operating activities	53,765	49,398
Cash Flows from Investing Activities:		
Purchases of rental equipment	(58,662)	(46,118)
Purchases of property, plant and equipment	(6,417)	(9,623)
Proceeds from sales of used rental equipment	19,212	16,057
Net cash used in investing activities	(45,867)	(39,684)
Cash Flows from Financing Activities:		
Net borrowings under bank lines of credit	31,431	23,996
Principal payments on Series A senior notes	(20,000)	(20,000)
Taxes paid related to net share settlement of stock awards	(2,792)	(319)
Payment of dividends	(14,501)	(12,390)
Net cash used in financing activities	(5,862)	(8,713)
Effect of foreign currency exchange rate changes on cash	(53)	18
Net increase in cash	1,983	1,019
Cash balance, beginning of period	2,501	852
Cash balance, end of period	$4,484	$1,871
Supplemental Disclosure of Cash Flow Information:		
Interest paid, during the period	$6,123	$5,817
Net income taxes paid, during the period	$11,675	$18,141
Dividends accrued during the period, not yet paid	$8,267	$6,214
Rental equipment acquisitions, not yet paid	$7,201	$6,359

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

McGRATH RENTCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

NOTE 1. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The condensed consolidated financial statements for the three and six months ended June 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 six months ended June 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 February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("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. 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 $17.0 million and $6.8 million at June 30, 2018 and December 31, 2017, respectively. Sales revenues totaling $1.2 million and $3.5 million were recognized during the three and six months ended June 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 $0.8 million and $2.0 million at June 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 six months ended June 30, 2018 and 2017:

(in thousands)	Mobile Modular	TRS-RenTelco	Adler Tanks	Enviroplex	Consolidated
Three Months Ended June 30, 2018					
Leasing	$46,634	$ 23,136	$16,977	$ —	$ 86,747
Non-lease:					
Rental related services	4,275	707	5,991	—	10,973
Sales	8,961	6,012	30	3,711	18,714
Other	1	497	51	—	549
Total non-lease	13,237	7,216	6,072	3,711	30,236
Total revenues	$59,871	$ 30,352	$23,049	$ 3,711	$ 116,983
2017					
Leasing	$43,562	$ 20,588	$15,149	$ —	$ 79,299
Non-lease:					
Rental related services	3,566	654	6,176	—	10,396
Sales	9,504	4,909	926	4,152	19,491
Other	6	388	2	—	396
Total non-lease	13,076	5,951	7,104	4,152	30,283
Total revenues	$56,638	$ 26,539	$22,253	$ 4,152	$ 109,582
Six Months Ended June 30, 2018					
Leasing	$91,905	$ 45,636	$32,760	$ —	$ 170,301
Non-lease:					
Rental related services	8,260	1,514	11,081	—	20,855
Sales	13,554	10,351	335	5,729	29,969
Other	3	889	51	—	943
Total non-lease	21,817	12,754	11,467	5,729	51,767
Total revenues	$113,722	$ 58,390	$44,227	$ 5,729	$ 222,068
2017					
Leasing	$85,960	$ 40,805	$29,734	$ —	$ 156,499
Non-lease:					
Rental related services	6,507	1,312	11,865	—	19,684
Sales	12,468	8,894	1,115	4,911	27,388
Other	6	842	—	—	848
Total non-lease	18,981	11,048	12,980	4,911	47,920
Total revenues	$104,941	$ 51,853	$42,714	$ 4,911	$ 204,419

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		Six Months Ended	
	June 30,		June 30,	
(in thousands)	2018	2017	2018	2017
Weighted-average number of shares of common stock for calculating basic earnings per share	24,145	23,985	24,106	23,968
Effect of potentially dilutive securities from equity-based compensation	439	107	443	196
Weighted-average number of shares of common stock for calculating diluted earnings per share	24,584	24,092	24,549	24,164

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

	Three Months	Six Months

(in thousands)	Ended June 30, 2018	Ended June 30, 2017	Ended June 30, 2018	Ended June 30, 2017
Options to purchase shares of common stock	—	306	—	10

NOTE 5. INTANGIBLE ASSETS

Intangible assets consist of the following:

(dollar amounts in thousands)	Estimated useful life in years	June 30, 2018	December 31, 2017
Trade name	Indefinite	$5,700	$ 5,700
Customer relationships	11	9,611	9,611
		15,311	15,311
Less accumulated amortization		(8,022)	(7,587)
		$7,289	$ 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 June 30, 2018 and assuming no subsequent impairment of the underlying assets, the amortization expense is expected to be $0.5 million for the remainder of fiscal year 2018, $0.9 million in the year 2019 and $0.2 million in 2020.

NOTE 6. 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 six months ended June 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
Six Months Ended June 30, 2018					
Rental revenues	$75,231	$43,694	$32,603	$ —	$ 151,528
Rental related services revenues	24,322	1,514	11,081	—	36,917
Sales and other revenues	14,169	13,182	543	5,729	33,623
Total revenues	113,722	58,390	44,227	5,729	222,068
Depreciation of rental equipment	10,521	17,443	7,916	—	35,880
Gross profit	53,050	27,242	21,912	1,894	104,098
Selling and administrative expenses	28,930	11,560	14,658	2,459	57,607
Income (loss) from operations	24,120	15,682	7,254	(565)	46,491
Interest (expense) income allocation	(3,422)	(1,313)	(1,576)	320	(5,991)
Income (loss) before provision for income taxes	20,698	13,993	5,678	(245)	40,124
Rental equipment acquisitions	22,287	34,502	2,669	—	59,458
Accounts receivable, net (period end)	63,003	18,391	18,239	5,462	105,095
Rental equipment, at cost (period end)	789,158	278,253	312,168	—	1,379,579
Rental equipment, net book value (period end)	550,285	122,647	203,590	—	876,522
Utilization (period end) [2]	77.2 %	62.8 %	61.3 %		
Average utilization [2]	77.3 %	62.8 %	58.5 %		
2017					
Rental revenues	$68,684	$39,551	$29,696	$ —	$ 137,931
Rental related services revenues	23,554	1,312	11,865	—	36,731
Sales and other revenues	12,703	10,990	1,153	4,911	29,757
Total revenues	104,941	51,853	42,714	4,911	204,419
Depreciation of rental equipment	10,666	16,071	7,884	—	34,621
Gross profit	47,578	23,847	19,832	1,624	92,881
Selling and administrative expenses	27,617	11,019	14,528	2,049	55,213
Income (loss) from operations	19,961	12,828	5,304	(425)	37,668
Interest (expense) income allocation	(3,289)	(1,126)	(1,515)	192	(5,738)
Income (loss) before provision for income taxes	16,672	11,939	3,789	(233)	32,167

Rental equipment acquisitions	21,531	25,510	2,558	—	49,599
Accounts receivable, net (period end)	57,268	18,443	15,918	4,910	96,539
Rental equipment, at cost (period end)	782,503	249,935	309,784	—	1,342,222
Rental equipment, net book value (period end)	551,101	96,547	215,559	—	863,207
Utilization (period end) [2]	75.7 %	61.6 %	55.4 %		
Average utilization [2]	76.6 %	62.3 %	53.4 %		

1. Gross Enviroplex sales revenues were $6,524 and $4,911 for the six months ended June 30, 2018 and 2017, respectively. There were $795 inter-segment sales to Mobile Modular in the six months ended June 30, 2018, which required elimination in consolidation. There were no inter-segment sales in the six months ended June 30, 2017.
2. Utilization is calculated each month by dividing the cost of rental equipment on rent by the total cost of rental equipment excluding accessory equipment and for Mobile Modular and Adler Tanks excluding new equipment inventory. The Average Utilization for the period is calculated using the average costs of rental equipment.

No single customer accounted for more than 10% of total revenues for the six months ended June 30, 2018 and 2017. Revenues from foreign country customers accounted for 4% and 5% of the Company’s total revenues for the same periods, respectively.

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 9% of the Company's total revenues in the six months ended June 30, 2018. Mobile Modular Portable Storage offers portable storage units and high security portable office units for rent, lease and purchase.

In the six months ended June 30, 2018, Mobile Modular, TRS-RenTelco, Adler Tanks and Enviroplex contributed 52%, 35%, 14% and negative 1% of the Company's income before provision for taxes (the equivalent of "pretax income"), respectively, compared to 52%, 37%, 12% and negative 1% 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 85% of consolidated revenues in the six months ended June 30, 2018 and 2017. Of the total rental operations revenues for the six months ended June 30, 2018, Mobile Modular, TRS-RenTelco and Adler Tanks comprised 53%, 24% and 23%, 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, and other direct costs of rental operations (which include direct labor, supplies, repairs, insurance, property taxes, license fees, cost of sub-rentals and amortization of certain lease costs).

The Company's Mobile Modular, TRS-RenTelco and Adler Tanks business segments sell modular units, electronic test equipment and liquid and solid containment tanks and boxes, respectively, which are either new or previously rented. In addition, Enviroplex sells new modular buildings used primarily as classrooms in California. For the six months ended June 30, 2018 and 2017, sales and other revenues of modular, electronic test equipment and liquid and solid containment tanks and boxes comprised approximately 15% of the Company's consolidated revenues. Of the total sales and other revenues for the six months ended June 30, 2018 and 2017, Mobile Modular and Enviroplex together comprised 59%, TRS-RenTelco comprised 39% and 37%, respectively, and Adler Tanks comprised 2% and 4%, 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 June 30, 2018	2017	Six Months Ended June 30, 2018	2017	Twelve Months Ended June 30, 2018	2017
Net income	$15,912	$11,461	$30,378	$19,434	$164,864	$42,040
Provision (benefit) for income taxes	5,194	7,447	9,746	12,733	(73,455)	31,199
Interest	2,999	2,949	5,991	5,738	11,875	11,399
Depreciation and amortization	20,360	19,348	40,288	38,752	79,952	78,514
EBITDA	44,465	41,205	86,403	76,657	183,236	163,152
Impairment of rental assets	—	—	39	—	1,678	—
Share-based compensation	964	732	1,828	1,538	3,488	3,043
Adjusted EBITDA [1]	$45,429	$41,937	$88,270	$78,195	$188,402	$166,195
Adjusted EBITDA margin [2]	39 %	38 %	40 %	38 %	39 %	38 %

Reconciliation of Adjusted EBITDA to Net Cash Provided by Operating Activities

(dollar amounts in thousands)	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017	Twelve Months Ended June 30, 2018	2017
Adjusted EBITDA [1]	$45,429	$41,937	$88,270	$78,195	$188,402	$166,195
Interest paid	(3,586)	(3,397)	(6,123)	(5,817)	(12,131)	(11,607)
Income taxes paid, net of refunds received	(10,103)	(12,576)	(11,675)	(18,141)	(23,038)	(28,017)
Gain on sale of used rental equipment	(6,027)	(4,971)	(9,875)	(7,914)	(19,694)	(15,371)
Foreign currency exchange loss (gain)	344	(11)	376	(237)	279	(42)
Amortization of debt financing cost	2	12	15	25	40	51
Change in certain assets and liabilities:						
Accounts receivable, net	(7,003)	(3,987)	777	338	(8,556)	(925)
Prepaid expenses and other assets	(11,635)	(7,303)	(14,938)	(8,839)	(2,975)	(4,027)
Accounts payable and other liabilities	9,621	11,218	2,084	6,754	2,905	7,943
Deferred income	5,571	2,646	4,854	5,034	1,540	3,509
Net cash provided by operating activities	$22,613	$23,568	$53,765			