MCGRATH RENTCORP
Form 10-Q
November 01, 2007

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, 2007

Commission file number 0-13292

McGRATH RENTCORP

(Exact name of registrant as specified in its Charter)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

Yes ¨ No x

At November 1, 2007, 25,362,703 shares of Registrant s Common Stock were outstanding.

FORWARD LOOKING STATEMENTS

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

Management cautions that forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected in such forward-looking statements including, without limitation, the following: the future prospects for and growth of the Company and the industries in which it operates, the level of the Company s future rentals and sales, customer demand and cost of raw materials, the Company s ability to maintain its business model; the Company s ability to retain and recruit key personnel; the Company s ability to maintain its competitive strengths and to effectively compete against its competitors; the Company s short-term decisions and long-term strategies for the future and its ability to implement and maintain such decisions and strategies, including its strategies: (i) to focus on rental revenue growth from an increasing base of rental assets, (ii) to actively maintain, repair, redeploy, manage and anticipate the need for various models of rental equipment cost-effectively and to maximize the level of proceeds from the sale of such products, and (iii) to create internal facilities and infrastructure capabilities that can provide prompt and efficient customer service, experienced assistance, rapid delivery and timely maintenance of the Company s equipment; the demand by the educational market (and the K-12 market in particular) for the Company s modular products; the effect of delays or interruptions in the passage of statewide and local facility bond measures on the Company s operations; the effect of changes in applicable law, and policies relating to the use of temporary buildings on the Company s modular rental and sales revenues, including with respect to class size and building standards; the effects of changes in the level of state funding to public schools and the use of classrooms that meet the Department of Housing requirements; the Company s ability to maintain and upgrade modular equipment to comply with changes in applicable law and customer preference; the Company s strategy to effectively implement its expansion into Florida, North Carolina, Georgia and other new markets in the U.S.; the Company s expectation that the first phase of its ERP upgrade project will be completed in early 2008 and the Company s reliance on its information technology systems; the Company s engaging in and ability to consummate future acquisitions; manufacturers ability to produce products to the Company s specification on a timely basis; the Company s ability to maintain good relationships with school districts, manufacturers, and other suppliers; the impact of debt covenants on the Company s flexibility in running its business and the effect of an event of default on the Company s results of operations; the effect of interest rate fluctuations; the Company s ability to manage its credit risk and accounts receivable; the timing and amounts of future capital expenditures and the Company s ability to meet its needs for working capital including its ability to negotiate lines of credit; the Company s ability to track technology trends to make good buy-sell decisions with respect to electronic test equipment; the effect of changes to the Company s accounting policies and impact of evolving interpretation and implementation of such policies; the risk of litigation and claims against the Company; the impact of a change in the Company s overall effective tax rate as a result of the Company s mix of business levels in various tax jurisdictions in which it does business; the adequacy of the Company s insurance coverage; the impact of a failure by third parties to manufacture our products timely or properly; the level of future warranty costs of modular equipment that we sell; the effect of seasonality on the Company s business; the growth of the Company s business in international markets and the Company s ability to succeed in those markets; and the Company s ability to pass on increases in its costs of rental equipment, including manufacturing costs, operating expenses and interest expense through increases in rental rates and selling prices. Further, our future business, financial condition and results of operations could differ materially from those anticipated by such forward-looking statements and are subject to risks and uncertainties including the risks set forth above and the Risk Factors set forth in this Form 10-Q. Moreover, neither we assume nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements.

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

Part I - Financial Information

Item 1. Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have reviewed the accompanying consolidated balance sheet of McGrath RentCorp and Subsidiaries as of September 30, 2007, and the related statements of income for the three-month periods ended September 30, 2007 and 2006 and the statements of income and cash flows for the nine-month periods ended September 30, 2007 and 2006. These interim financial statements are the responsibility of the Company s management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of McGrath RentCorp and Subsidiaries as of December 31, 2006, and the related consolidated statements of income, shareholders equity, and cash flows for the year then ended (not presented herein); and in our report dated March 9, 2007, 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, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Grant Thornton LLP
San Francisco, California
October 30, 2007

McGRATH RENTCORP

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share amounts)	**Three Months Ended September 30, 2007**	**2006**	**Nine Months Ended September 30, 2007**	**2006**
REVENUES				
Rental	$ 47,659	$ 43,896	$ 135,962	$ 124,735
Rental Related Services	9,968	8,278	25,988	22,444
Rental Operations	57,627	52,174	161,950	147,179
Sales	22,503	25,110	45,070	47,377
Other	621	591	1,931	1,848
Total Revenues	80,751	77,875	208,951	196,404
COSTS AND EXPENSES				
Direct Costs of Rental Operations				
Depreciation of Rental Equipment	13,427	11,399	38,176	33,571
Rental Related Services	6,660	5,587	17,919	15,295
Other	8,772	8,489	25,366	26,258
Total Direct Costs of Rental Operations	28,859	25,475	81,461	75,124
Costs of Sales	16,501	16,890	32,230	32,778
Total Costs of Revenues	45,360	42,365	113,691	107,902
Gross Profit	35,391	35,510	95,260	88,502
Selling and Administrative	13,108	11,278	37,363	33,634
Income from Operations	22,283	24,232	57,897	54,868
Interest Expense	2,662	2,959	8,115	8,085
Income Before Provision for Income Taxes	19,621	21,273	49,782	46,783
Provision for Income Taxes	7,652	8,296	19,415	17,365
Income Before Minority Interest	11,969	12,977	30,367	29,418
Minority Interest in Income of Subsidiary	92	302	77	237
Net Income	$ 11,877	$ 12,675	$ 30,290	$ 29,181
Earnings Per Share:				
Basic	$ 0.47	$ 0.51	$ 1.20	$ 1.17
Diluted	$ 0.46	$ 0.50	$ 1.19	$ 1.16
Shares Used in Per Share Calculation:				
Basic	25,342	24,960	25,230	24,927
Diluted	25,607	25,152	25,482	25,190
Cash Dividends Declared Per Share	$ 0.18	$ 0.16	$ 0.54	$ 0.48

McGRATH RENTCORP

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)		September 30, 2007		December 31, 2006
ASSETS				
Cash	$	2,608	$	349
Accounts Receivable, net of allowance for doubtful accounts of $1,400 in 2007 and $1,000 in 2006		79,031		59,834
Rental Equipment, at cost:				
Relocatable Modular Buildings		470,185		451,828
Electronic Test Equipment		224,191		186,673
		694,376		638,501
Less Accumulated Depreciation		(213,041)		(187,159)
Rental Equipment, net		481,335		451,342
Property, Plant and Equipment, net		60,468		58,146
Prepaid Expenses and Other Assets		18,869		15,871
Total Assets	$	642,311	$	585,542
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities:				
Notes Payable	$	184,500	$	165,557
Accounts Payable and Accrued Liabilities		54,604		55,509
Deferred Income		31,314		25,852
Minority Interest in Subsidiary		3,557		3,479
Deferred Income Taxes, net		112,673		104,353
Total Liabilities		386,648		354,750
Shareholders Equity:				
Common Stock, no par value -				
Authorized 40,000 shares				
Issued and Outstanding 25,363 shares in 2007 and 25,090 shares in 2006		42,202		33,963
Retained Earnings		213,461		196,829
Total Shareholders Equity		255,663		230,792
Total Liabilities and Shareholders Equity	$	642,311	$	585,542

McGRATH RENTCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	Nine Months Ended September 30, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 30,290	$ 29,181
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	39,934	35,140
Provision for Doubtful Accounts	928	364
Non-Cash Stock-Based Compensation	2,578	2,334
Gain on Sale of Rental Equipment	(7,242)	(7,689)
Change In:		
Accounts Receivable	(20,125)	(2,217)
Prepaid Expenses and Other Assets	(2,998)	(1,791)
Accounts Payable and Accrued Liabilities	(2,957)	4,990
Deferred Income	5,462	5,169
Deferred Income Taxes	8,320	6,246
Net Cash Provided by Operating Activities	54,190	71,727
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Rental Equipment	(78,384)	(91,703)
Purchase of Property, Plant and Equipment	(4,080)	(2,728)
Proceeds from Sale of Rental Equipment	19,037	17,953
Net Cash Used in Investing Activities	(63,427)	(76,478)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net Borrowings Under Bank Lines of Credit	18,943	14,825
Proceeds from the Exercise of Stock Options	3,979	1,441
Excess Tax Benefit from Exercise and Disqualifying Disposition of Stock Options	1,682	626
Repurchase of Common Stock		(526)
Payment of Dividends	(13,108)	(11,465)
Net Cash Provided by Financing Activities	11,496	4,901
Net Increase in Cash	2,259	150
Cash Balance, beginning of period	349	276
Cash Balance, end of period	$ 2,608	$ 426
Interest Paid, during the period	$ 7,371	$ 7,362
Income Taxes Paid, during the period	$ 9,413	$ 10,493
Dividends Declared, not yet paid	$ 4,565	$ 3,991
Rental Equipment Acquisitions, not yet paid	$ 11,011	$ 5,615

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McGRATH RENTCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2007

NOTE 1. CONSOLIDATED FINANCIAL INFORMATION

The consolidated financial information for the nine months ended September 30, 2007 and 2006 have not been audited, but in the opinion of management, all adjustments (consisting of normal recurring accruals, consolidation and eliminating entries) necessary for the fair presentation of the consolidated results of operations, financial position, and cash flows of McGrath RentCorp (the Company) have been made. Certain prior period amounts have been reclassified to conform to current year presentation. Such reclassifications did not affect total revenues, operating income or net income. The consolidated results for the nine months ended September 30, 2007 should not be considered as necessarily indicative of the consolidated results for the entire year. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company s latest Form 10-K.

NOTE 2. NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation Number 48, Accounting for Uncertainty in Income Taxes, (FIN 48) on January 1, 2007. Previously, the Company had accounted for tax contingencies in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies . As required by FIN 48, which clarifies SFAS No. 109, Accounting for Income Taxes, the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At January 1, 2007, the Company applied FIN 48 to all tax positions for which the statute of limitations remained open and determined there were no material unrecognized tax benefits as of that date. In addition, there have been no material changes in unrecognized benefits since January 1, 2007. As a result, the adoption of FIN 48 did not have a material effect on the Company s financial condition, or results of operation.

The Company is subject to income taxes in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require the application of significant judgment. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for the years before 2002.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in the provision for income taxes for all periods presented, which were not significant.

In September 2006, FASB issued SFAS No. 157, Fair Value Measurement (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not believe the adoption of SFAS No. 157 will have a significant effect on its financial condition, or results of operations.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No.159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not believe the adoption of SFAS No. 159 will have a significant effect on its financial condition, or results of operations.

NOTE 3. EARNINGS PER SHARE

Basic earnings per share (EPS) is computed as net income divided by the weighted average number of shares of common stock outstanding for the period. Diluted EPS is computed as net income divided by the weighted average number of shares outstanding of common stock and common stock equivalents for the period, including the dilutive effects of stock options and other potentially dilutive securities. Common stock equivalents result from dilutive stock options computed using the treasury stock method and the average share price for the reported period. The effect of dilutive options on the weighted average number of shares for the three months ended September 30, 2007 and 2006 was 265,141 and 191,424, respectively, and for the nine months ended September 30, 2007 and 2006 was 252,633 and 262,819, respectively. For the three months ended September 30, 2007 and 2006, stock options to purchase 16,000 and 585,500 shares of the Company s stock, respectively, were excluded from the calculation of diluted earnings per share because they were anti-dilutive. For the nine months ended September 30, 2007 and 2006, stock options to purchase 44,000 and 540,500 shares of the Company s stock, respectively, were excluded from the calculation of diluted earnings per share because they were anti-dilutive.

The Company s Board of Directors has authorized the Company to repurchase shares of the Company s outstanding common stock. These purchases are made in the over-the-counter market (NASDAQ) and/or through privately negotiated, large block transactions at such repurchase price as the officers of the Company deem appropriate and desirable on behalf of the Company. All shares repurchased by the Company are canceled and returned to the status of authorized but unissued shares of common stock. There were no repurchases of common stock in the three and nine months ending September 30, 2007. During the three and nine months ended September 30, 2006, the Company repurchased 22,733 shares of common stock for an aggregate repurchase price of $0.5 million, or an average price of $23.19 per share. As of September 30, 2007, 1,977,267 shares remain authorized for repurchase.

NOTE 4. 2007 STOCK INCENTIVE PLAN

The Company adopted the 2007 Stock Incentive Plan (the 2007 Plan), effective June 6, 2007, under which 1,875,000 shares of common stock of the Company, plus the number of shares that remain available for grants of awards under the Company s 1998 Stock Option Plan (the 1998 Plan) and become available as a result of forfeiture, termination, or expiration of awards previously granted under the 1998 Plan, were reserved for the grant of options to its employees, directors and consultants to purchase common stock of the Company. The awards have a maximum term of 10 years at an exercise price of not less than 100% of the fair market value of the Company s common stock on the date the option is granted. The 2007 Plan replaces the Company s 1998 Plan and the 2000 Long-Term Bonus Plan (the 2000 Plan). The 2000 Plan under which no awards have been granted, only provided for the grant of stock bonuses to officers and key employees.

NOTE 5. SEGMENT REPORTING

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, establishes annual and interim reporting standards for an enterprise s operating segments and related disclosures about its products, services, geographic areas and major customers. In accordance with SFAS No. 131, the Company s three reportable segments are Mobile Modular Management Corporation (Mobile Modular), TRS-RenTelco, and Enviroplex. The operations of each of these segments are described in Note 1 Organization and Business, and the accounting policies of the segments are described in Note 2 *Significant Accounting Policies* in the Company s latest Form 10-K. Management focuses on several key measures to evaluate and assess each segment s performance including rental revenue growth, gross profit, and income before provision for income taxes. As a separate corporate entity, Enviroplex revenues and expenses are maintained separately from Mobile Modular and TRS-RenTelco. Excluding interest expense, allocations of revenue and expense not directly associated with Mobile Modular or TRS-RenTelco are generally allocated to these segments based on their pro-rata share of direct revenues. Interest expense is allocated between Mobile Modular and TRS-RenTelco based on their pro-rata share of average rental equipment, 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, 2007 and 2006 for the Company s reportable segments is shown in the following table:

(dollar amounts in thousands)	**Mobile Modular**	**TRS-RenTelco**	**Enviroplex [1]**	**Consolidated**
Nine Months Ended September 30,				
2007				
Rental Revenues	$ 74,501	$ 61,461	$	$ 135,962
Rental Related Services Revenues	24,670	1,318		25,988
Sales and Other Revenues	24,036	14,887	8,078	47,001
Total Revenues	123,207	77,666	8,078	208,951
Depreciation of Rental Equipment	9,136	29,040		38,176
Gross Profit	62,231	30,739	2,290	95,260
Interest Expense (Income) Allocation	5,767	2,752	(404)	8,115
Income before Provision for Income Taxes	36,125	13,021	636	49,782
Rental Equipment Acquisitions	26,247	53,716		79,963
Accounts Receivable, net (period end)	50,443	23,250	5,338	79,031
Rental Equipment, at cost (period end)	470,185	224,191		694,376
Rental Equipment, net book value (period end)	355,174	126,161		481,335
Utilization (period end) [2]	82.9%	69.9%		
Average Utilization [2]	82.2%	67.2%		
2006				
Rental Revenues	$ 66,867	$ 57,868	$	$ 124,735
Rental Related Services Revenues	21,447	997		22,444
Sales and Other Revenues	25,012	14,739	9,474	49,225
Total Revenues	113,326	73,604	9,474	196,404
Depreciation of Rental Equipment	7,973	25,598		33,571
Gross Profit	54,753	30,430	3,319	88,502
Interest Expense (Income) Allocation	5,949	2,507	(371)	8,085
Income before Provision for Income Taxes	30,284	14,557	1,942	46,783
Rental Equipment Acquisitions	43,584	39,041		82,625
Accounts Receivable, net (period end)	41,924	20,156	3,655	65,735
Rental Equipment, at cost (period end)	445,175	180,185		625,360
Rental Equipment, net book value (period end)	338,899	106,325		445,224
Utilization (period end) [2]	82.9%	68.8%		
Average Utilization [2]	83.1%	70.0%		

1 Gross Enviroplex sales revenues were $8,988,000 and $12,067,000 for the nine months ended September 30, 2007 and 2006, respectively, which includes inter-segment sales to Mobile Modular of $910,000 and $2,593,000, which are eliminated in consolidation.

2 Utilization is calculated each month by dividing the cost of rental equipment on rent by the total cost of rental equipment excluding new equipment inventory and accessory equipment. 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, 2007 and 2006. In addition, total foreign country customers and operations accounted for less than 10% of the Company s revenues and long-lived assets for the same periods.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management s Discussion and Analysis of Financial Condition and Results of Operations 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, including but not limited to those set forth under this Item, as well as those discussed in Part II Item 1A, Risk Factors, and elsewhere in this document and those that may be identified from time to time in our reports and registration statements filed with the Securities and Exchange Commission.

This discussion should be read in conjunction with the Consolidated Financial Statements and related Notes included in Part I Item 1 of this Quarterly Report on 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 Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 14, 2007.

General

The Company, incorporated in 1979, is a leading rental provider of modular buildings for classroom and office space, and test equipment for general purpose and communications needs. The Company s primary emphasis is on equipment rentals. The Company is comprised of three business segments: Mobile Modular Management Corporation (Mobile Modular), its modular building rental division, TRS-RenTelco, its electronic test equipment rental division, and Enviroplex, its majority-owned subsidiary classroom manufacturing business. In the nine months ended September 30, 2007, Mobile Modular, TRS-RenTelco and Enviroplex contributed 73%, 26% and 1% of the Company s income before provision for taxes (the equivalent of pretax income), respectively, compared to 65%, 31% and 4% for the same period in 2006. Although managed as a separate business unit, Enviroplex s annual revenues, pretax income contribution and total assets are not material relative to the Company s consolidated financial position.

The Company generates the majority of its revenue from the rental of relocatable modular buildings and electronic test equipment on operating leases with 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 other services negotiated as part of the lease agreement with the customer and related costs are recognized on a straight-line basis over the term of the lease. Sales revenue and related costs are recognized upon delivery and installation of the equipment to the customer. 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 recover the equipment s capitalized cost in a short period of time relative to the equipment s rental life and when sold, sale proceeds recover a high percentage of its original capitalized cost.

Significant risks of rental equipment ownership are borne by the Company, which include, but are not limited to, uncertainties in the market for its products over the equipment s useful life, use limitations for modular equipment related to updated building codes or legislative changes, technological obsolescence of electronic test equipment, and rental equipment deterioration. The Company believes it mitigates these risks by continued advocacy and collaboration with governing agencies and legislative bodies for ongoing use of its modular product, staying abreast of technology trends in order to make good buy-sell decisions of electronic test equipment, and ongoing investment in repair and maintenance programs to insure both types of rental equipment are in good operating condition.

The Company s modular revenues are primarily affected by demand for classrooms which in turn is affected by shifting and fluctuating school populations, the level of state and local funding for public schools, the need for temporary classroom space during reconstruction of older schools and changes in policies regarding class size. In particular, public schools in the State of California from time to time experience fluctuations in funding from the state. As a result of any reduced funding, lower expenditures by these schools may result in certain planned programs, including the demand for classrooms, such as those Company provides, to be postponed or terminated. Reduced expenditures may result in schools reducing their long-term facility construction projects in favor of using the Company s modular classroom solutions; however, there can be no assurance that such events will occur. At this time, the Company can make 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 funding of public schools by the State of California. 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 Annual Report on Form 10-K for the year ended December 31, 2006 and *Item 1A. Risk Factors A significant reduction of funding to public schools could cause the demand for our modular classroom units to decline, which could result in a reduction in our revenues and profitability* , in Part II Other Information section 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 electronics, communications, manufacturing, aerospace and defense industries. Electronics revenues are primarily affected by the business activity within these industries related to research and development, manufacturing, and communication infrastructure installation and maintenance.

The Company s rental operations include rental and rental related service revenues, which comprised approximately 78% and 75% of consolidated revenues for the nine months ended September 30, 2007 and 2006, respectively. Of the total rental operations revenues for the nine months ended September 30, 2007 and 2006, Mobile Modular and Enviroplex comprised 61% and 60%, respectively, and electronics comprised 39% and 40%, respectively. The Company s direct costs of rental operations include depreciation of rental equipment, rental related service costs, impairment of rental equipment (if any), and other direct costs of rental operations which include direct labor, supplies, repairs, insurance, property taxes, license fees and amortization of certain lease costs.

The Company also sells both modular and electronic test equipment that is new, previously rented, or manufactured by its majority owned subsidiary, Enviroplex. The renting and selling of some modular equipment requires a dealer s license, which the Company has obtained from the appropriate governmental agencies. For the nine months ended September 30, 2007 and 2006, sales and other revenues of both modular and electronic test equipment comprised approximately 22% and 25%, respectively, of the Company s consolidated revenues. Of the total sales and other revenues for the nine months ended September 30, 2007 and 2006, Mobile Modular and Enviroplex comprised 68% and 70%, respectively, and TRS-RenTelco comprised 32% and 30%, respectively. The Company s cost of sales includes the carrying value of the equipment sold and the direct costs associated with the sale of equipment such as delivery, installation, modifications and related site work.

Selling and administrative expenses primarily include personnel and benefit costs, which include non-cash stock-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.

To supplement the Company s financial data presented on a basis consistent with Generally Accepted Accounting Principles (GAAP), the Company presents Adjusted EBITDA which is defined by the Company as net income before minority interest in income of subsidiary, interest expense, provision for income taxes, depreciation, amortization, and non-cash stock-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 the Company s period-to-period operating performance and evaluate the Company s ability to meet future capital expenditure and working capital requirements. Management believes the exclusion of non-cash charges, including stock-based compensation, is useful in measuring the Company s cash available to operations and the performance of the Company. Because the Company 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 generally accepted accounting principles in the United States 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 stock-based compensation charges and income from the minority interest in the Company s Enviroplex subsidiary. 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. Therefore, Adjusted EBITDA should only be used to evaluate the Company s results of operations in conjunction with the corresponding GAAP measures. The presentation of Adjusted EBITDA is not meant to be considered in isolation or as a substitute for the most directly comparable 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. Since Adjusted EBITDA is a non-GAAP financial measure as defined by the Securities and Exchange Commission, the Company includes in the tables below reconciliations of Adjusted EBITDA to the most directly comparable financial measures calculated and presented in accordance with accounting principles generally accepted in the United States.

Reconciliation of Net Income to Adjusted EBITDA

	Three Months Ended September 30,		**Nine Months Ended September 30,**		**Twelve Months Ended September 30,**	
(dollar amounts in thousands)	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Net Income	$ 11,877	$ 12,675	$ 30,290	$ 29,181	$ 42,187	$ 41,286
Minority Interest in Income of Subsidiary	92	302	77	237	121	208
Provision for Income Taxes	7,652	8,296	19,415	17,365	26,259	24,237
Interest	2,662	2,959	8,115	8,085	10,790	10,249
Income from Operations	22,283	24,232	57,897	54,868	79,357	75,980
Depreciation and Amortization	14,032	11,917	39,934	35,140	52,255	46,765
Non-Cash Stock-Based Compensation	874	786	2,578	2,334	3,369	2,378
Adjusted EBITDA [1]	$ 37,189	$ 36,935	$ 100,409	$ 92,342	$ 134,981	$ 125,123
Adjusted EBITDA Margin [2]	46%	47%	48%	47%	48%	46%

Reconciliation of Adjusted EBITDA to Net Cash Provided by Operating Activities

	Three Months Ended September 30,		**Nine Months Ended September 30,**		**Twelve Months Ended September 30,**	
(dollar amounts in thousands)	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Adjusted EBITDA [1]	$ 37,189	$ 36,935	$ 100,409	$ 92,342	$ 134,981	$ 125,123
Interest Paid	(1,739)	(2,345)	(7,371)	(7,362)	(10,520)	(10,255)
Income Taxes Paid	(3,337)	(1,919)	(9,413)	(10,493)	(16,168)	(20,430)
Gain on Sale of Rental Equipment	(2,892)	(3,728)	(7,242)	(7,689)	(9,904)	(10,228)
Change in certain assets and liabilities:						
Accounts Receivable, net	(14,872)	(9,963)	(19,197)	95	(15,424)	10,603
Prepaid Expenses and Other Assets	(1,952)	(161)	(2,998)	(1,791)	(1,058)	(1,672)
Accounts Payable and Accrued Liabilities	165	(298)	(5,460)	3,404	(1,612)	2,757
Deferred Income	12,853	10,695	5,462	3,221	683	(2,025)
Net Cash Provided by Operating Activities	$ 25,415	$ 29,216	$ 54,190	$ 71,727	$ 80,978	$ 93,873

1 Adjusted EBITDA is defined as net income before minority interest in income of subsidiary, interest expense, provision for income taxes, depreciation, amortization, and other non-cash stock-based compensation.

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

Adjusted EBITDA is a component of two restrictive financial covenants for the Company s unsecured line of credit and senior notes. Under these agreements, the Company is subject to the following financial covenants:

- Maintain a leverage ratio of funded debt to Adjusted EBITDA (as defined) not to exceed 2.25. At September 30, 2007 the actual ratio was 1.37.

- Maintain a fixed charge coverage of Adjusted EBITDA to fixed charges of at least 2.00. At September 30, 2007 the actual ratio was 3.06.

At September 30, 2007, the Company was in compliance with these covenants. There are no anticipated trends that the Company is aware of that would indicate non-compliance with these covenants, though, significant deterioration in our financial performance could impact the Company s ability to comply with these covenants.

Recent Developments

On October 5, 2007, the Company announced that the board of directors declared a cash dividend of $0.18 per common share for the quarter ended September 30, 2007, an increase of 13% over the prior year s comparable quarter.

In July 2007, the Company entered into an agreement with the minority shareholders of Enviroplex to increase its ownership of Enviroplex from 81.1% to 100%. The stock purchase will be for cash and will close upon satisfaction of certain obligations by the parties.

The Company adopted the 2007 Stock Incentive Plan (the 2007 Plan), effective June 6, 2007, under which 1,875,000 shares of Common Stock of the Company, plus the number of shares that remain available for grants of award under the Company s 1998 Stock Option Plan (the 1998 Plan) and become available as a result of forfeiture, termination, or expiration of awards previously granted under the 1998 Plan, were reserved for the grant of options to its employees, directors and consultants to purchase common stock of the Company. The awards have a maximum term of 10 years at an exercise price of not less than 100% of the fair market value of the Company s stock on the date the option is granted. The 2007 Plan replaces the Company s 1998 Plan and the 2000 Long-Term Bonus Plan (the 2000 Plan). The 2000 Plan under which no awards have been granted, only provided for the grant of stock bonuses to officers and key employees.

Results of Operations

Three Months Ended September 30, 2007 Compared to

Three Months Ended September 30, 2006

Overview

Consolidated revenues for the three months ended September 30, 2007 increased 4% to $80.8 million, from $77.9 million for the same period in 2006. Consolidated net income for the quarter decreased $0.8 million, or 6% to $11.9 million, or $0.46 per diluted share, from $12.7 million, or $0.50 per diluted share, for the same period in 2006.

For the three months ended September 30, 2007, on a consolidated basis:

Gross profit decreased $0.1 million, to $35.4 million from $35.5 million for the same period in 2006, with gross profit of Mobile Modular increasing $1.6 million, or 8%, due to higher gross profit on rental revenues, TRS-RenTelco decreasing $0.5 million, or 4%, due to lower gross profit on sales revenues, and Enviroplex decreasing $1.2 million, or 43%, primarily due to lower sales volume.

Selling and administrative expenses increased $1.8 million, or 16% to $13.1 million from $11.3 million for the same period in 2006, primarily as a result of higher personnel and employee benefit costs and increased bad debt expense.

Interest expense decreased $0.3 million to $2.7 million in 2007, due to 10% lower net average interest rates of 5.7% compared to 6.3% in 2006, and 1% lower average debt levels of the Company.

Pre-tax income contribution by Mobile Modular and TRS-RenTelco was 71% and 25%, respectively, compared to 61% and 28%, respectively, for the comparable 2006 period. These results are discussed on a segment basis below. Pre-tax income contribution by Enviroplex decreased to 4% in 2007 from 11% in 2006.

Adjusted EBITDA increased $0.3 million, or 1%, to $37.2 million compared to $36.9 million in 2006, with Mobile Modular increasing $1.2 million, TRS-RenTelco increasing $0.8, and Enviroplex decreasing $1.7 million.

Mobile Modular

For the three months ended September 30, 2007, Mobile Modular s total revenues increased $4.6 million, or 10%, to $48.9 million from the same period in 2006, due to $3.7 million higher rental and rental related services revenues, and $0.9 million higher sales revenues during the quarter. The revenue increase and higher gross margin on rental revenues, partly offset by lower gross margin on sales resulted in an 8% increase in pre-tax income to $14.0 million for the three months ended September 30, 2007, from $12.9 million for the same period in 2006.

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

Mobile Modular Q3 2007 compared to Q3 2006 (Unaudited)

	Three Months Ended			
	September 30,		**Increase (Decrease)**	
(dollar amounts in thousands)	**2007**	**2006**	**$**	**%**
Revenues				
Rental	$ 25,935	$ 23,857	$ 2,078	9%
Rental Related Services	9,505	7,902	1,603	20%
Rental Operations	35,440	31,759	3,681	12%
Sales	13,304	12,372	932	8%
Other	162	184	(22)	-12%
Total Revenues	$ 48,906	$ 44,315	$ 4,591	