MCGRATH RENTCORP
Form 10-K
March 14, 2007

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006 **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**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	**None**

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
Common Stock

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

Yes ____ No __X__

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

Yes ____ No __X__

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes __X__ No ____

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

Yes ____ No __X__

Aggregate market value of voting stock, held by nonaffiliates of the registrant as of June 30, 2006: $616,894,797.

As of March 8, 2007, 25,158,536 shares of Registrant s Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

McGrath RentCorp s definitive proxy statement with respect to its Annual Shareholders Meeting to be held June 6, 2007 which will be filed with the Securities and Exchange Commission within 120 days after the end of its fiscal year, is incorporated by reference into Part III, Items 10, 11, 12, and 13.

Exhibit index appears on page 70

FORWARD LOOKING STATEMENTS

Statements contained in this Annual Report on Form 10-K 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 mobile 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 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; the Company s engaging in and ability to consummate future acquisitions; manufacturer s 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 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 manufacturer 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-K. 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-K 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-K to conform such statements to actual results or to changes in our expectations.

PART I

ITEM 1. BUSINESS.

General Overview

McGrath RentCorp (the Company) is a California corporation organized in 1979 with corporate offices located in Livermore, California. The Company s common stock is traded on the NASDAQ National Global Select Market under the symbol MGRC.

The Company is a rental company with two rental products; relocatable modular buildings and electronic test equipment. Although the Company s primary emphasis is on equipment rentals, sales of equipment occur in the normal course of business. The Company is comprised of three business segments: Mobile Modular Management Corporation (MMMC), its modular building rental division, TRS-RenTelco, its electronic test equipment rental division, and Enviroplex, Inc. (Enviroplex), its majority-owned subsidiary classroom manufacturing business selling portable classrooms in California. In 2006, MMMC, TRS-RenTelco and Enviroplex contributed 66%, 30% and 4% of the Company s income before provision for taxes (the equivalent of pretax income), respectively, compared to 71%, 26% and 3% for 2005. Even though 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.

MMMC rents and sells modular buildings and accessories to fulfill customers temporary and permanent space needs in California, Texas and beginning in 2004, in Florida. These units are used as classrooms, temporary offices adjacent to existing facilities, sales offices, construction field offices, health care clinics, child care facilities and for a variety of other purposes. MMMC purchases the relocatable modular buildings, or modulars, from various manufacturers who build them to MMMC s design specifications. MMMC operates from two regional sales and inventory centers in California, one in Texas and one regional sales office in Florida. Although MMMC s primary emphasis is on rentals, sales of modulars routinely occur and can fluctuate quarter-to-quarter and year-to-year depending on customer requirements and budgets.

The educational market is the largest segment of our modular businesses. MMMC and Enviroplex provide classroom and specialty space needs serving public and private schools, colleges and universities. Within the educational market, the rental (by MMMC) and sale (by Enviroplex and MMMC) of modulars to public school districts for use as portable classrooms, restroom buildings and administrative offices for kindergarten through grade twelve (K 12) comprised approximately 55%, 59% and 59%, of MMMC s rental and sales revenues for 2006, 2005 and 2004, respectively. Fueled by increasing student population, insufficient funding for new school construction, class size reduction programs and aging school facilities, we believe demand will continue to be favorable.

TRS-RenTelco rents and sells electronic test equipment nationally and internationally from its Grapevine, Texas (Dallas Area) and Dollard-des-Ormeaux, Canada (Montreal Area) facilities. The Dallas facility houses the electronic test equipment inventory, sales engineers, calibration laboratories, and operations staff for U.S. and international business. The Montreal facility houses sales engineers and operations staff to serve the Canadian market. As of December 31, 2006, the original cost of electronic test equipment inventory was comprised of 70% general-purpose test equipment and 30% communications test equipment.

Engineers, technicians and scientists utilize general-purpose test equipment in developing products, controlling manufacturing processes, field service applications and evaluating the performance of their own electrical and electronic equipment. These instruments are rented primarily to aerospace, defense, electronics, industrial, research and semiconductor industries. To date, Agilent Technologies and Tektronix have manufactured the majority of TRS-RenTelco s general-purpose test equipment.

Communications test equipment, including fiber optic test equipment, is utilized by technicians, engineers and installation contractors to evaluate voice, data and multimedia communications networks, to install fiber optic cabling, and in the development and manufacturing of transmission, network and wireless products. These instruments are rented primarily to manufacturers of communications equipment and products, electrical and communications installation contractors, field technicians, and service providers. To date, Agilent has manufactured a significant portion of TRS-RenTelco s communications test equipment, with the remaining acquired from over 50 other manufacturers.

No single customer has accounted for more than 10% of the Company s total revenues generated in any given year. In addition, total foreign country customers and operations accounted for less than 10% of the Company s revenues and long-lived assets in any given year.

History, Strategic Expansion and Acquisitions

Prior to starting the Company, Robert McGrath, the Company s founder and Chairman of the Board, was a founder and served as President of Leasametric from 1969 until it was sold to Trans Union Corporation in 1977, and was involved in all aspects of its electronic test equipment rental business. Mr. McGrath was one of the pioneers of the electronic test equipment rental industry and contributed significantly to the success and direction of Leasametric, which was at the time one of the industry s largest and most respected companies. After the sale, Mr. McGrath continued with Trans Union until he founded the Company in 1979, initially renting relocatable modular offices. At the time that Mr. McGrath left Trans Union, he was subject to a non-compete agreement, which prevented him from engaging in the electronic test equipment rental business until 1984, when the Company went public.

The Company started modular operations in Northern California in 1979, expanded to Southern California in 1980, and by acquisition in 1982, grew the Southern California operations and entered the Texas market. When Mr. McGrath s non-compete expired in 1984, the Company entered the electronic test equipment rental business and in the same year went public. Secondary offerings were completed in 1986 and 1991. Proceeds from these offerings were used to fund organic growth, complete two modular acquisitions in 1986 and, in 1991, acquire a communications test equipment rental company from GE Capital operating as RenTelco. Also in 1991, the Company adopted a strategy to purchase large parcels of land and build regional modular sales and inventory centers for its facilities, and eventually completed two in California and one in Texas.

From 1991 through 2001 the Company s two rental businesses grew organically with the exception of a small modular acquisition in 1997. MMMC focused increasingly on educational rental growth and electronics benefited from its specialization in communications equipment as the telecom industry rapidly expanded. During this time, rental revenues for the modular business grew from $30.5 million in 1991 to $63.5 million in 2001 and, for the electronics business grew from $6.4 million in 1991 to $37.2 million in 2001, respectively.

Beginning in the latter half of 2001, the electronic test equipment rental industry experienced a significant downturn in business activity levels resulting from weakness in the telecommunications industry due to overcapacity and a general economic slowdown. Although both general-purpose and communications test equipment sectors were affected, the impact to our communications test equipment business levels was significant. As a result, during the first six months of 2002, TRS-RenTelco recorded non-cash impairment charges of $24.1 million as a result of excess communications equipment rental inventory relative to market demand, reducing net income by $14.5 million and reducing diluted earning per share by $0.58 per share resulting from the depressed and low projected demand for its rental products coupled with high inventory levels, especially in communications test equipment. Beginning in late 2003 and continuing into 2004, the general-purpose test equipment markets, and to a lesser extent, communications test equipment markets, showed signs of increasing business activity levels.

In early 2004, the Company leveraged its California classroom rental expertise and strategically expanded to Florida, renting modular classroom product. We believe that we have developed good relationships with school districts, manufacturers, and other suppliers while entering the market with an innovative classroom design, the hybrid , for the Florida market. The hybrid classroom is a low profile, steel frame product, which allows school districts to install their classrooms in much closer proximity to one another, thereby freeing up valuable playground space, eliminates the need for a separate ramp system on most installations and has significantly improved aesthetics compared to standard portable classrooms. The hybrid continues to gain popularity in the marketplace.

In May 2004, the Company entered into an Asset Purchase Agreement to purchase substantially all of the assets of Technology Rentals & Services (TRS), a division of CIT Group Inc. (CIT) in order to facilitate the growth of the electronics business. Based in Grapevine, Texas (Dallas Area), TRS was similar to the Company s existing electronic test equipment rental business, RenTelco, and was one of the leading providers of general purpose and communications test equipment for rent or sale in North America. The transaction was completed on June 2, 2004, for cash consideration of $120.2 million, including expenses of $0.6 million. The Company financed the acquisition from a revolving line of credit facility with its banks and $60 million in fixed-rate senior notes. Since June 2, 2004, TRS results have been included in the Consolidated Statements of Income, and since that date, the combined electronics business has operated under the name TRS-RenTelco.

During the remainder of 2004 and during 2005, the Company focused on its core rental businesses, integrating the acquired TRS operations and establishing Florida modular operations. During 2005, the Company purchased 122.5 acres of undeveloped land in Florida and, in 2006, has begun development of a portion of the property for a regional modular sales and inventory center.

Business Model

The Company invests capital in rental products and believes it recovers its original investment through rents less operating expenses in a relatively short period of time compared to the product s rental life. Historically when the Company s rental products have been sold, the proceeds on sale have recovered a high percentage of the original investment. With these dynamics, a significant base of rental assets on rent generates a considerable amount of operating cashflows to support continued rental asset growth. Similarly, the Company s rental products, relocatable modular buildings and electronic test equipment, have the following dynamics:

- The product required by the customer tends to be expensive compared to the Company s monthly rental charge, with the interim rental solution typically evaluated as a less costly alternative.

- Generally, we believe the Company s customers have a short-term need for our rental product. The customer s rental requirement may be driven by a number of factors including time, budget or capital constraints, future uncertainty impacting their ongoing need for the equipment, equipment availability, specific project requirements, peak periods of demand or the customer may want to eliminate the burdens and risks of equipment ownership. For modulars, in many cases a customer s initial short-term rental becomes part of the customer s ongoing infrastructure and turns into a long-term rental.

- Both modular and electronics rental products have long useful lives relative to the typical rental term with modulars having an estimated life of eighteen years compared to the typical committed term of twelve to twenty-four months, and electronics having an estimated life range of two to seven years depending on the type of product compared to a typical rental term of one to six months.

- Typically, we believe short-term rental rates recover the Company s original investment quickly, with modulars in approximately four years, and electronics in approximately two years, based the on the respective product s annual yield in 2006, or the annual rental revenues divided by the average cost of rental inventory for 2006.

- When each product is sold from rental inventory, a significant portion of the original investment is recovered. Asset management acumen is a critical element to each of the rental businesses and the resulting residuals realized when product is sold from inventory. Modular asset management requires designing and building the product for a long life, coupled with ongoing repair and maintenance investments, to ensure its long useful rental life and generally, higher residuals upon sale. Electronics asset management requires understanding, selecting and investing in equipment technologies that support market demand and, once invested, proactively managing the equipment at the model level for optimum utilization through its technology life cycle maximizes the rental revenues and residuals realized.

The Company believes that rental revenue growth from an increasing base of rental assets and improved gross profits on rents are the best measures of the health of each of our rental businesses. Additionally, we believe our business model and results are enhanced with operational leverage that is created from large regional sales and inventory centers for modulars, a single U.S. based sales, inventory and operations facility for electronics and shared senior management and back office functions for financing, human resources, insurance, and operating and accounting systems.

Employees

As of December 31, 2006, the Company had 603 employees, of whom 51 were primarily administrative and executive personnel, with 333, 136 and 83 in the operations of MMMC, TRS-RenTelco and Enviroplex, respectively. None of our employees are covered by a collective bargaining agreement, and management believes its relationship with our employees is good.

Available Information

We make available, free of charge at our website *www.mgrc.com*, the Company s Securities and Exchange Commission (SEC) filings. These filings include our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Act of 1934, which are available as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the SEC. Information included on our web site is not incorporated by reference to this Report. Furthermore, all reports the Company files with the SEC are available free of charge through the SEC s Web site at www.sec.gov. In addition, the public may read and copy materials filed by the Company at the SEC s Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. The public may also obtain additional information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330.

RELOCATABLE MODULAR BUILDINGS

Description

Modulars are designed for use as temporary classroom and office space and may be moved from one location to another. Modulars vary from simple single-unit construction site offices to multi-modular facilities, complete with wood exteriors and mansard roofs. The rental fleet includes a full range of styles and sizes. The Company considers its modulars to be among the most attractive and well designed available. The units are constructed with wood or metal siding, sturdily built and physically capable of a long useful life. Units are provided with installed heat, air conditioning, lighting, electricity and floor covering, and may have customized interiors including partitioning, carpeting, cabinetwork and plumbing facilities.

MMMC purchases new modulars from various manufacturers who build to MMMC s design specifications. With the exception of Enviroplex, none of the principal suppliers are affiliated with the Company. During 2006, MMMC purchased 32% of its modular product from one manufacturer. The Company believes that the loss of its primary manufacturer of modulars could have an effect on its operations since MMMC could experience higher prices and longer lead times for modular product until other manufacturers increased their capacity.

The modular product is manufactured to state building codes, has a low risk of obsolescence, and can be modified or reconfigured to accommodate a wide variety of customer needs. Historically, as state building codes have changed over the years, MMMC has been able to continue to use existing modular equipment, with minimal required upgrades, if any. The Company has no assurance that it will continue to be able to use existing modular equipment with minimal upgrades as building codes change in the future.

MMMC operates from three regional sales and inventory centers serving large geographic areas in California and Texas, and a sales office serving the Florida market in which the Company launched operations in 2004. The California and Texas operations have in-house infrastructure and operational capabilities to support quick and efficient repair, modification, and refurbishment of equipment for the next rental opportunity. MMMC believes operating from large regional sales and inventory centers results in better operating margins as operating costs are spread over a large installed customer base. MMMC actively maintains and repairs its rental equipment, and management believes this insures the continued use of the modular product over its long life and, when sold, generates high sale proceeds relative to its capitalized cost. When rental equipment returns from a customer, the necessary repairs and preventative maintenance are performed prior to its next rental. Making these expenditures for repair and maintenance throughout the equipment s life results in older equipment renting for similar rates as newer equipment. Management believes the condition of the equipment is a more significant factor in determining the rental rate and sale price than its age. Over the last three years, used equipment sold each year represented less than 3% of rental equipment, and has been, on average, 11 years old with sale proceeds recovering a high percentage of the equipment s capitalized cost. MMMC depreciates its rental equipment over 18 years using a 50% residual value effective January 1, 2002. Prior to 2002, MMMC used an 18% residual value.

Competitive Strengths

Market Leadership The Company believes MMMC is the largest supplier of modular educational facilities for rental to both public and private schools in California. Management is knowledgeable about the needs of its educational customers and the related regulatory requirements in the states where MMMC operates, which enable MMMC to meet its customer s specific project requirements.

Expertise The Company believes that over the 28 years MMMC has competed in the modular rental industry, MMMC has developed expertise that differentiates it from its competitors. MMMC has dedicated its attention to continuously developing and improving the quality of the modular product. MMMC has expertise in the licensing and regulatory requirements that govern the modular product in the states where it operate and its management, sales and operational staffs are knowledgeable and committed to providing exemplary customer service. MMMC has expertise in project management and complex applications.

Operating Structure MMMC believes that part of the strategy for MMMC should be to create facilities and infrastructure capabilities that its competitors cannot easily duplicate. MMMC achieves this by building regional sales and inventory centers designed to serve a broad geographic area and a large installed customer base under a single overhead structure, thereby reducing its cost per transaction. The Company s regional facilities and related infrastructure enable MMMC to maximize our modular inventory utilization through efficient and cost effective in-house repair, maintenance and refurbishment for quick redeployment of equipment to meet its customers needs. The Company s goal is to be more responsive at lower cost.

Asset Management The Company believes MMMC markets high quality, well-constructed and attractive modulars. MMMC requires manufacturers to build to its specifications, which enables MMMC to maintain a standardized quality fleet. In addition, through its ongoing repair, refurbishment and maintenance programs, the Company believes MMMC s modular buildings are the best maintained in the industry. The Company depreciates its modular buildings over an 18 year estimated useful life to a 50% residual value. Older buildings continue to be productive primarily because of MMMC s focus on ongoing fleet maintenance. Also, as a result of MMMC s maintenance programs, when equipment is sold, a high percentage of the equipment s capitalized cost is recovered. In addition, the fleet s utilization is regionally optimized by managing inventory through estimates of market demand, fulfillment of current rental and sale order activity, equipment returns and capital purchases.

Customer Service The Company believes the modular rental industry to be service intensive and locally based. The Company strives to provide excellent service by meeting its commitments to its customers, being proactive in resolving project issues and seeking to continuously improve the customer s experience. MMMC is committed to offering quick response to requests for information, providing experienced assistance, on time delivery and preventative maintenance of its units. MMMC s goal is to continuously improve its procedures, processes and computer systems to enhance internal operational efficiency. The Company believes this dedication to customer service results in high levels of customer loyalty and repeat business.

Market

MMMC s largest single demand is for temporary classroom and other educational space needs of public and private schools, colleges and universities in California, and to a lesser extent in Florida and Texas. Management believes the demand for classrooms is caused by shifting and fluctuating school populations, the lack of state funds for new construction, the need for temporary classroom space during reconstruction of older schools and class size reduction (see Classroom Rentals and Sales to Public Schools (K-12) below). Other customer applications include sales offices, construction field offices, health care facilities, church sanctuaries and child care services. Industrial, manufacturing, entertainment and utility companies, as well as governmental agencies commonly use large multi-modular complexes to serve their interim administrative and operational space needs. The modular product offers customers quick, cost-effective space solutions while conserving their capital. The Company s corporate, and California and Texas modular regional sales and inventory center offices are housed in various sizes of modulars.

Since most of MMMC s customer requirements are to fill temporary space needs, MMMC s marketing emphasis is on rentals rather than sales. MMMC attracts customers through its website at www.mobilemodularrents.com, extensive yellow page advertising, and direct mail. Customers are encouraged to visit a sales and inventory center to view different models on display and to see a regional office, which is a working example of a modular application.

Because service is a major competitive factor in the rental of modulars, MMMC offers quick response to requests for information, assistance in the choice of a suitable size and floor plan, in-house customization services, rapid delivery, timely installation and field service of its units. On MMMC s website, customers are able to view and select inventory for quotation, request in-field service and view billing and account balance information.

Rentals

Rental periods range from one month to several years with a typical initial contract term between twelve and twenty-four months. In general, monthly rental rates are determined by a number of factors including length of term, product availability and product type. Upon expiration of the initial rental agreement term, or any extensions, rental rates are reviewed, and when appropriate, are adjusted based on current market conditions. Most rental agreements are operating leases that provide no purchase options, and when a rental agreement does provide the customer with a purchase option, it is generally on terms management believes to be attractive to MMMC.

The customer is responsible for obtaining the necessary use permits and the costs of insuring the unit, transporting the unit to the site, preparation of the site, installation of the unit, dismantle and return delivery of the unit to one of MMMC s three regional sales and inventory centers, and certain costs for customization. MMMC maintains the units in good working condition while on rent. Upon return, the units are inspected for damage and customers are billed for items considered beyond normal wear and tear. Generally, the units are then repaired for subsequent use. Repair and maintenance costs are expensed as incurred and can include floor tile repairs, roof maintenance, cleaning, painting and other cosmetic repairs. The costs of major refurbishment of equipment are capitalized to the extent the refurbishment significantly improves the quality and adds value or life to the equipment.

At December 31, 2006, MMMC owned 26,467 new or previously rented modulars including accessories with an aggregate cost of $451.8 million, or an average cost per unit of $17,100. 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. At December 31, 2006, fleet utilization was 81.4% and average fleet utilization during 2006 was 82.9%.

Sales

In addition to operating its rental fleet, MMMC sells modulars to customers. These sales typically arise out of its marketing efforts for the rental fleet and from existing equipment already on rent. Such sales can be of either new or used units from the rental fleet, which permits an orderly turnover of older units. During 2006, MMMC s largest sale was for new modular classrooms to a California school district for approximately $2.6 million. This sale represented approximately 8% of MMMC s sales, 4% of the Company s consolidated sales, and 1% of the Company s consolidated revenues.

MMMC typically provides limited 90-day warranties on used modulars and passes through the manufacturers one-year warranty on new units to its customers. Warranty costs have not been significant to MMMC s operations to date, and the Company attributes this to its commitment to high quality standards and regular maintenance programs. However, there can be no assurance that warranty costs will continue to be insignificant to MMMC s operations in the future.

Seasonality

Typically, during each calendar year, our highest numbers of classrooms are shipped for rental and sale orders during the second and third quarters for delivery and installation prior to the start of the upcoming school year. The majority of classrooms shipped in the second and third quarters have rental start dates during the third quarter, thereby making the fourth quarter the first full quarter of rental revenues recognized for these transactions. These factors may impact the quarterly revenues and earnings of each year s second, third and fourth quarters.

Competition

Management estimates the business of renting relocatable modular buildings is an industry that today has equipment on rent or available for rent in the United States with an aggregate original cost of approximately $4.0 billion. Competition in the rental and sale of relocatable modular buildings is intense. Two major national firms are engaged in the rental of modulars, have many offices throughout the country and we believe have greater financial resources than MMMC. In addition, a number of other smaller companies operate regionally throughout the country. MMMC operates primarily in California, Texas and, beginning in 2004, in Florida. Significant competitive factors in the rental business include availability, price, service, reliability, appearance and functionality of the product. MMMC markets high quality, well-constructed and attractive modulars. The Company believes that part of the strategy for modulars is to create facilities and infrastructure capabilities that its competitors cannot easily duplicate. The Company s facilities and related infrastructure enable it to modify modulars efficiently and cost effectively to meet its customers needs. Management s goal is to be more responsive at less expense. Management believes this strategy, together with its emphasis on prompt and efficient customer service, gives MMMC a competitive advantage. MMMC is determined to offer quick response to requests for information, experienced assistance for the first-time user, rapid delivery and timely repair of its units. MMMC s already high level of efficiency and responsiveness continues to improve as procedures, processes and computer systems that control its internal operations are enhanced. The Company anticipates strong competition in the future and believes its process of improving its products and services must continue to be ongoing.

Classroom Rentals and Sales to Public Schools (K-12)

The rental and sales of modulars to public school districts for use as portable classrooms, restroom buildings and administrative offices for kindergarten through grade twelve (K-12) are a significant portion of the Company s revenues. The following table shows the approximate percentages of the Company s modular rental and sales revenues, and of its consolidated rental and sales revenues for the past five years, that rentals and sales to these schools constitute:

Rentals and Sales to Public Schools (K-12) as a Percentage of Total Rental and Sales Revenues

Percentage of:	*2006*	*2005*	*2004*	*2003*	*2002*
Modular Rental Revenues *(MMMC)*	50%	53%	52%	49%	49%
Modular Sales Revenues *(MMMC & Enviroplex)*	65%	67%	72%	50%	54%
Modular Rental and Sales Revenues *(MMMC & Enviroplex)*	55%	59%	59%	50%	51%
Consolidated Rental and Sales Revenues[1]	33%	34%	36%	41%	40%

1 Consolidated Rental and Sales Revenue percentage is calculated by dividing Modular rental and sales revenues to public schools (K-12) by the Company s consolidated rental and sales revenues. The declining percentage of public school (K-12) revenues as a percentage of the Company s consolidated rental and sale revenues for 2004 and 2005 primarily resulted from the added revenues from electronic test equipment operations of TRS acquired in June 2004.

School Facility Funding

Funding for public school facilities is derived from a variety of sources including the passage of both statewide and local facility bond measures, operating budgets, developer fees, various taxes including parcel and sales taxes levied to support school operating budgets, and lottery funds. Looking forward, the Company believes that any interruption in the passage of facility bonds, contraction or elimination of class size reduction programs, a lack of fiscal funding, or a significant reduction of funding from other sources to public schools may have a material adverse effect on both rental and sales revenues of the Company.

Legislation

In California (where most of the Company s educational rentals have occurred), school districts are permitted to purchase only portable classrooms built to the requirements of the California Division of State Architect (DSA). However, school districts may rent classrooms that meet either the Department of Housing (DOH) or DSA requirements. In 1988, California adopted a law which limited the term for which school districts may rent portable classrooms built to DOH standards for up to three years (under a waiver process), and also required the school board to indemnify the State against any claims arising out of the use of such classrooms. Prior to 1988, the majority of the classrooms in the Company s rental fleet were built to the DOH requirements, and since 1988 almost all new classrooms have been built to the DSA requirements. During the 1990 s additional legislation was passed extending the use of these DOH classroom buildings under the waiver process through September 30, 2000. In 2000, new California legislation was passed allowing for DOH classroom buildings already in use for classroom purposes as of May 1, 2000 to be utilized until September 30, 2007, provided various upgrades were made to their foundation and ceiling systems. In February 2006, new legislation was passed extending the use of these classroom buildings from September 30, 2007 to September 30, 2015. Currently, regulations and policies are in place that allow for the ongoing use of DOH classrooms from the Company s inventory to meet shorter term space needs of school districts for periods up to 24 months, provided they receive a Temporary Certification or Temporary Exemption from the DSA. As a consequence, the tendency is for school districts to rent the DOH classrooms for shorter periods and to rent the DSA classrooms for longer periods. There can be no assurance that these regulations and policies that allow for the continuing rental of DOH classrooms for new public school projects will remain in place. At December 31, 2006, the net book value of DOH classrooms represented less than 1.6% of the net book value of the Company s modular rental equipment and less than 1.0% of the total assets of the Company, and the utilization of these DOH classrooms was 76.5%.

In 2002, Florida passed a state constitutional amendment setting limits for the maximum allowable number of students in a class for pre-kindergarten through grade twelve. In 2007, school districts are required to meet class size limits based upon the average number of students per class at the school level. By 2009, school districts will be required to meet the class size requirements at the individual classroom level. The class size reduction program is scheduled for implementation through 2010.

ELECTRONIC TEST EQUIPMENT

Description

TRS-RenTelco s general-purpose rental inventory includes oscilloscopes, amplifiers, analyzers (spectrum, network and logic), signal source and power source test equipment. The communications rental inventory includes network and transmission test equipment for various fiber, copper and wireless networks. Agilent Technologies and Tektronix manufacture the majority of the general-purpose inventory and the communications test equipment inventory includes equipment from over 50 different manufacturers. TRS-RenTelco also rents electronic test equipment from other rental companies and re-rents the equipment to customers.

Competitive Strengths

Market Leadership The Company believes that TRS-RenTelco is one of the largest test equipment rental and leasing companies offering the broadest and deepest selection of general purpose and communications test equipment for rent in North America.

Expertise The Company believes that its knowledge of products, technology and applications expertise provides it with a competitive advantage over others in the industry. Customer requirements are supported by application engineers and technicians that are knowledgeable about the equipment s uses to ensure the right equipment is selected to meet the customer s needs. This knowledge can be attributed to the vast experience of TRS-RenTelco s management, sales and operational teams.

Operating Structure TRS-RenTelco is supported by a centralized distribution and inventory center on the grounds of the Dallas-Fort Worth Airport in Texas. The Company believes that the centralization of servicing all customers in North America and internationally by TRS-RenTelco s experienced logistics teams provides a competitive advantage by minimizing transaction costs and enabling TRS-RenTelco to ensure customer requirements are met.

Asset Management TRS-RenTelco s rental equipment inventory is serviced by an ISO 9001-2000 registered and compliant calibration laboratory that repairs and calibrates equipment ensuring that off rent equipment is ready to ship immediately to meet customer s needs. TRS-RenTelco s team of technicians, product managers and sales personnel are continuously monitoring and analyzing the utilization of existing products, new technologies, general economic conditions and estimates of customer demand to ensure the right equipment is purchased and sold, at the right point in the equipment s technology life cycle. The Company believes this enables it to maximize utilization of equipment and the cash flow generated by the rental and sales revenue of each model of equipment. TRS-RenTelco strives to maintain strong relationships with equipment manufacturers, which enables it to leverage those relationships to gain rental opportunities.

Customer Service The Company believes that its focus on providing excellent service to its customers provides a competitive advantage. TRS-RenTelco strives to provide exemplary to fulfill its commitments to its customers. TRS-RenTelco prides itself in providing solutions to meet customers needs by having equipment available, and responding quickly and thoroughly to their requests. TRS-RenTelco s sophisticated in-house laboratory ensures the equipment is fully functional and meets its customers delivery requirements. Service needs of TRS-RenTelco s customers are supported 24 hours a day, 7 days a week by its customer care specialists. TRS-RenTelco s goal is to provide service beyond its customers expectations, which, the Company believes, results in customer loyalty and repeat business.

Market

The business of renting electronic test equipment is a market which today has equipment on rent or available for rent in the United States and Canada with an aggregate original cost in excess of a half billion dollars. There is a broad customer base for the rental of such instruments, including aerospace, communications, defense, electrical contractor electronics, industrial, installer contractor, network systems and research companies.

TRS-RenTelco markets its electronic test equipment throughout the United States, Canada, and, to a limited extent, other countries. TRS-RenTelco attracts customers through its outside sales force, website at www.TRS-RenTelco.com, an extensive telemarketing program, trade show participation and direct mail campaigns. A key part of the sales process is TRS-RenTelco s knowledgeable inside sales engineering team that effectively matches test equipment solutions to meet specific customer s requirements.

The Company believes that customers rent electronic test equipment for many reasons. Customers frequently need equipment for short-term projects, to evaluate new products, and for backup to avoid costly downtime. Delivery times for the purchase of such equipment can be lengthy; thus, renting allows the customer to obtain the equipment expeditiously. The Company also believes that the relative certainty of rental costs can facilitate cost control and be useful in the bidding of and passthrough of contract costs. Finally, renting rather than purchasing may better satisfy the customer s budgetary constraints.

Rentals

TRS-RenTelco rents electronic test equipment typically for rental periods of from one to six months, although in some instances, there can be rental terms up to a year or greater. Monthly rental rates range from approximately 3% to 10% of the current manufacturers list price. TRS-RenTelco depreciates its equipment over 2 to 8 years with no residual value.

At December 31, 2006, TRS-RenTelco had an electronic test equipment rental inventory including accessories with an aggregate cost of $186.7 million. Utilization is calculated each month by dividing the cost of the rental equipment on rent by the total cost of rental equipment, excluding accessory equipment. Utilization was 66.3% as of December 31, 2006 and averaged 69.6% during the year.

Sales

TRS-RenTelco generally sells used equipment to maintain an inventory of equipment meeting more current technological standards, and to support maintaining target utilization levels at a model number level. TRS-RenTelco attempts to maintain an inventory where the majority of equipment is less than five years old. In 2006, approximately 18% of the electronics revenues were derived from sales. The largest electronics sale during 2006 represented approximately 10% of electronics sales, 3% of the Company s consolidated sales and less than 1% of consolidated revenues.

Seasonality

The Company does not believe the electronic test equipment rental business to be highly seasonal, except for the fourth quarter month of December and the first quarter months of January and February. These months may have lower rental activity due to holiday closures, particularly by larger companies, inclement weather and its impact on various field related communications equipment rentals, and companies operational recovery from holiday closures which may impact the start-up of new projects coming online in the first quarter. These factors may impact the quarterly results of each year s first and fourth quarter.

Competition

The U.S. and Canadian test equipment rental markets consist primarily of three major rental companies, which include TRS-RenTelco, and a number of smaller rental companies that makes for a very competitive market environment. TRS-RenTelco competes with these other test equipment rental companies on the basis of product availability, price, service and reliability.

Operating Segments

For segment information regarding the Company s three operating segments: Modulars, Electronics and Enviroplex, see Note 10. Segment Reporting to the audited consolidated financial statements of the Company included in Item 8. Financial Statements and Supplementary Data.

PRODUCT HIGHLIGHTS

The following table shows the revenue components, percentage of rental and total revenues, rental equipment (at cost), rental equipment (net book value), number of relocatable modular buildings, year-end and average utilization, average rental equipment (at cost), annual yield on average rental equipment (at cost) and gross margin on rental revenues and sales by product line for the past five years.

Product Highlights					
(dollar amounts in thousands)	*Year Ended December 31,*				
	2006	*2005*	*2004*	*2003*	*2002*
Relocatable Modular Buildings *(operating under MMMC and Enviroplex)*					
Revenues					
Rental	$ 91,124	$ 81,180	$ 71,460	$ 63,948	$ 66,214
Rental Related Services	29,913	25,053	22,142	16,203	16,936
Total Modular Rental Operations	121,037	106,233	93,602	80,151	83,150
Sales MMMC	34,209	49,107	27,617	18,478	20,124
Sales Enviroplex	12,393	10,562	9,254	11,007	12,488
Total Modular Sales	46,602	59,669	36,871	29,485	32,612
Other	729	625	444	495	678
Total Modular Revenues	$ 168,368	$ 166,527	$ 130,917	$ 110,131	$ 116,440
Percentage of Rental Revenues	53.9%	53.3%	59.4%	83.4%	80.8%
Percentage of Total Revenues	63.0%	61.2%	64.6%	84.1%	80.3%
Rental Equipment, at cost (year-end)	$ 451,828	$ 408,227	$ 339,537	$ 304,905	$ 285,901
Rental Equipment, net book value (year-end)	$ 343,590	$ 307,822	$ 245,924	$ 215,589	$ 200,593
Number of Units (year-end)	26,467	24,928	21,566	19,713	18,707
Utilization (year-end)[1]	81.4%	83.5%	86.1%	84.6%	85.2%
Average Utilization[1]	82.9%	84.9%	85.6%	84.2%	85.9%
Average Rental Equipment, at cost[2]	$ 385,630	$ 341,103	$ 303,294	$ 283,297	$ 274,912
Annual Yield on Average Rental Equipment, at cost	23.6%	23.8%	23.6%	22.6%	24.1%
Gross Margin on Rental Revenues	62.2%	63.8%	63.0%	63.0%	65.3%
Gross Margin on Sales					