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TRACKING THE NUMBERS

Outside Audit

Iron Mountain Is True to Its Name

Document-Storage Firm Piles Up Companies, Debt To Be Industry's Biggest

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Eight years and billions of dollars have helped Iron Mountain Inc. buy rather than build its title: America's biggest document-storage and records-management company.

Since its initial public offering of stock in 1996, the 53-year-old Boston firm has gobbled up 112 companies across the U.S., South America and Western Europe, boosting its revenue to an annualized $1.8 billion in the first six months of this year from $104.4 million in 1995. But that growth hasn't come without a price: $2.26 billion in long-term debt as of June.

Skeptics caution that this debt load leaves Iron Mountain too highly leveraged for it or investors' good. Indeed, the company's debt is almost twice its shareholder equity, or total assets minus liabilities. During the first half of 2004, the company spent $86 million, or about half its operating income, just to pay the interest on its debt. That is up 20% from $72 million spent in the first half of 2003. A downturn in business, or a broader move away from outsourcing paper-document storage, could affect Iron Mountain's ability to meet its financing needs.

Richard Reese

Iron Mountain stores its clients' documents in warehouses dotted around the country. It started out by convincing companies to store documents in an old iron-ore mine in case of nuclear attack -- thus the company moniker. Today the need for document storage is such a foregone conclusion in Corporate America that Iron Mountain's biggest competitor is the in-house records rooms of potential clients. Iron Mountain is also expanding its digital-storage business, but this is a fledging operation whose revenue is small. In a nutshell, the company's making a play that the paperless office is still hypothetical, and there remains big money to be made storing hard copies of key documents for clients.

Being highly leveraged suits Chief Executive Richard Reese just fine. The recurring and predictable nature of the company's document-storage revenue, and the fact that Iron Mountain has more cash coming in than going out ensures that the company will be able to manage its debt, he says. "What everybody who really owns this stock for the long-term understands is that we can push hard on the growth, and if we pull the lever back, it will just gush cash," Mr. Reese says.

Investors seem to agree. Iron Mountain stock is up 25% this year and hit an all-time high of nearly $34 last week on the New York Stock Exchange. (Yesterday in 4 p.m. Big Board composite trading, the stock was down 9 cents to $33.41.) But at $34 the stock is trading at over 34 times Wall Street's 2005 earnings estimate of 99 cents a share.

Much of the company's revenue comes from recurring fees charged for documents already being stored, and about half of the company's revenue growth -- excluding acquisitions -- comes as current customers increase their business.

That consistency gives investors the security they need while they wait for management to "flip the switch and manage this business more for cash flow, and invest less," says Robert W. Baird analyst Timothy Byrne.

Exactly when the company will start looking to extract cash and return it to shareholders in the form of a dividend or stock buyback is far from clear.

"We will give the cash back to them in time, but it's not going to happen in the near future," Mr. Reese says. "Why de-leverage if you can keep building the business?"

Mr. Reese adds that Iron Mountain is "looking for the point of no return," when the company's investments no longer add to the internal growth rate.

David Trainer, an analyst at research firm New Constructs LLC, however, reckons the company is already way past that point and has "too much capital generating too little cash." He says Iron Mountain earned a 5% return on capital over the past five years, which is under its 8.5% cost of debt.

Mr. Reese acknowledges that "if our cost of capital got too high and the opportunities for investment weren't there, we'd pull back," but he doesn't think that is the case at the moment.

The chief executive adds that Iron Mountain will naturally lower debt as its cash flow continues to increase. But operating cash flow fell slightly in the first half of 2004, to $129.7 million from $130.6 million in 2003's first half.

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