Cintas Corporation (CTAS)

Updated December 23rd, 2018 by Josh Arnold

Key Metrics

Current Price:	$160	**5 Year CAGR Estimate:**	5.0%	**Volatility Percentile:**	35.8%
Fair Value Price:	$128	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	77.0%
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.3%	**Growth Percentile:**	72.2%
Dividend Yield:	1.3%	**5 Year Price Target**	$189	**Valuation Percentile:**	10.0%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	12.2%

Overview & Current Events

Cintas Corporation is the U.S. industry leader in uniform design, manufacturing, & rental. The company also offers first aid supplies, safety services, and other business-related services. Cintas was founded in 1968 and has grown to a market capitalization of $17 billion and annual revenues of almost $7 billion. Cintas' CEO is Scott Farmer, the son of its founder Richard Farmer. Scott Farmer owns more than 14% of Cintas' stock, which shows that the company's upper management is incentivized to act in the best interests of its shareholders. Cintas qualifies to be a member of the Dividend Aristocrats Index with an impressive 35 years of consecutive dividend increases.

Cintas reported Q2 earnings on 12/20/18 and results were very strong. Revenue was up 7% as the company's organic revenue, which excludes foreign exchange and acquisitions, was also up 7%. The Uniform Rental segment saw its organic revenue rise 6.6% after a +4.2% showing in Q1, while the First Aid and Safety Services business saw its organic revenue increase 10.2% in Q2. Cintas continues to take advantage of strong business spending and is showing no signs of slowing revenue growth.

Gross margin dollars rose 8.2% in Q2 as the gross margin rate expanded 50bps to 45.1%. The Uniform business saw gross margins rise 60bps to 45.3% as it led the way in terms of profitability. Cintas also achieved some meaningful operating leverage as its SG&A costs rose just 5% against the 7% gain in revenue, excluding the integration costs from the company's 2017 acquisition of G&K Services. Indeed, adjusted operating margin rose 100bps to 16.5% in Q2, an impressive expansion of profitability thanks to prudent expense management and strong demand.

In total, adjusted earnings-per-share increased 34% in Q2 to $1.76 and the first half of the fiscal year has seen earnings-per-share rise 32%. Cintas saw fit after the strong Q2 report to boost guidance for the rest of the fiscal year. Revenue is now seen at ~$6.9 billion, representing a 6%+ gain over last fiscal year, while earnings-per-share was guided to a midpoint of $7.34. Accordingly, we've boosted our estimate for 2019 earnings-per-share to that same value. Cintas is performing very well but investors have continued to sell the stock since the Q1 report thanks likely to its lofty valuation and general broad market weakness.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.83	$1.49	$1.68	$2.27	$2.52	$2.79	$3.44	$4.09	$4.17	$7.03	***$7.34***	***$10.78***
DPS	$0.47	$0.48	$0.49	$0.54	$0.64	$0.77	$0.85	$1.05	$1.33	$1.62	***$2.05***	***$3.50***
Shares	153	153	138	127	122	117	112	104	105	106	***107***	***100***

Cintas has compounded its earnings-per-share at a rate of 7.6% since 2008. Over full economic cycles, we believe the company is capable of delivering continued earnings growth in the range of 8% per year. Applying an 8% growth rate to the updated midpoint of the company's 2019 earnings guidance gives a 2024 earnings-per-share estimate of $10.78.

In the near-term, Cintas' growth will be driven by the acquisition of G&K Services, which closed in March of 2017. The transaction is anticipated to be accretive to Cintas' earnings in fiscal 2019 and is expected to generate between $130 million and $140 million of annual cost synergies. Importantly, the acquisition was non-dilutive to continuing Cintas shareholders. The acquisition was funded using a combination of existing cash, assumption of existing G&K Services

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debt, and new debt. Q2 results showed some of the synergies coming into play despite the relatively early stage the acquisition is in at this point. SG&A costs were leveraged down meaningfully, and we believe this will continue to play out in the coming quarters as Cintas fully integrates G&K and removes redundancies. Revenue growth will also continue to drive earnings higher and the company's share repurchase program, which has seen Cintas buy back $508 million in stock thus far in fiscal 2019, will help as well by reducing the float.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.7	13.8	17.9	16.6	14.9	16.6	19.4	21.4	21.5	27.2	***21.8***	***17.5***
Avg. Yld.	1.4%	1.9%	1.8%	1.8%	1.6%	1.5%	1.4%	1.2%	1.2%	1.2%	***1.3%***	***1.9%***

Cintas' price-to-earnings ratio has varied from ~14 to ~27 over the last decade. We believe that excluding 2017's figure makes sense due to the irrationally high valuation assigned to the company. Ex-2017, Cintas has traded at an average price-to-earnings ratio of 17.5 over the last decade. We believe this represents a fair price to pay for a company of Cintas' caliber. This compares unfavorably, however, to the current price-to-earnings ratio of 21.8. If the company's valuation reverts to 17.5 times earnings over the next five years, this will introduce a meaningful 4.3% annual headwind to the company's annualized returns. However, the stock's valuation is much better than it has been in recent quarters thanks to the selloff from $217 to $160.

Safety, Quality, Competitive Advantage, & Recession Resiliency

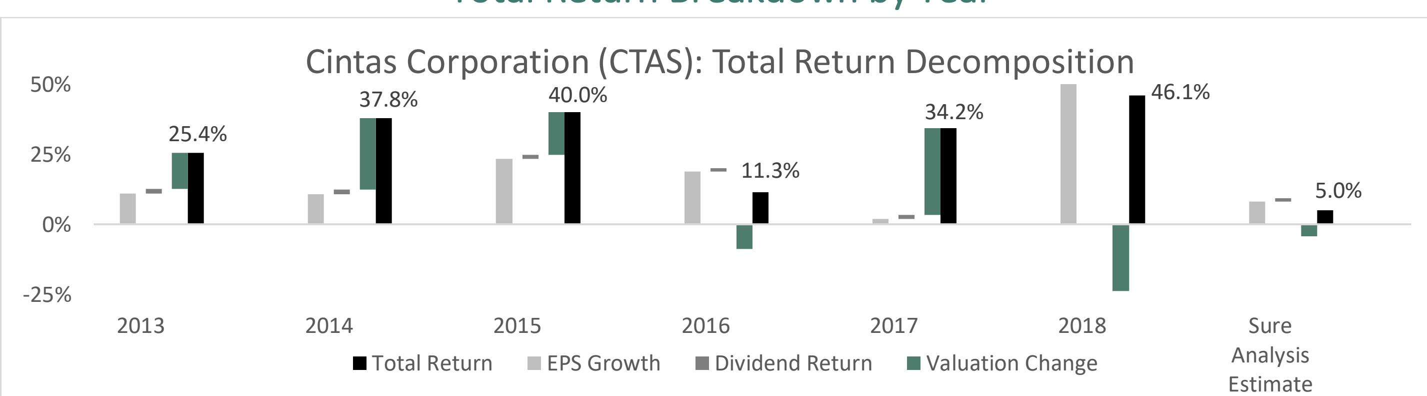
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	21%	26%	32%	29%	24%	25%	28%	25%	26%	32%	***28%***	***32%***

Cintas Corporation's debt as a proportion of its total assets has ballooned following the G&K Services acquisition. Accordingly, we expect the company to focus on debt repayment over the next several years. Conservative investors should also note that Cintas' gross profits as a percent of total assets are quite high, and the company's below-average payout ratio leaves room for continued dividend growth in the event that earnings growth slows.

Final Thoughts & Recommendation

Our recommendation on Cintas remains unchanged from last quarter. The fundamentals of the business are still attractive as the company is performing well. However, the stock remains overvalued despite the significant recent selloff, and we expect only 5% annual total returns to shareholders in the coming years. The company's impressive 8% forecast earnings growth rate will be partially offset by a 4.3% headwind from a lower valuation, and the diminutive yield of just 1.3% is not attractive. As a result, we are reiterating our sell recommendation on the stock.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	3775	3547	3810	4102	4246	4194	4370	4796	5323	6477
Gross Profit	1551	1498	1609	1739	1753	1750	1893	2101	2380	2909
Gross Margin	41.1%	42.2%	42.2%	42.4%	41.3%	41.7%	43.3%	43.8%	44.7%	44.9%
SG&A Exp.	1083	1110	1169	1199	1187	1147	1209	1332	1527	1917
D&A Exp.	158	152	193	194	189	191	155	165	197	279
Operating Profit	468	388	440	540	566	603	684	769	853	992
Operating Margin	12.4%	10.9%	11.6%	13.2%	13.3%	14.4%	15.6%	16.0%	16.0%	15.3%
Net Profit	226	216	247	298	315	374	431	694	481	843
Net Margin	6.0%	6.1%	6.5%	7.3%	7.4%	8.9%	9.9%	14.5%	9.0%	13.0%
Free Cash Flow	363	455	158	309	356	460	363	190	491	692
Income Tax	135	128	146	173	184	199	238	257	230	57

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	3721	3970	4352	4166	4346	4462	4192	4099	6844	6958
Cash & Equivalents	130	411	438	340	352	513	417	139	169	139
Accounts Receivable	358	362	429	451	496	508	496	546	736	805
Inventories	202	169	250	251	240	251	226	249	278	280
Goodwill & Int. Ass.	1456	1460	1590	1562	1610	1325	1232	1356	3401	3422
Total Liabilities	1354	1436	2049	2027	2144	2270	2260	2256	4541	3942
Accounts Payable	70	72	110	95	121	150	110	111	177	215
Long-Term Debt	787	786	1286	1285	1309	1301	1300	1294	3134	2535
Shareholder's Equity	2367	2534	2303	2139	2201	2193	1932	1843	2303	3017
D/E Ratio	0.33	0.31	0.56	0.60	0.59	0.59	0.67	0.70	1.36	0.84

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	6.0%	5.6%	5.9%	7.0%	7.4%	8.5%	10.0%	16.7%	8.8%	12.2%
Return on Equity	9.8%	8.8%	10.2%	13.4%	14.5%	17.0%	20.9%	36.7%	23.2%	31.7%
ROIC	7.1%	6.7%	7.1%	8.5%	9.1%	10.7%	12.8%	21.8%	11.2%	15.3%
Shares Out.	153	153	138	127	122	117	112	104	105	106
Revenue/Share	24.68	23.21	25.99	31.55	34.10	34.48	37.18	43.62	49.39	58.98
FCF/Share	2.38	2.97	1.08	2.38	2.86	3.78	3.08	1.73	4.55	6.31

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.