



# Cintas Corporation (CTAS)

Updated March 24<sup>th</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$195	<b>5 Year CAGR Estimate:</b>	1.4%	<b>Volatility Percentile:</b>	43.4%
<b>Fair Value Price:</b>	\$130	<b>5 Year Growth Estimate:</b>	8.0%	<b>Momentum Percentile:</b>	75.9%
<b>% Fair Value:</b>	150%	<b>5 Year Valuation Multiple Estimate:</b>	-7.7%	<b>Growth Percentile:</b>	75.7%
<b>Dividend Yield:</b>	1.1%	<b>5 Year Price Target</b>	\$192	<b>Valuation Percentile:</b>	4.2%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	6.3%

## 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 \$20 billion with 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 Q3 earnings on 3/21/2019 and results missed consensus expectations. Revenue was up 5.9% in Q3, but was fractionally lower than expectations. On an organic basis, revenue was up 6% during the quarter. The Uniform Rental and Facility Services segment saw its revenue rise 6.2%, while the First Aid and Safety Services segment was up 8.6%. Management said some revenue weakness was caused by severe winter weather during the quarter and that as customers closed their offices, it created challenges for its route schedules. That implies revenue weakness seen in Q3 will be temporary, but Cintas did trim its revenue guidance for the year after Q3.

Adjusted operating margins rose 90bps in Q3, from 15.7% to 16.6% of revenue. The gains came from an 80bps gain in gross margins, as the Uniform Rental and Facility Services segment saw its gross margins rise 80bps, while the First Aid and Safety Services segment produced a 130bps gain in Q3.

In total, adjusted earnings-per-share came in at \$1.84 in Q3, a 34.3% year-over-year gain. Through the first three quarters of the year, Cintas has produced a 32.9% gain in adjusted earnings-per-share. Guidance was bumped from a midpoint of \$7.34 to a new midpoint of \$7.45 with one quarter remaining; we've moved our estimate accordingly.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.83	\$1.49	\$1.68	\$2.27	\$2.52	\$2.79	\$3.44	\$4.09	\$4.17	\$7.03	<b>\$7.45</b>	<b>\$10.95</b>
<b>DPS</b>	\$0.47	\$0.48	\$0.49	\$0.54	\$0.64	\$0.77	\$0.85	\$1.05	\$1.33	\$1.62	<b>\$2.05</b>	<b>\$3.50</b>
<b>Shares</b>	153	153	138	127	122	117	112	104	105	106	<b>107</b>	<b>100</b>

Cintas has compounded its earnings-per-share at a rate of about 8% 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 \$10.95.

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. Q3 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 along with the company's share repurchase program, which will help as well by reducing the float.

*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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## 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	<b>26.1</b>	<b>17.5</b>
Avg. Yld.	1.4%	1.9%	1.8%	1.8%	1.6%	1.5%	1.4%	1.2%	1.2%	1.2%	<b>1.1%</b>	<b>1.8%</b>

Cintas' price-to-earnings ratio has varied from ~14 to ~26 over the last decade. However, we see fair value at 17.5 times earnings. This compares quite unfavorably to the current price-to-earnings ratio of 26.1. If the company's valuation reverts to 17.5 times earnings over the next five years, this will introduce a meaningful 7.7% annual headwind to the company's annualized returns. Shares sold off somewhat recently, but they remain elevated near \$200; our fair value estimate is just \$130.

## 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%	<b>28%</b>	<b>32%</b>

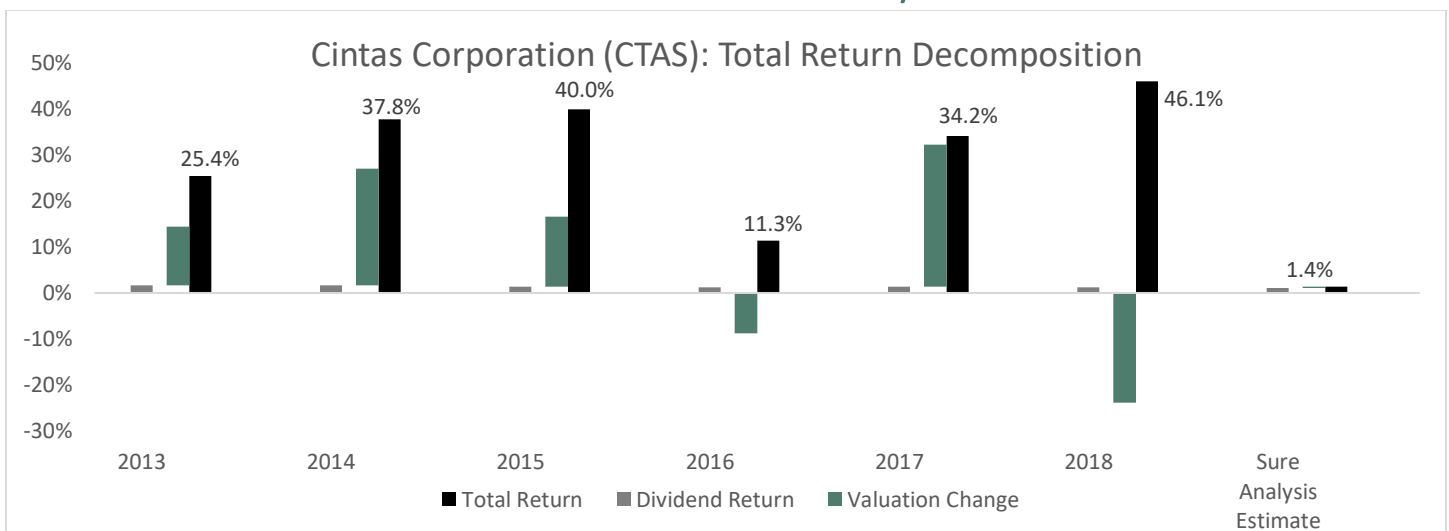
Cintas' payout ratio has always been quite low, and that is no different today. We see the dividend remaining around 30% of earnings for the foreseeable future with years of steady increases on the way.

Cintas' competitive advantage is in its massive size and scale, being the largest company of its kind. It has a huge customer book and these customers have relatively high switching costs, so retention is strong. However, recessions aren't kind to Cintas as it serves businesses and revenue is dependent upon its customers' headcount. When a recession strikes and unemployment rises, Cintas' earnings will suffer.

## 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 earnings-related selloff, and we expect only 1.4% annual total returns to shareholders in the coming years. The company's impressive 8% forecasted earnings growth rate will be mostly offset by a 7.7% headwind from a lower valuation, and the diminutive yield of just 1.1% is not attractive. As a result, we are reiterating our sell recommendation on the stock.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	3775	3547	3810	4102	4246	4194	4370	4796	5323	6477
<b>Gross Profit</b>	1551	1498	1609	1739	1753	1750	1893	2101	2380	2909
<b>Gross Margin</b>	41.1%	42.2%	42.2%	42.4%	41.3%	41.7%	43.3%	43.8%	44.7%	44.9%
<b>SG&amp;A Exp.</b>	1083	1110	1169	1199	1187	1147	1209	1332	1527	1917
<b>D&amp;A Exp.</b>	158	152	193	194	189	191	155	165	197	279
<b>Operating Profit</b>	468	388	440	540	566	603	684	769	853	992
<b>Operating Margin</b>	12.4%	10.9%	11.6%	13.2%	13.3%	14.4%	15.6%	16.0%	16.0%	15.3%
<b>Net Profit</b>	226	216	247	298	315	374	431	694	481	843
<b>Net Margin</b>	6.0%	6.1%	6.5%	7.3%	7.4%	8.9%	9.9%	14.5%	9.0%	13.0%
<b>Free Cash Flow</b>	363	455	158	309	356	460	363	190	491	692
<b>Income Tax</b>	135	128	146	173	184	199	238	257	230	57

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	3721	3970	4352	4166	4346	4462	4192	4099	6844	6958
<b>Cash &amp; Equivalents</b>	130	411	438	340	352	513	417	139	169	139
<b>Accounts Receivable</b>	358	362	429	451	496	508	496	546	736	805
<b>Inventories</b>	202	169	250	251	240	251	226	249	278	280
<b>Goodwill &amp; Int. Ass.</b>	1456	1460	1590	1562	1610	1325	1232	1356	3401	3422
<b>Total Liabilities</b>	1354	1436	2049	2027	2144	2270	2260	2256	4541	3942
<b>Accounts Payable</b>	70	72	110	95	121	150	110	111	177	215
<b>Long-Term Debt</b>	787	786	1286	1285	1309	1301	1300	1294	3134	2535
<b>Shareholder's Equity</b>	2367	2534	2303	2139	2201	2193	1932	1843	2303	3017
<b>D/E Ratio</b>	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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	6.0%	5.6%	5.9%	7.0%	7.4%	8.5%	10.0%	16.7%	8.8%	12.2%
<b>Return on Equity</b>	9.8%	8.8%	10.2%	13.4%	14.5%	17.0%	20.9%	36.7%	23.2%	31.7%
<b>ROIC</b>	7.1%	6.7%	7.1%	8.5%	9.1%	10.7%	12.8%	21.8%	11.2%	15.3%
<b>Shares Out.</b>	153	153	138	127	122	117	112	104	105	106
<b>Revenue/Share</b>	24.68	23.21	25.99	31.55	34.10	34.48	37.18	43.62	49.39	58.98
<b>FCF/Share</b>	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.

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