Cintas Corporation (CTAS)

Updated July 19th, 2019 by Josh Arnold

Key Metrics

Current Price:	$261	**5 Year CAGR Estimate:**	-2.1%	**Volatility Percentile:**	41.8%
Fair Value Price:	$147	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	85.5%
% Fair Value:	177%	**5 Year Valuation Multiple Estimate:**	-10.9%	**Growth Percentile:**	76.0%
Dividend Yield:	0.8%	**5 Year Price Target**	$215	**Valuation Percentile:**	2.6%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	3.6%

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 $27 billion with annual revenues in excess of $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 Q4 and full-year earnings on 7/16/19 and results were very strong once again. Revenue was up 7.4% in Q4 to $1.79 billion. The gain was from organic revenue growth of 7.6%, which adjusts for the impact of acquisitions and forex translation. The company's Uniform segment showed organic revenue growth of 6.8% while its First Aid segment rose 10.7% on an organic basis. Cintas continued its very impressive track record of revenue growth.

Gross profit was up 9.5% in dollar terms in Q4, rising from 45.1% to 45.9% in percentage of revenue terms. Both segments reported higher gross margins against the year-ago period.

Operating income was up 18.4% in dollar terms and as a percentage of revenue, moved 160bps higher to 17.5%. On an adjusted basis, which excludes integration expenses related to the G&K acquisition, operating margin rose 80bps from 16.8% of revenue to 17.6%.

Earnings-per-share rose from $1.68 to $2.06 in Q4. Adjusting for the G&K acquisition, earnings-per-share rose 17% from $1.77 to $2.07. Management guided for revenue of $7.24 billion to $7.31 billion and earnings-per-share of $8.30 to $8.45; our initial estimate is $8.38 for this year, representing ~10% growth over fiscal 2019.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.49	$1.68	$2.27	$2.52	$2.79	$3.44	$4.09	$4.17	$7.03	$7.60	***$8.38***	***$12.31***
DPS	$0.48	$0.49	$0.54	$0.64	$0.77	$0.85	$1.05	$1.33	$1.62	$2.05	***$2.15***	***$3.50***
Shares	153	138	127	122	117	112	104	105	106	108	***107***	***100***

Cintas has compounded its earnings-per-share at a rate of about 18% since 2010. 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 2020 earnings guidance gives a 2025 earnings-per-share estimate of $12.31.

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 generate between $130 million and $140 million of annual cost synergies. SG&A costs are being 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. Indeed, operating margin moved significantly higher in Q4 due to this. 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. Cintas also continues to boost organic revenue at very impressive rates, which we believe will be a primary driver of earnings-per-share growth moving forward.

The dividend is paid annually and we expect it will be raised in November of 2019 once again.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	13.8	17.9	16.6	14.9	16.6	19.4	21.4	21.5	27.2	25.9	***31.1***	***17.5***
Avg. Yld.	1.9%	1.8%	1.8%	1.6%	1.5%	1.4%	1.2%	1.2%	1.2%	1.0%	***0.8%***	***1.6%***

Cintas' price-to-earnings ratio has varied from ~14 to ~27 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 31.1, which is extremely high on an absolute basis and against the company's own historical valuations. If the company's valuation reverts to 17.5 times earnings over the next five years, this will introduce an enormous 10.9% annual headwind to the company's annualized returns. Shares have moved higher by about a third since our last update, making them more expensive than they've been at any time in the past decade. Indeed, the stock is 177% of our estimate of fair value today.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	26%	32%	29%	24%	25%	28%	25%	26%	32%	27%	***26%***	***28%***

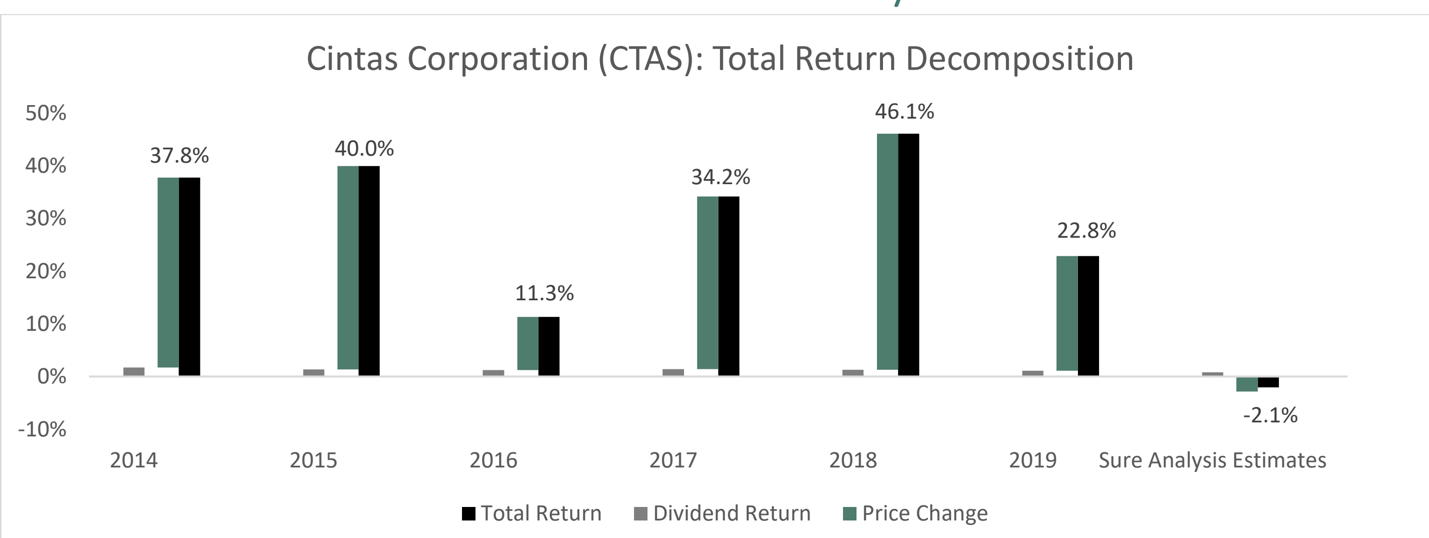
Cintas' payout ratio has always been quite low, and that is no different today. We see the dividend remaining under 30% of earnings for the foreseeable future with years of steady increases on the way.

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 very overvalued, and we expect -2.1% annual total returns to shareholders in the coming years. The company's impressive 8% forecasted earnings growth rate could be offset by a 10.9% headwind from a lower valuation, and the diminutive yield of just 0.8% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3547	3810	4102	4246	4194	4370	4796	5323	6477	6892
Gross Profit	1498	1609	1739	1753	1750	1893	2101	2380	2909	3129
Gross Margin	42.2%	42.2%	42.4%	41.3%	41.7%	43.3%	43.8%	44.7%	44.9%	45.4%
SG&A Exp.	1110	1169	1199	1187	1147	1209	1332	1527	1917	1981
D&A Exp.	152	193	194	189	191	155	165	197	279	360
Operating Profit	388	440	540	566	603	684	769	853	992	1148
Operating Margin	10.9%	11.6%	13.2%	13.3%	14.4%	15.6%	16.0%	16.0%	15.3%	16.7%
Net Profit	216	247	298	315	374	431	694	481	843	885
Net Margin	6.1%	6.5%	7.3%	7.4%	8.9%	9.9%	14.5%	9.0%	13.0%	12.8%
Free Cash Flow	455	158	309	356	460	363	190	491	692	791
Income Tax	128	146	173	184	199	238	257	230	57	220

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3970	4352	4166	4346	4462	4192	4099	6844	6958	7437
Cash & Equivalents	411	438	340	352	513	417	139	169	139	97
Accounts Receivable	362	429	451	496	508	496	546	736	805	910
Inventories	169	250	251	240	251	226	249	278	280	335
Goodwill & Int. Ass.	1460	1590	1562	1610	1325	1232	1356	3401	3422	3337
Total Liabilities	1436	2049	2027	2144	2270	2260	2256	4541	3942	4434
Accounts Payable	72	110	95	121	150	110	111	177	215	226
Long-Term Debt	786	1286	1285	1309	1301	1300	1294	3134	2535	2850
Shareholder's Equity	2534	2303	2139	2201	2193	1932	1843	2303	3017	3003
D/E Ratio	0.31	0.56	0.60	0.59	0.59	0.67	0.70	1.36	0.84	0.95

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.6%	5.9%	7.0%	7.4%	8.5%	10.0%	16.7%	8.8%	12.2%	12.3%
Return on Equity	8.8%	10.2%	13.4%	14.5%	17.0%	20.9%	36.7%	23.2%	31.7%	29.4%
ROIC	6.7%	7.1%	8.5%	9.1%	10.7%	12.8%	21.8%	11.2%	15.3%	15.5%
Shares Out.	153	138	127	122	117	112	104	105	106	108
Revenue/Share	23.21	25.99	31.55	34.10	34.48	37.18	43.62	49.39	58.98	62.95
FCF/Share	2.97	1.08	2.38	2.86	3.78	3.08	1.73	4.55	6.31	7.23

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