Cintas Corporation (CTAS)

Updated December 28th, 2019 by Josh Arnold

Key Metrics

Current Price:	$269	**5 Year CAGR Estimate:**	-2.2%	**Market Cap:**	$28B
Fair Value Price:	$152	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	11/05/20[1]
% Fair Value:	177%	**5 Year Valuation Multiple Estimate:**	-10.8%	**Dividend Payment Date:**	12/04/20[2]
Dividend Yield:	0.9%	**5 Year Price Target**	$224	**Years Of Dividend Growth:**	36
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	24.4%

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 $28 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 36 years of consecutive dividend increases.

Cintas reported Q2 earnings on December 17th and results were once again strong. Revenue was up 7% as organic revenue was up by the same amount. Growth was stronger for the First Aid and Safety Services business at nearly 11%.

Gross margin was up 10% during the quarter as margins were 46.2% of revenue against 45.1% in the year-ago period. Both of the company's operating segments saw gross margins improve, with the Uniform business up 130bps.

Operating income was up 21% from last year's Q2 as Cintas saw its operating margin rise 210bps to 18.1% of revenue. Last year's fiscal Q2 had a 50bps charge due to the G&K acquisition, but even accounting for that, operating margins rose nicely, adding 160bps.

Earnings-per-share came to $2.27 on an operating basis, up from $1.76 in the year-ago period. Guidance was boosted slightly to a new range of $8.60 to $8.80, so our new estimate reflects the midpoint of the updated range.

In addition, the company raised its annual dividend to $2.55, a boost of 50 cents over the prior payout, and the 36th consecutive year of dividend increases for Cintas.

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	***$8.70***	***$12.78***
DPS	$0.48	$0.49	$0.54	$0.64	$0.77	$0.85	$1.05	$1.33	$1.62	$2.05	***$2.55***	***$4.11***
Shares[3]	153	138	127	122	117	112	104	105	106	108	***107***	***100***

Cintas has compounded its earnings-per-share at a rate of about 19% 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 our updated 2020 earnings estimate gives a 2025 earnings-per-share estimate of $12.78.

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 generate between $130 million and $140 million of annual cost synergies, some of which have already accrued. 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 therefore removes redundancies. Indeed, operating margin moved significantly higher again in Q2 due to this. Revenue growth will also continue to drive earnings higher along with

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[1] Estimate

[2] Estimate

[3] Share count in millions

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.

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.

The dividend is paid annually and was raised late in 2019 once again, this time by 25%.

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	***30.9***	***17.5***
Avg. Yld.	1.9%	1.8%	1.8%	1.6%	1.5%	1.4%	1.2%	1.2%	1.2%	1.0%	***0.9%***	***1.8%***

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 30.9, 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 -10.8% annual headwind to the company's annualized returns. Shares have continued to move higher 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, making it one of the most expensive stocks in our coverage universe.

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%	***29%***	***32%***

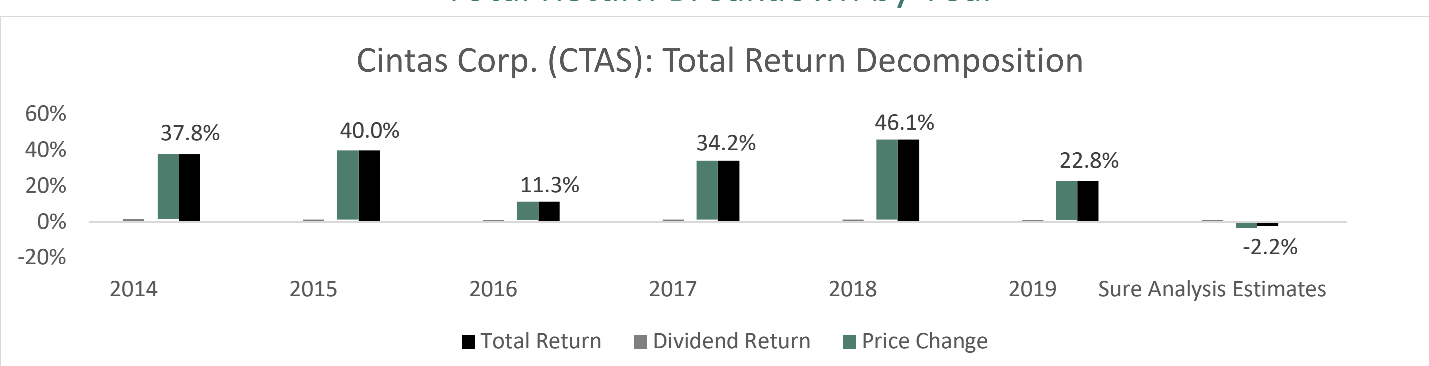
Cintas' payout ratio has always been quite low, and that is no different today. We see the dividend remaining under 35% of earnings for the foreseeable future with years of steady increases on the way.

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 are not 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 very well. However, the stock remains extremely overvalued in our view, and we expect -2.2% in annual losses to shareholders in the coming years. The company's impressive 8% forecasted earnings growth rate could be offset by a -10.8% headwind from a lower valuation, and the diminutive yield of just 0.9% 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	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.