Cintas

Industrials
NASDAQ: CTAS
Market Outperform | Buy

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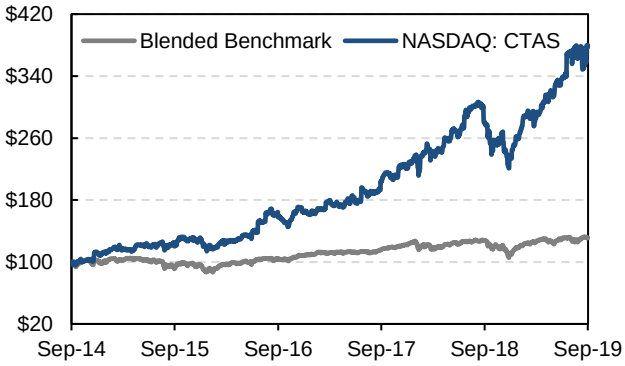
Return on Investment	
Current Share Price	$268.10
Target Price	$320.00
Dividend Yield	0.76%
Holding Period Return	20%
Company Quality (CQ) Score	3.6
Conviction Rating	2

Market Profile	
52-Week Range	$155.98 - $270.36
Market Capitalization (US$mm)	$27,888
Net Debt (US$mm)	$2,770
Enterprise Value (US$mm)	$30,657
Beta (5-Year Monthly)	0.98

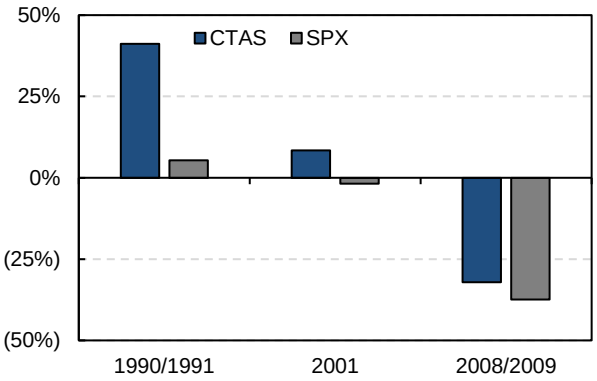
Metrics	2019A	2020E	2021E
Revenue (US$mm)	$6,892	$7,317	$7,767
Operating Income (US$mm)	$1,148	$1,238	$1,461
EBITDA (US$mm)	$1,508	$1,594	$1,830
Total Debt/EBITDA	1.90x	1.80x	1.57x
EV/EBITDA	20.3x	19.2x	16.8x

Historical Trading Performance (Indexed to $100)



Source: Bloomberg

Figure 1: Performance in the Last Three Recessions



Source: Bloomberg

Business Description

Cintas (NASDAQ: CTAS) is a leading uniform rental company that provides a number of commercial products and services to its customers, such as floor care, restroom supplies, doormats, first aid and safety products, fire extinguishers and testing, and safety training. CTAS provides its products and services to over one million businesses, primarily in North America, with additional services in Latin America, Europe, and Asia. CTAS's core segment is its Uniform Rental and Facility Services business, which is the top uniform supplier in the U.S. with over five million people wearing its uniforms every day. Founded in 1968, CTAS has grown sales and net income in 48 of the past 50 years, and has increased its annual dividend for 35 consecutive years.

Investment Thesis

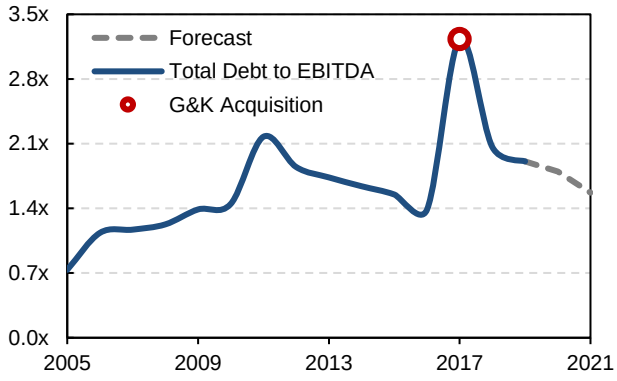
The CPMT views CTAS as an opportunity to add a top tier name for several reasons: **(1) steady and growing free cash flow** (14.4% CAGR since 2012) with a track record of returning capital to shareholders ($3.5B in total share repurchases and $1.1B in total dividends since 2012), **(2) a strong balance sheet** at 1.9x Total Debt/LTM EBITDA, **(3) quality management** with exceptional operating performance (beat consensus EPS estimates in 8 of the last 8 quarters) and high levels of insider ownership (the CEO holds 15% of outstanding shares and insiders account for ~19%), and **(4) CTAS's competitive advantage**, where it is the market share leader (21%) amongst its peers (NYSE: ARMK, UNF) at 8% and 6%, respectively. The market is largely untapped, and CTAS has a significant opportunity to increase its market penetration (the Company estimates its current penetration is less than 20% of its potential customer base). The CPMT believes that CTAS provides a compelling combination of growth and defensiveness given: (1) its competitive positioning and operating excellence, and (2) the nature of its core business: renting and servicing of uniforms and other garments, mats, mops, restroom cleaning services and supplies, and carpet and tile cleaning.

Although CTAS's core business is tied to uniform rentals and thus is sometimes viewed as representing a proxy for job growth, this correlation has weakened over the last 7 years, and the CPMT strongly believes that the Company is positioned to outperform in the next economic downturn. In the three most recent recessionary timeframes (7/31/1990 – 3/31/1991, 3/31/2001 – 11/30/2001, and 12/31/2007 – 6/30/2009), CTAS outperformed the S&P 500 Index in all three periods by 36%, 10%, and 5%, respectively (Figure 1). The CPMT recommends a buy on the stock with a target price of $320 based on our valuation discussed below.

Valuation

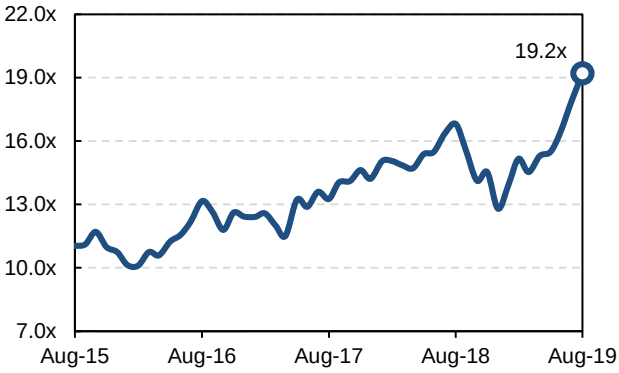
While the CPMT believes that the Company meets all of the criteria of our mandate, our main focus with CTAS is determining: (1) whether the premium the stock has relative to its peers is reasonable (CTAS's LTM EV/EBITDA multiple is 20.3x versus UNF at 10.1x and ARMK at 11.5x), (2) whether this premium is sustainable in the long-term, and (3) if CTAS's current market valuation represents a discount to intrinsic value. We valued CTAS based on a 5-year DCF with its terminal value based on an equal blend of Gordon Growth (6.75% WACC and 2.25% terminal growth rate) and an exit multiple of 18.0x EV/EBITDA. The CPMT believes that our target price is conservative, as it is in line with management guidance for revenue in 2020, and management has consistently shown the ability to beat its own guidance as well as street estimates. Our valuation excludes additional assumptions based on potential future (cont'd)

Figure 2: CTAS Leverage



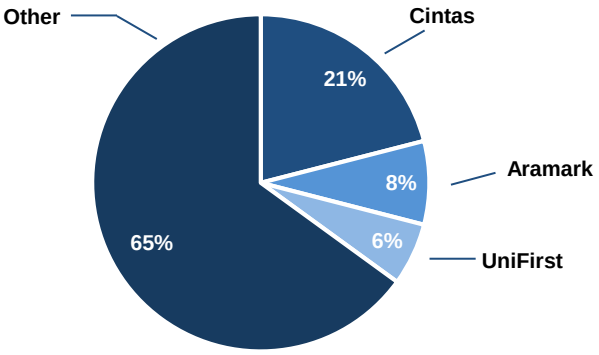
Source: Bloomberg, CPMT Estimates

Figure 3: CTAS EV/NTM EBITDA



Source: Bloomberg, CPMT Estimates

Figure 4: Uniform Services Market Share



Source: Street Research

acquisitions and transaction multiples and includes margin assumptions in line with historical results. Given that CTAS's Total Debt/LTM EBITDA is at 1.9x and the CPMT is confident that it could support leverage up to 3.5x, CTAS has considerable opportunity to pursue accretive acquisitions in the future that can provide additional upside to the stock. Management has shown the ability to successfully execute accretive acquisitions, evident by its most recent acquisition of G&K Services Inc in August 2016 for US$2.2B. The market viewed the deal positively, with CTAS trading up 5.19% on the day of the announcement, and the CPMT is confident that management has the discipline to pursue inorganic growth opportunities without overpayment. CTAS took on debt for the acquisition, bringing its Total Debt/LTM EBITDA to 3.2x (Figure 2), and management subsequently demonstrated its ability to quickly de-lever, bringing the Company back to 1.9x within 2 years. Risks to our target price represent rising input costs and any changes in CTAS's management team.

Management Team

CTAS's CEO and Chairman, Scott D. Farmer, has been with the Company for 38 years and has delivered excellent operational results during his tenure. He holds 15% of the Company's outstanding common shares, with a market value of ~US$4.2B. Under Farmer's leadership, CTAS has consistently beaten street estimates for EPS and operating income in each of the last five years. We believe this to be a product of conservative guidance and operational expertise. Farmer has also met or exceeded EPS and revenue growth targets linked to his compensation in each of the last three years.

Competitive Landscape

With its diverse array of business offerings, CTAS competes with a variety of peers in uniform services and the industrial services space. The Company's two most direct competitors are UNF and ARMK, both of which focus on providing uniform and facility services, with ARMK also offering food services. Together with CTAS, these three companies dominate the U.S. uniform and facility services market, with CTAS having the largest market cap of US$28B, which is more than twice the size of its next biggest competitor. CTAS's size has allowed it to realize economies of scale and cost synergies, which have contributed to high margins for the Company when compared to peers. CTAS's 2019 EBITDA margin was 22%, compared to 18% and 10% for UNF and ARMK, respectively.

Despite a mature business model, CTAS has the strongest growth and market penetration among peers, with a 5-year revenue CAGR of 10% and a 5-year EBITDA CAGR of 14%, versus the low single-digit growth seen by UNF and ARMK. This is evidence of CTAS's strong competitive advantages, combined with discretionary inorganic growth. Furthermore, CTAS has proven its ability to deploy capital effectively, generating the highest ROIC/WACC of its peer group at 2.6x, despite lower capital intensity than both UNF and ARMK (CTAS's capital expenditures averaged 23.8% of EBITDA over the last five years versus 33.5% for UNF and 44.5% for ARMK). Overall, CTAS has historically been the leader in its industry and is well-positioned to maintain its strong market presence going forward.

Next Steps

The CPMT recommends a buy on CTAS, and pending further due diligence, we are planning to initiate at a 2 conviction; however, we are willing to increase our conviction within the next six months if CTAS outpaces our organic growth expectations and retains its premium to peers. We believe CTAS suits our ongoing effort to position the portfolio defensively given its outperformance during the last three recessions and nature of its business model.