Cintas

Industrials
NASDAQ: CTAS
Market Perform | Hold

June 30, 2023
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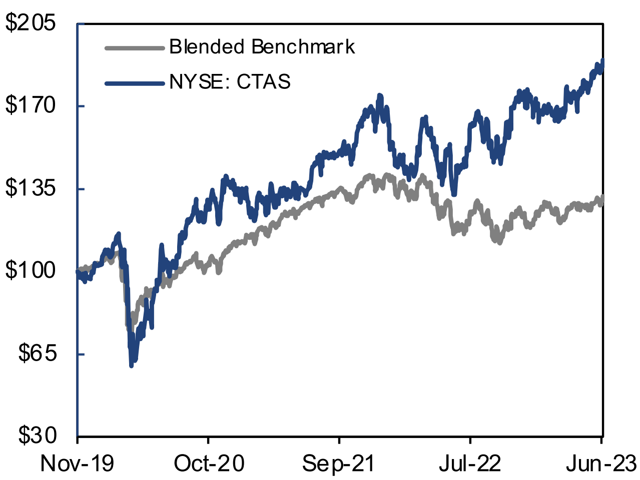
Return on Investment	
Current Share Price	$497.08
Target Price	$532.00
Dividend Yield	0.90%
Implied Return	8%
Conviction Rating	2

Market Profile	
52-Week Range	$363.59 - $497.97
Market Capitalization (US$mm)	$49,837
Net Debt (US$mm)	$2,829
Enterprise Value (US$mm)	$52,665
Beta (5-Year Monthly)	1.09

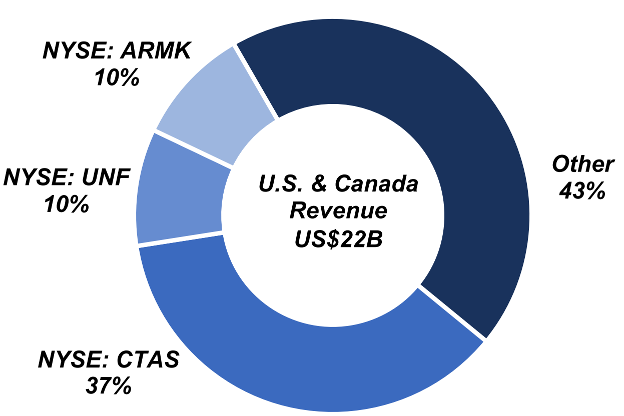
Metrics	**2024E**	**2025E**	**2026E**
Revenue (US$mm)	$9,423	$10,147	$10,955
EBITDA (US$mm)	$2,403	$2,589	$2,851
EPS (US$)	$14.29	$15.88	$17.81
EV/EBITDA	21.9x	20.3x	18.5x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Industrial Laundry & Linen Supply Market Share



Source: IBIS World

Business Description

Cintas (NASDAQ: CTAS) is a leading uniform rental company that designs, manufactures, and distributes workplace uniforms. The Company also provides various ancillary products and services, such as floor care, restroom supplies, doormats, first aid, safety products, fire extinguishers, and safety training. CTAS services over 1mm businesses, predominantly in North America, with additional services in Latin America, Europe, and Asia. The Company reports through three primary segments: (1) Uniform Rental and Facility Services, (2) First Aid and Safety Services, and (3) All Other. CTAS' core segment is Uniform Rental and Facility Services, which comprises ~80% of the Company's revenue.

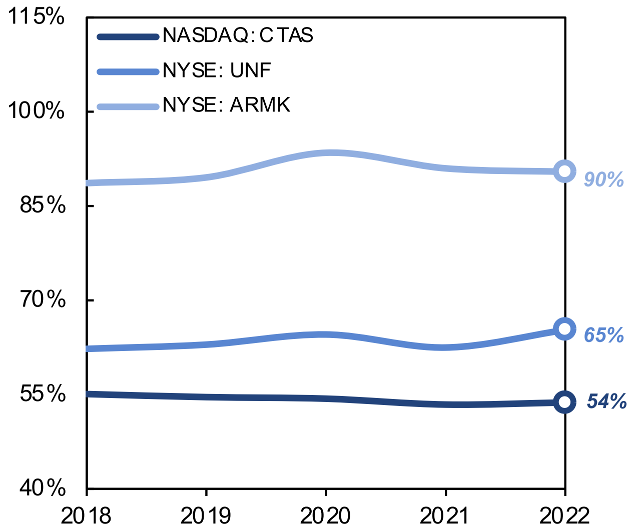
Industry Overview

CTAS dominates the highly fragmented U.S. industrial laundry and linen supply industry with the leading market share, exceeding its closest competitors by ~27%, with the other largest players holding only ~10% of the total market share. Companies within the industry have historically achieved economies of scale through M&A activity, diversifying product and service offerings, as well as expanding the number of routes available for product delivery. Larger and more diversified operators have a greater capacity to pivot operating models to accommodate changing industry trends, which creates natural barriers to entry.

The industrial laundry and linen supply industry is driven by downstream markets, which include manufacturers, healthcare organizations, hotels, and food service establishments. During the COVID-19 pandemic, operators experienced drastic declines in demand for uniform and laundry services, particularly from the food and hospitality industries, while demand from the healthcare services industry significantly increased. Top-line growth of companies without diversified customer bases were negatively impacted by this trend. Following the end of the pandemic, steady demand is expected by healthcare facilities due to additional healthcare employees, while a slower recovery may be experienced by food services and hospitality industries due to a reduced number of end customers. A further catalyst for demand growth in the industry is businesses continuing to outsource laundry and uniform rental services as a means of lowering operating costs and combating inflationary pressure.

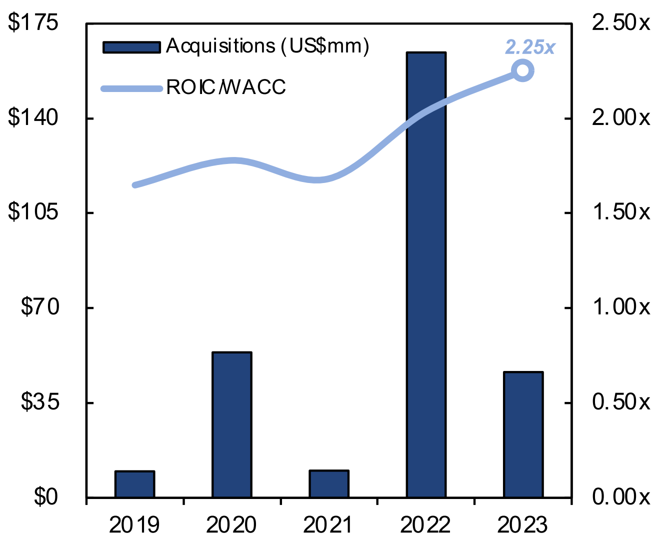
Implementation of new technology in the industrial laundry and linen supply industry has historically been dependent on company size and market share. Larger operators can afford to invest capital into the development of proprietary technologies that can optimize operating expenses and overall margins. This acts as a barrier to entry for smaller firms in the industry, which have benefited in the past from implementing cost-effective and mature technologies. Recently, larger players such as CTAS have achieved operating cost advantages by implementing technologies such as automation, RFID, and A.I. systems. The extensive capital required to develop these systems leaves small companies with low R&D budgets at a considerable disadvantage. This allows for the largest companies in the industrial linen industry to continue to expand market shares.

Figure 2: COGS as a Percentage of Revenue vs Peers



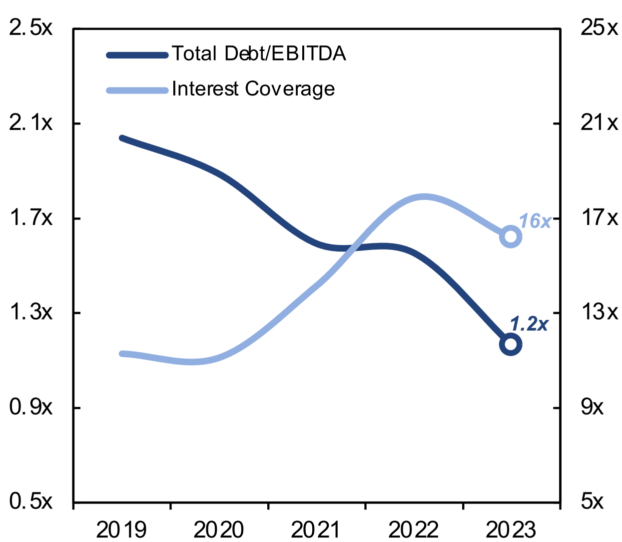
Source: S&P Capital IQ

Figure 3: LHS Acquisitions vs RHS ROIC/WACC



Source: Bloomberg

Figure 4: LHS Total Debt/EBITDA vs RHS Interest Coverage



Source: S&P Capital IQ

Mandate Fit

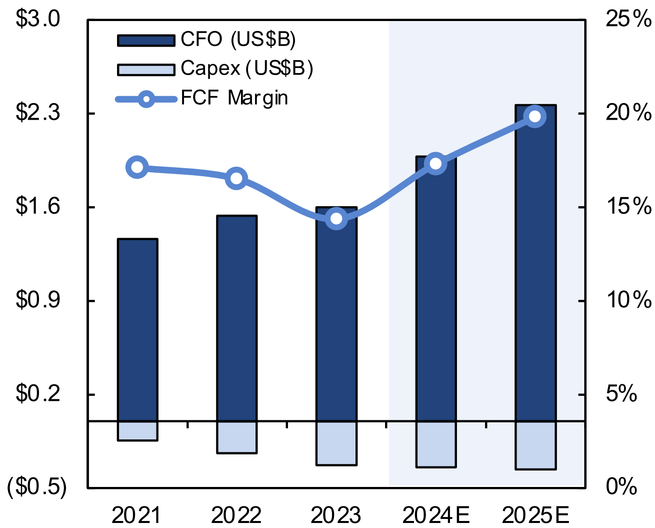
Quality Management: CTAS possesses a highly experienced management team led by President and CEO Todd Schneider. He has over 30 years of experience with the Company and has held various executive positions within CTAS' rental division. Schneider assumed the role in 2021 from Scott Farmer, the son of former CEO Dick Farmer and grandson of founder Doc Farmer. Schneider has played a crucial role in the strong performance of the Company's flagship uniform division, as well as the successful acquisition integration of G&K's uniform operations in 2017. CTAS continues to benefit from operational insights from the Farmer family, given Scott Farmer's current role as Executive Chairman.

CTAS' management has a strong track record of consistently returning value to shareholders through share repurchases and dividends. The Company has also demonstrated successful tuck-in acquisition integration with a proven history of delevering after M&A activity. The transition from Farmer's leadership to Schneider has so far been seamless, and the CPMT is confident that Schneider will continue to demonstrate the same strong capital discipline as the Farmer family. CTAS' executive compensation structure is also favourable, as ~87% of CEO and 76% of NEO compensation is incentive-based.

Competitive Advantage: CTAS' primary competitive advantage is derived from its leading market share within the industrial laundry and linen supply industry, in addition to its diverse customer base. The Company's wide array of end markets provided stable revenue growth during COVID-19, while competitors operating in niche markets experienced revenue declines. Additionally, no single customer composes more than 1% of CTAS' total revenue, so customer turnover does not materially impact top-line growth. The Company has successfully completed acquisitions to expand its customer base and the number of delivery routes. CTAS can continue leveraging this strategy to complete tuck-in acquisitions as the laundry services and linen supply industry is largely fragmented. CTAS' size and operational scale have also allowed the Company to achieve vertical integration, providing CTAS with more control over its supply chain, as well as the opportunity to earn recurring revenue from restocking and inspection of equipment. As the number of delivery routes available to the Company expands, CTAS can continue to strive to lower restocking and inspection costs. This is accomplished by optimizing routes and route density and providing multiple products and services to customers with only a single delivery trip. The Company boasts a 95% customer retention rate, with a 99% retention rate for national account customers, who usually sign multi-year contracts at the national level. This enhances CTAS' opportunity to earn recurring revenue and upsell current customers on multiple product offerings, cementing the Company as a one-stop shop for uniform and ancillary products and services.

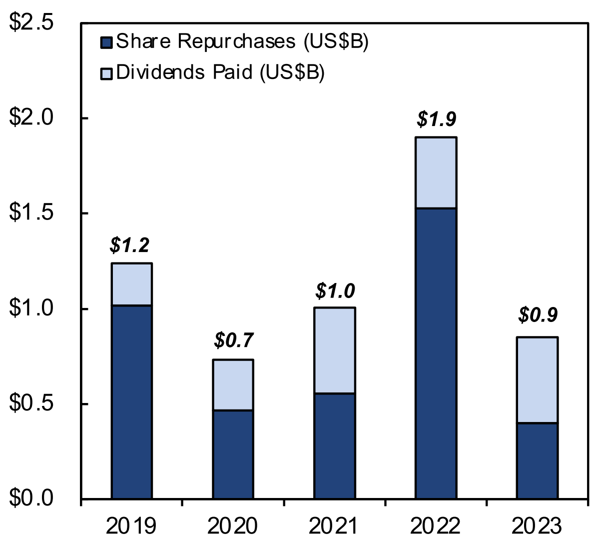
As margin efficiency is a key driver of expanding operations and growing market share in the industry, CTAS has invested in multiple technologies, such as A.I. and cloud-based software. For instance, CTAS' proprietary software, *SmartTruck,* reduces fuel costs by optimizing route density and reducing overall drive and idle times. The Company has also implemented SAP software into its operations to improve pricing and cross-selling opportunities. Specifically, CTAS can gather pricing information in real-time and adjust its prices to undercut competitors, which aids in market penetration and cross-selling. SAP also provides visibility in storage rooms and enables automatic order placement from (cont.)

Figure 5: LHS CFO and Capex vs RHS FCF Margin



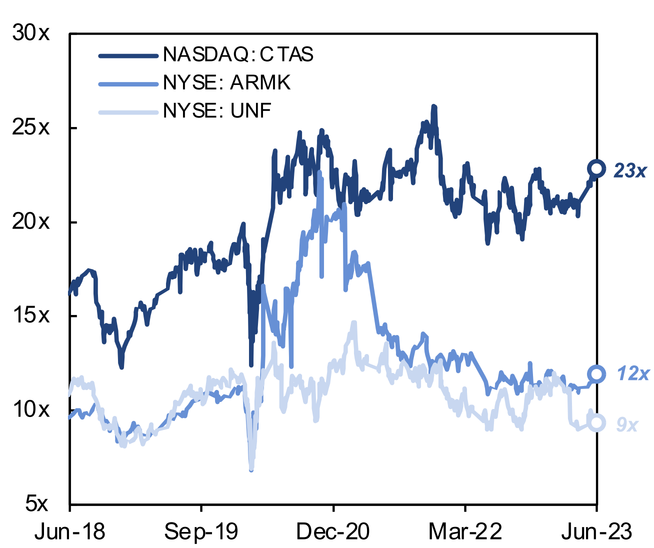
Source: CPMT Estimates, S&P Capital IQ

Figure 6: Return of Capital



Source: S&P Capital IQ

Figure 7: NTM EV/EBITDA vs Peers



Source: S&P Capital IQ

distribution centers which creates more efficient inventory tracking. The Company has also increased its focus on automation. In the laundry services segment, CTAS has integrated machines that automatically sort and group clothing for customers after they have been laundered, identify clothing needing repair, and machines that attach personalized accessories to uniforms, such as tags or bar codes. Automation of these processes lowers the number of employees required to operate this segment, which reduces wage expenses. Lastly, CTAS has partnered with Google (NASDAQ: GOOGL) to move client and vendor data to cloud-based infrastructures, which creates additional opportunities to lower operating costs.

Strong Balance Sheet: CTAS holds a strong balance sheet position, with a Total Debt/EBITDA ratio of 1.2x and a Net Debt/EBITDA ratio of 1.1x, compared to the peer averages of 3.1x and 2.6x, respectively. The Company paid down its senior notes that matured in 2023 as well as the outstanding amount of its commercial paper for a total consideration of ~US$249mm. As a result, CTAS does not hold any variable debt, which allows the Company to divert FCF allocation away from higher interest expense and towards capex and returning value to shareholders. Additionally, in 2022, CTAS amended the credit agreement supporting its commercial paper program, expanding the capacity of its revolving credit facility from US$1B to US$2B, The new agreement is currently undrawn., which provides ample liquidity for capex spending. CTAS also has A- and A3 credit ratings from S&P Global and Moody's, respectively.

Growing Free Cash Flow: CTAS has grown FCF at a 10% five-year CAGR. The Company has historically allocated a significant portion of its FCF to M&A, paying down outstanding long-term debt, conducting share repurchases, and paying dividends. As a result of CTAS paying down its 2023 senior notes, management has stated the Company will continue to search for strong M&A opportunities or conduct significant share repurchases as a possible alternative if valuations are unfavorable.

Investment Thesis and Valuation

CTAS was valued at US$532 using a five-year DCF with a WACC of 8.61%. The terminal value was determined through a 50/50 blend of (1) the Gordon Growth method, using a 3.00% terminal growth rate, and (2) an EV/EBITDA exit multiple of 23x. The Company has historically traded at a premium to its peers, which the CPMT believes is justified given CTAS' operational excellence and competitive advantage.

The CPMT views CTAS favorably, given its dominant market share, diverse customer base, industry-leading margins, and vertical integration. Given the Company's strong balance sheet position, CTAS is poised to take on new acquisition opportunities to grow its market share as well as expand its customer base and number of delivery routes. The Fund is confident that CTAS will continue to demonstrate capital and operational discipline when completing M&A, in addition to continued dividend payments and share repurchases. The Company can also continue introducing technology and A.I. initiatives into its operations to streamline workflow processes and further lower operating costs. However, the Fund believes that the market understands and appreciates the features that make CTAS such a strong company, which is reflected in the relatively low implied return. Thus, while the CPMT maintains conviction that CTAS will return its cost of equity, the Fund recognizes this as an opportunity to search for new names with higher alpha.