Cintas

Industrials
NASDAQ: CTAS
Market Outperform | Hold

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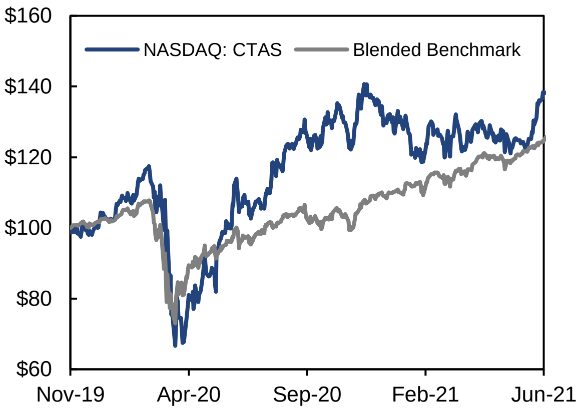
Return on Investment	
Current Share Price	$382.00
Target Price	$430.00
Dividend Yield	0.77%
Implied Return	13%
Conviction Rating	2

Market Profile	
52-Week Range	$266.14 - $382.52
Market Capitalization (US$mm)	$40,794
Net Debt (US$mm)	$2,213
Enterprise Value (US$mm)	$43,007
Beta (5-Year Monthly)	1.48

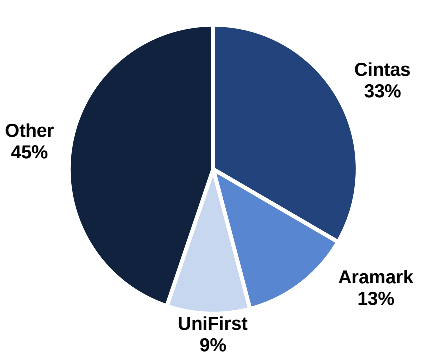
Metrics	2021E	2022E	2023E
Revenue (US$mm)	$7,107	$7,687	$8,191
EBITDA (US$mm)	$1,598	$1,710	$2,060
EPS	$10.22	$10.72	$11.64
EV/EBITDA	26.9x	25.2x	20.9x

Holding Period Return (Indexed to $100)



Source: Bloomberg

Figure 1: Uniform Services Market Share



Source: IBISWorld

Business Description

Cintas (NASDAQ: CTAS) is a leading uniform rental company that provides 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's products and services serve over 1mm 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 (generates ~95% of CTAS's revenue). It is the top uniform supplier in the U.S., with over 5mm people wearing its uniforms every day. CTAS divides its remaining segments into First Aid & Safety Services and All Other, both of which contribute to approximately half of the remaining 5% of revenue. Founded in 1968, CTAS has grown sales and net income in 49 of the past 51 years.

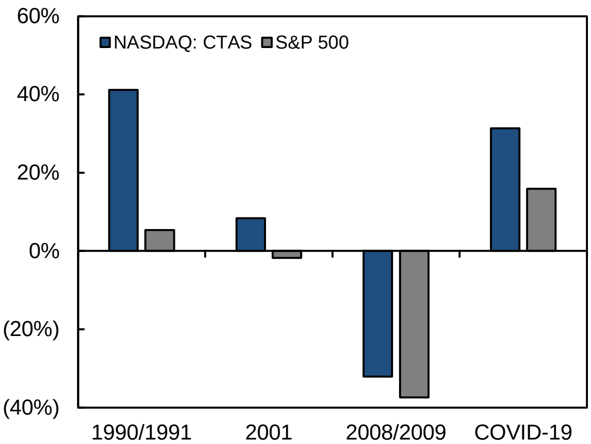
Industry Overview

CTAS is the largest player in the U.S. industrial laundry and linen supply industry, holding a market share of approximately 33.4%. The industry is primarily driven by downstream buyers in the manufacturing, food service, accommodation, and health care sectors, in which there is not only a high demand for rental and laundering services, but also high employee turnover. While the COVID-19 pandemic reduced the demand from the food services sector (-4.2%) and increased the demand from the health care sector (+1.7%), the outlook dictates slow growth in revenue and profitability over the next five years. The industry is in the mature phase of the life cycle, as intense and continual price-based competition is causing an increase in the market share concentration, expedited by the COVID-19 pandemic. Additionally, the market is highly saturated, and there is little room for technological innovation, resulting in rising barriers to entry. CTAS is well positioned to capitalize on these trends, as it is the dominant player in an industry that is unlikely to face any disruptive new entrants.

Mandate Fit

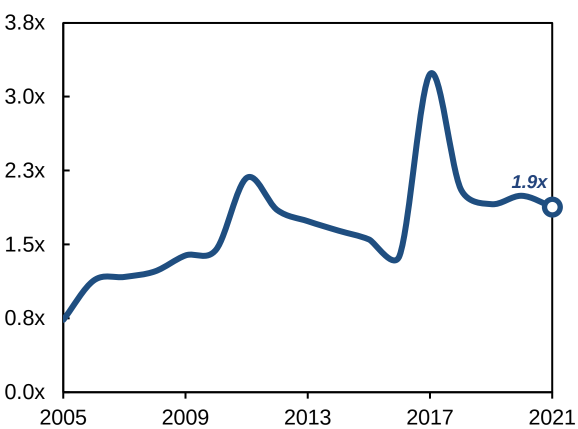
Quality Management: On June 1, 2021, Todd Schneider assumed the CEO position from Scott Farmer, who had held the position for 18 years. Scott Farmer is the grandson of CTAS founder Doc Farmer and the son of former CEO Dick Farmer. Having successfully navigated the Great Recession and the COVID-19 pandemic, Farmer proved CTAS's ability to consistently perform in unstable economic environments, a quality that was and continues to be a large part of the CPMT's investment thesis. Additionally, Farmer developed CTAS's target markets to include the hygiene, first aid, and fire industries, making CTAS the leading player in the industrial laundry and linen supply industry. Farmer will still be a part of the Company, acting as Executive Chairman instead. The transition from Farmer to Schneider is expected to be seamless, as Schneider has held prior positions in the Company such as Executive VP and COO of the rental division. His promotion is part of a comprehensive and multi-year succession plan that began a year ago, with Schneider becoming more active in investor calls over the last year.

Figure 2: Performance in the Last Four Recessions



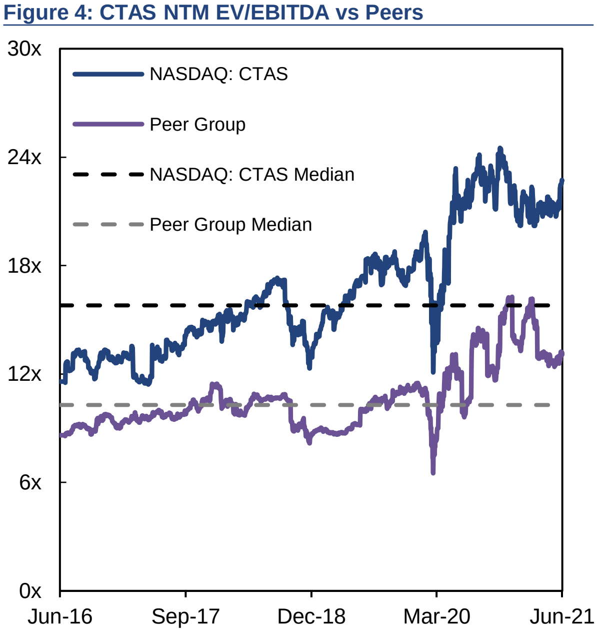
Source: Bloomberg, Company Filings, Street Research

Figure 3: CTAS LTM Total Debt/EBITDA



Source: Bloomberg

Figure 4: CTAS NTM EV/EBITDA vs Peers



Source: Bloomberg

Competitive Advantage: CTAS is well positioned to take advantage of economies of scale across the procurement, laundry, systems, and staffing areas due to its commanding market share in the industrial laundry and linen supply industry. The Company also boasts a customer retention rate of 95% and uses a multi-year contract scheme, which provides consistent and stable revenues through economic downturns, the most notable being the COVID-19 pandemic. In the 12 months following the pandemic's start, CTAS experienced a 1.5% decline in revenue relative to the 12 months prior. In contrast, CTAS's two main peers, Aramark (NYSE: ARMK) and UniFirst (NYSE: UNF), had a corresponding loss of 19.7% and 5.0%, respectively.

Balance Sheet: CTAS has continually paid down its debt with its growing FCF, which is reflected in its LTM Total Debt/EBITDA of 1.7x as of FQ3 2021, compared to 1.9x two years ago. S&P and Moody's both give CTAS an investment grade long-term credit rating (A- and A3 respectively), with S&P having shifted its outlook from negative to stable over the last quarter.

Growing Free Cash Flow: As of the end of FY2021, CTAS had a five-year FCF CAGR of 24.3%. While CTAS spends a significant portion of its FCF on its outstanding long-term debt, it consistently returns capital to its shareholders. Additionally, it has increased its annual dividend for 37 straight years.

ESG

In FY2020, the Company reduced its annual energy usage by 10% by optimizing its wash chemistry and laundry weights. Water usage is one of the top material ESG risk factors within the industrial laundry and linen supply industry. The Company returns 88.4% of its water withdrawals to the environment and uses 11% less water per pound of laundry compared to peer companies. The Textile Rentals Association of America indicates that CTAS uses 30% less energy than the industry average, which results in 10% lower GHG emissions, displaying their best-in-class ESG initiatives.

Risks

CTAS's revenues have a moderate, positive correlation with the growing permanent U.S. employment cycle (albeit less correlated than peers). CTAS may face increased environmental compliance and regulatory pressures within coming years due to the nature of the business. The Company also uses a global supply chain to source its supplies which offers potential supply chain disruption and foreign currency exchange risks.

Investment Thesis and Valuation

The CPMT reached a target price of $430.00 through a 50/50 blend of two methods: (1) a five-year DCF valuation assuming a WACC of 7.51% and a terminal growth rate of 1.5%; and (2) an exit multiple using a peer group median NTM EV/EBITDA of 13.2x. CTAS currently trades at a premium relative to peers, with a NTM EV/EBITDA of 23.3x; however, the CPMT believes that this is justified given the Company's operational stability, diverse end-market exposure, track record of outperformance and dividend growth, and overall mandate fit. CTAS is well positioned for the future as businesses prioritize employee health and workplace cleanliness throughout the pandemic and outsource noncore tasks such as laundry services and the maintenance of hand sanitizer stations. While competitors within the industry have underperformed, CTAS has been able to sustain operations while maintaining a strong outlook.