

## Cintas (CTAS) EQ Update 8/19 QTR

Current EQ Rating*	Previous EQ Rating
4+	4-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "-" sign indicates deterioration

\*For a more detailed explanation of the EQ Review Rating scale, please refer to the end of this report

**We are raising our earnings quality rating on CTAS to 4+ (Acceptable) given the lapping of the adoption of ASC 606 which, among other impacts, resulted in the capitalization of costs to obtain contracts.**

- CTAS reported EPS of \$2.32 which topped the consensus estimate by 17 cps. The effective tax rate of 10% was lower than most analysts were likely expecting. CTAS's tax rate can fluctuate considerably due to the impact of stock option exercises and management estimated in the call that the lower rate added about 6 cps which still makes the earnings beat look high quality.
- DSO jumped by just 1.2 days over the year-ago quarter. Note that the impact of the adoption of ASC 606 has now lapped eliminating the need to adjust receivables for a year-over-year comparison. Also gone is the impact of higher amortization of stock-based compensation due to a shortening of the amortization period last year.
- We are monitoring trends in capitalized contracts costs, deferred commissions, and related amortization expense and are all currently trending well.

- The company has ramped up its share buyback in the last three quarters as it has reduced its leverage to its target range after the G&K acquisition. Free cash flow after dividend and buyback was a negative \$455 million. The lower share count added over 3% to earnings growth in the period. Management is now talking potential acquisitions again and we would expect cash spend on the buyback to wane in coming quarters.

# Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

## Key Points to Understand About the EQ Score

**The EQ Review Rating is much more than a blind, quantitative scoring method.** While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

**The EQ Review Rating is not comparable to a traditional buy/sell rating.** The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

## Disclosure

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