ZACKS | Our Research. Your Success.

Jan 13, 2020

ServiceMaster (SERV)

$36.81 (As of 01/10/20)

Price Target (6-12 Months): **$39.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 12/23/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:F
	Value: D | Growth: F	Momentum: C

Summary

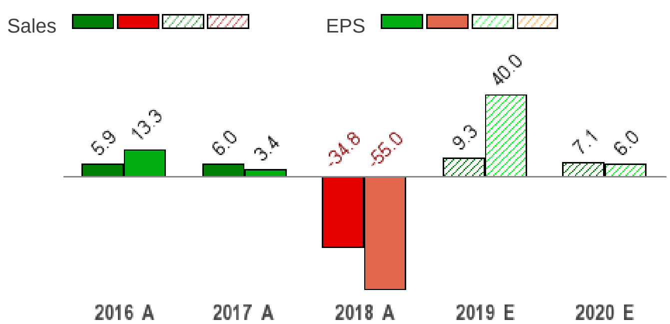
ServiceMaster's size and scale provide it competitive advantage in terms of purchasing power, operating and marketing efficiencies, and route density. The company enjoys brand awareness and a reputation of high-quality customer service. Its capital-light business model is characterized by strong Adjusted EBITDA margins and limited capital expenditure requirements. This model enjoys operating leverage from route density and fixed investments in infrastructure and technology. Acquisition remains an integral part of ServiceMaster's growth strategy. However, high cost of termite damage claims related to Formosan termite activity in the Mobile, Alabama is a concern. The company expects additional cost increase in 2020, which is likely to keep the bottom line under pressure, thereby weighing on the stock that has declined in the past year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$58.78 - $33.53**
20 Day Average Volume (sh)	**1,071,749**
Market Cap	**$5.0 B**
YTD Price Change	**-4.8%**
Beta	**0.45**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Building Products - Maintenance Service**
Zacks Industry Rank	**Bottom 5% (241 out of 254)**
Last EPS Surprise	**-13.9%**
Last Sales Surprise	**-0.4%**
EPS F1 Est- 4 week change	**-1.5%**
Expected Report Date	**02/25/2020**
Earnings ESP	**14.3%**
P/E TTM	**27.7**
P/E F1	**26.1**
PEG F1	**1.6**
P/S TTM	**2.5**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	521 E	598 E	569 E	530 E	2,224 E
2019	482 A	560 A	528 A	508 E	2,076 E
2018	675 A	874 A	873 A	457 A	1,900 A

EPS Estimates

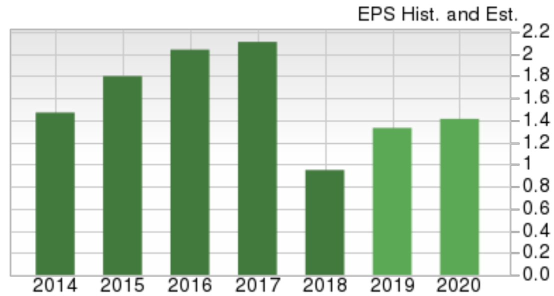
	Q1	Q2	Q3	Q4	Annual*
2020	$0.37 E	$0.51 E	$0.31 E	$0.23 E	$1.41 E
2019	$0.33 A	$0.50 A	$0.31 A	$0.19 E	$1.33 E
2018	$0.44 A	$0.79 A	$0.67 A	$0.19 A	$0.95 A

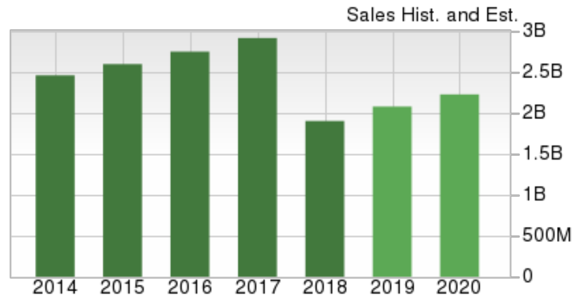
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/10/2020. The reports text is as of 01/13/2020.

Overview

Founded in 1929 and headquartered in Memphis, Tennessee, ServiceMasteris a leading provider of essential services to residential and commercial customers in the termite, pest control, cleaning and restoration markets. The company operates through an extensive network of more than 8,000 company-owned locations and franchise and license agreements.





The company's revenue streams are diversified across customers and geographies, allowing it to mitigate risks in any particular customer segment and geography. ServiceMaster's capital-light business model is characterized by strong Adjusted EBITDA margins and limited capital expenditure requirements. This model enjoys operating leverage from route density and fixed investments in infrastructure and technology.

ServiceMaster operates two reportable segments, **Terminix** and **ServiceMaster Brands**.

The Terminix segment provides termite and pest control services encompassing termite remediation, annual termite inspection and prevention treatments with damage claim guarantees, periodic pest control services, insulation services, mosquito control, crawlspace encapsulation, and wildlife exclusion.

The ServiceMaster Brands segment provides restoration, emergency response, commercial and residential cleaning, and information technology services. The segment operates under ServiceMaster, Terminix, Copesan, ServiceMaster Restore, ServiceMaster Clean, Merry Maids, Furniture Medic, and AmeriSpec trademarks and trade names.

ServiceMaster consists of an employee base of around 10,700 company associates and 34,000 employees of licensed franchisors. In 2018, the company had revenues, net loss and Adjusted EBITDA of $1,900 million, $41 million and $398 million, respectively. Terminix was the company's largest segment representing 87% of revenues, while ServiceMaster Brand represented the rest 13%.

ServiceMaster markets its services on a national and local level through the internet, direct mail, print advertisements,television and radio advertising, marketing partnerships,telemarketing, social media channels and national sales teams.

With nationwide presence, its segments are large, growing and highly fragmented.

Reasons To Buy:

Diversified revenue streams, strong margin capacity and limited capital expenditure requirements are positives for ServiceMaster.

- ServiceMaster's size and scale provide it competitive advantage in terms of purchasing power, operating and marketing efficiencies, and route density. The company enjoys brand awareness and a reputation of high-quality customer service. With nationwide presence, its segments are large, growing and highly fragmented. ServiceMaster is focused on improving its business through investments sales, marketing and advertising, as well as brand awareness and market penetration initiatives.

- The company's capital-light business model is characterized by strong Adjusted EBITDA margins and limited capital expenditure requirements. This model enjoys operating leverage from route density and fixed investments in infrastructure and technology. This helps generate productivity and expand margins through a number of initiatives such as metricdriven continuous improvement in customer care centers, application of consistent process guidelines at the branch level, leveraging size and scale to improve the sourcing of labor and materials, and deploying shared services models. The company has also deployed mobility solutions and routing and scheduling systems across many of its businesses in order to enhance overall efficiency and reduce operating costs.

- The company's revenue streams are diversified across customers and geographies, allowing it to mitigate risks in any particular customer segment and geography. Prudent investments and operational execution keep its revenues and adjusted EBITDA in agood shape. Consolidated revenue and Adjusted EBITDA grew at compound annual growth rates (CAGR) of 4% and 5%, respectively, from 2013 to 2018.

- Acquisition is an integral part of ServiceMaster's growth strategy. They have helped the company enhance offerings, expand geographic footprint and increase talent levels. From 2014 to 2018, the company completed around 75 acquisitions, out of which 20 were in 2018.

Reasons To Sell:

- ServiceMaster has a highly leveraged balance sheet. As of Sep 30, 2019, long-term debt was $1.39 billion while cash and cash equivalents were $140 million. Such a cash position implies that ServiceMaster needs to generate adequate amount of operating cash flow to service its debt. Also, high debt may limit the company's future expansion and worsen its risk profile.

- ServiceMaster's business is affected by weather conditions. Cooler temperatures and droughts obstruct development of termite swarms thus reducing demand for the company's termite control services. Pest control services and restoration services are also seasonal in nature. Seasonality causes considerable fluctuations in revenues and Adjusted EBITDA.

High debt, seasonality of business and high cost of termite damage claims are risks for ServiceMaster.

- Cost of termite damage claims related to Formosan termite activity in the Mobile, Alabama area has increased over the past few years. The company has also witnessed increase in the number of termite damage claims that involves litigation. These two trends have increased ServiceMaster's termite damage claim costs as a percentage of termite revenue between 7% and 8%. The company expects additional cost increase in 2020, which is likely to keep the bottom line under pressure, thereby weighing on the stock that has declined 28.4% in the past six months.

Last Earnings Report

ServiceMaster Lags Q3 Earnings & Revenue Estimates

Quarter Ending	09/2019
Report Date	Oct 22, 2019
Sales Surprise	-0.38%
EPS Surprise	-13.89%
Quarterly EPS	0.31
Annual EPS (TTM)	1.33

ServiceMaster reported disappointing third-quarter 2019 results wherein earnings and revenues missed the Zacks Consensus Estimate.

Results in Detail

Adjusted earnings per share of 31 cents missed the consensus mark by 13.9%. Revenues of $528 million missed the consensus estimate by 0.4%.

Operating income came in at $35 million and grew 10% year over year. Operating margin of 16% went up roughly 280 basis points.Adjusted EBITDA of $97 million grew 2% year over year. Adjusted EBITDA margin of 6.6% went up 160 basis points.

At the end of third-quarter 2019, the company had cash and cash equivalents of $140 million compared with $228 million at the end of prior quarter. Long-term debt was $1.39 billion compared with $1.25 billion at the end of prior quarter.

The company generated $55 million of cash from operating activities. Free cash flow came in at $49 million.

2019 Outlook

ServiceMaster expects 2019 revenues in the range of $2.07-$2.09 billion. Organic revenue growth at Terminix is expected to lie between 2.5% and 3%. Acquisition revenues are expected to be around $130 million. Adjusted EBITDA is expected between $415 million and $425 million.

Recent News

On **Dec 4, 2019,** ServiceMaster announced joining of Kim Scott as president of Terminix Residential.

On **Oct 22, 2019,** ServiceMaster announced acquisitions ofMcCloud Services and Gregory Pest Solutions.

Valuation

ServiceMaster hares are down 1.2% over the trailing 12-month period. The Zacks sub-industry is down 3.9% over the past year. Thebsector and S&P 500 index are up 39.1% and 28.3%, respectively in the same time frame.

The stock is currently trading at 25.93X forward 12-month price-to-earnings, which compares to 31.81X for the Zacks sub-industry, 25.29X for the Zacks sector and 18.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 38.95X and as low as 14.55X, with a 5-year median of 20.91X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $39.00 price target reflects 27.46X price-to-earnings.

The table below shows summary valuation data for SERV

Valuation Multiples - SERV

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	25.93	31.81	25.29	18.88
	5-Year High	38.95	40.63	25.29	19.34
	5-Year Low	14.55	18.48	18.76	15.17
	5-Year Median	20.51	26.5	20.56	17.44
P/S F12M	Current	2.24	3.03	3.98	3.5
	5-Year High	3.75	4.77	5.13	3.5
	5-Year Low	1.41	2.29	3.09	2.54
	5-Year Median	1.95	3.05	3.63	3
P/B TTM	Current	2.14	6.45	4.92	4.46
	5-Year High	13.73	12.53	6.73	4.47
	5-Year Low	1.98	6.26	4.13	2.85
	5-Year Median	7.43	10.3	5.32	3.61

As of 01/13/2020

Industry Analysis **Zacks Industry Rank:** Bottom 5% (241 out of 254)

Top Peers

ABM Industries Incorporated **(ABM)**	Neutral
Church & Dwight Co., Inc. **(CHD)**	Neutral
Ecolab Inc. **(ECL)**	Neutral
EMCOR Group, Inc. **(EME)**	Neutral
Johnson Controls International plc **(JCI)**	Neutral
Limbach Holdings, Inc. **(LMB)**	Neutral
Rollins, Inc. **(ROL)**	Neutral
Team, Inc. **(TISI)**	Underperform

Industry Comparison Industry: Building Products - Maintenance Service

Industry Peers

	SERV Neutral	X Industry	S&P 500	LMB Neutral	ROL Neutral	TISI Underperform
VGM Score	F	-	-	A	C	A
Market Cap	4.99 B	2.57 B	24.03 B	30.10 M	11.37 B	459.10 M
# of Analysts	9	2	13	1	4	1
Dividend Yield	0.00%	0.00%	1.78%	0.00%	1.21%	0.00%
Value Score	D	-	-	A	D	B
Cash/Price	0.03	0.02	0.04	0.03	0.01	0.02
EV/EBITDA	62.38	30.85	14.04	19.24	30.85	98.57
PEG Ratio	1.57	0.93	2.02	0.32	NA	NA
Price/Book (P/B)	2.14	1.67	3.32	0.67	14.09	1.04
Price/Cash Flow (P/CF)	22.20	10.50	13.52	7.06	38.36	9.36
P/E (F1)	26.42	26.05	18.82	3.88	43.69	37.80
Price/Sales (P/S)	2.46	0.40	2.63	0.05	5.82	0.39
Earnings Yield	3.83%	3.83%	5.31%	25.83%	2.30%	2.65%
Debt/Equity	0.65	0.65	0.72	0.88	0.39	0.90
Cash Flow ($/share)	1.66	1.62	6.94	0.55	0.91	1.62
Growth Score	F	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	5.62%	3.96%	10.56%	NA	12.99%	-47.65%
Proj. EPS Growth (F1/F0)	6.18%	8.90%	7.49%	731.25%	8.90%	217.65%
Curr. Cash Flow Growth	-40.32%	-40.32%	14.83%	-66.65%	20.35%	-58.84%
Hist. Cash Flow Growth (3-5 yrs)	8.25%	9.57%	9.00%	NA	12.75%	3.49%
Current Ratio	0.93	1.26	1.23	1.26	0.79	2.07
Debt/Capital	39.27%	39.27%	42.99%	46.81%	27.98%	47.26%
Net Margin	-4.64%	0.11%	11.08%	0.11%	10.42%	-1.42%
Return on Equity	7.91%	9.16%	17.16%	11.17%	31.20%	1.08%
Sales/Assets	0.41	1.33	0.55	2.38	1.33	1.17
Proj. Sales Growth (F1/F0)	7.15%	5.51%	4.20%	5.51%	6.80%	2.57%
Momentum Score	C	-	-	F	A	D
Daily Price Chg	-0.11%	-0.11%	-0.33%	0.64%	2.90%	-1.18%
1 Week Price Chg	-0.18%	-0.18%	-0.30%	12.38%	1.75%	-1.56%
4 Week Price Chg	-0.32%	1.87%	1.71%	37.37%	4.48%	-6.67%
12 Week Price Chg	-33.25%	-15.81%	6.05%	-18.27%	-2.53%	-15.81%
52 Week Price Chg	-0.89%	-3.08%	22.39%	-21.86%	-10.17%	-3.08%
20 Day Average Volume	1,071,749	403,299	1,580,816	71,584	1,177,689	141,935
(F1) EPS Est 1 week change	-0.31%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.47%	0.00%	0.00%	0.00%	0.21%	0.00%
(F1) EPS Est 12 week change	-17.16%	-4.46%	-0.50%	0.00%	0.21%	-60.00%
(Q1) EPS Est Mthly Chg	-0.68%	-0.68%	0.00%	NA	0.00%	NA

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	F
Momentum Score	C
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment.This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time.ZIR is not a broker-dealer.ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients.Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.