ServiceMaster (SERV)

$37.66 (As of 02/17/20)

Price Target (6-12 Months): **$45.00**

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

Summary

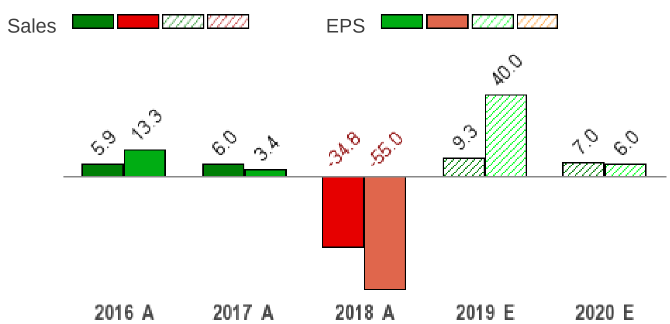
ServiceMaster's size and scale provide it competitive advantage in terms of purchasing power, operating and marketing efficiencies, and route density. The company enjoys brand awareness and a reputation of high-quality customer service. Its capital-light business model is characterized by strong Adjusted EBITDA margins and limited capital expenditure requirements. This model enjoys operating leverage from route density and fixed investments in infrastructure and technology. Buyout 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 cost increase in 2020, which is likely to keep the bottom line under pressure, thereby weighing on the stock that has underperformed its industry in the past year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$58.78 - $33.53**
20 Day Average Volume (sh)	**1,342,845**
Market Cap	**$5.1 B**
YTD Price Change	**-2.6%**
Beta	**0.49**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Building Products - Maintenance Service**
Zacks Industry Rank	**Bottom 16% (213 out of 255)**
Last EPS Surprise	**-13.9%**
Last Sales Surprise	**-0.4%**
EPS F1 Est- 4 week change	**-0.5%**
Expected Report Date	**02/27/2020**
Earnings ESP	**0.0%**
P/E TTM	**28.3**
P/E F1	**26.7**
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	2,222 E
2019	482 A	560 A	528 A	508 E	2,077 E
2018	675 A	874 A	873 A	457 A	1,900 A

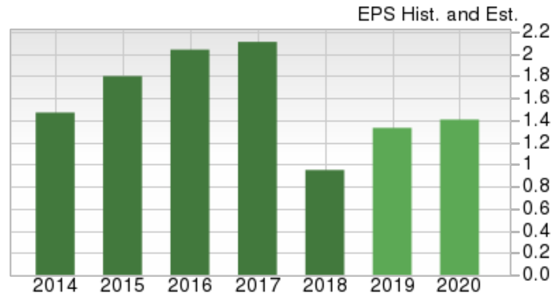
EPS Estimates

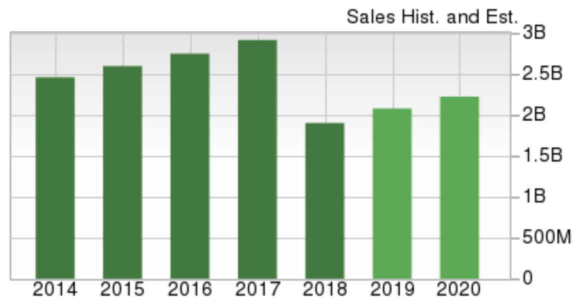
	Q1	Q2	Q3	Q4	Annual*
2020	$0.36 E	$0.51 E	$0.30 E	$0.23 E	$1.41 E
2019	$0.33 A	$0.50 A	$0.31 A	$0.19 E	$1.33 E
2018	$0.44 A	$0.79 A	$0.67 A	$0.19 A	$0.95 A

*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 02/17/2020. The reports text is as of 02/18/2020.

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 decreased 5.9% in the past year compared with 1.4% decline of the industry it belongs to.

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.

Valuation

ServiceMaster shares are down 5.9% over the trailing 12-month period. The Zacks sub-industry is down 1.4% over the past year. The sector and S&P 500 index are up 24.5% and 21%, respectively in the same time frame.

The stock is currently trading at 26.35X forward 12-month price-to-earnings, which compares to 34.71X for the Zacks sub-industry, 26.64X for the Zacks sector and 19.35X for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.95X and as low as 14.55X, with a 5-year median of 20.65X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $45.00 price target reflects 31.49X 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	26.35	34.71	26.64	19.35
	5-Year High	36.95	40.63	26.64	19.35
	5-Year Low	14.55	18.48	18.78	15.18
	5-Year Median	20.65	26.62	20.59	17.47
P/S F 12M	Current	2.29	3.27	4.26	3.58
	5-Year High	3.75	4.77	5.14	3.58
	5-Year Low	1.55	2.4	3.1	2.54
	5-Year Median	1.98	3.1	3.64	3
P/B TTM	Current	2.19	7.03	5.23	4.68
	5-Year High	13.73	12.53	6.72	4.68
	5-Year Low	1.98	6.26	4.13	2.85
	5-Year Median	7.39	10.28	5.27	3.62

As of 02/14/2020

Industry Analysis **Zacks Industry Rank:** Bottom 16% (213 out of 255)

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	D	-	-	A	D	A
Market Cap	5.11 B	2.59 B	24.61 B	31.91 M	13.04 B	412.65 M
# of Analysts	9	3	13	1	4	1
Dividend Yield	0.00%	0.00%	1.78%	0.00%	1.21%	0.00%
Value Score	C	-	-	A	D	C
Cash/Price	0.03	0.02	0.04	0.03	0.01	0.02
EV/EBITDA	63.51	35.22	14.06	19.75	35.22	93.13
PEG Ratio	1.56	0.97	2.09	0.34	NA	NA
Price/Book (P/B)	2.19	1.67	3.29	0.71	15.98	0.94
Price/Cash Flow (P/CF)	22.71	10.55	13.65	7.48	40.81	8.41
P/E (F1)	26.26	26.77	19.21	4.11	50.40	64.71
Price/Sales (P/S)	2.52	0.40	2.70	0.06	6.47	0.35
Earnings Yield	3.74%	3.74%	5.19%	24.34%	1.98%	1.55%
Debt/Equity	0.65	0.65	0.71	0.88	0.34	0.90
Cash Flow ($/share)	1.66	1.62	6.92	0.55	0.98	1.62
Growth Score	D	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	5.62%	3.96%	10.85%	NA	12.84%	-47.65%
Proj. EPS Growth (F1/F0)	5.68%	8.72%	7.17%	731.25%	8.22%	156.76%
Curr. Cash Flow Growth	-40.32%	-40.32%	8.56%	-66.65%	7.82%	-58.84%
Hist. Cash Flow Growth (3-5 yrs)	8.25%	9.57%	8.36%	NA	12.17%	3.49%
Current Ratio	0.93	1.26	1.23	1.26	0.75	2.07
Debt/Capital	39.27%	39.27%	42.91%	46.81%	25.49%	47.26%
Net Margin	-4.64%	0.11%	11.81%	0.11%	10.09%	-1.42%
Return on Equity	7.91%	9.16%	16.86%	11.17%	30.34%	1.08%
Sales/Assets	0.41	1.24	0.54	2.38	1.24	1.17
Proj. Sales Growth (F1/F0)	6.96%	5.51%	3.85%	5.51%	7.37%	1.53%
Momentum Score	F	-	-	D	F	D
Daily Price Chg	1.73%	0.37%	0.06%	3.75%	0.03%	0.37%
1 Week Price Chg	-2.72%	0.73%	2.47%	-2.75%	1.69%	1.25%
4 Week Price Chg	3.09%	-3.81%	0.59%	-8.59%	11.73%	-13.16%
12 Week Price Chg	4.15%	4.15%	6.98%	43.10%	11.32%	-15.64%
52 Week Price Chg	-5.14%	-5.14%	16.62%	-25.23%	0.35%	-11.70%
20 Day Average Volume	1,342,845	286,154	2,020,569	36,007	1,377,310	133,635
(F1) EPS Est 1 week change	-0.08%	0.00%	0.00%	0.00%	-0.63%	0.00%
(F1) EPS Est 4 week change	-0.47%	-0.47%	-0.05%	0.00%	-0.63%	-47.50%
(F1) EPS Est 12 week change	-4.47%	-3.98%	-0.17%	0.00%	0.000%	-47.50%
(Q1) EPS Est Mthly Chg	-2.74%	-4.44%	-0.24%	NA	-4.44%	NA

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	C
Growth Score	D
Momentum Score	F
VGM Score	D

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.

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