ServiceMaster Global Holding, Inc. (SERV)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/18/20): 28.26
52WK H-L ($) : 59 - 18
Market Cap (mil): 3,818
Shares Out (mil): 135.1
Float (mil): 131.8
Avg. Daily Vol (mil): 1.90
Dividend ($): 0.00
Yield (%): 0.0

Rating: Neutral
Suitability: Average Risk
Price Target ($) : 28
L-Term Rev. Gr Rate Est: 3%
L-Term EPS Gr Rate Est: 11%
Debt/Cap: 44.1%
ROE: NA

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FY Dec 2019A 2020E 2021E
28 Q1 0.33A 0.08A 0.24E
28 Q2 0.50A 0.25E 0.33E
28 Q3 0.31A 0.18E 0.24E
28 Q4 0.22A 0.10E 0.14E

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EPS (Net): 1Q-3Q2018 EPS have not been restated for home warranty spin

Company Description

ServiceMaster is a leading provider of residential and commercial services through both company-owned and franchised operations. The company's portfolio of company-owned and franchised brands include: Terminix (pest elimination/termite control services), ServiceMaster Clean/Restore (disaster recovery and commercial cleaning), Merry Maids (residential cleaning), AmeriSpec (home inspection services), and Furniture Medic (wood furniture repair). Franchise business in process of being sold, ex-Terminix.

Revenue Profile

Terminix Revenue by Service

Termit = 32%
Residential Pest 35%
Commercial Pest 22%
Other = 7%

Source: Company reports (2019)
ServiceMaster Global Holding, Inc.
May 18, 2020

Competition
ServiceMaster operates across several highly fragmented industries of small independent operators with SERV offering a leadership position within most markets. Public competitors include: Terminix -- Rollins (ROL), Rentokil Initial (RTO-LON), and Ecolab (ECL); Franchise Services Group -- ABM Industries (ABM).

Quick Summary
Recent results. 1Q20 profit shortfall was surprising, particularly given the limited COVID-related impact which looks only to build further. Positively, management has taken steps to reduce costs, which will help offset, though revenue pressures (particularly in Commercial) to remain. Silver lining is the balance sheet has ample capacity with significant FCF. Further, most headwinds are truly one-time, with customer service deferrals, not cancelations. We expect somewhat normalized conditions drive sharp recovery, despite steep 2Q20 pressures. Still, at just ~5% FCF yield, balanced risk/reward.

Investment Thesis
The call: Stable, cash-generative platform, fairly valued today as newer risks emerge. Shares of SERV continue to trade at a modest discount to peer Rollins (>30x EBITDA), the bull argument for this defensive-oriented steady cash flow business. Recent investor focus has centered on service shortfalls the core Terminix business which have led to elevated customer churn and below-market growth. That said, management is keenly focused on operational improvements to close the gap, while some improvements have been realized, progress has not been linear. While growth is improving, margins have suffered considerably, with a new and significant overhang entering the equation in late 2019 in the form of elevated Termite-related damage claims and a leadership transition in early 2020 (still interim, CEO). Once the issues are corrected, longer-term improving revenue growth combined with solid ~30% incremental EBITDA margins has the potential to compound ~10% EBITDA CAGR and mid-teens EPS, but the path to that algorithm is cloudy today, particularly in light of COVID.

Defensive business model; diverse revenue streams; consistent results. ServiceMaster benefits from a relatively low volatility pest and termite control business insulated from economic conditions. With 75% retention in pest and 85% retention in termite, highly recurring revenue streams with relatively low capital needs (3.0-3.5% of revenue) combine with 20%+ EBITDA margins to form the foundation of a good business.

Modest customer penetration opportunities; supplement trend to outsource. Management sees opportunity to enhance ServiceMaster's traditional offerings with emphasis on commercial market expansion (~20-25% of revenue) and mobile-focused consumer initiatives. A modest pipeline of tuck-in acquisitions and smaller ancillary product/service offerings are also additive to the overall growth model. Management also sees modest improvement in the company's cost structure, with new process improvements (centralized pricing, localized market programs), system investments and sales force incentive initiatives driving a culture focused on improved operating performance.

Risks & Caveats
Management execution. ServiceMaster has witnessed considerable management turnover in recent years with much of the current executive team having limited industry tenure. Management is investing heavily in customer satisfaction/retention and a focus on commercial (versus residential) pest with an eye to improving growth through reduced churn, particularly at Terminix, with pilot studies offering real-time feedback against a revamped technician incentive structure that rewards service quality.

Weather/seasonality. Demand for ServiceMaster’s services is highly seasonal, particularly in the core Terminix business, with weather a primary driver of pest/termite infestation.

Highly competitive industry with relatively lower barriers to entry. ServiceMaster operates in a fragmented and relatively capital-light industry, providing few barriers to entry. While ServiceMaster’s reputation and scale provide some degree of competitive insulation, particularly for larger commercial accounts, price remains a primary factor in vendor selection.

Supplemental Information

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Source: Baird estimates
Appendix - Important Disclosures and Analyst Certification

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Rating and Price Target History for: ServiceMaster Global Holding, Inc. (SERV) as of 05-18-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of SERV.

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