CINTAS CORP
Form 10-Q
April 09, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended February 28, 2014

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-11399

CINTAS CORPORATION
(Exact name of Registrant as specified in its charter)

WASHINGTON	31-1188630
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6800 CINTAS BOULEVARD
P.O. BOX 625737
CINCINNATI, OHIO 45262-5737
(Address of principal executive offices)(Zip Code)

(513) 459-1200
(Registrant's telephone number, including area code)

Indicate by checkmark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ü No

Indicate by checkmark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ü No

Indicate by checkmark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ü Accelerated Filer Smaller Reporting Company
Non-Accelerated Filer (Do not check if a smaller reporting company)

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No ü

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding March 31, 2014
Common Stock, no par value	120,192,562

CINTAS CORPORATION
TABLE OF CONTENTS

			Page No.
Part I.	Financial Information		
	Item 1.	Financial Statements.	
		Consolidated Condensed Statements of Income – Three Months and Nine Months Ended February 28, 2014 and 2013	3
		Consolidated Condensed Statements of Comprehensive Income – Three Months and Nine Months Ended February 28, 2014 and 2013	4
		Consolidated Condensed Balance Sheets – February 28, 2014 and May 31, 2013	5
		Consolidated Condensed Statements of Cash Flows – Nine Months Ended February 28, 2014 and 2013	6
		Notes to Consolidated Condensed Financial Statements	7
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.	31
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk.	41
	Item 4.	Controls and Procedures.	41
Part II.	Other Information		
	Item 1.	Legal Proceedings.	42
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds.	42
	Item 6.	Exhibits.	43
Signatures			44
Exhibits			

CINTAS CORPORATION
ITEM 1. FINANCIAL STATEMENTS.
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)
(In thousands except per share data)

	Three Months Ended		Nine Months Ended	
	February 28, 2014	February 28, 2013	February 28, 2014	February 28, 2013
Revenue:				
Rental uniforms and ancillary products	$801,702	$748,887	$2,398,884	$2,259,569
Other services	328,535	326,787	995,449	927,816
	1,130,237	1,075,674	3,394,333	3,187,385
Costs and expenses:				
Cost of rental uniforms and ancillary products	450,086	434,809	1,363,929	1,301,859
Cost of other services	201,026	198,924	608,380	565,674
Selling and administrative expenses	328,963	308,918	978,820	908,512
Operating income	150,162	133,023	443,204	411,340
Interest income	(44)	(132)	(196)	(358)
Interest expense	16,418	16,302	49,426	49,194
Income before income taxes	133,788	116,853	393,974	362,504
Income taxes	49,186	42,148	146,756	133,039
Net income	$84,602	$74,705	$247,218	$229,465
Basic earnings per share	$0.70	$0.60	$2.04	$1.84
Diluted earnings per share	$0.69	$0.60	$2.02	$1.83
Dividends declared per share	$—	$—	$0.77	$0.64

See accompanying notes.

CINTAS CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended		Nine Months Ended	
	February 28, 2014	February 28, 2013	February 28, 2014	February 28, 2013
Net income	$84,602	$74,705	$247,218	$229,465
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(5,121)	(8,173)	(3,727)	519
Change in fair value of derivatives	(102)	(36)	(291)	(187)
Amortization of interest rate lock agreements	488	488	1,464	1,464
Change in fair value of available-for-sale securities	1	1	(17)	(11)
Other comprehensive (loss) income	(4,734)	(7,720)	(2,571)	1,785
Comprehensive income	$79,868	$66,985	$244,647	$231,250

See accompanying notes.

CINTAS CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands except share data)

	February 28, 2014 (Unaudited)	May 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$348,859	$352,273
Marketable securities	4,840	5,680
Accounts receivable, net	529,668	496,049
Inventories, net	256,132	240,440
Uniforms and other rental items in service	498,649	496,752
Income taxes, current	—	9,102
Prepaid expenses	26,761	24,530
Total current assets	1,664,909	1,624,826
Property and equipment, at cost, net	981,197	986,703
Goodwill	1,532,568	1,517,560
Service contracts, net	83,972	92,153
Other assets, net	137,795	124,390
	$4,400,441	$4,345,632
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$117,336	$121,029
Accrued compensation and related liabilities	80,109	78,050
Accrued liabilities	259,310	271,821
Income taxes, current	9,018	—
Deferred tax liability	86,396	77,169
Long-term debt due within one year	633	8,187
Total current liabilities	552,802	556,256
Long-term liabilities:		
Long-term debt due after one year	1,300,523	1,300,979
Deferred income taxes	209,915	210,483
Accrued liabilities	93,168	76,422
Total long-term liabilities	1,603,606	1,587,884
Shareholders' equity:		
Preferred stock, no par value:	—	—
100,000 shares authorized, none outstanding		
Common stock, no par value:	233,927	186,332
425,000,000 shares authorized,		
FY 2014: 175,939,557 issued and 120,053,074 outstanding		
FY 2013: 174,786,010 issued and 122,281,507 outstanding		
Paid-in capital	117,897	109,822
Retained earnings	3,871,675	3,717,771

Treasury stock:	(2,015,018)	(1,850,556)
FY 2014: 55,886,483 shares		
FY 2013: 52,504,503 shares		
Accumulated other comprehensive income	35,552	38,123
Total shareholders' equity	2,244,033	2,201,492
	$4,400,441	$4,345,632

See accompanying notes.

5

CINTAS CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended February 28, 2014	February 28, 2013
Cash flows from operating activities:		
Net income	$247,218	$229,465
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	127,761	123,242
Amortization of intangible assets	17,524	17,884
Stock-based compensation	22,248	16,660
Deferred income taxes	8,733	31,905
Change in current assets and liabilities, net of acquisitions of businesses:		
Accounts receivable, net	(34,024)	(41,402)
Inventories, net	(16,130)	4,437
Uniforms and other rental items in service	(4,142)	(28,803)
Prepaid expenses	(1,892)	9
Accounts payable	(7,037)	13,475
Accrued compensation and related liabilities	2,219	(680)
Accrued liabilities	5,025	(3,788)
Income taxes payable	18,270	5,939
Net cash provided by operating activities	385,773	368,343
Cash flows from investing activities:		
Capital expenditures	(113,615)	(151,799)
Proceeds from redemption of marketable securities	49,635	97,651
Purchase of marketable securities and investments	(63,335)	(135,398)
Acquisitions of businesses, net of cash acquired	(32,965)	(64,625)
Other, net	(868)	(662)
Net cash used in investing activities	(161,148)	(254,833)
Cash flows from financing activities:		
Proceeds from issuance of debt	—	250,000
Repayment of debt	(8,010)	(225,472)
Proceeds from exercise of stock-based compensation awards	29,286	7,156
Dividends paid	(93,314)	(79,744)
Repurchase of common stock	(164,462)	(187,076)
Other, net	10,339	(1,385)
Net cash used in financing activities	(226,161)	(236,521)
Effect of exchange rate changes on cash and cash equivalents	(1,878)	656
Net decrease in cash and cash equivalents	(3,414)	(122,355)
Cash and cash equivalents at beginning of period	352,273	339,825
Cash and cash equivalents at end of period	$348,859	$217,470

See accompanying notes.

CINTAS CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The consolidated condensed financial statements of Cintas Corporation (Cintas, the Company, we, us or our) included herein have been prepared by Cintas, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. While we believe that the disclosures are adequately presented, it is suggested that these consolidated condensed financial statements be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2013. A summary of our significant accounting policies is presented beginning on page 35 of that report. There have been no material changes in the accounting policies followed by Cintas during the current fiscal year.

Interim results are subject to variations and are not necessarily indicative of the results of operations for a full fiscal year. In the opinion of management, adjustments (which include only normal recurring adjustments) necessary for a fair statement of the consolidated results of the interim periods shown have been made.

As disclosed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2013, inventories are valued at the lower of cost (first-in, first-out) or market. Inventory is comprised of the following amounts:

(In thousands)	February 28, 2014	May 31, 2013
Raw materials	$16,476	$19,800
Work in process	14,256	17,353
Finished goods	225,400	203,287
	$256,132	$240,440

2. New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 requires an entity to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income if the item reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For reclassification items not required under GAAP to be reclassified directly to net income in their entirety in the same reporting period, an entity is required to cross-reference to other disclosures currently required under GAAP that provide additional detail about those amounts. ASU 2013-02 applies to all public and private companies that report items of other comprehensive income. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012, with prospective adoption required. The Company adopted ASU 2013-02 effective June 1, 2013. See Note 9 entitled Accumulated Other Comprehensive Income (Loss) of "Notes to Consolidated Condensed Financial Statements" for details of required disclosure.

3. Fair Value Measurements

FASB Accounting Standard Codification (ASC) Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. It also establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Cintas' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

In order to meet the requirements of ASC 820, Cintas utilizes two basic valuation approaches to determine the fair value of its assets and liabilities required to be recorded on a recurring basis at fair value. The first approach is the cost approach. The cost approach is generally the value a market participant would expect to replace the respective asset or liability. The second approach is the market approach. The market approach looks at what a market participant would consider valuing an exact or similar asset or liability to that of Cintas, including those traded on exchanges.

All financial instruments that are measured at fair value on a recurring basis (at least annually) have been segregated into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the consolidated balance sheet date. These financial instruments measured at fair value on a recurring basis are summarized below:

(In thousands)	As of February 28, 2014			
	Level 1	Level 2	Level 3	Fair Value
Cash and cash equivalents	$348,859	$—	$—	$348,859
Marketable securities:				
Canadian treasury securities	—	4,840	—	4,840
Total assets at fair value	$348,859	$4,840	$—	$353,699
Current accrued liabilities	$—	$365	$—	$365
Total liabilities at fair value	$—	$365	$—	$365

(In thousands)	As of May 31, 2013			
	Level 1	Level 2	Level 3	Fair Value
Cash and cash equivalents	$352,273	$—	$—	$352,273
Marketable securities:				
U.S. municipal bonds	—	5,680	—	5,680

Accounts receivable, net	—	39	—	39
Total assets at fair value	$352,273	$5,719	$—	$357,992

Cintas' cash and cash equivalents and marketable securities are generally classified within Level 1 or Level 2 of the fair value hierarchy. Financial instruments classified as Level 1 are based on quoted market prices in active markets, and financial instruments classified as Level 2 are based on quoted market prices in non-active markets, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. The types of financial instruments Cintas classifies within Level 1 include most bank deposits and money market securities. Cintas does not adjust the quoted market price for such financial instruments.

The types of financial instruments Cintas classifies within Level 2 include Canadian treasury securities (federal) and highly rated U.S. state or municipal bonds. The valuation technique used for Cintas' marketable securities classified within Level 2 of the fair value hierarchy is primarily the market approach. The primary inputs to value Cintas' marketable securities is the respective instrument's future cash flows based on its stated yield and the amount a market participant would pay for a similar instrument. Primarily all of Cintas' marketable securities are actively traded and the recorded fair value reflects current market conditions. However, due to the inherent volatility in the investment market, there is at least a possibility that recorded investment values may change in the near term.

The funds invested in Canadian marketable securities are not presently expected to be repatriated, but instead are expected to be invested indefinitely in foreign subsidiaries. Interest, realized gains and losses and declines in value determined to be other than temporary on available-for-sale securities are included in interest income or expense. The cost of the securities sold is based on the specific identification method. The amortized cost basis of the marketable securities were $4.8 million and $5.7 million as of February 28, 2014 and May 31, 2013, respectively. All outstanding marketable securities at February 28, 2014 and May 31, 2013 had contractual maturities due within one year.

As of February 28, 2014, current accrued liabilities include foreign currency forward contracts. As of May 31, 2013, accounts receivable, net include foreign currency forward contracts. The fair value of Cintas' foreign currency forward contracts are based on similar exchange traded derivatives (market approach) and are, therefore, included within Level 2 of the fair value hierarchy.

The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Cintas believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the consolidated balance sheet date.

Cintas' non-financial assets and liabilities not permitted or required to be measured at fair value on a recurring basis primarily relate to assets and liabilities acquired in a business acquisition. Cintas is required to provide additional disclosures about fair value measurements as part of the consolidated financial statements for each major category of assets and liabilities measured at fair value on a non-recurring basis (including business acquisitions), if material. Based on the nature of Cintas' business acquisitions, which occur regularly throughout the fiscal year, the majority of the assets acquired and liabilities assumed consist of working capital, primarily valued using Level 2 inputs, property and equipment, also primarily valued using Level 2 inputs and goodwill and other identified intangible assets valued using Level 3 inputs. In general, non-recurring fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities, which generally are not applicable to non-financial assets and liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as definitive sales agreements, appraisals or established market values of comparable assets. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability and include situations where there is little, if any, market activity for the asset or liability, such as internal estimates of future cash flows and Company specific discount rates.

4. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share using the two-class method for amounts attributable to Cintas' common shares:

(In thousands except per share data)	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013	Nine Months Ended February 28, 2014	Nine Months Ended February 28, 2013
Basic Earnings per Share				
Net income	$84,602	$74,705	$247,218	$229,465
Less dividends to:				
Common shares	$—	$—	$92,244	$78,866
Unvested shares	—	—	1,070	878
Total dividends	$—	$—	$93,314	$79,744
Undistributed net income	$84,602	$74,705	$153,904	$149,721
Less: net income allocated to participating unvested securities	685	517	1,237	1,048
Net income available to common shareholders	$83,917	$74,188	$152,667	$148,673
Basic weighted average common shares outstanding	119,913	123,120	120,658	124,483
Basic earnings per common share:				
Common shares - distributed earnings	$0.00	$0.00	$0.77	$0.64
Common shares - undistributed earnings	0.70	0.60	1.27	1.20
Total common shares	$0.70	$0.60	$2.04	$1.84
Unvested shares - distributed earnings	$0.00	$0.00	$0.77	$0.64
Unvested shares - undistributed earnings	0.70	0.60	1.27	1.20
Total unvested shares	$0.70	$0.60	$2.04	$1.84

(In thousands except per share data)	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013	Nine Months Ended February 28, 2014	Nine Months Ended February 28, 2013
Diluted Earnings per Share				
Net income	$84,602	$74,705	$247,218	$229,465
Less dividends to:				
Common shares	$—	$—	$92,244	$78,866
Unvested shares	—	—	1,070	878
Total dividends	$—	$—	$93,314	$79,744
Undistributed net income	$84,602	$74,705	$153,904	$149,721
Less: net income allocated to participating unvested securities	685	517	1,237	1,048
Net income available to common shareholders	$83,917	$74,188	$152,667	$148,673
Basic weighted average common shares outstanding	119,913	123,120	120,658	124,483
Effect of dilutive securities – employee stock options	1,367	637	1,156	418
Diluted weighted average common shares outstanding	121,280	123,757	121,814	124,901
Diluted earnings per share:				
Common shares - distributed earnings	$0.00	$0.00	$0.77	$0.64
Common shares - undistributed earnings	0.69	0.60	1.25	1.19
Total common shares	$0.69	$0.60	$2.02	$1.83
Unvested shares - distributed earnings	$0.00	$0.00	$0.77	$0.64
Unvested shares - undistributed earnings	0.69	0.60	1.25	1.19
Total unvested shares	$0.69	$0.60	$2.02	$1.83

For the three months ended February 28, 2014 and 2013, options granted to purchase 0.4 million and 0.6 million shares of Cintas common stock, respectively, were excluded from the computation of diluted earnings per share. For the nine months ended February 28, 2014 and 2013, options granted to purchase 0.6 million and 0.8 million shares of Cintas common stock, respectively, were excluded from the computation of diluted earnings per share. The exercise prices of these options were greater than the average market price of the common stock (anti-dilutive).

On October 18, 2011, we announced that the Board of Directors authorized a $500.0 million share buyback program. On July 30, 2013, we announced that the Board of Directors authorized a new $500.0 million share buyback program, which does not have an expiration date. For the three months ended February 28, 2014, no shares of Cintas common stock were purchased. For the first nine months ended February 28, 2014, we purchased 3.2 million shares of Cintas common stock for a total purchase price of $157.7 million. In the period subsequent to February 28, 2014 through April 9, 2014, we did not purchase any shares of Cintas common stock. From the inception of the October 18, 2011 share buyback program through