ROLLINS INC
Form 10-Q
July 25, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10–Q

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

For the quarterly period ended June 30, 2014

Commission File Number 1-4422

ROLLINS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**51-0068479**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2170 Piedmont Road, N.E., Atlanta, Georgia

(Address of principal executive offices)

30324

(Zip Code)

(404) 888-2000

(Registrant’s telephone number, including area code)

Indicate by check mark 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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Rollins, Inc. had 145,749,359 shares of its $1 par value Common Stock outstanding as of July 15, 2014.

ROLLINS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

AS OF JUNE 30, 2014 AND DECEMBER 31, 2013

(in thousands except share data)

	June 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Cash and cash equivalents	$ 101,519	$ 118,216
Trade receivables, short-term, net of allowance for doubtful accounts of $7,893 and $9,078, respectively	86,156	72,849
Financed receivables, short-term, net of allowance for doubtful accounts of $1,731 and $1,777, respectively	12,821	12,220
Materials and supplies	13,136	12,251
Deferred income taxes, net	40,781	39,518
Other current assets	19,052	19,388
Total Current Assets	273,465	274,442
Equipment and property, net	94,678	87,215
Goodwill	255,515	211,847
Customer contracts and other intangible assets, net	139,231	128,569
Deferred income taxes, net	4,564	4,544
Financed receivables, long-term, net of allowance for doubtful accounts of $1,469 and $1,423, respectively	12,955	11,608
Prepaid Pension	10,393	7,113
Other assets	13,788	13,879
Total Assets	$ 804,589	$ 739,217
LIABILITIES		
Accounts payable	$ 27,972	$ 23,194
Accrued insurance	24,212	25,631
Accrued compensation and related liabilities	63,408	66,175
Unearned revenues	105,455	91,014
Other current liabilities	38,384	29,778
Total current liabilities	259,431	235,792
Accrued insurance, less current portion	31,340	28,245
Accrued pension	475	691
Long-term accrued liabilities	37,801	36,234
Total Liabilities	329,047	300,962
Commitments and Contingencies		
STOCKHOLDERS' EQUITY		
Preferred stock, without par value; 500,000 shares authorized, zero shares issued	—	—
	145,953	145,864

Common stock, par value $1 per share; 250,000,000 shares authorized, 145,952,711 and 145,864,443 shares issued and outstanding, respectively		
Treasury Stock, par value $1 per share; 192,583 and 0 shares, respectively	(193)	—
Paid in capital	57,338	53,765
Accumulated other comprehensive loss	(27,531)	(31,771)
Retained earnings	299,975	270,397
Total Stockholders' Equity	475,542	438,255
Total Liabilities and Stockholders' Equity	$ 804,589	$ 739,217

The accompanying notes are an integral part of these condensed consolidated financial statements.

ROLLINS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(in thousands per except share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
REVENUES				
Customer services	$369,357	$350,798	$682,745	$650,512
COSTS AND EXPENSES				
Cost of services provided	182,642	174,361	343,950	329,967
Depreciation and amortization	10,608	9,768	20,822	19,662
Sales, general and administrative	110,522	109,518	211,106	208,652
Interest income, net	(86)	(127)	(162)	(172)
INCOME BEFORE INCOME TAXES	65,671	57,278	107,029	92,403
PROVISION FOR INCOME TAXES	24,811	21,284	40,403	33,230
NET INCOME	$40,860	$35,994	$66,626	$59,173
NET INCOME PER SHARE - BASIC AND DILUTED	$0.28	$0.25	$0.46	$0.40
DIVIDENDS PAID PER SHARE	$0.105	$0.09	$0.21	$0.18
Weighted average participating shares outstanding - basic and diluted	145,875	146,210	145,933	146,224

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ROLLINS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
NET INCOME	$40,860	$35,994	$66,626	$59,173
Other comprehensive earnings (loss)				
Foreign currency translation adjustments	2,706	(1,335)	4,240	(2,112)
Other comprehensive earnings (loss)	2,706	(1,335)	4,240	(2,112)
Comprehensive earnings	$43,566	$34,659	$70,866	$57,061

The accompanying notes are an integral part of these condensed consolidated financial statements.

ROLLINS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2014	2013
OPERATING ACTIVITIES		
Net Income	$66,626	$59,173
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,822	19,662
Provision for deferred income taxes	509	963
Provision for bad debts	2,813	2,438
Stock based compensation expense	5,367	5,092
Excess tax benefits from share-based payments	(4,455)	(3,132)
Other, net	(899)	(63)
Changes in operating assets and liabilities	(772)	(10,992)
Net cash provided by operating activities	90,011	73,141
INVESTING ACTIVITIES		
Cash used for acquisitions of companies, net of cash acquired	(59,660)	(2,617)
Purchases of equipment and property	(11,471)	(9,614)
Other	1,108	233
Net cash used in investing activities	(70,023)	(11,998)
FINANCING ACTIVITIES		
Cash paid for common stock purchased	(12,789)	(9,145)
Dividends paid	(30,612)	(26,296)
Proceeds received upon exercise of stock options	—	6
Excess tax benefits from share-based payments	4,455	3,132
Net cash used in financing activities	(38,946)	(32,303)
Effect of exchange rate changes on cash	2,261	(2,325)
Net increase / (decrease) in cash and cash equivalents	(16,697)	26,515
Cash and cash equivalents at beginning of period	118,216	65,082
Cash and cash equivalents at end of period	$101,519	$91,597

The accompanying notes are an integral part of these condensed consolidated financial statements.

ROLLINS, INC. AND SUBSIDIARIES

NOTE 1. BASIS OF PREPARATION AND OTHER

Basis of Preparation -The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. There has been no material change in the information disclosed in the notes to the consolidated financial statements included in the Annual Report on Form 10-K of Rollins, Inc. (the "Company") for the year ended December 31, 2013. Accordingly, the quarterly condensed consolidated financial statements and related disclosures herein should be read in conjunction with the 2013 Annual Report on Form 10-K.

The preparation of interim financial statements requires management to make estimates and assumptions for the amounts reported in the condensed consolidated financial statements. Specifically, the Company makes estimates in its interim condensed consolidated financial statements for the termite accrual which includes future costs including termiticide life expectancy and government regulations, the insurance accrual which includes self insurance and worker's compensation, inventory adjustments, discounts and volume incentives earned, among others.

In the opinion of management, all adjustments necessary for a fair presentation of the Company's financial results for the interim periods have been made. These adjustments are of a normal recurring nature. The results of operations for the three and six month periods ended June 30, 2014 are not necessarily indicative of results for the entire year.

The Company has only one reportable segment, its pest and termite control business. The Company's results of operations and its financial condition are not reliant upon any single customer, or a few customers, or the Company's foreign operations.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

New Accounting Standards

Recently adopted accounting standards

In February 2013, the Financial Accounting Standard Board ("FASB") issued Accounting Standard Update ("ASU") No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02) to Comprehensive Income. The guidance requires disclosure of significant amounts reclassified out of accumulated other comprehensive income by component and their corresponding effect on the respective line items of net income. The provision of the new guidance was effective as of the beginning of our 2014 fiscal year. Adoption of this new guidance did not have a material impact on the Company's reported results of operations or financial position.

In February 2013, FASB issued ASU No. 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force). This guidance requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This stipulates that (1) it will include the amount the entity agreed to pay for the arrangement between them and the other entities that are also obligated to the liability and (2) any additional amount the entity expects to pay on behalf of the other entities. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The provision of the new guidance was effective as of the beginning of our 2014 fiscal year. Adoption of this new guidance did not have a material impact on the Company's reported results of operations or financial position.

In July 2013, FASB issued ASU No 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. Topic 740, Income Taxes, does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. There is diversity in practice in the presentation of unrecognized tax benefits in those instances. Some entities present unrecognized tax benefits as a liability unless the unrecognized tax benefit is directly associated with a tax position taken in a tax year that results in, or that resulted in, the recognition of a net operating loss or tax credit carryforward for that year and the net operating loss or tax credit carryforward has not been utilized. Other entities present unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward in certain circumstances. The objective of the amendments in this Update is to eliminate that diversity in practice. The provision of the new guidance was effective as of the beginning of our 2014 fiscal year. Adoption of this new guidance did not have a material impact on the Company's reported results of operations or financial position.

ROLLINS, INC. AND SUBSIDIARIES

Recently issued accounting standards to be adopted

In April 2014, FASB issued ASU 2014-08, (Topic 205 and 360): Reporting Discontinued Operations and Disclosure of Disposals of Components of an Entity. ASU 2014-08 amends the definition for what types of asset disposals are to be considered discontinued operations, and amends the required disclosures for discontinued operations and assets held for sale. ASU 2014-08 also enhances the convergence of the FASB’s and the International Accounting Standard Board’s reporting requirements for discontinued operations. The amendments in this update are effective for fiscal periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. The company is currently evaluating the impact of this standard on its consolidated financial statements.

In May 2014, FASB issued Accounting Standards Update ASU No. 2014-09, (Topic 606): Revenue from Contracts with Customers (ASU 2014-09) supersedes the revenue recognition requirements in “Topic 605, Revenue Recognition” and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective retrospectively for annual or interim reporting periods beginning after December 15, 2016, with early application not permitted. The company is currently evaluating the impact of this standard on its consolidated financial statements.

NOTE 3. EARNINGS PER SHARE

The Company follows ASC 260, *Earnings Per Share* (ASC 260) that requires the reporting of both basic and diluted earnings (loss) per share. Basic earnings (loss) per share is computed by dividing net income available to participating common stockholders by the weighted average number of participating common shares outstanding for the period. The calculation of diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. In accordance with ASC 260, any anti-dilutive effects on net earnings (loss) per share, of which there were none, are excluded at June 30, 2014 and June 30, 2013.

Basic and diluted earnings per share attributable to common and restricted shares of common stock for the period were as follows:

follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Basic earnings per share				
Common stock	$0.28	$0.25	$0.46	$0.40
Restricted shares of common stock	$0.27	$0.24	$0.44	$0.40
Total shares of common stock	$0.28	$0.25	$0.46	$0.40
Diluted earnings per share				
Common stock	$0.28	$0.25	$0.46	$0.40
Restricted shares of common stock	$0.27	$0.24	$0.44	$0.40
Total shares of common stock	$0.28	$0.25	$0.46	$0.40

NOTE 4. CONTINGENCIES

In the normal course of business, certain of the Company's subsidiaries are defendants in a number of lawsuits, claims or arbitrations which allege that the subsidiaries' services caused damage. In addition, the Company defends employment related cases and claims from time to time. We are involved in certain environmental matters primarily arising in the normal course of business. We are actively contesting each of these matters.

Presently, the Company and a subsidiary, The Industrial Fumigant Company, LLC, are named defendants in Severn Peanut Co. and Meherrin Agriculture & Chemical Co. v. Industrial Fumigant Co., et al. The Severn lawsuit, a matter related to a fumigation service, has been filed in the United States District Court for the Eastern District of North Carolina. The court dismissed plaintiffs' claim for breach of contract on March 15, 2014; plaintiffs' pending claim for damages is for negligence.

ROLLINS, INC. AND SUBSIDIARIES

On April 29, 2014, Foster Poultry Farms sued Orkin, LLC and Orkin Services of California, Inc., for breach of contract, breach of covenant of good faith and fair dealing, and negligence. The lawsuit is pending in the United States District Court for the Northern District of California. Foster Farms is seeking damages related to pest control services performed at its chicken processing facility during a six month period. The Company intends to defend this matter vigorously.

Management does not believe that any pending claim, proceeding or litigation, either alone or in the aggregate will have a material adverse effect on the Company's financial position, results of operations or liquidity; however, it is possible that an unfavorable outcome of some or all of the matters, however unlikely, could result in a charge that might be material to the results of an individual quarter or year.

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, short-term investments, trade receivables, notes receivable, accounts payable and other short-term liabilities. The carrying amounts of these financial instruments approximate their fair values. The Company has a Revolving Credit Agreement with SunTrust Bank and Bank of America, N.A. for an unsecured line of credit of up to $175.0 million, which includes a $75.0 million letter of credit subfacility and a $25.0 million swingline subfacility. There were no outstanding borrowings at June 30, 2014 and December 31, 2013.

NOTE 6. STOCKHOLDERS' EQUITY

During the six months ended June 30, 2014 the Company paid $30.6 million or $0.21 per share in cash dividends compared to $26.3 million or $0.18 per share during the same period in 2013.

During the second quarter ended June 30, 2014, the Company repurchased 0.2 million shares from the open market of its $1 par value common stock at a weighted average price of $29.86 per share compared to 0.2 million shares purchased at a weighted average price of $24.41 during the same period in 2013. For the six month period ended June 30, 2014, the Company repurchased 0.2 million shares from the open market of its $1 par value common stock at a weighted average price of $29.47 per share compared to 0.2 million shares purchased at a weighted average price of $24.41 during the same period in 2013.

The Company repurchased $0.4 million of common stock for each of the second quarters ended June 30, 2014 and 2013, respectively, and repurchased $6.1 million and $4.9 million of common stock for the six months ended June 30, 2014 and 2013, respectively, from employees for the payment of taxes on vesting restricted shares.

As more fully discussed in Note 14 of the Company's notes to the consolidated financial statements in its 2013 Annual Report on Form 10-K, stock options, time lapse restricted shares (TLRS's) and restricted stock units have been issued to officers and other management employees under the Company's Employee Stock Incentive Plans. The Company issues new shares from its authorized but unissued share pool. At June 30, 2014, approximately 3.6 million shares of the Company's common stock were reserved for issuance.

Stock Options

Stock options generally vest over a five-year period and expire ten years from the issuance date. For the six months ended June 30, 2014, the Company did not issue any shares of common stock under exercise of stock options by employees with one thousand shares issued for the same period in 2013.

The Company had no options outstanding under the Company's stock option plan as of June 30, 2014 or December 31, 2013.

The aggregate intrinsic value of options exercised during the six months ended June 30, 2014 and 2013 was zero and $20 thousand, respectively. There were no options exercised for the second quarters ended June 30, 2014 and 2013, respectively.

Time Lapse Restricted Shares and Restricted Stock Units

The following table summarizes the components of the Company's stock-based compensation programs recorded as expense:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(in thousands)	2014	2013	2014	2013
Time lapse restricted stock:				
Pre-tax compensation expense	$2,602	$2,546	$5,367	$5,092
Tax benefit	(1,001)	(980)	(2,066)	(1,960)

Restricted stock expense, net of tax	$1,601	$1,566	$3,301	$3,132

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ROLLINS, INC. AND SUBSIDIARIES

The Company recognized a tax benefit of approximately $1.1 million and $0.4 million during the second quarters ended June 30, 2014 and 2013, respectively, and approximately $4.5 million and $3.1 million for the six months ended June 30, 2014 and 2013, respectively, related to the vesting of restricted shares which have been recorded as increases to paid-in capital.

The following table summarizes information on unvested restricted stock outstanding as of June 30, 2014:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested Restricted Stock Units at December 31, 2013	2,454	$ 18.75
Forfeited	(79)	21.60
Vested	(674)	15.42
Granted	411	28.74
Unvested Restricted Stock Units at June 30, 2014	2,112	$ 21.64

At June 30, 2014 and December 31, 2013, the Company had $35.5 million and $30.7 million of total unrecognized compensation cost, respectively, related to time-lapse restricted shares that are expected to be recognized over a weighted average period of approximately 4.0 years and 3.8 years, respectively.

NOTE 7. PENSION AND POST RETIREMENT BENEFIT PLANS

The following table represents the net periodic pension benefit costs and related components in accordance with FASB ASC 715 "*Compensation - Retirement Benefits":*

Components of Net Pension Benefit Gain

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(in thousands)	2014	2013	2014	2013
Interest and service cost	$2,375	$2,166	$4,750	$4,332
Expected return on plan assets	(3,108)	(2,897)	(6,216)	(5,794)
Amortization of net loss	610	977	1,220	1,954
Net periodic loss/(benefit)	$(123)			