UNIFIRST CORP
Form 10-Q
April 04, 2018
Table of Contents

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 February 24, 2018

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: 001-08504
UNIFIRST CORPORATION
(Exact name of Registrant as Specified in Its Charter)

Massachusetts	04-2103460
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
68 Jonspin Road, Wilmington, MA	01887
(Address of Principal Executive Offices)	(Zip Code)

(978) 658-8888
(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 No
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 (§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 No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer Smaller Reporting Company Non-accelerated filer
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
The number of outstanding shares of UniFirst Corporation Common Stock and Class B Common Stock at March 30, 2018 were 15,420,788 and 3,711,009, respectively.

Table of Contents

UniFirst Corporation
Quarterly Report on Form 10-Q
For the Quarter ended February 24, 2018
Table of Contents

Part I – FINANCIAL INFORMATION	3
Item 1 – Unaudited Financial Statements	3
Consolidated Statements of Income for the Thirteen and Twenty-six Weeks ended February 24, 2018 and February 25, 2017	3
Consolidated Statements of Comprehensive Income for the Thirteen and Twenty-six Weeks ended February 24, 2018 and February 25, 2017	4
Consolidated Balance Sheets as of February 24, 2018 and August 26, 2017	5
Consolidated Statements of Cash Flows for the Twenty-six Weeks ended February 24, 2018 and February 25, 2017	6
Notes to Consolidated Financial Statements	7
Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3 – Quantitative and Qualitative Disclosures About Market Risk	35
Item 4 – Controls and Procedures	36
Part II – OTHER INFORMATION	36
Item 1 – Legal Proceedings	36
Item 1A – Risk Factors	36
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 3 – Defaults Upon Senior Securities	37
Item 4 – Mine Safety Disclosures	37
Item 5 – Other Information	37
Item 6 – Exhibits	37
Signatures	38

Certifications
Ex-31.1 Section 302 Certification of CEO
Ex-31.2 Section 302 Certification of CFO
Ex-32.1 Section 906 Certification of CEO
Ex-32.2 Section 906 Certification of CFO

Table of Contents

PART I – FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Consolidated Statements of Income
UniFirst Corporation and Subsidiaries
(Unaudited)

(In thousands, except per share data)	Thirteen weeks ended		Twenty-six weeks ended	
	February 24, 2018	February 25, 2017	February 24, 2018	February 25, 2017
Revenues	$419,264	$391,427	$835,042	$777,535
Operating expenses:				
Cost of revenues (1)	265,400	249,280	519,050	488,045
Selling and administrative expenses (1)	88,648	84,861	176,158	164,307
Depreciation and amortization	23,264	21,140	45,971	43,280
Total operating expenses	377,312	355,281	741,179	695,632
Operating income	41,952	36,146	93,863	81,903
Other (income) expense:				
Interest income, net	(1,430)	(1,120)	(2,706)	(1,921)
Other (income) expense, net	(186)	(108)	(32)	386
Total other income, net	(1,616)	(1,228)	(2,738)	(1,535)
Income before income taxes	43,568	37,374	96,601	83,438
(Benefit) provision for income taxes	(14,810)	14,858	4,017	32,708
Net income	$58,378	$22,516	$92,584	$50,730
Income per share – Basic:				
Common Stock	$3.02	$1.17	$4.79	$2.63
Class B Common Stock	$2.42	$0.93	$3.83	$2.10
Income per share – Diluted:				
Common Stock	$2.85	$1.10	$4.53	$2.49
Income allocated to – Basic:				
Common Stock	$46,744	$17,836	$74,126	$40,178
Class B Common Stock	$11,634	$4,518	$18,458	$10,184
Income allocated to – Diluted:				
Common Stock	$58,378	$22,362	$92,584	$50,381
Weighted average number of shares outstanding – Basic:				
Common Stock	15,481	15,305	15,471	15,295
Class B Common Stock	4,816	4,846	4,816	4,846
Weighted average number of shares outstanding – Diluted:				

Common Stock	20,463	20,263	20,434	20,250
Dividends per share:				
Common Stock	$0.0375	$ 0.0375	$0.0750	$ 0.0750
Class B Common Stock	$0.0300	$ 0.0300	$0.0600	$ 0.0600

(1) Exclusive of depreciation on the Company's property, plant and equipment and amortization on its intangible assets.

The accompanying notes are an integral part of these Consolidated Financial Statements.

3

Table of Contents

Consolidated Statements of Comprehensive Income
UniFirst Corporation and Subsidiaries
(Unaudited)

(In thousands)	Thirteen weeks ended		Twenty-six weeks ended	
	February 24, 2018	February 25, 2017	February 24, 2018	February 25, 2017
Net income	$58,378	$ 22,516	$92,584	$ 50,730
Other comprehensive income (loss):				
Foreign currency translation adjustments	1,250	3,332	(763)	(1,797)
Pension benefit liabilities	(1,192)	—	(1,192)	—
Change in fair value of derivatives, net of income taxes	(23)	(202)	59	122
Derivative financial instruments reclassified to earnings	10	(27)	14	(103)
Other comprehensive income (loss)	45	3,103	(1,882)	(1,778)
Comprehensive income	$58,423	$ 25,619	$90,702	$ 48,952

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Consolidated Balance Sheets
UniFirst Corporation and Subsidiaries
(Unaudited)

(In thousands, except share and par value data)	February 24, 2018	August 26, 2017
Assets		
Current assets:		
Cash, cash equivalents and short-term investments	$387,691	$349,752
Receivables, less reserves of $11,538 and $8,719	195,283	187,174
Inventories	84,509	79,068
Rental merchandise in service	152,669	151,340
Prepaid taxes	9,407	29,968
Prepaid expenses and other current assets	24,945	16,924
Total current assets	854,504	814,226
Property, plant and equipment, net of accumulated depreciation of $730,702 and $702,325	543,342	525,115
Goodwill	389,465	376,110
Customer contracts, net	68,333	67,485
Other intangible assets, net	4,104	4,259
Deferred income taxes	418	394
Other assets	30,568	31,539
Total assets	$1,890,734	$1,819,128
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$58,747	$64,691
Accrued liabilities	116,737	112,236
Accrued taxes	—	921
Total current liabilities	175,484	177,848
Accrued liabilities	107,208	106,736
Accrued and deferred income taxes	63,641	81,352
Total liabilities	346,333	365,936
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred Stock, $1.00 par value; 2,000,000 shares authorized; no shares issued and outstanding	—	—
Common Stock, $0.10 par value; 30,000,000 shares authorized; 15,492,219 and 15,453,308 shares issued and outstanding as of February 24, 2018 and August 26, 2017, respectively	1,549	1,545
Class B Common Stock, $0.10 par value; 20,000,000 shares authorized; 4,815,519 shares issued and outstanding as of February 24, 2018 and August 26, 2017	482	482
Capital surplus	87,740	86,245
Retained earnings	1,478,030	1,386,438
Accumulated other comprehensive loss	(23,400)	(21,518)

Total shareholders’ equity	1,544,401	1,453,192
Total liabilities and shareholders’ equity	$1,890,734	$1,819,128

The accompanying notes are an integral part of these
Consolidated Financial Statements

Table of Contents

Consolidated Statements of Cash Flows
UniFirst Corporation and Subsidiaries
(Unaudited)

Twenty-six weeks ended (In thousands)	February 24, 2018	February 25, 2017
Cash flows from operating activities:		
Net income	$92,584	$50,730
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	39,557	37,051
Amortization of intangible assets	6,414	6,229
Amortization of deferred financing costs	56	56
Gain on sale of assets	(135)	(517)
Share-based compensation	2,417	4,370
Accretion on environmental contingencies	346	300
Accretion on asset retirement obligations	470	423
Deferred income taxes	(20,613)	(1,346)
Changes in assets and liabilities, net of acquisitions:		
Receivables, less reserves	(6,931)	(12,887)
Inventories	(5,296)	9,233
Rental merchandise in service	(69)	444
Prepaid expenses and other current assets and Other assets	(7,067)	7,471
Accounts payable	(5,395)	3,695
Accrued liabilities	39	704
Prepaid and accrued income taxes	22,535	8,793
Net cash provided by operating activities	118,912	114,749
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired	(21,729)	(121,414)
Capital expenditures	(56,653)	(43,011)
Proceeds from sale of assets	1,164	826
Other	(200)	123
Net cash used in investing activities	(77,418)	(163,476)
Cash flows from financing activities:		
Proceeds from exercise of share-based awards, including excess tax benefits	430	2,283
Taxes withheld and paid related to net share settlement of equity awards	(2,094)	(1,546)
Payment of cash dividends	(1,447)	(1,448)
Net cash used in financing activities	(3,111)	(711)
Effect of exchange rate changes	(444)	(822)
Net increase (decrease) in cash, cash equivalents and short-term investments	37,939	(50,260)
Cash, cash equivalents and short-term investments at beginning of period	349,752	363,795
Cash, cash equivalents and short-term investments at end of period	$387,691	$313,535

The accompanying notes are an integral part of these
Consolidated Financial Statements.

6

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements

1. Basis of Presentation

These Consolidated Financial Statements of UniFirst Corporation (“Company”) have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to such rules and regulations; however, the Company believes that the information furnished reflects all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of results for the interim period.

It is suggested that these Consolidated Financial Statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended August 26, 2017. There have been no material changes in the accounting policies followed by the Company during the current fiscal year other than the adoption of recent accounting pronouncements discussed in Note 2. Results for an interim period are not indicative of any future interim periods or for an entire fiscal year.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued updated accounting guidance for revenue recognition, which they have subsequently modified. This modified update provides a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. This guidance will be effective for annual reporting periods, and any interim periods within those annual periods, that begin after December 15, 2017. Accordingly, the standard will be effective for the Company on August 26, 2018. The Company has established an implementation team and is working on the completion of its project plan to address the requirements of this standard. The Company is currently reviewing its customer contracts, assessing its incremental costs of obtaining customer contracts, and identifying any potential changes to business processes and controls to support accounting and disclosure considerations under this standard. The Company expects to adopt this standard using the modified retrospective adoption method and continues to evaluate the impact that this guidance will have on its financial statements and related disclosures.

In July 2015, the FASB issued updated guidance which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value. Subsequent measurement is unchanged for inventory measured using last-in, first-out or the retail inventory method. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016, and is to be applied prospectively, with early adoption permitted. Accordingly, the Company adopted this standard on August 27, 2017. The adoption of this guidance did not have a material impact on its financial statements.

In January 2016, the FASB issued updated guidance for the recognition, measurement, presentation, and disclosure of certain financial assets and liabilities. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. Accordingly, the standard will be effective for the Company on August 26, 2018. The Company expects that adoption of this guidance will not have a material impact on its financial statements.

In February 2016, the FASB issued updated guidance that improves transparency and comparability among companies by recognizing lease assets and lease liabilities on the balance sheet and by disclosing key information about leasing

arrangements. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, with early adoption permitted. Accordingly, the standard will be effective for the Company on September 1, 2019. The Company is currently evaluating the impact that this guidance will have on its financial statements and related disclosures.

In March 2016, the FASB issued updated guidance that simplifies several aspects of accounting for share-based payment transactions. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016 and, depending on the amendment, must be applied using a prospective transition method, retrospective transition method, modified retrospective transition method, prospectively and/or retroactively, with early adoption permitted. Accordingly, the Company adopted this standard on August 27, 2017. The adoption impact on the consolidated balance sheet as of February 24, 2018 was a cumulative-effect adjustment of $0.7 million, decreasing retained earnings and increasing capital surplus. The impact of the adoption on the consolidated statement of income was a decrease of $0.6 million and $2.2 million in the provision for income taxes during the thirteen and twenty-six weeks ended February 24, 2018 respectively. As a result of the adoption of the updated guidance, our excess tax benefit is no longer included in our calculation of diluted shares under the

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

treasury stock method, resulting in an increase of a nominal amount of shares in the effect of dilutive securities for the thirteen and twenty-six weeks ended February 24, 2018. The election to recognize forfeitures of share-based awards as they occur resulted in an increase of $0.1 million and $0.2 million in share-based compensation for the thirteen and twenty-six weeks ended February 24, 2018 respectively. Prior periods have not been adjusted.

In August 2016, the FASB issued updated guidance that reduces diversity in how certain cash receipts and cash payments are presented and classified in the Consolidated Statements of Cash Flows. This guidance will be effective for annual reporting periods, and any interim periods within those annual periods, that begin after December 15, 2017 and will be required to be applied retrospectively, with early adoption permitted. Accordingly, the standard will be effective for the Company on August 26, 2018. The Company is currently evaluating the impact that this guidance will have on its financial statements and related disclosures.

In October 2016, the FASB issued updated guidance to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. This guidance will be effective for annual reporting periods, and any interim periods within those annual periods, that begin after December 15, 2017 and will be required to be applied on a modified retrospective basis, with early adoption permitted. Accordingly, the standard will be effective for the Company on August 26, 2018. The Company is currently evaluating the impact that this guidance will have on its financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This ASU allows a reclassification from AOCI to retained earnings for tax effects resulting from the Tax Cuts and Jobs Act (the “Act”) and requires certain new disclosures. ASU 2018-02 will be effective for the Company for fiscal years beginning after December 15, 2018, with early adoption permitted. The update should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized. The Company elected to early adopt ASU 2018-02 in the second quarter of fiscal 2018. The effect of the adoption of the standard was an increase in AOCI of $1.2 million with the offset to retained earnings as recorded in the Company’s consolidated balance sheet and statement of changes in stockholders’ equity for the twenty-six weeks ended February 24, 2018.

3. Business Acquisitions

During the twenty-six weeks ended February 24, 2018, the Company completed three business acquisitions with an aggregate purchase price of approximately $25.8 million. The initial allocation of the purchase price is incomplete with respect to certain assets acquired. The Company is still in the process of measuring the fair value of intangible assets acquired and liabilities assumed. The results of operations of these acquisitions have been included in the Company’s consolidated financial results since their respective acquisition dates. These acquisitions were not significant in relation to the Company’s consolidated financial results and, therefore, pro-forma financial information has not been presented.

4. Fair Value Measurements

The assets or liabilities measured at fair value on a recurring basis are summarized in the tables below (in thousands):

	As of February 24, 2018
	Level 1

		Level 2	Level 3	Fair Value
Assets:				
Cash equivalents	$79,297	$—	$ —	$79,297
Pension plan assets	—	5,043	—	5,043
Total assets at fair value	$79,297	$5,043	$ —	$84,340
Liabilities:				
Foreign currency forward contracts	$—	$54	$ —	$54
Total liabilities at fair value	$—	$54	$ —	$54

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

	As of August 26, 2017			
	Level 1	Level 2	Level 3	Fair Value
Assets:				
Cash equivalents	$81,253	$—	$ —	$81,253
Pension plan assets	—	5,097	—	5,097
Total assets at fair value	$81,253	$5,097	$ —	$86,350
Liabilities:				
Foreign currency forward contracts	$—	$177	$ —	$177
Total liabilities at fair value	$—	$177	$ —	$177

The Company's cash equivalents listed above represent money market securities and are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The Company does not adjust the quoted market price for such financial instruments.

The Company's pension plan assets listed above represent guaranteed deposit accounts that are maintained and operated by Prudential Retirement Insurance and Annuity Company ("PRIAC"). All assets are merged with the general assets of PRIAC and are invested predominantly in privately placed securities and mortgages. At the beginning of each calendar year, PRIAC notifies the Company of the annual rates of interest which will be applied to the amounts held in the guaranteed deposit account during the next calendar year. In determining the interest rate to be applied, PRIAC considers the investment performance of the underlying assets of the prior year; however, regardless of the investment performance the Company is contractually guaranteed a minimum rate of return. As such, the Company's pension plan assets are included within Level 2 of the fair value hierarchy.

The Company's foreign currency forward contracts represent contracts the Company has entered into to exchange Canadian dollars for U.S. dollars at fixed exchange rates in order to manage its exposure related to certain forecasted Canadian dollar denominated sales of one of its subsidiaries. These contracts were included in other liabilities as of February 24, 2018 and August 26, 2017. The fair value of the forward contracts is based on similar exchange traded derivatives and are, therefore, included within Level 2 of the fair value hierarchy.

5. Derivative Instruments and Hedging Activities

As of February 24, 2018, the Company had forward contracts with a notional value of approximately 6.8 million CAD outstanding and recorded nominal amounts for the fair value of the contracts in other current liabilities with a corresponding loss in accumulated other comprehensive loss, which was recorded net of tax. During the twenty-six weeks ended February 24, 2018, the Company reclassified a nominal amount from accumulated other comprehensive loss to revenue, related to the derivative financial instruments. The loss in accumulated other comprehensive loss as of February 24, 2018 is expected to be reclassified to revenues prior to its maturity on February 22, 2019.

6. Employee Benefit Plans

Defined Contribution Retirement Savings Plan

The Company has a defined contribution retirement savings plan with a 401(k) feature for all eligible U.S and Canadian employees not under collective bargaining agreements. The Company matches a portion of the employee's contribution and may make an additional contribution at its discretion. Contributions charged to expense under the

plan for the thirteen weeks ended February 24, 2018 and February 25, 2017 were $3.9 million and $3.7 million, respectively. Contributions charged to expense under the plan for the twenty-six weeks ended February 24, 2018 and February 25, 2017 were $8.0 million and $7.3 million respectively.

Pension Plans and Supplemental Executive Retirement Plans

The Company maintains an unfunded Supplemental Executive Retirement Plan for certain eligible employees of the Company and two frozen non-contributory defined benefit pension plans. The amounts charged to expense related to these plans for the thirteen weeks ended February 24, 2018 and February 25, 2017 were $0.6 million and $0.9 million, respectively. The amounts charged to expense related to these plans for the twenty-six weeks ended February 24, 2018 and February 25, 2017 were $1.3 million and $1.7 million respectively.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

7. Net Income Per Share

The Company calculates net income per share by allocating income to its unvested participating securities as part of its earnings per share ("EPS") calculations. The following table sets forth the computation of basic earnings per share using the two-class method for amounts attributable to the Company's shares of Common Stock and Class B Common Stock (in thousands, except per share data):

	Thirteen weeks ended		Twenty-six weeks ended	
	February 24, 2018	February 25, 2017	February 24, 2018	February 25, 2017
Net income available to shareholders	$58,378	$ 22,516	$92,584	$ 50,730
Allocation of net income for Basic:				
Common Stock	$46,744	$ 17,836	$74,126	$ 40,178
Class B Common Stock	11,634	4,518	18,458	10,184
Unvested participating shares	—	162	—	368
	$58,378	$ 22,516	$92,584	$ 50,730
Weighted average number of shares for Basic:				
Common Stock	15,481	15,305	15,471	15,295
Class B Common Stock	4,816	4,846	4,816	4,846
Unvested participating shares	—	139	—	140
	20,297	20,290	20,287	20,281
Earnings per share for Basic:				
Common Stock	$3.02	$ 1.17	$4.79	$ 2.63
Class B Common Stock	$2.42	$ 0.93	$3.83	$ 2.10

The Company is required to calculate diluted EPS for Common Stock using the more dilutive of the following two methods:

- The treasury stock method; or
- The two-class method assuming a participating security is not exercised or converted.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

For the thirteen and twenty-six weeks ended February 24, 2018, the Company's diluted EPS assumes the conversion of all vested Class B Common Stock into Common Stock and uses the two-class method for its unvested participating shares. The following table sets forth the computation of diluted earnings per share of Common Stock for the thirteen and twenty-six weeks ended February 24, 2018 (in thousands, except per share data):

	Thirteen weeks ended February 24, 2018			Twenty-six weeks ended February 24, 2018		
	Earnings to Common shareholders	Common Shares	EPS	Earnings to Common shareholders	Common Shares	EPS
As reported - Basic	$46,744	15,481	$3.02	$74,126	15,471	$4.79
Add: effect of dilutive potential common shares						
Share-Based Awards	—	166		—	147	
Class B Common Stock	11,634	4,816		18,458	4,816	
Add: Undistributed earnings allocated to unvested participating shares	—	—		—	—	
Less: Undistributed earnings reallocated to unvested participating shares	—	—		—	—	
As reported – Diluted	$58,378	20,463	$2.85	$92,584	20,434	$4.53

Share-based awards that would result in the issuance of 4,368 shares of Common Stock were excluded from the calculation of diluted earnings per share for the thirteen weeks ended February 24, 2018 because they were anti-dilutive. Share-based awards that would result in the issuance of 1,001 shares of Common Stock were excluded from the calculation of diluted earnings per share for the twenty-six weeks ended February 24, 2018 because they were anti-dilutive.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

For the thirteen and twenty-six weeks ended February 25, 2017, the Company's diluted EPS assumes the conversion of all vested Class B Common Stock into Common Stock and uses the two-class method for its unvested participating shares. The following table sets forth the computation of diluted earnings per share of Common Stock for the thirteen and twenty-six weeks ended February 25, 2017 (in thousands, except per share data):

	Thirteen weeks ended February 25, 2017			Twenty-six weeks ended February 25, 2017		
	Earnings to Common shareholders	Common Shares	EPS	Earnings to Common shareholders	Common Shares	EPS
As reported - Basic	$17,836	15,305	$1.17	$40,178	15,295	$2.63
Add: effect of dilutive potential common shares						
Share-Based Awards	—	112		—	109	
Class B Common Stock	4,518	4,846		10,184	4,846	
Add: Undistributed earnings allocated to unvested participating shares	158	—		357	—	
Less: Undistributed earnings reallocated to unvested participating shares	(150)	—		(338)	—	
As reported – Diluted	$22,362	20,263	$1.10	$50,381	20,250	$2.49

Share-based awards that would result in the issuance of 11,821 shares of Common Stock were excluded from the calculation of diluted earnings per share for the thirteen weeks ended February 25, 2017 because they were anti-dilutive. There were no share-based awards that were excluded from the calculation of diluted earnings per share for the twenty-six weeks ended February 25, 2017 because they were anti-dilutive.

8. Inventories

Inventories are stated at the lower of cost or net realizable value, net of any reserve for excess and obsolete inventory. Work-in-process and finished goods inventories consist of materials, labor and manufacturing overhead. Judgments and estimates are used in determining the likelihood that new goods on hand can be sold to customers or used in rental operations. Historical inventory usage and current revenue trends are considered in estimating both excess and obsolete inventories. If actual product demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required. The Company uses the first-in, first-out ("FIFO") method to value its inventories.

The components of inventory as of February 24, 2018 and August 26, 2017 were as follows (in thousands):

February 24, 2018	August 26, 2017

Raw materials	$ 12,953	$18,468
Work in process	3,227	4,159
Finished goods	68,329	56,441
Total inventories	$ 84,509	$79,068

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

9. Goodwill and Other Intangible Assets

As discussed in Note 3, "Acquisitions", when the Company acquires a business, the amount assigned to the tangible assets and liabilities and intangible assets acquired is based on their respective fair values determined as of the acquisition date. The excess of the purchase price over the tangible assets and liabilities and intangible assets is recorded as goodwill.

The changes in the carrying amount of goodwill are as follows (in thousands):

Balance as of August 26, 2017	$376,110
Goodwill recorded during the period	13,367
Other	(12)
Balance as of February 24, 2018	$389,465

Intangible assets, net in the Company's accompanying Consolidated Balance Sheets are as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
February 24, 2018			
Customer contracts	$215,233	$ 146,900	$ 68,333
Other intangible assets	34,877	30,773	4,104
	$250,110	$ 177,673	$ 72,437
August 26, 2017			
Customer contracts	$208,711	$ 141,226	$ 67,485
Other intangible assets	34,249	29,990	4,259
	$242,960	$ 171,216	$ 71,744

10. Asset Retirement Obligations

The Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The Company continues to depreciate, on a straight-line basis, the amount added to property, plant and equipment and recognizes accretion expense in connection with the discounted liability over the various remaining lives which range from approximately one to twenty-six years.

A reconciliation of the Company's asset retirement liability for the twenty-six weeks ended February 24, 2018 was as follows (in thousands):

	February 24, 2018
Beginning balance as of August 26, 2017	$13,400
Accretion expense	470
Effect of exchange rate changes	164
Change in estimate	(405)
Ending balance as of February 24, 2018	$13,629

Asset retirement obligations are included in current and long-term accrued liabilities in the accompanying Consolidated Balance Sheets.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

11. Commitments and Contingencies

The Company and its operations are subject to various federal, state and local laws and regulations governing, among other things, air emissions, wastewater discharges, and the generation, handling, storage, transportation, treatment and disposal of hazardous wastes and other substances. In particular, industrial laundries currently use and must dispose of detergent waste water and other residues, and, in the past, used perchloroethylene and other dry cleaning solvents. The Company is attentive to the environmental concerns surrounding the disposal of these materials and has, through the years, taken measures to avoid their improper disposal. Over the years, the Company has settled, or contributed to the settlement of, actions or claims brought against the Company relating to the disposal of hazardous materials and there can be no assurance that the Company will not have to expend material amounts to remediate the consequences of any such disposal in the future.

U.S. GAAP requires that a liability for contingencies be recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Significant judgment is required to determine the existence of a liability, as well as the amount to be recorded. The Company regularly consults with attorneys and outside consultants in its consideration of the relevant facts and circumstances before recording a contingent liability. Changes in enacted laws, regulatory orders or decrees, management’s estimates of costs, risk-free interest rates, insurance proceeds, participation by other parties, the timing of payments, the input of the Company’s attorneys and outside consultants or other factual circumstances could have a material impact on the amounts recorded for environmental and other contingent liabilities.

Under environmental laws, an owner or lessee of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances located on, or in, or emanating from, such property, as well as related costs of investigation and property damage. Such laws often impose liability without regard to whether the owner or lessee knew of, or was responsible for the presence of such hazardous or toxic substances. There can be no assurances that acquired or leased locations have been operated in compliance with environmental laws and regulations or that future uses or conditions will not result in the imposition of liability upon the Company under such laws or expose the Company to third-party actions such as tort suits. The Company continues to address environmental conditions under terms of consent orders negotiated with the applicable environmental authorities or otherwise with respect to sites located in or related to Woburn, Massachusetts, Somerville, Massachusetts, Springfield, Massachusetts, Uvalde, Texas, Stockton, California, three sites related to former operations in Williamstown, Vermont, as well as sites located in Goldsboro, North Carolina, Wilmington, North Carolina, and Landover, Maryland.

The Company has accrued certain costs related to the sites described above as it has been determined that the costs are probable and can be reasonably estimated. The Company has potential exposure related to a parcel of land (the "Central Area") related to the Woburn, Massachusetts site mentioned above. Currently, the consent decree for the Woburn site does not define or require any remediation work in the Central Area. The United States Environmental Protection Agency (the "EPA") has provided the Company and other signatories to the consent decree with comments on the design and implementation of groundwater and soil remedies at the Woburn site and investigation of environmental conditions in the Central Area. The Company, and other signatories, have implemented and proposed to do additional work at the Woburn site but many of the EPA’s comments remain to be resolved. The Company has accrued costs to perform certain work responsive to EPA's comments. The Company has implemented mitigation measures and continues to monitor environmental conditions at the Somerville, Massachusetts site. In addition, the Company has received demands from the local transit authority for reimbursement of certain costs associated with its construction of a new municipal transit station in the area of the Company’s Somerville site. This station is part of a planned extension of the transit system. The Company has reserved for costs in connection with this matter; however,

in light of the uncertainties associated with this matter, these costs and the related reserve may change. The Company has also received notice that the Massachusetts Department of Environmental Protection is conducting an audit of the Company's investigation and remediation work with respect to the Somerville site.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

The Company routinely reviews and evaluates sites that may require remediation and monitoring and determines its estimated costs based on various estimates and assumptions. These estimates are developed using its internal sources or by third party environmental engineers or other service providers. Internally developed estimates are based on:

- Management's judgment and experience in remediating and monitoring the Company's sites;
- Information available from regulatory agencies as to costs of remediation and monitoring;
- The number, financial resources and relative degree of responsibility of other potentially responsible parties ("PRPs") who may be liable for remediation and monitoring of a specific site; and
- The typical allocation of costs among PRPs.

There is usually a range of reasonable estimates of the costs associated with each site. In accordance with U.S. GAAP, the Company's accruals reflect the amount within the range that it believes is the best estimate or the low end of a range of estimates if no point within the range is a better estimate. Where it believes that both the amount of a particular liability and the timing of the payments are reliably determinable, the Company adjusts the cost in current dollars using a rate of 3% for inflation until the time of expected payment and discounts the cost to present value using current risk-free interest rates. As of February 24, 2018, the risk-free interest rates utilized by the Company ranged from 2.9% to 3.2%.

For environmental liabilities that have been discounted, the Company includes interest accretion, based on the effective interest method, in selling and administrative expenses on the Consolidated Statements of Income. The changes to the Company's environmental liabilities for the twenty-six weeks ended February 24, 2018 were as follows (in thousands):

	February 24, 2018
Beginning balance as of August 26, 2017	$25,419
Costs incurred for which reserves had been provided	(627)
Insurance proceeds	56
Interest accretion	346
Change in discount rates	(858)
Balance as of February 24, 2018	$24,336

Anticipated payments and insurance proceeds of currently identified environmental remediation liabilities as of February 24, 2018, for the next five fiscal years and thereafter, as measured in current dollars, are reflected below.

(In thousands)	2018	2019	2020	2021	2022	Thereafter	Total
Estimated costs – current dollars	$8,658	$1,880	$1,477	$1,305	$1,157	$12,304	$26,781
Estimated insurance proceeds	(103)	(173)	(159)	(173)	(159)	(993)	(1,760)
Net anticipated costs	$8,555	$1,707	$1,318	$1,132	$998	$11,311	$25,021
Effect of inflation							7,623
Effect of discounting							(8,308)

Balance as of February 24, 2018	$24,336

Estimated insurance proceeds are primarily received from an annuity received as part of a legal settlement with an insurance company. Annual proceeds of approximately $0.3 million are deposited into an escrow account which funds remediation and monitoring costs for three sites related to former operations in Williamstown, Vermont. Annual proceeds received but not expended in the current year accumulate in this account and may be used in future years for costs related to this site through the year 2027.

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

As of February 24, 2018, the balance in this escrow account, which is held in a trust and is not recorded in the Company's accompanying Consolidated Balance Sheet, was approximately $3.6 million. Also included in estimated insurance proceeds are amounts the Company is entitled to receive pursuant to legal settlements as reimbursements from three insurance companies for estimated costs at the site in Uvalde, Texas.

The Company's nuclear garment decontamination facilities are licensed by the Nuclear Regulatory Commission ("NRC"), or, in certain cases, by the applicable state agency, and are subject to regulation by federal, state and local authorities. The Company also has nuclear garment decontamination facilities in the United Kingdom and the Netherlands. These facilities are licensed and regulated by the respective country's applicable federal agency. In the past, scrutiny and regulation of nuclear facilities and related services have resulted in the suspension of operations at certain nuclear facilities served by the Company or disruptions in its ability to service such facilities. There can be no assurance that such regulation will not lead to material disruptions in the Company's garment decontamination business.

From time to time, the Company is also subject to legal proceedings and claims arising from the conduct of its business operations, including personal injury claims, customer contract matters, employment claims and environmental matters as described above.

While it is impossible for the Company to ascertain the ultimate legal and financial liability with respect to contingent liabilities, including lawsuits and environmental contingencies, the Company believes that the aggregate amount of such liabilities, if any, in excess of amounts covered by insurance have been properly accrued in accordance with U.S. GAAP. It is possible, however, that the future financial position and/or results of operations for any particular future period could be materially affected by changes in the Company's assumptions or strategies related to these contingencies or changes out of the Company's control.

12. Income Taxes

In accordance with ASC 740, Income Taxes ("ASC 740"), each interim period is considered integral to the annual period, and tax expense is measured using an estimated annual effective tax rate. An entity is required to record income tax expense each quarter based on its annual effective tax rate estimated for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis, adjusted for discrete taxable events that occur during the interim period.

The Company's effective tax rate for the thirteen weeks ended February 24, 2018 was (34.0)% compared to a provision of 39.8% for the corresponding period in the prior year. The Company's effective tax rate for the twenty-six weeks ended February 24, 2018 was 4.2% compared to 39.2% for the corresponding period in the prior year. The reduction in the effective tax rates in the thirteen and twenty-six weeks ended February 24, 2018 as compared to the corresponding periods in the prior year was due primarily to the impact of the Act enacted on December 22, 2017. As a result of this law, U.S. corporations will be subject to lower income tax rates, which also caused the Company to remeasure its U.S. net deferred tax liabilities at the lower rates. The remeasurement of the Company's net deferred tax assets and liabilities resulted in an estimated net benefit of $22.7 million recorded to the Company's provision for income taxes. Also because of this law, the Company will be subject to a one-time transition tax for the deemed repatriation of its foreign earnings. The Company recorded an estimated charge of $2.5 million for this transition tax which partially offset the benefit mentioned above. For the thirteen and twenty-six weeks ended February 24, 2018, the Company's effective tax rates also were lower than the statutory tax rate due to the tax benefit from restricted stock units upon vesting.

U.S. Tax Reform
The Act reduces the U.S. federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creates new taxes on certain foreign sourced earnings.

As of February 24, 2018, the Company had not completed its accounting for the tax effects of enactment of the Act; however, as described below, the Company has made a reasonable estimate of the effects on its existing deferred tax balances and the one-time transition tax, and recognized a provisional net benefit of $20.2 million, which is included in income tax expense for the thirteen and twenty-six weeks ended February 24, 2018.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Act (“SAB 118”) directing SEC registrants to consider the impact of the U.S. legislation as “provisional” when they do not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete their accounting for the

change in tax law. In accordance with SAB 118, the amounts recorded related to accounting for the Act represent the Company's best estimate based on its interpretation of the U.S. legislation as the Company is still accumulating data to finalize the underlying calculations, or in certain cases, the U.S. Treasury is expected to issue further guidance on the application of certain provisions of the U.S. legislation. In addition, we also used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service, the SEC, the FASB and various other taxing jurisdictions. In particular, we anticipate that the U.S. state jurisdictions will continue to determine and announce their conformity or decoupling from the Act, either in its entirety or with respect to specific provisions. All of these potential legislative and interpretive actions could result in adjustments to our provisional estimates when the accounting for the income tax effects of the Act is completed.

In the thirteen and twenty-six weeks ended February 24, 2018, the Company revised its estimated annual effective rate to reflect a change in the federal statutory income tax rate from 35% to 21%. The rate change is administratively effective at the beginning of the Company's fiscal year, using a blended rate for the annual period. The Company's blended federal statutory income tax rate for fiscal 2018 is 25.9%.

The Company re-measured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is 25.9% for fiscal 2018 reversals and 21% for post-fiscal 2018 reversals. However, the Company is still analyzing certain aspects of the Act and refining its calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. The provisional net benefit amount recorded related to the re-measurement of the Company's deferred tax balance was $22.7 million.

The one-time transition tax is based on the Company's total post-1986 earnings and profits ("E&P") which were previously deferred from U.S. income taxes. The Company recorded a provisional amount for its one-time transition tax liability related to the deemed repatriation of the earnings of its foreign subsidiaries, resulting in an increase in income tax expense of $2.5 million in the thirteen and twenty-six weeks ended February 24, 2018. The Company has not yet finalized its calculation of the total post-1986 foreign E&P for these foreign subsidiaries. Further, the transition tax is based in part on the amount of those earnings held in cash and other specified assets. This amount may change when the Company finalizes the calculation of its post-1986 foreign E&P previously deferred from U.S. federal taxation and finalizes the amounts held in cash or other specified assets. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax and any additional outside basis difference inherent in these entities as these amounts continue to be indefinitely reinvested in foreign operations. The Company continues to evaluate this assertion in its ongoing analysis of the effects of tax reform on the Company's strategic initiatives. The Company believes that determining the amount of unrecognized deferred tax liability related to any remaining undistributed foreign earnings not subject to the transition tax and additional outside basis difference in these entities (i.e., basis difference in excess of that subject to the one-time transition tax) is not practicable.

Uncertain tax positions
The Company recognizes interest and penalties related to uncertain tax positions as a component of income tax expense which is consistent with the recognition of these items in prior reporting periods. During the thirteen and twenty-six weeks ended February 24, 2018, there were no material changes in the amount of unrecognized tax benefits or the amount accrued for interest and penalties.

All U.S. and Canadian federal income tax statutes have lapsed for filings up to and including fiscal years 2012 and 2009, respectively, and the Company has concluded an audit of U.S. federal income taxes for 2010 and 2011. With a few exceptions, the Company is no longer subject to state and local income tax examinations for periods prior to fiscal 2013. The Company is not aware of any tax positions for which it is reasonably possible that the total amounts of

unrecognized tax benefits will change significantly in the next 12 months.

13. Long-Term Debt

On April 11, 2016, the Company entered into an amended and restated $250 million unsecured revolving credit agreement (the “Credit Agreement”) with a syndicate of banks, which matures on April 11, 2021. Under the Credit Agreement, the Company is able to borrow funds at variable interest rates based on, at the Company’s election, the Eurodollar rate or a base rate, plus in each case a spread based on the Company’s consolidated funded debt ratio. Availability of credit requires compliance with certain financial and other covenants, including a maximum consolidated funded debt ratio and minimum consolidated interest coverage ratio as defined in the Credit Agreement. The Company tests its compliance with these financial covenants on a fiscal quarterly basis. At February 24, 2018, the interest rates applicable to the Company’s borrowings under the Credit Agreement would be calculated as LIBOR plus 75 basis points at the time of the respective borrowing. As of February 24, 2018, the Company had no

Table of Contents

UniFirst Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

outstanding borrowings and had outstanding letters of credit amounting to $77.6 million, leaving $172.4 million available for borrowing under the Credit Agreement.

As of February 24, 2018, the Company was in compliance with all covenants under the Credit Agreement.

14. Accumulated Other Comprehensive Income (Loss)

The changes in each component of accumulated other income (loss), net of tax, for the thirteen and twenty-six weeks ended February 24, 2018 and February 25, 2017 were as follows (in thousands):

	Thirteen weeks ended February 24, 2018			
	Foreign Currency Translation	Pension-related (1)(2)	Derivative Financial Instruments (1)	Total Accumulated Other Comprehensive (Loss) Income
Balance as of November 25, 2017	$(17,945)	$(5,477)	$ (23)	$ (23,445)
Other comprehensive income (loss) before reclassification	1,250	—	(23)	1,227
Amounts reclassified from accumulated other comprehensive income (loss)	—			