

SERVICEMASTER CO
Form 10-Q
November 15, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 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 September 30, 2010

o 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 1-14762

THE SERVICEMASTER COMPANY

Edgar Filing: SERVICEMASTER CO - Form 10-Q

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-3858106
(IRS Employer Identification No.)

860 Ridge Lake Boulevard, Memphis, Tennessee 38120

(Address of principal executive offices) (Zip Code)

901-597-1400

(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 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, 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

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

The registrant is a privately held corporation and its equity shares are not publicly traded. At November 15, 2010, 1,000 shares of the registrant's common stock were outstanding, all of which were owned by CDRSVM Holding, Inc.

The ServiceMaster Company is not required to file this Quarterly Report on Form 10-Q with the Securities and Exchange Commission and is doing so on a voluntary basis.

Table of Contents

TABLE OF CONTENTS

	Page No.
<u>Part I. Financial Information</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Condensed Consolidated Statements of Operations for the three months ended September 30, 2010 and September 30, 2009</u>	3
<u>Condensed Consolidated Statements of Operations for the nine months ended September 30, 2010 and September 30, 2009</u>	4
<u>Condensed Consolidated Statements of Financial Position as of September 30, 2010 and December 31, 2009</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and September 30, 2009</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	53
<u>Item 4. Controls and Procedures</u>	53
<u>Part II. Other Information</u>	53
<u>Item 1. Legal Proceedings</u>	53
<u>Item 6. Exhibits</u>	54
<u>Signature</u>	55

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****THE SERVICEMASTER COMPANY****Condensed Consolidated Statements of Operations (Unaudited)***(In thousands)*

	Three months ended September 30,	
	2010	2009
Operating Revenue	\$ 977,260	\$ 920,514
Operating Costs and Expenses:		
Cost of services rendered and products sold	561,236	527,445
Selling and administrative expenses	266,794	249,302
Amortization expense	30,868	40,429
Restructuring and Merger related charges	1,690	8,498
Total operating costs and expenses	860,588	825,674
Operating Income	116,672	94,840
Non-operating Expense (Income):		
Interest expense	71,267	74,216
Interest and net investment income	(3,989)	(4,558)
Other expense	209	176
Income from Continuing Operations before Income Taxes	49,185	25,006
Provision for income taxes	43,790	4,102
Income from Continuing Operations	5,395	20,904
Loss from discontinued operations, net of income taxes	(105)	(396)
Net Income	\$ 5,290	\$ 20,508

See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents**THE SERVICEMASTER COMPANY****Condensed Consolidated Statements of Operations (Unaudited)***(In thousands)*

	Nine months ended September 30,	
	2010	2009
Operating Revenue	\$ 2,619,730	\$ 2,523,733
Operating Costs and Expenses:		
Cost of services rendered and products sold	1,537,337	1,475,218
Selling and administrative expenses	714,132	662,994
Amortization expense	111,761	121,139
Goodwill and trade name impairment	46,884	
Restructuring and Merger related charges	9,781	22,859
Total operating costs and expenses	2,419,895	2,282,210
Operating Income	199,835	241,523
Non-operating Expense (Income):		
Interest expense	217,117	225,538
Interest and net investment income	(7,487)	(3,192)
Gain on extinguishment of debt		(46,106)
Other expense	556	555
(Loss) Income from Continuing Operations before Income Taxes	(10,351)	64,728
Provision for income taxes	3,888	20,720
(Loss) Income from Continuing Operations	(14,239)	44,008
Loss from discontinued operations, net of income taxes	(687)	(666)
Net (Loss) Income	\$ (14,926)	\$ 43,342

See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents**THE SERVICEMASTER COMPANY****Condensed Consolidated Statements of Financial Position***(In thousands, except share data)*

	As of September 30, 2010 (Unaudited)	As of December 31, 2009 (Audited)
Assets		
Current Assets:		
Cash and cash equivalents	\$ 197,040	\$ 253,463
Marketable securities	28,127	21,120
Receivables, less allowance of \$21,335 and \$20,314, respectively	442,093	348,655
Inventories	77,812	76,592
Prepaid expenses and other assets	46,020	36,564
Deferred customer acquisition costs	43,121	36,070
Deferred taxes	16,757	21,595
Assets of discontinued operations	10	42
Total Current Assets	850,980	794,101
Property and Equipment:		
At cost	448,982	345,100
Less: accumulated depreciation	(180,122)	(132,965)
Net property and equipment	268,860	212,135
Other Assets:		
Goodwill	3,119,484	3,119,754
Intangible assets, primarily trade names, service marks and trademarks, net	2,689,260	2,787,237
Notes receivable	23,880	23,490
Long-term marketable securities	111,518	111,066
Other assets	7,094	31,799
Debt issuance costs	55,909	66,807
Total Assets	\$ 7,126,985	\$ 7,146,389
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable	\$ 99,005	\$ 73,471
Accrued liabilities:		
Payroll and related expenses	102,711	74,385
Self-insured claims and related expenses	86,037	87,332
Other	139,590	156,649
Deferred revenue	452,751	449,746
Liabilities of discontinued operations	656	2,806
Current portion of long-term debt	50,316	64,395
Total Current Liabilities	931,066	908,784
Long-Term Debt	3,906,902	3,910,549
Other Long-Term Liabilities:		
Deferred taxes	932,656	957,077
Liabilities of discontinued operations	4,078	4,145
Other long-term obligations	178,719	179,503
Total Other Long-Term Liabilities	1,115,453	1,140,725

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Commitments and Contingencies (See Note 4)

Shareholder's Equity:

Common stock \$0.01 par value, authorized 1,000 shares; issued 1,000 shares			
Additional paid-in capital	1,453,393		1,446,529
Retained deficit	(251,350)		(236,424)
Accumulated other comprehensive loss	(28,479)		(23,774)
Total Shareholder's Equity	1,173,564		1,186,331
Total Liabilities and Shareholder's Equity	\$ 7,126,985	\$	7,146,389

See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents**THE SERVICEMASTER COMPANY****Condensed Consolidated Statements of Cash Flows (Unaudited)***(In thousands)*

	Nine months ended September 30,	
	2010	2009
Cash and Cash Equivalents at Beginning of Period	\$ 253,463	\$ 405,587
Cash Flows from Operating Activities from Continuing Operations:		
Net (Loss) Income	(14,926)	43,342
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss from discontinued operations	687	666
Depreciation expense	50,699	48,781
Amortization expense	111,761	121,139
Amortization of debt issuance costs	10,933	10,989
Gain on extinguishment of debt		(46,106)
Deferred income tax (benefit) provision	(13,516)	6,887
Stock-based compensation expense	6,864	5,992
Goodwill and trade name impairment	46,884	
Restructuring and Merger related charges	9,781	22,859
Cash payments related to restructuring charges	(10,249)	(19,805)
Change in working capital, net of acquisitions:		
Current income taxes	3,827	12,933
Receivables	(95,207)	(56,039)
Inventories and other current assets	(21,260)	(16,533)
Accounts payable	27,929	(9,214)
Deferred revenue	1,042	(2,919)
Accrued liabilities	(1,416)	(63,185)
Other, net	5,406	9,417
Net Cash Provided from Operating Activities from Continuing Operations	119,239	69,204
Cash Flows from Investing Activities from Continuing Operations:		
Property additions	(105,292)	(50,470)
Sale of equipment and other assets	1,558	2,756
Acquisition of The ServiceMaster Company	(2,219)	(1,482)
Other business acquisitions, net of cash acquired	(52,488)	(20,730)
Notes receivable, financial investments and securities, net	20,954	8,032
Net Cash Used for Investing Activities from Continuing Operations	(137,487)	(61,894)
Cash Flows from Financing Activities from Continuing Operations:		
Borrowings of debt	15,000	
Payments of debt	(49,797)	(201,371)
Debt issuance costs paid	(30)	(410)
Net Cash Used for Financing Activities from Continuing Operations	(34,827)	(201,781)
Cash Flows from Discontinued Operations:		
Cash used for operating activities	(3,348)	(2,329)
Cash used for investing activities		(914)
Net Cash Used for Discontinued Operations	(3,348)	(3,243)
Cash Decrease During the Period	(56,423)	(197,714)

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Cash and Cash Equivalents at End of Period	\$	197,040	\$	207,873
--	----	---------	----	---------

See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents

THE SERVICEMASTER COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Basis of Presentation

The ServiceMaster Company is a national company serving both residential and commercial customers. Its products and services include lawn care, landscape maintenance, termite and pest control, home service contracts, cleaning and disaster restoration, house cleaning, furniture repair and home inspection. ServiceMaster provides these services through a network of company-owned locations and franchise licenses operating under the following leading brands: TruGreen, TruGreen LandCare, Terminix, American Home Shield, ServiceMaster Clean, Merry Maids, Furniture Medic and AmeriSpec. ServiceMaster is organized into six principal reportable segments: TruGreen LawnCare, TruGreen LandCare, Terminix, American Home Shield, ServiceMaster Clean and Other Operations and Headquarters.

The condensed consolidated financial statements include the accounts of The ServiceMaster Company and its majority owned subsidiary partnerships, limited liability companies and corporations, collectively referred to as ServiceMaster, the Company, we, us or our.

The condensed consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles in the United States (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The Company recommends that the quarterly condensed 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 filed with the SEC for the year ended December 31, 2009. The condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods presented. All intercompany transactions and balances have been eliminated in consolidation. The results of operations for any interim period are not necessarily indicative of the results which might be achieved for a full year.

On March 18, 2007, ServiceMaster entered into an Agreement and Plan of Merger (the Merger Agreement) with ServiceMaster Global Holdings, Inc. (formerly CDRSVM Topco, Inc.) (Holdings) and CDRSVM Acquisition Co., Inc., an indirect wholly owned subsidiary of Holdings (Acquisition Co.). The Merger Agreement provided that, upon the terms and subject to the conditions set forth in the Merger Agreement, Acquisition Co. would merge with and into ServiceMaster, with ServiceMaster as the surviving corporation (the Merger).

On July 24, 2007 (the Closing Date), the Merger was completed, and, immediately following the completion of the Merger, all of the outstanding capital stock of Holdings, the ultimate parent company of ServiceMaster, was owned by investment funds sponsored by, or affiliated with, Clayton, Dubilier & Rice, Inc. (now operated as Clayton, Dubilier & Rice, LLC, CD&R), Citigroup Private Equity LP (together with its affiliate, Citigroup Alternative Investments LLC, Citigroup), BAS Capital Funding Corporation (BAS) and J.P. Morgan Ventures Corporation (JP Morgan) (collectively, the Equity Sponsors).

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Equity contributions totaling \$1,431.1 million from the Equity Sponsors, together with (i) borrowings under a new \$1,150.0 million senior unsecured interim loan facility (Interim Loan Facility), (ii) borrowings under a new \$2,650.0 million senior secured term loan facility and (iii) cash on hand at ServiceMaster, were used, among other things, to finance the aggregate merger consideration, to make payments in satisfaction of other equity-based interests in ServiceMaster under the Merger Agreement, to settle existing interest rate swaps, to redeem or provide for the repayment of certain of the Company's existing indebtedness and to pay related transaction fees and expenses. In addition, letters of credit issued under a new \$150.0 million pre-funded letter of credit facility (together with the senior secured term loan facility, the Term Facilities) were used to replace and/or secure letters of credit previously issued under a ServiceMaster credit facility that was terminated as of the Closing Date. On the Closing Date, the Company also entered into, but did not then draw under, a new \$500.0 million senior secured revolving credit facility (the Revolving Credit Facility).

The Interim Loan Facility matured on July 24, 2008. On the maturity date, outstanding amounts under the Interim Loan Facility were converted on a one-to-one basis into 10.75%/11.50% senior toggle notes maturing in 2015 (the Permanent Notes). The Permanent Notes were issued pursuant to a refinancing indenture. In connection with the issuance of the Permanent Notes, ServiceMaster entered into a registration rights agreement (the Registration Rights Agreement), pursuant to which ServiceMaster filed with the Securities and Exchange Commission (SEC) a registration statement with respect to the resale of the Permanent Notes, which was declared effective on January 16, 2009. ServiceMaster deregistered the Permanent Notes in accordance with the terms of the Registration Rights Agreement, and the effectiveness of the registration statement was terminated, on November 19, 2009.

Table of Contents

Note 2. Significant Accounting Policies

The Company's significant accounting policies are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The following selected accounting policies should be read in conjunction with that Annual Report on Form 10-K.

Revenues from lawn care and pest control services, as well as liquid and fumigation termite applications, are recognized as the services are provided. Revenues from landscaping services are recognized as they are earned based upon contractual arrangements or when services are performed for non-contractual arrangements. The Company eradicates termites through the use of non-baiting methods (e.g., fumigation or liquid treatments) and baiting systems. Termite services using baiting systems, termite inspection and protection contracts, as well as home service contracts, are frequently sold through annual contracts for a one-time, upfront payment. Direct costs of these contracts (service costs for termite contracts and claim costs for home service contracts) are expensed as incurred. The Company recognizes revenue over the life of these contracts in proportion to the expected direct costs. Those costs bear a direct relationship to the fulfillment of the Company's obligations under the contracts and are representative of the relative value provided to the customer (proportional performance method). The Company regularly reviews its estimates of direct costs for its termite bait and home service contracts and adjusts the estimates when appropriate. Revenue from trade name licensing arrangements is recognized when earned.

The Company has franchise agreements in its TruGreen LawnCare, Terminix, ServiceMaster Clean, AmeriSpec, Furniture Medic and Merry Maids businesses. Franchise revenue (which in the aggregate represents approximately four percent of consolidated revenue from continuing operations) consists principally of continuing monthly fees based upon the franchisee's customer level revenue. Monthly fee revenue is recognized when the related customer level revenue is reported by the franchisee and collectability is reasonably assured. Franchise revenue also includes initial fees resulting from the sale of a franchise. These fees are fixed and are recognized as revenue when collectability is reasonably assured and all material services or conditions relating to the sale have been substantially performed. Total profits from the franchised operations were \$17.3 million and \$51.9 million for the three and nine months ended September 30, 2010, respectively, and \$20.3 million and \$49.9 million for the three and nine months ended September 30, 2009, respectively. Consolidated operating income from continuing operations was \$116.7 million and \$199.8 million for the three and nine months ended September 30, 2010, respectively, and \$94.8 million and \$241.5 million for the three and nine months ended September 30, 2009, respectively. The Company evaluates the performance of its franchise businesses based primarily on operating profit before corporate general and administrative expenses, interest expense and amortization of intangible assets. The portion of total franchise fee income related to initial fees received from the sale of franchises was immaterial to the Company's condensed consolidated financial statements for all periods.

The Company had \$452.8 million and \$449.7 million of deferred revenue at September 30, 2010 and December 31, 2009, respectively. Deferred revenue consists primarily of payments received for annual contracts relating to home service contracts, termite baiting, termite inspection, pest control and lawn care services.

Customer acquisition costs, which are incremental and direct costs of obtaining a customer, are deferred and amortized over the life of the related contract in proportion to revenue recognized. These costs include sales commissions and direct selling costs which can be shown to have resulted in a successful sale.

TruGreen LawnCare has significant seasonality in its business. In the winter and spring, this business sells a series of lawn applications to customers which are rendered primarily in March through October (the production season). This business incurs incremental selling expenses at the beginning of the year that directly relate to successful sales for which the revenues are recognized in later quarters. On an interim basis, TruGreen LawnCare defers these incremental selling expenses, pre-season advertising costs and annual repairs and maintenance procedures that

Edgar Filing: SERVICEMASTER CO - Form 10-Q

are performed primarily in the first quarter. These costs are deferred and recognized in proportion to the contract revenue over the production season and are not deferred beyond the calendar year-end. Other business segments of the Company also defer, on an interim basis, advertising costs incurred early in the year. These pre-season costs are deferred and recognized approximately in proportion to revenue over the balance of the year and are not deferred beyond the fiscal year-end.

The cost of direct-response advertising at Terminix and TruGreen LawnCare, consisting primarily of direct-mail promotions, is capitalized and amortized over its expected period of future benefits.

The preparation of the condensed consolidated financial statements requires management to make certain estimates and assumptions required under GAAP which may differ from actual results. Disclosures in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 presented the significant areas that require the use of management's estimates and discussed how management formed its judgments. The areas discussed included revenue recognition; the allowance for uncollectible receivables; accruals for self-insured retention limits related to medical, workers' compensation, auto and general liability insurance

Table of Contents

claims; accruals for home service contracts and termite damage claims; the possible outcome of outstanding litigation; accruals for income tax liabilities, as well as deferred tax accounts; the deferral and amortization of customer acquisition costs; useful lives for depreciation and amortization expense; the valuation of marketable securities; and the valuation of tangible and intangible assets.

Note 3. Restructuring and Merger Related Charges

The Company incurred restructuring and Merger related charges of \$1.7 million (\$1.0 million, net of tax) and \$9.8 million (\$6.0 million, net of tax) for the three and nine months ended September 30, 2010, respectively, and \$8.5 million (\$5.6 million, net of tax) and \$22.9 million (\$14.4 million, net of tax) for the three and nine months ended September 30, 2009, respectively. Restructuring and Merger related charges were comprised of the following:

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
TruGreen LawnCare reorganization and restructuring(1)	\$ 695	\$ 5,951	\$ 6,657	\$ 5,951
Information technology outsourcing(2)				9,461
Terminix branch optimization(3)				3,219
Merger related charges(4)	44	786	1,180	2,234
Other(5)	951	1,761	1,944	1,994
Total restructuring and Merger related charges	\$ 1,690	\$ 8,498	\$ 9,781	\$ 22,859

(1) Represents restructuring charges related to a reorganization of field leadership and a restructuring of branch operations. For the three months ended September 30, 2010, these costs included consulting fees of \$0.7 million. For the nine months ended September 30, 2010, these costs included consulting fees of \$4.5 million and severance, lease termination and other costs of \$2.2 million. For the three and nine months ended September 30, 2009, these costs included consulting fees of \$4.1 million and severance, lease termination and other costs of \$1.9 million.

(2) On December 11, 2008, the Company entered into an agreement with International Business Machines Corporation (IBM) pursuant to which IBM provides information technology operations and applications development services to the Company. These services were phased in during the first half of 2009. For the nine months ended September 30, 2009, these costs included transition fees paid to IBM of \$7.2 million, employee retention and severance costs of \$1.3 million and consulting and other costs of \$1.0 million.

(3) Represents restructuring charges related to a branch optimization project. For the nine months ended September 30, 2009, these costs included lease termination costs of \$2.8 million and severance costs of \$0.4 million.

(4) Includes severance, retention, legal fees and other costs associated with the Merger.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

(5) For the three and nine months ended September 30, 2010, these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$1.2 million and \$1.7 million, respectively, and consulting and other (credits) costs of (\$0.2) million and \$0.2 million, respectively. For the three and nine months ended September 30, 2009, these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$0.4 million and consulting and other costs of \$1.4 million and \$1.6 million, respectively.

The pretax charges discussed above are reported in the Restructuring and Merger related charges line in the condensed consolidated statement of operations.

A reconciliation of the beginning and ending balances of accrued restructuring and Merger related charges, which are included in Accrued Liabilities - Other on the condensed consolidated statements of financial position, is presented as follows:

(In thousands)	Accrued Restructuring and Merger Related Charges	
Balance at December 31, 2009	\$	12,083
Costs incurred		9,781
Costs paid or otherwise settled		(17,085)
Balance at September 30, 2010	\$	4,779

Table of Contents

Note 4. Commitments and Contingencies

A portion of the Company's vehicle fleet and some equipment are leased through operating leases. The lease terms are non-cancelable for the first twelve-month term, and then are month-to-month, cancelable at the Company's option. There are residual value guarantees by the Company (ranging from 70 percent to 84 percent of the estimated terminal value at the inception of the lease depending on the agreement) relative to these vehicles and equipment, which historically have not resulted in significant net payments to the lessors. The fair value of the assets under all of the fleet and equipment leases is expected to substantially mitigate the Company's guarantee obligations under the agreements. At September 30, 2010, the Company's residual value guarantees related to the leased assets totaled \$59.2 million for which the Company has recorded a liability for the estimated fair value of these guarantees of approximately \$1.3 million in the condensed consolidated statement of financial position.

Prior to the Merger, the Company maintained lease facilities with banks totaling \$65.2 million, which provided for the financing of branch properties to be leased by the Company. In connection with the closing of the Merger, the Company amended these leases effective July 24, 2007. Among the modifications, the Company extended the lease terms through July 24, 2010 and made a \$22.0 million investment in the lease facilities. In July 2010, the Company purchased the properties for \$65.2 million. The Company's \$22.0 million investment in the lease facilities was returned to the Company upon purchase, resulting in a net cash payment of \$43.2 million. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$1.4 million and \$10.4 million in the three and nine months ended September 30, 2010, respectively, and \$2.7 million for the three and nine months ended September 30, 2009 related to this shortfall.

The Company carries insurance policies on insurable risks at levels that it believes to be appropriate, including workers' compensation, auto and general liability risks. The Company purchases insurance policies from third party insurance carriers, which typically incorporate significant deductibles or self-insured retentions. The Company is responsible for all claims that fall below the retention limits. As of September 30, 2010 and December 31, 2009, the Company had accrued self-insured claims of \$128.3 million and \$131.3 million, respectively, which are included in Accrued Liabilities - Self-insured claims and related expenses and Other long-term obligations on the condensed consolidated statements of financial position. During the nine months ended September 30, 2010 and 2009, the Company recorded provisions for uninsured claims totaling \$26.2 million and \$27.2 million, respectively, and the Company paid claims totaling \$29.2 million and \$34.7 million, respectively. In determining the Company's accrual for self-insured claims, the Company uses historical claims experience to establish both the current year accrual and the underlying provision for future losses. This actuarially determined provision and related accrual includes known claims, as well as incurred but not reported claims. The Company adjusts its estimate of accrued self-insured claims when required to reflect changes based on factors such as changes in health care costs, accident frequency and claim severity.

Accruals for home service contract claims in the American Home Shield business are made based on the Company's claims experience and actuarial projections. Termite damage claim accruals are recorded based on both the historical rates of claims incurred within a contract year and the cost per claim. Current activity could differ causing a change in estimates. The Company has certain liabilities with respect to existing or potential claims, lawsuits and other proceedings. The Company accrues for these liabilities when it is probable that future costs will be incurred and such costs can be reasonably estimated. Any resulting adjustments, which could be material, are recorded in the period the adjustments are identified.

As part of the American Residential Services and American Mechanical Services sale agreements in 2006, the Company continues to be obligated to third parties with respect to operating leases for which the Company has been released as being the primary obligor, as well as certain real estate leased and operated by the buyers. The Company's obligations under these agreements may be limited in terms of time and amount, and in some cases, the Company may have recourse against the buyers for potential future payments made by the Company. At the present time, the Company does not believe it is probable that the buyers will default on their obligations subject to guarantee. The fair value of

Edgar Filing: SERVICEMASTER CO - Form 10-Q

the Company's obligations related to these guarantees is not significant and no liability has been recorded.

In the ordinary course of conducting business activities, the Company and its subsidiaries become involved in judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. These proceedings include, on an individual, collective and class action basis, regulatory, insured and uninsured employment, general, and commercial liability actions and environmental proceedings. Additionally, the Company has entered into settlement agreements in certain cases, including putative class actions, which are subject to court approval. If one or more of these settlements are not finally approved, the Company could have additional or different exposure. The enactment of new federal or state legislation or the promulgation of new regulation or interpretation at any level of government may also expose the Company to potential new liabilities or costs, or may require the Company to modify its business model or business practices. At this time, the Company does not expect any of these proceedings or changes in law to have a material effect on its financial position, results of operations or cash flows; however, the Company can give

Table of Contents

no assurance that the results of any such proceedings may not be material to its financial position, results of operations and cash flows for any period in which costs, if any, are recognized.

Note 5. Goodwill and Intangible Assets

In accordance with applicable accounting standards, goodwill and intangible assets that are not amortized are subject to assessment for impairment by applying a fair-value based test on an annual basis or more frequently if circumstances indicate a potential impairment. The Company's annual assessment date is October 1. There were no goodwill or trade name impairment charges in the three months ended September 30, 2010. The results for the nine months ended September 30, 2010 include a non-cash impairment charge of \$46.9 million to reduce the carrying value of goodwill and trade names as a result of the Company's interim impairment testing of goodwill and indefinite-lived intangible assets. There were no goodwill or trade name impairment charges in the three and nine months ended September 30, 2009.

Based on the results of operations at TruGreen LandCare in the first six months of 2010 and the revised outlook for the remainder of 2010, the Company concluded there was an impairment indicator requiring the performance of an interim goodwill impairment test for the TruGreen LandCare reporting unit as of June 30, 2010. The first step of the goodwill impairment test involves a comparison of the estimated fair value of the reporting unit to its carrying amount, including goodwill. In performing the first step, the Company determined the fair value of the TruGreen LandCare reporting unit using a combination of a discounted cash flow analysis, a market-based comparable approach and a market-based transaction approach. Based on the results of the step one analysis, the Company determined that the carrying value of the TruGreen LandCare reporting unit exceeded its fair value, indicating that goodwill was potentially impaired. As a result, the Company completed the second step of the goodwill impairment test which involves calculating the implied fair value of the reporting unit's goodwill by allocating the fair value of the reporting unit to all assets and liabilities other than goodwill and comparing it to the carrying amount of goodwill. The Company determined that the implied fair value of goodwill was less than the carrying value for TruGreen LandCare by \$43.0 million, which was recorded as a goodwill impairment charge in the second quarter of 2010. As of June 30 and September 30, 2010, there was no remaining goodwill at TruGreen LandCare.

As a result of the aforementioned goodwill impairment indicators and in accordance with applicable accounting standards, the Company performed an impairment analysis on its indefinite lived intangible asset related to TruGreen LandCare's trade name to determine its fair value as of June 30, 2010. Based on the lower projected cash flows for TruGreen LandCare as discussed above, the Company determined the fair value attributable to the indefinite lived intangible asset was less than the carrying value for TruGreen LandCare by \$3.9 million, which was recorded as a trade name impairment in the second quarter of 2010.

The Company determined that there were no additional impairment indicators for goodwill or other indefinite lived intangible assets as of September 30, 2010.

The table below summarizes the goodwill balances by segment for continuing operations:

(In thousands)	TruGreen LawnCare	TruGreen LandCare	Terminix	American Home Shield	ServiceMaster Clean	Other Operations & Headquarters	Total
----------------	----------------------	----------------------	----------	----------------------------	------------------------	---------------------------------------	-------

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Balance at Dec. 31, 2009	\$	1,178,436	\$	43,901	\$	1,361,698	\$	348,010	\$	135,713	\$	51,996	\$	3,119,754
Impairment charge				(42,984)										(42,984)
Acquisitions		11,786				31,762						1,214		44,762
Other(1)		(393)		(917)		(483)		(190)		11		(76)		(2,048)
Balance at Sept. 30, 2010	\$	1,189,829	\$		\$	1,392,977	\$	347,820	\$	135,724	\$	53,134	\$	3,119,484

(1) Reflects the impact of the amortization of tax deductible goodwill and foreign exchange rate changes.

The accumulated impairment losses as of September 30, 2010 were \$43.0 million associated with our TruGreen LandCare segment. There were no accumulated impairment losses as of December 31, 2009.

Table of Contents

The table below summarizes the other intangible asset balances for continuing operations:

(In thousands)	As of September 30, 2010			As of December 31, 2009		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Trade names(1)	\$ 2,375,787	\$	\$ 2,375,787	\$ 2,380,100	\$	\$ 2,380,100
Customer relationships	682,618	(451,487)	231,131	669,581	(352,605)	316,976
Franchise agreements	88,000	(33,058)	54,942	88,000	(26,418)	61,582
Other	54,690	(27,290)	27,400	49,630	(21,051)	28,579
Total	\$ 3,201,095	\$ (511,835)	\$ 2,689,260	\$ 3,187,311	\$ (400,074)	\$ 2,787,237

(1) Not subject to amortization. Reflects the \$3.9 million trade name impairment at TruGreen LandCare discussed above and the impact of the amortization of tax deductible goodwill at TruGreen LandCare, which is applied to the trade name balance beginning July 1, 2010.

Note 6. Stock-Based Compensation

For the three and nine months ended September 30, 2010, the Company recognized stock-based compensation expense of \$2.5 million (\$1.5 million, net of tax) and \$6.9 million (\$4.3 million, net of tax), respectively. For the three and nine months ended September 30, 2009, the Company recognized stock-based compensation expense of \$2.1 million (\$1.7 million, net of tax) and \$6.0 million (\$4.1 million, net of tax), respectively. As of September 30, 2010, there was \$21.1 million of total unrecognized compensation cost related to non-vested stock options and restricted share units (RSUs) granted by Holdings under the ServiceMaster Global Holdings, Inc. Stock Incentive Plan (the MSIP). These remaining costs are expected to be recognized over a weighted-average period of 2.2 years.

As of September 24, 2010, the board of directors and stockholders of Holdings approved an amendment to the MSIP. The amendment to the MSIP increased by 800,000 the maximum number of shares of Holdings common stock available for issuance thereunder, to 13,845,000, and provides for the award of RSUs under the MSIP.

In addition, on September 24, 2010, the compensation committee of the Holdings board of directors approved an employee restricted stock unit agreement to be used when awards of RSUs are made under the MSIP and granted 735,000 RSU awards to certain senior executives of ServiceMaster. The RSUs had a grant-date fair value of \$10 per unit and will vest in three equal annual installments, subject to an employee s continued employment. Upon vesting, each RSU will be converted into one share of Holdings common stock.

On September 7, 2010, ServiceMaster announced the retirement of its Chief Executive Officer (CEO) with a targeted retirement date of December 31, 2010, or such earlier or later date as a successor CEO is appointed. On September 8, 2010, in connection with the CEO s retirement, Holdings extended the option period on the CEO s vested standalone options to three years following his departure date. This extension of the option period is considered a stock option modification resulting in additional stock compensation expense of \$0.5 million, of which \$0.3 million was recorded in the third quarter of 2010.

Note 7. Supplemental Cash Flow Information

Supplemental information relating to the condensed consolidated statement of cash flows for the nine months ended September 30, 2010 and 2009 is presented in the following table:

(In thousands)	Nine months ended			
	September 30,		2009	
	2010		2009	
Cash paid for or (received from):				
Interest expense	\$	238,727	\$	266,943
Interest and dividend income		(3,997)		(5,193)
Income taxes, net of refunds		12,139		1,457

Table of Contents

Note 8. Comprehensive Income

Total comprehensive income (loss) was \$6.7 million and (\$19.6) million for the three and nine months ended September 30, 2010 and \$24.5 million and \$66.2 million for the three and nine months ended September 30, 2009, respectively. Total comprehensive income primarily includes net income (loss), unrealized gain (loss) on marketable securities, unrealized gain (loss) on derivative instruments and the effect of foreign currency translation.

Note 9. Receivable Sales

The Company has entered into an accounts receivable securitization arrangement under which TruGreen LawnCare and Terminix may sell certain eligible trade accounts receivable to ServiceMaster Funding Company LLC (Funding), the Company's wholly owned, bankruptcy-remote subsidiary, which is consolidated for financial reporting purposes. Funding, in turn, may transfer, on a revolving basis, an undivided percentage ownership interest of up to \$50.0 million in the pool of accounts receivable to one or both of the unrelated purchasers who are parties to the accounts receivable securitization arrangement (Purchasers). The amount of the eligible receivables varies during the year based on seasonality of the businesses and could, at times, limit the amount available to the Company from the sale of these interests.

During the nine months ended September 30, 2010, there were no transfers of interests in the pool of trade accounts receivables to Purchasers under this arrangement. As of September 30, 2010 and December 31, 2009, the Company had \$10.0 million outstanding under the arrangement and, as of September 30, 2010, had \$40.0 million of remaining capacity available under the trade accounts receivable securitization arrangement.

The accounts receivable securitization arrangement is a 364-day facility that is renewable annually at the option of Funding, with a final termination date of July 17, 2012. Only one of the Purchasers is required to purchase interests under the arrangement. If this Purchaser were to exercise its right to terminate its participation in the arrangement, which it may do in the third quarter of each year, the amount of cash available to the Company under this agreement may be reduced or eliminated. As part of the annual renewal of the facility, which last occurred on July 20, 2010, this Purchaser agreed to continue its participation in the arrangement at least through July 19, 2011.

The Company has recorded its obligation to repay the third party for its interest in the pool of receivables as long-term debt in the condensed consolidated financial statements. The interest rates applicable to the Company's obligation are based on a fluctuating rate of interest based on the third party Purchaser's pooled commercial paper rate (0.36% at September 30, 2010). In addition, the Company pays usage fees on its obligations and commitment fees on undrawn amounts committed by the Purchasers. All obligations under the accounts receivable securitization arrangement must be repaid by July 17, 2012, the final termination date of the arrangement.

Note 10. Cash and Marketable Securities

Cash, money market funds and certificates of deposits, with maturities of three months or less when purchased, are included in the condensed consolidated statement of financial position captioned Cash and cash equivalents. As of September 30, 2010 and December 31, 2009, the Company's investments consist primarily of domestic publicly traded debt and certificates of deposit totaling \$102.0 million and \$93.9 million,

Edgar Filing: SERVICEMASTER CO - Form 10-Q

respectively, and common equity securities of \$37.7 million and \$38.3 million, respectively.

The aggregate market value of the Company's short-term and long-term investments in debt and equity securities was \$139.7 million and \$132.2 million, and the aggregate cost basis was \$131.4 million and \$126.7 million at September 30, 2010 and December 31, 2009, respectively.

As of September 30, 2010 and December 31, 2009, \$296.0 million and \$256.5 million, respectively, of the cash and short- and long-term marketable securities balance are associated with regulatory requirements at American Home Shield and for other purposes. American Home Shield's investment portfolio has been invested in a combination of high quality, short duration fixed income securities and equities.

Gains and losses on sales of investments, as determined on a specific identification basis, are included in investment income in the period they are realized. The Company periodically reviews its portfolio of investments to determine whether there has been an other than temporary decline in the value of the investments from factors such as deterioration in the financial condition of the issuer or the market(s) in which the issuer competes. The table below summarizes gross realized gains and gross realized losses, each resulting from sales of available-for-sale securities, and impairment charges due to other than temporary declines in the value of certain investments.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Gross realized gains, pre-tax	\$ 988	\$ 1,250	\$ 2,089	\$ 2,812
Gross realized gains, net of tax	605	770	1,279	1,732
Gross realized losses, pre-tax	(52)	(137)	(178)	(1,490)
Gross realized losses, net of tax	(32)	(84)	(109)	(918)
Impairment charges, pre-tax				(5,854)
Impairment charges, net of tax				(3,606)

The table below summarizes unrealized gains and losses in the investment portfolio.

(In thousands)	As of September 30, 2010	As of December 31, 2009
Unrealized gains	\$ 10,363	\$ 7,674
Unrealized losses	(2,099)	(2,226)
Portion of unrealized losses which had been in a loss position for more than one year	(189)	(739)
Aggregate fair value of the investments with unrealized losses	4,290	26,837

Note 11. Long-Term Debt

Long-term debt at September 30, 2010 and December 31, 2009 is summarized in the following table:

(In thousands)	As of September 30, 2010	As of December 31, 2009
Senior secured term loan facility maturing in 2014	\$ 2,563,875	\$ 2,583,750
10.75% /11.50% senior toggle notes maturing in 2015	1,061,000	1,061,000
Revolving credit facility maturing in 2013		
7.10% notes maturing in 2018(1)	65,068	63,624
7.45% notes maturing in 2027(1)	149,887	147,885
7.25% notes maturing in 2038(1)	60,431	59,824
Other	56,957	58,861
Less current portion	(50,316)	(64,395)
Total long-term debt	\$ 3,906,902	\$ 3,910,549

(1) The increase in the balance from December 31, 2009 to September 30, 2010 reflects the amortization of fair value adjustments related to purchase accounting, which effectively increases the stated coupon interest rates.

The Company had \$34.5 million and \$70.2 million of accrued interest at September 30, 2010 and December 31, 2009, respectively. Accrued interest is included in Accrued Liabilities - Other on the condensed consolidated statements of financial position.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

In June 2010, the Company entered into two, two-year interest rate swap agreements effective March 3, 2011. The total notional amount of the agreements was \$250.0 million. Under the terms of the agreements, the Company will pay a weighted average fixed rate of interest of 1.70% on the \$250.0 million notional amount and the Company will receive a floating rate of interest (based on the one month LIBOR) on the notional amount. Therefore, during the term of the swap agreements, the effective interest rate for \$250.0 million of the term loans will be fixed at a rate of 1.70% plus the incremental borrowing margin described in Note 14 in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

In June 2010, the Company entered into two, two-year interest rate swap agreements effective September 1, 2011. The total notional amount of the agreements was \$200.0 million. Under the terms of the agreements, the Company will pay a weighted average fixed rate of interest of 2.22% on the \$200.0 million notional amount and the Company will receive a floating rate of interest (based on the one month LIBOR) on the notional amount. Therefore, during the term of the swap agreements, the effective interest rate for \$200.0 million of the term loans will be fixed at a rate of 2.22% plus the incremental borrowing margin described in Note 14 in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Table of Contents

In accordance with accounting standards for derivative instruments and hedging activities, these interest rate swap agreements are classified as cash flow hedges and, as such, the hedging instruments are recorded on the balance sheet as either an asset or liability at fair value, with the effective portion of the changes in fair value attributable to the hedged risks recorded in other comprehensive income.

Note 12. Discontinued Operations

Reported loss from discontinued operations, net of income taxes for all periods presented includes the operating results of the sold businesses noted in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The operating results of discontinued operations are as follows:

(In thousands)	Three months ended September 30,		Nine months ended September 30,			
	2010	2009	2010	2009		
Operating Results:						
Operating revenue	\$	\$	6	\$	62	
Operating loss		(227)	(609)	(1,171)	(1,050)	
Loss from discontinued operations, before income taxes		(227)	(609)	(1,171)	(1,050)	
Benefit from income taxes		(122)	(213)	(484)	(384)	
Loss from discontinued operations, net of income taxes	\$	(105)	\$	(396)	\$	(666)

The table below summarizes the activity for the nine months ended September 30, 2010 for the remaining liabilities from operations that were disposed of in years prior to 2010. The remaining obligations primarily relate to long-term self-insurance claims. The Company believes that the remaining reserves continue to be adequate and reasonable.

(In thousands)	As of December 31, 2009	Cash Payments or Other	Expense	As of September 30, 2010				
Remaining liabilities of discontinued operations:								
ARS/AMS	\$	2,921	\$	(2,459)	\$	639	\$	1,101
LandCare Construction		722		(85)		11		648
LandCare utility line clearing business		911		(102)				809
Certified Systems, Inc. and other		2,149		(207)		1		1,943
InStar		248		(51)		36		233
Total liabilities of discontinued operations	\$	6,951	\$	(2,904)	\$	687	\$	4,734

Note 13. Income Taxes

The effective tax rates for the three and nine months ending September 30, 2010 are 89.0 percent and (37.6) percent, respectively. As required by ASC 740, we compute interim period income taxes by applying an anticipated annual effective tax rate to our year-to-date income or loss from continuing operations before income taxes, except for significant unusual or infrequently occurring items. Our estimated tax rate is

Edgar Filing: SERVICEMASTER CO - Form 10-Q

adjusted each quarter in accordance with ASC 740. The computed effective rate for the three months ending September 30, 2010 is higher than the customary relationship between income tax expense and income from continuing operations before income taxes due to a change in our forecasted annual rate. The computed effective rate for the nine months ending September 30, 2010 is lower than the customary relationship between income tax expense and loss from continuing operations before income taxes primarily due to the Company incurring foreign and state tax expense despite anticipating a full year loss from continuing operations before income taxes.

At September 30, 2010 and December 31, 2009, the Company had \$14.9 million and \$15.4 million, respectively, of tax benefits primarily reflected in state tax returns that had not been recognized for financial reporting purposes (unrecognized tax benefits). The Company currently estimates that, as a result of pending tax settlements and expiration of statutes of limitations, the amount of unrecognized tax benefits could be reduced by approximately \$9.3 million during the next 12 months.

Note 14. Business Segment Reporting

The business of the Company is conducted through six reportable segments: TruGreen LawnCare, TruGreen LandCare, Terminix, American Home Shield, ServiceMaster Clean and Other Operations and Headquarters.

In accordance with accounting standards for segments, the Company's reportable segments are strategic business units that offer different services. The TruGreen LawnCare segment provides residential and commercial lawn care services. The TruGreen LandCare segment provides landscaping services primarily to commercial customers. The Terminix segment provides termite and pest control services to residential and commercial customers. The American Home Shield segment provides home service contracts to consumers that cover heating, ventilation, air conditioning, plumbing and other home systems and appliances. The ServiceMaster Clean segment provides residential and commercial disaster restoration and cleaning services primarily under the ServiceMaster and ServiceMaster Clean brand names, on-site furniture repair and restoration services primarily under the Furniture Medic brand name and home inspection services primarily under the AmeriSpec brand name. The Other Operations and Headquarters segment includes the franchised and Company-owned operations of Merry Maids, which provides house cleaning services. The Other Operations and Headquarters segment also includes The ServiceMaster Acceptance Company Limited Partnership (SMAC), our financing subsidiary exclusively dedicated to providing financing to our franchisees and retail customers of our operating units, and the Company's headquarters operations, which provide various technology, marketing, finance, legal and other support services to the business units.

Table of Contents

In the second quarter of 2010, the Company revised its methodology for the allocation of general corporate overhead expenses to each reportable segment. The portion of general corporate support services previously allocated to each reportable segment is now reflected in the Other Operations and Headquarters segment. Under the revised method, allocations are limited to corporate support services incurred directly on behalf of each reportable segment. The operating income presented below for each reportable segment has been revised to reflect the new allocation methodology for all periods presented. The revision to the allocation methodology had no impact on reported operating revenue for each reportable segment or total operating income.

Segment information for continuing operations is presented below.

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Operating Revenue:				
TruGreen LawnCare	\$ 371,298	\$ 351,830	\$ 874,022	\$ 834,899
TruGreen LandCare	58,278	63,244	180,541	199,562
Terminix	295,172	272,598	889,482	843,134
American Home Shield	196,913	179,617	513,910	490,308
ServiceMaster Clean	34,041	32,132	98,337	92,869
Other Operations and Headquarters	21,558	21,093	63,438	62,961
Total Operating Revenue	\$ 977,260	\$ 920,514	\$ 2,619,730	\$ 2,523,733
Operating Income (Loss):(1),(2),(3)				
TruGreen LawnCare	\$ 66,730	\$ 51,373	\$ 80,248	\$ 75,382
TruGreen LandCare	(5,138)	27	(52,367)	8,658
Terminix	44,979	37,490	166,714	152,778
American Home Shield	28,777	24,279	57,245	60,423
ServiceMaster Clean	13,464	12,549	38,708	36,673
Other Operations and Headquarters	(32,140)	(30,878)	(90,713)	(92,391)
Total Operating Income	\$ 116,672	\$ 94,840	\$ 199,835	\$ 241,523

(1) Presented below is a reconciliation of segment operating income to income (loss) from continuing operations before income taxes.

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Total Segment Operating Income	\$ 116,672	\$ 94,840	\$ 199,835	\$ 241,523
Non-operating expense (income):				
Interest expense	71,267	74,216	217,117	225,538
Interest and net investment income	(3,989)	(4,558)	(7,487)	(3,192)
Gain on extinguishment of debt				(46,106)
Other expense	209	176	556	555
Income (Loss) from Continuing Operations before Income Taxes	\$ 49,185	\$ 25,006	\$ (10,351)	\$ 64,728

(2) As described in Note 5, includes a non-cash impairment charge of \$46.9 million recorded in the second quarter of 2010 to reduce the carrying value of goodwill and trade names at TruGreen LandCare as a result of the Company's interim impairment test of goodwill and indefinite-lived intangible assets.

(3) Includes (i) restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare, a branch optimization project at Terminix and information technology outsourcing at Other Operations and Headquarters and (ii) Merger related charges. Presented below is a summary of restructuring and Merger related charges (credits) by segment.

Table of Contents

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Restructuring and Merger related charges:				
TruGreen LawnCare	\$ 695	\$ 5,951	\$ 6,657	\$ 5,951
TruGreen LandCare	127	184	785	133
Terminix	1,061	214	1,139	3,365
American Home Shield		30	(127)	105
ServiceMaster Clean	61		61	
Other Operations and Headquarters	(254)	2,119	1,266	13,305
Total restructuring and Merger related charges	\$ 1,690	\$ 8,498	\$ 9,781	\$ 22,859

Note 15. Related Party Transactions

In connection with the Merger and the related transactions, the Company entered into a consulting agreement with CD&R under which CD&R provides the Company with on-going consulting and management advisory services in exchange for an annual management fee of \$2.0 million, which is payable quarterly. On July 30, 2009, the consulting agreement was amended and the annual management fee payable under the consulting agreement with CD&R was increased from \$2.0 million to \$6.25 million in order to align our fee structure with current market rates. Under this agreement, the Company recorded a management fee of \$1.6 million and \$4.7 million for the three and nine months ended September 30, 2010, respectively, and \$3.7 million and \$4.7 million for the three and nine months ended September 30, 2009, respectively. The full year management fee was applied in 2009, and the incremental fees relating to the first three quarters of 2009 were recorded and paid to CD&R in the third quarter of 2009. The amended consulting agreement also provides that CD&R may receive additional fees in connection with certain subsequent financing and acquisition or disposition transactions.

In addition, in August 2009, the Company entered into consulting agreements with Citigroup, BAS and JPMorgan, each of which is an Equity Sponsor or an affiliate of an Equity Sponsor. Under the consulting agreements, Citigroup, BAS and JPMorgan each provide the Company with on-going consulting and management advisory services through September 30, 2016 or the earlier termination of the existing consulting agreement between the Company and CD&R. The Company pays annual management fees of \$0.5 million, \$0.5 million and \$0.25 million to Citigroup, BAS and JPMorgan, respectively. The Company recorded consulting fees related to these agreements of \$0.3 million and \$0.9 million for the three and nine months ended September 30, 2010, respectively, and \$0.9 million for the three and nine months ended September 30, 2009. The full year management fee was applied in 2009, and the incremental fees relating to the first three quarters of 2009 were recorded and paid to Citigroup, BAS and JPMorgan in the third quarter of 2009. On September 30, 2010, Citigroup transferred the management responsibility for, and its proprietary interests in, certain investment funds that own shares of common stock of Holdings to StepStone Group LLC (StepStone) and Lexington Partners Advisors LP. Citigroup also assigned its obligations and rights under the consulting agreement to StepStone, and beginning in the fourth quarter of 2010, the consulting fee otherwise payable to Citigroup will be paid to StepStone.

Between the Merger and September 30, 2010, Holdings has completed open market purchases totaling \$65.0 million in face value of the Permanent Notes for a cost of \$21.4 million. The debt acquired by Holdings has not been retired, and the Company has continued to pay interest in accordance with the terms of the debt. The Company recorded interest expense of \$5.2 million for the nine months ended September 30, 2010 and 2009, respectively, related to the Permanent Notes held by Holdings. The Company made cash payments to Holdings of \$7.0 million and \$6.5 million during the nine months ended September 30, 2010 and 2009, respectively. Interest accrued by the Company and payable to Holdings as of September 30, 2010 and December 31, 2009 amounted to \$1.4 million and \$3.2 million, respectively.

Note 16. Newly Issued Accounting Statements and Positions

Edgar Filing: SERVICEMASTER CO - Form 10-Q

In September 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, Multiple-Deliverable Revenue Arrangements , which amends the multiple-element arrangement guidance under ASC 605, Revenue Recognition . This standard amends the criteria for separating consideration received for products or services in multiple-deliverable arrangements. This standard establishes a selling price hierarchy for determining the selling price of a deliverable, eliminates the residual method of allocation, and requires that total arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this standard significantly expands required disclosures related to a vendor s multiple-deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 (calendar year 2011). The Company is currently evaluating the effect of this standard on its condensed consolidated financial statements.

Table of Contents

In December 2009, the FASB issued ASU 2009-17, *Accounting by Enterprises Involved with Variable Interest Entities* (ASU 2009-17). ASU 2009-17 formally incorporates into the FASB Codification amendments to FASB Interpretation No. 46(R) made by Statement of Financial Accounting Standards (SFAS) 167 to require that a comprehensive qualitative analysis be performed to determine whether a holder of variable interests in a variable interest entity also has a controlling financial interest in that entity. In addition, the amendments require that the same type of analysis be applied to entities that were previously designated as qualifying special-purpose entities. This standard applies prospectively for fiscal years beginning on or after November 15, 2009. The Company adopted the required provisions of this standard during the first quarter of 2010. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*, which amends ASC 820 to add new requirements for disclosures about transfers into and out of Level 1 and 2 measurements and separate disclosures about purchases, sales, issuances and settlements relating to Level 3 measurements. The ASU also clarifies existing fair value disclosure requirements about the level of disaggregation and about inputs and valuation techniques used to measure fair value. Further, the ASU amends guidance on employers disclosures about postretirement benefit plan assets under ASC 715 to require that disclosures be provided by classes of assets instead of by major categories of assets. This standard is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company applied the required provisions of this standard on the Company's condensed consolidated financial statements during the first quarter of 2010 (see Note 17).

Note 17. Fair Value of Financial Instruments

The period end carrying amounts of receivables, accounts payable and accrued liabilities approximate fair value because of the short maturity of these instruments. The period end carrying amounts of long-term notes receivable approximate fair value as the effective interest rates for these instruments are comparable to market rates at period end. The period end carrying amounts of current and long-term marketable securities also approximate fair value, with unrealized gains and losses reported net-of-tax as a component of accumulated comprehensive income (loss), or, for certain unrealized losses, reported in interest and net investment income in the condensed consolidated statement of operations if the decline in value is other than temporary. The carrying amount of total debt was \$3,957.2 million and \$3,974.9 million and the estimated fair value was \$3,903.5 million and \$3,716.5 million at September 30, 2010 and December 31, 2009, respectively. The fair values of the Company's financial instruments reflect the amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The fair value estimates presented in this report are based on information available to the Company as of September 30, 2010 and December 31, 2009.

The Company has estimated the fair value of its financial instruments measured at fair value on a recurring basis using the market and income approaches. For investments in marketable securities, deferred compensation trust assets and derivative contracts, which are carried at their fair values, the Company's fair value estimates incorporate quoted market prices, other observable inputs (for example, forward interest rates) and unobservable inputs (for example, forward commodity prices) at the balance sheet date.

Interest rate swap contracts are valued using forward interest rate curves obtained from third party market data providers. The fair value of each contract is the sum of the expected future settlements between the contract counterparties, discounted to present value. The expected future settlements are determined by comparing the contract interest rate to the expected forward interest rate as of each settlement date and applying the difference between the two rates to the notional amount of debt in the interest rate swap contracts.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Fuel swap contracts are valued using forward fuel price curves obtained from third party market data providers. The fair value of each contract is the sum of the expected future settlements between the contract counterparties, discounted to present value. The expected future settlements are determined by comparing the contract fuel price to the expected forward fuel price as of each settlement date and applying the difference between the contract and expected prices to the notional gallons in the fuel swap contracts.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

The carrying amount and estimated fair value of the Company's financial instruments that are recorded at fair value for the periods presented are as follows:

(In thousands)	Balance Sheet Locations	Carrying Value	As of September 30, 2010 Estimated Fair Value Measurements			As of December 31, 2009	
			Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Carrying Value	Estimated Fair Value
Financial Assets:							
Deferred compensation trust assets							
	Long-term marketable securities	\$ 9,984	\$ 9,984	\$	\$	\$ 9,985	\$ 9,985
Investments in marketable securities							
	Marketable securities and Long-term marketable securities	129,661	45,798	83,863		122,201	122,201
Fuel swap contracts:							
Current							
	Prepaid expenses and other assets	3,382			3,382	7,840	7,840
Noncurrent							
	Other assets	640			640		
Total financial assets		\$ 143,667	\$ 55,782	\$ 83,863	\$ 4,022	\$ 140,026	\$ 140,026
Financial Liabilities:							
Fuel swap contracts:							
Current							
	Other accrued liabilities	\$ 804	\$	\$	\$ 804	\$ 924	\$ 924
Noncurrent							
	Other long-term obligations	192			192		
Interest rate swap contracts							
	Other long-term obligations	62,385		62,385		54,120	54,120
Total financial liabilities		\$ 63,381	\$	\$ 62,385	\$ 996	\$ 55,044	\$ 55,044

A reconciliation of the beginning and ending fair values of financial instruments valued using significant unobservable inputs (Level 3) is presented as follows:

(In thousands)	Fuel Swap Contract Assets (Liabilities)
Balance at December 31, 2009	\$ 6,916
Total gains (losses) (realized and unrealized)	
Included in earnings(1)	4,154
Included in other comprehensive income	(3,890)
Settlements, net	(4,154)
Balance at September 30, 2010	\$ 3,026

(In thousands)	Fuel Swap Contract Assets (Liabilities)
Balance at December 31, 2008	\$ (24,924)

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Total gains (losses) (realized and unrealized)		
Included in earnings(1)		(20,881)
Included in other comprehensive income		24,584
Settlements, net		20,881
Balance at September 30, 2009	\$	(340)

(1) Gains (losses) included in earnings are reported in cost of services rendered and products sold.

The Company uses derivative financial instruments to manage risks associated with changes in fuel prices and interest rates. The Company does not hold or issue derivative financial instruments for trading or speculative purposes. In designating its derivative financial instruments as hedging instruments under accounting standards for derivative instruments, the Company formally documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and strategy for the use of the hedging instrument. This documentation includes linking the derivatives to forecasted transactions. The Company assesses at the time a derivative contract is entered into, and at least quarterly thereafter, whether the derivative item is effective in offsetting the projected changes in cash flows of the associated forecasted transactions. All of the Company's designated hedging instruments are classified as cash flow hedges.

Table of Contents

The Company has historically hedged a significant portion of its annual fuel consumption of approximately 25 million gallons. The Company has also hedged the interest payments on a portion of its variable rate debt through the use of interest rate swap agreements. Substantially all of the Company's fuel swap contracts and interest rate swap contracts are classified as cash flow hedges, and, as such, the hedging instruments are recorded on the condensed consolidated statement of financial position as either an asset or liability at fair value, with the effective portion of changes in the fair value attributable to the hedged risks recorded in other comprehensive income. Any change in the fair value of the hedging instrument resulting from ineffectiveness, as defined by accounting standards, is recognized in current period earnings. Cash flows related to fuel and interest rate derivatives are classified as operating activities in the condensed consolidated statement of cash flows.

The effect of derivative instruments on the condensed consolidated statement of operations and other comprehensive income for the nine months ended September 30, 2010 and 2009, respectively, is presented as follows:

(In thousands) Derivatives designated as Cash Flow Hedge Relationships	Effective Portion of Loss Recognized in Accumulated Other Comprehensive Income (Loss) Nine months ended September 30, 2010	Effective Portion of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income Nine months ended September 30, 2010	Location of Gain (Loss) included in Income
Fuel swap contracts	\$ (3,890)	\$ 4,154	Cost of services rendered and products sold
Interest rate swap contracts	\$ (8,265)	\$ (38,516)	Interest expense

Derivatives designated as Cash Flow Hedge Relationships	Effective Portion of Gain (Loss) Recognized in Accumulated Other Comprehensive Income (Loss) Nine months ended September 30, 2009	Effective Portion of Loss Reclassified from Accumulated Other Comprehensive Income (Loss) into Income Nine months ended September 30, 2009	Location of Gain (Loss) included in Income
Fuel swap contracts	\$ 24,584	\$ (20,881)	Cost of services rendered and products sold
Interest rate swap contracts	\$ (2,752)	\$ (36,841)	Interest expense

Ineffective portions of derivative instruments designated in accordance with accounting standards as cash flow hedge relationships were insignificant during the nine months ended September 30, 2010. As of September 30, 2010, the Company had fuel swap contracts to pay fixed prices for fuel with an aggregate notional amount of \$78.2 million, maturing through 2012. Under the terms of its fuel swap contracts, the Company is required to post collateral in the event that the fair value of the contracts exceeds a certain agreed upon liability level and in other circumstances required by the counterparty. As of September 30, 2010, the Company had posted \$5.0 million in letters of credit as collateral under its fuel hedging program, none of which were issued under the Company's Revolving Credit Facility. As of September 30, 2010, the Company had interest rate swap contracts to pay fixed rates for interest on long-term debt with an aggregate notional amount of \$1.430 billion, maturing through 2013.

The effective portion of the gain or loss on derivative instruments designated and qualifying as cash flow hedging instruments is recorded in other comprehensive income. These amounts are reclassified into earnings in the same period or periods during which the hedged forecasted debt interest settlement or the fuel settlement affects earnings. The amount expected to be reclassified into earnings during the next 12 months includes unrealized gains and losses related to open fuel hedges and interest rate swaps. Specifically, as the underlying forecasted transactions occur during the next 12 months, the hedging gains and losses in accumulated other comprehensive income expected to be recognized in earnings is a loss of \$21.2 million, net of tax, at September 30, 2010. The amounts that are ultimately reclassified into earnings will be based on

actual interest rates and fuel prices at the time the positions are settled and may differ materially from the amount noted above.

Table of Contents

Note 18. Condensed Consolidating Financial Statements of The ServiceMaster Company and Subsidiaries

The following condensed consolidating financial statements of the Company and its subsidiaries have been prepared pursuant to Rule 3-10 of Regulation S-X. These condensed consolidating financial statements have been prepared from the Company's financial information on the same basis of accounting as the condensed consolidated financial statements. Goodwill and other intangible assets have been allocated to all of the subsidiaries of the Company based on management's estimates.

The payment obligations of the Company under the Permanent Notes are jointly and severally guaranteed on a senior unsecured basis by certain of the Company's domestic subsidiaries excluding certain subsidiaries subject to regulatory requirements in various states (Guarantors). Each of the Guarantors is wholly owned, directly or indirectly, by the Company, and all guarantees are full and unconditional. All other subsidiaries of the Company, either directly or indirectly owned, do not guarantee the Permanent Notes (Non-Guarantors).

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Operations****For the Three Months Ended September 30, 2010 (Unaudited)****(In thousands)**

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Operating Revenue	\$	\$ 758,593	\$ 224,864	\$ (6,197)	\$ 977,260
Operating Costs and Expenses:					
Cost of services rendered and products sold		457,808	109,421	(5,993)	561,236
Selling and administrative expenses	2,464	164,497	99,913	(80)	266,794
Amortization expense	56	21,848	8,964		30,868
Restructuring and Merger related charges	44	1,944	(298)		1,690
Total operating costs and expenses	2,564	646,097	218,000	(6,073)	860,588
Operating (Loss) Income	(2,564)	112,496	6,864	(124)	116,672
Non-operating Expense (Income):					
Interest expense (income)	48,752	26,097	(3,458)	(124)	71,267
Interest and net investment (income) loss	(825)	2,164	(5,328)		(3,989)
Other expense			209		209
(Loss) Income from Continuing Operations before Income Taxes					
	(50,491)	84,235	15,441		49,185
Provision for income taxes	2,567	22,454	18,769		43,790
(Loss) Income from Continuing Operations					
	(53,058)	61,781	(3,328)		5,395
Income (loss) from discontinued operations, net of income taxes		80	(185)		(105)
Equity in losses of subsidiaries (net of tax)	58,348	(8,864)		(49,484)	
Net Income (Loss)	\$ 5,290	\$ 52,997	\$ (3,513)	\$ (49,484)	\$ 5,290

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Operations****For the Three Months Ended September 30, 2009 (Unaudited)****(In thousands)**

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Operating Revenue	\$	\$ 719,387	\$ 219,992	\$ (18,865)	\$ 920,514
Operating Costs and Expenses:					
Cost of services rendered and products sold		448,203	98,107	(18,865)	527,445
Selling and administrative expenses	5,171	159,575	84,556		249,302
Amortization expense	55	31,431	8,943		40,429
Restructuring and Merger related charges	786	6,349	1,363		8,498
Total operating costs and expenses	6,012	645,558	192,969	(18,865)	825,674
Operating (Loss) Income	(6,012)	73,829	27,023		94,840
Non-operating Expense (Income):					
Interest expense (income)	72,226	5,597	(3,607)		74,216
Interest and net investment income	(40)	(2,290)	(2,228)		(4,558)
Other expense			176		176
(Loss) Income from Continuing Operations before Income Taxes	(78,198)	70,522	32,682		25,006
(Benefit) provision for income taxes	(53,727)	41,660	16,169		4,102
(Loss) Income from Continuing Operations	(24,471)	28,862	16,513		20,904
Loss from discontinued operations, net of income taxes			(396)		(396)
Equity in earnings of subsidiaries (net of tax)	44,979	10,736		(55,715)	
Net Income	\$ 20,508	\$ 39,598	\$ 16,117	\$ (55,715)	\$ 20,508

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Operations****For the Nine Months Ended September 30, 2010 (Unaudited)****(In thousands)**

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Operating Revenue	\$	\$ 2,054,342	\$ 607,004	\$ (41,616)	\$ 2,619,730
Operating Costs and Expenses:					
Cost of services rendered and products sold		1,291,877	286,872	(41,412)	1,537,337
Selling and administrative expenses	7,004	426,144	281,064	(80)	714,132
Amortization expense	167	84,700	26,894		111,761
Goodwill and trade name impairment		46,884			46,884
Restructuring and Merger related charges	1,180	8,642	(41)		9,781
Total operating costs and expenses	8,351	1,858,247	594,789	(41,492)	2,419,895
Operating (Loss) Income	(8,351)	196,095	12,215	(124)	199,835
Non-operating Expense (Income):					
Interest expense (income)	148,818	78,282	(9,859)	(124)	217,117
Interest and net investment loss (income)	1,344	4,906	(13,737)		(7,487)
Other expense			556		556
(Loss) Income from Continuing					
Operations before Income Taxes	(158,513)	112,907	35,255		(10,351)
(Benefit) provision for income taxes	(49,875)	6,446	47,317		3,888
(Loss) Income from Continuing					
Operations	(108,638)	106,461	(12,062)		(14,239)
Income (loss) from discontinued operations, net of income taxes		415	(1,102)		(687)
Equity in losses of subsidiaries (net of tax)	93,712	(22,449)		(71,263)	
Net (Loss) Income	\$ (14,926)	\$ 84,427	\$ (13,164)	\$ (71,263)	\$ (14,926)

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Operations****For the Nine Months Ended September 30, 2009 (Unaudited)****(In thousands)**

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Operating Revenue	\$	\$ 1,984,354	\$ 594,683	\$ (55,304)	\$ 2,523,733
Operating Costs and Expenses:					
Cost of services rendered and products sold		1,263,312	267,210	(55,304)	1,475,218
Selling and administrative expenses	7,178	419,898	235,918		662,994
Amortization expense	165	94,032	26,942		121,139
Restructuring and Merger related charges	2,234	9,449	11,176		22,859
Total operating costs and expenses	9,577	1,786,691	541,246	(55,304)	2,282,210
Operating (Loss) Income	(9,577)	197,663	53,437		241,523
Non-operating Expense (Income):					
Interest expense (income)	233,326	2,116	(9,904)		225,538
Interest and net investment loss (income)	1,123	2,142	(6,457)		(3,192)
Gain on extinguishment of debt	(46,106)				(46,106)
Other expense			555		555
(Loss) Income from Continuing Operations before Income Taxes	(197,920)	193,405	69,243		64,728
(Benefit) provision for income taxes	(110,795)	66,307	65,208		20,720
(Loss) Income from Continuing Operations	(87,125)	127,098	4,035		44,008
Loss from discontinued operations, net of income taxes			(666)		(666)
Equity in earnings of subsidiaries (net of tax)	130,467	(5,148)		(125,319)	
Net Income	\$ 43,342	\$ 121,950	\$ 3,369	\$ (125,319)	\$ 43,342

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Financial Position (Unaudited)**

As of September 30, 2010

(In thousands)

	The ServiceMaster Company		Non- Guarantors		Eliminations	Consolidated				
Assets										
Current Assets:										
Cash and cash equivalents	\$	39,114	\$	20,284	\$	137,642	\$	197,040		
Marketable securities						28,127		28,127		
Receivables		1,202		185,959		459,318		(204,386)	442,093	
Inventories				75,243		2,569			77,812	
Prepaid expenses and other assets		3,242		24,593		18,185			46,020	
Deferred customer acquisition costs				22,060		21,061			43,121	
Deferred taxes				15,988		1,017		(248)	16,757	
Assets of discontinued operations						10			10	
Total Current Assets		43,558		344,127		667,929		(204,634)	850,980	
Property and Equipment:										
At cost				324,433		124,549			448,982	
Less: accumulated depreciation				(129,944)		(50,178)			(180,122)	
Net property and equipment				194,489		74,371			268,860	
Other Assets:										
Goodwill				2,755,130		364,354			3,119,484	
Intangible assets, primarily trade names, service marks and trademarks, net				1,921,985		767,275			2,689,260	
Notes receivable		2,012,779		287		31,543		(2,020,729)	23,880	
Long-term marketable securities		9,984				101,534			111,518	
Investments in and advances to subsidiaries		3,671,237		1,493,466				(5,164,703)		
Other assets		101,555		4,101		1,015		(99,577)	7,094	
Debt issuance costs		55,909							55,909	
Total Assets	\$	5,895,022	\$	6,713,585	\$	2,008,021	\$	(7,489,643)	\$	7,126,985
Liabilities and Shareholders Equity										
Current Liabilities:										
Accounts payable	\$	5	\$	58,269	\$	40,731	\$		99,005	
Accrued liabilities:										
Payroll and related expenses		2,211		58,159		42,341			102,711	
Self-insured claims and related expenses				21,846		64,191			86,037	
Other		43,677		46,867		49,294		(248)	139,590	
Deferred revenue				139,123		313,628			452,751	
Liabilities of discontinued operations				233		423			656	
Current portion of long-term debt		111,382		13,778		129,542		(204,386)	50,316	
Total Current Liabilities		157,275		338,275		640,150		(204,634)	931,066	
Long-Term Debt		3,873,749		2,010,286		43,596		(2,020,729)	3,906,902	
Other Long-Term Liabilities:										

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Deferred taxes		760,180	272,053	(99,577)	932,656
Intercompany payable	610,198		61,804	(672,002)	
Liabilities of discontinued operations			4,078		4,078
Other long-term obligations	80,236	1,737	96,746		178,719
Total Other Long-Term Liabilities	690,434	761,917	434,681	(771,579)	1,115,453
Shareholder s Equity	1,173,564	3,603,107	889,594	(4,492,701)	1,173,564
Total Liabilities and Shareholder s Equity	\$ 5,895,022	\$ 6,713,585	\$ 2,008,021	\$ (7,489,643)	\$ 7,126,985

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Financial Position (Audited)**

As of December 31, 2009

(In thousands)

	The ServiceMaster Company		Guarantors	Non- Guarantors	Eliminations	Consolidated
Assets						
Current Assets:						
Cash and cash equivalents	\$	124,674	\$ 15,796	\$ 112,993	\$	\$ 253,463
Marketable securities				21,120		21,120
Receivables		1,162	133,866	424,395	(210,768)	348,655
Inventories			74,041	2,551		76,592
Prepaid expenses and other assets		7,840	15,239	13,485		36,564
Deferred customer acquisition costs			13,759	22,311		36,070
Deferred taxes			22,481	996	(1,882)	21,595
Assets of discontinued operations			15	27		42
Total Current Assets		133,676	275,197	597,878	(212,650)	794,101
Property and Equipment:						
At cost			262,223	82,877		345,100
Less: accumulated depreciation			(94,423)	(38,542)		(132,965)
Net property and equipment			167,800	44,335		212,135
Other Assets:						
Goodwill			2,755,813	363,941		3,119,754
Intangible assets, primarily trade names, service marks and trademarks, net			1,992,843	794,394		2,787,237
Notes receivable		1,992,857	707	22,783	(1,992,857)	23,490
Long-term marketable securities		9,985		101,081		111,066
Investments in and advances to subsidiaries		3,586,670	1,392,095	7,934	(4,986,699)	
Other assets		105,761	3,889	4,292	(82,143)	31,799
Debt issuance costs		66,807				66,807
Total Assets	\$	5,895,756	\$ 6,588,344	\$ 1,936,638	\$ (7,274,349)	\$ 7,146,389
Liabilities and Shareholders Equity						
Current Liabilities:						
Accounts payable	\$	1,046	\$ 42,325	\$ 30,100	\$	\$ 73,471
Accrued liabilities:						
Payroll and related expenses		2,185	33,687	38,513		74,385
Self-insured claims and related expenses			21,727	65,605		87,332
Other		51,391	41,716	65,424	(1,882)	156,649
Deferred revenue			138,691	311,055		449,746
Liabilities of discontinued operations			248	2,558		2,806
Current portion of long-term debt		141,230	27,226	106,707	(210,768)	64,395
Total Current Liabilities		195,852	305,620	619,962	(212,650)	908,784
Long-Term Debt		3,889,574	1,999,226	14,606	(1,992,857)	3,910,549
Other Long-Term Liabilities:						

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Deferred taxes		754,531	284,689	(82,143)	957,077
Intercompany payable	545,995			(545,995)	
Liabilities of discontinued operations			4,145		4,145
Other long-term obligations	78,004	2,284	99,215		179,503
Total Other Long-Term Liabilities	623,999	756,815	388,049	(628,138)	1,140,725
Shareholder s Equity	1,186,331	3,526,683	914,021	(4,440,704)	1,186,331
Total Liabilities and Shareholder s Equity \$	5,895,756	\$ 6,588,344	\$ 1,936,638	\$ (7,274,349)	\$ 7,146,389

Table of Contents

THE SERVICEMASTER COMPANY AND SUBSIDIARIES

Condensed Consolidating Statement of Cash Flows (Unaudited)

For the Nine Months Ended September 30, 2010

(In thousands)

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Cash and Cash Equivalents at Beginning of Period	\$ 124,674	\$ 15,796	\$ 112,993	\$	\$ 253,463
Net Cash (Used for) Provided from Operating Activities from Continuing Operations	(111,085)	290,685	(9,005)	(51,356)	119,239
Cash Flows from Investing Activities from Continuing Operations:					
Property additions		(61,778)	(43,514)		(105,292)
Sale of equipment and other assets		1,426	132		1,558
Acquisition of The ServiceMaster Company	(2,219)				(2,219)
Other business acquisitions, net of cash acquired		(52,276)	(212)		(52,488)
Notes receivable, financial investments and securities, net	22,012		(1,058)		20,954
Net Cash Used for Investing Activities from Continuing Operations	19,793	(112,628)	(44,652)		(137,487)
Cash Flows from Financing Activities from Continuing Operations:					
Borrowings of debt	5,000		10,000		15,000
Payments of debt	(25,438)	(10,918)	(13,441)		(49,797)
Debt issuance costs paid			(30)		(30)
Shareholders dividends		(25,678)	(25,678)	51,356	
Net intercompany advances	26,170	(136,973)	110,803		
Net Cash Provided from (Used for) Financing Activities from Continuing Operations	5,732	(173,569)	81,654	51,356	(34,827)
Cash Flows from Discontinued Operations:					
Cash used for operating activities			(3,348)		(3,348)
Net Cash Used for Discontinued Operations			(3,348)		(3,348)
Cash (Decrease) Increase During the Period	(85,560)	4,488	24,649		(56,423)
Cash and Cash Equivalents at End of Period	\$ 39,114	\$ 20,284	\$ 137,642	\$	\$ 197,040

Table of Contents**THE SERVICEMASTER COMPANY AND SUBSIDIARIES****Condensed Consolidating Statement of Cash Flows (Unaudited)****For the Nine Months Ended September 30, 2009****(In thousands)**

	The ServiceMaster Company	Guarantors	Non- Guarantors	Eliminations	Consolidated
Cash and Cash Equivalents at Beginning of Period	\$ 300,362	\$ 12,105	\$ 93,120	\$	\$ 405,587
Net Cash (Used for) Provided from Operating Activities from Continuing Operations	(129,660)	259,507	(17,009)	(43,634)	69,204
Cash Flows from Investing Activities from Continuing Operations:					
Property additions		(43,915)	(6,555)		(50,470)
Sale of equipment and other assets		2,651	105		2,756
Acquisition of The ServiceMaster Company	(1,482)				(1,482)
Other business acquisitions, net of cash acquired		(20,730)			(20,730)
Notes receivable, financial investments and securities, net			8,032		8,032
Net Cash (Used for) Provided from Investing Activities from Continuing Operations	(1,482)	(61,994)	1,582		(61,894)
Cash Flows from Financing Activities from Continuing Operations:					
Payments of debt	(186,448)	(12,704)	(2,219)		(201,371)
Debt issuance costs paid	(410)				(410)
Shareholders' dividends		(21,817)	(21,817)	43,634	
Net intercompany advances	99,556	(159,446)	59,890		
Net Cash (Used for) Provided from Financing Activities from Continuing Operations	(87,302)	(193,967)	35,854	43,634	(201,781)
Cash Flows from Discontinued Operations:					
Cash used for operating activities			(2,329)		(2,329)
Cash used for investing activities			(914)		(914)
Net Cash Used for Discontinued Operations			(3,243)		(3,243)
Cash (Decrease) Increase During the Period	(218,444)	3,546	17,184		(197,714)
Cash and Cash Equivalents at End of Period	\$ 81,918	\$ 15,651	\$ 110,304	\$	\$ 207,873

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Merger Agreement

On March 18, 2007, ServiceMaster entered into the Merger Agreement with Holdings and Acquisition Co., and the Merger was completed on July 24, 2007. Immediately following the completion of the Merger, all of the outstanding capital stock of Holdings, the ultimate parent company of ServiceMaster, was owned by investment funds sponsored by, or affiliated with, the Equity Sponsors.

Equity contributions totaling \$1,431.1 million from the Equity Sponsors, together with (i) borrowings under the Interim Loan Facility, (ii) borrowings under a new \$2,650.0 million senior secured term loan facility and (iii) cash on hand at ServiceMaster, were used, among other things, to finance the aggregate merger consideration, to make payments in satisfaction of other equity-based interests in ServiceMaster under the Merger Agreement, to settle existing interest rate swaps, to redeem or provide for the repayment of certain of the Company's existing indebtedness and to pay related transaction fees and expenses. In addition, letters of credit issued under a new \$150.0 million pre-funded letter of credit facility were used to replace and/or secure letters of credit previously issued under a ServiceMaster credit facility that was terminated as of the Closing Date. On the Closing Date, the Company also entered into, but did not then draw under, the Revolving Credit Facility.

On July 24, 2008, outstanding amounts under the Interim Loan Facility were converted on a one to one basis into the Permanent Notes. The Permanent Notes were issued pursuant to a refinancing indenture. In connection with the issuance of Permanent Notes, ServiceMaster entered into the Registration Rights Agreement, pursuant to which ServiceMaster filed with the SEC a registration statement with respect to the resale of the Permanent Notes, which was declared effective on January 16, 2009. ServiceMaster deregistered the Permanent Notes in accordance with the terms of the Registration Rights Agreement, and the effectiveness of the registration statement was terminated, on November 19, 2009.

Results of Operations

Third Quarter 2010 Compared to 2009

The Company reported third quarter 2010 revenue of \$977.3 million, a \$56.7 million, or 6.2 percent, increase compared to 2009. The revenue increase was driven by the results of our business units as described in Segment Reviews for the Third Quarter 2010 Compared to 2009 .

Operating income was \$116.7 million for the third quarter of 2010 compared to \$94.8 million for the third quarter of 2009. Income from continuing operations before income taxes was \$49.2 million for the third quarter of 2010 compared to \$25.0 million for the third quarter of 2009. The increase in income from continuing operations before income taxes of \$24.2 million reflects the net effect of:

(In millions)

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Non-cash purchase accounting adjustments(1)	\$	10.2
Interest expense(2)		2.9
Interest and net investment income(3)		(0.6)
Restructuring and Merger related charges(4)		6.8
Management and consulting fees(5)		2.8
Residual value guarantee charge(6)		1.3
Key executive separation charges(7)		(5.0)
Segment results(8)		5.8
	\$	24.2

(1) Consists primarily of decreased amortization of intangible assets as a result of certain finite lived intangible assets being fully amortized as of July 24, 2010.

(2) Represents a decrease in interest expense as a result of decreases in our weighted average interest rates and average long-term debt balances as compared to the third quarter of 2009.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

(3) As further described in Operating and Non-Operating Expenses, represents a decrease in interest and net investment income.

(4) Represents (i) a decrease in restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare and (ii) a decrease in Merger related charges.

(5) Represents management and consulting fees payable to certain related parties. A management fee is payable to CD&R pursuant to a consulting agreement under which CD&R provides the Company with on-going consulting and management advisory services in exchange for an annual management fee of \$6.25 million, which is payable quarterly. On July 30, 2009, the annual management fee payable under the consulting agreement with CD&R was increased from \$2.0 million to \$6.25 million in order to align the fee structure with current market rates. Under this agreement, the Company recorded a management fee of \$1.6 million and \$3.7 million for the third quarter of 2010 and 2009, respectively. The full year management fee was applied in 2009, and the incremental fees relating to the first three quarters of 2009 were recorded and paid to CD&R in the third quarter of 2009.

In addition, in August 2009, the Company entered into consulting agreements with Citigroup, BAS and JPMorgan, each of which is an Equity Sponsor or an affiliate of an Equity Sponsor. Under the consulting agreements, Citigroup, BAS and JPMorgan each provide the Company with on-going consulting and management advisory services through September 30, 2016 or the earlier termination of the existing consulting agreement between the Company and CD&R. The Company pays annual management fees of \$0.5 million, \$0.5 million and \$0.25 million to Citigroup, BAS and JPMorgan, respectively. The Company recorded consulting fees related to these agreements of \$0.3 million and \$0.9 million for the third quarter of 2010 and 2009, respectively. The full year management fee was applied in 2009, and the incremental fees relating to the first three quarters of 2009 were recorded and paid to Citigroup, BAS and JPMorgan in the third quarter of 2009. On September 30, 2010, Citigroup transferred the management responsibility for, and its proprietary interests in, certain investment funds that own shares of common stock of Holdings to StepStone Group LLC (StepStone) and Lexington Partners Advisors LP. Citigroup also assigned its obligations and rights under the consulting agreement to StepStone, and beginning in the fourth quarter of 2010, the consulting fee otherwise payable to Citigroup will be paid to StepStone.

(6) Represents a decrease in residual value guarantee charges related to a synthetic lease for operating properties that did not result in additional cash payments to exit the facility at the end of the lease term in July 2010. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$1.4 million and \$2.7 million in the three months ended September 30, 2010 and 2009, respectively, related to this shortfall.

(7) Represents key executive separation charges recorded in the third quarter of 2010 related to the pending retirement of our Chief Executive Officer and the resignation of the President of TruGreen LandCare.

(8) Represents a net increase in income from continuing operations before income taxes, non-cash purchase accounting charges, interest expense, interest and net investment income, restructuring and Merger related charges, management and consulting fees, residual value guarantee charge and key executive separation charges, reflecting the improvement in results at Terminix, American Home Shield and ServiceMaster Clean, offset, in part, by the decline in results at TruGreen LandCare, TruGreen LawnCare and Other Operations and

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Headquarters as described in Segment Reviews for the Third Quarter 2010 Compared to 2009 .

Operating and Non-Operating Expenses

The Company reported cost of services rendered and products sold of \$561.2 million for the third quarter of 2010 compared to \$527.4 million for the third quarter of 2009. As a percentage of revenue, these costs increased to 57.4 percent for the third quarter of 2010 from 57.3 percent for the third quarter of 2009. This percentage increase primarily reflects increased contract claims costs at American Home Shield, decreased labor efficiencies at TruGreen LandCare and increased costs related to ongoing initiatives at TruGreen LawnCare to transform our branch operations and to improve customer service, offset, in part, by, reduced fertilizer costs and residual value guarantee charges at TruGreen LawnCare and reduced fuel costs.

The Company reported selling and administrative expenses of \$266.8 million for the third quarter of 2010 compared to \$249.3 million for the third quarter of 2009. As a percentage of revenue, these costs increased to 27.3 percent for the third quarter of 2010 from 27.1 percent for the third quarter of 2009. This percentage increase primarily reflects investments in sales and marketing, increased provisions for incentive compensation, key executive separation charges of \$5.0 million recorded in the third quarter of 2010 related to the pending retirement of our Chief Executive Officer and the resignation of the President of TruGreen LandCare and increases in spending in the Company's headquarters functions to enhance capabilities in our centers of excellence and on initiatives

Table of Contents

designed to improve the performance of our operating segments, offset, in part, by decreased management and consulting fees payable to the Equity Sponsors due to the timing of fees recognized in 2009.

Amortization expense was \$30.9 million for the third quarter of 2010 compared to \$40.4 million for the third quarter of 2009. The decrease is a result of certain finite lived intangible assets being fully amortized as of July 24, 2010.

Non-operating expense totaled \$67.5 million for the third quarter of 2010 compared to \$69.8 million for the third quarter of 2009. This decrease includes a \$2.9 million decrease in interest expense resulting from decreases in our weighted average interest rates and average long-term debt balances, offset, in part, by a \$0.6 million decrease in interest and net investment income. Interest and net investment income was comprised of the following for the third quarter of 2010 and 2009:

(In thousands)	Three months ended September 30,	
	2010	2009
Realized gains(1)	\$ 2,016	\$ 2,763
Deferred compensation trust(2)	884	1,168
Other(3)	1,089	627
Interest and net investment income	\$ 3,989	\$ 4,558

(1) Represents the net investment gains and the interest and dividend income realized on the American Home Shield investment portfolio.

(2) Represents investment income resulting from a change in the market value of investments within an employee deferred compensation trust (for which there is a corresponding and offsetting change in compensation expense within income from continuing operations before income taxes).

(3) Represents interest income on other cash balances.

The effective tax rate on income from continuing operations was a provision of 89.0 percent for the third quarter of 2010 compared to a provision of 16.4 percent for the third quarter of 2009. The change in the effective rate is primarily due to a decrease in the state tax rates in 2009 applied to cumulative deferred taxes; an increase in unfavorable permanent book to tax differences from 2009 to 2010; and recording the impact of an adjustment to the Company's 2010 forecasted annual effective tax rate during the third quarter of 2010.

Restructuring and Merger Related Charges

Edgar Filing: SERVICEMASTER CO - Form 10-Q

The Company incurred restructuring and Merger related charges of \$1.7 million and \$8.5 million for the third quarter of 2010 and 2009, respectively. Restructuring and Merger related charges were comprised of the following:

(In thousands)	Three months ended September 30,			
	2010		2009	
TruGreen LawnCare reorganization and restructuring(1)	\$	695	\$	5,951
Merger related charges(2)		44		786
Other(3)		951		1,761
Total restructuring and Merger related charges	\$	1,690	\$	8,498

(1) Represents restructuring charges related to a reorganization of field leadership and a restructuring of branch operations. For the third quarter of 2010, these costs included consulting fees of \$0.7 million. For the third quarter of 2009, these costs included consulting fees of \$4.1 million and severance, lease termination and other costs of \$1.9 million. In connection with the restructuring of branch operations, we expect to incur cash charges through the second quarter of 2011 primarily related to consulting fees. Such charges are expected to amount to an additional \$0.7 million, pre-tax, and will be recorded as restructuring charges in the condensed consolidated statement of operations as incurred.

(2) Includes legal fees and other costs associated with the Merger.

(3) For the three months ended September 30, 2010, these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$1.2 million and a net reversal of consulting and other costs of \$0.2 million. For the three months ended September 30, 2009, these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$0.4 million and consulting and other costs of \$1.4 million.

Table of Contents**Key Performance Indicators**

The table below presents selected operating metrics related to customer counts and customer retention for the three largest revenue generating businesses in the Company. These measures are presented on a rolling, twelve-month basis in order to avoid seasonal anomalies.

	Key Performance Indicators as of September 30,	
	2010	2009
TruGreen LawnCare		
Growth in Full Program Accounts	1%	0%
Customer Retention Rate	69.5%	69.2%
Terminix(a)		
Growth in Pest Control Customers	5%	1%
Pest Control Customer Retention Rate	80.4%	77.9%
Growth (Reduction) in Termite Customers	0%	(1)%
Termite Customer Retention Rate	86.0%	85.8%
American Home Shield		
Growth (Reduction) in Home Service Contracts	3%	(2)%
Customer Retention Rate	66.3%	63.3%

(a) 2010 pest control customer count growth excluding the impact of the Antimite Termite and Pest Control acquisition completed in the third quarter of 2010 was 3%. The pest control customer retention rate in 2010 excluding the impact of the Antimite Termite and Pest Control acquisition was 80.1%.

Segment Reviews for the Third Quarter 2010 Compared to 2009

The following business segment reviews should be read in conjunction with the required footnote disclosures presented in the Notes to the condensed consolidated financial statements. This disclosure provides a reconciliation of segment operating income to income from continuing operations before income taxes, with net non-operating expenses as the only reconciling item. The operating income, EBITDA, Adjusted EBITDA, and Comparable Operating Performance for each reportable segment have been revised to reflect the Company's revised methodology for the allocation of general corporate overhead expenses for all periods presented. See Note 14 to the condensed consolidated financial statements for further information.

The Company uses Adjusted EBITDA and Comparable Operating Performance to facilitate operating performance comparisons from period to period. Adjusted EBITDA and Comparable Operating Performance are supplemental measures of the Company's performance that are not required by, or presented in accordance with, GAAP. Adjusted EBITDA and Comparable Operating Performance are not measurements of the Company's financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP or as alternatives to net cash provided by operating activities or any other measures of the Company's cash flow or liquidity. Adjusted EBITDA means net income (loss) before net income (loss) from discontinued operations; provision (benefit) for income taxes; other expense; gain on extinguishment of debt; interest expense and interest and net investment loss (income); and depreciation and amortization expense; as well as adding back interest and net investment loss (income), residual value guarantee charge and non-cash goodwill and trade name impairment. Comparable Operating Performance is calculated by adding back to Adjusted EBITDA an amount equal to the non-cash stock-based compensation expense and non-cash effects on Adjusted EBITDA attributable to the application of purchase

accounting in connection with the Merger.

The Company believes Adjusted EBITDA facilitates company-to-company operating performance comparisons by backing out potential differences caused by variations in capital structures (affecting net interest income and expense), taxation and the age and book depreciation of facilities and equipment (affecting relative depreciation expense), which may vary for different companies for reasons unrelated to operating performance. In addition, the Company excludes residual value guarantee charges that do not result in additional cash payments to exit the facility at the end of the lease term. The Company uses Comparable Operating Performance as a supplemental measure to assess the Company's performance because it excludes non-cash stock-based compensation expense and non-cash effects on Adjusted EBITDA attributable to the application of purchase accounting in connection with the Merger. The Company presents Comparable Operating Performance because it believes that it is useful for investors, analysts and other interested parties in their analysis of the Company's operating results.

The Company believes Comparable Operating Performance, which excludes the impact of purchase accounting and non-cash stock-based compensation expense adjustments, is useful to investors. The exclusion of the impact of these items facilitates a

Table of Contents

comparison of operating results from periods pre-dating the Merger transaction with the Equity Sponsors with periods subsequent to the Merger. The purchase accounting charges were not present prior to the Merger. In addition, charges relating to non-cash stock-based compensation expense prior to the Merger were computed under different plans and formulas than charges subsequent to the Merger. Moreover, such charges are non-cash and the exclusion of the impact of these items from Comparable Operating Performance allows investors to understand the current period results of operations of the business on a comparable basis with previous periods and, secondarily, gives the investors added insight into cash earnings available to service the Company's debt. We believe this to be of particular importance to the Company's public investors, which are debt holders. The Company also believes that the exclusion of the impact of purchase accounting and non-cash stock-based compensation expense may provide an additional means for comparing the Company's performance to the performance of other companies by eliminating the impact of differently structured equity-based long-term incentive plans (although care must be taken in making any such comparison, as there may be inconsistencies among companies in the manner of computing similarly titled financial measures).

Adjusted EBITDA and Comparable Operating Performance are not necessarily comparable to other similarly titled financial measures of other companies due to the potential inconsistencies in the method of calculation.

Adjusted EBITDA and Comparable Operating Performance have limitations as analytical tools, and should not be considered in isolation or as substitutes for analyzing the Company's results as reported under GAAP. Some of these limitations are:

- Adjusted EBITDA and Comparable Operating Performance do not reflect changes in, or cash requirements for, the Company's working capital needs;
- Adjusted EBITDA and Comparable Operating Performance do not reflect the Company's interest expense or the cash requirements necessary to service interest or principal payments on the Company's debt;
- Adjusted EBITDA and Comparable Operating Performance do not reflect the Company's tax expense or the cash requirements to pay the Company's taxes;
- Adjusted EBITDA and Comparable Operating Performance do not reflect historical cash expenditures or future requirements for capital expenditures or contractual commitments;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA and Comparable Operating Performance do not reflect any cash requirements for such replacements;
- Other companies in the Company's industries may calculate Adjusted EBITDA and Comparable Operating Performance differently, limiting their usefulness as comparative measures; and

- Comparable Operating Performance does not include the impact of purchase accounting and non-cash stock-based compensation expense, the latter exclusion may cause the overall compensation cost of the business to be understated.

Table of Contents

Operating revenues and Comparable Operating Performance by operating segment are as follows:

(In thousands)	Three months ended September 30,	
	2010	2009
Operating Revenue:		
TruGreen LawnCare	\$ 371,298	\$ 351,830
TruGreen LandCare	58,278	63,244
Terminix	295,172	272,598
American Home Shield	196,913	179,617
ServiceMaster Clean	34,041	32,132
Other Operations and Headquarters	21,558	21,093
Total Operating Revenue	\$ 977,260	\$ 920,514
Comparable Operating Performance:		
TruGreen LawnCare	\$ 80,290	\$ 75,673
TruGreen LandCare	(2,383)	2,754
Terminix	62,328	53,241
American Home Shield	41,276	37,438
ServiceMaster Clean	15,533	15,056
Other Operations and Headquarters	(24,492)	(23,563)
Total Comparable Operating Performance	\$ 172,552	\$ 160,599
Memo: Items included in Comparable Operating Performance:		
Restructuring and Merger related charges(1)	\$ 1,690	\$ 8,498
Management and consulting fees(2)	\$ 1,875	\$ 4,625
Memo: Items excluded from Comparable Operating Performance:		
Comparable Operating Performance of Discontinued Operations	\$ (227)	\$ (609)

(1) Represents (i) restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare and (ii) Merger related charges.

(2) Represents management and consulting fees payable to certain related parties. See Note 15 to the condensed consolidated financial statements for further information on management and consulting fees.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

The following table presents reconciliations of operating income, the most directly comparable financial measure under GAAP, to Adjusted EBITDA and Comparable Operating Performance for the periods presented.

(in thousands)	TruGreen LawnCare	TruGreen LandCare	Terminix	American Home Shield	Service Master Clean	Other Operations and Headquarters	Total
Three Months Ended September 30, 2010							
Operating income (loss)(1)	\$ 66,730	\$ (5,138)	\$ 44,979	\$ 28,777	\$ 13,464	\$ (32,140)	\$ 116,672
Depreciation and amortization expense	12,332	2,909	17,388	10,577	1,790	3,271	48,267
EBITDA	79,062	(2,229)	62,367	39,354	15,254	(28,869)	164,939
Interest and net investment income (2)				2,016	153	1,820	3,989
Residual value guarantee charge(3)	1,240				126	32	1,398
Adjusted EBITDA	80,302	(2,229)	62,367	41,370	15,533	(27,017)	170,326
Non-cash stock-based compensation expense						2,525	2,525
Non-cash (credits) attributable to purchase accounting(4)	(12)	(154)	(39)	(94)			(299)
Comparable Operating Performance	\$ 80,290	\$ (2,383)	\$ 62,328	\$ 41,276	\$ 15,533	\$ (24,492)	\$ 172,552
Memo: Items included in Comparable Operating Performance							
Restructuring and Merger related charges (credits)(5)	\$ 695	\$ 127	\$ 1,061	\$	\$ 61	\$ (254)	\$ 1,690
Management and consulting fees(6)	\$	\$	\$	\$	\$	\$ 1,875	\$ 1,875
Memo: Items excluded from Comparable Operating Performance							
Comparable Operating Performance of Discontinued Operations(7)	\$	\$	\$	\$	\$	\$ (227)	\$ (227)
Three Months Ended September 30, 2009							
Operating income (loss)(1)	\$ 51,373	\$ 27	\$ 37,490	\$ 24,279	\$ 12,549	\$ (30,878)	\$ 94,840
Depreciation and amortization expense	21,965	2,890	15,850	10,387	2,069	3,499	56,660
EBITDA	73,338	2,917	53,340	34,666	14,618	(27,379)	151,500
Interest and net investment income(2)				2,762	144	1,652	4,558
Residual value guarantee charge(3)	2,363				294	73	2,730
Adjusted EBITDA	75,701	2,917	53,340	37,428	15,056	(25,654)	158,788
Non-cash stock-based compensation expense						2,091	2,091
Non-cash (credits) charges attributable to purchase accounting(4)	(28)	(163)	(99)	10			(280)
Comparable Operating Performance	\$ 75,673	\$ 2,754	\$ 53,241	\$ 37,438	\$ 15,056	\$ (23,563)	\$ 160,599
Memo: Items included in Comparable Operating Performance							
Restructuring and Merger related charges(5)	\$ 5,951	\$ 184	\$ 214	\$ 30	\$	\$ 2,119	\$ 8,498
Management and consulting fees(6)	\$	\$	\$	\$	\$	\$ 4,625	\$ 4,625
Memo: Items excluded from Comparable Operating Performance							
Comparable Operating Performance of Discontinued Operations(7)	\$	\$	\$	\$	\$	\$ (609)	\$ (609)

Table of Contents

(1) Presented below is a reconciliation of total segment operating income to net income.

(In thousands)	Three months ended	
	2010	2009
Total Segment Operating Income	\$ 116,672	\$ 94,840
Non-operating Expense (Income):		
Interest expense	71,267	74,216
Interest and net investment income	(3,989)	(4,558)
Other expense	209	176
Income from Continuing Operations before Income Taxes	49,185	25,006
Provision for income taxes	43,790	4,102
Income from Continuing Operations	5,395	20,904
Loss from discontinued operations, net of income taxes	(105)	(396)
Net Income	\$ 5,290	\$ 20,508

(2) Interest and net investment income is primarily comprised of investment income and realized gain (loss) on our American Home Shield segment investment portfolio. Cash, short-term and long-term marketable securities associated with regulatory requirements in connection with American Home Shield and for other purposes totaled \$296.0 million as of September 30, 2010. American Home Shield interest and net investment income was \$2.0 million and \$2.8 million for the third quarter of 2010 and 2009, respectively. The balance of interest and net investment income primarily relates to (i) investment income (loss) from our employee deferred compensation trust (for which there is a corresponding and offsetting change in compensation expense within income from continuing operations before income taxes) and (ii) interest income on other cash balances.

(3) Represents residual value guarantee charges related to a synthetic lease for operating properties that did not result in additional cash payments to exit the facility at the end of the lease term in July 2010. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$1.4 million and \$2.7 million in the three months ended September 30, 2010 and 2009, respectively, related to this shortfall.

(4) The Merger was accounted for using purchase accounting. This adjustment represents the aggregate, non-cash adjustments (other than amortization and depreciation) attributable to the application of purchase accounting.

(5) Represents (i) restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare and (ii) Merger related charges.

(6) Represents management and consulting fees payable to certain related parties. See Note 15 to the condensed consolidated financial statements for further information on management and consulting fees.

(7) There are no adjustments necessary to reconcile operating loss from discontinued operations, the most directly comparable financial measure under GAAP, to Adjusted EBITDA or Comparable Operating Performance from discontinued operations for the third quarter of 2010 and 2009.

TruGreen LawnCare Segment

The TruGreen LawnCare segment, which includes lawn, tree and shrub care services, reported a 5.5 percent increase in revenue, a 29.9 percent increase in operating income and a 6.1 percent improvement in Comparable Operating Performance for the third quarter of 2010 compared to 2009. The revenue results reflect a 1.3 percent increase in customer counts, higher sales of expanded services to existing customers, lower discounts and improved price realization. The increase in customer counts was driven by an increase in new unit sales generated in our neighborhood selling channel and the contribution of acquisitions.

TruGreen LawnCare's Comparable Operating Performance improved \$4.6 million for the third quarter of 2010 compared to 2009. In addition to the favorable impact of increased revenue, TruGreen LawnCare's improved Comparable Operating Performance reflects a \$5.3 million decrease in restructuring charges and reduced fuel and fertilizer costs, offset, in part, by investments in sales and marketing and increased costs related to our ongoing initiatives to transform our branch operations and to improve customer service.

Table of Contents

TruGreen LandCare Segment

The TruGreen LandCare segment, which includes landscape maintenance services, reported a 7.9 percent decrease in revenue, a \$5.2 million decrease in operating income and a 186.5 percent decline in Comparable Operating Performance for the third quarter of 2010 compared to 2009. The decrease in revenue included a 9.0 percent decrease in base contract maintenance revenue and an 8.3 percent decrease in enhancement revenue. Revenue trends were primarily impacted by contract cancellations and pricing concessions granted in 2009 and 2010 in response to the impacts of a difficult economic environment. However, the ratio of enhancement revenue to base contract maintenance revenue for the third quarter of 2010 increased 33 basis points as compared to 2009.

TruGreen LandCare's Comparable Operating Performance declined \$5.1 million for the third quarter of 2010 compared to 2009. In addition to the unfavorable impact of decreased revenue, TruGreen LandCare's decline in Comparable Operating Performance reflects decreased labor efficiencies resulting from increased technician overtime and key executive separation charges, offset, in part, by reduced fuel costs. The Company is exploring strategic options relating to TruGreen LandCare, including the potential sale of the business.

Terminix Segment

The Terminix segment, which includes termite and pest control services and the distribution of pest control products, reported an 8.3 percent increase in revenue, a 20.0 percent increase in operating income and a 17.1 percent improvement in Comparable Operating Performance for the third quarter of 2010 compared to 2009. The segment's overall revenue results reflected growth in termite and pest control revenues, as well as increased product distribution revenue of \$6.2 million. Termite revenues increased 4.8 percent for the third quarter of 2010 compared to 2009, due to an increase in new unit sales, the contribution of acquisitions and a 20 basis point improvement in the customer retention rate. Pest control revenues increased 7.2 percent for the third quarter of 2010 compared to 2009, reflecting a 5.0 percent increase in customer counts due to an increase in new unit sales, the contribution of acquisitions and a 250 basis point improvement in the customer retention rate. In the third quarter of 2010, Terminix acquired the assets of Antimite Termite and Pest Control, a company with annual revenues of approximately \$30 million.

Terminix's Comparable Operating Performance improved \$9.1 million for the third quarter of 2010 compared to 2009. In addition to the favorable impact of increased revenue, Terminix's Comparable Operating Performance reflects reduced fuel costs, the favorable impact of acquiring assets in connection with exiting certain fleet leases, and favorable termite damage claims trends, offset, in part, by investments in sales and marketing, increased provisions for incentive compensation and an \$0.8 million increase in restructuring charges due to adjustments to lease termination reserves related to previous restructuring initiatives.

American Home Shield Segment

The American Home Shield segment, which provides home service contracts to consumers that cover heating, ventilation, air conditioning, plumbing and other systems and appliances, reported a 9.6 percent increase in revenue, an 18.5 percent increase in operating income and a 10.3 percent improvement in Comparable Operating Performance for the third quarter of 2010 compared to 2009. The increase in revenue reflects a 3.4 percent increase in customer counts and improved price realization. The increase in customer counts was driven by an increase in new unit sales and a 300 basis point improvement in customer retention. The revenue results for the third quarter of 2010, as compared to 2009, were also positively impacted by a difference between years in the timing of revenue recognition. American Home Shield recognizes revenue over the

contract period in proportion to the expected direct costs.

American Home Shield's Comparable Operating Performance improved \$3.8 million for the third quarter of 2010 compared to 2009. In addition to the favorable impact of increased revenue, American Home Shield's Comparable Operating Performance reflects the favorable impact of accelerating sales and marketing spend earlier in the year as compared to prior year, offset, in part, by a 15.9 percent increase in contract claims costs driven by an increase in the number of seasonal contract claims and a \$0.7 million reduction in interest and net investment income from the American Home Shield investment portfolio.

ServiceMaster Clean Segment

The ServiceMaster Clean segment, which provides residential and commercial disaster restoration and cleaning services through franchisees primarily under the ServiceMaster and ServiceMaster Clean brand names, on-site furniture repair and restoration services primarily under the Furniture Medic brand name and home inspection services primarily under the AmeriSpec brand name, reported a 5.9 percent increase in revenue, a 7.3 percent increase in operating income and a 3.2 percent improvement in Comparable Operating Performance for the third quarter of 2010 compared to 2009. Trends in revenue reflect an increase in national janitorial accounts, product sales to franchisees and other revenues.

Table of Contents

ServiceMaster Clean's Comparable Operating Performance improved \$0.5 million for the third quarter of 2010 compared to 2009, primarily reflecting the favorable impact of increased revenue.

Other Operations and Headquarters Segment

This segment includes the operations of Merry Maids, SMAC and the Company's headquarters functions. The segment reported a 2.2 percent increase in revenue, a 4.1 percent increase in operating loss and a 3.9 percent decline in Comparable Operating Performance for the third quarter of 2010 compared to 2009. The Merry Maids operations reported a 2.3 percent increase in revenue, a 59.2 percent increase in operating income and a 34.5 percent improvement in Comparable Operating Performance for the third quarter of 2010 compared to 2009.

The segment's Comparable Operating Performance declined \$0.9 million for the third quarter of 2010 compared to 2009, which includes key executive separation charges of \$4.3 million recorded in the third quarter of 2010 and increases in spending in the Company's headquarters functions to enhance capabilities in our centers of excellence and on initiatives designed to improve the performance of our operating segments. These items were offset, in part, by a \$2.8 million decrease in management and consulting fees payable to the Equity Sponsors due to the timing of fees recognized in 2009, a \$2.4 million decrease in restructuring and Merger related charges and a \$1.2 million improvement in Merry Maids' Comparable Operating Performance, primarily reflecting reduced overhead spending and increased labor efficiencies.

Discontinued Operations

The components of loss from discontinued operations, net of income taxes for the third quarter of 2010 and 2009 are as follows:

(In thousands)	Three months ended	
	September 30,	
	2010	2009
Operating loss	\$ (227)	\$ (609)
Interest expense		
Loss from discontinued operations, before income taxes	(227)	(609)
Benefit for income taxes	(122)	(213)
Loss from discontinued operations, net of income taxes	\$ (105)	\$ (396)

There are no adjustments necessary to reconcile operating loss from discontinued operations to Adjusted EBITDA or Comparable Operating Performance from discontinued operations for the third quarter of 2010 and 2009.

Table of Contents**Nine Months Ended September 30, 2010 Compared to 2009**

The Company reported revenue of \$2,619.7 million for the nine months ended September 30, 2010, a \$96.0 million, or 3.8 percent, increase compared to 2009. The revenue increase was driven by the results of our business units as described in Segment Reviews for the Nine Months Ended September 30, 2010 Compared to 2009 .

Operating income was \$199.8 million for the nine months ended September 30, 2010 compared to \$241.5 million for the nine months ended September 30, 2009. Loss from continuing operations before income taxes was \$10.4 million for the nine months ended September 30, 2010 compared to income from continuing operations before income taxes of \$64.7 million for the nine months ended September 30, 2009. The decrease in income from continuing operations before income taxes of \$75.1 million reflects the net effect of:

(In millions)	
Non-cash purchase accounting adjustments(1)	\$ 10.0
Interest expense(2)	8.4
Interest and net investment income(3)	4.3
Restructuring and Merger related charges(4)	13.1
Non-cash goodwill and trade name impairment(5)	(46.9)
Gain on extinguishment of debt(6)	(46.1)
Residual value guarantee charge(7)	(7.7)
Long-term incentive plan(8)	(4.4)
Key executive separation charges(9)	(5.0)
Segment results(10)	(0.8)
	\$ (75.1)

(1) Consists primarily of decreased amortization of intangible assets as a result of certain finite lived intangible assets being fully amortized as of July 24, 2010.

(2) Represents a decrease in interest expense as a result of decreases in our average long-term debt balances and weighted average interest rates as compared to the nine months ended September 30, 2009.

(3) As further described in Operating and Non-Operating Expenses , represents an increase in interest and net investment income.

(4) Represents the net positive effect of (i) an increase in restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare, (ii) a decrease in restructuring charges related to a branch optimization project at Terminix, (iii) a decrease in restructuring charges related to information technology outsourcing at Other Operations and Headquarters and (iv) a decrease in Merger related charges.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

- (5) Represents a non-cash impairment charge recorded in the second quarter of 2010 to reduce the carrying value of goodwill and trade names at TruGreen LandCare as a result of the Company's interim impairment testing of goodwill and indefinite-lived intangible assets. See Note 5 to the condensed consolidated financial statements for further information.
- (6) Represents the gain on extinguishment of debt recorded in the nine months ended September 30, 2009 related to the completion of open market purchases of \$89.0 million in face value of the Company's Permanent Notes. There were no open market or other purchases of Permanent Notes by the Company in the nine months ended September 30, 2010.
- (7) Represents an increase in residual value guarantee charges related to a synthetic lease for operating properties that did not result in additional cash payments to exit the facility at the end of the lease term in July 2010. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$10.4 million and \$2.7 million in the nine months ended September 30, 2010 and 2009, respectively, related to this shortfall.
- (8) Represents the reversal, in 2009, of a reserve for cash awards related to a long-term incentive plan as certain performance measures under the plan were not achieved. There was no similar reversal in 2010.
- (9) Represents key executive separation charges recorded in the third quarter of 2010 related to the pending retirement of our Chief Executive Officer and the resignation of the President of TruGreen LandCare.

Table of Contents

(10) Represents a net decrease in income from continuing operations before income taxes, non-cash purchase accounting adjustment charges, interest expense, interest and net investment income, restructuring and Merger related charges, non-cash goodwill and trade name impairment, gain on extinguishment of debt, residual value guarantee charge, long-term incentive plan adjustments and key executive separation charges, reflecting the decline in results at TruGreen LandCare, American Home Shield and Other Operations and Headquarters, offset, in part, by the improvement in results at Terminix, TruGreen LawnCare and ServiceMaster Clean as described in Segment Reviews for the Nine Months Ended September 30, 2010 Compared to 2009 .

Operating and Non-Operating Expenses

The Company reported cost of services rendered and products sold of \$1,537.3 million for the nine months ended September 30, 2010 compared to \$1,475.2 million for the nine months ended September 30, 2009. As a percentage of revenue, these costs increased to 58.7 percent for the nine months ended September 30, 2010 from 58.5 percent for the nine months ended September 30, 2009. This percentage increase primarily reflects increased contract claims costs at American Home Shield, decreased labor efficiencies at TruGreen LandCare, increased costs related to ongoing initiatives at TruGreen LawnCare to transform our branch operations and to improve customer service and increased residual value guarantee charges at TruGreen LawnCare, offset, in part, by, reduced fertilizer costs at TruGreen LawnCare and reduced fuel costs.

The Company reported selling and administrative expenses of \$714.1 million for the nine months ended September 30, 2010 compared to \$663.0 million for the nine months ended September 30, 2009. As a percentage of revenue, these costs increased to 27.3 percent for the nine months ended September 30, 2010 from 26.3 percent for the nine months ended September 30, 2009. This percentage increase primarily reflects investments in sales and marketing, increased provisions for incentive compensation, key executive separation charges of \$5.0 million recorded in the third quarter of 2010 related to the pending retirement of our Chief Executive Officer and the resignation of the President of TruGreen LandCare, increased costs related to ongoing initiatives at TruGreen LawnCare, increased provisions for certain legal matters at American Home Shield and increases in spending in the Company's headquarters functions to enhance capabilities in our centers of excellence and on initiatives designed to improve the performance of our operating segments.

Amortization expense was \$111.8 million for the nine months ended September 30, 2010 compared to \$121.1 million for the nine months ended September 30, 2009. The decrease is a result of certain finite lived intangible assets being fully amortized as of July 24, 2010.

Non-operating expense totaled \$210.2 million for the nine months ended September 30, 2010 compared to \$176.8 million for the nine months ended September 30, 2009. This increase includes a \$46.1 million gain on extinguishment of debt recorded in the nine months ended September 30, 2009, offset, in part, by an \$8.4 million decrease in interest expense resulting from decreases in our average long-term debt balances and weighted average interest rates and a \$4.3 million increase in interest and net investment income. Interest and net investment income was comprised of the following for the nine months ended September 30, 2010 and 2009:

(In thousands)	Nine months ended	
	2010	September 30, 2009
Realized gains(1)	\$ 5,245	\$ 5,524
Impairments of securities(2)		(5,854)
Deferred compensation trust(3)	511	1,670
Other(4)	1,731	1,852
Interest and net investment income	\$ 7,487	\$ 3,192

-
- (1) Represents the net investment gains and the interest and dividend income realized on the American Home Shield investment portfolio.
- (2) Represents other than temporary declines in the value of certain investments in the American Home Shield investment portfolio.
- (3) Represents investment income resulting from a change in the market value of investments within an employee deferred compensation trust (for which there is a corresponding and offsetting change in compensation expense within income from continuing operations before income taxes).
- (4) Represents interest income on other cash balances.

The effective tax rate on income from continuing operations was a provision of (37.6) percent for the nine months ended September 30, 2010 compared to a provision of 32.0 percent for the nine months ended September 30, 2009. The negative effective

Table of Contents

rate for the nine months ended September 30, 2010 is primarily attributable to the Company providing for state and foreign tax expense despite incurring a loss from continuing operations before income taxes.

Restructuring and Merger Related Charges

The Company incurred restructuring and Merger related charges of \$9.8 million and \$22.9 million for the nine months ended September 30, 2010 and 2009, respectively. Restructuring and Merger related charges were comprised of the following:

(In thousands)	Nine months ended September 30,	
	2010	2009
TruGreen LawnCare reorganization and restructuring(1)	\$ 6,657	\$ 5,951
Information technology outsourcing(2)		9,461
Terminix branch optimization(3)		3,219
Merger related charges(4)	1,180	2,234
Other(5)	1,944	1,994
Total restructuring and Merger related charges	\$ 9,781	\$ 22,859

(1) Represents restructuring charges related to a reorganization of field leadership and a restructuring of branch operations. For the nine months ended September 30, 2010, these costs included consulting fees of \$4.5 million and severance, lease termination and other costs of \$2.2 million. For the nine months ended September 30, 2009, these costs included consulting fees of \$4.1 million and severance, lease termination and other costs of \$1.9 million. In connection with the restructuring of branch operations, we expect to incur cash charges through the second quarter of 2011 primarily related to consulting fees. Such charges are expected to amount to an additional \$0.7 million, pre-tax, and will be recorded as restructuring charges in the condensed consolidated statement of operations as incurred.

(2) On December 11, 2008, the Company entered into an agreement with IBM pursuant to which IBM provides information technology operations and applications development services to the Company. These services were phased in during the first half of 2009. For the nine months ended September 30, 2009, these costs included transition fees paid to IBM of \$7.2 million, employee retention and severance costs of \$1.3 million and consulting and other costs of \$1.0 million.

(3) Represents restructuring charges related to a branch optimization project. For the nine months ended September 30, 2009, these costs included lease termination costs of \$2.9 million and severance costs of \$0.3 million.

(4) Includes severance, retention, legal fees and other costs associated with the Merger.

(5) For the nine months ended September 30, 2010, these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$1.7 million and consulting and other costs of \$0.2 million. For the nine months ended September 30, 2009,

these costs included adjustments to lease termination reserves related to previous restructuring initiatives of \$0.4 million and consulting and other costs of \$1.6 million.

Impairment of Goodwill and Trade Names

During the second quarter of 2010, the Company recorded a non-cash impairment charge of \$46.9 million to reduce the carrying value of goodwill and trade names at TruGreen LandCare as a result of an interim impairment test of goodwill and indefinite-lived intangible assets. See Note 5 to the condensed consolidated financial statements for further information.

Segment Reviews for the Nine Months Ended September 30, 2010 Compared to 2009

The following business segment reviews should be read in conjunction with the required footnote disclosures presented in the Notes to the condensed consolidated financial statements. This disclosure provides a reconciliation of segment operating income to income from continuing operations before income taxes, with net non-operating expenses as the only reconciling item. As noted in segment reviews for the third quarter 2010 compared to 2009, the Company uses Adjusted EBITDA and Comparable Operating Performance to facilitate operating performance comparisons from period to period. The operating income, EBITDA, Adjusted EBITDA, and Comparable Operating Performance for each reportable segment have been revised to reflect the Company's revised allocation methodology for all periods presented. See Note 14 to the condensed consolidated financial statements for further information.

Table of Contents

Operating revenues and Comparable Operating Performance by operating segment are as follows:

(In thousands)	Nine months ended September 30,	
	2010	2009
Operating Revenue:		
TruGreen LawnCare	\$ 874,022	\$ 834,899
TruGreen LandCare	180,541	199,562
Terminix	889,482	843,134
American Home Shield	513,910	490,308
ServiceMaster Clean	98,337	92,869
Other Operations and Headquarters	63,438	62,961
Total Operating Revenue	\$ 2,619,730	\$ 2,523,733
Comparable Operating Performance:		
TruGreen LawnCare	\$ 146,273	\$ 143,435
TruGreen LandCare	2,735	17,000
Terminix	216,400	200,005
American Home Shield	94,071	91,481
ServiceMaster Clean	45,217	43,294
Other Operations and Headquarters	(71,507)	(72,632)
Total Comparable Operating Performance	\$ 433,189	\$ 422,583
Memo: Items included in Comparable Operating Performance:		
Restructuring and Merger related charges(1)	\$ 9,781	\$ 22,859
Management and consulting fees(2)	\$ 5,625	\$ 5,625
Memo: Items excluded from Comparable Operating Performance:		
Comparable Operating Performance of Discontinued Operations	\$ (1,171)	\$ (1,050)

(1) Represents (i) restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare, a branch optimization project at Terminix and information technology outsourcing at Other Operations and Headquarters and (ii) Merger related charges.

(2) Represents management and consulting fees payable to certain related parties. See Note 15 to the condensed consolidated financial statements for further information on management and consulting fees.

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

The following table presents reconciliations of operating income, the most directly comparable financial measure under GAAP, to Adjusted EBITDA and Comparable Operating Performance for the periods presented.

(in thousands)	TruGreen LawnCare	TruGreen LandCare	Terminix	American Home Shield	Service Master Clean	Other Operations and Headquarters	Total
Nine months ended September 30, 2010							
Operating income (loss)(1)	\$ 80,248	\$ (52,367)	\$ 166,714	\$ 57,245	\$ 38,708	\$ (90,713)	\$ 199,835
Depreciation and amortization expense	56,843	8,684	49,838	31,714	5,374	10,007	162,460
EBITDA	137,091	(43,683)	216,552	88,959	44,082	(80,706)	362,295
Interest and net investment income (2)				5,244	153	2,090	7,487
Residual value guarantee charge(3)	9,222				982	245	10,449
Non-cash goodwill and trade name impairment(4)		46,884					46,884
Adjusted EBITDA	146,313	3,201	216,552	94,203	45,217	(78,371)	427,115
Non-cash stock-based compensation expense						6,864	6,864
Non-cash credits attributable to purchase accounting(5)	(40)	(466)	(152)	(132)			(790)
Comparable Operating Performance	\$ 146,273	\$ 2,735	\$ 216,400	\$ 94,071	\$ 45,217	\$ (71,507)	\$ 433,189
Memo: Items included in Comparable Operating Performance							
Restructuring and Merger related charges (credits)(6)	\$ 6,657	\$ 785	\$ 1,139	\$ (127)	\$ 61	\$ 1,266	\$ 9,781
Management and consulting fees(7)	\$	\$	\$	\$	\$	\$ 5,625	\$ 5,625
Memo: Items excluded from Comparable Operating Performance							
Comparable Operating Performance of Discontinued Operations(8)	\$	\$	\$	\$	\$	\$ (1,171)	\$ (1,171)
Nine months ended September 30, 2009							
Operating income (loss)(1)	\$ 75,382	\$ 8,658	\$ 152,778	\$ 60,423	\$ 36,673	\$ (92,391)	\$ 241,523
Depreciation and amortization expense	65,776	8,831	47,368	31,447	6,183	10,315	169,920
EBITDA	141,158	17,489	200,146	91,870	42,856	(82,076)	411,443
Interest and net investment (loss) income (2)				(331)	144	3,379	3,192
Residual value guarantee charge(3)	2,363				294	73	2,730
Adjusted EBITDA	143,521	17,489	200,146	91,539	43,294	(78,624)	417,365
Non-cash stock-based compensation expense						5,992	5,992
Non-cash credits attributable to purchase accounting(5)	(86)	(489)	(141)	(58)			(774)
Comparable Operating Performance	\$ 143,435	\$ 17,000	\$ 200,005	\$ 91,481	\$ 43,294	\$ (72,632)	\$ 422,583
Memo: Items included in Comparable Operating Performance							
Restructuring and Merger related charges(6)	\$ 5,951	\$ 133	\$ 3,365	\$ 105	\$	\$ 13,305	\$ 22,859
Management and consulting fees(7)	\$	\$	\$	\$	\$	\$ 5,625	\$ 5,625
Memo: Items excluded from Comparable Operating Performance							
Comparable Operating Performance of Discontinued Operations(8)	\$	\$	\$	\$	\$	\$ (1,050)	\$ (1,050)

Table of Contents

(1) Presented below is a reconciliation of total segment operating income to net income.

(In thousands)	Nine months ended	
	2010	September 30, 2009
Total Segment Operating Income	\$ 199,835	\$ 241,523
Non-operating Expense (Income):		
Interest expense	217,117	225,538
Interest and net investment income	(7,487)	(3,192)
Gain on extinguishment of debt		(46,106)
Other expense	556	555
(Loss) Income from Continuing Operations before Income Taxes	(10,351)	64,728
Provision for income taxes	3,888	20,720
(Loss) Income from Continuing Operations	(14,239)	44,008
Loss from discontinued operations, net of income taxes	(687)	(666)
Net (Loss) Income	\$ (14,926)	\$ 43,342

(2) Interest and net investment income (loss) is primarily comprised of investment income and realized gain (loss) on our American Home Shield segment investment portfolio. Cash, short-term and long-term marketable securities associated with regulatory requirements in connection with American Home Shield and for other purposes totaled \$296.0 million as of September 30, 2010. American Home Shield interest and net investment income (loss) was \$5.2 million and (\$0.3) million for the nine months ended September 30, 2010 and 2009, respectively. The balance of interest and net investment income (loss) primarily relates to (i) investment income (loss) from our employee deferred compensation trust (for which there is a corresponding and offsetting change in compensation expense within income from continuing operations before income taxes) and (ii) interest income on other cash balances.

(3) Represents residual value guarantee charges related to a synthetic lease for operating properties that did not result in additional cash payments to exit the facility at the end of the lease term in July 2010. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$10.4 million and \$2.7 million in the nine months ended September 30, 2010 and 2009, respectively, related to this shortfall.

(4) Represents a non-cash impairment charge of \$46.9 million recorded in the second quarter of 2010 to reduce the carrying value of goodwill and trade names at TruGreen LandCare as a result of the Company's interim impairment test of goodwill and indefinite-lived intangible assets. See Note 5 to the condensed consolidated financial statements for further information.

(5) The Merger was accounted for using purchase accounting. This adjustment represents the aggregate, non-cash adjustments (other than amortization and depreciation) attributable to the application of purchase accounting.

(6) Represents (i) restructuring charges related to a reorganization of field leadership and a restructuring of branch operations at TruGreen LawnCare, a branch optimization project at Terminix and information technology outsourcing at Other Operations and Headquarters and (ii) Merger related charges.

(7) Represents management and consulting fees payable to certain related parties. See Note 15 to the condensed consolidated financial statements for further information on management and consulting fees.

(8) There are no adjustments necessary to reconcile operating loss from discontinued operations, the most directly comparable financial measure under GAAP, to Adjusted EBITDA or Comparable Operating Performance from discontinued operations for the nine months ended September 30, 2010 and 2009.

TruGreen LawnCare Segment

The TruGreen LawnCare segment reported a 4.7 percent increase in revenue, a 6.5 percent increase in operating income and a 2.0 percent increase in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. The revenue results reflect a 1.3 percent increase in customer counts, higher sales of expanded services to existing customers, lower discounts and improved price realization. The increase in customer counts was driven by an increase in new unit sales generated in our neighborhood selling channel and the contribution of acquisitions.

Table of Contents

TruGreen LawnCare's Comparable Operating Performance improved \$2.8 million for the nine months ended September 30, 2010 compared to 2009. In addition to the favorable impact of increased revenue, TruGreen LawnCare's Comparable Operating Performance reflects reduced fuel and fertilizer costs, offset, in part, by investments in sales and marketing and increased costs related to our ongoing initiatives to transform our branch operations and to improve customer service.

TruGreen LandCare Segment

The TruGreen LandCare segment reported a 9.5 percent decrease in revenue, a \$61.0 million decrease in operating income and an 83.9 percent decline in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. The decline in revenue included a 10.8 percent decrease in base contract maintenance revenue and a 10.8 percent decrease in enhancement revenue. Revenue trends were primarily impacted by contract cancellations and pricing concessions granted in 2009 and 2010 in response to the impacts of a difficult economic environment. The ratio of enhancement revenue to base contract maintenance revenue for the nine months ended September 30, 2010 was comparable to 2009.

TruGreen LandCare's \$61.0 million decline in operating income includes a non-cash impairment charge of \$46.9 million to reduce the carrying value of goodwill and trade names to their estimated fair value as further described in Note 5 to the condensed consolidated financial statements. TruGreen LandCare's Comparable Operating Performance declined \$14.3 million for the nine months ended September 30, 2010 compared to 2009. In addition to the unfavorable impact of decreased revenue, TruGreen LandCare's Comparable Operating Performance reflects decreased labor efficiencies resulting from increased technician overtime and key executive separation charges, offset, in part, by reduced fuel costs. The Company is exploring strategic options relating to TruGreen LandCare, including the potential sale of the business.

Terminix Segment

The Terminix segment reported a 5.5 percent increase in revenue, a 9.1 percent increase in operating income and an 8.2 percent improvement in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. The segment's overall revenue results reflected growth in termite and pest control revenues, as well as increased product distribution revenue of \$18.8 million. Termite revenues increased 2.0 percent for the nine months ended September 30, 2010 compared to 2009, due to an increase in new unit sales, the contribution of acquisitions and a 20 basis point improvement in the customer retention rate. Pest control revenues increased 4.5 percent for the nine months ended September 30, 2010 compared to 2009, reflecting a 5.0 percent increase in customer counts due to an increase in new unit sales, the contribution of acquisitions and a 250 basis point improvement in the customer retention rate. In the third quarter of 2010, Terminix acquired the assets of Antimite Termite and Pest Control, a company with annual revenues of approximately \$30 million.

Terminix's Comparable Operating Performance improved \$16.4 million for the nine months ended September 30, 2010 compared to 2009. In addition to the favorable impact of increased revenue, Terminix's Comparable Operating Performance reflects reduced fuel costs, the favorable impact of acquiring assets in connection with exiting certain fleet leases, favorable termite damage claims trends and a \$2.2 million decrease in restructuring charges related to a branch optimization program completed in 2009, offset, in part by increased provisions for incentive compensation and investments in sales and marketing.

American Home Shield Segment

The American Home Shield segment reported a 4.8 percent increase in revenue, a 5.3 percent decrease in operating income and a 2.8 percent improvement in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. The increase in revenue reflects a 3.4 percent increase in customer counts and improved price realization. The increase in customer counts was driven by an increase in new unit sales and a 300 basis point improvement in customer retention.

American Home Shield's Comparable Operating Performance improved \$2.6 million for the nine months ended September 30, 2010 compared to 2009. In addition to the favorable impact of increased revenue, American Home Shields's Comparable Operating Performance reflects a \$5.6 million increase in interest and net investment income from the American Home Shield investment portfolio (primarily reflecting reductions in impairments of securities) offset, in part, by investments in consumer sales programs, an 8.9 percent increase in contract claims costs driven by an increase in the number of seasonal contract claims and increased provisions for certain legal matters.

Table of Contents

ServiceMaster Clean Segment

The ServiceMaster Clean segment reported a 5.9 percent increase in revenue, a 5.5 percent increase in operating income and a 4.4 percent improvement in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. Trends in revenue reflect an increase in national janitorial accounts, product sales to franchisees and other revenues.

ServiceMaster Clean's Comparable Operating Performance improved \$1.9 million for the nine months ended September 30, 2010 compared to 2009, primarily reflecting the favorable impact of increased revenues.

Other Operations and Headquarters Segment

This segment includes the operations of Merry Maids, SMAC and the Company's headquarters functions. The segment reported comparable revenue, a 1.8 percent improvement in operating loss and a 1.5 percent improvement in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009. The Merry Maids operations reported comparable revenue, a 35.3 percent increase in operating income and a 23.8 percent improvement in Comparable Operating Performance for the nine months ended September 30, 2010 compared to 2009.

The segment's Comparable Operating Performance improved \$1.1 million for the nine months ended September 30, 2010 compared to 2009, which includes a \$12.0 million decrease in restructuring and Merger related charges and a \$2.9 million improvement in Merry Maids' Comparable Operating Performance, primarily reflecting reduced overhead spending and increased labor efficiencies. These items were offset, in part, by key executive separation charges of \$4.3 million recorded in the third quarter of 2010, increased provisions for incentive compensation in 2010, due primarily to the reversal, in 2009, of a \$4.4 million reserve for cash awards related to a long-term incentive plan as certain performance measures under the plan were not achieved, and increases in spending in the Company's headquarters functions to enhance capabilities in our centers of excellence and on initiatives designed to improve the performance of our operating segments.

Discontinued Operations

The components of loss from discontinued operations, net of income taxes for the nine months ended September 30, 2010 and 2009 are as follows:

(In thousands)	Nine months ended September 30,	
	2010	2009
Operating Loss	\$ (1,171)	\$ (1,050)
Interest expense		
Loss from discontinued operations, before income taxes	(1,171)	(1,050)
Benefit for income taxes	(484)	(384)

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Loss from discontinued operations, net of income taxes	\$	(687)	\$	(666)
--	----	-------	----	-------

There are no adjustments necessary to reconcile operating loss from discontinued operations to Adjusted EBITDA or Comparable Operating Performance from discontinued operations for the nine months ended September 30, 2010 and 2009.

Table of Contents

FINANCIAL POSITION AND LIQUIDITY

Cash Flows from Operating Activities from Continuing Operations

Net cash provided from operating activities from continuing operations increased \$50.0 million to \$119.2 million for the nine months ended September 30, 2010 compared to \$69.2 million for the nine months ended September 30, 2009.

Net cash provided from operating activities for the nine months ended September 30, 2010 was comprised of \$209.1 million in earnings as adjusted for non-cash charges, offset, in part, by a \$79.7 million increase in cash required for working capital and \$10.2 million in cash payments related to restructuring charges. Working capital requirements were impacted by normal seasonal working capital needs. Working capital requirements were adversely impacted by growth in accounts receivable balances, due to increases in revenue as compared to prior year and unfavorable collection trends partially attributable to increases in revenue in service lines with longer than average collection terms, and the timing of interest payments on our Permanent Notes. Working capital requirements were favorably impacted by favorable timing of accounts payable and payroll and related payments.

Net cash provided from operating activities for the nine months ended September 30, 2009 was comprised of \$214.5 million in earnings as adjusted for non-cash charges, offset in part, by a \$125.5 million increase in cash required for working capital and \$19.8 million in cash payments related to restructuring charges. The increase in working capital requirements for the nine months ended September 30, 2009 was driven primarily by normal seasonal activity and the timing of interest payments on our Permanent Notes and Term Facilities.

Cash Flows from Investing Activities from Continuing Operations

Net cash used for investing activities from continuing operations was \$137.5 million for the nine months ended September 30, 2010 compared to \$61.9 million for the nine months ended September 30, 2009.

Capital expenditures increased to \$105.3 million for the nine months ended September 30, 2010 from \$50.5 million for the nine months ended September 30, 2009 and included vehicle purchases of \$32.8 million, real estate purchases of \$37.4 million in connection with exiting certain real estate leases as further discussed in *Liquidity*, recurring capital needs and information technology projects. The Company anticipates that capital expenditures, excluding vehicle fleet and real estate purchases, for 2010 will range from \$55.0 million to \$65.0 million, reflecting recurring needs and the continuation of investments in information systems and productivity enhancing operating systems. The Company's capital requirement for fleet vehicles for 2010 is expected to range from \$50.0 million to \$60.0 million. The Company has no additional material capital commitments at this time.

Cash payments for acquisitions, excluding the Merger, for the nine months ended September 30, 2010 totaled \$52.5 million, compared with \$20.7 million for the nine months ended September 30, 2009. Consideration paid for acquisitions consisted of cash payments and debt payable to sellers. The Company expects to continue its acquisition program at Terminix, TruGreen LawnCare and Merry Maids.

The increase in notes receivable, financial investments and securities for the nine months ended September 30, 2010 compared to September 30, 2009 reflects the return of the Company's \$22.0 million investment in previously leased real estate facilities as further discussed in *Liquidity*, offset, in part, by a decrease in net sales of certain marketable securities.

Cash Flows from Financing Activities from Continuing Operations

Net cash used for financing activities from continuing operations was \$34.8 million for the nine months ended September 30, 2010 compared to \$201.8 million for the nine months ended September 30, 2009. During the nine months ended September 30, 2010, the Company borrowed and repaid \$5.0 million under the Revolving Credit Facility, borrowed \$10.0 million under other financing arrangements, made scheduled principal payments of long-term debt of \$32.3 million and, as further discussed in *Liquidity*, made repayments of \$12.5 million in connection with exiting certain real estate leases. During the nine months ended September 30, 2009, the Company completed open market purchases of \$89.0 million in face value of the Permanent Notes for a cost of \$41.0 million. The Company also made repayments of \$125.0 million under the Revolving Credit Facility and made scheduled principal payments of long-term debt of \$35.4 million during the nine months ended September 30, 2009.

Table of Contents

Liquidity

The Company is highly leveraged, and a very substantial portion of the Company's liquidity needs arise from debt service on indebtedness incurred in connection with the Merger and from funding the Company's operations, working capital and capital expenditures.

The agreements governing the Term Facilities, the Permanent Notes and the Revolving Credit Facility contain certain covenants that limit or restrict the incurrence of additional indebtedness, debt repurchases, liens, sales of assets, certain payments (including dividends) and transactions with affiliates, subject to certain exceptions. The Company was in compliance with the covenants under these agreements at September 30, 2010.

Through July 15, 2011, the Company may, at its option prior to the start of any interest period, elect to pay interest on outstanding amounts under the Permanent Notes entirely in cash (Cash Interest), entirely by increasing the principal amount of the outstanding loans (PIK Interest), or 50 percent as Cash Interest and 50 percent as PIK Interest. Interest payable after July 15, 2011 is payable entirely as Cash Interest. All interest payments due through July 2010 were paid entirely as Cash Interest. The Company elected to pay all interest payable through January 2011 entirely as Cash Interest and expects to pay interest payable through July 15, 2011 entirely as Cash Interest.

Cash and short- and long-term marketable securities totaled \$336.7 million at September 30, 2010, compared with \$385.6 million at December 31, 2009. As of September 30, 2010 and December 31, 2009, \$296.0 million and \$256.5 million, respectively, of the cash and short- and long-term marketable securities balance are associated with regulatory requirements at American Home Shield and for other purposes. American Home Shield's investment portfolio has been invested in a combination of high quality, short duration fixed income securities and equities. The Company closely monitors the performance of the investments. From time to time, the Company reviews the statutory reserve requirements to which its regulated entities are subject and any changes to such requirements. These reviews may result in identifying current reserve levels above or below minimum statutory reserve requirements, in which case the Company may adjust its reserves. The reviews may also identify opportunities to satisfy certain regulatory reserve requirements through alternate financial vehicles, which could enhance our liquidity.

A portion of the Company's vehicle fleet and some equipment are leased through operating leases. The lease terms are non-cancelable for the first twelve-month term, and then are month-to-month, cancelable at the Company's option. There are residual value guarantees by the Company (ranging from 70 percent to 84 percent of the estimated terminal value at the inception of the lease depending on the agreement) relative to these vehicles and equipment, which historically have not resulted in significant net payments to the lessors. The fair value of the assets under all of the fleet and equipment leases is expected to substantially mitigate the Company's guarantee obligations under the agreements. At September 30, 2010, the Company's residual value guarantees related to the leased assets totaled \$59.2 million for which the Company has recorded a liability for the estimated fair value of these guarantees of approximately \$1.3 million in the condensed consolidated statement of financial position.

Prior to the Merger, the Company maintained lease facilities with banks totaling \$65.2 million, which provided for the financing of branch properties to be leased by the Company. In connection with the closing of the Merger, the Company amended these leases effective July 24, 2007. Among the modifications, the Company extended the lease terms through July 24, 2010 and made a \$22.0 million investment in the lease facilities. In July 2010, the Company purchased the properties for \$65.2 million. The Company's \$22.0 million investment in the lease facilities was returned to the Company upon purchase, resulting in a net cash payment of \$43.2 million. In the third quarter of 2009, the Company determined that it was probable that the fair value of the real properties under operating leases would be below the total amount funded under the lease facilities at the end of the lease term. The Company's estimate of this shortfall was \$15.9 million, which was expensed over the remainder of the lease term. The Company recorded charges of \$10.4 million in the nine months ended September 30, 2010 and \$5.5 million in 2009.

related to this shortfall.

The Company holds certain financial instruments that are measured at fair value on a recurring basis. The fair values of these instruments are measured using both the market and income approaches. For investments in marketable securities, deferred compensation trust assets and derivative contracts, which are carried at their fair values, the Company's fair value estimates incorporate quoted market prices, other observable inputs (for example, forward interest rates) and unobservable inputs (for example, forward commodity prices) at the balance sheet date.

Under the terms of its fuel swap contracts, the Company is required to post collateral in the event that the fair value of the contracts exceeds a certain agreed upon liability level and in other circumstances required by the counterparty. As of September 30, 2010, the fair value of the Company's fuel swap contracts was a net asset of \$3.0 million, and the Company posted \$5.0 million in letters of credit as collateral under its fuel hedging program, none of which were issued under the Company's Revolving Credit Facility. The continued use of letters of credit for this purpose could limit the Company's ability to post letters of credit for other purposes and could limit the Company's borrowing

Table of Contents

availability under the Revolving Credit Facility. However, the Company does not expect the fair value of its outstanding fuel swap contacts to materially impact its financial position or liquidity.

The Company's ongoing liquidity needs are expected to be funded by cash on hand, net cash provided by operating activities and, as required, borrowings under the Revolving Credit Facility and accounts receivable securitization arrangement (discussed below). We expect that cash provided from operations and available capacity under the Revolving Credit Facility and accounts receivable securitization arrangement will provide sufficient funds to operate our business, make expected capital expenditures and meet our liquidity requirements for the following 12 months, including payment of interest and principal on our debt. As of September 30, 2010, the Company had \$500.0 million of remaining capacity available under the Revolving Credit Facility and \$40.0 million of remaining capacity under the accounts receivable securitization arrangement.

The Company may from time to time repurchase or otherwise retire the Company's debt and take other steps to reduce the Company's debt or otherwise improve the Company's financial position. These actions may include open market debt repurchases, negotiated repurchases, other retirements of outstanding debt and opportunistic refinancing of debt. The amount of debt that may be repurchased or otherwise retired or refinanced, if any, will depend on market conditions, trading levels of the Company's debt, the Company's cash position, compliance with debt covenants and other considerations. Affiliates of the Company may also purchase the Company's debt from time to time, through open market purchases or other transactions. In such cases, the Company's debt may not be retired, in which case the Company would continue to pay interest in accordance with the terms of the debt, and the Company would continue to reflect the debt as outstanding in its condensed consolidated statement of financial position.

Between the Merger and September 30, 2010, Holdings has completed open market purchases totaling \$65.0 million in face value of the Permanent Notes for a cost of \$21.4 million. The debt acquired by Holdings has not been retired, and the Company has continued to pay interest in accordance with the terms of the debt. The Company recorded interest expense of \$5.2 million for the nine months ended September 30, 2010 and 2009, respectively, related to the Permanent Notes held by Holdings. The Company made cash payments to Holdings of \$7.0 million and \$6.5 million during the nine months ended September 30, 2010 and 2009, respectively. Interest accrued by the Company and payable to Holdings as of September 30, 2010 and December 31, 2009 amounted to \$1.4 million and \$3.2 million, respectively.

The Company has entered into an accounts receivable securitization arrangement under which TruGreen LawnCare and Terminix may sell certain eligible trade accounts receivable to Funding, the Company's wholly owned, bankruptcy-remote subsidiary, which is consolidated for financial reporting purposes. Funding, in turn, may transfer, on a revolving basis, an undivided percentage ownership interest of up to \$50.0 million in the pool of accounts receivable to one or both of the Purchasers. The amount of the eligible receivables varies during the year based on seasonality of the businesses and could, at times, limit the amount available to the Company from the sale of these interests.

During the nine months ended September 30, 2010, there were no transfers of interests in the pool of trade accounts receivables to Purchasers under this arrangement. As of September 30, 2010 and December 31, 2009, the Company had \$10.0 million outstanding under the arrangement and, as of September 30, 2010, had \$40.0 million of remaining capacity available under the trade accounts receivable securitization arrangement.

The accounts receivable securitization arrangement is a 364-day facility that is renewable annually at the option of Funding, with a final termination date of July 17, 2012. Only one of the Purchasers is required to purchase interests under the arrangement. If this Purchaser were to exercise its right to terminate its participation in the arrangement, which it may do in the third quarter of each year, the amount of cash available to the Company under this arrangement may be reduced or eliminated. As part of the annual renewal of the facility, which last occurred on July 20, 2010, this Purchaser agreed to continue its participation in the arrangement at least through July 19, 2011.

As a holding company, we depend on our subsidiaries to distribute funds to us so that we may pay our obligations and expenses, including our debt service obligations. The ability of our subsidiaries to make distributions and dividends to us depends on their operating results, cash requirements and financial condition and general business conditions. Our insurance subsidiaries and home services and similar subsidiaries (through which we conduct our American Home Shield business) are subject to significant regulatory restrictions under the laws and regulations of the states in which they operate. Among other things, such laws and regulations require certain such subsidiaries to maintain minimum capital and net worth requirements and may limit the amount of ordinary and extraordinary dividends and other payments that these subsidiaries can pay to us. For example, certain states prohibit payment by these subsidiaries to the Company of dividends in excess of 10 percent of their capital as of the most recent year end, as determined in accordance with prescribed insurance accounting practices in those states. Of the \$296.0 million as of September 30, 2010, which we identify as being potentially unavailable to be paid to the Company by its subsidiaries, approximately \$235.5 million is held by our home services and insurance subsidiaries and is subject to these regulatory limitations on the payment of funds to us. Such limitations will be in effect throughout 2010, and similar limitations will be re-computed as of December 31, 2010 and will be in effect in 2011. The remainder of the \$296.0 million, or \$60.5 million, is related to amounts that the Company's management does not

Table of Contents

consider readily available to be used to service the Company's indebtedness due, among other reasons, to the Company's cash management practices and working capital needs at various subsidiaries.

The Company's Annual Report on Form 10-K for the year ended December 31, 2009 included disclosure of the Company's contractual obligations and commitments as of December 31, 2009. The Company continues to make the contractually required payments and, therefore, the 2010 obligations and commitments as listed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 have been reduced by the required payments. There were no material changes outside of the ordinary course of business in the Company's previously disclosed contractual obligations and commitments during the nine months ended September 30, 2010.

Off-Balance Sheet Arrangements

The Company has off-balance sheet arrangements in the form of guarantees as discussed in Note 4 of the condensed consolidated financial statements.

Information Regarding Forward-Looking Statements

This report includes forward-looking statements and cautionary statements. Some of the forward-looking statements can be identified by the use of forward-looking terms such as believes, expects, may, will, shall, should, would, could, seek, aims, projects, is optimistic, estimates, anticipates or other comparable terms. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this report and include, without limitation, statements regarding our intentions, beliefs, assumptions or current expectations concerning, among other things, the degree and timing of economic recovery; governmental regulation or interpretation thereof; our liquidity; cash flows; results of operations; financial condition; prospects; growth strategies; future impairments; capital expenditures and requirements; customer retention; the continuation of acquisitions; strategies related to divestitures; attraction and retention of key personnel; the impact of interest rate hedges and fuel swaps; the cost savings from restructurings and reorganizations and expected charges related to such restructurings and reorganizations; and the impact of prevailing economic conditions.

Forward-looking statements are subject to known and unknown risks and uncertainties, many of which may be beyond our control. We caution you that forward-looking statements are not guarantees of future performance or outcomes, and that actual outcomes and performances, including, without limitation, our actual results of operations, financial condition and liquidity, and the development of the industries in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this report. In addition, even if our results of operations, financial condition and liquidity, and the development of the industries in which we operate are consistent with the forward-looking statements contained in this report, those results or developments may not be indicative of results or developments in subsequent periods. A number of important factors, including the risks and uncertainties discussed in Item 1A Risk Factors in Part I in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, could cause actual results and outcomes to differ materially from those in the forward-looking statements. Additional factors that could cause actual results and outcomes to differ from those reflected in forward-looking statements include, without limitation:

- the effects of our substantial indebtedness and the limitations contained in the agreements governing such indebtedness;

Edgar Filing: SERVICEMASTER CO - Form 10-Q

- our ability to generate the significant amount of cash needed to fund our operations and service our debt obligations and debt repurchases;
- changes in interest rates because a significant portion of our indebtedness bears interest at variable rates;
- our ability to secure sources of financing or other funding to allow for direct purchases of commercial vehicles, primarily for TruGreen LawnCare, Terminix and TruGreen LandCare;
- changes in the source and intensity of competition in our market segments;
- our ability to attract and retain key personnel, including a successor to our CEO who has announced his pending retirement with a targeted date of December 31, 2010, or such earlier or later date as a successor CEO is appointed;
- weather conditions and seasonality factors that affect the demand for our services, including any impact from climate change factors, known and unknown;
- higher commodity prices and lack of availability, including fuel and fertilizers (primarily at TruGreen LawnCare, Terminix and TruGreen LandCare) could impact our ability to provide and the profitability of our brands;

Edgar Filing: SERVICEMASTER CO - Form 10-Q

Table of Contents

- increases in operating costs, such as higher insurance premiums, self-insurance costs and health care costs;
- employee retention, labor shortages, including shortages due to immigration legislation, or increases in compensation and benefits costs, including costs related to the comprehensive health care reform law enacted in the first quarter of 2010;
- epidemics, pandemics or other public health concerns or crises could affect the demand for, or our ability to provide, our services resulting in a reduction in revenues;
- a continuation or change in general economic, financial and credit conditions in the United States and elsewhere (including further deterioration or disruption in the credit and financial markets), especially as such may affect home sales, consumer or business liquidity, bank failures, consumer or commercial confidence or spending levels including as a result of inflation or deflation, unemployment, interest rate fluctuations, mortgage foreclosures and subprime credit dislocations;
- a failure of any insurance company that provides insurance to us;
- changes in the type or mix of our service offerings or products;
- existing and future governmental regulation and the enforcement thereof, including regulation relating to restricting or banning of telemarketing; door-to-door solicitation; direct mail or other marketing activities; the Termite Inspection Protection Plan; pesticides and/or fertilizers; or other legislation, regulation or interpretations impacting our business models;
- laws and regulations relating to financial reform and the use of derivative instruments, including by companies such as ServiceMaster;
- the success of and costs associated with restructuring initiatives;
- the number, type, outcomes (by judgement or settlement) and costs of legal or administrative proceedings;
- possible labor organizing activities at the Company or its franchisees;

Edgar Filing: SERVICEMASTER CO - Form 10-Q

- risks associated with acquisitions and dispositions, including retaining customers from the businesses acquired, difficulties in integrating acquired businesses and achieving expected synergies therefrom;
- risks associated with budget deficits at federal, state and local levels resulting from deteriorating economic conditions, which could result in federal, state and local governments decreasing their purchasing of our products or services and/or increasing taxes on businesses to generate more tax revenues, which could adversely impact our revenue, earnings, tax payments and cash flows, as applicable;
- the timing and structuring of our business process outsourcing, including any current or future outsourcing of all or portions of our information technology, call center and other corporate functions, and risks associated with such outsourcing; and
- other factors described from time to time in documents that we file with the SEC.

You should read this report completely and with the understanding that actual future results may be materially different from expectations. All forward-looking statements made in this report are qualified by these cautionary statements. These forward-looking statements are made only as of the date of this report, and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking statements to reflect changes in assumptions, the occurrence of events, unanticipated or otherwise, changes in future operating results over time or otherwise.

Comparisons of results for current and any prior periods are not intended to express any future trends, or indications of future performance, unless expressed as such, and should only be viewed as historical data.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company is exposed to the impact of interest rate changes and manages this exposure through the use of variable-rate and fixed-rate debt and by utilizing interest rate swaps. The Company does not enter into these contracts for trading or speculative purposes. In the Company's opinion, the market risk associated with debt obligations and other significant instruments as of September 30, 2010 has not materially changed from December 31, 2009 (see Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009).

Fuel Price Risk

The Company is exposed to market risk for changes in fuel prices through the consumption of fuel by its vehicle fleet in the delivery of services to its customers. The Company uses approximately 25 million gallons of fuel on an annual basis. A 10 percent change in fuel prices would result in a change of approximately \$6.5 million in the Company's annual fuel cost before considering the impact of fuel swap contracts.

The Company uses fuel swap contracts to mitigate the financial impact of fluctuations in fuel prices. As of September 30, 2010, the Company had fuel swap contracts to pay fixed prices for fuel with an aggregate notional amount of \$78.2 million, maturing through 2012. The estimated fair value of these contracts at September 30, 2010 was a net asset of \$3.0 million. These fuel swap contracts provide a fixed price for approximately 80.5 percent, 74.7 percent and 11.3 percent of the Company's estimated fuel usage for the remainder of 2010, 2011 and 2012, respectively.

ITEM 4. CONTROLS AND PROCEDURES

Effectiveness of Disclosure Controls and Procedures. ServiceMaster's Chief Executive Officer, J. Patrick Spainhour, and ServiceMaster's Senior Vice President and Chief Financial Officer, Steven J. Martin, have evaluated ServiceMaster's disclosure controls and procedures (as defined in Rule 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. ServiceMaster's disclosure controls and procedures include a roll-up of financial and non-financial reporting that is consolidated in the principal executive office of ServiceMaster in Memphis, Tennessee. Messrs. Spainhour and Martin have concluded that both the design and operation of ServiceMaster's disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting. No change in ServiceMaster's internal control over financial reporting occurred during the third quarter of 2010 that has materially affected, or is reasonably likely to materially affect, ServiceMaster's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting business activities, the Company and its subsidiaries become involved in judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. These proceedings include, on an individual, collective and class action basis, regulatory, insured and uninsured employment, general, and commercial liability actions and environmental proceedings. For instance, American Home Shield Corporation was sued in a putative class action on May 26, 2009 in the U.S. District Court for the Northern District of Alabama by Abigail Rudd, *et al.*, and is alleged to have violated Section 8 of the Real Estate Settlement Procedures Act in connection with certain payments made to real estate agencies. The plaintiffs seek damages equal to three times the amount of the allegedly improper payments occurring after May 26, 2008. The Company intends to defend its interests vigorously.

Additionally, the Company has entered into settlement agreements in certain cases, including putative class actions, which are subject to court approval. If one or more of these settlements are not finally approved, the Company could have additional or different exposure. The enactment of new federal or state legislation or the promulgation of new regulation or interpretation at any level of government may also expose the Company to potential new liabilities or costs, or may require the Company to modify its business model or business practices. At this time, the Company does not expect any of these proceedings or changes in law to have a material effect on its financial position, results of operations or cash flows; however, the Company can give no assurance that the results of any such proceedings may not be material to its financial position, results of operations and cash flows for any period in which costs, if any, are recognized.

Table of Contents

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
10.1	Letter Agreement with J. Patrick Spainhour, executed on September 8, 2010, related to calculation of Mr. Spainhour's benefits upon retirement.
10.2	Amended and Restated ServiceMaster Global Holdings, Inc. MSIP
10.3	Form of Employee Restricted Stock Unit Agreement under the MSIP
31.1	Certification of Chief Executive Officer Pursuant to Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 15, 2010

THE SERVICEMASTER COMPANY
(Registrant)

By: */s/ Steven J. Martin*
Steven J. Martin
Senior Vice President and Chief Financial Officer