

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

NATIONAL SERVICE INDUSTRIES INC  
Form 10-Q  
January 11, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended November 30, 2001.

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-3208.

NATIONAL SERVICE INDUSTRIES, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

58-0364900

-----  
(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification Number)

1420 Peachtree Street, N.E., Atlanta, Georgia

30309-3002

-----  
(Address of principal executive offices)

(Zip Code)

(404) 853-1000

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

None

-----  
(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

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

Common Stock - \$1.00 Par Value 10,327,867\* shares as of December 31, 2001.

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

\* Outstanding shares as of December 31, 2001 have been adjusted to reflect the impact of the Company's one-for-four reverse stock split effected on January 7, 2001

Page 2

NATIONAL SERVICE INDUSTRIES, INC. AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (Unaudited) -  
NOVEMBER 30, 2001 AND AUGUST 31, 2001

CONSOLIDATED STATEMENTS OF INCOME (Unaudited) -  
THREE MONTHS ENDED NOVEMBER 30, 2001 AND 2000

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) -  
THREE MONTHS ENDED NOVEMBER 30, 2001 AND 2000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT  
MARKET RISK

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

SIGNATURES

INDEX TO EXHIBITS

Page 3

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

NATIONAL SERVICE INDUSTRIES, INC.

# Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

(In thousands, except share data)

	November 30, 2001 -----
<b>ASSETS</b>	
<b>Current Assets:</b>	
Receivables, less reserves for doubtful accounts of \$1,922 at November 30, 2001 and \$1,798 at August 31, 2001	\$ 62,202
Inventories, at the lower of cost (on a first-in, first-out basis) or market	18,791
Linens in service, net of amortization	54,063
Deferred income taxes	13,789
Prepayments	4,239
Insurance receivable (Note 8)	27,269
Other current assets	3,257
	-----
Total Current Assets	183,610
 <b>Property, Plant, and Equipment, at cost:</b>	
Land	12,898
Buildings and leasehold improvements	55,635
Machinery and equipment	258,806
	-----
Total Property, Plant, and Equipment	327,339
Less - Accumulated depreciation and amortization	161,785
	-----
Property, Plant, and Equipment - net	165,554
 <b>Other Assets:</b>	
Goodwill	--
Other intangibles	8,148
Insurance receivable (Note 8)	66,585
Other	37,203
	-----
Total Other Assets	111,936
Net assets of discontinued operations (Note 5)	--
	-----
Total Assets	\$ 461,100 =====
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>Current Liabilities:</b>	
Current maturities of long-term debt (Note 7)	\$ 1,033
Notes payable (Note 7)	2,240
Accounts payable	23,319
Accrued salaries, commissions, and bonuses	7,274
Current portion of self-insurance reserves	3,269
Environmental reserve (Note 9)	6,967
Current portion of litigation reserve (Note 8)	27,439
Other accrued liabilities	26,578
	-----
Total Current Liabilities	98,119
 Long-Term Debt, less current maturities (Note 7)	 1,723
	-----
Deferred Income Taxes	23,098

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Self-Insurance Reserves, less current portion	13,100
Litigation Reserve, less current portion (Note 8)	83,091
Other Long-Term Liabilities	7,164
Commitments and Contingencies (Notes 8 and 9)	
Stockholders' Equity:	
Series A participating preferred stock, \$.05 stated value, 500,000 shares authorized, none issued	
Preferred stock, no par value, 500,000 shares authorized, none issued	
Common stock, \$1 par value, 120,000,000 shares authorized, 14,479,745 shares issued (Note 11)	14,480
Paid-in capital	72,495
Retained earnings	565,183
Unearned compensation on restricted stock	(137)
Accumulated other comprehensive income	(43)
	-----
	651,978
Less - Treasury stock, at cost (4,151,878 shares at November 30, 2001 and 4,173,299 shares at August 31, 2001)	417,173
	-----
Total Stockholders' Equity	234,805
	-----
Total Liabilities and Stockholders' Equity	\$ 461,100
	=====

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

Page 4

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
NATIONAL SERVICE INDUSTRIES, INC. AND SUBSIDIARIES  
(In thousands, except per-share data)

	THREE MONTHS ENDING NOVEMBER 30,
	2001
	-----
Sales and Service Revenues:	
Service revenues	\$ 78,836
Net sales of products	55,553
	-----
Total Revenues	134,389

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

	-----
Costs and Expenses:	
Cost of services	47,764
Cost of products sold	42,016
Selling and administrative expenses	44,758
Restructuring expense and other charges (Note 10)	5,820
Amortization expense	481
Interest expense	111
Other (income) expense, net	(481)
	-----
Total Costs and Expenses	140,469
	-----
(Loss) income from continuing operations before income taxes and cumulative effect of a change in accounting principle	(6,080)
Income tax (benefit) expense	(2,432)
	-----
(Loss) income from continuing operations before cumulative effect of a change in accounting principle	(3,648)
	-----
Discontinued Operations (Note 5):	
Income from discontinued operations, net of tax of \$7,066 in 2001 and \$8,329 in 2000	11,534
Costs associated with effecting the spin-off, net of tax benefit of \$717	(19,069)
	-----
Total Discontinued Operations	(7,535)
	-----
Cumulative effect of a change in accounting principle, net of tax benefit of \$10,830	(17,602)
	-----
Net (Loss) Income	\$ (28,785)
	=====
Basic and diluted earnings per share (split adjusted):	
(Loss) earnings per share from continuing operations before cumulative effect of a change in accounting principle	\$ (0.35)
Discontinued operations:	
Income from discontinued operations, net of tax	1.12
Costs associated with effecting the spin-off, net of tax benefit	(1.85)
	-----
Total Discontinued Operations	(0.73)
	-----
Cumulative effect of a change in accounting principle, net of tax benefit	(1.71)
	-----
Net (Loss) Income	\$ (2.79)
	=====
Basic Weighted Average Number of Shares Outstanding	10,305
	=====
Diluted Weighted Average Number of Shares Outstanding	10,305
	=====

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

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

Page 5

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NATIONAL SERVICE INDUSTRIES, INC. AND SUBSIDIARIES  
(In thousands)

Cash Provided by (Used for) Operating Activities:

Net (loss) income from continuing operations

Adjustments to reconcile net income to net cash provided by (used for) operating activities:

Depreciation and amortization

Provision for losses on accounts receivable

(Gain) loss on the sale of property, plant, and equipment

Restructuring expense and other charges

Change in assets and liabilities, net of effect of acquisitions and divestitures-

Receivables

Inventories and linens in service, net

Deferred income taxes

Prepayments and other current assets

Accounts payable and accrued liabilities

Self-insurance reserves and other long-term liabilities

Net Cash Provided by Continuing Operations

Net Cash Provided by Discontinued Operations

Net Cash Provided by Operating Activities

Cash Provided by (Used for) Investing Activities:

Purchases of property, plant, and equipment

Sale of property, plant, and equipment

Acquisitions

Change in other assets

Net Cash Used for Investing Activities

Cash Provided by (Used for) Financing Activities:

Borrowings of notes payable, net

Repayments of long-term debt

Treasury stock transactions, net

Cash dividends paid

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

### Net Cash Used for Financing Activities

Net Change in Cash and Cash Equivalents

Cash and Cash Equivalents at Beginning of Period

Cash and Cash Equivalents at End of Period

#### Supplemental Cash Flow Information:

Income taxes paid during the period

Interest paid during the period

#### Noncash Activities:

Treasury shares issued under long-term incentive plan

Cumulative effect of a change in accounting principle

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

Page 6

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NATIONAL SERVICE INDUSTRIES, INC. AND SUBSIDIARIES  
(Dollar amounts in thousands, except per-share data and  
information contained in Note 8)

#### 1. BASIS OF PRESENTATION

On November 7, 2001, management of National Service Industries, Inc. ("NSI" or the "Company") approved the spin-off of its lighting equipment and chemicals businesses into a separate publicly-traded company with its own management and board of directors. The spin-off was effected on November 30, 2001 through a tax-free distribution ("Distribution") of 100% of the outstanding shares of common stock of Acuity Brands, Inc. ("Acuity"), a wholly-owned subsidiary of NSI owning and operating the lighting equipment and chemicals businesses. Each NSI stockholder of record as of November 16, 2001, the record date for the distribution, received one share of Acuity common stock for each share of NSI common stock held at that date.

Certain NSI corporate assets, liabilities, and expenses have been allocated to Acuity based on an estimate of the proportion of corporate amounts allocable to Acuity, utilizing such factors as revenues, number of employees, and other relevant factors. As a result of the spin-off, the Company's financial statements have been prepared with Acuity's net assets, results of operations, and cash flows presented as discontinued operations. All historical statements have been restated to conform with this presentation. In the opinion of management, the allocations have been made on a reasonable basis.

The interim consolidated financial statements included herein have been prepared by the Company without audit and the consolidated balance sheet as of August 31, 2001 has been derived from audited statements. These statements

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

reflect all adjustments, all of which are of a normal, recurring nature, which are, in the opinion of management, necessary to present fairly the consolidated financial position as of November 30, 2001, the consolidated results of operations for the three months ended November 30, 2001 and 2000, and the consolidated cash flows for the three months ended November 30, 2001 and 2000. Certain reclassifications have been made to the prior year's financial statements to conform to the current year's presentation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001.

The results of operations for the three months ended November 30, 2001 are not necessarily indicative of the results to be expected for the full fiscal year because the Company's revenues and income are generally higher in the second half of its fiscal year and because of the uncertainty of general business conditions.

### 2. RECENT ACCOUNTING STANDARDS

#### NEWLY ADOPTED ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 141 ("SFAS 141") "Business Combinations," and Statement No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 141 prospectively prohibits the pooling of interests method of accounting for business combinations initiated after June 30, 2001. SFAS 142 requires companies to cease amortizing goodwill that existed at June 30, 2001 and establishes a new method for testing goodwill for impairment on an annual basis (or an interim basis if an event occurs that might reduce the fair value of a reporting unit below its carrying value.) Any goodwill resulting from acquisitions completed after June 30, 2001 will not be amortized. SFAS 142 also requires that an identifiable intangible asset that is determined to have an indefinite useful economic life not be amortized, but separately tested for impairment using a fair value based approach.

Page 7

The Company adopted SFAS 142 as of September 1, 2001. Summarized information for the Company's acquired intangible assets is as follows:

#### Acquired Intangible Assets

	November 30, 2001		August 31, 2001	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets				
Customer contracts	\$10,215	\$ (2,707)	\$10,215	
Other	1,428	(788)	1,428	



Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Total	----- \$11,643 =====	----- \$ (3,495) =====	----- \$11,643 =====
-------	----------------------------	------------------------------	----------------------------

The Company amortizes customer contracts over estimated useful lives of seven years. Other acquired intangible assets consisting primarily of restrictive covenant agreements are amortized over the lives of the agreements, which average approximately four years. The Company recorded amortization expense of \$481 and \$417 related to intangible assets in the first three months of fiscal 2002 and fiscal 2001, respectively.

The changes in the carrying amount of goodwill during the period are summarized as follows:

	Textile Rental -----	Envelope -----	To ---
Balance as of August 31, 2001	\$ 4,162	\$ 24,270	\$ 2
Goodwill acquired during the quarter	--	--	(2
Transitional impairment losses	(4,162)	(24,270)	
Balance as of November 30, 2001	----- \$ -- =====	----- \$ -- =====	----- \$ -- =====

The textile rental and envelope segments each tested goodwill for impairment during the first quarter of 2002 as required by SFAS 142 upon adoption, utilizing a combination of valuation techniques including the expected present value of future cash flows, a market multiple approach and a comparable transaction approach. As a result of this valuation process as well as the application of the remaining provisions of SFAS 142, the Company recorded a pre-tax transitional impairment loss of \$28,432, representing the write-off of all of the Company's existing goodwill. This write-off was reported as a cumulative effect of a change in accounting principle, on a net of tax basis, in the Company's Consolidated Statement of Income for the three months ended November 30, 2001.

Prior to the adoption of SFAS 142 in September 2001, the Company amortized goodwill over estimated useful lives ranging from 10 years to 30 years. Had the Company accounted for goodwill consistent with the provisions of SFAS 142 in prior periods, the Company's income from continuing operations and net income would have been affected as follows:

	Three Months Ended November 30, -----	
	2001 -----	2000 -----
Reported (loss) income from continuing operations	\$ (3,648)	\$ 2,354
Add back: Goodwill amortization	--	188

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Adjusted (loss) income from continuing operations	----- \$ (3,648) =====	----- \$ 2,542 =====
Adjusted net (loss) income	----- \$ (28,785) =====	----- \$16,725 =====
Basic and diluted earnings per share:		
Reported (loss) income from continuing operations	----- \$ (0.35) -----	----- \$ 0.23 -----
Add back: Goodwill amortization	----- -- -----	----- -- -----
Adjusted (loss) income from continuing operations	----- \$ (0.35) =====	----- \$ 0.23 =====
Adjusted net (loss) income	----- \$ (2.79) =====	----- \$ 1.62 =====

Page 8

3. BUSINESS SEGMENT INFORMATION

The following tables summarize the Company's business segment information from continuing operations:

THREE MONTHS ENDED NOVEMBER 30, 2001	SALES AND SERVICE REVENUES	OPERATING PROFIT (LOSS)	DEPRECIATION AND AMORTIZATION EXPENSE
	-----	-----	-----
Textile Rental	\$ 78,836	\$ (5,379)	\$4,117
Envelope	55,553	2,154	2,204
	-----	-----	-----
	134,389	(3,225)	6,321
Corporate	--	(2,744)	213
Interest expense	--	(111)	--
	-----	-----	-----
Total	\$ 134,389	\$ (6,080)	\$6,534
	=====	=====	=====

THREE MONTHS ENDED NOVEMBER 30, 2000	SALES AND SERVICE REVENUES	OPERATING PROFIT (LOSS)	DEPRECIATION AND AMORTIZATION EXPENSE
	-----	-----	-----
Textile Rental	\$ 81,107	\$ 3,727	\$4,147

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Envelope	59,580	1,712	2,325
	-----	-----	-----
	140,687	5,439	6,472
Corporate	--	(1,263)	457
Interest expense	--	(439)	--
	-----	-----	-----
Total	\$140,687	\$ 3,737	\$6,929
	=====	=====	=====

Total Assets

	November 30, 2001	August 31, 2001
	-----	-----
Textile Rental	\$215,486	\$231,422
Envelope	114,414	141,945
	-----	-----
Subtotal	329,900	373,367
Corporate	131,200	124,731
	-----	-----
Total	\$461,100	\$498,098
	=====	=====

4. INVENTORIES

Major classes of inventory as of November 30, 2001 and August 31, 2001 were as follows:

	November 30, 2001	August 31, 2001
	-----	-----
Raw Materials and Supplies	\$ 7,666	\$ 6,716
Work-in-Process	1,398	817
Finished Goods	9,727	11,662
	-----	-----
Total	\$18,791	\$19,195
	=====	=====

5. DISCONTINUED OPERATIONS

On November 7, 2001, the Company's board of directors approved the spin-off of its lighting equipment and chemicals businesses into a separate publicly-traded company with its own management and board of directors. The spin-off was effected on November 30, 2001 through a tax-free distribution of 100% of the outstanding shares of common stock of Acuity, a wholly-owned subsidiary of the Company owning and operating the lighting equipment and chemicals businesses. Each NSI stockholder of record as of November 16, 2001, the record date for the

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Distribution, received one share of the Acuity common stock for each share of NSI common stock held at that date.

As a result of the November 2001 spin-off, the Company's financial statements have been prepared with these businesses' net assets, results of operations, and cash flows presented as discontinued operations through the effective date of the Distribution, November 30, 2001. All historical statements have been restated to conform with this presentation.

Page 9

Summarized financial information for discontinued operations is as follows:

	August 31, 2001 -----
Current Assets	\$ 559,116
Property, Plant, and Equipment - net	248,423
Goodwill and Other Intangibles	468,944
Other Long-Term Assets	54,092
Current Liabilities	(442,067)
Long-Term Debt, less current maturities	(373,707)
Other Long-Term Liabilities	(131,503)
Accumulated Other Comprehensive Income Items	16,998
	-----
Net Assets of Discontinued Operations	\$ 400,296 =====

A summary of the operating results of the discontinued operations is as follows:

	Three Months Ended November 30,	
	2001	2000
	-----	-----
Sales	\$481,691 =====	\$502,646 =====
Income before provision for income taxes	\$ 18,600	\$ 22,512
Provision for income taxes	7,066	8,329
	-----	-----
Income from discontinued operations	\$ 11,534 =====	\$ 14,183 =====

In conjunction with the spin-off, the Company and Acuity entered into various

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

agreements that address the allocation of assets and liabilities between them and that define their relationship after the separation, including a distribution agreement, a tax disaffiliation agreement, an employee benefits agreement, and a transition services agreement.

In addition, Acuity and NSI entered into a put option agreement, whereby NSI has the option to require Acuity to purchase the property where NSI's corporate headquarters are located for a purchase price equal to 85 percent of the agreed-upon fair market value of the property. This put option will commence on June 1, 2002 and expire on May 31, 2003.

### 6. EARNINGS PER SHARE

The Company accounts for earnings per share using Statement of Financial Accounting Standards No. 128, "Earnings per Share." Under this statement, basic earnings per share is computed by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed similarly but reflects the potential dilution that would occur if dilutive options were exercised.

Page 10

The following table calculates basic earnings per common share and diluted earnings per common share at November 30, and reflects the January 7, 2002 one-for-four reverse stock split further described in note 11:

	Thru
	----- 2001 -----
Basic weighted average shares outstanding	10,3
Add: Shares of common stock assumed issued upon exercise of dilutive stock options	-----
Diluted weighted average shares outstanding	10,3 =====
Basic earnings per common share:	
(Loss) income from continuing operations before cumulative effect of a change in accounting principle	\$ (0.
Income from discontinued operations, net of tax	1.
Costs associated with effecting the spin-off, net of tax	(1. -----
Total discontinued operations	(0. -----
Cumulative effect of a change in accounting principle, net of tax	(1. -----
Net (loss) income	\$ (2. =====
Diluted earnings per common share:	
(Loss) income from continuing operations before cumulative effect of a change	

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

in accounting principle	\$ (0.)
Income from discontinued operations, net of tax	1.
Costs associated with effecting the spin-off, net of tax	(1.)
Total discontinued operations	(0.)
Cumulative effect of a change in accounting principle, net of tax	(1.)
Net (loss) income	\$ (2.)

### 7. LONG-TERM DEBT

Outstanding borrowings at November 30, 2001 included approximately \$2,756 in notes payable at 8.5%.

In October 2001, the Company negotiated a \$40,000, three-year committed credit facility with a single major US bank that became effective at the time of the spin-off. The facility contains financial covenants including a leverage ratio, a ratio of income available for fixed charges to fixed charges, and a minimum net worth. Interest rates under the facility are based on the LIBOR rate or other rates, at the Company's option. The Company will pay an annual fee on the commitment based on the Company's leverage ratio. Approximately \$2,240 was outstanding under this facility at November 30, 2001.

### 8. LEGAL PROCEEDINGS

The Company is subject to various legal claims arising in the normal course of business out of the conduct of its current and prior businesses, including product liability claims. Based on information currently available, it is the opinion of management that the ultimate resolution of pending and threatened legal proceedings will not have a material adverse effect on the Company's financial condition or results of operations. However, in the event of unexpected future developments, it is possible that the ultimate resolution of such matters, if unfavorable, could have a material adverse effect on the Company's results of operations in a particular future period. The Company reserves for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated for financial statement purposes. While management believes that its reserves are appropriate based on information currently available, the actual costs of resolving pending and future legal claims against the Company may differ substantially from the amounts reserved.

Among the product liability claims to which the Company is subject are claims for personal injury or wrongful death arising from the installation and distribution of asbestos-containing insulation, primarily in the southeastern United States, by a previously divested business of the Company. Most claims against the Company seek both substantial compensatory damages and punitive damages. The Company believes that many of the claims against it are without merit. The Company believes its conduct with respect to asbestos-containing insulation was consistent with recognized safety standards at the relevant times, and the Company believes there is no basis for imposing punitive damages against it in connection with asbestos claims. In addition, the Company believes that it has substantial legal defenses against many of these claims, including that the Company did not manufacture any asbestos-containing building products, that the Company did not distribute or install products at certain sites where exposure is

alleged, and that statutes of repose in some states bar the claims. However, there is no assurance that the Company will be successful in asserting defenses to these claims.

Prior to February 1, 2001, the Center for Claims Resolution (the "CCR") handled the processing and settlement of claims on behalf of the Company and retained local counsel for the defense of claims. Pursuant to a written agreement among CCR members, the Company was responsible for varying percentages of defense and liability payments on a claim-by-claim basis for each claim in which it was named in accordance with predetermined sharing formulae. Substantially all of the Company's portion of those payments were paid directly by the Company's insurers. Since February 1, 2001, the Company has begun to retain trial counsel directly, rather than through the CCR, to defend asbestos-related claims against the Company and has engaged another outside consultant to provide claims processing and administration services for asbestos-related claims. Now that it is no longer a member of the CCR, the Company intends to be more vigorous in defending asbestos-related claims and will seek to dismiss without any settlement payment claims arising in jurisdictions or involving worksites where the Company did not distribute or install asbestos-containing products.

During the past two years, some members or former members of the CCR have failed, by reason of bankruptcy or otherwise, to make payments to the CCR for their shares of certain settlement agreements the CCR had reached on behalf of its members with plaintiffs. Consequently, with respect to some settlement agreements, the CCR has been unable to make the full payments contemplated by those agreements. In some circumstances, the Company and other members of the CCR have contributed additional funds to the CCR to permit it to make certain payments contemplated by the settlement agreements. As of December 31, 2001, the Company has contributed approximately \$5.3 million to the CCR for this purpose, and it may make further such payments in the future. Payments made since August 31, 2001 have been applied against the Company's accrual for asbestos liabilities established as of August 31, 2001. Some plaintiffs who are parties to settlement agreements with the CCR that contemplate payments that the CCR has been unable to make have commenced litigation against the CCR, the Company, and other members to recover amounts due under these settlement agreements. The Company believes that it should not be liable for settlement payments attributable to other members or former members of the CCR, and the Company has joined a joint defense group with other CCR members to defend these claims.

The Company believes that any amount it pays, including the \$5.3 million it has already contributed to the CCR, on account of payments contemplated by settlement agreements entered into by the CCR on behalf of its members, should be covered either by the Company's insurance or by surety bonds and collateral provided by those former members who failed to meet their obligations. There can be no assurance, however, that the Company can actually recover any of these amounts. Accordingly, no insurance or other recovery with respect to these amounts has been recorded as an asset in the Company's financial statements.

The amount of the Company's liability on account of payments contemplated by settlement agreements entered into by the CCR is uncertain. The Company has included in its reserves its estimate of the Company's potential liability in this respect, but the Company's ultimate liability for these matters could be greater than estimated if more CCR members or former members fail to meet their obligations or if the courts determine that the Company could be liable for settlement payments that were attributable to other CCR members.

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Several significant companies that are traditional co-defendants in asbestos claims, both members of the CCR and non-members, have sought protection under Chapter 11 of the federal bankruptcy code during the past two years. Litigation against such co-defendants generally is stayed or restricted as a result of their bankruptcy filings. The absence of these traditional defendants may increase the number of claims filed against other defendants, including the Company, and may increase the cost of resolving such claims. Due to the uncertainties surrounding the ultimate effect of these bankruptcies on remaining asbestos defendants, the effect on the amount of the Company's liabilities cannot be determined.

During the fiscal year ended August 31, 2001, the Company was served with approximately 30,000 asbestos-related claims and settled approximately 16,000 claims for an average of approximately \$1,035 per claim (including approximately 200 claims that were dismissed with no payment). As of August 31, 2001, there were approximately 35,000 open claims pending against the Company (including approximately 1,000 claims that were settled in principle after February 1, 2001 but not finalized) and approximately 12,000 additional claims that were settled in principle prior to February 1, 2001 but not finalized.

During the quarter ended November 30, 2001, the Company was served with approximately 2,300 asbestos-related claims and resolved approximately 13,600 claims for an average of approximately \$785 per claim (including approximately 11,300 claims that were dismissed with no payment as previously disclosed). As of November 30, 2001, there were approximately 23,700 open claims pending against the Company (including approximately 2,900 claims that were settled in principle after February 1, 2001 but not finalized) and approximately 11,200 additional claims that were settled in principle prior to February 1, 2001 but not finalized.

As of November 30, 2001 and August 31, 2001, an estimated accrual of \$110.5 million and \$113.4 million, respectively, for asbestos-related liabilities, before consideration of insurance recoveries, has been reflected in the accompanying financial statements, primarily in long-term liabilities. The amount of the accrual is based on the following: the Company's estimate of

Page 12

indemnity payments and defense costs associated with pending and future asbestos-related claims to be paid through 2004; settlements agreed to but not paid as of November 30, 2001; the Company's expected payment on account of settlement obligations of defaulting CCR members; interest on settlement payments that are subject to ongoing dispute resolution with certain insurance providers; and other legal fees and expenses. The Company's estimates of indemnity payments and defense costs associated with pending and future asbestos claims are based on the Company's estimate of the number of future asbestos-related claims and the type of disease, if any, alleged or expected to be alleged in such claims, assumptions regarding the timing and amounts of settlement payments, the status of ongoing litigation and settlement initiatives, and the advice of outside counsel with respect to the current state of the law related to asbestos claims. The ultimate liability for all pending and future claims cannot be determined with certainty due to the difficulty of forecasting the numerous variables that can affect the amount of liability. There are inherent uncertainties involved in estimating these amounts, and the Company's actual costs in future periods could exceed the Company's estimates due to changes in facts and circumstances after the date of each estimate.

The Company believes that it has insurance coverage available to recover most



## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

of its asbestos-related costs. The Company has reached settlement agreements with substantially all of its relevant insurers providing for payment of substantially all asbestos-related claims (subject to retentions) up to the various policy limits, except for the Company's payments on account of settlement obligations of defaulting CCR members, as discussed above. The timing and amount of future recoveries from insurance carriers will depend on the pace of claims review and processing by such carriers and on the resolution of any remaining disputes regarding coverage under such policies. The Company believes that substantial recoveries from the insurance carriers are probable. The Company reached this conclusion after considering its prior insurance-related recoveries in respect of asbestos-related claims, existing insurance policies, settlement agreements with insurers, the apparent viability of its insurers, the advice of outside counsel with respect to the applicable insurance coverage law relating to terms and conditions of those policies, and a general assessment by the Company and its advisors of the financial condition of the relevant insurers. Accordingly, an estimated aggregate insurance recovery of \$93.9 million and \$95.2 million has been reflected in the accompanying financial statements as of November 30, 2001 and August 31, 2001, respectively, with respect to previously paid claims and pending and future claims estimated to be paid through 2004 and the other items included in the accrual of asbestos-related liabilities. Approximately \$27.3 million and \$28.6 million of the aggregate insurance recovery and \$27.4 million and \$30.5 million of the asbestos-related accrual have been classified as current assets and liabilities in the accompanying balance sheet as of November 30, 2001 and August 31, 2001, respectively.

Management continues to monitor claims activity, the status of lawsuits (including settlement initiatives), legislative developments, and costs incurred in order to ascertain whether an adjustment to the existing accruals should be made to the extent that historical experience may differ significantly from the Company's underlying assumptions. As additional information becomes available, the Company will reassess its liability and revise its estimates as appropriate. Management currently believes that, based on the factors discussed in the preceding paragraphs and taking into account the accruals reflected as of August 31, 2001 the resolution of asbestos-related uncertainties and the incurrence of asbestos-related costs net to related insurance recoveries should not have a material adverse effect on the Company's consolidated financial position or results of operations. However, as the Company's estimates are periodically re-evaluated, additional accruals to the liabilities reflected in the Company's financial statements may be necessary, and such accruals could be material to the results of the period in which they are recorded. Given the number and complexity of factors that affect the Company's liability and its available insurance, the actual liability and insurance recovery may differ substantially from the Company's estimates. No assurance can be given that the Company will not be subject to significant additional asbestos litigation and material additional liabilities. If actual liabilities significantly exceed the Company's estimates or if expected insurance recoveries become unavailable, due to insolvencies among the Company's primary or excess insurance carriers, disputes with carriers or otherwise, the Company's results of operations, liquidity and financial condition could be materially adversely affected.

### 9. ENVIRONMENTAL MATTERS

The Company's operations, as well as similar operations of other companies, are subject to comprehensive laws and regulations relating to the generation, storage, handling, transportation, and disposal of hazardous substances and solid and hazardous wastes and to the remediation of contaminated sites. Permits and environmental controls are required for certain of the Company's operations to limit air and water pollution, and these permits are subject to modification, renewal, and revocation by issuing authorities. The Company believes that it is in substantial compliance with all material environmental

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

laws, regulations, and permits. On an ongoing basis, the Company incurs capital and operating costs relating to environmental compliance.

Environmental laws and regulations have generally become stricter in recent years, and the cost of responding to future changes may be substantial.

The Company's environmental reserves, which are included in current liabilities, totaled \$6,967 and \$7,291 at November 30, 2001 and August 31, 2001, respectively. The actual cost of environmental issues may be lower or higher than that reserved due to the difficulty in estimating such costs and potential changes in the status of government regulations.

Page 13

Certain environmental laws can impose liability regardless of fault. The federal Superfund law is an example of such an environmental law. However, liability under Superfund is mitigated by the presence of other parties who will share in the costs associated with clean-up of sites. The extent of liability is determined on a case-by-case basis taking into account many factors, including the number of other parties whose status or activities also subjects them to liability regardless of fault.

The Company is currently a party to, or otherwise involved in, legal proceedings in connection with state and federal Superfund sites, one of which is located on property owned by the Company. Except for the Blydenburgh Landfill matter in New York (which is discussed below), the Company believes its liability is de minimis at each of the currently active sites which it does not own where it has been named as a potentially responsible party ("PRP") due to its limited involvement at the site and/or the number of viable PRPs. For property which the Company owns on East Paris Street in Tampa, Florida, the Company was requested by the State of Florida to clean up chlorinated solvent contamination in the groundwater beneath the property and beneath surrounding property known as Seminole Heights Solvent Site and to reimburse approximately \$430 of costs already incurred by the State of Florida in connection with such contamination. The Company presented expert evidence to the State of Florida in 1998 that the Company is not the source of the contamination, and the State has referred this matter to the Environmental Protection Agency for review. At this point in time, it is not possible to quantify the extent, if any, of the Company's exposure.

In connection with the sale of certain assets, including 29 of the Company's textile rental plants in 1997, the Company has retained environmental liabilities arising from events occurring prior to the closing, subject to certain exceptions. The Company has received notice from the buyer of the textile rental plants of the alleged presence of perchloroethylene contamination on two of the properties in Texas involved in the sale. Because the Company is not the source of contamination, the Company asserted indemnification claims against the company from which it bought the properties. The prior owner is currently addressing the contamination at its expense at one of the properties, subject to a reservation of rights, and is currently reviewing the Company's claim regarding the other property. At this time, it is too early to quantify the Company's potential exposure in these matters, the likelihood of an adverse result, or the outcome of the Company's indemnification claims against the prior owner.

The State of New York has filed a lawsuit against the Company alleging that the Company is responsible as a successor to Serv-All Uniform Rental Corp. ("Serv-All") for past and future response costs in connection with the release or potential release of hazardous substances at and from the Blydenburgh

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

Landfill in Islip, New York. The Company believes that it is not a successor to Serv-All and therefore has no liability with respect to the Blydenburgh Landfill and responded to the lawsuit accordingly. The Company has also asserted an indemnification claim against the parent of Initial Services Investments, Inc., which the Company acquired in 1992 and which had previously purchased and sold certain assets of Serv-All.

In February 2001, the federal district court in the Eastern District of New York denied the Company's motion for summary judgment on the issue of successor liability and granted the State of New York's motion for partial summary judgment, issuing a declaratory judgment that the Company is a successor to Serv-All. Subsequently, the Company and the State of New York each filed a cross-motion for summary judgment on the Company's liability under the Comprehensive Environmental Response, Compensation, and Liability Act. On December 12, 2001, the Court granted summary judgment for the State. At a January 9, 2002 status conference, the Court verbally denied the Company's motion for summary judgment, and, explicitly recognizing that the issues presented by this case were appropriate for judicial review, ordered that judgment against the Company be entered but that execution of the judgment be stayed pending appeal to the Second Circuit Court of Appeals.

The Company will immediately appeal this order. Among other things, the Company will argue that the trial court erred in declaring the Company is a successor to Serv-All and in its verbal finding that the State's claims were not barred by the statute of limitations.

Furthermore, even if the Company were eventually found liable for the total amount claimed by the State, the Company would have a right to seek recovery of these costs from the many other parties whose wastes were disposed of at the Landfill. At this point, it is too early to quantify the Company's potential exposure, the likelihood of an adverse result, or the outcome of the Company's indemnification claim.

### 10. RESTRUCTURING EXPENSE AND OTHER CHARGES

During 2001, management conducted reviews of its continuing operations as part of management's strategic initiative to examine under-performing operations and to position the Company for an economic slowdown. As a result of these reviews, the Company approved a significant restructuring program and recorded a related charge of \$5,014 during the fourth quarter of fiscal 2001. The

Page 14

accrual included severance costs of \$3,087 for 367 employees of the textile rental and envelope segments, all of whom were terminated prior to the end of the fiscal year, \$1,582 in exit expenses to close and consolidate facilities in the envelope segment, and \$345 in losses related to the sale of two textile rental businesses. As of August 31, 2001, approximately \$118 of the severance accrual had been paid to employees.

During the first quarter of fiscal 2002, the Company closed two facilities in the textile rental segment and recorded a related charge of \$5,820. The charge included severance costs of \$11 for four employees, all of whom were terminated prior to the end of the first quarter, and \$1,396 in exit expenses to close and consolidate facilities. Exit expenses primarily include costs of lease terminations and costs to dispose of facilities. Additionally, as a further result of the closure of the two textile rental facilities, the Company recognized long-lived asset impairments totaling \$4,413. Textile rental assets to be disposed of were reduced to state them at their estimated fair value less

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

costs to sell. Assets to be disposed of primarily related to equipment located in the facilities included in the restructuring program noted above. After the charge, the remaining net book value of these assets was immaterial. Estimated fair market values were established based on an analysis of expected future cash flows.

The major components of the fiscal 2001 and 2002 restructuring charges and related activity are as follows:

	Reserve, August 31, 2001 -----	Cash Payments -----	Expense -----	Reserve, November 30, 2001 -----
Severance costs	\$2,969	\$(1,479)	\$ 11	\$1,501
Exit costs	\$1,582	\$ (776)	\$1,396	\$2,202

The losses resulting from the restructuring activities and asset impairments are included in "Restructuring expense and other charges" in the Consolidated Statements of Income.

### 11. SUBSEQUENT EVENT

On January 3, 2002, the Company's shareholders approved a one-for-four reverse stock split of NSI common stock, which began trading on a reverse split basis on January 7, 2002. As a result of the stock split, every four shares of NSI common stock were replaced with one share of NSI common stock. The reverse split did not change the number of authorized shares of NSI common stock or the par value per share of NSI common stock. All references to common stock, common shares outstanding, average numbers of common stock shares outstanding and per share amounts in these Consolidated Financial Statements and Notes to Consolidated Financial Statements prior to the effective date of the reverse stock split have been restated to reflect the one-for-four common stock reverse split on a retroactive basis.

Page 15

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and related notes.

National Service Industries ("NSI" or the "Company") is a diversified service and manufacturing company operating in two segments: textile rental and envelopes. The Company remained in solid financial condition at November 30, 2001. Net working capital was \$85.5 million, down slightly from \$87.7 million at August 31, 2001, and the current ratio remained constant at 1.9.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 141 ("SFAS 141") "Business Combinations," and Statement No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 141 prospectively prohibits the pooling of interests method of accounting for business combinations initiated after June 30, 2001. SFAS 142 requires companies to cease amortizing goodwill that existed at June 30, 2001 and establishes a new

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

method for testing goodwill for impairment on an annual basis (or an interim basis if an event occurs that might reduce the fair value of a reporting unit below its carrying value.) Any goodwill resulting from acquisitions completed after June 30, 2001 will not be amortized. SFAS 142 also requires that an identifiable intangible asset that is determined to have an indefinite useful economic life not be amortized, but separately tested for impairment using a fair value based approach.

The textile rental and envelope segments each tested goodwill for impairment during the first quarter of 2002 as required by SFAS 142 upon adoption, utilizing a combination of valuation techniques including the expected present value of future cash flows, a market multiple approach and a comparable transaction approach. As a result of this valuation process, as well as the application of the remaining provisions of SFAS 142, the Company recorded a pre-tax transitional impairment loss of \$28.4 million, representing the write-off of all of the Company's existing goodwill. This write-off was reported as a cumulative effect of a change in accounting principle, on a net of tax basis, in the Company's Consolidated Statement of Income for the three months ended November 30, 2001 (see note 2).

On November 7, 2001, the Company's board of directors approved the spin-off its lighting equipment and chemicals businesses into a separate publicly-traded company with its own management and board of directors. The spin-off was effected on November 30, 2001 through a tax-free distribution of 100% of the outstanding shares of common stock of Acuity Brands, Inc. ("Acuity"), a wholly-owned subsidiary of the Company owning and operating the lighting equipment and chemicals businesses. Each NSI stockholder of record as of November 16, 2001, the record date for the distribution, received one share of Acuity common stock for each share of NSI common stock held at that date (see note 5).

In conjunction with the spin-off, the Company and Acuity entered into various agreements that address the allocation of assets and liabilities between them and that define their relationship after the separation, including a distribution agreement, a tax disaffiliation agreement, an employee benefits agreement, and a transition services agreement. Under the tax disaffiliation agreement, Acuity will indemnify NSI for certain taxes and liabilities that may arise related to the Distribution. The agreement also sets out each party's rights and obligations with respect to deficiencies and refunds, if any, of federal, state, local, or foreign taxes for periods before and after the Distribution. The transition services agreement provides that NSI and Acuity will provide each other services in such areas as information management and technology, employee benefits administration, payroll, financial accounting and reporting, claims administration and reporting, legal, and other areas where NSI and Acuity may need transitional assistance and support. Management believes the amounts paid or received associated with these services are representative of the fair value of the services provided.

In addition, Acuity and NSI entered into a put option agreement, whereby NSI has the option to require Acuity to purchase the property where NSI's corporate headquarters are located for a purchase price equal to 85 percent of the agreed-upon fair market value of the property. This put option will commence on June 1, 2002 and expire on May 31, 2003.

As a result of the November 2001 spin-off, the Company's financial statements have been prepared with these businesses' net assets, results of operations, and cash flows presented as discontinued operations. Accordingly, the results of operations and liquidity and capital resources information presented below reflect only the continuing operations of the Company.

On January 3, 2002, the Company's shareholders approved a one-for-four reverse stock split of NSI common stock, which began trading on a reverse split basis

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

on January 7, 2002. As a result of the stock split, every four shares of NSI common stock were replaced with one share of NSI common stock. The reverse split did not change the number of authorized shares of NSI common stock or the par value per share of NSI common stock. All references to common stock, common shares outstanding, average numbers of common stock shares outstanding and per share amounts in these Consolidated Financial Statements, Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations prior to the effective date of the reverse stock split have been restated to reflect the one-for-four common stock reverse split on a retroactive basis.

Page 16

### RESULTS OF OPERATIONS

NSI generated revenue of \$134.4 million in the three months ended November 30, 2001, compared to revenue of \$140.7 million in the previous year. The decrease was related to the overall softer economy and lost revenues from the closure of two envelope manufacturing facilities in the fourth quarter of fiscal 2001.

Losses from continuing operations totaled \$3.6 million, or \$0.35 per diluted share, for the three months ended November 30, 2001, compared to income from continuing operations of \$2.4 million, or \$0.23 per diluted share, for the three months ended November 30, 2000. Income from continuing operations declined \$6.0 million primarily as a result of lower overall revenues and costs associated with restructuring activities in the Company's textile rental segment.

Textile rental segment first quarter revenues of \$78.8 million decreased 2.8 percent compared to last year's \$81.1 million. The operating loss was \$5.4 million compared to last year's operating profit of \$3.7 million. Reported operating profit reflects severance and restructuring charges of \$5.8 million for the first quarter related to the closure of two facilities. Excluding these charges, the decline in operating profit reflects the impact of lower revenues, primarily as a result of the soft economy and increases in labor and benefits costs.

The restructuring charge included severance costs of \$11 thousand for four employees, all of whom were terminated prior to the end of the first quarter, and \$1.4 million in exit expenses to close and consolidate facilities. Exit expenses primarily include costs of lease terminations and costs to dispose of closed facilities.

Additionally, as a further result of the closure of the two textile rental facilities, the Company recognized long-lived asset impairments totaling \$4.4 million. Textile rental assets to be disposed of were reduced to state them at their estimated fair value less costs to sell. Assets to be disposed of primarily related to equipment located in the facilities included in the restructuring program noted above. After the charge, the remaining net book value of these assets was immaterial. Estimated fair market values were established based on an analysis of expected future cash flows.

The envelope segment first quarter revenues of \$55.6 million decreased 6.8 percent from last year's results of \$59.6 million. Operating profit was \$2.2 million, up \$442,000 from the prior year. Last year's results included \$880,000 of costs associated with the reorganization of the Miami, Florida facility and approximately \$240,000 of goodwill amortization. The revenue decline reflects lower volumes from the courier market and the impact of the closure of two non-performing plants during the last half of fiscal 2001. Excluding the prior

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

year reorganization costs and goodwill amortization, which ceased upon the adoption of SFAS No. 142, profits decreased approximately \$678,000 as a result of the lower overall revenue and increased benefits costs.

Corporate expenses were \$2.7 million for the first quarter compared to last year's \$1.3 million. The planned increase is representative of on-going, stand-alone corporate costs.

First quarter net interest expense of \$111,000 decreased from last year's \$439,000 due to lower overall rates. Additionally, the provision for income taxes increased to 40 percent of income from continuing operations for the first quarter compared to 37 percent in the prior year as a result of the loss of certain state tax benefits associated with the spin-off.

### LIQUIDITY AND CAPITAL RESOURCES

#### Operating Activities

Continuing operations provided cash of \$3.8 million during the first quarter of fiscal 2002 compared with \$9.7 million during the respective period of the prior year. Fiscal 2002 operating cash flow was lower primarily because of a decrease in net income.

#### Investing Activities

Investing activities used cash of \$4.8 million versus \$4.2 million in the prior year. The increase in spending was due mainly to increased capital spending in the textile rental segment.

Capital expenditures totaled \$5.0 million compared to \$3.3 million in the first quarter of last year. In the first quarter of fiscal 2002, the textile rental segment invested primarily in replacing old equipment and delivery truck purchases and refurbishment. Capital expenditures in the envelope segment were primarily related to manufacturing equipment purchases and information systems. In the first quarter of fiscal 2001, capital expenditures in the envelope segment related primarily to manufacturing process improvements and information systems. The textile rental segment's expenditures were mainly attributable to building improvements, replacing old equipment and information systems.

Page 17

#### Financing Activities

Cash used by financing activities totaled \$5.9 million in the current-year first quarter compared to cash used of \$12.8 million in fiscal 2001 primarily as a result of lower dividends. First quarter dividend payments totaled \$6.6 million, or \$0.64 per share, compared with \$13.5 million, or \$1.32 per share, for the prior-year period.

Upon completion of the spin-off on November 30, 2001, approximately \$371.3 million of long-term debt was assumed by Acuity, leaving approximately \$2.8 million outstanding for the Company.

In October 2001, the Company negotiated a \$40 million, three-year committed credit facility with a single major US bank that became effective at the time of the spin-off. The facility contains financial covenants including a leverage ratio, a ratio of income available for fixed charges to fixed charges, and a minimum net worth. Interest rates under the facility are based on the LIBOR rate or other rates, at the Company's option. The Company will pay an annual

## Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

fee on the commitment based on the Company's leverage ratio. Approximately \$2.2 million was outstanding under this facility at November 30, 2001.

Management believes anticipated cash flows from operations, and the committed credit facilities are sufficient to meet the Company's planned level of capital spending and general operating cash requirements, including but not limited to cash requirements related to litigation as further described in note 8 to the financial statements, for the next twelve months.

On January 3, 2002, the Company's shareholders approved a one-for-four reverse stock split of NSI common stock, which began trading on a reverse split basis on January 7, 2002. As a result of the stock split, every four shares of NSI common stock were replaced with one share of NSI common stock. The reverse split did not change the number of authorized shares of NSI common stock or the par value per share of NSI common stock.

### Legal Proceedings

For information concerning legal proceedings, including trends and developments involving legal proceedings, see note 8 to the financial statements included in this filing.

### Environmental Matters

For information concerning environmental matters, see note 9 to the financial statements included in this filing.

### Quantitative and Qualitative Disclosures About Market Risk

#### Disclosures about Market Risk

The Company believes that its exposure to market risks that may impact the "Consolidated Balance Sheets," "Consolidated Statements of Income," and "Consolidated Statements of Cash Flows" primarily relate to changing interest rates and commodity prices. The Company does not enter into derivative arrangements for trading or speculative purposes.

#### Interest Rates

The Company's credit line is subject to interest rate fluctuations. These fluctuations expose the Company to changes in interest expense and cash flows. The Company's variable-rate debt amounted to \$2.2 million at November 30, 2001. Based on outstanding borrowings at November 30, 2001, a 10 percent adverse change in effective market interest rates would result in an immaterial amount of additional interest expense.

#### Commodity Price Risk

From time to time, the Company's textile rental segment enters into arrangements locking in for specified periods the prices the Company will pay for the volume of natural gas or other commodities to which the contract relates. The contracts are structured to reduce the segment's exposure to changes in the price of natural gas. However, these contracts also limit the benefit the segment might have otherwise received from decreases in the price of natural gas. The Company does not believe a 10 percent adverse change in market rates of natural gas would have a material impact on its "Consolidated Balance Sheets" or "Consolidated Statements of Income."

### Cautionary Statement Regarding Forward-Looking Information

This filing contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. Consequently, actual results may differ materially from those indicated by the forward-looking statements. A variety of risks and uncertainties could cause the Company's actual results to differ materially



Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

from the anticipated results or other expectations expressed in the Company's forward-looking statements. The risks and uncertainties include without limitation the following: (a) the uncertainty of general business and economic conditions, interest rate changes, and fluctuations in commodity and raw material prices and; (b) unexpected developments and outcomes in the Company's legal and environmental proceedings.

Page 18

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For information concerning legal proceedings, including trends and developments involving legal proceedings, see note 8 to the financial statements included in this filing.

Item 4. Submission of Matters to a Vote of Security Holders

At the annual meeting of stockholders held January 3, 2002, all nominees for director were elected to the board without opposition and Arthur Andersen LLP's appointment as independent auditor for the current fiscal year was ratified. The elected board members are as follows:

Brock A. Hattox, Chairman	Joia M. Johnson
Dennis R. Beresford	Michael Z. Kay
John E. Cay, III	Betty L. Seigel
Don L. Chapman	

In addition, stockholders voted on the following:

	Votes Ca
	-----
	Affirmative      Negati
	-----
National Service Industries, Inc. 2001 Nonemployee Directors' Stock Incentive Plan	6,889,750      1,622,
Amendment of the Corporation's Restated Certificate of Incorporation to effect a reverse stock split	5,861,876      2,662,

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits are listed on the Index to Exhibits (page 19).
- (b) A Form 8-K was filed on December 14, 2001 related to the completion of the distribution of the common stock of Acuity Brands, Inc. A Form 8-K was filed on January 7, 2002 related to the completion of a one-for-four reverse stock split of its common stock.

SIGNATURES

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

Edgar Filing: NATIONAL SERVICE INDUSTRIES INC - Form 10-Q

undersigned thereunto duly authorized.

NATIONAL SERVICE INDUSTRIES, INC.

-----  
REGISTRANT

DATE January 11, 2002

/s/ CAROL ELLIS MORGAN

-----  
CAROL ELLIS MORGAN  
SENIOR VICE PRESIDENT,  
GENERAL COUNSEL AND SECRETARY

DATE January 11, 2002

/s/ CHESTER J. POPKOWSKI

-----  
CHESTER J. POPKOWSKI  
SENIOR VICE PRESIDENT,  
CHIEF FINANCIAL OFFICER AND  
TREASURER

Page 19

INDEX TO EXHIBITS

- |                  |     |   |
|------------------|-----|---|
| EXHIBIT 10(iii)A | (1) | Restricted Stock Award Agreement under the National Service Industries, Inc. Long-Term Achievement Incentive Plan   |
|                  | (2) | Amendment No. 1 to the National Service Industries, Inc. Long-Term Achievement Incentive Plan (As amended and restated as of January 5, 2000) effective January 7, 2002 |
|                  | (3) | National Service Industries, Inc. 2001 Nonemployee Directors' Stock Incentive Plan effective November 27, 2001  |