SERVICEMASTER CO
Form 10-Q
August 14, 2013
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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 June 30, 2013

or

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

(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 x No o

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

The registrant is a privately held corporation and its equity shares are not publicly traded. At August 14, 2013, 1,000 shares of the registrant s common stock were outstanding, all of which were owned by CDRSVM Holding, Inc.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE SERVICEMASTER COMPANY

Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income (Unaudited)

(In thousands)

	Three months ended June 30, 2013	2012
Operating Revenue	$ 938,662	$ 962,165
Operating Costs and Expenses:		
Cost of services rendered and products sold	551,308	532,954
Selling and administrative expenses	263,743	241,929
Amortization expense	13,893	17,802
Goodwill and trade name impairment	673,253	67,700
Restructuring charges	298	5,026
Total operating costs and expenses	1,502,495	865,411
Operating (Loss) Income	(563,833)	96,754
Non-operating Expense (Income):		
Interest expense	63,463	59,700
Interest and net investment income	(1,749)	(1,396)
Other expense	141	177
(Loss) Income from Continuing Operations before Income Taxes	(625,688)	38,273
(Benefit) Provision for income taxes	(115,747)	16,028
Equity in losses of joint venture	(60)	(111)
(Loss) Income from Continuing Operations	(510,001)	22,134
(Loss) income from discontinued operations, net of income taxes	(231)	838
Net (Loss) Income	$ (510,232)	$ 22,972
Total Comprehensive (Loss) Income	$ (514,030)	$ 22,414

See accompanying Notes to the Condensed Consolidated Financial Statements

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THE SERVICEMASTER COMPANY

Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

(In thousands)

	Six months ended June 30, 2013	Six months ended June 30, 2012
Operating Revenue	$ 1,546,769	$ 1,616,854
Operating Costs and Expenses:		
Cost of services rendered and products sold	924,483	919,542
Selling and administrative expenses	461,326	433,299
Amortization expense	27,828	35,791
Goodwill and trade name impairment	673,253	67,700
Restructuring charges	3,575	9,016
Total operating costs and expenses	2,090,465	1,465,348
Operating (Loss) Income	(543,696)	151,506
Non-operating Expense (Income):		
Interest expense	123,698	124,514
Interest and net investment income	(4,168)	(4,038)
Loss on extinguishment of debt		39,193
Other expense	287	351
Loss from Continuing Operations before Income Taxes	(663,513)	(8,514)
Benefit for income taxes	(130,682)	(1,653)
Equity in losses of joint venture	(114)	(111)
Loss from Continuing Operations	(532,945)	(6,972)
Loss from discontinued operations, net of income taxes	(396)	(86)
Net Loss	$ (533,341)	$ (7,058)
Total Comprehensive Loss	$ (534,307)	$ (364)

See accompanying Notes to the Condensed Consolidated Financial Statements

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THE SERVICEMASTER COMPANY

Condensed Consolidated Statements of Financial Position (Unaudited)

(In thousands, except share data)

	As of June 30, 2013	As of December 31, 2012
Assets:		
Current Assets:		
Cash and cash equivalents	$ 385,034	$ 422,745
Marketable securities	33,649	19,347
Receivables, less allowances of $31,890 and $21,347, respectively	484,082	403,705
Inventories	59,434	56,562
Prepaid expenses and other assets	101,454	37,344
Deferred customer acquisition costs	56,890	33,921
Deferred taxes	110,214	107,499
Total Current Assets	1,230,757	1,081,123
Property and Equipment:		
At cost	693,319	633,582
Less: accumulated depreciation	(334,995)	(293,534)
Net Property and Equipment	358,324	340,048
Other Assets:		
Goodwill	1,998,686	2,412,251
Intangible assets, primarily trade names, service marks and trademarks, net	2,093,091	2,373,469
Notes receivable	33,462	22,419
Long-term marketable securities	126,312	126,456
Other assets	23,007	10,197
Debt issuance costs	45,599	44,951
Total Assets	$ 5,909,238	$ 6,410,914
Liabilities and Shareholder s Equity:		
Current Liabilities:		
Accounts payable	$ 127,849	$ 86,710
Accrued liabilities:		
Payroll and related expenses	81,233	78,188
Self-insured claims and related expenses	100,444	83,035
Accrued interest payable	52,243	54,156
Other	67,092	58,994
Deferred revenue	562,611	483,897
Liabilities of discontinued operations	640	905
Current portion of long-term debt	57,227	52,214
Total Current Liabilities	1,049,339	898,099
Long-Term Debt	3,905,624	3,909,039
Other Long-Term Liabilities:		

Deferred taxes		804,029		934,271
Other long-term obligations, primarily self-insured claims		128,446		114,855
Total Other Long-Term Liabilities		932,475		1,049,126
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		1,473,246		1,471,789
Retained deficit		(1,457,046)		(923,705)
Accumulated other comprehensive income		5,600		6,566
Total Shareholder s Equity		21,800		554,650
Total Liabilities and Shareholder s Equity	$	5,909,238	$	6,410,914

See accompanying Notes to the Condensed Consolidated Financial Statements

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THE SERVICEMASTER COMPANY

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Six months ended June 30, 2013	Six months ended June 30, 2012
Cash and Cash Equivalents at Beginning of Period	$ 422,745	$ 328,930
Cash Flows from Operating Activities from Continuing Operations:		
Net Loss	(533,341)	(7,058)
Adjustments to reconcile net loss to net cash provided from operating activities:		
Loss from discontinued operations, net of income taxes	396	86
Equity in losses of joint venture	114	111
Depreciation expense	46,194	37,756
Amortization expense	27,828	35,791
Amortization of debt issuance costs	4,929	6,528
Loss on extinguishment of debt		39,193
Call premium paid on retirement of debt		(32,250)
Premium received on issuance of debt		3,000
Deferred income tax benefit	(133,774)	(3,787)
Stock-based compensation expense	1,457	3,458
Goodwill and trade name impairment	673,253	67,700
Restructuring charges	3,575	9,016
Cash payments related to restructuring charges	(5,945)	(7,326)
Change in working capital, net of acquisitions:		
Current income taxes	(7,980)	(4,612)
Receivables	(77,096)	(79,724)
Inventories and other current assets	(77,373)	(61,944)
Accounts payable	45,132	38,204
Deferred revenue	78,606	52,344
Accrued liabilities	34,155	(18,470)
Other, net	(785)	16,576
Net Cash Provided from Operating Activities from Continuing Operations	79,345	94,592
Cash Flows from Investing Activities from Continuing Operations:		
Property additions	(38,832)	(48,362)
Sale of equipment and other assets	894	434
Other business acquisitions, net of cash acquired	(5,592)	(11,495)
Notes receivable, financial investments and securities, net	(17,959)	(14,613)
Notes receivable from affiliate	(10,250)	
Net Cash Used for Investing Activities from Continuing Operations	(71,739)	(74,036)
Cash Flows from Financing Activities from Continuing Operations:		
Borrowings of debt	855	600,000
Payments of debt	(27,484)	(633,045)
Discount paid on issuance of debt	(12,200)	
Debt issuance costs paid	(5,577)	(12,700)
Net Cash Used for Financing Activities from Continuing Operations	(44,406)	(45,745)

Cash Flows from Discontinued Operations:				
Cash used for operating activities		(911)		(238)
Cash used for investing activities:				
Proceeds from sale of businesses				(3,549)
Net Cash Used for Discontinued Operations		(911)		(3,787)
Cash Decrease During the Period		(37,711)		(28,976)
Cash and Cash Equivalents at End of Period	$	385,034	$	299,954

See accompanying Notes to the Condensed Consolidated Financial Statements

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THE SERVICEMASTER COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Basis of Presentation

The ServiceMaster Company (ServiceMaster, the Company, we, us or our) is a global company serving both residential and commercial customers. ServiceMaster s services include termite and pest control, lawn care, home warranties and preventative maintenance contracts, cleaning and disaster restoration, house cleaning, wood furniture repair and home inspection. ServiceMaster provides these services through a network of company-owned, franchised and licensed locations operating primarily under the following leading brands: Terminix, TruGreen, American Home Shield, ServiceMaster Clean, Merry Maids, Furniture Medic and AmeriSpec.

The condensed consolidated financial statements include the accounts of ServiceMaster and its majority-owned subsidiary partnerships, limited liability companies and corporations. All consolidated ServiceMaster subsidiaries are wholly owned. ServiceMaster is organized into five principal reportable segments: Terminix, TruGreen, American Home Shield, ServiceMaster Clean and Other Operations and Headquarters. Intercompany transactions and balances have been eliminated.

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 for the year ended December 31, 2012, as filed with the SEC (the 2012 Form 10-K). The condensed consolidated financial statements reflect all adjustments that 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. The results of operations for any interim period are not indicative of the results that might be achieved for a full year.

On July 24, 2007 (the Closing Date), ServiceMaster was acquired pursuant to a merger transaction (the Merger), and, immediately following the completion of the Merger, all of the outstanding common stock of ServiceMaster Global Holdings, Inc. (Holdings), the ultimate parent company of ServiceMaster, was owned by investment funds sponsored by, or affiliated with, Clayton, Dubilier & Rice, LLC (CD&R), Citigroup Private Equity LP (Citigroup), BAS Capital Funding Corporation (BAS) and JPMorgan Chase Funding Inc. (JPMorgan). On September 30, 2010, Citigroup transferred the management responsibility for certain investment funds that own shares of common stock of Holdings to StepStone Group LLC (StepStone) and its proprietary interests in such investment funds to Lexington Partners Advisors LP.

Note 2. Significant Accounting Policies

The Company s significant accounting policies are included in the 2012 Form 10-K. The following selected accounting policies should be read in conjunction with the 2012 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. 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 warranties, 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 warranties) 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 contracts and home warranties and adjusts the estimates when appropriate.

The Company has franchise agreements in its Terminix, TruGreen, ServiceMaster Clean, AmeriSpec, Furniture Medic and Merry Maids businesses. Franchise revenue (which in the aggregate represents approximately four percent of annual consolidated operating 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 generating activity is performed by the franchisee and collectability is reasonably assured. Franchise revenue also includes initial fees resulting from the sale of a franchise or license. These initial franchise or license fees are pre-established, fixed amounts 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 $20.6 million and $16.8 million for the three months ended June 30, 2013 and 2012, respectively, and $38.7 million and $33.6 million for the six months ended June 30, 2013 and 2012, respectively. Consolidated operating loss from

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continuing operations was $563.8 million for the three months ended June 30, 2013 compared to consolidated operating income from continuing operations of $96.8 million for the three months ended June 30, 2012. Consolidated operating loss from continuing operations was $543.7 million for the six months ended June 30, 2013 compared to consolidated operating income from continuing operations of $151.5 million for the six months ended June 30, 2012. 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 $562.6 million and $483.9 million of deferred revenue as of June 30, 2013 and December 31, 2012, respectively. Deferred revenue consists primarily of payments received for annual contracts relating to home warranties, 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. Deferred customer acquisition costs amounted to $56.9 million and $33.9 million as of June 30, 2013 and December 31, 2012, respectively.

TruGreen 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 defers these incremental selling expenses, pre-season advertising costs and annual repair and maintenance costs that are incurred primarily in the first quarter. These costs are deferred and recognized in proportion to the revenue generated 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 calendar year-end.

The cost of direct-response advertising at Terminix, 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 2012 Form 10-K presented the significant areas requiring the use of management 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 claims; accruals for home warranties 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.

Newly Issued Accounting Statements and Positions

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-02, Intangibles Goodwill and Other: Testing Indefinite-Lived Intangible Assets for Impairment, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment. This standard allows an entity testing an indefinite-lived intangible asset for impairment the option of performing a qualitative assessment before calculating the fair value of the asset. If entities determine, on the basis of the qualitative assessment, that the fair value of the indefinite-lived intangible asset is more likely than not greater than its carrying amount, the quantitative impairment test would not be required. Otherwise, further testing would be needed. This standard revises the examples of events and circumstances that an entity should consider in interim periods, but it does not revise the requirements to test indefinite-lived intangible assets (1) annually for impairment and (2) between annual tests if there is a change in events or circumstances. The amendments in this standard are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company adopted the required provisions of this standard during the first quarter of 2013. The adoption of this standard did not have a material impact on the Company s condensed consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amendments in this standard do not change

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the current requirements for reporting net income or other comprehensive income in financial statements and are effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted the required provisions of this standard during the first quarter of 2013. The disclosures required by this standard are presented in Note 7 of the Company s notes to condensed consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists to eliminate the diversity in practice associated with the presentation of unrecognized tax benefits in instances where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 generally requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except in certain circumstances. The amendments in ASU 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company is currently evaluating the effects that this guidance will have on its condensed consolidated financial statements.

Note 3. Restructuring Charges

The Company incurred restructuring charges of $0.3 million ($0.2 million, net of tax) and $5.0 million ($3.1 million, net of tax) for the three months ended June 30, 2013 and 2012, respectively, and $3.6 million ($2.2 million, net of tax) and $9.0 million ($5.5 million, net of tax) for the six months ended June 30, 2013 and 2012, respectively. Restructuring charges were comprised of the following:

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	**2013**	**2012**	**2013**	**2012**
Terminix branch optimization (1)	$ 12	$ 697	$ 962	$ 2,817
TruGreen reorganization and restructuring (2)	82	149	406	820
ServiceMaster Clean reorganization (3)	129	467	299	467
Centers of excellence initiative(4)	75	3,713	1,908	4,912
Total restructuring charges	$ 298	$ 5,026	$ 3,575	$ 9,016

(1) For the three months ended June 30, 2013, these charges included severance costs. For the six months ended June 30, 2013, these charges included severance costs of $0.1 million and lease termination costs of $0.9 million. For the three and six months ended June 30, 2012, these charges included lease termination costs.

(2) For the three and six months ended June 30, 2013 and the three months ended June 30, 2012, these charges included severance costs. For the six months ended June 30, 2012, these charges included severance costs of $0.3 million and lease termination costs of $0.5 million.

(3) For the three and six months ended June 30, 2013 and 2012, these charges included severance costs.

(4) Represents restructuring charges related to an initiative to enhance capabilities and reduce costs in the Company s headquarters functions that provide company-wide administrative services for our operations that we refer to as centers of excellence. For the three months ended June 30, 2013, these charges included severance and other costs. For the three months ended June 30, 2012, these charges included professional fees of $0.7 million and severance and other costs of $3.0 million. For the six months ended June 30, 2013 and 2012, these charges included professional fees of $1.5 million and $1.4 million, respectively, and severance and other costs of $0.4 million and $3.5 million, respectively.

The pretax charges discussed above are reported in Restructuring charges in the condensed consolidated statements of operations and comprehensive income (loss).

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

(In thousands)		**Accrued Restructuring Charges**
Balance as of December 31, 2012	$	4,542
Costs incurred		3,575
Costs paid or otherwise settled		(5,945)
Balance as of June 30, 2013	$	2,172

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Note 4. Commitments and Contingencies

A portion of the Company s vehicle fleet and some equipment are leased through month-to-month operating leases, cancelable at the Company s option. There are residual value guarantees by the Company (which approximated 84 percent of the estimated terminal value at the inception of the lease) 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. As of June 30, 2013, the Company s residual value guarantees related to the leased assets totaled $15.4 million for which the Company has recorded a liability for the estimated fair value of these guarantees of $0.2 million in the condensed consolidated statements of financial position.

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. 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.

A reconciliation of beginning and ending accrued self-insured claims, which are included in Accrued liabilities Self-insured claims and related expenses and Other long-term obligations, primarily self-insured claims on the condensed consolidated statements of financial position, net of reinsurance receivables, which are included in Prepaid expenses and other assets and Other assets on the condensed consolidated statements of financial position, is presented as follows:

(In thousands)		**Accrued Self-insured Claims, Net**
Balance as of December 31, 2012	$	103,825
Provision for self-insured claims		31,105
Cash payments		(24,415)
Balance as of June 30, 2013	$	110,515

(In thousands)		**Accrued Self-insured Claims, Net**
Balance as of December 31, 2011	$	108,082
Provision for self-insured claims		19,515
Cash payments		(18,921)
Balance as of June 30, 2012	$	108,676

Accruals for home warranty claims in the American Home Shield business are made based on the Company s claims experience and actuarial projections. Termite damage claim accruals in the Terminix business 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.

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 insured and uninsured matters that are brought on an individual, collective, representative and class action basis, or other proceedings involving regulatory, employment, general and commercial liability, automobile liability, wage and hour, environmental and other matters. The Company has entered into settlement agreements in certain cases, including with respect to putative collective and class actions, which are subject to court or other approvals. If one or more of the Company s settlements are not finally approved, the Company could have additional or different exposure, which could be material. At this time, the Company does not expect any of these proceedings to have a material effect on its reputation, business, financial position, results of operations or cash flows; however, the Company can give no assurance that the results of any such proceedings will not materially affect its reputation, business, financial position, results of operations and cash flows.

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Note 5. Goodwill and Intangible Assets

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. Based on the circumstances discussed below, interim impairment assessments for TruGreen s goodwill and indefinite-lived trade name were conducted for the quarter ended June 30, 2013. Based on the interim impairment assessment, the results of operations for the three and six months ended June 30, 2013 include a non-cash goodwill impairment charge of $417.5 million to reduce the carrying value of TruGreen s goodwill to its estimated fair value of zero as of June 30, 2013. As of the date of this filing, the second step of the goodwill impairment test has not been finalized due to the complexities involved in determining the implied fair value of goodwill. The amount recorded in the second quarter of 2013 is the Company s current estimate of the total goodwill impairment charge. A further adjustment, which may reflect a decrease to the estimate recorded in the second quarter of 2013, may be recorded in the third quarter of 2013 when the impairment analysis has been finalized. The results of operations for the three and six months ended June 30, 2013 also include a non-cash trade name impairment charge of $255.8 million to reduce the carrying value of the TruGreen trade name to its estimated fair value of $351.0 million as of June 30, 2013. The results of operations for the three and six months ended June 30, 2012 include a non-cash trade name impairment charge of $67.7 million to reduce the carrying value of the TruGreen trade name to its then estimated fair value.

Goodwill Impairment

Based on the revenue and operating results of TruGreen in the first six months of 2013 and the outlook for the remainder of 2013 and future years, the Company concluded there was an impairment indicator requiring an interim goodwill impairment assessment for TruGreen as of June 30, 2013. The Company estimated that the implied fair value of goodwill as of such date was less than the carrying value for TruGreen by $417.5 million, which was recorded as a non-cash goodwill impairment charge in the second quarter of 2013. As of June 30, 2013, there was no goodwill remaining at TruGreen.

Goodwill impairment is determined using a two-step process. The first step involves a comparison of the estimated fair value of a reporting unit to its carrying amount, including goodwill. In performing the first step, the Company typically determines the fair value of a reporting unit using a combination of a discounted cash flow (DCF) analysis, a market-based comparable approach and a market-based transaction approach. However, due to the significant decline in TruGreen s performance over the trailing 12 month period and the outlook for the remainder of 2013 and future years, the market-based comparable and market-based transaction approaches were determined to no longer provide a meaningful measure of fair value and were excluded from the interim impairment analysis performed in the second quarter of 2013. Determining fair value requires the exercise of significant judgment, including judgment about appropriate discount rates, terminal growth rates, and the amount and timing of expected future cash flows. The cash flows employed in the DCF analysis for TruGreen were based on the Company s most recent forecast for 2013 and the Company s projections for future years, which were based on estimated revenue growth rates and profit margins. The discount rate used in the DCF analysis was intended to reflect the risks inherent in the future cash flows of TruGreen. If the estimated fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not impaired, and the second step of the impairment test is not necessary. If the carrying amount of a reporting unit exceeds its estimated fair value based on the first step analysis, as was the case in TruGreen s second quarter 2013 interim test, then the second step of the goodwill impairment test must be performed. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with its goodwill carrying amount to measure the amount of impairment, if any. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. In other words, the estimated fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment is recognized in an amount equal to that excess. As noted above, the second step of the goodwill impairment test is not complete for TruGreen. The second step analysis is more complex and requires more data and analysis than the first step and as a result consumes more time. The Company has recorded its current estimate of TruGreen s goodwill impairment charge based on information available as of the date of this filing and will finalize the amount of this charge in the third quarter of 2013.

The goodwill impairment charge recorded in the second quarter of 2013 was primarily attributable to a decline in forecasted 2013 and future cash flows at TruGreen over a defined projection period as of June 30, 2013 compared to the projections used in the last annual impairment assessment performed on October 1, 2012. The changes in projected cash flows at TruGreen arose in part from the business challenges at TruGreen described in Segment Review TruGreen Segment in Management s Discussion and Analysis below. Although the Company projected future improvement in cash flows at TruGreen as a part of its June 30, 2013 impairment analysis, total cash flows and projected growth in those cash flows were lower than those projected at the time TruGreen was last tested for impairment in October 2012. The long-term growth rates used in the impairment tests at June 30, 2013 and October 1, 2012 were the same and were in line with historical U.S. gross domestic product growth rates. The discount rate used in the June 30, 2013 impairment test was 100 basis points (bps) lower than the discount rate used in the October 1, 2012 impairment test for TruGreen.

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The decrease in the discount rate is primarily attributable to changes in market conditions which indicated an improved outlook for the U.S. financial markets and a higher risk tolerance for investors since the last analysis in 2012.

Trade Name Impairment

Based on the revenue results at TruGreen in the first six months of 2013 and a lower revenue outlook for the remainder of 2013 and future years, the Company concluded that there was an impairment indicator requiring the performance of an interim indefinite-lived intangible asset impairment test for the TruGreen trade name as of June 30, 2013.

The impairment test for intangible assets not subject to amortization (other than goodwill) involves a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its estimated fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using a DCF valuation analysis. The DCF methodology used to value trade names is known as the relief from royalty method and entails identifying the hypothetical cash flows generated by an assumed royalty rate that a third party would pay to license the trade names and discounting them back to the valuation date. Significant judgments inherent in this analysis include the selection of appropriate discount rates and hypothetical royalty rates, estimating the amount and timing of future revenue attributable to the trade names over a defined projection period and identification of appropriate long-term revenue growth rate assumptions after the defined projection period. The discount rates used in the DCF analyses are intended to reflect the risk inherent in the projected future cash flows generated by the respective intangible assets.

As a result of the aforementioned impairment indicators, the Company performed an impairment analysis on its indefinite-lived intangible asset related to TruGreen s trade name to determine the fair value as of June 30, 2013. Based on the lower projected revenue for TruGreen as discussed above, the Company determined the estimated fair value attributable to the TruGreen trade name was less than its carrying value by $255.8 million, which was recorded as a trade name impairment in the second quarter of 2013.

The impairment charge in the second quarter of 2013 was primarily attributable to a decrease in the assumed royalty rate and a decrease in projected future growth in revenue at TruGreen over a defined projection period as of June 30, 2013 compared to the royalty rate and projections used in the last annual impairment assessment performed on October 1, 2012. The decrease in the assumed royalty rate was due to lower current and projected earnings as a percent of revenue as compared to the last annual impairment test. Although the Company projected future growth in revenue at TruGreen as part of its June 30, 2013 impairment analysis, total projected revenue was lower than the revenue projected at the time the trade name was last tested for impairment in October 2012. The long-term revenue growth rates used in the impairment tests at June 30, 2013 and October 1, 2012 were the same and were in line with historical U.S. gross domestic product growth rates. The discount rate used in the June 30, 2013 impairment test was 100 bps lower than the discount rate used in the October 1, 2012 impairment test for the TruGreen trade name. The decrease in the discount rate is primarily attributable to changes in market conditions which indicated an improved outlook for the U.S. financial markets and a higher risk tolerance for investors since the last analysis. Had the Company used a discount rate in assessing the impairment of its TruGreen trade name that was 100 bps higher (holding all other assumptions unchanged), the Company would have recorded an additional impairment charge of approximately $57.4 million in the second quarter of 2013.

As a result of the trade name impairment recorded in the second quarter of 2013, the carrying value of the TruGreen trade name was adjusted to its estimated fair value as of June 30, 2013. Any further decline in the estimated fair value of this trade name will result in additional trade name impairment. It is possible that such impairment, if required, could be material and may need to be recorded prior to the fourth quarter of 2013 (i.e., during the third quarter) if the Company s results of operations or other factors require such assets to be tested for impairment at an interim date.

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

(In thousands)	Terminix	TruGreen	American Home Shield	ServiceMaster Clean	Other Operations & Headquarters	Total
Balance as of December 31, 2012	$ 1,458,490	$ 417,069	$ 347,480	$ 135,769	$ 53,443	$ 2,412,251
Impairment charge		(417,453)				(417,453)
Acquisitions	3,323	681			713	4,717
Other(1)	(44)	(297)	(5)	(364)	(119)	(829)
Balance as of June 30, 2013	$ 1,461,769	$	$ 347,475	$ 135,405	$ 54,037	$ 1,998,686

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

Accumulated impairment losses as of June 30, 2013 and December 31, 2012 were $1.208 billion and $790.2 million, respectively, and related entirely to the TruGreen reporting unit.

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

(In thousands)	As of June 30, 2013 Gross	Accumulated Amortization	Net	As of December 31, 2012 Gross	Accumulated Amortization	Net
Trade names(1)	$ 1,959,000	$	$ 1,959,000	$ 2,214,800	$	$ 2,214,800
Customer relationships	698,581	(614,768)	83,813	697,264	(592,724)	104,540
Franchise agreements	88,000	(51,380)	36,620	88,000	(48,649)	39,351
Other	61,433	(47,775)	13,658	59,117	(44,339)	14,778
Total	$ 2,807,014	$ (713,923)	$ 2,093,091	$ 3,059,181	$ (685,712)	$ 2,373,469

(1) Not subject to amortization. Includes a non-cash impairment charge of $255.8 million recorded in the six months ended June 30, 2013 to reduce the carrying value of the TruGreen trade name as a result of the Company s interim impairment testing of indefinite-lived intangible assets.

Note 6. Stock-Based Compensation

For the three months ended June 30, 2013 and 2012, the Company recognized stock-based compensation expense of $0.2 million ($0.1 million, net of tax) and $1.8 million ($1.1 million, net of tax), respectively. For the six months ended June 30, 2013 and 2012, the Company recognized stock-based compensation expense of $1.5 million ($0.9 million, net of tax) and $3.5 million ($2.1 million, net of tax), respectively. As of June 30, 2013, there was $8.3 million of total unrecognized compensation costs related to non-vested stock options and restricted share units granted by Holdings under the Amended and Restated ServiceMaster Global Holdings, Inc. Stock Incentive Plan (the MSIP). These remaining costs are expected to be recognized over a weighted-average period of 2.4 years.

Note 7. Comprehensive Income

Comprehensive income (loss), which primarily includes net income (loss), unrealized gain (loss) on marketable securities, unrealized gain (loss) on derivative instruments and the effect of foreign currency translation is disclosed in the condensed consolidated statements of operations and comprehensive income (loss).

The following tables summarize the activity in other comprehensive income (loss), net of the related tax effects.

(In thousands)	Six months ended June 30, 2013 Unrealized Losses on Derivatives	Unrealized Gains on Available-for-Sale Securities	Foreign Currency Translation	Total
Beginning accumulated other comprehensive (loss) income	$ (2,029)	$ 5,295	$ 3,300	$ 6,566

Other comprehensive (loss) income before reclassifications	(182)	982	(2,808)	(2,008)
Amounts reclassified from accumulated other comprehensive income (loss)	1,696	(654)		1,042
Net current-period other comprehensive income (loss)	1,514	328	(2,808)	(966)
Ending accumulated other comprehensive (loss) income	$ (515)	$ 5,623	$ 492	$ 5,600

	Six months ended June 30, 2012			
(In thousands)	**Unrealized Losses on Derivatives**	**Unrealized Gains on Available-for-Sale Securities**	**Foreign Currency Translation**	**Total**
Beginning accumulated other comprehensive (loss) income	$ (14,268)	$ 4,330	$ 3,726	$ (6,212)
Other comprehensive (loss) income before reclassifications	(2,593)	1,456	(240)	(1,377)
Amounts reclassified from accumulated other comprehensive income (loss)	8,632	(561)		8,071
Net current-period other comprehensive income (loss)	6,039	895	(240)	6,694
Ending accumulated other comprehensive (loss) income	$ (8,229)	$ 5,225	$ 3,486	$ 482

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Reclassifications out of accumulated other comprehensive income included the following components for the periods indicated.

(In thousands)	Amount Reclassified from Accumulated Other Comprehensive Income As of June 30, 2013	As of June 30, 2012	Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) Location
(Gains) losses on derivatives:			
Fuel swap contracts	$ (1,082)	$ (1,134)	Cost of services rendered and products sold
Interest rate swap contracts	3,797	14,665	Interest expense
Net losses on derivatives	2,715	13,531	
Impact of income taxes	1,019	4,899	Provision (Benefit) for income taxes
Total reclassifications related to derivatives	$ 1,696	$ 8,632	
Gains on available-for-sale securities	$ (1,072)	$ (890)	Interest and net investment income
Impact of income taxes	(418)	(329)	Provision (Benefit) for income taxes
Total reclassifications related to securities	$ (654)	$ (561)	
Total reclassifications for the period	$ 1,042	$ 8,071	

Note 8. Supplemental Cash Flow Information

Supplemental information relating to the condensed consolidated statements of cash flows is presented in the following table:

(In thousands)	Six months ended June 30, 2013	2012
Cash paid for or (received from):		
Interest expense	$ 117,119	$ 125,607
Interest and dividend income	(2,289)	(2,575)
Income taxes, net of refunds	11,027	6,766

The Company acquired $31.8 million and $27.7 million of property and equipment through capital leases and other non-cash financing transactions in the six months ended June 30, 2013 and 2012, respectively, which have been excluded from the condensed consolidated statements of cash flows as non-cash investing and financing activities.

Note 9. Receivable Sales

The Company has an accounts receivable securitization arrangement under which Terminix and TruGreen 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 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. As of June 30, 2013, the amount of eligible receivables was approximately $46.4 million.

During the six months ended June 30, 2013, there were no transfers of interests in the pool of trade accounts receivables to Purchasers under this arrangement. As of June 30, 2013 and December 31, 2012, the Company had $10.0 million outstanding under the arrangement and, as of June 30, 2013, had $36.4 million of remaining capacity available under the accounts receivable securitization arrangement.

The accounts receivable securitization arrangement is a 364-day facility scheduled to mature on October 23, 2013. The Company has recorded its obligation to repay the Purchasers for their interest in the pool of receivables within the current portion of long-term debt on the condensed consolidated statements of financial position. The interest rates applicable to the Company s obligation are based on a fluctuating rate of interest based on the Purchasers pooled commercial paper rate (0.19 percent as of June 30, 2013). In addition, the Company pays usage fees on its obligations and commitment fees on undrawn amounts committed by the Purchasers. Unless the arrangement is renegotiated or extended prior to its expiration, all obligations under the accounts receivable securitization arrangement must be repaid by October 23, 2013.

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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 Cash and cash equivalents on the condensed consolidated statements of financial position. As of June 30, 2013 and December 31, 2012, the Company s investments consisted primarily of domestic publicly traded debt and certificates of deposit (Debt securities) and common equity securities (Equity securities). The amortized cost, fair value and gross unrealized gains and losses of the Company s short- and long-term investments in Debt and Equity securities as of June 30, 2013 and December 31, 2012 were as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale and trading securities, June 30, 2013:				
Debt securities	$ 112,259	$ 3,811	$ (807)	$ 115,263
Equity securities	38,643	6,514	(459)	44,698
Total securities	$ 150,902	$ 10,325	$ (1,266)	$ 159,961

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale and trading securities, December, 31, 2012:				
Debt securities	$ 99,071	$ 5,773	$ (20)	$ 104,824
Equity securities	38,786	3,809	(1,616)	40,979
Total securities	$ 137,857	$ 9,582	$ (1,636)	$ 145,803

The portion of unrealized losses which had been in a loss position for more than one year was $0.4 million and $1.5 million as of June 30, 2013 and December 31, 2012, respectively. The aggregate fair value of the investments with unrealized losses was $37.5 million and $13.1 million as of June 30, 2013 and December 31, 2012, respectively.

As of June 30, 2013 and December 31, 2012, $277.5 million and $243.7 million, respectively, of the cash and short- and long-term marketable securities balance were associated with regulatory requirements at American Home Shield and for other purposes. Such amounts, although not necessarily subject to third-party restrictions, are identified as being potentially unavailable to be paid to the Company by its subsidiaries. There are third-party restrictions on the ability of certain of the Company s subsidiaries to transfer funds to the Company. These restrictions are related to regulatory requirements at American Home Shield and to a subsidiary borrowing arrangement at The ServiceMaster Acceptance Company Limited Partnership (SMAC). As of June 30, 2013, the total net assets subject to these third-party restrictions was $162.7 million. 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 proceeds, gross realized gains and gross realized losses, each resulting from sales of available-for-sale securities. There were no impairment charges due to other than temporary declines in the value of certain investments for the three and six months ended June 30, 2013 and 2012.

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	**2013**	**2012**	**2013**	**2012**
Proceeds from sale of securities	$ 2,332	$ 5,251	$ 5,844	$ 7,730
Gross realized gains, pre-tax	341	493	842	879
Gross realized gains, net of tax	207	304	513	542
Gross realized losses, pre-tax		(20)		(20)
Gross realized losses, net of tax		(12)		(12)

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Note 11. Long-Term Debt

Long-term debt as of June 30, 2013 and December 31, 2012 is summarized in the following table:

(In thousands)	As of June 30, 2013	As of December 31, 2012
Senior secured term loan facility maturing in 2014 (Tranche A)	$	$ 1,219,145
Senior secured term loan facility maturing in 2017 (Tranche B)	995,705	1,000,741
Senior secured term loan facility maturing in 2017 (Tranche C) (1)	1,202,738	
7.00% senior notes maturing in 2020	750,000	750,000
8.00% senior notes maturing in 2020(2)	602,601	602,750
Revolving credit facility maturing in 2017		
7.10% notes maturing in 2018(3)	70,363	69,400
7.45% notes maturing in 2027(3)	157,229	155,894
7.25% notes maturing in 2038(3)	62,654	62,250
Vehicle capital leases(4)	62,600	37,837
Other	58,961	63,236
Less current portion	(57,227)	(52,214)
Total long-term debt	$ 3,905,624	$ 3,909,039

(1) Presented net of unamortized portion of $12.2 million original issue discount paid as part of the 2013 amendment (the 2013 Term Loan Facility Amendment) to the senior secured term loan facility (the Term Loan Facility).

(2) Includes unamortized portion of $3.0 million premium received on the sale of $100.0 million aggregate principal amount of such notes.

(3) The increase in the balance from December 31, 2012 to June 30, 2013 reflects the amortization of fair value adjustments related to purchase accounting, which increases the effective interest rate from the coupon rates shown above.

(4) The Company has entered into a fleet management services agreement (the Fleet Agreement) which, among other things, allows the Company to obtain fleet vehicles through a leasing program. All leases under the Fleet Agreement are capital leases for accounting purposes. The lease rental payments include an interest component calculated using a variable rate based on one-month LIBOR plus other contractual adjustments and a borrowing margin totaling 2.45 percent.

Interest rate swap agreements in effect as of June 30, 2013 are as follows:

Trade Date	Effective Date	Expiration Date	Notional Amount	Fixed Rate(1)	Floating Rate
June 10, 2010	September 1, 2011	September 1, 2013	50,000	2.25%	One month LIBOR
June 15, 2010	September 1, 2011	September 1, 2013	150,000	2.21%	One month LIBOR
August 18, 2011	September 1, 2011	August 1, 2013	530,000	1.51%	One month LIBOR

(1) Before the application of the applicable borrowing margin.

On February 22, 2013, the Company entered into the 2013 Term Loan Facility Amendment to amend the credit agreement governing the Term Loan Facility (the Credit Agreement) primarily to extend the maturity date of a portion of the borrowings under the Term Loan Facility. Pursuant to the 2013 Term Loan Facility Amendment, the maturity of the outstanding Tranche A loans was extended, and such loans were converted into a new tranche of term loans in an aggregate principal amount, along with new loans extended by certain new lenders, of $1.220 billion (the Tranche C loans). The maturity date for the new Tranche C loans is January 31, 2017. The interest rates applicable to the Tranche C loans under the Term Loan Facility are based on a fluctuating rate of interest measured by reference to either, at the Company s option, (i) an adjusted London inter-bank offered rate (adjusted for maximum reserves) plus 3.25 percent, with a minimum adjusted London inter-bank offered rate of 1.00 percent or (ii) an alternate base rate plus 2.25 percent, with a minimum alternate base rate of 2.00 percent. As part of the 2013 Term Loan Facility Amendment, the Company paid an original issue discount equal to 1.00 percent of the outstanding borrowings, or $12.2 million. Voluntary prepayments of borrowings under the Tranche C Loans are permitted at any time, in minimum principal amounts, without premium or penalty, except for a 1.00 percent premium payable in connection with certain repricing transactions within the first year. As a result of the amendment entered into in August 2012 (the 2012 Term Loan Facility Amendment) and the 2013 Term Loan Facility Amendment, the Company has, as of June 30, 2013, approximately $2.198 billion of outstanding borrowings maturing January 31, 2017, after including the unamortized portion of the original issue discount paid.

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Note 12. Discontinued Operations

Loss from discontinued operations, net of income taxes, for all periods presented includes the operating results of the previously sold businesses noted in the 2012 Form 10-K.

The operating results of discontinued operations were as follows:

(In thousands)	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Operating loss	$ (377)	$ (277)	$ (646)	$ (608)
Benefit for income taxes	(146)	(106)	(250)	(235)
Operating loss, net of income taxes	(231)	(171)	(396)	(373)
Gain on sale, net of income taxes		1,009		287
(Loss) income from discontinued operations, net of income taxes	$ (231)	$ 838	$ (396)	$ (86)

The table below summarizes the activity for the six months ended June 30, 2013 for the remaining liabilities of previously sold businesses. The remaining obligations primarily relate to self-insurance claims and related costs. The Company believes that the remaining reserves continue to be adequate and reasonable.

(In thousands)	As of December 31, 2012	Cash Payments or Other	Expense (Income)	As of June 30, 2013
Remaining liabilities of discontinued operations:				
TruGreen LandCare	$ 415	$ (514)	$ 353	$ 254
InStar	352	(70)	(8)	274
Other	138	(77)	51	112
Total liabilities of discontinued operations	$ 905	$ (661)	$ 396	$ 640

Note 13. Income Taxes

As of June 30, 2013 and December 31, 2012, the Company had $8.5 million and $8.3 million, respectively, of tax benefits primarily reflected in state tax returns that have 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 $0.7 million during the next 12 months.

As required by Accounting Standard Codification (ASC) 740 Income Taxes, the Company computes 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. The Company s estimated tax rate is adjusted each quarter in accordance with ASC 740.

The effective tax rate on (loss) income from continuing operations was 18.5 percent for the three months ended June 30, 2013 compared to 41.9 percent for the three months ended June 30, 2012. The change in the effective tax rate was primarily attributable to the impairment of permanently nondeductible goodwill in the amount of $279.7 million. The effective tax rate on (loss) income from discontinued operations was 38.7 percent for the three months ended June 30, 2013 compared to 38.3 percent for the three months ended June 30, 2012.

The effective tax rate on loss from continuing operations was 19.7 percent for the six months ended June 30, 2013 compared to 19.4 percent for the six months ended June 30, 2012. The effective tax rate for the six months ended June 30, 2013 was affected by the impairment of permanently nondeductible goodwill. The effective tax rate for the six months ended June 30, 2012 was affected by the impairment of the TruGreen trade name and the resulting impact on the allocation of the full year effective tax rate on income from continuing operations to interim periods. The effective tax rate on (loss) income from discontinued operations was 38.7 percent for each of the six month periods ended June 30, 2013 and 2012.

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Note 14. Business Segment Reporting

The business of the Company is conducted through five reportable segments: Terminix, TruGreen, 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 Terminix segment provides termite and pest control services to residential and commercial customers and distributes pest control products. The TruGreen segment provides residential and commercial lawn, tree and shrub care services. The American Home Shield segment provides home warranties and preventative maintenance contracts for household systems and appliances. The ServiceMaster Clean segment provides residential and commercial disaster restoration, janitorial and cleaning services through franchises primarily under the ServiceMaster, ServiceMaster Restore and ServiceMaster Clean brand names, on-site wood 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 provide home cleaning services. The Other Operations and Headquarters segment also includes 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. The composition of our reportable segments is consistent with that used by our chief operating decision maker to evaluate performance and allocate resources.

Information regarding the accounting policies used by the Company is described in Note 2. The Company derives substantially all of its revenue from customers and franchises in the United States with less than two percent generated in foreign markets. Operating expenses of the business units consist primarily of direct costs.

Segment information for continuing operations is presented below:

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	**2013**	**2012**	**2013**	**2012**
Operating Revenue:				
Terminix	$ 364,920	$ 347,245	$ 678,328	$ 658,664
TruGreen	307,646	351,372	401,647	482,483
American Home Shield	206,025	208,394	349,340	367,439
ServiceMaster Clean	36,296	32,409	71,710	64,354
Other Operations and Headquarters	23,775	22,745	45,744	43,914
Total Operating Revenue	$ 938,662	$ 962,165	$ 1,546,769	$ 1,616,854
Operating Income (Loss):(1),(2),(3)				
Terminix	$ 80,077	$ 68,438	$ 148,776	$ 137,508
TruGreen	(663,457)	8,791	(712,899)	(5,531)
American Home Shield	43,858	40,556	67,418	68,384
ServiceMaster Clean	15,486	10,537	29,500	22,813
Other Operations and Headquarters	(39,797)	(31,568)	(76,491)	(71,668)
Total Operating (Loss) Income	$ (563,833)	$ 96,754	$ (543,696)	$ 151,506

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

(In thousands)	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Total Segment Operating (Loss) Income	$ (563,833)	$ 96,754	$ (543,696)	$ 151,506
Non-operating Expense (Income):				
Interest expense	63,463	59,700	123,698	124,514
Interest and net investment income	(1,749)	(1,396)	(4,168)	(4,038)
Loss on extinguishment of debt				39,193
Other expense	141	177	287	351
(Loss) Income from Continuing Operations before Income Taxes	$ (625,688)	$ 38,273	$ (663,513)	$ (8,514)

(2) As described in Note 5, includes, as a result of the Company s impairment testing of goodwill and indefinite-lived intangible assets, pre-tax non-cash impairment charges of $673.3 million recorded in the three months ended June 2013 to reduce the

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carrying value of TruGreen s goodwill and trade name and $67.7 million recorded in the three months ended June 30, 2012 to reduce the carrying value of the TruGreen trade name.

(3) Includes restructuring charges primarily related to a branch optimization project at Terminix, a reorganization of field leadership and a restructuring of branch operations at TruGreen, a reorganization of leadership at ServiceMaster Clean and an initiative to enhance capabilities and reduce costs in our centers of excellence at Other Operations and Headquarters. Presented below is a summary of restructuring charges by segment:

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	**2013**	**2012**	**2013**	**2012**
Restructuring charges:				
Terminix	$ 12	$ 697	$ 962	$ 2,817
TruGreen	82	149	406	820
ServiceMaster Clean	129	467	299	467
Other Operations and Headquarters	75	3,713	1,908	4,912
Total restructuring charges	$ 298	$ 5,026	$ 3,575	$ 9,016

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. The annual management fee payable under the consulting agreement with CD&R is $6.25 million. Under this agreement, the Company recorded management fees of $1.6 million and $3.1 million in each of the three and six month periods ended June 30, 2013 and 2012, respectively, which is included in Selling and administrative expenses in the condensed consolidated statements of operations and comprehensive income (loss). The consulting agreement also provides that CD&R may receive additional fees in connection with certain subsequent financing and acquisition or disposition transactions. There were no additional fees incurred in each of the three and six month periods ended June 30, 2013 and 2012. The consulting agreement will terminate on July 24, 2017, unless terminated earlier at CD&R s election.

In addition, in August 2009, the Company entered into consulting agreements with Citigroup, BAS and JPMorgan. Under the consulting agreements, Citigroup, BAS and JPMorgan each provide the Company with on-going consulting and management advisory services through June 30, 2016 or the earlier termination of the existing consulting agreement between the Company and CD&R. On September 30, 2010, Citigroup transferred the management responsibility for certain investment funds that own shares of common stock of Holdings to StepStone and Lexington Partners Advisors LP. Citigroup also assigned its obligations and rights under its consulting agreement to StepStone, and beginning in the fourth quarter of 2010, the consulting fee otherwise payable to Citigroup became payable to StepStone. As of December 22, 2011, Holdings purchased from BAS 7.5 million shares of capital stock of Holdings, and, effective January 1, 2012, the annual consulting fee payable to BAS was reduced to $0.25 million. The Company pays annual consulting fees of $0.5 million, $0.25 million and $0.25 million to StepStone, BAS and JPMorgan, respectively. The Company recorded aggregate consulting fees related to these agreements of $0.25 million and $0.5 million in each of the three and six month periods ended June 30, 2013 and 2012, respectively, which is included in Selling and administrative expenses in the condensed consolidated statements of operations and comprehensive income (loss).

On April 19, 2013, the Company entered into a revolving promissory note with Holdings with a maximum borrowing capacity of $25.0 million that is scheduled to mature on April 18, 2018. Amounts outstanding under this agreement shall bear interest at the rate of 5.0 percent per annum.

As of June 30, 2013, Holdings had borrowed $10.3 million under this note.

Note 16. Fair Value Measurements

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 period-end market rates. The period-end carrying amounts of short- and long-term marketable securities also approximate fair value, with unrealized gains and losses reported net of tax as a component of accumulated other comprehensive loss on the condensed consolidated statements of financial position, or, for certain unrealized losses, reported in interest and net investment income in the condensed consolidated statements of operations and comprehensive income (loss) if the decline in value is other than temporary. The carrying amount of total debt was $3.963 billion and $3.961 billion and the estimated fair value was $3.911 billion and $4.018 billion as of June 30, 2013 and December 31, 2012, respectively. The fair value of the Company s debt is estimated based on available market prices for the same or similar instruments which are considered significant other observable inputs (Level 2) within the fair value hierarchy. The fair values presented reflect the amounts that would

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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 June 30, 2013 and December 31, 2012.

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.

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. The Company regularly reviews the forward price curves obtained from third-party market data providers and related changes in fair value for reasonableness utilizing information available to the Company from other published sources.

The Company has not changed its valuation techniques for measuring the fair value of any financial assets and liabilities during the year. Transfers between levels, if any, are recognized at the end of the reporting period. There were no significant transfers between levels during each of the six month periods ended June 30, 2013 and 2012.

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

		As of June 30, 2013			
			Estimated Fair Value Measurements		
(In thousands)	**Statement of Financial Position Location**	**Carrying Value**	**Quoted Prices In Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Financial Assets:					
Deferred compensation trust assets	Long-term marketable securities	$ 11,424	$ 11,424	$	$
Investments in marketable securities	Marketable securities and Long-term marketable securities	148,537	60,714	87,823	
Fuel swap contracts:					
Current	Prepaid expenses and other assets	722			722

Noncurrent	Other assets		44						44
Total financial assets		$	160,727	$	72,138	$	87,823	$	766
Financial Liabilities:									
Fuel swap contracts:									
Current	Other accrued liabilities	$	449	$		$		$	449
Noncurrent	Other long-term obligations, primarily self-insured claims		373						373
Interest rate swap contracts	Other accrued liabilities		1,317				1,317		
Total financial liabilities		$	2,139	$		$	1,317	$	822

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			As of December 31, 2012 Estimated Fair Value Measurements		
(In thousands)	**Statement of Financial Position Location**	**Carrying Value**	**Quoted Prices In Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Financial Assets:					
Deferred compensation trust assets	Long-term marketable securities	$ 11,987	$ 11,987	$	$
Investments in marketable securities	Marketable securities and Long-term marketable securities	133,816	45,152	88,664	
Fuel swap contracts:					
Current	Prepaid expenses and other assets	1,957			1,957
Total financial assets		$ 147,760	$ 57,139	$ 88,664	$ 1,957
Financial Liabilities:					
Fuel swap contracts:					
Current	Other accrued liabilities	$ 113	$	$	$ 113
Interest rate swap contracts	Other accrued liabilities	7,349		7,349	
Total financial liabilities		$ 7,462	$	$ 7,349	$ 113

The carrying amount and estimated fair value of the Company s assets that were recorded at fair value on a nonrecurring basis as of June 30, 2013 are as follows:

			As of June 30, 2013 Estimated Fair Value Measurements		
(In thousands)	**Statement of Financial Position Location**	**Carrying Value**	**Quoted Prices In Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
TruGreen Trade Name(1)	Intangible assets, primarily trade names, service marks and trademarks, net	$ 351,000	$	$	$ 351,000
TruGreen Goodwill(2)	Goodwill				

(1) In the second quarter of 2013, we recognized a non-cash impairment charge of $255.8 million to reduce the carrying value of the TruGreen trade name to its fair value of $351.0 million as a result of our interim impairment testing of indefinite-lived intangible assets. See Note 5 for further information regarding the factors that led to the completion of the interim impairment analysis along with a description of the methodology, assumptions and significant unobservable inputs used to estimate the fair value of the TruGreen trade name.

(2) In the second quarter of 2013, we recognized a non-cash impairment charge of $417.5 million to reduce the carrying value of TruGreen s goodwill to its implied fair value of zero as a result of our interim goodwill impairment testing. See Note 5 for further information regarding the factors that led to the initiation of the interim impairment analysis along with a description of the methodology, assumptions and significant unobservable inputs used to estimate the fair value of TruGreen s goodwill. As of the date of this filing, the second step of the goodwill impairment test has not been finalized due to the complexities involved in determining the implied fair value of goodwill. The amount recorded in the second quarter of 2013 is the Company s current estimate of the total goodwill impairment charge. A further adjustment, which may reflect a decrease to the estimate recorded in the second quarter of 2013, may be recorded in the third quarter of 2013 when the impairment analysis has

been finalized.

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

(In thousands)		**Fuel Swap Contract Assets (Liabilities)**
Balance as of December 31, 2012	$	1,844
Total gains (realized and unrealized)		
Included in earnings		1,082
Included in accumulated other comprehensive income		(1,900)
Settlements, net		(1,082)
Balance as of June 30, 2013	$	(56)

(In thousands)		**Fuel Swap Contract (Liabilities) Assets**
Balance as of December 31, 2011	$	(733)
Total gains (realized and unrealized)		
Included in earnings		1,134
Included in accumulated other comprehensive income		(1,244)
Settlements, net		(1,134)
Balance as of June 30, 2012	$	(1,977)

The following tables present information relating to the significant unobservable inputs of our Level 3 financial instruments as of June 30, 2013 and December 31, 2012:

Item		**Fair Value as of June 30, 2013 (in thousands)**	**Valuation Technique**	**Unobservable Input**	**Range**		**Weighted Average**
Fuel swap contracts	$	(56)	Discounted Cash Flows	Forward Unleaded Price per Gallon(1)	$3.26-$3.63	$	3.46
				Forward Diesel Price per Gallon(1)	$3.75-$3.86	$	3.82

Item		**Fair Value as of December 31, 2012 (in thousands)**	**Valuation Technique**	**Unobservable Input**	**Range**		**Weighted Average**
Fuel swap contracts	$	1,844	Discounted Cash Flows	Forward Unleaded Price per Gallon(1)	$3.36-$3.73	$	3.55
				Forward Diesel Price per Gallon(1)	$3.88-$3.96	$	3.90

(1) Forward price per gallon for unleaded and diesel were derived from third-party market data providers. A decrease in the forward price would result in a decrease in the fair value of the fuel swap contracts.

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.

The Company has historically hedged a significant portion of its annual fuel consumption of approximately 20 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. 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 statements 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 accumulated 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

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operating activities in the condensed consolidated statements of cash flows, other than cash flows related to one amended interest rate swap contract which are classified as financing activities.

The effect of derivative instruments on the condensed consolidated statements of operations and comprehensive income (loss) and accumulated other comprehensive income on the condensed consolidated statements of financial position is presented as follows:

(In thousands)

Derivatives designated as Cash Flow Hedge Relationships	Effective Portion of (Loss) Gain Recognized in Accumulated Other Comprehensive Income		Effective Portion of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Earnings		Location of Gain (Loss) included in Earnings
	Six months ended June 30, 2013				
Fuel swap contracts	$	(1,900)	$	1,082	Cost of services rendered and products sold
Interest rate swap contracts	$	3,698	$	(3,797)	Interest expense

Derivatives designated as Cash Flow Hedge Relationships	Effective Portion of (Loss) Gain Recognized in Accumulated Other Comprehensive Income		Effective Portion of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Earnings		Location of Gain (Loss) included in Earnings
	Six months ended June 30, 2012				
Fuel swap contracts	$	(1,244)	$	1,134	Cost of services rendered and products sold
Interest rate swap contracts	$	11,011	$	(14,665)	Interest expense

Ineffective portions of derivative instruments designated in accordance with accounting standards as cash flow hedge relationships were insignificant during the six months ended June 30, 2013. As of June 30, 2013, the Company had fuel swap contracts to pay fixed prices for fuel with an aggregate notional amount of $48.7 million, maturing through 2014. 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 June 30, 2013, the Company had posted $2.5 million in letters of credit as collateral under its fuel hedging program, none of which were posted under the Company s senior secured revolving credit facility (the Revolving Credit Facility). As of June 30, 2013, the Company had interest rate swap contracts to pay fixed rates for interest on long-term debt with an aggregate notional amount of $730.0 million, 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 accumulated 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 swap contracts. 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 $0.6 million, net of tax, as of June 30, 2013. 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.

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Note 17. 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 $600 million aggregate principal amount of 8 percent senior notes due 2020 (the 8% 2020 Notes) and $750 million aggregate principal amount of 7 percent senior notes due 2020 (the 7% 2020 Notes , and together with the 8% 2020 Notes, the 2020 Notes) are jointly and severally guaranteed on a senior unsecured basis by the Company s domestic subsidiaries that guarantee our indebtedness under the Term Loan Facility, the pre-funded letter of credit facility (together, the Term Facilities) and the Revolving Credit Facility (together with the Term Facilities, the Credit Facilities) (the Guarantors). Each of the Guarantors is wholly owned, directly or indirectly, by the Company, and all guarantees are full and unconditional. Our non-U.S. subsidiaries, our subsidiaries subject to regulation as an insurance, home warranty, service contract or similar company, or certain other subsidiaries (the Non-Guarantors) do not guarantee the 2020 Notes. A Guarantor will be released from its obligations under its guarantee under certain customary circumstances, including, (i) the sale or disposition of the Guarantor, (ii) the release of the Guarantor from all of its obligations under all guarantees related to any indebtedness of the Company, (iii) the merger or consolidation of the Guarantor as specified in the indenture governing the 2020 Notes, (iv) the Guarantor becomes an unrestricted subsidiary under the indenture governing the 2020 Notes, (v) the defeasance of the Company s obligations under the indenture governing the 2020 Notes or (vi) the payment in full of the principal amount of the 2020 Notes.

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THE SERVICEMASTER COMPANY AND SUBSIDIARIES

Condensed Consolidating Statement of Operations and Comprehensive Loss

For the Three Months Ended June 30, 2013 (Unaudited)

(In thousands)

	The ServiceMaster Company	Guarantors	Non-Guarantors	Eliminations	Consolidated
Operating Revenue	$	$ 712,043	$ 243,568	$ (16,949)	$ 938,662
Operating Costs and Expenses:					
Cost of services rendered and products sold		449,835	118,188	(16,715)	551,308
Selling and administrative expenses	4,364	157,334	102,151	(106)	263,743
Amortization expense		13,306	587		13,893
Goodwill and trade name impairment		667,990	5,263		673,253
Restructuring charges		221	77		298
Total operating costs and expenses	4,364	1,288,686	226,266	(16,821)	1,502,495
Operating (Loss) Income	(4,364)	(576,643)	17,302	(128)	(563,833)
Non-operating Expense (Income):					
Interest expense	29,216				