ROLLINS INC
Form 10-K
February 28, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

Commission file No. 1-4422

ROLLINS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**51-0068479** (I.R.S. Employer Identification No.)
2170 Piedmont Road, N.E., Atlanta, Georgia (Address of principal executive offices)	**30324** (Zip Code)

Registrant's telephone number, including area code: (404) 888-2000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each Exchange on which registered
Common Stock, $1 Par Value	**The New York Stock Exchange**

Securities registered pursuant to section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.   Yes o No ý

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer 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 ý

The aggregate market value of Rollins, Inc. Common Stock held by non-affiliates on June 30, 2006 was $565,497,414 based on the reported last sale price of common stock on June 30, 2006, which is the last business day of the registrant's most recently completed second fiscal quarter.

Rollins, Inc. had 68,253,766 shares of Common Stock outstanding as of January 31, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders of Rollins, Inc. are incorporated by reference into Part III, Items 10-14.

Rollins, Inc.
Form 10-K
For the Year Ended December 31, 2006
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PART I

Item 1. Business

General

Rollins, Inc. (the "Company") was originally incorporated in 1948 under the laws of the state of Delaware as Rollins Broadcasting, Inc.

The Company is a national service company with headquarters located in Atlanta, Georgia, providing pest and termite control services to both residential and commercial customers in North America. Services are performed through a contract that specifies the pricing arrangement with the customer.

Orkin, Inc. ("Orkin"), a wholly owned subsidiary of the Company founded in 1901, is one of the world's largest pest and termite control companies. It provides customized services from over 400 locations to approximately 1.7 million customers. Orkin serves customers in the United States, Canada, Mexico, Panama and Costa Rica providing essential pest control services and protection against termite damage, rodents and insects to homes and businesses, including hotels, food service establishments, food manufacturers, retailers and transportation companies. Orkin operates under the Orkin®, Western Pest Services, and PCO Services, Inc.® trademarks and the Acurid℠ service mark. The Orkin® brand name makes Orkin the most recognized pest and termite company throughout the country. The PCO Services brand name provides similar brand recognition throughout Canada. The Company is the largest pest control provider in Canada.

The Company has only one reportable segment, its pest and termite control business. Revenue, operating profit and identifiable assets for this segment, which includes the United States, Canada, Mexico, Panama and Costa Rica are included in Item 8 of this document, "Financial Statements and Supplementary Data" on pages 36 and 37. The Company's results of operations and its financial condition are not reliant upon any single customer or a few customers or the Company's foreign operations.

Acquisitions

On October 1, 2005, the Company acquired substantially all of the assets and assumed certain liabilities of the Industrial Fumigant Company ("IFC") for $23.5 million in cash. The Company's consolidated statements of income include the results of operations of IFC for all periods after October 1, 2005.

On April 30, 2004, the Company acquired substantially all of the assets and assumed certain liabilities of Western Pest Services ("Western"), and the Company's consolidated financial statements include the operating results of Western from the date of the acquisition. Western was engaged in the business of providing pest control services and the Company has continued this business. The acquisition was made pursuant to an Asset Purchase Agreement (the "Western Agreement") dated March 8, 2004, between Rollins, Inc. and Western Industries, Inc. and affiliates. The consideration for the assets and certain non-competition agreements was approximately $110.2 million, including approximately $8.4 million of assumed liabilities.

Prior to the acquisition, Western was recognized as a premier pest control business and ranked as the eighth largest company in the industry. Western was primarily a commercial pest control service company and its businesses complemented most of the services that Orkin offers, in an area of the country in which Orkin had not been particularly strong, the Northeast. The Company's consolidated statements of income include the results of operations of Western for all periods after April 30, 2004.

Common Stock Repurchase Program

In April 2005, The Company announced that as a result of having only 276,216 shares left under the Company's stock buyback program, the Company's Board of Directors authorized the purchase of an additional 4.0 million shares of our common stock. Total share repurchases for 2006 totaled 1,006,680. In

total 2,258,644 additional shares may be purchased under previously approved programs by the Board of Directors. The program does not have an expiration date.

Backlog

The dollar amount of service contracts as of the end of the Company's 2006, 2005, and 2004 calendar years was $82.6 million, $83.2 million and $81.2 million, respectively. Backlog services and orders are usually provided within the month following the month of receipt, except in the area of prepaid pest control and bait monitoring services, which are usually provided within twelve months of receipt. The Company does not have a material portion of its business that may be subject to renegotiation of profits or termination of contracts at the election of a governmental entity.

Orkin Franchise

The Company continues to expand its growth through the Orkin franchise program. This program is primarily used in smaller markets where it is currently not economically feasible to locate a conventional Orkin branch. There is a contractual buyback provision at the Company's option with a pre-determined purchase price using a formula applied to revenues of the franchise. There were 58 Company franchises at the end of 2006 compared to 57 at the end of 2005 and 49 at the end of 2004.

The Company began its Orkin franchise program in the U.S. in 1994, and established its first international franchise in Mexico in 2000, its second international franchise in Panama in 2003 and its third international franchise in Costa Rica in 2006.

Seasonality

The business of the Company is affected by the seasonal nature of the Company's pest and termite control services. The increase in pest pressure and activity, as well as the metamorphosis of termites in the spring and summer (the occurrence of which is determined by the timing of the change in seasons), has historically resulted in an increase in the revenue of the Company's pest and termite control operations during such periods as evidenced by the following chart. In addition, revenues were favorably impacted in 2004 after the acquisition of Western Pest Services on April 30, 2004.

(in thousands)	2006	2005	2004
First Quarter	**$ 194,187**	$ 183,915	$ 160,416*
Second Quarter	**232,222**	214,326	202,725*
Third Quarter	**227,816**	209,346	203,925*
Fourth Quarter	**204,653**	194,830	183,818
Year ended December 31,	**$ 858,878**	$ 802,417	$ 750,884

* Restated for change in accounting principle.

Inventories

The Company has relationships with multiple vendors for pest and termite control treatment products and maintains a sufficient level of chemicals, materials and other supplies to fulfill its immediate servicing needs and to alleviate any potential short-term shortage in availability from its national network of suppliers.

In early August 2004, the Company signed an agreement with Univar USA under which Univar provides warehouse, logistical and delivery services for Orkin's branches throughout the United States. This arrangement enables the Company to concentrate on its core pest and termite control business. It has expedited the delivery of products to all branches, and has resulted in improved service support while lowering branch inventories and freight costs.

As part of the agreement with Univar, Univar also acquired certain assets of Dettelbach Pesticide Corp, a wholly owned subsidiary of Orkin. Dettelbach, a southeastern pest control materials distributor, offered insecticides, termiticides, and equipment to pest control professionals and previously contributed approximately $3.0 million in annual revenue to the Company.

Competition

The Company believes that Rollins, through Orkin, Western Pest Services, and Industrial Fumigant Company, competes favorably with competitors as one of the world's largest pest and termite control companies. The Company's competitors include Terminix and Ecolab.

The principal methods of competition in the Company's pest and termite control business are quality of service and guarantees, including the money-back guarantee on pest and termite control, and the termite re-treatment and damage repair guarantee to qualified homeowners.

Research and Development

Expenditures by the Company on research activities relating to the development of new products or services are not significant. Some of the new and improved service methods and products are researched, developed and produced by unaffiliated universities and companies. Also, a portion of these methods and products are produced to the specifications provided by the Company.

The Company maintains a close relationship with several universities for research and validation of treatment procedures and material selection.

The Company also conducts tests of new products with the specific manufacturers of such products. The Company also works closely with industry consultants and suppliers to improve service and establish new and innovative methods and procedures.

Environmental and Regulatory Considerations

The Company's pest control business is subject to various legislative and regulatory enactments that are designed to protect the environment, public health and consumer protection. Compliance with these requirements has not had a material negative effect on the Company's financial position, results of operations or liquidity.

Federal Insecticide Fungicide and Rodentcide Act ("FIFRA")

This federal law (as amended) grants to the states the responsibility to be the primary agent in enforcement and conditions under which pest control companies operate. Each state must meet certain guidelines of the Environmental Protection Agency in regulating the following: licensing, record keeping, contracts, standards of application, training and registration of products. This allows each state to institute certain features that set their regulatory programs in keeping with special interests of the citizens' wishes in each state. The pest control industry is impacted by these federal and state regulations.

Food Quality Protection Act of 1996 ("FQPA")

The FQPA governs the manufacture, labeling, handling and use of pesticides and does not have a direct impact on how the Company conducts its business.

Environmental Remediation

The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), also known as Superfund, is the primary Federal statute regulating the cleanup of inactive hazardous substance sites and imposing liability for cleanup on the responsible parties. Responsibilities governed by this statute include the management of hazardous substances, reporting releases of hazardous substances, and establishing the necessary contracts and agreements to conduct cleanup. Customarily, the parties involved

will work with the EPA and under the direction of the responsible state agency to agree and implement a plan for site remediation. Consistent with the Company's responsibilities under these regulations, the Company undertakes environmental assessments and remediation of hazardous substances from time to time as the Company determines its responsibilities for these purposes. As these situations arise, the Company accrues management's best estimate of future costs for these activities. Based on management's current estimates of these costs, management does not believe these costs are material to the Company's financial condition or operating results.

Employees

The number of persons employed by the Company as of January 31, 2007 was approximately 8,400 compared to approximately 8,400 at December 31, 2006 and approximately 8,000 at December 31, 2005. This increase in the number of employees in 2006 was due in part to the addition of several salespeople and several small acquisitions.

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to these reports, are available free of charge on our web site at www.rollins.com as soon as reasonably practicable after those reports are electronically filed with or furnished to the Securities and Exchange Commission.

Item 1.A. Risk Factors

We may not be able to compete in the competitive and technical pest control industry in the future.

We operate in a highly competitive industry. Our revenues and earnings may be affected by the following factors: changes in competitive prices, weather related issues, general economic issues and governmental regulation. We compete with other large pest control companies, as well as numerous smaller pest control companies for a finite number of customers. We believe that the principal competitive factors in the market areas that we serve are product and service quality and availability, terms of guarantees, reputation for safety, technical proficiency and price. Although we believe that our experience and reputation for safety and quality service is excellent, we cannot assure that we will be able to maintain our competitive position.

We may not be able to identify, complete or successfully integrate acquisitions.

Acquisitions have been and will continue to be an important element of our business strategy. We cannot assure that we will be able to identify and acquire acceptable acquisition candidates on terms favorable to us in the future. We cannot assure that we will be able to integrate successfully the operations and assets of any acquired business with our own business. Any inability on our part to integrate and manage the growth from acquired businesses could have a material adverse effect on our results of operations and financial condition.

Our operations are affected by adverse weather conditions.

Our operations are directly affected by the weather conditions across the United States and Canada. The business of the Company is affected by the seasonal nature of the Company's pest and termite control services. The increase in pest pressure and activity, as well as the metamorphosis of termites in the spring and summer (the occurrence of which is determined by the timing of the change in seasons), has historically resulted in an increase in the revenue and income of the Company's pest and termite control operations during such periods.

Our inability to attract and retain skilled workers may impair growth potential and profitability.

Our ability to remain productive and profitable will depend substantially on our ability to attract and retain skilled workers. Our ability to expand our operations is in part impacted by our ability to increase our labor force. The demand for skilled employees is high, and the supply is very limited. A significant increase in the wages paid by competing employers could result in a reduction in our skilled labor force, increases in the wage rates paid by us, or both. If either of these events occurred, our capacity and profitability could be diminished, and our growth potential could be impaired.

Our operations could be affected by pending and ongoing litigation.

In the normal course of business, Orkin, one of the Company's subsidiaries, is a defendant in a number of lawsuits, which allege that plaintiffs have been damaged as a result of the rendering of services by Orkin. Orkin is actively contesting these actions. Some lawsuits or arbitrations have been filed (Ernest W. Warren and Dolores G. Warren et al. v. Orkin Exterminating Company, Inc., et al.; and Francis D. Petsch, et al. v. Orkin Exterminating Company, Inc. et al.) in which the plaintiffs are seeking certification of a class. The cases originate in Georgia and Florida. This includes Mark and Christine Butland et al. v. Orkin Exterminating Company, Inc. et al. pending in the Circuit Court of Hillsborough County, Tampa, Florida. In Butland, the Court issued a ruling certifying this as a class action, but Orkin appealed this ruling to the Florida Second District Court of Appeals, which in June 2006 denied certification of the class. Following the Plaintiffs' motion for rehearing, the court upheld its prior decision that class certification was improper but also ruled that the Plaintiffs can return to the trial court and attempt to certify a narrower class. Orkin will vigorously oppose any effort by the Plaintiffs to do so. In Warren, the Superior Court of Cobb County, Marietta, Georgia, ruled in August 2006, certifying the class action against Orkin. Orkin has appealed this ruling to the Georgia Court of Appeals. The Company believes these matters to be without merit and intends to vigorously contest certification and defend itself through trial or arbitration, if necessary. In the opinion of management, the outcome of these actions will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

Our operations may be adversely affected if we are unable to comply with regulatory and environmental laws.

Our business is significantly affected by environmental laws and other regulations relating to the pest control industry and by changes in such laws and the level of enforcement of such laws. We are unable to predict the level of enforcement of existing laws and regulations, how such laws and regulations may be interpreted by enforcement agencies or court rulings, or whether additional laws and regulations will be adopted. We believe our present operations substantially comply with applicable federal and state environmental laws and regulations. We also believe that compliance with such laws has had no material adverse effect on our operations to date. However, such environmental laws are changed frequently. We are unable to predict whether environmental laws will, in the future, materially affect our operations and financial condition. Penalties for noncompliance with these laws may include cancellation of licenses, fines, and other corrective actions, which would negatively affect our future financial results.

The Company's Management Has a Substantial Ownership Interest; Public Stockholders May Have No Effective Voice In the Company's Management

The Company has elected the "Controlled Company" exemption under rule 303A of the New York Stock Exchange ("NYSE") Company Guide. The Company is a "Controlled Company" because a group that includes the Company's Chairman of the Board, R. Randall Rollins, his brother, Gary W. Rollins, who is the President, Chief Executive Officer and Chief Operating Officer, also a director of the Company, certain companies under their control, and the nephew of R. Randall Rollins and son of Gary W. Rollins, Glen W. Rollins, who is the Vice President of Rollins, Inc., controls in excess of fifty percent of the Company's voting power. As a "Controlled Company," the Company need not comply with certain NYSE rules.

Rollins, Inc.'s executive officers, directors and their affiliates hold directly or through indirect beneficial ownership, in the aggregate, approximately 58 percent of the Company's outstanding shares of common stock. As a result, these persons will effectively control the operations of the Company, including the election of directors and approval of significant corporate transactions such as acquisitions and approval of matters requiring stockholder approval. This concentration of ownership could also have the effect of delaying or preventing a third party from acquiring control of the Company at a premium.

Item 1.B. Unresolved Staff Comments

None

Item 2. Properties.

The Company's administrative headquarters are owned by the Company, and are located at 2170 Piedmont Road, N.E., Atlanta, Georgia 30324. The Company owns or leases over 400 branch offices and operating facilities used in its business as well as the Rollins Training Center located in Atlanta, Georgia, the Orkin Customer Care Center located in Covington, GA, and the Pacific Division Administration and Training Center in Riverside, CA. None of the branch offices, individually considered, represents a materially important physical property of the Company. The facilities are suitable and adequate to meet the current and reasonably anticipated future needs of the Company.

Item 3. Legal Proceedings.

Orkin, one of the Company's subsidiaries, is a named defendant in Mark and Christine Butland et al. v. Orkin Exterminating Company, Inc. et al. pending in the Circuit Court of Hillsborough County, Tampa, Florida. The plaintiffs filed suit in March of 1999 and are seeking monetary damages and injunctive relief. The Court ruled in early April 2002, certifying the class action lawsuit against Orkin. Orkin appealed this ruling to the Florida Second District Court of Appeals, which remanded the case back to the trial court for further findings. In December 2004 the Court issued a new ruling certifying the class action. Orkin appealed this new ruling to the Florida Second District Court of Appeals. In June 2006, the Florida Second District Court of Appeals issued a ruling denying certification of the class. Following the Plaintiffs' motion for rehearing, the court upheld its prior decision that class certification was improper but also ruled that the Plaintiffs can return to the trial court and attempt to certify a narrower class. Orkin will vigorously oppose any effort by the Plaintiffs to do so. Orkin believes this case to be without merit and intends to defend itself vigorously through trial, if necessary. At this time, the final outcome of the litigation cannot be determined. However, in the opinion of management, the ultimate resolution of this action will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

Additionally, in the normal course of business, Orkin is a defendant in a number of lawsuits, which allege that plaintiffs have been damaged as a result of the rendering of services by Orkin. Orkin is actively contesting these actions. Some lawsuits or arbitrations have been filed (Ernest W. Warren and Dolores G. Warren et al. v. Orkin Exterminating Company, Inc., et al.; and Francis D. Petsch, et al. v. Orkin Exterminating Company, Inc. et al.) in which the Plaintiffs are seeking certification of a class. The cases originate in Georgia and Florida. In Warren, the Superior Court of Cobb County, Marietta, Georgia, ruled in August 2006, certifying the class action against Orkin. Orkin has appealed this ruling to the Georgia Court of Appeals. The Company believes these matters to be without merit and intends to vigorously contest certification and defend itself through trial or arbitration, if necessary. In the opinion of management, the outcome of these actions will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

Orkin is involved in certain environmental matters primarily arising in the normal course of business. In the opinion of management, the Company's liability under any of these matters would not and did not materially affect its financial condition, results of operations or liquidity.

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

There were no matters submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2006.

Item 4.A. Executive Officers of the Registrant.

Each of the executive officers of the Company was elected by the Board of Directors to serve until the Board of Directors' meeting immediately following the next Annual Meeting of Stockholders or until his earlier removal by the Board of Directors or his resignation. The following table lists the executive officers of the Company and their ages, offices with the Company, and the dates from which they have continually served in their present offices with the Company.

Name	Age	Office with Registrant	Date First Elected to Present Office
R. Randall Rollins (1)	75	Chairman of the Board of Directors	10/22/1991
Gary W. Rollins (1) (2)	62	Chief Executive Officer, President and Chief Operating Officer	7/24/2001
Michael W. Knottek (3)	62	Senior Vice President and Secretary	4/23/2002
Harry J. Cynkus (4)	57	Chief Financial Officer and Treasurer	5/28/1998
Glen W. Rollins (5)	40	Vice President	4/23/2002

(1) R. Randall Rollins and Gary W. Rollins are brothers.

(2) Gary W. Rollins was elected to the office of President and Chief Operating Officer in January 1984. He was elected to the additional office of Chief Executive Officer in July 2001. In February 2004, he was named Chairman of Orkin, Inc.

(3) Michael W. Knottek joined the Company in June 1997 as Vice President and, in addition, was elected Secretary in May 1998. He became Senior Vice President in April of 2002. From 1992 to 1997, Mr. Knottek held a variety of executive management positions with National Linen Service, including Senior Vice President of Finance and Administration and Chief Financial Officer. Prior to 1992, he held a variety of senior positions with Initial USA, finally serving as President from 1991 to 1992.

(4) Harry J. Cynkus joined the Company in April 1998 and, in May 1998, was elected Chief Financial Officer and Treasurer. From 1996 to 1998, Mr. Cynkus served as Chief Financial Officer of Mayer Electric Company, a wholesaler of electrical supplies. From 1994 to 1996, he served as Vice President Information Systems for Brach & Brock Confections, the acquirer of Brock Candy Company, where Mr. Cynkus served as Vice President Finance and Chief Financial Officer from 1992 to 1994. From 1989 to 1992, he served as Vice President Finance of Initial USA, a division of an international support services company. Mr. Cynkus is a Certified Public Accountant.

(5) Glen W. Rollins is the son of Gary W. Rollins. He joined the Company in 1989 and has held a variety of field management and staff positions within the organization. He was elected Executive Vice President of Orkin, Inc. in June 2001. In April 2002, he was named Vice President of Rollins, Inc. In February 2004, he was named President and Chief Operating Officer of Orkin, Inc.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The Common Stock of the Company is listed on the New York Stock Exchange and is traded on the Philadelphia, Chicago and Boston Exchanges under the symbol ROL. The high and low prices of the Company's common stock and dividends paid for each quarter in the years ended December 31, 2006 and 2005 (all prices were adjusted for the stock split effective March 10, 2005) were as follows:

STOCK PRICES AND DIVIDENDS
Rounded to the nearest $.01

	Stock Price		Dividends Paid		Stock Price		Dividends Paid
2006	**High**	**Low**	**Per Share**	**2005**	**High**	**Low**	**Per Share**
First Quarter	$ 21.75	$ 19.01	$ 0.0625	First Quarter	$ 18.98	$ 15.86	$ 0.050
Second Quarter	21.24	18.76	0.0625	Second Quarter	20.77	17.91	0.050
Third Quarter	22.08	18.97	0.0625	Third Quarter	22.08	18.82	0.050
Fourth Quarter	22.95	20.51	0.0625	Fourth Quarter	21.42	18.30	0.050

The number of stockholders of record as of January 31, 2007 was 1,757.

On January 23, 2007 the Board of Directors approved a quarterly cash dividend per common share of $0.075 payable March 12, 2007 to stockholders of record at the close of business February 12, 2007. The Company expects to continue to pay cash dividends to the common stockholders, subject to the earnings and financial condition of the Company and other relevant factors.

Issuer Purchases of Equity Securities

In April 2005, the Company announced that in addition to the 276,216 Shares still available for repurchase under the Company's existing plan, the Company's Board of Directors authorized the purchase of an additional 4.0 million shares of our common stock. Share repurchases for 2006 totaled 1,006,680 at a weighted average price of $19.34 per share. In total, 2,258,644 additional shares may be purchased under previously approved programs by the Board of Directors. The program does not have an expiration date. The following table summarizes the Company's share repurchases during the Company's fourth quarter of 2006:

Period	Total Number of Shares Purchased (1)	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Repurchase Plans	Maximum Number of Shares that May Yet Be Purchased Under the Repurchase Plans
October 1 to 31, 2006	3,068	$ 22.11		2,258,644
November 1 to 30, 2006	11,533	$ 22.07		2,258,644
December 1 to 31, 2006	13,259	$ 22.06		2,258,644
Total	27,860	$ 22.07		2,258,644

(1) Repurchases in connection with exercise of employee stock options.

PERFORMANCE GRAPH

The following graph sets forth a five year comparison of the cumulative total stockholder return based on the performance of the stock of the Company as compared with both a broad equity market index and an industry or peer group index. The indices included in the following graph are the S&P 500 Index and the S&P 500 Commercial Services Index.

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN*

ASSUMES INITIAL INVESTMENT OF $100
*TOTAL RETURN ASSUMES REINVESTMENT OF DIVIDENDS
NOTE: TOTAL RETURNS BASED ON MARKET CAPITALIZATION

Item 6. Selected Financial Data.

The following summary financial data of Rollins highlights selected financial data and should be read in conjunction with the financial statements included elsewhere in this document.

FIVE-YEAR FINANCIAL SUMMARY

Rollins, Inc. and Subsidiaries

All earnings per share and dividends per share have been restated for 2003 and 2002 for the three-for-two stock split effective March 10, 2003 for all shares held on February 10, 2003 and all shares prior to 2006 have been restated for the three-for-two stock split effective March 10, 2005.

	Years Ended December 31,				
(in thousands except per share data)	**2006**	**2005**	**2004**	**2003**	**2002**
OPERATIONS SUMMARY					
Revenues	**$ 858,878**	$ 802,417	$ 750,884	$ 677,013	$ 665,425
Income Before Income Taxes	**95,159**	87,955	98,712	60,030	43,726
Income before cumulative effect of a change in accounting principle	**57,809**	52,773	58,259	35,761	27,110
Cumulative effect on prior years of changing to different revenue and cost recognition method			(6,204)		
Net Income	**$ 57,809**	$ 52,773	$ 52,055	$ 35,761	$ 27,110
Income Per Share Basic:					
Income before change in accounting principle	**$ 0.86**	$ 0.78	$ 0.85	$ 0.53	$ 0.40
Cumulative effect of change in accounting principle			(0.09)		
Net Income	**$ 0.86**	$ 0.78	$ 0.76	$ 0.53	$ 0.40
Income Per Share Diluted:					
Income before change in accounting principle	**$ 0.84**	$ 0.76	$ 0.83	$ 0.51	$ 0.40
Cumulative effect of change in accounting principle			(0.09)		
Net Income	**$ 0.84**	$ 0.76	$ 0.74	$ 0.51	$ 0.40
Dividends paid per share	**$ 0.25**	$ 0.20	$ 0.16	$ 0.13	$ 0.09
Pro forma amounts assuming the new accounting method is applied retroactively					
Net Income	**$ 57,809**	$ 52,773	$ 58,259	*	*
Income Per Share Basic:	**$ 0.86**	$ 0.78	$ 0.85	*	*
Income Per Share Diluted:	**$ 0.84**	$ 0.76	$ 0.83	*	*

*The pro forma amounts for periods prior to 2003 are not determinable, as the newly adopted accounting method requires discrete information on claims outstanding and certain other post-contract liabilities that is not available.

FINANCIAL POSITION

At December 31,

(in thousands)	2006	2005	2004	2003	2002
Total assets	**$ 453,175**	$ 438,420	$ 418,780	$ 349,904	$ 318,338
Non-current capital lease obligations	**$ 124**	$ 560	$	$	$
Non-compete agreements	**$ 660**	$ 456	$ 1,700	$ 1,734	$ 2,913
Stockholders' equity	**$ 211,459**	$ 176,951	$ 167,549	$ 138,774	$ 90,690
Number of shares outstanding at year-end	**67,891**	68,011	68,504	67,735	67,199

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

RESULTS OF OPERATIONS

(in thousands)	Years ended December 31, 2006	2005	2004	% better/(worse) as compared to prior year 2006	2005
Revenues	**$ 858,878**	$ 802,417	$ 750,884	**7.0%**	6.9%
Cost of services provided	**457,869**	437,160	395,334	**(4.7)**	(10.6)
Depreciation and amortization	**26,860**	24,280	23,034	**(10.6)**	(5.4)
Sales, general and administrative	**280,578**	259,763	258,893	**(8.0)**	(0.3)
Pension Curtailment Gain		(4,176)		**(100.0)**	N/M
(Gain) on sales of assets	**(81)**	(982)	(24,716)	**(91.8)**	(96.0)
Interest income	**(1,507)**	(1,583)	(373)	**(4.8)**	N/M
Income before income taxes	**95,159**	87,955	98,712	**8.2**	(10.9)
Provision for income taxes	**37,350**	35,182	40,453	**(6.2)**	13.0
Cumulative effect of a change in accounting principle			(6,204)	**N/M**	N/M
Net income	**$ 57,809**	$ 52,773	$ 52,055	**9.5%**	1.4%

General Operating Comments

The Company's addition of the Industrial Fumigant Company in October 2005, along with continued emphasis on customer retention and building recurring revenues was the primary driver of revenue growth of 7.0% for the year ended December 31, 2006.

Rollins, Inc. and Subsidiaries
Revenue Reconciliation
Revenues Excluding the Industrial Fumigant Company

	Twelve Months Ended, December 31 2006 (unaudited)	2005 (unaudited)	$ Better/ (worse)	% Better/ (worse)
Reported net revenues	**$ 858,878**	**$ 802,417**	**$ 56,461**	**7.0%**
Less:				
The Industrial Fumigant Company (IFC)	25,920	6,275	19,645	3.1
Net revenues excluding IFC	**$ 832,958**	**$ 796,142**	**$ 36,816**	**4.6%**

The non-GAAP financial measure in the table above is provided to assist in the reader's understanding of the comparability of the Company's operations for 2006 and 2005. The Company believes that revenue excluding the Industrial Fumigation Company, a non-GAAP financial measure, is a useful basis to compare the Company's results, as it shows the Company's growth in revenue without this significant acquisition (see "adjusted revenues excluding the IFC" in previous table). Management of the Company believes that this non-GAAP measure provides both management and investors with a more complete understanding of the Company's underlying operating results and operating trends. Management uses this non-GAAP financial measure to analyze and forecast the Company's operating results and trends, especially when comparing such results to the Company's prior periods and forecasts. Because the excluded item does not exhibit the same growth pattern or variances as other factors affecting the

Company's revenues and net income, management believes that the non-GAAP measure is useful for trend analysis. However, the usefulness of the non-GAAP measures is limited because the measures alone do not give a complete assessment of historical financial position, operating results or cash flows. These are reflected in the U.S. GAAP financial statements, including the Company's consolidated statement of income. The non-GAAP financial information that the Company provides may also differ from the financial information provided by other companies. Therefore, the Company only uses the non-GAAP financial measures in the context of a complete disclosure of operating results. Investors should only consider the non-GAAP measures as part of the overall analysis of the Company's financial results and trends. The previous presentation reconciles reported net revenues (U.S. GAAP amounts) to revenue excluding the Industrial Fumigant Company for the years ended December 31, 2006 and 2005. The non-GAAP information should not be construed as an alternative to reported results under U.S. GAAP.

The financial results for the twelve months ended December 31, 2005 were positively impacted by an investment in sales and marketing. The Company expanded its sales force by approximately 100 associates which resulted in the highest percentage of internal sales improvement in the Company's recent history. The Company has also continued to emphasize technician sales which are up 14.0% in 2006.

For the year ended December 31, 2006, the Company had net income of $57.8 million compared to $52.8 million in 2005, which represents a 9.5% increase. In addition to the revenue increase of 7.0%, the Company's Cost of Services Provided as a percentage of revenues decreased by 1.2 percentage points to 53.3% while Sales, General and Administrative Expenses expressed as a percentage of revenues increased 0.3 percentage points to 32.7% and our Provision for Income Taxes expressed as a percentage of income before taxes decreased 0.7 percentage points to 39.3%. In 2005 the Company's results were benefited by a pension curtailment gain of $4.2 million ($2.5 million net of tax) that did not reoccur in 2006. Net Income expressed as a percentage of revenues increased to 6.7%, a 0.1 percentage point increase. Exclusive of the 2005 curtailment gain, net income improved 15%.

Rollins, Inc. and Subsidiaries
Net Income and Earnings Per Share Reconciliation
Earnings and Earnings Per Share Excluding Pension Curtailment Gain

(in thousands except per share information)	Twelve Months Ended, December 31 2006 (unaudited)	2005 (unaudited)	$ Better/ (worse)	% Better/ (worse)
Reported net income	**$ 57,809**	**$ 52,773**	**$ 5,036**	**9.5%**
Less:				
Pension Curtailment Gain (net of tax)		2,485	2,485	100.0
Income excluding Pension Curtailment Gain	**$ 57,809**	**$ 50,288**	**$ 7,521**	**15.0%**
Reported Earnings Per Share Basic	**$ 0.86**	**$ 0.78**	**$ 0.08**	**10.3%**
Less:				
Pension Curtailment Gain (net of tax)		0.04	0.04	100.0
Earnings Per Share Basic Excluding Pension Curtailment Gain	**$ 0.86**	**$ 0.74**	**$ 0.12**	**16.2%**
Reported Earnings Per Share Diluted	**$ 0.84**	**$ 0.76**	**$ 0.08**	**10.5%**
Less:				
Pension Curtailment Gain (net of tax)		0.04	0.04	100.0
Earnings Per Share Diluted Excluding Pension Curtailment Gain	**$ 0.84**	**$ 0.72**	**$ 0.12**	**16.7%**
Average Shares Outstanding Diluted	**68,876**	**69,772**	**(896)**	**(1.3)%**

The non-GAAP financial measures in the tables above are provided to assist in the reader's understanding of the comparability of the Company's operations for 2006 and 2005. The Company believes that adjusted income excluding pension curtailment, and adjusted earnings per share diluted, excluding pension curtailment, both non-GAAP financial measures, are a useful basis to compare the Company's results, as it shows the Company's growth in income without unusual items (see "adjusted income, excluding pension curtailment" and "adjusted earnings per share diluted, excluding pension curtailment" in previous table). The Company's results for 2005 include a $2.5 million pension curtailment gain, net of taxes, in connection with freezing the Company's defined benefit pension plan which was recorded in accordance with GAAP. There is no comparable gain for 2006. Management of the Company believes that this non-GAAP measure provides both management and investors with a more complete understanding of the Company's underlying operating results and operating trends. Management uses this non-GAAP financial measure to analyze and forecast the Company's operating results and trends, especially when comparing such results to the Company's prior periods and forecasts. Because the excluded item does not exhibit the same growth pattern or variances as other factors affecting the Company's revenues and net income, management believes that the non-GAAP measure is useful for trend analysis. However, the usefulness of the non-GAAP measures is limited because the measures alone do not give a complete assessment of historical financial position, operating results or cash flows. These are reflected in the U.S. GAAP financial statements, including the Company's consolidated statement of income. The non-GAAP financial information that the Company provides may also differ from the financial information provided by other companies. Therefore, the Company only uses the non-GAAP financial measures in the context of a complete disclosure of operating results. Investors should only consider the non-GAAP measures as part of the overall analysis of the Company's financial results and trends. The presentation above reconciles reported net income and earnings per share diluted (U.S. GAAP amounts) to adjusted income excluding pension curtailment and adjusted earnings per share diluted, excluding pension curtailment, both non-GAAP financial measures for the years ended December 31, 2006 and 2005. The non-GAAP information should not be construed as an alternative to reported results under U.S. GAAP.

For the year ended December 31, 2006, the Company's depreciation and amortization totaled $26.9 million comprised of $13.0 million of depreciation and $13.9 million of amortization of intangibles. The amortization represents a significant non-cash charge to the Statement of Income. For the year ended December 31, 2006, total amortization of intangibles expense was $13.9 million, versus $12.8 million in 2005. Based upon our fully diluted shares outstanding, amortization of intangible assets represented a charge of $0.20 pre-tax for the year ended December 31, 2006, $0.18 pre-tax for the year ended December 31, 2005, and $0.16 pre-tax for the year ended December 31, 2004. Amortization of intangible assets represented a charge of $0.12 after tax to GAAP earnings per share for the year ended December 31, 2006, $0.11 after tax to GAAP earnings per share for the year ended December 31, 2005, and $0.09 after tax to GAAP earnings per share for the year ended December 31, 2004.

For the year ended December 31, 2006, the Company's cash, short-term investments increased by $20.3 million. The Company had total cash and cash equivalents of $63.3 million as of December 31, 2006, a 47.1% increase from the year ended December 31, 2005.

The Company began its Orkin franchise program in the U.S. in 1994, and established its first international franchise in Mexico in 2000, its second international franchise in Panama in 2003, and its third international franchise in Costa Rica in 2006. At December 31, 2006, Orkin had 58 franchises in total as compared to 57 as of December 31, 2005.

Results of Operations 2006 Versus 2005

Revenues for the year ended December 31, 2006 were $858.9 million, an increase of $56.5 million or 7.0% from 2005 revenues of $802.4 million. The Company's acquisition of the Industrial Fumigant Company in October 2005, increased revenue by $25.9 million for the year ended December 31, 2006 and by $6.3 million for the year ended December 31, 2005. The Company's historical business excluding the

Industrial Fumigant Company was $833.0 million for the year ended December 31, 2006 and $796.1 million for the year ended December 31, 2005, a $36.9 million increase or 4.6% for the year compared to 2005 (see "Adjusted net revenues excluding IFC" in earlier table).

The Company's commercial revenue grew 9.0%, due primarily to the acquisition of the Industrial Fumigant Company, expanded sales force, better customer retention in Orkin's U.S. operations, and strong growth in its Canadian business operations, which is fundamentally a commercial business. Residential pest control revenues rose by 4.9% in 2006, due to an increased number of leads received, better average selling prices, continued improvements in customer retention, and a successful price increase. Every-other-month service, the Company's primary residential pest control service offering, now comprises over 63% of our residential pest control customer base at December 31, 2006.

The Company's foreign operations accounted for approximately 7.4% of total revenues for the year ended December 31, 2006 as compared to 7.1% in 2005.

Cost of Services Provided for the year ended December 31, 2006 increased $20.7 million or 4.7%, while the expense margin expressed as a percentage of revenues decreased, representing 53.3% of revenues for the year ended December 31, 2006 and 54.5% for the prior year. The dollar increase was mainly due to the addition of the Industrial Fumigant Company, which accounted for $17.7 million of the total, as well as increases in service salaries, insurance and claims, and fleet expenses due to higher fuel costs. Service technician productivity and average pay continued to improve, which leads to better employee retention and ultimately improved customer retention. Cost of Services Provided as a percent of revenue decreased primarily due to reduced insurance and claims and favorable group medical costs.

Sales, General and Administrative for the year ended December 31, 2006 increased $20.8 million or 8.0% while the expense margin increased by 0.3 percentage points, or 32.7% of total revenues compared to 32.4% for the prior year. The dollar increase for the year was primarily a result of the acquisition the Industrial Fumigant Company, as well as increases in administrative and sales salaries. Sales, General and Administrative expenses as a percent of revenues increased due to the higher salary expense related to approximately 100 plus sales associates the Company added to its sales force, greater administrative salaries due to expansion of call centers offset by the lower relative Sales, General and Administrative cost of the Industrial Fumigant Company.

Depreciation and Amortization expenses for the year ended December 31, 2006 were $26.9 million or 10.6% higher than the prior year. The increase was due to an additional $1.5 million of depreciation and amortization expense resulting primarily from the acquisition of the Industrial Fumigant Company. The Company had approximately $18.7 million in capital expenditures during the year ended December 31, 2006 compared to $25.5 million in 2005.

In June 2005, the Company recorded a $4.2 million non-cash curtailment gain in accordance with SFAS No. 88, "Employer's Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits", ("SFAS No. 88") in connection with freezing our defined benefit pension plan, using actuarial assumptions consistent with those we used at December 31, 2004. SFAS No. 88 requires curtailment accounting if an event eliminates, for a significant number of employees, the accrual of defined benefits for some or all of their future services. In the event of a curtailment, an adjustment must be recognized for the unrecognized prior service cost associated with years of service no longer expected to be rendered. This event did not reoccur in 2006.

Interest income for the year ended December 31, 2006 was $1.5 million, a decrease of $0.1 million compared to the year ended December 31, 2005 due to lower average invested assets over the course of 2006.

The Company's effective tax rate was 39.3% in 2006 compared to 40.0% in 2005. The effective tax rate was 40.0% for the first and second quarters of 2006, 38.8% for the third quarter and 37.8% for the fourth quarter of 2006 and in 2005 was as follows: 40.5% for the first three quarters; and 36.7% for the fourth quarter.

Results of Operations 2005 Versus 2004

Revenues for the year ended December 31, 2005 were $802.4 million, an increase of $51.5 million or 6.9% from 2004 revenues of $750.9 million. The Company's acquisitions of Western Pest Services, in April 2004, and the Industrial Fumigant Company in October 2005, increased revenue by $35.0 million for the year

The Company's commercial revenue grew 13.8% in 2005, due primarily to the acquisitions of Western Pest Services and the Industrial Fumigant Company, better customer retention in Orkin's U.S. operations, and strong growth in its Canadian business operations. Residential pest control revenues rose by 1.2% in 2005, due to an increased number of leads received, better average selling prices, continued improvements in customer retention, and successful price increase campaigns in Orkin's operations. Every-other-month service, the Company's primary residential pest control service offering, now comprised almost 61% of our residential pest control customer base at December 31, 2005.

The Company's foreign operations accounted for approximately 7.1% of total revenues for the year ended December 31, 2005 as compared to 6.5% in 2004.

Cost of Services Provided for the year ended December 31, 2005 increased $41.8 million or 10.6%, although the expense margin expressed as a percentage of revenues increased slightly, representing 54.5% of revenues for the year ended December 31, 2005 and 52.6% for the prior year. The dollar increase was mainly due to the additions of Western Pest Services and the Industrial Fumigant Company, which accounted for $24.5 million of the total, as well as increases in service salaries, insurance and claims, and fleet expenses due to higher fuel costs. Service technician productivity and average pay continued to improve in 2005, which leads to better employee retention and, in management's opinion, improved customer retention.

Sales, General and Administrative for the year ended December 31, 2005 increased $0.9 million or 0.3% while improving as a percentage of revenues by 2.1 percentage points, or 32.4% of total revenues compared to 34.5% for the prior year. The dollar increase for the year was primarily a result of the acquisitions of Western Pest Services and the Industrial Fumigant Company, as well as increases in administrative salaries, legal expenses, fleet costs, travel, advertising and promotions and other expenses.

Depreciation and Amortization expenses for the year ended December 31, 2005 were $24.3 million or 5.4% higher than the prior year. The increase was due to an additional $6.9 million of depreciation and amortization expense resulting from the acquisition of Western Pest Services and the Industrial Fumigant Company, while depreciation decreased in other areas as assets continues to become fully depreciated and amortized at a faster rate than new capital expenditures. The Company had approximately $25.5 million in capital expenditures during the year ended December 31, 2005 compared to $14.2 million in 2004.

In June 2005, the Company recorded a $4.2 million non-cash curtailment gain in accordance with SFAS No. 88, "Employer's Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits", ("SFAS No. 88") in connection with freezing our defined benefit pension plan, using actuarial assumptions consistent with those we used at December 31, 2004. SFAS No. 88 requires curtailment accounting if an event eliminates, for a significant number of employees, the accrual of defined benefits for some or all of their future services. In the event of a curtailment, an adjustment must be recognized for the unrecognized prior service cost associated with years of service no longer expected to be rendered.

Interest income for the year ended December 31, 2005 was $1.6 million, an increase of $1.2 million compared to the year ended December 31, 2004 due to higher invested assets with a higher return on the Company's investments.

The Company's effective tax rate was 40.0% in 2005 compared to 41.0% in 2004. The effective tax rate was 40.5% for the first three quarters of 2005 and 36.7% for the fourth quarter of 2005 and in 2004 was as

follows: 40.5% for the first quarter; 42.7% for the second quarter; 40.5% for the third quarter; and 38.7% for the fourth quarter.

Liquidity and Capital Resources

Cash and Cash Flow

	Years ended December 31,		
(in thousands)	**2006**	**2005**	**2004**
Net cash provided by operating activities	**$ 85,201**	$ 76,750	$ 71,513
Net cash used in investing activities	**(27,981)**	(51,387)	(64,288)
Net cash used in financing activities	**(36,389)**	(40,149)	(10,436)
Effect of exchange rate changes on cash	**(552)**	1,114	408
Net increase/(decrease) in cash and short-term investments	**$ 20,279**	$ (13,672)	$ (2,803)

The Company believes its current cash balances, future cash flows from operating activities and available borrowings under its $70.0 million line of credit will be sufficient to finance its current operations and obligations, and fund expansion of the business for the foreseeable future. The Company's operations generated cash of $85.2 million for the year ended December 31, 2006, compared with cash provided by operating activities of $76.8 million in 2005 and $71.5 million in 2004.

The Company invested approximately $18.7 million in capital expenditures during the year ended December 31, 2006. Capital expenditures for the year consisted primarily of equipment replacements and upgrades and improvements to the Company's management information systems. The Company expects to invest between $12.0 million and $15.0 million in 2007 in capital expenditures. During 2006, the Company made several acquisitions totaling $10.1 million compared to $27.2 million during 2005. The acquisitions were funded fully with cash from operations in 2006. The Company continues to seek new acquisitions and will also give consideration to any attractive acquisition opportunities presented. A total of $17.0 million was paid in cash dividends ($0.0625 per share a quarter) during the year ended December 31, 2006, compared to $13.7 million or $0.05 per share a quarter during 2005. The Company repurchased 1,006,680 shares of Common Stock in 2006 and there remain 2,258,644 shares authorized to be repurchased under prior Board authorization. The Company maintains $70.0 million of credit facilities with commercial banks, of which no borrowings were outstanding as of December 31, 2006. The Company maintains approximately $38.8 million in letters of credit, which reduced its borrowing capacity under the credit facilities. These letters of credit are required by the Company's fronting insurance companies and/or certain states, due to the Company's self-funded status, to secure various workers' compensation and casualty insurance contracts. These letters of credit are established by the bank for the Company's fronting insurance companies as collateral, although the Company believes that it has adequate liquid assets, funding sources and insurance accruals to accommodate such claims.

Orkin, one of the Company's subsidiaries, is aggressively defending a class action lawsuit filed in Hillsborough County, Tampa, Florida. In early April 2002, the Circuit Court of Hillsborough County certified the class action status of Butland et al. v. Orkin Exterminating Company, Inc. et al. Orkin appealed this ruling to the Florida Second District Court of Appeals, which remanded the case back to the trial court for further findings. In December 2004 the Court issued a new ruling certifying the class action status. Orkin appealed this ruling to the Florida Second District Court of Appeals. In June 2006, the Florida Second District Court of Appeals issued a ruling denying certification of the class. Following the Plaintiffs' motion for rehearing, the court upheld its prior decision that class certification was improper but also ruled that the Plaintiffs can return to the trial court and attempt to certify a narrower class. Orkin will vigorously oppose any effort by the Plaintiffs to do so. In Ernest W. Warren and Dolores G. Warren et al. v. Orkin Exterminating Company, Inc., et al., pending in the Superior Court of Cobb County, Marietta, Georgia, the Court ruled in August 2006 certifying the class action against Orkin. Orkin has appealed this

ruling to the Georgia Court of Appeals. Other lawsuits against Orkin, and in some instances the Company, are also being vigorously defended, including the Petsch case. For further discussion, see Note 7 to the accompanying financial statements.

The Company is currently under audit by the Internal Revenue Service (IRS) for tax years 2002 and 2003. The IRS has issued Notices of Proposed Adjustment with respect to various issues. The Company is currently reviewing its position regarding the adjustments and plans to defend against those adjustments that are without merit. The Company does not expect the resolution of these issues, taken individually or in the aggregate, to have a material adverse impact on the Company's financial condition or results of operations.

The Company made a contribution of $5.0 million to its defined benefit retirement plan (the "Plan") during 2006 and 2005 as a result of the Plan's funding status. The Company believes that it will make contributions in the amount of approximately $2.5 million in 2007. In the opinion of management, additional Plan contributions will not have a material effect on the Company's financial position, results of operations or liquidity.

Off Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments

Other than the operating leases disclosed in the table below, the Company has no material off balance sheet arrangements.

The impact that the Company's contractual obligations as of December 31, 2006 are expected to have on our liquidity and cash flow in future periods is as follows:

	Payments due by period				
Contractual obligations (in thousands)	**Total**	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Non-compete agreements	$ 746	$ 290	$ 267	$ 189	$
Non-cancelable operating leases	69,054	22,428	28,776	11,570	6,280
Capital leases	622	498	124		
Acquisition notes payable	234	30	90	60	54
Total (1)	$ 70,656	$ 23,246	$ 29,257	$ 11,819	$ 6,334

(1) Minimum pension funding requirements are not included as such amounts have not been determined. The Company estimates that it will contribute approximately 2.5 million to the plan in fiscal 2007.

Critical Accounting Policies

The Company views critical accounting policies to be those policies that are very important to the portrayal of our financial condition and results of operations, and that require management's most difficult, complex or subjective judgments. The circumstances that make these judgments difficult or complex relate to the need for management to make estimates about the effect of matters that are inherently uncertain. We believe our critical accounting policies to be as follows:

Accrual for Termite Contracts The Company maintains an accrual for termite claims representing the estimated costs of reapplications, repairs and associated labor and chemicals, settlements, awards and other costs relative to termite control services. Factors that may impact future cost include chemical life expectancy and government regulation. It is significant that the actual number of claims has decreased in recent years due to changes in the Company's business practices. However, it is not possible to precisely predict future significant claims. Positive changes to our business practices include revisions made to our contracts, more effective treatment methods that include a directed-liquid and baiting program, more effective termiticides, and expanding training.

Accrued Insurance The Company self-insures, up to specified limits, certain risks related to general liability, workers' compensation and vehicle liability. The estimated costs of existing and future claims under the self-insurance program are accrued based upon historical trends as incidents occur, whether reported or unreported (although actual settlement of the claims may not be made until future periods) and may be subsequently revised based on developments relating to such claims. The Company contracts an independent third party actuary on an annual basis to provide the Company an estimated liability based upon historical claims information. The actuarial study is a major consideration, along with management's knowledge of changes in business practices and existing claims compared to current balances. The reserve is established based on all these factors. Due to the uncertainty associated with the estimation of future loss and expense payments and inherent limitations of the data, actual developments may vary from the Company's projections. This is particularly true since critical assumptions regarding the parameters used to develop reserve estimates are largely based upon judgment. Therefore, changes in estimates may be material. Management's judgment is inherently subjective and a number of factors are outside management's knowledge and control. Additionally, historical information is not always an accurate indication of future events. It should be noted that the number of claims has been decreasing due to the Company's proactive risk management to develop and maintain ongoing programs. Initiatives that have been implemented include pre-employment screening and an annual motor vehicle report required on all its drivers, utilization of a Global Positioning System that has been fully deployed to Company vehicles, post-offer physicals for new employees, and pre-hire, random and post-accident drug testing. The Company has improved the time required to report a claim by utilizing a "Red Alert" program that provides serious accident assessment twenty four hours a day and seven days a week and has instituted a modified duty program that enables employees to go back to work on a limited-duty basis.

Revenue Recognition The Company's revenue recognition policies are designed to recognize revenues at the time services are performed. For certain revenue types, because of the timing of billing and the receipt of cash versus the timing of performing services, certain accounting estimates are utilized. Residential and commercial pest control services are primarily recurring in nature on a monthly or bi-monthly basis, while certain types of commercial customers may receive multiple treatments within a given month. In general, pest control customers sign an initial one-year contract, and revenues are recognized at the time services are performed. For pest control customers, the Company offers a discount for those customers who prepay for a full year of services. The Company defers recognition of these advance payments and recognizes the revenue as the services are rendered. The Company classifies the discounts related to the advance payments as a reduction in revenues. Termite baiting revenues are recognized based on the delivery of the individual units of accounting. At the inception of a new baiting services contract upon quality control review of the installation, the Company recognizes revenue for the delivery of the monitoring stations, initial directed liquid termiticide treatment and installation of the monitoring services. The amount deferred is the fair value of monitoring services to be rendered after the initial service. The amount deferred for the undelivered monitoring element is then recognized as income on a straight-line basis over the remaining contract term, which results in recognition of revenue in a pattern that approximates the timing of performing monitoring visits. Baiting renewal revenue is deferred and recognized over the annual contract period on a straight-line basis that approximates the timing of performing the required monitoring visits.

Prior to 2004, traditional termite treatments were recognized as revenue at the renewal date and an accrual was established for estimated costs of reapplications and repairs to be incurred. Under the accounting method adopted in 2004, the revenue received is deferred and recognized on a straight-line basis over the remaining contract term; and, the cost of reinspections, reapplications and repairs and associated labor and chemicals are expensed as incurred. For outstanding claims, an estimate is made of the costs to be incurred (including legal costs) based upon current factors and historical information. The performance of reinspections tends to be close to the contract renewal date and, while reapplications and repairs involve an insubstantial number of the contracts, these costs are incurred over the contract term. The accounting principle adopted in 2004 eliminates the need to obtain actuarial estimates of the claim costs to be

incurred and management's estimates of reapplication costs. Also, management believes the newly adopted this accounting method more closely conforms to the current pattern under which revenues are earned and expenses are incurred, and conforms to the accounting methodology of Orkin and its subsidiary, Western Pest Services. The costs of providing termite services upon renewal are compared to the expected revenue to be received and a provision is made for any expected losses.

Due to this change, in 2004 the Company recorded a cumulative adjustment to reduce net income by $6.2 million (net of income taxes). As the revenue is being deferred, the future cost of reinspections, reapplications and repairs and associated labor and chemicals applicable to the deferred revenue are expensed as incurred and no longer accrued. The Company will continue to accrue for noticed claims.

Contingency Accruals The Company is a party to legal proceedings with respect to matters in the ordinary course of business. In accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies,* the Company estimates and accrues for its liability and costs associated with the litigation. Estimates and accruals are determined in consultation with outside counsel. It is not possible to accurately predict the ultimate result of the litigation. However, in the opinion of management, the outcome of the litigation will not have a material adverse impact on the Company's financial condition or results of operations.

Stock-Based Compensation In December 2004, the FASB issued a revision of Statement of Financial Accounting Standards (or "FAS") No. 123, "Accounting for Stock-Based Compensation." The revision is referred to as "FAS 123R Share-Based Payment" (or "FAS 123R"), which supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," (or "APB 25") and will require companies to recognize compensation expense, using a fair-value based method, for costs related to share-based payments including stock options and stock issued under our employee stock plans. We have adopted FAS 123R using the modified prospective basis on January 1, 2006. Our adoption of FAS 123R resulted in compensation expense reduced diluted net income per share by approximately $0.01 per share for 2006. Stock-based compensation expense is affected by our stock price, as well as a number of complex and subjective valuation assumptions and the related tax effect. These valuation assumptions include, but are not limited to, the volatility of our stock price and employee stock option exercise behaviors.

Impact of Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Statements of Financial Accounting Standards

In January 2006, we adopted *SFAS No. 123, "Share-Based Payment (Revised 2004)."* SFAS 123R establishes standards for the accounting for transactions in which an entity (i) exchanges its equity instruments for goods or services, or (ii) incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of the equity instruments. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant. The Company adopted the provisions of SFAS 123R on January 1, 2006. Details related to the adoption of SFAS 123R and the impact to the Company's financial statements are more fully discussed in Note 8 Employee Benefit and Stock Compensation Plans.

In September 2006, the FASB issued *SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88 106, and 132(R)."* SFAS 158 requires an employer to recognize the overfunded or underfunded status of defined benefit post-retirement plans as an asset or a liability in its statement of financial position. The funded status is measured as the difference between plan assets at fair value and the benefit obligation (the projected benefit obligation for pension plans or the accumulated benefit obligation for other post-retirement

benefit plans). An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. SFAS 158 also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and the transition asset or obligation. The Company was required to recognize the funded status of the plan in its financial statements for the year ended December 31, 2006. The Company had previously recognized the funded status of the plan in prior financial statements. See Note 8 Employee Benefit and Stock Compensation Plans for additional information related to this plans. The requirement to measure plan assets and benefit obligations as of the date of the year-end statement of financial position is effective for the Company's financial statements beginning with the year ended after December 15, 2008. The Company currently uses December 31 as the measurement date for the plans.

SEC Staff Accounting Bulletins

In September 2006, the SEC issued *Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements."* SAB 108 addresses how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. The effects of prior year uncorrected errors include the potential accumulation of improper amounts that may result in a material misstatement on the balance sheet or the reversal of prior period errors in the current period that result in a material misstatement of the current period income statement amounts. Adjustments to current or prior period financial statements would be required in the event that after application of various approaches for assessing materiality of a misstatement in current period financial statements and consideration of all relevant quantitative and qualitative factors, a misstatement is determined to be material. SAB 108 is applicable to all financial statements issued by the Company after November 15, 2006. SAB 108 became affective for the Company's fiscal year ended December 31, 2006 and did not have a material effect on the Company's financial position or results of operations for the year ended December 31, 2006.

Recently Issued Accounting Pronouncements

Statements of Financial Accounting Standards

In September 2006, the FASB issued *SFAS No. 157, "Fair Value Measurements."* SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company's financial statements.

Financial Accounting Standards Board Staff Positions and Interpretations

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes an Interpretation of SFAS No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest, penalties, accounting in interim periods and disclosure related to uncertain income tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Accordingly, the Company will be required to adopt FIN 48 in first quarter 2007. The Company is currently evaluating the impact that the adoption of FIN 48 will have, if any, on its consolidated financial statements and notes thereto.

Forward-Looking Statements

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include statements regarding the expected impact of potential future pension plan contributions, future contributions of Western, expected contributions of the commercial business segment, the outcome of litigation arising in the ordinary course of business and the outcome of other litigation, as discussed in the Legal Proceedings section and elsewhere, interest rate risk and foreign exchange currency risk on the Company's financial position, results of operations and liquidity; the adequacy of the Company's resources and borrowings to fund operations and obligations; management's expectation regarding the Company's expense for amortization of intangibles during 2007; the Company's projected 2007 capital expenditures; the impact of the Company's contractual obligations; the impact of recent accounting pronouncements; and the expected outcome of the growth of national account revenue. The actual results of the Company could differ materially from those indicated by the forward-looking statements because of various risks, timing and uncertainties including, without limitation, the possibility of an adverse ruling against the Company in pending litigation; general economic conditions; market risk; changes in industry practices or technologies; the degree of success of the Company's termite process reforms and pest control selling and treatment methods; the Company's ability to identify potential acquisitions; climate and weather trends; competitive factors and pricing practices; potential increases in labor costs; and changes in various government laws and regulations, including environmental regulations. All of the foregoing risks and uncertainties are beyond the ability of the Company to control, and in many cases the Company cannot predict the risks and uncertainties that could cause its actual results to differ materially from those indicated by the forward-looking statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Market Risk

As of December 31, 2006, the Company maintained an investment portfolio subject to short-term interest rate risk exposure. The Company is also subject to interest rate risk exposure through borrowings on its $70.0 million credit facility. Due to the absence of such borrowings as of December 31, 2006, this risk was not significant in 2006 and is not expected to have a material effect upon the Company's results of operations or financial position going forward. However, the Company does maintain approximately $38.8 million in Letters of Credit. The Company is also exposed to market risks arising from changes in foreign exchange rates. The Company believes that this foreign exchange rate risk will not have a material effect upon the Company's results of operations or financial position going forward.

Item 8. Financial Statements and Supplementary Data.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Rollins, Inc. and Subsidiaries

At December 31, (in thousands except share information)	2006	2005
ASSETS		
Cash and cash equivalents	**$ 63,344**	$ 43,065
Trade receivables, short-term, net of allowance for doubtful accounts of $6,132 and $4,534, respectively	**52,693**	47,705
Materials and supplies	**8,401**	9,082
Deferred income taxes	**19,435**	27,510
Prepaid income taxes		3,036
Other current assets	**7,200**	6,069
Total Current Assets	**151,073**	136,467
Equipment and property, net	**72,141**	65,932
Goodwill	**133,606**	133,743
Customer contracts and other intangible assets, net	**68,610**	71,841
Deferred income taxes	**14,069**	15,946
Trade receivables, long-term, net of allowance for doubtful accounts of $1,096 and $1,081, respectively	**8,796**	9,368
Other assets	**4,880**	5,123
Total Assets	**$ 453,175**	$ 438,420
LIABILITIES		
Capital leases	**$ 498**	$ 825
Accounts payable	**16,309**	17,204
Accrued insurance	**14,310**	17,605
Accrued compensation and related liabilities	**47,305**	41,822
Unearned revenue	**79,441**	79,990
Accrual for termite contracts	**8,526**	10,476
Other current liabilities	**18,817**	21,746
Total current liabilities	**185,206**	189,668
Capital leases, less current portion	**124**	560
Accrued insurance, less current portion	**23,635**	18,996
Accrual for termite contracts, less current portion	**11,675**	12,724
Accrued pension	**6,946**	20,651
Long-term accrued liabilities	**14,130**	18,870
Total Liabilities	**241,716**	261,469
Commitments and Contingencies		
STOCKHOLDERS' EQUITY		
Preferred stock, without par value; 500,000 authorized, zero shares issued		
Common stock, par value $1 per share; 170,000,000 and 99,500,000 shares authorized, respectively; 70,789,181 and 70,079,254 shares issued, respectively	**70,789**	70,079
Paid in capital	**11,737**	14,464
Unearned compensation		(5,881)
Retained earnings	**149,615**	123,621
Accumulated other comprehensive loss	**(17,784)**	(23,264)
Treasury stock, par value $1 per share; 2,898,074 shares at December 31, 2006 and 2,068,240 shares at December 31, 2005	**(2,898)**	(2,068)

Total Stockholders' Equity		**211,459**		176,951
Total Liabilities and Stockholders' Equity	**$**	**453,175**	$	438,420

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

CONSOLIDATED STATEMENTS OF INCOME

Rollins, Inc. and Subsidiaries

Years ended December 31, (in thousands except per share data)	**2006**	2005	2004
REVENUES			
Customer services	**$ 858,878**	$ 802,417	$ 750,884
COSTS AND EXPENSES			
Cost of services provided	**457,869**	437,160	395,334
Depreciation and amortization	**26,860**	24,280	23,034
Sales, general and administrative	**280,578**	259,763	258,893
Pension curtailment		(4,176)	
Gain on sales of assets	**(81)**	(982)	(24,716)
Interest income	**(1,507)**	(1,583)	(373)
	763,719	714,462	652,172
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	**95,159**	87,955	98,712
PROVISION FOR INCOME TAXES			
Current	**31,343**	31,529	27,375
Deferred	**6,007**	3,653	13,078
	37,350	35,182	40,453
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	**57,809**	52,773	58,259
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET OF TAXES OF $4,017			(6,204)
NET INCOME	**$ 57,809**	$ 52,773	$ 52,055
INCOME PER SHARE BASIC			
Income before cumulative effect of change in accounting principle	**0.86**	0.78	0.85
Cumulative effect of change in accounting principle			(0.09)
Net Income per share basic	**$ 0.86**	$ 0.78	$ 0.76
INCOME PER SHARE DILUTED			
Income before cumulative effect of change in accounting principle	**0.84**	0.76	0.83
Cumulative effect of change in accounting principle			(0.09)
Net Income per share diluted	**$ 0.84**	$ 0.76	$ 0.74
Weighted average shares outstanding basic	**67,165**	67,898	68,321
Weighted average shares outstanding diluted	**68,876**	69,772	70,167
DIVIDENDS PAID PER SHARE	**$ 0.25**	$ 0.20	$ 0.16

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Rollins, Inc. and Subsidiaries

	Common Stock		Treasury								
(In thousands)	**Shares**	**Amount**	**Stock**	**Amount**	**Paid-In-Capital**	**Treasury Paid-In-Capital**	**Comprehensive Income (Loss)**	**Accumulated Other Comprehensive Income (Loss)**	**Unearned Compensation**	**Retained Earnings**	**Total**
Balance at December 31, 2003	**68,356**	**$ 68,356**	**(621)**	**$ (621)**	**$ 2,321**	**$ 2,087**	**$**	**$ (314)**	**$ (107)**	**$ 67,052**	**$ 138,774**
Net Income							52,055			52,055	52,055
Other Comprehensive Income, Net of Tax											
Minimum Pension Liability Adjustment							(18,355)				(18,355)
Foreign Currency Translation Adjustments (1)							2,408				2,408
NSO Stock Options							131				131
Realized Loss on Investments							64				64
Other Comprehensive Income							(15,752)	(15,752)			
Comprehensive Income							$ 36,303				
Cash Dividends										(10,924)	(10,924)
Common Stock Purchased			(38)	(38)		(899)					(937)
Issuance of 401(k) Company Match			83	83		2,052					