SERVICEMASTER CO
Form 10-K
March 28, 2008

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

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

**For the fiscal year ended December 31, 2007**

**OR**

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

**Commission File Number 1-14762**

# THE SERVICEMASTER COMPANY

(Exact name of registrant as specified in its charter)

| **Delaware** | **36-3858106** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**860 Ridge Lake Boulevard, Memphis, Tennessee 38120**
(Address of principal executive offices, including zip code)

**(901) 597-1400**
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

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 ý No o

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 o No ý

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 the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment to this Annual Report on Form 10-K. ý

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 the 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 ý (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 Act). Yes o No ý

On July 24, 2007, the registrant completed a transaction pursuant to an Agreement and Plan of Merger, dated as of March 18, 2007, among the registrant and two corporations formed to effect the merger transactions. Pursuant to the merger transaction, the registrant's publicly traded securities were cancelled in exchange for cash. As a result of the merger transaction, the registrant became a privately held corporation and its equity shares are no longer publicly traded. At March 14, 2008, 1,000 shares of the registrant's common stock were outstanding, all of which were owned by CDRSVM Holding, Inc.

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

**THE SERVICEMASTER COMPANY**
**ANNUAL REPORT ON FORM 10-K**

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## PART I

### ITEM 1. BUSINESS

The ServiceMaster Company ("ServiceMaster" or the "Company") is a national company serving both residential and commercial customers. Its services include lawn care, landscape maintenance, termite and pest control, home warranty, disaster response and reconstruction, cleaning and disaster restoration, house cleaning, furniture repair, and home inspection. As of December 31, 2007, ServiceMaster provided these services through a network of approximately 5,500 company-owned locations and franchise licenses operating under the following leading brands: TruGreen, TruGreen LandCare, Terminix, American Home Shield, InStar, Merry Maids, ServiceMaster Clean, Furniture Medic and AmeriSpec. Approximately 98% of ServiceMaster's revenues are generated by sales in the United States. Incorporated in Delaware in 1991, ServiceMaster is the successor to various entities dating back to 1947.

ServiceMaster is organized into five principal operating segments: TruGreen LawnCare; TruGreen LandCare; Terminix; American Home Shield; and Other Operations and Headquarters. All ServiceMaster subsidiaries are wholly owned. The financial information for each operating segment for 2007, 2006 and 2005 is contained in Part II, Item 8 of this Annual Report on Form 10-K.

***RECENT EVENTS MERGER TRANSACTION***

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

On July 24, 2007 (the "Closing Date"), the Merger was completed, and each issued and outstanding share of ServiceMaster common stock, other than shares held by ServiceMaster or Holdings or their subsidiaries and shares held by stockholders who validly perfected their appraisal rights under Delaware law, was converted into the right to receive $15.625 in cash (the "Merger Consideration"). Each share of ServiceMaster common stock owned by ServiceMaster, Holdings or Acquisition Co. or any of their respective direct or indirect wholly-owned subsidiaries was cancelled and retired, and no consideration was paid in exchange for it.

Immediately following the completion of the Merger, all of the outstanding capital stock of Holdings, the ultimate parent company of ServiceMaster, was owned by investment funds sponsored by, or affiliates with, Clayton, Dubilier & Rice, Inc ("CD&R"), Citigroup Private Equity L.P., BAS Capital Funding Corporation and J.P. Morgan Ventures Corporation. (collectively, the "Equity Sponsors").

***SERVICES***

The following table shows the percentage of ServiceMaster's consolidated revenue from continuing operations derived from each of ServiceMaster's reportable segments in the years indicated:

| Segment | 2007 | 2006 | 2005 |
|---|---|---|---|
| TruGreen LawnCare | 33% | 32% | 32% |
| TruGreen LandCare | 12% | 13% | 14% |
| Terminix | 33% | 32% | 33% |
| American Home Shield | 16% | 17% | 16% |
| Other Operations and Headquarters | 6% | 6% | 5% |

***TruGreen LawnCare Segment***

The TruGreen LawnCare segment provides lawn care services primarily under the TruGreen brand name. Revenues derived from the TruGreen LawnCare segment constituted 33%, 32% and 32% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2007, 2006 and 2005, respectively. The TruGreen LawnCare business is seasonal in nature. Weather conditions such as a drought, or snow in the late spring or fall, can affect the demand for lawn care services and may result in a decrease in revenues or an increase in costs.

TruGreen LawnCare is a leading provider of lawn, tree and shrub care services in the United States, serving both residential and commercial customers. As of December 31, 2007, TruGreen LawnCare provided these services in 43 states and the District of Columbia through approximately 206 company-owned locations and 53 franchised locations. As of December 31, 2007, TruGreen LawnCare also provided lawn care services through a subsidiary in Canada and had licensing arrangements with licensees who provided these services in Japan and the United Kingdom.

***TruGreen LandCare Segment***

The TruGreen LandCare segment provides landscape maintenance services primarily under the TruGreen LandCare brand name. Revenues derived from the TruGreen LandCare segment constituted 12%, 13% and 14% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2007, 2006 and 2005, respectively. The TruGreen LandCare business is seasonal in nature. Weather conditions such as a drought can affect the demand for landscape maintenance services, or declines in the volume of snow fall can affect the level of snow removal services, and may result in a decrease in revenues or an increase in costs.

TruGreen LandCare is a leading provider of landscape maintenance services in the United States, serving primarily commercial customers. As of December 31, 2007, TruGreen LandCare provided these services in 41 states and the District of Columbia through approximately 70 company-owned locations and had no international operations.

***Terminix Segment***

The Terminix segment provides termite and pest control services primarily under the Terminix brand name. Revenues derived from the Terminix segment constituted 33%, 32% and 33% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2007, 2006 and 2005, respectively. The Terminix business is seasonal in nature. The termite swarm season, which generally occurs in early spring but varies by region depending on climate, leads to the highest demand for termite control services and, therefore, the highest level of revenues. Similarly, increased pest activity in the warmer months leads to the highest demand for pest control services and, therefore, the highest level of revenues.

Terminix is a leading provider of termite and pest control services in the United States, serving both residential and commercial customers. As of December 31, 2007, Terminix provided these services in 46 states and the District of Columbia through approximately 380 company-owned locations and 128 franchised locations. As of December 31, 2007, Terminix also provided termite and pest control services through three subsidiaries in Mexico and had licensing arrangements whereby licensees provided these services in 13 other countries, primarily in Japan, the Caribbean and the Middle East.

***American Home Shield Segment***

The American Home Shield segment provides home warranty contracts for systems and appliances primarily under the American Home Shield brand name. Revenues derived from the

American Home Shield segment constituted 16%, 17% and 16% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2007, 2006 and 2005, respectively. The American Home Shield business is seasonal in nature. Sales volume in the American Home Shield segment depends, in part, on the number of home resale closings, which historically has been highest in the spring and summer months. American Home Shield's costs related to service call volume are highest in the summer months, especially during periods of unseasonably warm temperatures.

American Home Shield is a leading provider of home warranty contracts for systems and appliances in the United States. It provides residential customers with contracts to repair or replace electrical, plumbing, central heating and central air conditioning systems, hot water heaters and other covered appliances that break down due to normal wear and tear and services those contracts through independent repair contractors. As of December 31, 2007, American Home Shield issued and administered home warranty contracts in 49 states and the District of Columbia and had no international operations.

***Other Operations and Headquarters Segment***

The Other Operations and Headquarters segment provides residential and commercial disaster restoration and cleaning services primarily under the ServiceMaster and ServiceMaster Clean brand names, home cleaning services primarily under the Merry Maids brand name, on-site furniture repair and restoration services primarily under the Furniture Medic brand name and home inspection services primarily under the AmeriSpec brand name. The Other Operations segment also includes ServiceMaster's headquarters functions. Revenues derived from the Other Operations and Headquarters segment constituted 6%, 6% and 5% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2007, 2006 and 2005, respectively.

**ServiceMaster Clean.** ServiceMaster Clean is a leading franchisor in the residential and commercial disaster restoration and cleaning field in the United States. As of December 31, 2007, ServiceMaster Clean provided these services in all 50 states and the District of Columbia through approximately 3,000 franchised locations. As of December 31, 2007, ServiceMaster Clean, through subsidiaries, also provided disaster restoration and cleaning services in Canada, Ireland, the United Kingdom and Spain and had entered into licensing arrangements to provide these services in six other countries: Honduras, Lebanon, Saudi Arabia, Japan, Malaysia and the Philippines.

**Merry Maids.** Merry Maids is a leading provider of home cleaning services in the United States. As of December 31, 2007, these services were provided in 48 states and the District of Columbia through approximately 75 company-owned locations and 450 franchised locations. As of December 31, 2007, Merry Maids, through subsidiaries, also provided home cleaning services, in Canada, Denmark, Ireland and the United Kingdom and had entered into licensing arrangements to provide these services in five other countries: Hong Kong, Japan, Korea, Malaysia, and the Philippines.

**Furniture Medic.** Furniture Medic is a leading provider of on-site furniture repair and restoration services in the United States serving residential customers. As of December 31, 2007, Furniture Medic provided these services in 49 states and the District of Columbia through approximately 275 franchised locations. As of December 31, 2007, Furniture Medic also provided on-site furniture repair and restoration services through subsidiaries in Canada and the United Kingdom and had entered into licensing arrangements to provide these services in France and Saudi Arabia.

**AmeriSpec.** AmeriSpec is a leading provider of home inspection services in the United States serving residential customers. As of December 31, 2007, AmeriSpec provided these services in 46

states and the District of Columbia through approximately 288 franchised locations. AmeriSpec also provided home inspection services through a subsidiary in Canada.

***Businesses Held Pending Sale***

InStar is a direct provider of disaster response and reconstruction services for customers in the United States. As of December 31, 2007, InStar provided these services in 32 states and the District of Columbia through 15 company-owned locations and had no international operations. In the fourth quarter of 2007, management of the Company concluded that InStar did not fit within the long-term strategic plans of the Company and committed to a plan to sell the business.

***MARKETING AND DISTRIBUTION***

ServiceMaster markets its services primarily through yellow pages advertisements, direct mail, the internet, television and radio advertising, print advertisements, door-to-door solicitation and telemarketing. Additionally, American Home Shield markets its home service contracts through real estate brokerage offices in conjunction with the resale of single-family residences and through financial institutions and insurance agencies.

***HEADQUARTER FUNCTIONS***

The Business Support Center, headquartered in Memphis, Tennessee, administers payroll, benefits, risk management, travel and certain procurement services for ServiceMaster's internal operations. Various administrative support departments also provide personnel, communications, marketing, government and public relations, administrative, accounting, financial, tax, human resources, information technology and legal services.

***SERVICE MARKS, TRADEMARKS AND TRADE NAMES***

ServiceMaster holds various service marks, trademarks and trade names, such as ServiceMaster, Terminix, TruGreen, TruGreen LandCare, Merry Maids, ServiceMaster Clean, American Home Shield, AmeriSpec, InStar and Furniture Medic, that it deems particularly important to the advertising and franchising activities conducted by each of its operating segments. As of December 31, 2007, ServiceMaster's marks were registered in the United States and 118 other countries.

***FRANCHISES***

Franchises are important to the TruGreen LawnCare, Terminix, ServiceMaster Clean, Merry Maids, AmeriSpec and Furniture Medic businesses. Total franchise fees (initial and recurring) represented 3.7%, 3.6% and 3.4% of consolidated revenue from continuing operations in 2007, 2006 and 2005, respectively. Related franchise operating expenses were 2.2%, 2.3% and 2.1% of consolidated operating expenses in 2007, 2006 and 2005, respectively. Total franchise related profits comprised 31.7%, 15.8% and 14.1% of consolidated operating income in 2007, 2006 and 2005, respectively. Franchise agreements entered into in the course of these businesses are generally for a term of five to ten years. The majority of these franchise agreements are renewed prior to expiration. The majority of international licenses are for ten year terms.

***COMPETITION***

ServiceMaster competes with many other companies in the sale of its services, franchises and products. The principal methods of competition in ServiceMaster's businesses include quality and speed of service, name recognition and reputation, pricing and promotions, customer satisfaction, brand awareness, professional sales forces, and reputation/referrals. Competition in all of the Company's markets is strong.

**Lawn Care Services.** Competition in the market for lawn care services comes mainly from local, independently owned firms and from homeowners who care for their own lawns. Competition also comes from Scotts, which continues to expand towards a more national footprint.

**Landscape Maintenance Services.** Competition in the market for commercial landscape maintenance services comes mainly from small, owner-operated companies operating in a limited geographic market and, to a lesser degree, from a few large companies (notably, The Brickman Group and The Valley Crest Companies) operating in multiple markets, and from property owners who perform their own landscaping services.

**Termite and Pest Control Services.** Competition in the market for termite and pest control services comes mainly from regional and local, independently owned firms, from homeowners who treat their own termite and pest control problems, and from Orkin, a subsidiary of Rollins, which operates on a national basis. Ecolab Inc. competes nationally in the commercial pest control segment.

**Home Warranty Contracts for Systems and Appliances.** Competition in the market for home warranty contracts for systems and appliances comes mainly from regional providers of home warranties. Several competitors are initiating expansion efforts into additional states.

**Home Inspection Services.** Competition in the market for home inspection services comes mainly from regional and local, independently owned firms.

**Residential & Commercial Disaster Restoration and Cleaning Services.** Competition in the market for disaster restoration and cleaning services comes mainly from local, independently owned firms and a few national professional cleaning companies such as ServPro, Paul Davis, Befor and BMS Cat.

**Home Cleaning Services.** Competition in the market for home cleaning services comes mainly from local, independent contractors and a few national companies such as Stanley Steemer and Chem Dry.

**Furniture Repair Services.** Competition in the market for furniture repair services comes mainly from local, independent contractors.

***MAJOR CUSTOMERS***

ServiceMaster has no single customer that accounts for more than 10% of its consolidated operating revenue. Additionally, no operating segment has a single customer that accounts for more than 10% of its operating revenue. None of ServiceMaster's operating segments is dependent on a single customer or a few customers, the loss of which would have a material adverse effect on the segment.

***REGULATORY COMPLIANCE***

***Government Regulations***

ServiceMaster's operating segments are subject to various federal, state and local laws and regulations, compliance with which increases ServiceMaster's operating costs, limits or restricts the services provided by ServiceMaster's operating segments or the methods by which ServiceMaster's operating segments sell those services or conduct their respective businesses, or subjects ServiceMaster and its operating segments to the possibility of regulatory actions or proceedings.

These federal and state laws include laws relating to consumer protection, wage and hour regulations, deceptive trade practices, permit and license requirements, Real Estate Settlement

Procedures Act, workers' safety (e.g., the Occupational Safety and Health Act), environmental regulations (e.g., the Clean Air Act) and employee benefits (e.g., the Consolidated Omnibus Budget Reconciliation Act of 1985 and the Employee Retirement Income Security Act of 1974). The TruGreen LawnCare, TruGreen LandCare and Terminix businesses must also meet the Department of Transportation and Federal Motor Carrier Safety Administration requirements with respect to their fleets of vehicles. American Home Shield is regulated by the Department of Insurance in certain states and the Real Estate Commission in Texas. TruGreen and Terminix are regulated by various state and local laws and regulations which are enforced by state Departments of Agriculture, Pest Control Boards, Departments of Environmental Conservation and similar government entities.

***Consumer Protection and Telemarketing Matters***

ServiceMaster is subject to federal and state laws and regulations designed to protect consumers, including laws governing consumer privacy and fraud, the collection and use of consumer data, telemarketing and other forms of solicitation. Noncompliance with these laws and regulations can subject ServiceMaster to fines or various forms of civil or criminal prosecution, any of which could have an adverse effect on its financial condition, results of operations and cash flows.

The telemarketing rules adopted by the Federal Communications Commission pursuant to the Federal Telephone Consumer Protection Act and the Federal Telemarketing Sales Rule issued by the Federal Trade Commission govern ServiceMaster's telephone sales practices. In addition, many states have adopted statutes and regulations targeted at direct telephone sales activities. The implementation of Do-Not-Call lists requires TruGreen LawnCare, and, to a lesser extent, ServiceMaster's other operating segments, to rely more extensively on other marketing methods and channels.

***Franchise Matters***

TruGreen LawnCare, Terminix, ServiceMaster Clean, Merry Maids, AmeriSpec and Furniture Medic are subject to various federal, state and international laws and regulations governing franchise sales and marketing and franchise trade practices generally, including applicable rules and regulations of the Federal Trade Commission. These laws and regulations generally require disclosure of business information in connection with the sale of franchises. Certain state regulations also affect the ability of the franchisor to revoke or refuse to renew a franchise. ServiceMaster seeks to comply with regulatory requirements and deal with franchisees in good faith. From time to time, ServiceMaster and one or more franchisees may become involved in a dispute regarding the franchise relationship, including, among other things, payment of royalties or fees, location of branches, advertising, purchase of products by franchisees, compliance with ServiceMaster standards and franchise renewal criteria. There can be no assurance that compliance problems will not be encountered from time to time or that material disputes with one or more franchisees will not arise.

***Environmental Matters***

ServiceMaster's businesses are subject to various federal, state and local laws and regulations regarding environmental matters. Terminix, TruGreen LawnCare and TruGreen LandCare are regulated under many federal and state environmental laws, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Superfund Amendments and Reauthorization Act of 1986, the Federal Environmental Pesticide Control Act of 1972, the Federal Insecticide, Fungicide and Rodenticide Act of 1947, the Resource Conservation and Recovery Act of 1976, the Clean Air Act, the Emergency Planning and Community Right-to-Know Act of 1986, the Oil Pollution Act of 1990 and the Clean Water Act of 1977. ServiceMaster cannot predict the effect

on its operations of possible future environmental legislation or regulations. During 2007, there were no material capital expenditures for environmental control facilities.

***Environmental Matters Businesses Held Pending Sale***

InStar, a business held pending sale, is governed by the provisions of the Clean Air Act, the National Emissions Standards for Hazardous Air Pollutants and the Occupational Safety and Health Act relating to the possible presence of asbestos in the structures serviced by InStar. In addition, InStar must comply with numerous state and local jurisdictions which also regulate procedures which may give rise to the disturbance of asbestos.

On November 8, 2006, InStar entered into a plea agreement with the United States Attorney's Office for the Southern District of Florida requiring that InStar implement an environmental compliance plan, pay a fine of $0.5 million for each count, for a total of $1 million, and make a contribution of $2 million to the Florida Environmental Task Force Trust Fund, in each case relating to conduct that occurred prior to our acquisition of InStar. In addition, InStar entered into a compliance agreement with the United States Environmental Protection Agency ("EPA"). The plea agreement entered into between InStar and the United States Attorney's Office for the Southern District of Florida and the EPA compliance agreement will require ongoing monitoring and compliance by InStar for up to five years, violation of which could potentially result in further fines, loss of licenses, loss of certain federal grants and procurement contracts, and possible criminal sanctions. As part of InStar's plea agreement with the United States Attorney's Office and the EPA compliance agreement, InStar has implemented a comprehensive environmental compliance plan. The environmental compliance plan requires, among other things, mandatory training for all InStar employees on the proper identification, handling and management of hazardous substances, internal monitoring and audits of the compliance plan, and third-party auditing and reporting of compliance with the plan. If the compliance plan is not fulfilled or the plea agreement is violated, potential risks to us include additional and substantial fines, expanded investigation and prosecution by the United States Attorney's Office, loss of certain key contractor licenses currently held by InStar, loss of federal grants and procurement contracts for InStar, negative media exposure and damage to our reputation that could result in loss of business for InStar and other of our business units, and possible criminal sanctions.

***INSURANCE***

We maintain insurance coverage that we believe is appropriate for our business, including workers' compensation, auto liability, general liability, umbrella and property insurance. In addition, we provide various insurance coverages, including deductible reimbursement policies, to our business units through our wholly-owned captive insurance company, which is domiciled in Vermont.

***EMPLOYEES***

On December 31, 2007, ServiceMaster had approximately 29,000 employees.

***AVAILABLE INFORMATION***

ServiceMaster maintains a website at *http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=SVM&script=1901* that includes a hyperlink to a website maintained by a third-party where ServiceMaster's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports are available without charge as soon as reasonably practicable following the time that they are filed with or furnished to the Securities and Exchange Commission.

## ITEM 1A. RISK FACTORS

The following discussion of risk factors contains "forward-looking statements," as discussed in Item 7. These risk factors may be important to understanding any statement in this Annual Report on Form 10-K or elsewhere. The following information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

**We have substantial debt and may incur additional debt, which could adversely affect our financial health and our ability to obtain financing in the future, react to changes in our business and make payments on our debt.**

As of December 31, 2007, we had an aggregate principal amount of debt outstanding of approximately $4.13 billion.

Our substantial debt could have important consequences to holders of our debt and others. Because of our substantial debt:

- our ability to engage in acquisitions without raising additional equity or obtaining additional debt financing could become impaired;
- our ability to obtain additional financing for working capital, capital expenditures, acquisitions, debt service requirements or general corporate purposes and our ability to satisfy our obligations with respect to our debt may be impaired in the future;
- a large portion of our cash flow from operations must be dedicated to the payment of principal and interest on our debt, thereby reducing the funds available to us for other purposes;
- we are exposed to the risk of increased interest rates because a portion of our borrowings, including under the Interim Loan Facility, the Term Facilities and the Revolving Credit Facility (each as defined in Note 14 to the consolidated financial statements included elsewhere in this report and, collectively, the "Credit Facilities"), and certain floating rate operating leases are at variable rates of interest;
- it may be more difficult for us to satisfy our obligations to our creditors, resulting in possible defaults on, and acceleration of, such debt;
- we may be more vulnerable to general adverse economic and industry conditions;
- we may be at a competitive disadvantage compared to our Competitors with less debt or with comparable debt on more favorable terms and that, as a result, they may be better positioned to withstand economic downturns;
- our ability to refinance debt may be limited or the associated costs may increase; and
- our flexibility to adjust to changing market conditions and ability to withstand competitive pressures could be limited, or we may be prevented from carrying out capital spending that is necessary or important to our growth strategy and efforts to improve operating margins of our businesses.

**Despite our indebtedness levels, we and our subsidiaries may be able to incur substantially more debt, including secured debt. This could further exacerbate the risks associated with our substantial debt.**

We and our subsidiaries may be able to incur additional debt in the future. The terms of our debt do not prohibit us or our subsidiaries from doing so. The Credit Facilities provide us with commitments for additional borrowings of up to $500 million under the Revolving Credit Facility and permit additional borrowings beyond those commitments under certain circumstances. If new debt is added to our current debt levels, the related risk we face would increase, and we may not be able to meet all of our debt obligations.

**The agreements and instruments governing our debt contain restrictions and limitations that could significantly impact our ability to operate our business.**

The agreements governing our debt contain covenants that, among other things, restrict our ability to:

- dispose of assets;
- incur additional debt (including guarantees of additional debt);
- prepay other debt or amend other debt instruments;
- pay dividends and make certain payments;
- create liens on assets;
- enter into sale and leaseback transactions;
- engage in certain asset sales, mergers, acquisitions, consolidations or sales of all or substantially all of our assets;
- engage in certain transactions with affiliates;
- permit our subsidiaries to pay dividends to entities other than ServiceMaster;
- change our business; and
- engage in acquisition activity and make investments (including joint ventures).

The restrictions in the agreements governing our debt may prevent us from taking actions that we believe would be in the best interest of our business and may make it difficult for us to execute our business strategy successfully or effectively compete with companies that are not similarly restricted. We may also incur future debt obligations that might subject us to additional restrictive covenants that could affect our financial and operational flexibility. We cannot assure you that we will be able to refinance our debt, at maturity or otherwise, on terms acceptable to us, or at all.

Our ability to comply with the covenants and restrictions contained in the agreements governing our debt may be affected by economic, financial and industry conditions beyond our control. The breach of any of these covenants or restrictions could result in a default under an agreement that would permit the applicable lenders to declare all amounts outstanding thereunder to be due and payable, together with accrued and unpaid interest. If we are unable to repay debt, lenders having secured obligations, such as the lenders under the Term Facilities, could proceed against the collateral securing the debt. In any such case, we may be unable to borrow under the Credit Facilities and may not be able to repay the amounts due under the Credit Facilities. This could have serious consequences to our financial condition and results of operations and could cause us to become bankrupt or insolvent.

**Our ability to generate the significant amount of cash needed to pay interest and principal on our debt and our ability to refinance all or a portion of our debt or obtain additional financing depends on many factors beyond our control.**

As a holding company, we have no independent operations or material assets other than our ownership of equity interests in our subsidiaries, and we will depend on our subsidiaries to distribute funds to us so that we may pay our obligations and expenses, including satisfying our obligations under our debt. Our ability to make scheduled payments on, or to refinance our obligations under, our debt will depend on the ability of our subsidiaries to make distributions and dividends to us, which, in turn, will depend on their operating results, cash requirements and financial condition, general business conditions, and any legal and regulatory restrictions on the payment of dividends to which they may be subject, many of which may be beyond our control, and as described below. The payment of ordinary and extraordinary dividends by our subsidiaries that are regulated as insurance, home warranty, service contract or similar companies is subject to applicable state law limitations. If we cannot receive sufficient distributions from our subsidiaries, we may not be able to meet our obligations to fund general corporate expenses or service our debt obligations.

If our cash flow and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets, seek to obtain additional equity capital or restructure our debt. In the future, our cash flow and capital resources may not be sufficient for payments of interest on and principal of our debt, and such alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

The Revolving Credit Facility will mature in 2013 and the Term Loan Facilities will mature in 2014. The interim loans under the Senior Interim Credit Facility mature on July 24, 2008, and permanent financing issued under the Senior Interim Credit Facility, if any, would mature on July 24, 2015. We may not be able to refinance any of our debt or obtain additional financing, particularly because of our anticipated high levels of debt and the debt incurrence restrictions imposed by the agreements governing our debt, as well as prevailing market conditions. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. The agreements governing our indebtedness restrict our ability to dispose of assets and use the proceeds from any such dispositions. We cannot assure you we will be able to consummate those sales, or if we do, what the timing of the sales will be, whether the proceeds that we realize will be adequate to meet debt service obligations when due or whether we would receive fair value for such assets.

**Increases in interest rates would increase the cost of servicing our debt and could reduce our profitability.**

A significant portion of our outstanding debt, including under the Credit Facilities, bears interest at variable rates. As a result, increases in interest rates, whether because of an increase in market interest rates or a decrease in our creditworthiness, would increase the cost of servicing our debt and could materially reduce our profitability and cash flows. Each one percentage point change in interest rates would result in an approximately $16 million change in the annual interest expense on our Term Loan Facilities after considering the benefit of the interest rate swaps into which we have entered. Assuming all revolving loans were fully drawn, each one percentage point change in interest rates would result in a $5 million change in annual interest expense on our Revolving Credit Facility. In addition during 2008, the Interim Loan Facility provides for floating rates and automatic step ups in rates up to a maximum cash rate of 10.75%. The maximum cash rate would provide for an increase in interest expense compared to current rates of approximately $23 million on an annual basis. We are also exposed to increases in interest rates in respect of our floating rate

operating leases, and a one percentage point change in interest rates would result in an approximately $3 million change in annual rent expense in respect of such operating leases. The impact of increases in interest rates could be more significant for us than it would be for some other companies because of our substantial debt and floating rate operating leases.

**Weather conditions and seasonality affect the demand for our services and our results of operations.**

The demand for our services and our results of operations are affected by weather conditions and by the seasonal nature of our lawn care and landscape maintenance services, termite and pest control services, home warranty and home inspection services, and disaster restoration services. For example, in our markets that do not have a year-round growing season, the demand for our lawn care and landscape maintenance services decreases during the winter months. Droughts and late spring or fall snow storms can adversely impact the demand for lawn care and landscape maintenance services; above normal temperatures can result in increased service calls in the home warranty business; and cooler temperatures can impede the development of the termite swarm and lead to lower demand for our termite services. For instance, in the first quarter of 2007, results in our TruGreen LawnCare segment were adversely impacted by late first quarter snowfalls in the Midwest and Northeast, revenue from termite completions declined in our Terminix segment as termite swarm activity was negatively impacted by cooler than normal weather conditions, and InStar was negatively impacted by a substantially lower volume of hurricane-related work.

**Our markets are highly competitive. Competition could reduce our market share and adversely impact our results of operations.**

We operate in highly competitive markets. Changes in the source and intensity of competition in the markets served by us impact the demand for our services and may result in additional pricing pressures. The relatively low capital cost of entry to certain of our businesses has led to strong competitive markets, including regional and local owner-operated companies. Regional and local competitors operating in a limited geographic area may have lower labor, benefits and overhead costs. The principal methods of competition in our businesses include name recognition, quality and speed of service, pricing, customer satisfaction and reputation. No assurance can be given that we will be able to compete successfully against current or future competitors and that the competitive pressures that we face will not result in reduced market share or negatively impact our financial performance.

**Increases in fuel prices and other operating costs adversely affect our results of operations.**

Our financial performance is affected by the level of our operating expenses, such as fuel, wages and salaries, employee benefits, health care, vehicle, self-insurance costs and other insurance premiums as well as various regulatory compliance costs, all of which may be subject to inflationary pressures. In particular, our financial performance is adversely affected by increases in these operating costs. In recent years, fuel prices have fluctuated widely and have generally increased, including sharp increases in 2006 and 2007. These fuel price increases raise our costs of operating vehicles and equipment. Fuel price increases can also result in increases in the cost of fertilizer, chemicals and other materials used in our business. We cannot predict the extent to which we may experience future increases in fuel costs and other operating costs. In 2007, our cost of services rendered and products sold increased in part due to increased health benefit and fuel costs throughout the Company. To the extent such cost increases continue, we may not be able to fully pass these increased costs through to our existing and prospective customers, and the rates we pay to our subcontractors may increase, any of which could have a material adverse impact on our operating results. With respect to fuel, our fleet, which consumes roughly 30 million gallons

annually, has been negatively impacted by significant increases in fuel prices. Each year, we hedge approximately two-thirds of our estimated annual fuel usage. Fuel costs, even after the benefits of related hedges, increased approximately $8 million pretax in 2007. Based upon the hedges we have executed for 2008, as well as current Department of Energy price forecasts, we would again expect an additional adverse impact in 2008. A shortage in supply of fuel would also adversely affect our business.

**Our future success depends on our ability to attract and retain trained workers and third party contractors.**

Our future success and financial performance depends substantially on our ability to attract, retain and train workers and attract and retain third party contractors. Our ability to expand our operations is in part impacted by our ability to increase our labor force including on a seasonal basis, which may be adversely impacted by a number of factors, including a failure of the U.S. Congress to reauthorize the returning worker exception to the H2B Visa Program, which may negatively impact the number of foreign nationals available to engage in seasonal employment. In the event of a labor shortage, we could experience difficulty in delivering our services in a high-quality or timely manner and could be forced to increase wages in order to attract and retain employees, which would result in higher operating costs and reduced profitability.

**We may not successfully implement our business strategies or realize all of our expected cost savings.**

We may not be able to fully implement our business strategies or realize, in whole or in part within the time frames anticipated, the anticipated benefits of our various initiatives, such as our Terminix Termite Inspection and Protection Plan and TruGreen TruNatural Targeted Lawn Care program and our agreement with Realogy Corporation, or our expected cost savings and efficiency improvements, including those related to the Company's reorganization and restructuring of certain of its businesses and support functions ("Fast Forward"). Our various business strategies and initiatives, including our productivity and customer retention initiatives, are subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. We expect to incur certain costs to achieve our expected cost savings and efficiency improvements. These costs may turn out to be substantially higher than we currently estimate, and we may not fully achieve our expected cost savings and efficiency improvements. Our ability to successfully realize cost savings and the timing of any realization may be affected by factors such as the need to ensure continuity in our operations, contracts, regulations and/or statutes governing employee-employer relationships, our ability to renegotiate contracts or find alternative suppliers and other factors. Our business strategy may also change from time to time. As a result, we may not be able to achieve our expected results of operations.

**Changes in general economic conditions, especially as they may affect home re-sales or consumer confidence or spending levels, may adversely affect the demand for our services.**

Changes in general economic conditions and consumer confidence affect the demand for our services. Unfavorable general economic conditions such as those experienced in recent months, including rising fuel prices, changes in interest rates, continued or further softening of the home resale market, increases in home foreclosures and increases in unemployment rates, could reduce consumer confidence and related spending levels and, in turn, reduce the demand for our services. These factors could also negatively impact the timing or the ultimate collection of accounts receivable, which would negatively impact our operating revenues, profitability and cash flow.

**Public perceptions that our products and services are not environmentally friendly or safe may adversely affect the demand for our services.**

In providing our services, we use, among other things, fertilizers, herbicides and pesticides. Public perception that our products and services are not environmentally friendly or safe, whether justified or not, could lead to reduced demand for our services, impair our reputation, involve us in litigation, damage our brand names and otherwise have a material adverse effect on our business, financial condition and results of operations.

**Changes in the types or mix of our service offerings could affect our financial performance.**

Our financial performance is affected by changes in the types or mix of services we offer our customers. For example, when Terminix transitioned from offering primarily bait termite services to providing both liquid and bait termite services, this transition required the purchase of additional equipment and additional training for our associates. The bait and termite service lines also have different price points (for both the initial treatment and for renewals), different ongoing service obligations, and different revenue recognition policies. These changes in mix can also affect the timing of our revenues, as, for example, when the switch to a new bait product in early 2005 allowed us to recognize revenue from the use of bait termite applications more quickly and thereby reduced deferrals of revenue relating to such applications to future periods. An unsuccessful rollout or adjustment of our service offerings could have a material adverse effect on our financial performance.

**Government laws and regulations applicable to our businesses could increase our legal and regulatory expenses and affect our financial performance.**

Our businesses are subject to significant federal, state and local laws and regulations. These federal and state laws include laws relating to consumer protection, wage and hour requirements, the employment of immigrants, permit and licensing requirements, workers' safety, the environment, insurance and home warranty, employee benefits, telemarketing, the application of fertilizers, herbicides, pesticides and other chemicals, noise and air pollution from power equipment and local regulations, including water management techniques. It is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting our businesses. The laws and regulations applicable to our businesses will likely change in the future and affect our operations and financial performance. In addition, if we were to fail to comply with any applicable law or regulation, we could be subject to substantial fines or damages, be involved in litigation and suffer the loss of licenses or penalties that may affect how our business is operated, which, in turn, would have a material adverse effect on our business, financial condition and results of operations.

**The loss of the services of management personnel and other employees as a result of restructuring could adversely affect our financial performance.**

Among the purposes of Fast Forward is to eliminate layers and bureaucracy and simplify work processes in order to better align the Company's work processes around its operational and strategic objectives. Fast Forward has resulted in employee workforce reductions as part of the cost-savings to be achieved and may include additional workforce reductions in the future. Ultimately, Fast Forward is expected to enhance our financial performance; however, the loss of management personnel and other employees could affect our success and financial performance until the Fast Forward process is completed.

**Our business process outsourcing initiatives may increase our reliance on third-party contractors and expose our business to harm upon the termination or disruption of our third-party contractor relationships.**

Our strategy to increase profitability by reducing our costs of operations includes the implementation of business process outsourcing initiatives. As a result, our future operations may increasingly rely on third-party vendors to provide services that we currently perform internally. Any disruption, termination, or substandard provision of these outsourced services could adversely affect our brands, customer relationships, operating results and financial condition. Also, if a third-party outsourcing provider relationship is terminated, there is a risk that we may not be able to enter into a similar agreement with an alternate provider in a timely manner or on terms that we consider favorable. In addition, in the event a third-party outsourcing relationship is terminated and we are unable to replace it, there is a risk that we may no longer have the capabilities to perform these services internally.

**Compliance with our subsidiary's environmental plan and the costs and effects of legal or administrative proceedings could adversely impact our business and financial results.**

On November 8, 2006, InStar entered into a plea agreement with the United States' Attorney's Office for the Southern District of Florida requiring that InStar implement an environmental compliance plan, pay a fine of $0.5 million for each count, for a total of $1 million, and make a contribution of $2 million to the Florida Environmental Task Force Trust Fund, in each case relating to conduct that occurred prior to our acquisition of InStar. In addition, InStar entered into a compliance agreement with the EPA. The plea agreement entered into between InStar and the United States Attorney's Office for the Southern District of Florida and the EPA compliance agreement will require ongoing monitoring and compliance by InStar for up to five years, violation of which could potentially result in further fines, loss of licenses, loss of certain federal grants and procurement contracts, and possible criminal sanctions. As part of InStar's plea agreement with the United States Attorney's Office and the EPA compliance agreement, InStar has agreed to implement a comprehensive environmental compliance plan. The environmental compliance plan requires, among other things, mandatory training for all InStar employees on the proper identification, handling and management of hazardous substances, internal monitoring and audits of the compliance plan, and third-party auditing and reporting of compliance with the plan. If the compliance plan is not fulfilled and the plea agreement is violated, potential risks to us include additional and substantial fines, expanded investigation and prosecution by the United States Attorney's Office, loss of certain key contractor licenses currently held by InStar, loss of federal grants and procurement contracts for InStar, negative media exposure and damage to our reputation that could result in loss of business for InStar and other of our business units, and possible criminal sanctions.

**Laws and regulations regarding the use of pesticides and fertilizers and claims of personal injury and property damage involving product liability, as well as other environmental laws and regulations, could result in significant costs that adversely affect our operating results.**

Local, state, federal and international laws and regulations relating to environmental matters affect us in several ways. In the United States, all products containing pesticides must be registered with the U.S. Environmental Protection Agency (EPA) (and similar state agencies) before they can be sold. The failure to obtain or the cancellation of any such registration, or the other withdrawal from the market place of such pesticides, could have an adverse effect on our business, the severity of which would depend on the products involved, whether other products could be substituted and whether our competitors were similarly affected. The pesticides we use are manufactured by independent third parties and are evaluated by the EPA as part of its ongoing exposure risk assessment. The EPA may decide that a pesticide we use will be limited or will not be

re-registered for use in the United States. We cannot predict the outcome or the severity of the effect of the EPA's continuing evaluations.

In addition, the use of certain pesticides, herbicides and fertilizer products is regulated by various local, state, federal and international environmental and public health agencies. These regulations may require that only certified or professional users apply the product or that certain products be used only on certain types of locations, may require users to post notices on properties to which products have been or will be applied, may require notification to individuals in the vicinity that products will be applied in the future or may ban the use of certain products. Even if we are able to comply with all such regulations and obtain all necessary registrations, we cannot assure you that our products, particularly pesticide products, will not be alleged to cause injury to the environment or to people under any circumstances. The costs of compliance, remediation or products liability lawsuits could materially affect our future operating results.

Local, state, federal and foreign agencies regulate the disposal, handling and storage of waste, air and water discharges from our facilities and the investigation and clean-up of contaminated sites. We could incur significant costs, including clean-up costs, fines and civil or criminal sanctions and claims by third parties for property damage and personal injury, as a result of violations of or liabilities under these laws and regulations. If there is a significant change in the facts and circumstances surrounding the assumptions upon which we operate or if we are found not to be in substantial compliance with applicable environmental and public health laws and regulations, it could have a material impact on future environmental capital expenditures and other environmental expenses and our results of operations, financial position and cash flows. In addition, potentially significant expenditures could be required to comply with environmental laws and regulations, including requirements that may be adopted or imposed in the future.

**We may not be able to adequately protect our intellectual property and other proprietary rights that are material to our business.**

Our ability to compete effectively depends in part on our rights to service marks, trademarks, trade names and other intellectual property rights we own or license, particularly our registered brand names, *Terminix*, *TruGreen*, *TruGreen LawnCare, TruGreen LandCare*, *Merry Maids*, *ServiceMaster Clean*, *American Home Shield*, *AmeriSpec*, *InStar*, *Furniture Medic* and *ServiceMaster.* We have not sought to register every one of our marks either in the United States or in every country in which they are used. Furthermore, because of the differences in foreign trademark, patent and other intellectual property or proprietary rights laws, we may not receive the same protection in other countries as we would in the United States. If we are unable to protect our proprietary information and brand names, we could suffer a material adverse effect on our business, financial condition or results of operations.

Litigation may be necessary to enforce our intellectual property rights and protect our proprietary information, or to defend against claims by third parties that our products or services infringe their intellectual property rights. Any litigation or claims brought by or against us could result in substantial costs and diversion of our resources. A successful claim of trademark, patent or other intellectual property infringement against us could subject us to damages or prevent us from providing certain services under our recognized brand names, which could have a material adverse effect on our business, financial condition or results of operations.

**Disruptions or security failures in our information technology systems could create liability for us and/or limit our ability to effectively monitor, operate and control our operations and adversely affect our operating results**.

Our information technology systems facilitate our ability to monitor, operate and control our operations. While we have disaster recovery plans in place, any disruption in these plans or the

failure of these plans to operate as expected could, depending on the magnitude of the problem, adversely affect our operating results by limiting, among other things, our capacity to monitor, operate and control our operations effectively. In addition, because our systems contain information about individuals and businesses, our failure to maintain the security of the data we hold, whether the result of our own error or the malfeasance or errors of others, could harm our reputation or give rise to legal liabilities relating to violations of privacy or otherwise, which may lead to lower revenues, increased costs and other material adverse effects on our results of operations.

**We are subject to various restrictive covenants that could adversely impact our operations.**

From time to time, we enter into noncompetition agreements that restrict us from entering into lines of business (i.e., heating, ventilation and air conditioning repair and installation, electrical repair and installation, plumbing) or operating in certain areas into which we may desire to expand our business. We also are subject to non-solicitation and no hire covenants that may restrict our ability to solicit potential customers or employees. To the extent that such restrictive covenants prevent us from taking advantage of business opportunities, our operations may be adversely impacted.

**Future acquisitions and our reorganization efforts could affect our financial performance.**

We plan to continue to pursue opportunities to expand through selective acquisitions. Our ability to make acquisitions at reasonable prices and to integrate acquired businesses are important factors in our future growth. We cannot assure that we will be able to manage or integrate acquired businesses successfully. Any inability on our part to consolidate and manage growth from acquired businesses could have an adverse effect on our financial performance, and there can be no assurance that any acquisition that we make in the future will provide us with the benefits that were anticipated when entering into such acquisition. The process of integrating an acquired business and/or reorganizing our management and merit processes may create unforeseen difficulties and expenses, including the diversion of resources needed to integrate new businesses, technologies, products, personnel or systems; the inability to retain employees, customers and suppliers; the assumption of actual or contingent liabilities; failure to follow internal processes; write-offs or impairment charges relating to goodwill and other intangible assets; and unanticipated or unknown liabilities relating to acquired businesses.

**We are indirectly owned and controlled by the Equity Sponsors, and their interests as equity holders may conflict with holders of our debt.**

We are indirectly owned and controlled by the Equity Sponsors, who will have the ability to control our policies and operations. The directors appointed by affiliates of the Equity Sponsors are able to make decisions affecting our capital structure, including decisions to issue or repurchase capital stock, pay dividends and incur additional debt. The interests of the Equity Sponsors may not in all cases be aligned with the interests of the holders of our debt. For example, if we encounter financial difficulties or are unable to pay our debts as they mature, the interests of our Equity Sponsors might conflict with the interests of holders of our debt. In addition, our Equity Sponsors may have an interest in pursuing acquisitions, divestitures, financings or other transactions that, in their judgment, could enhance their equity investments, even though such transaction might involve risks to holders of our debt. Furthermore, the Equity Sponsors may in the future own businesses that directly or indirectly compete with us. One or more of the Equity Sponsors also may pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

**ITEM 2. PROPERTIES**

The headquarters for TruGreen LawnCare, TruGreen LandCare and Terminix, along with the corporate headquarters, are located in leased premises at 860 Ridge Lake Boulevard, Memphis, Tennessee. The headquarters for American Home Shield are located in leased premises at 889 Ridge Lake Boulevard, Memphis, Tennessee. The headquarters for ServiceMaster Clean, Merry Maids, AmeriSpec and Furniture Medic and a training facility are located in leased premises at 3839 Forest Hill Irene Road, Memphis, Tennessee. In addition, ServiceMaster leases space for a call center located at 6399 Shelby View Drive, Memphis, Tennessee; offices located at 850 and 855 Ridge Lake Boulevard, Memphis, Tennessee; a training facility located at 1650 Shelby Oaks Drive North, Memphis, Tennessee; and a warehouse located at 1575 Two Place, Memphis, Tennessee. ServiceMaster believes that the headquarters, call center facility, offices, training facilities and warehouse located in Memphis are suitable and adequate to support the current needs of its operating companies and corporate headquarters in the Memphis area. ServiceMaster currently has a lease on office space in Downers Grove, Illinois that housed its former corporate headquarters. ServiceMaster has exercised an option to terminate the lease as of June 30, 2008 in connection with the consolidation of its corporate offices in Memphis, Tennessee.

ServiceMaster's operating companies own and lease a variety of facilities principally in the United States for branch and service center operations and for office, storage, call center and data processing space. The following chart identifies the number of owned and leased facilities for each operating company. ServiceMaster believes that these facilities, when considered with the headquarters, call center facility, offices, training facilities and warehouses described above, are suitable and adequate to support the current needs of its business.

| Operating Company | Owned Facilities | Leased Facilities |
|---|---|---|
| TruGreen LawnCare | 5 | 316 |
| TruGreen LandCare | 1 | 137 |
| Terminix | 12 | 479 |
| American Home Shield | 1 | 5 |
| ServiceMaster Clean | 0 | 6 |
| Merry Maids | 0 | 79 |
| InStar | 0 | 21 |

**ITEM 3. LEGAL PROCEEDINGS**

***New York Department of Environmental Conservation Notice of Violation to Terminix***

On July 21, 2006, the New York State Department of Environmental Conservation, Division of Legal Affairs, Region 4 ("NYDEC"), sent to Terminix a certified letter enclosing a Notice of Hearing, Pre-Hearing Conference and Complaint, naming as Respondents Terminix and seven individuals employed by four Terminix branches located in New York. The Complaint alleged various violations by the Respondents of Article 33 of the Environmental Conservation Law of the State of New York and Part 20 et seq. of Title 6 of the Official Compilation of Codes, Rules and Regulations and sought a $1,500,000 fine, the submission of a plan by the Respondents through a third-party consultant for evaluating purported training, record-keeping, employee license certifications and pesticide label distribution issues at four New York branches, and the submission of a plan to address any issues identified during such evaluation. On September 29, 2006, Terminix filed on behalf of the Respondents an Answer and Affirmative Defenses.

Terminix met with the NYDEC on numerous occasions since the filing of its Answer and Affirmative Defenses to discuss the resolution of the matter, and Terminix and the NYDEC have reached agreement on the final terms of the consent agreement. Under the final agreement, Terminix will make a one-time payment of $150,000, with a suspended fine in the amount of

$200,000. The suspended fine is conditioned upon Terminix adhering to the compliance portion of the consent agreement. On June 22, 2007, the Commissioner executed the consent agreement and the agreement is now final. The initial compliance report was due and submitted to the NYDEC on September 22, 2007. The final report will be due for submission on June 22, 2008.

***Class Action suits brought against the Company and CD&R***

Following the announcement of the proposed acquisition of ServiceMaster in 2007, five (5) complaints were filed against ServiceMaster concerning the proposed merger: *Kaiman v. Spainhour, et al*. (filed in Chancery Court in Memphis, Tennessee) ("Kaiman"); *Golombuski v. The ServiceMaster Co.*, et al. (filed in Circuit Court in Memphis, Tennessee) ("Golombuski"); *Sokol and Bowen v. The ServiceMaster Co., et al.* (filed in Circuit Court in Memphis, Tennessee) ("Sokol"); *Palmer v. The ServiceMaster Co., et al.* (filed in Cook County Circuit Court in Chicago, Illinois) *("Palmer");* and *Smith v. The ServiceMaster Co., et al.* (filed in Chancery Court for Newcastle County, Delaware) *("Smith").*

All of the complaints name ServiceMaster, its CEO and its Board of Directors as defendants. The *Kaiman, Golombuski and Smith* complaints additionally name CD&R as a defendant and the Smith complaint also names the investors in CDRSVM Topco, Inc., CDRSVM Topco, Inc. and Acquisition Co. All of the complaints allege breach of fiduciary duties and seek injunctive relief. The *Kaiman* complaint also contains a specific count seeking indemnification of costs. The *Golombuski* and *Smith* complaints also allege that CD&R aided and abetted the individual defendants' breach of fiduciary duties, while the *Kaiman* complaint generally alleges that "defendants" breached their fiduciary duties or aided and abetted a breach of fiduciary duty. The *Smith* complaint also alleges that there are material omissions in the preliminary proxy statement relating to the proposed acquisition that the Company filed with the SEC on April 16, 2007. All five of the complaints challenged and indicated an intent to enjoin the proposed acquisition of ServiceMaster.

After the plaintiff in the *Smith* case filed a motion for expedited discovery and for the scheduling of a preliminary injunction hearing, the parties to the *Smith* case reached an agreement in principle to settle that case on a class wide basis and entered into a Memorandum of Understanding reflecting that agreement. The Memorandum of Understanding provides, among other things, for ServiceMaster to include certain additional disclosures in the final Proxy Statement with respect to the proposed merger (subsequently made on June 19, 2007) and for a reduction of the Company termination fee from $100 million to $90.8 million (subsequently made). The Memorandum of Understanding stated that if the settlement contemplated by the Memorandum of Understanding is approved, plaintiff and his counsel intend to petition the court for an award of fees and expenses. It further stated that the parties reached no agreement with regard to an appropriate award of fees to plaintiff's counsel, and defendants reserved all rights to oppose any fee application. The parties are negotiating a definitive Stipulation of Settlement, which requires confirmatory discovery to be completed by the plaintiffs and the approval of the Delaware Court.

Notwithstanding the settlement agreement reached in the *Smith* case, the plaintiffs in the other four pending actions nonetheless attempted to pursue those actions. The *Kaiman*, *Golombuski* and *Sokol* complaints were consolidated, and the Tennessee court handling those cases entered an order denying the plaintiffs' motion for expedited discovery and granting a stay of these actions pending the resolution of the *Smith* case in Delaware. The Illinois court handling the *Palmer* case denied the plaintiff's motion for expedited discovery and dismissed the complaint on the basis of the pending settlement in Delaware. The plaintiffs in *Palmer* appealed to the Illinois Appellate Court. The *Palmer* appeal was voluntarily dismissed on October 25, 2007.

The Company believes that the settlement agreement with respect to the *Smith* case should resolve all of the foregoing litigation, other than the *Palmer* action, which has already concluded. Notwithstanding the settlement, the Company believes the foregoing lawsuits to be without merit

and, if the settlement is not fully consummated for any reason, intends to defend the remaining actions vigorously.

***New York Department of Environmental Conservation Notice of Violation to TruGreen LawnCare***

On or about March 31, 2006, TruGreen LawnCare received a Notice of Violation ("NOV") from the New York Department of Environmental Conservation ("NYDEC") alleging violations of New York pesticide law related to residential lawn applications occurring in New York over a 6-year period. The alleged violations include applying pesticides without signed contracts, applying pesticides without providing warning labels, expired applicator licenses, improper posting, undocumented training records, failing to comply with labeling requirements, improper application, and other, similar application issues. None of the allegations claim property damage or harm to humans, wildlife or the environment. In January of 2007, the NYDEC made an initial civil penalty demand against TruGreen in the amount of $260,000 to resolve these alleged violations. On March 23, 2007, TruGreen agreed in principle to settle the matter for a total of $150,000. TruGreen and the NYDEC executed a Consent Order on June 7, 2007. According to the terms of the Consent Order, TruGreen paid the sum of $100,000 contemporaneous with the execution of the Consent Order, and an additional sum of $50,000 was suspended provided TruGreen submitted a satisfactory recycling plan and demonstrates compliance with such plan throughout the next year. TruGreen submitted the recycling plan to the NYDEC. The NYDEC requested additional information concerning the recycling vendor and the training of TruGreen's branch employees on recycling procedures, which has been supplied by TruGreen. TruGreen is currently awaiting final NYDEC approval of the submitted plan, at which time this matter will be closed.

***Colorado Department of Agriculture Notice of Disciplinary Proceedings to Terminix***

On or about September 2, 2004, two Terminix branches in Colorado, Colorado Springs and Pueblo, received subpoenas duces tecum from the Colorado Department of Agriculture requesting customer information regarding Sentricon termite baiting system customers of those branches. Those Terminix branches produced documents to the Colorado Department of Agriculture in response to those subpoenas. In 2007, the Colorado Department of Agriculture conducted announced inspections of several Terminix branches in Colorado. On February 5, 2008, the Colorado Department of Agriculture issued Notices of Disciplinary Proceedings relating to the Colorado Springs, Colorado, and Pueblo, Colorado, Terminix branches, which included approximately 270 alleged violations of various sections of the Colorado Pesticide Applicators' Act, including failure to properly inspect monitoring devices pursuant to the label requirements, failure to install auxiliary stations and follow self-recruitment procedures, and failure to replace monitoring devices and/or bait in those stations. The maximum financial penalty for each individual violation could be $1,000 and additional penalties could include the suspension or revocation of the license for Terminix in the state of Colorado. Terminix has requested and received an extension of time to respond to the Notice and must submit a response by March 26, 2008.

***Squires v. The ServiceMaster Company and Clayton, Dubilier & Rice, Inc.***

On March 11, 2008, a lawsuit was filed by Vernon Squires, on behalf of himself and a putative class, against the Company and CD&R, in the Chancery Court of Tennessee. The Complaint alleges that, in connection with the acquisition of the Company by CD&R, the defendants improperly cancelled out-of-the-money stock options that had been previously granted to individuals in connection with certain stock option plans. The Complaint asserts causes of action against the Company for breach of contract and breach of the duty of good faith and fair dealing, conversion, and for a declaratory judgment, and asserts additional claims against CD&R. The Complaint seeks compensatory damages, attorneys' fees and costs, as well as pre-judgment and post-judgment interest against the Company. No specific monetary demand has been asserted. CD&R has notified the Company that CD&R believes it is entitled to indemnification by the Company for the claims against CD&R under the Complaint pursuant to its Indemnification Agreement with the Company. See "Certain Relationships and Related Transactions, and Director Independence Indemnification Agreements." Unless otherwise extended, the Company will answer or move against the Complaint by April 11, 2008.

In the ordinary course of conducting our business activities, we become involved in other judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. These proceedings include general and commercial liability actions and a small number of environmental proceedings. We do not expect any of these proceedings to have a material effect on our business, financial condition, or results of operations.

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

During the fourth quarter of the fiscal year covered by this Annual Report on Form 10-K, no matters were submitted to a vote of security holders.

# PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our sole class of issued equity is common stock, all of which is held by CDRSVM Holding, Inc., which is a company wholly owned by CDRSVM Investment Holding, Inc., a company wholly owned by ServiceMaster Global Holdings, Inc.

### Quarterly Cash Dividends

The following table sets forth the cash dividends paid on ServiceMaster's common stock:

| | 2007 | 2006 |
|---|---|---|
| **Cash Dividends Per Share:** | | |
| First Quarter | $ 0.12 | $ 0.11 |
| Second Quarter | 0.12 | 0.11 |
| Third Quarter | 0 | 0.12 |
| Fourth Quarter | 0 | 0.12 |
| | $ 0.24 | $ 0.46 |

On July 24, 2007, the Company completed a merger transaction pursuant to an Agreement and Plan of Merger, dated as of March 18, 2007, among the Company and two corporations formed to effect the merger transaction. Pursuant to the merger transaction, the Company's publicly traded securities were cancelled in exchange for cash. As a result of the merger transaction, the Company became a privately held corporation and its equity shares are no longer publicly traded. As a result, the Company is not required to file this Annual Report on Form 10-K with the Securities and Exchange Commission and is doing so on a voluntary basis.

There are restrictions on the Company's ability to pay dividends in the future. For further discussion see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K.

**ITEM 6. SELECTED FINANCIAL DATA**

**Five-Year Financial Summary**

| (In thousands, except per share data) | Successor | Predecessor | | | | |
|---|---|---|---|---|---|---|
| | Period from Jul. 25, 2007 to Dec. 31, 2007 | Period from Jan. 1, 2007 to Jul. 24, 2007 | Year Ended December 31 | | | |
| | | | 2006 | 2005 | 2004 | 2003 |
| **Operating Results:** | | | | | | |
| Operating revenue | $ 1,422,358 | $ 1,934,390 | $ 3,332,703 | $ 3,239,478 | $ 3,068,068 | $ 2,895,028 |
| Operating income(1) | 33,240 | 143,932 | 324,128 | 340,083 | 324,308 | 110,655 |
| *Percentage of operating revenue* | *2.3%* | *7.4%* | *9.7%* | *10.5%* | *10.6%* | *3.8%* |
| Non-operating expense | 181,734 | 6,551 | 43,639 | 45,385 | 53,464 | 58,394 |
| (Benefit) provision for income taxes(1),(2) | (52,182) | 51,692 | 95,205 | 114,137 | (45,779) | 54,716 |
| (Loss) income from continuing operations(1),(2) | (96,312) | 85,689 | 185,284 | 180,561 | 316,623 | (2,455) |
| (Loss) income from businesses held pending sale and discontinued operations, net of income taxes(1),(2) | (27,208) | (4,588) | (15,585) | 18,364 | 14,604 | (222,232) |
| Net (loss) income | $ (123,520) | $ 81,101 | $ 169,699 | $ 198,925 | $ 331,227 | $ (224,687) |
| Cash dividends per share | $ | $ 0.24 | $ 0.46 | $ 0.44 | $ 0.43 | $ 0.42 |
| **Financial Position:** | | | | | | |
| Total assets | $ 7,591,060 | | $ 3,134,441 | $ 3,048,009 | $ 3,161,074 | $ 2,975,131 |
| Total liabilities | 6,287,526 | | 1,945,583 | 1,893,369 | 2,069,539 | 2,058,305 |
| Total long-term debt outstanding | 4,130,811 | | 706,954 | 677,289 | 825,959 | 837,976 |
| Minority interest | | | 100,000 | 100,000 | 100,000 | 100,309 |
| Shareholders' equity(1),(2) | 1,303,534 | | 1,088,858 | 1,054,640 | 991,535 | 816,517 |

(1)

The 2007 results include restructuring charges for severance, as well as costs associated with Fast Forward, and payments for employee retention and severance related to the Company's decision to consolidate its corporate headquarters into its operations support center in Memphis, Tennessee and close its former headquarters in Downers Grove, Illinois. The restructuring charges totaled $26.0 million pretax ($15.9 million after-tax) in the period from July 25 to December 31, 2007 and $16.9 million pretax ($10.7 million after-tax) in the period from January 1 to July 24, 2007. The results also include merger charges related to the purchase of ServiceMaster by a group of investors led by Clayton, Dubilier & Rice, Inc. The merger related charges totaled $0.8 million pretax ($0.1 million after-tax) in the period from July 25 to December 31, 2007, $41.4 million pretax ($34.7 million after-tax) in the period from January 1 to July 24, 2007 and $1.0 million pretax ($0.7 million after-tax) in 2006.

The 2006 results include restructuring charges for severance, as well as costs associated with "Project Accelerate", the Company's initiative to improve the effectiveness and efficiency of its functional support areas, and accruals for employee retention and severance

to be paid in future periods that are related to the Company's decision to consolidate its corporate headquarters into its operations support center in Memphis, Tennessee and close its former headquarters in Downers Grove, Illinois. The restructuring charges totaled $21.6 million pretax and $6.9 million after-tax. The after-tax impact of the restructuring charges includes

approximately $6 million of non-recurring net operating loss carry forward benefits which became realizable to the Company as a result of its decision to consolidate its corporate headquarters in Memphis.

In accordance with SFAS 142, the Company's goodwill and intangible assets that are not amortized are subject to at least an annual assessment for impairment by applying a fair-value based test. In the fourth quarter of 2007, the Company recorded a non-cash impairment charge associated with the goodwill at its InStar business in the amount of $12.9 million pre-tax ($8.8 million after-tax). This charge is classified within the financial statement caption "(loss) income from businesses held pending sale and discontinued operations, net of income taxes." In the first quarter of 2006, the Company recorded a $42 million pre-tax ($25 million after tax) impairment charge for expected losses on the disposition of American Residential Services and American Mechanical Services. In the third quarter of 2003, the Company recorded a non-cash impairment charge associated with the goodwill and intangible assets at its TruGreen LandCare business unit. This charge, which is included in the results of continuing operations for 2003, totaled $189 million pre-tax ($156 million after-tax). Also in the third quarter of 2003, the Company recorded a non-cash impairment charge of $292 million pretax ($227 million after-tax) associated with the goodwill and intangible assets of certain sold operations and this charge is classified within the financial statement caption "(loss) income from businesses held pending sale and discontinued operations, net of income taxes".

In addition to the impairment charges noted above, the Company also recorded an impairment charge of $18.1 million pre-tax ($12.3 million after-tax) in the fourth quarter of 2007 related to the long-lived assets (other than goodwill) at its InStar business in connection with the decision to sell the InStar business. This charge is classified within the financial statement caption "(loss) income from businesses held pending sale and discontinued operations, net of income taxes."

(2)

In the fourth quarter of 2006, the Company recorded a reduction in income tax expense of $7 million resulting from the favorable resolution of state tax items related to a prior non-recurring transaction.

Related to a comprehensive agreement with the Internal Revenue Service regarding its examination of the Company's federal income taxes through the year 2002, the Company recorded a non-cash reduction in its 2004 tax provision related to deferred taxes on intangible assets, which had not previously been recorded, thereby increasing net income by approximately $159 million. Approximately $150 million related to continuing operations and $9 million related to discontinued operations.

## Item 7. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Merger Agreement

On March 18, 2007, ServiceMaster entered into the Merger Agreement with Holdings and Acquisition Co. The Merger Agreement provided that, upon the terms and subject to the conditions set forth in the Merger Agreement, Acquisition Co. would merge with and into ServiceMaster, with ServiceMaster as the surviving corporation.

On the Closing Date, the Merger was completed, and each issued and outstanding share of ServiceMaster common stock, other than shares held by ServiceMaster or Holdings or their subsidiaries and shares held by stockholders who validly perfected their appraisal rights under Delaware law, was converted into the right to receive $15.625 in cash. Each share of ServiceMaster common stock owned by ServiceMaster, Holdings or Acquisition Co. or any of their respective direct or indirect wholly-owned subsidiaries was cancelled and retired, and no consideration was paid in exchange for it.

Immediately following the completion of the Merger, all of the outstanding capital stock of Holdings, the ultimate parent company of ServiceMaster, was owned by investment funds sponsored by, or affiliates with the Equity Sponsors.

Equity contributions totaling $1,431.1 million from the Equity Sponsors, together with (i) borrowings under a new $1,150 million senior unsecured interim loan facility ("Interim Loan Facility"), (ii) borrowings under a new $2,650 million senior secured term loan facility, and (iii) cash on hand at ServiceMaster, were used, among other things, to finance the aggregate Merger Consideration, to make payments in satisfaction of other equity-based interests in ServiceMaster under the Merger Agreement, to settle existing interest rate swaps, to redeem or provide for the repayment of certain of the Company's existing indebtedness and to pay related transaction fees and expenses. In addition, letters of credit issued under a new $150 million pre-funded letter of credit facility (together with the senior secured term loan facility, the "Term Facilities") were used to replace and/or secure letters of credit previously issued under a ServiceMaster credit facility that was terminated as of the Closing Date. On the Closing Date, the Company also entered into, but did not draw under, a new $500 million senior secured revolving credit facility (the "Revolving Credit Facility").

In connection with the Merger and the related transactions (the "Transactions"), ServiceMaster retired certain of its existing indebtedness, including ServiceMaster's $179.0 million, 7.875% notes due August 15, 2009 (the "2009 Notes"). On the Closing Date, the 2009 Notes were called for redemption and they were redeemed on August 29, 2007. Additionally, the Company utilized a portion of the proceeds from the Term Facilities to repay at maturity ServiceMaster's $49.2 million, 6.95% notes due August 15, 2007 (the "2007 Notes").

### Results of Operations

Although the ServiceMaster Company continued as the same legal entity after the Merger, the accompanying consolidated financial statements are presented for two periods, Predecessor and Successor, which relate to the period preceding the Merger and the period succeeding the Merger, respectively. The separate presentation is required under generally accepted accounting principles in the United States ("GAAP") when there is a change in accounting basis, which occurred when purchase accounting was applied to the acquisition of the Predecessor. Purchase accounting requires that the historical carrying value of the assets acquired and liabilities assumed be adjusted to fair value, which may yield results that are not comparable on a period-to-period basis due to the different, and sometimes higher, cost basis associated with the allocation of the purchase price. The

Company refers to the operations of the ServiceMaster Company for both the Predecessor and Successor periods. The consolidated statement of financial position as of December 31, 2007 and the consolidated statements of operations, shareholders' equity and cash flows for the period July 25, 2007 to December 31, 2007 reflect the financial position, operations and cash flows of the Successor. The consolidated statement of financial position as of December 31, 2006, the consolidated statements of operations, shareholders' equity and cash flows for the period January 1, 2007 to July 24, 2007, and the years ended December 31, 2006 and 2005 reflect the financial position, operations and cash flows of the Predecessor.

The period to period comparisons of our results of operations have been prepared using the historical periods included in our financial statements. Accordingly, in this "Results of Operations" section, we compare the period from January 1 to July 24, 2007 and the period from July 25 to December 31, 2007 with the year ended December 31, 2006. In addition, we compare the year ended December 31, 2006 with the year ended December 31, 2005.

**Periods from January 1 to July 24, 2007 and July 25 to December 31, 2007 Compared with the Year Ended December 31, 2006**

The Company reported revenue of $1,934.4 million in the period from January 1 to July 24, 2007 and $1,422.4 million in the period from July 25 to December 31, 2007 compared to $3,332.7 million in the year ended December 31, 2006. The revenue for the period from July 25 to December 31, 2007 has been reduced by $60.6 million (non-cash) resulting from recording deferred revenue at its fair value in connection with purchase accounting. Excluding purchase accounting, revenue for the combined periods for the year ended December 31, 2007 increased $84.6 million, or 2.5 percent, over 2006 levels, driven by the results of our business units as described in our "Segment Review (Periods from January 1 to July 24, 2007 and July 25 to December 31, 2007 compared with the Year Ended December 31, 2006)".

Operating income was $143.9 million in the period from January 1 to July 24, 2007 and $33.2 million in the period from July 25 to December 31, 2007 compared to $324.1 million in the year ended December 31, 2006. (Loss) Income from continuing operations before income taxes was $137.4 million in the period from January 1 to July 24, 2007 and ($148.5) million in the period from July 25 to December 31, 2007 compared to income from continuing operations before income taxes of $280.5 million in the year ended December 31, 2006. The decrease in (Loss) Income from continuing operations before income taxes as compared to the year ended December 31, 2006 primarily reflects the net effect of:

- The net unfavorable impact of non-cash purchase accounting adjustments in the period from July 25 to December 31, 2007 of $136.9 million consisting primarily of increased amortization of intangible assets of $128.5 million, a $60.6 million reduction in revenue and reduced deferred customer acquisition expense of $54.3 million.
- A $146.1 million increase in interest expense as a result of the new debt structure upon the completion of the Transactions.
- A $41.2 million increase in charges related to the Merger which cannot be capitalized as part of the purchase cost for financial reporting purposes.
- A $21.3 million increase in restructuring charges primarily resulting from the consolidation of the Company's corporate headquarters into its operations support center in Memphis, Tennessee.
- A $50.3 million, or 14.5 percent, increase in operating income before income taxes, non-cash purchase accounting adjustments, interest expense, merger related charges and

restructuring charges supported by profit growth at Terminix, TruGreen LawnCare and American Home Shield.

The Company continued to experience significant increases in its fuel costs. The Company's fleet, which consumes roughly 30 million gallons annually, continued to be negatively impacted by significant increases in oil prices. Historically, the Company has hedged approximately two-thirds of its estimated annual fuel usage. Fuel costs, after the impacts of the hedges, increased approximately $8 million pretax in the combined periods for the year ended December 31, 2007 compared to the year ended December 31, 2006. Based upon the hedges the Company has executed to date for 2008, as well as current Department of Energy price forecasts, the Company would again expect an incremental adverse impact in 2008, currently projected at $8 to $10 million, pretax.

Health care costs continued to experience strong inflationary pressures for the combined periods for the year ended December 31, 2007. In total, health care and related costs did not increase significantly for the combined periods for the year ended December 31, 2007 as inflationary increases were offset by favorable experience in self-insured claims. For 2008, the Company estimates that it will incur approximately $5 million to $8 million pretax of incremental health care costs due to inflationary pressures.

The decline in short term interest rates has had a beneficial impact on the Company's business on both operating income (loss) and non-operating expense (income) by virtue of its effect on variable rate-based fleet and occupancy leases and investment income. Short term interest rates have improved the Company's results by approximately $1 million pretax for the combined periods for the year ended December 31, 2007 compared to the year ended December 31, 2006.

***Operating and Non-Operating Expenses***

The Company reported cost of services rendered and products sold of $1,196.3 million for the period from January 1 to July 24, 2007 and $898.5 million for the period from July 25 to December 31, 2007 compared to $2,082.1 million for the year ended December 31, 2006. The period from July 25 to December 31, 2007 includes a $10.1 million (non-cash) decrease in cost of services rendered and products sold from recording deferred costs of services at their fair value in connection with purchase accounting. Excluding purchase accounting, as a percentage of revenue, these costs decreased to 61.6 percent for the combined periods for the year ended December 31, 2007 from 62.5 percent for the year ended December 31, 2006. This decrease primarily reflects the impact of improved labor efficiency at Terminix and a decrease in the incidence of contract claims at AHS, offset by increases in fuel and other factor costs throughout the enterprise.

The Company reported selling and administrative expenses of $530.7 million for the period from January 1 to July 24, 2007 and $331.1 million for the period from July 25 to December 31, 2007 compared to $896.7 million for the year ended December 31, 2006. The period from July 25 to December 31, 2007 includes a $44.2 million (non-cash) decrease in selling and administrative expenses resulting from recording deferred customer acquisition costs at their fair value offset by increased depreciation as a result of recording property and equipment at its fair value in connection with purchase accounting. Excluding purchase accounting, these costs decreased as a percentage of revenue to 26.5 percent for the combined periods for the year ended December 31, 2007 from 26.9 percent for the year ended December 31, 2006. The decrease in selling and administrative expenses as a percentage of revenue primarily reflects lower functional support costs and improved sales labor efficiency at TruGreen LawnCare and Terminix.

Amortization expense was $5.2 million for the period from January 1 to July 24, 2007 and $132.7 million for the period from July 25 to December 31, 2007 compared to $7.2 million for the year ended December 31, 2006. The increase reflects $128.5 million of amortization for the period

from July 25 to December 31, 2007 related to recording amortizable intangible assets of $861 million in purchase accounting.

Non-operating expense totaled $6.5 million for the period from January 1 to July 24, 2007 and $181.7 million for the period from July 25 to December 31, 2007 compared with $43.6 million for the year ended December 31, 2006. This change includes a $148.2 million increase in interest expense for the combined periods for the year ended December 31, 2007, primarily resulting from the increased debt levels related to the Merger, and a $0.9 million decrease in interest and investment income for the combined periods for the year ended December 31, 2007 reflecting (1) the impact to investment gains and income realized on the American Home Shield investment portfolio from revaluing the investment portfolio in purchase accounting, and (2) lower investment income resulting from a decrease in the market value of investments within an employee deferred compensation trust (for which there is a corresponding and offsetting decrease in compensation expense within operating income). Investment returns are an integral part of the business model at American Home Shield, and there will always be some market-based variability in the timing and amount of investment returns realized from year to year.

The effective tax rate on income (loss) from continuing operations was 37.6 percent for the period from January 1 to July 24, 2007 and (35.1) percent for the period from July 25 to December 31, 2007 compared to 33.9 percent for the year ended December 31, 2006. The effective tax rate for the combined periods for the year ended December 31, 2007 includes reductions in tax expense resulting from the favorable resolution of state tax items related to a prior non-recurring transaction, as well as the incremental deferred tax benefits that became recognizable during the second quarter of 2007 upon the conversion of the minority equity interests in Terminix into eight million shares of ServiceMaster common stock. These factors were offset, in part, by the unfavorable impact of merger related book expenses that are not deductible for federal income tax reporting purposes.

***Restructuring and Merger Related Charges***

The Company recognized restructuring charges of $16.9 million for the period from January 1 to July 24, 2007 and $26.0 million for the period from July 25 to December 31, 2007. Approximately $25.4 million of the charges for the combined periods for the year ended December 31, 2007 are related to the Company's consolidation of its corporate headquarters into its operations support center in Memphis, Tennessee and closing of its headquarters in Downers Grove, Illinois. The Company believes the consolidation of the Downers Grove support functions and positions with the operating unit leadership in Memphis will improve the speed and effectiveness of communications and decision-making. Such costs include employee retention and severance costs, lease termination costs, training of replacement employees, and temporary employee staffing and recruiting costs. Almost all such costs were cash expenditures. In accordance with GAAP, these costs were expensed over the transition period.

In connection with the consolidation, the Company expects to realize reductions in travel and rent costs of approximately $3 million per year, with full realization of these annual savings beginning in 2008. Depending on the impact of Fast Forward (as discussed below), savings may be realized from state and local tax incentives.

The transition to Memphis was substantially completed in 2007 and the Company expects costs incurred related to this transition in 2008 to be insignificant.

The restructuring amount for the combined periods for the year ended December 31, 2007 also included approximately $7.9 million of charges, primarily severance costs, related to organizational changes made within the TruGreen LandCare operations.

The Company is engaged in a reorganization and restructuring of certain of its businesses and support functions ("Fast Forward"). The purpose of Fast Forward is to eliminate layers and bureaucracy and simplify work processes in order to better align the Company's work processes around its operational and strategic objectives. It is expected that Fast Forward will be effected in phases. The first phase involves, among other things, a reduction in work force and various process improvements, including the closing of American Home Shield's call center located in Santa Rosa, California. The second phase is expected to include the creation of centers of excellence, the outsourcing to third party vendors of various business activities that currently are handled internally, as well as other employee workforce reductions expected to result in cost-savings. The first phase of Fast Forward was completed in the first quarter of 2008, and the second phase is expected to begin implementation in the second half of 2008.

In connection with the first phase of Fast Forward, the Company incurred costs of approximately $9.8 million pre-tax in the period from July 25 to December 31, 2007. Such costs include lease termination costs and related asset impairments related to closing the Santa Rosa call center of approximately $3.7 million; and severance and other costs of approximately $6.1 million.

The Company expects that it will incur substantial additional costs in order to implement the second phase of Fast Forward, but is currently unable to estimate the aggregate amount or timing of such charges or the anticipated related cash outlays.

Management has set a goal of achieving $60 million in annual cost savings from Fast Forward and other initiatives currently underway, which are expected to be fully realized by the end of 2009.

The 2006 aggregate restructuring charges totaled $21.6 million pretax. The after-tax impact of the restructuring charges including approximately $6 million of non-recurring net operating loss carryforward benefits which became realizable to the Company as a result of its decision to consolidate its corporate headquarters in Memphis, Tennessee, totaled $6.9 million. The 2006 aggregate restructuring charges were comprised of the following:

Severance costs and third party professional fees and expenses resulting from the organizational changes made as part of "Project Accelerate" (a Company initiative to improve the effectiveness and efficiency of its functional support areas) and severance costs associated with the resignation in the second quarter of 2006 of the Company's former Chief Executive Officer. These costs totaled $11.2 million, substantially all of which was paid by the end of 2006.

Approximately $10.4 million of restructuring charges in the fourth quarter of 2006 related to the Company's consolidation of its corporate headquarters into its operations support center in Memphis, Tennessee and closing of its headquarters in Downers Grove, Illinois.

The Company incurred Merger related expenses totaling $41.4 million for the period from January 1 to July 24, 2007 and $0.8 million for the period from July 25 to December 31, 2007 compared to $1.0 million for the year ended December 31, 2006. These Merger related costs include investment banking, accounting, legal and other costs associated with the Merger, which cannot be capitalized as part of the purchase cost for financial reporting purposes.

**Key Performance Indicators**

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

| | Key Performance Indicators | |
|---|---|---|
| | **2007** | **2006** |
| **TruGreen LawnCare** | | |
| Growth in Full Program Accounts | 2% | 0% |
| Customer Retention Rate | 65.1% | 62.9% |
| **Terminix(a)** | | |
| Growth in Pest Control Customers | 2% | 9% |
| Pest Control Customer Retention Rate | 78.1% | 79.5% |
| Growth in Termite Customers | 1% | 0% |
| Termite Customer Retention Rate | 87.6% | 87.5% |
| **American Home Shield** | | |
| Growth in Warranty Contracts | 6% | 2% |
| Customer Retention Rate | 61.9% | 58.2% |

(a) 2006 pest control customer count growth, excluding the impact of the Safeguard Pest Control acquisition completed at the beginning of the fourth quarter of 2006, was 5%. The customer retention rate in 2006, excluding the impact of the Safeguard acquisition added to the customer base, was approximately 78.9%.

**Segment Review (Periods from January 1 to July 24, 2007 and July 25 to December 31, 2007 Compared with the Year Ended December 31, 2006)**

The following business segment reviews should be read in conjunction with the required footnote disclosures presented in the Notes to the Consolidated Financial Statements. This disclosure provides a reconciliation of segment operating income to income from continuing operations before income taxes, with net non-operating expenses as the only reconciling item.

The Company uses Adjusted EBITDA and Comparable Operating Performance to facilitate operating performance comparisons from period to period. Adjusted EBITDA and Comparable Operating Performance are supplemental measures of the Company's performance that are not required by, or presented in accordance with, GAAP. Adjusted EBITDA and Comparable Operating Performance are not measurements of the Company's financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP or as alternatives to net cash provided by operating activities or any other measures of the Company's cash flow or liquidity. "Adjusted EBITDA" means net income before net income (loss) from businesses held pending sale and discontinued operations; provision (benefit) for income taxes; minority interest and other expense, net; interest expense and interest and net investment income; and depreciation and amortization expense; as well as adding back interest and net investment income. The Company views its total interest and investment income as an integral part of its business model and earnings stream. "Comparable Operating Performance" is calculated by adding back to Adjusted EBITDA non-cash option and restricted stock expense and non-cash effects on Adjusted EBITDA attributable to the application of purchase accounting in connection with the Merger.

The Company believes Adjusted EBITDA facilitates company-to-company operating performance comparisons by backing out potential differences caused by variations in capital structures (affecting net interest income and expense), taxation and the age and book depreciation of facilities and equipment (affecting relative depreciation expense), which may vary for different companies for reasons unrelated to operating performance. The Company uses Comparable Operating Performance as a supplemental measure to assess the Company's performance because it excludes non-cash option and restricted stock expense and non-cash effects on Adjusted EBITDA attributable to the application of purchase accounting in connection with the Merger. The Company presents Comparable Operating Performance because it believes that it is useful for investors and lenders to analyze disclosures of the Company's operating results on the same basis as that used by the Company's management.

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

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

- Adjusted EBITDA and Comparable Operating Performance do not reflect changes in, or cash requirements for, the Company's working capital needs;

- Adjusted EBITDA and Comparable Operating Performance do not reflect the Company's interest expense, or the cash requirements necessary to service interest or principal payments on the Company's debt;

- Adjusted EBITDA and Comparable Operating Performance do not reflect the Company's tax expense or the cash requirements to pay the Company's taxes;

- Adjusted EBITDA and Comparable Operating Performance do not reflect historical cash expenditures or future requirements for capital expenditures or contractual commitments;

- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA and Comparable Operating Performance do not reflect any cash requirements for such replacements; and

- Other companies in the Company's industries may calculate Adjusted EBITDA and Comparable Operating Performance differently, limiting their usefulness as comparative measures.

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

| | Successor | Predecessor | | |
|---|---|---|---|---|
| (In thousands) | Jul. 25, 2007 to Dec. 31, 2007 | Jan. 1, 2007 to Jul. 24, 2007 | Year Ended Dec. 31, 2006 | Year Ended Dec. 31, 2005 |
| Operating Revenue: | | | | |
| TruGreen LawnCare | $ 501,830 | $ 597,147 | $ 1,052,257 | $ 1,024,641 |
| TruGreen LandCare | 169,741 | 242,154 | 444,338 | 453,323 |
| Terminix | 445,760 | 645,700 | 1,075,481 | 1,056,285 |
| American Home Shield | 209,661 | 331,361 | 564,817 | 528,687 |
| Other Operations and Headquarters | 95,366 | 118,028 | 195,810 | 176,542 |
| Total Operating Revenue | $ 1,422,358 | $ 1,934,390 | $ 3,332,703 | $ 3,239,478 |
| Comparable Operating Performance: | | | | |
| TruGreen LawnCare | $ 102,296 | $ 84,208 | $ 172,157 | $ 184,369 |
| TruGreen LandCare | 1,483 | 965 | 5,622 | 12,728 |
| Terminix | 74,047 | 120,057 | 166,594 | 157,346 |
| American Home Shield | 41,528 | 63,432 | 91,360 | 96,409 |
| Other Operations and Headquarters | (17,025) | (60,277) | (20,458) | (32,604) |
| Total Comparable Operating Performance | $ 202,329 | $ 208,385 | $ 415,275 | $ 418,248 |
| Memo: Items included in Comparable Operating Performance: | | | | |
| Restructuring charges and Merger related expenses(1) | $ 26,815 | $ 58,350 | $ 22,640 | $ |
| Management fee(2) | $ 875 | $ | $ | $ |

(1) Comparable Operating Performance includes (i) restructuring charges associated with Project Accelerate, (ii) severance costs and costs related to the consolidation of our corporate headquarters in Memphis, Tennessee, including the closing of our office in Downers Grove, Illinois, (iii) costs to exit leases and severance payments related to organizational changes within the TruGreen LandCare operations, (iv) charges related to Fast Forward and (v) Merger related expenses. Substantially all of the restructuring charges and Merger related expenses are included in the Comparable Operating Performance of the Other Operations and Headquarters segment, with the exception of $5.9 million included in the American Home Shield segment for the period from July 25 to December 31, 2007 and $7.9 million included in the TruGreen LandCare segment for the period from July 25 to December 31, 2007.

(2) Represents a management fee payable to CD&R pursuant to a consulting agreement under which CD&R will provide the Company with on-going consulting and management advisory services for a minimum annual fee of $2 million.

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

| (in thousands) | TruGreen LawnCare | TruGreen LandCare | Terminix | American Home Shield | Other Operations and Headquarters | Total |
|---|---|---|---|---|---|---|
| **Successor Jul. 25, 2007 to December 31, 2007** | | | | | | |
| Operating income (loss)(1) | $ 42,156 | $ (6,351) | $ 49,216 | $ (20,764) | $ (31,017) | $ 33,240 |
| Depreciation and amortization expense | 88,628 | 5,928 | 28,543 | 22,038 | 10,504 | 155,641 |
| EBITDA before adding back interest and investment income, net | 130,784 | (423) | 77,759 | 1,274 | (20,513) | 188,881 |
| Interest and investment income, net(2) | | | | (6,749) | 3,186 | (3,563) |
| Adjusted EBITDA | 130,784 | (423) | 77,759 | (5,475) | (17,327) | 185,318 |
| Non-cash option and restricted stock expense | | | | | 300 | 300 |
| Non-cash charges attributable to purchase accounting(3) | (28,488) | 1,906 | (3,712) | 47,003 | 2 | 16,711 |
| Comparable Operating Performance | $ 102,296 | $ 1,483 | $ 74,047 | $ 41,528 | $ (17,025) | $ 202,329 |
| Memo: Items included in Comparable Operating Performance | | | | | | |
| Restructuring charges and merger related expenses(4) | $ 405 | $ 7,920 | $ 76 | $ 5,874 | $ 12,540 | $ 26,815 |
| Management fee(5) | $ | $ | $ | $ | $ 875 | $ 875 |
| Memo: Items excluded from Comparable Operating Performance | | | | | | |
| Comparable Operating Performance of InStar | $ | $ | $ | $ | $ (6,382) | $ (6,382) |
| Comparable Operating Performance of all other discontinued operations | | | | | (165) | (165) |
| Comparable Operating Performance of businesses held pending sale and discontinued operations | $ | $ | $ | $ | $ (6,547) | $ (6,547) |

| (in thousands) | TruGreen LawnCare | TruGreen LandCare | Terminix | American Home Shield | Other Operations and Headquarters | Total |
|---|---|---|---|---|---|---|
| **Predecessor Jan. 1, 2007 to Jul. 24, 2007** | | | | | | |
| Operating income (loss)(1) | $ 75,656 | $ (2,206) | $ 109,461 | $ 35,582 | $ (74,561) | $ 143,932 |
| Depreciation and amortization expense | 8,552 | 3,171 | 10,596 | 3,687 | 6,408 | 32,414 |
| EBITDA before adding back interest and investment income, net | 84,208 | 965 | 120,057 | 39,269 | (68,153) | 176,346 |
| Interest and investment income, net(2) | | | | 24,163 | 4,461 | 28,624 |
| Adjusted EBITDA | 84,208 | 965 | 120,057 | 63,432 | (63,692) | 204,970 |
| Non-cash option and restricted stock expense | | | | | 3,415 | 3,415 |
| Non-cash charges attributable to purchase accounting(3) | | | | | | |
| Comparable Operating Performance | $ 84,208 | $ 965 | $ 120,057 | $ 63,432 | $ (60,277) | $ 208,385 |
| Memo: Items included in Comparable Operating Performance | | | | | | |
| Restructuring charges and merger related expenses(4) | $ | $ | $ | $ | $ 58,350 | $ 58,350 |
| Management fee(5) | $ | $ | $ | $ | $ | $ |
| Memo: Items excluded from Comparable Operating Performance | | | | | | |
| Comparable Operating Performance of InStar | $ | $ | $ | $ | $ (5,739) | $ (5,739) |
| Comparable Operating Performance of all other discontinued operations | | | | | 326 | 326 |
| Comparable Operating Performance of businesses held pending sale and discontinued operations | $ | $ | $ | $ | $ (5,413) | $ (5,413) |

| (in thousands) | TruGreen LawnCare | TruGreen LandCare | Terminix | American Home Shield | Other Operations and Headquarters | Total |
|---|---|---|---|---|---|---|
| **Predecessor Year Ended Dec. 31, 2006** | | | | | | |
| Operating income (loss)(1) | $ 157,695 | $ (587) | $ 152,161 | $ 62,780 | $ (47,921) | $ 324,128 |
| Depreciation and amortization expense | 14,462 | 6,209 | 14,433 | 8,222 | 11,010 | 54,336 |
| EBITDA before adding back interest and investment income, net | 172,157 | 5,622 | 166,594 | 71,002 | (36,911) | 378,464 |
| Interest and investment income, net(2) | | | | 20,358 | 5,584 | 25,942 |
| Adjusted EBITDA | 172,157 | 5,622 | 166,594 | 91,360 | (31,327) | 404,406 |
| Non-cash option and restricted stock expense | | | | | 10,869 | 10,869 |
| Non-cash charges attributable to purchase accounting(3) | | | | | | |
| Comparable Operating Performance | $ 172,157 | $ 5,622 | $ 166,594 | $ 91,360 | $ (20,458) | $ 415,275 |
| Memo: Items included in Comparable Operating Performance | | | | | | |
| Restructuring charges and merger related expenses(4) | $ | $ | $ | $ | $ 22,640 | $ 22,640 |
| Management fee(5) | $ | $ | $ | $ | $ | $ |
| Memo: Items excluded from Comparable Operating Performance | | | | | | |
| Comparable Operating Performance of InStar | $ | $ | $ | $ | $ 7,781 | $ 7,781 |
| Comparable Operating Performance of all other discontinued operations | | | | | 17,837 | 17,837 |
| Comparable Operating Performance of businesses held pending sale and discontinued operations | $ | $ | $ | $ | $ 25,618 | $ 25,618 |

| (in thousands) | TruGreen LawnCare | TruGreen LandCare | Terminix | American Home Shield | Other Operations and Headquarters | Total |
|---|---|---|---|---|---|---|

| (in thousands) | TruGreen LawnCare | TruGreen LandCare | Terminix | American Home Shield | Other Operations and Headquarters | Total |
|---|---|---|---|---|---|---|
| **Predecessor Year Ended Dec. 31, 2005** | | | | | | |
| Operating income (loss)(1) | $ 171,758 | $ 4,317 | $ 145,568 | $ 70,959 | $ | |