

SERVICEMASTER CO  
Form 10-K  
February 28, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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

For the fiscal year ended December 31, 2005

OR

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

**36-3858106**  
(I.R.S. Employer  
Identification No.)

**3250 Lacey Road, Suite 600, Downers Grove, Illinois 60515**  
(Address of principal executive offices, including zip code)

**(630) 663-2000**  
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange which registered
Common Stock, \$0.01 par value per share	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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  No

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark 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 the Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

The aggregate market value of shares of common stock held by non-affiliates of the registrant as of June 30, 2005 was \$3,838,410,329

The number of shares of the registrant's common stock outstanding as of February 21, 2006 was 292,775,000

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain parts of the registrant's Definitive Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated into Part III of this Form 10-K.

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

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**PART I****ITEM 1. BUSINESS**

The ServiceMaster Company ( ServiceMaster ) is a national company serving both residential and commercial customers. Its services include lawn care, landscape maintenance, termite and pest control, home warranty, home inspection, disaster restoration, cleaning, furniture repair, plumbing, drain cleaning, electrical, heating, and air conditioning. As of December 31, 2005, ServiceMaster provided these services through a network of over 5,500 company-owned locations and franchise licenses operating under the following leading brands: TruGreen ChemLawn, TruGreen LandCare, Terminix, ARS Service Express, Rescue Rooter, American Mechanical Services, American Home Shield, AmeriSpec, Merry Maids, ServiceMaster Clean and Furniture Medic. 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 ChemLawn, TruGreen LandCare; Terminix; American Home Shield; and Other Operations. All ServiceMaster subsidiaries are wholly owned, except for The Terminix International Company L.P., in which Allied Bruce-Terminix Companies, Inc. is a Class B limited partner. The financial information for each operating segment for 2005, 2004 and 2003 is contained in Part II, Item 8 of this Form 10-K.

**CHANGE IN SEGMENT REPORTING**

The Company intends to sell its American Residential Services (ARS) and American Mechanical Services (AMS) companies so it can concentrate resources on its main growth businesses. The Company has retained an investment banking firm to serve as its financial advisor in this process. The ARS/AMS operations provide heating, ventilation, air conditioning (HVAC), plumbing and electrical installation and repair services and were previously disclosed as the Company's ARS/AMS segment. Because the Company intends to sell these companies, the results of these operations are reported within the financial statement caption "businesses held pending sale and discontinued operations" for all periods.

The Company has expanded its business segment reporting to allow for better ongoing visibility into the components of the business. The operations that previously were reported in the TruGreen segment have been further broken out into the TruGreen ChemLawn segment and the TruGreen LandCare segment. TruGreen LandCare is an important part of the Company's continuing operations and separately presenting the segment results for the TruGreen LandCare operations recognizes the importance of this business to the future growth of the enterprise while also enhancing overall disclosure. All previously reported segment financial information reflects the aforementioned changes in segment reporting.

**SERVICES**

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

<u>Segment</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
TruGreen ChemLawn	32%	32%	31%
TruGreen LandCare	14%	14%	15%
Terminix	33%	33%	33%
American Home Shield	16%	16%	16%
Other Operations	5%	5%	5%

**TruGreen ChemLawn Segment**

The TruGreen ChemLawn segment provides lawn care services primarily under the TruGreen ChemLawn brand name. Revenues derived from the TruGreen ChemLawn segment constituted 32%, 32% and 31% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2005, 2004 and 2003, respectively. The TruGreen ChemLawn business is seasonal in nature. Weather conditions, such as a drought, affect the demand for lawn care services and may result in a decrease in revenues or an increase in costs.

TruGreen ChemLawn is a leading provider of lawn care services in the United States serving both residential and commercial customers. As of December 31, 2005, TruGreen ChemLawn provided these services in 46 states and the District of Columbia through 208 company-owned locations and 52 franchised locations. As of December 31, 2005, TruGreen ChemLawn also provided lawn care services through a subsidiary in Canada and had entered into licensing arrangements to provide these services in eight other countries, primarily in the Middle East.

**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 14%, 14% and 15% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in 2005, 2004 and 2003, respectively. The TruGreen LandCare business is seasonal in nature. Weather conditions, such as a drought, affect the demand for landscape maintenance 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, 2005, TruGreen LandCare provided these services in 42 states and the District of Columbia through 102 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% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in each of 2005, 2004 and 2003. 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, 2005, Terminix provided these services in 47 states and the District of Columbia through 364 company-owned locations and 133 franchised locations. As of December 31, 2005, Terminix also provided termite and pest control services through a subsidiary in Mexico and had entered into licensing arrangements to provide these services in 37 other countries, primarily in 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 and home inspection services primarily under the AmeriSpec brand name. Revenues derived from the American Home Shield segment constituted 16% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in each of 2005, 2004 and 2003. The American Home Shield and AmeriSpec businesses are 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 is highest in the summer months, especially during periods of unseasonably warm temperatures.

**American Home Shield.** 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 appliances that break down due to normal wear and tear and administers those contracts through independent repair contractors and American Residential Services. As of December 31, 2005, American Home Shield issued and administered home warranty contracts in 49 states and the District of Columbia and had no international operations.

**AmeriSpec.** AmeriSpec is a leading provider of home inspection services in the United States serving residential customers. As of December 31, 2005, AmeriSpec provided these services in 47 states and the District of Columbia through two company-owned locations and 224 franchised locations, and AmeriSpec also provided home inspection services through a subsidiary in Canada.

#### **Other Operations Segment**

The Other Operations segment provides residential and commercial disaster restoration and cleaning services primarily under the ServiceMaster and ServiceMaster Clean brand names, domestic house cleaning services primarily under the Merry Maids brand name and on-site furniture repair and restoration services primarily under the Furniture Medic brand name. The Other Operations segment also includes ServiceMaster's headquarters functions. Revenues derived from the Other Operations segment constituted 5% of the revenue from continuing operations of the consolidated ServiceMaster enterprise in each of 2005, 2004 and 2003.

**ServiceMaster Clean.** ServiceMaster Clean is a leading franchisor in the residential and commercial cleaning field in the United States. As of December 31, 2005, ServiceMaster Clean provided these services in all 50 states and the District of Columbia through 3,189 franchise licenses. As of December 31, 2005, ServiceMaster Clean also provided disaster restoration and cleaning services through subsidiaries in Canada, Ireland, the United Kingdom and Spain and had entered into licensing arrangements to provide these services in 18 other countries, primarily in Asia and the Middle East.

**Merry Maids.** Merry Maids is a leading provider of domestic house cleaning services in the United States. As of December 31, 2005, these services were provided in 48 states and the District of Columbia through 63 company-owned locations and 781 franchise licenses. As of December 31, 2005, Merry Maids also provided domestic house cleaning services through subsidiaries in Canada, Denmark, Ireland and the United Kingdom and had entered into licensing arrangements to provide these services in eight other countries, primarily in Asia.

**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, 2005, Furniture Medic provided these services in 49 states and the District of Columbia through 354 franchise licenses. As of December 31, 2005, 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.

#### **Businesses Held Pending Sale**

American Residential Services and American Mechanical Services provide plumbing, drain cleaning, heating, ventilation, air conditioning and electrical services primarily under the ARS Service Express, American Mechanical Services and Rescue Rooter brand names. The American Residential Services and American Mechanical Services businesses are seasonal in nature, with the greatest activity occurring in May through August during the peak air conditioning season.

**American Residential Services.** American Residential Services, which includes the businesses of ARS Service Express and Rescue Rooter, is a leading provider of plumbing, drain cleaning, heating, ventilation, air conditioning and electrical services in the United States

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serving residential customers. As of December 31, 2005, American Residential Services provided these services in 25 states and the District of Columbia through 61 company-owned locations and had no international operations.

**American Mechanical Services.** American Mechanical Services is a leading provider of heating, ventilation, air conditioning and electrical services in the United States serving commercial customers. As of December 31, 2005, American Mechanical Services

provided these services in 7 states and the District of Columbia through 20 company-owned locations and had no international operations.

### **MARKETING AND DISTRIBUTION**

ServiceMaster markets its services primarily through yellow pages advertisements, direct mail, television and radio advertising, print advertisements, door-to-door solicitation and telemarketing. Additionally, American Home Shield markets its home service contracts through participating 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 coordinates administration of 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. The Business Support Center is headquartered in Downers Grove, Illinois and has additional personnel located in Memphis, Tennessee.

### **PATENTS, TRADEMARKS AND LICENSES**

ServiceMaster holds various service marks, trademarks and trade names that it deems particularly important to the advertising and franchising activities conducted by each of its operating segments. These marks are registered in the United States and over 113 other countries and are renewed at each registration expiration date.

### **FRANCHISES**

Franchises are important to TruGreen ChemLawn, Terminix, ServiceMaster Clean, Merry Maids, AmeriSpec and Furniture Medic businesses. Total franchise fees (initial and recurring) represented 3.4%, 3.3% and 3.2% of consolidated revenue in 2005, 2004 and 2003, respectively. Related franchise operating expenses were 2.1%, 2.1% and 2.0% of consolidated operating expenses in 2005, 2004 and 2003, respectively. Total franchise fee profits comprised 10.5%, 10.3% and 10.9% of consolidated operating income (excluding the impairment charge in 2003) before headquarter overhead in 2005, 2004 and 2003, respectively. Franchise agreements made in the course of these businesses are generally for a term of five years. ServiceMaster renews the majority of its franchise agreements prior to their expiration.

### **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 of service, name recognition, pricing, customer satisfaction and reputation. 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.

**Landscape Maintenance Services.** Competition in the market for 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 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 thousands of regional and local, independently owned firms, from homeowners who treat their own termite and pest control problems and from Orkin, Inc., a subsidiary of Rollins, Inc., which operates on a national basis.

**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.

**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.



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**House Cleaning Services.** Competition in the market for house cleaning services comes mainly from local, independently owned firms and a few national companies.

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

**Electrical, Heating, Ventilation and Air Conditioning.** Competition in the market for electrical, heating, ventilation and air conditioning services comes mainly from regional and local, independently owned firms throughout the United States and a few national companies.

**Plumbing and Drain Cleaning Services.** Competition in the market for plumbing and drain cleaning services comes mainly from regional and local, independently owned firms throughout the United States and a few national companies.

### **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, permit and license requirements, workers safety (*e.g.*, the Occupational Safety and Health Act), environmental regulations and employee benefits (*e.g.*, the Consolidated Omnibus Budget Reconciliation Act of 1985 and the Employee Retirement Income Security Act of 1974). The TruGreen ChemLawn, TruGreen LandCare, Terminix, American Residential Services and American Mechanical Services 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.

### **Consumer Protection and Telemarketing Matters**

ServiceMaster is subject to numerous 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 ChemLawn, and, to a lesser extent, ServiceMaster's other operating segments, to seek additional marketing methods and channels.

### **Franchise Matters**

TruGreen ChemLawn, Terminix, ServiceMaster Clean, Merry Maids, AmeriSpec and Furniture Medic are subject to various federal and state 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, 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 ChemLawn 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 Emergency Planning and Community Right-to-Know Act of 1986, the Oil Pollution Act of 1990 and the Clean Water Act of 1977. American Residential Services and American Mechanical Services are also 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 Resource Conservation and Recovery Act of 1976, the Emergency Planning and Community Right-to-Know Act of 1986, the Clean Water Act of 1977 and the Clean Air Act of 1970. ServiceMaster cannot predict the effect on its operations of possible future environmental legislation or regulations. During 2005, there were no material capital expenditures for environmental control facilities, and no such material expenditures are anticipated in 2006.

## **EMPLOYEES**

On December 31, 2005, ServiceMaster had a total of approximately 39,000 employees.

**AVAILABLE INFORMATION**

ServiceMaster maintains a website at <http://www.svm.com> 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. A copy of each of ServiceMaster's Corporate Governance Principles, Audit and Finance Committee Charter, Compensation and Leadership Development Committee Charter, Governance and Nominating Committee Charter, Financial Code of Ethics and Code of Conduct is posted on ServiceMaster's website at <http://www.svm.com> under Corporate Governance and is available in print to any shareholder who requests it by writing to the Corporate Secretary at the following address: The ServiceMaster Company, 3250 Lacey Road, Suite 600, Downers Grove, Illinois 60515.

## ITEM 1A. RISK FACTORS

This Form 10-K contains or incorporates by reference statements concerning future results and other matters that may be deemed to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. ServiceMaster intends that these forward-looking statements, which look forward in time and include everything other than historical information, be subject to the safe harbors created by that legislation. ServiceMaster notes that these forward-looking statements involve risks and uncertainties that could affect its results of operations, financial condition or cash flows. Factors that could cause actual results to differ materially from those expressed or implied in a forward-looking statement include the following, among others:

### **Weather conditions and seasonality affect the demand for ServiceMaster's services.**

The demand for ServiceMaster's services is affected by weather conditions. The business of ServiceMaster is also affected by the seasonal nature of its lawn care and landscape maintenance services; termite and pest control services; home warranty and home inspection services; plumbing, drain cleaning, heating, ventilation, air conditioning and electrical services; and disaster restoration services. For example, droughts can affect the demand for lawn care and landscape maintenance services; extreme weather conditions could result in increased service calls in the home warranty business; cooler temperatures could impede the development of the termite swarm and lead to lower termite swarm activity; and mild weather conditions could result in lower demand for plumbing, heating and air conditioning services.

### **Competition could reduce ServiceMaster's market share and hurt its financial performance.**

ServiceMaster operates in highly competitive markets. Changes in the source and intensity of competition in the markets served by ServiceMaster impact the demand for its services and may result in additional pricing pressures. For example, the entry of national home-improvement retailers into ServiceMaster's service lines may impact its financial performance. The principal methods of competition in ServiceMaster's businesses include quality of service, name recognition, pricing, customer satisfaction and reputation. No assurance can be given that ServiceMaster will be able to compete successfully against current or future competitors and that the competitive pressures that ServiceMaster faces will not result in reduced market share and negatively impact its financial performance.

### **ServiceMaster's future success depends on its ability to attract and retain trained workers.**

ServiceMaster's future success and financial performance depends substantially on its ability to attract and retain trained workers. ServiceMaster's ability to expand its operations is in part impacted by its ability to increase its labor force. In the event of a labor shortage, ServiceMaster could experience difficulty in delivering its services in a high-quality or timely manner and could be forced to increase wages in order to attract and retain trained employees, which would result in higher operating costs.

### **Increases in operating costs affect ServiceMaster's financial performance.**

ServiceMaster's financial performance is affected by factor costs, such as labor, health care, vehicle, fuel, self-insurance, and insurance premiums. In particular, ServiceMaster's financial performance is affected by increases in operating costs, such as the increased fuel costs experienced in 2005.

### **Changes in the types or mix of service offerings affect ServiceMaster's financial performance.**

ServiceMaster's financial performance is affected by changes in the types or mix of service offerings. For example, offering both liquid and bait termite services requires additional equipment and training and results in different pricing and post-sale monitoring activities.

### **Changes in laws and regulations applicable to ServiceMaster's businesses affect ServiceMaster's financial performance.**

ServiceMaster's businesses are subject to various federal, state and local laws and regulations. These federal and state laws include laws relating to consumer protection, wage and hour restrictions, permit and licensing requirements, workers' safety, environmental regulations, employee benefits and telemarketing. It is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting ServiceMaster's businesses. The laws and regulations applicable to ServiceMaster's businesses will likely change in the future and affect ServiceMaster's operations and financial performance. In addition, if ServiceMaster were to fail to comply with any applicable law or regulation, ServiceMaster could be subject to fines or penalties that may affect how a business is operated.

### **Future acquisitions affect ServiceMaster's financial performance.**

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ServiceMaster plans to continue to pursue opportunities to expand through acquisitions. Acquisition activity includes small roll-up acquisitions in existing service lines and may include new business acquisitions. ServiceMaster's ability to continue to make acquisitions at reasonable prices and to integrate the acquired businesses are important factors in ServiceMaster's future growth. ServiceMaster cannot assure that it will be able to manage or integrate acquired businesses successfully. Any inability on ServiceMaster's part to consolidate and manage growth from acquired businesses could have an adverse effect on ServiceMaster's financial performance.

### **Changes in general economic conditions affect the demand for ServiceMaster's services.**

Changes in general economic conditions affect the demand for ServiceMaster's services. Unfavorable general economic conditions, including, but not limited to, changes in interest rates, fuel and oil prices, and unemployment rates could reduce consumer spending levels and, in turn, reduce the demand for ServiceMaster's services.

ServiceMaster is subject to a number of risks that might cause ServiceMaster's actual results to differ materially from its expressed or implied forecasts, targets or projections, including:

- Litigation against ServiceMaster, particularly any class action litigation;
- Unanticipated changes in senior management;
- Legislation or other governmental action that detrimentally impacts ServiceMaster;
- Unexpected outcome of any Internal Revenue Service audit;
- New accounting pronouncements or changes in accounting policies; and
- Impairment of goodwill or other intangible assets.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2. PROPERTIES**

**BUSINESS SUPPORT CENTER**

ServiceMaster leases approximately 66,000 square feet of office space to accommodate personnel from the Business Support Center in Downers Grove, Illinois. The lease expires at the end of 2012, but ServiceMaster has an option to terminate the lease as of December 31, 2007 by giving written notice to the lessor by June 30, 2006. Additionally, ServiceMaster leases warehouse space in Naperville, Illinois. ServiceMaster also leases office space in Memphis, Tennessee as described below to accommodate Memphis-based personnel from the Business Support Center. ServiceMaster believes that these office facilities and warehouse are suitable and adequate to support the Business Support Center's current needs in the Chicagoland and Memphis areas.

**OPERATING COMPANIES**

The headquarters for TruGreen ChemLawn, TruGreen LandCare, Terminix, American Residential Services and Rescue Rooter are located in leased premises at 860 Ridge Lake Boulevard, Memphis, Tennessee. The headquarters for American Home Shield and AmeriSpec are located in leased premises at 889 Ridge Lake Boulevard, Memphis, Tennessee. The headquarters for ServiceMaster Clean, Merry Maids and Furniture Medic and a training facility are located in leased premises at 3839 Forest Hill Irene Road, Memphis, Tennessee. The headquarters for American Mechanical Services is located in leased premises at 8039 Laurel Lakes Court, Laurel, Maryland. In addition, ServiceMaster leases space for a call center located at 6399 ShelbyView 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 are suitable and adequate to support the current needs of its operating companies in the Memphis and Laurel areas.

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.

<u>Operating Company</u>	<u>Owned Facilities</u>	<u>Leased Facilities</u>
TruGreen ChemLawn	5	290
TruGreen LandCare	2	181
Terminix	11	455
American Home Shield	1	5
ServiceMaster Clean	0	9
Merry Maids	0	63

American Residential Services	4	76
American Mechanical Services	1	19

**ITEM 3. LEGAL PROCEEDINGS**

In the ordinary course of conducting its business activities, ServiceMaster becomes involved in judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. As of February 28, 2006 these proceedings included general and commercial liability actions and a small number of environmental proceedings. ServiceMaster does not expect any of these proceedings to have a material adverse effect on its financial condition, results of operations or cash flows.

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

During the fourth quarter of the fiscal year covered by this 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**

ServiceMaster's common stock is traded on the New York Stock Exchange under the symbol SVM. At February 21, 2006, ServiceMaster's common stock was held of record by approximately 41,000 persons. ServiceMaster estimates that approximately 36,000 persons held shares of its common stock in the names of nominees as of that date.

**Quarterly Cash Dividends and Price Per Share Data**

The following tables set forth the cash dividends and quarterly prices of ServiceMaster's common stock, as reported on the New York Stock Exchange Composite Transactions:

Cash Dividends Per Share:	2005	% Chg	2004	% Chg	2003
First Quarter	\$ 0.11	5%	\$ 0.105	0%	\$ 0.105
Second Quarter	0.11	5	0.105	0	0.105
Third Quarter	0.11	0	0.11	5	0.105
Fourth Quarter	0.11	0	0.11	5	0.105
	\$ 0.44	2%	\$ 0.43	2%	\$ 0.42

Price Per Share:	2005		2004		2003	
	High	Low	High	Low	High	Low
First Quarter	\$ 13.90	\$ 12.74	\$ 12.05	\$ 10.65	\$ 11.41	\$ 8.95
Second Quarter	13.90	12.50	12.50	11.35	10.95	8.97
Third Quarter	13.93	13.10	13.25	11.12	10.73	9.35
Fourth Quarter	14.28	11.69	13.87	12.30	12.10	10.20

In February 2006, ServiceMaster's Board of Directors authorized \$250 million for share repurchases. This authorization replaces the unused portion (\$30 million at December 31, 2005) from the previous authorization granted in July 2000. As presented in the following table, there were no share repurchases of ServiceMaster's common stock for the three months ended December 31, 2005 under its share repurchase authorization. Decisions relating to any future share repurchases will depend on various factors such as ServiceMaster's commitment to maintain investment grade credit ratings and other strategic investment opportunities.

**ISSUER PURCHASES OF EQUITY SECURITIES**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan
October 1-31, 2005		\$		\$ 30,000,000
November 1-30, 2005		\$		\$ 30,000,000
December 1-31, 2005		\$		\$ 30,000,000 <sup>(1)</sup>
Total		\$		

<sup>(1)</sup> In February 2006, ServiceMaster's Board of Directors authorized \$250 million for share repurchases. This authorization replaces this \$30 million that remains as of December 31, 2005 from the previous authorization granted in July 2000.





## ITEM 6. SELECTED FINANCIAL DATA

## Five-Year Financial Summary

(In thousands, except per share data)

	2005	2004	2003	2002	2001
<b>Operating Results:</b>					
Operating revenue	\$ 3,239,478	\$ 3,068,068	\$ 2,895,028	\$ 2,781,829	\$ 2,656,634
Operating income (loss) <sup>(1)</sup>	340,083	324,308	110,655	315,357	(72,252)
Percentage of operating revenue	10.5%	10.6%	3.8%	11.3%	(2.7%)
Non-operating expense	45,385	53,464	58,394	93,152	127,527
Provision (benefit) for income taxes <sup>(2)</sup>	114,137	(45,779)	54,716	76,949	(3,923)
Income (loss) from continuing operations <sup>(2)</sup>	180,561	316,623	(2,455)	145,256	(195,856)
Income (loss) from businesses held pending sale and discontinued operations, net of income taxes <sup>(1, 2, 3)</sup>	18,364	14,604	(222,232)	11,738	312,240
Net income (loss)	\$ 198,925	\$ 331,227	\$ (224,687)	\$ 156,994	\$ 116,384
Earnings (loss) per share:					
Basic	\$ 0.68	\$ 1.14	\$ (0.76)	\$ 0.52	\$ 0.39
Diluted: <sup>(1, 2, 3)</sup>					
Income (loss) from continuing operations	\$ 0.61	\$ 1.06	\$ (0.01)	\$ 0.47	\$ (0.66)
Income (loss) from businesses held pending sale and discontinued operations	0.06	0.05	(0.75)	0.04	1.05
Diluted earnings (loss) per share	\$ 0.67	\$ 1.11	\$ (0.76)	\$ 0.51	\$ 0.39
Shares used to compute basic earnings per share	291,251	290,514	295,610	300,383	298,659
Shares used to compute diluted earnings per share	296,807	303,568	295,610	305,912	298,659
Shares outstanding, net of treasury shares	290,896	290,524	292,868	298,253	300,531
Cash dividends per share	\$ 0.44	\$ 0.43	\$ 0.42	\$ 0.41	\$ 0.40
Share price range:					
High price	\$ 14.28	\$ 13.87	\$ 12.10	\$ 15.50	\$ 14.20
Low price	\$ 11.69	\$ 10.65	\$ 8.95	\$ 8.89	\$ 9.84
<b>Financial Position:</b>					
Total assets <sup>(1)</sup>	\$ 3,028,870	\$ 3,140,202	\$ 2,956,426	\$ 3,414,938	\$ 3,621,245
Total liabilities	1,874,230	2,048,667	2,039,600	2,095,929	2,311,381
Total debt outstanding	658,150	805,088	819,271	835,475	1,155,193
Minority interest	100,000	100,000	100,309	100,309	102,677
Shareholders' equity <sup>(1, 2)</sup>	1,054,640	991,535	816,517	1,218,700	1,207,187

(1)

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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 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, and \$0.53 per diluted share. Also in the third quarter of 2003, the Company recorded a non-cash impairment charge associated with the goodwill and intangible assets at its American Residential Services (ARS) and American Mechanical Services (AMS) operations. The Company is currently holding these operations for sale, accordingly, the financial results for the ARS and AMS operations, as well as the impairment charge related to these operations (\$292 million pre-tax, \$227 million after-tax), are classified within the financial statement caption "businesses held pending sale and discontinued operations" for all periods. See the "Goodwill and Intangible Assets" note in the Notes to Consolidated Financial Statements. In the fourth quarter of 2001, the Company recorded in continuing operations a pre-tax charge of \$345 million (\$279 million, after-tax) or \$.94 per diluted share related primarily to goodwill and asset impairments as well as other items.

- (2) In January 2005, the Company announced that it had reached a comprehensive agreement with the Internal Revenue Service regarding its examination of the Company's federal income taxes through the year 2002. As a result of this agreement, the Company recorded a non-cash reduction in its 2004 tax provision, thereby increasing net income by approximately \$159 million. Approximately \$150 million related to continuing operations (\$.49 per diluted share) and \$9 million related to businesses held pending sale and discontinued operations (\$.03 per diluted share). See the "Income Taxes" note in the Notes to the Consolidated Financial Statements.
- (3) The Company intends to sell its American Residential Services (ARS) and American Mechanical Services (AMS) companies so that it can concentrate resources on its main growth companies. These operations were previously disclosed as the Company's ARS/AMS segment. Because the Company intends to sell these companies, the results of these operations are classified within the financial statement caption "businesses held pending sale and discontinued operations" in all periods. See the Management Discussion and Analysis of Financial Position and Results of Operations for a discussion of the components of businesses held pending sale and discontinued operations.

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

### Results of Operations

#### *Consolidated Review of 2005 and Outlook for 2006*

2005 was an encouraging year for ServiceMaster (the Company) as it reported revenue and earnings per share in line with management's expectations. It was also a year where every one of the Company's business segments achieved growth in revenue and two of the Company's core businesses, Terminix and TruGreen ChemLawn, each surpassed \$1 billion in revenue for the first time. In 2005, the Company overcame significant challenges including record high fuel prices, steadily rising interest rates, unusual weather aberrations, including the hurricanes, and continued expansion in telemarketing restrictions. The Company overcame these obstacles by focusing on what it could control, like safety, customer satisfaction, and sales force and geographic expansion.

In 2006, the Company will be implementing three significant changes to its business portfolio. (1) The Company intends to sell American Residential Services (ARS) and American Mechanical Services (AMS). These are businesses, in large markets, with strong management teams. These companies are making good progress on key initiatives that will make them even better in the future. But there were two fundamental issues that led the Company to the difficult decision to sell these operations. First, is the Company's need to have fewer priorities, so that it can pursue them with greater intensity. Second, the Company concluded that ARS and AMS businesses are not compatible with the Company's overall business model. ARS and AMS are not built around the kind of repeat business experienced in the Company's other operations, and hence the ARS and AMS operations are more cyclical and weather dependent. These two businesses also operate at much lower margins, and they would require meaningful time and capital to establish widely recognized national brands such as those the Company enjoys in each of its other businesses.

(2) In February 2006, the Company announced an agreement to acquire InStar Services Group, Inc. InStar is a leading direct provider of commercial disaster response and reconstruction services in the United States with 2005 revenues of approximately \$130 million. InStar provides a continuum of services, from planning prior to an event, to emergency response following the event and ultimately including cleaning, recovery and reconstruction. InStar has been growing rapidly and is expected to grow at a much faster rate than the businesses held pending sale. InStar has solid profit margins and operates in an extremely large market with a tremendous opportunity to gain a larger share. The Company believes there is a great strategic fit in combining the capabilities of InStar with the Company's existing disaster restoration business within ServiceMaster Clean. ServiceMaster Clean's disaster restoration business already totals over \$500 million in customer level revenue through its franchisee network and has been growing at double digit rates for more than five years. The Company expects the InStar acquisition, after interest and amortization costs, to be accretive in the \$.01 per share range for the period in 2006 following the acquisition.

(3) The Company has launched Project Accelerate, an internal, multi-phase reengineering project designed to improve the effectiveness and efficiency of all functional support areas. Upon completion, Project Accelerate will result in an organization that is better aligned to respond faster to the marketplace, its customers, and provide better day-to-day support for front line associates who are in the homes and businesses of customers every day. This project is consistent with the Company's goal of becoming systematically stronger and is expected to have a positive financial impact on the enterprise. The reduction in direct support costs, combined with more effective purchasing of outside services and other cost reductions, is targeted to produce annualized gross savings in the range of \$50 to \$75 million, and net savings of \$25 million to \$35 million after reinvestments into the business and the impact of factor cost increases. Those savings should begin to be realized in 2006, and reach end state (on an annualized run rate basis) in 2007. Excluding the effects of one-time severance and implementation costs, the amounts of which the Company will be determining over the course of the first quarter 2006, the Company estimates the 2006 savings from Project Accelerate in the \$0.02 per share range, helping the Company to offset rising factor costs and contribute to continued strong bottom-line growth.

Going forward, the Company will be comprised of leading service brands that collectively have strong cash flow, solid revenue growth potential, greater operating margins and stronger returns on invested capital. The Company believes that its improved portfolio, combined with solid execution of its business strategies, will enable it to deliver mid to high-single digit revenue growth and low double-digit earnings growth in 2006. From a base of earnings from continuing operations of \$0.61, the Company's earnings per share target for 2006 is \$0.69. Based on the actions the Company is taking in 2006, the Company's target is to achieve high single digit revenue growth and earnings per share growth in the mid-teen level during 2007 and beyond, with cash from operations growing and continuing to substantially exceed net income.

#### **2005 Compared with 2004**

Revenue from continuing operations for 2005 was \$3.2 billion, a six percent increase over 2004. Most of the revenue growth was organic, with every business segment achieving increases over 2004 levels.

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The Company reported income from continuing operations in 2005 of \$181 million and income from businesses held pending sale and discontinued operations of \$18 million. Total net income was \$199 million in 2005 compared with \$331 million in 2004. The 2004 total included a \$159 million nonrecurring reduction in the tax provision and corresponding increase in net income resulting from the agreement with the IRS. Diluted earnings per share were \$.67 in 2005 compared with \$1.11 in 2004.

Diluted earnings per share from continuing operations were \$.61 in 2005 compared with \$1.06 in 2004. As more fully discussed below, the diluted earnings per share from continuing operations for 2004 include a \$.49 per share (\$150 million) non-cash reduction in the tax provision resulting from the Company's agreement with the IRS.

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Operating income for 2005 increased five percent to \$340 million, compared with \$324 million in 2004. The increase in operating income primarily reflects solid profit growth at Terminix supported by improved labor and material cost efficiencies, improved profitability in the TruGreen LandCare operations, and reduced safety-related costs throughout the enterprise. These factors were offset in part by higher fuel costs, increased claim costs at American Home Shield due to hotter weather conditions, a \$10 million unfavorable adjustment recorded by Terminix to correct the estimation of prior year damage claim reserves, a \$4 million gain that TruGreen ChemLawn realized in the third quarter of 2004 from the sale of a support facility, as well as the first time inclusion of approximately \$3 million of seasonal operating losses in the Canadian operations acquired by TruGreen ChemLawn in April 2004.

As previously disclosed, the Company has experienced both positive and negative trending in some of its key factor costs. The Company's large fleet continues to be negatively impacted by significant increases in oil prices, which have also adversely impacted fertilizer costs at TruGreen ChemLawn. Although the Company hedges approximately two-thirds of its estimated annual fuel usage, even net of the hedges, fuel costs of continuing operations increased approximately \$13 million in 2005. Oil prices remain high, and the Company currently estimates that its continuing operations will absorb approximately \$.02 per share of incremental fuel costs in 2006. As previously discussed, GPS and routing and scheduling technologies that the Company has been implementing will tighten routes and reduce drive time and fuel consumption. Health care costs continue to experience strong inflationary pressures, and this is expected to continue. The Company will also be making an additional investment in employee health care benefits of approximately \$.01 per share in 2006, as part of its efforts to further enhance its position as an employer of choice.

On the positive side, the Company continues to experience very favorable results from its efforts to reduce safety-related costs, which include workers compensation, auto and general liability claims. In 2005, the Company achieved a four percent reduction in vehicle collisions and a double digit decline in lost employee work day cases. Total costs from continuing operations, including the income statement effects of favorable trending of prior year claims, were down almost \$10 million for the year. The Company has set a goal of \$12 to \$15 million of additional savings from continuing operations over the next two to three years.

### ***Tax Agreement***

In January 2005, the Company reached a comprehensive agreement with the Internal Revenue Service (IRS) regarding its examination of the Company's federal income taxes through the year 2002. As a result of this agreement, the Company recorded in its 2004 financial statements certain deferred tax assets which had previously not been recorded due to uncertainties associated with the complexity of the matters under review and the extended period of time effectively covered by the examination. This resulted in a non-cash reduction in the Company's 2004 income tax provision, thereby increasing 2004 consolidated net income by approximately \$159 million (\$150 million, or \$.49 per diluted share, related to continuing operations and \$9 million, or \$.03 per diluted share, related to businesses held pending sale and discontinued operations). Related to the IRS agreement, the Company realized tax savings of \$25 million in 2004, made tax payments in early 2005 totaling \$131 million and realized a \$45 million reduction in estimated tax payments in the third and fourth quarters of 2005. Additionally, this agreement resulted in a deferred tax annuity totaling \$57 million that will be realized through 2016.

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

Cost of services rendered and products sold increased five percent compared to the prior year and decreased as a percentage of revenue to 62.1 percent in 2005 from 62.6 percent in 2004. This decrease reflects improved labor and materials management at TruGreen LandCare and improvements in safety-related costs throughout the enterprise. Selling and administrative expenses increased eight percent and increased as a percentage of revenue to 27.2 percent from 26.7 percent in 2004. The increase in selling and administrative expenses primarily reflects investments to increase market penetration and improve customer retention and other strategic initiatives.

Net interest expense decreased \$8 million from 2004, primarily reflecting lower interest expense resulting from the repayment of fixed rate debt in April 2005, as well as higher investment income experienced on the American Home Shield investment portfolio. It is important to note that 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 for continuing operations was a 39 percent tax expense in 2005 and a 17 percent tax benefit in 2004. The comparison of the effective tax rate is impacted by the Company's agreement with the IRS which resulted in a \$150 million non-cash reduction in the 2004 income tax provision for continuing operations. The Company expects that its effective tax rate for 2006 will approximate 39 percent.

### ***Segment Review (2005 vs 2004)***

The 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,

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with net non-operating expenses as the only reconciling item. The Company's segment reviews include discussions of capital employed, which is a non-U.S. GAAP measure that is defined as the segment's total assets less liabilities, exclusive of debt balances. The Company believes this information is useful to investors in helping them compute return on capital measures and therefore better understand the performance of the Company's segments. The Notes to the Consolidated Financial Statements also include a reconciliation of segment capital employed to its most comparable U.S. GAAP measure.

**Key Performance Indicators**

<u>As of December 31,</u>	<u>2005</u>	<u>2004</u>
<b>TruGreen ChemLawn -</b>		
Growth in Full Program Contracts	1%	8%
Customer Retention Rate	61.2%	62.2%
<b>Terminix -</b>		
Growth in Pest Control Customers	3%	7%
Pest Control Customer Retention Rate	77.2%	78.1%
Growth in Termite Customers	0%	0%
Termite Customer Retention Rate		