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SERVICEMASTER CO
Form 10-Q/A
May 14, 2003

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

FORM 10-Q/A

X QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2002

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

For the transition period from _____ to _____

Commission file number 1-14762

THE SERVICEMASTER COMPANY
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-3858106
(IRS Employer Identification No.)

3250 Lacey Road, Downers Grove, Illinois
(Address of principal executive offices)

60515-1700
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock: 302,368,000 shares of common stock on August 7, 2002.

Explanatory Note:

This amendment is being filed to reflect the restatement of the Company's unaudited condensed consolidated financial statements, as discussed in Note 2 thereto, and other information related to such restated financial statements.

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PART I. FINANCIAL INFORMATION

THE SERVICEMASTER COMPANY CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) (In thousands, except per share data)

| | Three Months Ended June 30, | |
|---|--------------------------------|--------------------|
| | 2002 (Restated 4) | 2001 (Restated) |
| OPERATING REVENUE | \$ 1,034,937 | \$ 1,020,0 |
| OPERATING COSTS AND EXPENSES: | | |
| Cost of services rendered and products sold..... | 680,381 | 681,0 |
| Selling and administrative expenses..... | 217,728 | 205,0 |
| Goodwill, trade name and other intangible amortization (1)..... | 2,152 | 18,0 |
| | 900,261 | 904,1 |
| Total operating costs and expenses..... | | |
| OPERATING INCOME | 134,676 | 115,9 |
| NON-OPERATING EXPENSE (INCOME): | | |
| Interest expense | 21,725 | 31,8 |
| Interest and investment income..... | (1,966) | (4,3 |
| Minority interest and other expense, net..... | 2,014 | 2,8 |
| | 112,903 | 85,5 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | | |
| Provision for income taxes..... | 41,466 | 35,8 |
| | 71,437 | 49,7 |
| INCOME FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY ITEMS | | |
| Income from discontinued operations, net of income taxes (2) | 295 | 4,2 |
| Extraordinary gain (loss), net of income taxes (3) | (9,229) | |
| | \$ 62,503 | \$ 53,9 |
| NET INCOME | ===== | ===== |
| PER SHARE: | | |
| Basic Earnings Per Share: | | |
| Income from continuing operations before extraordinary items | \$ 0.24 | \$ 0. |
| Discontinued operations, net (2) | - | 0. |
| Extraordinary gain (loss) (3) | (0.03) | |
| | \$ 0.21 | \$ 0. |
| | ===== | ===== |
| Shares | 301,092 | 298,5 |
| Diluted Earnings Per Share: | | |
| Income from continuing operations before extraordinary items | \$ 0.23 | \$ 0. |
| Discontinued operations, net (2) | - | 0. |
| Extraordinary gain (loss) (3) | (0.03) | |
| | \$ 0.20 | \$ 0. |

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| | | |
|---------------------------|---------|-------|
| Shares | ===== | ===== |
| | 316,474 | 310,7 |
| Dividends per share | \$ 0.10 | \$ 0. |
| | ===== | ===== |

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(1) The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets", which eliminates the amortization of goodwill and intangible assets with indefinite lives beginning in 2002. Had the provisions of SFAS 142 been applied to 2001, amortization expense would have been reduced by \$15.6 million (\$10.6 million, after-tax) and \$30.5 million (\$20.7 million, after-tax) for the three and six month periods ended June 30, 2001, respectively.

(2) In the fourth quarter of 2001, the Company's Board of Directors approved a series of actions related to the strategic review of its portfolio of businesses that commenced earlier in 2001. These actions included the sale in November 2001 of the Company's Management Services business as well as the decision to exit certain non-strategic and under-performing businesses including TruGreen LandCareConstruction and Certified Systems, Inc., as well as certain Terminix operations in Europe. During the third quarter of 2002, the Company sold its remaining European Terminix operations. These operations are classified in "Discontinued operations" for all periods presented.

(3) The Company purchased a portion of its public debt securities in the second quarter of 2002 and in the first quarter of 2001. The Company has recorded an extraordinary gain (loss) from the early extinguishment of debt related to these repurchases. The Company intends to adopt SFAS 145 beginning in fiscal 2003. Adoption of SFAS 145 in 2003 will result in the reclassification of the extraordinary gain/loss into income from continuing operations.

(4) See Note 2 in the Notes to the Condensed Consolidated Financial Statements for the basis of the restatement and the financial statement impact.

See Notes to Condensed Consolidated Financial Statements

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THE SERVICEMASTER COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

| (In thousands) | As of Jun. 30, | As of D |
|--|-------------------|-----------|
| ASSETS | 2002 (Restated 1) | 2001 (Res |
| | ----- | ----- |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 132,744 | \$ 40 |
| Marketable securities | 72,340 | 7 |
| Receivables, less allowance of \$33,919 and \$28,397, respectively | 401,733 | 34 |
| Inventories | 77,957 | 6 |
| Prepaid expenses, deferred costs and other assets | 130,156 | 8 |
| Deferred taxes and income taxes receivable | 117,852 | 9 |
| Assets of discontinued operations | 44,237 | 6 |
| | ----- | ----- |
| Total Current Assets | 977,019 | 1,11 |
| | ----- | ----- |
| PROPERTY AND EQUIPMENT: | | |
| At cost | 473,782 | 46 |
| Less: accumulated depreciation | (281,445) | (27 |
| | ----- | ----- |
| Net property and equipment | 192,337 | 19 |
| | ----- | ----- |
| OTHER ASSETS: | | |
| Goodwill | 1,909,792 | 1,90 |
| Intangible assets, primarily trade names | 259,096 | 26 |
| Notes receivable | 59,352 | 5 |
| Long-term securities and other assets | 73,789 | 8 |
| | ----- | ----- |
| Total Assets | \$ 3,471,385 | \$ 3,62 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 100,832 | \$ 9 |
| Accrued liabilities: | | |
| Payroll and related expenses | 79,270 | 8 |
| Self-insured claims and related expenses | 79,838 | 6 |
| Income taxes payable | 11,258 | |
| Other | 109,864 | 13 |
| Deferred revenues | 428,572 | 34 |
| Liabilities of discontinued operations | 55,160 | 5 |
| Current portion of long-term debt | 44,496 | 3 |
| | ----- | ----- |
| Total Current Liabilities | 909,290 | 80 |
| | ----- | ----- |
| LONG-TERM DEBT | 831,873 | 1,12 |
| | ----- | ----- |
| LONG-TERM LIABILITIES: | | |
| Deferred taxes | 257,146 | 23 |
| Liabilities of discontinued operations | 21,632 | 5 |
| Other long-term obligations | 112,323 | 10 |
| | ----- | ----- |
| Total Long-Term Liabilities | 391,101 | 38 |
| | ----- | ----- |

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| | | |
|--|--------------|---------|
| MINORITY INTEREST | 102,200 | 10 |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Common stock \$0.01 par value, authorized 1 billion shares; issued 315,503 and 314,538 shares, respectively | 3,155 | |
| Additional paid-in capital | 1,049,452 | 1,03 |
| Retained earnings | 336,649 | 32 |
| Accumulated other comprehensive loss | (5,783) | (|
| Restricted stock | (491) | |
| Treasury stock | (146,061) | (15 |
| | ----- | ----- |
| Total Shareholders' Equity | 1,236,921 | 1,20 |
| | ----- | ----- |
| Total Liabilities and Shareholders' Equity | \$ 3,471,385 | \$ 3,62 |
| | ===== | ===== |

(1) See Note 2 in the Notes to the Condensed Consolidated Financial Statements for the basis of the restatement and the financial statement impact.

See Notes to Condensed Consolidated Financial Statements

THE SERVICEMASTER COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

| | Six Months Ended June 30, 2002 (Restated 1) | (Re -- |
|--|--|-----------|
| | ----- | --- |
| CASH AND CASH EQUIVALENTS AT JANUARY 1 | \$ 402,644 | \$ |
| CASH FLOWS FROM OPERATIONS: | | |
| NET INCOME | 74,144 | |
| Adjustments to reconcile net income to net cash flows from operations: | | |
| Income from discontinued operations | (78) | |
| Extraordinary (gain) loss | 9,229 | |
| Depreciation expense | 24,291 | |
| Amortization expense | 4,306 | |
| Deferred income tax expense | 39,758 | |
| Change in working capital, net of acquisitions: | | |
| Receivables | (59,876) | |
| Sale of receivables | -- | |
| Inventories and other current assets | (62,160) | |
| Accounts payable | 4,590 | |
| Deferred revenues | 84,625 | |

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| | | |
|--|------------|----|
| Accrued liabilities | 22,179 | |
| Tax refund from prior years payments | -- | |
| Other, net | 2,165 | |
| | ----- | |
| NET CASH PROVIDED FROM OPERATIONS | 143,173 | |
| | ----- | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Property additions | (29,387) | |
| Sale of equipment and other assets | 1,140 | |
| Business acquisitions, net of cash acquired | (6,849) | |
| Proceeds from business sales and minority interests | -- | |
| Notes receivable, financial investments and securities | (4,228) | |
| | ----- | |
| NET CASH USED FOR INVESTING ACTIVITIES | (39,324) | |
| | ----- | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net payments of debt | (295,570) | |
| Purchase of ServiceMaster stock | -- | |
| Shareholders' dividends | (59,598) | |
| Other, net | 12,825 | |
| | ----- | |
| NET CASH USED FOR FINANCING ACTIVITIES | (342,343) | |
| | ----- | |
| CASH USED FOR DISCONTINUED OPERATIONS | (31,406) | |
| | ----- | |
| CASH DECREASE DURING THE PERIOD | (269,900) | |
| | ----- | |
| CASH AND CASH EQUIVALENTS AT JUNE 30 | \$ 132,744 | \$ |
| | ===== | == |

(1) See Note 2 in the Notes to the Condensed Consolidated Financial Statements for the basis of the restatement and the financial statement impact.

See Notes to Condensed Consolidated Financial Statements

THE SERVICEMASTER COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1: The condensed consolidated financial statements include the accounts of ServiceMaster and its subsidiaries, collectively referred to as "the Company". Intercompany transactions and balances have been eliminated in consolidation.

Note 2: The condensed consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles and pursuant to the rules and regulations of the Securities and Exchange Commission.

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The Company suggests that the quarterly condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's most recent Annual Report to Shareholders and the Annual Report to the Securities and Exchange Commission on Form 10-K. The condensed consolidated financial statements reflect all adjustments, which are in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for any interim period are not necessarily indicative of the results which might be obtained for a full year.

RESTATEMENT

The Company has restated its consolidated financial statements for the year ended December 31, 2001 as well as the previously reported quarterly results for 2002 and 2001. Subsequent to the original issuance of these condensed consolidated financial statements, management determined that the historical accounting treatment relating to the items below required revision. The table below presents the net income impacts from the restatements.

| (In millions, except per share data) | Three Months Ended June 30, 2002 | Three Months Ended June 30, 2001 | Six Months Ended June 30, 2002 | Six Months Ended June 30, 2001 |
|--|--|--|--------------------------------------|--------------------------------------|
| Continuing Operations: | | | | |
| AHS deferred acquisition costs | \$ - | \$ (0.5) | \$ - | \$ (0.5) |
| Trade name license fee | (1.3) | - | (2.5) | - |
| Interim accounting (TruGreen) | 7.8 | 5.6 | (4.0) | - |
| Other, net | 2.9 | (0.2) | 2.7 | - |
| Tax adjustment from reincorporation | - | (0.2) | - | - |
| Income Impact | \$ 9.4 | \$ 4.7 | \$ (3.8) | \$ (0.5) |
| Diluted EPS Impact | \$ 0.03 | \$ 0.02 | \$ (0.01) | \$ (0.01) |
| Discontinued Operations: | | | | |
| Income Impact | \$ 0.1 | \$ (1.4) | \$ (0.1) | \$ (0.1) |
| Diluted EPS Impact | \$ - | \$ - | \$ - | \$ (0.01) |
| Cumulative effect of accounting change: | | | | |
| Income Impact | \$ - | \$ - | \$ 44.6 | \$ - |
| Diluted EPS Impact | \$ - | \$ - | \$ 0.15 | \$ - |

A summary of the significant effects of the restatement is as follows:

| (in thousands, except per share data) | Three Months Ended June 30, 2002 | | Three Months Ended June 30, 2001 |
|---|-------------------------------------|-------------|--|
| | As Previously Reported (1) | As Restated | As Previously Reported (1) |
| Operating revenue | \$1,032,807 | \$1,034,937 | \$1,015,687 |
| Operating income | 118,158 | 134,676 | 108,386 |
| Income from continuing operations before income taxes | 97,305 | 112,903 | 77,468 |

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| | | | |
|-----------------------------------|----------|----------|----------|
| Income from continuing operations | 62,024 | 71,437 | 45,019 |
| Discontinued operations, net | 200 | 295 | 5,694 |
| Extraordinary loss, net | (9,229) | (9,229) | - |
| ===== | ===== | ===== | ===== |
| Net income | \$52,995 | \$62,503 | \$50,713 |
| ===== | ===== | ===== | ===== |
| Diluted earnings per share: | | | |
| Income from continuing operations | \$0.20 | \$0.23 | \$0.15 |
| Discontinued operations, net | - | - | 0.02 |
| Extraordinary loss, net | (0.03) | (0.03) | - |
| ===== | ===== | ===== | ===== |
| Diluted earnings per share | \$0.17 | \$0.20 | \$0.17 |
| ===== | ===== | ===== | ===== |

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| | As of June 30, 2002 | | As of December 31, 2001 |
|--|-------------------------------|-------------|-------------------------------|
| | As Previously Reported (1) | As Restated | As Previously Reported (1) |
| ----- | ----- | ----- | ----- |
| Current assets | \$949,102 | \$977,019 | \$1,131,824 |
| Net property, plant, and equipment | 177,605 | 192,337 | 180,937 |
| Other long-term assets | 2,357,518 | 2,302,029 | 2,361,978 |
| ----- | ----- | ----- | ----- |
| Total assets | \$3,484,225 | \$3,471,385 | \$3,674,739 |
| ----- | ----- | ----- | ----- |
| Current liabilities | \$898,091 | \$909,290 | \$796,113 |
| Long-term debt | 817,141 | 831,873 | 1,105,518 |
| Long-term liabilities | 458,198 | 391,101 | 449,470 |
| Minority interest | 102,200 | 102,200 | 102,677 |
| Total shareholders' equity | 1,208,595 | 1,236,921 | 1,220,961 |
| ----- | ----- | ----- | ----- |
| Total liabilities and shareholders' equity | \$3,484,225 | \$3,471,385 | \$3,674,739 |
| ===== | ===== | ===== | ===== |

| | Six Months Ended June 30, 2002 | | Six Months Ended June 30, 2001 |
|--|-----------------------------------|-------------|--------------------------------------|
| | As Previously Reported (1) | As Restated | As Previously Reported (1) |
| ----- | ----- | ----- | ----- |
| (in thousands, except per share data) | | | |
| Operating revenue | \$1,766,192 | \$1,769,200 | \$1,735,278 |
| Operating income | 178,920 | 174,372 | 166,583 |
| Income from continuing operations before | | | |

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| | | | |
|---|----------|----------|----------|
| income taxes | 137,603 | 131,420 | 106,383 |
| Income from continuing operations before extraordinary items and cumulative effect of accounting change | 87,051 | 83,295 | 62,025 |
| Discontinued operations, net | 157 | 78 | 11,912 |
| Extraordinary gain (loss), net | (9,229) | (9,229) | 6,003 |
| Cumulative effect of accounting change, net | (44,577) | - | - |
| ----- | ----- | ----- | ----- |
| Net income | \$33,402 | \$74,144 | \$79,940 |
| ===== | ===== | ===== | ===== |
| Diluted earnings per share: | | | |
| Income from continuing operations before extraordinary items and cumulative effect of accounting change | \$0.28 | \$0.27 | \$0.21 |
| Discontinued operations, net | - | - | 0.04 |
| Extraordinary gain (loss), net | (0.03) | (0.03) | 0.02 |
| Cumulative effect of accounting change, net | (0.15) | - | - |
| ----- | ----- | ----- | ----- |
| Diluted earnings per share | \$0.11 | \$0.24 | \$0.26 |
| ===== | ===== | ===== | ===== |

- 1) During the third quarter of 2002, the Company sold its Terminix operations in the United Kingdom. The financial results from these operations have been reclassified from "Continuing Operations" to "Discontinued Operations" for all periods presented. Amounts as restated include this reclassification. The amount for 2002 reflects the cumulative effect of the change in accounting principle at American Home Shield.

AMERICAN HOME SHIELD DEFERRED ACQUISITION COSTS

In July 2002, the Company changed its method of accounting for deferred customer acquisition costs in its American Home Shield business from SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," pursuant to which the Company believed it was appropriate to amortize deferred acquisition costs over the expected customer life to FASB Technical Bulletin No. 90-1, "Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts," pursuant to which deferred acquisition costs are amortized over the initial contract life.

The new method of accounting reduced after-tax earnings by \$.03 per diluted share in 2002, but had no material impact on cash flow in current or future years. In the second quarter of 2002, the Company retroactively recorded to the first quarter of 2002 a cumulative charge of \$45 million (\$.15 per diluted share) to effect this change.

Following discussions with the Staff of the Securities and Exchange Commission, the Company has restated prior years to account for deferred acquisition costs in accordance with FASB Technical Bulletin No. 90-1. The effect of this restatement is to eliminate the cumulative charge for the accounting change and reduce full year income from continuing operations by \$8.5 million or \$.03 per diluted share in 2001, and \$6.1 million or

\$.02 per diluted share in 2000. In addition, this change results in a reduction of retained earnings of \$30 million at January 1, 2000. This restatement reduced

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income from continuing operations by \$.5 million for the second quarter of 2001 and \$4.7 million for the six months ended June 30, 2001.

TRADE NAME LICENSE FEE

In connection with the sale of its Management Services business in the fourth quarter of 2001, the Company entered into a three-year licensing arrangement with ARAMARK Corporation for the use of the ServiceMaster trade name. This agreement was valued at \$15 million and accordingly, a like amount was allocated from the purchase price. The Company intended to recognize this amount over the three-year contractual period, and as such, recognized \$2 million related thereto in each of the first and second quarters of 2002. In November 2002, the Company announced that it had determined that it was appropriate to recognize the entire \$15 million licensing fee in the fourth quarter of 2001. The effect of this correction is to increase full year income from continuing operations by \$9 million and diluted earnings per share by \$.03 in 2001, and to reduce income from continuing operations by \$2.5 million and diluted earnings per share by \$.01 in the first half of 2002. For the second quarter 2002, this restatement reduced income from continuing operations by \$1.3 million.

INSURANCE (TRUGREEN)

In January 2002, the Company reported that it had recognized a \$9 million pretax expense in 2001 relating to a revised estimate of the 2000 insurance reserve requirements. Net income has been restated for this item which results in an increase to full year income from continuing operations of \$3.7 million (or \$.01) in 2001 and a decrease to income from continuing operations of the same amount in 2000. The remaining adjustment results in a decrease to full year income from discontinued operations of \$1.1 million in 2000. This restatement impacted the fourth quarter of 2001.

REINCORPORATION TAX

Prior to 1997, the Company was in partnership form and therefore was not a federal taxpayer. Consequently, the Company did not record deferred tax balances reflecting the differences between the book and tax basis of its assets and liabilities. When the Company converted to corporate form in 1997, it realized a significant step-up in the tax basis of its assets, which was largely reflected as an increase in the basis of the tax intangibles and provided for significant tax deductions over the next 15 years. In accounting for this event in 1997, the Company recorded the net deferred tax asset associated with differences between the book and tax basis of its tangible assets and liabilities. As it related to intangible assets, the Company made a determination that the tax basis of intangibles equaled the overall book balance of intangible assets on an enterprise basis. Subsequently it was determined that intangible assets needed to be considered at the individual business unit level which resulted in a situation where tax basis exceeded book basis in certain units. This difference created an additional deferred tax asset. The Company restated the financial statements to reflect the deferred tax asset as if it had been recorded in 1997.

This change results in an increase to retained earnings as of January 1, 2000 of \$92.6 million, and an increase to the full year tax provision for continuing operations of \$.8 million in both 2001 and 2000 and an increase to the full year tax provision for discontinued operations of \$.8 million and \$1.2 million in 2001 and 2000, respectively. This restatement also results in an increase to the tax provision relating to the gain on certain businesses sold in the fourth quarter of 2001 of \$45.8 million. The net impact of these items was to increase deferred tax assets by \$33.4 million and equity by \$43.2 million as of December 31, 2001. This restatement increased the tax provision for continuing operations by \$.2 million and \$.4 million for the second quarter and six months ended June 30, 2001, respectively. In addition, the tax provision for discontinued operations increased by \$.3 million and \$.6 million for the second quarter and six months ended June 30, 2001, respectively.

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OTHER, NET

Other items primarily relate to adjustments in accruals, timing of revenue and expense items and other miscellaneous items. The Company also determined it was appropriate to expense the costs associated with telephone directory placements when the directory is published rather than expensing the cost over the contract period. In addition, certain operating leases of constructed properties have been included in the balance sheet as assets with associated debt. The financial statements have been restated from the amounts previously reported for these items. The restatement related to these items resulted in income from continuing operations increasing \$2.9 million and decreasing \$.2 million for the second quarter 2002 and 2001, respectively. Income

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from continuing operations increased by \$2.7 million and \$2.8 million for the six months ended June 30, 2002 and 2001, respectively. Income from discontinued operations increased by \$.1 million and decreased by \$1.1 million for the second quarter 2002 and 2001, respectively. For the six months ended June 30, 2002 and 2001, income from discontinued operations decreased by \$.1 million and \$1.8 million, respectively.

INTERIM ACCOUNTING

TruGreen ChemLawn incurs pre-season advertising costs and annual repair and maintenance procedures in the first quarter. These costs are deferred and recognized as expense in proportion to the related revenues. Full-year results are not affected. The quarterly information for 2002 and 2001 has been restated to treat certain costs that were previously deferred, as current period costs. There was no impact on full-year results for 2002 and 2001 as a result of this change. This restatement resulted in income from continuing operations increasing by \$7.8 million and \$5.6 million for the second quarter of 2002 and 2001, respectively, and decreasing by \$4.0 million and \$9.3 million for the six months ended June 30, 2002 and 2001, respectively.

Note 3: The Company has identified the most important accounting policies in order to portray its financial condition and results of operations. These relate primarily to revenue recognition and the deferral of customer acquisition costs. The following revenue recognition policies have not changed since year-end. Revenues from lawn care, non-baiting termite, pest control, heating/air conditioning and plumbing services are recognized as the services are provided. Revenues from landscaping services are recognized based upon agreed monthly contract payments or when services are performed for non-contractual arrangements. Revenues from the Company's commercial installation contracts, primarily relating to HVAC, are recognized on the percentage of completion method in the ratio that total incurred costs bear to total estimated costs. Fees from home warranty and termite baiting contracts are recognized as revenues over the life of the contract in proportion to the direct costs (service or claim), which are expensed as incurred. Franchised revenues (which in aggregate represents approximately three percent of consolidated totals) consist of initial franchise fees and continuing monthly fees based upon the franchisee revenue. Revenue is recognized when reported from the franchisee and collectibility is assured.

Customer acquisition costs, which are incremental and direct costs of obtaining the customer, relating to several of the Company's contracts are deferred and amortized over the life of the contract, in proportion to revenue recognized. These costs include sales commissions and direct selling costs which can be shown to have resulted in a successful sale.

TruGreen ChemLawn has significant seasonality to its business. In the winter and

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early spring, this business sells a series of lawn applications to customers which are rendered primarily in March through October. The Company incurs incremental selling expenses at the beginning of the year that directly relate to successful sales in which the revenues will be recognized in later quarters. This business also defers, on an interim basis, pre-season advertising costs and annual repairs and maintenance procedures that are performed in the first quarter. These costs are deferred and recognized approximately in proportion to the contract revenue over the production season, and are not deferred beyond the calendar year-end.

As noted above, TruGreen's pre-season advertising costs are deferred and recognized approximately in proportion to the contract revenue over the year. These costs are not deferred beyond the calendar year-end. Beginning in 2002, the cost of direct-response advertising at Terminix is capitalized and amortized over its expected period of future benefits. This direct-response advertising consists primarily of direct-mail promotions, for which the cost is capitalized and amortized over the one-year customer contract life.

The preparation of the financial statements requires management to make certain estimates and assumptions required under generally accepted accounting principles which may differ materially from the actual results. Disclosures in the 2001 Annual Report presented the significant areas that require the use of management's estimates and discussed how management formed its judgment. The areas discussed included the allowance for receivables, accruals for self-insured retention limits related to medical, workers compensation, auto and general liability insurance, the possible outcome of litigation and the useful lives for depreciation and amortization expense and the valuation of tangible and intangible assets. There have been no changes in these areas or methodologies in 2002.

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Note 4: The Company carries insurance policies on insurable risks which it believes to be appropriate. The Company generally has self-insured retention limits and has obtained fully insured layers of coverage above such self-insured retention limits. Accruals for self-insurance losses are made based on the Company's claims experience and actuarial assumptions. The Company has certain liabilities with respect to existing or potential claims, lawsuits, and other proceedings. The Company accrues for these liabilities when it is probable that future costs will be incurred and such costs can be reasonably estimated.

The Company believes that other legal proceedings and currently pending litigation arising in the ordinary course of business will not have a material effect on the consolidated financial statements.

Note 5: In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 142, "Goodwill and Other Intangible Assets". SFAS 142 requires that after December 31, 2001, existing goodwill will no longer be amortized and intangible assets with indefinite useful lives will not be amortized until their useful lives are determined to be no longer indefinite. In accordance with SFAS 142, the Company discontinued the amortization of goodwill and indefinite lived intangible assets effective January 1, 2002. 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. The Company completed its initial assessment of goodwill impairment in the second quarter of 2002 and the testing concluded that there were no impairment issues. Estimated fair value was determined for each reporting unit by utilizing the expected present value of the future cash flows

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of the units. In all instances, the estimated fair value of the reporting units exceeded their book values. In accordance with SFAS 142, the following table provides summarized transitional information for the periods ended June 30, 2002 and 2001, with the 2001 information presented on an adjusted basis to reflect the elimination of amortization expense required under SFAS 142:

| (in thousands, except per share data) | Three Months Ended June 30, | | Six Mon Jun |
|---|--------------------------------|-----------|----------------|
| | 2002 | 2001 | 2002 |
| Reported operating income | \$134,676 | \$115,931 | \$174,372 |
| Add back: Goodwill and trade name amortization | - | 15,621 | - |
| Operating income as adjusted under SFAS 142 | \$134,676 | \$131,552 | \$174,372 |
| Reported income from continuing operations before extraordinary gain/(loss) | \$71,437 | \$49,735 | \$83,295 |
| Add back: Goodwill and trade name amortization, net of tax | - | 10,550 | - |
| Income from continuing operations before extraordinary gain/loss as adjusted under SFAS 142 | 71,437 | 60,285 | 83,295 |
| Discontinued operations, net of taxes | 295 | 4,225 | 78 |
| Extraordinary gain/(loss), net of taxes | (9,229) | - | (9,229) |
| Net income as adjusted under SFAS 142 | \$62,503 | \$64,510 | \$74,144 |
| Reported basic earnings per share from continuing operations before extraordinary gain/(loss) | \$0.24 | \$0.17 | \$0.28 |
| Add back: Goodwill and trade name amortization, net of tax | - | 0.04 | - |
| Basic earnings per share from continuing operations before extraordinary gain/(loss) as adjusted under SFAS 142 | 0.24 | 0.20 | 0.28 |
| Discontinued operations, net | - | 0.01 | - |
| Extraordinary gain/(loss), net | (0.03) | - | (0.03) |
| Basic earnings per share as adjusted under SFAS 142 | \$0.21 | \$0.22 | \$0.25 |

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| (in thousands, except per share data) | Three Months Ended June 30, | | Six Mon Jun |
|---|--------------------------------|--------|----------------|
| | ----- | | ----- |
| Reported diluted earnings per share from continuing operations before | | | |
| extraordinary gain/(loss) | \$0.23 | \$0.16 | \$0.27 |
| Add back: Goodwill and trade name amortization, net of tax | - | 0.03 | - |
| | ----- | | ----- |
| Diluted earnings per share from continuing operations before extraordinary gain/(loss) as adjusted under SFAS 142 | 0.23 | 0.20 | 0.27 |
| Discontinued operations, net | - | 0.01 | - |
| Extraordinary gain/(loss), net | (0.03) | - | (0.03) |
| | ----- | | ----- |
| Diluted earnings per share as adjusted under SFAS 142 | \$0.20 | \$0.21 | \$0.24 |
| | ===== | | ===== |

The following table summarizes goodwill and intangible assets.

| (in thousands) | As of June 30, 2002 | As of December 31, 2001 |
|------------------------------|---------------------------|-------------------------------|
| | ----- | ----- |
| Goodwill (1) | \$1,909,792 | \$1,904,178 |
| Trade names (1) | 238,550 | 238,550 |
| Other intangible assets | 76,478 | 74,197 |
| Accumulated amortization (2) | (55,932) | (51,611) |
| | ----- | ----- |
| Net other intangibles | 20,546 | 22,586 |
| | ----- | ----- |
| Total | \$2,168,888 | \$2,165,314 |
| | ===== | ===== |

(1) Not subject to amortization

(2) Annual amortization expense of approximately \$6 - \$8 million is expected over the next five years.

Note 6: The Company has announced that, beginning in 2003, it will begin accounting for employee stock options as compensation expense in accordance with SFAS 123, "Accounting for Stock Based Compensation." If the Company continues its historical pattern of option granting, the impact would be approximately \$.005 per diluted share in 2003, growing to approximately \$.03 per diluted share over five years.

In April 2002, the FASB issued SFAS 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". The primary impact to the Company of SFAS 145 is that it rescinds SFAS 4 which required all material gains and losses from the extinguishment of debt to be classified as extraordinary items. SFAS 145 requires that the more restrictive criteria of APB Opinion No. 30 will be used to determine whether such gains or losses are extraordinary. The Company intends to adopt SFAS 145 in its fiscal year 2003, as required by SFAS 145. Adoption of SFAS 145 will result in the

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reclassification of the extraordinary gains/losses into income from continuing operations included in the accompanying Condensed Consolidated Statements of Income.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. The provisions of SFAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002.

Note 7: On October 3, 2001 the Company's Board of Directors approved a series of strategic actions which were the culmination of an extensive portfolio review process that was initiated in the first quarter of 2001. The goal of the portfolio review was to increase shareholder value by creating a focused and aligned company that provides the greatest return and growth potential. The Company determined it could best achieve these goals with a portfolio of businesses which support the business strategy to become America's Home Service Company and have attractive cash flow and return characteristics. As part of this determination, in the fourth quarter of 2001, the Company sold its Management Services business to ARAMARK Corporation for

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approximately \$800 million. Also in the fourth quarter of 2001, the Company's Board of Directors approved the exit of non-strategic and under-performing businesses including TruGreen LandCare Construction, Certified Systems Inc. (CSI), and certain other small operations. The Company sold its TruGreen LandCare Construction operations to Environmental Industries, Inc. (EII) in certain markets and entered into an agreement with EII to manage the wind-down of commercial landscaping construction contracts in the remaining markets. In addition, the Company sold all of its customer contracts relating to the exit of CSI (the Company's professional employer organization), to AMS Staff Leasing, N.A., Inc. The Company also completed, in the fourth quarter of 2001, the sale of certain subsidiaries of its European pest control and property services operations. The results of these discontinued business units have been separated and classified as Discontinued Operations in the accompanying financial statements.

The Company continues to carry certain assets on its financial statements relating to these operations. Management is actively selling the remaining equipment and collecting the outstanding receivables. The Company believes that the remaining assets are presented at their net realizable value. In addition, reserves and accrual balances remain on the financial statements relating to these operations. Cash payments incurred for the wind-down of LandCare construction contracts, lease termination costs, workers compensation and health claims as well as professional service fees have been made in the first six months of 2002. The remaining balances are outlined in the table below.

In the fourth quarter of 2001, the Company recorded a charge for asset impairments and other items which included accruals for residual value guarantees on leased properties, severance for former executives and terminated employees, and other costs. During the second quarter of 2002, the Company completed the sale of its ownership interest in five assisted living facilities. These properties were financed through a synthetic lease arrangement, whereby, the Company guaranteed the residual value of the properties. At year-end, a \$13.5 million reserve was established representing the amount by which the residual value guarantees exceeded the value of bids to purchase the facilities at that time. The final sales price was significantly greater than these bid

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levels and the Company realized a gain of \$3.6 million from the sale on the assisted living properties.

The table below summarizes the activity during the six months ended June 30, 2002 for the remaining liabilities from the discontinued operation and the reserves for items recorded in the fourth quarter of 2001. The Company believes that the remaining reserves continue to be adequate and reasonable.

| (in thousands) | Balance at December 31, 2001 | Cash Payments or Other | Income/ (Expense) | Balance at June 30, 2002 |
|---|------------------------------------|------------------------------|----------------------|--------------------------------|
| | ----- | ----- | ----- | ----- |
| Remaining liabilities from discontinued operations | | | | |
| LandCare Construction | \$34,100 | \$12,000 | \$(100) | \$22,2 |
| Certified Systems, Inc. | 23,800 | 5,500 | - | 18,3 |
| Management Services | 7,400 | 900 | - | 6,5 |
| International businesses | 19,600 | (400) (1) | - | 20,0 |
| Other | 16,100 | 6,300 | - | 9,8 |
| Reserves related to strategic actions in the fourth quarter of 2001 | \$36,000 | \$10,600 | \$3,600 | \$21,8 |

(1) The liabilities of this business were assumed by the buyer of the sold operations. No cash payments were required.

The Company recorded a \$3.2 million charge in the second quarter of 2002 relating to the severance and termination agreement of a key executive. This severance will be paid out over three years.

Note 8: Basic earnings per share are computed by dividing income available to common stockholders by the weighted-average number of shares outstanding for the period. The weighted average common shares for the diluted earnings per share calculation includes the incremental effect related to outstanding options whose market price is in excess of the exercise price. Shares potentially issuable under convertible securities have been considered outstanding for purposes of the diluted earnings per share calculations. In computing diluted earnings per share, the after-tax interest expense related to convertible debentures is added back to net income in the numerator, while the diluted shares in the denominator include the shares issuable upon conversion of the debentures. The effects of outstanding stock options whose market price is in excess of the exercise price

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and shares potentially issuable under convertible securities have not been included for the six months ended June 30, 2002 and 2001, respectively, as their effect would have been anti-dilutive.

The following table reconciles both the numerator and the denominator of the basic earnings per share from continuing operations computation to the numerator and the denominator of the diluted earnings per share from continuing operations computation.

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(in thousands, except per share data)

| | Three Months | | | |
|--|---------------------|---------|--------|--------|
| | Ended June 30, 2002 | | | |
| Continuing Operations: | Income | Shares | EPS | Income |
| ----- | ----- | ----- | ----- | ----- |
| Basic earnings per share | \$71,437 | 301,092 | \$0.24 | \$49,7 |
| | | | ===== | |
| Effect of dilutive securities, net of tax: | | | | |
| Options | | 7,182 | | |
| Convertible securities | 1,195 | 8,200 | | 1,1 |
| | ----- | ----- | | ----- |
| Diluted earnings per share | \$72,632 | 316,474 | \$0.23 | \$50,9 |
| | ===== | ===== | ===== | ===== |

| | Six Months | | | |
|--|---------------------|---------|--------|--------|
| | Ended June 30, 2002 | | | |
| Continuing Operations: | Income | Shares | EPS | Income |
| ----- | ----- | ----- | ----- | ----- |
| Basic earnings per share | \$83,295 | 300,653 | \$0.28 | \$50,4 |
| | | | ===== | |
| Effect of dilutive securities, net of tax: | | | | |
| Options | | 7,047 | | |
| | ----- | ----- | | ----- |
| Diluted earnings per share | \$83,295 | 307,700 | \$0.27 | \$50,4 |
| | ===== | ===== | ===== | ===== |

Note 9: In the Condensed Consolidated Statements of Cash Flows, the caption Cash and Cash Equivalents includes investments in short-term, highly-liquid securities having a maturity of three months or less. Supplemental information relating to the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2002 and 2001 is presented in the following table:

| | (in thousands) | |
|-----------------------------------|----------------|-------------|
| | 2002 | 2001 |
| Cash paid or (received) for: | | |
| Interest expense..... | \$ 44,956 | \$ 64,845 |
| Interest and dividend income..... | \$ (6,108) | \$ (4,366) |
| Income taxes..... | \$ 31,294 | \$ (12,277) |

The decrease in interest paid in 2002 is primarily due to reduced debt levels reflecting debt retirements utilizing the proceeds from the sale of Management Services. The increase in interest income received is also due to the proceeds received from the Management Services sale as the Company maintained significant cash levels throughout the year. The tax payment in 2002 resulted from the gain on the sale of the Management Services business which compared to the prior year tax refund of \$21 million related to prior year over-payments.

Note 10: Total comprehensive income was \$57.7 million and \$51.8 million for the

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three months ended June 30, 2002 and 2001, respectively, and \$70.9 million and \$52.2 million for the six months ended June 30, 2002 and 2001, respectively. Total comprehensive income includes primarily net income, changes in unrealized gains and losses on marketable securities and translation balances.

Note 11: On March 23, 2001, the Company entered into an agreement which provides for the ongoing revolving sale of a designated pool of accounts receivable of TruGreen and Terminix. At June 30, 2002, there were no outstanding receivables sold to third parties under this agreement. However, the Company may sell its receivables in the future which would provide an alternative funding source.

Note 12: In the second quarter of 2002, the Company recorded an extraordinary loss on early debt extinguishment of \$9.2 million after-tax or \$.03 per diluted share resulting from the repurchase of approximately \$218 million in ServiceMaster corporate bonds pursuant to a tender offer. In the first quarter of 2001, the Company repurchased approximately \$35 million of its public debt securities and recorded an extraordinary gain of \$6.0 million after-tax or \$.02 per diluted share. The Company intends to adopt SFAS

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145 beginning in fiscal 2003. Adoption of SFAS 145 will result in the reclassification of the extraordinary gain/loss into income from continuing operations.

Note 13: The Company maintains minority investors in the combined ARS/AMS entity as well as in Terminix. Members of management acquired, at fair market value, equity interests in ARS. The Company and the equity investors have respective options to acquire or sell the minority interests in the future at a price based on fair market value. The future acquisition of this minority interest will be recorded as additional purchase cost at the time of payment. At Terminix, the minority ownership reflects an interest issued to the prior owners of the Allied Bruce Terminix Companies in connection with that acquisition. This equity security is exchangeable into eight million ServiceMaster common shares. The ServiceMaster shares are included in the shares used for the calculation of diluted earnings per share.

In January 2001, Jonathan P. Ward, President and Chief Executive Officer of ServiceMaster, purchased from ServiceMaster a 5.50% convertible debenture due January 9, 2011, with a face value of \$1.1 million. ServiceMaster financed the purchase of the debenture with a 5.50% full recourse loan due January 9, 2011. In May 2001, Mr. Ward purchased a second 5.50% convertible debenture due May 10, 2011, with a face value of \$1.1 million. ServiceMaster financed 50% of the purchase price of this second debenture with a 5.50% full recourse loan due May 10, 2011. Each debenture becomes convertible into 20,000 shares of ServiceMaster common stock on December 31 on each of the years 2001 through 2005.

Note 14: The business of the Company is conducted through five operating segments: TruGreen, Terminix, American Home Shield, ARS/AMS and Other Operations. Due to the Company's sale of its Management Services business unit and its exit from other businesses in 2001, certain operations have become more significant for segment reporting purposes. As a result, the Company has expanded its business segment reporting which will allow for better ongoing visibility into the components of the business. The companies that previously were reported in the Home Maintenance & Improvement segment have been further broken out into American Home Shield and the combination of ARS/AMS. The franchise operations, ServiceMaster Clean and Merry Maids, formerly in the Home Maintenance & Improvement segment, are reported in the Other Operations segment. In accordance with Statement of Financial Accounting Standards No. 131, the

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Company's reportable segments are strategic business units that offer different services. The TruGreen segment provides residential and commercial lawn care and landscaping services through the TruGreen ChemLawn and TruGreen LandCare companies. As a result of the decision in the fourth quarter of 2001 to exit the LandCare Construction business, the results of the construction operations are now included in discontinued operations for all periods. The Terminix segment provides termite and pest control services to residential and commercial U.S. customers. The American Home Shield segment provides home warranties to consumers that cover heating, ventilation, air conditioning (HVAC), plumbing and certain appliances. This segment also includes home inspection services provided by AmeriSpec. The American Residential Services, (ARS) and American Mechanical Services (AMS) segment provides HVAC and plumbing services provided under the ARS, AMS and Rescue Rooter brand names. The Other Operations segment includes the franchise operations of ServiceMaster Clean and Merry Maids, which provide disaster restoration and cleaning services as well as the Company's headquarters operations which provides various technology, marketing, finance and other support services to the business units.

Segment information is presented below. As discussed in Note 2 in the Notes to the Condensed Consolidated Financial Statements, the information for 2002 and 2001 has been restated.

SFAS 142, "Goodwill and Other Intangible Assets", eliminates the amortization of goodwill and intangible assets with indefinite lives beginning in 2002. The table below also presents "Proforma" information for 2001 which eliminates amortization expense related to goodwill and intangible assets with indefinite lives, so that these periods are presented on a comparable basis to the 2002 information.

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| (In thousands) | Three Months Ended June 30, 2002 Reported | Three Months Ended June 30, 2001 Reported |
|-------------------------|--|--|
| ----- | | |
| Operating Revenue: | | |
| TruGreen | \$434,279 | \$430,065 |
| Terminix | 256,652 | 231,633 |
| American Home Shield | 116,440 | 100,027 |
| ARS/AMS | 192,079 | 224,173 |
| Other Operations | 35,487 | 34,136 |
| ----- | | |
| Total Operating Revenue | \$1,034,937 | \$1,020,034 |
| ===== | | |
| Operating Income: | | |
| TruGreen | \$67,920 | \$61,912 |
| Terminix | 44,289 | 33,279 |

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| | | |
|------------------------|-----------|-----------|
| American Home Shield | 17,834 | 10,949 |
| ARS/AMS | 10,191 | 13,352 |
| Other Operations | (5,558) | (3,561) |
| <hr/> | | |
| Total Operating Income | \$134,676 | \$115,931 |
| <hr/> | | |

| | As of June 30, 2002 | As of Dec. 31, 2001 |
|--|------------------------|------------------------|
| <hr/> | | |
| Identifiable Assets: | | |
| TruGreen | \$1,148,644 | \$1,082,135 |
| Terminix | 846,789 | 823,333 |
| American Home Shield | 356,344 | 323,229 |
| ARS/AMS | 505,736 | 519,026 |
| Other Operations (and discontinued businesses) | 613,872 | 873,522 |
| <hr/> | | |
| Total Identifiable Assets | \$3,471,385 | \$3,621,245 |
| <hr/> | | |

| | Six Months Ended June 30, 2002 Reported | Six Months Ended June 30, 2001 Reported | S |
|-------------------------|--|--|---|
| <hr/> | | | |
| Operating Revenue: | | | |
| TruGreen | \$663,422 | \$659,820 | |
| Terminix | 476,925 | 428,421 | |
| American Home Shield | 202,356 | 173,189 | |
| ARS/AMS | 357,170 | 415,345 | |
| Other Operations | 69,327 | 66,120 | |
| <hr/> | | | |
| Total Operating Revenue | \$1,769,200 | \$1,742,895 | |
| <hr/> | | | |

| | | |
|------------------------|-----------|-----------|
| <hr/> | | |
| Operating Income: | | |
| TruGreen | \$74,444 | \$61,454 |
| Terminix | 82,225 | 63,204 |
| American Home Shield | 21,189 | 12,076 |
| ARS/AMS | 7,305 | 18,621 |
| Other Operations | (10,791) | (5,095) |
| <hr/> | | |
| Total Operating Income | \$174,372 | \$150,260 |
| <hr/> | | |

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The following table summarizes the previously amortized goodwill and trade names by segment that, beginning on January 1, 2002 are no longer amortized.

| | June 30, 2002 | December 31, 2001 |
|----------------------|------------------|----------------------|
| TruGreen | \$911,183 | \$910,573 |
| Terminix | 708,722 | 705,608 |
| American Home Shield | 72,085 | 72,085 |
| ARS/AMS | 347,967 | 347,863 |
| Other Operations | 108,385 | 106,599 |
| | ----- | ----- |
| Total | \$2,148,342 | \$2,142,728 |
| | ===== | ===== |

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MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
OF OPERATIONS

RESULTS OF OPERATIONS

SECOND QUARTER 2002 COMPARED TO SECOND QUARTER 2001

CONSOLIDATED REVIEW

The Company has restated its financial statements for 2001 as well as the previously reported 2002 quarterly results. See Note 2 of the Notes to the Condensed Consolidated Financial Statements for the description of the restatement and the financial statement impact. This Management Discussion and Analysis reflects the impacts of the restatement.

Revenue for the second quarter was \$1.03 billion, one percent above 2001, and operating income was \$135 million. The Company reported income from continuing operations in 2002 of \$71 million, income from discontinued operations of \$.3 million, and a \$9 million extraordinary loss from the early extinguishment of debt. Net income was \$63 million in 2002 and \$54 million in 2001 and diluted

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earnings per share were \$.20 in 2002 and \$.18 in 2001.

Diluted earnings per share from continuing operations were \$.23 in 2002 compared with \$.16 in 2001. As discussed further in Note 4 of the Notes to the Condensed Consolidated Financial Statements, Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets", requires that beginning in 2002, goodwill and trade names no longer be amortized. SFAS 142 does not permit the restatement of the 2001 financial information to reflect the impact of SFAS 142. The diluted earnings per share equivalent of reduced amortization expense under SFAS 142 is \$.03 (\$16 million pretax) for the second quarter of 2001.

Second quarter operating income in 2002 was \$135 million compared to \$116 million in 2001. The 2001 figure includes \$16 million of amortization expense that has been eliminated under SFAS 142. Operating margins after adjusting for the amortization expense eliminated under SFAS 142 increased to 13.0 percent of revenue in 2002 from 12.9 percent in 2001. The increase in operating income reflects continued strong performance at American Home Shield, solid performance from Terminix and the TruGreen lawn care operations, partially offset by lower volume in the heating, ventilation and air conditioning (HVAC) and plumbing businesses of ARS and AMS, increased workers compensation claims at TruGreen LandCare, as well as increased expenditures related to Company-wide operational initiatives and overhead support.

Cost of services rendered and products sold decreased slightly for the quarter and decreased as a percentage of revenue to 65.7 percent in 2002 from 66.8 percent in 2001. This decrease reflects a change in mix of the business as TruGreen ChemLawn, Terminix, and American Home Shield increased in size in relationship to the overall business of the Company. These businesses generally operate at higher gross margin levels than the rest of the business, but also incur somewhat higher selling and administrative expenses as a percentage of revenue. Selling and administrative expenses increased six percent and increased as a percentage of revenue to 21.0 percent from 20.1 percent in 2001. The increase in selling and administrative expenses reflects the change in business mix discussed above, as well as enterprise-wide initiatives to measure customer and employee satisfaction, improved marketing techniques and expenditures on the Six Sigma programs.

In the second quarter of 2002, the Company completed two non-recurring transactions. The ownership interest in five assisted living facilities was sold during the quarter, and a gain of \$3.6 million was realized. In addition, a key executive signed a termination and severance agreement in the quarter. The Company recorded a \$3.2 million charge relating to this agreement. Cash payments will be made over a three-year period.

Interest expense decreased from the prior year, primarily due to reduced debt levels as a portion of the proceeds received from sales of the Management Services and certain European pest control businesses were used to pay down debt. Interest and investment income decreased primarily reflecting a reduced

level of investment gains realized on the American Home Shield investment portfolio. Minority interest and other expense decreased primarily due to losses incurred in 2001 relating to the sale of accounts receivables under the Company's securitization program.

The tax provision in 2002 reflects a lower effective tax rate than 2001 based on

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benefits received through the consolidation for tax purposes of the ServiceMaster Home Service Center. As a result of the Company's acquisition of the minority interest, it was able to reorganize the subsidiary in 2002 and utilize prior year net operating losses of this subsidiary operation.

OTHER DEVELOPMENTS

New distribution channels for the Company's services continue to be explored. In July 2002, the Company announced that it had entered into an agreement to provide Yahoo! consumers the ability to schedule and purchase ServiceMaster home services through the newly created Home Service Center on Yahoo! Real Estate. Also in August, the Home Service Center (a subsidiary of the Company) partnered with Sears, Roebuck and Company to allow customers to tap into the network of Sears parts and repair services.

In July 2002, the Company and the Home Depot announced that they had concluded their joint home services pilot program. The two companies will, however, continue to explore ways to expand existing relationships for installation and other services on a local basis.

SEGMENT REVIEW

SEGMENT RESULTS FOR 2002 REFLECT THE ELIMINATION OF GOODWILL AND TRADE NAME AMORTIZATION REQUIRED UNDER SFAS 142. THEREFORE, FOR COMPARATIVE PURPOSES, 2001 RESULTS HAVE BEEN PRESENTED ON A PROFORMA BASIS AS IF SFAS 142 HAD BEEN IN EFFECT FOR 2001 THEREBY EXCLUDING THE AMORTIZATION EXPENSE AFFECTED BY THE NEW ACCOUNTING STANDARD. (SEE THE BUSINESS SEGMENT REPORTING IN NOTE 14 IN THE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS). MANAGERMENTS DISCUSSION AND ANALYSIS FOCUSES ON THE 2002 REPORTED AND THE 2001 PROFORMA AMOUNTS.

The TruGreen segment includes lawn care operations performed under the TruGreen ChemLawn brand name and landscape maintenance services provided under the TruGreen LandCare brand name. This segment's results for both 2002 and 2001 exclude the discontinued TruGreen LandCare Construction business. The TruGreen segment reported revenue of \$434 million, one percent above 2001. Operating income decreased one percent to \$68 million from \$69 million (proforma) in 2001, primarily reflecting solid growth in the lawn care operations, offset by increased workers compensation claims (approximately \$5 million) in the landscape operations. Revenue in the lawn care business improved two percent over 2001, reflecting growth in customer counts from increased sales and improved retention rates. The sales growth has been supported by the deployment of more sophisticated marketing tools and by reaching customers more effectively through broader distribution channels. The higher level of full program customers has also increased the sale of ancillary services in the quarter. Operating income margins in the lawn care operations improved as a result of revenue growth and increased leverage of fixed costs. The landscape maintenance operations experienced a decline in revenue for the quarter. Although volume was down, the base of business consists of more profitable contracts with a stronger customer base and improved pricing. Operating income margins in the landscaping operations declined primarily reflecting increased workers compensation claims, partially offset by lower material costs. This business is focusing on specific operating initiatives including hiring a senior sales leader, expanding and developing its sales force, continuing to focus on labor efficiency programs, and improving the results of the bottom quartile of its branches.

The Terminix segment, which includes the domestic termite and pest control services, reported an 11 percent increase in revenue to \$257 million from \$232 million in 2001 and operating income growth of 14 percent to \$44 million from \$39 million (proforma) in 2001. Revenue growth was supported by the 2001 acquisition of Sears Termite & Pest Control as well as new sales and improved customer retention in both the termite and pest control business. Operating income margins improved over the prior year reflecting the beneficial impact of

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acquisitions and improved labor efficiency, offset in part by costs for quality improvement initiatives and direct marketing expenditures. The segment has produced steady

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improvement in customer retention rates which reflects the increased emphasis on training and customer service processes in the branches.

The American Home Shield segment, which provides home warranties to consumers that cover HVAC, plumbing and other appliances, reported a 16 percent increase in revenue to \$116 million from \$100 million in 2001. This increase in revenue reflected strong growth in the real estate and third party channels as well as improved customer renewal rates. Operating income increased 54 percent to \$18 million from \$12 million (proforma) in 2001. Operating income margins improved reflecting both lower service costs per claim and a decrease in the incidence of claims.

The ARS/AMS segment provides direct HVAC and plumbing services under the American Residential Services (ARS), Rescue Rooter, and American Mechanical Services (AMS) (for commercial accounts) brand names. The segment reported revenue of \$192 million, a decrease of 14% from \$224 million in 2001. Operating income decreased to \$10 million from \$16 million (proforma) in 2001. A decline in call volume for air conditioning and plumbing repairs and reduced construction activity continued to affect the industry and resulted in the decline in revenue and profit. A comprehensive rebuilding of marketing and sales strategies is underway to counteract the impact of the decrease in demand, and in the second quarter, the Company hired a chief marketing officer for the ARS operations.

The Other Operations segment includes the Company's ServiceMaster Clean, Merry Maids, and international operations as well as its headquarters functions. Reported segment revenue of \$35 million in 2002 compared with \$34 million in 2001, primarily reflecting growth in the ServiceMaster Clean and Merry Maids businesses. The operations achieved revenue and profit growth, primarily driven by a strong growth in disaster restoration and increased franchise sales at ServiceMaster Clean and the beneficial impact of acquisitions at Merry Maids. This segment reported an operating loss of \$6 million in 2002 compared with a loss of \$3 million (proforma) in 2001, reflecting increased expenditures in the headquarters organization for Six Sigma and other enterprise-wide initiatives to support purchasing efficiencies, marketing programs and technology projects.

RESULTS OF OPERATIONS

SIX MONTHS ENDED JUNE 30, 2002 AS COMPARED TO JUNE 30, 2001

CONSOLIDATED REVIEW

Revenue for the six months in 2002 increased two percent to \$1.8 billion and operating income was \$174 million. The Company reported income from continuing operations in 2002 of \$83 million and a \$9 million extraordinary loss from the early extinguishment of debt. Net income was \$74 million in 2002 and \$66 million in 2001 and diluted earnings per share were \$.24 in 2002 and \$.22 in 2001.

Diluted earnings per share from continuing operations were \$.27 in 2002 compared with \$.17 in 2001. As discussed in the three-month comparison, the diluted earnings per share equivalent of reduced amortization expense under SFAS 142 are

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\$.07 (\$30 million pretax) for the six months of 2001.

Six month operating income in 2002 was \$174 million compared to \$150 million in 2001. The 2001 figure includes \$30 million of amortization expense that has been eliminated under SFAS 142. Operating margins after adjusting for the amortization expense eliminated under SFAS 142 decreased to 9.9 percent of revenue in 2002 from 10.4 percent in 2001. The decline in operating income reflects strong increases at American Home Shield and Terminix offset by reduced volume in the HVAC and plumbing businesses of ARS and AMS and increased expenditures related to Company-wide operational initiatives.

Cost of services rendered and products sold decreased slightly for the six months and decreased as a percentage of revenue to 68.5 percent in 2002 from 69.5 percent in 2001. Selling and administrative expenses increased 10 percent and increased as a percentage of revenue to 21.4 percent in 2002 from 19.8 percent in 2001. The increase in selling and administrative expenses reflects strong growth in operations that have higher gross margin levels than the rest of the business, but also incur somewhat higher selling and administrative expenses as a percentage of revenue, as well as increase expenditures on initiatives to

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measure customer and employee satisfaction, improved marketing techniques and expenditures in Six Sigma.

Interest expense decreased from the prior year, primarily due to reduced debt levels as a portion of the proceeds received from the sales of the Management Services and certain European pest control businesses were used to pay down debt. Interest and investment income decreased primarily reflecting a reduced level of investment gains realized on the American Home Shield investment portfolio. Minority interest and other expense increased from the prior year primarily due to the elimination of minority interest income related to the ServiceMaster Home Service Center initiative that was recorded in 2001. In the first quarter of 2001 and until May 2001, the operating losses totaling \$6.1 million of ServiceMaster Home Service Center had been offset through minority interest income (below the operating income line) because of investments in the venture made by Kleiner Perkins Caufield & Byers. In December 2001, the Company acquired the minority interest in the ServiceMaster Home Service Center held by Kleiner Perkins and management. The operating losses incurred in the first six months of 2002 from ServiceMaster Home Service Center have been included in the accompanying financial statements without an offset at minority interest income in the consolidated statements of income.

The tax provision in 2002 reflects a lower effective tax rate than 2001 based on benefits received through the consolidation for tax purposes of the ServiceMaster Home Service Center. As a result of the Company's acquisition of the minority interest, it was able to reorganize the subsidiary in 2002 and utilize prior year net operating losses of this subsidiary operation.

KEY PERFORMANCE INDICATORS

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

KEY PERFORMANCE INDICATORS
As of June 30,

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| | 2002 | 2001 |
|--------------------------------------|-------|-------|
| TRUGREEN - | | |
| Growth in Full Program Contracts | 1% | -3% |
| Customer Retention Rate | 64.5% | 62.4% |
| TERMINIX - | | |
| Growth in Pest Control Customers | 12% | 14% |
| Pest Control Customer Retention Rate | 77.5% | 76.2% |
| Growth in Termite Customers | 8% | 20% |
| Termite Customer Retention Rate | 90.1% | 88.8% |
| AMERICAN HOME SHIELD - | | |
| Growth in Warranty Contracts | 15% | 11% |
| Customer Retention Rate | 53.2% | 51.1% |

SEGMENT REVIEW

SEGMENT RESULTS FOR 2002 REFLECT THE ELIMINATION OF GOODWILL AND TRADE NAME AMORTIZATION REQUIRED UNDER SFAS 142. THEREFORE, FOR COMPARATIVE PURPOSES, 2001 RESULTS HAVE BEEN PRESENTED ON A PROFORMA BASIS AS IF SFAS 142 HAD BEEN IN EFFECT FOR 2001 THEREBY EXCLUDING THE AMORTIZATION EXPENSE AFFECTED BY THE NEW ACCOUNTING STANDARD. (SEE THE BUSINESS SEGMENT REPORTING IN NOTE 14 IN THE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS). MANAGEMENT'S DISCUSSION AND ANALYSIS FOCUSES ON THE 2002 REPORTED AND THE 2001 PROFORMA AMOUNTS.

The TruGreen segment reported revenue of \$663 million, slightly above the prior year. Operating income of \$74 million in 2002 was comparable to the 2001 proforma amount. Revenue in the lawn care business improved two percent over 2001. Customer contracts have increased one percent over the prior twelve

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months compared with a three percent decline in the prior year period, reflecting the benefit of new marketing strategies as well as the impact of improved customer retention. In addition to telemarketing, which is the primary channel used by TruGreen ChemLawn to sell its services, the business has expanded expenditures in direct mail and television advertising leading to higher sales of new customers. Quality and other satisfaction initiatives have resulted in improving retention of existing customers. The customer retention rate improved 210 basis points to 64.5 percent compared to the same period last year. The retention rate continued to increase in the second quarter. Operating income margins in the lawn care operations increased reflecting improved labor productivity. Revenue in the landscaping operations declined reflecting a decrease in snow removal services due to mild winter weather and a slight decrease in its core maintenance business. Despite the decline in the maintenance business, the base of contracts is more profitable reflecting a stronger customer base and improved pricing. Operating income margins in the landscaping operations declined primarily reflecting the decreased volume of higher margin snow removal business and increased workers compensation claims. Management is highly focused on mid-season sales of enhanced services to support second half of the year growth expectations.

The Terminix segment reported an 11 percent increase in revenue to \$477 million from \$428 million in 2001 and operating income growth of 13 percent to \$82 million from \$73 million (proforma) in 2001. Revenue growth was driven by the

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acquisition in 2001 of Sears Termite & Pest Control as well as solid internal growth. One area where the Company has begun to see challenges is from the decrease in profitable pest control customers from the Sears name in certain markets. New sales in these markets have not kept pace with cancellations. As a result, the Company expects to see a reduction in revenue growth in the fourth quarter. Terminix has continued to show favorable comparisons in both termite and pest control customer retention, reflecting increased focus on quality, training, and customer service processes in the branches. Operating income margins improved over 2001 reflecting the impact of the acquisitions, continuing migration to higher margin products, improved labor efficiencies and lower material costs. Terminix is in the process of rolling out a new operating system to support its field operations. This system is expected to be in all branches by 2004.

The American Home Shield segment reported a 17 percent increase in revenue to \$202 million from \$173 million in 2001 and operating income growth of 59 percent to \$21 million compared to \$13 million (proforma) in 2001. Revenue growth reflected increases in all sales channels, complemented by improved customer retention. Operating income margins improved as the segment benefited from strong volume growth, lower service costs per claim and a decrease in the incidence of claims.

The ARS/AMS segment reported a 14 percent decrease in revenue to \$357 million from \$415 million in 2001 and operating income of \$7 million compared to \$23 million (proforma) in 2001. A soft economic environment combined with mild weather led to lower demand for heating, air conditioning and plumbing repairs and replacement service. These operations also experienced lower construction activity in both the residential and commercial sectors. With new leadership in place, this business continues to focus on cost containment initiatives and is implementing significant changes to its sales and marketing programs.

Other Operations revenue increased to \$69 million from \$66 million in 2001, primarily reflecting growth in the ServiceMaster Clean and Merry Maids businesses. These businesses achieved solid revenue and profit growth, supported by strong demand for disaster restoration services at ServiceMaster Clean and acquisitions at Merry Maids. This segment reported an operating loss of \$11 million compared with a loss of \$3 million (proforma) in 2001, reflecting increased expenditures on enterprise-wide initiatives including procurement, marketing, and technology.

FINANCIAL CONDITION

Net cash provided from operations of \$143 million was \$38 million higher than the first six months of 2001 before the impact of the Company's accounts receivable securitization program and tax refunds in 2001. Net cash provided from operations is 72 percent higher than earnings for the six months and represents a 36 percent increase over the \$105 million that was reported last year. This increase was driven, in part, by a significant reduction in the use of working capital, primarily at TruGreen ChemLawn and American Home Shield as a result of better receivables, payables and inventory management. Management believes that funds generated from operations and other existing resources will continue to be adequate to satisfy ongoing working capital needs of the Company.

Cash and marketable securities totaled approximately \$205 million at June 30, 2002. During the second quarter of 2002, the Company completed the last major phase of the debt reduction program announced in October 2001, when through a tender offer, the Company repurchased \$218 million of its publicly traded debt.

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As a result the Company reduced its total outstanding debt level in the quarter to approximately \$876 million. This represents a reduction in debt outstanding of approximately \$1.1 billion over the last two years and the Company's lowest level since the first quarter of 1997. The debt repurchase allowed the Company the opportunity to strengthen its credit profile by focusing the majority of the repurchase on debt with shorter maturities. Approximately 60% of the Company's debt now matures beyond seven years and 40% beyond fifteen years. The Company's first public bond maturity is not due until 2005.

The Company maintains a three-year revolving credit facility for \$490 million, which will expire in December 2004. As of June 30, 2002 the Company had issued approximately \$130 million of letters of credit under the facility and had unused commitments of approximately \$360 million. The Company also has \$550 million of senior unsecured debt and equity securities available for issuance under an effective shelf registration statement. In addition, the Company has an agreement to ultimately sell, on a revolving basis, certain receivables to unrelated third party purchasers. At June 30, 2002, there were no receivables outstanding that had been sold to third parties. The agreement is a 364-day facility that is renewable at the option of the purchasers. The Company may sell up to \$65 million of its eligible receivables to these purchasers in the future and therefore has immediate access to cash proceeds from these sales. The amount of eligible receivables varies during the year based on seasonality of the business and will at times limit the amount available to the Company. The Company also maintains operating lease facilities with banks totaling \$95 million that provide for the acquisition and development of properties to be leased by the Company. There are residual value guarantees of these properties up to 82 percent of the fair market value of the properties. At June 30, 2002, there was approximately \$72 million funded under these facilities. Of the \$95 million in facilities, \$80 million expires in October 2004 and \$15 million expires in January 2008. Approximately \$15 million of these leases that involve constructed properties have been included on the balance sheet as assets with related debt as of June 30, 2002 and December 31, 2001. The majority of the Company's vehicle fleet is leased through operating leases. The lease terms are non-cancelable for the first twelve month term, then are month-to-month leases, cancelable at the Company's option. There are residual value guarantees (ranging from 70 percent to 87 percent depending on the agreement) on these vehicles, which historically have not resulted in significant net payments to the lessors. At June 30, 2002, there was approximately \$265 million of residual value relating to the Company's fleet.

The following table presents the Company's obligations and commitments:

| (In millions) | Total | 2002 | 2003 and 2004 | 2005 and 2006 | 2007 and later years |
|-------------------------------------|---------|-------|------------------|------------------|-------------------------|
| Debt balances | \$ 876 | \$ 21 | \$ 73 | \$ 169 | \$ 613 |
| Non-cancelable operating leases (1) | 253 | 30 | 93 | 62 | 68 |
| Total amount | \$1,129 | \$ 51 | \$ 166 | \$ 231 | \$ 681 |

(1) Includes lease payments and residual value guarantees on leased properties.

There have been no material changes in the terms of the Company's financing agreements since December 31, 2001. As described in the Company's latest Annual Report to Shareholders, the Company is party to a number of debt agreements which require it to maintain certain financial and other covenants, including limitations on indebtedness and interest coverage ratio. In addition, under certain circumstances, the agreements may limit the Company's ability to pay dividends and repurchase shares of common stock. These limitations are not

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expected to be a factor in the Company's future dividend and share repurchase plans. Failure by the Company to maintain these covenants could result in the acceleration of the maturity of the debt. At June 30, 2002 the Company was in compliance with the covenants related to these debt agreements and based on its operating outlook for the remainder of 2002, expects to be able to maintain compliance in the future.

The assets and liabilities relating to the discontinued companies have been classified in separate captions on the Condensed Consolidated Statements of Financial Position. In the first quarter, the Company made

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approximately \$70 million in tax payments relating to the sale of Management Services. There were other cash payments relating to the wind-down of the discontinued operations which were offset by cash collected on assets remaining from these operations. Assets of the discontinued operations have declined reflecting cash collections on receivables and the sale of fixed assets. The liabilities from discontinued operations have decreased reflecting cash outflows related to the wind-down of contracts, lease termination costs, workers' compensation payments and legal costs.

Receivables and inventories increased from year-end levels, reflecting general business growth and increased seasonal activity. Prepaid expenses, deferred costs and other assets increased from year-end levels, reflecting the seasonality in the lawn care operations and increased volume of contracts written at Terminix and American Home Shield. The lawn care operations incur incremental selling expenses at the beginning of the year that directly relate to successful sales in which the revenues will be recognized in later quarters. This business also defers, on an interim basis, pre-season advertising costs and annual repairs and maintenance procedures that are performed in the first quarter. These costs are deferred and recognized in proportion to the contract revenue over the production season, and are not deferred beyond the calendar year-end. The Company also capitalizes sales commissions and other direct contract acquisition costs relating to termite and pest control contracts as well as home warranty contracts. Deferred revenue grew significantly reflecting increases in customer prepayments for lawn care services and strong growth in warranty contracts written at American Home Shield.

Capital expenditures which include recurring capital needs and information technology projects are higher than prior year levels reflecting the payments of the residual value guarantees relating to leases for the five assisted living facilities sold in the quarter. See Note 7 for additional details. The Company has no material capital commitments at this time.

Total shareholders' equity was \$1.2 billion at June 30, 2002 and December 31, 2001, reflecting earnings which were offset by cash dividends. Cash dividends paid directly to shareholders totaled \$60 million or \$.20 per share for the six months ended June 30, 2002. In July 2002, the Company paid a third quarter cash dividend of \$.105 per share and declared a fourth quarter cash dividend of \$.105 per share payable on October 31, 2002. This quarterly dividend payment provides for an annual payment for 2002 of \$.41 per share, a 2.5% increase over 2001. The Company approves its actual dividend payment on a quarterly basis and continually reviews its dividend policy, share repurchase program and other capital structure objectives. The Company has not undertaken material share repurchases during the first six months of 2002 or for the year ended 2001. Decisions relating to any future share repurchases will take various factors into consideration such as the Company's commitment to maintain investment grade credit ratings, general business conditions, and other strategic investment

opportunities.

FORWARD LOOKING STATEMENTS

THE COMPANY'S FORM 10-Q/A FILING CONTAINS 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. THE COMPANY 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 SUCH LEGISLATION. THE COMPANY 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): EXTREME WEATHER CONDITIONS THAT AFFECT THE DEMAND FOR THE COMPANY'S SERVICES; COMPETITION IN THE MARKETS SERVED BY THE COMPANY; LABOR SHORTAGES OR INCREASES IN WAGE RATES; UNEXPECTED INCREASES IN OPERATING COSTS, SUCH AS HIGHER INSURANCE, HEALTH CARE OR FUEL PRICES; INCREASED GOVERNMENTAL REGULATION OF TELEMARKETING; GENERAL ECONOMIC CONDITIONS IN THE UNITED STATES, ESPECIALLY AS THEY MAY AFFECT HOME SALES OR CONSUMER SPENDING LEVELS; TIME AND EXPENSES ASSOCIATED WITH INTEGRATING AND WINDING DOWN BUSINESSES; AND OTHER FACTORS DESCRIBED FROM TIME TO TIME IN DOCUMENTS FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION.

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QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The economy and its impact on discretionary consumer spending, labor wages, fuel costs, insurance costs and medical inflation rates could be significant to future operating earnings.

The Company does not hold or issue financial instruments for trading or speculative purposes. The Company has entered into specific financial arrangements in the normal course of business to manage certain market risks, with a policy of matching positions and limiting the terms of contracts to relatively short durations. The effect of financial instrument transactions is not material to the Company's financial statements.

The Company generally maintains the majority of its debt at fixed rates (over 95% of total debt at December 31, 2001 and June 30, 2002) and, therefore, its exposure to interest rate fluctuations is not significant to the Company's results of operations. The payments on the approximately \$72 million of funding outstanding under the Company's real estate operating lease facilities as well as its cancelable vehicle fleet and equipment operating leases are tied to floating interest rates. However, the Company does not expect interest rate fluctuations to be significant to the Company's results of operations.

The following table summarizes information about the Company's fixed rate debt instruments as of December 31, 2002 and presents the principal cash flows and related weighted-average interest rates by expected maturity dates. The fair value of the Company's fixed rate debt was approximately \$880 million at

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December 31, 2002.

| (In millions) | Expected Maturity Date | | | | | There- After | Total |
|-----------------|------------------------|------|-------|------|------|-----------------|-------|
| | 2003 | 2004 | 2005 | 2006 | 2007 | | |
| Fixed rate debt | \$31 | \$24 | \$151 | \$11 | \$59 | \$559 | \$835 |
| Avg. Rate | 4.2% | 4.8% | 8.2% | 6.0% | 6.7% | 7.5% | 7.2% |

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PART II. OTHER INFORMATION

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

- (a) The 2002 Annual Meeting of Shareholders was held on April 26, 2002.
- (b) The following persons were elected as Class of 2005 directors:

| Name | Votes For | Votes Withheld | Broker Non-Votes |
|----------------------|-------------|----------------|------------------|
| Paul W. Berezny, Jr. | 247,162,142 | 7,248,494 | N/A |
| Carlos H. Cantu | 248,659,562 | 5,751,074 | N/A |
| Vincent C. Nelson | 246,594,910 | 7,815,726 | N/A |
| Charles W. Stair | 248,226,619 | 6,184,017 | N/A |
| Jonathan P. Ward | 250,546,178 | 3,864,458 | N/A |

No votes were cast for any other nominee for directors. The Class of 2003 continuing in office are: Herbert P. Hess, Michele M. Hunt, Dallen W. Peterson, and David K. Wessner. The Class of 2004 continuing in office are: Brian Griffiths, Sidney E. Harris, James D. McLennan, C. William Pollard and Donald G. Soderquist.

No other matters were submitted to shareholders.

ITEM 6(A): EXHIBITS

| | |
|--------------|---|
| Exhibit 18.1 | Letter Re: Change in Accounting Principles |
| Exhibit 99.1 | Certification of Chief Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code |
| Exhibit 99.2 | Certification of Chief Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code |

ITEM 6(B): REPORTS ON FORM 8-K

A report on Form 8-K was filed on May 22, 2002 reporting under "Item 4. Changes

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in Registrant's Certifying Accountant." In this filing, the Company reported that on May 20, 2002 it had dismissed ArthurAndersen LLP as its independent accountants and, effective May 22, 2002, the Company engaged Deloitte & Touche LLP as its new independent accountants.

A report on Form 8-K/A was filed on May 24, 2002 for the purpose of including a revised Exhibit 16.1 to the Form 8-K filed on May 22, 2002.

A report on Form 8-K was filed on June 20, 2002 reporting under "Item 5. Other Events". The purpose of the report was to provide updated Key Performance Indicators that were included in the Company's first quarter earnings release. The Company discussed these metrics in an investors conference on June 20, 2002.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 14, 2003

THE SERVICEMASTER COMPANY
(Registrant)

By: _____ /s/Steven C. Preston

Steven C. Preston
Executive Vice President and Chief Financial Officer

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Jonathan P. Ward, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of The ServiceMaster Company;

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2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: May 13, 2003

/s/ Jonathan P. Ward

Jonathan P. Ward
Chairman and Chief Executive Officer

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CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Steven C. Preston, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of The ServiceMaster Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: May 13, 2003

/s/ Steven C. Preston

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Steven C. Preston
Executive Vice President and Chief Financial Officer