ABM INDUSTRIES INC /DE/
Form 10-Q
September 05, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2013

OR

¨ **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: 1-8929

ABM INDUSTRIES INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	**94-1369354**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
551 Fifth Avenue, Suite 300, New York, New York	**10176**
(Address of principal executive offices)	**(Zip Code)**

212-297-0200

(Registrant s telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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 by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 28, 2013
Common Stock, $0.01 par value per share	55,134,236 shares

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q, and in particular statements found in Item 2., Management s Discussion and Analysis of Financial Condition and Results of Operations, which are not statements of historical fact constitute forward-looking statements. These statements give current expectations or forecasts of future events and are often identified by the words will, may, should, continue anticipate, believe, expect, plan, appear, project, estimate, intend, seek, or other words and terms of similar meaning in discussions of future strategy and operating or financial performance. Such statements reflect the current views of ABM Industries Incorporated (ABM), and its subsidiaries (collectively referred to as ABM, we, us, our, or the Company), with respect to future events and are b assumptions and estimates which are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in these statements. These factors include but are not limited to the following:

- risks relating to our acquisition strategy may adversely impact our results of operations;
- our strategy of moving to an integrated facility solutions provider platform, which focuses on vertical market strategy, may not generate the growth in revenues or profitability that we expect;
- we are subject to intense competition that can constrain our ability to gain business, as well as our profitability;
- increases in costs that we cannot pass on to clients could affect our profitability;
- we have high deductibles for certain insurable risks, and therefore we are subject to volatility associated with those risks;
- we primarily provide our services pursuant to agreements that are cancelable by either party upon 30 to 90 days notice;
- our success depends on our ability to preserve our long-term relationships with clients;
- we are at risk of losses and adverse publicity stemming from any accident or other incident involving our airport operations;
- our international business exposes us to additional risks;
- we conduct some of our operations through joint ventures, and our ability to do business may be affected by the failure of our joint venture partners to perform their obligations or the improper conduct of joint venture employees, partners, or agents;
- significant delays or reductions in appropriations for our government contracts may negatively affect our business and could have an adverse effect on our financial position, results of operations, or cash flows;
- we are subject to a number of procurement rules and regulations relating to our business with the U.S. Government and if we fail to comply with those rules, our business and our reputation could be adversely affected;

negative or unexpected tax consequences could adversely affect our results of operations;

we are subject to business continuity risks associated with centralization of certain administrative functions;

a decline in commercial office building occupancy and rental rates could affect our revenues and profitability;

deterioration in economic conditions in general could reduce the demand for facility services and, as a result, reduce our earnings and adversely affect our financial condition;

a variety of factors could adversely affect the results of operations of our building and energy solutions business;

financial difficulties or bankruptcy of one or more of our major clients could adversely affect our results;

our ability to operate and pay our debt obligations depends upon our access to cash;

future declines in the fair value of our investments in auction rate securities could negatively impact our earnings;

uncertainty in the credit markets may negatively impact our costs of borrowing, our ability to collect receivables on a timely basis, and our cash flow;

we incur accounting and other control costs that reduce profitability;

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- sequestration under the Budget Control Act of 2011 or alternative measures that may be adopted in lieu of sequestration may negatively impact our business;
- any future increase in our level of debt or in interest rates could affect our results of operations;
- an impairment charge could have a material adverse effect on our financial condition and results of operations;
- we are defendants in class and representative actions and other lawsuits alleging various claims that could cause us to incur substantial liabilities;
- federal health care reform legislation may adversely affect our business and results of operations;
- changes in immigration laws or enforcement actions or investigations under such laws could significantly adversely affect our labor force, operations, and financial results;
- labor disputes could lead to loss of revenues or expense variations;
- we participate in multiemployer pension plans which, under certain circumstances, could result in material liabilities being incurred; and
- natural disasters or acts of terrorism could disrupt services.

Additional information regarding these and other risks and uncertainties we face is contained in our Annual Report on Form 10-K for the year ended October 31, 2012 and in other reports we file from time to time with the Securities and Exchange Commission.

We urge readers to consider these risks and uncertainties in evaluating our forward-looking statements. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in our expectations with regard thereto or any change in events, conditions, or circumstances on which any such statement is based.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)	**July 31, 2013**	**October 31, 2012**
ASSETS		
Current assets		
Cash and cash equivalents	$ 38,688	$ 43,459
Trade accounts receivable, net of allowances of $10,569 and $11,125 at July 31, 2013 and October 31, 2012, respectively	658,118	561,317
Notes receivable and other	38,630	43,960
Prepaid expenses	57,606	46,672
Prepaid income taxes	1,449	385
Deferred income taxes, net	39,490	43,671
Insurance recoverables	11,314	9,870
Total current assets	845,295	749,334
Insurance deposits	28,478	31,720
Other investments and long-term receivables	4,083	5,666
Investments in unconsolidated affiliates, net	17,076	14,863
Investments in auction rate securities	12,994	17,780
Property, plant and equipment, net of accumulated depreciation of $131,214 and $107,771 at July 31, 2013 and October 31, 2012, respectively	72,704	59,909
Other intangible assets, net of accumulated amortization of $121,693 and $100,180 at July 31, 2013 and October 31, 2012, respectively	149,311	109,138
Goodwill	867,779	751,610
Noncurrent deferred income taxes, net	7,342	17,610
Noncurrent insurance recoverables	57,989	54,630
Other assets	40,352	38,898
Total assets	$ 2,103,403	$ 1,851,158
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Trade accounts payable	$ 146,539	$ 130,410
Accrued liabilities		
Compensation	134,384	121,855
Taxes other than income	25,463	19,437
Insurance claims	83,779	80,192
Other	104,320	95,473
Income taxes payable	6,668	8,450
Total current liabilities	501,153	455,817
Noncurrent income taxes payable	43,336	27,773
Line of credit	348,481	215,000
Retirement plans and other	40,158	38,558
Noncurrent insurance claims	276,035	263,612

Total liabilities		1,209,163		1,000,760
Commitments and contingencies				
Stockholders Equity				
Preferred stock, $0.01 par value; 500,000 shares authorized; none issued				
Common stock, $0.01 par value; 100,000,000 shares authorized; 55,119,901 and 54,393,907 shares issued and outstanding at July 31, 2013 and October 31, 2012, respectively		551		544
Additional paid-in capital		254,663		234,636
Accumulated other comprehensive loss, net of taxes		(2,013)		(2,154)
Retained earnings		641,039		617,372
Total stockholders equity		894,240		850,398
Total liabilities and stockholders equity	$	2,103,403	$	1,851,158

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended July 31, 2013	Three Months Ended July 31, 2012	Nine Months Ended July 31, 2013	Nine Months Ended July 31, 2012
Revenues	$ 1,216,768	$ 1,079,235	$ 3,572,508	$ 3,210,264
Expenses				
Operating	1,095,766	971,628	3,211,858	2,885,964
Selling, general and administrative	85,329	79,100	257,560	248,284
Amortization of intangible assets	6,975	5,334	21,469	16,184
Total expenses	1,188,070	1,056,062	3,490,887	3,150,432
Operating profit	28,698	23,173	81,621	59,832
Other-than-temporary impairment credit losses on auction rate security recognized in earnings				(313)
Income from unconsolidated affiliates, net	1,596	747	3,924	5,380
Interest expense	(3,335)	(2,407)	(9,678)	(7,682)
Income from continuing operations before income taxes	26,959	21,513	75,867	57,217
Provision for income taxes	(10,883)	(8,887)	(27,135)	(22,204)
Income from continuing operations	16,076	12,626	48,732	35,013
Loss from discontinued operations, net of taxes		(49)		(94)
Net income	$ 16,076	$ 12,577	$ 48,732	$ 34,919
Net income per common share Basic				
Income from continuing operations	$ 0.29	$ 0.23	$ 0.89	$ 0.65
Loss from discontinued operations, net of taxes				
Net income	$ 0.29	$ 0.23	$ 0.89	$ 0.65
Net income per common share Diluted				
Income from continuing operations	$ 0.29	$ 0.23	$ 0.87	$ 0.64
Loss from discontinued operations, net of taxes				
Net income	$ 0.29	$ 0.23	$ 0.87	$ 0.64
Weighted-average common and common equivalent shares outstanding				
Basic	54,950	54,145	54,727	53,863
Diluted	56,281	55,000	55,861	54,819
Dividends declared per common share	$ 0.150	$ 0.145	$ 0.450	$ 0.435

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended July 31,		Nine Months Ended July 31,	
(in thousands)	**2013**	**2012**	**2013**	**2012**
Net income	$ 16,076	$ 12,577	$ 48,732	$ 34,919
Other comprehensive income:				
Unrealized (losses) gains on auction rate securities:				
Unrealized (losses) gains on auction rate securities		(1,290)	214	1,034
Reclassification adjustment for credit losses recognized in earnings				313
Net unrealized (losses) gains on auction rate securities		(1,290)	214	1,347
Unrealized gains (losses) on interest rate swaps:				
Unrealized gains (losses) arising during the period	785	(49)	236	(117)
Reclassification adjustment for loss included in interest expense	149	42	292	121
Net unrealized gains (losses) on interest rate swaps	934	(7)	528	4
Foreign currency translation	(154)	(155)	(401)	(86)
Defined and post-retirement benefit plans adjustments:				
Reclassification adjustment for amortization of actuarial losses	34	24	104	73
Reclassification adjustment for settlement losses	6		70	
Net defined and post-retirement benefit plans adjustments	40	24	174	73
Other comprehensive income (loss), before tax	820	(1,428)	515	1,338
Income tax (expense) benefit related to other comprehensive income	(398)	522	(374)	(583)
Comprehensive income	$ 16,498	$ 11,671	$ 48,873	$ 35,674

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	Nine Months Ended July 31, 2013	2012
Cash flows from operating activities:		
Net income	$ 48,732	$ 34,919
Loss from discontinued operations, net of taxes		94
Income from continuing operations	48,732	35,013
Adjustments to reconcile income from continuing operations to net cash provided by continuing operating activities:		
Depreciation and amortization	46,758	38,559
Deferred income taxes	(1,429)	(421)
Share-based compensation expense	9,762	7,303
Provision for bad debt	2,298	1,661
Discount accretion on insurance claims	378	536
Auction rate security credit loss impairment		313
Gain on sale of assets	(252)	(1,298)
Income from unconsolidated affiliates, net	(3,924)	(5,380)
Distributions from unconsolidated affiliates	1,983	4,583
Changes in operating assets and liabilities, net of effects of acquisitions:		
Trade accounts receivable	(41,861)	(27,042)
Prepaid expenses and other current assets	1,338	(12,761)
Insurance recoverables	(4,803)	5,261
Other assets and long-term receivables	3,427	7,790
Income taxes payable	12,717	13,455
Retirement plans and other non-current liabilities	(4,444)	(2,119)
Insurance claims	6,321	9,910
Trade accounts payable and other accrued liabilities	7,300	6,794
Total adjustments	35,569	47,144
Net cash provided by continuing operating activities	84,301	82,157
Net cash provided by discontinued operating activities		1,623
Net cash provided by operating activities	84,301	83,780
Cash flows from investing activities:		
Additions to property, plant and equipment	(21,427)	(23,765)
Proceeds from sale of assets and other	1,255	2,185
Purchase of businesses, net of cash acquired	(191,344)	(5,640)
Investments in unconsolidated affiliates	(101)	
Proceeds from redemption of auction rate security	5,000	
Net cash used in investing activities	(206,617)	(27,220)
Cash flows from financing activities:		
Proceeds from exercises of stock options (including income tax benefit)	9,777	10,055
Dividends paid	(24,250)	(23,425)
Deferred financing costs paid		(14)

Borrowings from line of credit	768,000	604,000
Repayment of borrowings from line of credit	(634,519)	(652,000)
Changes in book cash overdrafts	1,454	7
Other	(2,917)	
Net cash provided by (used in) financing activities	117,545	(61,377)
Net decrease in cash and cash equivalents	(4,771)	(4,817)
Cash and cash equivalents at beginning of year	43,459	26,467
Cash and cash equivalents at end of period	$ 38,688	$ 21,650

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(continued from previous page)

(in thousands)	Nine Months Ended July 31, 2013	2012
Supplemental Data:		
Cash paid for income taxes, net of refunds received	$ 15,802	$ 8,928
Tax effect from exercise of options	22	
Cash received from exercise of options	9,755	10,051
Interest paid on line of credit	5,903	4,139

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. NATURE OF BUSINESS

ABM Industries Incorporated, together with its consolidated subsidiaries (hereinafter collectively referred to as ABM, we, us, our, or th Company), is a leading provider of end-to-end integrated facility solutions services to thousands of commercial, governmental, industrial, institutional, retail, and residential facilities located primarily throughout the United States. The Company s comprehensive capabilities include expansive facility solutions, energy solutions, commercial cleaning, maintenance and repair, HVAC, electrical, landscaping, parking, and security services, provided through stand-alone or integrated solutions. The Company was reincorporated in Delaware on March 19, 1985, as the successor to a business founded in California in 1909.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and Article 10 of Regulation S-X under the Securities Exchange Act of 1934, as amended. The unaudited consolidated financial statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) filed with the U.S. Securities and Exchange Commission (SEC) in our Annual Report on Form 10-K for the fiscal year ended October 31, 2012. Unless otherwise noted, all references to years are to our fiscal year, which ends on October 31.

In the opinion of our management, our unaudited consolidated financial statements and accompanying notes (the Financial Statements) include all normal recurring adjustments considered necessary by management to fairly state the financial position, results of operations, and cash flows for the interim periods presented. Interim results of operations are not necessarily indicative of the results for the full year.

The accounting policies applied in the accompanying Financial Statements are the same as those applied in our audited consolidated financial statements as of and for the year ended October 31, 2012, contained in our 2012 Annual Report on Form 10-K, unless indicated otherwise.

Certain amounts in the prior year consolidated balance sheet have been reclassified to conform to the current year presentation.

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2013 Changes in Reportable Segments

In periods prior to the first quarter of 2013, our reportable segments consisted of Janitorial, Parking, Security, and Facility Solutions. Effective in the first quarter of 2013, we revised our reportable segments to align them with the reorganization of our operational structure to an onsite, mobile, and on-demand market-based structure. Our Onsite Services include the Janitorial, Parking, and Security reportable segments and a portion of our prior Facility Solutions segment. As a result, we have separated our previous Facility Solutions reportable segment into two new reportable segments, Facility Services and Building & Energy Solutions. The Building & Energy Solutions measurement of segment operating profit also includes the results of certain investments in unconsolidated affiliates that provide facility solutions primarily to the U.S. Government. Services provided by those affiliates complement services provided by our other business operations included in the Building & Energy Solutions segment. Air Serv Corporation (Air Serv), which was acquired on November 1, 2012, is reported in a new segment, Other. Refer to Note 4, Acquisitions, for further details on this acquisition.

Our segments and their activities are as follows:

Segment	**Activities**
Janitorial	Provides a wide range of essential janitorial services for clients in a variety of facilities, including commercial office buildings, industrial buildings, retail stores, shopping centers, warehouses, airport terminals, health facilities, educational institutions, stadiums and arenas, and government buildings.
Facility Services	Provides onsite mechanical engineering and technical services and solutions for facilities and infrastructure systems for clients in a variety of facilities, including: schools, universities, shopping malls, museums, commercial infrastructure, airports and other transportation centers, data centers, high technology manufacturing facilities, corporate office buildings, and resorts.
Parking	Provides parking and transportation services and operates parking lots and garages for clients at many facilities, including office buildings, hotels, medical centers, retail centers, sports and entertainment arenas, educational institutions, municipalities, and airports.
Security	Provides security services for clients in a wide range of facilities, including Class A high rise, commercial, industrial, retail, medical, petro-chemical, and residential facilities. Security services include: staffing of security officers; mobile patrol services; investigative services; electronic monitoring of fire and life safety systems and access control devices; and security consulting services.
Building & Energy Solutions	Provides services related to preventative maintenance, retro-commissioning, mechanical retrofits and upgrades, electric vehicle charging stations, electrical service, systems start-ups, performance testing, and energy audits to a wide variety of clients in both the private and public sectors, including U.S. Government entities. This segment also provides support to U.S. Government entities for specialty service solutions such as leadership development, education and training, language support services, medical support services, and construction management. The Building & Energy Solutions segment also includes our franchised operations under the Linc Network, TEGG, CurrentSAFE, and GreenHomes America brands which provide electrical preventive and predictive maintenance solutions, the recently acquired HHA Services, Inc. (HHA), and the assets and business of Calvert-Jones Company, Inc. (Calvert-Jones).
Other	This segment includes Air Serv which provides integrated facility solutions services for airlines and freight companies at airports primarily in the United States. Services include passenger assistance, wheelchair operations, cabin cleaning, cargo handling, shuttle bus operations, access control, and janitorial services, among others.

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Parking Revenue Presentation

Our Parking segment reports both revenues and expenses, in equal amounts, for costs directly reimbursed from our managed parking lot clients. Parking revenues related solely to the reimbursement of expenses totaled $75.4 million and $75.6 million for the three months ended July 31, 2013 and 2012, respectively, and $227.5 million and $229.7 million for the nine months ended July 31, 2013 and 2012, respectively.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-11 (ASU 2013-11), *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The update clarifies that an unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. In situations where the tax benefit is not available at the reporting date under the governing tax law or if the entity does not intend to use the deferred tax asset for such purpose, the unrecognized tax benefit should be presented as a liability and not combined with deferred tax assets. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments are to be applied to all unrecognized tax benefits that exist as of the effective date and may be applied retrospectively to each prior reporting period presented. While early adoption is permitted, we expect to adopt ASU 2013-11 on November 1, 2014. We do not expect the adoption of these new presentation requirements to have a material impact on our consolidated financial position, results of operations, or cash flows.

In July 2013, the FASB issued Accounting Standards Update No. 2013-10 (ASU 2013-10), *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. The update permits the use under Topic 815 of the Fed Funds Effective Swap Rate as a benchmark interest rate for hedge accounting purposes in addition to the interest rates on direct treasury obligations of the U.S. Government and the London Interbank Offered Rate (LIBOR). The update also removes the restriction on using different benchmark rates for similar hedges. ASU 2013-10 is effective immediately and can be applied prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. We do not expect the adoption of ASU 2013-10 to have a material impact on our consolidated financial position, results of operations, or cash flows.

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3. NET INCOME PER COMMON SHARE

Basic net income per common share is net income divided by the weighted-average number of shares outstanding during the period. Diluted net income per common share is based on the weighted-average number of shares outstanding during the period, adjusted to include the assumed conversion of certain restricted stock units (RSUs), vesting of performance shares, and exercise of stock options. The calculations of basic and diluted net income per common share are as follows:

(in thousands, except per share amounts)	Three Months Ended July 31, 2013	Three Months Ended July 31, 2012	Nine Months Ended July 31, 2013	Nine Months Ended July 31, 2012
Income from continuing operations	$ 16,076	$ 12,626	$ 48,732	$ 35,013
Loss from discontinued operations, net of taxes		(49)		(94)
Net income	$ 16,076	$ 12,577	$ 48,732	$ 34,919
Weighted-average common and common equivalent shares outstanding Basic	54,950	54,145	54,727	53,863
Effect of dilutive securities:				
RSUs	520	363	463	367
Performance shares	444	250	383	269
Stock options	367	242	288	320
Weighted-average common and common equivalent shares outstanding Diluted	56,281	55,000	55,861	54,819
Net income per common share				
Basic	$ 0.29	$ 0.23	$ 0.89	$ 0.65
Diluted	$ 0.29	$ 0.23	$ 0.87	$ 0.64

The diluted net income per common share excludes certain stock options, RSUs, and performance shares, since the effect of including these awards would have been anti-dilutive as follows:

(in thousands)	Three Months Ended July 31, 2013	Three Months Ended July 31, 2012	Nine Months Ended July 31, 2013	Nine Months Ended July 31, 2012
Stock options	482	1,208	888	1,131
RSUs		105	17	77
Performance shares			25	

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4. ACQUISITIONS

Air Serv Acquisition

On November 1, 2012, we acquired all of the outstanding stock of Air Serv for an aggregate purchase price of $162.9 million in cash, including a $4.1 million working capital adjustment paid in the second quarter of 2013 (the Air Serv Acquisition). Approximately $11.9 million of the cash consideration was placed in an escrow account to satisfy any applicable indemnification claims, pursuant to the terms of the purchase agreement.

Air Serv provides integrated facility solutions services for airlines and freight companies at airports primarily in the United States. The operations of Air Serv are included in the Other segment as of November 1, 2012, the acquisition date. Included in our consolidated statements of income were revenues of $86.8 million and operating profit of $3.8 million for the three months ended July 31, 2013, and revenues of $250.6 million and operating profit of $8.7 million for the nine months ended July 31, 2013.

HHA Acquisition

On November 1, 2012, we acquired all of the outstanding stock of HHA for an aggregate purchase price of $33.7 million in cash, including a $0.6 million working capital adjustment received in the third quarter of 2013 (the HHA Acquisition). Approximately $1.4 million of the cash consideration remains in an escrow account to satisfy any applicable indemnification claims pursuant to the terms of the purchase agreement.

HHA provides facility solutions, including housekeeping, laundry, patient assist, plant maintenance, and food services, to hospitals, healthcare systems, long-term care facilities, and retirement communities. The operations of HHA are included in the Building & Energy Solutions segment as of November 1, 2012, the acquisition date. Included in our consolidated statements of income were revenues of $13.6 million and operating profit of $0.7 million for the three months ended July 31, 2013, and revenues of $39.5 million and operating profit of $1.0 million for the nine months ended July 31, 2013.

Calvert-Jones Acquisition

On November 1, 2012, we acquired substantially all of the assets and assumed certain liabilities of Calvert-Jones for a cash purchase price of $6.3 million, which is subject to an additional working capital adjustment (the Calvert-Jones Acquisition). Approximately $0.7 million of the cash consideration was placed in an escrow account to satisfy any applicable indemnification claims, pursuant to the terms of the purchase agreement.

Calvert-Jones provides mechanical and energy efficient products and solutions in the Washington, D.C. area. The operations of Calvert-Jones are included in the Building & Energy Solutions segment as of November 1, 2012, the acquisition date. Included in our consolidated statements of income were revenues of $5.3 million and operating profit of $0.6 million for the three months ended July 31, 2013, and revenues of $13.7 million and operating profit of $0.5 million for the nine months ended July 31, 2013.

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Allocation of Consideration Transferred to Acquire Air Serv, HHA, and Calvert-Jones

The following table summarizes the allocation of consideration transferred to acquire Air Serv, HHA, and Calvert-Jones and the amounts of identified assets acquired and liabilities assumed at the acquisition date.

(in thousands)	Air Serv	HHA	Calvert-Jones
Purchase price:			
Total cash consideration	$ 162,881	$ 33,680	$ 6,250
Allocated to:			
Cash and cash equivalents	$ 10,686	$ 832	$
Trade accounts receivable	52,749	3,161	1,329
Prepaid expenses and other	5,559	942	441
Property, plant and equipment	17,488	123	49
Other intangible assets	44,610	15,000	2,600
Goodwill	88,149	23,796	4,196
Other assets	27	468	
Trade accounts payable	(4,609)	(639)	(1,200)
Accrued liabilities	(25,478)	(4,587)	(861)
Insurance claims	(9,311)		
Net deferred income tax liabilities	(10,104)	(5,399)	
Other	(6,885)	(17)	(304)
Net assets acquired	$ 162,881	$ 33,680	$ 6,250

The amount allocated to goodwill for Air Serv and HHA is reflective of our identification of buyer-specific synergies that we anticipate will be realized by, among other things, reducing duplicative positions and back office functions and by reducing professional fees and other services. Goodwill is also attributable to expected long-term business growth through the expansion of our vertical market expertise in servicing the end-to-end needs of airlines, airport authorities, and healthcare service markets. None of the goodwill associated with the acquisitions of Air Serv and HHA will be amortizable for income tax purposes as we acquired all of the outstanding stock of these companies.

Goodwill for the Calvert-Jones acquisition is attributable to projected long-term business growth through our expansion of existing vertical and geographic market offerings in building and energy solutions. A significant portion of the goodwill associated with the Calvert-Jones acquisition is expected to be amortizable for income tax purposes.

Other intangible assets primarily consist of customer contracts and relationships with a weighted-average life of 15 years for Air Serv, 13 years for HHA, and 12 years for Calvert-Jones.

The preliminary estimated fair value of trade accounts receivable acquired in the Air Serv Acquisition reflects gross contractual amounts of $53.1 million, of which $0.4 million is expected to be uncollectable. The preliminary estimated fair value of trade accounts receivable acquired in the HHA and Calvert-Jones acquisitions approximates the contractual amounts.

We have incurred combined acquisition-related costs of $1.2 million, of which $0.3 million have been incurred during the nine months ended July 31, 2013. These expenses are included in selling, general and administrative expenses in the accompanying unaudited consolidated statements of income.

Assuming these acquisitions were made at November 1, 2011, the consolidated pro forma results would not be materially different from reported results.

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TEGG and CurrentSAFE Acquisition

On May 1, 2012, we acquired substantially all of the assets and assumed certain liabilities of TEGG Corporation (TEGG) and CurrentSAFE Corporation (CurrentSAFE) and also acquired certain software technology from TEGG s shareholder, for an aggregate purchase price of $5.5 million in cash, net of cash acquired. The purchase price reflects a $0.1 million working capital adjustment received in the fourth quarter of 2012. Approximately $0.5 million of the cash consideration was placed in an escrow account to satisfy any applicable indemnification claims, pursuant to the terms of the purchase agreement. The assets acquired represent the franchise operations of TEGG and CurrentSAFE, and through this acquisition we expanded our electrical services to include electrical preventive and predictive maintenance solutions. The acquired net assets and results from operations have been included in the Building & Energy Solutions segment since May 1, 2012, the acquisition date. Assuming this acquisition was made at November 1, 2011, the consolidated pro forma results would not be materially different from reported results.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the fair value hierarchy, carrying amounts, and fair values of our financial instruments that are measured on a recurring basis and other select significant financial instruments as of July 31, 2013 and October 31, 2012:

		July 31, 2013		October 31, 2012	
(in thousands)	**Fair Value Hierarchy**	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets measured at fair value on a recurring basis					
Assets held in funded deferred compensation plan [(1)]	1	$ 5,219	$ 5,219	$ 5,029	$ 5,029
Investments in auction rate securities [(2)]	3	12,994	12,994	17,780	17,780
Interest rate swaps [(3)]	2	413	413		
		18,626	18,626	22,809	22,809
Other select financial asset					
Cash and cash equivalents [(4)]	1	38,688	38,688	43,459	43,459
Total		$ 57,314	$ 57,314	$ 66,268	$ 66,268
Financial liability measured at fair value on a recurring basis					
Interest rate swap [(3)]	2	$ 98	$ 98	$ 214	$ 214
Other select financial liability					
Line of credit [(5)]	2	348,481	348,481	215,000	215,000
Total		$ 348,579	$ 348,579	$ 215,214	$ 215,214

(1) Represents investments held in a Rabbi Trust associated with our OneSource Deferred Compensation Plan, which we include in Other assets on the accompanying unaudited consolidated balance sheets. The fair value of the assets held in the funded deferred compensation plan is based on quoted market prices.

(2) For investments in auction rate securities, the fair values were based on discounted cash flow valuation models, primarily utilizing unobservable inputs. See Note 6, Auction Rate Securities, for the roll-forwards of assets measured at fair value using significant unobservable Level 3 inputs and the sensitivity analysis of significant inputs.

(3) Includes derivatives designated as hedging instruments. The fair values of the interest rate swaps are estimated based on the present value of the difference between expected cash flows calculated at the contracted interest rates and the expected cash flows at current market interest rates using observable benchmarks for LIBOR forward rates at the end of the period. See Note 8, Line of Credit, for more information.

(4) Cash and cash equivalents are stated at nominal value, which equals fair value.

(5) Represents outstanding borrowings under our $650.0 million five-year syndicated line of credit. Due to variable interest rates, the carrying value of outstanding borrowings under our line of credit approximates the fair value. See Note 8, Line of Credit, for more information.

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Our non-financial assets, which include goodwill and long lived assets held and used, are not required to be measured at fair value on a recurring basis. However, if certain trigger events occur, or if an annual impairment test is required, we would evaluate the non-financial assets for impairment. If an impairment were to occur, the asset or liability would be recorded at the estimated fair value.

During the nine months ended July 31, 2013, we had no transfers of assets or liabilities between any of the above hierarchy levels.

6. AUCTION RATE SECURITIES

At October 31, 2012, we held investments in auction rate securities from four different issuers having an original principal amount of $5.0 million each (aggregating $20.0 million). During the nine months ended July 31, 2013, one of the auction rate securities was redeemed by the issuer at its par value of $5.0 million. No gain or loss was recognized upon its redemption. These auction rate securities are debt instruments with stated maturities ranging from 2033 to 2050, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. Auctions for these securities have not occurred since August 2007.

At July 31, 2013 and October 31, 2012, the estimated fair values of these securities, in total, were approximately $13.0 million and $17.8 million, respectively.

As of July 31, 2013, none of our auction rate securities were in an unrealized loss position. As of October 31, 2012, two of our auction rate securities, with an aggregate fair value of $7.8 million, were in a continuous unrealized loss position for less than twelve months and the remaining two auction rate securities, with an aggregate fair value of $10.0 million, were not in an unrealized loss position.

The following table presents the significant assumptions used to determine the fair values of our auction rate securities at July 31, 2013 and October 31, 2012:

Assumption	**July 31, 2013**	**October 31, 2012**
Discount rates	L + 0.36% - L + 3.16%	L + 1.37% - L + 6.86%
Yields	2.15%, L + 2.00%	2.15%, L + 2.00% - L + 3.50%
Average expected lives	4 - 10 years	4 - 10 years

L - One Month LIBOR

The fair values of our auction rate securities are affected most significantly by the changes in the average expected lives of the securities, but are also impacted by the specific discount rate used to adjust the outcomes to their present values. If the average expected lives of the securities increase or decrease, the fair values of the securities will decrease or increase accordingly, in amounts that will vary based on the timing of the projected cash flows and the specific discount rate used to calculate the present value of the expected cash flows.

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The following tables present the changes in the cost basis and fair values of our auction rate securities as of July 31, 2013 and October 31, 2012:

(in thousands)	Cost Basis	Fair Value (Level 3)
Balance at November 1, 2012	$ 17,994	$ 17,780
Unrealized gains included in accumulated other comprehensive loss		214
Redemption of security by issuer	(5,000)	(5,000)
Balance at July 31, 2013	$ 12,994	$ 12,994

(in thousands)	Cost Basis	Fair Value (Level 3)
Balance at November 1, 2011	$ 18,307	$ 15,670
Unrealized gains included in accumulated other comprehensive loss		2,110
Other-than-temporary credit loss recognized in earnings	(313)	
Balance at October 31, 2012	$ 17,994	$ 17,780

At July 31, 2013, there were no unrealized gains or losses recorded in accumulated other comprehensive loss (AOCL). At October 31, 2012, unrealized losses of $0.2 million ($0.1 million net of taxes) were recorded in AOCL.

7. INSURANCE

We use a combination of insured and self-insurance programs to cover workers compensation, general liability, property damage, and other insurable risks. For the majority of these insurance programs, we retain the initial $1.0 million of exposure on a per-claim basis either through deductibles or self-insurance retentions. Beyond the retained exposures, we have varying primary policy limits between $1.0 million and $5.0 million per occurrence. As of July 31, 2013, to cover general liability losses above these primary limits, we maintained commercial insurance umbrella policies that provide $200.0 million of coverage. Workers compensation liability losses have unlimited coverage due to statutory regulations. Additionally, to cover property damage risks above our retained limits, we maintain policies that provide $75.0 million of coverage. We are also self-insured for certain employee medical and dental plans. We retain up to $0.4 million of exposure on a per claim basis under our medical plan.

We had insurance claims reserves totaling $359.8 million and $343.8 million at July 31, 2013 and October 31, 2012, respectively. The balance at July 31, 2013 and October 31, 2012 includes $6.1 million and $13.0 million in reserves, respectively, related to our medical and dental self-insured plans. We also had insurance recoverables totaling $69.3 million and $64.5 million at July 31, 2013 and October 31, 2012.

During the three months ended July 31, 2013, our annual actuarial evaluations were performed for the majority of our casualty insurance programs (excluding a portion of the claims existing from certain previously acquired businesses). As a result of these evaluations, it was determined that there were unfavorable developments in certain general liability, automobile liability, and workers compensation claims for various policy years prior to 2013.

Certain general liability claims related to earlier policy years reflected loss development that was measurably higher than previously estimated. The majority of the adverse impact seen in the general liability program was the result of claim development in two jurisdictions - California and New York. A similar trend was also experienced in our automobile liability program, which was largely attributable to considerable changes in a small population of the automobile liability claim pool.

In California, a jurisdiction in which we maintain a significant presence, the workers compensation claim development patterns warranted an unfavorable adjustment to our insurance reserves. In response to California s challenging workers compensation environment, we undertook several claim expense reduction initiatives to resolve claims at an accelerated pace where feasible. Conversely, the workers compensation loss patterns in states other than California warranted a favorable adjustment which partially offset the adverse development experienced in California.

After analyzing the historical loss development patterns, comparing the loss development against benchmarks, and applying actuarial projection methods to determine the estimate of ultimate losses, we increased our expected reserves for prior year claims, which resulted in an increase in the related insurance expense of $9.9 million during the nine months ended July 31, 2013 and was recorded as part of Corporate expenses, consistent with prior periods.

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Insurance reserve adjustments resulting from periodic actuarial evaluations of ultimate losses relating to years prior to 2012 during the nine months ended July 31, 2012 were $9.5 million. During the fourth quarter of 2013, actuarial assessments using recent claim development experience are expected to be completed for several of our remaining insurance programs, which are primarily related to certain previously acquired businesses, and may result in additional expense recognition during the period.

We had the following standby letters of credit, surety bonds, and restricted insurance deposits outstanding at July 31, 2013 and October 31, 2012, to collateralize our self-insurance obligations:

(in thousands)	**July 31, 2013**	**October 31, 2012**
Standby letters of credit	$ 103,901	$ 104,968
Surety bonds	39,344	34,933
Restricted insurance deposits	28,478	31,720
Total	$ 171,723	$ 171,621

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8. LINE OF CREDIT

On November 30, 2010, we entered into a five-year syndicated credit agreement (Credit Agreement) that replaced our then-existing $450.0 million syndicated credit agreement dated November 14, 2007. The Credit Agreement provides for revolving loans, swing line loans, and letters of credit up to an aggregate amount of $650.0 million (the Facility). At our option, we may increase the size of the Facility to $850.0 million at any time prior to the expiration (subject to receipt of commitments for the increased amount from existing and new lenders). During the year ended October 31, 2011, the Credit Agreement was amended to reduce the borrowing spread interest on loans, extend the maturity date to September 8, 2016, and revise certain defined terms.

Borrowings under the Facility bear interest at a rate equal to an applicable margin plus, at our option, either a (a) eurodollar rate (generally LIBOR) or (b) base rate determined by reference to the highest of (1) the federal funds rate plus 0.50%, (2) the prime rate announced by Bank of America, N.A. from time to time, and (3) the eurodollar rate plus 1.00%. The applicable margin is a percentage per annum varying from zero to 0.75% for base rate loans and 1.00% to 1.75% for eurodollar loans, based upon our leverage ratio.

We also pay a commitment fee, based on the leverage ratio, payable quarterly in arrears, ranging from 0.225% to 0.300% on the average daily unused portion of the Facility. For purposes of this calculation, irrevocable standby letters of credit, issued primarily in conjunction with our self-insurance program, and cash borrowings are included as outstanding under the Facility.

The Credit Agreement contains certain leverage and liquidity covenants that require us to maintain a maximum leverage ratio of 3.25 to 1.0 at the end of each fiscal quarter, a minimum fixed charge coverage ratio of 1.50 to 1.0 at any time, and a consolidated net worth in an amount not less than the sum of (i) $570.0 million, (ii) 50% of our consolidated net income (with no deduction for net loss), and (iii) 100% of our aggregate increases in stockholder s equity, beginning on November 30, 2010, each as further described in the Credit Agreement, as amended. We were in compliance with all covenants as of July 31, 2013.

If an event of default occurs under the Credit Agreement, including certain cross-defaults, insolvency, change in control, and violation of specific covenants, among others, the lenders can terminate or suspend our access to the Facility, declare all amounts outstanding under the Facility, including all accrued interest and unpaid fees, to be immediately due and payable, and may also require that we cash collateralize the outstanding standby letters of credit obligations.

The Facility is available for working capital, the issuance of up to $300.0 million for standby letters of credit, the issuance of up to $50.0 million in swing line advances, the financing of capital expenditures, and other general corporate purposes, including acquisitions. As of July 31, 2013, the total outstanding amounts under the Facility in the form of cash borrowings and standby letters of credit were $348.5 million and $103.9 million, respectively. As of October 31, 2012, the total outstanding amounts under the Facility in the form of cash borrowings and standby letters of credit were $215.0 million and $105.0 million, respectively.

At July 31, 2013 and October 31, 2012, we had up to $197.6 million and $330.0 million borrowing capacity, respectively, under the Facility, the availability of which is subject to and may be limited by compliance with the covenants described above.

Interest Rate Swaps