ABM INDUSTRIES INC /DE/
Form 10-Q
March 09, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED JANUARY 31, 2007

o **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 of Incorporation)	(I.R.S. Employer Identification No.)
160 Pacific Avenue, Suite 222, San Francisco, California	94111
(Address of principal executive offices)	(Zip Code)

415/733-4000

(Registrant s telephone number, including area code)

N/A

(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 the filing requirements for at least the past 90 days. Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Number of shares of common stock outstanding as of February 28, 2007: 48,951,375.

ABM INDUSTRIES INCORPORATED
FORM 10-Q
For the three months ended January 31, 2007
Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)	**January 31, 2007**	**October 31, 2006**
	(Unaudited)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 90,665	$ 134,001
Trade accounts receivable	391,944	392,018
Less: Allowances	(7,943)	(8,041)
Accounts receivable, net	384,001	383,977
Inventories	23,356	22,783
Deferred income taxes	45,037	43,945
Prepaid expenses and other current assets	59,525	47,035
Prepaid income taxes	3,765	
Total current assets	606,349	631,741
Long-term receivables	13,455	14,097
Property, plant and equipment, at cost		
Land and buildings	4,137	4,131
Transportation equipment	14,673	14,659
Machinery and other equipment	84,686	82,405
Leasehold improvements	17,499	17,827
	120,995	119,022
Less: Accumulated depreciation	(89,540)	(86,837)
Property, plant and equipment, net	31,455	32,185
Goodwill, net of accumulated amortization	251,079	247,888
Other intangibles, at cost	39,497	39,431
Less: Accumulated amortization	(16,715)	(15,550)
Other intangibles, net	22,782	23,881

Deferred income taxes	41,377	42,120
Other assets	26,594	24,362
Total assets	$993,091	$1,016,274

(Continued)

Table of Contents

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)	January 31, 2007	October 31, 2006
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Trade accounts payable	$ 66,890	$ 66,336
Income taxes payable	1,363	36,712
Accrued liabilities:		
Compensation	74,136	78,673
Taxes other than income	26,532	20,587
Insurance claims	62,705	66,364
Other	50,509	50,613
Total current liabilities	282,135	319,285
Retirement plans and other non-current liabilities	27,417	26,917
Insurance claims	132,029	128,825
Total liabilities	441,581	475,027
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; 55,897,560 and 55,663,472 shares issued at January 31, 2007 and October 31, 2006, respectively	560	557
Additional paid-in capital	233,604	225,796
Accumulated other comprehensive (loss) income	(166)	149
Retained earnings	439,850	437,083
Cost of treasury stock (7,028,500 shares)	(122,338)	(122,338)
Total stockholders equity	551,510	541,247
Total liabilities and stockholders equity	$ 993,091	$1,016,274

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

Table of Contents

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED JANUARY 31

(in thousands, except per share data)	**2007**	**2006**
	(Unaudited)	
Revenues		
Sales and other income	$703,549	$666,601
Expenses		
Operating expenses and cost of goods sold	630,105	606,176
Selling, general and administrative	58,613	52,893
Intangible amortization	1,340	1,578
Interest	133	123
Total expenses	690,191	660,770
Income before income taxes	13,358	5,831
Income taxes	4,654	1,841
Net income	$ 8,704	$ 3,990
Net income per common share		
Basic	$ 0.18	$ 0.08
Diluted	$ 0.18	$ 0.08
Average common and common equivalent shares		
Basic	48,766	49,185
Diluted	49,736	50,087
Dividends declared per common share	$ 0.12	$ 0.11

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

5

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED JANUARY 31

(in thousands)	**2007**	**2006**
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 8,704	$ 3,990
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	4,891	5,127
Share-based compensation expense	2,963	1,160
Provision for bad debt	859	762
Gain on sale of assets	(381)	(112)
Increase in deferred income taxes	(349)	(208)
Increase in trade accounts receivable	(883)	(20,828)
(Increase) decrease in inventories	(573)	419
Increase in prepaid expenses and other current assets	(12,158)	(8,061)
Increase in other assets and long-term receivables	(1,556)	(467)
(Increase) decrease in net income taxes	(39,114)	1,396
Increase (decrease) in retirement plans and other non-current liabilities	500	(364)
(Decrease) increase in insurance claims	(455)	3,901
Increase in trade accounts payable and other accrued liabilities	1,543	1,369
Total adjustments to net income	(44,713)	(15,906)
Net cash used in operating activities	(36,009)	(11,916)
Cash flows from investing activities:		
Additions to property, plant and equipment	(3,441)	(3,799)
Proceeds from sale of assets	669	269
Purchase of businesses	(2,975)	(7,069)
Other		(221)
Net cash used in investing activities	(5,747)	(10,820)
Cash flows from financing activities:		
Common stock issued	4,275	3,447
Dividends paid	(5,855)	(5,409)
Net cash used in financing activities	(1,580)	(1,962)
Net decrease in cash and cash equivalents	(43,336)	(24,698)
Cash and cash equivalents at beginning of period	134,001	56,793
Cash and cash equivalents at end of period	$ 90,665	$ 32,095

Supplemental Data:

Cash paid for income taxes	$ 43,301	$ 307
Tax benefit from exercise of options	$ 822	$ 338
Cash received from exercise of options	$ 3,453	$ 3,109
Non-cash investing activities:		
Common stock issued for business acquired	$ 491	$

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

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

In the opinion of management, the accompanying unaudited consolidated financial statements contain all material adjustments necessary to present fairly ABM Industries Incorporated (ABM) and subsidiaries (the Company) financial position as of January 31, 2007 and the results of operations and cash flows for the three months then ended. These adjustments are of a normal, recurring nature, except as otherwise noted.

The preparation of financial statements in accordance with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of sales and expenses during the reporting period. These estimates are based on information available as of the date of these financial statements. Actual results could differ materially from those estimates.

The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis and the consolidated financial statements and the notes thereto included in the Company s Form 10-K Annual Report for the fiscal year ended October 31, 2006, as filed with the Securities and Exchange Commission (SEC).

2. Net Income per Common Share

The Company has reported its earnings in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share. Basic net income per common share is based on 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, including common stock equivalents. Stock options and restricted stock units account for the difference between basic average common shares outstanding and diluted average common shares outstanding. Performance shares did not have an effect on the diluted average common shares outstanding. The calculation of net income per common share was as follows:

	Three Months Ended January 31,	
(in thousands, except per share data)	2007	2006
Net income available to common stockholders	$ 8,704	$ 3,990
Average common shares outstanding Basic	48,766	49,185
Effect of dilutive securities:		
Stock options	931	902
Restricted stock units	39	
Average common shares outstanding Diluted	49,736	50,087
Net income per common share		
Basic	$ 0.18	$ 0.08
Diluted	$ 0.18	$ 0.08

For purposes of computing diluted net income per common share for the three months ended January 31, 2007 and 2006, options to purchase common shares of 758,593 and 1,610,861, respectively, at weighted average exercise prices of $20.51 and $19.47, respectively, were excluded from the computation as they had an anti-dilutive effect.

3. Share-Based Compensation Plans

The following tables show the activity under the Company s 2006 Equity Incentive Plan, the Time-Vested Incentive Stock Option Plan, the 1996 Price-Vested Performance Option Plan, the 2002 Price-Vested Performance Stock Option Plan, and the Age-Vested Career Stock Option Plan.

Options

	Number of shares (in thousands)	Weighted-average exercise price per share	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at October 31, 2006	5,712	$ 16.09		
Granted	3	23.32		
Exercised	169	12.08		
Forfeited or expired	38	16.32		
Outstanding at January 31, 2007	5,508	$ 16.21	6.30	$ 53,018
Exercisable at January 31, 2007	3,018	$ 15.58	4.72	$ 30,972

Restricted Stock

	Number of shares (in thousands)	Weighted-average grant date fair value per share
Unvested at October 31, 2006	232	$ 18.71
Granted		
Vested		
Forfeited	3	18.71
Unvested at January 31, 2007	229	$ 18.71

Performance Shares

As of January 31, 2007, 124,654 performance shares with a grant date fair value of $18.71 had not vested. No grants of performance shares were made in the first quarter of 2007.

Share-Based Compensation

The Company recognized share-based compensation expense as follows:

	Three Months Ended January 31,	
(in thousands, except per share data)	2007	2006
	$ 2,963	$ 1,160

Share-based compensation expense recognized in selling, general and administrative expenses before income taxes		
Income tax benefit	1,156	166
Total share-based compensation expense after income taxes	$ 1,807	$ 994
Total share-based compensation expense after income taxes per common share		
Basic	$ 0.04	$ 0.02
Diluted	$ 0.04	$ 0.02

Share-based compensation expense in the three months ended January 31, 2007 included $2.0 million of additional expense attributable to the accelerated vesting of two tranches of stock option grants under the Price-Vested Performance Stock Option Plans comprising a total of 481,638 shares. These options fully vested when ABM s stock price achieved the $22.50 (for one tranche) and $23.00 (for the other tranche) target prices for ten trading days within a 30 consecutive trading day period during the first quarter of 2007.

Share-based compensation expense of $0.5 million associated with the Employee Stock Purchase Plan (ESPP) was recognized in the three months ended January 31, 2006. Because of changes to the ESPP effective May 1, 2006, the value of the awards is no longer treated as share-based compensation. As a result, no share-based compensation expense associated with the ESPP was recognized in the three months ended January 31, 2007.

The Company estimates the fair value of each option award on the date of grant using the Black-Scholes option valuation model. The Company uses an outside expert to determine the assumptions used in the option valuation model. The Company estimates forfeiture rates based on historical data and adjusts the rates periodically or as needed. The adjustment of the forfeiture rate may result in a cumulative adjustment in any period the forfeiture rate estimate is changed. During the three months ended January 31, 2007, the Company recorded an adjustment to the forfeiture rate, resulting in a cumulative benefit adjustment of $33,124.

The assumptions used in the option valuation model for the three months ended January 31, 2007 and 2006 are shown in the table below:

	Three Months Ended January 31,	
	2007	2006
Expected term from the date of grant	5.2 years	6.7 years
Expected stock price volatility	25.3%	26.3%
Expected dividend yield	2.1%	2.1%
Risk-free interest rate	4.6%	4.4%
Weighted average fair value of grants	$ 5.85	$ 5.67

4. Parking Sales Presentation

The Company s Parking segment reports both revenues and expenses recognized, in equal amounts, for costs directly reimbursed from its managed parking lot clients in accordance with Emerging Issues Task Force (EITF) Issue No. 01-14, Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred. Parking sales related solely to the reimbursement of expenses totaled $71.1 million and $64.1 million for the three months ended January 31, 2007 and 2006, respectively.

5. Insurance

The Company self-insures certain insurable risks such as general liability, automobile, property damage, and workers compensation. Commercial policies are obtained to provide for $150.0 million of coverage for certain risk exposures above the self-insured retention limits (*i.e.*, deductibles). For claims incurred after November 1, 2002, substantially all of the self-insured retentions increased from $0.5 million per occurrence (inclusive of legal fees) to $1.0 million per occurrence (exclusive of legal fees) except for California workers compensation insurance which increased to $2.0 million per occurrence from April 14, 2003 to April 14, 2005, when it returned to $1.0 million per occurrence, plus an additional $1.0 million annually in the aggregate.

The Company uses an independent actuary to evaluate the Company s estimated claim costs and liabilities no less frequently than annually and accrues self-insurance reserves in an amount that is equal to the actuarial point estimate. Using the actuarial report, management develops annual insurance costs for each operation, expressed as a rate per $100 of exposure (labor and revenue) to estimate insurance costs. Additionally, management monitors new claims and claim development to assess the adequacy of the insurance reserves. The estimated future charge is intended to reflect the recent experience and trends. Trend analysis is complex and highly subjective. The interpretation of trends requires the knowledge of all factors affecting the trends that may or may not be reflective of adverse developments (*e.g.*, changes in regulatory requirements and changes in reserving methodology). If the trends suggest that the frequency or severity of claims incurred has increased, the Company might be required to record additional expenses for self-insurance liabilities. Additionally, the Company uses third party service providers to administer its claims and the performance of the service providers and transfers between administrators can impact the cost of claims and accordingly the amounts reflected in insurance reserves.

The January 31, 2007 actuarial report covering substantially all of the Company s self-insurance reserves showed favorable developments in the Company s reserves for 2006 and prior years workers compensation, general liability and auto liability claims, amounting to an aggregate $4.2 million benefit. The benefit was recorded in Corporate.

The total estimated liability for claims incurred but unpaid at January 31, 2007 and October 31, 2006 was $194.7 million and $195.2 million, respectively.

In connection with certain self-insurance programs, the Company had standby letters of credit at January 31, 2007 and October 31, 2006 supporting estimated unpaid liabilities in the amounts of $102.3 million and $93.5 million, respectively.

6. Goodwill and Other Intangibles

Goodwill. The changes in the carrying amount of goodwill for the three months ended January 31, 2007 were as follows:

(in thousands)	Balance as of October 31, 2006	Initial Payments for Acquisitions	Contingent Amounts and Other	Balance as of January 31, 2007
Janitorial	$ 153,890	$	$2,700	$ 156,590
Parking	30,180			30,180
Security	43,642		491	44,133
Engineering	2,174			2,174
Lighting	18,002			18,002
Total	$ 247,888	$	$3,191	$ 251,079

Of the $251.1 million carrying amount of goodwill as of January 31, 2007, $45.3 million was not amortizable for income tax purposes.

Other Intangibles. The changes in the gross carrying amount and accumulated amortization of intangibles other than goodwill for the three months ended January 31, 2007 were as follows:

	Gross Carrying Amount				Accumulated Amortization			
(in thousands)	October 31, 2006	Additions	Retirements and Other	January 31, 2007	October 31, 2006	Additions	Retirements and Other	January 31, 2007
Customer contracts and related relationships	$33,713	$241	$	$33,954	$(12,281)	$(1,156)	$	$(13,437)
Trademarks and trade names	3,050			3,050	(1,767)	(135)		(1,902)
Other (contract rights, etc.)	2,668		(175)	2,493	(1,502)	(49)	175	(1,376)
Total	$39,431	$241	$(175)	$39,497	$(15,550)	$(1,340)	$175	$(16,715)

The weighted average remaining lives as of January 31, 2007 and the amortization expense for the three months ended January 31, 2007 and 2006 of intangibles other than goodwill, as well as the estimated amortization expense for such intangibles for each of the five succeeding fiscal years are as follows:

	Weighted Average Remaining Life	Amortization Expense Three Months Ended January 31,		Estimated Amortization Expense Years Ending October 31,				
($ in thousands)	(Years)	2007	2006	2008	2009	2010	2011	2012
Customer contracts and related relationships	9.3	$1,156	$1,185	$3,830	$3,284	$2,737	$2,191	$1,702
Trademarks and trade names	2.1	135	135	540	202			
Other (contract rights, etc.)	7.7	49	258	182	166	136	136	117
Total	8.9	$1,340	$1,578	$4,552	$3,652	$2,873	$2,327	$1,819

The customer relationship intangible assets are being amortized using the sum-of-the-years-digits method over their useful lives consistent with the estimated useful life considerations used in the determination of their fair values. The accelerated method of amortization reflects the pattern in which the economic benefits of the customer relationship intangible assets are expected to be realized. Trademarks and trade names are being amortized over their useful lives using the straight-line method. Other intangible assets, consisting principally of contract rights, are being amortized over the contract periods using the straight-line method.

7. Acquisitions

Acquisitions have been accounted for using the purchase method of accounting. The operating results generated by the companies and businesses acquired have been included in the accompanying consolidated financial statements from their respective dates of acquisition. The excess of the purchase price (including contingent amounts) over fair value of the net tangible and intangible assets acquired is included in goodwill. Most purchase agreements provide for initial payments and contingent payments based on the annual pre-tax income or other financial parameters for subsequent periods ranging generally from two to five years.

No acquisitions were made during the three months ended January 31, 2007. Contingent payments on earlier acquisitions were $3.5 million in the three months ended January 31, 2007 of which $3.0 million was paid in cash and $0.5 million was settled with the issuance of 26,459 shares of ABM s common stock. Cash paid for acquisitions, including initial payments and contingent amounts, was $7.1 million in the three months ended January 31, 2006, of which $1.6 million was the contingent amount due on earlier acquisitions.

The Company made the following acquisitions during the three months ended January 31, 2006:

On November 1, 2005, the Company acquired substantially all of the operating assets of Brandywine Building Services, Inc., a facility services company based in Wilmington, Delaware, for approximately $3.6 million in cash. In the three months ended January 31, 2007, a contingent payment of $0.6 million was made, bringing the total purchase price paid to date to $4.2 million. Additional cash consideration of approximately $1.8 million is expected to be paid based on the financial performance of the acquired business over the next three years. With annual revenues in excess of $9.0 million, Brandywine Building Services, Inc. was a provider of commercial office cleaning and specialty cleaning services throughout Delaware, southeast Pennsylvania and south New Jersey. Of the total initial payment, $3.0 million was allocated to customer relationship intangible assets (amortized over a useful life of 14 years under the sum-of-the-year-digits method), $0.5 million to goodwill and $0.1 million to other assets. The contingent payment was allocated to goodwill.

On November 27, 2005, the Company acquired substantially all of the operating assets of Fargo Security, Inc., a security guard services company based in Miami, Florida, for an initial payment of approximately $1.2 million in cash plus an additional payment of $0.4 million based on the revenue retained by the acquired business over the 90 days following the date of acquisition. With annual revenues in excess of $6.5 million, Fargo Security, Inc. was a provider of contract security guard services throughout the Miami metropolitan area. Of the total initial payment, $1.0 million was allocated to customer relationship intangible assets (amortized over a useful life of five years under the sum-of-the-year-digits method), and $0.2 million to goodwill. The final contingent payment of $0.4 million made in 2006 was allocated to goodwill.

On December 11, 2005, the Company acquired substantially all of the operating assets of MWS Management, Inc., dba Protector Security Services, a security guard services company based in St. Louis, Missouri, for an initial payment of approximately $0.6 million in cash plus an additional payment of $0.3 million based on the revenue retained by the acquired business over the 90 days following the date of acquisition. With annual revenues in excess of $2.6 million, Protector Security Services was a provider of contract security guard services throughout the St. Louis metropolitan area. Of the total initial payment, $0.6 million was allocated to customer relationship intangible asset (amortized over a useful life of six years under the sum-of-the-year-digits method). The final contingent payment of $0.3 million made in 2006 was allocated to goodwill.

8. Line of Credit Facility

ABM has a $300 million syndicated line of credit scheduled to expire in May 2010. No compensating balances are required under the facility and the interest rate is determined at the time of borrowing based on the London Interbank Offered Rate (LIBOR) plus a spread of 0.375% to 1.125% or, for overnight borrowings, at the prime rate or, for overnight to one week, at the Interbank Offered Rate (IBOR) plus a spread of 0.375% to 1.125%. The spreads for LIBOR and IBOR borrowings are based on the Company s leverage ratio. The facility calls for a non-use fee payable quarterly, in arrears, of 0.100%, based on the average daily unused portion. For purposes of this calculation, irrevocable standby letters of credit issued primarily in conjunction with the Company s self-insurance program plus cash borrowings are considered to be outstanding amounts. As of January 31, 2007 and October 31, 2006, the total outstanding amounts under the facility were $107.5 million and $98.7 million, respectively, in the form of standby letters of credit.

The facility includes usual and customary covenants for a credit facility of this type, including covenants limiting liens, dispositions, fundamental changes, investments, indebtedness, and certain transactions and payments. In addition, the facility also requires that the Company satisfy three financial covenants: (1) a fixed charge coverage ratio greater than or equal to 1.50 to 1.0 at fiscal quarter-end; (2) a leverage ratio of less than or equal to 3.25 to 1.0 at fiscal quarter-end; and (3) consolidated net worth greater than or equal to the sum of (i) $341.9 million, (ii) an amount equal to 50% of the consolidated net income earned in each full fiscal quarter ending after May 25, 2005 (with no deduction for a net loss in any such fiscal quarter) and (iii) an amount equal to 100% of the aggregate increases in stockholders equity of ABM after May 25, 2005 by reason of the issuance and sale of capital stock or other equity interests of ABM, including upon any conversion of debt securities of ABM into such capital stock or other equity interests, but excluding by reason of the issuance and sale of capital stock pursuant to the Company s ESPP, employee stock option plans and similar programs. The Company is currently in compliance with all covenants.

Table of Contents

9. Comprehensive Income

Comprehensive income consists of net income and other related gains and losses affecting stockholders equity that, under generally accepted accounting principles, are excluded from net income. For the Company, such other comprehensive income items consist of unrealized foreign currency translation gains and losses. The Company s other comprehensive loss was $0.3 million for the three months ended January 31, 2007 and other comprehensive income was $0.2 million for the three months ended January 31, 2006. Comprehensive income for the three months ended January 31