

G&K SERVICES INC  
Form 10-Q  
May 02, 2008

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**  
**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended March 29, 2008**  
**Commission file number 0-4063**  
**G&K SERVICES, INC.**  
(Exact name of registrant as specified in its charter)

MINNESOTA

41-0449530

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

5995 OPUS PARKWAY  
MINNETONKA, MINNESOTA 55343

(Address of principal executive offices and zip code)

Registrant's telephone number, including area code (952) 912-5500

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

Yes  No

Indicate by check mark 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. (Check one):

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

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

Yes  No

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

Common Stock, par value \$0.50 per share, outstanding  
April 28, 2008 was 19,773,718 shares

**G&K Services, Inc.**  
**Form 10-Q**  
**Table of Contents**

	<b>PAGE</b>
<b><u>PART I</u></b>	
<b><u>Item 1. Financial Statements</u></b>	
<u>Consolidated Condensed Balance Sheets as of March 29, 2008 and June 30, 2007</u>	3
<u>Consolidated Condensed Statements of Operations for the three and nine months ended March 29, 2008 and March 31, 2007</u>	4
<u>Consolidated Condensed Statements of Cash Flows for the nine months ended March 29, 2008 and March 31, 2007</u>	5
<u>Notes to Consolidated Condensed Financial Statements</u>	6
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	12
<b><u>Item 3. Quantitative and Qualitative Disclosure About Market Risk</u></b>	19
<b><u>Item 4. Controls and Procedures</u></b>	19
<b><u>PART II</u></b>	
<b><u>Item 1. Legal Proceedings</u></b>	20
<b><u>Item 1A. Risk Factors</u></b>	20
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	21
<b><u>Item 6. Exhibits</u></b>	21
<b><u>Signatures</u></b>	22
<u>302 Certification of Chief Executive Officer</u>	
<u>302 Certification of Chief Financial Officer</u>	
<u>906 Certification of Chief Executive Officer</u>	
<u>906 Certification of Chief Financial Officer</u>	

**Table of Contents**

**PART I**  
**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**

*G&K Services, Inc. and Subsidiaries*

	March 29, 2008 (Unaudited)	June 30, 2007
(In thousands)		
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 18,038	\$ 22,759
Accounts receivable, less allowance for doubtful accounts of \$4,271 and \$3,405	112,754	98,276
Inventories, net	139,073	140,780
Other current assets	20,576	14,912
Total current assets	290,441	276,727
<b>Property, Plant and Equipment, net</b>	253,566	255,996
<b>Goodwill</b>	434,414	380,070
<b>Other Assets</b>	75,170	79,021
	\$ 1,053,591	\$ 991,814
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 27,873	\$ 21,911
Accrued expenses	80,579	68,927
Deferred income taxes	7,400	6,568
Current maturities of long-term debt	7,837	65,838
Total current liabilities	123,689	163,244
<b>Long-Term Debt, net of Current Maturities</b>	281,474	149,005
<b>Deferred Income Taxes</b>	28,443	34,298
<b>Accrued Income Taxes - Long Term</b>	12,319	
<b>Other Noncurrent Liabilities</b>	43,749	53,279
<b>Stockholders Equity</b>	563,917	591,988
	\$ 1,053,591	\$ 991,814

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

**Table of Contents****CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS***G&K Services, Inc. and Subsidiaries*

(Unaudited)

(In thousands, except per share data)	For the Three Months		For the Nine Months	
	Ended		Ended	
	March 29, 2008	March 31, 2007	March 29, 2008	March 31, 2007
<b>Revenues</b>				
Rental operations	\$ 233,001	\$ 211,842	\$ 691,277	\$ 628,273
Direct sales	18,140	23,400	58,918	60,861
Total revenues	251,141	235,242	750,195	689,134
<b>Operating Expenses</b>				
Cost of rental operations*	148,870	136,951	439,927	403,436
Cost of direct sales*	14,367	16,923	43,593	44,579
Selling and administrative	53,770	50,110	160,559	150,031
Depreciation and amortization	12,579	11,326	36,993	33,776
Total operating expenses	229,586	215,310	681,072	631,822
<b>Income from Operations</b>	21,555	19,932	69,123	57,312
Interest expense	3,828	3,647	11,776	10,526
<b>Income before Income Taxes</b>	17,727	16,285	57,347	46,786
Provision for income taxes	7,080	4,136	21,899	15,801
<b>Net Income</b>	\$ 10,647	\$ 12,149	\$ 35,448	\$ 30,985
Basic weighted average number of shares outstanding	19,621	21,304	20,452	21,227
<b>Basic Earnings per Common Share</b>	\$ 0.54	\$ 0.57	\$ 1.73	\$ 1.46
Diluted weighted average number of shares outstanding	19,742	21,445	20,590	21,394
<b>Diluted Earnings per Common Share</b>	\$ 0.54	\$ 0.57	\$ 1.72	\$ 1.45
<b>Dividends per share</b>	\$ 0.05	\$ 0.04	\$ 0.15	\$ 0.12

\* Excludes depreciation and intangible amortization

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

**Table of Contents****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS***G&K Services, Inc. and Subsidiaries*

(Unaudited)

(In thousands)	For the Nine Months Ended	
	March 29, 2008	March 31, 2007
<b>Operating Activities:</b>		
Net income	\$ 35,448	\$ 30,985
Adjustments to reconcile net income to net cash provided by operating activities -		
Depreciation and amortization	36,993	33,776
Other Adjustments	1,829	3,340
Changes in current operating items, exclusive of acquisitions	(5,504)	(18,772)
Other assets and liabilities	4,211	1,862
Net cash provided by operating activities	72,977	51,191
<b>Investing Activities:</b>		
Property, plant and equipment additions, net	(16,576)	(23,214)
Acquisitions of business assets, net	(63,687)	(47,543)
Purchase of investments, net	(2,521)	(2,043)
Net cash used for investing activities	(82,784)	(72,800)
<b>Financing Activities:</b>		
Repayments of long-term debt	(7,341)	(7,579)
Proceeds from short-term borrowings, net	81,801	26,446
Cash dividends paid	(3,082)	(2,575)
Sale of common stock	4,220	3,004
Repurchase of common stock shares	(70,735)	
Net cash provided by financing activities	4,863	19,296
<b>Decrease in Cash and Cash Equivalents</b>	(4,944)	(2,313)
<b>Effect of Exchange Rates on Cash</b>	223	(619)
<b>Cash and Cash Equivalents:</b>		
Beginning of period	22,759	19,690
End of period	\$ 18,038	\$ 16,758

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

**Table of Contents**

G&K SERVICES, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(Amounts in millions, except per share data)  
Three and nine month periods ended March 29, 2008 and March 31, 2007  
(Unaudited)

**1. Basis of Presentation for Interim Financial Statements**

The consolidated condensed financial statements included herein, except for the June 30, 2007 balance sheet which was derived from the audited consolidated financial statements for the fiscal year ended June 30, 2007, have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In our opinion, the accompanying unaudited consolidated condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly our financial position as of March 29, 2008, and the results of our operations for the three and nine months ended and our cash flows for the nine months ended March 29, 2008 and March 31, 2007. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures herein are adequate to make the information presented not misleading. It is suggested that these consolidated condensed financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our latest report on Form 10-K.

The accounting policies we follow are set forth in Note 1 in our Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

The results of operations for the three and nine month periods ended March 29, 2008 and March 31, 2007 are not necessarily indicative of the results to be expected for the full year.

**2. Adoption of New Accounting Pronouncements**

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109, which fundamentally changes the way that we are required to account for our uncertain tax positions for financial accounting purposes and is effective for our fiscal year beginning July 1, 2007. FIN 48 prescribes rules regarding how we should recognize, measure and disclose in our financial statements the tax positions that we have taken or will take on our tax return that are reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in an increase in a liability for income taxes payable, or a reduction in a deferred tax asset or an increase in a deferred tax liability.

As a result of the implementation of FIN 48, we recognized a \$1.6 million decrease to the beginning balance of retained earnings on our balance sheet. At the adoption date of July 1, 2007, we had \$13.7 million of unrecognized tax benefits, of which \$4.2 million would favorably affect our effective tax rate in any future periods, if recognized. At March 29, 2008, we had \$16.0 million of unrecognized tax benefits, of which \$4.6 million would favorably affect our effective tax rate in any future periods, if recognized.

We or one or more of our subsidiaries file income tax returns in the U.S., Canada and multiple state jurisdictions. We have substantially concluded on all U.S. Federal and Canadian income tax examinations through fiscal years 2004 and 2003, respectively. With few exceptions, we are no longer subject to state and local income tax examinations for years before fiscal year 2003.

We continue to recognize interest and penalties related to uncertain tax positions as a component of income tax expense. Upon adoption of FIN 48, we had \$1.8 million of accrued interest and penalties related to uncertain tax positions, of which \$1.4 million would favorably affect our effective tax rate in any future periods, if recognized. At March 29, 2008, we had \$2.6 million of accrued interest and penalties related to uncertain tax positions, of which \$1.7 million would favorably affect our effective tax rate in any future periods, if recognized.

We are not aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly change in the next 12 months.



**Table of Contents****Accounting Pronouncements Not Yet Adopted**

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurement (SFAS 157). SFAS 157 provides a definition of fair value, provides guidance for measuring fair value in U.S. GAAP and expands disclosures about fair value measurement. SFAS 157 will be effective at the beginning of fiscal 2009.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 will be effective at the beginning of fiscal 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141(R)). SFAS 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 141(R) will be effective at the beginning of fiscal 2010.

We are currently evaluating the impact of SFAS 157, SFAS 159 and SFAS 141(R) on our consolidated financial statements.

**3. Per Share Data**

Basic earnings per common share was computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share was computed similarly to the computation of basic earnings per share, except that the denominator is increased for the assumed exercise of dilutive options and other dilutive securities, including non-vested restricted stock, using the treasury stock method.

	Three Months Ended		Nine Months Ended	
	March	March	March	March
	29,	31,	29,	31,
	2008	2007	2008	2007
Weighted average number of common shares outstanding used in computation of basic earnings per share	19.6	21.3	20.5	21.2
Weighted average effect of non-vested restricted stock grants and assumed exercise of options	0.1	0.1	0.1	0.2
Shares used in computation of diluted earnings per share	19.7	21.4	20.6	21.4

Potential common shares related to our outstanding stock options and restricted stock grants of 1.3 million and 0.8 million for the three months ended March 29, 2008 and March 31, 2007, respectively, and 0.9 million and 0.6 million for the nine months ended March 29, 2008 and March 31, 2007, respectively, were excluded from the computation of diluted earnings per share. Inclusion of these shares would have been anti-dilutive as the exercise price of these shares exceeded their market value.



**Table of Contents****4. Comprehensive Income**

For the three and nine month periods ended March 29, 2008 and March 31, 2007, the components of comprehensive income were as follows:

	Three Months Ended		Nine Months Ended	
	March 29, 2008	March 31, 2007	March 29, 2008	March 31, 2007
Net income	\$ 10.6	\$ 12.1	\$ 35.4	\$ 31.0
Other comprehensive income:				
Foreign currency translation adjustments, net of tax	(6.2)	1.5	6.4	(5.3)
Net unrealized holding gain (loss) on derivative financial instruments, net of tax	(2.2)	0.5	(4.1)	(1.0)
Comprehensive income	\$ 2.2	\$ 14.1	\$ 37.7	\$ 24.7

**5. Inventories**

The components of inventory as of March 29, 2008 and June 30, 2007 are as follows:

	March 29, 2008	June 30, 2007
Raw Materials	\$ 5.2	\$ 5.5
Work in Process	3.8	4.4
Finished Goods	49.0	52.9
New Goods	\$ 58.0	\$ 62.8
Merchandise In Service	\$ 81.1	\$ 78.0
Total Inventories	\$ 139.1	\$ 140.8

**6. Goodwill and Intangible Assets**

Goodwill includes the following:

	United States	Canada	Total
Balance as of June 30, 2007	\$ 315.8	\$ 64.3	\$ 380.1
Acquisitions, net of purchase accounting adjustments	51.6		51.6
Currency exchange and other		2.7	2.7
Balance as of March 29, 2008	\$ 367.4	\$ 67.0	\$ 434.4

The net increase in goodwill includes an increase of approximately \$51.6 million related to acquisitions in fiscal 2008 and an increase of approximately \$2.7 million resulting from a change in foreign currency exchange rates.

---

**Table of Contents**

Our other intangible assets, which are included in other assets on the consolidated condensed balance sheet, are as follows:

	March 29, 2008	June 30, 2007
Other Intangible Assets:		
Customer Contracts	\$ 119.3	\$ 111.7
Accumulated Amortization	(76.8)	(68.5)
Net	\$ 42.5	\$ 43.2
Non-Competition Agreements	\$ 11.1	\$ 11.1
Accumulated Amortization	(9.9)	(9.4)
Net	\$ 1.2	\$ 1.7

The customer contracts include the combined value of the written service agreements and the related customer relationship.

Amortization expense was \$8.4 million and \$8.1 million for the nine months ended March 29, 2008 and March 31, 2007, respectively. Estimated amortization expense for each of the next five fiscal years based on the intangible assets as of March 29, 2008 is as follows:

2008 remaining	\$2.6
2009	7.6
2010	7.4
2011	6.7
2012	6.0
2013	4.5

**7. Long-Term Debt**

We maintain a \$325.0 million unsecured revolving credit facility which expires in August 2010. As of March 29, 2008, borrowings outstanding under the revolving credit facility were \$146.3 million. The unused portion of the revolver may be used for general corporate purposes, acquisitions, share repurchases, working capital needs and to provide up to \$50.0 million in letters of credit. As of March 29, 2008, letters of credit outstanding against the revolver were \$21.1 million.

Borrowings under the revolving credit facility bear interest at 0.55% to 1.50% over the London Interbank Offered Rate ( LIBOR ), or the Canadian prime rate for Canadian borrowings, based on a leverage ratio calculated on a quarterly basis. Advances outstanding as of March 29, 2008 bear interest at a rate of 3.99%. We also pay a fee on the unused daily balance of the revolving credit facility based on a leverage ratio calculated on a quarterly basis.

We have issued \$50.0 million of 8.4% unsecured fixed rate private placement notes with certain institutional investors. The 10-year notes have a nine-year average life with a final maturity on July 20, 2010. Beginning on July 20, 2004, and annually thereafter to maturity, we will repay \$7.1 million of the principal amount at par. As of

March 29, 2008, the outstanding balance was \$21.4 million.

We maintain a loan agreement whereby the lender will make loans to us on a revolving basis up to \$60.0 million. This agreement has a termination date of October 21, 2010. We are required to pay interest on outstanding loan balances at a rate per annum of one month LIBOR plus a margin or, if the lender is funding the loan through the issuance of commercial paper to third parties, at a rate per annum equal to a margin plus the average annual interest rate for such commercial paper. In connection with the loan agreement, we granted a first priority security interest in certain of our U.S. based receivables. The amount of funds available under the loan agreement will be based on the amount of eligible receivables less various reserve requirements. We used the net proceeds of this loan to reduce

**Table of Contents**

indebtedness under our unsecured credit facilities. At March 29, 2008, there was \$45.0 million outstanding under the agreement at a current interest rate of 3.28%.

We have \$75.0 million of unsecured variable rate private placement notes. The notes bear interest at 0.60% over LIBOR and are scheduled to mature on June 30, 2015. The notes do not require principal payments until maturity. The interest rate and interest payments are reset and paid on a quarterly basis. As of March 29, 2008, the outstanding balance of the notes was \$75.0 million at a current rate of 5.46%.

**8. Share-Based Compensation**

We grant share-based awards, including restricted stock and options to purchase our common stock. Stock option grants are for a fixed number of shares to employees and directors with an exercise price equal to the fair value of the shares at the date of grant. Share-based compensation for awards is recognized in the consolidated statements of operations on a straight-line basis over the requisite service period. The amortization of share-based compensation reflects estimated forfeitures adjusted for actual forfeiture experiences. Our estimated forfeiture rate is reviewed and updated on an annual basis. As share-based compensation expense is recognized, a deferred tax asset is recorded that represents an estimate of the future tax deduction from the exercise of stock options or release of restrictions on the restricted stock. At the time share-based awards are exercised, cancelled, expire or restrictions lapse, we recognize adjustments to income tax expense. Total compensation expense related to share-based awards was \$1.8 million and \$1.5 million for the three months ended and \$4.4 million and \$3.6 million for the nine months ended March 29, 2008 and March 31, 2007. The number of options that have been exercised and restricted stock that vested since June 30, 2007, was 0.2 million shares.

**9. Employee Benefit Plans**

The components of net periodic pension cost are as follows for the three months ended March 29, 2008 and March 31, 2007:

	Pension Plan		Supplemental Executive Retirement Plan	
	Three Months Ended		Three Months Ended	
	March	March	March	March
	29,	31,	29,	31,
	2008	2007	2008	2007
Interest cost	\$ 0.8	\$ 0.8	\$ 0.2	\$ 0.2
Expected return on assets (Favorable)/Unfavorable	(0.9)	(0.7)		
Net periodic pension (income) cost	\$ (0.1)	\$ 0.1	\$ 0.2	\$ 0.2

The components of net periodic pension cost are as follows for the nine months ended March 29, 2008 and March 31, 2007:

	Pension Plan		Supplemental Executive Retirement Plan	
	Nine Months Ended		Nine Months Ended	
	March	March	March	March
	29,	31,	29,	31,
	2008	2007	2008	2007

Edgar Filing: G&K SERVICES INC - Form 10-Q

Service cost	\$	\$	1.5	\$	\$	0.3		
Interest cost		2.4	2.3	0.5		0.5		
Expected return on assets (Favorable)/Unfavorable		(2.8)	(2.1)					
Net periodic pension (income) cost	\$	(0.4)	\$	1.7	\$	0.5	\$	0.8

10

---



**Table of Contents****10. Segment Information**

We have two operating segments, United States and Canada, which have been identified as components of our Company that are reviewed by our Chief Executive Officer to determine resource allocation and evaluate performance. Each operating segment derives revenues from the branded identity apparel and facility services industry, which includes garment rental and non-apparel items such as floor mats, dust mops, wiping towels, selected linen items and restroom products. No single customer accounted for more than 1.5% of our consolidated revenue.

Corporate expenses are allocated to the segments based on segment revenue. We evaluate performance based on income from operations. Financial information by geographic location for the three and nine month periods ended March 29, 2008 and March 31, 2007 is as follows:

For the Three Months Ended	United States	Canada	Total
Third Quarter Fiscal Year 2008:			
Revenues	\$ 204.8	\$ 46.3	\$ 251.1
Income from operations	14.5	7.1	21.6
Depreciation and amortization expense	10.9	1.7	12.6
Third Quarter Fiscal Year 2007:			
Revenues	\$ 195.8	\$ 39.4	\$ 235.2
Income from operations	13.8	6.1	19.9
Depreciation and amortization expense	9.8	1.5	11.3
For the Nine Months Ended	United States	Canada	Total
Fiscal Year 2008:			
Revenues	\$ 613.4	\$ 136.8	\$ 750.2
Income from operations	44.8	24.3	69.1
Depreciation and amortization expense	31.7	5.3	37.0
Fiscal Year 2007:			
Revenues	\$ 570.1	\$ 119.0	\$ 689.1
Income from operations	38.3	19.0	57.3
Depreciation and amortization expense	29.0	4.8	33.8

For the nine months ended March 29, 2008, the Canada segment results were positively impacted by \$0.7 million resulting from the net effect of a gain on the sale of property, offset by expenses associated with fires at two of our production facilities. The net Canadian impact was offset by expenses in our United States segment during the nine months ended March 29, 2008, which included severance associated with the restructuring of our manufacturing operations and certain management positions, an increase in our inventory reserves and expenses associated with certain legal matters all of which occurred in the first quarter of fiscal 2008. The net effect of these items on the United States segment was approximately \$1.7 million of expense for the nine months ended March 29, 2008.

**11. Stock Repurchase**

In May 2007, our Board of Directors authorized the repurchase of up to \$100.0 million of G&K Services outstanding common stock. For the three months ended March 29, 2008, we purchased a total of 621,250 shares totaling \$23.5 million and for the nine months ended March 29, 2008, we purchased 1,791,735 shares totaling \$69.7 million. Cash used for the purchase of shares totaled \$23.5 million for the three months ended and \$70.7 million for the nine months ended March 29, 2008. The cash used during the nine month period ending March 29, 2008 included \$1.0 million for shares repurchased in the fourth quarter of fiscal year 2007 but not paid until July 2, 2007. As of March 29, 2008, we had \$21.4 million remaining under this authorization.

11

---

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Unaudited)

**Overview**

G&K Services, Inc., founded in 1902 and currently headquartered in Minnetonka, Minnesota, is a market leader in providing branded identity apparel and facility services programs that enhance image and safety in the workplace. We serve a wide variety of North American industrial, service and high-technology companies providing them with rented uniforms and facility services products such as floor mats, dust mops, wiping towels, restroom supplies and selected linen items. We also sell uniforms and other apparel items to customers in our direct sale programs. The North American rental market is approximately \$7.0 billion, while the portion of the direct sale market targeted by us is approximately \$5.0 billion.

Our industry continues to consolidate from many family owned and small local providers to several large providers. We are participating in this industry consolidation. Our rental acquisition strategy is focused on acquisitions in the rental and direct purchase businesses that expand our geographic presence and/or expand our local market share in order to further leverage our existing production facilities.

In the third quarter of fiscal year 2008, our revenue was \$251.1 million, a 6.8% increase from the \$235.2 million reported during the third quarter of fiscal 2007. The increase in quarterly revenue was driven by organic rental growth, strong revenue contribution from acquisitions and the benefit of foreign currency translations; offset by a decrease in direct sales revenue.

We reported third quarter earnings of \$0.54 per diluted share. Prior-year third quarter earnings were \$0.57 per diluted share, and reflected an unusually low effective tax rate of 25.4%. The higher effective tax rate in the current year period resulted in a \$0.11 per diluted share difference when comparing third quarter earnings to the prior-year period. For the quarter, income before taxes was up 8.9% compared to the prior-year period. This increase was driven by strong operating performance and favorable foreign currency exchange rates, offset by higher gasoline prices and increased bad debt expense. In addition, third quarter results were negatively impacted by continued economic softness and on-going system investments and expenses related to system implementation activities.

In fiscal 2008, we acquired several businesses which strengthened our market position and increased the utilization of our existing operations. The proforma effect of these acquisitions, had they been acquired at the beginning of each fiscal year, was not material.

**Critical Accounting Policies**

The discussion of the financial condition and results of operations are based upon the consolidated condensed financial statements, which have been prepared in conformity with United States generally accepted accounting principles. As such, management is required to make certain estimates, judgments and assumptions that are believed to be reasonable based on the information available. These estimates and assumptions affect the reported amount of assets and liabilities, revenues and expenses, and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, the most important and pervasive accounting policies used and areas most sensitive to material changes from external factors. See Note 1 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended June 30, 2007 for additional discussion of the application of these and other accounting policies.

**Table of Contents****Results of Operations**

The percentage relationships to revenues of certain income and expense items for the three and nine month periods ended March 29, 2008 and March 31, 2007, and the percentage changes in these income and expense items between periods are presented in the following table:

	Three Months Ended		Nine Months Ended		Percentage Change	
	March 29, 2008	March 31, 2007	March 29, 2008	March 31, 2007	Three Months FY 2008 vs. FY 2007	Nine Months FY 2008 vs. FY 2007
<b>Revenues:</b>						
Rental	92.8%	90.1%	92.1%	91.2%	10.0%	10.0%
Direct	7.2	9.9	7.9	8.8	(22.5)	(3.2)
Total revenues	100.0	100.0	100.0	100.0	6.8	8.9
<b>Expenses:</b>						
Cost of rental sales	63.9	64.6	63.6	64.2	8.7	9.0
Cost of direct sales	79.2	72.3	74.0	73.2	(15.1)	(2.2)
Total cost of sales	65.0	65.4	64.5	65.0	6.1	7.9
Selling and administrative	21.4	21.3	21.4	21.8	7.3	7.0
Depreciation and amortization	5.0	4.8	4.9	4.9	11.1	9.5
Income from operations	8.6	8.5	9.2	8.3	8.1	20.6
Interest expense	1.5	1.6	1.6	1.5	5.0	11.9
Income before income taxes	7.1	6.9	7.6	6.8	8.9	22.6
Provision for income taxes	2.9	1.7	2.9	2.3	71.2	38.6
Net income	4.2%	5.2%	4.7%	4.5%	(12.4)%	14.4%

**Three months ended March 29, 2008 compared to three months ended March 31, 2007**

**Revenues.** Total revenue in the third quarter of fiscal 2008 increased 6.8% to \$251.1 million from \$235.2 million in the third quarter of fiscal 2007.

Rental revenue increased \$21.2 million, or 10.0% in the third quarter. Our organic rental growth rate was approximately 2.75% during the current quarter. Organic rental growth resulted from strong new account and route sales performance offset by an increase in economic-driven customer attrition and a reduction in employment levels within certain industries. The organic rental growth rate is calculated using rental revenue, adjusted for foreign currency exchange rate changes and revenue from newly acquired businesses compared to prior-period results. We

believe that the organic rental growth rate better reflects the growth of our existing rental business and is therefore useful in analyzing our financial condition and results of operations.

Direct sale revenue decreased 22.5% to \$18.1 million in the third quarter of fiscal 2008 compared to \$23.4 million in the same period of fiscal 2007. The organic direct sale growth rate during the current period was a negative 25.0%. The decrease in direct sale revenue was primarily the result of a decrease in orders from a large direct sale customer, the non-renewal of a contract with a major customer and to a lesser extent, a decrease in shipments as a result of our system implementation.

*Cost of Rental.* Cost of rental operations increased 8.7% to \$148.9 million in the third quarter of fiscal 2008 from \$137.0 million in the same period of fiscal 2007. As a percentage of rental revenue, our gross margin from rental sales increased to 36.1% in the third quarter of fiscal 2008 from 35.4% in the same period of fiscal 2007. The improvement in rental gross margin was a result of improved leverage from overall revenue growth and lower merchandise costs. The improvement in rental gross margin was partially offset by higher production and delivery costs associated with increased energy prices.

**Table of Contents**

*Cost of Direct Sales.* Cost of direct sales decreased to \$14.4 million in the third quarter of fiscal 2008 from \$16.9 million in the same period of fiscal 2007. Gross margin from direct sales decreased to 20.8% in the third quarter of fiscal 2008 from 27.7% in the third quarter of fiscal 2007. The decrease in gross margin resulted from additional expenses associated with the implementation of a new system and the impact of fixed cost absorption associated with lower direct sales volume.

*Selling and Administrative.* Selling and administrative expenses increased 7.3% to \$53.8 million in the third quarter of fiscal 2008 from \$50.1 million in the same period of fiscal 2007. As a percentage of total revenues, selling and administrative expenses increased to 21.4% in the third quarter of fiscal 2008 from 21.3% in the third quarter of fiscal 2007. During the quarter we continued to gain positive leverage from revenue growth and productivity savings from the implementation of our handheld technology platform. These gains were offset by increased bad debt expense driven by certain customer insolvencies. Bad debt expense increased by approximately \$1.3 million in the current quarter when compared to the same period in the prior fiscal year. In addition, administrative expenses increased over the prior-year period due to the on-going investment in systems implementation and acquisition integration activities.

*Depreciation and Amortization.* Depreciation and amortization expense increased to \$12.6 million in the third quarter of fiscal 2008 from \$11.3 million in the same period of fiscal 2007. This increase was primarily due to businesses acquired in fiscal 2008 which were partially offset by lower capital expenditures. As a percentage of total revenues, depreciation and amortization increased to 5.0% in the third quarter of fiscal 2008 from 4.8% in the third quarter of fiscal 2007.

*Interest Expense.* Interest expense was \$3.8 million in the third quarter of fiscal 2008, up from \$3.6 million in the same period of fiscal 2007. The increase in interest expense is primarily the result of higher debt balances during the third quarter of fiscal year 2008 compared to the same period of the prior fiscal year, offset by lower interest rates.

*Provision for Income Taxes.* Our effective tax rate increased to 39.9% in the third quarter of fiscal 2008 from 25.4% in the same period of fiscal 2007. The prior year tax rate was significantly lower than our statutory rate primarily due to the expiration of certain statutes and the favorable resolution of other tax matters which resulted in the reversal of tax reserves in the prior year that were no longer required. The current year tax rate was higher than our statutory rate due to an increase in reserves for our uncertain tax positions, offset by the utilization of a net operating loss previously deemed to be unrealizable. Both periods included adjustments resulting from the final calculation and filing of our annual income tax returns.

***Nine months ended March 29, 2008 compared to nine months ended March 31, 2007***

*Revenues.* Total revenue for the first nine months of fiscal 2008 increased 8.9% to \$750.2 million compared to \$689.1 million for the same period in the prior fiscal year.

Rental revenue increased \$63.0 million, or 10.0% in the first nine months. Our organic rental growth rate was approximately 3.25% in 2008 versus 4.5% in 2007. Organic rental growth resulted from increased route performance and new account sales, offset by an increase in economic-driven customer attrition and softness in the overall economy, which has resulted in a net reduction in the number of employees wearing uniforms and a reduction in ancillary products rented by existing customers.

Direct sale revenue decreased 3.2% to \$58.9 million in the first nine months of fiscal 2008 compared to \$60.9 million in the same period of fiscal 2007. The organic direct sale growth rate during the current period was a negative 6.2%. The decrease in direct sale revenue resulted from sales to a significant direct sale customer in the third quarter of fiscal year 2007, that didn't reoccur in fiscal 2008. Direct sale revenue was also negatively impacted by a contract with a major customer that was not renewed.

*Cost of Rental and Direct Sale.* Cost of rental operations increased 9.0% to \$439.9 million in the first nine months of fiscal 2008 from \$403.4 million in the same period of fiscal 2007. Gross margin from rental sales improved to 36.4% in the first nine months of fiscal 2008 from 35.8% in the same period of fiscal 2007. The improvement in rental margins is primarily the result of leveraging our overall rental growth and lower merchandise and production costs, offset by higher energy costs. Cost of direct sales decreased to \$43.6 million in the first nine months of fiscal 2008 from \$44.6 million in the same period of fiscal 2007. Gross margin from direct sales decreased to 26.0% in the first nine months of fiscal 2008 from 26.8% in the same period of fiscal 2007. The decrease in direct sales margins is the result of expenses associated with the implementation of a new system and the impact of fixed cost absorption

associated with lower direct sales volume.

*Selling and Administrative.* Selling and administrative expenses increased 7.0% to \$160.6 million in the first nine months of fiscal 2008 from \$150.0 million in the same period of fiscal 2007. As a percentage of total revenues, selling and administrative

**Table of Contents**

expenses decreased to 21.4% in the first nine months of fiscal 2008 from 21.8% in the same period of fiscal 2007. The improvement is the result of leveraging our existing infrastructure to support higher sales volumes as well as the realization of efficiencies gained through the rollout of our handheld technology throughout our route delivery organization and other productivity initiatives. These improvements were partially offset by costs associated with a fire at a production facility and higher bad debt expense associated with certain customer insolvencies.

*Depreciation and Amortization.* Depreciation and amortization expense increased to \$37.0 million in the first nine months of fiscal 2008 from \$33.8 million in the same period of fiscal 2007. The increase was due to depreciation and amortization associated with acquired businesses. As a percentage of total revenues, depreciation and amortization expense remained at 4.9% in the first nine months of both fiscal 2008 and 2007.

*Interest Expense.* Interest expense was \$11.8 million in the first nine months of fiscal 2008, up from \$10.5 million in the same period of fiscal 2007. The increase was primarily due to higher debt balances during the first nine months of fiscal year 2008 compared to the same period of the prior fiscal year, offset by lower interest rates.

*Provision for Income Taxes.* Our effective tax rate increased to 38.2% in the first nine months of fiscal 2008 from 33.8% in the same period of fiscal 2007. The increase is primarily due to the reversal of tax reserves in the prior year that were no longer required.

***Liquidity, Capital Resources and Financial Condition***

Our primary sources of cash are net cash flows from operations and borrowings under our debt arrangements. Primary uses of cash are interest payments on indebtedness, capital expenditures, acquisitions, share repurchases and general corporate purposes.

Working capital at March 29, 2008 was \$166.8 million, up approximately 47.0% from \$113.5 million at June 30, 2007. The increase in working capital is primarily due to the renewal of a credit facility in the first quarter of fiscal 2008, which resulted in a reclassification of \$58.0 million from current maturities of long term debt.

*Operating Activities.* Net cash provided by operating activities was \$73.0 million in the first nine months of fiscal 2008 and \$51.2 million in the same period of fiscal 2007. The increase in cash generated from operating activities is primarily due to higher net income as well as lower expenditures on inventory and accounts payables, partially offset by lower cash received from receivables.

*Investing Activities.* Net cash used in investing activities was \$82.8 million in the first nine months of fiscal 2008 and \$72.8 million in the same period of fiscal 2007. In fiscal 2008 and 2007, cash was used primarily for acquisition of business assets and purchases of property, plant and equipment.

*Financing Activities.* Cash provided by financing activities was \$4.9 million in the first nine months of fiscal 2008 and \$19.3 million in the same period of fiscal 2007. Cash provided by financing activities in fiscal 2008 was principally from our credit facilities and issuance of stock under employee stock option agreements, partially offset by repurchases of shares under our share repurchase program. Cash provided by financing activities in fiscal 2007 was principally from our credit facilities and issuance of stock under employee stock option agreements. We paid dividends of \$3.1 million during the first nine months of fiscal 2008.

We maintain a \$325.0 million unsecured revolving credit facility which expires in August 2010. As of March 29, 2008, borrowings outstanding under the revolving credit facility were \$146.3 million. The unused portion of the revolver may be used for general corporate purposes, acquisitions, share repurchases, working capital needs and to provide up to \$50.0 million in letters of credit. As of March 29, 2008, letters of credit outstanding against the revolver were \$21.1 million.

Borrowings under the revolving credit facility bear interest at 0.55% to 1.50% over the London Interbank Offered Rate ( LIBOR ), or the Canadian prime rate for Canadian borrowings, based on a leverage ratio calculated on a quarterly basis. Advances outstanding as of March 29, 2008 bear interest at a rate of 3.99%. We also pay a fee on the unused daily balance of the revolving credit facility based on a leverage ratio calculated on a quarterly basis. We have issued \$50.0 million of 8.4% unsecured fixed rate private placement notes with certain institutional investors. The 10-year notes have a nine-year average life with a final maturity on July 20, 2010. Beginning on July 20, 2004, and annually



**Table of Contents**

thereafter to maturity, we will repay \$7.1 million of the principal amount at par. As of March 29, 2008, the outstanding balance was \$21.4 million.

We maintain a loan agreement whereby the lender will make loans to us on a revolving basis up to \$60.0 million. This agreement has a termination date of October 21, 2010. We are required to pay interest on outstanding loan balances at a rate per annum of one month LIBOR plus a margin or, if the lender is funding the loan through the issuance of commercial paper to third parties, at a rate per annum equal to a margin plus the average annual interest rate for such commercial paper. In connection with the loan agreement, we granted a first priority security interest in certain of our U.S. based receivables. The amount of funds available under the loan agreement will be based on the amount of eligible receivables less various reserve requirements. We used the net proceeds of this loan to reduce indebtedness under our unsecured credit facilities. At March 29, 2008, there was \$45.0 million outstanding under the agreement at a current interest rate of 3.28%.

We have \$75.0 million of unsecured variable rate private placement notes. The notes bear interest at 0.60% over LIBOR and are scheduled to mature on June 30, 2015. The notes do not require principal payments until maturity. The interest rate and interest payments are reset and paid on a quarterly basis. As of March 29, 2008, the outstanding balance of the notes was \$75.0 million at a current rate of 5.46%.

*Cash Obligations.* Under various agreements, we are obligated to make future cash payments in fixed amounts. These include payments under the variable rate term loan and revolving credit facility, the fixed rate term loan, capital lease obligations and rent payments required under non-cancelable operating leases with initial or remaining terms in excess of one year.

At March 29, 2008, we had available cash on hand of \$18.0 million and approximately \$157.6 million of available capacity under our revolving credit facility. We anticipate that we will generate sufficient cash flows from operations to satisfy our cash commitments and capital requirements for fiscal 2008 and to reduce the amounts outstanding under the revolving credit facility; however, we may utilize borrowings under the revolving credit facility to supplement our cash requirements from time to time. We estimate that capital expenditures in fiscal 2008 will be approximately \$25-\$27 million.

Cash generated from operations could be affected by a number of risks and uncertainties. In fiscal 2008, we may actively seek and consider acquisitions of business assets. The consummation of any acquisition could affect our liquidity profile and level of outstanding debt. We believe that our earnings and cash flow from operations, existing credit facilities and our ability to obtain additional debt or equity capital, if necessary, will be adequate to finance acquisition opportunities.

***Off Balance Sheet Arrangements***

At March 29, 2008, we had \$21.1 million of stand-by letters of credit that were issued and outstanding, primarily in connection with our property and casualty insurance programs. No amounts have been drawn upon these letters of credit.

***Pension Obligations***

We account for our defined benefit pension plan using SFAS No. 87 Employer's Accounting for Pensions ( SFAS 87 ) and SFAS No. 158 Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans . Under SFAS 87, pension expense is recognized on an accrual basis over employees' approximate service periods. Pension expense calculated under SFAS 87 is generally independent of funding decisions or requirements. We recognized income of \$0.1 million for our defined benefit pension plan in the third quarter of fiscal 2008 and \$0.1 million of expense in the same period of fiscal 2007. At June 30, 2007, the fair value of our pension plan assets totaled \$41.5 million. Effective January 1, 2007 we have frozen our defined benefit pension plan and related supplemental executive retirement plan. We incurred \$0.2 million in costs associated with this action in fiscal year 2006. All benefits earned by defined benefit plan participants through the end of calendar year 2006 will be available upon retirement under plan provisions. Future growth in benefits did not occur beyond December 31, 2006.

The calculation of pension expense and the corresponding liability requires the use of a number of critical assumptions, including the expected long-term rate of return on plan assets and the assumed discount rate. Changes in these assumptions can result in different expense and liability amounts, and future actual experience can differ from these assumptions. Pension expense increases as the expected rate of return on pension plan assets decreases. At

June 30, 2007, we estimated that the pension plan assets will generate a long-term rate of return of 8.0%. This rate was developed by evaluating input from our outside actuary as well as long-term inflation assumptions. The expected long-term rate of return on plan assets at June 30,

**Table of Contents**

2007 is based on an allocation of equity and fixed income securities. Decreasing the expected long-term rate of return by 0.5% (from 8.0% to 7.5%) would increase our estimated 2008 pension expense by approximately \$0.2 million. Pension liability and future pension expense increase as the discount rate is reduced. We discounted future pension obligations using a rate of 6.40% at June 30, 2007. Our outside actuary determines the discount rate by creating a yield curve based on high quality bonds. Decreasing the discount rate by 0.5% (from 6.40% to 5.90%) would increase our accumulated benefit obligation at June 30, 2007 by approximately \$4.9 million.

Future changes in plan asset returns, assumed discount rates and various other factors related to the participants in our pension plan will impact our future pension expense and liabilities. We cannot predict with certainty what these factors will be in the future.

***Litigation***

We are involved in a variety of legal actions relating to personal injury, employment, environmental and other legal matters that arise in the normal course of business.

On April 9, 2008, the Commissioner of Environmental Protection of the State of Connecticut secured a temporary injunction in Superior Court in the State of Connecticut against us, prohibiting us from laundering shop or printer towels at our Waterbury, Connecticut facility, requiring us to cease use of certain related equipment, and requiring us to comply with certain throughput limits prescribed in permits previously issued by the State of Connecticut to us relative to this facility. The Commissioner alleges that our operations at this facility violate certain previously issued permits and/or that we are operating this facility in the absence of certain required permits. Any violation of the temporary injunction by us would subject us to monetary penalties. We are and will continue to conduct our Waterbury, Connecticut facility in strict accordance with the terms of the temporary injunction, and we will continue to work in good faith with the Connecticut Department of Environmental Protection to resolve this matter, including with respect to any amounts which may be payable.

On March 5, 2008, we were advised by the United States Securities and Exchange Commission that it is conducting an informal investigation of our company. We believe this matter stems from a dispute with a former location general manager primarily related to our internal budgeting and incentive compensation program. The dispute with this former employee was previously resolved to the parties' satisfaction. The correspondence received from the SEC states that it has not concluded that anyone has broken the law and that the investigation does not mean the SEC has a negative opinion of any person, entity or security. We are cooperating fully with the SEC in working through this matter. At this point, we cannot predict the length, scope or results of this investigation, nor its impact, if any.

Currently, none of these legal actions are expected to have a material adverse effect on our results of operations or financial position.

***Share-Based Compensation***

We grant share-based awards, including restricted stock and options to purchase our common stock. Stock option grants are for a fixed number of shares to employees and directors with an exercise price equal to the fair value of the shares at the date of grant. Share-based compensation for awards is recognized in the consolidated statements of operations on a straight-line basis over the requisite service period. The amortization of share-based compensation reflects estimated forfeitures adjusted for actual forfeiture experiences. Our estimated forfeiture rate is reviewed and updated on an annual basis. As share-based compensation expense is recognized, a deferred tax asset is recorded that represents an estimate of the future tax deduction from the exercise of stock options or release of restrictions on the restricted stock. At the time share-based awards are exercised, cancelled, expire or restrictions lapse, we recognize adjustments to income tax expense. Total compensation expense related to share-based awards was \$1.8 million and \$1.5 million for the three months ended and \$4.4 million and \$3.6 million for the nine months ended March 29, 2008 and March 31, 2007. The number of options that have been exercised and restricted stock that vested since June 30, 2007, was 0.2 million shares.

## **Table of Contents**

### **Adoption of New Accounting Pronouncements**

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48),

Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109, which fundamentally changes the way that we are required to account for our uncertain tax positions for financial accounting purposes and is effective for our fiscal year beginning July 1, 2007. FIN 48 prescribes rules regarding how we should recognize, measure and disclose in our financial statements the tax positions that we have taken or will take on our tax return that are reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods.

Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in an increase in a liability for income taxes payable, or a reduction in a deferred tax asset or an increase in a deferred tax liability.

As a result of the implementation of FIN 48, we recognized a \$1.6 million decrease to the beginning balance of retained earnings on our balance sheet. At the adoption date of July 1, 2007, we had \$13.7 million of unrecognized tax benefits, of which \$4.2 million would favorably affect our effective tax rate in any future periods, if recognized. At March 29, 2008, we had \$16.0 million of unrecognized tax benefits, of which \$4.6 million would favorably affect our effective tax rate in any future periods, if recognized.

We or one or more of our subsidiaries file income tax returns in the U.S., Canada and multiple state jurisdictions. We have substantially concluded on all U.S. Federal and Canadian income tax examinations through fiscal years 2004 and 2003, respectively. With few exceptions, we are no longer subject to state and local income tax examinations for years before fiscal year 2003.

We continue to recognize interest and penalties related to uncertain tax positions as a component of income tax expense. Upon adoption of FIN 48, we had \$1.8 million of accrued interest and penalties related to uncertain tax positions, of which \$1.4 million would favorably affect our effective tax rate in any future periods, if recognized. At March 29, 2008, we had \$2.6 million of accrued interest and penalties related to uncertain tax positions, of which \$1.7 million would favorably affect our effective tax rate in any future periods, if recognized.

We are not aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly change in the next 12 months.

### **Accounting Pronouncements Not Yet Adopted**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). SFAS 157 provides a definition of fair value, provides guidance for measuring fair value in U.S. GAAP and expands disclosures about fair value measurement. SFAS 157 will be effective at the beginning of fiscal 2009.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 will be effective at the beginning of fiscal 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141(R)). SFAS 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 141(R) will be effective at the beginning of fiscal 2010.

We are currently evaluating the impact of SFAS 157, SFAS 159 and SFAS 141(R) on our consolidated financial statements.

### **Cautionary Statements Regarding Forward-Looking Statements**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor from civil litigation for forward-looking statements. Forward-looking statements may be identified by words such as estimates, anticipates, projects, plans, expects, intends, believes, seeks, could, should, may and will or the negative versions thereof and similar and by the context in which they are used. Such statements are based upon our current expectations and speak only as of the date made. These statements are subject to various risks, uncertainties and other factors that could cause actual results to differ from those set forth in or implied by this quarterly report on Form 10-Q. Factors that might cause such a difference include, but are not limited to, the possibility of greater than anticipated operating costs, including energy costs, lower sales volumes, the performance and costs of integration of acquisitions or assumption of unknown liabilities in connection with acquisitions, fluctuations in costs of materials and labor, costs and possible effects of

union organizing activities, loss of key management, uncertainties regarding any existing or newly-discovered expenses and liabilities related to environmental compliance and remediation, failure to achieve and maintain effective internal controls for financial reporting

**Table of Contents**

required by the Sarbanes-Oxley Act of 2002, the initiation or outcome of litigation or government investigation, higher assumed sourcing or distribution costs of products, the disruption of operations from catastrophic events, changes in federal and state tax laws and the reactions of competitors in terms of price and service. We undertake no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made except as required by law. Additional information concerning potential factors that could effect future financial results is included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

**Interest Rate Risk**

We are subject to market risk exposure related to changes in interest rates. We use financial instruments, including fixed and variable rate debt, as well as interest rate swaps to manage interest rate risk. Interest rate swap agreements are entered into for periods consistent with related underlying exposures and do not constitute positions independent of those exposures. Assuming the current level of borrowings, a one percentage point increase in interest rates under these borrowings would have increased our interest expense for the third quarter of fiscal 2008 by approximately \$0.4 million. This estimated exposure considers the mitigating effects of interest rate swap agreements outstanding at March 29, 2008 on the change in the cost of variable rate debt. The current fair market value of all outstanding contracts at March 29, 2008 is a negative \$6.2 million.

**Energy Cost Risk**

We use derivative financial instruments to manage the risk that changes in energy costs will have on our future financial results. We purchase futures contracts to effectively hedge a portion of anticipated energy purchases. The futures contracts are reflected at fair value in the consolidated balance sheet and the related gains or losses on these contracts are deferred in stockholders' equity (as a component of other comprehensive income) for contracts that cash flow hedge accounting is achieved or in the statements of operations depending on the effectiveness of the hedge. Upon settlement of each contract, the actual gain or loss is reflected in cost of rental operations. The current fair market value of all outstanding contracts at March 29, 2008 is a positive \$1.0 million.

**Foreign Currency Exchange Risk**

We have material foreign subsidiaries located in Canada. The assets and liabilities of these subsidiaries are denominated in the Canadian dollar and as such are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Results of operations are translated using the average exchange rates throughout the period. The effect of exchange rate fluctuations on translation of assets and liabilities are recorded as a component of stockholders' equity. Gains and losses from foreign currency transactions are included in results of operations.

**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) or Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Form 10-Q. Based on their evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective.

There have been no changes in our internal controls over financial reporting that occurred during the period covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II  
OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

On April 9, 2008, the Commissioner of Environmental Protection of the State of Connecticut secured a temporary injunction in Superior Court in the State of Connecticut against us, prohibiting us from laundering shop or printer towels at our Waterbury, Connecticut facility, requiring us to cease use of certain related equipment, and requiring us to comply with certain throughput limits prescribed in permits previously issued by the State of Connecticut to us relative to this facility. The Commissioner alleges that our operations at this facility violate certain previously issued permits and/or that we are operating this facility in the absence of certain required permits. Any violation of the temporary injunction by us would subject us to monetary penalties. We are and will continue to conduct our Waterbury, Connecticut facility in strict accordance with the terms of the temporary injunction, and we will continue to work in good faith with the Connecticut Department of Environmental Protection to resolve this matter, including with respect to any amounts which may be payable.

On March 5, 2008, we were advised by the United States Securities and Exchange Commission that it is conducting an informal investigation of our company. We believe this matter stems from a dispute with a former location general manager primarily related to our internal budgeting and incentive compensation program. The dispute with this former employee was previously resolved to the parties' satisfaction. The correspondence received from the SEC states that it has not concluded that anyone has broken the law and that the investigation does not mean the SEC has a negative opinion of any person, entity or security. We are cooperating fully with the SEC in working through this matter. At this point, we cannot predict the length, scope or results of this investigation, nor its impact, if any.

Currently, none of these legal actions are expected to have a material adverse effect on our results of operations or financial position.

**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended June 30, 2007, which could materially affect our business, financial condition or future results. There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended June 30, 2007. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently believe are immaterial also may materially adversely affect our business, financial condition and/or operating results.

20

---

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table includes information about repurchases we made of our common stock during the periods indicated:

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number  (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
<b>Month #1 (Fiscal month beginning December 30, 2007 and ending February 2, 2008)</b>	576,150	\$37.73	576,150	\$ 23,135,383
<b>Month #2 (Fiscal month beginning February 3, 2008 and ending March 1, 2008)</b>	45,100	\$38.85	45,100	\$ 21,381,867
<b>Month #3 (Fiscal month beginning March 2, 2008 and ending March 29, 2008)</b>		\$		\$

In May 2007, our Board of Directors authorized the repurchase of up to \$100.0 million of G&K Services outstanding common stock. For the three months ended March 29, 2008, we purchased a total of 621,250 shares totaling \$23.5 million and for the nine months ended March 29, 2008, we purchased 1,791,735 shares totaling \$69.7 million. Cash used for the purchase of shares totaled \$23.5 million for the three months ended and \$70.7 million for the nine months ended March 29, 2008. The cash used during the nine month period ending March 29, 2008 included \$1.0 million for shares repurchased in the fourth quarter of fiscal year 2007 but not paid until July 2, 2007. As of March 29, 2008, we had \$21.4 million remaining under this authorization.

**ITEM 6. EXHIBITS**

## a. Exhibits

10.1 Other Events with the U.S. Securities and Exchange Commission, dated March 5, 2008 (incorporated herein by reference to Registrant's Form 8-K filed March 12, 2008).

31.1 Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**Table of Contents**

SIGNATURES

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

G&K SERVICES, INC.  
(Registrant)

Date: May 2, 2008

By: /s/ Jeffrey L. Wright  
Jeffrey L. Wright  
Senior Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

By: /s/ Thomas J. Dietz  
Thomas J. Dietz  
Vice President and Controller  
(Principal Accounting Officer)

22