

**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 September 26, 2020
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission file number 000-11917



THE DAVEY TREE EXPERT COMPANY

(Exact name of registrant as specified in its charter)

Ohio

34-0176110

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

**1500 North Mantua Street
P.O. Box 5193
Kent, OH 44240**

(Address of principal executive offices) (Zip code)

(330) 673-9511

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
N/A	N/A	N/A

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large Accelerated Filer

Accelerated Filer

Emerging Growth Company

Non-Accelerated Filer

Smaller Reporting Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 22,651,885 Common Shares, \$1.00 par value, outstanding as of October 30, 2020.

The Davey Tree Expert Company
Quarterly Report on Form 10-Q
September 26, 2020
INDEX

	<u>Page</u>
Part I. Financial Information	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets	2
Condensed Consolidated Statements of Operations	3
Condensed Consolidated Statements of Comprehensive Income (Loss)	4
Condensed Consolidated Statements of Shareholders' Equity	5
Condensed Consolidated Statements of Cash Flows	7
Notes to Condensed Consolidated Financial Statements	
A — Basis of Financial Statement Preparation	8
B — Seasonality of Business	9
C — Accounts Receivable, Net and Supplemental Balance-Sheet Information	9
D — Business Combinations	11
E — Identified Intangible Assets and Goodwill, Net	12
F — Long-Term Debt and Commitments Related to Letters of Credit	13
G — Leases	16
H — Stock-Based Compensation	18
I — Net Periodic Benefit Expense--Defined Benefit Pension Plans	21
J — Income Taxes	22
K — Accumulated Other Comprehensive Income (Loss)	22
L — Per Share Amounts and Common and Redeemable Shares Outstanding	24
M — Operations by Business Segment	26
N — Revenue Recognition	29
O — Fair Value Measurements and Financial Instruments	31
P — Commitments and Contingencies	33
Q — The Davey 401KSOP and Employee Stock Ownership Plan	35
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	37
Results of Operations	38
Liquidity and Capital Resources	43
Cash Flow Summary	43
Contractual Obligations Summary and Commercial Commitments	44
Capital Resources	44
Critical Accounting Policies and Estimates	45
Note Regarding Forward-Looking Statements	45
Item 3. Quantitative and Qualitative Disclosures about Market Risk	47
Item 4. Controls and Procedures	47
Part II. Other Information	47
Item 1. Legal Proceedings	47
Item 1A. Risk Factors	48
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	50
Item 6. Exhibits	51
Exhibit Index	52
Signatures	53

"We," "us" "our," "Davey" and "Davey Tree," unless the context otherwise requires, means The Davey Tree Expert Company and its subsidiaries.

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(In thousands, except per share data dollar amounts)

	September 26, 2020	December 31, 2019
Assets		
Current assets:		
Cash	\$ 25,058	\$ 11,000
Accounts receivable, net	265,688	231,311
Operating supplies	10,984	12,127
Other current assets	34,049	26,987
Total current assets	335,779	281,425
Property and equipment, net	205,294	199,850
Right-of-use assets - operating leases	53,315	40,033
Other assets	21,298	22,335
Intangible assets, net	10,846	10,934
Goodwill	45,152	42,285
Total assets	\$ 671,684	\$ 596,862
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 40,905	\$ 41,191
Accrued expenses	80,221	52,431
Current portion of long-term debt and finance lease liabilities	35,355	24,650
Other current liabilities	48,517	47,400
Total current liabilities	204,998	165,672
Long-term debt	106,551	143,354
Lease liabilities - finance leases	6,667	1,795
Lease liabilities - operating leases	35,197	25,200
Self-insurance reserve	77,169	62,113
Other noncurrent liabilities	11,343	12,268
Total liabilities	441,925	410,402
Commitments and contingencies (Note P)		
Redeemable common shares related to 401KSOP and Employee Stock Ownership Plan (ESOP); 5,174 and 5,147 shares at redemption value as of September 26, 2020 and December 31, 2019	128,834	124,555
Common shareholders' equity:		
Common shares, \$1.00 par value, per share; 48,000 shares authorized; 37,740 and 37,767 shares issued and outstanding before deducting treasury shares and which excludes 5,174 and 5,147 shares subject to redemption as of September 26, 2020 and December 31, 2019	37,740	37,767
Additional paid-in capital	104,223	96,366
Retained earnings	229,057	179,770
Accumulated other comprehensive loss	(5,928)	(5,403)
	365,092	308,500
Less: Cost of common shares held in treasury; 20,065 shares at September 26, 2020 and 19,737 shares at December 31, 2019	264,167	246,595
Total common shareholders' equity	100,925	61,905
Total liabilities and shareholders' equity	\$ 671,684	\$ 596,862

See notes to condensed consolidated financial statements (unaudited).

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands, except per share dollar amounts)

	Three Months Ended		Nine Months Ended	
	September 26, 2020	September 28, 2019	September 26, 2020	September 28, 2019
Revenues	\$ 337,453	\$ 307,473	\$ 944,980	\$ 856,796
Costs and expenses:				
Operating	208,510	193,137	597,963	546,931
Selling	60,203	56,921	162,287	153,854
General and administrative	19,891	19,895	60,477	57,610
Depreciation and amortization	13,825	15,319	42,553	44,121
Gain on sale of assets, net	(476)	(582)	(2,045)	(1,751)
Total costs and expenses	301,953	284,690	861,235	800,765
Income from operations	35,500	22,783	83,745	56,031
Other income (expense):				
Interest expense	(1,579)	(2,018)	(5,477)	(6,597)
Interest income	1,688	94	1,885	270
Other, net	(1,499)	(1,886)	(4,550)	(6,694)
Income before income taxes	34,110	18,973	75,603	43,010
Income taxes	9,483	5,539	21,018	10,322
Net income	\$ 24,627	\$ 13,434	\$ 54,585	\$ 32,688
Net income per share:				
Basic	\$ 1.08	\$.59	\$ 2.38	\$ 1.43
Diluted	\$ 1.03	\$.56	\$ 2.27	\$ 1.37
Weighted-average shares outstanding:				
Basic	22,874	22,793	22,956	22,830
Diluted	23,854	24,002	24,002	23,927

See notes to condensed consolidated financial statements (unaudited).

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands)

	Three Months Ended		Nine Months Ended	
	September 26, 2020	September 28, 2019	September 26, 2020	September 28, 2019
Net income	\$ 24,627	\$ 13,434	\$ 54,585	\$ 32,688
Components of other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	629	(384)	(610)	823
Amortization of defined benefit pension items:				
Net actuarial loss (gain)	16	5	49	(1,461)
Prior service cost	13	12	36	36
Defined benefit pension plan adjustments	29	17	85	(1,425)
Other comprehensive income (loss), net of tax	<u>658</u>	<u>(367)</u>	<u>(525)</u>	<u>(602)</u>
Comprehensive income	<u>\$ 25,285</u>	<u>\$ 13,067</u>	<u>\$ 54,060</u>	<u>\$ 32,086</u>

See notes to condensed consolidated financial statements (unaudited).

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)
(In thousands, except per share data)

	Common Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Common Shares Held in Treasury	Total Common Shareholders' Equity
Balances at June 27, 2020	\$ 37,784	\$ 103,291	\$ 204,999	\$ (6,586)	\$ (262,210)	\$ 77,278
Net income	—	—	24,627	—	—	24,627
Change in 401KSOP and ESOP related shares	(44)	(1,067)	—	—	—	(1,111)
Shares sold to employees	—	1,119	—	—	1,058	2,177
Options exercised	—	84	—	—	458	542
Stock-based compensation	—	796	—	—	—	796
Dividends, \$.025 per share	—	—	(569)	—	—	(569)
Currency translation adjustments	—	—	—	629	—	629
Defined benefit pension plans	—	—	—	29	—	29
Shares purchased	—	—	—	—	(3,473)	(3,473)
Balances at September 26, 2020	\$ 37,740	\$ 104,223	\$ 229,057	\$ (5,928)	\$ (264,167)	\$ 100,925
Balances at January 1, 2020	\$ 37,767	\$ 96,366	\$ 179,770	\$ (5,403)	\$ (246,595)	\$ 61,905
Net income	—	—	54,585	—	—	54,585
Change in 401KSOP and ESOP related shares	(27)	(661)	(3,590)	—	—	(4,278)
Shares sold to employees	—	7,269	—	—	8,053	15,322
Options exercised	—	(489)	—	—	1,864	1,375
Stock-based compensation	—	1,738	—	—	—	1,738
Dividends, \$.075 per share	—	—	(1,708)	—	—	(1,708)
Currency translation adjustments	—	—	—	(610)	—	(610)
Defined benefit pension plans	—	—	—	85	—	85
Shares purchased	—	—	—	—	(27,489)	(27,489)
Balances at September 26, 2020	\$ 37,740	\$ 104,223	\$ 229,057	\$ (5,928)	\$ (264,167)	\$ 100,925

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)
(In thousands, except per share data)

	Common Shares	Additional Paid-in Capital	Common Shares Subscribed, Unissued	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Common Shares Held in Treasury	Common Shares Subscription Receivable	Total Common Shareholders' Equity
Balances at June 29, 2019	\$ 37,617	\$ 91,921	\$ 5,948	\$ 167,611	\$ (5,269)	\$ (245,116)	\$ (431)	\$ 52,281
Net income	—	—	—	13,434	—	—	—	13,434
Change in 401KSOP and ESOP related shares	6	(61)	—	—	—	—	—	(55)
Shares sold to employees	—	193	—	—	—	250	—	443
Options exercised	—	216	—	—	—	283	—	499
Subscription shares	—	(1,413)	(5,838)	—	—	7,258	417	424
Stock-based compensation	—	592	—	—	—	—	—	592
Dividends, \$.025 per share	—	—	—	(575)	—	—	—	(575)
Currency translation adjustments	—	—	—	—	(384)	—	—	(384)
Defined benefit pension plans	—	—	—	—	17	—	—	17
Shares purchased	—	—	—	—	—	(4,306)	—	(4,306)
Balances at September 28, 2019	\$ 37,623	\$ 91,448	\$ 110	\$ 180,470	\$ (5,636)	\$ (241,631)	\$ (14)	\$ 62,370
Balances at January 1, 2019	\$ 37,272	\$ 82,623	\$ 6,799	\$ 157,472	\$ (5,034)	\$ (235,042)	\$ (729)	\$ 43,361
Net income	—	—	—	32,688	—	—	—	32,688
Change in 401KSOP and ESOP related shares	351	6,886	—	(7,945)	—	—	—	(708)
Shares sold to employees	—	3,754	—	—	—	5,794	—	9,548
Options exercised	—	(793)	—	—	—	2,572	—	1,779
Subscription shares	—	(1,981)	(6,689)	—	—	10,480	715	2,525
Stock-based compensation	—	959	—	—	—	—	—	959
Dividends, \$.075 per share	—	—	—	(1,745)	—	—	—	(1,745)
Currency translation adjustments	—	—	—	—	823	—	—	823
Defined benefit pension plans	—	—	—	—	(1,425)	—	—	(1,425)
Shares purchased	—	—	—	—	—	(25,435)	—	(25,435)
Balances at September 28, 2019	\$ 37,623	\$ 91,448	\$ 110	\$ 180,470	\$ (5,636)	\$ (241,631)	\$ (14)	\$ 62,370

See notes to condensed consolidated financial statements (unaudited).

THE DAVEY TREE EXPERT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Nine Months Ended	
	September 26, 2020	September 28, 2019
Operating activities		
Net income	\$ 54,585	\$ 32,688
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42,553	44,121
Other	108	(1,106)
Changes in operating assets and liabilities, net of assets acquired:		
Accounts receivable	(34,801)	(35,956)
Accounts payable and accrued expenses	28,389	18,691
Self-insurance reserve	14,424	5,952
Prepaid expenses	(7,506)	(10,388)
Other, net	1,676	3,212
	<u>44,843</u>	<u>24,526</u>
Net cash provided by operating activities	99,428	57,214
Investing activities		
Capital expenditures:		
Equipment	(38,071)	(45,148)
Land and buildings	(2,408)	(1,108)
Purchases of businesses, net of cash acquired and debt incurred	(3,826)	(3,800)
Proceeds from sales of fixed assets	2,691	2,502
	<u>(41,614)</u>	<u>(47,554)</u>
Net cash used in investing activities	(41,614)	(47,554)
Financing activities		
Revolving credit facility borrowings	522,500	358,000
Revolving credit facility payments	(554,500)	(386,500)
Purchase of common shares for treasury	(27,489)	(25,435)
Sale of common shares from treasury	16,698	13,852
Dividends paid	(1,708)	(1,745)
Proceeds from notes payable	152,128	95,200
Payments of notes payable	(149,843)	(71,027)
Payments of finance leases	(1,525)	(1,061)
	<u>(43,739)</u>	<u>(18,716)</u>
Net cash used in financing activities	(43,739)	(18,716)
Effect of exchange rate changes on cash	(17)	97
Increase (Decrease) in cash	14,058	(8,959)
Cash, beginning of period	11,000	22,661
	<u>Cash, end of period</u>	<u>\$ 25,058</u>
	<u>\$</u>	<u>\$ 13,702</u>
Supplemental cash flow information follows:		
Interest paid	\$ 6,408	\$ 7,355
Income taxes paid	17,055	2,239

See notes to condensed consolidated financial statements (unaudited).

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

A. Basis of Financial Statement Preparation

The condensed consolidated financial statements present the financial position, results of operations and cash flows of The Davey Tree Expert Company and its subsidiaries. When we refer to “we,” “us,” “our,” “Davey,” or “Davey Tree”, we mean The Davey Tree Expert Company and its subsidiaries, unless otherwise expressly stated or the context indicates otherwise.

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”), as codified in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), and with the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information. The condensed consolidated financial statements include all adjustments which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are of a normal, recurring nature. All intercompany accounts and transactions have been eliminated.

Certain information and disclosures required by U.S. GAAP for complete financial statements have been omitted in accordance with the rules and regulations of the SEC. We suggest that these condensed consolidated financial statements be read in conjunction with the financial statements included in our annual report on Form 10-K for the year ended December 31, 2019 (the “2019 Annual Report”).

Use of Estimates in Financial Statement Preparation--The preparation of financial statements in accordance with U.S. GAAP requires the use of estimates and assumptions that affect reported amounts. Our condensed consolidated financial statements include amounts that are based on management’s best estimates and judgments. Estimates are used for, but not limited to, accounts receivable valuation, depreciable lives of fixed assets, self-insurance reserves, income taxes and revenue recognition. Actual results could differ from those estimates.

While the coronavirus (“COVID-19”) pandemic did not have a material adverse effect on our reported results for the first nine months of our fiscal year, the overall extent and duration of the impact of COVID-19 on businesses and economic activity generally remains unclear. The extent to which our operations may be impacted by COVID-19 will depend largely on future developments, which are highly uncertain due to its continual evolution, such as the current widespread resurgence of cases, and cannot be accurately predicted, including new information which may emerge concerning the severity of the outbreak and actions by government authorities to contain the pandemic or treat its impact, including reimposing previously-lifted measures and the possibility additional measures will be put in place, among other things.

The Company’s fiscal quarters each contain thirteen operating weeks, with the exception of the fourth quarter of a 53-week fiscal year, which contains fourteen operating weeks. The Company’s fiscal quarter that ended September 26, 2020 is referred to as the third quarter of 2020, and the fiscal quarter ended September 28, 2019 is referred to as the third quarter of 2019.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Recent Accounting Guidance

Accounting Standards Adopted in 2020

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326)--In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)." ASU 2016-13 replaced the incurred loss impairment methodology in U.S. GAAP for most financial instruments, including trade receivables, with an impairment model, known as the current expected credit loss model, that is based on expected losses rather than incurred losses. The Company adopted the new standard effective January 1, 2020, and it did not have a material effect on the Company's results of operations.

Accounting Standards Not Yet Adopted

Accounting Standards Update 2019-12, Income Taxes (Topic 740)– Simplifying the Accounting for Income Taxes--In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (ASU 2019-12)", which simplifies the accounting for income taxes by removing certain exceptions to the general principles in ASC 740 and also clarifies and amends existing guidance to improve consistent application. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020, including applicable interim periods. The Company will adopt ASU 2019-12 beginning January 1, 2021. The adoption of ASU 2019-12 is not anticipated to have a material effect on the Company's financial statements.

B. Seasonality of Business

Due to the seasonality of our business, our operating results for the three and nine months ended September 26, 2020 are not indicative of results that may be expected for any other interim period or for the year ending December 31, 2020. Our business seasonality traditionally results in higher revenues during the second and third quarters as compared with the first and fourth quarters of the year, while the methods of accounting for fixed costs, such as depreciation expense, amortization, rent and interest expense, are not significantly impacted by business seasonality.

C. Accounts Receivable, Net and Supplemental Balance-Sheet Information

Accounts receivable, net, consisted of the following:

Accounts receivable, net	September 26, 2020	December 31, 2019
Accounts receivable	\$ 199,749	\$ 176,849
Unbilled Receivables ⁽¹⁾	69,810	58,277
	<u>269,559</u>	<u>235,126</u>
Less allowances for doubtful accounts	3,871	3,815
Accounts receivable, net	<u>\$ 265,688</u>	<u>\$ 231,311</u>

⁽¹⁾ Unbilled Receivables consist of work-in-process in accordance with the terms of contracts, primarily with utility services customers.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The following items comprise the amounts included in the balance sheets:

	September 26, 2020	December 31, 2019
Other current assets		
Refundable income taxes	\$ 333	\$ 339
Prepaid expenses	33,123	25,664
Other	593	984
Total	<u>\$ 34,049</u>	<u>\$ 26,987</u>
Property and equipment, net		
Land and land improvements	\$ 19,218	\$ 19,270
Buildings and leasehold improvements	46,693	44,414
Equipment	622,205	604,211
	688,116	667,895
Less accumulated depreciation	482,822	468,045
Total	<u>\$ 205,294</u>	<u>\$ 199,850</u>
Other assets, noncurrent		
Assets invested for self-insurance	\$ 15,359	\$ 15,426
Investment--cost-method affiliate	1,258	1,314
Other	4,681	5,595
Total	<u>\$ 21,298</u>	<u>\$ 22,335</u>
Accrued expenses		
Employee compensation	\$ 29,642	\$ 26,381
Accrued compensated absences	10,831	10,744
Self-insured medical claims	4,296	1,824
Income tax payable	10,451	6,420
Customer advances, deposits	1,528	1,674
Taxes, other than income	20,990	1,775
Other	2,483	3,613
Total	<u>\$ 80,221</u>	<u>\$ 52,431</u>
Other current liabilities		
Notes payable	\$ 338	\$ 1,853
Current portion of:		
Lease liability-operating leases	17,933	14,665
Self-insurance reserve	30,246	30,882
Total	<u>\$ 48,517</u>	<u>\$ 47,400</u>

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Other noncurrent liabilities	September 26, 2020	December 31, 2019
Pension and retirement plans	\$ 6,943	\$ 6,552
Deferred income taxes	649	567
Other	3,751	5,149
Total	<u>\$ 11,343</u>	<u>\$ 12,268</u>

D. Business Combinations

Our investments in businesses during the first nine months of 2020 were \$5,240, including liabilities assumed of \$380 and debt issued, in the form of notes payable to the sellers, of \$1,034, and have been included in our Residential and Commercial segment. Measurement-period adjustments are not complete. The measurement period for purchase price allocations ends as soon as information of the facts and circumstances becomes available, but does not exceed one year from the acquisition date. During the nine months ended September 28, 2019, our investment in businesses was \$5,527, including liabilities assumed of \$402 and debt issued, in the form of notes payable to the sellers, of \$1,322.

The following table summarizes the preliminary purchase price allocation of the estimated fair values of the assets acquired and liabilities assumed:

Detail of acquisitions:	September 26, 2020	December 31, 2019
Assets acquired:		
Cash	\$ —	\$ 3
Receivables	—	2,332
Operating supplies	23	84
Prepaid expense	—	27
Equipment	623	1,837
Deposits and other	—	96
Intangibles	2,018	4,067
Goodwill	2,576	4,174
Liabilities assumed	(380)	(1,479)
Debt issued for purchases of businesses	(1,034)	(2,612)
Cash paid	<u>\$ 3,826</u>	<u>\$ 8,529</u>

The results of operations of acquired businesses have been included in the condensed consolidated statements of operations beginning as of the effective dates of acquisition. The effect of these acquisitions on our consolidated revenues and results of operations for the period ended September 26, 2020 was not significant. Pro forma net sales and results of operations for the acquisitions, had they occurred at the beginning of the nine months ended September 26, 2020, are not material and, accordingly, are not provided.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The acquired intangible assets consist of tradenames, non-competition agreements and customer relationships. The tradenames and customer relationships were assigned an average useful life of six years and the non-competition agreements were assigned an average useful life of five years.

E. Identified Intangible Assets and Goodwill, Net

The carrying amounts of the identified intangible assets and goodwill acquired in connection with our acquisitions were as follows:

	<u>September 26, 2020</u>		<u>December 31, 2019</u>	
	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:				
Customer lists/relationships	\$ 29,803	\$ 21,528	\$ 28,301	\$ 20,024
Employment-related	8,684	7,651	8,391	7,348
Tradenames	7,629	6,091	7,402	5,788
Amortized intangible assets	46,116	<u>\$ 35,270</u>	44,094	<u>\$ 33,160</u>
Less accumulated amortization	35,270		33,160	
Identified intangible assets, net	<u>\$ 10,846</u>		<u>\$ 10,934</u>	
Goodwill		<u>\$ 45,152</u>		<u>\$ 42,285</u>

The changes in the carrying amounts of goodwill, by segment, for the nine months ended September 26, 2020 and September 28, 2019 follow:

	<u>Balance at January 1, 2020</u>	<u>Acquisitions</u>	<u>Translation and Other Adjustments</u>	<u>Balance at September 26, 2020</u>
Utility	\$ 4,911	\$ —	\$ —	\$ 4,911
Residential and Commercial	37,374	2,576	291	40,241
Total	<u>\$ 42,285</u>	<u>\$ 2,576</u>	<u>\$ 291</u>	<u>\$ 45,152</u>

	<u>Balance at January 1, 2019</u>	<u>Acquisitions</u>	<u>Translation and Other Adjustments</u>	<u>Balance at September 28, 2019</u>
Utility	\$ 4,911	\$ —	\$ —	\$ 4,911
Residential and Commercial	33,060	1,798	129	34,987
Total	<u>\$ 37,971</u>	<u>\$ 1,798</u>	<u>\$ 129</u>	<u>\$ 39,898</u>

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Estimated future aggregate amortization expense of intangible assets--The estimated future aggregate amortization expense of intangible assets, as of September 26, 2020 was as follows:

	Estimated Future Amortization Expense
Remaining three months of 2020	\$ 700
2021	2,475
2022	2,244
2023	2,076
2024	1,601
Thereafter	1,750
	<u>\$ 10,846</u>

F. Long-Term Debt and Commitments Related to Letters of Credit

Our long-term debt consisted of the following:

	September 26, 2020	December 31, 2019
Revolving credit facility:		
Swing-line borrowings	\$ 18,000	\$ 10,000
LIBOR borrowings	12,000	52,000
	<u>30,000</u>	<u>62,000</u>
Senior unsecured notes:		
5.09% Senior unsecured notes	—	6,000
3.99% Senior unsecured notes	50,000	50,000
4.00% Senior unsecured notes	25,000	25,000
	<u>75,000</u>	<u>81,000</u>
Term loans	34,907	24,076
	<u>139,907</u>	<u>167,076</u>
Less debt issuance costs	291	420
Less current portion	33,065	23,302
	<u>\$ 106,551</u>	<u>\$ 143,354</u>

Revolving Credit Facility --As of September 26, 2020, we had a \$250,000 revolving credit facility with a group of banks, which expires in October 2022 and permits borrowings, as defined, up to \$250,000, including a letter of credit sublimit of \$100,000 and a swing-line commitment of \$25,000. Under certain circumstances, the amount available under the revolving credit facility may be increased to \$325,000. The revolving credit facility contains certain affirmative and negative covenants customary for this type of facility and includes financial covenant ratios with respect to a maximum leverage ratio (not to exceed 3.00 to 1.00 with exceptions in case of material acquisitions) and a minimum interest coverage ratio (not less than 3.00 to 1.00), in each case subject to certain further restrictions as described in the credit agreement. As of September 26, 2020, we had unused commitments under the facility approximating \$217,123, with \$32,877 committed, consisting of borrowings of \$30,000 and issued letters of credit of \$2,877.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Borrowings outstanding bear interest, at Davey Tree's option, of either (a) base rate or (b) LIBOR plus a margin adjustment ranging from .875% to 1.50%--with the margin adjustments based on the Company's leverage ratio at the time of borrowing. The base rate is the greater of (i) the agent bank's prime rate, (ii) LIBOR plus 1.50%, or (iii) the federal funds rate plus .50%. A commitment fee ranging from .10% to .225% is also required based on the average daily unborrowed commitment.

5.09% Senior Unsecured Notes--During July 2010, we issued 5.09% Senior Unsecured Notes, Series A (the "5.09% Senior Notes"), in the aggregate principal amount of \$30,000 pursuant to a Master Note Purchase Agreement (the "Purchase Agreement") between the Company and the purchasers of the 5.09% Senior Notes. The 5.09% Senior Notes were due and repaid in full on July 22, 2020.

The 5.09% Senior Notes were equal in right of payment with our revolving credit facility and all other senior unsecured obligations of the Company. Interest was payable semiannually and five equal, annual principal payments commenced on July 22, 2016 (the sixth anniversary of issuance). The Purchase Agreement contained customary events of default and covenants related to limitations on indebtedness and transactions with affiliates and the maintenance of certain financial ratios.

3.99% Senior Unsecured Notes--On September 21, 2018, we issued 3.99% Senior Notes, Series A (the "3.99% Senior Notes"), in the aggregate principal amount of \$50,000. The 3.99% Senior Notes are due September 21, 2028.

The 3.99% Senior Notes were issued pursuant to a Note Purchase and Private Shelf Agreement (the "Note Purchase and Shelf Agreement") between the Company, PGIM, Inc. and the purchasers of the 3.99% Senior Notes. Subsequent series of promissory notes may be issued pursuant to the Note Purchase and Shelf Agreement (the "Shelf Notes") in an aggregate additional principal amount not to exceed \$50,000 (\$25,000 of which was issued on February 5, 2019).

The 3.99% Senior Notes are equal in right of payment with our revolving credit facility and all other senior unsecured obligations of the Company. Interest is payable semiannually and five equal, annual principal payments commence on September 21, 2024 (the sixth anniversary of issuance). The Note Purchase and Shelf Agreement contains customary events of default and covenants related to limitations on indebtedness and transactions with affiliates and the maintenance of certain financial ratios. The Company may prepay at any time all, or from time to time any part of, the outstanding principal amount of the 3.99% Senior Notes, subject to the payment of a make-whole amount.

In conjunction with the issuance of the 3.99% Senior Notes, on September 21, 2018, the Company entered into an amendment to its revolving credit facility. The amendment amended certain provisions and covenants in the credit agreement to generally conform them to the corresponding provisions and covenants in the Note Purchase and Shelf Agreement. The amendment also permitted the Company to incur indebtedness arising under the Note Purchase and Shelf Agreement in an aggregate principal amount not to exceed \$75,000, which included the \$50,000 of 3.99% Senior Notes, plus an additional \$25,000 in Shelf Notes (which were issued on February 5, 2019).

4.00% Senior Unsecured Notes--On February 5, 2019, we issued 4.00% Senior Notes, Series B (the "4.00% Senior Notes") pursuant to the Note Purchase and Shelf Agreement in the aggregate principal amount of \$25,000. The 4.00% Senior Notes are due September 21, 2028. Subsequent series of Shelf Notes may be issued pursuant to the Note Purchase and Shelf Agreement in an aggregate additional principal amount not to exceed \$25,000. A further amendment to the revolving credit facility would be required for such a transaction to be permissible under the revolving credit facility. The 4.00% Senior Notes are equal in right of payment with our revolving credit facility and

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

all other senior unsecured obligations of the Company. Interest is payable semiannually and five equal, annual principal payments commence on September 21, 2024.

The net proceeds of all senior notes were used to pay down borrowings under our revolving credit facility.

Term loans--Periodically, the Company will enter into term loans for the procurement of insurance or to finance acquisitions.

Aggregate Maturities of Long-Term Debt--Aggregate maturities of long-term debt based on the principal amounts outstanding at September 26, 2020 were as follows: 2020--\$8,025; 2021--\$25,768; 2022--\$30,942; 2023--\$172; 2024--\$15,000; and thereafter \$60,000.

Accounts Receivable Securitization Facility--In May 2020, the Company amended its Accounts Receivable Securitization Facility (the "AR Securitization program") to extend the scheduled termination date for an additional one year period, to May 18, 2021. In addition to extending the termination date, the Amendment included a change to the letter of credit ("LC") issuance fee payable under the terms of the agreement.

The AR Securitization program has a limit of \$100,000, of which \$83,355 and \$76,732 were issued for LCs as of September 26, 2020 and December 31, 2019, respectively.

Under the AR Securitization program, Davey Tree transfers by selling or contributing current and future trade receivables to a wholly-owned, bankruptcy-remote financing subsidiary which pledges a perfected first priority security interest in the trade receivables--equal to the issued LCs as of September 26, 2020--to the bank in exchange for the bank issuing LCs.

Pre-petition receivables from PG&E Corporation and its regulated utility subsidiary, Pacific Gas and Electric Company (collectively, "PG&E"), which had filed voluntary bankruptcy petitions under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of California on January 29, 2019 and successfully emerged from bankruptcy on July 1, 2020, while remaining in the securitized pool, are considered ineligible and are excluded from performance ratios and reserves.

Fees payable to the bank include: (a) an LC issuance fee, payable on each settlement date, in the amount of 1.00% per annum (.90% previously) on the aggregate amount of all LCs outstanding plus outstanding reimbursement obligations (e.g., arising from drawn LCs), if any, and (b) an unused LC fee, payable monthly, equal to (i) .35% per annum for each day on which the sum of the total LCs outstanding plus any outstanding reimbursement obligations is greater than or equal to 50% of the facility limit and (ii) .45% per annum for each day on which the sum of the total LCs outstanding plus any outstanding reimbursement obligations is less than 50% of the facility limit. If an LC is drawn and the bank is not immediately reimbursed in full for the drawn amount, any outstanding reimbursement obligation will accrue interest at a per annum rate equal to a reserve-adjusted LIBOR or, in certain circumstances, a base rate equal to the higher of (i) the bank's prime rate and (ii) the federal funds rate plus .50% and, following any default, 2.00% plus the greater of (a) adjusted LIBOR and (b) a base rate equal to the higher of (i) the bank's prime rate and (ii) the federal funds rate plus .50%.

The agreements underlying the AR Securitization program contain various customary representations and warranties, covenants, and default provisions which provide for the termination and acceleration of the commitments under the AR Securitization program in circumstances including, but not limited to, failure to make payments when due, breach of a representation, warranty or covenant, certain insolvency events or failure to maintain the security interest in the trade receivables, and defaults under other material indebtedness.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Total Commitments Related to Issued Letters of Credit--As of September 26, 2020, total commitments related to issued LCs were \$88,242, of which \$2,877 were issued under the revolving credit facility, \$83,355 were issued under the AR Securitization program, and \$2,010 were issued under short-term lines of credit. As of December 31, 2019, total commitments related to issued LCs were \$81,619, of which \$2,877 were issued under the revolving credit facility, \$76,732 were issued under the AR Securitization program, and \$2,010 were issued under short-term lines of credit.

As of September 26, 2020, we were in compliance with all debt covenants.

G. Leases

We lease certain office and parking facilities, warehouse space, equipment, vehicles and information technology equipment under operating leases. Lease expense for these leases is recognized within the Condensed Consolidated Statements of Operations on a straight-line basis over the lease term, with variable lease payments recognized in the period those payments are incurred. The following table summarizes the amounts recognized in our Condensed Consolidated Balance Sheet related to leases:

	Condensed Consolidated Balance Sheet Classification	September 26, 2020	December 31, 2019
Assets			
Operating lease assets	Right-of-use assets - operating leases	\$ 53,315	\$ 40,033
Finance lease assets	Property and equipment, net	9,118	3,183
Total lease assets		\$ 62,433	\$ 43,216
Liabilities			
Current operating lease liabilities	Other current liabilities	\$ 17,933	\$ 14,665
Non-current operating lease liabilities	Lease liabilities - operating leases	35,197	25,200
Total operating lease liabilities		53,130	39,865
Current portion of finance lease liabilities	Current portion of long-term debt and finance lease liabilities	2,290	1,348
Non-current finance lease liabilities	Lease liabilities - finance leases	6,667	1,795
Total finance lease liabilities		8,957	3,143
Total lease liabilities		\$ 62,087	\$ 43,008

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The components of lease cost recognized within our Condensed Consolidated Statements of Operations were as follows:

	Condensed Consolidated Statements of Operations Classification	Three Months Ended		Nine Months Ended	
		September 26, 2020	September 28, 2019	September 26, 2020	September 28, 2019
Operating lease cost	Operating expense	\$ 2,877	\$ 1,845	\$ 7,776	\$ 4,912
Operating lease cost	Selling expense	2,322	2,188	7,127	6,513
Operating lease cost	General and administrative expense	389	214	844	617
Finance lease cost:					
Amortization of right-of-use assets	Depreciation and amortization	570	339	1,404	1,024
Interest expense on lease liabilities	Interest expense	45	28	103	91
Other lease cost ⁽¹⁾	Operating expense	1,216	855	3,895	2,585
Other lease cost ⁽¹⁾	Selling expense	284	195	953	811
Other lease cost ⁽¹⁾	General and administrative expense	13	12	31	15
Total lease cost		<u>\$ 7,716</u>	<u>\$ 5,676</u>	<u>\$ 22,133</u>	<u>\$ 16,568</u>

⁽¹⁾ Other lease cost includes short-term lease costs and variable lease costs.

We often have options to renew lease terms for buildings and other assets. The exercise of lease renewal options is generally at our sole discretion. In addition, certain lease agreements may be terminated prior to their original expiration date at our discretion. We evaluate each renewal and termination option at the lease commencement date to determine if we are reasonably certain to exercise the option on the basis of economic factors. The table below summarizes the weighted average remaining lease term as of September 26, 2020.

Operating leases	3.9 years
Finance leases	5.7 years

The discount rate implicit within our leases is generally not determinable and therefore the Company determines the discount rate based on its incremental borrowing rate. The incremental borrowing rate for each lease is determined based on its term and the currency in which lease payments are made, adjusted for the impacts of collateral. The table below summarizes the weighted average discount rate used to measure our lease liabilities as of September 26, 2020.

Operating leases	3.12 %
Finance leases	1.90 %

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Supplemental Cash Flow Information Related to Leases

	Nine Months Ended	
	September 26, 2020	September 28, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ (15,222)	\$ (12,524)
Operating cash flows from finance leases	(103)	(91)
Financing cash flows from finance leases	(1,525)	(1,061)
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	28,246	52,889
Finance leases	7,339	—

Maturity Analysis of Lease Liabilities

	As of September 26, 2020	
	Operating Leases	Finance Leases
Remaining three months of 2020	\$ 5,383	\$ 506
2021	18,060	2,357
2022	14,213	1,446
2023	7,995	1,246
2024	4,581	1,175
Thereafter	5,955	2,672
Total lease payments	56,187	9,402
Less interest	3,057	445
Total	<u>\$ 53,130</u>	<u>\$ 8,957</u>

H. Stock-Based Compensation

Our shareholders approved the 2014 Omnibus Stock Plan (the “2014 Stock Plan”) at our annual meeting of shareholders on May 20, 2014. The 2014 Stock Plan replaced the expired 2004 Omnibus Stock Plan (the “2004 plan”) previously approved by the shareholders in 2004. The 2014 Stock Plan is administered by the Compensation Committee of the Board of Directors and has a term of ten years. All directors of the Company and employees of the Company and its subsidiaries are eligible to participate in the 2014 Stock Plan. The 2014 Stock Plan (similar to the 2004 plan) continues the maintenance of the Employee Stock Purchase Plan, as well as provisions for the grant of stock options and other stock-based incentives. The 2014 Stock Plan provides for the grant of five percent of the number of the Company’s common shares outstanding as of the first day of each fiscal year plus the number of common shares that were available for grant of awards, but not granted, in prior years. In no event, however, may the number of common shares available for the grant of awards in any fiscal year exceed ten percent of the common shares outstanding as of the first day of that fiscal year. Common shares subject to an award that is forfeited, terminated, or canceled without having been exercised are generally added back to the number of shares available for grant under the 2014 Stock Plan.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Stock-based compensation expense under all share-based payment plans -- our Employee Stock Purchase Plan, stock option plans, stock-settled stock appreciation rights ("SSARs") and restricted stock units ("RSUs") -- was included in the results of operations as follows:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 26, 2020</u>	<u>September 28, 2019</u>	<u>September 26, 2020</u>	<u>September 28, 2019</u>
Compensation expense, all share-based payment plans	\$ 858	\$ 655	\$ 2,567	\$ 2,184

Stock-based compensation consisted of the following:

Employee Stock Purchase Plan--Under the Employee Stock Purchase Plan, all full-time employees with one year of service are eligible to purchase, through payroll deduction, common shares. Employee purchases under the Employee Stock Purchase Plan are at 85% of the fair market value of the common shares--a 15% discount. We recognize compensation costs as payroll deductions are made. The 15% discount of total shares purchased under the plan resulted in compensation cost of \$1,067 being recognized for the nine months ended September 26, 2020 and \$866 for the nine months ended September 28, 2019.

Stock Option Plans--The stock options outstanding were awarded under a graded vesting schedule, measured at fair value, and have a term of ten years. Compensation costs for stock options are recognized over the requisite service period on the straight-line recognition method. Compensation cost recognized for stock options was \$398 for the nine months ended September 26, 2020 and \$444 for the nine months ended September 28, 2019.

Stock-Settled Stock Appreciation Rights-- A SSAR is an award that allows the recipient to receive common shares equal to the appreciation in the fair market value of our common shares between the date the award was granted and the conversion date of the shares vested. Effective January 1, 2019, management and the Compensation Committee replaced the issuance of future SSARs with performance-based restricted stock units ("PRSUs") for certain management employees.

The following table summarizes our SSARs as of September 26, 2020.

Stock-Settled Stock Appreciation Rights	Number of Rights	Weighted- Average Award Date Value	Weighted- Average Remaining Contractual Life	Unrecognized Compensation Cost	Aggregate Intrinsic Value
Unvested, January 1, 2020	262,705	\$ 3.47			
Granted	—	—			
Forfeited	(2,254)	3.53			
Vested	(119,255)	3.32			
Unvested, September 26, 2020	<u>141,196</u>	<u>\$ 3.60</u>	<u>1.1 years</u>	<u>\$ 309</u>	<u>\$ 3,516</u>

Compensation costs for SSARs are determined using a fair-value method and amortized over the requisite service period. "Intrinsic value" is defined as the amount by which the fair market value of a common share exceeds the grant date price of a SSAR. Compensation expense for SSARs was \$214 for the nine months ended September 26, 2020 and \$269 for the nine months ended September 28, 2019.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Restricted Stock Units--During the nine months ended September 26, 2020, the Compensation Committee awarded 86,959 PRSUs to certain management employees and 11,904 RSUs to nonemployee directors. The Compensation Committee made similar awards in prior periods. The awards vest over specified periods. The following table summarizes PRSUs and RSUs as of September 26, 2020.

Restricted Stock Units	Number of Stock Units	Weighted- Average Grant Date Value	Weighted- Average Remaining Contractual Life	Unrecognized Compensation Cost	Aggregate Intrinsic Value
Unvested, January 1, 2020	224,259	\$ 17.11			
Granted	98,863	23.74			
Forfeited	(1,871)	17.37			
Vested	(65,944)	15.52			
Unvested, September 26, 2020	<u>255,307</u>	<u>\$ 20.09</u>	<u>2.7 years</u>	<u>\$ 3,056</u>	<u>\$ 6,357</u>
Employee PRSUs	<u>220,157</u>	<u>\$ 19.92</u>	<u>3.0 years</u>	<u>\$ 2,622</u>	<u>\$ 5,482</u>
Nonemployee Director RSUs	<u>35,150</u>	<u>\$ 21.14</u>	<u>1.6 years</u>	<u>\$ 434</u>	<u>\$ 875</u>

Compensation cost for PRSUs and RSUs is determined using a fair-value method and amortized on the straight-line recognition method over the requisite service period. "Intrinsic value" is defined as the amount by which the fair market value of a common share exceeds the grant date price of a PRSU or an RSU. Compensation expense on PRSUs and RSUs totaled \$888 for the nine months ended September 26, 2020 and \$605 for the nine months ended September 28, 2019.

We estimated the fair value of each stock-based award on the date of grant using a binomial option-pricing model. The binomial model considers a range of assumptions related to volatility, risk-free interest rate and employee exercise behavior. Expected volatilities utilized in the binomial model are based on historical volatility of our stock prices and other factors. Similarly, the dividend yield is based on historical experience and expected future changes. The binomial model also incorporates exercise and forfeiture assumptions based on an analysis of historical data. The expected life of the stock-based awards is derived from the output of the binomial model and represents the period of time that awards granted are expected to be outstanding.

The fair values of stock-based awards granted were estimated at the dates of grant with the following weighted-average assumptions.

	Nine Months Ended	
	September 26, 2020	September 28, 2019
Volatility rate	9.7 %	9.9 %
Risk-free interest rate	.7 %	2.3 %
Expected dividend yield	.4 %	.7 %
Expected life of awards (years)	8.1	8.8

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

General Stock Option Information--The following table summarizes activity under the stock option plans for the nine months ended September 26, 2020.

Stock Options	Number of Options Outstanding	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, January 1, 2020	1,428,082	\$ 15.13		
Granted	174,897	24.20		
Exercised	(83,769)	10.94		
Forfeited	(21,645)	19.15		
Outstanding, September 26, 2020	<u>1,497,565</u>	\$ 16.36	5.6 years	<u>\$ 12,789</u>
Exercisable, September 26, 2020	<u>1,028,683</u>	\$ 14.26	4.4 years	<u>\$ 10,940</u>

As of September 26, 2020, there was approximately \$1,426 of unrecognized compensation cost related to stock options outstanding. The cost is expected to be recognized over a weighted-average period of 2.8 years. "Intrinsic value" is defined as the amount by which the market price of a common share exceeds the exercise price of an option.

Common shares are issued from treasury upon the exercise of stock options, SSARs, RSUs, PRSUs or purchases under the Employee Stock Purchase Plan.

I. Net Periodic Benefit Expense--Defined Benefit Pension Plans

The results of operations included the following net periodic benefit expense (income) recognized related to our defined-benefit pension plans.

	Three Months Ended		Nine Months Ended	
	September 26, 2020	September 28, 2019	September 26, 2020	September 28, 2019
Components of pension expense (income)				
Service costs--increase in benefit obligation earned	\$ —	\$ —	\$ —	\$ 75
Interest cost on projected benefit obligation	26	31	79	167
Expected return on plan assets	—	—	—	(37)
Settlement loss	—	—	—	1,677
Amortization of net actuarial loss	22	6	66	81
Amortization of prior service cost	16	16	48	48
Net pension expense of defined benefit pension plans	<u>\$ 64</u>	<u>\$ 53</u>	<u>\$ 193</u>	<u>\$ 2,011</u>

During April 2019, we entered into an agreement to purchase a guaranteed group annuity contract from a third-party insurance company which unconditionally and irrevocably guarantees the full-payment of all annuity payments to the remaining 231 participants in our Employee Retirement Plan ("ERP") for which benefits were frozen effective December 31, 2008. The April 2019 agreement transferred all remaining ERP benefit obligations to the third-party insurance company, resulting in a pretax actuarial settlement loss of \$1,677.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The components of net periodic benefit expense, other than the service cost component, are included in the line item other income (expense) in the statement of operations.

J. Income Taxes

Our income tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate and, if our estimated annual tax rate changes, we make a cumulative adjustment. The estimated annual effective tax rate for the nine months ended September 26, 2020 was 27.7%. Our annual effective tax rate for the nine months ended September 28, 2019 was estimated at 24.0%. Our actual effective tax rate was 27.8% and 29.2% for the three months ended September 26, 2020 and September 28, 2019, respectively. Our effective tax rate was 27.8% and 24.0% for the nine months ended September 26, 2020 and September 28, 2019, respectively. The change in the effective tax rate from statutory tax rates is primarily due to the impact of state and local taxes which are partially offset by favorable discrete items.

On March 27, 2020, Congress approved and the President signed the Coronavirus Aid, Relief, and Economic Security ("CARES") Act into law. The CARES Act is a tax-and-spending package intended to provide economic relief to address the impact of the COVID-19 pandemic. The Company is currently evaluating several significant business tax provisions, such as net operating losses and employee retention credits to determine the impact on the Company.

As of September 26, 2020, we had unrecognized tax benefits of \$1,639, of which \$713 would affect our effective rate if recognized, and accrued interest expense related to unrecognized benefits of \$69. At December 31, 2019, we had unrecognized tax benefits of \$1,850, of which \$654 would affect our effective rate if recognized, and accrued interest expense related to unrecognized benefits of \$64. Unrecognized tax benefits are the differences between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for financial reporting purposes.

We recognize interest accrued related to unrecognized tax benefits in income tax expense. Penalties, if incurred, would be recognized as a component of income tax expense.

The Company is routinely under audit by U.S. federal, state, local and Canadian authorities in the area of income tax. These audits include questioning the timing and the amount of income and deductions and the allocation of income and deductions among various tax jurisdictions. With the exception of U.S. state jurisdictions and Canada, the Company is no longer subject to examination by tax authorities for the years through 2016. As of September 26, 2020, we believe it is reasonably possible that the total amount of unrecognized tax benefits will not significantly increase or decrease.

K. Accumulated Other Comprehensive Income (Loss)

Comprehensive income (or loss) is comprised of net income (or net loss) and other components, including foreign currency translation adjustments and defined benefit pension plan adjustments.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The following summarizes the components of other comprehensive income (loss) accumulated in shareholders' equity for the three and nine months ended September 26, 2020 and the three and nine months ended September 28, 2019:

Three Months Ended September 26, 2020	Foreign Currency Translation Adjustments	Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Balance at June 27, 2020	\$ (5,872)	\$ (714)	\$ (6,586)
Other comprehensive income (loss) before reclassifications			
Unrealized gains (losses)	\$ 629	\$ —	\$ 629
Amounts reclassified from accumulated other comprehensive income (loss)	—	38	38
Tax effect	—	(9)	(9)
Net of tax amount	629	29	658
Balance at September 26, 2020	\$ (5,243)	\$ (685)	\$ (5,928)

Three Months Ended September 28, 2019	Foreign Currency Translation Adjustments	Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Balance at June 29, 2019	\$ (4,612)	\$ (657)	\$ (5,269)
Other comprehensive income (loss) before reclassifications			
Unrealized gains (losses)	\$ (384)	\$ —	\$ (384)
Amounts reclassified from accumulated other comprehensive income (loss)	—	22	22
Tax effect	—	(5)	(5)
Net of tax amount	(384)	17	(367)
Balance at September 28, 2019	\$ (4,996)	\$ (640)	\$ (5,636)

Nine Months Ended September 26, 2020	Foreign Currency Translation Adjustments	Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2020	\$ (4,633)	\$ (770)	\$ (5,403)
Other comprehensive income (loss) before reclassifications			
Unrealized gains (losses)	\$ (610)	\$ —	\$ (610)
Amounts reclassified from accumulated other comprehensive income (loss)	—	114	114
Tax effect	—	(29)	(29)
Net of tax amount	(610)	85	(525)
Balance at September 26, 2020	\$ (5,243)	\$ (685)	\$ (5,928)

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Nine Months Ended September 28, 2019	Foreign Currency Translation Adjustments	Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2019	<u>\$ (5,819)</u>	<u>\$ 785</u>	<u>\$ (5,034)</u>
Other comprehensive income (loss) before reclassifications			
Unrealized gains (losses)	\$ 823	\$ —	\$ 823
Amounts reclassified from accumulated other comprehensive income (loss)	—	(1,573)	(1,573)
Tax effect	—	148	148
Net of tax amount	<u>823</u>	<u>(1,425)</u>	<u>(602)</u>
Balance at September 28, 2019	<u>\$ (4,996)</u>	<u>\$ (640)</u>	<u>\$ (5,636)</u>

The change in defined benefit pension plans of \$38 and \$114 for the three and nine months ended September 26, 2020, respectively, and \$22 and \$(1,573) for the three and nine months ended September 28, 2019, respectively, is included in net periodic pension expense classified in the condensed consolidated statement of operations as general and administrative expense or other income (expense).

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

L. Per Share Amounts and Common and Redeemable Shares Outstanding

We calculate our basic earnings per share by dividing net income or net loss by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated in a similar manner, but include the effect of dilutive securities. To the extent these securities are antidilutive, they are excluded from the calculation of earnings per share. The per share amounts were computed as follows:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 26, 2020</u>	<u>September 28, 2019</u>	<u>September 26, 2020</u>	<u>September 28, 2019</u>
Income available to common shareholders:				
Net income	\$ 24,627	\$ 13,434	\$ 54,585	\$ 32,688
Weighted-average shares (in thousands):				
Basic:				
Outstanding	22,874	22,790	22,956	22,822
Partially-paid share subscriptions	—	3	—	8
Basic weighted-average shares	<u>22,874</u>	<u>22,793</u>	<u>22,956</u>	<u>22,830</u>
Diluted:				
Basic from above	22,874	22,793	22,956	22,830
Incremental shares from assumed:				
Exercise of stock subscription purchase rights	—	13	—	73
Exercise of stock options and awards	980	1,196	1,046	1,024
Diluted weighted-average shares	<u>23,854</u>	<u>24,002</u>	<u>24,002</u>	<u>23,927</u>
Net income per share:				
Basic	\$ 1.08	\$.59	\$ 2.38	\$ 1.43
Diluted	\$ 1.03	\$.56	\$ 2.27	\$ 1.37

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Common and Redeemable Shares Outstanding--A summary of the activity of the common and redeemable shares outstanding for the nine months ended September 26, 2020 follows:

	Common Shares Net of Treasury Shares	Redeemable Shares	Total
Shares outstanding at January 1, 2020	18,029,921	5,146,882	23,176,803
Shares purchased	(763,901)	(368,350)	(1,132,251)
Shares sold	263,212	395,503	658,715
Options and awards exercised	145,297	—	145,297
Shares outstanding at September 26, 2020	<u>17,674,529</u>	<u>5,174,035</u>	<u>22,848,564</u>

On September 26, 2020, we had 22,848,564 common and redeemable shares outstanding and employee options exercisable to purchase 1,028,683 common shares.

Stock Subscription Offering--Beginning May 2012, the Company offered to eligible employees and nonemployee directors the right to subscribe to common shares of the Company at \$9.85 per share in accordance with the provisions of The Davey Tree Expert Company 2004 Omnibus Stock Plan and the rules of the Compensation Committee of the Company's Board of Directors (collectively, the "plan"). The offering period ended on August 1, 2012 and resulted in the subscription of 1,275,428 common shares for \$12,563 at \$9.85 per share.

Under the plan, a participant in the offering purchasing common shares for an aggregate purchase price of less than \$5 was required to pay with cash. All participants (excluding Company directors and officers) purchasing \$5 or more of the common shares had an option to finance their purchase through a down-payment of at least 10% of the total purchase price and a seven-year promissory note for the balance due with interest at 2%. Payments on the promissory note were made either by payroll deductions or annual lump-sum payments of both principal and interest.

Common shares purchased under the plan were pledged as security for the payment of the promissory note and the common shares were not issued until the promissory note was paid-in-full. Dividends were paid on all subscribed shares, subject to forfeiture to the extent that payment was not ultimately made for the shares.

All participants in the offering purchasing in excess of \$5 of common shares were granted a "right" to purchase one additional common share at a price of \$9.85 per share for every three common shares purchased under the plan. As a result of the stock subscription, employees were granted rights to purchase 423,600 common shares. Each right could have been exercised at the rate of one-seventh per year and expired seven years after the date that the right was granted. Employees could not exercise a right if they ceased to be employed by the Company. All rights expired in August 2019.

M. Operations by Business Segment

We provide a wide range of arboricultural, horticultural, environmental and consulting services to residential, utility, commercial and government entities throughout the United States and Canada. We have two reportable operating segments organized by type or class of customer: Residential and Commercial, and Utility.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Residential and Commercial--Residential and Commercial provides services to our residential and commercial customers including: the treatment, preservation, maintenance, removal and planting of trees, shrubs and other plant life; the practice of landscaping, grounds maintenance, tree surgery, tree feeding and tree spraying; the application of fertilizer, herbicides and insecticides; and natural resource management and consulting, forestry research and development, and environmental planning.

Utility--Utility is principally engaged in providing services to our utility customers--investor-owned, municipal utilities, and rural electric cooperatives--including: the practice of line-clearing and vegetation management around power lines and rights-of-way and chemical brush control, natural resource management and consulting, forestry research and development, and environmental planning.

All other operating activities, including research, technical support and laboratory diagnostic facilities, are included in "All Other."

Measurement of Segment Profit and Loss and Segment Assets--We evaluate performance and allocate resources based primarily on operating income and also actively manage business unit operating assets. Segment information, including reconciling adjustments, is presented consistent with the basis described in our 2019 Annual Report.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Segment information reconciled to the condensed consolidated financial statements follows:

	<u>Utility</u>	<u>Residential and Commercial</u>	<u>All Other</u>	<u>Reconciling Adjustments</u>	<u>Consolidated</u>
Three Months Ended September 26, 2020					
Revenues	\$ 185,500	\$ 151,435	\$ 518	\$ —	\$ 337,453
Income (loss) from operations	<u>20,301</u>	<u>20,273</u>	<u>(2,758)</u>	(2,316) (a)	35,500
Interest expense				(1,579)	(1,579)
Interest income				1,688	1,688
Other income (expense), net				<u>(1,499)</u>	<u>(1,499)</u>
Income before income taxes					\$ 34,110
Segment assets, total	<u>\$ 296,519</u>	<u>\$ 227,977</u>	<u>\$ —</u>	<u>\$ 147,188</u> (b)	<u>\$ 671,684</u>
Three Months Ended September 28, 2019					
Revenues	\$ 160,088	\$ 146,769	\$ 616	\$ —	\$ 307,473
Income (loss) from operations	<u>10,941</u>	<u>17,667</u>	<u>(3,456)</u>	(2,369) (a)	22,783
Interest expense				(2,018)	(2,018)
Interest income				94	94
Other income (expense), net				<u>(1,886)</u>	<u>(1,886)</u>
Income before income taxes					\$ 18,973
Segment assets, total	<u>\$ 247,031</u>	<u>\$ 238,692</u>	<u>\$ —</u>	<u>\$ 115,475</u> (b)	<u>\$ 601,198</u>
Nine Months Ended September 26, 2020					
Revenues	\$ 547,984	\$ 396,293	\$ 703	\$ —	\$ 944,980
Income (loss) from operations	<u>56,817</u>	<u>42,242</u>	<u>(11,005)</u>	(4,309) (a)	83,745
Interest expense				(5,477)	(5,477)
Interest income				1,885	1,885
Other income (expense), net				<u>(4,550)</u>	<u>(4,550)</u>
Income before income taxes					\$ 75,603
Segment assets, total	<u>\$ 296,519</u>	<u>\$ 227,977</u>	<u>\$ —</u>	<u>\$ 147,188</u> (b)	<u>\$ 671,684</u>
Nine Months Ended September 28, 2019					
Revenues	\$ 451,749	\$ 404,134	\$ 913	\$ —	\$ 856,796
Income (loss) from operations	<u>26,816</u>	<u>44,772</u>	<u>(11,825)</u>	(3,732) (a)	56,031
Interest expense				(6,597)	(6,597)
Interest income				270	270
Other income (expense), net				<u>(6,694)</u>	<u>(6,694)</u>
Income before income taxes					\$ 43,010
Segment assets, total	<u>\$ 247,031</u>	<u>\$ 238,692</u>	<u>\$ —</u>	<u>\$ 115,475</u> (b)	<u>\$ 601,198</u>

Reconciling adjustments from segment reporting to the condensed consolidated financial statements include unallocated corporate items:

- (a) Reclassification of depreciation expense and allocation of corporate expenses.
- (b) Corporate assets include cash, prepaid expenses, corporate facilities, enterprise-wide information systems and other nonoperating assets.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

N. Revenue Recognition

We recognize revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers.

Nature of Performance Obligations and Significant Judgments

At contract inception, the Company assesses the goods and services promised in its contracts with customers and identifies a performance obligation for each promised good or service (or bundle of goods and services) that is distinct. To identify the performance obligations, the Company considers each of the goods or services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices.

Our contracts with our customers generally originate upon the completion of a quote for services for residential and commercial customers or the receipt of a purchase order (or similar work order) for utility customers. In some cases, our contracts are governed by master services agreements, in which case our contract under ASC 606 consists of the combination of the master services agreement and the quote/purchase order. Many of our contracts have a stated duration of one year or less or contain termination clauses that allow the customer to cancel the contract after a specified notice period, which is typically less than 90 days. Due to the fact that many of our arrangements allow the customer to terminate for convenience, the duration of the contract for revenue recognition purposes generally does not extend beyond the services that we have actually transferred. As a result, many of our contracts are, in effect, day-to-day or month-to-month contracts.

Disaggregation of Revenue

The following tables disaggregate our revenue for the three and nine months ended September 26, 2020 and September 28, 2019 by major sources:

Three Months Ended September 26, 2020	Utility	Residential and Commercial	All Other	Consolidated
Type of service:				
Tree and plant care	\$ 135,021	\$ 90,049	\$ (10)	\$ 225,060
Grounds maintenance	—	36,296	—	36,296
Storm damage services	7,061	4,069	—	11,130
Consulting and other	43,418	21,021	528	64,967
Total revenues	<u>\$ 185,500</u>	<u>\$ 151,435</u>	<u>\$ 518</u>	<u>\$ 337,453</u>
Geography:				
United States	\$ 176,528	\$ 140,571	\$ 518	\$ 317,617
Canada	8,972	10,864	—	19,836
Total revenues	<u>\$ 185,500</u>	<u>\$ 151,435</u>	<u>\$ 518</u>	<u>\$ 337,453</u>

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Three Months Ended September 28, 2019	Utility	Residential and Commercial	All Other	Consolidated
Type of service:				
Tree and plant care	\$ 119,449	\$ 85,112	\$ (86)	\$ 204,475
Grounds maintenance	—	40,721	—	40,721
Storm damage services	1,709	1,550	—	3,259
Consulting and other	38,930	19,386	702	59,018
Total revenues	<u>\$ 160,088</u>	<u>\$ 146,769</u>	<u>\$ 616</u>	<u>\$ 307,473</u>

Geography:				
United States	\$ 150,118	\$ 135,868	\$ 616	\$ 286,602
Canada	9,970	10,901	—	20,871
Total revenues	<u>\$ 160,088</u>	<u>\$ 146,769</u>	<u>\$ 616</u>	<u>\$ 307,473</u>

Nine Months Ended September 26, 2020	Utility	Residential and Commercial	All Other	Consolidated
Type of service:				
Tree and plant care	\$ 408,371	\$ 233,810	\$ (121)	\$ 642,060
Grounds maintenance	—	100,352	—	100,352
Storm damage services	8,087	6,047	—	14,134
Consulting and other	131,526	56,084	824	188,434
Total revenues	<u>\$ 547,984</u>	<u>\$ 396,293</u>	<u>\$ 703</u>	<u>\$ 944,980</u>

Geography:				
United States	\$ 522,094	\$ 369,297	\$ 703	\$ 892,094
Canada	25,890	26,996	—	52,886
Total revenues	<u>\$ 547,984</u>	<u>\$ 396,293</u>	<u>\$ 703</u>	<u>\$ 944,980</u>

Nine Months Ended September 28, 2019	Utility	Residential and Commercial	All Other	Consolidated
Type of service:				
Tree and plant care	\$ 335,658	\$ 231,988	\$ (90)	\$ 567,556
Grounds maintenance	—	114,320	—	114,320
Storm damage services	2,933	4,163	—	7,096
Consulting and other	113,158	53,663	1,003	167,824
Total revenues	<u>\$ 451,749</u>	<u>\$ 404,134</u>	<u>\$ 913</u>	<u>\$ 856,796</u>

Geography:				
United States	\$ 420,701	\$ 376,304	\$ 913	\$ 797,918
Canada	31,048	27,830	—	58,878
Total revenues	<u>\$ 451,749</u>	<u>\$ 404,134</u>	<u>\$ 913</u>	<u>\$ 856,796</u>

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Contract Balances

Our contract liabilities consist of advance payments and billings in excess of costs incurred and deferred revenue. The Company has recognized \$150 and \$1,411 of revenue for the three and nine months ended September 26, 2020, respectively, that was included in the contract liability balance at December 31, 2019 and \$119 and \$1,925 of revenue for the three and nine months ended September 28, 2019, respectively, that was included in the contract liability balance at December 31, 2018. Net contract liabilities consisted of the following:

	September 26, 2020	December 31, 2019
Contract liabilities - current	\$ 3,558	\$ 3,129
Contract liabilities - noncurrent	1,662	2,705
Net contract liabilities	<u>\$ 5,220</u>	<u>\$ 5,834</u>

O. Fair Value Measurements and Financial Instruments

FASB ASC 820, "Fair Value Measurements and Disclosures" ("Topic 820") defines fair value based on the price that would be received to sell an asset or the exit price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. Market participants are defined as buyers or sellers in the principal or most advantageous market for the asset or liability that are independent of the reporting entity, knowledgeable and able and willing to transact for the asset or liability.

Valuation Hierarchy--Topic 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The hierarchy prioritizes the inputs into three broad levels:

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.

Level 2 inputs are observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data.

Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Our assets and liabilities measured at fair value on a recurring basis at September 26, 2020 were as follows:

Assets and Liabilities Recorded at Fair Value on a Recurring Basis	Total Carrying Value at September 26, 2020	Fair Value Measurements at September 26, 2020 Using:		
		Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Assets invested for self-insurance, classified as other assets, noncurrent	\$ 15,359	\$ 15,359	\$ —	\$ —
Liabilities:				
Deferred compensation	\$ 3,132	\$ —	\$ 3,132	\$ —

Our assets and liabilities measured at fair value on a recurring basis at December 31, 2019 were as follows:

Assets and Liabilities Recorded at Fair Value on a Recurring Basis	Total Carrying Value at December 31, 2019	Fair Value Measurements at December 31, 2019 Using:		
		Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Assets invested for self-insurance, classified as other assets, noncurrent	\$ 15,402	\$ 15,402	\$ —	\$ —
Liabilities:				
Deferred compensation	\$ 2,786	\$ —	\$ 2,786	\$ —

The assets invested for self-insurance are certificates of deposit--classified as Level 1--based on quoted market prices of the identical underlying securities in active markets. The estimated fair value of the deferred compensation--classified as Level 2--is based on the value of the Company's common shares, determined by independent valuation.

Fair Value of Financial Instruments--The fair values of our current financial assets and current liabilities, including cash, accounts receivable, accounts payable, and accrued expenses, among others, approximate their reported carrying values because of their short-term nature. Financial instruments classified as noncurrent liabilities and their carrying values and fair values were as follows:

	September 26, 2020		December 31, 2019	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Revolving credit facility, noncurrent	\$ 30,000	\$ 30,000	\$ 62,000	\$ 62,000
Senior unsecured notes, noncurrent	75,000	83,099	75,000	79,558
Term loans, noncurrent	1,842	2,068	6,774	7,124
Total	\$ 106,842	\$ 115,167	\$ 143,774	\$ 148,682

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

The carrying value of our revolving credit facility approximates fair value--classified as Level 2--as the interest rates on the amounts outstanding are variable. The fair value of our senior unsecured notes and term loans--classified as Level 2--is determined based on expected future weighted-average interest rates with the same remaining maturities.

Market Risk--In the normal course of business, we are exposed to market risk related to changes in foreign currency exchange rates, changes in interest rates and changes in fuel prices. We do not hold or issue derivative financial instruments for trading or speculative purposes. In prior years, we have used derivative financial instruments to manage risk, in part, associated with changes in interest rates and changes in fuel prices. Presently, we are not engaged in any hedging or derivative activities.

P. Commitments and Contingencies

We are party to a number of lawsuits, threatened lawsuits and other claims arising out of the normal course of business. On a quarterly basis, we assess our liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. Where it is probable that we will incur a loss and the amount of the loss can be reasonably estimated, we record a liability in our consolidated financial statements. These legal accruals may be increased or decreased to reflect any relevant developments on a quarterly basis. Where a loss is not probable or the amount of the loss is not estimable, we do not record a legal accrual, consistent with applicable accounting guidance. Based on information currently available to us, advice of counsel, and available insurance coverage, we believe that our established accruals are adequate and the liabilities arising from the legal proceedings will not have a material adverse effect on our consolidated financial condition. We note, however, that in light of the inherent uncertainty in legal proceedings there can be no assurance that the ultimate resolution of a matter will not exceed established accruals. As a result, the outcome of a particular matter or a combination of matters may be material to our results of operations for a particular period, depending upon the size of the loss or our income for that particular period.

In November 2017, a suit was filed in Savannah, Georgia state court ("State Court") against Davey Tree, its subsidiary, Wolf Tree, Inc. ("Wolf Tree"), one former Davey employee, two Wolf Tree employees, and one former Wolf Tree employee alleging various acts of negligence and seeking compensatory and punitive damages for wrongful death and assault and battery of the plaintiff's husband, a Wolf Tree employee, who was shot and killed in August 2017.

In July 2018, a related survival action was filed by the deceased's estate against Davey Tree, its subsidiary, Wolf Tree, and four current and former employees in Savannah, Georgia, which arises out of the same allegations, seeks compensatory and punitive damages and also includes three Racketeer Influenced and Corrupt Organizations Act ("RICO") claims under Georgia law seeking compensatory damages, treble damages, and punitive damages. The 2018 case was removed to the United States District Court for the Southern District of Georgia, Savannah Division ("Federal Court"), on August 2, 2018. The Company filed a motion to dismiss the RICO claims. Plaintiffs filed a motion to remand the case to state court, which the Company has opposed.

The cases were mediated unsuccessfully in December 2018 and the State Court case was originally set for trial on January 22, 2019. However, as discussed below, all of the civil cases were later stayed on December 28, 2018 and currently remain stayed.

On December 6, 2018, a former Wolf Tree employee pled guilty to conspiracy to conceal, harbor, and shield illegal aliens. On December 21, 2018, the United States federal prosecutors filed a motion to stay both actions on the grounds that on December 13, 2018, an

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

indictment was issued charging two former Wolf Tree employees and one other individual with various crimes, including conspiracy to murder the deceased. On December 17, 2018, the United States Attorney's Office for the Southern District of Georgia informed the Company and Wolf Tree that they are also under investigation for potential violations of immigration and other laws relating to the subject matter of the ongoing criminal investigation referenced above. The Company and Wolf Tree are cooperating with the investigation.

On December 28, 2018, the State Court granted the United States' motion to stay but indicated that it would nonetheless consider certain pending matters, including: (1) Plaintiff and a co-defendant's motions that Davey Tree be forced to produce privileged documents and testimony, which had been submitted to a Special Master for recommendation; and (2) the Defendants' motions for summary judgment. On January 11, 2019, the Special Master issued his recommendation that both Plaintiff and the co-defendant's motions to force Davey to disclose privileged information be denied. The State Court judge has not yet moved on the recommendation. On January 29, 2019, the State Court heard oral argument on Defendants' motions for summary judgment, and the motions remain pending during the stay of the cases.

On January 28, 2019, the Federal Court also granted the United States' motion to stay. On January 29, 2019, the State Court ordered the parties to return to mediation, which occurred on April 17, 2019 but was unsuccessful in resolving the matters.

In both cases, the Company has denied all liability and is vigorously defending the action. It also has retained separate counsel for some of the individual defendants, each of whom has denied all liability and also is vigorously defending the action.

PG&E Bankruptcy Filing

On January 29, 2019, Pacific Gas & Electric Company, and its parent company PG&E Corporation, our largest utility customer, filed voluntary bankruptcy petitions under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of California. PG&E accounted for approximately 12% of revenues during 2019, and 12% in 2018. As a utility company, PG&E serves residential and industrial customers in California and has an ongoing obligation to continue to serve its customers, and we continue to perform under our contracts with PG&E post-petition. As of the date of the bankruptcy filing, we had pre-petition accounts receivable of approximately \$15,000.

On June 20, 2020, the Court confirmed PG&E's Plan of Reorganization (the "Plan") filed as part of its Chapter 11 bankruptcy proceeding. On July 1, 2020, PG&E emerged from Chapter 11, successfully completing its restructuring process and implementing the Plan. In the Plan, unsecured creditors, like Davey Tree, will be paid in full with interest accruing on the past amounts due at the federal judgment rate. Davey Tree has received the majority of its pre-petition amounts outstanding and expects to receive the balance before the end of 2020. Further, Davey Tree's primary contracts were assumed by PG&E. Due to PG&E's implementation of the Plan, we do not anticipate PG&E's bankruptcy will have a material impact on our future cash flows or results of operations as we will receive full payment for the amounts owed.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Northern California Wildfires

On October 7, 2019 and October 8, 2019, four lawsuits were filed against multiple vegetation management contractors to PG&E, including Davey Tree, for damages resulting from the Northern California wildfires. The filing dates - exactly two years after the start of the fires - suggest that these lawsuits are intended to preserve any claims that might otherwise have become barred by the applicable statute of limitations. Davey Tree has been served with only one of the four complaints, in the case of *Quinisha Kyree Abram v. ACRT, Inc., et. al.*, Case No. CGC-19-579861 filed in the Superior Court of the State of California, County of San Francisco (the “Abram case”). The Abram case was initially stayed until July 29, 2020, and later was stayed until September 30, 2020. The Court then vacated the September 30, 2020 case management conference and issued an order to show cause regarding dismissal for failure to serve the first amended complaint, which Plaintiffs had not yet served. The hearing on the order to show cause is November 24, 2020. Davey Tree has filed a demurrer and motion to dismiss in this action to the original complaint. In the PG&E bankruptcy, the Tort Committee, representing wildfire victims from both the 2017 and 2018 Northern California wildfires, served subpoenas related to these wildfires on numerous contractors of PG&E, including Davey Tree Surgery Company, Davey Resource Group, and Davey Tree, to which we responded.

In addition, an action was brought against Davey Tree in Napa County Superior Court, entitled *Donna Walker, et al. v. Davey Tree Surgery Company* on August 8, 2019. On October 8, 2019, the court issued an order staying that action. The court deferred ruling on Davey’s demurrer and motion to dismiss the complaint based on the absence of PG&E as an indispensable party. The court stayed any activity in the case until until December 15, 2020.

In all cases, the Company has denied all liability and will vigorously defend the actions.

Q. The Davey 401KSOP and Employee Stock Ownership Plan

On March 15, 1979, the Company consummated a plan, which transferred control of the Company to its employees. As a part of this plan, the Company initially sold 120,000 common shares (presently, 23,040,000 common shares adjusted for stock splits) to its Employee Stock Ownership Trust (“ESOT”) for \$2,700. The Employee Stock Ownership Plan (“ESOP”), in conjunction with the related ESOT, provided for the grant to certain employees of certain ownership rights in, but not possession of, the common shares held by the trustee of the ESOT. Annual allocations of shares have been made to individual accounts established for the benefit of the participants.

Defined Contribution and Savings Plans—Most employees are eligible to participate in The Davey 401KSOP and ESOP Plan. Effective January 1, 1997, the plan commenced operations and retained the existing ESOP participant accounts and incorporated a deferred savings plan (a “401(k) plan”) feature. Participants in the 401(k) plan are allowed to make before-tax contributions, within Internal Revenue Service established limits, through payroll deductions. Effective January 1, 2020, we match, in either cash or our common shares, 100% of the first three percent and 50% of the next two percent of each participant's before-tax contribution, limited to the first five percent of the employee’s compensation deferred each year. All nonbargaining domestic employees who attained age 21 and completed one year of service are eligible to participate. In May 2004, we adopted the 401K Match Restoration Plan, a defined contribution plan that supplements the retirement benefits of certain employees that participate in the savings plan feature of The Davey 401KSOP and ESOP Plan, but are limited in contributions because of tax rules and regulations.

The Davey Tree Expert Company
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 26, 2020
(Amounts in thousands, except share data)

Our common shares are not listed or traded on an established public trading market, and market prices are, therefore, not available. Semiannually, an independent stock valuation firm determines the fair market value of our common shares based upon our performance and financial condition. The Davey 401KSOP and ESOP Plan includes a put option for shares of the Company's common stock distributed from the plan. Shares are distributed from the Davey 401KSOP and ESOP Plan to former participants of the plan, their beneficiaries, donees or heirs (each, a "participant"). Since our common stock is not currently traded on an established securities market, if the owners of distributed shares desire to sell their shares, the Company is required to purchase the shares at fair value for two 60-day periods after distribution of the shares from the Davey 401KSOP and ESOP. The fair value of distributed shares subject to the put option totaled \$2,978 and \$4,749 as of September 26, 2020 and December 31, 2019, respectively. The fair value of the shares held in the Davey 401KSOP and ESOP totaled \$125,856 and \$119,806 as of September 26, 2020 and December 31, 2019, respectively. Due to the Company's obligation under the put option, the distributed shares subject to the put option and the shares held in the Davey 401KSOP and ESOP (collectively referred to as 401KSOP and ESOP related shares) are recorded at fair value, classified as temporary equity in the mezzanine section of the consolidated balance sheets and totaled \$128,834 and \$124,555 as of September 26, 2020 and December 31, 2019, respectively. Changes in the fair value of the 401KSOP and ESOP Plan related shares are reflected in retained earnings while net share activity associated with 401KSOP and ESOP Plan related shares are first reflected in additional paid-in capital and then retained earnings if additional paid-in capital is insufficient.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(Amounts in thousands, except share data)

Management's Discussion and Analysis of Financial Condition and Results of Operations is provided as a supplement to the accompanying condensed consolidated financial statements and notes to help provide an understanding of our financial condition, cash flows and results of operations.

We provide a wide range of arboricultural, horticultural, environmental and consulting services to residential, utility, commercial and government entities throughout the United States and Canada.

Our Business--Our operating results are reported in two segments organized by type or class of customer: Residential and Commercial, and Utility. Residential and Commercial provides services to our residential and commercial customers including: the treatment, preservation, maintenance, removal and planting of trees, shrubs and other plant life; the practice of landscaping, grounds maintenance, tree surgery, tree feeding and tree spraying; the application of fertilizer, herbicides and insecticides; and natural resource management and consulting, forestry research and development, and environmental planning. Utility is principally engaged in providing services to our utility customers--investor-owned, municipal utilities, and rural electric cooperatives--including: the practice of line-clearing and vegetation management around power lines and rights-of-way and chemical brush control, natural resource management and consulting, forestry research and development, and environmental planning. All other operating activities, including research, technical support and laboratory diagnostic facilities, are included in "All Other."

Impact of COVID-19

While the coronavirus ("COVID-19") pandemic did not have a material adverse effect on our reported results for the first nine months of 2020, the overall extent and duration of the impact of COVID-19 on businesses and economic activity generally remains unclear due to the inherent uncertainty surrounding COVID-19, given its continual evolution, such as the current resurgence of cases.

We have taken steps to support our employees and protect their health and safety, while also ensuring that our business can continue to operate and provide services to our customers. Where possible, we have transitioned our employees to work from home and implemented measures to ensure social distancing when providing services to our customers, including providing personal protective equipment and limiting contact within vehicles. We have also provided additional administrative leave for employees affected by COVID-19 directly or indirectly and converted our 2020 Annual Meeting of Shareholders to a virtual-only format. We also drew \$50,000 from our revolving credit facility to provide us with additional liquidity in light of the uncertainty resulting from COVID-19. The \$50,000 additional borrowing from our revolving credit facility was repaid in the second quarter of 2020. In the first nine months of 2020, we incurred expenses of \$3,147 as a result of the COVID-19 pandemic mainly for administrative leave and personal protective equipment. We have also experienced a reduction of travel expenses of approximately \$3,700 largely related to restrictions imposed as a response to the pandemic.

The extent to which our operations may be impacted by COVID-19 will depend largely on future developments, which are highly uncertain and cannot be accurately predicted, including new information which may emerge concerning the severity of the outbreak, the current resurgence of cases in the United States and potential challenges caused by the colder winter months, including the onset of the cold and flu season, and actions by government authorities to contain the pandemic or treat its impact, including reimposing previously-lifted measures and the possibility additional restrictions will be put in place, among other things. The situation surrounding COVID-19 remains fluid, and the potential for a material impact on our business increases the longer the coronavirus impacts the level of economic

activity in the U.S. and globally. Even after the COVID-19 pandemic has subsided, we may experience an impact to our business as a result of the current economic recession and any economic downturn or recession that may occur in the future.

RESULTS OF OPERATIONS

The following table sets forth our consolidated results of operations as a percentage of revenues and the percentage change in dollar amounts of the results of operations for the periods presented.

	Three Months Ended			Nine Months Ended		
	September 26, 2020	September 28, 2019	Change	September 26, 2020	September 28, 2019	Change
Revenues	100.0 %	100.0 %	— %	100.0 %	100.0 %	— %
Costs and expenses:						
Operating	61.8	62.8	(1.0)	63.2	63.8	(.6)
Selling	17.8	18.5	(.7)	17.2	18.0	(.8)
General and administrative	5.9	6.5	(.6)	6.4	6.7	(.3)
Depreciation and amortization	4.1	5.0	(.9)	4.5	5.2	(.7)
Gain on sale of assets, net	(.1)	(.2)	.1	(.2)	(.2)	—
Income from operations	10.5	7.4	3.1	8.9	6.5	2.4
Other income (expense):						
Interest expense	(.5)	(.7)	.2	(.6)	(.7)	.1
Interest income	.5	—	.5	.2	—	.2
Other, net	(.4)	(.6)	.2	(.5)	(.8)	.3
Income before income taxes	10.1	6.1	4.0	8.0	5.0	3.0
Income taxes	2.8	1.8	1.0	2.2	1.2	1.0
Net income	<u>7.3 %</u>	<u>4.3 %</u>	<u>3.0 %</u>	<u>5.8 %</u>	<u>3.8 %</u>	<u>2.0 %</u>

Third Quarter—Three Months Ended September 26, 2020 Compared to Three Months Ended September 28, 2019

Our results of operations for the three months ended September 26, 2020 compared to the three months ended September 28, 2019 follows:

	Three Months Ended			
	September 26, 2020	September 28, 2019	Change	Percentage Change
Revenues	\$ 337,453	\$ 307,473	\$ 29,980	9.8 %
Costs and expenses:				
Operating	208,510	193,137	15,373	8.0
Selling	60,203	56,921	3,282	5.8
General and administrative	19,891	19,895	(4)	—
Depreciation and amortization	13,825	15,319	(1,494)	(9.8)
Gain on sale of assets, net	(476)	(582)	106	(18.2)
	<u>301,953</u>	<u>284,690</u>	<u>17,263</u>	<u>6.1</u>
Income from operations	35,500	22,783	12,717	55.8
Other income (expense):				
Interest expense	(1,579)	(2,018)	439	(21.8)
Interest income	1,688	94	1,594	1,695.7
Other, net	(1,499)	(1,886)	387	(20.5)
Income before income taxes	34,110	18,973	15,137	79.8
Income taxes	9,483	5,539	3,944	71.2
Net income	<u>\$ 24,627</u>	<u>\$ 13,434</u>	<u>\$ 11,193</u>	<u>83.3 %</u>

Revenues--Revenues of \$337,453 increased \$29,980 compared with \$307,473 in the third quarter of 2019. Utility Services increased \$25,412 or 15.9% compared with the third quarter of 2019. The increase is attributable to new accounts as well as increased work year-over-year and price increases on existing accounts. Most of our Utility Services segment work has been deemed essential services and has not been significantly affected by COVID-19. Residential and Commercial Services increased \$4,666 or 3.2% from the third quarter of 2019. Increases in tree and plant care revenues, storm damage revenue and consulting and other were partially offset by a decrease in grounds maintenance revenue.

Operating Expenses--Operating expenses of \$208,510 increased \$15,373 compared with the third quarter of 2019. Utility Services increased \$14,855 or 12.7% compared with the third quarter of 2019 but, as a percentage of revenue, decreased to 71.0% from 73.0%. The increase is attributable to additional expenses for labor and benefits expenses which were partially offset by decreases in fuel expense, subcontractor expense and crew meals and lodging expenses. Residential and Commercial Services increased \$104 or 0.1% compared with the third quarter of 2019 but, as a percentage of revenue, decreased to 49.7% from 51.2%. Increases in labor and benefits expenses were offset by decreases in fuel expense and materials expense.

Operating expenses for the third quarter of 2020 also included \$953 of expenses related directly to COVID-19, including \$447 for additional administrative leave offered to employees who have been unable to work due to COVID-19 imposed restrictions whether from the virus itself or government imposed restrictions or closures.

Fuel costs of \$8,100 decreased \$1,620, or 16.7%, from the \$9,720 incurred in the third quarter of 2019 and impacted operating expenses within all segments. The \$1,620 decrease included usage decreases approximating \$335 and price decreases approximating \$1,285.

Selling Expenses--Selling expenses of \$60,203 increased \$3,282 compared with the third quarter of 2019 but, as a percentage of revenues, decreased to 17.8% from 18.5%. Utility Services increased \$2,055 or 11.2% compared to the third quarter of 2019 but, as a percentage of revenue, decreased to 11.0% from 11.4%. The increase is attributable to increases in field management wages and incentive expense which were partially offset by a decrease in travel expense. Residential and Commercial Services increased \$1,220 or 3.1% from the third quarter of 2019 but, as a percentage of revenue, decreased to 27.0% from 27.1%. The increase was primarily attributable to an increase in field management expense which was partially offset by decreases in travel expense and employee development expenses.

General and Administrative Expenses--General and administrative expenses of \$19,891 decreased \$4 from \$19,895 in the third quarter of 2019. Decreases in travel and living expenses and professional fees were offset by an increase in salary and incentive expense.

Depreciation and Amortization Expense--Depreciation and amortization expense of \$13,825 decreased \$1,494 from \$15,319 incurred in the third quarter of 2019, primarily due to decreased capital expenditures in recent years and an increase use of operating leases for equipment.

Gain on the Sale of Assets, Net--Gain on the sale of assets of \$476 for the third quarter of 2020 decreased \$106 from the \$582 gain in the third quarter of 2019. Our average gain per unit was lower in the third quarter of 2020 as compared with the third quarter of 2019.

Interest Expense--Interest expense of \$1,579 decreased \$439 from the \$2,018 incurred in the third quarter of 2019. The decrease is attributable to lower interest rates during the third quarter of 2020, as compared with the third quarter of 2019.

Interest Income--Interest income of \$1,688 increased \$1,594 from the \$94 of interest income in the third quarter of 2019. The increase is attributable to interest on PG&E pre-petition receivables which was approved by the United States Bankruptcy Court and received during the third quarter of 2020.

Other, Net--Other expense, net, of \$1,499 decreased \$387 from the \$1,886 of other expense incurred in the third quarter of 2019 and consisted of nonoperating income and expense, including pension expense and foreign currency transaction gains/losses on the intercompany account balances of our Canadian operations.

Income Taxes--Income taxes for the third quarter of 2020 were \$9,483, as compared to \$5,539 for the third quarter of 2019. Our tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, that are taken into account in the relevant period. The effective tax rate as of the third quarter of 2020 was 27.8%, as compared with the third quarter of 2019 effective tax rate of 29.2%.

Net Income--Net income of \$24,627 for the third quarter of 2020 was \$11,193 more than the \$13,434 net income for the third quarter of 2019.

First Nine Months—Nine Months Ended September 26, 2020 Compared to Nine Months Ended September 28, 2019

Our results of operations for the nine months ended September 26, 2020 compared to the nine months ended September 28, 2019 follows:

	Nine Months Ended			
	September 26, 2020	September 28, 2019	Change	Percentage Change
Revenues	\$ 944,980	\$ 856,796	\$ 88,184	10.3 %
Costs and expenses:				
Operating	597,963	546,931	51,032	9.3
Selling	162,287	153,854	8,433	5.5
General and administrative	60,477	57,610	2,867	5.0
Depreciation and amortization	42,553	44,121	(1,568)	(3.6)
Gain on sale of assets, net	(2,045)	(1,751)	(294)	16.8
	<u>861,235</u>	<u>800,765</u>	<u>60,470</u>	<u>7.6</u>
Income from operations	83,745	56,031	27,714	49.5
Other income (expense):				
Interest expense	(5,477)	(6,597)	1,120	(17.0)
Interest income	1,885	270	1,615	598.1
Other, net	(4,550)	(6,694)	2,144	(32.0)
Income before income taxes	75,603	43,010	32,593	75.8
Income taxes	21,018	10,322	10,696	103.6
Net income	<u>\$ 54,585</u>	<u>\$ 32,688</u>	<u>\$ 21,897</u>	<u>67.0 %</u>

Revenues--Revenues of \$944,980 increased \$88,184 compared with \$856,796 in the first nine months of 2019. Utility Services increased \$96,235 or 21.3% compared with the first nine months of 2019. The increase is attributable to new accounts, as well as increased work year-over-year and price increases on existing accounts within both our U.S. and Canadian operations. Most of our Utility Services segment work has been deemed essential services and has not been significantly affected by COVID-19. Residential and Commercial Services decreased \$7,841 or 1.9% compared with the first nine months of 2019. Decreases in grounds maintenance revenue were partially offset by increases in tree and plant care revenue, storm damage revenue and consulting and other revenue. While our Residential and Commercial Services segment work was deemed essential services in most states, we experienced temporary shutdowns or work restrictions related to COVID-19 in a few states and certain Canadian provinces. Where possible, Residential and Commercial Services employees affected by a shutdown or work restrictions were reassigned to assist with Utility Services operations.

Operating Expenses--Operating expenses of \$597,963 increased \$51,032 compared with the first nine months of 2019 but, as a percentage of revenues, decreased to 63.2% from 63.8%. Utility Services increased \$60,246 or 18.3% compared with the first nine months of 2019 but, as a percentage of revenue, decreased to 71.0% from 73.0%. The increase was attributable to increases in additional labor and benefits expense and subcontractor expense which were partially offset by a decrease in fuel expense. Residential and Commercial Services decreased \$9,822 or 4.6% compared with the first nine months of 2019 and, as a percentage of revenue, decreased to 51.3% from 52.7%. The decrease was primarily attributable to decreases in fuel expense, subcontractor expense and materials expense.

Operating expenses for the period also included \$3,148 of expenses related directly to COVID-19, including \$1,974 for additional administrative leave offered to employees who have been unable to work due to COVID-19 imposed restrictions whether from the virus itself or government imposed restrictions or closures.

Fuel costs of \$23,238 decreased \$3,483, or 13.0%, from the \$26,721 incurred in the first nine months of 2019 and impacted operating expenses within all segments. The \$3,483 decrease included usage decreases approximating \$6 and price decreases approximating \$3,477.

Selling Expenses--Selling expenses of \$162,287 increased \$8,433 compared with the first nine months of 2019 but, as a percentage of revenue, decreased to 17.2% from 18.0%. Utility Services increased \$6,390 or 11.9% compared to the first nine months of 2019 but, as a percentage of revenue, decreased to 11.0% from 11.9%. The increase was primarily attributable to additional field management wages and incentive expense, which were partially offset by a decrease in field management travel expense. Residential and Commercial Services experienced an increase of \$1,620 or 1.6% compared to the first nine months of 2019 and, as a percentage of revenue, increased to 26.4% from 25.5%. The increase was attributable to increases in field management wages and incentive expense which were partially offset by a decrease in travel expense.

General and Administrative Expenses--General and administrative expenses of \$60,477 increased \$2,867 from \$57,610 in the first nine months of 2019. The increase was primarily attributable to an increase in salary and incentive expense which were partially offset by a decrease in travel expense.

Depreciation and Amortization Expense--Depreciation and amortization expense of \$42,553 decreased \$1,568 from \$44,121 incurred in the first nine months of 2019. The decrease was attributable to lower capital expenditures in recent years and an increased use of operating leases for equipment.

Gain on the Sale of Assets, Net--Gain on the sale of assets of \$2,045 for the first nine months of 2020 increased \$294 from the \$1,751 gain in the first nine months of 2019. We sold more individual units of equipment during the first nine months of 2020 as compared with the first nine months of 2019.

Interest Expense--Interest expense of \$5,477 decreased \$1,120 from the \$6,597 incurred in the first nine months of 2019. The decrease was attributable to lower interest rates during the first nine months of 2020, as compared with the first nine months of 2019.

Interest Income--Interest income of \$1,885 increased \$1,615 from the \$270 of interest income in the first nine months of 2019. The increase is attributable to interest on PG&E pre-petition receivables which was approved by the United States Bankruptcy Court and received during the third quarter of 2020.

Other, Net--Other expense, net, of \$4,550 decreased \$2,144 from the \$6,694 expense incurred in the first nine months of 2019 and consisted of nonoperating income and expense, including pension expense and foreign currency gains/losses on the intercompany account balances of our Canadian operations.

Income Taxes--Income taxes for the first nine months of 2020 were \$21,018, as compared to \$10,322 for the first nine months of 2019. Our tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, that are taken into account in the relevant period. The effective tax rate for the first nine months of 2020 was 27.8%. Our effective tax rate for the first nine months of 2019 was 24.0%. The change in the effective tax rate from statutory tax rates is primarily due to the impact of state and local taxes which are partially offset by favorable discrete items.

Net Income--Net income of \$54,585 for the first nine months of 2020 was \$21,897 more than the net income of \$32,688 for the first nine months of 2019.

LIQUIDITY AND CAPITAL RESOURCES

Our principal financial requirements are for capital spending, working capital and business acquisitions. Cash generated from operations, our revolving credit facility and note issuances are our primary sources of capital.

Cash Flow Summary

Our cash flows from operating, investing and financing activities for the nine months ended September 26, 2020 and September 28, 2019 follow:

	Nine Months Ended	
	September 26, 2020	September 28, 2019
Cash provided by (used in):		
Operating activities	\$ 99,428	\$ 57,214
Investing activities	(41,614)	(47,554)
Financing activities	(43,739)	(18,716)
Effect of exchange rate changes on cash	(17)	97
Increase (decrease) in cash	<u>\$ 14,058</u>	<u>\$ (8,959)</u>

Cash Provided By Operating Activities--Cash provided by operating activities was \$99,428 for the first nine months of 2020, a \$42,214 increase when compared to the first nine months of 2019. The \$42,214 increase in operating cash flow was primarily attributable to the increase in net income of \$21,897 resulting from increased revenue and operating margins, a change of \$9,698 related to accounts payable and accrued expenses, and a change of \$8,472 related to self-insurance reserves partially offset by a change of \$1,155 related to accounts receivable.

Overall, accounts receivable increased \$34,801 during the first nine months of 2020, as compared to an increase of \$35,956 during the first nine months of 2019. With respect to the change in accounts receivable arising from business levels, the “days-sales-outstanding” in accounts receivable (sometimes referred to as “DSO”) at the end of the first nine months of 2020 increased by three days to 72 days, when compared to 69 days at the end of the first nine months of 2019.

Accounts payable and accrued expenses increased \$28,389 in the first nine months of 2020, or \$9,698 more than the \$18,691 increase in the first nine months of 2019. The increase was primarily related to increases in income taxes and payroll taxes payable. Self-insurance reserves increased \$14,424 in the first nine months of 2020, which was \$8,472 more than the increase of \$5,952 experienced in the first nine months of 2019. The increase is attributable to increased exposures within our workers compensation, general liability and vehicle liability lines of coverage.

As we cannot predict the duration or scope of the COVID-19 pandemic and its impact on our customers and suppliers (or workforce), the negative financial impact to our results cannot be reasonably estimated, but could be material. We are actively managing the business to maintain cash flow and we have significant liquidity. We believe that these factors will allow us to meet our anticipated funding requirements.

Cash Used In Investing Activities--Cash used in investing activities for the first nine months of 2020 was \$41,614, a \$5,940 decrease when compared to the first nine months of 2019. The decrease was primarily the result of decreases in capital expenditures for equipment of \$7,077, which was partially offset by an increase in expenditures for land and buildings of \$1,300. Our decrease in capital expenditures is partially the result of our increased use of operating leases for equipment.

Cash Used In Financing Activities--Cash used in financing activities of \$43,739 increased \$25,023 during the first nine months of 2020 as compared with \$18,716 of cash used during the first nine months of 2019. During the first nine months of 2020, our revolving credit facility, net used \$32,000 in cash as compared with \$28,500 used during the first nine months of 2019. We use the credit facility primarily for capital expenditures, redemptions of shares and payments of notes payable related to acquisitions. In the first quarter of 2020, we drew \$50,000 from our revolving credit facility to provide additional liquidity as a precaution because of uncertainty resulting from COVID-19. The \$50,000 was repaid during the second quarter of 2020. Notes payable provided a net \$2,285 during the first nine months of 2020, a decrease of \$21,888 when compared to the \$24,173 provided in the first nine months of 2019, including \$25,000 provided by the issuance of 4.00% Senior Notes during the first nine months of 2019. Treasury share transactions (purchases and sales) used \$10,791 for the first nine months of 2020, \$792 more than the \$11,583 used in the first nine months of 2019. Dividends paid of \$1,708 during the first nine months of 2020 decreased \$37 as compared with \$1,745 paid in the first nine months of 2019.

The Company currently repurchases common shares at shareholders' requests in accordance with the terms of the Davey 401KSOP and ESOP Plan and also repurchases common shares from time to time at the Company's discretion. The amount of common shares offered to the Company for repurchase by the holders of shares distributed from the Davey 401KSOP and ESOP Plan is not within the control of the Company, but is at the discretion of the shareholders. The Company expects to continue to repurchase its common shares, as offered by its shareholders from time to time, at their then current fair value. However, other than for repurchases pursuant to the put option under the Davey 401KSOP and ESOP Plan, as described in Note Q, such purchases are not required, and the Company retains the right to discontinue them at any time. Repurchases of redeemable common shares at the shareholders' request approximated \$5,280 and \$8,761 during the nine months ended September 26, 2020 and September 28, 2019, respectively. Share repurchases, other than redeemable common shares, approximated \$22,209 and \$16,674 during the nine months ended September 26, 2020 and September 28, 2019, respectively.

Contractual Obligations Summary and Commercial Commitments

As of September 26, 2020, total commitments related to issued letters of credit were \$88,242, of which \$2,877 were issued under the revolving credit facility, \$83,355 were issued under the AR Securitization program, and \$2,010 were issued under short-term lines of credit. As of December 31, 2019, total commitments related to issued LCs were \$81,619, of which \$2,877 were issued under the revolving credit facility, \$76,732 were issued under the AR Securitization program, and \$2,010 were issued under short-term lines of credit.

Also, as is common in our industry, we have performance obligations that are supported by surety bonds, which expire during 2020 through 2023. We intend to renew the surety bonds where appropriate and as necessary.

Capital Resources

Cash generated from operations, our revolving credit facility and note issuances are our primary sources of capital.

Business seasonality traditionally results in higher revenues during the second and third quarters as compared with the first and fourth quarters of the year, while our methods of accounting for fixed costs, such as depreciation and amortization expense, rent and interest expense, are not significantly impacted by business seasonality. Capital resources during these periods are equally affected. We satisfy

seasonal working capital needs and other financing requirements with the revolving credit facility and other short-term lines of credit. We are continually reviewing our existing sources of financing and evaluating alternatives. At September 26, 2020, we had working capital of \$130,781, and short-term lines of credit approximating \$9,112 and \$217,123 available under our revolving credit facility.

For more information regarding our outstanding debt, see Note F, Long-Term Debt and Commitments Related to Letters of Credit.

We believe our sources of capital, at this time, provide us with the financial flexibility to meet our capital-spending plans and to continue to complete business acquisitions for at least the next twelve months and for the reasonably foreseeable future. However, we cannot predict the full extent of the potential impact resulting from the COVID-19 pandemic on our business, results of operations and sources of capital.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented.

As discussed in our annual report on Form 10-K for the year ended December 31, 2019, we believe that our policies related to revenue recognition, the allowance for doubtful accounts, stock valuation and self-insurance reserves are our “critical accounting policies and estimates”--those most important to the financial presentations and those that require the most difficult, subjective or complex judgments.

On an ongoing basis, we evaluate our estimates and assumptions, including those related to accounts receivable, specifically those receivables under contractual arrangements primarily with Utility customers; allowance for doubtful accounts; and self-insurance reserves. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements relate to future events or our future financial performance. In some cases, forward-looking statements may be identified by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continue" or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to differ materially from what is expressed or implied in these forward-looking statements. Some important factors that could cause actual results to differ materially from those in the forward-looking statements, some of which have been, and may further be, exacerbated by the COVID-19 pandemic, include:

- The coronavirus pandemic (COVID-19) has negatively impacted, and could have a material adverse effect on, our business, results of operations, financial position or cash flows.
- We may be unable to attract and retain a sufficient number of qualified employees for our field operations, and we may be unable to attract and retain qualified management personnel.
- We have significant contracts with our utility, commercial and government customers that include liability risk exposure as part of those contracts. Consequently, we have substantial excess-umbrella liability insurance, and increases in the cost of obtaining

adequate insurance, or the inadequacy of our self-insurance reserves or insurance coverages, could negatively impact our liquidity and financial condition.

- The unavailability or cancellation of third-party insurance coverage may have a material adverse effect on our financial condition and results of operations as well as disrupt our operations.
- We could be materially adversely affected by wildfires in California and other areas as well as other severe weather events and natural disasters, including negative impacts to our business, reputation, financial condition, results of operations, liquidity and cash flows.
- Our business, other than tree services to utility customers, is highly seasonal and weather dependent.
- Significant customers, particularly utilities, may experience financial difficulties, resulting in payment delays or delinquencies.
- We are subject to litigation and third-party and governmental regulatory claims and adverse litigation judgments or settlements resulting from those claims could materially adversely affect our business.
- Significant increases in fuel prices for extended periods of time will increase our operating expenses.
- We are subject to intense competition.
- Various economic factors may adversely impact our customers' spending and pricing for our services, and impede our collection of accounts receivable.
- The impact of regulations initiated as a response to possible changing climate conditions could have a negative effect on our results of operations or our financial condition.
- The seasonal nature of our business and changes in general and local economic conditions, among other factors, may cause our quarterly results to fluctuate, and our prior performance is not necessarily indicative of future results.
- We may misjudge a competitive bid and be contractually bound to an unprofitable contract.
- A disruption in our information technology systems, including a disruption related to cybersecurity, or the impact of costs incurred to comply with cybersecurity or data privacy regulations, could adversely affect our financial performance.
- We are dependent, in part, on our reputation of quality, integrity and performance. If our reputation is damaged, we may be adversely affected.
- Because no public market exists for our common shares, the ability of shareholders to sell their common shares is limited.
- Our failure to comply with environmental laws could result in significant liabilities, fines and/or penalties.
- We may encounter difficulties obtaining surety bonds or letters of credit necessary to support our operations.
- The uncertainties in the credit and financial markets, including the negative impact of COVID-19, may limit our access to capital.
- Fluctuations in foreign currency exchange rates may have a material adverse impact on our operating results.
- Significant increases in health care costs could negatively impact our results of operations or financial position.
- Our facilities could be damaged or our operations could be disrupted, or our customers or vendors may be adversely affected, by events such as natural disasters, pandemics, such as COVID-19, terrorist attacks or other external events.
- Our inability to properly verify the employment eligibility of our employees could adversely affect our business.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this quarterly report on Form 10-Q to conform these statements to actual future results.

The factors described above, as well as other factors that may adversely impact our actual results, are discussed in "Part I - Item 1A. Risk Factors." of our annual report on Form 10-K for the year ended December 31, 2019, as well as in "Part II-Item 1. Risk Factors" of this quarterly report on Form 10-Q.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk.*

With the exception of the impacts of COVID-19, which are discussed elsewhere in this document, there have been no material changes in our reported market risks or risk management policies since the filing of our 2019 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 9, 2020.

Item 4. *Controls and Procedures.*

(a) Management's Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this report in ensuring that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

In response to the COVID-19 pandemic, we have required certain employees, some of whom are involved in the operation of our internal control over financial reporting, to work from home. Despite working remotely, there have been no changes in our internal control over financial reporting during the fiscal quarter ended September 26, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Items 3, 4 and 5 are not applicable.

Item 1. Legal Proceedings.

We are party to a number of lawsuits, threatened lawsuits and other claims arising out of the normal course of business. On a quarterly basis, we assess our liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. Where it is probable that we will incur a loss and the amount of the loss can be reasonably estimated, we record a liability in our consolidated financial statements. These legal accruals may be increased or decreased to reflect any relevant developments on a quarterly basis. Where a loss is not probable or the amount of the loss is not estimable, we do not record a legal accrual, consistent with applicable accounting guidance. Based on information currently available to us, advice of counsel, and available insurance coverage, we believe that our established accruals are adequate and the liabilities arising from the legal proceedings will not have a material adverse effect on our consolidated financial condition. We note, however, that in light of the inherent uncertainty in legal proceedings there can be no assurance that the ultimate resolution of a matter will not exceed established accruals. As a result, the outcome of a particular matter or a combination

of matters may be material to our results of operations for a particular period, depending upon the size of the loss or our income for that particular period.

In November 2017, a suit was filed in Savannah, Georgia state court ("State Court") against Davey Tree, its subsidiary, Wolf Tree, Inc. ("Wolf Tree"), a former Davey employee, two Wolf Tree employees, and a former Wolf Tree employee alleging various acts of negligence and seeking compensatory and punitive damages for wrongful death and assault and battery of the plaintiff's husband, a Wolf Tree employee, who was shot and killed in August 2017.

In July 2018, a related survival action was filed by the deceased's estate against Davey Tree, its subsidiary, Wolf Tree, and four current and former employees in Savannah, Georgia, which arises out of the same allegations, seeks compensatory and punitive damages and also includes three Racketeer Influenced and Corrupt Organizations Act ("RICO") claims under Georgia law seeking compensatory damages, treble damages, and punitive damages. The 2018 case was removed to the United States District Court for the Southern District of Georgia, Savannah Division ("Federal Court"), on August 2, 2018. The Company filed a motion to dismiss the RICO claims. Plaintiffs filed a motion to remand the case to state court, which the Company has opposed.

The cases were mediated unsuccessfully in December 2018 and the State Court case was originally set for trial on January 22, 2019. However, as discussed below, all of the civil cases were later stayed on December 28, 2018 and currently remain stayed.

On December 6, 2018, a former Wolf Tree employee pled guilty to conspiracy to conceal, harbor, and shield illegal aliens. On December 21, 2018, the United States federal prosecutors filed a motion to stay both actions on the grounds that on December 13, 2018, an indictment was issued charging two former Wolf Tree employees and one other individual with various crimes, including conspiracy to murder the deceased. On December 17, 2018, the United States Attorney's Office for the Southern District of Georgia informed the Company and Wolf Tree that they are also under investigation for potential violations of immigration and other laws relating to the subject matter of the ongoing criminal investigation referenced above. The Company and Wolf Tree are cooperating with the investigation.

On December 28, 2018, the State Court granted the United States' motion to stay but indicated that it would nonetheless consider certain pending matters, including: (1) Plaintiff and a co-defendant's motions that Davey Tree be forced to produce privileged documents and testimony, which had been submitted to a Special Master for recommendation; and (2) the Defendants' motions for summary judgment. On January 11, 2019, the Special Master issued his recommendation that both Plaintiff and the co-defendant's motions to force Davey to disclose privileged information be denied. The State Court judge has not yet moved on the recommendation. On January 29, 2019, the State Court heard oral argument on Defendants' motions for summary judgment, and the motions remain pending during the stay of the cases.

On January 28, 2019, the Federal Court also granted the United States' motion to stay. On January 29, 2019, the State Court ordered the parties to return to mediation, which occurred on April 17, 2019 but was unsuccessful in resolving the matters.

In both cases, the Company has denied all liability and is vigorously defending the action. It also has retained separate counsel for some of the individual defendants, each of whom has denied all liability and also is vigorously defending the action.

Item 1A. Risk Factors.

Our Annual Report on Form 10-K for the year ended December 31, 2019, includes a detailed discussion of our risk factors. There have been no material changes to the risk factors as previously disclosed other than as described below. However, some of the risk factors

disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019 have been, and we expect will continue to further be, exacerbated by the impact of the COVID-19 pandemic.

Our business, results of operations, financial position or cash flow could in the future be materially adversely impacted by the coronavirus pandemic (COVID-19).

The global spread of the coronavirus pandemic (COVID-19) has created significant volatility and uncertainty and economic disruption. The extent to which COVID-19 impacts our business, operations and financial results will depend on numerous evolving factors that we may not be able to accurately predict including: the duration and scope of the pandemic, including the current resurgence of cases in the United States and potential challenges caused by the colder winter months, including the onset of the cold and flu season; the impact of the pandemic on economic activity, including the possibility that any future recovery from the COVID-19 pandemic and related impact may also be slowed or reversed by a number of factors, including new or additional resurgences in COVID-19 infections; government imposed restrictions in response to the pandemic, including the temporary shutdowns and work restrictions related to COVID-19 in a few states and certain Canadian provinces impacting our Residential and Commercial Services segment and the possibility that previously-lifted restrictions will be reimposed, or additional restrictions put in place; the effect on our customers and their demand for our services; and the ability of our customers to pay for our services. Clients may slow down decision making, delay planned work or seek to terminate existing agreements. The degree of impact of COVID-19 on our customer sales demand will depend on the extent and duration of the economic contraction.

We have taken steps to support our employees and protect their health and safety, while also ensuring that our business can continue to operate and provide services to our customers. Where possible, we have transitioned our employees to work from home and implemented measures to ensure social distancing when providing services to our customers. The resources available to employees working remotely may not enable them to maintain the same level of productivity and efficiency, and these and other employees may face additional demands on their time, such as increased responsibilities resulting from school closures or the illness of family members. Our increased reliance on remote access to our information systems could also increase our exposure to potential data breaches. There is no certainty that such measures will be sufficient to mitigate the risks posed by COVID-19, in which case our employees may become sick, our ability to perform critical functions could be harmed, and our business and operations could be negatively impacted.

While COVID-19 did not have a material adverse effect on our reported results for the first nine months of 2020, due to the inherent uncertainty surrounding COVID-19 given its continual evolution, such as the current resurgence in cases, we are unable to predict the ultimate impact that it may have on our business, including how it will impact our customers, employees, supply chain and liquidity. The situation surrounding COVID-19 remains fluid, and the potential for a material impact on our business increases the longer the coronavirus impacts the level of economic activity in the U.S. and globally. Even after the COVID-19 pandemic has subsided, we may experience an impact to our business as a result of the current economic recession and any economic downturn or recession that may occur in the future.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table provides information on purchases of our common shares outstanding made by us during the first nine months of 2020.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
Fiscal 2020				
January 1 to January 25	1,005	\$ 22.60	—	866,570
January 26 to February 22	645	22.60	—	866,570
February 23 to March 28	331,652	24.20	—	866,570
Total First Quarter	333,302	24.19	—	
March 29 to April 25	297,079	24.20	—	866,570
April 26 to May 23	251,981	24.20	—	866,570
May 24 to June 27	110,488	24.20	—	866,570
Total Second Quarter	659,548	24.20	—	
June 28 to July 25	1,128	24.20	—	866,570
July 26 to August 22	51,039	24.90	—	866,570
August 23 to September 26	87,434	24.90	—	866,570
Total Third Quarter	139,601	24.89	—	
Total Year-to-Date	1,132,451	\$ 24.28	—	

Our common shares are not listed or traded on an established public trading market and market prices are, therefore, not available. Semiannually, for purposes of the Davey 401KSOP and ESOP, the fair market value of our common shares is determined by an independent stock valuation firm, based upon our performance and financial condition, using a peer group of comparable companies selected by that firm. The peer group currently consists of: ABM Industries Incorporated; Comfort Systems USA, Inc.; Dycom Industries, Inc.; FirstService Corporation; MYR Group, Inc.; Quanta Services, Inc.; Rollins, Inc.; and Scotts Miracle-Gro Company. The semiannual valuations are effective for a period of six months and the per-share price established by those valuations is the price at which our Board of Directors has determined our common shares will be bought and sold during that six-month period in transactions involving Davey Tree or one of its employee benefit or stock purchase plans. Since 1979, we have provided a ready market for all shareholders through our direct purchase of their common shares, although we are under no obligation to do so (other than for repurchases pursuant to the put option under The Davey 401KSOP and ESOP Plan, as described in Note Q, The Davey 401KSOP and Employee Stock Ownership Plan). The purchases described above were added to our treasury stock.

At the Annual Meeting of Shareholders of the Company held on May 16, 2017, the shareholders of the Company approved proposals to amend the Company's Articles of Incorporation to (i) expand the Company's right of first refusal with respect to proposed transfers of shares of the Company's common shares, (ii) clarify provisions regarding when the Company may provide notice of its decision to exercise its right of first refusal with respect to proposed transfers of common shares by the estate or personal representative of a deceased shareholder, and (iii) grant the Company a right to repurchase common shares held by certain shareholders of the Company.

On May 10, 2017, the Board of Directors of the Company adopted a policy regarding the Company's exercise of the repurchase rights granted to the Company through amendments to the Company's Articles of Incorporation, as approved by shareholders on May 16, 2017.

Until further action by the Board, it is the policy of the Company not to exercise its repurchase rights under the amended Articles with respect to shares of the Company's common shares held by current and retired employees and current and former directors of the Company (subject to exceptions set forth in the policy) (collectively, "Active Shareholders"), their spouses, their first-generation descendants and trusts established exclusively for their benefit.

Until further action by the Board, it is also the policy of the Company not to exercise its rights under the amended Articles to repurchase shares of the Company's common shares proposed to be transferred by an Active Shareholder to his or her spouse, a first-generation descendant, or a trust established exclusively for the benefit of one or more of an Active Shareholder, his or her spouse and first-generation descendants of an Active Shareholder, or upon the death of an Active Shareholder, such transfers from the estate or personal representative of a deceased Active Shareholder. The Board may suspend, change or discontinue the policy at any time without prior notice.

In accordance with the amendments to the Articles approved by the Company's shareholders at the 2017 Annual Meeting, on May 17, 2017, the Company's Board of Directors authorized the Company to repurchase up to 200,000 common shares, which authorization was increased by an additional 1,000,000 common shares in May 2018. Of the 1,200,000 total shares authorized, 866,570 remain available under the program. Share repurchases may be made from time to time and the timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors. The Company is not obligated to purchase any shares, and repurchases may be commenced, suspended or discontinued from time to time without prior notice. The repurchase program does not have an expiration date.

Item 6. *Exhibits.*

See Exhibit Index page below.

Exhibit Index

Exhibit No.	Description	
31.1	Certification of Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed Herewith
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed Herewith
32.1	Certification of Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.	Furnished Herewith
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.	Furnished Herewith
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 26, 2020, formatted in iXBRL (inline eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets (unaudited), (ii) the Condensed Consolidated Statements of Operations (unaudited), (iii) the Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited), (iv) the Condensed Consolidated Statements of Shareholders' Equity (unaudited), (v) the Condensed Consolidated Statements of Cash Flows (unaudited), and (vi) Notes to Condensed Consolidated Financial Statements (unaudited). The instance document does not appear in the interactive data file because its XBRL tags are embedded within the inline XBRL document.	Filed Herewith
104	Cover Page Interactive Data File (embedded within the inline XBRL document)	Filed Herewith

Signatures

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

THE DAVEY TREE EXPERT COMPANY

Date: November 3, 2020

By: /s/ Joseph R. Paul

Joseph R. Paul

Executive Vice President, Chief Financial Officer and Secretary

(Principal Financial Officer)

Date: November 3, 2020

By: /s/ Thea R. Sears

Thea R. Sears

Vice President and Controller

(Principal Accounting Officer)

Certification***Certification of Chief Executive Officer***

I, Patrick M. Covey, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Davey Tree Expert Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2020

/s/ Patrick M. Covey

Patrick M. Covey

Chairman, President and Chief Executive Officer

Certification

Certification of Chief Financial Officer

I, Joseph R. Paul, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Davey Tree Expert Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2020

/s/ Joseph R. Paul

Joseph R. Paul

Executive Vice President, Chief Financial Officer and Secretary

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Certification of Chief Executive Officer

I, Patrick M. Covey, President and Chief Executive Officer of The Davey Tree Expert Company (the "Company"), do hereby certify in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended September 26, 2020 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), as applicable; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 3, 2020

/s/ Patrick M. Covey

Patrick M. Covey

Chairman, President and Chief Executive Officer

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Certification of Chief Financial Officer

I, Joseph R. Paul, Executive Vice President, Chief Financial Officer and Secretary of The Davey Tree Expert Company (the "Company"), do hereby certify in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the period ended September 26, 2020 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), as applicable; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 3, 2020

/s/ Joseph R. Paul

Joseph R. Paul

Executive Vice President, Chief Financial Officer and Secretary