

## REINVENTING OUR COMPANY AND REGENERATING OUR SUCCESS

Last year we called our annual report “New Beginnings”. In this report – titled “Reinvention and Regeneration” – we look at the progress we are making on the demanding journey back to strong, sustainable growth. From transforming our relationships with customers to creating closer ties with employees; from rethinking business models to streamlining processes; 2006 saw our new management team address an array of challenges and carry out many decisive actions, with some success. Over the following pages we look at how far we have come. We assess the improvements made, the areas that remain difficult and the opportunities we see ahead.

### OUR STRATEGY

Our ambition is to be the brand of choice in every market that we serve and to be the trusted provider of services for our commercial and residential customers. We aim to be recognised as a leading international business, dedicated to outstanding customer service.

In 2006 we continued to progress the strategy we formulated in 2005 to redirect and re-energise Rentokil Initial and restore it to sustainable, profitable growth. 2005 was focused on developing a detailed plan to achieve these goals and to ensuring we had the right business structure and management team in place. 2006 has been a year of action to implement this plan based on a number of key themes:

- Fixing deep-seated operational problems in businesses such as UK Washroom and UK Pest Control.
- Improving the profitability of every business through productivity and process improvements.
- Reshaping the business portfolio to enhance shareholder value: building on strong market positions or exiting businesses worth more to others.

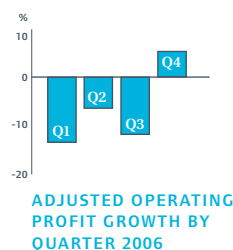
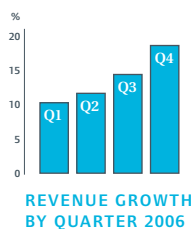
- Developing a more customer focused, outward looking and dynamic culture.

- Developing a talented and committed management team.

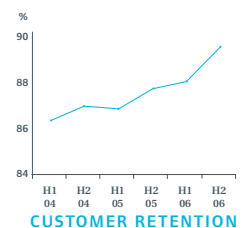
While simple to describe, this is a big agenda. The desirability of achieving each element is unarguable; the challenge is in achievability, the impact and how quickly it can be delivered – not everything can be completed in a year. As a board, we believe we are generally on track with where we set out to be at this stage, although some things have done better than we had anticipated whilst others have been slower.

The principal risks and uncertainties relating to our strategy are summarised below and discussed at greater length in the relevant parts of this review.

- Disruption in the businesses undergoing extensive organisational change.
- Ensuring acquisitions are integrated properly and meet the investment case.
- Resolving the challenges in the Textiles and Washroom Services division in some of its continental European markets.
- Retaining the management team.



**12.7%**  
REVENUE GROWTH





## MAKING PROGRESS

Doug Flynn (left), Chief Executive, and Brian McGowan (right), Chairman  
“As a board, we believe we are generally on track with where we set out to be at this stage, although some things have done better than we had anticipated whilst others have been slower.”

## WHAT WE ACHIEVED IN 2006

### Fixing Operational Problems

We have continued to work on fixing the deep-seated operational problems in a number of specific businesses and progress was made in many of them during the year.

One example of this is UK Washroom, perhaps the most complex performance improvement programme we are undertaking. The first stage involved separating the washroom business from the linen and workwear activities, which were then closed. The second stage was integration of the former Rentokil and BET washroom operations – run separately since BET was acquired ten years ago – to build a new washroom business different from either of those it is replacing. Thirty branches have been closed and we now operate from 25 locations with plans to reduce to 20. You can read more about this on page 12.

UK Pest Control is another example of how we are tackling operational problems. Despite its leading market position, this business had suffered for some time from an erosion of customer contracts as a result of inadequate service performance and a one dimensional approach to winning new customers. A new management team is addressing these issues by using service knowledge and customer focus, combined with efficient delivery, to retain and win customers. Page 17 gives more details on this and the benefits we expect to gain.

Significant restructuring has also been carried out in the French textiles business. The new structure centralises the management of processing plants while retaining profit and loss responsibility at branch level. Sales management has been bolstered in an endeavour to improve sales productivity. The centralised management of processing should lead to a better approach to plant investment and capacity utilisation.

The three businesses in these examples together account for over 15% of total revenue from continuing operations and their success is therefore critical to the overall success of the company. In each case, a significant amount of organisational change is taking place affecting a large number of people in many different locations. To avoid the risk that the change programmes will not be executed as well or as quickly as anticipated, there are detailed plans in place which are monitored closely to ensure we can correct any deviations in an effective and timely manner.

### Improving Profitability

Another key part of our strategy in 2006 was to improve the profitability of every business in the group. As well as dealing with operational challenges such as the ones described above, this centres on productivity and process improvements. Through this we can improve the quality and reduce the cost of what we do.

A great deal of progress can and is being made simply by challenging the way businesses are organised and processes are carried out. While technology investment has lagged and will help in the future, more can be done in the short to medium-term by “working smarter”. The benefits of the group’s work in this area will be realised over the next several years; it is not a question of quick wins.

There are clear opportunities to improve quality and customer responsiveness and reduce costs through the processes we employ. These opportunities are available in almost every area of what we do. They include new IT systems and the setting up of centralised services to increase administrative efficiency. In the UK, for example, a service centre is being created in Dudley. In some businesses, such as UK Pest Control, we have taken out layers of management. In others, we are rationalising processing plants, for example in Textiles in southern Germany. At the group’s head office, certain functions have been resized and headcount reduced by transferring responsibility for activities such as R&D and health & safety to the divisions to ensure these functions are aligned to business goals.

### Reshaping the Business Portfolio

Our role as a board is to optimise the shape of the group as well as to oversee operational performance. We do not believe we can simply “fix the businesses” before we start to reshape the company. Clearly both are necessary and need to be addressed in parallel to ensure opportunities to create value are not overlooked. For example, had we waited until challenges in other divisions were resolved we would have missed out on the value-creating acquisition of Target Express.

In 2006 we acquired over 70 operations for a consideration of £429 million. At the same time we exited a number of businesses, generating disposal income of over £144 million.

All these transactions were based on our commitment to enhance shareholder value by building on strong market positions or exiting businesses which are worth more to others. In considering an

acquisition we look at a number of important criteria; does it meet financial hurdles? can our management run the enlarged business? do we have a clear post-acquisition plan? is the acquisition capable of building a market leading position and of good growth? Ensuring that post-acquisition plans are tightly controlled is essential to ensuring that acquisitions are integrated so that they meet the goals set out in the approved investment case. This is particularly true for larger deals which could pose a significant integration risk like Ehrlich and Target Express. The board therefore regularly reviews the major integration plans and progress against them.

Acquisitions have focused on areas which have superior growth rates in terms of both our markets and our own businesses, particularly Pest Control, Parcel Delivery and Asia Pacific.

The acquisition of JC Ehrlich was highlighted in last year's annual report. Ehrlich and the existing US Rentokil pest control businesses have now been fully integrated and are performing well in the world's largest pest control market. Ehrlich's revenues grew by 9% in 2006, ahead of market growth of some 6%.

At the end of 2005 we began a process to transform City Link into an integrated parcel delivery business and moved a considerable way along this path in 2006. By the end of the year, we owned over 80% of the City Link network having bought nine franchises during 2006. Target Express, acquired in November for £213 million, will be integrated with City Link to create a leading overnight parcel delivery business with the number two position in the UK. They are highly complementary with similar business models and a shared passion for operational excellence and customer service. There are substantial synergies between City Link and both the acquired franchises and Target Express. It will take all of 2007 and 2008 to realise those synergies in full. With revenue growth rates approaching

10% in both City Link and Target Express in 2006, they easily outstripped market growth of around 4%.

Asia Pacific is also undergoing an acquisition-led transformation. Its markets are growing at an average of 5-6% a year, although there is some variation between the more established markets of Australasia and new markets of North Asia. In 2006, 25 acquisitions were completed in the region for a total of £47 million. Asia Pacific is rapidly becoming a powerhouse for growth within the group and we expect this to continue for the foreseeable future. The board is confident that the local management team which has been built in Asia Pacific in the past year has the skills and experience to manage this growth.

In the first half of 2006 we sold Manned Guarding in a series of transactions for a total of £150 million. In November, we announced that we were undertaking a strategic review of the Electronic Security division in Europe and the USA. As a result of that announcement, strong interest in purchasing this business has come from trade and private equity buyers. A formal sale process commenced in January 2007 and we expect resolution by the end of June 2007.

### Building and Developing Our Team and Culture

The culture and the commitment of management and staff are extremely important to the success of the group. These are not easily measured and it is difficult for shareholders to appreciate the degree of improvement. However, without progress in these areas our overall success is impossible.

Our ability to recruit and assimilate a large number of new managers into a complex, fast moving environment and then retain them is of utmost importance to achieving our strategic and operational goals. Great emphasis is therefore placed on both

### ACQUIRING THE LEAD IN ASIA PACIFIC

**We completed 71 acquisitions in 2006 and the division with the highest number of deals was Asia Pacific.**

Here, we completed 25 acquisitions spread across nine countries: from washroom services and pest control in Australia to dust mats in China, from tropical plants in New Zealand to electronic security in Singapore.

Some of the acquisitions enhanced existing strong market positions – such as Pink

Healthcare, which consolidated our position as Australia's leading washroom services company.

# £47m

2006 ACQUISITION SPEND

Other acquisitions provided entry into markets new to the group, including a number of deals made in China, our first steps into Vietnam and an entry into the electronic security market in Singapore.

The acquisition pipeline looks healthy for 2007 with further deals likely across the region. Indeed, we have already made progress with the acquisition of Campbell Brothers, which gives us an entry into residential pest control in Australia and Ding Sharn, through which we are now the number one pest control company in Taiwan.



recruitment and reward to ensure we have the right people and are able to keep them. We are delighted with the response of existing and new staff who are motivated by the scale of the challenges we face.

Many changes have been made to the company's senior management team and the influx of new people – together with the commitment of those who have been with the group for some time – is slowly bringing about a change in the culture of our company. We are leaving behind the inward focused, risk averse culture and moving towards a high performance, outward looking, innovative ethos.

Cultural change is being effected through strong leadership and by creating a climate where people are empowered to make decisions about their businesses and their careers. To do this, we must support our current leaders and in 2006 we introduced a group-wide leadership programme which provides our people with the tools to develop their skills. However, developing today's leaders is not enough; we must also identify and recognise the potential of future leaders. A talent management process, also introduced in the past year, is enabling us to understand better the performance and potential of our people so we can make the best use of these for both the business and each individual. There are more details about these programmes on page 8 and the Corporate Responsibility section starting on page 34 details some other workplace initiatives designed to enhance the working lives of our people.

Ensuring that rewards and incentives are aligned to the aims of the business – and ultimately the interests of our shareholders – is a key element of encouraging strong performance. We have introduced a performance review process to enable us to link reward and performance for all the group's managers, some 2,000 people. Shareholders approved a new long-term incentive plan for the top 500 or so senior people at the 2006 AGM, further information on

which is provided in the directors' remuneration report starting on page 46.

As well as changes in operational management, there were a number of changes to the board in 2006. As mentioned in last year's annual report, Ron Spinney and Paul Mason stepped down from the board in May and we reiterate our thanks to them both. We were pleased to welcome two new non-executive directors, Alan Giles and Peter Bamford, who joined the board in May and July respectively. Alan and Peter's biographies are on page 39 and we are delighted with the contribution they are already making to the board.

#### HOW WE MEASURE ACHIEVEMENT

The board uses a number of key performance indicators (KPIs) to judge progress towards strategic objectives. Although many of these KPIs are "output" measures – such as portfolio development, revenue and profit growth – in a complex company such as Rentokil Initial the board believes they are the most relevant way of demonstrating to shareholders progress on important issues such as customer satisfaction, service levels, staff satisfaction and innovation. This is because if we fail to move forward in the latter we will be unable to make sustainable progress in the former. A commentary on performance against KPIs at group and divisional level can be found in the review of performance.

For businesses with recurring revenue, KPIs relating to contract portfolio development are important, some because they are an inherent measure of the level of service we are providing to our customers and others because they are indicators of market strength. The contract portfolio represents the annualised value of our customer contracts and is a leading indicator of performance. We refer to the increase in the contract portfolio as "net gain" which

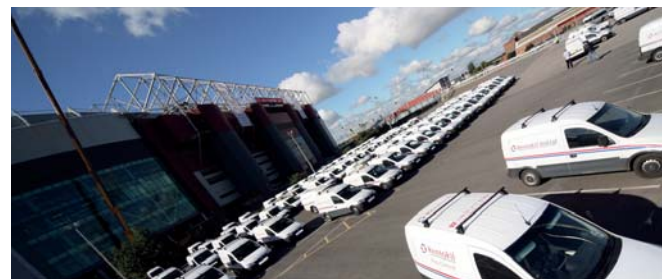
#### UNITED AT OLD TRAFFORD

**At a time of change it is vital to get employee communications right.**

In September 2006, Rentokil Pest Control in the UK organised a two-day conference for 750 of its managers, technicians and surveyors. The aim was to ensure that the company's employees received a clear briefing at first hand about the planned reorganisation programme and were given the opportunity to provide their input before the programme was carried out.

The changes agreed were wide ranging: 26 branches across the UK will fold into 11 area/regional offices, a new National Call Centre is to be introduced in Dudley and a new National Support Centre created in the Thames Valley, multiple local area service teams will be created and a new Technical Service team focused on the needs of high dependency customers is to be established.

The gathering at Old Trafford – home of Manchester United – was the first company conference in many years to include the entire front line pest control team.



is made up of a number of component KPIs. “New business wins” shows us how successful our sales activities are. “Customer retention” indicates how satisfied our customers are with the services we provide. Changes in the “as used” portion of contracts show variations in the amount of business existing customers give us under their contracts and the impact of price movements: as such they can often be an early indicator of market trends. For example, in some of the European textiles businesses, a decline in the “as used” portion of garments contracts (i.e. the actual number of garments we process for customers) is a reflection of a shift in manufacturing jobs to lower cost countries. For non-portfolio businesses such as Parcel Delivery, the equivalent KPIs are number of consignments and revenue per consignment.

After the portfolio, we look at growth in total and organic revenue. We then look at net margin which is a way to judge the success of performance and productivity improvement initiatives; improving efficiency in a sustained way is fundamental to first stabilising and then expanding margins.

Our profit KPI is operating profit (profit before interest, tax and amortisation). In 2006 we have reported operating profit both before and after one-off costs, referring to the latter as adjusted operating profit. We believe that to look at underlying trends we need to strip out these costs as they principally relate to one-time restructuring/rationalisation projects. As the level of one-off costs diminishes in the future, we will no longer need to use adjusted operating profit as a KPI.

For the overall group, we look at all these KPIs plus some which are only relevant to the group as whole. These are operating cash flow and free cash flow – which are measures of our ability to invest in our businesses and to pay dividends – and profit before tax and

amortisation (PBTA). As with operating profit, in 2006 we have also used adjusted PBTA which excludes one-off costs.

#### WHAT WE EXPECT TO ACHIEVE IN 2007

In 2007, shareholders can expect to see progress in those businesses which have been undergoing deep change to the extent that by the end of the year they will be back to “business as usual”. In particular Pest Control and Washroom in the UK will both complete the transition to their final planned configurations.

The Pest Control division is now on a satisfactory growth path and with the completion of the UK changes during the year we are confident this sound business will return to profitable growth in 2007 and beyond.

Textiles and Washroom Services still has a number of operational issues to deal with and faces difficult market conditions in continental Europe which impacted our ability to recover higher costs in 2006, leading to margin erosion. The board believes that this division is the major challenge for the group and it is vital that progress is made in 2007. New divisional management is in place and shareholders will be kept informed of our plans as the year progresses.

Overall, we expect to achieve more in terms of both customer retention and new sales growth. We also expect to make progress in improving efficiencies. We are confident that productivity improvements can be made in most areas including administration, service and sales. Given the scope in this area we expect gains to be made over each of the next several years.

2007 will be an important year for those businesses that have been active acquirers as they progress integration and development plans; most particularly in Parcel Delivery and Asia Pacific. In Asia

#### REINVENTING CUSTOMER SERVICE

**Putting customers at the centre of everything we do is essential for success.**

Our research shows that customers who are happy with the way we manage their accounts and resolve any problems that occur are more likely to keep their business with us.

In the UK, individual branches have traditionally carried out account

management. Now, a customer service centre is being established at Dudley, near Birmingham, to handle both customer facing and back office functions. The new operation builds on the infrastructure of a service centre which has been operated by the Facilities Services division with great success for some years.

By the second quarter of 2007 more than 400 staff will be in place dealing with customer enquiries, inbound and outbound telesales, accounts payable and receivable and payroll, together with HR

administration and IT support, for the UK operations of Pest Control, Washroom Services, Facilities Services and Tropical Plants. Customers will benefit from longer opening hours and our ability to gain instant access to customer data and to follow-up to ensure issues have been dealt with, and swifter handling of new business enquiries.

As well as improving our responsiveness to customers, there will be an ongoing cost saving of around £3 million a year by the end of 2008.



Pacific, the integration plans for both larger acquisitions like Pink and Campbell Brothers (acquired in January 2007) and the smaller businesses are reasonably straightforward and should be largely completed within the year. Parcel Delivery requires a much more sophisticated process as it absorbs both the franchise network and combines with Target Express. The integration will be completed by the end of 2008.

The sale of Electronic Security is expected to be completed before the end of June. The proceeds of this sale will be used to pay down debt. Further acquisitions will be made, including the outstanding City Link franchises and additional deals in Asia Pacific. The board believes there may be some consolidation in the European textiles and washroom industry during 2007 and will monitor this situation to ensure we are able to take advantage of any opportunities that might arise to protect or enhance shareholder value.

Overall, the board expects 2007 to be a year of stabilisation, building on the progress made in 2006 in revenue growth – particularly organic growth – and improvements in contract retention rates. Profit before tax and amortisation will be in line with 2006 before the impact of costs associated with rationalisation projects and the integration of Target Express. Some regression is expected in the first quarter due to a number of specific factors, not least the declining trends in Textiles and Washroom Services which were still apparent in the fourth quarter of 2006. However, we have recently begun to see some improvements in contract portfolio development in this division and, if these trends continue, we would expect to improve on the position for the year.

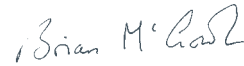
The dividend policy is unchanged; we will continue to take a cautious approach to dividend growth until the recovery in the businesses is well established. However, the board does not believe there will be a need to reduce it from the 2006 level.

## SUMMARY

The board's intention is to create a group capable of sustained profit growth. Following the work we have done over the past two years, we expect several of our key businesses to achieve this in 2007, particularly Pest Control (in Europe and the USA), Parcel Delivery, UK Cleaning and Asia Pacific. This will come from a combination of organic growth – from better customer retention rates and higher new sales – and acquisitions. At the same time we do not underestimate the need to resolve the issues affecting Textiles and Washroom Services.

A need for a clear growth trajectory firstly in revenue and then in profit has been behind our thinking and actions in our business operations and acquisitions and disposals. A key part of that has been much greater focus on customers – on identifying their needs through customer segmentation and through improving service levels. Our marketing and selling is getting better and we are broadening our routes to markets.

Finally, we asked a lot from our people in 2006 and we are proud of the way they stepped up to the challenge. We extend our thanks to each of them for their hard work and continuing commitment.



**Brian McGowan**  
Chairman



**Doug Flynn**  
Chief Executive

14 March 2007