

FINANCIAL REVIEW

CENTRAL COSTS

£ million	Fourth quarter			Full year		
	2007	2006	change	2007	2006	change
At 2006 constant exchange rates						
Central costs	0.1	(9.6)	101.0%	(28.5)	(19.5)	(46.2%)
One-off items	–	2.6	–	–	(9.2)	–
Central costs before one-off items	0.1	(7.0)	101.4%	(28.5)	(28.7)	(0.7%)

Central costs for the quarter were £7.1 million below the same quarter last year, mainly as a result of the partial reversal of 2006 and 2007 LTIP charges, the reassessment of bonus and similar provisions (reflecting lower-than-expected profits for the year) and the release of certain property provisions due to favourable changes in sub-let income. In the full year, there were a number of non-recurring charges and credits which have not been treated as one-off items as they are not linked to the group's restructuring programme. The largest two items which occurred in the second quarter were an asset retirement, together with associated charges, of £10 million and the £10 million net release of surplus property and environmental provisions. This followed a successful exit from onerous lease liabilities at a large site in Maldon, Essex. A cash payment of £13.2 million was made and the associated provisions were released. In addition, start-up costs of some £3.0 million were incurred in the first half on setting up the UK Shared Service Centre in Dudley. The run-rate of central costs is expected to be around £9.0 million per quarter in 2008.

ONE-OFF ITEMS

One-off items relate to the group's restructuring programme and consist of consultancy, redundancy and reorganisation costs net of the profit on sale of certain properties in the UK washroom business. They have been separately identified as they are not considered to be "business as usual" expenses and have a varying impact on different businesses and reporting periods. In aggregate they make it difficult to understand underlying trends in performance unless they are separately identified.

Across the group, the net cost of these one-off items for the year was £28.4 million, compared with £22.6 million last year. This represents costs of £39.1 million offset by profit of £10.7 million on the disposal of surplus UK washroom properties. Of the costs, £25.4 million related to the integration of City Link and Target Express. Another £12.8 million was incurred in the rationalisation of Textiles and Washroom with a further £0.9 million to complete the UK Pest Control and Facilities Services rationalisation programmes. £18.3 million of the City Link integration costs are provisions for the estimated cost of exiting surplus leasehold depots.

INTEREST

Net interest payable for the year was £71.9 million, a £20.8 million increase over the prior year. Of the increase, approximately £6.1 million was attributable to higher levels of average debt and £14.7 million to effective interest rates which were, on average, approximately 1.3% higher than in 2006.

The interest charge was reduced by approximately £7.7 million in the third quarter and approximately £8.7 million in the fourth quarter as a result of the receipt of £533 million in early July and £92 million in late December following the sale of the group's Electronic Security division. Approximately £800 million of the group's forecast debt is at fixed rates of interest averaging 5.8%. The balance is exposed to LIBOR.

TAX

The blended headline rate for 2007 was 30.0% (2006: 30.7%). This represents the weighted headline tax rates appropriate

to the countries in which the group operates. The income statement tax charge for 2007 for continuing businesses was 21.3% of profit before tax from continuing operations, compared with 20.1% for 2006. The principal factor that caused the effective tax rate to be lower than the blended rate is the release of provisions for prior year items as the positions are now agreed with the relevant tax authorities. The blended headline rate for 2008 is expected to be approximately 29.3%.

DISCONTINUED OPERATIONS

Our Electronic Security division was sold during the year at a headline price of £595 million. The sales of the UK, Netherlands and US businesses were completed in early July 2007 and the French business completed in December, following regulatory approval by the French authorities. As a result the activities of the division have been treated as discontinued operations and excluded from the profit before income tax. Revenue from the Electronic Security division for the periods to completion was £181.2 million, generating adjusted operating profit of £25.7 million before amortisation of intangible assets (excluding computer software and development costs). Profit on sale of the division was £524.8 million on which no tax is expected to be paid.

DIVIDENDS

The board has recommended an unchanged final dividend of 5.25p per share which, if approved, will be payable on 23 May 2008 to shareholders on the Register on 18 April 2008. The total dividend for the year will be 7.38p, the same as last year. The board's dividend policy remains unchanged and the dividend will not be increased until the group returns to sustainable profitable growth.

CASH FLOW AND DEBT

Operating cash flow was £188.1 million compared with £211.0 million in the prior year. Although EBITDA was £36.2 million better than last year (reflecting the non-recurrence of losses incurred in the UK linen and workwear business in 2006 and partially offset by the disposal of Electronic Security in July 2007), the working capital and net

capex outflows were £46.0 million and £13.1 million worse than 2006, leaving operating cash flow £22.9 million below last year. The working capital outflow has three main components: the payment made to exit the onerous property in Essex; the cash payment in 2007 of certain reorganisation costs provided at the end of 2006; and an increase in trade receivables consistent with the increase in fourth quarter revenues.

Free cash flow was £102.1 million (2006: £128.6 million) reflecting lower net tax payments following the receipt of certain refunds in the first half.

Acquisition activity resulted in a cash outflow of £197.4 million for the year with receipts from disposals (mainly Electronic Security) producing an inflow of £596.8 million. Additional contributions of £80.0 million were made to, or for the benefit of, the UK Pension Scheme during the year.

At 31 December, net debt was £947.1 million. The group currently has £852 million of committed bank finance with available headroom of £775 million at the end of February 2008. This is adequate to deal with the group's foreseeable requirements and also to provide cover for 2008's capital market maturities (€100 million in July 2008 and £250 million in November 2008) in the event that the debt capital markets remain difficult for the remainder of the year.

FINANCIAL RISK MANAGEMENT POLICIES

The board has approved the following financial risk management policies. These policies cover those financial risks that are material to the company's operations and financial results. The board has set appropriate delegated authorities, treasury financing parameters and reporting procedures to ensure compliance with such policies at all times. The effect of the company's treasury activities is reflected in the disclosures in notes 16, 21 and 22.

CAPITAL STRUCTURE AND FINANCING STRATEGY (LIQUIDITY RISK)

The board has set the following policies so as to minimise the company's exposure to liquidity risk and thus ensure that the company is able to meet its liabilities as they fall due.

The company is committed to maintaining a debt/equity capital structure that is sufficiently robust so as to ensure the continued access to a broad range of financing sources and thus be able to maintain sufficient flexibility to pursue commercial opportunities, in a timely manner as they present themselves, without the imposition of onerous financing terms and conditions. The company will target a minimum financing headroom of £200 million, when measured against its latest forecast/anticipated cash flows over a rolling nine-month time horizon. The company's sources of finance should be structured in a manner so as to minimise potential refinancing risk particularly arising from a bunching of debt/note facility maturities.

The company's financing sources should be diversified, across the international banking and capital markets, so as to avoid the over-reliance upon a single source, or disproportionately large source, of funds from an individual capital market note issue or bank finance provider.

In autumn 2005, the group's credit rating from Standard & Poor's was reduced from BBB+ with negative outlook to its current level of BBB. Following the publication of the group's preliminary results at the end of February 2008, Standard & Poor's has placed the group's rating on negative outlook. This outlook change primarily reflected the increased business risk of the group as a result of the recent issues at City Link. We continue to target a stable BBB+ rating in the medium-term as we believe that this strikes an appropriate balance between an efficient capital structure (as represented by a low weighted average cost of capital), liquid access to the capital markets and reasonable pricing.

At 31 December 2007, the group had approximately £544.9 million of undrawn committed bank credit facilities. The company is in compliance with the financial and other covenants within its committed bank credit facilities as well as all obligations relating to the notes issued under the Euro Medium Term Note (EMTN) programme.

In 2007 the group lengthened the maturity profile of its debt. This was achieved through the successful issuance of a €500 million seven year bond in March and the one year extension of the existing £500 million five year syndicated bank credit facility in October, from October 2011 to October 2012.

MARKET PRICE RISK

The company and its reported results are exposed to financial market price movements. These risks principally arise from the interest and foreign exchange rate markets. In addition, through its UK defined benefit pension scheme ("the scheme" – see note 24), the company also has exposure to equity market price movements. The trustee directors are responsible for setting the risk management strategy for this scheme. In 2006 this scheme's exposure to equity market price movements was markedly reduced. In 2006 the scheme's assets were switched from being predominantly in equities (80%/20% equities/bonds) to being mostly in corporate bonds (20%/80% equities/bonds). A 10% movement in equity prices in any one year would give rise to a +/-£20.0 million movement in scheme assets and thus a corresponding movement in the underlying scheme deficit. Shortly after this asset switch, the scheme also undertook inflation and interest rate hedging actions. These actions, together with the closure of the scheme to future accrual with effect from September 2006 were undertaken so as to increase the likelihood that the scheme's assets (together with the company's agreed future contributions) would be sufficient to meet its anticipated financial commitments to existing and future pensioners. The company has agreed a schedule of future company contributions with the scheme's trustee in December 2005.

INTEREST RATE RISK

The policy is to manage interest rate exposures on a 12-month rolling basis (measured quarterly). Unless otherwise agreed by the board, a minimum of 50% of the company's estimated future interest rate exposures should

be fixed (or capped) for a minimum period of nine months forward. Additionally, in the event that the company's interest cover (measured by the ratio of adjusted operating profit to net interest payable) is forecast to fall below 4.75 the board will be required to approve a remedial action plan.

Some 80% of the group's net borrowings are currently at fixed rates of interest for 2008. Thereafter, in the event that interest rates rise or fall by 1% p.a. simultaneously across the group's borrowings, the net interest payable by the group would then correspondingly increase or reduce by approximately £2 million on an annualised basis.

FOREIGN EXCHANGE RISK

Foreign exchange risk can arise as follows:

1. from retranslation of overseas business profits into the sterling functional reporting currency of the company;
2. from retranslation of assets and liabilities of overseas companies into the functional currency of the company;
3. from cross-border trading transactions of group companies; and
4. from the use of currency denominated borrowings and financial instruments used to finance business operations.

The company has a policy of not hedging foreign exchange translation risks outlined in 1 and 2 above. Further, the company has a policy of not hedging foreign exchange risks arising from cross-border trading activities given that these are immaterial.

The company policy is to fund its business operations centrally with borrowings that are substantially denominated (90% or greater) in the same actual or effective currencies*, and in the same proportion as the group's forecast cash flows generated by the business.

*Actual or effective currency. The use of either actual currency borrowings or currency swaps is permitted. Currency swaps economically change the actual currency of borrowing into an effective amount, borrowed in a different currency. Currency swaps will be used in preference to actual currency borrowings when the all-in cost is cheaper than the alternative currency borrowings and/or they enable a closer match to the company's debt maturity calendar.

TREASURY RISK

The company utilises financial instruments to manage financial risks that arise naturally from its business operations. Only group treasury personnel are authorised to deal such instruments on behalf of the company. The board has set strict policies for the use of such instruments. The company's policy is to ensure that their use shall be:

- strictly limited to the management of known or anticipated financial exposures which arise from the company's existing or planned commercial operations;
- only undertaken by suitably qualified or experienced group treasury staff;
- undertaken only after efforts have been taken to avoid the need for use of such derivative instruments to manage the group's financial exposures;
- limited to the management of interest rate or foreign exchange exposures (i.e. no equity related or commodity hedging shall be undertaken without specific board approval);
- undertaken only after the preparation of clear documentation which explains the purpose for the use of the specific derivative and its proposed financial accounting treatment;
- capped by the maximum approved counterparty limit for that transaction; and
- subject where relevant to detailed "hedge effectiveness" testing by group treasury, through to maturity of the transaction, if designated and documented as a "hedge" at the outset of the transaction.

CREDIT RISK

The company limits its exposure to credit risk on financial instruments by ensuring, where appropriate, that instruments used are subject to International Swaps and Derivatives Association market standard legal documentation.

The board also sets maximum counterparty approval limits for individual financial counterparties. These limits are reviewed and varied to take account of changes to the underlying credit rating of individual credit counterparties as required.

ACQUISITIONS

The group acquired businesses in the year for a net consideration of £201.0 million.

Details of the businesses acquired and the revenue and operating profit therefrom are set out in note 30 to the accounts.

PENSIONS

The group's IAS 19 net pension asset was £50.0 million at the end of 2007 compared with a deficit of £118.8 million at December 2006. The group has a number of small defined benefit schemes outside the UK but the principal scheme ("The Scheme") is in the UK which had an asset of £63.9 million at December 2007 compared with a deficit of £108.3 million a year ago. The principal reason for the reduction in the deficit is due to pension contributions of £80.6 million and a change in the underlying financial assumptions (in particular the yield on AA-rated corporate bonds rose significantly and the long-term outlook for inflation increased). Overall, this led to a lower value being placed on liabilities at the end of the year resulting in a gain of some £117.6 million. During the year, equity markets increased (but returned less than assumed) and bond markets ended relatively flat (and returned approximately in line with assumed). The swaps also increased in value. Overall, this led to a loss on assets of around £11.9 million. Experience losses on liabilities were £14.0 million and £80.6 million was paid into the scheme during the year.

ACCOUNTING STANDARDS

The financial statements included in this annual report have been prepared and presented under IFRS as adopted by the EU. The group's accounting policies are set out on pages 71 to 78.

The group has adopted IFRS 7, "Financial Instruments: Disclosure", the complementary amendment to IAS 1, "Presentation of Financial Statements – Capital Disclosures" and IFRIC 14, "IAS 19 – the limit on a defined benefit asset, minimum funding requirements and their interaction" during the year. IFRS 8 "Operating Segments" (effective 1 January 2009) has not been adopted in 2007.