

## Financial review

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### Central costs

£ million	Fourth quarter 2008	2007	Change	Full year 2008	2007	Change
At 2007 constant exchange rates						
Central costs	<b>(9.6)</b>	–	–	<b>(39.0)</b>	(28.5)	(36.8%)
One-off items	–	–	–	–	–	–
Central costs before one-off items	<b>(9.6)</b>	–	–	<b>(39.0)</b>	(28.5)	(36.8%)

Full year central costs were £10.5 million higher than the prior year. Severance costs were incurred in early 2008 associated with the changes in the group's leadership and there has been a higher than normal level of professional fees. In addition, there were a number of non-recurring benefits in Q4 2007 not repeated in 2008 – namely the release of bonus, incentive plan and certain property provisions.

### One-off items

One-off items relate mainly to the group's restructuring programme and consist of consultancy, redundancy and reorganisation costs net of the profit on sale of certain properties. 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.

Across the group the net cost of these one-off items for the year was £19.3 million, compared with £28.4 million in the prior year. Of these £16.4 million related to the integration of City Link and Target Express and represent the write-off of various fixed assets and provisions made for rentals outstanding on vehicles and trailers no longer considered suitable for the integrated business. A further £2.4 million of redundancy and associated costs were incurred in Asia following a complete reorganisation of the region earlier this year.

### Net debt and cash flow

£ million at actual exchange rates	Year to date		
	2008	2007	Change
Adjusted EBITA – continuing businesses	<b>167.2</b>	279.5	(112.3)
Adjusted EBITA – discontinuing businesses	<b>5.0</b>	25.5	(20.5)
One-off items	<b>(19.6)</b>	(28.4)	8.8
Depreciation	<b>190.8</b>	156.6	34.2
Other non-cash	<b>4.9</b>	(6.2)	11.1
EBITDA	<b>348.3</b>	427.0	(78.7)
Working capital	<b>3.2</b>	(68.1)	71.3
Capex – additions	<b>(237.8)</b>	(228.7)	(9.1)
Capex – disposals	<b>15.8</b>	57.9	(42.1)
Operating cash flow	<b>129.5</b>	188.1	(58.6)
Interest	<b>(67.3)</b>	(58.9)	(8.4)
Tax	<b>(27.3)</b>	(27.1)	(0.2)
Free cash flow	<b>34.9</b>	102.1	(67.2)
Dividends	<b>(106.7)</b>	(133.4)	26.7
(Acquisitions)/disposals	<b>(43.0)</b>	399.4	(442.4)
Special pension payment	<b>(33.3)</b>	(80.0)	46.7
FX and fair value adjustments	<b>(267.0)</b>	(47.0)	(220.0)
(Increase)/decrease in net debt	<b>(415.1)</b>	241.1	(656.2)
Closing net debt	<b>(1,362.2)</b>	(947.1)	(415.1)

Operating cash flow at actual rates of exchange was £58.6 million lower than 2007 due to lower EBITA and higher net capex partly offset by a better working capital movement. EBITDA was £78.7 million lower than last year at £348.3 million due to lower operating profit in the current year and the absence of profit from the Electronic Security division which was sold in H2 2007.

Lower disposal proceeds in 2008 accounted for the higher net capex over the previous year – gross capex was 4.0% ahead of last year at £237.8 million. The working capital flows were £71.3 million better than 2007 mainly as a result of much better collection of debtors than in the previous year coupled with a large outflow last year mainly as a result of a £28 million payment made in 2007 to exit from a legacy property which did not recur.

Tax and interest payments (including finance lease interest) were £8.6 million higher than last year, primarily due to the different phasing of interest payments. Free cash was therefore £34.9 million (£16.4 million outflow at the half year) compared with an inflow of £102.1 million in 2007.

Acquisitions and disposals consumed a further £43.0 million, dividend payments amounted to £106.7 million, a further special pension contribution was made of £33.3 million and fair value and foreign exchange losses of £267.0 million produced a total cash outflow of £415.1 million to leave net debt at £1,362.2 million at the end of the year.

### Funding

At 31 December 2008 the balance sheet carrying value of the group's net debt was £1,362.2 million. Of this, £952.6 million is represented by capital market notes issued by the group and the earliest maturity of any of these instruments is 2013. Of the balance of the group's debt of £409.6 million, £436.2 million is drawn under the group's central committed bank facilities and the balance comprises net cash and is made up of cash in the businesses and offset by other borrowings. There are two committed bank lines – a £500 million revolving credit facility which expires in October 2012 and a £125 million revolving credit facility which has an initial expiry date of 22 December 2009 but which is extendable, at the group's sole option, to 30 September 2010. This facility is undrawn and replaces the former £252 million facility which had a latest expiry date of 31 January 2010. These bank lines provide the group's principal source of day-to-day liquidity. Details of the make up of the group's net debt are set out in note 21 to the financial statements.

The group's practice is to reforecast on a monthly basis the expected full year outcome in terms of profit and cash and current and prospective performance are reviewed formally with each of the group's divisions each month. These forecasts, together with supplementary short-term cash forecasts which are provided by the divisions to group treasury, allow the group's cash and debt position to be managed actively.

At 31 December 2008 and 18 March 2009 the group had undrawn headroom in its committed bank facilities of £188.8 million and £245 million respectively. After reviewing group and company cash balances, borrowing facilities and projected cash flows, the directors believe that the group and company have adequate resources to continue operations for the foreseeable future.

In reaching this conclusion the directors have had regard to the group's operating plan and budget for 2009 and projections contained in the three-year plan. The directors have considered carefully the risks to the group's trading performance and cash flows as a result of the difficult global economic environment, the shortage of credit available in the bank finance market in particular and the other principal risks to the group's performance. The group's budget for 2009 shows profitability and cash flow improving compared to 2008, substantially assisted by the cost reduction measures already taken at City Link.

The group has adequate headroom in its bank facilities in terms of funds available to withdraw and has good and improving headroom in relation to its covenant. The group's bank facilities contain a single financial ratio covenant which requires EBITDA to be no less than 4 x interest payable (on the basis of the definitions and subject to the adjustments set out in the bank facility documentation). The covenant is tested on 30 June and 31 December annually for the previous 12 months. At 31 December 2008 the covenant ratio was 5.6 x, equivalent to £102.9 million of EBITDA headroom.

The group had two bond maturities during the year. A €100 million floating rate note which matured in July and a further £250 million 6.125% bond which matured in November. Both were repaid from bank facilities. In September and October 2008 the group raised a total of £125 million by issuing new debt securities and the proceeds were used to reduce drawings on the group's bank lines.

- On 30 September we raised £75 million through the issue of 25-year Floating Rate Reset Notes. From issue until 20 August 2013 the Reset Notes will bear interest at three-month LIBOR + 3.98%. Thereafter the interest rate will be 4.55% plus a credit spread which will be reset every two years by auction. Noteholders may put the Reset Notes back to the issuer, at par, on 20 August 2013 and on each biennial interest reset date thereafter. We may call the Reset Notes at fair market value on interest payment dates from 20 August 2011. If not put or called, the Reset Notes will mature on 20 August 2033.
- On 23 October 2008 we raised a further £50 million through the issue of Floating Rate Notes due 2013 (the "FRNs"). The FRNs were issued at par and carry a coupon of LIBOR + 3.25%.
- Rentokil Initial 1927 plc, a wholly owned subsidiary of Rentokil Initial plc, guarantees the obligations of Rentokil Initial plc to its bondholders, banks and certain other financial counterparties. These

guarantees were due to expire on 19 November 2008 but were extended in November to coincide with the maturity of the £300 million 5.75% Notes due 2016.

At 31 December 2008 the carrying value of the group's net debt was £1,362.2 million, a £415.1 million increase over the year. Of this increase, £227.5 million was due to foreign exchange translation movements and £39.5 million due to IAS 39 debt valuation moves. The group's policy is to match closely the currency of its borrowings to the currency of its operating cash flows so as to achieve an economic hedge of its currency exposures and to protect its interest cover covenant from foreign exchange movements. Following the deterioration in trading in City Link and UK Washrooms and because most of the group's central costs are incurred in the UK, the group currently has minimal net Sterling operating cash flows. For 2008 some 85% of the group's operating cash flows arose in Euro or Euro-proxy currencies and around 10% arose in US dollar or proxy currencies and the currency mix of our debt at 31 December 2008 broadly reflected this. The depreciation in Sterling in the fourth quarter meant that the Sterling value of the group's debt increased significantly as a result, although the Sterling value of the group's profits and overseas assets benefited for the same reason. It is likely that most of the group's cash flows will continue to arise in foreign currencies in 2009.

### Interest

Full year net interest payable of £61.9 million was £10.0 million lower than 2007 at actual rates of exchange. This reduction was primarily due to a year-on-year reduction in rates of £3.7 million and a further £6.8 million year-on-year benefit from IAS 19 net pension interest, with a small year-on-year adverse variance of £0.5 million due to slightly higher average debt.

The group's policy is that, at any time, at least 50% of its forecast interest rate exposure for the following nine months should be fixed or capped. The €500 million bond which matures in 2014 carries a fixed rate of interest of 4.625% but the rest of the group's bond and capital markets debt is effectively at floating rates (an interest rate swap was executed when the £300 million 2016 bond was issued to convert it to floating rate debt). For 2009 and assuming a Sterling Euro exchange rate of 1.13 for the year:

- Substantially all of the group's debt has been fixed for January and February at an average monthly cost of £4.9 million.
- For the period March to September 2009 the interest cost of the 2014 and 2016 bonds has been fixed at a monthly cost of £3.3 million. The balance of the debt remains at floating rates.
- Between October and December only the interest cost of the €500 million 2014 bond is at fixed rates.

In addition, the group has purchased approximately £125 million of interest rate caps for the second, third

and fourth quarters to protect against unexpected increases in LIBOR.

### Tax

The blended headline rate for 2008 was 31.6% (2007: 30.0%). This represents the weighted headline tax rates for the countries in which the group operates. The increase in the blended headline rate was due to the lower level of UK profits in 2008. The income statement tax charge for 2008 was 28.1% of profit before tax compared with 21.3% for 2007. 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 tax rate for 2009 is expected to be approximately 30.1%.

### IFRS 8

IFRS 8, "Operating Segments" will be adopted by the group from 1 January 2009. IFRS 8 requires us to amend our segmental reporting so that it aligns fully with our internal management structure, and comparative figures have been restated. The principal changes involve the reallocation of the UK Washrooms business and the UK Shared Service Centre to the Facilities Services division, the transfer of the South African business to the Pest Control division and the transfer of the Medical, Supplies and Specialist Hygiene businesses from Facilities Services to the Textiles and Washrooms division. Re-worked quarterly comparatives for 2008 are available from [www.rentokil-initial.com](http://www.rentokil-initial.com).

### 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 (adjusted for planned acquisitions

and any maturing debt obligations) over a rolling 12-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 BBB. Following the publication of the group's interim results in August 2008, Standard & Poor's reduced the group's credit rating to its current level of BBB-. After the group's third quarter trading statement in November, Standard & Poor's changed the outlook on this rating to negative outlook. 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 2008, the group had approximately £188.8 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 2008 the group lengthened the maturity profile of its debt. This was achieved through the successful issuance of Euro bonds totalling £125 million in September and October and the replacement of the £252 million facility with the £125 million syndicated bank credit facility in December from January 2010 to September 2010.

#### 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, movements in interest rates used to discount liabilities for reporting purposes under IAS 19, changes over time to actuarial mortality assumptions, defaults on bonds and inflation. 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 surplus. 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. Following the agreement of the 31 March 2007 actuarial valuation of the scheme in July 2008, £50 million was released from escrow into the pension scheme and a further £33.3 million was placed in escrow.

#### 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 is forecast to fall below 4.75 the board will be required to review a remedial action plan.

Some 59% of the group's net borrowings are currently at fixed rates of interest for 2009. 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 £6 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 £42.0 million. Details of businesses acquired and revenue and operating profit therefrom are set out in note 30 to the accounts.

### Pensions

The group's IAS 19 net pension asset was £134.9 million at the end of 2008 compared with £50.0 million at December 2007. 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 £154.4 million at December 2008 compared with an asset of £63.9 million a year earlier.

During the year equity markets performed poorly, and corporate bond markets also returned less than assumed. The performance of the swap portfolio was very good, however, and overall this led to a gain on assets of around £6.1 million.

The financial assumptions underlying the calculation of the liabilities also changed during the year (in particular the yield on AA-rated corporate bonds rose significantly and the long-term outlook for inflation decreased). The effect of this was partially offset by an increase in the expense reserve, and also a strengthening of the mortality assumption in line with the change between the 31 March 2005 and 31 March 2007 funding valuations. Overall, this led to a lower value being placed on the liabilities at the year end than at the beginning of the year, resulting in a gain of around £53.0 million.

Experience losses on the liabilities were £15.6 million. This is primarily due to the higher than expected increases awarded to deferred pensions and pensions in payment due to actual inflation being higher than assumed inflation.

This meant that in total there was an actuarial gain of £49.5 million during the year and together with a credit to the income statement of some £7.1 million and pension contributions of £33.9 million, this resulted in an increase in the net pension asset in the UK of £90.5 million.

### 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 in pages 52 to 60.