

Financial review

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Overview

Full year revenue of £2,355.8 million declined by 2.2% over last year, but grew 5.0% at actual exchange rates. Group operating profit (before amortisation and impairment of intangible assets) increased by 7.2% to £158.2 million and adjusted operating profit (again before amortisation and impairment of intangible assets) amounted to £195.3 million, an increase of 16.8% on the prior year. Group full year adjusted profit before tax and amortisation grew by 29.8% to £140.1 million. Profit before income tax from continuing operations was £47.2 million (2008: £22.8 million), an increase of 107.0%. This profit reflects £55.8 million of amortisation and goodwill impairment charges (2008: £65.5 million) and is stated after charging one-off costs of £37.1 million (2008: £19.6 million).

One-off items

One-off costs relate directly to the group's various performance improvement initiatives and consist mainly of redundancy and other reorganisation costs including consultancy, plant and office closure costs net of the profit on sale of certain properties, profit or loss on disposal of businesses not classified as discontinued and acquisition integration cost. They have been separately identified as they represent an investment in the future performance of the group and are not considered to be "business as usual" expenses and have a varying impact on different businesses and reporting periods.

This year these have amounted to £37.1 million (2008: £19.6 million) and represent costs associated with the reorganisation of the Textiles and Washrooms division (primarily the closure of processing plants in Belgium and France), the costs associated with the closure and relocation of the London corporate office and redundancy costs and impairment of assets relating to the continued integration of the City Link and Target Express businesses.

Net debt and cash flow

£m at actual exchange rates	Year to date		
	2009	2008	Change
Adjusted EBITA – continuing businesses	220.8	167.2	53.6
Adjusted EBITA – discontinuing businesses	–	5.0	(5.0)
One-off items	(40.2)	(19.6)	(20.6)
Depreciation	215.9	190.8	25.1
Other non-cash	7.7	4.9	2.8
EBITDA	404.2	348.3	55.9
Working capital	91.7	3.2	88.5
Capex – additions	(189.2)	(237.8)	48.6
Capex – disposals	10.0	15.8	(5.8)
Operating cash flow	316.7	129.5	187.2
Interest	(61.5)	(67.3)	5.8
Tax	(17.5)	(27.3)	9.8
Purchase of available-for-sale investments	(0.8)	–	(0.8)
Free cash flow	236.9	34.9	202.0
Dividends	–	(106.7)	106.7
Acquisitions/disposals	(6.8)	(43.0)	36.2
Special pension payment	–	(33.3)	33.3
FX and fair value adjustments	24.0	(267.0)	291.0
Increase/(decrease) in net debt	254.1	(415.1)	669.2
Closing net debt	(1,108.1)	(1,362.2)	254.1

Operating cash flow at actual rates of exchange was £187.2 million higher than 2008 due to higher EBITDA, better working capital movements and lower net capex. EBITDA was £55.9 million higher than last year due mainly to improved trading performance offsetting higher one-off costs. Inflows from working capital were £88.5 million higher than last year mainly as a result of lower debtors. Savings in net capex amounted to £42.8 million, with reductions being achieved in most divisions.

Tax and interest payments (including finance lease interest) were £15.6 million lower than last year following receipt of tax refunds in respect of prior periods. Free cash was therefore £202.0 million higher than last year at £236.9 million.

Deferred acquisition and disposal cash flows consumed £6.8 million and foreign exchange gains and fair value adjustments added a further £24.0 million, producing a total cash inflow of £254.1 million, leaving net debt at £1,108.1 million at 31 December 2009.

Funding

At 31 December 2009 the group had net debt of £1,108 million. Of this, £915 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, £32 million is held as cash and other borrowings in the businesses and £225 million is drawn under the group's £500 million bank facility, which matures in October 2012. This facility provides the group's principal source of day to day liquidity. The group's Letter of Credit facilities of c.£70 million equivalent require refinancing in October 2010. Negotiations have commenced and no difficulties in securing replacement facilities are anticipated.

The group has good 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 4x 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 for the previous 12 months. At 31 December 2009 the covenant ratio was 7.0x, equivalent to £185 million of EBITDA headroom.

Full details of the group's net debt and borrowing facilities are set out in note 21 to the financial statements.

Cash generation and dividend

Cash generation has been a key priority during 2009. A number of measures have been pursued to achieve this including a continuation of the drive on working capital, optimisation of capital expenditure and the implementation of cost reduction programmes across the group. As a result we have made excellent progress during the year in operating cash flow, generating £317 million, representing 143% conversion from profit. This, coupled with our decision to pass the interim dividend, enabled us to retire our fully undrawn £125 million revolving credit facility 12 months early on 3 September 2009. Headroom at 26 March 2010 was £285 million.

In view of the continuing economic uncertainty in the markets within which we operate and our desire to strengthen the group's balance sheet to increase our financial flexibility, the board has decided to not propose a final dividend to shareholders.

Interest

Net interest payable of £57.6 million for the year was £4.3 million lower than in 2008. Favourable effective interest rates reduced the year-on-year charge by £7.1 million and mark to market moves by a further £4.3 million. These benefits were partly offset by higher interest charges of £4.6 million, due to higher average net debt, mainly as a result of 2008 translation differences, adverse net pension interest charges of £1.7 million and other smaller items amounting to £0.8 million.

Tax

The blended headline rate of tax for 2009 was 27.0% (2008: 31.6%). This represents the weighted headline rates appropriate to the countries in which the group operates. The decrease in the blended rate was due to one-off restructuring costs within Belgium and France and a significant reduction in the UK loss position. The income statement tax charge for 2009 was 24.8% of profit before tax from continuing operations, compared with 28.1% for 2008. The principal factor that caused the effective tax rate to be lower than the blended rate is the reduction of the deferred tax provision in respect of overseas unremitted earnings, partially offset by various adjustments in respect of the prior period provisions for deferred taxation. The blended tax rate for 2010 is expected to be 28.6%. The actual tax rate for 2010 is expected to be broadly in line with 2009.

IFRS 8

IFRS 8, "Operating Segments" has been 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. In addition, revenues are now stated gross of inter group trading rather than net and revenues and profits are shown at constant exchange rates consistent with our internal reporting and review processes.

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 2008, 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 2009 the group had approximately £275 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.

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 for existing employees 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.

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 times the board will be required to review a remedial action plan.

At the end of December 2009 approximately 97% of the group's debt was at a fixed rate of interest. During 2010 this proportion will reduce slightly to approximately 87%. Accordingly, the group is not materially exposed to rising interest rates.

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 £2.7 million. Details of businesses acquired and revenue and operating profit therefrom are set out in note 30 to the accounts.

Pensions

The group's total IAS 19 net deficit was £6 .3 million at the end of 2009 compared with a net surplus of £13 .9 million at December 2008. The group has a number of small defined benefit schemes outside the UK but the principal scheme ("the Scheme") is in the UK.

The UK scheme had a net deficit of £ 7.9 million at December 2009 compared with a net surplus of £15 .4 million a year earlier. This represents an adverse movement of £202.3 million due primarily to an increase in liabilities.

The net deficit comprises the aggregate of the value of the Scheme assets and liabilities:

- the Scheme assets reduced by £50.0 million to £978.8 million driven by a reduction in value of our interest rate swap portfolio, partly offset by an increase in value of our equity portfolio – our Scheme comprises approximately 20% equities and 80% bonds and other financial instruments; and
- the Scheme liabilities increased by £152.3 million to £1,026.7 million driven by:
 - a reduction in yield on AA corporate bonds – the yield determines the discount factor used to calculate the net present value of the future scheme liabilities (the lower the yield, the greater the liabilities);
 - the longer-term outlook for increased inflation – inflation drives our view on future pension increases; and
 - favourable experience gains on liabilities due to pension and salary increases being lower than anticipated, in part offsetting the above.

Asset allocation is determined by the trustees in conjunction with the company. The next triennial valuation of the UK Scheme takes place during 2010.

Further details are shown in note 24 on pages 74 and 75.

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 45 to 52.