Rentokil Initial Interim Results 2016

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London - 020 7870 7100
www.global-lingo.com

Introduction

Andy Ransom

Chief Executive Officer, Rentokil Initial

Welcome

Good morning, ladies and gentlemen, and thank you all for joining us today. In a few moments, Jeremy will provide you with details of our financial results for the first six months of 2016. Jeremy will talk in detail; I will give you a brief summary in a moment. I will then come back and update you on our Right Way plan, and in particular the progress that we are making in our three core businesses.

Strong overall performance in H1 2016

Firstly, though, just to set the scene for this morning, let me give you a few opening remarks. In terms of the headlines, I am pleased to report a strong overall performance in the first six months of the year. Let me take you quickly through each of the six areas that you can see there on the screen, starting with revenue.

Revenue

Our revenue from ongoing operations increased by 11.5% at constant exchange rates, of which organic revenues grew by 2.5%. There were good performances in North America, reflecting a series of high quality acquisitions, and also in the UK and Ireland, Latin America, Asia and in the Pacific.

Adjusted operating profit

Adjusted operating profit grew by 11% in the first half, a good overall performance, reflecting our focus on the growth in emerging markets and our density-building activities. Clearly, though, as we have highlighted previously, market conditions in Europe do remain challenging, particularly for our French business.

Pest Control

In our Pest Control business, revenues were up just over 25% with 5.5% organic growth, and profits were up 28%. I am pleased to say that following the acquisition of Residex earlier this month, for the first time our Pest Control business now accounts for over half of the group's revenues and profits.

Growth and emerging

Our strategy of focusing on profitable growth in our emerging and growth quadrants continues to be successful, with revenue growth of 17.4% and 18.8% respectively in those quadrants in the first half. 19 of the 20 acquisitions we completed were in these two higher growth quadrants which, following the acquisition of Residex on 1st July, together now account for some 70% of group revenues.

North America

In North America, revenues grew by almost 40% in the first half, driven by the continuing acquisition programme as well as good organic revenue growth, particularly in our Pest business which was up 4.7%. The integration of Steritech remains on track.

Leadership in Digital Pest Control

Finally, just a word about our leadership in digital pest control. For three years now, we have worked quietly behind the scenes to develop our digital strategy. Today, we have the digital tools in place to support the entire customer journey from first contact right the way through to e-billing. Rentokil is leading the market in digital pest control, and yesterday's announcement of our collaboration with Google and with PA means that we are working with best-in-class partners to drive the development of our connected products and to investigate the development of new services.

Executing Strategy

All in all, a strong overall performance in the first half. We are on track to deliver our 2016 revenue profit and cash expectations, and reflecting our good progress in the first six months the board has declared a 13.8% increase in the interim dividend.

With that, let me now handover to Jeremy and he will take you through the first-half financials in detail.

Financial Review

Jeremy Townsend

Chief Financial Officer, Rentokil Initial

Financial highlights (continuing operations)

Thank you, Andy, and good morning, everyone. I will now run through the key financial highlights for the first half.

Revenue for ongoing businesses, which excludes the impact of all divestments, in the first half grew by 11.5% driven by growth from acquisitions of 9% and organic sales of 2.5%.

Adjusted operating profit before interest for the half was up by 11% and adjusted profit after interest was up 16.9%, reflecting lower interest costs following the bond refinancing in Q1. On an actual exchange rate basis, adjusted profit before tax was up 22.5%, reflecting a £6.6 million favourable impact of exchange differences in the period. With the slightly lower adjusted tax rate reflecting a change in deferred tax accounting in our US business, adjusted EPS of 3.9p is up 17.1%.

Free cash flow was £57 million in the half, broadly in line with the prior year, with increased EBITDA and reduced working capital outflows offset by a planned increased investment in capital expenditure. As Andy has just mentioned, based on our strong first half performance, we have declared an interim dividend of 0.99p per share, a 13.8% increase on last year's interim dividend.

Progress against medium-term targets

With this now in our third year of the Right Way plan, I thought it would be useful to review how we are progressing against our medium-term targets for revenue, profit and cash. Against our mid-single-digit revenue growth target, we have achieved three-year compound annual revenue growth of 6.8%, supported by strong progress in acquisitions but also an improving trend in organic growth.

We have achieved a three-year compound annual growth in profits of 8.7%, in line with our high-single-digit target. The growth has been achieved through leverage from the increased revenue, improved margins in our growth and emerging markets and a significant reduction in central and divisional overheads.

In relation to free cash flow, we delivered a significant improvement in 2014 and have maintained this improvement in 2015 and the first half of 2016. This has enabled us to increase our annual free cash flow target to a minimum of a £110 million this year and £120 million in 2017.

Performance by region

North America

Now, looking at first-half performance by region. Ongoing revenue in North America grew by 39.9%, with growth from Steritech and other acquisitions of 35.9%. Organic revenue increased by 4%, driven by organic growth in Pest Control of 4.7%.

Operating profit in North America was up by 64.8%, driven by the increased scale of the business and acquisition synergies, with net operating margins up by 1.8 percentage points compared to the first half of 2015.

We are very pleased with the Steritech acquisition and we are on track to deliver our profit targets for the year. The M&A pipeline has continued to be strong and we have acquired seven businesses in the region year-to-date with annualised revenues of around $120 million.

The focus for the second half of the year remains unchanged: driving organic growth initiatives, integrating Steritech and the other recent acquisitions, thereby boosting the scale and net margins of the business.

Europe

In Europe, ongoing revenue was up 0.5% with organic revenue up 0.3%. Ongoing revenue growth of 1.1% was achieved in Southern Europe and 2.9% in Germany. However, revenues were 1.0% lower in France and the Benelux.

Europe: Latin America

In Latin America, which is supported out to the Europe region, we continue to make good progress through both acquisitions and strong organic growth, with total revenue up by 15.3%.

Europe: Workwear category

Performance in the Workwear category continues to be challenging across the region, and France in particular, where pricing pressure continues to have a significant impact on revenue and margins. As a result, profit in Europe was 4.3% lower than the prior period primarily due to France.

With economic conditions in Europe continuing to be difficult, we continue to focus on the quality initiative in Workwear to mitigate the competitive environment and the pricing pressure. Overall, we would expect performance in the region in the second half to be in line with the first half.

UK and rest of world

In the UK and rest of the world region, ongoing revenue increased by 4.1% primarily from organic growth of 3.7%. Revenue growth in the UK and Ireland of 4.3% was driven by strong performance in both the Pest and Hygiene categories. Growth in the rest of the world of 3.7% was led by strong performance in the Nordics, Caribbean, Africa and MENAT. Margins were 0.7 percentage points higher at 19.5%, reflecting leverage from revenue growth and continued strong cost control. We anticipate further improvements in the region through the application of the successful UK operating model across the rest of the world businesses.

Asia

In Asia, ongoing revenue in the first half was up 11.9%, with 7.9% of organic growth driven by strong performance in both Pest and Hygiene. We continue to see very high growth from the emerging markets of India, China and Vietnam. However, revenue growth is also strong in our larger and more developed markets in Malaysia and Indonesia.

Profits in the region grew by 34.3%, reflecting the impact of some small acquisitions, but was primarily due to leverage on the revenue growth with margins up 1.7 percentage points. We see further opportunities to improve margins in the region through revenue leverage, with increased density and yield management from both organic growth and through further acquisitions.

Pacific

In the Pacific, revenue increased in the first half by 9.4%, with 5.8% coming from acquisitions in Pest and Hygiene. Organic growth of 3.6% was achieved through a strong jobbing performance in Pest and improved retention in Hygiene. Profit growth of 10.8% was achieved in the period through leverage from the revenue growth, with operating margins increasing by 0.3 percentage points to 20.6%. We see further opportunities for improved performance in the region through service productivity.

Opportunity to build margins in our growth and emerging markets

A key part of the Right Way plan has been to allocate capital to build scale in our key strategic growth and emerging quadrants. The impact of this can be seen in this chart, which shows the compound revenue growth in North America Pest Control of 23.5% over the last three years and 9.9% in Asia. This growth has enabled a significant improvement in Pest Control net operating margins in both regions, as we have leveraged investments in overheads and built increased customer density. We see further opportunities to build our margins in these key areas towards those achieved and are more developed and mature markets elsewhere in the group.

Operating cash flow

Looking now at operating cash flow: in the first half, this was £98 million, in line with the prior year. EBITDA was £16 million higher, reflecting increased underlying profit and exchange gains, and working capital outflows were £6 million lower than the prior year. These favourable movements were offset by an increased investment in CAPEX of £16 million, in part due to the phasing of 2015 projects and in part due to currency movements.

Free cash flow and movement in net debt

Continuing free cash flow in the first half of £57 million was also in line with the prior year, with cash tax £3 million higher and cash interest £1 million lower. Spend on acquisitions amounted to £35 million, and taking into account the Residex acquisition which happened in early July and our continuing strong pipeline, we would expect to exceed our M&A spend for the year, and we now would be guiding it to be in the range £70–80 million.

£37.5 million of dividends were paid in the first half, a 13.3% percent increase on the first half of 2015.

As noted previously, sterling continues to be very volatile and has been weakening during 2016. There was a particularly marked reduction on 27th June following the UK's decision to leave the European Union. Clearly, this has a favourable impact on our profit and loss account, while the overall impact on the sterling value of our euro- and US dollar-denominated debt is adverse, with net debt increasing by £143 million due to foreign exchange movements in the half. As I will discuss further in a moment, our net debt to EBITDA ration has been unaffected by the FX movements, demonstrating that our approach to managing foreign exchange fluctuations is working as anticipated.

Capital allocation

In terms of uses of free cash flow, our capital allocation model remains unchanged, with the priorities being, firstly, investment and value-enhancing M&A with a focus on our strategic emerging and growth quadrants; secondly, maintaining a progressive dividend policy; and thirdly, paying down net debt, with our policy of maintaining a BBB investment grade debt rating underpinning our balance sheet position.

As I will show in the next couple of slides, our capital allocation model combined with our free cash flow has enabled us to acquire 73 businesses in the growth and emerging markets, with annualised revenues of £323 million.

Net debt bridge

Looking at the last 12 months, we have funded our bolt-on and strategic acquisitions and our dividend payments entirely out of free cash flow. Over the last three years the picture is exactly the same, with free cash flow again effectively funding acquisitions and cash dividends. It is worth noting that the sale of IF in 2014 has effectively funded the Steritech acquisition last year, and that the impact of FC movements over three years is relatively small, leaving net debt over the period around £60 million higher than three years ago, and with our net debt to EBITDA ratio exactly the same.

Balance sheet

Based on our continuing strong free cash flow, on the progress we have made on the Steritech acquisition, Standard & Poor's removed the negative outlook from our credit rating in June. We continue to have adequate liquidity head room on our banking facilities, and our cost of net debt is now 3.5% following the bond refinancing in Q1.

Pension scheme

As well as the strong balance sheet from a liquidity perspective, we also have a very well funded pension scheme. We are close to finalising our tri-annual pension scheme valuation as at 31st December 2015, and the scheme is now in surplus on a technical provisions basis.

The pension fund trustees have consequently agreed that the £9.6 million of cash currently held on escrow can be returned to the company, and that no further cash payments are required at this stage. Our pension scheme advisers informed us that, of the companies in the FTSE 350 with similarly large pension schemes, we are the best funded, and at this time we do not anticipate the company having to make any cash payments into the scheme in the future.

Delivering shareholder value

Just a quick reminder that we are now taking restructuring costs above the line; these were £3.8 million in the first half compared to £1.8 million in the first half of 2015. Our guidance continues to be costs of around £7 million for the full year.

One-off costs, which include the cost of integrating significant acquisitions, were £2 million in the first half, mainly due to the cost of integrating Steritech. These costs are estimated to be around £5 million for the full year.

EU referendum

Before I finish with some further comments on guidance for the full year, just a few words on the recent EU referendum in the UK and its impact on Rentokil Initial. As we said in our pre-close announcement earlier in the month, around 90% of our revenues are derived from outside the UK, and we have minimal cross-border trading across our businesses. Global macro-economic impacts aside, the direct impacts of Brexit have little impact on the group. The most obvious impact on the financial performance, as we have already noted, is the impact on exchange translation, with the weakening of sterling increasing the national amount of debt on the balance sheet but also having a favourable impact on our profit and loss account. If today's exchange rates were to continue for the rest of the year, we estimate that the impact would be a favourable amount around £26 million; an increase of around £11 million compared to the guidance that we provided at the prelims.

Summary and guidance for 2016

Before I hand back over to Andy, some remaining guidance for the full year. Central and divisional overheads are now expected to be about £3 million higher than 2015, reflecting the recent performance of our share price and the positive impact that this has had on the group's long-term incentive plans.

Interest cost guidance is unchanged at £37 million with cash costs around £15 million higher than this, with lower interest rate levels offset by adverse currency movements.

Our guidance for adjusted effective tax rate has reduced to around 22%, reflecting the change in deferred tax treatment of our US business as I mentioned earlier. This is an accounting change, and our cash tax guidance remains unchanged between £35–40 million. In other areas of the cash flow statement, I expect net CAPEX now to be in the range of £210–220 million, reflecting the phasing of 2015 expenditure and foreign exchange rate movements, and working capital outflows to be around £10 million for the year. Given the first half performance, I remain confident that we will achieve our free cash flow target for the year of at least £110 million.

As I have already said, with the acquisition of Residex on 1st July, we have now spent more than the original guidance of our £50 million for M&A for the year, and I would now revise this guidance to be a range of £70–80 million. With that, I would now like to hand back over to Andy.

Strategy Update

Andy Ransom

Chief Executive Officer, Rentokil Initial

Consistent strategy

Thanks, Jeremy. Let me start my time-honoured tradition now with a very brief reminder of what that Right Way plan that Jeremy refereed to is all about. As you all know, I hope, we have got a very established business model: we have our five geographic regions; we are operating on a lean, single-country operating model; we have got our three core business lines that are all driven by the expertise of our colleagues. Today I am just going to focus on these parts of the model.

Firstly, on our core plan to accelerate our growth in Pest Control, as well as our focus on operational execution in Hygiene and our drive to create a product and services quality champion in Workwear.

Underpinning this are our levers to drive organic revenue growth, and today in particular I am going to share some details on the excellent progress that we are making in leading the digital pest control industry. I will then conclude with a brief update on M&A activity which, as you know, utilises our differentiated model with our four quadrants to align our capital allocation and to prioritise our growth strategies.

We have deployed a consistent strategy over the last three years, it is working well, and we are continuing to execute the same plan at pace.

Accelerating growth in Pest Control

Strong H1: building on market-leading positions

Let me start with Pest Control. In Pest Control, we have continued to strengthen our position as global industry leaders through innovation, through digital expertise and through acquisitions. As I have said before, this is the best pest control business in the world and it is our core growth engine.

Today Rentokil is the number one pest control business in 46 countries around the world. We delivered a strong first half performance, with ongoing revenues increasing by just over 25% and profits were up 28%. Organic revenue also increased up by 5.5% in the first half.

As you can see there, there was double-digit organic growth in a number of our emerging markets, including India, Chile, Brazil, while our core growth markets of Germany, the United States and the UK also delivered very respectable organic growth levels.

Consistent delivery in attractive and growing market

Rentokil is now well positioned to capitalise on the increasing demand for pest control around the world. On this slide here, we have listed just a few other factors which are driving consistent growth in global pest control demand, including increasing population, additional legislation in critical areas such as food safety and the growing pest burden of species such as mosquitoes. Just to underscore the good long-term growth prospects of the pest control industry, several external market research companies have recently published pest control market reports indicating compound annual growth rates in the region of 4–5% being set to continue over the next few years.

Rentokil: multiple organic growth levers

As you can see on the left of this chart, revenues in our Rentokil Pest Control business have increased consistently over the last three years, with growth of around 15% per annum. As well as operating in attractive markets, Rentokil has a series of good organic growth levers such as our strengthening global and national accounts capability, our shared technical expertise, our market-leading positions in emerging markets, a strong pipeline of innovations and, increasingly, our new digital platforms. I will cover some of these in more detail over the next few minutes.

Opportunity to develop global and NA national accounts

Starting over the opportunity to develop our global sales capability, and our national account footprint in North America. Firstly, with major international food and hospitality and healthcare companies increasingly looking for consistency of standards and reporting across their geographies, Rentokil was in a strong and virtually unique position to take advantage of the global account opportunity. We now have a dedicated global sales organisation in place across our five regions, we have recently signed our first major global contract with an international food and agricultural products company, and there is now a strong global sales pipeline in place where two years ago there was none.

Secondly, in North America we now have a far more competitive national accounts proposition, and that is leveraging the combined national sales expertise of both Rentokil and Steritech's organisations. We are targeting specific account prospects within the most attractive industry segments, and we are taking a standardised approach to sales metrics and sales processes. As a result of this approach, so far this year we have increased our national account sales in North America by over 60%.

Integrated mosquito management in USA

A great example of how the combined Rentokil–Steritech operation is working together effectively is our success in securing the contract to support the CDC in combating the possible threat of the zika virus in North America. We are very proud to have secured this two-year contract which not only includes pest control but also potentially community outreach and education programmes.

Of course, it is not just North America which is combating the potential threat of mosquito-borne diseases. In Central and Latin America, and across the Caribbean, Rentokil is undertaking monitoring and control services to support its customers against the potential threat of zika, while at the same time in Asia we have got more than 30 years of experience in helping customers to combat the threat of dengue fever.

Mosquito control – protecting people across the globe

As you can see from the map, in those countries where mosquito-borne threats are at their peak, Rentokil – those are our countries marked in red there – has got commanding market positions, with trained technicians and the technology ready to support our customers.

Digital pest control

Finally, before I move to Hygiene, I would like to touch on our leadership in digital pest control services. There is barely an aspect of our lives that has not been impacted by the digital revolution and this trend is set to continue, and we see this as a tremendous opportunity in Pest Control.

Rentokil is leading in Internet of Things (IoT) services

As you may have seen from yesterday's announcement, Rentokil is leading the industry in the commercialisation of the Internet of Things through connected devices. For us, digital means both the opportunity to develop innovative new services, but also to drive more productive ways of working across the entire customer journey.

Rather than me try and describe for you in detail how far we have come with our digital journey, I want to share with you a very short three-minute video that captures the progress that we are making at Rentokil in this very exciting area.

[VIDEO STARTS]

Speaker: At Rentokil Initial, our mission is to protect people and enhance lives, and across the world we enable our experts to deliver a great service through state of the art digital technologies. These days when someone has a problem, they go online. Over the last 12 months, we have helped over ten million website visitors with their pest control problems. This is important because in our UK Pest Control business, 65% of new business finds Rentokil through its digital channels. We then offer multiple advanced ways to contact us and arrange an appointment.

Arriving on site, our sales teams with tablets and a range of apps deliver a digital sales experience, meaning no more piles of time-consuming paperwork. Surveyors can instantly access a library of materials to deliver a more structured and professional site survey, electronic quotes and customer agreement. With the contract signed, our customers receive access to our new digital customer portal, myRentokil. With over 60,000 registered customers already, this is an intelligent one-stop shop for all their needs, from the basics of checking service agreements or invoices to incisive analytics such as risk profiling across the customer's estate of properties.

Our service technicians undertake regular service visits, and digital technologies are making their role more efficient and effective. Service+ is a new cloud-based tool to optimise the territory and daily routes of technicians, reducing drive time and costs and improving our speed of response. By the end of this year, 10,000 colleagues will be smart-phone or tablet enabled, and our latest app, ServiceTrack, provides a suite of advanced digital tools to automate processes from pre-notification of arrival time to proof of service, and is fully integrated with e-billing.

Increasingly, technicians can deploy a range of Internet-of-Things-inspired, sensor-based connected products. PestConnect, our innovative remote monitoring mousetrap, uses wireless data connectivity to communicate with technicians when activated, as well as automatically updating the customer's colour-coded sitemap on myRentokil.

This same mobile connectivity is used successfully in our Hygiene connect and Auto Gate products, and there is a strong pipeline of next-generation products on the way from our global science centre.

In the field, a range of digital collaboration tools from Google help colleagues to deliver a better service. Using Google Hangouts, technicians can video-call technical managers for advice, or use our own private social media channels to share information. All of these enabling technologies are in use today and being rolled out across the globe. Behind them are best-in-class technology partners and the Rentokil Initial organisation with a digital first mindset.

In the future, Rentokil Initial will use this combination of technologies to deliver big data insight for predictive risk profiling that will further improve effectiveness and efficiency. Interfaces are being built to connect systems, people and processes to provide real-time business information to our colleagues and to customers, from tracking weather patterns with pest activity to remotely connected soap dispensers that alert service teams when a customer needs a service before they realise.

With this core digital network in place underpinned by Google Cloud, Rentokil Initial has a market-leading Internet of Things platform, enabling a smarter workplace for colleagues, an enhanced service for customers and profitable growth for shareholders.

Rentokil Initial. Protecting People. Enhancing Lives.

[VIDEO ENDS]

Andy Ransom: As you have just seen there on the video, we have digital expertise now at every stage of the customer journey, right from the web searching all the way through to e-billing. Customer feedback to date has been excellent. In short, we are going to deliver better services for our customers; many of those services potentially being premium services, but it also gives us the opportunity to lower our cost, where we can use technology to make our service delivery model even more efficient.

I hope that has given you a thorough update on our Pest Control in the first half. I am now going to pick up some key points on Hygiene and Workwear, before closing on M&A.

Executing Now in Hygiene

World's leading hygiene services business

I am pleased to report that our Hygiene business delivered ongoing revenue growth of 4.2% in the first half, and increased organic growth of 2.5%. Having rolled out our three new product ranges across the majority of our markets, we are seeing the benefits coming through in sales. For example, in France our Hygiene business delivered organic growth of almost 5% in the first half. There were further good performances in Asia, in the Pacific and in the UK, but also a very big performance in our Irish market. With good market positions and excellent new ranges, our focus now is on operational execution to continue to drive profitable growth and to increase our margins.

Key revenue KPIs moving in the right direction

Just to build on the revenue story, you can see here on the left of the chart how organic revenue has grown over the last two years in line with the launch of our new product ranges. The Signature, Reflection and Colour ranges are all contributing in building momentum behind the Hygiene business. We are beginning now to deliver more consistent revenue growth and, as a portfolio business, the combination of good sales and improvement in customer retention, which was up nearly two percentage points in the first half, all support the overall improving revenue picture.

Operational execution to drive growth and margin expansion

Our priority now is all about operational execution, and in particular on building density; density of our products on the customer's washroom wall, but also the number of customers that we have in any particular route.

Here just one of two examples of those operational execution initiatives. Firstly, our focus on product density. Having undertaken an extensive margin analysis across our Hygiene business, we know how margins grows significantly with the second, third and fourth product on the customer's wall, so we have aligned sales incentives and promotions increasingly to be focused to drive this.

Secondly, we are taking the lessons from our Pest Control business into Hygiene to build customer density. Service+ is our propriety web-based tool for planning and route optimisation. We use it in large parts of the pest business and, where we do, we typically can deliver productivity improvements of up to 10%. We have now begun to pilot a Hygiene version of the same tool with the aim of delivering similar efficiency gains in the future.

Finally, I am delighted that we have reached the point in Hygiene where we can now start to expand our acquisition programme with a small number of highly targeted city-based acquisitions. In the first half we acquired three hygiene companies, and whist our main focus will remain on Pest Control acquisitions, I do expect us to continue to target good Hygiene deals in the future to build density and to grow margins.

Focusing on quality in Workwear

Delivering differentiation through product and service quality

Turning now to Workwear. Just to recap for one moment, our Workwear business operates across major European markets of Germany, France and the Benelux. It is a profitable and cash generative business with good overall market share.

That said, for some time now it has been operating under significant pricing pressure, particularly in France but also within highly competitive markets in the Benelux. As you can see here, margins remain under pressure in the first half, with revenues down 1.8% and profits down 14.3%. That is why we believe that the quality strategy is the best approach to mitigate this. We have set out a plan to create a product and service quality champion in Workwear. In the first half, we saw an improvement in our key customer service metric which improved by 2.3%, and importantly we saw an improvement in customer retention which was up over 2%.

Quality agenda making progress

In terms of the specific work streams, we are making progress across a number of areas. For instance, we are delivering our best performance for five years in safety. We delivered our best performance ever in our critical measure of 'on time, in full' laundry processing. This has been reflected in a reduction in the number of customer complaints as customers begin to notice the improvements starting to come through.

We are also making progress on improving our responsiveness, with our target of 85% of all customer calls being answered within 15 seconds, and that is now being met in most of our branches across the business. Customer satisfaction rates have also now improved for six quarters in a row.

Underpinned by strong, rigorous processes

Underpinning this quality programme are strong and rigorous processes. We have developed a new set of KPIs which are being applied across all of our countries, all of our service lines, our processing plants, and all of our branches, and all in more detail than ever before. This same approach of focusing on the detail is also being applied to deliver much greater visibility on our SKUs. We have reduced the SKUs across the business by about 20% as a result of those initiatives.

We have a focused plan, we have clear KPIs across the business, we have the clear aim to become the quality champion in the workwear industry, and therefore to deliver better revenues and margins. Quite clearly, we have got a lot more work to in the business before we get there.

Profitable growth enhanced by acquisitions

Finally, let me give you a brief update on our acquisition strategy. In the first six months of the year, we completed 20 acquisitions. 16 were in Pest Control, and with the addition of Residex which we acquired at the beginning of July, we have added total annualised revenues of about £100 million so far this year.

As you know, we monitor the integration and the performance of our acquired businesses very closely to ensure that they are continuing to meet our financial hurdles. For all acquisitions in the 18-month period from 1st January 2014, all but two very small acquisitions are delivering the expected returns at or above their respective target levels required by our quadrant capital allocation model.

Quadrant strategy

Here is a snapshot about performance by quadrant in the first half of 2016; again, demonstrating that that quadrant allocation model is continuing to work very well. As I mentioned earlier, we have had very good performances in the emerging and growth markets: revenues and profits up significantly year on year, and these two quadrants now accounting for 70% of our revenues.

In manage for value – which is now a very small part of the group; it is mainly in the more challenged Southern European markets – that delivered a very creditable performance, with profit growth of almost 5% on the back of slightly increased revenues. As I mentioned, trading has continued to be tougher in the protect and enhance markets across Europe, where revenues and profits declined by 1.2% and 7.6% respectively.

Strong performance in first half

As I said at the beginning, a strong overall first half. I am encouraged by the progress that we have made against our Right Way plan. Once again, we have continued to meet or exceed our medium-term targets, with first-half revenues increasing by 11.5% and profits by 11%, and we still have a lot of opportunities ahead of us.

Pest Control is a highly attractive and growing market, and Rentokil grew strongly in the first six months. In Hygiene we have delivered improved organic revenue growth, and in Workwear, while we are seeing encouraging operational progress against the quality agenda, given the challenging markets that we operate in we clearly do have a lot more yet to achieve in this business.

Our capital allocation model is working well, our acquisition strategy is delivering the targeted returns, and finally our progress in the first half has been reflected by the board's decision to declare a 13.8% increase in the interim dividend. So overall, we remain on track to achieve our 2016 revenue, profit and cash expectations. With that, Jeremy and I will now be very happy to take questions.

Q&A

Hector Forsythe (Stifel): Good morning. Obviously just a little bit of a focus on Workwear: can you just give us an idea as to how Germany is performing? You mentioned it was tough across the regions; I assume that includes Germany?

Also the cleanroom business: scale of the cleanroom business, and how that is performing in mix?

Jeremy Townsend: Yeah, it has been tough across the board. The main issue has been France, but Germany's profitability has been down slightly in the first half. The German region had some strong profitability in the first half of last year. So I would not necessarily extrapolate that as a trend for the full year, but the Workwear business in Germany had a softer first half than it did in the first half of last year. The real problem there, Hector, has been in France.

The cleanroom business I think continues to grow reasonably well. There have been some issues in the markets, particularly in our very strong Swiss business actually, between the Swiss exchange rate, which is customers looking for where they deploy the cleanroom activity. However, generally the cleanroom business remains pretty strong; it is higher margin and it is growing pretty well.

Emily Roberts (Deutsche Bank): Hi, good morning. A couple for me please. First on the Residex acquisition: could you please expand a little more on the strategic rationale for growing product distribution, and also give some colour on what you think on the margins might be in the second half, given it is probably a bit of a dilutive effect there?

Then secondly, on the US organic growth rates into Q2 for Pest Control: how much of Q1 was driven by weather, and what might you expect for the second half?

Then final question from me is: there are some French labour reforms coming up; any idea on the potential impact on your French labour costs? Thank you.

Andy Ransom: Thanks, Emily. Residex, as you say, is a products distribution business. What we did was effectively take advantage of a great opportunity to buy the number two player in that space. We have been in products distribution for Pest Control for a very long time in North America. We see it as a very complementary business to what we do. It is essentially, for those of you who do not know the business, we provide pest control products but also into turf and ornamental supplies to the industry. So we will supply not just our own business, but we will supply other pest control companies. We have been doing that for decades.

When the opportunity came along to acquire the second player in the industry, and to give us scale, taking our business to over $200 million, we thought that was a really excellent opportunity. You are correct: not as heartland strategy as Pest Control services, but given we were already in the business this was a growing opportunity. It is a terrific geographic fit; it is going to give us good synergies across the piece.

In terms of margins for distribution businesses, they would typically operate in the 5%, 6%, 7% range. Ours is operating at around that sort of range. Residex was lower than that, so you are quite right, it will have a dilutive effect. Over the next couple of years, we would expect the combined business to be achieving margins of the sort that I have just talked, 5%, 6%, 7% and maybe possibly higher, because there are good density synergies.

Do you want to add anything on Residex?

Jeremy Townsend: No, that is fine. Obviously, overall, it will dilute the North American margins due to the weighting.

Andy Ransom: Organic revenue growth rates in North America, I think was your next question? I think we said at the time, in the first quarter, there was definitely a weather impact on the first quarter. It was a very strong first quarter. I put a slide up earlier that talked about long-term growth rates in pest control industry globally of sort of 4%, 5%. We see North America long term growth rates for pest control in that sort of range. It depends on which part of the industry; termite is typically lower, that might be a 2% growth. However, residential and commercial, we would see normally in that sort of 4%, 4.5%, something like that. Without being able to predict the weather, our best view would be North America growth rates in the second half for the industry would probably be similar sorts of growth rates. I cannot really put a number on how much of the growth in Q1 was weather, nor can I really say much about Q2. I can tell you that there was snow in May up the Eastern seaboard, which is almost unheard of, so May was a weak month for organic growth.

The labour situation in France: all I can tell you is, at the moment, we have not received any information from our team indicating that the labour reforms will have a bearing on the labour costs in our business at the moment. However, it is certainly something that we will have to keep an eye on because, as you know, the whole labour situation in France is very topical at the moment. However, at the moment we do not have any definitive view on a positive or negative impact.

Joel Spungin (Bank of America Merrill Lynch): Hi, good morning. I have got three. First thing, just on Workwear again. Obviously you mentioned some of the initiatives that you are putting in place to try and improve quality. I guess my question was: when you benchmark to competitors, does Rentokil have a quality problem at the moment, or has it had historically versus the key competitors in France in particular? I.e., are you trying to make up the gap on your main competitors, or are you trying to sort of move ahead of them? That was my first question.

My second question was with regards to Hygiene. Obviously, the margins in Hygiene came down a little bit; I think you alluded to there being some investment in sales initiatives and things like that, which may have had some impact. Can you give us a sense of what the payoff of that investment is going to be, and whether over the mid-term you would expect those margins to recover?

Then finally, just on the agreement you made in North America with the CDC. I saw on the news this morning there was the first case, potentially, of zika virus which is not from someone who was travelling abroad in the US. Are you able at this stage to flesh out a little bit more or quantify what the opportunity from that contract could be?

Andy Ransom: Thanks, Joel. I will pick up the first and the third, and Jeremy can cover Hygiene. On Workwear, the direct answer is no, we do not have a quality problem and we are not trying to play catch-up. I think, if I am honest, back in 2013 in Benelux, I might have given you a different answer to that. However, today I can confidently tell you no, we do not have a quality problem.

It is our view – and I do not speak for the industry – it is our view, Rentokil Initial's view that the industry as a whole, and this is based on market research, is providing a level of quality in the services that they provide which costumers find adequate but not exciting. That is our view. The market research we have done suggests that there is a significant opportunity if you can dazzle and delight your costumers by being outstanding in service delivery, particularly in the workwear space, that there is an opportunity for that player. The opportunity would come in the form of more costumers converting to an outsourced workwear solution. Across the industry, our estimate is it is something like 25–30% of the entire addressable market has moved to outsourcing. 70–75% of people who could choose to have a workwear supplier choose not to, which again, really rather reinforces our view that the industry is not providing a compelling quality proposition.

Our belief is there is an opportunity there. We are trying to get ahead of the industry and we believe that that opens up potential new customers. It certainly gives you a much stronger hand to play in terms of customer retention, and we believe it gives you much stronger hand to play in terms of price.

At the moment, we are operating in weak market conditions against strong competitors and, in my view, with little differentiation across the industry. That is why we are specifically targeting the opportunity to be the best.

Jeremy, do you want to cover the Hygiene one?

Jeremy Townsend: Yes. Obviously, we were pleased with the Hygiene growth in the half but less pleased that the profit growth did not follow that. There are some specific technical reasons around that. Part of that is the sales commissions associated with the revenue growth. Part of it is, as we put the new kits into the costumers that Andy demonstrated there, the set-up costs and the kit going in tends to depress margins at the start of the contract and then flow through, so we would expect some improvement from both of those factors as the contracts mature.

Then there is a little bit of a piece: some of that revenue growth has been driven by acquisitions in the Pacific where the margins of that business were slightly lower, and we are looking to improve those margins over time as well through synergies. I think all of those factors will show an increase. The other point to point out, I think, on Hygiene is margins in hygiene continue to be stronger than Pest, so they are pretty strong margins across the board.

However, we are keen to further improve those margins and we are focusing the team on density both in the washroom and on the high street, and we think there is further opportunity within the group to improve the margins in the category by a greater level of focus on density in those areas. It is a good observation; I think we are very happy with the sales growth. I think there is more potential to drive those margins forward, Joel.

Andy Ransom: The only thing I would add to that is if you were to back out the French and Benelux Hygiene numbers from the group numbers, then profits in Hygiene grew by about 4%, so you can see there is a geographic mix in there as well.

On the CDC, the honest answer, Joel, is no, I probably cannot put a lot of colour on it. Partly because of confidentiality reasons, we are not allowed to talk about the detail, and partly because, honestly, no one really knows what may or may not happen. Our job is to be effectively the partner, or one of the partners, to CDC should the need arise. From a humanitarian point of view, we hope the need does not arise, but if it does then we have very, very detailed plans and preparations to support the CDC. We are supporting them already in Puerto Rico, and only time will tell whether or not we need to be called into full action in the United States. I honestly do not know, but the details remain confidential.

Jane Sparrow (Barclays): Good morning. Just a couple on the Pest business, your digital offering that you announced yesterday: how does that compare with the other large players? Obviously I expect the flippant answer is, 'Obviously it is significantly better,' but can you sort of say –

Andy Ransom: Thank you, Jane. You have answered your own question!

Jane Sparrow: Already answered the question for you! However, does it put you sort of well ahead of the competition or is it keeping pace with the other large players?

Then the second one, just on the global pipeline in the Pest business. You said that you are sort of in a unique position compared to the competition, so who else on that contract that you won earlier this year – how are they bidding? Is it alliances of international companies getting together?

Andy Ransom: Great, thanks, Jane. On the digital first – I was going to repeat the exact words that you used, but I cannot remember what you said! No, joking aside, we are significantly ahead of the competition in our view. It is our view; you would have to talk to the competitors as to what they might be working on in the background.

What I can tell you is we have been working very hard for three years, if not longer, on this, and what you saw on the video there is bringing all of those components together in a consistent way. The big breakthrough from us is not merely in the existence of the technology, it is now the ability to deploy the technology. Creating clever stuff is the easy bit; creating clever stuff that you can deploy in 70 countries around the world, sending millions and millions and millions of messages of data, and then making sense of that data, that is the really neat part of that.

We think there are elements of that story: the use of smartphones in the field, I would not say we are particularly further ahead of some of the competition. However, terms of a digital landscape, end-to-end customer journey right from first search through to e-billing, I do not think anyone gets anywhere close to Rentokil. That is my honest view, but you should talk to the other guys and see what they have to say.

On the global accounts piece, I think it is quite interesting. We have been sort of somewhere between reactive and proactive in this space. Largely, we are responding to customers coming to us saying, 'Could you offer a global account?' We have not seen a lot of global tenders per se. We have had very large international customers who care about their brand, who care about their reputation, who care about quality and we are looking for consistent standards; who love the online digital reporting; who are probably using Rentokil in parts of their global estate, and they are coming to us and saying, 'Well, could you provide this across the entire globe?'

There are some smaller global contracts which are out to tender and going out to tender. Typically, they are not involving dozens and dozens of countries, they are involving a few countries. Obviously, if the customer need is only for a few countries around the world, there are more players than just Rentokil. However, if you are looking for extensive global coverage, we are in 70 countries around the world and no one else gets close.

I said we are somewhat reactive and proactive: because of the positive experience that we have been having with customers coming to us, we have now put in place a dedicated global sales team who are now proactively going to customers and talking to them about the opportunity. We have got a very big pipeline of global account opportunities; time will tell how many of those we covert into revenue. Two years ago, that pipeline was empty. There was not a single account in it. As we are two years on, it is very significant. I think it is an exciting area, but it is really being driven, if I am honest, by customer need saying to us, 'Can you do it?' It is not an easy thing to do.

Chris Banberry (Peel Hunt): Good morning. With regard to Residex, why has it been delivering below the 5–7% margin, and how has the business performed over the last couple of years?

Secondly, with regard to Hygiene, what is the average number of products now per customer site, and how has that been developing over the last couple of years?

Finally, with regard to the rollout of Service+ in Hygiene, where do you expect to be with that by the year end? Thank you.

Andy Ransom: Okay. On the first one on Residex, I think it is a business that grew very quickly over the last three years. My honest view is that that growth probably came at the cost of margin. Our business has been a solid and steady performer over that three-year period, we were probably growing more or less in line with the market, whereas Residex was growing very, very quickly. I think the honest answer is that they made a bigger investment in headline sale capability, and that translated into margin. We are hoping to get the benefit of both a boost to our sales performance but also leveraging our scale to get the margins up to those more industry levels.

Average service line per Hygiene is quite difficult to be definitive about, but the average across our global estate is just over two. That tells you something about the hygiene industry. What that does tells you: if the average is just over two, when you think about the average wash room, you do not think there are only two items in there. What that tells you is there are a very significant number of customers for hygiene services that only take one service, and that one service typically is the feminine hygiene service. Part of our plan is to sell more value to customers who are typically only taking the one service, which is feminine hygiene.

That number has increased over recent times as we have put the new ranges in. The average sales on the new ranges, and I am really going off-piste now, but I think it is about three. So there is a material difference between the old ranges and the new, but that is probably about right.

Jeremy Townsend: Yeah.

Andy Ransom: Your question on Service+: difficult to say really. I know this stuff sounds really easy; it is incredibly complex to create a route planning and route scheduling and route optimisation system that works really, really well. It has taken us probably five years of work on Service+ in Pest Control. The Hygiene routes are different to Pest Control. If they were the same, we could have just put that out into the field.

Pest Control operatives are typically doing six to eight visits a day, so the system needs to, first off, work out which customers am I going to allocate to you, Chris? Which logically make most sense to give you, those customers? Then I am going to work out some customers have eight visits a year, ten visits a year, 12 visits a year, 26 visits a year, so I have got to plan those in a logical plan. Then I have got to work out the fact that in the summer we get lots of unscheduled call outs, and then we get call backs to customers saying, 'We have got a problem.' The system has been designed to cope with all of those moving pieces, and it does it extremely well.

Hygiene model is quite different. The hygiene guys are typically stopping 25, 30 times a day, the service frequency might be once a week. There is more consistency there, there are fewer call backs, there is no summer season. Whilst that might sound easier, it is actually a more complex set of algorithms to crack to get that model really, really tight.

What I can tell you is we are piloting the Hygiene version of Service+, we are piloting it as we speak in Southern Europe. First blush looks very good. If it turns out to be very good, then it will be a 2017 deployment rather than H2 2016.

Any more questions? Fantastic. Thank you very much everyone for coming. Thanks for your questions. Thank you.

Jeremy Townsend: Thank you.

[END OF TRANSCRIPT]