TRANSCRIPT

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Rentokil Initial plc

Q1 Results

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PARTICIPANTS:

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Morgan Stanley; Analyst
Suhasini Varanasi
Goldman Sachs; Analyst
James Rosenthal
Barclays; Analyst
Sylvia Barker
JPMorgan; Analyst
Nicole Manion
UBS; Analyst
Allen Wells
Jefferies; Analyst

PRESENTATION:

Operator^ Welcome, everyone. And thank you for standing by for the Rentokil Initial First Quarter 2024 Results Conference Call.

With us today are Chief Executive, Andy Ransom and CFO, Stuart Ingall-Tombs.

I will now turn the call over to Andy.

Please go ahead.

Andrew Ransom^ Thank you very much. And good morning, everyone.

I'm going to make some brief opening remarks and then Stu and I will be very happy to take any questions.

Rentokil Initial plc

Q1 Results

I will refer to a few slides that are available on the Investors section of our website.

The presentation obviously includes a cautionary statement on Slide 2 regarding forward-looking statements.

We've had a positive overall start to the year with group revenue up by 4.9% to GBP 1.29 billion.

Organic growth for the group was 3.1%. And in North America, our RIGHT WAY 2 plan has delivered a stabilizing performance with organic growth of 1.5%. Europe, the group's second largest region, delivered another strong performance with organic growth of 6.2% in the quarter. The U.K. and Sub-Saharan Africa region contributed 4.1% organic growth against an ongoing challenging backdrop.

Asia and MENAT was up by 4.3%, while our Pacific region delivered organic growth of 7.3%.

Our bolt-on M&A program continued to create value with eight acquisitions in the quarter, delivering combined annualized revenues in the year before acquisition of around GBP 45 million. This includes an excellent deal in India, where we've acquired HiCare, the country's second largest pest control company.

Moving on to the next slide, and to North America's performance.

In Q1, organic revenue in Pest Control was up 1.5%. Core Pest Control services was up 1% in the quarter.

We saw a good pickup in performance in February, although the early Easter holiday period was a slight drag on March.

After a challenging second half of 2023 we've put in place and we've started to execute our RIGHT WAY 2 growth plan, and we're beginning to see the first signs of a positive impact and a stabilized performance.

I'm delighted to report that the strong improvements in colleague retention that we delivered in 2023 have continued in the first quarter with total colleague retention in North America increasing by a further 1.5 percentage points. Sales colleague retention was also up by a very encouraging 2.7 percentage points after a flat performance in 2023.

I talked to the prelims about the opportunity to drive organic growth through both new and existing customers. And as we moved through the quarter, the number of service technicians submitting leads has increased by 8 percentage points.

Turning to the acquisition of new customers.

It's very early days for the new Terminix It brand and marketing program, which we've launched towards the end of the quarter, and will ramp up significantly as we now go into peak season. The initial reaction has been excellent, and we're confident that it will have a positive impact on go-forward lead generation.

To date, we've already seen an improvement in the quality of our inbound digital leads and expect to build on quality and quantity as we enter the peak season.

We've only had two weeks of data in the current quarter. But we're encouraged by the increased lead flow volumes that we are seeing. So early days, but all of this gives us confidence in the future growth in the region and we've reiterated our target for organic growth of 2% to 4% for full year.

Turning now to the Terminix integration. This is all tracking nicely to plan.

We're now well into phase two of the integration program, which is preparing for full route and branch integration.

We successfully completed the merger of the two legal entities and that's a significant milestone and a critical enabler of future integration activities.

We've made good progress with the combination of the general ledger and internal reporting systems and we've implemented multiple further developments in the operational technology stack. We remain on track to realize $40 million of net synergy costs in the current year. So overall, we've made a positive start to the year.

We've delivered a good group revenue performance, supported by continued strong price discipline. North America performance has stabilized in the quarter supported by the early initiatives of our RIGHT WAY 2 plan.

Our [Terminix It] sales and marketing program is now ready to go for the peak season. And in fact, you can view some of those ads on the RI website. And our integration program is on track.

Our other regions have delivered good organic growth, particularly in Europe and the Pacific. And our bolt-on M&A continues to create value with our expectation for total spend in 2024 remaining at about GBP 250 million. That all means that our full year '24 outlook remains unchanged including expectation of 2% to 4% organic growth in North America, accompanied by modest margin progression.

So thank you very much. And at this point, I'll hand back to the operator for questions and answers.

Operator^ (Operator Instructions) We now have our first question from Annelies Vermeulen from Morgan Stanley.

Annelies Vermeulen^ I have two questions, please.

I'll take them one at a time. So firstly, how much of that GBP 25 million of marketing spend has been deployed already and towards what? Is it mostly the Terminix It campaign? And based on what you've seen so far, how confident are you that, that number will be enough to deliver on your organic growth guidance? In other words, is there a possibility that, that number may need to go up as we move through the year? That's my first question.

Stuart Ingall-Tombs^ Yes. Stuart here. Thanks.

I'll take that. So a relatively modest amount of that GBP 25 million being spent so far. I don't know the exact number, but it's -- most of that GBP 25 million is going to be spent in the second and third quarter. And actually, the Terminix It element is a relatively small amount of that GBP 25 million because it's a real brand, top-of-funnel type marketing. It's not the bottom-of-funnel pay-per-click activity.

So is it enough? Well we believe it is because otherwise, we wouldn't have named that number. We've seen nothing in the first quarter to suggest it should be more or less.

What I would say though is if it's delivering a good return, and it's been tremendously successful, then we'll reserve the right to invest more than that if it supports a higher growth trajectory, and we can see the business case and the logic for that. So [less] on that subject.

Annelies Vermeulen^ That's very clear. And then the second one is, so you've reiterated again today to progress with the branch integration midyear, which clearly is in the middle of your crucial peak trading period. Are you concerned about that at all? And how do you balance progressing the integration with delivering on your organic guide? In other words, would you delay those branch integrations if it became apparent that those were having a detrimental impact on your sales? Or is the priority to deliver on those integrations regardless of what it may mean for your organic growth guide?

Andrew Ransom^ Thanks, Annelies. I'll take that one. Well I'm fresh off the plane. Well not very fresh, to be honest, but off a plane from New York and spent few days with the team. And we've just come out of some excellent meetings, talking about preparation for integration, we've chosen the first region carefully in the knowledge that we start the integration in the season, but we're comfortable with that.

It's a slow start to the integration. We don't rush at this. So we'll be going at a decent pace. We're not overly concerned about that. But as you say, there's a lot of things you got to do and got to get them right in the integration.

So we'll take a cautious approach and we'll be measuring everything, measuring everything that we do in that integration to make sure that it's not having a deleterious effect on growth or customer experience or colleague experience. And if we see anything, we'll pivot. That's what we do. So we'll try and see if there's anything that causes any concern to customers, if it is, we'll adjust and address.

So we've integrated branches through the season before. We didn't use to, but we changed the tag maybe about five years ago. So -- and then in terms of the impact on growth, we've done our very best to make a good estimate of whatever impact the integration program will have. And we've included that impact within the 2% to 4%.

So as we sit here, we've got a good level of confidence that the integration will start well and go well. There'll inevitably be some issues. You can't put two network businesses like this together without creating some issues. But as we sit here, we're pretty confident that it will go well. And we've tried to make an assessment of what impact that would have and that's within the 2% to 4% guidance.

Operator^ Our next question comes from Suhasini Varanasi from Goldman Sachs.

Suhasini Varanasi^ Two from me as well please. Can you maybe share some color on organic growth through the quarter in 1Q? Was March perhaps a bit weaker than your expectations? And do you know why that happened?

And second question is on the margins. I appreciate it, sir, it's a revenue call but as we head into the first half results, can you maybe share your thoughts on margins for the first half? Should we expect any improvement? Or is it basically going to be more stablish and then with the improvement weighted to second half?

Stuart Ingall-Tombs^ Yes. Thanks, Suhasini. Yes.

Look, we end up at 1.5% having guided to 2% in the early part of March. So we were clearly expecting some acceleration in the second half of March, but really to just seem to get in the way of that.

So after a promising start, March didn't quite deliver the way we hoped it had. And that's why we're looking through the end of March into April. So we're pretty confident about our revenue guidance now as we look at the various elements of the RIGHT WAY 2 plan.

So yes, just a little bit of a pause, if you like, at the end of March, and we weren't expecting to the degree it happened. Margins, I guided to flat-ish in H1, modest improvement in H2. I've really got nothing to add on that at this point. It's -- that's still our outlook. That's still what I'd expect. So I'll reiterate the guidance.

Operator^ Question comes from Sylvia Barker from JPMorgan.

It seems like Sylvia retracted the question. Let's go next for now from James Rose from Barclays.

James Rosenthal^ I've got two, please, if I may. Firstly, if you look back at previous marketing campaigns, so Terminix is done, and the last one was two years ago, how long did it take to see leads respond in a more meaningful way from that last campaign? And then secondly, could you talk through plans you have in place to start improving customer retention in North America overall? And when would you hope to see customer retention figures start to edge upwards?

Andrew Ransom^ I don't honestly know the answer to the question.

It's a difficult one to calibrate in terms of how quickly the market responds to a campaign. We've tested our ads. As I said, you can see them on the group website. So you can have a look for yourself and see whether or not they hit the spot. The reaction that we've had is good.

So it really does depend on how well those ads are received by the watching public as to how quickly they respond, and it also depends on how widely they get accessed and through which channels they get access. It's really difficult to give you any sort of quantification of that. But we think it's a good campaign.

It's got off to a good start, and reaction we've had is positive and be very interested for anyone who chooses to look at them on the website, if you've got any thoughts on that.

I think on customer retention, it's a very good point you made, James, and we're very focused on it. Broadly speaking, customer retention in our U.S. business is around about the 80% mark, broadly speaking. Customer retention for the group is around about the 85% mark. There's clearly a significant opportunity there.

You do find that residential customer retention is typically weaker than either termite or commercial. So whether we can get to the full group average quickly or not remains to be seen. But we are very focused on it.

We've just appointed a new very experienced Head of Customer Experience who joined the group recently. And what we're doing is addressing every customer touch point in the customer journey. So not just the sharp end, as we call it, when the technician visits the customer.

But every single touch point when the customer deals with us, whether that's landing on the website, whether it's making a phone call to us, whether it's rebooking an appointment that they want to change, which is a very, very frequent activity.

So we're looking at every aspect, taking best practice from our own group, but also elsewhere.

We've invested in technology to make the customer experience better. So there's a lot of things going on. And you're absolutely right, there's an opportunity to improve customer retention in North America, and we intend to take it.

Operator^ We are now taking the question from Sylvia Barker from JPMorgan.

Sylvia Barker^ Apologies for that, I has some technical issue with a meeting.

I have three quick ones, please. Firstly, just on the organic trend. So that moved down, driven by March from 2-ish, let's say, growth within services to one in Q1. Is that driven mainly by residential? Or is it more pro-based?

Then question number two, your change in sales incentives. Could you just talk a little bit more about what is changing? And if there are any additional costs relating to that?

And then final question. How much do you spend on marketing as a proportion of sales today, whether in North America or overall for the group?

Andrew Ransom^ Yes. The first one, residential is the weakest resi, then termite and commercial. So the same order that we've talked about previously not too much difference between them, but residential was the weakest. Sales incentives, a real focus on sales incentives because one of the things that we have to do when we start the branch integrations just in a few weeks is we have to harmonize the terms and conditions and harmonize the pay and incentives for anyone impacted by the integration.

So the first branch is coming together, we will be adjusting sales incentives. So the sales teams, whether that's the indoor sales teams or the field sales teams they will be adjusted so that they're on the same schemes. And the thing with salespeople is if you get your incentives right then any investment you make in sales will be self-funded because it will generate increased sales and increased revenue.

So there are some costs involved. They're not significant, but there are some costs involved as we harmonize and adjust those pay -- base pay and incentives, but those costs are included in the investment figure that we've already talked about, the GBP 100 million. So you've got gross synergies of GBP 325 million, investments of GBP 100 million, giving you net synergies of GBP 225 million incremental costs in sales incentives, which I say, are not material, but they are within the GBP 100 million. And as I say, if we get the sales incentive structure right, it should be a good thing because it should be incentivizing a higher level of sales performance.

And on the third, sorry to disappoint, but we don't break out quite deliberately. We don't break out the marketing spend. It is a competitive sports marketing. So we don't break out definitively the actual dollar spend, we have of course, this year said there will be an incremental $25 million going into marketing in North America. But other than that, we don't break it down.

Operator^ Next question comes from Nicole Manion from UBS.

Nicole Manion^ Two questions from me, please. Firstly, on the distribution business in North America. I think you can sort of back it out a little bit from the overall test number and the services number, but maybe if you could just comment a little bit on trends in that business in Q1, how you see it may be going forward?

And then secondly, just moving away from the U.S. a little bit, on the HiCare acquisition in India. I know it's always a market you've been in for a long time, but it looks pretty insignificant. Maybe you can comment on how that changes things and yes, how significant that is in terms of sort of scaling up your position there, that would be great.

Andrew Ransom^ Thanks, Nicole. I haven't got the figure right in front of me, but I believe the distribution business was around about 4%, 5%. Stu is firing up his computer. He'll correct me if I'm wrong. Yes. We've seen a reasonably positive start to the season.

As you know we use distribution as something of a litmus test as to how the market is performing. And it's been a reasonably positive start to the distribution season from what we've seen so far.

It's a bit difficult to call because there's lots of these sort of early season discounts that the manufacturers put in. So customers sometimes load up on those if they think the price is a good price, they buy more product than they actually need. So it's quite difficult to be binary about it, but I'd say, a reasonably positive start over in distribution.

HiCare, very nice acquisition, we were already the number one in India and they're the number two. So it's consolidating a nice number one position.

I'm not sure I'd consider it insignificant. India population of 1.3 billion people, good growth, fantastic city growth, emerging middle class or burgeoning middle-class populations with millions and millions of people entering the middle classes each year in India.

So the point behind the India play is it's part of our Cities of the Future program where we've identified the cities, which are going to be mega cities in the next 10, 20, 30, 40, 50 years. So it's very much a long-term strategic positional play. And our belief is that if you look out into the future, the scale of those cities and the growth in those cities and the growth of pest control in those cities will be considerable.

But you're right, as it stands today, relatively small. But strategically, given the scale and the importance of India to be number one in the Indian market, and comfortably, number one, I think, is a very good positional play.

Stuart Ingall-Tombs^ And distribution is actually 7%.

Andrew Ransom^ Okay.

Operator^ We have our next question from Allen Wells from Jefferies.

Allen Wells^ Three for me, please.

I don't want to dwell too much on this, but like just digging back to this kind of understanding what's changed from when you set that guidance. Obviously you flagged Easter having a bit of an impact, but I'm guessing you would have known Easter dates when you set that. So maybe you can just talk a little bit about what actually happened over Easter that might be different? Or maybe you can quantify the Easter impact, that would just be really, really interesting just to understand where that dropped away. That's the first question.

Second question, I just wanted to understand the pricing component within that Pest Control number, particularly in North America. I'm assuming, obviously there's some annualization in last year's price increases, but I'd just be keen to understand, did you mean -- put for any meaningful price increases from January 1? Or were there some strategy to kind of move these prices upwards as you move into the busier pest season?

And then just finally, anecdotally, I'm just hearing that some of the pricing around -- cost around kind of digital leads and search terms has been creeping up in pest control, maybe interested in seeing what you're hearing there, is maybe that kind of the dollar investment in growth in those areas may be going a bit less. Just any comments there on how you think returns on that lead generation plays out?

Stuart Ingall-Tombs^ Yes. Thanks, Allen.

I'll take the first two and leave the third one to Andy. So what -- I mean you're absolutely right. Easter was not a surprise in a sense, when it was happening.

And we sort of calculate stuff on a trading day basis, and we knew it was going to cost us a couple of trading days, but we sort of know the impact of that and it was just greater than that. And so I think it's an Easter effect. It wasn't a standard sort of weekend or something like that where you get a bit moving about between calendar year.

So yes, look, it just hit us harder than we were expecting. And I think interrupted a little bit of the momentum that we could see building. So yes, we were disappointed because we didn't say 2% and then expect to miss it for sure, but that just took us by surprise, honestly.

Pricing component, it's about 4%, I think, across the region. So a pretty standard sort of pricing.

As you know we do it on a monthly basis, inception of annual anniversary and the inception of your contract. So we don't take any particular different view of the inflation -- of the -- doing more in the season than out of season. It's just what our forward view of inflation is.

So it sort of net down about 4%, which looks like a pretty good call given the pickup in the U.S. inflation we saw last week. Andy?

Andrew Ransom^ Cost per lead is, again, since a competitive sport, I said it earlier, it's a little tricky to give definitive answers there. We're trying to get the phone to ring in 600-odd branches. Obviously 600 branches going down to around about 400 over the next couple of years. So it depends really which city and so it's very much a local thing we're doing here. So you're trying to choose the terms that you want and you're willing to pay for, but also in the cities that you're after, but also at the time of month that you're after.

So it's very tactical. It is daily. It requires a lot of focus. I think there is some evidence to support your point that in some of those markets or some of the search terms cost per lead is going up or has gone up, but that is not a universal truth. That's not to say that all markets, all search terms have gone up by any means at all.

And in terms of, as Stuart said earlier, most of our dry powder, if you like, in terms of paid ad, paid advertising or Google and other companies, that's reserved for Q2, Q3 in the main high season. So again, difficult to pick trends out of the quieter months, but some evidence to support your statement but not a universal truth, given you're talking multiple cities and multiple terms and multiple competitors out there.

Allen Wells^ Great. Could I ask just one quick extra question just on the Hygiene side as well. Obviously not really talked too much about so far. But I guess, growth holding up pretty solidly in Q1. It seems like there is slightly more macro exposed in maybe Pest Control, just anecdotally, how do you feel on that? It feels like pricing is holding up okay. Customer retention and cancellations, seem like they're okay. Like any additional comments there on your confidence around Hygiene for the rest of the year?

Andrew Ransom^ No. I think you covered it there.

From -- I just reviewed the Hygiene business. We have a sort of quarterly global review of the category, we just had that last week. And there was a reasonable degree of confidence across the category and across the world. So I think holding up pretty well.

As you've said, pricing okay, customer retention, okay. So far, so good into the year. And the outlook, nobody's coming off their numbers. So they're all saying, steady as she goes at the moment.

Operator^ We don't have any questions as of the moment. We'd now like to hand back over to the management for the final remarks.

Andrew Ransom^ Well thank you very much indeed. Thank you for joining us. I appreciate that. And no doubt we'll see many of you over the coming weeks. But for the moment, that's it. Appreciate it. And see you all very soon. Thank you.

Operator^ Thank you for attending today's call. We hope you have a wonderful day. Stay safe.