

# FINAL TRANSCRIPT

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## **RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call**

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Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

## CORPORATE PARTICIPANTS

### **Doug Flynn**

*Rentokil Initial PLC - Chief Executive*

### **Andrew Macfarlane**

*Rentokil Initial PLC - CFO*

## CONFERENCE CALL PARTICIPANTS

### **Mark Shepperd**

*UBS - Analyst*

### **David Allchurch**

*Morgan Stanley - Analyst*

### **Karl Green**

*Credit Suisse - Analyst*

### **Andrew Ripper**

*Merrill Lynch - Analyst*

### **Piethein Leune**

*ING - Analyst*

### **Andrew Grobler**

*Goldman Sachs - Analyst*

### **Iain Armstrong**

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### **Mike Murphy**

*Panmure Gordon - Analyst*

### **Laurent Brunelle**

*Exane - Analyst*

### **David Greener**

*[Cintas] - Analyst*

### **Rob Harris**

*UBS - Analyst*

## PRESENTATION

### **Operator**

Good morning, ladies and gentlemen, and welcome to today's Rentokil Initial third-quarter results conference call. For your information, this conference is being recorded. At this time, I would like to hand the call over to your host today, Mr. Doug Flynn. Please go ahead, sir.

### **Doug Flynn - Rentokil Initial PLC - Chief Executive**

Thank you. Good morning and thank you all for joining me on the call today. With me, I have Andrew Macfarlane, our Chief Financial Officer. I will run through the third-quarter financial and operational highlights; and then Andrew and I will take any questions.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

I am pleased to report the Group continues to move forward despite the challenging European Textiles and Washroom market which we described at the half-year. This quarter has seen us continue to make progress against our priorities of improving top-line growth and customer retention.

In the third quarter, we saw organic revenue grow by 3.5%. We saw growth of 13.7% if you include acquisitions. That is our sixth consecutive quarter of top-line growth.

Our customer retention rates continue to improve. In particular, the Rentokil Pest Control division recorded its best quarter for some time in terms of both revenue and profit growth. In continental Europe, all of the major Pest Control markets produced higher revenue and operating profit than the same quarter last year, most notably in France, the Netherlands, Belgium, Germany, Spain, and Portugal, where organic growth rates were typically over 5%. A 4.9% increase in operating profits was achieved by the Pest Control division in the quarter.

We also made progress in our efforts to build a stronger position in key markets through structural change and acquisitions. Our City Link parcel delivery business continues to go from strength to strength. We have acquired a further 16 City Link franchises for a total consideration of GBP25.5 million. We are confident of completing the buyback process ahead of schedule in 2007.

Our revenue in the division was up 65% year-on-year. But if we exclude the impact on franchise acquisitions, organic revenue growth was up 7.6% in the quarter, compared with an estimated 3 to 4% market growth in the same period.

In Asia-Pacific, the acquisitions we previously announced of Pink Healthcare and CWS branded washroom and dustmat businesses helped the division to a 19.5% increase in revenue in the third quarter. All markets increased revenue with strong growth in Australia, New Zealand, Singapore, Hong Kong, and the Philippines. Excluding the impact of acquisitions, revenue grew by 4.7% in the quarter.

Now, taken together, these are encouraging numbers. Our outlook for the remainder of the year and 2007 remain unchanged.

Finally, returning to the Textiles and Washroom business, as we indicated in August at the interim results, we are experiencing challenging trading conditions. However, we are taking action.

For instance, we have announced plans to close three processing plants in Germany, with capacity being transferred to other existing facilities. The UK Washroom business reorganization is also on track. Once the branch reorganization is complete, the cost base of this business will be reduced by some GBP3 million per annum compared with the situation in April 2006. Further profit improvements are expected to come from better sales, service, and process productivity in 2007 and 2008.

So in summary, we have brought in new management where appropriate. We're working hard to change the culture of the Company to one where people are looking outside and are customer focused. Overall, we're making tangible progress against our stated priorities, and the business is moving forward. But as I am sure you will appreciate, there is still a lot of work to be done.

So thank you for listening, and let us pass it back to our moderator for any questions.

## QUESTIONS AND ANSWERS

### Operator

(OPERATOR INSTRUCTIONS) Mark Shepperd from UBS.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Mark Shepperd** - UBS - Analyst

I wonder if I can ask about the outlook and the cash impact of the restructuring costs that you all are taking? Because I think you are guiding to a higher level of restructuring costs in the second half. Can you give us some indication of what the cash implication of those costs will be, both in terms of this fiscal year and 2007?

And I just wonder if you could give us any guidance at all on what the expected accounting costs are likely to be in 2007.

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Most of the one-off costs that we're talking about will become cash at some time. So relatively little of it has to do with asset write-downs. Obviously, our obligation is to recognize the cost at the time we make the announcement or formulate the plans. So the cash flow tends to follow after that.

Of the GBP25 to GBP30 million in the second half, about half of it will be cash out in this year. The balance will be cash out in '07, mainly redundancy and probably payments to get out of leaseholds.

**Mark Shepperd** - UBS - Analyst

Half comes in '06, and half comes in '07 of that 25, 30?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Yes.

**Mark Shepperd** - UBS - Analyst

Are you giving any guidance at all, now that we have got a bigger number in '06, Andrew? Are you giving any guidance at all on what the estimate for restructuring charges are or will be for '07?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

No; I think the distinction that I would make is -- as you have noticed in '05 and '06 we have had what we have described as one-off items affecting most divisions most quarters. We typically haven't been very specific about the benefit that we would get from that, other than to say that we are restructuring businesses or upgrading management.

It is possible that there may be some continued restructuring next year, but it is going to be more isolated, and we -- be more confined perhaps to divisions. If we do that, we will be talking much more explicitly about the payback we expect and over the time period we expect to get the benefit.

You will see some of that flavor in the third-quarter statement where we start to talk in those terms about the German closures.

**Mark Shepperd** - UBS - Analyst

That is useful. Thanks very much, Andrew.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Operator**

David Allchurch from Morgan Stanley.

**David Allchurch** - Morgan Stanley - Analyst

Two questions if I may, please. First of all, obviously UK Pest Control is still the laggard. When do you think that division might get back to positive organic sales growth, please?

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Well, we like to think it will in 2007.

**David Allchurch** - Morgan Stanley - Analyst

(multiple speakers) half-way point?

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Well, I think we're going to see a modestly positive '07 for UK Pest Control. There is no reason to -- although there is significant restructuring going on right now in that business, we should be through that certainly by the end of the first quarter of '07.

Therefore, the distractions that go on when you are doing significant restructuring should be behind them. They should be looking to a positive growth for the balance of the year.

**David Allchurch** - Morgan Stanley - Analyst

Right. Secondly on the four major performance improvement plans, I think you mentioned it may be difficult to achieve your '06 textile rental French improvement of 100 basis points. Could you particularly focus on that? Talk about whether or not you think you can improve, or make strides towards achieving that in '07, '08? Or any further updates on some of those ambitious performance improvement plans, please.

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

I think the issue of improving margins in that Washrooms business remains high on the agenda. But we really have had to step away from that undertaking at this point. But it remains very high on the agenda.

We -- putting a timeline on it right now, I am not sure we are ready to do that at the moment, David. But it remains very high on the agenda.

**David Allchurch** - Morgan Stanley - Analyst

On the French textile rental, obviously there has been a pretty tough climate this year. But do you still see scope to get sort of useful margin improvement in that, which is a large profit driver for you, the French textile rental business?

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Well, there is certainly scope to improve the productivity in that business. You know, we are engaged in that discussion right now with our management team, given the market has been slightly tougher or somewhat tougher than we had originally planned around.

I note in some of the commentary as to whether or not the Group lacks visibility of what is going on in this market. The Group certainly doesn't lack visibility. But it has been -- it doesn't take too many percentage points in terms of volume demand to make it significantly tougher to deliver the performance.

That has been the experience in the marketplace. It has been 1 or 2 percentage points below where we expected demand to be.

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**David Allchurch** - Morgan Stanley - Analyst

Right. Finally, I think you mentioned one or two encouraging trends in September as you exit the quarter. Is there anything else that you would mention or highlight that just gives you a bit more enthusiasm as you end '06 and enter '07?

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**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Well, I think certainly the things we're doing in the Pest Control division give us a great deal of confidence. All the underlying aspects of that market remain very positive. You know, in every marketplace it is a GDP-plus underlying market growth. Certainly, with our market shares and the focus we are putting on that division, we expect to see that being an ongoing driver for the Company in the years ahead.

Certainly, in Asia-Pacific we are making very good progress. It is probably not showing up so much in the numbers in terms of the P&L. But I feel very confident of the team we put in place and the things they are doing.

The same goes for City Link. Our Electronic Security business continues to be outperforming its peer group, albeit it is not currently showing much growth.

So I think there's a lot of things that we have got at the moment that we feel fairly good about. We often feel that the business is struggling in all this sort of stuff. But the fact is we have got a mixture of the very, very good businesses and some businesses that are in remedial care.

So you know, we have just got to get those businesses that have been in remedial care turned around and continue to drive the businesses that have always performed well.

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**David Allchurch** - Morgan Stanley - Analyst

All right, thank you.

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**Operator**

Karl Green from Credit Suisse.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Karl Green** - Credit Suisse - Analyst

I have just got a question going back to the textile and Washroom Services business. If we look at the margin progression, stripping out the one-offs, it seems like the year-on-year deterioration has got worse in the third quarter compared with Q1 and Q2. Obviously you have seen that UK Washroom revenue down 12% in the third quarter.

But just looking at the overall margin, what has been the bigger driver of that deterioration? Is it the fact that you have got density benefits or economies of scale unwinding in the UK temporarily? Or is it more because of the tough conditions in France and other parts of Continental Europe?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

It is inevitably a combination of both things. In the UK, we have still got really quite an inefficient business model. As you know, we came from 50 [branch] or 50 sites down to 35 by about April. We still have too high a cost base for that business. We are targeting to get down to about 20 sites by March next year.

So we still haven't got efficient routes. We still haven't got the most efficient sales model. Our service and processing costs are still too high. It will be probably autumn '07 before we have a new plan that will fix that.

So we understand what is going on with the margin in the UK Washroom business. We also what understand what is happening to the margins in the Continental business. The big problem there is that in France, Belgium, we are struggling to get pricing price increases to basically stick. In the Netherlands, we're still seeing pricing going back. Things are a bit easier in Germany.

So our main problem is the inability to pass through all of the cost price inflation that we are suffering.

**Karl Green** - Credit Suisse - Analyst

Okay, just following on from that, then, I think at the first-half stage, you kindly gave a bridge for the (indiscernible) division. You did indicate what the underlying UK Washroom EBITDA contraction had been; and likewise the impact for France, Netherlands, Belgium, and Germany. Could you give us those numbers for Q3?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

No, we will do that again at the full year, though.

**Karl Green** - Credit Suisse - Analyst

Okay, just one final one on this subject. So what you are saying is, in terms of this revenue decline, are you confident that when you start to see the UK Washroom revenues build again that you will see a disproportionate margin benefit on the upside, if and when that happens?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Yes, definitely.

**Karl Green** - Credit Suisse - Analyst

Okay, thank you.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Operator**

(OPERATOR INSTRUCTIONS) Andrew Ripper from Merrill Lynch.

**Andrew Ripper - Merrill Lynch - Analyst**

I have got three if I may. First of all, going back to the reorganization and the payback lengths, for the additional clarity in terms of UK Washroom, Germany, and Pest. Just looking at your anticipated spend in the second-half of GBP25 to GBP30 million. You know, the three sort of bigger initiatives that you have flagged add up to about GBP16 million. The payback on those you have given us seems to be about GBP11 million, although I am not quite sure about what you mean on the Pest Control side.

Just wondering, there is clearly another sort of GBP10 to GBP15 million there of costs that are sort of missing, presumably in relation to smaller initiatives. If you lump those initiatives in as well, what is your view of hard cost savings when you get to the full run rate, whether it is '08 or whenever? Can you give us a number overall, please?

**Andrew Macfarlane - Rentokil Initial PLC - CFO**

The [chances] that we have got is that if you look, for example, at what we're doing in UK Pest Control, where we are saying GBP4 to GBP5 million of restructuring costs. We are saying that we will pay that back out of cost savings alone within three years. Which is all to do with people and branches.

But actually what that spend does is it unlocks a new business model, which will let us drive the top line much faster and improve service productivity. So we should do better than that.

So when you say -- what is the payback on that money? It is -- you mean just in hard cost savings, or what to expect the run rate (multiple speakers)?

**Andrew Ripper - Merrill Lynch - Analyst**

Well, yes, if you start with -- ask [how] hard cost savings (multiple speakers) (inaudible) three years. Do you mean GBP1.5 million per annum? Or are you talking about annual savings?

**Andrew Macfarlane - Rentokil Initial PLC - CFO**

We mean GBP1.5 million per annum.

**Andrew Ripper - Merrill Lynch - Analyst**

Okay, I'm talking about -- you [set aside] GBP4 to GBP5 million of cost there; GBP6 million of cost in the UK Washroom; GBP6 million of cost on German textile. I add that up; that's about GBP16 million.

You are spending GBP25 to GBP30 million in total in the second half. So there is some GBP15 million out there, or GBP10 to GBP15 million that is -- of spend which you have not detailed. I am just wondering what the payback on that would be on an annual basis.



Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

I think we are going to be better able to answer this completely -- because quite frankly, we have not -- it is a good question in the way you are totting it up. But quite frankly, we have not addressed it in that way. I think we're going to be able to answer that better at the full year. But it is a good question and perhaps we should be looking at (multiple speakers).

**Andrew Ripper** - Merrill Lynch - Analyst

(multiple speakers) to come back to it. In terms of the Pest Control, obviously that seems -- Pest Control in Germany (indiscernible) incremental. You have been very specific about when you're going to realize the German savings. On Pest Control, you talk about 25% headcount reduction, which presumably is going to happen quite quickly. So will we see that GBP1.5 million come in next year or from the middle of next year?

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Yes, I think you'll see it certainly by the middle of next year, and more probably by the end of the first quarter next year. Although there might be some will trail over into (inaudible). Some will trail over into second quarter, so full run rate should be achieved by the end of the second quarter.

**Andrew Ripper** - Merrill Lynch - Analyst

Okay. Then just come back to this cost issue on European Textiles. Can you be specific, please, about what your cost inflation is for the whole of the textile business, both in terms of employment costs, and utility and power?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

About 4%.

**Andrew Ripper** - Merrill Lynch - Analyst

4% per annum?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Yes.

**Andrew Ripper** - Merrill Lynch - Analyst

So in terms of sort of price that you need to get to offset that?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

It depends, also -- and understand it is about product mix and about route density -- but 2.5 to 3% price increases is good.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Ripper** - Merrill Lynch - Analyst

Okay. What would you say you are currently achieving, for example, in France?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Just under 1%.

**Andrew Ripper** - Merrill Lynch - Analyst

About 1% price inflation in France. Okay, that's great.

Then the final question was on the contract pool. (indiscernible) had the feeling there's some seasonalities, which may impact the contract pool when we are looking at it on a sequential basis. This seems to be particularly true in the [FM] business, where you had a quite big increase in the pool over the quarter.

Can you just explain that increase? Is that a seasonal impact? A seasonal effect? Or have you just won a lot of business in the quarter?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

It is just a bit lumpy. As it happens, in the third quarter of last year we had some big contract wins from [M&S] and others. Again, similarly, [Mistrela].

**Andrew Ripper** - Merrill Lynch - Analyst

It accounts for about 5 percentage points of your 7% pool growth (multiple speakers).

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

We had big wins from [HBoss], Metronet, Nissan, and Network Rail, for example, in the last quarter. In the third quarter.

**Andrew Ripper** - Merrill Lynch - Analyst

Okay, so it is real growth, though; it is not seasonal. Okay, fine.

Just you're obviously [flagging] improving [termination] rates. If we look at textile and Pest Control, I think you are down to about 9-odd in textile and Washroom, and 14-odd in Pest Control. Is that as far as it goes, or can you do more?

If it is as far as it goes, presumably for next year, in order to push the pull forwards you have got to be working pretty hard on the sales and marketing initiatives, which presumably we will hear more about tomorrow?

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

I think there are still some businesses that really have been getting a lot of attention, that have retention rates that are still nowhere near where we want them to be. So there is a quite significant drop-through to the bottom line, and will appear as

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

growth, simply by improving our retention rates in a number of businesses. Getting them performing will see -- will pretty much infer that the business is back in good health again.

So there is further to go in the retention rates, and my guess is that there probably is at least a further two years of broad improvement. Though there will be some businesses where you're absolutely right that there is no particular purpose in trying to do more than we are doing now. But certainly, that is not true across the board.

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**Andrew Ripper** - Merrill Lynch - Analyst

Do you have any sort of ambition in terms of -- I know historically you have talked about getting to market rates of sales growth next year. But with sort of how niche a lot of your businesses are, it is not really clear to me what market growth rates are.

Is it possible to draw you out on some sort of sales growth expectation for the Group for next year?

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**Doug Flynn** - Rentokil Initial PLC - Chief Executive

Not yet, but our ambitions will certainly go beyond market growth, but we may be prepared to talk about that at the full-year results.

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**Andrew Ripper** - Merrill Lynch - Analyst

Thanks, guys, for your answers. Thank you.

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**Operator**

Piethein Leune from ING.

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**Piethein Leune** - ING - Analyst

A couple of questions if I may. The first one is regarding the cash flow. I think I seem to remember with the half-year there were some issues with the working capital, -- let's say the operating working capital. Not really clear to me how that has moved during the quarter. Can you shed some light on that, please?

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**Andrew Macfarlane** - Rentokil Initial PLC - CFO

The answer is it has improved. The reason we don't give all of that information every quarter is it just too sensitive to particular payments, as to whether they flop into one month or the next. But no, we have seen improvement in working capital in the businesses. So we are on our way to delivering the performance we said.

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**Piethein Leune** - ING - Analyst

Secondly, on the interest line item, it came out a little bit higher than I expected. Also, here of course you don't give the whole split out. But could you give us a little bit of indication on where the moving parts are here?

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

There's three main components in our interest line. They're sort of real interest on real debt. I am going to give you some figures.

So real interest on real debt third quarter '06 was 13.8 compared to 15.1 last year. The national pension interest was a charge of 1 million in '06; a charge of 1.3 million in '05.

The real driver of the difference, however, is the mark-to-market on some of our treasury activities for those things that don't count as accounting hedges. In '06 that gave us a credit in the third quarter of 0.3 million; but last year the credit was 2.2 million. The thing that is surprising is the change in the mark-to-market.

**Piethein Leune** - *ING - Analyst*

Then, lastly, with regards to outlook and (indiscernible). Last time I questioned you if you had any thoughts of potentially giving us some more detail on margin targets with the full-year figures. How has the discussion with you internally progressed? (multiple speakers)

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Certainly not for the Q3 update. You know, we continue to be mindful of your suggestions. But I can't say anything more than that.

**Piethein Leune** - *ING - Analyst*

Okay, thank you. Maybe the last question. Nothing mentioned about the active portfolio program that you mentioned. Is there any movement there that we can expect shortly? Or any thoughts that you want to share with us?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

We continue to look at the ways in which we can generate value from our portfolio of assets. But the fact of the matter is that, as we have had the discussion before, these are all B-to-B businesses. It is a very sensitive subject. We don't want to flag things before we are ready to act upon them.

**Piethein Leune** - *ING - Analyst*

Okay, thank you very much.

**Operator**

Andrew Grobler from Goldman Sachs.

**Andrew Grobler** - *Goldman Sachs - Analyst*

Just a couple of quick questions, picking up from Andrew's question on cost growth. What is the wage increases across your business?

Secondly, just briefly, could you give us an update on what is happening to the IT projects?

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

I think wage inflation across the whole Group is probably about 3%.

**Andrew Grobler** - *Goldman Sachs - Analyst*

Thanks. IT?

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

IT, expect capital spend on Oracle and related projects this year of about GBP6 million.

**Andrew Grobler** - *Goldman Sachs - Analyst*

What is it likely to be, going into next year?

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

Probably about the same again.

**Andrew Grobler** - *Goldman Sachs - Analyst*

Okay, great. Thank you.

**Operator**

Iain Armstrong from Brewin Dolphin Securities.

**Iain Armstrong** - *Brewin Dolphin Securities - Analyst*

Most of my questions have been answered already. But just going back to the point about IT projects and CapEx, any guidance on overall CapEx? Given for example, your Pest Control business is growing a bit faster than expected, is that going to have any impact?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Pest Control tends to be a pretty light user of CapEx; and beyond the IT projects, it is a really -- has a fairly modest impact. Andrew should talk to [analysts]; but the key things are where we are reshaping some of these businesses and we are putting a modest amount of investment into some of the sites.

Some of the fleets are being upgraded. But the biggest driver is volume, and that is -- equipment for rental is the biggest driver of CapEx. But perhaps, Andrew?

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Year-to-date, cash CapEx is GBP99.7 million. That is a net figure, so that is net of disposal proceeds. Gross CapEx year-to-date GBP126.7 million compared with GBP137 million last year. Last year's figure includes Style and Manned Guarding, though.

**Iain Armstrong** - Brewin Dolphin Securities - Analyst

Okay. With regards to this interest line, because this had distortion of mark-to-market, which is course was much lower this year -- the credit was much lower this year than last. Is that going to be a permanent feature? Or has your activities in the mark-to-market been reduced over the last 12 months?

**Andrew Macfarlane** - Rentokil Initial PLC - CFO

Unfortunately, it will be a permanent feature. It is driven by a peculiarity of IFRS. Our normal treasury policy is to -- we have a mixture of fixed and floating rate debt. Some of the activities that we do to fix our floating-rate debt for the short-term. So typically we are operating sort of six months to a year out, mainly with FRA to fix interest rates.

That doesn't always meet the accounting definition of a hedge. Whatever the mark-to-market is on that FRA program, unfortunately, it has to go through the P&L. So just adds an element of volatility which you can't predict.

**Iain Armstrong** - Brewin Dolphin Securities - Analyst

Finally, just a question on the European, on the textile business. Because the euro zone is growing very strongly at the moment. We have had very good numbers from people like Randstad with regards to staffing, that sort of thing. I realize, of course, the German hospitals are being downsized; so that is probably not particularly helpful for you.

But is it a bit of a lag effect that perhaps you have -- also the extra cost of energy etc.; now you have got energy prices falling; that you can actually hold on to some of those increases that you have tried to put through?

**Doug Flynn** - Rentokil Initial PLC - Chief Executive

I think it is more of a systemic change in the marketplace, in that there is a small drift away of manufacturing employment out of Western Europe, mostly to Eastern Europe, but beyond as well. For example -- and the business, in particular the garment rental part, which is a big piece of the -- that drives the profitability of that division, is highly reliant on manufacturing industry.

In Northern Europe, something like 60% of wear for work is outsourced into our sort of model. By comparison, we are seeing services growing as a source of employment. But the penetration rate in the services area is only about 30%. In any case, it tends to be simpler sort of garments.

So we are seeing this drift away in manufacturing employment. Let me give you an example. It was in excess of 2% in Germany in the last 12 months. It was in excess of 1% in France; it was about -- I think it was about 1.5% in France. That's the sort of range that exists right across Europe. So that is having an ongoing impact that is affecting the entire industry.

On top of that, there is some excess capacity in the marketplace, as well; and probably a few too many players. So all of those things are impacting the business, making it difficult to get price increases through, and impacting the volumes. So we have to deal with that environment.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Iain Armstrong** - *Brewin Dolphin Securities - Analyst*

Would you have said that, in the period since you have to come into Rentokil, that that process has accelerated? You obviously were aware of the situation when you came to Rentokil. Do you think it has actually (inaudible)?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

I can tell you when I came to Rentokil, that wasn't one of the things that was really apparent. I think if anything, it is certainly far more apparent now. It is a factor that we are certainly far more aware of.

But I think if you look at the volumes in the whole industry -- and it is not an easy industry to add up -- that is borne out by the experience our competitors are having as well. It is not an easy industry to add up because there are so many players in private hands. So the numbers aren't that easy to get hold of.

But you know, that is a fact of life. We have got to deal with it. We have got to make our operations more efficient to perform in that environment. My expectation is that we will see a little consolidation in that sector over the next few years.

**Iain Armstrong** - *Brewin Dolphin Securities - Analyst*

Thank you very much.

**Operator**

Mike Murphy from Panmure Gordon.

**Mike Murphy** - *Panmure Gordon - Analyst*

Doug, can I take you back to a comment you made at the very beginning? Which is, still a lot of work to be done, quote unquote. I get a sense, actually, that we still haven't or you still haven't, actually, sort of finished in terms of restructuring this. You also said later that possibly some one-off costs next year. So I get a sense that maybe actually that Rentokil doesn't reach stability until maybe 2007, the second half; maybe first half of 2008. Would you like to comment?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Well, I think in terms of the broader guidance, we do expect to see modest profit growth next year; and we do expect to see some acceleration thereafter. So in terms of the broader guidance, that remains absolutely as it is.

But some of the things that we are pursuing now are relatively slowish and longer-term. They relate to improving efficiency in processing, in service and delivery, in administration, and in sales.

Now those sort of things are mostly being done through process changes. That is a fairly slow burn, but it does result in reducing costs, in making more efficient -- perhaps centralizing some activities and quite frankly, perhaps distributing others.

So all of that has an impact on some one-off costs. But it will happen over time. There will be very clear paybacks for any of those costs that are taken. As Andrew said earlier, we are going to try to be clearer. We perhaps have not been as clear as we could have been in describing the paybacks on some of these one-off costs as we go forward. We will try to summarize it a bit more clearly, I think, for the full year in that regard.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Mike Murphy** - *Panmure Gordon - Analyst*

The only problem with some of those one-off costs and the paybacks of those is that they get eroded by competitive action and/or your customers actually not wanting any price increases, even to save costs. But [frankly] actually, if your gross margins are coming down then some of that is going to be eroded.

So I doubt you are get going to get all the benefit of those reduced costs coming through, unless you factor that into your paybacks.

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

That is an extremely -- that is quite a difficult thing to do. If we look at just simply the cost side of it, then we will try to give you the information as factually as we possibly can. But you are absolutely (multiple speakers).

**Mike Murphy** - *Panmure Gordon - Analyst*

Maybe we can work out actually that all of those costs are not going to come straight to the bottom line (multiple speakers) and that is our judgment.

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Yes, that's correct. We simply have to look at the other side of the equation, which is the revenue side. Our ability to get through price increases and the impact of competitive activity. You are absolutely right.

**Mike Murphy** - *Panmure Gordon - Analyst*

Plus the network impacting some of the businesses, your density, will help.

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Correct.

**Mike Murphy** - *Panmure Gordon - Analyst*

Okay, clearly we will learn a little bit more about this tomorrow. Is that the game plan?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Well, the game plan for tomorrow is mostly to put our managers in front of the investors, for them to talk in a little bit more granular detail about what they are doing in the businesses.

It is going to be a -- it is not going to be so much about the financials and the numbers. I will MC it tomorrow. But Andrew won't be onstage; he will be there certainly to help answer any of your questions.

But it is really to put our managers -- to talk about their businesses and the go-forward with those businesses.



Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

We are also going to try and help you with a bit more information about markets, market dynamics, structured markets, those sorts of things.

**Mike Murphy** - *Panmure Gordon - Analyst*

Great, thanks, guys. Thank you.

**Operator**

Laurent Brunelle from Exane.

**Laurent Brunelle** - *Exane - Analyst*

Just to come back very briefly on the French textile business, you are saying in H1 that there was a sign of volume and price improvements. It seems that is not the case anymore. Could you just clarify that, please?

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

The pricing environment hasn't really changed in the third quarter. We are getting price increases around just under 1% in the third quarter.

What I can say is that we did put through some price increases over the summer, to try and recoup energy [chip]. Some of the increase in energy cost. In general, those price increases have stuck quite well. So that is giving us some offset for energy costs.

But typically what we see in this business, a lot of our customers are on three-year contracts; so you may be able to put through annual price increases during the life of a contract; but when the contract comes up for renegotiation, you may be looking for significant rebasing.

**Laurent Brunelle** - *Exane - Analyst*

Okay. What about the volume, please?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

I think the volumes are generally being impacted by the things we talked about earlier. There is some drift in the as-used volume in France as there is in some of the other markets within the existing contracts. I think that -- my guess is that is being affected by the other players there as well.

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

If we have a look, for example, in the French garments business during the third quarter, we had -- we have two effects. What we describe as customer wins minus losses is one effect. But also, as you said, the as-used volume -- which is increases in volume -- those customers taking more volume, less those who are reducing it. On balance, customers took less garments from us in France in the third quarter.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Laurent Brunelle** - *Exane - Analyst*

Okay, thanks.

**Operator**

David Allchurch from Morgan Stanley.

**David Allchurch** - *Morgan Stanley - Analyst*

Actually follow-up questions. Apologies. The first one is just go back to French textile rentals. So do you think the cost increase into '07 will be less than 4%, given energy costs have moderated? Do you think you have got more chance of getting better price improvements to offset that, given there are two main players in France?

Secondly on City Link, just update us on the incremental profit next year from buying in these franchisees. Obviously you have had some of that profit this year. When you first announced, you were looking for GBP5 million of extra profit. How much incremental might come in, in '07, please?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Okay, on the first one which was -- you referenced 4%. Possibility of recovery 4% price increases. I don't think our recent history in these businesses -- we haven't had 4% over the last few years, so I think that (multiple speakers).

**David Allchurch** - *Morgan Stanley - Analyst*

Is there a chance that the cost increase next year in France is more like 2, 2.5? Or can you see it staying at 4%?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

It was cost increase you said? I thought you said price increase.

**David Allchurch** - *Morgan Stanley - Analyst*

No, I think you said this year the cost increase was 4%. I was trying to look into next year and see the degree to which the delta on that might change and you might see a lower level of cost increases in French textile rental.

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

I think we will see a lower level. As you say, energy price increases seem to have moderated, so that will be helpful.

**David Allchurch** - *Morgan Stanley - Analyst*

On the price increases, the ones that have stuck and the contracts, are you more hopeful of closing that gap or getting better price increases next year in France than '06?

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

The price increases that we got have dealt with about two-thirds of the increase in the energy costs, assuming they stick. So they are not enough to change the overall dynamic of the marketplace.

**David Allchurch** - *Morgan Stanley - Analyst*

Great. On City Link, please, on the incremental for next year?

**Andrew Macfarlane** - *Rentokil Initial PLC - CFO*

I'm trying to find an easy way to answer your question. Obviously what is happening in '06 is you're seeing a full-year effect of acquisitions made in '05; plus a part-year effect of acquisitions in '06.

Next year you're going to see the full-year effect of '06 acquisitions and the part-year effect of '07 acquisitions. I think -- I hope I can give you more clearer guidance when we do the full-year numbers. We will try and show you what has happened organically to profits in '06.

**David Allchurch** - *Morgan Stanley - Analyst*

Thank you.

**Operator**

We have no further questions. I would like to turn the call back over. Pardon. We still have one question in the queue. [David Greener] from [Cintas].

**David Greener** - *[Cintas] - Analyst*

Can you give us some updates on the French regulatory inquiry that was announced last week, particularly with regards to timescale and what you think your worst-case scenario could be?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Well, the answer is we are not clear on what a worst-case scenario might be, in terms of -- but what we can do is we can look at other cases. At this stage it is extremely difficult to determine what a likely outcome might be.

Quite frankly, we are still trying to understand whether we have indeed transgressed. The whole case remains -- it is effectively sub judice. We are still trying to understand a lot of the issues attached to this. You know, nothing much has changed since we made the statement. There is really no comments we can make at this stage.

In terms of the time frame, though, we can give a view about that. I think there is only a 50-50 chance that it will be resolved by the end of 2007. This is going to be a slow process, I think.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

**David Greener** - *[Cintas] - Analyst*

In terms of those other cases that you're looking at, do they tend to be -- if you have transgressed, do they tend to be resolved in terms of a fine?

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

Yes, they do. They do tend to be addressed in terms of a fine. (indiscernible) issues. It may well revolve around things like, if we have transgressed, what was the economic damage that was done to the clients?

**David Greener** - *[Cintas] - Analyst*

Right, okay.

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

At this stage, we don't know.

**David Greener** - *[Cintas] - Analyst*

Okay, great. Thanks.

**Operator**

Rob Harris from UBS.

**Rob Harris** - *UBS - Analyst*

Dave just asked my question. Thanks.

**Operator**

It appears that we have no further questions, so I would like to turn the call back over to your host for any additional or closing remarks.

**Doug Flynn** - *Rentokil Initial PLC - Chief Executive*

I don't really have anything further to add. I hope that has been useful. I think we made in this third quarter some tangible progress against our stated priorities and the business is moving forward.

But we are all very clear -- [both] you are aware that there is still an enormous amount of work still to be done. But thank you very much for joining us all. Bye now.

**Operator**

This will conclude today's conference. Thank you for your participation, ladies and gentlemen. You may now disconnect.

Nov. 08. 2006 / 4:00AM, RTOKY - Rentokil Initial plc Third Quarter Trading Update Conference Call

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