

FINAL TRANSCRIPT

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RTOKY - Rentokil Initial plc Quarter 1 Trading Update Conference Call

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Andrew Ripper

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PRESENTATION

Operator

Good day and welcome to the Quarter 1 Trading Update conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Alan Brown. Please go ahead sir.

Alan Brown - Rentokil Initial plc - CEO

Morning everyone. Thanks for joining Rentokil Initial's Quarter 1 results call. Alan Brown speaking, Chief Executive and I've got Michael Murray with me.

Overall the first quarter has seen Rentokil Initial make further progress against our turnaround plan but this remains at an early stage of implementation and we have a lot to do, particularly given the challenging marketplace, particularly in the UK, also in

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the US. Nevertheless I'm encouraged by continued improvement in customer service across the Group and the successful focus on cash generation during Quarter 1.

Looking at the financials which are shown at actual exchange rates the Group revenues were GBP635m in the first quarter, up about 10% on the Q1 2008 comparable, whilst adjusted profit before tax was GBP21.6m up, 16%, slightly ahead of market consensus which we think was about GBP17.5m.

We've clearly benefited from our heavy euro exposure which for the year as a whole accounts for about 80% of our earnings stream and given the strong appreciation of the euro against sterling that's helped us quite significantly as you can see with the comparison in the note of actual versus constant exchange rates.

At the full year results in February I highlighted our ongoing focus on tighter cost and cash management and I'm pleased to say we've made improvements to them both, particularly in cash. Operating cash flow was GBP57.6m for the quarter compared to GBP17m in the first quarter of 2008 and we've seen good progress on all of accounts receivables, creditors and capital expenditure. This is particularly evident in City Link where wholesale cost savings have helped us a lot and helped us certainly mitigate pretty well completely against the anticipated revenue decline which is evident across the whole of the UK parcels market.

And our number one priority over the last year has been to focus on improving customer service in every division and I'm very pleased that we've made further progress in this area, particularly in the turnaround businesses, City Link, UK Washrooms, our businesses in Australia and also in UK Pest.

However our UK Pest Control issues are significant and though the business continues to operate profitably we have seen long-term decline in revenue, market share and profitability. We, as you know, have been looking closely at the issues surrounding UK Pest and as a result of that we have developed a six-point turnaround plan to restore the performance of UK Pest Control and I'm sure we'll come back and talk about that later on. At the heart of the plan is a focus on delivering sales and service through a network of local branches which is completely in line with our global mission statement.

We are developing specific sales and marketing plans for major customer target groups. I've outlined three in the note, national accounts, small to medium-size enterprises and residential. We've got the new Managing Director in place and the new Finance Director for the UK business and they over the last couple of weeks have started to work on filling out this six-point plan.

Elsewhere in the Pest group however I should stress that business is running well. I've just returned from Tripoli where I saw first-hand our significant Libyan operations on the ground which is looking like a very exciting prospect for us indeed.

Finally our outlook for 2009 remains unchanged. We obviously continue to be very cautious about the rest of the year. But I am pleased that the turnaround is gathering momentum in difficult market circumstances. We are sticking to our five strategic thrusts which I outlined at the year end and I hope we can give further detail at our next update on July 31 along of course with the Q&A session we are about to have.

So at this point I'm going to hand back to [Bernadette] to start the Q&A session.

QUESTIONS AND ANSWERS

Operator

Thank you. The question and answer session will be conducted electronically. (Operator Instructions). We will take our first question from David Hancock from Morgan Stanley. Please go ahead.

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David Hancock - Morgan Stanley - Analyst

Good morning, yes. Just two questions from me. Firstly on the operating cash conversion. It's clearly very strong in the quarter and well ahead of your 95% target for the full year. Can you just talk a little bit about the drivers of that and in particular net CapEx to depreciation again was below 100%, good working capital inflow. So can you update us on where you expect to be for the full year given those performances? Can you do better than the GBP95m? And can you in particular talk about the drivers of the CapEx performance in the quarter please?

Alan Brown - Rentokil Initial plc - CEO

David, I'm not going to move away from our cash conversion target for the full year at this stage although obviously I'm delighted to be so far ahead of it. It is a very genuine good performance in Q1, there are no funnies in there. Let me hand over to Michael to talk a bit about the detail.

Michael Murray - Rentokil Initial plc - CFO

I think David as you've pointed out the cash has come from various areas, including the working capital, creditors and debtors, and also from capital. As Alan said, there's no funnies, it's not a one-off, it's the start I think of reaping some benefits from the much greater focus that we've placed across the business on cash collection. And that's been achieved through a number of programs within the divisions where there's particular focus on improving certain methodologies and the way we do collect our cash. It's not rocket science to be quite honest with you so far, 30 simple techniques. And each of the divisions are now working ahead of that. We currently share best practice and build momentum. So really focus I think has in itself delivered quite a lot in terms of the results so far.

In terms of the full year target, I think as Alan's just said we're not going to move from that. I think it's not a bad target to start with. Of course we would like to beat it if we could but at this point in time we're I think in the early days, we're reaping some early benefits in terms of repeating wins and from now on it's really building momentum, building focus and more rigor and discipline into the processes.

In terms of capital, again I'm afraid it's not rocket science, it's basically been achieved through focus within the operations. I think pushing home the importance of cash, not just from the working capital but also from capital expenditure, and that we only spend capital when we genuinely need it and not at the risk of service to the business which is obviously key and a priority. Really nothing more than that. It's really more focus, better discipline across the various areas of cash collection.

David Hancock - Morgan Stanley - Analyst

Great. Thank you. And then just a second question on the one-off charges in the quarter. You have flagged a few in the statement but you've also flagged the full year at about GBP20m of investment in capabilities. Can you just clarify what those charges were in the first quarter please?

Michael Murray - Rentokil Initial plc - CFO

The one-off costs?

David Hancock - Morgan Stanley - Analyst

Both. The one-offs and how much reinvestment you did in the quarter.

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Michael Murray - Rentokil Initial plc - CFO

Okay. The one-off costs were predominantly related to property and the fact that we're moving from our head office here in Portland Place as of today. And that's GBP3m related to that in areas of assets and fee rental to the next tenant in this building. So it's a one-off cost, not to be repeated, and predominantly driven by that to be honest with you.

Alan Brown - Rentokil Initial plc - CEO

Yes, we're moving -- we're closing our operations in Portland House. We're also giving up about a third of the floor space at our office in Gatwick Place which we've never actually occupied. And I am moving down to the remaining two-thirds of the office in Gatwick Place. We are all squeezing in there and we're saving GBP1.5m to GBP2m per annum as a result of closing these corporate head offices.

David Hancock - Morgan Stanley - Analyst

Okay. Thank you.

Operator

We'll now move to our next question from Mark Wade from Aladdin Capital Management. Please go ahead.

Mark Wade - Aladdin Capital Management - Analyst

Good morning. Mark Wade from Aladdin Capital here. Two very quick questions. Firstly, can you tell us what the cash was at the quarter end?

Secondly, you've obviously benefited quite favorably from the FX movements during the quarter. Can you talk us through the measures you're taking there that is going to make sure that if FX moves against you that you're not going to be -- you're not going to see a very negative impact there?

Alan Brown - Rentokil Initial plc - CEO

Yes Mark, the net debt at the end of the quarter was about GBP1,288m.

Mark Wade - Aladdin Capital Management - Analyst

Yes I was looking for the cash so I can see your liquidity.

Alan Brown - Rentokil Initial plc - CEO

Well I'm not sure, there's about GBP40m in cash I think. But with regard to liquidity the better thing is to look at our headroom which is about GBP215m. So we're fine on that.

And with regard to FX, it's a tricky one on FX but in terms of our earnings stream we benefited hugely of course from over 80% of our earnings being in euro. So we're very well protected there. We've had numerous internal debates about what currency

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we should be holding our debt in because it has been our policy to follow our earnings stream quite closely in the currency of our debt.

I think what we're going to do is actually pull that back a little bit and we're going to really hold between 50% and 70% of our debt in euro around -- being up around 75%, 80%. We think that we'll be a bit more balanced and are not going to move the currency of our debt around too much. We're going to try and steady at about 50% to 75% in euro, the rest in sterling and US.

So the -- I should stress of course that because of the nature of our business we have very little transaction exposure in currency. It's all about translation apart from the debt side.

Mark Wade - Aladdin Capital Management - Analyst

Thank you very much.

Operator

We will now move to our next question from Andrew Ripper from Merrill Lynch. Please go ahead.

Andrew Ripper - Merrill Lynch - Analyst

Yes, good morning chaps. I've got a couple of questions if I may starting off with textiles. I appreciate there's some one-offs in the quarter and if you strip them out it looks like the profits were down about GBP3.5m despite revenue growth at local FX being up 4.5%. So I wondered Alan if you could give us some color please on what's happening on pricing and the major cost items?

And also in terms of the cost initiatives you mention in the final paragraph in the press release on that division, what are you doing, basically you talk about bedding down cost initiatives? And do you have any feel yet on things like the scope for procurement savings please?

Alan Brown - Rentokil Initial plc - CEO

Yes Andrew. I think it's well known both internally and externally that I've not been happy with the cost management in this division. I've certainly told you guys that before. And you will see in the announcement that we have changed the Director responsible for the division as of April 1. He's a gentleman who's extremely well known to me who's come in to take that on. And we've also changed the CFO of that division. Both are ex-Unilever, both are people I've personally worked with over the years, and they will get to grips with it.

The revenue, as you said, is continuing to progress well and other than Spain which is a bit of a basket case at the moment I think for everyone, it's a general market condition there. I have to say I've been pleasantly surprised with the trading performances of our businesses in France and Germany in particular at the top line.

If I could then come on to talk about the costs side. I think -- I've always said to you that I felt the opportunity was somewhere between big and enormous. And you may remember I talked to you of the AT Kearney work. That has gone on somewhat and it has confirmed that the opportunities are certainly very substantial.

We've discovered some basic stuff which we weren't aware of. First of all we have 75 plants in Europe, including the UK. I thought we had only 62 but we've now found about 13 more. Pretty basic stuff. We've certainly confirmed that the asset utilization is low. I think we've pretty well decided that we should be able to run our businesses on a five-day-a-week two-shift basis. I don't

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think we're yet at the point where we could really consider running our plants in a three-shift basis. I think we've got to walk before we can run type of thing. But even if one reckons on working five days a week at two shifts, then the capacity utilization is substantially below where it should be. I would say there's certainly 30% plus at least that we could get out of our existing plants if we were to retain them all, which of course is unlikely.

So I know a lot more than I'm able to tell you. You can understand the sensitivity of these things. I certainly think that we will be able to move ahead in one country very quickly. And I would expect that you will hear more about that at the Quarter 2 results. And then we're looking at what the -- I now know a good feel of what the potential is in some of the other countries and I can confirm that it is substantial. But clearly the implementation period is going to be long. It matters a lot, make sure we do it properly and to take account of the various processes that one must go through.

Andrew Ripper - Merrill Lynch - Analyst

Yes, okay. Are there any --?

Alan Brown - Rentokil Initial plc - CEO

Let me just go on a bit more because I have more to tell you. There's more.

If we talk then about the procurement side, what we have discovered is that we're spending about GBP64m per annum on garments. We're buying about 5m garments a year. We have 7,900 different specs for garments. We have agreements with 136 suppliers. The top two suppliers supply all the countries but they negotiate in every country separately. So it's just unbelievable really. So we clearly have some very significant opportunities there. We're holding about 14 weeks' stock I think of new garments. So there's -- everything one would have hoped for I have to say in terms of opportunity. But again I have to stress that it's going to take quite a bit of working through over the next year or two before we start to see some results from there.

Andrew Ripper - Merrill Lynch - Analyst

Yes. Where do you think the easy wins are in this division? I appreciate your changes, thinks like the network, it's going to take a little while. Is there anything that you would announce but could be impactable by the end of this financial year?

Alan Brown - Rentokil Initial plc - CEO

I think that the procurement side, I would hope we'd get some pretty rapid progress on. Which is not obviously requiring any upfront investment. It's just about getting serious with the supplier base.

Andrew Ripper - Merrill Lynch - Analyst

Yes, yes. Okay. And then also looking at the costs side, the story in City Link seems to have moved on a bit. You've reduced the number of depots by seven and it looks like you've taken out another 500 or so heads. How much are you saving through those incremental actions in the quarter please?

Michael Murray - Rentokil Initial plc - CFO

We have accelerated it to an extent so that's brought some additional savings with it. I think, without going into the numbers, you've got the point where we're at now in terms of the heads and the vehicles which is -- at the end of Q1 vehicles were down at just under 2,400 and people around the 6,000 mark. At the end of '08 the vehicles were 2,764 and people around 6,500. So I

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think we told you last year that we made savings of GBP30m which we're bringing into this year. Part of it, a small element of those savings in terms of several million, were in the last quarter of last year. So you can add on top of that this reduction in heads and the reduction in vehicles.

Andrew Ripper - Merrill Lynch - Analyst

Yes. Okay, okay. And then maybe going up a level then, in terms of the overall cost savings target for this year is it still GBP50m in year cost? And supplemental to that, what have you done on salaries please across the Group?

Michael Murray - Rentokil Initial plc - CFO

In terms of the GBP50m target that we set we're at this point in time only a few months into the year. We're still sticking with that and working towards that. In terms of costs across the Group, with the exception of where there is collective labor agreements or trade union agreements we've obviously tried to minimize the cost down to zero in most cases but that's not possible in some areas.

Alan Brown - Rentokil Initial plc - CEO

Normally speaking in the UK and I suppose in the US we've managed to stick with zero wage and salary increases Andrew. But in Continental Europe we've not been able to do that and the average increase would be I guess in the order of 2.5% across Continental Europe. That's all because of collective agreements being in place which we can't sidestep.

Andrew Ripper - Merrill Lynch - Analyst

Yes, I understand. Is there anything else on cost that perhaps you'd like to flag across any division for this year that may make a material difference beyond what we've already discussed in parcels and textiles?

Alan Brown - Rentokil Initial plc - CEO

I don't think so. Obviously I will come back at some stage and not in the near future and outline to you the progress we're making on the broad administration project. I've highlighted that we've got a GBP500m admin bill. And that project has kicked off but I'm more minded to update you on that project towards the back end of this year because that will take some time to build momentum.

But I think in small terms what I would say is that we're confident about GBP50m this year. I remain, as I always have done, confident about the longer term potential for significant ongoing cost savings. But other than the GBP50m, the precise phasing of the delivery of those and the gettability of those savings is not yet quite clear to me.

Andrew Ripper - Merrill Lynch - Analyst

Yes, all right. Thanks very much for your answers guys, I appreciate it.

Operator

(Operator Instructions). We will move to our next question from Laurent Brunelle from Exane. Please go ahead.

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Laurent Brunelle - Exane BNP Paribas - Analyst

Yes, good morning. Laurent Brunelle for Exane BNP Paribas. Two questions if I may. First, can you maybe give us more color on our top line assumptions for 2009? And given what you achieved in Q1 which was not so bad and on a like for like basis.

And regarding City Link, what kind of top line decline do you have in your budget to get the GBP20m -- less than GBP20m operating losses please?

Alan Brown - Rentokil Initial plc - CEO

Laurent, thank you for your questions. With regard to City Link, I'll be as specific as I can. But I would repeat the guidance I gave at the year end where I said that I felt that we could contain losses to within GBP20m providing the revenue did not decline by more than 10% for the year as a whole. I would reiterate that guidance and would say that after one quarter's experience we'll be slightly more confident than we were than we will stick within that guidance.

Though the revenue has been down 10.7% in the quarter nevertheless this is the most difficult comparable quarter because it was Quarter 1 2008 where we really lost lots of small customers. At the beginning of Quarter 1 2008 we were still getting revenue from some of the small customers.

The other thing which I think gives me some mild encouragement is that the stability of the weekly revenues in City Link has been notable over the first quarter other than for the period of snow and the period of the bank holidays of course. The revenues were much more stable in the first quarter than it was any time last year to be honest with you.

That's not to say of course that we couldn't still see a material step in activity if the UK economy were to worsen. But the business is relatively stable at the moment and I would predict that the revenue loss will be less than 10% for this year given current trends.

Elsewhere in terms of trading, I would have thought we will see a continual relation to current revenue though I say that there is downside risk if the economy deteriorates. If the economies stay where they are broadly speaking I would expect we will continue with current revenues. Again revenues have been reasonably consistent through the quarter. One might argue March is slightly better than the previous two quarters but I wouldn't really attribute anything to that of significance.

So I think the revenue base, reflecting the fact and what we've said in some of our businesses is portfolio, our revenue base is proving to be a little bit more predictable than perhaps I'd feared three months ago.

Laurent Brunelle - Exane BNP Paribas - Analyst

Have you seen any particular sequential deterioration in trends in any businesses in April?

Alan Brown - Rentokil Initial plc - CEO

Well not particularly. I would say at this stage, not particularly. The City Link business gets disrupted by bank holidays etc. etc. but we factored that in. But I wouldn't pretend to be the best business to guide week by week basis of what our revenue is doing. What we've seen are the trends you'd expect. We've seen the Ambius plant business has been hard hit, particularly in North America. And the City Link business has been hit obviously. But those portfolio businesses have been less hit. And I have to say that I've been quite pleasantly surprised by the consistency of revenue in France and Germany which of course are very big businesses for us. And there we've seen the business continue to make progress.

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Laurent Brunelle - Exane BNP Paribas - Analyst

Okay. Thank you.

Operator

We will now move to our next question from [Edmond Decker] from Nomura. Please go ahead.

Unidentified participant

Yes, good morning. This is [Edmond Decker] from Nomura. I just had a quick question on the facilities services business. Could you talk a little bit about the business development there? If you look at your contract portfolio then the rate of termination has steadily accelerated in the first quarter, also revenues are down. Would you expect similar trends to continue for the rest of the year?

And also could you comment a little bit on how the performance in the division has been relative to the rest of the market i.e. versus your competitors? Thanks.

Alan Brown - Rentokil Initial plc - CEO

Yes. Thanks for your question. I would not expect to see portfolio losses continue. They tend to be linked to some chunky items. We have lost a few sizeable contracts in the second half of last year. And I think those are working through. I think the business is making progress in some new areas of business to be honest with you. So I'm not particularly worried about that. The ability of this business to get rid of the costs that are associated with contracts is very good of course. So the business over a number of years has managed to eke out some more profit regardless of whether it's winning or losing contracts.

So overall I think I'm reasonably okay with the progress the business is making. It is focusing on protecting margins to be honest with you rather than going all out to win businesses at unacceptable rates.

What we have found historically in this business, and we've got some very experienced managers here, is that in really tough times you do tend to get squeezed a lot by unsustainable pricing from competition. But if you just hang back a bit then the business often comes back to you as service is not delivered by competition. So that's one of these moments where we think we ought just to hang back slightly.

Within that business reporting of course we have the UK Washrooms operation which is not strictly part of the cleaning business but it's part of the same management reporting group. That business which is one of our turnaround businesses that we reiterate our guidance on. They're back into profit for the year as a whole. The businesses obviously are still struggling on the top line because of very tough market conditions here. But I'm pleased to say it's not losing customers. What we're experiencing is that many customers are under pressure to reduce the quantity of service they're taking. But as I say overall the business is making progress in costs and will be back in profit this year. So IFS as a whole should make fairly good progress in the bottom line 2009 versus 2008.

Unidentified participant

Perfect. Thank you.

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Operator

We will move to our next question from Tom Sykes from Deutsche Bank. Please go ahead.

Tom Sykes - Deutsche Bank - Analyst

Yes, good morning. If you could just say on the portfolio businesses whether you have any particular indexation or in particular RPI linkages on any of the contracts there?

And just in terms of the churn of contracts which has obviously been a little bit higher, would you expect this first quarter to be the highest in terms of the level of churn? And if not, do you think you can continue the level of new business wins which has obviously been quite high as well as the contract terminations being quite high?

Alan Brown - Rentokil Initial plc - CEO

Yes. I think we've restated a bit the way we calculate our terminations this quarter. We previously tended to focus on terminations related only to winning or losing customers. We've now incorporated in terminations changes in the size of the contract with an existing customer so that the base if you like of termination calculations has changed somewhat.

I would expect we will continue to see our customers looking for opportunities to save money of course. And we will see continued pressure on reductions of existing contracts, albeit that the trend in terms of actually losing customers is not changing very much, it's been relatively stable. I think we're doing an increasingly good job in holding onto customers, albeit quite often we're having to give something to them to stay with us.

Tom Sykes - Deutsche Bank - Analyst

Does that mean there's going to be a big issue on pricing as well because it's not the customer base that's changing much there, people are pinching them off you at lower prices or --?

Alan Brown - Rentokil Initial plc - CEO

Again -- it's a tricky one isn't it because obviously we're in negotiations with customers and quite often you end up giving a little on price to ensure you keep the business. So it's not quite clear cut.

With regard to your question about do we have RPI increases in place, we have had in some parts of the business, in Pest for example. But those are not things that one wants to implement without discussion with customers and referring to them (inaudible). The better answer to you is no we don't have RPI automatic increases in place and there's no client negotiation.

Tom Sykes - Deutsche Bank - Analyst

I guess the reason I'm asking is that you don't see a big risk that if RPI goes negative there's auto-kickers on the contracts that you have (multiple speakers)?

Alan Brown - Rentokil Initial plc - CEO

We're not exposed. No, we're not exposed in that sense, no.

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Tom Sykes - Deutsche Bank - Analyst

Okay. And just in terms of the City Link business, you obviously have a varying different number of services and different rates for them. Have you also seen -- you're saying that it seems like the volumes have been relatively stable -- do you think the movement down from premium to lower quality services that that effect has already happened? You talk about the revenue per consignment but you don't see at the moment a further leg down in the quality of service that people might want to go for?

Michael Murray - Rentokil Initial plc - CFO

Tom, when you say volumes have been stable, volumes have been stable within the quarter but in the report we do note that the Q1 parcel volumes were down 8%.

Tom Sykes - Deutsche Bank - Analyst

No. You just made the comments from February that --?

Michael Murray - Rentokil Initial plc - CFO

Sure, okay. Sure, sure, fair enough. Also we mentioned the price. Of course there is pricing competition but I think, as Alan's already stated, the volumes have been fairly level, the customers level and consistent within the last number of weeks. So we see no real change in that. And I think if you're providing the service that we are providing which is getting better and near the top at the moment customers still have a better requirement for that service. At the same time whilst managing their costs.

Alan Brown - Rentokil Initial plc - CEO

There are one or two contrary trends taking place here within the mix of the business. Yes, there are some customers talking about trying to move away from next day delivery to delivery after two or three days. But that is being talked about. I wouldn't say it's having a major impact in the business.

But on the other hand we have seen our mail business increase quite substantially and that has been obviously a benefit to us. So there's some contrary things taking place here.

Tom Sykes - Deutsche Bank - Analyst

So the mix effect on the revenue per consignment as well as --?

Michael Murray - Rentokil Initial plc - CFO

Absolutely, absolutely. I mean the RPC is still down 3.8% but there's a complicated number of things happening here with the mail thing being positive, some of the other stuff being more negative.

Tom Sykes - Deutsche Bank - Analyst

Okay.

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Michael Murray - Rentokil Initial plc - CFO

Basically it's been pure price to be honest with you, more than people making big change in product mix.

Tom Sykes - Deutsche Bank - Analyst

Okay. And in terms of the B2C and B2B volumes and the differences in that in the 10% can you maybe give a -- on that.

Michael Murray - Rentokil Initial plc - CFO

It's difficult for us to give you a guide in there and the reason is our business mix has changed somewhat because of the success of the Amazon contract. So our customer base has changed somewhat because of Amazon Q1 2009 versus Q1 2008. But one should also remember, of course, that the consumer stuff is relatively low in the first quarter compared to the fourth quarter. So I think we'll be able to give you some better indication of that when we get towards the end of the year.

Tom Sykes - Deutsche Bank - Analyst

Right, okay. So you'd expect the revenue change to perhaps get slightly better as presumably your B2C is not down by as much, so as that becomes a better part of the mix. Is that why you have a bit more confidence?

Michael Murray - Rentokil Initial plc - CFO

Well I wouldn't say the B2C rates are wonderful.

Tom Sykes - Deutsche Bank - Analyst

Right.

Michael Murray - Rentokil Initial plc - CFO

But I would certainly say that the B2C volume will be okay. Certainly the Internet volume will be okay, but that will come more through in Q4 --

Tom Sykes - Deutsche Bank - Analyst

Sure, exactly, yes.

Michael Murray - Rentokil Initial plc - CFO

-- in the rest of the year.

Tom Sykes - Deutsche Bank - Analyst

Okay, thanks very much.

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Operator

We will now take a question from Mr. Jaime Brandwood from UBS. Please go ahead.

Jaime Brandwood - UBS - Analyst

Morning. Just two quick questions really. Firstly just in terms of your commentary regarding your expectation to see profit growth in the second half of the year. Clearly your expectation is that you'll see it in parcels and it sounds like you're also potentially going to see it in Facilities Services. I wonder if there's any other divisions where at this point you'd be comfortable saying you'd expect a return to profit growth in the second half? That's the first question.

Michael Murray - Rentokil Initial plc - CFO

Well let's see. I hope that Textiles & Washrooms will start to get some of the benefits from the procurement initiatives. In Pest I think you know that Pest is in so much on the extent of how quickly we're able to start making progress in the UK, and I do think that's going to take time. I don't think that's a quick one at all.

Jaime Brandwood - UBS - Analyst

Yes.

Michael Murray - Rentokil Initial plc - CFO

So no, I think you're broadly right. I think its partials. The Washrooms business, absolutely and then hopefully something in Textiles & Washrooms.

Jaime Brandwood - UBS - Analyst

Okay. And then this might be too long term a type of question, but obviously you've had this fantastic working capital inflow and probably for the remainder of this year and maybe some of next your ongoing initiatives on receivables and so forth will produce working capital inflows, as well. But as we try and take a longer term view on this business and its characteristics and hopefully if you return to top line growth do you see this as a business that can carry on generating working capital inflows, or longer term is this a business which goes back to seeing working capital related outflows in the cash flow?

Alan Brown - Rentokil Initial plc - CEO

The short term objective is clearly to try and avoid needing to refinance this GBP125m bond which expires December --

Michael Murray - Rentokil Initial plc - CFO

2010.

Alan Brown - Rentokil Initial plc - CEO

-- 2010, so if we're able to get back to our GBP200m headroom without renewing that then I'll be very pleased with that indeed. Because I think you're aware the rest of our facilities are what are 2012 and on and on and on. So --

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Jaime Brandwood - UBS - Analyst

Yes, yes.

Alan Brown - Rentokil Initial plc - CEO

Okay in that. So that's really the short term objective. And I think if we get the working capital down to a level which enables us to work within that then I would hope then we'd be able to stabilize working capital even if we then saw revenue growth through incremental improvement in working capital efficiency. I'm not sure, I think I did mention to you that for example we have something like 14 week stock of new garments in the Textiles & Washrooms business, which seems to me rather a lot.

Jaime Brandwood - UBS - Analyst

Yes.

Alan Brown - Rentokil Initial plc - CEO

So we've got lots of options to go for I think. But beyond that once we've got working capital down to a reasonable level, say beginning early mid next year, I think that probably cash generation's much more dependent on driving our profit margins.

Jaime Brandwood - UBS - Analyst

Okay. I guess the question is in the long term is this a net positive working capital business or could you --?

Alan Brown - Rentokil Initial plc - CEO

No. No, I don't think we're going to get to net positive. No, no. Definitely not. But if we can get that working capital down to this GBP350m we're aiming for and we can stick at that and grow revenue I'd be very pleased.

Jaime Brandwood - UBS - Analyst

Thanks a lot.

Operator

(Operator Instructions). We'll take our next question from Karl Green from Altium. Please go ahead.

Karl Green - Altium - Analyst

Yes, thanks very much. I've got three hopefully quick questions. Firstly obviously what you've got in front of you in UK Pest Control is a huge opportunity for self improvement, but you do make the comment about the ongoing competitor activity there and I think you used the word activity rather than specifically pricing pressure. I think your predecessors have talked in the past about some of the actions being taken by people like Ecolab. Can you just elaborate in terms of what exactly is happening in the market, which is certainly something which is going to be, I suppose, out of your control?

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My second question very simply just on the Asian business. You've obviously referred to the drop off in the fumigation business. Just to get a sense as to where that could recover to in a year or two's time can you indicate the relative importance of that in revenue terms and also the broad ballpark margins on fumigation?

And then my final question very simply is on the UK Catering business, whether further down the line you're minded to dispose of that?

Alan Brown - *Rentokil Initial plc - CEO*

Right. Thanks, Karl. With regard to UK Pest, I think Ecolab was in the particular part of the market they operate, which tends to be with some of the larger customers, are doing a good job and they service their customers well and professionally. They don't compete across the whole market but in the particular sector which they operate, and they're a pretty good competitor.

The broader issue is really the local and regional players. They tend to compete partly on price, but partly on responsiveness. And I think that the area that I'm least satisfied with our performance is in responsiveness, or call out or to a particular customer need, which is particularly disappointing because we're quite good at this elsewhere in the world.

And I think it really stems back to the extent of organizational change we've had over the business, over the last two or three years and moving from 26 branches down to 11 areas. Total turmoil in terms of the way we run the business has really resulted in taking our eye off the local customer. And we've had too much turnover in terms of technicians on the ground and just not enough operationally focussed management.

Karl Green - *Altium - Analyst*

Okay, so just to be clear do you think you can restore some competitive advantage just through your self help measures rather than worrying too much about the competition?

Alan Brown - *Rentokil Initial plc - CEO*

Precisely. The competition is many and varied. Apart from Ecolab we don't have any really big competitors. It's all about ourselves sorting out the way we run the business.

And with regard to Asia on fumigation, the revenues about GBP8m to GBP10m per annum top side. It is quite high margin, however. So when you get hit by it, particularly in Malaysia and Singapore and Australia, it does affect you and it is absolutely related to the reduction in trade. Will it come back? Well we certainly hope so, but that could take a while.

I think we're through the worst of it. We've downsized our fumigation activities significantly by transferring people into the mainstream Pest Control business.

Karl Green - *Altium - Analyst*

And just to clarify, is this part of the aircraft in fumigation or is it other sort of creating warehouse fumigations, as well, is it?

Alan Brown - *Rentokil Initial plc - CEO*

It's mostly shipping.

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Michael Murray - Rentokil Initial plc - CFO

Shipping, yes.

Karl Green - Altium - Analyst

Shipping.

Alan Brown - Rentokil Initial plc - CEO

UK Catering business is proving an interesting adjunct to our cleaning operations, I have to say. The business is doing rather well, so I'm less inclined than I was I have to say, to consider disposing of that business separately.

I should also add just a bit of color on that is that we always have had a minority shareholder in that business who owns about 25% of the business, so we have to respect his interests in that business, as well.

Karl Green - Altium - Analyst

Okay. Thanks very much.

Operator

From Company Loomis we will take our next question from Mr. Mike Murphy. Please go ahead.

Mike Murphy - Loomis - Analyst

Yes, thank you. Good morning, guys. In terms of developing capabilities you said that the P&L investment at the time of the finals would be GBP20m. Can you just confirm that that is still the case, and if not where the variance is?

Secondly, can you just explain a little bit on the Textiles and the strategy for that business because you talked about the asset utilization being low, and clearly actually you've alluded to increasing the capacity by changing the shift pattern, etc. And can you put that in the context of the market in Europe which appears to be oversupplied as evidenced by your margins being depressed in a number of markets where the price increases have not covered cost escalations?

Alan Brown - Rentokil Initial plc - CEO

Yes, Mike. With regard to the GBP20m, what I said with the GBP20m is that we would spend GBP20m providing we were able to first of all afford to do, so and secondly in providing we had the initiatives under way. I am reasonably pleased with the progress we're making on a whole range of initiatives. We're still at the setting up phase, so the expenditure in the first quarter has been relatively modest, but I think as the year goes on we will spend some further money. So whether or not we spend GBP20m, I don't know at this point.

Mike Murphy - Loomis - Analyst

Okay, yes.

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Alan Brown - *Rentokil Initial plc - CEO*

With regard to Textiles & Washrooms business, I think what I was alluding to was the potential to take out capacity, rather than to put more volume through the existing capacity.

Mike Murphy - *Loomis - Analyst*

Okay.

Alan Brown - *Rentokil Initial plc - CEO*

We operate many of our plants on a one shift basis at the moment. It's quite clear that the standard modus operandi should be two shift probably five days a week, and we see lots of opportunities to get that level of utilization over time, over time. I stress it will take time.

Mike Murphy - *Loomis - Analyst*

Yes, I thought you said it would lead to 20% extra utilization, but I see what you're saying now actually in terms of contracting the number of plants.

Alan Brown - *Rentokil Initial plc - CEO*

Exactly, there are two ways to do it. You can either (inaudible) or take (inaudible) out.

Mike Murphy - *Loomis - Analyst*

But how much would it cost? Because clearly actually then you can on a pro rata basis, you could take 20% of the plants out, i.e. take about 15 plants out of Europe, and clearly actually that would lead into some one-off costs.

Alan Brown - *Rentokil Initial plc - CEO*

The --

Mike Murphy - *Loomis - Analyst*

Or have you not decided what strategy to pursue?

Alan Brown - *Rentokil Initial plc - CEO*

Well I've decided the strategy, don't you worry about that. I've decided the strategy. The implementation that's the challenge.

Mike Murphy - *Loomis - Analyst*

Okay.

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Alan Brown - Rentokil Initial plc - CEO

The indicator that I work with, I'm most comfortable with is working on IRR, Internal Rate of Return. And it would be my experience perhaps in these types of fairly straightforward financial adjustments to capacity, one should be certainly getting more than 40% IRR on a typical restructure. So that would be the benchmark I would have in mind, 40% plus IRR.

Mike Murphy - Loomis - Analyst

On the spend?

Alan Brown - Rentokil Initial plc - CEO

Yes. (inaudible) what cash we need to invest, what cash return you get according to IRR.

Mike Murphy - Loomis - Analyst

Okay. And just finally on Textile rental, you mentioned the 14 weeks of stock. That suggests about GBP16m worth of stock and how much could that come down? Could you half it to seven weeks and therefore generate GBP8m from that? (multiple speakers)

Alan Brown - Rentokil Initial plc - CEO

Precisely, about EUR17m of stock is what I calculate it to be, which is not very different from GBP16m. What it could come down to, I don't know at this stage. I don't know, but it's clearly going to come down. We've got a lot of work to do though, because we've got to rationalize that 7,900 product lines. That'll help a lot.

Mike Murphy - Loomis - Analyst

But it wouldn't be unreasonable to say if you rationalize the lines and then you will be able to keep fewer stocks coming to you in a smaller range and to halve that wouldn't be inconceivable just from the outside, just a back of the envelope calculation? I don't want to (inaudible) anything.

Alan Brown - Rentokil Initial plc - CEO

No, that's not unreasonable. I think that would be -- certainly a man in a cap and on the bus might start from that position, yes.

Mike Murphy - Loomis - Analyst

And can you say on the UK business, I can't see any reference to what exactly that did, but obviously it was down last year by 18%. Can you say what it was down in Q1?

Michael Murray - Rentokil Initial plc - CFO

In Q1 the UK Washrooms business just below breakeven in Q1.

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Mike Murphy - Loomis - Analyst

No, sorry. In terms of sales?

Michael Murray - Rentokil Initial plc - CFO

In terms of sales?

Mike Murphy - Loomis - Analyst

Yes. You've given the sales for the others apart from Spain but (inaudible) you said down 9%, sorry.

Alan Brown - Rentokil Initial plc - CEO

We're just looking to see if we can find it.

Michael Murray - Rentokil Initial plc - CFO

Yes, down GBP2m on the previous year.

Mike Murphy - Loomis - Analyst

Down GBP2m. So it would have been running at what is it, sort of late teens the UK business? So down about 10%, yes, in the round?

Michael Murray - Rentokil Initial plc - CFO

Yes.

Alan Brown - Rentokil Initial plc - CEO

Yes. That would be right.

Mike Murphy - Loomis - Analyst

Thanks, guys.

Operator

We now move to our next question from Darren Hook from Barclays Capital. Please go ahead.

Darren Hook - Barclays Capital - Analyst

Hi, good morning. I just want you to comment briefly on your level of commitment to investment grade ratings? And in this regard could we expect additional measures? For example, right now I see your strategy as growing profitability and you're obviously making progress on that to restore the financial metrics to being in line with regards to what S&P want. But if for

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whatever reason there was to be a disappointment in that regard could we expect you to bring into play additional measures or not?

And also could you comment on what do you expect your peak draw down on your bank facilities to be this year? Thank you.

Alan Brown - *Rentokil Initial plc - CEO*

Darren, thanks. Yes, I think that it's pretty clear we are committed to stabilizing and indeed improving our investment grade rating. I think we are on negative watch. I would certainly hope as a result of these first quarter results that there's a chance that we would be moved away from negative watch. And I think what I've been very clear about is that if we are able to meet our internal target for this year then we feel pretty comfortable that we'll be able to stay well within our current financing facilities. But I've also been clear that if for whatever reason, economic conditions put us materially off our current offering plan then we would look to take alternative measures.

Having said that we're now 13 weeks on from the year-end position and we've got 13 weeks of more confidence under our belt because this has performed extremely well in terms of cash generation during the quarter. But I do accept that in these very turbulent markets there is still risk that for whatever reason, particularly in the top line, we do get materially blown off course. And then under those circumstances, yes, we would consider taking other measures.

Darren Hook - *Barclays Capital - Analyst*

Okay. Well thank you. You're actually on negative outlook, not negative watch, so better than being on watch.

Alan Brown - *Rentokil Initial plc - CEO*

Okay, this is too specific of an area for me to play and I should stay out of it.

Darren Hook - *Barclays Capital - Analyst*

Okay, thank you.

Operator

We will now take our next question from Mark Shepperd from UBS. Please go ahead.

Mark Shepperd - *UBS - Analyst*

Morning. Can I just explore a little bit further the cost reduction plans in City Link? Because you've in the very first quarter reduced the depot network quite significantly from 98 to 91. Can you give us any idea what your target for number of depots is by the year end?

Alan Brown - *Rentokil Initial plc - CEO*

Yes, I think we can. I think we would say that certainly we'll be down to no more than 86 by the year end, Mark.

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Mark Shepperd - UBS - Analyst

Okay, so you've done probably the bulk of it in the first quarter really?

Alan Brown - Rentokil Initial plc - CEO

We've done a fair bit, yes, but there'll be some more to come. I think quarter two there won't be much change and in quarter three, quarter four. It all depends on leases and IT systems, but it tends to go in chunks.

Mark Shepperd - UBS - Analyst

Right. And any thoughts on the hub?

Alan Brown - Rentokil Initial plc - CEO

Yes.

Mark Shepperd - UBS - Analyst

Or the hubs, I should say.

Alan Brown - Rentokil Initial plc - CEO

Lots in the hub.

Mark Shepperd - UBS - Analyst

Yes. Is it going to be this year or next?

Alan Brown - Rentokil Initial plc - CEO

Definitely not this year. I've been very clear about that. Never, never, never this year.

Mark Shepperd - UBS - Analyst

Never this year, but --

Alan Brown - Rentokil Initial plc - CEO

But chance we would certainly -- I'll review the plans the next month or two. We'll see whether it's going to be next year or the year after.

Mark Shepperd - UBS - Analyst

Okay, and so next year or the year after and obviously a significant cost savings to come when that comes through, yes?

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Alan Brown - Rentokil Initial plc - CEO

That's correct, yes. Yes. We're implementing this big change in cages and trailers, which will give us a big saving, as well. But that will be implemented by the end of September, so we should see savings coming through in Q4 from the changes to the cages and the trailers.

Mark Shepperd - UBS - Analyst

Yes. And the other thing I just wanted to just ask about is the UK Pest Control business, Alan. Because you say by your own admission the service levels are now very, very strong. But you're still seeing revenue decline. What do you think the issue is there? To play devil's advocate with you, if you've got a strong product but the revenue is declining, does that mean that you're overcharging or you're just not marketing it properly? Is there an issue that you've got the wrong pricing structure or you need to spend more on marketing or (multiple speakers) going to change the revenue growth profile?

Alan Brown - Rentokil Initial plc - CEO

Mark, I think the reason UK Pest is complicated, and I've always said it's the most complicated issue for the (inaudible) business, albeit not the biggest issue, but the most complicated is that it's all of the above. There is no doubt that in some specific areas we're overpriced. I accept that.

Mark Shepperd - UBS - Analyst

Yes.

Alan Brown - Rentokil Initial plc - CEO

But I think the bigger issue is that if you lose that mantra of being the best and you get a reputation for being slipshod then it takes a long time to get it back, and in certain sectors of the market in the UK that's happened to us. So although we've restored service over the last nine months to I think very high levels, word of mouth would still be that Rentokil-Initial is not delivering as good results as it should be given its premium pricing.

Mark Shepperd - UBS - Analyst

Right.

Alan Brown - Rentokil Initial plc - CEO

But in addition to that I think that the service is more than just about turning up when you say you will turn up, and that's where I think we've fallen down. We've not been sufficiently responsive to emergencies or particular issues, and I think that our management of customer relationships has not been good as the local guy on the ground.

And then I think thirdly there is a marketing issue, which is not so much about building the brand, but the marketing issue in terms of targeting the right customers. If I look at our sales force at the moment they tend to walk the streets rather than having a more sophisticated approach by targeting those customers that we know really would benefit from our service. So there are a whole range of issues we've got to sort out.

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I think we've begun to scope out exactly what has to be done, but I've had the new management team in place now for three or four weeks, and I'm not as advanced as I am say in City Link or anything like it in being able to really convey to you the precision with which we're going to move forward in UK Pest. But what I would say is that we've been in this place before with City Link, with UK Washrooms and with Australia and I think we've shown that given time we can sort these things out. But UK Pest is still at the back of the pack in terms of making progress, so again I would hope I'll be able to come back at the year end with much more detail of where we're getting to on this.

Mark Shepperd - UBS - Analyst

All right. Okay. Best of luck.

Alan Brown - Rentokil Initial plc - CEO

Yes, cheers.

Operator

We'll now take our next question from Laurent Brunelle from Exane. Please go ahead. Mr. Brunelle, your line is now open, please go ahead.

Laurent Brunelle - Exane BNP Paribas - Analyst

Yes, one more question please, if I may? Just to check, do you still have targets of reducing DSO as you said last February? Is it still on the agenda, please?

Michael Murray - Rentokil Initial plc - CFO

Yes. We announced the target and we're sticking with the target from 65 to 59 days is the year-end what we're aiming for.

Laurent Brunelle - Exane BNP Paribas - Analyst

Okay, just a bit of a check. Okay, thanks.

Michael Murray - Rentokil Initial plc - CFO

Thank you.

Alan Brown - Rentokil Initial plc - CEO

I think we have time for one more question.

Operator

We'll take our next question from [Lily] (inaudible). Please go ahead.

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Unidentified participant

Yes. Good morning. I would like to have more color on your liquidity position and whether you have any covenants on the credit facilities?

Michael Murray - Rentokil Initial plc - CFO

Sorry, we've only got one covenant on the facility and that's EBITDA to interest cover of four ratio. At the year-end that was running at 5.6. It's reviewed every six months on a 12-month look back, so at the mid year we can update you. But we're hopeful that that will improve. So four is the covenant, 5.6 was the last measure and we're hopeful to improve that.

In terms of liquidity, I think Alan's already said the best measure for us is the headroom. Headroom is GBP215m at the moment and that's bearing in mind, of course, that we've just recently paid down two-thirds of our interest costs for the year.

Unidentified participant

Thank you.

Alan Brown - Rentokil Initial plc - CEO

Okay, have we got one more coming through?

Operator

We will take our next question from Jarrod Castle from UBS. Please go ahead.

Jarrod Castle - UBS - Analyst

Good morning. Just maybe if you could end up on this, and I don't know what you can or can't say on it. But you have seen the overall Group margin go from a double digit margin to a single digit. Do you think when you benchmark yourselves after having been there for a year that you're going to get it back up to a double digit? And could you give maybe some kind of timeframe that you'd be working towards? Or do you have even in mind where you would see the Group margin in three year's time, something like that?

Alan Brown - Rentokil Initial plc - CEO

Jarrod, thanks. Honestly I've not really looked at it in that sense. What I see at the moment is really from where I am there's so many opportunities to improve the business that I'm much more focused on getting the momentum behind each of the opportunities.

And what all that adds up to I've not focused on greatly. We're still effectively almost four years away from the time when everything has to deliver, and I think it's much more important that I get as much momentum pushed behind all of the individual projects than actually working out what the end game's going to be.

And there's so much uncertainty at the moment because of the difficult (inaudible) and whether the management is there to deliver in these projects. And I've not been seduced (inaudible) or looking at what the margin might get to. But I think if we do a really great job and if we start to get the momentum behind these projects, I still think I'm going to make some money out

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of this thing, and as you know I'm still aiming to get GBP1.80 a share. Let's work out what margin we need to get to get GBP1.80 a share. That's what I'm aiming for by 2013.

Jarrold Castle - UBS - Analyst

Okay. Thanks very much for that.

Alan Brown - Rentokil Initial plc - CEO

Ladies and gentlemen, thank you very much indeed for your attention. I reiterate that I think we've had a pretty good first quarter but uncertain times lie ahead. Thanks very much for your attention.

Michael Murray - Rentokil Initial plc - CFO

Thank you.

Operator

That will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.

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