THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

RTO.L - Rentokil Initial plc Q1 Trading Update Conference Call

EVENT DATE/TIME: MAY 02, 2014 / 8:15AM GMT

CORPORATE PARTICIPANTS

Andy Ransom *Rentokil Initial plc - Chief Executive*

Jeremy Townsend *Rentokil Initial plc - CFO*

CONFERENCE CALL PARTICIPANTS

Andrew Ripper *BofA Merrill Lynch - Analyst*

Robert Plant *JPMorgan - Analyst*

Sylvia Foteva *Deutsche Bank - Analyst*

Christopher Banberry *Peel Hunt - Analyst*

PRESENTATION

Operator

Good day and welcome to the Q1 trading update conference call. Today's conference is being recorded. At this time I would like to turn the call over to Mr. Andy Ransom. Please go ahead, sir.

Andy Ransom - *Rentokil Initial plc - Chief Executive*

Good morning everyone. This is Andy Ransom speaking, Chief Executive of Rentokil Initial. I'm here with Jeremy Townsend, our Chief Financial Officer. I'm now going to give a short run-through of the main points from our Q1 IMS and then of course we'll be happy to take any questions.

As you will have seen in the announcement this morning, we've delivered our first quarter revenue, profit and cash performance all in line with our expectations. At the strategy presentation in February we indicated that our immediate focus would be on improved profitability and cash generation, and we've made a good start at putting this strategy into action.

We've made good progress in profitability, with adjusted operating profit increasing by 7.6% at constant exchange, reflecting growth in France, Germany, North America and Asia as well as lower central overheads. Restructuring and one-off costs were significantly lower in the first quarter at GBP2.1m versus GBP5.1m last year, contributing to an increase in profit before tax of 21.7%. We now expect restructuring and one-off costs to be in the region of GBP10m for the year, which is approximately GBP10m lower than we indicated at the preliminary results.

Cash flow performance in Q1 was in line with expectations and we're on track to deliver significant improvements in 2014 through lower restructuring costs as well as reduced CapEx and lower working capital outflows and pension contributions.

On an organic basis revenue increased by 0.4% in the first quarter, driven by good growth in our emerging and growth quadrants, which were 8.8% and 2.2% up respectively. Acquisitions primarily in those emerging and growth quadrants contributed a further 1% to revenue growth. However, reported revenue for the quarter was down 0.6%, which is due in part to the disposal of our Belgian flat linen business and our Korean joint venture in 2013 which reduced revenue by 2%, as well as lower revenues in our protect and enhance quadrant, particularly Benelux where, as expected, trading conditions remain a challenge.

M&A activity in the first quarter included the sale of Initial facilities to Interserve, the proceeds of the sale amounting to GBP250m we received on March 18. And we also acquired 10 businesses primarily in the pest control category with combined annualized revenues of GBP22.4m. These included our first pest control acquisition in Chile and four small bolt-on deals in North America, which, as you know, is a very important market for us.

So, in summary, we're encouraged by a solid first quarter in line with our expectations. I'm pleased with the start we've made in executing the strategy that we outlined in February and we remain confident in making further progress for the remainder of the year.

And, with that, I'll hand back to the operator and Jeremy and I will be very happy to take any questions.

QUESTIONS AND ANSWERS

Operator

Thank you sir. (Operator Instructions). Andrew Ripper, Merrill Lynch.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Yes, good morning. Thank you chaps. Just got a few questions mainly in relation to cash flow and starting with M&A. And at the final results, you talked about spending around GBP50m per annum and obviously I know you haven't given a consideration in relation to the GBP22m, but I would guess you've spent over GBP20m in the first quarter. Can you give us a sense of what the pipeline is like and whether the first quarter's activity is indicative of what we can expect for the full year? And then I've got some follow-ups on cash flow.

Andy Ransom - *Rentokil Initial plc - Chief Executive*

I'll take that one first so you can do the outlook if you like, Jeremy. Yes, I think what I said at the time -- good morning Andrew, by the way, sorry. What I said at the time was that we'd look to spend around GBP50m per annum on average. There'll be some years where we spend a bit more, some years where we spend a bit less. I'm really pleased that we've got off to a good start with the level of acquisitions we've been able to get over the line in the first quarter. Prices vary according to deals of course, but we've spent in the first quarter on those deals or committed to spend I guess around about GBP25m, Jeremy?

Jeremy Townsend - *Rentokil Initial plc - CFO*

Yes, that order of magnitude.

Andy Ransom - *Rentokil Initial plc - Chief Executive*

Yes, so just over a pound for pound of revenue acquired. So that's the first quarter. The pipeline remains good, Andrew, so we are not throttling back on execution. As I've always said, M&A is an opportunistic sport so we will take the deals if they're good deals as and when we can find them. So we've got some nice deals we're looking at in the second quarter. We've got some more that we'd like to look at in the third quarter.

So I'll let Jeremy comment in terms of the likely outturn on cash spend for the M&A in general.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Yes. Could you just give us an indication of what multiple of EBIT you're paying on these bolt-ons as well please?

Andy Ransom - *Rentokil Initial plc - Chief Executive*

It does vary Andrew. It really does. I'm not trying to duck the question. If we are looking buying a small business that's in an established market and it's going to bolt into an existing operation, if it's in a mature market that might be 5, 6, 7 times. If we're looking at emerging markets, high growth and possibly lower EBIT because it's a less mature business, less density, that will be a higher multiple. So it really is difficult to generalize. We obviously have a sophisticated M&A model to run the numbers on lots of different bases, but those sorts of multiples wouldn't be far off the mark based on whether it's emerging markets or mature, Andrew.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Okay. Okay.

Jeremy Townsend - *Rentokil Initial plc - CFO*

In terms of spend for the year, as Andy said, M&A is opportunistic. Until the deal crosses the line, all deals have a level of probability attached to them. Given the run rate year to date I think we're likely to be ahead of the GBP50m or so we've guided in terms of expectations on an average year basis, but equally I wouldn't expect that GBP25m per quarter to continue for the rest of the year. It might do but that's unlikely. So I think that that quarter on an EV basis, so in the GBP60m to GBP70m.

We have got a business we're looking at in the clean-room space which could tip us over GBP100m if we bring that one in. We're currently in discussions around that. So if that one came off then that number, GBP60m, GBP70m, will be nearer GBP100m, Andrew.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Yes, okay. Fine. And then just on the outlook for cash flow, it's a multi-part question really and obviously where I'm driving to is what a realistic outcome is for free cash flow this year. But the organic looked a bit soft in the quarter. Just wondering, you gave specific guidance on working capital at the finals, does that change at all as a result of the organic growth run rate? I think your previous guidance was 15 to 25.

And then in terms of the interest, obviously it's going to step down significantly from the second quarter. I wonder if you can just remind us of the order of magnitude of that.

And then in relation to the re-org costs, which obviously are dropping away significantly now, can you also remind us of whether there's going to be any difference between the cash cost and the P&L cost for this year. Thanks.

Jeremy Townsend - *Rentokil Initial plc - CFO*

Thanks Andrew. So oddly enough organic growth tends to drive working capital outflows, everything else considered. So a slightly lower organic growth would impact that, but I wouldn't necessarily call that for the year. There's much bigger swings and roundabouts in terms of the phasing of working capital. So I wouldn't change the working capital guidance we gave at the prelims.

In terms of the restructuring costs, there's an element of the 2014 cost which is a flow through -- the cash cost is an element of the flow through from 2013. But given now that we've got a much clearer perspective of what we're likely to have an impact from the P&L, I'd say there's a GBP5m to GBP10m upside there from a cash point of view in terms of that lower P&L guidance. Otherwise we're bang in line in the first quarter with the free cash flow expectations. So I think there's a bit of upside from those lower restructuring costs. Otherwise we're exactly where we were when we talked to you in February.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Okay. Thank you. And then just finally on the interest.

Jeremy Townsend - *Rentokil Initial plc - CFO*

Yes, so on the interest side, just to point a couple of things out. From a P&L point of view you'll notice that the adjusted profit before tax growth rate is slightly below the adjusted profit. That's because of the interest impact in the first quarter. We've now paid the bond off so we don't have the carry cost on the cash in terms of refinancing that bond. So that differential there you've got between the adjusted operating profit and adjusted profit before tax should come away.

And from an interest point of view, interest costs will be slightly higher than last year just because of the phasing. But our current forecast is in the GBP50m to GBP55m level in terms of cash flow. It's just short of the GBP55m level so broadly in line with where we were previously. And that's because, just the way the bond's phased, we've got a slightly higher interest cost in the year in cash than we have in profit.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Yes, and that would be commensurate presumably with the P&L cost of something around GBP47m, GBP48m, something like that.

Jeremy Townsend - *Rentokil Initial plc - CFO*

Absolutely right. About GBP48m, I would say.

Andrew Ripper - *BofA Merrill Lynch - Analyst*

Okay. Thanks.

Operator

Robert Plant, JP Morgan.

Robert Plant - *JPMorgan - Analyst*

Morning guys. Two questions please. The first one is, is it fair to compare the 0.4% organic growth to the 1.1% last year? And, if so, what got worse, what got better?

And secondly, you've given the disclosure in terms of the quadrants. Is this how you're going to report going forward? Could we get more detail in terms of perhaps by sector, for example how pest control did? Thank you.

Andy Ransom - *Rentokil Initial plc - Chief Executive*

Hi Robert. Good morning. I'll deal with the first question and Jeremy can pick up the second or between us. Is it fair to compare? If the question is should we consider that to be a negative, the move from 1.1% to 0.4% quarter to quarter, I would say no.

The organic revenue growth in the quarter is absolutely in line with the plan that we had for the business. So we could see this shape and it's not atypical for our business, given the level of pest control revenues in our business, that Q1 tends to be the quietest quarter. So, no, I think it's actually a continuation of where we were in the third quarter and the fourth quarter so I don't think there's been any material change. Obviously we are looking to improve that over time and there are lots of initiatives going on with that. But there is a seasonal element with our quarters.

The negative in the quarter on organics was Benelux and that is a continuation. That's something that we've got a good strong plan in place for to return our Benelux business to a better place than it's been. That will take a bit of time, but we will see progress for the Benelux as the year progresses.

So, no, I don't think you should read any negative into that, but it's going to take a bit more time for us to get the levels of organic revenue coming through that we want to see. We actually had a very slow start in a couple of markets in January and February, which picked up significantly in March. So I think the business is tracking exactly where we thought it would and it is a continuation of where it was in the fourth quarter.

Some good organic growth numbers coming out of markets like the UK, which show for us a little bit of pick-up in those markets. We've seen a better performance out of France in March. We've got really good growth coming out of the emerging markets. Asia is still going well, Latin America going well. So it really is performing essentially in line with how we saw it.

Jeremy, do you want to pick up --

Jeremy Townsend - *Rentokil Initial plc - CFO*

Yes, on the reporting side, Robbie, you'll remember that when we presented in February, we did say we were going to pare back a lot of the detail that we've typically presented in Q1 and Q3, and what we've got in here in the statement is a reflection of that. We're trying to use the quadrant framework just to provide a bit of color and we think it helps get a better feeling for the business.

The primary reporting framework is going to continue to be the regions, the regions that we presented. And at the half year we will provide as well a category split as part of the more detailed figures. So at the half year and the year end we'll continue to provide the category split and a regional split. The regional split will be the primary area of reporting from an accounting point of view, but we do think that the quadrant analysis just helps provide some color.

So we haven't got a category analysis for this round of presentation. I think what you can say is that there's a relatively high element of the pest category in those emerging and growth quadrants. The US is primarily pest. The acquisitions that we've done in the emerging segment are pest-based. So that growth in the first quarter is more oriented towards pest, but I think we're better going through that in detail when we get to the half year in terms of looking at the category split.

Robert Plant - *JPMorgan - Analyst*

Thank you guys.

Operator

Sylvia Foteva, Deutsche Bank.

Sylvia Foteva - *Deutsche Bank - Analyst*

Hi. Good morning. Can I please ask three questions? So first of all on the organic growth, so obviously I appreciate there is seasonality, but then it has slowed down year on year a little bit. But you do talk about a recovery towards March. So should we assume that the exit rate is then more similar to Q4 or Q3 of last year?

Then secondly, how much of the profit delta I guess year on year was due to overheads being better placed and are you still guiding to overheads being GBP10m better for the full year?

And then lastly just more of a housekeeping question. Can you possibly provide the adjusted profit before tax per quarter for 2013 excluding facilities?

Andy Ransom - *Rentokil Initial plc - Chief Executive*

Morning Sylvia. I'll pick off the first question. Very simply the answer is yes. So the exit rate in March was very comparable, in fact slightly ahead from memory, of the exit rate for the fourth quarter. That is the simple answer is yes to the first question.

Jeremy, want to take the others?

Jeremy Townsend - *Rentokil Initial plc - CFO*

So we will present you, Sylvia, with the -- we're going to circulate after this call the comparatives for the ex-IF businesses for both 2013 and 2012.

Can you remind me what the second question was there?

Andy Ransom - *Rentokil Initial plc - Chief Executive*

The overhead reduction.

Jeremy Townsend - *Rentokil Initial plc - CFO*

Overhead reduction, yes. So, yes, we're absolutely on track with the overhead reduction. We guided to that being round about GBP10m for the year, so roughly GBP2.5m of the profit improvement is the first quarter of that. We are looking at opportunities around the business following the IF sale to drive that further forward and we'll be in a better position to talk to that for the half year, but for the moment the guidance stays at a GBP10m reduction and GBP2.5m in the quarter. And you'll see the margins, the overall net operating margins, have improved slightly and obviously that's a key driver of that.

Sylvia Foteva - *Deutsche Bank - Analyst*

Right. Okay. And that's just central overheads or -- because I guess you mentioned --

---

Jeremy Townsend - *Rentokil Initial plc - CFO*

Central and divisional. So we're looking at the overheads that we use at the center, but also the overheads we use to operate the divisions. So and reducing that effectively from a run rate of GBP80m or so to about GBP70m for the year.

Sylvia Foteva - *Deutsche Bank - Analyst*

Yes, okay. Alright. Thanks a lot.

Operator

(Operator Instructions). Christopher Banberry, Peel Hunt.

Christopher Banberry - *Peel Hunt - Analyst*

Good morning. I was just wondering if this GBP3m increase in the operating profit was the net impact from acquisitions and disposals?

Jeremy Townsend - *Rentokil Initial plc - CFO*

Yes, the impact from acquisitions and disposals, the net impact is about GBP700,000.

Christopher Banberry - *Peel Hunt - Analyst*

Fantastic. Thank you very much for that.

Operator

As there no further questions in the queue I would like to turn the call back to Mr. Andy Ransom, for any additional or closing remarks.

Andy Ransom - *Rentokil Initial plc - Chief Executive*

Okay. Thank you all for joining today's call and we look forward to updating you again at the time of the interims which is on August 1. Thanks very much for joining us. Thank you.

Operator

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