S&P Global
Market Intelligence

Rentokil Initial plc LSE:RTO

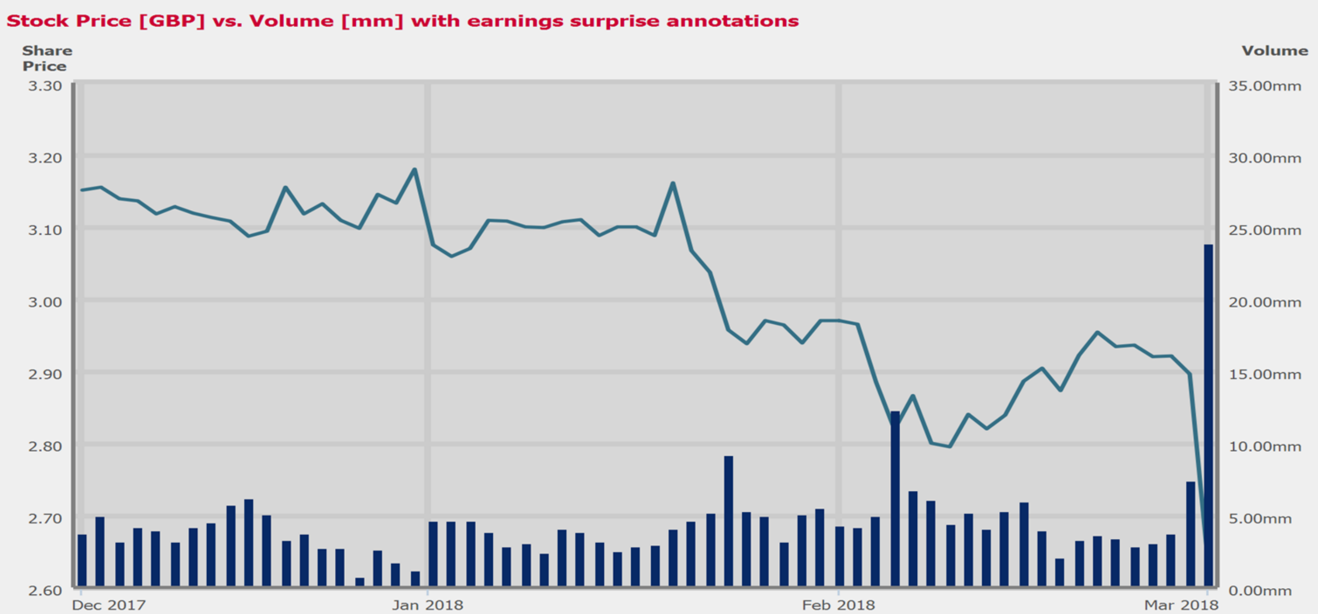
FY 2017 Earnings Call Transcripts

Thursday, March 01, 2018 9:30 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.12	0.12	0.00	0.13
Revenue (mm)	2347.62	2412.30	▲2.76	2346.03

Currency: GBP
Consensus as of Mar-01-2018 8:55 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2017	0.12	0.12	0.00 %

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Call Participants

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Presentation

John David Gibson McAdam
Former Chairman

Good morning, ladies and gentlemen. I must admit I'm slightly surprised to be looking at so many people, given the weather conditions, but I'm delighted that you made it, so it's a pleasure to see you. So welcome to the Rentokil Initial preliminary results for 2017. I'm pleased to tell you that 2017 has been another successful year with a strong financial performance. Our key financial metrics of ongoing revenue, ongoing operating profit and free cash flow were all in excess of our medium-term financial targets. Organic growth, in particular, at 3.8% represents a significant improvement on 2016. At a category level, Pest Control has performed well. We remain encouraged by the progress we're making in hygiene, a strongly complementary business to Pest Control.

2017 has been a particularly good year for M&A, focused on growth and emerging markets. In particular, our joint venture with India's largest pest control company, PCI, represents a strategically important step in a country with massive growth potential. The year has also marked a step-change in the execution of our strategy following the completion in June of our joint venture with Haniel, creating a leading provider of workwear and hygiene services in Europe. As a result, the composition of our profits is predominantly weighted towards our core higher growth businesses of pest control and hygiene, which now account for around 90% of the group's operating profit.

The board is especially encouraged to see the company sustained its growth momentum, delivering in line with our strategy through a combination of organic initiatives and carefully targeted acquisitions. Based, therefore, on our performance in 2017 and our expectation of further growth in 2018, the board is pleased to recommend an increase in the final dividend for 2017 to 2.74p, resulting in a total dividend growth for the year of 15.1%. Let me now hand over to Andy and Jeremy, who will talk you through the highlights of the year and describe our plans in more detail. Thank you very much.

Andrew M. Ransom
CEO & Executive Director

Thank you, John. Good morning, ladies and gentlemen. Thank you, all, for joining us today, as John says particularly, given the winter wonderland conditions we're enjoying at the moment, so good to see you all here. In a few moments, Jeremy is going to provide you with details of our results for 2017. He's going to look at the 5 regions, which have delivered a strong overall financial performance in excess of our medium-term guidance. I will then come back to provide an update, firstly, on the excellent overall progress we made in 2017 against the RIGHT WAY plan, as we drive growth in our strong core markets of pest control and hygiene. Secondly, on how we're differentiating the company, particularly through our innovations and the use of digital technology. And thirdly, on the success of our acquisition program, with 2017 being a particularly strong year for M&A delivery. But first, let me just say a few words to set the scene for today by covering the key highlights. We delivered a strong overall performance during the year, with revenue from ongoing operations, which excludes the results of disposed businesses, up by 14.5% at constant exchange rates, with all regions contributing to this growth. Organic revenue growth continued to build at 3.8% for the full year, and with Pest Control delivering organic revenue growth of 5.8%. For the second year, our Pest Control business grew overall by over 20%. And in Asia and Latin America, we now have an emerging markets Pest Control business that's close to GBP 200 million and which grew by over 50% last year, aided of course by the excellent agreement with PCI in India, but also by 9.6% organic revenue growth in Asia and 18.5% in Latin America.

Ongoing operating profit grew by 14.8% in the year, another good overall performance, reflecting growth in all regions, including our Europe region, which pleasingly has returned to profitable growth in 2017 after a number of years of decline. And as you can see, free cash flow was also strong, and our balance sheet remains robust.

Finally, turning to acquisitions. As I've said, 2017 was an exceptional year for M&A, with 41 acquisitions delivering GBP 225 million of combined annualized revenues. This is a material step up from 2016, and it reflects the strength of our ongoing M&A pipeline. Of course, in addition, we also delivered 2 significant joint venture deals, 1 in Europe and 1 in India, and we also took an important step towards returning to profitable growth in France with the sale of a 8 flat linen laundries. The completion of our joint venture agreement with Haniel creates a leading provider of workwear and hygiene, with the scale needed to succeed, while in India, our majority interest in the joint venture with PCI is a strategically important step in a country with significant future growth potential. So in summary, 2017 has been another strong year, both in terms of the underlying performance of our businesses and through the delivery of our M&A agenda, as we again continued to execute our RIGHT WAY strategy at pace. So with that, I'll now hand over to Jeremy, who will take you through the group financials and the regional performances in more detail.

Jeremy Townsend
CFO & Executive Director

Thank you, Andy, and good morning, everyone. I'll now run through the key financial highlights for 2017 in a bit more detail. And unless I stay to the country, all numbers are at a constant rate of exchange. Ongoing revenue in the year grew by 14.5%, with organic growth of 3.8% and growth from acquired businesses of 10.7%. Adjusted operating profit before interest for the year, on an ongoing basis, increased by 14.8%, driven by strong profit growth in North America, Asia and Pacific. Adjusted profit after interest at actual exchange rates grew by 13.8%, driven by the increase in ongoing profit and favorable exchange rate movements of GBP 19 million, offset by the impact of the transfer of our German and Benelux textiles and hygiene businesses into a joint venture with Haniel, which reduced second half profits by GBP 21 million.

Free cash flow was again strong in 2017. Operating cash flow at GBP 258 million was GBP 11 million higher than the prior year, and free cash flow at GBP 176 million was GBP 19 million higher. Adjusted EPS at actual exchange rates increased by 13.6%, with growth in adjusted -- in line with growth in adjusted profit before tax. The revenue, profit and free cash flow results for 2017 demonstrate another year of delivery against the financial targets that we set for the business in 2014, and which we revised at the 2017 interims. The trend of increasing organic growth continued in the year, and our profit growth was ahead of our target level of around 10%, reflecting leverage from the organic growth as well as the impact of our continuing M&A program. Free cash flow continues to be strong, in line with our medium-term target of 90%.

Looking now at performance by region. North America delivered a strong performance in 2017, supported by acquisitions and improved organic growth. Revenue grew by 21.1% in the year, driven by the continued strong acquisition pipeline as well as increased organic revenue growth, which was 4.8%, with Pest Control organic growth over 5%. 9 acquisitions were completed in 2017, with annualized revenues of over GBP 100 million, increasing revenues in North America by 16.3%.

Operating profit was up 22%, reflecting the impact of the acquisitions and leverage from the increased organic growth. Margins improved by 0.1 percentage points to 13.6%. Pest Control margins, excluding products, increased by 0.7 percentage points to 16.7%. Overall, margins in North America were held back by the dilutive impact of acquisitions, and in particular, the lower margin Residex products business. We anticipate further opportunities for margin improvement in 2018 through leverage from the organic and inorganic revenue growth, in line with our plan to deliver $1.5 billion of revenues in 2020, with net operating margins of 18%.

Ongoing revenues in Europe were up 7.3% in the year, with strong growth in Germany, Southern Europe and Latin America, which is managed through the Europe region. Revenues in France grew for the first time since 2014. Profit in the year was slightly higher than 2016, with growth in Germany and Southern Europe offset by declines in France, where profits continue to be impacted by pricing pressure. Trading conditions in France have started to improve, and we plan to return the business to profitable growth by the end of 2018. These results exclude the impact of the Haniel JV, which I'll come back to later in my presentation.

Revenue in the U.K. and the rest of the world region was up 6.8%, of which 1.4% was organic. U.K. revenues grew by 4.2%, driven by growth in both pest control and hygiene. However, the U.K. property care market has been challenging, impacting both revenue and profit margins. Ongoing revenue growth has been strong in the rest of the world, driven by growth in all of its regional clusters. 10 businesses were acquired in 2017, with annualized revenues of GBP 23 million, and profits increased by 6.1% in the year, reflecting the organic growth in pest and hygiene and the impact of the acquisitions. However, margins were slightly down due to the impact of the U.K. property care business.

The Asia region has continued to make excellent progress in 2017. Revenues were up 37.3%, with organic revenue growth of 7.6%, with good performance from both pest and hygiene. Acquisitions contributed growth of 29.7%, primarily due to our joint venture with PCI in India. Operating profit in the region was up 39.5%, reflecting leverage from the organic revenue growth and the impact of the PCI JV. Margins increased by 0.2 percentage points, with an increase in organic pest and hygiene margins, offset by the dilutive impact of the PCI joint venture. We believe there are further significant opportunities for margin improvement in the region through inorganic and organic revenue growth, service productivity and back office rationalization. And our joint venture in Japan continues to trade well, growing by 4.5% -- growing revenue by 4.5% and profit by 8.7%.

The Pacific business again performed well, with revenue up by 7.7% and profits up by 9.6%. Organic revenue growth of 4.2% resulted from good performance in both pest and hygiene. Operating margins improved by 0.4 percentage points, driven by leverage on the revenue growth. There were 7 small acquisitions in the region during the year, 6 in pest control and 1 in hygiene, with annualized revenues of GBP 7 million. The region anticipate further improvements in margin in 2018 through leverage from inorganic and organic revenue growth as well as improved service productivity.

Turning now to cash flow. As I've said, operating cash flow of GBP 258.4 million was up GBP 10.6 million, despite the impact of the removal of cash flows from the businesses, which transferred to the Haniel JV in the second half of the year, and the fact that we received a GBP 7.3 million special dividend from our Japanese associate in 2016. The first dividend that will be received from the Haniel JV will be EUR 9.5 million in 2018, relating to the 2017 half year of trading, and the first full dividend of EUR 19 million will be received in 2019 relating to the 2018 trading year.

In terms of EBITDA, EBITDA was favorably impacted by FX movements, which offset the impact of the Haniel JV. Conversely, net CapEx was around GBP 10 million lower, with the reduction in CapEx arising from the JV, partly offset by an adverse FX impact. Working capital outflows were higher in 2017, in part, reflecting a change in mix of revenue in the group, with an increased proportion of revenues from emerging markets and national accounts.

Continuing free cash flow of GBP 176 million was GBP 19 million higher than last year. Cash interest payments were GBP 13.2 million lower than in 2016, reflecting the timing of bond interest payments, following recent debt refinancings. Cash tax payments were GBP 4.3 million higher, reflecting the increased profitability of the group. Our cash tax paid, as a percentage of profit, remains relatively low, however, at around 15%.

Free cash flow was used to fund GBP 64 million in cash dividend payments, a 15.9% increase on 2016. And cash received from the transfer of businesses through the Haniel JV and the sale of 8 French laundries contributed GBP 452 million in cash, of which GBP 281 million was spent on acquisitions. Sterling strengthened towards the end of 2017, particularly against the U.S. dollar. And the impact of this overall reduced the Sterling value of our euro and dollar-denominated debt by GBP 29 million compared to the prior year. And taking all of the above into account, our net debt reduced by GBP 311 million in the year to GBP 927.3 million.

We are pleased with the improved free cash flow delivery of the business over the last 4 years, and the way we've been able to invest this in our acquisitions focused on our core pest and hygiene categories and businesses in our growth and emerging markets. We will continue to apply our capital allocation model, looking for opportunities to invest in acquisitions that meet our target return levels. Our acquisition pipeline remain strong, and I would anticipate that we will spend between GBP 200 million and GBP 250 million on acquisitions in 2018, including the acquisition of Cannon Hygiene from OCS.

Our strong revenue, profit and cash performance has enabled us to propose a 15.1% increase in our dividend for 2017. We will execute our capital allocation policy within our overall commitment to maintain a BBB investment-grade credit rating, using any available free cash flow to pay down net debt.

Just coming back to the Haniel JV. Our financial performance in 2017 has been enhanced by the impacts of the Haniel JV and the sale of the 8 laundries in France. And this chart shows the performance of the group in 2016 compared to the performance of the group in 2017, with the results of these businesses completely eliminated. As you can see from the chart, the JV transaction, combined with the JV -- combined with the laundry sale, has had the following impacts. It significantly increased the proportion of our group revenues, of our core Pest Control and Hygiene businesses. It's increased the reported organic growth of the business from 3% to 3.8%, increased the underlying net margins by 0.3 percentage points, which affected the reduction in central and regional overheads, and a relatively small impact from free cash flow relative to the amount of cash proceeds generated, reduced underlying net CapEx by around GBP 60 million, and significantly reduced our net debt figure.

Following the Haniel JV, our net debt-to-EBITDA ratio has reduced from 2.5x at the end of 2016 to 1.9x at the end of 2017. And with our continuing strong levels of free cash flow and improved credit metrics, our credit rating remains at BBB. Our strong metrics enabled us to raise a EUR 400 million, 7-year bond in November 2017 at a coupon of less than 1%. And we continue to have significant funding capacity, with roughly GBP 600 million of centrally-held funds and undrawn committed facilities at the year-end. Our cost of net debt has increased slightly, reflecting around GBP 300 million of cash held on the balance sheet at the 31st of December. And our pension scheme remains effectively fully funded, with one of the strongest positions in the FTSE 350. Following agreement of the scheme valuation at 31st of December, 2015, GBP 9 million of cash previously held in escrow has now been returned to the company, and no future cash payments are expected.

So finally, before I hand over to Andy, some more numbers for your models in relation to 2017. Following a GBP 2 million decrease in central and divisional overheads last year, we would expect 2018 costs to be around GBP 4 million higher, reflecting increased investment in our digital capability. As you know, we now report restructuring costs above the line, and these are again expected to be around GBP 7 million in 2018. This guidance is for restructuring costs only and does not include one-off items, which by their nature, are more unpredictable. Integration cost for significant acquisitions and disposals will continue to be reported as one-off costs in 2018. With our 18% investments in the Haniel JV, combined with our Japanese associate, profit from associates is a more material number in 2018, and in my estimate, is that these will be in the region of GBP 20 million to GBP 25 million.

Cash and P&L interest cost is expected to be around GBP 46 million this year, slightly higher than 2017 due to a change in the currency mix of debt and FX movements. In relation to the overall FX impact on profits, Sterling has strengthened recently, particularly against the U.S. dollar. And should current exchange rates remain for the remainder of the year, I would estimate an adverse impact on our profits of between GBP 10 million and GBP 15 million. We estimate that our effective tax rate will be around 22.5%, in line with 2017. Our cash tax payable is expected to increase to GBP 45 million to GBP 50 million, reflecting the increased profitability of the group as well as the impact of U.S. tax reforms on our cash tax payable.

In terms of other cash flow guidance, I would expect working capital outflows in 2018 at the same level of 2017 at around GBP 15 million, and net CapEx in the region of GBP 165 million to GBP 175 million, reflecting the impact of the Haniel JV, and again, subject to foreign exchange movements. I'd now like to hand you back to Andy.

Andrew M. Ransom
CEO & Executive Director

Thanks, Jeremy. So let me start with our RIGHT WAY strategy. On the screen there, you'll see our summarized strategy model. I introduced this to you at our interims last August when we reaffirmed our focus on the strong core markets of pest control and hygiene, and at the same time, we up-weighted our medium-term financial guidance. As I'm sure you'll recall, we remain very focused on, first, our core Pest Control and Hygiene businesses, whilst we are protecting and enhancing our workwear business in France, our U.K. property care business and our global plants business, Ambius. Second, we're focused on our multi-local operations, with over 1,800 local service teams, covering around 90% of global GDP over 90 of the world's 100 largest cities. And we're generating around 90% of group revenues from outside of the United Kingdom. And third, there's also no change to our focus on building our business on the expertise of our people, or indeed, to our leadership in innovation and digital technologies. In the interest of time, I'm not going to go through the model in further detail, but over the next few slides, I'll outline a few examples of the good progress that's being made across the different parts of our model. And I'll start in the top left there, covering in more detail our market-leading businesses in our strong core markets. Here's a summary of the ongoing businesses and their performances in 2017. As you'll see on the left there, Pest Control, which now accounts for 64% of revenues and 69% of profits, delivered a strong full year performance, with ongoing revenues increasing by 21.4% of which organic growth was 5.8%, and profits grew by 18.1%. In our Pest Control growth markets, that's North America, the U.K., Germany and Australia, for example, ongoing revenues grew by 16.9%, while in our emerging markets that may include, Brazil, China, Indonesia, Malaysia, ongoing revenues grew by 57.1%. Our Hygiene business, which accounts for 19% of group revenues and 20% of profits delivered an increase in ongoing revenues of 7.6% of which organic growth was 2.1%. And profits grew by a very respectable 9.7%, with our focus on operational execution increasing net margins in Hygiene from 17.4% to 17.7% during the year.

Finally, as you can see, our Protect and Enhance businesses, which together account for 17% of group revenues and 11% of profits, increased revenues by 0.9%, and I think it was quite an encouraging performance, but profits were lower by around 1/5 in the Main due to lower profits in France Workwear. As you know, at the interims, we stated our ambition is to return our businesses in France back into profitable growth by the end of this year, and we remain on track to achieve that.

Now I'll cover these businesses in a little more detail. One of the great things about our pest control business is not just how good our business is, but it operates in a strong and growing industry. As you can see, our pest control business has delivered a 4-year CAGR of 17.2%. This outstanding business is our key growth engine, and it's extremely well-positioned to capitalize on the increasing demand for pest control around the world; with industry reports continuing to estimate that the global pest control market will grow by around 5% per annum over the next few years. That demand is driven by a number of factors, including increased economic growth, a growing population, urbanization and regulatory change, particularly, in areas such as food safety, as well as the drive for consistent international standards. Today, Rentokil is the world's largest commercial pest control company and is the #1 in 44 countries.

As you can see on the right of the screen, in North America, we've undertaken a long-term program to create value, delivering a full year CAGR of 23.2%. Today, we're the #3 business in this market, with over 300 local branches, and we continue to build scale and density in key cities in order to expand our margins. Through a combination of organic growth and acquisitions, we remain on track to create a business in North America, with revenues in excess of $1.5 billion in margins in the region of 18%, and to do this by the end of 2020. So as you can see, the opportunity to create substantial shareholder value in North America remains significant. And uniquely to Rentokil, of course, we're also building an important emerging markets business. In the emerging markets, Rentokil is strongly positioned, with the pest control business now delivering revenues of approximately GBP 200 million per annum. Our position is unmatched by any competitor. We have the scale, the brand, the technology and the local experience. And these markets will be a major platform for the medium-term growth of the company. As an example, in India, the pest control market is growing around 15% per annum, and the longer-term opportunity for growth is substantial, with high GDP growth and increasing population and urbanization as well as it being one of the world's largest exporters of food and medicines. Our majority stake in the JV with PCI has given us an important national market position in India, with over 250 local branches. And I'm pleased to report that the integration is going very well indeed.

So let me update you on our digital and innovation programs in pest control before I move on to hygiene. Last year, we made very good progress against our digital customer agenda, which is designed to drive organic growth to deliver further differentiation in the market and to create deeper customer relationships. Over the last 12 months, we've increased our web inquiries and contacts by over 30%. We rolled out our myRentokil customer portals to more than 100,000 customers. And we aim to complete the deployment to substantially all of our commercial customers globally by the end of this year. We've installed over

50,000 PestConnect systems and we've introduced our second generation of connected pest products. And we've launched our online command center, meaning, that we can now track and monitor and analyze all remotely pest activity in those 50,000 connected devices from country level, right the way down to each individual device inside a customer's premise.

Last year, we also launched a series of new customer innovations, for instance, Lumnia, which is the first insect light trap to use LED lighting. Not only is it highly effective, but it also uses up to 60% less energy. We also introduced RapidPro, which is a new fast-acting bait formulation. It's highly effective against mouse infestations, including those that are resistant to traditional baits. Both products have been tested against existing competitor ranges to ensure that they set new benchmarks in the industry, and initial sales for both of these have been well above our year 1 targets.

Now Power Center, that's our new global home for science, innovation and training, which we opened here in the U.K. last September, is providing us with more laboratory space to develop a much broader innovation pipeline. Coming soon from this world-class center of excellence are new launches, including an Internet-connected multi-catch rodent device and a full range of those LED Lumnia units. And just to reinforce why this is important, in 2017, just buy one example, 21% of all pest jobs sales in the U.K. came from innovations that were launched in the last 2 years. That's up a further 5 percentage points on 2016.

So let me turn now to pest control sister service, washroom hygiene. As you can see, our Hygiene business has delivered a 4-year CAGR of 4.9%, with ongoing revenues reaching GBP 403 million in 2017. This is an excellent business, and while we expect global market growth to be broadly GDP-correlated, there are also several trends, which we believe could potentially lead to above GDP growth in a number of markets. And those trends include changing demographics, increasing consumer expectation from improved hygiene standards, more hygiene compliance and regulation as well as increasing numbers of women in the workplace, in turn, increasing the demand for feminine hygiene services.

Today, Initial is the #1 hygiene services business in 23 markets, and it's one of the largest commercial hygiene services companies in the world. While there are a number of positive factors that we believe are relevant to the future development of the hygiene market, our primary focus today remains on operational execution every day, and introducing new tools to drive density and productivity.

Increasingly, Rentokil Initial is becoming a leading digital enterprise, with over 10,000 smartphone-enabled technicians, we're now deploying new field service and new field sales acts as well as back-office tools to optimize routes and to drive productivity across the operating model. Across our markets, technicians are moving from the use of paper and PDAs to smartphones and digital records. Whilst this equally applies to pests, of course, it's the hygiene business, where much of the initial deployment has taken place, in line with that focus on operational execution.

ServiceTrak is our smartphone field service app used by technicians to record the service visit. For instance, the start time, the services performed, customer recommendations, customer signature, service end time. The proof of service is e-mailed to the customer at the end of the visit, and the data is uploaded to our customer data systems, allowing our customer care teams to view the information and easily deal with customer queries. Today, in Asia, for example, we have over 1,200 techs trained and enabled with ServiceTrak. And as one example, in Indonesia, which was the first of our markets to fully deploy smartphones in service track, the Hygiene gross margin improved by 1.2 percentage points last year. This year, we expect to reach 100% deployment within Hygiene and to reach about 50% in Pest Control.

So finally, on Hygiene, just a few words on the recent acquisition of Canon Hygiene. This acquisition was completed on the 1st of February and is one of the few Hygiene services businesses operating in multiple countries. It's an excellent business, a very good fit with our existing operations, operating in 9 countries, including the U.K., Ireland, Australia and Thailand, and it also marks our entry into the hygiene market in India. With approximately GBP 77 million of annualized revenues, it replaces a large proportion of the Hygiene revenues, which we contributed to the joint venture with Haniel last year. And clearly, over the next couple of years, we expect to gain a good level of synergies from enhanced density and from combining back office infrastructures. Specific to the U.K. part of the deal only, the transaction is currently undergoing a review by the competition of markets authority. This is a very similar process to the EU Competition Authority review that was undertaken and then approved before we could carry out the joint venture with Haniel. We are confident that the CMA will approve the U.K. deal. However, no integration of the U.K. business can take place until the deal has been cleared.

So all in all, the Hygiene business had a very good 2017, and with the combination of great products, the good global market and our focus on operational execution, including the use of technology, I believe it's got every prospect to have a very good 2018.

Turning now to our third business, Protect and Enhance. We've got 3 main businesses in Protect and Enhance: Ambius, a U.K. Property Care business and France Workwear. Each of these business is profitable and cash generative, but each of them has weaker growth characteristics than our Pest and Hygiene businesses. Together, they account for about 11% of group profits. In Ambius, we've got a good business. It's mainly in America, but also with smaller operations in 16 other markets. We have high levels of expertise and customer service. Our focus here is to protect our core office plants business, but also targeting new higher-margin areas, for example, our living walls and our premium scenting products. In our U.K. Property Care business, we have unrivaled expertise in woodworm and damp-proofing services. And we've created a national business with scale. 2017 was, however, significantly impacted by the slowdown in the U.K. property market, so our focus here is on cost and on efficiency, whilst also sharing our digital expertise from pest control.

Finally, turning to France and our remaining Workwear business. Whilst we're continuing to make good operational progress in this business, as expected, 2017 remained challenging, with continued margin pressure in a highly competitive marketplace. However, as I mentioned earlier, with our new team, our new plan in place and having disposed of 8 breakeven flat linen laundries, we remain on track to return this business into profitable growth by the end of this year.

So finally, I want to touch briefly on 2 areas of great importance as key enablers of sustainable profitable growth that I referred to in our model earlier. Firstly, into our people agenda, and secondly, it's the importance of great customer service. One of the biggest challenges affecting companies all around the globe today is the ability to attract and retain the right numbers and the right quality of people. We identified this both as an issue, but also an opportunity about 18 months ago when we launched our employer-of-choice initiative, where we set out to differentiate our company in the global war for talent through the quality of our workplace. This is the part of the model I showed you earlier, and it's probably the part that most people outside of the company take least notice of. But if any company is to deliver sustainable profitable growth in the services sector, then a brilliant workplace culture is without doubt the most important part of the business model. And as you can see from the illustration on the right, there's also an appealing financial angle to this. By improving colleague retention, we can reduce the number of people we need to recruit, to train and the time taken to get new recruits up to speed. And of course, this, in turn, has a positive financial impact, reducing costs, improving productivity, but also improving customer retention.

We've already made great progress in many parts of our employer-of-choice program. For colleague motivation and enablement, these have been verified externally now at world-class levels for the first time. We have an award-winning learning and development team that has created over 500 learning assets last year for our online training portal. And these modules have had over 2 million views within RI last year. We also have a successful internal promotion model, where for example, we saw over 130 internal promotions in the U.K. alone last year. And as you can see there on the right, we're also seeing some important external recognition. For example, with Glassdoor placing Rentokil Initial 7th out of 700,000 companies in their listing of Britain's best places to work. Of course, from these highly motivated colleagues, comes great service. If you haven't visited the Trustpilot website before, it's a sort of TripAdvisor style site for customers to review independently the service that they have received from companies. And as you can see, our businesses here in the U.K., they're all rated excellent, and that's from over 3,000 customer reviews. We set out to train our service teams better than anyone else in our industry to give them the best tools, and then to measure and reward their performance, and we also measure customer satisfaction. Just to give you an idea of the scale of this, last year, we undertook 110,000 calls to customers to get their views of our service. And as you can see, our Net Promoter rating is very strong, with a score of over 40 points. And as one would indeed hope, our focus on delivering outstanding customer service is also now resulting in improved levels of customer retention, up by almost

1% to 85.7% last year, and with several of our businesses, like the Caribbean, now hitting our aspirational target of 90% customer retention.

Last year, we completed 41 acquisitions, 33 of which were in Pest Control. It was an exceptional year for M&A. As you can see, in the first quarter, we completed deals to make us the #1 pest provider in India and in the Middle East. We then completed the Haniel JV, then the disposal of 8 laundries in France. We rounded off the year with the vector control agreement in North America as well as getting the Cannon Hygiene deal signed. Let me just highlight 2 things. First, as you know, we monitor the integration and performance of our acquired businesses very closely to ensure that they are continuing to meet our financial hurdles. As you can see for all acquisitions, in the last 18-month monitoring period, every one of the deals is delivering the expected returns at/or above its respective target levels. And secondly, as I mentioned earlier, we are continuing to build a pipeline of acquisitions that has never been stronger. And therefore, as Jeremy mentioned earlier, our target spend for this year is between GBP 200 million and GBP 250 million. This is our RIGHT WAY strategy in action, and obviously, we're going to continue to execute this aggressively in 2018.

So finally then, in summary, in 2017, we delivered a strong performance. We made excellent progress in our revenue, profit and cash. We exceeded our medium-term targets. And we remain very well positioned to continue to deliver sustainable profitable growth with strong core markets, leadership in digital and innovation, common IT platforms to drive productivity, highly motivated colleagues, delivering outstanding customer service and a strong balance sheet to support an excellent pipeline of acquisitions. All in all, we are confident of delivering further progress in 2018. With that, I'll be happy to take any questions with Jeremy. Thank you.

Question and Answer

Jane Linsdey Sparrow
Barclays Bank PLC, Research Division

Jane Sparrow from Barclays. 3 questions, please. Just firstly, on the North American pest services margin. I think at the first half, that was up 1.6 percentage points. And obviously, for the full year is up 0.7. Is that just a tougher comp affect in the second half? Second question, you talked about the strong pipeline in M&A. You're obviously not the only people pursuing past acquisitions. Can you talk about vendor price expectations and current conditions there? And then thirdly, just on the preferred supplier agreement that you signed with ISS and Sodexo, does that sort of formalize an existing arrangement, where you're already working with them quite a lot? I'm just trying to understand potential incremental benefit from that contract.

Andrew M. Ransom
CEO & Executive Director

Thanks, Jane. Do you want to take the first one, Jeremy? I'll take...

Jeremy Townsend
CFO & Executive Director

Yes. So yes, the root to margin development isn't always going to be smooth. I think we're still on track to get to our 18% by 2020. We've had a waiting of M&A coming through, which is dilutive. We've had some issues in -- with the weather in Puerto Rico, with the CDC contract there, which has impacted margins. Margins are still improving, and as we head into 2018, by the acquisitions we've gotten, we see further opportunity for -- to driving that margin forward. So you will get some quarters from time to time, depending on the impact, particularly in Q4, which tends to be a lower revenue quarter. But generally, Jane, as we're building in the revenue with M&A and organics, we expect those margin to improve over time. So it was really the impact of M&A in the fourth quarter flowing through, and as that gets embedded in, we should expect that to further improve.

Andrew M. Ransom
CEO & Executive Director

Thanks, Jane. On pipeline of M&A, so I've been doing M&A for 30 years, so it's a subject that's pretty close to my heart. I'd say our M&A pipeline is as strong as I've ever seen it. We spent a long time building that pipeline, not just in markets, like North America, which obviously a strong target; but right across the globe, and we've got in-house capability now that we've put in place in all of our regions. And I think the strength of the pipeline is what we now are seeing as a result of 2 or 3 years of hard work of building relationships and contacting customers. So I think the supply is not drying up, if anything. The supply is better than it's been ever, I would say. Prices have moved up. I mentioned that, I think, 6 months ago. It moved up, particularly in North America, and we reflected on that when we put our financial targets out at the interims, where we said, going forward, for Pest Control acquisitions in our growth markets, which would include North America, we changed our IRR target from 15%, where it had been before, to 13%. So we've reflected on the need to be competitive for assets by, saying, actually, provided we do what we do, deliver against the targets, 13% IRR is a very, very respectable return. So for me, I think any other point I'd make on M&A is, this is a very -- it's a very well-articulated plan within our company. This is not a random activity. We go after the companies that we want to go after, the cities that we want to target, the management teams that we want to join us, the brands that we think would sit well within our business, the quality of operations and the price points. So I will state that not all acquisition targets are created equal out there, and one of the things I'd like to think we do well is to select the best businesses. And sometimes, the best businesses come at the slightly higher price. On the preferred supplier agreement, I'd say we've had good relationships with both companies for quite some time. We've been a good supplier to Sodexo for quite a while. That one, that agreement, might fit more your description more formalizing of an existing relationship. The one with ISS, whilst ISS has been a customer of ours around the globe, that is a new step forward. That is ISS have has placed 2 preferred supplier agreements for pest control, 1 with us and 1 with another company, and we are hopeful over the next 2 or 3 years that we can see really good increase in revenue from that customer arrangement. So the thing with global preferred supplier agreements, very often, winning them is sometimes the easy way. Then you have to go and sell in each country against the framework agreement. So I guess, I'd say, particularly on the ISS one, the hard work starts now. All of our country teams are now focused on calling on the local customers and introducing themselves, using the preferred supplier agreement to open the door.

Katharine Rycroft
Head of Investor Relations

A question on behalf of Sylvia Barker from Deutsche Bank. How much operating profit from known M&A will flow through into 2018?

Jeremy Townsend
CFO & Executive Director

From 20 -- okay. So we've spent GBP 280 million on M&A in '17. The areas, I guess, to focus on of GBP 100 million in the U.S., where I've been just saying to Jane, I think as we drive the synergies out to those deals, do we get the profit from those pieces. We don't tend to disclose the absolute profit, but what we're looking for is double-digit returns in year 2 of the deliveries. So as we get -- as those annualize, we'll be looking for 10%, 12% returns on that investment, and then the other one is PCI. That's more of a growth-driven model. So the profit is coming through from PCI, coming through will help drive profit. I guess, overall, Katharine, what the M&A drives is the 10% profit guidance, so it forms part of that build, and it's part of the model to drive the 10% profit growth. So while I wouldn't want to disclose the profit overall on the acquisitions, not least because some of those we're still looking to get clearance on, the overall number, I think, will depend on our 10% guidance for the year. So I think that's probably the best way of putting it in terms of the leverage we're going to get from that investment.

Katharine Rycroft
Head of Investor Relations

Thanks, Jeremy, and 3 questions also from Allen Wells at Exane on European margins in Cannon. European margins were down 130 basis points year-on-year. Is it possible to split this between French workwear, the LatAm impact and any other moving parts? And taking these in turn, would you expect these to get better or worse in 2018? With Cannon, it looks like it's a 6% margin business, well below RTO's hygiene margins. Do you have a view on potential synergies or target margins would be? Or is there any reason why they can't move up to group levels? And finally, with Cannon again, is there any overlap with the assets placed into the JV? If so, how do you plan to manage competition here?

Andrew M. Ransom
CEO & Executive Director

I'll do turns for you, if you like.

Jeremy Townsend
CFO & Executive Director

Yes. So the overall driver is the French workwear. You can see that in the figures in terms of the decline in profitability in France. As you said, we're looking to get France into profitable growth by the end of 2018, so we would be expecting margin improvements overall in France and in Europe. There is a mix effect in LatAm, so LatAm is similar to Asia and North America as far as it's a growth market. Margins there tend to be near 10%. And as LatAm grows more quickly, there's a slight negative impact from the mix effect, but margins are improving in Latin America. So over time, that should work its way through. So we would expect margin improvements in Europe overall. The other impact is going to be the Hygiene business that we bought from CWS-boco in Italy. It's about EUR 40 million. That's a very low-margin business, and that will have a mixed impact on an annualized basis, but again, we're very confident of getting those margins up by the time we get to 2019. So there's a bit of M&A mix in there, Katharine, but overall, margins should be improving in Europe as we get France into profitable growth by the end of the year.

Andrew M. Ransom
CEO & Executive Director

The second question related on Jeremy's touched on a little bit. The second question related to the Cannon acquisition, is there any reason why we can't get the margins in that business up to group margins for Hygiene. The simple answer is no. There is no reason. It's a little hard work between the 2 points, but there's absolutely no reason. The Cannon Hygiene business is a business model that we recognize. It looks similar to our business model. And as I've talked many times, the way you create margins in the route-based businesses that we operate is all about local density, so where the combination of those assets gives us local city density, we would drive margins up accordingly. So the short answer is absolutely no reason why we won't get the Cannon margins up. That will take a little time. We have to do a lot of changes and a lot of route planning and a lot of moving parts in that operational focus that I talked about a few minutes ago, but no reason why we shouldn't get them up. Third question was, is there any overlap? And answer is no. No overlap at all. Sometimes, you get lucky, don't you? But the footprint of the Cannon operations were not overlapping with the footprint of the joint venture. So absolutely no complexity coming out of that.

Daniel James Hobden
Crédit Suisse AG, Research Division

Dan Hobden, Credit Suisse. Just 3, if I may. With respect to the North American targets, can you just confirm that they're for the whole business, and not just pest control? Staying in the U.S., how much of that U.S. revenue and margin target is organic as opposed to the level of M&A assumption? And then final one, maybe a topical one, given the weather, what sort of impact do you think the weather is going to be having on your Q1 trade in? You have 3 pest in the U.S., U.K. and Europe.

Andrew M. Ransom
CEO & Executive Director

Sorry. We've got the crystal ball out, but -- so the first question, in terms of the GBP 1.5 billion, 18%, now that's the whole of the North American business. Obviously, we've got different businesses within North America operating at different margin points. So to land at least 18% margins for the whole North America business, that means the Pest Control margins will have to be above 20%, and then you've got some -- you got the Ambius business and you got the Products and Brand Standards business, but that is the North American target as a whole. The split between organic and M&A is -- that will be what it will be to a certain extent. We're growing 4.5%, 5%, 6% North America. I think -- I'm on the record of saying I think we can do better than that in terms of organics, but we have to do it. So I think that 5%, give or take, plus or minus, is a reasonable number. 6% is a reasonable number for organics over the next few years in North America. And then the balance will come from M&A. If we get a lot of M&A targets coming along quickly, then we're going to get there sooner by definition. And then if we have a few fallow quarters, as they happen from time to time, it will take a bit longer. But I think it's a pretty good target. We got the entire North American business team very, very focused on this GBP 1.5 billion, 18%. And as I mentioned earlier, I think the pipeline at the moment is pretty good. So absolutely no reason why we won't deliver that. Third question?

Daniel James Hobden
Crédit Suisse AG, Research Division

Weather.

Andrew M. Ransom
CEO & Executive Director

Weather. Well, I don't think -- it depends how long this goes on for here. I don't think it will have a material bearing here in the U.K. but well, the forecast looks chilly for the next few days. When the weather is really a whiteout conditions, and clearly, we can't get our vans on the road to service customers. So what we will typically do is try and catch that up. And if we can catch it up in the quarter, typically, you won't see much impact at all. We might have to pay a bit more over time to get there, but typically, that will be fine. If some of that catch up has fallen to early Q2, then you might see a little bit of sort of difference between Q1, Q2. But I'll be -- at this stage, I'll be surprised if we could see it, let alone anyone else externally looking. So I don't even think it will be material. At this stage, North America and other markets, no reason at all to believe. I think we had a couple of whiteout days, but you would always, in this time of year, get a couple of whiteout days. So Jeremy, unless we have a different view?

Jeremy Townsend
CFO & Executive Director

That's right. We did have a season in America 3 or 4 years ago, where it was absolutely freezing cold, which affected the whole book pattern, and that's very different. There's a polar vortex, but it's been nothing that cold. I think it has been the weather impacts '17 into '18. Q4, there was certainly some impact from the hurricanes and the bad weather in -- particularly in the southeast and the eastern seaboard, which explains some of the Q4 versus Q3 performance, which again, will give us a comp in Q4 next year in 2018 in terms of the comparative. So that's had a bigger impact, I think, than any of the weather we've had in Q1. So...

Katharine Rycroft
Head of Investor Relations

A question from Josh Masser of Morgan Stanley. Looking at that American impact from the weather, with North America organic growth, what would growth have been ex the impact from Puerto Rico?

Andrew M. Ransom
CEO & Executive Director

Well, I was hoping the Eft was going to answer that one. I left that one [indiscernible]. I think it would probably be another 0.5 percentage point on growth.

Jeremy Townsend
CFO & Executive Director

Yes. I think if you look at North America, Q3, Q4, you'd probably say half of the difference roughly would be down to the weather in terms of performance. Q4 as well is a relatively soft month versus Q3 because Q3 is the more seasonal pest month. So you tend to get more growth in the -- Q3. It's difficult to identify Puerto Rico. We also have a big contract with CDC around Zika that's coming to an end, or worse coming to an end when the hurricane hit. But yes, it's probably about -- that only says about 0.5% or so.

Matija Gergolet
Goldman Sachs Group Inc., Research Division

Matija Gergolet from Goldman Sachs. I think on France, on your target of bringing that -- the Workwear business back to profitable growth, could you share with us what was the profitability, say, last year at the EBIT level? And what do you exactly mean by no profitable growth? I mean, on one hand, you say that the macro -- you expect the macro to get to be improving, but no -- so is your kind of, say, improvement based on the macro? Or can you be a bit more, say, specific on your targets there at least?

Andrew M. Ransom
CEO & Executive Director

Well, as far as what does -- what do I mean when I say profitable growth, I mean, revenue growing and profit growing. At the moment this year, we've got revenue back into growth, but profit still went backwards. So the ambition is to see the top line growing and the bottom line growing. That's what we mean by profitable growth. And yes, I think it's a number of things. Why are we saying that? I think number one, no particular order. I think the confidence level in the French economy, post Macron, is more positive. And Workwear business is much more correlated to employment than it is to GDP. And employment is correlated to confidence, so we see business confidence improving in France. Therefore, we see more jobs, more shifts being put on. So we see the market for workwear gently improving, which we haven't seen for some time. We have exited some unprofitable or breakeven operations. The Workwear label that we use covers a number of things. It principally covers workwear and flat linen. Flat linen into health care, hospitals, et cetera, is a really tough sector. Everywhere in the world, it's a tough sector. So we took the step to move outs of the weakest parts of the operations, which was most of our flat linen into [indiscernible]. So that was a positive move. We've got a new head of French business, who's been in now for about a year, and he's very energetic, dynamic individual. And I do think that the competitive rivalry feels less intensive in the French marketplace, and that's a difficult one to judge. That's more of a gut feeling. But the level of noise coming out of our French team seems to be at the lower decibel count than previously in terms of our challenging the competitive situation. So that combination, put that together, executed well, we believe, will get us back to the position. By the end of the year, we'll be able to point to revenues moving up and profit moving up. I said at the half year. I don't think this will be easy. This is a big lift for the organization, but I'm really, really encouraged by what I'm seeing in France and our team and the overall performance, and we've started '18 well on that journey. So we'll see how we go, but that's my answer. Hopefully, that answers your question.

Jeremy Townsend
CFO & Executive Director

In terms of numbers, France was down about 7% or about GBP 3 million, and that's predominantly due to the workwear business. So that's the quantum of what we're looking to manage.

Katharine Rycroft
Head of Investor Relations

Question from Chris Bamberry of Peel Hunt. With the strength of the U.S. economy, what level of wage inflation are you experiencing there, and how are you mitigating this?

Jeremy Townsend
CFO & Executive Director

The U.S. economy is a massive economy, and there are all types of pockets around the country. Some of the economies, some of the state employment is very strong, and we're seeing some wage inflation. Other parts of economy, less strong and less challenges. I think around the group, we face issue the same way. Looking to pay people the right amount, looking to retain people, using both pay and other recognition measures to retain people, as Andy described in the an employer of choice piece. I think we'd say, overall, wage inflation in the U.S. of around about 2% to 3%, and what we look to do is maintain margins through efficiency and pricing to make sure that overall margins are maintained. So I don't think it's the biggest issue we've got in terms of employment. There are other strong economies, parts of Australia, parts of Europe, parts of the U.K, where employment is equally full, and we take the same approach around the group, making sure we do everything we can to retain our people through the employer of choice, and paying around the inflation level.

Andrew M. Ransom
CEO & Executive Director

And just to give a practical example of sort of the detail that we go to on this because it is, as I said, in my little piece, it is, I think, arguably, strategically, the most important thing for business services company to get its people strategy right. Every one of our markets, we now monitor how many people apply for every single job. We now monitor how many days it takes to fill a vacancy. Those are just 2 examples. So this is an area that we believe, that if you could be really, really good at this, that's the way to combat the fact that there are generally fewer people looking for the vacancies that are out there. So it's a combination, as Jeremy said, but being really focused, having a plan, executing the plan. We do a lot on variable pay as well as fixed pay to give people the opportunity to make more money for those people that want to make more money. Not everyone wants to work overtime, and not everyone wants to put in extra hours, but some do. So we keep our pay schemes very flexible, and that tends to work for us. So it's an area that all companies need to be focused on. We got on this earlier than most, I would say. And I think we're making good progress.

Katharine Rycroft
Head of Investor Relations

Question from the Sylvia Barker of Deutsche. How much you should we think about Hygiene organic growth in the first quarter of 2018 and onwards?

Andrew M. Ransom
CEO & Executive Director

Sylvia, you're asking more questions by not being in the room than when you're in the room. So Hygiene organic growth rates, generally, what I've said and I've said many times, and I think hygiene business is broadly GDP-correlated. In '16, I think we delivered 4%, which was a very much a top performance, top performance that we've delivered in a very long time. Last year, we delivered just over 2%. I think 2% to 3% is the general range. I think our average GDP rating across our markets is somewhere like 2.5%, 2.4%, 2.6%, I think, at the moment. So overall, I would imagine that our Hygiene business will be in 2% plus, but some of that will depend on specific market factors. I'm not going to comment on Q1. But generally, I would say, over the next 2, 3 years, it should be GDP there or thereabouts. I have no doubt we'll outperform in some quarters and we'll probably underperform, potentially, depending on specific factors. But I will confirm, I think the Hygiene business is in very good shape, got a great operation. It is all about operational execution. It's a very, very detail-oriented business, so you have to get it right in every single branch in every single country every single day. That's why I keep talking about operational excellence. The variables, I think, for 2018 we've bought a lovely business in Italy, CWS business, but that is going to take a little bit of time to turn that around. And we've got -- assuming we get the approvement from the CMA, we've got some heavy lifting to do in the U.K. business. And sometimes, when you integrate assets, that puts a little bit of a drag on organics because very often, when you do an acquisition for the first year or 2, you see, you tend to see a little bit higher level of customer attrition than you would if you've been looking after that customer yourself for the last 10 years. So no real guidance on Q1, but the Hygiene business is in very good shape. Its customer retention is up this year nicely, and I think it's a great business.

James Peter Winckler
Jefferies LLC, Research Division

Jim of Jefferies. Just wondering if you have a comment on Terminix the other day came out shifting the next strategy towards commercial pest control in the U.S., specifically with the acquisition of Copesan. Just wondering if you have a comment on how you guys plan on addressing that, and if you're doing anything proactively to kind of address that competitive aspect?

Andrew M. Ransom
CEO & Executive Director

Thanks. Not specifically. I mean, one of the great things about business is you've always got competitors, and you always will have competitors. Terminix is a good heritage large pest control company that has built its franchise predominantly on termite and residential and has a new management team, and a new strategy, publicly stated, as you say, to be more focused on commercial. I respect all of our competitors, and we'll see what they do with that. But simply stating that they're going to focus more on commercial is one thing. Actually being effective in achieving it is another thing. And I won't really comment on the Copesan deal, other than to say I think that will be an interesting deal to integrate. I think that will be. Good luck to them is what I will say.

Katharine Rycroft
Head of Investor Relations

Two further questions, please, from Rajesh Kumar at HSBC. Can you give us some split of the pest control organic growth between pricing volumes? And secondly, what sort of medium-term organic drop through margins are reasonable expectations?

Jeremy Townsend
CFO & Executive Director

So yes, in terms of price tends to be market-related. We look to get inflation around the group, so roughly 2% to 2.5%, I'd say, of the Pest Control organic growth is price related. And again, we just talked about the wage inflation in the U.S that U.S. is a bulk of the -- a big part of the Pest Control business, so that will be certainly true with the U.S. market. So it's about 2% to 2.5%, but with obviously good volume growth as well. In terms of drop through, we tend to aim for GBP 2 of profit for every GBP 1 of revenue growth. That's part of the model for driving the margin improvement, as we drive that revenue grow through. Clearly, that drives profit improvement. And it's inherent in our overall financial targets, 5% to 8% of revenue growth, with roughly 10% of profit growth. So that gives you an indication of the drop through. You tend to get a lag impact from M&A. You don't get that 2x until you're working through. That tends to be more in a 1:1 ratio. But in terms of organic growth, yes, it's about 2:1.

Unknown Analyst

One more question with regards to the U.S. There was no mention about, say, the recent tax changes in the U.S. in your presentation. Now should we assume that there is virtually no impact? Or is there any impact basically from the recent?

Jeremy Townsend
CFO & Executive Director

I did mention it briefly in cash tax. So just very high level, the effective tax rate comes down, but because some of the limitations on deductibles, our cash tax rate goes up slightly, roundabout GBP 4 million to GBP 5 million or so. That's part of the cash tax guidance that leaves us from the GBP 40 million in 2017 to the GBP 45 million to GBP 50 million in 2018. Part of that is a more profitable group, and about GBP 4 million to GBP 5 million of it is U.S. cash tax.

Unknown Analyst

And reported tax, there is no change?

Jeremy Townsend
CFO & Executive Director

It's broadly equal. It's -- effective rate is 22.5%. So it is not that far in line with the U.S. corporation tax.

Andrew M. Ransom
CEO & Executive Director

I'm not sure...

Jeremy Townsend
CFO & Executive Director

No more questions from Sylvia?

Katharine Rycroft
Head of Investor Relations

No more questions.

Andrew M. Ransom
CEO & Executive Director

I think we'll stay in, in the other [indiscernible]. If there are no other questions, thank you very much, ladies and gentlemen. See you in a few months’ time.

Jeremy Townsend
CFO & Executive Director
Thank you.