

Compass Half Year Results

Presentation

Dominic Blakemore

Chief Executive

Good morning and thank you for joining us. We have a busy agenda today. I'll begin by making a few comments on the highlights of the half. Johnny will then take you through the financials and I'll come back for a more detailed review of our operating performance and our strategy going forward. There will be plenty of time for questions and answers at the end.

I'm pleased to report that Compass had another strong half. Organic revenue was up by 4.8% and excluding the impact of Easter and weather, our growth was 5.3%. Our operating margin was 7.5%. We've taken significant cost actions to address inflationary pressures in the UK with benefits to come in the second half. The business continues to be very cash generative, with free cash flow of £465 million in the first half. EPS on a constant currency basis was up by 10% and we're proposing to increase the interim dividend by the same amount. The business is trading well and our full year expectations are unchanged and on that positive note, I'd like to hand over to Johnny.

Johnny Thomson

Group Finance Director

Thank you, Dominic, and good morning everyone. So let's start by taking a look at revenue. The recent strength of sterling against our other trading currencies had a negative impact of £700 million on 2017 half year revenues. North America grew by 7.3%. Growth was broad-based across all sectors. New business was excellent and retention was also very strong at 97%. Europe grew by 0.5%. Performance in Q2 was impacted by the timing of Easter and adverse weather conditions in the UK, France and Germany. Mid-single digit growth in the UK was mostly offset by subdued trading across Continental Europe. Rest of world grew by 3.4%. Strong performances in Turkey, China, India and Spanish-speaking Latin America drove growth of 5.3%. Our commodity business declined by 1.7%, better than expected at this stage, due to the delayed transition from construction to production in Australia.

As a result of these movements, Group organic revenue grew by 4.8% in the first half. If we exclude the impact of the timing of Easter and bad weather, we estimate growth would have been 5.3%. FX reduced operating profit by £57 million. Growth in absolute operating profit of £44 million and £10 million in North America and rest of world respectively was offset by a £21 million decline in Europe. Associates and lower overheads added £5 million, resulting in a 4.5% increase in constant currency operating profit.

Margins in North America remained high at 8.5% as a continued focus on pricing and efficiencies offset labour headwinds and the impact of snowstorms in Quarter 2. At these exciting top line growth rates, we expect margins for the full year to be unchanged. In Europe, inflation and cost of change actions in the UK and the impact of the weather across the region diluted margins by 80 basis points in the half. The benefits of the cost actions in the UK will come through in the second half, however margins for the region will still decline year-on-year.

Margins in rest of world improved by 40 basis points. We are leveraging our overheads better in growth markets such as Turkey and continue to see benefits from the restructuring we did a few years ago in markets like Australia. We expect margin progression for the full year to be similar. The mixed benefit of higher margins in North America and the excellent improvement in rest of world, combined with Group overhead leverage, mostly offset the decline in Europe, resulting in an operating margin decline for the Group of 10 basis points in the half as anticipated, and we continue to expect modest margin progression for the full year.

As you know, FX has a translation impact only for Compass. The strengthening of sterling has a negative translation impact of £57 million on operating profit. To give you a sensitivity, a 1% move in sterling against all of our trading currencies would change full year 2017 operating profit by around £15 million. If current spot rates continue through 2018, FX would negatively impact profit by £90 million. Further details regarding FX sensitivities can be found in the supplementary slides.

So let's take a look at the bottom of the income statement in more detail. Net finance costs were £55 million, slightly above last year due to the interest on additional debt to fund the special dividend. We continue to expect net finance costs for the full year to be around £120 million. As a result of the changes in tax legislation in the US and as announced in January, our tax rate was 24% in the half. This remains our expectation for the full year, although we note that the tax environment continues to be uncertain. Constant currency EPS grew by 10%, boosted by last year's share consolidation and this year's tax benefit. In line with our policy, we are proposing to increase the half year dividend by the same amount.

Moving on now to cash flow. Depreciation and amortisation increased slightly to £244 million due to our investments in CapEx. Gross capital expenditure was 3.5% of revenue as planned, reflecting the investment in the LA Dodgers contract in the first half. We expect full year CapEx to be between 3% and 3.5% and we will continue to use CapEx as a tool to support strong growth rates with high returns. Dominic will talk a bit more about our future CapEx expectations in a second. Working capital was a £27 million outflow. For the full year, we continue to expect working capital to be an inflow of around £40 million, as the impact of the extra payroll in 2016 in the UK and US reverses. Operating cash was marginally down due to FX movements.

Positively, we have absorbed the investments in the Dodgers to deliver operating cash conversation in line with last year.

Post-employment benefits were unchanged year-on-year and we expect the full year payments to be around £15 million. Net interest was higher due to the additional debt to fund the £1 billion special dividend. The cash tax rate reduced to 18.5% due to the usual timing differences in the first half and the lower US tax rates. For the full year, we expect the rate to be between 19% and 22%. Excluding the impact of FX, absolute free cash flow would have been in line with last year. Free cash flow conversation was 53% and we expect full year cash conversion to be back within our target range of 55% to 60%.

Looking at the balance sheet, and again starting on the left of the chart, opening net debt was £3.4 billion and the business generated cash of £834 million before CapEx. We invested £369 million in CapEx to support our long term growth, while net acquisitions totalled £318 million. The acquisition of Unidine completed on 31 December 2017 and we're excited about the contribution this business will make to our senior living sector. We returned £353 million to shareholders in the form of ordinary dividends. FX and other items reduced net debt by £87 million and so on 31 March 2018, net debt to EBITDA was 1.6 times as we continue to deleverage following the additional debt to fund the special dividend.

As usual, I've pulled together some of the key 2018 full year assumptions on one page as reference for your modelling and in conclusion, we're pleased with the first half. The business is performing as expected and we continue to grow organic revenue strongly, have industry leading margins, invest in the business and grow dividends in line with constant currency EPS. Now back to Dominic.

Dominic Blakemore

Chief Executive

Thanks Johnny. I'm really pleased with our revenue performance in the half. We continue to see good new business wins across the Group. Retention is strong at nearly [95%] (sic - see slide 19 of presentation, 'c.97%') and like for like revenues reflect sensible pricing.

Let's look at the performance of each of the regions in turn. Starting with North America, which had another very strong half. Our organic revenue grew by 7.3%, with good growth in B&I, healthcare, vending and sports and leisure and retention was particularly strong at 97%. Margins remained at 8.5%, despite the strong growth rates and the above average labour cost pressures. I'm really pleased with the balance of our North American business amongst the different sectors. We aren't over or under exposed to any particular sector, which I believe allows us to drive sustainable growth.

This is enhanced by our strategy of sectorisation and sub-sectorisation, which allows us to really focus on the different client requirements and ensure we have a tailored offer to meet our clients' needs. Essentially, sub-sectorisation makes us more like a regional player, but with the cost advantage of being a big one. A great example of this is Northwestern University and the Kellogg Business School. It's a significant

account on a campus with 25,000 students that we've recently won as a result of our differentiated offer. It's a great example of how subsectors drive growth independently, but can also combine to maximum effect on these bigger accounts. Chartwells is providing the core higher ed offer, Levy is arranging food services for the athletics facilities, FLIK will oversee dining and retail at the Kellogg Business School, Canteen offers the latest technology in vending and unattended mini-markets to the students and Bon Appétit is assisting with the culinary and sustainability offer.

And our sources of growth in North America have been remarkably stable over time, with about a third of our growth coming from first time outsourcing, a third from small regional players and a third coming from the larger players. And pleasingly, our pipeline reflects this shape as we look forward as well.

So we've developed a successful model for consistent, long term growth in North America. We sectorised and sub-sectorised the business, differentiating the offer and unlocking exciting market opportunities. We use our scale in food costs and overheads and most importantly, we have the right culture and people. These ingredients, combined with a dynamic outsourcing market, make me very optimistic about the future of our North American business.

In Europe, the picture is mixed. Good growth in the UK driven by new business in B&I and healthcare continues to be offset by a more subdued performance on the continent. As expected, margins were down due to the inflationary pressures we saw in the UK. We are taking actions to address this, including labour efficiency programs, intensifying our pricing conversations with clients and increasing our purchasing savings and we fully expect the benefits of these actions to come through in the second half.

Although the outsourcing environment on the continent is not as dynamic as it is in the UK, we're taking actions to improve our growth prospects in the region. We've begun to sub-sectorise our largest markets. In France, we're launching a new premium B&I brand and in Germany, we've made three small acquisitions - Kanne Café, a retail health sector specialist with revenues of around £30 million, and Royal Business and Leonardi, two premium B&I brands with combined revenues of around £30 million. We now have a small Continental European leadership team and the seven business units we talked to you about before are now fully in place. So we can now start to leverage our regional and sub-regional scale. For example, we've increased our Continental European procurement and the savings are now starting to come through.

I am pleased with the improving performance in our rest of the world region, where organic revenue was up by 3.5% (sic - see slide 26 in presentation, '3.4%'). Strong growth in Turkey, India, China and the Spanish speaking Latin American countries was offset by continued weakness in our commodity business in Australia. Margins improved by 40 basis points as we continue to see the benefit from the restructuring we did a few years ago coming through.

And so in summary, North America continues to perform very strongly. In Europe, the UK is driving the growth and we are taking actions to strengthen our prospects on the continent and performance in the rest of the world is improving. For the full year, we expect continued strong organic revenue growth and modest margin improvement.

So moving on to strategy. Compass has delivered an excellent performance over the last decade. We focused on food services, where we can truly differentiate our product

and use the cost advantage of our scale. We've taken a very limited approach to support services, which we mainly do in our defence, offshore and remote sector and in healthcare in North America and in some of our bigger markets around the world. We're selective in terms of acquisition, have avoided large deals, focusing on small bolt-ons which improve our capability in a sector or a sub-sector. And last but not least, we focus on great execution with a real emphasis on quality and innovation.

Our organic revenue growth has been between 4% and 6% and we've continued to improve margins modestly, whilst achieving a strong return on capital employed. This model generates significant amounts of cash, which we've either reinvested in the business or return to shareholders. Given the success of our strategy of focus on food, we're really excited about the market opportunity we see in food services. We're the global market leader, and yet we only have a 10% share. There's a structural growth opportunity from the 75% of the market that is currently serviced by small regional players or in-house providers that don't have the cost advantage of our scale.

And I believe we've developed significant competitive advantage. We deliver strong and disciplined organic revenue growth. This is mainly due to our decentralised structure and our strategy of sectorisation and sub-sectorisation. This has given us unique scale in purchasing and overheads, particularly in North America. We have great people, a strong talent pipeline and a clear culture of performance and accountability. I believe that this ability to grow and use our scale gives us an advantage that is very hard to replicate.

We've always adapted to changing circumstances. Inflation is returning and we are facing increasing competition for labour and at the same time, our consumers are becoming more demanding and there's an increased focus on the social and environmental impact we have as a business. Over the years, we've remained flexible and reacted swiftly to changes and I'm committed that that should continue to be the case. We're not complacent and we're increasing our intensity around the three Ps of performance, people and purpose. We'll continue to drive our performance with an even greater focus on operational execution in our core food business. We need to attract, retain and develop the very best people in our industry, and we'll integrate our community, social and environmental purpose into the Group's day-to-day operational strategy.

Historically, we've taken a relatively informal approach to sharing best practice. This means that we have often ourselves unnecessarily reinventing the wheel in a number of our markets. I want this to change. We'll create a small, core central team of experts to identify and roll out best practice in a more systematic and disciplined way, with greater emphasis on common technology platforms. This will save us the cost of funding similar initiatives across the Group whilst increasing the commitment and accountability of our markets and ensuring consistency and speed of execution.

We already drive performance using our management and performance framework, MAP. It's the way we run the business. We will double down on MAP and there are four areas that we'll execute with more intensity and greater sharing of best practice. In MAP 1, our approach to sectorisation and sub-sectorisation, continuously improving our core offer with an emphasis on quality and innovation. In MAPs 1 and 2 our approach to pricing and in an inflationary environment, we need to improve our capabilities in this area. In MAP 3, our approach to food costs. I want us to be more consistent in terms of our core food purchasing processes and systems across the

Group. And in MAPS 4 and 5, our approach to labour, whether it's in unit or overheads. We will be more productive and efficient in managing our biggest cost item.

To manage our workforce more effectively, we'll invest in systems to improve time and attendance and the use of overtime, agency and temporary labour. We need to remove unproductive work, simplifying our processes and being more intelligent in how we design our work activities. Technology, such as cashless and cashier-less solutions and apps that allow consumers to pre-order and pre-pay all help improve productivity. And finally, we'll improve our hiring, on-boarding and back office processes to leverage our overhead costs across the Group more effectively.

To continue to drive our performance, we also need to tighten our portfolio of businesses. Targeted and disciplined bolt-on acquisitions strengthen our capabilities. M&A is a really important way to support our organic growth potential. It has also proven to be an extraordinary source of talent over the years. We're also looking at disposals to simplify the portfolio and we'll consider them based on potential, be that market growth, scalability or our own market position and capabilities.

People are at the centre of our business and we will increase our focus on our teams going forward. We're leveraging our position as an attractive employer with a great culture to attract the right people, retain and engage them with initiatives such as better on-boarding, provide more training and better career development with access to both technical and professional qualifications, and we'll have succession plans much deeper within the operational workforce. We currently employ around 600,000 people, with women accounting for around 55% of our total workforce. However, amongst our top 400 leaders, the male to female ratio is 70:30. Our target is for women to be at least 40% of the leadership team, with an ambition of parity over time.

And finally, we have purpose and corporate responsibility. We have four areas of focus which we've aligned to the seven United Nations sustainability goals, where we believe we can make the most impact. For example, on 27 April we held our second Stop Food Waste Day, where 30 countries held activities to increase awareness and reduce waste in our units, at home and throughout the supply chain, communicating directly with up to 10 million consumers on a single day. We've made great progress in the past few years, and we're developing our purpose to articulate better our ongoing contribution to society.

Bringing all of this together, the current model and excellent past performance is sustainable. This is a clear strategy of continuity and consistency, but the priorities I outlined will allow us to adapt to an ever-changing environment. We aim to deliver between 4% and 6% organic revenue growth with modest margin improvement. We'll grow the ordinary dividend in line with constant currency earnings. CapEx will be up to 3.5% of revenues as we continue to invest in attractive opportunities across the Group. And we'll do bolt-on M&A to strengthen our capabilities whilst exiting non-core businesses that dilute management focus, returning any surplus cash to shareholders whilst keeping net debt to EBITDA at around 1.5 times.

And so in summary, we will focus on food. We're increasing our intensity around MAP and the systematic rollout of best practices and technology. We're reviewing the portfolio to strengthen our capability and simplify the business. We're attracting and

retaining the very best talent and we'll integrate our social and environmental ambitions into our strategy and day-to-day operations. I believe we're very well placed to generate sustainable long term shareholder value.

Thank you for your time this morning and now we'll take your questions.

Q&A Session

Dominic Blakemore

So we could just ask you for - ask you for your name and then we'll take calls on the line later in the meeting. [You're going first]. Vicki.

Vicki Stern - Barclays

Morning. It's Vicki Stern from Barclays. Three questions. Just firstly, you touched on disposals. Just any more detail as to what those might look like, either - is that sort of regions you're talking about, segments, are they - their profitability, anything that you can call out there? Secondly, just on the return in investor capital on that incremental CapEx, so I think you're sort of willing to go up to around 3.5% of sales. How does the return look like on that CapEx and how does that perhaps vary by region? And finally just on the acquisitions, is the plan still very much bolt-ons or would you consider any larger acquisitions? Thanks.

Dominic Blakemore

Okay, I take the questions on disposals and acquisitions and then I'll hand the [rogue] question over to Johnny. First of all in terms of disposals, I think we set out this morning the criteria by which we'll review the portfolio. It's very much whether we've got a strong market position, whether we believe we can growth those businesses in line with the organic growth rate of the Group and also whether we have the management capabilities and strengths to operate those service lines and sub-sectors.

I think in the round, we estimate that we're considering around 5% of the total revenues of the Group. At this point, we would expect them to be pretty much neutral to both growth and margin, but I think what's really important is it will allow us to really redouble our efforts on the core of the business and therefore drive the performance priorities that you've heard me talk about this morning. We think that that [tale] is distracting to management, particularly where it's outside of the core food services.

In terms of acquisitions, it remains - our preference remains bolt-on M&A, not the larger deals. Again it's very much about building out our offer in the core sectors within the core markets. We are excited by potentials within food, but they'll still sit within that bolt-on criteria that you've seen us do before.

Johnny Thomson

Yes, just on return capital, Vicki, I guess the first thing to say is that our financial model is unchanged. We still expect to see 4% to 6% organic revenue growth. We still

expect to see some modest margin improvement over time. So that remains unchanged. I think the CapEx, up to 3.5% is at the margins in small, incremental, when it comes to return on capital. It really just gives us the extra space to invest where - in the opportunities as they arise such as the LA Dodgers. We may not spend 3.5% every time, but it just gives us that little bit of space. So we're comfortable that we can maintain at least these high levels of return in capital into the future.

Just in terms of the regional split and that, as we've said in the past and I would expect to continue, a larger proportion of our capital goes into the North American business where of course we see some of the exciting opportunities coming through. A lower proportion of our capital goes into the rest of the world business, principally because for cultural reasons, they consume less CapEx. That's it.

Dominic Blakemore

I think the point is we won't constrain ourselves where we see opportunity in either CapEx or M&A.

Harry Martin - Bernstein

Hi, I'm Harry Martin from Bernstein. Just firstly on the sharpening of the focus on food, is there anything that's materially changed in your view of support services and what is it about the North American healthcare market that makes support services there attractive? Then secondly on Europe margins, given the comments about re-leveraging scale there but also cost headwinds, can you just give a bit more colour on where you see the margin trajectory over the next few years and then is there any update on food buy in Europe?

Dominic Blakemore

Okay, if I take the first couple and then Johnny will deal with margins and Europe food buy. In terms of the sharpening of focus, look, this isn't about exiting support services as a Group. We have a compelling multi-service offer in defence, offshore remote and also within healthcare. I think we are at our best when we focus on food, but within those sectors I think we have all of the capability to be able to deliver a compelling offer, and this isn't just about North American healthcare. We have the same model within the UK and within another - within other of our rest of the world operations. It's typically at its most successful where you have a captive community on a scale asset for prolonged periods of time where it's not just about managing the services. The services and the broad suite of services are all valued and it's also about the ability to manage labour to those locations. So we think that those attributes make it a successful model that we've built out.

We're less [inaudible] towards support services where it's single line, particularly in B&I and we'll certainly be looking at those as part of our review.

Johnny Thomson

And just on the margin question, for Europe particularly we've taken fairly firm robust action in the UK as I talked about in the presentation and we're confident that the UK and the European margins will rebound nicely in the second half of the year. In terms of looking further forward, we still expect margins in Europe to move forward. We've got plenty of opportunities. We're doing further work on the business units. We are -

to your point on procurement, we are increasingly consolidating, albeit from a small base, our procurement across the European continent. It will never be to quite the same level that we can do in the US for obvious reasons. It's not as homogenous a market, but we are starting to increase the volume purchases.

In time, I would expect that food buy may become a greater consideration, but for the moment, it's really about core basics and procurement in Europe.

[Dominic Blakemore]

Any more questions? Jeffrey.

Jeffrey Harwood - Stifel

So Jeffrey Harwood from Stifel. Two questions. First of all, can you touch on the pipeline of new business? And secondly on the disposals, obviously in absolute terms quite a big figure here. Should we expect a series of piecemeal disposals or could there be a sort of block transaction?

Dominic Blakemore

Just tackling the question on new business first, I think our pipeline looking forward very much reflects the growth levels that you've seen us deliver in the last several years and the first half of this year. The pipeline in North America is vibrant. We're growing as a Group at 8.5% and the pipeline supports that. The pipeline in - of new business in Europe is similar. So I think we feel we're in good shape on the pipeline. I think if anything in terms of our net new performance, the area of improvement that we're looking to drive further is our retention levels in Continental Europe.

And then just in terms of disposals, I think we feel 5% is a modest number. It's likely to be piecemeal. It's likely to take 12 to 24 months to transact and so we'll keep you updated as we go.

Angus [Tweedie] - Merrill Lynch

It's Angus from Merrill Lynch. Can I ask firstly on North American organic growth, can you help quantify the impact of weather that you saw in the second quarter and give us any sort of idea of the run rate growth year-to-date? And then secondly on the CapEx, can you discuss which industries it's going into and I mean is this going into education, given we saw very strong retention rates there but not necessarily good new business wins in the last quarter?

Johnny Thomson

Yes. Just on the first point, the North American growth rate in Quarter 2 was 6.3%. The impact of Easter and weather was about a percentage point, obviously taking you up to 7.3%. So I guess the 8.2% that we reported in the first half as we discussed in January was perhaps a little generous because we had some one-off sports and leisure events. So I guess the answer for a run rate is somewhere in the middle, which is why we retain our full year expectations of 7.5% for North America.

And just on the CapEx point, you know, we look at opportunities across all sectors and all sub-sectors and so we're pretty open-minded about that. I would say that in general, higher education and sports and leisure can be a little bit more CapEx

intensive and therefore we're clearly disciplined about how we review those with the appropriate return on capital triggers. We are increasingly, however, putting CapEx into other opportunities too and the Canteen business and the success of that business and how we've invested in rolling out the network would be a good example of that. So there's plenty of opportunities.

Dominic Blakemore

I think your point is right. CapEx is very helpful at aiding retention. It tends to increase the average contract longevity. So it's very helpful for us.

Okay, if there's no more questions on the floor, we'll move to the Sky. So any questions over the conference call line?

Operator

(Operator instructions)

Dominic Blakemore

Okay, I think that's it. So thank you all very much for joining us. Thank you for your time today.

[End]