**Company:** **The Compass Group Holdings PLC**

**Conference Title:** **Compass Group PLC IFRS 15 Conference Call**

**Moderator:** **Hannah Bhangu**

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Operator: Welcome to Compass group's IFRS 15 Conference Call. Hosting today's call is Laura Carr, Group Financial Controller, and Sandra Moura, Head of Investor Relations and Corporate Affairs. A link to the slides related to this call can be found on the investor relations section of our website, www.compass-group.com. Following the presentation, you will have the opportunity to ask questions. If you'd like to ask a question, please press star one on your touchtone telephone. If you are using a speakerphone, please release the mute function to allow the signal to reach our equipment. Today's call is being recorded.

I will now turn the call over to Laura Carr, please go ahead.

Linda Carr: Thank you and good afternoon everyone. Thank you very much for dialling in today to hear about how the adoption of the new revenue standard IFRS 15 will have a very minimal impact on Compass Group. My name is Laura Carr and I am the Group Financial Controller here at Compass. We plan to give you a brief overview of the expected impact of the new standard and then open the call for any questions that you may have.

Before we get into the new standard, we thought it may be helpful to go back to basics and remind you of our business model and how we generate revenue. Compass is primarily a food service provider. We generate revenue by providing food service to our clients. Additionally, we provide cleaning and other soft support services. Revenue is recognised when the services performed, or when the goods, i.e. food, drinks or meals, are sold to either the client or directly to the consumer. We've a given a couple of examples here in the slides. When we perform food services for our client, we typically bill them on a monthly basis. In a fixed price contract, revenue is calculated as the number of meals served that month times the agreed fixed price of the meal.

In a management fee contract, we would invoice them the value of the cost incurred that month plus an agreed management fee. We also generate revenue directly from consumers. So we may have a P&L contract with a local hospital, where we operate a coffee shop. In this example, the revenue is generated as we sell food and drinks to consumers at the coffee shop. It is important to note, that we do not have any long-term contract accounting, and so we do not make any judgements or estimates regarding a level of completion of a service, in order to recognise revenue.

Compass makes investments in clients where the returns are attractive. These investments are typically capitalised and amortised over the life of the client contract. Some examples of client investments include purchasing equipment to enable us to provide our services at the client's site, such as ovens or catering equipment in the kitchen. Or we may pay clients to gain exclusive access to their consumers, for example at a sport stadium. And sometimes we pay a client a signing-on bonus to secure a contract. Currently, client investments are reported as either property, plant and equipment, PP&E, contract and tangibles or pre-payments, depending on their nature. As you'll see from the slides that follow, under IFRS 15, Compass will make some balance sheet reclassifications of clients' investments, to provide more meaningful disclosure of the investments that we make.

The new revenue standard IFRS 15 will apply to Compass for the FY19 financial year. In summary, IFRS 15 will not have a significant impact on the timing and recognition of revenue for Compass. Given that we have a simple business model, we already follow simple revenue recognition principles, and we do not use long-term contract accounting. We will discuss the impact on each line item on the next couple of slides, but the key headlines are that we expect absolute revenue will be reduced by less than 0.5%. Absolute profit will be increased by a minor amount, and therefore margin will increase modestly.

When we release the financials on an IFRS 15 basis in FY19, we will restate the comparatives for FY18 and therefore, as a result, there will be no impact on our key performance indicators of organic revenue growth and margin progression, assuming all other things remain equal.  Therefore our guidance and outlook remain unchanged by IFRS 15.

As I already mentioned, we will also reclassify some of our client investments on the balance sheet. This mainly relates to the creation of a new balance sheet category, called, "Contract fulfilment assets."  And finally, given that this an accounting change only, there is no impact on net cash or free cash flow.

We will now run through the line items where IFRS 15 has an impact on the financial statements. Firstly, please note that these numbers are FY18 estimates, and have not been finalised, nor have they been audited.  We will report the final numbers in our interim results next year.  So looking at the income statement, revenue will be very slightly reduced, we estimate by less than 0.5% as some amounts that were previously treated as an expense, will now be deducted from revenue. Operating profit, will increase slightly by circa 0.3%, as we will now be required by IFRS 15 to capitalise salesforce commissions.

The P&L impact will be the timing difference between the previous practice of expensing these costs as incurred, compared to capitalising and amortising them over the life of the contract.  As a result of these small changes to revenue and profit, our absolute margin will increase by around four basis points.  I would just like to reiterate again, that when we report under IFRS 15, the comparatives will also be adjusted in the same way, so we do not expect any impact to our key KPIs as organic revenue growth or margin progression if all things – other things are equal.

And finally EBITDA will also increase slightly as the sales commissions are no longer expensed and EBITDA will not include the amortisation charged from those commissions.

Moving onto the balance sheet. The main change in IFRS 15 will be a reclassification of client investments and the creation of a new category called, "Contract fulfilment assets." We estimate this reclassification will move approximately £800 million out of intangibles and into contract fulfilment assets. The prior year balance sheet will also be reclassified to enable comparability.

There will be a new contract-related asset on the balance sheet, as we are required to capitalise salesforce commissions. These costs were previously expensed as incurred. We estimate this brought-forward asset, to be approximately £40 million and the related deferred tax liability to be around £10 million. As a result of the capitalisation of these sales commissions, we expect overall net assets to increase by less than 2%.

Finally, we expect the IFRS 15 will have a less than 10 basis points impact on our return on capital employed measure. This is due to a slight increase in NOPAT and a small increase in average capital employed, both as a result of the capitalisation of sales commissions. As the comparative will be also be restated, there'll be no impact to rocky progression.

To clarify the timeline for the implementation of the new standard, we will apply IFRS 15 for our year ending 30th September, 2019, and we will then restate our FY18 results retrospectively, to provide comparable data. We will not restate any prior history. When we report our full year results for FY18 this November, the financial statements and investor presentation will include an updated quantification of the expected impact of IFRS 15 on FY18. In May next year, at our FY19 interim results, the accounts will be presented in an IFRS 15 basis for the first time, with the restated comparatives for 2018. And then in November 2019 when we present our full year results, again, those will be on an IFRS 15 basis, with the FY18 comparatives restated.

Hopefully that very brief overview has clarified that IFRS 15 will not have a material impact on Compass. We look forward to giving you more details in the FY18 financial results in November, but in the meantime, we'd like to open the call now for any questions that you may have. Thank you.

Operator: We will now take a question from Jamie Rollo of Morgan Stanley, please go ahead.

Jamie Rollo: Yeah, hi there. Afternoon everyone. I'm just wondering, what – I mean as you say it's not really important, this has no impact on cash, why are you going to the trouble of reclassifying the intangible assets then?

Laura Carr: I think – because IFRS 15 has the ability to allow you to capitalise assets related to a contract, it just makes sense to us to use that categorisation. So I mean, nothing's changed fundamentally, as you said, but it is an appropriate category for us. So contract fulfilment assets really defines exactly what those assets are.

Jamie Rollo: Okay, but you could have reclassified them before? It's not like you were prevented from doing that before IFRS 15, were you?

Laura Carr: Well, no, it's not. There's no change ultimately. It's just the IFRS 15 has specifically got the wording, which says that you can capitalise costs incurred to fulfil a contract. So we think those particular words are very applicable to us. You're right, it doesn't change the balance sheet, it's just a categorisation.

Jamie Rollo: Okay, obviously, it would have quite a big EBITDA impact, but I mean, not that that matters so much, but you’re not – but it wasn't – you're not concerned about the potential impact that it would've had to EBITDA then?

Laura Carr: Well no, I don't think it would have any impact to EBITDA. It's just a balance sheet classification between intangibles and contract fulfilment assets.

Jamie Rollo: Right. I'm just thinking, because other companies that have done this, have generally moved – at the moment there's amortisation charges, there's intangibles, but the standard is suggesting that comes off revenue? So I think it would have been an EBITDA impact, but it was in – no EBIT or earnings impact impact.

Laura Carr: Okay, sorry. Yeah. No but the point is – the point –

Jamie Rollo: Okay, the other thing is – sorry.

Laura Carr: Sorry, the point is, Jamie, that I don't – the IFRS 15 is not changing our view that the monies that we invest in our clients are investments, and therefore should be amortising in expense. It's not a deduction of revenue. That's quite a key point.

Jamie Rollo: Okay. And just the other question was – is, and this obviously a slightly sort of arcane area, but I, or our accounting expert read the rules to suggest that you could only separate out that benefit, i.e. the client[?] investment, if it was sufficiently separable from the actual vendor product itself, the contract. And that in reality, you wouldn't pay an upfront bonus, for example, if you didn't expect to get economics from the contract with a customer. So how can these be separated into a separate category, if essentially they are part of the contract, they're part of the same thing, they wouldn't be done if there weren't a fee to be received on the contract?

Laura Carr: To your point, a contract fulfilment asset may be specifically for us to refurbish a restaurant at a client's site. It is pretty separable, and we feel that that asset then will allow us to generate the revenues from the contract over the period of the life. So that's why we feel that we can capitalise it and then we spread those costs over the life of the contract.

Jamie Rollo: But using that example, you wouldn't do the refurbishment and spend the money if you weren't going to get a return back on that and therefore the – it's inseparable from a contract itself, isn't it? Or else you wouldn't be spending the money to begin with.

Laura Carr: Yeah, but I think the accounting is that we invest it and then it generates revenue throughout the life of the contract. So it feels appropriate then to capitalise it. It will be clearly visible on the balance sheet as a contract fulfilment asset, and then that'll be amortised over the life of the contract, where we generate the return.

Jamie Rollo: Okay. Thank you very much.

Laura Carr: Thanks Jamie.

Operator: Again, ladies and gentlemen, if you wish to ask a question, please press star one on your touchtone keypad. We will now take another question. We'll take a question from Tim Ramskill from Credit Suisse, please go ahead.

Tim Ramskill: Thanks, good afternoon. Just one question from me really. So again, on the same topic of client investments, as Jamie mentioned, as other companies did it with – in a different way, including Sodexo, your closest peer. So just to be clear, do you have – excuse me, did you have any choice in how you go about accounting for it? Could you have taken that write-off – that effectively – that DNA charge to that client investment as a deduction to revenues or did you feel that wasn't a possible option for you?

Laura Carr: Hi Tim. So I think the IFRS 15, for us hasn't changed the way that we view our accounting, and I think that's the key message that we're trying to bring today. So it's not a question of choice. We feel that we're creating an asset when we invest in our clients, and they will capitalise today on a non-IFRS 15 basis and will continue the same treatment in the future on an IFRS 15 basis. So I think – I appreciate your referencing differences to our competitors, but I think we're different today, and we're very comfortable with our view today that we are creating an asset that should be amortised over the life of the contract. Does that answer your question?

Tim Ramskill: Okay. I think so, yeah. I just look at the way that – [inaudible] my understanding is correct, the way that they account for it, does a couple of things. One, it means that the CAPEX to sales numbers that they tend to quote are understated relative to yourselves, which I think is misunderstood by a lot of investors. So it's sort of an important consideration. And then, they do ultimately capitalise it, but the amortisation of that asset – or the depreciation if you like – of that asset is taken as a deduction to revenues. So it kind of just ends up where – you just end up with a situation where we've got some different treatment going on by two very – otherwise very similar companies.

Laura Carr: Yeah, and obviously we don't – we won't – wouldn't comment on their accounting policy and so we – the purpose of this call is to really reassure you that our treatment is consistent with how we do things. So obviously, if we did do what you were just referring to, we'd have a lower revenue number and our absolute margin percentage would be higher. But I think we're really comfortable with how we do it today and the good news for us is, as we've done a very deep dive in IFRS 15 and reviewed everything, that all the current treatments remain valid. So the only real change in policy is the capitalisation of salesforce commissions, which is not a choice under IFRS 15.

Tim Ramskill: Okay, fine. And then – sorry, just one very quick one, and I suspect the answer is no, but in terms of sort of H1, H2, is there anything within any of what you've sort of unearthed thus far that suggest that there's a seasonality to any of these effects that mean that we might see a sort of modest impact on a full-year basis, but there might be any skew in terms of H1?

Laura Carr: I don't – there's nothing that I know at the moment, and as soon as – if we did think that there was an impact, we'd get back to you, but that'll probably be in November. I don't think there should be.

Tim Ramskill: Okay, no, great. Thank you.

Laura Carr: Thank you.

Operator: We will now take another question from Jaafar Mestari from Exane.

Jaafar Mestari: Hi, good afternoon. Just have a quick question on that total £800 million of asset reclassification. Could you maybe talk to the geographical breakdown of those assets? And as a separate point, the end markets breakdown, with some of your verticals are particularly subject to that. So I'm thinking about sports and leisure in particular. Thank you.

Laura Carr: Yes, I mean, just, as you can see in our segmental analysis that we already provide, a big chunk of that £800 million will obviously be in North America, where the sort of contract structures that we have, do lend themselves to client investments. And in terms of sort of sectors, I don't think we give that breakdown, but obviously there are higher sort of CAPEX investments in healthcare and education, as you'd probably imagine.

Jaafar Mestari: Thank you.

Laura Carr: And sports and leisure.

Jaafar Mestari: Thanks.

Laura Carr: Thanks.

Operator: We will now take another question from Najet El Kassir from Berenberg Bank.

Najet El Kassir: Good afternoon everyone. Just in regarding the equity, will this change in accounting would impact your equity, or not really?

Laura Carr: No, not really. Only the salesforce commission piece. So the net assets change is less than 2%, but it's a very minor amount.

Najet El Kassir: Okay. Thank you very much.

Laura Carr: Thank you.

Operator: We will now take another question from Jarrod Castle from UBS.

Jarrod Castle: Thanks. Just on the contract assets, the circa £40 million, on average, what will the amortisation period be? And then just secondly on salesforce commission, in absolute terms, how stable is that amount and how much will you be capitalising each year? Thanks.

Laura Carr: Thanks. I mean, I think the £40 million should be capitalised over our average contract length, which I think we say is about three to five years. It's a relatively stable number, and it's obviously very small as we're highlighting today is – it's the brought forward net book value, is £40 million.

Jarrod Castle: And relative to that amortisation – so let's say it's four years, £10 million in terms of further salesforce commissions, is that roughly the run rate? I mean, is that number – do we expect that number is pretty stable after amortisation or moves around a lot?

Laura Carr: It should be relatively stable, and don't forget the timing difference in the P&L on adoption is actually the difference between expensing and capitalising and amortising. So the P&L impact on transition is smaller than the ongoing amortisation rate.

Jarrod Castle: Okay. Thank you.

Laura Carr: Thank you.

Operator: We will now take another question from Jamie Rollo from Morgan Stanley. Please go ahead.

Jamie Rollo: Oh yes, one more – thanks, one more if I may? What's the – so the £800 million again, to get back on that, what's the P&L amortisation charge associated with that please?

Laura Carr: I'm just trying to think. I mean, the total amortisation I think of all contracts and tangibles, is that that £193 million last year, off the top of my head. So it's a big chunk of that, I think. I'll have to get back to you, Jamie, on exact number, sorry. But it's obviously, it's – of the contract –

Jamie Rollo: But it's not changing though? Yeah – sorry.

Laura Carr: No change – sorry. There's no change to how we amortise them. It's just literally a balance sheet categorisation change.

Jamie Rollo: Okay. And if I look at that £800 million number, which I think is equivalent to the – I think it was £900 million a year ago in the 2017 accounts, that's the sort of other client contracts, intangibles, i.e. not the one [inaudible] in acquisition, but historic cost of that was about £1.6 billion?

Laura Carr: Yeah.

Jamie Rollo: As you say the amortisation charge, I think it was a couple of hundred million. So [inaudible] for eight year, useful economic life, that is longer than a three to five years average contract length. Can you just talk a bit about how that works? Obviously you're signing up pretty long term contracts with higher ed and sports and leisure, but to get the average of eight years, that just seems quite the high side, doesn't it?

Laura Carr: Yeah. No, you're right. I think a three to five is sort of the global average of contracts, and you're exactly right that as we invest in the areas, particularly North America, in those higher ed and education contracts, they are longer and therefore that's where the CAPEX is. So the average useful economic life is higher in those investments.

Jamie Rollo: Okay. But to get an average of eight, you're obviously signing some at 15, 20 years?

Laura Carr: Exactly. Yeah.

Jamie Rollo: Okay. Thank you.

Laura Carr: And you can see from the North American sort of wins that we announce, that they are very big contracts and very – yeah.

Jamie Rollo: Thank you.

Laura Carr: Great, thanks.

Operator: We'll take another question from Richard Clarke of Bernstein, please go ahead.

Richard Clarke: Hi, good afternoon. Just on the salesforce commissions, so ₤40 million capitalise, we're talking roughly ₤10 million a year, maybe slightly more. So that's about 0.5% of your new business wins per year. Is that a good way to think about it? Is that sort of the run rate of commissions you're paying? And then the variability by geographies where you've said the US has a slightly bigger margin impact, is that because you pay more commissions in the US, than you do in other geographies?

Laura Carr: I think – I mean, the overall picture – it's a very small number. They do tend to skew towards the US, and I mean, I haven't really thought about it on a new business percentage win, but yeah, so if it's ₤10 million a year, it's a very small number.

Speaker: And also remember there's an element of salesforce commissions that's paid in year two or year, three depending on the performance of the contract.

Richard Clarke: Okay, thanks.

Operator: Again ladies and gentlemen, if you wish to ask a question at this time, please press star one on your telephone keypad. We will now take another question from Tim Barrett from Numis.

Tim Barrett: Oh hi there. Sorry if I missed this, but did you say exactly what you're netting off revenue now? So what that 50 basis points reduction in revenue relates to? Thanks.

Laura Carr: I don't think you did miss it, and so we're saying it's up to about 50 basis points. So, fundamentally nothing's changed under IFRS 15, but as we've done a very detailed review through the adoption process, building up contract by contract, there are some payments to clients that we feel we do not receive a distinct good or service in return. So under IFRS 15, we've cleaned that up and there will now be a deduction off revenue.

Tim Barrett: Okay, and that's about £100 million?

Laura Carr: It's definitely less than 0.5%. So I've given myself a bit of wiggle room till November, but it's less than – yeah, it's not – it's going to be less than that.

Tim Barrett: Okay. And you said that's stuff you didn't feel you were getting a return on?

Laura Carr: No, not a return. It's just that the – if you look at the IFRS 15 lens[?], you have to be very clear that you'll receive a distinct good or service in return for that payment. And I think there's some areas that we just wanted to be very prudent. So we've taken the decision to deduct them from revenue, but it's very minor if you think about the size of our revenues.

Tim Barrett: Sure. All right, thanks.

Operator: There are no more questions in the telephone queue at this time.

Speaker: Thanks so much. If anyone else has any further questions, just give us a ring. Thanks for joining.

Laura Carr: Thank you.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation, you may now disconnect.