

Company: The Compass Group Holdings PLC

Conference Title: Compass Group PLC Full-Year Results

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Operator

Welcome to the Compass Group PLC full-year results question and answer session. Hosting today's call Dominic Blakemore, Chief Executive Officer. Following the opening remarks, you will have an opportunity to ask questions. In order to ask a question, please signal by pressing star one on your telephone keypad. Please be sure to unmute your line before doing so.

I will now turn the call over to Dominic Blakemore for opening remarks.

Dominic Blakemore

Thank you very much and good morning to everyone. As usual, I'm joined by Karen Witts, this morning, our CFO, to answer your questions on our 2020 results. Of course, no year is the same but 2020 has been a challenging one for Compass. Although we continue to live in uncertain times, we're entering the new fiscal year in good shape. We're controlling the controllable. We're evolving our strategy, adapting our operations and focusing on execution and improving the quality of the business so we can emerge from the pandemic stronger than we've ever been. Thank you. And now we're happy to take your questions.

Operator

And we'll now take our first question from Jamie Rollo of Morgan Stanley. Please go ahead.

Jamie Rollo

Thanks. Morning everyone, I've got three questions, please. You've helpfully given us the margin guidance for Q1 of 2.5% and you're saying you can get to 7% on a lower revenue basis than the company used to do. Just thinking about the path back to that 7%, should that be sort of fairly linear with the

revenue recovery, or are there any sort of bumps in the road we should be aware of? Sort of, also, what sort of loss of revenue should we think about to get back to that 7%? Is it 5%; is it 10%, for example?

Secondly, on the pre-recorded presentation, you're talking about 4–6% of revenues potentially being permanently lost to working from home and online learning. So it would just be helpful to run through the maths behind that calculation and also what the profit impact could be from that.

And then, just finally, dividend is mentioned quite a few times, keen to bring it back when appropriate. I mean, I'm not sure what appropriate means, so if we can have – sort of think about the boundaries of what might need to happen. And does it also mean that leverage needs to be below the sort of 1–1.5 or within the – the bounds of the 1–1.5 times new leverage target?

Thank you.

Dominic Blakemore

Thank you, Jamie and good morning. Let me tackle the margin question first and then maybe I'll ask Karen to add any more colour.

Look, we're really pleased to have guided this morning to 2.5% in the first quarter. So that's continued improvement over the final quarter of last year without really seeing any more volume growth. We broadly think the first quarter of the new financial year will have volumes down around a third against the prior year. So that really is about seeing the actions that we've already put in place coming through.

When we talk about getting to 7%, you know, obviously we've done our internal planning. We can see the levers that we can pull. We've taken significant actions around gross margins with menu standardisation, which allows us to rationalise our SKUs and suppliers and create value. We've talked a lot in the presentation today about labour flexibility, how we introduce that through the use of central kitchens, through labour pooling. And of course, Karen has shown you the action that we've already

taken on restructuring and will continue to take across both in-unit and our overheads. So, when we add all of that together, we can see a path to good margin recovery, which isn't predicated on full volume recovery but does, obviously, require us to see an improvement from where we are.

Will the margin recovery be linear? I think we're in too uncertain a world to really say that. Look, we've had the second wave impact and you know, we've taken that into account in our guidance in this quarter. Will we see another third wave impact in the New Year? Possibly. Will that slow us a little from what we could do? Potentially and that's why we feel, you know, unable to guide beyond the first quarter right now. And then, of course, on the positive side, if the vaccines kick in and give us a momentum into the second half of the year, potentially things could accelerate from there.

So, you know, I think it would be unwise of us to say it's linear. It would be unwise of us to guide too far out.

And of course the other part of this for us is that we have choices. So, you know, you have to remember, at the moment, we continue to have overhead invested in the business for recovery and for a bigger business; we have overhead within sports and leisure. We have costs within the vending business where we see much lower margins and of course, in a number of contracts, whilst we're recovering losses, we aren't effectively invoicing a margin on lower volumes. So all of those will come back over time too. And yes, that could be lumpy if we see sports and leisure open up in any meaningful way in the second half of the year. But what we have got is we've got confidence on the 7% and we've got confidence that, you know, we can take choices along the way, which will show our progress in getting there.

That was a full answer, Karen, I don't know if there's anything more you'd add to that.

Karen Witts

Nothing thanks, no.

Dominic Blakemore

Karen seems happy with that.

On the 4–6% of revenues, the first thing to say is you called it permanently lost. I wouldn't describe it as permanently lost. What we've attempted to do today is give you a sensible view on what the risk could be. So when I say how we size that, for everyone's benefit, our B&I business is 40% of the total. Around half of that is office-based business sub-sector. So, at the moment we've seen quite different trends in industry, which is predominantly manufacturing, where we have seen, clearly, a return to that working environment.

Within the office environment and particularly within major cities, you know, we see the potential greater risk of more permanent working-from-home trends. And again, just to give you a few data points on that, pre-COVID, you know, we think, on average, an employee in that sector was working one to one and a half days from home and it was on a quite unstructured basis, really, at the employee's choice rather than managed by the employer. The 4–6% assumes, broadly, that that will rise to two to two and a half days and therefore could be about a 25% impact on that 20% of our business.

And you know, I would say, I think the pendulum is swinging in both directions at the moment. At the beginning of the pandemic, we heard an awful lot about how effective it is using technology to work from home. We know that, for a lot of CEOs, that's attractive around cost containment and management. But what we're also hearing now is, you know, how important it is to be in the office for, you know, creativity, for teamworking, for projects, for coaching and development. We know there are cohorts of people out there who – for whom the home environment isn't great. You know, they either live in multi-tenanted houses or don't necessarily have the technology and are desperately missing the office environment. And you know, we conducted a survey through the pandemic of 23,000 employees of our clients in 25 countries and it was resounding that people, you know, want to have a balance between office and home that allows them to have access to teams, to coaching, to personal development. And of course, you know, we're also seeing a lot of the mental health concerns emerging as well. So we've – you know,

we've quantified it in both B&I and Higher Ed on the basis I just described at around a 4–6% risk. Could it be less? Quite possibly. And you know, we're working very, very hard to mitigate that as well, by looking at other revenue opportunities that we've talked about, with acquisitions like Feedr and EAT Club, which give us tech-enabled food service models into smaller businesses, as well as targeting other sectors.

So, you know, I think we've – we're being, you know, thoughtful and cautious on the risk but we're clearly taking all the actions you'd expect to mitigate that and actually take the opportunity.

And then, on the dividend point, let me just hand over to Karen.

Karen Witts

Thanks Dominic. Hello, Jamie. Well, on the dividend, we – you know, we recognise the importance of the dividend to our stakeholders and I hope you've heard from us already this morning that, you know, we are confident that we will, A, regain our margin position and B, from what Dominic has just said, that we don't believe that the pandemic has structurally damaged our business.

Also, we were very pleased that, you know, we said we said we'd get to break even in quarter four and we got to 0.6% positive margins and we've given you some guidance for Q1. But I would say we are very early in this recovery and also, from a leverage perspective, you know, yes we have reset our target, 1–1.5 times, but it is important to remember that our peak leverage is going to be in March 2021. The way the net debt to EBITDA ratio is calculated, it will take, you know, the full hit of the pandemic into that calculation. So I just feel that, you know, it is too early to say anything just now. You know, we will continue to update when we give you these trading updates.

Jamie Rollo

Thanks. Sorry, Dominic, can I just come back on the first question?

Dominic Blakemore

Sure.

Jamie Rollo

Could we look at it another way, such that margins, you're saying, would be above the 7.5% percent, if you get that full revenues, as you do expect to do? Is that what you're saying? Is that another way to look at it?

Dominic Blakemore

That's – I think you're possibly putting words in my mouth there, Jamie. You know, right now we're saying we see a path back to our historic level of margin. But what's really important is, look, we've learned a lot through this pandemic, haven't we?

You know, we've rationalised our menus to create value in purchasing. You know, we've introduced greater flexibility than we've ever had before. We've found new ways of being lean within our overhead. So, look, if the volumes do come back, we said we'd get back over 7% without the full volumes. If the volumes come back, is that a path to our historic level of margin? And are we creating opportunity for the future? We'd like to think so.

Jamie Rollo

Okay. Thanks.

Operator

Our next question comes from Bilal Aziz of UBS. Please go ahead.

Bilal Aziz

Good morning, everyone. Thank you very much for taking my questions. Just three quick ones from me, please.

Just thinking a bit ahead, how should we think about major moving pieces when we start to think about the margin drivers, particularly into the second half? I.e., is there anything structurally different with regards to the way we should be thinking about your conversion margins?

Secondly, with regards to first-time outsourcing, is there anything fundamentally different with the new contract wins you are now seeing, with regards to capital intensity or contract structure at this stage?

And finally, probably a bit early to comment on this but do you have any visibility or guidance for resizing costs you may need to incur right there in 2021? Or do you think you're done with the majority of that?

Thank you.

Dominic Blakemore

Thank you, Bilal. Thank you. Why don't I cover the first two and then Karen can update you on the resizing costs.

So, look, when it comes to the margin drivers, I'm not sure we're seeing anything dramatically different, as you would expect, within our operating model. But what we are seeing is, you know, as I described earlier, greater flexibility within our offer, creating value. That might sound a bit counterintuitive when I say we've rationalised menus but in order to provide digital technology, digital apps to our consumers, necessarily, we've had to have a more standardised menu and that creates value. So, now, that does create opportunity within gross margin for us from using the technology. We're also seeing, within labour, the opportunity to, again, using technology, have less front-of-house labour, or to redeploy it elsewhere, using the pooling of labour, having created new labour agreements but also offering our employees the opportunity to work across healthcare or education and B&I, in a given city, in a way that, perhaps, they haven't done before. That allows us to have greater labour flexibility, less reliance on agency costs, so does that give us a marginal opportunity in in-unit labour? Yes.

And clearly you've seen today, you know, we've taken a run rate, £70 million, out of our above-unit overheads. In pre-COVID terms, that would be as much as 25 or 30bps of margin. So, you know, we'd like to think that we can drive towards a sort of lower – a lower-cost overhead base as well and only put that overhead back where it's really creating value or is necessitated by a volume recovery.

So I'm not sure that we see different margin drivers but I think it's an evolution of the existing P&L, as it were. But in a very, you know, exciting way.

And then, just in terms of first-time outsourcing. I mean, we're really excited by, you know, the book of business that we signed in the last eight months. It's been across all sectors. Obviously some of that hasn't yet opened up and will mobilise, you know, as we get the other side of lockdowns and hopefully into a vaccine-led world.

So, you know, that has been good. You know, what we're seeing is, you know, we're still deploying capital. We believe it's a competitive advantage. We using it in slightly different sectors. So we're seeing a bit more demand in healthcare than there's been before. And that first-time outsourcing is really – you know, if you think, post-financial-crisis, it was it was cost-led. I think we're now seeing it capability-led. This is about institutions having suppliers they can trust that are resilience and reliable in their supply chain but also can really help lead them on health and safety and you know, the learnings we've had from this will apply in healthcare and education for years to come. And we truly believe that we offer that. So, you know, there's an exciting pipeline. There's good opportunities, there's incomings but we do believe that using capital again, as we've done before, will differentiate us in that space.

Then over to Karen for the resizing guidance.

Karen Witts

Okay. So let's just put the resizing into a bit of context. Any resizing that we do depends on combination of factors. One is the speed at which volumes come back. The second is the levels of government

support that might be in place which are there to help protect jobs. And the third is labour legislation and the flexibility of the labour legislation. So, back in Q3, we announced some early resizing and that early resizing was in the US and Latin America and that's where the labour legislation more easily allowed you to restructure.

We've announced a bit more now, in this update and that is more focused on Europe. We're – the objective with this resizing is really to do two things. I've alluded to the government support and that government support, we received more than £400 million of it in FY2020, but it has been tailing off from its peak. So, in order not to carry excess cost, we've got to make sure that our labour patterns and our return to work mirrors what's happening with labour legislation.

So the resizing that we've announced focuses on the combination of MAP 4 costs, which is primarily going to be cost avoidance and MAP 5 cost, which is primarily our overhead, our management layer costs, where I announced the £122 million charge for the restructuring and that will avoid £280 million of MAP 4 costs and £70 million of the MAP 5 and that £70 million is going to be one of the important building blocks for getting our margin back to the place that we want to get it to.

If we have to do more right-sizing going forward, then we will do that. But that really is going to be dependent on how quickly or slowly the volumes come back and the extent to which we are still receiving government support and that's a bit of a moving target. The governments themselves are changing their view quite frequently.

Bilal Aziz

Brilliant. Thank you. Just a very quick follow-up please. Do you see any material impact in the US minimum wages going up to \$15 for your business in the next year, please?

Dominic Blakemore

Sorry, was the question do we gain from it?

Bilal Aziz

Yeah, your broader margin impact from that.

Dominic Blakemore

Sure. I mean, we obviously need to recover the increase of any minimum wage or living wage inflation and we'll typically do that through negotiation with our clients or through driving further efficiency. It's always been a balance of the two. Typically we seek to protect our margin on, you know, any higher revenues from those actions.

Bilal Aziz

Thank you very much.

Operator

Our next question comes from Vicki Stern of Barclays. Please go ahead.

Vicki Stern

Hi, morning. Just, firstly, coming back on the net new business wins, I mean, historically you were doing around 3% net new a year and obviously you talked quite positively today about the signings, particularly in North America and the strong pipeline. You know, looking through the next 12 months, I appreciate the slower mobilisation point but just can you talk about your view on whether you can get back to that sort of 3% plus level that you saw previously on net new?

Coming back on remote learning, you gave some more details on the work-from-home assumptions that are part of that 4–6% structural change. Could you just flesh out a little bit more what you're saying on remote learning and just sort of more broadly there, your view on the opportunity for new business wins in higher education? Is it as attractive a segment going forward are you likely to do as much there?

And then finally, on delivery, just overall, would you say COVID has been a positive or a negative catalyst for B2B delivery rollout to offices? My perception would have been that it's been a positive catalyst for that because we've got more, I suppose, demand for flexibility as work from home becomes more pronounced but you also talked about the incremental safety concerns and considerations for businesses allowing delivery in. Just overall, how do you see that for the market going forward? And do you think that offers much to your sort of mix in terms of where delivery can be in the next 2–3 years? How material will that be for you, do you think?

Dominic Blakemore

Vicki, thank you very much. Let me take net new business first. Yeah, look, you know, we've said today that the book of business we've signed in the second half was really positive. One thing I do want to call out is you'd have seen in our sector analysis today that healthcare grew on an annual basis and was back in growth in the fourth quarter. So, you know, despite – and clearly there's been, you know, a significant volume impact in that sector from, you know, the suspension of elective surgery. And so what's underlying that has been a very good net new business wins contribution in healthcare. And I think we're sort of leading the industry in that sector, which is a sector that we want to focus on as we look forward. So I think that's a great case study of where we see opportunity.

The pipeline looks good. We do believe there'll be an acceleration in first-time outsourcing. Those are the trends that have underpinned the 3% historically and therefore, you know, we absolutely believe that we can get back there. And finally, you know, we're seeing – we're seeing even, you know, as you strip everything back, I think a very resilient performance in the rest of world region. And you know, we continue to believe that we will do better in Europe over time. We saw, I think, the first blushes of that, pre-COVID and I think we're hopeful that we will see that with the strategic changes that we're making there.

When it comes to remote learning, look, you know, we've said how we've modelled it out. You know, I think what we're seeing is we're saying, you know, either, you know, remote learning – a hybrid model of

taught and remote but what we're seeing – and you know, I know the academic sector reasonably well now – I think there's a flight to quality within there as well, where remote is not just about students coming to a given campus but truly doing it remotely from other countries.

So I think you're going to see all sorts of trends within that sector. But, fundamentally, again, our research that we've done with students and with academics tells us that, you know, students want – they still want the full on-campus experience and therefore it will remain an exciting sector. And of course, you know, that particular consumer is most open to a digitally-enabled solution, which can be collected from different points on campus, which can be delivered to residents.

I think there's all sorts of options for us there. So I think it remains an exciting sector. Of course you've seen, you know, how tremendous these campuses can be for us in North America, where there is, you know, huge scale. There's lots of different audiences. You've got the academics, you've got the students, you've got the alumni, you've got the sporting events and I believe all of those things will remain true. And therefore we think it's an exciting sector to invest in as we look forward.

And then, lastly, on delivery, look, we've learned a lot. Very honestly, things have accelerated. You know, we made three acquisitions, two pre-COVID, one post. We couldn't have made those at a better time, if I'm brutally honest. SmartQ in India, a very small acquisition but we've got some phenomenal technologists there who developed an app called Time2Eat, which we've rolled out in ten countries through the pandemic and we'll continue to roll out, which allows you to pre-order, pre-pay, book a slot in the cafeteria, have your meal delivered to you, have a meal kit taken to you that you can take home for the evenings.

So I think we've learned an awful lot there from the technology acquisitions. We've acquired EAT Club on the west coast of the US. Now, you know, clearly their volumes are depressed right now, as most of the smaller tech companies are closed. But, pre-COVID, they had volumes of around 130 million. We've got circa 400 million, all in, in delivered food solutions in North America already.

And, you know, when we've built these sub-sectors, the way we've built vending, the way we've built office coffee, we've invested in them as a combination of CAPEX and M&A. We've grown them to scale and you know, that would be our hope and expectation of this form of delivery.

But we recognise the price point is different. You know, there's logistics and cost to deliver. You know, there may be challenging access to certain locations as we go forward. So, actually, we think, as the incumbent caterer, it gives us an advantage and I think it becomes a net positive for us now that we've got, you know, proper tested business models that we can roll forward.

Vicki Stern

Thank you. Just a follow up on that. You talked in the presentation earlier about, obviously, complexities alongside it and you've mentioned there are sort of different price points. Would you be confident that that business could get to sort of similar margins, above 7%? Or would that be a structurally lower business but still an attractive one to be in?

Dominic Blakemore

Yeah, look, I think all of our evidence tells us that we can get the margins to the right place because the cost base is different. You know, we can produce at scale in commissaries or central kitchens in a way that we can't on site. You know, the central kitchens don't need to be in, you know, high real estate locations. You know, we understand that the consumer is willing to pay, you know, a significant portion of the delivery cost to have the experience in the office and of a high quality. So I think there's ways and means for us to address those challenges.

Vicki Stern

Great. Thanks very much.

Operator

Our next question comes from James Ainley of Citi. Please go ahead.

James Ainley

Morning, everybody. Three questions from me as well, please. First one: can you give us a bit of colour on what universities are saying to you about their plans for a return to in-person teaching in January, if the vaccine [inaudible]?

Second, in your presentation, you mentioned DOR decline related to the macro environment and I would be interested just to get a bit of colour about what you're seeing there and should we expect that to continue into 2021? And then, finally, on net new business trends, coming – again, from the presentation, kind of notable that Europe is clearly lagging here. And I just want to hear your thoughts about action plans, post COVID, to, you know, improve that performance.

Thank you.

Dominic Blakemore

Thank you, James. So, look, when it comes to universities' return to teaching, I think, you know, it's quite frankly, all bets are off in the second term, or semester, right now. I think we're all – you know, I think every government is unveiling its sort of winter plans. You know, we're seeing greater lockdowns in the US and that may now change also, under a Democrat regime.

You know, what – we really are planning for, you know, very dull volumes in our second quarter, up to our half year and our margin actions are being taken almost independently and exclusively of our volume recurring. So I think, you know, the sort of –35%, you know, we've talked about across the piece in the quarters is really our planning assumption until we see the benefit of better testing, better vaccines, or vaccine, sorry and better weather. And you know, we hope to see those starting to kick in our second – second half of the financial year and particularly in the higher ed sector as well.

Sorry, the comments on DOR due to macro: we've seen a little bit of tightening in volume production but not a lot. And actually, you know, I had a call yesterday with our LATAM team and we're actually starting to see volumes picking up quite significantly there. So it's been a very resilient sector for us through the pandemic. We've won a lot of very good new business in that sector, in – as we called out today, in our – in a couple of our major markets and you know, we would benefit from, you know, any infrastructural investment that governments pursue as part of economic recoveries within that sector.

And of course, you know, that portfolio to us now is largely production and not construction. So it isn't a sector that runs off; it's a sector that benefits from increased head count driven by volume. And then, just on Europe, I think Europe has been our most impacted region because of its skew to B&I and that's shown up in volumes and in new business and also – and also retention.

So I think it's difficult to read the trends of the second half, particularly because we've seen probably the biggest slowdown in activity. In recent weeks, we've won some great new business in both the UK and continental Europe. We're excited about the pipeline. We've invested in our regional teams. We've worked very hard on having digital offers to deploy faster in those markets. So it's a combination of activities that we think will help us. And we also think, as we're seeing already in the UK, you know, governments will invest in public sectors, particularly around education and healthcare. And we think that that will be a net benefit to our exposure to those markets.

James Ainley

Thanks and just to follow up on that a minute, how long do you think it's going to take for the sort of net new business trend to improve it in continental Europe?

Dominic Blakemore

Look, it's very difficult to say, James, right now because we've got to navigate through the volume recovery first. But, look, you know, we'll keep updating you. We're very open to the question. We know we've got to do better in Europe and you know, we'll shine a light on it as we do these presentations.

James Ainley

Thank you.

Operator

Our next question comes from Richard Clarke from Bernstein. Please, go ahead.

Richard Clarke

Good morning. Thanks for taking my questions. Just the first one on the – coming back to the 4–6%. You mentioned in the presentation you'll be looking to mitigate that through new business wins. I just want to confirm what that means. Do you mean mitigating that to 2019 levels, or do you think you'll be able to mitigate back to where you would have been if it wasn't for the pandemic, i.e., there will be 4–6% new revenue streams that wouldn't have existed, positive new revenue streams that exist if it wasn't for the – if it wasn't because of the pandemic.

Second question, just following up on what Vicki said about the new – the net new wins this year, you mentioned the 5–7% is impacted. Any hint on what that number is on a more normalised level? So what did you kind of actually win in terms of normalised revenues in 2020?

And then just on the – sort of similar, you've given the CAPEX guidance, £350–400 million. I think, in the first half of 2019, you did £395 million, albeit I'm mixing net and gross up a little bit there. Should we therefore think about a similar amount of new wins in the first half of 2021 compared to the first half of 2019, or are there other components that take that CAPEX away from new wins?

Dominic Blakemore

Thank you, Richard. Let me then take the first two and then I'll hand over to Karen on CAPEX. If I may be so bold, your first question was definitely an analyst's question.

We are – you know, look, our first, second and third base is to restore this business to its scale and profitability of pre-COVID, taking into account, social distancing, recession, potentially, as well as the impact of B&I remote trends. So, you know, we're confident we can do that over time through the combination of factors that we've set out today. But, you know, we need to see how we travel, don't we? And when we talk about mitigating, I mean, look, it's a combination of factors, again.

In part, we believe that the delivery models that we are piloting access new markets to us. We've talked about, you know, SMEs or smaller companies who wouldn't previously have had cafeterias or rooms for kitchens; we can now access that with these models. It gives us alternative solutions for our existing clients which may allow us to drive footfall and volume within existing accounts.

So we're going to work very, very hard on the like-for-like component within B&I, as well as the new client base that we couldn't previously get to. And then, of course, you know, we've talked today about, you know, we want to increase our exposure to health care and education. We think we'll see more opportunity from first-time outsourcing. We're gearing ourselves up – sales teams up to focus on that. So it's going to be a combination of factors within B&I and across the sectors too.

And then our net new business, how impacted is it? Look, it depends on the mix of business and which sectors it's come from, but, broadly, you know, our second half volumes have been down you know, 35–40% and therefore, you know, second half new business has been depressed by at least that, if not more. You know, if you annualise that, it's about 20–25% and you know, would you gross up new business for that? I think those are maths and you know, directionally it tells us we – you know, on full volumes, we've done a lot better than the number that we reported today but we can't give you a precise value for that

because new business is calculated as volumes on site on a new contract over last year and some of our wins won't even have opened.

Karen, CAPEX?

Karen Witts

On the CAPEX – morning, Richard – the CAPEX guidance, in a way, is actually linked back to the high level of new business wins because that guidance of £350–400 million for the first half that we have given, we're seeing about 75% of that is already committed, so that means it relates to what we have won.

Now, clearly, there could be a little bit of variability on that number when it finally comes through because it will depend on where and when we mobilise those contracts.

Richard Clarke

Thanks. Maybe just a quick follow-up on the CAPEX. You mentioned that gross was 3.5% in 2020 – 3.7% and the net is 3.5%. So what's the difference there? What were you able to sell in 2020 to get you back to the 3.5%?

Karen Witts

I mean it's a very small number. It's just some reductions of assets – sales of assets but, you know, overall we stick within – you know, in a normal year, we would be – you know, we sit within the guidance of 3–3.5%. I think that, you know, we will have a – likely a smaller absolute number in 2021 but it is important to us that we invest in good contracts for growth.

Dominic Blakemore

Yeah. I mean it remains a very important part of our model. You know, we've tested ourselves on returns that we've achieved previously and we're – you know, we're confident that those returns are of the levels that we communicate and will continue to be so.

We have strong approval processes, post-audits and you know, look, if the opportunity comes in the pipeline, then we'd like to explore that opportunity, if it's a moment in time as part of – you know, if we go back to earlier questions, can we accelerate net new? You know, can we restore the business to pre-COVID levels? This is a really important part of the strategy.

Richard Clarke

Thanks very much.

Operator

Our next question comes from Leo Carrington of Credit Suisse. Please go ahead.

Leo Carrington

Thank you. Morning. Firstly, can I ask, on the central production units you mentioned and I guess Grab & Go as well, are the CPUs mostly to support vending and delivery, or are they also to, in a way, replace some of the traditional kitchens? And then, in vending itself, has there been any change in the competitive landscape in the US? Sodexo, I guess, mentioned vending at their capital markets day. And also, just looking back, why has Europe not been such a focus in the past, or not been such an opportunity in the past?

And then just a quick follow-up on new business again, sorry for the nth question but can you see from your pipeline if there's likely to be a wave of new business from first-time outsourcing as a consequence of the pandemic, then normalisation, or would you say it's actually a sustained step up in new business as the value of outsourcing has been proven through this period?

Dominic Blakemore

Thank you, Leo. Yeah, let me take the last question first. I think it's too early to say whether this is likely to be a sustained step up. What we do see is we see a robust pipeline and within that, a strong component of first-time outsourcing and we also see and hear a lot of incomings that we'd like to convert into sales opportunities. So I think, you know, we talked about, you know, we've seen the early signs of an acceleration. I think that's how we'd describe it. It's now up to us. You know, these things don't just happen. You know, I've said this before, after the financial crisis. We enjoyed real success in first-time outsourcing because we invested in sales teams, we invested in the proposition and we converted the mood of the moment and you know, that's up to us to do. And again, we will report how we progress on that to you.

When it comes to vending, yeah, we don't see a change in the landscape in North America at all. You know, vending has been a terrific part of our portfolio. Over the last five or six years, it's been growing double digit top and bottom line. And why? Because actually it was enabled by technology sooner than many other parts of our business. It benefited from cashless. It benefited from open vending. It benefited from cashierless vending. And what we're now focused on is, to really, you know, sort of touch into your CPU question, it's about having hot meal offers delivered into the vending solution that a consumer would typically expect to see of the quality of the high street. And we do that from central kitchens.

So, as we said today, we've got 70 around the world. They have been used for various different purposes. So, some would have been used for large-scale production to deliver into healthcare or schools. Some of them would be to produce hot meal solutions into vending. Others would be for the packaged snacks in vending.

You know, what we're seeking to do now is repurpose them so that it gives us all of the options across all sectors. And we have that network across all of our major markets. We've got them in France, Spain,

Germany, UK, US, Australia. So we're excited about the potential there. And of course, you know, if clients become sub-scale on site, then the economics work for us to use them. But it also gives us the opportunity to have a more relevant and more varied offer.

And then, just, I think your question was on vending in Europe. You know, we have invested in North America, we've built the network. We always had a vending business and you know, it actually – we actually struggled for a while, when there was a lot of price sensitivity, when, you know, the machines weren't able to accommodate all of the different SKUs that the consumer wanted, as consumer choices changed and you know, we've learned a lot through that. And you know, whilst we don't have that vending presence in our European business today, you know, we're looking at how we can provide that sort of offer to the consumer in different ways.

Leo Carrington

Thank you.

Operator

Our next question comes from Kean Marden of Jefferies.

Kean Marden

Morning, all. I have two. Apologies, Dominic, I think the first one you may characterise as an analyst-type question. So, if we – I appreciate you're slightly reluctant to think about incremental margins as the business recovers but would the mass be correct – if we look at the sort of revenue and margin narrative that you communicated today, it suggests something like a 25% margin on the sequential improvement in revenues, sort of H1 this year, on the second half of next year. And then a quick question for Karen, you mentioned earlier that, interestingly, your contract split was still a third, a third, a third. But I guess the characteristics of those contracts have changed quite a bit. And you sort of referenced this a little bit when you talked about putting some floors in place. So maybe if you could just sort of dwell on

those and potentially what reverts back to sort of prior contract norms as the post-COVID environment improves?

Dominic Blakemore

Yeah. Thank you for those questions. Just, look, I'll take the first one and then hand to Karen. On that incremental margin performance, I think what we have to remember is, you know, from quarter four to – well, first of all, quarter three to quarter four and then quarter four to quarter one guidance, we've probably only seen ten points of volume improvement.

So what you first get is the step change from the contract negotiations that we've entered into and the benefits of resizing, to the extent it's flowing into the P&L and isn't replacing government support for previously-furloughed roles, as such.

So you inevitably get step changes in our operating margin that won't be linear and therefore I don't think the 25% rule can apply. You know, if you think about it, we went through a very deep process through, you know, the depths of the pandemic to renegotiate all contracts. Now, in many instances, what we were doing there is agreeing with clients that we could invoice our losses.

You know, as we see the benefit of that, that gets us a step change in margin. When the volumes come back, we then need to have another conversation with our clients which says, you know, what's a fair margin on lower volumes and how do we get back to the old structures?

So, there's an awful lot going on there in how we build that margin that means it's not a linear and it's difficult to apply a rule of thumb to. But, you know, as you've heard us say today –

Kean Marden

Yes.

Dominic Blakemore

You know, we expect to make strong progress in the first quarter. I mean, to have gone from – you know, we're guiding to 2.5% – from –5% to 2.5% with only 10% of volume improvement, I think, really shows that – the strength of the actions and you know, we'll continue to work it from here.

Karen Witts

So I think – I think Dominic started to answer some of that question but let me just sort of continue with that. So, you're right, our contracts are still about a third, a third, a third and we actually like that portfolio but clearly, given the impact of the pandemic, we have to be able to open our business units profitably and we've had very great response from our clients in general. We have renegotiated pretty much everything that needed to be renegotiated and you know, we have got tens of thousands of contracts around the group, so the teams have done a phenomenal job here.

Some of the renegotiations will be of a temporary nature. Some will be more permanent. What we're making sure that we are doing, when we're signing new contracts, is make sure that we have got the robust kind of protections that we feel that we are going to need going forward. So, you know, we have always had CAPEX buy-back protections in our contracts but now we're working with clients to get the right kind of volume protections in place, too.

Kean Marden

Right, thank you, Karen.

Operator

Our next question comes from Tim Barrett of Numis.

Tim Barrett

Hi, morning everybody. Just one topic left on mine, I think. Can you talk a bit more about sports and leisure? I know it's only ten-ish percent but clearly a very profitable part of your business. The fact that

you haven't talked about it within the 4–6% of revenues, I guess, tells us you think there are no permanent changes but what are your clients telling you about resumption in sports and leisure and how do you feel about that longer term? Thanks very much.

Dominic Blakemore

Yeah. I feel quite positive about sports and leisure, if I may. I think it's – is it a – is it binary? I think the – you know, the advent of a vaccine would allow us to get back into stadia. Between now and then, I think we will see sort of bolder reopening plans, albeit at small – at lower levels. A lot of our business is done in hospitality, which is likely to open first. So I think that is a positive for us. And I think there's an incredible will, you know, publicly and privately to get these sorts of events back open for everyone to benefit from.

So I feel positive about it. We've been very deliberate in sports and leisure that we've kept – we believe we've got the best operators in the industry in the UK and the US and we've kept our management teams as intact as we possibly can because we believe being able to reopen is going to be quite challenging in the near term and we want to do it flawlessly to enhance our reputation. And we also believe that that would allow us to be a net winner over time.

So, you know, I hope we're not being naïve. I think the vaccine is important but I also believe that there's very strong will and a huge amount of pent-up demand, as, you know, we can all imagine.

Tim Barrett

Okay. And nothing assumed in the margin recovery in the first quarter, I guess, because you said it's pretty binary?

Dominic Blakemore

No, we've very much assumed the sports and leisure recovery in line with the slow recovery case we talked about back in May, which would see some activity in the second half.

Tim Barrett

Great, thanks Dominic.

Dominic Blakemore

Thank you. Thanks.

Operator

Ladies and gentlemen, this concludes our question and answer session for today. I would now like to turn the call back to Dominic Blakemore for any additional or closing comments.

Dominic Blakemore

I'd just like to say thank you all very much for your contributions this morning. We've got to know each other very well over the years and it's been a very challenging year for all of us. So we'd like to wish you, from Compass, a very peaceful and restful Christmas break.

We look forward to talking to you in the New Year and hopefully having some more positive updates and hopefully further news on the impact of a vaccine, positively, for our business.

Thank you.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.