Company: **The Compass Group Holdings PLC**

Conference Title: **Compass Group PLC Third Quarter Trading Update Call**

Speaker: **Dominic Blakemore**

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Operator:

Welcome to the Compass Group PLC third quarter trading update call. Hosting today's call is Dominic Blakemore, the group chief executive. I will now turn the call over to Dominic Blackmore for opening remarks.

Dominic Blakemore:

Thank you. Good morning, and thank you for dialing in. As usual, I'm joined by Karen, our CFO.

I'm sure you've read this morning's Q3 trading update. Before opening the call to questions, I'd like to say a few words on our performance and our outlook. In Q3, our revenues grew by 36.4%, lapping the first full quarter of COVID-impacted revenues. As anticipated, we saw a gradual improvement in B&I and education, whilst the more defensive sectors of healthcare and seniors and defense, offshore and remote continued to grow, now surpassing pre-COVID levels. Our sports and leisure business benefited significantly from higher attendance levels following an easing of restrictions in North America. The retention rate remained strong at 95.4% year to date, and we continue to see a flight to trust.

I'm pleased to say that the trends we reported at the half-year results continue, with around 50% of new business wins coming from first-time outsourcing. We win in contracts across all sectors and all regions, and we're particularly excited by the increased wins in Europe and in defensive sectors such as healthcare and education. Our operating margin increased by 80 basis points to 5% as we benefited from some operating leverage and ongoing cost management, which was partly offset by mobilization costs, inflationary pressures and reducing support.

Looking forward, we're delighted to be welcoming back consumers, and we're working with our clients to reopen and mobilize sites in line with the changing restrictions. As previously mentioned, September will be a key month in terms of reopening of education, sports and leisure and B&I, and as a result we expect to be trading at 80 to 85% of pre-COVID levels. In Q4, we also expect to improve our operating margin by a further 50 to 100 basis points, so between 5.5% and 6%.

So, in summary, revenues are improving across all regions, with two out of our five sectors now trading well above 2019 levels. Our retention rate is strong, and we continue to benefit from the acceleration in first-time outsourcing as well as market share gains. We continue to progress our margins across all regions, and we're firmly on track to rebuilding our operating margin above 7% before we return to pre-COVID volumes. Over the longer term, we're excited about the strong pipeline and the significant structural market opportunities globally. These opportunities, combined with innovation and a more efficient operating model, will help us emerge from the pandemic stronger than we've ever been and will allow us to further consolidate our position as the industry leader in food services. We'll update the market again on 21st September with a fourth quarter pre-close statement ahead of the full-year 2021 results on 23rd November. Thank you, and we're now very happy to take your questions.

Jamie Rollo:

Morning. Three questions, if I may. The Q4 sales guidance is a nice step up. I'm just wondering what you're factoring in for sort of Delta variant and some signs of delayed return to work. What sort of cushion there? Secondly, on the margin trajectory, you're reconfirming the return to pre-COVID margins before pre-COVID sales volumes, but I'm just sort of wondering, as we're getting closer to that, what is that threshold? I mean, clearly it's not at the 80, 85% of sales, but is it 90%? Is it 95%? And if it's not too early to talk about next year, given we're only a few months away, consensus is around a 6.5% margin. That probably seems a little bit low if you're coming out of Q4 at sort of six-ish percent. And then just one technical question. It'd be helpful to give us the percent of revenue that comes from sports and leisure by quarter in a – in a normal year, just so we can think about that sort of seasonal recovery that you've seen in Q3. Thank you.

Dominic Blakemore:

Thank you, Jamie. If I take the first two, and then, Karen, perhaps you can take the latter two. I think that's why we've given a range of 80 to 85%. I think, if sports and leisure comes back without any significant restrictions on the attendance levels – so, in line with the conversations that we're having with our clients – and that we see the scale of opening up that we anticipate within B&I and education – for example, you know, we would expect, as we've seen in the UK on school bubbles, that there will be greater attendance levels in schools and less need to isolate and close schools. We know that most higher ed institutions – UK, US and elsewhere – are planning a wider move back to in-person on-campus teaching. So there may be some volumes which are still held back by international students not being able to return. And within B&I we are expecting a pickup in volumes in September as we get beyond Labor Day and the northern hemisphere summer holidays.

So those are the assumptions which would see us at the higher end of the range we've given and should the Delta variant bite more significantly again here or in Europe, or in the US, then I think our view is that we would be at the – toward the lower end of that range. And I think that's how we've factored things in, Jamie.

In terms of the margin trajectory and the threshold, you know, we've deliberately strayed from that, and we'll continue to do so. We think there are a number of levers, positive and negative, of margin development. On the positive side, we've obviously got the operational and overhead leverage as the volumes come back, as well as the self-help that we continue to initiate and drive, and you'll see that we've still got some resizing costs to go in Europe in the fourth quarter. I think, on the sort of – the negative side of that equation, we've obviously got significant mobilization and net new is accelerating. Our new business is over 11% in the quarter. So we have got mobilization on new business and mobilization on reopening, and we will continue to incur those costs in quarters to come as we grow at the order of magnitude of 30%-plus organic.

The second is obviously the higher-than-average inflation. Inflation's running at sort of near double what we're used to. So, you know, we have to be able to mitigate as much of that as we can, as well as being sort of robust on pricing. And then of course the third element for us is that we've had significant support from clients and governments. You know, less of that now in the UK and US, more in Europe on the government side, which will run off through the final quarter of this year and the first quarter of next. And obviously the client support has been in different contract structures, which will revert. So I think, when we weigh all of that up, we expect to continue to make progress. We're not calling when we'll be at 7% and we're not calling at what volume levels that will be. As we get to November, I'm sure we'll be able to give you a clear review of that.

Karen, do you want to take the next year view and also the sports and leisure?

Karen Witts:

Yeah, will do, Dominic.. In fact, Jamie, I think Dominic has actually picked up quite a lot of what I would say around next year. I mean, we're trying to be as helpful as possible a quarter out, and this time round we've actually given some revenue guidance. But, as we point out, September is quite a key month for us, and that goes back to the point that you made about whether or not we'll see any delays in back to work or any impacts from the Delta variant. So it's too early for us to comment, really, on next year, and we will give you some input on that at the full year. I mean, it's also going to depend on the combination of these headwinds and tailwinds that Dominic's just spoken about.

Sports and leisure – it can be a bit lumpy. In a normal year, it tends to be slightly weighted towards the second half of the year. But I think, in the environment in which we're in, we are actually seeing some rescheduling of certain events into months when we wouldn't necessarily see them. Quarter 4 is quite a big quarter for sports and leisure in North America and in the UK. In the UK, for instance, we've got Wimbledon and the football season. In North America, you've got a combination of football, soccer, baseball coming through.

Operator:

The next question is from Bilal Aziz from UBS. Your line is open, please go ahead.

Bilal Aziz:

Good morning, everyone, and thank you for taking my questions. I appreciate you don't quantify the net new wins at third quarter, but everything in the statement reads as if you at least, perhaps, sustained the momentum you saw in the first half of the year, so perhaps just a quick update on that side. And then – I think you've touched on it already, just on the margin guidance into the fourth quarter. You haven't quite explicitly flagged mobilization or cost inflation specifically. So are some of those costs tapering off, or are they embedded within that fourth quarter guidance right now still? Thank you.

Dominic Blakemore:

Bilal thanks for the question. Yeah, look, the net new in Q3 was around 6%. So if you break down our organic growth in the quarter at 36%, like-for-like was 30 and net new 6, with retention rates sort of broadly 95.5. That means that we're seeing new business of 11. I think you have to recognize that new business calculation for us is new openings in the quarter over the volumes that we experienced in Q3, so it's slightly flatter, but I think what it does show you is a significant acceleration on the trends in the first half, which is testament to the amount of new business we're winning, the fact that it's now opening up and the benefit we're seeing in the flight to trust. On margin guidance in Q4, that guidance is all in, for everything we're seeing – inflation, you know, the challenges of opening, reopening, new guidance, new protocols, the challenge of things like the pingdemic, as well as inflation. You know, typically when we open new business, we incur mobilization throughout the first year of the contract. When we've got a step up, we will continue to incur higher levels of mobilization. I think the mobilization that is the the reopening or the ramp up in volumes will be a little bit more near in, but it's likely to affect us for a couple of quarters as those volumes build back. So I think these features are – you know, they're here with us for a while and they need to be baked into all the guidance we give you. Now, what we want to do is make progress over and above that.

Operator:

Next question from Vicki Stern from Barclays. Please go ahead.

Vicki Stern:

Hi. Just coming back on the signings, obviously, incredibly impressive numbers so far. Just a little bit of a sense on how you're feeling on the outlook and the pipeline and, I mean, more broadly, just the sustainability of this sort of unprecedented 5 to 6% net new versus, I guess, around 3% that you were doing in the years pre COVID. And then secondly, related to that, just what's happening in Europe? You called that out as one market where you think you're doing particularly well. Is that in any way skewed more to first-time outsourcing, more to share gains now than before? Just curious why that's standing out so much for you. And then, just jumping on to volumes, just what's driving such a strong improvement in the organic for healthcare and defense, offshore, remote so well ahead of 2019 levels? I suppose, how much of that is new signings feeding in, how much is sort of cross-sell, and I suppose how much of a drag still remains in those sectors, particularly healthcare, as a result of COVID? Thanks.

Dominic Blakemore:

Yeah. So let me take the third one first. Just on volumes, I mean, we're very, very pleased that we are, you know, almost 10% up on pre-COVID levels in those two sectors. You know, a good chunk of that is new business, so we know we've done particularly well in both of those sectors. Then there's also – within healthcare, you know, we've talked about a number of our retail offers have had to close because of the containment measures, and footfall has been low. They're only opening up sort of now-ish. So we expect to see a benefit from that on top, as we go forward in healthcare, so we think that's very positive. Within DOR, you know, we've had new business wins, but we've also seen an uptick in volumes because there's been more man-days as production has increased with demand for commodity. So that's been another good sector for us. And actually, in the aggregate, if we can get to sort of 10% above pre-COVID levels on those two sectors, it starts to pretty much mitigate, as we've said before, any risk on remote in B&I and education. So we think that's a really positive data point for us.

On signings, yeah, look, the outlook is good. You know, we continue to see new business at the highest levels we've enjoyed in most of our regions – growth of 20% above 2019, up to 50% first-time outsourcing. The pipeline looks good. You know, when we've taken the measures we've taken to protect margin, we've protected our investments in sales and retention to be very, very focused on exploiting the opportunity. So, you know, with a good pipeline, with good sellers, and again, many of the other issues we'll talk about today around complexity of managing inflation and volumes that are highly volatile, I think that gives us the opportunity to differentiate ourselves and therefore unlock first-time outsourcing and show our clients that they can really rely and trust us. So it feels positive. I don't think we can talk about the duration of its sustainability, but I think the opportunity is there and therefore it's our job to maintain that momentum.

Yes, Europe looks good in new business. We're having a very strong year, the strongest we've seen for some time, and that's very positive. It's coming across multiple sectors with a bit more contribution from healthcare, which is good. The first-time outsourcing level is up by around 10 percentage points. Still not at the levels that we've quoted for the group, so there's more opportunity there, but we're doing better on new business than we've done, and we're also doing better on retention. So we think that combination will support, you know, a positive trajectory in Europe beyond the volume recovery.

Operator:

Next question from Jaafar Mestari from Exane BNP Paribas. Go ahead.

Jaafar Mestari:

Hi. Good morning. Two questions from me, please. Firstly, is it worth updating the gross new business figure? You gave us this £1.1 billion in the first six months, and, as you commented, there's been a couple of other wins, some particularly large and some in healthcare. And then secondly, I'm just curious about sports and leisure – what the current attendance level or attendance cap is, and whether there's still improvement potential there, or is this as good as it gets for now, and the discussion is only on the seasonality, as we've heard before.

Dominic Blakemore:

Yeah. I mean, first of all, just in terms of the gross new business, I think we'll update you on that at the full year. We don't typically give that on quarters, but, you know, as we said, we continue to trend around the same levels of our performance of 2019. So, very positive in terms of new signings. And of course, those aren't yet showing themselves in our new business ratio – our new business KPI – because a number of those signings will not yet have mobilized.

In terms of sports and leisure, as you can witness here in the UK, we are still on a journey of ramping up volumes. So there are some events that are trading at full capacity. So I think some of the cricket events here in the UK are now toward capacity. We know that the football season should be at capacity when that starts up. You know, of course, a number of the clubs have now said we need double vaccine and a negative test. We've seen outdoor events in the US toward capacity. So I think a lot of this now is about sort of continuing the ramp up and the calendar. You know, there's still a way to go, isn't there, on that recovery for us, which is – which is very positive.

Operator:

Next we have Richard Clarke from Bernstein. Please go ahead.

Richard Clarke:

Good morning. Thanks for taking my questions. Three, if I may. I just want to follow up a bit on Jamie's question about where you are on the sort of volume recovery. The 80 to 85% guidance for Q4 – I presume that includes none of the FX drag, but it does include some pricing impact. It does include some – the footprint increase. So would I be right in thinking actually your volumes are still sort of somewhere between 25 to 30% below pre COVID? So we've got a fair distance to go – still to go, to get back to pre-COVID volumes. Is my maths right there? And then the second question is just the news last night on a Wall Street Journal article saying that Google’s going to require fully vaccinated people to work in its campus. Does that change any of your views at all, and does that change any of your ability to staff your contracts? Does that cause you any issues in getting hold of staff? And then, third question is on M&A, I think you mentioned at H1 you’d looked at three deals you'd passed on all three. Have you passed on any more, And maybe any other update you can look at there?

Dominic Blakemore:

Yeah, thank you. Richard. I mean, look, I think first base for us is getting this business back to the size and shape that it was pre COVID. If we're getting benefits from pricing or footfall and the new business wins, I think that's all positive. And we said before that the mix may be different. I think that therefore means that if there's a slower recovery of volumes, then it means that volume recovery will benefit us for several years thereafter if it comes back in – you know, in a slower order. So I think, you know, you may be right. If you were doing a like-for-like calculation of our volumes now compared to, the volumes pre COVID, they would certainly be below the 80 to 85%, but we think this gives us the opportunity to accelerate to the size we were pre COVID and then, hopefully, enjoy that volume recovery thereafter, and also mitigate the risks that we've talked about in previous calls around any virtual trends.

On the comments about Google – I haven't spoken to our Google clients since yesterday evening. I mean, clearly, you know, what we are seeing is that different clients are putting in place different controls and policies for their workforce. We need to be able to respond to those within local rules and legislation. We think, again, that complexity is an advantage. You know, we've shown that we can – we can manage through, you know, the high levels of isolation requirements. It's why having a digitally enabled workforce that's very flexible and can move across sectors is important. If clients require us to have vaccinated staff, we will find staff who are prepared to work in those environments. And if we have staff who aren't, we'll look to put them in other operations where we've got regular testing protocols. So we think we can operate to those requirements and, again, differentiate ourselves.

When it comes to an impact on clients, I actually think it could probably be a net positive. You know, ultimately, if the employees are willing to comply with those policies, I think it means everyone feels more confident about the workplace they're in and potentially enables a quicker return and less social distancing or less caution on site, which I think is ultimately positive for the recovery within the B&I estate.

Sorry, Karen, I haven't passed many over to you today, so do you want to take the M&A question?

Karen Witts:

I think we like M&A and bolt-on M&A – but we're very judicious about the things that we look at, and we've got nothing to update on right now from what we said at the half-year, Richard.

Operator:

The next person will be Leo Carrington from Credit Suisse. Your line is open, please go ahead.

Leo Carrington:

Good morning. Thank you. On inflation pass-through, I think your comments implied some sort of lag or negative impact, but, more broadly, if there has been a lag, how well have you been able to pass through inflation to clients? And, maybe on a related note, can you update us on how your volumes in the GPO are doing? And is inflation a negative or a positive driver for the GPO in terms of attracting more third-party spend? And then on a different note, it appears that competition in vending might be ramping up. Today Pret obviously announced its launching coffee vending. Your competitor, Sodexo, is now talking about vending too. Have you seen any change of competitive dynamics here? Thank you.

Dominic Blakemore:

Yeah. Thank you, Leo. I'll take just the last question, then hand the first three over to Karen. Just with regards to vending, I mean, I think what's most important in vending is you need scale and density for the fixed costs that we incur on distribution centers, delivery, logistics and so on. You know, we've built that platform in North America. We continue to bolt onto it through acquisition and through scale growth. So I think we feel we're very well placed and what's exciting and interesting in developments there, is how the offer innovates and how we need to compete on that. We talk a lot, don't we, about sort of our open vending offer and how we put hot offers into that through other parts of our business. I think having that route to market, the logistics and the density gives us a great platform to innovate and compete. So I think the more development we see in there, the sort of more exciting the sector becomes. And, you know, that's a good place to be. Thing you have to remember, as well, that in other countries where we don't have that, we don't compete and therefore we seek to partner. And I think the more exciting partnership opportunities there are, that can also be a positive for our business, because of course we have the place in the estate and therefore we can partner with others so you've got the compelling offer.

Karen, over to you.

Karen Witts:

So, to the question on inflation, I mean, we are used to dealing with inflation. It really is part of what we do. What we're seeing at the moment, though, is a higher level of both food and labor inflation than we're used to seeing, but we've got that factored into any guidance that we are giving. Now, we try to make sure that we don't have a lag between the inflation that we're seeing and what we pass through. And just to remind you that there actually is quite a lot in our contract structure that does allow for the pass-through. We will be expected to mitigate to the best of our ability, but our cost-plus contracts allow us to pass on unmitigated inflation and, where we've got P&L contracts, then they would allow us to pass inflation on right through to the end part of the consumer pricing.

And, in fact, the first question and your second question sort of links, because you're asking about GPO and impacts of inflation there, whether it was positive or negative. Maybe the first thing to say is that our suppliers have been very supportive and continue to be very supportive, and they have generally upheld or honored the pricing structures that we've had in place with them and the volume discounts, even at a time when volumes have been lower – and volumes are still tracking lower through the GPO than they were pre COVID. What we've also seen from suppliers is that, for a couple of big ones where they generally put price increases into the marketplace, they have not increased our prices. In terms of inflation being a positive or a negative, I think it's no different in the GPO, really, than it is for our new business wins. Clearly we have to manage the impact of any cost inflation in our pass through costs. But also you're right that, in the same way as inflation can act as a catalyst for first-time outsourcing, then it can act as a catalyst for more third parties coming through the GPO.

Operator:

Next question from Kean from Jefferies. Go ahead. Your line is open.

Kean Marden:

Thanks. Morning, all. So a few questions from me as well. First of all, have you possibly switched away from a cost-plus contract back to sort of their former economic structure at this point? And, if so, can you maybe just provide us with an update about how that dialogue has progressed? Secondly, on resourcing, so obviously you need to ramp the resourcing to match the volume build over the next couple of months. Have you already secured the headcount for that ramp in sort of late August and into September, or is that still to come? And then, thirdly, just to check some maths here, am right in thinking that your Q4 revenue guidance assumes that education is back to about 90, 95% of pre COVID in September?

Dominic Blakemore:

Thanks, Kean. You know, first of all, just on the sort of make-up of contracts, I think, as we've said throughout, this is very dynamic and organic. So to give you an example, you know, in our sports and leisure sector, we would have moved to cost-plus arrangements in a number of areas where clients have wanted us to retain teams – a skeleton team – through lockdown, just on the basis of sort of uncertainty about when things might pick up, and also to work with them on the development of new offers and new processes when things do pick up again. As we've moved into a world of restricted volumes, again we've put different structures in place which are based around targeted, anticipated volume levels. And then, when we move into a world that's fully reopened with full capacity, then we're moving back to original contract structures again, where we can but with downside protections. And I think everybody understands that. I think, in the main, these conversations are going pretty well. They're not easy, they are continuous. You know, I was with one of our teams where it took seven or eight rounds to work through this with the client, and that's why we've focused very much on freeing up our operating teams to focus on these things, because they really, really matter.

But ultimately, you know, as we keep coming back to saying, if you think about our services right now, they're critical in healthcare, age care, education. You know, getting the offer right in a complex world of sports and leisure where the hospitality experience is important, and what we're seeing is the consumer's willing to spend more on that than they've ever done. Then, our clients sort of really recognize our services and are working with us. When it comes to resourcing, it's a little bit different everywhere. If you think about European countries, there's still a lot of government support. So, you know, labor has stayed on the payroll through the government support measures, and we have that labor availability. You know, within the UK we've talked about Constellation, which gives us the ability to move our labor across sectors very dynamically. And there are obviously sort of some seasonality with our sectors, which allows us to manage that accordingly. And some of the challenges of the labor resourcing which I think other hospitality sectors are experiencing, apply less to us. You know, we have a nine-to-five routine in most of our sectors, which doesn't mean long evening shifts, which I think people have moved away from when other job opportunities have come their way. We're working very, very hard in North America. I think the biggest sort of war for talent on the frontline is there. And we're working really hard on building that pool and staying in contact with our employees throughout the period of any layoff, putting new benefits in place that attracts them back. And of course there is a degree of inflation, which Karen talked to. So, you know, we're working very, very hard. We're not saying it's easy. We think we're managing it right now. And again, you know, we need to manage it as well or better than anyone else to differentiate ourselves and retain our reputation with clients, both new and future.

And then finally, on the Q4 revenue guidance for education, I think we'd still be more conservative than the numbers you suggest. You know, we'll obviously see a quiet July and August with only one month of significant step-up, but we would still expect there to be some marginal disruption there. You know, talking to some of our clients, we know that, for international students flying back into the UK, US, it's costly, it requires isolation or quarantine in many instances. And, there's still uncertainty in the international student's mind about what might happen next, and we want to see a prolonged period of reopening before they come. So I think we're conservative on the higher ed side. I think on the lower ed, there's higher volumes. I think that still gives us, you know, opportunity for volume recovery as we go forward,

Operator:

It appears there are no further questions at this time. I'd like to turn the conference back to the Mr Speaker for any additional or closing remarks. Please go ahead, sir.

Dominic Blakemore:

Thank you all very much for your time today – I know it's a busy day. We look forward to speaking to you in November. Thank you and goodbye.

Karen Witts:

Thanks very much.