AGM and Q1 Trading Update

Presentation

Dominic Blakemore
Group Chief Executive

Good morning, everyone. Welcome to the first quarter results call. I'm delighted to have Petros here with me today, who took over as our CFO in December.

We've had a great start to the year with strong organic revenue growth and a couple of exciting strategic acquisitions. Growth was strong across all of our regions, but we're particularly pleased with Europe which continues to build a solid track record of performance. We were positively surprised by the like-for-like volumes, particularly in B&I which have benefited from more return-to-office and hospitality events around Christmas compared to the year before. The outsourcing environment continues to be strong with good recent wins and our first-time outsourcing rates in line with last year.

As we focus on core markets with significant growth opportunities, we're using our scale and the strength of our balance sheet to invest both organically and through M&A. This quarter we completed the acquisition of HOFMANNs in Germany and agreed to buy CH&CO in the UK. Both businesses have exciting growth potential to expose you to a diverse portfolio of subsectors and more flexible operating models. Two weeks ago, we also announced the disposal of our small operations in China.

Until these deals are complete, our guidance remains unchanged. Operating profit growth is expected to be towards 13% delivered through high single-digit organic revenue growth and ongoing margin progression. You'll remember that we said in November there'd be some lumpiness this year, the first half benefiting from stronger pricing with net new weighted towards the second half of the year.

It's been a great quarter and we're delivering on our strategic growth priorities. By focusing on the attractive opportunities in our core markets and investing in CapEx and M&A, we're unlocking future growth. As a result, profit growth will continue to exceed revenue, generating strong cash generation and long-term compounding shareholder returns.

Thank you. We'll now turn the line back to the operator to take your questions.

Q&A Session

Jamie Rollo - Morgan Stanley

Thanks. Good morning, everyone. Three questions, please.

The first, it'd be great if you could please break down the organic sales number into price, like-for-like volume and net new and perhaps just elaborate a little bit more on that lumpiness and timing of contract mobilisation.

Secondly, do you think your guidance is a tad conservative? Because I don't think it factors in any volume growth for the year. Also that volume growth should be quite accretive to margins.
Then just from the M&A side, that's two quite big transactions in Europe. Are you aiming to replicate what the Company did in the US 20 to 30 years ago with a broader-based portfolio of brands? Should we therefore expect several more years of heightened M&A? When we looking at more disclosure on these two deals? Thank you.

Dominic Blakemore

Yes. Thanks, Jamie. Good morning. I'll take one and three and then let Petros comment on guidance and probably add some colour in on M&A as well.

First of all, on organic, you've heard us say we're really pleased with the first-quarter performance. I think what's most striking, as you rightly say, is the positive volumes that we've seen. Whilst we do attribute some of that to seasonal events in December, we've clearly got some momentum and tailwind within the return to office, so we are tracking that and looking to see what that means for the second quarter and beyond as we go. In terms of the 12% for the first quarter, broadly half of that is price, which would have been in line with our expectations and the balance, net new and volume.

When it comes to net new, we did signal some lumpiness. A couple of reasons there. We had a couple of losses in the second half of last year, which we'll annualise by the half year of '24. In addition, there's been a couple of large accounts which have - their mobilisation on the new business side has been deferred out a quarter and, in a couple of cases, into the second half. We feel, on a net new standpoint, confident still in our 4% to 5% guidance for the full year. We expect that to probably be around the 3.5% in the first. Then obviously that means that we'll be in the higher end of our range in the second half, so in the high fours, in the second half of the year.

That's supported both by our view of mobilisations and new business but also by the quality of new business that we've continued to win in the first quarter. We made a really good start on new business, particularly in North America and Europe. Our gross new business ARO is tracking about $3.3 billion on an LTM basis, consistent with last year so very strong. It's probably fair to say that we've seen a little bit of slowness in the UK and APAC, but we do anticipate that that's going to come through very positively in the second quarter. We're highly optimistic about our new business win opportunities in '24. With that, also still seeing 45%-plus coming from first-time outsourcing which we've always said is particularly positive for us.

On M&A, I think you've really hit the nail on the head. We do genuinely believe that the acquisitions that we've made in the US have truly differentiated our business model. They've given us the sub-sectorisation within sectors, which we think is compelling. Within a number of our sectors now, within a given client, we can operate as many as five or six different subsectors. We just don't believe that that can be replicated within the industry.

I think given the confidence that we've now got in our performance outside of North America and particularly in Europe, it feels like the right time for us to be prosecuting the M&A agenda in Europe. I think I'd remind you that Fazer was probably the first of those bigger deals in Europe that brought us the subsector richness within B&I. I think we would have perhaps done more had it not been for the intervention of COVID. But again, it feels like the time is right now. Opportunities are coming to market. We've been building relationships for a number of years.

We've announced CH&CO which is an absolutely terrific business. It's got a fantastic management team. It's a business we've been talking to for many years. We've had putative discussions before, but COVID intervened. Cost of living intervened. Inflation intervened. It feels now is the right time. When we look at that, we know there's a huge complementarity of subsector but also regional presence. We don't believe they're businesses that would compete with one another. They can exist together. I'm sure Petros will come on to it. The financials are very attractive with the opportunity for growth acceleration and cost synergy over time.
I think that's a great example of how the North American template can be replicated outside of North America and create real value for us. I think because of some of the market conditions with cost of finance, again it feels like more of those opportunities are coming to market now. I think we're in a great place with our leverage, balance sheet strength and the strategic synergies we can bring to really exploit them.

Petros, do you want to add anything on M&A and then on the guidance points?

Petros Parras

Thank you, Dominic. Morning, Jamie.

Maybe on guidance, just to remind everyone, we guided towards the high single digit in November. Like for like. Maybe a few points to call out here. We will be data driven. We're seeing, in Q1, volumes come in nicely, particularly in B&I. Within Europe you have seen some of the numbers there. There is some seasonality in there also, some very nice activity with clients from hospitality and some nice volumes in sports and leisure. I think when you put all together, our guidance remains unchanged. We're going to get more datapoints as we go to quarter 2 and then we provide an update in half 1.
On the M&A, maybe two thoughts. I think it starts with the optionality in the balance sheet. We have talked for quite some time now. This gives us a nice opportunity to entertain M&A acquisitions. Dominic spoke about the subsector differentiation and operating flexible models. I think it's fair to say the blueprint of North America has generated some very attractive financial returns. We continue to remain disciplined in where we invest. Dominic spoke about the discipline on how long some of these deals take.
These two opportunities for us, they present a nice opportunity. They will be in excess of WACC by end of year 2. We feel, over the long term, they will provide very nice volume creation within the business. Keep in mind, we'll continue to invest organically in CapEx as this is a very big lever of the Company to grow the business.

Jamie Rollo - Morgan Stanley

Thank you. Sorry, Dominic, can I just come back? I think you said 3.5% net new was your first-half estimate. Was that also within the 6% that was both volume and net new? Was that also the Q1 number, 3.5%, or was it a bit lower than that?

Dominic Blakemore

It was in that range, Jamie.

Jamie Rollo - Morgan Stanley

Thank you very much.

Vicki Stern - Barclays

Yes, morning. First one, you sounded very confident there on the signings run rate so far. Just how about on retention? Just based on what you're seeing across both retention and signings, how confident you're feeling not just in the 4% to 5% guide for the full year but that medium-term net new guide of 4% to 5% that you'd laid out a year or so back?
Second one is on the win rate, so you talked about FTOs still very strong. Just curious about the wins on the small and large competitors, just some colour there on the movement of those parts. Seeing some of your large competitors being a bit more active, so just curious on your side.

Then finally, on the profitability, so Aramark were talking the other day about inflation paring back perhaps a little bit faster than they'd expected so far this year. How is that running for you versus your initial expectations? With that, any initial thoughts on margins and that path back to the pre-COVID levels more medium term? Thanks.

Dominic Blakemore

Yes. Thanks, Vicki. Good morning. I'll hand over to Petros on the profitability point in a second, but why don't I tackle some of those growth questions?

First of all, it's probably fair to say, as I said earlier in the call, we had a couple of losses in the second half of last year in one particular sector, which dented a little bit the run rate on retention. Nothing particularly material, but we'll be annualising that by the half year of '24. We've got very good line of sight of those contracts that are out to bid. We expect to see very strong retention on a full-year basis again for '24 and beyond, so I think we're in really good shape there.

Thank you for the question on the medium-term guidance on net new, because I think it's very easy to obsess quarter by quarter. Individual accounts and the timings of mobilisation and demobilisation can affect the numbers in a quarter very easily. I think it's fair to say we're more confident today than we've ever been on our ability to sustain an acceleration in net new. We've always talked about being a point or so better than historically. That was our ambition. We've got more confidence in being able to achieve that than ever.

We've got qualified pipelines in all of our regions that are at record levels. That's the star point. We need to scale the business to achieve growth. We're very focused on that, not least in talent. We are actively driving our talent agenda everywhere in the business, because we truly believe that talent is the only limiting factor in our ability to grow and manage the volumes that we believe we can win in the marketplace and acquire through M&A.

I'd also like to add to that that the performance - we've always said this isn't a track record yet in Europe. We want to build that track record over many, many years. But we are now starting to get into three years and four years of consistent performance outside of North America. We're tracking another very positive year in our European business in 2024. I think we're really excited. I'd probably say the business as you see it today is in as good shape as it's ever been in my tenure with Compass.

If we add to that, what we see at the moment is how do we place a few bets to sustain the medium-term growth rate at these levels in a bigger business? I think that's what you see in this deal with HOFMANN. It's what you see in this deal with CH&CO. We're very obsessed at the moment. It's how we unlock those other subsectors of growth opportunity such that they can contribute to sustaining the elevated levels of growth, because growing at 4% to 5% net new will support our medium-term ambition of mid to high single-digit organic growth as and when we see pricing and inflation come off a bit. I think that's really important.

First-time outsourcing win rates remain very positive. In terms of performance against competitors, we continue to be a net winner in all quadrants of the market as we look at them, whether that's against the big international competitors, the regional players or the smaller players. It's a continuation of the trends that we see. Then we think a lot of that is about, as we've always said, the ability to combine our disproportionate scale - which is now bigger than ever it's been in the marketplace - with that very niche frontend subsector offer. Petros.

Petros Parras

Thank you, Dominic. Morning, Vicki. I think maybe I'll touch on inflation shortly and then I will share a few thoughts on profitability.

Do you recall last year when inflation was running around 7% towards the end of last year? In the first half, we see this around 6% which is consistent with the pricing you are seeing in the organic. The components of this, we do see some easing on the food cost. Bear in mind European market is still low double digit. We talked before, you recall, the stickiness on the labour inflation. We believe this is going to be there for the medium run.

All in all, what you see now, you see inflation and pricing to progress at a similar rate. Remember what we discussed last year on the operating profit growth. For example, we talked a lot on how the business is naturally hedged to deliver a nice profit growth regardless if inflation would be higher or lower. Obviously, you will see some ongoing margin progression. Recall last year half 1 margin was 6.6%. We're going to see some really nice operating profit growth in the first half. You're going to see margin progression because of the comparators of last year.

Vicki Stern - Barclays

Thank you for that. Sorry, just circling back on the medium-term margin's ability to get back to that 7.5%, are you still confident in that in time?

Petros Parras

Of course. We're confident. In the previous call we said, we don't see a ceiling to this. You will continue to experience an operating profit growth and an ongoing margin progression as we go.

Vicki Stern - Barclays

Great. Thanks very much.

Jaafar Mestari - BNP Paribas

Hi. Good morning. Yes, quite a few moving parts today on growth and I appreciate this is a revenue trading update. But could you maybe take these different points and remind us, just in theory, what they do to margins? In particular, what's the flow-through from like-for-like volumes? Is it 30%, 25%? Is it below? Because it's related to events in part so more costs. That's one point.

On the deferrals to some contracts, was that due to margins in H1? Do you already have start-up costs in H1 already or is it all happening within H2 when they are a week from actually starting?

The last point is on net new, so full year very much in line with guidance. But if it's slightly lower retention, what does that do again to your margin profile between H1 and H2, please?

Dominic Blakemore

Yes. Jaafar, I think we have to be careful not to attribute too much science to those different drivers. In reality we're talking about 30, 40, 50 bps of difference in each of the drivers in a quarter, so we don't obsess about that. I think the truths are our net new performance will come at a lower margin as we've always said. Why is that? Because when we open new accounts, they'll start at a lower margin, and we'll have mobilisation costs. When we retain big business, we'll inevitably offer cost savings to our clients and therefore there'll be a drag from periods of more retention activity. Those things are going on in the business all the time.

You're right. Where we see volume, it can tend to drop through with a higher margin, but it really does depend where that volume is. If we enjoy volume in sports and leisure, often the benefit or the upside is to the client, and we have a fixed return on those higher volumes. It's really difficult to read straight through as it were. We'd probably look at the margin impact of net new on an annual basis rather than a half year or a quarter. As we sit within our guidance, it has the impact that we anticipate within our margin. I think what's most important for us is we've guided to high levels of growth and margin progression. That's what you'll see this year.

Jaafar Mestari - BNP Paribas

Thank you, so no big impact there. Then on the margin sequence then, if this doesn't change it much, do you still think H1 is broadly in line with the Q4 exit rate? It's up year on year, but it's continuing on that Q4 '23 exit rate. Then there's more progress in H2. Is that still the sequence?

Petros Parras

I think that's about right, Jaafar, yes.

Jaafar Mestari - BNP Paribas

Super. Thank you very much.

Julien Richer – Kepler Cheuvreux

Yes. Good morning, everyone. Two quick questions for me please, the first one on sport and leisure and volume. You have been talking about volume being a little bit better on that division. Can you please tell us if it's true for both Europe and the US or if it's really specific to the US and if there is any increase in spend per head also? Second question on pricing, so if pricing has to slow down in the future because of inflation normalising, also have you started to see that type of slow down on pricing during the negotiation and discussion with your clients already? Thank you.

Petros Parras

All right. Thank you. Thank you, Julien. I think with sports and leisure, what you will see is you will see similar trends in the North American business and in the rest of the world. I think it's a combination of both more participation in venues that we're very pleased with - keep in mind, within a venue, we may have multiple offers. It's not only about one offer or more participation in venues. We're seeing average ticket value to go higher. Overall quite some support from our clients to get the events going and very pleasing for our consumers.
On your second question on inflation, I think the way to think about this - and we discussed this also in the past - we will not try to predict what is going to happen in the second half. I think we referenced, in the first half, we do see a singular rate of inflation and pricing. We will see how this pans out for the second half.

We continue to take pricing where appropriate. But keep in mind we also referenced in the past, it starts with mitigation as well, so what is the value we offer to our clients as we go through in these conversations? Pricing most likely is the second component in these conversations and what is the value we're offering them? We keep always an eye on that and then we expect to give an update for the rest of the year in half 1.

Dominic Blakemore

Yes. If I may, Julien, just add a couple of thoughts to both those questions, yes, the first is I'm incredibly optimistic about sports and leisure for us as a sector and as a business. The recovery post-COVID has been incredibly positive. The consumer reaction to price inflation has been very positive. I think what we see emerging is potentially a new consumer within that category. We've got travel tourists who will come to major cities across Europe and the US to experience sports and leisure and who really want to spend to enjoy those occasions. We're seeing competing demand for tickets at the higher end.

Many of our clients are working on how they develop super premium offers, which plays brilliantly well to what we're doing and our sub-sectorisation. We're actually very, very excited about the potential. We're building our sports and leisure presence across Europe in a way that we haven't done before. We're taking the established brand, Levy, alongside some very powerful local operators to create a compelling offer in that sector. We really feel good about sports and leisure in the medium term.

I think just on the pricing/inflation standpoint, I think Petros called it out, but labour is sticky, right. I think that's going to really be the delta over the course of the next year.
I think we can all see food inflation coming off and coming off sequentially, but I think labour's sticky in the system and will be for a while. I think that's good for us, right. We've always said, let's just take it back to where we were in the 2010s. We had - what one point of blended cost inflation. We had to see all of that off. I think blended cost inflation as the 2% to 3% in the new normal will be helpful for us, because we can demonstrate the value of our offer and we can still take pricing meaningfully. I think we feel that as things calm, it's really all about what we see on the labour side of things going forward.

Julien Richer – Kepler Cheuvreux

Very good. Thank you.

Jarrod Castle - UBS

Good morning, everyone. Just coming a little bit back to M&A but from the other angle, you said you've exited China. Over a number of years, you've exited a number of smaller markets. I just wanted to get some colour on why you decided to exit China. Then also just on that theme, have you entered any new markets? What is your view on more nascent markets where you see some exciting growth opportunities?

Then obviously very strong labour market still, especially in the US. I just wanted to get some colour in terms of ability to get staff, ability to mobilise a very good new contract win.
Then just coming back to recent M&A, you've paid over 1x sales for CH&CO. I know it's different business, but Fazer was under 1x and 12x EBITDA, I think, when you disclosed it. Is CH&CO very profitable or is it because you see very good synergies from that business? I guess to broad terms, generally how much additional margin can you bring to acquisitions? How much in general, at a discount to your margin, are these companies at? Thanks.

Dominic Blakemore

Hi, Jarrod. Thank you. Some really good questions there.

I'll take the M&A question first. First of all, it's a misnomer to believe that our M&A targets are trading at lower margins than we are. I think that's the star point. Some of the businesses have excellent margin structures, because they offer something different to us and are able to price according for that. I think that's really exciting. When we look at the M&A we've done over years, particularly in North America, they have contributed margin as well as growth over time. We think that's an aspect that we really do need to focus on.

The recent acquisitions we've done will both be accretive to the European region off the bat from a margin standpoint as well as offering further synergy over time. That's why these businesses are particularly premium and attractive to us. We see the opportunity in M&A as being, first of all, sustaining our accelerated growth levels, secondly bringing us brilliant management teams. Thirdly, there has to be a cost and margin opportunity as well.

When it comes to labour market, I'm delighted to say that our LTM labour turnover rates in all of the five regions that we report internally have fallen over the last quarter, which is a fantastic statistic for us that we track relentlessly. There are levels now which are back pre-COVID and below. I think that tells you that, from a Compass labour standpoint, we are attracting labour. We're retaining those colleagues better than we've ever done. We're incredibly focused on that, because we know that that drives incredible efficiency and consistency in our operations. A lot more to do as there is in all parts of our business, but we're excited there. We think we've really dealt with the pig in the python, as it were, of reopening post-COVID.

Then just your first question last on exits, you're right. I think now, in pretty much 18 months, we've exited 10 countries. I think we're probably about two thirds of a way through a programme that we've been looking at. We're now in 34 countries. Now does that mean we could be in around 30? Yes. If I remind you why that is, our set up - I think the right attribute to this business is to be in organised developed markets where there's an opportunity to premiumise our offer. It's not driven by a commoditised value offer and where we can deliver scale, not just nationally but within sectors and subsectors.

We see huge opportunity within our top 20 countries. In a number of our top 20 countries, we're still not present in all of our core sectors. There's opportunity there. There's opportunity organically and inorganically. There's opportunity for vending and micro-markets across the core countries. We've seen that in the US. There's more for us to do in many of the countries. The opportunities are absolutely huge in our core. I've now become convinced that we distract ourselves by managing a tail. As I said, we've exited 10 countries. I don't think you guys, as the analyst community, have barely even seen the numbers move as a result. Yet I can promise you that the amount of management time that we can now dedicate back into the core is materially different from how it was before.

With regard to China, rightly or wrongly, we've been trying there for 20 years. We're still a $100 million business. I don't believe our product is as valued as we would like. There is sufficient scale in organised international clients for us to be able to grow that business. It feels right to be honest and step out and move on. As I said, there'll be a few more still to do, but I think we're at the tail end of the programme. Excitingly I think we're now at a point where we can double down on the core and really start to accelerate there through M&A.

In terms of the question about other market entries, there's nothing on the list. I think actually some of what we've been doing recently is stepping away from countries we entered chasing growth. I think we've learned a few lessons through that. Yes, certainly we won't be repeating those in the near term. I think we feel really good about where the portfolio is and the opportunities as we go forward.

Jarrod Castle - UBS

Great. Thanks, Dominic.

Neil Tyler - Redburn Atlantic

Yes, good morning. Thanks very much. Dominic, I'd just like to come back to your comments on M&A that you touched on earlier that some of the processes had been interrupted by COVID, but I wanted to ask whether perhaps the list of opportunities might have grown as a consequence of how some smaller competitors are viewing their position post-COVID. I think you talked about the financing market and how that had played a part, but I wonder if you wouldn't mind sharing your thoughts a little bit on the lengthening or otherwise of the list of opportunities.

Dominic Blakemore

Yes, no. Thank you, Neil. That's a good question. Look, I think there's a couple of things at play. COVID meant that people had to go deep and manage their businesses through a difficult time. I think what it also meant is that a number of owner managers potentially had to go a term longer than they'd anticipated in realising their own timeframe and when was right for them to step away from the business. As a result, I think now is we see businesses that have either stabilised post-COVID, post-inflation, post-pricing or actually, on the flipside, it may have been a little bit damaged by that. They're more ready to consider the opportunities to partner.
What we can do is we can be the big brother to some of those owner managers and provide the environment in which they can realise a level of performance that can get to their original personal targets in quite a different way. That feels exciting. I think that the cost of finance does, of course, play into that. I think there was probably a hiatus of deals for around 18 months because of that. I think you now see some of those assets coming back to market.
Yes, yes, there is a pipeline. It is exciting. I think we've found a way of working, particularly with owner managers, that is much more creative and collaborative to realise value mutually. I think that makes us a really good partner.

But I should finish by saying we have three current and former CFOs on the Board, so we're nothing if not disciplined. Where we do spend money, we will be doing it within all of the returns criteria's that we've always said. I just want to echo the point that Petros made earlier. There is so much opportunity for CapEx organically for growth as well. We have to make sure that M&A is the right distraction and bringing in the right managers for us to be able to do everything.

Neil Tyler - Redburn Atlantic

Thank you. That's really helpful. Thanks very much.