Compass Group
30Mar15

Speaker Key

OP	Operator
RC	Richard Cousins
TR	Tim Ramskill
DB	Dominic Blakemore
JC	Jared Castle
NE	Nick Edelman
WE	Wyn Ellis
JH	Jeffrey Harwood

OP Good morning, ladies and gentlemen and welcome to the pre-close trading update conference call. My name is Dave and I'll be your coordinator for today's conference. For the duration of the call you will be on listen-only. However, at the end of the call you'll have the opportunity to ask questions. If at any time you need assistance, please press star zero on your telephone keypad and you'll be connected to an operator. I'm now handing you over to Richard Cousins to begin today's conference. Thank you.

RC Thank you, Dave, and good morning, everyone. Thanks for dialling in. With me this morning I have our Group Finance Director, Dominic Blakemore. I'll start by giving you a brief overview of trading in the first half of the year and then say a few words on the outlook before opening the call, as usual, to questions.

Compass is having a strong first half of the year with expected organic revenue growth towards 5.5% and operating profit margin improvement of around ten basis points. We saw good levels of new business, high retention rates across all regions, and modest like-for-like revenue growth.

Looking at the three regions individually, North America is having a really strong first half, with organic revenue growth expected to be around 8%. New business wins have been good, retention levels remained unusually high, and there was some improvement in like-for-like revenues. We continue to generate good levels of efficiencies which we are reinvesting to drive and support this above-average growth. The margin expansion for the first half is therefore expected to be around five basis points.

Encouragingly, Europe & Japan has returned to growth, despite a mixed economic backdrop across the region. This performance reflects our increased focus on organic growth and the investments we've made in our sales and retention teams. For the first half organic revenue growth is expected to be around 0.5%, with improving levels of new business wins and retention rates, and recovering but still negative like-for-like volumes. Also, as a result of our continued focus on efficiencies, we expect an operating margin improvement of around ten basis points.

Turning to the fast growing and emerging region, strong levels of new business wins in emerging markets are expected to deliver around 14% organic revenue growth. This is helping offset the expected decline in the Australian offshore and remote sector. As a result, we anticipate organic revenue growth for the region overall to be towards 8%. We have also made good progress in driving operating efficiencies and we are reinvesting as appropriate to support growth. However, due to the weakness in like-for-like volumes in some emerging markets and pressures in offshore and remote business, we expect the operating margin to decline by around ten basis points compared to the first half of 2014.

In terms of FX, whilst sterling has weakened against the US dollar, it has strengthened against a number of other key currencies. Taken together at current rate, these movements would benefit half-year revenue and profit by around 0.5% and full-year revenue and profit by around 2.5%. This is, of course, a translation impact only.

So, in summary, we are having anther really good first half and our expectations for the full year remain positive. However, we should note that the economic environment in some of our emerging markets is uncertain, and lower commodity prices are impacting our offshore and remote business. Nevertheless, our pipeline of new contracts is really encouraging, and our continued focus on organic growth and efficiencies gives us confidence in achieving another year of delivery. In the longer-term, we remain excited about the significant structural growth opportunities and with the potential for further revenue and margin growth.

And with that I'd like to hand back to Dave for questions.

OP Thank you. Ladies and gentlemen, if you'd like to ask a question, please press star one on your telephone keypad. If you change your mind and want to withdraw your question, please press star one again. You will be advised when to ask your question. The first question is from the line of Tim Ramskill of Credit Suisse. Please go ahead.

TR Thanks, good morning. Two questions from me, please. The first is just around the extraction space, mining and oil and gas. Richard, can you maybe just talk us through how that's evolved in terms of in particular, I guess, the oil and gas piece becoming part of the same story that you've experienced over the course of the last few months or even year or so in mining. And also maybe just touch on to what extent clients are actively pushing on you to share some of the pain with them, if that's the right description.

And then the second question is, can you just reference wage inflation and how, if at all that's showing any signs of picking up and how you manage wage inflationary pressures which I always think maybe are a little bit more difficult to manage versus food cost pressures where maybe you've got more levers you can pull around procurement and menu management, etc. Thank you.

RC Okay. I'll talk about the offshore and remote and then I'll hand over to Dominic for the wage inflation. So, in terms of the mining, oil and gas, that's now, I think, including defence, 12%/13% of our revenue. Five percentage points, roughly, would be oil and gas and five or six percentage points for mining, leaving the rest for defence, which, of course, is pretty solid. I think the trends are relatively predictable and clearly the reductions in price are significant and clients are reacting both in the production space where... that we have noticed headcount reduction and also in construction where some projects are being delayed or maybe even cancelled. We think we're managing the situation well. We're taking out quite a lot of costs, as you rightly imply, where clients are seeking significant cost reduction, and we're able to do that by reducing scope, taking out costs of the whole supply chain, which obviously affects the overall cost to our clients. So, it is tough. We are noticing the revenue trends but I think we're managing it pretty well.

TR And can I just complete that? Do you think you've seen the worst of it or is there any sign of stability or how would you anticipate the next six months?

RC I think on production it will begin to level off in that the price of iron ore, which is obviously very relevant for our Australian business, the price of copper and very significantly oil and gas and the trends have been in the market now for some months. In construction, however, I do think we will notice it for a year or two. I don't think there's going to be a sudden reversal.

TR Thank you.

RC In terms of wage inflation, Dominic?

DB Thank you, Richard. Hi, Tim.

TR Hi.

DB In terms of wage inflation, I think we're probably seeing a little bit more upward pressure on minimum wage in particular than we've seen in the last few years. So, I think above average wage inflation. We, of course, try to manage that in the round with all cost inflation, so obviously a touch of benefit on food at the moment. There are still a number of levers that we can pull in terms of driving efficiency around better scheduling and so on, which we're working very hard on, and we have lean programmes in many of our businesses which will allow us to drive further efficiencies out of labour and, again, enable us to manage the situation. I think a great example is in North America last year where we absorbed both the cost of Obamacare and increases to minimum wages in a number of cities and states whilst continuing to manage to deliver the ongoing improvements in margin in the North American region. So, I think it will be, as we always say, more of the same but it probably is a touch of above average at the moment.

TR Okay, thank you very much.

OP The next question is from Jared Castle from UBS in London. Please go ahead.

JC Thank you. Good morning, gentlemen. Two questions, if I may, please. Firstly, can you maybe just talk a little bit about retention rates in quarter two versus quarter one, if there was any change in the trend and then also just maybe a little bit of... a bit more colour about markets, I guess. And then, secondly, just in terms of Europe, are you still shedding clients in terms of contracts which are viewed as underperforming or is it now just more a case of natural churn and selective market wins?

RC Okay. Let's do them in reverse order. Are we shedding clients in Europe? No, that is now behind us, so it's just normal management. In terms of our retention rates, globally they've been pretty consistent Q2 against Q1, roughly about 94%, with the usual geographical mix, whereby North America would be well above that and I think I said in my script our North American retention rates at the moment are particularly strong, which is great but I think it's probably unsustainable, so they might inch down in the second half. I think the most significant trend for us here is Europe where our retention performance is much improved and we're seeing that in our top line. So, the fact that Europe has returned to growth in the first half with roughly half a percentage point and we will do better in the second half I think is really encouraging for the future of a balanced Group. We've invested a lot behind retention. A lot of training. We've enlarged the size of the teams using North American best practice across the world and it seems to be working well.

JC Okay, thank you very much.

OP We now have a question from Nick Edelman from Goldman Sachs. Please go ahead, Nick.

NE Thank you. Morning, everyone. I also have two questions, please. The first is just on the new business wins. You've talked positively on those in each of the regions. I just wonder whether you can give an indication by region how much of that is the market... a positive market backdrop as opposed to you being more successful in terms of the proportion of bids that you're winning.

And then the second question is, please, is just in the EMs where you talk about weakness and like-for-like volumes, could you just talk about whether that's getting worse or stable? Thank you.

RC Okay. In terms of new business wins, as you know, Nick, data in this industry is not great and we really struggle to monitor it month by month, indeed even year by year sometimes. I think overall we would describe the trends towards outsourcing as moderately positive, so I think we're enjoying that and I think in terms of our market share, we seem to be doing better than many but I always think it's important you do it very carefully and very slowly in order to maintain the discipline. So, I think we feel positive about the trends there. As I said in the script, we have spent a lot of money on investing in our teams and training and I think we've been rewarded for that.

In terms of emerging markets, I think it's a very mixed picture. We're delighted with our win rate and our retention rate in the emerging markets. I mentioned the number of 14%, which I think is the strongest we've had in some time. We're making excellent progress in India and China, indeed the Group Board visited China two or three weeks ago, which I think illustrates our positive sentiment towards that part of the world but the biggest businesses for us in the emerging markets are Brazil and Turkey and I think it might get a fraction tougher before it gets better.

We have noticed some worsening of the like-for-like volume trends, particularly in business and industry as corporates in those two countries, and one or two others, are more cautious. So, I think we need to be sensible as we look forward in terms of the like-for-like volumes in the emerging markets.

NE Okay, thank you very much.

OP The next question is from Wyn Ellis from Numis. Please go ahead, Wyn.

WE Yes, hi, good morning. Two quick questions from me, if I can, please. First of all, on your margin guidance where you say for the Group you're expecting 10 basis points broadly at the half-year, if you break it down regionally, North America you're talking five, Europe and Japan 10 and negative in emerging markets, I find it difficult to see, unless I'm missing something, how you get to 10 overall, if the largest region in particular is below that.

And the other question I have is just on your guidance on the FX impact on the business, £31 million at the profit level. I presume you mean operating profit there.

And what offset will there be in terms of higher interest costs because of the movements in currencies?

RC Okay. Wyn, on the first question, yes, you're right, we're getting some leverage on central costs which are flat to slightly down half on half, so that's what contributes to the rounded 10 bps on a Group basis.

And then with regard... yes, it is, the £31 million is at the operating cost level. We do swap debt into our currencies of operation, so there is a little bit of offset there at an earnings level, probably around £4 million/£5 million.

WE Okay, thank you very much.

OP You now have a question from the line of Jeffrey Harwood from Stifel. Please go ahead, Jeffrey.

JH Yes, good morning, I've got two questions. First of all, on the rated acquisition activity, presumably there's been little or no activity there in the first half. Is the bias likely to be more on returning cash to shareholders rather than spending it on acquisitions? Secondly, on Europe and Japan, I wondered if you could give some details on trading in the main countries there, please.

RC Sure. So, in terms of M&A, I think we've spent £50 million/£60 million in the first half, which seems to be pretty consistent with what we've been spending for the last couple of years. As you know, Jeffrey, we're very keen to be balanced here. We do not rule out an increase in M&A activity, strongly minded towards the small to medium, although I have to say that our pipeline is not particularly full at the moment. So, in terms of priorities, no change.

We will leave the door open for M&A and where we have spare capacity consistent with our balance sheet strategy and the net debt to EBITDA of 1.5, we will continue to return capital to shareholders. I think we've done £310 million of a £500 million planned buyback and that process will go on in our second half. In terms of Europe and Japan and the major countries, UK, which obviously is our biggest and that's globally, I guess, as you include Ireland, about 11% of our global revenue, are doing a bit better, actually.

I think the economy, of course, in the UK is reasonably good but, more significantly, we've improved our win rate. We've improved our attention rate, so we feel quite good about the UK. It's looking the best it has for some years. Our French business, the MAP 1 element, the B2B element, is going well but the MAP 2 element, the like-for-like, is tougher. The French economy, as I'm sure you're all aware, is not firing on all cylinders and we are noticing that in our units.

Germany is very solid. Spain is beginning to recover, actually. Like-for-like was incredibly tough for a five-year period but over the last six months we have noticed an improvement in the Spanish economy and our MAP 1 trends are also positive there. And then, finally, of our larger businesses, let's pop over to Japan. Japan is solid. We were there a couple of weeks ago. It will grow this year. We've done well in our MAP 1 performance and the economy is pretty predictable. The GST increase of last year was difficult to manage but I think that's now behind us and we're performing in a solid way.

JH	Okay, thank you.

OP	Ladies and gentlemen, just as a reminder, if you have a question or comment, please press star one now on your telephone keypad. Just as a further reminder, if you have a question or comment, please press star one now. We have no further questions, so I'll hand you back to your host. Thank you.

RC	Thank you, Dave. Thanks, everyone, for joining us. We look forward to seeing you at our half-year results presentation on 13 May. Thank you for your time.

OP	Thank you for joining today's call. You may now replace your handsets.