Compass Group
Full Year Results

Richard Cousins

Chief Executive Officer

Okay, are we ready? Good morning and thank you for joining us. Today we have the usual agenda, and there'll be plenty of time for questions and answers at the end. Before Johnny takes you through the financial detail I'd like to begin by making a few comments on the business highlights.

I'm pleased to report that Compass has delivered another strong set of results. Organic revenue grew by 5%. We've worked hard to drive growth in the business and the consistency of delivery is encouraging.

Operating profit on a constant currency basis grew by 5.6% and our operating margin, including restructuring cost, was flat, as expected.

Free cash flow was up by an impressive 26% due to currency and better cash conversion.

EPS on a reported basis was up by 14%, but more honestly, constant currency earnings per share were up by almost 8% and we are proposing to increase the dividend by the same amount.

And on that positive note, I'd like to hand over to Johnny.

Johnny Thomson

Group Finance Director

Thank you, Richard. Morning everyone. Good to see you all. So on the first slide let's start by looking at revenue. I'm working from left to right. Sterling's weakness against all of our major trading currencies benefited revenues by £882 million, which gives us a rebase to 2015.

North America grew organic revenue by 8.1% in the year. Encouragingly, growth continues to be broad-based across almost all sectors.

New business wins were excellent, particularly in B&I, canteen and healthcare. Retention remained high at 96.3% and like-for-like volumes were very good in sports and leisure.

We are pleased with our progress on growth in Europe from minus 2.4% in 2013 to plus 2.2% last year and 2.8% this year.

New business wins were strong and we are working to improve retention.

Our fourth quarter growth rate, however was slower impacted by the closures of some contracts and challenging sports and leisure comps in the UK.

Rest of the world, excluding offshore and remote, grew by 3.6%. Good performances in New Zealand, Asia and Spanish speaking Latin America were offset by continued volume weakness in Brazil. Our offshore and remote business contracted by 10%. The decline in Australia accelerated in the second half as large construction projects come to an end. This trend will continue into 2017.

Taking all of these movements together, Group organic revenue grew by 5%.

A moment now to talk about phasing. Our growth rate of 4% in the second half of 2016 reflects the expected decline in Australia, an annualised 60 basis point impact on the Group's growth and the slowdown in Europe. We expect full year 2017 to be at the bottom of our 4% to 6% range with growth weighted to the second half as the comps unwind.

Let's now look at operating profit. Starting on the left of the chart, FX was a £72 million benefit to operating profit. The strong performances in North America and continued improvement in Europe increased operating profit by £85 million and £10 million respectively.

In Rest of World, a decline of £26 million in Australia dominated the operating profit performance despite £5 million of improvement elsewhere. Taking all these movements together, constant currency profit growth for the Group was 5.6%.

Moving on now to operating margins. In North America margins were flat. Positively, we continue to drive efficiencies and benefit from overhead leverage. This allowed us to offset the high mobilisation costs which accompany strong top line growth, above average labour inflation and the dilutive impact of the CulinArt acquisition.

In Europe, again, efficiencies more than offset mobilisation costs. With its underlying margin improvement, we funded the cost of creating nine business units, which will, in time, optimise our scale in procurement and the back office. As a result, European margins remained flat at 7.2%.

In Rest of World, margins, excluding Australia, were flat. We are pleased that the savings from the restructuring along with pricing and ongoing efficiencies offset weak volumes in Brazil and in our offshore and remote sector. The impact of the construction cycle in our Australian business reduced margins in Rest of World as a whole by 50 basis points.

Restructuring costs for the Group were £25 million in the year for a total £51 million over the two-year program. With the benefit of corporate overhead leverage, margins for the Group were flat pre- and post-restructuring.

Let's now look at FX, which as you know has a translation impact only. Currency movements, due to the weakening of sterling against most of our major currencies, benefited operating profit in the year by £72 million. If current spot rates were to continue into 2017, FX would benefit full year 2016 operating profit by £194 million.

To give you a sensitivity, a 1% move in sterling against all of our trading currencies would change 2016 operating profit by around £13 million and all details regarding FX sensitivities can be found in the appendices to the presentation.

Moving onto the bottom half of the income statement, net finance costs were £101 million in line with last year. We expect 2017 net finance cost to be around £110 million, reflecting the impact of the weakness of sterling on our foreign currency borrowings.

The underlying tax rate was 24.5%, also in line with last year. In May I mentioned that changes to international tax rules from the OECD BEPS Project could impact our tax rate going forward. Parts of this have become effective in the recent UK Finance Act. As a result, our 2017 tax rate will increase by around 100 basis points. We expect the tax environment to remain uncertain.

Constant currency EPS grew by 7.8% to £0.611 and we propose to increase the dividend by the same amounts, in line with our policy.

Let's now look at operating cash flow. Depreciation and amortisation increased by £55 million due to our investments in CapEx and £20 million of currency movements. Gross capital expenditure was 2.9% of revenues and we expect 2017 CapEx to be similar to this year.

Working capital in 2016 was better than expected. Some underlying improvements and some timing differences offset the expected £70 million payroll related outflow in the UK and US. We continue to focus on improving working capital and expect a small outflow next year.

Operating cash grew by 8% and operating cash conversion increased to 89% as a result of the good working capital performance.

Looking at the non-operating components of free cash flow. Post-employment benefits were £39 million. This was lower than in 2015 because of one-off payments made into the US plan last year. We have just completed our triannual valuation of the UK defined benefit plan, which is now in a funding surplus. We have therefore agreed with the Trustees to stop the cash contributions. We expect total Group contributions to pension plans to be around £20 million going forward.

The cash tax rate of 18% benefited from changes in legislation in North America. In 2017 we expect the rate to be between 20% and 23%.

We made good progress in free cash flow generation. At 63%, our conversion was slightly above our target range due to the better than expected working capital and cash tax performances. We continue to focus on cash, and we expect free cash flow conversion to be within our target 55% to 60% range next year.

Our priorities for uses of cash are unchanged. We continue to be excited by the structural growth opportunity in our sector, and invest in the business via CapEx and M&A to support our long-term growth ambitions.

We are also committed to returning significant cash to shareholders through our policy of growing dividends in line with constant currency earnings.

We will maintain a strong investment grade credit rating and we will continue to target a full year net debt to EBITDA ratio of around 1.5 times. We will do this by returning surplus cash to shareholders through share buybacks or other means.

So looking now at the balance sheet, and again starting on the left of the chart. Opening net debt was £2.6 billion and the business generated cash of £1.5 billion before CapEx. We reinvested £729 million to support our long-term growth, £549 million in CapEx and £180 million on M&A, principally the acquisition of CulinArt.

We also returned £596 million to shareholders, £496 million in dividends and £100 million in share buybacks.

And finally, FX was £395 million [sic - see slide 16 "£403 million"].

Net debt to EBITDA was 1.6 times due to the significant shift in FX rates in the fourth quarter of the year.

I've pulled together all of our 2017 full year assumptions on one page as reference for your modelling.

And so in conclusion, we've delivered another strong year and I'll now hand back to Richard.

Richard Cousins

Chief Executive Officer

Thanks Johnny. We continue to be rewarded for our focus on organic growth. New business wins were 8.8% driven by strong performances in most countries. Lost business was 5.9% and like-for-like revenue grew by 2.1%, reflecting sensible price increases. Modest volumes improvements in North America were largely offset by negative volumes in Rest of the World. As a result, organic revenue growth for the year was 5%.

We remain focused on margins. This year we faced cost inflation, especially labour in Europe and North America, volume declines in offshore and remote and Brazil and mobilisation costs.

We also reinvested in the business to support our organic growth and created nine regional business units in Europe.

And we kept margins flat by continuing to focus on efficiencies, overhead leverage and appropriate price increases.

North America, the Group's core growth engine, continues to perform exceptionally well. Organic revenue growth was 8.1%, driven by strong new business, high retention and good like-for-like revenues in most sectors. The North American business continues to be very exciting given the large structural growth opportunity in this vast and dynamic market.

Our strategy of sub-sectorisation where we divide the business into smaller segments is working. We have sharpened our offer and are driving broad-based growth across all sectors except DOR. This approach, combined with the cost advantage of our scale, is making our growth in North America more diversified and sustainable over the long run.

Performance in Rest of the World continues to be a bit mixed. Our businesses in B&I, healthcare, education and sports and leisure, which accounts for over 60% of the region, performed reasonably well. Good growth in New Zealand, India and Spanish speaking Latin America was partly offset by continued weakness in Brazil and, as a result, revenue increased by 3.6%.

Our offshore and remote business continues to be challenging due to the overall weakness in commodities. The restructuring programme we announced in 2015 is now complete. We've adjusted our cost base, and are now well placed to compete in these new market conditions.

In the early years of this decade, high commodity prices contributed to both high levels of output and site construction activity. With big double-digit growth in our offshore and remote business, maybe we were spoilt. As you can see, the trend has turned.

In Australia, iron ore and LNG construction projects are ending and are not being replaced with new ones.

Chile has been impacted by lower copper prices and our oil and gas businesses have been challenging around the region.

At some point this will stabilise, but 2017 will continue to be another tough year.

We are pleased with our progress in Europe. Even though H2 was slightly slower, revenues for the year were up by 2.8%, the highest growth rate we have seen since 2008.

New business wins were strong and we are improving retention. However, trading in the North Sea and France remains challenging.

Efficiencies generated throughout the business more than offset mobilisation costs and the impact of weak volumes in oil and gas. This allowed us to fully offset the cost of creating business units to strengthen our position in the region.

At our investor seminar back in June we talked about our plans to replicate the key elements of our North American business model in Europe. The senior teams are in place and Europe is now managed in nine sub-regional business units. This new structure will allow us to leverage our scale and procurement, lower our back office costs and speed up the sharing and implementation of best practice. And over time it will result in more consistent top line growth and margin improvement.

What about the future? Well, our strategy is clear and unchanged. Food remains our core competence and we take a cautious and incremental approach to support services. Our priority is organic growth, and we will only do bolt-on M&A if there are attractive targets.

Finally, we focus on best in class execution where we combine the cost advantage of our scale with a focus on quality and innovation.

The contract food service market is estimated to be more than £200 billion. There is a large structural opportunity for growth given that over 80% is still operated by either in-house providers or regional players.

I've talked about how we are increasing our focus on innovation. Let me take you through a few more interesting examples from around the world. This year Fortune

Magazine listed Compass as one of the 50 companies that changed the world in recognition of the work we are doing in encourage our consumers to eat in ways that are healthy for them and more sustainable for the environment.

In vending, we are continuing to evolve our offer, and are providing more premium products in our designed coffees. We now have a NanoMarkets solution for smaller spaces, and we are rolling out a Smartphone app to expedite the mobile payments.

In the UK, we are piloting a system that increases the speed of service by allowing consumers to pre-order, prepay and self-checkout.

In Canada, we are using our digital hospitality platform, which pulls together various data streams that include data analytics, consumer feedback and social media to improve our understanding of buying behaviours.

Even though we are more focused on innovation, our core business model remains clear and unchanged. Top of our agenda is organic growth, and we continue to put more focus and resources behind both MAPs one and two driving new business and retention and consumer sales.

Our obsession with costs, that's MAPs three, four and five, food, labour and overheads, is never ending and there is still considerable opportunity to improve margins.

We invest as required to support growth and create value for our shareholders by delivering a balanced package of EPS growth, a strong and progressive dividend, and return of surplus capital, where that's appropriate, either via share buybacks or other means. It's a proven and sustainable model.

And so to summarise, it's been another strong year. Our business in North America is in great shape. The restructuring in the Rest of the World is complete, and we are making good strategic progress in Europe.

We continue to return cash to shareholders, and remain focused on strong growth with discipline.

Our expectations for 2017 are positive with a weighting to the second half and we remain excited about the structural growth opportunities in the business.

Thank you for your time and attention. We are happy now to take questions. In the normal way I'd be grateful if you would wait for the microphone and give your name and company that you represent.

Okay, who is going to go first? Vicki, I think you just won.

Q&A Session

Vicki Stern - Barclays

Yes, morning. It's Vicki Stern from Barclays. A question just on the Rest of World. So you talk about another tough year probably ahead in that division. How to think about margins there? Are you fairly confident that you can hold things better than in

2016? And I suppose what would it take for you to require another restructuring program in that region?

Richard Cousins

I think, as I said earlier, our margins in the Rest of the World went back by 50 basis points in 2016. I think we've done a lot of hard work in the last two years on the restructuring, as you can imagine and so I think we feel as if we in a good position going into 2017.

Most of the businesses are now at least flat margin going into 2017. Australia is still challenging for the obvious reasons around the construction cycle. However, I think we feel we are in a good position now to get close to flat margins year on year. Perhaps not quite there, but close to it. Maybe a minus 10 basis points would be a reasonable assumption. At this stage Vicki I don't think we assume doing more restructuring. It's now about ongoing efficiencies within the normal course of business.

Jamie?

Jamie Rollo - Morgan Stanley

Good morning. Jamie Rollo from Morgan Stanley. Just a question on Europe. With the Q4 sales around zero quite a sharp slowdown from the 3.7 stage, could you just try and call out some of the items that were behind that? You mentioned France, comps in the UK, contract exits. And what gives you the confidence that, that growth rate will actually accelerate in fiscal 2017?

Richard Cousins

It's a good question. We would expect Q1 to be similar, maybe even a fraction worse, not sure. But we've analysed the pipeline to death and we feel increasingly positive about H2 in Europe. The biggest business in Europe clearly is the UK. Sometimes win rates can be a bit lumpy. Our win rates in the UK have been very strong, but they mainly come on stream in our second half. So we would be quite bullish that the UK will see a sharp acceleration through 2017, but Q1, H1 will be dull.

Jamie Rollo

Contract exits?

Richard Cousins

Contract exits, there's a few closures. We had some in the North Sea, some in Denmark, some in the UK where clients have closed sites and we take that as a retention hit. Clearly not our fault.

Richard Clarke - Bernstein

Hi. Good morning. Richard Clarke from Bernstein. Two questions from me please. Just with all the political changes we've seen around the world, those that have happened and perhaps those to come, are you seeing any kind of caution from any of your clients in getting new business coming through? And is that reflected in your 4% organic growth for next year?

And then secondly just on dividend policy. Your policy is to grow in line with constant currency growth. If my calculations are correct, that would put your payout below 50% next year because you'll grow faster. Any plans to change that dividend policy with the exchange rates?

Richard Cousins

Okay, well in terms of the divi, you win some you lose some. When sterling was strong, our dividend cover drifted down to about 1.8% I think one year and who knows maybe it will be a fraction above 2% next year. So I think for the moment we are comfortable with our policy.

In terms of the political situation, who knows. In terms of the US, I have to say our pipeline for the US looks really excellent and we are going to be really quite bullish about 2017.

The UK, maybe we saw a little bit of a slowdown in decision-making over the long summer before and after the referendum. In a sense, that has perhaps contributed to our H1/H2 weighting in 2017, because decision-making I think was a bit slow.

I think in the end we don't get too excited about short-term political noise. This is a very low risk business spread across 50 countries, 40,000 sites with great balance across each of our sectors. So I think people have got to eat, people continue to outsource, I think we'll do as well as most.

Richard Clarke

Thank you very much.

Tim Ramskill - Credit Suisse

Thank you. It's Tim Ramskill from Credit Suisse. Can we just come back to Europe please? I guess, Richard, in terms of the restructuring you've put in place there you talked both about growth and margin, but which of those opportunities do you think is the greater or which excites you more?

And then just related to that, just a point of clarification, in terms of the exits in Europe you mentioned a lot of it's been due to closures rather than lost business. On the lost business side, is there any change in the dynamic or has that been consistent?

Richard Cousins

No, in terms of retention rates in Europe, they have continued to inch up. As you know, they are structurally lower than North America and always will be. But I think we are quite pleased with progress in terms of European retention.

In terms of the growth margin, Johnny, do you want to comment on that?

Johnny Thomson

Yes. I think we feel positive about both actually Tim. I don't mean to hedge the bets here, but I think the creation of the business units helps us to fast-forward on the implementation of the best practice principally from North America. So that process has started but we feel it can accelerate. And I think over the next two or three years, as the structures solidify and as we get better systems in place, we can then start to drive out better efficiencies through overhead leverage and better procurement. So I think it's a story of both to be honest.

David Phillips - Redburn

Hi. Good morning. David Phillips from Redburn. Could I ask a couple? Start on slide 29 and your innovation investment in the customer experience. Could you put an absolute number on how much your spending sort of run rate in a year on these new initiatives at the moment?

Richard Cousins

No.

David Phillips

Ballpark?

Richard Cousins

We debated that long and hard about 18 months ago when we started putting more focus behind innovation how do we measure the cost, how do we measure the benefits and concluded that it would become a bureaucratic industry. So, no I don't think we can give you an intelligent number. It's not huge, but no.

David Phillips

Okay thanks. And the second one, I heard you say in the past that the element of choice that Obamacare brought to catering in hospitals was a positive for you. Are your guys on the ground feeling that that innovation is here to stay or is there a risk that it could be victim to changes?

Richard Cousins

I think whatever the new President does with healthcare it seems to have been creating instability. And however you look at it, that means hospitals are going to drive out cost. So I think we've done well from Obamacare. Our pipeline in healthcare is very strong. And we would be bullish that that momentum will continue as far as we can sensibly see.

James Ainley - Citigroup

Thanks. It's James Ainley from Citi. Can I just ask about the M&A environment? A couple of your competitors have been doing a few more deals. Could you talk about what you're seeing in terms of seller's expectations in terms of multiples and whether you might be more ambitious this year on M&A?

Johnny Thomson

Well yes, as you know we've been relatively cautious. We haven't spent a great deal on M&A over the last five or ten years. Our average is somewhere between £100 million to £200 million. We obviously did a very exciting deal CulinArt in the US this year which was great. And as we look forward, I think we would expect to do similar levels £100 million to £200 million, small bolt-on's, North America, maybe a fraction more in Europe. So nothing has really changed from that perspective, and I don't think we see the pipeline as being materially different either.

Richard Cousins

And it's very difficult for us to answer your question on multiples as well, because we tend to buy private companies. Our model is to build relationships with people. You don't necessarily get businesses at the lowest price, but you get good businesses, you get buy-in from the management. Continuity I think is important. So I think we would struggle to give you any yardstick for multiples.

James Ainley

Thank you.

Jarrod Castle - UBS

Thank you. It's Jarrod Castle from UBS. Morning. Just looking a little bit ahead to 2019 when the new lease accounting kicks in, will that have any impact on the way you look at the balance sheet in terms of capitalising minimum lease payments?

Johnny Thomson

There will be around about £500 million or £600 million, round about, that that will come onto our balance sheet from leases, which I think brings us into the way that the rating agencies would measure our balance sheet anyway. So other than that, I don't think there are any particular changes.

Jarrod Castle

Okay, thanks.

Richard Cousins

Any more questions, please? On the telephone lines we've got thousands of people none of whom want to ask a question. Oh we've got another one from Tim.

Tim Ramskill

Thanks. Tim again from Credit Suisse. Just coming back in terms of the US so the growth opportunities, I guess it's probably maybe correct me, two or three years ago since you landed a couple of really very significant contracts and talked at the time about both the healthcare, education sectors in terms of more opportunities like that. Just maybe an update on whether any of those have been landed, and how you think about that one.

Richard Cousins

Our pipeline for those sort of mega contracts is underwhelming. Our pipeline for mid-sized contracts is the best it's ever been. So actually we are really content with the way it's going. You rightly said the two mega contracts; one was in higher Ed and one was in healthcare. Healthcare in particular is strong. Education is about average in North American terms, which is still very good. We are very comfortable with winning lots and lots of mid-sized contracts.

David Phillips

Hi. Thanks. David Phillips at Redburn again. A follow-up on Foodbuy and Foodbuy Europe. Can you give us a run rate for what you think gross purchasing will be in 2017 and how much of that will be third party please?

Richard Cousins

Foodbuy Europe is probably only about £200 million. It's quite small. If you compare it to the US where in total we are buying or tracking about $20 billion, which clearly is a very significant operation, Europe is small. But we think the direction of travel is clear. We've made one acquisition in the UK a couple of years ago and a small one in Holland recently. We like the business model and we think we will quietly grow it.

Jarrod Castle

Thanks. It's Jarrod Castle again. I guess coming back to Vicki's question just in terms of restructuring, if you look a bit further ahead three to five years out, is there any big initiatives that would actually result in some form of restructuring or is it just kind of MAP program from now on?

Johnny Thomson

As we stand today, I think that's quite a difficult one to answer would you say. Nothing that sits right in front of us that would cause us to think of restructuring. But, of course, you'd expect us to say that things change very quickly in this world.

Richard Cousins

I think what's ongoing is our obsession with cost. I think the moment we say to you we are bored of cost and we are just going to sit back and congratulate ourselves then we are toast. The mood in the business is very healthy I think, very humble and we remain really cautious and therefore, keep driving away at costs. So we only do restructuring when big events happen.

Oh god there's loads more questions.

Jamie Rollo

Jamie Rollo again. Can I ask about tax? Is that 100-basis points increase? You mentioned FX rates in the release. Is that just the mix of US going up, or is there something else in there? And what could that 25.5% go to worse case let's say in a few years' time?

Johnny Thomson

Yes, the increase of 100 basis points is fractionally to do with FX but mostly to do with the Finance Act and passing BEPS and how that affects the Group. So I wouldn’t read too much into the FX point.

Going beyond 2017, I'm not going to give any guidance because as I said things remain very uncertain. There is proposed legislation out there which if passed could make further changes to our tax rate. So at this stage I can't give you any guidance Jamie.

Jamie Rollo

But it could stay flat beyond 2017, or will it definitely go up do you think?

Johnny Thomson

Who knows who knows?

Jamie Rollo

Don't know, okay thanks.

Richard Cousins

Jeffrey?

Jeffrey Harwood - Stifel

Yes, Jeffrey Harwood from Stifel. As we look at the prospects for margin improvement this year, would I be right in saying that most of the improvements are going to reflect the elimination of the restructuring costs of £25 million that, that figure dropping out of the equation?

Johnny Thomson

I think that's right. We will see that, of course. But I think on top of that you should expect a small amount, modest amount, of margin improvement across the Group on an underlying basis too, and I would say a handful of bps, maybe mid-single digits.

Richard Cousins

If you compare 2017 with 2016, in 2016 we've obviously seen 5% revenue growth and flat margins. In 2017, revenue growth will be a bit slower. Still north of 4% we think but we are quite bullish that margins will move nicely forward.

Okay, any questions on the telephone? Any more questions? Thank you everybody for your time. Have a good Christmas.

[End]