COMPASS GROUP PLC

HALF YEAR 2016 RESULTS

Analyst Presentation

Richard Cousins

Group Chief Executive

Thank you, everyone, for joining us this morning; nice to see you all.

Today we have the usual agenda and there'll be plenty of time for question 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 5.8%. We've worked hard in this area and the momentum we're seeing is really quite encouraging.

Operating profit grew by 6.4% and, as expected, our operating margin before restructuring was flat.

[Indiscernible] earnings per share were up by 8% and we're proposing to increase the dividend by the same amount.

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

Johnny Thomson

Group Finance Director

Thank you, Richard, and good morning everyone. My name is Johnny Thomson. I've been CFO of Compass for around six months now. I've been with the Group for a little over seven years. My last role was Managing Director of our Latin American business. I'm excited to be here and looking forward to getting to know you all.

As we go through the presentation you'll see there are some new slides in there. They reflect how I see the business, so I hope you find them helpful. Of course, all the information that you're used to receiving is either in the slides or the appendices as normal, so let's begin.

We'll start by looking at revenue. Working from left to right, currency was a £18 million hit to revenue in the first half, which gives us a re-based 2015.

North America grew by 8.3% in the half. Encouragingly, growth was well balanced across all of the sub-sectors. New business was strong particularly in Bon Appetite, canteen and healthcare, and retention was again excellent at 96.5%.

There was the expected volume weakness in our offshore and remote sector, but we're managing that well, and it was more than offset by modest volume increases in other sectors.

The momentum we saw in Europe in the second half of 2016 continued into the first half of 2016 with organic revenue growth of 3.7%. The overall economic backdrop is a bit better. We had strong rates of net new business wins in the UK and Southern Europe. Some volume growth in the UK and Germany was offset by challenges in our North Sea business and weakness in France.

Organic growth was 1.7% in the Rest of the World. Excluding our offshore and remote sector, the region grew by 5% as pricing and new business was partly offset by volume declines in Brazil.

In Australia, the biggest business in our offshore and remote sector, revenues declined by 6%. This was due to pricing pressures, site closures and the beginning of what we call the construction cliff, where our units goes from construction into production with significantly less people on site. This trend in Australia will accelerate through the second half of 2016, and into 2017.

Taking all of these movements together Group organic revenue grew by 5.8%.

Now let's look at operating profit. FX was £3 million benefit to operating profit, even though it was a headwind to revenues. This is because of the mix of currency moves.

The US dollar strengthened in our highest margin region, whilst all other currencies weakened versus sterling.

The strong performances in North America and Europe increased profit by £44 million and £6 million respectively.

In the Rest of the World profits were up across the region with the exception of Australia. Therefore, our profits for the Rest of the World as a whole declined by £6 million in the first half.

Restructuring costs were £11 million. We continue to expect a full-year charge of around £25 million to complete the £50 million program as announced in July of last year.

All these movements together with flat corporate overheads results in organic profit growth, before restructuring, of 5.8%, and constant currency growth after restructuring of 4.8%.

Let's now look at our operating margins, starting with North America where margins increased slightly to just over 8.5%.

In the first half we experienced higher mobilization costs to support our top line growth; volume pressures in our offshore and remote sector; as well as slightly above average labour inflation. We offset this through ongoing efficiencies across MAPs 3 and 4, some pricing and continued overhead leverage.

In Europe margins of 7.4% were flat in the half. Operating efficiencies have been offset by higher mobilization costs as growth accelerates.

Margins in the Rest of the World were 6.4%. Excluding Australia, we're pleased that margins in the region were flat. The savings from the restructuring along with pricing and ongoing efficiencies offset the impact of weak volumes in Brazil and our offshore and remote sector.

Therefore, the lower profitability in Australia was the driver of the 40 basis point margin decline.

Given this regional performance and taking advantage of our corporate overhead leverage, margins for the Group pre-restructuring costs were flat. Post-restructuring, they were down 10 basis points. But, remember, this is due to the phasing of the restructuring costs in the second half of last year. For the full year we still expect flat margins pre and post-restructuring.

As you all know, FX in Compass is [indiscernible] only. This slide analyses the impact of different currencies on last year's half-year and full-year profit. If current spot rates continue for the rest of the year we estimate that FX would benefit full-year 2015 operating profits by £39 million. This is principally driven by the strength of the US dollar.

FX will, of course, continue to change, to give you a sensitivity, if sterling were to move by 1% against all of our trading currencies we expect this would change 2015 operating profit by £12 million.

All details regarding FX sensitivities can be found in the appendices to this presentation.

Moving on now to the bottom half of the income statement. Net finance costs reduced to £47 million, because of lower pension interest due to an increase in the surplus of the UK scheme. As a result, for the full year we expect the net finance costs to be around £100 million. The underlying tax rate was 24.5% in line with full-year 2015. We expect a similar rate for the full-year 2016.

There are significant changes expected in tax legislation principally the OECD BEPS project. We're waiting for these proposals to be finalized and will update you on the impact they will have on Compass at the appropriate time.

Constant currency EPS grew by 8.1% to 30.8 pence, and the interim dividend increased by 8.2% to 10.6 pence in line with our dividend policy.

Let's now look at operating cash flow. Gross capital expenditure was 2.7% of revenue in line with recent trends. Encouragingly, our net cash conversion remains stable reflecting the strong returns we continue to deliver on CapEx. The investment in the camp we are building for a client in our CAMEA region will happen in the second half of the year, and so we are still expecting full-year CapEx to be around 3%.

Working capital was an £83 million outflow re-electing our normal half-year seasonality. Our full-year guidance for working capital remains unchanged: we expect the usual small annual working capital outflow. This year we will have an incremental £70 million outflow due to the timing of our payroll run in September.

Positively, operating cash grew by 8% or £45 million. Our conversion was 79% slightly better than the first half of last year.

Looking at the non-operating components of free cash flow. We continue to make payments to fund our pension liabilities. The full-year cash contribution is expected to be around £50 million, in line with previous years.

Net interest was £39 million, and net tax was £112 million. The underlying cash tax rate for the half-year was 17%, this is lower than our full-year expectation of around 20%, because of the phasing of payments.

We generated £73 million more cash than last year, an increase of 23%. At 55% free cash flow conversion was, therefore, better than the first half last year.

This is not a new slide, but it is an important one. Our priorities for uses of cash are clear and 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 return 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 through shareholders through share buybacks or other means.

Looking now at the balance sheet, again starting on the left of the chart opening net debt was £2.6 billion. The business generated cash of £646 million before CapEx.

We reinvested around £400 million in the business to support our long-term growth. We spent £250 million on CapEx and £144 million on M&A, principally for the acquisition of CulinArt in North America.

We also returned almost £400 million to shareholders; £322 million for the 2015 final dividend, and £72 million in share buybacks.

Finally, other movements were £172 million. This includes £161 million of FX, mainly due to the strengthening of the US dollar, resulting in closing net debt of £2.9 billion.

Net debt to EBITDA was 1.7 times, it's always a little higher in the first half. This is because of the seasonality over free cash flow and the payments of the previous year's full-year dividend. We are on track for a full-year ratio of 1.5 times.

I've covered all of these points, but I thought it would be helpful to pull together our full-year assumptions on one page as reference for your modelling.

In conclusion, we've delivered a strong first half. The top line is in good shape, and is converting nicely into profits and cash. We are reinvesting that cash in the business to support growth and continue to return cash to shareholders by the dividend and buybacks.

I'll now hand back to Richard.

Richard Cousins

Group Chief Executive

Thanks, Johnny. Over the next 20 minutes or so I'll cover our regional performances in the year, and update you on our strategy.

The momentum in Compass is really encouraging. We continue to benefit from having a global business with a balanced exposure to different sectors, regions, and countries. Our great business in North America is in rude health, and the progress in Europe is encouraging.

However, we are facing some challenges in our offshore and remote business in some emerging markets, where we're aggressively taking our costs down in response to the new market conditions.

We are being rewarded for our focus on organic growth. New business wins accelerated the 9% driven by strong performances in almost all countries.

We had 5.5% of lost business in line with the half last year. Like-for-like revenue grew by 2.3% reflecting sensible price increases and modest volume improvements in North America and parts of Europe. As a result, organic revenue growth was an exciting 5.8%.

We remain obsessed with margins. The main headwinds are increasingly labour inflation, and, to a much lesser extent, food costs. Given our focus on organic growth, we continue to reinvest in the business, mainly sales and retention, to ensure our growth is balanced and sustainable. Whilst we are being rewarded for that investment, it does mean we have to content with higher mobilization costs.

In parallel, we remain relentlessly focused on offsetting these challenges through cost reductions and efficiencies; improving overhead leverage; and appropriate price increases. As a result, margins pre-restructuring were flat.

North America, the Group's core growth engine, continues to perform exceptionally well. Organic revenue growth was 8.3%, driven by strong new business, high retention, and good like-for-like revenues in most sectors. Margins increased modestly.

I remain really excited about the North American business. The opportunity is significant, with two-thirds of the market still in the hands of self-operators or small regional players.

Sub-sectorisation, where we segment the business down into smaller opportunities, is allowing us to sharpen our offer and accelerate growth. This strategy is working really well.

10 years ago, we ran our North American business through seven or eight core sectors. However, over recent years, we've started to break it down further, such that today we operate 24 subsectors, each addressing a different part of business and industry; healthcare; education; vending; sports and leisure; and so on.

As the clear market leader, we have the advantage of scale and, yet, are able to provide clients with specific solutions tailored to each subsector.

As you can see, our growth is well-balanced and diversified, which makes it more sustainable over the long run. This is a unique and increasingly successful model.

Turning to the Rest of the World. Performance in this super region was a bit mixed. Our core B&I, healthcare, education, and sports and leisure operations performed well, with organic revenue growth of 5%.

Good progress was made in New Zealand; parts of the Middle East; India; China; and, of course, Spanish-speaking Latin American countries. However, we have seen a downturn in Brazil, and a more significant one, due to the commodity cycle, in our offshore and remote sector.

Let's drill down further and look at the data over the last 4.5 years. The orange line maps two very different trends. Our core operations, shown with the grey bars, have improved nicely, and we were particularly pleased with 2015. However, the Brazilian recession is quite serious and, hence, the slowdown in the first half of 2016.

Clearly, in the earlier years of this decade we enjoyed a booming commodity sector, shown by the dark grey bars. A slowdown was inevitable, but it has been sharp. Most stark has been Australia, where like-for-like reductions are combining with the completion of a number of labour-hungry construction projects. The Australian cycle, probably, has another couple of years to run before it bottoms out.

We took early action to take out costs and adjust to the new market environment, and I'm very pleased that the restructuring program is on track.

Importantly, we continue to make good progress in Europe. Revenues were up by 3.7% in the half. Retention continued to improve, and volumes have stabilized. Margins were flat, given the increase in mobilization costs, which come with faster revenue growth, combined with the impact of weakness in oil and gas in our North Sea business.

We operate in 23 countries in Europe, and each market is improving its performance at a different rate. The UK and Iberia are in good shape. They were the first markets to embrace and implement North American sales and retention techniques, and they're being rewarded for their efforts.

By and large, the rest of the region is progressing well. However, Norway is having a tough time because of oil and gas, while the economic environment in France is still challenging.

We're now creating sub-regional clusters in Europe to better leverage our scale in procurement, lower costs, and speed up the sharing and implementation of best practice.

Our largest European business by some distance is, of course, the UK. We've made excellent progress over the last 18 months. 2.5 years ago, we brought over an American to run the business, and economic stabilization has combined with a significant improvement in our own performance.

In particular, new contract wins are strong and we've made excellent progress with retention, partly through the implementation of best practice and partly through an increased focus on quality and service. We feel good about our second most important market.

Let's now switch to our global strategy, which is clear and unchanged. Food remains our core competence, and we take a cautious and incremental approach to support services.

Organic growth is our focus, and we will do bolt-on M&A only if there are attractive medium or small targets. We concentrate on delivering the highest quality and performance, whilst relentlessly driving to be the lowest cost, most efficient provider.

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 in-house providers or small regional players. Recently, we have started to sharpen our focus on innovation.

Our tight strategy liberates us to increase our efforts in this area. We seek to be more innovative in all parts of our core business. This, clearly, includes the more glamorous aspects shown on the right of the chart, but it also implies the basic operational stuff on the left.

Innovation doesn't come from thin air, nor, in general, does it come from our global headquarters in Surrey; or even our North American offices in North Carolina. Rather, it comes from units, from subsectors, from managers who understand the needs of our clients and consumers, and are able to have interesting ideas and create new concepts and solutions.

We're increasingly focused on spreading these ideas, and best practices in general, within a country or across the globe. We'll talk in more detail about what we're doing in this important area at our Investor Seminar on June 30.

Our business model remains clear and unchanged. Top of our agenda is organic growth. We continue to put more focus and resources behind both MAPs 1 and 2: driving new business and retention; and consumer sales.

Our obsession with cost, that's MAPs 3, 4 and 5, food, labour and overheads, is never ending. 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.

So, to summarize. It's been another strong six months. Our business in North America is in great shape; restructuring in the Rest of the World is on track; and Europe is performing well.

We continue to return cash to shareholders and remain focused on strong growth with discipline. Our expectations for 2016 are positive and unchanged. We remain excited about the significant structural growth opportunities in the business.

Thank you for your time and attention. We'll now obviously take questions. Please, when you receive the microphone, if you'd just give us your name and organization, we'd be very grateful. So who's going to open the batting? Vicki?

Q&A Session

Vicki Stern - Barclays

Just a question of Rest of World. Obviously, the trends have accelerated somewhat. What would it take for you to contemplate a further restructuring program there? And just more broadly, your thoughts about the medium-term margin effect.

Richard Cousins

Do you like to answer that, Johnny?

Johnny Thomson

Yes. I think we took early steps, Vicki, on the restructuring, as you know, in July of last year. I think we feel positive, as I said in my presentation, about the benefits that are coming through on that.

We still expect the £50 million-ish of restructuring in total over the program. At this stage, I wouldn't envisage us requiring any more restructuring. Of course, the world might change but, at this stage, I think, that would be our position.

As time goes on, we continue to do ongoing efficiencies as part of how we manage business normally.

Tim Ramskill - Credit Suisse

Tim Ramskill, Credit Suisse. Sticking with the same region, Richard, just in terms of the chart you've given in terms of the split between the oil and gas businesses and the remote site piece and the rest, you talk in the statement about pressures continuing accelerating into H2 and then into 2017. So maybe just some sense as to the shape of those two elements across that timeframe.

Richard Cousins

Well, obviously, we don't give hard forecasts for 2017, but it is fairly clear that the direction of travel is negative in the commodity sector. We need to remind ourselves it's only 7% of our business. Perhaps we talk about the other 90% in a minute. I think it's going to continue to ease down for the next year or maybe two.

Absent Brazil, I think, the rest of the Rest of the World is looking quite good, actually. I was in Japan two or three weeks ago and that's looking very solid. New Zealand is strong. Australia, outside of the commodities sector, is doing well.

India, I think, is beginning to ease towards breakeven, and we like the way that's going. China is still solid; it's come off a fraction, but still growing well. Middle East is good.

And, as I said in the script, the Spanish-speaking Latin American businesses are growing nicely, double-digit there.

So I think we need to be balanced. Oil and gas, iron ore and other commodities only 7%, but I think we've got another couple of years.

From the floor

Very sensibly, around disciplined growth has been one of the mantras of this business. Could you talk a little bit about the capability and the capacity of the North American business to continue to deliver such incredible run rates on net new business gains, and I see the base keeps getting bigger every year.

What are the pressures that that causes and can it go higher or are we at the right level now?

Richard Cousins

I think it's a great question. Can it go higher? No, I wouldn't want to promise that. But we have delivered 6%/7%/8% year after year after year. I think we would feel bullish that we can continue in that range.

I'll be in -- well, we'll be in Charlotte this week won't we? And we'll spend two or three hours just on management development. We do that three or four times a year. It's crucial, as you imply in your question, that a business of that scale invest in people all the time. I think we've made excellent progress over the last couple of years globally, but particularly in the US. So it's a highly pertinent question, but I think we understand the relevance of it.

You go first and then Jamie.

Jarrod Castle - UBS

Jarrod Castle, UBS. Just on the UK business, can you give us the split between public and private? There's been some recent softening in the UK indicators, PMIs, etc., and you don't seem to be seeing that. But is there any [form of] slowdown that worries you?

Richard Cousins

The split between public and private is imprecise, because some of our education is private and some of it is state. Of course, it's not directly state, it's indirectly and so on. But in simple terms, it would be about one-third healthcare and education; and two-thirds B&I, sports and leisure, defence, offshore and remote and so on.

In terms of your question about short-term economic volatility, we really don't notice that. I have to say, our UK business is performing really well. That's a medium-term thing.

I don't think we see short-term changes in our consumers; our employees; patients; students; people attending sporting occasions. Their average ticket item is, what,

£3/£4. Now, clearly we saw changes during the global crisis of eight years ago. But I have to say the momentum in the UK is really encouraging.

Jamie Rollo - Morgan Stanley

Jamie Rollo, Morgan Stanley. Just back on the US, you talked about some like-for-like volume growth there and, indeed, parts of Europe. Could you possibly quantify some of those numbers. Clearly, oil and gas is offsetting it. But if you could talk a bit about how that could drop through to the bottom line, given the high conversion margins on like-for-like volumes.

Johnny Thomson

I'll talk about North America to start with, Jamie. We have -- our like for likes overall are round about 3%, which is round about par for North America. Most of that is pricing, so a little bit, around 1% is volumes.

As you rightly say, the oil and gas sector has pulled some volumes down. But we've seen some nice uptake in some of the other sectors, principally sports and leisure.

In Europe, volumes are between 0% and 1%, around that mark. Again, it's a mixed batch isn't it? We were just talking about the UK there; volumes in the UK are a little better, they're more positive.

But on the other side, again, there's some pressure from the oil and gas in Norway. France is a little weaker it seems, so round about flat to a little bit positive in Europe.

Of course, we also have the rest of the world, where volumes have come off quite sharply for the obvious reasons. Therefore, across the whole Group, our volumes are round about flat.

Jamie Rollo

On the Rest of the World margin question, I think you said Australia was possible for the first half 40 basis point drop in Rest of World. That's one-quarter of that business, so is it fair to say that about 160 basis points was the Australian margin drop?

And if things are getting worse from here, what does that mean for Rest of World margins for the second half and for next year? I think we're all assuming for next year flattish margins in Rest of World, given the restructuring benefits.

Johnny Thomson

Well for the rest of this year, our guidance hasn't changed. We're round about minus 50 basis points for the rest of year.

As we're minus 40 basis points first half and, as we talked about, Australia accelerating the decline into the second half, therefore, you'd expect our year-on-year margin as we go into the second half to be slightly worse than 40 basis points, to get us to that 50 basis points.

We don't, obviously, give guidance on 2017. But, of course, we're taking a lot of restructuring actions in the second half of this year too, with the balance of our £50 million program. So we'd expect that to flow through as a benefit into 2017.

Nigel Parson - - Canaccord Genuity

Nigel Parson, Canaccord. I just wondered if you could talk a bit more about the CAMEA big project. I just sense it's one of the biggest projects -- capital projects that you might have ever have done. And I just wondered how that might feed through into your P&L, whether we should expect a tick up in margin.

Richard Cousins

No, I described it as medium sized in the Middle East or the larger part of Middle East. It's for a blue chip oil client, probably one of the biggest in the world.

The project's about £30 million, so it's not that huge. But it's going to be nicely revenue accretive with a very respectable margin, as you would expect with that kind of capital. So I don't think you'll notice it from a global perspective, but we think it's a nice project for the medium to long term.

Simon Larkin - BofA Merrill Lynch

Simon Larkin, Merrill Lynch. I've got a question on innovation. You've been talking about innovation increasingly over the last 12/18 months. Are you at a point now where you're becoming increasingly optimistic that innovation can do something more than being a retention tool but, actually, can drive volume?

Richard Cousins

It's a great question and we really struggle to measure it. That's the problem with innovation, you could make an industry out of it. I think Compass is at its best when it's got a small centre, empowering local managers to drive their own business.

I think the key point with regard to innovation, I said six months ago when we talked about it for the first time in this forum, is a business such as Compass, which is going to have a tight strategy and we're very cautious on M&A, we can't just sit back and shrug our shoulders and say it's business as usual.

We've got to be permanently innovative in all aspects of our business. The most obvious parts or the more glamorous parts, I put on the chart, the MAP 2 side, digital.

Three or four years ago, a bunch of middle-aged men were saying, digital, we ought to worry about that at some point in the future, but not now. That's no longer acceptable. What we hear from our clients and consumers is that they do care; they do want us to invest; and we are.

Can I tell you what the benefits of that are? No, I can't. But I think you can see in our overall numbers that we seem to be winning, retaining at a better rate. I think our like for likes are also coming through partly as a result, but I can't quantify.

So it's a state of mind. It's a direct consequence of a tight and focused strategy. We're very ambitious to grow. We're very ambitious to do more innovation. We'll give you more detail at our shareholder conference in five/six weeks' time.

Jarrod Castle

Jarrod Castle, UBS. Can you maybe just talk about CulinArt, the acquisition and the attraction of it? And then, also, could we see some more brands being added? Thanks.

Richard Cousins

Yes, CulinArt's a nice business. It's largely in northeast part of the US, principally in B&I and education. We've done many tuck-in deals like that before in the US. This is perhaps slightly above average size. It's circa $250 million.

We like the look of the business. We like the contracts. We like the management. And, we think the synergies will be very useful. So it's a nice tuck in; not transformational; very low risk. Expect more of the same.

I think some years our acquisition spend, as indeed it was last year, will be very modest, £100 million or maybe even less. And then another year, who knows, we could do £300 million/£400 million. But I guess in 2016 it'll be somewhere in the middle of that range. But we think it's a nice, sensible move.

Okay, no more questions from the floor, any over the phone? This could be a record short meeting. You can go and do something more interesting now. Thank you for your time; good to see you.