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Speakers: Richard Cousins and Johnny Thomson

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Presentation

Operator

Good morning ladies and gentlemen. Welcome to the Compass Group Quarter Three Trading Update Call. Throughout the call, all participants will be in a listen-only mode and afterwards there will be a question and answer session. Just to remind you, the conference call is being recorded and your personal data will be held in the United States. If you do not consent to the call being recorded, or your personal data being transferred to the United States, please hang up now.

Today I am very pleased to present Richard Cousins, Chief Executive. Please begin.

Richard Cousins

Thank you Richard. Good morning ladies and gentlemen and thank you for dialling in. With me this morning I have our Group Finance Director, Johnny Thomson. I'll start by giving you a brief overview of our third quarter trading, then say a few words on the outlook, before opening the call to questions.

Compass continues to have a good year. Organic revenue growth was 5.6% for the nine months to the end of June and 5.2% in the third quarter. The operating margin for the nine-month period was flat, excluding restructuring costs. Let's look at the regions individually to understand what drove results in the third quarter.

Firstly, performance in North America continues to be very good, with organic revenue growth of 8.3% in the quarter and for the nine months to the end of June. We are still seeing strong growth across all sectors, with the exception of oil and gas. Margins, including the diluted impact of the CulinArt acquisition were flat for the nine months to 30th June 2016.

In Europe, organic revenue grew 3.7% in the quarter and in the nine months to the end of June. We continued to deliver efficiencies, which has allowed us to further reinvest in sales and retention and to improve the year-to-date margin slightly.

Turning now to the rest of the world, organic revenue grew by 0.2% in the nine months to the end of June and declined by 2.8% in the third quarter. Trading in our offshore remote business is, as expected, rather challenging. Revenues were down 9% in the quarter, as large construction projects in Australia came to an end. Our non-commodity-related business in the rest of the world, however, grew by 4% in the third quarter, with good rates of net new business across the region, partially offset by continued economic weakness in Brazil.

Our ongoing efficiency programme and the restructuring announced in July of last year has partially offset the pressures in our mining and oil and gas businesses, as well as soft volumes in some emerging markets. However, due to the impact of the construction cliff in Australia, the operating margin for the nine months to June declined by 50 basis points, as expected.

In summary, Compass has had a good third quarter and our overall expectations for the full year are unchanged. Growth in North America is very good and our future pipeline is strong. Although we are pleased with the recovery in Europe, the macroeconomic outlook has become a little uncertain. In the rest of the world, trading is more challenging but we continue to manage the region tightly. We remain focussed on costs and efficiencies which, combined with the expected restructuring savings, will allow us to deliver a flat operating margin for the full year, including restructuring costs. Looking to the longer term, we remain really excited about the significant structural market growth opportunity and the potential for revenue growth, margin improvement and continued returns to shareholders.

Thank you, now I'll hand back to Richard and we'll obviously be happy to take your questions.

Q&A

Operator
Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw that question, you may do so by pressing 02 to cancel. There will be a brief pause while questions are being registered.

And our first question comes from the line of Jamie Rollo from Morgan Stanley. Please go ahead, your line is now open.

Jamie Rollo
Thanks, morning everyone. Two questions, please. First, on the rest of world, could you talk a bit about what has caused this additional slow down? Because I think back in May you were looking to sort of 0% growth – well, 0% organic for the year and back in November looking at plus 3% and it looks like, given the trajectory, it's going to be slightly negative now. So is that more on the mining side or more on the M side[?] or a bit of both and when does that sort of – that decline bottom out?

And I guess the other question is, if we just take your comments on the rest of world trajectory and Europe being a bit more uncertain, how does that leave organic sales growth, do you think, for 2017, in the context of your 4–6% sort of medium-term target guidance? Thank you.

Richard Cousins
Okay, thanks Jamie. Johnny, do you want to take the first one and I'll take the second.

Johnny Thomson
Yeah. On the rest of the world, Jamie, I think, as Richard said at the front, we obviously declined by 2.8% in the quarter versus growth of 1.7% in the half. It is, of course, challenging, as Richard noted. You should note, of course, that it is 15% of the group at this stage. The O&R business, the Offshore and Remote business, the commodities part of it declined by 9% from minus 4% in the first half. Now, to a large degree, that's as expected, as Australia has gone down the construction cliff, so Australia has gone from minus 5% first half to minus 15% in the quarter and that's largely within our expectations. Within the O&R sector what I would say, it's probably slightly down overall because of – Chile, I would say, would be the one area where maybe there's been some acceleration in the slow down in the volumes in our Chilean mining business. But other than that, we largely expected the declines.

In the non-Offshore and Remote business, the non-commodities-based business, we grew by 5% in the first half and 3% in the quarter, so it's just come off slightly. I would note that Brazil continues to be really tough; it is a challenging environment there and although we expect things to pick up from Brazil in the longer term and we're still very positive about it, it is still a challenging environment. So I would say we've just come off a little bit, and as you roll forward into next year, I would expect something similar, somewhere in the minus 1%, minus 2%, minus 3% contraction for next year.

Richard Cousins
Okay, so that's in the rest of the world; if we look globally at 2017, I think we're going to have another good year. We talked at our shareholder conference four/five weeks ago about that 4–6% range, as you referred to, Jamie. We would certainly expect to be within that range next year. This year it looks as if we're going to be in the upper half. Next year I think we might be in the lower half. If you look at Europe, I mean I'm delighted with our European recovery relative to where we were three/four years ago at minus 3%; it looks as though we're going to finish this year north of plus 3%, so that's a terrific turnaround. I do think, however, perhaps the first six to nine months of this year have flattered us just a fraction. If you look at some of the challenges with the French economy in general and specifically related to terrorism, where I think we have noticed some volume weakness; we obviously have some concerns about Turkey, following the coup and the UK economy, I think, is uncertain. So I think we would see Europe still doing well next year, but fractionally weaker and rest of the world I think Johnny has just described. Finally, of course, that leaves us with the flagship, which I think is clearly North America. It's in great shape, particularly the US and we would expect another very strong year next, perhaps not quite at the 8-and-a-bit, but certainly very strong.

Jamie Rollo
Thank you very much.

Operator
Thank you, our next question comes from the line of Jeffrey Harwood from Stifel. Please go ahead, your line is now open.

Jeffrey Harwood
Yes, good morning. Just on the comments on the European prospects, does that really relate to your views on what might happen next, as opposed to anything you're seeing at the moment?

Richard Cousins
I think that's a fair point, Jeffrey. I mean Q3 was the same as H1, at 3.7%, but we've been through our forecasts very carefully for our fourth quarter; now we haven't finished the budgetary process for 2017 yet but obviously we have a draft budget and yes, I think it is more what we expect to happen than what we've seen thus far but those three countries that I referred to, France, Turkey and the UK, I think the concerns are fairly obvious and I think it would be naive of us to assume that we won't see a little bit of a slow down relative to the first six to nine months but I do want to keep stressing, relative to where we were three to four years ago, I still feel very positive about Europe.

Jeffrey Harwood
Okay, thank you.

Operator
Thank you, our next question comes from the line of James Rowland Clark from Barclays. Please go ahead, your line is now open.

James Rowland Clark
Hi, good morning, just one question please. When you're thinking about dividend growth going forwards, given recent currency movements, should we be thinking about this on underlying or reported earnings?

Johnny Thomson
Yes, thank you. I'll just talk about – I'll talk about FX in general but specifically to your point on dividends. Our dividend policy, as you know, is to grow the dividend in line with underlying constant currency EPS growth. I think that's just a good reminder for everyone, in terms of their models, to make sure you're reflecting constant currency and not reported EPS growth.

If I could just take advantage of that, to widen the FX a little, you'll have seen from our statement that the FX impact on our earnings for the first nine months was £30 million – sorry, that's not in the statement – but at spot rates for the full year, we would expect the impact to be a £60 million tailwind to our earnings.

I would say also, for your models, that on interest and tax we expect a very, very modest impact and therefore to be absorbed within our current guidance. And the only other point I would mention on FX would be the impact on our net debt to EBITDA ratio, again mentioned in our statement, at spot rates clearly the closing rates at a weaker sterling to the average rate will increase our net debt to EBITDA to around about 1.7x, we expect. Although, we also still target and expect, on an underlying basis – constant currency basis – that our net debt to EBITDA will be 1.5x and again that should unwind next year, as average rates catch up with closing rates.

James Rowland Clark
Thank you.

Operator
Thank you, our next question comes from the line of Jarrod Castle from UBS. Please go ahead, your line is now open.

Jarrod Castle
Thanks, good morning, gentlemen. Two questions: just sticking with currency, you make mention of a 700 million revenue benefit and 60 million total benefit at the operating level. If I look at, you know, the implied margin, that's 8.6% and you know, obviously none of your divisions are at that margin, so is there some kind of cost-versus-revenue allocation, so it's – i.e. you know, how does that margin – that implied margin of 8.6% get there?

And then just secondly, just on organic growth, can you give some colour on pricing versus volume growth? Thanks.

Richard Cousins

Okay, well your first question was so complicated we're going to think about that one for five seconds. Organic growth – it's always complicated, isn't it, when you've got our wins, our losses, you've got like-for-like volumes and like-for-like pricing. I think what we've seen in the third quarter has been pretty consistent with H1, whereby good, steady new business wins, retention, continue to be very strong in North America and better than we were in Europe and the rest of the world as well, though I think, structurally, those retention rates will never be as good as North America.

In terms of like-for-like volume, as ever, it's a combination of volume and price: steady and slightly positive in North America, smaller increments in Europe and the rest of the world, of course, an extremely complex story with, on average, above average inflation and therefore pricing reflecting that, but clearly some volume pressures in both the commodity businesses and some of the emerging markets, so it's a complex picture.

In terms of your first question, Johnny?

Johnny Thomson

Yeah, I think, just, if I understand your question correctly, what I'd say is that we do take some reported margin benefits because of the mix of business between the regions. Of course, with North America being, you know, 55–56% of the group and at the highest margin, the impact of currency, when you consolidate the three regions, does give us a few basis points of margin kick. However, I would say that comes and goes, of course, as currency goes and we've had the opposite in recent years. So I think that's within the normal course of business.

Jarrod Castle

Okay, thanks I guess. Thanks.

Operator

Thank you and as another reminder, if you do wish to ask a question, please press 01 on your telephone keypad. There will be a further pause while any questions are being registered.

Okay, as there appear to be no further questions, I return the conference to yourself, Richard.

Richard Cousins

My word, that was the shortest ever call. Thank you everyone for attending, we'll see you at our full-year results in November; have a good summer.

Johnny Thomson

Thank you.

Operator

Thank you, this now concludes our conference call. Thank you all for attending; you may now disconnect your lines.