Conference Title: Compass Group PLC Q1 Trading Update

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Operator:

Hello and welcome to the Compass Group Q1 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, this conference call is being recorded. Today I am pleased to present Dominic Blakemore, CEO and Palmer Brown, Interim Group Finance Director. Please go ahead with your meeting.

Dominic Blakemore:

Good morning ladies and gentlemen. Thank you all for dialing in. With me joining our Interim Group Finance Director Palmer Brown. I'd like to say a few words about our performance and outlook before opening the call to questions.

We're really pleased with the performance this quarter. Group organic revenue growth was 6.9% for Q1 with good performances across all three of our regions. This is driven by strong levels of new business wins, continued good retention rates and bolstered by the impact of the new UK defense contracts and a positive sporting events calendar. Excluding these last two factors, our underlying growth was around 5.5%. We continue to generate efficiencies through our management and performance program, which allows us to offset inflationary headwinds.

Now turning to the regions. In North America, organic revenue is up 8%. Growth was very good across all sectors and particularly in vending business and industry, and sports and leisure; the latter of which benefited from the timing of certain events. Excluding these one-off revenues, our underlying growth in North America was approximately 7%.

Europe reported 6.4% organic revenue growth in the first quarter reflecting continued momentum from new business wins and notably the significant impact of defense contracts in the UK, which we mobilized in the second half of last year. A favorable calendar in sports and leisure as well as continued good growth in Continental Europe. The underlying performance was more like 3.5% in the quarter.

In rest of the world, organic revenue increased by 2.8% with ongoing good performance in developing markets partially offset by the runoff of the last major offshore construction project in Australia. Excluding offshore and remote, our growth was 4.5% in the region. On acquisitions, we spent £197 million during the quarter on acquisitions in North America.

Targeted and disciplined bolt-on acquisitions focused on our core food offerings strengthened our capabilities and there's a good pipeline of opportunities across the group. Currency movements compared to the same quarter last year had a positive translation impact on revenues of £107 and on profit of £10 million.

If current spot rates were to continue for the remainder of this year, foreign exchange translation would positively impact 2018 revenue by £508 million and our operating profit by £43 million. So, in summary, we've had an excellent start of the year. We now expect to be slightly above the middle of our target 4-6% organic growth range for the full year and with some modest margin progression.

In the longer term, we remain excited about the significant structural growth opportunities globally and the potential for further revenue and margin expansion. Thank you, and we'd now be happy to take your questions.

Operator:

Thank you sir. If you would like to ask a question, please ask by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We will now take the first question from Vicky Stern of Barclays. Please go ahead.

Vicky Stern:

Hi, morning, I've got three questions. Just firstly on Europe, obviously, quite a nice step-up in the underlying growth rate, I think coming from this conference, Europe in particular. Just who are you taking share from, is it share gains and where is the extra growth coming from? Secondly on margins, I think you previously used to call out what quarterly margins were running out. Just any commentary on how margin is progressing so far this year? And then just finally on the acquisitions, just perhaps a few more details on what you've acquired in Q1 and what sorts of prices and what sorts of margins we should have in mind? Thanks.

Dominic Blakemore:

Thanks Vicky and good morning. I'll take the Europe question and then I'll hand over to Palmer for margin and M&A. Yeah, first of all, we're really pleased with the overall European performance and I think it's worth being really clear on the numbers there. 6.4% is really exceptional for the quarter in Europe including the UK. And as we said, that is driven by nearly 14% growth in the UK, half of which is coming from the defense contracts and the other 7% would be benefited a touch by Sports & Leisure. So, we think that the UK growth rate is sort of closer to 5-6% underlying, which is still a good run rate. But I just want to make sure we've cautioned that the 14% is truly exceptional.

In terms of Continental Europe, we are growing at 2.2%, and that's on the back of 2.5% in the fourth quarter of last year. So, we're really pleased with that continued momentum over two quarters. And frankly, that's a couple of points better than we've done for quite some time in the Continental European region.

I think the single biggest delta of improvement is retention, where we're seeing a stronger retention rate across the region. And, obviously, we've been working very hard on putting measures in place for some time now, which have resulted in that improvement and we'll continue to focus on it. I think maybe the other point or so is coming from better new business in some of our northern business units; so, Benelux, Nordics, DAC[?]. And I that's being largely driven by taking a little bit of share, but also some first-time outsourcing as well.

So, I think it's a balanced picture and I don't think it's one that's being predominantly driven by taking market share, I think it's all factors that drive our net new business. Over to Palmer for the other two.

Palmer Brown:

Yeah, on the margin point, I don't think anything's really changed from what we're seeing. We're still excited about the margin opportunities we see across the group. We've just gone through most of our business units over the course of the last three or four months. There are opportunities that exist across the patch, but at the same time, we've got a number of headwinds we're dealing with.

We've got inflation in most countries. Some of those countries are pronounced. We look at the UK in particular on both the food and the labor, the labor within the US and some other pockets as well. There are uncertainties that exist across the globe as well. And when we look at our model of course with these higher growth rates, we – the mobilization and start-up cost, so it's is another something we have to overcome.

That said, I think we still feel comfortable that we are seeing some margin progression for the full year. It will probably be a bit second half weighted, but in the grand scheme of things, we remain excited about the opportunities and thus far, we've been able to combat the headwinds. On the acquisitions question, thus far, all the acquisitions spent in the quarter was in North America. We bought a couple of vending office coffee and micro market companies in a similar vein to what we've done in the past.

Similarly, we bought a couple of food buy related companies, again, similar to what we've done in the past. We view both of these as core business for us, key drivers for our growth going forward. We are excited about the pipeline both within North America and outside of North America. I think we've become more confident about our ability to do acquisitions outside of North America.

We have seen some good opportunities there and I think we want to be opportunistic where those opportunities arise. On the margin question regarding the acquisitions, I think keep in mind, we've got the acquisitions and the disposals happening at the same time. There's a bit of a timing issue as to when these will occur. As we look at it, we expect them to be roughly neutral when it all washes out. But there may be a little bit of toing and froing month to month or quarter to quarter, but largely neutral once it all washes out.

Vicky Stern: Great, thanks very much.

Operator:

If you find that your question has been answered, you may remove yourself from the queue by pressing star two. We will now take our next question from Jaafar Mestari of Exane BNP Paribas. Please go ahead.

Jaafar Mestari:

Hi, good morning. Couple of questions for me please. The first one is just following up on this points about disposals and acquisitions, which you just said should broadly neutral to revenue once it's all reflected. Could we just maybe discuss the cash side of that? And do you think the disposal proceeds for the full year could cover a large parts or a material part of your M&A spends, or you're going to be a net buyer net seller?

And then my second question is on the US healthcare markets, which is already talked about in today's comments. Competitor Sodexo last month flagged uncertainty around the US healthcare; contract renewals this year looking a bit tough. And do you feel like this is market wide something you're also noticing declines higher expectations and/or is your impression that this is maybe Sodexo-specific and may even be an opportunity for you to take share in US healthcare?

Dominic Blakemore:

I'll handle the North American healthcare and then I'll pass back to Palmer on the cash question on M&A Jaafar. So, I think to cut to the chase, I think it is specific timing on individual contracts. We had a very nice run in healthcare as you know over the last 18 months. We expect that growth in healthcare to moderate a touch as we go through this year, but we still see lots of good opportunity. And I think particularly, there are moments in time when a group of contracts may come up to rebid simultaneously, and I think that can cause some pressure. We don't see that within our portfolio today.

Separately, I think it's probably worth saying that we talk a lot about the negative side of the labor pressures that we've seen in the US both inflation and availability of labor. I think that can also be as we said before a positive for outsourcing and, increasingly, it becomes a driver of the decision to outsource particularly first-time contracts. So, I think that is an opportunity in a number of our sectors as a result of that as well.

Palmer Brown:

On the acquisition point, again, there's a bit of timing issues and unpredictability that's built in. One of the things that's very clear is that we have done the 200 million of acquisitions in the quarter, so that's done and dusted. We have a couple of disposals that should happen in the first half. I think if you look forward to the full year, I think it's a reasonable expectation that we will be a net buyer just given the timing of the way things will happen.

The disposal program will continue into ’20. We’re probably roughly 4% of the way through it now, lots of good activity that’s happening. And I think just given the start of the year where we are on acquisitions and anticipated timing, I think it’s a reasonable expectation that we’ll be a net buyer. But you know, the quantity and magnitude of that remains to be seen. Thank you very much.

Jaafar Mestari: Right. Thank you very much.

Operator: We will now take our next question from Jarrod Castle of UBS. Please go ahead.

Jarrod Castle:

Thank you. Good morning gentlemen. Three from me. One, just looking at some of the results you mentioned positive sporting calendar. And I just wanted to get a view if you think this continues during the year or is this just the shift between quarters.

Two, you gave a bit of color on retention rates, but can you give a bit of color maybe per geography and what you’re seeing? And then lastly US shutdown, if that’s had any impact on your business in the US during the current quarter. Thanks.

Dominic Blakemore:

Thanks Jarrod. Let me pick up on our retention rates and then I’ll hand to Palmer on the other two US related questions. So, firstly, on the retention rates, look we continue to trend in North America at the level of retention that we achieved at the end of last year. I think we’ve seen an improvement in Europe of a point or so let’s say. But conversely, in rest of world we’ve obviously got the runoff of some big business which is just going the other way at touch.

So, in the round, I think we are slightly better at a group level, but of course as retention is a fairly imprecise number. I think the good news is we've got a reasonable confidence that our retention rates will continue to trend to the levels you've seen for the group as we look forward.

Palmer Brown:

Good morning, Jarrod. On the sporting, Sports & Leisure calendar question, I think there are a couple things that are happening there. One is a bit of a just a shift within the schedule in terms of our teams compared to prior years. So, we may have games that have fallen earlier into the schedule whereas they would have been later last year, given that and the lumpiness of the sporting events, one or two games can cause a bit of a difference.

You also have a bit of one-time events that can distort things a bit. So, for instance, in North America, we operate in a lot of arenas where the NBA and the hockey teams play. Those are also the venues where most of the concerts occur. And so, concert schedules and calendars can cause a bit of inflation compared to prior year. So, we've had a bit of that. The two countries where we're seeing this primarily are in the UK and the US. In fairness, those are the biggest countries we have in the sports and leisure sector.

Your question regarding the US shutdown, we do have some business with the US government. It's not a lot. The business we do have is deemed to be nonessential by the US government, which means that in a shutdown phase, those businesses are in fact shutdown. So, it's not military type business that would continue to operate. That being said, the impacts that we've had thus far are not material and we don't expect them to be material even if the shutdown commences once again.

Jarrod Castle: Okay, thanks very much.

Operator:

As a reminder, if you wish to ask a question, please signal by pressing star one. We will now take our next question from Tim Barrett of Numis. Please go ahead.

Tim Barrett:

Good morning everyone. I had one specific thing on Europe and then one bigger picture question. On Europe, I think at the end of last year, we were talking quite a lot about the UK being in quite pronounced negative volume territory. And if I understood it, you're now saying 5-6% underlying organic. So, can you just try and could you marry the two up for us and talk about the trend?

And then secondly in the past, I think you've said at the top end of your organic guidance range, it would be more difficult to eke out margin progression. Is there something different about this year? Thanks a lot.

Dominic Blakemore:

Thanks for the questions, Tim. Firstly, on Europe and the UK, yeah, you're absolutely right and we haven't talked on this call about Brexit. I think it's probably worth just a moment on how we're seeing that because I think that's the driver of the underlying question. What we saw in the first quarter is very much a continuation of what we talked about at the end of last year. So, we're seeing higher inflation. We're seeing a slowdown in some client decision making and hiring freezes and that stand[?] we believe weakened consumer sentiment has resulted in negative volumes which have continued through the first quarter in the UK.

So, where we've got those direct consumer volumes effectively, where it's mapped to business to the consumer, we've continued to see negative volumes at the order of 3%. That is also largely been offset by price as the actions that we've taken it now flowed through in full. So, our like-for-like within this sort of map[?] to consumer segments is broadly neutral. So, when I talk to 5-6% organic growth in the UK, that's largely net new business coupled with sort of Sports & Leisure volumes as well.

So, again, in the round, we believe at this point that we are mitigating those impacts. The actions we took last year are allowing us to mitigate both inflation and the negative consumer volumes and we're obviously lapping the actions we took in the first half of last year, but, of course, we're incurring the mobilization on the strong growth. So, sort of in the round, the UK margin, that was broadly flat, but we're still seeing those negative consumer volumes.

In terms of the company's model as we call it, yeah, absolutely, we believe that in that 4-6% organic growth range, if we're at the top end of it, we will expect minimal margin progression. And it's very much – and in fact, I think this year is a case study and this quarter is a case study with the sorts of growth rates that we're enjoying and where they're coming from better net new business in the main, that puts pressure on us from a sort of mobilization standpoint on the new. But also, as we've always said, where we're improving our retention rates, that does have an impact on the margin of the business in the short term. So, that becomes a drag in the short term on top of the normal headwinds that we face and that we're mitigating every day in the business. But in the round, we've always been very, very excited by the higher growth levels. We think is right for the business. It gives us more volume in purchasing more consumers to retail to and more opportunity in the medium term. But we recognize that it will put -- it means it means minimal margin growth. But by the same definition, at the lower ends of those growth range, we think that's when we should start to enjoy the opportunity to manage the margin.

Tim Barrett: Thanks really helpful, thanks very much.

Operator: We will now take our next question from Richard Clarke of Bernstein. Please go ahead.

Richard Clarke:

Good morning, couple of questions for me please. So, first one just on the US. You called out the strong business and industry performance and, obviously, that's carrying on from last year. Just wondering what's driving that; is that continued strong growth in things like vending and the coffee shop offers you've got in, or is it kind of broadly across the spectrum of the business and industry.

And then second one, clearly, you are kind of doing some M&A; any comment you can make on what impact that might have on potential cash returns this year?

Dominic Blakemore:

I'll let Palmer pick up on the North America B&I point and then I'll handle the M&A one. So, over to Palmer first.

Palmer Brown:

Sure. Richard, to your B&I question. We've got a strong B&I business within North America. I think it's grown nicely over time. And when we look at the last year and the first quarter of this year, I think the growth that you're seeing is pretty widespread throughout the types of businesses that we have. You mentioned our vending office coffee micro markets business. We have seen nice growth in those segments and that is certainly the case in the first quarter, so that momentum continues.

It's still a relatively smaller portion of the overall B&I business we have, but the growth rates that we're seeing there are quite nice. I would say we continue to enjoy a nice growth in the tech areas as well. I guess some of the industrial businesses we're seeing some nice growth. So, I think it's pretty widespread. I would consider our B&I business fairly healthy overall and we remain excited about the prospects looking forward.

Dominic Blakemore:

Great. Thanks Palmer. On the M&A point, really, to kind of grandiose back in that sort of capital allocation framework. We still believe that our priorities are to invest in the business. We said that any investment with capex will be up to 3.5%, and that's the guidance we maintain for this year especially as we're enjoying the higher growth rates.

Secondly, I think we've got a renewed focus on M&A, but more particularly outside of North America. We think there's a very important part for bolt-on, so a non-transformation M&A to play for us as a group. There's some exciting opportunities in food-only businesses which add scale great management and good brands, and that's the pipeline of opportunities we'd like to pursue.

We will prioritize capex and M&A to the extent that there is surplus capital in the balance sheet either within a year or as we look forward at the M&A pipeline over several years, then we'll consider returns. I think it's more appropriate that we should have updated the half year and the full year on exactly what that looks like as both some of the disposals and acquisitions start to crystallize.

Richard Clarke: Very clear. Thank you very much.

Operator:

Once again, if you wish to ask a question, please signal by pressing star one. We will now take the next question from Jamie Rollo of Morgan Stanley. Please go ahead.

Jamie Rollo:

Morning. Two questions please. First, just on the margin guidance again for the full year. I think for Europe, you were talking about up 5% to up 10% this year back in November. I know a lot of the sales growth is new contract wins. But is that guidance still there because obviously last year margins fell quite a lot. So, what do you think it bounced back a bit more without strong top line?

And secondly on the full year sales guidance of just above 5, I mean probably splitting hairs here, but it implies the rest of the year is going to be below 5. I know Q1 there was a one-off there, but they're not going to be reversing. So, are we not looking at something nearer 5.5$ this year like last year? Thank you.

Dominic Blakemore:

Yeah, good morning Jamie. Thanks for those questions. First of all, on the margin guidance for Europe, I think the answer is yes, we still expect to make margin progression second half weighted in the UK and contributing to Europe. So, that guidance remains unchanged despite those higher levels of growth that we've enjoyed and will enjoy in the first half of the year.

In terms of full year guidance, look, all I can really say at this point is we've made an excellent start to the year, but it's only a quarter. The world feels a bit of an uncertain place at the moment. We haven't talked a lot about Brexit, but that's the risk we may see more from the government shutdown, and it's obviously been gilet jaune activity in France which has caught on in some other European countries. So, we remain a touch cautious and conservative in the outlook as a result of those factors and I think rightly so.

And it's probably right to say as well that the quality of our second half will be predicated on our retention and new business performance in the first half of this year; and it's still early days. So, at the moment, I think we feel good about slightly above the midpoint of the range and we will talk to you again in the half year.

Jamie Rollo: Okay. Thanks a lot.

Operator:

As a final reminder, if you wish to ask a question, please signal by pressing star one. It appears there are no further questions at this time. So, I'd like to hand the call back over to today's host for any additional or closing remarks.

Dominic Blakemore:

Thank you very much and thank you everyone for your questions. We will speak to you again at the half year results in May and have a good day.

Operator:

Ladies and gentlemen, this concludes today's conference. Thank you all for your participation. You may now disconnect.