G4S
2018 Half Year Results Presentation
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G4S

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Introduction & Key Highlights

Ashley Almanza, Chief Executive Officer
Welcome to G4S's half year results presentation. If we've not met, I'm Ashley Almanza, I'm the Chief Executive and I'm joined by, Tim Weller, our CFO, and we also have, Helen Parris, our Director of Investor Relations, with us today.

We have as usual a presentation, I think that will last about 40 minutes and there will be plenty of time for Q&A afterwards.

We begin as usual with the customary legal disclaimer, please read it carefully in your own time.

Our agenda this morning starts with the highlights from our results, which we released at seven o'clock this morning. Tim will then take us through the financials in a bit more detail. I will come back and present a business review and then we'll go to Q&A. So with that I'm going to go directly to the highlights.

I'm sure you have all seen our results statement this morning. And you would have seen that following a first quarter decline in revenues we had a marked improvement in our revenue generation in the second quarter, with 2.8% organic growth. Meaning that for the first half as a whole, revenues were broadly flat year on year.

By segment we saw our Secure Solutions business grow by 3.2% and we saw growth in all of our four regions, geographic regions in Secure Solutions.

Cash as expected was down, was down 13% in revenues and that as you know was driven by a very large retail Cash Solutions contract, which we began to mobilise in the fourth quarter of 2016 and we had five months of those comps in our 2018 numbers. So that mobilisation continued through to May of 2017. The effect of that year on year comparison is now fully annualised, so we shouldn't see the effect - we won't see the effect going forward.

At a profit level PBITA came in at £212m versus £219m in the prior year. Again, by segment we maintained our net operating margins in Secure Solutions. I think that was a pretty satisfactory performance, given what we've seen across the industry, which is wage inflation, particularly in developed markets, North America, UK, Europe. We managed to offset that wage inflation with a positive revenue mix and through some modest productivity gains in the first half going through to the bottom line.

In Cash Solutions our margin was 10.7%, down from 11% in the same period last year. This was a function of course the revenue decline we saw, but also increased business and product development costs in our Cash Technology business and some quite exceptional attack related costs. And that came on the back of a really unprecedented surge in violent attacks on the CIT industry, not just G4S, but as 40, 45% of the market share we obviously bore a big part of that attack assault on the industry in South Africa.

I am pleased to say that as a result of management action and government action, working together, we are starting to see those attacks beginning to abate, but they had a significant effect on our business in South Africa in the first half.

Those effects - revenue, increased business development, and product development spend and the attack related costs in South Africa were partially, not wholly, offset by a £6m profit on the early completion of a bullion contract in our UK business.

Operating cash flow, we saw OCF conversion of 84% versus 80% last year and the Half 1 / Half 2 split is following the seasonal pattern that we've been in the business for many years now.

Earnings per share was bang in line with last year, 7.4 pence per share and the Board has declared and interim dividend of 3.59 pence per share.

So that's the highlights from the first half, I'd like to now turn to the outlook for the full year.

When looking at the outlook there are three important building blocks, very obviously - revenue, margins, and productivity. We know from our sales wins, new contract wins in the first half, £700m, that that will give us some momentum into the second half. And that combined with very good contract retention, I would say exceptional contract retention in the first half, those two factors working together give us very obviously positive revenue momentum into the second half.

Alongside that we expect also to see margin improvements, firstly from those new contracts and looking at the sales mix in the new contract wins, including technology enabled Security Solutions, so where we're selling our people and technology together and sales in the our Cash Technology Service line. They give us a positive sales mix in the second half with an associated margin benefit.

And then of course price increases. We have seen across the industry higher wage levels and through the first half of the year we have had to increase wages, enter into new wage settlements and alongside that we started a programme of engaging with our customers where we don't have automatic indexation, which is more common in our UK contract base, but less common in North America and in Europe and indeed the rest of the world. It tends to be done on a negotiated basis.

So we started our price increase programme with customer communications in the second quarter and we expect to see the benefit in our margin of price increases in the second half.

And then of course productivity, we announced last year a new three year productivity programme, designed to deliver between £90m and £100m of productivity gains over that three year period. More than half of those we expect to drop to the bottom line, but as we pointed out in the early stage of the programme we intended to, and did, reinvest a lot of the gains in building our capability, particularly in our technology businesses and in sales and business development resource.

As we move into the second half of the year we see the balance between reinvestment and capturing those benefits to the bottom line starting to shift, so we expect an incremental net benefit to the bottom line in the second half.

So those three building builds, revenue momentum, margin improvements and productivity gains underpin the positive outlook that we have for the full year. And on that note I'm going to hand you over to Tim who is going to take us through the numbers in a bit more detail.

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Financial Review

Tim Weller, Chief Financial Officer
Thanks Ashley, morning everyone. As Ashley's outlined we've reported a solid set of first half results with the improving momentum since the second quarter, underpinning the positive outlook for the second half and for the full year. Let me continue with the underlying results of the business.

Overall Group revenues grew by 0.2%, reflecting very strong comparatives in the US Cash Solutions business and slower growth in the Europe and Middle East region.

PBITA was £212m down 3.2% with modest growth in Secure Solutions. And an £11m reduction in profits in our Cash Solutions business, reflecting the demanding comparatives in the North American region of our Cash Solutions business, investment in business development and increased operating costs which are mainly attack related, as Ashley mentioned. Partially offset by the benefit from the early completion of bullion centre contract in the UK.

The interest charge was £54m, £2m lower than the first half of 2017. This improvement reflected a £1m reduction in other finance costs and a £1m decrease in the pension interest charge. We continued to expect a full year interest charge of around £105m.

The effective tax rate for the half year is 24% and earnings were unchanged compared with the same period in 2017 at £115m, with earnings per share at 7.4p.

Non-controlling interest raised to £5m, mainly driven by trading conditions in some of entities in The Middle East where we're minority shareholders.

Operating cash flow, after pension deficit repayments of £21m was £179m, down around 2% with a conversion rate of 84% of PBITA, slightly better than the same period last year.

Turning now to the bridge from underlying results to our statutory results as set out on page four of today's release. As explained in the RNS which we issued on the 11th of July, this half year we've simplified our reporting by eliminating the separate presentation of portfolio businesses now the portfolio programme is substantially complete.

Therefore the results of the businesses which have previously been categorised as portfolio, that have not been sold or closed are now included in our underlying results. These businesses delivered first half revenue and PBITA broadly in line with last year and therefore our reporting simplification had no effect on the Group's underlying growth rates.

We continue to manage effectively the onerous contract portfolio, related cash outflows of £6m in the half, unchanged from the same period in 2017. With operational improvements enabling us to keep spend at the lower end of our expected range. No changes to the onerous contract provisions were required during the first half of 2018. You should be aware the onerous contract costs will see a material reduction once the current Compass contract comes to an end in august 2019.

In the first six months we sold our businesses in Hungary and the Philippines and our Secure Data Storage business in Kenya, realising net cash proceeds of £32m. In aggregate these businesses generated revenue of £10m and PBITA of £1m up to their dates of disposal in the half.

Restructuring costs of £11m after tax relate mainly to strategic efficiency programmes in Europe, The Middle East and Americas regions. And underlying PBITA included non-strategic reorganisation costs of £4m mainly in our Secure Solutions businesses, the same level as the first half of 2017.

And finally the other reconciling charge of £2m reflects at £8m charge in respect of historical employer liabilities in Asia, pre-tax disposal profits of £4m, acquisition related amortisation of £2m and disposal related tax credits of £4m.

So that was the bridge and now let's turn to the statutory results. Statutory revenues for the half year were £3.7bn. As we already said underlying revenues showed a small increase in the first half and therefore the 7.5% reduction in statutory revenues primarily reflects the impact of foreign exchange movements, coupled with a reduction of £139m in revenues from businesses disposed of during the current period in the prior year, including the Group's business in Hungary and Israel and our Youth Service business in North America.

PBITA declined by 10.5% reflecting 3.2% decline in our underlying results, coupled with the adverse impact of exchange rate movements and the reduction in disposed businesses PBITA of £8m.

Specific and other set of disclosed items including investment in restructuring, profit on disposal of businesses and amortisation in respect of historical acquisitions resulted in net charge of £20m after last year's gain of £37m. The main reason for the year on year difference is the £68m profit on disposal of businesses which were recorded in the first half of last year.

As a result statutory earnings were £48m lower at £103m with EPS down to 6.7p per share from 9.8p.

This slide looks in more detail at the cash flow trends we've seen in the first half where we saw a £55m working capital outflow compared with the outflow of £84m in 2017.

Receivables movements resulted in working capital outflow of £20m, £31m better than 2017. And a decrease in payables over the first half of 2018 resulted in a working capital outflow of £30m compared with an outflow of £40m last year.

Overall operating cash conversion of 84% and that reflected the typical seasonal pattern with lower conversion in the first half of the year than that which we normally see at the full year. We continue to expect operating cash conversion of over 100% for 2018 as a whole.

Now let's look at cash flow and net debt across the half. This slide shows the full movement in net debt starting with the year end of 2017, net debt of £1.5bn. As I said before underlying operating cash flow is £179m.

In terms of investing activities, we invested £50m in capex and finance leases. We continue to expect this to be in the range of £100m to £120m for the full year.

The £10m restructuring outflow is mainly in respect of strategic restructuring investment in our Europe and Middle East and Americas regions.

And we received net cash consideration of £32m from disposals and made no significant acquisitions.

Looking at the use of funds of £223m, we paid net interest of £66m which was higher than the first half of 2017 reflecting the timing of annual interest payments on certain of our recent bond issues. Overall we anticipate a cash interest cost for the full year broadly in line with the income statement charge of around £105m.

Cash tax paid was £48m in line with previous guidance.

Our dividends paid to equity and minorities were £104m.

After a small foreign exchange movement we finished the half with net debt £79m higher than the December year end, the amount of just £1.5bn reflecting the normal seasonality of the business.

And then on the financing front. We have very strong liquidity with £967m of cash and cash equivalents and in addition access to un-utilised but committed funds of £1bn from our revolving credit facility.

Our recent seven year, €550m Eurobond which we launched in May was more than three times oversubscribed with an order book of €1.7bn. This covered our July maturities in full and a large portion of those in December 2018. This means we've now secured interest cost savings which will amount to an annualised level of around £20m from the end of 2019 onwards following the redemption of our more expensive debit.

Our net debt to EBITDA finished the half year at 2.7 times unchanged from the last half year. We continue to expect it to be 2.5 times or below by the end of the year. And with that I'll hand back to Ashley.

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Business Review

Ashley Almanza, Chief Executive Officer
Thanks Tim. Turning now to our business review. I think you all know that four years ago we launched a portfolio programme and the objective of that was to improve our strategic focus. Along the way we sold more than 50 businesses, raised substantial cash proceeds, improved our net operating margin but very importantly we improved the strategic focus of the company.

At the same time, and in parallel, we began investing in strengthening our resource and capacity across the company. This was a general management technology, skills and capability, customer facing technology, as well as back off technology, business development and very importantly product development.

And bringing these two things together we completed substantially our portfolio of programmes at the end of last year. And we made sufficient progress with strengthening our resource and capability, both customer facing and support functions, to reorganise the group. And from the 1st of January this year we created a Global Cash division and we consolidated our Secure Solutions business into four regions.

And so today we have a much more focussed group, a Global Cash business operates in 40 countries, represents 17% of our revenues. And our Secure Solutions business which operates in 90 countries obviously represents the balance, 83% of our revenues.

And what we'd like to do now is just touch on the strategic positon of those two businesses, how they performed in the first six months and where we see them going in the second half of the year and further beyond.

So starting with our Secure Solutions business and the market context, I think this is well understood by everybody but there's significant change going in the security market at the moment. Historically there have been two major, let's say, product and service groups or markets within the overall security market. On the one hand traditional Manned Security services, everything from static land guarding through to more sophisticated mobile deployments and then Security Technology products and services.

And increasingly over recent years we've seen these markets starting to converge, as players, G4S and typically larger players beginning to offer customers integrated solutions. And the drivers for that change, well there are many factors, the two most important in our view, firstly on the demand side.

Our customers and particularly our larger customers have much more complex security needs today and they're looking for more sophisticated solutions to address those needs. And typically those solutions involve bringing people and technology together to respond to their needs. So there's a demand side driver that continues to evolve in one direction which is greater use of technology.

Customers are also looking for lower total cost of ownership and that's supported by supply side factors because over time the unit cost of labour continues to rise and if you like the normalised unit cost or technology continues to fall. And that presents a very obvious substitution opportunity, economic opportunity. That's most prevalent today in developed markets where the arbitrage between technology and unit labour costs is greater. That is what we have seen and what we continue to see.

G4S has not only been responding to this trend in the marketplace, in fact we've been helping to drive this trend. And we've been doing that by investing in resource and capability and changing the way in which we organise ourselves and the way in which we go to market.

So the slide some of you have seen before, six/seven years ago the company possessed many, but not all of the ingredients that you would need to successfully go to market with an integrated security offering. In the last four or five years we've been investing particularly in risk consulting, in security software and secure integration services.

We've also brought in new management, talent with extensive technology experience and changed the leadership in our technology businesses which has given us the ability to offer bundled offerings. So combining security offices with technology but not all of the technology and perhaps not in all cases being involved at the front end in the design, build, operate, maintain.

Today in North America, UK and Europe we're able to offer an integrated service to our customers starting with risk assessment through design, build, operate and maintain. That brings very obvious benefits to our customers, lower total cost of ownership, greater functionality and of course benefits for us. In general we expect longer commercial relationships with these customers so longevity in our contract portfolio and an opportunity to earn a higher margin.

The capability that we have developed in North America, UK and Europe we're now extending across our global market footprint. We now for example have secure integration capability in 43 of the 90 countries in which we operate.

Technology enabled security revenues represent 42% of our total revenue base. That 42% we expect not only to grow but to depend, that is to say to up sell to the customers that represent that 42% today. We have over 500,000 monitoring connections globally and alongside the investment we made in our own resource and capability, we've built strategic partnerships that give us a qualified supply chain to not only broaden our offering to our customers but also we think to more efficiently manage a fixed cost base.

So that's the strategic context, the strategic position of the business. I'd like to now look at all of our new regions in turn, how they performed in the first half and what the outlook is for the second half.

Starting with Africa where we saw organic growth of 4.2% and PBITA margin of 7.1% which was a 20 bases point improvement on the same period last year. That was principally driven by change in revenue mix with a good increase in our systems and technology business particularly in Southern Africa and East Africa. As we look ahead to the second half we can see that the new contract wins that we've had in the first half of the year in Mining, Transportation, Telecommunications, Manufacturing and Distribution will give us a positive revenue mix in the second half of the year.

Now our business in Americas which combines Canada, US, Latin America saw organic growth of 4.1%. The strongest drivers of that were the two areas where we had been investing for the last few years which was corporate services and a secure integration. And that of course not only contributes to the top line but gives us an opportunity to earn higher margin.

We saw our margin go up in the US against a background of tight labour markets, probably tighter than in any other market in which we're operating in today in the US. And we managed to offset wage inflation with positive revenue mix and some modest productivity gains. We expect those productivity gains to increase in the second half.

And we continue to describe our growth in the US as self-constrained. That is to say we continue to see some contracts coming to market on terms and conditions which we do not feel able to take on or willing to take on I should say. In the last 12 months easily over $100m of revenue that we've looked at and said that's for somebody else. Time will tell whether or not that commercial discipline has been the right decision, the right path to take.

As we look ahead we continue to see good growth in a number of sectors particularly energy, IT and healthcare where we've got a very strong proposition in those verticals. And we continue to see positive revenue mix effects particularly in the second half of this year on the back of our wins in the first half.

We expect greater contribution from our productivity programme to drop through to the bottom line in the second half of the year.

In Asia organic growth of 7.7% and margin also of 7.7%, good contract wins in IT, transportation. We saw our business in India stabilise and begin to grow again. And we maintained our net margins again with our revenue growth and revenue mix offsetting wage inflation which we've started to see in Asia as well, I'd say above trend wage inflation.

The outlook for the second half is driven firstly by first half contract wins as with our other regions. Again, positive revenue mix and price increase programme which is more customary in Asia, our customers are more used to it, an annual price increase programme. And we're getting on with that now and expect to see the benefits of that in the second half.

And finally our Europe, Middle East region, in Secure Solutions, we saw revenues basically flat year on year. You all know that in The Middle East we had significant headwinds last year, that means business is beginning to stabilise on the top line. And we saw quite strong growth in our risk management business which principally delivered services into The Middle East.

In Europe again we're seeing a constrained growth driven by a tight labour market that has two effects, obviously direct staff vacancies which effects your margin as well. And also commercial terms, where let's say, prices don't keep up with wage inflation and we've had to make some judgement calls on that just as we did in North America.

A margin of 6.7% reflects both the revenue trends and the labour cost. As we look ahead again on the back of a strong first half in terms of new contract wins, contract retentions and we have revenue momentum and some productivity benefits dropping through to the bottom line.

And alongside that in Europe we've got a pan European recruiting driving going to reduce overtime and reduce staff turnover. So it's recruitment and retention programme which we believe will deliver benefits in the form of lower overtime and lower staff turnover.

So I want to turn now to our new Cash division which as I mentioned earlier represents 17% of our revenues. Now you will know that we had a Global Cash business operating in 40 countries around the world. That Cash business offers a full spectrum of products and services, most obviously conventional Cash services, CIT, cash processing, ATM replenishment, ATM engineering and international secure logistics, those service lines form the bulk of our conventional Cash business and we offer those in all of the markets in which we operate today.

We also have a new set of products and services which have emerged in the last few years and those of Cash Technology and services both in terms of recycling the hardware and the software and service platform that we sell alongside and hardware which we describe as cash technology services. That business is not present in all of our markets or rather those service lines are not available in all of our markets, they are principally operating in North America and Southern Africa and we’re starting to get going in Europe and in Asia.

Now we think that G4S is uniquely positioned to take advantage of changes that are occurring in the payment industry generally. And in particular we see customers, be they bank customers, retail, leisure customers looking for ease of use and of course lower cost of cash handling.

When we look at the industry as a whole obviously at a basic entry level the whole industry is able to offer standard CIT services to customers. Many - most competitors are able to offer some sort of cash flow or ATM services although the level of sophistication varies greatly.

Once you get to large, mid players more or less everyone can offer their services and a few can offer smart safes and some form of bank cash processing, mainly bank automation. When you get to the big four which we claim to be part of, G4S, Prosegur, Loomis and Brink's, they can offer alongside us, a much broader product offering to customers and service offering including utilities, bank branch outsourcing and recycling.

We believe that we continue to be the only one of the major players or any player in the industry that can offer end to end cash management including cash recycling and the software and service that goes with that hardware. And more recently we launched G4S Pay which gives some of our customers the ability to process both cash and electronic payments in a single solution.

We intend to use that advantage to grow our business and as we look ahead we can think of our Cash business I think as having a very clear set of priorities. On the left hand side this is the position as we see it today. We have a well-established conventional cash business offering services that we all know. And we do have a bank outsourcing business, most obviously in the UK, and probably our best example in the Netherlands where G4S processes most of the cash handled in the Netherlands. There’s a cash utility owned by the major banks called GSN and we provide most of the services that that utility delivers in the Netherlands.

So we have a model which we know works, it delivers lower unit costs for the banks and the retailers in the Netherlands and higher quality service. We know it works and our goal of course is to take that model and apply it in all of the markets in which we operate.

We do some bank outsourcing today, in the UK. But the big prize, as we look ahead in conventional Cash services, is to get more banks to outsource their cash processing, cash handling, to G4S.

And then we have our new products and services, Retail Cash Solutions and bank automation. Bank automation, we actually launched in Southern Africa. We now have over 200 bank branches using our bulk teller automated services, which means you can remove those tellers from branches, and customers can interact directly with our devices and our software platform. We intend to roll that out in other markets.

And then Retail Cash Solutions, which encompasses Cash 360, as it's known in Europe, Deposita in Africa and Asia, and of course Retail Cash Solutions, as it's known in North America. A very exciting business, and when we put those two together - bank automation, Retail Cash Solutions - we believe that over the next 3 to 5 years, we'll grow that business by 2 to 3 times.

That business has the clear potential to deliver more profits than our Global Cash business today, our conventional Cash business, and we're obviously we've been investing very heavily in product development, general management, and sales from business development resources in that business.

Today, in this business, we have coming up for 2000 employees now, globally. Some of those, most of those, are in what we call the service part of that business, that is, back-offer services that support the overall interim cash management for our clients. A good number of those are technologists, including software engineers, and specialist salespeople who are taking this product to market. So they have a different profile from the employee that we've typically employed in that business.

If you look at our sales, product development, and support costs in this business, the new products, bank automation and Retail Cash Solutions, they're running now at about £20m per annum. All of that is expensed.

So, turning to the first half performance, which both Tim and I have touched on, so I will move through quickly. We've already discussed the year on year effect of the large Retail Cash Solutions contracts in North America, and the impact that had on revenues. That's now annualised.

PBITA margin, as already mentioned, the effect of revenue, but also increased product development costs. Attack related costs in South Africa, partially offset by the bullion contract.

And then, more importantly, the outlook, the sales wins that we've had in the first half of the year, together with a very large now pilot programme. Again, that's part of the increase in our cost base in this business, a very substantial pilot programme, principally in North America but also some in Europe. And as we convert those pilots, they will begin to contribute to not only revenue, but margin.

And then, as part of our overall productivity programme, we have a restructuring programme which has already started, addressing both direct and indirect costs that will contribute to the bottom line in the second half.

So, wrapping up, before we go to Q&A, I want to return to the outlook. Three very important building blocks: revenue, driven by our contract wins and contract retention in the first half of the year; margin, driven by an improving sales mix and a price increase programme; and productivity, driven by the ongoing programme that we announced last year. All of those building blocks give us the confidence in the full-year outlook for the Group.

And on that note, we will turn to Q&A. Could I ask you, please, because we're on a webcast, so could I ask you, please, if you want to ask a question, raise your hand. We'll bring a microphone to you, and if you could give your name and affiliation, then people not in the room can know who's asking the question. Thank you.

Who has the microphone? Would you go to the gentleman with his hand raised there, please?

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Questions and Answers

Bilal Aziz, UBS
Good morning. Just three questions from me, please. Firstly, you flagged £700m worth of new contract wins. Can you perhaps split that by Cash and Secured solutions, and tied to that,

you mentioned some of the progress you're making with Cash 360 pilots. Perhaps just a number on store numbers you expect to ramp up on the second half of the year?

Second question, you're quite clearly flagged wage inflation. Can you perhaps give us an indication of the exact level you're seeing in the US right now, and your staff turnover related to that?

And lastly, just on Middle East, you're flagging some stabilisation there as well. You had a significant drop-through on the negative side, in margins, in the second half of last year, so where do your margins stand in the first half, and do you expect a similar uplift as you go up in the market, or has the pricing dynamic changed in that? Thank you.

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Ashley Almanza, Chief Executive Officer
Thank you. Tim was taking notes. I'm not sure we caught all of your one question, with your multi-headed single question, so we'll try and answer all of those, and then we'll come back if we've missed anything.

So, on wins in the first half, they tend - and this half was no different - they tend to follow the revenue base. So, if you think about a sort of 80/20 split, that's a good rule of thumb for contract wins.

In terms of pilots, number of stores was your question, that we expect to ramp up? Actually, we've already started to contract two new contracts, last month, July, that will begin to contribute. They're not the same scale as the very large retailer that we mobilised in 2017, but they are, let's say, the first part of a large programme. In other words, we're mobilising the first part of those contracts before - I think it's Black Friday. Is it Friday or Thursday?

Helen Parris, Director of Investor Relations
Friday.

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Ashley Almanza, Chief Executive Officer
Friday. Black Friday. And then we stop, and we start again in January on those programmes. You know, that's probably, over the programme, both parts, this year and early next year, 1000 stores. And then the pilot programme is a significant part of that number. What we can't say today is the rate at which those pilots will turn into store mobilisations. We'll have to give you that update either at the third quarter trading update, or when we present our full year results.

Wage inflation varies a great deal. We talk about the US as a single market, but of course there are many, many wage markets in the US, and it's literally on a location-by-location basis. There's a broad spectrum. I think we're seeing what pretty much everyone is seeing, which is mid-single digits, maybe 4% to 5% in some markets, and zero in some other markets, so it's a mix.

And, as I say, we have a structured customer engagement programme, ongoing dialogue with customers, because the US is a much more a negotiated price programme rather than indexation programme, to pass those costs through.

Turnover right across the industry has picked up. I would say, two years ago, we had run at about 20%, 25%. That's closer to 40%, 45% now. So, very high rates of turnover - in tight markets, there's some markets where we have zero turnover, but in those markets, where we're seeing tight labour markets, we're seeing that sort of level of turnover.

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Tim Weller, Chief Financial Officer
The final one was Middle East.

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Ashley Almanza, Chief Executive Officer
Middle East. Tim.

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Tim Weller, Chief Financial Officer
The final question, and margins in the first half versus the second half last year and the first half of last year. We saw margins in the first half of this year about 200 basis points lower than the first half of last year, in the Middle East Secure Solutions, so it's quite a bit margin erosion. That is broadly in line with the second half of last year. So it's continued at about the same level.

Looking at the last few months of the half, it's beginning to move up, and yes we do, as we move into the second half, expect margin accretion in the Middle East, as we do in a number of our other regions.

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Ashley Almanza, Chief Executive Officer
Thanks, Tim. Could we take our next question? I think that's Paul. It is. Hi, Paul.

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Paul Checketts, Barclays Capital
I've got a couple of questions on the Cash Solutions side, please. Are you able to split out what the Cash in Transit and Cash Processing businesses did in the first half, in terms of organic and margins?

And then, with regards to the Cash Technology side and the prediction that you'll do 2 to 3 times growth, what's the base, is it about £200m of annual revenues at the minute, from which you're saying that could treble?

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Ashley Almanza, Chief Executive Officer
The 2 to 3 times we're focussed on is profit. These businesses are quite different. I know you know this, but I'll say it anyway for completeness, but our conventional Cash business is a capital intensive business with a, let's say, standard industry opex profile that gives margins 10% to 12%. That's the norm.

Our new service lines are very different, and they are not nearly as capital intensive. We employ quite different people, so the opex on a unit basis is higher, but the margins are also significantly higher. And that's the reason for us taking the view that, over the median term, this has the potential to contribute at least, and probably more than, our conventional Cash business to the bottom line.

So it's not - and we should be clear, or will be clear about that - it's not a comment on the revenue, because the revenue line will follow really the model that customers embrace, and there are two models that we are able to offer today. The first is the one that we went to market with originally, which is where we sell the software, the hardware, and the service as an integrated package. Some customers still want to do that, but they want to buy the hardware directly, and that has an impact on the revenue growth.

And so for us it's much easier to provide - and I think not just easier but more sensible - to provide guidance on where we see the profit contribution coming from that business. Because in the end, the bottom line will be more or less the same whether or not customers by the hardware, or we buy the hardware. There might be a handling fee on it, but that's not where we do, and where we're going to, make the money. We make the money with the software and the service integration that we provide, so that's a comment on where we see the 2 to 3 times.

And you can see the base profit we disclose today from our conventional business. We don't provide, on a half-year basis, the split in organic growth and margins, but in simple terms, our new service lines actually had negative growth. That's the minus 13%. That is driven by the big contract mobilisation. If you strip that out -

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Tim Weller, Chief Financial Officer
It'd be slightly positive.

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Ashley Almanza, Chief Executive Officer
Yeah, 1%.

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Paul Checketts, Barclays Capital
And if you looked at the second half, would the Wal-Mart contract, would that be at margin levels now that are consistent with what you'd expect across the contract? Or is there a – does it continue to ramp up? What would be the shape of profitability once the hardware sales are out of the way?

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Ashley Almanza, Chief Executive Officer
I've asked Tim to comment on the year on year effect in the second half, but I just want to say, our comments on margins and revenue are not contract-specific. It's clearly not in our interests - and, nor our customers, various customers' desire to comment on individual contracts, so the answer is in relation to the business. We understand your questions, but it will be in relation to the business as a whole. Tim, would you?

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Tim Weller, Chief Financial Officer
We have now got to the point when the effect of that large contract is of course annualised, so there should be no distortive impact between the second half of '17 and the second half of '18 from that contract. So effectively we are now reverting to, effectively, the organic growth, excluding the impact of that big mobilisation in the first half, well, second half of '16 and first half of '17.

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Paul Checketts, Barclays Capital
Thanks.

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Ashley Almanza, Chief Executive Officer
Okay. That was a draw. I think I saw him first. Sorry again. Could we go to Andy?

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Andy Grobler, Credit Suisse
Just a couple, if I may, please. At the end of June, you had £1.3bn in cash on the balance sheet, and I know part of that is just the bond you issued in May. What is the right level? Once you go through this process, what is the right level of cash as a proportion of sales, or in absolute terms?

And then secondly, portfolio, I know those businesses are now all shoved into the main numbers, but there's still a little bit left which, looking at it, looks pretty heavily loss-making. What are the plans for that business, which looks to be in Cash Solutions? Can you close it, sell it, improve it? What do you think?

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Ashley Almanza, Chief Executive Officer
Thank you, Andy. I'll take the second part first, and Tim, I'll ask you to take the first part, please.

All the options are on the table. We can restructure that business, turn it around, which is where the effort is focussed right now, or ultimately deal with it in the same way we dealt with all the other businesses that we were not able to make sufficient progress with. So, all options on the table, but the focus of the effort right now is on restructuring and turnaround.

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Andy Grobler, Credit Suisse
And what's the timeline for that? Because looking at it, it looks to be minus-20-odd-percent margins.

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Ashley Almanza, Chief Executive Officer
We don't - our plan is to sort that out, certainly, in the next 12 months, one way or another.

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Tim Weller, Chief Financial Officer
And on the - what is the appropriate level of cash? You're right, the level of cash we have at the moment is rather more than would be appropriate. But if you look on page 12 in the pack we've handed out, there's an analysis of the upcoming bond maturities, and clearly having raised over €1.5bn between '16 and the first half of 2018 in the bond market, we are pre-funding a lot of the forthcoming - well, it's a billion pounds of redemptions between 2018 and 2019. So you would naturally expect that level of cash to reduce.

As I said in the presentation, we've got a £1bn worth of revolving credit facility. The idea with a revolver is, you don't draw them. But I would expect the bulk of that excess cash we have at the moment to be used up over the remainder of this year, and into next year, as we redeem what are some pretty expensive tranches of debt. Hence the point I was making about a lot of the interest benefit we talked about last year, in terms of the overall performance improvement of the Group has now been locked in by virtue of the bond issues we've done in anticipation of redeeming the forthcoming tranches of debt, where I think the most expensive was 7.75% rate, replaced with debt somewhere between 2% and 3%. Hence the bottom line benefit we anticipate.

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Andy Grobler, Credit Suisse

So, on kind of a normalised basis, and with revenues where they are now, about 300-odd million is what you think is necessary to run the business?

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Tim Weller, Chief Financial Officer
Yeah. I mean, clearly it's not possible to drip fund, and therefore we've gone to the market with benchmark bond issues, which is why you can end up with large amounts of cash available in anticipation of the redemptions, so, yes.

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Andy Grobler, Credit Suisse
Thank you.

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Ashley Almanza, Chief Executive Officer
Thank you. Could we go to Kean, please?

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Kean Marden, Jefferies International Ltd
Good morning. Could I first just ask a couple of questions regarding the H1/H2 margin bridge, because obviously to get to full-year consensus you need quite a big reversal, big swing in the margins. So I suppose there are two areas that it would be particularly helpful if you could shed some light. First of all, just the reinvestment of gross efficiency savings, which I know we've touched on in the past, and you've been resistant to providing specific numbers, but any more additional information would be helpful?

And then secondly, if you have any insight into sort of unrecovered wage rate inflation in the first half, so effectively the gap between price and wage rate inflation, and therefore how that would swing into the second half?

And then, an unrelated question, just maybe some insight into why your guidance for restructuring costs has moved up for the full year. Thanks.

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Ashley Almanza, Chief Executive Officer
Okay. So, restructuring and productivity realisation. We said 90 to 100 million when we launched the programme, 20 of which is the financing, which Tim and Nigel have already secured for us, although the benefits don't start to come until next year, and we get the full benefit the year after that.

So, if you take that off, that gives 70 to 80, and I suppose crudely, that's sort of 20 to 30 per year on the straight line basis. But obviously it takes a while for the programme to get set up and get going, so there will be a back-end loading, so you make an adjustment for that. And certainly in the first half of this year, I would say the contribution to the bottom line was modest, so, significant reinvestment in sales, business development, and in particular, product development in things - and service development in Secure Integration and in our Cash Technology business, where we're spending proper money now.

As we move into the second half, I think, without putting a specific number on it, and being too granular about this, you will appreciate some of this affects the shape of our organisation, and affects people, so we tend to communicate with them first and then reveal the results afterwards. But in broad terms, if you were to take that simple annualised run rate, assume very little in the first half - so, divide by 2 and then divide again - we're starting to get into the postal code. So, about a quarter of the run rate would be what we would start to expect to see.

We might not get all of that in the fourth quarter, but I think as the other part of your question referred to - we have started to accelerate the programme, which is why we expect to get more this year than previously anticipated.

That, you can look at in a number of ways, perhaps too much caution at the start of the programme, but now that it's up and running and on track, we are finding opportunities to accelerate the programme, and we're going to take those opportunities. Hence the slight bump up in the run rate.

I think the other part of your question was wage price inflation. It varies quite a lot depending on the market. So, in the UK, we're able to close that gap more quickly, partly because of the indexation. In the US, I would say the gap has been reasonably significant in the first half, so, if inflation is running at, let's say, 2% to 4%, we've recovered less than half of that. In emerging markets, it varies quite a bit. Historically, at least, in Asia, customers have been - and in Africa - have been accustomed to, and willing to, accept more than one price increase per year.

Everybody's cost-conscious now, and we have to make a judgement about whether we go to a customer once or twice a year, and so actually, in emerging markets, it's been a similar pattern to developed markets this year, where I would say the gap has increased on prior years.

It's a bit of art to this, because it's about account management. Many in this audience will know all about that. It's about account management, and I think there is some correlation between our customer satisfaction metrics and our ability to negotiate price increases. So we track those as well. We look at our net promoters score. That affects when we go to the market.

Look, long story short, we recovered less than 50% of the wage inflation in the first half. Yeah. Did I cover all of them? No. What did I miss?

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Kean Marden, Jefferies International Ltd
Presumably, the higher restructuring cost guidance is because you accelerated the programme?

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Ashley Almanza, Chief Executive Officer
Yes, I beg your pardon. Yes. Yes, sorry. I think, unless – oh, we've got an online question, apparently. Could you give the microphone to Helen, please? Thank you.

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Helen Parris, Director of Investor Relations
Thank you. So, the question comes from Rajesh at HSBC, and the first question is, could you comment on the impact of labour turnover? I think probably in the US -

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Ashley Almanza, Chief Executive Officer
Yes.

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Helen Parris, Director of Investor Relations
- But I guess as a general point.

And then the other question he has is whether we capitalise any mobilisation costs for the Retail Cash Solutions business?

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Ashley Almanza, Chief Executive Officer
The second one's quite easy. The answer is no. I think that's right?

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Tim Weller, Chief Financial Officer
It is indeed "no".

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Ashley Almanza, Chief Executive Officer
Just checking, but, yeah, that is right. No, we don't capitalise mobilisation costs of anything.

Labour impacts, let's take North America, US and Canada combined. If you're running at the sort of levels of turnover that we normally see, so let's say in the range of 20% to 30%, for our business, that can cost you $15m to $20m a year. Where does the cost come from? It comes in screening, selection, training, deployment, uniforms, so on.

Obviously, as that goes up, you can take steps to mitigate that effect, the cost of that. You can get your training costs a bit sharper, and we've seen that across the industry. So, for example, in North America, we know now that our biggest competitors, if we look at - for new hires, training of what we would call a CPO, which is a high-end security officer - we put twice as many hours into initial training as our major competitors.

So, you know, the question is, are we getting the benefit of that in the marketplace? Can we restructure that training programme to make it more efficient? And the answer is, we think we can. But today, we are spending roughly twice what our competitors are spending on training of a CPO.

Anyway, so I think that's the sort of normal run rate in the course of a year for 20% to 30% turnover, in a business like North America would be $15m to $20m cost. Thank you.

Paul has another question, we'll go there, we'll come back to you Paul. Was there another question? No. Could you take the microphone up there behind you please to the gentleman with his hand raised?

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Paul Checketts, Barclays Capital
Could I just come back to the Cash Solutions retail side please and it's more of a big picture question. It feels like at the minute you've got a lead on the competition. Could you explain to us what some of the constraints are internally in terms of how fast that business can grow?

And is there a case that given you've got that advantage currently that you could be investing more and being more aggressive in expanding the growth of that business, including in Europe and the UK where you have established Cash in Transit businesses?

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Ashley Almanza, Chief Executive Officer
A very good and very difficult question. As I said we're spending around £20m a year now on sales, business development, product development and service support in our let's call it Cash Technology service line, all through the P&L, don't capitalise that either, which is right, it's not a complaint that's how you should do it I believe. But - so that's a judgement call, we want to be judicious in the use of shareholder funds.

We are looking at whether we can - because we have, when we started this journey we set up effectively four centres of excellence and they had their own funding and their own ideas. And we are frankly looking at whether or not we can now rationalise that and get a better bang for buck on development. That's one area to both reduce cost and accelerate, have a more standardised product offering right across our global footprint and then a standardised go to market proposition that goes with that product and accelerate the sales.

We have hired more sales people, more support staff, we think we've got the balance right, but it's a constant question for us, should we be more aggressive, should we go harder?

We are also spending on new product development, so going back to some of our first customers with the next generation of the product. So we've got a lead that we want to keep. We take the view that somebody will have something to offer, you know, it doesn't matter whether you're in America, Europe or Asia; the world is too big and too full of smart people for us to be out there on our own forever. So you raise a very good question, our goal is to go as hard as possible.

I think we're running 23 pilots at the moment; we're carrying quite a lot of water. We would like to expand that some more.

I'm not sure I'm really answering your question other than to agree with you it's a very important question for us and we feel like we're investing a lot of effort. We would like to put more money to work but we don't want to do that in a reckless way. We don't want to just throw money at the opportunity; we want to do it in a measured way.

I do think it's possible that we could go faster.

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Paul Checketts, Barclays Capital
… UK and Europe where you have the risk if cannibalising?

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Ashley Almanza, Chief Executive Officer
Yes, I mean the other - I missed a part of the answer - the other, I hesitate to say this, but the other constraint is it's always us in the end that is the constraint. But I think I've mentioned before when you look at the sales process for these services it's not like CIT or even Manned Security. It's a longer sales cycle with a somewhat more complex set of stakeholders.

Typically if you're talking about retail you need to persuade your bank partner. The first customer - the first internal customer or stakeholder that normally buys into this is the treasury department or the finance department because they can see the substantial benefits it brings. You have to convince store operations and IT as well and there is quite a long qualification process to get our IT systems accepted, they talk directly to the customers' IT systems and the banks' IT systems. Those of you who work in banking will know, many of you, that the compliance process is quite extensive.

So that is to some degree a rate limiting factor, it's also a huge advantage for us as we now have four partner banks for example in North America. We're pretty sure that no one else has got a fully - even one fully integrated bank partner. Again that will change, but it takes - it took us the best part of two years to get our first fully integrated platform where corporate treasury and the bank agreed to have our software talking to their systems. That is a rate limiting factor, the speed at which you can persuade customers.

And then of course they have competing priorities. I mentioned earlier that everything stops basically between October - you might run into the last week of October, but November you stop and you don't start again until maybe the second or third week of January.

I mean I could sit here and grumble all day, it's a great opportunity and it's a perennial question for us, should we be putting more money and going harder? And we try to get it right Paul, but time will tell whether or not we've under-burned or over-burned on that. I'd like to go faster for sure.

Okay, any other questions? Thank you very much for coming along and for engaging and I look forward to updating you with our third quarter trading update and full year results. Thank you.

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