RPS Group plc

Q3-2018 trading update conference call transcript

Conference call recorded at 09.30 hrs, Thursday 25 October 2018

Operator

Hello, and welcome to the RPS Conference Call. Throughout the call, all participants will be in listen-only mode, and afterwards there'll be a question-and-answer session. Just to remind you, this conference is being recorded. Today, I'm pleased to present John Douglas, Chief Executive, and Gary Young, Finance Director. Please begin your meeting.

John Douglas

Good morning, folks. Welcome to our Q3 call for 2018. We've said previously that we will talk to markets four times a year. So, we gave a Q1 trading update at the time of the AGM in early May and we presented the half year results in early August. We're now giving a Q3 trading update in late October and we'll get into the habit of talking regularly in late October or early November. And we will of course present the full-year results in March 2019.

As we said right at the top of the RNS, we are talking about investment that'll impact short-term profitability but will drive longer term sustainable growth. And it's fair to say that RPS is going through a fundamental shift from being a conglomerate of small consulting and service businesses, providing large local expertise, to what we are and should be, which is a leading global professional services firm, solving problems that matter for a complex, urbanising and resource scarce world.

Turning first to Q3. Our group fee income for Q3 2018 was £139 million, flat in constant currency but down a little in absolute terms. And PBTA for Q3 was £12.8 million, so down around 8% in constant currency terms and closer to 10% in absolute terms. And as we know, that was below expectations and will have some ramifications for the full-year results.

Bank debt was down to £86.2 million, which compares to £90.6 million at the corresponding period last year. I note though that we've also paid off deferred consideration of approximately £7 million over the last year, so our indebtedness has reduced quite sharply compared to the prior comparable period. That's good news. Paying down the deferred consideration has taken the handcuffs off some former business owners and you can see the impact of this in the segment results.

And finally, cash conversation is quite seasonal, and we tend to look at a rolling 12 months. We were pleased that we're able to deliver a rolling 12 month cash conversion of 93%.

Turning now to the outlook for FY18. I'm going to choose my words with appropriate care. For the Board's expectation for full-year '18, the fee income will be slightly above FY17 at constant currency and PBTA will be slightly below. We expect that fee income will be marginally below market expectations while PBTA will be below market expectations. And we do of course reiterate our previously stated dividend policy that will hold the dividend flat.

As you'd expect at the end of Q3, we're still in the midst of a rigorous and disciplined planning and budgeting process, but we do have some visibility on FY19. The current view of the Board is that group fee income will be slightly higher in FY19 than in FY18 and total segment profit will be higher. However, we are making some necessary investment in the business and that will impact group PBTA in 2019. So, group level costs in FY19 are likely to be higher compared to FY18 of the order of around £2.5 million, and the majority of this will be ongoing.

And additionally, we will incur one-off brand relaunch costs of around £2 million, although I'm careful to say that's embedded in our thinking. Taking into account the additional costs, the Board's current view is that PBTA will be broadly similar to FY18. Really importantly, we continue to invest in RPS in support of its strategic priorities that are really essential to improve the longer-term performance of the group.

People remain our highest priority and you can see why. The loss of key staff from some recently acquired businesses after the settlement of deferred consideration is affecting business performance in this year. We've been delighted with the HR team that we're pulling together and with the progress they're making. Brand matters and brand matters a lot. And again, we have a formidable team and we're making good progress. When I talk to you next at the time of the full year's, you'll see stronger branding and you'll see a very different website; and brand matters because it's a key to retention but it's also key to organic growth.

Linked to the above, we're all already talking differently about sectors and services and are working more productively across boundaries. Energy has been a success story. John Thompson has done a strong job of pulling the business together and we've been helped by rising oil price.

And finally, we remain very focused on achieving organic growth but we continue to consider selective acquisitions that add density but not further diversification. And our strategy remains to fund potential acquisitions through existing bank facilities and within the leverage limits that we've imposed on ourselves.

Investment in the group IT systems is required to underpin these priorities. We've just appointed a new Chief Information Officer, who'll commence at the end of this month. A major component of our IT investment will be a global ERP system that will be developed by the end of 2019 and with deployment completed in 2021. As you might expect, our new CIO will review the project really carefully before significant funds are committed to it. But based on what we currently know, we anticipate a total capital investment of around £14 million, which will be mainly incurred in 2019 and 2020.

Before I close, I'll stop where I started. We are making a really fundamental shift. It will require investment and effort. Things don't just change because you want them to, but it will produce a much stronger more profitable business. We have provided some detailed commentary on segments but I think this is probably a good place to stop and take questions.

Q&A

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question, please dial zero one on your telephone keypads now. We have a first question from Julian Cater of Numis Securities. Please go ahead.

Julian Cater

Good morning. It's Julian Cater. Can I ask two questions, please? John, you've alluded to the sort of higher staff churn than is desirable; and clearly your HR initiatives will have a bearing on that in the medium-term, but in the short-term you might need to address it through selective increases in salaries to hold people in place. I just wonder whether you could talk about your confidence in recovering that through higher consultant rates to avoid any sort of additional margin pressure.

And then my second question, unrelated, is in respect to the ERP system. I appreciate you're addressing some historic underinvestment there, but I wonder whether you could talk a little bit more about the benefits you think you can extract from that system. Is it an opportunity to improve consultant utilisation rates? Is it an opportunity to bring down lock up days, improve working capital management, maybe there are other factors that you consider as well?

John Douglas

Yeah, delighted to pick them both off. So, first of all, we've been, I think, pretty clear on where our staff turnover rates are. We think they should be around 10%. They're mid teens, so they're not catastrophically out of control but they're certainly higher than they should be. And, of course, with a portfolio of businesses, you'll understand that some businesses will be at five, which means some businesses might be closer to 20, which is getting much higher than it should be.

First of all, I don't think we need to carpet-bomb the place with money. In order to stem turnover, we have to first of all get a much more rigorous performance management system in place so that we know we're paying the right people the extra money, not just giving everyone extra money. And we also need to think more cleverly about the way we pay people. So, particularly, in some jurisdictions like America, we need to have a higher variable component. People in America get paid to sell and we need to reflect that.

So, firstly, quite a bit of the change that we're anticipating is sophisticated increase, not blunt force increase. There are some jurisdictions where we're just paying out the money. For example, Ireland at the moment I think we're just paying junior people too little. And so, that's perhaps one of the exceptions, where we may need to think about addressing that quickly.

So it's not a blunt force attempt, it's a sophisticated attempt. And then you go to the next part; how do we get paid for it? The first thing I'd say is that high turnover is really bad for whole bunch of things. High turnover irritates clients, no end. If you think about your own experience, you're engaged in professional services firm, they start doing work, you get comfortable with the consultants and then they just disappear on you. So, dropping turnover has an immediate positive impact on client satisfaction.

Dropping turnover has an immediate positive impact on your recruitment costs because typically it costs you money to find people and typically when you find somebody they're not effective day one. And indeed, some of the problems we're suffering in our American infrastructure business arose because we lose a project manager half way through a design, the new guy turns up and it just takes a while for him to come up to speed. So, there's immediate benefit in client satisfaction. There's immediate benefit in recruitment cost. There's immediate benefit in efficiency. People don't hit their stride for typically six months.

And the other benefit of course is if you think about something circa 15% staff turnover, we don't fill every job instantly so that we carry a level of vacancy. So, in some places, we have open positions, by which I mean work for somebody who isn't sitting at their desk. And one of the things we'd really like to show you is more organic growth, and the easiest way for me to show that organic growth is fill those empty seats. And our vacancy rate will drop as you bring your turnover down.

So, I think there's a raft of mechanisms to bring that money back. So, that's perhaps the turnover question. ERP is interesting because I'm over the age of 50, so I'm no longer an ideologue, I'm a pragmatist. So, I don't turn up in an organisation and say, 'Guys, we have to sweep the old systems away and put in a clean new system.' I'm actually saying something quite different, which is we need to have a coherent global design so that as and when local systems comes to the backend of their life, they'll be replaced with elements of the global system. So, we'll step our way through Australia. We'll do Netherlands. We'll need to do something in Ireland, UK. We'll possibly then go to Norway. We may in the foremost of time but with no urgency circle back round on America. So, this is planned and it's not big bang but it is being done in the framework of global design.

At one stage in my life I ran a transport business, which is a little different to consulting but we bought our trucks thinking that they would run 60 years and 600,000 kilometres. They ultimately ran ten years and a million kilometres. We thought we were management geniuses. But in year 11, every single truck lost every single component the same year. I guess that's what we're trying to avoid. We're replacing an old truck with a new truck. So, it's not the first time we've put an ERP in the company but we are working with 20-year old ERPs in some cases and we are – it's unequivocally true that when we replace a myriad of localised ERPs with a global ERP, we will make cost savings.

Julian Cater

Great. Okay, thank you very much, John.

Operator

Thank you. Ladies and gentlemen, as a reminder, if you wish to ask a question, please dial zero one on your telephone keypads now. We currently have no further questions.

John Douglas

All right, guys. I should pay my respect to Gary, obviously wrote such a clear and thoughtful note that there was no ambiguity. But delighted to talk to people offline as well as on open call. Thanks again, guys. Take care.

Operator

Ladies and gentlemen, thank you for your attendance. This call is being concluded. You may now disconnect.

- Ends -