Company Name: ISS A/S
Company Ticker: ISS DC
Date: 2015-11-18
Event Description: Q3 2015 Earnings Call

Market Cap: 44,096.20
Current PX: 237.50
YTD Change($): +59.40
YTD Change(%): +33.352

Bloomberg Estimates - EPS
Current Quarter: 4.268
Current Year: 13.989
Bloomberg Estimates - Sales
Current Quarter: 20300.500
Current Year: 79257.462

Q3 2015 Earnings Call

Company Participants

- Nicholas Richard Ward
- Jeff Olsen Gravenhorst
- Heine Dalsgaard

Other Participants

- Jonas Guldborg Hansen
- Matthew G. Lloyd
- Emily Roberts
- Kristian Godiksen
- Jesper Herholt Jensen
- Staffan Åberg

MANAGEMENT DISCUSSION SECTION

Nicholas Richard Ward

Ladies and gentlemen, good morning. This is Nick Ward, Head of Investor Relations at ISS and I would like to welcome you all to our Q3 2015 Results Teleconference. Please be aware that the announcement, the quarterly report, as well as the slides used for this call can also be found on our website. Later today, a replay will be available and we will post a transcript of the call as soon as it is ready.

I'd like, as always, to draw your attention to slide number two regarding forward-looking statements. And the agenda for the call is on slide three. Presenting today, as always, will be Group CEO, Jeff Gravenhorst; and Group CFO, Heine Dalsgaard. We'll open up for Q&A at the end of the presentation.

And with that, I'll hand over to Jeff.

Jeff Olsen Gravenhorst

Thank you, Nick, and good morning everybody. Let me start on slide fife with the business highlights. The third quarter 2015 has been another good quarter for ISS. With regards to our operating performance, organic growth of 4.8% in Q3, in line with the Q2 results. Our third quarter margin increased year-on-year 6.5% from 6.4% previously. Our cash conversion remains strong at 99%. Net result of DKK 737 million was significantly higher than the DKK 651 million delivered in Q3 last year.

Currency adjusted integrated facility services, our strategic focus product grew 7% in the third quarter supported by contract startups and expansions that we detailed earlier this year, including the launch of Danske Bank late in the third quarter and the mobilization of Homerton University Hospital.

Please note that in the third quarter, in 2014, the integrated facility services growth was 16%. So we did face some tough comps within this particular product area, service area. Year-to-date, constant currency IFS growth has been 9%, in line with growth for the same period in 2014. Some of our more notable contract wins during the third quarter included the Danish Broadcasting Corporation, Gotthard Base Tunnel in Switzerland, and local healthcare provider in

Singapore.

Furthermore, we have successfully secured all of our business with HP. As this customer, as you probably know, has split itself into HP Inc. and Hewlett Packard Enterprise. We are delighted to be working with these two major customers on an going basis.

Currency adjusted growth within Global Corporate Clients was 11% during the third quarter, much of which was like-for-like. We continue to see significant ongoing growth potential with both existing and new Global Corporate Clients customers. We also continue to see very good growth out of our emerging markets. Organic growth was 8% in the quarter in line with Q2. Operating margin improved to 6.4%.

As we detailed at the recent Capital Markets Day, our strategic initiatives are ongoing and driving demonstrative – demonstrable improvements in our growth and our margins. And as such, we are looking to accelerate the rollout of some of our project GREAT initiatives in countries, and in particular, we finalized the overall Group structure, which I will explain a little bit more about later on.

Phase III of our procurement program has been launched and we are targeting gross saving of around DKK 100 million in addition to the DKK 350 million-DKK 450 million range that we've given previously for phase I and phase II combined. Finally, after the quarter-end, we completed the divestment of CMC, a non-core call center activities in Turkey.

So in summary, a very solid performance so far in 2015. Background macroeconomic conditions remained difficult; increasingly so in certain countries. And we remain mindful of these economic challenges. IFS continues to be a key differentiator for us and a key driver of our growth through new contract wins, contract expansions, and capturing an increased share of non-portfolio revenue from our customers. We firmly believe that these results support our strategy of self-delivery, integration, and successful execution.

Please turn to slide six. As we've done in the recent quarters, I would like to spend some time on discussing two new contracts that we launched during the third quarter. The first one is Danske Bank. ISS has worked in partnership with Danske Bank for some 40 years now predominantly providing cleaning solutions in Denmark. Danske Bank's strategic priorities are three-fold. First, they want to ensure first-class customer experience when visiting Danske Bank's premises. Secondly, they want to motivate their employees and drive increased productivity. And thirdly, they want to increase cost efficiency. Cost is important, but is not the most important priority. And the concept of end-user experience was at the heart of their thinking.

We are now providing a fully integrated service solution for Danske Bank across the Nordic region with more than 500 ISS employees. The contract is for five years and started to ramp up on September 1. And ISS' onsite management and self-delivery credentials were key to securing this contract.

Danske wanted a partner who would ensure a smooth transition of its own workers and a partner who would provide transparency and clear accountability. Our global financial services credentials, most notably, our demonstrable success with Barclays were also a major selling point. So whilst we are the clear leader within the financial service sector, we still see significant scope for further growth within this space.

The second contract is Homerton University Hospital. And Homerton University Hospital of North East London has chosen to bundle a number of self FM services that were previously delivered by separate suppliers. ISS had not worked with Homerton since 2003, but proves successful in a competitive tender procurement process. Under a five-year contract with a two-year option to extend, we will now provide catering, cleaning, security, portering, waste and other services across these three sites. The contract will mobilize during the third quarter and officially launched in October 1. During this procurement process, ISS scored best on both cost and quality, and our heavy focus on people engagement supporting patient care resonated strongly with the client. In addition, Homerton appreciated our forward-thinking and innovation.

Our UK team is very experienced in this sector, but still took time to collaborate with colleagues from Singapore where some of our ideas around technology, for example, how to expedite the turnaround of beds after patient has left the hospital have been well-received by Homerton. This is a great example of how ISS is seeking to exploit best practices across the globe further leveraging our people, processes and technology.

ISS is very well placed within UK healthcare, but the pipeline remains strong and there are longer term opportunities to expand within hard FM and to capitalize on our acquisition of GS Hall, which has clearly strengthened our technical service credentials.

With that, I would like to hand over to Heine.

Heine Dalsgaard

Thank you, Jeff, and good morning everyone. Turning to slide seven, you will see once again our three key financial priorities namely, resilient organic growth, improved operating margin, and strong cash conversion. Q3 organic growth of 4.8% was in line with Q2. We saw slightly slower growth in Western Europe Q3 versus Q2, but are still very pleased with 4% given ongoing challenging macroeconomic conditions. New contract launches continue to drive our performance here. Growth strengthened in the Nordic and Asia regions again driven by the timing of new contract wins.

As indicated on prior calls, we have seen a slowdown in organic growth in the Pacific. Our IFS business continues to perform well with a growth of 7% in Q3, which is strong, as said, in particular taking into account the 16% growth in Q3 last year. GCC had another very important quarter and very good quarter with constant currency growth of 11%. We have consistently said throughout the year that we see no meaningful support from any macro economy recovery. That remains the case. And in certain country, macro economy remains very challenging. In that context, our organic growth performance is robust.

The operating margin improvement from 6.4% in Q3 2014 to 6.5% in Q3 this year corresponds to an increase of 8 basis points. There were some slightly unusual year-on-year developments across the regions with certain one-off, one-time effects and other timing consideration distorting the underlying [ph] picture (09:43). However, our strategic initiatives continue to positively impact our financial results and the underlying development is fully in line with our expectations.

For the first nine months of 2015, our margins were 10 bps higher year-on-year at 5.4%. Cash conversion for the last 12 months was 99%, reflecting a strong cash performance across the Group. As we always say, cash generation remains a key priority for us in ISS.

With this, I would like to hand back to Jeff.

Jeff Olsen Gravenhorst

Thank you, Heine. Please turn to slide nine. If we split the world into – ISS world into developed markets and emerging markets, the organic growth performance of Q3 was completely in line with the performance in Q2. Our operating margins were stable year-on-year in developed markets and up year-on-year in emerging markets.

Of course, in any one quarter and in any one region there will be variances due to timing and other factors. So let's look a little bit more into the regional detail by starting with Western Europe on slide 10.

Organic growth in Western Europe of 4% in Q3 was down slightly from the 5% growth in Q2. The Q3 operating margin was 10 basis point lower year-on-year but the margin is ahead by 20 basis points year-to-date. Switzerland, Germany, and Turkey remain the strongest growth countries, but we've seen a notable slowdown in growth in Switzerland Q3 versus Q2 given the annualization of a contract startup with a Swiss food producer in August 1 – as of August 1.

Growth in Switzerland will slowdown – will slow further as we annualize the Credit Suisse contract which started November 1 last year. Elsewhere in Q3, the Q3 performance were broadly consistent with the second quarter with a number of countries still struggling for growth in the absence of meaningful macroeconomic support.

The Netherlands continue to see some significant year-on-year margin erosion, but, subsequently, the business has actually stabilized – sequentially, sorry, the business actually has stabilized, remembering that we now have a new country manager, a country CFO, and new Commercial Director. The sales pipeline has been rebuilt and the growth opportunity is tentatively more encouraging. Restoring the quality of revenue growth is key to driving improved profitability. There's a long way to go, but we have – we are very pleased with the recent progress.

We also saw a shift in the timing of the Annual [ph] Eid (12:32) Festival in Turkey from October last year, that means in Q4 to September this year. This is purely a timing impact but has negatively impacted year-on-year growth and margin developments in Turkey.

Finally, our hygiene and prevention business in France has had a softer quarter. It was typically seasonally strong part of the year. Market demand for pest services was unusually low and our margin was further impacted by one-off mix effects from legal changes in France, which led to a short-term pickup in low margin installation of fire detection equipment. While the macro backdrop is unhelpful, our strategic initiatives are progressing according to plan and delivering tangible underlying benefits.

Turning to the Nordics. As I mentioned, the ramp up of Danske Bank contract started on September 1 and this will be supportive of growth in the region over the coming quarters as will our contract expansion with Danish Railways. However, there are several developments that will offset this to some extent.

We are up against some tough comps from Q4 2014, which was driven in particular by revenue strength within our Danish defense contract. Second, we're seeing a significant downscaling from a major IT customer in Finland. As such, the demand for our service is reducing here. And this development will gather momentum in Q4.

In Norway, currency weakness has actually driven strength in the country's travel and tourism sector. We are active in this – in the hotel industry and have won some additional business in this sector, which has been positive for our growth in the third quarter. Hotel occupancy has been high, but this business is seasonal. And so the year-on-year revenue strength cannot be [ph] expected to prove sustained – prove sustained (14:27) through Q4. Oil price weakness continues to weigh on overall Norwegian economic developments.

In Sweden, growth in 2015 has been supported by project-based work in nuclear segment. This work is typically carried out over the summer months, so it will not be repeated in Q4. And so we can see activity will also be lower in 2016. The net of these effects is that we actually see organic growth from the Nordic region to be slightly lower in Q4 than in Q3. Our margin in the Nordic region was again very strong driven as usual by seasonal strength through the summer vacation period.

Please turn to slide 11. Asia has had an excellent third quarter. Organic growth of 14% is the highest we've seen for seven quarters. Virtually all of our markets were strong. We have had a far better mix of retention and new sales in Hong Kong supported by new IFS contract with the Government Property Agency, GPA, earlier this year. In China, we've seen growth in retail sector in addition to the Huawei and Huashan contracts we've discussed on the prior calls. India has seen significant growth on the back of Global Corporate Clients' customers, with the likes of Barclays, Citi and HP increasing their workforce in this country.

From a margin perspective, the underlying development in Asia is solid, but we did see some notable one-off positive impact from Singapore related to a final settlement and clarification of certain contractual obligations and associated state subsidies.

Our Q4 performance in Latin America was heavily impacted by Brazil and this is likely to be the case for a few more quarters to come. Customers are under pressure to cut cost across the board. They are cutting non-portfolio work, looking to reduce service scope, and even seeking to terminate contracts early. All of these puts a tremendous strain on our business. We are responding by cutting off underlying workforce and making some selective detox in our back office. We're also looking to proactively renegotiate or exit unprofitable contracts. And we'll focus on these segments and customers where we see good opportunities to make a fair margin.

Our new country manager has been placed for the last seven weeks. Elsewhere in the region, our performance has been solid. Chile continues to see very good growth albeit slightly lower than the first half. We are happy with the outlook here. In Mexico, we've seen lower growth in 2015, but profitability remains strong, but good opportunities in this market, especially within the Global Corporate Clients' customers.

Please turn to slide 12. We've been very clear in our communication on slowing of organic growth in the Pacific region and the reasons behind this. As a reminder, we are seeing lower activities in the remote site resource sector due to two contract loses, which were only partly compensated by a contract gain. In addition, the two customer sites are moving from construction to production, which further reduces demand for our services as normal. We have also seen new contract startups elsewhere being delayed into Q1 2016. So we expect a further sharp deterioration of organic growth rate in Q4. That said, there remain some sizable opportunities in our pipeline. Pacific region has been a clear beneficiary of our strategic initiatives, the change to our organization structure and the improved efficiencies across the business continues to drive an uplift in our margins, particularly in our priority segments, overall margins are up 80 basis points year-to-date.

In North America, our Q3 performance is consistent with what we have communicated. In Q2 we see an improved mix of business with higher demand for Global Corporate Clients and IFS customers and exit from lower margin single service contracts. As we communicated at the Capital Markets Day, we see significant opportunities in this marketplace, but we are still starting from a low base and it will take some time to get there.

Finally, in Eastern Europe, organic growth of 4% was in line with the second quarter. However, the operating margin fell by 130 basis points year-over-year to 6.2%. Organic growth was driven by new contracts in Russia, Slovakia, and Slovenia, all with large multi-national customers. We lost business in Poland, but expect to replace this with gains elsewhere. Margin weakness has been driven by Romania and Czech Republic where we've suffered from weak contract potentials.

Please turn to slide 13. Before we go into the financials, I want to give you a highlight of the changes at HP that will have some impact on our regional profitability in the coming quarters. HP has been a customer with ISS since 2008 and has really been a fabulous success story for us. Our portfolio revenue base has increased more than five-fold over the past seven years as we have expanded geographically into Americas and increased our breadth of services. In addition, HP is an excellent source of non-portfolio revenue opportunities for ISS.

HP has now split itself into two: HP Inc. and the Hewlett Packard Enterprise. Three individual regional contracts with the old HP have been replaced by two global contracts with these two new entities. It is important to stress here, that there is absolutely no change whatsoever to our overall revenue or profitability post these changes. However, in order to reflect the needs of the two separate customers, going forward, and in order to accurately reflect the current cost of delivery, we've agreed to rebalance the revenue across individual countries and regions.

These changes came into effect November 1 to coincide with HP's new year-end. As a result, there will be an uplift in profitability and margin in both North America and Latin America and a corresponding reduction in Eastern Europe, and, to a lesser extent, Western Europe. We cannot quantify the exact details on the individual customer contract, but on a full-year basis, the margin impact from these three regions most effective will be around plus/minus 50 basis points.

There will be a partial impact in Q4 results. To be clear, the overall revenues and profitability are completely unaffected.

With that, please turn to slide 14. We first introduced our new and strengthened organization structure in June. This structure is more efficient with one less management layer, will support a stronger focus on our customer segment, together with the implementation of best practices across the ISS Group. Today, I can announce the final management changes that will complete our senior team.

Last month, we announced the appointment of Martin Gaarn Thomsen as Group Chief Operating Officer of Global Operations. Martin has been with ISS for 16 years and has a wealth of invaluable experience from across the Group. He has been Regional CEO for both Asia Pacific and Western Europe region dealing with both fast-growth emerging markets and more mature developed markets. Most recently, he was Country Manager of ISS Denmark spearheading the [audio gap] (22:53-22:59) implementation of project GREAT initiatives. This has resulted in an improved margin performance and a number of high-profile contracts wins, including the Danish Defense, Danish Railways, Siemens and Danske Bank.

Today, we are delighted to announce that Dan Ryan will join ISS from G4S as the Regional CEO of Americas, succeeding John Peri who has decided to leave ISS at the end of 2015. Dan has spent the last five years as Regional CEO for Asia and Middle East at G4S. He's led a significant transformation and enhanced performance. Prior to G4S, Dan spent 20 years with a global logistics and transportation company, NOL, and led a review, redesign and transformation of NOL's organization across its Americas divisions. Dan is a U.S. citizen and will relocate to U.S. from Hong Kong.

Thomas Hinnerskov will return to Europe to become Regional CEO, Western Europe. Thomas has joined ISS in 2002, has held numerous positions as Regional CEO, country management and business turnaround roles. For the past four years, Thomas has been Regional CEO for Asia Pacific, our fastest-growing region.

And finally, Dane Hudson will succeed Thomas as Regional CEO of Asia Pacific. Dane joined ISS in 2011 and has led our Pacific business over the subsequent period establishing the strong leadership team beneath him and driving a significant business transformation of this important region within the ISS Group. Scott Davies will step up to replace Dane as Country Manager, Pacific. Scott currently leads the Health and [ph] Government (24:49) and the Global Corporate Clients part of – in the [ph] APEC (24:59) region.

All these changes demonstrate the strength and the depth of management across ISS bench and our ability to manage succession. And in addition to that, with Dan's arrival, we have proven our ability to attract some of the best talent within the industry to join the organization. And I'm very happy with the announcement of today's position. Looking forward to taking into effect from early 2016.

With that, I would like to hand back to Heine for more details on the financial results.

Heine Dalsgaard

Thank you, Jeff. Please turn to slide 16. So total Q3 revenues increased by 6.9% year-on-year to DKK 19.688 million. Divestments and acquisitions impacted revenue growth by a net of minus 1%. The major disposal that impacted this figure was personnel services in the Nordic that we sold in September last year.

The GS Hall acquisition, which we announced on January 20 this year, remains our only acquisition year-to-date, and has a gross impact of plus 1% on Q3 revenue growth. There were no further acquisitions or disposal announced during Q3, but as said, as a subsequent event, we completed the disposal of our CMC or the non-core call center activities in Turkey on October 30.

The annual revenue from CMC was, in 2014, DKK 336 million. Currency fluctuation boosted revenue growth by 3% primarily related to British pounds, U.S. dollar and Swiss francs. Finally, as we have seen, organic was 4.8%.

Please turn to slide 17. Our Q3 operating profit increased by DKK 98 million year-on-year to DKK 1.276 million. The operating margin increased 8 basis points to 6.5%. Given the seasonality of our margins, we choose to illustrate the evolution of operating margin on an LTM basis. Hence, on this measure, we've been trending slightly higher over eight consecutive quarters. We are very pleased with this.

During Q3, a notable positive contributions to the Group's year-on-year margin improvement came from Germany, United States and Singapore. These were offset primarily by continued operational challenges in the Netherlands and Brazil as we have discussed previously.

For the first nine months, our operating margin increased by 10 basis points year-on-year to 5.4%. Within this performance, corporate costs are 9 basis points higher. This increase reflects the higher cost of being a listed company, including our LTIP and also timing differences between the quarters. This is fully in line with our expectations. Hence, our expectation for the full-year continues to be that corporate cost will amount to approximately 0.8% of revenues. With regards to the divestment of CMC; this is a high-margin business. On a full-year basis, this divestment will have a 7 basis point dilutive impact on Group margins moving forward.

Please turn to slide 18. Some highlights from the Q3 income statement. Other operating income and expenses amounted to a net expense of DKK 55 million in the quarter. This figure includes DKK 50 million on restructuring projects, broadly in line with the Q2 amount. As Jeff has detailed, we are accelerating the rollout of project GREAT to more countries, which this year include Germany, Spain, Belgium, the U.S., and also Brazil. In addition, the changes to our Group organizational structure detailed by Jeff will also have an impact.

Financial income and expenses amounted to DKK 168 million, some DKK 80 million lower than Q3 last year. The major movement was a DKK 65 million reduction in net interest expenses due to lower debt and also lower financing costs. FX losses of DKK 33 million in Q3 relate primarily to intercompany balances and due to the high FX volatility across the world in Q3. We clearly cannot guide on potential FX developments going forward, but we do expect non-FX related items within our financial income and expenses to be similar in Q4 to those in Q3.

Income taxes amounted to DKK 316 million, equivalent to an effective tax rate of 30%. This is fully in line with our comments and expectations for the full-year. Profit before goodwill impairment amounted to DKK 737 million, some DKK 86 million higher year-on-year. Amortization and impairment of brands and customer contracts, net of tax, was DKK 122 million similar to Q1 and also to Q2.

Please turn to slide 19. Cash flow from operating activities amounted to DKK 884 million in the quarter, DKK 150 million higher year-on-year. On an LTM basis, our measure of cash conversion remains strong at 99%. Net interest paid in Q3 was DKK 63 million lower year-on-year in part reflecting lower net borrowings, lower margins, and lower underlying rates.

In addition, there has been a change in the timing of interest payments following the refinancing of term loan A with bonds, which we did in November 2014. Our two bonds pay interest annually. Our bond maturing in 2024 pays interest in December, and the other maturing in 2020 pays interest in January.

With regards to income taxes paid, there is always variation in the cash tax rate from quarter-to-quarter due to timing considerations. Our cash tax rate will be higher in Q4 due to payment of bi-annual on account taxes in Denmark, but also in other countries.

Please turn to slide 20. Our net debt stood at DKK 14 billion at the end of Q3 and our leverage was 2.7 times pro forma adjusted EBITDA. This is an increase versus the 2.6 times at the end of Q4 2014, but it's fully in line with our expectations and reflecting the typical seasonality of our cash flow including, of course, the dividend payment in April this year.

On a 12-month basis, our leverage has fallen 0.4 times [ph] of return (31:55). Our policy with regards to shareholder returns is, of course, unchanged. We are committed to maintaining a disciplined and efficient balance sheet. We will divest non-core businesses whilst considering selective competence-enhancing acquisitions. We do target a dividend payout ratio of 50%. And we will seek to return additional funds to shareholders to maintain balance sheet efficiency once our leverage target of below 2.5 times pro forma adjusted EBITDA has been achieved.

With that, I hand back to Jeff.

Jeff Olsen Gravenhorst

Thank you, Heine. So please turn to slide 22 on our outlook for the full-year 2015. We have changed our organic growth guidance from 3.5% to 4.5% to 4% to 4.5%. Our large contract launches, especially in Europe and IFS strength generally across the Group are driving our revenues. We now have some more visibility on timing and sustainability for the remainder of the year. However, we remain cautious of difficult macroeconomic conditions and highlight and expect a sharp slowdown in growth in Pacific in Q4 and marginally slower growth in the Nordics to a large extent because of tougher comps. At this stage, we anticipate organic growth in Q4 to be lower than Q2 and Q3.

If we take into account all completed divestments as of October 31 and the acquisition of GS Hall together with FX movements to-date, we now expect to deliver total revenue growth of between 7% and 7.5% in 2015.

On operating margin, we will maintain our focus on sustainable margin improvements into 2015, which will be supported by ongoing strategic initiatives, as described. We would expect to deliver margin for 2015 that is higher than the 5.6% delivered in 2014.

Cash conversion. Finally, cash conversion will remain a priority. And we expect our cash conversion to be at year-end around or above the 90%.

So with that, ladies and gentlemen, let me first apologize for my cold and my voice. But apart from that, we're very pleased with our performance so far in 2015 and we remain positive with regards to the outlook for the rest of the year and beyond.

And with this, I would like to open up for Q&A session.

Q&A

Operator

Thank you. [Operator Instructions] And we have the first question comes from Jonas Guldborg from Carnegie. Please go ahead. Your line is now open.

<Q - Jonas Guldborg Hansen>: Yes. Good morning. I have two questions on Asia. Firstly, could you be able to quantify how much of the 14% organic growth that was driven by this demand for non-portfolio services that you see in Hong Kong and China? And also on Asia, this positive one-off related to Singapore in Q3, how big was that one-off or how much did it affect the margin in the quarter? And then, lastly, if I could get you to repeat what you said about Group organic growth for Q4 here on the last slide, please.

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you. Obviously, when we look at the Asian [ph] quantify the (36:02) non-portfolio growth, we actually don't specify that [ph] anywhere (36:04). But I can say that the underlying growth rate on portfolio is quite good in China and in Hong Kong. So we're pleased with that result. We don't actually specify the non-portfolio part of it and India for that matter. So but underlying, the portfolio is actually also quite good.

If we took the Singapore one-off, it really is about a normal reconciliation of the business. And again, we don't quantify these one-offs in the individual quarters.

On the Q4, you want me to repeat what I said about Q4? What I'm saying is that, we expect Q4 Group growth – organic growth to be lower in Q4 than it has been in Q3 and Q2, predominantly driven by the fact that we have in the Nordics stronger comps from last year as mentioned, but also the sharp decline in the Pacific region, which is really driven by the resource sector. Still, good healthy business, but it will decline compared [ph] also to some of the strong growth (37:10) from last year.

<Q - Jonas Guldborg Hansen>: Okay. Thank you.

Operator

Thank you. And our next question comes from Matthew Lloyd from HSBC. Please go ahead. Your line is now open.

<Q - Matthew G. Lloyd>: Good morning, gentlemen. Two questions for me. Firstly just – have you seen any pickup in spot or non-portfolio growth more broadly across the organization and what affect might that have on margin if and when it comes? And then, secondly, a more sort of specific question. What percentage of your staff in the UK earn under £9 an hour and therefore are likely to be caught in a sort of successive hikes in living or minimum wage?

<A - Jeff Olsen Gravenhorst>: Good. I will take the first question. On the – the pickup in spot, I think, generally, there is not any pickup that is sort of coming from macroeconomic development, which we would hope to see [ph] the day that we see more growth than 2% in our (38:12) – we see 2% GDP growth in the countries that we're in on average.

Having said that, of course, with the Global Corporate Clients on the IFS part, we do, of course, have some increases in spot business, one-off business with them. Overall, though, it's a little bit lower in the third quarter than it was in the first two quarters but not actually picking up as we would like to see [ph] when the (38:40) overall growth rates are better.

Margin impact from picking up; of course, there is a margin impact. It again depends on which type of project work we take over. So if it's a sort of – if it's a job that could be done with the resources we have on site, of course, it has a good margin impact. When it's major project works where we do additional resources on site, then it comes in at a little bit above average margin. So it will have a positive impact, but it depends on what type of businesses it is.

In respect to your second question, I just want to clarify, what did you say, below £9 or did you say below £7?

<Q - Matthew G. Lloyd>: Below £9, because that's where the minimum wage is going.

<A - Jeff Olsen Gravenhorst>: You got to remember that – that is by 2020. So there are some years to go to get to 9% (sic) [£9] (39:32). The minimum wage would go to around 7 point – no, sorry. The minimum wage right now is £6.5 and that will go to £7.20 by April 2016. And we have right now 44% of our employees in the UK who are covered by living wage, so you can make the opposite math.

Living wage is £7.85 currently and £9.15 in London. So it's a little bit of a mixed picture, of course, here. But we've got to be careful that we're not converting everything to £9 right now. It's not until 2020. So we are in a good shape in the UK. Most of our – about half of our business is either on living wage or on its way to living wage. So 44% is on and another 8% is coming on within next 12 months. Yeah, that's it basically.

<Q - Matthew G. Lloyd>: Okay. And do you normally have a differential maintenance issue in the – people who earn above the minimum wage want some pay rise when minimum wage goes up. Some of your competitors have said it's an issue.

<A - Jeff Olsen Gravenhorst>: Of course, it will be. It will be that the living wage will – there will be a [ph] knock on (40:41) on living wage over the years to come. That's for sure. This is a normal part of our business. We do have salary increases every year. We've had that for the past 115 years.

So our job is to make sure that we actually get that covered in price increases or in scope changes or in efficiency improvements. And there is still scope within this business to convert customers from paying for the number of hours that goes [ph] into it and to (41:08) pay for the services that we render. And that is – part of our success is to convert into IFS contracts where we get more and more delivered with a better efficiency rate. So that's the way we deal with it.

<Q - Matthew G. Lloyd>: Okay. Thank you very much.

Operator

Thank you. Our next question comes from Emily Roberts from Deutsche Bank. Please go ahead. Your line is now open.

<Q - Emily Roberts>: Hi. Good morning. It's Emily from Deutsche Bank. A few from me, please. The first is, at the Capital Markets Day in September, you mentioned the potential for a slight reduction in the effective tax rate in 2016. Is there any further guidance on that?

And secondly, just back to those non-portfolio trends, I know you can't give exact numbers around what proportion of the growth came from non-portfolio year-to-date, but could you give us an idea of the underlying trend? Have you seen a bit more growth? What was the exit rate that came in Q3? And then, perhaps any expectations for the rest of the year?

And then, finally, are there any big renewals that we should be aware of for next year? Thank you.

<A - Heine Dalsgaard>: So if I take the one on the effective tax rate and the short answer is that there is no change compared to what we said at the Capital Markets Day. We still see us having a run rate slightly below 30%. So it remains unchanged. We do expect a lower tax rate for 2016.

<A - Jeff Olsen Gravenhorst>: Okay. And if I can take the non-portfolio part, there is a accretive impact from the non-portfolio part if you look at it from an organic growth overall, but it is minimal. Between the quarters, it's a little bit lower in Q3, but that's really on the back of some strong comps from last year on non-portfolio in the month. But this is not a meaningful development, to be honest, because, overall, it's in line with what we saw last year. We still grow. It's not that much higher than it is for our portfolio growth, everything being equal. So nothing, unfortunately, to share other than it's following our portfolio growth plus a little bit.

On the renewals for next year, I think you asked them too. There are always a number of renewals. I think, on average, we have our contracts for around seven years to nine years. Contract terms are typically three years to five years, some – few times it's seven years. So every year, you will see quite a significant number of renewals. There is nothing specific that I would like to highlight other than in Pacific we are seeing some renewals within the resource segment, which is out for tender now, but that's the only one that from a Group perspective doesn't have a material impact.

<Q - Emily Roberts>: Great. Thank you very much.

Operator

Thank you. Our next question comes from Kristian Godiksen from SEB. Please go ahead. Your line is now open.

<Q - Kristian Godiksen>: Thank you. Yeah. A couple of questions from my side. I was wondering if you could give an update on any potential acquisition of a catering company in the U.S. You were talking about that for a couple of quarters. And also the potential for you looking into technical service companies in the U.S. or other regions?

My second question is regarding the Netherlands, if you could elaborate on the outlook for that? So, I guess, that is still the main reason why you underperformed in Western Europe. So, yeah, outlook, how long should we expect before you will see a change in that?

And then, thirdly, also for you, Heine, you mentioned that once you're below the given target of 2.5 times, you'll increase distribution. And I guess, end of this year, it's no secret that you will go below that. So should we, based on your comment, expect that we could already end of this year see or in connection with the full-year results expect extraordinary distribution despite the seasonality in your cash flow? Thank you.

<A - Jeff Olsen Gravenhorst>: Thank you. I will start with the acquisitions part. I think it's important to remember that the success that we've had for the last many years now is within integrated facility services. And it's very important part of that, it is to self-deliver our services to our clients. So that's our focus and that's also been a big part of the success that we've had over the last few years.

In that, of course, our aim is to continue to be stronger and stronger on self-delivery. And any acquisitions that we do is to support that. We are not looking to expand geographical presence or anything like that, we are looking to improve our self-delivery capabilities, and in that, we have said particularly we want to do that in the Americas. What we did buy this year was GS Hall, of course, is a good example of how we can do a competence-enhancing acquisition.

Now, what we have – you are right that we have not concluded the acquisition on catering in the U.S. I think it's – it really is a matter of making sure that we find the right candidate at the right price point at the right time. Time is fine with us. So in order for us not to be waiting too long, we have converted into self-delivery on catering in the U.S., as we speak. So that has been [ph] up and alive (46:33) for the last few months, happy with the service, and our clients are happy with our delivery as well. Having said that, we continue, but we have not finalized that process yet.

We will also be looking still at technical services where we can still do some competence-enhancing acquisitions to support our organic growth strategy as it is overall. So that's basically where we are now. We will make sure you get told the soonest we are closer to any deals.

In regards to Netherlands, I'm actually quite happy with the development in Netherlands. It's been stabilized over the last quarters. I think we have a very strong team in place and we will see some improvements also as we go forward. It's still from a relatively low start, but I am quite confident that this is a market that can deliver good margins, but it does mean that we need to grow a little bit faster than [ph] what we're doing (47:29). Pipeline is good. It's [ph] build up (47:32) and the team is right. So I do expect that within the next year that we'll see some good improvements from there. Then, Heine?

<A - Heine Dalsgaard>: Yeah, in terms of the additional cash returns [ph] assets (47:48), so the leverage at the end of Q3 this year was 2.7 times adjusted EBITDA, which then is approximately 40 basis point lower than the same period last year. And you are right that we ended last year at 2.6 times. So far, so good.

Remember and I know you're aware of that, but take into account the seasonality in our operating cash, which means that leverage will go up in particular in the first half of the year and then go down towards the end of the year.

So we will do additional cash returns to our shareholders as we have discussed previously. But in terms of being more specific as to setting a date and also specifically saying how, we cannot say now more at this point in time than what we did at the Capital Markets Day. So unchanged compared to the detailed discussions we had at the Capital Markets Day.

<Q - Kristian Godiksen>: Okay. And just a quick follow-up on the Netherlands, I guess, Jeff, weren't you more severely impacted from the Netherlands in Q3 or is it just me that's misremembering, because – yeah.

<A - Jeff Olsen Gravenhorst>: Netherlands actually is in line with our expectations. So I think on a year-on-year basis, yes, there's an impact. But from an LTM or a run rate impact, there's not more. So actually we're doing okay.

<Q - Kristian Godiksen>: Okay, okay. Okay, thank you.

Operator

Thank you. Our next question comes from Jesper Jensen from Nordea. Please go ahead. Your line is now open.

<Q - Jesper Herholt Jensen>: Thank you very much. I have a couple of questions. So first one, maybe just to following up on that Netherlands question. Let's say there's no meaningful improvement when we look out a year from now. Is the Netherlands a strategic priority for you as a country given the structure of the labor market and also the mix of the contract portfolio you have there right now? That was the question number one.

<A - Jeff Olsen Gravenhorst>: [ph] If we (49:50) start with that, Jesper, yes, Netherland is important. It's quite an important part of Europe. And from a Global Corporate Clients perspective, it's important that we are present there, so we can support our clients; number one. Number two is there are some meaningful contracts actually or companies in the Netherlands, headquartered in the Netherlands. So I think it's quite important over time that we are placed in the right spot.

You're quite right, it's a difficult market to work with from a labor market perspective. So the transformation that we are undergoing right now from sort of more mid to small customers, we are improving our presence and doing quite well within larger accounts. So it's a matter of continuing that transformation.

I'm quite confident that we will be better in a year from now, quite sure of that. And I also know that Netherlands or we all know that Netherlands is one of the countries who have worked somewhat with the reforms, so it's becoming a little bit more flexible, nowhere near what see in Denmark or England, but it's getting more flexible. So, I would say, yes, it is a priority market, but particularly within our priority segments. And that's what we're working on.

<Q - Jesper Herholt Jensen>: Okay. Thank you. The second question I have is on the, I guess, the implied organic growth outlook for the fourth quarter, 3% to 5% is [indiscernible] (51:02). Given the visibility that you have for October right now, just wondering what sort of scenario could drive the lower end of that range? I mean, do you still have open pitches that are of meaningful size that can impact the quarter?

<A - Jeff Olsen Gravenhorst>: I need you to repeat what you said about the 3% to 5% Jesper, just to make absolute sure.

<Q - Jesper Herholt Jensen>: Yeah. Just the – sort of the implied organic growth guidance for the fourth quarter, I guess, is 3% to 5%.

<A - Jeff Olsen Gravenhorst>: No. It's quite important actually to say that we expect fourth quarter to be below the quarter of Q2 and Q3. And the reason for that is, clearly, we got good contracts with startups, but we also have stronger comps in the Nordics, that's one. We do see – we've had some one-off gains or seasonality gains, these are normal, with the nuclear sector in Sweden in Q3 and – mainly Q3, which doesn't get repeated. Our success with the hotels in Norway actually goes down in the fourth quarter, because the seasonality, of course, on holiday seasons. So that's some of the impacts. And then, the most important one is that the Pacific will be significantly lower than it was in Q2 and Q3. So those are the reasons. That's why we do expect it to be lower in Q4 than in Q3 or Q2.

<Q - Jesper Herholt Jensen>: Okay. Thank you. Lastly, on your sort of recent M&A, I have a couple of questions. Obviously, CMC is a very dilutive transaction if it's 7 basis points for next year, considering you sold it for 1.3 times revenue. And if we sort of back it out, it implies that [ph] you're selling it (52:37) around six times operating profit. I'm just, first of all, wondering whether that's broadly right? And then, secondly, it seems to be quite a low multiple for disposing a high growth and reasonably high-margin business. So in the light of that, are you still comfortable with making margin progress going forward? 7 basis points is very meaningful for your business, obviously.

<A - Heine Dalsgaard>: So, first of all, CMC is divested and excluded from the accounts from October 30. So the impact this year is only two months. It is right that it's a high-growth company, also with an annual revenue of around DKK 350 million. Margin is, as you say, significantly above Group average and there will be a full-year effect on Group margin of 7 basis points.

The numbers mentioned in the statements are net cash. So that means net cash proceeds net of debt, net of charges, net of costs to the transactions. You cannot calculate a multiple based on the numbers we have provided. At the request of the buyer of the business, we cannot disclose [ph] EV (53:48) or further multiples on this transaction, and this, Jesper, we'll, of course, have to respect. What we have guided on is net cash proceeds, so net of debt and net of cost and net of restructuring.

<Q - Jesper Herholt Jensen>: Okay. That's very clear. The final question just on GS Hall. [ph] It seems it had (54:09) a pretty weak quarter actually looking at the margins relative to Q1 and Q2. I'm just wondering whether that's normal seasonality in that business or whether there's anything that has surprised you in the development there over the third quarter?

<A - Heine Dalsgaard>: There is nothing in particular there, Jesper. It's seasonality throughout the year and between the quarters.

<Q - Jesper Herholt Jensen>: Okay. Thank you.

Operator

Thank you. Our next question comes from Staffan Åberg from Handelsbanken. Please go ahead. Your line is now open.

<Q - Staffan Åberg>: Well, thank you. Most of my questions have been answered. But I was wondering one thing, on the back of us now witnessing the largest immigration wave in Europe since the Second World War. Do you see any indication of possible wage deflation in some parts of Europe?

<A - Jeff Olsen Gravenhorst>: Right now I don't see that. And we have to remember that refugees are not readily available, obviously, in all jurisdictions for – as a labor. And I think it's too early to actually say that. I think in some countries we already now – in Denmark, for example, we do need some labor coming in.

So, I would say, I don't see that. We actually see the opposite. As you know, minimum wage is coming up and the living wage rates and so forth. So the quick answer to it is no. Having said that, I don't think any of us knows the extent of what's going to happen or the speed of what's going to happen. So I would like to have that as a quantification at the end.

<Q - Staffan Åberg>: Okay. Thank you.

Operator

Thank you. [Operator Instructions] And the next question comes from Kristian Godiksen again from SEB. Please go ahead. Your line is now open.

<Q - Kristian Godiksen>: Okay. Thank you. I just have a quick follow-up. So, Jeff, if I heard you correctly, you said that you're expecting low organic growth in Q4 compared to Q2, Q3, right? I'm not sure I understand why that should be the case, because you mentioned seasonality. I guess seasonality is always there. I guess that will have – the year-on-year impact will be zero, I guess. I'm assuming, I guess, it's timing between Q3 and Q4. And then further I guess you should see further start up of contracts and contracts having full-year impacts in the quarter. And I guess especially, I am referring to the UK loss to hospital contract in addition to that, having a full-year impact of 0.3 percentage points. So I'm a bit unsure why you should expect low organic growth in Q4?

<A - Jeff Olsen Gravenhorst>: Let me talk about that, Kristian. I think this is now – you're absolutely right if this was normal. We have picked up a number of new contracts, in particular, in Norway within the hotel sector. That has had an impact this year and not last year, this year's growth in the third quarter. Because the season actually stops, then you don't continue to see that until next year. So it's not there in Q4, right?. So it's not year-over-year, it's actually in-year because we've had success with that segment. That success is actually not giving us the growth in Q4 as it was giving us in Q3.

The same thing goes for the nuclear extra works that's done in Sweden. This is something that doesn't come every year. It's come this year in the third quarter. It doesn't, of course, sits in the fourth quarter, so it can't help us on that growth, but it wasn't there last year either, but the additional growth was there in this quarter – or in this third quarter. So that's why those two are coming out of the comps back both compared to last year, but also to the prior segment.

But most importantly, it is actually that Pacific last year was a growth engine also for us. This year, it has a sharp decline, as we said already. So that's the major driver.

Then you have compensating factors which is, of course the – compensating, the new wins, the startups, et cetera. We also had – last year we won the big food producer out of the Swiss operations outside of [indiscernible] (58:21) we'll see a lower growth in particular in Switzerland also for the remaining year. So those are the moving parts and that's what we're saying is, when we put all these moving parts together, we see a lower growth in Q4 than we see in Q3 or Q2.

<Q - Kristian Godiksen>: Okay. Thank you.

Operator

Thank you. That was our last question. We have no further questions at this time. So I hand the conference back to you speakers.

Nicholas Richard Ward

Great. Well, thank you everybody for dialing in. Thank you for your questions and your interest in ISS. We appreciate it and we look forward obviously to speaking to you at the next quarter in March. Many thanks.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you all for participating. You may now disconnect your lines.