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PRESENTATION

Martin Kjær Hansen ***ISS A/S - Head of Group IR***

Ladies and gentlemen, this is Martin Hansen, Head of Investor Relations at ISS, and I would like to welcome you to our results teleconference call. Please be aware that the announcement, the report, as well as the slides used for this call can be found on our website. Later today, a replay will also be available, and we will post a transcript of the call as soon as it is ready as well.

I'd like to draw your attention to Slide #2 regarding forward-looking statements. Presenting today will be group CEO, Jeff Gravenhorst; and group CFO, Pierre-François Riolacci. We'll open for Q&A at the end of the presentation, as usual.

With that, I'll hand over to Jeff.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

Thank you, Martin, and good morning, everyone.

Turning to our financial highlights for the continuing business, we're pleased to see that the organic growth remains strong in the first half-year -- first half of the year at 6% driven in particular by Key Accounts. We continue to see strong commercial momentum as well as sustained demand for projects and above base work.

The operating margin was 3.7% in the first half, slightly down as expected partly driven by growth with our high level contract launches and extensions and the launch of our transformational investments. This was partly offset by very good progress in the U.S. and in Sweden.

Free cash flow for the first half-year of 2019 was negative by DKK 2.7 billion, DKK 1.7 billion (sic) [DKK 1.4 billion] lower year-over-year, mainly driven by lower use of factoring of almost DKK 1 billion and our higher growth. Net profit adjusted for the first half year of '19 was flat at around DKK 800 million.

Finally, our leverage for H1 2019 was 3.4x, slightly higher than the 3.2x a year ago. The development was mainly driven by higher growth leading to higher debt and the relative operational performance in our discontinued operations.

You may also want to know that the absolute level is impacted by our decision to reclassify all restructuring costs above the line. We gradually returned to our leverage target of maximum 2.8x, driven mainly by the EBITDA growth starting from the second half of this year.

Turning to some of the recent commercial highlights, we continue to see strong organic growth of 6% for the first half of 2019, with a Key Account growth of 8% organically. Global Key Account grew organically by 7% in the first half of '19 and 11% in the second quarter of 2019, now accounting for 15% of group revenue. Growth was driven by the expansion with existing accounts as well as contract launches.

I'm also very pleased to announce that we launched the Deutsche Telekom contract on the 1st of July, the single largest contract in the history of ISS as well as several key contract extensions and expansions including an international manufacturing company, the Danske Bank and Vattenfall.

While our commercial momentum is generally very strong, we have unfortunately had to announce the loss of Novartis. ISS was among the 2 final bidders but unfortunately we didn't make it over the finishing line. As of today there is no further update on timing or impact as negotiation is still ongoing with the expected new provider. As such, we continue to expect the revenue to drop out from January 2020.

I will cover the commercial angle in more detail over the next few slides, so for now I'll just reaffirm, we continue to see a solid momentum and a strong pipeline.

In December 2018, we provided a strategic -- strategy update laying out the plan on how we will structurally transform to deliver industry-leading growth of 4% to 6% going forward.

Firstly, our strategic divestment program is proceeding as planned with 29% of assets successfully divested or signed. A number of other divestment processes are coming to an end, and as such we expect the significant step-up in divestments towards the end of the year. We expect the combined net divestment proceeds remain at DKK 2 billion to DKK 2.5 billion.

In addition, we successfully initiated our transformational investment in the first half of 2019, which I'll come back to in a couple of slides.

With this, I would like to turn to Slide 5. As expected, we went live with the Deutsche Telekom contract on the 1st of July and I'm very pleased to welcome around 8,000 new colleagues to ISS. The contract is the largest in our 120-year history and has a duration for 10.5 years. It has been a huge undertaking to get this contract up and running. Very proud of the combined efforts from the customer as well as from the ISS organization at large. It truly shows the strength of partnerships and also of being a global company. Our total transition and mobilization cost before launch ended at DKK 590 million in line with the originally expected DKK 550 million to DKK 600 million on which the contract was priced.

As a result of transition/mobilization over the last 2 years, we have now started the contract. However, we still have a number of things ongoing to stabilize and fully ramp up the delivery including the part of the technology part, so the IT. We continue to expect Deutsche Telekom to generate around 4% organic growth starting at margins broadly in line with the group.

With this, I would like to look at the regional development in more detail on Slide 6. Continental Europe delivered very strong organic growth in the first half of the year at 8%. Q2 in isolation delivered 9% organic growth, the strongest quarter on record, and this is still before the launch of Deutsche Telekom. Importantly, the strong performance is supported by most countries in the region in particular Turkey driven by volume growth in the Healthcare segment and price increases on the back of wage inflation. Nominal Danish krona growth from Turkey including FX impact was approximately 10% in the first half.

Even without the price increases in Turkey, organic growth in Continental Europe was still a bit strong at 6%. Growth was further supported by Iberia, Netherlands and Germany on the back of contract launches as well as solid demand from projects and above base work across several countries in the region.

The Continental Europe operating margin ended at 4.5 percentage point in the first half 2019, up 0.5 percentage point year-over-year. The margin was positively impacted by a significant one-off settlement linked to the transaction of a large contract. Transition of a large contract adjusted for this one-off, underlying margin was still slightly up as a result of solid performance especially Iberia as a result of restructuring completed last year and supported further by divestment of loss making noncore activities in the Netherlands in November 2018. This was partly offset by short-term impacts related to very high level of contract launches and extensions especially in a very successful country like ISS Switzerland.

Finally, our operational improvements following the implementation of GREAT in France are progressing but remain behind schedule. This is disappointing, I'll have to say, so there is some catching up to be done here in the second half of 2019.

Northern Europe also delivered strong organic growth of 5%, actually the strongest in almost a decade. Growth was particularly strong in Denmark and the U.K. driven by contract launches and expansions. In addition, we continue to see solid demand for projects and above base work.

The operating margin reached 4% in the first half down 1.1 percentage point year-over-year. The margin decrease was driven by contract launches and extensions in the U.K. as well as in Denmark where margin ramp-up on a large contract is coming through slower than expected. In addition, Northern Europe is spearheading a few of our transformational investments including the organic buildout of technical services capabilities in Denmark as well as the Global Shared Services initiative being piloted in the -- piloted with the consolidation, centralization and automation of our organization in the U.K.

Headwinds in the first half was partly offset by Sweden where I'm very pleased to see our recovery plan progressing with ongoing margin turnaround gaining more traction.

Please turn to Slide 7. Organic growth in Asia Pacific was 5% and was supported by most countries in the region especially driven by strong performance in Australia following the startup of multiple contracts and a high retention rate. China also continued to be a key driver for the region's organic growth following a period of strategic adjustment to our operating model.

In Hong Kong, current turmoil impacted our performance on some of our operations. Demand for projects and above base work was flat in the first half of the year.

Operating margin in Asia Pacific was 5.1% in the first half down 1.4 percentage point year-over-year. Margins were negatively impacted by contract related one-offs. In addition, the margin was adversely impacted by contract launches and extension, notably in Australia and Singapore, coupled with contract-specific underperformance in increasingly challenging environment in Hong Kong, as well as structured commercial investments in China, as expected to support the growth capabilities.

Over the last year or so, margin in a couple of countries have been normalizing from a very high level as previously communicated. While APAC remains a margin accretive region also in the first half, it is currently underperforming, what we see a normalized performance.

Organic growth in the Americas was 2% in the first half and remain positive despite the previously announced exit of a long tail of small underperforming legacy contracts in the U.S. Excluding these exits, organic growth in the region would have been 5% driven by strategic segments in the U.S., the Integrated Facility Services segment and the Food Services business. In addition, Mexico also delivered solid growth driven by one of our new Global Key Accounts wins.

The Americas operating margin was 3.9% on the first half of 2019, up 1.2 percentage points year-over-year. As expected, margin improvements continues in the U.S. on the back of the successful turnaround initiatives and efficiency plans within the specialized services divisions. The margin also benefit from further synergies and scale advantages materializing within the Food Services business in North America.

As you know, Americas has been a drag on group margins for many years. We have not had enough scale nor the fully integrated Key Account model in place. We've taken big steps over the last couple of years and we are now starting to see benefits coming through.

The region is on track to deliver its strongest margin in many years, a solid run rate improvement driven by our strategic choices and strengthening of our key account focus. As the turnaround completes and the contract trimming phases out, we also expect to see the region contributing much more to the organic growth.

Our market share remains very small in the U.S. and, as such, it is the single biggest growth opportunity across ISS.

Please turn to Slide 8. We've extended and expanded a significant number of contracts since Q1 results in May with some of the larger ones illustrated on this slide. As you know, a central part of our organic growth strategy is to continue to grow the existing clients, and

I'm therefore happy to see that a lot of these extensions also comes with additional revenue.

To mention a couple, we've extended and significantly expanded our global partnership with an international manufacturing company in Vattenfall in Germany. With all of these expansions, we now only have 1 contract left with maturity in 2019. And we expect this extension to be finalized soon. With this, we will have successful renewed all 2019 maturities except for Novartis as previously mentioned.

You may also note that 2020 is a rather small year in terms of large contracts of renewal. On an individual contract basis, we actually don't have any major contracts up for renewal of more than 1% of revenue before the end of 2021.

Please turn to Slide 9. As announced in connection with the strategy update in December, we have identified a number of transformational projects which will significantly strengthened our capability of delivering services to key accounts and will yield attractive financial returns. Part of the proceeds from the strategic divestment program will be reinvested back into the business through an accelerated investment program covering DKK 700 million to DKK 800 million over 2019 and 2020.

In the first half of 2019, we have invested close to DKK 200 million, split more or less equally between OpEx and CapEx. Investments include the accelerated rollout of our new state-of-the-art facilities management system, FMS@ISS, which will become the backbone of all future data and technology driven projects. Investments include further development and improvement as well as the accelerated migration of Key Account clients from old to new platform.

We're also boosting our solutions portfolio, for example CRM, to include commercial tools for developing our Key Accounts. Investments also include building a global Shared Services organization to drive centralization, standardization and automization across ISS. With the finalization of GREAT and with the standardization of country organizational structures, we now see a potential for both intercompany -- intercountry and cross-country organization, a back office functions. A pilot project is currently up and running in the U.K. to be extended to other countries.

Finally, we're investing and organically building out our technical services starting with parts of North America. We're also investing organically in our capabilities and excellent [senders] within both catering and workplace management. The latter relates to further building out of capabilities taken over through the acquisition of SIGNAL in 2017.

In these cases, we simply see a higher return on our organic investment compared to simply acquiring, which is however still also on the agenda. We are currently seeing the early impact of these initiatives especially on the top line. With this, I would like to turn to Slide 10.

Let's turn to a brief update on our divestment pipeline, which is progressing with 29% of the divestment portfolio now signed or completed. Argentina and Uruguay were divested at the beginning of the year and Estonia in July. And I'm happy to say that we signed the divestment of Israel earlier this week. In addition, we have completed a number of small business units divestments.

Some of these divestments were completed or signed very recently with proceeds to be received in the second half. In addition, another 57% of the portfolio is now in transition phase with the negotiations well advanced for some of the assets.

While the assets divested or signed so far are below average in term of value and proceeds, we will start to see more significant proceeds come through over the coming months. The value in our divestment pipeline mainly lies within a few assets. And within the next few months, we should be very well advanced with most of these transactions. As such, we expect to sign some of the sizable divestments in the coming few months and we would also expect to see more material divestment proceeds come in by year end.

All in all, we are on track to realize the combined DKK 2 billion to DKK 2.5 billion in net divestment proceeds during 2019 and 2020.

Please turn to Slide 11. Before we go through the first half-year in more detail, I would like to take a step back and look at our performance over a longer perspective. ISS has a very long track record of solid and resilient organic growth. During the last 26 years, we've just had 1 year with negative organic growth in 2003. And with an updated outlook for 2019, we're well on track to deliver the strongest organic growth in several decades.

Likewise, we have a strong -- we have a long track record of stable margins. Although we are currently at the bottom end of our historical range, we are still within a tight range of just 0.8 percentage points from the top to the bottom of an even tighter if you exclude the restructuring charges.

This clearly demonstrate the robustness of our operating model through the economic cycle. That being said, I'm not entirely satisfied with our current level of margin performance even though it also includes a deliberate acceleration investment or accelerated investment into the business.

I believe the margin should and will eventually be in the 5.5% area in line with our medium-term outlook. And as such, post an upside relative to the 2019 outlook of 5% to 5.1% margin.

With that, I would like to hand over to Pierre for further details. Please turn to Slide 13.

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

Thank you, Jeff, and good morning all of you. Of course, I will start saying that I'm extremely pleased with the commercial momentum in this first half of the year and also to see that the focus on Key Accounts is definitely paying off.

Looking at H1 numbers, we see the total growth is plus 5%. It does include a currency impact, a slightly positive plus 0.5 and negative impact of acquisition and divestments, of course, of minus 1.5, which means that the organic growth in H1 at 6% is strong and driven of course by these Key Accounts. Key Accounts growth is about 8% in the first half.

And on the building blocks, so you see that the loss of HPI, DXC and Citi EMEA impacted growth negatively by 0.5% in H1. So now decreasing and would be largely annualizing going forward. By the way, in H2, we have Deutsche Telekom in that box of major contract development also to allow you to follow-up more specifically.

On the other contract development in the rest of the portfolio, still strong plus 5.4% in H1 driven by this Key Account contract wins and expansions and following this strong commercial momentum.

As expected, this momentum has slowed from 6% in Q1 to 4.9% in Q2, as a result of the annualization of a number of large contracts launched at the beginning of 2018.

Projects and above base work remained quite solid with the contribution of plus 1.1% to the total growth. And while contribution in first and second quarter was broadly similar, we see that volatility in quarter has increased, and this remains of course our main uncertainty.

And indeed, going into Q3, we expect of course organic growth to step up driven mainly by the launch of Deutsche Telekom, which should generate around 4% of organic growth including non-portfolio work and which I flagged is still uncertain.

Outside Deutsche Telekom, we are likely to see further slowdown from the rest of the portfolio, that's a continuation of the trend that we've seen from Q1 to Q2.

We do not have any mentionable losses going out, so the development will continue to be driven by a further annualization of these large contracts which have supported growth over the last year. It will also include 2 Global Key Accounts that we launched gradually during last year as well as Aviva in U.K, a professional service company in the Netherlands, Victoria State Government School in Australia, a former client in the U.S., some significant contracts, of which, combined new revenues was around DKK 1 billion.

On top of those, the existing portfolio, especially the expansions that Jeff mentioned earlier will help us to keep some traction in the portfolio development. And this is an important component going forward of our midterm gross target. The main uncertainty, both under positive and negative side lies with nonportfolio work especially in relation with Deutsche Telekom. With a strong H1 and even stronger growth in H2, we now expect to deliver 6.5% to 7.5% organic growth this year up from previously 5% to 7%.

Please turn to Slide 14. If we turn to operating profit, it came in at DKK 1.4 billion in H1 2019. So plus 2% compared to last year. This is a margin of 3.7% which is marginally down compared to last year of 3.9%. Precisely, minus 12 basis points for those who make the calculation and this is quite in-line with what we expected and communicated earlier in the year.

Jeff has already covered the regional developments, so let me just quickly summarize at the group level. Clearly, the development of operating profit was supported by our strong top line growth. In addition we see a solid margin improvement in some of our key underperforming assets from 2018. And clearly our turnaround incentive in the U.S. and Sweden are now gaining speed; that helps. We are also seeing the benefit from last year divestment of underperforming non-core assets mainly in the Netherlands. And then the margin was supported as well by the ongoing normalization of restructuring.

These positive drivers were however offset by our transformational investment that Jeff mentioned. It was a drag of around 0.3 points in the first half. This is in line with the plan. In addition, the margin was negatively impacted by contract startups with low first year margin as well as contract extensions including the usual price adjustment which will be followed of course by the agreed efficiencies. So well-known margin profile, but it helps more when growth is accelerating. Again, this was anticipated to a large extent.

We've also seen a bit of underperformance in a few countries some of which is contract-specific but nothing really major. And we expect largely to catch up in H2.

One-offs in H1 were broadly comparable to last year with positives in Continental Europe related to pension once again but also a contract-related settlement and negative mainly in Australia, Pacific and mainly related to contracts.

So looking into the second half of 2019, where our guidance implied flat to 0.2 higher margins year-over-year, we continue to expect those operating profit and margin of course to be up year-over-year, as communicated earlier. Revenue growth will be even stronger but supported by the Deutsche Telekom contract, which is not expected to dilute margins in the first year.

The turnaround in North America and Sweden is set to gain further traction and restructuring would be the much larger year-over-year benefit. Remember that restructuring peaked in H2 2018 at around DKK 300 million, which gives us a good basis of comparison. In addition, we expect to see the margin ramp-up on new and extended contracts compared to H1.

Of course, as always, we see both upside and downside risks. On the low side, some of the underperforming units in H1 need to catch up in H2. Jeff mentioned that France and Hong Kong as an example. And of course, we need the Deutsche Telekom contract to be stabilized as expected as planned.

On the high side we are also pursuing the few positive one-offs in H2, albeit, at a much lesser extent than last year and we are working on contingency plans on savings and phasing of transformational project to give us some buffer.

Please turn to Slide 15. I think that we have covered already revenues and operating profit. I will just say a word about our depreciation. It is a significant increase of DKK 470 million (sic) [DKK 438 million] year-over-year to DKK 766 million, i.e. 2% of revenues. This increase as you know is mainly driven by IFRS 16. Excluding the impact of the new standard, depreciation relative to revenue is slightly up at 0.9% compared to 0.8% last year. We continue to expect a similar increase for the year as a whole in line with what we discussed before.

All in all, we expect depreciation relative to revenues to be at 2% plus of our revenue in 2019 including the IFRS 16 impact.

On the other income and expenses, a much lower amount than usual, DKK 53 million in H1 '19, DKK 40 million in H1 '18. You see the impact of restructuring costs now presented as part of operating profit before other items rather than within other income and expenses. And of course these are comparable figures, which has been restated accordingly. So other income and expenses today are entirely driven by costs related to acquisitions and divestment. There will be more costs coming in H2, as our divestment program develops. And hopefully, there would be also some capital gains.

Financial income and expenses. You see a net expense increase by DKK 37 million to DKK 327 million in H1 '19, which is driven by the change of standard IFRS 16. We expect H2 to be on a similar term than H1.

The goodwill impairment which is the DKK 144 million in H1. I have to mention the impact of the remeasurement of the held-for-sale Hygiene and

Prevention business in France. As you remember, we were not in a position to close the initial transaction, that was definitely a disappointment, and we have to go back to the market and it comes with a cost.

The amortization and impairment of brand and customer contract was DKK 168 million in H1. We are slowly getting to the end of the amortizing on the PPA from when ISS was taken priority in 2005. As such, amortization will step down over the next few years again to DKK 350 million in '19 and even lower in 2020.

The net profit reported from discontinued operation is negative by DKK 100 million in H1 as operating profits were more than offset by a fair value adjustment in Israel.

The net profit reported for the group is DKK 402 million which is up DKK 532 million year over year mainly due to lower fair value adjustment compared to last year.

I have mentioned a couple of fair value adjustments on our assets to be disposed of, but it is worth mentioning that we are sticking to our expectation of DKK 2 billion to DKK 2.5 billion in net positive from a divestment program reducing both capital employed and net debt for that precise amount.

Please turn to Slide 16 for the cash flow statement. The cash generated by operation improved by about DKK 0.5 billion mainly as a result of IFRS 16 change in standard as a treatment of the leases payment.

The change in working capital was seasonally low with a year-over-year decline driven mainly by significantly lower factoring reflecting a more restrictive approach, our correction just in working capital in details in Slide 17.

So net interest paid and received increased by DKK 72 million with the main driver being again IFRS 16. And then of course, let's spend some time with the cash flow from investing activities.

Capital expenditures, which is, let's say, the traditional definition, was approximately DKK 40 million higher year-over-year, i.e. 1.3% of revenues driven mainly by our transformational investment and also some transitional mobilization of Deutsche Telekom partly offset by investment discipline across all the other parts of the business. As previously communicated, we expect CapEx relative to revenue to increase in H2 and to end the full year at up to 1.5% of our total revenues.

Let me highlight our decision to buy or lease from a given asset is based entirely on the operational rationale, the flexibilities that we want to own the assets and the NPV approach. As a result, we treat additions and disposal from leased asset as a type of CapEx which is also reflected in our definition of free cash flow. I will come back once again on that.

As such, there may be a bit of trade-off at any given point in time between traditional CapEx and additions to leased assets. In H1, the combined CapEx and addition to leased assets was about 2% of the revenue, which is in line with depreciation. We expect to be higher than that on the full year to an amount which we'll discuss.

The net cash outflow from acquisition and divestment of DKK 172 million related to the divestment of Argentina and Uruguay, the acquisition of [Ploris] in Germany and some prior year divestment adjustment.

The cash flow from financing activities is DKK 2,154 billion in H1 '19 compared to '18. It is driven by proceeds that we got from the issuance of a 7-year Eurobond for principal amount of DKK 500 million principally. This was partly offset by dividends paid to shareholders, DKK 1.4 billion, and payment of lease liabilities following the implementation of IFRS 16 because that's on that line the lease payment are now reported.

When we go to free cash flow, again, I come back to that, we previously in the year adjusted a free cash flow definition to include the negative impact from additions to leased assets effectively treating it as a type of CapEx to offset the positive accounting impact from IFRS 16 related depreciation and amortization reflected in EBITDA. With that in mind, our free cash flow is negative by DKK 2.7 billion for H1 '19 including an outflow from discontinued operation of around DKK 300 million.

Free cash flow was down almost DKK 1.3 billion compared to last year mainly driven by the reversal of nonrecourse factoring versus year end. Let me come with Slide 17 to this development. And indeed, if you look at the figures of development in more detail, we see of course that EBITDA including discontinued operations increased by DKK 0.4 billion. And the addition from this asset was a negative DKK 0.3 billion. Those are largely driven by IFRS 16 in H1.

As mentioned on the previous slide, change in working cap was negative by DKK 1.3 billion year-over-year, the deterioration, DKK 1.3 billion.

As you may recall, we gave a commitment to completely roll off all short-term user factoring which was largely completed in H1. As such, factoring was a drag of DKK 0.9 billion year-over-year. So when you compare factoring valuation in H1 last year versus factoring valuation this year, a drag of DKK 0.9 billion.

Stripping out the full factoring utilization entirely, I will highlight that our debtor days are sitting at 55 days, which I think is pretty decent especially given that they also includes the impact of the transition and mobilization costs of Deutsche Telekom in the lead up to launching 1st of July. As we see on this slide, these costs were DKK 0.2 billion higher year-over-year.

Over the last year, we have also been impacted by a tightening of rules regarding supplier payments especially in the U.K. This was a key influence both in H2 last year, and again now in H1 with an impact of DKK 0.2 billion year-over-year. We also faced an expected build up of working capital related to growth. Of course, we have strong organic growth and there is an impact on the working cap. And on the other side, we received a settlement related to a transition of a large contract as expected.

So to summarize, the DKK 1.3 billion decline was driven by factoring for DKK 0.9 billion and a mix of other movements in the working cap for DKK 0.4 billion including high revenue growth and the final prelaunch transition and mobilization of Deutsche Telekom.

Let's turn to Slide 18 to look at what we are heading to for the rest of the year.

As you may recall, we delivered DKK 2.4 billion in free cash flow in 2018. Excluding the change in factoring in '18, the free cash flow was positive DKK 0.8 billion, and we discussed that at length during the full year results.

Our outlook for 2019 remains DKK 1.8 billion to DKK 2.2 billion, including a slight reduction on factoring, let's say, minus DKK 100 million to minus DKK 300 million. In other words, we expect of free cash flow excluding factoring, rendering cash flow to improve significantly from the DKK 0.8 billion in '18 to a minimum of DKK 2 billion in '19.

Where does this improvement come from? First, it starts with a strong EBITDA growth, which is expected in H2 as a result of historically strong organic growth as well as higher EBITDA margin. For the year, this alone is a benefit based on our own guidance on top line margin and depreciation of around DKK 400 million, close to 10% H2.

In addition, we expect to catch up on a number of negative one-offs in working cap that we flagged in H2 2018. And you remember, we mentioned that we had DKK 500 million, DKK 600 million of negatives in H2 '18, which led to the unusually weak performance that we had last year. These are one-offs that we will not have this year and of course it will help us on the comparison especially in H2.

We are also rolling out of new group-wide working cap optimization initiative which is focused in particular on supplier payment terms to offset part of the headwinds that we had over the last 12 months. We have already made good progress on negotiation and the cash benefit is expected to start to come through in H2. We are talking about a few hundred million on that line, positive.

Finally, we have a bunch of other smaller tailwinds coming from tax, share-based payments, asset optimization that will help us in the cash flow statement, and again another few hundred million. Against these benefits, we see high working cap build up on the back of the very strong organic growth partly materialized in H1. But let's say a few hundred millions again on this year as a whole that will be on the negative side. And also, we expect slightly higher CapEx than last year.

So in summary, we expect a solid H2 with free cash flow driven by the usual strong seasonality as well as a number of other benefits as I just described. That's the underlying free cash flow.

On factoring, we've heard loud and clear the message from the market. For the full year, we plan to keep restrictive approach targeted to cover value accretive transaction based on cost of fund but also to target exceptionally long payment terms. With that, the level of factoring could actually decrease more than the initially planned DKK 100 million, DKK 300 million on which the outlook is still based, despite ramping up the Deutsche Telekom factoring program in H2. We will update you in connection with the Q3 release once we have full visibility on both legs.

No matter how much we end up reducing the level of factoring, this will not impact the 2019, excluding factoring, at a minimum -- free cash flow at a minimum of DKK 2 billion as illustrated on the slide. Once again, we stick to the expected sharp improvement of the underlying cash flow despite higher growth and this is based on [recovering] for 2018 negative one-offs in working cap and also a strong EBITDA growth.

With that, I will hand you over to Jeff to finish off with the outlook on Page 19.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

Thank you, Pierre.

The outlook for 2019 for organic growth and operating margin has been adjusted slightly, mainly on the back of the ongoing strong commercial momentum that we just described in the business. The outlook for free cash flow remains unchanged. As such, we now expect industry-leading organic growth in the range of 6.5% to 7.5%, so up from the 5% to 7% previously announced and above our medium-term targets of 4% to 6%.

With a strong start to the year, combined with our updated expectation for the second half, we now expect to end stronger than previously outlooked at 5% to 7%. Growth will step up in the second half significantly supported by the launch of Deutsche Telekom.

However, we also expect to continue to see slight softening of the underlying growth we experienced from Q1 to Q2, driven mainly by the annualization of contract launches which have supported growth over the last year.

Finally, we do not have a lot of visibility on the nonportfolio demand and although it remains solid in the first half, it has lately become somewhat more volatile. Wherever we end up in the 6.5% to 7.5% growth, I believe it would be industry-leading, and as such, very pleasing.

In terms of the operating margin, we continue to expect to end up in the low end of the original outlook of 5.0% to 5.2% as mentioned in connection with our Q1 trading update in May. Given the continued stronger than expected organic growth, we now formalize and narrow this margin guidance to 5.0% to 5.1%.

Our run rate improvements, including normalization and restructuring, are expected to offset some positive one-offs from 2018, as well as the 2019 transformational projects investments.

In the first half, our first half margin development and phasing was largely as expected and communicated earlier in the year. However, given the stronger-than-expected organic growth this in isolation is a slight negative on the margin on the short term. As you probably remember, wins and extension typically start with a low first year margin before ramping up.

In addition, we've also seen some selective local underperformance and delays partly offset by the turnaround in North America and Sweden in particular.

The outlook continues to be based on Deutsche Telekom delivering on a margin broadly similar to the group. And looking past our transition period in 2019 and '20, we expect our margin to greatly improve to around the 5.5% in the medium term.

Finally, we continue to expect free cash flow to be between DKK 1.8 billion to DKK 2.2 billion, including negative nonrecurring items such as our transformational investments and the peak transition and mobilization of Deutsche Telekom.

Given the stronger than expected organic growth driving a high working capital buildup, we could end up in the year in the low end of the range of the outlook range.

This concludes our presentation of results for the first half of 2019, with which I would like to open up for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is over the line Bilal Aziz at UBS.

Bilal Aziz ***UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst***

Just 3 quick questions from my side. So you suggested there was some selective underperformance in some of your regions in the first half. Can you please detail that out please and will that require any more restructuring above what you've guided for?

Apologies if I've missed it? Can you give some detail around the restructuring in the first half and the guidance in the second half so that we can get sense from that phasing?

And lastly, just your performance in the U.K., how that traded through the first half, and I guess your expectations for the second half there as well.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

Yes, so on the selective underperformance, I mean clearly, we're a big business. We still have 450,000 to 500,000 people in continuing business. There are always some ups and downs. And one of the things this year is Hong Kong. As you've seen both from the -- from media and everything else, we do actually run a lot of the infrastructure in Hong Kong and that has an impact on our performance.

On top of that, we do struggle with a couple of -- with 1 particular contract in Hong Kong that gives us some underperformance. Right now we don't see that as a need for any major restructuring which was your question.

Another one is, as I mentioned, we are behind -- slightly behind, on the restructuring in France which is, of course, disappointing as I said but it is a big undertaking where we're taking 35 local branches into 9 to 10 hubs. The AUCs, on the above unit cost -- the infrastructure costs has been reduced.

In the moving around of contracts and employees, there is some visibility that needs to be strengthened, so this is not additional restructuring, it's simply just a matter of continuing to get that through.

Other than that, it's pretty much in line with what we normally chart, the normal sort of ups and downs that we see across the business.

I'll just continue on with the U.K., if you don't mind, your question 3. On the U.K., we have -- we continue to see a very good commercial performance. I think the Brexit obviously is coming up. We all know this and it looks more like the hard one than anything else. The currency has been impacted, which of course is an issue when you translate it into Danish kroner, but remembering that we have a natural hedge, that actually helps us because all of our -- almost all of our cost is in local currency as well as our revenues in local currency.

There is one area which is of course food services which is -- does have a certain size, particularly in some part of our food businesses where we see some food inflation that's coming through that gives us some challenging margin development. But other than that, it's actually in line with our expectation.

I think from a portfolio commercial perspective, as said, we've had some very good wins and very good growth. But of course, uncertainty is never good and it's particularly on the above base and project work that we can see on the technical services side and [it's that way] our investments are being held back. And so outlook for this year, we've built that in, that uncertainty into our commercial outlook for the year.

So good, very solid business. As you remember, a big part of our business is based on the public sector arena, so in the hospital sector which continues to perform. And we're growing. Also we have a big part of our business in advisory so we could be legal, lawyer/auditors, continue to perform.

A big part is banks, they have more or less adjusted now but of course it's not done but we can follow them to other countries. Then, as I said, the rest of it follows, what I just argued.

So Pierre, maybe on the restructuring?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

Yes. So if you remember last year we had a total of DKK 530 million. We had DKK 230 million in the first half, or DKK 300 million in the second half. This year, we land H1, around DKK 150 million which means that we have some tailwind, but it's clear that the tailwind will get much stronger in H2. We indicated that the full year should be anywhere between DKK 200 million and DKK 250 million, so we are talking about something that could be DKK 200 million in H2.

Operator

So we now go to the line of James Winckler at Jefferies.

James Peter Winckler ***Jefferies LLC, Research Division - Equity Analyst***

The first one just on the transformation costs of sort of net about DKK 100 million on P&L in terms of OpEx. I wonder if you can give any split from a divisional basis, just in case of sort of where those landed in being able to judge sort of relative to our estimates how that impacted margins in H1?

And then just interesting on the U.K. bit. As far as I understand, the government sort of relaxed their payment requirements of -- from 90% payment within 60 days to 75% and relative to your comments of sort of increased scrutiny of payments in the U.K. hurting cash flow in the short term here. I'm wondering if that should improve in -- due to those developments or if most of that is due to sort of private national accounts?

And then lastly, apologies if I missed this, with regard to the full year factoring year-over-year change, down year-over-year, DKK 900 million. As far as I'm aware, the last conversation was about a full year DKK 500 million reduction. So does that mean in the second half, you're sort of throwing some of that back on in terms of relative to H1?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

On the transformational spend, to be fair, most of this is either sitting in the corporate or actually in Europe, because that's mainly in Europe that we are moving forward quickly in this transformational, which are building these technical services initiative on one hand. And on the other hand, moving forward with our centralization, Shared Services, and of course, the new technology platforms that we are migrating. And this is an operating costs.

So this is in Europe with let's say, a clear focus on Northern Europe versus Continental Europe. So that's where we are actually focusing a lot. Jeff, you mentioned the technical services in the Nordics. We should mention this is an initiative in the U.K. in Shared Services. And then the rest is for migration of systems, very much focused in Europe. So you could really -- I cannot give you a number, but already put it in Europe and with a clear lead to Northern Europe versus Continental.

On the factoring, so let -- just you remember that last year, we landed with a total factoring at year-end of DKK 2.5 billion, which was an increase year-over-year of about DKK 1.6 billion. This year, it's clear that we have some moving parts and I indicated that we have some moving parts. We were expecting at the beginning of the year that we would have a slight decrease of factoring. We were expecting definitely to reverse the one-offs and we had mentioned that very openly for at least a DKK 500 million. And on the other side, we're expecting to ramp up supply chain financing which is related to the Deutsche Telekom contract. So this of course is happening.

What I'm saying today is that we could go further in terms of reducing factoring to really cover only exceptionally long payment terms. And that would entail that we can grow further in terms of decreasing factoring on the existing base. This is a bit of an uncertainty. And the other uncertainty, of course is the amount of factoring that will be triggered by Deutsche Telekom. I think that we were very clear that we do have uncertainty on the nonportfolio work.

So -- and of course, this is a contract which is new to us. It's a bit difficult to know what will be there in October, November, December which are the key months that will trigger this factoring story. And that's why we feel much more comfortable to update you in Q3 when we have better visibility on both legs of -- which are going to drive the net factoring level. But it's -- excluding factoring, again, there is no change in our views of the underlying cash flow.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

On the U.K. and the working capital business debtor days, sort of the relaxation from the government, there are many -- there are 2 different things working in the U.K. on the payment side. One is, of course, the rules from the government saying that you have to pay within 60 days no matter what you have agreed or a certain part of it has to be paid with that. And other part of course, is that the implication of some of our bigger clients having -- or bigger competitors in the market having issues over the last few years of course, means there is a very, very strong focus from some of our major vendors on tighter payment days.

But we also mentioned or Pierre mentioned in the cash flow forecast that we do see some optimization capabilities in the way that we deal with our vendors. Of course this is something we're working with right now which will give us a positive impact and is baked into the forecast of cash flow for the year-end as also just walked through.

Operator

We now go to the line of Magnus Jensen of SEB.

Magnus Thorstholm Jensen

Magnus speaking here. A couple of questions already answered. But I have one on the extension of contracts that you have had since you reported the last time. Is any of these extensions expansions as well or is it just a continuation of your already existing contract?

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

As I mentioned actually quite often this is what happens when you make the new negotiations. A big part of our growth in the first half year and also growth going forward comes from the fact that we expand and sometimes actually significantly expand our revenue with our clients.

I think going forward, we'll see more and more of this that we get bigger relationship as we can --as we are with our clients, we can tap into bigger potential either by expanding regions or by expanding number of services.

So if you take just for the last 3, Vattenfall, I already mentioned; there's a global professional company -- service company I can't mention the name on; and an international manufacturing company. so just 3 businesses we expanded with around DKK 500 million just from those 3 contracts. So it is quite significant what we can see of expansion and what is coming through.

Magnus Thorstholm Jensen

So just to clarify, on the DKK 500 million, that -- what is impacting this quarter or is it that what you expect for the next 12 months?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

That's an annual revenue impact from the extension expansion of those 3.

Operator

We now go to the line of Morten Eismark at ABG Sundal Collier.

Morten Raunholt Eismark ***ABG Sundal Collier Holding ASA, Research Division - Research Analyst***

A couple of questions related. I understand that the spinning off the selected countries is on time and I understand that you confirm the target of creating DKK 2 billion to DKK 2.5 billion in the process. So related hereto, can you shed some light on the potential M&A targets? I'm thinking regions and segments and perhaps a specific comment on the U.S./North America trying to build some scale in that region.

And related hereto my second question, can you also confirm that if you do not find suitable M&A targets within a given time frame, say no later than 2020, you will return those extra proceeds to shareholders account around 40% of the original divestment number earmarked for acquisitions? Those were my questions, please.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

Thank you. Yes, you're quite right on the DKK 2 billion to DKK 2.5 billion. On the M&A side, it's pretty -- it's in line with what we have communicated before, so this will be segments-oriented, either service segments or customer segments.

So clearly, some of the very strong segments for us has been within the hospital sector across the entire world, but it's also the technical services and food services. That actually goes hand in hand. So it's within either very strong customer focus or very strong technical and food service area.

Looking from a regional perspective it is of course we have a stronghold in Europe, we all know this, so we will be focusing on can we make ourselves even stronger but U.S. is a growth engine. So of course, that is an area where we have a really strong focus on other businesses to acquire and to add on to our business.

We are very selective, as you've seen over the last few years. The acquisition of Guckenheimer has been a -- really very successful, and that's on the back of using a lot of time on due diligence, not just as the company, but also of ourselves, and where do we see the market and where can we make a big impact? Again, this is where we see a double-digit organic growth on our food services business.

So it will be predominantly within technical services. It will be within food services or it will be in some of the stronghold of our customer segments. But it could be in all the regions now we have shared -- sort of shortened it down to the 31 countries. They're all basically in focus but more focused on the Americas growth story.

Pierre, on the...

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

For sure. I mean the -- it's clear that you heard what Jeff -- about our discipline on acquisitions. Now if we cannot source a deal, we'll be left with indeed some proceeds that will be available. We have to of course, to do the sanity check on our trajectory to our credit metrics, which is in good shape, but we will do that. And of course, any amount that is left will be sent back to shareholders. We'll need to discuss, of course, the way to do it, whether it is dividend or buybacks. It's clear that given the stock price today, there might be some indication. But that's something that will be done, of course, before the end of the divestment program which would come in 2020, hopefully early enough.

Operator

We are now over to the line of Allen Wells of Exane BNP Paribas.

Allen David Wells ***Exane BNP Paribas, Research Division - Research Analyst***

Three quick ones from me. First one, I just noticed in Continental Europe, you flag what looks like some of the one-offs in there, so certain of them linked to the transaction of large contracts as well as the positive impact of pensions.

Is there any way you can quantify the sort of argued one-off benefits in Continental Europe on that margin improvement there? That's the first question.

And the second question obviously with the DT contract starting, I think the language from you guys historically has been around margins coming in broadly neutral for that contract in the second half of the year. Obviously has that started now? Is there an update? Is that still the expectation?

And finally, maybe just a more sort of high-level question. If I just think about the movements in the first half, you've had -- margin should have benefited from the reduction in the restructuring charges that you highlighted year-on-year and obviously benefiting from lower margin -- the divestment of lower margin activities partially offset by the investments that are being made, the DKK 100 million.

So net-net, margins -- underlying margins, if you exclude those, should be declining. I guess in the context of the business doing more in higher-margin Integrated Facility Services, as you sit here now, what's the main driver of that underlying margin pressure that you're seeing within the business and how do you expect that to transition over the next sort of 12 to 18 months?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

On the first one, I think that it was pretty clear when Jeff went through the regional review on Continental Europe. We mentioned that we do have this one-off that he mentioned. Without this one-off, the margins would be slightly up. I will not go further into details.

We have actually one other one-off which is clearly detailed in the notes, which I will remind you is actually exactly in line with what we had last year. So it has no impact year-on-year, and it means that it gives you some ideas of magnitude of the one-offs.

Now, I'm always a bit careful with this one-off, because in a business, as a size of ISS, you will always have some plus and minus. So it is our job to try to highlight the big-ticket so that it gives you an ID and that's what we try to do. But it's not necessarily a precise science.

So here, there was definitely a good point in that settlement that helped our margin. But excluding that one, our margin would have been slightly up year-on-year. So it's not like if we had a negative trend that we would have to flag.

Jeff Olsen Gravenhorst ***ISS A/S - Group CEO & Member of Executive Group Management Board***

On DTAC, yes, it's the same language, I actually already mentioned it that we are expecting this to be broadly neutral to the group for the year and of course that will improve over the years of the contract. So that is part of when we start our big contracts, then there is always a lower margin.

So in this very high growth period, there is a pressure on the margin in the start-up period and now you've seen the 6%, that does not include DTAC where there's been a long ramp-up period. So this is where we have more investments in the beginning and therefore a slight drag on the margin.

Remembering also that we have included quite a high OpEx investment into systems, into the technical platform of course, also is the drag on the margin for the first 6 months. But apart from that, we don't see any major changes in the market conditions. We are continuing to be very disciplined on getting price increases through which I think we have been very good at this year, actually across the board, representing the wage increases that we've also seen. And in particular, this was highlighted in Turkey where even the net growth in absolute numbers sits at 10% and very strong margin.

So I think overall, this is in line with what we have communicated before: strong start of the contracts and investment into OpEx. And then we're helped by some one-offs but there are also some one-off negatives in this. So no difference to what we have said earlier.

Operator

We'll go to the next line which is Matija Gergolet at Goldman Sachs. (Operator Instructions).

Matija Gergolet ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

A couple of questions from my side. So firstly, just coming back to the one-offs, so just to clarify. So this DKK 71 million pension one-off benefit in the second quarter, could you expect, say, more of this type of, say, benefit pensions, actually entitlement renegotiations?

I think in your press release you mentioned that now the one-offs, positive or negative, they broadly cancel out, are you including the pension DKK 71 million benefit when you say that the positive and the negatives broadly cancel out between Europe and Asia Pacific? So that's the first one.

Second question is on the free cash flow. I mean if I compare the free cash flow definition now compared to I think the year end, I think there's a slight change in the definition. I think it went from -- with regards to IFRS 16 treatment, from -- I think you used to say that you would basically neutralize the impact by using the repayment of lease liabilities which are DKK 530 million in the first half. Now you are basically -- you have switched to basically showing what is the net additions to the liabilities which is around DKK 300 million, so that's a DKK 200 million delta.

Can you explain a little bit the rationale why you basically changed the definition? So was the thinking around the free cash flow?

And then thirdly, on the divestments, so now your leverage say is above 3x net debt to EBITDA and you mentioned your target was 2.8, which you seem to be comfortable of achieving it basically by year end.

Can you just confirm that basically given the current leverage you're still very comfortable to basically do say a buyback or a special dividend on the back of the asset disposals?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

Thank you. Good questions. On the one-offs, we say so this contribution to one-off to the result in H1 are indeed broadly in line with what we had last year. So let's say a plus [first DKK 30 million] as a net.

And you're right to point out that indeed these pensions, we had already a couple of -- over the last couple of years and for the same amount, so which means that we have in this plus [DKK 30 million], we have a plus DKK 70 million coming from pension in both half-year, both quarter 2.

Now indeed, we have other one-off positives and negatives, and when that positive is a big one it's coming from this contract settlement. And a lot of the negative one-offs are also coming from a contract settlement or contract adjustment. As you can imagine, also labor cost-related, we have a few of those here and there in different countries and that's why we try to report on it now.

Again, clearly, in a business like ISS, it is part of our job to revisit our existing portfolio and see if we can find some optimization. There is no secret and we discussed this one last year quite heavily, that we do have in one country some optimization and social contribution. And this was something that we were expecting to deliver at some point.

We could not deliver last year but we are still working on it. So it might be that in H2 we also come with some one-offs. And last year was a big-ticket in H2, but we don't give up that we can also generate some positive here and there.

We are pretty transparent in the way we communicate about that. And of course, it helped us to offset some headwinds that we may have in other parts of the business. And that's our job to make sure we leverage our size to get these sort of deals that help our result.

And by the way, there are also cash, so there are good deals and you've seen that we have cash in, this contract settlement has been cashed in, in H1. Of course, it helps. So that's real money that we are working on.

Yes, there are grounds to work more on this and we will of course carry on like we did, like we've done over the last few years.

On the free cash flow, we changed the definition to indeed include the impact of the new lease that we are entering in, DKK 336 million in H1. I think it is very important that we keep a definition of free cash flow which is as close as possible to the variation of the net debt.

And of course, there are still things in between like the conversion of foreign currency denominated debt or divestment in acquisition that will always be a bit of a difference with free cash flow. But we try to get to a free cash flow definition which is as close as possible to the valuation of net debt. And I think it makes a ton of sense because really and especially going forward, balance sheet-wise, it is totally neutral to lease an asset or to invest in the asset and that's exactly what we want to do. We want to leverage this -- you can either, it's a new burden or it's a new opportunity but anyway, it's a new situation. So it really give us flexibility to manage our capital, both in leasing and investing and that's why we think it does make sense, one, for you to have a definition of free cash flow which is as close as possible to the net debt, but also for us to pursue as all the optimization that we can have on an asset base and that's something that we definitely plan to do and we are working on it and we believe there is value in there.

And we could potentially decrease our capital employed being smart in the way we make the arbitration between leased and owned, like many other companies in the world.

So that's part of our new story of free cash flow. It's not big amount and you've seen that in H1 and we don't expect to see massive amount but it does create another flexibility to the business to be more agile and disciplined.

On the DCR, yes we do have this target of 2.8x. It's clearly more demanding now that restructuring costs are in the EBITDA. So clearly we are not trying to be less disciplined than ever. On the contrary, I think we impose us this year to be with -- including restructuring. So I think that's -- which is going into the right direction. That's a good point.

Are we going to be there at the end of the year? No, but we don't need to. And what is very important for us is that we keep the discipline. We keep the trajectory and we improve while in the same time transforming the company. Of course, we'll get some help of the portfolio rationalization including exiting some businesses which are not very free cash flow accretive so that will help us going forward.

But our view is that we will improve the DCR and we don't need to be at 2.8x at the end of the year. It could come later on. And that's not a commitment that we take to be. It's more directional. And as long as we're comfortable with the direction, it give us full flexibility to deliver on our capital allocation according to our commitment.

Matija Gergolet ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

Can I ask you just a very quick one, just for modeling purposes for us? IFRS 16, you showed us very clearly it was the impact in the financial line. Could you tell us what was the impact more or less at the EBIT line, just more for modeling purposes?

Pierre-François Riolacci ***ISS A/S - Group CFO & Member of Executive Group Management Board***

EBIT is pretty flat. Actually pretty flat because we do have some push on the interest line but we also are amortizing in a different way, a bit more aggressive -- a bit more actually, yes aggressive, I'm not telling you more, so it is flattish on the EBIT side.

Operator

As that was the final question on today's call, please may I pass it back to you for any closing comments at this stage.

Martin Kjær Hansen ***ISS A/S - Head of Group IR***

Thank you all for participating. From ISS side, this concludes today's conference call. Thank you.