THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2018 ISS A/S Earnings Call

EVENT DATE/TIME: NOVEMBER 08, 2018 / 9:00AM GMT

CORPORATE PARTICIPANTS

Jeff Olsen Gravenhorst *ISS A/S - Group CEO & Member of Executive Group Management Board*
Martin Kjær Hansen *ISS A/S - Head of Group IR*
Pierre-François Riolacci *ISS A/S - Group CFO & Member of Executive Group Management Board*

CONFERENCE CALL PARTICIPANTS

Allen David Wells *Exane BNP Paribas, Research Division - Research Analyst*
Bilal Aziz *UBS Investment Bank, Research Division - Associate Director and Equity Research Analyst*
James Peter Winckler *Jefferies LLC, Research Division - Equity Analyst*
Klaus Kehl
Matija Gergolet *Goldman Sachs Group Inc., Research Division - Equity Analyst*
Michael K. Vitfell-Rasmussen *ABG Sundal Collier Holding ASA, Research Division - Analyst*
Paul Daniel Alasdair Checketts *Barclays Bank PLC, Research Division - Director*

PRESENTATION

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

Ladies and gentlemen, this is Martin Hansen. I'm 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's 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 the Q&A at the end of this presentation.

And 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. If we start with our financial highlights. The total revenue growth in Q3 was negative by 0.7% combined -- due to combined 4.1% negative impact from currency and divestments. Organic growth remained solid at 3.4%. That's driven by a continued strong commercial momentum as well as solid demand for nonportfolio.

The operating margin was 6.1% in Q3, down 0.3 percentage points, including a 6 basis points impact -- positive impact from currency, acquisitions and divestment. As such, the margin declined -- reduced compared to the first half, in line with our expectations, as communicated in August.

Cash conversion ended at 91% or 95% excluding the working capital impact from the transition and mobilization of Deutsche Telekom. Net profit adjusted was DKK 675 million. That's a reduction compared to the third quarter 2017. It's driven by a mix of currency, operating performance as well as increased GREAT-related investment in, especially, France.

Our leverage at quarter-end was 2.9x, slightly above the 2.7x a year ago, mainly impacted by lower operating performance, including the currency impact. Leverage would have been stable at 2.7x, excluding the currency impact. Nevertheless, we expect to be within our leverage target of maximum 2.5x at the year-end.

Finally, I would like to stress that we are fully committed to maintain the normal ordinary dividend at least equal to the DKK 7.70 per share paid this year.

Turning to some of the recent commercial highlights. We continue to see strong growth within key accounts, which now represents 56% of our total revenue. The increase in share was driven by further wins and expansions as well as upgrading further existing clients to key account delivery.

Global Key Accounts decreased by 3% in constant currency in the first 9 months during to the -- due to the ramp-down of DXC, HPI and the EMEA region with an international bank, largely offset by growth with existing Global Key Accounts and the launch of Shire, Huawei, LEGO as well as 2 clients, which we can afford to not name. In other words, the 3 losses in isolation reduced our Global Key Account revenue by approximately 20%, but it's been largely offset by new and existing clients. As such, the underlying development within our Global Key Accounts remains very strong.

Despite the decrease in the Global Key Accounts, our Integrated Facility Services offering grew 9% in constant currency in the first 9 months of 2018 and now represents 40% of total revenue. Growth continued to be driven by solid demand for both international and local IFS contracts in all our regions. Recent contract wins include TSB Bank and a company in the retail sector in the U.K. and extension and expansion with PostNord and Nordea across the Nordics. We continue to see a very active pipeline, which, together with the successful renewal of all large key accounts -- of renewal in 2018, the upcoming annualization of the HP losses and the launch of Deutsche Telekom provides a good basis for organic growth in 2019.

In terms of strategic highlights. We, earlier this year, announced further cost-cutting initiatives enabled by standardization of country organizations through GREAT. Focus will be on reducing overhead cost, and a pilot has been successfully initiated in the U.K. And we are on track to deliver the expected market benefits. We are moving forward in completing the divestment of Hygiene and Prevention business in France and our non-core activities in the Netherlands. With this, our focus on local resources can now be reinvested in developing our successful key account platform further.

Finally, I will finish off the highlights slide by mentioning that as a part of our annual strategy review, we'll provide a strategy update on the 10th of December. We will host a separate conference call, and practical details will be available on the Investors section of our website in due course.

With this, I would like to turn to Slide 5 for regional update. Continental Europe continued to deliver another solid quarter with 5% organic growth. We continue to see remarkable strong volume growth in Turkey, driven especially by the Healthcare segment. Price increases on the back of wage inflation also supported the organic growth. So total growth in Turkey was obviously negative, impacted by the currency development in Q3.

Growth was also supported by Spain on the back of both contract launches and nonportfolio demand, driven, among others, by early benefits from our investment benefits in building our own technical services capabilities locally.

Finally, Austria was a key contributor to organic growth in the region. In Austria, we have been investing in building up our own self-delivery catering organization. The investment is starting to bear fruit with the expansion of certain IFS contracts to now also include catering.

Last but not least, it is worth noting that the organic growth in Continental Europe remains at 5% despite the impact of the loss of DXC Technology and the international bank in EMEA. Very pleasing.

The Continental Europe operating margin ended at 6.4%. We continue to see strong margin performance across several countries in the region. However, the region continued to be impacted by a large contract phasing in and out as well as underperformance in the non-core business unit in Netherlands. The divestment of this business unit was signed in September and is expected to close by November. The implementation of GREAT in France is on track, and in less than 1 year from now Deutsche Telekom will launch. All in all, solid underperformance -- underlying performance across most parts of this region.

In Northern Europe, organic growth was 1%. Growth was particularly strong in Denmark, driven by nonportfolio demand as well as contract launches such as the Danish Defence and LEGO, and likewise, in Norway, driven by a number of new key accounts.

Organic growth in the U.K. was supported by a few large nonportfolio projects. However, solid underlying organic growth continued to be more than offset by the revenue reduction from the DXC, HP Inc., the EMEA region with an international bank and the U.K. Ministry of Defence. Excluding these losses, the bulk of the U.K. operation continued to deliver a solid performance, both in terms of organic growth, margins and commercial momentum in general. Significant recent wins in the U.K. in the third quarter includes the -- an IFS contract with TSB Bank across 550 branches as well as a client within the retail sector. As the new but large losses annualize -- as the few but large losses annualize, the solid underlying performance will become visible.

Turning to Sweden. I would like to highlight that while Sweden was not a key driver behind organic growth in the region in the third quarter, we've had a couple of important extensions and expansions. I am pleased to say that we recently extended and expanded our IFS partnership with PostNord at approximately 550 sites across the Nordic region. The process was led by our Swedish team, where the bulk of the contract will be delivered. Going forward, we will, to a great extent, self-deliver technical services. So it's also an example of how our investment in building our technical services presence in the Nordic region are paying off. Needless to say, an important expansion for us, especially in Sweden. And in addition, we extended our significant local key account relationship with Vattenfall.

The operating margin reached 8.1%, down 0.5 percentage point, which is sequentially better than Q2, as expected. Again, the year-over-year reduction was materially impacted by a large key account contract phasing in and out, especially in the U.K. and in Denmark, for the reasons just mentioned. However, the impact is now starting to ease. In addition, we continue to invest in our technical services capability across the region, which is initially a drag on the margins.

Please turn to Slide 6. Organic growth in Asia Pacific was 5% and was supported by most countries in the region, mainly Australia, Hong Kong and Indonesia. Growth was partly offset by revenue reduction from DXC Technology and HP Inc. While it wasn't a key contributor to growth in the third quarter, China is now starting to deliver positive organic growth again following a period of strategic structural adjustments to our platform to refocus on key accounts. We recently expanded in China with Apple as well as our Global Key Account, Huawei.

The operating margin in Asia Pacific was 6.5%, down from 7.6% in the third quarter in 2017. APAC continued to be heavily impacted by large key account contracts phasing in and out. In addition, the margin was impacted by the expected normalization margins in Singapore.

Organic growth in Americas was flat. Organic growth was supported by Guckenheimer, which was well in excess of 20%, driven mainly by new clients and growth in -- on existing accounts but also supported by in-sourcing of catering. The remaining key account business in the U.S. also continues to perform well, especially in the aviation segment. In addition, Chile and Mexico continue to deliver solid growth. Growth continued to be offset by DXC Technology and HP Inc., by the tough nonportfolio comparable in the third quarter 2017 as well as limited new sales in Brazil.

The Americas operating margin ended at 4%, up from 2.5% last year. Margin improvements were driven by further synergy improvements at Guckenheimer as well as generally solid performance in the IFS business in the U.S. The margin remains impacted by large key accounts phasing in and out, albeit subsequently less as well as performance in Brazil. As expected, the third quarter margin also remains impacted by operational challenges in the specialized services division in North America. However, the turnaround initiatives are progressing according to plan.

We are now in the middle of exiting approximately DKK 250 million worth of loss-making or low-margin contracts in the legacy business. This revenue will gradually exit the business during the course of Q4 2018. Reducing our exposure to small clients also enable us to adjust our cost structure. As an example, we're closing down a number of branches from currently 30 to around 7. While this leads to restructuring related to certain overhead positions and termination of leaseholds, there's an attractive payback on our investment. All in all, we are on track to deliver further margin improvement in Q4, as expected.

Please turn to Slide 7. As a brief note before I hand over to Pierre, I would like to briefly wrap up on some of the more recent commercial developments. We have now successfully extended all 7 large key account contracts which were up for renewal in 2018. This includes Nordea across the Nordic region, where we can now celebrate our 40 years of partnership with an extension for another 5 years. We are slowly starting to up dialogue around 2019 maturities, most of which are placed towards the end of 2019. So still a year away. In addition, we signed new contracts with TSB Bank and a retail company, both in the U.K., and extended and expanded the PostNord, as covered a couple of slides ago. We continue to see strong commercial momentum and a solid pipeline.

And with that, I would like to give the word to Pierre, who take you through the financials in more details. So please turn to Slide 9.

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, before I jump into the Q3 details, just a reminder that we have an extremely solid and resilient business with stable organic growth and stable margin. You know that, that it's always good to think about it when we go into a quarter.

And I suggest that we move to Page 10 to look at Q3 in isolation. You're familiar with the graph. So we first adjust our sales in Q3 last year for currency and acquisition divestments. As you can see, we still have headwinds on currency, almost DKK 450 million in the quarter coming from Turkey, Sweden and Australia mainly. In total, the revenue was down almost DKK 800 million due to ForEx and M&A to DKK 19 billion Q3 2017 adjusted. On that basis, the organic growth was 3.4% in the quarter. So slightly higher than Q2, and as such, the best quarter of the year.

There is a negative impact from the HPI, DXC and the European part of an international bank, losses that were incurred in '17, which is stable to minus 2.3%. Q3 is the last quarter where we had the full drag as the loss of DXC will start to annualize from Q4. So we expect a drag in Q4 of about minus 1.7, minus 1.8 coming from HPI and that European part of the bank.

Nonportfolio revenue is another strong quarter with positive contribution of plus 1.2% -- percentage point to the group organic growth and driven especially by Europe. When we move to the next quarter of Q4, you need to remember that the year-end 2017 nonportfolio was very strong and we were, in particular, supported by the flooding related projects in the U.S. for about DKK 250 million, which peaked in Q4 '17. And you remember on Americas, the organic growth was about 8%. This is very tough comparison base. And in addition, some of the key project works in the U.K. in Q3 2018 were short term in nature and may not support us in Q4 '18. So you should expect soft nonportfolio development in Q4. That's indeed what we expect.

The momentum in the rest of the portfolio businesses remained strong and increased further actually to 4.5%. That's definitely very good. The gradual improvement this year reflects the ongoing strong commercial momentum that Jeff went through. But again, as we move into Q4, you should note that we are in the middle of exiting about DKK 250 million of loss-making or low-margin contracts in the U.S. Jeff mentioned that.

And also, we see the beginning of the annualization of a number of key contracts, launches during Q4 last year, like ABB in APAC and also some big contracts in the U.K. like NatWest or South -- work with Shire that were launched at the end of 2017 with a combined impact of more than DKK 0.5 billion. Also, you remember that Shire, which is about 1% of our group sales, reached the full run rate at the end of last year. So now again, annualizing. And that will impact organic growth in Q4 that we, therefore, expect lower than Q3.

So if we just move to Page 11 and operating profit. Again, we similarly adjust operating profit from currency and M&A. And we do have a headwind of about DKK 47 million on the absolute level of operating profit in Q3.

Turning to the margin. Q3 operating margin declined by 27 bps from 632 to 605 year-on-year, which is in line with expectation that were communicated earlier in August. And as expected as well, it does include 6 basis points positive impact from ForEx and M&A.

Jeff has covered already the regions. So I would just highlight a few things. In Q3, it's clear that we see a lot of the same things or the same drivers that we had in Q2. And the majority of the group margin decline continues to be related to the current unusually high level of large key account contracts phasing in and phasing out. However, the margin headwind from this phasing of contract has actually started gently to ease in Q3, as expected.

The margin is also impacted by the underperformance in a couple of non-key account business units. Especially, our non-core activities in the Netherlands continue to be a drag on margin, similar to the level that we had in Q2. Good news is that the divestment is set to be completed in November, and the drag will reduce going forward in Q4, as expected.

Corporate cost ending up at 0.6% of revenues both for Q3 and year-to-date. For the year, we continue to expect corporate cost in percentage of revenue to be about 0.7%, down from -- slightly down from 0.8 last year due to savings initiative, which are being completed.

And finally, I would like to highlight that one-off in operating profit in quarter were net neutral actually, so no significant impact in quarter.

So in summary, margin performance in this Q3 was in line with our expectation in August. Q3 will be the last quarter of declining margins, and we are on track to deliver a solid margin uplift in Q4. And as such, we see no need to change the outlook for the year.

I suggest we move forward and look at the full income statement, Page 12. Again, a reminder because it does have quite a few lines of the P&L. The revenues are down by almost DKK 800 million on ForEx and M&A and that offset actually the good level of organic growth that we have commented.

Just a word on operating expenses and just brief on the staff cost, which are slightly higher in Q3. And this is definitely correlated to the ramp-up of new contracts as we are -- at the moment, we are ramping a big contract. And you see a gradual shift to own staff, from temps and from subcontractors, which are included in other operating expenses. So the staff costs are ramping up because we are also moving in these big contracts structure.

You can see also that the consumables were stable in Q3. And you may note that we increased in year-to-date number. And this year-to-date number was driven by the acquisition of Guckenheimer that incurred in May 2017. It's a clear illustration that the move in consumables is an outcome of the business mix shift that we had due to the Guckenheimer acquisition.

Now if we move further down the line, other operating and expenses, which is a charge of DKK 176 million. The big ticket here is the DKK 166 million of cost structuring coming predominantly from the implementation of GREAT projects in France, in Sweden and in the U.S., as expected.

In addition, the significant consolidation and centralization and automation projects that we have in the U.K. was kicked off in Q3. And as such, we triggered some project-related restructuring cost. We continue to expect GREAT implementation in France, U.S. and Sweden to cost up to DKK 450 million over the 2 years period '18, '19. Sweden will be fully completed by year-end. That's good news. And we are now bringing forward some initiative in France.

And we're also taking bigger and bolder steps in the U.S., as covered by Jeff, and of course, in addition with what we are doing on this small contracts. So we now expect the phasing to be a bit more front-end loaded with about DKK 400 million on these 3 countries in 2018 compared to previously about DKK 300 million.

In addition to this top 3 big restructuring project, we continue to expect a sort of hard core restructuring in line with the historical level that we have already discussed many times on these calls of about DKK 100 million, DKK 150 million this year, probably about DKK 150 million, which is, among other, driven by the restructuring in the U.K. on the back of the sufficiency initiative, which have now kicked off, and again in line with what we have already mentioned.

So in summary, we are investing in the business because we see an attractive payback linked to this savings project. And it is kicking in, in Q4. In total, we expect the restructuring to be around DKK 550 million in 2018, DKK 400 million plus DKK 150 million.

If you move to financial income and expenses, which is a charge of DKK 155 million, up DKK 12 million. I want to be very clear that the increase is mainly driven by higher interest rate related to our U.S. dollar swap. We are talking about swap of about $350 million, which has significantly increased, of course, with the acquisition of Guckenheimer a bit more than a year ago. We have also higher interest payments on the back of the last year refinancing, where you remember, we locked for 10-year bond issue fixed rate in euro. And of course, there is a cost attached to this long-term EOIs versus short-term EOIs.

For the same reasons and as previously communicated, we expect our financial income and expense for the full year to be higher than '17. Based on where we are year-to-date and our updated expectation for the remainder of the year, we expect the full year to be around DKK

560 million to DKK 580 excluding FX. So that's a bit higher than we mentioned -- what we mentioned 3 months ago, and this is the back of increasing interest rates in Turkey.

The taxation -- on the tax side, you see that quarter 3 in '18, the ETR, the effective tax rate is 25%. It's in line with the underlying effective rate. We end up year-to-date at 25.5%, which is, I think, a very good proxy of what we expect for the full year between 25% and 26%.

Therefore, the net profit adjusted from continuing operation is DKK 645 million in Q3, which is down DKK 119 million compared to last year. And this decline, as you can see, was mainly driven by lower operating profit, including the currency impact, and also higher restructuring charges.

The adjusted net profit, you see as a net impact from our discontinued operation, which is a gain of DKK 39 million in Q3. And this is just a conversion gain on the expected losses that we had in our discontinued operation due to the depreciation of the Argentina peso. So the net profit adjusted and -- at DKK 684 million in Q3 compared to DKK 764 million last year, down DKK 80 million for the reason that I just alluded to.

I suggest we move to the cash side, Page 13. As you can see, Page 13, our cash flow from operation is down in the quarter year-on-year by DKK 106 million. It reflects a decrease in operating profit, again, driven by currency headwind and the operating performance, as reflected in the margin development.

On the working cap, Jeff mentioned the cash conversion at 91%, which is definitely at the low end of usual numbers. It is in line, of course, with our target. I will come back on that. The changes in working capital is negative DKK 223 million in the quarter, which is actually in line with normal seasonality.

And we put on the graph on the right hand, you can see for the last 4 years where we have been in change in working cap in Q3. It's clear that Q3 2017 was a bit of an exceptional year. And you remember, we had a very strong cash flow at the end of September in '17. And again, be careful because there, when you compare year-on-year, you compare variation against other variation. So actually, it's very difficult to map in year-on-year the evolution.

For both the quarter and year-to-date, the working cap is impacted by the strong commercial momentum that we have but also the transition and mobilization of Deutsche Telekom. We now expect slightly higher weight towards working capital instead of CapEx on that contract, Deutsche Telekom. So you remember that we told you that we were expecting the cash out in Deutsche Telekom to be at 70% working cap, 30% CapEx. Now we believe it's more 85% working cap, 15% CapEx. But it doesn't change neither the cash out or the profit profile.

It's an important point, this Deutsche Telekom contract, because adjusted from this Deutsche Telekom, our cash conversion ratio would be 95% against 91%, which is more in line with our usual numbers.

I need to mention also that on top of the strong commercial momentum, we do have larger rebates and bonuses for procurement programs. You know that we are increasing efficiency in procurement, and part of this efficiency is translated into these year-end bonuses. And the cash profile can be different from the recognition and that, of course, the more efficient you are, the more you have to recognize these bonuses for the year and you have a settlement once a year.

And last but not least, we did have some timing of payment and collection around the quarter-end. That did not help us, and that's the reason why we end up at this minus DKK 223 million in the quarter.

On the other expenses, it's a charge of DKK 177 million on the cash, which is very much in line with the P&L. So no other comment on that one.

On the investment side, capital expenditures are running at 1.3% of our revenues in Q3. It's definitely on the high side. That was expected. You know that we have a range of 0.9 to 1.4. So the 1.3 is there. If you look at the year-to-date, it was 1.2%. And it's, again, on the high-end because we are investing in our digital platform, and you see impact of our IT investment. In the short term, we continue to expect capital expenditures to be in the high end of this range, driven by Deutsche Telekom and ongoing investment on IT.

Free cash flow, it's an outflow of DKK 960 million for the first 9 months, where in '18, we were basically at the average. How do we bridge these 2 numbers, which is close to a variation of DKK 1 billion actually of free cash? DKK 550 million is explained the development in working capital, as I mentioned that already, with a strong comparison in 2017, actually close to being sustainable.

You remember, we went out with very high cash conversion, where in the meantime, Q3 is suffering from this timing on collection and payment. That's the first reason. Second reason is the impact of Deutsche Telekom that I have commented on. And the third one is the buildup of this procurement rebates.

So DKK 550 million on the working cap. And then we have DKK 330 million, which is on the back of a lower EBITDA. Currency fluctuation -- currency conversion explained half of the decline, and the other half is actually due to the operational impacts that we have commented with the operating profit development.

So the abovementioned items drive all -- most of the decline in our free cash flow. Clearly, our ability to generate cash remains strong. And setting aside the FX impact, the FX conversion impact and Deutsche Telekom, we see no structural changes in our free cash flow generation. For sure, we are investing in the business like we are with Deutsche Telekom startup cost but also with digital operating expenditures and capital expenditures, also restructuring. That's a great implementation, which will initially be a cash outflow before we get the benefits back. We are running the business for the long run, and we should not allow short-term burns to impact the optimal allocation of capital.

With this component, I would like to hand you back to Jeff with some final remarks. Please turn to Page 19 -- 15.

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

Thank you, Pierre-François. Our outlook for organic growth, operating margin and cash conversion remains unchanged. With a stronger-than-expected organic growth year-to-date and despite Q4 expectedly being lower, we will most likely end the year at the higher end of the 1.5% to 3.5% range.

On the operating margin, the headwinds has peaked in the first half and started to ease in Q3, as expected. We remain confident that Q3 will be the last quarter with declining margins. And we are on track to deliver a good recovery in Q4 2018. Also remember, in the Q4, we'll be impacted by some one-off income as well, as mentioned last time. As such, we see no need to change our guidance. However, as communicated in August, we are likely to end up in the lower end of the range, which is around the 5.6% plus or minus 10 basis points.

Finally, the guidance for cash conversion remains above 90%, remembering that we have been impacted this year also by [DTAC].

With that, we would like to open up for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Michael Rasmussen of ABG.

Michael K. Vitfell-Rasmussen ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Starting off with a couple of questions here. First of all, if you could just add some words on the building blocks in 2019 for organic growth, if we look beyond Deutsche Telekom, such as if you can kind of remind us a little bit about the various contracts and comps, however, that is going to impact '19. My second question goes to Sweden. I do recall that in Q2, you talked about the whole turnaround that took a little bit longer than you had hoped for. Can you please give us just a general update on the market and including how Samhall is acting after the EU verdict earlier this year? Then my final question. At the IPO, I do recall that you said that the IFS margin was 100 basis points higher than group margins. Now when the IFS is 40% of revenues, and I'm still looking at margins on a group basis that are actually below the level it was at the IPO, so is this -- does this mean that you're seeing margin pressure on the non-IFS part of the business? Or what's going on here, please?

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

Yes, maybe first on the 2019 organic growth. The easy part is the Deutsche Telekom contract, which is set to start 1st of July 2019. So of course, it will have a significant impact in here, about 2% of growth coming from that contract only. Now I suggest that if you want to see how we are entering 2019, a few comments maybe that -- and we can use the way we explain organic growth in '18 to look forward into '19. On the HPI, DXC and the bank, you know that DXC was launched 1st of October 2017. So now it will be out. HPI and the bank, the bulk will start at early March for HPI and at the end of March for the bank, but we still had some projects going up to Q2. So you would expect that these headwinds will actually decrease significantly in Q1 and will be nearly off in Q2. So that part would be off. On the nonportfolio, it's not an easy guess. And this is the most volatile part of the journey. What we see in '18 is that we have limited big one-off like we had in '17. Especially, this big flooding project in the U.S. was a big ticket. So peak was in Q4 '17, but we still had some revenues in the first quarter of '18. So when you look forward in '19, you know that it's in there. But I would say that the overall time on the nonportfolio, despite this Q1 item when you compare, the nonportfolio revenues, we don't know. But you know that with our move to key accounts and with more technical services exposure, that tends to be slightly positive. That's what we have seen in the past. But we are exposed to a lot of variation. And then the other portfolio, that's our contract portfolio. I think Jeff was quite clear on the renewal of big contracts. We do not have -- we have renewed actually all the contracts which we have coming for in '18. So you don't have a negative on that one. We do have some renewal in '19, but there are -- you can say that about 75% to 80% of the contracts for renewal in '18, they are actually after September 30. So they should not drag on the first year. So we are entering with not too much, at least on the renewal side. And then as I mentioned, we have the ramp-up of the contracts which are helping us today like LEGO, like Danish Defence, hospitals in Turkey. That will help us forward in the beginning, but of course, now we need to know where we'll end up in the second half. That will depend on the wins that we were locking in this quarter Q4 and the first 2 quarter of '19. We are definitely entering with strong Q3, 4.5%. It will come down in Q4 due to the annualization. But we still have good tailwind from this contract ramp-up that will help us in the first half and then Deutsche Telekom coming on top of it. So I don't know, we don't want to guide today, of course, on organic growth. But we see good, underlying growth in '19, and on top of that, [DTAC] coming in and limited exposure on renewal.

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

Okay. If I continue with the questions on the Swedish situation then. As we said, we are stabilized in Sweden. And the country has actually now expanded and gone into new contracts, as we said, with PostNord but also with Vattenfall. We have extended for another year. And I think on the Samhall part, we still need to see sort of the implementation from the Swedish government on what Samhall can do and cannot do and whether we get the same rights to other companies or to the privately held companies as given to Samhall. That's still to come through. Having said that, we still -- we don't see the same impact from the Samhall activity in Sweden. So that has stabilized the business somewhat other than the growth perspective. But again, as I said, Michael, they still have to implement the ruling. On the margin side, we still see that the key account business is a higher-margin business than the other traditional single-service business. When we look at development of the margin since the IPO, clearly that's been impact from divestments, that's been impact from currency, all of it taking something like 15, 20 basis points out of our margin. Then over the last year, we have had the phasing in and out of very large contracts, which has seen big impact. But if you look at it overall, where we've had some setbacks in margin generally has been on the specialized services and on the non-core activities. And that's really hit the margin. Sweden, as we know, the U.S., as you know, the Brazil margin, as you know, and also in China for that matter. So it's still the right segment. We have committed to that. And we still believe that, that is margin-accretive strategy to the overall service lines.

Operator

The next question is from Paul Checketts of Barclays.

Paul Daniel Alasdair Checketts ***Barclays Bank PLC, Research Division - Director***

I've got a couple of questions, please. Can I start off just on sort of a larger topic that's become a feature across many businesses in recent weeks? And that's wage inflation. We've seen it become more acute across Europe and North America. And for many, it's proving somewhat more difficult to pass through than would normally be the case. Would you give us a sense of whether you're seeing it increase and how you're feeling about the ability to pass it on? That's the first one. And then the second one, can I just return to a couple of things that were mentioned. The first one is the U.K. restructuring. I've always seen that as one of the really strong businesses in the portfolio.

Can you elaborate on what it is that you're doing to restructure that business and why it's needed? And then I just had a point of clarification. On the IT investment spend, you're saying it's somewhat higher now. Are you communicating to us that actually going forward, there is going to be a higher level of investment going into IT? Or is it just a bit of phasing and it's a reiteration of what we've before at the Capital Markets Day?

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

Thank you, Paul. On the wage inflation, yes, of course. I mean, if you look at Europe, as we said also, there is more pressure on the wage increases as we see them in the European market. There has been a high pressure on that in the U.K. for a period of time. So we've seen 12% increase over the last year's minimum wages from 2016 to '17 alone. And then you also have the Apprentice Levy and so forth. So I think despite that, in the U.K., we've actually maintained the flat margin, even a little bit higher. So we are -- in our major countries, we are really good at passing on the price increases. Or even to our extent, we are taking costs out, making efficiencies or changing scope in order to deal with it. The same answers as we always had. But I have to say, of course, it's a tighter market. You can argue that it's been for many years. But it will always be a timing difference only because it's not as if we make -- the margin in this business is so small that you have to get the price increases. Just take the U.K. for example. 12% wage increases, we cannot absorb that. And the industry knows it and the customer knows it. But neither can our competitors. So at the end of the day, you will find ways to compensate for those increases. Then you can have a little bit timing up and down. And I've mentioned that many times over the years, that it could be a quarter swing and so forth while you get either the efficiency improvements gone or you get the price increases through. That, of course, is also something we'll see next year, which is always a little bit difficult when you start predicting on next year's performance. But at the end of the day, I think we're good -- well placed and we're capable of dealing with it. Even in the U.S., we've seen some inflation, which is 2.5%, which, I think, we can -- we are good to cope with. Overall, inflation is actually not a bad thing for outsourcers because we can actually go in and improve on the cost for running these facilities. So productivity improvements is our hand. This is what we focus on. And particularly for the Integrated Facility Services self-delivery model, this is a way or an argument for us to go in and increase efficiency on delivery and thereby productivity and thereby lowering prices. So that's a good instrument. So it is, overall, not a bad thing for us. But of course, that can always be a timing difference. Sorry, on the U.K.

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

Yes. On the U.K., yes, it's a strong business. You know also that we had -- it's a business that was impacted by the losses of DXC and also HPI and also the European part of the bank. So it's a business also which has been facing some headwinds on the top line. And that had also to do what had to be done to protect margins. But actually, it's not a negative restructuring. It's not a reaction. It's a positive restructuring. And we also discussed a few months ago what are the initiatives that we are doing to boost our profit. And among those, there is definitely more in term of shared services in back office and outsourcing. And we are moving forward into U.K. with a significant project of shared services and outsourcing. And we are incurring costs to implement that project. It's a good -- so these costs are significant, and that's why we have this impact in the quarter. Actually, we have some other in the next few months. But the good thing is that we have an agreement with our partner whereby part of these costs are actually supported by the partner. So it does improve our cash profile, which is, of course, quite important. And the very good thing is that we can also get some early benefit of the savings, which are associated to that initiative. So it's not only back-ended, but it is also front-ended. And it will help us in the coming quarters also to support our margins in the U.K. and hopefully wider than the U.K. because we believe that this is a project which does offer some upside beyond one country. So that's part of the initiative. Again, not a negative restructuring but building a platform, leveraging our size, leveraging our alignment to generic, most of the things in the future. So we see that as a very, very good investment with a payback, which is, cash-wise, quite early. On the IT investment, yes, they are higher. And I think that if you -- one of you asked a question about since the IPO. And if you look at the numbers on the balance sheet, software and related assets were about DKK 440 million at the end of 2013. They have doubled in 4 years, at the end of '17. So it's not new that we are investing in our IT platform. But it's definitely something that we need to do given our positioning in the market. And you're right, this is something that we'll come back during the strategy update because I think it's good for you to understand where we are and what are our plans in terms of developing a digital platform.

Operator

The next question is from Bilal Aziz of UBS.

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

Three questions from my side. Firstly, you reiterated guidance for the full year. I know it's very early days into the quarter, but can you perhaps just remind us on the main building block for that? Because it is quite a material impact, you still have obviously within the fourth quarter. Secondly, you've extended all your major contracts this year. Would there be a phasing-in impact of that again next year? Presumably, you've renegotiated some of the terms and conditions around that. So will they be slightly dilutive next year? And lastly, just to clarify the restructuring guidance you have given. I appreciate they're higher by about DKK 100 million this year. Is that, just to confirm, being pulled forward from next year, so net-net, not a huge amount of change versus what you usually have over 2 years?

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

Maybe I'll start with Q4 margin development, and maybe, Jeff, you will take the contract phasing in looking forward. On the -- yes, you're right. It's clear that Q4, to get to where we want to be, in line with our guidance, it takes Q4, which has to be quite stronger than last year, depends what number you take, but let's say, 70, 80 bps better than last year. And I think that's -- we stick to the comment that we made in Q2. I think we see the same trends. So there will be some run rate improvement coming from the underlying efficiency, the implementation of GREAT, all the hard work, which is being done, which is helping us, including the over-performance of some strong countries that we expect to get the benefit of in Q4. We also expect the turnaround of some of our operations, especially in North America. I think Jeff mentioned what we are doing on the small customers. We do expect some relief of execution of that plan. And to be very candid, we have launched also some cost-cutting initiatives that help us in Q4. That's what you need to do where -- when you have to deliver decent margins. Then next to this run rate, there are also one-off. We mentioned that in the past. It's clear that I think that you heard from what I said earlier with shared services and outsourcing has been secured. So it will help us again in Q4. That's good news. But we do have still some negotiation ongoing on some of the transaction. And we need this one-off to help us in Q4. That's part of it. So half of the improvement on the back of run rate improvement, another half on the back of this one. Now trying to get really to the core of your question, what are the key assumptions underlying our Q4 expectation? We need to deliver still one-off, 2 one-offs that we are working on. Some have been secured, but not all of them. So that's definitely a risk. We need to get the over-performance of, let's say, half a dozen of countries, which have to chip in and deliver good performance. Clearly, we'll get some of them. Are we going to get all of them? That's the question. And also, we count on the easier term in Q4 of some of the operation, namely North America, on top of it. And also, we need to make sure our big contracts are ramping up according to our plan. And of course, it's a lot of work. So that's not new because you remember, we discussed that 3 months ago. I would say that compared to Q3, we have, of course, a bit less uncertainties. We have secured the transaction in the U.K. Also, I am pleased to see that cost-cutting initiative, procurement savings are coming gently in line with expectation. That does help us. And also, Sweden is stabilized now, and so that's very important because it's a business which has been tough. And now we see some stability in that business, and that helps us to be a bit more confident. It's not a walk in the park, to be very candid. It's not easy to generate such an uplift in margin. And I'm not telling you it is it, but we are very confident that we have a good portfolio of projects and we are working hard on it.

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

On the extension this year, we have -- in the report, there's also a number of contracts. You can see that we have won a number of contracts this year, expanded many and only lost 2. I think as you know, with the larger contracts, you always start a little bit lower margin and then you work the margin up during the period of the contract. That means that some of the contracts we started off this year, of course, gets into new momentum next year. So that should be an uplift. On some of the ones that starts next year, on the larger ones, yes, of course, they will be slightly dilutive. But it does not have the same impact on the group level, as you've seen in 2018 from HPI, HP Inc. So nevertheless, yes, it's the same pattern, but you'll also have contracts this year that goes into the second year -- next year that would pick up. So that's the overall comment on that.

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

Maybe on the restructuring, yes, I mean, I alluded to, but I just confirm that the reason that we have an increased restructuring is, first and at most, that we are bringing forward some of this restructuring from '19 in France. And to that, we are bolder in the U.S. to execute what is being done in Q4. And yes, most of this increase of DKK 100 million on the back of phasing.

Operator

The next question is from Allen Wells of Exane BNP Paribas.

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

Just a couple from me. First, maybe just following on from Bilal's question on the 4Q. Could you just remind me, the M&A impact in the margin in the fourth quarter, what you'd expect that to be? And maybe if you could explain if you still expect the overall full year impact from M&A and FX to be broadly neutral for the margin. That's the first question. Secondly, again just on the other income. Is there any way at this stage you can give us some help oat the range of absolute other income for next year? I mean, I think most of consensus has that declining really materially versus the DKK 550 million that you guide for next year. That's also with the DKK 200 million, DKK 300 million. Is that a fair number today as it stands today? Could you help us with it? And then finally, just maybe sort of understanding question. I was just looking through the accounts. 3Q discontinued items, it was a meaningful profit. It was about DKK 39 million in the P&L. But if you go back and you look at the nature you're writing down goodwill in Argentina and France, et cetera, could you maybe explain what's going on there? And then maybe just as a final clarification question is on the divestment of business line in the cash flow statement, it's actually negative. And why would the divestment be a negative number, if possible?

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

Thank you. I just take note of the question to make sure I don't forget any. On the ForEx and M&A, we stick to what we said so far, which is that we expect that impact to be broadly neutral. You remember, it was minus 6, I think, in H1 cumulative. This quarter is plus 6. So you should expect some tailwind in Q4, 5, 6 bps. That's what we expect based on current expectation on currencies and also divestment and acquisition. That's one. Other income and expenses in 2019. That's a tricky one because, of course, it is linked to capital gains and losses and also restructuring. I think that we do not guide today on '19. But I think when you try to model, and I fully recognize you have to, please always remember that we have a sort of hard core restructuring, which is 100, 150, 200. That's the bandwidth that we have been at for years. So we probably will try to give you a bit more color in a month's time about what we do on this account. But you have this hard core. And then you have a residual amount coming from this France restructuring mainly that you need to add on top of it. So when you build up your numbers, I think that the best guess that you can have today is hard core plus this residual amount in France. So that gives you some sort of number. And I, again, won't guide on 2019. And on the accounting part, the DKK 39 million is -- it's -- I was about to say it's very simple, but I recognized the scope is never simple. But we are disposing of this Argentina and Uruguay operation. It is actually a net liability. So as it is a net liability, when the currency is actually weakening against DKK, then the future loss is actually lower that what you have forecasted. And that's exactly what's happening in Q3. We have the same vision on the deal itself, and we do not have any write-off or write-up. It's just that we are converting in DKK the loss which is actually in pesos. And when the pesos is lower, we get to benefit. So you don't -- you cannot look at the quarter. You really need to look at the year-to-date, and that gives you a better picture of where we are. In the goodwill side, there is nothing new in this quarter compared to what we have in Q2. It has -- so we have commented there. So there is no further impact. And when it comes to divestments, how can you have a negative impact on divestments, well, if you are divesting a jewel, for sure, you should not have a negative impact. But some of the businesses that we are divesting, and especially in Netherlands, are not profit-making. They are loss-making. And of course, your EV too -- equity value can be in the other way around. And that's the reason why we do have this divestment, which can be negative, that we are not divesting a lot actually in the quarter, but we are divesting assets which are not necessarily brilliant. And that's why we can be negative in terms of impact on the net debt.

Operator

The next question is from Matija Gergolet of Goldman Sachs.

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

That's a tough one. I'll go for a technical question as well. When I look at the depreciation charge, right, we have like 6% decline, 5%, 6% in the year-to-date. And also, when I look at the last 5 years, depreciation is roughly 10% lower compared to where it was, say, 5 years ago. In the meantime, your revenues have been flat. I mean, your CapEx to sales seems to be consistently 1.1, 1.15x depreciation. I mean, can you a little bit elaborate on why depreciation, say, is still falling this year? And secondly, should we expect actually a step-up in depreciation in, say, '19 or in '20? Because there's something I can't reconcile there.

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

I recognize it was hard core to choose only one question, and I'm glad you pick up that one. The last question, depreciation, as you pointed out, is 0.86% of sales, where the last question on CapEx is 1.2%. And you asked the same in Q3. So I think that's the core of your question. I think there are 2 items that you need to factor in. The first one is that, as I mentioned, a lot of our investment is about IT. And you know that with IT, you invest and you start depleting only at the time you put the system in life. So you can have quite a significant gap when you embark into significant projects, and we are. I'm referring to the FMS, TRIRIGA project. It's a significant project. It's a project which has few capital expenditures for a while. Now we are coming to life, but that's the reason why you can see CapEx coming up. And the depreciation will, of course, pick up on that one as we develop and roll out the solution. And you have that on FMS and you have that in general in '18. So you can have a few quarters which is, I recognize, not the usual pattern of IFS because we -- you know that we are extremely asset light. We do not build facilities. So we are not used to see quarters -- a few quarters, 18 months or 2 years investments and then only depleting when we start using, and of course, according to rollout plan. So that's one of the reason. That's a key reason. The other reason, which is behind that, is that we also divest business. And when we divest business, we get rid of fixed assets, including intangibles. So it is -- when you divest more than you acquire, and it's clearly what has been occurring in ISS for a while, if you look at the last few years, we have divested more than we have acquired, then you have an impact, which is kicking in, which is that you are getting rid of this asset. So that's the 2 key points that explain the discrepancy. Now yes, you may argue, yes, what does that mean? Does that mean that with this IT project, you have depreciation charge that will pick up in the next year? The answer is yes. We will have to deplete these assets. But of course, if we are investing in this IT project, there are good reasons behind that. And it's because there is value. And that value will come either because we have in-sourced services that today we are buying outside and they are in other operating expenses or the value will come from more productivity, more efficiency or more added value services that we can sell to customers. We do not invest in IT if there is not a business case. So you have CapEx, and then you will have higher depreciation rate. But you will expect that your EBITDA is boosted by the efficiency or the services that you serve to customers. It may sound a bit naive, but I think that at the end of the day, that's exactly the decision-making that is steering this sort of decision. So that's exactly where we are. And we'll give you some more flavor again when we go for strategy update because you're right, I mean, this is something that has happened over the last few years. It's good to know where we are and where we are going, and we expect to help you a bit in a month's time on that.

Operator

The next question is from Klaus Kehl of Nykredit Markets.

Klaus Kehl

This is Klaus Kehl from Nykredit Markets. One question related to the development in the net working capital and cash flow. You elaborated quite a lot on it and gave us all the reasons why it has developed as it has. But could you give us any indications where you expect net working capital to end year-end, what kind of cash flow you would expect to -- for the full year? Or yes, just to get a feeling for whether you expect all this to normalize in Q4. That will be my question.

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

Thank you. That's a fair question. We don't guide on free cash flow, as you know. But clearly, I was mentioning the timing -- the negative timing in the collection and the payments. And I think that there is no reason why we should see that repeating in Q4. So we do expect to improve our number significantly in Q4. Again, there is no concern about our capability to generate cash flow. You need to remind -- you need to remember that cash conversion point in ISS is DKK 45 million and we are collecting every week nearly DKK 2 billion. So for sure, it's difficult for us to give a precise guidance. But of course, we do expect to improve our numbers compared to Q3 significantly, and we will capitalize on the seasonality. Now when you look at the free cash number for the year, I think there are 2 items that will be for us difficult to assess. One is Deutsche Telekom. There is a cash out there. We have been very transparent. We explained about -- you know that we have mobilization transaction cost in Deutsche Telekom in the range of DKK 0.5 billion. We expect about 40% in -- to be incurred in 2018. So that's about DKK 200 million on the back of [DTAC]. That's one. And the other one is the high level of restructuring that we have in France, which is now a big cash out. It was not a strong cash out at the beginning of the year. It was a provision in P&L, but now we see the cash out coming in because actually, people are leaving. So that's when we pay. And so we have Q4 on restructuring, cash, which will be higher. And that's -- again, that's another DKK 200 million that we have to face. So these are 2 items, which are difficult, for sure, to overcome in 2018. But for the rest, we don't see an underlying deterioration on our free cash capabilities.

Operator

And the last question is from James Winckler of Jefferies.

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

Historically, you've tended to close the gap in your growth guidance as it gets close to the end of the year. Given you're at kind of 3.2%, 9 months year-to-date, it seems pretty -- curious to know that you're going to end up near the top end of this range. Is there a reason why you're leaving that wide berth open for the guidance and maybe some expectations for Q4 you have passed on previously?

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

Yes. Is it a serious case that we could end up at 1.5? That's difficult to build. We are clearly saying that we expect to end up at the high end of the guidance. So above 2.5. And that's -- I think I've been very pretty clear on the trends we see in Q4. We see Q4 slowing down. That's for sure for the good reason I mentioned and especially the nonportfolio base. So I -- again, I highlight that. You know that we are exiting some of the U.S. portfolio. That's also a negative drag. So that's why we expect Q4 to be down. Can we end up below the 2.5? We believe it is unlikely. That's why we are comfortable to say high end. Now yes, you could discuss should we narrow the guidance. And I'm not -- I think clearly, to be very candid, you guys are not giving us easy time when we -- each time we tweak the guidance knowing the guidance is actually seen as an (inaudible) signal. I think we don't want to create over-volatility, moving our guidance each and every quarter. And that's why we keep it as it is because we are comfortable to be in the range. And that's -- as we are in the range, we feel no need to update. Now we are very transparent with the building blocks. We give some color on where we expect to end, whether at the high end in organic growth or low end on margin. And I think that's the way we try to communicate with some stability with you.

Operator

There are no further questions. I hand back to the speakers.

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

Thanks a lot. With that, we will conclude the call. You may now disconnect.