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PRESENTATION

Operator

Welcome to the ISS Interim Report for H1 2023 Conference Call. (Operator Instructions) This call is being recorded.

I'm pleased to present Jacob Johansen, Head of Investor Relations. Speaker, please begin.

Jacob Schmidt Johansen ***ISS A/S - Head of IR***

Ladies and gentlemen, good morning, and welcome to the ISS First Half 2023 Interim Report Conference Call. My name is Jacob Johansen for Investor Relations. And I'm here at our global headquarter in Søborg, Copenhagen. With me in the room today is our group CEO, Jacob Aarup-Andersen; Group CFO, Kasper Fangel; as well as Kristian from the IR team. Before we start, I will ask you all to pay attention and carefully read the disclaimer on Slide 33.

With this, I'll hand over the word to Jacob and Slide #3, please.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you, Jacob, and good morning, everyone. So Q2 marked another important milestone in the strong execution of the OneISS strategy. The focus, the priorities are unchanged. The strong commercial momentum was maintained with double-digit organic growth rates, and we therefore upgrade the outlook for the full year. At the same time, the margin continued to improve. Activity levels across the customer portfolio continued to increase, and we have secured some important contract wins and extensions.

Today, we also announced 2 portfolio changes to our business. We announced the intention to divest our business in France, except for global key accounts. And we also announced that we, in line with our strategy, have made an acquisition in Spain. I will present the details of both of those later in the presentation.

All in all, with the results achieved in the first half of 2023 and the strong strategy execution, we are well on track to reach our targets. And with today's portfolio changes, we are even more confident in achieving a margin of above 5% in 2024.

Please turn to Slide #5 for the strategic update. The strategic priorities as part of the OneISS strategy are unchanged. And with success we have during 2023 enhanced our focus on growth. The commercial momentum remains strong, and we can clearly see that the investments which we've made as part of the OneISS strategy are yielding visible results. We've secured some notable contract wins, which are a testament to our enhanced global focus on specific prioritized customer segments.

We've also managed to improve the customer retention rate further. It now stands at 95%, which is the highest level seen in the company's more than 120-year history. On the operational side, the expected improvements from the OneISS efficiencies and cost initiatives are coming through, and the operating margin on the Deutsche Telekom contract and in the U.K. continued to improve.

Please turn to Slide #6 for a look at the situation in France. Across the group, the implementation of the OneISS strategy has delivered positive results. In France, we have, since 2020, been through a restructuring of the business, and we've established a solid foundation in the French market. But this hasn't resulted in the expected financial improvement as the commercial development has been muted and the market has been characterized by challenging conditions. To build a profitable, sustainable business in France, it will require further significant investments and management intention also from significant group resources.

Therefore, we have announced the intention to divest the French business, except for our global key account customers. With this, we intend to strategically reposition ISS in the French market to focus on servicing existing and future global key account customers. As of today, ISS France, except for global key accounts, will therefore be classified as held for sale and discontinuing operations. Therefore, the 2023 outlook is updated to also reflect these changes.

This is the right thing to do. We need to allocate our resources to businesses and markets where we can deliver attractive growth and attractive margins. Today's announcement will drive positive shareholder value versus the current situation, and it will enhance the ISS Group's margins and cash flow in the future.

Please go to the next slide in our latest acquisition. Today, we also announced that we've signed the acquisition of the Spanish cleaning provider, Grupo Fissa. This acquisition lives up to all criteria in our approach to M&A that we presented to you at the Capital Markets Day back in November. Grupo Fissa is a bolt-on acquisition in a country with an experienced management team that has a strong operational and financial track record. It will enhance our position within health care, which is a prioritized customer segment, and it supports our ambition to remain the #1 in cleaning globally. With the acquisition, we will add around 1% to group revenue. And it's financially accretive with positive margin contribution after synergies to both Spain and the group as a whole within just 6 months. Return on invested capital is, as you would expect, clearly above the required return. The transaction is expected to close during Q3. And afterwards, we will run a swift integration process, which we expect to complete in the first quarter next year.

Please turn to Slide #9. During Q2, we've conducted a customer engagement survey amongst our key accounts across Europe. Across all parameters, ISS is growing high, and it confirms that we have a strong portfolio of satisfied customers. We build our business on long-term partnerships with our customers, and it's therefore essential when maintaining and expanding these partnerships. I would especially highlight the relationship score of 4.6 out of 5. This is exactly what we've been investing in and what we have enhanced with the OneISS strategy, being closer to the customer every day and creating long-lasting partnerships. It also translates into a strong NPS score, and there is a close link to improvement of the customer retention rate. 95% is record high, and maintaining this level is an important contributor to growth going forward. And remember, I've said this many times, the best sale is to maintain existing customers.

Please go to Slide #10, where we will look at commercial achievements. At the Capital Markets Day back in November, we presented our strategic focus on the 3 prioritized customer segments, office-based production-based and healthcare. We don't want to be everything to everyone. We want to be everything to our prioritized segments. Since then, we've seen clear evidence that this approach is yielding results.

In Australia, we won an IFRS contract with a leading regional bank. We've not previously serviced banks in Australia at all. But within this global prioritized segment, we have 20 of the world's fairly [30] (corrected by company after the call) largest banks as customers. In the tender process, we brought in group banking competencies to support the local team in Australia. And what really made a difference was when we invited the customer to the U.S. to visit one of our global banks customers and experience our outstanding service delivery.

Another prime example is with an American pharmaceutical customer, where we previously only delivered food services. The customer had multiple different suppliers and, therefore, lack consistency across sites. Through deep interaction with the customer and our proven global IFS self-delivery competencies, especially towards life sciences customers, we managed to increase scope, both in terms of services and geography. These use cases are very important from a commercial perspective. And when a banking or pharmaceutical contract comes out for tender, it also increases our likelihood of winning it.

So let's go to Slide 11 and the commercial momentum. So here in the second quarter, we won an office-based IFS contract with the U.K. Department for Environment, Food & Rural Affairs, also known as DEFRA. We're very excited about this win, and it's very encouraging to see commercial success in the U.K. After years of focus on restructuring and internal operations, we've increased our focus on growth in the U.K., and it's now paying off. And as we've highlighted previously, we see a strong pipeline in the U.K. both for private and public customers.

We've also extended a good number of key account contracts, including the global contract with a major consulting customer which we extended with an increased geographical scope as India is now also included. With this, we only have 2% of group revenue up for renewal for the rest of the year.

Now this concludes my part of the presentation, and let me hand over the word to Kasper to go through the financials and Slide #13, please.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Thank you, Jacob, and good morning from me as well. The strong growth momentum was maintained in Q2, and thereby the organic growth for the first half ended at 10.9%. The improvement in the operating margin continued in the first half, where the margin was 3.3%. But excluding the French business that we intend to divest, margin was 3.6%. As expected, free cash flow was negative DKK 1.1 billion as receivables increased due to the high growth. With the progress achieved in the quarter, we are well on track towards our financial targets, and we are now even more confident in reaching a margin of above 5% in 2024.

Please go to the next slide for a close look at the organic growth development. With 10.4% organic growth in Q2, the strong momentum was maintained and organic growth in the first half landed at 10.9%. The drivers behind the development were unchanged. And price increases implemented to offset cost inflation had a contribution of around 6 percentage points, of which around half was from Turkey. Underlying volume growth from higher activity level across the customer portfolio increased organic growth by around 4 percentage points. Net new contract wins had a slight positive contribution of around 0.5% while revenue from projects and above-base work grew organically by 2% in Q2 and was flat for the first half.

Please turn to Slide 15 and the margin development. The improvement of the operating margin continued in the first half of 2023. Reported margin was 3.3%, but included in this number are one-off costs related to the strategic review in France. This diluted the margin by around 20 bps. Underlying margin was therefore around 3.5%. Excluding the business in France that we intend to divest, group operating margin was 3.6%. The positive development was driven by continued improvements in the previous hotpots, DTAG and in the U.K., combined with benefits from the OneISS efficiencies. We also had positive contribution from operating leverage from the higher revenue. Price increases are implemented with a margin neutral effect. They're not contributing to the margin development, but positively to the absolute profit.

Please turn to the next page and the regional development. All regions delivered solid organic growth in the first half of 2023. As you know, price increases have been a focus point across the group. The highest contribution was seen in Central and Southern Europe, where price increases in Turkey to offset the high inflation was the main driver of the 16% organic growth. The higher activity level at customer sites and improved office occupancy rates had predominantly a positive contribution on food services. Combined with net new contract wins, this yield 20% organic growth in the Americas region.

Margin improved in all regions except for Northern Europe, where lower contribution from margin enhancing above base work and lower revenue in Denmark offset the positive underlying development across the region. The Central and Southern European region delivered solid margin improvements. This was driven by continued positive development on the Deutsche Telekom contract and underlying margin improvements across the region. In Asia and Pacific, the already strong margin improved by 10 bps despite a lower level of COVID-19-related above-based services in China and Hong Kong.

Please turn to Slide 17 and cash flow. As expected, free cash flow was negative in the first half of 2023 and amounted to negative DKK 1.1 billion. This was driven by changes in working capital, which were an outflow of DKK 1.6 billion. On the next slide, I will explain the drivers behind this development. In addition, compared to last year, both interest and tax payments increased slightly. Together, these factors partly offset the improved operating profit.

Please go to Slide 18 and the working capital development. As we showed on the previous slide, changes in working capital development were negative DKK 1.6 billion. This was driven by receivables, which increased by DKK 1.8 billion as a result of the high growth. If we compare the development to last year, receivables increased by DKK 900 million in a half year where organic growth was 6.7%. This year, organic growth was significantly higher and receivables increased accordingly. On top of this, the customer prepayments from 2022 of DKK 200 million reversed. Utilization of factoring increased by DKK 0.1 billion to DKK 1.4 billion, in line with the key account growth as more receivables became eligible for our strict factoring policy.

Please turn to Slide 19. With a negative free cash flow and dividends paid to shareholders in the first half, financial leverage landed at 2.9x. Despite this increase, our balance sheet is still very robust. As we expect a solid free cash flow generation in the second half of the year, we expect, despite the acquisition in Spain, to end the year within the targeted range of a gearing between 2.0x and 2.5x.

With this, I have covered the financial part of the presentation, and please turn to Slide 21 for a look at the outlook for 2023. On the back of the performance in the first half of the year and our expectations for the development in the rest of the year, we are upgrading outlook for organic growth. We now expect 7% to 9% organic growth compared to 6% to 8% before. The outlook for operating margin of 4.25% to 4.75% and free cash flow of around DKK 2 billion is maintained. As ISS France has been classified to held for sale and discontinued operations, the outlook for organic growth and margin is without any contribution from the French business. Free cash flow is unaffected by the reclassification.

Please turn to the next slide for a deeper look at the drivers behind organic growth. As I just mentioned, organic growth outlook is upgraded to 7% to 9% from previously 6% to 8%. The main drivers behind the strong organic growth are still price increases and underlying volume growth. We continue to expect price increases implemented across the group to contribute with around 4 to 5 percentage points to organic growth. The underlying volume growth from increased activity level at customer sites and higher office occupancy is expected to drive organic growth of 3 to 4 percentage points, which is a higher contribution compared to what we previously expected. From net contract wins, we still expect a positive contribution while a lower level of projects and above-base revenue will have a slight negative effect. Compared to our previous guidance that included France, there's also a small contribution from the reclassification of France. However, the positive impact is below 0.5% for the full year.

Please go to Slide 23 and outlook for operating margin. The outlook for operating margin and the drivers behind the development are unchanged. We still expect the margin to be between 4.25% and 4.75%. The improvement compared to last year will be driven by higher margin on DTAG and in the U.K. Additionally, OneISS efficiencies and cost initiatives as well as operating leverage from higher revenue is expected to improve margin. The reclassification of France to discontinued operations has a positive contribution to margin. The effect is around 10 bps compared to our previous expectation for operating margin outlook for 2023.

We have 3 years into the successful implementation of the OneISS strategy, and we can clearly see the benefits are coming through. As a natural next step, we will, throughout the second half of the year, go through all OneISS initiatives and compare benefits to business cases. And most likely, there will be some areas where we'll invest more and accelerate and there will be certain areas where we'll do the opposite. As the new CEO, I'll work with the management team to get this exercise executed over the course of this year. In summary, we are well on track to deliver on our financial targets, and we are now even more confident in reaching margin of above 5% in 2024.

Please turn to Slide 24 and the outlook for free cash flow. Free cash flow in 2023 is still expected to be around DKK 2 billion. Changes in working capital, including reversal of customer prepayments from 2022, are expected to be negative. As we've seen here in the first half of the year, high growth is driving increases to receivables and, thereby, a negative cash flow from changes in working capital. There is a correlation between organic growth rates and free cash flow and specifically working capital. Lower versus high end of the organic growth interval will be the determined factor of whether the cash flow will be slightly above or slightly below the DKK 2 billion. We expect growth rates to normalize in the second half of the year, but changes in working capital for the full year will still be negative. All building blocks behind the development are unchanged.

With this, I've completed the financial part of the presentation. But before I hand over to Jacob for final remarks, I just want to say thank you to you, Jacob, for a fantastic collaboration in the last 3 years. I will do my utmost to continue and build on your great leadership, and I can't wait to get started as the CEO on September 1.

With that, over to you, Jacob.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you, Kasper. Thank you for those kind words. In the first half of 2023, you can say the rigorous execution of our strategy has continued. The benefits are becoming really increasingly visible on both the commercial and the operational front. The strong organic growth momentum has been maintained, and we delivered double-digit organic growth for something that is completely unprecedented for ISS.

These results would not have been achieved without a massive effort by all of our place makers. They are every day delivering excellent services to our many customers across the world. So a big thank you from all of us. We're building a stronger ISS, and we are fully on track to reach our financial targets. And with the intention to divest our business in France, we are even more confident in delivering a margin above 5% in 2024.

With this, we are ready to open the Q&A session. So over to you, operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question will be from the line of Kristian Godiksen from SEB.

Kristian Godiksen ***SEB, Research Division - Analyst***

Let me start with a number of questions here. So first of all, on the guidance part. I was wondering why you still keep the range for the price parameter in the organic growth guidance range when, as I understand, all prices have been locked in. And then also on the guidance, maybe if you could comment a bit on why you don't narrow the guidance. It's a very wide range now for the second half, and that goes basically both for the organic growth guidance, but also for the margin guidance.

And then secondly, on the margin guidance. I was wondering if you could comment a bit on where you're trending on the margin guidance. Is that still in the midrange? And then I guess you will have this 10 bps of positive impact from the divestment of France. Or how should we think about that?

And then maybe thirdly, before I jump back to the queue. Maybe if you could comment a bit on the multiples you have paid to acquire the Grupo Fissa and what is the potential for selling more services to the customers taken over.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you very much, Kristian. Why don't I start on Spain, and then Kasper can talk about your 3 guidance questions. I guess you were asking why the price increase component is unchanged on the organic, why not a narrow range and where our margin is trending with the France disposal. But on Spain, let me take that first. So we haven't given a multiple. We don't -- and I'm cognizant that if we look at some of the history of ISS, there was an element where acquisitions were done as a part of multiple arbitrage. And we've been very open around. That's not how this management team operates. We made it very clear that this is a business that will be margin accretive to the group within 6 months, so the moment the integration is done. We've also made it clear that it's a return on invested capital that is clearly above our hurdle rate. And if you calibrate those things, you will probably see that, that means we will have not have paid a multiple that is higher than our own trading multiple. But I'm not going to give you the multiple. Out of principle, we don't do that anymore.

The question about more services. There's no doubt that there are 2 exciting things around this. There's a lot of exciting things around this acquisition. But first of all, it gives us a much stronger footprint in the south of Spain and it also increases our presence significantly around health care. Both of those elements, it means that we can start selling other services into those customer segments. So there's no doubt that we believe once the initial case, which is around the integration, taking out the cost synergies and making sure that we have taken the infrastructure synergies out, then it's around driving a stronger top line from the acquisition. And that is exciting because there's no doubt, our team in Spain is incredibly capable. You know, Kristian, that it's one of our strongest countries, and therefore they have a very strong business plans around driving accelerated growth on top. But when we talk about benefits, synergies, margins, et cetera, we never take any positive impact from revenue in. That's cream on top if you want to call it that.

And then over to you, Kasper, on the guidance questions.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. Thanks for good questions here, so let me try to take them one by one. So the reason for the organic growth guidance of 7% to 9% and keeping relatively broad range here is basically around the above-base work in the second half. As you remember, probably from last year, we had a record high above-base level in Q4 last year. So the comparison is tough against that. But that being said, we are very confident with the 7% to 9% as a revised guidance for the full year here.

And on price increases, you're indeed right that it is locked in now. But remember, last year, we had incremental price increases throughout the year. So we also had price increases kicking in, in the second half. So we are up against a stronger comparison there, and that's basically the reason why we're keeping that as is.

On the margin side, I think you're right. You're probably alluding to the fact that when we announced the Q1 results, I mentioned that a good data point to expect as a full year landing point was the midpoint of the range, so 4.5%. And you're absolutely right with the positive contribution of approximately 10 bps that we get from France, then the expectations will be slightly higher than that, so let's say 4.6%.

Kristian Godiksen ***SEB, Research Division - Analyst***

Okay. Perfect. Maybe just a follow up -- a quick follow up on the guidance part of it. So you mentioned projects in above-base, but there you don't have a range. I guess you have a range for the underlying volume growth and for the net price increases. And for the price increases, I guess, maybe let me put it another way. So the current run rate you have with price increases, is that trending to the 4%? Or is that trending to the 5% because, otherwise, I'm a bit unsure why there is an interval there.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes, you're right that there is a potential of going to the top end there. So I don't think we should go into the details. I think I phrased it. And from a high-level point of view, we are very confident around the 7% to 9%. But there are some things that need to be watched carefully, and that is the comparison base in the second half and especially in Q4 with this above-base. It was record high. It has never been higher in 2022 compared to what we saw last year on project and above-base work in Q4.

Kristian Godiksen ***SEB, Research Division - Analyst***

Okay. But maybe just to -- maybe ask you from my side. On the price part, do you need to implement more price increases in order for you to reach the 5%?

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

No, no. We do not need to do that. We are done with that. So with the current level, we'll get to that percentage.

Operator

The next question will be from the line of Annelies Vermeulen from Morgan Stanley.

Annelies Judith Godelieve Vermeulen ***Morgan Stanley, Research Division - Research Analyst***

I have a couple of questions. So firstly, just on France, given you've been trying to turn this business around for the last couple of years and you guys are the experts. So if it's not been successful for you, I don't imagine it would necessarily be successful for somebody else. How confident are you in your ability to divest it, particularly at a decent price? Is there a risk that you end up having to write it off altogether? I'm just wondering how confident you are in your ability to be at a sensible price within a sensible time frame.

And then just secondly on the free cash flow. I know you've been very clear that it would be negative in the first half, but I think it's potentially been a bit more negative than the market was expecting. And clearly, you have a lot to deliver in the second half. So could you remind us of the moving part for the second half, particularly around -- I'm guessing a lot of it is the receivables, but if there's anything else we should be aware of. And what's going to -- what the components are of potentially a DKK 3 billion swing in the second half?

And then just lastly, the ICV arbitration process with Deutsche Telekom is still ongoing. Is there any update you can give on progress that you're making or potential timing of resolution?

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you very much, Annelies. Why don't I do France and Deutsche Telekom, and then Kasper will do cash flow. So starting on France, you asked about the confidence in our ability to sell, and I appreciate that you said we are the experts. I think we -- you're right that, of course, we know our asset. And as you also know, we put a very strong team on over the last 12 months in terms of turning around the business.

I would also say though, if we're staying within the frame of your question that we may be the experts in our business, but one of the major issues that we are flagging as part of the conclusion of the strategic review is our lack of critical mass or the lack of scale. And therefore, our business, combined with another business in France, will have a significantly different likelihood of delivering stronger profitability. So it is one of these cases where an asset can be worth more to another owner simply for that reason that they can get scale advantages that we can't get.

So I'm not concerned about that. We, of course, have confidence in executing a process that creates value for our shareholders. Otherwise, we wouldn't be doing it. You would appreciate -- and I know you well, so you would appreciate this that we cannot go into details on the process from here. We have today announced our intention to divest, and now the process needs to run its course. I think I can guarantee also for new management that the moment we have things to update you on, we'll update you. We are -- it's, of course, in everyone's interest to run a smooth process here.

For all stakeholders, it's also very important for us to take good care of both our employees and our customers in France that it's a smooth transition for everyone. But we have confidence in this process. We have spent a lot of time. We have spent a lot of efforts over multiple years. Actually, historically, it's been more than a decade where France has been worked on. And we've gotten to the point now where the strategic options, there's no doubt that the right thing to do for our shareholders and for all stakeholders, including employees and customers, is what we're laying out today.

Then on Deutsche Telekom, so you are correct that the arbitration proceedings are continuing. I will always remind you that we have initiated those proceedings. It's an ongoing process. And as you know, it is -- by nature, it's a confidential process. We have exchanged claims as normal in an arbitration process, and that process is following so far the agreed schedule between the 2 parties and the arbitration, all the arbitrators here. So we have the same confidence in the process as we've had before. We wouldn't initiate this if it wasn't because we thought that we had a rightful claim, but we will see how it develops from here. But I can only say with confidence that the process is where we would expect it to be at this stage.

I would also just remind you that in parallel and unaffected by the arbitration, we continue to execute on the Deutsche Telekom contract, driving efficiencies and optimizing the operation and profitability continues to increase on the contract. There are still opportunities to improve it further. And also just before the question comes, we are, of course, not assuming any positive outcome from the arbitration in any of our outlooks. So that's separately on the side.

I think that's the amount of information we can give on that situation. Over to you, Kasper, on the cash flow.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. Thank you, Jacob. So first of all, the free cash flow in the first half is landing pretty much spot on where we expected it to land. So not a negative surprise to us, and hence also why we signaled this when we announced the Q1 results. And the key moving parts, as you alluded to yourself in the second half, is, of course, working capital that I expect will recover and reverse in the second half as growth normalize. And the second thing is the profit increase in the second half. And both of these things I'm very confident with, and we have an ability to generate a strong free cash flow, and I don't see any reason why we shouldn't be able to do that as well. So a strong confidence around the DKK 2 billion outlook for free cash flow this year.

Operator

The next question will be from the line of Michael Rasmussen from Danske Bank.

Michael K. Vitfell-Rasmussen ***Danske Bank A/S, Research Division - Research Analyst***

Just a few more questions on the business in France. So can you talk a little bit about the underlying margin of the stand-alone business here that you're putting up for sale kind of maybe not currently, but just over a little bit of a longer period of time. And also, when we look into the second half of 2023, will there be any further one-off costs relating to this sale? Or has all of that been taken? Obviously, depending on how long this process takes, just a bit of flavor on that. I have a few more questions. Maybe we should take those on France first.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

So of course, we have this full transparency in the disclosure in the first half report. And as you can see, the French business was loss-making to a magnitude of DKK 90 million in the first half. DKK 80 million of that -- approximately DKK 80 million of that DKK 90 million is one-off exceptional costs. So the underlying position was around negative DKK 10 million. And of course, we expect the French business to improve from that position in the second half with the same things as the rest of the business, so seasonality, but also improvement plans that are expected to come through. So it's important to understand these DKK [80] (corrected by company after the call) million of one-offs.

And in a more longer-term horizon for France, you know what we had in our targets. We were clear around that on the Capital Markets Day. We expected France to be around the 1% for this year and then incrementally improve over the course of this year and improve a strong -- generate a stronger margin next year. So that's it. And hence, that's 1/10 in uptick in margins, if you will, from divesting France, that's where that comes from.

In terms of exceptionals, I mean France is being classified as a discontinued operations, which means it doesn't go into the ordinary results anymore. So it will sit on a separate line in the P&L and also why it's stripped out of the outlook for the full year. And I don't expect a significant additional one-off costs related to this process in the second half.

Michael K. Vitfell-Rasmussen ***Danske Bank A/S, Research Division - Research Analyst***

Okay. Great. And that actually also answered my second question. Another question for you guys is further M&A opportunities. I mean, any kind of service lines that you would like covered? Or any regions that are of interest? I know that you guys have been talking about potentially the Americas also historically. And if you could kind of combine that with also shareholder returns going forward.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Yes. Let me take that one, Michael. So first of all, you can say we've done -- if you look at it, we've done 2 acquisitions while we've done Livit in Switzerland back in November. And we've done our Spanish acquisition today, and both of them, of course, relatively small bolt-on acquisitions with instant accretion to our shareholders. And we are very clear. We laid out a footprint back in November at the Capital Markets Day that we are incrementally moving into M&A, but with a very, very stringent approach to M&A, with a very, very high focus on our capital allocation being shareholder value creating. And therefore, you should not expect a step change from us from an M&A perspective.

You mentioned the U.S. as an example. There are areas where we -- where if the right attractive opportunity like the 2 acquisitions we've done, if they do occur in what we call the M&A approved countries, which are countries that are well performing, strong management teams, strong operating model, et cetera, if they do occur, then we will look at similar acquisitions like the 2 ones you have seen over the last 6 months.

There is -- at this stage, we don't have the appetite to go and do major M&A. We don't think that's the right time in the journey we're on as a company because we're also acknowledging the need to constantly be stringent around our capital allocation and making sure that the business is also ready for it. We are unchanged in terms of our perspective on shareholder returns. We laid out a very clear hierarchy back in November last year, which is around maintaining our investment-grade rating. It's around paying out dividends in the range of 20% to 40%. It is around doing highly accretive M&A like the ones we have done, and then it's around returning the remainder of excess capital to shareholders. We are fully cognizant that if you do the math on our guidance for the rest of the year, we will end up in a situation at the end of the year where we are likely to have a strong capital position. At that point, the Board will need to make a call on what they want to do with that capital. But we have no doubt that, of course, as a company, we will continue to stick stringently to the capital allocation policy we have laid out to you.

But I guess the chinks of your question is also, are we looking into a major M&A pipeline in front of us? No, we are not. Are we looking at individual opportunities that could create value for shareholders? Yes, but it's not -- it will not be at the expense of shareholder returns. So I think you should take that with the comfort that we are in a strong capital position, and we will be in a strong capital position at the end of the year as laid out by Kasper on the guidance side.

Operator

The next question will be from the line of Klaus Kehl from Nykredit.

Klaus Kehl ***Nykredit Realkredit A/S, Research Division - Chief Analyst***

Yes. Two questions from my side. We talked a little bit about the cash flow and that you expected to see a normalization in the second half of the year. But could you comment a little bit about whether you're actually seeing the normalization right now, so we will see the improvement in Q3? Or is it kind of an end-of-year normalization that we should expect? That would be my first question.

Second question is related to, again, these price hikes, and we talked about the price hikes on group level. But how does it work in Turkey? I mean, we are seeing sky high inflation in the first half of the year. And I guess inflation will be sky high again in the second half of the year. So do you raise prices once a year? Or do you need to raise prices again in Turkey here in the second half of the year? That would be my final question.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you, Klaus. Let me start on the price increases, and then I'll let Mr. cash flow speak cash flow on the price increases. So the way it works, Klaus, is we don't only do price increases once a year. So our price increase cadence follows the inflationary cadence you can say. So of course, when we are talking commodities and these types of things, it's usually a yearly regulation. But when we talk wage changes, wage increases, it will follow the timing of the wage increase.

So you mentioned Turkey, and I can get to that in a second, but you also see in other European countries where we recently have seen correct -- sorry, wage changes within the year, I think Belgium had -- in the middle of the year had an additional wage increase. And we're seeing the same in Turkey, as you mentioned. And when that happens, we go and reprice it through. Turkey has had -- I think that's clear. Turkey has had also this year another wage increase or minimum wage increase here over the summer for the second half, and that has been implemented in -- through our price increase process, and it is part of the guidance that we're giving you. It is not having a incremental increase versus last year because last year, we also had a major wage increase in the middle of the year in Turkey. But I can assure you that we will -- we price through new increases as they come through. At the moment, they have a certain magnitude, of course. And the changes in Turkey, unfortunately, have a magnitude where we need to make sure we price them through immediately to not have any heat. So that is indeed the case.

Over to you, Kasper.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes.Thanks, Klaus. Totally fair question on cash flow. But I will just come back to what I also mentioned before. Of course, I would never give a guidance of around DKK 2 billion if I didn't have a path to get there and if I wasn't comfortable with that. So very comfortable with that. As you will appreciate, I'm obviously not going to give any monthly free cash flow results for July or where we are for August. But what I will come back to is that the organization will agree. If you ask them whether cash flow is a strong focus in ISS, it's literally every single day. And it's not only a finance exercise, it's an operational exercise. And it will start to improve gradually and then -- from the negative position we have in the first half, and then we'll get to around DKK 2 billion for the full year. So very confident with that, Klaus.

Operator

The next question will be from Allen Wells from Jefferies.

Allen David Wells ***Jefferies LLC, Research Division - Equity Analyst***

Three for me, please. Just firstly, we'll stick to the guidance side. Obviously, if I look at the growth guidance upgrade from the start of the year to where we are now, you've got some underlying margin improvement from the France divestment. And obviously, the free cash flow guidance hasn't changed. I mean you can correct a scenario where there's anywhere between DKK 100 million and DKK 600 million of additional cash flow, depending on where you were at the start of the year in that original guidance. Is the reason that the free cash flow guidance changed because of the working capital drain from growth? Is that the right way to think about the fact that the free cash flow line hasn't been upgraded from the start of the year to where we are now? That's the first question, please.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

I'm not sure where you get the DKK 400 million from, to be honest. I mean just back of an envelope calculation, 1% organic growth is approximately DKK 800 million and then you add margin to that. Let's take the midpoint, 4.5%, and then you deduct 25%, which is our ETR, the effective tax rate. Then that will be -- what is that around, DKK 20 million in free cash flow. So I'm not sure you get the DKK 400 million from.

The point is that, yes, working capital temporarily is tying up -- is being tied up as we grow. I've never seen in my 15 years in ISS the first half where we have an organic growth of a double-digit organic growth. And of course, it does impact working capital. But it is a temporary impact. And as I said, I expect the lower growth in the second half, and that's also why I'm confident with the DKK 2 billion on free cash flow.

Allen David Wells ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then secondly, just on the Northern Europe. I noticed that margins went backwards in the half year, I think it's 4.3%. I think you made a comment saying the underlying margin improvement is offset by lower above-base in some issues in Denmark. Could you just talk a little bit about what's going on here as well because I think, in general, we were expecting above-base as slow as you move through the year. As you've mentioned on the call, it was always very, very high for last year. And so to see margins moving backwards because of, in part, above base just raises a few questions for me. So can you just kind of talk through exactly what the moving parts are. And maybe in terms of the full year expectations for Northern Europe, would you expect to see a margin improvement if the above-base work continues to slow? And then as a general comment, is lower above base in the second half expected to be obviously a headwind to margins across the rest of the group, if that were to play out?

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Okay. Why don't I do that. So the focus on Northern Europe, I think that's -- it's only fair when you see that. But you're actually highlighting part of the answer yourself as well. So you can say, first of all, the underlying improvements that we've done in Northern Europe, we are continuing to drive operational efficiencies in the U.K., especially -- which, as you know, is a key part of that region. It's a significant part of that region. And we're also driving cost initiatives continue to drive that in the U.K. But a key driver here, as you say, is that the U.K. in terms of the above-base business over the last couple of years, it has been high during COVID and it's come down. And part of that operational leverage, we all know that, that came in at higher margins. So that's out.

But Denmark is also a key driver here. You know that we took out the Danish Defense contract. We exited that. You're all fully aware of that. We made that conscious choice to do that. But we also made a conscious choice not to reduce the overhead in Denmark to the same extent to maintain margins in the short term because we wanted to make sure that we had an organization and a setup that was ready to continue to drive growth. Because if you carve out the Danish Defense exit, which you know was something we initiated, Denmark is seeing strong growth and strong momentum and is seeing a lot of commercial interest. We are very open because it's also a public tender. So it's fully out there that there is a very big situation right now in Denmark, Bygningstyrelsen, government property agency where we are one of the last 2 players in that tender. So there's a number of things going on in Denmark, where we have, on purpose, decided to reduce, say, our short-term operational leverage to make sure we have enough overhead cost.

So not a concern here. It's deliberate choices that we're seeing. If you adjust for that, we -- I think we will continue to see a margin uplift also from Northern Europe going forward. Overall, this is not something you can use to then extrapolate to trends you will see in other regions, et cetera. This is specifically around 2 countries where, as I said, especially the Denmark situation is a driver.

Allen David Wells ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then very final question, just on below line items in P&L. I noticed the interest cost was a little bit higher in the first half than we expected. I think part of that looks like it's FX. Have you got any kind of guidance or range expectation for full year interest costs as well, so we can just check where we are there?

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. So obviously, as you know, from the note disclosure we did in connection with the full year results, then we have around 18% of our debt is variable. And that means that we are impacted by the general increase to interest levels. So that is one part. And I expect what you've seen in the first half, you will see the same in the second half.

On FX, that's hard to predict, obviously. The hit that we're getting on FX in the first half is related to TRY , which has devaluated but -- and actually, it's a receivable we have towards a partner that goes back to when we did the acquisition a couple of years back in Turkey, where we helped with funding. But we did that through local funding. So what I'm going with that is that we are getting a P&L hit in the first half, but we have a corresponding positive because our debt has decreased. So this is not something from an economical point of view, that is a deficit to us. It's net zero.

Operator

Next question will be the line of Nicole Manion from UBS.

Nicole Manion ***UBS Investment Bank, Research Division - EMEA Equity Research Analyst of Support Services***

Just a question, please, around the France divestment. What does this mean, if anything, for how we should think about your key account model more broadly, if you don't need that installed base of contracts locally in order to service key accounts?

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thanks, Nicole. Let me take that. You should not infer anything from this change in terms of how we will approach key accounts more generally. The French situation is a specific situation, which we've been working on over a significant amount of time. And it's not a strategic decision that will lead to operational changes across our key account model.

We -- in France, we have a relatively limited amount of global key accounts and the ones that we have there will be serviced the way that they have been serviced throughout. We generally -- as you say, we generally have the support of the broader base when we're servicing larger global key accounts. And the setup we will do in France will, of course, ensure that we still have that in a strong partnership with whoever does the continuing business, but also the fact that we are surrounded by strong ISS businesses around. But the structure around how we will service them, I think we can come into that once a transaction has been consummated. But just to be very clear, this is not a change in our approach to key accounts in general.

Operator

The next question will be from the line of Peter Sehested from ABG.

Peter Sehested ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

It's Peter from ABG. I have two. My first one pertains to return-to-office trends and what you're actually seeing in the market. We're reading 2 things. One is that employers or office companies are sort of shutting down and not extending leases, et cetera, et cetera, all else pointing to lower net amounts of office space. On the other hand, we are seeing strong development in your business. And sort of, let's say, the semi-paranoid observer would say that basically what we are seeing right now in the market is a desperate move by employers to get people back into the office. And that extra amount of activity is actually clouding an underlying deterioration in square feet service. So when that abnormal level of spending comes to, A, let's say, more steady state, we are actually -- will we see the negative impact of lower office space? So is this a scenario that we should fear looking, let's say, 12 months out? That was my first question.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Thank you, Peter. Let me take that. I think that's a completely fair fear to have. And we've discussed this fear, if I can call it that, well, you call it that, at different levels over the last 3 years by now because, of course, it is an ongoing debate on what are the effects of the pandemic and the future of work and how does it impact our industry as a whole. First of all, if we look at the data and the facts and also the many conversations we are having, as you know, we look into more workplaces than anyone else in the world, and therefore, we have these conversations all the time with C-suites all over the world.

We are seeing lower square meters, but we've seen lower square meters, that development we've seen over the last 3 years now. And we do not expect that, that effect is in front of us. We do expect that most of that effect has already happened or is happening and is in the budgets that we are servicing at the moment. We don't see this accelerating or becoming a bigger issue going forward. We could -- when we had these conversations 1.5 years ago with many of you, we were looking into that development. Now we are literally in the middle of that wave, if not towards the second half of that wave, if I can use that term.

So it is not a concern for us. Why? Because we have seen that in all the places where people are lowering square meters, the financial impact on us is either limited or just nonexisting. Why? We are seeing budgets across major customers, especially larger accounts, which is where the most significant part of our business is done with larger companies -- global larger companies. And here, we are seeing that people are just reallocating their budgets towards other users towards their employees. Our job is to make sure that we capture that wallet, and we have. So the driver -- so the underlying growth you're seeing in our business is exactly that. It is that we are maintaining our business with larger customers even if they are -- sorry, decreasing their square meters.

The other thing I'm seeing across the Board and which is not a temporary effect is that we are continuing to see a normalization of return to office. That is not, I think you used the word, desperate employers. On the contrary, actually, we are seeing an organic return to office. People are simply coming back to the offices. We are getting to critical mass in many office environments globally where you'd rather actually be in the office in most parts of the week because, otherwise, you're missing out. We're also seeing that the slowing global economy has also accelerated people's return to office because simply when there is a higher risk of losing your job, you do spend more time in the office. That's just a stated fact we can see in the data.

And finally, we are seeing a number of large companies now coming out with mandatory return to office and mandatory requirements for work hours in the office. We don't think that's a temporary effect. We think that's a continued movement. So sorry for the long answer, but it's more to say, we have seen these effects for the last 1.5 years. We actually think we're in the middle or in the second half of this, and we know how to deal with it. We've managed to get at least the same revenues out of these customer relationships and partnerships where people have reduced square meters, and we don't see a reason why that should change from here.

Peter Sehested ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Appreciate the long answer because this is the future in France in the past. Now my second question pertains to your growth, the composition of organic growth for Q3. If we work backwards from organic growth, take out the above-base component and net out the price component of 6%. And I assume, as you say, food is growing by 20%. It comprises 3% -- or 15% your of group. That is a food component alone of 3%. Net new wins of 0.5%, stripping that out, that leaves very, very little left for base -- let's say, the base business ex food. How should we think of that going forward? Because that is -- leaves us with a very, very low number, let's say, less than 1%. So basically, it's the sort of the impact on organic growth if food slows down or normalizes as we go into second half and into next year.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. I mean I can give you some details. And then, of course, the exact decimal numbers, I suggest to discuss that with IR after the call, Peter. But on the 10.4% organic growth that we have in Q2, approximately 4% of that comes from food. And you're right, of course, we're going into a stronger and more difficult comparison here in the second half because we saw a ramp on food throughout last year. So we are against a stronger comparison, which obviously will decrease that number in the second half. But just on food, I think an interesting data point there is that in terms of index, we are back at plus 100% on an indexation versus pre-pandemic. So actually, the food revenue has increased compared to what we saw before the pandemic. And it is one of these attractive things that customers are really investing in, and we have super traction on that service line. The participation rate is increasing, and we can see that the products that the customers are asking for, that's exactly what we can deliver. So actually very excited about that.

Operator

The last question will be from the line of Jesper Jensen from Nordea.

Jesper Herholt Jensen ***Nordea Markets, Research Division - Head of Equity Research of Denmark, Senior Director & Sector Coordinator***

Firstly, I guess another question for Mr. cash flow Kasper. So I guess, you have sort of consistently delivered growth ahead of expectations for quite a few quarters now. The free cash flow guidance, as you say, is based on growth rates sort of normalizing somewhat in the second half of the year. So I guess my question is, can you help us understand what the impact would be on these cash flow dynamics if the growth rate continues to achieve expectations? So basically, just to avoid any negative cash flow surprises, let's say, growth continues to be somewhere in the double digits. What will the impact, the free cash flow, I guess, then the DKK 2 billion will become stretched?

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. Thanks, Jesper. I think I'll come back to what I mentioned in the presentation. The determined factor here is where we are ending on the organic growth. And if we are ending in the high end of the organic growth, then I think that our free cash flow will be slightly below DKK 2 billion this year. If we end in the low end, then I think it will be above the DKK 2 billion. So it is really where we're ending on the organic growth on which side of the DKK 2 billion mark that we will -- where we will expect to land.

Jesper Herholt Jensen ***Nordea Markets, Research Division - Head of Equity Research of Denmark, Senior Director & Sector Coordinator***

Sure. I appreciate that. It's just that if you look back over the previous quarters, you've actually delivered growth substantially ahead of what you guided or expected. So I guess my question is, we go about the night, what sort of impact should we be thinking about in case that happens? I guess it's a positive, just to understand.

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. But it is positive because it's generated -- it's healthy because it's generated from growth. But I think, I mean, the way I look at a range of around DKK 2 billion is -- the low end is DKK 1.8 billion and the high end is DKK 2.2 billion. I think that's the range, the ballpark that is reasonable and fair to assume.

Jesper Herholt Jensen ***Nordea Markets, Research Division - Head of Equity Research of Denmark, Senior Director & Sector Coordinator***

Okay. Fair enough. So another question was on the margins, really. So I guess, as you alluded to, seeing a positive impact now from France, they moved to discontinued. You're also seeing, I guess, small margin accretion from the Spanish acquisitions that you expect to close in Q3. And yes, you've obviously kept the guidance for the full year unchanged. I'm just sort of wondering what are the sort of main uncertainties that you see over the next 5 months that have sort of allowed you to keep that low end of the guidance range. What is it that you see that could sort of potentially put guidance in that very low end?

Kasper Fangel ***ISS A/S - Group CFO & Member of the Executive Group Management Board***

Yes. First of all, as I said in my presentation, the positive contribution from excluding France is 1/10, and 1/10 is just not enough to trigger a change to our outlook for operating margins. So that's the first point.

But what I appreciate, it's a fair question, Jesper. The right range on operating margin. But to be honest, it's simply to have the ability and the freedom to do what is right for the company in a more longer-term perspective. It's almost 3 years ago that we initiated the OneISS strategy and initiated a lot of initiatives that obviously are done with the purpose, which is to generate the value. And as I said in my presentation, it's only natural -- Jacob and I have mentioned that before, it's only natural that we're using the second half to evaluate that these benefits are also coming through in the business. And there will be things where we will further accelerate our investments, and there will also be things where we will do the opposite. And I'm very comfortable with the range on margin, and this gives us the flexibility needed to make the right decisions for the company in the long term.

Jesper Herholt Jensen ***Nordea Markets, Research Division - Head of Equity Research of Denmark, Senior Director & Sector Coordinator***

Okay. Understood. So last one is on France, really this has been rumbling on for quite a while. I was just wondering and perhaps also a bit curious, I mean, what was the deciding factor here? Is it -- was it just purely financial performance, more clients leaving? Is it management? Or I mean, what is it that now trigger the decision after having been an issue for such a long period of time?

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

Yes. Thanks, Jesper, and I appreciate that. You can say there's a number of things around this. But it's not purely financial but, of course, it all in the end boils into the financial business case, of course. But strategically, you can say 12 months ago, roughly, we put in a strengthened management team in France. We've had a very, very strong management team working there together with a bunch of group resources, some of our best people here. And that has also enabled us when we then, this spring, decided to accelerate a strategic review in terms of what the future of France should be with the expectation, of course, that we could drive a significantly better French business out of that strategic review. It's quite clear that the data that came back and the strategic analysis was that we were both struggling from a strategic perspective and from a financial perspective. And so it's a combination of both factors.

We have to say there's no doubt that we -- in areas in France, we have a strong business. And of course, we are happy with the team. But we are set up in a way where we are lacking critical mass. We're set up in a way where we are exposing to customer segments that are just tough. You know we are heavy in industry and aviation, and these types of things. So we have a setup where we were struggling to get real commercial momentum, and we could not see how we could drive both commercial momentum and a significant step change in profitability given the strategic positioning we had.

So the opportunity -- sorry, the option in front of us would have been to invest significantly both in terms of capital cost but also resources over a longer period of time to try to regain -- or sorry, to gain that critical competitive market position. And it's been an enterprise choice that we simply think that we allocate your capital as owners in a better way to more profitable end markets with stronger growth potential for us.

We've gone -- as you know, we've gone through a significant amount of work for a very long time. You also know this company very well, and you know that France has been under intense scrutiny for, I guess, more than a decade where we have not found the perfect position there. Now we just have to admit the strategic positioning of ISS France, ex our global key accounts, will be better off in another context than with another owner.

Operator

As we are running out of time. I will hand it back to the speakers for any closing remarks.

Jacob Aarup-Andersen ***ISS A/S - Group CEO & Member of the Executive Group Management Board***

All right. Thank you very much, and thank you for your questions and comments. Of course, any follow-ups, then you grab the IR team who will be eagerly awaiting by the phone for any good conversations around note disclosures and these types of things.

Just a closing remark from my side, we are pleased with the operational performance in the first half. We're also pleased with the continued strong momentum on both growth, but also the continued delivery on our margin journey here. So very, very pleased with what we deliver today on an underlying basis. No doubt that we talked a lot about France, but the change to France is the right thing to do. It's the right thing to do for all stakeholders involved, and it will create real positive shareholder value. It will increase the margin and cash flow profile of ISS going forward, and it is the right thing to do to create value for all stakeholders involved in ISS France.

I will, in 3 weeks, hand over the keys to Kasper. Appreciate the kind words earlier, Kasper. They were not part of the script. This is not part of the script either, but I just want to wish you a massive good luck on the next part of the journey. You're going to do incredibly well.

You're going to ensure a strong continuation of a journey where we, over the last 3 years, we have taken ISS to what I believe is a better place and you will again take it to the next level. So I have no doubt that you will do incredibly well. And we'll stay very close and remain a very, very big fan of ISS and you and the rest of the leadership team.

To all of you on the investor call, thank you for the dialogue over the last 3 years, very, very sharp comments and questions sometimes, almost uncomfortably good questions. So very well done on that. And thank you for the partnership. And maybe I'll see a couple of you in a brewing world somewhere out there. Thank you very much for today. Thank you.