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Company Name: ISS A/S
Company Ticker: ISS DC
Date: 2017-08-17
Event Description: Q2 2017 Earnings Call

Market Cap: 45,247.35
Current PX: 243.7
YTD Change($): +5.3
YTD Change(%): +2.223

Bloomberg Estimates - EPS
Current Quarter: 4.450
Current Year: 16.114
Bloomberg Estimates - Sales
Current Quarter: 20495.286
Current Year: 81520.385

Q2 2017 Earnings Call

Company Participants

- Nicholas Ward, Head of Group Investor Relations
- Jeff Gravenhorst, Group Chief Executive Officer
- Pierre-Francois Riolacci, Group Chief Financial Officer

Other Participants

- Bilal Aziz, Analyst
- Srinivasa Raju Sarikonda, Analyst
- Paul Checketts, Analyst
- Andrew Farnell, Analyst
- Kristian Godiksen, Analyst
- Sylvia Barker, Analyst
- Michael Vitfell-Rasmussen, Analyst

Presentation

Nicholas Ward, Head of Group Investor Relations

Ladies and gentlemen, this is Nick Ward, Head of Investor Relations at ISS, and I would like to welcome you to our Q2 2017 Results Teleconference. Please be aware that the announcements, the interim report, and the slides used on the call can also be found on our website and later today a replay will be available and we will post a transcript of the call as soon as it is ready.

I'd like to draw your attention to slide number two regarding forward-looking statements. And presenting today, as usual, will be Group CEO Jeff Gravenhorst, and Group CFO Pierre-Francois Riolacci. We'll open for Q&A at the end of the presentation and we have one hour. And with that, I will hand over to Jeff.

Jeff Gravenhorst, Group Chief Executive Officer

Thank you, Nick, and good morning, everyone. Please turn to slide five. With regards to our operating performance, total revenue growth in Q2 was 2%; organic growth was plus 1%, which, as we anticipated, was below the 2.6 seen in Q1. We did face some challenges in the quarter and also saw lower demand for non-portfolio services, following several quarters of positive non-portfolio growth. That said ,we saw good growth in a number of markets, most notably in the US, in Turkey and in Singapore.

Second quarter operating margin for continuing operation was stable year-on-year at 5.4% with operating profit slightly up at 1.079 billion. Our cash conversion was 92%, below the level of recent quarters, but still within our guidance. Net profit adjusted fell to DKK510 million, being negatively impacted by a 181 million write-off net of tax of an asset held for sale. Our leverage at the quarter-end was at 2.8 times, above the 2.5 times a year ago, principally due to the acquisitions -- the acquisition of Guckenheimer.

In terms of commercial development, growth in -- within facility -- Integrated Facility Services was 4% in the first half after 6% growth in Q1. During the second quarter, we faced the annualization of a number of important 2016 contract startups or expansions, notably Novartis, PostNord, Norwegian Armed Forces, Rolls-Royce and Pittsburgh Airport.

Bloomberg Transcript

Major new contract launches or expansions within Q2 were somewhat more limited, principally Shire, which started a gradual rollout in June.

Moreover, we saw a negative year-on-year growth in non-portfolio services within the quarter, many of which are tied to IFS contracts. This development is driven by a mix of timing, tough comps, and some instances of customers deferring decisions on spend.

Within Global Corporate Clients, local currency revenue growth remained strong at 10%, which is of course very satisfying. During the quarter, we learned from DXC Technology and HP Inc that they've chosen alternative partners to lead their FM services delivery, and as such, we will see reduction in the scope of our services starting respectively from Q4 2017 and Q1 2018. This is clearly disappointing and I will comment further later on in the presentation on this.

On a positive note, I'm pleased to announce a string of important new contracts and contract expansions with the National Westminster Bank, ABB, Huawei, BHP Billiton and the South Warwickshire NHS Foundation Trust. I will also provide some background to these developments a little bit later. I'm also very pleased that we yesterday confirmed a five-year expansion or extension of the -- of our global agreement with Barclays out to 2022.

Execution of our strategic initiatives is ongoing with an expanded rollout of GREAT in 2017, progressing according to plan. We've taken the decision to exit Argentina and Uruguay. As you know, we constantly review our portfolio to ensure we are allocating capital and resource efficiently and we have already exited a number of countries in recent years.

Neither of these two countries is sufficiently important for our key account customers, and Argentina has always been a challenging marketplace. Given each country is a discrete cash generating unit and their combined materiality, they account for about 0.6% of our 2016 group revenue, we've chosen to treat them as discontinued items. Our disclosure in Note 9 of today's report offers full transparency. Finally I'm pleased to say that the early integration steps of our three acquisitions this year, Guckenheimer, Evantec and Signal are all progressing well.

So Q2 was a more challenging quarter with a number of moving parts that we will explain over the coming slides. However, at the outset, I would like to stress that this is one quarter. While we're not entirely satisfied with the result and are clearly focused on improving the performance, we are confident that we will do so and remain confident in our capabilities and our positioning. Our pipeline is strong and we are positive on the prospects ahead.

Please turn to slide seven. Organic growth in Continental Europe was 1% versus 4% in Q1. Turkey, Switzerland and the Netherlands were key contributors, partly offset by France and Spain. In addition, we continued the deliberate reduction of our public sector exposure within Eastern Europe and Greece, reflecting our strict focus on both profitability and payment terms.

The sequential slowdown from Q1 was mainly driven by lower non-portfolio demand, most notably in Germany, which was supported by exceptionally large projects in Q1 as well as the annualization of Novartis where we saw a significant expansion of services across Europe in the first half of 2016.

The pipeline in the Continental Europe remains encouraging. Operating margin improved by 0.7 percentage points, driven mainly by a negotiated reduction in our pension obligation. In addition, the Netherlands continues to see benefits from GREAT implementation and improvements were partly offset by Israel as a result of lower activity.

In Northern Europe, organic growth was 1% versus 2% in Q2. The total revenue growth was minus 6%, heavily impacted by FX moves and divestments, principally the security services business in Finland. Organic growth was supported by a strong performance within business services and IT and industrial manufacturing segment in the UK and Ireland as well as contract launches in Norway and Denmark. This was partly offset by contract losses and downscaling in Sweden.

The slowdown in growth versus Q1 reflects the timing of contract launches, especially the annualization of PostNord and the Norwegian Armed Forces. In addition, we saw lower non-portfolio demand as well as ongoing challenges in Sweden.

The 0.5 year-on-year reduction in North European margin was driven by a strong performance in all countries across the region, offset by operational challenge in Sweden and the FX impact, notably the depreciation of the pound versus Danish krone.

Specifically in Sweden, year-on-year performance has been impacted by a few things; the first, underlying operational challenges within our cleaning division and healthcare division creating some revenue and margin pressure, but also a reduction in high-margin project work within the nuclear segment compared to 2016. These services are typically delivered in the summer and only every second year, and they were delivered in 2016, and thereby not this year; one-off costs also included in this quarter included some fair value adjustments, investments in building up our technical service capabilities in Sweden.

So I mentioned, in Q1, we established a region-wide cleaning excellence team to ensure the best practices and cost efficiencies are adopted in Sweden, to improve our overall competitiveness, regain market share and restore margins. For the rest of Northern Europe, we've seen a year-to-date margin increases in Denmark and Norway as a result of ongoing operational efficiency linked to GREAT, and also the UK albeit offset by the FX moves that I just highlighted.

Please turn to page -- slide eight. Q2 organic growth in Asia-Pacific was 0 versus minus 1% in Q1. As expected, organic growth continues to be under pressure in Q2 as a result of the three major contract losses in Australia during 2016. This negative impact started to annualize in Q2; Royal North Shore was lost in April 2016, and will annualize fully over Q3 and Q4. Outside these three contract losses, Australia is performing very well, something that I will return to later.

Organic growth in Asia excluding China remained strong, driven by growth in Singapore, India and Indonesia. Over the last few quarters, as we have discussed, we've seen negative organic growth in China as we make structural adjustments to our operating model. We are reducing exposure to certain customer segments that are more price driven and strengthening our efforts with multinational customers where our broader value proposition is more suited. We are starting to see the benefit of our strategic choices, evidenced by our new contract with ABB, which will help restore China to positive organic growth during the year.

The operating margin increased by 0.2 percentage points to 7.1%. The improvement was mainly driven by strong performances in Singapore, India and Hong Kong, supported by operational efficiencies, contract outperformance and cost savings, partly offset by margin decreases in Thailand and China.

Organic growth in the Americas was 1% versus 4% in Q1. Organic growth was mainly driven by contract startups within the IFS division and Guckenheimer in the US together with stronger demand for non-portfolio services in Mexico and solid growth in Chile. The sequential slowdown in growth versus Q1 was driven by lower portfolio demand and the timing of contract launches in the US, including the annualization of Rolls-Royce, which was launched in Q2 2016.

As expected, Brazil remains a challenge. Consistent with our prior communication, organic growth in Brazil remains materially negative, reflecting our decision to downsize the business and refocus on key accounts. Whilst the situation is expected to improve towards the end of the year, Brazil remains a headwind to overall organic growth throughout 2017. However, the steps we deemed necessary to refocus our business Brazil are now largely complete and the operation has stabilized.

The Americas operating margin declined by 0.5 percentage points from Q2 2016, largely driven by the US. This reflects the impact of significant new contract launches where margins are typically lower in the early months. We also made some structural investments in the business to position us for future growth. Finally, we've seen some challenges within our specialized services segment.

And with this, I would like to hand over to Pierre-Francois.

Pierre-Francois Riolacci, Group Chief Financial Officer

Thank you, Jeff, and good morning all of you. We move to slide 10 please, and just start with the organic growth. So our Q2 revenues were up 2% to DKK20.1 billion during this quarter. We had some tailwind from the net divestment, acquisition impact of plus 1%, and this is of course the impact of the first consolidation of Guckenheimer from the end of April.

We -- for the full year, we expect this revenue growth on the back half of this net divestment, acquisition to be a positive 1%, again, on the date of the transaction, which has been completed at the end of July. The net currency impact was negative during the second quarter by 0.8%. Actually it was quite negative coming from the UK and Turkey, but it was offset by some positives coming from the US, Brazil, Australia and some Asian countries.

For the full year now, based on the fallout, we expect a negative contribution from ForEx of about minus 2%, which reversed [ph] with this 1% organic growth in the second quarter, which definitely reflects some weaknesses that Jeff alluded to on Brazil, Australia, Sweden and China that we had already actually flagged, but it also reflects year-on-year growth in non-portfolio services, which is definitely down actually negative, as Jeff mentioned it. We stated earlier in May that we saw second quarter as the organic growth low point for the year and we keep that assessment, which means that we see organic growth picking up gently from Q3.

Now if we want to dig in page 11, and the organic growth drivers, we need first to make a few adjustments, and I would try to take you through. First, we need to strip out the discontinued operation, Argentina and Uruguay, from the reported Q2 2016 revenues, which are on the left of the graph. That's minus 117 million that we take out.

Then we show the impact on last year's revenues if calculated at today's ForEx, right, and we make also the usual adjustment on the acquisitions and divestments. One is a negative 155; the other one is a positive 270, which give us an adjusted Q2 base of revenue of DKK19.9 billion, as you can see on the graph, and that's what we can compare like-for-like.

Based on that, you see the impact of these Australian contract losses that we had already flagged, which is minus 0.7% of organic growth this quarter, which is a bit smaller than Q1, and it will be even smaller in Q2 and negligible in Q4. We had this Swedish operation, which has been suffering from some contract losses, as Jeff alluded to, and some timing issues, minus 0.4% of organic growth.

Then we have the negative impact of us downsizing our Brazilian operations, which is ongoing and in the same category, you can also add us trimming our China single service contract portfolio, which is accelerating the shift to the IFS business in this country. Taken together, Brazil and China, that's a negative of minus 0.8% organic growth.

And then the non-portfolio weakness is quite obvious, minus 0.4%. And of course, it's a bit different on what we had seen in the previous quarter where the non-portfolio was actually a growth driver. Now it turned to be negative in Q2. The rest of our business is delivering a 3.3% organic growth.

Please turn to slide 12 to catch on operating margin. You are used to that last words (inaudible) operating margin presentation. The numbers have been restated for discontinued items, but only from the fourth quarter of 2016 onwards. For the full year 2016, the restated margin is 5.78%, which compares to 5.77%, so very small adjustment.

When you look at the graph, it's clear that our operating margin performance is more or less stable over the last two quarters, and let's try to get a bit closer to that and move to the slide number 13. So same approach then for the revenues, but of course, talking about our margin, we prefer to be on a longer period to avoid the cutoff impact between quarters. So we look at it from a first half perspective.

So the margin that was released last year was 4.91%, which is a DKK19 million of operating profit before the items. The adjustment for Argentina, Uruguay is minimal. So the margin isn't changed. You can see the numbers on the graph. We have again the adjustment on the ForEx and the net acquisition and divestments, which is respectively minus 30 million and minus 10 million, which have actually an impact on our margin of negative of 10 basis points on the first half, which was more or less consistent with what we had also in the first quarter. So if we want to compare like-for-like, from an operating perspective, it's 4.81, which is the adjusted basis for 2016 first half.

So then you have the impact that we had in the different regions, and I think that Jeff already mentioned as a key trend; the strong profit improvement in continental Europe for more than DKK120 million. It does include a positive impact from the net pension gain that Jeff mentioned and you would see in our notes to financial statement that we are talking about an amount of a bit more than DKK60 million. We have a lower contribution from Northern Europe, minus 37 million, which is reflecting the difficulties that we had in our Swedish operation, operational challenges, also some one-off items. I would like to highlight again that the margins in all other countries in Northern Europe were actually improving in the first half of the year.

We had a strong profit delivery in Asia-Pacific with plus DKK49 million year-on-year, which is a very good number, a reduction in operating profit from the Americas, which is driven by this North America business where we had this startup costs associated with the big new IFS contracts, which are ramping up, some switch-over investment in the business, but also underperformance in our specialized services businesses as well as the marginal one-off items that hit again America.

The increase in corporate cost, which is the final step of the bridge, reflects our higher investment in technology and especially the spending which is related to the IBM partnership as well our investment in our regional leadership teams, which is in line with our new GREAT organization, which is delivering efficiency at the country level.

Just to help you through in assessing our operating performance, in the first half of 2017, the net impact of the one-off items in our operating profit, including the 60 million pension gain, the net impact is about positive 20 million to 30 million, 20 million to 30 million, and we have, again, the 60 [ph] some negatives, which are either labor-related, prior year claims that were settled during the first half, some of them were reserved in the previous year, some of them were not, but for the P&L, of course. I'm talking here only about the P&L. We have some labor one-off charges and we have also some assets valuation which are obviously non-cash. So again, for the first half '17, net impact of the one-off, positive 20 million to 30 million.

So if we adjust for ForEx and the net impact of the acquisition and divestments, you can see that our H1 2017 operating margin has improved from 4.81 to 4.95. That is a plus 14 basis points with the net positive one-off of about 6, 7 bps, which means that a bit more than half of the improvement is actually on the back of the business performance.

That's it for the operating profit. I suggest that we move to slide 14 to look a bit further down in the P&L. Of course, the important event in the second quarter is the fair value adjustment that we had in a business classified as held for sale in Northern Europe for DKK212 million. We are now confident that we can diversify that in this valuation range that we have now in the balance sheet and it would be done in the next quarter. This non-cash write-off was partly offset by gains on the divestment of our assets, Iceland and also the Swedish real estate administration services businesses, which were completed during the second quarter.

We had significant restructuring costs during the quarter, 63 million, which means that year-to-date, we have DKK107 million of restructuring, which is a bit higher than usual. Half of it is on the back of GREAT and we are pleased to tell that on these countries where we have been investing and we are investing in restructuring, we see pickup in margins. So it is paying off and also a big chunk of this restructuring in the quarter was still dedicated to Brazil and would stay for again a few months.

We had also, in the other income and expense, a 17 million charge of -- related to acquisition and integration cost, of course, related to Guckenheimer and Evantec. By the way, we are pleased with the first month of integration of Guckenheimer, but also the margin uplift that we have seen during the second quarter in Evantec, as expected, it's good to see that it's coming on time.

On the financial income and expenses, we see a year-on-year deterioration of DKK24 million. The main point is that we had less ForEx gains that we had last year and also we do recognize we have a higher average net debt, which is linked to Guckenheimer kicking in. So we have a slight increase in our interest charge.

Tax wise, you can see that the H1 effective tax rate is 25.5%. It is of course a bit supported by the non-taxable gain on divestments, but we see the effective tax rate for the full year at 25.5 with a run rate, which is probably slightly higher, maybe around 26%, but still a run rate for tax, which is quite lower than last year, and I must say a bit better than what we expected earlier this year, and this is on the back of course of improved efficiency of our tax structure.

The net profit is 554 million in the second quarter. It is impacted by this write-down. The net of tax impact of the write-down is DKK181 million. One point I would like to mention here is that we will not take the discontinued operations' net income into the base of our calculation for the dividend payout, which is based, as you know, in the adjusted net profit. And I would like also to mention that we have flexibility in our payout around 50%, and we will not allow a write-down like the one we had on the available for sale, which is a non-cash item, to trigger a decrease in our absolute dividend level, just for the sake of clarity.

About the discontinued operation, which are related to Argentina and Uruguay, I think that Jeff explained why we had this treatment. I would like to point to the net loss in the second quarter of DKK57 million. Let's say that two-third of it is actually linked to exit cost and restructuring cost, mainly labor cost, that's -- and the other third is linked to fair value adjustment given now it is an available for sale. You will have full disclosure in the Note 9 to the financial statement.

We move now to page 15 and the cash flow statement. Again, on the cash flow, we prefer to comment on the first half, then on the quarter to avoid the cutoff between the quarters. And another point I want to make is that the cash flow statement is not adjusted for discontinued operation, as you know.

I think that the first point that we -- I would like to draw your attention on is the separator at the top of the page, which is -- which reflect the cash generated by operation, which is DKK2.2 billion, 2,174 million for H1 2017, which is down DKK19 million compared to last year. The discrepancy that you see between the variation of the operating profit, which is plus 47, and the negative variation of this separator, is linked to the one of I pointed out earlier that we had positive one-offs which are in the P&L, but these positive one-offs like the net pension gain are non-cash.

There will be cash in the future, of course, because they will translate into reduced contribution to the pension scheme later, but today they are non-cash. Where part of the one-offs that we had were actually impacting the cash flow and that's why you had that discrepancy between the improvement of the operating profit and a slight decrease of this cash -- part of the operating point.

The working capital variation is for the first half minus 1.8 billion. It is actually a cash outflow, which is higher than in H1 last year by about DKK250 million. It reflects a cash conversion at the end of June '17, which is at 92%, definitely lower than what we have seen over the last two quarter. It does reflect some timing issues on payments. The DSO is up by one day to 47 days, not a trend. It is a quarter only, but it's clear that it is lower than what we have been used to deliver even if we guide, as you know, on being above 90%. Still we expect to be higher in the remainder of the year. As I just commented, it's not a trend.

The other expenses paid are minus DKK157 million in this first half directly linked to the increase in restructuring that I already commented to, and of course, the integration costs, which were linked to Guckenheimer and Evantec. The net interest paid is minus DKK188 million. It does include January coupons that we paid on the 2021 five-year bond and of course this one timer will not impact the cash interest that we paid in H2.

The income taxes cash out is DKK477 million. It's slightly up compared to last year. There is a lot of timing issues. It could depend when we pay our tax and also when we collect some tax credit, we get the actual refunds. So there are some seasonal moves. We expect that, as we discussed already, that the cash tax rate this year would be slightly up compared to last year, but still slightly below the effective tax rate that we have reduced to 25.5.

As a result, the cash flow from operating activities is negative DKK421 million in H1, definitely lower than last year. On the cash flow from investing activities, it is strongly negative, 1,869 million. This is actually reflecting mainly the acquisition of Guckenheimer. We have a 1.7 billion of acquisition, mainly Guckenheimer.

We have also some capital expenditures, which are a bit higher. They are for -- they account for 1.1% of the revenue in H1 2017, up compared to last year, which was 0.9%, but in line with our expectation to be in the bandwidth of 1% to 1.3% for the year. It reflects, again, the investment that we do on -- especially on the IT part.

The cash outflow on the financing activities is of course reflecting the payment of our ordinary dividend in April, and it's been offset by the drawings on the credit facility. So the free cash flow is negative 865 million, reflecting the variation of the operating cash flow and also the higher CapEx that I just mentioned.

Page 16 is not bringing a lot more, but it is the LTM presentation. Of course, the comments that I just shared on the H1 are also reflecting in that part and gives a good idea of our conversion in free cash flow of our operating profit. No further comment on that.

I suggest we go to page 17 to look at the capital allocation. We have generated a free cash of 2.3 billion over the last 12 months. We have invested 1.4 billion in M&A, which is reflecting the acquisition, but of course net of the proceeds we got from our divestments. We have sent back 2.1 billion to our shareholders through ordinary and extraordinary dividends, and then to bridge to the net debt, we have to take in account a finance lease adjustment that we had in Q4 last year, which is mainly related to the contractual arrangement with IBM as well as a DKK170 million of other non-cash effect including of course the ForEx and we end up with a net debt increase of 1.6 billion, which is by the way the amount of the acquisition of Guckenheimer, to a net debt -- total net debt at June end of 14.7 billion.

Page 18, you can see that our leverage is increasing at 2.8 at the end of the second quarter, which is reflecting this increase of the net debt on the back of the acquisition of Guckenheimer. We of course stick to our leverage target of being below 2.5, which means that the near-term focus would be on the debt reduction until that objective has been met and taking of course in account our usual cash flow seasonality, therefore no chance to a balance sheet or capital allocation priority.

I think we are done with the finance part and I hand it back to Jeff.

Jeff Gravenhorst, Group Chief Executive Officer

Thank you, Pierre. If I can draw your attention to slide 20, I wanted to give you an update on our global corporate clients contract renewal pipeline. As we've stated before, we started 2017 with two global corporate clients contracts that were due to expire at the end of this year. The most significant of these was Barclays where we now extended out global agreement until 2022. We are currently in dialogue with the other customer and will update you in due course.

In 2018, we have a further four contracts that were due to expire. However, these include DXC Technology and HP Inc., both of whom have chosen to revoke early termination option, and disappointingly, have chosen a new lead partner for their global FM services. The transition of these services at DXC is now expected to commence on the 1st of October, although there are some uncertainty over the spend -- the speed, sorry, at which this transition will take place.

At HP Inc., we expect the transition to start on the 1st of February 2018, but with a staggered regional approach over several months beginning with North America, then Asia-Pacific, and finally EMEA. And in both of these cases, we are still negotiating and hope to retain the delivery of certain services, but that also remains unclear.

These are really unusual circumstances, given the level of structural changes within the original HP contract, HP business, which has led to a change in the customers' short-term priorities. We provide a retail revenue split for the first quarter of 2017 for DXC and HP Inc. in an appendix to these slides to help your modeling.

Our contract with HP Enterprise is ongoing and is currently due to expire in December 2018. There is one other global corporate client where our current contract is due to expire next year, but where we have exclusive dialogue regarding an extension. And we have a further three contracts due to expire in 2019.

Please turn to slide 21. I am very pleased to be able to announce five new expanded contracts. We've been delivering cleaning services since 2003 to a growing proportion of the NatWest and RBS UK real estate portfolio. Our relationship with the customer is excellent, evidenced by the fact that they invited us on an exclusive basis to make a proposal to deliver nationwide technical services.

We will start delivering planned preventative maintenance and reactive maintenance from November across some 2,000 properties in the UK. This is a three-year deal, but we still have potential to win additional services in due course. This is a great example of expanding our geographical-- geographic and service footprint within the UK. Moreover, it is a clear vindication of our technical service credential and a further payback on our 2015 acquisition of GS Hall.

ABB is a great example of the opportunities we face in Asia. The decision to reposition our Asian business, most notably in China, is driven by the IFS strategy and our choices around customers and services. We have explained to you our desire to focus more on multinational customers where factors other than price, namely our value, our focus on quality, transparency, end user experience, and strict compliance play an important part in the outsourcing decision. Moreover, our self-delivery potential across the region gives us a real competitive edge. In the short term, however, we have made -- we've had to make some tough choices, choosing to walk away from certain local customers where we do not see an ability to sustain an appropriate term.

We've also seen a trend towards pan--regional deals and have subsequently invested in our commercial and operational capabilities region wise. This five-year IFS contract with ABB is an early vindication of our choices. It will provide a material boost to our revenue, especially in China and India, and represent a clear upgrade on the quality of our earnings in the region.

Earlier this year, I was able to tell you about our relationship with Huawei as they've expanded into Europe. We're currently working with Huawei in nine European countries and expect to deliver services in additional eight countries in the coming quarters. Today, I'm pleased to tell you we've also started delivering services in Mexico with potential to expand further in Latin America.

We're not the only international services partner delivering to Huawei. So the competition will be tough. However, the future growth potential with this customer is sizable, particularly in China, and we are pleased with the evolution of our relationship so far.

We also had to make some tough choices in Australia where our revenue has come under pressure, following the three major contract losses in 2016. Two of these contracts were lost in a highly competitive bidding process. We were prepared to be commercial, but knew the level at which we felt we could make an appropriate return.

We are disciplined, so much done [ph]. We've secured IFS work on four new remote site camps in Australia, including two with BHP Billiton in Western Australia, which we announced today. Our retention rate in 2017 is set to end in the high 90s. We knew we had a great team and a great offering and are now well placed to return to growth in Australia.

Finally, we today announced a five-year IFS contract with South Warwickshire NHS Foundation Trust starting in November. This is a former client of IFS who left us in 2017 on good terms, but in a process that was largely driven by price. We're delighted to be renewing our relationship with the Trust, especially as only 25% of the decision criteria this time was based on price. The remaining 75% was based on quality of solution, management capabilities, business risk and the environment, a real testament to the strength and credential of our UK healthcare offerings.

These are five excellent examples how and why our strategy is working. Short-term bumps on the road are not in any way undermining our confidence in our competitive positioning in the industry and the significant growth opportunities for growth.

Please turn to slide 23. So on the back of the lower organic growth seen in Q2, combined with our latest expectation for the remainder of 2017, we've narrowed our organic growth outlook from 1.5% to 3.5% to 1.5% to 2.5%, or put simply, our guidance now sits in the lower half of our original range. Much of our business has performed well in the first half in Europe, Asia and North America. However, as discussed this morning, we have one or two challenges.

So what has changed since we set the first of our 2017 outlook back in February? Well, first, the revenue performance in Sweden and China is somewhat weaker than we expected; second, our non-portfolio revenue is weaker, and we are conscious -- we are cautious on the demand here for the rest of the year, and we now expect to see negative revenue impact from the loss of services with DXC Technology from 1st of October, albeit at a very uncertain level. The rest of our outlook comments are unchanged, namely an operating margin that is above the 5.78 realized in 2016, restated for reclassification of discontinued operations; cash conversion above 90%.

So in isolation, a disappointing quarter. However, it's one quarter. We see Q2 as the low point for organic growth in '17, we take great encouragement from the contract announcements just made and our pipeline remains very healthy.

We are confident that we will swiftly address the major challenges and deliver further value for our shareholders.

So with that, I would like to open up for Q&A.

Questions And Answers

Operator

Thank you. (Operator Instructions) And we have our first question from the line of Bilal Aziz from UBS. Please go ahead. Your line is now open.

Bilal Aziz, Analyst

Good morning, everyone. Just three quick questions from me please. Firstly, just on the IFS business, clearly growth slowed again to 4%. Appreciate it's off a very tough comp, but twice has that business been impacted by the lower non-portfolio work versus just a lack of new wins. And how should we think about that as we go through the remainder of the year?

Secondly, on the UK, can you comment on the performance of that business? Clearly, you've mentioned some pullback in the non-portfolio work, but how much of that was actually centered in the UK? Have you seen some financial institutions pulling back spend there as well?

And thirdly, just more on the bigger picture, can you just talk a bit about the pipeline for larger contracts? Clearly you did the Guckenheimer acquisition and there could be some revenue synergies from that angle. Have you seen any discussions there or elsewhere in terms of the large GCC client base? Thank you.

Jeff Gravenhorst, Group Chief Executive Officer

Yeah. Thank you very much. When we look at the second quarter, the growth in the IFS was low. If we look at it on the global corporate clients point, second quarter was 10%, and with the global corporate clients overall, we also had a 10% growth in our non-portfolio. So that's sort of following on the back of last year.

The non-portfolio growth in IFS in general has been lower in this quarter. It's not a trend. It is simply a matter of how much we had last year. So just to give you a couple of examples, we have a very large manufacturer, and car manufacturing client in Germany where we had some big refurbishments going on last year in Q2. That of course is not done this year. It does not mean that we won't pick it up if it happens -- when it happens again. It just doesn't come back in Q2 this year. We've expanded the relationship with this client. So definitely it's just a matter of timing.

The same thing go, if you look at, as I said, with the nuclear sector in Sweden, last year, we had the refurbishments going on in the big plants. That only comes every second year. So again, that is a timing of what happens between quarters. So yes, it is slower growth in IFS and is impacted by -- in general, by the non-portfolio growth, but it's not a trend. It is simply just quarter-over-quarter.

The other point that is of course impacting the growth in IFS overall is the annualization of the one, the mining sector. So we still have the contract losses in Australia, we still have the impact from that in the second quarter albeit RBS was starting to pan out and this one was slowdown. But we also have the impact of all the large startups we had last year in the second quarter. So that includes of course the Novartis startup, the Norwegian Armed Forces and PostNord. So it is, as I say, really just a matter of timing.

Shire, on the other hand, just started in Q2 and will of course ramp up in Q3, Q4, as will all the new contracts I just mentioned, so the ABB, the BHP Billiton, the South Warwickshire NHS Trust in the UK will also come in second half. So again, we still see a very good potential within IFS, and with a stronger growth in IFS than the rest of the business.

On the UK non-portfolio, I think we've just got a -- overall, UK is doing pretty well. As I say, we've expanded the business with the NatWest Bank and -- or RBS Bank. Also as an example on top these, the hospitals, schools contracts are going well, but in general, of course, we have a big sector within the banking industry and here within the banking clients, we can see a drop in the non-portfolio work this year, and I think this is more related to some sort of sitting a little bit on the fence on decision on where is this going to go.

We have heard the banks announcing where they're going to move their -- a lot of their work places, to Dublin, to Frankfurt, to Munchen, but nothing has really happened yet, and I think everybody is waiting for Brexit to sort of come through on that. So there is a little bit of drop in the non-portfolio in that sector. Having said that, we still have seen good pickup in other parts of the business.

Overall pipeline on larger contracts, very strong. I think it's as strong as ever, and there is good momentum in the business both from a global client perspective, but certainly also by country. So particularly, I will highlight that we've seen some very good growth in the continental Europe on some of our tax [ph] countries, and also maybe -- and also we have good synergies that we asked for from the Guckenheimer acquisition. We've already seen some cross-selling of services, and of course, there are still many opportunities to cross-sell both ways, but also to gain new clients in the North American market.

Bilal Aziz, Analyst

Brilliant. Thank you.

Operator

The next question comes from the line of Srini Sarikonda from HSBC. Please go ahead. Your line is now open.

Srinivasa Raju Sarikonda, Analyst

Hi, this is Srini from HSBC. A couple of questions from me please. On guidance, you have cut your revenue guidance range and you said that the growth from high margin non-portfolio business is coming down, but your margin guidance remains same. What factors do you think will help in offsetting the above headwinds?

Jeff Gravenhorst, Group Chief Executive Officer

Yeah. Clearly there is a couple of things in this, which goes the wrong way. You can argue that the non-portfolio usually has higher margins, but also the FX in the UK of course also goes the other way. So because of the UK being high margin, that will also impact our margin negatively.

On the positive side, of course, it's about efficiencies. At this -- we've seen good margin expansions in some of our countries I've just mentioned when we went through the presentation, but it's all about continuing to deliver on utilizing our procurement benefits, utilizing our concept [ph] benefit and improving our efficiencies across the board.

Apart from that, of course, we will also see improvements in some of the areas where we have not performed so well so far this year. So it really is about just improving our performance where it's possible, but also using our capabilities and improving efficiencies.

Srinivasa Raju Sarikonda, Analyst

Okay. On the one-off adjustments you have mentioned, are there any one-offs you expect in H2, which will continue either positively or negatively impacting the margins?

Pierre-Francois Riolacci, Group Chief Financial Officer

Well, usually one-offs are quite difficult to forecast. So we have today no -- not identified special amounts, but we have big operations, and of course, over six months, there may be some positive and negative popping up. That's part of it. We -- as you can imagine, there is quite a string of one-off and we do not bother you with the details of each and every. We try to be very transparent on the overall impact because that's part of our global performance and we need to figure out what is the run rate. But today we do not see a major one anywhere. We'd be, again, be transparent and we are working on the underlying performance and that's why we are transparent, and that's where we try to be.

Srinivasa Raju Sarikonda, Analyst

I understand. One last question, please. Some of your peers have been mentioning that there is a high single-digit wage rate inflection they are seeing particularly in North America. Do you see such similar environment in North America or anywhere else?

Jeff Gravenhorst, Group Chief Executive Officer

We see high inflation in countries and we see that across the board, have always seen that. It depends on the country of course, but we don't see anything that is out of the usual and clearly we will address that in the way we always do it by passing it on to customers and improve our efficiencies and adjust our service scope. That's the only way you can deal with us. This is what we've done for 117 -- 116 years now. So it's no different. Some countries will have high inflation and some would have lower.

Srinivasa Raju Sarikonda, Analyst

I got it. Thank you.

Operator

The next question comes from the line of Paul Checketts from Barclays Capital. Please go ahead. Your line is now open.

Paul Checketts, Analyst

Good morning, everyone. I've got two areas I'd like to ask some questions on, please. The first is around the likely growth on -- of organic growth in the second half. I know this is somewhat hard to predict, but if you looked at the non-portfolio work in the second half, do you think it's a realistic base case that it will be negative as it has been in the quarter?

And then the second element relates to the new work you announced today. I'm sure you won't want to tell us the precise size of the contracts, but is there any way you can elaborate on the collective impact of the contracts and comment on the timing of the ramp-up of the work?

And then the second area is just a longer-term one relating to your use of capital and cash, to your capital and use of cash. If you looked at the portfolio now, we've had another couple of businesses that you're looking to dispose of. If you look at the remaining portfolio, is there much left that you would consider non-core? And on the topic of acquisitions, can you give us an update on what you see as the gaps in the portfolio and the likely size of any deals, please? Thanks.

Jeff Gravenhorst, Group Chief Executive Officer

Yeah. Paul, on the growth side for the second half on the non-portfolio, we -- in the guidance we gave you right now, of course, we expect it to be less of a positive contributor for the second half year than it was last year. So -- and this is of course based on that that we did -- we have seen very good growth on non-portfolio over the last year in the second half.

On the new work, we don't give you the exact details of every contract, as you know, but if you take it sort of from an overall perspective, it's a 1% impact on our above -- on our total growth annually. Then on the capital, Pierre?

Pierre-Francois Riolacci, Group Chief Financial Officer

Yeah. I mean, as you know, we still have a few available for sale assets, which are there in the balance sheet. So you can count that there would be a few hundreds of millions of disposals that will be completed in the next quarter because that's part of us trimming the portfolio. Do you -- should you expect anything bigger? As far as we see, no, definitely. Does that mean that this is the end of it? No, because we carry on scrutinizing our portfolio and we just made a decision about Argentina and Uruguay. I mean, we are -- we want to be agile. We do not want to tie our hands. So there would be a stream. If you look at the last quarter, there has been a few, there will be a few, and you cannot call out that -- you cannot make the assumption that it would stop at the end of what is today in the balance sheet. So we are actively managing the portfolio, but nothing big.

Jeff Gravenhorst, Group Chief Executive Officer

Acquisition gap point of view, clearly we have now closed the gap on food services in the US at least with a nice size organization in California and we've seen some good benefit from that already. We will be looking at particularly technical services, as we said before. So we're still working on that, but that's more across the fleet [ph].

Paul Checketts, Analyst

The assets that you're looking at or could potentially come into play, are they what sort of size? They -- is it, I suppose I'm asking if -- as we move into next year, do we move back towards a situation where the free cash flow potentially comes back to shareholders in some sort of yield or are there assets on the horizon that will mean, like this year that that's where the cash goes to?

Jeff Gravenhorst, Group Chief Executive Officer

It's hard to say. The key point is that, it depends on what asset comes around. I mean, right now it's -- if there is a good opportunity, of course it's our job to look at the opportunity, but for now, we are not looking at whether we -- I would say it a different way, the acquisitions we have bought are in the size of the Guckenheimers of the GS Hall. We will continue to look at whether there are good opportunities and then we'll come back and give you more guidance on that. What we do say is that we are looking for companies and then it depends on what type of asset comes around.

Paul Checketts, Analyst

Thanks.

Operator

The next question comes from the line of Andrew Farnell from Morgan Stanley. Please go ahead. Your line is now open.

Andrew Farnell, Analyst

Okay. Good morning, everyone. Just on slide 20, would you be able to talk about the win rate on rebids for your global accounts and how many global accounts have you got in your pipeline?

Jeff Gravenhorst, Group Chief Executive Officer

The number of contracts in the pipeline, we don't disclose off for many reasons, but it's as healthy as it has been. The win rates on these is -- are typically very -- much higher than they are on the smaller direct business or specialized services business and will typically be between either one out of three or two out of -- or one out of two, and that's very -- it's very binary because you always get into the last two in these events. So that is that kind of level that you will be looking at.

Andrew Farnell, Analyst

Okay. And just on the -- obviously you're not separately talking about them, but in terms of the four that you've got coming up in '18, what is the performance and relationship like with the client?

Jeff Gravenhorst, Group Chief Executive Officer

They are good with all as they also were with HP. So clearly as you've seen right now and over the last many years, we have renewed also HP many times and we still have HP. With HP, it's a little bit of a different scenario where one client is split into three, and then co-living for a while and then they'll break out. So this is a little bit -- they had -- already had some incumbent provider. That is a different situation than it is for the others.

We have very good relationship, very good customer satisfaction scores and -- with all of our corporate clients and we are on exclusive basis, as you can also see here, already in negotiation with one for next year. So I'm very confident with them all. Of course, the testimony is the large part we have renewed.

Andrew Farnell, Analyst

Okay, thanks. And then just on the IFS, just a follow-up on that. I mean, the slowdown there, which has been mainly due to comps, can you just talk about whether you're seeing any reluctance on the client side when you're going into purchase of a new business or any difficulties on the client side with IFS?

Jeff Gravenhorst, Group Chief Executive Officer

No. Clearly this is about evidence. So this is still an area where we need to educate the market. There is still a big potential for integrated facilities services. All of the benefits of the self-delivery that is about compliance and ensuring that everybody is vetted and trained in health and safety and procedures onsite, everybody understands and buy into. On top of that, when you can integrate the services between them, then of course it's the same argument. So there is still market out there, which is the many (inaudible) market, but overall, we don't see a decline in our market. We see that the healthy growth continues to be the single service or the agent model.

Andrew Farnell, Analyst

Okay. Fine. Then just one final one on working capital. This I know you said isn't a trend, but it is worse than usual. Are you expecting this to reverse out in 2H?

Pierre-Francois Riolacci, Group Chief Financial Officer

We do expect to improve our performance compared to the end of June. And yes, that's what we have in mind because, again, it's not a trend. However, we cannot commit that we would deliver the sort of cash conversion, 97%, 98% that has been in many quarters, but we believe that there is definitely room for improvement from where we are at the end of June, again, because it was linked to some timing issues.

Andrew Farnell, Analyst

Okay. That's great. Thanks.

Operator

The next question comes the line of Kristian Godiksen from SEB. Please go ahead. Your line is now open.

Kristian Godiksen, Analyst

Yeah. Thank you. A couple of questions from me as well. Firstly, could you potentially give us a sense of the magnitude of the pickup in the organic growth in the second half where I hope you could give some building blocks as you gave on page 11 in your presentation regarding contract annualization, new contract ramping up, and non-portfolio business. That would be very helpful.

Secondly, wondering on the distribution part, coming back to that bit, could you see yourselves paying out extraordinary dividends on the back of the Q3 results despite net debt-to-EBITDA being above the 2.5 times when you have in mind that you have a very strong cash inflow in the fourth quarter? And then thirdly, I was wondering when will we see the fruits of the increased investments in the IBM partnership? Thank you.

Pierre-Francois Riolacci, Group Chief Financial Officer

On the organic growth for H2, I think that you have the H1 numbers and you have our narrowed guidance. So it gives you a hint of where we could be in H2. I think that what is definitely a tailwind is the annualization of the losses in Australia. So that's pretty easy to model. On the other hand, we have an amount of revenues that will be lost on DXC in Q4, but today it is difficult for us to know exactly what it would be, given we don't know exactly the timing and what could be possibly retained. So there is uncertainty in there.

The other tailwind will be definitely the startup of these new contracts that we have mentioned. Some of them are already there and they are ramping up like Shire. Some of they are brand-new and they are starting up. So indeed, there, there is uncertainty in the timing. And the last point is, of course, the non-portfolio revenues. Again, it was a positive contribution in Q1 plus 0.6; negative Q2, minus 0.4. That's difficult to be more precise on that, but I think that you know where are our main uncertainties and I think you can figure out where we are. Brazil, the downsizing will continue; same in China, maybe not in the same magnitude, but you can work it out.

Kristian Godiksen, Analyst

Okay.

Jeff Gravenhorst, Group Chief Executive Officer

IBM question, clearly we've invested into this smart building approach together with IBM on three different levels, which we went through in detail last time. We've now gone through the development and testing phase and that's coming to an end here in Q -- in the second half, and we are starting -- we expect to roll this out from the end of this year, beginning of next year. It's already part of some of our GCC, must be -- will be rolled out with those coming -- in the next few months. So clearly we will see the bigger benefits from next year and onwards.

Kristian Godiksen, Analyst

Okay. Thanks. And on the distribution part, and then just one final -- or just a follow-up, sorry, on the organic growth part. I guess I had expected at least that the organic growth should accelerate in Q3 and then further into Q4, but I guess now with the loss of DXC in Q4 and with the winding off of contracts in LatAm, is -- I guess it's not that obvious anymore. How do you look upon that?

Pierre-Francois Riolacci, Group Chief Financial Officer

As I mentioned, we expect Q3 to gently pick up from Q2, and I think also in Q4. We have shared what are the key uncertainties. It's a bit too early to say, but definitely we see Q4 stronger than Q2.

Kristian Godiksen, Analyst

Okay. And on the distribution part?

Jeff Gravenhorst, Group Chief Executive Officer

Distribution.

Pierre-Francois Riolacci, Group Chief Financial Officer

Oh, distribution. Well, we will make our decision public when releasing the Q3 numbers. I think that we have been very clear on our capital allocation priorities and our policy is unchanged. I think also that I've been very clear that we want to stick to our 2.5 policy, which doesn't mean of course that we can be out for a few quarters, but today, our focus is to get back to this level and that's the journey that we are in.

Kristian Godiksen, Analyst

Okay. Thank you.

Operator

The next question comes from the line of Sylvia Barker from Deutsche Bank. Please go ahead, Your line is now open.

Sylvia Barker, Analyst

Yes. Good morning. Sylvia from Deutsche Bank. A couple of questions please. So first of all on renewals, can you just talk us through kind of what you're seeing on renewals now? So Barclays, for example, I don't know if you can kind of mention specifically, but what are you actually working towards or is that keep the revenue roughly the same, try and offer more or with some these big clients, do you have any potential to actually offer more services? So kind of what should we expect happens to the revenue line and then margins on a number of kind of product -- service lines provided?

Then secondly, relating to DXC and HP Inc., so looking out to 2018, should we assume that 2% is roughly what -- is prudent to kind of take out -- take out for that, or has that changed in anyway? And then finally, just on the non-portfolio work, so it sounds like that was obviously spread across the board, but you did have at least one big customer. What was the kind of -- through 2016 and into '17, kind of what was the ramp-up of that particular project? Thank you.

Jeff Gravenhorst, Group Chief Executive Officer

Yeah. If we just take it from renewals, clearly with Barclays, we can be -- it's very specific, we've just come out with that, it's an extension of the existing contract. There we already have a very high penetration of our services. So we have a very broad service line delivered. So -- but we will always be looking for supporting with even more services, but in the -- contract as it stands is pretty much the same as what we have today, but of course what we have seen over the last years is that we keep expanding the relationship and getting more and more services on, which we expect to do with all of our clients. So to me, it is always renewals and trying to expand the scope, although expand the scope in -- while we have the contract.

On the -- second question was on DXC and HP impact -- HP Inc. impact of the 2%. It is very, very hard to say because clearly they have other partners from an overall perspective. These partners don't have the breadth in self-delivery as we have, and that's why there is a potential for us to keep some of the service lines in there, and delivering the services to them. And how much of that will happen, we don't know. Clearly, this is something that we are in dialogue with and we will give clarity on that when we have it, but right now we can't give you any guidance on that. The total exposure is close to 2% overall, but we are working on retaining some of this.

And the last question was on the impact -- the volume impact in the quarter of the two ramp up. We are not that specific in the guidance here other than I would mention if we could not -- if we did not have an impact on the growth numbers between the two years.

Sylvia Barker, Analyst

Okay. Thank you.

Operator

And our final question for today comes from the line of Michael Rasmussen from ABG Sundal Collier. Please go ahead. Your line is now open.

Michael Vitfell-Rasmussen, Analyst

Thank you so much. Could you discuss a little bit more the Q2 impacts of the 20 million to 30 million that you mentioned in the one-offs? I want to understand the specific drivers and is it rightly understood that the Q2 impact from the pension contribution is a positive 3 basis points and the negative impact from the Guckenheimer is a negative 3 basis points in the second quarter, please?

My second question goes on to the Guckenheimer. I see it's roughly a 4% margin business at the moment. How long do you think it will take to bring that margin up to kind of group levels? And then finally on continental Europe. Is it rightly understood that if we adjust out the possible positive pension obligation, then we are down 10 basis points underlying? And since I'm guessing that you're also still getting quite some interesting benefits from GREAT, does this mean that underlying margins are down even more in continental Europe? Thank you very much.

Pierre-Francois Riolacci, Group Chief Financial Officer

I would start maybe with this margin point. So I think that on -- you can go back to page 13 to get some idea, but this -- there is indeed a positive one-off of 60 million, which show that on the first half of the year, continental Europe is improving excluding this pension item by more than DKK60 million. So I think that it is definitely not under pressure and this is overall a string of countries, which are delivering good performance. So we do not see a specific pressure on that area.

Of course, there are also a few negative one-offs in continental Europe, but they are minimal and the one-offs are more actually geared to Northern Europe, to Americas, and to a lesser extent to APAC. So I think it's a region, which is delivering robust earnings and we do not see any sort of pressure.

On the ForEx and net divestment and acquisition, I think that we've been very transparent on the first half numbers. I mean, we can work out and we can follow up with the quarterly number. We are happy to, but I think that this is very consistent with our view that of course operation wise, the second quarter was more challenging than the first quarter. I hope that you get that feel and that's -- we are not trying to move away from that.

Michael Vitfell-Rasmussen, Analyst

No, but it's just -- when I look at the second quarter numbers, and if I adjust, then you get to operating profits of 418, i.e., a margin of 5.4% in continental Europe and the same number for last year was 5.5%.

Pierre-Francois Riolacci, Group Chief Financial Officer

You are working on the second quarter only, are you?

Michael Vitfell-Rasmussen, Analyst

Yes, yes. Yes. I'm more interested in the second quarter rather than the first half.

Pierre-Francois Riolacci, Group Chief Financial Officer

Well. Okay, I understand that, but again, please, when you look at the margins, we are working our best effort to try to give you a run rate and give you an idea where we are going. I mean, of course on the quarter, we are aware that we may have some cut off here and there. We mentioned some very significant (inaudible) based work in one of our country in continental Europe last year, which was yielding good margin. This is not there. So you may have, of course, from one quarter to the other, a few operating items, but again, we do not see any deterioration in margin in continental Europe in the second quarter. That's not the way we see the run rate.

Michael Vitfell-Rasmussen, Analyst

Okay, great. Thank you very much.

Jeff Gravenhorst, Group Chief Executive Officer

We see a pickup in continental Europe margin. On the Guckenheimer impact, you're quite right that it was around 4%. There is no specific guidance on when it comes in than we did, but we do expect to see the synergies coming through of course during this year, and that means there will be some impact beginning next year and the full sort of up -- ramping up of the margin, we will probably see it in 2019. That's at least the plan.

Michael Vitfell-Rasmussen, Analyst

Thank you, Jeff.

Nicholas Ward, Head of Group Investor Relations

Great. Okay. Thank you everybody for your questions and your interest. Obviously Martin and myself will be around for the rest of the day. So please do give us a call. Otherwise, we wish you well for the rest of today. Thank you.

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