Company Name: ISS A/S
Company Ticker: ISS DC
Date: 2016-08-16
Event Description: Q2 2016 Earnings Call

Market Cap: 48,273.74
Current PX: 260.0
YTD Change($): +11.3
YTD Change(%): +4.544

Bloomberg Estimates - EPS
Current Quarter: 4.255
Current Year: 15.118
Bloomberg Estimates - Sales
Current Quarter: 19743.667
Current Year: 79409.867

Q2 2016 Earnings Call

Company Participants

- Nicholas Richard Ward
- Jeff Olsen Gravenhorst
- Peter Harder Thomsen
- Peter Thomsen

Other Participants

- Paul Checketts
- Emily Roberts
- Michael Vitfell-Rasmussen
- Rory McKenzie
- Jonas Hansen
- Staffan Åberg

MANAGEMENT DISCUSSION SECTION

Nicholas Richard Ward

Ladies and gentlemen, this is Nick Ward, Head of Investor Relations at ISS, and I'd like to welcome you to our Q2 2016 results teleconference. Please be aware that the announcements, the interim report, as well as the slides used for this call can be found on our website. Later today, a replay will be available and we will post the transcripts of the call as soon as it is ready.

I'd like to draw your attention to slide number 2 regarding forward-looking statements. Presenting today will be Group's CEO, Jeff Gravenhorst, and Head of Group Controlling, Peter Thomsen. We've also got Barbara Jensen, our Head of Group Treasury in the room.

We'll open for Q&A at the end of the presentation and with that, I would like to hand over to Jeff.

Jeff Olsen Gravenhorst

Thank you, Nick, and good morning, everyone. Can I please ask you to turn to slide number 5? I'm pleased to say that in the second quarter, we continued our solid start to 2016 and overall, this has basically been a business-as-usual quarter. With regards to our operating performance, organic growth of 3.8% in the second quarter basically in line with what we saw in the first quarter. However, the second quarter revenue were 2% lower year-on-year, FX negatively impacted growth by 5% as the Danish kroner strengthened against the number of currencies, most notably, the British pound. As a reminder, the FX moves only have translational impact and not transactional impact on our accounts.

I'm pleased to say that our margin increased again to 5.4% in Q2 as in Q1. This improvement was made despite a 7 basis points negative impact from net divestments mainly related to the call center CMC in Turkey. Cash conversion remain strong at 97%. Net profit is 4% high year-on-year, DKK 498 million, close to 16% higher than year-to-date last year. Our leverage at the quarter-end was 2.5 times. that's below the 2.9 times leverage 12 months ago. But as expected, above the 2.1 times at the year-end 2015 due to the usual seasonality of our cash flows.

Progress with the integrated facility services remains very positive. Local currency revenue growth was 15% in the second quarter driven once more by new contract startups and contract expansions. Integrated facility services now represents 37% of Group revenue.

Within Global Corporate Clients, local currency revenue growth was 16%, and GCC represented about 11% of second quarter group revenue. We remain pleased with the development of some of our major contract expansions, for example, Danske Bank, Danish State Railways, Novartis and PostNord. We've also crated new or extended ISS contracts with a major logistic company and a number of public institutions in the UK with Skanska and SEB in Sweden with a major international bank in Mexico and Jakarta Airport in Indonesia.

Last month, we announced a major new commercial agreement with IBM which, we believe, will greatly strengthen our IFS capabilities driving even higher service standards for our customer, some potential significant efficiency gains and ultimately, transforming the way buildings are being managed, but I will come back to that a little bit later and give you more details on that.

Organic growth and margin developments remain firmly underpinned by our strategic initiatives, which you are familiar with. Customer segmentation and the associated alignment of our contract organization structure has been implemented or is in the process of being implemented for approximately 70% of our group revenue.

Phase IV of the procurement excellence programs have been initiated and the geographical scope of the program continues to expand. Our business process outsourcing initiatives are being rolled out progressively across new countries, and we now have a 150 full-time equivalent supporting ISS through our BPO partner Cognizant in India.

I'm also pleased to say at least – I'm also delighted that we now have able to announced the appointment of the Pierre-François Riolacci as our new groups Group's Financial Officer Pierre-François joins ISS from Air France-KLM where he's been the CFO since 2013.

He will start early November and will relocate to Copenhagen. Pierre-François has tremendous service industry experience through both his time at Air France and before that from Veolia which is of course a very well-known competitor and colleague within our industry. He is fantastic addition to the company and his appointment further illustrates our ability to recruit top international talent to ISS.

So once again, a solid start to 2016, as always we do face some challenges across the group with macroeconomic risk and uncertainty arguably higher now especially post the Brexit decision. We are mindful that some challenges may intensify over the coming months. However, we have confidence in our business model and our strategy and remain upbeat about the opportunities ahead. As always, we remain highly focused and motivated to deliver.

Please turn to slide 6. Now, let me provide more details on two of our recently expanded customer relationships. PostNord is a long-standing customer of ISS. The business faces ongoing change with the need to optimize delivery networks and refine the property portfolio. This has created an opportunity for us at ISS. PostNord's objectives are to increase the flexibility, responsiveness and efficiency of their FM solution, to centralize control as opposed to site-based decision making, to reduce their retained organization cutting their own in-house FM-related administrative burden by placing their trust in a recognized and capable partner.

Having provided some cleaning and some catering services to PostNord across parts of the Nordic portfolio, ISS will now deliver an Integrated Facility Services solution across all Nordic countries. The buildup of this contract will take time well into 2017 as we help PostNord procure or manage their facility services from a highly dispersed setup into a single solution.

This is a complex process. And when fully implemented, the total contract value could almost triple to approximately SEK 450 million. PostNord chose ISS because we have a strong existing relationship, a high service ethos, and unrivaled pan-Nordic geographical reach.

Moreover, we are able to demonstrate our achievements with other blue chip Nordic clients, for example, Nordea, Danske Bank, and Telenor. Finally, PostNord wanted to benefit from our technology, including INSIGHT@ISS where effective data capture and subsequent analysis and benchmarking allows us to drive intelligent change based on the customer's future needs.

For now, our focus is on the execution. Delivering the transformation required by PostNord and capturing the revenues highlighted. Longer term, the ongoing evolution of PostNord's business could create further opportunities for ISS and our significant additional FM services with the client that we could potentially target.

Norwegian Armed Forces, ISS has already been providing some cleaning services to the Norwegian Armed Forces service but the part of this work was being delivered in-house. Driven by a need to realize higher quality and greater efficiency, the client decided to outsource all cleaning services by tender process for 10 separate regional contracts.

Initially, the Norwegian Armed services did not want a single provider, but as the process develops and our relationship strengthened, it became clear that ISS was the stand-out solution. We won all 10 tenders. The contract is vast, some 1,200 buildings with a footprint of approximately 1 million square meters. This adds significant complexity and as with PostNord, the contract will build up over time as we assume control.

We have a four-year contract with a 3-year extension option. The total contract value over these seven years could be up to NOK 2.1 billion subject to certain additional work orders primarily related to army training exercises. Once again, we managed to significantly expand our existing relationship. We also provide catering services under a separate contract to the Norwegian Armed Forces.

Our geographical reach coupled with an ability to reduce complexity and associated cost persuaded the Norwegian Armed Forces to choose one nationwide partner. This is the largest public sector outsourcing contract in the Norwegian history and gives evidence of our single service and public sector credentials. There are potential midterm opportunities within public services with this client which we will assess over time.

Please turn to slide 8. Within our developed markets, the second quarter organic growth remains stable at 2% and margins improved to 6.2%. In emerging markets, second quarter organic growth softened slightly but remained very strong at 8%, and margins were firm at 6.2%. Emerging market organic growth year-to-date has been 9% with a slight improvement in the margins of 6.2%.

As always, there are some notable variations across certain countries. So let's take a closer look into the individual regional performances. So please turn to slide number 9. Q2 organic growth in Continental Europe was 4% which is in line with the first quarter. During the quarter we saw a strong performance in Belgium. This reflects both local contract success, for example, we secure a large catering contract at an [ph] FMCG (10:45) customer's distribution center in [ph] Antwerp (10:46) as well a growth with some of our large regional customers. For example, an additional site with Novartis. We are pleased with the performance in the Belgium, not at least given the investment we've made through our great restructuring and a sharper focus on key accounts.

In Turkey, as we mentioned in the first quarter, we successfully introduced price increases on the back of a 29% hike in the minimum wage, but we're also seeing underlying volume growth. I will discuss Turkey in a little bit more detail later.

In Israel, we've seen weaker retention and new sales. On the back of some stiff competition in Greece, we are making some further selective contract exits principally within the topic sector as we continue to derisk the business.

In the second quarter, operating margin 5.5% was strong especially given the negative impact from the CMC divestments in Turkey. France had a good quarter. Germany continues to benefit from the great restructuring which we discuss in details at our full year results in March, offsetting this was a weak performance across Eastern Europe where market conditions are currently difficult. In Northern Europe, organic growth improved to 4% in Q2 versus 2% in Q1. The UK had a strong quarter with a startup of a number of contracts in the education sector, a good grow within the financial services. Some of which was project related.

Contract launches continues to drive a strong performance in Denmark, and we also had some recent success in Norway. Finland does remain under pressure with contract downsizing, continuing to impact our result, most notably with one large customer within the technology sector. In Q2, operating margin Northern Europe was broadly stable. The timing of the Easter does have an impact on quarterly margin development, for example in the UK, where we have a significant healthcare business.

We typically build the customers in 12 equal monthly installments throughout the year, however, labor cost tend to influence by the timing of weekends and in particular public holidays. With Easter coming in March this year, as opposed to April last year, our UK margins saw a slight negative impact in Q1 which was then recovered in Q2.

We delivered some cost savings within our Danish property service business, but this was offset to some extent by reduced activity in the Norwegian catering business related to the oil-and-gas sector and also contract startup in Norway.

Please turn to slide 10. In the Asia Pacific region, organic growth is low from 7% in Q1 to 4% in Q2. Across Asia, we continue to deliver double-digit organic growth with notable strength coming from Singapore, Indonesia, India and China. We did see a reduction in non-portfolio services in Singapore versus an exceptionally strong Q1, but overall organic growth in Q2 was still very healthy.

Most of the slow down in growth can be attributed to Australia, reflecting the losses of a large contract within the healthcare sector in April. We also lost a contract within resource segment in July in line with the previous communication. Pressures on the Australian remote site business remain intense evidenced by further recent contract loss which we currently expect in October.

We are growing our business in other sectors, but given the scale of some of these losses, growth in Australia is expected to weaken further in the third quarter. Despite the revenue pressure in Australia, we are seeing improvement in our margins as we drive operational efficiencies across contracts and reduce above unit cost overhead.

The Asia Pacific region has also benefit from efficiency gains in Singapore and India. In Americas, organic growth of 4% is up on the 2% achieved in the first quarter, reflecting a strong development in the U.S. and notably across the Integrated Facility Services division and within the aviation segment. The revenue performance has also been strong in Mexico and wage-driven price increase continue to lift revenues in Argentina.

However, we are seeing further revenue weakness in Brazil. We've initiated a structural adjustment of our business platform across certain business units and we have consciously chosen to exit contracts. There is a restructuring cost to test this process which we anticipate will increase during the second half. The second quarter operating margin for the region was weaker year-on-year at 4.1%. However, this is, in part, due to the timing differences. And for the first half 2016, we see margin developments broadly stable.

On top of the good growth performance in the U.S., we have actually also seen good margin improvement.

With that, I would like to hand over to Peter for an update on the financials.

Peter Harder Thomsen

Thank you, Jeff, and good morning, everyone. Please turn to slide 12. In Q2 2016, our revenue decreased by 2 percentage points. This comprise firstly a negative impact from divestments of 1% and negative impact of 5% from currency and a positive impact of 3.8% from organic growth. Clearly, we have seen some turbulence in the FX markets particularly post the 23rd of June Brexit decision. The main currencies impacting our revenue growth in Q2 were the British pound, Norwegian kroner, Australian dollar, Swiss franc and Turkish lira.

Please turn to slide 13. In Q2 2016 operating margin was 5.4% compared with 5.3% in Q2 2015. This improvement comes despite a negative 7 basis points impact from divestments. We have therefore been able to maintain the steady positive margin developments seen over recent quarters. This development continues to be driven by our strategic initiatives and an improving mix of revenues as our IFS business grows.

Corporate costs in Q2 amounted to 0.8% of revenue, in line with our expectations for the full year. While these costs may vary from quarter-to-quarter due to timing differences, it is clear that our underlying group margin performance is being driven by our countries and regions. If we look at the breakdown of the year-over-year change in LTM operating profit, you can see that the Northern Europe and Asia Pacific regions are the key positive contributors. This profit improvement was driven by positive organic revenue growth and underlying margin improvements. Operating profit in Continental Europe has been negatively impacted by both divestments principally CMC and FX.

On an organic basis, this region has seen a healthy uplift in profitability. Only in the Americas have we seen an organic reduction in profitability as underlying strength in the U.S. was more than offset by difficulties in Latin America, notably Brazil.

Please turn to slide 14. Let me highlight some additional points from our income statement. Firstly, we incurred DKK 60 million of other income and expenses net in Q2, bringing the year-to-date figure to DKK 88 million. The Q2 chart mainly comprises divestment losses and further restructuring projects related to the implementation of project GREAT in Iberia, Finland and Belgium. However, we have also initiated some structural adjustments of our business platform in Brazil as we seek to reduce ongoing risk against a very difficult macro backdrop and to drive margin improvement.

Secondly, our financial income and expenses net of DKK 120 million for the quarter was positively impacted by a DKK 5 million FX gain, principally due to movement in the DKK-euro exchange rate. Thirdly, our effective tax rate was 28% in the quarter, in line with our expectations for the full year. Fourthly, we incurred a DKK 24 million goodwill impairment charge on divesting our activities in Greenland.

Please turn to slide 15. Some additional points for the cash flow statement. As I highlighted on the Q1 call, our depreciation charge has fallen year-on-year, consistent with the reduction in our tangible fixed assets, i.e. property, plant and equipment. Factors behind these include divestments, FX and other mix effects. We've also seen a shift from owned assets, i.e. vehicles to operationally leased assets as a result of our procurement initiatives.

The working capital cash outflows seen in Q2 2016 are somewhat higher than those in Q2 2015. This reflects changes in trade receivables resulting from contract launches, project work and quarterly timing differences. At 97%, our LTM cash conversion remains very strong and entirely consistent with our expectations.

As a reminder, the year-on-year swing and changes in provisions, pensions and similar obligations, reflect a sizable positive impact in Q1 2015 related to the pension obligations assumed with the Vattenfall contract.

Our net interest paid/received varies from quarter to quarter, subject to timing of annual interest payments on our three bonds. These annual interest payments are made either in January or December. Consequently, cash outflows are lower in Q2 and Q3.

H1 2016 cash flow from investing activities is comprised of DKK 295 million from investments in intangible assets and property, plant and equipment net. This equates to 0.8% of group revenue, below our usual run rate, which is principally due to timing differences. Cash flow from investing activities in H1 2015 included the acquisition of GS Hall. Finally, cash flow from financing activities in Q2 2016 included a DKK 1.358 billion ordinary dividend payment made here in April.

Please turn to slide 16. Finally, we have illustrated, again, how our free cash flow has been allocated on an LTM basis. Net financial expenses remains a modest source of cash consumption, thanks to the reduction in our borrowings and the low interest rates and margins we currently face.

We have made no acquisitions in the last 12 months. The most meaningful divestment was CMC in Turkey completed in Q4 2015. On an LTM basis, this analysis now captures the DKK 1.358 million dividend paid in April 2016, which was some 50% higher than prior year. Most of the remaining cash flow has been used to reduce net debt except for the DKK 149 million treasury share repurchase completed in Q1 2016.

Given this cash allocation, our leverage has fallen from 2.9 times at the end of Q2 2015 to 2.5 times at the end of Q1 2016. The increase in leverage from Q4 2015 is consistent with the seasonal working capital outflows and the timing of our annual dividend payment.

There has been no change to our leverage objectives or capital allocation priorities which remain entirely consistent with previous communication. To be clear, we wish to maintain a strong and efficient balance sheet and to strike an optimal balance between reinvesting capital back into the business and returning surplus funds to shareholders.

Our leverage target remains below 2.5 times when taking into account seasonality of our cash flows. Where we see clear opportunities to create value and drive improved organic growth and/or improved margins, we will commit capital to our business. Thereafter, we see healthy potential to return additional funds to shareholders above and beyond our ordinary dividend policy target.

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

Jeff Olsen Gravenhorst

Thank you, Peter. Now, I'd like now just to go a little deeper into some of the business developments, starting on slide 18.

Now, last month, we announced a major new agreement with IBM. In recent quarters, we spent some time illustrating how we use technology to enhance our value proposition to our clients, to improve real-time feasibility and to deliver analysis and benchmarking so as to make informed decisions together with our clients. This agreement with IBM will drive a significant improvement in our capabilities. There are essentially three key elements to the agreement with IBM.

First is an upgrade to our real estate management tool which we call FMS@ISS. As a reminder, this is the system that allows our employees and our customer employees to make and track helpdesk request. It also enables work order management and asset management. This includes locking assets such as [indiscernible] (23:58) systems, sliding, elevators, escalators, fire alarm systems, power generators, et cetera. We then optimize life cycle planning and the scheduling of maintenance in the system.

Moving forward, FMS will be based on IBM's TRIRIGA platform. This is an akin to an engine upgrade. We will benefit from increased capability and flexibility and enhanced end-user interface. TRIRIGA will be rolled out to all existing FMS users, and then we plan to extend the solution to a significant number of new users. We will receive dedicated support throughout from an IBM project management team and acceleration team.

Second, is the launch of an ISS, so the Integrated Facilities Services support tool which we're calling Integration@ISS. The goal here is to increase the benefit we can extract from our integrated self-delivery model, by using technology to enhance workforce optimization. With support from IBM, we will collate and analyze the wealth of data across our customer side. This will include employee skills levels, shift patterns, task, cost variations and others.

Algorithms will optimize the allocation of task across a workforce, which we believe will further improve employee engagement and drive potentially significant efficiency gains. We're looking to develop a global blueprint by year-end, and then to roll out this tool across several hundred customer sites over the next two to three years. And once again, we will receive dedicated IBM support both in terms of project management and training. Finally, over time we have increased the use of sensors through our customer buildings both in building maintenance systems and across the workspace in general. These sensors give us valuable insight on occupancy, utilization rates, energy consumptions, et cetera.

This allows us to make informed recommendations on the signing and creating the optimal workplace that gives building users what they need and desire in the most cost and efficient way. However, moving forward, we will use the power of Watson's Internet of Things to develop a true understanding of how customer's buildings are used and to evolve the behavior from a reactive to a proactive service offering. This is cognitive intelligence.

It will allow us to become intelligent and efficient in a way we serve these buildings. By using predictive technologies, we can create a better and more efficient end-user experience. Why we've chosen IBM as our partner because they offer industry leading technology and have made huge commitment to developing cognitive intelligence. Moreover, they will offer us the necessary support across with our global platform. It is in the combination of IBM's technology and ISS's access to data and self delivery capabilities and credentials that make this partnership unique and that we can create a very compelling proposition.

Please turn to slide number 19. Given the UK's 23rd of June decision to leave the EU and the recent political upheaval in Turkey, I want to spend time giving some background on ISS's activities and outlook in these two countries. As most of you know, the United Kingdom is ISS' largest country and generated 15% of group revenue in 2015 with an above average margin. The country has delivered an excellent financial performance for many years now. The outsourced FM market is actually the most developed market in the world and ISS has a strong position. That said, encouraging growth opportunities remain.

We have a balanced portfolio with approximately 40% of our revenue generated within profit sector notably healthcare, defense, education and transport. Our biggest single sector is financial services which is approximately one quarter of the total revenue.

So far in 2016, we have seen no discernible impact from Brexit either in the run-up to the 23rd of June referendum or afterwards. There has been no change to our business pipeline. Timetables and decision making on this have been on the unaffected thus far. And once again, we remain encouraged about these opportunities.

As we have explained, the immediate impact has been the depreciation of the British pound and the subsequent reduction to revenue and operating profit when we translated into the Danish krona. Given the strength of our UK margin, this creates a slight negative mix impact or mix effect to the group margin, but the impact here is modest.

Clearly, we would rather be operating against a strong macro backdrop rather than a weak or uncertain backdrop. Hence, reduced GDP growth assumptions are likely to have some impact. We're not immune to that. However, our business model has proven robust in the prior economic downturn and we're confident that structural drivers of growth in the UK coupled with our ongoing innovation, our focus on service excellence and cost efficiencies will continue to support our revenue and profit development in the UK. There has been some speculations of certain companies may seek to downsize activities in the UK and upscale elsewhere in Europe. However, our customers are generally taking a wait-and-see approach, and our conversations with them at this stage has offered very little clarity.

If some customers do chose to switch certain operations elsewhere in Europe, we will of course seek to move with them wherever possible, and we would see our geographical reach across Europe as a key positive to that. For now, we continue to offer services that are not discretionary in nature and it is business as usual.

With regards to supply of labor in the UK and our workforce needs, I would highlight that across the ISS group, the main driver of labor inflation are minimum wages, collective bargaining agreements and all social security cost. Supply and demand is not typically a factor. As you know, around 25% of our workforce today is paid the minimum wage and around 50% [indiscernible] (30:37) living wage.

Today, some 17% [indiscernible] (30:39) of our workforce is represented by non-UK EU nationals. Our expectation is that non-UK residents will be allowed to secure their status on right to work in the UK. As said earlier, we are providing non-discretionary services, offices, factories, hospitals, schools only to be serviced and maintained.

If wage inflation increases, the additional cost pressure are felt by the whole industry, not just by ISS. These companies can find ways to – most companies that could find ways to mitigate these pressures through productivity enhancement or other efficiency gains will win. We've proven our ability to deliver in those markets where labor supply challenges do exist such as for example, Singapore. This is why we are pursuing our integrated self-delivery model and this is why we are entering into agreement with the likes, for example, IBM.

As for Turkey this is our 11th largest country within ISS and they account for around 4% of group revenue in 2015. Margin here is also above average. We have a great business and a great position within Turkey, although this market is much less involved than many European markets and only 11% of our Turkish revenue comes Integrated Facility Services contracts.

The business is predominantly within the private sector. We've seen a [indiscernible] (32:12) impact to our business post the attempted coup in July. Only three small customers saw a shutdown of their facilities. With the bombing earlier this year, the Turkey Tourism factor – sector is currently facing some notable weakness. Tourism accounts for less than 3% of our revenue in Turkey.

There are some potential risk in the retail sector but we also see ongoing business opportunities that's encouraging most notably within healthcare. There is no change to our outlook for ISS Turkey at this stage.

Please turn to slide 20. At the full-year result presentation in March, we provide a case study on ISS Germany where we illustrated the evolution of our business through various acquisitions, divestments, some key contract wins and then the great reorganization in 2015. This has given Germany a very strong focus on platform from which to grow in the coming years.

Today, I just want to briefly discuss ISS Switzerland, which is second only to the UK in terms of revenue and likely the UK has delivered excellent financial results for many years now.

On the left-hand side, you will see the development of our Swiss revenue. Over the past seven years, we delivered a highly impressive average organic growth rate of 5.4%. Of course, growth can prove lumpy, but this reflects the timing of new contract wins and IFS Switzerland has had some notable business gains with high-quality clients. In addition, this growth has been driven by IFS or Integrated Facility Services, which now accounts for two-thirds of our total Swiss business.

Importantly, IFS Switzerland is a great illustration of how customer relationships across the group can strengthen our capabilities and financial performance both in-country and globally. Examples here includes UBS, Novartis and Nestlé, where relationships have either originated in Switzerland and then expanded internationally or vice versa.

IFS Switzerland has delivered consistently strong retention rates in the mid-90s, which compares very favorable with the group average of just less than 91%. In the recent years, these retention rates have been supported by increasing levels of satisfaction, as evidenced by the improvement of our customer Net Promoter Score. It's a great quality business with great quality clients who, in turn, are receiving a great quality of service.

Also, of interest is our revenue split by service. Two points as noted here. First, our biggest service is Property, principally technical maintenance and engineering. This is consistent with the high level of IFS revenue here. As we said before, Property Services is often the largest component.

Second, we have no catering business in Switzerland. Many of you have asked whether it is easier to develop an Integrated Facilities Services solution from the catering heritage than from a cleaning heritage. ISS Switzerland gives clear evidence that our ISS aspirations are, in fact, supported by our heritage.

Finally, underpinning this performance is our local management team. Our Swiss CEO, Andre Nauer, has established a sustained and outstanding team most of whom have been with ISS for many years and has consistently delivered for the company. I would like to express my gratitude to all of them. Please turn to slide 22 for an update on our outlook.

With regard with our 2016 outlook, we now expect organic growth to be between 2.5% and 4%, an operating margin that is above the 5.7% realized in 2015, and a cash conversion above 90%. We have slightly narrowed our organic growth outlook by 50 basis points and this reflects the solid organic growth achieved in the first half of 2016, contract launches and progress within our ISS business in general.

However, we remain cautious on certain European countries and also Brazil. The economic outlook is arguably a little less certain today than at the corresponding stage in 2015. And we need to be mindful of some of the risks that we face. We see this as a realistic and honest assessment at this juncture.

Our margin and cash conversion commentary is unchanged. So, in summary, we're pleased with the progress that we made in the first half year of 2016, particularly given that we are delivering against our expectations and that is being driven by the strategic choices that we've made. Certain challenges ahead

ay prove a little greater, but we remain confident in our capabilities or opportunities and our ability to execute.

With that, I would now like to start for the Q&A.

Q&A

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Paul Checketts from Barclays. Please go ahead. Your line is now open.

<Q - Paul Checketts>: Good morning, Jeff. I've just got about three questions, please. The first is a slightly broad one. It's about the organic growth guidance and it implies quite a broad range for the second half. I'm hoping you would just flesh out why you have kept that quite broad, what the key variants are.

And then, the second is related to that. If we look at Q4 last year, organic growth was very strong. I don't know if that was down to strength in the non-portfolio demand. Can you just tell us, was there a large weighting within that to the UK and to Financial Services?

And then, the last question is relating to Australia. And my understanding, correct me if I'm wrong, but my understanding is there's been some very aggressive bidding from some your competitors there. Are you seeing that sort of behavior anywhere else or is it remaining localized in Australia? Thanks.

<A - Jeff Olsen Gravenhorst>: Thank you, Paul. Maybe if I just start answer the question from the back because that will get you back up to the guidance actually. So, if we start with Australia, it really is localized to the mining and resource sector in Australia as we seen it. The reason why that is, is of course that's why we have our strongest mining business the be honest.

So, we have some resource business elsewhere in the emerging markets and we have not seen the same behavior there. There's no doubt that there has been some consolidation in that market within some of the major mining companies. And so the way that they now tender the services has been consolidated because they're looking for large cost savings and to the extent where we have chosen not to participate.

So, of course we find that very aggressive pricing and we are in this business to make money. So, we don't see it elsewhere, but it does have an impact on Australia and it does have an impact overall of course on the Asia Pacific region as we just saw from peers walk through.

Though the Q4 2015, yes, it was very strong and it was very strong on [ph] once (40:18) only and of course that [ph] once only (40:21) comes also from some of our larger international clients and that also includes some weighting into the financial sector.

So, that leads you to the first question, why do we keep it broad. I think, I actually don't think it is that broad, 2.5% to 4%. I think it is with six months left to go it is still a reasonable frame [indiscernible] (40:47) or a range to be working with. But the driver of course is that we did have those strong comps last year and those comps last year did include a lot of above base work as well.

And as we do have Brexit and other uncertainties, I think it is the [ph] why (41:01) approach to guide 2.5% to 4%. We don't see 2% anymore and that's why we narrow the range. But of course we still need to be prudent on that, the Brexit can and the wait and see approach can actually also mean that the certain [indiscernible] (41:19) business that we won't see this year as we saw it last year. Nothing major is indicating that right now, but as you know, with [indiscernible] (41:26) business. We don't have that much of a time, visibility on that as we do have on our portfolio business. So that's the reason why we keep these ranges as we do right now.

<Q - Paul Checketts>: Thanks.

Operator

The next question comes from the line of Emily Roberts from Deutsche Bank. Please go ahead. Your line is now open.

<Q - Emily Roberts>: Hi. Good morning, and three from me, please. First of all, could you give us some more color on what percentage of the 4% organic growth in Northern Europe was from the non-portfolio businesses. And secondly, of the new contracts that you've launched in the second half, could you give us any color or any idea of how much organic growth you've essentially booked for next year? I know it's too early for guidance, but any color that would be helpful.

And then, finally on M&A, you previously mentioned some white spots in the U.S. could you give us some more color on the number of targets you're talking to whether any are close to the line and also geographically, do you have the U.S. coverage that you'd like now? Thank you.

<A - Jeff Olsen Gravenhorst>: Okay. Thank you. If we just take for the non-portfolio growth, I think, what we're seeing right now is pretty stable in line with our portfolio growth. We don't give further details on that in terms of numbers, but we have not seen a meaningful pickup. We don't see a strong organic growth on our portfolio growth.

For new contracts guidance for next year, we do say when we win new contracts. If they are meaningful, we'll give you some numbers for that as well. but we don't actually do forecast for our outlook for next year. So, I can't give you anymore on that, I'm afraid.

On the M&A activities, clearly, you're quite right. We are very strong in delivering Integrated Facilities Services in self-delivery model across the world. And that's, of course, why we can have clients like HP and Barclays and Citi and so forth. But there are areas where we can improve our self-delivery capabilities and we have gone through that a few times on these calls.

Notably, these are within the various products or services that's improved our technical services across the group. It's also getting closer into workplace management, which is more advisory on how to create workplace to optimize end users' satisfaction. And then, it is the catering part but that is notably or most importantly in the Americas.

So, it's three areas, catering in Americas, and then, in general, it's technical services and workplace management. That means, of course, when we look into geography, we're not looking to expand our presence in emerging markets as such right now or going into new countries. Of course, we're always alert to how the macroeconomics develop.

But it's geographically more important to look at our capabilities particularly in the North America. So, we continue to look at that and we are continuously working with the pipeline. It's quite important that any acquisition that we will make go through very tight filters both strategically and financially. And we will, of course, inform you as soon as we have made a deal. We can say that the pipeline is there, we are actually working with it. But there is no use on acquisitions right now.

<Q - Emily Roberts>: Just as a quick follow-up. Is your geographical coverage in the U.S. where you'd like it to be? Thank you.

<A>: No. That is a no. We are working with that. We have good organic growth [ph] as well as we (45:19) said already now, but we come from a relatively small platform. It is an area where we need to become even more meaningful as we go forward. And that's why we're looking for acquisitions to support also our organic going forward.

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

Operator

The next question comes from the line of Michael Rasmussen from ABG. Please go ahead. Your line is now open.

<Q - Michael Vitfell-Rasmussen>: Thank you very much. I would like to start, if you would, just give an update on the phase III cost savings initiatives. You haven't really spent much time on this. How long are we in the process of that? And also, are you seeing as much as you saw from the first two cost saving initiatives which you launched at the IPO?

Then, depreciation seems to be well on track in the first half down 6% to 7%. How long can you continue to see lower depreciations from the strategy rollout? And then, finally, if you would just add a bit more on the guidance. I mean, what needs to go wrong for you to reach 2.5% in the full year and what needs to go right if you need to reach the 4%? Thank you.

<A>: Yeah. Thanks, Michael. I'll start from the back here on the guidance side. I do actually believe that we all recognize the world is a little bit uncertain that has been for – it actually has been uncertain for a while but the Brexit has not helped, that's for sure. So, it's difficult to say what needs to go really wrong, but we do know that the comps from last year was pretty strong and part of that was the non-portfolio work. So, we will work very hard on repeating that, but again, we do know that, as I said to Paul also, comes from the financial sector, from the international clients last year. And it has a relatively short visibility. So, it really depends on the activity and the certainty or uncertainty level within UK, within financial sector as a result of Brexit. That's why we keep the range as we keep it.

And then, of course, we do know that we have lost some business in Australia. So, within the resource part. And we do know that we are restructuring in Brazil in order to get a little bit ahead of the curve. And that means that we are deliberately exiting some business. So, that's why we know that there are some losses up against the wins that we have, and that's why we keep the range of 2.5% to 45.

On the first question, I'll hand that over to Peter.

<A - Peter Thomsen>: Thanks, Jeff. With respect to the procurement program, as we've informed earlier, you could say, phases I to III identify the accumulated savings of around DKK 450 million to DKK 50 (sic) [550] (48:07) million. But that was over the period to – it would ramp up from 2013 to 2019. And at the end of 2015, we saw approximately 55% of those savings had been achieved. So you could say, it's ramping up until the end of 2019.

With respect to the next phase as being phase IV, we don't give any specific guidance on the volume of this or the value of that at this point in time.

And then, you had a question with respect to depreciation, CapEx. I'm not sure I understood the question fully, but I presume it was along the lines that – you could say our CapEx and our depreciations were lower, you were saying. And the reason for that is if we go back to what we talked about last time, is that we have seen a declining path, and we're running at a CapEx level of around 0.9% of revenue now. And it is because we're seeing divestments and FX and other mix effects impact in that.

Secondly, we're also seeing a shift from owned assets to leased assets as I talked about earlier. The vehicles standing from our procurement activities and we're also getting our customers to invest in or make capital investments as oppose to ourselves. So, you could say – and if you look specifically for the half year here in 2016, our CapEx was simply lower mainly due to the timing of investments. And you could say as such, we would not expect CapEx in any one year to be different from what the historical range has been. Which has been between the 0.9% to 1.4% of revenue. If that didn't answer your question please let me know and I'm happy to elaborate.

<Q - Michael Vitfell-Rasmussen>: No. I mean, yeah, my question was – I understood why you saw first half down. I was just wondering how long it could continue, but obviously you answered that because you said that we should see CapEx in the historical range going forward. So, that's fine. Thank you.

Operator

The next question comes from the line of Rory McKenzie from UBS. Please go ahead. Your line is now open.

<Q - Rory McKenzie>: Morning all. Three for me please. One just on timing of comps for H2. Last year a lot of contracts ramping up and starting off, Danske, DSB, the Homerton Hospital as well. Can you remind me on the timing when those became, I guess, fully at run rate you're seeing now and so when the comps will get tougher for you for growth in H2. And then secondly just on Continental Europe. Obviously, the margin trend there was down in H1 due to our Turkey divestment and the HP rebalancing. But, obviously, now you're in positive territory in the year-on-year margins. So, I guess what's been such a big improvement and change there in quite a short time period. And those will be first and I've got one more on the IBM thing. Just those if you could please.

<A>: Yeah. Just on the contracts, as we have already noted but just to remind you Danske Bank started on the 1st of September 2015, and of course it was ramped up. Homerton, 1st of October 2015, again a ramp-up in the third quarter. Railways started 1st of October in Denmark, and then it was a ramping up from the rest of the – yeah, 1st of October. And then, on the Danish [indiscernible] (51:36) company 1st of January 2016.

Then we have expanded our services for Novartis that started January and a number of other contracts that we mentioned today comes in during the year. And then we just got to remind ourselves that we, last year, had a very large contact which is – which was Vattenfall which of course was ramped up during last year but had a big impact on last year's [indiscernible] (52:03).

<Q - Rory McKenzie>: Sure.

<A>: Second question here was on the Continental Europe margins. I think it's important to see that, of course it's the strategic initiatives. So, our restructure of the company and so forth by country of course helps from the margin side. But it is important also to remember what we said on the difference between Q1 and Q2 in the UK, for example, where we had Easter in Q1 this year, where we had it in Q2 last year. And when you have higher cost, when you need to have open for a hospital 24/7 of course that has an impact on the margin between the quarters. So it's important to look at the half year numbers when you look at that. But in general of course, we have the impact from all of our strategic initiatives which should help improve the margin.

<Q - Rory McKenzie>: Okay. Great. And then just on the IBM contract. So, about the arrangement in terms of [indiscernible] (52:52) co-investments you need to make into that to help roll out these new services. And as you go and expands these services and platforms to more, more customers, again, would there be more up-front investments to have this larger platform and ecosystem. I know you talked about some of the requirements as you roll that out given it's presumably a much bigger, broader system and how much IBM is helping with those investments.

<A>: Yeah. I think, first and foremost, the first part of it is the replacement of the system that we already have. So, we have a portion of investments which will fall out. And then, this would come in instead. Over time, I do believe that we'll see higher investment within technology. But as it is also improving efficiency and then, I think, it will offset some of the other investments that we do. So, we still believe that will be within the historical investment range.

<Q - Rory McKenzie>: Okay. Thanks.

Operator

The next question comes from the line of Jonas Guldborg from Carnegie. Please go ahead. Your line is now open.

<Q - Jonas Hansen>: Yeah. Good morning. Two left for me. Firstly, how should we model other income and expenses for the second half? You talked about this increase in restructuring costs in relation to Brazil. And then, is it possible for you to put any further color on the strong margin development in the Asia Pacific region in light of the falling revenue? Thank you.

<A>: Yeah. With respect, you can say, restructuring costs including the other income expenses, we don't give any specific guidance on that. I believe you're modeling around [ph] 150 (54:36) at the moment for the full year and that is probably the level you should leave it at.

<Q - Jonas Hansen>: Okay.

<A>: Margin, I think, the key thing here is that we've made a quite effective great restructuring in Australia, basically more than a year ago now. And we see an improved margin from that perspective. You'll notice also that the resource sector is not a margin above average margin. So that is, of course, also helping us. And with the hospital contract that went out also was below average margins. So, those are some of the points of supporting margin development. Apart from that, Singapore, in particular, has very strong performance. So, those are, in general, just good efficiency improvements across the countries that helps the margin improvement.

<Q - Jonas Hansen>: Okay. Clear. Thank you very much.

Operator

The next question comes from the line of Staffan Åberg from Handelsbanken. Please go ahead. Your line is now open.

<Q - Staffan Åberg>: Well, hello, most of my questions have been answered, but I have one for you today. You divested the whole business in Greenland, can you fill us in on the rationale behind doing that and also what is the probability that you exit other countries where your turnover is on a similar low side. I'm thinking for example Iceland, a couple of the countries in Eastern Europe, or Malaysia, Borneo, why not Uruguay?

<A>: Yeah. Let's start with Greenland. There's no doubt, Greenland is a very, very small country. I think, we all know that and historically we've been there. It is a difficult market to operate. Two, it's not strategically important for anything anymore. I think, the point is, that we are aligning the company to be the same sort of setup, the same focus, narrowing the range of services that we work with. In that, we've been in broader [indiscernible] (56:41) service range in Greenland because it's such a small country.

Now, as this has been non-strategic services and no strategic customer focus, small country, and then it's a long way away. So, if there is any issue, then management resources is simply not prioritized to be given to Greenland. That's why we have of course, chosen to say, the value for us is really not that high on an ongoing basis. We'd rather focus on something else and that's why we sold it off. As to the future, we are constantly looking at what makes sense and what does not make sense. So, there will be divestments and there are also divestment candidates that are listed like the assets held for sale. So, of course, we will mention specifically what that is as and when it happens.

But the line of thinking, of course, is that is has to be strategic, it has to be relevant and relevance also includes, do we have international potential from being in the country that we're in. That all I can say today.

<Q - Staffan Åberg>: Okay. Thank you.

Operator

The next question comes from the line of [ph] Srinivasa Sarikonda (57:46) from HSBC. Please go ahead. Your line is now open.

<Q>: Hi. This is [ph] Srini (57:53) from HSBC. Most of my questions are answered but just a follow-up question on depreciation thing. Do you see a lower depreciation to continue in future? Because the margin expansion we see in operating margins, but EBITDA margin remains similar to last year. So, can we expect a similar lower depreciation going forward? But you're saying the CapEx will be in line with last year. Does this drive your depreciation cost going forward? Thank you.

<A>: I think it's important to look at – when we look at depreciate – we look at EBITA and not EBITDA, of course. And in that, if we make more investments into successes and we buy them, then, of course, the depreciation will come back again. But at the end of the day, whether its leased and it just sits within the operating expenses and that includes the financing and the depreciation part, obviously, and if we buy it ourselves, then it sits within depreciation. That's why we don't differ that much between – and that's why we follow the EBITA as opposed to the EBITDA. So over time if the CapEx goes up, then of course also the depreciation over time would go up.

<Q>: Okay. Thank you.

<A>: But the EBITA will remain the same.

<Q>: Okay. Thank you.

Operator

We have no further questions at this time. So, I'll return the conference to the speakers.

Nicholas Richard Ward

Great. Thanks very much, everybody. Thank you for your questions and your interest. Thanks, too, to Jeff and to Peter. For any follow-up questions, Martin and myself will be around during the course of the day. So, please just give us a call. Have a good day to all of you. Thank you.

Operator

Thank you, ladies and gentlemen. This now concludes your conference.