Company Name: ISS A/S
Company Ticker: ISS DC
Date: 2015-08-27
Event Description: Q2 2015 Earnings Call

Market Cap: 42,889.36
Current PX: 231.00
YTD Change($): +52.90
YTD Change(%): +29.702

Bloomberg Estimates - EPS
Current Quarter: 4.148
Current Year: 13.855
Bloomberg Estimates - Sales
Current Quarter: 19671.333
Current Year: 79146.385

Q2 2015 Earnings Call

Company Participants

- Nicholas Ward
- Jeff Olsen Gravenhorst
- Heine Dalsgaard

Other Participants

- Staffan Åberg
- Jonas G. Hansen
- Paul D. Checketts
- Emily Roberts
- Michael K. Rasmussen
- Kristian Godiksen
- Jesper Herholt Jensen
- Matija Gergolet

MANAGEMENT DISCUSSION SECTION

Nicholas Ward

Ladies and gentlemen, this is Nick Ward, Head of Investor Relations at ISS, and I'd like to welcome you all to our Q2 2015 results teleconference. Please be aware that the announcement, the quarterly 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 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 the agenda for the call is outlined on slide three.

Presenting today, as always, will be our Group Chief Executive Officer, Jeff Gravenhorst; and Group Chief Financial Officer, Heine Dalsgaard. We'll open for Q&A at the end of the presentation.

And with that, I'll hand over to Jeff.

Jeff Olsen Gravenhorst

Thank you, Nick, and welcome, everybody to our Q2 results call. Before we start, I would like to draw your attention to slide four, where we've provided details of our forthcoming Capital Markets Day in London on September 17. This half day session, we'll provide analyst and investors with more color on our markets, our strategy, and our key priorities, both operational and financial.

[indiscernible] (01:03) Executive Group Management team will be present, so there'll be an excellent opportunity to discuss the business and our vision with those key individuals who are driving the business on a day-to-day basis.

There will be a live webcast, however, for those of you who wish to attend, who've not yet signed up, please contact Martin in our Investor Relations team.

Please turn to slide six. The progress during the second quarter of 2015 has been very encouraging. With regards to our operating performance, organic growth was 4.8% in Q2, an improvement from the 3.1% we saw in the first quarter. Our Q2 margin increased year-over-year to 5.3% from 5.2% last year. This improvement comes despite some macroeconomic turmoil and also despite some operational challenges in the Netherlands and Brazil.

Our cash conversion remains strong at 99%, and the net result of DKK 601 million was significantly higher than the DKK 486 million we delivered in Q2 last year.

The shift towards the Integrated Facility Services saw the broader multiservice contracts continues across our industry. And this is where ISS is very strongly positioned. So the currency adjusted IFS growth, this is what we sort of the closer we can get through organic growth within IFS remains strong at 10% in Q2. This is driven by new contract startups, including Vattenfall in Germany, Swisscom in Switzerland, UBS in the UK and Huawei in China. IFS is now representing 33% of our Group revenue.

We have announced some additional IFS wins recently, including a major contract expansion with the Danish State Railways, and the same with also the Danish bank across the Nordics and the Baltic countries, and a new contract in Huashan Hospital in China, and in the Healthcare segment in the UK.

Our Global Corporate Clients represents 10% of Group revenue, and currency adjusted growth within the Global Corporate Clients was 13% during Q2 versus 6% in Q1. This growth within our largest clients across the globe was boosted by startup of the significant new Cleaning contract with a major financial service customer and of ongoing portfolio and non-portfolio growth with existing customers.

Emerging markets continue to perform. It now accounts for 25% of the Group revenue. The organic growth for the quarter was 8%, and that's despite some challenges in certain markets. We had achieved 7% in Q1. And the operating margin was flat year-over-year at 6.1% and we're very pleased with this performance.

We continue to make good progress with our strategic initiatives. These includes procurement, customer segmentation to focus on our customers, business process outsourcing, organizational restructuring and our excellence projects. In line with our guidance, these initiatives are driving a steady improvement in our margins and improving our competitiveness.

Phase III of our procurement program is being launched, and we've also announced a new and strengthened organizational structure, which will increase our customer focus. And I will say more about that a little bit later in the presentation.

So in summary, a very solid start to 2015. The background macroeconomic conditions remain challenging in a number of our markets. Whilst we've seen some improvement in parts of Europe, this has been modest. Our progress thus far has been heavily driven by new contracts win and retaining customers. Once again, the strength and resilience of our result is a large testament to our strategy of self-delivery, integration and successful execution.

Please turn to slide seven. I would like to spend a couple of minutes discussing two important IFS contracts, which we've launched in Q2, just to give a flavor of what we actually do. Huawei is the first one. We are now, ISS, providing Integrated Facility Services to the first large multifunctional residential campus. This campus provides apartments, recreation centers and other living amenities for its residents. And ISS will under a three-year contract provide Cleaning, Security, Office Support, Customer Service and Facility Management.

The key objective for Huawei is to attract and retain talented employees through the provision of comfortable and enjoyable working and living conditions. And our services, this is exactly where we can be a key part of meeting that objective or making that objective a reality.

ISS' international brand and our international reputation prove highly attractive in the bid as did our leading position in the Hong Kong market and our local presence in China. In short, ISS will be delivering international service standards in the Mainland of China and the rollout of this contract would be supported by a number of our ISS Hong Kong and international employees, alongside our local ISS team, who will bring considerable experience in supporting, of course, also the local ISS team.

The contract started on April 1. This is a high-profile contract for ISS China, for ISS Asia and overall, of course, for the Group and this affords us the opportunity to demonstrate our service credential with a truly multinational client.

The second one is UBS, the rationalization of its real estate in London is of utmost importance to UBS. And for the first time in the UK, the UBS Investment Bank and the Private Wealth Management and Global Asset Management will come together in a shared office space.

A diverse or a disperse real estate portfolio of 1.5 million square meters, square feet will be consolidated into three buildings and they move to the brand new 5 Broadgate, is the largest construction and fit-out project across Europe in 2015.

ISS' credential in the UK are excellent. However, our long-term relationship with UBS in Switzerland where we build a strong reputation was clearly instrumental in securing this important contract. Our proposition for UBS moves away from simply looking at measured service output and focuses instead on occupant satisfaction and guest experience. Moreover, we have the required experience in financial service sector together with the procedures and systems to mitigate the significant risk and manage the complexity of this major transformation.

5 Broadgate will be fitted out over the next 12 months and ISS will support UBS in moving some 6,000 staff into the new facility from August 2016. These two IFS contracts are great examples of how clients are placing their trust in ISS to look after their facilities and the people who work in those facilities.

With that, I would like to hand over to Heine.

Heine Dalsgaard

Thank you, Jeff, and good morning, everyone. So turning to slide eight, you will see once again our three key financial priorities, namely: resilient organic growth, improved operating margin and strong cash conversion. So organic growth improved to 4.8% in Q2 versus the 3.1% we delivered in Q1. The result was driven by a further strengthening of growth in Western Europe, mainly due to the impact from new contract startups as well as the ongoing strength in Turkey.

In general, our IFS business continues to perform very well with the growth of 10% in Q2. Organic growth in the Pacific slowed slightly versus Q1, but remained strong at 8%. Our organic growth from emerging markets remained strong at 8%, slightly up on the 7% achieved in Q1. The operating margin improved again from 5.2% in Q2 last year to 5.3% in Q2 this year. Once again, Western Europe was a key driver. But we also saw useful margin improvements in the Nordic, Pacific and North America regions.

Our strategic initiatives continue to positively impact our financial results. For the whole of first half, our margins were 10 basis points higher, year-on-year at 4.9%, despite the continued operational challenges in the Netherlands and Brazil.

Cash conversion for the last 12 months was 99%, reflecting once again a strong cash performance across the entire Group. As you all know, cash generation remains a key priority for all of us in ISS.

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

Jeff Olsen Gravenhorst

Thank you, Heine. And please turn to slide 10. Our developed markets have delivered a pickup in organic growth driven by Western Europe and a healthy year-on-year improvement in the operating margin. As we've said repeatedly, it is our strategic initiatives that lies squarely behind these developments. Our emerging markets continue to deliver strong organic growth of 8%, with a stable operating margin.

And let's take a closer look into the regions in more details, and please turn to slide 11. Starting with the Western Europe, as mentioned, we've seen further improvement in this region. Organic growth strengthened from 2% in Q1 to 5% in Q2. Operating margin improved by 20-basis point year-over-year.

As in Q1, organic growth has been driven by Switzerland, Germany and Turkey. We have seen a selective pickup in growth elsewhere, including the UK and Spain, and some increased demand for non-portfolio services, in particular, UK and Switzerland. Organic growth in the rest of the region principally remains weak, and the performance in the Netherlands continues to be challenging.

The year-on-year margin improvement of 20 basis points is below the 50-basis point improvement we saw in Q1. However, you will recall that the Q1 performance was flattered by the divestment of our French landscaping activities in 2014.

Lower than expected sales in Netherlands has had a negative impact on the margin and that will continue through the year. We are pleased with the initiatives that the new management team in the Netherlands have put in place and the sales pipeline has been rebuilt in line with the commercial, general I outlined at the previous call.

Nordics. Turning to the Nordic region, Q2 organic growth was stable at 1%. However, the operating margin improved by 10 basis points year-over-year to 6.7%. Organic growth in Finland and Sweden remain solid. Growth was also boosted by some contract start-up in Norway during the quarter.

Organic growth in Denmark was negatively reflecting annualization of new contracts and the timing of contract start-ups, and the second quarter will benefit with the expansion of the contract with the Danske, the Danish bank and the Danish State Railways.

Initiatives in Norway drove the year-on-year improvement in operating margin. Sweden contract start-ups and Denmark, some lower project base work saw some margin decline.

Please turn to slide 12. Second quarter organic growth in Asia was 10%, up from 8% in Q1. Operating margin flat year-on-year. As we indicated on our last quarterly call, organic growth has now improved in Hong Kong due to contract wins. We also saw some new contracts driving organic growth in China and in Thailand. Singapore was boosted by strong performance from particularly our Global Corporate Clients. We saw operational improvement margins in Hong Kong and some cost savings in India as well.

Second quarter organic growth in Latin America was 4% compared to the first quarter of 6%. Operating margin was 20 basis points higher year-over-year at 4.9%. Organic growth was strong in Chile, due to strong retention of customers and high demand for non-portfolio services. And in Argentina, we saw good price increases. But weak growth in Mexico mainly driven by the fact that we didn't start up any major contracts in the first half. That is more a timing issue. And Brazil, we've shown some contract losses and client downscaling. And the outlook for Brazil remains challenging.

Margin strength in Chile and Mexico that were largely offset by Brazil, which saw cost increases in addition to the top-line weaknesses, which are top-line weakness we highlighted earlier. Brazil is currently experiencing a combination of cost inflation, but weak economic growth, and hence, weakening demand.

Brazil will receive increased focus and will benefit from the strengthening regional structure of the Americas. And in addition, we've put in a new Brazilian Country Manager with vast regional international experience as well as industry experience.

Please turn to slide 13. The second quarter growth in Pacific eased back slightly to 8% versus 10% in Q1. Growth continues to be driven by the remote site resource and Healthcare segments. We have talked in the past about slower growth set to come from resource segment. In September, we will start the work at two remote sites in the Western Australia, which will only be partly compensated by a new site in Queensland. Later this year, two of our largest resource customers will move from construction phase to production phase, which will result in lower revenues.

We have also seen a number of good new wins in the latter month, which will kick in at the end of – during the end of this year. Operating margin in Pacific continues a positive trend, delivering a healthy 80 basis points improvement year-over-year to 4.9%. Strength within the IFS and the aviation segments were the key drivers.

In North America, organic growth recovered to 1% positive in Q2 versus negative 2% in the first quarter. Operating margin improved by 100 basis points year-over-year. Contract exits during 2014 and 2015 continue to impact growth, but this was more than offset by growth elsewhere, most notably a continued pickup in demand for non-portfolio services, particularly within our Global Corporate Client customers.

As we stated in the first quarter conference call, North America is in the midst of transformation. Our restructured sales efforts will take time to deliver but we remain confident in the significant opportunity afforded by this market.

Margin upside was driven by an improved contract mix, IFS and the higher non-portfolio activity mentioned already. Finally, in Eastern Europe, organic growth was 4% in Q2 versus 1% in the first quarter. However, the operating margin fell by 100 basis points year-over-year to 6.3%.

Organic growth was driven by new contract wins in Poland and Slovenia and higher demand of non-portfolio services in Slovakia. However, this was partly offset by contract losses and reduced scope of services in Czech Republic.

We have made some structural changes in the Czech Republic, which we firmly believe will benefit the business in the longer term. However, the near-term performance has been impacted by increased competition and this has weighed on the overall regional result.

With that, I would like to hand back to Heine for some more details on the financials.

Heine Dalsgaard

Thank you, Jeff. So please turn to slide 15. Total Q2 revenues increased by 9.8% year-on-year to DKK 20.2 billion. Divestments and acquisitions impacted revenue growth by a net of minus 1%. The major disposal that impacted this figure was the personnel services in the Nordic that we sold in September last year. The GS Hall acquisition, which we announced on January 20 this year remains our only acquisition year-to-date, and had a gross impact of plus 1% on Q2 revenue growth.

There were no further acquisitions or disposals announced during Q2, but as a subsequent event, we yesterday announced the disposal of our non-core call center activities in Turkey. The annual revenue from these activities from Turkey was in 2014, DKK 336 million. We will come back with more information after the closing, which is expected to take place during Q4.

Currency fluctuations boosted revenue by 6% plus. Primarily related to the British pound, Swiss franc, and the U.S. dollar.

Finally, as we've already seen, organic growth was plus 4.8%. So 4.8% plus 6% from FX, minus the 1% from divestment gives a total revenue growth of 9.8% in Q2.

Please turn to slide 16. Our Q2 operating profit increased by DKK 111 million year-on-year to DKK 1.067 million, and the operating margin increased by 8 basis points to 5.3%. Given the seasonality of our margins, we choose to illustrate the evolution of our operating margin on an LTM basis. And on this measure, we have been trending slightly higher over seven consecutive quarters now.

During Q2, notable positive contributions to the Group's year-on-year margin improvement came from Germany, the UK, the U.S. and the Pacific offset primarily by the continued operational challenges in the Netherlands and Brazil.

For the first half, our operating margin increased by 10 basis points year-on-year to 4.9%. Within this performance, corporate costs amounted to 0.7% of sales, up from 0.6% in first half 2014. This increase reflects the higher costs of being a listed company, including our LTIP and also timing between the quarters. This is fully in line with our expectations.

Please turn to page 17. Some highlights from the Q2 income statement. Other operating income and expenses amounted to a net expense of DKK 44 million in the quarter. This figure includes DKK 48 million on restructuring projects. The Q2 restructuring charge is primarily related to our strategic execution program. It is higher than Q1 and is more reflective of the anticipated full-year run rate. We will continue to rationalize head count and property across the organization as we roll out our strategic initiatives.

Financial income and expenses amounted to DKK 164 million, some DKK 54 million lower than Q2 last year. If we strip out the impact from FX, the year-on-year reduction in net financial expenses was DKK 85 million. The major movements were DKK 55 million, a reduction in net interest expenses due to lower net debt and also lower financing costs, and the absence of DKK 21 million of refinancing expenses in Q2 last year.

Income taxes amounted to DKK 258 million, equivalent to an effective tax rate of 30%, which is in line with our comments for the full year. Profit before goodwill impairment amounted to DKK 601 million, some DKK 115 million higher year-on-year. Amortization and impairment of brands and customer contracts, net of tax was DKK 122 million similar to the level in Q1.

Please turn to slide 18. Cash flow from operating activities amounted to DKK 843 million in the quarter, DKK 441 million higher year-on-year. On an LTM basis, our measure of cash conversion remained very strong at 99% versus the 97% at the end of Q1. Net interest paid in Q2 was DKK 133 million lower year-on-year in part reflecting that Q2 2014 included payment of interest on the 2016 high yield notes, and the term loan A, which were both repaid in 2014.

In addition, both margins and underlying rates are lower in 2015. Remember that our two bonds under the EMTN program will pay interest annually, our bond maturing in 2024 pays interest in December and the other maturing in 2020 pays in January.

With regards to income taxes paid, please note that Q1 2014 included certain tax payments relating to a specific divestment. The Q2 2015 cash tax rate was 25%, and it was affected by timing considerations between the two quarters. Year-to-date in 2015 our cash tax rate was 30%, which is in line with the effective tax rate in the P&L.

Finally, in April, we paid out our first dividend since the March 2014 IPO, resulting in a cash outflow of DKK 901 million.

Please turn to slide 19. Our net debt stood at DKK 14.7 billion at the end of Q2 and our leverage was 2.9 times pro forma adjusted EBITDA. This is an increase versus the 2.6 times at the end of Q4 2014, which is fully in line with our expectations and reflecting the typical seasonality of our cash flow including of course, the dividend payment in April.

On a 12-month basis, our leverage have fallen 0.3 of a turn. Our policy with regards to shareholder returns is of course, unchanged. We are committed to maintaining a disciplined and efficient balance sheet. We will divest non-core businesses whilst considering selective competence enhancing acquisitions, we target a dividend payout ratio of 50% and once we have reached our targeted leverage of below 2.5 times adjusted EBITDA, we will seek to return additional funds to shareholders to maintain balance sheet efficiency.

With that, I hand back to Jeff.

Jeff Olsen Gravenhorst

Thank you, Heine. And please turn to slide 21. During the last quarter, we have announced a new organizational structure, which will become effective from September 1. Closer alignment across the Group is something that we have been pursuing since we launched the ISS Way Strategy back in 2008. And the model that we have today has served us well. But the changes that we have now announced are the next logical step ensuring that best practices can effectively and efficiently be replicated across the Group, particularly as we intensify our focus on our key accounts.

We have restructured the senior management team in order to make us more agile and much more responsive to the customer needs. So in addition to the model, we have now created two new roles. We've appointed a Group Chief Operating Officer, who will work closely with our regional and country organization to ensure that we deliver consistent, excellent service standards across the globe, increasing our focus on key accounts and customer retention, and to ensure that the benefits we are realizing in areas such as procurement, business process outsourcing, [ph] organizations restructure and structure (26:20) and customer segmentation are maximized.

Andrew Price will become the Group Chief Commercial Officer. Given his previous role within the Global Corporate Clients and the more sophisticated demanding nature of some of our – some of those customers, Andrew is ideally placed to drive innovation and commercial intelligence across the broader playing field. He will work on a global and regional basis ensuring we maximize the new sales opportunities that our unique platform of geographical breadth, integrated services breadth and sales delivery efforts.

Finally, we've created a dedicated region for the Americas, both North and Latin America, which will be headed up by John Peri reflecting the strategic importance of this marketplace.

Henrik Andersen will now leave ISS to pursue an external opportunity effective November 30. Henrik has been with ISS for more than 15 years. And for the last two years, Henrik has served as the Group Operating Officer for EMEA and has such delivered excellent results. We wish Henrik good luck and all the best for the future in his new endeavors.

And finally, I would like to turn to slide 23 to discuss our outlook. So with regards to the full-year 2015, we have increased our organic growth guidance from 2% to 4% organic growth to now 3.5% to 4.5%. This change is mainly due to a number of large contract launches, especially in Europe and to the IFS strength generally across the Group. We believe these benefits will continue for the remainder of the year. However, we remain cautious of the difficult macro conditions in certain European countries and of course, recent turmoil in emerging markets, in particular, China.

If we take into account all completed divestments and the acquisition of GS Hall together with the FX movements to the end of July, we now expect to deliver total revenue growth of 6.5% to 8.5% in 2015. Please note that this guidance does not include the sale of CMC, which is yet to be completed.

We will maintain our focus on sustainable margin improvements in 2015, which will be supported by ongoing strategic initiatives. We expect to deliver a margin for 2015, which is higher than that of 5.6% delivered in 2014. Finally, cash conversion will remain a priority and we expect our cash conversion to end of the year above 90%.

Ladies and gentlemen, we are pleased with our start of 2015 and positive with regards to the outlook for the rest of the year.

And with this, I would like to open for the Q&A session.

Q&A

Operator

Thank you. [Operator Instructions] We have a first question from Staffan Åberg. Please go ahead, sir.

<Q - Staffan Åberg>: Yes. Thank you. This is Staffan Åberg from Handelsbanken Capital Markets. And hello everybody. Looking at the collapsing commodity markets, in which countries would you say you have the largest direct exposure to that sector? And how would you say that has affected you so far, and what is your view on it looking ahead?

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you, Staffan. Overall, I mean the commodity market is impacting us mostly where we have the mining sectors. Overall, it's a relatively small part of the business from a Group perspective, but it does actually have an impact in Australia. And hence, the reason why we are seeing a tailing off in the Australian growth.

We still have good growth in Australia and other sectors, as I just mentioned, but this is the market where it has the largest impact. You could say, there are smaller impacts also in Chile and in Indonesia from this, but it is nothing on an overall Group perspective.

So I would say, the collapse in commodity is not in the direct – directly impacting us in any significant way. Of course, if it hits the overall and as it hits the overall economic turmoil, it has an indirect effect. But this is where our business is very resilient, and we've been able to grow despite of that.

<Q - Staffan Åberg>: Okay. Thank you for that. And given the current sentiment towards emerging markets, I guess it's not really the right time to ask this. But what is your take on expanding into Africa and the Middle East, let's say, on a five-year horizon?

<A - Jeff Olsen Gravenhorst>: I think, we always keep our eye out for all markets and movements throughout the world. We have been very diligent in our choices of markets over the years. And particularly over the last five years, we've been refocusing our business on becoming excellent in the countries we're in and focusing on key accounts and on integrated services. And, of course, excelling in our chosen specialized services. So that means that we've chosen to focus on where we are.

Now, we are, of course, looking at Middle East. It's a big opportunity from a facility services perspective. In the past, it has been a market which has not really been – where we haven't been able to deliver to the standards that we want to deliver the standards, both in – mainly in terms of compliance and in the way of getting the right labor forces. Little bit the same argument for Africa, but that's moving, and I think there are selected segments which are becoming more attractive.

So it's a long answer to a short question. But we are not right now endeavoring on those markets. But they are on the radar, and we'll continue to follow it, but there is no immediate plans to go ahead.

<Q - Staffan Åberg>: Okay. Thank you. And finally, what can we expect regarding key topics that you might address on the upcoming Capital Markets Day?

<A - Jeff Olsen Gravenhorst>: Basically, it is an update about our strategic and operational initiatives. It's pretty much painting the picture of where do we see the market going and why and why ISS is actually in a good spot for that development of the market. But that – and then, of course, a little bit more detail on operations.

<Q - Staffan Åberg>: Okay. Thank you so much.

Operator

Thank you. Our next question is from Jonas Goldberg (sic) [Jonas Hansen] (33:32) from Carnegie. Please go ahead.

<Q - Jonas G. Hansen>: Yeah. Good morning, everybody. I was – my first question is on organic growth in Western Europe. Are you able or maybe rather willing to shed some light on which organic growth range in Western Europe you're basing your Group guidance on your new raised Group guidance?

Then on non-portfolio activities, you're starting to see some improvement here and there. Can you elaborate a bit on this and what's the impact on growth in the quarter and is this spreading to other countries, regions and so forth?

And then lastly, on net working capital, do you still expect a positive impact on cash flow for the full year?

<A - Jeff Olsen Gravenhorst>: Heine, if you will take the guidance on regions.

<A - Heine Dalsgaard>: Sure. So we don't comment specifically on any guidance range for a specific region. So it is still, it's part of the range we have set for the 3.5% to 4.5%. We don't comment specifically on any specific regions. With regards to non-portfolio, it's the same level as in Q1.

<A - Jeff Olsen Gravenhorst>: To give you a little bit more flavor on the non-portfolio. What we see is it really is a result like our overall growth on our own focus. It's not really driven by the macroeconomic conditions.

Our key focus now is larger clients, either key accounts definitely within the IFS sector and there we can see that we've had the success in the non-portfolio business. So it's not driven by macroeconomic conditions. And then back to Heine on the last question.

<A - Heine Dalsgaard>: Just on the net working capital, Jonas. Our guidance is that we expect net working capital and cash conversion to be above DKK 90 million, and that's our guidance.

<Q - Jonas G. Hansen>: Okay. Thank you.

Operator

Thank you. Our next question is from Paul Checketts from Barclays. Please go ahead.

<Q - Paul D. Checketts>: Good morning, everyone. I've got three questions, please. Number one is on the GCC and IFS work. What were the costs associated with starting the contracts, and in ballpark figures, what do you think they will be this year? And will you able to comment on the pipeline for larger bids?

And then the second one is relating to the UK. What's your assessment of the likely impact of the increase in the minimum wage, and how are you setting about trying to mitigate any increases?

And then the last one is about returns to shareholders. If you ended the year a little below your 2.5% net debt to EBITDA level, but you knew you were going to have the usual outcomes in Q1, what would be the – would we expect to see any cash or would it be more into 2016? Thanks.

<A - Jeff Olsen Gravenhorst>: Thank you, Paul. If we start with the GCC and IFS works, the costing of starting up, this is basically the same as we've talked about a number of times. In the beginning of a larger startup, the margins is slower, and then it will build up, will ramp up over the period of the contract.

There's no doubt that with the startups that we have now, these are not global startups. So these are more regional startups. And for that, we see a smaller impact of that in the year. And that's the reason why that even though there is some startup costs related to the startup of DSB, Danske Bank, and so forth, we still remain confident to deliver on our guidance.

On the pipeline of bids, we don't comment more specifically the normal. We do have a good activity which has also resulted in some good wins that you've seen. We'll continue to have also on the global arena, the same amount of good prospects as we normally have. So from a market perspective, the market is clearly still supporting IFS delivery, but we also see that we do get our fair share of it, if not increasing.

UK, the impact on the minimum wage increase, clearly there is a number of things that we do. Number one is that in most of our contracts and this is across the world. We do have clauses that allows us to adjust prices as a consequence of change of law. But also from a business model, it is a matter of we are more and more delivering an output-spec contract not about how many hours but the quality of the service and all of the efficiencies and improvements that we're doing at the moment with investments into new technology, new ways of working and so forth, of course helps us to offset some of these. So efficiency is one thing, another one is price increases.

And then thirdly, just to let you know that in the UK, we are already about 50% of our employees are on minimum wage. We were one of the founders of our sector within our industry, within the Living Wage Foundation. We do believe in paying a fair pay to our employees and that's why it has always been on our agenda. So we don't expect a significant impact, there will be ways to increase prices when that's necessary and there are ways to improve efficiency when that's necessary.

And with the last question on the return to shareholder, Heine?

<A - Heine Dalsgaard>: So Paul, on the return to shareholder, as you know, our target is to take our leverage to below 2.5 times adjusted EBITDA. However, we are targeting a dividend payout ratio of 50%. So we expect to additional shareholder returns. That of course depends on the leverage. And as you know, because of the seasonality we have in our cash flow, our leverage will go up in Q1 and also Q2. So from that point of view, the earliest where we sort of being – going to be sustainably below the 2.5 times is going to be in second half 2016. But it's something we will come back with at a later stage.

<Q - Paul D. Checketts>: Thanks.

Operator

Our next question is from Emily Roberts from Deutsche Bank. Please go ahead.

<Q - Emily Roberts>: Good morning. It's Emily from Deutsche Bank. I have a few questions. So the first is obviously going back to that cash returns. Do you think this is going to be something that you might be considering on a recurring basis or should we consider this a one-off special dividend and not think about any more in the future? Thanks.

<A - Heine Dalsgaard>: So first of all, the dividend payout is still targeted to be 50% like it was also on the basis of 2014. With respect to additional shareholder returns, it is something we will come back to at a later point in time.

<Q - Emily Roberts>: Okay. Thank you. And my second question is around the new contracts that you've signed. And I was just wondering if you could give some color around the dates in which they start, so I'm thinking, is there any more acceleration from these new contracts that we will see in Q3 and Q4. Thanks.

<A - Jeff Olsen Gravenhorst>: Yeah. The ones, some of the bigger ones where we have already announced is the UBS in the UK was launched in June 1, 2015, which of course, would be ramping up as people, as the 6,000 people are moving into the building up to the end of 2016 [indiscernible] (41:40). So they would be moving up to the end of 2016.

Huawei is launched in April 2015 is up and running. The big single service contract to the large international bank started in the first quarter – in April 1, sorry, and that's ramping up throughout the year. The Danish Railways will be starting at the October 1 and the Danish bank, Danske Bank will start September 1. But we have to remember that we also come up to annualization of Nestle contract that started in the second half last year.

So obviously, there is a number of good startups but we also still see some challenging markets, one, the annualization of Nestle, tail off of Pacific with the resource industry, and of course, Brazil and the Netherlands were not actually growing to what we expected to.

<Q - Emily Roberts>: Got it. Thank you. And then the final question is in terms of M&A, you have said in the past that you would look to add some catering and technical services in the U.S., as I understand it. I was wondering if you could give any updates on where you are with this maybe timings, availability of potential deals, et cetera.

<A - Jeff Olsen Gravenhorst>: Yes. Just a reminder, of course, the point of the activities with [ph] M&A and D (42:58) for that matter is to sharpen our focus. I think the result we're seeing now with the key account focus and the IFS focus, we've been able to grow the business at a satisfactory level. We see good pipeline as well.

The strength we need to build there is to keep the focus on those services. That's why we divested as we have over the last few years, and that's why we divested the call center we announced last night with – in Turkey.

Now, the flipside of that is, of course, we want to invest in the business that we're good at. So that will, of course, also mean we want to invest in self-delivery capabilities in North America. So you're quite right. The focus is on catering. The focus is also on technical services in the U.S. and in Europe and basically across. There is nothing imminent right now. We are working with some candidates. But as you know, with this, it's difficult to give an exact time. We need to buy the right company at the right price, and that's why the timing can be a little bit difficult to predict.

Just to let you – to make sure you know where we are on the self-delivery side, in North America, we have actually converted some of our contracts into self-delivery and we're doing that during the year. So we can deliver the services in the way we're supposed to deliver them in the IFS model, also in the North America.

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

Operator

Thank you. Our next question is from Michael Rasner (sic) [Michael Rasmussen] (44:22) from ABG. Please go ahead.

<Q - Michael K. Rasmussen>: Yes. Thank you. And well done on a good quarter, you guys. Just talking about margins in the second half just to make sure we get this right, I mean, second half is always somewhat stronger margins than first half, but I just want to be able to understand how the contract start-ups and then all the moving parts are going to impact Q3 and especially Q4, which was very, very strong last year. And also taking into account that the divestment of the high-margin call center business in Turkey, could we actually see margins be down year-on-year in the fourth quarter? That's my first question.

My second question is a bit of a household question. Am I right in assuming that the table that you put in terms of your new margins on debt, will that give you annual savings of DKK 50 million per year on the debt side.

And then finally, in relation to the large Cleaning contract that you announced with the Bank, when are you going to follow that customer to Asia and the U.S.? Is that going to be this year or will that be into 2016? Thank you.

<A - Heine Dalsgaard>: Hello, Michael. So with respect to the margin and in particular also with the effect from CMC, it's clear that CMC is a high-margin business. But please bear in mind that the closing is expected to take place during Q4, so the effect this year will be limited of course, depending on when it closes. From our point of view, margin really is irrelevant. It is the price that we can achieve and how we can recycle the proceeds into the business. That determines the value creation.

In terms of margin overall for the Group, if we look at where we are today with this is, where we thought we would be back in March when we set the guidance, I think it's important to highlight three things. One is that our organic growth has surpassed our expectations. Clearly pleasing, of course, although this does have a certain effect on start-up costs. Point number two is that our strategic initiatives have been delivered according to plan, which is positive. And point number three then is that the performance in both in Netherlands and Brazil was expected to be challenging, but that these markets have proven to be even tougher than we had imagined.

So our guidance for 2015 margins to be above 2014 simply, and clearly remains the same. We are 10 basis points ahead half year. The sort of the competitive environment remains challenging as it always will, and we can only say, we are very pleased with the progress so far.

In terms of the new margins on the debt facilities, the number you come up with is assuming that we use the RCF. So the credit facility is 100%, that's not the case. So the effects on a yearly basis is going to be significantly smaller than the number you've come up with.

<A - Jeff Olsen Gravenhorst>: With regards to the large Cleaning contract to the Bank, as announced, it is actually already in mobilization in also Asia and the Americas for that matter. So it is being mobilized across those regions as well.

<Q - Michael K. Rasmussen>: Okay. Great. Thank you very much.

Operator

Thank you. We have the next question from Justin Godiksen (sic) [Kristian Godiksen] (48:16) from SEB. Please go ahead.

<Q - Kristian Godiksen>: Yes, hello? This is Kristian from SEB. So to start with, can you please try to explain me why organic growth should slowdown from the 4.8% you delivered in Q2, because as I see it, you have a lot of contracts, which are not fully ramped up combined with new contracts won also starting up. And you will also get easy comparisons from, let's say, just the UK hospital contract you lost in end of last year? That was my first question.

Secondly, the last contracts started up in 2015. How ramped up are they here at end of Q2? So how much impact did they have in the second quarter? And also on the Global Corporate Client Cleaning contract, can you give a flavor on size and when that is ramped up and maybe and perhaps if number of employees are something similar.

Thirdly, the Statoil contract you lost last year, did that have any impact on this Q2 growth?

And then just fourthly, if I may, can you maybe comment a bit on the timing and on the finding on a new Chief Operating Officer, since you now have created the role? Thank you.

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you. We start with the overall growth expectations for the second quarter. There is no doubt that we are very happy with the growth for the first quarter. For half year, it's about 4%. It's very difficult when you go into the exact quarter on comparisons. Nevertheless, 4% for the first half year, we expect 3.5% to 4.5% for the full year and that takes in of course a lot of ups and downs.

We do have a number of contract startups. DSB, as you know, Danske Bank, as you know. We have expansions but we also see the flipside. There is no doubt that we'll see the annualization of the Nestle contract we announced last year, we started last year. There is a slowdown, as I said, on the resource sector in Pacific, which would slow down the growth compared to very strong growth last year in Pacific.

Brazil and Netherlands are not growing, as we expected it too. So we think that that will remain a challenge for the rest of the year. And then we do believe that the macroeconomic conditions will remain unsupportive. I don't see a lot of upsides coming from the macroeconomic development. And with that, of course, we're taking a cautious look at what happens in China right now and particularly also Brazil as a market.

And then, of course, there is also a number of renewals, as always, that happens in a business like ours. And then, of course, we have to put that into the account as well as the number of project works that we did last year also, so it is a difficult thing to predict. Having said that, we remain confident that we can keep the level up where we see it for the first half year so we expect to be 3.5% to 4.5%, but it is as I said, there're a lot of positives and negatives that comes together and we believe that with the guidance we're giving, it's a balanced and realistic view everything considered.

You asked for very specific details on the individual contracts. The Statoil contract had only – actually had impact for Q2, didn't have any impact or have negative impact for Q1 and it tailed off in Q2 and of course would tail off as we go throughout the rest of the year, as I said, Nestle will go the other way as well as some of the project works from the last year.

The ramp up of the Cleaning contract, we have not and do not actually announce and this is of course, in agreement with the clients talk about the exact size of these contracts. But we can say that the – it's a nice looking Cleaning contract, it's a triple-digit million Danish kroner contract that is not at the average size of GCC accounts normally. So it's a nice size contract but that's it. And it's been ramped up as expected to this point but we don't give any more details on that.

If I can just end up with the COO structure, there is no doubt that the structure is going ahead and we were launching it and we have of course, also the support of Henrik up till December 1 and before September 1, we expect to come up with what's going to be – who's going to take over from that and we do have a number of candidates for that already, so we will move ahead as planned.

<Q - Kristian Godiksen>: Okay. And just a quick follow up if I may. So on the first question regarding the organic growth. I guess, you mentioned that the weak macroeconomic outlook can take – could hamper growth in the second half. I guess that was also the case in the second quarter. And you also mentioned the contract retention, which is an uncertainty, but I guess that was also the case in Q1 and Q2. So my question is basically, how large of a contract is

Nestle and what magnitude of slowdown are we talking about in the Pacific?

<A - Jeff Olsen Gravenhorst>: I understand the interest in this question, but I have say there are a lot of moving parts when you sit with 50-odd countries. So some are up and some are down. We expect the same thing as we said at the beginning of the year. We've been successful in winning and launching contracts faster than originally expected with a little bit more project works in the beginning. We're taking a good, solid, realistic view on our portfolio development for the second half year, and that's – we don't go further into details here, but we do expect that we can deliver 3.5% to 4.5% organic growth for the full year.

<Q - Kristian Godiksen>: Okay. Thank you.

Operator

Thank you. We have the next question from Jesper Jensen from Nordea. Please go ahead.

<Q - Jesper Herholt Jensen>: Thank you, and good morning. Just a couple of questions. Firstly on the procurement program, you've now launched the third phase, and I appreciate, it might be little early to give us some targets in terms of savings, but maybe you can sort of indicate the potential and maybe also just to remind us which areas is it that you're targeting here in Phase III. That was the first question.

<A - Jeff Olsen Gravenhorst>: Yeah. Phase III is obviously of – the first two phases were the lower-hanging fruits, if you can say it like that, and they will both have impact both this year and next year as we said before. The third category is a little bit more, can we say, sticky. So it's a smaller impact overall and the categories that goes into the third category is more how we manage our fleet, for example. So it's a little bit more tricky and has more processes included in it. So we don't actually come up with the numbers, yet, Jesper, and we will be a little bit more clear on this as we go forward.

<Q - Jesper Herholt Jensen>: Okay. Thank you. And just, maybe just a follow-up on your business process outsourcing. I think in the last quarter, you gave us some numbers on actual headcounts. You were looking at it in the Nordics and Belgium and Netherlands and then I was just wondering whether you can sort of add to that in terms of Australia and the opportunities you see in the other European countries?

<A - Heine Dalsgaard>: Yes. So you're right, Jesper. We did give some indications as to the potential we had and have seen in the Nordic and we see the same potential in the other markets that we are rolling it out to right now. So that means the Netherlands, Belgium and Luxembourg and also Australia. So that's why we've done the analysis in those countries. We see its pluses and minuses here and there, but overall, the same potential.

<Q - Jesper Herholt Jensen>: Okay. And the last question then is just on the tax credit scheme in France, the CIC scheme. I was just wondering whether you could provide us with an update to understand maybe there's been a little bit of discussion where that scheme is still going to continue in France and maybe you can update us on what you hear and what the potential impact would be on your business if it was discontinued?

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you, Jesper. Obviously, this is an initiative that replaced the former initiative, which is about sort of helping the employment of the lower wage groups in France. These are initiatives that's always been there. It is to encourage recruitment, training, and investment into the workforce in France. So our own expectations is that if this goes away, something else comes in – comes to take over from its place as we've seen throughout the many, many years.

Now, we have to put it in perspective of course that the impact overall can – there is an impact, if it should fall away altogether, which we do not believe. The credit is about 6% of our wages, but it's only of the wages which is on the lowest level, wages that do not exceed 2.5 times the French minimum wage.

Now, our revenue in France, about 7% of our Group, and then we have to take out, that we have wages which are probably 50% of our country revenue, and then you can go down to which part of those wages are below 2.5 times, which is not – obviously not all of it. So when you sum it all up, it's not a material significant impact on the Group, but as I said, whether it's going to be scrapped or not remains to be seen, and if it is, then probably something else will come in place.

<Q - Jesper Herholt Jensen>: Okay. Thank you.

Operator

Thank you. We have the last question from Matija Gergolet from Goldman Sachs. Please go ahead.

<Q - Matija Gergolet>: Yes. Hello. Good morning. Just a couple of – well, two sort of questions. One is a bit more on the numbers. I mean there has been a lot to say, talk and questions about the Brazil, the Netherlands and probably also China, [indiscernible] (58:45) no weaknesses in the current markets. Could you give us the numbers about what was the potential sales coming from those markets in the first half, and possibly some numbers or at least some color about the current profitability such as now if the Netherlands at the moment at all profitable or are you actually – I mean, are you above breakeven or below for example?

And then secondly, a bit more strategically. So as far as I can remember, you're also, say, planning to gradually exit the more route-based businesses, which I think were fairly small like 4% of your revenues. Just wanted to hear some comments whether that is still ongoing and basically, at what stage are we at the moment?

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you. If we just start by taking Brazil and Netherlands, which we've talked a little bit about, combined, they are both less than 5% of our revenue. So around 2% on the two. We don't comment on the individual earnings per country but we typically don't run around with massively low losing countries. So – but other than that, we don't give more details on the individual countries. On – so basically, it's a relatively small part of our business. If you look at China, we're running around 1% or just below 1% of our business. I think those were the three you were asking about.

And if we then look into the exit of the route-based, I think it's – we have to look at it at a slightly different way. It ends up probably in the same spot but our focus is on delivering the services that fits into these key account and IFS contracts and that means in some countries we've got good branch network for example, for delivering services to our bank branches, that you could call route-based. We're certainly not going to divest that.

So there are certain route-based businesses which means – which fits in very well to our business and then there are others which just not really fit in, and those are the ones that we've sold off over the years. And part of that has been pest control in certain countries, and it's been mobile patrolling [indiscernible] (01:00:48) security in certain countries but it is a country-by-country evaluation.

The markets [ph] hence, us being very local, we (01:00:55) present are slightly different from one region to another, and that's why it's not that easy to say just everything in the route-based is basis being exited. That's not the case. We're on track, and the bulk of the exits has been done, but there will always be some as we saw yesterday with the selling of call center. But that's basically it.

<Q - Matija Gergolet>: Okay. Thank you for the color.

Operator

Thank you. We have no more questions for the moment.

Nicholas Ward

Okay. Thanks very much, everybody. Thank you for your time, for your interest, and your questions. We look forward to seeing many of you hopefully on September 17 at our Capital Markets Day. And with that, we bid you farewell. Thank you.