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Full Year 2023 ISS A/S Earnings Call

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PRESENTATION

Operator

Welcome to ISS annual report 2023 conference call. Today's call is being recorded. (Operator Instructions) I will now hand it over to Jacob Johansen please begin.

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

Good morning, ladies, and gentlemen, and welcome to the ISS full year 2023 conference call. As said, my name is Jacob Johansen, Head of Investor Relations, and I'm here at our global headquarter Søborg, Copenhagen. With me in the room today is our Group CEO, Kasper Fangel; as well as Kristian from IR colleagues. Before we start, I'll ask you to pay a close attention to the disclaimer on slide 33 with a short introduction, I'll hand over the word to Kasper and slide number 3.

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

Thank you, Jacob, and good morning, everyone. 2023 was another positive chapter in ISS journey towards building a company that is growth oriented, people-centric and performance focused. We've executed well, both strategically and operationally. Not only have we delivered financial results in line with the expectations in 2023, but we move into '24 with strong operating momentum, clarity of strategic focus, customers that value what we do and a market that will continue to provide favorable conditions for growth.

This year, we delivered the highest growth rate in the history of ISS. Our strategic direction is unchanged, and we have, in fact, further strengthen our ability to deliver through a focus on fewer strategic initiatives, in essence, doing less things, but doing them better and with the right level of investment and scale.

The store organic growth momentum was maintained throughout the year and ended at 9.7% for the full year. It's also encouraging to see that we delivered the expected improvement in profitability, both margin and free cash flow in line with outlook. This also means that we have significantly deleveraged the business and we now within our targeted gearing range. We'll therefore initiate a share buyback program of DKK1 billion to be executed over the next 12-months.

Before we move on, I want to highlight another item impacting 2024. As previously mentioned, ISS. and Deutsche Telekom have certain contractual disagreements. And in late 2022, we have initiated an arbitration process towards Deutsche Telekom to get a binding ruling on these disagreements. It's expected the process will be completed mid 2025 at the latest.

The disagreement concerns remuneration for services delivered and Deutsche Telekom is currently holding back payments. We are obviously working with both local and global experts and legal advisers. And let me be very clear, we are confident in our case, at the end of the presentation. I'll come back on how this impact our outlook for the full year.

Let me provide you with an update on our main strategic initiatives. In Q3, we refocused and prioritized the OneISS strategy and the many initiatives behind it. Although a process that includes people matters is always tough from an emotional point of view, I'm satisfied with the execution of the program. It has not created any interruption for customers and I can already now see the strengthened internal focus on fewer things with higher quality will benefit the business going forward.

I'll come back to this on the next slide where I will provide some additional color. Also during Q4, we have completed a comprehensive customer survey to gain additional insights to our customers' priorities. The results are promising, and I will later in the presentation, go further into the details.

We've been able to maintain our customer retention rate at 95%, in line with our midterm target and in the beginning of '24, we've successfully extended two global key account contracts. All in all, the pipeline of commercial opportunities remains solid and we are in a good position regarding the largest contracts up for renewal this year.

We've also made solid progress on M&A. The process of finalizing the divestment of our French business is progressing as planned, and we expect to be able to close the transaction in the first half of this year. The integration of Grupo Fissa in Spain is completed and benefits are on track to be realized here in 2024.

Lastly, Livit, FM in Switzerland have achieved synergies that exceed the initial business plan. These are important data points as they underpin our ability to generate value through simple bolt-on acquisitions.

Please go to the next slide for a closer look at the OneISS review. I'm pleased to see that review of the OneISS initiatives is completed. I'll not spend time on the strategic purpose of the review. As you have heard me talk about that several times before. Post the completion of the review the company is operating with strengthened focus. And let me give you an example of that. Everything we do at corporate level needs to be justified as a benefit to our business. The assessment of that justification is simple, does it create value at site level. The value at site level can be a visible and a direct benefit to the customer or it can be something that makes our staff work more efficient, that can be a technology solution, innovation, process improvement or something else.

And as you'll hear later on when I presented results from our customer survey, this adjustment aligns well with what is appealing to our customers. This review has provided that mindset to our leaders across the organization, and we've improved the link between cost and value at site level significantly, which I'm very pleased with from a financial point of view, the summary is as following fully as expected, we have incurred one-off costs. We can see the split of the DKK233 million on the slide, the exercise was a group-based exercise where the decisions of which activities to scale down was made at central level leaving two countries aligning accordingly.

With this, we reduced the cost base and operational benefits will also be generated. We, therefore, expect to achieve savings of around DKK250 million annually with around DKK200 million to have effect here in 2024.

Please turn to slide 8 and our commercial development. In the last quarter, we've seen good commercial activity on local and regional deals. In November, we were awarded the IFS contract as a part of the third outsourcing way with the Danish Building and Property Agency. The contract will start up in May. We've also seen good activity on the contract renewal front, and we have extended a long list of key account contracts, including the extension of two significant global partnerships with Nordea and an industry and manufacturing customer.

In addition to the specific contracts mentioned on the slide, we have good traction on local deals. We have won several contracts across the whole group. And we continue to see customers expanding scope with us, both regarding service lines and geographies.

When I look into the coming year, I'm also very pleased to see that we only have 4% of our larger contracts up for renewal that is lower than what we have seen historically. And there is no single contracts above 1 percentage points of group revenue. The 2025 target has increased slightly to 10%. As we've seen a couple of short-term extensions. It's still a good mix of different customer segments and countries.

Please go to the next slide to look at the customer survey. We have conducted we have in Q4 2023, conducted our annual Global Customer Engagement Survey with over 2,000 respondents. It sheds important light on the key priorities that our customers are focused on as it relates to integrated facility services.

When you cluster the many insights we have gained from the survey, we see free common overarching priorities that will shape the

market activity moving forward. First one is service efficiency and quality. Second one is more innovation and flexible service solutions. The third one is achievement of sustainability commitments. These priorities are important responses to key megatrends affecting all businesses globally.

Macro volatility requiring organizational resilience, hybrid work as the new normal sustainability as an enabler to talent attraction. And finally, the overall redefining of the relationship between people and work of people and workplace.

It's also interesting to note that the relative importance of these priorities can be different based on segments or even countries. And here, we believe our OneISS strategy with the segment focus is well calibrated to the current context, we also believe that our ability to deploy placemakers, who care whose talents are supported by leading technology and who are focused on delivering quality, flexibility, innovation, and sustainability is a winning formula.

Please turn to slide 11. We'll go through the financials.

The financial results for 2023 are solid and in line with outlook. Organic growth was almost 10% after several upgrades of the outlook during 2023. In Q4, organic growth was 7%, which as expected was lower than the previous quarters. As the comparison base grew during 2022, in line with customers return to office.

As expected, the underlying margin was 4.6% and including the one-off costs related to the OneISS review, as I just spoke about earlier, the reported margin was 4.3%. Free cash flow for 2023 was also as expected, DKK1.8 billion.

Please go to the next slide for deep dive on the drivers behind the organic growth. The organic growth in '23 was driven by two factors, price increases and underlying volume growth price increases contributed with around two-third to the development. While the other one-third came from volume growth, around half of the price increases were in Turkey across all countries, we've seen high inflation, mainly driven by wages where minimum wage and collective agreements have been adjusted.

We have strong processes in place to mitigate these effects and with the terms of our contracts we can increase prices towards customers accordingly. Price increases are typically done in the beginning of the year, but we also made price increases in selected countries during the rest of the year. The underlying volume growth driven by increased activity level at customer sites and continued higher occupancy rates across the Group.

From a commercial perspective, 2023 has been a year with high retention rates, but also lower than historically win rates instead have seen growth from expanding our services with current customers and price increases. And of course, I'm fully aware that what is crucial going forward is that the net new contract wins is a significant positive. And therefore, it's also pleasing to see that we have a number of significant contracts starting up early this year. DEFRA in the UK being the biggest, organic growth from projects and above-base work was as expected, negative with 2% in Q4 for 2023 as a whole, the negative contribution was marginally.

Please turn to slide 13 and the margin. The operating margin developed as expected in 2023 and the underlying margin improved to 4.6% from the 4.0% reported in 2022. The increase was driven by efficiencies and cost initiatives across the Group, continued improvement in the UK and on the Deutsche Telekom contract as well as operating leverage from the higher revenue.

The price increases that I just spoke about had an offsetting effect to cost inflation and the margin was therefore unaffected, including the one-off costs from the OneISS review, reported margin was 4.3%.

Please go to the next slide. We launched the OneISS strategy in 2020, we have delivered steady margin improvements 2023 was another step on this journey to re-establish margins at historical levels, with the improvements that we have achieved over the last years and with the review and prioritization of the OneISS strategic initiatives, we are well on track to improve margins further in '24 and achieve a margin of above 5% in line with our financial targets.

Please turn to slide 15 and the free cash flow. Free cash flow in 2023 amounted to DKK1.8 billion. As expected, changes in working

capital generated a cash inflow as the pressure on receivables from growing the business was more than offset by stronger than expected cash collection in December. The factoring balance increased from DKK1.3 billion to DKK1.4 billion in 2023, in line with organic growth.

The balance was unchanged since the half year, the net effect of depreciation and CapEx was an outflow of DKK200 million as we have added CapEx additions related to contracts starting in the beginning of 2024 earlier than expected, and we have accelerated our investment in the electrical car fleet.

Please go to the next slide where we take a closer look at the capital structure since 2020, we have deleveraged the business significantly. This has been achieved through a combination of increased earnings and lower net debt, going out of 2023, the leverage ratio was 2.2 times. And we're now firmly within our leverage target of 2.0 times to 2.5 times, which is the first priority in our capital allocation policy.

Therefore, we propose a dividend payment of 20% of adjusted net profit equal to DKK2.3 per share at the Annual General Meeting in April. And in addition, we are today, launching a share buyback program of DKK1 billion, fully in line with the capital allocation policy.

With this, I've concluded the financial part of the presentation, so let us go to slide 18 and the outlook.

In 2024, we expect to continue the solid development from the previous years. We expect organic growth to be in the range of 4% to 6% and an operating margin above 5%, both fully in line with our financial targets. Our free cash flow is expected to be above DKK2.4 billion underlying corresponding to a cash conversion of above 60%.

However, we have timing effects impacting our cash flow this year, and I've already mentioned the Deutsche Telekom situation, all in all that could be a negative timing impact of up to DKK600 million, meaning our reported free cash flow would be above DKK1.8 billion in '24.

But let me be crystal clear that this is purely timing, it's not a matter of if we get these payments, but a matter of when they will be paid. I will on the following slide go into the detail on each of the three outlook KPIs, slide 19, please. The drivers behind the organic growth in '24 will be the same as we saw in '23 as wage inflation is still running relatively high across the world we will implement price increases to offset the increase to our cost base, primarily from wage inflation.

Here we will follow exactly the same process as we have successfully done over the last years. For 2024, the contribution from price increases expected to be 3%-percentage-points to 4%-percentage-points slightly lower than in '23.

We are seeing a solid activity level at the customer sites and for '24, we expect the underlying volume development to drive organic growth of 1% to 2%. We expect a slight positive contribution from net contract wins as some of the positive effects from DEFRA and the Danish Building Property Agency and local contract wins are offset by contract losses that the demobilize in '24. Organic growth from projects and above base is expected to be neutral to slightly negative. This adds up to an organic growth of 4% to 6%.

Please go to slide 20 and the margin building blocks. We expect continued margin improvement in '24 and in line with our financial targets, we expect the margin to be above 5%. The two main building blocks behind the improvement from the 4.6% underlying margin in '23. First of all, we expect to execute on the detailed plans that will drive continued operational improvements across the Group.

As communicated at the Capital Markets Day in '22, we expect the margin in the UK to be in line with Group average margins in '24, while Deutsche Telekom will remain dilutive. As mentioned, the review of the OneISS initiatives will also be driving benefits, and we expect around DKK200 million of cost savings and operational benefits here in '24.

Please go to the next slide for the free cash flow. We expect the strong underlying cash flow generation to be maintained in '24. Further to the dynamics that I just mentioned regarding timing, we expect this year's free cash flow to be impacted by slightly higher interest and tax payments due to the higher profit and a slight negative contribution from working capital.

Capex is expected to normalize with additions equaling the level of depreciation Please turn to slide 22. Let me put a few words on phasing of our free cash flow. As things have normalized post COVID-19, you should continue to expect seasonality within our cash flow with H1 being structurally lower than H2. This is consistent with the development in the first half of '23, where free cash flow was negative DKK1.1 billion in the first half and positive DKK2.9 billion in the second half.

I will not guide specifically for the first half, but it's important for me to highlight the structural drivers behind the development. First of all, we have seasonality in our earnings. Our absolute profit is therefore lower in the first half than in the second half in addition, we have certain payments that only occurs in the first half like bonuses and normal prepayments of different items like licenses and rents. All in all, this means that you should expect the free cash flow to be negative in the first half of '24 at ballpark, the same level as in '23.

Please turn to slide 23 where, I will provide some closing remarks.

2023 was an eventful year for ISS. As mentioned in my opening remarks, another positive chapter in ISS has journey towards building a company that is growth oriented people centric and performance focused. We delivered solid financial results, including one of the highest organic growth rates in the history of the company.

We continue to execute well both strategically and operationally, and we move into '24 with strong operating momentum, clear focus, customers who likes us and a market that wants and needs what we sell. We continue to build on the solid foundation for the future through a focus on fewer strategic initiatives, in essence, doing less things, but doing them better and the right level of investment and scale.

Lastly, I would like to extend a couple of thank you. First to our more than 350,000 placemakers, who are the true magic of ISS, and although I have the privilege of communicating these results. These outcomes belong to them and a testament to their hard work, dedication and unwavering commitment to serving customers with excellence in every interaction every day.

Finally to our customers, thank you for placing your trust in us and allowing us the opportunity to earn your business. Our commitment is to continue to work with you in creating workplaces that fosters belonging, community, creativity, sustainability and impact.

With this, I conclude the presentation, and we will open up for Q&A where I will be supported by IR.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Michael Rasmussen, Danske Bank.

Michael Rasmussen *Danske Bank A/S - Analyst*

Yes, thank you very much. I Three questions from my side. First of all, Kasper, if you could talk a little bit about them, the 2024 guidance of a small impact positive from net contract wins. Can you talk a little bit more in detail about the potential pipeline and also which regions we should see these wins coming in? So that's my first question.

Second question also on the guidance in terms of the net working capital impact and of course, this is excluding the Deutsche Telekom one-off. Why is that going to be a drag in 2024, are you seeing the customers asking for longer payment terms, that we see a bit of a reversal of what we saw in 2023?

And then my final question is also on cash flow 2024 and taking into account the leverage. So assuming that you find no bolt-on acquisitions should one either ISS consider interim dividends or maybe adjusting the share buybacks? Thank you.

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

Yeah, good morning. Thank you so much, Michael. Let me just put a few words on your commercial question as the first one. I mean, we do have a solid pipeline, and I would like to put a few words on that. I think there the good distinction to make here is between local and global customers. From a local perspective, we're really seeing the things that we have worked with the OneISS strategy is coming through and we can see that we have value propositions that is beating the local commodity players. We're coming to customers' with a value proposition that really resonates with them.

We're coming with piece of technology that local players cannot compete with. And we also more effective on price because we moved to work in a more efficient way. And that's exactly what we are seeing with the many contract wins that we have launched locally, and I expect that to continue. So these are not big items, but it's a solid prospects that they're that we're lending locally in a number of local markets and that visibility will continue over the course of '24.

Then from a global perspective, I mean, I'll not shy away from the fact that, of course, I'm disappointed that we haven't won a global contract in the last 12-months. And but there's nothing structurally that has changed there, and I'm still optimistic about that.

The same continues as we have seen and I've entertained you with it the many last time that the decision making processes are taking longer because there's simply more importance on the customer side of this decision so more people are involved.

But with certain we're getting traction when we are coming with our value proposition and what matters to customers is that we can deliver services, of course, as I mentioned, when I went through the survey in a effective way, but also with consistency across the global portfolio and where we can do that.

We have a number of prospects that I'm positive on but I have stopped giving a guidance on that. They're just around the corner because then it will sound ridiculous because I have done that several times before. But the pipeline definitely is lucrative. And then I'm pleased on the commercial side I'm pleased to see that we continue the high retention rate at 95%. I also and I fully get that the competition is also higher than where they've been historically but this is something that we work with structurally and it's good to see that it's coming through and we are closer to the customers today compared to what was the case two, three years ago.

In terms of net working capital and the small drag in that, expected to be a small drag in this year. There's no structural changes on payment terms at all, this is fully consistent with what we have mentioned several times before and also what we had in the Capital Markets Day as we grow there. Will be a small drag on working capital, but this year is not expected to be more than them. And what we've seen historically, and we are super close to the business in terms of making sure that we are not giving up on that getting favorable payment terms from our customers.

And the last thing on capital allocation. We have the capital allocation policy, and that's exactly what I mentioned on the last two conference calls. When we have excess capital, then we assume we stick to the policy, and that's what's behind the DKK1 billion in, our share buyback program that we are we launching today and of course, we'll continue to look at it where the business is from a leverage perspective and continue to have that dialogue with the Board. But we are fully committed to the capital allocation policy.

Michael Rasmussen Danske Bank A/S - Analyst

Great thank you. Thank you very much Kasper.

Operator

(Operator Instructions) Annelies Vermeulen, Morgan Stanley.

Annelies Vermeulen Morgan Stanley - Analyst

Hi, good morning, Kasper, my three questions as well. And they just firstly on the Deutsche Telekom arbitration process, and you say you initiated this in late 2022, you expect that could run until mid 2025. So I'm curious as to what your assumptions are internally around that process and therefore, what, if anything is included in the full year '24 guidance?

And three years for this kind of process, is that typical or would you say this is quite an extended process and also on the payment that would holding? Is that the services that they've already received? And therefore, are you 100% confident that you will get those payments? Or is that something that could in effect be written off as part of the arbitration process, that's the first question.

And then secondly, on just coming back on capital allocation as well. I think you're authorised to do a buyback of up to 10% of the share capital, I think where DKK1 billion is about 4% or 5% and given where the stock price is and given, that I think you could do the full 10% and it will be within your leverage range? And on my calculations, is there a reason why you're only doing DKK1 billion and or is it because you expect to do more acquisitions or anything else and that we should be aware of for 2024.

And then lastly, just on the margin guide, and as you say, you guys have margin guide of over 5% at the end of 2022. But since then, we've had the sale of France, we had the review of the strategic initiatives, which you say will and come with cost benefit, though, given what's behind that decision to keep that margin guidance unchanged? Is there anything else in that actually dragging on margins that is offsetting the benefit you're getting from France and the strategic review? Or is it just the case, if we say over 5% for that could be anything from 5.1% to 5.5% or higher? And how should we think about that, thank you.

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

Good morning and thank Annelies three very good question. So thanks for that let me take the first one on the on margin. Clearly when we are guiding above 5% on operating margin, then as I'm sure you would expect it's not saying it's the same as saying that we have a forecast of 5.01%. Of course, we have an internal forecast that is significantly better than that what is important for us on the margin side is that we're doing the right things for the business and we're early in the year, and we want to make sure that we have the flexibility to do what is right for the business throughout this year there's nothing off track you're exactly right.

We got an uplift from selling France of 10 bps. We got an uplift of 30 bps from the OneISS review DKK200 million that is kicking in this year and the rest of the business is trending in line with expectations. But because it's early in the year. We think this is the right guidance to come out with to make sure that we have the maneuver room to do the right thing for ISS. In terms of the capital allocation, and I mean your back of an envelope calculation is totally right? So I'm not pushing back on that in any way, shape or form now we are getting started we ISS has not done a share buyback program before.

Now we do DKK1 billion in this context, DKK1 billion is a lot of money and we will do that and then we keep an eye on it.

Of course, we do, as I said, we have a policy for reasons that is to follow it. Otherwise, we shouldn't have a policy and we will continue to do that and by our Board is of the same opinion as I'm expressing here. So now we're getting started and then we will evaluate along the way.

And last one on the on Deutsche Telekom a couple of questions that you have had there. The first one in terms of the, my comfort level is very high. And I'm basing that, of course, on the on the many detailed conversation and work that that I have done also in my previous position as Group CFO, I've really been in the details on that on this one here, but also basing it on the come for that we're getting from our experts both the arbitration experts and the lawyers and the other external advisors that that we're having in here, and it's relatively simple.

It is exactly as you were saying, DTAG is holding back payments for services that we're delivering. And of course, you have to pay for services that are being delivered. So I don't see an impairment risk around this at all. It's a matter of when the cash is coming in, where that's coming in in '24 or '25. And if there are some withholdings being done in '24, then I'm confident that that is going to come in '25 because it's binding that this procedure needs to be completed over the course of the first half of '25.

And on your I think you circled around your question around the Deutsche Telekom and the relationship in general. We are, of course, it's our biggest customer and continue to work with them and continue to work with the improvement plans that we have from an operational point of view. And we separate the two things, the arbitration case and the operational track and the operational track is going in line with expectations. And that's also why we have seen that the profitability on the contract has increased year-over-year from

'22 to '23, and we expect that to continue in over the course of this year. And then on the arbitration. just a quick word on that one. Is there anything that is extraordinary they are I mean, luckily, I've never been involved in any other arbitration cases.

But what I'm hearing is that it's pretty normal that when you're getting close to the final deadline, that things are getting more tense and are being a little bit more tense in the whole equation and that's what we are seeing here.

It's been important for us to go out and tell you as soon as we knew that this has an impact. It could have an important, or a significant impact for 2024 cash flow. And that's why we're laying it out with this transparency in the report.

Annelies Vermeulen *Morgan Stanley - Analyst*

That's great thank you very much.

Operator

(Operator Instructions) Kristian Godiksen, SEB.

Kristian Godiksen *SEB - Analyst*

Thank you. A number of questions from my side as well. So maybe Kasper, can you comment a bit on these DKK200 million in additional improvements from the readjustment of the ISS initiatives, so that equivalent to around the 25 basis points. So I was wondering, on slide 20, and I guess you could have put the above 5% and one step to the left and the benefits from the OneISS to the right?

So you should have reached above 5% even adjusting not for the benefits as I guess, that would have been in line with when you launched the OneISS and the target of about 5% from 2024. So when that's the first question, maybe you can also comment a bit on the maneuver room you mentioned, is that the M&A or acceleration of certain investments? Or what does that mean and that must be the first question?

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

Yeah, good morning, Kristian. I mean, I could have done many things, but the key point here is what I've already mentioned to Annelies that is our business is running fast in the right direction. And it's not that I'm sitting and looking at a forecast of 5.01%.

So it's coming through and the OneISS adjustments are also coming through I don't want to be specific. If I wanted to be specific, I would have been that in the guidance, we will deliver above 5% on margin in '24 and I don't have any specific in mind other than the fact that we are in February now and I think together with my management team, that is the right thing to come up with to with the guidance this early in the year, that is above 5%. And then of course, as we move one over the course of the year, we will socialize where we are and most likely the guidance will also be narrowed accordingly.

Kristian Godiksen *SEB - Analyst*

Okay. Then the second question would be on the size of the share buyback. So and mechanically, if you do not do any M&A and even if Deutsche Telekom the payments as well withheld also in '24, then you will be below the -- low end of your of your capital structure type, can you maybe comment a bit on how you decided on the DKK1 billion and the no, how do you see that evolving throughout the year?

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

Yeah, what I can comment on is I can see the same as I mentioned earlier, Kristian, we have a capital allocation policy that clearly lays out the priorities, you should not think that anything has changed on the M&A arena.

It's not that I'm sitting here thinking that we need to go out and do over the course of this year and make a significant transformational M&A, that's not where we are at. But I want to have the flexibility and the opportunities to do bolt-on acquisitions.

It's coming through you know, a better than expected in Switzerland, and I'm only talking to the numbers here, but strategically, the fit is

also excellent and I expect the same and there's no reason to believe that that shouldn't be the same for Spain as well. So I want to have some capital to simple bolt-on acquisitions with low risk. And then as I said, we will continue to evaluate the capital allocation policy and we'll follow that one, of course, also throughout this year.

Kristian Godiksen SEB - Analyst

Okay thank you, then so obviously, the market there based on share price reaction is very worried about the Deutsche Telekom contract and how interpreted. So maybe could you comment a bit on how dilutive the contract is to the Group margin and then obviously also maybe on the risk of these DKK600 million in relation to the arbitration and how this can be translated into the relation to claims that are made by Deutsche Telekom and the arbitration?

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

Yeah I mean, I totally appreciate that this is an important matter and I'm happy to write as much information and transparency, but only to a degree where it doesn't hurt our current arbitration case, obviously. But I think Kristian in terms of my comfort level offer of this, that's the same as I mentioned before, this is what they are withholding is for services that we are providing and I don't see any reason that they shouldn't pay that and my comfort level is also backed by external advisers, as I mentioned before. So it's a matter of when the cash is coming in, whether it's this year or next year.

And in terms of the contract specifics, you know that the contract is around DKK4 billion in annual turnover, and it is diluting to us, but it's running at a black number. So it is profitable, but it's still diluting too Group average margins.

Kristian Godiksen SEB - Analyst

Okay, perfect thanks a lot.

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

Your last question on sorry, I just looking at my notes when you made the questions here, the last question around, well, what is the worst-case scenario? I think that's basically what you're asking about between the lines where we will be sitting with the same costs and not having offsetting revenue. And the clear answer to that is absolutely not absolutely not, we are not going to sit with the with cost providing services that we're not getting paid for. So that is not going to be the case.

Operator

(Operator Instructions) Nicole Manion, UBS.

Nicole Manion UBS Investment Bank - Analyst

Hi, good morning. First question, please. If you could give us an update on what you see as the wage inflation trends across the group, whether you're confident that your pricing growth is still offsetting that and also it looks like that there might have been an uptick in that regard in Q4. So if you comment on that specifically will be good and also what you're seeing and lately in terms of employee satisfaction, how you think that's kind of trending that's the first question? Thanks.

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

Yeah, thank you, and good morning. So some we're looking at a consolidated picture where wage inflation from a growth perspective is going to be around 5% so lower than what we saw in there in '23 and also remember in '23, we had a number of countries, where there were adjustments more than once during the year but around 5% is what we're looking at in '24. And I'm fully confident that we can pass that on to customers. We've done that now successfully the last two, three years. And the system has proven itself and there and there's no danger signs that will not to be the case this year as well. So I don't see that as a threat to margin in '24.

Nicole Manion UBS Investment Bank - Analyst

Okay thank you. And maybe just a follow-up on Deutsche Telekom. I know you sort of touched on this, but just looking at the consensus expectations for, free cash flow in 2024 that number. And consensus is obviously relatively close to the DKK2.4 billion underlying that you're pointing to today.

So maybe could you touch on what's changed recently in terms of DKK600 million variance? It looks like that might be somewhat new news to you, at least maybe if you could kind of touch on sort of what happened there in recent weeks, I suppose or months. Thanks.

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

Yeah, but this is simply what we would have spoken about here during the call it is a worsening situation on DTAG. Now it has a material impact in '24. And that's exactly what I'm flagging, but I want to be clear that if we land at a free cash flow of what I'm saying here and what has been converting to is, of course, if we land at a free cash flow of DKK1.8 billion in '24. That means that the expectation for cash flow in '25 will be DKK600 million higher. And that's what I mean with facing that, that it's not that these money are gone. It's a matter about whether they are kicking in '24 or '25.

Nicole Manion UBS Investment Bank - Analyst

Okay thank you.

Operator

(Operator Instructions) Kristian Godiksen, SEB.

Kristian Godiksen SEB - Analyst

Perfect. Thank you, sorry that was just on the wage inflation, you mentioned Kasper that is expected to be around the 5%. And how does that translate into you expect price increases of 3% to 4% I assume there's also some inflation on the consumables that will be the first question?

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

Yeah. So the 5% growth, I expect that to convert into a net contribution on top line of between 3% and 4% with the same dynamics as we've seen historically that we do help our customers to get some synergies, which is easing the burden on their side. So it's not a straight pass on with the 5%, but the net contribution is going to be slightly lower than the 5%.

Kristian Godiksen SEB - Analyst

Okay that makes sense. But then the second question I have is on the UK. You mentioned that that is in line to the margin. And just to be clear, is that in line the adjusting for the corporate cost or is that yeah that's just the question.

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

This is obviously all in that I'm looking at it. I'm not looking at it with only local markets glasses on. I'm looking at all of our local markets from an enterprise perspective.

Kristian Godiksen SEB - Analyst

Okay, perfect that's good. And then thirdly, maybe could you comment a bit on the worry in the market that has been on regarding reduction in square meters, maybe can you comment a bit on, how many clients have you seen that need to do this, re-scope of the size of the office space and maybe to confirm whether it's still your expectation that they should have a net neutral impact on your revenue?

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

Yeah. So we are not seeing that, that customer's budgets are reducing. We are seeing that customers and business in general are investing into the workplace and yes, we have a number of customers that has reduced square meters, but the level of spend per square meter has gone up accordingly.

And then we have seen a number of customers that have initiated saving exercises. But we see that as an opportunity because we are working with them as a partner. So for us an opportunity to take over additional service lines from smaller companies that they're using and bundling it with our scope and therefore help the customer achieve savings. But at the same time growing our business.

Kristian Godiksen SEB - Analyst

Perfect. And then final question from my side and maybe could you comment a bit on what you see as upside and downside potential for the UBS/ Credit Suisse, which are both the client that I am not sure you can say both, but they were both client of yours? I guess it is one company now?

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

Yes, I can comment on that. I mean, first of all, we are super happy that we are a trusted partner in that in that process. And as you said, they are lighthouse customers of ours at the moment, it's business as usual. And we've not seen material changes to our business, and we're working in a partnership with them helping them to achieve what they need to achieve at the moment, no impact, but there, but without further disclosing anything, it's not something that we are worried about from a from a longer-term perspective.

Kristian Godiksen SEB - Analyst

Is it something you're more optimistic about them, maybe?

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

The opposite of worried it is optimistic, so yes Kristian.

Kristian Godiksen SEB - Analyst

Okay that sounds good thanks a lot that's all for me.

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

Thank you, Kristian.

Operator

(Operator Instructions) Klaus Kehl, Nykredit.

Klaus Kehl Nykredit Realkredit A/S - Analyst

Yes, hello, Klaus Kehl from Nykredit.

And I guess it's pretty obvious that you're not the best friends with Deutsche Telekom right now. And without going into a lot of contract details, which you obviously can't. Could you just from a very high level, talk about what kind of switching costs or exit cost would Deutsche Telekom have and what would be a kind of realistic worst-case scenario for ISS and yeah, please make it realistic. And I don't assume that you will be stuck with all of the costs and do nothing but more realistic? Thank you.

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

Yeah. Thanks, Klaus. And I get and also follow your question, but that would be pure speculation. I don't see such a scenario, so I don't want to start to speculate on that, Klaus.

Klaus Kehl Nykredit Realkredit A/S - Analyst

Okay. But could you then just talk about switching costs and exit costs or I guess you both would be hurt--

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

But we I know we are in an arbitration process. We are that for a reason that is that we want to draw a line in the sand and then of course, the target is from our side. And I'm sure the same from DTAG side is that then we got to have a fruitful partnership where we're helping each other to do what really matters, which is to for us to drive excellent services to it to Deutsche Telekom's staff and their customers.

And we are not coming in to this with an approach that we need to exit the contract. And that's why I'm saying it's pure speculation. So I don't want to start to quote numbers here on something that the I don't see as a likely scenario.

Klaus Kehl Nykredit Realkredit A/S - Analyst

Okay, great. Thank you very much.

Operator

I will now hand the word back to the speakers for any closing remarks.

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

Thank you very much and thanks, everyone, for listening in much appreciated.

Obviously, IR keeping themselves available over today, but also the coming days and next week, and please feel free to reach out to IR and I will also keep myself are available if there are certain things that need my involvement. But with that, thanks for attending the call and have a very good rest of your day.

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