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PRESENTATION

Operator

Welcome to the ISS Annual Report for 2022. (Operator Instructions) This call is being recorded. Today, I'm pleased to present Jacob Aarup-Andersen, Group CEO; and Kasper Fangel, Group CFO. Speakers, please begin.

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

Good morning, ladies and gentlemen. And welcome to this conference call following the release of ISS Annual Report 2022. My name is Jacob Johansen. I'm Head of Investor Relations. And with me here for today's call at our global headquarter in Søborg, is our group CEO, Jacob Aarup-Andersen; Group CFO, Kasper Fangel, and Kristian, my IR colleague.

Before we start, I will ask you to pay close attention to the disclaimer on Slide 32. So let's begin the presentation, and I will hand over the word to Jacob and Slide #3, please.

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

Thank you, Jacob, and good morning, everyone. So let me start with a short summary. First of all, with the achievement of the turnaround targets, we have now entered the next part of the OneISS strategy. As presented at the Capital Markets Day in November, we are increasingly focusing on growth, and we are targeting to deliver strong growth at sustainable and attractive margins. The investments in enhancing the commercial processes are starting to show results with both contract wins, a long list of contract extensions and continued record high retention rate.

The solid business momentum has continued, and the financial results improved during 2022. Organic growth accelerated sequentially throughout the year to 9.4% in Q4. On operating margin, it improved in line with outlook and the strong cash flow generation was maintained. Kasper will come back with all the details on the financials.

Finally, financial leverage ended 2022 at 2.6x. That's well below the turnaround target we set out in 2020. Our capital structure is now very healthy. Our capital allocation is clear, and we will resume dividend payments. Even though our macroeconomic and geopolitical uncertainty is elevated and visibility generally is low, we are very comfortable in our ability to deliver good growth and continued solid value creation in 2023.

Let's turn to Slide #5 for the strategic update. As already highlighted at the Capital Markets Day, the financial turnaround targets have been achieved, and we have now entered the next phase of the OneISS strategy. We are seeing progress on all strategic initiatives, and our 5 priorities for 2023 are unchanged. With focus on growth, brilliant operating basics, technology, planet and people, we will drive further improvements.

The commercial momentum continues to improve, and we have, over the last months, secured important contract wins and renewals. These are clear testaments that our investments in the commercial processes and operating model are working and driving positive outcomes. I will especially highlight the partnership with a major global health care customer. With the extension and expansion, the contract develops from a smaller local contracts into a much larger and uniform global key account IFS contract. This is exactly how we want to grow with our customers.

M&A is part of our capital allocation, and it's part of our value creation going forward. Therefore, it's very encouraging that the integration of the Swiss acquisition, Livit FM, is progressing faster than planned and with higher synergies than expected in the business case.

Please go to the next slide. Improving customer retention is an important component in achieving our target to deliver stronger organic growth going forward. Excluding the deliberate exit of the contract with the Danish Defence, we are at 94%, already a record high level for ISS, but we have an ambition to improve further to move above 95%. Retaining existing customers is the best sale. It entails lower risk as we already engaged with the customer, and we grow with our customers as they grow and typically, we increase our share of wallet. To enhance our relationship towards our existing customers, we are fully launching the [Customer for Life] program, which was started on selected accounts last year. It's a dedicated systematic enterprise-wide approach towards our customers to drive the right mindset and activity to keep customers with ISS forever. With the program, we engage with our customers in a structured way over the entire contract period to drive value and create true partnerships with enhanced likelihood of retention. In the initial phase, the program will focus on all of our global key accounts and important customers in 5 selected large countries.

So let's turn to Slide 7 for our status on the Livit FM acquisition. As you will recall, in October, we announced the acquisition of the Swiss facility management provider, Livit FM. Since the day of that acquisition, we have, as planned, run a well-managed and structured integration process. Importantly, IT integration and migration have been concluded ahead of plan and the onboarding of employees and operational integration have successfully been completed.

A significant share of the synergies have been realized faster than expected, and the business is now margin-accretive to both country and group and clearly value-creating from a ROIC perspective. We also expect higher synergies to be realized than assumed in the original business case. This acquisition strengthens the already-strong position of ISS Switzerland in the real estate asset management segment which we can now utilize towards other large asset managers. Livit FM is a prime example of our updated approach to M&A. The case is highly synergetic within well-known service lines in a well-run ISS country and with a relatively short payback period. And importantly, it's being fully integrated into ISS to reap all scale synergies.

Please go to the next slide where we will take an overall look at our capital allocation policy and also our M&A approach. Our capital allocation policy is clear. We presented it to you at our Capital Markets Day and a component is M&A. Firstly, we are committed to maintaining an investment-grade rating through a financial leverage of 2 to 2.5x. We are also committed to pay an annual dividend to our shareholders of 20% to 40% of adjusted net profit, already applicable for 2022.

If we then do M&A, we have 3 nonnegotiables: There must be a clear strategic fit. The acquisition should be financially accretive, and it should have clear synergy potential realized in a structured integration process. Livit FM ticks all of those boxes. We see 3 archetypes of acquisitions for ISS as we target to accelerate scale, accelerate innovation or technology in our business. In the initial phase, the majority of capital is expected to be allocated to enhance scale. As a fourth priority, any excess capital will be distributed to shareholders through establishing share buyback programs.

Let's take a deeper look at the market and business dynamics. So let's go to Slide 10, please. The commercial momentum continued to improve during the last month, and we have secured several commercial opportunities, both new wins and contract extensions. We again showed our strength within one of our prioritized segments, financial services. We won a new major key account IFS contract with a regional bank in Australia. This contract win is a prime example of what we're targeting commercially. An IFS contract in a prioritized segment with sustainability and technology involvement from global segment specialists around the group, bringing the best of the franchise, all of ISS to a customer. We now operate services for 20 of the world's 30 largest banks, something we're very proud of.

We have also established a new partnership with a global health care company. From having a few local contracts, the relationship has now developed into a large global key account customer. Again, we have extended a long list of medium-sized contracts in line with our strict focus on customer retention. Now looking at the years ahead, we have 4% of revenue up for renewal in 2023. That's a normal level at this time of the year, and it's representing a good mix of different customers, both geographically and customer types. The 8% of renewal in '25 represents the last year's long list of renewals as the contracts typically have been extended by 3 to 4 years.

Please turn to the next slide. Managing the high inflation is a key focus area. Anyone who follows ISS would not be surprised by that statement. We have rigid and well-embedded processes in place. They have in 2022, proven valuable and through very hard and dedicated work, we've successfully managed the situation with positive effect to organic growth and operating margin being unaffected.

Raising prices to offset the effect is not just about sending an invoice with a higher amount. It's about having the right and precise clauses in the contract. It's about proactively and consistently engaging with the customer and being transparent on this situation. The majority of our cost base is wages, and these costs are mainly adjusted through collective agreements. The wages are typically renegotiated and adjusted during Q1. At this point in time, we, therefore, have a relatively good visibility on the wage increases that we will face in the different countries, and therefore, also the price increases we will implement accordingly at the same time.

But it's a mixed picture. In some countries and within some service lines, we are seeing low double-digit wage increases, while in other countries, the increase is only low single-digit. All in all, we will, also in 2023, maintain the core processes that have served us well throughout our history. We expect a positive contribution to organic growth, and we expect margins to be unaffected.

Please turn to Slide 12 for status on COVID-19 recovery. The strong growth in Q4 was also visible when comparing to before the COVID-19 pandemic. Organic revenue was 3% above the level from Q4 2019, especially the development within food service is remarkable. Even this service line is now almost fully recovered at index 98, so basically, it's back at par with '19. That is despite employees not being fully back in the offices. As we now have entered 2023, 3 years after the outbreak of COVID-19 and the business is recovered, we will not report on COVID-19 recovery going forward. The future growth from here will be dependent on new business and underlying development as also communicated at the Capital Markets Day.

With this, I believe I've concluded my part of the presentation. So let me hand over to Kasper to look at financials on Slide 14, please.

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

Thank you very much, Jacob, and good morning from me as well. 2022 was a strong year for ISS. The financial turnaround was successfully completed. We upgraded the full year outlook several times during the year and organic growth was 7.8% for 2022 with an accelerated momentum in Q4 that landed at 9.4%. Operating margin for the full year was as expected, 3.8%, while free cash flow was better than expected and amounted to DKK 1.7 billion.

Please go to the next slide for a detailed review of organic growth. As mentioned, organic growth improved during the year in 2022 and ended Q4 at 9.4%. The drivers behind the development have basically been the same throughout the year, return-to-office combined with scope and price increases. For the full year, price increases contributed with just below 3 percentage points with around half of that coming from Turkey. Revenue from projects and above-base work declined, but to a lower extent than expected. More traditional above-base work almost offset the decline in COVID-19-related cleaning services and the project revenue remained solidly above the pre-pandemic level. For the full year 2022, projects and above-base had a negative contribution to group's organic growth of 0.3 percentage points and accounted for 18% of revenue.

Please turn to Slide 16 for a look at the margin development. The margin improvement continued in the second half of 2022, where operating margin was 4.6%. This led to a margin for the full year of 3.8% as expected. The higher margin was a result of continued improvement in the underperforming areas, mainly on the Deutsche Telekom contract and in the U.K.

The operating leverage from the higher revenue was partly offset by commercial investments and additional costs related to mobilization of contract wins. The rising inflation was well managed through 2022 with well-embedded processes, which allowed us to handle the situation successfully. As such, the cost pressure has been managed through price increases and operational efficiencies and the negative effects have thereby been mitigated and the margin was, in general, unaffected.

Let's turn to Slide #17, where we look at free cash flow. The free cash flow in 2022 was DKK 1.7 billion, and it thereby came in stronger than expected in our latest outlook. We have, over the past couple of years, had a laser focus on managing working capital and the positive effects are clearly visible. Despite the increased activity level and higher revenue, changes in working capital were positive DKK 0.4 billion. The inflow was supported by prepayments from customers, DKK 0.2 billion. And as expected, utilization of factoring increased slightly as the higher revenue led to more receivables becoming eligible for our factoring policy. The free cash flow was reduced by DKK 0.5 billion from the payments of the last part of the restructuring and one-offs booked back in 2020, totally in line with our expectations. Other payments of DKK 0.2 billion are related to other ordinary provisions.

Please turn to Slide 18 for a closer look at the working capital development. As I just mentioned, working capital was managed tightly, resulting in an inflow and the picture is basically unchanged since the first half. The increase in payables can be mainly explained by the higher business activity within food services, which typically carry longer supplier payment terms. The level of overdue receivables remained very healthy.

Please go to the next slide and leverage. The deleveraging continued in the second half of 2022, and the leverage ratio ended the year at 2.6x. The net debt was reduced to DKK 11.5 billion from the free cash flow and the net proceeds from M&A. As the turnaround leverage target of below 3x has been reached, we resumed dividend payments with 20% of adjusted net profit equaling DKK 2.1 per share. Our leverage target is 2.0 to 2.5x and with the positive development in 2022, we are already close to the targeted range.

Please turn to Slide 21, where I will go through the outlook for 2023. Despite the elevated macroeconomic and geopolitical uncertainties, we expect good growth, continued margin improvement and solid cash flow generation in 2023. Organic growth is expected to be between 4% and 6%. Operating margin is expected to be between 4.25% and 4.75% unchanged compared to the preliminary outlook presented at the Capital Markets Day. And free cash flow is expected to be around DKK 2 billion. Like in 2022, outlook is excluding any effects of hyperinflation.

On the next slides, I'll go through the building blocks behind each of the KPIs. Let's go to Slide 22, please. Let's start with the organic growth outlook. In 2023, we expect price increases to contribute 3 to 4 percentage points to organic growth. Cost increases as a result of the high inflationary environment will, as in 2022, be passed on to customers. We also expect the positive underlying volume development, partly driven by the full year effect of return-to-office and partly by continued scope increases with our existing customers. The contracts that we have won during 2022 will have a small, positive contribution. The positive effect will, in the first half, be partly offset by the exit of the contract with the Danish Defence. Projects in above-base work is expected to decline slightly against 2022, which was another strong year, but project revenue is expected structurally to remain above pre-pandemic level.

Please turn to Slide 23 and the margin outlook Operating margin is expected in the range of 4.25% to 4.75%. Overall, there are 3 areas that will provide the improvements in 2023. The largest contributor to the improvement is coming from further improvements in the previous hotspots. And remember, the run rate margin going out of 2022 was above 4%. So a good part of the improvements have already been achieved. Benefits from the OneISS investments in, for example, the operating model and technology are expected combined with business efficiencies to improve margins across the group. And the third element is that we also expect operating leverage from the higher revenue as we now have a platform where we can absorb additional revenue without increasing overhead costs accordingly.

Please turn to the next slide for the details on free cash flow outlook. The solid free cash flow generation will continue in 2023. Changes to working capital is expected to be negative. This is due to a combination of the prepayments from customers in 2022 and the higher revenue leading to increased receivables, simply from higher revenue, not from us extending customer payment terms.

Tax payments are expected to increase in 2023 due to the higher profit and the ETR level from 2023 and onwards is expected to be around 24%. This highlights ISS's ability to convert a high share of operating profit into free cash flow. With normal seasonality and the negative effect from working capital expected to be realized in H1, the majority of the cash flow will be generated in the second half of 2023.

This concludes my part of the presentation, and I will hand the word back to Jacob for some closing remarks and Slide 25, please.

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

Thank you, Kasper. So a couple of ending remarks on my side before we open up. First of all, 2022 was a strong year for ISS. We have said that despite the challenging macroeconomic environment, our business model showed very strong resilience. And I have to say we managed to take advantage of sometimes a very tough situation. As our customers return to the workplaces, we have seen additional demand for our services.

This would not have been achieved without the strong and dedicated effort by our more than 350,000 placemakers around the world. They go above and beyond every single day to make a difference for our customers. And I want to send a special note of appreciation to all of you. With the financial turnaround complete, we've entered the next phase of the OneISS strategy. We've established a strong foundation. The strategic priorities are unchanged and even in a possible recession scenario, we're confident in our ability to deliver strong growth at sustainable and attractive margins.

With this, let us open up for Q&A session. Operator, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from the line of Simona Sarli from Bank of America.

Simona Sarli ***BofA Securities, Research Division - Research Analyst***

I have 3 and that -- if that is okay, I will take them one-by-one. Regarding your growth outlook related to volumes, you speak also about the tailwind from the annualization from the return-to-the-office trend. So if you can quantify how much of your volume growth is coming from that as well as how much is driven from new contract wins and extensions?

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

Yes, Simona, certainty, we can do that. So as I said in my presentation, we expect approximately so up to 2 percentage points to come from volume growth and return-to-office. So that's approximately 2% of the 4% to 6%. That is the outlook for this year's growth. And the other point you mentioned was that net price increases?

Simona Sarli ***BofA Securities, Research Division - Research Analyst***

No, it was from how much of the volume increase will be driven by new contracts and/or contract extensions?

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

Got it. Got it. And there, we expect the net contribution of approximately 1% to the organic growth of this year.

Simona Sarli ***BofA Securities, Research Division - Research Analyst***

Second question, if you could please provide an update on the progress made with the Deutsche Telekom contract, and in particular, your margin expectation for this year and next year related to this contract?

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

Yes, thanks Simona. Jacob here. Good to speak. So on Deutsche Telekom, in terms of the latest update on the operational performance. So first of all, you know that we are continuing to drive operational improvements on the account. We did that throughout '21 -- 2021 and '22, and we also informed you that we turned breakeven on the contract at the end of the year as expected. And when I look at '23, there's continued hard work going on from our teams in terms of driving continued operational improvements. And therefore, we have not -- on purpose, we have not given a specific margin target for '23.

But as Kasper went through the margin bridge a little bit earlier today, he described how that was one of the components giving us the growth in margin. But we will not be specific, but of course, the Deutsche Telekom contract is now moving from breakeven end of last year into what would be low single-digit margins. And we have made it very clear that we believe that over time that this contract should be contributing like any other contract to the performance of the group, and that has not changed in any way. So continued improvement this year. It's one of our levers on the margin bridge. But we will not be specific on a specific margin target on a contract.

Simona Sarli ***BofA Securities, Research Division - Research Analyst***

And lastly, on the free cash flow, which came in ahead of expectations. If you could please quantify in your chart, you were showing the use of factoring being slightly higher on a year-over-year basis as well as higher customer prepayments. So how much was that contributing in 2022?

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

Yes, definitely. So the factoring increase year-over-year is approximately DKK 160 million, totally in line with our expectations and also totally in line with what we have communicated throughout all our communication in 2022.

On factoring, I just want to be very clear on that. As I've said several times, it's one of these areas that we have strengthened significantly under my leadership as a CFO. We have a strict policy in place where we're only doing factoring if it makes sense from an economical perspective, so from a funding perspective, and if the payment terms are greater than 60 days. And of course, that is embedded throughout the organization. So that's clear on that one.

And on prepayments from customers, that was DKK 200 million exactly as we disclosed when we sent out the initial announcement around the results on the 3 KPIs for 2022.

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

Maybe just -- thank you, Kasper. And maybe just a comment from my side as well on the factoring. So we are fully aware that this company 5 years ago under different leadership, had a short issue -- short-term issue around factoring. And we appreciate the questions because we've also been getting them this morning. We've guided -- we are probably the listed company that guides the most transparent around factoring than you can find globally due to that. And we have, from day 1 with our guidance in early '22, we have said that we expected a couple of hundred million from factoring in our cash flow. We said it again and again and again.

So -- and that is with 160 million that is bang in line with the guidance we have been giving quarter-after-quarter through '22. We, again, this year, are very clear around factoring, and we will continue to be very clear around factoring more clear than any other company I have ever seen due to the history of our previous team 5 years ago, just to be very clear around that. So hopefully, that erases any confusion.

Simona Sarli ***BofA Securities, Research Division - Research Analyst***

So in your guidance of free cash flow for 2023, you are not including any further positive contribution from an increasing use of factoring?

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

So what I'm -- just come back to what I mentioned around the policy. If an invoice is eligible for factoring and it makes sense for -- therefore, makes sense from an economic perspective, then, of course, we will use factoring. But we will be fully transparent, as Jacob said, around the level, the expected level. I do expect a slight increase in factoring also this year because I think with the customers that we will grow with, you will have some more invoices that are eligible for factoring, but not dramatical amounts in any way, shape or form, a small increase.

Operator

The next question will be from the line of Nicole Manion from UBS.

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

Two questions from me, please. The first one, just on your commercial momentum in light of the general economic backdrop and potential for cost cutting at clients this year. Could you perhaps give some detail around the type of conversations you're having with customers about budgets for 2023? That's the first one.

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

Jacob here. So yes, on commercial momentum, so obviously, you just heard us talk about what we've seen in recent quarters here. And we've actually seen a bit of an accelerated commercial momentum in terms of all the hard work on retention has been great, but we're starting to see more wins also in terms of larger situations. And a lot of that has been the situations that we've been working on for a long time. So as I've alluded to in previous quarters, there's been a longer lead time in the COVID and post-COVID period in terms of getting bigger deals over the line, and we see those lead times are gradually coming in now. So we're seeing that momentum.

Of course, in terms of the customer conversations, you're right that there is a backdrop now of -- overall economic backdrop that is slightly worsening versus what we've seen in recent years for many global companies. But we are not seeing a step change from what we've seen in '22. So just to be very clear around that. There is, of course, customers that are looking for cost cutting. Listen, that's our business. That's the conversation that we're always having. We have seen plenty of those conversations also in '20 and '21 and '22. And we're seeing those conversations at the moment as well, but we're not seeing a step change.

As you will have seen in the growth acceleration over the -- throughout the year of '22, what we are also seeing is that existing customers are increasing their spend in different -- in new categories. We're also seeing that we are winning more wallet with existing customers, so we're growing with existing customers. So it is a mix of both reductions and increases. And many customers looking for savings in some parts of their spend, which they then reinvest in other parts of their spend.

So overall, for us, it's not a -- we haven't seen a step change. It's good conversations, good commercial momentum and a lot of good dialogue. And last comment is, do remember that this industry usually is very resilient in economic recessions for the simple reason that we are an outsourcing business. And people looking for cost savings will also lead to an increased amount of first-time outsourcing, and we are having those dialogues at the moment. So no drama on that front.

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

Okay. Great. And maybe a sort of a second question is related to the first. I know you had a slide on this book, maybe a bit more detail around the outlook for working capital. Again, given the backdrop, customers in some segments might be looking to preserve cash, you might think. So it would be good to hear about how you're thinking about your own working capital dynamics in light of some of that stuff.

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

Yes. I mean, we do not see any changes in customers' payments behavior. But also we are very, very disciplined and are watching that on a daily basis, so we can jump on it if it becomes an issue. The expected negative working capital for this year is purely a function of higher revenue, not us extending payment terms with customers or expecting late payments from customers. So purely linked to the revenue development.

Operator

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

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

And well done, guys on a good end to 2022. I have 3 questions. I'll take them one at the time. First of all, if you could just elaborate a bit further on your retention rates. Is that just you being conservative or you're actually getting fairly close to your medium-term ambition already by now? So should we foresee some contract losses diluting this? Or are your ambitions simply somewhat above the 95% level?

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

So on the retention rate, I don't know if we have been conservative. We obviously believe in our ability to retain our largest customers and you are right that the retention rate has developed quite favorably now for an extended period of time. We've gone from very close to 90% to now being on an adjusted basis at the 94% level when you adjust for the Danish Defence contract. And you also know that's up again on just the last 12 months basis.

That being said, I think there is a limit to what your retention rate should be. There's no doubt that we believe that we will get us to 95%

over the foreseeable future. But that being said, I don't think we, as a business, should be striving for much higher retention rates because when you look at our -- the size of our business, the complexity and the diversity, there will always have to be a flow. And we will also have contracts that we would want to exit because they just developed in a way we didn't expect or whatever circumstances drive a need for us to recalibrate a customer relationship and therefore, exit a contract.

So they were -- you're never going to get to 100%. I think if you're at 95%-plus than you are at industry-leading standards. And that also means that we have -- still have some way to go more than 1%, I would say, to be above the 95%. And we're not -- because that was basically the underlying question. No, we're not flagging that we're about to lose some big contracts. That's not the point that's in there. But we also recognize that it's hard work to keep retention rates like this. So a lot of hard work goes into it, and we believe we get above 95% within the foreseeable future.

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

Great. So on Livit, you talk about how you've been harvesting synergies and how this has gone a bit faster than you expected. Can you just give us a bit further details in terms of what exactly has happened faster and within which areas? And also, are you looking at some top line synergies as well when you look into cases like Livit here?

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

Let me take that one as well. So yes, no, listen, we're very pleased with the Livit acquisition. It's a fantastic franchise that has joined the ISS family and some fantastic capabilities. So we're very pleased with that.

In terms of the synergies, there's no doubt that our integration has gone very smooth and that means systems integrations and also how we have integrated the operating structure into our operating structures in Switzerland. I mean that means [being, lo,] practical in terms of how we set up our regional teams combining the different organizations, et cetera, the classic hardcore integration work. And we have a phenomenal team that has been running this with a very high cadence following the very strong playbooks that we have agreed as part of our new systematic approach to M&A, and they have delivered very well. So there's big kudos to the team that has delivered there. That also means that we've been driving synergies faster, but we can also see now as we have done that work and as we're moving into the next layers of synergies on the systems side and in terms of the overlapping functions, et cetera, that we've been able to take out more synergies than initially expected in the business case. And you know the business case was attractive when we announced it. And we now estimate that our synergies -- cost synergies in total, will be 30% higher than initially expected in the business case. And as we also alluded to, that's accretive for both ISS Switzerland, but also for the group.

On the top line, yes, we do believe this will drive top line synergies. That was never in the business case. We are conservative people here. When we do M&A, we don't base it on top line synergies. We base it on the hard facts around cost and efficiencies. And so top line is, say, in addition to that. And we are now significantly stronger in the asset manager segment in Switzerland, which is a very important segment. And it also gives us broader capabilities beyond the boundaries of Switzerland. So we do believe this will drive further growth in the segment, in the landlord segment within asset management, which is very big in Switzerland. So we're not going to quantify that, but I think that's going to be a growth driver for the Swiss business.

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

Great. And my last question is also partly related still to the M&A opportunities out there. Are you seeing the weakening macro conditions just giving you any kind of interesting opportunities maybe in the shorter term here, i.e., should one expect maybe further M&A before you start looking at the share buyback options further on in 2023?

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

Yes. So on M&A, I wouldn't say that we're seeing pipelines changing due to the macroeconomic environment. But what I can say is that the M&A pipelines that are out there globally, so in most countries, are very much formed by the fact that COVID has really disrupted this industry. So there's a lot of players that simply realize that they're lacking scale in the world post-COVID, where especially the value proposition that is important to win big businesses, much more, you just require a different type of value proposition with technology, sustainability and more content. So there is an element that COVID has disrupted the market and created broader pipelines across the regions, not so much the economic environment.

When we think about M&A, it's important that it hits all of our criteria. And a key criteria for us is that it is strategically -- a strategic fit that fits with the OneISS strategy and enhances our ability to execute on our strategic ambitions. I say that because we're not just sitting there waiting for something to pop up due to a financial issue or an economic environment. We are very -- in a very structured fashion, targeting assets that will enhance our ability to execute and create value for you. That's important for us, and it has to be stringently a very strong financial accretive business case, as you know.

So I'm sure that if the current softening continues for the next period of time, more assets will come to market, no doubt about that. There are assets out there that are private equity owned as well, and maybe that brings things to the market. But we're not going to speculate on that. For us, it's very much around doing the right M&A that fits us strategically.

And you mentioned buybacks. You know our priorities that we made very clear in November at the Capital Markets Day, leverage target 2% to 2.5%, then we pay a dividend of 20% to 40% of net income. And then the focus is on value-creating M&A. If we have excess capital after that, then you get it back in buybacks. But we follow that stringent approach, and we'll continue to do that. So at this stage, of course, I think it's too early to talk about buybacks.

Operator

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

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

I'm Annelies Vermeulen from Morgan Stanley. I also have a couple of questions, which I'll take one-by-one. So firstly, I just wanted to delve into your pricing expectation for 2023, being 3% to 4%. Just so I understand it correctly, is that based on discussions that you've already had with your customers and price increases that you've already locked in? Or is that your expectation of how it will develop through the year? The reason I ask that is the parts of Europe and other places where wage inflation is already running well into double digits. So I'm just curious as to whether that 3% to 4% could, in fact, be too conservative at this stage, if you could comment on that at all.

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

Yes, I can certainly comment on that one. So we are expecting that our cost base will increase with approximately same percentage as we saw in 2022 over the -- in year 2023. So between 4% and 5%. But then you know then the mechanism starts where there is the proactive dialogue with customers and in collaboration in a partnership, you find various efficiencies, which meets the budget that the customer has allowed on their side and allows us to adjust our cost base accordingly so that it doesn't hurt our margins. And that's why it's not going to be 4% to 5% that we are expecting as a net contribution to growth. It's going to be lower.

But then the reason why we expect a higher growth contribution this year from price increases compared to last year is because that there is an annualized effect from last year where we did see increases throughout the year. And of course, you will get the full year impact of that this year. That's why the growth contribution is expected to be higher in 2023 from this particular element compared to 2022.

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

Okay. That's clear. And then secondly, I suppose a related question. Could you just remind us on the phasing of growth in margins and free cash flow? I know margins and free cash flow typically are higher in the second half. Are there any one-off timing type things we should be aware of as we forecast those components through the year?

And then similarly for organic growth, thinking about your guidance, clearly, the comp will get tougher through the year. So again, anything else we should be aware of in terms of timing or specific contract renewals starting on certain dates and so on? And as a related point, actually, if there's any comment you can give so far on the growth year-to-date in Q1, that would be helpful as well.

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

Yes. Okay. Let me go through these one-by-one, and I'll do it -- I think I can do relatively quickly. So of course, there's no doubt about that, the growth expected to -- is expected to be higher in the first half of this year compared to the second half, exactly as you're saying, predominantly because the comparison gets tougher throughout the year. I will not start to disclose our organic growth in the first part of this year for obvious reasons. But you're right, our Q4 growth last year, of course, was very high, which also means that we are entering the year with a strong growth run rate.

On the margin side, I think the easiest thing is to take the exit position for 2022 as a starting point. I just lost my mic here, so I'll just get it on again, sorry. And if you're adjusting that one for seasonality, the above 4%, which is the exit position, then that would be 3.25% for the first half. But we do expect to see underlying improvements in the first half.

So I expect the margins to be around 3.5% for the first half. And then that obviously means that margins in the second half is going to be greater than 5% to take us to a margin range between 4.25% and the 4.75%. And on the growth -- on the cash flow, as I said in my presentation, I do expect the cash flow predominantly to be generated in the second half of this year. And the 2 main reasons for that is, one, the DKK 200 million of prepayments that we have spoken about. And then the fact that we expect a slight negative working capital, and that will happen already from the first half because of the strong growth that we expect to see in the first half of this year.

Operator

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

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

Klaus Kehl from Nykredit. First of all, a follow-up question to the Livit acquisition. You stated that you now have a ROIC in -- that's exceeding 10%. Could you be a little bit more specific about this? Are we talking about 12%? Is it 15%? Or -- yes, what do you mean by exceeding?

And secondly, and just to be clear, when you talk about ROIC, do you then talk about a ROIC after tax or before tax? That would be my first question.

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

Jacob here. So we -- we're not going to give you the precise ROIC, but when we say it exceeds our hurdle rate, it's not just marginally exceeding it, it's substantially exceeding it. And we, when we do ROIC, it's after tax.

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

Okay. So just to be clear, you say it's substantially exceeding 10%?

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

Well, you asked me whether it was 12%. I think that's close to 10%, so it's higher than that. But listen, we're not going to go into more detail on it. It's accretive at all measures for us.

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

Okay. Great. And then perhaps a slightly more boring question. Your tax rate here in '22 is quite low, especially in the second half. Do you have any comments about what to expect on the tax rate in '23?

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

Yes, you're right. Our tax rate is low in '22, which is driven by the utilization of deferred tax assets and some nontaxable gains on divestments. And I expect, Klaus, the tax rate, the ETR going forward from this year and onwards to be 24%, which is better than what we have previously guided around the 25%. But a lot of good work has gone in to this particular topic, and I'm very pleased that we are seeing the benefits coming through.

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

Okay. So '24% going forward, and you mentioned some tax assets, I'm not really aware of what kind of tax assets you're holding, but could you elaborate a bit on that?

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

Yes. From previous losses that we're now utilizing against profit in countries that are -- have increased their profit and then use these tax losses against that. So nothing extraordinary in any way, shape or form totally ordinary business.

Operator

The last question will be from the line of Allen Wells from Jefferies.

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

Just a couple from me, please. Firstly, just around the above-base work. Obviously, it declined less than maybe you expected through the year, and it's still above pre-pandemic levels. I'm just really interested to understand why you think it didn't decline as much as the initial expectation was? And when you think about the sustainable level of above-base, what's driving that? Is this a change in contracting strategy, given slightly uncertain macro conditions? Just keen on your thoughts to the first question, please.

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

So just on a above-base, youre right that it declined less than expected. And theres a number of things driving that. We are generally seeing a high activity level amongst our especially office-based clients around reshaping their workplaces. And at the same time, as you can see, a lot of the COVID above-base business fell out of the numbers. That was the time where customers started ramping back in offices and traditional above-based business came back topped with the fact that we are seeing a more structural approach to people refurbishing their offices, rethinking their workplaces and using us as workplace advisers and also capital projects advisers and therefore, doing the above-base and projects for them.

We're seeing that as a structural trend where we see -- we're looking in -- for many clients, we're looking into multiyear plans around how they are developing and refurbishing their workplace strategies for a number of years. And that's also why we are saying when you look at above-base compared to pre-COVID, the -- if I may use the term ordinary above-base that we always have in this business, which is the maintenance of chillers and boilers and all this sort of stuff. This type of above-base work and the ongoing events business, et cetera, all that stuff, we expect to be roughly at the level that we've seen pre-COVID. But then on top of that, we do have a structural trend for years ahead of us where people are working on multiyear plans around refurbing in terms of improving their workplaces and just creating more flexible and modular workplaces where one of the models we're also seeing in some -- a number of the commercial models is that there is, structurally, a higher proportion of services that moves into above-base to give more flexibility.

So we think structurally, this will continue, but not at the peak levels you saw the peak of COVID because there, we just had a lot of you know, special COVID disinfection and cleaning.

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

Great. And then just following up on the office environment that you commented on. Obviously, still half of your business. Just be interested to get a feeling of how you're thinking about the kind of the office outlook there? Obviously, there's an expectation that would drop off with the work from home, definitely didn't happen as significant as maybe the initial estimates where I have seen some kind of bloomberg articles, et cetera, over the last couple of weeks to talk about demand only being back to 1/3 of pre-pandemic levels. But just interested just to get your feeling on what's going on in the office environment from a business perspective for ISS.

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

Sure so I think it's very, very nuanced depending on where in the world you are. So you are right, it didn't fall off a cliff like some people have predicted. I remember we came up with the OneISS strategy in December 2020. We said we thought global office square meters would drop by 10% to 15% in 3 years and everyone ridiculed that now the number is actually lower. And I think one of the reasons is the fact that people have recognized that they need more square meters per employee to deliver a better workplace experience. So they may have fewer employees in the office, but they need more square meters to deliver those enhanced services and workplace experience to their employees.

We do see people reducing square meters. But to be clear, we've been seeing that for the last year, and we are seeing that continuing in '23. There are certain areas. I'm sure the reference you're making is either in London or New York reference because there we do see a tougher outlook in terms of office square meters, but it is very nuanced. If I look across Western Europe, Asia, which are obviously massive markets for us, Western Europe ex-U.K. we are not seeing a significant drop in office square meters and especially not in the demand for our services.

A good number to also look at is our food business is mainly an office-based food business, as you know. There, we have an average office occupancy across the world of around 70%, but lower in the U.S. where our biggest food business is. Despite all of that, our revenue is at an index 98. So it's basically back to pre-COVID levels. So we do not need everyone to be in the office. We do not need everyone to pertain -- sorry, preserve their office square meters for us to deliver our services. Actually, we've proven the contrary. So I expect a continued reduction in office square meters, but at a pace which is 5% to 10%, which is what we guided for in November.

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

Very final question. Just want to just jump back to the factoring questions from earlier on. How do you think about the cost of factoring? And what is the cost of your factoring balance if it creeps just mindful of a rising rate environment? Maybe you can help me where exactly is that cost reported as well within the financial accounts?

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

Yes, yes. It -- what we measure against is obviously our funding rate. So that will be against our funding rate where the assessment will be done, Allen.

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

Thank you very much. And I think with that, I understand that's the last question. Thank you very much for your questions. We have an eager and capable IR team waiting by the phones ready to take any questions from your side. So really looking forward to that. Thanks for the interest and looking forward to seeing many of you over the next couple of days.