Company Name: ISS A/S
Company Ticker: ISS DC
Date: 2016-05-04
Event Description: Q1 2016 Earnings Call

Market Cap: 47,104.03
Current PX: 253.7
YTD Change($): +5.0
YTD Change(%): +2.010

Bloomberg Estimates - EPS
Current Quarter: 3.418
Current Year: 15.436
Bloomberg Estimates - Sales
Current Quarter: 20009.000
Current Year: 79961.071

Q1 2016 Earnings Call

Company Participants

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

Other Participants

- Jonas Guldborg Hansen
- Michael Vitfell-Rasmussen
- Emily Charlotte Roberts
- Paul D. Checketts
- Kristian Godiksen
- Rory E. McKenzie

MANAGEMENT DISCUSSION SECTION

Nicholas Richard Ward

Ladies and gentlemen, this is Nick Ward, Head of Investor Relations at ISS, and I'd like to welcome you to our Q1 2016 results teleconference. Please be aware that the announcements, the interim report as well as the slides used for this call can also be found on our website. Later today, a replay will be available, and we will post a transcript for the call as soon as it is ready.

I'd like to draw your attention to slide number two regarding forward-looking statements. Presenting today will be Group's CEO, Jeff Gravenhorst; and Head of Group Controlling, Peter Thomsen. Peter has been with ISS for nine years in his current role. His responsibilities include financial controlling of the Group and all our internal and external financial reporting.

And with CFO, Heine Dalsgaard, now confirmed to step down on the 31st of May, Peter is perfectly suited to deliver our financial results until a new CFO has been identified. We will open for Q&A at the end of the presentation.

And with that, I'd like to hand over to Jeff.

Jeff Olsen Gravenhorst

Thank you, Nick, and good morning, everyone. Please turn to slide five. I'm pleased to say that we made a solid start to 2016, essentially in line with our expectations. With regards to our operating performance, organic growth was 3.7% in Q1. As expected, this was lower than the 4.8% we achieved in the three previous quarters. This is due to the annualization of Vattenfall and Swisscom in particular.

However, growth was slightly higher than we originally envisaged. Our Q1 margin increased year-over-year to 4.5%. This improvement comes despite a seven basis points negative impact from net divestments, mainly related to the CMC divestments in Turkey. Our cash conversion remained strong at 99%. Net profit was significantly higher year-on-year at DKK 399 million. And our leverage at quarter end was 2.3 times EBITDA, well below the 2.9 times level 12 months ago as expected, above the 2.1 times at year-end 2015, due to the usual seasonality of our cash flows.

Progress within the integrated facility services remains very positive. Local currency growth was 11% in Q1, driven by new contract startups and contract expansions. Integrated facility services now represents 35% of Group revenue.

Within Global Corporate Clients, local currency revenue growth was 15%. We've redefined our GCC portfolio, and I will provide some details on this shortly, but on our new definition, Global Corporate Clients represent 10% of Q1 Group revenue.

We're pleased with the development of some of our major contracts expansions, for example, Danske Bank, DSB, the Danish Railways and Novartis. We also announced the new IFS wins with Mitsui Fudosan Group in Taiwan.

Whilst IFS remains a key driver for us, we should not underestimate the importance of single and multi-service revenues. During Q1, we extended our multi-service relationship with McLaren in the UK, secured significant cleaning contracts within the hotel sector in the UK and Pittsburgh Airport in the U.S., and won a significant cleaning contract with Brittany Ferries in France.

Our revenue and margin development are firmly underpinned by our strategic initiatives. These initiatives are consistent with what we've communicated to you in the past and include customer segmentation, organizational structure, procurement, business process outsourcing and others.

Execution and delivery is fully in lined with our expectations. We will continue with these projects throughout 2016 and beyond. So as I said, we are pleased to have had a solid start to 2016, albeit [ph] not without its (03:56) challenges. It is still early in the year, and we remain highly focused and motivated to deliver.

Please turn to slide six. As we've done in the recent quarters, I would like to provide some more details on two of our recent contracts. DSB, the Danish State Railway is an example of how we've taken a longstanding relationship – customer relationship, and driven significant expansion. In fact, we've been providing services to DSB for the last 50 years. They were keen to increase their level of outsourcing to achieve their key priorities, which were lower service cost, increased end user satisfaction, standardization of service delivery across the network, and improved safety for passengers and employees.

We now have a five-year IFS contract we started on the 1st of October 2015, around 400 ISS full-time employees engaged across some 339 DSB locations. It is the largest public sector contract in ISS Denmark's history.

DSB saw ISS as one of the very few partners capable of delivering their needs on a nationwide basis. They were also impressed with our operational process framework, where we document actual work procedures and processes to ensure maximum quality of output and minimum risk to employees' health and safety.

In addition, like our IT infrastructure, notably our end user portal, FMS@ISS that we discussed with you on the last quarterly call. The contract is still in its startup phase, but we are pleased with the progress thus far. We see some medium-term potential to expand the relationship further, and believe this contract strengthens our public sector credentials.

Rolls-Royce. Rolls-Royce is a brand new customer for ISS. However, they have outsourced their facility management services for many years, although in the Americas and Asia, this has been done via a subcontractor model and not through a self-delivery model.

They were looking for greater alignment of services across the real estate portfolio. And this five-year contract became fully operational on the 1st of April. It covers multiple sites in the U.S., Brazil, and Asia, but the key facilities are at Indianapolis and at the selective campus in Singapore.

Rolls-Royce has a long-term real estate strategy in place, and they wanted to capitalize on this, ensuring optimal service delivery and value. ISS was chosen on the back of our proven ability to align services globally and our data analytics and benchmarking capabilities inside at IFS, which are the key drivers of change. Again, we discussed this technology with you at our last quarterly call.

We will be seeking to develop a progressive partnership with Rolls-Royce, moving away from a purely task-oriented service model. We also hope to offer more innovation around asset management and hence capture a share of future project work. In the medium-term, we will pursue any opportunities to expand this relationship across geographies.

Please turn to slide eight. 75% of our revenue is generated in developed markets, and here we continue to grow, albeit at a slower pace, against some challenging macro conditions. The annualization of key contract launches and lower growth from non-portfolio services are the key reasons in line and with our expectations.

In emerging markets, organic growth remained strong. Operating margins were influenced by divestments and the HP revenue rebalancing to repeat the impact of the HP rebalancing [ph] is 0 (07:54) at Group level.

Let's have a look in more detail as we discuss the regional performances. So please turn to slide number nine. As we highlighted in March, we are now reporting our regional revenues and profit across four regions, consistent with the way in which our business is managed.

Continental Europe generated organic growth of 4% in Q1 with Turkey, Switzerland, Austria and Spain as the main contributors. We benefited from contract launches, scope increases and strong price increases in Turkey on the back of a 29% increase in the minimum wage, post last year's elections. We are now – we are very satisfied with how successful we've been at passing these price increases through to our customers.

As you know, Vattenfall was launched on the 1st of January 2015, and Swisscom ramped up during the first quarter, so the annualization of these two contracts led to a slowdown in our overall growth for the region as expected.

The operating margin declined by 20 basis points to 4.3%. We saw margin improvements in Switzerland, Germany and Belgium, with the latter two countries benefiting from our great restructuring initiatives. Our margin in Turkey reduced, but solid because of the CMC divestment. The underlying margin in Turkey actually strengthened, despite the minimum wage increases we faced.

The region, overall, saw a negative impact from the HP revenue rebalancing and macroeconomic conditions remain unchanged in a number of countries.

In Northern Europe, 2% organic growth was driven by very strong performance in Denmark due to Danske Bank and the Danish Railways. We also saw good growth in the UK, albeit slower than Q4 due to a weaker growth from non-portfolio services. Growth in Finland continued to be impacted heavily by downsizing of a major IT customer, and we also saw slower non-portfolio growth in Sweden and Norway.

The operating margin was stable at 5.9% with improvement coming from our property services business in Denmark and several businesses in Finland. Norway saw some negative margin development within its oil-exposed catering activities. And the UK margin was slightly softer, but only due to timing considerations. I'm pleased to say that, as expected, the increase in the minimum wage in the UK last month has been offset by appropriate price increases and efficiency gains.

Please turn to slide 10. Asia Pacific had again a strong quarter with 7% organic growth. Singapore was the standout performer, but growth here was boosted by significant project work or non-portfolio work that we have expected to arise later in the year, but was ultimately brought forward into the end of the first quarter. We also generated strong growth in Indonesia and China. Organic growth slowed in Hong Kong. In Australia, growth remained negative as two remote sites in the resource sector moved from construction to production in line with what we've already communicated. As a reminder, the resource industry is under pressure in Australia and we will see further revenue reductions during the year from previously communicated contract losses.

In addition, we have lost a sizable healthcare contract with Royal North Shore in Australia. The customer has chosen to take the services back in-house and the revenue drops out from the beginning of this month.

The Asia Pacific margin increased by 40 basis points year-over-year with the improvement driven to a large extent by non-portfolio work in the quarter. The Australian margin was slightly lower year-on-year, but this is simply reflective of timing considerations. Despite the short-term revenue weakness facing Australia, we still have very strong business here and expect margin improvements for the full year.

Finally, in the Americas, we delivered 2% organic growth. Growth was positive in the U.S., thanks largely to success within the aviation segment. We saw very strong growth in Argentina largely due to wage-driven price increases. Growth in Chile has slowed versus 2015 but still remains under considerable pressure with further contract losses, contract exits and scope reductions. The Americas margin was 10 basis points lower year-over-year. Margins in the U.S. was – or in North America was higher with some benefits from HP rebalancing together with improvements in both aviation and within our integrated facility services segment. Our margins in Brazil remains under pressure given the revenue weakness and cost associated with downsizing of our workforce.

Please turn to slide 11. At our Capital Markets Day, we spent time highlighting our focus on key accounts, close to 1% of our customers generating more than 60% of Group revenue. This is where we see the greatest potential for growth in revenue and in profitability. Both of these accounts are local in nature, some are regional and very small number are global. We have now appraised our 15 Global Corporate Clients and concluded that whilst our relationship for each of these accounts is at a global level, the delivery for five of them is predominantly made locally.

As such, we've chosen to reclassify our list of GCC accounts and this now includes the 10 names illustrated above or illustrated here. These 10 Global Corporate Clients accounts require active support from global operations team. They generated 10% of our Group revenue in 2015 and revenue grew at 15% in local currency into the first quarter of 2016. The names that are no longer on this list represent less than 1% of Group revenue, but they are no less important to us. This simply reflects the reality of our delivery model.

With that, I would like to hand over to Peter Thomsen, who, as Nick said, is our Head of Group Controlling, and will take us through our financials.

Peter Harder Thomsen

Thank you, Jeff, and good morning, everyone. Please turn to slide 13. In Q1 2016, our revenue increased by 0.1 percentage point. This comprised firstly a negative impact of 1% from divestments on our one acquisition; secondly, a negative impact of 3 percentage points from currency, and lastly a positive impact from organic growth of 3.7 percentage points.

The main currencies impacting our revenue growth in Q1 were the Turkish lira, the Brazilian real, the British pound and the Norwegian kroner. Whilst our organic growth has slowed from the levels seen in the previous three quarters, the 3.7% achieved in Q1 is within our full year guidance of 2 percentage points to 4 percentage points. And, as Jeff mentioned, it is slightly higher than we had expected at the start of the year. This was principally due to two factors: firstly, the timing of project work in Singapore that we had expected later in the year and a stronger-than-expected performance in Turkey as we successfully passed on price increases and defended underlying margins in the face of a significant uplift in the minimum wage.

Please turn to slide 14. In Q1 2016, our operating margin was 4.5% versus 4.4% in Q1 2015. This improvement comes despite a negative 7-basis-point impact from divestments. As such, we have been able to drive a 10th consecutive quarter of LTM margin improvement. This improvement has been driven by our strategic initiatives and an improving mix of revenue as our IFS business grows.

One of those initiatives is our group-wide procurement program. We first presented the chart on the right at our Capital Markets Day in September. Today, we have updated it to include the third phase of our procurement program. The chart illustrates the timing of the cumulative benefits we expect to arise from these three phases. Please note that the data in the chart shows the year-end run rate and not the in-year benefits. As such, the first full year of savings from these three phases will be 2019.

The anticipated gross value of the saving from phases I to III remains at DKK 450 million to DKK 550 million. A significant amount will be passed back to customers, as we seek to improve our competitiveness. However, we are seeing net benefits and these procurement initiatives are a clear driver of the margin improvement we have seen over recent quarters.

Please turn to slide 15. Let me highlight some additional points from our income statement. Firstly, we have incurred DKK 28 million of other income and expenses net in Q1, which mainly comprised restructuring projects related to the implementation of Project GREAT in Spain, Finland and Belgium. Secondly, our financial income and expenses net of DKK 107 million for the quarter was positively impacted by a DKK 18 million FX gain, principally due to the movement in the DKK-euro exchange rate. Thirdly, our effective tax rate was 28% in the quarter, in line with our expectations for the full year.

Please turn to slide 16. And some additional points to the cash flow statement. You'll note that our depreciation charge has fall year-on-year. You should also note that our tangible fixed assets, i.e., property, plant and equipment, have also fallen. Factors behind this include divestments, FX and other mix effects. We have also seen a further shift from owned assets, i.e. vehicles, to operationally leased assets as a result of our procurement initiatives. Hence, [ph] EBIDA (17:57) and not EBITDA is the best indication of our profit progress.

The working capital cash outflows seen in Q1 2016 are similar to Q1 2015 and are entirely consistent with the seasonality of our business. The year-on-year swing in changes and provisions, pensions and similar obligations, reflects a sizable positive impact in Q1 2015 related to the pension obligations assumed with Vattenfall contract in Germany.

Our net interest paid received varies from quarter to quarter subject to the timing of annual interest payments on our three bonds. Please note that whilst the five-year 2021 bonds pays interest annually in January, the first payment will not be until January 2017. Please also note that cash flow from investing activities in Q1 2015 included the acquisition of GS Hall in the UK.

Finally, cash flow from financing activities in Q1 included the DKK 149 million treasury share repurchase in March to cover our obligations under the LTIP program. In addition, we repaid borrowings of DKK 259 million as a result of a reduction in our working capital facilities.

Please turn to slide 17. Finally, we've illustrated again how our free cash flow has been allocated on an LTM basis. Net financial expenses remains a modest source of cash consumption, thanks to the reduction in our borrowings and the low interest rates and margins we currently face. On an LTM basis, the acquisition of GS Hall no longer features, so the last 12 months only includes divestments, most notably CMC in Turkey. The dividends paid reflects the DKK 901 million outflow from April 2015. Our dividend paid in April 2016 was some 50% higher and this will be evident when we update this chart for the next quarterly results.

Most of the remaining cash flow has been used to reduce debt, except the DKK 149 million treasury share repurchase already highlighted. Given this cash allocation, our leverage has fallen from 2.9 times EBITDA at the end of Q1 2015 to 2.3 times at the end of Q1 2016. The increase in leverage from Q4 2015 is entirely consistent with the seasonal working capital outflows.

Given the sizable dividend payment made in April 2016, the leverage should be expected to rise further at the end of Q2. Our thoughts on returning surplus capital to shareholders are unchanged, but we will be making no further comment on this call.

With that, I'd like hand back to Jeff.

Jeff Olsen Gravenhorst

Thank you, Peter, and please turn to slide 19. Our outlook for 2016 is unchanged. We expect organic revenue growth of between 2% and 4%. Our operating margin, that is above 5.7% realized in 2015 and cash conversion above 90%.

We saw slightly stronger than expected organic growth in Q1, but as Peter explained, some of this was a timing issue. Moreover, the loss of Royal North Shore and further revenue reduction in Brazil, there are challenges we need to overcome.

So, finally, consensus in GDP forecast on an IFS country-weighted basis, we have softened – has softened slightly since we spoke last time and we continue to see uncertain conditions in certain markets. So, as I said, a solid start to 2016, but it is early in the year and we remain highly focused and motivated to deliver on this outlook.

With that I would like to hand back to the operator and open up for Q&A.

Q&A

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Jonas Guldborg at Carnegie. Please go ahead.

<Q - Jonas Guldborg Hansen>: Yeah. Good morning, Jeff and Peter. Three questions. First, if we look at the margin improvement from – since 10 quarters ago and until today, then can you split how much is coming from the cost savings initiatives and how much is due to IFS contracts?

Then, if you could put some words on the size of the lost Australian hospital contract. And finally, what was the local currency growth in the Global Corporate Clients segment on the old definition?

<A - Jeff Olsen Gravenhorst>: All right. Thank you. I mean basically, we've been through this a couple times on the margin improvements. There's no doubt that we have benefits coming through the whole period from the procurement program, as you've seen in Peter's presentation here, also a sizeable amount that has already hit in quarter-by-quarter over that period.

We also have, from the restructuring, where we have taken out layers in the organization on the Project GREAT. We also made a lot of reinvestments into sales forces, people and culture into the procurement organization that actually realizes these savings. On top of that, IFS business, our key account business, does give a bit higher margin in general, but we've seen also improved margins in our specialized services.

So whatever I'm saying here is that there's a lot moving parts and it's very, very difficult to split the last three years or four years margin improvements up to what comes from what. A lot of things happening every year. Salary goes up. We need to pass on price increases to the customer. So it's just a lot of hard work to ensure that every year that we see an expansion of the margin wherever that comes from. So that's basically the answer. We don't split it.

Secondly, on the size of the hospital in Australia. Obviously, it is not big enough for us to make a special announcement on it. It's just to highlight that in Australian Pacific, it will have an impact. So, overall, again, it's not going to have a material impact on the Group and that's why it's not separately announced as a contract loss. Here, the story behind this is there's a contract, which is – where the employees are managed by the – were actually hired by the public sector and managed by us. And now they've chosen to take the contract back in to figure out how they want to outsource that in the future and that's the main reason for it.

Lastly, on what would be the constant currency growth, including all the old definition or in the old definition would be exactly the same. So [ph] that's no different (24:56) from the 15%. It really is just the minor change that we don't necessarily want to follow those 10 global accounts when they're basically locally delivered.

<Q - Jonas Guldborg Hansen>: Perfect. Thank you.

Operator

Next question comes from Michael Rasmussen of ABG. Please go ahead.

<Q - Michael Vitfell-Rasmussen>: Thank you very much, and congrats on the numbers, guys. So three questions please. First of all, can we talk a little bit about the non-portfolio business seems to be a little bit of growing demand in the first quarter as well? Can you talk about a little bit more what you think is driving this and was this ahead of your expectations?

Secondly, I'd like to talk a little bit more about wage inflation. It seems like you're quite successful in passing this on to customers. Why do you think this is different from kind of the old days? It seems to be a quite big problem in the service industry back in the days. And finally on IFS contracts, can you please remind us if you have any larger contracts that are for re-bid soon? Thank you very much.

<A - Jeff Olsen Gravenhorst>: Okay. Thank you, Michael. Non-portfolio overall, actually us – I think we also mentioned that when you get into the detailed report, we don't see an additional growth within that overall. What has impacted the first quarter is that we've seen more non-portfolio work, particularly in Asia than we expected for the first quarter, so that's particularly in Singapore. But that's because it's been moved from what we expect to see in later quarters of quarter two and quarter three and then it would be moved into quarter one. So overall, I still don't see that the non-portfolio part or the project part is increasing to the level that you will see when the macro-economy is actually in a good position.

The main reason for that is that there's still uncertainty. And uncertainty is – just means that our clients will hold back on certain things. In Europe, we see uncertainty, probably, up towards the Brexit discussion. And the good thing is that's going to be over and done within a relatively short period of time than we know. But the uncertainty is the worst part for us because that's where you don't take any decisions. So overall, there's this basically the same level of non-portfolios, what we seen also last quarter.

On the wage inflation, I'm sorry to say this, Michael, but it's actually – it's never been a major issue for our business. It is something that we've been doing for 115 years now. Every single year, we need to deal with this. There are wage inflation basically everywhere. We've gone through a long period of time in emerging markets where wages have gone up quite significantly and we need to pass that on. Sometimes you can pass it on as a straight cost increase or price increase. But most times, you go with this as an increase and then you sit down with the client and discuss, well, the salaries goes up by 5%, you need to give me an increase of 5%, and then the discussion will end up with what I can't afford it. So how can we re-scope the contract, either by giving us additional services to compensate or by actually reducing the scope of services that we do; all that we, by different methods and different methodology, increase the efficiency on the contract. So those are the measures that we use.

And now, these days, I think that's even, I won't say it more easy, but we have more instruments to do so because we do have a strong focus on service levels and outputs as opposed to just how many hours is used for cleaning a hospital. What we look at is how can you do it the most effective way. And we have more tools both tangible, but also of course technology that can prove that. So we've always been good at passing this on. You can have timing differences, but overall we've always been good at that. And again this year, we shown that also in the high-inflation countries.

The last part on IFS for re-bid, there is one bank of re-bid at the end of the year – for next year, so there's nothing in-year impact. But there'll be one of the big global ones for next year, not this year.

<Q - Michael Vitfell-Rasmussen>: Great. Thank you very much. That was exactly what I was looking for. Thank you.

Operator

The next question comes from Emily Roberts at Deutsche Bank. Please go ahead.

<Q - Emily Charlotte Roberts>: Hi. Good morning. Three from me, please. First of all, on IFS, could you give us a bit more color on the opportunity that you're seeing and based within your key account clients but obviously with new customers and maybe some color by vertical and region where you see the most opportunity?

And second question is on the impact of the minimum wage on UK margins. You mentioned that the Turkish margins didn't fall after you managed to push through the minimum wage. Could you give any color on what you expect for UK margins, please?

And then finally, on interest. Obviously, you have some savings on the Q1 interest payments. Could you give some guidance for the full year and also perhaps next year given the 2021 bond interest payments will be coming in? Thank you.

<A - Jeff Olsen Gravenhorst>: Yeah. Thank you. IFS opportunities, clearly you could argue that there are IFS opportunities everywhere, but I do think it falls into various categories. So if you look at it from an overall perspective, there are global – there's a good interest in regional to global accounts at the moment. So customer is looking for how can I get more transparency of my service spend across the world, how can I ensure better consistency in the service delivery to facilities across the world.

And because compliance is becoming a bigger and bigger item for all blue-chip companies, it goes for everybody, but the blue-chip companies would take this very seriously. How can I ensure compliance of all of the regulatory needs and actually also all sorts of behavior in all of my sites across either regions of globe? Those are the main drivers, of course, combined with how can I save costs on this. So the bundling of the services to take out synergies at management level that's the first part of synergies. It's always easy.

So with that, of course, there was a big interest in, is there a benefit in putting regions or countries together into regions. We see a lot of interest in Europe from that. They're used to working with output contracts more than maybe the emerging markets are. We do see global interest, but they will typically end up in regional contracts.

Then we see in Europe, obviously by country, also again for exactly the same reasons; very good interest in moving to a different type of model, where we are helping our customers to become better at their job. So our [indiscernible] (32:04) to support their needs. So that is moving very heavily in Europe.

If you look at the rest of the markets, in emerging markets, this comes from a different level. Emerging markets are looking for cost savings. So that's the driver for it and that's why we believe that bundling and IFS will also be good opportunities but probably more in the mid-term where the European and regional and global is more short-term.

Within sectors, it's still is the banking and IT sector, which has the main driving force within IFS. But having said that, manufacturing industry, not from a global perspective but regional or country perspective, this is becoming more and more interesting because there are many services that we can take over and we can help them with to improve service levels, but also to reduce cost. That includes, of course the pharma industry, in which we have been very successful with the Novartis deal as you can see. So those are predominantly the segment for IFS.

If we move to the wage inflation question, as you said, I commented on the margin impact in Turkey. The margin impact in the UK from the wage increases we expect to be zero. So I don't expect any margin impact as a result of that. That's a 7.5% increase on the minimum wage into what's now called a Living Wage. That does not impact all our employees in the UK because most of our employees are at a higher level than that already. So that's why you will not see any impact also because we have been managing to pass that on to our customers.

So, Peter, if you can answer on the interest level?

<A - Peter Harder Thomsen>: Yes, thanks, Jeff. Well, you noted that our interest expenses declined to DKK 107 million for the quarter and bear in mind that this is impacted by a positive impact of FX of DKK 18 million. So the underlying net financial expenses amount to DKK 125 million.

You also know that we've been working hard on minimizing our financial expenses and there are a lot of moving parts in financial expenses that can vary through the year. But our best estimate currently is that we'll end the year with around DKK 500 million to DKK 550 million in net interest expenses, excluding any FX impact gains or losses.

With respect to [ph] 2017 (34:32), I won't comment on that, but I will obviously draw your attention to the fact that our bonds carry fixed interest rates which constitute the majority of our debt.

<Q - Emily Charlotte Roberts>: Great. Thank you very much. I have a quick additional question if that's okay. And just on Brazil and obviously the market remains challenging there, should we expect some additional restructuring costs for the second half of the year?

<A - Jeff Olsen Gravenhorst>: It is a scenario where we will reduce our presence as our customer will also reduce the need for our services. I think it is a region where we will be looking at reducing scope. From that perspective, we'll be seeing some restructuring costs coming through from Brazil.

<Q - Emily Charlotte Roberts>: Could you quantify [ph] them at all (35:15) for us?

<A - Jeff Olsen Gravenhorst>: No, I don't know yet. So – but it is not out of line from what you've seen in earlier years.

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

Operator

Next question comes from Paul Checketts of Barclays Please go ahead.

<Q - Paul D. Checketts>: Morning, everyone. I've got three questions as well, please. The first is on organic growth. It came in stronger than people expected in this quarter. Can you map out how you think it would phase over the rest of the year based on what you can see at the [ph] minute (35:48), Jeff?

And then just the second question is on the Rolls-Royce contract that you talked about. You mentioned that you would aspire to move away from, I think, how you referred to was task-based services. Can I ask, when you bid for that work, did you propose structuring it in the way you would like to move it to now?

And then last question is, can you just [indiscernible] (36:13) on the changes to GCC? I didn't quite follow why this is happening now. I'd just like to understand a bit more on what exactly how it's changed? Thanks.

<A - Jeff Olsen Gravenhorst>: Paul, can you just repeat the question on Rolls-Royce? I didn't actually get that.

<Q - Paul D. Checketts>: When you're talking about the Rolls-Royce contract, you mentioned that over time you would like to move this away from being based on task-based services. I think that's how you phrased it. And I think this comes back to the Capital Markets Day when you talked about a new way of structuring work where you're more aligned to the customer. I'm interested in when you bid for that work, did you suggest to them then that you structured it differently? And why didn't they take it up at that point, if you think they may do in the future? Thank you.

<A - Jeff Olsen Gravenhorst>: Okay. All right. Thank you, Paul. If you take the organic growth, the one thing is that it's still very difficult to predict within a relatively narrow range here. So, going through Q1, the one thing we need to notice or take note off is that the growth is a little bit higher than what we expected. But we also have some timing differences as we said on Singapore where we got more projects into first quarter which we don't expect to have an impact full year.

The second point was that we have been better at getting the price increase through in Turkey quicker than we originally anticipated. So Turkey is a little bit higher in Q1. Now, because we expected it from Q2, it's not going to have a material impact on the full year but it of course has an impact in the first quarter.

So that's why we don't see a big difference to what we talked about short period of time ago, when we came out with full year results of 2% to 4%. And when you then also take into consideration that what we mentioned at the time was that Pacific will go into negative territory, because of the resource areas, then that's been reduced a little bit further from that hospital development, which was not expected at that time. But overall, again, it's within the expectations as we mentioned a month ago.

Brazil is a little bit worse than originally expected. So overall, I think [ph] that our (38:40) expectations with the startups of contract is coming through, it's exactly as what we talked about when we did the full year announcement. And that's a range between 2% and 4%. How exactly to predict that by quarter? I actually would like to or will shy away from. I think it's more important that we hold the 2% to 4% organic growth for the year.

On Rolls-Royce, I think maybe it's a way of – I phrased it, I'm not sure. But of course the way that we offer this to the client is a different solution. This is what they want. The clients are asking for a much more custom-oriented solution, which is backed up by the technology solutions that we can actually give them the benchmarking, the data insights. So we will restructure that to the future setup already immediately.

So when we go through the transition phase, that's when we will put it together in the way that it was bid, and the way that it's meant to be delivered, which is a more custom-oriented, customer-supporting way as opposed to a task-oriented delivery. That means, of course, that we are focusing on the output of our services to help create a better service to support the business of Rolls-Royce, and thereby giving them transparency, giving them consistency, and giving them assurance on the compliance.

And then on the last of part on GCC, why do we do it know? You might have noticed also when we [ph] talk at Capital Markets Day (40:13), clearly this is about key accounts, it's not really about only Global Corporate Clients. Sometimes global [ph] bids (40:19) comes out and we negotiate and it end up in a regional [ph] bid (40:21). Sometimes it's a local contract like Vattenfall in Germany can be much bigger than a Global Corporate Clients account.

So for us, to make it meaningful to disclose Global Corporate Clients, they have to have a certain size. So these are Global Corporate Clients. And then they should be delivered as a global delivery. Whereas the five contracts we've taken out has been negotiated globally as a contract, and they are managed from a key account point of view, so relationship-wise globally, because there's an expansion potential, but they are purely locally delivered. So there's a local relationship.

And then as you can see from the numbers, they are very small, and that's why we're just clearing off the picture [indiscernible] (41:13) it doesn't have the major impact on any numbers, it's just to say that the bulk, so that means 10% of our revenue sits with those 10 accounts. It gives a more meaning to you as well, but you can see what's the size of these contracts when they are meaningful as opposed to the smaller ones. So it's actually to help you as well from the outside here.

<Q - Paul D. Checketts>: Thanks.

Operator

Next question comes from Kristian Godiksen at SEB. Please go ahead.

<Q - Kristian Godiksen>: Yes. Hello, gentlemen. A couple of questions from my side as well. Jeff, you mentioned that you had some good traction within the regional to global clients. Should we expect any announcements within that, and maybe also, potential losses of some regional contracts which, yeah, could go to other global contract suppliers?

And secondly, I know that you have won an airport in the U.S. Could you comment on what is the potential for that kind of business and I guess that is all IFS business?

And then thirdly, can you just, please bear with me with the numbers, but please confirm that if Turkey has implemented – or in Turkey that you've implemented the 30% minimum wage increase and you have passed that fully on, then as wages makes up around 70% of OpEx, that should give 21% of tailwind in Turkey alone. And as Turkey makes up around 4% of Group revenue, it should have a full-year impact of 84 basis points for the Group. And I guess that should be the impact in Q1, and that should also be the impact in – for the full year?

<A - Jeff Olsen Gravenhorst>: Okay. Good. The first question, Kristian, is on pipeline. As you know, we will, of course, let you know as soon as we have won something that's sizeable, then, we'll come out with it, either as a press release or as an announcement. We have a good pipeline, and I think there's a lot of activity here in line with what I talked about earlier. There's interest, it's very, very hard to say when exactly is that – these negotiations going to stop, and when are these going to start the contracts.

So overall, we will obviously let you know as soon as something happens on those. I can't give you more color on it, other than saying that it's definitely at the level of what we've seen earlier. Both from a regional perspective, country perspective and a global perspective, but good development in those.

On the aviation part, in the U.S. airports are actually single service, Kristian, it's not an IFS contract. So we have a good development in that segment in the U.S. Of course, it's a segment where we can, because it's a large site-based service. We can then move from that in the U.S., into broader packages. That is, of course, our aim with that. But so far, it is predominantly cleaning of airports. We have a number of airports and segmenting that out and really focusing on what's the need of airports, of course, makes even more meaningful to them. And with that, we can expand our services over time, which we've done in other countries.

So, for us, of course, our aim or our job is to make sure that we share best practices across all the airports that we have across the world, whether it is Pudong Airport in China or whether it's in Thailand or it is in Zürich, Geneva or in the U.S., that's our aim. So good potential. It is a very strong segment of ours, but in particular, in the U.S., it actually still is single service, just to get that corrected.

On the Turkish part, well that would be nice, if that was the case obviously. But it is not all wages, and they're not all on minimum wage. So of course, it's a lot less than OpEx. We have large catering businesses there, which of course is not impacted by it. And that means that we have a far less impact than what you have on your calculation right now. Don't likely think we disclosed that overall, but it is not all of the business impact with 29% wage increases, it's actually quite a lot less than that. So I can't quantify on that right now, Kristian, but that is the case.

<Q - Kristian Godiksen>: Okay. Thank you. And just lastly, if I may. I know that Heine is stepping down here end of the May, and you're still in the process of finding his successor. Maybe if you can give some flavor on what is the status on that?

<A - Jeff Olsen Gravenhorst>: Yeah. Obviously, we've been out there searching for a while. And we've [ph] crossed the (46:04) testing candidates. We have a number of people to choose from I have to admit. So of course, it takes some time. It's a very important appointment, so we will do the proper due diligence on this, and we will come back as soon as possible. It should be within a reasonable time, so within hopefully next month or so that we can come up with something, but you never know. So I will qualify that statement, which we'll make absolutely sure that we've done our best to appoint the right person.

Having said that, I do want to remind you that we do have a very, very strong financial organization within ISS. Also, here at head office, we've got very strong functional heads and functions. So we [ph] can't get by (46:44) and we will get by, as if business as usual.

<Q - Kristian Godiksen>: Okay. Many thanks, Jeff.

Operator

Next question comes from Rory McKenzie of UBS. Please go ahead.

<Q - Rory E. McKenzie>: Hey, good morning, all. Just two for me please. Firstly, can you talk about the customer segmentation program, what's the number of contracts or customers you can have pruned or exit in Q1 here in Spain, Belgium? And can you update sort of how far through your countries you are. For example, what would the slide 14, right-hand side chart look like if you were to talk to how far through are your country base you were with the segmentation?

And then second question, just on CapEx and your spending there. That's obviously down quite a bit in Q1. Is that shift to leasing rather owning you talked about within procurement, and what's your full year outlook for capital expenditure now? Thank you.

<A - Jeff Olsen Gravenhorst>: Yeah. If we take your first question on the customer segmentation. Just a quick reminder on this. The customer segmentation is not about trimming contracts or actually exiting contracts. It is mainly about structuring our business in a key account organization where we can focus on best practice sharing and volume sharing and talent sharing. That makes a lot easier when you have a key account sector, and then split that in certain countries, will even go into customer segmentation like healthcare, banks, retail, et cetera.

So overall, there's no pruning in the numbers. No pruning or trimming of contracts or exiting contract as a result of the segmentation in those countries. There might be in some other country, and we'll let you know if and when that actually happens as we go through the countries.

We are at the mapping and implementation, more than 60% of our revenue now in number of countries. So now it's about executing on that organizational model and making sure that we share best practice in a better way, and that of course will improve our operating margin potential, but certainly also our customer focus from that perspective, better up-selling opportunities, better improving our share of wallet opportunities. But clearly also better references. So that should improve our organic growth going forward. That's the whole point of the customer segmentation model, is to become more relevant to our customers.

Then you were asking on slide 14, and I guess your question was on how far we are on the procurement implementation. Is that what – or I'm not sure I got that part?

<Q - Rory E. McKenzie>: No, will that slide would've looked like if you did it for the segmentation. But I guess you said you're over 60% through. So that's kind of the answer?

<A - Jeff Olsen Gravenhorst>: Good. And then maybe on CapEx, if Peter will answer that now?

<A - Jeff Olsen Gravenhorst>: Yeah. I can take that. Well, as you've noted, we have a CapEx of 0.8% of revenue for Q1 2016. That is slightly lower than you've seen in other quarters, and that is principally due to timing issues. And as we pointed out, there are couple of other factors driving this. One is the shift from owned assets to operational leased assets. And also what we do is wherever possible we try to get our customers to make the capital investments, for example, in kitchen refurbishments, restaurants, et cetera, as opposed to us. So we are maintaining our focus on having a capital-light business.

However, if we do see the opportunities and the potential to invest and have attractive returns, we will do that. But if we look forward for the full year, we don't give any specific guidance, but for now, I'll say that we expect any one year to be within the historical range we've seen of between 0.9% to 1.4% of revenue.

<Q - Rory E. McKenzie>: Okay. Great. Thank you.

Operator

Next question comes from [ph] Henry Naish (50:39) at the Exane BNP Paribas. Please go ahead.

<Q>: Yeah. Good morning, everyone. Just a quick follow-up on the project work in Asia. So I think you mentioned that some of that non-portfolio work had been accelerated in Q3 into Q1 in Singapore. Should we be inferring from that that's going to hit organic growth and operating margins in the next couple of quarters and how much [Technical Difficulty] (51:02) impact be? Thanks.

<A - Jeff Olsen Gravenhorst>: Yeah. You say that – this is what we expected to happen for the full year. It just happened a little bit earlier. So yes, it will, of course, also have a – that will – it will not carry through as an uplift in organic growth for the rest of the year, and then, of course, it will balance out with our expectations as we said for the full year between 2% and 4% growth.

<Q>: Okay. That's it. Thanks.

Operator

[Operator Instructions] We have a follow-up question from Kristian Godiksen of SEB. Please go ahead.

<Q - Kristian Godiksen>: Yeah. I just have one follow-up question. I mentioned that – I noticed that you mentioned in the results that you do not expect any major pick-up in the macroeconomic environment. But I mean do you see just a pickup then? And then just maybe lastly also, I guess, since we haven't touched upon it on this quarter, I guess, there is no news to either an acquisition of a catering or a technical service business?

<A - Jeff Olsen Gravenhorst>: Okay. On the macroeconomic side, I think, Kristian, the point is we don't see any difference, to be honest, from two months ago. Actually, you can argue that GDP forecast is slightly down in our countries, so [indiscernible] (52:38) countries. Whether it's 2.02 or 1.83 or whatever it is, probably it doesn't have a big impact on our business. The only point is, we don't see any changes right now. If I see anything, I see uncertainty, and everybody talks about Brexit.

Now, as you know, Brexit doesn't have a direct impact on us, but I do think it has an impact on people being hesitant of customer perspective and I'm just happy that this is going to be done with within the next month or so. So no, I don't see any changes at all honestly.

On the acquisition side, no there's no news. We're still working on that, and we're working on where do we see room for improvement on competence-enhancing acquisitions, we'll keep focus on it. It has to be the right target, the right price and the right time.

So we will let you know as soon as there is anything new on that.

<Q - Kristian Godiksen>: Okay. Sounds good. Many thanks.

Operator

We have a follow-up question from [ph] Henry Naish (53:34) at Exane BNP Paribas. Please go ahead.

<Q>: Yeah. Hi there. Just a quick clarification on the procurement and BPO stuff. I think you may be want to cover this later in the call. But I just wanted to check just in terms of how that's split between regions, is there a specific regional focus on those initiatives? How do you see margin benefits splitting between the various operating regions? Thanks.

<A - Jeff Olsen Gravenhorst>: On the procurement side. We've had focus – it was procurement, right, the first one? Yeah. On the procurement side, the focus was originally on Europe. Now, it's actually the rest of the world. So we will see an impact also from the procurement benefits in Americas and in Asia, Pacific is already doing pretty well on that. So Asia will be impacted and Americas.

On the BPO, it's predominantly in Europe. So the focus on BPO, the business process outsourcing is in the Nordics region and now we moved into Netherlands, Belgium, part of – and Australia also. So Europe, Australia, that's the key focus right now. We will look at the benefits for other regions as well, but that's why you will see the benefits in the short-term.

<Q>: Okay. Perfect. Thanks.

Operator

There are no further questions at this time. Please go ahead, speakers.

Nicholas Richard Ward

Great. Okay. Well, thank you to Jeff, and thank you to Peter, and thanks everyone for listening in, for your interest and your questions. Martin and myself will be around during the course of the day if you have any follow-up. But otherwise we wish you well. Thank you.