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March 28, 2012

Summary:
ISS A/S

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Summary:

ISS A/S

Credit Rating: BB-/Stable/--

Rationale

The ratings on Denmark-based facilities services provider ISS A/S and related entities (ISS) reflect Standard & Poor's Ratings Services' view of the group's highly leveraged financial profile and weak credit measures. The ratings also take into account the potential for shareholder-friendly policies as a result of ISS' private equity ownership. Another risk may take the form of wage inflation, which could weigh negatively on ISS' cost base should the group find it difficult to pass the related cost increase onto customers.

The group's weaknesses are partially mitigated by its strong business risk profile, underpinned by a solid business position in an attractive--albeit fragmented and competitive--industry and a sound service delivery platform for driving organic growth. With 2011 year-end sales of Danish krone (DKK) 77.6 billion, ISS benefits from a strong business position, particularly in Northern Europe, where it is a leader in most of its markets. Although there are few barriers to entry and pricing is competitive in the facilities services sector, the group has relatively high contract retention rates, and is large enough to benefit from economies of scale. It also benefits from good geographic diversity and a highly diversified customer base.

S&P base-case operating scenario

Our revenue forecast incorporates our view that GDP in the European Union will only rise by 0.2% in 2012. We continue to believe that ISS will perform better than the overall economy. In our base-case assessment, we anticipate that revenues at year-end 2012 will rise by just over 4%, to nearly DKK81 billion, exhibiting slower organic growth than in the year-ended December 2011, when it was reported at 6.2%. We forecast that organic growth will be slower in most regions than in 2011, particularly in North America where organic growth was over 28% in 2011. By contrast, we believe that organic growth in Western Europe (51% of 2011 revenue) will recover somewhat, as we anticipate that there will be limited impact from disposals, when compared to 2011.

For ISS, we forecast that the Standard & Poor's-adjusted EBITDA margin will increase in 2012, by 20 basis points to 7.1%. We anticipate that the main reason for this rise will be a recovery in margins in North America and a strengthening of margins in Asia and Latin America. On the other hand, we forecast margins in Europe and Pacific regions to be slightly weaker.

S&P base-case cash flow and capital-structure scenario

In our-base case assessment, we forecast that adjusted funds from operations (FFO) will reach about DKK3.4 billion in 2012, demonstrating resilience in ISS's business model. We anticipate that unadjusted FFO will rise by DKK200 million from a 20 basis point rise in the EBITDA margin, and that the adjustments for operating lease depreciation and pensions will increase at the same rate of revenues. We do not forecast one-off adjustments as in 2011 for the initiated IPO process or restructuring costs, which added DKK270 million to adjusted FFO in the year-ending December 2011. Hence, we anticipate FFO to be broadly in line with the 2011 figure.

Our base-case scenario also assumes a small cash outflow for acquisitions of DKK200 million. Accompanied by scheduled debt amortizations, we anticipate that cash will decrease by nearly DKK600 million in 2012 to just over DKK3.5 billion. Overall, we believe that net debt will be broadly neutral, with adjusted FFO/debt at just over 9%, the same level for the year-ended December 2011.

With our forecast increase in the adjusted EBITDA margin, we forecast that adjusted EBITDA will be just under DKK6 billion in the year-ended December 2012. Therefore, we anticipate adjusted debt to EBITDA to be just over 6x in 2012, down from 6.8x at the end of December 2011.

Liquidity

We assess ISS' liquidity as "adequate" under our criteria, and consider that ISS has sound relationships with its banks and a satisfactory standing in credit markets. Furthermore, we forecast that in 2012, sources of liquidity will exceed uses by a coverage ratio of nearly 2.0x. We anticipate that this ratio will remain broadly stable in 2013.

Sources of liquidity include unused amounts available under the committed revolving credit facility (RCF) of nearly DKK950 million, maturing in December 2014. Additionally, surplus cash and equivalents totaled DKK2.0 billion at year-end December 2011, which we believe will sufficiently cover short-term maturities and peaks in working capital. We anticipate that the group will continue to generate strong FFO of nearly DKK2.0 billion in the full year-ending December 31, 2012. Consequently, we forecast total liquidity sources of just under DKK5.0 billion in December 2012, falling somewhat to about DKK4.2 billion in December 2013.

In terms of uses of liquidity, we project that debt amortizations and an increase in net working capital will consume about DKK1.2 billion in 2012 and DKK700 million in 2013. We forecast capital expenditure spending of just over DKK1.2 billion in 2012 and DKK1.2 billion in 2013. In addition, we project an outflow of DKK200 million for possible acquisitions, contributing to total uses of DKK2.6 billion in 2012, dropping to DKK2.1 billion in 2013. Therefore, we estimate excess liquidity of nearly DKK2.1 billion in 2012 (sources exceeding uses by 1.8x), and to be broadly stable at DKK2.1 billion in 2013 (2.0x).

Following minor debt amortizations in 2012 and 2013, ISS' next significant debt repayments are not scheduled until 2014 and 2015, as we anticipate that the securitization program due in 2013 will continue to be rolled over. Covenant headroom is currently at adequate levels and we forecast that this headroom will reduce somewhat in 2012 as covenant targets tighten modestly.

Recovery analysis

The issue ratings on ISS' €581.5 million subordinated facility (including the add-on notes) due 2016; on ISS Global's €110.4 million issuance under the €2 billion unsecured European Medium Term Note program due 2014; and on ISS Financing's €525 million secured notes due 2014 are 'B', two notches below the corporate credit rating on ISS. The recovery ratings on these facilities are '6', indicating our expectation of negligible (0%-10%) recovery in the event of a payment default.

For further information, see ISS A/S Recovery Rating Profile, published Jan. 13, 2012, on RatingsDirect on the Global Credit Portal.

Outlook

The stable outlook reflects our view that ISS' operating performance will remain steady in the near term, thanks to the flexibility of its cost base. While a slower growth environment is likely to materialize in 2012, we anticipate that credit metrics would moderately improve and adjusted EBITDA margins would rise by 20 basis points. Based on current information, we anticipate that credit measures will improve gradually in the medium term, supported by continued organic growth in the mid-single digits, as well as by a reduction in net debt levels. This should allow adjusted debt to EBITDA to decline toward 5x-6x, and EBITDA interest coverage to remain at about 2.5x in the medium term.

Downside risk is most likely to arise from a change in acquisition strategy toward larger debt-financed acquisitions or a significant decline in organic growth rates toward zero or negative growth. Both factors could, accompanied by weaker margins, lead to a reduction in credit measures from those that we consider commensurate with the rating. Potential downside could also arise should the group face difficulties in refinancing its maturing notes well before their due dates.

Upside rating potential is constrained by the group's highly leveraged financial risk profile. We forecast that credit metrics would not improve to levels commensurate with an "aggressive" financial risk profile before 2016.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Standard & Poor's Revises Its Approach To Rating Speculative-Grade Credits, May 13, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- Critical Mass, Diversity And Cost Flexibility Support Success In European Business Services, Nov. 19, 2007

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