S&P Global Ratings

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Summary:

ISS A/S

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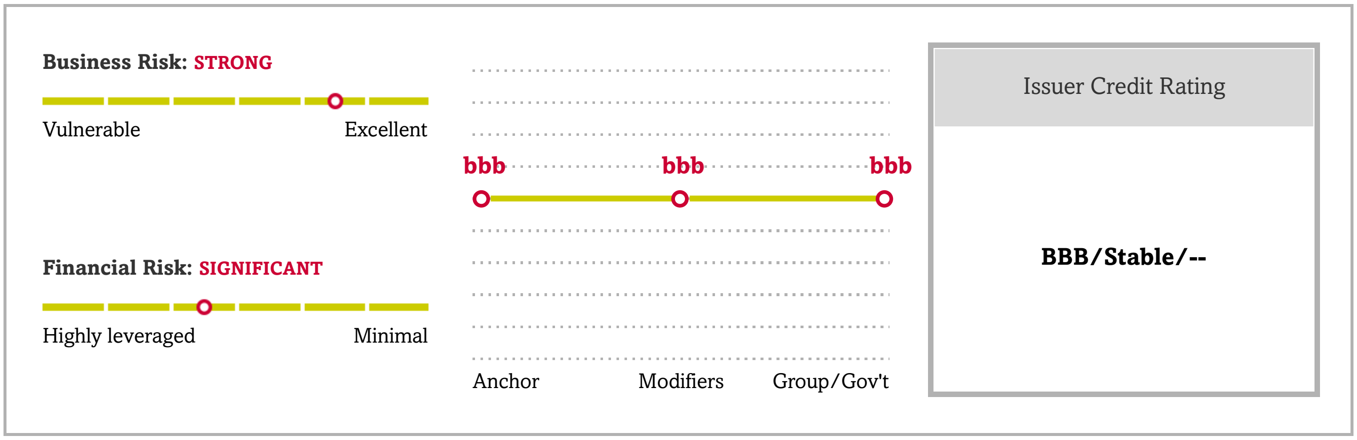

Rationale

Business Risk: Strong	Financial Risk: Significant
• Leading player in the naturally resilient facilities services industry. • Wide geographic and customer diversity. • Resilient nature of the basic services business. • Highly competitive and fragmented facilities management sector, with relatively low margins. • Limited flexibility in pricing.	• Strong cash generation from business operations, with low fixed asset intensity and capital expenditure (capex) needs. • Forecast funds from operations (FFO) to debt of 24%-27%. • Bolt-on acquisition strategy targeted at enhancing core service offering. Financial policy targeted at maintaining stable credit metrics. • Exceptional liquidity position.

Outlook: Stable

The stable outlook on ISS A/S reflects S&P Global Ratings' expectation that the company will continue to see modest growth in revenues and generate sustainable cash flows. We also expect that ISS will continue to distribute excess cash to shareholders, such that credit metrics will stay relatively stable over time. We consider ISS' S&P Global Ratings-adjusted FFO to debt of 20%-30% as commensurate with the current rating, and expect the ratio to remain at the higher end of that range.

Downside scenario

ISS' credit metrics provide comfortable headroom at the current rating. However, we could lower the rating if shareholder distributions rose significantly, debt levels increased, or ISS' operating performance deteriorated such that FFO to debt fell below 20% on a sustained basis.

Upside scenario

We could raise the rating if ISS' operating performance continues to be stable while it maintains strong free operating cash flows. An upgrade would depend on the company implementing a financial policy to continually reduce leverage and refraining from distributing excess cash to shareholders. We could consider raising the rating if ISS sustained FFO to debt above 30%.

Our Base-Case Scenario

Assumptions

- GDP growth in the eurozone of 2.1% in 2018 and 1.7% in 2019, and of about 3.0% in 2018 and 2.5% in 2019 in the U.S. In ISS' other key operating region, Asia Pacific, we forecast GDP growth of 5.6% in 2018 and 5.6% in 2019.
- About 2.0%-4.0% organic growth in 2018 and 2019.
- A slight deterioration in the adjusted EBITDA margin to 7.0%-7.5% in 2018, followed by a rebound to 7.5%-8.0% in 2019.

Key Metrics

2017A 2018E 2019E

EBITDA margin (%) 7.5 7.0-7.3 7.5-8.0

Debt/EBITDA (x) 2.8 2.9-3.2 2.6-2.9

FFO/debt (%) 26.5 22.0-24.0 25.0-28.0

A--Actual. E--Estimate.

Company Description

ISS is a large, long-established facilities services group with operations in over 50 countries in Europe, Asia-Pacific, Latin America, and North America. ISS provides single services, multi-services, or integrated facilities services for private and public entities locally, regionally, and globally. Services include cleaning, office support, catering, security, and property and facilities management. The company is publicly held following its IPO in 2014.

During the first half (H1) of 2018, ISS reported revenue of Danish krone (DKK) 39.1 billion (down from DKK39.5 billion in H1 2017) as currency fluctuations offset stronger organic growth of 3.2% (H1 2017: 1.8%). This organic growth was driven by recently won contracts. The group continues to record strong revenue growth from integrated facilities management contracts, which now represent 39% of total group revenues, up by 9% year-on-year (yoy). The group's reported EBITDA in H1 2018 declined by about 15% yoy to DKK 1.8 billion. However, we attribute most of that decline to contract ramp-up expenses and exit costs. The decline also relates to exceptional restrucuring costs that we already expected ISS to incur given the number of contracts up for tender during the first half of 2018, and the group's recent acquisitions.

Over the past few years, ISS has made significant disposals to allow it to focus on its core competencies. The company has reinvested a proportion of the proceeds in acquisitions allowing it to shift toward technical services, which are key to facilitate the expansion of its integrated facilities services. We expect the group to continue looking for acquistions to expand its technical service capabilities as well as selectively closing gaps in its service or geographical portfolio. An example of this is its acquisition of U.S.-based cateering company Guckenheimer in 2017.

Business Risk: Strong

ISS holds leading market positions in the facility services industry across its key geographies, mainly throughout the Nordic region and Western Europe, as well as in emerging markets. ISS has good geographic diversity, and a highly diverse customer base comprising thousands of private and public customers. Historically, ISS has had a strong track record of integrating its many acquisitions, which has produced a solid global service delivery platform with critical mass to support future organic growth opportunities. The company has also managed to maintain less volatile operating profitability (measured by EBITDA margin) than that of most its peers, contributing to what we see as its strong competitive position.

ISS' integrated facilities management business offers some barriers to entry due to the necessary scale required for global service offerings, while single services generally have low barriers. ISS exhibits good contract retention, which has remained stable in recent years at about 90%.

Our business risk assessment is constrained by the competitive nature of the facilities services sector, which leaves limited pricing flexibility for service providers, keeping operating margins relatively low at about 4%-7% across the sector. Ongoing efforts to control overheads, staff costs, and food price inflation are therefore necessary.

Peer comparison

Financial Risk: Significant

ISS' financial metrics have improved following the company's focus on profitable organic growth and the divestment of noncore activities. We believe that ISS will continue to generate organic growth in the near-to-medium term by securing integrated facilities management contracts with new clients such as the 10-year contract with Deutsche Telekom announced in October 2017. We expect growth to be further bolstered by ISS' bolt-on acquisition strategy targeted at enhancing its core service offering.

We forecast that ISS' adjusted debt to EBITDA will marginally weaken to about 2.9x-3.2x in 2018 as restructuring costs are likely to burden operating results. We expect that leverage metrics will then strengthen to 2.6x-2.9x in 2019 as the company continues to generate organic revenue growth in the low-single digits, while benefiting from the newly won Deutsche Telekom contract and continued strong organic growth from the emerging markets. We expect the company's FFO-to-debt ratio to be around 22%-24% in 2018 and around 25%-28% in 2019, consistent with a significant financial risk profile.

Furthermore, we expect ISS to maintain its acquisition spending and shareholder returns policies in line with recent years such that credit metrics will not deviate materially from current levels. We believe that ISS will continue to generate healthy free operating cash flow given its high cash conversion rates and the flexibility it enjoys in terms of capex requirements.

Financial summary

Liquidity: Exceptional

We assess ISS' liquidity as exceptional because we forecast that the company's sources of liquidity will exceed its uses by more than 2.0x over the next 24 months, and that sources less uses would continue to be positive should EBITDA fall by 50%. We consider that ISS has well-established and solid relationships with its banks and exhibits prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and cash equivalents of about DKK4.4 billion as of June 30, 2018; • Approximately DKK6.1 billion available under its current revolving credit facility; and • Cash FFO of about DKK3.4 billion over the next 12 months.	• Capex and working capital requirements of DKK1.2 billion; • About DKK1.6 billion of assumed dividends and share repurchases; • Seasonal working capital requirement of about DKK1.4 billion; and • Post-retirement employee benefit top-ups of around DKK250 million.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2018, ISS's capital structure consisted of DKK17.3 billion of total borrowings, all of which were unsecured.

Analytical conclusions

We rate ISS' unsecured notes 'BBB', in line with the issuer credit rating, as we do not consider there to be subordination risk in the capital structure.

Reconciliation

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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