Credit Opinion: FS Funding A/S

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Denmark

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	B2
Senior Subordinate	Caa1

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Opinion

Company Profile

FS Funding A/S is the holding company for ISS A/S (`ISS', or `the company'). ISS is one of the world's largest providers of facilities services, with the majority of revenues emanating from cleaning services (61% in 2005), as well as property (23%), office support (4%) and catering services (6%), and integrated services the remainder. The company has operations in 48 countries, albeit primarily within Europe, with the Nordic countries accounting for about 28% of revenues in the first nine months of 2006. The company generated DKK 52.9bn (c.EUR 7.1bn) in the twelve months to 30 September 2006.

ISS is a wholly-owned subsidiary of FS Funding A/S, which was incorporated in March 2005 for the purpose of the subsequent acquisition of ISS. FS Funding's ultimate shareholders include the private equity funds EQT Partners and Goldman Sachs Capital Partners.

Credit Strengths

- ISS maintains a leading position in the European facilities services industry, enabling greater economies of scale;

- Diversified customer base with over 100 thousand customers with the top ten accounting for less than 5% of 2005 revenues;

- Stable operating margins and flexible cost base. The company estimates that staff costs amount to about two thirds of turnover, and employees can be reallocated between contracts, enabling the company to adjust to changing demand;

- Stable customer relationships. The company estimates that the average length of its customer relationships is between eight and ten years;

- The company continues to integrate a large number of smaller acquisitions while protecting its overall operating margins.

Credit Challenges

- The main constraint to the rating continues to be the highly leveraged capital structure, with Adj. Total Debt/EBITDA at about 7.6x in the twelve months to 30 September 2006;

- The company remains very acquisitive, which Moody's expects will continue in keeping with the company's `Route 101' strategy of eventually attaining DKK 101bn in revenues;

- Due to its low barriers to entry, the market remains highly fragmented with an estimated 75,000 operators in the European facilities services sector, and an established grey market. The industry is also characterised by a high turnover rate among its employees;

- The trend in the industry away from `cost plus fee' contracts and towards P&L or `fixed fee' contracts increasingly places the burden of cost overruns on the supplier.

Notching Considerations

The company's debt capital structure consists primarily of senior facilities in a total amount of c.DKK 14bn, the MTNs due 2010 and 2014 in an aggregate amount of EUR 1.35bn and EUR 1.3bn of subordinated notes due 2016. These notes are issued in two tranches, an EUR 850mn FRN bearing interest at 6.625% over three month EURIBOR, and EUR 454mn 8.875% notes. The senior facilities and the subordinated notes are secured, respectively, by a first and second-priority interest on all the share capital of ISS and the rights of a proceeds loan from FS Funding A/S to various operating subsidiaries of ISS Global. The 2016 notes are structurally subordinated to all debt liabilities of the Issuer's subsidiaries, including the MTNs due 2010 and 2014, and are subordinated in right of payment to all Senior Debt, including the Senior Facilities and secured borrowings. The subordinated notes are rated Caa1, two notches below the B2 corporate family rating, to reflect their subordination to a substantial share of debt within the capital structure.

Financial Profile

Since being acquired the company has continued to grow predominantly through acquisitions, with 19% revenue growth reported in the first nine months of 2006, of which 14% through acquisitions and 5% being organic. Revenues reached DKK 52.9bn (c.EUR 7.1bn) in the twelve months to 30 September 2006, and the reported EBITDA margin remained at about 7%, relatively unchanged over 2005.

Total balance sheet debt as of 30 September 2006 was at DKK 28.8bn, or DKK 30.2bn adjusted for unamortized costs, which more accurately represents the true debt burden of the company. The debt level has continued to increase in 2006, as expected at the time of the initial rating, such that the Adjusted Total Debt/EBITDA in the year to 30 September 2006 is estimated at 7.6 times based on reported EBITDA, albeit having declined somewhat since the initial rating was assigned in April 2006.

Moody's expects that the company's growth will continue to be fuelled by acquisitions, in particular if it retains its `Route 101' strategy of reaching DKK 101bn in revenues. In the first nine months of 2006 the company paid DKK 3.27bn for a total of 88 acquisitions, which follows a large number of bolt-on acquisitions in previous years. In this regard, continued deleveraging will depend on the company's ability to maintain consistent growth in operating profits.

Liquidity

The company's liquidity is considered adequate. At 30 September 2006 it reported DKK 968mn in short-term debt and DKK 1.67bn in cash and equivalents. The short-term debt comprised primarily borrowings of DKK 844mn under a committed Revolving Credit Facility of DKK 1.75bn, which is available to fund working capital requirements and local credit facilities. The company's long-term debt consists mainly of its MTNs due 2010 and 2014, and the senior facilities, including the RCF, which mature in 2012 and 2013. Within the senior facilities c.DKK2.4bn of acquisition facility B remained undrawn as of 30 September 2006. Moody's notes that the company's cash flows tend to be highly seasonal, with various payments and working capital outflows depressing operating cash flows in the early part of the year. As such, cash flows tend to be quite heavily skewed towards the fourth quarter, in part due to working capital movements in the last quarter.

Rating Outlook

The stable outlook reflects the company's still highly leveraged capital structure and generally weak credit metrics, but is supported by its diversity of operations and steady growth in revenues and operating profits largely through acquisitions.

What Could Change the Rating - Up

The rating or outlook could be positively impacted by a further improvement in adjusted leverage, on an actual basis, to below 7x, with stable cash flows and the EBITDA margin being maintained around the current level of 7%.

What Could Change the Rating - Down

The outlook or rating could be negatively impacted by continued borrowing without a commensurate increase in operating profits, resulting in reported leverage approaching eight times; a marked deterioration in operating margins below current levels; or if concerns were to develop about liquidity on account of the company's continued growth in borrowings in order to finance acquisitions.