RESEARCH

ISS Group

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ISSUER CREDIT RATINGS	
ISS A/S	
Corporate Credit Rating	B+/Stable/B
FS Funding A/S	
Corporate Credit Rating	B+/Stable/--
ISS Global A/S	
Corporate Credit Rating	B+/Stable/--

AFFIRMED RATINGS	
FS Funding A/S	
Sub debt	
Foreign currency	B-
ISS Global A/S	
Sr unsecd debt	
Foreign currency	B-

Business risk profile:
Strong
Financial risk profile:
Highly leveraged
Debt maturities:
Pro forma capitalization at Dec. 31, 2005 (adjusted for the refinancing and debt raised for funding the acquisition of Tempo Services Ltd. in February 2006):
--Dkr1.04 billion in short-term borrowings, of which Dkr872 million consists of borrowings under revolving credit facilities by operating subsidiaries for funding working capital requirements and finance leases.
--Dkr1.25 billion in borrowings made by FS Funding under Term Facility B, which matures in August 2006, and is expected to be repaid through proceeds from dividends from ISS A/S and ISS Global A/S, in turn financed by a new drawdown under Term Facility B by ISS Global.
-- Mandatory repayments under the senior facilities are only Dkr200 million annually between 2006-2008. In 2009, repayments under the facilities are Dkr343 million.
-- In 2010, the €850 million (Dkr6.3 billion) EMTN bond matures, and there are also about Dkr750 million in repayments under the senior facilities.
-- In 2011, there are about Dkr970 million in repayments under the senior facilities.
-- Almost Dkr9.4 billion of debt matures during 2012 and 2014.
-- The proposed €975 million (Dkr7.3 billion) subordinated notes would mature in 2016, replacing the current Dkr6.7 billion subordinated bridge facility.
-- The Dkr925 million PIK bridge facility expires on Nov. 11, 2006, but will be extended by 11 years (to 2017) if not refinanced.
Collateralization:
Drawings by ISS Global A/S under senior secured credit facilities of Dkr6.9 billion, Dkr2.5 billion revolving of credit facilities, a Dkr500 million letter of credit facility, and the Dkr4.9 billion acquisition facilities are secured against assets in operating subsidiaries.
Total rated debt:
€2.33 billion (Dkr17.30 billion), including the proposed €975 million notes.

Corporate credit rating history:	
May 17, 2005	B+/B
May 12, 2005	BB+/B
Apr. 9, 2002	BBB+/A-2

Major Rating Factors

Strengths:

- Market leader in most of its operations, and a well-known brand;
- Good geographical diversity throughout Europe;
- Resilient nature of basic services business; and
- Strong cash generator, with low asset intensity and capital expenditure needs.

Weaknesses:

- Highly leveraged financial profile;
- Competitive industry with fairly weak margins;
- Few barriers to entry preventing local competition, although the group's size allows for economies of scale; and
- Little price flexibility (but high cost flexibility).

Rationale

The ratings on the ISS group entities FS Funding A/S, ISS A/S, and ISS Global A/S reflect the group's highly leveraged financial profile and weak credit measures. This is mitigated by the group's strong business profile, underpinned by its solid business position in an attractive--albeit fragmented and competitive--industry.

Pro forma for the recently announced debt refinancing through the proposed issuance of €975 million of senior subordinated notes and including the debt raised in connection with the acquisition of Tempo Services Ltd. at the beginning of 2006, the group's adjusted debt would have been about Danish krone (Dkr) 26.1 billion (€3.5 billion; including a pay-in-kind {PIK} loan and unfunded postretirement liabilities) at Dec. 31, 2005.

With sales of Dkr46.4 billion in 2005, ISS benefits from a strong business position, particularly in Northern Europe, where it is a market leader in most of its operations. The group benefits from good geographical diversity across Europe and a highly diversified customer base. Standard & Poor's considers ISS' business sector to be attractive, as it is resilient to recession and is likely to benefit from increasing outsourcing. Although there are few barriers to entry and pricing is competitive in this sector, the group has a good record of contract retention, and is large enough to benefit from economies of scale.

Acquisitions have been and are likely to continue to be part of ISS' strategy to add competencies and build critical mass and geographical presence. Although the acquisition strategy adds some risk to the business, ISS' track record is good, with management successfully integrating acquired companies. As a result of the competitive nature of the facilities services business, ISS' operating profit margins are relatively low, with EBITDA margins of about 7% (not adjusted for operating leases).

The group's financial profile is highly leveraged following the buy-out in May 2005 by a private equity consortium consisting of EQT III and EQT IV (EQT) and Goldman Sachs Capital Partners. This resulted in weak credit measures, with adjusted debt to EBITDA expected to be about 7.0x-7.5x (not lease-adjusted) in the near term, and EBITDA cash interest of about 2x. Standard & Poor's does not incorporate material improvements in these ratios in the medium term, reflecting the company's acquisitive growth strategy. Acquisition spending is discretionary and flexible, however, and the acquisitions are normally immediately cash flow-enhancing. Furthermore, ISS benefits from good free operating cash flows, reflecting low capital expenditures needs. The group's highly flexible cost base (primarily related to staff) provides additional cushioning in a downturn.

Liquidity

Liquidity resources are adequate, reflecting the expectation that annual debt maturities will be modest until 2010. The major liquidity resource is a Dkr1.75 billion committed revolving credit facility, of which Dkr872 million was drawn at Dec. 31, 2005. There is also a Dkr750 million uncommitted revolving credit facility. In addition, there is a letter of credit/guarantee facility of Dkr500 million, and separate acquisition facilities totaling Dkr4.9 billion (of which Dkr1.4 billion has been drawn). These facilities mature in 2012 and 2013, respectively, and include financial covenants. Headroom under the covenants is, however, expected to be sufficient. The group is also expected to continue to post positive free operating cash flows (before acquisitions).

Recovery analysis

The proposed €975 million (Dkr7.3 billion) notes have been rated two notches below the corporate credit rating as the notes are contractually and structurally subordinated to substantial priority liabilities within the group, including non-interest-bearing liabilities at operating subsidiary level. For similar reasons, the two existing EMTN bonds totaling €1.35 billion (Dkr10.1 billion), maturing in 2010 and 2014 and issued by ISS

Global under the group's EMTN program, continue to be rated two notches below the corporate credit rating, although the €975 million bonds will be structurally subordinated to the EMTN bonds.

Unrated committed senior secured facilities consist of:

- Dkr6.9 billion term facilities with final maturity in 2012 and 2013.
- A seven-year Dkr1.75 billion revolving credit facility.
- A seven–year Dkr500 million letter of credit facility.
- Dkr4.9 billion acquisition facilities maturing in 2012 and 2013.
- The capital structure also includes a Dkr750 million uncommitted revolving credit facility, maturing in 2012.

The senior facilities are secured by a share pledge in the shares of ISS A/S held by FS Funding. It is also a condition of the senior facilities agreement that material subsidiaries guarantee the senior facilities and provide security pledges over their bank accounts, trade and intercompany receivables, and intellectual property and share pledges as far as legally possible. As is usual, there will be limitations on the amounts certain subsidiaries can guarantee in accordance with local laws. Neither ISS A/S nor any of its subsidiaries has guaranteed or granted any security relating to the borrowings of FS Funding under the senior facilities. Also, ISS A/S will not pledge its shares in ISS Global A/S.

Drawings under the facilities are about Dkr9.2 billion. Drawings under the facilities have been made by ISS Global and FS Funding. The bank debt in FS Funding (about Dkr1.25 million) is expected to be repaid in 2006 with proceeds from dividends from ISS A/S and ISS Global, which will be financed by further drawings under the senior facilities by ISS Global. Other debt in the structure includes a Dkr925 million subordinated PIK loan (Dkr999 million at Dec. 31, 2005, including accrued interest), issued by FS Equity A/S, which is the parent holding company to FS Funding. The proceeds from the loan have been on-lent to FS Funding, and the loan will be subordinated to the proposed €975 million notes.

Outlook

The stable outlook reflects our expectation that ISS' operating performance should remain steady, and is underpinned by the group's ability to generate strong cash flow. We do not incorporate material improvements in ISS' credit measures, reflecting the expected continued acquisition strategy, which also limits the upside potential in the ratings. Nor, however, do we expect any material deterioration in the credit measures. If this were to occur, however, it could result in a negative rating action.

Business Description

ISS is a large and long-established facilities services group, with operations in 46 countries in Northern and Continental Europe, Asia, South America, and Australia. In 2005, the group had sales of Dkr46 billion. The group provides general facilities services for private and public entities, such as:

- Cleaning services, (including washroom services), accounting for 61% of 2005 sales;
- Property services (including landscaping, pest control, damage control services, and maintenance and technical services), accounting for 23% of 2005 sales;
- Catering services, accounting for 6% of 2005 sales;
- Office support services (call centers, reception services, office logistics and access control), accounting for 4% of 2005 sales, and
- Integrated facility services (multiple facility services with on-site management and single-point contact for the customer), accounting for 6% of 2005 sales.

In May 2005, ISS was acquired by a private equity consortium consisting of funds advised by EQT Partners (EQT), which together has 55% ownership in ISS, and Goldman Sachs Capital Partners, which owns the remaining 45%. ISS was subsequently de-listed from the Copenhagen Stock Exchange.

Table 1 ISS Group Bond Structure

Issuing entity	**ISS Global A/S**	**ISS Global A/S**	**FS Funding A/S**
Amount	€850 million	€500 million	€975 million
Maturity	Sept. 18, 2010	Dec. 8, 2014	2016
Coupon	4.75% fixed rate	4.50% fixed rate	To be announced
Debt rating*	B-	B-	B-
Form	Senior notes under €2 bil. EMTN	Senior notes under €2 bil. EMTN	Senior subordinated

Ranking	**Notes issued under the EMTN program rank pari passu among themselves and equally with all other unsecured obligations of the issuer.**		The notes are subordinated in right of payment to all other senior debt, and structurally subordinated to debt in subsidiaries, including senior facilities and EMTN program.
Security and guarantees	**No**		Not guaranteed by any of the issuer's subsidiaries. Secured by second-priority security interest in all outstanding share capital of ISS, and a second-priority security interest in a €50 million principal amount of loans from the issuer to subsidiaries in the U.K., France, Norway and Spain.
Call option	Not applicable	Not applicable	35% 2009, 100% 2011, or prior to 2011 upon the payment of a make-whole premium.
Change of control	No	No	Yes. Put at 101%
Cross default	**Yes, at €30 million**		In the event of a default on any other debt with an outstanding principal amount in excess of €30 million.
Standstill	--	--	179 days
Certain covenants	--	--	Covenants are not applicable if the notes reach investment-grade rating.
Limitation on indebtedness	--	--	A limitation on indebtedness exists, but does not prohibit substantial further borrowings under existing credit facilities.
Restricted payments	--	--	Restrictions on dividends, purchases (and issuing) of own shares and on acquisitions of subordinated debt; exceptions include situations where the restricted payment does not lead to an event of default, and if the payment does not exceed 50% of net income.
Asset sales	**If ISS Global or any of its principal subsidiaries ceases or threatens to cease to carry on the whole or substantial part of its business, subject to certain limited exceptions, this creates an event of default.**		Asset sales over €15 million must be sold at fair market value. Proceeds may be used within one year to repay senior debt or invest in additional assets. Also, there is a limitation on the sale of all or substantially all of the issuer's properties and assets unless the new owner assumes obligations under the notes.
Transactions with affiliates	--	--	Transactions with a market value of more than €20 million require the approval of the majority of the disinterested members of the board. For transactions with market value of more than €30 million, a fairness opinion from an independent financial advisor with experience of the market is required.
Negative pledge	**Yes, but excludes non-tradable and short-term debt.**		The issuer is not allowed to take any action that could impair the security interest. Incurrence of "permitted collateral liens" are, however, not deemed as such actions and include those arising in "the normal course of business".
*At April 21, 2006.			

Business Profile

Industry characteristics

The European facility services sector is a fragmented but mature industry, characterized by high-volume, low-value contracts. In most sectors of the market, there are few barriers to entry, but high margins are achievable, depending on the industry subsector. Consolidation is continuing at a fairly fast pace.

The trend in recent years has been toward outsourcing many of these mostly essential services. As a result, most segments of the industry are growing, and the sector is resilient to recession.

Keys to success in the industry include:

- Size, critical mass, and diversity in terms of geographical reach, service portfolio, and customer base;
- A presence in attractive service segments, with, for example, more stable demand and lower price competition than the industry average;
- The ability to provide a consistent high-quality service at a competitive price;
- Well-motivated staff with a professional attitude, and the ability to minimize turnover while controlling staff costs; and
- Good internal control systems, and the ability to integrate acquisitions.

Competitive position

ISS is a strong player in the European facilities services business, with particular strength in the Nordic region (which accounts for about 30% of its sales). Cleaning services account for almost two-thirds of turnover, and in most of the countries where it operates, ISS is one of the three largest players. As part of its long-term strategy ISS has in recent years increased its focus on broadening its service, developing and offering integrated facility service solutions (which can include a range of cleaning, property, canteen, and office support services). Although this is expected to lead to a gradual rebalancing of the current business mix, cleaning is often a starting point for developing integrated facility service contracts, and it is likely to remain a major activity for the group also in the future. One of ISS' major competitive advantages is its size, which also supports staff flexibility (for example, the same staff can provide different services within the same location). ISS is sizable and well known enough to be invited to tender for most large contracts in its areas of operation. Size and quality are the key barriers to entry in this fairly basic and competitive industry, as customers want good, reliable service at a competitive price.

ISS has a well-diversified and largely loyal customer base, which lends stability to the business. No single customer contributes as much as 1% of the group's revenues, and the 10 largest customers account for less than 5% of total turnover. Although the industry tends to renew contracts frequently, ISS' level of contract retention has remained stable for some years, at about 85%-90%. The wide customer base and geographical spread give ISS a measure of diversity, despite the largely undiversified business stream. ISS is also expected to increase its presence in emerging markets, such as Brazil, Russia, India, and China.

Acquisitions have been and are likely to remain an essential part of its growth strategy. The risks associated with the acquisition strategy are mitigated by management's good track record in integrating the acquisitions and the fact that acquisitions are normally small in size (less than Dkr100 million in sales). On the positive side, the acquisitions have contributed to building up ISS' strong market positions, and widen the service portfolio and geographical reach.

Operating efficiency/profitability

ISS has reasonable operating profit margins for the sector, at about 7% (before depreciation and amortization, not lease adjusted, and about 9% lease-adjusted). Due to the large number of acquisitions, it is difficult to assess margin development clearly: most acquisitions tend to be of companies with initially lower margins than those of ISS' existing business. Standard & Poor's expects margins to stay broadly flat in the coming years because continued cost efficiencies at ISS might be matched by continued price pressure. We would not expect significant margin deterioration in a downturn, as demonstrated in 2003, and ISS benefits from a highly flexible cost base, which could be quickly adjusted if necessary. Staff costs make up about 70% of total costs, and there are comparatively few fixed costs. Members of staff are mostly attached to specific contracts, meaning that ISS can slim down quickly if contracts are lost. Contracts also often include pass-through clauses for wage increases.

ISS has about 310,000 employees. Staff turnover is high, at about 50%, although this is a common industry characteristic. High staff turnover imposes replacement costs, and can affect the quality of service. At the same time, the high employee turnover makes it easier for ISS to adapt staff levels to any temporary weaknesses in market conditions.

Peer comparison

Reflecting the fragmented nature of the industry, competitors tend to differ from country to country. Major rated competitors include Sodexho Alliance S.A. (BBB+/Stable/A-2), Compass Group PLC (BBB+/Stable/--), and Rentokil Initial PLC (BBB/Stable/--). All these companies are leading market players like ISS and benefit from a diversified customer base and geographical spread. As table 1 shows, while Sodexho's and Compass' margins are similar to ISS', Rentokil Initial has the highest margins in the peer group, largely reflecting its business mix (with a large share of high-margin businesses such as washroom services and pest control). The three peers all have stronger financial profiles than ISS, as a result of ISS' increased leverage in 2005 following the acquisition by the private equity consortium.

Financial Risk Profile

Accounting

Since Jan. 1, 2005, ISS has reported according to IFRS, having previously reported according to the Danish Financial Statements Act, including Danish Accounting Standards. The main change from the transfer to IFRS was related to the non-amortization of goodwill, which would have had a Dkr0.9 billion positive effect on ISS A/S' operating profit after deprecation and amortization in 2004, although it is a non-cash item. Reported unfunded postretirement liabilities also increase under IFRS to about Dkr0.7 billion in 2004 from Dkr0.3 billion under Danish Accounting Standards. At Dec. 31, 2005, the unfunded liability in FS Funding A/S was Dkr0.8 billion before tax adjustments (about Dkr0.7 billion after tax). Although Standard & Poor's views these liabilities as debt-like, they are not material in relation to ISS' overall total debt of almost Dkr28 billion.

ISS has material commitments under operating lease agreements, primarily relating to properties and vehicles. Adjusting for these off-balance-sheet commitments, debt increases by about Dkr2.8 billion on a net present value basis, using a 5% discount rate. The debt to EBITDA ratio increases by about 0.5x. The negative impact in credit terms from these obligations are, however, mitigated by the fact that the lease contracts are mostly short-term, at three years or less, which means that ISS can relatively quickly adjust its needs to changes in the operating environment. In addition, leasing contracts for vehicles are flexible, and allow for the return of vehicles before the contract expires (although all vehicles in a particular country would need to be returned).

Corporate governance/ Risk tolerance/Financial Policy

Following the buy-out by EQT and Goldman Sachs Capital Partners in May 2005, ISS is highly leveraged, with an adjusted debt-to-EBITDA rate of about 7.5x (including a PIK loan and postretirement liabilities, but not lease-adjusted) pro forma for the refinancing and recent acquisition of Tempo Services Ltd. As bolt-on acquisitions are likely to remain a tool for growth, and will probably be financed with internal cash flow and additional debt, Standard & Poor's does not expect material improvements in credit measures over the medium term. Furthermore, as the bolt-on acquisitions normally enhance cash flow immediately, we do not expect any material deterioration in credit measures. In addition, any potential major acquisition is expected to be financed in such a way that credit measures do not weaken. Dividend pay-out is highly restricted, and the company is expected to dedicate free cash flows to growth investments.

Cash flow adequacy

Although operating margins are relatively low, ISS' free operating cash flow generation is strong, reflecting the low capital intensity of the business. Gross capital expenditure in relation to sales has been less than 2% over the past few years, and operating cash flows have historically covered gross capital expenditure by 3x-4x. The significantly increased debt levels following the buy-out have, however, resulted in weak cash flow protection measures. In the near to medium term, EBITDA net cash interest coverage is expected to be about 2x, and FFO to net debt in the range of 5%-7% (not lease-adjusted). ISS is, however, even at this high leverage, expected to continue to post positive free operating cash flows. Although free cash flows are expected to be consumed for acquisitions rather than debt reduction, acquisition spending is discretionary and flexible, and can be cut back if needed. Also, when evaluating credit measures on a yearly basis, we take into account the fact that operating cash flows are slightly understated, as they do not show full-year cash flows from acquisitions made during the year.

Capital structure/Asset protection

The high debt levels result in a weak capital structure for the ratings, with adjusted debt to capital of about 79% pro forma the refinancing and acquisition of Tempo Services. Although the positive credit features of the €925 million PIK loan are its subordination to other existing debt, and the fact that no interest is paid until the loan is repaid, Standard & Poor's views the loan as debt (see also Standard & Poor's article "PIK Pressure: How Pay-In-Kind Bonds Have Affected European Corporate Credit Ratings", published on Sept. 20, 2005, on RatingsDirect, Standard & Poor's Web-based credit analysis system).

ISS' EMTN bonds, totaling Dkr10.1 billion, carry low interest rates, as they were issued before the buy-out (when the capital structure was much stronger), and do not include any change of control clauses. This means that the average cost of debt for ISS is relatively low for the current ratings. Debt maturities are also long-dated, with small mandatory annual repayments before 2010, when the €850 million (Dkr6.3 billion) EMTN bond matures.

The balance sheet is heavily oriented toward the short term, with fixed assets comprising about 14% of ISS' Dkr13.8 billion total tangible assets. ISS also has about Dkr32.5 billion of intangible goodwill, brands, and customer contracts resulting from acquisitions in its Dkr46 billion of total assets.

Table 2 Peer Comparison Of FS Funding A/S * (A Holding Company in the ISS Group)

	FS Funding A/S	**Rentokil Initial PLC**	**Sodexho Alliance SA**	**Compass Group PLC**
	Year ended Dec. 31, 2005	Year ended Dec. 31, 2005	Year ended Aug. 31, 2005	Year ended Sept. 30, 2004
Corporate credit rating at April 20, 2006	B+/Stable/--	BBB/Stable/--	BBB+/Stable/A-2	BBB+/Stable/--
Business profile	Strong	Satisfactory	Strong	Strong
Financial profile	Highly leveraged	Intermediate	Intermediate	Intermediate
Sales (€ mil.)	6,225¶	3,368	11,672	17,352
EBITDA/sales (%)	7.0¶	20.9	6.1	7.8
EBITDA net interest coverage (x)	About 2§	7.5	6.3	5.7
Net debt/EBITDA (x)	About 7.3§	2.2	1.4	3.3

*Credit ratios adjusted for operating leases, but not for postretirement liabilities. EBITDA margins not adjusted. ¶ISS A/S 2005 figures. §Pro forma figures for 2005. Not lease-adjusted. Net debt including PIK loan. Net cash interest (excluding accrued interest on PIK loan).

Table 3 ISS A/S Financial Statistics*

	Year ended Dec. 31				
(Dkr mil.)	**2005¶**	**2004**	**2003**	**2002**	**2001**

Revenues§	46,440	40,355	36,165	37,984	34,852
Operating income	4,230	3,614	3,424	3,360	2,742
Net income§	935	817	286	246	222
Funds from operations (FFO)	2,661	2,594	2,731	2,490	1,961
Capital expenditures§	683	708	585	667	452
Net debt	18,838	10,138	7,073	7,703	8,325
Shareholders' equity	2,285	8,822	7,741	7,419	6,699
Total assets	34,651	33,480	25,674	24,511	24,427
Operating income/sales (%)	9.1	9	9.5	8.8	7.9
EBITDA net fixed-charge coverage (x)	4.9	6.3	7.5	5.9	5.8
FFO/net debt (%)	14.1	25.6	38.6	32.3	23.6
Free operating cash flow¶/net debt (%)	4.7	13.0	25.0	20.6	12.7
Return on average net adjusted permanent capital (%)	11.6	10.8	8.1	7.7	7.1
Net debt/capital (%)	89.2	53.5	47.7	50.9	55.4
*2004-2005 figures based on IFRS. 2001-2003 figures based on Danish accounting standards, with operating lease-adjusted values. ¶ISS A/S credit measures for 2005 do not include the impact of about Dkr 6.8 billion of additional net debt at FS Funding. §Not adjusted for operating leases. Dkr--Danish krone.					

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