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Research Update:

Facilities Services Firm ISS 'BB-' Rating Affirmed, Off Watch Pos On Termination Of Acquisition By G4S; Outlook Stable

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Overview

- U.K.-based security services company G4S PLC has abandoned plans to acquire Denmark-based facilities services group ISS A/S.
- The acquisition would have involved G4S repaying about £1.1 billion of ISS' debt with proceeds of a share rights issuance, and the majority of the remaining debt by way of an acquisition facility.
- We are therefore affirming our long-term corporate credit rating on ISS at 'BB-' and removing it from CreditWatch positive.
- 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.

Rating Action

On Nov. 2, 2011, Standard & Poor's Ratings Services affirmed its 'BB-' long-term corporate credit ratings on Denmark-based facilities services provider ISS A/S (ISS) and related entities ISS World Services A/S and ISS Financing PLC, and removed them from CreditWatch, where they were placed with positive implications on Oct. 19, 2011. The outlook is stable.

At the same time, we removed from CreditWatch positive our 'B' issue ratings on ISS' €581.5 million subordinated facility (including the add-on notes) due 2016; on ISS Global A/S' €110.4 million issuance under the €2 billion unsecured euro medium-term note (EMTN) program due 2014; and on ISS Financing's €525 million secured notes due 2014.

Rationale

The affirmation and removal from CreditWatch reflect the termination of G4S' proposed acquisition of ISS for £5.2 billion. Under the acquisition, G4S would have repaid about £1.1 billion of ISS' debt with proceeds of a share rights issuance, and the majority of the remaining debt by way of an acquisition facility. This would have reduced debt levels at ISS.

We anticipate that ISS' organic revenue growth will slow somewhat, to about 5.7% in the second half of 2011, as a result of weaker global economic conditions and continued uncertainty in its Mediterranean markets. We forecast that the group's full-year 2011 adjusted EBITDA margin will be about 6.8%, down slightly from just more than 7% in 2010. We believe that ISS' credit metrics will improve somewhat throughout 2011, to 6.6x at year-end (down from

7.5x in 2010), after which we anticipate a further improvement supported by strengthening operating cash flows and slow but steady deleveraging. Furthermore, we anticipate that funds from operations (FFO) to Standard & Poor's-adjusted debt will reach 9% by December 2011.

The ratings continue to reflect our view of the group's highly leveraged financial risk profile and weak credit metrics. They also take into account the potential for shareholder-friendly policies as a result of ISS' private equity ownership. Wage inflation is another risk that could weigh negatively on ISS' cost base, should the group find it difficult to pass the related cost increase onto customers.

These weaknesses are partially mitigated by ISS' strong business risk profile, underpinned by a solid business position in an attractive--albeit fragmented and competitive--industry and its sound service delivery platform that enables organic growth. With 2010 year-end sales of Danish krone (DKK) 74.1 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 of about 90%, and is large enough to benefit from economies of scale. Additional business strengths are ISS' good geographic diversity and highly diversified customer base.

Liquidity

We assess ISS' liquidity as adequate under our criteria. The unused amount under the revolving credit facility (DKK900 million) and excess cash and equivalents (which we estimate at DKK1.5 billion at year-end December 2011) sufficiently cover short-term maturities and peaks in working capital. We anticipate that the group will continue to generate strong FFO of nearly DKK2 billion in the full year ending Dec. 31, 2011.

We forecast total liquidity sources of DKK4.4 billion in December 2011, rising to nearly DKK5 billion in December 2012. In terms of liquidity uses, we project that debt amortizations and a decrease in net working capital will consume about DKK900 million in 2011 and DKK1 billion in 2012. We forecast capital expenditures of DKK1.0 billion in 2011 and DKK1.1 billion in 2012, contributing to total uses of DKK1.9 billion in 2011 and DKK2.1 billion in 2012. Therefore we foresee excess liquidity of nearly DKK2.5 billion in 2011 (sources exceeding uses by 2.3x), and DKK2.9 billion in 2012 (2.4x).

Following minor debt amortizations in 2011, 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. This revised repayment schedule is the result of a successful "amend and extend" exercise completed in June 2011, which also reset covenant levels to incorporate adequate headroom. We forecast that covenant headroom will continue to be adequate in the medium term.

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 EMTN 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 our full report on ISS A/S, published Oct. 14, 2011, 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 an environment of slower growth may occur worldwide in 2012, we anticipate that credit metrics will remain broadly stable. Based on current information, we anticipate that credit metrics will improve gradually in the medium term, supported by continued organic growth in the mid-single digits, as well as by a reduction in debt-funded acquisitions. This should allow adjusted debt to EBITDA to decline toward 5x-6x, and EBITDA interest coverage to increase to more than 2x over 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 lead to a reduction in credit metrics over a longer period than we would 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.

Related Criteria And Research

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

- U.K.-Based Security Services Company G4S 'BBB/A-2' Rtgs Affirmed Following Announcement To Acquire ISS; Outlook Stable, Oct. 19, 2011
- ISS A/S, Oct. 14, 2011
- 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

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
ISS A/S		
ISS Global A/S		
Corporate Credit Rating	BB-/Stable/--	BB-/Watch Pos/--
ISS World Services A/S		
Corporate Credit Rating	BB-/Stable/B	BB-/Watch Pos/B
ISS A/S		
Subordinated Debt	B	B/Watch Pos
Recovery Rating	6	6
ISS Financing PLC		
Senior Unsecured Debt*	B	B/Watch Pos
Recovery Rating	6	6
ISS Global A/S		
Senior Unsecured Debt	B	B/Watch Pos
Recovery Rating	6	6

*Guaranteed by ISS A/S and ISS World Services A/S.

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.