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Research Update:

Ratings On Denmark-Based ISS Affirmed At 'BBB-' After Sale Of Shares To Institutional Investors; Outlook Stable

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Overview

- Private-equity firms, EQT Funds and Goldman Sachs Capital Partners (together the "Financial Sponsors"), along with Ontario Teachers' Pension Plan, have sold 31 million existing shares in Denmark-based facilities services provider ISS to institutional investors.
- As a result, the Financial Sponsors now own less than 40% shares in ISS.
- Therefore, we are changing our assessment of ISS' financial policy to "neutral" from "FS-4" and affirming our long-term 'BBB-' corporate credit ratings on ISS.
- The stable outlook reflects our view that ISS' operating performance will remain steady in the near term, and that the company will continue to deleverage.

Rating Action

On Oct. 1, 2014, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term corporate credit ratings on Denmark-based facilities services provider, ISS A/S (ISS), and subsidiaries ISS World Services A/S and ISS Global A/S. At the same time, we affirmed our short-term corporate credit rating on ISS World Services at 'A-3'.

We also affirmed our issue rating of 'BBB-' on ISS' €2.85 billion senior unsecured credit facilities.

We affirmed our issue ratings of 'BBB-' on ISS Global's €110 million 4.5% senior unsecured medium-term notes due 2014 and €2 billion senior unsecured medium-term-note program.

Rationale

EQT Funds and Goldman Sachs Capital Partners (together the "Financial Sponsors"), and the Ontario Teachers' Pension Plan, have sold 31 million additional shares to institutional investors. The Financial Sponsors now own 33% of shares in ISS. According to our criteria, ISS is no longer a financial sponsor-controlled company, so we are revising our financial policy assessment to "neutral" from "FS-4". Our assessment of ISS' financial risk profile as "significant" is unaffected by this revision.

Our "neutral" financial policy assessment reflects our view that credit ratios will not deviate materially from our projections over the 2014-2016 forecast horizon, beyond what we have projected. We base our assessment on management's financial policy, recent track record, and operating forecasts. A "neutral" financial policy assessment effectively reflects a low probability of event risk.

We assess ISS' business risk profile as "strong" and its financial risk profile as "significant", which leads to our anchor of 'bbb'. To arrive at the issuer credit rating, however, we adjust the anchor downward by one notch in our "comparable rating analysis," whereby we review an issuer's credit characteristics in aggregate. This downward notching reflects our opinion that ISS lacks a track record under its new financial structure, and that funds from operations (FFO) to debt will likely remain at the lower end of our 20%-30% range for a "significant" financial risk profile assessment.

Our base case assumes:

- Revenues of nearly Danish krone (DKK) 74 billion in 2014 (organic growth of 2%-3%).
- Higher organic revenue growth in emerging markets coming from higher volumes in existing contracts and new contracts.
- Negative organic growth in Europe due to the tough macroeconomic environment and difficult conditions in certain markets.
- Foreign exchange fluctuations, which will continue to affect reported revenues.
- Stable operating margins and a Standard & Poor's-adjusted EBITDA margin of 7.3%-7.6% in 2014.

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA of 2.9x-3.1x at year-end 2014.
- FFO to debt of 20%-23% at year-end 2014.

Liquidity

We assess ISS' liquidity as "adequate," under our criteria. We forecast that sources of liquidity will exceed uses by more than 1.5x over the next 18 months. We consider ISS to have sound relationships with its banks, as well as prudent risk management.

We anticipate that ISS' sources of liquidity for the 12 months to Dec. 31, 2014, will total DKK31.0 billion, including:

- A cash balance of about DKK3.3 billion as of January 2014;
- Approximately DKK1.7 billion available under its current revolving credit facility;
- FFO of about DKK1.6 billion in 2014;
- Asset sales of about DKK1.6 billion;
- Proceeds from new shares issuance of about DKK8 billion; and
- New debt issuance of about DKK15 billion.

We anticipate that uses of liquidity for the 12 months to Dec. 31, 2014, will include:

- Capex of DKK1 billion;
- Estimated acquisition spending of DKK100 million; and
- Retirement of approximately DKK25 billion debt.

Sources and uses of liquidity include new share issuances from the IPO, new debt issuance, the retirement of pre-IPO debt, as well as proceeds from asset sales, all of which are one-off items. Without these, the expected sources of liquidity for 2014 would be about DKK7 billion and uses would be about DKK1 billion.

Outlook

The stable outlook reflects our view that ISS' operating performance will remain steady in the near term, and that it will continue to deleverage and increase FFO following a reduction in interest payments. We consider adjusted FFO to debt of above 20% to be commensurate with our 'BBB-' rating.

Upside scenario

If ISS were to reduce its debt, and/or establish a stable track record under the current financial structure, we would consider removing our negative comparable rating adjustment, which would in turn lead us to upgrade ISS. FFO to debt of more than 30% on a sustained basis would also be consistent with a higher rating.

Downside scenario

We currently view a downgrade as unlikely. However, we could lower our rating if ISS were to refocus its strategy toward debt-financed acquisitions; if it made sizable dividend payments; or if operating profit margins tightened such that credit metrics weakened. An adjusted FFO-to-debt ratio below 20% could also lead us to lowering our rating.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--

Business risk: Strong

- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: 'bbb'

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: 'bbb'

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

ISS A/S

ISS Global A/S

Corporate Credit Rating

BBB-/Stable/--

ISS World Services A/S

Corporate Credit Rating

BBB-/Stable/A-3

ISS A/S

Senior Unsecured

BBB-

ISS Global A/S

Senior Unsecured

BBB-

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