

CREDIT FOCUS

Rate this Research



ISS A/S: Increasingly Conservative Financial Policies Strengthen Credit Profile

RATINGS

ISS A/S

Outlook	Positive
Corporate Family Rating	B1
Senior Secured	Ba3/ LGD3
Senior Subordinate	B3/LGD6

KEY INDICATORS

	9/30/2013	12/31/2012	12/31/2011
	(L)		
Pretax Income (USD Million)	\$128.6	\$139.4	\$108.0
Revenue (USD Million)	\$13,949.5	\$13,723.6	\$14,507.0
RCF / Net Debt	7.2%	6.7%	6.3%
FCF / Debt	2.7%	1.7%	0.8%
(EBITDA-CapEx) / Interest Exp	1.4x	1.4x	1.3x
Debt / EBITDA	6.3x	6.1x	6.7x

Source: Moody's Financial Metrics

Analyst Contacts:

PARIS +33.1.5330.1020

Knut Slatten +33.1.5330.1077
 Assistant Vice President - Analyst
 knut.slatten@moodys.com

Eric de Bodard +33.1.5330.1040
 Managing Director - Corporate Finance
 eric.debodard@moodys.com

LONDON +44.20.7772.5454

Elena Marcén Argilés +44.20.7772.5585
 Associate Analyst
 elena.marcenargiles@moodys.com

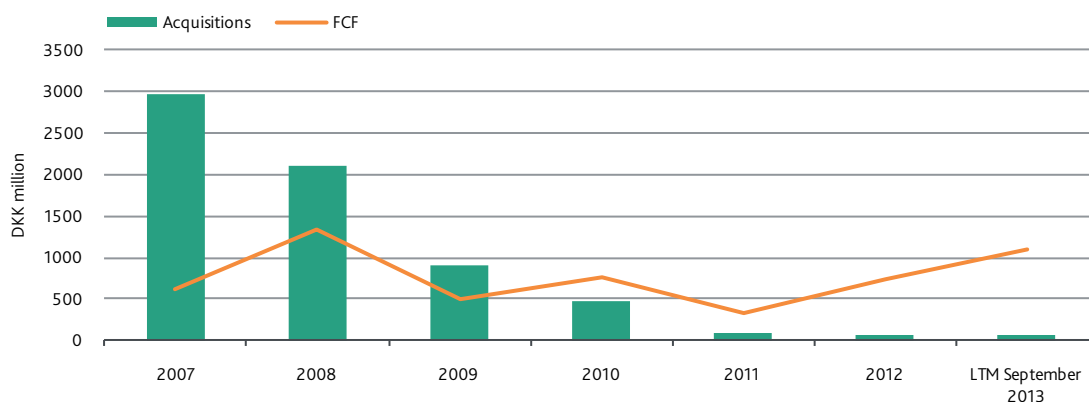
- » **Scaling back of debt-funded acquisitions supports deleveraging.** Over the past two to three years, [ISS A/S](#) (B1 positive), one of the world's leading facilities services companies, has moved away from its previously aggressive acquisition strategy, under which the company's annual acquisition spend exceeded its free cash flows (FCF), thereby increasing leverage. While ISS is likely to continue to make smaller, bolt-on acquisitions, we believe these will be funded using FCF and therefore lead to further strengthening of credit metrics.
- » **ISS's current focus is on utilising its existing platform to deliver profitable organic growth.** The organic growth is mainly driven by an increasing portion of Integrated Facility Services (IFS) in the company's business mix, as well as an increasing exposure to emerging markets, where fundamentals are stronger.
- » **Divestment of non-core activities is credit enhancing.** ISS is currently in the process of divesting assets it considers to be non-core to the business. The streamlining of the portfolio is credit enhancing for ISS because it is using the proceeds from divestments to redeem outstanding debt. However, the divestment of higher-margin activities will lead to an erosion of profitability in the short term.
- » **Capital injection supports the company's financial policies.** The introduction of new investors in the ultimate holding company has de-risked ISS's capital structure as the company has used the equity to repay debt. The equity injection is evidence that ISS's financial policies are currently oriented towards lower absolute levels of net debt, prior to an eventual IPO by the company.
- » **Redemption of higher-yielding debt and recent refinancing improves liquidity.** The redemption of ISS's more expensive debt will strengthen its FCF as interest expenses decrease. ISS's recent refinancing has further improved its liquidity profile as debt maturities have been extended and headroom to financial covenants has increased.
- » **Further deleveraging expected, but could be hampered by restructuring costs.** While we expect ISS to continue on a path of deleveraging, high restructuring costs have adversely affected the company in 2013 and slowed down the pace of this deleveraging. Because challenging conditions are ongoing in a number of markets, we believe ISS will find it difficult to achieve EBITDA growth this year.

Scaling back of debt-funded acquisitions supports deleveraging

In the period between 2006 and 2010, ISS spent an aggregated amount of around DKK10 billion (€1.3 billion) on acquisitions. The annual acquisition spend largely surpassed the company's FCF, leading to an ever more aggressive capital structure, with leverage – measured as adjusted debt/EBITDA – peaking at 7.4x in 2009. Since 2009, however, the company has significantly scaled back its acquisition activity, allowing for FCF to support deleveraging (see Exhibit 1). For example, in 2012, ISS spent only DKK60 million (€8 million) on acquisitions.

EXHIBIT 1

Acquisitions Are Currently Well Below FCF, Allowing for Net Debt Reduction



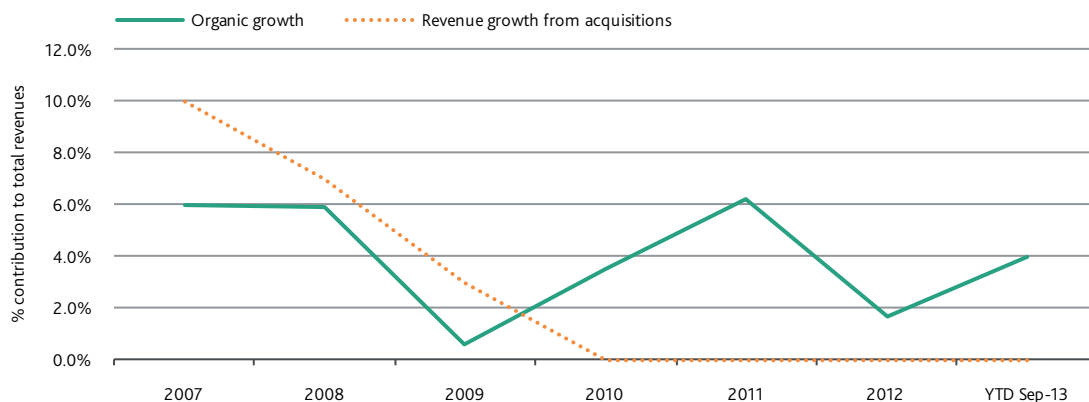
Source: ISS Annual Reports and Moody's Research

While we expect ISS to pursue a similar strategy going forward, we believe the company could yet consider smaller selected bolt-on acquisitions, notably to strengthen its existing service platform in emerging markets. However, we do not anticipate these acquisitions to represent significant amounts and we would expect the company to be able to comfortably finance such transactions – if they were to occur – with FCF. As such, ISS's credit metrics should continue to strengthen.

ISS's current focus is on utilising its existing platform to deliver profitable organic growth

While the acquisition spree undertaken by ISS in previous years contributed to a ramp-up in leverage, it did allow for the company to build a global service platform, which today plays a key role in supporting operating performance. With the contribution from acquisitions to ISS's revenues today being virtually non-existent (see Exhibit 2), the company is currently pursuing a strategy of profitable organic growth. This strategy is supported notably by ISS's strong performance in emerging markets and the further development of the company's Integrated Facility Services. ISS has also shown its willingness to focus on profitable organic growth by exiting – or not bidding for – contracts that do not correspond to the company's internal criteria of profitability.

EXHIBIT 2

The Contribution of Acquisitions to ISS's Revenue Growth Has Decreased Considerably

Source: ISS Annual and Quarterly Reports

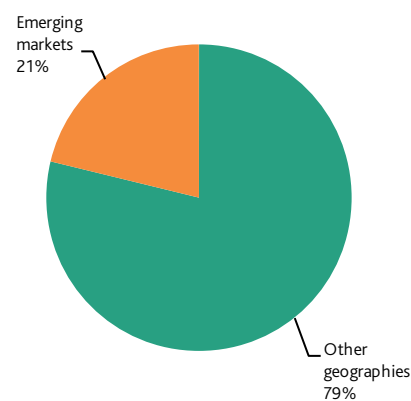
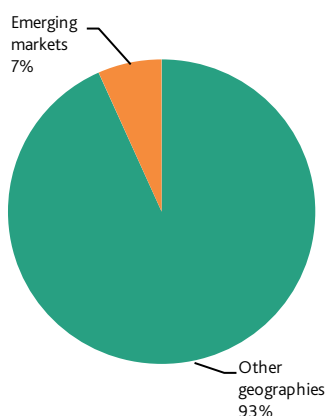
In 2005, ISS generated only around 6% of its revenues from emerging markets (comprising Asia, Eastern Europe, Latin America, Israel, South Africa and Turkey). As of September 2013, the percentage had risen to 23% for the first nine months of the year (see Exhibit 3). On balance, emerging markets benefit from more favourable dynamics because of their higher GDP growth and lower outsourcing penetration rate. We expect these regions to continue to be among the main drivers of future revenue growth for ISS, as exemplified by the double-digit growth ISS recorded in countries such as China, India and Thailand (around 3% of total revenues) in 2012—well above the company's total organic growth (see Exhibit 4).

EXHIBIT 3

ISS's Geographical Split Is Shifting, with an Increased Focus on Emerging Markets*

2005

2012



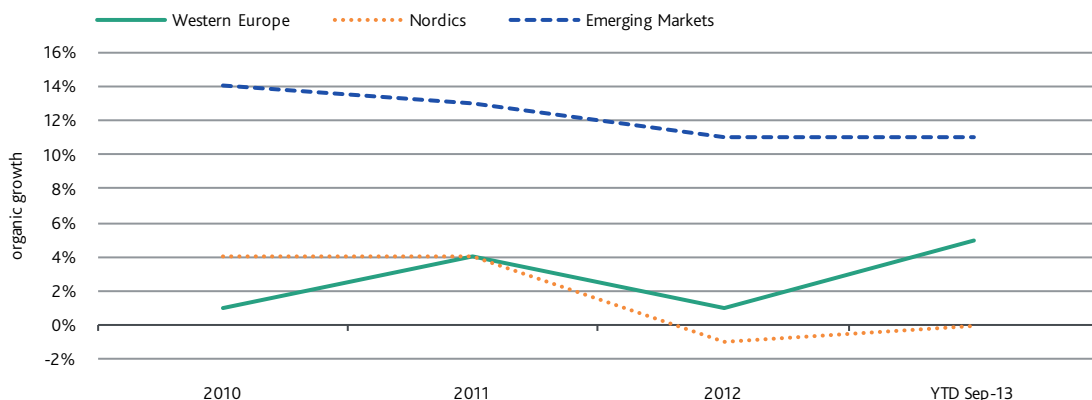
*Emerging Markets include:

2005: Central and Eastern Europe, Asia, Latin America, Pacific

2012: Asia, Eastern Europe, Latin America, Israel, South Africa, Turkey

Source: ISS Annual Reports

EXHIBIT 4

Emerging Markets Are Largely Outpacing Growth in ISS's Core Markets

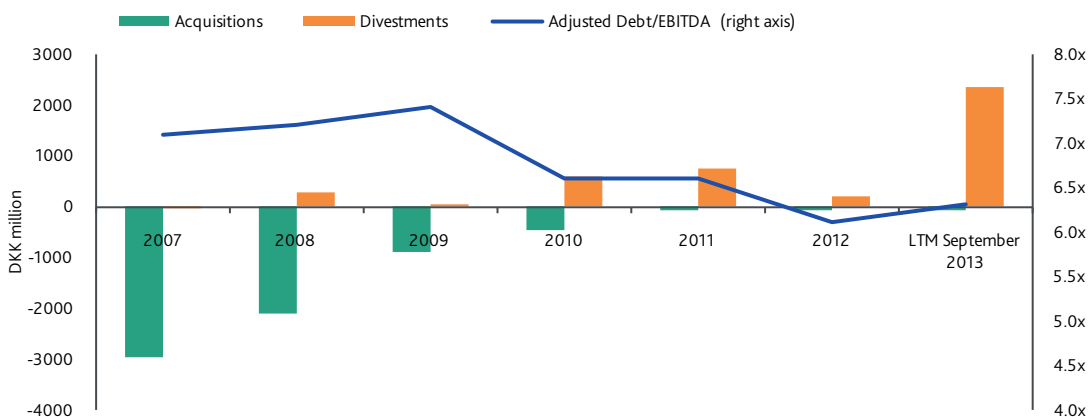
Source: ISS Annual Reports

IFS is another pillar driving organic growth for ISS. The company offers packages of services bundled together on a global or enlarged basis; the service continues to grow in importance, representing 23% of revenues in the 2012 fiscal year (to December). The start-up of several large IFS contracts contributed strongly to ISS's solid growth rates in Western Europe, where, for the first nine months of 2013, it recorded organic growth of 5%. We expect IFS to be a driver of organic growth for the foreseeable future. We also note favourably that the activity enhances barriers to entry to the market as only a few players have the capabilities and geographic reach to take on such large-scale contracts.

Divestment of non-core activities is credit enhancing

During the past 18 months, ISS has increasingly focused on streamlining its portfolio by divesting itself of activities it considers non-core to the business (see Exhibit 5). In May 2013, ISS completed the sale of its pest control business in several countries¹ for an enterprise value of approximately DKK2 billion (c €270 million), an amount which by itself was close to the company's targeted amount of divestments for 2013. The company also sold off its Nordic damage control activities as well as some other minor activities during the first nine months of 2013.

EXHIBIT 5

Acquisitions Have Been Replaced by Divestments

Source: ISS Annual Reports and Moody's Financial Metrics

¹ Australia, Austria, Belgium, Denmark, Germany, Italy, the Netherlands, New Zealand, Norway, Portugal, Spain and Switzerland.

We consider the divestment of non-core activities to be credit enhancing for ISS as it is using the funds generated to redeem debt, particularly the most costly of its debt obligations. For example, the divestment of its pest control activities allowed the company to redeem around €232 million (approximately DKK1.7 billion) of its 8.875% subordinated notes. We expect the company to continue pursuing a similar strategy going forward: as of 30 September 2013, ISS had a total of five business units comprising net assets of around DKK1.2 billion (€160 million) classified as held for sale.

On the other hand, the company's divestments will adversely affect its operating performance in 2013 and the effects will continue to be felt into 2014. For the first nine months of 2013, divestments had an unfavourable impact of 1.8% on the company's revenues. Furthermore, according to ISS, the divestment of the pest control segment, which was one of the group's higher-yielding businesses, had a negative impact of DKK21 million (€3 million) and led to a fall in operating margin of 21 basis points. On an annualised basis, ISS expects its operating margin to decrease by around 20 basis points and the company has indicated that its 2013 margin will be slightly below the previous year's as a result.

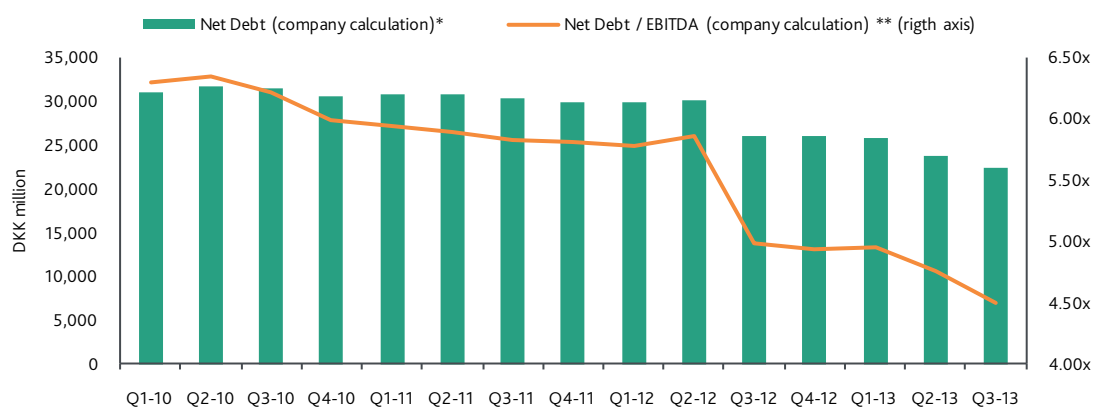
Capital injection supports the company's financial policies

In August 2012, the Ontario Teachers' Pension Plan and KIRKBI Invest A/S announced its investment of €500 million of equity into the ultimate holding company of ISS A/S. The investment corresponded to an ISS A/S share price of DKK105 and gave the two new investors a combined ownership stake of 26%. In December 2012, ISS used the proceeds of the equity injection to prepay €525 million of its 11% senior notes due 2014.

We believe the equity injection, which led to a decrease in net leverage of around 0.7x, confirms ISS's organic growth and deleveraging-orientated strategies and financial policies. The funds received from the new shareholders have contributed to a de-risking of the capital structure (see Exhibit 6) and we consider the equity injection to represent the first step towards an IPO that is likely to take place within the next one to two years.

EXHIBIT 6

Equity Injection Reduced Net Debt and Contributed to Further Deleveraging



*Seasonality adjusted carrying amount of Net Debt

**Seasonality adjusted carrying amount of Net Debt measured to Pro Forma adjusted EBITDA

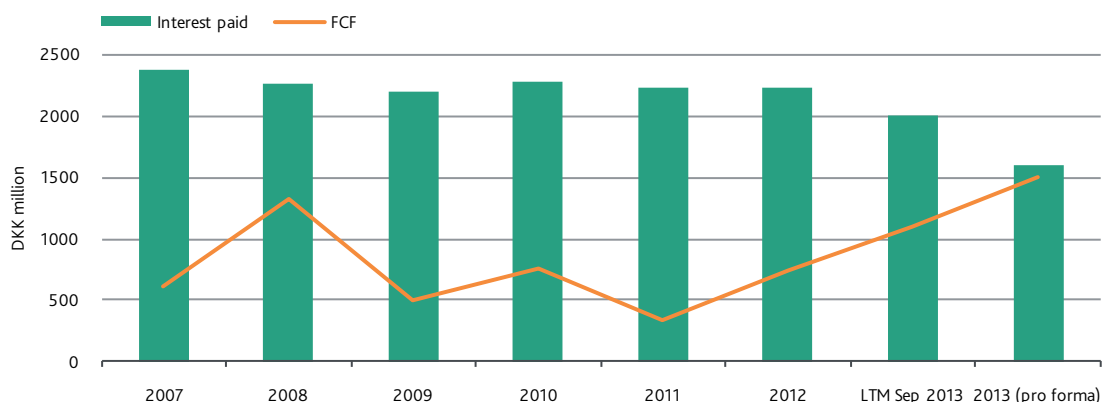
Source: ISS Results Presentations

Redemption of higher-yielding debt and recent refinancing improves liquidity

In tandem with ISS's deleveraging, we expect interest costs to significantly abate, thereby strengthening the company's FCF. During the first nine months of 2013, the company's interest expenses were down by DKK230 million (EUR31 million), reflecting in particular the fact that it has not had to pay interest on the notes it redeemed last year, which carried an interest rate of 11%. In addition, ISS expects to realise annualised benefits equivalent to approximately €20 million following the €232 million redemption the company made on its 8.875% subordinated notes in July 2013. On 18 November 2013, ISS announced its intention to reduce the outstanding subordinated notes by a further €94.5 million. This should lead to a reduction in interests of a further €8 million on an annualised basis. As a consequence, we would expect ISS's interest costs to decrease by around €86 million (approximately DKK640 million) on an annualised basis. This represents a reduction of 27% on the DKK2.373 billion (around €320 million) ISS paid in interest expenses in the 2012 fiscal year (see Exhibit 7).

EXHIBIT 7

Interest Paid Has Decreased, Allowing for Higher Free Cash Flow

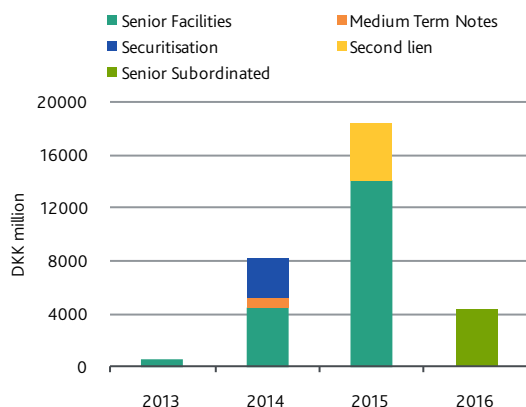


In April 2013, ISS went through an amend and extend operation, which saw the company replacing its €600 million second lien loan with a newly raised senior secured facility of an equal amount. Positively, the refinancing extended a significant portion of the company's debt for three years, thereby significantly reducing its refinancing risk (see Exhibit 8). Following the refinancing, we also expect ISS to continue to maintain ample headroom under its financial covenants. This had not always been the case, with the company's liquidity profile dented by limited headroom in the past.

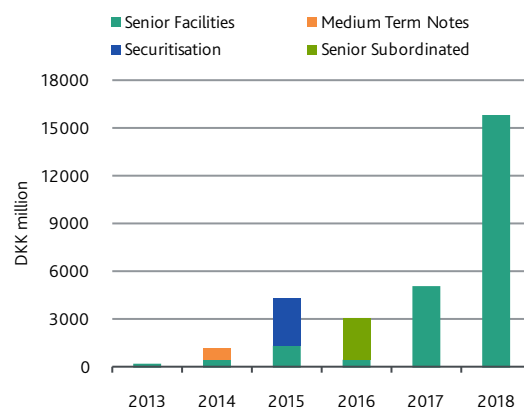
EXHIBIT 8

Refinancing Risk Has Diminished Significantly

Maturity profile prior to refinancing



Current Maturity profile



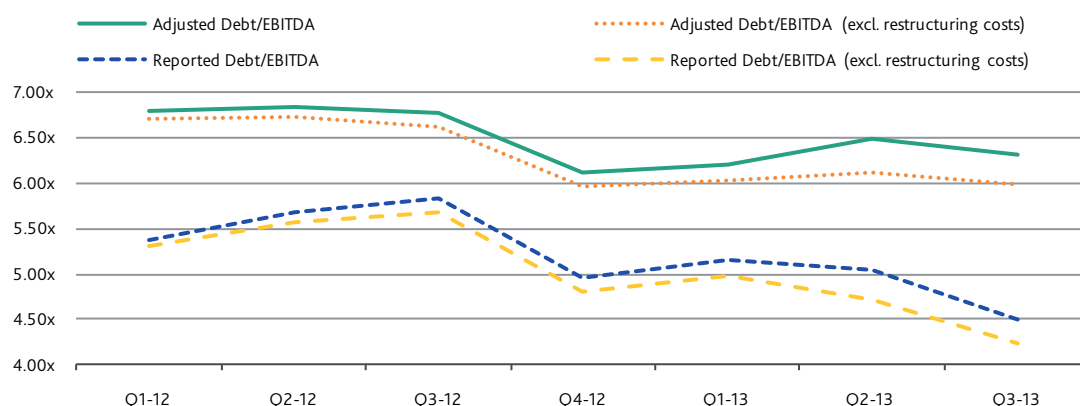
Source: ISS Results Presentations

Further deleveraging expected, but could be hampered by restructuring costs

ISS's high leverage (defined as adjusted debt/EBITDA) of around 6.3x continues to constrain its credit. In many ways, 2013 has been a challenging year in a number of the company's markets, negatively impacting EBITDA, which has been further affected by the DKK296 million (€40 million) of restructuring costs ISS has incurred this year to date. As such, we do not expect that ISS will have achieved growth in EBITDA in 2013 and deleveraging will therefore essentially materialise through the reduction of absolute debt levels. However, we note positively that ISS's financial policies are more conservative than in the past and we would expect the company to continue on its path of deleveraging, given that it is using FCF and funds from divestments to reduce its debt.

EXHIBIT 9

Leverage Is Likely to Continue Trending Downwards



Source: Moody's Financial Metrics

Moody's Related Research

Credit Opinion:

- » [ISS A/S](#)

Analysis:

- » [ISS: Focus on Global Contracts Builds Barriers to Entry, December 2012 \(148079\)](#)

Special Comment:

- » [European Business Services: Recovery Is Fragile, But Prospects Are Improving, November 2013 \(160089\)](#)

Rating Methodology:

- » [Global Business & Consumer Service Industry, October 2010 \(127102\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Rate this Research



Report Number: 161255

Authors
Knut Slatten
Elena Marcén Argilés

Editor
Simon Culshaw

Production Associate
Vinod Muniappan

© 2013 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657/AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972/AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for retail clients to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.