ISS A/S

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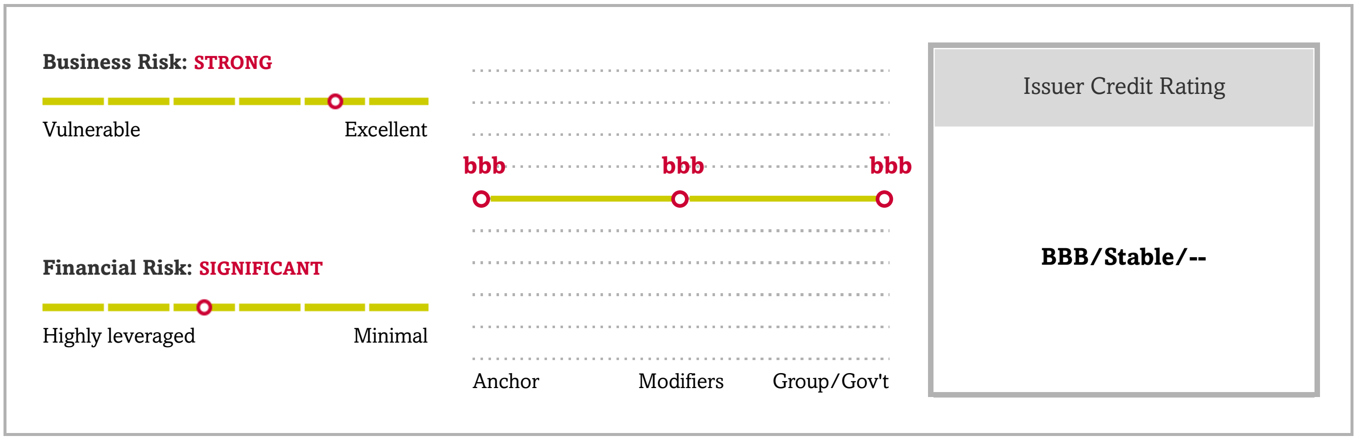

Credit Highlights

Overview

Key Strengths	Key Risks
Leading player, with strong reputation in the naturally resilient facilities and services industry.	Highly competitive and fragmented facilities management sector.
Widely diversified geographic, customer, and market base.	Limited pricing flexibility and relatively lower margins versus larger peers.
Strong free cash flow generation (FOCF), with low fixed-asset intensity and capital expenditure (capex) needs.	Shareholder-friendly financial policy, albeit focused on maintaining stable credit metrics.
Acquisition and investment strategy to focus on enhancing core service offerings and key accounts.	Potential for weaker credit metrics in short-term resulting from divestment of operations in 13 countries.

ISS has a leading market position resulting from its strong execution track record, brand reputation and long-term customer relationships. In 2018, the company has been successful in growing its integrated facility services business and its key accounts, which now represent 59% of group revenue. Both of which contribute to building barriers to entry for competitors and stickiness of customers in a very fragmented industry.

We expect ISS's credit metrics to remain strong as its high percentage of recurring revenue and low fixed assets intensity drives substantial and steady FOCF. We expect FOCF generation of Danish krone (DKK) 2.5 billion to DKK2.8 billion in 2019 and 2020, as the company benefits from good operating leverage, stable working capital needs, and modest capex.

We believe that credit metrics will be negatively affected by the company's plan to dispose of operations in 13 countries. Although we don't view the withdrawal from these countries as having a material impact on the group's geographic diversification, it will temporarily offset organic growth. The group plans to use the disposal proceeds for investments in its service platform and shareholder distributions; rather than debt repayment. This will likely lead to a ratio of FOCF to debt in the lower end of our 20%-30% range.

Outlook: Stable

The stable outlook on ISS reflects our expectation that the company will continue to see modest growth in revenues and generate sustainable cash flows. We also expect that ISS will continue to distribute excess cash to shareholders, such that its credit metrics will stay relatively stable over time. ISS will post S&P Global Ratings-adjusted funds from operations (FFO) to debt of 20%-30%, at lower end of the range over next 12 months, in our opinion, primarily following the disposal of operations in noncore countries.

Downside scenario

ISS' credit metrics provide moderate headroom for the current rating. We could lower the rating if shareholder distributions rose significantly, debt levels increased, or ISS' operating performance deteriorated such that FFO to debt fell below 20% on a sustained basis.

Upside scenario

We could raise the rating if ISS' operating performance continues to be stable while it maintains strong FOCF. An upgrade would depend on the company implementing a financial policy to continually reduce leverage and refraining from distributing excess cash to shareholders. We could consider raising the rating if ISS sustained FFO to debt above 30%.

Our Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- GDP growth in the eurozone of 1.6% in 2019 and in 2020, and of about 2.3% in 2019 and 1.8% in 2020 in the U.S. In ISS' other key operating region, Asia-Pacific, we forecast GDP growth of 5.3% in 2019 and in 2020.
- About 4.0%-5.0% organic growth in 2019 and 2020, with additional growth of 1%-2% coming from acquisitions.
- Adjusted EBITDA margins of around 7.3% to 7.4% in 2019 and 7.5% in 2020, as restructuring costs continue to roll off.
- Strong adjusted FOCF generation of around DKK2.5 billion to DKK2.8 billion.
- Annual capex of about DKK1.1 billion-DKK1.3 billion over the coming years.
- A dividend payout ratio of about 50% of net profit in 2019 and 2020, or at least equal to the DKK7.70 per share paid in 2018. Any extraordinary dividends over next year to be funded from the divestment of noncore operations proceeds.
- Mergers and acquisitions-related cash spending of about DKK400 million annually over the next two years.

Key Metrics

	2018A	2019E	2020E
EBITDA margin*(%)	7.3	7.3-7.4	7.4-7.5
Debt/EBITDA (X)	3.0	3.1-3.4	3.0-3.3
FFO/debt (%)	23.6	21-23	22-24

*S&P Global Ratings-adjusted. A--Actual. E—Estimate. FFO—Funds from operations.

Base-case projections

The company demonstrated solid organic revenue growth in 2018, despite the negative impact of foreign exchange and divestment of noncore operations, and we expect this will continue in 2019. We forecast organic revenue growth will continue to be driven by new integrated facilities management contract wins and the launch of the 10-year Deutsche Telkom contract in July 2019 (estimated at 2% revenue growth contribution), and will be further bolstered by bolt-on acquisitions.

We forecast that EBITDA margins will remain stable with potential upside of 10 basis points (bps) to 20 bps in 2019 and 2020. Operating efficiencies resulting from the company's transformational projects, which have now been completed, and a focus on driving higher margin integrated services contracts will likely offset restructuring costs resulting from noncore operations divestments.

2019 credit metrics will be affected by the divestment of noncore operations and expectation of increased factoring. We believe this will be a short-term impact, as three quarters of the proceeds from the divestments will be reinvested into supporting further growth initiatives, with the remaining distributed to shareholders.

Company Description

ISS is a large, long-established facilities services group with operations in over 40 countries in Europe, Asia-Pacific, Latin America, and North America. ISS provides single services, multi-services, or integrated facilities services for private and public entities locally, regionally, and globally. Services include cleaning, office support, catering, security, and property and facilities management. The company is publicly held following its IPO in 2014.

Over the past few years, ISS has made significant disposals to allow it to focus on its core competencies. This strategy continued in 2018 with the announcement that it would dispose of operations in 13 noncore countries. We anticipate that the company will use the proceeds from the disposals to invest in its service platform and shareholder distributions. We expect the group will continue focusing on growing its key accounts and integrated service offerings and looking for acquisitions to expand its technical service capabilities, as well as selectively closing gaps in its service or geographic portfolio.

Business Risk: Strong

ISS holds leading market positions in the facility services industry across its key geographies and a highly diverse customer and end-market base comprising thousands of private and public customers. The company has long-term relationships with its clients, resulting in stable retention rates of above 90% and the majority of their contracts are in the three-to-five year range, which provides for additional revenue visibility. ISS' integrated facilities management business offers some barriers to entry thanks to the necessary scale required for global service offerings, while single services generally have low barriers.

ISS has a strong track record of integrating its many acquisitions, which has produced a solid global service delivery platform with critical mass to support future organic growth opportunities. The company has also managed to maintain less volatile operating profitability (measured by EBITDA margin) than that of most its peers, contributing to what we see as its strong competitive position. However, given that lower margin cleaning services make up a significant portion of the company's revenue base, total adjusted EBITDA margins at around 7.3% are lower than most of its peers'. We anticipate any margin expansion will stem from its efforts to control costs and the potential for economies of scale in the integrated services offering.

Peer comparison

In our view, Compass and Sodexo are ISS closest peers, although Compass focuses on food services and contract catering and Sodexo provides contract catering, facilities management, and also an employee voucher business segment. Nevertheless, we assess all three facility service providers as having strong business risk profiles based on strong geographic and product diversity, limited client concentration, and stable operating margins.

We assess Compass and Sodexo's financial risk as intermediate, one category higher than our assessment of ISS's financial risk, including forecast adjusted leverage of 2.0x-3.0x and FFO to debt of above 30%. This results in stronger ratings for Compass (A/Stable/A-1) and Sodexo (A-/Stable/A-1). Our rating on Compass also reflects that it is twice as large as ISS, benefits from higher margins, and that its credit metrics are at the higher end of the intermediate financial risk category.

We have also included peers with relatively similar revenue size, who provide outsourced security services. G4S's recent high number of operational risk events and payments of onerous contracts versus its peers is reflected in a negative comparable rating analysis, resulting in an issuer credit rating one notch lower than that on ISS, of 'BBB'.

Table 1

ISS A/S -- Peer Comparison					
Industry Sector: Facilities Services					
	ISS A/S	**Securitas AB**	**Compass Group PLC**	**Sodexo S.A.**	**G4S PLC**
Rating as of April 3, 2019	BBB/Stable/--	BBB/Stable/A-2	A/Stable/A-1	A-/Stable/A-1	BBB-/Stable/A-3
	--Fiscal year ended--				
(Mil. DKK)	**--Dec. 31, 2018--**		**--Sept. 30, 2018--**	**--Aug. 31, 2018--**	**--Dec. 31, 2017--**
Revenue	73,592.0	74,441.1	192,275.4	152,151.7	65,661.3
EBITDA	5,368.0	4,688.8	20,588.1	11,182.7	5,783.6
FFO	3,807.0	3,659.7	16,109.2	9,226.0	3,751.5
Net income from cont. oper.	1,213.0	2,212.6	9,419.5	4,853.8	2,029.9
Cash flow from operations	4,242.0	2,327.1	17,440.5	9,181.3	3,617.3
Capital expenditure	1,052.0	0.0	6,790.4	2,453.0	914.3
Free operating cash flow	3,190.0	2,327.1	10,650.1	6,728.3	2,703.0
Discretionary cash flow	1,765.0	1,255.9	5,986.4	3,567.0	1,201.6
Cash and short-term investments	6,834.0	2,368.8	8,113.3	15,605.1	6,945.3
Debt	16,150.8	11,102.8	39,673.1	23,831.8	18,902.1
Equity	12,472.0	12,953.8	22,104.5	24,813.1	7,829.2
Adjusted ratios					
EBITDA margin (%)	7.3	6.3	10.7	7.4	8.8
Return on capital (%)	8.9	13.7	24.7	17.0	14.5
EBITDA interest coverage (x)	6.8	14.5	14.5	10.2	4.6
FFO cash interest coverage (X)	9.6	N.M.	20.7	11.8	4.4
Debt/EBITDA (x)	3.0	2.4	1.9	2.1	3.3
FFO/debt (%)	23.6	33.0	40.6	38.7	19.8
Cash flow from operations/debt (%)	26.3	21.0	43.9	38.5	19.1
Free operating cash flow/debt (%)	19.8	21.0	26.8	28.2	14.2
Discretionary cash flow/debt (%)	10.9	11.3	15.1	15.0	6.3

DKK--Danish krone. FFO--Funds from operations. N.M.--Not meaningful

Financial Risk: Significant

We anticipate that the further disposal of noncore operations will have a negative impact on the company's credit metrics as the group plans to make greater use of factoring and supply chain financing to manage the working capital impact of longer payment terms under its key accounts. Additionally, the group's plan to use the disposal proceeds for investments in its service platform and shareholder distributions, as well as our expectation of some restructuring costs, will result in a modest increase in leverage.

However, we believe that ISS will continue to generate organic growth in the near to medium term by securing integrated facilities management contracts with new clients, including the 10-year contract with Deutsche Telekom, which commences in July 2019. We expect growth to be further bolstered by ISS' bolt-on acquisition strategy targeted at enhancing its core service offering.

We forecast that ISS' adjusted debt to EBITDA will be about 3.3x in 2019 and strengthen to around 3.1x in 2020. At the same time, we expect adjusted FFO in 2019 and 2020 will be around DKK4 billion and adjusted FFO to debt will remain in the 20%-30% range over the next two years, albeit at the lower end of the range.

Financial summary

Table 2

ISS A/S -- Financial Summary

Industry Sector: Facilities Services

	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Rating history	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB-/Positive/--	BBB-/Stable/--
(Mil. DKK)					
Revenue	73,592.0	79,912.0	78,658.0	79,579.0	74,105.0
EBITDA	5,368.0	5,984.0	6,314.0	6,312.5	6,011.5
FFO	3,807.0	4,453.6	4,608.6	4,467.3	4,056.2
Net income from continuing operations	1,213.0	2,101.0	2,224.0	2,211.0	1,011.0
Cash flow from operations	4,242.0	4,524.6	4,596.6	4,711.3	3,503.2
Capital expenditure	1,052.0	992.0	875.0	913.0	848.0
Free operating cash flow	3,190.0	3,532.6	3,721.6	3,798.3	2,655.2
Discretionary cash flow	1,765.0	2,109.6	1,625.6	2,891.3	2,655.2
Cash and short-term investments	6,834.0	6,275.0	4,300.0	4,526.0	3,557.0
Debt	16,150.8	16,779.3	16,839.9	17,177.6	16,723.6
Equity	12,472.0	13,814.0	13,920.0	14,504.0	12,920.0
Adjusted ratios					
EBITDA margin (%)	7.3	7.5	8.0	7.9	8.1
Return on capital (%)	8.9	12.0	11.8	11.9	10.3
EBITDA interest coverage (x)	6.8	7.1	7.5	7.2	4.6
FFO cash interest coverage (x)	9.6	13.9	16.5	13.7	5.9
Debt/EBITDA (x)	3.0	2.8	2.7	2.7	2.8
FFO/debt (%)	23.6	26.5	27.4	26.0	24.3
Cash flow from operations/debt (%)	26.3	27.0	27.3	27.4	20.9
Free operating cash flow/debt (%)	19.8	21.1	22.1	22.1	15.9
Discretionary cash flow/debt (%)	10.9	12.6	9.7	16.8	15.9

DKK--Danish krone. FFO--Funds from operations. N.M.--Not meaningful

Liquidity: Exceptional

We assess ISS' liquidity as exceptional because we forecast that the company's sources of liquidity will exceed its uses by more than 2.0x over the next 24 months, and that sources less uses would continue to be positive should EBITDA fall by 50%. We consider that ISS has well-established and solid relationships with its banks and exhibits prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and cash equivalent of about DKK6.8 billion as of Dec. 31, 2018; • Approximately DKK7.0 billion available under its current revolving credit facilities; and • Cash FFO of about DKK2.9 billion over the next 12 months.	• Capex and working capital requirements of DKK1.4 billion and seasonal working capital requirements of about another DKK1.4 billion; • About DKK1.4 billion of assumed dividends; and • Post-retirement employee benefit top-ups of around DKK255 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec 31, 2018, ISS's capital structure consisted of DKK17.3 billion of total borrowings, all of which were unsecured.

Analytical conclusions

We rate ISS' unsecured notes 'BBB', in line with the issuer credit rating, as we do not consider there to be subordination risk in the capital structure.

Reconciliation

Table 3

Reconciliation Of ISS A/S Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. DKK)

	--Fiscal year ended Dec. 31, 2018--						
ISS A/S reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
	17,660.0	12,458.0	4,191.0	3,573.0	473.0	4,191.0	3,347.0
S&P Global Ratings' adjustments							
Interest expense (reported)	--	--	--	--	--	(473.0)	--
Interest income (reported)	--	--	--	--	--	37.0	--
Current tax expense (reported)	--	--	--	--	--	(785.0)	--

Table 3

Reconciliation Of ISS A/S Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. DKK) (cont.)

Operating leases	4,304.8	--	1,126.0	299.6	299.6	826.4	826.4
Postretirement benefit obligations/deferred compensation	931.0	--	(71.0)	(71.0)	21.0	(111.4)	68.6
Surplus cash	(6,770.0)	--	--	--	--	--	--
Share-based compensation expense	--	--	19.0	--	--	19.0	--
Non-operating income (expense)	--	--	--	37.0	--	--	--
Non-controlling Interest/Minority interest	--	14.0	--	--	--	--	--
Debt - Fair value adjustments	25.0	--	--	--	--	--	--
EBITDA - Business Divestments	--	--	103.0	103.0	--	103.0	--
D&A - Impairment charges/(reversals)	--	--	--	(1,187.0)	--	--	--
Total adjustments	(1,509.2)	14.0	1,177.0	(818.4)	320.6	(384.0)	895.0

S&P Global Ratings' adjusted amounts

	Debt	Equity	EBITDA	EBIT	Interest expense	FFO	Cash flow from operations
	16,150.8	12,472.0	5,368.0	2,754.6	793.6	3,807.0	4,242.0

DKK--Danish krone. FFO--Funds from operations.

Ratings Score Snapshot

Issuer 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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Exceptional (no impact)

- **Management and governance:** Strong (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of April 8, 2019)*

ISS A/S	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Issuer Credit Ratings History	
17-Mar-2016	BBB/Stable/--
30-Mar-2015	BBB-/Positive/--
20-Mar-2014	BBB-/Stable/--

Ratings Detail (As Of April 8, 2019)*(cont.)	
Related Entities	
ISS Global A/S	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
ISS World Services A/S	
Issuer Credit Rating	BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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