STANDARD & POOR'S

Standard & Poor's Research

Summary:

S&PCORRECT: ISS A/S

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*(**Editor's Note:** This article, originally issued Feb. 11, 2013, has been republished to update the "Recovery analysis" section, the previous version of which was published in error. A corrected version follows.)*

Credit Rating:	BB-/Positive/--

Rationale

The ratings on Denmark-based facilities services provider ISS A/S and related entities (ISS or the group) reflect Standard & Poor's Ratings Services' view of the group's "highly leveraged" financial risk profile and weak overall credit measures. The ratings also take into account the potential for shareholder-friendly policies as a result of ISS' majority ownership by private equity firms Goldman Sachs Capital Partners and EQT Partners, which we incorporate into our assessment of the group's "aggressive" financial policy. Another key risk may take the form of wage inflation, which could weigh negatively on ISS' operating profit margins if the group finds it difficult to pass the related cost increase onto customers.

The group's weaknesses are partially mitigated by its "strong" business risk profile, underpinned by a solid business position in an attractive--albeit fragmented and competitive--industry and a sound service delivery platform for driving organic growth. With sales of Danish krone (DKK) 78.8 billion in the rolling 12 months to Sept. 31, 2012, ISS benefited 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 in the provision of individual services, we perceive that barriers to entry for multiple/integrated facilities services are higher. While pricing is competitive in the facilities services sector, the group has relatively high contract retention rates and is large enough to benefit from economies of scale. The group also benefits from good geographic diversity, a highly diversified customer base, and a broad service mix.

We assess ISS' management and governance score as being "strong" under our criteria in view of management's consistent track record of delivering on operational goals, maintaining market leadership, not suffering from unexpected operational risks, and having good depth and breadth of management.

S&P base-case operating scenario

Our revenue forecast for ISS incorporates our view that GDP growth in the EU will be flat in 2013, with inflation near the 2% level. We continue to believe that ISS will perform better than the overall economy. In our base-case assessment, we anticipate that 2013 full-year revenues will grow by 4%, to nearly DKK82 billion, excluding any disposal of non-core assets. This is better growth than the 2.0% reported in the nine months to Sept. 31, 2012, which contained disposals, although still slower than the 4.8% revenue growth delivered in 2011. We forecast a mild improvement in Western Europe (51% of 2011 revenues) with revenue growth of 1% in 2013, following a slight decline evidenced in 2012. The Nordic region, which is the second-largest revenue contributor, is expected to show 4.5% growth, recovering from the negative growth in 2012 resulting from disposals. We believe that revenue growth in

North America will slow further in 2013, to 8%; a stark decline from the 28% growth observed in 2011.

We forecast that ISS' Standard & Poor's-adjusted EBITDA margin in 2013 will be about 7-20 basis points (bps) up from the annualized Sept. 31, 2012, result. We anticipate that this increase will be fueled by a recovery in the EBITDA margin across all regions, and most notably in Nordic countries and North America.

S&P base-case cash flow and capital-structure scenario

Our 2013 forecast does not benefit from any potential asset disposals, but does capture the reduction in interest costs resulting from the December 2012 redemption of the 2014 11% senior notes. In our base-case assessment, we forecast 2013 full-year adjusted funds from operations (FFO) at DKK3.4 billion, outperforming the 2012 result by just less than 5%. We anticipate that unadjusted FFO will rise by DKK100 million due to a 20 bps rise in the EBITDA margin, and that the adjustments for operating lease depreciation and pensions will increase at the same rate of revenues.

Our base-case scenario also assumes a small cash outflow for acquisitions of DKK100 million. Improvement in working capital flow in 2013, accompanied by the insignificant amount of scheduled debt amortizations for the year should support, in our view, the net cash position and keep it in line with the previous year's DKK3.5 billion. Overall, we believe that net debt will be broadly neutral, with adjusted FFO to debt at just less than 11%.

With our forecast increase in the group's adjusted EBITDA margin, we believe that adjusted EBITDA will be about DKK6 billion in the year ending Dec. 31, 2013. Therefore, we anticipate that adjusted debt to EBITDA will be about 5.0x-5.5x in 2013, down from nearly 6.3x in the 12 months to Sept. 31, 2012.

Liquidity

We assess ISS' liquidity as "adequate" under our criteria, and consider that the group has sound relationships with its banks and a satisfactory standing in credit markets. Furthermore, we forecast that in 2013, sources of liquidity will exceed uses by a coverage ratio of more than 2x.

Sources of liquidity include unused amounts available under the committed revolving credit facility of DKK1.7 billion, maturing in December 2014. Additionally, surplus cash and equivalents are expected to total DKK1.2 billion at year-end December 2012, which we believe will sufficiently cover short-term debt maturities and peaks in working capital. We anticipate that the group will continue to generate strong unadjusted FFO of DKK2.0 billion in the full year ending Dec. 31, 2013. Consequently, we forecast total liquidity sources of DKK4.3 billion in 2013.

In terms of uses of liquidity, we project that debt amortizations and an increase in net working capital will consume just less than DKK0.7 billion in 2013. We forecast capital expenditure of just less than DKK1.2 billion in 2013. In addition, we project an outflow of DKK100 million for possible acquisitions, contributing to total uses of DKK2.0 billion in 2013.

ISS has no significant debt amortizations until 2014 and 2015. We also forecast that covenant headroom will remain adequate in the medium term.

Recovery analysis

The issue ratings on ISS' €581.5 million subordinated facility (including the add-on notes) due 2016, and on ISS Global's €110.4 million issuance under the €2 billion unsecured European Medium-Term Note program 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.

The issue and recovery ratings reflect our valuation of the group as a going concern, underpinned by our view of ISS' resilient business risk profile, its leading market position, well-known brand, and strong customer base. On the other hand, the ratings are constrained, in our view, by the potential exposure to various insolvency regimes post default, the significant amount of priority debt ranking ahead of the rated instruments, and their unsecured nature.

To calculate recoveries for the remaining €110 million notes due 2014 and €581.5 million senior subordinated notes due 2016, we simulate a default scenario. We believe that a default would be triggered mainly by high leverage and significant debt maturities, an inability to manage the cost base, and reduced FOCF as a result of deteriorating operating performance. In our opinion, the time lag between any decline in the group's revenues and an appropriate reduction in its cost base would hamper its profitability and ability to generate free cash flow.

Under our simulated scenario, we assume that a default would occur in 2015, triggered by ISS' inability to repay its debt obligation. At that point, we estimate that the group's EBITDA would have fallen to about DKK2.7 billion.

We value ISS as a going concern, and envisage a stressed enterprise value of about DKK17.5 billion, which is equivalent to a 6.5x stressed EBITDA multiple.

We then deduct priority liabilities, mainly comprising enforcement costs, 50% of the unfunded pension deficit, and the debt ranking ahead (in particular, the DKK2 billion of securitization and about DKK18 billion of senior secured credit facilities outstanding at default, including prepetition interest). This leaves no residual value for the €110 million notes due 2014 and the €581.5 million senior subordinated notes due 2016, leading to our recovery rating of '6' for these instruments.

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. Based on management's current policy of deleveraging, we anticipate that credit measures will improve gradually in the medium term, supported by continued organic growth in the mid-single digits. The outlook also reflects our view that ISS will deliver stable operating performance and benefit from recent notable contract wins. We consider debt to EBITDA of about 5x and EBITDA interest coverage of close to 2x to be commensurate with a 'BB-' rating.

We could raise the rating if ISS achieves further significant deleveraging. A sustained improvement in adjusted debt to EBITDA to less than 5x and adjusted FFO to debt to more than 12% could lead us to reassess ISS' financial risk profile as "aggressive."

Downside risk is most likely to arise from a change in acquisition strategy toward debt-financed acquisitions or a tightening in operating profit margins.

Related Criteria And Research

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

- Key Credit Factors: Global Criteria for Rating Companies In The Service Sectors, Nov. 12, 2012
- 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
- 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

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