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Research Update:

ISS A/S 'BB' Ratings Placed On CreditWatch Positive On Announced IPO And Proposed Deleveraging

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Overview

- Denmark-based facility services provider ISS A/S has announced its intention to float shares in a primary share issuance, which, along with proceeds under new credit facilities, the company proposes to use for overall debt reduction.
- We are placing on CreditWatch positive our 'BB' long-term corporate credit ratings on ISS and its subsidiary ISS World Services A/S.
- The CreditWatch placement reflects a possible upgrade following our review of the potential positive implications of an IPO for ISS, including its financial policy and capital structure.

Rating Action

On Feb. 20, 2014, Standard & Poor's Ratings Services placed on CreditWatch with positive implications its 'BB' long-term corporate credit ratings on Denmark-based facilities services provider ISS A/S and the company's subsidiaries ISS World Services A/S and ISS Global A/S.

At the same time, we placed on CreditWatch positive our 'B' short-term rating on ISS World Services A/S.

In addition, we affirmed our 'BB' and 'B+' issue ratings on ISS' debt instruments. The recovery ratings on these instruments remain unchanged.

Rationale

The CreditWatch placement follows ISS' announcement that it intends to float shares in a primary share issuance to raise additional capital. The group proposes to use the extra capital--targeted at about Danish Krone (DKK) 8 billion in IPO proceeds--to delever its capital structure.

We assess ISS' financial risk profile as "aggressive" under our criteria. We forecast that Standard & Poor's-adjusted debt to EBITDA for the financial year ending Dec. 31, 2013, will be under 4.5x, while adjusted funds from operations (FFO) to debt will be about 13%. We estimate that if the proceeds of the IPO were fully used to repay debt, pro forma adjusted debt to EBITDA for 2014 could drop closer to 3x with FFO to debt rising to the low 20% range. These metrics would be consistent with a financial risk profile assessment of "significant," as defined by our criteria.

Our assessment of ISS' business risk profile as "strong" would be unaffected by the prospective IPO.

Our base case for ISS assumes:
- Organic revenue growth in the low to mid-single digits for 2014 and 2015.
- Stable operating margins.
- IPO proceeds used for debt reduction.

We may reassess the current financial policy assessment of FS-5 for ISS following the completion of the IPO. If we consider that ISS would continue deleveraging post the IPO, maintain limited acquisition spending, and introduce a stable dividend policy, we could revise the financial policy assessment to FS-4.

Liquidity

We characterize ISS' liquidity as "adequate" under our criteria. We forecast that the company's sources of liquidity will exceed its uses by more than 1.2x over the next 18 months. We consider that ISS has sound relationships with its banks and practices prudent risk management.

We anticipate that ISS will benefit from large recurring cash balances, good free cash flow generation of about Danish krone (DKK) 2.6 billion in 2014, and more than DKK1 billion available under its current revolving credit facility. With nearly DKK1.4 billion of debt maturities occurring in 2014, we assume minor acquisition spending and capital expenditures of just over DKK1 billion.

CreditWatch

We aim to resolve the CreditWatch following ISS' successful completion of the IPO and once we have confirmation from ISS on the final use of the new funding. We expect this to happen within 90 days. In addition, we will seek to ascertain from the group's reference shareholders (EQT Partners and Goldman Sachs Capital Partners) their investment horizon, strategy, and degree of support for the revised financial policy.

We would view a further reduction in ISS' debt burden as positive and we could raise the ratings as a result. The magnitude of any potential ratings upside would depend on our satisfactory assessment of: 1) the group's likely sustainable future credit metrics; 2) the group's revised financial policy, together with an assessment of the group's future shareholder structure; and 3) the group's sustained adequate liquidity.

We could affirm the ratings at their current level if ISS is unsuccessful in its IPO.

Ratings Score Snapshot

Corporate Credit Rating: BB/Watch Pos/--

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

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Financial sponsor-5 (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Negative (-1 notch)

Recovery Analysis

Key analytical factors
- The issue rating on ISS' DKK23 billion senior secured facilities with various maturities up to and including 2018 is 'BB' in line with the corporate credit rating on ISS. The recovery rating on these instruments is '3' indicating our expectation of "meaningful" (50%-70%) recovery prospects for noteholders in the event of default. The recovery rating is underpinned by the company's good valuation, "strong" business risk profile, comprehensive security package, and the favorable jurisdiction of Denmark. However, it is constrained by the high levels of first-lien debt, which dilutes overall recovery prospects.
- The issue rating on ISS' €110.4 million 4.5% senior unsecured Euro Medium-Term Notes due 2014 and €256 million 8.875% subordinated notes due 2016 is 'B+' and the recovery rating on these notes is '6' indicating our expectation of "negligible" (0%-10%) recovery prospects for noteholders in the event of default. Our recovery rating on these debt instruments reflects their structural and contractual subordination to the senior facilities.
- Our hypothetical default scenario contemplates a default in 2017, triggered by the company's inability to manage the cost base in a context of decreasing revenues, and reduced free cash flow as a result of deteriorating operating performance.

Simulated default assumptions

- Year of default: 2017
- EBITDA at default: About DKK2.7 billion
- Implied enterprise value multiple: 6.5x
- Jurisdiction: Denmark

Simplified waterfall

- Net enterprise value (after 9% admin costs): About DKK16.1 billion
- Priority claims: About DKK4.0 billion
- Senior secured credit facilities: About DKK23 billion*
- --Recovery expectation: 50%-70%
- Senior unsecured notes claims: About DKK840 million*
- --Recovery expectation: 0%-10%
- Subordinated notes claims: About DKK1.9 billion*
- --Recovery expectation: 0%-10%

*All debt amounts include six months' prepetition interest.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- 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; CreditWatch/Outlook Action

	To	From
ISS A/S		
ISS Global A/S		
Corporate Credit Rating	BB/Watch Pos/--	BB/Positive/--
ISS World Services A/S		
Corporate Credit Rating	BB/Watch Pos/B	BB/Positive/B

Ratings Affirmed

ISS A/S
 Subordinated

Local Currency	B+	B+
Recovery Rating	6	6
ISS Global A/S		
Senior Secured	BB	BB
Recovery Rating	3	3
Senior Unsecured		
Local Currency	B+	B+
Recovery Rating	6	6

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