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ISSUER COMMENT
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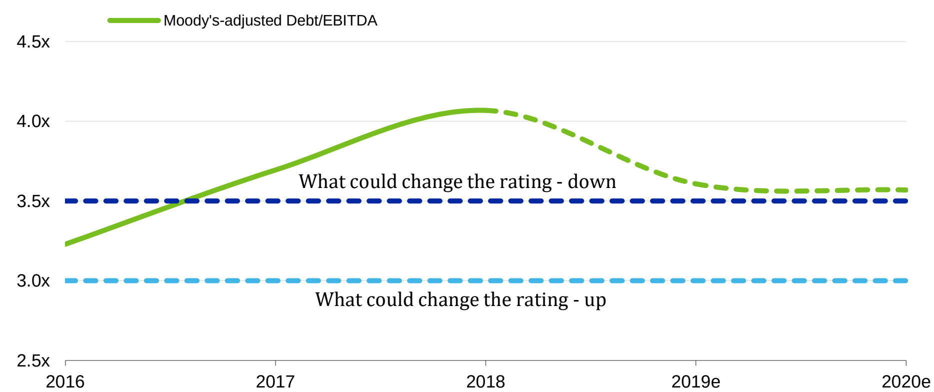
ISS Global A/S

Likely loss of Novartis contract may hinder our deleveraging expectation

On 27 May 2019, leading global provider of facility services ISS Global A/S (Baa2 stable) announced its current contract with Novartis AG (A1 stable) is unlikely to be extended upon its expiration on 31 December 2019. The contract loss is credit negative because it may lead to a slower deleveraging profile in 2020 than we initially expected due to its large size.

We continue to expect recent contract wins as well as a reduction in gross debt will support deleveraging to a Moody's-adjusted debt/EBITDA of around 3.5x in 2019-2020 from 4.1x in 2018. However, there is now limited rating headroom for further deviation to our initial expectation of deleveraging, execution challenges in implementing the new strategy or the new contract with Deutsche Telekom AG (DT, Baa1 negative), or underperformance against revenue and margin expectations.

Exhibit 1
We expect leverage to return towards 3.5x in 2019-2020
Moody's-adjusted debt/EBITDA



Moody's projections for 2019-20 are Moody's opinion and do not represent the views of the issuer
Source: Moody's Investors Service

We continue to expect organic revenue growth of 5%-6% in 2019 as a result of new contract wins, in particular the DT contract which will commence in July 2019 and is expected to be worth around 4% of revenue annually. However, the loss of the Novartis contract – which generated revenue of DKK 2.0 billion in 2018 (2.8% of ISS' total revenue) – will pressure organic revenue growth in 2020 and offset the additional growth from the full-year contribution of the DT contract.

Organic revenue growth in Q1 2019 was 6.1% driven by all regions, and key accounts in particular which delivered organic growth of 8.7%. The company expects the pace of organic growth in Q2 2019 to reduce because the benefits of new contracts started in early 2018 will subside. The start of the DT contract in July will support an acceleration in organic growth from Q3 2019.

The company estimates the annualised first year impact of the loss of the Novartis contract on its reported operating margin of 5.0% in 2018 (based on the new definition which now includes restructuring items) to be 0.1-0.2 percentage points including exit costs because the contract has higher margin than the group's average. That said, we believe that the impact on the 2020 operating margin could be lower at the lower end of the range because the contract would have unlikely be renewed at the same level of margins. New contract wins or renewals typically start with lower margin before ramping up because cost savings and efficiencies are achieved over time. Margins generally reach a high point towards the end of the contractual term.

The Novartis contract would be the only key account contract the company would have lost so far this year. Out of the DKK5.7 billion of key account contracts maturing in 2019 (12 contracts in total), the company has already extended DKK 2.3 billion. There is now around DKK1.4 billion of key account contracts up for renewal in the second half of 2019 with the vast majority in the last quarter. The company also successfully extended the DKK 2.2 billion of key account contracts up for renewal in 2018 (seven contracts in total).

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