

Research:

Research Update: ISS 'B+' Corporate Credit Ratings Affirmed; Unsecured Debt Rating Cut To 'B-'; Outlook Stable

Publication date: 07-Nov-2005
Primary Credit Analyst: Alf Stenqvist, Stockholm (46) 8-440-5925;
alf_stenqvist@standardandpoors.com
Secondary Credit Analysts: Peter Tuving, Stockholm (46) 8-440-5913;
peter_tuving@standardandpoors.com
Vanessa Brathwaite, London (44) 20-7176-3723;
vanessa_brathwaite@standardandpoors.com

Credit Rating: B+/Stable/B

■ Rationale

On Nov. 7, 2005, Standard & Poor's Ratings Services affirmed its 'B+' long-term corporate credit ratings on Denmark-based facilities services group ISS A/S and wholly owned subsidiary ISS Global A/S. The 'B' short-term corporate credit rating on ISS A/S was also affirmed. At the same time, however, Standard & Poor's lowered its senior unsecured debt ratings on ISS Global to 'B-' from 'B'. Ratings were removed from CreditWatch, where they were placed with negative implications on March 29, 2005.

In addition, Standard & Poor's assigned its 'B+' long-term corporate credit rating to ISS Holding A/S, a holding company in the ISS group. The outlooks on all the long-term corporate credit ratings are stable.

The ratings on the ISS entities reflect the group's highly leveraged financial profile and weak credit measures. This is mitigated by the group's strong business profile, underpinned by its strong business position in an attractive--albeit fragmented and competitive--industry.

After recent finalizing of financial arrangements, the group has interest-bearing net debt of about Danish krone (Dkr) 23 billion (€3.1 billion; \$3.6 billion), including a Dkr925 million pay-in-kind (PIK) facility.

With sales of Dkr40.4 billion in 2004, ISS benefits from a strong business position, particularly in Northern Europe, where it is a market leader in most of its operations. The group benefits from good geographical diversity across Europe. Standard & Poor's considers ISS' business sector to be attractive as it is resilient to recession and is likely to benefit from increasing outsourcing. Although there are few barriers to entry and pricing is competitive in this sector, the group has a good record of contract retention, and is large enough to benefit from economies of scale. Acquisitions have been and are likely to continue to be part of ISS' strategy to add competences and build critical mass and geographical presence. Although the acquisition strategy adds some risk to the business, ISS' track record is good, with management successfully integrating acquired companies. As a result of the competitive nature of the facilities services business, ISS' operating profit margins are relatively low, with EBITDA margins of about 7% (not adjusted for operating leases).

The group's financial profile is highly leveraged following the buy-out in May 2005 by a private equity consortium consisting of EQT III and EQT IV (EQT) and Goldman Sachs Capital Partners. This resulted in weak credit measures, with net debt to EBITDA expected to be above 7.0x (not lease-adjusted) in the near term, and EBITDA cash interest of about 2x. Standard & Poor's does not incorporate material improvements in these ratios in the medium term, reflecting the company's acquisitive growth strategy. Acquisition spending is discretionary and flexible, however, and the acquisitions are normally immediately cash enhancing. Also, ISS benefits from good free operating cash flows, reflecting low capital expenditures needs. The group's highly flexible cost base (primarily staff related) provides additional cushioning in a downturn.

Liquidity

Liquidity resources are adequate. The major liquidity resource is a Dkr1.75 billion committed revolving credit facility. There is also a Dkr750 million uncommitted revolving credit facility. The facilities will primarily be used for working capital purposes, as annual debt maturities are expected to be very modest until 2010. In addition, there is a letter of credit/guarantee facility of Dkr500 million, and separate acquisition facilities totaling Dkr5.25 billion. The facilities mature in 2012 (except for the Dkr3.5 billion acquisition facility, which matures in 2014), and include financial covenants. Headroom under the covenants is, however, expected to be sufficient. The group is also expected to continue to post positive free operating cash flows (before acquisitions).

Recovery analysis

The two existing bonds totaling €1.35 billion (Dkr10.1 billion), maturing in 2010 and 2014 respectively, and issued by ISS Global under the group's EMTN program, are now rated two notches below the corporate credit rating. This reflects the fact that there is a substantial level of priority liabilities within the group, including non-interest bearing liabilities at operating subsidiary level, which are structurally senior to the notes.

Unrated committed senior secured facilities consist of:

- Dkr5.7 billion term facilities with final maturity in 2012 and 2014;
- A seven-year Dkr1.75 billion revolving credit facility;
- A seven-year Dkr500 million letter of credit facility; and
- Dkr1.75 billion acquisition facility "A" maturing in 2012.

In addition, the capital structure includes the following uncommitted facilities:

- Dkr3.5 billion acquisition facility "B" maturing in 2014; and
- An additional Dkr750 million seven-year revolving credit facility.

The senior facilities were initially secured by a share pledge in the shares of ISS A/S held by ISS Holding. However, further security will be put in place. It is a condition of the senior facilities agreement that material subsidiaries guarantee the senior facilities and provide security pledges over their bank accounts, trade and intercompany receivables, and intellectual property and share pledges as far as legally possible. As is usual, there will be limitations on the amounts certain subsidiaries can guarantee in accordance with local laws. Neither ISS A/S nor any of its subsidiaries has guaranteed or granted any security relating to the borrowings of ISS Holding (the parent holding company in the group) under the senior facilities. Also, ISS A/S will not pledge its shares in ISS Global A/S.

Current drawings under the facilities are about Dkr5.9 billion. Drawings under the facilities have been made by ISS Global and ISS Holding. The bank debt in ISS Holdings has been and is expected to be pushed down further to ISS Global and its subsidiaries. Other debt in the structure includes a Dkr6.6 billion subordinated bridge facility and a Dkr925 million subordinated PIK Bridge facility, both of which are expected to be refinanced in the short term.

■ Outlook

The stable outlook reflects Standard & Poor's expectation that ISS' operating performance should remain steady, and is underpinned by the group's ability to generate strong cash flow. We do not incorporate material improvements in ISS' credit measures, reflecting the expected continued acquisition strategy, which also limits the upside potential in the ratings. Nor, however, do we expect any deterioration in the credit measures. If this were to occur, however, it could result in a negative rating action.

■ Ratings List

Ratings Removed From CreditWatch And Lowered
To From

ISS Global A/S
Senior unsecured debt
B- B/Watch Neg

Ratings Removed From CreditWatch And Affirmed
To From

ISS A/S
Long-term corporate credit rating
B+/Stable B+/Watch Neg

ISS Global A/S
Corporate credit rating
B+/Stable/-- B+/Watch Neg/--

Ratings Affirmed
ISS A/S
Short-term corporate credit rating
B

New Rating
ISS Holding A/S
Corporate credit rating
B+/Stable/--

Additional Contact: Industrial Ratings Europe;
CorporateFinanceEurope@standardandpoors.com

Ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office Hotline (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5916; or Moscow (7) 095-783-4017. Members of the media may also contact the European Press Office via e-mail on: media_europe@standardandpoors.com.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.