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Research Update:

ISS Outlook Revised To Stable From Negative On Better-Than-Expected Performance; 'BBB-' Rating Affirmed

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Rating Action Overview

- Danish facilities management firm ISS A/S reported 2.2% year-on-year revenue growth and improved its S&P Global Ratings-adjusted EBITDA margin to close to 5% in 2021 despite challenging market conditions, while also making good progress with its divestment program.
- We think the operational challenges associated with the COVID-19 pandemic have largely subsided, while the financial hit from the malware attack ISS experienced in 2020 is now in the past, so the group can progress with its strategic initiatives to improve operational efficiency. For 2022, we expect ISS to achieve debt to EBITDA of just below 3.0x and funds from operations (FFO) to debt of about 28%.
- We are therefore revising our outlook on ISS to stable from negative. We are affirming our 'BBB-' long-term issuer credit ratings on the company and its subsidiaries.
- The stable outlook reflects our expectation that ISS will sustainably increase its revenue and EBITDA base with the easing of the pandemic-related challenges and its ongoing initiatives to turn around underperforming contracts and geographies, while also exercising prudence in its returns to shareholders, such that credit metrics remain commensurate with the current rating level.

Rating Action Rationale

Despite pandemic-induced headwinds, ISS increased its revenue base in 2021. The group faced challenging trading conditions in early 2021, as repeated waves of lockdowns reduced activity levels, particularly in the first half of the year. However, with the rollout of vaccines, more people returning to work in the office, and the post-pandemic economic recovery, ISS has started rebuilding its topline. Continued strong demand for its deep-cleaning and disinfection services--alongside the gradual reopening of client offices and industrial sites, which has boosted demand for its other services--allowed the group to expand its revenue base by 2.2% in 2021. We expect revenues to further increase by about 2.5% in 2022 as ISS benefits from continuing pandemic recovery, particularly in the food service business. It should also enjoy contract wins, confirmed by its strong trading in the first quarter of the year. Nevertheless, our forecast takes into account the prevailing economic uncertainty, as well as the group's planned exit of its Danish defense contract, which will likely drag on its revenue. In addition, divestments completed up until April 2022 will also depress total reported growth.

New strategic direction is boosting EBITDA margins. ISS initiated a new strategy in 2020 to tackle historical underperformance across some key contracts as well as geographies. It has also looked to unlock operational efficiencies and become more streamlined. While the new strategic direction has borne restructuring costs, the group's turnaround initiatives are progressing well. Moreover, the operational and financial consequences of the malware attack that the group experienced in early 2020 have gradually abated; ISS has remedied the disruption caused by the incident and strengthened its cyber defense. This, in conjunction with a higher topline that fed through to profitability, allowed the group to post an S&P Global Ratings-adjusted EBITDA margin of 4.9% in 2021, having been negative in 2020. We expect margins to further improve to about 6.0%-6.5% by 2022, as the turnaround plan bears fruit.

We expect credit metrics to strengthen over our 12-month forecast horizon. The recovery of the revenue base and ISS' margin-supportive strategic direction have boosted the group's credit metrics in 2021, with debt to EBITDA of 4.3x and FFO to debt of 16.8% (from our expectation of debt to EBITDA of 5.8x-6.3x and FFO to debt of 12%-15%). We expect metrics to strengthen further as the group progresses with its strategy and expands organically.

In our view, the group's financial policy supports the 'BBB-' rating. ISS reacted prudently to the pandemic and has suspended shareholder distributions since 2020 to preserve liquidity. Moreover, as part of its new strategic direction, it has initiated a divestment program with a scope of Danish krone (DKK) 2 billion in net disposal proceeds. To date, ISS has signed or completed disposals worth around DKK1.9 billion, with the remainder likely to occur by year-end 2022. We view these financial policy measures favorably, as they support the group's cash flow and underscore its commitment to retain credit metrics at their current level.

Outlook

The stable outlook on ISS reflects that we expect the group to continue to modestly increase revenues, gradually improve profitability, and generate sustainable cash flows, while still exercising prudence around shareholder returns, as it has done during the pandemic.

Downside scenario

We could lower the ratings if shareholder distributions rise significantly, debt levels increase, or ISS' operating performance deteriorates--such that adjusted FFO to debt falls sustainably below 20%.

Upside scenario

We could raise the rating if ISS' operating performance continues to improve--with positive organic growth, additional margin upside, and strong free operating cash flows (FOCF)--resulting in FFO to debt sustained above 30%. An upgrade would also hinge on the group implementing a financial policy consistent with metrics remaining at these levels.

Company Description

Danish based ISS A/S is a facilities service provider with cleaning services at its core. Its other service offerings relate to property (building maintenance and asset life cycle management), catering, support (reception services and mail handling), security, and facilities management. The company operates in more than 30 countries across the globe, recording revenues of DKK71.4 billion.

Our Base-Case Scenario

Assumptions

- Revenue growth of about 2.5% in 2022 amid the fading effects of the COVID-19 pandemic and new contract wins, slightly weighed down by the strategic decision to exit or renegotiate some underperforming contracts, as well as divestments completed up until April 2022.
- S&P Global Ratings-adjusted EBITDA margin of 6.0%-6.5% in 2022, as the topline expansion feeds into EBITDA generation and is further supported by the group's various turnaround initiatives (for which the restructuring expenses have already been largely incurred).
- Capex of about 1.3% of revenue.
- Slightly positive working capital inflow of DKK10 million in 2022, with some DKK100 million in outflows thereafter driven by revenue growth.
- No acquisitions.
- No shareholder distributions until at least 2023.

Key metrics

- S&P Global Ratings-adjusted debt to EBITDA of 2.8x-3.0x in 2022 and 2.3x-2.5x in 2023.
- Our adjusted FFO to debt of 27%-29% in 2022, improving to above 30% in 2023.
- Our adjusted FOCF to debt of 15%-16% in 2022, and 23%-25% in 2023.

Liquidity

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.

We expect principal liquidity sources over the next 12 months will include:

- Unrestricted cash balance of about DKK3.4 billion as of Dec. 31, 2021;
- Undrawn revolving credit facilities of about DKK7.3 billion as of Dec. 31, 2021;
- Cash FFO of about DKK2.2 billion; and
- Working capital inflow of DKK10 million.

We expect principal liquidity uses over the same period will include:

- Debt repayment of about DKK40.5 million,
- Working capital outflow of DKK1.4 billion including the seasonal working capital requirement, and
- Capex of approximately DKK950 million.

Environmental, Social, And Governance

ESG credit indicators: To E-2, S-2, G-1; From E-2, S-4, G-1

Social factors are now a neutral consideration in our credit rating analysis for ISS (compared with negative previously). This is because we no longer expect the pandemic to impair the company's revenue generation and profitability, as ISS customers' employees are increasingly returning to the office. Revenue increased by 2.2% in 2021 and we anticipate that EBITDA margins will recover to 2019 levels in 2022. In addition, the group has remedied the negative operational and financial impact of the malware attack it experienced in 2020. ISS strengthened its IT security and control processes in response, and we do not consider the group to be more exposed to cyber risk than its peers.

Governance factors remain a positive consideration in our credit rating analysis. This is underpinned by very strong operational effectiveness and a consistently delivered strategy aligning with management objectives.

Ratings Score Snapshot

Issuer Credit Rating	**BBB-/Stable/--**
Business risk:	Satisfactory
Country risk	Low
Industry risk	Intermediate
Competitive position	Satisfactory
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)
Stand-alone credit profile:	
Group credit profile	

Issuer Credit Rating	BBB-/Stable/--
Entity status within group	
Related government rating	
Likelihood of government support	
Rating above the sovereign	

Environmental, social, and governance (ESG) credit factors for this change in outlook:

- Health and safety
- Social Capital

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
ISS Finance B.V.	
Senior Unsecured	BBB-
ISS Global A/S	
Senior Unsecured	BBB-

Ratings Affirmed; Outlook Action

	To	From
ISS A/S		
ISS Global A/S		
Issuer Credit Rating	BBB-/Stable/--	BBB-/Negative/--
ISS Finance B.V.		
ISS World Services A/S		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3