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Research

Summary: ISS A/S

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Credit Rating: BBB+/Stable/A-2

□ Rationale

The ratings on Denmark-based facilities services group ISS A/S and wholly owned subsidiary ISS Global A/S reflect the group's above-average business profile, underpinned by its strong business position in an attractive--albeit fragmented and competitive--industry. The ratings are also supported by the group's moderate financial profile. At Sept. 30, 2004, the group had interest-bearing net debt (including estimated operating lease obligations) of about Danish krone (Dkr) 10.6 billion (€1.4 billion).

With sales of Dkr36 billion in 2003, 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 experience 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, especially in Europe and Asia. Most acquisitions are smaller and bolt-on, but there have also been medium-sized to larger ones. For example, at the beginning of August 2004, ISS acquired Engel Group Ltd., a leading player in the Finnish facility service market. 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 facility service business, operating profit margins are relatively low. For the first nine months of 2004, ISS' operating margin (before depreciation and amortization, not adjusted for operating leases) was 7.0%, almost unchanged from 7.1% in the corresponding period in 2003.

Standard & Poor's assessment of the group's financial profile as moderate is based largely on the group's ability to generate high levels of free operating cash flows. Of these, however, most are likely to continue to be consumed by further acquisitions. ISS' cost base is flexible, and there is little need for working capital or capital expenditure.

Overall, lease-adjusted credit measures are expected to remain broadly in line with the ratings. At year-end 2003, the group's operating cash flow (after working capital and capital expenditure) to net debt was strong at about 26%, funds from operations to net debt 39%, and EBITDA net interest coverage 6.3x. Ratios are, however, expected to be lower for 2004, reflecting the higher acquisition activity in the year.

Liquidity.

ISS' liquidity is strong and benefits from good cash flow generation and adequate committed banking facilities (of which Dkr7.8 billion was unused at Dec. 31, 2003). The group also had about Dkr2.3 billion of cash and short-term investments at the end of September 2004, while short-term debt was about Dkr1.2 billion. The group has raised equity for acquisitions in recent years. It also intends to extend the debt

maturity profile through a proposed 10-year benchmark bond (expected to be at least €500 million), to be issued under its €2 billion EMTN program. The notes are expected to be used to repay existing debt. As a strong cash generator, the group could deleverage relatively quickly if required by slowing its rate of acquisitions.

□ **Outlook**

The stable outlook reflects Standard & Poor's expectation that ISS' business conditions should remain steady, and is underpinned by the group's ability to generate strong cash flow. The ratings allow flexibility for acquisitions, assuming ISS maintains its financial profile.

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