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Research Update:

French Facility Services Provider La Financiere Atalian Affirmed At 'B'; Outlook Negative

May 29, 2020

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Rating Action Overview

- La Financiere Atalian, which generated revenue of over €3 billion in 2019, continues to improve its operational performance and remains on a positive deleveraging trend.
- Atalian's S&P Global Ratings-adjusted debt at end-2019 amounted to €1.5 billion, and we anticipate its adjusted debt to EBITDA strengthen toward 8x in 2020.
- We are therefore affirming our 'B' ratings on Atalian and its senior unsecured notes.
- The negative outlook points to our assumption that Atalian's deleveraging, although improving, is still slower than anticipated since the Servest acquisition in 2018.

Rating Action Rationale

Atalian's operations are likely to suffer COVID-19 disruptions throughout peak months in 2020. We expect the company to see the largest disruption to operations during May and June 2020 as a result of services being delayed or postponed due to global governments' lockdown measures. We consequently expect revenues will be less than in 2019. That said, Atalian's EBITDA will likely benefit this year, primarily from the continued realization of the past years' cost-saving measures, contract extensions, and improved product mix as a result of COVID-19

Slower-than-anticipated deleveraging could create rating pressure. While the company has seen slower-than-expected deleveraging than our initial assumptions at the time of the 2018 Severest acquisition, its debt metrics continue to signal improvements from a peak of 11x S&P Global Ratings-adjusted debt to EBITDA in 2018. We expect the company will deleverage toward 8x for financial year 2020, which is somewhat hindered by slightly lower EBITDA compared with the budget given the COVID-19 fallout. We note the new management's strong focus on improved cash generation, improved operational performance, and steady deleveraging. In addition, we expect funds from operations (FFO) to debt to strengthen toward 7.5% in 2020 and free operating cash flow (FOCF) to debt to improve to 2%. These credit metrics will remain commensurate with our 'B' rating.

We foresee no near-term liquidity pressures. Management expects to generate sufficient cash to support the business over the coming months and as operations continue to ramp up in post lockdown period. The company has numerous available sources to uphold its liquidity position, including availability under its factoring lines, and cash on balance sheet of €106 million as at end-March 2020 and continued focus on working capital management. We also note that management has leaned on government support measures, such as the delay in tax payments and furlough where available. Moreover, we understand Atalian has applied for a PGE loan to further bolster its liquidity profile and expects it to be signed in the coming weeks.

Outlook

The negative outlook points to our assumption that Atalian's deleveraging, although improving, is still slower than anticipated since the Servest acquisition in 2018.

Downside scenario

We could lower the rating on Atalian if it's operating performance was weaker than anticipated throughout 2020. This would result in slower EBITDA growth than anticipated and material negative working capital outflows, leading to negative FOCF at year-end. In addition, we could lower the rating if we forecast that leverage would remain above 7.5x beyond 2021, if coverage of cash interest by FFO declines below 2x, or if we observe a deterioration in the company's liquidity.

Upside scenario

We could revise the outlook to stable if adjusted debt to EBITDA improved toward 7x, while FOCF strengthened while maintaining adequate liquidity.

Company Description

Atalian is a leading provider of outsourced cleaning and facility management services in Europe with over 32,000 clients (corporates and local authorities) and more than 137,000 employees worldwide. Atalian started in France in 1944 as a cleaning company, then diversified into broader facility management services, and expanded abroad from 1999, expanding first in Central and Eastern Europe, then South East Asia, Africa, the U.S. (with the acquisition of Temco in 2016) and the U.K. with the acquisition of Servest in 2018. In 2019, the group reported revenue of over €3 billion.

Our Base-Case Scenario

Assumptions

- An 8.0% GDP contraction in France in 2020, with a rebound to 6.1% in 2021. We expect a similar trend in both the U.K. and U.S., with a negative GDP of 6.5% and 5.2% respectively in 2020, then bouncing back to 6.0% and 6.2%.
- Revenue to decline by about 7% in 2020, year over year because of postponed or delayed cleaning during the lockdown. We expect growth to recover, particular to more specialized

cleaning services, in the latter half of 2020 and into 2021, given more cleaning and sanitization will likely be required following this pandemic.

- A change in product mix toward specialized cleaning services and higher-margin contracts, as well as benefit from cost-saving will likely support absolute EBITDA growth and therefore increase our margin projection to about 90bps year over year.
- Capital expenditure of about 1.4% of revenue, in line with 2019. We expect this will revert to about €50 million in the years thereafter.
- Working capital outflow of about €40 million per year, excluding factoring.
- No acquisitions.
- Dividends of about €5 million-€6 million from 2021.
- No proceeds from divestment of non-core assets.

Key metrics

Based on these assumptions, we arrive at the following credit measures:

- S&P Global Ratings-adjusted debt to EBITDA around 8.0x at year-end 2020, improving to about 7.2x in 2021.
- Adjusted FFO to debt of about 7.4% at end-2020, then improving to around 8.5% in 2021.
- FOCF to debt of about 2% in 2020, improving to about 3% by 2021.

Liquidity

We assess Atalian's liquidity as adequate, with sources of cash forecast to exceed uses by more than 1.2x over the next 12 months. The absence of debt maturities until the revolving credit facility (RCF) matures in 2023, alongside the likely imminent signing of the PGE loan, further supports our liquidity assessment. We understand that the group also has €225 million factoring facility (recourse and non-recourse) available for liquidity purposes (not included in the covenant calculation) with availability of more than €70 million at this time, but we do not include this facility in our liquidity assessment. Principal liquidity sources over the next 12 months:

Principal liquidity sources over the next 12 months:

- About €106 million cash on-balance-sheet, as of March 31, 2020;
- A fully drawn RCF facility as at March 31, 2020;
- FFO of about €90 million;

Principal liquidity uses:

- Capex of about €40 million;
- Working capital outflows of €40 million, excluding factoring.
- No returns to shareholders in 2020, in line with the French State PGE directive.
- Litigation payment of €5 million to the Department of Education.
- Deferred payment expenses as at March 2020 of approximately €30 million.

Covenants

The RCF documentation includes a maximum 1.75x net secured leverage ratio, tested on June 30 and December 31 of each year. The leverage ratio was 0.53x at Dec. 31, 2019, therefore we anticipate that the company will maintain ample headroom under the covenant.

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue ratings on the €625 million 4% senior unsecured notes due 2024, €350 million 5.125% senior unsecured notes due 2025, and £225 million 6.625% senior unsecured notes due 2025 are 'B'. The '4' recovery rating on the bonds remains constrained by their unsecured nature, as well as the existence of prior-ranking liabilities: A €163 million factoring facility, that we assume 50% utilized at default, a €103 million secured RCF, and other minor bank borrowings. We expect recovery prospects of 30% for the bonds in the event of a default.
- Under our hypothetical default scenario, we assume a combination of loss of market shares and margin contraction due to heightened competition and economic slowdown in Europe, in particular in the French and U.K. markets.
- We value the company as a going concern, based on its diverse customer base, strong market positions in France and internationally, and the asset-light nature of the business.

Simulated default assumptions

- Year of default: 2022
- Jurisdiction: France

Simplified waterfall

- Emergence EBITDA: €129 million (minimum capex at 1.5% of three-year average sales; cyclicality adjustment of 5% is standard for the Business Services sector; 5% operational adjustment.)
- Multiple: 5.5x (in line with industry-average multiple)
- Gross enterprise value (EV) at emergence: €707 million
- Net EV after administrative expenses (5%): €671 million
- Priority liabilities (factoring, PGE and RCF): €164.2 million*
- Total collateral value available for senior unsecured debt: €507 million
- Estimated senior unsecured debt claims at default: €1.26 billion*
- Recovery expectation: 30%-50% (rounded estimate: 30%)

*Includes six months of prepetition interest and an 85% drawn RCF.

Ratings Score Snapshot

Issuer Credit Rating: B/Negative/--

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed	
La Financiere Atalian SAS	
Issuer Credit Rating	B/Negative/--
Senior Unsecured	B
Recovery Rating	4(30%)