Research Update:

France-Based Caterer Sodexo S.A. Outlook Revised To Stable On Continued Recovery; 'BBB+' Rating Affirmed

July 6, 2022

Rating Action Overview

- Sodexo's operations continue to benefit from the rebound in volumes and improving EBITDA margin during the fiscal year ending Aug. 31, 2022 (fiscal 2022), and we expect the company will maintain stable credit metrics in fiscal 2023.
- We forecast S&P Global Ratings-adjusted debt to EBITDA at about 3x and funds from operations (FFO) to debt of about 25% in fiscal 2022, with modest improvements anticipated in the coming years.
- We revised the outlook on Sodexo to stable from negative, affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on the company, and affirmed our 'BBB+' issue rating on its senior unsecured debt.
- The stable outlook indicates that improving volume growth and margins should support continued strong cash flow generation to achieve FFO to debt of about 25% in fiscal 2022 and sustain it above this level thereafter.

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Rating Action Rationale

Sodexo's decent performance continued into the third quarter of fiscal 2022 and the easing of pandemic-related restrictions in most markets supports the outlook revision. Organic growth recovery continues across all business subsegments and geographical regions because the easing of restrictions, particularly across Europe and U.S., has supported a stronger rebound in business and administrative services, especially in the sports and leisure and corporate segments. The growth in facility management has supported the slower recovery in the food business, which has now reached about 90% of 2019 revenue, and new commercial wins should support continued recovery toward 2019 revenue levels in fiscal 2023. The effects of the pandemic are not fully over, with some isolated lockdowns, particularly in China, affecting Q3 revenue. However, we expect the company will achieve decent growth in fiscal 2022, supporting an improvement in FFO to debt to about 25% from 22% in fiscal 2021 and continued leverage reduction toward 3.0x from 3.5x over the same period, which supports our revision of the outlook to stable.

Management continues to address the inflation environment. Although inflation pressure could constrain margins in the coming year, it should also drive growth. Sodexo is well positioned to pass on the increasing cost base, with the U.S. market comprising more than 40% of cost-plus contracts, the U.K. utilizing its indexation clauses, and retail sales contributing to about 20% of profit and loss contracts. We expect management will engage in further negotiations and initiatives at localized levels. Operational efficiencies as a result of the "GET" efficiency program, continued improvement in scale, higher financial revenue from the benefits and rewards (BRS) business, and the abovementioned contract structure and management initiatives should also mitigate the rising effects of food costs and inflationary pressure on Sodexo's business.

The BRS business remains a strategic part of Sodexo. The company is no longer exploring a potential minority sale of the BRS business and thinks it can strategically grow this business with continued organic and inorganic investment. BRS is an integral contributor to Sodexo's EBITDA generation and continued tailwinds in this sector should support the company's overall performance into the coming years. Although the company may increase investments to support this business via capital expenditure (capex) and smaller bolt-on acquisitions, we expect this will largely be offset by improved scale and stronger margins that can help sustain credit metrics.

We expect credit metrics and liquidity to remain relatively stable in the coming years. Although macroeconomic conditions remain challenging and Sodexo's management continues to adjust to market dynamics, we expect it should be able to sustain FFO to debt above 25% in the coming years. Our adjusted debt includes about €200 million of pension- and guarantee-related liabilities, about €940 million of leases, and about €200 million debt at parent company Bellon S.A., given that dividend distributions from Sodexo are Bellon's sole source of repayment. We expect ongoing EBITDA recovery and solid free cash generation of more than €700 million, offsetting the higher shareholder activities that we incorporate in dividend payments (about 50%-65% of the prior year's net income). We anticipate greater acquisition spend of about €400 million-€500 million per year in the coming years.

Outlook

The stable outlook reflects our expectation that continued rebound in volumes and improved margin generation from its GET operational efficiency program will support FFO to debt of about 25%, which we expect Sodexo to sustain in the coming years.

Downside scenario

We could lower the ratings if Sodexo witnessed further operational disruption, resulting in lower-than-anticipated EBITDA or cash generation such that FFO to debt dropped below 25% on a prolonged basis or leverage was sustained above 3.5x.

In addition, credit metrics could also weaken if the company undertook more shareholder-friendly actions than we expect or the amount of debt held at Bellon materially increased.

Upside scenario

Although unlikely in the short term, we could raise our rating on Sodexo if it sustained FFO to debt comfortably above 30% and debt to EBITDA of 2.5x or below. We could also consider raising the ratings if the company made a sustained improvement in operations and follows a firm financial policy commitment to sustain these credit metrics.

Company Description

Sodexo is one of the world's largest service providers, offering more than 100 services, including food services, reception, maintenance, cleaning, and facilities and equipment management. It also provides services and programs to boost employee engagement and simplify and optimize mobility and expense management, as well as in-home assistance, child-care centers, and concierge services. It has operations across 56 countries, with more than 412,000 employees. It is one of the largest private employers worldwide, and serves 100 million consumers each day through onsite, personal and home, and benefits and rewards services.

The company reported revenue of €17.4 billion in fiscal 2021 and is listed on the CAC NEXT 20, CAC 40 ESG, FTSE4Good, and DJSI indices. Its largest shareholder is the Bellon family, with 42.8% of equity and 57.2% of voting rights as of Aug. 31, 2021.

Our Base-Case Scenario

Assumptions

- Revenue increase of more than 15% in fiscal 2022 and 8% in fiscal 2023 due to continued rebound in activities. Solid commercial momentum to minimize the impact of continued working from home, along with price pass-through, should support this growth in the coming years. We expect Sodexo will continue making bolt-on acquisitions to support about a third of this growth in fiscal 2023.
- We expect the adjusted EBITDA margin will improve to about 6.5% in fiscal 2022 from 5.6% in fiscal 2021, with continued growth momentum into fiscal 2023 as nonrecurring costs ease and the company sustains operational improvements to generate an approximate 7% margin in this period. We anticipate some inflationary pressures during fiscal 2023, although we think there could be further upside to adjusted margins if management can mitigate these pressures with cost pass-through and renegotiations.
- Capex to sales of 2.6% of revenue.
- Modest working capital outflow of about €75 million in fiscal 2022.
- Dividend distributions of about €260 million in fiscal 2023 increasing to about €400 million in fiscal 2024 based on about 65% of the prior year's net income.
- Bolt-on mergers and acquisitions of €400 million-€500 million.
- We have also assumed debt at Bellon will remain relatively stable at about €200 million, which we incorporate in our adjusted debt.

Key metrics

Sodexo SA--Key Metrics*

	--Fiscal year ending Aug. 31--				
	2020a	2021a	2022e	2023f	2024f
(Mil. €)					
Revenue growth (%)	(12.0)	(9.8)	~15.5	~8.0	~5.0
EBITDA margin (%)	5.1	5.6	~6.5	~7.0	~7.5
Capital expenditure	398	296	~450	~550	~600
Funds from operations/debt (%)	14.8	22.2	~25.0	25.0-28.0	25.0-28.0
Debt to EBITDA (x)	4.2	3.5	~3.0	~3.0	~3.0
Free operating cash flow to debt (%)	5.6	20.1	~9.0	~13.0	~14.0

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We view Sodexo's liquidity as exceptional. We expect liquidity sources will exceed uses by 2.0x and that net sources would remain positive even if EBITDA declined by more than 50%. We also consider that the company's strong standing in both domestic and overseas financial markets support its liquidity.

We expect principal liquidity sources over the 12 months from Feb. 28, 2022 will include:

- Unrestricted cash, cash equivalents, and short-term investments of about €2.6 billion;
- Unused revolving credit facility of about €1.3 billion; and
- Cash FFO of about €800 million.

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

- Minimal additional net investment in working capital of about €50 million;
- Capex of about €500 million;
- Dividends of about €280 million-€350 million over the coming 24 months;
- About €120 million relating to a French competition authority fine and the residual impact on the deferred payments from fiscal 2021; and
- Repayment of maturing debt of about €77 million.

Environmental, Social, And Governance

ESG credit indicators: To E-2, S-3, G-1; From E-2, S-4, G-1

We now consider social factors as only moderately negative in our credit rating analysis. We see strong recovery in revenue and cash flow because the effects of pandemic-related restrictions are falling away and demand for catering services in sporting and other venues has resumed. Nonetheless, the moderately negative assessment indicates that new virus variants could result in new restrictions in the short term. More generally, we think the sector will remain sensitive to health and safety issues.

Governance factors are a positive consideration. This is underpinned by our view of senior management's deep expertise in managing global operations, which are subject to currency effects and a track record of implementing operational efficiency programs to improve margins.

Issue Ratings - Subordination Risk Analysis

We rate Sodexo's debt in line with the issuer credit rating of 'BBB+', given that all of its debt is unsecured and there are no elements of significant subordination risk in its capital structure.

Ratings Score Snapshot

Issuer Credit Rating	**BBB+/Stable/A-2**
Business risk	Strong
Country risk	Low
Industry risk	Intermediate
Competitive position	Strong
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	Positive (+1 notch)

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Health and safety

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		
Sodexo S.A.		
Senior Unsecured	BBB+	
Commercial Paper	A-2	
Sodexo Finance DAC		
Commercial Paper	A-2	
Sodexo Inc.		
Senior Unsecured	BBB+	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Sodexo S.A.		
Sodexo Inc.		
Sodexo Finance DAC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2

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