

Interview: Sodexho

Strategic focus on profitable growth

MICHEL LANDEL, CHIEF EXECUTIVE OFFICER OF SODEXHO ALLIANCE. At its Annual Meeting, the food services company reaffirmed its commitment to profitable growth. During the next few years, it should benefit from accelerated organic growth in revenues and improved margins.

"We want to generate 7% organic growth within the next two to three years"

In the first quarter of fiscal 2006 (which ends on August 31), Sodexho Alliance reported organic growth in revenue of 5.1%. What's your full-year target?

In fiscal 2005-2006, we expect organic growth to accelerate, ending the year between 4.5% and 5%. We want to continue expanding in our food services business while strengthening our capabilities in facilities management and speeding our development in Service Vouchers and Cards. To achieve these goals, we're focusing on three key areas: retaining clients through our Clients For Life® program, increasing sales at our existing sites and attracting new clients.

You have operations in 76 countries. How are your various regional markets evolving?

In North America, we've enjoyed very solid growth in the Healthcare and Seniors segment. In Continental Europe, the Healthcare segment is also growing very fast, while the Corporate Services segment continues to improve, especially in France, Spain and Germany. In the United Kingdom, revenues in the first quarter showed positive growth for the first time in three years, rising 1.4%. We foresee an increase for the full fiscal year, but it's still a little early to say how big it will be. Lastly, in fast growing markets like China, India and Russia, we expect to continue to see double-digit revenue increases.

For the full fiscal year, you forecast an increase in EBIT of 5 to 6%. Aren't you being too prudent?

No, I think we're being realistic. We're pursuing our development to achieve our medium-term growth objectives and improve our margins. In line with these goals, we're continuing to invest not only in our Clients For Life® program but also in our information systems, sales teams and employee training.

In first quarter 2005-2006, revenues in the Corporate Services segment were down slightly in North America. What's the outlook for this market?

In the Corporate Services segment in the United States, we've refused to get involved in the price war that has been going on for several years. Even if we've sometimes lost market share, profitable growth is our strategic priority. We're continuing to broaden our offering and expand our range of services on existing sites, and we hope to see a return to growth in the segment within two to three years.

In the United States, your presence is especially strong in the southern part of the country, which was very hard hit by hurricanes last September...

Reopening dates and enrollment figures are still uncertain for some of the universities. For fiscal 2005-2006, these hurricanes are expected to reduce revenues by \$30 million and EBITA by \$5-10 million.

With the deployment of troops to Iraq, your contract with the US Marine Corps has been less profitable than forecast. How are your negotiations coming along?

Our discussions are continuing in a very positive atmosphere. The client is very satisfied with our services and we have excellent relations with the Marines. Thanks to the experience we've acquired

over the past three years, we're very well positioned to bid for other contracts, with the US government having announced its intention to continue outsourcing services for the other branches of the military. With the Marine, we're very confident that we can reach an agreement that is satisfactory to both parties. However, the timing for reaching an agreement is not something we control.

What are your long-term objectives for organic revenue growth?

Our goal is to generate 7% organic growth within the next two to three years. We've set a client retention rate objective of 95% for fiscal 2007-2008, compared with 93.3% at present.

Your debt to equity ratio is down to 27%. Don't you think you could be more generous with your shareholders?

The dividend voted by shareholders represents a payout rate of 60% (excluding US litigation), which is among the highest for listed companies. We continue to derive competitive advantage from our business model and our ability to generate cash flow. We then reinvest this cash flow in human resources and IT systems, and use it to pay down debt and compensate our shareholders.

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1951. Born in Morocco.

1975. Graduates from the European Business School in Paris.

1984. Joins Sodexo as operating manager for Eastern and North Africa.

1989. Appointed to head Sodexo's North American operations.

September 2005. Appointed Chief Executive Officer of Sodexo Alliance.

"Profitable growth is our strategic priority"

Our analysis: Expected acceleration in revenue and earnings growth

Sodexo Alliance's Annual Shareholders Meeting on January 31 at the Palais des Congrès in Paris went smoothly. The 14 resolutions were approved, with an average 97.3% of the votes cast. Hardly surprising, since the diversified food services provider's share price has soared by nearly 69% since December 31, 2004.

The Company's repeated earnings warnings now seem to be a thing of the past and Michel Landel has turned in a faultless performance since being named Chief Executive in September 2005. (Founder Pierre Bellon still serves as Chairman of the Board).

Judging from the market's positive reaction to Sodexo's first quarter 2005-2006 revenue figures, investors like the outlook for faster revenue growth and improved earnings. The Company foresees organic growth of 7% two to three years from now, compared with an estimated 4.5 to 5% for 2005-2006.

Margins are also expected to improve and the market feels that senior management may be overly prudent in forecasting a 5 to 6% increase in EBITA for fiscal 2005-2006. In the United Kingdom in particular, the recovery that began in the first quarter of 2005-2006 is expected to continue.

More generally, Compass, the other food services giant, has decided to sell certain assets following a drop in its margins in the UK. It has also been accused of a number of irregularities regarding certain contracts signed with the United Nations. Sodexo Alliance's management feels that these factors will put the market on a healthy footing and lead to an end of the price war in certain regions. All of these developments are expected to support Sodexo Alliance's margins.

Lastly, the Company has an especially healthy balance sheet. At August 31, its debt to equity ratio had declined to 27%, from 41% and 52% at the end of the two previous fiscal years. This should enable the Company either to make acquisitions or to be more generous with its shareholders.

Our recommendation

The share is currently trading at 20 times fiscal 2005-2006 earnings per share. Given Sodexo Alliance's leadership position and prospects for faster growth in revenue and earnings, we still rate it a buy with a price target of €44.

Technical analysis

The share's upward trend over the past several months should enable it to reach €40 and eventually €41.50. On a day-to-day basis, the RSI lacks vigor but remains above the rising trend line.