S&P Global Ratings

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Research Update:

Sodexo Downgraded To 'BBB+' On Slower Recovery From COVID Disruption; Outlook Negative

April 7, 2021

Rating Action Overview

- Pandemic-related restrictions continue to weigh on Sodexo S.A.'s performance, and we now anticipate a phased recovery, where it will take until fiscal 2024 (year-ending Aug. 31, 2024) for the company's funds from operations (FFO) to debt to return comfortably above 30%.
- At the end of fiscal 2021, we expect Sodexo's debt to EBITDA (leverage) will remain above 4x on an S&P Global Ratings-adjusted basis, with FFO to debt below 20%, but we expect both metrics will continue to improve in the coming years.
- We are therefore downgrading Sodexo to 'BBB+/A-2' from 'A-/A-1', and lowering our issue rating on its unsecured debt to 'BBB+' from 'A-'.
- The negative outlook reflects that there remains high uncertainty about the timing of the catering market's recovery, and we could downgrade Sodexo if its credit metrics take longer to recover than we expect.

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Rating Action Rationale

We expect Sodexo's credit metrics will take until fiscal 2024 to rebound to pre-pandemic levels. Given ongoing pandemic-related restrictions across some of Sodexo's geographies and business segments--in particular offices, sports and leisure, and universities--we now expect more muted growth for the company in the second half of fiscal 2021. Following a 12% revenue decline and a 30% reduction in S&P Global Ratings-adjusted EBITDA in fiscal 2020, we forecast continued top-line pressure in fiscal 2021 with revenue decreasing about 10% and a minimal decline in absolute EBITDA, despite margin improvement year over year. That said, we expect a small improvement in FFO to debt in fiscal 2021, however remaining below 20%, and we expect leverage will remain elevated above 4x before a phased recovery in fiscals 2022-2024. The prolonged impact from the pandemic will likely push recovery of credit metrics out by one year, and we do not expect FFO to debt will rebound comfortably above 30% until fiscal 2024.

The pandemic has had a mixed impact across Sodexo's business segment, but margins have been supported by both cost initiatives and furlough schemes. The health care and seniors segment has remained largely resilient over the past year, supported primarily by a new contract for rapid testing in the U.K. and improved customer retention in North America. The business and administration (B&A) and education segments continue to see improvements quarter over quarter, but we expect revenue will remain below pre-pandemic levels in fiscal 2021 by about 30% for B&A and 60% for education. Overall, we expect the company's margins will continue to improve following Sodexo's implementation of its Global Effectiveness and Transformation program, with much of this margin benefit expected during fiscal 2022. This, coupled with a rebound in volumes should result in an S&P Global Ratings-adjusted EBITDA margin of 6.9% at fiscal year-end 2022, which is 90% of pre-pandemic margins.

We do not expect any pressure on Sodexo's exceptional liquidity following repayment of its U.S. private placement (USPP) notes. Sodexo is no longer bound by financial covenants and has strong financial flexibility, following the prepayment of its USPP notes in August 2020. The company's substantial cash on balance sheet of about €2.2 billion as of half-year fiscal 2021 and full availability under its revolving credit facility support our exceptional liquidity assessment. This is despite the cash reversal of a number of nonrecurring items, including government-deferred payments, a fine for anti-competitive behavior, the impact of its cost-saving initiatives, and the planned resumption of dividend distributions in the coming 12-24 months.

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

- Health and safety

Outlook

The negative outlook reflects that there remains high uncertainty about the timing of the catering market's recovery, and increased risk of a further downgrade if Sodexo's credit metrics do not recover at the pace we expect due to a prolonged impact from the pandemic.

Upside scenario

We could consider revising the outlook to stable if FFO to debt rebounds toward 25% and Sodexo continues deleveraging. We expect that a quicker containment of COVID-19, improved EBITDA margin, or lower levels of shareholder-friendly activity could support this rebound.

Downside scenario

We could lower the ratings if we anticipate that the pandemic will have a longer-term impact on the company, resulting in FFO to debt remaining below 25% on a prolonged basis. We expect this could result from a slower rebound in volumes due to continued restrictions across geographies and limited capacity at events for an extended period of time.

Company Description

Sodexo is one of the world's largest service providers offering over 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 64 countries, with over 420,000 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 €19.3 billion in fiscal 2020 and is included in the CAC 40 ESG , CAC Next 20, FTSE4Good, and DJSI indices.

Our Base-Case Scenario

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Assumptions

- Negative growth of about 10% in 2021 with a minimal level of inorganic growth. We expect a rebound in 2022 of about 12% of which 10% is supported by increased volumes as pandemic-related restrictions ease and the remainder by inorganic growth. In the coming years, we expect growth of 5%-7%.
- S&P Global Ratings-adjusted EBITDA margins to increase about 30 basis points (bps) in 2021, followed by a strong rebound in 2022 to about 6.9% as volumes improve.
- Strong cash management, particularly in the onsite business to support minimal working capital obligations, following the reversal of deferred-government payments.
- Capital expenditure (capex) increasing gradually toward 2.5% of revenue per year in coming years, but we expect capex will be largely in line with the prior year in fiscal 2021.
- Sodexo will use internally generated funds as the main financial pillar for mergers and acquisitions and shareholder remuneration. We forecast minimal acquisitions in 2021, but an increase to €200 million in 2021. We forecast a return to dividends in 2021 at the lower end of 50%-60% of the prior year's net income, amounting to about €70 million in 2022.

Key metrics

- S&P Global Ratings-adjusted debt to EBITDA to remain above 4.0x at fiscal year-end 2021, improving toward 3x by 2022.
- Adjusted FFO to debt of about 17% at end-2021, then improving to about 25% in 2022.
- Discretionary cash flow to debt of about 7% in 2021, improving to about 12% by 2022.

Liquidity

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

We estimate that principal liquidity sources over the next 12 months include:

- Unrestricted cash, cash equivalents, and short-term investments of about €2.2 billion;
- Unused, committed credit lines of about €1.7 billion; and
- Cash FFO, adjusted for finance leases, of about €550 million.

For the same period, we estimate that principal liquidity uses include:

- Minimal additional net investment in working capital;
- Capex of about €400 million;
- Dividends of about €60 million-€80 million, over the coming 24 months.
- €128 million relating to a French competition authority fine; and
- Repayment of maturing debt of about €636 million.

Dent maturities

On Feb. 28, 2021:

- One year: €636 million
- One-to-five years: €1,502 million
- Thereafter: About €2,880 million

Covenants

Following the repayment of the USPP debt in August 2020, the company is no longer bound by financial covenants.

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+/Negative/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)
- Liquidity: Exceptional (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Strong (no impact)
- Comparable ratings analysis: Positive (+1 notch)

Related Criteria

- 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
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded

	To	From
Sodexo S.A.		
Sodexo Inc.		
Sodexo Finance DAC		
Issuer Credit Rating	BBB+/Negative/A-2	A-/Negative/A-1
Sodexo S.A.		
Senior Unsecured	BBB+	A-
Commercial Paper	A-2	A-1
Sodexo Finance DAC		
Commercial Paper	A-2	A-1