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## Sodexo

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### Table Of Contents

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Rationale

Outlook

Standard & Poor's Base-Case Scenario

Company Description

Business Risk: Strong

Financial Risk: Intermediate

Liquidity

Covenant Analysis

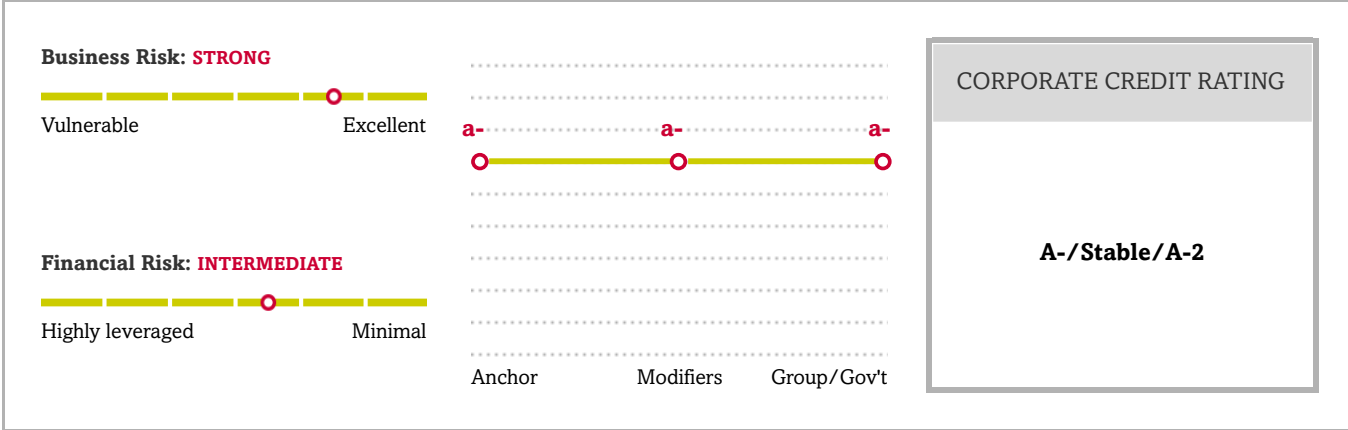
Other Credit Considerations

Ratings Score Snapshot

Reconciliation

Related Criteria And Research

# Sodexo



## Rationale

Business Risk: Strong	Financial Risk: Intermediate
<ul style="list-style-type: none"> <li>• Leading provider of integrated services, including facilities management, catering, and benefits and rewards.</li> <li>• Diversified client base and geographic coverage.</li> <li>• High visibility on cash flow generation given elevated retention rates and multi-year contracts.</li> <li>• Limited price flexibility and modest operating margins in the On-site Services business.</li> <li>• Somewhat cyclical revenues from its Corporate and Remote Sites segments, and exposure to fluctuations in food prices.</li> </ul>	<ul style="list-style-type: none"> <li>• Strong recurring free cash flow generation stemming from the inherent low capital intensity of the business and structural working capital inflows, combined with the service voucher business' cash float.</li> <li>• Reliance on customer prepayments in the voucher activity.</li> <li>• Lower shareholder returns relative to peers.</li> </ul>

**Outlook: Stable**

Standard & Poor's Ratings Services' stable outlook reflects our view that France-headquartered global food and facilities management service provider Sodexo will continue to deliver a resilient operating performance, despite a likely challenging operating environment over the next 18 months. Under our base case, we expect the company's adjusted funds from operations (FFO) to debt to stay about 40%, with acquisition spending and shareholder returns remaining moderate.

**Downside scenario**

We could consider a negative rating action if the company undertook significant net debt-financed acquisitions during fiscal year 2015 ending Aug. 31., resulting in adjusted FFO to debt falling below 30%. We would also likely lower our rating if severe headwinds in France or Latin America weakened the operating performance or, less likely, the company adopted a more aggressive shareholder returns policy than currently.

**Upside scenario**

We could consider a positive rating action if Sodexo sustainably strengthened its financial risk profile, posting adjusted FFO to debt of about 45% on a sustainable basis. If we saw the company meet its 2015 margin objectives, coupled with targeted acquisitions and consistent shareholder returns, we could consider a positive rating action. However, given Sodexo's stated financial policy and leverage targets, we view this possibility as remote.

**Standard & Poor's Base-Case Scenario**

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>Revenue growth in the low single digits in 2015, given our expectations of modest trading conditions and potentially adverse foreign exchange swings.</li> <li>A gradual improvement in operating margins, reflecting the ongoing benefits of the company's efficiency program.</li> <li>No further nonrecurring cash outlays for restructuring.</li> </ul>		<b>2014</b>	<b>2015e</b>	<b>2016e</b>
	Organic growth (%)	2.3	2-4	2-4
	Operating margin (%) *	5.3	5.3-5.7	5.5-5.8
	FFO to debt (%) *	40.1	40-45	40-45
e—Estimate. *Standard & Poor's adjusted metrics.				

**Company Description**

France-headquartered Sodexo is one of the world's largest services providers (with over 100 services), with revenues at just over €18 billion in the 12 months ended Aug. 31, 2014. The group derives the bulk of its revenues from its On-site Services (OSS) activity that spans from delivering food and facilities management services (such as reception, landscaping, or air conditioning maintenance) to corporates, educational and health institutions, and public authorities.

The Benefits and Rewards Services (BRS) activity offers all sizes of companies and public sector services vouchers, cards or other digital solutions for use by their employees or citizens to pay for items such as food, gasoline, child care costs, and employee incentives.

## Business Risk: Strong

### A global leader that is withstanding increasingly tougher operating conditions

Sodexo continues to retain its strong market leading position despite sluggish global growth, low inflation, and persistent uncertain operating conditions in some emerging markets. In OSS, the company has built a strong presence in North America (38% of revenues in 2014) and it's the largest player in a number of European countries (together 40%). It also has limited, but expanding, operations in the Asia-Pacific region and Latin America (together 18%), with a size comparable to that of its largest food services competitor, U.K.-based Compass Group PLC. In addition, the company is the second largest service voucher issuer globally (4% of revenues, but 28% of operating profit before corporate eliminations) after France-based Edenred S.A.

Sodexo's client base adds to the diversity of its earnings, with 32,700 sites through its food and facilities management business and 425,000 clients through its voucher business. None of its contracts account for more than 2% of total sales. Although contracts generally do not have a fixed maturity and can be terminated with three months' notice, Sodexo's average contract duration is more than ten years, and the company's retention rate has consistently stood at well above 90%. These strengths are tempered somewhat by the cyclical revenues from the corporate segment (especially the profitable Remote Sites business). Furthermore, the company is exposed to fluctuations in food prices and salary inflation (in emerging countries), with contracted pass-through clauses that may prove difficult to apply to customers.

### S&P Base-Case Operating Scenario

In our view, the group will deliver a resilient operating performance in 2015 and 2016 because of new contracts and better trading conditions in North America, the U.K., and Ireland. However, this will be somewhat mitigated by continuing difficult market conditions in continental Europe. While we recognize the group has started to benefit from its €160 million cost savings program, we do not yet fully incorporate the improvement in operating margins to the targeted 6% level in our base case given the slow economic recovery in Europe.

### Peer comparison

Table 1

Sodexo: Peer Comparison - Facilities Services				
(Mil. €)	Sodexo	Compass Group PLC	ISS A/S	Edenred S.A.
Rating as of March 19, 2015	A-/Stable/A-2	A/Stable/--	BBB-/Stable/--	BBB+/Stable/A-2
--Average of past three fiscal years--				
Revenues	18,216.3	21,371.6	10,536.9	1,043.7
EBITDA	1,348.2	2,078.4	835.9	406.0
Funds from operations (FFO)	902.2	1,598.8	400.3	253.6
Net income from cont. oper.	484.7	791.8	(60.8)	169.0
Cash flow from operations	921.7	1,601.1	430.4	372.3

**Table 1**

<b>Sodexo: Peer Comparison - Facilities Services (cont.)</b>				
Capital expenditures	264.7	551.7	129.1	45.7
Free operating cash flow	657.0	1,049.4	301.3	326.6
Discretionary cash flow	398.3	533.1	301.3	139.6
Cash and short-term investments	623.9	422.7	34.2	256.0
Debt	2,156.0	3,129.4	4,136.8	513.3
Equity	3,093.3	3,259.0	507.5	(1,214.6)
<b>Adjusted ratios</b>				
EBITDA margin (%)	7.4	9.7	7.9	38.9
Return on capital (%)	18.1	21.3	8.1	(56.4)
EBITDA interest coverage (x)	6.6	13.7	2.5	8.3
FFO cash int. cov. (x)	6.8	17.6	2.5	7.8
Debt/EBITDA (x)	1.6	1.5	4.9	1.3
FFO/debt (%)	41.8	51.1	9.7	49.4
Cash flow from operations/debt (%)	42.7	51.2	10.4	72.5
Free operating cash flow/debt (%)	30.5	33.5	7.3	63.6
Discretionary cash flow/debt (%)	18.5	17.0	7.3	27.2

## Financial Risk: Intermediate

### Robust, cautiously reinvested cash flow generation

The stability and low capital intensity of the sector make Sodexo's business model very cash flow generative. Over the period 2009-2014, reported free operating cash flow (FOCF) has averaged about 4% of revenues, or €0.7 billion. The company's financial solidity is also underpinned by management's conservative financial policy in terms of liquidity and shareholder returns, which are calibrated by operating performance. Given that we expect the pay-out ratio to be at the top-end in 2015, we assume that shareholder returns might be less moderate going forward. Besides, we believe that its very wide market reach creates potential for bolt-on, debt-financed acquisitions to complement organic growth. In addition, we note that the company reported €1.6 billion of operating cash from its BRS business, compared with €2.5 billion of outstanding vouchers at year-end 2014. We believe this mismatch between available cash for BRS and the voucher liability could be a weakness in Sodexo's balance sheet if growth in issue volumes turns negative.

### Financial summary

**Table 2**

<b>Sodexo: Financial Summary - Facilities Services</b>					
<b>--Fiscal year ended Aug. 31--</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>(Mil. €)</b>					
Revenues	18,016.0	18,397.0	18,236.0	16,047.0	15,230.0
EBITDA	1,310.5	1,242.5	1,491.7	1,264.0	1,149.0
Funds from operations (FFO)	845.1	811.8	1,049.8	870.6	761.0
Net income from continuing operations	490.0	439.0	525.0	451.0	409.0

**Table 2**

<b>Sodexo: Financial Summary - Facilities Services (cont.)</b>					
Cash flow from operations	923.1	725.3	1,116.6	942.6	1,091.0
Capital expenditures	245.0	241.0	308.0	242.0	236.0
Free operating cash flow	678.1	484.3	808.6	700.6	855.0
Discretionary cash flow	412.1	221.3	561.6	471.6	640.0
Cash and short-term investments	696.7	589.1	585.9	588.4	612.5
Debt	2,106.2	2,158.3	2,203.4	1,898.5	2,186.6
Equity	3,221.0	2,990.0	3,069.0	2,565.0	2,739.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	7.3	6.8	8.2	7.9	7.5
Return on capital (%)	17.7	16.1	20.7	19.2	17.4
EBITDA interest coverage (x)	6.6	6.3	6.8	6.8	6.3
FFO cash int. cov. (x)	6.6	5.9	7.9	7.3	6.7
Debt/EBITDA (x)	1.6	1.7	1.5	1.5	1.9
FFO/debt (%)	40.1	37.6	47.6	45.9	34.8
Cash flow from operations/debt (%)	43.8	33.6	50.7	49.7	49.9
Free operating cash flow/debt (%)	32.2	22.4	36.7	36.9	39.1

### S&P Base-Case Cash Flow And Capital Structure Scenario

We expect Sodexo's cash flow to be in line with an intermediate financial risk profile as reflected by our forecast of FFO to debt at about 40% and adjusted debt to EBITDA at about 1.6x, based on our following assumptions:

- Capital expenditure (capex) lower than 2% of revenues annually;
- Acquisitions of slightly more than €0.3 billion per year; and
- Dividends to be at the top end of the company's pay-out range in 2015, at about 56%.

### Liquidity: Strong

The 'A-2' short-term rating reflects Sodexo's sizable cash balances, strong FOCF generation, and large availability under its committed credit lines. We view Sodexo's liquidity as "strong," as defined under our criteria. We anticipate that its sources of funding should cover its needs by at least 1.5x in the 12 months following group 2014 results (fiscal year ended Aug. 31).

Principal Liquidity Sources	Principal Liquidity Uses
<p>On Aug. 31, 2014, Sodexo's near-term liquidity sources included:</p> <ul style="list-style-type: none"> <li>• Net cash and cash equivalents of close to €3 billion (excluding €415 million restricted cash tied to the vouchers segment);</li> <li>• Unused committed credit lines of just below €1 billion available until July 2018, given the exercise of extension options; and</li> <li>• Forecasted cash FFO of about €770 million for 2015, by our estimates.</li> </ul>	<p>These sources compare favorably with the company's potential liquidity uses of below €2.8 billion over the 12 months to August 2015, comprising:</p> <ul style="list-style-type: none"> <li>• Short-term debt of about €1 billion (including the repayment of the €880 million bond due January 2015);</li> <li>• Capex of about €300 million;</li> <li>• Our expectations of outflows on account of acquisitions of more than €300 million;</li> <li>• Seasonal working capital requirement of about €600 million;</li> <li>• Dividend payment of about €300 million; and</li> <li>• Share repurchase of €50 million.</li> </ul>

### Debt maturities

On Aug. 31, 2014, pro-forma the refinancing of the €880 million bonds due in January 2015

- 1 Year: €105 million.
- 1-2 Years: €225 million.
- 2-3 Years: €10 million.
- 3-4 Years: €409 million.
- 4-5 Years: €169 million.
- Thereafter: €2,082 million.

### Covenant Analysis

While there are no covenants attached to its syndicated facilities, Sodexo's U.S. private placements have standard maintenance covenants, including for net assets and net leverage, which leave the company with substantial headroom.

### Other Credit Considerations

We derive our 'a-' rating on Sodexo from:

Our anchor of 'a-', based on our "strong" business risk and "intermediate" financial risk profile assessments for the company. We assess that the modifiers have no impact on the rating outcome, given the rating category of the anchor.

## Ratings Score Snapshot

### Corporate Credit Rating

A-/Stable/A-2

### Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Strong

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: a-

### Modifiers

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

## Reconciliation

Table 3

Reconciliation Of Sodexo Reported Amounts With Standard & Poor's Adjusted Amounts										
(Mil. €)	--Fiscal year ended Aug. 31, 2014--									
	Debt	Shareholders' equity	Revenues	EBITDA	Operating inc.	Interest expense	EBITDA	Cash flow from ops	Div. paid	Capex
Sodexo reported amounts	3,913.0	3,189.0	18,016.0	1,183.0	933.0	161.0	1,183.0	825.0	266.0	245.0
Standard & Poor's adjustments										
Interest expense (reported)	--	--	--	--	--	--	(161.0)	--	--	--
Interest income (reported)	--	--	--	--	--	--	20.0	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(288.0)	--	--	--
Operating leases	332.5	--	--	123.5	24.9	24.9	98.6	98.6	--	--
Post-retirement benefit obligations/deferred compensation	241.0	--	--	(6.0)	(6.0)	11.7	(17.5)	(0.5)	--	--



Table 3

Reconciliation Of Sodexo Reported Amounts With Standard & Poor's Adjusted Amounts (cont.)										
Surplus cash	(2,394.3)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	28.0	--	--	28.0	--	--	--
Dividends received from equity investments	--	--	--	12.0	--	--	12.0	--	--	--
Non-operating income (expense)	--	--	--	--	34.0	--	--	--	--	--
Non-controlling Interest/Minority interest	--	32.0	--	--	--	--	--	--	--	--
Debt - Guarantees	14.0	--	--	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	--	(30.0)	(30.0)	--	(30.0)	--	--	--
Total adjustments	(1,806.8)	32.0	0.0	127.5	22.9	36.6	(337.9)	98.1	0.0	0.0

#### Standard & Poor's adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capex
Adjusted	2,106.2	3,221.0	18,016.0	1,310.5	955.9	197.6	845.1	923.1	266.0	245.0

Capex - Capital Expenditure

## Related Criteria And Research

### Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19,
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	<b>a-/bbb+</b>	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

## Ratings Detail (As Of March 19, 2015)

### Sodexo

Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	A-

### Corporate Credit Ratings History

20-Feb-2014	<i>Foreign Currency</i>	A-/Stable/A-2
18-Feb-2013		BBB+/Positive/A-2
06-Dec-2004		BBB+/Stable/A-2
20-Feb-2014	<i>Local Currency</i>	A-/Stable/A-2
18-Feb-2013		BBB+/Positive/A-2
06-Dec-2004		BBB+/Stable/A-2

### Related Entities

#### Sodexo Inc.

Issuer Credit Rating	A-/Stable/A-2
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\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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