Research Update:

Sodexo S.A. Affirmed At 'BBB+/A-2' On Solid Operating Performance And Credit Metrics; Outlook Stable

February 17, 2023

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Rating Action Overview

- France-based caterer Sodexo S.A. should comfortably maintain S&P Global Ratings-adjusted ratios of funds from operations (FFO) to debt of 36%-37% and debt to EBITDA of 2.2x-2.3x in the next 12-24 months, particularly thanks to the previous fiscal year's stronger-than-anticipated performance and faster-than-expected deleveraging.
- However, we do not exclude the possibility of debt-funded acquisitions or increased shareholder returns, as per Sodexo's stated leverage target.
- We affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings Sodexo and our 'BBB+' issue rating on the company's senior unsecured debt.
- The stable outlook reflects our expectation that, over the next 12-24 months, Sodexo will generate strong cash flow and solid credit metrics, including adjusted FFO to debt comfortably above 25%.

Rating Action Rationale

We assume Sodexo's ongoing sound operating performance and healthy cash flow will enable the group to sustain S&P Global Ratings-adjusted credit metrics comfortably within the thresholds for our 'BBB+' rating. Sodexo delivered better-than-expected operating performance in the fiscal year ended Aug. 31, 2022, positioning the company to enter fiscal 2023 with increased rating headroom. According to our estimates, the group will maintain adjusted FFO to debt of 36%-37% and adjusted debt to EBITDA of 2.2x-2.3x over the coming two years. The growth momentum that we observed in the first quarter of fiscal 2023 should continue in both on-site services and benefits and rewards services (BRS) throughout the year and in fiscal 2024, albeit at a slower pace. Performance will be bolstered by the group's focus on client retention as well as its ability to win new contracts in underpenetrated markets and thanks to offers adapted to increased work from home. We also believe growth will stem from the company's cross-selling opportunities across catering and facility management services; continued price increases to pass through cost inflation; and the increasing contribution from Entegra, the group's purchasing organization. This will in turn drive moderate improvements in margins and free operating cash flow (FOCF). That said, we assume higher capital expenditure (capex) to support such growth will somewhat constrain cash flow. The overall favorable developments prompted us to positively reassess Sodexo's financial risk profile as intermediate from significant.

Nevertheless, the possibility of sizable debt-funded transactions or higher shareholder returns weighs on our view of Sodexo's creditworthiness. Sodexo's reported net debt to EBITDA was close to 1x at the end of fiscal 2022, signaling that the group would have flexibility for material debt-funded acquisitions or higher dividends under its stated net leverage target of 1x-2x (equivalent to about 2x-3x as adjusted by S&P Global Ratings). The group has not indicated any near-term plans for such measures. At this time, however, we do not regard the group's financial policy commitment as supportive of a higher rating, which would imply maintaining an adjusted debt to EBITDA at 2.5x or below and adjusted FFO to debt comfortably above 30% on a sustainable basis.

Our rating factors in the BRS business as a strategic part of Sodexo. BRS is an important contributor to Sodexo's EBITDA, and continued tailwinds in the benefits and rewards sector should further support the company's overall performance over the coming years. Moreover, we expect BRS' organic growth and planned investments will drive improvements in scale and margins that will help sustain credit metrics. In particular, the group plans to moderately increase capex to 10% of sales by fiscal 2025, from 9.1% in fiscal 2022, and continue to make bolt-on acquisitions in this market.

Outlook

The stable outlook reflects our expectation that Sodexo will continue to generate strong cash flow and deliver stable credit metrics in the next 12-24 months, including FFO to debt comfortably above 25%.

Downside scenario

We could lower the ratings if Sodexo undertook more shareholder-friendly actions than we expect or the amount of debt held at Bellon materially increased, such that FFO to debt dropped below 25% on a prolonged basis or leverage stayed above 3.5x.

Additional rating pressure could stem from a weakening in credit metrics if Sodexo experienced operational disruption that resulted in materially lower-than-anticipated EBITDA or cash generation.

Upside scenario

We could raise our ratings if Sodexo maintained FFO to debt comfortably above 30% and debt to EBITDA of 2.5x or below, alongside a tighter financial policy commitment to sustain these credit metrics.

Company Description

Sodexo is one of the world's largest service providers, offering food services, reception, maintenance, cleaning, and facilities and equipment management, among its more than 100 services. It also runs programs to boost employee engagement and simplify and optimize mobility, as well as in-home assistance and concierge services, reaching a total of 200 million consumers each day. It operates in 53 countries, with more than 422,000 employees, making if one of the largest French private employers worldwide. The company reported revenue of €21.1 billion in fiscal 2022.

Sodexo 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 57.5% of voting rights as of Aug. 31, 2022.

Our Base-Case Scenario

Assumptions

- Stagnating GDP growth in Europe and the U.S. in 2023, then picking up to about 1.5% in both regions in 2024.
- CPI inflation slowing to 4.3% in the U.S. in 2023, from 8.1% in 2022, then moderating to 2.7% in 2024. We expect CPI inflation to remain elevated in Europe in 2023, at about 6.5% (down from 9.0% in 2022), before reducing toward 2.0% in 2024.
- Revenue increase of about 10% to €23.2 billion in fiscal 2023, moderating to 5%-6% in fiscal 2024, with solid commercial momentum minimizing the impact of continued working from home, coupled with price increases. We expect Sodexo will continue to make bolt-on acquisitions contributing about a third of this growth.
- Moderate improvement in EBITDA margin to 7.5%-7.7% in fiscal 2023, from 7.4% in fiscal 2022, underpinned by volume growth, cost inflation pass-through and operating efficiencies.
- Capex to sales of 2.6%-2.7% of revenue in fiscal 2023, compared with 2.3% in fiscal 2022.
- Modest working capital outflow of about €50 million per year.
- Dividend distributions of about €350 million in fiscal 2023, increasing to €370 million-€390 million in fiscal 2024, based on about 50% of the prior year's net income.
- Bolt-on mergers and acquisitions of €400 million per year.
- We have also assumed debt at Bellon will remain relatively stable at about €75 million, which we incorporate in our adjusted debt calculation.

Key metrics

- S&P Global Ratings-adjusted FFO to debt of 36%-37% in fiscals 2023 and 2024, compared with 39.7% in fiscal 2022;
- Adjusted debt to EBITDA of 2.2x-2.3x in fiscals 2023 and 2024, from 2.1x in fiscal 2022; and
- Reported FOCF after lease payments of €490 million-€510 million in fiscal 2023 and €570

million-€590 million in fiscal 2024, compared with €482 million in fiscal 2022.

Liquidity

We view Sodexo's liquidity as exceptional, based on our estimate that 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 24 months from Nov. 30, 2022 will include:

- Unrestricted cash, cash equivalents, and short-term investments of about €2.4 billion;
- Unused revolving credit facility of about €1.3 billion; and
- Cash FFO of €1.1 billion-€1.3 billion per year.

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

- Minimal additional net investment in working capital of about €50 million;
- Capex of €600 million-€650 million per year;
- Dividends of €350 million-€400 million per year; and
- Repayment of maturing debt of about €500 million in January 2024.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-3, G-1

We consider social factors as moderately negative in our credit rating analysis. We have seen strong recovery in revenue and cash flow as the effects of pandemic-related restrictions have subsided and demand for catering services in sporting and other venues has resumed. Nonetheless, the moderately negative assessment reflects our view that 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:	Intermediate
Cash flow/leverage	Intermediate
Anchor	a-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Exceptional (no impact)
Management and governance	Strong (no impact)
Comparable rating analysis	Neutral (no impact)

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

Related Research

- Sodexo's Strong Full-Year Results Increase Rating Headroom, Nov. 25, 2022

Ratings List

Ratings Affirmed	
Sodexo S.A.	
Sodexo Inc.	
Sodexo Finance DAC	
Issuer Credit Rating	BBB+/Stable/A-2
Sodexo S.A.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Sodexo Finance DAC	
Commercial Paper	A-2
Sodexo Inc.	
Senior Unsecured	BBB+