S&P Global Ratings

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Research Update:

Food Service Provider Elior Group Downgraded To 'B' On Delayed Improvements In Profitability; Outlook Negative

June 14, 2023

Rating Action Overview

- French food service provider Elior Group S.A. has struggled to convert solid organic growth into improved profitability amid high inflation and difficult contract renegotiations.
- It completed its acquisition of the multiservices business from Derichebourg S.A. in April 2023, and we now anticipate that Elior's pro forma leverage will be about 6.7x in 2023, its funds from operations (FFO) to debt will remain below 10% and that free operating cash flow (FOCF) after lease payments will be negative by €60 million.
- Because we expect covenant headroom to tighten by the end of March 2024, we revised down our assessment of liquidity to less than adequate. We have also lowered to 'B' from 'B+' our ratings on Elior and the group's senior unsecured notes.
- The negative outlook indicates that we could downgrade Elior again if the group is unable to improve its operating margins and so suffers sustained negative cash flows, a deterioration in liquidity, or tightening covenant headroom.

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Rating Action Rationale

S&P Global Ratings expects Elior's operating margins to remain significantly below pre-pandemic levels in 2023. From October 2022 to March 2023, the group saw significant cost inflation as in most of the countries in which it operates. Contract renegotiations in France also proved difficult--the group secured price increases totaling €283 million a year from March 31, 2023, but this will not fully offset the impact of increased costs on its operating margins. Nevertheless, the group reported earnings before interest, taxes, and amortization (EBITA) to net revenue of 1.7% in the first half of fiscal 2023, which represents a significant year-on-year improvement. In the same period last year, EBITA was negative. That said, Elior achieved a significant part of the improvement in absolute EBITA by exiting the loss-making preferred meals business. We consider underlying profitability at its existing catering contracts to be lower than expected.

In our view, further improvements to profitability are likely to come from the restructuring, reorganization, and efficiency measures that the group is implementing. However, some initiatives take time to implement and the group operating efficiency initiatives may not offer it a short-term benefit. In addition, consumer price indexes (CPI) tend to lag inflation so the slowdown in inflation is unlikely to reduce Elior's costs during 2023. At the same time, sluggish GDP growth in all of the group's markets suggests a higher risk of delays to operating performance recovery for Elior. Although we still forecast a significant improvement in S&P Global Ratings-adjusted EBITDA margins (to 3.7%-3.9% in 2023 from 1.3% in 2022), we do not expect this to be enough to enable the group to reduce leverage to a level commensurate with a 'B+' rating. Pro forma the 12-month contribution from the Derichebourg multiservices (DMS) business, we now forecast that adjusted leverage will be 6.7x in 2023--our previous forecast was 5.6x-5.8x. We also project that FOCF after leases will be negative by about €60 million, compared with our previous expectation of negative €15 million. Beyond the fiscal year ending Sept. 30, 2023, we consider that margin recovery and cash flow improvement will depend on the successful integration of the DMS operations. This is predicted to generate about €30 million in synergies by the end of fiscal 2026. In our view, integrating the DMS operations carries potential execution risks, as do the recent changes to management and governance at the group level.

We now assess the group's liquidity as less than adequate because we anticipate that covenant headroom will be tight on March 31, 2024. In December 2022, with support from its lenders, Elior obtained a covenant waiver that loosened the net leverage ratio that the group will have to comply with on Sept. 30, 2023, to 6.0x. In March 2024, the covenant ratio will revert to 4.5x. Given that we forecast covenant headroom will only be about 10% on March 31, 2024, there is limited room for underperformance. That said, the group's liquidity position is supported by a largely undrawn revolving credit facility (RCF) which had €300 million available as of March 31, 2023, of a total of €350 million. It also had a positive cash balance at the end of the first half of fiscal 2023 and relatively low capital expenditure (capex) requirements, estimated at 1.7%-2.0% in the next 12 months. The group also benefits from committed securitization facilities.

Outlook

The negative outlook indicates that we could downgrade Elior if the group's operating margins do not improve in line with our base case, resulting in sustained negative cash flows, a deterioration in liquidity, or tightening covenant headroom.

Downside scenario

We could lower the rating if the recovery in Elior's margins and cash flow were further delayed by persistently high cost inflation; weaker demand for its services related to macroeconomic uncertainty; or higher-than-expected costs associated with the group's restructuring initiatives or its integration of DMS. Specifically, we could lower the rating if:

- FOCF after leases remained negative in fiscal 2024, with no prospect of near-term recovery;
- FFO cash interest coverage remained below 2.0x; or
- Liquidity and covenant headroom tightened further.

If the recovery in operating margins were slower, this could also indicate to us that the company's business risk profile was deteriorating.

Upside scenario

We could revise the outlook to stable if the group's profitability improved such that leverage reduces, FOCF after leases turns positive, and covenant headroom sustainably improves.

Company Description

Founded in 1991, France-based Elior is a leading global operator in contract catering and support services. It offers services targeted at three key client markets: corporate entities and government agencies (business and industry), education establishments, and health care and leisure facilities. The group has leading positions in five key countries, employs about 97,000 people, feeds over 3 million people in 20,250 restaurants every day, and offers support services at 2,400 sites in France. The group generated €4.45 billion in revenue in fiscal 2022. It is listed on Euronext Paris.

Our Base-Case Scenario

Assumptions

- Muted GDP growth in most of the group's markets in 2023--0.4% in France, 1.1% in Spain, 0.4% in Italy, and 0.7% in the U.S.--and a GDP decline of 0.5% in the U.K. In 2024, GDP growth of 1.2% in France, 1.6% in Spain, 1.0% in Italy, 1.5% in the U.K., and 1.2% in the U.S.
- In 2023, CPI growth to remain elevated at 5.4% in France, 4.6% in Spain, 5.8% in the U.K., 4.7% in the U.S., and 2.3% in Italy. In 2024, CPI growth to be 2.3% in France, 3.2% in Spain, 1.4% in the U.K., 2.4% in the U.S., and 2.3% in Italy.
- Revenue growth of about 15% in fiscal 2023, comprising stand-alone revenue growth of about 5.5% (including the negative impact of exiting the preferred meals business) and a five-month contribution from DMS of €410 million-€420 million. Growth is supported by gradual post-pandemic recovery, price increases from the contract negotiations, and steady retention rates of above 90%. In fiscal 2024, organic revenue growth is predicted to be steady at 4%-5%, supported by the full-year contribution of DMS, bringing total revenue growth to 15%-17%.
- Adjusted EBITDA margins of 3.7%-3.9% in fiscal 2023, from 1.3% in fiscal 2022. Input cost inflation will continue to weigh on margins through fiscal 2023, and will not be fully passed through, despite contract renegotiations. Further pressure arises from restructuring costs associated with reorganizing operations and integrating DMS.
- EBITDA margins to exceed 5% in fiscal 2024, as cost inflation slows significantly and Elior reaps the benefits of its contract renegotiations and contractual indexation, the termination of loss-making contracts, and reduced exceptional costs.
- Capex of about €87 million (1.7% of revenue) in fiscal 2023 and about 2.0% of revenue afterward.
- Working capital outflows of about €20 million each year.
- No material acquisition in the next two years.

- No dividend payments until fiscal 2025.

Forecast summary

Elior Group S.A.--Forecast summary

Industry sector: Facilities services

	--Fiscal year ended Dec. 30--					
(Mil. €)	**2019a**	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**
Revenue	4,923	3,967	3,690	4,451	5,113	5,959
EBITDA (reported)	280	4	91	68	198	326
Plus: Operating lease adjustment (OLA) rent	67	--	--	--	--	--
Plus/(less): Other	(19)	(24)	(6)	(11)	(2)	(2)
EBITDA	328	(20)	85	57	196	324
Less: Cash interest paid	(70)	(24)	(33)	(49)	(68)	(72)
Less: Cash taxes paid	(24)	(11)	(6)	(14)	(11)	(28)
Plus/(less): Other	21	19	11	9	--	--
Funds from operations (FFO)	255	(36)	57	3	116	224
Free operating cash flow (FOCF)	189	(37)	(12)	(108)	(16)	56
Debt (reported)	584	783	927	1,071	1,071	1,041
Plus: Lease liabilities debt	276	250	246	199	199	173
Plus: Pension and other postretirement debt	87	80	79	48	48	48
Less: Accessible cash and liquid Investments	(68)	(26)	(80)	(64)	(28)	(15)
Plus/(less): Other	295	233	209	223	223	257
Debt	1,174	1,320	1,381	1,477	1,513	1,504
FOCF (adjusted for lease capex)	118	(85)	(89)	(160)	(72)	19
Cash and short-term investments (reported)	83	41	80	64	28	15
Adjusted ratios						
Debt/EBITDA (x)	3.6	(66.0)	16.2	25.9	7.7	4.6
FFO/debt (%)	21.7	(2.7)	4.1	0.2	7.7	14.9
FFO cash interest coverage (x)	4.6	(0.5)	2.7	1.1	2.7	4.1
FOCF/debt (%)	16.1	(2.8)	(0.9)	(7.3)	(1.0)	3.7

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. Capex--Capital expenditure. 2023 forecast metrics include the consolidation of the Derichebourg multiservices (DMS) business from the acquisition closing date, and are not pro forma.

Liquidity

We assess Elior's liquidity position as less than adequate, despite sources of liquidity exceeding uses by more than 1.2x over the next 12 months. The assessment is constrained by the group's expected tight covenant headroom as of March 31, 2024.

We estimate that Elior's liquidity sources over the 12 months from March 31, 2023, will be:

- Unrestricted cash on balance sheet of about €45 million;
- €300 million available under the committed €350 million RCF; and
- Unadjusted cash FFO after lease payments of €105 million-€110 million.

We estimate that Elior's liquidity uses over the same period will include:

- Capex of €100 million-€105 million;
- Working capital outflows of €60 million-€70 million, including intrayear fluctuations; and
- €28 million for the first amortization of the French state-guaranteed loan (PGE) in October 2023.

Covenants

Under the group's senior facilities agreement, and following the waiver agreement in December 2022, Elior will have to comply with a net leverage covenant of 6.0x on Sept. 30, 2023, reducing to 4.5x from March 2024 and beyond. We expect Elior's covenant headroom for Sept. 30, 2023, will be adequate (above 15%) but that it will tighten to about 10% as of March 31, 2024.

Environmental, Social, And Governance

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

Governance factors remain a moderately negative consideration in our credit rating analysis of Elior, reflecting our view that management failed to anticipate and mitigate operational risks that have significantly affected the group's profitability and cash flows in the past two years. This includes the group's:

- Inability to rapidly adjust the cost base in light of reduced volumes because more people are working from home post-pandemic;
- Delayed actions to mitigate high input cost inflation, which reduced the EBITDA margins to 1.3% in 2022, compared with 2.3% in 2021;
- Tightening covenant headroom, as reflected in the negotiation of several covenant waivers since 2020; and
- Given the recent changes in management and governance, we will closely monitor if the corrective actions being implemented improve the group's operating performance and, ultimately, its credit strength.

Social factors remain a moderately negative consideration in our credit rating analysis of Elior. The group's revenue has recovered to about 95% of pre-pandemic levels as the effects of pandemic-related restrictions fade away and demand for catering services at business and corporate clients returns. Nevertheless, our moderately negative assessment reflects our view that the sector remains sensitive to health and safety issues, and that any virus variant resulting in renewed social distancing measures or increased absenteeism at corporate restaurants or school canteens could have a significant impact on the group's operating performance and credit metrics.

Issue Ratings - Recovery Analysis

Key analytical factors

- We lowered to 'B' from 'B+' our issue rating on Elior's €550 million senior unsecured notes, in line with the rating action on the issuer credit rating. The recovery rating is unchanged at '3', reflecting our expectation of meaningful recovery (50%-70%, rounded estimate: 55%) in the event of a payment default. Recovery prospects are supported by our valuation of the company as a going concern but constrained by the group's significant amount of prior-ranking liabilities.
- Besides the senior unsecured notes, the group has unrated debt facilities. These include a €100 million senior unsecured term loan and a €350 million RCF, which rank pari passu with the notes. Elior also raised a €225 million state-guaranteed loan in March 2021, which will amortize by 25% a year from October 2023 to March 2027. Elior Group also has about €360 million of securitization facilities, and drawings under its bank overdraft facility. We assume 60% of the securitization facilities would be drawn at the time of default and consider these claims to be priority liabilities.
- In our hypothetical default scenario, we assume a payment default in 2026, following a prolonged deterioration in economic conditions, including high inflation, which would reduce demand for Elior's products as its clients cut costs and consumers reduce discretionary spending.
- We value Elior as a going concern, given its strong market position, resilient business model, good geographic diversification, and asset-light structure.

Simulated default assumptions

- Year of default: 2026
- Jurisdiction: France

Simplified waterfall

- Emergence EBITDA: €155 million
- Multiple: 5.5x
- Gross enterprise value at emergence: €853 million
- Net enterprise value after administrative expenses (5%): €810 million
- Priority liabilities: €217 million (mainly comprising the assumed drawing under the securitization facilities and bank overdraft facilities).
- Collateral value available to senior secured debt: €593 million
- Estimated senior unsecured debt claims: €1,026 million*
- --Recovery expectation: 50%-70% (rounded estimate: 55%)

*Includes six months of prepetition interest.

Ratings Score Snapshot

Issuer credit rating	B/Negative/--
Business risk:	Fair
Country risk	Low
Industry risk	Intermediate
Competitive position	Fair
Financial risk:	Highly leveraged
Cash flow/leverage	Highly leveraged
Anchor	b
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Less than adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	b
Group credit profile	bb+
Entity status within group	Nonstrategic

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: Recovery Rating Criteria For Speculative-Grade Corporate Issuers , Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments , Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers , Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , 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

- Elior Group 'B+' Rating Affirmed On Expected Gradual Profitability Improvement And Announced Acquisition; Outlook Stable, Feb. 8, 2023
- French Food Service Provider Elior Group Downgraded To 'B+' On Slower-Than-Expected Recovery; Outlook Stable, May 25, 2022

Ratings List

Downgraded

	To	From
Elior Group S.A.		
Issuer Credit Rating	B/Negative/--	B+/Stable/--
Elior Group S.A.		
Elior Participations S.C.A		
Senior Unsecured	B	B+
Recovery Rating	3(55%)	3(55%)