RATING ACTION COMMENTARY

Fitch Rates Elior Group S.A. 'B+'; Outlook Positive

Wed 23 Oct, 2024 - 13:29 ET

Fitch Ratings - Paris - 23 Oct 2024: Fitch Ratings has assigned Elior Group S.A. (Elior) a Long-Term Issuer Default Rating (IDR) of 'B+'. The Outlook is Positive. Fitch has also assigned its 2026 senior unsecured notes a 'B+' rating with a Recovery Rating of 'RR4'.

Elior's 'B+' IDR reflects our analytical approach for a stronger parent (Derichebourg S.A., BB+/Stable, owning 48% of the share capital) and a weaker subsidiary (Elior). Fitch applies a bottom-up assessment in accordance with its Parent and Subsidiary Linkage (PSL) Criteria with a single-notch uplift from Elior's Standalone Credit Profile (SCP) of 'b'.

Elior's ratings are constrained by currently weak credit metrics, including high leverage and limited free cash flow (FCF) generation over the next 12-18 months. They also reflect a robust business profile with a strong position in the French catering market and meaningful scale, as well as improved business diversification following the acquisition of Derichebourg Multi Services (DMS) in 2023. Its diverse contract base results in low customer churn and moderate revenue and earnings stability across economic cycles.

The Positive Outlook reflects Fitch's expectation of an improvement in credit metrics over the next 12-18 months as strengthening profitability helps increase FCF and reduce Fitch-adjusted EBITDA leverage to 5.5x. This may support an upgrade in the next 12-18 months, assuming Elior maintains a solid business profile and a stable relationship with Derichebourg.

KEY RATING DRIVERS

Robust Business Model: Elior's SCP of 'b' is underpinned by its robust business model owing to its strong position in the French catering market, a large contract base and a diverse customer pool with low churn rates. The addition of DMS increases business diversification away from the sole catering business with the multi-services segment representing 28% of revenue in the last 12 months to March 2024. It also provides scope for future growth through cross-selling.

PSL Approach, Stronger Parent: In applying its PSL Criteria, Fitch assesses the legal and operational incentives for Derichebourg to support Elior as 'Low' and the strategic incentive as 'Medium'. This reflects the material asset value Elior represents for Derichebourg, leading to an overall bottom-up approach where Elior's 'b' SCP is lifted by one notch to its 'B+' IDR. We will monitor the evolving relationship between the parent and subsidiary. In case of diminishing strategic importance of Elior for Derichebourg we may assess Elior on a standalone basis, which may lead to the removal of the one-notch uplift above its SCP.

Recovering Profitability: We estimate Fitch-adjusted EBITDA margin to have reached 3.6% in FY24 (year-end to September) and to further strengthen to above 4% after FY25. This represents a meaningful increase from FY20-FY23 levels and will be key in driving Elior's FCF and leverage to levels that are commensurate with a 'b+' SCP, as underlined in its Positive Outlook.

The improvement follows the exit of non-profitable contracts undertaken in the last 18 months, and the full impact from integrating the more profitable DMS. Elior has also been working on optimising its catering cost structure to adapt to changing customer needs, particularly in the business & industry segment.

Rapid Deleveraging Expected: Fitch expects rapid deleveraging, as a result of continued recovery and profitability improvements. We forecast Fitch-adjusted EBITDA leverage to decline to 6.5x in FY25 and 5.5x in FY26, from a high 7.3x estimated at FYE24. We see manageable execution risk, as most of the profitability improvement measures relate to contract renegotiation and its cost structure has been updated. We expect good retention rates to be maintained with its main customers across catering and multi-services. Deleveraging 0.5x a year until FY28 may support an upgrade in the next 12-18 months, as signaled by the Positive Outlook.

Stabilising FCF: We expect Elior to return to moderate FCF generation in the next 12-18 months, which should further strengthen in excess of EUR50 million a year or around 1% of revenues from FY26. This will be driven by improving profitability and contained capex under its asset-light business model. The consolidating FCF profile comes after years of negative FCF during the pandemic followed by years of high inflation. Stabilising FCF is a critical factor behind an upgrade. Conversely, persistently neutral-to-negative FCF could weigh on the ratings.

Refinancing Ahead: Elior faces approaching refinancing risk, with its EUR550 million notes due in July 2026. We expect it to address it in the upcoming months after having focused its resources on integrating DMS, profitability recovery and cost-inflation protection measures. While leverage may still be at the high end, Fitch believes Elior is better placed now for this refinancing exercise than it was 18 months ago.

Limited Geographical Diversification: Elior's revenues are concentrated in Europe, at 76% of FY23 net sales (pro-forma for the DMS acquisition). The group has a historical focus on the French market, with around half of its sales generated in the country. This concentration exposes Elior to downturns affecting the region. This is partly mitigated by the group's diverse end-markets.

Strong Market Share, Revenue Visibility: Elior benefits from a strong market share in its key French catering market, at around 32%. We also view positively the group's exposure to different end-markets, such as private businesses, healthcare providers and education companies, which provides some revenue and earnings stability across economic cycles. Elior also has high retention rates (93.6% at end-March 2024 excluding voluntary contract exits) across its diversified customer base with multi-year contracts and its top 10 customers accounting for 12% of FY23 total revenue.

Financial Policy Focuses on Deleveraging: We factor into our rating analysis Elior's focus on deleveraging and on limiting dividend payments until net leverage (as calculated by the group) reaches below 3.0x, which corresponds to a Fitch-defined leverage of below 5.0x. We expect Derichebourg to be supportive of this strategy given the nature of its investments in Elior. Evidence of a more aggressive financial policy undermining the deleveraging of the business will put the ratings under pressure.

DERIVATION SUMMARY

Fitch rates Elior using its Business Services Navigator framework. Elior benefits from a strong position in its core French market and shows reasonable diversification across the catering and multi-service segments.

Elior's closest peer in terms of business profile is Sodexo (BBB+ Stable). The large rating difference is warranted by Elior's lower geographical diversification, much smaller scale and weaker credit metrics overall. Elior is mostly present in Europe (around 76% of its revenue) while Sodexo has a balanced presence across Europe (35% of FY23 revenue), North America (46%) and rest of the world (18%). Elior's leverage is expected to remain above 5.5x over the next 24 months, while Sodexo's is forecast at around 2.5x.

We also compare Elior with other business services providers such as Circet Europe SAS (B+/Positive) and Assemblin Caverion Group AB (B/Stable). Compared with both peers, Elior 'b' SCP reflects a more balanced end-market and geographical mix, but also lower profitability and FCF, as well as higher forecast leverage. The Positive Outlooks for Circet and Elior reflect their deleveraging prospects. Finally, Elior's 'B+' IDR benefits from a one-notch uplift due to the stronger parent in accordance with Fitch's PSL Criteria.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Revenue growth of 15.2% in FY24, followed by mid-single digit growth to FY28

- EBITDA margin of 3.4% in FY24, gradually reaching 4.3% by FY28

- Capex at 2% of revenue over the forecast period

- Working-capital inflow of 0.4% of revenue in FY24 and outflow of 0.1% - 0.3% to FY28

- No dividend payments over the forecast period

- M&A spend of about EUR30 million in FY24 and EUR10million a year to FY28

RECOVERY ANALYSIS

In conducting its bespoke recovery analysis, Fitch estimates that Elior's asset-light business model, in the event of default, would generate more value from a going-concern (GC) restructuring than a liquidation of the business.

We have assumed a 10% administrative claim in the recovery analysis.

Our analysis assumes post-restructuring GC EBITDA of around EUR180 million. We have applied a 5x distressed multiple, reflecting Elior's scale, customer and geographical diversification.

We assume Elior's securitisation programme at around EUR400 million would need to be replaced by alternative funding at distress, ranking senior to its unsecured notes. We also assume a fully drawn EUR350 million revolving credit facility (RCF).

Based on current metrics and assumptions, the waterfall analysis generates a ranked recovery at 42%, corresponding to the 'RR4' band. This indicates a 'B+' instrument rating for the senior unsecured bonds, in line with Elior's IDR.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Loss of contracts leading to a deterioration of Elior's competitive position in its main markets

- EBITDA margins remaining below 3.5%

- Gross debt / EBITDA above 6.5x on a sustained basis

- EBITDA interest cover below 2.0x

- (Cash flow from operations (CFO) less capex)/debt below 1%

- Neutral-to-negative FCF

- A multi-notch downgrade of Derichebourg's rating or weakening of strategic ties with Derichebourg leading to Fitch's assessment of Elior on a standalone basis

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Continued recovery in revenue growth and demonstration of cross-selling capabilities across segments

- Improving profitability leading to EBITDA margins above 4% on a sustained basis

- Gross debt / EBITDA below 5.5x on a sustained basis

- EBITDA interest cover above 3.0x

- (CFO less capex)/debt above 3%

- FCF margins consistently in excess of 1%

LIQUIDITY AND DEBT STRUCTURE

Sufficient Liquidity: Elior had a reported cash position of EUR81 million as of March 2024 and EUR190 million available under its RCF of EUR350 million. In addition, the group has access to a securitisation programme, which provides additional liquidity through receivables financing.

Approaching Debt Maturities: Elior has a senior unsecured bond due in July 2026, an EUR11 million term loan B and an EUR39 million RCF both due in July 2025, and another EUR89 million term loan B and EUR311 million RCF, both due in July 2026.

However, we view refinancing risk as manageable, supported by Elior's improving profitability and FCF generation. We assume timely debt refinancing, albeit at a higher debt cost in our rating case.

ISSUER PROFILE

Elior is an international contract catering and diversified services provider with leading catering market share in France. Its services include cleaning, facility management, electrical and climate engineering, remote surveillance, energy efficiency, public lighting and green spaces.

DATE OF RELEVANT COMMITTEE

14 October 2024

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	RECOVERY ⬍	PRIOR ⬍

Elior Group S.A.	LT IDR B+ Rating Outlook Positive New Rating				WD
senior unsecured	LT	B+	New Rating	RR4	

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Elior Group S.A.	EU Issued, UK Endorsed

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