Research Update:

French Food Service Provider Elior Group Downgraded To 'B+' On Slower-Than-Expected Recovery; Outlook Stable

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Rating Action Overview

- Elior Group's financial metrics will remain significantly affected by pandemic-related headwinds in fiscal 2022 due to the omicron variant, which hit the group's profitability in the first half of the fiscal year, exacerbated by high cost-inflation pressure.
- We anticipate that Elior will not materially deleverage from the very high S&P Global Ratings-adjusted debt to EBITDA of about 16x achieved in fiscal 2021, and that its free operating cash flow (FOCF) will remain significantly negative in fiscal 2022. These metrics should gradually improve in fiscal 2023.
- We therefore lowered our ratings on Elior and the group's senior unsecured notes to 'B+' from 'BB-'.
- The stable outlook indicates that we think the group's revenue and operating margins will recover from the pandemic, supported by Elior taking appropriate measures to manage cost inflation and restore profitability in the coming 12-18 months, resulting in S&P Global Ratings-adjusted debt to EBITDA improving to about 5.5x and funds from operations (FFO) to debt to above 12% in fiscal 2023.

Rating Action Rationale

Extended restrictions associated with omicron weighed heavily on Elior's activities in the first half of fiscal 2022 (starting Oct. 1, 2021), in particular on its education, business, and industry segments. Omicron severely disrupted Elior's operations. Reduced attendance in restaurants due to classroom closures and delayed office returns hit EBITDA margins amid resource-planning challenges stemming from unpredictable demand. Although Elior reported close to 20% revenue growth year-on-year in first-half 2022 (of which 18% organic), the group's EBITA remained negative (minus €16 million), showing only a modest improvement compared with the previous year. The French contract catering business was particularly badly hit because of the more

stringent social-distancing restrictions implemented by the government, while EBITA from international operations turned positive in the first half. We forecast the group's operating environment will nevertheless improve in the second half of 2022, as coronavirus-related restrictions ease and social and economic activities return to normal, including more people going back to the office, which should support demand for Elior's services.

High cost inflation will also weigh on margins despite the group's mitigating actions. Elior is highly exposed to cost inflation and a large proportion of its contracts do not allow for an immediate pass-through of increased costs to customers. The group is negotiating existing contracts to mitigate inflation effects and is also implementing additional cost-saving measures to help restore operating margins--including procurement and selling, general and administrative (SG&A) expenses. The group's broader margin-restoration plan targets the elimination of unprofitable contracts, including the decision to terminate its loss-making Preferred Meals business in the U.S., and adapting the group's production unit footprint to persistently lower demand related to ongoing remote working. While it restructures its operations, we anticipate that the group's margins will remain weak in fiscal 2022 and that it will bear high one-off restructuring costs. Its cost-mitigation and cost-efficiency initiatives will contribute to a significant improvement in EBITDA margins in fiscal 2023, in our view, but we do not foresee a recovery to pre-pandemic levels before fiscal 2024.

Financial metrics will remain weak in fiscal 2022, but we anticipate leverage to improve to about 5.5x and FOCF to turn positive in fiscal 2023. We do not foresee Elior's S&P Global Ratings-adjusted leverage and FFO to debt improving from the very weak levels reported the year before. Moreover, despite the group's efforts to keep capital expenditure at a minimum (below 2% of revenue), FOCF will further deteriorate in fiscal 2022 because of the negative impact from working capital--the group will continue repaying the delayed social charges and value-added taxes that it was able to postpone during the pandemic. However, as the demand for Elior's services continues to rebound in 2023 and cost-inflation mitigations bear fruit, we anticipate the group will be able to post materially positive FOCF in fiscal 2023, which will support deleveraging to about 5.5x.

We expect Elior will maintain adequate liquidity and will face no immediate covenant pressure, having obtained a covenant waiver for the September 2022 test. With the waiver, the next covenant test will now occur based on March 31, 2023 results, with a target leverage of below 7.5x. The covenant then reduces to 4.5x in September 2023. This provides additional time for Elior to turn around its operations, while the group's financial policy continues to focus on cash preservation and deleveraging. As such, we expect the group will only resume dividend payments based on fiscal 2024, and will refrain from making any significant acquisitions until it has restored its credit metrics.

Pandemic-related risks, while diminished, remain. The spread of new coronavirus variants could derail our expected path to recovery for Elior. Our base-case forecast assumes no such events materialize, and that potential hiccups in return-to-office or school attendance will remain limited.

Outlook

The stable outlook indicates that we anticipate the group's revenue and operating margins will recover from the pandemic, supported by Elior taking appropriate measures to manage cost

inflation and restore profitability in the coming 12-18 months, resulting in S&P Global Ratings-adjusted debt to EBITDA improving to about 5.5x and FFO to debt to above 12% in fiscal 2023.

Downside scenario

We could lower the rating if operating conditions remained challenging in fiscal 2023 due to persistently high inflation and margin-restoration initiatives that could result in a larger cash outflow than we expect. Especially, we could lower the rating if:

- We anticipated the group's EBITDA margins will remain well below pre-pandemic level on a prolonged basis;
- We no longer expected Elior to deleverage toward 5.5x and its FFO to debt to increase above 10% on a sustained basis;
- We expected FOCF to remain negative; or
- The group faced heightened liquidity and covenant pressure once it resumes its leverage covenant test from March 2023.

Upside scenario

We could upgrade Elior if sustained positive organic growth combined with EBITDA margin improvement beyond our expectations, on the back of an improved operating environment and successful restructuring measures, resulted in S&P Global Ratings-adjusted debt to EBITDA improving to below 4.5x and FFO to debt to above 16% on a sustained basis.

Company Description

Founded in 1991, France-based Elior Group is a global leading operator in contract catering and support services, offering a broad range of services targeted at three key client markets: corporate entities and government agencies (business and industry), education establishments, and health care and leisure facilities. Elior has leading positions in five key countries and employs about 99,000 people, feeding over 3.6 million people in 22,700 restaurants every day, and offering support services at 2,400 sites in France. The group generated €3.690 billion in revenue in fiscal 2020-2021.

Our Base-Case Scenario

Assumptions

- Expected GDP growth of 2.7% and 1.8% in France in 2022 and 2023, respectively; 3.3% and 1.2% in the U.K., and 2.4% and 2.0% in the U.S.
- Revenue growth of about 16%-17% in fiscal 2022 supported by solid recovery post-pandemic with volumes and revenues approaching pre-pandemic levels in the group's education and health care businesses, and reaching close to 75% of pre-pandemic levels in the business and industry segment, despite omicron effects during first half of the fiscal year. Now that most sanitary restrictions have been lifted, we anticipate an accelerated return to the office

supporting a gradual recovery in business and industry revenues.

- About 4%-5% revenue growth in fiscal 2023, with positive organic growth from contract wins and ongoing volume recovery toward pre-pandemic levels in all Elior's businesses but factoring in the negative impact from the termination of the Preferred Meals business in the U.S. as well as potential effects from contract renegotiations to offset cost inflation, which could result in the loss or termination of unprofitable contracts.
- Adjusted EBITDA margins of about 2.0%-2.5% in fiscal 2022, showing no improvement from. fiscal 2021, due to significant omicron-related effects on operating margins in the first half of the fiscal year, costs associated with reorganizing the group's operations, and terminating the Preferred Meals business in the U.S. EBITDA margins will be further dragged down by high food, energy, and wage cost inflation, which we expect the group won't be able to fully pass through despite contract renegotiations.
- We anticipate EBITDA margins to improve to above 6% in fiscal 2023, as Elior reaps the benefits from contract renegotiations, the termination of loss-making contracts and business (Preferred Meals in the U.S.) and reduced exceptional costs.
- Capex remaining below 2% of revenues in fiscal 2022 with no significant increase in capex intensity in fiscal 2023.
- No material acquisition in the next two years.
- No dividend payments and no share buyback transaction until fiscal 2025.

Key metrics

Based on these assumptions, we derive the following credit metrics:

- S&P Global Ratings-adjusted debt to EBITDA to remain very high at about 16x in fiscal 2022 and improving to about 5.3x-5.5x in fiscal 2023.
- Adjusted FFO to debt of about 3%-4% in fiscal 2022, improving to about 15%-16% in fiscal 2023.
- Negative adjusted FOCF to debt in fiscal 2022, improving to above 5% in fiscal 2023.
- FFO cash interest coverage of about 2.2x-2.4x in fiscal 2022, improving to above 5.5x in 2023.

Liquidity

We assess Elior's liquidity position as adequate, with sources of liquidity exceeding uses by greater than 1.2x over the next 12 months.

We estimate that Elior's liquidity sources over the 12 months from March 31, 2022, will be:

- Balance sheet cash of about €38 million;
- Unadjusted cash FFO--after lease payments--of about €31 million; and
- €320 million available under the committed €350 million RCF that matures in June 2026.

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

- About €80 million-€90 million of capex.

- €80 million of working capital outflows including intra-year fluctuations.

Covenants

Under the group's senior facilities agreement, and following the waiver agreement obtained in May 2022, Elior will have no covenant test before March 2023. Then, it will have to comply with a 7.5x net leverage covenant as of March 31, 2023, reducing to 4.5x for the following test period on Sept. 30, 2023, and going forward. We expect Elior will have less than 15% covenant headroom for the covenant test of September 2023, but headroom will gradually increase thereafter.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-4, G-2

Social factors are a negative consideration in our credit rating analysis of Elior Group. The group's business has experienced significant health and safety challenges due to social distancing amid the pandemic. Closures in offices, schools, and corporate facilities resulted in a 19% revenue decline in fiscal 2020, and further 7% revenue decrease year-on-year in fiscal 2021. EBITDA turned negative in fiscal 2020 due to high restructuring provisions, and remained depressed in fiscal 2021. Although we forecast gradual deleveraging, the path to recovery remains uncertain given potentially prolonged pandemic effects.

Issue Ratings - Recovery Analysis

Key analytical factors

- We lowered the issue rating on Elior Group's €550 million senior unsecured notes to 'B+' from 'BB-'. The recovery rating on the notes remains 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 debt, the group still has debt facilities that are not rated. These include a €100 million senior unsecured term loan and a €350 million revolving credit facility, which rank pari passu with the notes. Elior also raised a €225 million state guaranteed loan in March 2021, which amortizes 25% annually from October 2023 to October 2027. Elior 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 the claims priority liabilities.
- In our hypothetical default scenario, we assume a payment default in 2026, following a prolonged deterioration in economic conditions, including a high inflation environment, which would reduce demand for Elior's products as its clients continue to cut costs and consumers continue to reduce their 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: €154 million
- Multiple: 5.5x
- Gross enterprise value at emergence: €848 million
- Net enterprise value after administrative expenses (5%): €805 million
- Priority liabilities: €217 million (comprising mainly the assumed drawing under the securitization facilities and bank overdraft facilities).
- Collateral value available to senior secured debt: €588 million
- Estimated senior unsecured debt claims: €1.025 billion*
- --Recovery expectation: 50%-70% (rounded estimate: 55%)

*Includes six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: B+/Stable/--

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: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Health and safety

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: 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

Ratings List

Downgraded; Outlook Action

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49)

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