Research Update:

# Spie Outlook Revised To Stable From Negative On Rebounding Credit Metrics; 'BB' Ratings Affirmed

**August 1, 2019**

## Rating Action Overview

- A recovery in Spie's Oil, Gas, & Nuclear segment, solid growth in its French business, and declining restructuring costs will drive its S&P Global Ratings-adjusted debt to EBITDA to the low-4x range and funds from operations (FFO) to debt above 15% in 2019.
- We are therefore revising our outlook on Spie to stable from negative, and affirming our 'BB' ratings on the group and its senior secured debt.
- The stable outlook reflects our view that Spie will continue to increase revenues organically, enabling the company to sustain its credit metrics within the thresholds for our 'BB' rating.

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## Rating Action Rationale

After difficult market conditions weighed on Spie's operating performance in 2018, benefits from the company's reorganization in its French business, a rebound in its Oil, Gas, & Nuclear sector, and a decline in restructuring costs will drive its S&P Global Ratings-adjusted debt to EBITDA to the low-4x range in 2019 from around 4.8x at the end of 2018. These positive developments will also strengthen the company's adjusted FFO-to-debt ratio to around 17% in 2019 from 15% at the end of last year.

We expect Spie's revenues to continue rising organically in the low-single-digit percentage range through 2020. In October 2018, the group launched a new digital monitoring offering for its technical facility management business line in France, and we expect it will spur revenue in 2019. Additionally, strong growth in Oil, Gas, & Nuclear in Africa has driven double-digit percent growth in the first half of 2019. However, overall growth has been burdened by substantial headwinds in the U.K., where demand visibility is limited and customers have delayed decision-making in anticipation of tariffs that could come from Brexit. This has also weighed on profitability, since the company's reported segment EBITA margins in northwestern Europe have dropped below 2% from over 6% for the group as a whole (including International Financial Reporting Standards 16). While we recognize the U.K. market will continue to face hurdles, this region accounts for about 5% of total revenues and has had only a moderate impact on the group's overall growth and profitability.

Despite these challenges, we expect the company's S&P Global Ratings-adjusted EBITDA margins to improve to about 8.0% in 2019 from approximately 7.5% in 2018 due largely to declining restructuring costs. The company embarked on several margin-conscious initiates in 2017-2018, such as a reorganization in France, disposal of distribution services activities in the U.K., and a sizable integration related to the SAG acquisition in 2017. Restructuring costs totaled €45 million and €32 million in 2017 and 2018, respectively, and we expect these costs to decline to less than €10 million in 2019, including any potential costs incurred to integrate acquisitions that closed in 2019.

Our view of Spie's business risk profile is supported by its solid market position as one of Europe's leading providers of installation and maintenance services for mechanical, electrical, and IT systems; technical facilities management; and oil, gas, and nuclear maintenance services. This position has been enhanced further by acquisitions in recent years, including four thus far in 2019 that will add over €200 million of revenues annually and enhance Spie's market positions in Austria, Germany, and France. Still, because the European market remains highly competitive and fragmented, Spie has relatively small absolute market shares (less than 10%), even in core geographies such as France and Germany.

The company benefits from a comprehensive service offering, flexible cost base, and good customer retention rates. We also view Spie's customer diversification as strong with a diverse base of over 26,000 clients, predominantly on relatively small contracts with a significant share relating to maintenance type contracts and renovation activity that translate into relatively strong revenue stability and earnings.

Our view of Spie's financial risk profile reflects our expectation that adjusted debt-to-EBITDA will decline to the low 4x range in 2019. We believe the company will generate close to €300 million of free cash flow (before International Financial Reporting Standards [IFRS] 16 impact) in 2020 and use the funds to meet its public dividend policy of 40% of adjusted net income, and for small acquisitions, such that leverage falls below 4x in 2020.

## Outlook

The stable outlook reflects our view that Spie's revenues will continue to rise organically in at least the low-single-digit percent range, with expanding EBITDA margins as restructuring costs decline, and an adjusted debt to EBITDA below 4.5x and FFO to debt above 15%.

### Downside scenario

We could take a negative rating action if operating headwinds or a renewed need for large restructuring programs result in declining EBITDA, or if the company adopts a more aggressive financial policy, such that adjusted debt to EBITDA stays above 4.5x and FFO to debt remains below 15%.

### Upside scenario

While Spie has historically shown willingness to engage in debt-funded mergers and acquisitions, we could consider an upgrade if the company adopted a more conservative financial policy that prioritized deleveraging over additional acquisitions or shareholder payments. A positive rating action would require a commitment from management to sustain adjusted debt to EBITDA below 4x and FFO to debt above 20%.

## Company Description

Spie is a provider of multi-technical services employing more than 45,000 employees working from close to 600 sites in 38 countries. Services include provision of electrical, heating ventilation, and air conditioning (HVAC), and mechanical engineering services to a wide range of industrial, commercial, and public sector companies.

## Our Base-Case Scenario

Our base-case scenario incorporates the following assumptions:

- GDP growth in France, Germany, and the Netherlands of 1.4%, 0.6%, and 1.7%, respectively, in 2019.
- Organic revenue growth for Spie of around 2%-3%, greater than GDP in its core markets, boosted by Oil & Gas (and Nuclear?) growth in North Africa and solid growth in France, partially offset by challenges in the U.K.
- Total revenue growth in the mid-single-digit percent range in 2019 pro-forma for the full year of acquisitions.
- Adjusted EBITDA margins increasing from around 7.5% in 2018 to about 8.0% in 2019, driven primarily by lower restructuring costs of less than €10 million in 2019, versus above €30 million in 2018.
- Cash from operations of (before IFRS 16 impact) €330 million-€340 million in 2019.
- Relatively stable capex of €50 million-€60 million in 2019.

These assumptions lead us to derive the following credit metrics (pro-forma for full year of acquisitions):

- Adjusted debt to EBITDA declining to the low-4x range in 2019.
- FFO to debt increasing to the 17%-18% range in 2019.
- Free cash flow (before IFRS 16 impact) between €270 million and €290 million in 2019.

## Liquidity

We assess Spie's liquidity as strong. We forecast that the group's sources of liquidity will exceed its uses by over 1.5x over the next 24 months due to its large cash balances and solid free operating cash flow (FOCF) generation. Furthermore, we assess that the company's sources of liquidity would be sufficient to cover its uses, even if EBITDA were to decline by 30%.

Principal Liquidity Sources:

- Cash and marketable securities of about €439 million as of June 30, 2019;
- Availability of about €410 million under the revolving credit facility, which matures in 2023; and
- FFO of about €320 million-€340 million over the next 12 months.

Principal Liquidity Uses:

- About €259 million of securitization funding due in June 2020;
- Capital expenditure (capex) of about €50 million-€60 million;
- Around €50 million of contracted acquisitions that will be funded in the second half of 2019;
- Minimal working capital outflows as we assume the company had already incurred most of the seasonal needs at end June 2019; and
- Dividends of about €90 million-€100 million.

## Issue Ratings - Recovery Analysis

### Key analytical factors

- Spie issued a €600 million bond to repay half of its €1.2 billion unsecured term loan A, which we rated 'BB' prior to its withdrawal. The company also has €600 million outstanding on an existing bond.
- We rate Spie's bonds, which we view as pari passu with the company's banking facilities, 'BB' with a '3' recovery rating.
- The recovery rating is constrained by the significant amount of prior-ranking liabilities, in the form of the group's material pension deficit and the existing receivables securitization program.
- Under our hypothetical default scenario, we contemplate a marked deterioration in economic conditions alongside increased competition and an inability to integrate recent acquisitions.
- We value Spie as a going concern, given its large customer base and good product diversification.

### Simulated default assumptions

- Year of default:2024
- Jurisdiction: France

### Simplified waterfall

- Emergence EBITDA: €292.5 million (capital expenditure [capex] represent 1% of combined sales, reflecting our view of the minimal required capex at default).
- EBITDA multiple: 6.5x
- Gross enterprise value (EV): €1.9 billion
- Net EV after administrative expenses (5%) and pension deficit (50% of tax-adjusted deficit): €1.5 billion
- Estimated priority claims (bank overdrafts and securitization facility, assumed drawings at default): €318 million
- Estimated value available to senior unsecured claims: €1.2 billion
- Estimated senior unsecured claims: €2.4 billion

- Recovery range: 50%-70% (rounded estimate: 50%)
- Recovery rating: 3

## Ratings Score Snapshot

| | |
|---|---|
| Issuer Credit Rating | BB/Stable/-- |
| Business risk | Satisfactory |
| Country risk | Low |
| Industry risk | Intermediate |
| Competitive position | Satisfactory |
| Financial risk | Aggressive |
| Cash flow/Leverage | Aggressive |
| Anchor | bb |
| Modifiers | |
| Diversification/Portfolio effect | Neutral (no impact) |
| Capital structure | Neutral (no impact) |
| Liquidity | Strong (no impact) |
| Financial policy | Neutral (no impact) |
| Management and governance | Fair (no impact) |
| Comparable ratings analysis | Neutral (no impact) |

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

**Ratings Withdrawn**

| | To | From |
|---|---|---|
| **Spie SA** | | |
| Senior Unsecured | NR | BB |
| Recovery Rating | NR | 4(35%) |
| **Ratings Affirmed** | | |
| **Spie SA** | | |
| Senior Unsecured | BB | |
| Recovery Rating | 3(50%) | |

**Ratings Affirmed; Outlook Action**

| | To | From |
|---|---|---|
| **Spie SA** | | |
| Issuer Credit Rating | BB/Stable/-- | BB/Negative/-- |

NR--Not rated.