

Research Update:

France-Based Spie Outlook Revised To Negative On COVID-19-Related Delay In Deleveraging; 'BB' Rating Affirmed

August 17, 2020

Rating Action Overview

- Spie SA performed slightly below our expectations in 2019, and we forecast additional pressure on credit metrics in 2020 as a result of COVID-19 containment measures.
- Despite the relative resilience of Spie's sales, we forecast the group's EBITDA will fall by 15%-20% in 2020, leading to increased leverage of above 5.0x and funds from operations (FFO) to debt of below 15% for the full year.
- We are therefore revising our outlook to negative from stable and affirming our 'BB' ratings on Spie and its senior debt.
- The negative outlook reflects our view of Spie's slower-than-anticipated deleveraging in 2019 and weaker expectations for 2020 due to COVID-19 containment measures, with limited headroom for any underperformance.

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Rating Action Rationale

The company's 2019 results were somewhat below our previous expectations. Spie saw revenue growth of 3.9% in 2019, primarily driven by both its French and German/Central European divisions. The company's S&P Global Ratings-adjusted EBITDA margin decreased by about 10 basis points (bps) due to a weaker operating performance, particularly in the U.K. where some clients' investment decisions were delayed due to the uncertainty regarding Brexit. In combination with higher debt due to increased pension obligations following revised discount rates in various countries, Spie's S&P Global Ratings-adjusted debt to EBITDA increased to 4.8x, significantly above our expectations of about 4.0x.

We expect a weaker performance in 2020 due to COVID-19 containment measures and the group's relatively high operating leverage, which should be somewhat mitigated by the critical nature of the group's services. In March 2020, governments around the world enacted measures

to contain the spread of COVID-19, which severely curtailed short-term economic activity in the countries where Spie is present. As a result, the company was unable to operate at some client sites, particularly in France, which endured a strict lockdown. The difficult price environment in the oil and gas industry also impacted activity in the first half of the year. We therefore expect a mid-single-digit decline in Spie's revenue in 2020, helped by a fair recovery in the second half of the year given the critical nature of the services provided by the company and the backlog accumulated during the first six months of the year. We expect Spie's S&P Global Ratings-adjusted EBITDA will decrease more than revenue in 2020 due to the company's largely incompressible fixed costs base, a loss of productivity of about 10% at sites because of social distancing and sanitary measures, and extra costs related to the purchase of protection equipment for employees.

We expect little headroom for underperformance under Spie's credit metrics for full-year 2020.

As a result of our lower forecast operating performance for Spie in 2020, we expect its S&P Global adjusted leverage will increase to above 5.0x. From 2021, we expect low-single-digit growth for Spie's sales given by an improved macroeconomic environment and its exposure to clients who will likely benefit from post-COVID-19 plans regarding an energy transition toward green sources. Driven by strong cash flow generation, we expect debt to EBITDA will revert toward 4.5x in 2021. We forecast Spie will resume its mergers and acquisition bolt-on activity from 2021 to strengthen its share in highly fragmented markets, as well as dividend distribution, somewhat preventing faster deleveraging.

We acknowledge a high degree of uncertainty about the evolution of the coronavirus pandemic.

The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions, but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until second-half 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

Outlook

The negative outlook reflects our view that we could downgrade Spie in the next 12 months given its slower-than-anticipated debt reduction in 2019 and weaker expectations for 2020 due to COVID-19-related containment measures, with limited headroom for any underperformance.

Downside scenario

We could lower the rating if the group does not deleverage as expected, such that debt to EBITDA remains above 4.5x or FFO to debt below 15% on a weighted-average basis. This could happen if:

- The company prioritizes acquisitions or shareholder returns over deleveraging to below these levels.
- A resurgence of COVID-19 impacts Spie's ability to deliver on its contracts and negatively affects EBITDA generation.

Upside scenario

We could consider revising the outlook to stable if Spie focuses on reducing its leverage while improving its operating performance such that, on a sustained basis, debt to EBITDA improves well below 4.5x and FFO to debt increases to comfortably above 15%.

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, and mechanical engineering services to a wide range of industrial, commercial, and public sector companies.

The company generated almost €7 billion in revenue and S&P Global adjusted EBITDA close to €500 million in 2019.

Our Base-Case Scenario

In our base-case scenario, we assume:

- GDP declines in France, Germany, and the Netherlands of 9.5%, 6.2%, and 5.9%, respectively, in 2020, followed by growth of 6.8%, 4.4% and 3.9% respectively, in 2021.
- Revenue decline of 4%-5% in 2020 as COVID-19-related containment measures in first-half 2020 such as lockdowns prevented Spie from operating at some sites, and depressed oil prices put pressure on the Oil and Gas and Nuclear divisions' revenue. In 2021, we expect revenue will increase by about 5%, driven by the improved macroeconomic environment, Spie's exposure to clients benefiting from the post-COVID-19 stimulus plan related to the energy transition toward green sources, and about €200 million from bolt-on acquisitions.
- An S&P Global Ratings-adjusted EBITDA margin of about 6.4% in 2020, corresponding to a 90bps decline versus 2019, explained by the lower absorption of fixed costs, lower productivity, and extra costs for sanitary equipment. We expect Spie's EBITDA margin will increase back to 7.3% in 2021, driven by the topline and better operating efficiency.
- Cash from operations of €340 million-€350 million in 2020.
- Relatively stable capital expenditure (capex) of €60 million-€70 million in 2020.
- No shareholder distributions in 2020 but resuming from 2021 with a payout ratio of about 40% of the company's adjusted net income.
- No acquisitions in 2020, but resuming from 2021 at about €90 million.

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA of about 5.6x and 4.3x in 2020 and 2021 respectively.
- FFO to debt of about 13% in 2020, increasing to about 16% in 2021.
- Free cash flow from operations (FOCF) of €270 million-€290 million in 2020, increasing to €340 million-€360 million in 2021.

Liquidity

We assess Spie's liquidity as strong. We forecast 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 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%.

We estimate that the company's principal liquidity sources over the next 12 months will include:

- Cash on balance sheet of €726 million as of June 30, 2020.
- Availability of about €600 million under the group's revolving credit facility, which matures in 2025, with the line availability reduced to €410 million from 2024; and
- FFO of about €360 million-€380 million over the next 12 months.

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

- Capex of €60 million-€70 million;
- Intra-year working capital outflows of about €50 million.

Covenants

The term loan B is covenant-lite, with a covenant test applying only once a year at the end of December. We expect Spie will retain ample headroom (above 30%) against the senior secured net leverage test that is set at 4x, without tightening.

Issue Ratings - Recovery Analysis

Key analytical factors

We rate Spie's bonds, which we rank pari passu with the company's banking facilities, at '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 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: 2025
- Jurisdiction: France

Simplified waterfall

- Net enterprise value after administrative expenses (5%): €1.57 billion
- Estimated senior secured debt claims: €2.6 billion
- --Recovery expectation: 50%-70% (rounded estimate: 60%)
- Second-lien debt claim: €500 million
- --Recovery expectations: 0%

All debt amounts include six months prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB/Negative/--

Business risk: Satisfactory

- Country risk: Very 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 rating 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Ratings Affirmed; Outlook Action

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

Ratings Affirmed

Spie SA		
Senior Unsecured	BB	
Recovery Rating	3(50%)	

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) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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