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Sodexo

Primary Credit Analyst:
Bertrand Jabouley, Paris (33) 1-4420-7335; bertrand_jabouley@standardandpoors.com

Secondary Contact:
G. Andrew Stillman, CFA, London 44(20)7176 7036; andrew_stillman@standardandpoors.com

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Sodexo

Major Rating Factors

Corporate Credit Rating
BBB+/Stable/A-2

Strengths:

- Leading worldwide player in food catering and facilities management.
- Diversified client base and geographic coverage.
- High earnings visibility given multiyear contracts and high renewal rates.
- Strong free cash flow generation supported by Motivation Solutions operating margins and limited capital outlays.

Weaknesses:

- Limited price flexibility.
- Somewhat cyclical revenues from the corporate segment, and some exposure to fluctuations in food prices.
- Influence of Bellon S.A. as the majority owner of Sodexo.

Rationale

The ratings on France-based on-site and motivation solutions provider Sodexo reflect Standard & Poor's Ratings Services' view of its business risk profile as "strong" and financial risk profile as "intermediate."

The company benefits from higher-than-average stability and visibility of revenues and cash flow, thanks to the long average length of its contracts and high renewal rates. The ratings are further supported by the high margins of Sodexo's Motivation Solutions (MS; service vouchers) business and the improving margins of its core On-Site Solutions (OSS; food and facilities management) business. The company also enjoys low capital requirements. These factors are partially offset by limited price flexibility because of modest barriers to entry and strong competition from both large and local players, the cyclicality of revenues from the corporate segment, and exposure to fluctuating food prices. The ratings are also constrained by the company's moderate leverage, and its relationship with France-based major shareholder Bellon S.A. (not rated), which we consider has significantly lower credit quality.

S&P base-case operating scenario

We anticipate that the current uncertain macroeconomic environment will not greatly affect Sodexo, given the company's long-term multiyear contracts and high renewal rates. That said, looking ahead, our base-case credit scenario for 2012 incorporates a still significant 25% probability of an imminent recession in North America, and our expectation of a mild recession in Europe in the first half, which would slow organic growth in these regions. As a consequence, we take a cautious view of Sodexo's sales growth and operating margin expectations for the next few years. We believe that total growth could be lower than the company's guidance of 9%-12% in 2012--in spite of a robust sales performance in its first quarter--and 7% beyond. Over the next few years, we forecast annual organic growth of at least 3%-5% (broadly consistent with recent performance), acquisitions contributing about 1 to 2 percentage points a year to revenue growth, and therefore total growth of 4%-7% annually. For 2012, however, we anticipate that total growth will comfortably exceed 7%, given the positive effect from the Lenôtre-Roth Bros-Puras do Brasil consolidation. In addition, we believe that the higher growth rate and margins for the MS business, compared with the OSS business, will directly benefit to Sodexo's consolidated operating income. Consequently, and given the company's initiatives to improve margins in OSS, we anticipate that the consolidated operating margin should rise steadily from 5.3% in 2011 toward--without necessarily reaching--the company's target of 6.3% by financial year 2015 (ending Aug. 31), which in our view is somewhat ambitious.

S&P base-case cash flow and capital-structure scenario

Given our assumptions for Sodexo's revenues and margins for 2012, we believe the company should post unadjusted funds from operations (FFO) of at least €750 million and free operating cash flow (FOCF) of about €500 million, given capital outlays of €250 million and our assumption of limited change in working capital. Though we understand that the company's primary focus is organic growth, we believe that Sodexo will use part of its financial flexibility to make acquisitions. In 2012, acquisitions already include Roth Bros. (undisclosed amount), Puras do Brasil (€525 million), and Lenôtre (€75 million). We believe Sodexo could enter into further transactions--albeit of a lower scale--by August 2012. We anticipate total distribution to shareholders should grow steadily from about €220 million in financial year 2012 and represent about 40% of FOCF on average annually. Excluding further sizable acquisitions and other one-off items, such as provision utilization or share repurchases, we forecast Sodexo's FFO-to-debt ratio, which was about 54% in 2011, could decrease to about 40% in 2012, and strengthen steadily thereafter.

Liquidity

The 'A-2' short term rating reflects Sodexo's large cash balances, strong FOCF generation, and available and unused credit facilities. According to our criteria, Sodexo's liquidity is "strong."

We estimate that sources of funding should cover uses by at least 1.5x in the next 12 months and 1.0x in the subsequent 12 months. At financial year-end 2011, Sodexo held cash and cash-equivalents (excluding restricted cash and financial assets related to its MS business) of about €1.4 billion and unused committed credit facilities of about €1.1 billion, which will be available until July 2016, with an option for an additional year extension for two years. While there are no covenants attached to these syndicated facilities, the company's two U.S. private placements have standard maintenance covenant packages, including net assets and net leverage, which leave Sodexo with significant headroom. We anticipate that the company will generate about €500 million of FOCF in fiscal 2012. We forecast that uses of cash will include acquisitions in excess of €700 million given already announced transactions, and dividend payments of approximately €220 million in fiscal 2012. On Aug. 31, 2011, short-term financial debt amounted to €175 million, with about €70 million maturing in the subsequent 12 months. There are no sizable debt maturities before January 2015, when a €880 million bond is due.

Outlook

The stable outlook reflects our view that Sodexo will continue to deliver adequate operating performance in the next few years, despite an uncertain economic climate that could weigh negatively on net contract gains in the near term. The outlook also assumes that the company's adjusted FFO to debt will remain above 35%. Given the recent acquisitions, including that of Puras do Brasil in September 2011 for an enterprise value of about €525 million, we think that Sodexo has limited headroom vis-à-vis our target ratio.

We could consider an upgrade in the next couple of years if Sodexo sustainably strengthens its financial profile, so that FFO to debt would be firmly established in the 40%-45% range. This could happen through a combination of accelerating sales growth and improving margins above our base-case scenario expectations, with no marked increase in returns to shareholders, for instance.

However, we could consider a downgrade if the company makes significant net debt-financed acquisitions in the upcoming quarters, excessively uses its share buyback programs, or experiences deteriorating operating performance or governance issues.

Given the company's strategy and internal leverage targets, we anticipate that Sodexo will continue using its financial flexibility, primarily to consolidate its industry through acquisitions in order to further improve its geographic diversification and widen the range of services offered. As a result, we believe credit ratios will not materially strengthen from their current levels, which are commensurate with the ratings, therefore rendering any rating change unlikely.

Business Description

Service company Sodexo had sales of about €16.0 billion in the 12 months ended Aug. 31, 2011, and operates in two main areas:

- On-Site Service Solutions (food and facilities management). Services include food, reception management, landscaping, heat ventilation, air conditioning, cleaning, maintenance, and security either individually or through comprehensive contracts. They also cover remote-site management, providing services to workers on offshore oil rigs, large construction projects, and mining sites. Clients comprise corporates, public authorities, hospitals, clinics, retirement homes, schools, colleges, and universities.
- Motivation Solutions (service vouchers). Companies or public authorities of all sizes offer vouchers to their employees or citizens to pay for items such as food, gasoline, child care costs, and employee incentives. The vouchers often have tax or social-charge benefits for their users.

Chart 1

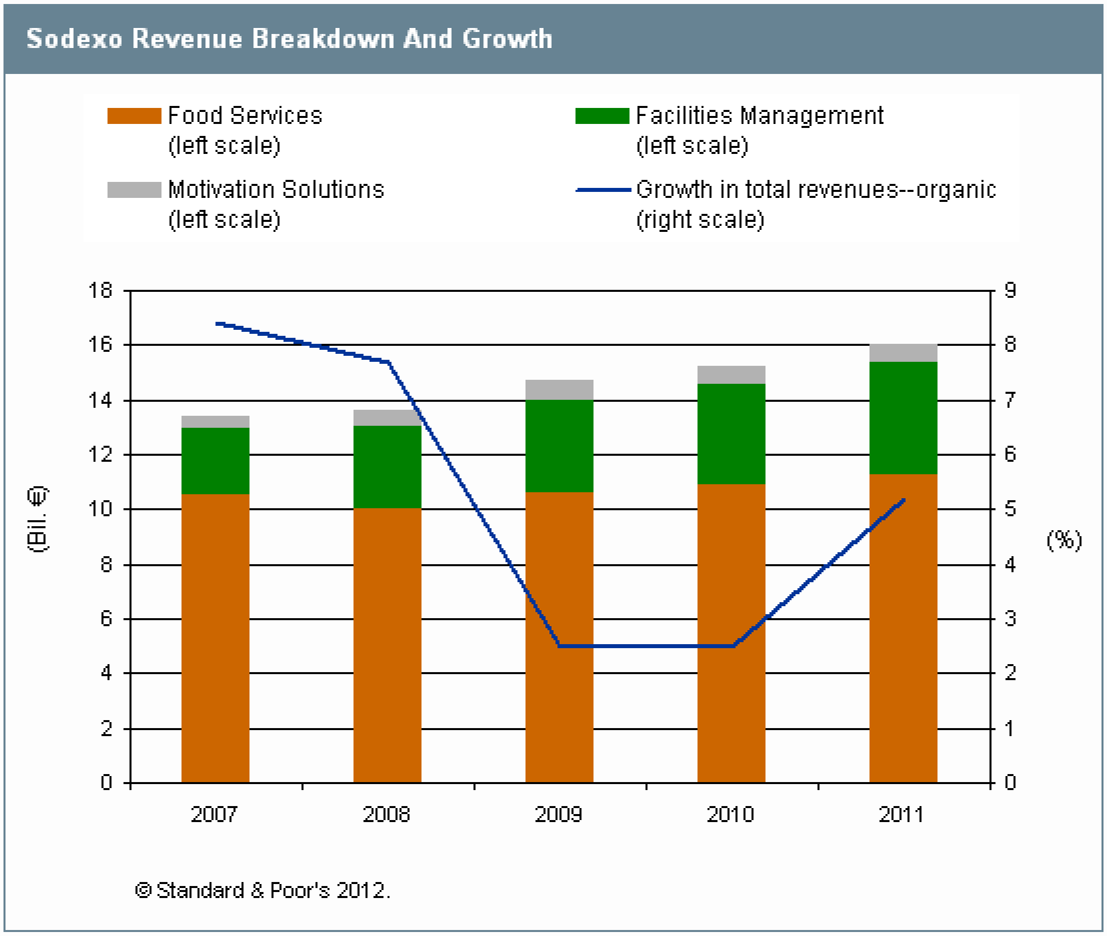
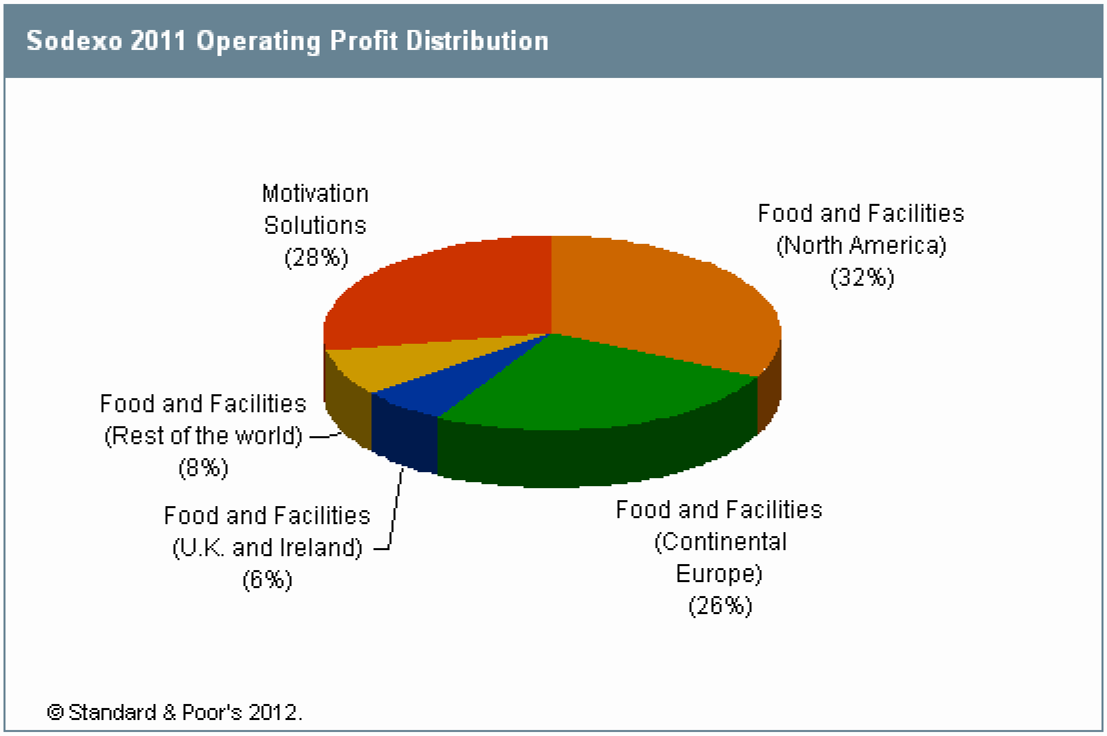

Sodexo Revenue Breakdown And Growth
Food Services (left scale)
Facilities Management (left scale)
Motivation Solutions (left scale)
Growth in total revenues--organic (right scale)
(Bil. €)
(%)
0
2
4
6
8
10
12
14
16
18
0
1
2
3
4
5
6
7
8
9
2007
2008
2009
2010
2011
© Standard & Poor's 2012.

Chart 2



Business Risk Profile: Leading Positions In A Stable Industry With Good Growth Potential

The major supports for the company's "strong" business risk profile are:

- Sodexo's market leading positions among global food and facilities management service providers. With a size comparable to that of its closest competitor, Compass Group PLC (A-/Stable/--), the company has a strong presence in North America and is the largest player in a number of European countries. It also has limited, but expanding, operations in the Asia-Pacific region and Latin America.
- The company's No.2 position worldwide in service vouchers after Edenred S.A. (BBB+/Stable/A-2). We view the industry favorably, as it is relatively stable, has high operating margins of above 30%, and offers high growth rates in excess of 10% throughout regular economic conditions, given that market sources estimate world market penetration at only about 40%.
- Good geographic diversification. In financial 2011, North America generated about 37% of revenue, Europe 44%, and the rest of the world 19%.
- Client base diversity. The company operates 33,400 sites through its food and facilities management business and serves 385,000 clients through its vouchers business. None of its contracts account for more than 2% of total sales.
- High contract retention rates and long-term client relationships. Although contracts generally do not have a fixed

maturity and can be terminated with three months' notice, Sodexo's average contract duration is more than nine years. The company's renewal rate has stood close to 94% over the past three years.

These supports are partially offset by:

- The highly competitive and fragmented nature of the food and facilities management sector due to modest barriers to entry. This leaves limited pricing flexibility for service providers and relatively low operating margins throughout the sector at about 4%-6%. Therefore ongoing efforts to control overheads, staff costs, and food price inflation are necessary.
- Exposure to economic cycles in the corporate services business segment, which contributed roughly 37% of the company's on-site services revenue in financial 2011. This is largely due to this segment's dependence on corporate expenditures and employment levels.

Financial Risk Profile: Strong Cash Flow Generation Used Primarily For External Growth

The main strengths of Sodexo's "intermediate" financial risk profile are:

- Strong free operating cash flow generation with high visibility. The stability and low capital intensity of the sector make Sodexo's business model very cash flow generative. Over the last five years, reported FOCF--before changes in working capital--amounted to about 3% of revenues, growing steadily to about €0.5 billion.
- Sodexo's strong liquidity profile. Limited maturities over the next 24 months are largely covered by cash, undrawn committed credit lines, and free cash flow generation. We anticipate the company will refinance its acquisitions to preserve a comfortable liquidity headroom.

These strengths are moderated by:

- Sodexo's potentially acquisitive strategy to complement organic growth. Its very wide market reach creates potential for bolt-on acquisitions. We therefore anticipate that Sodexo will use the bulk of its financial headroom for acquisitions or implement shareholder-friendly measures.
- The company's relatively weak capital-structure metrics and asset-protection measures. Sodexo's adjusted ratio of debt to debt plus equity stood at 38% on Aug. 31, 2011 and more than 40% of the company's total assets are intangible. Goodwill represents the majority of these assets in light of the company's acquisitive track record. In addition, we note that the company reported €1,605 million of cash related to its MS activity, compared with €2,421 million worth of outstanding vouchers at year-end 2011. We consider that this mismatch between available cash for MS and the vouchers liability could be another weakness in Sodexo's balance sheet.
- Major shareholder Bellon's effective control of Sodexo. Bellon is a France-based company controlled by members of the founding Bellon family, and 18.5% by Sodexo through related entity Sofinsod. Bellon held 37.7% of Sodexo's share capital and 47.6% of voting rights on Aug. 31, 2011. This number could theoretically inflate to about 55%, given the company's double voting rights mechanisms. Although we view Sodexo's governance practices as consistent with the ratings, we will continue to monitor certain aspects because of their potential importance to creditors and other financial stakeholders.

Financial Statistics/Adjustments

Sodexo reports its financial statements under International Financial Reporting Standards. We adjust its financial debt for operating leases (€417 million), the pension deficit (€188 million) and financial guarantees (€8 million). Moreover, we take into account the company's surplus cash, which is readily available under reported cash and cash equivalents. This is calculated by excluding restricted cash of about €389 million, as disclosed in the notes to the company's financial statements, as well as an estimate (about €200 million) of cash and equivalents that is tied to daily operations or to countries where relatively unstable financial systems involve cash repatriation risks.

Table 1

Reconciliation Of Sodexo Reported Amounts With Standard & Poor's Adjusted Amounts

(Mil. €)	--Financial year ended Aug. 31, 2011--									
Sodexo reported amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	2,437.0	2,535.0	16,047.0	1,097.0	853.0	148.0	847.0	847.0	229.0	242.0
Standard & Poor's adjustments										
Operating leases	417.2	--	--	28.6	28.6	28.6	96.4	96.4	--	114.5
Postretirement benefit obligations	187.5	--	--	(3.0)	(3.0)	--	1.3	1.3	--	--
Surplus cash and near cash investments	(1,481.0)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	17.0	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	32.0	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(100.0)	--	--
Minority interests	--	30.0	--	--	--	--	--	--	--	--
Debt--guarantees	8.0	--	--	--	--	--	--	--	--	--
Total adjustments	(868.3)	30.0	0.0	42.6	57.6	28.6	97.7	(2.3)	0.0	114.5
Standard & Poor's adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	1,568.7	2,565.0	16,047.0	1,139.6	910.6	176.6	944.7	844.7	229.0	356.5

Table 2

Sodexo Peer Comparison

	Sodexo	Compass Group PLC	Edenred S.A.	Experian Finance PLC	Adecco S.A.
Corporate credit rating on Feb. 17, 2012	BBB+/Stable/A-2	A-/Stable/(A-2)	BBB+/Stable/A-2	A-/Stable/A-2	BBB/Stable/A-2
	--Average of past three fiscal years--				
(Mil. €)					
Revenues	15,319.3	16,597.2	937.7	2,924.9	17,806.0
EBITDA	1,060.6	1,432.7	378.0	923.5	819.9
Net income from continuing operations	417.7	720.1	54.3	379.6	308.7
Funds from operations (FFO)	815.9	1,217.6	220.3	817.6	763.1
Capital expenditures	345.3	411.7	44.9	266.4	226.1
Free operating cash flow	557.6	859.0	282.7	550.2	610.3
Dividends paid	213.7	327.1	115.0	186.7	142.3
Discretionary cash flow	344.0	531.9	167.7	363.4	468.0
Cash and short-term investments	571.3	367.2	269.6	29.4	500.7
Debt	1,783.0	2,049.7	550.9	1,849.1	1,474.4
Equity	2,539.6	3,465.7	(1,122.4)	1,713.6	3,159.7
Adjusted ratios					
EBITDA margin (%)	6.9	8.6	40.3	31.6	4.6
EBITDA interest coverage (x)	5.7	11.2	4.7	11.0	8.5
EBIT interest coverage (x)	4.7	9.0	4.3	7.3	6.1
Return on capital (%)	20.0	21.8	(71.9)	17.0	13.0
FFO/debt (%)	45.8	59.4	40.0	44.2	51.8
Free operating cash flow/debt (%)	31.3	41.9	51.3	29.8	41.4
Debt/EBITDA (x)	1.7	1.4	1.5	2.0	1.8
Total debt/debt plus equity (%)	41.2	37.2	(96.4)	51.9	31.8

Table 3

Sodexo Financial Summary

	--Financial year ended Aug. 31--				
	2011	2010	2009	2008	2007
Rating history	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. €)					
Revenues	16,047.0	15,230.0	14,681.0	13,611.0	13,385.0
EBITDA	1,139.6	1,044.5	997.6	926.8	849.5
Net income from continuing operations	451.0	409.0	393.0	376.0	347.0
Funds from operations (FFO)	844.7	842.2	760.8	747.8	666.6
Capital expenditures	356.5	392.6	286.7	287.8	408.6
Free operating cash flow	588.3	706.6	378.1	617.0	446.0
Discretionary cash flow	359.3	491.6	181.1	438.0	297.0
Cash and short-term investments	589.0	555.0	570.0	504.0	493.0
Debt	1,568.7	1,830.6	1,949.7	1,411.9	1,127.7
Equity	2,565.0	2,739.0	2,314.7	2,198.6	2,300.0

Table 3

Sodexo Financial Summary (cont.)

Adjusted ratios					
EBITDA margin (%)	7.1	6.9	6.8	6.8	6.3
EBITDA interest coverage (x)	6.5	6.1	4.8	6.0	5.9
EBIT interest coverage (x)	5.2	4.9	4.1	4.9	4.8
Return on capital (%)	20.3	18.5	21.3	21.4	19.5
FFO/debt (%)	53.9	46.0	39.0	53.0	59.1
Free operating cash flow/debt (%)	37.5	38.6	19.4	43.7	39.5
Debt/EBITDA (x)	1.4	1.8	2.0	1.5	1.3
Debt/debt and equity (%)	37.9	40.1	45.7	39.1	32.9

Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Summary: Sodexo, Jan. 12, 2012
- Economic Research: Assessing The Severity Of The Eurozone Recession Is A Close Call, Jan. 31, 2012
- Economic Research: U.S. Economic Forecast: Recovery Warms Up In January, Feb. 10, 2012

Ratings Detail (As Of February 27, 2012)	
Sodexo	
Corporate Credit Rating	BBB+/Stable/A-2
Corporate Credit Ratings History	
06-Dec-2004	BBB+/Stable/A-2
28-Nov-2002	BBB+/Negative/A-2
20-Sep-2002	BBB+/Watch Neg/A-2
Business Risk Profile	Strong
Financial Risk Profile	Intermediate
Debt Maturities	
On Aug. 31, 2011: 2011-2012: €175 mil. 2012-2013: €68 mil. 2013-2014: €616 mil. 2014-2015: €902 mil. 2015-2016: €207 mil. Thereafter: €470 mil.	
Related Entities	
Sodexo Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (2 Issues)	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com