



European Business and Consumer Services Rating Methodology

Corporates

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Call for comments

Scope welcomes market participants' comments on its proposed methodology.
Please send your comments by 24 November 2023 to consultation@scoperatings.com.

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1. Introduction

This proposed methodology will supplement our [General Corporate Rating Methodology](#) for the rating analysis of European business and consumer services companies. It can also be applied selectively to non-European issuers where appropriate. Our financial risk profile assessment of services companies remains largely based on the metrics set out in our [General Corporate Rating Methodology](#).

We define services companies as those that generate most of their revenue and cash flow from services provided either to other businesses (B2B)¹ or directly to consumers (B2C). Services companies can be asset-light or asset-heavy. Asset-light companies typically leverage on their workforce and intangibles (e.g. expertise, intellectual property, networks) to produce cash flow and include professional services firms that provide consultancy, audit, agency services or central support, or services that can be sold through a digital platform (called a marketplace of services). Asset-heavy companies produce cash flow by the use of fixed assets and their services include mobility services, machinery rental and contract manufacturing, private/consumer services and environmental services such as waste management and recycling. IT services companies are not covered in this methodology.

This sector methodology will improve credit differentiation through an industry-specific credit risk evaluation and a more detailed and nuanced assessment of credit factors. Our approach enhances transparency and highlights the relative importance of key rating drivers when analysing services corporates.

Generally, parameters that would qualify a services company for an investment grade rating are: a strong brand with a high service strength, a scalable business, good cross-selling potential, a high market share (which translates into price-setting power that enables sufficient profitability) and cash flow with medium or low volatility. Investment grade companies should also be broadly diversified in terms of geographies, distribution channels, product portfolios and customer bases, and able to sustain strong credit metrics. Companies with a non-investment grade rating will generally lack adequate financial depth and have more volatile revenues and profitability, with balance sheets more exposed to negative developments.

If implemented as proposed, the methodology is expected to have limited impact on outstanding ratings.

2. The European business and consumer services industry

Introduction

The services industry is a broad sector, with many services available to both private consumers and businesses.

Demand for services is influenced by GDP growth, demographics, income development, consumer confidence and preferences, employment growth, and governmental spending. The internet has changed the services industry dramatically over the last two decades, affecting the way services are constructed, marketed and sold. This ongoing transformation is also increasing transparency for consumers.

Services are growing in demand. Consumers are moving away from owning assets or hiring employees towards using machinery, flexibly adapting production staffing, and contracting on-demand expertise and seasonally needed services.

Given the broad range of services offered in the industry, we carefully consider company-specific factors to better understand individual issues during the rating process.

Use of services

Customers commonly use a service when: i) the activity is not core to their operations; ii) internal capacity is constrained; iii) specialised workers or assets are needed; and iv) they have opted for a variable-cost model to ensure they can continue to scale up.

Companies providing specialised labour and assets often develop their services by incorporating their experience with multiple customers.

Some providers cater to a niche market or meet local demand, for example, private services and specialised machinery rental. At the other end of the spectrum, large players provide bespoke, high-quality services under a global brand, which can include mobility services and professional services such as assurance and advisory.

¹ B2B services include outsourced central service functions.

Asset-light and asset-heavy business models

We differentiate between two business models in the services industry: asset-heavy and asset-light.

Asset-heavy services are often standardised and involve fixed assets used frequently by customers. The services are often identical among providers because most consist of the rental of an asset or must meet regulatory requirements. These services are usually highly scalable. A strong brand is important as customers are more likely to use the service for longer, developed by offering a good quality of services and assets. Assets used for the services are also often repurposed for better-performing markets or services, or even sold.

Asset-light services with specialised workforce tend to be characterised by providing added value to customers by providing knowledge and human resources. In most cases, switching to another provider is less frequent, costly and inconvenient. Examples are professional services or outsourced central services. Switching providers is easy in case the service is provided only once for a special purpose or for a limited timeframe and therefore switching costs would not apply.

We classify a company as asset-light or asset-heavy by looking at its balance sheet. Business models in the services industry vary widely, depending on the company's service range, service strength (defined in later in the methodology), service complexity, size, operational exposure to regulation, integration with the customer's business, and the cyclicity of its markets and industries.

Specialised versus unspecialised workers in business models

We differentiate between business models that i) require a specialised workforce; and ii) use an unspecialised workforce, have services that are operated by the customer, or have digitalised services.

Services not requiring a specialised workforce are more scalable but also easier to substitute. Service strength is therefore very important when scaling up a business.

Acquisition, training and retaining personnel is costly and time-consuming and hence companies employing a high share of specialised workers have lower growth prospects but have better-protected cash flows.

Figure 1 – Examples of asset-heavy and asset-light services and their requirement for workforce (not exhaustive)

	Specialised workforce	Unspecialised workforce
Asset-heavy	<p><u>Machinery rental and contract manufacturing</u>²: forklifts-, cranes, speciality vehicles</p> <p><u>Environmental services</u>: energy services</p>	<p><u>Mobility services</u>: taxi, car rental, car/e-moped/e-scooter sharing</p> <p><u>Private/consumer services</u>: physical fitness facilities, car washes, drycleaning</p> <p><u>Environmental services</u>: recycling, waste management</p>
Asset-light	<p><u>Professional services</u>: assurance, advisory, legal services</p> <p><u>Agency services</u>: real estate agencies, travel agencies, concessions operators, fund managers (fee-linked services)</p> <p><u>Central support services</u>: marketing, payroll, HR</p> <p><u>Facility services</u>: repair and maintenance services (such as for equipment, heating, plumbing and air conditioning)</p> <p><u>Private/consumer services</u>: for-profit education, childcare, consumer tax and legal services, product repair</p>	<p><u>Facility services</u>: operation of premises, manned guarding, catering and cleaning</p> <p><u>Marketplace of services/ platform</u>³</p>

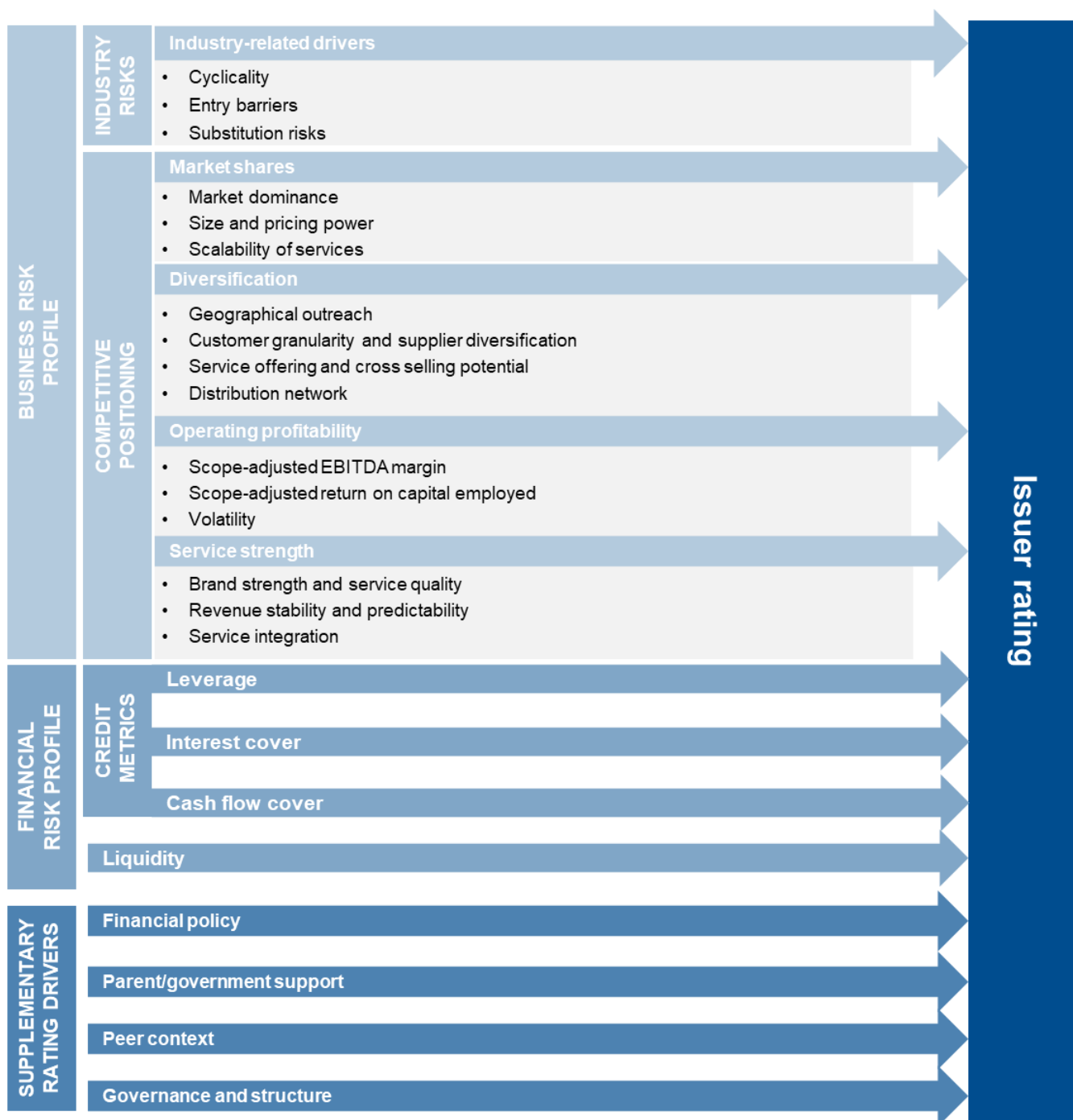
² Assets may be leased by the company. Nevertheless, this does not make the company's operations similar to those of asset-light companies.

³ A marketplace of services has recently emerged. This includes smartphone apps for services such as local transport, home delivery, handyman services that connect several available providers. We view this type of product similarly to agency services (asset-light) as their cash flow typically comes from a fee linked to sales.

3. Rating drivers

We apply our rating methodology as outlined in Figure 2. The rating analysis takes into account credit risk factors specific to European business and consumer services as specified in this sector methodology as well as factors common to all industries such as management, liquidity, legal structure, governance and country risks which are explained in more detail in the [General Corporate Rating Methodology](#). The following business risk and financial risk indicators are non-exhaustive and may overlap; some may not apply to certain corporates. We may add issuer-specific rating factors, and a company's business model is decisive for the applicable indicators. No rating driver has a fixed weight in the assessment. Please refer to the [General Corporate Rating Methodology](#) for more detail.

Figure 2 – General rating grid for European business and consumer services corporates



3.1 Business risk profile

When evaluating the business risk profile, we analyse the industry dynamics and business drivers that are unique to European business and consumer services companies. Our two-fold approach analyses the business risks for the industry and the competitive positioning of the company. The overall industry rating is less important for the business risk profiles of smaller companies.

3.1.1 Industry fundamentals

We assess the industry fundamentals of services companies by examining the following industry drivers:

- Cyclicalities
- Entry barriers
- Substitution risks

Cyclicalities

We consider the cyclicalities of both B2B and B2C services industries as medium to high. However, business cycle volatility varies across the industry. For example, providers of advanced and personalised services, where labour hoarding can be important, may operate differently from operational and standardised services companies, which can adjust workforce size more easily.

Non-discretionary services are less cyclical (e.g. environmental services, mobility services and machinery rental) while others have a discretionary element or correlate with GDP and interest rates. Asset-light services with unspecialised workforce are mostly non-discretionary (e.g. facility services and central support services), but their use seems correlated with the economic cycle and hence are downsized in an economic downturn. This is because companies view these services as a cost centre and economic downturns result in less spending. Some parts of the industry are also subject to seasonal effects, which we may also account for in our assessment. Asset-heavy services companies with specialised workforce are generally less cyclical because their services are harder to insource.

In cases of economic slowdown, customers tend to cancel services that were used to cover capacity constraints. Companies that are more resilient to economic downturns provide business-critical services, are adaptable, and can diversify their service offering. Even so, business-critical services, while having a low cyclicalities, are often bundled with non-critical services, which tend to be scaled back quickly in a downturn.

Based on this combination of factors, we therefore view cyclicalities in the overall industry as medium to high.

Entry barriers

Entry barriers for services corporates can differ depending on the investments needed in the asset base and the specialisation of the workforce. Investments in the asset base may have to be financed, while putting together the right workforce and establishing teams can happen over a long period.

The asset-heavy services industry has medium-to-high entry barriers, depending on the size of the initial investment needed and the specialisation of the workforce. The asset-light segment has low-to-medium entry barriers, which depends on the need to build up skilled staff, an extensive network and a reputation. More importantly, the complexity of the service, which is usually related to the level of specialised workforce required, can increase entry barriers as this reduces the willingness to switch service providers, especially if the service is crucial to operations. In addition, services are often tendered for a long period, and change will not always be immediate for companies with high service strength.

Substitution risk

Substitution risk varies depending on the investments needed in assets and workers as well as the time needed to change provider. Basic services (such as cleaning), professional services (such as for-profit education and other specialised services with strong service strength) and the marketplace of services have medium substitution risk, whereas customer-operated asset-heavy services have medium-to-high substitution risk. Where asset investments are significant and local community approvals or licences are needed, e.g. for certain mobility services, substitution risk is medium.

Asset-heavy companies with a specialised workforce have low substitution risk because they usually provide tailored services and have significant inhouse expertise.

Industry risk classification

Barriers to entry and substitution risk are differentiating factors for the industry, which ultimately depends on the degree of the specialisation of the workforce and asset-intensity. We define the four main industry groups for services companies, giving each an industry risk rating based on their risk drivers:

1. **Asset-light** balance sheet and mainly **unspecialised workforce**: medium cyclical, low entry barriers and medium substitution risk – leading to a **BB industry risk rating**.
2. **Asset-light** balance sheet and mainly **highly specialised workforce**: medium cyclical, medium entry barriers and medium substitution risk – leading to a **BBB industry risk rating**.
3. **Asset-heavy** balance sheet and mainly **unspecialised workforce**: medium cyclical, medium entry barriers and medium to high substitution risk – leading to a **BB industry risk rating**.
4. **Asset-heavy** balance sheet and mainly **highly specialised workforce**: high cyclical, high entry barriers and low substitution risk – leading to a **BBB industry risk rating**.

Figure 3 – Our industry matrix for European business and consumer services companies

Cyclical / Entry barriers	Low	Medium	High
High	CCC/B	B/BB	4 BB/BBB
Medium	1 B/BB	2+3 BB/BBB	BBB/A
Low	BB/BBB	BBB/A	AA/AAA

Source: Scope Ratings

We apply a blended industry risk rating when a services company is exposed to several sectors. We usually calculate this rating based on the proportion each sector contributes to EBITDA.

3.1.2 Competitive positioning

We assess the competitive positioning of services companies by examining the following risk drivers:

- Market shares
- Diversification
- Operating profitability
- Service strength

For certain competitive positioning assessments, our classification spans multiple rating categories (e.g. AA and above; CCC and below). We then perform a peer comparison to position the issuer in a single rating category.

Market shares

We review three criteria to assess market shares: i) market dominance; ii) size and pricing power; and iii) scalability of services. We assess the first two separately because a large market share does not necessarily translate into pricing power. Scalability of services provides a forward-looking indicator on how market share can develop and is based on multiple factors such as permits required, workforce used, assets needed and level of digitalisation.

Services companies range from large multinationals with strong brands to small local companies. Many small companies focus on a local market to exploit their comparative advantages, e.g. professional services (tax advisory) or central support services (payroll). Multinationals, in contrast, may provide standardised cross-border services and provide a broader range of services under one brand which share the same values but have local use restrictions or local added value. Multinationals have the clear advantage in leveraging their economies of scale to establish pricing power, serve large clients and market their brands.

Market shares of services companies are often lower than in other sectors. This is because entry barriers for asset-light companies are low, while asset-heavy companies can start a new business with relatively low investment, which can be later scaled up. In

contrast, sectors involving production capacity typically need larger investments and have tighter regulatory requirements, resulting in a less fragmented market than the services sector.

Therefore, as service markets are often fragmented, a double-digit market share can translate into a high sub-score for market share. Large and medium-sized service entities often rely on mergers and acquisitions to diversify their services, gain market share and expand their client base. Top-tier providers have double-digit market shares and visible, well-known brands. Mid-tier providers are usually secondary in terms of brand, service range and market size. Local providers that are less well known and have single-digit market shares are therefore generally rated below investment grade.

However, size alone is not an absolute rating criteria. A small regional provider can still be assigned a moderate rating if it has non-discretionary services and its services are scalable.

The market fragmentation also leads to strong competitive pressures in terms of pricing, services development, and consumer sentiment and preferences. To remain competitive, companies must actively manage prices and costs, be innovative, and create services and tools. Service providers with strong pricing power can differentiate themselves from competition, are able to secure and renew large long-term tenders and provide services that are integrated in the customer's operations, making them harder to replace.

Lastly, scalability of services often involves a local service provider acting as a franchisee or paying royalties to operate under a global brand. The entity owning the global brand does not guarantee the success or the debt repayment capability of the entity. Nevertheless, such arrangements ensure the service provided and the level of quality are the same across countries or even continents. This is often done through a network, which is a key advantage for local service providers. Economies of scale and digitalisation are therefore key in this regard as databases as IT tools make services scalable and cost-effective.

Asset-heavy companies can be scalable under the same terms and conditions, which can include a minimum service quality, pricing formulas adapted to the market, similar insurances and warranties, and regulatory approvals (e.g. recycling is often a state or tendered monopoly, or taxi licences can be restricted by local councils).

Figure 4 – Market shares by rating category

Market shares	AA and above	A	BBB	BB	B	CCC and below
Market dominance	Dominant global position	Dominant international position	Good international position in most services categories (top-tier and mid-tier)	Moderate regional market shares; modest position in most service categories and/or high local market share	Weak, mostly local position in most service categories	Very weak and deteriorating market share
Size and pricing power	Revenues of over EUR 5bn; very strong bargaining power and price-setting ability	Revenues of EUR 2bn-5bn, strong bargaining power and price-setting ability	Revenues of EUR 1bn-2bn and/or good bargaining power	Revenues of EUR 250m-1bn and/or moderate bargaining power	Revenues of EUR 50m-250m and/or limited bargaining power	Revenues of under EUR 50m, weak bargaining power and/or price follower
Scalability of services	Highly scalable business across regions with low administrative entry barriers (digitalised services and/or mostly unspecialised workforce or operated by customer with some specialised workers)	Highly scalable business across regions with moderate administrative entry barriers (digitalised services and/or mostly unspecialised workforce or operated by customer)	Highly scalable business across regions with moderate administrative entry barriers (digitalised services and/or mostly unspecialised workforce or operated by customer)	Moderately scalable business across regions with some tenders/licences/administrative entry barriers (need for specialised workforce)	Specialised/customised businesses with local character and significant adjustments needed across regions to the service composition as well as limited scalability	High share of discontinued operations and/or not scalable service

Diversification

We review four diversification categories: i) geographical; ii) customer granularity and supplier diversification; iii) service offering and cross-selling potential; and iv) distribution networks.

Strong geographical diversification can help to mitigate the impact from adverse regional economic conditions and is thus essential to our analysis. The range of services offered helps not only to diversify existing revenue sources but also to sell more services to existing customers, enabling better business development.

The degree of a company's customer and supplier diversification indicates the vulnerability or strength of its business model or operations. The company's distribution network is also linked to this assessment, as companies using multiple channels are more robust during downturns. For instance, companies using a combination of e-commerce platforms, the marketplace of services and traditional marketing and distribution will have much better and faster geographical access to customers than companies focused on traditional retail distribution models.

Asset-light services companies often need targeted communication with customers (conferences, referrals, tenders). However, a new service can be more easily sold to an existing, satisfied customer (cross-selling). In addition to traditional distribution channels, companies must be able use social media to successfully engage with younger and more tech-savvy consumers.

Figure 5 – Diversification by rating category

Diversification	AA and above	A	BBB	BB	B	CCC and below
Geographical outreach	Strong international presence; major player in many countries		International presence; operating in many countries	Limited diversification by countries	Only national presence with low growth opportunities	Purely local player in a shrinking market
Customer granularity and supplier diversification	Highly diversified regarding customers and suppliers (no significant dependence on large customers or suppliers)		Good diversification regarding customers and suppliers ⁴	Some dependence on certain customers and/or suppliers	Heavy dependence on single customer and/or supplier	Loss of or high probability of losing main customer/supplier
Service offering and cross-selling potential	Highly diversified service offering, large share of non-discretionary services and high cross-selling potential		Diversified service offering of non-discretionary and discretionary services and high cross-selling potential	Less diversified service offering with predominately discretionary services and moderate cross-selling potential	Highly concentrated service offering, primarily based on a single discretionary service and limited cross-selling potential	
Distribution network	Multiple well-established and robust distribution channels		Multiple distribution channels including third-party sales ⁵	Concentrated distribution channels with low third-party sales	Single distribution channel ⁶	

⁴ No dependence on top 10 customers and a handful of alternative suppliers for each service category

⁵ Multiple distribution channels usually refer to sales via physical sales/call centres, the internet through an own website/application, or third parties and their marketplace type application.

⁶ A single distribution channel usually refers to sales via physical sales or call centres/virtual sales offices.

Operating profitability

This analytical section consists of three measures to assess profitability and operating efficiency: i) the Scope-adjusted EBITDA margin; ii) Scope-adjusted return on capital employed and iii) the volatility of Scope-adjusted EBITDA margin.

High and stable profitability supports credit quality. This can be helped by variable-cost structures, the ability to reduce operating costs through productivity measures, digitalisation and the ability to adapt to market downturns. Profit margins of asset-light companies tend to be higher but also more volatile than that of asset-heavy companies.

Scope-adjusted return on capital employed is a financial ratio that we use to measure profitability and the efficiency with which a company uses funding to generate profits. A high ratio is more appealing to both equity and debt investors.

Volatility in Scope-adjusted EBITDA constitutes a risk. We deem volatility as high if recurring revenues are volatile. For example, sudden peaks in margins may be due to one-off revenues or success fees, whereas cost inflation that cannot be passed on to customers or the loss of key customers can cause a sudden drop.

Our analysis looks at both past and expected Scope-adjusted EBITDA volatility based on:

- Recurring service income: subscription-based services, contracts (minimum of one year)
- Non-recurring fees: single use of service, multi-usage (not pre-contracted)
- Initial or outcome-based service fees: one-off large project-based fees usually due at the start of the service as a set-up fee or at the end as an outcome-based fee or success fee

Figure 6 – Operating profitability by rating category

Profitability	AA and above	A	BBB	BB	B	CCC and below
Scope-adjusted EBITDA margin	>30%	30.0% to 22.5%	22.5% to 15.0%	15.0% to 7.5%	7.5% to 0%	Negative
Scope-adjusted return on capital employed	>40%	40% to 30%	30% to 20%	20% to 10%	10% to 0%	<0%
Volatility	Low		Medium		High	

Service strength

Service strength is a key factor in our assessment of services companies' competitive position. We review three business protection categories: i) brand strength and service quality; ii) revenue stability and predictability; and iii) service integration.

Branding plays a key role in our analysis of services companies as it is a key differentiating factor. A strong brand is also fundamental to maintaining commercial success. We assess intangible assets on the balance sheet to identify any vulnerability to changes in brand perception and/or competition. Strong brands lead to greater customer loyalty, lower price sensitivity, higher bargaining power and a greater ability to set prices and charge a premium, allowing good visibility over future revenues. The presence of established brands also creates an entry barrier, though digital marketing has made this less important. Consumer products companies and retailers often provide services under a brand. Such services, which are sold at the point of sale, usually have higher margins than production and retail/wholesale activity. Companies are also increasingly using social media and smartphone applications to build brands and communicate with customers. For example, automated sales offers can help to retain customers and boost demand.

Building strong brands need time and implies high advertising costs. B2C services companies are heavy users of advertising to inform customers and differentiate themselves to gain market share or create new markets. This sector is characterised by fierce competition, rapidly shifting consumer preferences and the continuous entry of alternative services and providers. Players compete on both price and quality, underscoring the importance of brand identification and product differentiation.

B2B services companies advertise similarly to B2C companies when both private consumers and companies can use their services. In addition to advertising, B2B companies also create and boost demand by educating the market, attending conferences, networking with existing and potential clients and cross-selling to existing clients.

Service quality is important as customers, especially in a fragmented market, will change to a provider with better service quality or a better ESG score. Service quality is strongly linked to brand strength. Service quality may decline over time if investments are not continually made in specialised labour or asset quality and customer ESG preferences.

Our second measure of service strength is revenue stability and predictability. This is measured using the churn rate and the cost to switch to a different service provider. The numbers of users, recurring users or subscriptions are often public data and constitute a key measurement for the services industry. The churn rate captures the share of lost customers. It is calculated as: lost customers over a period divided by the total customers at the start of period. One-off customers and those that do not convert to a subscription are considered lost customers over the same period. It is a key measure as customer retention is essential for a services company.

Customers often use multiple service providers. This causes price competition if the alternative service is equally convenient. Churn rates thus become visible gradually. If there is strong involvement in a customer's operations, there is usually a single service provider and hence the churn rate is visible immediately as the service is usually taken fully to a different provider. Sometimes, the ordering party acquires the service provider to insource the services.

Lastly, we look at the integration of a service in the customer's business as this is a good way to secure revenue. Critical and recurring business processes are mostly performed exclusively by a trusted service provider. Such providers typically provide a range of services or a complex service in the field. The more standardised the service and the less integrated the provider is with the customer, the less the provider's business is protected. Once service strength is high, changing service providers becomes costly, time consuming and inconvenient.

Figure 7 – Service strength by rating category

Service strength	AA and above	A	BBB	BB	B	CCC and below
Brand strength and service quality	Globally/internationally well-known brand with high-quality attributes and sustainability of services	Internationally/regionally well-known brand with good quality attributes and sustainability of services	Internationally/regionally well-known brand with good quality attributes and sustainability of services	Domestic/regionally known brand with moderate quality attributes and sustainability of services	Low brand strength with basic service quality attributes and low sustainability of services	Negative brand perception or reputational issues
Revenue stability and predictability	Low customer churn rate with high share of recurring revenues and multi-year contract length with high switching costs	Medium churn rate with high recurring revenues and monthly subscription fee with contract length of at least one year and moderate switching costs	Medium churn rate with high recurring revenues and monthly subscription fee with contract length of at least one year and moderate switching costs	High churn rate with moderate recurring revenues and monthly subscription fee and usually cancellable contract with low switching cost	High churn rate with very low or no recurring revenues and no minimum subscription fee and no switching costs	
Service integration	Critical business processes covered, mostly exclusively, with very high integration with the customer's business	High integration in the customer's business with several services, mostly on an exclusive basis	High integration in the customer's business with several services, mostly on an exclusive basis	Medium integration in the customer's business with several services, mostly not on an exclusive basis	Low or no integration in the customer's business; rather commoditised service	Decreasing service level; commoditised service

3.2 Financial risk profile

Our assessment of a services company's financial risk profile follows the general guidance presented in our [General Corporate Rating Methodology](#).

We focus on recent and forward-looking data including (but not limited to) key parameters like leverage, interest cover and cash flow. We also assess liquidity, which is particularly important for non-investment grade issuers.

The financial risk profile indicates a company's financial flexibility and viability in the short to medium term. A company with a strong financial risk profile is more likely to be resilient to economic downturns, adverse industry dynamics, unfavourable regulation, or an unexpected loss of a revenue source. The ability to retain financial flexibility during an economic downturn is a rating driver for services companies as it indicates an ability to invest at all phases of the economic cycle.

3.2.1 Credit metrics

Our general assessment of credit metrics (e.g. leverage, interest cover and cash flow cover) is outlined in the [General Corporate Rating Methodology](#).

3.2.2 Liquidity

Our general assessment of liquidity is outlined in the [General Corporate Rating Methodology](#).

3.3 Supplementary rating drivers

3.3.1 Financial policy

Our assessment of supplementary rating drivers is described in the [General Corporate Rating Methodology](#).

3.3.2 Parent/government support

Our assessment of parent support is described in the [General Corporate Rating Methodology](#). When assessing the credit quality of services companies that may benefit from government support, we incorporate the sovereign's or sub-sovereign's capacity and willingness to bail out a services company in financial distress, as laid out in Scope's rating methodology for [Government Related Entities](#).

3.3.3 Peer context

Our assessment of supplementary rating drivers is described in the [General Corporate Rating Methodology](#).

3.3.4 Governance and structure

Our assessment of supplementary rating drivers is described in the [General Corporate Rating Methodology](#).

3.4 Environmental, social and governance (ESG) assessment

Credit-relevant environmental and social factors are implicitly captured in the rating process, while corporate governance is explicitly captured at the 'governance and structure' analytical stage (see 3.3.4).

The rating analysis focuses on credit quality and credit assessment drivers. An ESG factor is only credit-relevant when it has a discernible and material impact on the issuer's cash flow, and, by extension, its overall credit quality.

Credit-relevant ESG factors can directly and indirectly affect all elements of the business risk profile, financial risk profile and supplementary rating drivers. This is in contrast to ESG ratings, which are largely based on quantitative scores on various rating dimensions.

Services companies are increasingly focused on environmental factors, using modern and efficient equipment to provide services. The sustainability of services and the automation of processes are gaining importance in the industry, not just because of cost efficiencies gained but also because of higher demand for greener services. This means green modes of transport for mobility and food delivery, good working conditions at the service provider, fair customer treatment and sound governance.

The main social factors for the services industry include oversight of the workers and physical assets used as well as relationships with local communities, especially in emerging countries or when using an unspecialised, low-paid or imported workforce. Services companies are under increasing scrutiny to respect human rights and local resources. A failure to incorporate ESG aspects in strategy could expose a company to reputational risks, which can have severe consequences for brand value. Customers often hold a company to a higher standard than what is required by law. A low employee churn rate is indicative of decent working

conditions, which can include proper accommodation and wages, good access to healthcare, training, bearable working hours and proper work equipment.

Strong governance ensures the proper reporting and enforcement of ESG policies in the company.

The [General Corporate Rating Methodology](#) provides further detail on how ESG factors and supplementary rating drivers are incorporated in the credit analysis.

4. Issuer rating

The final issuer rating is based on our analysis of the business risk profile, financial risk profile and supplementary rating drivers. The rating committee decides on the relative importance of each rating driver. The business risk profile and financial risk profile are generally weighted equally for companies that are crossover credits between investment-grade and non-investment-grade related to the final issuer rating. The business risk profile is typically emphasised for investment-grade companies, while the financial risk profile is the focus for non-investment grade companies. However, the latter also depends on the level of the financial risk profile.

Less focus is granted to strong financial risk profiles of companies showing a weak/vulnerable business risk profile (in the B or low BB category) since the financial risk profile is more volatile. This takes into account that the credit rating of companies with business risks that reflect weak or moderate credit quality should not be bolstered by a temporarily strong financial risk profile. Hence, the weighting between the business risk and financial risk profiles is adapted to each issuer's business model and markets.

5. Additional methodology factors

For more details on our rating Outlooks for corporate issuer ratings, long-term and short-term debt ratings, the recovery analysis see the [General Corporate Rating Methodology](#).

6. Appendix

6.1 Definition of financial items and key performance indicators applicable only to the services industry

The General Corporate Rating Methodology defines in detail the indicators used in our financial risk profile assessments.

Scope-adjusted EBITDA return on capital employed (%)
Operational efficiency measure
$\frac{\text{Scope-adjusted EBITDA}}{\text{(average property, plant and equipment + average intangible assets + average current assets – average short-term liabilities)}}$

This ratio measures efficiency at generating earnings from assets. It allows a comparison between companies with varying business mixes and capital intensities. Balance sheet values are typically used as reported, while EBITDA is adjusted for significant, exceptional and non-recurring items. We account for the average exposure of capital employed taking the average of the balance sheet values for periods t+1, t and t-1.

Churn rate
Used to assess services strength
$\frac{\text{Lost customers over a period}}{\text{Total customers at start of a period}}$

This ratio shows the development in recurring services and hence a company's service strength. A high churn rate indicates that a service is less attractive to its customers and/or a business is no longer scalable, which hinders the ability to generate cash flow.

Note: Non-recurring customers or customers that do not convert to subscription-based services are considered lost customers over the same period.

6.2 Related documents

For more information, please refer to the following documents:

- [General Corporate Rating Methodology](#)
- [Government Related Entities Rating Methodology](#)
- [Credit rating definitions](#)



European Business and Consumer Services Rating Methodology

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