Research Update:

Equifax Inc. 'BBB+' Rating Outlook Revised To Negative Following Announcement Of Cybersecurity Incident

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Table Of Contents

Overview
Rating Action
Rationale
Outlook
Ratings Score Snapshot
Related Criteria
Related Research
Ratings List
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Overview

- Atlanta-based consumer credit reporting agency Equifax Inc. announced a significant cybersecurity incident potentially affecting 143 million U.S. consumers.
- We are affirming our 'BBB+' corporate credit rating on Equifax and revising the outlook to negative from stable.
- The negative outlook reflects substantial uncertainty surrounding the eventual impact of this incident. We believe the company's strong market position, large recurring revenue base, and strong cash flow generation will enable the company to successfully remediate the attack and mitigate the impact to its core business. However, with considerable uncertainty, including potential for impacts on strategy, substantial litigation, fines and costs related to the incident, we expect that leverage could remain elevated above 2x over the next two years.

Rating Action

On Sept. 11, 2017, S&P Global Ratings affirmed all ratings, including its 'BBB+' corporate credit rating, its issue level rating of 'BBB+' on the company's senior unsecured debt, and its 'A-2' commercial paper rating, and revised the outlook to negative from stable.

Rationale

The rating action follows the company's announcement of a significant cybersecurity incident potentially affecting approximately 143 million U.S. consumers or roughly 45% of the population. Criminals exploited an Equifax run website through a website application vulnerability to gain access to files that contained names, Social Security numbers, birth dates, addresses and, in some instances, driver's license numbers. In addition, credit card numbers for approximately 209,000 U.S. consumers, and certain dispute documents with personal identifying information for approximately 182,000 U.S. consumers, were accessed. Based on the company's investigation, the unauthorized access occurred from mid-May through July 2017. The company reported that there was no evidence of unauthorized activity on Equifax's core consumer or commercial credit reporting databases.

In response to the incident, Equifax has offered its consumer credit
protection service free for one year to U.S. consumers who enroll by Nov. 21, 2017, including those who were not affected by the breach. In addition to these expenses, we believe the company faces meaningful costs related to lawsuits and potential government investigations, though any costs will be at least partially covered by cyber insurance. Further, we project that Equifax will see some pressure on its operations over the next 12 to 18 months. In particular, the company's Global Consumer Solutions business (13% of 2016 revenue) could see steep revenue declines since it derives a large portion of revenues from the U.S. consumer credit protection service. Finally, the incident also poses reputational risk that would have an impact on its other lines of business albeit to a lesser extent.

Equifax S&P Global Ratings-adjusted leverage (which nets 75% of cash against debt) is 2.2x as of June 30, 2017, and we expect that leverage will remain around this level through the end of the year as costs to remediate the cybersecurity incident and significant declines in its U.S. consumer business offset modest debt repayment and continued growth in its other lines of business. We project leverage will decline to around 2x by the end of 2018 with continued elevated costs. We do not expect the cybersecurity incident will have a substantial impact on the firm's financial policies including dividend payments, modest acquisitions and moderate share repurchases.

Nevertheless, we note that our assumptions in our current base-case scenario are partially derived from the experience of a very limited number of companies affected by cybersecurity incidents of this magnitude. These include Target in 2013, Yahoo! in 2013 and 2014 and eBay in 2014. The impact to Equifax could ultimately be more severe since the company has built its business as a leader in managing and protecting data. Additionally, there is inherent uncertainty surrounding the legal process in cases such as this as well as the potential for government intervention and increased regulation. We expect that extensive internal and external investigations will lead to more information in the coming months. Thus, we expect the impact of the event on costs and core operations could be significantly worse than our current base case before the breach causing leverage to remain elevated above our downside trigger of 2x.

Equifax is a leading provider of consumer and commercial credit scoring and analytics worldwide through its comprehensive credit files and demographic databases. We based our assessment of Equifax's business risk profile on the company's strong market position, the global credit information sector's high barriers to entry, and its consistently strong profitability. We view the recently announced cybersecurity incident, exposure to consumer lending markets and U.S. health care policy uncertainty as key near-term risks, but believe that the probability of Equifax facing significant share declines or loss of market position as low.

The company's core U.S. credit reporting business is mature, but provides a stable base of recurring revenues that Equifax has been able to expand upon through the development of increasingly sophisticated analytic tools and richer consumer data. The company competes primarily against Experian PLC and
Transunion LLC in this segment, and these three firms dominate the U.S. market. Although Equifax continues to derive a significant proportion of revenue from consumer mortgage, automotive, and credit card lending, it has grown end-market diversity through the increasing use of credit scoring data in other industry verticals, including healthcare and insurance.

Our base-case assumptions include the following:
• U.S. real GDP growth of 2.2% and 2.3% in 2017 and 2018 respectively;
• Eurozone real GDP growth of 1.4% and 1.3% in 2017 and 2018 respectively;
• APAC real GDP growth of 4.4% and 4.5% in 2017 and 2018 respectively;
• Equifax revenues grow in the mid- to high-single digits in 2017 and low- to mid-single digits in 2018, slightly faster than GDP due to Equifax's ability to grow revenue organically, exposure to international markets, and expansion into new industries offset by declines in the U.S. consumer business;
• EBITDA margins dip to the low- to mid-30% range in 2017 and 2018 due to costs related to the cybersecurity incident rebounding to the upper 30% in 2019 as excess costs abate.

Based on these assumptions, we arrive at the following credit measures:
• S&P Global Ratings adjusted debt to EBITDA of around 2.2x at the end of 2017 declining to 2x by the end of 2018;
• FOCF to debt of 30% by the end of 2017 increasing to around 33% in 2018.

Liquidity
We assess Equifax's liquidity as strong, due to our expectation that sources of cash will exceed uses by about 2.5x over the next 12 months, and 1x or more for the subsequent 12 months. We expect that net sources would be positive and there would be sufficient covenant headroom, even if there were a 30% decline in forecasted EBITDA. The company has a generally high standing in credit markets and has well established relationships with banks.

Principal liquidity sources:
• Cash of $131.4 million as of June 30, 2017, pro forma for the July 2017 redemption of $272.5 million in notes;
• Annual operating cash flow of about $800 million – $900 million (inclusive of costs related to the cybersecurity incident); and
• Approximately $383 million available under its $900 million revolving credit facility, after commercial paper outstanding.

Principal liquidity uses:
• Annual capital expenditures of $180 million-$200 million; and
• Annual dividends of $180 million-$200 million.

Covenants
Equifax's credit facility carries a maximum leverage ratio financial maintenance covenant of 3.5x. Equifax had more than 30% EBITDA cushion as of June 30, 2017. We expect the firm to maintain ample headroom under the covenant over the next two years.
Outlook

The negative outlook reflects significant uncertainty surrounding the impact of the recent cybersecurity incident. We believe the company's strong market position, large recurring revenue base, and strong cash flow generation will enable the company to successfully remediate the attack and mitigate the impact to its core business. However, with substantial litigation expected and potential fines, as well uncertainty surrounding costs to remediate and possible strategy shifts, we expect that debt leverage could remain elevated above 2x over the next two years.

Upside scenario

We could revise the outlook back to stable over the next two years if the company makes progress settling litigation related to the cybersecurity incident while maintaining strong operating performance in its core businesses and reducing leverage below 2x.

Downside scenario

We could lower our ratings if costs to remediate the cybersecurity incident, loss of market share and revenue due to the attack, further weakness in internal controls that would affect our view of management and governance framework or increasingly aggressive shareholder return policies lead to sustained adjusted net leverage in excess of 2x.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Negative/A-2

Business risk: Satisfactory
• Country risk: Very low
• Industry risk: Intermediate
• Competitive position: Satisfactory

Financial risk: Modest
• Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers
• Diversification/Portfolio effect: Neutral (no impact)
• Capital structure: Neutral (no impact)
• Financial policy: Neutral (no impact)
• Liquidity: Strong (no impact)
• Management and governance: Satisfactory (no impact)
• Comparable rating analysis: Neutral (no impact)
Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Technology Software And Services Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Cyber Risk And Corporate Credit, June 9, 2015

Ratings List

<table>
<thead>
<tr>
<th>Ratings Affirmed; Outlook Action</th>
<th>To</th>
<th>From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equifax Inc. Corporate Credit Rating</td>
<td>BBB+/Negative/A-2</td>
<td>BBB+/Stable/A-2</td>
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</tbody>
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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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.