FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Intralot at 'CCC+', Removes from Rating Watch Positive

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Fitch Ratings - Stockholm - 05 Feb 2024: Fitch Ratings has affirmed Intralot S.A.'s Long-Term Issuer Default Rating (IDR) at 'CCC+' and removed it from Rating Watch Positive (RWP). Fitch has also affirmed Intralot Capital Luxembourg S.A.'s 2024 senior unsecured notes' rating at 'CCC' with a Recovery Rating 'RR5', and removed it from RWP.

The rating action reflects residual refinancing risks relating to the company's remaining EUR230 million September 2024 senior unsecured notes, with Intralot's ability to refinance the debt in a timely manner being contingent on an imminent successful placement of EUR130 million of bonds. The looming refinancing risk is partially offset by Intralot's slightly reduced leverage at end-2023 after an equity placement allowed the company to redeem EUR126 million of the outstanding 2024 notes. The 'CCC+' rating also takes into account the maturity of a USD230 bank loan million due in July 2025.

KEY RATING DRIVERS

Equity Placement Reduces Leverage: Intralot's EUR135 million equity placement in 2H23 allowed it to improve its capital structure through a EUR126 million cancellation of its 2024 notes. We estimate Intralot to have further improved its leverage metrics as of 2023 to 3.7x from 4.9x in 2022 as a result of both EBITDAR growth and partial debt prepayment.

Looming Refinancing Risk: Uncertainty around the refinancing risk in our rating case to 2026 constrains the rating, with the majority of Intralot's debt maturing in 2024 and 2025. We acknowledge the progress made on the 2024 debt refinancing, but see residual risks after process delays, with its refinancing being contingent on an imminent successful placement of a EUR130 million bond.

In addition, the rating is affected by the USD230 million bank loan maturity in July 2025. A refinancing of the 2025 debt well in advance of its maturity is instrumental to returning Intralot to a performing credit profile under our current rating case, assuming continuation of its positive operational momentum and prudent capital allocation.

US Operations Driving Performance: As of end-2022, over 60% of Intralot's EBITDAR was generated in the US and Canada through Intralot Inc., its wholly-owned US subsidiary. Fitch forecasts that the new contracts signed in 2023 will additionally support low-to-mid single-digit revenue growth in the region over the medium term. We expect Intralot's US operations to continue exhibiting strong profitability, with EBITDAR margins maintained at above 40%.

Change in Financial Strategy: Fitch acknowledges the shift in Intralot's financial strategy towards greater conservatism and disciplined capital allocation. In 2022, Intralot used equity placement to streamline its capital structure and refinanced its US subsidiary debt with less restrictive terms and gradual principal repayment. However, this US subsidiary debt remains structurally senior to Intralot's 2024 notes. We expect the company to proactively address its refinancing well ahead of next year's July maturities.

Low Leverage for Rating: EBITDAR growth and net debt reduction in 2022 allowed Intralot to improve its EBITDAR leverage to 4.9x in 2022 from 5.7x in 2021. We estimate 2023 EBITDAR to have grown further to EUR130 million, despite anticipated modest year-on-year decline in revenues from its non-renewal of license in Malta. Continued organic deleveraging should support refinancing prospects, with 2023 credit metrics estimated to be strong for Intralot's rating.

Contract Portfolio Expiration Risks: Fitch views Intralot's contracted revenues as more visible and predictable, albeit subject to license/contract renewal risks, and the company is not always able to compete for renewals with local or international peers. The current portfolio has a moderate license/contract expiration profile, with no large renewals in the medium term, except for a license in Morocco in 2025 that Fitch assumes will not be renewed in its rating case. In 2027, contracts in Argentina and Australia, collectively generating 27% of EBITDAR as of 2022, will expire. Intralot's ability to maintain a balanced license expiration profile remains important for the rating trajectory.

Exposure to Emerging-Market Currencies: Our ratings reflect that most of Intralot's revenues are not generated in its reporting currency, increasing its exposure to foreign-exchange (FX) market volatility. In 2022, Turkey and Argentina accounted for around 25% of Intralot's revenues (up from around 20% in 2021). We believe the high inflationary environment makes it difficult for Intralot to fully pass on cost increases, and hence expect it to continue to undermine revenue growth and profitability.

Intralot does not employ financial derivatives to hedge its currency risk. Hence currency volatility, especially in emerging markets, could materially affect its performance.

DERIVATION SUMMARY

Intralot's current financial profile is not comparable with that of other more business-to-consumer EMEA gaming companies, such as Flutter Entertainment plc (BBB-/Stable), Entain plc (BB/Stable), Allwyn International a.s. (BB-/Stable), or its B2B peers International Game Technology plc (BB+/Stable) and Light & Wonder, Inc. (BB/Stable).

After the completion of its 2021 restructuring, Intralot has similar scale and a comparable financial profile to Inspired Entertainment, Inc. (B/Stable). Inspired exhibits slightly lower leverage with longer maturities and a more intact, albeit higher geographically concentrated, business model, resulting in a two-notch difference between the ratings.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Revenue declining by low-to-mid single digits in 2023 and 2024, driven by FX volatility in Argentina (as assumed by Fitch)

- Average 2025-2026 annual revenue growth at low single digits, mainly driven by Intralot's operations in the US (EUR160 million-EUR180 million contribution per year)

- Improved profitability for operations in the US and Croatia, resulting in EBITDA margin stabilising at around 33% by 2026

- Average annual capex at 12% of revenue to 2026, primarily for the suite of contract renewals and new projects in the US as well as ongoing maintenance for the lottery segment and growth initiatives within US operations

- Net working capital at around 10%-13% of revenue to 2026

RECOVERY ANALYSIS

The recovery analysis assumes that Intralot would be considered a going concern (GC) in bankruptcy and that it would be reorganised rather than liquidated. We have assumed a 10% administrative claim.

We applied a distressed enterprise value (EV)/ EBITDA multiple of 5.0x to Intralot's wholly-owned operations.

The GC EBITDA of Intralot (now including Intralot Inc.) of EUR65 million reflects our view of a sustainable, post-reorganisation EBITDA level, on which we base the valuation of the group excluding JVs. JVs in Turkey and Argentina are assumed to provide an additional around EUR20 million to the GC EV.

After deducting 10% for administrative claims, our principal waterfall analysis would generate a ranked recovery in the 'RR5' band, leading to a notching-down of the senior unsecured debt from the IDR. In the debt waterfall we treat Intralot Inc.'s term loan and revolving credit facility (RCF) - assumed fully drawn in distress - as ranking senior to the 2024 senior unsecured notes. This results in a waterfall- generated recovery calculation of 24% based on current assumptions.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Successful completion of refinancing leading to absence of debt maturities within a 12-18 month period

- Healthy liquidity, as underlined by positive free cash flow (FCF) and a lack of permanent RCF drawdowns

- EBITDAR leverage below 5.5x

- EBITDAR coverage above 1.8x on a sustained basis

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Failure to refinance upcoming debt maturities six to 12 months in advance

- EBITDAR leverage above 7.0x

- EBITDAR coverage below 1.5x

- Sustained negative or volatile FCF and lack of sufficient operational liquidity to support operations within the next 12-18 months

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity for Operations: Virtually all of Intralot's debt mature in 2024 and 2025. We expect the company to proactively address 2024 and 2025 refinancing given its equity placement and FCF would not be sufficient.

Refinancing risk aside, we expect Intralot to have sufficient liquidity to fund its operations, with forecast positive FCF and a USD50 million RCF providing additional flexibility for its growing US operations.

ISSUER PROFILE

Intralot is a supplier of integrated gaming systems and services. It develops, operates and supports customised software and hardware for the gaming industry and provides innovative technology and services to state and state-licensed lottery and gaming organisations worldwide.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
Intralot S.A.	LT IDR	CCC+	Affirmed		CCC+ Rating Watch Positive
Intralot Capital Luxembourg SA					
senior unsecured	LT	CCC	Affirmed	RR5	CCC Rating Watch Positive

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Anton Shishov
Director
Primary Rating Analyst
+46 85051 7802
anton.shishov@fitchratings.com
Fitch Ratings Ireland Nordic Region Filial
Kungsgatan 8 Stockholm 111 43

Elena Stock
Senior Director
Secondary Rating Analyst
+49 69 768076 135
elena.stock@fitchratings.com

Alex Griffiths, FCA
Managing Director
Committee Chairperson
+44 20 3530 1709
alex.griffiths@fitchratings.com

MEDIA CONTACTS

Isobel Burke
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Intralot Capital Luxembourg SA	EU Issued, UK Endorsed
Intralot S.A.	EU Issued, UK Endorsed

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