

## **FITCH REVISES INTRALOT'S OUTLOOK TO STABLE; AFFIRMS IDR AT 'B+'**

Fitch Ratings-London-17 May 2017: Fitch Ratings has affirmed Intralot S.A's Long-Term Issuer Default Rating (IDR) at 'B+'. The Outlook has been revised to Stable from Negative. A full list of rating actions is at the end of this commentary.

The Stable Outlook reflects our belief that Intralot's underlying business model and financial trends appear to have stabilised, underpinned by steady recurring contracted revenues and cash-flow generation. We view management's attempts to rebalance the portfolio over the past year positively, while the planned sale of its Oceania business, whilst not seen as critical to steer Intralot's credit profile, has been delayed due to circumstances beyond its control.

Despite the improvement seen in FY16 Intralot's high gross leverage remains not fully aligned with a 'B+' rating, but the business profile is commensurate with a 'BB' rating category for the sector. The solid business risk profile together with a weaker financial profile supports Intralot's IDR at 'B+'. In its assessment Fitch estimates that Intralot will maintain a conservative financial structure. Any evidence of a deteriorating operating environment, contracts not renewing or renewing on worse terms, unexpected cash leakages, or weakening of liquidity will be negative for the rating.

### **KEY RATING DRIVERS**

**Recurring Contracted Revenue Base:** Intralot's credit profile benefits from more than 85% of revenues recurring and contracted up until 2021, with only three contracts up for renewal in 2018. The fall in EBITDA margin appears to have stabilised and we expect this to improve to 13.7% in 2017. However due to high switching costs, we expect many of the contracts to be renewed, although we continue to believe these could be on lower margins in future and may require a higher renewal fee. EBIT margins are now above the minimum threshold of 7% supporting the 'B+' rating.

**Weak Free Cash Flows:** We expect free cash flow (FCF) to be negative in 2017 and 2018, bottoming at -1.8% in 2018 due to one-off investments and some renewal fees and then to turn positive thereafter. FCF can be volatile as a result of upfront investments related to new contracts of contract renewals; however this does contribute to a steady operating cash-flow generation due to its recurring profit stream as a key credit support.

**Leverage Declines From 2015 Peak:** Fitch expects funds from operations (FFO) adjusted gross leverage to remain high at about 6.0x in 2017 and 2018. Our base-case projections do not factor in any proceeds from the sale of Oceania. This level of gross leverage is not commensurate with a 'B+' rating which indicates low financial headroom. However, FFO adjusted net leverage remains within our sensitivity guidance for the rating below 4.5x. We anticipate some deleveraging from the group's underlying operating performance, but the potential sale of Oceania or other assets could still be used to accelerate the debt reduction process.

**Reputable Gaming Operator, Technology Supplier:** Intralot has established itself in the international gaming sector as a reputable provider of, among other products, systems to manage lotteries through software platforms and hardware terminals, and in betting, a large algorithm-based sportsbook. This has enabled it to win important contracts for the supply of technology and the management of lotteries in the US and Greece and for sports betting in Turkey and Germany.

**Positive Scope for Growth:** The gradual liberalisation of gaming markets, governments' keenness on finding ways to raise tax proceeds and the increasing supply of new games, should all provide increasing opportunities for Intralot. The company should be able to leverage on its experience and reputation and also benefit from the limited number of reputable suppliers in the industry, allowing the group to expand into new geographies. Intralot is also well positioned to benefit from opportunities in the US.

**Limited Linkage with Greece:** Intralot generates only less than 10% of its EBITDA in Greece (rated 'CCC'). We view Greece's low sovereign rating as neutral for Intralot's ratings given its contractual requirement to maintain large portions of its cash outside Greek banks. In the event of a sovereign default, including Greece's exit from the euro - a scenario that we do not currently envisage - the company has contingency plans in place that it could complete within three months. Intralot's wide geographic diversification of its business and lack of meaningful reliance on Greek banks for funding mitigates its exposure to Greece and other countries with 'b' economic environment.

**Above-Average Recovery Expectations:** In our bespoke going-concern recovery analysis we look at Intralot's 2016 EBITDA of EUR106 million (after deducting attributable EBITDA to minority interests) and this is further discounted to arrive at an estimated post-restructuring EBITDA available to creditors of around EUR84.8 million. We apply a conservative distressed EV/EBITDA multiple of 4.5x to Intralot's wholly owned operations.

We also estimate EUR100 million of additional value stemming from minority interests, mainly from emerging markets. In terms of distribution of value, all unsecured debt would recover 58% in the event of default consistent with an 'RR3' and an instrument rating of 'BB-', one notch above the IDR.

## DERIVATION SUMMARY

Intralot is positioned well in the 'B' rating category compared to its peers. The main differentiating factor being its visibility of revenue from recurring contracted EBITDA. Intralot has smaller revenue and EBITDA than Ladbrokes, William Hill, IGT, and Scientific Games. However, it does have good geographic diversification and benefits from the more profitable emerging markets. It also has an established position in the US, and is well placed for potential future growth opportunities. Compared to peers at the 'B' rating level, Intralot has certain differentiating characteristics, such as the abovementioned contracted EBITDA and specialist supplier technology expertise.

## KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- revenue growth of 2% in 2017, accelerating in 2018 and 2019 underpinned by new contracts and some organic growth;
- EBITDA margin remaining steady at between 13.5% and 14.0%;
- rental expenses lower as a result of leases associated with expiring contracts;
- minority profits fully paid out fully as dividends, EUR39 million in 2017, EUR44 million in 2018;
- capex higher in 2017 and 2018 due to contract renewals and investments in new contracts which we assume will be partially funded by debt drawdowns;
- we forecast capex falling back towards about EUR45-50 million per annum from 2019;
- no common dividends.

## RATING SENSITIVITIES

#### Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Revenue growth and steady profitability supported by a stronger return on capital on existing and future contracts with limited capex outlays
- FFO adjusted net leverage reducing sustainably below 3.0x (or FFO gross lease adjusted leverage below 4.0x), with cash deposited predominantly at investment grade-rated counterparties
- FFO fixed charge cover above 3.0x, unaided by favourable interest carry
- Evidence of sustained positive FCF generation in the low to mid-single digits of sales.

#### Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Evidence that new contracts or renewals are occurring at materially less favourable conditions for Intralot, resulting in continuing weak EBIT margins of under 7%, large upfront concession fees or capex outlays (2016: 8.2%)
- FFO adjusted net leverage sustainably above 4.5x (or FFO adjusted gross leverage above 5.5x) (FY16: 4.3x and 5.6x respectively)
- FFO fixed charge cover below 2.0x (2016: 1.8x)
- Material reduction in liquidity without a commensurate reduction in gross debt levels

## LIQUIDITY

Comfortable Liquidity Following Refinancing: At end-2016, Intralot had EUR164 million of cash on its balance sheet, of which about 7% was deposited in Greek banks, and around EUR65 million of undrawn availability under committed facilities. This was sufficient for liquidity purposes with no significant debt maturity until 2019, when the term facilities mature, while the two bonds (totalling EUR500 million) mature during 2021. During the start of 2017, Intralot drew EUR15 million under its RCF with respect to the new Amelco partnership.

In response to the Greek debt crisis and to protect its liquidity position, Intralot fully drew on its syndicated revolving credit facility (RCF; EUR120 million of EUR200 million facility) maturing May 2017. This was replaced by a new EUR225 million syndicated facility maturing in 2019 (RCF EUR86 million, term loan EUR99 million and standby RCF EUR40 million) following the successful placement of the EUR250 million unsecured notes in September 2016 extending maturities.

## FULL LIST OF RATING ACTIONS

Intralot S.A.

--Long-Term IDR affirmed at 'B+'; Outlook Stable (previously Negative)

Intralot Capital Luxembourg S.A.

--Senior unsecured notes affirmed at 'BB-/RR3';

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### Summary of Financial Statement Adjustments

Regular minority dividends adjustments: We deduct the estimated amount of recurring dividends paid to / dividends received from minorities of EUR41 million (2016) from our calculation of FFO.

Leases: Although operating leases are modest, Fitch has adjusted the debt by adding 8x of annual operating lease expense related to long term assets of EUR64 million (2016).

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### Applicable Criteria

Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016)

<https://www.fitchratings.com/site/re/887669>

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)

<https://www.fitchratings.com/site/re/895493>

Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 21 Nov 2016)

<https://www.fitchratings.com/site/re/890199>

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