

RATING ACTION COMMENTARY

Fitch Upgrades Intralot to 'CCC+'

Mon 15 Aug, 2022 - 7:08 AM ET

Fitch Ratings - Stockholm - 15 Aug 2022: Fitch Ratings has upgraded Intralot S.A.'s Long-Term Issuer Default Rating (IDR) to 'CCC+' from 'CCC'. We have also affirmed the senior unsecured rating on the 2024 notes issued by Intralot Capital Luxembourg S.A. at 'CCC' and revised the Recovery Rating to 'RR5' from 'RR4'.

The upgrade of the IDR reflects our revised parent-subsidary linkage (PSL) assessment, which considers the refinancing of Intralot's US operations' debt with new bank financing (maturing in 2025). The terms of this new debt improve Intralot's access to its subsidiary's cash flows and are favourable for the cost of debt at consolidated level. The revised PSL assessment also takes into account the increase in ownership of Intralot Inc. to 100%, fully equity-funded via placement of common shares. Retaining access to Intralot Inc.'s cash flows remains critical for Intralot to support adequate debt service ratios and its current rating.

The 'CCC+' IDR reflects our view of high refinancing risks in relation to its 2024 notes, as Intralot will not generate sufficient free cash flow (FCF) to be able to fully repay them, thus relying on continuing access to the debt capital and bank markets for refinancing. At the same time, the limited scale of Intralot's ex-US operations compared with the amount of its debt could lead to refinancing difficulties or more onerous terms, putting further pressure on Intralot's cash flow generation.

KEY RATING DRIVERS

Parent Subsidiary Linkage Reassessed: New debt terms at the Intralot Inc. level increase Intralot's access to the cash flows of its US subsidiary due to the elimination of

cash upstream restrictions. Therefore, we now assess Intralot's credit profile based on consolidated accounts, as opposed to our previous deconsolidation of Intralot Inc. for the calculation of leverage and coverage metrics. However, we acknowledge that US cash is not pooled at the Intralot S.A. level, which weakens its standalone liquidity profile.

2024 Notes Refinancing Risk: Fitch considers Intralot's 2024 notes to be structurally subordinated to Intralot Inc.'s debt. Refinancing this debt with no recourse to Intralot Inc. remains a challenge as Intralot S.A.'s (ex-US operations) standalone leverage is materially above consolidated levels, and we foresee very limited organic deleveraging at the ex-US business in 2022-2023. Prepayment of debt using cash upstream from Intralot Inc. or the partial monetisation of assets could help reduce the leverage of the ex-US business prior to refinancing.

US Performance Critical for Rating: We expect that Intralot Inc.'s business will continue to generate at least two-thirds of Intralot's consolidated EBITDA over 2022-2025, and we assume that its share of group's profits will be increasing over the medium term. Access to Intralot Inc.'s cash flows through dividends and management and service fees remains critical to Intralot's debt service as US debt remains currently ring-fenced.

Limited Scale Outside US: After the Maltese contract was not renewed, we expect Intralot's non-US business to generate EBITDA in the range of EUR30-40 million, with negative growth in 2023-2025. This business scale, at current profitability levels, provides little cash flow generation to service Intralot's 2024 notes. The Fitch case points to a standalone (i.e. ex-US) funds from operations (FFO) fixed charge cover at around 1.1-1.3x in 2022-2024, with more than 50% of interest expenses in 2023 fully dependent on the cash upstream from Intralot Inc. Otherwise consolidated FFO fixed charge sits at a more comfortable level above 2.0x.

Consolidated Leverage Considerably Lower: Intralot's consolidated leverage profile has improved since 2021 due to Intralot Inc.'s materially stronger standalone profile, which we previously deconsolidated for calculation of leverage and coverage metrics. We forecast that Intralot will be able to maintain adjusted gross debt/EBITDAR at around 6.0x-6.5x in 2022-2024. On a standalone basis, Intralot's leverage remains excessive, with FFO adjusted leverage forecast at 11.0x-12.0x in 2022-2024, compared with 7.0x-8.0x on a consolidated basis.

Exposure to FX Volatility: Most of Intralot's revenues are not generated in its reporting currency, increasing its exposure to FX market volatility. In 2021, Turkey and Argentina accounted for around 20% of Intralot's revenues and Turkish lira and Argentine peso depreciation in 2022 will affect consolidated revenues and operating results. US dollar

appreciation to the euro should partially offset this impact. Intralot does not employ financial derivatives to hedge its exposure to currency risk and future exposure to 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 gaming companies, such as Flutter Entertainment plc (BBB-/Negative), Entain (BB/Positive), Allwyn International a.s. (Sazka, BB-/Stable). Intralot has smaller size and lower through-the-cycle profitability than gaming operator Codere (WD).

After the completion of its 2021 restructuring, Intralot has similar business profile characteristics to Inspired Entertainment, Inc. (B-/Positive) but it still exhibits significantly weaker leverage profile vs Inspired, which we expect to demonstrate deleverage to levels more consistent with 'B' over the next two years, hence its Positive Outlook.

KEY ASSUMPTIONS

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

- FY22 revenues declining by 13.5% reflective primarily of the reduction in the contribution from Malta; a further decline (-14.7%) in FY23 on the back of the complete removal of the Maltese revenue as well as FX volatility in Argentina (as assumed by Fitch)

- Flat revenues in FY24 followed by a low single digit (<3%) growth in FY25 driven mainly by Intralot's operations in the US (EUR150-170 million contribution per year)

- Profitability improvement for operations in the US and Croatia, resulting in the EBITDA margin stabilising at around 30%

- EUR40 million capex in FY22 required primarily for the suite of contract renewals and new projects in the US segment; 7-9% of revenues thereafter to support the ongoing maintenance for the lottery segment as well as growth initiatives within the US operations

- Low double-digit annual working capital outflows

- Dividends of around EUR8 million paid annually by Intralot Inc. in 2022-2025

KEY RECOVERY RATING ASSUMPTIONS

The recovery analysis assumes that Intralot would be considered a going concern 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 going concern EBITDA of Intralot S.A. (now including Intralot Inc.) of EUR65 million reflects our view of a sustainable, post-reorganisation EBITDA level, upon 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 going concern EV.

After deducting 10% for administrative claims, our principal waterfall analysis would generate a ranked recovery in the 'RR5' band, indicating a lower rating for the unsecured debt at parent company than its IDR. In the debt waterfall we treat the new Intralot Inc.'s term loan and revolving credit facility (RCF) - assumed fully-drawn in distress, ranking senior to the 2024 notes. This results in a waterfall generated recovery calculation of 11% based on current assumptions.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Healthy liquidity evidenced by positive FCF and lack of permanent RCF drawdowns;
- Refinancing risk managed through organic deleveraging, cash accumulation or divestments
- FFO margin sustainably above 10%;
- FFO-based gross adjusted leverage below 6.0x and total adjusted debt/EBITDAR below 5.5x;
- FFO fixed charge cover sustainably above 1.8x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO adjusted gross leverage above 7.5x and total adjusted debt/EBITDAR above 7x;
- FFO fixed charge cover below 1.5x;

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

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Improved Liquidity at Consolidated Level: As of end-March 2022, Intralot had around EUR100 million of cash on balance sheet, of which EUR55 million was within the US operations. Intralot Inc.'s liquidity has further improved with the addition of an RCF (USD50 million). Intralot's operations outside the US continue to exhibit weaker cash flow generation and remain reliant on cash upstream from Intralot Inc. for comfortable debt service coverage.

Debt structure at consolidated level remains weak, with large maturities coming in 2024 and 2025. Deleveraging ahead of refinancing is now critical for Intralot's credit profile.

ISSUER PROFILE

Intralot is a supplier of integrated gaming systems and services. The group develops, operates and supports customised software and hardware for the gaming industry and provides innovative technology and services to state and state licenced lottery and gaming organizations worldwide. Intralot also holds some licences for full games operation.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

| ENTITY / DEBT ↕ | RATING ↕ | | | RECOVERY ↕ | PRIOR ↕ |
|-----------------------------------|----------|------|----------|------------|---------|
| Intralot S.A. | LT IDR | CCC+ | Upgrade | | CCC |
| Intralot Capital Luxembourg SA | | | | | |
| senior unsecured | LT | CCC | Affirmed | RR5 | CCC |

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Country-Specific Treatment of Recovery Ratings Criteria \(pub. 05 Jan 2021\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)
\(including rating assumption sensitivity\)](#)

[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

APPLICABLE MODELS

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

[Corporate Monitoring & Forecasting Model \(COMFORT Model\), v8.0.3 \(1\)](#)

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