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Rating Action: Moody's downgrades Intralot to B2 and maintains a negative outlook

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London, 12 September 2018 -- Moody's Investors Service ("Moody's") has today downgraded Intralot S.A.'s corporate family rating (CFR) to B2 from B1 and probability of default rating (PDR) to B2-PD from B1-PD. Concurrently, Moody's has downgraded to B2 from B1 the instrument ratings on the EUR250 million Senior Notes due 2021 and EUR500 million Senior Notes due 2024, both issued by Intralot Capital Luxembourg S.A. The outlook on the ratings is negative.

RATINGS RATIONALE

The downgrade of Intralot's CFR to B2 reflects the continued high Moody's adjusted leverage which has remained above the downgrade trigger of 4x for the past year (4.2x at LTM June 2018), as well as Moody's expectation that leverage will increase towards 5x by the end of 2018 due to a decrease in EBITDA driven mainly by unfavorable currency movements particularly the Turkish lira. Moody's expectation is that there will be no deleveraging before 2020 unless significant disposal proceeds are used to repay debt. In addition to high leverage the downgrade is due to the persistent negative free cash flow generation since 2015 which is expected to continue until 2020 as a result of the capital expenditures required to grow the business and achieve new contract wins, as well as dividend payments to minorities.

Intralot's B2 CFR also reflects (i) the company's significant presence in certain emerging markets including Argentina, Azerbaijan and Turkey, the latter contributing 23% of 2017 EBITDA (20.6% in H1 2018); (ii) limited historic growth track record; (iii) exposure to regulatory and fiscal risks inherent to the gaming industry; (iv) the risk of further unfavorable foreign exchange movements resulting from the discrepancy between the main currency of the debt and its cash flow generation, and; (v) the existence of significant minority interests which results in pro-rata leverage being materially higher than reported (fully consolidated) leverage, as well as substantial cash leakage through dividend outflows to the minorities.

More positively, Intralot's B2 CFR takes into account (i) a leading market position as a global supplier of integrated gaming systems and services; (ii) a diversified contract portfolio with 87 contracts and licences; (iii) its broad geographical presence in 50 jurisdictions with a foothold in the US which has significant growth potential following the invalidation of the US federal sports betting ban, although with dependency on certain countries in emerging markets such as Turkey and Argentina; (iv) good revenue visibility as a result of a large number of long-term contracts, and; (v) a proven track record of renewing existing contracts and winning new business, with growth potential from further liberalization of the gaming sectors in less mature markets.

LIQUIDITY

Moody's considers Intralot's liquidity profile to be weak. The company's significant near-term cash requirements to support working capital, capital expenditures and dividend payments to minorities are expected to drive negative free cash flow until at least the end of 2019. Although there is a significant consolidated cash balance of c. EUR195 million at 30 June 2018, this cash is not fully available since around 30% resides in partnerships and belongs to minorities according their relevant stakes, and there is also a small degree of risk of currency devaluation against the euro. Moody's also notes the requirement for around EUR60 million of cash for basic operational needs and expects the company to need access to its revolving credit facilities (RCFs) over the next 18 months. The RCFs include two EUR40 million facilities both maturing on 30/6/2021 which contain leverage and interest coverage covenants that are currently in the process of being renegotiated due to the risk of being breached if tested. Moody's expects that the RCFs will be reduced to a combined range of EUR60 million to EUR70 million, and that they will be successfully renegotiated, but cautions that any failure to renegotiate the covenants in a timely manner will put immediate further pressure on the ratings. The company has stated that its 20% stake in Gamenet Group S.p.A. (B1, stable) which is valued at EUR53 million based on Gamenet's market capitalization as at 11 September 2018 will be sold at an appropriate time and this could reduce pressure on liquidity.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects Moody's expectation that leverage will continue to increase into 2019, that free cash flow will remain negative until at least 2020, and that there is considerable uncertainty related to the timing of intended disposals and the use of the potential sale proceeds for debt reductions and/or to improve liquidity, which could hinder any positive movements in its credit metrics.

WHAT COULD CHANGE THE RATING UP/DOWN

Given the negative outlook, Moody's anticipates no upward pressure on the ratings. A stabilization of the negative outlook could result if the company reduces its debt from the proceeds of expected disposals and maintains an adjusted debt/EBITDA of 4x or less, delivers on its growth strategy for the remaining core business while generating positive free cash flow, and stabilizes liquidity.

Downward pressure on the ratings could result from (i) Debt/EBITDA (as adjusted by Moody's) sustainably exceeding 5.0x in any year going forward; (ii) interest coverage (measured as EBIT/interest expense, and as adjusted by Moody's) falling below 1.5x; (iii) further deterioration of the underlying cash or other source of a weakening in the company's liquidity; or (iv) a materially adverse regulatory change.

STRUCTURAL CONSIDERATIONS

The EUR500 million 5.250% Senior notes due 2024 and EUR250 million Senior Notes due 2021 are pari passu. The notes and bank facilities share the same guarantee package, set for a minimum of 70% of the consolidated EBITDA and total assets in the facilities agreements. Moody's notes that the presence of minorities in certain guarantor subsidiaries reduces the potential support available from such entities.

The principal methodology used in these ratings was Gaming Industry published in December 2017. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

PROFILE

Headquartered in Athens, Intralot, is a global supplier of integrated gaming systems and services. Intralot designs, develops, operates and supports customized software and hardware for the gaming industry and provide technology and services to state and state licensed lottery and gaming organizations worldwide. Intralot operates a portfolio of 87 contracts and licenses across 50 jurisdictions employing approximately 5,100 people. Intralot is listed on the Athens stock exchange and has a market capitalization of c. EUR110 million as at 11 September 2018.

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Related Issuers

- Intralot Capital Luxembourg S.A.
- Intralot S.A.

Related Research

- Credit Opinion: Intralot S.A.: Update following September 2017 refinancing
- Credit Opinion: Intralot S.A.: Update following the issuance of EUR250 million senior unsecured notes due 2021
- Announcement: Moody's: EMEA gaming sector outlook stable into 2019 on steady earnings growth
- LGD Assessment: Intralot S.A.
- Covenant Quality Assessment: Intralot Capital Luxembourg S.A.: Covenant Quality Post-Sale Snapshot: €500m 5.25% Senior Notes due 2024

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