FitchRatings

Fitch Rates Intralot's planned EUR450m Bond 'BB-(EXP)'

Fitch Ratings-London/Paris-11 September 2017: Fitch Ratings has assigned Intralot Capital Luxembourg S.A's planned EUR450 million bond an expected senior unsecured rating of 'BB-(EXP)' with a Recovery Rating of 'RR3'. The bond is rated one notch above Intralot's Long-Term Issuer Default Rating of 'B+'/Stable.

Proceeds from the notes, which mature in September 2024, will be used for early redemption of the company's EUR250 million 6% notes due in 2021 as well as other outstanding credit facilities. The planned notes are guaranteed by Intralot SA and some material subsidiaries, and will rank pari passu with all existing and future unsecured indebtedness of the issuer that is not subordinated to the notes, including senior credit facilities that are not secured. The final rating of the notes is contingent upon receipt of final documents conforming to the information already received by Fitch and confirmation of the final amount and tenor of the notes.

The planned bond issue will marginally enhance Intralot's financial flexibility by extending the average debt maturity profile and reducing interest costs. Despite improved performance continuing into the first half of 2017, Intralot's high leverage remains not fully aligned with a 'B+' rating but we expect Intralot will deleverage from 2018. The rating profile remains well anchored around a business profile that is commensurate with a 'BB' rating category for the sector. Any evidence of deteriorating operating environment, contracts not being renewed or renewed on worse terms, or unexpected cash leakages, could however 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 group has recently secured long-term contract renewals in the U.S. market, resulting in the securing of EUR35 million of EBITDA until 2025 in that market. This number should increase to about EUR50 million per annum if the new Illinois contract is secured. Due to high switching costs, we expect many of the contracts will be renewed in the future, although we continue to believe these could be on lower margins and may require a higher renewal fee.

Margin Impacted by Business Mix: The strong growth of Licenced Operations (+21.9% in H117) is having a negative impact on group EBITDA margins, which were 12.6% in the first half of 2017 compared to 14% last year. Licenced Operations represented 78% of total group sales in H117 versus 73% in H116. This is a significantly less profitable division than Technology and Management Contract Businesses, which has not performed as anticipated this year mainly due to weaker performance in Turkey and some one-off effects in the US.

The top-line growth is leading to a higher actual level of EBITDA. While margins are lower than our previous expectations, absolute EBITDA is in line with our forecasts. We expect that operating performance in the management contract and technology contract businesses will normalise from the second half of 2017, and forecast an overall EBITDA margin of 12.4% for the year, improving slightly thereafter. EBIT margins remain 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, mainly due to one-off investments related to the new Illinois contract and some contract renewal fees and to then turn positive. FCF can be volatile as a result of upfront investments related to new contracts of contract renewals. However, this does contribute to steady operating cash-flow generation due to its recurring profit stream and is a key credit support. After 2018 the group does not have any major contract renewals until 2021 and therefore capex should remain at lower levels.

Capex Driving Higher Leverage: Fitch expects funds from operations (FFO) adjusted gross leverage to increase to 6.5x in 2018 (FFO adjusted net leverage will reach about at 5.0x) due to higher capex than was previously expected. This level of leverage is not commensurate with a 'B+' rating which indicates low financial headroom. However, we anticipate continued deleveraging from 2018 through improvements in the group's underlying operating performance following this expenditure.

In addition, our base-case projections do not factor in any proceeds from the expected sale of the group's stake in Gamenet during the IPO process, or the disposal of other assets. These options provide additional flexibility for Intralot and if executed successfully could result in significant net debt reduction, bringing net leverage back within out sensitivity guidance for the current rating level.

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.

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 less than 10% of its EBITDA in Greece (rated 'B-'). 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. Currently, less than 10% of cash is held in Greece, and following the new transaction, the group will have less reliance on funding from Greek banks due to a higher capital markets allocation. 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 a 'b' economic environment.

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 Coral (BB/Stable), 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 above-mentioned contracted EBITDA and specialist supplier technology expertise.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- revenue growth of about 12% in 2017 as a result of strong growth in licenced betting operations, falling back to mid-single digits thereafter driven by a combination of new contracts and some organic growth;
- EBITDA margin falling to 12.4% in 2017 and remaining between 12.7%-12.8% thereafter;
- 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;
- capex falling back to about EUR45m per annum from 2019;
- no common dividends.

RECOVERY ASSUMPTIONS:
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, resulting from attributable FY16 EBITDA from minorities of EUR68 million discounted by 50% and applying a conservative EV/EBITDA valuation of 3.0x.
In terms of distribution of value, all unsecured debt including the planned new bond would recover 58% in the event of default (assuming that the EUR125 million unsecured RCF will be fully drawn). This is consistent with an 'RR3' and an instrument rating of 'BB-', one notch above the IDR.

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: We expect the group's liquidity profile will improve following the completion of the planned refinancing transaction. EUR500 million of bonds maturing in 2021 will leave only one older EUR250 million bond outstanding due 2021, while the new notes will not be repayable until September 2024. The plan to repay the outstanding credit facilities is also beneficial, effectively pushing the 2019 maturity to 2024.
We expect the group will have cash on balance sheet of about EUR175 million at end-2017 and this will be complemented by approximately EUR125 million in committed unsecured credit facilities.

Contact:

Principal Analyst
Patrick Durcan
Analyst
+44 20 3530 1298

Supervisory Analyst
Sophie Coutaux
Senior Director
+33 1 44 29 91 32
Fitch France S.A.
60 Rue de Monceau
75008 Paris

Committee Chairperson
Pablo Mazzini
Senior Director
+44 20 3530 1021

Date of Relevant Rating Committee: 16 May, 2017

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).

Media Relations: Adrian Simpson, London, Tel: +44 203 530 1010, Email: adrian.simpson@fitchratings.com.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

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 - Effective from 10 March 2017 to 7 August 2017 (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895493)
Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers - Effective from 21 November 2016 to 16 June 2017 (pub. 21 Nov 2016) (https://www.fitchratings.com/site/re/890199)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1028973)
Solicitation Status (https://www.fitchratings.com/site/pr/1028973#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS (https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM (https://www.fitchratings.com). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY (https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD

PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.
Copyright © 2017 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.