FitchRatings

15 May 2019 | Downgrade

Fitch Downgrades Intralot to 'CCC+', Senior Unsecured Rating Maintained on RWN

Fitch Ratings-Paris-15 May 2019:

Fitch Ratings has downgraded Greek gaming group Intralot S.A.'s (Intralot) Long-Term Issuer Default Rating (IDR) to 'CCC+' from 'B-', and removed it from Rating Watch Negative (RWN) where it was placed on 7 March 2019. Fitch has also downgraded the senior unsecured rating on the bonds issued by Intralot Capital Luxembourg S.A., guaranteed by Intralot's key subsidiaries, to 'CCC+'/'RR4'/36% from 'B-'/'RR4'/33%. The senior unsecured rating remains on RWN.

The downgrade reflects heightened liquidity and refinancing risks, with continuing negative free cash flow (FCF), albeit partly driven by capex associated with new contracts, and leverage remaining at a level no longer compatible with a 'B-' rating. The maintenance of the senior unsecured rating on RWN reflects Fitch's expectation that new debt to continue investing in operations and new contracts would be raised on a secured basis, likely compressing expected recoveries for unsecured creditors.

Key Rating Drivers

Heightened Liquidity Risk: Following the breach of its financial covenants under the revolving credit facilities (RCF) at end-2018 (leverage ratio at 5.28x vs covenant level 3.75x, interest coverage ratio at 2.97x vs. covenant level 3.50x), Intralot currently does not have access to liquidity lines. Fitch believes Intralot may need these lines to continue operating, if the group displays negative FCF generation over the next four years as we currently forecast. We believe that Intralot would have to provide security to reach an agreement with lenders, either in the form of a pledge on subsidiary's assets or on financial assets. Interest payments of about EUR50 million per year are high for the current EBITDA, which has been partly depressed by weak emerging market currencies, leading to weak FFO fixed charge cover ratio forecast to reach 1.6x this year, below FY18's 1.8x.

High Refinancing Risk and Leverage: Fitch believes that Intralot's funds from operations (FFO) adjusted net leverage will likely remain between 8.0x-8.5x by 2021, a level consistent with a 'CCC' rating category. The gradual ramp-up of US operations will not fully offset the recent loss of an important contract in Turkey and the disposal of the partnership in Azerbaijan. In our view, if

Intralot is unable to significantly improve its operating profile and reduce gross debt and leverage over the next two years it will find it difficult to refinance its EUR250 million unsecured bond due in September 2021 on an unsecured basis. Moreover, the terms of this bond prevent its refinancing for the full amount on a secured basis.

Execution Risk Rising: The significant number of changes that have or are likely to occur within the company increase execution risks. Intralot reshuffled its management team at the beginning of 2019 following the loss of the Inteltek contract. The company aims to implement a cost-cutting plan and improve operational efficiency. Uncertainties remain around this turnaround plan. Adding to these challenges, the loss of Inteltek contract will have to be offset by new contracts which could lead to aggressive bidding driven by competition. This may require additional capex, which would need to be funded against the backdrop of tightening liquidity for the group.

Asset Disposals Uncertain: In the near term, Fitch believes that liquidity will not be materially supported by assets disposals. Although the company has disposed some of its non-core assets, the net cash inflows are either constrained by minority shareholders as for Azerinteltek (company was 100% consolidated while economic ownership was 23%) or the implementation of contingent consideration in the sale agreement as for Totolotek (up to around EUR10 million full selling price includ ing contingent consideration). Intralot owns 20% of Italy-based Gamenet (valued around EUR50 million as of 13 May 2019), but management has stated that is not ready to sell its stake at the current market price.

Contract Portfolio Satisfactory, Lacking Scale: Intralot has established itself in the international gaming sector as a reputable provider of products, including systems to manage lotteries through software platforms and hardware terminals, and in betting, a large algorithm-based sportsbook. This has enabled Intralot to win important contracts for the supply of technology and the management of lotteries in the US and Greece and for sports betting in Germany. However , it lacks scale relative to larger competitors such as IGT or Scientific Games.

Difficult Contract Renewals, Negative FX: Contract renewal can prove more challenging than expected, as highlighted by the recent loss of the Inteltek contract in Turkey ending in August 2019 (representing a material 15% of group's FY18 consolidated EBITDA). Intralot's sizeable exposure to emerging markets such as Turkey and Argentina (we estimate both countries represented around 36% of FY18 consolidated EBITDA) also means that foreign-currency debt service capability has been largely impaired due to weak euro-translated revenues and profits from this exposure. The combination of high FX translation risks and asset disposals is expected to result in euro revenues and EBITDA at end 2019 to be 17% and 32% lower than at end-2016, respectively. However, we estimate total debt will have increased by 17% in the same period.

Growth Prospects Remaining: 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 track record and technical reputation and benefit from the limited number of reputable suppliers in the industry, allowing it to expand into new countries. Intralot could also benefit from opportunities in the US in the wave of recent changes in legislation in many states, although possible arbitrary changes in legislation remain a typical risk in this sector, while competition is intense.

Deteriorating Unsecured Recovery Prospects: Fitch believes it is highly likely that Intralot will raise secured debt before reaching a hypothetical default situation. We think this scenario is plausible as Intralot is in discussions with its lenders regarding funding needed to support its operations, while its currently undrawn EUR80 million RCF is not available due to covenant breaches. According to Fitch's estimates, incurring EUR50 million secured indebtedness, if not allocated to a corresponding decrease in unsecured debt, could cause the recovery rate on unsecured debt to be downgraded to 'RR5', therefore its 'CCC+'/'RR4' rating is on RWN.

Derivation Summary

Intralot has smaller revenue and EBITDA than GVC Holdings Plc (BB+/Stable), William Hill Plc, International Game Technology and Scientific Games Corporation. Intralot's leverage is significantly higher than that of GVC Holdings Plc, and liquidity is tighter than peers. Intralot displays a similar size to Net Holding A.S. (B/Stable), and stronger business profile characteristics , with more visibility of revenues and EBITDA from recurring long-term contracts, a higher geographic diversification, and specialist supplier technology expertise, but much higher leverage consistent with the 'CCC' rating category.

Key Assumptions

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

-Revenue declining in the next two years due to the end of Inteltek contract in August 2019, the disposal of Totolotek (April 2019), partly offset by increasing revenue within the US;

-EBITDA margin improving as a consequence of the disposal of unprofitable Polish operations, while US operations gradually ramps-up;

-Minority profits fully paid out as dividends, in the range of EUR20 million -EUR22 million over the rating horizon;

-Capex stabilizing at EUR55 million over the rating horizon;

-No common dividends.

Key Recovery Assumptions

In our bespoke going-concern recovery analysis we considered Intralot's FY18 EBITDA of EUR116 million, deducting attributable EBITDA to minority interests and Inteltek. This was further discounted by 15% to arrive at an estimated post-restructuring EBITDA available to creditors of around EUR58 million. We applied a distressed enterprise value / EBITDA multiple of 5x to Intralot's wholly-owned operations.

We also estimate approximately EUR50 million of additional value stemming from associates.

In terms of distribution of value, as per Fitch's assumed capital structure in a default situation, all unsecured debt would recover 36%. Fitch believes that lenders would ask for security over certain assets should the group raise new debt. This would have an impact on the expected recovery rates for unsecured creditors in the event of a default, leading to a potential downgrade of the Recovery Rating to 'RR5' from 'RR4', depending on the amount of new secured debt. This is reflected in the RWN on the 'CCC+' senior unsecured rating.

RATING SENSITIVITIES

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

-Steady improvement in operating liquidity driven by neutral to positive FCF, sizeable asset disposals with cash proceeds available for debt service at Intralot SA and/or procured external liquidity lines.

-Sustained improvement in operating performance, for example through winning new contracts or improving performance of existing ones, combined with efficient cost -cutting measures, leading to growing EBITDA and FFO, alleviating risks around near-to medium term refinancing needs.

-FFO-based net adjusted leverage sustainably below 7x (FFO gross lease adjusted leverage sustainably below 7.5x).

-FFO fixed charge cover sustainably above 1.8x.

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

-Lack of sufficient operational liquidity cushion and inability to monetise assets.

-Continued operating underperformance and/or loss of existing contracts leading to further shrinking of operations in particular EBITDA, continuing negative FCF and FFO gross lease-adjusted leverage sustainably trending above 8.5x leading to increased refinancing risks.

-FFO fixed charge cover below 1.5x.

Liquidity and Debt Structure

Tightening Liquidity: As of 31 December 2018, Intralot was displaying EUR162 million of cash on its balance sheet. We view the EUR77.8 million cash located within partnerships, as well as the EUR30 million required for working capital purposes, as restricted. Additionally, we restrict the portion of the cash located within the Maltese subsidiary that does not belong to Intralot (27% of EUR13 million, i.e. EUR3.5 million). Consequently, we calculate readily available cash amounted to EUR51.1 million. Intralot's inability to draw on its RCF due to covenant breaches further compounds the group's minimal liquidity headroom to support its operations and bid for new contracts.

Intralot does not face any significant debt maturities until September 2021, when the first bond (with a face value of EUR250 million) matures, while the second bond (with a face value of EUR500 million, and EUR495 million remaining due) matures in 2024. However, refinancing of the 2021 bond may be challenging, if leverage stays high, even on a secured basis as the bond documentation currently prevents a secured refinancing for the full amount.

Summary of Financial Adjustments

Sources of Information

Public Ratings with Credit Linkage to other ratings

Intralot Capital Luxembourg SA
----senior unsecured; Long Term Rating; Downgrade; CCC+; RW: Neg
Intralot S.A.; Long Term Issuer Default Rating; Downgrade; CCC+; RW: Off

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Applicable Criteria
Corporate Rating Criteria (pub. 19 Feb 2019)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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