FitchRatings

18 Jun 2020 | Downgrade

Fitch Downgrades Intralot to 'CC'; Senior Unsecured to 'C'

Fitch Ratings-Paris-18 June 2020:

Fitch Ratings has downgraded Greek gaming group Intralot S.A.'s (Intralot) Long Term Issuer Default Rating (IDR) to 'CC' from 'CCC', and the senior unsecured rating on the bonds issued by Intralot Capital Luxembourg S.A., and guaranteed by Intralot's key subsidiaries, to 'C'/'RR5' from 'CCC'/'RR4'.

The downgrade of the IDR reflects increasing risk of a debt restructuring as well as refinancing risk for Intralot's EUR250 million bond maturing in September 2021. Intralot is currently discussing with its bondholders to modify its capital structure. Fitch views that these negotiations may result in some form of debt restructuring, which would qualify as a Default or Restricted Default under our Criteria. Should this occur, post-restructuring Fitch would assign a rating to reflect the new capital structure in place, and the growth prospects that such a new structure would allow the group to pursue. Although liquidity will be eroded we view it sufficient for Intralot to pursue operations over the next few months until the new structure is implemented.

The downgrade of the senior unsecured ratings encapsulates also legal challenges in Bulgaria that would result, in our view, in a further reduction of Intralot's scale, leading to lower recovery prospects (RR5) for bond investors.

Key Rating Drivers

Capital Structure Reshuffle Inevitable: We estimate that Intralot's funds from operations (FFO) adjusted gross leverage will remain high at above 10x by September 2021 when the EUR250 million bond is due. We see a heightened risk that Intralot would be forced into some form of debt restructuring over the next 12 to 18 months to address the refinancing. The terms of the bond prevent a refinancing for the full amount on a secured basis. Intralot announced it has appointed Evercore Partners and Allen & Overy to assess all available financial and strategic options that may be available to modify the group's capital structure.

Bulgarian Operations may Stop: In Bulgaria Intralot has two 49%-owned partnerships, Eurobet and Eurofootball, from which the authorities have requested the payment of state fees of BGN403 million (around EUR200 million). Bulgarian authorities have decided to nationalise lottery, leading to the end of Eurobet operations (5.2% of proportionate EBITDA). Although Intralot firmly contests these claims, the Bulgarian authorities have decided to suspend Eurofootball's license (14.4% of proportionate EBITDA) for three months until these taxes are paid. In our view, Intralot will not be able to afford these payments, meaning that it would likely stop its Bulgarian operations. These claims, according to the company, are non-recourse to Intralot.

Below-Average Recoveries for Bondholders: We have lowered our going-concern EBITDA to EUR55 million from EUR65 million to reflect the uncertainty in Bulgaria with likely termination of activities. Base on the current capital structure, we estimate that bondholders would be subordinated to around EUR70 million of priority debt, leading to a 'C'/ 'RR5' instrument rating.

High Pandemic Exposure: Closures of gaming halls combined with cancellations of sports events (sport betting represented 44.4% of 2019 consolidated revenues) will lead to a material contraction of Intralot's revenues in 2020. We also factor in a reduction in lottery revenues (42.7% of 2019 consolidated revenues) due to lockdowns. The group has implemented mitigating measures such as cost cutting and capex reductions. Overall, we now estimate that Intralot will post large negative free cash flow (FCF) of over EUR70 million in 2020, which will likely result in a material erosion of the EUR119 million unrestricted cash (as per Fitch's definition) held at end-2019.

Shrinking Contract Portfolio: Intralot's contract portfolio has materially shrunk over the last two years due to asset disposals (Poland, Azerbaijan), contracts loss (Morocco, Turkey) or legal issues (Bulgaria). We view execution risk related to the renewal of Bilyoner contract in Turkey (4% of Intralot's proportionate EBITDA), to be renewed at end-August 2020. The renewal of the contract in Malta in 2022 (14.9% of 2019 proportionate EBITDA) could entail capex investment based on historical data, which the current capital structure may not allow. In our view, Intralot lacks scale relative to larger competitors such as IGT or Scientific Games.

Favourable Underlying Industry Trends: The gradual liberalisation of gaming markets, notably in the US, governments' keenness on finding ways to raise tax proceeds and digitalisation of lotteries should all provide opportunities for Intralot, as evidenced by the recent contracts won such as the sport betting offering in New Hampshire. It should be able to leverage on its track record and technical reputation and benefit from a limited number of reputable suppliers in the industry, allowing it to expand into new countries. However, the lack of access to funding has constrained it to move toward an asset-light strategy, reducing opportunities to regain scale.

Derivation Summary

Intralot's current financial profile is not comparable with that of other gaming companies such as Flutter Entertainment plc (BBB-/Negative), GVC Holdings Plc (BB/Negative), Sazka Group a.s. (BB-/Negative). Intralot is similar in business-profile characteristics to Inspired Entertainment, Inc.

(C), but currently has higher liquidity. However, refinancing risk is high, and a debt restructuring seems inevitable, which is consistent with a 'CC' rating.

Key Assumptions

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

- Revenue to fall around 50% in 2020 due to the impact of the coronavirus pandemic and shutdown of Bulgarian operations. We forecast revenues trending towards EUR390 million-EUR400 million by 2022.

- Taxes claimed by the Bulgarian authorities are not paid. Activity in Bulgaria does not resume.

- EBITDA margin in 2020 contracting to around 10%, before recovering towards 17%-18% by 2022.

- Recurring dividends paid to minority interests of around EUR3 million per annum.

- Capex of around EUR40 million-EUR45 million per year. We estimate that Intralot would cut its capex plan in 2020 to preserve cash.

- No material M&A activity and no common dividends.

Fitch's Key Recoveries Assumptions

In our bespoke going-concern recovery analysis we considered an estimated post-restructuring EBITDA available to creditors of around EUR55 million (versus EUR65 million previously), reflecting the cancellation of the Eurobet license and our view that Intralot will not be able to resume Eurofootball operations. We applied a distressed enterprise value (EV)/ EBITDA multiple of 5x to Intralot's wholly-owned operations.

We also estimate approximately EUR10 million of additional value stemming from associates.

We assume EUR70 million of priority debt, including a fully drawn USD40 million revolving credit facility (RCF) in the US, and a EUR18 million secured overdraft.

After deducting 10% for administrative claims, our principal waterfall analysis generates a ranked recovery in the 'RR5' band, indicating a 'C' instrument rating. The waterfall analysis output percentage on current metrics and assumptions is 26%.

RATING SENSITIVITIES

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

- Reducing immediate refinancing risk, implying successful refinancing of the EUR250 million bond due September 2021, coupled with liquidity sufficient to support operations over the next 12 months;

- 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, hence allowing for deleveraging; and

- FFO fixed charge cover sustainably above 1.2x.

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

- Public announcement that a default or default-like process has begun or is imminent, such as a debt restructuring plan; and

- Lack of sufficient operational liquidity cushion

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

Tightening Liquidity: Intralot materially improved its liquidity profile during 2019 due to the completion of its asset disposal programme, notably Hellenic Lotteries (EUR20 million) and Gamenet (EUR78 million). As of 31 March 2020, we estimate that Intralot had around EUR100 million-EUR105 million readily available cash (excluding EUR30 million restricted cash for working capital, and around EUR10 million cash located in partnerships). The cash position included a EUR8 million secured overdraft as of 31 March 2020, which was fully drawn in April. We expect liquidity to tighten over the next 12 months due to negative FCF amid the coronavirus pandemic, although prudent cash management reduces liquidity risk until bond refinancing.

Intralot has no committed RCF available at group level. We do not view the USD40 million RCF granted to the US subsidiary as a mitigating factor, since it cannot be used to finance corporate needs or bridge a liquidity gap at other subsidiaries.

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
The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Intralot S.A.; Long Term Issuer Default Rating; Downgrade; CC
Intralot Capital Luxembourg SA
----senior unsecured; Long Term Rating; Downgrade; C

Contacts:
Primary Rating Analyst
Sophie Coutaux,
Senior Director
+33 1 44 29 91 32
Fitch Ratings Ireland Limited
60 rue de Monceau
Paris 75008

Secondary Rating Analyst
Maxence Chappron,
Senior Analyst
+33 1 44 29 91 26

Committee Chairperson

Giulio Lombardi,
Senior Director
+39 02 879087 214

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email:
adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Applicable Model

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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