FitchRatings

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Fitch Downgrades Intralot's IDR to 'RD' on Exchange Completion; Subsequently Upgrades to 'CCC+'

Fitch Ratings - Paris - 24 Aug 2021: Fitch Ratings has downgraded Intralot S.A.'s (Intralot) Long-Term Issuer Default Rating (IDR) to 'Restricted Default' (RD) from 'C' following the exchange of 2021 notes issued by Intralot Capital Luxembourg S.A. to new 2025 notes issued by Intralot Inc. with an 18% discount to nominal value, and a partial debt-to-equity exchange of 2024 notes, both of which are considered a distressed debt exchange (DDE) under Fitch's Ratings Definitions.

Fitch has subsequently upgraded the Long-Term IDR to 'CCC+' reflecting the new capital structure and Fitch's assessment of parent-subsidiary linkage between Intralot and Intralot Inc., under its Parent-Subsidiary Linkage Criteria.

The 'CCC+' IDR reflects Intralot's weak Standalone Credit Profile (SCP) and weak legal ties with its US-based subsidiary, Intralot Inc. The rating reflects its substantially smaller scale and Intralot's weaker market opportunities of its non-US operations, as well as higher leverage metrics after deconsolidating Intralot Inc.'s profile (only adding back cash flows allowed to be up-streamed to Intralot under current documentation). However, we acknowledge the adequate debt service cover at parent level under the new capital structure.

Fitch has also upgraded the senior unsecured rating assigned to the 2024 notes issued by Intralot Capital Luxembourg S.A. from 'C'/'RR4' to 'CCC+'/'RR4'. A higher recovery percentage within the 'RR4' band (50% vs. 32% previously) reflects a higher waterfall generated recovery computation (WGRC), which takes additional EV recovered from the sale of US business into account in case of distress.

The withdrawal of the 2021 notes' rating is due to the exchange of the bonds upon completion of the group's debt restructuring.

Key Rating Drivers

Debt Restructuring Complete: Intralot has completed its debt restructuring in August 2021 through an exchange of 2021 notes to 2025 notes issued by Intralot Inc. and through partial equitisation of its 2024 notes into 34.27% of indirect Intralot Inc. ownership. Under Fitch's Ratings Definitions, this restructuring is considered as a DDE, leading to the downgrade of Intralot's Long-Term IDR to 'RD'.

Weak Parent-Subsidiary Linkage: We assess links between Intralot and Intralot Inc. as weak, as per our Parent-Subsidiary Linkage (PSL) Criteria. Independent treasury, presence of debt ring-fencing and restrictions imposed on cash up-streaming by new bond documentation outweigh certain operational ties such as board control and Intralot's ownership of some IPs used by Intralot Inc. We note that since legal ties are imposed by the notes' documentation, refinancing of the notes on different terms would lead to a reassessment of the parent-subsidiary linkage.

Limited Impact of US Business on Rating: Fitch recognises that as a group, Intralot has strong growth opportunities in the US market. We assume that Intralot Inc.'s own SCP, which is positioned within the 'b' rating category, is stronger than Intralot's SCP as it has larger scale in terms of annual EBITDA and substantially stronger credit metrics, namely FFO adjusted leverage (of 5.0x-5.5x) and FFO fixed charge cover metrics (forecast around 2.5x). However, remaining unsecured debt holders at the parent level do not have direct recourse to the US operations.

Deconsolidated Credit Metrics In Focus: We assess some of Intralot's qualitative factors, as well as the development of its leverage and coverage metrics deconsolidated from Intralot Inc. - in our forecasts we take certain cash flows into account that are allowed to be up-streamed to Intralot under current documentation. The rest of Intralot's operations retain its brand strength and even without US operations there is a material degree of geographic diversification. However, Intralot's scale and market opportunities (without Intralot Inc.) are weaker than in the US, while competition remains high.

A number of key contracts (predominantly Malta but also Morocco) are also approaching their maturity (2022) and their extension with be key to help develop Intralot's business scale.

Weak Deleveraging Prospects: Under Fitch's rating case, Intralot's FFO adjusted leverage (calculated excluding Intralot Inc. but including permitted and predictable cash up-streaming) will stay in the range of 10-12x until its outstanding notes mature in 2024, having peaked at 13x in 2021. We believe that refinancing risk will stay high under current forecasts underpinning its 'CCC+' IDR. However, Intralot has additional deleveraging capacity from available put options that allow it to sell another 14% of Intralot Inc. for extra liquidity or deleveraging purposes.

Satisfactory Debt Service Capabilities: We expect Intralot's FFO fixed charge cover to be between 1.2x-1.8x over 2022-2024, which is adequate at parent level, albeit substantially weaker than on a consolidated basis. The acceptable level of coverage ratios is supported by expected cash inflows from Intralot Inc., which we expect would account for up to 50% of Intralot's consolidated interest payments (excluding Intralot Inc.) in 2022-2024 under the Fitch rating case projections.

Expected Recovery from Pandemic Impact: Intralot's 2020 results were materially affected by the pandemic, with revenues down almost 50% and a negative double-digit free cash flow (FCF) margin for the third consecutive year. We expect that revenue and profitability will rebound in 2021 for both the US business and the rest of Intralot's markets. We forecast that high single-digit revenue growth along with EBITDA margin in the low 20s should help Intralot reach over EUR80 million EBITDA on a consolidated basis. Fitch case assumes that group EBITDA will stay between EUR80-90 million over the next four years. underpinned by a cash generative US business and recovering profit margins outside US.

Derivation Summary

Intralot's current financial profile is not comparable with that of other gaming companies such as

Flutter Entertainment plc (BBB-/Stable), Entain (BB/Positive), Sazka Group a.s. (BB-/Stable). Intralot has smaller size and lower through-the cycle profitability than gaming operator Codere (C), which is currently in the middle of a debt restructuring process.

After its restructuring, Intralot has similar business-profile characteristics to Inspired Entertainment, Inc. (B-/Stable), but has materially weaker credit metrics on a standalone basis (with Intralot Inc. deconsolidated).

Key Assumptions

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

- High single digit growth of US business in 2021, followed by low growth in 2022-2023, mostly driven by new business opportunities (expected to contribute up to USD12 million in 2023).

- Mid-teen growth of its non-US business in 2021, followed by normalisation in 2022-2024, resulting in revenues of around EUR200 million in 2024.

- Improvement in profitability for operations in the US, Australia and Croatia, resulting in an EBITDA margin of 35-38% for its US business in 2021-2024, and 10% for its RoW business in 2021, improving to 14-15% in 2022-2024.

- Capex peaking in 2022 due to around EUR50 million investment in renewing of Maltese license, financed through external debt.

- No PIK interest for the 2025 notes.

- Dividends of around EUR3 milion-EUR4 million paid annually by Intralot Inc. in 2022-2024.

- Annual service fees of around EUR2 million paid by Intralot Inc to Intralot S.A.

- Annual restricted payment of EUR8.25 million paid by Intralot Inc.

Recovery Analysis Assumptions:

In our bespoke going-concern recovery analysis we consider an estimated post-restructuring EBITDA of Intralot S.A. (excluding Intralot Inc.) available to creditors of around EUR25 million. We apply a distressed enterprise value (EV)/EBITDA multiple of 4.5x to Intralot's wholly-owned operations reflecting its relatively small scale, modest growth prospects mitigated by certain revenue visibility resulting from mid to long-term contracts.

We also take a potential sale of Intralot Inc. into account if the parent company was to face a distressed scenario. Although we do not expect Intralot Inc. to be in distress in this scenario, and sale of a majority stake in a functioning business would assume higher multiple than for the sale of minority stake, we believe that it would be under a degree of forced sale, and therefore apply a 7.5x multiple for the forecast 2021 EBITDA of EUR56 million, resulting in EUR141 million of net proceeds for Intralot S.A. Another EUR10 million could be expected to be received from Intralot's sale of its stake in Argentinian partnership.

After deducting 10% for administrative claims, our principal waterfall analysis would generate a ranked recovery at least in the 'RR3' band, indicating a higher rating for the unsecured debt at parent company than its IDR. The recovery rating is capped at 'RR4' as per Fitch's Country-Specific Treatment of Recovery Ratings Criteria given Greece is the country of incorporation for Intralot SA.

In our view, Intralot SA and the guarantors of its 2024 unsecured bond are in different jurisdictions, many of which we consider to be debtor-friendly, therefore not sufficient to allow for a reliable weighted-cap analysis. As such the waterfall analysis output percentage on current metrics and assumptions is 50% (even though the percentage recovery would be materially higher due to value stemming from its controlling US stake).

RATING SENSITIVITIES

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

- 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 continuously growing EBITDA and FFO, allowing steady deleveraging with Intralot's standalone FFO adjusted leverage below 10.0x;

- Standalone FFO fixed charge cover consistently above 1.2x;

- Increased access to cash flows from Intralot Inc. due to lifted upstream restrictions based on current or new debt documentation;

- Additional recourse to Intralot Inc. for the majority of Intralot S.A.'s creditors (in the form of guarantees or cross-default provisions).

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

- Material deterioration of EBITDA generated outside the US (e.g. non-renewal of Maltese contract);

- Standalone FFO fixed charge cover deterioration below 1.0x;

- Lack of sufficient operational liquidity cushion to support operations within the next 6-12 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

Liquidity Satisfactory Post-restructuring: Intralot S.A.'s (with Intralot Inc. deconsolidated) current accounts balance was EUR63 million as of June 2021. Working capital requirements for the parent are estimated at around EUR20 million by management. Availability of an additional EUR33 million basket with up to EUR8.25 million available per year (subject to liquidity covenant at Intralot Inc. level), as well as the presence of a put option that could provide additional one-time cash inflows further supports liquidity.

Aside from the put option and the restricted payment basket, there are additional payables to Intralot S.A. from Intralot Inc. due in 2021-2022 amounting to around EUR20 million, including EUR6 million payable under the inter-group loan and payables to Intralot S.A. related to Intralot Inc's contract with British Columbia Lottery Corporation.

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.

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 organisations worldwide. Intralot also holds some licences for full games operations.

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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Intralot S.A.	LT IDR	RD	Downgrade		C
	LT IDR	CCC+	Upgrade		C
Intralot Capital Luxembourg SA					
• senior unsecured	LT	CCC+	Upgrade	RR4	C
• senior unsecured	LT	WD	Withdrawn		C

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◉	◆
STABLE	⊙	

Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

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

Country-Specific Treatment of Recovery Ratings Criteria (pub.05 Jan 2021)

Parent and Subsidiary Linkage Rating Criteria (pub.26 Aug 2020)

Applicable Models

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

Solicitation Status

Endorsement Status

Intralot Capital Luxembourg SA	EU Issued, UK Endorsed
Intralot S.A.	EU Issued, UK Endorsed

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