23 Oct 2020 | Upgrade

Fitch Upgrades Intralot's Senior Unsecured Notes to 'CC'; Affirms IDR at 'CC'

Fitch Ratings-Paris-23 October 2020:

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

The upgrade of the senior unsecured rating reflects a lower amount of Intralot's priority debt following the expiry of the company's USD40 million US revolving credit facility (RCF). This in turn leads to higher recoveries noteholders based on the current capital structure.

The 'CC' IDR reflects heightened debt restructuring risk due to current negotiations between Intralot and its bondholders regarding the upcoming EUR250 million bond maturity in September 2021. We would view a debt restructuring 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 Intralot to pursue.

Although liquidity is being eroded we view it sufficient for Intralot to continue operating over the next few months until a new capital structure is implemented.

Key Rating Drivers

Capital Structure Restructuring Inevitable: We expect Intralot to see a debt restructuring to refinance its EUR250 million September 2021 senior secured bond, and highly likely also its EUR474 million senior unsecured bond due in 2024 given cross-acceleration provisions. The terms of the 2021 bond prevent a refinancing for the full amount on a secured basis. 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 implying an unsustainable capital structure that will require a long-term resolution.

Average Recoveries for Bondholders: The non-renewal of the USD40 million senior secured RCF has improved recovery prospects for senior unsecured notes, leading to an instrument rating upgrade to 'CC'/RR4 from 'C'/RR5 as per Fitch Corporates Notching and Recovery Ratings Criteria.

Based on the current capital structure, we estimate that bondholders would be subordinated to EUR26 million of priority debt. In case a large amount of senior secured debt is introduced as part of the debt restructuring, this would diminish the recovery prospects for senior unsecured note holders.

High Pandemic Exposure: Intralot's revenues fell 25% yoy in 1H20 - pro-forma for Bulgaria and Inteltek contracts discontinuation - as the pandemic led to closures of gaming halls and cancellations of sports events. We forecast that Intralot will generate negative free cash flow (FCF) of over EUR70 million in 2020 despite cost-cutting and some capex reductions. This will erode Intralot's liquidity, which comprised EUR119 million unrestricted cash (as per Fitch's definition) at end-2019, although leaving sufficient cash to operate until the next bond maturity in September 2021.

Growing US Exposure: Intralot's US subsidiary has become the largest EBITDA contributor due to a contraction in Intralot's contract portfolio. The relative resilience of the US operations during the first wave of the pandemic compared with other countries further increased Intralot's reliance on the US, which generated nearly 90% of 1H20 Intralot-defined EBITDA. In our view, Intralot Inc. could generate around EUR45million-EUR50 million annualised EBITDA over the next three years, more than half of total EBITDA. However, we believe that fierce competition from larger gaming operators would constrain Intralot's expansion in the growing US market.

Shrinking Contract Portfolio: Intralot's contract portfolio has materially shrunk over the last two years due to asset disposals (Poland, Azerbaijan), contract loss (Morocco, Turkey) or legal issues (Bulgaria). We see renewal risk for its Bilyoner contract in Turkey (4% of Intralot's proportionate EBITDA), which is renewed every few months. The renewal of the contract in Malta in 2022 (14.9% of 2019 proportionate EBITDA) could entail higher capex in line with prior years, which cannot be accommodated under the current capital structure. In our view, Intralot lacks scale relative to larger competitors such as IGT or Scientific Games to sustain its contract portfolio.

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 provide growth opportunities for Intralot. 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. (CCC+), but has higher refinancing risk, and debt restructuring seems inevitable, which is consistent with a 'CC' rating.

Intralot has smaller size and lower profitability than gaming operator Codere (CCC(EXP)), which is currently in the middle of a debt restructuring process. The two-notch difference is driven by our expectations of Intralot's upcoming debt restructuring.

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. Operations in Bulgaria do not resume.

- EBITDA margin in 2020 contracting to around 12%, before recovering towards 17%-18% by 2022.

- Capex of around EUR40 million-EUR50 million per year up to 2023.

- No material M&A activity and no common dividends for the next four years.

Key Recovery Rating Assumptions

In our bespoke going-concern recovery analysis we considered an estimated post-restructuring EBITDA available to creditors of around EUR55 million, which would allow Intralot to continue operating as a going concern. 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.

The USD40 million RCF previously provided to Intralot Inc. has not been renewed, reducing the amount of priority debt.

After deducting 10% for administrative claims, our principal waterfall analysis generated a ranked recovery in the 'RR4' band, indicating a 'CC' instrument rating. The waterfall analysis output percentage on current metrics and assumptions is 32%, in the low-end of the 'RR4' band, versus 26% or 'RR5' previously, leading to a one notch upgrade of the senior unsecured rating.

RATING SENSITIVITIES

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

- Reducing immediate refinancing risk from a 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

Eroding Liquidity: Intralot's current liquidity profile continues to benefit from completion of its asset disposal programme in 2019 for around EUR100 million. Intralot has used around EUR30 million cash during 1H20 to pay interest charges of EUR23 million; the latter exceeded Fitch-defined EBITDA of EUR21 million.

As of 30 June 2020, we estimate that Intralot had around EUR95 million-EUR100 million readily available cash (excluding EUR30 million restricted cash for working capital, and around EUR10 million cash located in partnerships and not fully owned subsidiaries). This cash position included a EUR18 million secured and fully drawn overdraft, the repayment of which can be requested at any time. We expect liquidity to tighten over the next few months due to negative FCF, although prudent cash management reduces the pace of liquidity utilisation until bond refinancing in September 2021.

Intralot has no committed credit lines, even at operating companies, since the USD40 million RCF granted to the US subsidiary expired in August 2020.

Criteria Variation

Intralot's financial access in our Corporate Rating Criteria does not envisage financial market development (FMD) scores below 'b'. Greece, where Intralot is headquartered, has an FMD score of 'ccc'. As an issuer with average access to its local market and limited access to international funding, the Financial Access score matches the FMD of Greece. given its heavy reliance on the local financial market and inability to access international markets. Consequently, the issuer's Operating Environment is limited to 'b+' compared with 'bb+' previously.

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

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.

Intralot S.A.; Long Term Issuer Default Rating; Affirmed; CC

Intralot Capital Luxembourg SA
----senior unsecured; Long Term Rating; Upgrade; CC

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
Elena Stock,
Senior Director
+49 69 768076 135

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
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