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Research Update:

Greek Gaming Company Intralot S.A. Rating Lowered To 'B' On Margin Pressure And Challenging Markets; Outlook Negative

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Overview

- We believe that a challenging operating environment in selected markets, such as Italy, could constrain the recovery in Intralot's profitability that we had anticipated in the second half of 2015.
- We have revised our business risk profile to "weak" from "fair" to reflect the pressures.
- We are therefore lowering our issuer credit rating on Intralot to 'B' from 'B+'.
- The negative outlook reflects our opinion that the ongoing challenging operating environment in selected key markets for Intralot could further erode margins relative to our base case and could also restrict headroom under Intralot's financial covenants.

Rating Action

On July 10, 2015, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Greek gaming company Intralot S.A. to 'B' from 'B+'. The outlook is negative.

Rationale

The downgrade reflects that Intralot's profit margins, which declined in 2014, fell again in the first quarter of 2015 at a slightly higher rate than we previously anticipated. This was due to challenging operating conditions in selected markets, primarily Greece and Italy. Consequently, we have revised our business risk profile for Intralot to "weak" from "fair". Although Intralot is headquartered in Greece, we do not link its ratings with those on the sovereign because less than 5% of EBITDA is generated in Greece.

Intralot's business risk profile continues to be supported by its position as a major supplier of integrated gaming systems and services, and its role as a game manager on behalf of third parties, including state-owned operators. The contract-based nature of Intralot's business offers some medium-term visibility on its revenues. The company has largely maintained and gained gaming contracts, which fosters rapid growth, particularly in deregulating markets. We believe Intralot's business risk profile is constrained, however, by its pronounced exposure to emerging markets, as well as to different regulatory and tax systems. Another constraint is the company's lack of scale

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in large and relatively predictable gaming and lottery markets such as the U.S. and some Western European markets. We also observe a shift in the company's focus toward lower-margin licensed business, which has constrained profitability.

Our assessment of Intralot's financial risk profile as "aggressive" reflects credit metrics that are largely in the "significant" category. We adjust our assessment downward by one category due to our opinion that not all of the cash flows are available to service debt. This is because some of the cash ultimately belongs to significant minority interests in some of Intralot's subsidiaries.

Our assessment of Intralot's financial risk profile is also based on the company's exposure to foreign exchange risk and its weak discretionary cash flow generation, which we consider to be a true measure of free operating cash flow (FOCF) for Intralot, reflecting the fact that dividends are currently paid only at the subsidiary level, mostly in the companies where significant minority shareholders are present.

Our base case assumes:
- Revenue growth of about 6% in 2015 and 14% in 2016.
- Slight decline in Standard & Poor's-adjusted EBITDA margin to just below 10% in 2015 and 2016.
- Working capital outflows in the low single digits in the next few years.
- Capital expenditures of about €60 million-€70 million in 2015 and 2016.
- Dividend payments of about €25 million-€35 million in 2015 and 2016.

Based on these assumptions, we arrive at the following credit measures:
- Adjusted EBITDA of about €190 million in 2015 and €220 million in 2016.
- Discretionary cash flow of about €15 million-€20 million in 2015 and 2016.
- Adjusted debt to EBITDA of about 3x in 2015, falling to about 2.5x-3.0x in 2016.
- Adjusted EBITDA interest cover of about 3.0x in 2015 and about 3.5x in 2016.

Liquidity

We assess Intralot's liquidity as "less than adequate" under our criteria. Although we estimate that the ratio of sources to uses of funds remains comfortably above 1.2x, we believe that there is an increased likelihood that covenant headroom could fall below the 15% we require for an "adequate" assessment, as a result of lower than expected earnings growth.

We understand that Intralot's key sources of liquidity for the 12 months from March 31, 2015, include:
- About €100 million of forecasted FFO in 2015; and
- Cash balances of about €400 million, including the fully drawn €200 million syndicated facility and about €150 million in subsidiaries in which the company does not have majority ownership.

We estimate Intralot's main liquidity uses over the same period to be:

- Up to €30 million in intrayear working capital variations;
- Capital spending of approximately €65 million; and
- About €30 million of dividends related to minority interests.

Outlook

The negative outlook reflects our opinion that the ongoing challenging operating environment in selected key markets for Intralot, such as Italy and Greece, could further erode margins relative to our base case and could also restrict headroom under Intralot's financial covenants.

Downside scenario

We would consider lower the ratings over the next 12 months if we assess that there has been a material weakening in Intralot's operating margins or credit ratios, or if the gradual improvement that we forecast under our base case in the second half of 2015 and 2016 fails to materialize. In particular, we could lower the ratings if adjusted EBITDA interest cover fell below 1.5x for an extended period.

Upside scenario

We consider a positive rating action less likely in the next 12 months. We would need to observe a significant recovery in operating performance and an improvement in covenant headroom enough to bring us to revise our assessment of Intralot's liquidity upward to "adequate".

Ratings Score Snapshot

Corporate Credit Rating: B/Negative/--

Business risk: Weak
- Country risk: Moderately High
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria And Research

Related Criteria

- Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
Intralot S.A.		
Corporate Credit Rating	B/Negative/--	B+/Negative/--
Intralot Capital Luxemburg S.A.		
Senior Unsecured*	B	B+
Intralot Finance Luxembourg S.A.		
Senior Unsecured*	B	B+

*Guaranteed by Intralot S.A.

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