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Research Update:

Intralot Downgraded To 'CCC+' On Weakened Liquidity And Elevated Leverage; Outlook Negative

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Rating Action Overview

- Following Intralot losing its betting contract with Turkish gaming platform IDDAA, and the disposal of Azerinteltek at end-2018, we expect the company's operating performance to deteriorate further and lead to an increase in adjusted leverage to 8.5x-9.0x by end-2019.
- We believe this reduces Intralot's ability to fund its operational, financial, and capital expenditure (capex) needs, as well as to refinance its €15 million loan with Nomura maturing end-March 2019.
- Intralot's ability to build a sufficient liquidity cushion depends on substantial asset disposals and/or renegotiation of already-exceeded covenants under its revolving credit facilities (RCFs).
- As a result, we are lowering to 'CCC+' from 'B-' our long-term issuer credit rating and issue ratings on Intralot. The outlook remains negative.
- The negative outlook reflects our view that we could lower the ratings further in the next 12 months if cash balances continue to deplete. This would happen if the company was unable to dispose non-core assets and failed to renegotiate its springing covenants for the RCFs. We could also downgrade Intralot if it appeared more likely to launch a distressed restructuring transaction.

Rating Action Rationale

The downgrade follows Intralot's tightening liquidity position and recent loss of one of two Turkish contracts; IDDAA which represented about 10% of proportionate EBITDA in 2017. Specifically, we expect a further increase in proportionate adjusted debt to EBITDA to 8.5x-9.0x by year-end 2019, and we expect Intralot will only start reducing leverage in 2020-2021. We expect discretionary cash flow (DCF; free operating cash flows [FOCF] after minority dividend payments) on a fully consolidated basis will be negative in the next three years. This reflects poor operating cash flow generation, significant capex requirements, and dividend payments to minorities. This puts further pressure on the rating.

Under our revised forecasts we expect consolidated EBITDA to decline to about €105 million in 2019 from about €140 million-€145 million expected for 2018 (including Azerinteltek). This is mainly because of the exclusion of the Inteltek operations in Turkey (€23 million EBITDA in 2017) as well as the

Azerinteltek business in Azerbaijan (€20 million EBITDA in 2017). On a proportionate basis, we expect S&P Global Ratings-adjusted EBITDA in 2019 will be about €85 million. We expect S&P Global Ratings-adjusted leverage to increase above 8.5x by end of 2019. Such high leverage, along with the impending liquidity shortfall, brings into question Intralot's capital structure sustainability.

We also believe liquidity could come under pressure in the next 12 months. Intralot's cash on balance sheet and funds from operations (FFO) will barely cover the company's working capital changes, capex, and minority dividend payments over the next 12 months. Intralot has a €15 million loan with Nomura maturing in March 31, 2019, with an already-breached net leverage covenant of 3.75x. If this covenant is not renegotiated, they will not be able to refinance it and therefore the loan will be paid with cash on balance sheet. The two bilateral facilities, amounting to €70 million, are currently not available given that the springing covenant of 4.75x has been exceeded.

The negative outlook reflects that we could downgrade Intralot further in the next 12 months if it fails to dispose non-core assets and/or renegotiate the financial covenants of its RCFs. This would lead to liquidity stress and the company being unable to fund capex needs and other expenses.

In our view, Intralot's business remains constrained by its significant exposure to emerging markets (such as Turkey, Morocco, and Argentina), potential significant foreign-exchange fluctuations and the high regulatory and taxation risk in the global gaming industry. These constraints are somewhat offset by Intralot's strong position among leading gaming-technology and sports-betting companies and it being a vertically integrated company that provides technology as well as operating machines. Intralot is also well positioned in the U.S., which could benefit it in the future in light of changes in U.S. sport betting regulations.

For additional analysis of Intralot's business risk, see "Greek Gaming Company Intralot Outlook Revised To Negative On Increased Leverage; 'B' Ratings Affirmed," published April 25, 2018, on RatingsDirect.

Earnings from Intralot's partly-owned subsidiaries (such as those in Turkey, Bulgaria, and Argentina) are fully consolidated, while debt is largely situated at the HoldCo level. This distorts the company's credit metrics. We therefore assess Intralot's financial risk profile on a proportionate basis because not all of the group's cash flows are available to service debt, since they belong to partnerships and ultimately to minorities according to their relevant stakes.

On a fully consolidated basis, Intralot has weak DCF generation with a highly leveraged DCF-to-debt ratio. We consider this a true measure of free cash flow for Intralot, since we measure DCF after deducting significant nondiscretionary dividends paid to minority interests at the subsidiary level.

Our base case assumes:

- Macroeconomic prospects varying in Intralot's operating countries; we expect real GDP growth over 2019-2020 will be about 1.5%-2.5% in the U.S. and the Netherlands, 3.0%-3.5% in Bulgaria, and 3.0%-5.0% in Morocco. We believe this could boost Intralot's revenue growth over the period but we remain cautious due to uncertainty in some key markets. Argentina, for example, is expected to contract by 0.8% in 2019.
- Revenue to decrease by about 20% in 2019, mainly driven by the loss of the Inteltek contract in Turkey and the disposal of Azerinteltek in Azerbaijan. On a like-for-like basis, we expect a decrease of about 2% in revenue mainly due to underperformance in Turkey (under the outstanding contract of Bilyoner) and Morocco.
- We expect Intralot will grow by about 2%-3% annually in 2020-2021.
- Intralot's adjusted EBITDA margin to decrease to about 11%-12% in 2019-2020, mainly on the loss of the higher margin IDDAA contract.
- Dividends to minority interests of €20 million-€25 million annually during 2019-2020. We view Intralot's dividends to minority interests as nondiscretionary because its non-controlling partners are entitled to their share of profits at the operating subsidiary level.
- Annual capex of about €60 million in 2019-2020, which is lower than previously forecast given that about €15 million was related to the IDDAA contract.
- Gross debt to remain broadly stable over the next two years because we assume that Intralot will not be able to draw the RCFs to finance capex given the current covenants.

Based on these assumptions, we arrive at the following credit measures:

- On a proportionally consolidated basis, we expect an adjusted debt-to-EBITDA increase to about 8.5x during 2019-2020. On a fully consolidated basis, we forecast adjusted leverage of around 6.5x-7.0x in 2019-2020.
- On a proportionally consolidated basis, we expect EBITDA interest coverage of 1.5x in 2019 and 2020. On a fully consolidated basis, we forecast about 2.0x EBITDA interest coverage for 2019 and 2020.
- We expect negative reported DCF in the next three years due to weaker cash flow generation, high minority dividend payments, and material capex needs.

Outlook

The negative outlook reflects our view that S&P Global Ratings-adjusted debt to EBITDA will climb to around 8.5x-9.0x driven by the expected decline in earnings and profitability coming from the loss of the Turkish contract and disposal of Azerinteltek. We believe that this will lead to liquidity constrains. Significant asset disposals will be needed to regain a liquidity cushion. Moreover, the company will likely require a further amendment or

waiver of covenants over the near term to gain access to the RCFs.

Downside scenario

We could lower the rating on Intralot if its liquidity position weakened further. This could stem from the company not managing to sell non-core assets and failing to achieve the required covenant amendment or waiver of its springing covenants under the RCF. We would also consider a downgrade if a distressed exchange or potential restructuring seemed likely over the next 12 months. This could include a company voluntary agreement or buying back portions of its bonds.

Upside scenario

We could revise the outlook to stable if Intralot successfully disposes non-core assets without materially affecting its profitability, and if it renegotiates the springing covenants under the RCFs so that it has some headroom to use them if needed.

An outlook revision to stable would also need Intralot to restore its profitability by effective efficiency measures and improved market conditions.

Liquidity

We assess Intralot's liquidity as weak. We expect sources of cash to be slightly lower than the uses over the next 12 months and we see the likelihood of regaining better-than-weak liquidity as low. Moreover, Intralot currently has a poor standing in the credit markets (notes are trading well below par) and we believe that it will face difficulties amending the springing covenants of the RCFs.

For the 12 months started Jan. 1, 2019, we calculate the following principal liquidity sources:

- Cash and liquid investments immediately available at the Intralot level of about €80 million; and
- Our forecast funds from operations of about €18 million-€20 million.

For the same period, we calculate the following principal liquidity uses:

- About €5 million non-seasonal working capital requirements;
- About €10 million seasonal working capital requirements;
- Capex of approximately €60 million; and
- About €25 million of dividends related to minority interests.

Covenants

Documentation governing Intralot's €500 million and €250 million senior unsecured notes do not include any maintenance financial covenants. However, Intralot has a springing maintenance covenant of 4.75x maximum net leverage on two bilateral credit facilities amounting to €70 million. Intralot's net leverage is already above 4.75x and therefore these facilities are not available for Intralot, unless it manages to renegotiate with lenders.

Issue Ratings - Recovery Analysis

Key analytical factors

- The issue and recovery ratings on the €500 million senior unsecured notes due 2024 and the €250 million senior unsecured notes due 2021 are 'B' and '4', indicating our expectation of meaningful (40%-60%, rounded estimate 45%) recovery prospects in the event of default.
- The recovery ratings are constrained by the high amount of senior unsecured debt ranking pari passu and the relatively weak guarantor coverage.
- Our hypothetical default scenario assumes a prolonged period of negative DCF if the company's cash balance is not restored by non-core asset disposals or availability of bilateral facilities.
- We value the business as a going concern, given its leading position in gaming technology and sports betting industries globally.

Simulated default assumptions

- Year of default: 2020
- Jurisdiction: Greece

Simplified waterfall

- EBITDA at emergence: €68.3 million (capex at 1.5% of three-year average sales, cyclicality adjustment is 10%, in line with sector assumptions, no operational adjustment was used)
- Multiple: 5.5x.
- Gross enterprise value at default: €376 million
- Net enterprise value after administrative costs (5%): €357 million.
- Estimated senior unsecured debt: €777 million
- Recovery range: 40%-60% (rounded estimate 45%)
- Recovery rating: 4

Ratings Score Snapshot

Issuer Credit Rating: CCC+/Negative/--

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

Financial risk: Highly Leveraged

Cash flow/Leverage: Highly Leveraged

Anchor: b-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Weak (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: 'ccc+'

Related Criteria

- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Industry Top Trends 2019: Hotels, Gaming, And Leisure, Nov. 13, 2018
- Consolidation Helps European Gaming Companies Ride Out Regulatory Changes, Sept. 12, 2018

Ratings List

Downgraded

	To	From
Intralot S.A.		
Issuer Credit Rating	CCC+/Negative/--	B-/Negative/--
Intralot Capital Luxembourg S.A.		
Senior Unsecured	CCC+	B-
Recovery Rating	4(45%)	4(45%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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