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Research Update:

Greek Gaming Company Intralot Outlook Revised To Negative On Increased Leverage; 'B' Ratings Affirmed

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Research Update:

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Overview

- Greece-based gaming company Intralot S.A.'s leverage increased in 2017 due to a rise in debt and a reduction in EBITDA. We expect leverage to further increase in 2018 to 7.0x-7.5x.
- We project that free operating cash flow will turn negative in 2018 as a result of high capital expenditure needs for Intralot's Illinois project. Starting 2019, this project is expected to support EBITDA growth considerably.
- We are revising our outlook on Intralot to negative from stable. At the same time, we are affirming our 'B' long-term issuer credit rating and 'B' issue rating on the senior unsecured notes.
- The negative outlook reflects our view that we could downgrade Intralot in the next 18 months if its adjusted leverage remains above 7.0x and EBITDA interest cover ratio stays below 2.0x on a proportionally consolidated basis.

Rating Action

On April 25, 2018, S&P Global Ratings revised its outlook on Greece-based gaming company Intralot S.A. to negative from stable and affirmed the 'B' long-term issuer credit rating.

At the same time, we affirmed our 'B' issue rating on the senior unsecured notes issued by Intralot Capital Luxembourg S.A. The recovery rating on these notes is unchanged at '4' reflecting our expectation of average recovery (30%-50%, rounded estimate: 45%) in the event of payment default.

Rationale

The outlook revision reflects that we could downgrade Intralot in the next 18 months if its leverage remains above 7.0x and EBITDA interest cover below 2.0x. This could be the case if we observed an increase in debt to finance capital expenditure (capex) needs or if Intralot failed to increase EBITDA without paying down debt.

Our rating action follows the financial year 2017 (ending Dec. 31) results, in

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which Intralot reported an increase in proportionate adjusted debt to EBITDA to around 7.0x. During 2017, the company increased gross debt from €660 million to €750 million, and at the beginning of 2018, issued a new €15 million term loan with Nomura. This led to an increase in the 2018 forecast gross debt to €765 million and higher leverage. The company also reported substantially lower revenues than our previous forecast (€1,104 million compared with €1,340 million), mainly due to the disposal of the operations in Jamaica and adverse foreign exchange changes in Turkey. On a proportionate basis, EBITDA in 2017 was €109 million, slightly below our previously forecast of €113 million, while on a continuing basis, EBITDA increased by 5.5%.

In February 2018, Intralot won the Illinois license contract, which will start generating significant EBITDA and cash flows from December 2018. As a result of the delay in obtaining this license, coupled with the adverse gaming market conditions in Turkey (that is, illegal market growth in the gaming market), we don't expect any EBITDA growth in FY2018. We therefore anticipate that the proportionate adjusted debt to EBITDA will increase to 7.2x-7.5x by the end of 2018, well above the 6.4x that we forecast in April 2017.

In our view, Intralot's business remains constrained by its significant exposure to emerging markets (for example, Turkey, Morocco, and Azerbaijan). However, the disposal of the Jamaican operations and the acquisition of the Illinois license reduces this exposure to close to 50% of total EBITDA. We believe that the high regulatory and taxation risk relating to the global gaming industry could pose substantial risk and volatility on Intralot's future profitability. However, this should, to some extent, be mitigated by the geographical diversification of Intralot's group entities.

Despite the company's good track-record of obtaining as well as renewing gaming licenses and government contracts worldwide, we believe that future license renewals pose a risk to Intralot's business. For example, the Turkish license (Inteltek) expires at the end of 2018, which currently represents around 10% of the total EBITDA. Failure to renew this could lead to a substantial loss of profitability and cash flows.

These business constraints are somewhat offset by Intralot's strong position among gaming technology leaders and largest sports betting companies. They are also mitigated by the company being vertically integrated, providing technology as well as being the operator of the licenses. We also acknowledge the expected increase in EBITDA margin from 2019 as a result of the sale of the lower-margin Jamaican operations and successful acquisition of higher-margin Illinois contract.

Intralot's credit metrics are distorted by the full consolidation of its partially owned subsidiaries earnings (such as in Turkey, Bulgaria, and Argentina), while the debt is largely situated at the holding company. 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 as they ultimately belong to significant minority interests in some of Intralot's subsidiaries.

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We estimate that Intralot will post around 3% fully-consolidated revenue growth in 2018, but broadly stable EBITDA on a proportionally consolidated basis. We expect the company to require significant capex in 2018 (€130 million-€140 million), which we assume will be largely financed by cash on balance sheet and the new term loan of €15 million. Under our base case, we believe that Intralot will increase gross debt up to €760 million-€770 million, leading to adjusted leverage of around 7.2x-7.5x and EBITDA interest coverage below 2.0x in 2018.

On a fully consolidated basis, Intralot has weak discretionary cash flow (DCF) generation with a highly leveraged DCF to debt. We consider this to be a true measure of free cash flow for Intralot, as DCF is measured after deducting significant dividends paid to minority interests at the subsidiary level.

Our base case assumes:

- Varying macroeconomic prospects in Intralot's operating countries, but core countries such as the U.S., Turkey, Bulgaria, and Argentina are expected to have 2%-3% annual GDP growth over 2018-2019. We believe this should boost Intralot's like-for-like revenue growth over the same period.
- Revenue to increase at around 3% in 2018, mainly driven by the Bulgarian and Azerbaijan businesses. In 2019, we expect a decrease of 2.5%-3.0% in revenues as a result of the expected sale of the operations in Poland.
- Intralot's adjusted EBITDA margin to decrease to 15% in 2018 driven by the Illinois project implementation costs as well as lower margins, on an absolute basis, under the new OPAP contract. In 2019 and onwards, we expect the EBITDA margin to increase to nearly 17% thanks to the higher-margin U.S. operations.
- Dividends to minority interest of €40 million-€42 million during 2018-2019. We view Intralot's dividends to minority interest as non-discretionary in nature, as non-controlling partners of Intralot are entitled to their share of profits at the operating subsidiary level.
- Capex of around €130 million-€140 million in 2018, primarily related to the Illinois project implementation. We assume that the capex needed to roll-out the Illinois project will be financed by cash on balance sheet. In 2019, we expect capex to normalize to €50 million-€55 million.
- Gross debt of around €760 million-€770 million at the end of 2018 and relatively stable thereafter.
- We expect future sales of holdings to be used to pay down debt, but we do not incorporate those in our base case as we are not aware of any contractual sales.

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

- On a proportionally consolidated basis, we expect adjusted debt to EBITDA to increase to around 7.0x-7.5x in 2018, decreasing to below 7.0x by 2019 once the Illinois contract starts generating full-year EBITDA. On a

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fully-consolidated basis, we forecast 4.5x-5.0x adjusted leverage in 2018 and 4.0x-4.5x in 2019.

- On a proportionally consolidated basis, we expect EBITDA interest coverage of slightly below 2.0x in 2018, recovering back to above 2.0x by 2019. On a fully-consolidated basis, we forecast slightly below 3.0x EBITDA interest coverage for 2018 and above 3.0x for 2019.
- We expect negative DCF in 2018 due to high capex needs, while in 2019 we forecast €5 million-€10 million DCF.

Liquidity

We assess Intralot's liquidity as adequate. We expect sources of cash to comfortably exceed uses by more than 1.2x over the next 12 months even if EBITDA declines by 15%. In our view, the company has generally prudent risk management in the context of an adequate liquidity assessment, but we think Intralot would be unlikely to be able to absorb high-impact, low-probability events without the need for refinancing, given the highly competitive market and the volatility of the industry.

We estimate Intralot's key sources of liquidity for the next 12 months starting Dec. 31, 2017, to be:

- €238 million of cash and cash equivalents on balance sheet, of which about €120 million is immediately available; €100 million of undrawn bilateral credit facilities; and
- Our forecasted funds from operations of about €80 million-€90 million.

We estimate Intralot's key sources of liquidity for the next 12 months starting Dec. 31, 2017, to be:

- Around €5 million-€10 million non-seasonal working capital requirements;
- Capex of approximately €130 million-€140 million; and
- About €40 million-€45 million of dividends related to minority interests.

Covenant analysis

Documentation governing Intralot's €500 million and €250 million senior unsecured notes do not include any maintenance financial covenants. However, the €15 million term loan with Nomura issued in Dec 2017 has a financial covenant at 3.75x maximum net leverage. Under our base case, we expect Intralot to have very limited headroom under this covenant in 2018. However, this covenant only applies to the €15 million term loan, which we don't consider as material and cannot trigger a cross default to other outstanding debt, if the drawn amount is lower than €35 million.

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Outlook

The negative outlook reflects our view that we could downgrade Intralot in the next 18 months if its adjusted leverage remains above 7.0x and EBITDA interest cover ratio stays below 2.0x on a proportionally consolidated basis. We could also lower the ratings if the company fails to generate sustainably positive free operating cash flow (FOCF; after minority dividend payments) on a fully-consolidated basis.

Downside scenario

We could lower the ratings if Intralot maintains leverage above 7x and EBITDA interest coverage below 2.0x even after 2018. This could be the case if the company raises further debt to finance capex needs or if EBITDA is lower than our base case. The latter could occur if the company disposed of business operations without compensating with new profitable acquisitions, or if the proceeds from those sales were not used to pay down debt.

Rating pressure could also arise if headroom under Intralot's financial covenants tightened and the company had over €35 million of drawn debt under the 3.75x net leverage covenant.

Upside scenario

We could revise the outlook back to stable if Intralot demonstrated more than 5% growth in revenues, an EBITDA margin above 15% and generation of sustainably positive FOCF, showing that new license acquisitions such as the Illinois license are beginning to bear fruit. This improvement in performance would need to be coupled with a stable gross debt. We could also consider revising the outlook back to stable if the company substantially decreased debt, leading to adjusted leverage below 7.0x and EBITDA interest coverage above 2.0x on a sustainable basis.

Ratings Score Snapshot

Corporate Credit Rating: B/Negative/--

Business risk: Weak

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

Financial risk: Highly Leveraged

Cash flow/Leverage: Highly Leveraged

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Anchor: b

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

Stand-alone credit profile: b

Issue Ratings--Recovery Analysis

Key Analytical Factors

- The issue and recovery rating on the €500 million senior unsecured notes due 2024 and the €250 million senior unsecured notes due 2021 are 'B' and '4', respectively, 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 unfavorable changes in regulation as well as challenging economic conditions leading to a significant decline in discretionary consumer spending.
- 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: 2021
- Jurisdiction: Greece

Simplified Waterfall

- EBITDA at emergence: €75.4 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: €415 million
- Net enterprise value after administrative costs (5%): €394 million.
- Estimated senior unsecured debt: €857 million
- Recovery range: 40%-60% (rounded estimate 45%)

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- Recovery rating: 4

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, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Intralot S.A.		
Corporate Credit Rating	B/Negative/--	B/Stable/--

Rating Affirmed

Intralot Capital Luxembourg S.A.		
Senior Unsecured	B	
Recovery Rating	4(45%)	

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed

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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 the 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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