07 Mar 2019 | Downgrade

# Fitch Downgrades Intralot to 'B-'; on Rating Watch Negative

Fitch Ratings-Paris-07 March 2019: Fitch Ratings has downgraded Greek gaming group Intralot S.A.'s (Intralot) Long Term Issuer Default Rating (IDR) to 'B-' from 'B', and the senior unsecured rating on the bonds issued by Intralot Capital Luxembourg S.A., guaranteed by Intralot's key subsidiaries, to 'B-'/'RR4'/33% from 'B'/'RR4'/44%. Fitch has also placed the ratings on Rating Watch Negative (RWN).

The downgrade reflects the uncertainty about the group's ability to significantly deleverage, which is no longer compatible with a 'B' rating, and mounting competitive pressures in some markets putting the renewal of key contracts at risk. This results in higher leverage than we previously expected over the next four years. The RWN is based on Intralot's inability to raise material asset disposal proceeds to significantly reduce leverage and the uncertainty around the availability of sufficient liquidity headroom, in light of leverage over the covenant threshold at year-end 2018 preventing drawings on the revolving credit facility (RCF).

Fitch aims to resolve the RWN within six months, subject to the group providing an update on its liquidity situation and a review of its strategic plan.

Key Rating Drivers
Mounting Liquidity Risks: Fitch expects that Intralot's leverage ratio, as defined under the RCF documentation, was above the threshold of 3.75x as of December 2018, preventing Intralot from drawing on these lines. At end-2018, the RCFs were undrawn. Fitch has not been provided with final documentation of the amended RCFs. In addition to the RCF covenants, Intralot would be above its incurrence leverage covenant threshold under the bonds' documentation, limiting its ability to raise additional debt to support its operations or finance capex, although we acknowledge that it will not face meaningful long-term debt refinancing needs until 2021. According to management, bond documentation would allow Intralot to raise around EUR100 million of secured debt. Material asset sales could increase headroom but have not yet materialised, apart from the Azerbaijan partnership sold in November 2018.

Continued High Leverage: Intralot's 45%-owned Turkish subsidiary, Inteltek, sold its 51% stake in Azerbaijan operations for EUR19.5 million in 4Q18. This subsidiary accounted for 15% of consolidated revenue and 14% of consolidated EBITDA. In addition, in late February Inteltek lost the tender for the renewal of its contract in Turkey. We estimate the aggregate impact of these factors represents an increase in gross leverage by around 1.0x.

Sustained Capex Prevents Deleveraging: We believe that management will continue to bid for new contracts, requiring sustained new capex while associated revenues will come with delay. We now estimate that free cash flow (FCF) will remain negative over the rating horizon, and funds from operations (FFO) adjusted leverage to be higher than we expected in October 2018, declining only to 7.9x (6.8x previously) by end-2021 from 8.6x in 2018, leading to our assessment of heightened refinancing risks.

Increasing Strategy Execution Risks: Following the loss of the Inteltek contract in Turkey and the recent change in CEO, Intralot may re-define its strategy. Fitch believes the company will have to find new growth prospects in other markets to offset the significant portion of EBITDA that was generated by Inteltek. In Turkey, the company expects to continue to operate its distribution contract through the Bilyoner partnership . However, Fitch believes that competitive pressure is increasing.

FX Volatility Affects EBITDA: We estimate the recent FX volatility in emerging countries, in particular in Argentina (B/Negative, 10% of last 12 months (LTM) consolidated EBITDA at end September 2018) and Turkey (BB/Negative, 22% of LTM consolidated EBITDA at end September 2018, before the recent contract loss) will affect 2018 EBITDA by around EUR20 million, or 14% of group EBITDA according to management. Although the group has a hedging policy, it only uses short-term forward contracts, with limited protection in case of prolonged FX volatility.

Contract Portfolio Remains Satisfactory: Intralot has established itself in the international gaming sector as a reputable provider of products including systems to manage lotteries through software platforms and hardware terminals, and in betting, a large algorithm-based sportsbook. This has enabled Intralot to win important contracts for the supply of technology and the management of lotteries in the US and Greece and for sports betting in Germany. However, contract renewal can prove more challenging than expected, as highlighted by the recent loss of the Inteltek contract in Turkey.

Growth Prospects Intact: The gradual liberalisation of gaming markets, governments' keenness on finding ways to raise tax proceeds and the increasing supply of new games should all provide increasing opportunities for Intralot. The company should be able to leverage on its experience and reputation and benefit from the limited number of reputable suppliers in the industry, allowing it to expand into new countries. Intralot is also well positioned to benefit from opportunities in the US in the wave of recent changes in legislation in many states, although possible arbitrary changes in legislation remain a typical risk in this sector, while competition is intense.

Derivation Summary
Intralot has smaller revenue and EBITDA than GVC Holdings Plc (BB+/Stable), William Hill Plc, International Game Technology and Scientific Games Corporation. Intralot's leverage is significantly higher than that of GVC Holdings Plc. Compared with Net Holding A.S. (B/Stable), Intralot is larger and displays stronger business profile characteristics with more visibility of revenues and EBITDA from recurring long-term contracts, a higher geographic diversification, and specialist supplier technology expertise.

Key Assumptions
- Revenue and profitability impacted by the disposal of Azerbaijan and the loss of the Inteltek contract, partly offset by new contracts notably in the US;
- EBITDA margin declining until 2019, then recovering thanks to higher profitability of new contracts;
- Minority profits fully paid out as dividends (for FY2017 we deducted an estimated amount of recurring dividends paid to / dividends received from minorities of EUR36 million from our calculation of FFO);
- Capex higher in 2018 following the Illinois contract, going down to historical levels afterwards;
- No common dividends.

Recovery Ratings Assumptions:
In our bespoke going-concern recovery analysis we estimated Intralot's FY18E EBITDA in the range of EUR140 million-EUR145 million, deducted attributable EBITDA to minority interests and Azerinteltek and Inteltek, and this was further discounted by 30% to arrive at an estimated post-restructuring EBITDA available to creditors of around EUR58 million. We applied a distressed enterprise value / EBITDA multiple of 5x to Intralot's wholly-owned operations.

We also estimate EUR44 million of additional value stemming from minority interests.

In terms of distribution of value, all unsecured debt would recover 33% in the event of default (assuming Intralot's unsecured RCF would be fully drawn in a hypothetical event of default, and the US facilities lender to be granted first claim priority). This is consistent with a 'RR4' Recovery Rating and an instrument rating of 'B-', i.e. the same as the IDR. All lines are currently unsecured, like the bonds. Fitch believes that banks could ask for security over some assets in the covenant waiver negotiations. This would have an impact on the recovery percentage of the bonds, and possibly on the Recovery Rating, leading to a potential downgrade of the senior unsecured rating.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action (i.e. off RWN, Outlook Stable)

- Evidence of sufficient liquidity to support operations combined with sustained neutral to positive FCF generation, and disposal of assets enhancing liquidity
- EBITDA growth derived from a stronger return on capital on existing and future contracts, and efficient management of FX risks, leading to FFO margin sustainably above 4%
- FFO-based net adjusted leverage below 7x (FFO gross lease adjusted leverage below 7.5x).
- FFO fixed charge cover sustainably above 1.8x

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Lack of sufficient operational liquidity cushion and inability to monetise assets
- Evidence that new contracts or renewals are occurring at materially less favourable conditions for Intralot, resulting in continuing weak FFO margin of under 3.5%, large upfront concession fees or capex outlays, or EBITDA impacted by persisting FX volatility; non-renewal of significant contracts
- FFO adjusted net leverage above 7.5x (or FFO adjusted gross leverage above 8x)
- FFO fixed charge cover below 1.5x
- Sustained negative FCF

Liquidity and Debt Structure

Tightening Liquidity: At end September 2018, Intralot had EUR151million of cash on its balance-sheet (EUR113 million on a proportionate basis, which we view as unrestricted). Intralot does not face any significant debt maturities until 2021, when the first bond (with a face value of EUR250 million) matures, while the second bond (with a face value of EUR500 million, and EUR495 million remaining due) matures in 2024. At end September 2018, Intralot also had undrawn RCF of EUR80 million, maturing on 30 June 2021. However, Fitch believes that Intralot does not have access to its bank RCFs since its leverage (as defined in the RCF documentation) would be above the covenant threshold as of December 2018.

A liquidity source could arise from sale of non-strategic assets. Given the uncertainty, Fitch did not included this in its forecasts.

Intralot Capital Luxembourg SA

----senior unsecured; Long Term Rating; Downgrade; B-; RW: Neg
Intralot S.A.; Long Term Issuer Default Rating; Downgrade; B-; RW: Neg

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**Applicable Criteria**
Corporate Rating Criteria (pub. 19 Feb 2019)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)

**Additional Disclosures**
Dodd-Frank Rating Information Disclosure Form

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