

RATING ACTION COMMENTARY

Fitch Downgrades Intralot to 'CCC'

Thu 23 Dec, 2021 - 5:47 AM ET

Fitch Ratings - Stockholm - 23 Dec 2021: Fitch Ratings has downgraded Intralot S.A.'s (Intralot) Long-Term Issuer Default Rating (IDR) to 'CCC' from 'CCC+', and the senior unsecured rating on the 2024 notes issued by Intralot Capital Luxembourg S.A. to 'CCC'/'RR4' from 'CCC+'/'RR4'.

The ratings have been also removed from Under Criteria Observation (UCO), where they were placed on 02 December 2021. The downgrade is not linked to the application of the new Parent Subsidiary Linkage (PSL) criteria published on 01 December 2021.

The downgrade reflects a deterioration in Intralot's Standalone Credit Profile (SCP, deconsolidating the US subsidiary and only adding back cash flows allowed to be up-streamed to Intralot under current documentation), stemming from a forecast material decrease in revenues and EBITDA. This decrease is related to the non-renewal of the Maltese lottery license, which was not previously assumed under the rating case.

The 'CCC' IDR reflects Intralot's weak SCP, its substantially smaller scale than in Fitch's previous rating case, as well as deteriorating leverage metrics, which increases uncertainty about Intralot's ability to refinance its bond maturing in 2024. Cash flow up-streamed from the US subsidiary, which is performing well, is the main support for liquidity and interest payment on the bond.

KEY RATING DRIVERS

Malta License Not Renewed: Maltco, Intralot's 73%-owned subsidiary, did not participate in a bid for a new 10-year concession to operate the National Lottery of

Malta. Maltese operations generated a material portion of EBITDA outside the US, and the revised Fitch rating case now assumes substantially lower business scale outside the US from 2023. This drives an increase in leverage that we forecast will peak shortly before the 2024 notes mature, substantially increasing refinancing risks.

PSL Application: Fitch applies its PSL Criteria when assigning Intralot's IDR. Intralot has a weaker SCP than Intralot Inc. due its smaller scale and higher leverage. We take into account Intralot's limited access to Intralot Inc.'s cash flow, primarily restricted until 2025 in the debt documentation. We view this as insulated ring-fencing. We also consider the Access and Control linkage factor as Porous, given the presence of significant minority shareholders following the debt restructuring, the separate treasury department and the funding raised by Intralot Inc. Fitch therefore assesses Intralot's IDR on a standalone basis, deconsolidating the US operations.

Limited Impact of US Business on Rating: Fitch recognises that as a group, Intralot has strong growth opportunities in the US market. We assume that Intralot Inc.'s own SCP, which is positioned within the 'b' rating category, is stronger than Intralot's SCP as it has larger scale in terms of annual EBITDA and substantially stronger credit metrics, namely funds from operations (FFO) adjusted leverage (of 5.5x-6.5x) and FFO fixed charge cover metrics (forecast around 2.0x-2.5x). However, remaining unsecured debt holders at the parent level do not have direct recourse to the US operations.

Focus on Deconsolidated Credit Metrics: We assess some of Intralot's qualitative factors, as well as the development of its leverage and coverage metrics deconsolidated from Intralot Inc. In our forecasts we take certain cash flows into account that are allowed to be up-streamed to Intralot under current documentation. The rest of Intralot's operations retain a portion of its brand strength and even without US operations there is some degree of geographic diversification, mostly in Argentina and Australia. However, Intralot's scale and market opportunities (without Intralot Inc.) are weaker than in the US, while competition remains high.

Limited Deleveraging Prospects: Under Fitch's rating case, Intralot's FFO adjusted leverage (calculated excluding Intralot Inc. but including permitted and predictable cash up-streaming) will stay high until its outstanding notes mature in 2024, having peaked at 16x in 2023. We believe that refinancing risk will stay high under current forecasts, underpinning its 'CCC' IDR. Intralot has additional deleveraging capacity from available put distribution options that allow it to sell another 14% of Intralot Inc. for extra liquidity or deleveraging purposes.

Satisfactory Debt Service Capabilities: We expect Intralot's FFO fixed charge cover to be between 1.0x-1.5x in 2022-2023, which should be satisfactory at the parent level,

albeit substantially weaker than on a consolidated basis. The acceptable level of coverage ratios is supported by expected cash inflows from Intralot Inc., which we expect would account for over 65% of Intralot's consolidated interest payments (excluding Intralot Inc.) in 2022-2024 under the Fitch rating case projections.

Business Recovery Driven by US: On a consolidated basis, Intralot's operations in 2021 demonstrated a recovery, leading to last 12 month revenues as of 9M21 that were almost at the pre-pandemic level. However, we note that there is a lot less visibility for business outside the US and we forecast that even on a consolidated basis, Intralot's revenues will deteriorate by 15-20% annually in 2022-2023, with growth of the US operations unable to offset expiration and non-renewal of several important contracts and licenses (Turkey, Malta).

DERIVATION SUMMARY

Intralot's current financial profile is not comparable with that of other gaming companies such as Flutter Entertainment plc (BBB-/Stable), Entain (BB/Positive), Sazka Group a.s. (BB-/Stable). Intralot has smaller size and lower through-the cycle profitability than gaming operator Codere (WD).

After the restructuring, Intralot has similar business-profile characteristics to Inspired Entertainment, Inc. (B-/Stable), but has materially weaker credit metrics on a standalone basis (with Intralot Inc. deconsolidated).

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

High single digit growth of US business in 2021, followed by low (under 2%) growth in 2022-2023, mostly driven by new business opportunities (expected to contribute up to USD12 million in 2023).

- Mid-teen growth of the rest of the world (RoW) business in 2021, followed by normalisation in 2022-2024, resulting in revenues around EUR115 million in 2024 for the business outside the US.

- Profitability improvement for operations in the US, Australia and Croatia, resulting in an EBITDA margin of 35-36% for the US business in 2022-2024, and 10.3% for the RoW business in 2021, improving to around 15% in 2022-2023

- Annual capex at 5-7.3% of sales no longer reflecting the EUR45 million investment needed for Maltese license renewal

- No PIK interest for the 2025 notes

- Dividends of around EUR6 million-EUR10 million paid annually by Intralot Inc. in 2022-2024

- Payment of EUR8.25 million per year to Intralot

Recovery Analysis Assumptions:

The recovery analysis assumes that Intralot would be considered a going concern in bankruptcy and that it would be reorganised rather than liquidated. We have assumed a 10% administrative claim.

We applied a distressed enterprise value (EV)/ EBITDA multiple of 4.5x to Intralot's wholly-owned operations.

Going concern EBITDA of Intralot S.A. (excluding Intralot Inc.) of EUR15 million reflects our view of a sustainable, post-reorganisation EBITDA level, upon which we base the valuation of the group excluding US operations and minority stakes. It is lower than our previous going concern estimate of EUR25 million due to the Maltese license non-renewal. Our distress scenario also considers a potential sale of Intralot Inc. stake and Intralot's stake in Argentinian operations.

After deducting 10% for administrative claims, our principal waterfall analysis would generate a ranked recovery in the 'RR3' band, indicating a higher rating for the unsecured debt at parent company than its IDR. The Recovery Rating is capped at 'RR4' as per Fitch's Country-Specific Treatment of Recovery Ratings Criteria given Greece is the country of incorporation for Intralot S.A., leading to a recovery percentage of 50% under our waterfall generated recovery calculation.

RATING SENSITIVITIES

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

- Sustained improvement in operating performance outside the US, for example through winning new contracts or improving performance of existing ones, combined with efficient cost-cutting measures, leading to continuously growing EBITDA and FFO, allowing for standalone FFO adjusted leverage trending below 10.0x;

- Standalone FFO fixed charge cover consistently above 1.0x;

- Increased access to the cash flows of Intralot Inc., for example due to lifted upstream restrictions based on current or new debt documentation;
- Additional recourse to Intralot Inc. for the majority of Intralot S.A. creditors (in the form of guarantees or cross-default provisions).

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Material deterioration of EBITDA generated outside the US leading to unmanageable leverage and heightened refinancing risk for the 2024 bond;
- Standalone FFO Fixed charge cover deterioration below 1.0x;
- Lack of sufficient operational liquidity cushion to support operations within the next 6-12 months.

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

Satisfactory Liquidity, Minimal Headroom: Fitch expects Intralot to have around EUR50 million liquidity at the end of 2021 on a consolidated basis (after applying Fitch adjustment of EUR45 million for readily available cash). Lack of short-term maturities supports Intralot's liquidity profile. However, liquidity still remains thin as Intralot S.A. heavily relies on cash flows from Intralot Inc. to support its interest payments.

ISSUER PROFILE

Intralot is a supplier of integrated gaming systems and services. The group develops, operates and supports customised software and hardware for the gaming industry and provides innovative technology and services to state and state licenced lottery and

gaming organizations worldwide. Intralot also holds some licences for full games operation.

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

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	RECOVERY ⇅	PRIOR ⇅
Intralot S.A.	LT IDR CCC	Downgrade	CCC+
Intralot Capital Luxembourg SA			
senior unsecured	LT CCC	Downgrade	RR4 CCC+

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Country-Specific Treatment of Recovery Ratings Criteria \(pub. 05 Jan 2021\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)](#)
(including rating assumption sensitivity)

[Corporate Rating Criteria \(pub. 15 Oct 2021\)](#) (including rating assumption sensitivity)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

APPLICABLE MODELS

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)

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