FitchRatings

07 Nov 2019 | Downgrade

Fitch Downgrades Intralot to 'CCC', Senior Unsecured Rating off RWN

Fitch Ratings-Paris-07 November 2019:

Fitch Ratings has downgraded Greek gaming group Intralot S.A.'s (Intralot) Long-Term Issuer Default Rating (IDR) to 'CCC' from 'CCC+'.

Fitch has also downgraded the senior unsecured rating on the bonds issued by Intralot Capital Luxembourg S.A., guaranteed by Intralot's key subsidiaries, to 'CCC'/'RR4' from 'CCC+'/'RR4', and removed it from Rating Watch Negative (RWN) where it was placed on 15 May 2019.

The downgrade of the IDR reflects higher leverage than our expectations, difficulties in renewing contracts amid increasing competition, and our expectation of continuing negative free cash flow (FCF). All these factors materially increase refinancing risk on Intralot's EUR250 million unsecured 2021 bond.

The removal of the Rating Watch reflects improved liquidity following the announced disposal of Gamenet, reducing the risk that secured debt would need to be raised in the next six months. Nevertheless, secured debt issuance remains likely, with potential adverse impact on expected recoveries for unsecured creditors.

Key Rating Drivers

Leverage Remains High: Fitch believes that Intralot's funds from operations (FFO) adjusted net leverage will remain high at around 8.5x up until 2021. The gradual ramp-up of US operations will somewhat offset the recently reduced operations scope and contracts renewals signed at less favourable terms. However, the company will cease to receive dividends from Gamenet (estimated around EUR4 million-EUR5 million p.a.), reducing FFO.

Increasing Refinancing Risk, Secured Debt Likely: Despite the recent asset disposals, which remove the immediate need for additional financing, Fitch sees a high risk that Intralot would need to raise secured debt to refinance its EUR250 million bond due in 2021. Issuing secured debt would erode the recovery prospects for Intralot's unsecured debt, and could lead to a downgrade of the instrument rating.

In our view, if Intralot is unable to significantly improve its operating profile and reduce gross debt and leverage over the next 12 to 18 months it will find it difficult to refinance its EUR250 million bond due in September 2021 on an unsecured basis. Moreover, the terms of this bond prevent its refinancing for the full amount on a secured basis.

Difficult Contract Renewals: Since the beginning of 2019, Intralot has experienced severe setbacks on its contract portfolio. The company lost the tender to extend its Inteltek contract, which was terminated in August 2019. This represented 15% of Intralot's 2018 consolidated EBITDA. The extension of its Bilyoner contract in Turkey (11% of 2018 consolidated EBITDA) - which is now on a three-month extension period ending in December 2019 - remains uncertain and we believe any renewal would be subject to lower margins. In Morocco, Intralot extended its sport-betting licence for another 10 years, albeit at weaker margins. Apart from Bilyoner, the next material contract renewal is in 2022 in Malta, which is subject to execution risk as associated capex may need to be debt-funded.

Geographic Concentration; FX Risk: We expect Intralot to generate around 40% of consolidated EBITDA from the US. We also estimate that Argentina (CC) and Turkey (BB-/Stable) would represent around 15%-20% of consolidated EBITDA up to 2022. Although we see some growth prospects in emerging countries and in Bulgaria (BBB/Positive) that would generate around 15%-20% of EBITDA, Intralot's significant exposure to Turkey and Argentina can result in material foreign exchange challenges, and could impair Intralot's foreign-currency debt service capability through weaker revenues and profits when translated into euros.

Contract Portfolio Lacks Scale: 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 via 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, we believe the company lacks scale relative to larger competitors such as IGT or Scientific Games. The recent change in strategy towards asset-light contracts - dictated by lack of access to capex funding - means Intralot is unlikely to win large contracts and to materially gain on size in the medium-term.

High Execution Risk: A newly appointed management team is working on many fronts to turn around the company. Fitch sees material execution risk despite some progress made and recent asset disposals providing flexibility to the implementation of the company's new strategy. Intralot is in the midst of a restructuring process to reduce its cost structure and capex that aim to generate annualised savings of around EUR10 million. Also the recent legal issues around the award of the sport betting contract in Washington DC in a no-bid process highlights another source of increasing execution risk for Intralot.

Asset Disposals Completed, Liquidity Improved: Intralot successfully disposed of its non-core assets, notably its announced sale of equity stake in Gamenet for EUR75 million and completed disposal of Hellenic Lotteries for EUR20 million, providing a liquidity buffer. We deem execution risk around the closing of the Gamenet disposal as low, and consider the transaction could be completed by end-2019. However, we continue to view interest payments of about EUR50 million per year as high for Intralot's current EBITDA, which will result in weak FFO fixed charge cover of around 1.5x-1.6x.

Growth Prospects: The gradual liberalisation of gaming markets, governments' keenness on finding ways to raise tax proceeds and an increasing supply of new games should all provide increasing opportunities for Intralot. The company should be able to leverage on its track record and technical reputation and benefit from a limited number of reputable suppliers in the industry, allowing it to expand into new countries, although now limited to asset-light contracts. We believe that Intralot could also benefit from some opportunities in the US in the wave of recent legislative changes 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), International Game Technology and Scientific Games Corporation. Intralot is similar in size to Net Holding A.S. (B/Stable) and in business profile characteristics to Inspired Entertainment, Inc. (B/Stable). Leverage, however, is significantly higher than these peers', which is consistent with a 'CCC' category rating, and liquidity is also tighter.

Key Assumptions

Fitch's Key Assumptions within our Rating Case for the Issuer

- Revenue declining in 2019 following the disposal of Totolotek. For 2019-2022 the ramp-up of US operations would offset weaker economics of renewed contracts and smaller scope of operations

-EBITDA margin improving in 2019 as a consequence of the disposal of unprofitable Polish operations and ramp-up of US operations. Afterwards, this would be offset by lower margins under renewed contracts and continued weak economic conditions in Argentina and Turkey

- Dividends paid to minority interests in the range of EUR18 million-EUR21 million from 2020 onwards

- Capex gradually declining towards EUR40 million in 2021, before increasing in 2022 to renew its license in Malta

- No common dividends

- Disposal of Gamenet for EUR75 million by end-2019

Key Recovery Assumptions

In our bespoke going-concern recovery analysis we considered an estimated post-restructuring EBITDA available to creditors of around EUR65 million (vs.EUR58 million previously), to reflect the effective implementation of the Illinois contract, and the disposal of Gamenet that would provide some room to implement cost cutting and / or bid for new contracts. We applied a distressed enterprise value (EV)/ EBITDA multiple of 5x to Intralot's wholly-owned operations.

We also estimate approximately EUR10 million of additional value stemming from associates. This is a material contraction from EUR50 million previously, since we assumed Gamenet equity stake is sold.

After deducting 10% for administrative claims, our principal waterfall analysis generated a ranked recovery in the 'RR4' band, indicating a 'CCC' instrument rating. The waterfall analysis output percentage on current metrics and assumptions was 33%.

RATING SENSITIVITIES

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

- Steady improvement in operating liquidity, driven by neutral-to-positive FCF

- Sustained improvement in operating performance, for example through winning new contracts or improving performance of existing ones, combined with efficient cost -cutting measures, leading to growing EBITDA and FFO, and alleviating risks around near- to medium-term financing needs

- FFO lease adjusted gross leverage sustainably below 8.5x (2018: 8.3x)

- FFO fixed charge cover sustainably above 1.4x (2018: 1.8x)

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

- Lack of sufficient operational liquidity cushion

- Continued operating underperformance and/or loss of existing contracts leading to further shrinking of operations, in particular, EBITDA and continuing negative FCF, and lack of progress on refinancing by mid-2020

- FFO fixed charge cover below 1.0x

Liquidity and Debt Structure

Liquidity Improved: As of 30 June 2019, Intralot had around EUR47 million readily cash available. We view the EUR48.4 million cash located within partnerships, as well as the EUR30 million required for working capital purposes, as restricted. Additionally, we restrict the portion of the cash located within the Maltese subsidiary that does not belong to Intralot (27% of EUR9.9 million).

The company recently improved its liquidity through the disposal of its equity stake in Hellenic Lotteries (EUR20 million) and Gamenet (EUR75 million, to be completed by end-2019). However, we estimate that the upsize of the revolving credit facility available at Intralot Inc. (USA) to USD40 million from USD20 million does not materially enhance overall liquidity, since it is only available to this specific operating company.

Intralot's EUR250 million bond matures in September 2021, The second bond (with a face value of EUR500 million, of which EUR495 million remains due) matures in 2024. Refinancing of the 2021 bond may be challenging, if leverage remains high, even on a secured basis as the bond documentation currently prevents a secured refinancing for the full amount.

ESG Considerations

Unless otherwise disclosed in this sector, the highest level of 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 to the way in which they are managed by the entity.

For more information on our ESG Relevance Scores visit: www.fitchratings.com/esg.

Intralot S.A.; Long Term Issuer Default Rating; Downgrade; CCC
Intralot Capital Luxembourg SA
----senior unsecured; Long Term Rating; Downgrade; CCC; RW: Off

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Applicable Criteria
Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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