Fitch Downgrades Intralot to 'B', Outlook Negative.

Fitch Ratings - London - 16 October 2018: Fitch Ratings has downgraded Greek gaming group Intralot SA's Long Term Issuer Default Rating (IDR) to 'B' from 'B+'. The Outlook is Negative.
The downgrade reflects our expectation of weaker profits for 2018 and high capex resulting in a permanently higher leverage than in our previous rating case over the next four years. Operational performance is impacted by foreign exchange volatility and increased competitive pressure in some markets. The latter, together with possibly lower- or longer-than-planned return on capex could delay and limit the extent of deleveraging. This would increase refinancing risk and put pressure on the company's liquidity cushion over the next 12 to 18 months, which explains the Negative Outlook.

RATING ACTIONS

ENTITY	RATING	RECOVERY	PRIOR
Intralot Capital Luxembourg SA			
senior unsecured	LT B Downgrade	RR4	BB-
Intralot S.A.	LT IDR B Downgrade		B+

KEY RATING DRIVERS

Increased Leverage: Fitch now expects funds from operations (FFO) adjusted net leverage to rise to around 8x in 2018 and 2019, from 6.6x in 2017. This level of leverage is not commensurate with a 'B' rating, hence a low financial headroom. However, meaningful deleveraging from 2020 could materialise through improvements in underlying group operating performance, and application of proceeds from disposals to gross debt reduction, which could moderate refinancing risks and help revert the rating outlook to Stable.

Unfavourable FX Drives Down EBITDA: Less than 5% of the group's EBITDA is in euro, and a significant share of EBITDA is derived from contracts in Turkey or Latin America, while debt is mostly denominated in euro. Recent FX volatility, in particular, in Argentina and Turkey should impact the 2018 EBITDA by around EUR20 million as per management guidance. This represents 12% of 2017 EBITDA. Although the group hedges its foreign

dividend flows it is using mainly short-term forward contracts, which offers limited protection during period of prolonged FX volatility. This vulnerability is captured in the 'B' rating.

Free Cash Flow Impacted by Capex: We expect free cash flow (FCF) to be more negative in 2018 and 2019 than in previous years, mainly due to one-off capex related to the new Illinois contract and some contract renewal fees. FCF can be volatile as a result of upfront investments related to new contracts or contract renewals. However, such contracts contribute to steady operating cash flow generation due to their recurring profit stream. This is a key credit support. After 2018 the group does not have any major contract renewals until 2021 and therefore capex should remain lower, rebuilding some cash flow headroom.

Asset Sales Could Help Deleveraging: Our base-case projection does not factor in any proceeds from the expected sale of the group's 20% stake in Gamenet, which management would be looking to complete in the near future. These asset sale options provide additional flexibility for Intralot and, if implemented successfully, could result in significant net debt reduction, bringing net leverage back to levels consistent with a 'B' category rating. This could lead to the Outlook being revised to Stable. However, asset sales are one-off and subject to execution risk.

Contract Portfolio Remains Strong: Intralot has established itself in the international gaming sector as a reputable provider of systems to manage lotteries through software platforms and hardware terminals, and, in betting, a large algorithm-based sportsbook. This has enabled it to win important contracts for the supply of technology and the management of lotteries in the US and Greece and for sports betting in Turkey and Germany. The renewal rate of contacts continues to be high at 90%.

Growth Potential in Several Markets: 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 group 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. The group is gradually reinforcing its presence in developed countries, and retrenching from emerging markets. It recently won contracts in Germany and Croatia. Intralot is also well- positioned to benefit from opportunities in the US or Turkey arising from the wave of recent changes in legislations.

DERIVATION SUMMARY

Intralot's main differentiating factor from peers is the visibility of revenue and EBITDA from recurring long-term contracts. Intralot has smaller revenue and EBITDA than GVC Holdings plc ('BB+'(EXP)/Stable), William Hill, IGT and Scientific Games. However, it has good geographic diversification and benefits from the higher growth potential of emerging markets. Compared with Net Holding A.S. ('B'/Stable), Intralot is larger and has a stronger business profile with contracted EBITDA and specialist supplier technology expertise. The leverage of Intralot is, however, significantly higher than that of GVC and Net Holding.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer:
- Revenue to contract in the low single digits in 2018 due to FX volatility, before returning to moderate growth in 2019
- EBITDA margin declining by 230bp in 2018, before broadly stablising in 2019 and slowly increasing thereafter
- Dividends paid to minorities broadly in line with previous years' (EUR34 million in 2018)
- Capex higher in 2018 and 2019, mainly due to Illinois contract and other contract renewals
- No common dividends

In our bespoke going-concern recovery analysis we looked at Intralot's 2017 EBITDA of EUR172 million, deducted attributable EBITDA to minority interests, and this was further discounted to arrive at an estimated post-restructuring EBITDA available to creditors of around EUR74 million. In light of increased volatility in future performance expectations we have discounted the EBITDA by 30% vs. 20% in our previous calculation. We applied a distressed enterprise value /EBITDA multiple of 5x to Intralot's wholly-owned operations.

We also estimate EUR42 million of additional value stemming from minority interests.

In terms of distribution of value, all unsecured debt would recover 44% in the event of default (assuming Intralot's unsecured revolving credit facility will be fully drawn). This is consistent with an 'RR4' Recovery Rating and an instrument rating of 'B', i.e. the same rating as the IDR compared with one notch higher in our previous analysis, as a result of the higher EBITDA discount.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action (i.e. Outlook being revised to Stable)
-EBITDA growth derived from a stronger return on capital on existing and future contracts, and efficient management of FX risks, leading to FFO margin of around 5% on a sustained basis
- FFO-based adjusted net leverage trending towards 5.5 x (FFO lease adjusted gross leverage trending towards 6.0x), with cash deposited predominantly at investment grade-rated counterparties
- FFO fixed charge cover above 2.2x on a sustained basis (2017: 2.5x)
- Evidence of sustained neutral-to-positive FCF generation, reflecting sustainable capex investments

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Evidence that new contracts or renewals are occurring at materially less favourable conditions for Intralot, resulting in continuing weak FFO margin staying under 4%, large upfront concession fees or capex outlays , or EBITDA impacted by persisting unfavourable FX rates
- FFO adjusted net leverage sustainably above 6.5x (or FFO adjusted gross leverage above 7x)
- FFO fixed charge cover below 1.8x
- FCF remaining negative erodingliquidity, leading to increased reliance on external sources of financing or asset sales

LIQUIDITY AND DEBT STRUCTURE

At end-2017, Intralot had EUR208 million of cash on balance sheet, of which EUR80.7 million was with partners, which we view as unrestricted (as we deem EUR30 million not available for debt service due to working capital requirements). Of this cash about 5.5% is deposited in Greek banks, and 80% is in euro or US dollar. This is sufficient as 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) matures in 2024. At end June 2018 Intralot also had undrawn revolving credit facilities of EUR80 million.

In September 2017, Intralot issued a EUR500 million senior unsecured bond paying a fixed coupon of 5.25%. The proceeds allowed it to repay other shorter-dated and more expensive notes. This extended the maturity profile of Intralot, and reduced its cost of debt.

SUMMARY OF FINANCIAL STATEMENT ADJUSTMENTS

We deduct the estimated amount of recurring dividends paid to / dividends received from minorities of EUR36 million (2017) from our calculation of FFO.

Although operating leases are modest, Fitch has adjusted the debt by adding 8x of annual operating lease expense related to long term assets.

We use the nominal value rather than the reported value of debt. The adjustment is EUR12 million.

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (/site/re/10024585)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018) (/site/re/10026835)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10048568)
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