Research Update:

Gaming Company Intralot S.A. Downgraded To 'B-' On High Leverage And Tight Covenant Headroom; Outlook Negative

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Gaming Company Intralot S.A. Downgraded To

- Gross debt of about €750 million-€755 million at the end of 2018, followed by an increase of about €30 million in 2019 related to a planned drawing of an RCF to finance capex. We expect Intralot will fully repay this €30 million in 2020.

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

- On a proportionally consolidated basis, we expect an adjusted debt-to-EBITDA increase to about 8.5x-9.0x in 2018 and 2019. On a fully consolidated basis, we forecast adjusted leverage of 5.5x-6.0x in 2018 and 2019.
- On a proportionally consolidated basis, we expect EBITDA interest coverage of 1.5x in 2018 and 2019, climbing slightly to 1.7x by 2020. On a fully consolidated basis, we forecast 2x-2.5x EBITDA interest coverage for 2018 and 2019.
- We expect negative DCF in 2018 and 2019 due to weaker cash flow generation and high capex needs.

Liquidity

We have revised our assessment of the company's liquidity to less than adequate. This reflects our view that the ratio of liquidity sources to uses is about 1.2x in our base case for the next 12 months, and may decline below the minimum 1.2x threshold for our adequate liquidity assessment over this timeframe in case of further operating setbacks. It also reflects tight covenant headroom, which we currently estimate at less than 10% in 2019--below the 15% we require for adequate liquidity--which could pressure the company's ability to draw on its RCF if needed.

However, we do not view the company's liquidity as weak, because the company still maintains a large amount of cash and the majority of the short-term liquidity uses are related to capex, which is unlikely to result in liquidity stress. Furthermore, we note that although the company's notes are trading well below par, the capital structure is long-dated and the notes are not due before 2021 and 2024.

For the 12 months started July 1, 2018, we calculate the following principal liquidity sources:

- Cash and liquid investments immediately available at Intralot level of about €100 million;
- Our forecast funds from operations of about €50 million; and
- €85 million availability under the company's bilateral credit facilities.

For the same period, we calculate the following principal liquidity uses:

- Negligible nonseasonal working capital requirements for the next 12 months following €30 million outflows in the first half of 2018;
- Capex of approximately €120 million; and
- About €40 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, Intralot has a springing maintenance covenant on two bilateral credit facilities amounting to a total of €70 million. The €30 million bilateral facility has a covenant of 4.75x maximum net leverage, and the €40 million facility is currently under negotiations to increase the net leverage covenant to 4.75x from 3.75x. We assume the successful amendment of the second bilateral facility, and therefore a leverage covenant of 4.75x, which will be tested if the RCF is drawn. Under our base case, we expect covenant leverage of about 4.4x as of Dec. 31, 2018, remaining at this level in 2019. This is lower then 10% headroom, which could pressure the company's ability to draw high amounts on the RCF if needed.

Outlook

The negative outlook reflects our view that the volatile environment in some of Intralot's operating markets (mainly Turkey and Argentina) could put pressure on the company's operating performance in the next 12 months and consequently prevent any potential deleveraging. If Intralot maintained leverage at its current level for a prolonged period and DCF remained negative, we might reconsider our view of the capital structure's sustainability.

In addition, the tight covenant headroom of less than 10% in our 2018 and 2019 forecasts reduces the company's ability to absorb further unexpected operating setbacks, and could put pressure on the rating if the company needed to draw on the RCF but had limited ability to do so.

Downside scenario

We could lower the ratings if Intralot's DCF remained negative for a prolonged period and the company maintained leverage above 8.5x with no clear deleveraging trend. This could happen if Intralot raised further debt to finance capex needs or if EBITDA dropped lower than our base case. The latter could occur if the company's operating performance were weaker than expected, for example if Intralot disposed profitable operations or lost key licenses without replacing them with new profitable acquisitions, or if the market conditions further deteriorated.

Rating pressure could also arise if the headroom under Intralot's financial covenants further tightened, such that it posed a liquidity stress and rendered the company unable to fund capex needs and other expenses from the existing facilities.

Upside scenario

We could revise the outlook back to stable if operating performance stabilized such that we started seeing a gradual increase in EBITDA and decrease in leverage. We could also consider revising the outlook back to stable if the company substantially decreased debt by using proceeds from asset sales (such as Gamenet shares, for example) so that we no longer considered the capital structure at risk of becoming unsustainable.

We are unlikely to raise the rating over the next 12 months, given our expectations of sustained high leverage and no return to material positive DCF before 2020. However, we could foresee such a scenario if Intralot made a very swift recovery by posting 4%-6% revenue growth in 2019 as a result of securing new licenses or improving the performance of the existing ones. This could support the reduction in adjusted leverage to below 7x, as well as the generation of sustainably positive DCF. This would have to be combined with sufficient liquidity sources to cover capex and other expenses.

Ratings Score Snapshot

Issuer 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

Anchor: b-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than 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 ratings 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 expectations for meaningful recovery prospects (30%-50%; rounded estimate: 45%).
- The high amount of senior unsecured debt ranking pari passu and the relatively weak guarantor coverage constrain the recovery ratings.
- Our hypothetical default scenario assumes challenging economic conditions in Intralot's key markets leading to a significant decline in discretionary consumer spending, as well as unfavorable changes in regulation.
- 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: 2020
- Jurisdiction: Greece

Simplified waterfall

- EBITDA at emergence: €73.5 million (capex at 1.5% of three-year average sales; cyclicality adjustment is 10%, in line with sector assumptions; we used no operational adjustment)
- Multiple: 5.5x
- Gross enterprise value at default: €404 million
- Net enterprise value after administrative costs (5%): €384 million
- Estimated senior unsecured debt: €839 million
- Recovery range: 30%-50% (rounded estimate 45%)
- 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

Related Research

- Greek Gaming Company Intralot Outlook Revised To Negative On Increased Leverage; 'B' Ratings Affirmed, April 25, 2018

Ratings List

Downgraded

	To	From
Intralot S.A.		
Issuer Credit Rating	B-/Negative/--	B/Negative/--
Intralot Capital Luxembourg S.A.		
Senior Unsecured	B-	B
Recovery Rating	4(45%)	4(45%)

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