FITCH RATES INTRALOT'S EUR250M BOND 'BB-'

Fitch Ratings-London-21 October 2016: Fitch Ratings has assigned Intralot Capital Luxembourg S.A's recently issued EUR250m bond a senior unsecured rating of 'BB-'/'RR3'.

The bond is rated one notch above Intralot's Long-Term Issuer Default Rating of 'B+'/Negative. The new bond's terms and conditions are materially the same as the EUR325m unsecured bond which was repaid and cancelled in October 2016.

Despite Intralot's improving recent operating performance suggesting a stabilisation of margin erosion mainly through operational improvements and, to a lesser extent, from better trading, the Negative Outlook reflects Intralot's high leverage (on both a gross and net of cash basis) and the risk of a slower-than-expected deleveraging path. This is reflected by weak fixed charge cover and negative free cash flow (FCF) generation, following significant cash outflows in FY15, a situation that will likely start to reverse in FY16. In addition, the business model remains challenged by competition, pressure on margins and regulation.

For its IDR to stabilise at 'B+', we would expect management to deliver on planned asset rebalancing transactions during the year, with continuation of a deleveraging policy by way of gross debt reduction, coupled with sustained improvement in the operating performance. We expect to review the rating and Outlook at the end of 4Q16 when we assume the disposal of the Peru and Oceania businesses would be completed or well progressed.

KEY RATING DRIVERS
Recurring Contracted EBITDA
We acknowledge that more than 95% of EBITDA is recurring. While we recognise Intralot's operational improvement during 1H16, profit margins have been structurally falling in recent years as the group takes on lower margin licensed operations activities in response to available opportunities in the market. Balancing this, in 2015, 50% of EBITDA was derived from contracts with a duration of four to five years. The remainder is derived from licenses that do not expire. Due to the high switching costs from changing supplier, many of these should be renewed although Fitch believes they could be on lower margins and may require a renewal fee.

For the Outlook to stabilise we expect EBIT margins (calculated on a gross revenue basis) to improve, due to a better margin mix, following the Gamenet transaction and expected disposals, to 9.5% by FY18. If achieved, this will be above the minimum threshold of 7% consistent with a 'B+' IDR.

Weak Cash Flows

trending toward 2.0x by 2017 helped by planned asset rebalancing. If achieved on a forward-looking basis, these metrics along with enhanced profitability would remain compatible with the rating. However, any meaningful delays in achieving these targets, or if management allocated proceeds to a different purpose than permanent debt reduction, it will likely be negative for the ratings.

Management has taken more decisive action towards the weakening leverage profile, which Fitch views positively. This follows significant cash outflows in 2015 of around EUR150m primarily related to increased working capital linked to regulation in Italy, higher-than-usual minority dividends and other one-off items, such as suppliers' payment normalisation.

Reputable Gaming Operator and Technology Supplier
Intralot has established itself in the international gaming sector as a reputable provider of, among other products, 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.

Scope for Growth
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 also benefit from the limited number of reputable suppliers in the industry, allowing the group to expand into new geographies, such as Africa.

Limited Linkage with Greece
Intralot generates only 2% of its revenues and less than 5% of its EBITDA in Greece (CCC). We

- Completion of Gamenet, Peru and Oceania transactions by FYE16.
- Underlying group revenue increasing by around 1%-2% annually from FY17.
- EBITDA margins (calculated on a gross margin basis) improving towards 14.8% by FY18.
- Minority dividends fully paid out and increasing annually in line with profits, of around EUR44m in FY16 and EUR47m in FY17.
- Capex of around EUR80m in FY16, and remaining between 4% and 5% as a percentage of sales going forward.
- No common dividend payments or other shareholder distributions.
- Debt reduction of around EUR160m from corrective actions including albeit not limited to, asset rebalancing by FYE16.

RATING SENSITIVITIES
Future developments that may, individually or collectively, lead to negative rating action include:
- Evidence that new contracts or renewals are occurring at materially less favourable conditions for Intralot, resulting in continuing weak FFO and EBIT margins of under 7%, large upfront concession fees or capex outlays (FY15: 3.3% and 4.1% respectively).
- FFO adjusted net leverage sustainably above 4.5x (or FFO adjusted gross leverage above 5.5x) (FY15: 4.8x and 7.0x respectively).

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SUMMARY OF FINANCIAL STATEMENTS ADJUSTMENTS
- Regular minority dividends: We deduct the estimated amount of recurring dividends paid to / dividends received from minorities of EUR40.8m (FY15) from our calculation of FFO.
- Debt buy back of EUR47m is added back to reported debt in FY15, effectively deemed part of the group's contractual financial obligations. Going forward, a portion of the debt has been extinguished upon the refinance of the 2018 bond, while EUR11.3m related to the 2021 bond has been sold back to the market.
- Leases: Although operating leases are modest, Fitch has adjusted the debt by adding 8x of annual operating lease expense related to long term assets of EUR73.6m (FY15).

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.