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Research Update:

Austria-Based Gaming Group Novomatic AG 'BBB/A-2' Ratings Affirmed On Acquisition Of Casinos Austria; Outlook Stable

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Overview

- Austria-based gaming group Novomatic AG plans to acquire a majority stake in competitor Casinos Austria for an enterprise value of €500 million-€550 million, financed with debt.
- We expect that the anticipated rise in Novomatic's leverage ratios from this planned acquisition will be in line with our previous expectations.
- We are therefore affirming our 'BBB/A-2' corporate credit ratings on Novomatic and assigning our 'BBB' long-term issue rating to the company's proposed €300 million senior unsecured notes.
- The stable outlook reflects our view that Novomatic's revenues will continue to rise and its EBITDA margins will remain broadly stable, excluding the Casinos Austria acquisition effects. It also reflects our expectations that the company's leverage ratios will remain in our modest category.

Rating Action

On Jan. 25, 2016, Standard & Poor's Ratings Services affirmed its 'BBB/A-2' long- and short-term corporate credit ratings on Austria-based gaming group Novomatic AG. The outlook is stable.

At the same time, we affirmed our 'BBB' ratings on the company's existing debt instruments. We assigned our 'BBB' long-term issue rating to the company's proposed €300 million senior unsecured notes, maturing in 2023.

Rationale

Novomatic has announced it will purchase Casinos Austria for an equity value of €250 million-€300 million for about a 50% stake, plus net financial debt including pension provisions of the whole group of slightly above €250 million. Management expects the deal will close in summer 2016. Regulatory approvals are still outstanding.

In order to finance the transaction, and to repay €95 million of its currently drawn revolving credit facility (RCF), the company intends to issue €300 million of senior unsecured notes, due in 2023. If, contrary to our expectations, the acquisition of Casinos Austria is cancelled, the company intends to use the proceeds to finance other smaller acquisitions and/or to repay €150 million of maturing debt in 2017.

Casinos Austria operates 32 casinos in 12 countries, of which 12 are located in Austria. In addition, it holds a 68% stake in the Austrian lottery and operates in the area of online gambling and sports betting. We expect the full consolidation of Casinos Austria will increase Novomatic's revenues by more than €1.2 billion per year and improve its EBITDA by more than €100 million.

In light of this acquisition, we still consider Novomatic's business risk profile to be satisfactory. While we believe that the deal further strengthens Novomatic's leading market position in Austria and its strong position outside its home market, Casinos' lower EBITDA margin nevertheless somewhat offsets these benefits. According to our estimates, on a fully consolidated basis, the acquisition should reduce the Novomatic group's Standard & Poor's-adjusted EBITDA margin to around 25%, from 30% previously. These figures, however, exclude potential synergies, which are too early to quantify at this stage.

The acquisition will also raise Novomatic's leverage, as a result of which we now assess its financial risk as modest compared with minimal previously. The deterioration is, however, in line with our previous expectations.

On a weighted-average basis for 2013-2017, we estimate Novomatic's Standard & Poor's-adjusted funds from operations (FFO) to debt at 55%-60%. We estimate adjusted debt to EBITDA at around 1.5x over the same period and adjusted free operating cash flow (FOCF) to debt at 25%-30%.

Management says its strategy is to further expand the business both organically and through acquisitions. We therefore already factor a possible further rise in leverage into the upper end of our modest financial risk category.

In our base case, we assume:

- Real GDP in the eurozone growing by 1.5%-2.0% per year in 2016 and 2017, with real private consumption growing by around 1.5%, and CPI inflation of 1.0%-1.5% per year.
- Novomatic will increase its revenues by around 5% per year both in 2016 and 2017 because of strong anticipated expansion in the number of operated, rented, and sold gaming machines. The full consolidation of Casinos Austria from the second half of 2016 should boost reported revenue growth to around 35%-40% in 2016 and 25%-30% in 2017, respectively.
- Mainly driven by the acquisition of Casinos Austria, we expect the Standard & Poor's-adjusted EBITDA margin to decline to around 25% from 2017 from above 30% in 2015. This excludes potential upside from synergies of the deal, which at this point are too uncertain to take into consideration.
- Reported FOCF before acquisitions of around €300 million per year.
- Acquisitions of more than €700 million in 2016, due to Casinos Austria, including debt, and around €150 million from 2017 for several smaller

acquisitions.
- Dividends of €50 million annually.

Based on these assumptions, we arrive at the following credit measures for Novomatic. Note that our 2016 estimates only include six months of profit and cash flow contribution from Casinos Austria.
- Adjusted debt to EBITDA of 1.8x-1.9x in 2016 and 1.6x-1.7x in 2017.
- Adjusted FFO to debt of 40%-45% in 2016 and 45%-50% in 2017.
- Adjusted FOCF to debt of about 25% in 2015 and 25%-30% in 2017.

Liquidity

We view Novomatic's liquidity as strong under our criteria. We estimate that group's liquidity sources will likely meet liquidity needs by more than 2x over the next 12 months. This also holds true when we exclude the proceeds from the proposed notes as a source and the associated cash outflow for the acquisition as a use.

Although the existence of the group's significant on-balance-sheet cash, availability of credit lines, and its sound cash flow are supportive, our view is constrained by significant planned capital expenditures and the risk of cash outflows related to mergers or acquisitions. Under our base case, we estimate headroom under financial covenants at more than 60%.

Over the coming 12 months, we estimate principal sources of liquidity will reach around €1.7 billion, including:
- About €550 million in cash and equivalents and short-term financial assets;
- Undrawn credit facilities of around €350 million out of total lines of €440 million;
- FFO of above €500 million; and
- €300 million proceeds from the placement of senior unsecured notes.

Uses of liquidity should amount to below €0.8 billion, including:
- No significant changes in working capital or intra-year working capital swings;
- Capital expenditures of around €250 million;
- Acquisitions including Casinos Austria, of €450 million-€500 million (excluding acquired debt); and
- Dividends of €50 million.

Outlook

Our stable outlook reflects our view that Novomatic will likely increase its revenues by 4%-5% per year over the next two years, excluding the effects of the acquisition of Casinos Austria. We expect Novomatic will generate a Standard & Poor's-adjusted EBITDA margin around the middle of the 20%-30% range over the same period. This should translate into sufficient reported FOCF to fund smaller acquisitions and dividend payments on a recurring basis. Our outlook also incorporates management's intention to raise the group's leverage through acquisitions. If this occurs, we expect that the group's leverage ratios will not exceed the thresholds that are commensurate with our modest financial risk category.

Downside scenario

We could lower our ratings on Novomatic if management decides to pursue large debt-funded acquisitions, which would push our leverage ratios for the group into our intermediate category or higher. Specifically, this would be the case if our ratio of adjusted debt to EBITDA exceeded 2.0x, FFO to debt fell below 45%, or our adjusted FOCF-to-debt ratio declined to below 25%.

We could also lower our ratings if large debt-financed purchases, or any legislative changes, among other factors, resulted in a material reduction in the group's profitability, liquidity coverage, or covenant headroom. In particular, we would consider lowering the ratings if the group was unable to generate meaningfully positive FOCF that exceeded both the group's acquisition budget and planned dividend payments.

Upside scenario

We could raise our ratings on Novomatic by one notch if management pursues a financial policy that prevented a deterioration of the group's leverage ratios to below our minimal category. This would imply maximum adjusted debt to EBITDA of 1.5x and adjusted FOCF to debt remaining above 40%.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Satisfactory
- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Negative (-1 notch)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013

Ratings List

Ratings Affirmed	
Novomatic AG	
Corporate Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
New Rating	
Novomatic AG	
Senior Unsecured	BBB

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