S&P Global
Ratings

RatingsDirect®

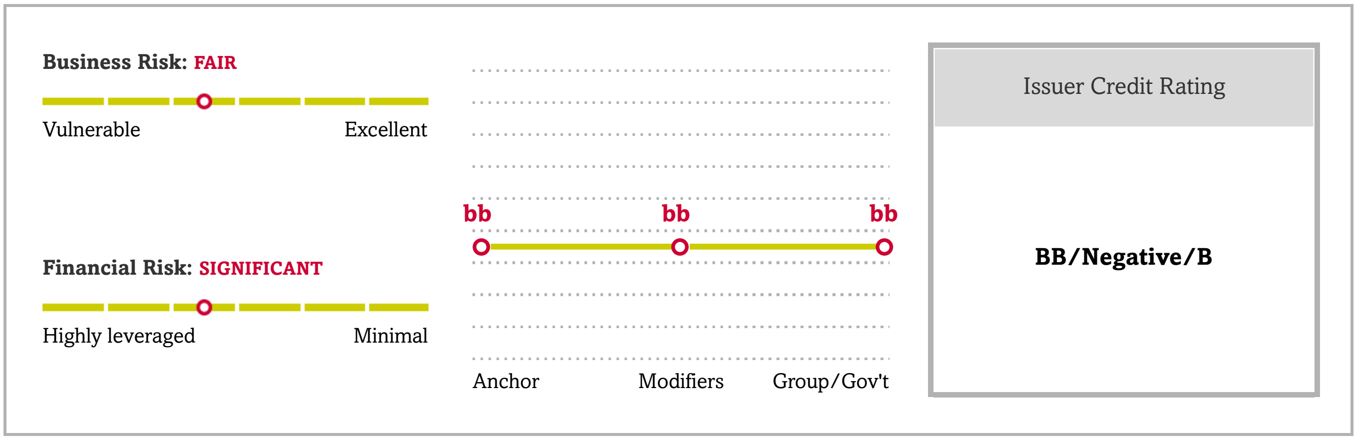
Analysis Update: Novomatic AG

Primary Credit Analyst:
Marion Casassus, Paris + 33 14 075 2516; marion.casassus@spglobal.com

Secondary Contact:
Patrick E Flynn, London + 44 20 7176 0053; patrick.flynn@spglobal.com

Table Of Contents

Analysis Update: Novomatic AG



Credit Highlights

Overview

Key strengths	Key risks
Leading European manufacturer of slot/amusement with Prizes (AWP) machines (business to business; B2B), with significant vertically integrated gaming operations (business to customer; B2C).	Lack of strong online presence or greater product diversity outside B2B and B2C gaming machines. About 5% of 2019 revenue came from the group's online division.
The group has significant revenue and EBITDA scale in the gaming machines segment, with 2019 revenue of €2.6 billion and EBITDA of €663 million.	Ongoing legal and bribery investigations, which the company has denied involvement in and against which it is defending itself.
Well-known brand and technological capabilities from continual investment, making the group a leading gaming machine competitor in Europe	Relatively weak free operating cash flow (FOCF) after leases in light of historically high capital expenditure (capex) to sales, which may limit the scope to undertake substantial strategic mergers and acquisitions (M&A) without the use of debt capital.
	S&P Global Ratings-adjusted leverage has increased every year since 2015 (until year-end 2020), with deleveraging expected in 2021 and our medium-term base case, likely to require significant recovery in operations and earnings to pre-COVID-19 levels.

Novomatic' s 2020 performance and credit metrics took a significant hit from COVID-19. Novomatic reported a revenue decline of 33% to €1.7 billion in 2020 from €2.6 billion in 2019. Despite efforts to reduce its cost base with significant savings achieved, adjusted EBITDA declined 55% to €297 million in 2020 versus €663 million in 2019, reflecting the relatively high fixed-cost base of the business. FOCF after lease payments were roughly neutral at €3.6 million compared with €115.3 million in 2019, limiting the impact on its balance sheet. S&P Global Ratings adjusted leverage reached 5.7x in 2020 from 2.9x in 2019.

Revenue must recover well from COVID-19 disruption to improve Novomatic's credit metrics in line with our base case forecast in 2021. We continue to forecast Novomatic's S&P Global Ratings-adjusted leverage will decline in 2021, but remain marginally above 4x, before further reducing comfortably below 4x in 2022 as operating performance recovers from COVID-19 disruption, which is in line with our prior base case forecast. That said, we see limited headroom for the rating to absorb further delays in recovery, with the 2021 forecast deleveraging likely to require a strong back-ended 2021 earning recovery. A reduction in leverage will require a significant and rapid rebound in EBITDA, and therefore this could come under pressure if we witnessed, for example, a sharper macroeconomic downturn than we currently forecast, or should cash-preserving measures prove insufficient to continue to protect the balance sheet, such that credit metrics would remain above our rating thresholds for a prolonged period.

Novomatic Historical Credit Metrics*

	--Year ending Dec. 31--					
	2015	**2016**	**2017**	**2018**	**2019**	**2020**
Adjusted debt	835.6	1,093.6	1,405.5	1,717.1	1,901.5	1,704.0
Adjusted EBITDA	605.2	601.6	610.4	610.9	663.1	297.4
Adjusted leverage(x)	1.4	1.8	2.3	2.8	2.9	5.7
FOCF (mil. €)	103.2	17.6	(24.3)	(68.3)	243.0	121.4

*All metrics as adjusted by S&P Global Ratings. FOCF--Free operating cash flow; FOCF is before dividend payments and lease payments.

Novomatic will need to demonstrate a track record of deleveraging to achieve our forecast, after multiple years of increasing debt and leverage.

In our view, a full recovery is also contingent on Novomatic' s ability to monitor structural challenges. The pandemic and related lockdowns significantly benefited online gaming operations. We think the degree of return to land-based gaming remains uncertain in the medium term in some product categories including slot machines, especially the longer restrictions persist in some countries. We believe, this could accelerate a structural customer shift to online. Novomatic through its B2B and B2C operations is principally exposed to land-based gaming machine markets, with only 5% of its revenue base coming from online. Some competitors, for example, Aristocrat Leisure, have diversified more aggressively into digital and online segments. If structural end markets and the Novomatic's land-based customer base suffer more enduring structural impacts or delayed capex or machine replacement, competitors' expansion into online could negatively affect Novomatic. S&P Global Ratings's base case is for relatively modest organic FOCF after leases in the next two years, which in our view could somewhat constrain any very substantial online organic or inorganic investment, without impacting credit metrics. We note that Novomatic has received a sports betting license in the regulated German market; however, it currently has modest market share behind the two largest incumbent competitors.

Liquidity remains adequate. On March 31, 2021, Novomatic had about €512 million available cash and liquid investments and about €610 million available under its revolving credit facility (RCF) for liquidity management. We believe the group has sufficient liquidity sources to cover expected outflows and scheduled redemptions totaling €364 million over the next 12 months, comprising the €200 million bond maturing in June, €100 million term loan maturing in March 2022, and €68 million OeKB loans amortization.

Covenant compliance might come under pressure again and add downside risk. Although it successfully negotiated a covenant reset earlier this year, increasing the net leverage test to 7x until Dec. 31, 2021, we note there remains a potential for a breach under the financial maintenance covenant of its RCF for the next reporting date on June 30, 2021, given very limited headroom and continued COVID-19-related restrictions in some key markets, such as Germany and Italy. However, our current base case remains that the group will either negotiate a waiver or obtain shareholder support in a timely manner, comfortably ahead of any potential breach, if it were not able to meet its next covenant test. This is based on the group's still robust business profile standing, adequate liquidity profile, manageable gross debt position, and perceived satisfactory relationships with financiers. We currently envisage full availability of the RCF over the next 12 months.

Legal proceedings pose reputational risks and could constrain Novomatic's ability to do business if current investigations lead to prosecution or other legal actions. Investigations by Austrian economic and corruption authorities against Novomatic, its former CEO, the majority shareholder, and some former and current employees are ongoing. The allegations include attempting to illegally influence gaming legislation and licensing in Austria. The investigations are connected to broader allegations surrounding a political scandal in Austria, which began in 2019, and are likely to continue for some time. Although we understand Novomatic and named parties deny any wrongdoing and are cooperating fully with authorities, and we believe the current impact of the investigations on Novomatic's business is minimal, the longer they continue, the investigations could nevertheless threaten the group's reputation, in our view. This would particularly be the case if they resulted in legal proceedings against the company or connected parties. Gaming operators rely on their good standing and reputation, and that of their key personnel, among regulators to maintain gaming licenses. This has always been the case with Novomatic, but things could become more challenging if the investigations and potential proceedings are protracted or damaging evidence comes to light in public forums.

Outlook

The negative outlook reflects the existing uncertainty and the risk that Novomatic could underperform our base case over the next 12 months, such that leverage remains above S&P Global Ratings-adjusted 4x for an extended period. Financial underperformance could occur if, for example, the extent and duration of lockdowns are worse and longer than anticipated, or any recovery is more muted than forecast. On this basis, we forecast S&P Global Ratings-adjusted debt to EBITDA could remain high, at 3.9x-4.4x, in 2021, but we think that would be temporary.

The outlook also reflects our view of the downside risk to Novomatic should the ongoing investigations by Austrian authorities progress to prosecution or other legal action, against the company or connected parties, and the impact this could have on the group's reputation and standing.

Downside scenario

We could lower the rating if:

- The impact of the pandemic and related recession were more severe than we assume, resulting in S&P Global Ratings-adjusted debt to EBITDA remaining above 4x, or FOCF after all lease payments remaining negative on a prolonged basis.
- If the trend in favor of online gaming grew stronger than we assume.
- The liquidity of the group weakened to a degree not offset by any remedial action, for instance by not obtaining a covenant waiver in case of a potential breach.
- The investigations progressed to prosecution or other legal action, or led to findings of unethical behavior. While it is not our base-case scenario, we could also consider lowering the rating if investigations were protracted and we saw impacts on Novomatic's reputation or standing in operating or financial markets.

Upside scenario

We could revise the outlook to stable if we gained more certainty regarding the COVID-19 pandemic and the related recession's effect on consumer spending in the European gaming market and on Novomatic's operating performance, liquidity, and cash flow. In particular, an outlook revision to stable would depend on the group's ability to manage costs, cash, and upcoming debt maturities, with its S&P Global Ratings-adjusted debt to EBITDA therefore falling below 4x after 2021. A stable outlook would also hinge on a favorable resolution of the ongoing investigations.

Company Description

Novomatic operates in two segments:

- Gaming Technology (B2B), which engages in the production, sale, and rental of gaming and entertainment machines and content, as well as the operation of online content for business customers; and
- Gaming Operations (B2C), which is involved in the operation of casinos and electronic gaming machines, as well as the online B2C business, and the provision of sports and horse racing betting services..

Novomatic is a mostly European business, with key markets in Germany, Austria, and Italy representing about 56% of its revenue.

The group is effectively controlled by Professor Johann F. Graf (founder of the group) through investment holding company Novo Invest GmbH.

Ratings Score Snapshot

Issuer Credit Rating

BB/Negative/B

Business risk: Fair

- **Country risk:** Intermediate
- **Industry risk:** Intermediate
- **Competitive position:** Fair

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bb

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Austrian Gaming Group Novomatic AG Downgraded To 'BB' On Extended Business Disruption Dec. 9, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	**bb**	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 16, 2021)*	
Novomatic AG	
Issuer Credit Rating	BB/Negative/B
Senior Unsecured	BB
Issuer Credit Ratings History	
09-Dec-2020	BB/Negative/B
12-May-2020	BB+/Negative/B
13-Jun-2019	BB+/Stable/B
29-Nov-2017	BBB-/Stable/A-3
21-Jun-2017	BBB/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable

Ratings Detail (As Of June 16, 2021)*(cont.)

across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Copyright © 2021 by Standard & Poor’s Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor’s Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an “as is” basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT’S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P’s opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR’S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor’s Financial Services LLC.