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## Research Update:

# Ratings On Aristocrat Leisure Ltd. Raised To 'BB+' On More-Conservative Financial Policies; Outlook Stable

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## Research Update:

# Ratings On Aristocrat Leisure Ltd. Raised To 'BB+' On More-Conservative Financial Policies; Outlook Stable

## Overview

- Aristocrat has stated its commitment to more-conservative financial policies.
- We are raising the ratings on Aristocrat and the company's related debt to 'BB+' from 'BB'.
- The outlook is stable, reflecting our view that Aristocrat is committed to sustaining adjusted debt to EBITDA less than 2.5x under normal operating conditions, with the ability to increase to 3.0x for strategic opportunities.

## Rating Action

On May 29, 2017, S&P Global Ratings raised its corporate credit rating on Australia-based gaming machine maker Aristocrat Leisure Ltd. to 'BB+' from 'BB'. The outlook is stable. We also raised our issue-level ratings on Aristocrat's related debt to 'BB+'. The recovery rating on the company's loan is '3', indicating our expectation for moderate (60%) recovery in the event of default.

## Rationale

We raised the rating on Aristocrat to reflect the company's stated commitment on May 25, 2017, to financial policies that it believes are in line with an investment-grade rating. In our opinion, this policy commitment should support credit metrics in line with the 'BB+' rating. To this end, we expect the group to target debt to EBITDA (after S&P Global Ratings' adjustments) of less than 2.5x under normal operating conditions and no greater than 3x for strategic opportunities.

We do not expect the company to maintain current leverage levels of about 1x over the next two to three years. It is more likely that Aristocrat will use its strong balance sheet to grow its core business, develop products for adjacent markets, undertake capital management, or seek merger and acquisition opportunities. That said, we do not expect its debt to EBITDA to exceed 3x under such circumstances.

Aristocrat's operating performance remains solid, driven by the company's North American business as it expands its Class III premium gaming operations as well as expansion in the group's digital segment. Furthermore, we expect

the group's successful integration of Video Gaming Technologies to support earnings stability through its recurring revenue stream. That said, we still believe Aristocrat remains somewhat exposed to the underlying cyclicity inherent in the gaming machine technologies industry.

## **Liquidity**

We continue to assess Aristocrat's liquidity as strong. The group's strong performance in its North American operations should help support its cash flow generation as a major source of liquidity over the next 12 to 24 months. The group also retains its revolving facility, which is currently undrawn. We expect the company to reinvest its cash flows in product innovation in its core business and develop products for adjacent markets.

As a result, we expect Aristocrat's liquidity sources over uses to be greater than 1.5x over the next 12 months and more than 1x over the following 12 months. We also expect sources to exceed uses even if EBITDA were to decline by 30%, which could transpire if market conditions become less favorable.

In addition, we expect the company to have sufficient headroom under its covenants. We believe the company has well-established, solid relationships with banks and a generally high standing in credit markets, where it was able to secure a term loan with a recent repricing.

Principal liquidity sources:

- Cash on hand of about A\$395 million as of March 31, 2017
- Forecast FFO of about A\$725 million
- Undrawn credit facility of A\$100 million

Principal liquidity uses:

- Capital expenditures of about A\$200 million-A\$220 million over the next 12 months
- Dividends of about A\$240 million-A\$270 million over the next 12 months
- No upcoming debt maturities

## **Outlook**

The stable outlook reflects our view that Aristocrat is committed to sustaining debt to EBITDA less than 2.5x under normal operating conditions, with the ability to increase to 3.0x for strategic opportunities.

The stable outlook also reflects our expectation that Aristocrat's strengthened market position in gaming-machine sales and gaming operations will reduce the company's historically high volatility of profitability.

## **Downside scenario**

We could lower the rating if the company's debt to EBITDA is greater than 3.0x as a result of corporate activity or capital management decisions, or greater than 2.5x under normal operating conditions. A decision to increase leverage beyond this level would undermine our assessment of the company's future financial policy commitments.

We could also lower the rating if a material deterioration were to occur in the economic environment in the U.S. or Australia, or if Aristocrat's market position across its portfolio severely weakens.

### **Upside scenario**

While upward rating action is unlikely over the one to three years, we could raise the rating if Aristocrat's cash flow generation and financial policies enable it to sustain debt to EBITDA of less than 1.5x. These financial ratios take into consideration the volatility of Aristocrat's profitability.

## **Ratings Score Snapshot**

Corporate Credit Rating: BB+/Stable/--

Business risk: Fair

- Country risk: Very low
- Industry risk: Intermediate
- Competitive Position: Fair

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 rating analysis: Neutral (no impact)

## **Recovery Analysis**

### **Key analytical factors**

The 'BB+' issue rating and recovery rating of '3' on Aristocrat's senior secured A\$100 million revolving credit facility and US\$1.3 billion, Term Loan B (TLB) are based on our valuation of Aristocrat as a going concern and the facilities' weak security and guarantee package.

Our hypothetical default scenario assumes a decline in Aristocrat's revenues and margins, stemming from a deterioration of general economic conditions in the U.S. and Australia; unfavorable regulatory changes; and increasing competition from larger players in the industry causing Aristocrat to be unable to refinance its debt at maturity.

We value the group as a going concern, reflecting our view of the group's diversified position in attractive gaming markets including U.S., Australia, Macau, and Singapore; its technological knowledge and expertise in gaming equipment manufacturing; and its contractual relationships with customers.

### Simulated default and valuation assumptions

- Simulated year of default: 2022
- EBITDA at emergence: A\$137 million
- EBITDA multiple: 6.5x
- Jurisdiction: Australia

### Simplified waterfall

- Net enterprise value (after 5% admin. costs): A\$1,079 million
- Secured first-lien debt claims: A\$1,317.2 million
- Recovery expectations: 64.3% (60%)

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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: Ratios And Adjustments, Nov. 19, 2013
- 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: 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Aristocrat Leisure Ltd. Corporate Credit Rating	BB+/Stable/--	BB/Positive/--
Aristocrat Leisure Ltd. Senior Secured AUD100 mil revolving credit facility bank ln due 10/20/2019 Recovery Rating	BB+ 3 (60%)	BB 3 (55%)
US\$1 bil syndicated bank ln due 10/21/2021 Recovery Rating	BB+ 3 (60%)	BB 3 (55%)

Aristocrat International Pty Ltd.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB+	BB
Recovery Rating	3(60%)	3(55%)
US\$1 bil syndicated bank ln due 10/21/2021	BB+	BB
Recovery Rating	3(60%)	3(55%)

Aristocrat Technologies Australia Pty Ltd.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB+	BB
Recovery Rating	3(60%)	3(55%)
US\$1 bil syndicated bank ln due 10/21/2021	BB+	BB
Recovery Rating	3(60%)	3(55%)

Aristocrat Technologies Inc.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB+	BB
Recovery Rating	3(60%)	3(55%)
US\$1 bil syndicated bank ln due 10/21/2021	BB+	BB
Recovery Rating	3(60%)	3(55%)

Tonkor Enterprises Inc.

Senior Secured

Local Currency	BB+	BB
Recovery Rating	3(60%)	3(55%)

Video Game Technologies Inc.

Senior Secured

Local Currency	BB+	BB
Recovery Rating	3(60%)	3(55%)

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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