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Research Update:

Aristocrat Leisure Ltd. Outlook Revised To Positive On Improved Operating Performance; 'BB' Rating Affirmed

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Research Update:

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Overview

- Aristocrat has improved its operating performance across its gaming portfolio, including the successful integration of U.S.-based gaming-machine supplier Video Gaming Technologies, Inc. (VGT), resulting in materially stronger credit metrics.
- In addition, we believe Aristocrat's increased exposure to recurring revenue is likely to promote a more stable earnings profile through the economic cycle.
- As a result, we have revised the rating outlook on Aristocrat Leisure Ltd. to positive from stable.
- We also affirmed the 'BB' corporate credit rating and issue-level ratings on Aristocrat and its related debt.

Rating Action

On July 28, 2016, S&P Global Ratings revised its outlook on Australia-based gaming machine maker Aristocrat Leisure Ltd. to positive from stable. At the same time, we affirmed our 'BB' corporate credit rating and issue-level ratings on Aristocrat and its related debt. Our recovery rating on the company's loan is '3H', indicating our expectation for moderate (60% to 70%) recovery in the event of default.

Rationale

The positive outlook reflects our view of Aristocrat's improved operating performance as a result of the company's strengthening market position, higher-margin product mix, and successful integration of Video Gaming Technologies, Inc. (VGT) in October 2014.

Our base-case forecasts indicate that Aristocrat's strong cash flow generation should allow it to sustain adjusted debt-to-EBITDA at less than 2.5x and funds from operations (FFO) to debt above 30% over the near term. However, we do not view Aristocrat's current financial policies as necessarily supporting these credit metrics over the medium to long term. Accordingly, we expect the company to have greater financial flexibility at the current 'BB' rating level to pursue inorganic growth or capital management activity.

Further supporting our positive outlook is the company's less volatile earnings mix, particularly from its North American gaming operations, where it

typically receives a fixed daily fee or turnover-based commission. In our opinion, measures taken to reduce the company's reliance on product sales are likely to support a more robust earnings profile through the economic cycle.

The positive outlook also reflects the company's recent operating performance, including its increased market share in North America following the successful integration of VGT and its leading market position in Asia-Pacific. In addition, Aristocrat has a growing presence in the online social gaming space, where the number of average daily users has increased to approximately 1.22 million from around 715,000 per day. While the company posted a strong first-half result, it expects earnings to somewhat moderate in the second half of the year ending Sept. 30, 2016.

We note that consolidation in the sector over the past couple of years has created a more competitive environment for Aristocrat and may cause greater pricing pressures given its relatively smaller size compared with rated peers, Scientific Games Corp. and International Game Technology Plc (IGT), the two largest players in North America. There is also the potential that market share could come under pressure in the Australian market with Austria-based gaming group Novomatic AG taking a 53% stake in local player Ainsworth Game Technology Ltd. (not rated). Nevertheless, we believe that Aristocrat's leading brands and content, commitment to design and development, and strong customer relationships will support the company's market position.

Liquidity

We consider Aristocrat's liquidity to be strong. We expect that sources of liquidity in the next 12 months will exceed uses by at least 1.5x and 1x over the next two years. We expect that liquidity sources will continue to exceed uses if EBITDA were to decline by 30%. The company has no debt maturities over the next two years.

Principal Liquidity Sources:

- Cash on hand of about A\$340 million;
- Our forecast funds from operations (FFO) of about A\$500 million; and
- Availability of funds under the group's A\$100 million revolving credit facility (RCF).

Principal Liquidity Uses:

- Capital expenditure of about A\$150 million;
- Our forecast dividends of about A\$170 million; and
- Debt amortization of about A\$15 million per year.

Outlook

The positive outlook reflects a one-in-three chance that Aristocrat's strong cash flow generation and increased profitability would enable the group to sustain a financial risk profile in line with our expectations for a higher rating.

Upside scenario

We could raise the rating if Aristocrat's cash flow generation and financial policies enable it to sustain FFO to debt of more than 30% and debt to EBITDA of less than 2.5x. These financial ratios take into consideration the volatility of Aristocrat's profitability. Upward ratings pressure could also occur through a strengthening of Aristocrat's business risk profile, particularly through an increase in scale, scope and diversity, or if we believe that the company's earnings profile is likely to be more resilient through the economic cycle.

Downside scenario

We could affirm the rating with a stable outlook if Aristocrat's cash flow generation or financial policies are unlikely to sustain FFO to debt of more than 30% and debt to EBITDA of less than 2.5x over the medium to long term. This could also occur if there is a material deterioration in the economic environment in the U.S. or Australia; or if Aristocrat undertakes further large debt-funded acquisitions.

Ratings Score Snapshot

Corporate Credit Rating: BB/Positive/--

Business risk: Fair

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

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

The issue rating on the senior secured debt is 'BB' and recovery rating '3H', reflecting our expectation of moderate recovery prospects (60% to 70%) in the event of default. The company's senior secured A\$100 million RCF and US\$1.3 billion syndicated loan rank pari passu.

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; ineffective new product development; and increasing competition from larger players in the industry. Our hypothetical default scenario also incorporates six-months' interest and assumes that the RCF is 85% drawn.

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 its customers.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - Recovery: Revised Revolver Usage Assumptions For Recovery Analysis In Corporate Ratings - November 20, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Leisure And Sports Industry - March 05, 2014
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Corporates - Recovery: Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt - August 10, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Aristocrat Leisure Ltd. Corporate Credit Rating	BB/Positive/--	BB/Stable/--

Ratings Affirmed

Aristocrat Leisure Ltd.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB
Recovery Rating	3H
US\$1.3 bil fltg rate syndicated bank ln due 10/20/2019	BB
Recovery Rating	3H

Aristocrat International Pty Ltd.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB
Recovery Rating	3H
US\$1.3 bil fltg rate syndicated bank ln due 10/20/2019	BB
Recovery Rating	3H

Aristocrat Technologies Australia Pty Ltd.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB
Recovery Rating	3H
US\$1.3 bil fltg rate syndicated bank ln due 10/20/2019	BB
Recovery Rating	3H

Aristocrat Technologies Inc.

Senior Secured

AUD100 mil revolving credit facility bank ln due 10/20/2019	BB
Recovery Rating	3H
US\$1.3 bil fltg rate syndicated bank ln due 10/20/2019	BB
Recovery Rating	3H

Tonkor Enterprises Inc.

Senior Secured

Local Currency	BB	
Recovery Rating	3H	3L

Video Game Technologies Inc.

Senior Secured

Local Currency	BB	
Recovery Rating	3H	3L

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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.globalcreditportal.com and at 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. Use the Ratings search box located in the left column.

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