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Ratings

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Research Update:

Australia-Based Aristocrat Leisure Ltd. Placed On CreditWatch Negative On Casino Closures Amid COVID-19 Outbreak

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Rating Action Overview

- Temporary closures of casinos amid the COVID-19 outbreak have significantly cut Aristocrat Leisure Ltd.'s land-based revenue.
- We expect Aristocrat's EBITDA generation to severely reduce, causing leverage in the year ending Sept. 30, 2020, to be outside of our base-case assumptions. We believe prolonged casino closures will likely compromise the group's ability to maintain an adjusted debt-to-EBITDA ratio below 3.0x.
- We are placing the 'BB+' issuer credit rating on Aristocrat, as well as the related issue ratings on the company's secured A$286 million revolving credit facility and US$1.85 billion term loan B issue rating, on CreditWatch with negative implications.
- The CreditWatch placement reflects the company's direct exposure to casino disruptions and the substantial risk Aristocrat's adjusted debt to EBITDA could materially exceed 3.0x over the next year. Based on our current expectations regarding the likely timing and impact of the casino closures, we do not expect a downgrade, if any, to exceed one notch.

Rating Action Rationale

We placed the Aristocrat ratings on CreditWatch with negative implications due to substantially lower forecast earnings amid COVID-related casino restrictions. We expect significant loss of revenue and cash flow generation through Aristocrat's land-based segments compared with our prior base-case assumptions, stemming from country-specific measures in response to the COVID-19 pandemic. We also believe the negative impacts to operators' capital budgets and consumer sentiment following the COVID-19 outbreak will likely constrain the recovery path once restrictions on casinos have been relaxed.

Prior to the outbreak, Aristocrat had relatively modest leverage, including debt to EBITDA of about 1.7x for the year ended Sept. 30, 2019. The company's low leverage and solid liquidity position provided it with a good buffer entering the COVID-19 outbreak. However, the rapid deterioration in end-market conditions has since eroded this buffer.

Aristocrat's portfolio diversification and increased contribution from its digital segment will only partially offset the decline in land-based earnings. The composition of Aristocrat's earnings profile has shifted toward digital gaming, which accounted for about 28% of group EBITDA as of Sept. 30, 2019. We believe this earnings diversification has helped to reduce Aristocrat's historical earnings volatility in its land-based segment. Despite this, we believe the land-based revenue decline due to enforced casino closures will offset this diversification benefit. Further, we expect casino operators to meaningfully reduce capital spending budgets, severely dragging down revenue in Aristocrat's outright sales of class III gaming machines across its business geographies.

As the situation evolves, the group's liquidity and covenant compliance will be key. The cash balance of about A$720 million helps to underpin the current liquidity position. We also believe Aristocrat's operational cost savings and a scaling back of gaming operations capital expenditure should help to minimize cash outflow. In our view, the temporary suspension of the group's progressive dividend policy until the COVID-19 disruptions are resolved is supportive of the current liquidity position. That said, we will continue to monitor the group's liquidity, including its compliance with financial covenant obligations.

In our opinion, improvement in credit metrics in fiscal 2021 is largely contingent upon a swift and sustained relaxation of public activity guidelines. Despite meaningful reductions to Aristocrat's cost base, we expect significant EBITDA declines for the duration of the COVID-19 shutdown period and a muted recovery. We also believe that the speed at which the land-based earnings profile can recover is somewhat predicated on casino operators' capital budgets returning to pre-COVID-19 levels, which we believe are likely to be constrained for some time after the virus is contained. As a result, we believe there is increased risk that revenue and EBITDA may not grow sufficiently in fiscal 2021 to support leverage improvement, keeping leverage elevated for an extended period.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Environmental, Social, and Governance (ESG) Credit Factors for this rating and outlook change:

- Social: Safety Management Factors

CreditWatch

The CreditWatch negative placement reflects our view that temporary casino closures amid the COVID-19 outbreak, and the resultant decline in land-based earnings, may cause Aristocrat's adjusted debt-to-EBITDA ratio to exceed 3.0x over the next one to two years.

We will continue to monitor Aristocrat's evolving operating environment over the next 90 days to ascertain the extent to which casino closures and social distancing measures have damaged Aristocrat's balance sheet and future earnings profile. The company's future capital management decisions, including dividends, are likely to be key rating considerations. We will also monitor the company's compliance with its financial covenant obligations.

We could lower the rating if we forecast adjusted debt-to-EBITDA to be sustained materially above 2.5x beyond fiscal 2020. Based on our current expectations regarding the likely timing and impact of the casino closures, we do not expect a downgrade, if any, to exceed one notch.

We could resolve the CreditWatch and affirm the 'BB+' issuer credit rating if we believe that Aristocrat's debt-to-EBITDA ratio is likely to recover below 2.5x in fiscal 2021. This upside scenario would likely be dependent on an improving economic outlook from the containment of the COVID-19 outbreak and ongoing active management of the group's cost base.

Our Base-Case Scenario

- Negative real GDP growth in Australia of 4.0% in 2020 with a return to growth of 5.7% in 2021; Negative real GDP growth in the U.S. of 5.2% in 2020 with a return to growth of 6.2% in 2021;
- Weakening end-market conditions in Aristocrat's key operating locations and a decline in consumer discretionary spending;
- Significant decline in revenue in the Americas, Australia, and New Zealand, as well as International segments through fiscals 2020 and 2021. Double-digit growth in Digital segment revenues, in line with historical periods;
- Annual capital expenditure of around A$225 million-A$250 million in fiscals 2020 and 2021; and
- No additional large, debt-funded acquisitions.

Liquidity

We consider Aristocrat to have adequate liquidity. We expect the company's sources of liquidity, including cash, to exceed its uses by more than 1.2x over the next 12 months, and we expect net sources to remain positive even if EBITDA declines by 15%.

We believe the group has well-established, solid relationships with banks, as well as a generally high standing in credit markets, as indicated by its ability to fund its acquisitions as well as the repricing of its debt.

Aristocrat's meaningful cash balance (about A$720 million) underpins the group's liquidity position. We note the group's quantitative covenants include a prescribed debt-to-EBITDA ratio for the bank facility and a cross-default clause for the term loans. We will exclude from our sources of liquidity revolver borrowing availability if we believe the facility is at risk of becoming inaccessible due to covenant constraints.

As of March 31, 2020, we expect Aristocrat to have the following sources and uses of liquidity over the next 12 months:

Principal liquidity sources:

- Cash and cash equivalents of about A$720 million;
- Minimal undrawn revolving credit facilities; and
- Minimal cash funds from operations (FFO).

Principal liquidity uses:

- No debt maturities over the next 12 months;
- No mandatory term loan amortization due to prepayments paid to date; and
- Annual capital expenditure of about A$250 million.

Our liquidity calculation includes the group's fully drawn A$150 million revolving credit facility (RCF), which has been upsized to A$286 million.

Covenant Analysis

The group's quantitative financial covenants include a prescribed debt-to-EBITDA ratio for its revolving credit facility and a cross-default clause for the term loans. In our view, Aristocrat continues to remain compliant with its covenants, and we will continue to monitor the company's requirements under its negative pledge deeds for each of the funding facilities.

Issue Ratings - Recovery Analysis

Key analytical factors

The 'BB+' issue rating and recovery rating of '3' on Aristocrat's senior secured A$150 million RCF and US$1.85 billion term loan B 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 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, Asia Pacific, and EMEA (Europe, Middle East, and Africa); its technological knowledge and expertise in electronic gaming equipment manufacturing; casino management systems, digital social games, and web and mobile gaming services; and its contractual relationships with customers.

Simulated default assumptions

- Simulated year of default: 2025
- EBITDA at emergence: A$353.0 million

- EBITDA multiple: 6.5x
- Jurisdiction: Australia

Simplified waterfall

- Net enterprise value (after 5% administrative costs): A$2,179.6 million
- Secured first-lien debt claims: A$2,991.0 million
- Recovery expectations: 68.5% (65%)

Ratings Score Snapshot

Issuer Credit Rating: BB+/Watch Neg/--

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)

Stand-alone credit profile: bb+

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

CreditWatch/Outlook Action

	To	From
Aristocrat Leisure Ltd.		
Issuer Credit Rating	BB+/Watch Neg/--	BB+/Stable/--
Aristocrat Leisure Ltd.		
Senior Secured		
Local Currency	BB+ /Watch Neg	BB+
Recovery Rating	3(60%)	
Aristocrat International Pty Ltd.		
Senior Secured		
Local Currency	BB+ /Watch Neg	BB+
Recovery Rating	3(60%)	
Aristocrat Technologies Australia Pty Ltd.		
Senior Secured		
Local Currency	BB+ /Watch Neg	BB+
Recovery Rating	3(60%)	
Aristocrat Technologies Inc.		
Senior Secured		
Local Currency	BB+ /Watch Neg	BB+
Recovery Rating	3(60%)	
Video Game Technologies Inc.		
Senior Secured		
Local Currency	BB+ /Watch Neg	BB+
Recovery Rating	3(60%)	

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