FitchRatings

RATING ACTION COMMENTARY

Fitch Assigns First-Time 'BBB-' IDR to Aristocrat Leisure Ltd; Outlook Stable

Wed 17 Nov, 2021 - 11:31 AM ET

Fitch Ratings - New York - 17 Nov 2021: Fitch Ratings has assigned long-term Issuer Default Ratings (IDR) of 'BBB-' to Aristocrat Leisure Ltd. (parent and guarantor), Aristocrat International Pty Limited (borrower) and co-borrowers Aristocrat Technologies Australia Pty Limited, Aristocrat Technologies, Inc., and Video Gaming Technologies, Inc. (collectively, ALL). Fitch assigned a 'BBB-' rating to ALL's senior secured revolver and senior secured term loans. The Rating Outlook is Stable.

The rating reflects ALL's strong business profile as a global gaming supplier, conservative financial policy and visible de-levering path pro forma for the announced Playtech Plc (herein: Playtech) acquisition. Fitch forecasts ALL's gross leverage to peak at 3.0x pro forma for the acquisition and subsequently decline to 2.5x by fiscal year-end 2023 (Sept. 30). The Playtech acquisition provides ALL with an immediate foothold in the online real money gaming (RMG) industry with established, profitable B2B and B2C businesses, which Fitch views positively.

KEY RATING DRIVERS

Playtech Acquisition: ALL is in the process of buying Playtech for roughly AUD5 billion with a funding mix of cash, debt, and equity. The acquisition gives ALL immediate exposure in online RMG, including in North America, a rapidly growing segment that ALL has yet to meaningfully participate in. Playtech's profitable B2B and B2C operations (primarily in

Italy) already generate EBITDA margins in excess of 20%. This is in contrast to online RMG operators in the U.S., where customer acquisition costs are currently fueling material cash flow burn. In addition, the acquisition further diversifies ALL's pro forma cash flows. Prior to the deal announcement, ALL's credit profile had some headroom for M&A and Fitch views the funding mix favorably given the equity and excess cash components.

Strong Credit Metrics: ALL has an established track record of operating with a conservative balance sheet and adhering to stated financial policies (targets net leverage below 2.5x). ALL quickly de-levered through EBITDA growth and debt paydown following prior debt-funded acquisitions, including VGT (2014) and Plarium/Big Fish (2017/2018). Fitch estimates pro forma gross leverage for Playtech to be 3.0x and to decline back to 2.5x by FY2023, which includes modest debt paydown assumed by Fitch. The company consistently exhibits credit metrics consistent with investment grade gaming issuers and superior to ALL's major, U.S.-based, gaming supplier peers. The company's leverage, strong FCF generation and strong liquidity position provide financial flexibility to absorb material design and development investment and/or a downturn, as seen in 2020.

Manageable Pandemic Impact: ALL's outright slot sales and gaming operations segments were negatively impacted during the pandemic, due to its reliance on casino visitation and operator purchases. Despite the temporary casino shutdowns, the company was able to weather the impact well due to a fast recovery in U.S. regional gaming and thanks to Aristocrat's large existing slot footprint. Additionally, ALL benefited from having a large, established digital gaming segment (40% of pre-pandemic business), which had an exceptionally strong year similar to other digital casino/casual gaming segments. Combined revenues only declined mid-single digits for FY2021, much stronger than other suppliers and casino operators, primarily due to ALL's Digital outperformance.

Leading Market Share: Aristocrat is the top slot supplier in Australia and is an established top-three supplier in North America. Its momentum in class III slot machines has been driven by the North American gaming operations segment, which benefits from recurring revenue and high margins, albeit with some capital intensity as the machines remain on ALL's balance sheet. ALL holds about a 20% share in total slot sales in the U.S., and a higher share of premium install units. ALL's North American class III gaming operations footprint was nearly 25,000 machines as of March 31, 2021, nearly double from five years ago.

Growing Digital Footprint: ALL's digital business has grown meaningfully through both M&A and heavy investments in new content. ALL's previous acquisitions of Plarium and Big Fish increased ALL's digital business from 16% of total revenue in 2017 to 40% at year-end 2019. Fitch believes there are limited synergies into Aristocrat's landbased segment, but its

Digital products provides healthy diversification to its core slot business (as evidenced during the pandemic).

Aristocrat's digital business tends to be hit driven and competitive, especially within social gaming. The business also requires considerable R&D investment and customer acquisition costs. These factors may cause operating cashflows to be more volatile and thus Fitch favors the traditional slot business, but recognizes the benefits digital provides in terms of product diversification and scale. In 2020, Digital grew over 30% due to more consumers remaining at home using digital products, which helped to offset the significant declines seen in the legacy slot business. Despite more entertainment options for consumers, Digital continued to experience YoY growth throughout 2021.

DERIVATION SUMMARY

ALL's 'BBB-' IDR reflects its conservative credit profile based on generally low leverage, strong FCF generation, and solid market position as a global gaming supplier. The company generally operates with gross leverage well inside 2.5x, despite having a "below 2.5x" net leverage target. Fitch views this as appropriate for low investment grade gaming suppliers that are subject to persistent slot machine competition, cyclical gaming-driven cash flows, and the hit-driven nature of mobile casual gaming. ALL's leading market position in the slot segment, greater diversification and lower leverage position it stronger than peer Everi Holdings (BB-/Stable).

ALL's leverage is also lower than gaming operator peers Las Vegas Sands (BBB-/Negative) and Seminole Tribe of Florida (BBB/Stable), which Fitch has greater leverage tolerance for given strong monopolistic-like position in their respective markets. Flutter Entertainment (BBB-/Stable) has strong existing RMG position in the UK, Australia, and the U.S. but primarily as a B2C operator. Similar to ALL, Flutter maintains a conservative leverage profile and generates strong FCF.

Fitch applied the strong subsidiary/weak parent approach under its Exposure Draft: Parent and Subsidiary Linkage Rating Criteria. Fitch views the linkage as strong across ALL's entities given the openness of access and control by the parent and relative ease of cash movement throughout the structure. The rated entities are viewed on a consolidated basis, and the ratings are linked.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

--ALL's legacy gaming revenues fully recover to pre-pandemic levels by 2022 and grow in the mid-to-high single digit range thereafter, aided primarily by its robust gaming operations business in North America. Digital revenue growth slows in 2022 as other consumer entertainment options enjoy more normalized operating environments, but long-term growth remains solid in the mid-to-high single digit range;

--Playtech fully recovers to pre-pandemic levels in 2022 as pandemic-related operating restrictions no longer weigh on the B2C segment. Thereafter, B2B grows in the high-single digit range and benefits from ALL's content integration. Fitch assumes B2C also continues to grow but at more modest levels;

--Total EBITDA margins decline as the lower-margin Playtech is acquired, but settle around 30%;

--The Playtech acquisition closes in mid-FY2022 and is funded with AUD1.3 billion in entitlement offering, AUD2.77 billion in USD-equivalent term loan B, and cash on hand;

--Recurring capex is roughly 8% of revenues, which includes spending related to ALL's premium gaming operations. Fitch assumes roughly AUD200 million in Italy concession payments between 2023-2024 (related to Playtech's B2C business);

--Annual dividends are 35% of NPATA (net profit after tax before amortization of acquired intangibles);

--Fitch assumes AUD100 million of tuck-in acquisitions annually;

--ALL pays down AUD200 million of term loan (includes amortization) annually, which is in-line with voluntary debt paydown following the Big Fish acquisition in 2018.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Gross debt/EBITDA sustaining below 1.5x, combined with a public commitment to remain at or below that level;

-ALL continues market share momentum in North America and/or expands footprint in new segments successfully.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Gross leverage sustaining above 2.5x;

-A change in financial policy with raised leverage targets and/or an aggressive growth strategy pursuing debt funded acquisitions without a reasonable de-levering path.

Fitch will reassess ALL's leverage sensitivities should the company transition toward a fully unsecured capital structure, which would increase ALL's financial flexibility. Conversely, Fitch could also reassess ALL's sensitivities if an increasing revenue mix from ALL's digital non-casino gaming takes share from the slot segment.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

ALL's liquidity remains strong pro forma for the Playtech transaction, which includes full availability on its AUD286 million revolver and over AUD1 billion in excess cash. FCF margin is also forecasted to remain robust, ranging from mid- to high-single digits percentage of revenue. Fitch expects a small amount of debt paydown relative to ALL's excess cash balances, with additional allocation toward dividends and tuck-in M&A. The term loans do not mature until 2024.

Fitch rates the secured debt on par with the IDR given the collateral is mostly intangible assets, specifically goodwill.

ISSUER PROFILE

Aristocrat Leisure Ltd. is a global gaming supplier that operates in the slot machine, digital gaming, and gaming technology space.

DATE OF RELEVANT COMMITTEE

16 November 2021

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING		
Video Gaming Technologies, Inc.	LT IDR	BBB- Rating Outlook Stable	New Rating
senior secured	LT	BBB-	New Rating
Aristocrat Leisure Ltd.	LT IDR	BBB- Rating Outlook Stable	New Rating
Aristocrat Technologies, Inc.	LT IDR	BBB- Rating Outlook Stable	New Rating
senior secured	LT	BBB-	New Rating
Aristocrat International Pty Ltd	LT IDR	BBB- Rating Outlook Stable	New Rating
senior secured	LT	BBB-	New Rating

Aristocrat Technologies Australia Pty Limited	LT IDR	BBB- Rating Outlook Stable	New Rating
senior secured	LT	BBB-	New Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Exposure Draft: Parent and Subsidiary Linkage Rating Criteria (pub. 15 Oct 2021)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Aristocrat International Pty Ltd	-
Aristocrat Leisure Ltd.	-
Aristocrat Technologies Australia Pty Limited	-
Aristocrat Technologies, Inc.	-
Video Gaming Technologies, Inc.	-

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Corporate Finance   Gaming, Lodging, and Leisure   Asia-Pacific   North America

United States   Australia