FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Rating Outlook of Aristocrat to Positive; Affirms Ratings at 'BBB-'

Thu 11 Jan, 2024 - 12:05 PM ET

Fitch Ratings - Toronto - 11 Jan 2024: Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Aristocrat Leisure Limited (parent and guarantor), and co-borrowers Aristocrat Technologies Australia Pty Limited and Aristocrat Technologies, Inc. (collectively, Aristocrat or ALL) at 'BBB-'. Fitch has also affirmed ALL's senior secured debt ratings at 'BBB-'. The Rating Outlook has been revised to Positive from Stable.

The affirmation reflects ALL's strong business profile as a global gaming supplier and low gross leverage. The company is expected to continue to manage its balance sheet conservatively, while concurrently investing in its existing portfolio, returning capital to shareholders through dividends and opportunistic buybacks, and pursuing potential acquisitions.

The revision of the Outlook demonstrates Aristocrat's accelerated and concerted push into the online real money gaming (RMG) space, while maintaining its leading position in social casino, casual, and role-playing games (RPG) gaming genres.

KEY RATING DRIVERS

Strong Credit Metrics: ALL has an established track record of operating with a conservative balance sheet. 2023 EBITDA leverage declined marginally to 1.1x and is on track to be sub 1.0x over Fitch's rating horizon. Aristocrat has a financial policy on a net cash basis in the 1.0x-2.0x range over the medium term and reported net leverage of -0.4x in 2023, relatively consistent from the prior year, due to continued strong cash generation.

Fitch expects the all-cash AUD1.8 billion NeoGames acquisition to close in the first half of calendar year 2024, steady capex investment to support growth, a favorable dividend policy, and share buybacks under the existing AUD1.5 billion program that expires in May

2024 and has about 49% remaining would bring the leverage to about half a turn, still short of the target in the near term. Consequently, Fitch believes another acquisition could be possible once ALL has integrated NeoGames and Roxor as there is capacity at the current rating to be able to fund strategic M&A and/or weather a downturn in the near term.

Fitch does not expect any voluntary debt paydown due to strong interest income generation under the current interest rate environment. However, there is a possibility to move to an unsecured capital structure, should Aristocrat's credit rating remain investment-grade as required by the existing credit documents, and the rates are supportive.

Leading Market Share: Aristocrat is an established top-three supplier in North America. Its strong position in class III slot machines has been driven by the North American gaming operations segment, which benefits from recurring revenue underpinned by long-term multi-year contracts and high margins, albeit with some capital intensity as the machines remain on ALL's balance sheet. Aristocrat is also the top slot supplier in its home market, Australia, though the country accounts for less than 10% of its sales and the effects of the proposed anti-gaming reform in the country is uncertain.

ALL holds a mid-20% share in total slot sales in the U.S. and was positively affected by increased penetration of premium cabinets and growth in strategic adjacencies (such as video lottery terminals and historical horse racing) over the past year, while balancing a double-digit rise in average sales prices. Aristocrat has a higher share of premium install units, which have increased as operator capital spending directed to expansionary and replacement shipments has returned to more normalized levels, rising by around 5,300 units from the prior year to 36,925 at Sept. 30, 2023. Fitch expects suppliers' growth in North America to temper in 2024, given lack of material new capacity, but market shares could shift based on the acceptance of new products such as ALL's NFL-themed slots and its push into the coin-operated amusement machines space.

Evolving Online RMG Strategy: Fitch anticipates ALL to continue pursuing strategic M&A over the medium term, particularly in the real-money gaming (RMG) sector, given its strong financial flexibility and solid portfolio of slot content, all the while adhering to funding in a manner that is consistent with 'BBB-' leverage metrics. ALL's acquisition of Roxor (B2B online supplier) in 1H23 and the upcoming closing of NeoGames (RMG, iLottery, iGaming and online sports betting provider) in 2024 will accelerate growth in this space and assist with its build and buy strategy.

Sizable Digital Footprint: ALL's Pixel United business has grown meaningfully through both M&A and heavy investments in new content. Its previous acquisitions of Plarium (role-playing, strategy, and action) and Big Fish (social casino gaming) studios increased its digital business from 16% of total revenue in 2017 to 42% at YE 2023. Fitch believes there are limited synergies into Aristocrat's land-based segment, but its digital products provide healthy diversification and scale to its core slot business (as evidenced during the pandemic). The business also requires considerable R&D investment and customer acquisition costs, which may cause operating cashflows to be volatile, but Fitch recognizes that the traditional slot business can also be cyclical.

Aristocrat's digital business tends to be hit-driven and faces competition from Playtika and Light & Wonder, among dozens of others, especially within social gaming, which tends to drive just over half of the segment sales. Daily active users (DAU) have steadily declined from a peak of 8.1 million in 2018 to 4.6 million in 2023, and while ALL has grown its average revenue from DAU by 53 cents to 93 cents over that period, U.S. dollar sales moderated sequentially by low single digits in each of the last two years due to a pullback in certain geographies, resulting in a total market decline, an ongoing focus on DAU quality, and a maturing of the portfolio. Fitch expects the digital segment to continue driving portfolio diversity across the three studios and release more games, while efficiently managing its user acquisition spend.

Parent Subsidiary Linkage: A parent-subsidiary relationship exists between Aristocrat Leisure Limited and its rated subsidiaries under Fitch's Parent and Subsidiary Linkage Rating Criteria. Fitch determines Aristocrat Leisure's standalone credit profile (SCP) based on consolidated metrics and believes the subsidiaries have a stronger SCP than the parent. As such, Fitch has followed the stronger subsidiary path. Legal ring fencing is considered open given the existence of cross-guarantees between the entities. The access and control factor is also evaluated as open given Aristocrat Leisure's 100% ownership of the two subsidiaries. Due to the aforementioned rating linkages, Fitch equalizes the IDRs of the three entities.

DERIVATION SUMMARY

ALL's 'BBB-' IDR reflects its conservative credit profile based on low leverage, strong FCF generation, and solid market position as a global gaming supplier. The company has a net leverage target of 1.0x-2.0x. 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 to be stronger than other slot peers. International Game Technology (IGT; BB+/Stable) has a similar credit profile to ALL's despite slightly higher leverage, thanks to meaningful lottery exposure, which can withstand higher leverage as the lottery business tends to be resilient and less prone to recessionary headwinds and economic shocks, threats seen elsewhere in the gaming industry, resulting in favorable characteristics relative to other forms of gaming such as less cash flow volatility, stable low-to-mid single-digit growth rates, and higher profit margins.

Light & Wonder (LNW; BB/Stable) is another global slot supplier with similar market share as ALL's and has a conservative leverage profile, with a target net leverage in the 2.5x-3.5x range, and solid expected FCF margin for a gaming supplier and mobile developer. Everi Holdings (EVRI; BB-/Stable), which is not only a slots supplier but also a cash services provider to the casino industry, is rated three-notches below ALL. While it has low leverage metrics and sufficient liquidity, Everi's market share is only in the high-single digits and it faces intense competition, potential regulatory changes, adaptation risks of new gaming technologies, and integration risks of newly-acquired companies.

On the other hand, Flutter Entertainment (FLTR; BBB-/Stable), a large Ireland-based bookmaker and online gaming company with major global presence, is rated on par with ALL, reflecting the former's best-in-class scale and market position among online sports betting and online gaming services.

KEY ASSUMPTIONS

--Total revenues organically increase approximately 2.5% in 2024, followed by mid-single digit growth thereafter;

--Segmentally, 2024 and 2025 Gaming sales taper to a 3%-4% growth rate, given Fitch's expectation of lack of material new capacity and a slowdown in traditional regional gaming growth, with unit sales, unit installations, average selling price (ASPs) and average gaming operations fees pulling back across all geographies, before expanding to mid-single digits over the forecast horizon;

--Pixel United sales contract marginally in 2024 due to a slight decline in DAU, offset partially by continued strength in average bookings per DAU. Sales expand thereafter in mid-high single digits;

--Design & Development (D&D) spend remains in-line with historical at roughly 13% of revenues;

--EBITDA margin remains stable in the mid-30s over Fitch's forecast period;

--Capex continues to remain in the 5% range;

--While a possibility for further M&A exists, Fitch has not incorporated any acquisitions in its projections;

--The approximately AUD1.8 billion all-cash NeoGames acquisition closes by June 2024, in line with management's expectations; however, the incremental contribution has not been factored into Fitch's assumptions;

--Total gross debt balance remains tied to the revolver and term loans, with modest required annual amortizations of 5% until a successful refinancing in 2027. Fitch assumes no debt paydown;

--Capital allocation is balanced between shareholder returns, via both dividends and share repurchases, and tuck-in M&A in the digital space.

RATING SENSITIVITIES

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

--A conservative financial policy and a transition to a fully unencumbered capital structure;

--ALL maintains slot segment market share momentum and continues growth and profitability in the digital segment (as evidenced by an increasing proportion of the consolidated EBITDA), while consistently driving FCF margin in mid-high teens;

--EBITDA leverage sustaining below 2.5x.

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

--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;

--EBITDA leverage sustaining above 3.0x.

LIQUIDITY AND DEBT STRUCTURE

Solid Liquidity Supported by FCF: ALL's current liquidity is strong between near-full availability on its USD500 million revolver and AUD3.2 billion in cash at Sept. 30, 2023. While FCF net of the NeoGames acquisition will be negative in 2024, Fitch forecasts FCF to remain positive over the rating horizon, with FCF margin expected to remain robust in the low-teens. Fitch does not anticipate any voluntary debt paydown, rather allocations only toward modest amortizations, dividends, share repurchases and tuck-in M&A. The term loans do not mature until 2027 and 2029. 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.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Aristocrat Leisure Ltd.	LT IDR Affirmed	BBB- Rating Outlook Positive	BBB- Rating Outlook Stable

Aristocrat Technologies, Inc.	LT IDR	BBB- Rating Outlook Positive Affirmed	BBB- Rating Outlook Stable
senior secured	LT	BBB- Affirmed	BBB-
Aristocrat Technologies Australia Pty Limited	LT IDR	BBB- Rating Outlook Positive Affirmed	BBB- Rating Outlook Stable
senior secured	LT	BBB- Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Aristocrat Leisure Ltd.	EU Endorsed, UK Endorsed
Aristocrat Technologies Australia Pty Limited	EU Endorsed, UK Endorsed
Aristocrat Technologies, Inc.	EU Endorsed, UK Endorsed

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