

Research Update:

# Aristocrat Leisure Upgraded To 'BBB-' On More Conservative Financial Policy And Capital Discipline; Outlook Stable

May 17, 2023

## Rating Action Overview

- Australia-based gaming provider Aristocrat Leisure Ltd. (Aristocrat) has revised its financial policies to incorporate a more conservative target net leverage range of 1.0x to 2.0x.
- Aristocrat has demonstrated a disciplined approach to capital management in pursuit of long-term growth and competitive positioning. We believe the company will maintain credit metrics appropriate for an investment-grade rating, which reflects its appetite for growth acquisitions and modest shareholder returns.
- On May 18, 2023, S&P Global Ratings raised its long-term issuer credit rating on Aristocrat to 'BBB-' from 'BB+'. Consistent with the higher issuer credit rating, we also raised the related issue ratings on the company's secured US\$500 million revolving credit facility, US\$1.3 billion term loan A, and secured US\$250 million term loan B.
- The stable outlook reflects our expectation that Aristocrat will maintain leverage commensurate with an investment-grade rating. The outlook also reflects Aristocrat's diverse earnings profile and its measured approach to using capital to expand.

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## Rating Action Rationale

### We raised the rating on Aristocrat to reflect the company's stated commitment to maintain more conservative financial policies.

In our opinion, this commitment should support credit metrics in line with the 'BBB-' rating. To this end, we expect the group to target debt to EBITDA (after S&P Global Ratings' adjustments) of less than 2.0x under a range of variable trading conditions, including the possibility of corporate activity and capital management.

**Aristocrat has demonstrated a disciplined approach to capital management in pursuit of long-term growth and competitive positioning.**

We do not expect the company to maintain current leverage levels of about 1.0x over the next two to three years. In our view, Aristocrat will use its strong balance sheet to grow its core business and allocate capital toward acquisitions. That said, we expect its financial policies to accommodate any further acquisitions or shareholder returns.

**We believe Aristocrat's strong free cash flow and low capital intensity will allow it to maintain adjusted leverage consistent with the rating expectations.**

Aristocrat has a track record of adhering to its conservative financial stance and operating with modest levels of leverage. The group's strong cash flow generation has supported the timely deleveraging of sizeable debt-funded acquisitions. The group's operations generate strong cash flow, which in turn ensures balance sheet flexibility.

**The proposed NeoGames acquisition improves Aristocrat's scale and earnings diversification.**

Aristocrat's proposed acquisition of Israel-based online gaming solutions provider, NeoGames S.A. (NeoGames), accelerates the company's expansion into the real money gaming (RMG) segment. The combination of Aristocrat's content, existing customer base, long-established relationships with regulators, with NeoGames technology and RMG platform, provides the company with global scale. While we expect initial EBITDA contributions to be modest, the acquisition would position Aristocrat to benefit from the growing US\$81 billion RMG segment.

**The acquisition aligns with our expectation that Aristocrat will use its strong balance sheet to grow its core business and develop products and capabilities for adjacent markets.**

Aristocrat will fund the proposed A\$1.8 billion transaction with existing cash on balance sheet. It expects to complete the acquisition in fiscal 2024. We acknowledge the transaction remains subject to hurdles, including the approval of no less than 66.7% of NeoGames shareholders. Additionally, certain gaming regulatory, antitrust, and foreign investment approvals must be met.

In our view, there are inherent risks with the acquisition. These include delays or conditions attached to regulatory approvals. The integration, realization of operational synergies, and the retention of key personnel and key customers will call on management's experience and skill.

**As cost-of-living pressures bite, Aristocrat's land-based, and online gaming segments remain exposed to a slowdown in consumer discretionary spending.**

Pressure on consumer spending from persistent inflation, elevated interest rates, recession risks, and increasing unemployment could dampen discretionary spending on gaming. Aristocrat is not immune to these risks. Despite uncertain market conditions, we expect Aristocrat will generate solid EBITDA growth in 2023 of about 10%. Our base case assumes Aristocrat will continue to benefit from recovery in outright machine sales and gaming operations (land-based segment), as

the capital budgets of casino operators return to pre-pandemic levels. However, we expect digital revenue growth to remain subdued, as the surge in demand during the pandemic unwinds. The possibility that digital revenues do not return to growth is a key downside risk to our base case.

## **Balance sheet and liquidity strength enable Aristocrat to execute its operating strategy.**

Aristocrat's minimal near-term debt maturities, sizable cash balance, and undrawn revolving credit facility of about A\$3.4 billion as of March 31, 2023, support the group's liquidity position. Additionally, this provides ample flexibility to fund the proposed A\$1.8 billion acquisition of NeoGames. We also expect the company to complete its A\$1.5 billion on-market share buyback program over the next 12 months. As of February 2023, A\$478 million of it had been completed. Given the company is funding the program with free cash flow, the buyback program should not materially affect the company's credit metrics or limit its growth aspirations.

## **Outlook**

The stable outlook reflects our view that Aristocrat is committed to sustaining adjusted debt to EBITDA less than 2.0x under a range of variable trading conditions, including the possibility of acquisitions and shareholder returns. We expect the company to remain disciplined in its approach to deploying capital to strengthen its market position in gaming-machine sales and operations, digital games, and complementary growth channels.

## **Upside scenario**

An upgrade would most likely occur from a material and sustainable improvement in the group's business risk profile. This may occur if the company materially increased its scale or diversified its business into uncorrelated business lines, while maintaining stability of its credit metrics and profitability.

## **Downside scenario**

We could lower the rating on Aristocrat if strategic investment decisions result in debt-to-EBITDA remaining above 2.0x without a credible and timely deleveraging path. We could also lower the rating if capital management initiatives or weak operating performance increases debt-to-EBITDA above 2x for an extended period.

Downward rating pressure could also emerge if significant regulatory or structural change, or a substantial escalation in competition, meaningfully weakened the group's market positions.

## **Our Base-Case Scenario**

- Real GDP growth in Australia of 1.6% in 2023, 1.7% in 2024, and 2.5% in 2025;
- U.S. real GDP growth of 0.7% in 2023, 1.2% in 2024, and 1.8% in 2025;
- Land-based operations revenue growth of about 10% in fiscal 2023. We expect this growth to derive support from continued recovery across Aristocrat's key operating markets, driven in large part by casino operators' capital budgets returning to pre-pandemic levels;

- Digital segment revenue growth to remain relatively flat in fiscal 2023 as the surge in demand for digital gaming during the pandemic continues to normalize;
- EBITDA margins to remain stable between 33%-34%, yet still below pre-pandemic levels;
- Annual capital expenditure of about A\$300 million in the fiscal years 2023 and 2024 (year ending June 30);
- Dividend distributions of about A\$275 million-A\$325 million;
- On-market share buybacks of about A\$1.0 billion over the next 12 months); and
- Were the NeoGames transaction to proceed as proposed, we expect Aristocrat to be able to use its existing available cash of about A\$3.0 billion at Sept. 30, 2022, to fund the A\$1.8 billion acquisition.

## **Liquidity**

We consider Aristocrat to have strong liquidity. We estimate the company's sources of liquidity, including cash, would exceed uses by 1.5x over the next 12 months, and net sources to remain positive even if EBITDA declines by 30%.

We believe the group has well-established, solid relationships with banks, as well as a generally high standing in credit markets. Indicative of this is the company's ability to refinance its existing revolving credit facility and term loan B in mid-2022, improving its liquidity profile and allowing it to fund acquisitions.

Post-NeoGames acquisition we expect Aristocrat will maintain strong liquidity. Supporting this is the group's ability to cash fund the transaction and remainder of its on-market buyback program. Additionally, Aristocrat's undrawn revolving facilities, and minimal near-term debt maturities, give the company ample buffer to meet liquidity requirements over the next 12 months.

As of March 31, 2023, our base case estimates Aristocrat to have the following sources and uses of liquidity:

### Principal Liquidity Sources

- Cash and cash equivalents of approximately A\$2.7 billion-A\$2.8 billion;
- Undrawn revolving credit facilities of about US\$500 million; and
- Cash funds from operations (FFO) of about A\$1,500 million-A\$1,600 million.

### Principal Liquidity Uses

- No debt maturities;
- Capital expenditure of about A\$300 million;
- Dividends of A\$450 million-A\$550 million;
- On-market share buybacks of about A\$1.0 billion over the next 12 months; and
- Annual amortization of 5% on the US\$1.3 billion term loan A and 1% on the US\$250 million term loan B.

## Debt Maturities

Aristocrat has no near-term debt maturities. The company's US\$1.30 billion term loan A and US\$250 million term loan B are long-dated and mature in 2027 and 2029 respectively.

## Covenant Analysis

Aristocrat continues to comfortably comply with its quantitative financial covenants.

## Ratings Score Snapshot

Issuer Credit Rating: BBB-/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: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

## Environmental, Social, And Governance

### ESG credit indicators: E-2, S-3, G-2

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments , April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings , March 28, 2018
- 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 , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

## Ratings List

### Ratings Affirmed

#### Aristocrat Technologies Australia Pty Ltd.

Senior Secured	BBB-
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#### Aristocrat Technologies Inc.

Senior Secured	BBB-
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### Upgraded

	To	From
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#### Aristocrat Leisure Ltd.

Senior Secured	BBB-	BB+
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#### Aristocrat Technologies Australia Pty Ltd.

Senior Secured	BBB-	BB+
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#### Aristocrat Technologies Inc.

Senior Secured	BBB-	BB+
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### Upgraded; CreditWatch/Outlook Action

	To	From
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#### Aristocrat Leisure Ltd.

Issuer Credit Rating	BBB-/Stable/--	BB+/Positive/--
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### Not Rated Action

	To	From
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#### Aristocrat Leisure Ltd.

Senior Secured		
Local Currency	BBB-	BB+
Recovery Rating	NR	3(65%)

**Aristocrat Technologies Australia Pty Ltd.**

Senior Secured		
US\$1.35 bil fltg rate Syndicated term loan A bank ln due 05/24/2027	BBB-	BB+
Recovery Rating	NR	3(65%)
US\$500 mil fltg rate Syndicated term loan B bank ln due 05/24/2029	BBB-	BB+
Recovery Rating	NR	3(65%)

**Aristocrat Technologies Inc.**

Senior Secured		
US\$1.35 bil fltg rate Syndicated term loan A bank ln due 05/24/2027	BBB-	BB+
Recovery Rating	NR	3(65%)
US\$500 mil fltg rate Syndicated term loan B bank ln due 05/24/2029	BBB-	BB+
Recovery Rating	NR	3(65%)

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