S&P Global Ratings

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Summary:
Novomatic AG

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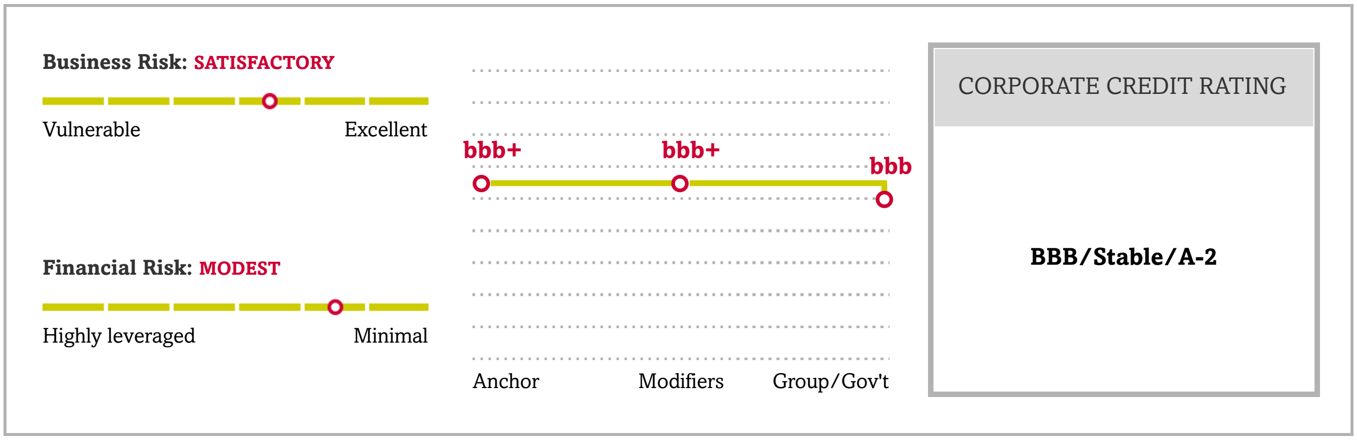

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Leading European gaming technology company, with complementary gaming machine operations. • Profitability well above that of gaming peers, supported by technology business with relatively high barriers to entry. • Significant proportion of contracted revenues lend stability to earnings and cash flow. • Good geographic diversification across Europe provides some protection against regulatory risk. • High regulatory risks in key markets, including reduction in gaming machines and arcades in Germany in 2017.	• Competition authorities have blocked the debt-funded acquisition of Casinos Austria, which moderately improves forecast ratios relative to our previous base case. • Forecast adjusted funds from operations (FFO) to debt of more than 50% remains consistent with a modest financial risk profile. • Strong liquidity, supported by sizable balance sheet cash and undrawn committed facilities. • Weaker free operating cash flows (FOCF) than we previously forecast in the near term, due to rise in capital expenditure (capex). • Strategy of growth through acquisitions continues to support our one-notch reduction due to financial policy.

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Outlook: Stable

Our stable outlook reflects our view that Novomatic will likely increase its revenues by 4%-5% per year over the next two years, assuming no transformational acquisitions. We expect Novomatic will generate an S&P Global Ratings-adjusted EBITDA margin around the middle of the 20%-30% range over the same period. This should translate into sufficient reported FOCF to fund smaller acquisitions and dividend payments on a recurring basis. Our outlook also incorporates management's intention to raise the group's leverage through acquisitions. If this occurs, we expect that the group's leverage ratios will not exceed the thresholds that are commensurate with our modest financial risk category.

Downside scenario

We could lower our ratings on Novomatic if management decides to pursue large debt-funded acquisitions or shareholder returns, which would push our leverage ratios for the group into our intermediate category or higher. Specifically, this would be the case if our ratio of adjusted debt to EBITDA exceeded 2x, FFO to debt fell below 45%, or our adjusted FOCF-to-debt ratio stayed materially below 25% for an extended period. We could also lower our ratings if large debt-financed purchases, or any legislative changes, among other factors, resulted in a material reduction in the group's profitability, liquidity coverage, or covenant headroom. In particular, we would consider lowering the ratings if the group was unable to generate meaningfully positive FOCF that exceeded both the group's acquisition budget and planned dividend payments.

Upside scenario

While less likely, we would consider raising the rating on Novomatic by one notch if management committed to a financial policy that would ensure maintenance of ratios consistent with our minimal category. This would imply maximum adjusted debt to EBITDA of sustainably less than 1.5x, FFO to debt of more than 45%, and adjusted FOCF to debt of more than 40%.

Our Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- Revenue growth of about 7% in 2016 and about 4% in 2017, significantly outstripping GDP growth, due to rising number of machines operated and several smaller acquisitions.
- Lower revenue and EBITDA than we previously forecast since the Casinos Austria acquisition is no longer taking place, but also lower debt, resulting in better ratios than we previously forecast.
- We include the recent €500 million debt issue that was meant to part-fund Casinos Austria, and will now be used to fund future smaller acquisitions and repay existing debt of about €150 million.
- Acquisitions of more than €450 million in 2016 and 2017 and around €150 million thereafter will result in decreasing margins over the forecast period to around 24% in 2017, due to increasing personnel and operating costs.
- Reported free operating cash flow (FOCF) before acquisitions of around €150 million-€250 million per year.

Key Metrics

	2015a	2016f	2017f
EBITDA margin (%)	29.0	28-29	26-27
FFO to debt (%)	55.1	55-60	45-50
Debt to EBITDA (x)	1.4	1.2-1.4	1.5-1.7
FOCF to debt (%)	12.3	15-20	20-23

*Fully S&P Global Ratings-adjusted. a--Actual. e--Estimate. FFO--Funds from operations. FOCF--Free operating cash flow.

Business Risk: Satisfactory

Novomatic is a leading gaming technology company, with clear No. 1 positions in Austria and Germany and top three positions in the U.K., Spain, and Italy. We see this segment of gaming as having relatively supportive credit characteristics, due to higher barriers to entry compared with the operation gaming machines, resulting in significantly higher profit margins for Novomatic compared to gaming peers. The second main segment, the operation of machines and arcades, complements the technology segment since Novomatic can quickly adapt products relative to market trends and direct customer feedback. In addition, gaming technology contributes a substantial proportion of predictable revenues, with about 30%-35% of the group's revenues from machine rentals being almost fully predictable for the current and subsequent year. Finally, Novomatic's good diversification across Europe provides a degree of insulation against adverse regulation in any specific market.

That said, we see regulatory risk for gaming machine operators in Novomatic's two largest markets, Austria and Germany, as high. For example, in 2014 Novomatic was forced to decommission all gaming terminals in Vienna, and legislative changes in Germany effective from 2017 will likely lead to a material reduction in the number of rented gaming machines in the country. These known changes have been factored into our base case forecast, but there remains an element of unpredictability due to regulatory risk in most gaming machine markets. Partly mitigating this risk is Novomatic's presence in gaming technology, which tends to be only indirectly affected by regulation in the gaming machine segment.

Financial Risk: Modest

Novomatic has a relatively low debt burden, particularly now that the Casinos Austria acquisition will not go ahead, with adjusted FFO-to-debt expected to remain about 50% or higher, and adjusted debt-to-EBITDA expected to be less than 2x in the medium term. Novomatic has strong underlying free cash flow generation, with moderate dividend payments and generally moderate capex needs. The company has been in a peak capex phase in 2015 and 2016, however, which has resulted in a lower adjusted FOCF-to-debt ratio than we expect to see for a minimal financial risk profile, but we assume that this ratio will recover from 2017 toward 20%-25%.

Liquidity: Strong

We estimate that the Novomatic group's liquidity sources will likely meet liquidity needs by more than 2x over the next 12 months. The group's significant on-balance-sheet cash, availability of credit lines, and sound cash flow support the liquidity assessment, but our view is constrained by significant planned capital expenditures and the risk of cash outflows related to mergers or acquisitions. Under our base case, we estimate headroom under financial covenants at more than 60%.

Principal Liquidity Sources	Principal Liquidity Uses
• About €625 million in cash and equivalents and short-term financial assets as of June 30, 2016; • Undrawn credit facilities of around €185 million at the end of the second quarter of 2016; • FFO of above €420 million; and • €500 million proceeds from the placement of senior unsecured notes.	• No significant changes in working capital or intra-year working capital swings; • Capital expenditures of around €250 million annually; • Acquisitions of €300 million-€400 million, the majority of which is attributable to Ainsworth; and • Dividends of €50 million.

Other Credit Considerations

Management has outlined its strategy to further expand the business both organically and through acquisitions. Although the Casinos Austria acquisition will not go ahead, we expect that Novomatic will continue to seek other transactions to support its growth, especially outside of Austria and Germany. We factor the associated potential rise in leverage into our current long-term rating on the group by adjusting down our 'bbb+' anchor by one notch due to financial policy considerations.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Intermediate
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Modest

- **Cash flow/Leverage:** Modest

Anchor: bbb+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-1 notch)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	**bbb+**	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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