Fitch Ratings

Fitch Affirms Net Holding A.S.at 'B'; Outlook Stable

Fitch Ratings - Madrid - 28 November 2018: Fitch Ratings has affirmed Turkish gaming group Net Holding A.S. at Long-Term Issuer Default Rating (IDR) 'B' with Stable Outlook.

The IDR of Net Holding reflects its sustainable business model, despite uncertainty in Turkey that has led to a sharp depreciation of the Turkish lira in recent months, due to the group maintaining more than 80% of its revenue in hard currencies. It also reflects the deleveraging capacity of the group, following a reduction in its planned investment, but free cash flow (FCF) trend remains uncertain. Despite better-than-expected credit metrics in 2017 and forecasted for 2018, the rating is currently limited by the small scale of Net Holding related to rated peers and its high exposure to Northern Cyprus as gaming destination.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Net Holding A.S.	LT IDR B Affirmed		B

KEY RATING DRIVERS

Sustainable Business Model: Net Holding has shown resilient performance in recent years, particularly in 2018 against a sharp depreciation of the Turkish lira following major geopolitical events. We expect revenue to continue growing, due to the opening of new casinos in the Balkans and for EBITDA margins to stabilise at around 32% (from 31.3% in 2017), on growing numbers of customers being more attracted to lower-margin games. Profit margins are solid for the rating, and in relation to larger and more diversified rated peers'.

Low Geographic and Customer Diversification: Net Holding's business remains quite small and has limited geographic diversification with nearly all EBITDA generated from, and material assets located in, the Turkish Republic of Northern Cyprus (TRNC). Its main complex (Merit Royal) represented 46% of total EBITDA in 2017. In addition, there is significant concentration of main customers, with the group's top 50 clients representing around 15%-18% of overall EBITDA. These factors are a rating constraint.

Limited Impact from FX Exposure: Customers continue to pay in hard currencies, driving sound revenue growth and profitability improvements given that the group's cost base is predominantly in Turkish lira. This is positive for leverage although it is offset by debt growth due to the latter being predominantly denominated in foreign currencies. Further depreciation of the Turkish lira could impact revenue coming from Turkish customers, but Net Holding is actively developing marketing plans to reach a more geographically diversified customer base.

Cash Flow Generation to Improve: We expect the group's FCF generation to positively evolve in the coming years due to improvement in profitability as well as a slowdown in the group's investment plan. Capex is significantly lower than in previous years and just one major development in Northern Cyprus is scheduled to materialise in mid-2020. We forecast that FCF will improve and turn positive in 2019, assuming no further unexpected large-scale investments in the future.

Deleveraging Capacity: Given Net Holding's expected improvement of FCF generation, we expect leverage metrics will improve in the next four years due to the slowdown in investments. This is expected to reduce funds from operations (FFO) adjusted gross leverage towards 2.7x by 2020 (4.1x in 2017), a level which would be commensurate with a higher rating. However, the small size of the group and its concentration risk are key rating constraints. Additionally, a majority of its operating assets are pledged, which reduces the group's capacity to monetise asset base to protect its leverage metrics.

Adequate Financial Flexibility: Revenue growth and stable margins should drive FFO improvement, which should offset an increase in interest costs due to the Turkish lira depreciation and higher rental costs as a result of international expansion. This should lead to a significant improvement of FFO fixed charge cover, which we expect to reach 3.1x by end-2020 from 2.6x at end-2017.

DERIVATION SUMMARY

Net Holding's rating of 'B' reflects a weaker credit profile than the rest of Fitch-rated peers such as Crown Resorts Limited (BBB/Stable), Las Vegas Sands Corp (BBB-/Positive) and MGM Resort International (BB/Stable), which benefit from stronger financial profiles with larger scale and high-quality assets in more attractive markets, as well as from greater geographical diversification of operations. Compared with European gaming supplier Intralot SA (B/Negative), Net Holding is still smaller (2017 EBITDAR of EUR50 million vs. EUR176 million for Intralot) and has a different business profile as a sole casino operator unlike Intralot who is a provider of systems to manage lotteries usually entailing long-term contracts, and in betting, a large algorithm-based sportsbook. Leverage is, however, materially higher for Intralot.

KEY ASSUMPTIONS

- Firm revenue growth to TRY1.4 billion by 2020, mainly driven by Turkish lira depreciation, with low- to mid- single digit organic growth and higher growth in the Balkans
- Improvement in profitability in 2018, mainly due to the impact from international operations, especially after the closure in Split (Croatia) and the opening in Bulgaria. However, Northern Cyprus's EBITDA margin is expected to slightly decrease with the positive impact from Turkish lira depreciation offset by a change in the customer base behaviour. New agreements with Asian junketeers will provide the group

with more Asian gamers playing lower- margin games
- Capex as per management guidance
- Annual working capital outflows in line with increasing revenue

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Improvements in the business profile through geographic diversification of EBITDA generation and profitable growth in the Northern Cyprus business, with Fitch-adjusted EBITDA rising towards USD100 million
- FFO adjusted gross leverage falling below 4.0x on a sustained basis as a result of continued improvements in profitability
- FFO fixed charge coverage remaining above 2.5x on a sustained basis

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Unsuccessful expansion plans resulting in sales remaining well below the Fitch rating case for a sustained period
- FFO-adjusted gross leverage above 5.5x on a sustained basis, possibly as a result of a failure to convert revenue growth into profitability improvements
- FFO fixed charge coverage falling below 1.8x on a sustained basis
- Lack of financial discipline, including opportunistic financing or investment activities, which may lead to pressure on FCF generation and liquidity in future.

LIQUIDITY AND DEBT STRUCTURE

Satisfactory Liquidity: At end-September 2018 Net Holding had Fitch-adjusted cash balance of TRY563 million. Additionally it has committed undrawn facilities of TRY805 million, including EUR100 million from Denizbank. This is more than sufficient to cover short-current debt of TRY480 million. All debt was provided by local banks and 91% was expressed in hard currencies as of end-September 2018.

Summary of Financial Statement Adjustments
- Operating leases capitalised using a blended multiple of 6.0x, an average between Bulgaria and Turkey multiples
- TRY29 million in 2017 included as restricted cash locked up in casinos due to legal requirement and operating purposes
- Group EBITDA adjusted to strip out income and costs associated with FX movements
- TRY26.4 million added back to EBITDA in 2015 relating to a one-off cost relating to a bid for the Turkish Lottery

DATE OF RELEVANT COMMITTEE

26-Nov-2018

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10053448)
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