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Fitch Revises IDEMIA's Outlook to Negative; Affirms IDR at 'B'

Fitch Ratings - Frankfurt am Main - 13 Nov 2020: Fitch Ratings has revised technology company IDEMIA Group SAS's (IDEMIA) Outlook to Negative from Stable. Its Long-Term Issuer Default Rating (IDR) has been affirmed at 'B'. A full list of rating actions is provided below.

The Outlook change of IDEMIA reflects Fitch's expectation that its funds from operations (FFO) gross leverage will remain above its downgrade threshold of 7.0x in 2020-2021. IDEMIA's performance was under pressure in 2020 due to COVID-related restrictions and an overall slowdown of activities by government bodies and corporations.

We expect a healthy recovery in revenue and EBITDA from 2021, but not sufficiently to reduce leverage to below 7.0x next year. Revenue prospects are supported by a strong order book, but we see less visibility around the pace of EBITDA margin improvement from 2022. We also expect IDEMIA's free cash flow (FCF) to turn positive only in 2022 compared with our previous expectation for 2020. This will be supported by improving EBITDA, lower restructuring costs and working capital and capex normalisation.

The ratings are supported by IDEMIA's strong global market positions in identification, authentication, payment and connectivity solutions. High leverage is the main constraint for the rating and the company's ability to reduce it organically with stronger EBITDA and FCF will be key for the ratings.

Key Rating Drivers

COVID-19 Impact Contained: The pandemic and associated lockdowns had an adverse impact on IDEMIA's certain segments, in particular, identification solutions related to travel (TSA pre-check) and to those requiring the physical presence of customers (ID documents enrollment). IDEMIA was able to contain the negative impact due to timely reaction and good geographic and business diversification. As a result, revenue declined only 2.8% yoy in 9M20 on a like-for-like basis. Revenue in government solutions (GS) declined 5.7% yoy while secured enterprise transactions (SET) demonstrated better resilience with flat revenues for the same period.

EBITDA Under Pressure: IDEMIA's 15% yoy EBITDA decline in 9M20 led to a spike in FFO gross leverage to 9.1x. Deleveraging below the downgrade threshold of 7.0x depends on continuing improvement of revenues and the success of the company's efforts in sustaining profitability. We project Fitch-defined EBITDA margin to improve to historical levels of 15%-16% in 2022-2023 from an estimated 12.5% in 2020. We have limited visibility on EBITDA development post-2021 and the evolving pandemic remains

an uncertainty that also may delay recovery.

Healthy Backlog: We expect a recovery in revenue in 2021 following improved performance in 3Q20 and, in particular, a positive momentum in the GS segment after it was hit hard in 1H20. IDEMIA had a healthy order backlog at end-3Q20, which was 5% lower than at end-2019 but 8% higher than at end-2Q20 and 12% higher than at end-3Q19. We expect further improvement towards end-2020. IDEMIA and its customers have adapted to social distancing and other restrictions and we expect that the impact of COVID-19 will be less pronounced in 2021 than in 1H20 even if the pandemic worsens.

Decreased Non-Recurring Costs: We expect non-recurring costs to fall to around EUR40 million in 2020 and EUR20 million in 2021 from EUR74 million in 2019 and EUR100 million in 2018. We treat a portion of 2020 one-off costs and all 2021 one-offs costs related to transformation and cost-cutting projects as recurring and include them in EBITDA. This is because we see them as part of IDEMIA's continuing efforts to improve operational efficiency.

Positive FCF Likely in 2022: We expect IDEMIA to start generating moderately positive FCF from 2022. The main drivers will be revenue growth, EBITDA margin improvement, stable capex and a lack of large non-recurring expenses, which were the main drag on FCF in 2017-2019. We expect capex to normalise at around 8% of revenues in 2021-2023.

COVID Long-Term Impact: The current crisis highlighted the importance of data digitalisation, identity management, facial recognition, traffic control and other technologies for government bodies and corporates alike. With its strong market shares in the key sectors IDEMIA is well-positioned to benefit from rising demand for these technologies in the long term. Slow adoption of innovative products by customers is a main challenge for the industry rather than technological risk, in our view.

Derivation Summary

IDEMIA's technology peers such as Nokia Corporation (BBB-/Stable), Telefonaktiebolaget LM Ericsson (BBB-/Stable) and STMicroelectronics N.V. (BBB/Stable) are rated in the investment-grade category. Despite higher volatility in both revenue and margins than IDEMIA, they have greater scale and stronger cash flows as well as no or very low net leverage.

Fitch recognises the strong business position and technology leadership of IDEMIA within its chosen markets but its smaller scale and high leverage place its rating in the 'B' category. Higher-rated FinTech companies such as Nets Topco Lux 3 Sarl (Nets; B+/Stable) and Nexi S.p.A. (BB-/RWP) benefit from leadership in their markets, strong growth prospects and healthy cash flow generation. Similarly rated European software companies such as Dedalus SpA (B/Stable) and TeamSystem Holding S.p.A (B/Stable) exhibit higher margins and better deleveraging prospects than IDEMIA and hence have higher leverage allowance for their rating category.

IDEMIA is broadly comparable with the other peers that Fitch covers in its technology and credit opinions portfolios. It has slightly higher leverage but benefits from market leadership in its core operating segments, healthy liquidity and global diversification.

Key Assumptions

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

- Reported revenue to decline 5.5% in 2020 followed by low mid-single digit growth in 2021-2023
- Fitch-defined EBITDA margin at 12.5% in 2020 (pre-IFRS 16), improving towards 16% by 2023, reflecting the impact of efficiency measures and a better business mix
- Capex on average at around 8% of revenues in 2020-2023
- A portion of non-recurring costs treated as recurring in 2020 and all transformation programme costs are reflected above FFO in 2021-2023
- No M&A from 2021

KEY RECOVERY RATING ASSUMPTIONS

In conducting its bespoke recovery analysis, Fitch estimates that IDEMIA's intellectual property, patents and recurring contracts, in case of default, would generate more value in a going-concern restructuring than a liquidation of the business.

- We estimate post-restructuring EBITDA would be around EUR300 million. We would expect a default to come from either a fall in revenue and EBITDA from the loss of major contracts following reputational damage, for example as a result of compromised technology (leading to sustained high leverage and negative cash flow) or from a major shift in technology usage that can make IDEMIA's products obsolete.
- We have applied a 6x distressed multiple to post-restructuring EBITDA to account for IDEMIA's scale, customer and geographical diversification as well as exposure to secular growth in biometric-enabled identification technology. The 6x multiple is also around half the valuation paid for Morpho (12.4x), which in our view, reflects an appropriate distressed valuation.
- 10% of administrative claims have been taken off the enterprise valuation to account for bankruptcy and associated costs and the company's revolving credit facility (RCF) is assumed to be fully drawn, as per our criteria
- EUR40 million of prior-ranking debt at operating subsidiaries included in recovery analysis as IDEMIA's senior secured term loan B (TLB) and RCF are structurally subordinated to debt at its operating subsidiary
- Our recovery expectation for senior secured lenders of the TLB and the RCF is 66% (in line with a 'RR3') leading to a one-notch uplift for the senior secured debt rating at 'B+'.

RATING SENSITIVITIES

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

- FFO gross leverage below 7.0x combined with FFO interest cover of 3x and positive FCF can lead to a revision of Outlook to Stable
- FFO gross leverage below 5.0x combined with profitability improvement and sustainably positive FCF generation would lead to an upgrade to 'B+'

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

- FFO gross leverage sustainably above 7.0x without a clear path for deleveraging combined with negative FCF
- A material loss of market share or other evidence of a significant erosion of business or technology leadership in core operations

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

Satisfactory Liquidity: At end-3Q20 IDEMIA had long-dated debt maturities, with no material obligation falling due before 2024. It had EUR164 million of cash and EUR300 million RCF, of which EUR225 million was undrawn at end-3Q20 and overall liquidity is adequate. We expect liquidity to remain satisfactory as we forecast largely neutral FCF in 2020 (after including disposals) and modest negative FCF in 2021.

Summary of Financial Adjustments

EUR25 million of cash on balance sheet is assumed to be not readily available to account for intra-year working-capital changes.

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.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY		PRIOR
IDEMIA Group S.A.S.	LT IDR	B 	Affirmed		B 
• senior	LT	B+	Affirmed	RR3	B+

ENTITY/DEBT	RATING		RECOVERY	PRIOR	
secured					
IDEMIA America Corp.					
• senior secured	LT	B+	Affirmed	RR3	B+
IDEMIA France S.A.S.					
• senior secured	LT	B+	Affirmed	RR3	B+

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◆
NEGATIVE	⊖	◆
EVOLVING	◉	◆
STABLE	◐	

Applicable Criteria

[Corporate Rating Criteria \(pub.01 May 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Notching and Recovery Ratings Criteria \(pub.14 Oct 2019\) \(including rating assumption sensitivity\)](#)

[Country-Specific Treatment of Recovery Ratings Rating Criteria \(pub.26 Feb 2020\)](#)

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)

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