



RATING ACTION COMMENTARY

Fitch Affirms IDEMIA at 'B'; Negative Outlook

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Fitch Ratings - Frankfurt am Main - 09 Nov 2021: Fitch Ratings has affirmed IDEMIA Group SAS's (IDEMIA) Long-Term Issuer Default Rating (IDR) at 'B' and the senior secured debt ratings assigned to the term loan B (TLB) and the revolving credit facility (RCF) at 'B+'/'RR3'. The Outlook remains Negative.

The maintenance of the Negative Outlook on IDEMIA's IDR reflects Fitch's expectation that funds from operations (FFO) gross leverage will remain above its downgrade threshold of 7.0x in 2022 despite a healthy recovery in revenue and EBITDA in 2021. Negative free cash flow (FCF) is a drag on the ratings and we expect it to turn moderately positive only from 2022, subject to a continuing post-pandemic market recovery and progress on the company's cost efficiency programme.

KEY RATING DRIVERS

High Leverage: We expect IDEMIA's funds from operations (FFO) gross leverage to be at 8.7x at end-2021 and gradually decline in 2022-2024. The company was adversely affected by the Covid-19 pandemic in 2020 but was able to contain the damage with a timely response and good geographic and business diversification. In 2021 it returned to growth with 9M21 revenue demonstrating a 3.5% increase yoy on a like-for-like basis and a significant improvement in margins. However, the recovery is not sufficiently strong to reduce the leverage to below the downgrade threshold in 2022. There is still some uncertainty around the extent of positive market momentum and continuing improvement in profitability, which are key factors for IDEMIA's deleveraging.

Markets Recovery: Most of the markets in which IDEMIA operates are recovering from the Covid-19 impact in 2020 which is evidenced by company's healthy performance in 9M21. The Government Solutions (GS) segment demonstrated 10% yoy organic growth during that period, attributable to a recovery in air traffic in the US and increased activity in services requiring personal presence which suffered the most during the Covid-19-related restrictions (ID documents). Developed markets, including the US, demonstrate better performance due to their faster recovery from the pandemic, but we expect that the delayed recovery in emerging markets will help IDEMIA to keep a strong momentum in 2022.

The Secured Enterprise Transactions (SET) segment was quite resilient to the pandemic in 2020, declining by only 1% yoy organically while in 2021 the segment accelerated, supported by volumes growth in both payments and connectivity solutions, selective price increases and improved contracts pipeline in authentication.

Chip Shortage Crisis Neutral: The global chip shortage crisis does not have a visible impact on IDEMIA's operations and margins. The company has been proactive in managing the components inventory and benefits from its large scale, allowing for better negotiating position with the suppliers. IDEMIA is able to effectively pass through the increased costs of the components to its customers while a more selective approach to services and customer mix allow for better profitability control. A shortage in components supply make tech vendors like IDEMIA more valuable for customers who want to stay with large and reliable providers, while a change of vendor could present operational risks for their business.

Improving FCF Trend: We expect IDEMIA to continue demonstrating improvement in FCF generation, with moderately positive FCF from 2022. We expect 2021 FCF to be modestly negative, partly due to higher-than-usual cash tax payments attributable to active cash extraction from selected operating subsidiaries. The main drivers for positive FCF 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 2017-2020. We expect capex to normalise at around 7.5% of revenues in 2022-2024.

Improving Earnings Quality: We expect non-recurring costs to decline in 2022-2024 which should support deleveraging. From 2021 we treat most restructuring and transformation expenses as recurring and include them in FFO as they are attributable to cost-cutting projects and are likely to persist. We see them as part of IDEMIA's continuing efforts to improve operational efficiency with a view to standardisation, simplification and digitalisation of business processes. We expect these efforts to lead to IDEMIA's Fitch-

defined EBITDA margin to increase to 15% in 2021 from 13% in 2020 and continue to gradually improve in 2022-2024.

Strong Market Positions: IDEMIA has strong market shares in all its key segments, typically ranking first or second. The GOV segment's solutions require an established reputation, a high level of reliability and strong execution. In this segment IDEMIA benefits from long-term contracts which provide good revenue visibility over a three-five-year period. The Secure Enterprise Solutions (SET) segment's products are more commoditised and the markets more competitive, resulting in price and profitability pressures. The company is tackling these challenges with new hi-tech products, a more selective approach to the customer services mix and by investing in technology at the early stages of adoption which has substantial long-term growth potential.

Amend and Extend Neutral: The extension of TLB's maturities performed in March 2021 is largely neutral for IDEMIA's credit profile, as we do not consider the refinancing risk high for the company. At the same time, the extension comes at the cost of higher cash interest which would put modest pressure on free cash flow (FCF) from 2021.

DERIVATION SUMMARY

The ratings are supported by IDEMIA's strong global market positions in identification, authentication, payment and connectivity solutions.

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 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) show higher margins, have a high share of recurring revenues and demonstrate better deleveraging prospects than IDEMIA and so higher leverage allowance for their rating category.

IDEMIA is broadly comparable with the 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

- Low- to mid-single digit revenue growth in 2022-2024
- Fitch-defined EBITDA margin at 15% in 2021 gradually improving towards 17% by 2024, reflecting the impact of efficiency measures and a better business mix
- Capex on average at around 7.5% of revenues in 2022-2024
- All transformation programme costs are reflected above FFO
- No M&A from 2022

KEY RECOVERY RATING ASSUMPTIONS

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

- We estimate post-restructuring EBITDA would be around EUR285 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 making 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 under our criteria

-EUR36 million of prior-ranking debt at operating subsidiaries is 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 63% (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 could 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: IDEMIA has long-dated debt maturities, with no material obligation falling due before 2026. It had EUR168 million of cash and EUR300 million RCF, of which

EUR247 million was undrawn, at end-3Q21 and overall liquidity is adequate. We expect liquidity to remain satisfactory as we forecast modest positive FCF in 2022 growing in 2023 and 2024.

ISSUER PROFILE

IDEMIA, headquartered in France, is the result of the merger between Oberthur Technologies and Morpho (the Security and Identity Solutions division of French engineering and defence group Safran). IDEMIA is a global leader in digital security solutions with emphasis on identification, authentication and biometrics.

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.

RATING ACTIONS

ENTITY/DEBT	RATING		RECOVERY		PRIOR
IDEMIA Group S.A.S.	LT	B Rating Outlook Negative	Affirmed		B Rating Outlook Negative
● senior secured	LT	B+	Affirmed	RR3	B+
IDEMIA America Corp.					
● senior secured	LT	B+	Affirmed	RR3	B+
IDEMIA France S.A.S.					

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Wendi Wu

Associate Director

Primary Rating Analyst

+49 69 768076 157

wendi.wu@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Slava Bunkov

Senior Director

Secondary Rating Analyst

+7 495 956 9931

slava.bunkov@fitchratings.com

Damien Chew, CFA

Senior Director

Committee Chairperson

+44 20 3530 1424

damien.chew@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick

London

+44 20 3530 1103

peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)](#)

[\(including rating assumption sensitivity\)](#)

[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)

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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