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CREDIT OPINION

19 May 2021

Update

 Rate this Research

RATINGS

IDEMIA Group

Domicile	Paris, France
Long Term Rating	B3
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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IDEMIA Group

Update to credit analysis

Summary

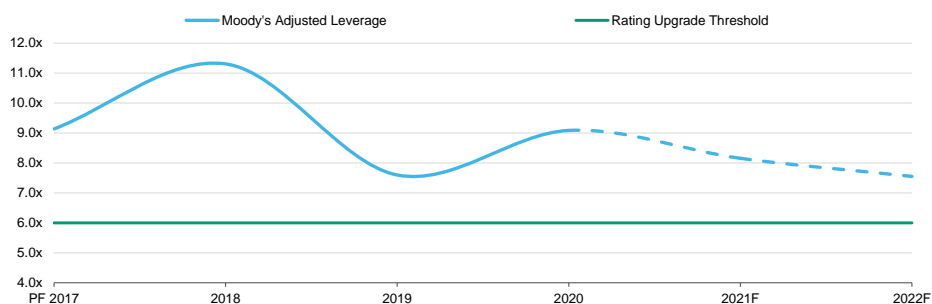
IDEMIA Group's (IDEMIA) B3 corporate family rating (CFR) remains weakly positioned in its rating category, reflecting the company's high Moody's-adjusted (gross) leverage of 9.1x as of 31 December 2020 and negative Moody's-adjusted free cash flow (FCF) of around €60 million in 2020. Although we forecast an improvement in IDEMIA's financial metrics over the next 12-18 months, with Moody's-adjusted leverage improving towards 7.5x by December 2022 and Moody's-adjusted FCF/debt approaching break-even, such an improvement is highly dependent on a recovery in revenue, tight cost control and a reduction in nonrecurring items, all of which are subject to uncertainty and execution risk.

The B3 CFR is also constrained by the company's relatively limited recurring revenue and a lack of visibility in certain business lines, given the unevenness of new contracts and renewal cycles; as well as technological risks inherent in its business model. These factors are partly offset by the high barriers to entry in IDEMIA's various business lines; the company's strong market share in its key segments; its good geographical and customer diversification; and its adequate liquidity, which includes a €171 million cash balance and a €300 million undrawn revolving credit facility (RCF), both as of 31 December 2020.

The negative outlook reflects the execution risk associated with a future improvement in IDEMIA's financial metrics. We could change the outlook to stable if the company were to successfully improve its financial performance, such that its leverage decreases and its FCF turns positive on a sustained basis.

Exhibit 1

Moody's expects IDEMIA's high leverage will improve over the next 12-18 months Moody's-adjusted debt/EBITDA



2021F and 2022F figures are based on our assumptions and forecasts.
Source: Moody's Investors Service

Credit strengths

- » Strong market position in key segments such as payment cards, and identity and security solutions
- » High barriers to entry, given the need for technological know-how, and a track record of delivery and performance
- » Good customer and geographical diversification

Credit challenges

- » Relatively limited recurring revenue and lack of visibility into the performance of certain business lines, given the unevenness of new contracts and renewal cycles
- » Execution risk associated with achieving an improvement in revenue, profitability and cash flow, in the context of a mixed financial track record
- » High Moody's-adjusted leverage of 9.1x as of December 2020 and consistently negative FCF

Rating outlook

The negative rating outlook reflects the execution risk associated with IDEMIA's future revenue and EBITDA growth, a reduction in its nonrecurring items on a sustained basis, and its leverage reduction and cash flow generation potential in general. We could change the outlook to stable if IDEMIA's revenue and EBITDA performance were to improve materially in 2021-22 while the company significantly reduces its nonrecurring items, such that its leverage decreases and its FCF turns positive.

Factors that could lead to an upgrade

Because of the weak rating position at present, an upgrade is unlikely but could occur over time if IDEMIA returns to significantly positive top-line growth; reduces and maintains its Moody's-adjusted leverage below 6.0x; generates significant positive FCF on a sustained basis; and maintains adequate liquidity.

Factors that could lead to a downgrade

We could downgrade IDEMIA's rating if the company fails to reduce its Moody's-adjusted leverage because of, among other factors, revenue strain or a failure to deliver cost synergies; or its FCF remains negative to a larger extent or for a longer period than we expect, impairing the company's liquidity.

Key indicators

Exhibit 2

IDEMIA Group [1]

	2017 PF	2018	2019	2020	2021F	2022F
Revenue (USD Billion)	\$2.8	\$2.4	\$2.6	\$2.5	\$2.5	\$2.6
EBITA Margin	7.7%	4.6%	8.6%	6.6%	7.7%	8.3%
EBITA / Interest Expense	1.9x	0.9x	1.7x	1.2x	2.1x	2.1x
Debt / EBITDA	9.1x	11.3x	7.6x	9.1x	8.2x	7.6x
Retained Cash Flow / Net Debt	-5.9%	4.2%	2.7%	1.7%	3.1%	4.1%
Free Cash Flow / Debt	-8.0%	-6.5%	-4.4%	-5.5%	-0.4%	-0.8%

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. 2021F and 2022F are our estimates.

Source: Moody's Financial Metrics™

Profile

Headquartered in Paris, IDEMIA is an international group that develops, manufactures and markets specialised security technology products and services mainly for identity and public security, payments, telecommunications and automotive markets. The group has

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been majority-owned by funds controlled by Advent International since November 2011, when the private-equity sponsor purchased Oberthur for €1.1 billion (or company-adjusted EBITDA of 9.1x in 2011). Oberthur subsequently completed the acquisition of Safran's identity and security business, Morpho, on 31 May 2017 for a total consideration of €2.4 billion (or company-adjusted EBITDA of 11.9x in 2016). As part of the Morpho acquisition, Advent International was joined by BpiFrance as a minority investor. IDEMIA is the new brand name for the Oberthur-Morpho venture.

IDEMIA generated revenue of €2.2 billion and company-adjusted EBITDA of €362 million in 2020. The company is organised along two internal reporting lines: Secured Enterprise Transactions (key products include payment cards, mobile money solutions, SIM cards, embedded secure elements for mobile phones and tablets, and access cards for digital television) and Government Solutions (products include identity solutions, public security, and biometric and document identification). Revenue was split almost evenly between the two divisions in 2020, according to company reporting.

Detailed credit considerations

Strong market positions across a number of verticals

Size is very important in the industry, with economies of scale essential to remaining competitive as products mature. The acquisition of Morpho was transformational for the company as it consolidated its market positions in several verticals and improved its diversification by adding a new security vertical with a market leading position.

Today, IDEMIA is a leading player in the payment card and telecom SIM card markets, which together form the company's Secured Enterprise Transactions business line, alongside Gemalto N.V. (Gemalto), the global leader owned by Thales (A2 negative).

IDEMIA is also a global leader through its Government Solutions business line, with a world-leading biometric identity and security businesses that compete with companies such as Gemalto/Thales, NEC Corporation, Vision-Box SA and Suprema Inc.

Limited number of companies, particularly in payment, identity and security product lines, reflecting the high barriers to entry

IDEMIA enjoys strong market positions in its key verticals (Secure Enterprise Transactions and Government Solutions), which are defensible because of the high barriers to entry. The digital security industry demands high reliability. Payment smart card manufacturers need to obtain restrictive certifications required by their customers and demonstrate an ability to process significant amounts of highly sensitive data. Similar certifications are required for identity and security contracts with public-sector customers.

We view the company's long track record of operations in its core industries, with a diversified portfolio of long-standing blue-chip customers, as positive. In its Secured Enterprise Transactions vertical, IDEMIA's clients include more than 1,200 multinational financial institutions. The critical nature of digital security products and related services for banks and governments supports trusted long-standing relationships with clients, leading to limited customer churn and favouring well-established companies.

The company's size and global footprint allow for economies of scale in a market driven by a large volume of shipments, delivery, reactivity and full-service provision to customers with global operations. IDEMIA's operations are supported by a global manufacturing and service centre network in 60 countries, offering secure devices and delivering documents in 140 countries, 11 manufacturing sites built around five key regional hubs, and 39 secure service centres. These underpin IDEMIA's global competitiveness because they allow for local personalisation and delivery reactivity, enhanced confidential data management and customer service.

Highly diversified portfolio of customers

IDEMIA benefits from a diversified portfolio of long-standing blue-chip customers, including more than 1,200 multinational financial institutions, 400 mobile operators and 100 government entities. Following the acquisition of Morpho, the company has a customer portfolio that is more balanced between public- and private-sector markets. While, on a standalone basis, Oberthur generated most of its revenue from corporates, including financial institutions and mobile operators, Morpho's business identity and security business was geared towards public-sector clients. No single client accounts for more than 3% of the group's sales, although there is a higher degree of customer concentration within certain subsegments because of its reliance on big-ticket contracts.

Limited recurring revenue and lack of visibility into the performance of certain business lines

The acquisition of Morpho in 2017 was expected to increase the group's exposure to growth markets and improve its recurring revenue and overall revenue visibility. Morpho's security business, which was incorporated into Government Solutions, was considered fast

growing and, therefore, was likely to mitigate the revenue constraints arising from the telecom subsegment, excess inventory in the banking card segment and volatility in identity solutions. In reality, the Government Solutions division has underperformed compared with our expectations and has proved to be a somewhat uneven source of revenue. This, in combination with a certain degree of volatility in the payment solutions business line, reduces visibility into IDEMIA's future top line.

Innovation has enabled the company to maintain its competitive position, but technological risk is high

We view positively IDEMIA's track record in developing products and services that respond to the evolving needs of customers. However, IDEMIA's technological risk is high because the company must not only innovate but also monetise its technological solutions and ensure that the adoption of new technologies provides the same economies as those they replace.

For example, we expect the adoption of the embedded SIM (eUICC/eSIM) technology in mobile handsets, instead of physical SIM cards, to occur over the next three to five years. The exact impact of the adoption of the eSIM technology on IDEMIA's top line is difficult to model. The widespread adoption of eSIM technology could lead to a shift in IDEMIA's customer base from more than 200 mobile operators to a handful of global handset makers. In addition, IDEMIA could have new competitors who do not operate in the physical smart card market. However, the impact of such developments on IDEMIA is likely to be mitigated by the reduced importance of telecom solutions following the acquisition of Morpho; the fact that the eSIM technology could be limited to developed countries, which account for a relatively modest proportion of the company's annual shipments; and IDEMIA's inclusion of virtual SIM card in its product portfolio.

Technological or substitution risk applies to payment cards to a smaller extent. The latest technologies to be implemented in the payment industry include mobile payment, which enables payment through smartphones because of local (near-field communication) connectivity. Although this innovation is likely to reduce card usage, in particular, because of lower wear and tear, and loss, we do not believe, at this stage, that the physical payment card will be fully substituted.

Significant growth is required to improve the company's financial metrics following the setback caused by the coronavirus pandemic in 2020

IDEMIA's financial track record has been mixed. Although its financial performance was weak in the first two years following the Morpho acquisition, marked by declining revenue, limited growth in profitability, very large exceptional items and highly negative FCF, IDEMIA achieved an improvement in several key metrics in 2019 as the company, led by a new management team, outperformed our expectations.

Unfortunately, the pandemic exerted renewed pressure on the company's financials in 2020, with its revenue declining 6% year on year and its company-adjusted EBITDA decreasing to €362 million in 2020, from €397 million a year earlier. IDEMIA's Moody's-adjusted EBITDA also fell to €247 million, from €299 million, over the same period.

It is crucial that IDEMIA reestablishes the growth momentum achieved in 2019, and we believe that the impact of the pandemic on the company's financial performance will prove temporary. Going forward, we expect revenue growth to improve towards 3%-4% per year, which, in combination with tight cost control, which will drive an improvement in company-adjusted EBITDA towards €385 million in 2021 and €405 million in 2022. As a result, we forecast the company's Moody's-adjusted EBITDA (which reflects our adjustments for items including exceptional costs and capitalised development costs) will improve towards €275 million and €300 million in 2021 and 2022, respectively. That said, we highlight that significant execution risk exists.

A key metric that requires focus and improvement is IDEMIA's Moody's-adjusted FCF, which remained negative at €60 million in 2020. The company's historically negative FCF is likely to continue, but at a more reduced pace, on the back of revenue and EBITDA growth, with its Moody's-adjusted FCF approaching break-even on a sustained basis by 2023 according to our forecasts.

Leverage will improve over 2021-22, but will remain high

IDEMIA's Moody's-adjusted leverage increased significantly to 9.1x as of 31 December 2020, from 7.6x a year earlier, mainly because of the impact of the pandemic. We expect the company to reduce its leverage towards 8.2x and 7.6x in 2021 and 2022, which, however, will remain at the high end of the range for the company's B3 CFR.

Exhibit 3

Reconciliation of IDEMIA's adjusted gross leverage as of 31 December 2020 (in € million)

EBITDA bridge	
	FY2020
Company Adjusted EBITDA	362
Non-recurring income and expenses	(36)
Capitalised Development Costs - Additions	(68)
Other adjustments	(11)
Moody's adjusted EBITDA	247
Debt bridge	
Term Loan B	1,981
Finance leases	153
Other financial debt	43
Bank overdraft	(24)
Factoring (off BS)	42
Pensions	51
Moody's adjusted debt	2,246
Moody's adjusted debt / EBITDA	9.1x

The reconciliation is based on audited accounts, which include the impact of IFRS 16.

Source: Moody's Investors Service

ESG Considerations

IDEMIA is tightly controlled by Advent International which, as majority owner, controls the board. As is often the case in highly levered, private equity sponsored deals, owners have a high tolerance for leverage/risk and governance is comparatively less transparent. That said, the rating agency also highlights that, following the appointment of new management, the company has significantly improved its transparency and financial disclosure. Moody's has factored these considerations into its assessment of the credit risk associated with IDEMIA.

Liquidity analysis

IDEMIA has adequate liquidity. Although its Moody's-adjusted FCF was significantly negative at €60 million in 2020, the company preserved its liquidity by raising cash proceeds from asset disposals. As a result, IDEMIA's liquidity amounted to €470 million as of 31 December 2020, which included €170 million of cash and a fully undrawn €300 million RCF. We expect these sources to be sufficient to absorb the cash outflow related to negative FCF that we project over the next 12-18 months. The RCF has a springing leverage covenant, tested only when 35% of the facility is drawn. If tested, the maximum net leverage is set at 7.8x, compared with a pro forma net leverage ratio of 4.1x as reported by the company as of December 2020.

IDEMIA recently extended most of its €2.0 billion equivalent term loan B and €300 million RCF. More specifically, the company extended the maturity of its €1,385 million and \$655 million term facilities to January 2026, from January 2024, and the maturity of its RCF to July 2025. Only a \$75 million portion of the term loan remained unextended and is due January 2024.

Structural considerations

IDEMIA's probability of default rating (PDR) of B3-PD is aligned with its CFR, reflecting our assumption of a 50% family recovery rate, in line with our practice for covenant-lite all-first-lien loan capital structures. The senior secured term loan and senior secured RCF rank pari passu and are both rated B3, in line with the CFR and reflecting the absence of any significant liabilities ranking ahead or behind.

The senior secured facilities benefit from guarantees equivalent to a minimum of 80% of the company's EBITDA and gross assets. The security package includes share pledges, along with pledges over bank accounts and intercompany receivables, which we consider fairly weak. The shareholder loans and preferred shares used in the post-acquisition capitalisation of the company are not included in the debt structure as they meet our criteria for full equity treatment.

Methodology and scorecard

The principal methodology used in this rating was the [Global Manufacturing Companies](#), published in March 2020.

The one-notch difference between the scorecard-indicated outcome and the actual rating assigned reflects the level of IDEMIA's negative FCF and the significant execution risk associated with the company's overall financial performance over the next 12 to 18 months.

Exhibit 4

Rating factors

IDEMIA Group			Moody's 12-18 Month Forward View As of 5/5/2021 [3]	
Manufacturing Industry Grid [1][2]			Measure	Score
Current FY 12/31/2020				
Factor 1 : Scale (20%)				
Measure				
a) Revenue (USD Billion)	\$2.5	Ba	\$2.5 - \$2.6	Ba
Factor 2 : Business Profile (25%)				
a) Business Profile	Ba	Ba	Ba	Ba
Factor 3 : Profitability and Efficiency (5%)				
a) EBITA Margin	6.6%	B	7.7% - 8.0%	Ba
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	9.1x	Ca	7.8x - 8.2x	Ca
b) Retained Cash Flow / Net Debt	1.7%	Caa	3.1% - 3.6%	Caa
c) Free Cash Flow / Debt	-5.5%	Ca	-0.6x - -0.4x	Caa
d) EBITA / Interest Expense	1.2x	Caa	2.1x	B
Factor 5 : Financial Policy (15%)				
a) Financial Policy	B	B	B	B
Rating:				
a) Indicated Outcome from Scorecard		B2		B2
b) Actual Rating Assigned				B3

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of 12/31/2021.

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Financial Metrics™

Ratings

Exhibit 5

Category	Moody's Rating
IDEMIA GROUP	
Outlook	Negative
Corporate Family Rating	B3
Bkd Sr Sec Bank Credit Facility	B3/LGD4

Source: Moody's Investors Service

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