MOODY'S INVESTORS SERVICE

CREDIT OPINION
2 July 2020

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

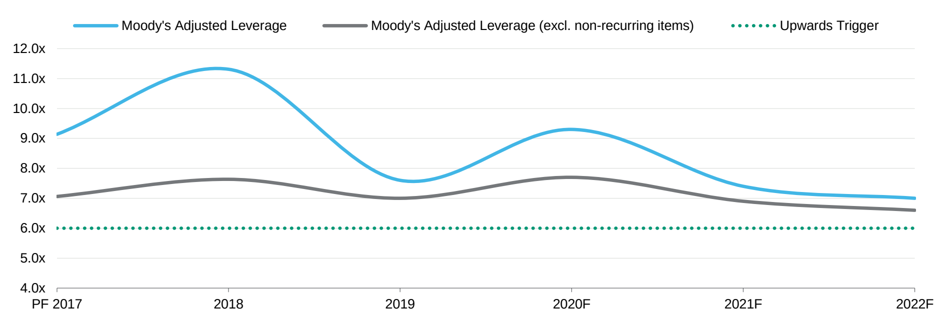
IDEMIA Group's (IDEMIA or the company) B3 corporate family rating (CFR) takes into account the improvement in revenue and EBITDA trends witnessed over the course of 2019, but also the need for further growth, reduction in non-recurring items and improvement in Moody's-adjusted free cash flow (FCF) going forward.

The company's CFR is supported by its strong market share in key segments; high barriers to entry in various business lines, where counterparties such as financial institutions and governments require a track record of delivery and performance; good geographic and customer diversification; and adequate liquidity, which is composed of a €305 million cash balance and a €95 million undrawn revolving credit facility (RCF), both as of 31 March 2020.

Concurrently, the rating also reflects relatively limited recurring revenue and a lack of visibility in certain business lines, given the unevenness of new contracts and renewal cycles; technological risk; IDEMIA's high Moody's-adjusted (gross) leverage of 7.6x as of 31 December 2019 and limited deleveraging since the acquisition of Morpho in 2017; and negative Moody's-adjusted FCF.

We believe that IDEMIA will experience a temporary set-back related to the coronavirus outbreak in 2020, despite the expected resilience of several product lines, but forecast the company will be in a position to build on the financial momentum generated in 2019 from 2021 onwards.

Exhibit 1
IDEMIA's Moody's-adjusted leverage ratio improved in 2019, but is likely to remain high



Source: Moody's Investors Service

Credit strengths

» Strong market position in key segments such as payment cards, 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 geographic diversification

Credit challenges

» Relatively limited recurring revenue and lack of visibility in certain business lines, given the unevenness of new contracts and renewal cycles

» Mixed financial track record, characterized by weak performance over 2017 and 2018, and execution risks surrounding the ability to sustain the improvement seen in 2019

» High Moody's-adjusted leverage of 7.6x and weak, albeit improving, free cash flow

Rating outlook

The negative outlook reflects the execution risk associated with future revenue and EBITDA growth, an expected reduction in non-recurring items on a sustained basis and the company's deleveraging and cash flow generation potential in general. We could change the outlook to stable if the improvement in financial performance recorded in 2019 continues and IDEMIA delivers synergies and significantly reduces nonrecurring items, such that leverage decreases while FCF turns positive.

Factors that could lead to an upgrade

Given the weak rating position at present, an upgrade is not likely but could take place over time if IDEMIA returns to materially positive top-line growth, reduces and maintains Moody's-adjusted leverage below 6.0x, generates material positive FCF on a sustained basis and maintains adequate liquidity.

Factors that could lead to a downgrade

The rating could be downgraded if IDEMIA fails to reduce Moody's-adjusted leverage because of, among other factors, revenue pressure or a failure to deliver cost synergies; its FCF remains negative to a larger extent or a longer period than expected and this impairs the company's liquidity.

Key indicators

Exhibit 2

IDEMIA Group [1]

	FY 2017 PF	FY 2018	FY 2019	Fwd view 12-18 months
Revenue (USD Billion)	$2.8	$2.4	$2.6	$2.5 - $2.6
EBITA Margin	7.7%	4.6%	8.6%	7.2% - 8.5%
EBITA / Interest Expense	1.9x	0.9x	1.7x	1.5x - 1.7x
Debt / EBITDA	9.1x	11.3x	7.6x	8.3x - 9.3x
Retained Cash Flow / Net Debt	-5.9%	4.2%	2.7%	5.6% - 6.8%
Free Cash Flow / Debt	-8.0%	-6.5%	-4.4%	-1.6% - -0.8%

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

Profile

Headquartered in Paris, France, IDEMIA is an international group that develops, manufactures and markets specialized security technology products and services mainly for identity and public security, payments, telecommunications and automotive markets. The group has been majority-owned by funds controlled by Advent International since November 2011, when the private equity sponsor purchased Oberthur for €1,126 million (or 9.1x 2011 company-adjusted EBITDA). Oberthur subsequently completed the acquisition of Safran's identity and security business, Morpho, on 31 May 2017 for a total consideration of €2,425 million (or 11.9x 2016e company-adjusted EBITDA). 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 combination.

IDEMIA generated revenue of €2.3 billion and company-adjusted EBITDA of €397 million in 2019, which equates to an adjusted EBITDA margin of 17.0%. The company is now organized 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, access cards for digital television) and Government Solutions (products include identity solutions, public security and biometric and document identification). Revenue was split broadly evenly between the two divisions in 2019, according to company reporting.

Detailed credit considerations

Strong market positions, enhanced by the complementary acquisition of Morpho

IDEMIA benefits from its number two global position in the payment smart card and telecom SIM card industries behind Gemalto N.V. (Gemalto), the global leader that is now owned by Thales (A2 stable).

The acquisition of Morpho in 2017 was complementary and significantly improved Oberthur's business profile by adding scale to existing verticals. At the same time, the purchase also provided a new security vertical with a market leading position.

Scale is very important in the industry, with economies of scale essential to remaining competitive as products mature. Although Morpho's card payments and telecom SIM business segments were subscale, they added to Oberthur's existing business and, thus, consolidated its number two market position with an additional €350 million of revenue. Similarly, Oberthur's identity business segment's scale increased significantly following the transaction.

Additionally, with the purchase of Morpho, Oberthur diversified into a world-leading security business that competes with companies such as 3M Company (A1 negative), NEC Corporation, Vision-Box SA and Suprema Inc.

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

IDEMIA enjoys strong market positions in its key verticals (Secure Enterprise Transactions and Government Solutions), which are defensible because of high barriers to entry. The digital security industry demands high reliability. Payment smart card manufacturers need to obtain restrictive certifications imposed 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, clients include over 1,200 multinational financial institutions. The critical nature of the digital security products and related services provided for banks and governments supports trusted long-standing relationships with clients, leading to limited customer churn, favoring 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. Operations are supported by a global manufacturing and service center 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 centers. These underpin IDEMIA's global competitiveness, as they allow for local personalization 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, over 400 mobile operators and over 100 government entities. Following the acquisition of Morpho, the company's customer portfolio became more equally 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 toward public-sector clients. No single client accounts for more than 3% of the group's sales, even though within certain sub-segments, there is a higher degree of customer concentration because of its reliance on big-ticket contracts.

Limited recurring revenue and lack of visibility in some of IDEMIA's business lines

The acquisition of Morpho in 2017 was expected to increase the group's exposure to growth markets and improve recurring revenue and visibility. Morpho's security business, which was incorporated into Government Solutions, was considered fast growing and, thus, was likely to mitigate the revenue constraints arising from the telecom sub-segment, excess inventory in the banking card segment and volatility in identity solutions. In reality, the Government Solutions division has underperformed compared to our expectations and has proven 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 in terms of IDEMIA's future top line.

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

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

For example, we expect the adoption of embedded SIM (eUICC/eSIM) technology within mobile handsets, in place of physical SIM cards, over the next three to five years. The exact impact of eSIM on IDEMIA's top line is difficult to model. On the one hand, the widespread adoption of eSIM technology would affect customer relationships, shifting from more than 200 mobile operators globally to a handful of global handset makers. In addition, IDEMIA could face new competitors that are not operating in the physical smart card market. However, the impact is likely to be mitigated by the reduced importance of telecom solutions following the acquisition of Morpho; the fact that eSIM technology could be limited to developed countries, which account for a relatively modest proportion of annual shipments; and IDEMIA's inclusion of virtual SIM card in its product portfolio.

Technological or substitution risk applies to a smaller extent to payment cards. 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. While this innovation is likely to reduce card usage, in particular wear and tear and loss, we do not believe, at this stage, that the physical payment card will be fully substituted.

Financial performance improved in 2019, but more growth is required; coronavirus impact is a temporary setback

IDEMIA's financial performance in the first two years following the acquisition of Morpho was weak, marked by declining revenue, limited growth in profitability despite the delivery of significant synergies, very large exceptional items and highly negative cash flow. That said, 2019 witnessed an improvement in several key metrics. Led by a new management team, IDEMIA outperformed expectations, with revenue rising 9% year on year in 2019 (6% on a constant-currency basis) and company-adjusted EBITDA improving to €397 million from €386 million in 2018. The company also reduced its exceptional items in 2019, which led to a significant improvement in Moody's-adjusted EBITDA to €306 million from €200 million in 2018.

The key metric that continues to require additional improvement is cash flow, which remained negative, despite improving from prior-year levels. More specifically, Moody's-adjusted FCF (which excludes cash proceeds from disposals) remained negative at -€103 million in 2019, mainly because of high levels of capital spending, despite continuing to improve from -€147 million and -€171 million in 2018 and 2017, respectively.

It is important that IDEMIA continues to build on the momentum that the new management team has generated, despite a temporary setback from the coronavirus outbreak in 2020. Although we think that most of the company's business lines will be relatively resilient to the recent lockdowns and economic downturn, we forecast company-adjusted EBITDA to decline toward €375 million in 2020. We expect that this will be followed by a subsequent recovery toward €415 million in 2021, on the back of a recovery in revenue growth. Importantly, we believe that IDEMIA's historically negative cash flow generation will continue, but at a more reduced pace because of lower non-recurring items and a reduction in capital spending from exceptional levels in 2019, with Moody's-adjusted FCF at a negative €40 million in 2020 and around break-even in 2021.

Lower leverage but limited expectations for further improvements over 2020 and 2021

IDEMIA's Moody's-adjusted leverage improved to 7.6x as of 31 December 2019, from 11.3x a year earlier, mainly because of an improvement in EBITDA and lower non-recurring items. However, we see limited improvement from recent levels during the course of the next 12-18 months, given the aforementioned impact of the coronavirus, which will keep leverage high at around 9x in 2020 and around 7.5x in 2021, which is 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 2019 (in € million)

EBITDA bridge	
	FY2019
Company Adjusted EBITDA	397
Non-recurring income and expenses	(14)
Others	3
Exchange losses and hedging instruments result	(6)
IFRS 2 Share bases payments	(5)
Unusual Items	(10)
Pension expense	1
Capitalised Development Costs - Additions	(60)
Moody's adjusted EBITDA	**306**
Debt bridge	
Revolving credit facility	35
Term Loan B	2,043
Financing fees	(47)
Finance leases	138
Factoring (on BS)	1
Other financial debt	40
Bank overdraft	8
Total debt	**2,219**
Factoring (off BS)	42
Pensions	52
Moody's adjusted debt	**2,313**
Moody's adjusted debt / EBITDA	**7.6x**

The reconciliation is based on audited accounts, which include the impact of IFRS 16.
Source: Moody's Investors Service

Liquidity analysis

IDEMIA has adequate liquidity. Although Moody's-adjusted FCF was significantly negative at -€103 million in 2019, the company preserved its liquidity by raising cash proceeds from asset disposals. As a result, its liquidity amounted to €400 million as of 31 March 2020, which included €305 million of cash on balance and €95 million available under its €300 million RCF. We expect this liquidity to be sufficient to absorb the cash outflows 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 at 4.5x as reported by the company as of the first quarter of 2020.

The €300 million RCF matures in January 2023, whereas IDEMIA's term debt matures in 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 €2,100 million term loan and the €300 million 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 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 capitalization of the company are not included in the debt structure as they meet our criteria for full equity treatment.

Rating methodology and scorecard factors

The principal methodology used in these ratings was 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				
Manufacturing Industry Grid [1][2]	Current FY 12/31/2019		Moody's 12-18 Month Forward View As of 6/11/2020 [3]	
Factor 1 : Business Profile (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Business Profile	Ba	Ba	Ba	Ba
Factor 2 : Scale (20%)				
a) Revenue (USD Billion)	$2.6	Ba	$2.5 - $2.6	Ba
Factor 3 : Profitability (10%)				
a) EBITA Margin	8.6%	Ba	7.2% - 8.5%	Ba
Factor 4 : Coverage and Leverage (40%)				
a) EBITA / Interest Expense	1.7x	B	1.5x - 1.7x	B - Caa
b) Debt / EBITDA	7.6x	Caa	8.3x - 9.3x	Ca
c) Retained Cash Flow / Net Debt	2.7%	Caa	5.6% - 6.8%	Caa
d) Free Cash Flow / Debt	-4.4%	Caa	-1.6% - -0.8%	Caa
Factor 5 : Financial Policy (10%)				
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 12/31/2019.
[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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