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CREDIT OPINION

25 May 2022

Update



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RATINGS

IDEMIA Group

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

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

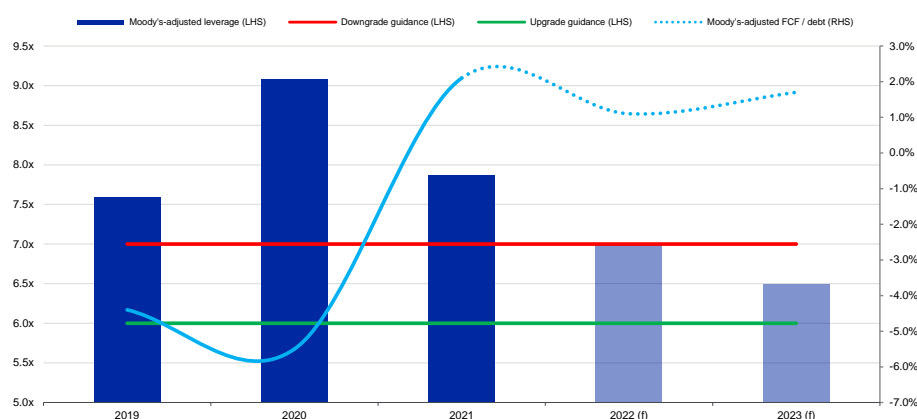
Summary

IDEMIA Group's (IDEMIA) B3 corporate family rating (CFR) reflects our expectation that the company's credit metrics will remain weak despite an improvement in growth momentum and financial metrics in 2021. This improvement drove the recent change in the outlook on the rating to stable from negative. Over the next 12-18 months, we forecast Moody's-adjusted (gross) leverage will remain high at around 7x, with weak interest coverage of about 2x and limited annual Moody's-adjusted free cash flow (FCF)/debt of only 1%-2%.

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 €250 million cash balance and a €300 million undrawn revolving credit facility (RCF), both as of 31 December 2021.

Exhibit 1

We expect IDEMIA's leverage to improve but remain high over the next 12-18 months
Moody's-adjusted leverage and Moody's-adjusted FCF / debt



2022 (f) and 2023 (f) 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 in IDEMIA's various business lines, given the need for technological know-how and scale
- » Good geographical and customer 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 its plans to improve revenue, profitability and cash flow
- » High Moody's-adjusted leverage of 7.9x as of December 2021 and limited FCF

Rating outlook

IDEMIA's stable rating outlook reflects our expectation of continued growth in revenue and EBITDA over the next 12-18 months, such that its Moody's-adjusted leverage falls to around 7.0x and Moody's-adjusted FCF remains at least in the low-single digits as a percentage of Moody's-adjusted debt. The outlook also incorporates our assumption that there will be no significant increase in leverage from any future debt-funded acquisitions or shareholder distributions, and that the company will maintain adequate liquidity.

Factors that could lead to an upgrade

Positive pressure on the rating could develop over time if the company continues to record growth in revenue and Moody's-adjusted EBITDA, such that its Moody's-adjusted leverage improves to well below 6.0x and Moody's-adjusted FCF/debt remains in the mid-single digits in percentage terms, both on a sustained basis.

Factors that could lead to a downgrade

Negative pressure on the rating could arise if IDEMIA fails to reduce Moody's-adjusted leverage to around 7.0x on a sustained basis; its FCF turns negative; or the company's liquidity deteriorates to a level that it is no longer adequate.

Key indicators

Exhibit 2

IDEMIA Group

	PF 2017	2018	2019	2020	2021	2022 (f)	2023 (f)
Revenue (USD billion)	\$2.8	\$2.4	\$2.6	\$2.5	\$2.5	\$2.6	\$2.7
EBITA margin	7.7%	4.6%	8.6%	6.6%	8.3%	9.4%	10.0%
EBITA / Interest expense	1.9x	0.9x	1.7x	1.2x	1.4x	1.9x	2.1x
Debt / EBITDA	9.1x	11.3x	7.6x	9.1x	7.9x	7.0x	6.5x
Retained cash flow / Net debt	-5.9%	4.2%	2.7%	1.7%	4.2%	6.6%	7.7%
Free cash flow / Debt	-8.0%	-6.5%	-4.4%	-5.5%	2.1%	1.1%	1.7%

All ratios are based on adjusted financial data and incorporate our Global Standard Adjustments for Non-Financial Corporations. The forecasts represent our view, not the view of the issuer.

Source: Moody's Financial Metrics™

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Profile

Headquartered in Courbevoie, France, IDEMIA Group (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 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 €396 million in 2021. 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 2021, according to company reporting.

Detailed credit considerations

Expectations for a continued improvement in financial performance have resulted in the stabilisation of IDEMIA's rating

Although IDEMIA's financial track record has been mixed since the acquisition of Morpho in 2017, its operating performance rebounded in 2021, following a difficult 2020, and we expect the company to maintain growth momentum. Headline revenue and company-adjusted EBITDA rose 2% and 6% year over year in 2021, respectively, although underlying, constant-perimeter growth was stronger, at 6% and 15%. We estimate that company-adjusted EBITDA of €396 million in 2021 was around 6% higher than in 2019, adjusting for certain asset disposals made over the period. Management continued to successfully reduce exceptional costs during the course of 2021, which also contributed to an improvement in Moody's-adjusted EBITDA to €288 million in 2021 and a significant reduction in Moody's-adjusted leverage to 7.9x as of December 2021, from 9.1x a year earlier. Its Moody's-adjusted FCF (calculated excluding asset disposal proceeds) of €47 million turned positive in 2021, after several years of FCF burn, although this positive FCF was mainly because of a €69 million working capital inflow, which we consider non-recurring.

We forecast revenue will continue to grow at 3%-4% per year going forward, which, in combination with an improvement in product mix and tight cost control, is likely to drive an improvement in company-adjusted EBITDA towards €420 million in 2022 and €440 million in 2023. As a result, Moody's-adjusted EBITDA (which reflects our adjustments for items including exceptional costs and capitalised development costs) will improve towards €320 million and €340 million in 2022 and 2023, respectively. Importantly, we also forecast positive Moody's-adjusted FCF of €25 million-€40 million per year over the next 12-24 months, thanks to improved profitability and stable capital intensity of around 7% of sales (broadly unchanged from 2021 levels).

Our expectations regarding the sustainability of the improvement in IDEMIA's credit metrics, including organic revenue and company-adjusted EBITDA growth; limited non-recurring items compared with historical levels; and positive FCF were the key factors that led to the change in IDEMIA's rating outlook to stable.

Credit metrics will likely improve over the next 12-18 months but remain weak

IDEMIA's Moody's-adjusted leverage decreased significantly to 7.9x as of 31 December 2021, from 9.1x a year earlier, mainly because of the recovery in Moody's-adjusted EBITDA following the pandemic. Although we expect Moody's-adjusted leverage to continue to improve towards 7.0x in 2022 and 6.5x in 2023, we take into consideration the fact that these levels are high, and consistent with a B3 CFR.

Exhibit 3

Moody's-adjusted leverage reconciliation as of 31 December 2021

EBITDA		Debt	
EUR million	2021	EUR million	2021
Company adjusted EBITDA	396	Senior secured term loan B	2,024
Non-recurring income & expenses	(38)	Other financial debt	33
Capitalised development costs	(58)	Finance leases	143
Other Moody's adjustments	(12)	Factoring (off-balance sheet)	60
Moody's-adjusted EBITDA	288	Pensions	45
		Other adjustments	(36)
		Moody's-adjusted debt	2,269
Moody's-adjusted leverage			7.9x

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

Source: Moody's Investors Service

IDEMIA's other credit metrics, including interest coverage (calculated as Moody's-adjusted EBITA/interest) of below 2.0x and Moody's-adjusted FCF/debt of only 1%-2% per year, are also likely to remain weak over the next 12-24 months, which is again consistent with a B3 CFR.

Strong market positions across a number of verticals

Scale is very important in the industry, with economies of scale being 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.

Currently, IDEMIA is a leading company in the payment card and telecom SIM card markets, which together form the company's Secured Enterprise Transactions business line, alongside [Thales](#) (A2 negative), which purchased Gemalto N.V. in 2019.

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

Limited number of companies, particularly in the 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 that offer secure devices and deliver documents in 140 countries, 6 manufacturing sites (located in China, India, France, Colombia, Brazil, and US), 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 companies, 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 likely 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 topline.

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 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 as a portion of total revenue in recent years; the fact that the eSIM technology could be limited to developed countries; and IDEMIA's inclusion of virtual SIM cards 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, particularly because of lower wear and tear, and loss, we do not believe that physical payment cards will be fully substituted at this stage.

ESG considerations

IDEMIA is tightly controlled by Advent International, which, as the majority owner, controls the board. As is often the case in highly levered, private equity sponsored deals, owners have a higher tolerance for leverage and risk and governance is relatively less transparent, compared with publicly listed peers. We have factored in these governance considerations into our assessment of credit risk associated with IDEMIA.

Liquidity analysis

IDEMIA has adequate liquidity, supported by €250 million of cash on balance as of 31 December 2021 and a fully undrawn €300 million senior secured RCF. Additionally, we forecast that the company's Moody's-adjusted FCF will be in the range of €25 million to €40 million over 2022 and 2023, following several years of negative FCF. The senior secured RCF has a springing leverage covenant that is only tested once 35% of the facility is drawn. If tested, the maximum net leverage is set at 7.8x. We do not currently expect a breach under the senior secured RCF covenant.

In 2021, IDEMIA extended its €2.0 billion equivalent term loan B and €300 million RCF. More specifically, the company extended the maturity of its €1,450 million and \$655 million term facilities to January 2026 from January 2024, and the maturity of its RCF to July 2025.

Structural considerations

IDEMIA's senior secured term loan and senior secured RCF rank pari passu and are both rated B3, in line with the CFR, reflecting the absence of any significant liabilities ranking ahead or behind. The probability of default rating (PDR) of B3-PD is aligned with the 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 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 weak.

Methodology and scorecard

The principal methodology used in rating IDEMIA was the [Manufacturing](#) rating methodology, published in September 2021.

The one-notch difference between the scorecard-indicated outcome and the actual rating assigned reflects the company's high leverage, weak interest cover and limited FCF, as well as the execution risk associated with the company's plan to improve its financial performance and credit metrics.

Exhibit 4

Rating factors

IDEMIA Group

Manufacturing industry scorecard [1]			Current 12/31/2021		Moody's 12-18 month forward view as of 05/11/2022 [2]	
Factor 1 : Scale (20%)	Measure	Score			Measure	Score
a) Revenue (USD billion)	\$2.5	Ba			\$2.6	Ba
Factor 2 : Business profile (25%)						
a) Business profile	B	B			B	B
Factor 3 : Profitability and efficiency (5%)						
a) EBITA margin	8.3%	Ba			9.4% - 9.7%	Ba
Factor 4 : Leverage and coverage (35%)						
a) Debt / EBITDA	7.9x	Ca			6.7x - 7.0x	Caa
b) Retained cash flow / Net debt	4.2%	Caa			6.6% - 7.1%	Caa
c) Free cash flow / Debt	2.1%	B			1.1% - 1.4%	B
d) EBITA / Interest expense	1.4x	Caa			1.9x - 2.0x	B
Factor 5 : Financial policy (15%)						
a) Financial policy	B	B			B	B
Rating:						
a) Scorecard-indicated outcome		B2				B2
b) Actual rating assigned						B3

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

[2] This represents our forward view, not the view of the issuer.

Source: Moody's Investors Service

Ratings

Exhibit 5

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

Source: Moody's Investors Service

Appendix

Exhibit 6

Summary of Moody's-adjusted metrics

(EUR million)	2021	2022 (f)	2023 (f)	2024 (f)
Revenue	2,220	2,300	2,376	2,447
EBITDA	288	325	350	370
EBITA	185	216	237	254
Interest expense	(132)	(114)	(114)	(114)
Funds from operations (FFO)	90	131	151	171
Retained cash flow (RCF)	85	131	151	171
Free cash flow (FCF)	47	25	40	55
Debt	2,269	2,269	2,269	2,269
Cash & cash equivalents	250	275	314	369
Debt / EBITDA	7.9x	7.0x	6.5x	6.1x
EBITA / Interest expense	1.4x	1.9x	2.1x	2.2x
RCF / Net debt	4.2%	6.6%	7.7%	9.0%
FCF / Debt	2.1%	1.1%	1.7%	2.4%

Source: Moody's Investors Service

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