

## Research Update:

# Idemia France Outlook Revised To Stable On Expected Cash Flow Improvement; 'B-' Rating Affirmed

March 23, 2021

## Rating Action Overview

- The pandemic prevented French identity solutions and smart card provider Idemia France SAS from posting break even free operating cash flow (FOCF) in 2020. Instead, it reported negative FOCF after leases of about €60 million, in line with 2019, and an increase in leverage (excluding preferred shares) to 9.7x from 7.9x in 2019.
- Idemia is extending its debt maturities to 2026, giving it the flexibility to implement its growth strategy in the next few years. Although its government solutions business segment (49% of revenue) will continue to struggle in 2021, a top-line recovery, coupled with costs savings and positive working capital movements, should improve FOCF after leases and adjusted leverage in 2021.
- We are therefore revising our outlook to stable from negative and affirming our 'B-' issuer rating and issue rating.
- The stable outlook indicates that Idemia is forecast to expand revenue by 1%-3%, increase profitability, and stabilize capital expenditure (capex) in 2021, amid favorable working capital movements. As a result, it should post moderately negative FOCF after leases and adjusted leverage of about 9.0x (excluding preferred shares).

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## Rating Action Rationale

**Idemia's expected return to neutral FOCF was hampered by the pandemic, which disrupted its market, and by adverse foreign exchange (FX) changes.** It therefore reported another year of negative FOCF in 2020 as its revenue dropped by 7% (3% on a comparable basis) and EBITDA fell by about €50 million (including €36 million of non-recurring costs).

**The government solutions segment, which brings in nearly half of revenue, was hardest hit.**

Lockdowns prevented citizens from accessing public facilities to obtain and renew identity documents (IDs). Revenue dropped 5.4% compared with 2019, on a constant FX and perimeter

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basis. The travel restrictions during 2020 also cut into the travel pre-check business offered by the U.S. Transportation Security Administration (TSA). The secure enterprise transactions segment reported a decline of 1.1%, mainly because lockdowns caused the authentication business to underperform.

**The company managed to reduce capex to about €170 million in 2020 (including capitalized development costs) from €196 million in 2019.** However, Idemia's relatively low EBITDA margin, still-material restructuring costs, and high debt service, combined with a top-line decline caused reported FOCF after lease payments to be negative by €60 million. We had previously expected FOCF to be neutral.

**We no longer treat Idemia's €784 million preferred shares as debt, given that these securities meet our noncommon equity criteria requirements.** Consequently, S&P Global Ratings-adjusted leverage in 2020 was 9.7x, rather than 12.6x. Our debt treatment of the €328 million shareholder loan remains unchanged. However, we understand the company is considering converting the entire shareholder loan to preferred shares, on the same terms as the current preferred shares. Excluding the shareholder loan, we calculate that adjusted leverage would have been 8.5x in 2020.

**When lockdown and mobility restrictions ease, we anticipate that Idemia's performance will start to recover.** Our base case suggests revenue growth of 2% in 2021 and a further 3%-4% growth in 2022 (assuming constant FX rates of about 1.19 USD/EUR). Both government and enterprise solutions are likely to see a progressive recovery as lockdowns and travel restrictions start to ease. Growth could also benefit from the positive momentum in the payments and connectivity segments as the use of metal and eco-friendly cards, 5G deployments, biometrics terminals, and digital IDs increases.

**A global shortage of chipsets may limit Idemia's ability to sell its products.** All of the chips the company needs are purchased from semiconductor manufacturers. The company has now secured around 93% of its 2021 chip needs and will take further actions to secure 100% of the planned volumes for 2021 and 2022. For example, it could continue to sign early contracts with suppliers and commit to paying higher prices. Under our base case, we assume that Idemia will be able to fully cover its backlog in 2021 but that this will do moderate damage to its profitability margin.

**Under our base case, we expect Idemia's FOCF to be slightly negative after leases in 2021, and then positive in 2022, based on the top-line and EBITDA improvements.** Idemia anticipate about €25 million-€30 million in positive working capital changes related to action plans implemented after the pandemic disruptions in 2020, for which the cash inflows will fully materialize in 2021. These actions included optimized inventory management, more favorable payment terms with suppliers, and improvements to government contracts. We also anticipate that capex will remain stable at €165 million-€170 in 2021-2022; it fell by about €26 million in 2020 compared with 2019.

**In our view, failure to restore its FOCF generation in line with our base case could lead to an unsustainable capital structure.** Given that it is still unclear how long the pandemic-related disruptions will last, there are still downside risks, mainly in the travel sector. It is also unclear whether Idemia can achieve the working capital inflows it has estimated. Moreover, Idemia still relies heavily on third parties to supply chipsets. Should Idemia fail to deliver revenue growth or to optimize its cost structure, we could reconsider our view on the sustainability of its capital structure.

**Research Update: Idemia France Outlook Revised To Stable On Expected Cash Flow Improvement; 'B-' Rating Affirmed****Idemia should benefit from positive market developments because its mission critical products and services give it a leading position in the market.**

The company holds a No. 2 position as a provider of payment cards and services to financial institutions (after Gemalto, owned by Thales). These segments represented about 38% of the company's revenue in 2020. In the connectivity segment, which represents 8% of Idemia's revenue, the company is the No. 2 provider of SIM cards. Moreover, Idemia holds a No. 1 position in civil IDs and public security services market in the U.S. and a No. 2 position outside the U.S.

**Idemia's markets are highly competitive and success depends on scale and the ability to provide end-to-end services while controlling key aspects of the hardware (80% of Idemia's revenues) and software (20%).**

In our view, Idemia's moderate scale and its No. 2 position in some business segments could constrain its ability to grow as it plans. That said, we expect Idemia to maintain a stable market share for the next two-to-three years as the company harnesses its broad product and services offerings and keeps investing in research and development (R&D) to seize the opportunity provided by the pandemic of an accelerated digital transition. For example, we see a rising demand for digital IDs, digital and biometric identification and authentication, growing cybersecurity concerns, and increasing use of digital payment cards and digital transactions globally. The main growth has come from developing countries.

**Outlook**

The stable outlook indicates that as Idemia recovers from the pandemic-related business disruptions in 2020, it is likely to post revenue growth of 1%-3%. Its EBITDA margin could increase to 13%. We also expect Idemia to report slightly negative reported FOCF after leases in 2021, up from negative €60 million in 2020, and about 8.0x adjusted leverage (excluding the shareholder loan) or 9.0x (including the shareholder loan).

**Downside scenario**

We could lower the rating if the group's reported FOCF after leases underperformed our expectations and if leverage deteriorated sustainably and significantly above 8.0x (excluding the shareholder loan) or 9.0x (including the shareholder loan). This may occur if Idemia's recovery is weaker than we currently anticipate, due to persisting mobility restrictions and confinements, major competitive setbacks in key segments, or if the company fails to capitalize on the market trends.

We could also lower the rating if Idemia's liquidity position deteriorated significantly or we saw a heightened risk of a specific default event, such as distressed exchange or similar restructuring.

**Upside scenario**

We could raise the rating if Idemia's revenue and profitability prospects improved materially, likely from favorable market trends and improved market position in its key operating segments. This would result in above €50 million FOCF generation after lease payments, adjusted FOCF to debt approaching 5% (including the shareholder loan) and adjusted leverage sustainably below 6.5x (excluding the shareholder loan) or below 7.5x (including the shareholder loan), while maintaining adequate liquidity.

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Idemia is a global leader in the identification and security market for both government solutions (49% of 2020 revenue) and secure enterprise transactions (51% of revenue). The company is also a leader in biometric innovation in the banking sector. In 2020, Idemia generated €1,176 million in revenue and €328 million in EBITDA (including nonrecurring costs).

**Our Base-Case Scenario**

- Real GDP growth of 4.2% and 3.0% in the U.S. in 2021 and 2022, 4.8% and 3.9% in the eurozone, 6.0% and 5.0% in the U.K., 6.1% and 4.6% in Asia-Pacific, and 4.1% and 3.2% in Latin America.
- Revenue growth of about 1%-3% in 2021, mainly based on the recovery in both secure enterprise transactions and government solutions. For 2022, we anticipate 3%-4% revenue growth, primarily coming from government solutions and the rising identity and public security needs.
- Nonrecurring restructuring costs of €40 million-€45 million in 2021, decreasing to about €30 million in 2022.
- An adjusted EBITDA margin of about 13% in 2021, after 12.3% in 2020, as continued nonrecurring expenses squeeze margins. We expect margins to expand toward 15% in 2022, when restructuring expenses come down and cost synergies resulting from the new efficiency program materialize. This program targets diverse operating expense reductions and is expected to deliver €20 million of cost savings by end of 2022.
- Idemia's anticipation of about €25 million working capital inflow in 2021, followed by neutral working capital changes from 2022 onward.
- Annual capex of €165 million-€170 million in 2021-2022, including capitalized R&D costs of about €60 million-€70 million.
- Annual cash interest expense of about €100 million-€110 million.
- No dividends and no significant mergers or acquisitions.

Based on these assumptions, we arrive at the following adjusted credit measures:

**Idemia Key Metrics**

(Mil. €)	--Fiscal year ended Dec. 31--			
	2019a	2020a	2021f	2022f
Revenue (constant currency)	2,339	2,176	2,100-2,300	2,200-2,400
S&P Global Ratings-adjusted EBITDA margin (%)	14.5	12.3	12.5-13.5	14-15
Nonrecurring costs	(74)	(36)	40-45	30
S&P Global Ratings-adjusted debt to EBITDA (x)*	7.9	9.7	9.0-9.2	7.5-8.0
Reported FOCF after lease payments	(55)	(57)	(10)-0	20-40
FOCF/debt (%)	(2.5)	(1.1)	0-1	2-3

\*Excluding preferred shares and including the shareholder loan. a--Actual. f--Forecast. FOCF--Free operating cash flow.

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We assess Idemia's liquidity as adequate, with sources of liquidity covering uses by more than 1.2x over the next 12 months. Despite the substantial liquidity headroom, we do not assess liquidity as strong, given Idemia's challenging and volatile operating environment.

We expect the following principal liquidity sources:

- Cash balances and short-term investments of about €170 million.
- €300 million fully undrawn revolving credit facility (RCF) maturing in 2025, once the current refinancing is closed.
- Reported funds from operations of about €130 million.

We expect the following principal liquidity uses:

- Intra-year seasonal peak working capital outflows of about €100 million.
- Annual capex, including capitalized R&D costs, of €180 million-€190 million.

**Covenants**

We foresee sufficient headroom of about 3x EBITDA under the RCF's springing covenant, set at a maximum of 7.8x consolidated senior secured net leverage (4.1x in fourth-quarter 2020).

**Issue Ratings - Recovery Analysis****Key analytical factors**

- We affirmed Idemia's existing senior secured debt issue rating at 'B-'. The recovery rating is unchanged at '3'. Our rounded recovery estimate is 60%. The recovery prospects remain supported by limited prior-ranking liabilities but constrained by the significant amount of senior secured debt, including the term loan Bs and the RCF.
- We view the security and guarantee package as comprehensive. The documentation contains a minimum guarantor coverage test (corresponding to 80% of EBITDA and 80% of gross assets).
- We view the documentation in Idemia's amend and extend offer as issuer-friendly in terms of credit protection and in line with the previous offer. There is no maintenance covenant on the senior secured debt, except a springing maximum 7.8x consolidated senior secured net leverage covenant under the RCF (to be tested when more than 35% drawn). Restrictions on additional indebtedness are subject to incurrence-based maximum 4.5x and 2.0x consolidated senior secured net leverage and fixed-charge coverage ratio tests, respectively. The documentation has several other issuer-friendly features, including sizable debt baskets and restricted payment carve outs.
- Our hypothetical default scenario assumes operating underperformance resulting from a deterioration in the smart card market, weaker revenue growth in the new identity and security segments, and the potential loss of customers due to increasing competition from better-capitalized competitors.

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- We value Idemia as a going concern, given its established market position in identity and security solutions, diversified customer base, resilient business model, opportunities for growth, and the now-higher barriers to enter the industry.

**Simulated default assumptions**

- Year of default: 2023
- Minimum capex (percentage of next two years' average sales): 4% (excluding capitalized R&D)
- Cyclical adjustment factor: +10% (standard sector assumption)
- Operational adjustment factor: -5%
- Emergence EBITDA after recovery adjustments: About €261 million
- Implied enterprise value multiple: 6.0x
- Jurisdiction: France

**Simplified waterfall**

- Gross enterprise value at default: about €1.6 billion
- Administrative costs: 5%
- Net value available to debtors: €1.5 billion
- Priority claims [1]: about €50 million
- Secured debt claims [1]: about €2.3 billion
- Recovery expectation [2]: 60% (Recovery rating: 3)

[1] All debt amounts include six months of prepetition interest. RCF assumed 85% drawn on the path to default.

[2] Rounded down to the nearest 5%.

**Ratings Score Snapshot**

Issuer credit rating: B-/Stable/--

Business risk: Fair

- Country risk: Low
- Industry risk: Moderately High
- Competitive position: Fair

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

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- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: FS-6 (no further impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

**Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

**Ratings List****Outlook Action; Ratings Affirmed**

	To	From
<b>Idemia France SAS</b>		
Issuer Credit Rating	B-/Stable/--	B-/Negative/--
<b>Idemia France SAS</b>		
Senior Secured	B-	B-
Recovery Rating	3(60%)	3(60%)
<b>Oberthur Technologies SA</b>		
Senior Secured	B-	B-
Recovery Rating	3(60%)	3(60%)
<b>Oberthur Technologies of America Corp.</b>		
Senior Secured	B-	B-

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	To	From
Recovery Rating	3(60%)	3(60%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.



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