

Research Update:

# Idemia France Upgraded To 'B' On Improved Credit Metrics; Outlook Stable

December 5, 2022

## Rating Action Overview

- French identity, security, and payments solutions provider Idemia France SAS' revenue in 2022-2023 will be stronger than previously anticipated, thanks to market tailwinds such as increased digitalization, technology ramp-ups, and increasing security requirements.
- We also anticipate improved EBITDA margins on the back of operating efficiencies and a favorable product and geographic mix, which coupled with moderate capital expenditure (capex) should lead to solid free operating cash flow (FOCF) after leases and adjusted leverage of 4.5x-5.5x.
- We are therefore raising our long-term credit ratings on Idemia to 'B' from 'B-'.
- The stable outlook reflects our view that Idemia will capitalize on market growth in its enterprise and government solutions segments while EBITDA margins further improve, leading to solid reported FOCF after leases of €100 million-€150 million per year and leverage of close to 5.0x in the next 12 months.

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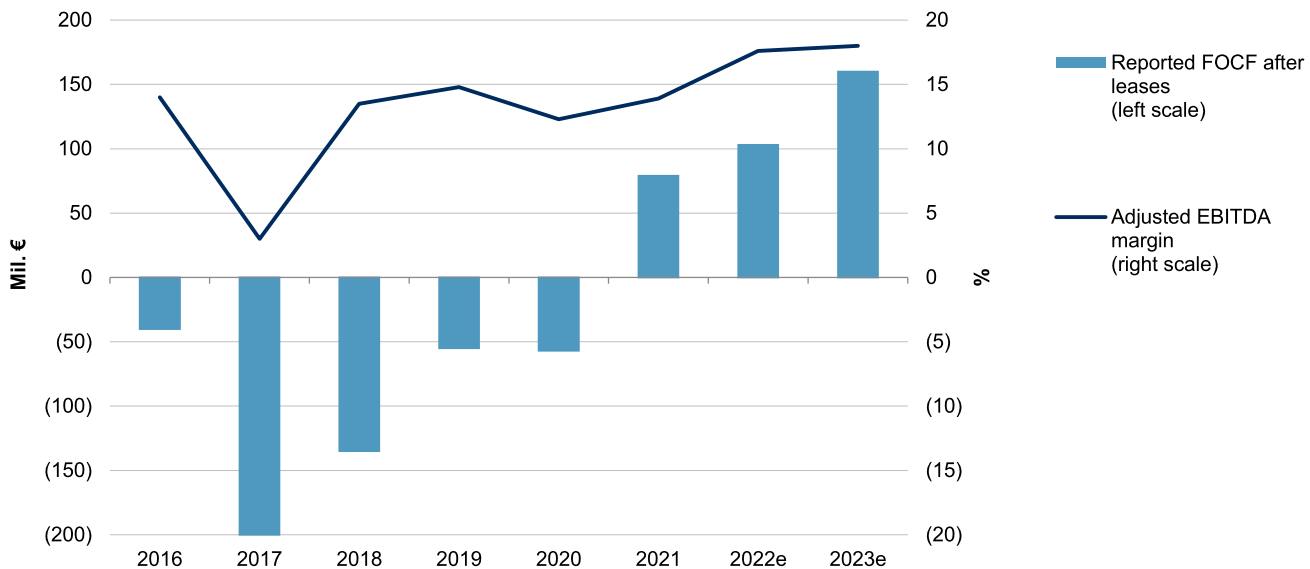
## Rating Action Rationale

**We expect Idemia's revenue to outperform our previous base case for 2022-2023.** S&P Global Ratings anticipates the company will report an annual revenue growth rate of 18%-19% in 2022 (around 12% on a constant currency basis), compared with our previous forecast of 3%-5%, led by both the government solutions and secured enterprise transactions (SET) segments. Lockdowns during 2020-2021 prevented citizens from accessing public facilities to obtain or renew their ID documents, while travel restrictions have impaired pre-check travel business. As pandemic-related restrictions eased and demand for cybersecurity and authentication increased, Idemia reported a solid recovery in the government solutions segment (47% of total revenue), with 7% like-for-like revenue growth (21% reported) in the first nine months of 2022. Revenue in the SET segment (53% of revenue) grew by 24% like for like (22% reported), mainly from rising demand for connected devices (such as connected cars), 5G technology, metal cards, and digital payments globally. Beyond 2022, we anticipate 3%-5% annual growth as Idemia continues capitalizing on positive industry trends, broad product capabilities including its own intellectual

property, low customer attrition with long-term relationships, and its solid market position as a No. 2 provider of payment cards and services to financial institutions (after Thales), No. 2 provider of SIM cards, No. 1 in the civil ID and public security services market in the U.S., and a leading position outside the U.S.

**We also anticipate adjusted EBITDA margins of 17%-18% for 2022, and approaching 20% in the following years.** Over the last decade, Idemia's profitability was negatively affected by operating inefficiencies, several restructuring initiatives and integration costs after the merger with Morpho. Since then, the company has reduced structural cost issued. Moreover, in early 2021, Idemia launched its efficiency plan aimed at improving internal processes, simplifying the organization and streamlining costs. The company has so far implemented the plan in certain business functions and achieved €70 million of cost efficiencies, incurring about €20 million of nonrecurring costs. We expect the company to further reduce its costs as the plan is deployed across the rest of the organization. Moreover, the geographic mix in Idemia's order backlog has shifted toward typically higher-margin jurisdictions, such as Europe, North America, and Japan. Also, as banks, fintech firms, telecom operators, and automotive manufacturers are increasingly digitalizing, Idemia will benefit from selling higher-margin digital and more sophisticated products, further supporting its ability to pass on inflation costs to customers. In the government segment, the majority of contracts are indexed while in the enterprise solutions segment, the company has short-term contracts (mostly for three months), which are renewed on a recurring basis. Idemia has so far successfully managed to increase prices at contract renewals. As a consequence of Idemia's cost-reduction initiatives and favorable product and geographic mix, we forecast an improvement of EBITDA margins to 17%-18% in 2022, the highest level since 2012.

### Idemia France SAS--Profitability And Cash Flow Trajectory



Source: S&P Global Ratings.

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**We have revised upward our FOCF forecast for 2022-2023.** After several years of generating negative FOCF, Idemia's reported FOCF after lease payments turned positive in 2021, supported by a €69.4 million working capital inflow. We expect this positive trend to continue in 2022-2023, with about €100 million-€150 million of annual FOCF after leases, compared with our previous expectation of €20 million-€60 million. The main driver for the improvement is the supportive business environment, improving profitability, and moderate capex of 6%-7% of revenue. Despite the global shortage of chipsets, Idemia was able to secure all its chip needs and passed the increased cost of the components on to its customers. Unlike its smaller competitors, Idemia designs most of its own chips, which allows it to go straight to the source suppliers and secure the requested products for its clients. The supply chain could still face challenges in 2023, but we expect the situation will gradually improve and Idemia will continue to secure its supply and maintain a solid profitability margin.

## **Outlook**

The stable outlook reflects our view that Idemia will capitalize on the market tailwinds in both enterprise and government solutions, leading to revenue growth of 18%-19% in 2022 followed by 3%-5% growth in 2023, coupled with improved EBITDA margins of 17-18%, leading to solid reported FOCF after leases of €100 million-€150 million per year and leverage of close to 5.0x.

## **Downside scenario**

We could lower the rating if Idemia's leverage increased beyond 6.5x and FOCF to debt declined and stayed below 5% for a prolonged period. This may occur if Idemia materially underperforms our base case due to major competitive setbacks in key segments or if it fails to capitalize on market trends. It could also occur if the company adopts a more aggressive financial policy, with debt-funded acquisitions or dividend distributions, for example.

## **Upside scenario**

We could raise the rating if FOCF to debt exceeds 10%, while adjusted leverage sustainably remains below 5.5x. This would result from Idemia's revenue and profitability improving beyond our expectations, likely thanks to favorable market trends and improved market positions in its key operating segments, alongside a financial policy in line with those credit metrics.

## **Company Description**

Idemia is a global leader in the identification and security market for both government solutions and secure enterprise transactions. In 2021, Idemia generated €2.2 billion of revenue and €396 million in EBITDA (including non-recurring costs).

## **Our Base-Case Scenario**

### **Assumptions**

- Real GDP growth of 0%-3% in the main operating countries in 2022-2023.

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- Revenue growth of 18%-19% in 2022 and 3%-5% in 2023 supported by growth both in the SET and government solutions segments.
- An adjusted EBITDA margin of 17%-19% in 2022-2023, supported by operating efficiencies, sales of higher-margin products in the enterprise segment and a favorable geographic mix, partly offset by still substantial restructuring expenses of about €25 million per year during 2022-2023.
- Negative €50 million working capital in 2022, reversing the €69 million working capital inflow in 2021 that resulted from favorable supplier terms against the backdrop of COVID-19 and optimized inventory management. From 2023, we anticipate neutral working capital changes.
- Annual capex of €170 million-€180 million in 2022-2023, including capitalized research and development (R&D) costs of about €55 million-€60 million.
- Annual cash interest expense of €110 million-€120 million.
- Dividends of about €5 million and no significant mergers or acquisitions.

## Key metrics

### Idemia France SAS--Key Metrics

Mil. €	--Fiscal year ended Dec. 31--			
	2020a	2022a	2022f	2023f
Revenue (constant currency)	2,176	2,220	2,600-2,700	2,700-2,800
S&P Global Ratings-adjusted EBITDA margin (%)	12.3	13.9	17-18	17-19
Non-recurring costs	(36.0)	(33)	(25)	(25)
S&P Global Ratings-adjusted debt to EBITDA (x)	9.7	7.3	4.5-5.5	4.5-5.5
Reported FOCF after lease payments	(57.0)	79	80-110	100-200
FOCF/debt (%)	(1.1)	3.8	5-6	7-9

a--Actual. f--Forecast. FOCF--Free operating cash flow.

## Liquidity

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 because of Idemia's challenging and volatile operating environment.

We expect the following principal liquidity sources in the 12 months started Oct. 1, 2022:

- Cash balances and short-term investments of about €237 million.
- A €300 million fully undrawn revolving credit facility (RCF) maturing in 2025.
- Reported funds from operations of €300 million-€350 million.

We expect the following principal liquidity uses:

- Regular debt amortization of about €6 million (no large debt maturity in the next 12 months).
- Intra-year seasonal peak working capital outflows of about €100 million.

- Annual capex, including capitalized R&D costs, of €170 million-€180 million.
- Annual dividend of €4 million-€5 million.

## **Covenants**

There is a springing covenant on the RCF stipulating maximum consolidated senior secured net leverage of 7.8x. Although the company would have ample headroom, given its reported net leverage of 3.5x as of the end of third-quarter 2022, the covenant is untested since the RCF is undrawn.

## **Issue Ratings--Recovery Analysis**

### **Key analytical factors**

- The rating on the existing senior secured debt is 'B', in line with the ICR. The recovery rating, unchanged at '3', reflect our expectation of about 60% recovery in a default scenario. Recovery prospects remain supported by limited prior-ranking liabilities except for senior secured debt, including the term loan B and 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 for the senior secured debt as issuer friendly in terms of credit protection and is in line with the previous offer. There is no maintenance covenant on the senior secured debt, but there is a springing covenant on the RCF stipulating maximum consolidated senior secured net leverage of 7.8x. The covenant is tested when more than 35% of the RCF is drawn.
- Restrictions on additional debt are subject to incurrence-based covenants stipulating maximum consolidated senior secured net leverage of 4.5x and fixed-charge coverage of 2.0x. The documentation has several other issuer-friendly features, including sizable debt baskets and restricted payment carve-outs.
- In our hypothetical default scenario, we assume operating underperformance resulting from a deterioration in the smart card market, weaker revenue growth in the new identity and security segments, and a potential loss of customers due to increasing competition from better-capitalized competitors.
- 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: 2025
- Minimum capex (percentage of next two years' average sales): 4% (excluding capitalized R&D)
- Cyclicity adjustment factor: +10% (standard sector assumption)
- Operational adjustment factor: -5%

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- Emergence EBITDA after recovery adjustments: About €280 million
- Implied enterprise value multiple: 6.0x
- Jurisdiction: France

### Simplified waterfall

- Gross enterprise value at default: about €1.68 billion
- Administrative costs: 5%
- Net value available to debtors: €1.6 billion
- Priority claims [1]: about €50 million
- Secured debt claims [1]: about €2.4 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

- 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: Neutral (no impact)

### ESG credit indicators: E-2, S-2, G-3 Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

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- 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
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Upgraded

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

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