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Research Update:

Enjoy S.A. Upgraded To Preliminary 'CCC+' From 'D' On Bond Exchange, New Debt Rated Preliminary 'CCC+', Outlook Stable

October 1, 2020

Rating Action Overview

- Chilean casino operator Enjoy S.A. has completed the exchange of its bonds due 2022 for new bonds of $210 million due 2027.
- On Oct. 1, 2020, S&P Global Ratings raised its long-term issuer credit rating to preliminary 'CCC+' from 'D'. At the same time, we assigned a preliminary 'CCC+' issue-level rating to the new bonds. Our preliminary ratings assume the company will successfully complete the exchange of its local debt during the next months.
- Despite the much stronger liquidity position following the reorganizational plan and the improved capital structure, the rating reflects our expectation that Enjoy's revenue and EBITDA will reach the pre-pandemic levels only by 2022.
- The stable outlook indicates our expectation that Enjoy's current cash balances will be adequate to fund the free cash flow shortfall in the next 12 months as the company's results improve gradually following the casino reopenings.

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Rating Action Rationale

Restructuring plan bolstered the liquidity and capital structure. On Sept. 30, 2020, Enjoy announced it has completed the exchange of its bonds due 2022 for new bonds of $210 million due 2027. This will improved significantly the company's liquidity position, given the absence of significant debt maturities until 2027. The company has decreased its interest expenses during the next few years, given that the interest rate will drop 6% from 10.5% in the first year of the bonds' term, increasing annually and reaching 9.5% in the last year. Furthermore, Enjoy's overhaul plan included the conversion of a significant portion of unsecured debt into equity, reducing the company's leverage and strengthening its capital structure.

The main characteristics of the reorganization agreement.

- Conversion of 80% of unsecured debt into equity (convertible bonds A1 and A2);
- Extension of secured debt maturity, pushing amortization of senior secured international notes to 2027 from 2022;
- Raising new funding for Chilean peso (CLP) 50 billion (about $60 million) to ensure liquidity availability for ramping up operations and investments from the end of 2020 through 2021. This new financing will be repaid with convertible bonds D, which we expect to be converted into equity in 2022; and
- Reduce interest expenses for the next few years because of coupon reductions and debt conversion, reducing sharply cash interest in 2021 because of payment-in-kind considerations in most of the debts.

Weak operations because of the macroeconomic woes and the COVID-19 pandemic. Despite the much improved capital structure, we don't expect the company's revenue and EBITDA to recover to the pre-pandemic levels until 2022. Enjoy's properties remained closed during the second quarter of 2020, preventing revenue generation and an EBITDA loss for the quarter of CLP18.4 billion. Consequently, for the 12 months ended June 2020, revenue had fallen 20.8% and EBITDA 79% compared to the same period in 2019. As a result, although the company should have some comfort in terms of cash interest coverage metrics and wouldn't face any large debt amortization (only some leases in 2021 for CLP14 billion) until 2027, we expect weak credit metrics. Therefore, we believe that Enjoy's financial obligations could become unsustainable in the long term if the business recovery is weaker than the company's expectations.

License renewals may result in significant cash outflows. Enjoy faces considerable investments because of the municipal license renewals during the next 2-2.5 years, which will probably result in negative free operating cash flows through 2022. The company is currently renewing three casino licenses and applying for a new one, but given the sharp economic and industry downturn, Enjoy and other operators have requested the regulator to extend the renewal timeframe. According to the current terms, some of the licenses should be active by year-end. The government recently stated that the licenses will be extended at least by the time that the casinos remained closed due to the pandemic. In addition, Enjoy estimates it will get at least an additional 12-month extension.

Asset sales may improve leverage metrics during the next few years. We're excluding asset sales from our base-case scenario given uncertainties over value and timing, but we believe the company could sell some of its real estate assets during 2021 and 2022. The additional proceeds could accelerate debt reduction and further improve the company's capital structure.

Outlook

The stable outlook reflects our expectation that current cash balances will be adequate to fund negative free cash flows in the next 12 months amid the company's gradually improving results following casino reopenings. The outlook also reflects our view that the company will maintain cash interest coverage of above 3x because most of interest expenses will be capitalized during 2021.

Downside scenario

We could lower the rating to 'CCC' if we believe the company were likely to default or file for liquidation in the next 12 months. A liquidity crisis could stem from inability to reopen casinos and hotels for several months, resulting in a much steeper-than-expected cash burn, leading to wider free cash flow deficits, failure to complete investments as required by the license renewals, and cash interest coverage below 1x.

Upside scenario

We could raise the rating to 'B-' if the company is successful in reopening its casinos and pursing its business plans, enabling the leverage metric drop below 6.0x and start generating sustainably positive free cash flows once investments for municipal licenses are completed. In such a scenario, we expect moderate, but consistent, revenue growth.

Company Description

Enjoy is the second-largest Chilean gaming operator, with a 37.6% market share as of the end of 2019. It owns and operates casinos and related hospitality and entertainment facilities including hotels, restaurants, bars, convention centers, and spas, among others. Enjoy owns and operates 10 casinos and 11 hotels in Chile, Argentina, and Uruguay.

Our Base-Case Scenario

Assumptions

- Revenue to decrease 50%-55% in 2020. The company had reported healthy results during first quarter of 2020 with a strong recovery in Uruguay. However, the COVID-19 outbreak forced Enjoy to close all of its properties in late March. We're assuming the company will only start to gradually reopen the casinos and hotels in October.
- A sound recovery in 2021, but with a weak performance in the first quarter, which is historically the strongest quarter for the company. Revenue to be 20%-25% lower than in 2019.
- Revenue to reach the pre-pandemic level in 2022, which we consider as a conservative forecast because Enjoy will operate new casinos in Pucon and the Los Angeles and San Antonio casinos, which the company only consolidated on its balance sheet by mid-2019.
- EBITDA to contract in 2020, although the company reduced costs and expenses significantly during the closure months.
- Given weak revenue, very low margins in 2021 and stronger ones in 2022. However, we expect longer-term EBITDA margins to be below historical levels, mostly because following the license renewals, taxes will increase considerably. As of 2018, taxes represented about 63% of costs, and the company expects this metric to increase to 71%.
- The license renewals costs of about $120 million for the next four years and maintenance capex of about 3.5% of revenues. In line with company's plans, we assume minimal capex this year, given Enjoy's expectations that the license renewals will be extended for at least 12 months.

- The capital structure will consist of higher debt in 2020 because of the new financing for CLP50 billion, the exchange rate impact on the international bond and interest capitalization; all convertible bonds A1 and A2 are converted into equity in 2021; most of the interests are capitalized; the convertible bonds D are 100% converted into equity in 2022.
- We are not including asset sales in our forecast.
- According to management guidance, no dividend or tax payments in the next couple of years. During 2020 the company received a tax reimbursement.

Key metrics

- Adjusted EBITDA margin contraction of 15%-20% in 2020, rising to 5%-10% in 2021, and 15%-17% in 2022.
- Funds from operations (FFO) to debt of -5% to -10% in 2020, 0%-6% in 2021, and 10%-12% in 2022.
- Debt to EBITDA of 25x-30x in 2021 due to still small EBITDA, and significantly improving to 6x-7x by 2022.

- EBITDA interest coverage of 3.4x-3.6x in 2021 and 2022.

Liquidity

We assess Enjoy's liquidity as less than adequate. This is because even though following the reorganization and new funding, the company's liquidity ratio will be satisfactory for the next 12 months, the weak cash FFO for the next 24 months and the considerable capex will rapidly erode the metric. We don't believe Enjoy would have the ability to absorb low-probability adversities without refinancing, and we believe access to refinancing could be limited. However, the company doesn't have to comply with any payment acceleration financial covenants until 2024 and has no substantial amortization until 2027 when international bond comes due.

Principal Liquidity Sources

- Total cash and equivalents for CLP50.6 billion as of June 2020; and
- New financing for CLP50 billion.

Principal Liquidity Uses

- Short-term maturities for CLP4.8 billion as of June 2020;
- Negative cash FFO after operational leases payments of about CLP15 billion in the next 12 months;
- Working capital needs for about CLP8 billion in the next 12 months; and
- Capex of CLP18 billion - CLP20 billion for the next 12 months.

Covenants

The International bond does not include payment acceleration covenants; financial covenants will post limitation on incurrence of additional indebtedness.

The financial covenants are defined as follows:

- The consolidated fixed charge coverage ratio shall be greater than 2.0x; and
- The net debt to EBITDA shall not exceed 4.5x

Additionally the notes include limitations on restricted payments, asset sales, events of license loss, limitation on dividend payments and transactions with affiliates.

Following the debt exchange, the local bonds (Bono Renta Fija B), the remaining 20% in unsecured debt would have the payment acceleration financial covenants starting in March 2024:

- Net debt to EBITDA of maximum of 6.5x between March 2024 and December 2025;
- Net debt to EBITDA of maximum of 6x between March 2026 and December 2026;
- Net debt to EBITDA of maximum of 5.5x between March 2027 and December 2027;
- Net debt to EBITDA of maximum of 5.0x between March 2028 and December 2028; and
- Net debt to EBITDA of maximum of 4.5x as of March 2029.

Compliance

We believe the company will comply with the covenants during the next few years.

Issue Ratings - Subordination Risk Analysis

Capital structure

- CLP165 billion in international secured bonds, of which 92% related to senior tranche A and 8% to junior tranche B;
- CLP36 billion in an unsecured domestic bond (bono Renta Fija B); and
- CLP50 billion in unsecured debt.

Analytical conclusions

The new bond will have two tranches: tranche A (senior) of $193.7 million and tranche B (junior) of $16.8 million. Although the tranche B is junior to tranche A, we assigned the 'CCC+' rating based on the security package of the bonds which includes mortgages on real estate assets and pledge on common stock of operating subsidiaries. We rate Enjoy's senior secured bonds at the same level as the issuer credit rating, given that we believe this debt is better positioned than unsecured debt because of the additional protection that the security provides.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March

28, 2018

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

CreditWatch/Outlook Action

	To	From
Enjoy S.A.		
Issuer Credit Rating	CCC+(prelim)/Stable/--	D/--/--
Enjoy S.A.		
Senior Secured	NR	D
New Rating		
Enjoy S.A.		
Senior Secured	CCC+(prelim)	