

# Codere

Q319 results

## Moving on from accounting irregularities

Q319 results were dominated by previously announced accounting irregularities in the Mexico, Panama and Colombia divisions. These have been confirmed as one off and confined to H119 but, as a direct result, management has lowered FY19 EBITDA guidance by c €10m to €250–255m (pre-IFRS 16). As a positive, the Spanish division is developing strongly, with encouraging momentum in online. Codere's focus is now on refinancing the senior notes and rebuilding trust with the investment community. We have lowered our FY19 EBITDA by 8.7% and our FY20 EBITDA by 8.0%. The stock is very illiquid and trades at 4.2x EV/EBITDA for FY20e, which is at a deep discount to peers.

Year end	Revenue (€m)	Adjusted EBITDA** (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/17	1,638.2	273.5	0.01	0.0	N/A	N/A
12/18	1,476.4	282.9	0.48	0.0	6.3	N/A
12/19e***	1,406.7	321.8	(0.19)	0.0	N/A	N/A
12/20e***	1,443.9	338.8	(0.09)	0.0	N/A	N/A

Note: \*EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. \*\*Adjusted EBITDA excludes non-recurring items. \*\*\*Includes IFRS 16 adjustments; FY19 EBITDA is c €70m higher due to IFRS 16.

## FY19 EBITDA guidance lowered by c €10m

Codere has restated H119 results, with EBITDA reduced by €16.5m (€14.5m from Mexico, €1.3m in Colombia and €0.4m in Panama) and has lowered its pre IFRS 16 FY19 EBITDA guidance by c €10m (€250–255m from €260–270m in October). This compares to initial guidance of €280–290m. At end Q319, Mexico comprised 22% of revenues and 30% of EBITDA. We have lowered our Mexican revenues by 8.0% and our Mexican FY19 EBITDA goes from €161.3m to €126.6m (c €90m pre IFRS 16). Altogether we are lowering our group FY19 revenues by 1.4% and our adjusted EBITDA goes from €352.4m to €321.8m, which is in line with company guidance (€70m higher due to IFRS 16 accounting changes).

## Focus on refinancing during H120

At the end of Q319, Codere reported net debt of €1,078m, which equates to a net debt/adjusted LTM EBITDA of 3.2x (or 3.1x before IFRS 16 adjustments). The company posted a small net cash outflow for 9M19 (including FX variations) and we now forecast a net cash outflow of €10.6m for FY19 (rather than a positive inflow previously). We expect Codere to focus on refinancing its €792m senior notes during H120.

## Valuation: Illiquid, at deep discount for EV/EBITDA

As a result of a restrictive shareholders' agreement, Codere's stock is highly illiquid and trades at 4.2x EV/EBITDA for FY20, which is a deep discount to peers. Catalysts include stabilisation in Argentina, a return to confidence in Mexican growth, demonstrable net cash flow, successful debt refinancing and a resolution of the complex shareholders' agreement (which includes a possible share placing).

## Travel & leisure

18 November 2019

Price **€3.00**

Market cap **€356m**

Adjusted net debt (post IFRS 16) (€m) at 30 September 2019 1,078

Shares in issue 118.5m

Free float 5%

Code CDR

Primary exchange IGBM

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs (2.1) (2.7) (23.7)

Rel (local) (1.3) (9.6) (24.3)

52-week high/low €4.4 €2.9

## Business description

Codere is an international gaming company that manages c 57,000 gaming machines, 30,000 bingo seats and 7,600 sports betting terminals across Latin America, Spain and Italy. It was founded in 1980, listed in 2007 and completed a successful debt for equity swap in 2016.

## Next events

FY19 results March 2020

## Analysts

Victoria Pease +44 (0)20 3077 5740

Richard Williamson +44 (0)20 3077 5700

[gaming@edisongroup.com](mailto:gaming@edisongroup.com)

[Edison profile page](#)

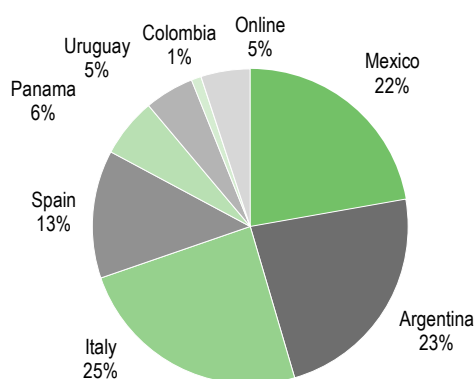
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## Mexican pressures lead to weaker Q319

### Results highlights

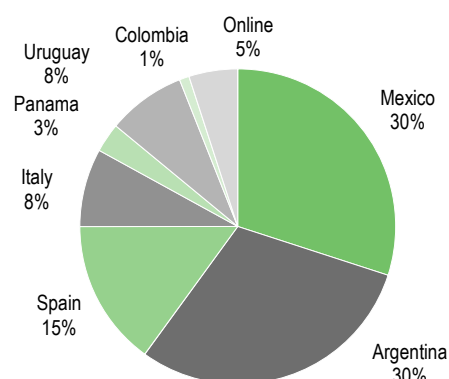
- **9M19 revenue declined by 6.3% to €1,045.3m**, mostly due to the devaluation of the Argentine peso (€83.6m lower revenues from Argentina) and was lower than our forecasts due to Mexican accounting irregularities. Positive momentum was achieved in Online, Spain, Italy and Uruguay. It is important to note that Mexican revenues were particularly weak in Q319, falling by 6.5% to €75.9m, as management was focusing on mitigating damage and implementing organisational changes and therefore this is not likely to be a run-rate level going forward.
- **9M19 adjusted EBITDA declined from €203.6m to €184.4m (pre IFRS 16)**, again largely due to the devaluation of the Argentine peso, increased taxes and accounting irregularities in Mexico, Colombia and Panama (see below for more details). Adjusted EBITDA (post-IFRS 16) was €237.2m. Q319 pre IFRS 16 EBITDA from Mexico was €19.8m vs €24.8m in the previous year. As above, we believe this is lower than the run-rate, given the focus on provisions and organisational changes in the period.
- **Net cash flow breakeven (prior to FX):** For 9M19 Codere generated operating cash flow of €122.3m, with FCF of €83.4m (prior to €37.3m interest payments, €20.2m growth capex and €16.9m of deferred capex). Net cash flow (excluding repayment of financial debt and FX variations) was €4.3m.
- **Increasing gaming capacity:** The total number of slots increased 0.7% to 56,617 in 9M19, mainly driven by growth in Mexico. In terms of venues, gaming halls increased from 144 to 150.

Exhibit 1: Q319 revenue split



Source: Codere

Exhibit 2: Q319 adjusted EBITDA split



Source: Codere

### Accounting irregularities

As announced in October, Codere has detected inconsistencies in the financial reporting of some of its Latam subsidiaries during 2019 (Mexico, Colombia and Panama). These inconsistencies were intentional, coordinated in Mexico by a small group of individuals and performed through inappropriately inflating revenue and delaying costs recognition. Codere has subsequently introduced organisational changes and reinforced internal controls to strengthen operational systems and enhance accounting and reporting robustness. Codere has restated H119 results, with EBITDA lowered by €16.5m (€14.5m from Mexico, €1.3m in Colombia and €0.4m in Panama). Furthermore, management has lowered its pre IFRS 16 FY19 EBITDA guidance by c €10m (€250–255m from €260–270m in October and €280–290m initially).

### **Net debt/LTM EBITDA of 3.1x**

At Q319, Codere reported net debt of €1,078m, which equates to a net debt/adjusted LTM EBITDA of 3.2x (or 3.1x before IFRS 16 adjustments). Despite the lower EBITDA, this remains well within banking covenants (based on pre IFRS 16) and Codere has sufficient funds to service the debt, with comfortable interest service ratios. Within this amount, Codere had €90.5m cash and €138.1m liquidity (including liquidity from the credit facility).

We expect the company to refinance the €792m senior notes in the near term (H120) and note that licence renewals are due in Argentina and Italy in the years 2021–24 (c €60–80m), although refinancing terms may be affected by Moody's and S&P's recent ratings and outlook changes. In October, S&P assigned a B- rating with negative outlook to the company and its senior secured notes. Prior to the announcement regarding accounting irregularities, Moody's changed the Codere Corporate Family Rating from B2 to B3 and Probability of Default Rating from B2-PD to B3-PD, with the outlook maintained as stable. At the same time, Moody's also changed the rating on the senior secured notes B2 to B3, with the outlook maintained as stable.

In terms of Argentina, we note that Codere has a long history of managing Argentine FX and inflation fluctuations, including capital controls. As an example, at Q319, more than 95% of cash to be repatriated in 2019 was already in Madrid.

## **Estimate changes**

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### **Lowering estimates largely due to Mexico**

We have lowered our FY19 revenue forecast by 1.4% to €1406.7m, largely on the back of Mexican accounting irregularities. Q319 Mexican results were affected by the need for damage limitation and we are forecasting a small uptick in Mexican revenues for Q419, retuning to mid-single digit growth thereafter as the opening of new halls contributes to growth.

Our EBITDA goes from €352.4m to €321.8m, which is in line with company guidance. Our Mexican FY19 EBITDA goes from €161.3m to €126.6m (which equates to c €90m pre IFRS 16).

Our summary divisional table and estimate changes are below:

**Exhibit 3: Summary income statement (€m)**

	2014	2015	2016	2017	2018	2019e	2020e	2021e
Mexico	342	355	330	340	328	317	333	349
Argentina	489	682	535	582	408	308	271	298
Spain	150	156	170	188	220	196	225	259
Italy	264	284	322	336	337	349	361	372
Other	141	162	190	192	184	238	254	269
<b>Revenue</b>	<b>1,386</b>	<b>1,640</b>	<b>1,546</b>	<b>1,638</b>	<b>1,476</b>	<b>1,407</b>	<b>1,444</b>	<b>1,547</b>
growth	0%	18%	-6%	6%	-10%	-5%	3%	7%
Gaming taxes	(469)	(572)	(551)	(597)	(528)	(499)	(517)	(560)
Gross profit	871	1,018	947	986	896	855	874	930
One-off items	(67)	(34)	(52)	(29)	(53)	(37)	(10)	(10)
<b>Adjusted EBITDA</b>	<b>213</b>	<b>280</b>	<b>268</b>	<b>274</b>	<b>283</b>	<b>322</b>	<b>339</b>	<b>371</b>
margin	15%	17%	17%	17%	19%	23%	23%	24%
Mexico	75	92	89	93	106	127	143	151
Argentina	93	146	131	134	96	75	64	70
Spain	18	25	30	25	26	48	60	76
Italy	29	27	26	24	28	28	28	30
Other	19	14	23	28	40	57	58	60
Corporate costs	(21)	(23)	(31)	(30)	(13)	(12)	(14)	(16)
<b>Adjusted EBITDA</b>	<b>213</b>	<b>280</b>	<b>268</b>	<b>274</b>	<b>283</b>	<b>322</b>	<b>339</b>	<b>371</b>
Normalised operating income (pre inflation adj)	88	158	160	161	169	136	151	182
Inflation Adjustment	0	0	0	0	(20)	(17)	(5)	0
Operating income (post inflation adj)	21	125	108	131	97	83	136	172
Net finance costs	(129)	(132)	(129)	(64)	(67)	(113)	(113)	(109)
Associates & joint ventures (post-tax share)	3	3	(0)	(0)	(0)	(0)	(0)	(0)
One-off items	(61)	(72)	(1,096)	17	(33)	(19)	0	0
<b>Normalised PBT</b>	<b>(39)</b>	<b>29</b>	<b>31</b>	<b>96</b>	<b>102</b>	<b>24</b>	<b>38</b>	<b>72</b>
PBT	(167)	(76)	(1,116)	84	(3)	(49)	23	62
Tax	(41)	(63)	(37)	(64)	(30)	(38)	(40)	(43)
Normalised profit after tax	(5)	32	(5)	32	63	(14)	(2)	30
Profit after tax	(208)	(139)	(1,153)	20	(34)	(87)	(17)	20
Minority Interest	35	26	31	(17)	(7)	(8)	(9)	(10)
Net income for equity	(173)	(113)	(1,122)	3	(40)	(94)	(26)	10

Source: Codere, Edison Investment Research. Note: Online is included in other operations from FY19 onwards. EBITDA is post IFRS 16 from FY19 onwards.

**Exhibit 4: Estimate changes**

	Revenue (€m)			EBITDA (€m)			EPS (€)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2019e	1426.2	1406.7	(1.4)	352.4	321.8	(8.7)	0.20	(0.19)	NM
2020e	1472.8	1443.9	(1.9)	368.4	338.8	(8.0)	0.26	(0.09)	NM
2021e	1577.4	1546.9	(1.9)	403.7	371.0	(8.1)	0.55	0.17	(69.1)

Source: Edison Investment Research

**Exhibit 5: Financial summary**

	€m	2015	2016	2017	2018	2019e	2020e	2021e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>								
Revenue		1,639.5	1,545.8	1,638.2	1,476.4	1,406.7	1,443.9	1,546.9
Cost of Sales		(621.7)	(599.3)	(651.8)	(580.9)	(551.7)	(570.3)	(617.0)
Gross Profit		1,017.8	946.5	986.4	895.5	855.0	873.6	929.9
Adjusted EBITDA		280.1	267.7	273.5	282.9	321.8	338.8	371.0
Normalised operating profit		158.1	159.7	160.5	169.0	136.5	151.5	181.7
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals, including inflation accounting		(33.6)	(51.5)	(29.4)	(72.2)	(53.6)	(15.0)	(10.0)
Share-based payments		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit		124.5	108.2	131.1	96.9	82.9	136.5	171.7
Net Interest		(131.7)	(128.5)	(64.2)	(67.2)	(112.5)	(113.2)	(109.1)
Joint ventures & associates (post tax)		2.7	(0.2)	(0.1)	(0.1)	(0.3)	(0.3)	(0.3)
Exceptionals		(71.7)	(1,095.9)	17.2	(32.7)	(18.7)	0.0	0.0
Profit Before Tax (norm)		29.1	31.0	96.2	101.7	23.7	38.0	72.2
Profit Before Tax (reported)		(76.2)	(1,116.4)	83.9	(3.1)	(48.6)	23.0	62.2
Reported tax		(63.2)	(36.5)	(64.2)	(30.4)	(38.0)	(40.0)	(42.6)
Profit After Tax (norm)		(34.1)	(5.5)	32.0	63.3	(14.3)	(2.1)	29.6
Profit After Tax (reported)		(139.4)	(1,152.9)	19.8	(33.6)	(86.6)	(17.1)	19.6
Minority interests		26.3	31.2	(17.0)	(6.8)	(7.8)	(8.8)	(9.8)
Discontinued operations		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)		(7.8)	25.7	15.0	56.5	(22.1)	(10.9)	19.8
Net income (reported)		(113.1)	(1,121.7)	2.8	(40.4)	(94.4)	(25.9)	9.8
Basic average number of shares outstanding (m)		55	1,879	2,254	119	119	119	119
EPS - basic normalised (€)		(0.14)	0.01	0.01	0.48	(0.19)	(0.09)	0.17
EPS - diluted normalised (€)		(0.14)	0.01	0.01	0.48	(0.19)	(0.09)	0.17
EPS - basic reported (€)		(2.07)	(0.60)	0.00	(0.34)	(0.80)	(0.22)	0.08
Dividend (€)		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)		18.3	(-5.7)	6.0	(-9.9)	(-4.7)	2.6	7.1
Gross Margin (%)		62.1	61.2	60.2	60.7	60.8	60.5	60.1
Adjusted EBITDA Margin (%)		17.1	17.3	16.7	19.2	22.9	23.5	24.0
Normalised Operating Margin		9.6	10.3	9.8	11.4	9.7	10.5	11.7
<b>BALANCE SHEET</b>								
Fixed Assets		1,069.9	1,051.4	988.8	1,137.1	1,356.5	1,286.2	1,232.9
Intangible Assets		606.9	566.8	528.2	613.1	599.6	587.2	577.6
Tangible Assets		385.0	414.4	388.9	453.6	684.1	626.2	582.5
Investments & other		77.9	70.2	71.8	70.4	72.8	72.8	72.8
Current Assets		371.2	428.1	346.8	307.5	309.6	297.6	304.6
Stocks		11.6	11.4	10.0	10.9	11.0	11.0	11.0
Debtors and taxes receivable		188.4	209.3	178.3	163.6	158.6	153.6	148.6
Cash & cash equivalents		110.3	142.1	104.5	81.8	85.0	78.0	90.0
Other		60.9	65.3	54.0	51.2	55.0	55.0	55.0
Current Liabilities		(1,807.3)	(408.7)	(384.2)	(388.4)	(445.0)	(420.0)	(415.0)
Creditors		(338.5)	(160.2)	(158.4)	(169.6)	(144.6)	(119.6)	(114.6)
Tax and social security		(35.6)	(198.7)	(158.7)	(147.9)	(147.9)	(147.9)	(147.9)
Short term borrowings		(1,423.7)	(40.0)	(58.0)	(60.4)	(142.0)	(142.0)	(142.0)
Other		(9.4)	(9.8)	(9.1)	(10.5)	(10.5)	(10.5)	(10.5)
Long Term Liabilities		(249.6)	(997.1)	(946.5)	(964.0)	(1,186.0)	(1,156.0)	(1,106.0)
Long term borrowings		(76.4)	(840.1)	(795.1)	(803.1)	(1,025.1)	(995.1)	(945.1)
Other long term liabilities		(173.2)	(157.0)	(151.4)	(160.9)	(160.9)	(160.9)	(160.9)
Net Assets		(615.8)	73.7	5.0	92.2	35.1	7.8	16.5
Minority interests		6.3	24.8	(83.8)	(83.4)	(85.0)	(85.0)	(85.0)
Shareholders' equity		(609.5)	98.5	(78.8)	8.8	(49.9)	(77.2)	(68.5)
<b>CASH FLOW</b>								
Op Cash Flow before WC and tax		280.1	267.7	273.5	282.9	251.8	268.8	301.0
Working capital		(8.3)	18.9	(13.8)	(4.8)	(30.0)	(30.0)	(10.0)
Exceptional & other		(21.8)	(59.6)	(21.3)	(43.5)	(37.6)	(15.0)	(10.0)
Tax		(43.2)	(48.8)	(70.9)	(51.8)	(38.0)	(40.0)	(42.6)
Net operating cash flow		206.8	178.2	167.5	182.8	146.2	183.7	238.4
Maintenance capex		(47.0)	(80.4)	(87.1)	(82.1)	(68.0)	(68.0)	(73.0)
Growth capex inc acquisitions		(18.9)	(47.0)	(61.6)	(81.2)	(20.0)	(20.0)	(29.0)
Net interest		(31.0)	(77.8)	(67.7)	(67.1)	(60.5)	(63.2)	(64.1)
Equity financing		0.1	0.0	2.1	(0.4)	0.0	0.0	0.0
Dividends		(2.4)	(4.6)	(5.8)	(7.5)	(8.3)	(9.1)	(10.0)
Other		(47.2)	(21.6)	14.4	46.2	0.0	0.0	0.0
Net Cash Flow		60.4	(53.2)	(38.2)	(9.3)	(10.6)	23.5	62.3
Opening net debt/(cash)		1,305.5	1,389.8	738.1	748.6	781.6	1,081.8	1,058.3
FX (cash balance)		(8.9)	0.0	(10.3)	(8.3)	(3.0)	0.0	0.0
Other non-cash movements (inc equity swap, FX on debt)		(135.8)	704.9	37.9	(15.4)	(286.6)	0.0	0.0
Closing net debt/(cash)		1,389.8	738.1	748.6	781.6	1,081.8	1,058.3	996.0

Source: Codere, Edison Investment Research

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Frankfurt +49 (0)69 78 8076 960  
Schumannstrasse 34b  
60325 Frankfurt  
Germany

London +44 (0)20 3077 5700  
280 High Holborn  
London, WC1V 7EE  
United Kingdom

New York +1 646 653 7026  
1,185 Avenue of the Americas  
3rd Floor, New York, NY 10036  
United States of America

Sydney +61 (0)2 8249 8342  
Level 4, Office 1205  
95 Pitt Street, Sydney  
NSW 2000, Australia