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Research Update:

Kuwait Projects Co. (Holding) 'BBB-/A-3' Ratings Affirmed; Outlook Remains Negative On Continued Weak Performance By OSN

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Rating Action Overview

- We expect the reported loan-to-value (LTV) ratio of Kuwait Projects Co. (Holding) K.S.C. (KIPCO) to improve to below 30% once the company completes its recently announced rights offering in 2019.
- However, despite the capital increase, the LTV ratio remains under pressure due to the underperformance of some of KIPCO's key assets, particularly Panther Media Group Ltd. (OSN), which has been posting losses since 2016.
- While KIPCO is working on a turnaround and expects OSN to return to profitability in 2020, it is also actively looking for a buyer or new strategic partner for OSN.
- Given OSN's underperformance, we have questions about its reported valuation, and if its performance does not improve materially over the next 12 months, we could apply a further haircut to OSN's value. If by that time, KIPCO still holds a material stake at OSN, the haircut would trigger a material increase in KIPCO's LTV ratio.
- We are consequently affirming our 'BBB-/A-3' global scale and 'gcAA-' Gulf Cooperation Council regional scale issuer credit ratings on KIPCO, and keeping the outlook negative.
- The negative outlook points to continued rating pressure in 2019 due to the performance issues at OSN, and the potential for the LTV ratio to move above 30% if we were to apply further haircuts to the value of certain assets.

Rating Action Rationale

The affirmation follows KIPCO's announcement, on Jan. 31, 2019, that it is looking to raise additional capital via a rights offering before the end of July 2019. As per our calculations, using the stock prices of KIPCO's listed assets as of Dec. 31, 2018, KIPCO had a loan-to-value (LTV) ratio of around 34% at year-end 2018. Including the rights offering, which we assume will be around Kuwaiti dinar (KWD) 100 million ($330 million), we expect that KIPCO's LTV ratio will return to around 25%, which we view as commensurate with the rating.

We understand that KIPCO has already received the full support of its key shareholder, Al Futtooh Holding Co. K.S.C. (AFH), for the rights offering, and we expect the company to complete this transaction on a timely basis. We view the rights offering as a strong commitment from the owner to KIPCO's financial policy. Following the injection, we expect that KIPCO's S&P Global Ratings-adjusted debt will decrease to $869 million from $1.2 billion.

In the short term, the rights offering offsets the weakening of KIPCO's credit profile stemming from the weak operating performance of some of its assets, notably Panther Media Group Ltd. (OSN). However, we believe that the average credit profile of the investment portfolio continued to weaken over 2018, and any further weakening could lead us to reassess KIPCO's investment position and downgrade the company to 'BB+'. We now assess the average creditworthiness of KIPCO's portfolio to be at the low end of the 'bb' rating category.

While the rights offering brings much needed and timely relief, we still believe that the LTV ratio remains under pressure over the next 12–24 months. There are two reasons for our view.

First, one of KIPCO's key assets is OSN. KIPCO values its 60.5% stake in this unlisted company at $913 million, which represents around 25.9% of KIPCO's reported portfolio value at year-end 2018. This valuation dates from 2009 and KIPCO has not adjusted it since then. While OSN was a very profitable asset up until 2016, it has been posting losses since then.

KIPCO started taking measures to improve OSN's profitability in 2018, including the appointment of a new CEO, and a detailed review of its key cost items. A gradual decline in OSN's cost base should therefore be visible over the next 12 months. At the same time, OSN is actively working on recovering some of the clients and revenues it has lost in Saudi Arabia over the past two years.

While KIPCO expects OSN to return to profitability in 2020, it also classified OSN as held for sale in November 2018. KIPCO's management is open to fully exiting OSN provided it gets a price that matches its internal target. Alternatively, management could also bring on board a strategic partner that could help it improve OSN's performance.

The second reason for KIPCO's LTV ratio remaining under pressure is that in light of OSN's weak financial performance, we see a risk that OSN's monetization value could be lower than its current reported value.

However, if KIPCO is able to fully or partially exit OSN, even at a lower valuation than its current reported $913 million value, this could significantly improve KIPCO's LTV ratio.

Another key asset for KIPCO is United Gulf Holding (UGH), in which KIPCO has a 48.3% direct stake. While UGH is listed on the Bahrain Stock Exchange, it has a free float of less than 10% and its shares are not actively traded. Based on its Dec. 31, 2018, stock price, UGH's market capitalization is over 3.5x its tangible equity base. We do not think this premium is justified by UHG's very limited return on equity (ROE) generation.

We now apply haircuts to the valuations of both OSN and UGH, and include the expected proceeds from the planned rights offering. We estimate KIPCO's LTV ratio at slightly below 30% after these adjustments. This leaves little headroom for KIPCO in the current rating category.

Based on its reported values, and not accounting for our haircuts, we estimate that the value of KIPCO's total portfolio at year-end 2018 was about $3.53 billion. Burgan Bank, UGH, and OSN are the largest assets, with valuations of approximately $946 million, $657 million, and $913 million, respectively, on Dec. 31, 2018. Together, these entities represent around 71% of the total portfolio. The valuations stand against net debt of $869 million as of Dec. 31, 2018, incorporating expected proceeds of around $330 million from the rights offering, to be raised before July 2019.

KIPCO's cash flow adequacy ratio improved to around 0.5x in 2018 from 0.3x in 2017, and we expect it to hover at around 0.6x for the next 24 months. While this is a low level, we do not see any possible near-term risks because KIPCO has cash and liquid investments that significantly exceed the cash flow deficit.

According to management's numbers, KIPCO's cash in hand stood at $1.17 billion at year-end 2018, and this should further increase with the scheduled rights offering. KIPCO has manageable debt maturities of $731 million in 2019 and 2020, and no other debt maturity until 2023, which puts it in a very comfortable liquidity position.

We continue to view KIPCO's investment portfolio as concentrated--given its reliance on the three aforementioned entities--and this weighs on KIPCO's risk profile. We view KIPCO's portfolio liquidity as weak compared with similar rated companies, reflecting the unlisted nature of OSN, as well as small free floats and limited liquidity in the major listed assets, notably United Gulf Bank.

Given OSN's continued weak performance and UGH's limited ROE generation, we believe that the potential creditworthiness of these two assets is lower than that of KIPCO's other entities. In the meantime, we note that Gulf Insurance Group and Burgan Bank have maintained steady credit quality over the past few years, supporting KIPCO's creditworthiness.

High controlling stakes in its investees suggest that KIPCO has significant influence over their strategic decisions.

Outlook

The negative outlook reflects our view of the continued pressures on KIPCO's LTV ratio given uncertainties over the valuation of its two key assets, particularly OSN, as OSN's financial performance remains very weak. We also see risks associated with the declining creditworthiness of the portfolio. Any further weakening of the creditworthiness of the portfolio or a reassessment of the portfolio valuation could lead to a one-notch downgrade by the end of 2019.

Downside scenario

We could lower the ratings if KIPCO's LTV ratio rises above the 30% threshold, or if the creditworthiness of the portfolio continues to weaken. We believe that asset deterioration is most likely to come from OSN not being able to improve its performance. If KIPCO is unable to improve OSN's financial performance notably over the next 12 months, we could apply a larger haircut to OSN's reported valuation. If by that time KIPCO still holds a large stake at OSN, this could result in a material increase in KIPCO's LTV ratio, potentially to above 30% if the other assets have not also increased in value.

Furthermore, persistent weak performance of KIPCO's key assets--resulting in continued low dividends such that cash flow adequacy stays below 0.7x--could also trigger a one-notch downgrade. We see this latter scenario as a longer-term risk.

Upside scenario

We could revise the outlook to stable if OSN's financial performance improves substantially over the next 12 months, or if KIPCO fully or partially exits OSN on good financial terms, limiting the negative impact of OSN on KIPCO's LTV ratio and its creditworthiness.

Company Description

KIPCO is a majority-owned operating holding company of AFH--which is connected to Kuwait's ruling Al Sabah family--and we continue to expect that KIPCO will receive financial support from AFH when needed, as it has on several occasions in the past. In late 2011, for example, KIPCO received a $101 million cash injection from AFH that helped the company maintain its LTV target of 30%, while AFH is also supporting the recently announced rights offering.

Our Base-Case Scenario

In our base case for KIPCO, we assume:

- No major changes in the portfolio, other than a partial or full sale of OSN.
- A dividend inflow of around $95 million for 2019 and 2020.
- Cash receipts from the scheduled rights offering of $330 million, while KIPCO could also inject additional capital into OSN this year.
- A dividend payout of $45 million–$50 million for 2019 and 2020.

- Operating and interest costs of about $165 million-$170 million.

Based on these assumptions, we arrive at the following credit measures:
- Cash flow adequacy of 0.5x in 2018, improving slightly to 0.6x in 2019 and 2020.
- LTV ratio at or below 30%. We expect that AFH will provide further support if KIPCO's LTV ratio is sustainably above 30%.

Liquidity

We view KIPCO's liquidity as strong, based on our estimate that sources of cash should cover uses by about 3x over the 12 months from Dec. 31, 2018, and more than 1.5x over the 24 months from this date, even if dividend inflows were to shrink by 30% for any reason. KIPCO repaid $233 million in February 2019. There are no debt maturities in the next 12 months.

We believe that KIPCO manages its liquidity proactively, as it has a track record of refinancing its debt maturities in advance and extending its debt maturity profile. Most recently, in November 2018, KIPCO issued a KWD100 million ($330 million) local currency bond, which matures in 2023. Due to KIPCO's size, position, and indirect ownership by Kuwait's royal family, we believe that the company enjoys good connections with local banks. However, KIPCO's bank connections outside the local economy may not be as strong. Still, we acknowledge that the company has secured financing in international bond markets.

Principal Liquidity Sources

- Parent company cash and cash equivalents of $1.17 billion on Dec. 31, 2018;
- Undrawn committed credit lines of $66 million; and
- Dividends and fees from portfolio companies of around $95 million per year for 2019 and 2020.

Principal Liquidity Uses

- $233 million in debt maturities repaid in 2019 and $500 million in 2020. There are no debt repayments in 2021 and 2022;
- Parent company dividend payments of around $45 million–$50 million per year; and
- Operating and interest costs of about $165 million-$170 million per year.

Issue Ratings--Subordination Risk Analysis

Capital structure

KIPCO's capital structure comprises:

- About $2.38 billion of senior unsecured debt, of which $1.73 billion was issued by Kuwait Projects Co. SPC Ltd. and is guaranteed by KIPCO; and
- $656 million of local currency Kuwait bonds, also senior unsecured and issued by KIPCO.

Analytical conclusions

The issue rating on KIPCO's notes is 'BBB-', in line with the issuer credit rating, because there are no significant elements of subordination risk present in KIPCO's capital structure.

Ratings Score Snapshot

Issuer credit rating: BBB-/Negative/A-3

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Investment position: Fair

Financial risk: Intermediate

- Leverage/Cash flow: Intermediate
- Funding and capital structure: Neutral

Anchor: bb+

Modifiers

- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 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 And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Kuwait Projects Co. (Holding) K.S.C.	
Issuer Credit Rating	BBB-/Negative/A-3
Gulf Cooperation Council Regional Scale	gcAA-/--/--
Kuwait Projects Co SPC Ltd	
Senior Unsecured	BBB-
Kuwait Projects Co. (Cayman)	
Senior Unsecured	BBB-

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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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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.