Research Update:

Kuwait Projects Co. (Holding) Downgraded To 'BB+/B' And 'gcA'; Outlook Negative

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Rating Action Overview

- Kuwait Projects Co. (Holding) K.S.C. (KIPCO) is an investment holding company with substantial investments in financial services, media, and real estate across the Middle East and North Africa (MENA) region.
- Since March KIPCO has seen its loan-to-value (LTV) ratio deteriorate sharply because the price of its key listed assets has depreciated following the equity market sell-off.
- Moreover, we have increased our haircuts on two of the key assets, Middle East pay TV operator OSN and merchant banking company United Gulf Holding (UGH), which creates further pressure on KIPCO's LTV ratio.
- KIPCO's management continues to pursue a partial stake sale in OSN to a new strategic partner, potentially selling other assets for proceeds, and obtaining an additional cash injection from the key shareholder Al Futtooh Group (AFH) if the OSN stake sale is delayed.
- We are consequently lowering our global scale ratings on KIPCO to 'BB+/B', and our regional scale rating to 'gcA'.
- The negative outlook reflects our view of significant pressures on the company's LTV and portfolio credit quality, as well as uncertainty about its liquidation of assets and the capital injection.

Rating Action Rationale

We lowered the ratings because KIPCO has seen its LTV ratio deteriorate sharply and we see as uncertain that it will be able to sell a partial stake in OSN. Its key listed assets' prices have depreciated during the equity market sell-off. Moreover, we have increased our haircuts on OSN and UGH, because we have concerns on the valuation of these two assets given their financial performance, and this creates further pressure on KIPCO's LTV ratio. KIPCO's management continues to pursue a partial stake sale in OSN to a new strategic partner, potentially selling other assets, and obtaining an additional cash injection from the key shareholder AFH if the OSN stake sale is delayed.

KIPCO's LTV ratio has increased well above our previous expectations and company's stated financial policy. We expect KIPCO to report a ratio of 38.3% as of March 31, 2020, which has worsened from an expected 32.8% at year-end 2019. Our adjusted LTV ratio for KIPCO is now significantly above 45% on the back of:

- The global sell-off of equities and the negative impact on the valuation of KIPCO's listed assets in Kuwait.
- Our increased haircuts on valuation of KIPCO's two key assets, OSN and UGH, based on their weak performance.

This is well above the 30% threshold that is commensurate with our previous assessment of KIPCO's financial risk profile as intermediate, and as a result, we now view KIPCO's financial risk as significant.

OSN's weak performance, combined with KIPCO's acquisition of an additional stake in the company, weighs on KIPCO's portfolio quality. Contrary to earlier guidance that it would undertake a partial exit from OSN, on March 15 KIPCO announced that it had increased its stake by a further 27.1%. Although at this stage we are not changing our assessment of KIPCO's asset credit quality, we see it as a negative, because we believe OSN has significantly lower creditworthiness than KIPCO's other key assets. OSN has been generating operating losses since 2016, and while management expects it to become EBITDA positive by year-end 2020, we believe OSN's return to sustainable, strong revenue generation is uncertain because of high competition in pay TV and streaming services. Moreover, we have further increased our haircut to the value of OSN. Finally, we believe that current volatility in financial markets reduces the likelihood that KIPCO will be able to sell a partial stake in OSN to a strategic partner on a timely basis, at the valuation it is targeting, which is key to unlocking value and providing relief to the company's LTV ratio.

We also further increased our haircuts on KIPCO's second key asset, UGH, given the declining asset valuations globally and continued relative weak performance of this asset. Although 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 March 31, 2020, stock price, UGH's market capitalization is over 4.0x its tangible equity base. We do not think this premium is justified by UHG's very limited return on equity generation.

We now don't expect improvement in KIPCO's cash flow adequacy ratio in 2020-2021. Given the difficult market conditions, we anticipate the ratio will remain unchanged at 0.5x, due to weaker dividend flows relative to earlier management guidance on recovery. This is mitigated by the fact that cash in hand stood at $1.17 billion on March 31, 2020 (according to management's numbers). Additionally, other than $500 million payable in July 2020, KIPCO has no other debt maturity until 2023, which puts the company in a very comfortable liquidity position.

We continue to view KIPCO's investment portfolio as concentrated, which weighs on our view of the business risk profile. We estimate that the value of KIPCO's total portfolio on March 31, 2020, not including our haircuts, was about $3.83 billion. Burgan Bank, with a valuation of approximately $731 million, UGH ($652 million), and OSN (1.3 billion) are the largest assets. Together, these entities represented around 70% of the total portfolio, before our haircuts. The valuations stand against net debt of $1.47 billion as of March 31, 2020. Taking into account our assessment of KIPCO's portfolio average credit quality in the low end of the 'BB' category, we currently see KIPCO's business risk profile at the low end of fair.

KIPCO's management is committed to various initiatives to ensure the LTV metric improves to below 45% in the near term. We understand that KIPCO has already received the full support of its key shareholder, AFH, for another round of cash injection in the form of a potential shareholder equity loan or another form of capital that will receive full equity content, in case the OSN deal is further delayed. KIPCO will launch the capital transaction by the last quarter of 2020 at the latest, and complete it at the latest by March 31, 2021, in the case that the management believes it will be unable complete the OSN transaction before March 31, 2021.

Outlook

The negative outlook reflects continued pressure on investment portfolio quality and the LTV ratio currently being above the level we see commensurate with the rating.

Downside scenario

We would lower the ratings over the next six to 12 months, if we don't see improvement in OSN's financial performance and depending on the progress of the partial stake sale of OSN. We will also evaluate the performance of other key assets in the portfolio, notably UGH, as well as the progress on the capital injection by the key shareholder to bring adjusted LTV down.

Even if the company announces the capital increase, we may still lower the rating depending on the size of the capital injection and the financial performance of OSN and KIPCO's other assets.

Upside scenario

We could affirm the rating if KIPCO is able to reduce the adjusted LTV ratio to a level closer to 30% over the next 12 months. However, we would also need to observe a meaningful recovery in OSN's financial performance and ability to attract a strategic investor.

Company Description

KIPCO is a majority-owned operating holding company of AFH, which is connected to Kuwait's ruling Al Sabah family. It has substantial investments in financial services, media, and real estate across the MENA region. 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 also supported the $312 million rights offering in 2019.

Our Base-Case Scenario

In our base case for KIPCO, we assume:

- Potential capital increase at an amount to ensure LTV remains below 45% in case the OSN deal is delayed.
- Given the uncertainties around the OSN sale process, a sale and accompanying proceeds is not in our base case.
- A dividend inflow of around $95 million–$100 million for 2020–2021, with some downside risk.

- Operating and interest costs of about $170 million-$180 million.

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

- Cash flow adequacy of 0.5x in 2019–2021. While this remains below our 0.7x threshold, given KIPCO's significant cash balances, this is not a negative rating factor at this stage.
- LTV ratio to improve visibly below 45% by March 31, 2021, at the latest. We expect that AFH will provide further support if KIPCO's LTV ratio is sustainably above 45%.

Liquidity

We view KIPCO's liquidity as strong, based on our estimate that sources of cash should cover uses by over 1.7x over the 12 months from March 31, 2020, and more than 2.0x over the 24 months from the same date, even if dividend inflows were to shrink by 30% for any reason.

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. 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. We also 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 March 31, 2020;
- Undrawn committed credit lines of $53 million; Dividends and fees from portfolio companies of around $95 million per year for 2019 and 2020; and
- Given the uncertainty in timing, we have not incorporated any cash flows from neither the potential shareholder injection, nor sales proceeds from the partial OSN sale or any other liquidation of assets.

Principal Liquidity Uses

- $500 million debt maturity on July 2020;
- Parent company dividend payments of around $45 million–$50 million per year;
- Additional capital injection of $32 million into OSN; and
- Operating and interest costs of about $165 million-$170 million per year.

Covenants

Compliance expectations

According to management's numbers, KIPCO currently has ample headroom under its financial covenants specified under its Kuwaiti dinar bonds issuance.

Requirements

Under its Kuwaiti dinar bonds, KIPCO needs to ensure the ratio of its debt obligations to shareholders' equity does not exceed 2.5x to 1x at any time.

Issue Ratings - Subordination Risk Analysis

Capital structure

KIPCO's capital structure comprises about $2.64 billion of senior unsecured debt, of which around $2 billion was issued by Kuwait Projects Co. SPC Ltd., and is guaranteed by KIPCO; and $654 million of Kuwaiti dinar bonds, also senior unsecured and issued by KIPCO.

Analytical conclusions

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

Ratings Score Snapshot

Issuer Credit Rating:	BB+/Negative/B
Gulf Cooperation Council Regional Scale:	gcA
Business risk:	Fair
Country risk:	Moderately high
Industry risk:	Intermediate
Investment position:	Fair
Financial risk:	Significant
Leverage/Cash flow:	Significant
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: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

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