

Research Update:

# KIPCO Ratings Put On CreditWatch Negative On Performance, Pending Benefits From Transformative Merger

May 26, 2022

## Rating Action Overview

- Kuwait Projects Co. (Holding) K.S.C.'s (KIPCO's) leverage remains very high and cash flow remains limited, but we believe that the currently in progress merger with Quraan Petrochemical Industries Co. (QPIC) is a highly transformative event and would potentially limit further erosion in KIPCO's credit profile in the case of a successful completion, which KIPCO expects to achieve before year-end 2022.
- Despite a sizable rights offering in 2021, KIPCO was unable to reduce its leverage, and its cash balance deteriorated sharply because it had to inject additional capital into some key investments.
- KIPCO's management is engaged in major initiatives, including raising additional funding and obtaining commitments, among others, to ensure it has enough funds to service its maturities over the next 12–18 months.
- In the meantime, absent a successful merger, we don't believe that KIPCO will be able to significantly improve its balance sheet, liquidity, and high leverage while maintaining a financial performance commensurate with its current credit profile.
- We have therefore placed the 'BB-/B' global scale and 'gcBBB-' Gulf Cooperation Council regional scale issuer credit ratings on KIPCO on CreditWatch with negative implications.

The CreditWatch indicates that we could lower the ratings on KIPCO by more than one notch if by year-end KIPCO is unable to complete the QPIC transaction and consequently unable to substantially improve its leverage and liquidity.

## Rating Action Rationale

**On March 14, KIPCO and QPIC (unrated) announced a preliminary agreement for a merger process by way of amalgamation on a noncash transaction.** (See "Bulletin: KIPCO's Potential Merger With Local Peer QPIC Is A Transformational Event, But It's Too Soon To Assess The Credit

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Impact," published March 15, 2022, on RatingsDirect.) The proposed merger should provide support to KIPCO's weakened balance sheet and cash flow generation. KIPCO already controls about 29.5% of QPIC's share capital and expects the transaction will close before year-end 2022. The boards of both firms already approved the transaction. KIPCO's management believes it is highly likely that the transaction will take place, and we think various stakeholders have strong incentives for that outcome, as well, since KIPCO is a high-profile and visible entity in Kuwait. KIPCO expects that its main owner, Al Futooh Group (AFH), will continue to have at least a 30% stake in the merged entity.

**We believe the transaction will provide substantial support to KIPCO's overall credit profile.**

QPIC has much lower leverage. It had total assets of Kuwaiti dinar (KWD) 780 million (about \$2.6 billion) at year-end 2021 versus less than \$375 million in borrowings. Some of QPIC's key portfolio assets are Equate Petrochemical Co. (BBB/Positive/A-2), SADAFCO (unrated), and National Petroleum Services Co. (unrated), which are well-established and profitable companies in their respective sectors of petrochemicals, food processing, and oilfield services. Furthermore, they provide QPIC with a healthy and stable stream of dividend income.

**Subject to completion of the merger, we believe KIPCO's overall portfolio characteristics will improve in the next 12-18 months, because it will have a relatively less concentrated portfolio with exposure to multiple sectors.** After the potential merger, KIPCO would have a more diverse portfolio and a larger balance sheet, which should help the company address the persisting performance issues in some of its key assets such as Middle East pay television operator OSN and United Gulf Holding, whose relative weight in the portfolio will decline visibly after a successful merger. However, we note that at this stage, these benefits might not necessarily lead to a change in our business profile assessment on KIPCO.

**Leverage and liquidity have further deteriorated, given capital injections to subsidiaries.**

Despite the expected above-mentioned medium-term benefits of the merger, KIPCO's financial profile remains under increasing pressure, and this is the main reason for the CreditWatch placement. Even though the company has raised \$265 million fresh capital via a rights offering in fourth-quarter 2021, its adjusted reported loan-to-value ratio for March 31, 2021 (using March 31 prices for its listed assets for portfolio value, and including the 2022 capital injection guidance to subsidiaries in our debt values, as well as our valuation adjustments to OSN and United Gulf Holding for portfolio value) has further deteriorated since our last review in July 2021 and remains much higher than our 60% threshold.

**During 2021, KIPCO injected substantial cash into its key assets, OSN (unrated), Burgan Bank, and Gulf Insurance Group (GIG), and incurred elevated operating and funding costs, while generating limited dividend income from its portfolio.** KIPCO's cash flow adequacy remained well below our 0.7x threshold as of March 31, 2022. Given our expectations for similar dividend income and cost levels, we don't expect a recovery in the cash flow adequacy ratio in the absence of the new assets KIPCO expects to take over following the completion of the merger.

**We expect the adjusted loan-to-value ratio for KIPCO to decline to a level comfortably below 60% by year-end 2022.** This is based on information provided by KIPCO management and is subject to successful completion of the QPIC merger. We expect its cash flow adequacy in 2023 and thereafter to improve notably, given the strong dividend inflows coming from QPIC's portfolio companies such as Equate and dairy company SADAFCO. Therefore, we have not revised our financial risk profile for KIPCO at this stage. However, if the merger with QPIC is unsuccessful, and

KIPCO does not receive a high-quality portfolio of cash-generating assets, given the potential further capital injection requirements, particularly at OSN, we would likely negatively reassess KIPCO's financial risk profile to highly leveraged from aggressive currently.

**Liquidity has weakened substantially and is dependent on funding arrangements and asset monetization efforts.** We now view KIPCO's liquidity as less than adequate, reflecting the constant deterioration of liquidity profile over the past two to three years. Despite a capital injection of \$265 million in the last quarter of 2021, KIPCO's year-end cash balance declined from \$625 million at the start of the year to \$409 million because it had to inject large amounts of fresh capital into its key assets such as OSN, Burgan Bank, and GIG. In the meantime, KIPCO only generated around \$43 million dividends from its portfolio, while reporting high operating expenses and funding costs. Moreover, in first-quarter 2022, it injected additional funds into its assets, and its cash balance declined to \$359 million.

**KIPCO has a \$500 million bond maturing under its euro medium-term note program on March 2023 and around \$330 million in Kuwaiti dinar bonds on November 2023.** Other than KIPCO's guidance of lower capital injections in 2022, we expect no meaningful change in its dividend inflows and operating and funding costs prior to the potential merger. We understand that KIPCO's management has already secured substantial funding commitments from its relationship banks and is considering some additional initiatives to significantly shore up its liquidity position over the next months. We view this as supportive, and it is one of the reasons why we are not lowering the rating at this time. Specifically, KIPCO expects that before end-June, it will have funding sources that will comfortably cover its 12-month funding requirements by at least 1.2x. Although we believe KIPCO will be able to raise funds thanks to its standing in the markets and its relationships, we note that its liquidity profile now depends heavily on external funding efforts, rather than internal cash generation; therefore we revised down our liquidity assessment to less than adequate. If KIPCO's management is unable to shore up its liquidity sources to cover the March 2023 maturities by July 30, 2022, we would revise down its liquidity position further to weak.

## **CreditWatch**

The negative CreditWatch reflects our view that, although the pending merger with QPIC should strengthen KIPCO's balance sheet and support KIPCO's credit profile over time, the failure of this transaction would result in KIPCO no longer being able to maintain its key metrics commensurate with its current rating. KIPCO's management is, however, confident it will close the transaction by year-end 2022, and we think it is in all stakeholders' interest that it happen, to avoid further stress at a visible entity like KIPCO. Nevertheless, if the transaction is delayed, or faces unexpected challenges, KIPCO's financial performance could further deteriorate rapidly. We could lower the long-term rating on KIPCO by more than one notch if KIPCO is unable to complete the QPIC transaction by year-end 2022 and move its adjusted loan-to-value ratio to well below 60%. To affirm the rating, and assign a stable outlook, we would also need to see a sharp improvement in KIPCO's post-merger liquidity, as well as its cash flow adequacy ratio.

## **Company Description**

KIPCO is AFH's majority-owned operating holding company, which is connected to Kuwait's ruling Al Sabah family, with substantial investments in financial services, media, and real estate across

the Middle East and North Africa. 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 and \$265 million rights offering in late 2021.

## **Issue Ratings - Subordination Risk Analysis**

### **Capital structure**

KIPCO's capital structure comprises about \$2.2 billion of senior unsecured debt, of which about \$1.5 billion was issued by Kuwait Projects Co. SPC Ltd. and is guaranteed by KIPCO; and \$650 million is local currency Kuwait bonds, also senior unsecured and issued by KIPCO, as well as a KWD20 million bank loan.

### **Analytical conclusions**

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

### **ESG credit indicators: E-2, S-2, G-4**

### **Related Criteria**

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Bulletin: KIPCO's Potential Merger With Local Peer QPIC Is A Transformational Event, But It's Too Soon To Assess The Credit Impact, March 15, 2022

## Ratings List

### Ratings Affirmed; CreditWatch/Outlook Action

	To	From
<b>Kuwait Projects Co. (Holding) K.S.C.</b>		
Issuer Credit Rating	BB-/Watch Neg/B	BB-/Negative/B
Gulf Cooperation Council Regional Scale	gcBBB-/Watch Neg/--	gcBBB-/--/--
Senior Unsecured	BB-	
Kuwait Projects Co SPC Ltd		
Senior Unsecured	BB-	
Kuwait Projects Co. (Cayman)		
Senior Unsecured	BB-	

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