FitchRatings

**RATING ACTION COMMENTARY**

# Fitch Downgrades KIPCO to 'BB-', Outlook Stable

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Fitch Ratings - Dubai - 21 Dec 2023: Fitch Ratings has downgraded Kuwait Projects Company Holding K.S.C.P.'s (KIPCO) Long-Term Issuer Default Rating (IDR) to 'BB-' from 'BB'. The Outlook is Stable.

The downgrade reflects the company's high leverage, with a net loan-to-value (LTV) ratio at 41.4% expected at end-2024 and stressed gross LTV at 66.6% at end-2024. We expect that debt will remain elevated in our forecast, which is only somewhat mitigated by the company's debt reduction target. KIPCO's weighted average portfolio credit strength by equity value is relatively weak at 'b+', driven by Fitch's assessment of credit quality of its subsidiaries and weak recent profitability within its banking and financial sector.

The high concentration of assets and dividend flows from the three largest entities, which contribute around 60% to the gross asset value, is also incorporated into the rating. However, the company successfully refinanced its debt maturities and is in the process of effectively monetising its investments that it plans to use for debt repayment.

KIPCO's rating is supported by a combination of a transformed portfolio with increased diversification across several industries and presence in the Middle East & North Africa (MENA) region, established record of long-term returns, significant influence over the majority of companies in its portfolio, a record of asset sales and stable dividend flow from the portfolio companies through the cycle.

## KEY RATING DRIVERS

**Pressure from High Leverage:** We expect KIPCO's net LTV will reduce towards 41.4% by end 2024 from 46.5% in September 2023 as proceeds from asset sales will be primarily used for deleveraging as prioritised by management. Nevertheless it will remain above 40% over the next three to four years. We expect a stressed gross LTV at around 66.6% at end-2024. High leverage metrics are a constraint for the rating.

KIPCO also has a weak level of gross investment holding company (IHC) debt/recurring cash received at above 10x. This has a limited impact on the rating as we expect the company to service debt from the sale of holding stakes and refinancing rather than through cash generated by investments.

**'b+' Portfolio Credit Quality:** We assess the weighted average portfolio credit strength by equity value of KIPCO's portfolio at 'b+', based on 85.2% of the gross asset value of the portfolio after the disposal of Gulf Insurance Group (GIG) expected to be completed over 4Q23-2024. The top three entities, accounting for 63% of the portfolio, have the highest credit quality, which is offset by the lower credit assessment of entities that contribute single digit stakes to the portfolio. Most holdings have robust business profiles and generate stable cash flows, while some smaller stakes are cash flow negative and are in the process of business turnaround.

Many entities are market leaders in their segments in Kuwait or Saudi Arabia. Greater Equate is the second-largest ethylene glycol producer globally. For the assessment of the entities' credit quality we look at the standalone profiles to exclude potential state or parental support.

**Portfolio Transformation Ongoing**: Over the past two years, KIPCO has been undergoing portfolio optimisation. In 2022, it acquired Qurain Petrochemical Industries Company (QPIC), which substantially increased its gross asset value and added significant stakes in petrochemical (Greater Equate) and consumer (SADAFCO). In December 2023, KIPCO sold its stake in GIG for USD860 million and plans smaller disposals over 2024. These deals increased diversification of the portfolio into the petrochemical and consumer sectors, having previously been weighted towards the financial sector and focussed on Kuwait .

Following completion of the ongoing stake sales, KIPCO's portfolio will be more diversified by sector and geographically. The petrochemical, banking and food and beverage sectors will each contribute around 20%-25% to the portfolio. The remaining 3%-8% share will be from media, financial services, real estate, logistics, education and other sectors. KIPCO retains a regional focus on the MENA region but with improved exposure geographically, including Equate's significant asset base in North America.

**High Asset Value Concentration:** After the sale of GIG, the share of three largest entities in the portfolio: SADAFCO, Burgan Bank K.P.S.C. (A/Stable) and Greater Equate will rise to 63% expected at end-2024 from 53% at end-2022 based on gross asset value. Dividend flows are even more concentrated with three largest entities contributing each around 30% to the dividend flow.

**Supporting Shareholder:** KIPCO's major shareholder is Al Futtooh Holding Company K.S.C. (Closed) (AFH), a Kuwaiti company owned by the family office of the Kuwaiti ruling family, which currently owns 31.9% of KIPCO. The shareholder has a record of providing support to KIPCO through equity capital raising and a reduction in the dividend if needed. The merger with QPIC was fully funded by equity and as a result of this transaction the major shareholder's stake decreased from 44.9%. The company did not pay dividends in 2023.

**Financial Flexibility Balancing:** KIPCO has significant influence on the majority of its dividend streams (although some is in regulated or government-owned entities). Its dividend stream has historically been relatively stable, with no more than a 35% decline in any given year, including during the pandemic. KIPCO has weak IHC cash cover of slightly of 1.1x expected over 2023-2027.

Asset liquidity could be limited by the scale of KIPCO's three largest publicly-listed holdings, their small market capitalisations and concentration of trading on emerging market exchanges. This is mitigated by KIPCO's recent active refinancing efforts, which have materially improved so that there are no liquidity needs until the middle of 2025 given the expected proceeds from stakes' sales. This compares with tight liquidity a year ago.

## DERIVATION SUMMARY

KIPCO's Fitch-rated peers include Investment AB Latour (A/Stable), Loews Corporation (A-/Stable), Criteria Caixa S.A., Unipersonal (BBB+/Stable), CDP RETI SpA (BBB/Stable) and Turkish investment holding company

Ordu Yardimlasma Kurumu (Oyak; B/Stable).

Oyak is one of Turkiye's largest IHC, with solid market positions in steel, automotive and cement. Oyak has less end-market diversification due to its high exposure to Turkiye (B/Stable), which is mitigated by its more conservative leverage metrics and LTV than KIPCO. Oyak's gross stress LTV is expected at below 30%. Oyak also has a high dependency on the dividends of a single asset, Erdemir which along with the geographical concentration in Turkiye leads to a higher fluctuation in the dividend and is a constraint on the rating.

CDP RETI has a highly concentrated (three assets) portfolio with significant stakes in Italian gas and electric utility companies. The company has a conservative LTV close to 20%. This is offset by structurally limited diversification of assets and aggressive debt refinancing strategy, under which refinancing occurs very close to the maturity date.

Caixa's rating is based on its conservative investment and financial policies, low leverage targets and a comfortable liquidity position. Its gross LTV is expected to remain well below 30%. As of end-2022, around 62% of the gross asset value and 80% of the dividends received are concentrated on the two largest assets, stakes in CaixaBank and Naturgy, which is a rating constraint. At the same time, management is focusing on diversifying its portfolio, which now has over 80 large-cap OECD names.

Caixa has a solid record of dividends received over the last six years despite very challenging economic and financial conditions at times. Criteria maintains its investment strategy of focusing on leading companies with high credit quality, and prioritising liquid stakes with healthy distribution policies. Its average credit quality of portfolio is assessed at 'bbb' based on 94% of the gross asset value as of end-2022.

Loews' ratings reflect its extremely low leverage and strong financial structure metrics. While its core holdings are diversified across insurance, energy transport, hotels and packaging, CNA's and Boardwalk's high asset value concentration, which together represent over 60% of total asset value, constrains its credit rating. The subsidiaries' solid ratings partially offset the relatively weak diversification score. Loews has a well-articulated and conservative investment strategy, which seeks to realise strong and consistent dividends from subsidiaries.

Latour is a mixed industrial IHC with six wholly-owned subsidiaries and 10 investment holdings, all of which are listed, supporting the company's solid liquidity. Latour's long-term commitment to its investments and its medium to strong ability to influence their operations, either through 100% ownership or as principal owner, create stability and value-adding effects. Over 40% of the net asset value of Latour's portfolio consists of six wholly-owned diversified industrial companies. Its equity portfolio has only limited concentration. Latour's LTV was at 11% at end-1H23.

## KEY ASSUMPTIONS

- Dividends received averaging USD122 million for 2023-2026.

- Debt outstanding to decrease to USD2.2 billion at end-2024 and remain within USD2.2 billion-USD 2.4 billion for 2023-2026.

- Net interest expense averaging USD120 million for 2023-2026.

- Gross proceeds from GIG sale of USD860 million in 2023-2024. No acquisitions over the forecast period.

- No dividend paid to the shareholder over the forecast period.

- Average USD70 million investments in the subsidiaries over 2023-2026.

- Gross asset values largely stable; net the value of assets sold derived by public market prices for listed stakes and Fitch's assumptions for valuations for unlisted stakes and assuming Fitch haircuts for LTV calculations.

- No cash tax paid by Kuwaiti corporates.

## RATING SENSITIVITIES

**Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**

- An improvement in the weighted average portfolio credit strength

- Net LTV consistently at or below 40%

- Stressed gross LTV consistently at or below 60%

**Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

- Net LTV consistently well above 45%

- Stressed gross LTV consistently well above 65%

- Deterioration of the portfolio credit strength or higher portfolio concentration

- Change in investment or financial policy at the holding company level resulting in acquisitions or shareholder-friendly actions leading to deterioration of credit quality

## LIQUIDITY AND DEBT STRUCTURE

**Strong Liquidity:** KIPCO's liquidity has substantially improved over the last year due to active debt management including the net raise of USD525 million consisting of six-year Sukuk issuance and a syndicated facility along with the expected gross proceeds from the GIG stake sale of USD860 million expected over 2023-2024. KIPCO's cash balance as at 30 September 2023 was USD331 million. We expect KIPCO to generate negative free cash flow of around USD80 million over 2023-2026 due to investments into some subsidiaries. Available liquidity is sufficient to cover for the investment outflows and the upcoming maturities until mid-025.

## ISSUER PROFILE

KIPCO is a Kuwait-based IHC with a portfolio of over 10 listed and unlisted holdings in which it tends to have large minority stakes to influence operations and financial policy. The portfolio has an estimated gross asset value of USD5.2 billion as of September 2023 and includes companies operating in the MENA region across a range of sectors including petrochemicals, banks, and consumer.

### Criteria Variation

Fitch's Corporate Ratings Criteria (IHC Rating Criteria) refers to the assessment of the credit strength of the subsidiaries/investments when calculating the weighted average portfolio credit strength by equity value. However, in the case of Burgan Bank K.P.S.C. (A/Stable), Fitch considered it more appropriate to use the Viability Rating of 'bb', to exclude the impact on the IDR of potential support from the Kuwaiti authorities.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| Kuwait Projects Company Holding K.S.C.P. | LT IDR | BB- Rating Outlook Stable | Downgrade | BB Rating Outlook Stable |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 04 Nov 2023)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Kuwait Projects Company Holding K.S.C.P. | UK Issued, EU Endorsed |

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