

Alargan International Real Estate Company – Bond Rating Raised to ‘BBB’

Capital Intelligence Ratings (CI Ratings or CI), the international credit rating agency, today announced that it has raised the Rating on the KWD26.5mn five-year bond issued by Alargan International Real Estate Company (ARE) in April 2012 to ‘BBB’. The Outlook for the Rating is revised to ‘Stable’. The principal factor supporting the upgrade is that there are already clearly identified resources (cash plus unutilised committed funding lines) in place to repay this particular obligation. The rating upgrade also reflects the increase in equity and the fall in debt (and therefore leverage) that has resulted from the successful exit from an erstwhile associate. More generally, Alargan continues to enjoy a sound financial profile, a geographically diversified business model, and a good funding structure – there is almost no reliance on short-term bank borrowing (although the bond issue itself has now become a current liability).

The main constraints on the bond rating remains the size of the company, in balance sheet terms, and the risk profile of the sector in which it operates, although ongoing changes to the business model have already begun to lower the overall risk profile. This process will continue, with the proportion of revenues coming from recurring rental income steadily increasing over time. While profitability has in the past been neither a supporting nor constraining factor, it has been consistently sound, while the effect of the results in 2015 in lowering leverage are a supporting positive. More generally, the company has in the past had a good earnings track record and the change to the business model to build up a larger base of recurring rental income is also a supporting factor. Set against this however is the fact that the shift in the business model will have the effect of reducing revenues in the near term and this will impact full year 2016 profitability – and possibly that of H1 2017 as well.

Alargan is a small company in purely balance sheet terms, but – to a certain extent – its size reflects the corporate structure that had in the past been used for development projects, whereby most were held off-balance sheet through special purpose vehicles (SPVs) with their own non-recourse (to Alargan) financing arrangements. While any real estate development business involves risk, Alargan has generally sought to reduce this risk through development partnerships, through the financial and funding structures selected, and through the sale of developments while they are still in the construction phase. Nonetheless, risks remained. Alargan has always sought to further mitigate these by keeping the exposure to any single project or financing vehicle as low as possible and this will continue to be the pattern in the future for development activities, especially outside Kuwait. The new business model adds activities that are generally lower on the risk spectrum for real estate. The intention is to steadily build up a portfolio of income producing properties. In Kuwait this will be through developments by Alargan itself. In non-MENA markets this will be through taking small individual stakes in larger income-producing and fully let assets in mature markets in Western Europe and North America.

The fact that secured borrowings still remain contributes to an element of structural subordination – although this has steadily reduced as almost all secured borrowings outside the main funding facility have been repaid. The amount of such remaining borrowing is not considered large enough to impact the rating, while its maturity structure (more than three-quarters is repayable after the maturity date of the bond) is also a significant positive. In addition, Alargan has a solid balance sheet with improved financial ratios, which are forecast to remain strong throughout the short remaining life span of the bond.

After a very strong 2015, 2016 will see a sharp reduction in both net profit and profitability. Even stripping out a large disposal gain from the comparison, the current year will be somewhat lacklustre in terms of earnings. This, however, in large part reflects a much more liquid balance sheet and the timing of expected revenues from the sale from ongoing developments. Next year should, however hopefully see a rather stronger performance. The changes that are taking place in the business model will mean that the revenue streams become steadily more predictable over time – and less ‘lumpy’ - as the proportion of recurring rental income steadily rises. Alargan expects post 2016 net profit going forward to improve on higher rental income and from the gains on sales.. In terms of balance sheet, overall debt

will rise in 2017 as leverage is added to the non-MENA investments in income-producing properties. This will raise leverage a little but the forecast leverage ratios in the forecasts are at a comfortable level. Funding risks will also reduce as additional borrowings to buy non-MENA income producing assets under the new business model are linked, in that the asset will come packaged with pre-arranged long-term local-currency funding in the country concerned.

Alargan International Real Estate Company (Alargan) was established in March 2002, but the origins of the group date back to 1994. The Company was listed on the Kuwait Stock Exchange (KSE) in July 2007.

CREDIT RATINGS

Issue Rating	Outlook
BBB	Stable

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The information sources used to prepare the credit ratings are the rated entity and public information. CI considers the quality of information available on the issuer to be satisfactory for the purposes of assigning and maintaining credit ratings. CI does not audit or independently verify information received during the rating process.

The rating has been disclosed to the rated entity and released with no amendment following that disclosure. Ratings on the issuer were first released in October 2011. The ratings were last updated December 2015.

The principal methodology used in determining the ratings is Bond Rating Methodology. The methodology, the meaning of each rating category, the time horizon of rating outlooks and the definition of default, as well as information on the attributes and limitations of CI's ratings, can be found at www.ciratings.com. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at <http://cerep.esma.europa.eu>.