MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns a Ba2 rating to ACC's proposed certificates with a negative outlook

24 Mar 2021

London, 24 March 2021 -- Moody's Investors Service ("Moody's") has today assigned a Ba2 rating to the contemplated sukuk issuance by Arabian Centres Sukuk II Limited. At the same time, Moody's has upgraded to Ba2 from Ba3 the rating on the USD500 million sukuk certificates due in 2024 issued by Arabian Centres Sukuk Limited. Arabian Centres Company's (ACC) Corporate Family Rating (CFR) remains unchanged at Ba2. All ratings are on negative outlook.

The rating action follows the announcement that ACC will issue a benchmark size sukuk whose proceeds will be used to refinance a portion of the secured debt under its existing secured Murabaha and Ijara facilities, repay $200 million drawn under the revolving credit facility, and keep the remaining cash on balance sheet to finance future capital spending.

RATINGS RATIONALE

Today's upgrade of the existing sukuk and the assignment of the Ba2 on the proposed sukuk leads to an alignment of these ratings with the CFR. Post transaction, ACC's unsecured debt will increase to above 50% of total debt (excluding leases and unamortized transaction costs) from 26% as of December 2020 and as a result, the CFR will reference an unsecured rating. Moody's notes that, depending on the size the sukuk issuance, unencumbered assets might not increase as a result of the transaction as the loan to value (LTV) ratio required to release collateral will not be met. However, Moody's expects the LTV ratio to decrease over time supported by the amortization of secured debt and the unencumbered assets to increase. Moody's also factors in the expectation that ACC intends to maintain a predominantly unsecured debt structure going forward.

ACC's Ba2 CFR continues to reflect (1) the long-term positive fundamentals for shopping mall operators in Saudi Arabia, supported by favorable demographics and low retail GLA per capita; (2) the company's strong market position as the largest retail mall operator in Saudi Arabia with good growth opportunities in the medium to long term; (3) ACC's high-quality retail property portfolio, with strong, albeit slightly decreasing, portfolio occupancy rates of around 90% as of 31 December 2020; (4) a diversified tenant base representing local and international brands; and (5) a diversified asset base made up of three super-regional, twelve regional and six community malls in the largest cities of Saudi Arabia with a market value of SAR22.8 billion ($6.1 billion) as of December 2020.

The Ba2 CFR also factors in (1) ACC's concentration in a single country, Saudi Arabia, Government of (A1 negative); (2) renewal risk on land leases, with leasehold malls contributing to 60% of ACC's revenue; (3) a high portion of tenant leases expiring over the next two years; and (4) significant, albeit declining, related party transactions.

LIQUIDITY

ACC has good liquidity despite the lost rental income because of discounts agreed with tenants for the lock down months. As of December 2020, pro-forma the transaction, ACC had SAR1.35 billion of cash and cash equivalents, which, in addition to an undrawn $200 million RCF (pro-forma the transaction) and an expected SAR1 billion of funds from operations are more than sufficient to cover debt repayments of SAR90 million, capital spending of SAR1 billion and dividend payments of SAR712 million over the course of the next twelve months. However, Moody's notes that ACC has limited headroom under some of its maintenance covenants. The rating assumes that ACC will obtain waivers or amendments, if required, from its lenders sufficiently in advance of the next reporting period.

NEW SUKUK CERTIFICATES

In Moody's view, certificate holders will effectively be exposed to Arabian Centres Company's senior unsecured credit risk. Holders of the certificates will not be exposed to the performance risk of the sukuk portfolio assets and do not have any preferential claim or recourse over the relevant wakala assets, or rights to cause any sale or disposition of these assets except as expressly provided under the English Law transaction documents.

Based on the review of the structure, the proceeds of the certificates will be used by Arabian Centres Sukuk II Limited (in its capacity as the Issuer and Trustee) to acquire a portfolio of assets. This will comprise of (1) no less than 55% of the aggregate face amount of the certificates in wakala assets (specifically Arabian Centres Company's ownership interests in certain leasehold shopping malls); and (2) no more than 45% of the aggregate face amount of the certificates in Shari'ah-compliant commodities to be sold to Arabian Centres Company on a deferred payment basis pursuant to the terms of the Murabaha Agreement.

Arabian Centres Sukuk Limited will collect rental income from the wakala assets, which will be available to make periodic profit distributions to certificate holders.

Following the occurrence of a dissolution event, Arabian Centres Capacity (in its capacity as the Obligor) is required to (1) pay the Issuer an amount equal to a minimum of 51% of the face amount of the certificates outstanding along with any due but unpaid periodic distribution amount, irrespective of the performance of the underlying assets through the exercise of the purchase undertaking; and (2) pay the Issuer the aggregate outstanding amounts of the deferred sale price equal to a maximum of 49% of the outstanding certificate amounts under the Murabaha agreement. The proceeds from (1) and (2) will be used by the Issuer to fund the relevant dissolution amount and make payment to the holders of the certificates.

Moody's rating of the sukuk instrument does not express an opinion on the sukuk structure's compliance with Shari'ah law. The rating on the sukuk certificates is subject to Moody's review of the final documentation along with the terms and conditions which are not expected to change in any material way from the draft documents reviewed.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook reflects the challenging operating environment that ACC continues to face, despite the re-opening of all the malls in its portfolio. Saudi Arabia's GDP has contracted by 5% in 2020 and Moody's expects it to increase by 3.2% in 2021.

The negative outlook also reflects the risk of ACC's rent collections do not remain in line with pre-COVID levels, resulting in an increase in the company's receivables book (including related-party receivables), which was already high compared to peers as of December 2020.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

In light of the negative outlook, an upgrade is unlikely at the moment. The outlook could change to stable from negative if ACC's operating performance continues improving, as reflected by increasing footfall, rent collections and occupancy ratios as well as a stabilization of the rental income which has suffered from discounts. At the same time, other factors that could lead to changing the outlook to stable from negative include (1) Moody's adjusted Net debt to EBITDA (including lease liabilities) decreasing to below 6.5x; and (2) Moody's adjusted Fixed charge coverage remaining above 2.5x.

ACC's ratings could be under pressure if the operating environment in Saudi Arabia deteriorates, leading to lower occupancy rates and deteriorating operating cash flows, including lower collections and higher receivables from related and third party tenants. At the same time, other factors that could lead to downgrading ACC's ratings include (1) Moody's adjusted Net debt to EBITDA (including lease liabilities) increasing above 7.5x; and (2) Moody's adjusted Fixed charge coverage decreasing below 2.0x.

In addition, the rating of the existing sukuk will be downgraded to the Ba3 level, in case the company were not able to successfully execute the proposed transaction.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms published in September 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1095505. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The local market analyst for this rating is Julien Haddad, +971 (423) 795-39.

CORPORATE PROFILE

Arabian Centres Company, listed on the Tadawul Stock exchange, is the largest owner and operator of retail malls in Saudi Arabia with a total of 21 existing malls that cover a total leasable area (GLA) of over 1.2 million square meters (sqm). The portfolio has an estimated fair value of SAR22.8 billion ($6.1 billion) as of December 2020.

For the LTM ending December 2020, ACC reported revenues were SAR 1.9 billion ($511.5 million) with net income of SAR455.2 million ($121.4 million).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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