MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades ACC to Ba2; ratings on review for downgrade

26 May 2020

London, 26 May 2020 -- Moody's Investors Service, ("Moody's") has today downgraded Arabian Centres Company's (ACC) corporate family rating (CFR) to Ba2 from Ba1. Moody's has also downgraded to Ba3 from Ba2 the rating on the USD500 million sukuk due in 2024 issued by Arabian Centres Sukuk Limited. At the same time, Moody's has placed all ratings on review for downgrade. The outlook on all ratings has been changed to ratings under review from stable.

"The downgrade of the CFR to Ba2 from Ba1 is driven by an expected increase in leverage stemming from a likely decline in rental income over the course of the next 12 months due to the business disruptions caused by the outbreak of the coronavirus ", says Julien Haddad, a Vice President -- Senior Analyst, and the local market analyst on ACC."

RATINGS RATIONALE

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The retail real estate segment is one of the sectors most affected by the shock given the closure of malls and falling retail sales which will put negative pressure on the financial health of retailers. With the exception of food anchors and other essential service providers, ACC's shopping centres have been closed from 16 March 2020 to 28 April 2020 in line with government authorities' requirements. Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Today's rating action reflects a weaker than expected operating environment in Saudi Arabia with Moody's expectation of GDP contraction of 3.8% in 2020, with the non-hydrocarbon sector contracting by 4.0% (the weakest reading growth since 1986). In addition, the Saudi Arabian government's decision to increase VAT to 15% from 5% will likely lead to a substantial pullback in discretionary consumption and will dent retailers' financial strength.

Moody's expects that ACC will have to provide concessions through extended payment terms all the way to rent reductions to support retailers. Moody's estimates that the company's net Debt to EBITDA will increase to 6.8x for fiscal-year ending March 2021 (FY2021) from an expected 6.0x for FY2020 under the assumption of one-two months of lost rental income in FY2021 and an increase in impairment losses on accounts receivables. Moody's also expects ACC's fixed charge coverage ratio to decline to 2.5x in FY2021. Based on the financial statements as of December 2019, the company has a sizeable receivables book with a gross carrying amount of SAR503.4 million (SAR303 million on a net basis) out of which a material portion relates to rental income overdue over 90 days. In addition, rental receivables outstanding with related parties remain high at SR237.7 million as of December 2019. In light of the changing operating environment, there is a growing risk of an increase in the size and duration of the receivables book and a mismatch between reported rental income and cash collections. This leads to the preliminary assessment that leverage as measured by Net Debt to EBITDA may underestimate the true cash flow generation of the business.

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) ACC's adequate liquidity profile with no material debt maturing before 2024; (3) 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; (4) ACC's high-quality retail property portfolio, with stable portfolio occupancy rates of around 93% as of 30 September 2019; (5) a diversified tenant base representing local and international brands; and (6) 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 SAR22.7 billion ($6.0 billion) as of December 2019.

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 the Mall of Dhahran's land lease due in five years and representing 15% of revenue; (3) a high portion of tenant leases expiring over the next two years; and (4) a high level of secured debt of 70% of total debt.

The Ba3 rating on the outstanding sukuk is one notch lower than the CFR to reflect its subordination to secured debt which represent the predominant class of debt in the capital structure.

LIQUIDITY

As of 31 December 2019, ACC had more than SAR 1.0billion of cash and cash equivalents, on a pro-forma basis following the full drawdown of the SAR750 million revolving credit facility (RCF). Those sources, in addition to an expected SAR1 billion of funds from operations are more than sufficient to cover ACC's debt repayments of SAR450 million (including 50% of the RCF), capital spending of SAR350 million and dividend payments over the course of the next twelve months, which Moody's expects to decrease compared to FY2020 as the company prudently preserves cash.

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

During the review process, Moody's will assess (1) the impact of the current weak environment on the retailers and the ability of ACC to renew leases, given that a high proportion of leases expires in the next 12 months; (2) the risk of a decrease in cash collections and the impact on ACC's liquidity and credit metrics; and (3) the company's actions to protect its balance sheet against a backdrop of falling rents.

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.

CORPORATE PROFILE

Arabian Centres, 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 SAR22.7 billion ($6 billion) as of 31 December 2019.

For the nine-month ending 31 December 2019, reported revenues were SAR 1.7 billion ($450 million) with net income of SAR 545.8 million ($146 million).

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

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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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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