MOODY'S INVESTORS SERVICE

Rating Action: Moody's confirms ACC's Ba2 CFR; negative outlook

10 Sep 2020

London, 10 September 2020 -- Moody's Investors Service ("Moody's") has confirmed Arabian Centres Company's (ACC) Ba2 corporate family rating (CFR). Moody's has also confirmed the Ba3 rating on the USD500 million sukuk due in 2024 issued by Arabian Centres Sukuk Limited. At the same time, Moody's has changed the outlook to negative from ratings under review. This concludes the review initiated on 26 May 2020.

"The negative outlook reflects the challenging operating environment ACC will face 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. "The confirmation of the CFR reflects the view that ACC has good liquidity to withstand the cash flow impact stemming from discounts on rents provided to the retailers and that leverage will increase to a level still commensurate with the Ba2 CFR".

RATINGS RATIONALE

The rapid and widening spread of the coronavirus outbreak and the deteriorating global economic outlook are creating a severe and extensive credit shock across many sectors, regions and markets. 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 has been putting negative pressure on the financial health of retailers. Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

The confirmation of the Ba2 CFR reflects the company's progress in renewing leases despite the challenging operating environment and Moody's understanding that lease renewal rates have been relatively stable. During the first quarter of FY2021, ACC renewed 750 leases, decreasing the percentage of leases expiring in calendar year 2020 to 21.1% from 38.5% as of March 2020.

The confirmation of the ratings also reflects ACC's good liquidity despite the lost rental income because of discounts agreed with tenants for the lock down months. As of June 2020, ACC had SAR921 million of cash and cash equivalents, which, in addition to an expected SAR1 billion of funds from operations are more than sufficient to cover debt repayments of SAR90 million, capital spending of SAR610 million and dividend payments of SAR423 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 from its lenders sufficiently in advance of the next reporting period.

With the exception of food anchors and other essential service providers, ACC's shopping centres have been closed for a period of six weeks between March and April because of lock down measures imposed by the local authorities. Footfall fell by more than 75% and collections decreased significantly during the lockdown months. While both metrics have improved during the month of July, they are yet to recover to pre-lockdown levels.

In order to support its tenants, ACC has waived 6 weeks of rent to all its tenants affected by the lockdown and provided additional discounts to tenants in the fashion, food and beverage as well as the entertainment sectors. ACC also suspended any lease escalations for calendar years 2020 and 2021. ACC estimates the total impact of those measures on revenues to be around SAR420 million, with SAR144 million already recorded up to June 2020. ACC also recorded a cash outflow of SAR320 million during the same period.

As a result, ACC's leverage (Moody's adjusted net debt to EBITDA) deteriorated to 6.7x for the last twelve months (LTM) ending June 2020 from 5.4x for FY2019. The increase in leverage was also driven by an increase in impairment loss on account receivables, with ACC recording a one-time impairment of more than SAR60 million in the fourth quarter FY2020 related to COVID. Moody's expects ACC's leverage to weaken further to 7.3x for FY2021 before improving to levels around 6.6x in 2022, driven by further pressure on rents and collections. Moody's notes that the amount of overdue receivables remains sizeable and that ACC has only partly provided for those receivables despite some overdue for up to two years. In addition, Moody's prior expectation that the balance of receivables with related parties would reduce materially has not been met over the last twelve months. As of June 2020, gross receivables from third parties were SAR451 million, with an additional SAR209 million for rentals due from related parties (on which no provisions were taken). Moody's understands that management is taking actions to improve collections including moving to monthly billing and that overdue rent from related parties will materially decline over the next few quarters.

ACC's Ba2 CFR is underpinned by (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 a stable, albeit slightly decreasing, portfolio occupancy rates of around 91.4% as of 30 June 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 SAR22.1 billion ($5.9 billion) as of June 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 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; (4) a high level of secured debt of 74% of total debt (excluding lease liabilities); and (5) significant related party transactions.

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.

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. Moody's expects Saudi Arabia's GDP to contract in 2020 by 4.5% in 2020 and to rebound by 2.9% in 2021.

The negative outlook also reflects the risk of ACC's rent collections not increasing to levels in line with pre-COVID resulting in an increase in the company's receivables book (including related-party receivables), which was already high compared to peers as of June 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, in line with July, reflected by increasing footfall, rent collections and occupancy ratios. At the same time, other factors that could lead to changing the outlook to stable from negative include (1) Net debt to EBITDA decreasing to below 6.5x; and (2) 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) Net debt to EBITDA increasing above 7.5x; and (2) Fixed charge coverage decreasing below 2.0x.

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 SAR22.1 billion ($5.9 billion) as of 30 June 2020.

For the LTM ending June 2020, ACC reported revenues were SAR 2.1 billion ($560 million) with net income of SAR 563.7 million ($150 million).

The local market analyst for this rating 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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