Fitch Ratings 2019 Outlook: GCC Corporates

Macro-Economic Challenges Pressure Cash Flows

Gulf Cooperation Council (GCC) Corporates Sector Outlook: Stable
GCC economies remain predominantly oil based despite noticeable efforts to boost non-oil sector growth. GCC economies are more exposed to global monetary tightening policy and higher interest rates as generally their currencies are pegged to the US dollar. GCC corporates have a higher proportion of government ownership than most of the Fitch-rated universe, including issuers in the oil & gas, utilities, telecom sectors as well as some engineering & construction.

There is greater delegation of sovereign projects to non-government-related entities (GREs), despite a softening in expected oil prices, a key driver for sovereign investment in the region. We expect the development of new economic frameworks supporting residential construction in particular to lead to deeper property ownership by nationals. However, we expect the pace of fiscal consolidation to slow despite its importance in stimulating growth in non-oil sectors.

Rating Outlook: Stable
Most Fitch-rated entities in industrials, property and real estate, natural resources and utilities are on Stable rating Outlooks reflecting strong sector fundamentals, high oil prices and favourable macroeconomics. GCC telecoms are all GREs and Outlooks are linked to sovereign ratings. We do not expect weakening links between GREs and the sovereigns under our relevant criteria. However, we expect more privatisation plans in 2019, starting within the utilities sector, without compromising the links with the sovereigns.

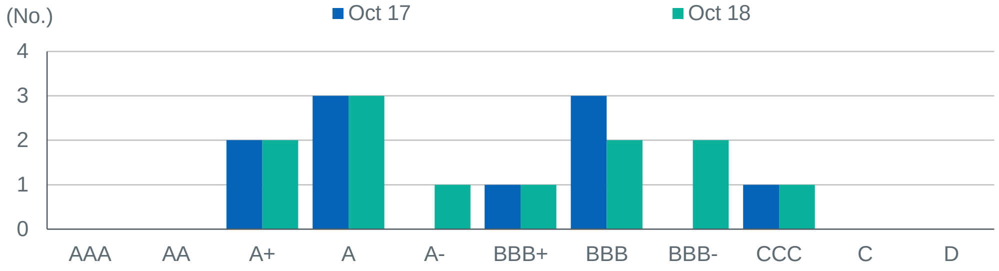
Rating Distribution Weighting: Standalone Investment Grade
The majority of GCC standalone entities are strong investment grade, supported by resilient rental income and stable financial metrics (eg Majid Al Futtaim), and by robust business profiles and strong market position (eg National Central Cooling Company PJSC).

What to Watch

- Government initiatives to boost home ownership mainly in Saudi Arabia and Abu Dhabi.
- Increased sukuk issuance for first-time issuers.
- Increased investments in e-commerce platforms.
- Further subsidy reforms and privatisation plans in the regulated utility sector.
- Increase foreign-exchange (FX) exposure for GCC technology, media and telecommunications players.

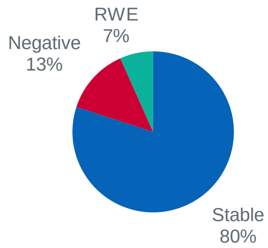
Samer Haydar, Associate Director, EMEA Corporates
"While the majority of GCC corporates are on a stable outlook, increasing macro-economic challenges and new government reforms will put pressure on cash flows at a time when we expect increasing debt capital market activity in 2019."

GCC Corporates - LT IDR Distribution



Source: Fitch Ratings

GCC Corporates - Ratings Outlook/Watch
As at Oct 18



Source: Fitch Ratings

GCC Sector Forecasts

Leverage Trend: Rising for Property Real Estate; Steady for Telecoms and Utilities

We expect total adjusted debt/operating EBITDA, loan/value (LTV) ratio and funds from operations (FFO) net leverage to be fairly stable for industrials and property real-estate companies in 2019. LTV expectations are on the cusp of 50%, supported by long-term funding (more than 18 months) and net interest coverage above 3x for investment-grade issuers. We forecast telecom issuers to maintain leverage-light balance sheets and flat leverage in 2019 for utilities.

Cash-Flow Generation: Neutral

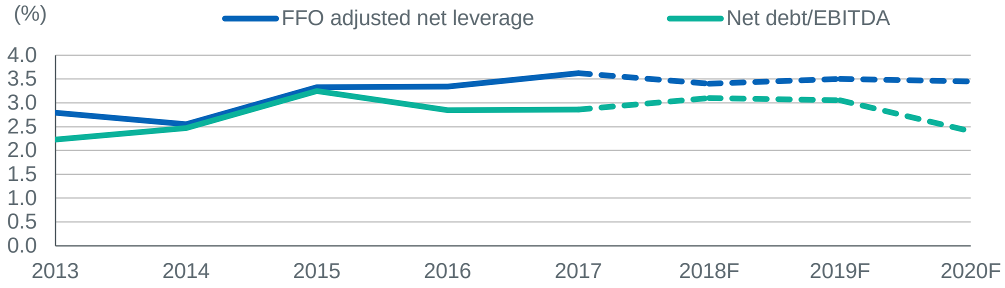
We view neutral cash-flow generation for GCC telecoms supported by good cash buffers in currencies pegged to the dollar in their domestic markets. However, Fitch forecasts the majority of property real estate and utilities' players to remain free cash flow (FCF) negative, mainly due to high dividend and capex outflows.

Liquidity Position: Manageable

We expect market liquidity to remain strong in the strong GCC economies such as UAE, Qatar and KSA and is yet to become more selective on the back of rising interest rates. The capital structure for investment-grade GCC-based corporates is well diversified. Deepening domestic capital markets are coming into focus. The UAE has taken initiative to establish the local debt capital market for local issuances and to ensure the availability of adequate funding for the non-oil sector and non-GRE corporates.

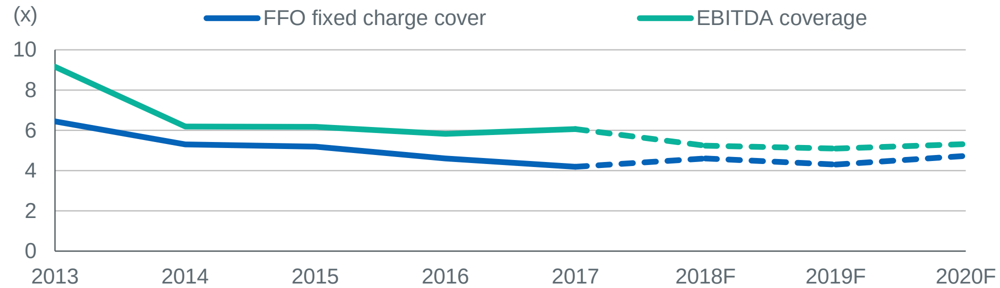
Most of the rated entities in the region are utilising sukuk as means of refinancing their respective current facilities, improving liquidity, expanding funds and diversifying funding options. We expect the popularity of sukuk to continue increasing and to tap the wider regional and local investor pool that includes Islamic investors. To date, corporate funding has been reliant on commercial banks.

GCC Corporates - Median Leverage



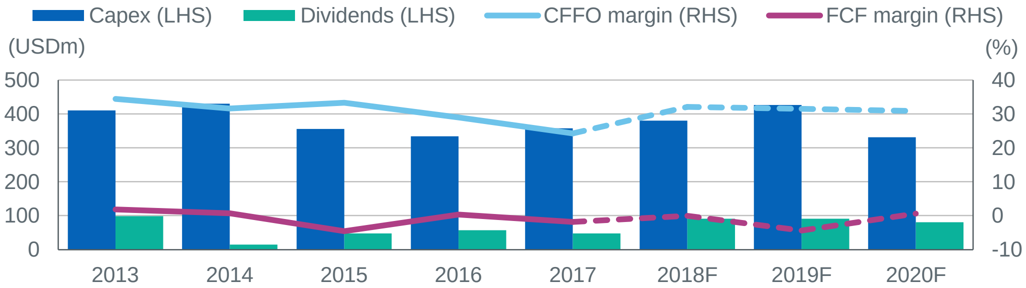
Source: Fitch Ratings

GCC Corporates - Median Coverage



Source: Fitch Ratings

High Capex and Dividend Outflows Limiting FCF Generation



Source: Fitch Ratings

GCC Sector Fundamentals

Property: Boosting Home Ownership

We expect the real-estate sector will remain under pressure with a differentiation between prime assets in prime locations versus secondary assets, particularly in the UAE. We expect stable occupancy ratios in the retail space and in prime residential areas. Average occupancy rates are expected to be above 90% for major mall operators like Majid Al Futtaim Holding LLC (BBB/Stable).

We expect stable key performance indicators for Jebel Ali Free Zone FZE (BBB+/Stable), Dubai Investments Park Development Company LLC (BB+/Stable) and Emirates REIT (BB+/Stable) despite continued softening for the commercial and hospitality segments.

Governments in Saudi Arabia and Abu Dhabi have put in place initiatives to boost home ownership and launch national housing programs, which we expect to cautiously stimulate activity in the contracting/construction and infrastructure projects, faced by a selective appetite from local banks. Abu Dhabi's government (AA/Stable), through its "2030 Vision" programme, established the DARI initiative, which allows nationals to utilise an AED2 million housing soft loan from the government.

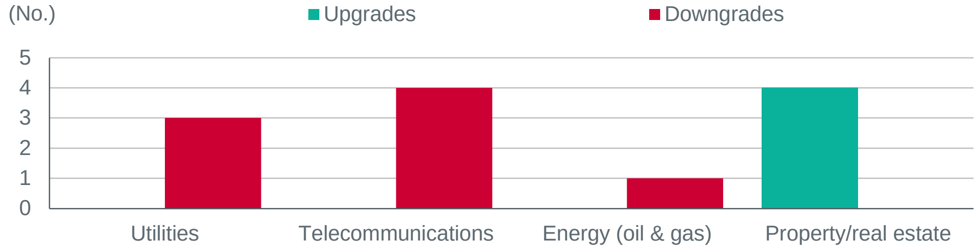
The government of Saudi Arabia (A+/Stable), through its "National Transformation Programme 2020", has set the key objectives of doubling the contribution of real-estate activity to the economy, increasing the percentage of Saudi families owning homes to 52% and increasing the percentage of real-estate financing to non-oil GDP to 15%.

Telecoms: Strong Domestic Markets

GCC telecoms' ratings are linked to the sovereign with the majority having an investment-grade standalone credit profile. Stable domestic performance remains key with low-single-digit growth in the UAE, Qatar and Oman. The impact of international exposure and FX mismatches is evident in the case of Ooredoo. Batelco will remain exposed to FX volatility coupled with concerns over network separation in its domestic market. Omantel's international exposure is limited to dividend received from Zain.

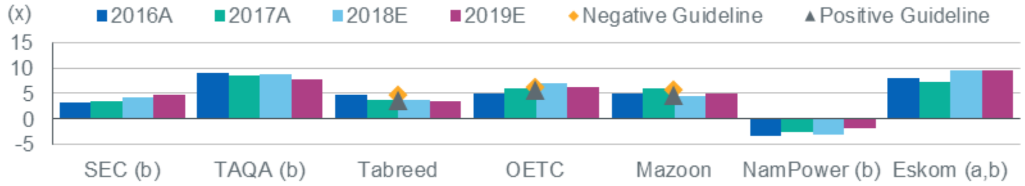
We expect stable dividend policies for GCC telecoms for 2019.

GCC Corporates - LT IDR Changes By Sector
2014-2018



Source: Fitch Ratings

FFO Adjusted Net leverage
EMEA Utilities



(a) 2018 Actual for Eskom
(b) GRE supported IDR for SEC, TAQA, NamPower and Eskom therefore no positive or negative net leveregae guidelines
Source: Fitch Ratings

GCC Sector Fundamentals

Utilities: Subsidy Reforms and Privatisation Plans

Fitch expects further announcements in 2019 regarding potential unbundling or privatisation for GREs like Saudi Electricity Company (SEC), Oman Electricity Transmission Company and Mazoon. We do not expect changes in the links between the GREs and sovereign as a result of possible privatisation plans in the case of SEC, which could trigger change of control clauses in bond and loans covenants.

GCC countries are reducing subsidies to water and electricity sectors, with Saudi Arabia and Oman in the lead, which we believe is neutral as electricity tariffs remain significantly subsidised. The increase in tariffs will be paid to the government and will not benefit utility providers such as SEC. We expect the district cooling sector to play a growing role in the utility sector, given its cooling distribution and low energy consumption model, such as Tabreed (BBB/Stable).

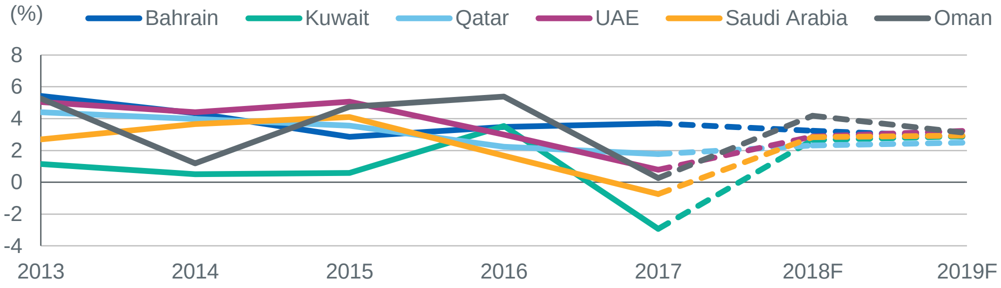
Oil & Gas: Low Production Costs Shield Against Oil Price Volatility

We expect oil prices to remain volatile in 2019, which will be driven by geopolitics to a large extent. Middle Eastern oil producers are well positioned to survive this resumed volatility given generally low production costs in most countries of the region, strong balance sheets and potential support available from governments. Most countries – with the notable exception of Saudi Arabia – have adjusted their budgets to the USD50-USD60/bbl oil price.

Saudi Arabia still needs oil at above USD80/bbl to balance its budget, but this is mitigated by the country's strong fiscal and external balance sheets. Our base case for 2019 is USD65/bbl for Brent crude.

We expect exploration and development investments to remain stable in the region – Middle Eastern producers have not significantly curtailed investments even when oil prices collapsed in 2015-2016. Production in some countries may fall year on year following the OPEC decisions. However, this should not have a significant impact on earnings.

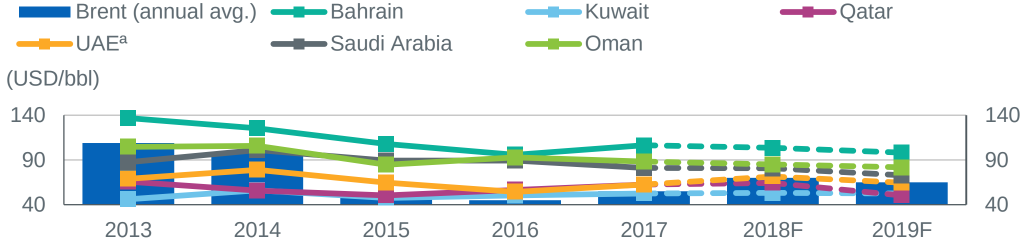
GDP Growth Per Country



Source: Fitch Ratings

Fiscal Break-Even Oil Prices

Expressed in brent terms



[a] Source: IMF - REO
Source: Fitch Ratings

Key Rating Triggers for Select Issuers on Watch, Positive or Negative Outlook or CCC or Below

Issuer	IDR	Outlook/Watch	Coverage Ratio 2018F(x)[a]	Leverage 2018F (x)[b]	Key Downgrade Trigger	Key Upgrade Trigger
Mazoon Electricity Company SAOC	BBB-	Negative	4.6	4.6	• Sovereign rating downgrade. • Negative changes to the regulatory framework. • FFO adjusted net leverage above 5.5x, and FFO fixed-charge coverage below 3.5x on a sustained basis.	• The revision of the Outlook on Oman's sovereign rating to Stable provided the links with the parent remain unchanged. • Stronger regulatory environment and FCF. • FFO adjusted net leverage below 4.5x, and FFO fixed-charge coverage above 3.5x on a sustained basis.
Oman Electricity Transmission Company SAOC	BBB-	Negative	2.8	7.0	• Sovereign rating downgrade. • Negative changes to the regulatory framework. • FFO adjusted net leverage above 6.2x and FFO fixed-charge coverage below 3x on a sustained basis.	• The revision of the Outlook on Oman's sovereign rating to Stable provided the links with the parent remain unchanged. • Stronger regulatory environment and FCF. • FFO adjusted net leverage below 5.5x and FFO fixed-charge coverage below 3.5x on a sustained basis.
Oman Telecommunications Company S.A.O.G.	BBB-	Negative	21.7[c]	4.2	• Sovereign rating downgrade. • Pressure on FCF driven by EBITDA margin erosion, consistently higher capex and shareholder distributions, or significant underperformance in the core domestic market and at other key subsidiaries. • FFO adjusted net leverage on a deconsolidated basis sustained above 3.8x as a result of M&A, significant reduction in dividends from Zain and weakness in domestic FCF without remedial action from the company.	• A two-or-more notch upgrade of the sovereign rating, or a revision of the sovereign Outlook to Positive, with continued support from the government of Oman, without a weakening in the links with the sovereign. • FFO adjusted net leverage on a deconsolidated basis sustainably below 3.3x. • Improved visibility on the impact on FCF of increased domestic competition from new entrants and expectations of manageable erosion to voice services revenue.
Kuwait Energy plc	CCC	Evolving	5.5	1.3	• Termination of the acquisition process coupled with no or little progress with achieving a sustainable capital structure. • Default becoming probable, a payment default or a debt restructuring that is viewed by Fitch as a distressed debt exchange.	• Completion of the acquisition by UEG. • Success in obtaining long-term financing and/or raising cash from disposals and stable production from Iraqi green fields leading to a significant liquidity buffer in the form of available cash or committed facilities at each quarter-end.

[a] FFO Fixed-Charge Coverage
[b] FFO adjusted net leverage
[c] 4.5x in 2019F
Source: Fitch Ratings

Outlooks and Related Research

2019 Outlooks
Global Economic Outlook (December 2018)
Emerging Market Capital Inflows to Remain Subdued after Post-Crisis Low (November 2018)
Oil Windfall to Test Durability of Gulf Exporter Reforms (July 2018)
UAE Eases Foreign Ownership for Growth, Free Zones Tested (June 2018)

Analysts

Paul Lund
+44 20 3530 1244
paul.lund@fitchratings.com

Samer Haydar
+971 4 424 1240
samer.haydar@fitchratings.com

Shrouk Diab
+971 4 424 1250
shrouk.diab@fitchratings.com