CAPITAL STANDARDS
An Independent Rating Agency

# Salhia Real Estate Co. K.S.C. (Closed)

August 2010, Kuwait

| | |
|---|---|
| ***Rating*** | ***BBB-*** |
| ***National Rating*** | ***A-$_{KW}$*** |
| ***Outlook*** | ***Stable*** |

## Report Contents



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## Corporate Profile

*"Leading Kuwaiti real estate company with a unique position in the high-end commercial and hospitality sector in the GCC, UK and Germany"*

Salhia Real Estate Company K.S.C. (closed) (referred to as "Salhia" or "the company", rated 'BBB-' with a stable outlook is a leading Kuwaiti real estate company in the commercial and hospitality sector. The company's credit rating is reflective of the quality of its portfolio, sector and geographical diversification, stable operating cash flows, and an experienced management. The rating is also supported by Salhia's position as one of the top 10 real estate companies in Kuwait. The rating is however constrained by high leverage, earning volatility, liquidity pressure, and a challenging operating environment.

Salhia owns high-end properties in prime locations in the GCC, UK and Germany, which contributes to very high occupancy rates in most of its properties. The high occupancy rate enhances Salhia's cash flow position and operating profitability. The company was established in 1974, giving it a strong track record of operations in: 1) Real estate, 2) Hotels, and 3) Care home. Salhia is a KSE listed company with the largest shareholders being Mr. Ghazi Fahad Al-Nafisi (16.42%), Al-Zaben Global General Trading Company (6.34%) and Mr. Issa Abdulla Al-Othman (5.13%). The rest of the shares are widely held by the public.

Salhia's real estate operations include rental income from commercial properties in the GCC and UK. These properties include office buildings, high-end shopping malls, hotels and industrial real estate. Salhia focuses on investing in 'class A' properties in prime locations to assure market leadership and stable cash flows. The company has insignificant operations in the residential sector.

The hotel operations include two hotel properties in Kuwait managed by the Marriott Group. The Courtyard Marriott which is a 4-star hotel located in the heart of Kuwait City and includes the luxurious Arraya Ballroom Hotel. The JW Marriott is a 5-star hotel located in Kuwait city (Al Salhia area) and is connected to the Salhia shopping mall. Salhia's care home business in Germany is operated through its 90.89% owned subsidiary Haddia Holding GMBH. Haddia owns 13 nursing homes and 4 senior residence homes.

# Key Rating Considerations

- Salhia is a leading real estate company with a strong market position in high-end properties across the GCC, UK and Germany
- The company benefits from a well diversified revenue stream encompassing commercial, home care and hotel operations
- The focus on long term investment and rental operations has resulted in stable operating cash flows and relatively lower asset volatility
- The selection of property type and location increases the company's ability to mitigate the negative impacts of a volatile economic environment
- The company benefits from improving operating margins. However potential pressure on earnings from the oversupply in the commercial real estate market in Kuwait, and low levels of liquidity (current ratio in FY2009: 0.23x) constrains financial performance.
- Financial flexibility is further constrained by a high level of encumbered assets (FY2009: 30.48%) and short-term debt (in FY2009: 51.14% of total debt)

## *Outlook*

The outlook for Salhia is stable, supported by their market position as a provider of high-end properties and stable operating cash flow. Salhia has a high quality asset base and enjoys a diversified revenue stream from its operations. The management plans to deleverage the company to improve financial flexibility. Furthermore, management is targeting a debt-to-equity ratio of less than 1 at the end of FY2010. The financial crisis affected Salhia to some extent; however, the majority of these effects were impairments of properties and unrealized losses on the investment portfolio.

Salhia is expected to benefit from the real estate development in countries like Qatar, Bahrain, Saudi Arabia and the government of Kuwait's expansion plans. Salhia also benefits from its partnership with Key Property Investment, a leading UK real estate company.

# Management Strategy

### *Conservative investment strategy*

Salhia's approach to investing in prime real estate properties provides the company with a unique market position in Kuwait, UK and other GCC countries. The company focuses on long-term development of properties whereby they hold, innovate, fix and rent properties for reliable and stable income. The business model does not include short-term speculative property trading, which is reflected in stable cash flow from operations.

### *High Geographic and Segmental diversification*

Salhia's operations in the commercial and hospitality segment across the GCC, UK, and Germany adds diversity to the company's real estate portfolio and achieves stable operating income. Salhia successfully expanded its market position through development of international activities which should provide a more profitable and stable revenue stream over the longer term.

### *Liquidating investment portfolio to deleverage*

Salhia plans to deleverage by the end of FY2010 to reach debt-to-equity target ratio of less than 1, through liquidation of their KWD 48 mn foreign investment portfolio. A KWD 12.5 mn short-term loan was obtained through a financial institution to partially fund the purchase of investments. This loan is secured against the investment portfolio. Salhia is also focusing on increasing the maturity of its debt portfolio, given that in FY2009, short-term debt constituted 51.14% of total debt (FY2008: 57.63%).

### *Implementation of cost accounting to avoid overstated real estate value*

The value of real estate owned by Salhia is recorded at cost in the balance sheet. This conservative strategy reflects the management's focus on stable cash flows and avoidance of volatility in the income statement, mainly from revaluation of property.

### *Encumbered asset*

Salhia's favorable relationship with its banks, especially in Kuwait and the UK has resulted in financial and operational flexibility, as reflected by the adequate credit lines. CSR notes a high encumbrance of assets in the balance sheet; however, these assets are primarily for construction projects against long-term loans. Encumbered assets are expected to decline by the end of 2010, giving Salhia more flexibility with its asset base.

## Business Model & Operating Segments

### *Commercial Real Estate generating stable rental income*

Salhia's real estate operations include commercial properties generating rental-income. The company operates real estate properties in Kuwait, Bahrain and the UK. Office buildings and shopping malls constitute the majority of Salhia's real estate operations, with insignificant operations in the residential sector in UK. The real estate investment strategy is based on selecting prime locations and building high quality properties. This strategy yielded the company 100% occupancy rates for most of its properties.

## Salhia Real Estate Co. K.S.C. (Closed)

### *High-end Real Estate Projects*

#### Projects in Kuwait

- **Salhia Commercial Complex:** One of the first luxurious shopping malls in Kuwait with more than 16,000 square meters of retail space and more than 25,000 square meters of office space. In 2009, Salhia Complex had a 100% occupancy rate for the sixteenth consecutive year and a waiting list (as of FY2009). This is mainly due to complex's prime location and high quality service such as parking space that fits more 400 cars and an outdoor strip "Salhia Plaza" that includes restaurants and coffee shops.
- **Sahab Tower:** a 20-floor office building with 3 floors of retail space. The tower was opened in 1997, and after a year of operations (in 1998) the tower achieved a 100% occupancy rate which continued until the current date (eleven consecutive years as of FY2009).
- **Arraya Commercial Center:** a luxurious property comprising a shopping mall, office space, a 4-star hotel (Courtyard Marriott), an outdoor plaza and a multi-storey parking space. Tenants include famous international retailers, and for six consecutive years (as of FY2009), Salhia has managed to maintain a 100% occupancy rates for both the retail and office space.
- **New Arraya Tower (Arraya II):** One of the tallest office buildings in Kuwait, reaching 300 meters high. The design of the building with no intervening inner columns provides more space and flexibility for tenants. Arraya II has 60 floors with floor areas ranging from 520 square meters to 740 square meters. The occupancy rate for Arraya II stands at 82% (as of FY2009).

***Al-Asima Project*:** One of the largest construction projects to be carried out by the private sector with a total cost of KWD 240 mn. However, the project was halted due to conflicts between Salhia, the Ministry of finance and the State Properties Department. The origin of the conflict was the classification of the government land, whether it should be accounted as B.O.T or as rental. Constructions are not expected to commence before mid 2011 as Salhia has to revaluate the feasibility of the project once the official government contract is awarded.

#### Projects in UK

Through its 50% owned joint venture Key Property Investments (KPI), Salhia owns a portfolio of rental-income generating properties in UK, and is engaged in refurbishment and development activities. KPI owns properties across UK such as London, Farnborough, Manchester and others. The properties are diversified across sectors, namely, retail, office buildings, leisure, residential, industrial, hotels and logistics. In the recent financial crisis, KPI's financial performance was negatively impacted by competition and over supply in the market.

*A Selection of KPI's real estate projects in the UK:*

- **Elephant & Castle (London):** a mixed use center located south of the River Thames with more than 21,000 square meters of retail space and more than 8,000 square meters of office space. Future plans include development of the surrounding area of Elephant & Castle which aims to create 60,400 square meters of retail and other commercial facilities, and up to 5,300 new homes.

- **Queensmead and Kingsmead (Farnborough):** a 31,000 square meters property with retail, office, residential and parking space. Conditional planning consent was obtain by KPI for partial development of the property to include 11,600 square meters of retail space, a 4,600 square meters supermarket, a 77-room hotel and 159 residential apartments. The construction of the residential apartments is in progress.

**Salhia Tower, Bahrain**: is an office building with 36,000 square meters of rentable office space, 7,900 square meters of retail space and parking space for almost 900 cars. This property is in a prime location in Bahrain Bay. The design of the project is expected to be completed by 2010, then construction will commence.

### *Hotel Operations concentrated in Kuwait*

Salhia's hotel operations include two hotels in Kuwait managed by Marriott Group.

**JW Marriott Hotel:** Salhia signed a management agreement with the Marriott Group in 2002. The JW Marriott is a 5-star hotel located in the heart of Kuwait City (Salhia area) and connected to the Salhia Complex. The hotel comprises of 241 rooms, 74 suites, conference and meeting facilities, and five restaurants.

**Courtyard Marriott Hotel:** is a 4-star hotel located near the financial and business district in Kuwait. The hotel is designed to accommodate business people, with rooms' equipped with work desks, high-speed internet connections and satellite TV. A business center has been added along with four private meeting rooms. The hotel is comprised of 306 rooms and 12 suites.

**Arraya Ballroom:** is also managed by Marriott Group. It comprises of 1,500 square meters of meeting space, bridal suites and offices on two floors. The grand ballroom is divisible into six separate halls. It is the largest indoor events venue equipped with audio-visual and communications technology. Arraya Ballroom is known for holding events and conferences on the regional level such as economic and political forums along with other celebrations such as marriage and formal activities.

### *Care Home Operations in Germany*

Salhia's care home operations are managed through its 91% owned subsidiary, Haddia Holding GMBH. Haddia is specialized in high quality care for the elderly. Haddia's subsidiary, SAREC Gmbh, owns 18 nursing care properties located in different district of Northern Germany. These nursing properties include 13 nursing homes, 4 senior residence homes and one office building. All properties have long term lease agreements with a private operator (DANA Gmbh) of nursing homes. Dana Ambulante and Gredo are responsible for catering and services. All of the previously mentioned companies are subsidiaries of Salhia (either directly held or through Haddia Holding GMBH).

According to statistics released by the government of Germany, it is expected that the number of people over the age of 80 will almost triple in 2050 when compared to 2006 (from 3.7 mn to 10 mn). The statistics released also predicted that the average age of the population would shift from 42 to 50. The care home industry is highly regulated and labor intensive with prices controlled by the government. However, it is expected that the care home operations would have a positive outlook on the long-run with a steady and sustainable growth.

# Financial Risk Profile

## *Diversified Revenue Stream*

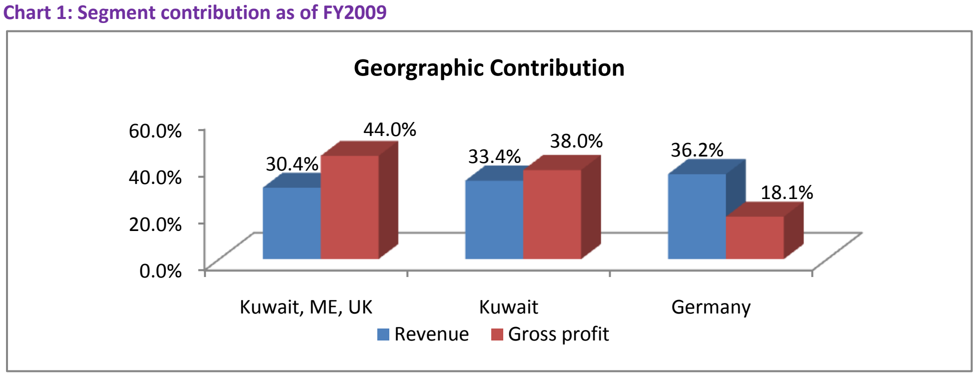
Salhia has a well diversified revenue stream generated from its three core operations. The volatility in the real estate operating profit is mainly due to the results of associates and Joint Ventures (JVs). The operating profits from hotel operations witnessed a steady increase over FY2005-FY2009 due to the increased activities and business travels. Arraya Ballroom also contributes to this segment's profit as it is one of the few options in Kuwait for formal events. CSR expects profit from hotel operations to stabilize in the near future driven by completion of new hotel properties, and intensifying competition.

**Table 1: Segments**

| *KWD mn* | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| *Real Estate Operations* | 7.57 | 2.01 | 2.93 | 4.36 | 3.99 |
| *Hotel Operations* | 5.98 | 5.93 | 4.46 | 4.72 | 3.44 |
| *Care home Operations* | 1.47 | 1.41 | 1.22 | 1.40 | 1.64 |
| *Total Profit* | ***15.02*** | ***9.34*** | ***8.60*** | ***10.48*** | ***9.07*** |

**Source: Salhia Real Estate Company**

**Chart 1: Segment contribution as of FY2009**




**Source: CSR research**

## *Care home operations a drag on profits*

Salhia operates care homes in Germany through its subsidiary (Haddia Holding) and owns 13 nursing homes, 4 senior residence homes and one office building in different districts of Northern Germany. Haddia managed to increase occupancy rates to reach an average of 88% which contributed to an increase in sales from € 34.9 mn to € 37.2 mn in FY2009. It is worth noting that though the care home operations constitute around 36% of the revenue, the gross profit margins has remained historically low. This is primarily on account of government regulations and subsidies provided to care home residents.

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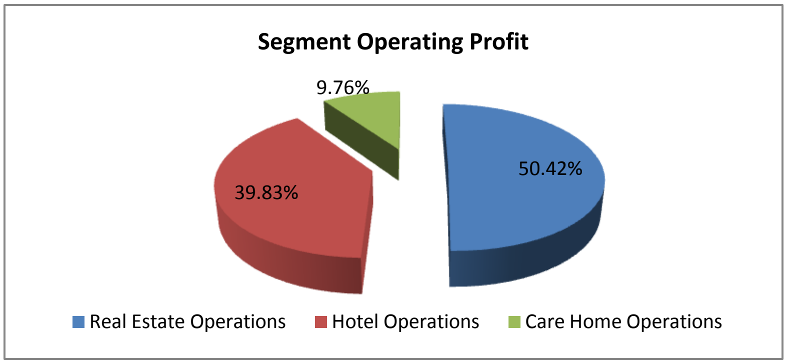
**Chart 2: Segment Operating Profit as of FY2009**




**Source: Salhia Real Estate Company**

The real estate and hotel operations comprised 90.25% of the total operating profit of Salhia in 2009. These two segments have been providing stable and reliable profits over the past years. The care home operations witnessed a horizontal trend since FY2005 as it has unique characteristics where the prices are set by the German government, resulting in a constrained performance. The key behind their care home operations is the value of the land they operate on, which is located in prime areas in Germany. Salhia expects to benefit from real estate value appreciation in the medium-term. Overall the performance of Salhia's core segments assures a steady and stable growth over the years.

### *Stable Operating Margins driven by rental income*

Salhia's operational revenues are primarily generated through real estate, hotel and care home activities. Revenue from operation remained less correlated to economic activity throughout FY2005-FY2009, and the company registered an increasing trend in operating profitability over the period. The company has maintained a stable EBITDA margin driven by the improving operational efficiency and effective cost management.

**Table 2: Profitability**

| *Profitability Ratios* | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Gross profit margin | 60.99% | 57.42% | 57.78% | 55.67% | 59.54% |
| Operating profit margin | 33.99% | 31.19% | 25.29% | 28.71% | 26.84% |
| EBITDA margin | 45.40% | 42.93% | 38.04% | 42.96% | 42.23% |
| ROA | 2.82% | (13.84%) | 9.61% | 20.97% | 8.37% |
| ROE | 5.73% | (34.38%) | 20.48% | 36.26% | 17.01% |

**Source: CSR Research & Salhia Real Estate Company**

### *Volatile Net Profit Margins*

Salhia's Net Profit Margin has been extremely volatile driven by Investment income, gain on sale of properties, and Impairment on AFS investments. Investment income is derived from gain on sale of financial assets, dividend income, and interest income from managed portfolios. The nature of equity markets have resulted in this volatility. CSR notes that the Net profit margins could be less volatile depending on the company's plan to liquidate a majority of its portfolio. Salhia's gain on sale of property is largely derived by the opportunities for reinvestment.

Table 3: Non-Operating Items

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Net profit margin | 15.72% | (82.76%) | 76.44% | 134.12% | 51.81% |
| Investment income | 7,774 | 8,606 | 6,130 | 885 | 11,467 |
| Gain on sale of properties | - | - | 26,781 | 49,057 | 4,912 |
| Impairment on AFS investments | (9,514) | (47,895) | (4,862) | - | - |

Source: CSR Research & Salhia Real Estate Company

### *Coverage ratios*

Salhia enjoys above average fixed charge coverage and is expected to improve further in FY2010 and FY2011, if the company successfully manages to reduce debt and maintains its conservative strategy. Salhia benefits from adequate levels of reinvestment flexibility (Reinvestment ratio = CFO / Additions to investment properties and PP&E). This flexibility allows the company to balance between funding projects (purchase of properties, construction activities, etc.) through internally generated funds and debt issuances. The ability to balance between these funding options allows the company to maintain capital structure targets.

Table 4: Coverage Ratios

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Fixed charge coverage ratio | 2.74x | 2.64x | 2.75x | 1.28x | 1.81x |
| Reinvestment ratio | 2.79x | 0.77x | 0.98x | 0.70x | 1.71x |

Source: CSR Research & Salhia Real Estate Company

## Asset Quality

### *Diversified asset base*

Salhia has a well diversified portfolio with almost no single location, tenant, industry or economic sector concentration. The company operates in Kuwait & the GCC, Germany and the UK. The company's core activities are commercial real estate (including offices and shopping malls), hospitality, nursing homes, and Industrial & logistic real estate. Salhia operates high end properties in Kuwait like Al Raya, Al Raya 2, and the Salhia complex. The company's business model is to acquire a real estate (either constructing or purchasing), operate and sale when the opportunity arises.

### *Cost accounting approach*

The company has KWD 32.3 mn worth of loans that are secured by investments in securities, property and land with a carrying value of KWD 85.3 mn which restrains the financial flexibility of the company to a certain extent. However, based on an independent third party valuations, the fair value of real estate properties including investment properties and property amounted to KWD 431 mn (balance sheet amount of *Total Investment Properties and Property & Equipment:* KWD 172 mn). The valuations are 2.5 times more than the values recorded in the balance sheet, which reflects high quality of Salhia's real estate portfolio.

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### *Financial assets Available for sale highly exposed to global volatility*

Salhia's investment portfolio is largely (around 76% of the investment portfolio) invested in the foreign markets exposing the company to volatility in the global equities. Salhia recorded high impairment losses in 2008 due to the crisis in the global and local equities.

In 2010, the company plans to liquidate a large portion of its foreign investment. This strategy is expected to significantly reduce Salhia's exposure to equity market risks. The investment portfolio is expected to have a value of about KWD 20 mn at year end, after the liquidation of foreign investments, reducing the investment portfolio to around 6.8% of total assets in FY2010 (FY2009: 21.6%). The volatile effect of equity markets on the company's balance sheet and income statement is expected to decline significantly.

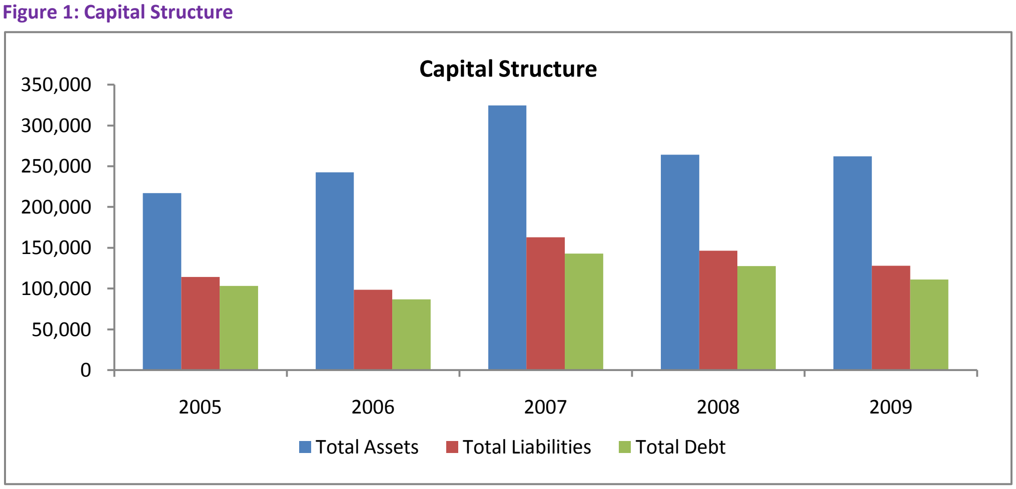
**Table 5: Investment Portfolio**

| | 2009 KWD mn |
|---|---|
| Managed portfolios | 79.1 |
| Managed funds | 0.3 |
| Unquoted securities | 28.0 |
| *Less: impairment loss* | *43.6* |
| **Total** | **63.8** |
| Local investments | 15.3 |
| Foreign investments | 48.5 |

**Source: Salhia Real Estate Company**

### *Leverage*

**Figure 1: Capital Structure**



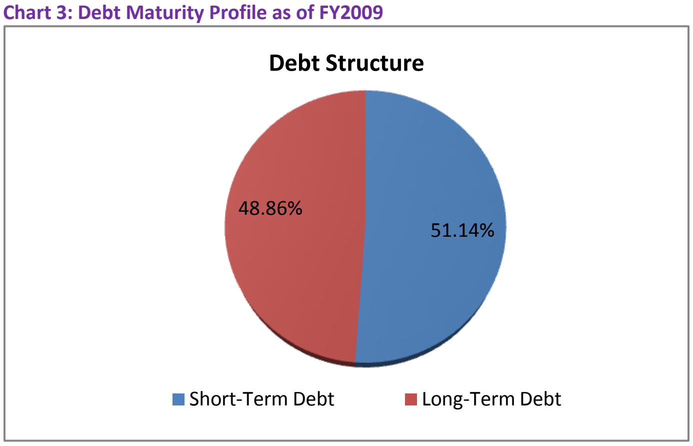

**Source: Salhia Real Estate Company**

The company's debt over assets (the value of assets used based on cost) though high at 51.14% in FY2009 is expected to improve in the medium-term driven by the focus on deleveraging. While using the market value of assets based on valuation prepared by third independent parties, the adjusted debt to assets ratio would drop to less than 31%. This indicates that Salhia's financial flexibility is enhanced by its high quality asset portfolio.

The cash flow leverage for Salhia has been declining since FY2007 due to lower debt levels and improvement in operating efficiency. The cash flow leverage (Net Debt over EBITDA) of 5.15x (in FY2009) indicates financial flexibility, and adequate cushion to sustain downturns. Salhia's secured debt constitutes 29.15% of its total debt. However, the company's borrowings are covenant-free which provides the company greater operational and financial flexibility.

Salhia's total debt as of FY2009 stood at KWD 111 mn and the management is planning to reduce debt to around KWD 70 mn at the end of 2010. This reduction will be achieved through the sale of investment assets (foreign investments) and bank facilities such as available credit lines. In FY2010/FY2011, Salhia's estimated debt profile would be classified into three categories; KWD 30 mn in long-term local debt, KWD 20 mn in short-term debt, and KWD 30 mn long-term debt taken by its subsidiary (Haddia) which is non-recourse to Salhia. Having a short-term oriented borrowing scheme significantly pressures the company's liquidity levels. Through the period of FY2005-FY2009, Salhia's short-term borrowings have been increasing relative to the total debt. In FY2005, Salhia had a 25.37% of short-term debt/total debt which has increased to 51.14% in FY2009.

**Chart 3: Debt Maturity Profile as of FY2009**




**Source: CSR Research & Salhia Real Estate Company**

## *Liquidity*

Salhia has low levels of liquidity with a current ratio of 0.23 times in FY2009, largely due to short-term borrowing (FY2008: 0.17 times). The current ratio is based on contractual undiscounted payments i.e. including interest payments. CSR notes that the successful implementation of deleveraging plan, would improve the liquidity in the near term. Salhia's market position and reputation facilitated good credit terms with local banks. As of June 2010, Salhia had an available balance on its credit lines enough to cover 2009's interest payments by more than 2.5 times. This enhances the company's liquidity position, given that around 42% of the credit lines are available as of June 2010.

## *Moderate Dividend Payout*

Salhia has a track record of more than 35 years and the company has been growing steadily over that period. The dividend payout ratio has been stable and moderate over the last 5 years with an average payout ratio of 41.73%. The company's plan to deleverage and liquidate investment portfolio is expected to further stabilize income and dividends in the near future.

**Salhia Real Estate Co. K.S.C. (Closed)**

# Peer Comparison

**Table 6: Peer Comparison**

| | Salhia | Mazaya | Injazzat | United Real Estate | Average |
|---|---|---|---|---|---|
| Total Assets (KWD mn) | 262.34 | 363.72 | 170.70 | 327.41 | ***281.04*** |
| EBITDA Margin | 45.40% | 15.2% | 76.4% | 46.5% | ***45.88%*** |
| EBITDA/ Interest Expense | 3.2x | 3.96x | 1.23x | 1.92x | ***2.62x*** |
| Return on Assets (ROA) | 2.65% | 6.1% | -1.0% | 0.2% | ***3.29%*** |
| Debt/ Equity | 91.4% | 35.2% | 168.0% | 63.0% | ***93.68%*** |
| Debt/ EBITDA | 5.53x | 6.20x | 17.42x | 9.09x | ***9.49x*** |
| Debt maturing in 1 year (% of total) | 51.14% | 100.0% | 28.0% | 66.5% | ***61.41%*** |

**Source: CSR research, Company annual reports**

The selected companies for the peer comparison are believed to be operating in activities similar to Salhia.

Salhia is one of the largest real estate companies in Kuwait and enjoys leadership in commercial real estate and the hotel segment. The operating efficiency of Salhia (EBITDA margin) is in line with the selected peers. Salhia has a high EBITDA/Interest coverage when compared to its peers as Salhia was less affected by the financial crisis and its operating profits increased in FY2008 and FY2009. Salhia's Debt over EBITDA of 5.53 indicates better financial flexibility than its peers. However Salhia's leverage and maturity profile of debt continued to remain weak compared to peers. The company's debt-to-equity ratio of 91.4%, and short-term debt component are expected to decline as the company plans to pay off some short-term obligations after liquidating a part of its investment portfolio.

Salhia has a strong position among its peers and some leadership in the Kuwaiti real estate market. The company benefits from higher financial flexibility and an experienced management team which has led the company to a steady growth over the past years.

# Snapshot of the first quarter of FY2010

### *Changes in the value of the balance sheet*

In the first three months of FY2010, the total assets decline by KWD 6.3 mn mainly due to change in the value of property and equipment. The total liabilities declined by KWD 7.8 mn as the company reduced debt levels by KWD 6.8 mn. Total equity increased by over KWD 1 mn supported by an increase in retained earnings. Overall Salhia's balance sheet did not witness significant changes and continued to remain stable.

### *Earnings boosted by lower impairment loss on financial assets*

Salhia recorded a net profit of KWD 2.5 mn for the quarter ending March 2010 (March 2009: KWD 0.04 mn). The significant increase in net profits is owed to the lower impairment losses in 2010; KWD 0.5 mn as compared to KWD 4.8 mn in 2009. This is mainly due to the stability of equity markets around the world. Impairment losses for FY2010 is expected to be significantly lower than FY2009.

### *Stable operating cash flows*

In the first quarter of FY2010 the operating cash flow has been stable, when compared to Q12009. The stability in operating cash flows is mainly driven by the high quality properties that Salhia owns which provide stable and reliable income. No significant additions have been made to investment properties and property & equipment.

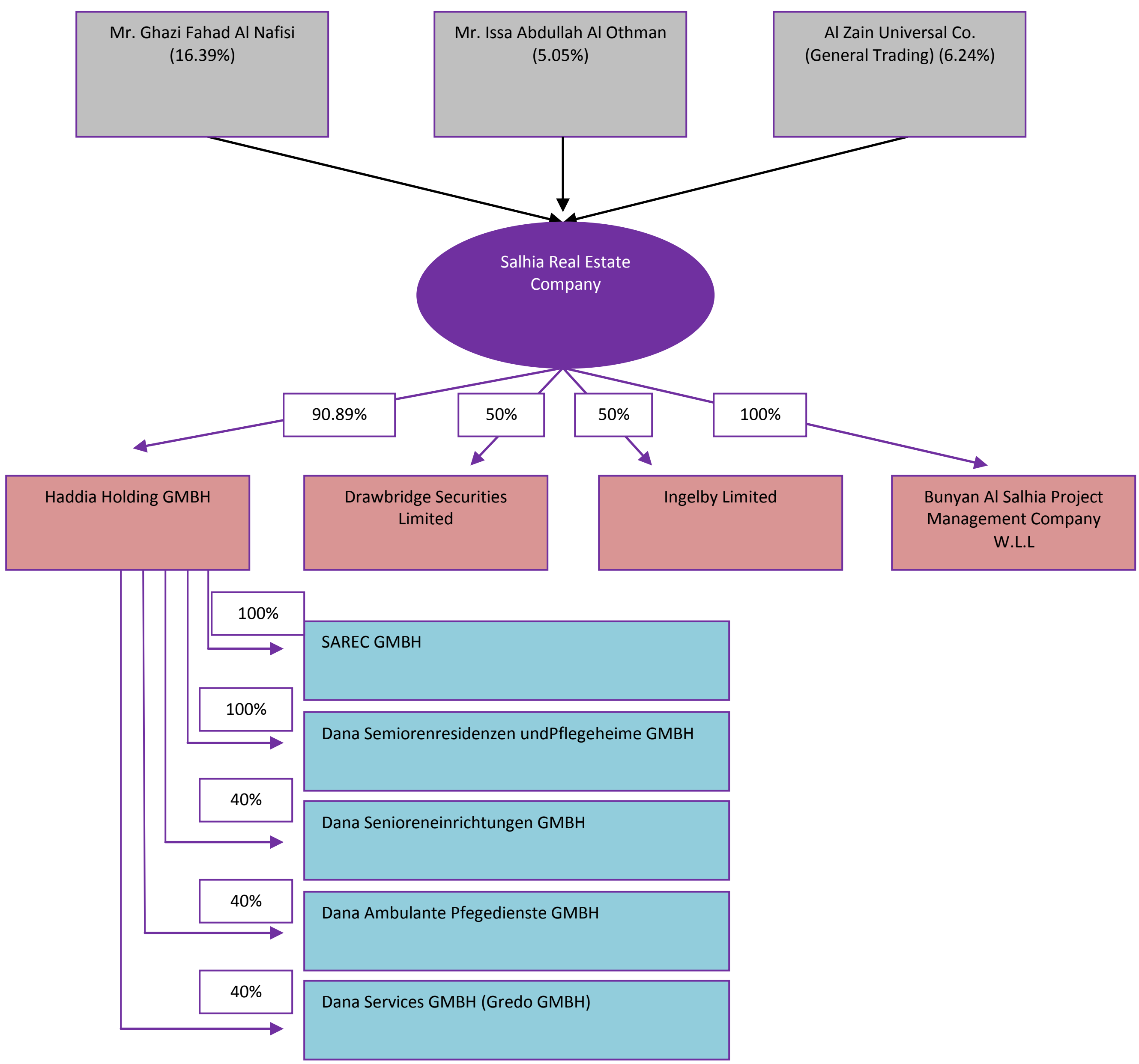
# List of Related Research

- CSR Real Estate Rating Methodology (http://capstandards.com/meth-realestate.php)
- Kuwait Real Estate Industry Report (May, 2010) (http://capstandards.com/CSR_Kuwait-Real-Estate-Industry_May2010.pdf)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available.*

# Appendix

## *Ownership Structure and Subsidiaries*



## Salhia Real Estate Co. K.S.C. (Closed)

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### *Rating Grid*

| Factor | Sub-factor | AA | A | BBB | BB | B |
|---|---|---|---|---|---|---|
| Internal Environment | Ownership & Corporate Structure | | | ■ | | |
| | Company Track Record | | ■ | | | |
| | Management Vision & Risk Appetite | | ■ | | | |
| | Revenue Diversification | | | ■ | | |
| | Joint Venture & Fund Business | ■ | | | | |
| External Environment | Economic Environment | | | ■ | | |
| | Real Estate Market | | | | ■ | |
| | Market Position | | | ■ | | |
| Profitability | Gross Margins | | | | | ■ |
| | Fixed Charge Coverage | | | ■ | | |
| | Earning Momentum | | | | ■ | |
| Asset Quality | Portfolio Diversification | | | ■ | | |
| | Development Activity | | | ■ | | |
| | Free Asset Base | | | ■ | | |
| Leverage | Capital Structure | | | ■ | | |
| | Cash Flow Leverage | | | ■ | | |
| | Secured Leverage & Covenants | | | ■ | | |
| | Debt Maturity Profile | | | | | ■ |
| Liquidity | Funding Capacity | | | | ■ | |
| | Access to Capital Markets | | | | ■ | |
| | Dividend Payout | ■ | | | | |

## Salhia Real Estate Co. K.S.C. (Closed)

# *Financial Statements*

| Balance Sheet (KWD 000s) | | | | | |
|---|---|---|---|---|---|
| Fiscal Year End December | 2009 | 2008 | 2007 | 2006 | 2005 |
| Assets | | | | | |
| Cash & Bank Balances | 3,561 | 6,472 | 4,460 | 2,458 | 2,540 |
| Fixed Deposits | 3,911 | 1,163 | 5,886 | 20,000 | - |
| Inventories | 337 | 367 | 351 | 462 | 430 |
| Accounts receivables and other assets | 9,628 | 6,387 | 43,027 | 8,370 | 7,108 |
| AFS investments | 63,798 | 71,830 | 102,673 | 36,819 | 28,100 |
| Investment in JVs | 9,040 | 10,956 | 14,408 | 18,575 | 15,447 |
| Investment properties | 68,786 | 39,031 | 35,985 | 51,812 | 64,159 |
| PP&E | 103,280 | 127,803 | 117,907 | 103,956 | 99,281 |
| Total Assets | **262,341** | **264,009** | **324,697** | **242,452** | **217,065** |
| **Liabilities & Shareholders' Equity** | | | | | |
| Due to banks | 33,016 | 44,964 | 62,276 | 6,925 | 19,477 |
| Accounts payable and other liabilities | 17,148 | 18,662 | 19,849 | 11,560 | 10,770 |
| Long-term loans | 77,921 | 82,586 | 80,736 | 79,875 | 83,911 |
| Total Liabilities | 128,085 | 146,212 | 162,861 | 98,360 | 114,158 |
| Deferred gain | 12,926 | 11,537 | 9,505 | 9,056 | - |
| Total Equity | **121,328** | **106,261** | **152,330** | **135,035** | **102,906** |

| Income Statement (KWD 000s) | | | | | |
|---|---|---|---|---|---|
| Fiscal Year End December | 2009 | 2008 | 2007 | 2006 | 2005 |
| Revenue | 44,213 | 44,147 | 40,803 | 36,503 | 33,778 |
| Operating costs | (17,249) | (18,799) | (17,225) | (16,180) | (13,667) |
| ***Gross Profit*** | ***26,964*** | ***25,348*** | ***23,578*** | ***20,323*** | ***20,111*** |
| Share in JV's result | (272) | 2,544 | 755 | 1,668 | 1,498 |
| Share of associate's results | (1390) | (2,032) | (448) | - | - |
| G&A expenses | (4373) | (5,885) | (7,386) | (5,323) | (5,204) |
| Depreciation | (5043) | (5,181) | (5,202) | (5,200) | (5,198) |
| Sales and marketing expenses | (857) | (1,024) | (979) | (987) | (2,140) |
| ***Operating Profit*** | ***15,029*** | ***13,770*** | ***10,318*** | ***10,481*** | ***9,067*** |
| Investment income | 7,774 | 8,606 | 6,130 | 885 | 11,467 |
| Gain on sale of properties | - | - | 26,781 | 49,057 | 4,912 |
| Foreign exchange gain (loss) | (857) | (705) | 2,365 | 30 | 286 |
| Interest income | 76 | 175 | 781 | 131 | 69 |
| Other income | 1,170 | 392 | 158 | 285 | 102 |
| Provision for impairment or reversal | 1,059 | (3,673) | - | (200) | (123) |
| Finance costs | (6,263) | (7,158) | (7,500) | (8,846) | (7,145) |
| Impairment on AFS investments | (9,514) | (47,895) | (4,862) | - | - |
| ***Profit before tax*** | **8,474** | **(36,488)** | **34,171** | **51,823** | **18,635** |
| Foreign tax | (1,076) | (48) | (1,716) | (972) | (456) |
| Contributions and directors' fees | (449) | - | (1,264) | (1,894) | (677) |
| **Profit for the year** | **6,949** | **(36,536)** | **31,191** | **48,957** | **17,502** |

## Salhia Real Estate Co. K.S.C. (Closed)

| Cash Flow Statement (KWD 000s) | | | | | |
|---|---|---|---|---|---|
| Fiscal Year End December | 2009 | 2008 | 2007 | 2006 | 2005 |
| Cash from operating activities | 17,241 | 18,898 | 18,993 | 11,301 | 13,080 |
| Cash from investing activities | 7,861 | 11,722 | (68,961) | 49,784 | 4,893 |
| Cash from financing activities | (12,841) | (41,101) | 17,409 | (28,617) | (29,399) |
| Cash & cash equivalents at the year end | (13,010) | (25,273) | (14,794) | 15,531 | (16,937) |

| Key Financial Ratios | | | | | |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| **Liquidity Ratios** | | | | | |
| Current ratio | 0.23 | 0.17 | 0.63 | 1.10 | 0.35 |
| Quick Ratio | 0.22 | 0.17 | 0.63 | 1.09 | 0.33 |
| Solvency Ratios | | | | | |
| Long-Term Debt-to-Equity | 52.91% | 52.51% | 53.76% | 58.58% | 74.92% |
| Debt-to-Equity | 91.40% | 120.00% | 93.90% | 64.30% | 100.50% |
| Total Assets-to-Equity (financial Leverage) | 2.16 | 2.48 | 2.13 | 1.80 | 2.11 |
| **Profitability Ratios** | | | | | |
| Gross profit margin | 60.99% | 57.42% | 57.78% | 55.67% | 59.54% |
| Operating profit margin | 33.99% | 31.19% | 25.29% | 28.71% | 26.84% |
| EBITDA margin | 45.40% | 42.93% | 38.04% | 42.96% | 42.23% |
| Net profit margin | 15.72% | -82.76% | 76.44% | 134.12% | 51.81% |
| ROA | 2.65% | -13.84% | 9.61% | 20.19% | 8.06% |
| Operating return on assets | 5.73% | 5.22% | 3.18% | 4.32% | 4.18% |
| Return on total capital | 2.99% | -15.63% | 10.56% | 22.07% | 8.48% |
| ROE | 5.73% | -34.38% | 20.48% | 36.26% | 17.01% |
| **Coverage Ratios** | | | | | |
| Debt coverage | 0.16 | 0.15 | 0.13 | 0.13 | 0.13 |
| Interest coverage | 2.74 | 2.64 | 2.75 | 1.28 | 1.81 |
| Reinvestment ratio | 2.79 | 0.77 | 0.98 | 0.70 | 1.71 |

# Long-Term Credit Ratings

| | |
|---|---|
| *Investment Grade* | |
| AAA | An issuer/issue with an 'AAA' credit rating is classified as the ***highest*** rating by Capital Standards when compared to its peers. The issuer/issue is highly unlikely to be affected by adverse changes in the environment and economic conditions*. |
| AA | An issuer/issue with an 'AA' credit rating is classified as a ***very strong*** rating by Capital Standards when compared to its peers. The issuer/issue is slightly susceptible to the changes in the environment and economic conditions. |
| A | An issuer/issue with an 'A' credit rating is classified as a ***strong*** rating by Capital Standards when compared to its peers. The issuer/issue is susceptible to adverse changes in the environment and economic conditions. These changes can affect the debt servicing capabilities to an extent that is rendered weaker than those rated 'AA' and 'AAA'. |
| BBB | An issuer/issue with a 'BBB' credit rating is classified as a***dequate*** rating by Capital Standards when compared to its peers. The issuer/issue is influenced by changes in the environment and economic conditions. These changes can affect the debt servicing capabilities to an extent that is rendered weaker than those rated 'A', 'AA' and 'AAA'. |
| *Speculative Grade* | |
| BB | An issuer/issue with a 'BB' credit rating is classified as a ***less than adequate*** rating by Capital Standards when compared to its peers. The issuer/issue is strongly influenced by changes in the environment and economic conditions. This could lead to deterioration in an issuer/issue's capacity to meet its financial obligation to an extent that is rendered relatively weaker than the ones rated under the Investment Grade. |
| B | An issuer/issue with a 'B' credit rating is classified as a ***weak*** rating by Capital Standards when compared to its peers. The issuer/issue could suffer impairment in its debt service capacity due to changes in the environment and economic conditions. Their willingness to service debt obligations could also get subdued. |
| CCC | An issuer/issue with a 'CCC' credit rating is classified as a ***very weak*** rating by Capital Standards when compared to its peers. The issuer/issue generally has lower tolerance towards unexpected swings in the environment and economic conditions. As a result, their debt servicing capacity is dependent upon favorable environment and economic conditions. |
| CC | An issuer/issue with a 'CC' credit rating is classified by Capital Standards as a rating with a ***very high default probability*** when compared to its peers. The issuer/issue generally has fragile and uncertain cash flows, as well as other factors, making them very vulnerable to nonpayment. |
| C | An issuer/issue with a 'C' credit rating is classified as ***on the verge of default*** by Capital Standards when compared to its peers. The issuer/issue is extremely susceptible to breaching its debt covenants and the likelihood of them filing for bankruptcy is very high. Hence, they become highly qualified for nonpayment. |
| R | An issuer is under ***regulatory supervision*** due to its financial situation. During the regulatory supervision, the regulators can favor some obligations over others or issue the payment of some obligations and not others. (Rating applicable to issuers only) |
| SD | An issuer has ***selectively defaulted*** due to failure in payment within the due date. (Rating applicable to issuers only) |
| D | An issuer/issue with a 'D' credit rating has ***defaulted***. The issuer/issue failed to pay its obligation within the due date even if the applicable grace period has not expired. However, this does not apply if there is evidence that such payments will be made during the grace period. The 'D' rating would also be assigned to an issuer filing for bankruptcy or taking similar actions. |
| NR | An issuer/issue is ***not rated*** because either a rating wasn't requested, lack of sufficient information, or Capital Standards does not rate the issuer/issue as a matter of policy. |

## Additional Indicators to Credit Ratings

**+ or -** The plus (+) and the minus (-) signs show relative positioning of an issuer/issue within the major rating categories. (Used in Long-Term Ratings only)

**kw** This modifier is appended to a rating assigned in accordance to the ***Kuwaiti National Rating Scale.***

**sa** This modifier is appended to a rating assigned in accordance to the ***Saudi National Rating Scale.***

## Salhia Real Estate Co. K.S.C. (Closed)

**ae** This modifier is appended to a rating assigned in accordance to the ***Emirati National Rating Scale.***

**bh** This modifier is appended to a rating assigned in accordance to the ***Bahraini National Rating Scale.***

**qa** This modifier is appended to a rating assigned in accordance to the ***Qatari National Rating Scale.***

**om** This modifier is appended to a rating assigned in accordance to the ***Omani National Rating Scale.***

**CW** The ***CreditWatch*** placement indicates that Capital Standards is *currently* considering changing the rating due to an event or deviation occurring that might affect the credit worthiness. Such events could be mergers, acquisitions, regulatory actions, etc. However, it is to be noted, that a placement on credit watch does not mean that a change in the rating is imperative. A watch could be positive, negative or affirmed.**

**CO** A ***Credit Outlook*** indicates the direction a rating is likely to move *over a one or two-year period*. An outlook reflects financial or other deviations that have not yet reached the level that would trigger a rating action, but which may do so if the trend continues. An outlook may be stable, positive, negative, or evolving.**

**WR** A ***Withdrawn Rating*** signifies the removal of a rating on either the issuer or the issue being rated. A withdrawal could be due to inadequate information, bankruptcy, reorganization, liquidation, certain business reasons, or an issue or obligation reaching its maturity.***

**SR** A ***Suspended Rating*** signifies the rating being placed on hold at an intermediate stage before the occurrence of a withdrawal. A suspension could be due to the issuer failing to provide information required for the rating process or revision.

**(pi)** This modifier is appended to a rating solely based on ***public information***.

**** <u>Credit Watches and Outlooks:</u>**

*Credit Watch*

**Positive** indicates a potential upgrade in the rating.

**Negative** indicates a potential downgrade in the rating.

**Evolving** indicates rating may be raised, lowered, or affirmed.

*Credit Outlook*

**Stable** indicates a rating is not liable to change over a one or two-year period.

**Positive** indicates a possibility of an upgrade in the rating over a one or two-year period.

**Negative** indicates a possibility of a downgrade in the rating over a one or two-year period.

**Evolving** indicates a possibility of the trend having conflicting elements, both positive and negative.

*<u>It is to be noted that ratings that are not on Credit Watch or Outlook can be upgraded or downgraded if circumstances warrant such an action.</u>*

*****<u>Reasons for assigning Withdrawn Rating (WR):</u>**

- Inadequate Information: A rating can be withdrawn due to lack of insufficient information to assess the creditworthiness of an issuer/issue effectively. This would typically hold in situations where the issuer declines to provide information requested by Capital Standards and Capital Standards cannot otherwise obtain the necessary information through other public means.
- Bankruptcy/Reorganization/Liquidation: If an issuer/issue defaults, goes bankrupt, goes into reorganization or is liquidated, Capital Standards would no longer have a reason to maintain the issuer/issue's rating.
- Business Reasons: Capital Standards can withdraw a rating for reasons other than bankruptcy or inadequate information. In this situation, Capital Standards will weigh the market needs against the cost of maintaining and monitoring the rating.
- Maturity of Obligation: A rating is withdrawn when the rated obligation has matured.

# CSR's National Rating Scale

The below table shows CSR rating scale versus the international rating scale for Kuwait:

| Rating | National Rating |
|---|---|
| AAA | AAA |
| AA+ | AAA |
| AA | AAA |
| AA- | AAA |
| A+ | AA+ |
| A | AA |
| A- | AA- |
| BBB+ | A+ |
| BBB | A |
| BBB- | A- |
| BB+ | BBB+ |
| BB | BBB |
| BB- | BBB- |
| B+ | BB+/BB |
| B | BB- |
| B- | B+/B |
| CCC | CCC |
| D | D |
| SD | SD |

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