GCR downgrades Kenya Kazi Limited's issuer ratings to $BB_{(KE)}$/ $B_{(KE)}$ on constrained liquidity

Rating action

Nairobi, 22 December 2020 – GCR Ratings ("GCR") has downgraded the national scale long term and short-term Issuer ratings on Kenya Kazi Limited ("KK") to $BB_{(KE)}$ and $B_{(KE)}$ respectively, with the ratings maintained on Negative Outlook. Concurrently, GCR has downgraded Gardaworld Kenya ("GWK") national scale long term and short-term issuer ratings to $BB_{(KE)}$ and $B_{(KE)}$ respectively, with the Negative Outlook maintained. At the same time, GCR has downgraded Gardaworld Kenya's medium-term note ("MTN") programme's national scale long term senior unsecured debt rating to $BB_{(KE)}$, with the Negative outlook also maintained.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Kenya Kazi Limited	Long Term issuer	National	$BB_{(KE)}$	Negative Outlook
	Short Term issuer	National	$B_{(KE)}$	
Gardaworld Kenya	Long Term issuer	National	$BB_{(KE)}$	Negative Outlook
	Short Term issuer	National	$B_{(KE)}$	
Gardaworld Kenya MTN Programme	Long Term issue	National	$BB_{(KE)}$	Negative Outlook

Rating rationale

The ratings on Kenya Kazi Limited ("KK") and Gardaworld Kenya ("GWK") (including its debt programme) reflect a group analysis (jointly referred to as the group). GWK is a non-operating holding company with its sole investment being KK, the operating entity and its subsidiaries. The analytical approach consolidates the debt on GWK's balance sheet, and associated costs, into the KK financial statements. In addition, GCR has factored in support from its ultimate parent company Gardaworld Security Corporation ("Gardaworld").

The ratings downgrade and the Negative Outlook reflect the deterioration in the group's credit profile, due to weak earnings and cash flows, combined with a reliance on short-term funding, which have all constrained the group's liquidity position. On the positive side, the rating takes into account the group's strong competitive position in the integrated security solutions market, a diversified client base, geographic diversification as well as the operational, technical and current/ pledged liquidity support it receives from Gardaworld.

Although there was some improvement in FY20, with the EBITDA margin widening to 5.4% (FY19: 4.1%) and a return to a net profit before tax of KES69m (FY19: KES46.5m loss), the margins remain below historical levels and leave the company vulnerable to sudden shocks which put the debt repayments under pressure. GCR projects weaker earnings and cash flows for FY21. Management accounts for the eight months to August 2020 show a 15.6% year-on-year decrease in EBITDA, in spite of a contracted cost base of about 10.3% compared to FY20, largely due to the impact of COVID-19 related disruptions. Whilst earnings are forecast to improve in FY22, they are likely to remain below historical levels, with pressure on margins from a combination of a difficult economic environment and intense industry competition.

While we do not consider the group to be overly geared, as the consolidated net debt to EBITDA ratio remained within the 300% range in FY20 (FY19: 323%), weak earnings and cash flows from the constrained economic environment and an over-dependence on short-term funding has placed significant strain on the liquidity profile of the group. Going forward, GCR expects the ultimate parent and related companies to continue to service the interest and ultimately help refinance the GWK's MTN, which is due for repayments in December 2021 and June 2022. Even after making this assumption, credit metrics of the group have deteriorated markedly. At FY20, the ratio of operating cash flow to total debt was at 16.0% in FY20 (FY19:65.9%). Furthermore, interest coverage has reduced over time to 1.4x in FY20.

Of primary concern to GCR, is KK's liquidity position. Without including support by the shareholder, uses versus sources of cash has deteriorated to below 1x. This weak position reflects the reduction in cash flows, but it is exacerbated by the reliance on the short-term commercial paper programme and bank overdrafts. As a result, we are factoring in strong ongoing parental support into the financial profile of the company. The basis of which includes some assimilation and a good history of support, alongside a letter of comfort by the parent company Gardaworld, detailing that it is aware GWK and its subsidiaries may be dependent on it for continued financial support to enable it to meet its financial obligations as they fall due and its commitment to continue providing such financial support to the company and its subsidiaries for a period of at least 12 months from when the accounts were signed off (September 2020).

The ratings continue to be supported by its competitive position. KK operates in a highly competitive industry and is one of the leading players with an entrenched position with high profile clients such as embassies and multinationals not only in Kenya but in the other 6 countries in which it operates in. KK expects to get new clients in the mining sector, the oil and gas sectors and diplomatic missions within the region.

Outlook statement

The negative outlook foremost represents the group's strained liquidity position and short-term refinancing risk. Over the longer-term, it also reflects the deteriorated credit performance metrics especially in a highly competitive industry which makes it difficult not only to grow the revenues but also sustain the margins and additionally, the COVID-19 pressures on the business environment.

Rating triggers

A downgrade could transpire if liquidity does not improve in the short to medium term, either organically or through group support. Furthermore, if the losses persist or if gross debt increases further, which would result in a further deterioration in credit protection metrics, the ratings are likely to come down. Withdrawal of support from the parent company, Gardaworld could also bring down the rating. An upgrade could result from a material reversal of the above factors.

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Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Corporate Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, November 2020
GCR Corporate Sector Risk Scores, July 2020

Ratings history

Kenya Kazi Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term issuer	Initial	National	$BBB_{(KE)}$	Positive	September 2016
Short Term issuer		National	$A3_{(KE))}$		

Long Term issuer	Last	National	BBB$_{(KE)}$	Negative	December 2019
Short Term issuer		National	A3$_{(KE)}$		

Gardaworld Kenya

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term issuer	Initial/last	National	BBB$_{(KE)}$	Negative Outlook	December 2019
Short Term issuer	Initial/last	National	A3$_{(KE))}$	Negative Outlook	December 2019

Gardaworld Kenya Medium Term Note Programme

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term issue	Initial	National	BBB$_{(KE)}$	Stable	November 2016
Long Term issue	Last	National	BBB$_{(KE)}$	Negative	December 2019

Risk score summary

Rating components and factors	Risk score
Operating environment	**7.00**
Country risk score	3.50
Sector risk score	3.50
Business profile	**1.50**
Competitive position	1.50
Management and governance	0.00
Financial profile	**(3.50)**
Earnings	(0.50)
Leverage & Capital Structure	(1.50)
Liquidity	(1.50)

Comparative profile	**1.00**
Group Support	1.00
Peer analysis	0.00
External support	0.00
Total Score	**6.00**

Glossary

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Income	Money received, especially on a regular basis, for work or through investments.

Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instruments.

The credit ratings have been disclosed to Kenya Kazi Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Kenya Kazi Limited participated in the rating process through virtual management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Kenya Kazi Limited and other reliable third parties to accord the credit ratings included:

- Five-year financial projections
- Historical accounts or relevant entities
- Company presentations
- Year-to date management accounts
- Other relevant documents