



GCR revises the National Scale Issuer Rating on H. Young to BBB_(KE) on Criteria Change; Outlook Stable.

Rating Action

Johannesburg, 31 October 2019 - GCR Ratings ("GCR") has revised the long-term National Scale Issuer rating accorded to H. Young and Company (East Africa) Limited to BBB_(KE) from BBB_(KE) and affirmed the short-term National Scale Issuer rating at A3_(KE); with a Stable Outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
H. Young and Company (East Africa) Limited	Issuer Long Term	National	BBB _(KE)	Stable Outlook
	Issuer Short Term	National	A3 _(KE)	

On May 22, 2019 GCR announced that it had released a new rating framework and sectoral criteria. As a result, the ratings were placed "Under Criteria Observation". Subsequently, GCR has finalised the H. Young and Company (East Africa) Limited ("H. Young") rating review under the new Criteria for Rating Corporate Entities. As a result, the ratings have been removed from 'Under Criteria Observation' and the rating reviewed in line with the new methodology.

Rating Rationale

The ratings reflect H. Young's continued sound earnings performance, underpinned by a substantial order book, albeit counterbalanced by the high gearing and limited geographic diversification.

H. Young's ratings are supported by the company's sustained sound revenue and earnings growth, underpinned by a sizeable order book of both government and private sector work, which provides a good level of revenue predictability over the medium term. Despite the intense bidding competition in the industry, H Young's profit margins have evidenced resilience, supported by a focus on cost control and prudent risk management that enables efficient project delivery. Nevertheless, note is taken of the potential for earnings volatility in the industry and the high reliance on government contracts and payment schedules. That said, GCR expects the operating margin to be maintained within the 15-20% range over the rating horizon as the company runs down the existing contracts.

The ratings are constrained by high gearing, as H. Young's debt increased during FY18 to finance the acquisition of capital equipment to meet the new contracts. Thus, despite the steady improvement in earnings, net debt to EBITDA remained flat at 3.0x at FY19, while the EBITDA coverage of interest remained somewhat low at 2.8x. In particular, the operating cash flow coverage of debt remains very low at 5.1% in FY19 (FY18: 17.1%), due to the sizeable working capital absorption associated with the new contracts. As no significant capital expenditure is planned over the rating horizon, GCR expects the credit metrics to improve gradually, as debt is amortised, with



the net debt to EBITDA declining below 2.5x and EBITDA coverage of interest increasing to over 3.5x. Cash flow coverage of debt is also expected to improve to above 20% as the working capital position unwinds.

H. Young's liquidity profile is considered to be sound, underpinned by c.KSh1bn in committed debtors discounting facilities at 1H FY20. Note is also taken of the terming out of the debt maturity profile, following the refinancing of some short-term facilities by four-year amortising term loans during 1H FY20. Thus, the company is expected to achieve liquidity coverage of at least 1x in respect of its one-year requirements, on the back of small near-term debt maturities and negligible capital expenditure requirements. GCR is also of the view that long established funding relationships with highly rated domestic financial institutions somewhat mitigate the refinancing risk.

The ratings take cognisance of H. Young's established position as a mid-tier construction company in Kenya, backed by a good track record of successful completion of big projects. The company has over the years successfully carved a defensible niche focussing on mid-size road and infrastructure projects for which a large part of the funding is from the government or from international development finance agencies. Nevertheless, the lack of geographic diversification and concentration of the order book to a few contracts somewhat constrains the business profile assessment. Moreover, GCR considers corporate governance structures to be under-established, with the board inadequately constituted to provide independent oversight of management performance and hold management accountable to shareholders and creditors.

Outlook Statement

The Stable Outlook reflects GCR's expectation that earnings will continue to evidence growth over the rating horizon as projects in the pipeline progress, while gearing metrics will gradually improve as debt is amortized.

Rating Triggers

Positive rating action could arise from a significant improvement in gearing metrics, resulting in net debt to EBITDA of 2x–2.5x or better and interest coverage above 4x, achieved together with much improved cash flow coverage of debt (c20%-30%). Conversely, a downgrade could arise from earnings underperformance or higher leverage due to aggressive funding for growth. Failure to sustain a smoothed-out, medium term debt expiry profile would be viewed negatively.

Analytical Contacts

Primary analyst	Tavonga Muchemedzi	Analyst: Corporate Ratings
Johannesburg, ZA	tavongam@GCRratings.com	+27 11 784 1771

Secondary analyst	Eyal Shevel	Sector Head: Corporate Ratings
Johannesburg, ZA	shevel@GCRratings.com	+27 11 784 1771
Committee chair	Mathew Pirnie	Sector Head: Financial Institutions
Johannesburg, ZA	MathewP@GCRratings.com	+27 11 784 1771

Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Real Investment Trusts and Other Commercial Property Companies, May 2019
GCR's Country Risk Score report, published June 2019
GCR's Corporate Sector Risk Score reports/Market Alerts, published September 2019

Ratings history

H. Young and Company (East Africa) Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Issuer Long term	Initial	National	BB+ _(KE)	Positive Outlook	October 2014
Issuer Short Term	Initial	National	B _(KE)		
Issuer Long term	Last	National	BBB _(KE)	Stable Outlook	October 2018
Issuer Short Term	Last	National	A3 _(KE)		

Risk Score Summary

Risk score	7.25
Operating environment	7.00
Country risk score	4.50
Sector risk score	2.50
Business profile	-0.25

Competitive Position	0.00
Management and governance	-0.25
Financial profile	0.50
Earnings performance	1.50
Leverage and Capital Structure	-1.50
Liquidity	0.50
Comparative profile	0.00
Group Support	0.00
Peer analysis	0.00

Glossary

Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial Instruments, using an established and defined ranking system of rating categories.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
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.
DCM	Debt Capital Market(s).
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.
Debt Service Ratio	A measure of a company's ability to service its interest and principal redemption costs, expressed as the ratio of earnings or cash flows over a period to the sum of interest and principal payments over the same timeframe.

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.
Downgrade	The rating has been lowered on its specific scale.
Facility	The grant of availability of money at some future date in return for a fee.
Gearing	Gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds, EBITDA or operating income.
Hedge	A form of risk management aimed at mitigating financial loss or other adverse circumstances. May include taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
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 Ratings	See GCR Rating Scales, Symbols and Definitions.
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.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Market value	An assessment of the property value, with the value being compared to similar properties in the area.

Policy	The legal document issued by the company to the policyholder, which outlines the conditions and terms of the insurance.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Horizon	The rating outlook period.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
REIT	Real Estate Investment Trust. A company that owns, operates or finances income-producing real estate.
Rent	Payment from a lessee to the lessor for the temporary use of an asset.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Upgrade	The rating has been raised on its specific scale.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings 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; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the ratings is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

The credit ratings have been disclosed to H. Young and Company (East Africa) 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.

H. Young and Company (East Africa) Limited participated in the rating process *via* face-to-face 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 H. Young and Company (East Africa) Limited and other reliable third parties to accord the credit ratings included:

- the 2019 audited annual financial statements (plus four years of audited comparative numbers);
- management accounts for 1Q FY20
- a breakdown of debt facilities available and related counterparties at 31 July 2019 (including related debt covenants)
- a breakdown of the order book at 31 July 2019