



AREF Energy Holding Company K.S.C.C.

November 2011, Kuwait

Rating	BB+
National Rating	BBB+_{KW}
Outlook	Stable

Corporate Profile

“A Kuwait-based investment holding company focused on energy sector in the MENA region.”

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AREF Energy Holding Company K.S.C. (Closed) (herein referred to as “AREF Energy” or “the holding company” or “the company”) is an investment holding company, which strives to generate returns through value creation in medium-sized energy sector companies in the MENA (Middle East and North Africa) region. Capital Standards (CSR) has assigned the holding company BB+ rating on an international scale and BBB+_{KW} rating on a national scale. The outlook assigned to the ratings is stable.

The ratings reflect the low amount of debt at the holding company level, the liquid balance sheet and the risk mitigating mechanisms embedded in the organizational structure. However, the above strengths are offset by the company’s lack of long profitable track-record and the inherently high risk nature of its business. AREF Energy’s investment portfolio exhibits both geographic and sector-wise concentration, because of its business strategy. Furthermore, the liquidity of AREF Energy’s portfolio is constrained owing to the unlisted nature of all its investments. The core income of AREF Energy is primarily driven by net gain on sale of investments and is, hence, highly volatile.

Analysts

Divya Chandran K

d.chandran@capstandards.com
 +965 22258822 ext.517

Munirah Al Jiran

m.aljiran@capstandards.com
 +965 22258822 ext.516

Abdulwahab Al-Saif

a.alsaif@capstandards.com
 +965 22258822 ext.513

Capital Standards (CSR)

Al Nassar Tower, 11th Floor,
 Fahad Al-Salem St., Kuwait City
 P.O.Box 26620, Safat, 13127 Kuwait
 Office: +965 2225 8822
 Email: services@capstandards.com
 Website: www.capstandards.com

Kuwait Finance House is the ultimate parent of the company. As of Sep-2011, AREF Energy has an investment portfolio of KWD 60.16 mn, spread across 9 investments. In FY2010, supported by the profitable sale of Dewitt Oil & Gas Projects (DeWitt), the company reported net profits of KWD 10.80 mn. These profits covered the losses accumulated in FY2008 and FY2009. Net losses reported for the first nine months of FY2011 amount to KWD 1.39 mn.

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Key Rating Considerations

- AREF Energy is a relatively young company, established in 2007. Therefore the company lacks a profitable track record of operation.
- The investment decision-making process is clearly defined and follows a collaborative approach, involving all the major functions within the organization. Multiple levels of approval process and stated limits to investment values are risk mitigation mechanisms embedded within the decision-making process.
- Many of the investments in the existing portfolio were transferred to the company from the parent company in 2007 (at the time of establishment), at prices far exceeding the current investment limits. Therefore, AREF Energy's investment portfolio exhibits high value-wise concentration at present.
- The portfolio is exposed to geographic and sector concentration risks, primarily because of the strategic direction of the business.
- A majority of the companies in AREF Energy's investment portfolio are in the development stage or the high growth stage of their operations. Therefore, the portfolio, in general, has low profitability and weak credit quality.
- Despite having significant influence over most of its investments, AREF Energy's ability to upstream dividends is low.
- The core income of the company follows a highly volatile pattern, as it is primarily driven by gain on sale of investments.
- The liquidity position is strong at present, owing to the low amount of debt on the balance sheet and the large cash reserves generated through profitable divestment of DeWitt.

Outlook & Key Rating Drivers

CSR has assigned a stable rating outlook for AREF Energy, as all the identified major risks are reflected in the currently assigned rating. CSR does not anticipate the risks to exacerbate from the existing levels, owing to the management focus on mitigating the risk exposures of the company. Furthermore, CSR believes AREF Energy would be able to maintain the financial flexibility indicators of leverage and coverage ratios at levels required by the assigned rating.

An upgrade of the rating and/or outlook would be triggered if (i) the concentration risks associated with its investment portfolio diminish meaningfully, (ii) the proportion of mature stage, dividend paying investments increases in the portfolio and (iii) the credit quality of the portfolio improves, supported by the sustained profitability of investments. On the other hand, a negative rating action would be warranted if AREF Energy is unable to profitably divest its investments, the credit quality of the portfolio further weakens and/or the liquidity of the company substantially deteriorates.

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Business Profile

AREF Energy is a Sharia-compliant investment holding company, which was incorporated in 1996 as Excellent Education Foundation Company to focus on education sector in Kuwait. The company was listed on the Kuwait Stock Exchange in 2005 and was subsequently renamed in 2007 as AREF Energy Holding Company, with the altered mandate of investing in energy sector companies. AREF Investment Group (AIG), which owns 72.60% stake in AREF Energy, is in the process of selling its stake to Development Enterprise Holding Company (DEHC). The ultimate parent would continue to be Kuwait Finance House (KFH), as both AIG and DEHC are subsidiaries of KFH.

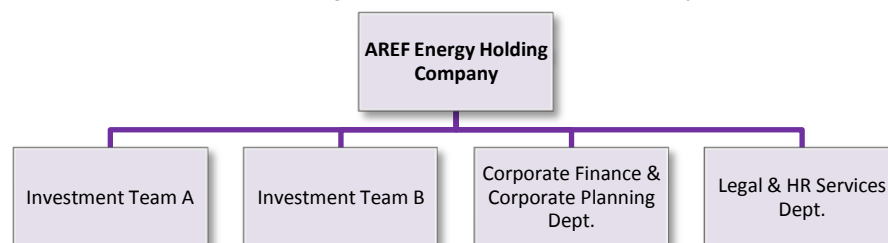
Conservative policies mitigate risks arising from absence of a separate risk department

Financial statements of AREF Energy, which are prepared in accordance with the International Financial Reporting Standards (IFRS), are accompanied by adequate financial disclosures and are filed with the regulatory authorities in a timely manner. Moreover, the annual reports of the company are detailed, and CSR, therefore, considers the transparency levels of the company above par compared to its peers. CSR believes the lack of a formal corporate governance framework and a separate risk management division is partially mitigated by (i) the satisfactory transparency levels, (ii) the conservative dividend policy of the management and (iii) the well-defined investment decision-making process. The company did not pay dividends in the last three years. The management does not plan to initiate dividend payouts until the company matures and builds a sizeable portfolio that ensures regular cash inflows. Furthermore, the management is in the process of forming a risk management division reporting directly to the board of directors.

Investment decisions are reviewed and approved by cross-functional committees

At present, AREF Energy's organizational structure segregates the functions of deal making and operational management of investments. The business development unit (BD) is involved in deal sourcing and deal making, while the venture development division (VD) actively monitors the operational activities of the investments. To improve the accountability of different divisions, the organizational structure is currently being altered. The new structure envisages two investment teams, each of which is exclusively responsible for the end-to-end management of a set of investments – from deal sourcing, to monitoring of operations of subsidiaries and divestment. Each individual member of VD and BD would be dedicated to one investment team each, and at the end of the restructuring, the separate divisions of VD and BD would cease to exist.

Exhibit 1: The new structure envisages 2 investment teams, instead of separate VD and BD.



Source: Aref Energy, CSR

The investment teams (currently, BD) identify and filter potential investment opportunities based on four factors – geography, sector, size and stage of investment. The senior management reviews all the potential investments that meet the four criteria. On receiving senior management approval, the

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investment teams prepare investment summaries in consultation with representatives of the legal team and the corporate finance & planning department. The investment summaries are then presented to the 3 member investment committee constituted by the board of directors. After securing the preliminary approval of the committee, due diligence and valuation exercises follow. On satisfactory completion of due diligence, a detailed investment case is made to the investment committee, and the final approval for closing the deal is sought.

Once the deal is struck, AREF Energy strives to be an active shareholder by appointing its representatives on the boards of the investee companies. The investment teams (currently, VD) monitor the operational performance of the investments and seek to achieve all the value creation objectives set at the time of acquiring the stakes, by providing both financial and business support to the investee companies.

Investment strategy defines investment value limits, to mitigate concentration risks

The strategic fit of all the investment opportunities are ascertained by screening the potential investments using the following four criteria.

1. Sector – The stated strategy of AREF Energy is to be a leading energy sector investment holding company within the region. The company invests in oil & gas exploration & production (E&P) companies, companies engaged in power generation, energy services companies and technology companies working in the energy sector.
2. Size of the deal – The ideal deal size is between KWD 5 mn and KWD 10 mn. As the equity capital of AREF Energy is only around KWD 75 mn, the management believes deal size should be capped at KWD 10 mn to ensure that risk concentration remains low. The lower limit of KWD 5 mn limits the number of investments in the portfolio to 10 or 11. Furthermore, the ideal share of interest in investments is between 20% – 50% to enable AREF Energy to influence the management decision making process and be an active investor.
3. Stage of investment – The investment targets are mostly operating companies with growth potential. Turnaround projects with high growth potential, where AREF Energy can create value, are the other major target segment. Mature investments paying cash dividends currently form only a small portion of the portfolio. However, the management plans to increase the proportion of mature investments in its portfolio in the future.
4. Geography – The company's focus is on the MENA region. AREF Energy believes that geographical proximity is an important factor in ensuring the company can exert sufficient influence over its investments.

All the 9 investments in the existing portfolio are unlisted

As of Sep-2011, there are 9 investments in AREF Energy's asset portfolio. Small to medium sized, unlisted companies in energy sector form the core investments of AREF Energy. The investment horizon is typically medium to long term. The company is an active investor and seeks to influence the decision making process of its investments through board representation. AREF Energy expects to generate returns mostly via value appreciation that can be realized at divestment.

Between 2011 and 2014, the management plans to exit KEC, Higleig, KDDB and Makamin. The proceeds from the sale of these investments, together with external debt, would be used to make new investments of over KWD 90 mn.

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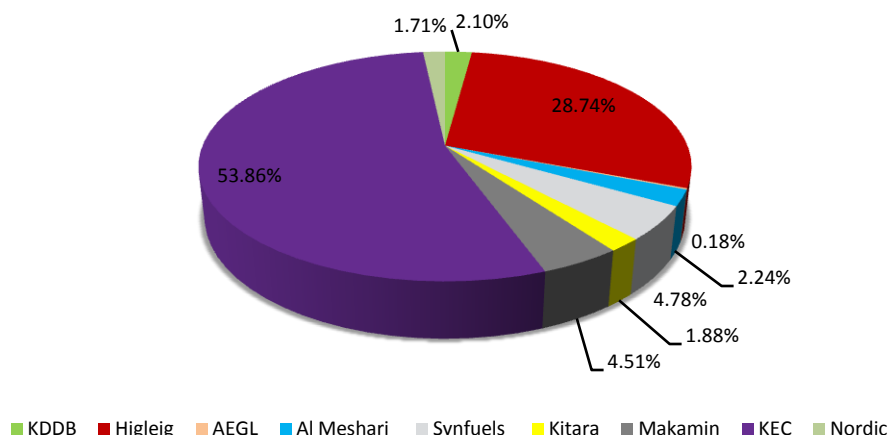
Exhibit 2: Portfolio composition of AREF Energy, as of Sep-2011.

Investments	Place	Interest	Total investment (KWD mn)
AREF Energy Global Limited (AEGL)	Cayman	100.00%	0.11
Khalifa Duajj Dabbous and Brothers Company (KDDB)	Kuwait	80.00%	1.26
Nordic Energy FZC	Dubai, UAE	75.00%	1.03
Higleig Petroleum Services & Investment Co. Ltd.	Sudan	64.25%	17.29
Al Meshari Heavy Equipment Trading L.L.C.	Dubai, UAE	51.00%	1.35
Kitara OFIL Limited	Mauritius	35.40%	1.13
Synfuels International Inc.	U.S.A	25.00%	2.87
Makamin Oil & Gas Services	Saudi Arabia	10.00%	2.72
Kuwait Energy Company (KEC)	Kuwait	14.17%	32.40

Source: AREF Energy, CSR

Nordic Energy FZC based in Dubai, UAE is the most recent investment of Aref Energy. The equity capital infused into Nordic amount to only AED¹ 700,000 (approx. KWD 52,500). However, the company is committed to advancing loans up to an amount of AED 55 mn (approx. KWD 4.12 mn), to support the operational activities of Nordic.

AREF Energy estimates the fair value of its major investments on a periodic basis, as all the investments in the company's portfolio are unlisted in nature. Owing to the conservative nature of estimation assumptions, the volatility in the fair values of investments and, consequently, bottom line volatility arising from unrealized movements in fair value are minimal. For analytical purposes, CSR estimates the portfolio volatility of AREF Energy to be moderate. The estimation used the volatility of equity indices in the region as a proxy.

*Investment portfolio is exposed to significant concentration risks***Exhibit 3: Composition of the investment portfolio based on book value of assets, as of Sep-2011.**

Source: AREF Energy, CSR

¹ United Arab Emirates Dirham

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Despite having investments in 9 different companies, AREF Energy's portfolio remains highly concentrated in terms of value. The two largest investments of AREF Energy – KEC and Higleig – together account for 82.60% of the total book value of the portfolio. Many investments in AREF Energy's existing portfolio were transferred from the parent company in 2007, at book values very different from the current investment limits set by the management. While book values of KEC and Higleig far exceed the upper limit of KWD 10 mn, book values of many other transferred investments are far below the lower limit of KWD 5 mn, resulting in very high value-wise concentration. Furthermore, the portfolio lacks diversification in terms of geography and sector, primarily because of the stated strategy of the company.

Geographic concentration – Most of the company's investments are concentrated within the Middle East region. In FY2008 and FY2009, the revenues of AREF Energy, on a consolidated basis, were derived predominantly from the Middle East. In FY2010, the top line contribution from outside the Middle East region rose, driven by the successful exit from DeWitt in the US. Currently, Synfuels, Kitara OFIL and AREF Energy Global are the investments of AREF Energy that are based outside the MENA.

The risks related to the geographic concentration are further exacerbated by the country risks associated with the less developed countries such as Sudan and Egypt. 28.74% of AREF Energy's investments are in Higleig which operates solely in Sudan, while 61.51% of KEC's revenues are derived from Egypt.

Exhibit 4: The consolidated revenues of AREF Energy are driven primarily by its investments in the MENA.

Geographic Segment Revenues (KWD mn)	FY2010	FY2009	FY2008
Kuwait	(0.16)	0.08	3.84
Middle East	24.26	39.45	44.79
Others	24.90	(0.44)	0.00
Total	48.99	39.10	48.63

Source: AREF Energy, CSR

Sector concentration – AREF Energy classifies its business into two segments – (1) Energy, pertaining to energy related activities and (2) Others, involving investment and other related activities. The consolidated assets and revenues of the company largely belong to the Energy segment. Within the Energy segment, the investments of AREF Energy fall broadly into 3 sub-sectors – oil and gas exploration & production, new technologies and energy services. However, owing to the dominance of KEC in AREF Energy's portfolio, the portfolio is currently skewed towards E&P business.

It is pertinent to note that the company has been striving to improve portfolio diversification within the energy services sub-sector. The investments span across segments as varied as equipment rentals, power generation and mud logging services. The recent investment in Nordic (a well services company involved in snubbing & work-over, coiled tubing and well intervention) could further improve the diversification within energy services companies in AREF Energy's portfolio.

Exhibit 5: Over 90% of the consolidated revenues and assets of AREF Energy belong to the energy sector.

2010 Segment Information (KWD mn)	Energy	Others	Total
Segment revenues	46.40	2.59	48.99
Segment results	16.86	2.14	19.00
Segment assets	100.20	8.15	108.35

Source: AREF Energy, CSR

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Portfolio performance is constrained by weak operating performance of investments

CSR believes that the credit quality of AREF Energy's asset portfolio is weak, owing to the sustained poor operating performance of most of its investments, significant exposure to country risks and the lack of track record of many companies in the portfolio. KEC is the only publicly rated investment of AREF Energy (Capital Intelligence: BBB-/Stable). Many of the investments of AREF Energy do not have operating histories of over 5 years. Furthermore, a majority of AREF Energy's investments were not profitable in FY2010.

The financial performances of the four largest investments of AREF Energy, which together account for 91.89% of the total portfolio value, are analyzed below.

Kuwait Energy Company is a Kuwait-based private oil and gas E&P company, established in 2005. As of Dec-2010, the company has 48.80 mn barrels of oil equivalent (mmboe) of proved and probable (2P) reserves. Both the reserves and the working interest have grown significantly since inception. The 2P reserves grew at a CAGR of 46.14% since 2006, while the working interest grew at a CAGR of 110.13%. In FY2010, the average working interest production of the company was 13,258 boepd (barrels of oil equivalent per day). Although, the reserves are spread across 8 countries in the MENA region and Europe, a majority of the working interest is currently derived from Egypt (61.51%) and Oman (20.80%).

Exhibit 6: Although profitable on a net basis, operating income has been far from steady.

Key figures & ratios	2010	2009	2008
Proven + Probable reserves (mmboe)	48.80	51.20	43.40
Oil & Gas sales (USD mn)	141.77	88.31	90.80
Sales growth rate	0.61	-0.03	1.94
EBIT (USD mn)	18.96	-8.36	-2.84
Net profits (USD mn)	21.90	5.55	29.88
Dividend paid out (fils/share)	5.00	0.00	0.00
Net profit margin	15.45%	6.29%	32.91%
Debt to equity	8.40%	11.87%	6.28%
EBIT/Capital Employed	2.77%	-1.29%	-0.51%

Source: KEC annual reports, CSR

The company was profitable on a net basis in all the years since inception. However, operating income was negative in FY2008 and FY2009, mostly due to the significant write offs of exploration expenditure in those years. Being a young company, KEC's investment cash outflows related to acquisition of oil & gas assets and finding & development activities are high. The operations are financed through a combination of equity rights issues and long term debt. Although the amount of debt on KEC's balance sheet increased considerably in the last 5 years, the absolute amount of debt, in comparison to the equity capital, is low; debt to equity ratio was 8.40% in FY2010. In FY2010, KEC reported net profits of USD 21.90 mn (approx. KWD 6.02 mn), and paid out dividends at a payout ratio of over 85%.

Higleig Petroleum Services & Investment Co. Ltd. is a Sudanese private, limited liability company engaged in EPC (Engineering, Procurement and Construction) contracting. The projects undertaken by the company include buildings and road construction, oil and gas field production facilities and electro-mechanical implementations.

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Although Higleig is one of the largest oil services EPC contracting companies in Sudan, the revenues declined steadily in FY2009 and FY2010. In FY2010, the reported contract revenues amounted to SDG² 177.79 mn (approx. KWD 18.13 mn) – a year-on-year drop of 42.70%. Furthermore, the margins contracted during the same period. Consequently the Funds from operations (FFO) reduced considerably from its peak in FY2008. The management attributes the declining market share to political issues, which resulted in the exclusion of Higleig from tendering for government contracts. Despite the bottom line losses, the operating cash flows increased, because of the reduction in working capital requirement. Investing cash outflows, on the other hand, decreased, due to the management decision to rationalize the asset base through sale of underutilized equipment. Supported by the strong cash flows, a significant portion of the debt was paid down by Higleig in the last three years.

Exhibit 7: Higleig lost significant market share in the last three years.

(Fig. in SDG mn)	2010	2009	2008
Contract revenues	177.79	310.29	383.25
Revenue growth rate	-42.70%	-19.04%	51.98%
Operating income *	(20.25)	(20.25)	15.55
Net profits	(16.25)	(25.62)	15.84
Total assets	414.03	477.49	488.08
Total equity	200.27	216.52	246.59
Total debt	54.76	108.93	120.59
Cash flows from operations	53.95	25.65	13.32
Cash flows from investing	(7.23)	(8.62)	(23.71)

Source: AREF Energy, CSR

* Excludes investment income and foreign exchange gains / losses.

In FY2008, the book value of AREF Energy's investments in Higleig was KWD 23.66 mn, including KWD 2.61 mn of goodwill. In FY2010, the goodwill was completely written off, and the book value of the equity investment as of FY2010 stood at KWD 17.62 mn.

Synfuels International Inc. was established in 1999 to ascertain the commercial viability of new technologies for converting natural gas to liquids (GTL) and natural gas to ethylene (GTE), and subsequently market and sublicense the technologies. Revenues are expected to be driven by royalties from sub-licensing the technologies, fees from consulting services associated with plant construction, and sales of reactors & catalyst materials used in operations of the plant. Synfuels has already completed 2 transactions involving sublicensing of rights to use portions of the technologies. However, the company has not started generating revenues yet, and is still in the development stage.

Exhibit 8: Synfuels has not started generating revenues yet.

(Fig. in USD mn)	FY2010	FY2009	FY2008
Revenues	0.00	0.00	0.00
Net income	(2.05)	(4.69)	(6.31)
Total assets	2.05	4.19	9.24
Patents	1.33	1.14	0.91
Total Equity	1.92	3.98	8.67

Source: AREF Energy, CSR

² Sudanese Pound

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In FY2010, the company made losses of USD 2.05 mn (approx. KWD 0.56 mn). As of June-2011, the accumulated shareholders' deficit amounted to USD 46.80 mn (approx. KWD 12.87 mn), and the total shareholders' equity is less than USD 1.00 mn (approx. KWD 0.28 mn). The management believes that the operating expenses for the coming years would be funded through the sale of some of the patents that are not essential for GTE and GTL processes. The patents on new technologies form over 75% of the total assets of the company.

Makamin Petrol & Gas Services Co. is a Saudi Arabian oil & gas services company established in 2008. The company is engaged in delivering upstream turnkey projects, involving technological design services, drilling & well services, pipeline services and industrial inspection services. In FY2010, the company expanded its service portfolio to include marine offshore services such as supply, chartering and support of vessels. Makamin has operations across the MENA region and in parts of Europe and the US. Currently, the company's overall market share is estimated to be only 3% in Saudi Arabian oil & gas sector. In FY2010, Makamin reported net profits of SAR³ 1.32 mn (approx. KWD 0.10 mn), with revenues of SAR 37.48 mn (approx. KWD 2.74 mn). However, the operating cash flows were negative, owing to the increase in work-in-progress resulting from rapid growth in operating activities. Furthermore, being a young company the investment cash outflows of Makamin are high. At present the company is debt-free, and the liquidity position is strong with SAR 55.41 mn (approx. KWD 4.04 mn) of cash on hand, while its total liabilities amount to only SAR 9.63 mn (approx. KWD 0.70 mn). The total equity of the company stood at SAR 301.40 mn (approx. KWD 22.00 mn), as of FY2010.

Exhibit 9: Despite the growth in top line, the operating income remains negative.

(Fig. in SAR mn)	FY2010	19 months ending Dec-2009
Contract revenues	37.48	11.94
Net operating income	(0.94)	(9.26)
Net income	1.32	(0.30)
Operating cash flows	(14.78)	(11.76)
Investing cash flows	(107.00)	(110.25)
Cash & equivalents	55.41	177.99
Current liabilities	8.92	15.11

Source: AREF Energy, CSR

Financial Profile

To gain insight into the financial strength of the holding company, the standalone, deconsolidated financials were analyzed. The latest financial statement analyzed for the purpose of the following analysis was the one ending Sep-2011. The standalone financial statements are not audited separately.

Stable income has historically been insufficient to cover the overhead expenses

The core income of a holding company typically has three constituents – (i) dividend income, (ii) finance income and (iii) gain or loss from sale of investments. The financial flexibility of a holding company depends on its ability to generate enough stable income – dividend income and finance income – to cover its current liabilities and non-discretionary expenses.

³ Saudi Arabian Riyal

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Until FY2010, dividends were not a source of income for AREF Energy. AREF Energy has influence over all of its investments, through board representation. However, the company's ability to up-stream dividends from its investments is minimal, since all the major investments, with the exception of Higleig, are in the development stage or growing rapidly. Although Higleig is a mature company with a long track record, its operating performance has been on a downtrend for the last 2 years. Therefore, Higleig's ability to payout dividends is minimal. Furthermore, there are legal issues preventing Higleig from paying out cash dividends.

Therefore, finance income earned on bank deposits and loans advanced to related parties was the only stable source of income for AREF Energy in FY2008, FY2009 and FY2010. It is worth noting that, since inception, the stable income generated by AREF Energy was not sufficient to cover the annual overhead expenses of the company. In 2011, KEC paid out dividends on its FY2010 earnings. The KWD 0.90 mn of annual dividends paid out by KEC, albeit narrows, does not completely bridge the gap between the annual overhead charges and the stable income of the company.

Exhibit 10: The stable income generated by AREF Energy can barely cover the annual overhead expenses.

(Fig. in KWD '000)	9M2011	FY2010	FY2009	16months ending Dec-2008
Dividend income	900.00	0.00	0.00	0.00
Finance income	148.44	20.25	12.66	2.79
Overhead expenses	997.27	2,055.97	1,209.61	1,768.57

Source: AREF Energy, CSR

Coverage ratios show large variability owing to the volatile nature of core income

Furthermore, the stable income was not sufficient to cover even the finance charges of the company in FY2009 and FY2010. The coverage ratio, calculated as dividend & finance income-to-finance charges, was only 0.05x and 0.07x in FY2009 and FY2010 respectively. The coverage ratios for FY2009 and FY2010 that are calculated as total core income-to-finance charges, however, exhibit large variability, due to the volatile nature of the total core income of the company.

As of Sep-2011, both the coverage ratios are robust at 7.97x, supported by the dividend income received from KEC as well as the increased investments in wakala deposits.

Exhibit 11: The volatility exhibited by the core income is due to the y-o-y variability in gain on sale of investments.

Coverage ratios	9M2011	FY2010	FY2009	16months ending Dec-2008
Total core income (KWD '000)	1,048.44	25,094.40	-12.88*	2.79
Finance charges (KWD '000)	131.51	304.01	280.26	280.83
(Dividend income+finance income)/finance charges (x)	7.97	0.07	0.05	0.01
Total core income/finance charges (x)	7.97	82.55	-0.05	0.01

Source: AREF Energy, CSR

*Total core income is negative, owing to the marginal loss realized on sale of an investment during the year.

Core income volatility is driven by unstable nature of cash flows from divestments

The total core income of AREF Energy shows significant variance over the years, driven by the volatile gains derived from sale of investments. The core income of the company grew significantly in FY2010, as

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DeWitt was divested in the year for a sale consideration of KWD 36.34 mn and a net gain of KWD 25.07 mn. The total core income stood at KWD 25.09 mn in FY2010, up from a loss of KWD 0.01 mn in FY2009. The cash flows associated with sale of investments are considered inherently volatile, owing to the liquidity and price risks associated with equity investments. The unlisted nature of AREF Energy's investments is an added constraint to the company's ability to profitably divest investments at short notice. Furthermore, macroeconomic factors such as global economic outlook, interest rate scenario and risk appetite in the market have a bearing on the liquidity available in equity markets.

Debt level, which is currently low, is expected to remain supportive of the rating

Owing to the absence of profitable divestments in FY2008 and FY2009, AREF Energy had to raise debt in those years to bridge the funding gap between the core income and the overhead expenses. Between FY2008 and FY2009, the debt levels of the company increased from KWD 1.19 mn to KWD 6.55 mn. Despite the increase, the amount of debt in relation to the company's equity remained low; debt-to-equity was only 10.14% in FY2009. Due to the increase in core cash flows in FY2010, the debt outstanding declined to KWD 2.56 mn by Sep-2011, further improving the debt-to-equity ratio to 3.57%. Debt-to-book value of the investment portfolio stood at 4.25% as of Sep-2011. After adjusting the debt to include the capital commitments of up to KWD 4.12 mn to Nordic, the debt-to-equity stood at 8.08%, while debt-to-portfolio book value stood at 9.62%.

The management plans to invest over KWD 90 mn in new investments between FY2011 and FY2014. The company would fund the new investments partly through proceeds from divestments and partly through external debt. Debt-to-book value of the portfolio is estimated to be between 15% and 20% by FY2014, if the management raises over KWD 20 mn and divests KEC, Hagleig, KDDB and Makamin, as planned. Furthermore, according to the strategic plan, the debt-to-equity ratio is not estimated to exceed 25% in the medium term.

Comfortable liquidity position, due to the profitable divestment in FY2010

Owing to the successful exit from DeWitt, the liquidity position of AREF Energy is strong at present. The proceeds from the divestment increased AREF Energy's cash & equiv. from KWD 1.91 mn in FY2009 to KWD 17.83 mn in Sep-2011, while reducing the amount of debt by KWD 3.99 mn. Even after accounting for KWD 2.17 mn of cash on hand that is locked as performance guarantee for KDDB, the cash ratio and the current ratio of the company were robust at 5.78x and 6.92x, respectively, as of Sep-2011. The liquidity position of the company is further bolstered by the KWD 1.50 mn of undrawn committed credit lines available.

Conclusion

The factor model employed by CSR generated a BBB- rating for the holding company. However, CSR adjusted the rating to BB+ with a stable outlook, to reflect the weak credit quality of a majority of the investments in the company's portfolio and the volatile nature of the holding company's cash flows. The weakness in credit quality can be primarily attributed to the lack of profitable track record of the investments. Furthermore, many of the investments are in the development stage or growing rapidly. The low amount of debt and the strong liquidity position stemming from the large cash reserves of the company are rating strengths for AREF Energy. These strengths are effectively offset by the volatile income of the company, the weak credit quality of the portfolio constituents, minimal ability to up-stream dividends and the concentration risks associated with the portfolio.

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Appendix

A – Rating Grid

AREF Energy Holding Company							
	AAA	AA	A	BBB	BB	B	CCC
Factor 1: Quality of Assets (40%)							
Concentration							
Portfolio volatility							
Geographic reach							
Sector segmentation							
Factor 2: Corporate Governance (20%)							
	High		Medium			Low	
Dividend policy							
Structural complexity							
Shareholder protection							
Transparency							
Factor 3: Financial Strength (40%)							
Market value of debt							
Coverage ratio							
Dividend control							
Liquidity							

Corporate Credit Rating based on the model	BBB-
CSR Adjusted Corporate Credit Rating	BB+
National Scale Rating	BBB+ _{KW}
Outlook	Stable

AREF Energy Holding Company



B – Financial Snapshot

Balance sheet of the holding company				
(Fig. in KWD '000)	9M2011	FY2010	FY2009	FY2008
Assets				
Cash & equivalents	17,830.13	23,822.52	1,915.79	358.99
Accounts receivables	507.09	160.69	766.20	435.03
Current assets	18,337.22	23,983.21	2,681.99	794.03
Short term investments	32,400.00	32,400.00	32,400.00	32,400.00
Financial assets at fair value through income statement	2,589.98	1,061.01	724.32	690.88
Investment in subsidiaries	14,309.77	15,981.58	17,352.27	20,717.39
Investment in associates	3,086.95	3,476.15	2,720.83	3,667.79
Available for sale investments	2,715.60	2,715.60	2,715.60	2,715.60
Intangible assets	948.35	673.86	13,298.68	13,521.11
Total assets	74,473.08	80,389.36	71,919.36	74,569.54
Liabilities & Equity				
Total debt	2,559.34	4,039.56	6,549.59	1,190.88
Accounts payables	151.90	1,246.85	687.06	382.85
Total current liabilities	2,711.24	5,286.41	7,236.65	1,573.73
Total liabilities	2,875.51	5,408.82	7,303.81	1,616.33
Shareholders' equity	71,597.57	74,980.54	64,615.55	72,953.21

Income statement of the holding company				
(Fig. in KWD '000)	9M2011	FY2010	FY2009	16M ending Dec-2008
Dividend income	900.00	0.00	0.00	0.00
Finance income	148.44	20.25	12.66	2.79
Gain on sale of investments	0.00	25,074.15	(25.54)	0.00
Unrealized gain on investments	0.00	0.00	0.00	3,600.00
Share of results of subsidiaries	(547.21)	(683.80)	(2,856.14)	343.51
Share in results of associates	(316.62)	(480.95)	(969.01)	(490.53)
Administrative expenses	1,015.76	1,451.97	929.35	1,487.74
Impairment of intangibles	0.00	(2,607.50)	(3,245.69)	(3,734.37)
Finance charges	131.51	304.01	280.26	280.83
Contributions and statutory tax deductions	26.44	8,075.96	0.00	0.00
Net profits	(1,386.35)	10,798.28	(7,959.61)	(3,641.04)

AREF Energy Holding Company



Key Ratios	9M2011	FY2010	FY2009	16M ending Dec-2008
Profitability				
Return on assets [*]	-2.41%	14.18%	-10.87%	-3.66%
Return on equity [*]	-2.53%	15.47%	-11.57%	-3.74%
Liquidity, Leverage & Coverage				
Cash ratio (x)	5.78	4.51	0.26	0.23
Current ratio (x)	6.92	10.87	4.95	21.53
(Dividend income + Finance income)/Finance charges (x)	7.97	0.05	0.05	0.01
Total core income/Finance charges (x)	7.97	82.55	-0.05	0.01
Debt/Equity	3.57%	5.39%	10.14%	1.63%

^{*}For 9M2011 and Dec-2008, the ratios are annualized.

AREF Energy Holding Company



C - CSR's National Rating Scale

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

International 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

AREF Energy Holding Company**D–CSR’s Related Reports**

- Investment Houses Rating Methodology
(<http://www.capstandards.com/meth-investmentHouses.php>)
- Rating Announcement of Kuwait Projects Company (Holding)
(<http://www.capstandards.com/upload/report/report-29141145.pdf>)

AREF Energy Holding Company



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