FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Gulf Cooperation Council Interconnection Authority 'A+'/Stable

Fri 09 Aug, 2024 - 10:18 AM ET

Fitch Ratings - Frankfurt am Main - 09 Aug 2024: Fitch Ratings has assigned Gulf Cooperation Council Interconnection Authority (GCCIA) a Long-Term Foreign Currency Issuer Default Rating (IDR) of 'A+'. The Outlook is Stable.

KEY RATING DRIVERS

'Extremely Likely' Support: We believe extraordinary support from GCCIA's owners of six GCC member states would be extremely likely, reflecting a support score of 40 (out of a maximum of 60) under Fitch's Government-Related Entities (GRE) Rating Criteria. This reflects our assessment of responsibility-to-support and incentive-to- support factors.

'Very Strong' Decision Making/Oversight: GCCIA's six member-state owners oversee its strategy, including fees, capex and funding through its Board of Directors, where each member state is represented by two appointed government officials. GCC Electricity and Water Ministerial Committee approves GCCIA's annual fees and monitors its annual performance. Fitch views the Ministerial Committee's close and frequent oversight and its guidance to both the Board and six-member states underscore the state's tight control over the Authority.

'Very Strong' Precedents of Support: GCCIA receives consistent support from its owners in the form of top-up payments to annual fees to cover any shortfall in debt servicing resulting from an unforeseen rise in operating expenses due to planned expansion investments . We expect these additional contributions to average 32% of its operating revenue over the medium term. The Authority has also received equity injections for the construction of an initial power interconnection grid, totalling USD1.4 billion in 2009-2011 and a further USD127 million at end-2023.

GCCIA also benefits from a supportive regulatory environment and is exempted from taxation and duties. Since it became operational in 2009 it has not paid any dividends to the member states.

'Strong' Government Policy Role Preservation: GCCIA is a high-profile GRE for energy security in the Gulf by providing emergency support to prevent power outages and meeting increasing demand for power exchanges including renewables. This service is essential for the public in the Gulf region. GCCIA's supranational policy role means it has a major role in fostering economic and political ties within the Gulf region. We therefore believe that a default would have strong repercussions on the political leadership and the agenda of its six member states in implementing the long-term regional energy policy.

'Strong' Contagion Risk: GCCIA has incurred debt from regional development banks even though governments generally have access to lending from development funds. GCCIA's financing was exceptionally approved due to its strategic importance as a supranational GRE. This provides GCC members a strong incentive to support GCCIA to avoid contagion effect on other GREs of the member states. We expect GCCIA to have a growing presence in the financial markets. We forecast debt to rise to USD1.3 billion at end-2026 (2023: USD0.1 billion) with majority of financing from GCC regional development banks.

Standalone Credit Profile (SCP): GCCIA's SCP is assessed at 'bbb+', which reflects the combination of a 'a' category financial profile and a 'Midrange' risk profile corresponding to a 'bbb' category SCP. As the risk profile is skewed towards the high end of our 'Midrange' assessment this leads us to arrive at the 'bbb+' final SCP.

GCCIA's 'Midrange' risk profile reflects a combination of the following assessments:

Revenue Risk: 'Midrange'

Core revenues (annual fees) are highly predictable and visible. They are derived solely from its regulated activities with low demand risk and fully contracted with largely 'AA' rated counterparties (53%). Contracts with lower-rated counterparties are 25% (A), 15% (BB) and 7% (B). It also factors in our expectation of redistribution of annual fees among the stronger counterparties in the event of non-payment by weaker counterparties although no formal solidarity mechanism is in place.

GCCIA is able to increase annual fees sufficiently to cover inflationary increases in operating expenses. Ability to set charges to national electricity companies is, however, subject to the approval of Ministerial Committee.

Expenditure Risk: 'Midrange'

GCCIA's cost drivers are well-identified with a full pass-through of operating costs, supply and volume risk, but this is constrained by financially midrange counterparties on average. GCCIA's pass-through additional operating costs are mainly maintenance costs resulting from expansion projects, We also factor in adequate supply of resources and labour with limited volatility, established mechanisms for investment planning, and financing that is planned and contracted well in advance.

Liabilities and Liquidity Risk: 'Midrange'

The assessment reflects an evolving capital and financial markets framework for debt and liquidity management, GCCIA's good access to regional development banks, its low cost of funding and a lengthy tenor. However, GCCIA is not yet a regular or a large issuer of financial market debt. We also factor in in its ample liquidity with cash and liquid deposits of USD150.2 million, which covers almost 1x its outstanding debt, and its undrawn committed credit lines of USD70 million.

Financial Profile 'a'

The 'a' financial profile assessment primarily stems from GCCIA's leverage (net debt/Fitch-calculated EBITDA) of 6x in 2028 in Fitch's rating case, which is in the middle of its peers' range.

GCCIA's revenue and profitability for the last five years have been increasing, driven by growth of its regulated activities. It has an average EBITDA margin of about 30%. The Authority was almost debt-free, resulting in a net cash position. With the implementation of large infrastructure investments in 2023-2028, we expect GCCIA's net adjusted debt / EBITDA to increase sharply to an average of 16x in 2024-2025 before it moderates from 2026 towards 6x by 2028, supported by strong earnings.

High cash flow visibility will be supported by expected transfers from the six member states to cover deficit for repayments of loans. We project earnings to cover at least 1x of annual debt servicing, while gross interest coverage, though declining sharply from historical levels, should remain robust at 2x-4x in 2024-2028.

DERIVATION SUMMARY

Fitch views GCCIA as a GRE owned by its six GCC member states and equalises its ratings with that of the weighted average credit profile of its six GCC member states at 'A+'. This reflects 'Extremely Likely' support from the member states and a 'bbb+' SCP at three notches away from the weighted average credit profile of the six GCC member states.

The weighted average credit profile of the six GCC member states is driven by a blend of all six-member states' IDRs weighted according to their proportional share of the annual benefits stemming from the usage of the interconnection grid, with no major shifts expected within the rating horizon in the annual benefit structure are expected following the implementation of expansion projects.

Short- Term Ratings

GCCIA's Short Term IDR of 'F1' is derived as a weighted average of the six GCC member states' Short Term IDRs under Fitch's Public Policy Revenue-Supported Entities Rating Criteria.

KEY ASSUMPTIONS

Fitch's base and rating cases incorporate 2023 financial accounts and projections by GCCIA for 2024-2028 and are based on the following assumptions:

- Operating revenue CAGR of 25.3%, in line with contracted annual tariffs

- Operating spending CAGR of 14.8%, driven by increases in maintenance cost and depreciation for the additional assets from expansion projects and an expected inflation rate of 3%

- A negative capital balance of around USD261.3 million a year due to expansion projects related to the interconnection grid

- Cost of debt on average at 4.5%, reflecting funding from GCC development banks at below market rates

-The rating case incorporates additional stress on GCCIA's operating revenue of 1% a year

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

-An increase in the proportional share of annual benefits from 'AA-' and 'A+' rated GCC member states. This could result from the upgrade of the largest 'AA-' rated GCC member states such as Abu Dhabi (25.84%) and Kuwait (21.12%) and the largest 'A+' rated GCC member state such as Saudi Arabia (23.39%)

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

A decline in the proportional share of annual benefits from 'AA-' and or 'A+' rated GCC member states. This could result from the downgrade of the largest 'AA-' rated GCC member states such as Abu Dhabi and Kuwait or could result from a downgrade of the largest 'A+' rated GCC member state such as Saudi Arabia together with 'AA-' rated member states like Kuwait or Abu Dhabi

-A weaker assessment of support factors leading to a support score of less than 35 points could result in GCCIA's ratings being notched down once from the weighted average credit profile of its member states at 'A+'

-A downward assessment of SCP by one notch triggered by net adjusted debt/EBITDA increasing to over 8x on a sustained basis, while support factors' assessment remains unchanged

LIQUIDITY AND DEBT STRUCTURE

Until 2023, GCCIA was almost debt-free. With the commencement of the planned expansion projects, GCCIA increased its outstanding financial debt to USD128.4 million at end-2023 and has borrowed from regional development banks for its interconnection network expansion projects in Kuwait and one other non-member country, Iraq.

GCCIA's capex-related debt at end-2023 was contracted in fixed rates and hedged, thereby alleviating interest-rate or foreign-exchange risks. Total debt consists of only loans from regional development banks with an amortising profile and a lengthy maturity profile.

ISSUER PROFILE

GCCIA as a unique supranational body in regional transmission and distribution of electricity through a 400KV power grid interconnecting the electrical networks of its six Gulf member states. Its role is to provide sustainable electricity security, with significant economic benefits for the GCC region as a whole.

Criteria Variation

Fitch has applied a variation from its GRE Rating Criteria for multi- owner GREs and factored in extraordinary support from the six GCC member states that are the shareholders of GCCIA with no single government having more than 50% of shares or materially more shares than the others. This is because GCCIA as a unique supranational GRE carries out essential public services for the GCC region, which underpin the six GCC member states' responsibility and incentives to provide extraordinary support in case of financial distress of GCCIA.

In the absence of the variation, GCCIA's IDR would have been equalised with its SCP.

In the application of the variation, Fitch derived the weighted average credit profile of the six GCC member states based on their proportional shares of the annual benefits stemming from the usage of the interconnection grid. This resulted in a blended IDR of the six member states at 'A+'.

DATE OF RELEVANT COMMITTEE

18 July 2024

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

GCCIA's ratings are credit-linked to the weighted average rating of its six GCC owners (Abu Dhabi, Kuwait , Oman, Bahrein, Qatar and Saudi Arabia)

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit **https://www.fitchratings.com/topics/esg/products#esg-relevance-scores**.

RATING ACTIONS

ENTITY / DEBT	RATING		
Gulf Cooperation Council Interconnection Authority	LT IDR	A+ Rating Outlook Stable	New Rating
	ST IDR	F1	New Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Policy Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 09 Jul 2024)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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Gulf Cooperation Council Interconnection Authority	-

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