

Research Update:

# Qatar-Based Business Services Provider Mekdam Holding Group Assigned 'gcBBB-' GCC Regional Scale Rating

March 7, 2021

## Rating Action Overview

- Qatar-based business services company Mekdam Holding Group's offering includes extra low voltage, engineering, outsourcing and secondment, as well as security and alarm monitoring.
- The company benefits from strong partnerships with international solution providers, good cash flow visibility, and a relatively flexible cost structure, although it is significantly smaller than rated peers and has limited geographic diversification.
- Mekdam has strong credit ratios, and we forecast S&P Global Ratings-adjusted leverage below 1.0x in 2021-2022, supported by EBITDA margins of 15%-18%, and minimal ongoing capital expenditure (capex), although a high dividend payout ratio and possible head office construction could weigh on discretionary cash flow generation.
- We are assigning our long-term Gulf Cooperation Council (GCC) regional scale rating of 'gcBBB-' to Mekdam.

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## Rating Action Rationale

**Mekdam has access to international suppliers, good earnings visibility, and a highly flexible cost structure.** We view as positive the company's leading position in Qatar across its Technology, Technical Services, and CAMS divisions; its strong partnerships with international system providers, such as CISCO; and its good track record with Qatari government-related entities as recurring customers, for example Qatar Petroleum (AA-/Stable/--). In addition, with a ratio of backlog to revenue higher than 2.0x in 2020, we see good earnings visibility, despite a nonrecurring client base, given the project nature of Mekdam's business. We also consider Mekdam's highly flexible cost structure, with variable costs contributing to more than 70% of total direct costs, although this does not fully translate into above-average profitability. We expect Mekdam's profitability will range between 15% and 18% over the next 12 months-18 months, supported by its highly flexible cost structure and GDP growth in Qatar.

**These strengths are constrained by the company's limited scale and geographic diversification.**

Our assessment is balanced by the highly fragmented industries Mekdam operates in, its 100% concentration on the Qatari market, and fairly limited scale (around \$50 million revenue) compared with peers such as GS4 (\$20 billion) and Sprie (\$20 billion), which are also more geographically diversified. Although the customer base is granular, with no customer representing more than 20% of consolidated revenue, we note a predominance of government-related and quasi government entities, which could pressure working capital management, in our view. As a result, we believe a material improvement in scale and profitability, alongside building a track record of operating efficiency, which could result from managing working capital swings, could be beneficial for the rating.

**We anticipate Mekdam's performance will rebound from 2021, following a weak performance in 2020 caused by slower macroeconomic conditions and the impact of COVID-19.**

In particular, we anticipate that reported EBITDA will be Qatari riyal (QAR) 25 million-QAR30 million in 2021, a 10% improvement from 2020, and strengthen to QAR35 million-QAR40 million in 2022. We expect the recovery in the Technology division, following a 30% year-on-year decline in 2020 as a result of COVID-19-related lockdowns, to be the key contributor.

**Minimal business capex requirements and relatively stable margins underpin Mekdam's modest financial risk profile.**

The company has minimal capex requirements of QAR1 million-QAR2 million annually, translating into around 1% of total sales. In addition, we forecast EBITDA margins at 15%-18% in 2021 and 2022, benefiting from the high-value CAMS segment (25%-30% of consolidated EBITDA) and overall recovery of the domestic macroeconomic environment, which should help sustain demand in other operating divisions. We expect leverage to remain below 1.0x in 2021 and 2022, but estimate that discretionary cash flow (DCF) could be pressured, given potential capex to construct Mekdam's new headquarters, which we understand is still at an early stage, and a dividend payout ratio above 50% of net income. We believe if Mekdam were to experience a material decline in profitability or higher volatility in margins, causing DCF to turn negative for a prolonged period and leverage to exceed 2.0x, this would be detrimental for the rating. Similarly, if liquidity were to deteriorate to less than adequate as a result of higher-than-expected spending needs, we could lower the rating.

## Company Description

Mekdam Holding Group is a Qatar-based limited liability company established in 2018. The company operates three wholly owned subsidiaries:

- Mekdam Technology (55% of 2020 revenue; 42% of 2020 EBITDA), a one-stop system integrator of more than 65 different systems across information communication technology, audiovisual, safety and security, services and maintenance, engineering, and mobile telephony product offerings.
- Mekdam Technical Services (28% of 2020 revenue; 24% of 2020 EBITDA), which provides manpower outsourcing and recruitment services, with expertise across various sectors including oil and gas, information technology, and health care.
- Mekdam CAMS (8% of 2020 revenue; 28% of 2020 EBITDA), which offers a centralized alarm monitoring system across Qatar, with more than 4,000 active connections. It has somewhat of a monopoly with connectivity to the national command center (NCC) grid, including 100% coverage of malls, exchanges, schools, petrol stations, hotels, and The Pearl City. We

understand this is tailor-made software in collaboration with the Ministry of Interior, Civil Defense, and NCC.

In 2020, Mekdam generated QAR168.7 million of revenue and QAR26.8 million of EBITDA, on an S&P Global Ratings-adjusted basis.

## **Our Base-Case Scenario**

### **Assumptions**

- Real domestic GDP growth of about 2% in 2021 and 2022, respectively, following a decline of 4.4% in 2020.
- Consumer price index inflation of 1%-3% in 2021 and 2022, compared with a decline of 2.3% in 2020.
- Revenue growth of 8%-10%, higher than GDP throughout our forecast period, supported by the strong QAR400 million backlog, and relatively short project tenures.
- EBITDA margins of 15%-18% in 2021 and 2022, compared with 16.9% in 2020. We expect the company's flexible cost structure, with 70%-75% comprising variable costs, and continued top-line growth to support stable margins.
- Minimal capex of QAR1 million-QAR2 million per year, about 1% of consolidated revenue, in line with historical trends. Additionally, we incorporate about QAR60 million in 2021-2023 for the construction of the company's head office in Lusail, although we understand that project is at an early stage and its timing is at management's discretion.
- Slightly negative working capital outflow of QAR3 million-QAR4 million.
- Dividends of QAR15 million-QAR18 million in 2021-2023, compared with QAR16.7 million.
- Capital increase of QAR15.8 million, which took place in February 2021.
- No planned acquisitions.

### **Key metrics**

Based on these assumptions, we arrive at the following credit measures:

- Adjusted debt to EBITDA of 0.5x-1.0x in 2021 and 2022 (compared with 0.9x in 2020).
- Negative DCF in 2021 and 2022 (compared with QAR14.9 million in 2020), due to high discretionary capex.
- Adjusted debt to reach QAR14 million-QAR16 million in 2021 and QAR25 million-QAR26 million in 2022 (compared with QAR24.5 million in 2020).

### **Liquidity**

We consider Mekdam's liquidity to be adequate, with sources covering uses by more than 1.2x in the 12 months from Jan. 1, 2021. The liquidity assessment is supported by Mekdam's strong relationship with two Qatari banks (Arab Bank-Doha branch and Masraf Al Rayan) and prudent

working capital management.

Principal liquidity sources in the 12 months from Dec. 31, 2020, include the following:

- Accessible cash balance of QAR10 million;
- Cash funds from operations (FFO) of about QAR30 million-QAR35 million; and
- Capital increase of QAR15.8 million executed in February 2021.

Principal liquidity uses over the same period include:

- Debt maturities of QAR4 million-QAR5 million;
- Capex of QAR30 million, including the Lusail tower construction; and
- Seasonal working capital requirements of QAR3 million-QAR4 million.

## **Covenants**

The company has two bank covenants stipulating a minimum liquidity ratio of 1.0x (2.6x as of Dec. 31, 2020) and maximum debt to equity of 3x (0.3x as of Dec. 31, 2020). We expect there will be enough headroom in 2021 such that a 15% decline in EBITDA will not result in a breach of the covenant.

## **Ratings Score Snapshot**

GCC Regional Scale Rating: gcBBB-

Business risk: Vulnerable

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Vulnerable

Financial risk: Modest

- Cash flow/Leverage: Modest

Modifiers:

- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral
- Liquidity: Adequate
- Financial policy: Neutral
- Management and governance: Fair
- Comparable rating analysis: Neutral

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### New Rating

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#### Mekdam Holding Group

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Issuer Credit Rating gcBBB-/--/--

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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