3 February 2022 Corporates

Lisi Lake Development JSC Georgia, Real Estate

SCOPE **B+** STABLE

Corporate profile

Lisi Lake Development JSC (LLD) is a real estate developer based in Georgia with a core focus on developing premium residential property. LLD was founded in 2010 when it acquired a large undeveloped plot of land in the vicinity of Georgia's capital city of Tbilisi. The 355-hectare plot was pre-developed by the company through the addition of critical infrastructure such as roads, electricity, and water supply as well as schools and community spaces. In 2011, LLD started building on the plot and selling premium residences and plots.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	0.7x	2.1x	2.8x	4.6x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	15.7x	5.7x	3.6x	2.4x
Scope-adjusted loan/value ratio (%)	9%	9%	8%	9%

Rating rationale

Scope Ratings GmbH (Scope) has affirmed the issuer rating of B+/Stable on Lisi Lake Development JSC.

The affirmation is supported by i) LLD's conservative financing structure, which relies on equity and a largely unencumbered asset portfolio that bears little net debt compared to the asset base (Scope-adjusted loan/value ratio of below 10%); ii) the successful refinancing of a USD 12m bond in December 2021, fully in line with the rating base case; and iii) the robust sales metrics in 2021, with a stable sales volume for apartments and a larger contribution from plots at the main project, Lisi Green Town. LLD's performance has benefited from the growing demand, fuelled by the pandemic, for high-quality, modern living space outside of the city centre.

The business risk profile remains constrained by i) LLD's limited size as a small residential property developer; ii) the weak diversification in terms of geographies and projects with substantial cluster risk with regards to the Lisi Lake projects in Tbilisi; and iii) economic risks, including high inflation, foreign exchange risks, and the lower liquidity of Georgia's premium real estate market compared with the more mature western European market. Credit-positive is the diversified customer base due to the core retail residential business as well as the asset quality with a focus on the premium residential segment.

The financial risk profile reflects LLD's adequate credit metrics. Scope-adjusted interest coverage stood at 2.1x in 2020. We expect the figure to remain at around 3.0x given i) the low level of financial debt compared to the issuer's size; and ii) the reduced financing costs after the refinancing of bond in 2021 at a lower rate. We forecast financial leverage, as measured by the Scope-adjusted debt/EBITDA ratio, to remain moderate, averaging 3.9x in 2020-22. This forecast excludes operating profits from the Buknari project and is solely based on ongoing project sales in Lisi Lake at similar margins as in previous years.

Ratings & Outlook

Corporate rating	B+/Stable
Senior unsecured rating	BB-

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Related Methodologies

Corporate Rating Methodology: July 2021

European Real Estate Rating Methodology January 2022

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Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Stable Outlook is supported by the expectation of i) robust sales at the core development, Lisi Green Town, as well as access to funding ensured by low balance-sheet and financial leverage; ii) leverage (Scope-adjusted debt/EBITDA) remaining moderate at 4x on average and interest cover at above 3x on average; iii) USD 1.25m in yearly sunk costs for the Buknari project due to the current delay and limited visibility as of today.

A negative rating action is possible if interest cover reduced below 2x on a sustained basis. This could happen through a sales volume slump caused by either delay in the execution of developments or a serious deterioration in Georgia's real estate market.

A positive rating action is remote but may be warranted if the business risk profile improved (development pipeline substantially growing in size and diversification improving) coupled by a substantial increase in the share of recurring revenues while credit metrics remain at current levels.

Rating drivers

Positive rating drivers	Negative rating drivers
• Good local market position due to attractive land bank, established brand and network within the local real estate and financial industry • Record of the construction and sale of existing residential units and plots in Lisi Lake • Unencumbered land banks in Tbilisi and Buknari, good locations which should offer above-average liquidity within the Georgian market • Strong operating cash profitability thanks in part to very low land acquisition costs • Low loan/value ratio of around 10%, even after the placement of the USD 12m bond in Dec 2018 (refinanced in 2021)	• High dependency on the main development project in Lisi Lake, despite recent diversification efforts • Exposure to the still relatively volatile Georgian economy with inherent risks such as high inflation and (indirect) FX risk • Pure play developer with negligible recurring (rental/other) income • Small player with lack of scale when compared to other International/European upscale residential developers • High project concentration translates into high potential cash flow volatility

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Substantial improvement in business risk profile (size, diversification and recurring revenues) while credit metrics remain at current levels	• Scope-adjusted EBITDA interest cover sustained below 2x

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover (x)	0.7x	2.1x	2.8x	4.6x	5.5x
Scope-adjusted debt/EBITDA (x)	15.7x	5.7x	3.6x	2.4x	2.0x
Scope-adjusted loan/value ratio (%)	9%	9%	8%	9%	9%
Scope-adjusted EBITDA in USD m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	1.0	5.9	4.3	6.9	8.3
add: operating lease payments in respective year	0.0	0.0	0.0	0.0	0.0
less: gain on sale of investment properties	0.0	3.0	0.0	0.0	0.0
Scope-adjusted EBITDA	1.0	2.8	4.3	6.9	8.3
Scope-adjusted debt in USD m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	16.4	16.1	15.4	16.5	16.5
add: other	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	16.4	16.1	15.4	16.5	16.5
Cash balance in USD m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Cash balance[1]	3.5	3.8	2.3	2.2	4.3

[1] Netting of cash: generally, only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible.

Business risk profile: B+

LLD is a Georgian residential real estate developer whose activities comprise the development of premium residential units and the selling of plots for the development of villas. Other rental activities contribute little to revenues.

Small property company in a highly fragmented market

With about USD 185m of total Scope-adjusted assets as of December 2020, LLD is a small real estate developer in the European context. The company has brand recognition in Georgia as a developer of residential space, with a strong niche focus on upscale residential real estate units and plots in the so-called Lisi Green Town community in Tbilisi.

Performance has benefited from the growing demand, fuelled by the pandemic, for high-quality, modern living space outside of the city centre. Revenues in 2020 were USD 12m and the company expect the figure to reach around USD 18m in 2021. Sales of both apartments and villa plots have grown, with the latter noticeably growing by 32% YoY, representing 60% of total sales in 2021 (from 49% in 2019). In the case of apartments, the main driver in 2020 was larger volume (19% YoY more sq m sold) as opposed to price per square metre in 2021 (26% YoY, per company reports).

Despite its robust performance and market share in upscale residential real estate in Tbilisi, strengthened by the addition of projects in Batumi and Kohta-Mitarbi, we expect LLD to remain small. This limited size is a negative rating driver since it implies enhanced sensitivity to unforeseen shocks, greater cash flow volatility, limited economies of scale and higher key person risk.

Geographical focus on Tbilisi

Its development portfolio is situated in Georgia's main real estate markets of Tbilisi and the Batumi area, two markets that are not yet mature and may therefore lack liquidity in times of market distress. As of January 2022, the Batumi project is substantially behind the initial schedule and the signing of a new agreement with the local government is still ongoing, with limited visibility on new timeline. This very modest diversification of revenue sources fully exposes the company to the cyclicality of the Georgian real estate market and is therefore credit-negative.

High project concentration remains

Also, credit-negative is the revenue dependency on property sales without additional recurring income streams. However, increasing revenues from plot sales (60% of sales in 2021) are mitigating construction and development risks while generating attractive cash margins due to the comparatively low initial price to acquire the land.

The company has confirmed plans to target a certain portion of recurring revenue. To accelerate this process, it has bundled all commercial assets in group subsidiary Lisi Rental to execute a long-term buy-and-hold strategy from 2020. Nonetheless, these activities still contribute little to total revenues.

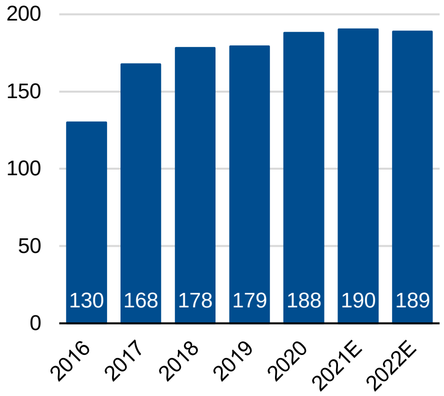
Asset quality to support portfolio liquidity

Asset quality is credit-positive, as the development portfolio comprises high-quality modern residential space. Also positive is the highly diversified customer base due to the core retail residential business. Demand should remain strong in this segment, with newly built residential units having higher liquidity than the average real estate property.

High pre-sale ratios mitigate risk of sunk construction costs

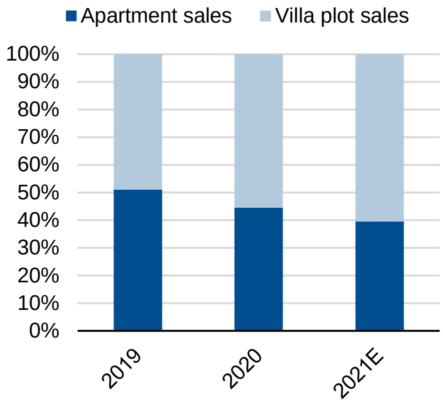
Pre-sale ratios for current residential development buildings are decent, at above 90% for Lisi Green Town, phase II. Pre-sales and reservations for the other assets (Townhouse, phase III, expected to be completed in 2023) are about 30%.

Figure 1: Scope-adjusted assets (USD m)



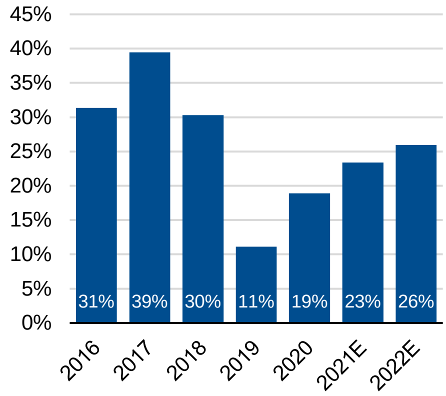
Sources: LLD, Scope

Figure 2: Sales by asset class



Sources: LLD, Scope

Figure 3: Scope-adjusted EBITDA margin



Sources: LLD, Scope

Profitability supported by high-margin villa plot sales

Profitability, as measured by the Scope-adjusted EBITDA margin, was above 30% before being weighed down from 2019 by sunk costs from the Buknari project. We expect the margin to remain at around 25% into the medium term, which is robust given the pandemic environment, supported by the higher share of high-margin villa plot sales.

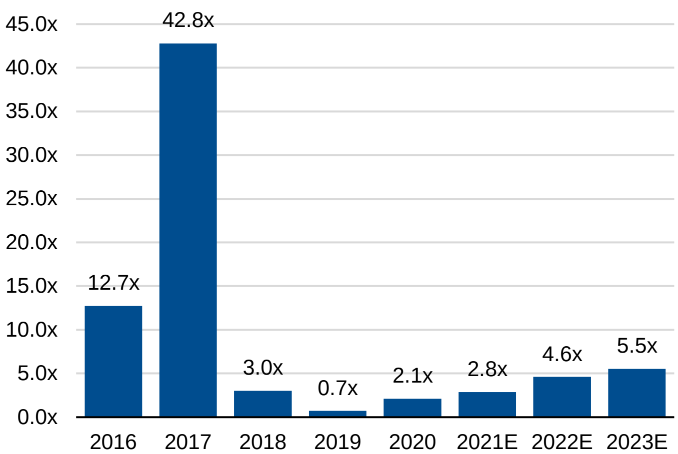
Due to the timing mismatch between cash outflows and inflows (expenses and revenues), we have calculated a proxy internal rate of return estimated at around 18%. Worth noting is the different profitability between apartments and villa plots, with the average net profit margin at 31% for the former and 67% for the latter.

Financial risk profile: BB-

Adequate debt protection although debt increase in 2018

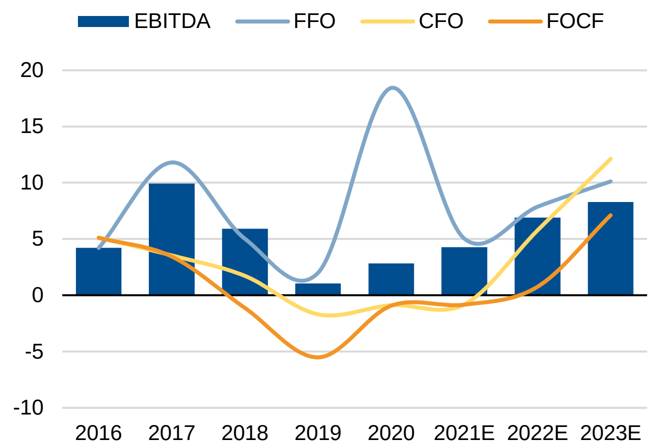
The Scope-adjusted EBITDA interest cover stood at 2.1x in 2020. We expect the figure to remain at above 3.0x (average 3.2x for 2020-22) given the low level of financial debt compared to the issuer's size. Debt protection benefits from i) large share of debt being subject to a fixed interest rate, resulting in better visibility on financial costs; and ii) the reduced financing costs after the refinancing of a bond in 2021 (bond rate reduced to 6.5% from 8%).

Figure 4: Scope-adjusted EBITDA interest cover (x)



Sources: LLD, Scope estimates

Figure 5: Cash flows (USD m)



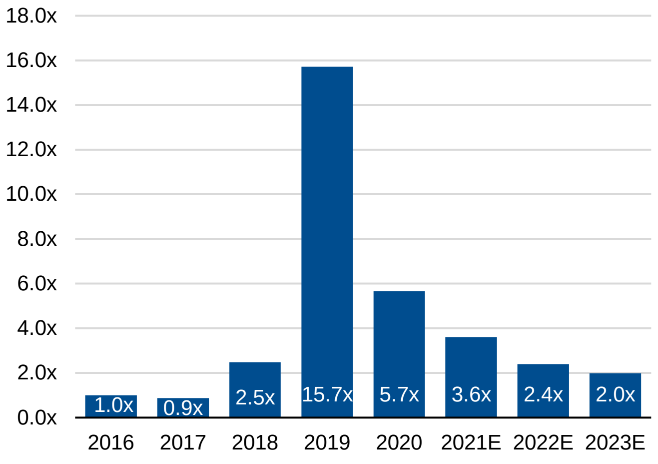
Sources: LLD, Scope estimates; 'Sa' = Scope-adjusted

The ratio might fluctuate as cash flows strongly depend on the timely delivery and disposal of projects. If projects are delayed, LLD may have to rely on external financing to cover interest payments. We believe external financing is available as the company has a large pool of unencumbered assets (properties and a land bank) that allow for additional secured financing.

Low leverage

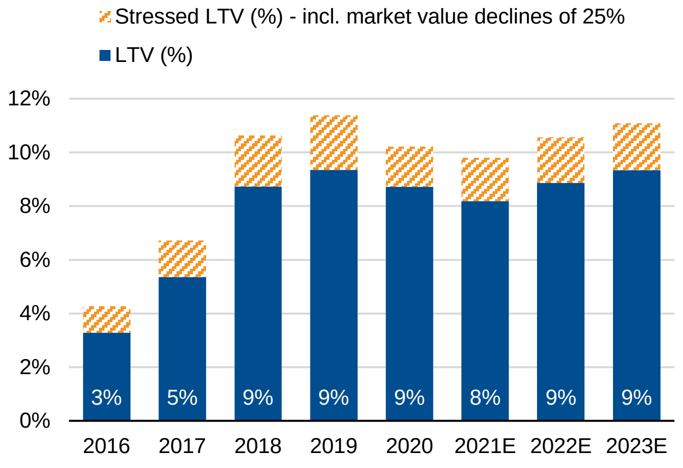
Leverage, as measured by Scope-adjusted debt/EBITDA, was very low until 2019 when it was spiked due to weaker EBITDA. We foresee financial leverage to return to previous low levels over the next 2-3 business years (3.9x average for 2020-22). Our forecast excludes operating profits from the Buknari project but includes the project's sunk costs of USD 1.2m yearly, and forecasted revenues are based on ongoing project sales in Lisi Lake at similar margins as in previous years.

Figure 6: Scope-adjusted debt/EBITDA



Sources: LLD, Scope estimates

Figure 7: Scope-adjusted loan/value ratio



Sources: LLD, Scope

Adequate liquidity

We deem liquidity as adequate following the successful refinancing of the USD 12m senior unsecured bond in December 2021 and based on the view that the issuer will continue to benefit from good access to external, secured financing given its low loan/value ratio of below 10% as of December 2021.

in EUR k	2021E	2022E
Short-term debt (t-1)	13.7	2.3
Unrestricted cash (t-1)	3.8	2.3
Open committed credit lines (t-1)	0.0	0.0
Free operating cash flow (t)	-0.8	0.8
Coverage	**0.2x**	**1.3x**

Long-term and short-term debt ratings

Senior unsecured debt: BB-

We have affirmed the debt class rating on senior unsecured debt at BB- reflecting an 'above-average' expected recovery rate in a hypothetical liquidation scenario in 2023. The recovery assumptions are driven by elevated risks related to the issuer's development activities, evidenced by the Buknari project's delays. Moreover, all unsecured debt may become structurally subordinated to any current or future senior secured debt, given the large, unencumbered asset base.

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