JSC Lisi Lake Development
Republic of Georgia, Real Estate

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.1x	3.5x	3.1x	5.0x
Scope-adjusted debt/EBITDA	5.7x	3.5x	5.6x	3.0x
Scope-adjusted loan/value ratio	9%	8%	12%	15%

Rating rationale

The rating affirmation is driven by JSC Lisi Lake Development's (LLD) sound credit metrics and liquidity. The ratings also reflect the company's successful execution of its development pipeline and robust sales for its core projects. The company's focus on the premium segment, land secured below current market prices and lean organisational setup support profitability.

Main rating constraints include LLD's highly concentrated pipeline (cluster risk) and lack of diversification in terms of geographies and revenue, which hinder its ability to offset potential cash flow volatility arising from economic cycles and industry dynamics or to benefit from economies of scale.

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation that the company will successfully execute its development pipeline and benefit from sustained sales volumes. Moreover, the Stable Outlook reflects our expectation that the company will keep leverage under control, with Scope-adjusted debt/EBITDA below 6x.

A positive rating action is remote but could be warranted if the business risk profile improved. This could be achieved if the company increased its size and improved its diversification, in conjunction with a significant increase in recurring revenues while keeping credit metrics at current levels.

A negative rating action could occur if the Scope-adjusted EBITDA/interest cover ratio fell below 2x for a prolonged period. This could be triggered by a sharp decline in sales volumes, delays in pipeline execution or a pronounced deterioration in the Georgian real estate market.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
03 February 2023	Affirmation	B+/Stable
03 February 2022	Affirmation	B+/Stable
03 February 2021	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

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Related Methodologies and Research

General Corporate Rating Methodology; July 2022

European Real Estate Rating Methodology; January 2023

ESG considerations for the credit ratings of real estate corporates; April 2021

European Real Estate sector Outlook; October 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Good standing in the premium residential property segment, benefitting from favourable growth prospects in property prices • Strong operating profitability supported by low cost of land, increasing prices and lean organisational setup • Ownership of a large pool of unencumbered land in Tbilisi, which benefits from good liquidity within the Georgian market • Moderate leverage and adequate debt protection in spite of anticipated increase in indebtedness	• Despite recent diversification efforts, the development pipeline remains largely concentrated around Lisi Lake in Tbilisi, posing a cluster risk for the company's cash flow • High exposure to potential volatility and shifting demand in the Georgian property development market, correlated to the Georgian state's economic fundamentals • Small residential developer compared to European peers, limiting economies of scale, although mitigated by a large adjoining land area • Limited recurring revenue sources (i.e. rental income, other services)

Positive rating-change drivers	Negative rating-change drivers
• Substantial improvement of diversification and/or of recurring revenue leading to an improved business risk profile, with credit metrics at current levels	• Scope-adjusted EBITDA interest cover below 2x on a sustained basis

Corporate profile

LLD is a Georgian pure-play residential property developer, with a primary focus on the premium segment. The company's activities primarily revolve around the development and sale of residential flats and serviced plots around Lisi Lake in Tbilisi. More recently, LLD has expanded its reach by starting a major project in Buknari, near the Black Sea. In addition to residential units, the project will include a hotel, restaurants, conference rooms and sport facilities. Furthermore, the company has set out a new strategy (build-to-hold model) to grow a portfolio of income-generating assets, mainly by retaining ownership of commercial properties in its mixed-use development projects.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	0.7x	2.1x	3.5x	3.1x	5.0x	3.8x
Scope-adjusted debt/EBITDA	15.7x	5.7x	3.5x	5.6x	3.0x	3.8x
Scope-adjusted loan/value ratio	9%	9%	8%	12%	15%	13%
Scope-adjusted EBITDA in USD m						
EBITDA	1.0	5.9	5.2	4.7	12.1	9.3
Other items[1]	0.0	-3.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**1.0**	**2.9**	**5.2**	**4.7**	**12.1**	**9.3**
Funds from operations in USD m						
Scope-adjusted EBITDA	1.0	2.9	5.2	4.7	12.1	9.3
less: cash interest paid	-1.5	-1.4	-1.5	-1.5	-2.4	-2.5
less: cash tax paid per cash flow statement	-1.1	-1.1	-1.2	-1.4	-1.8	-1.9
add: dividends from associates	0.2	0.2	0.2	0.0	0.0	0.0
Change in provisions	0.0	0.0	0.0	0.0	0.0	0.0
Funds from operations (FFO)	**-1.4**	**0.6**	**2.7**	**1.8**	**7.9**	**4.9**
Net cash interest paid in USD m						
Net cash interest per cash flow statement	-1.5	-1.4	-1.5	-1.5	-2.4	-2.5
Change in other items	0.0	0.0	0.0	0.0	0.0	0.0
Net cash interest paid	**-1.5**	**-1.4**	**-1.5**	**-1.5**	**-2.4**	**-2.5**
Scope-adjusted total assets in USD m						
Total assets (reported)	179.2	188.0	222.5	228.7	254.9	260.8
less: cash and cash equivalents	-3.5	-3.8	-2.7	-11.6	-9.9	-0.4
Scope-adjusted total assets	**175.7**	**184.2**	**219.8**	**217.1**	**245.0**	**260.4**
Scope-adjusted debt in USD m						
Reported gross financial debt	16.4	16.1	18.2	26.3	36.5	35.0
less: cash and cash equivalents (no cash netting)	0.0	0.0	0.0	0.0	0.0	0.0
add: non-accessible cash	0.0	0.0	0.0	0.0	0.0	0.0
Other items	0.0	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	**16.4**	**16.1**	**18.2**	**26.3**	**36.5**	**35.0**
Accessible cash (for informatory purposes only)	3.5	3.8	2.7	11.6	9.9	0.4

[1] Includes disposal gains on investment properties

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Environmental, social and governance (ESG) profile[2]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

LLD does not report on extra-financial performance and has no specific ESG targets. Nonetheless, the company is amongst the first developers in its region to incorporate sustainability measures into its projects, such as rainwater collectors and energy-efficient building standards. It also builds on only 20% of its development surface and keeps the remaining 80% for green and outdoor areas. At the 2021-22 International Property Awards, the Lisi Green Town development won the Landscape Architecture and the Sustainable Residential Development awards (since 2012, LLD has won an award every year in various categories).

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B+

Industry risk profile: BB

LLD's activities are centred around the development and sale of residential properties (flats, villas and serviced plots), which translates into an industry risk assessment of BB (homebuilders).

Small regional residential developer

LLD is a small developer carrying a limited number of projects over a sizeable land area. As of end-2021, Scope-adjusted total assets amounted to USD 219.8m (up 19% YoY), largely made up of the value of land owned by LLD. It is worth noting that a significant share of the plots is treated as investment properties (59% of total assets) to benefit from long-term appreciation, before envisaging potential development projects or disposals later on.

The company has grown at a reasonable pace over the years, maintaining a sound balance between capital deployed and external financing. We expect a similar growth profile going forward with total assets reaching USD 260m by YE 2024. The anticipated growth is supported by the project pipeline rollout, the appreciation of properties and the rental portfolio build-up.

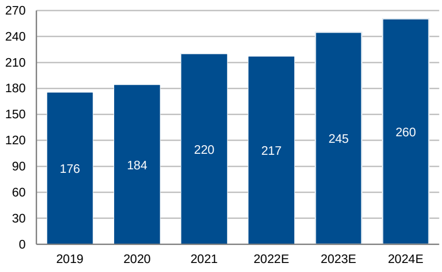
Highly fragmented Georgian residential development market

The Georgian residential development market is highly fragmented, particularly in Tbilisi where there are over 300 registered developers, often with only one or two active projects. There are few developers in Tbilisi with more than three active residential projects (e.g. Archi with 19, Aim Building with seven, M^2 with four, Apart Development with four, X_2 Development with four and Domus with three), although not all the aforementioned developers are LLD's direct competitors as they do not operate in the premium segment. All in all, the competitive landscape is largely comprised of small regional or local developers, many of which have only recently entered the market.

Figure 1: Lisi Green Town land plot area and competitors' projects

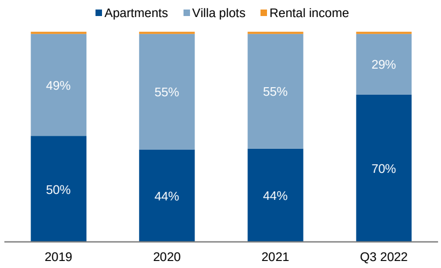
Sources: Korter

Figure 2: Scope-adjusted total assets (USD m)



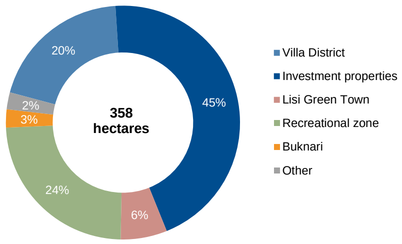
Sources: LLD, Scope estimates

Figure 3: LLD's revenue by segment



Sources: LLD, Scope

Figure 4: LLD's land allocation



Sources: LLD, Scope

High geographical concentration around Tbilisi

95% of LLD's development activities are carried out near Lisi Lake in Tbilisi, both in terms of completed and future developments. Planned land acquisition includes 39,000 sq m situated next to the development area of Lisi Green Town (to be purchased with the bond proceeds for USD 5.5m), as well as 45,000 sq m of land in the Vashlijvari district of Tbilisi. While LLD's first steps to expand its geographical outreach with the introduction of the Buknari project is a positive factor, the development pipeline still remains concentrated around Tbilisi. After extensive administrative delays, the Buknari project received the necessary permits in December 2022 and construction should start in spring 2023.

Given the cyclical nature of real estate development, a high geographical concentration bears the risk of volatility and shifting demand in the Georgian residential real estate market. As such, LLD's future performance is largely correlated with that of the Georgian state and the capital city, as well as inbound tourism (to Buknari). Moreover, the high concentration of the company's activities next to Lisi Lake represents a cluster risk for the company's cash flow.

Limited diversification of income

Revenue sources that are less volatile than real estate development, such as rental income or service fees, are insignificant so far as they contribute only around 1% of LLD's total revenue as of end-June 2022. The lack of recurring and stable revenue is a consequence of LLD's develop-to-sell model. To balance this, the company has set out a new strategy (build-and-hold) to grow a portfolio of income-generating assets, mainly by retaining ownership of commercial properties from mixed-use developed projects. Specifically, lease-and-hold activities are carried by LLD's subsidiary Lisi Rentals (established in 2019), which has leased a total of 2,535 sq m to five tenants as of end-September 2022, mostly stores in Lisi Green Town (e.g. grocery stores, coffee shops, pharmacies and restaurants). Management estimates that Lisi Rentals will generate USD 0.6m-0.8m of rental income by 2024, noting that some lease agreements include a revenue-based rent charge structure (3% to 12% of the tenant's monthly turnover). Regarding LLD's future investments, an increase of recurring revenues would be credit-positive for the company.

Weak diversification across segments

LLD's revenue primarily comes from the development and sale of premium residential properties and serviced plots. The premium positioning of the company bolsters price and demand. While its dependence on continuous property sales without additional recurring income streams is credit-negative, the revenue share coming from the sale of serviced plots (29% of total revenue in the nine months to end-September 2022; 55% of revenue in 2021) is a mitigant as it implies reduced development risk and provides attractive cash returns (largely supported by the low cost of the acquired land).

Focus on premium residential projects supports price and attractiveness

LLD has been offering high-end residential properties and serviced plots since 2011, successfully shaping its brand recognition within the Georgian residential market. Focused on the premium segment, the company aims to offer high-quality modern living spaces, in line with the highest European standards. The location of the company's core projects (i.e. Lisi Green Town and Villa District) is particularly attractive for residents seeking open and green areas, while wanting to stay close to the capital. The quality positioning of LLD's projects bolsters prices and demand.

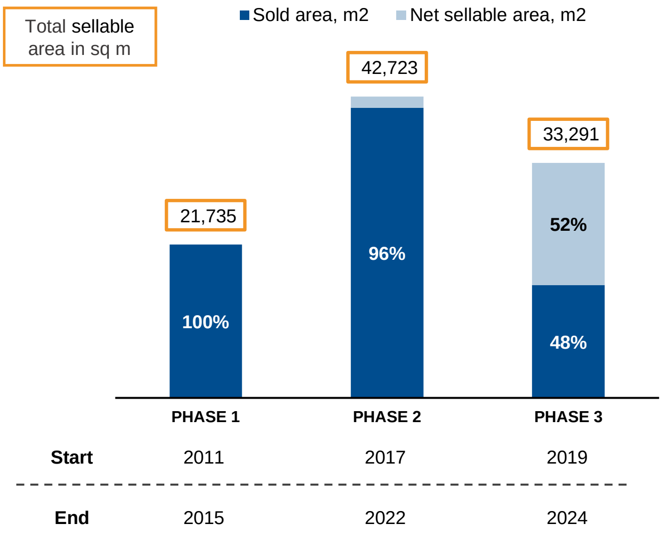
The company lacks geographical diversification and granularity as its activities primarily revolve around Lisi Lake.

Project phasing and achieved pre-sale rate support cash flow visibility

While LLD does not have a minimum pre-sale requirement before engaging into the construction phase, the company usually aims for 30% of pre-sales before kick-starting a specific project phase. With regards to ongoing projects, the company shows close to 100% commercialisation rates on early phases (phase I & II) and above 40% on the latest (phase III). In H1 2022, the company's sales remained solid and prices have shown continued and strong growth. Favourable growth prospects in property prices provide a cushion against inflationary pressure and potentially long disposal periods, should LLD experience a slowdown or sharp decline in sales. On the Buknari project, the construction start is expected in spring 2023 and the company has already received strong interest from potential buyers, with over 80 clients registered.

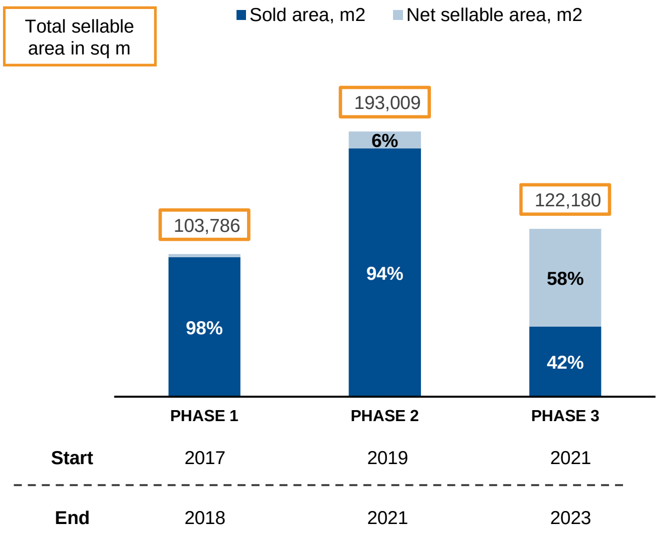
In the context of develop-to-hold activities (still negligible), the company displays a 100% pre-lease rate as commercial properties (adjoining residential units) are mostly let before construction is complete. The rental is still in its early build-up phase, the tenant base is concentrated (five tenants) and the weighted average unexpired lease term stands above 5.0 years.

Figure 5: Pre-sale rate and planning – Lisi Green Town
[As of end-June 2022]



Sources: LLD, Scope

Figure 6: Pre-sale rate and planning – Villa district
[As of end-June 2022]

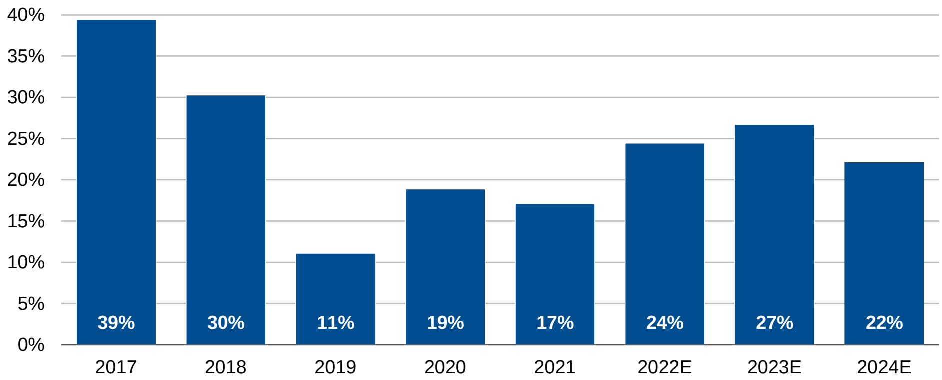


Sources: LLD, Scope

Profitability supported by growing prices

On the back of its premium positioning combined with low land cost coupled with expanding real estate prices, LLD has achieved strong operating margins in recent years (2015-21 median: 19%), above most pure-play residential developers. Profitability as measured by Scope-adjusted EBITDA stood at 17% in 2021 (2020: 19%), impacted by sunk costs related to the Buknari project (initial preparation works to meet investment commitments), high prices of raw and building materials and costs related to a one-off transaction (land plot sales). We expect profitability to remain around 15-25% during the forecasted period, although subject to volatility. Our profitability assumption is supported by solid sales volumes in core projects and rising property prices, providing a cushion against potential cost overruns. LLD's projects individually benefit from an internal rate of return of above 30%.

Figure 7: Scope-adjusted EBITDA margin



Sources: LLD, Scope estimates

Financial risk profile: BB-

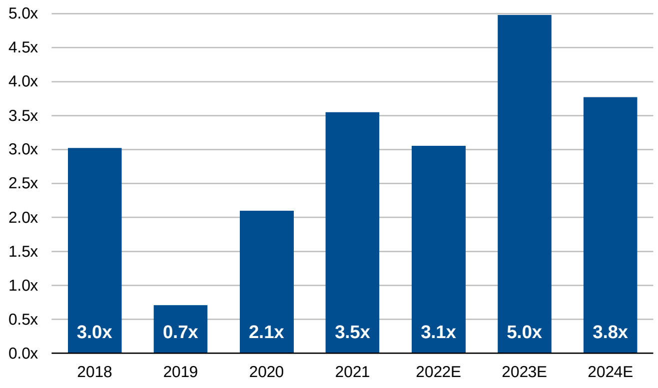
Adequate debt protection

Debt protection has weakened significantly since 2018 after a USD 12m bond placement, which temporarily drove down the Scope-adjusted EBITDA/interest cover to below 1x in 2019. Interest cover has gradually improved since, reaching 3.5x at end-2021 (end-2020: 2.1x). This level is sufficient to cover LLD's current and future interest payments, while providing some headroom against potential cash flow volatility. The company is lightly exposed to interest rate risks since all its debt has fixed rates and is denominated in USD.

While LLD's debt has been rising, it has managed its cost of capital well by balancing bank financing (operational needs) and bond placements (long-term investments). The company's strategic ambition to grow a rental portfolio represents a buffer against volatility. However, projected recurring revenue is not expected to fully cover interest payments in the near future. Therefore, LLD's cash flow is likely to remain tied to the volume of property sales in the short term.

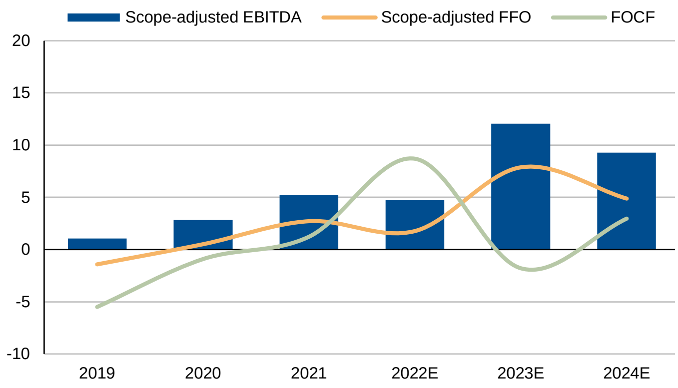
As such, we expect interest cover to remain around 2-4x, supported by stable profitability growth and a limited need for additional financing.

Figure 8: Scope-adjusted EBITDA/interest cover (x)



Sources: LLD, Scope estimates

Figure 9: Cash flow (USD m)



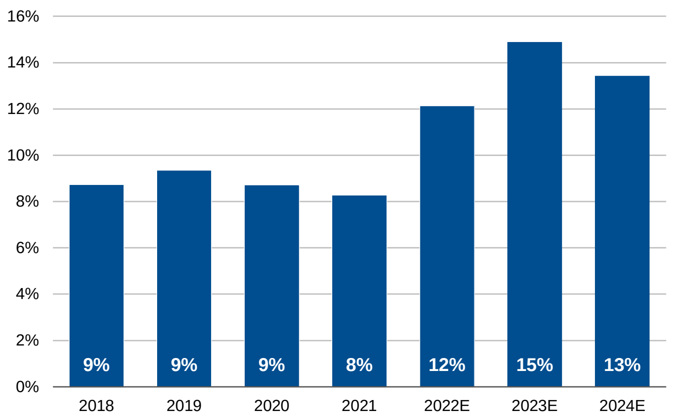
FFO: funds from operations
FOCF: free operating cash flow
Sources: LLD, Scope estimates

Moderate leverage…

Leverage as measured by Scope-adjusted debt/EBITDA came down to 3.5x at end-2021 (from 5.7x in FY 2020) shortly after its 2019-20 peak. Leverage has remained satisfactory for a residential developer, as it provides some headroom against potential market value declines or reduced demand. Moreover, the company's access to external financing (secured and unsecured) remains good, which is further supported by the large pool of unencumbered assets.

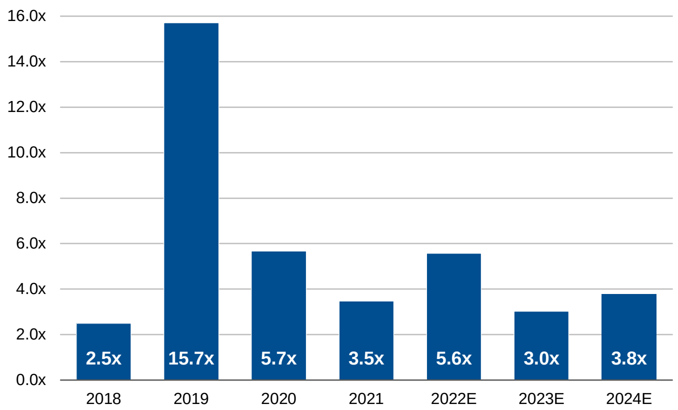
We expect leverage to remain at 3-5x in the short-term, primarily driven by the anticipated increase in indebtedness following the USD 10m bond issue in December 2022 (first tranche) and additional financing (second tranche of USD 10m) to build up the company's pipeline.

Figure 10: Scope-adjusted loan/value (%)



Sources: LLD, Scope estimates

Figure 11: Scope-adjusted debt/EBITDA (x)

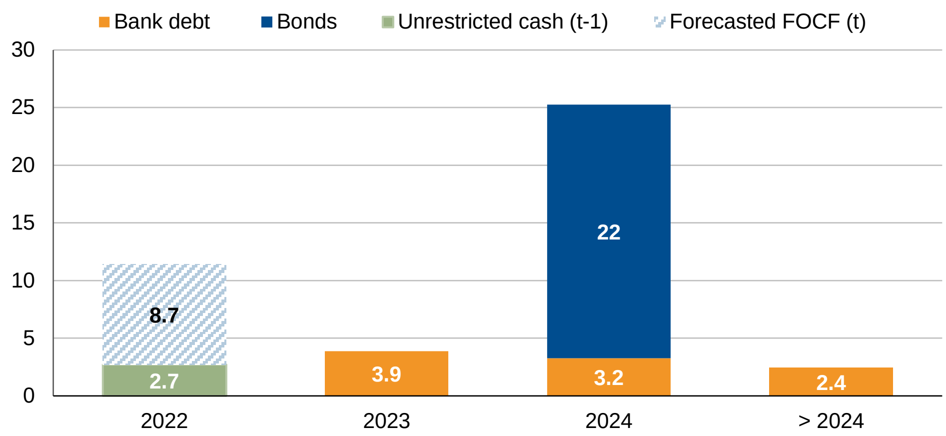


Sources: LLD, Scope estimates

… despite an anticipated increase in indebtedness

Scope-adjusted debt could increase up to USD 35m (assuming the placement of the second USD 10m bond tranche), although the impact on leverage would be limited. The bond proceeds will be allocated towards the purchase of land, the refinancing of costly existing loans and new development projects, and profitability is expected to ramp-up accordingly.

Figure 12: Debt maturity schedule – As of end-September 2022



Sources: LLD, Scope estimates

Adequate liquidity

LLD's liquidity is adequate and as follows:

Balance in USD m	2022E	2023E	2024E
Unrestricted cash (t-1)	2.7	11.6	9.9
Open committed credit lines (t-1)	0.0	0.0	0.0
Free operating cash flow	8.7	-1.8	3.0
Short-term debt (t-1)	1.9	3.9	25.0
Coverage	**>200%**	**>200%**	**52%**

In view of the issuer's good relationships with local banks and its sound record in capital markets, liquidity and refinancing risks are manageable. Besides, outstanding bonds (USD 22m as of end-2022) are not due before December 2024, providing sufficient time to consider refinancing options. The large share of unencumbered assets (loan-to-value ratio under 20%) could also serve as a backstop for secured lending.

Long-term debt rating

Senior unsecured debt rating: BB-

Our recovery analysis is based on a hypothetical default scenario in 2024 and LLD's liquidation value (subject to haircuts on investment properties and inventories, as well as a 10% liquidation cost). On that basis, we have assessed an 'above average' recovery for the company's senior unsecured debt, resulting in a BB- rating for this debt class. With an unencumbered asset ratio well above 100%, senior unsecured debt holders could also benefit from a large pool of assets not pledged as collateral.

Appendix: Peer comparison

	JSC Lisi Lake Development	Euroboden GmbH	Kopaszi Gat Zrt.	SunDell Estate Nyrt.	Veritasi Homes & Properties Ltd.
	B+/Stable	B+/Negative	B+/Stable	B/Stable	B/Stable
Last reporting date	31 December 2021	30 March 2022	30 June 2022	31 December 2021	September 30, 2022 (9 months)
Business risk profile					
Scope-adjusted total assets (EUR m)	201	600	228	130	51
Portfolio yield	na	na	na	na	na
GLA (thousand sq m)	na	na	439	na	na
Countries active in	1	2	1	1	1
Top 3 tenants (%)	na	na	50%	na	na
Top 10 tenants (%)	na	na	90%	na	na
Office (share NRI)	na	na	55%	na	na
Retail (share NRI)	na	na	0%	18%	na
Residential (share NRI)	na	na	43%	82%	na
Hotel (share NRI)	na	na	2%	na	na
Logistics (share NRI)	na	na	0%	na	na
Others (share NRI)	na	na	0%	na	na
Property location	‘B’	'A'	'B'	'B'	‘B’
EPRA occupancy rate	na	na	na	na	na
WAULT (years)	na	na	na	na	na
Scope-adjusted EBITDA margin	17%	21%	28%	25%	39%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	3.5x	1.4x	86.3x	4.4x	12.6x
Scope-adjusted debt/EBITDA	3.5x	20.8x	13.8x	25%	0.6x
Scope-adjusted loan/value ratio	8%	50%	67%	5.6x	31%
Weighted average cost of debt	na	2.1%	5.7%	3.5%	16.5%
Unencumbered asset ratio	> 100%	> 100%	ca. 100%	> 100%	na

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