Lisi Lake Development JSC
Georgia, Real Estate

SCOPE

STABLE
B+

Corporate profile

JSC Lisi Lake Development (LLD) is a real estate developer based in Georgia and focussed primarily on premium residential property projects. LLD was founded in 2010 when it acquired a large undeveloped plot of land within a close vicinity from the center of Georgia's capital city of Tbilisi. The 400-hectare plot was pre-developed by the company through the addition of critical infrastructure such as roads, electricity, water supply as well as schools and community spaces. In 2011, LLD started building on the plot and selling premium residential living space. While the company continues to develop multiple project stages of Lisi Lake, its core project in Tbilisi, the group aims at geographical expansion by starting a major residential project on the Black Sea shoreline in the greater Batumi area.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	41.0x	3.0x	3.6x	2.2x
SaD/EBITDA	0.4x	0.8x	3.3x	4.5x
LTV (%)	2%	3%	10%	9%
FOCF/SaD	91%	48%	(-) FOCF	20%

Rating rationale

The change in Outlook to Stable from Positive for Lisi Lake Development (LLD) is driven by delays of the Buknari project (USD: >30m investment volume planned for 2019E to 2021E) that was expected to lead to improved diversification and increased recurring revenue. According to the management, the delay is caused by a hold-up in the building master plan approval process. As a consequence, Scope substantially reduced revenue and profit forecasts for 2019E to 2021E underpinned by the current lack of visibility on the progress of the Buknari project. The revision leads to weaker credit metrics thus a weaker financial risk profile with leverage as measured by the company Scope-adjusted debt to Scope-adjusted EBITDA increasing to 3.3x and 4.5x for 2019E and 2020E, respectively (2018: 0.8x) and no improvements of Scope-adjusted EBITDA interest cover that is forecasted remain within a range of 3.6x to 2.2x for 2019E and 2021E. However, Scope believes that Lisi Lake benefits from good access to external, secured financing given the company's relatively low loan to value ratio of c. 10% after the placement of the corporate bond.

The B+ issuer rating for Lisi Lake Development ('LLD'), a Tbilisi, Georgia-based residential real estate developer with a focus on the premium segment, is supported by the company's:

- conservative financing structure that relies on equity and bears only little net debt compared to its asset base (loan/value ratio of approx. 10%)
- above-average profitability for its main project Lisi Lake in Tbilisi that limits external financing needs.
- local brand recognition and network that enables off-market deals, particularly with regard to the sourcing of new attractive plots that allow the company to develop larger residential projects.

Ratings & Outlook

Corporate Ratings B+/stable

Senior Unsecured Rating BB-

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Related methodologies

Corporate Rating Methodology

European Real Estate Rating Methodology

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The issuer rating is negatively affected by:

- LLD's current lack of size and scope, being a small residential property developer that is fully dependent on the sales of properties and/or land to end-customers.
- A lack of substantial recurring revenues leading to high cash flow volatility.
- Low diversification with substantial cluster risk with regards to the Lisi Lake Projects in Tbilisi.
- Risks related to a less resilient economy, inflation and foreign exchange rates as well as limited liquidity in the Georgian premium real estate market compared to more mature Western European premium property markets

Outlook and rating-change drivers

The Stable outlook is supported by Lisi Lake's progress and sales on its core development Lisi Lake as well as secured funding of the current project stages in the group's main project Lisi Green Town (Tbilisi).

It also incorporates the company's loan/value ratio (LTV) to stay at a moderate level of c. 10% going forward and despite Scope-adjusted debt that is expected to grow in the course of the business expansion to between USD 15m and USD 20m. The outlook reflects the agency's revised forecast that includes the conservative assumption of USD 5m in sunk costs for the Buknari project due to the current delay and only ongoing project sales in Lisi Lake at a similar pace and margin as demonstrated in the previous years.

A negative rating action is possible if Scope-adjusted debt to Scope-adjusted EBITDA were to increase to above 5x on a sustained basis. This could happen, if the LLD's sales volumes slumped because of i) further delays in the execution of the development pipeline or ii) a serious deterioration of the real estate market environment in Georgia.

Scope would consider a positive rating action if the issuer managed to significantly improve its business risk profile by executing on the planned diversification of its development portfolio and/or creating a substantial share of recurring revenues independent from continued asset sales that limit cash-flow volatility.

Long-term and short-term debt instrument ratings

The company has successfully placed a USD 12m (2018/21 - ISIN GE2700603717) of senior unsecured notes with a coupon of 8% on 17 December 2018. Proceeds have been and will be invested into the development projects in Buknari (Black Sea project) and further project stages within Lisi Green Town. Scope downgraded the instrument rating to BB- from BB reflecting reduced recovery headroom in a hypothetical liquidation scenario as at 2021. The reduced recovery assumptions are driven by higher anticipated risk related to the issuers project development activities, evidenced by delays of the Buknari project.

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Business risk profile

Scope assesses industry risk for LLD as high because the company is a pure play developer and therefore exposed to the most cyclical part of the real estate industry. Scope's short-term credit view for the industry is stable but anticipates increasing sensitivity to changes in politics, economic conditions and interest rates. Georgia's less mature market also results in higher volatility. LLD's core activity consists of developing premium residential real estate projects in Tbilisi and other cities in Georgia. For the time being, the company has a very concentrated project pipeline with a focus on the Lisi Lake projects in Tbilisi and one other major early-stage project on the shore of the Black Sea. However, as of January 2020 the Buknari project has suffered a significant delay, which leads to substantially reduced revenue and

profit forecasts in Scope's financial model for 2019E to 2021E. Management has stated that it still plans to expand its number of projects, targeting other regions in Georgia.

With total assets of less than USD 200m at year-end 2019, LLD is still a small company, despite its growth plans in its Georgian home market. Asset quality is slightly credit positive: all residential units are newly built in premium quality and the land bank consists of prime locations in the Georgian market. In addition, LLD's land bank in Tbilisi was acquired at prices significantly below the current market value. In combination with relatively little debt in relation to its asset base, this allows the company above-average unlevered and levered internal rates of return.

LLD's EBITDA margin was over 30% for the last business years 2016 and 2017, when sales volumes were significant. Scope believes this margin will decrease over time. This is because the significant competitive advantage of having a land bank acquired at low prices about 10 years ago is lessening as new projects will be acquired at current market prices. Nevertheless, substantial volumes of land at LLD's main Lisi Lake project can be developed in the course of later project stages.

Scope expects LLD to grow further in size in the next two years thanks to an expanding project pipeline. However, the company's limited size and market position also indicate a heightened sensitivity to unforeseen shocks and stronger volatility in cash flows. This is particularly the case as LLD is highly exposed to the inherent cyclicality in the real estate market, with almost 100% of its revenues linked to development activity at present, which Scope judges to be credit negative.

LLD's potential cash flow volatility is negatively affected by its very concentrated pipeline of two main projects (divided into several sub-projects and phases that can be managed and timed separately to a certain extent). The largest project (Lisi Lake) represents the lion's share of expected revenue over the next 24 months. This very modest diversification might affect future cash flows if projects suffer delays or cost overruns.

Moreover, management has stated its intention to improve geographical diversification via investments in further projects within Georgia, with the exception of further projects in Tbilisi. Scope sees this strategy – once successfully executed – as credit positive. However, the Buknari project delay has lowered the agency's expectations with regard to anticipated diversification in 2020E. It also eliminates the upward momentum on the issuer rating that Scope expected for 2019E/2020E. The agency has therefore lowered its Outlook for the issuer rating to Stable from Positive.

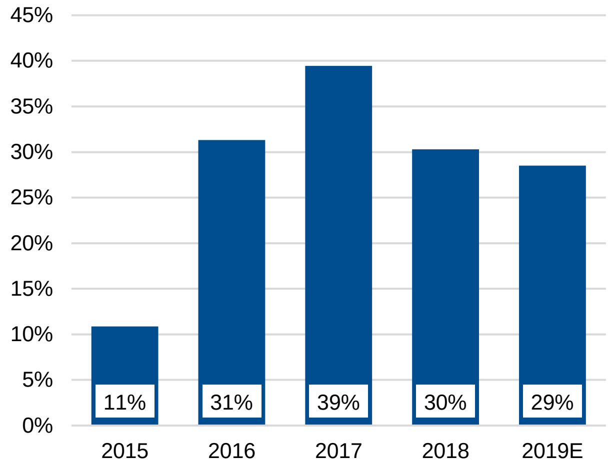
Financial risk profile

LLD's EBITDA interest cover stood at double-digit levels until the placement of the USD 12m bond in December 2018, when it dropped to 1.2x at year-end 2018. Scope expects it to fall to between 1.5x and 2.5x for 2019E to 2021E. The agency's conservative forecast incorporates additional costs from the delayed Buknari project but no revenues for the time being.

If projects are significantly delayed or sales slump, LLD may be dependent on external financing to cover its interest payments in the future. However, Scope believes such external financing should be available as the company has a large pool of unencumbered assets (both properties and in the land bank) that would allow for additional secured financing.

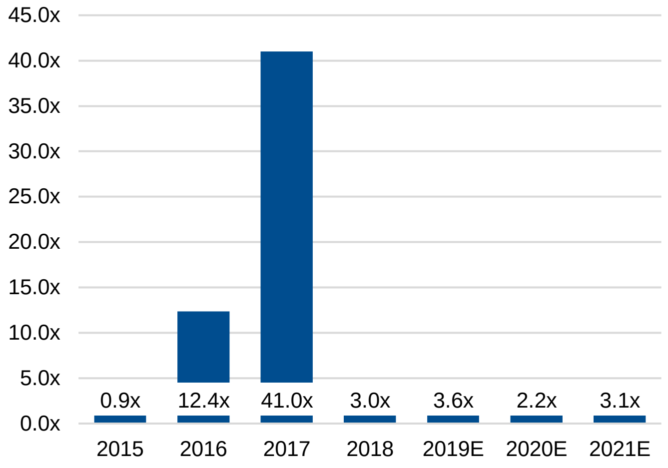
LLD's loan/value ratio has been in the low to mid-single digit range and is expected to stay at a moderate level of approx. 10% going forward, even after the successful placement of a USD 12m corporate bond in December 2018. Scope's new financial forecast foresees Scope-adjusted debt growing in the course of business expansion and staying in the USD 15m-USD 20m range for the next 24 months.

Figure 1: EBITDA-margin



Source: Scope estimates

Figure 2: EBITDA interest coverage



Source: Scope estimates

With Scope-adjusted debt/EBITDA below 2.0x for the last few business years, LLD has had a very low level of operating leverage for a real estate developer. However, Scope expects operating leverage to increase to a significantly higher range of 4.0x to 5.0x over the next two to three business years. This conservative forecast excludes operating profits from the Buknari project and is solely based on ongoing project sales in Lisi Lake at a similar pace as previous years.

At present, LLD's ability to generate cash flow from operations is entirely dependent on its property sales volume, due to a lack of substantial recurring revenues. This absence of significant recurring revenue, without the continuous sale of properties, limits the analytical value of leverage ratios based on projected operating income. LLD plans to add properties from other asset classes, such as hotels or office properties, that also contribute recurring rental income.

Rating drivers

Positive rating drivers	Negative rating drivers
• Good market position due to attractive land bank, established brand and excellent network within the local real estate and financial industry • Track record from the construction and sale of the existing residential units in Lisi Lake • Unencumbered land bank in Tbilisi and Tsikhisdziri is in good locations within the Georgian market and should offer above-average liquidity • Strong operating cash profitability thanks to i.a. very low land bank acquisition costs • Low loan/value ratio (LTV) of c. 10%, even after the placement of the USD 12m bond in Dec 2018.	• 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 little recurring (rental/other) income yet • 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 of diversification and/or recurring revenues leading to improved BRP	• Deterioration of market conditions and/or the Georgian economy as a whole leading to a drop in operating cash flow • SaD/EBITDA of more than 5x

Financial overview

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FOCF/SaD	91%	48%	(-) FOCF	20%
Scope-adjusted EBITDA in EUR m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	9.9	5.9	5.7	3.5
Operating lease payment in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	9.9	5.9	5.7	3.5
Scope funds from operations in EUR m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	9.9	5.9	5.7	3.5
less: (net) cash interest as per cash flow statement	-0.2	-2.0	-1.6	-1.6
less: cash tax paid as per cash flow statement	0.0	0.0	0.0	0.0
add: cash profit not incl. in P&L	2.1	4.2	2.5	2.5
Scope funds from operations	11.8	8.1	6.6	4.4
Scope-adjusted debt in EUR m	**2017**	**2018**	**2019F**	**2020F**
Reported gross financial debt	8.7	14.7	23.3	20.8
deduct: cash, cash equivalents	5.1	10.2	4.3	4.9
Scope-adjusted debt	3.8	4.5	19.0	15.9

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