Lisi Lake Development JSC
Georgia, Real Estate

STABLE
B+

Corporate profile

Lisi Lake Development JSC (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 in the vicinity of the centre 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	2018	2019	2020E	2021E
Scope-adjusted EBITDA/interest cover (x)	3.0x	0.7x	2.4x	3.6x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	0.8x	13.5x	3.2x	1.9x
Scope-adjusted loan/value (LTV) (%)	3%	8%	6%	6%

Rating action

Scope has affirmed the issuer rating of B+/Stable and the BB- senior unsecured debt rating of Lisi Lake Development JSC.

Rating rationale

The affirmation is driven 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 approx. 10%); and ii) the stable operating results in 2020, with a slightly larger overall sales volume for both apartments and plots at the main project, Lisi Green Town. In addition, the gradual ramp-up of recurring rental revenues, started in 2020, is expected to continue over the next several business years. The rating is still constrained by i) LLD's current lack of size and scope, being a small residential property developer that is dependent on the sales of properties and/or land to end-customers; ii) low diversification with substantial cluster risk with regards to the Lisi Lake projects in Tbilisi; and iii) economic risks, especially given the Covid-19 pandemic, high inflation, foreign exchange risks, and low liquidity of Georgia's premium real estate market compared with the more mature western European market. Operating profitability is expected to stay at about a 30% Scope-adjusted EBITDA margin in our financial base case while financial leverage is expected to remain moderate at less than 2.0x, as measured by Scope-adjusted debt (SaD) to Scope-adjusted EBITDA. However, if projects are delayed significantly or sales slump, LLD may have to depend on external financing to cover future interest payments. However, we believe external financing is available as the company has a large pool of unencumbered assets (properties and a land bank), which allows for additional secured financing. We expect free operating cash flows for the next 2-3 years to stay volatile, depending on the pace of expansion into new projects and/or stages as well as potential acquisitions of rental properties. Liquidity is still adequate, based on our view that the issuer will continue to benefit from good access to external, secured financing given the low LTV of around 10% after the placement of the corporate bond. We nevertheless flag the upcoming maturity of the USD 12m senior unsecured corporate bond in 2021.

Ratings & Outlook

Corporate rating	B+/Stable
Senior unsecured rating	BB-

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Related methodologies

Corporate Rating Methodology,

European Real Estate Rating Methodology

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Outlook and rating-change drivers

The Stable Outlook is supported by robust sales at the core development Lisi Green Town – even during the pandemic – as well as access to funding ensured by low balance-sheet and financial leverage. It also incorporates the expectation that LTV will remain moderate at less than 10%. The Outlook also reflects our assumption of USD 5m in sunk costs for the Buknari project due to the current delay and ongoing project sales to occur only at Lisi Lake with similar margins as in the previous years. The Outlook further anticipates a successful refinancing of the USD 12m bond due in December as a consequence of the issuers low leverage, high unencumbered asset position and good access to bank financing.

A negative rating action is possible if SaD to Scope-adjusted EBITDA were to reach above 5x on a sustained basis. This could happen through a sales volume slump caused by i) further delays in the execution of developments; or ii) a serious deterioration in Georgia's real estate market.

We would consider a positive rating action if the business risk profile improved significantly through an execution of the planned diversification of the development portfolio and/or a substantial share of recurring revenues independent from continued asset sales that limit cash flow volatility.

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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 industries • Track record from the construction and sale of existing residential units and plots at Lisi Lake • Unencumbered land bank in Tbilisi and Buknari is well-located and should offer above-average liquidity in Georgia • Strong operating cash profitability thanks to very low land bank acquisition costs, among other factors • Low LTV of around 10%, even after the placement of the USD 12m bond in December 2018	• High dependency on main development project at Lisi Lake, despite recent diversification efforts • Exposure to still relatively volatile Georgian economy with inherent risks such as high inflation and (indirect) FX risk • Pure play developer with little recurring income (rental/other) • Small player compared to other international/European upscale residential developers • High project concentration, translating into high potential cash flow volatility

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Substantial improvement in diversification and/or recurring revenues leading to improved business risk profile	• Deterioration in Georgia's real estate market and/or economy, leading to a drop in operating cash flow • SaD/EBITDA of more than 5x

Financial overview

		Scope estimates		
Scope credit ratios	**2019**	**2020E**	**2021E**	**2022E**
EBITDA/interest cover (x)	0.7x	2.4x	3.6x	5.9x
Scope-adjusted debt/EBITDA	13.5x	3.2x	1.9x	1.4x
LTV (%)	8%	6%	6%	6%
Scope-adjusted EBITDA in USD m	**2019**	**2020E**	**2021E**	**2022E**
EBITDA	1.0	3.6	5.5	8.3
Operating lease payments in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**1.0**	**3.6**	**5.5**	**8.3**
Scope-adjusted debt in USD m	**2019**	**2020E**	**2021E**	**2022E**
Reported gross financial debt	16.4	14.4	13.6	15.6
deduct: cash, cash equivalents	3.5	3.0	3.3	4.4
Scope-adjusted debt	**13.9**	**11.4**	**10.3**	**11.2**

Business risk profile (B+)

Real estate developer industry risk of B

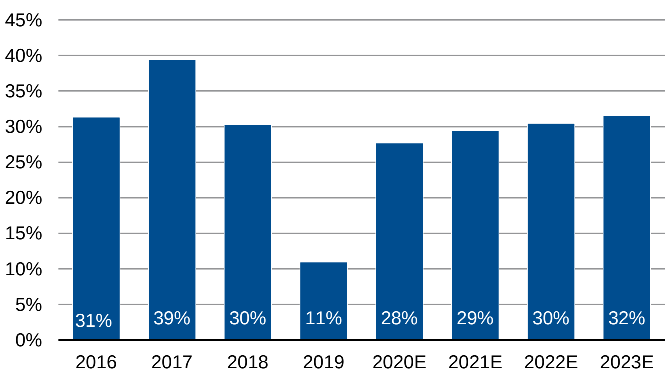
We assess industry risk for LLD as high (B) because the company is a pure play developer and therefore exposed to the most cyclical part of the real estate industry with relatively low entry barriers.

With a total asset value of around USD 180m, LLD is a small property company in the highly fragmented real estate market in Georgia (Figure 10). This is despite LLD's robust share of its core market: upscale residences and plots in Tbilisi, with activity centred on the Lisi Green Town community project. LLD is expected to maintain this core focus, despite projects in other locations such as the Batumi area and Kokhta-Mitarbi (joint venture with minority stake). LLD's small size is a negative rating driver, because it implies a greater sensitivity to unforeseen shocks, greater volatility in cash flows, and higher key person risk.

Geographical focus on Tbilisi and the Batumi area

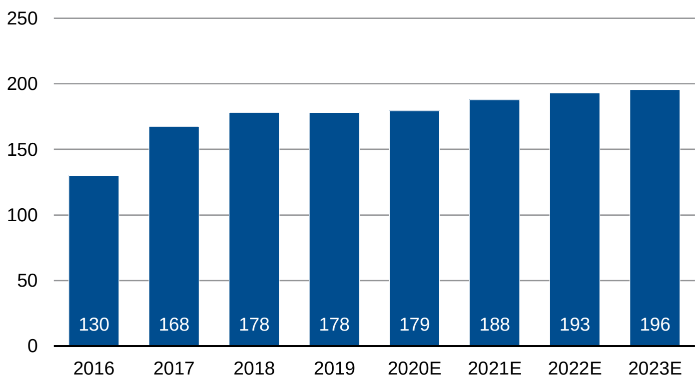
We have a mixed view on asset quality. LLD's development portfolio is situated in Georgia's main real estate markets of Tbilisi and the Batumi area, but both markets are not yet mature and may lack asset liquidity in times of market distress. The company has brand recognition in Georgia as a developer of premium, modern residential spaces. Currently, it is adding properties with recurring rental income (retail, hotels, offices). This effort started with the commercial core portfolio at Lisi Green Town, the ski resort joint venture and will eventually include revenues from hotels in Buknari.

Figure 1: Scope-adjusted EBITDA margin



Source: Scope estimates

Figure 2: Scope-adjusted assets (USD m)



Source: Scope estimates

High pre-sale and pre-lease ratios mitigate risk of sunk construction costs

LLD's pre-sale and pre-lease rates are above average. The pre-lease ratio is 100%, because, to date, most properties the company has built for its rental portfolio required a tenant before construction was initiated.

For apartment buildings, construction starts when the pre-sale rate reaches around 40%. However, LLD currently sells roughly 50% of its plots, which reduces the risk of sunk costs if sales do not occur as planned, because zoning for the respective part of the larger plot generates relatively little cost. Further, no construction costs are incurred before plots are sold.

Since 2017, LLD has been expanding its geographical outreach to greater area of Batumi, a Georgian city close to the Black Sea, a well-known holiday destination within the region.

Delays at Black Sea project persist

As of January 2021, progress at the Black Sea project is well behind the timeline projected by management as authorities in the Adjara region are yet to grant a construction permit. This unusually long waiting time and lack of transparency is credit-negative for the 2020 monitoring figures. We have therefore lowered the diversification sub-score back to B from B+, as revenue from this project – and associated diversification benefits – was anticipated for 2019. We retain our assumption of some USD 5m in sunk costs over the three years of the project, but zero sales revenues.

High project concentration remains as of 2021

This very modest diversification of revenue sources fully exposes the company to the cyclicality of the Georgian real estate market and is credit-negative. Regarding future investments, an increase in recurring revenues would be accretive for LLD's credit quality.

LLD management intends to grow its project pipeline within Georgia without additional exposures to the greater Tbilisi area, given the already large share of Lisi Lake projects in the portfolio. This planned expansion is positive for diversification as it reduces cluster risks while increasing geographical diversification.

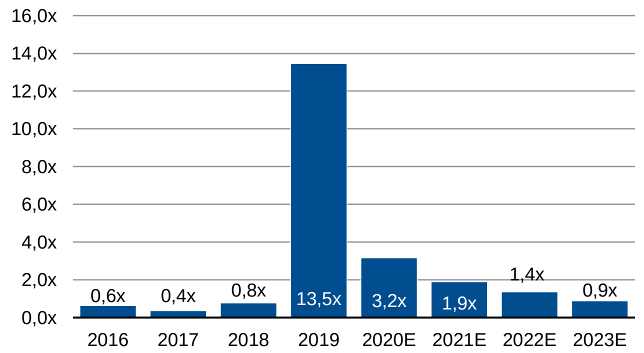
Scope-adjusted margins of around 30% expected in our base case

Profitability, as measured by the Scope-adjusted EBITDA margin, recovered in 2020 to around 30% after being weighed down by sunk costs from the Buknari project in 2019. This is robust given the pandemic environment. In the medium term, we expect this figure to range between 25% and 35%, depending on sales volumes and the split between residential units and plot sales.

Financial risk profile (BB-)

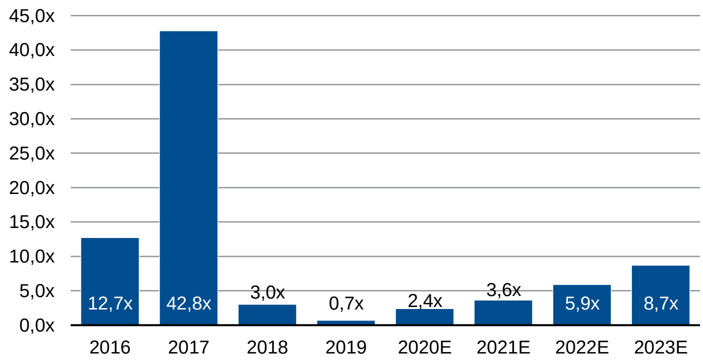
LLD's EBITDA interest cover stood at double-digits until the USD 12m bond was placed in December 2018. The figure dropped temporarily below 1.0x in 2019 and is expected to eventually stabilise above 3.0x. The temporary drop was caused by the severe slump in Scope-adjusted EBITDA in 2019, mostly due to the expansion of the Buknari project.

Figure 3: SaD/Scope-adjusted EBITDA



Source: Scope estimates

Figure 4: Scope-adjusted EBITDA interest cover

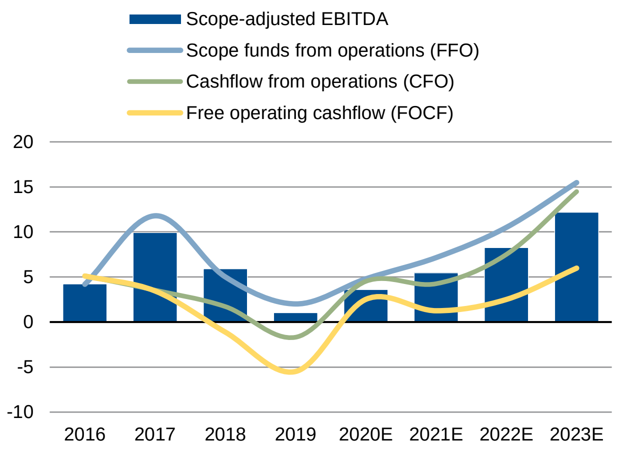


Source: Scope estimates

Temporary drop of Scope-adjusted EBITDA weighed on 2019 numbers

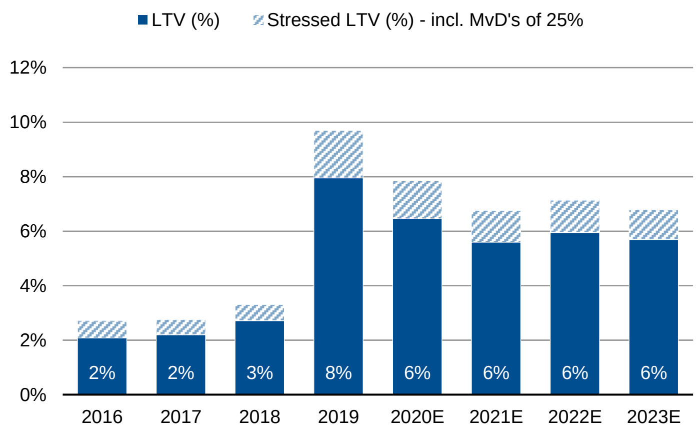
If projects are delayed significantly or sales slump, LLD may have to depend on external financing to cover future interest payments. We believe external financing is available as the company has a large pool of unencumbered assets (properties and a land bank) that allow for additional secured financing.

Figure 5: Cash flows (USD m)



Source: Scope estimates

Figure 6: Scope-adjusted LTV



Source: Scope estimates

Single-digit LTV expected to continue

LLD, while a relatively young company, had positive free operating cash flows in its first years of operation. Free operating cash flows have since been volatile and we expect this to continue for the next 2-3 years, depending on the pace of expansion into new projects and/or stages as well as the potential acquisition of rental properties.

Liquidity is adequate

Position	2020E		2021E	
Unrestricted cash (t-1)	USD m	3.5	USD m	3.0
Open committed credit lines (t-1)	USD m	0.0	USD m	0.0
Free operating cash flow (t)	USD m	2.5	USD m	1.3
Short-term debt (t-1)	USD m	3.0	USD m	12.8
Coverage		**2.0x**		**0.3x**

We deem liquidity as adequate but flag the upcoming maturity of the USD 12m senior unsecured bond in December 2021. However, we deem the successful refinancing of the issue as likely and have incorporated it in our base case financial forecast.

In case the roll-over of the issue should not be possible, we hint at the more than USD 130m (>10x the bond volume) in unencumbered and externally appraised real estate on the balance sheet which should enable the company to obtain sufficient funds via secured lending in case needed. This option serves as a back-stop in terms of liquidity in our view.

Long-term and short-term debt instrument ratings

Scope affirms the debt class rating on senior unsecured debt at BB- reflecting an above-average expected recovery rate in a hypothetical liquidation scenario as of 2023. The recovery assumptions are driven by elevated risks related to the issuers project development activities, evidenced by delays of the Buknari project.

Sen. unsecured debt rating affirmed at BB-

Moreover, Scope hints at the structural subordination of all unsecured debt under any current or future senior secured debt that the company might occur, given its large, unencumbered asset base.

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