Veritasi Homes & Properties Ltd.
Federal Republic of Nigeria, Real Estate

B STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	31.1x	99.4x	8.5x	3.3x
Scope-adjusted debt/EBITDA	1.0x	1.1x	0.9x	1.8x
Scope-adjusted loan/value ratio	23%	32%	32%	18%

Rating rationale

Veritasi's first-time issuer rating is driven by the company's sustainable growth in the Nigerian real estate development industry. The business risk profile benefits from the good asset quality: most of the projects are located in the high-demand and growing area of Lekki (Lagos region), which minimises the risk of price falls. However, the company's small size and lack of geographical diversification expose it to the socio-economic trends of one area, constraining the business risk profile assessment.

The financial risk profile partially offsets the weak business risk profile, benefitting from a healthy balance sheet due to an absence of bank debt. Although we believe Veritasi will continue to prefer balanced growth, credit metrics could still deteriorate quickly through impaired cash generation as a result of cash flow volatility due to the concentrated development pipeline and the external financing needed to push growth.

Veritasi's credit rating is also driven by the peer context. Against real estate development peers, Veritasi is smaller, less profitable, and less diversified. Moreover, the comparison reflects our view that the company is exposed to risks that are independent from management's control given the country's weak governance, political instability, lack of rule of law, low institutional and regulatory quality and control of corruption, and the high volatility of the macroeconomy of a developing country including soaring interest rates amid high inflation and high external vulnerabilities.

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation that Veritasi will be able to deliver its pipeline while maintaining adequate credit metrics. Furthermore, the Outlook reflects the expectation that the issuer will remain small until it can gain more favourable external financing sources.

A negative rating action could occur if Scope-adjusted interest cover were sustained below 3.0x. A negative rating action could also occur if liquidity further deteriorated, pressured by cost overruns, customer payment delays or a weakening macroeconomic environment.

A positive rating action could be warranted if Veritasi improved its geographical diversification and significantly grew its pipeline while keeping Scope-adjusted debt/EBITDA below 2x, and if liquidity improved. An improvement in liquidity could occur through a shift from short-term to long-term debt financing, improved cash flow from operations or increased availability on committed credit lines.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
22 Dec 2022	New	B/Stable

Ratings & Outlook

Issuer	B/Stable
Short-term debt	S-4

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

European Real Estate Methodology; January 2022

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

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Properties located in a prime location in Lagos with growing demand • Core market of Lagos is one of Africa's largest cities; urbanisation and housing increasingly prioritised by local government, giving strong tailwind to Veritasi Adequate credit metrics due to absence of debt and limited external financing needs going forward	• Small portfolio in context to peers • Limited record due to recent establishment • Weak diversification with only one location and one segment (residential) • Environmental risk of flooding (ESG factor) • Weak liquidity • Potential cash flow volatility (concentrated portfolio) • Execution risk due to non-controllable factors (corruption and crime – ESG factor)

Positive rating-change drivers	Negative rating-change drivers
• Growth in size and broader geographical foothold while keeping Scope-adjusted debt/EBITDA below 2x and improved liquidity	• Worsening liquidity • Scope-adjusted EBITDA interest cover below 3x on a sustained basis

Corporate profile

Veritasi Homes & Properties Ltd. (Veritasi) is a real estate development company that was established in 2017 and commenced operations in 2018. Its headquarters are in Lagos, Nigeria. The company focuses on developing residential properties in the luxury, premium and classic segments in Lagos. Veritasi's activities range from the acquisition of land to the development, sale and management of properties.

Current projects are all located in the Lagos district. Veritasi plans to expand in the rest of Nigeria and Africa.

The company's owners are also its managing directors, Nola Rilwan Adetola (80%) and Yusuf Olarewaju Oluwatobi (20%).

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**LTM 2022**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	31.1x	99.4x	15.2x	8.5x	3.3x	3.8x
Scope-adjusted debt/EBITDA	1.0x	1.1x	0.7x	0.9x	1.8x	1.6x
Scope-adjusted loan/value ratio	23%	32%	31%	32%	18%	net cash
Scope-adjusted EBITDA in NGN m						
EBITDA	1,546	3,032	11,820	9,780	4,533	5,073
Operating lease payments	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**1,546**	**3,032**	**11,820**	**9,780**	**4,533**	**5,073**
Funds from operations in NGN m						
Scope-adjusted EBITDA	1,546	3,023	11,819	9,780	4,533	5,073
less: (net) cash interest paid	-50	-30	-775	-1,157	-1,354	-1,320
less: cash tax paid per cash flow statement	-236	-939	-1,414	-405	-968	-1,146
add: dividends from associates	0	0	0	0	0	0
Change in provisions	0	0	0	0	0	0
Funds from operations (FFO)	**1,259**	**2,054**	**9,630**	**8,218**	**2,211**	**2,607**
Free operating cash flow in NGN m						
Funds from operations	1,259	2,054	9,630	8,217	2,211	2,607
Change in working capital	-1,666	-3,598	-18,740	-15,791	2,899	3,572
Non-operating cash flow	0	0	0	0	0	0
less: capital expenditure (net)	0	0	0	0	0	0
less: dividends	0	0	0	0	-1,182	-431
Free operating cash flow (FOCF)	**-407**	**-1,544**	**-9,110**	**-7,574**	**3,928**	**5,748**
Net cash interest paid in NGN m						
Net cash interest per cash flow statement	-50	-30	-775	-1,157	-1,354	-1,320
Change in other items	0	0	0	0	0	0
Net cash interest paid	-50	-30	-775	-1,157	-1,353	-1,320
Scope-adjusted debt in NGN m						
Reported gross financial debt	1,623	3,418	8,666	8,463	8,259	8,055
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents	-195	-533	-1,375	-643	-4,367	-9,911
add: non-accessible cash	0	0	0	0	0	0
Scope-adjusted debt (SaD) (no cash netting)	**1,622**	**3,418**	**8,666**	**8,462**	**8,259**	**8,055**
Scope-adjusted debt (SaD) (cash netting)	**1,428**	**2,885**	**7,291**	**7,820**	**3,892**	**-1,856**

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Environmental, social and governance (ESG) profile[1]

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)

Potential environmental and social risks

We identified no material governance risks.

However, the company is exposed to environmental risk. Lagos, especially Lekki, is above sea level. Therefore, during the annual rainy season, flood risk is high. Experts believe that as sea levels continue to rise the city may become uninhabitable by the end of the century.

By operating in Nigeria, the group also faces different social norms than in western Europe. Nigeria has a high crime rate, ranking 18th among the least peaceful countries in the world and 154th among the 180 countries listed in Transparency International's Corruption Index. Moreover, Veritasi is exposed to risks that are outside of management's control given Nigeria's weak governance, political instability, lack of rule of law, and low institutional and regulatory quality. This could come with negative and uncontrollable repercussions on the company's business.

[1] 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

Veritasi focuses on developing real estate for sale. Its properties are divided into premium and affordable. The company can also sell undeveloped or partially developed projects (serviced plots and site and service projects). All projects are residential. We rate the industry as BB based on high cyclicality, medium barriers to entry and low substitution risk.

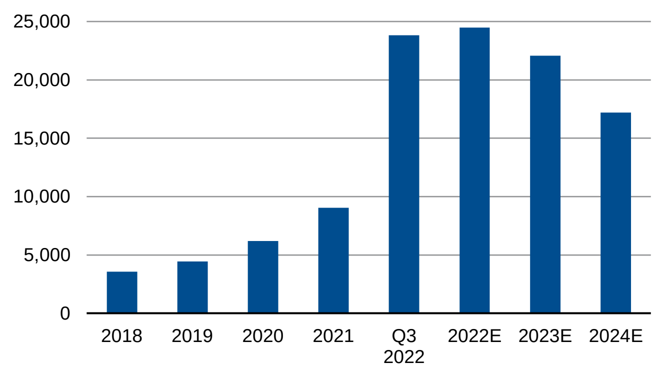
Nigeria is estimated to have a deficit of around 20 million houses as at October 2022. While real estate players are seeking to bridge this gap, there is room for more investment and the real estate sector represents clear potential in the country's economy. However, costs are rising for real estate developers in Nigeria. Prices for building materials went up between 35% and 75% in 2021, while the average interest rate of 16.5% represents a barrier to entry for companies without sufficient own funds or good access to bank financing. On the other hand, with the supply shortage, developers have been able so far to pass on the higher costs to customers.

Small share of a highly fragmented market

Within the highly fragmented Nigerian market, Veritasi focuses on the niche area of Lekki, a peninsula in the Lagos region. Its asset base, although up by 200% to EUR 51m YoY as of September 2022, remains small, limiting the company's visibility in the market. The high cost of external financing is one reason, forcing Veritasi to concentrate on a few projects and preventing the execution of larger plans. However, we believe that the asset base can grow given the high demand in Lekki, combined with rapid population growth and increasing demand for housing in Lagos.

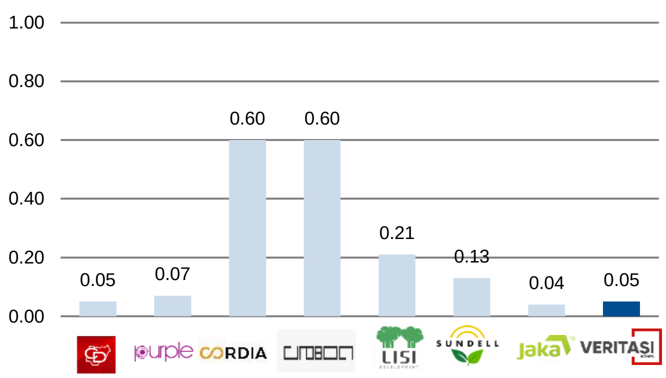
The ability to enter and compete in the market is closely linked to a company's reputation, capacity to understand the Nigerian regulatory and macro-economic environment and its access to favourable sources of financing. Veritasi is well equipped to compete locally. Our view is based on Veritasi's access to external funding (NGN 6bn commercial paper issuance), its partnership with Lagos Business School (which supports broker loyalty through free tuition and courses for brokers), and its visibility in the market and investment in research, which also help to control costs.

Figure 1: Scope-adjusted total assets (NGN m)



Sources: Veritasi, Scope estimates

Figure 2: Total assets, peer comparison (EUR bn)[2]



Sources: Veritasi, Public information, Scope estimates

Projects concentrated in one geographical area…

With a geographical focus in Lagos, specifically in the Lekki peninsula, diversification is poor. The company's performance is therefore fully correlated with the economic performance of the state and the city.

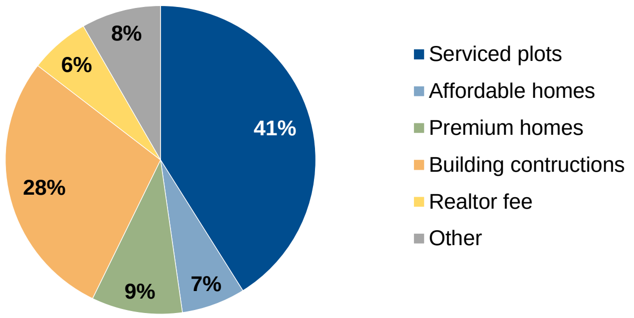
[2] Includes developers in Scope coverage and two Nigerian companies that disclose public information.

…but with some revenue diversification

Veritasi's long-term objective is to expand outside of Lagos, even Nigeria. It is looking at opportunities in Johannesburg (South Africa) and Accra (Ghana). Land was recently acquired in the Nigerian capital of Abuja, around 480km from Lagos. However, there are no tangible expansion plans, reasonable given the recent company's establishment.

The issuer's activities in premium homes, affordable homes, serviced plots and, going forward, extra-luxury properties, partially mitigate the risk of cash flow volatility. Credit-positive is that most of its revenues are from sales of serviced plots and building constructions. The option to sell at various project stages makes the company less exposed to delays and/or cost overruns, which are the most common risks associated with development activity.

Figure 3: Product diversification by revenues (as per Q3 results September 2022)

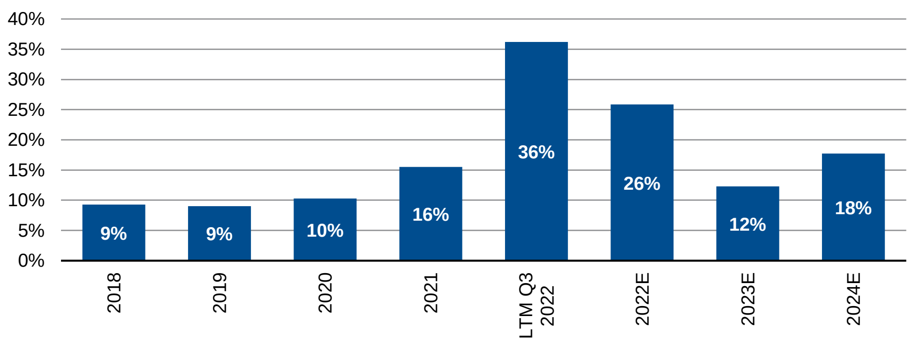


Sources: Veritasi, Scope

Good asset quality but in a high-risk country

Lekki is a premium residential area, hosting some of the most expensive properties in Lagos, minimising the risk of price falls for the issuer. Demand for living in the area is also high, ensuring units are sold fast and reducing the risk of liquidity shortfalls. However, in our assessment of the asset quality we also highlight the potential risk linked to the macro-economy of a developing country, the high crime and corruption rate of Nigeria and the high risk of flooding as Lekki is slightly above sea level.

Figure 4: Scope-adjusted EBITDA margin over the years



Sources: Veritasi, Scope estimates

Marginal profitability

Scope-adjusted EBITDA margins have been within 9%-16% since the company was founded, peaking at 36% in the 12 months ending September 2022 thanks to the delivery of one large project and the sales rates of three ongoing projects. While 2022 has been the most productive, we anticipate margins to return to past levels in the coming years based on the disclosed pipeline. Profitability is expected to be highly volatile, typical for a real estate developer. A higher-than-expected margin is possible if new projects can be secured and executed during the next two years. Profitability will also depend on cost overruns, adverse climate conditions, and the high Nigerian inflation rate, forecast at 15% and 12.5% in 2023 and 2022 respectively. High corruption in Nigeria could also dampen profits (ESG factor: credit negative). We consequently maintain our view that the company's ability to control costs is limited and that cost overruns are likely, putting pressure on profitability.

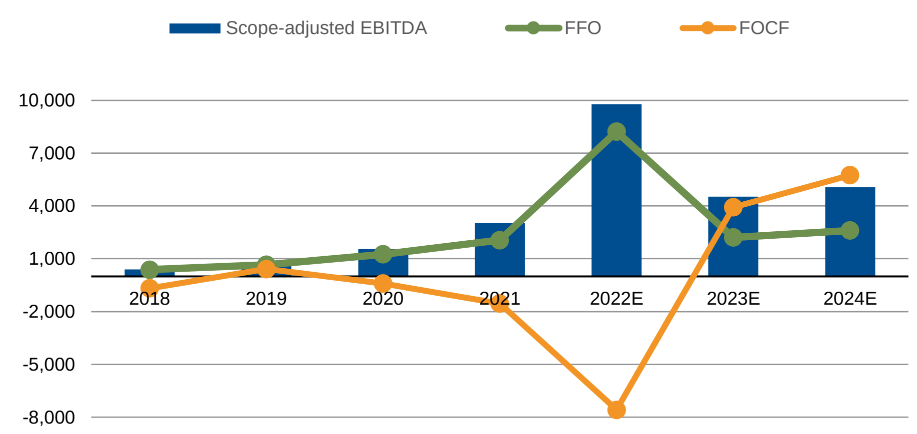
Financial risk profile: BBB-

Debt protections benefited from historically low indebtedness

Scope-adjusted EBITDA interest cover has been historically robust, driven by Veritasi's policy to finance its initial growth with own funds. In 2022, the ratio reduced significantly as the push for stronger growth led to the need for external financing. We anticipate that the ratio will trend downward due to the high average cost of financing in Nigeria (benchmark lending rate 16.5%) but remain above 3x, as we believe Veritasi will continue to pursue a cautious leverage policy as the rising interest rates could put significant pressure on profitability. The expansion phase has led to negative free operating cash flow over the years, especially in 2022 when the company purchased four land plots, with two projects that started in 2022 and two expected to start in 2023-2024.

Our rating scenario includes future cash flows based on the disclosed project pipeline, reflecting stable inventory in the next two years, but we acknowledge the growth ambitions and likely addition of new projects. Thus, we expect cash flows to be volatile.

Figure 5: Cash flows (NGN m)



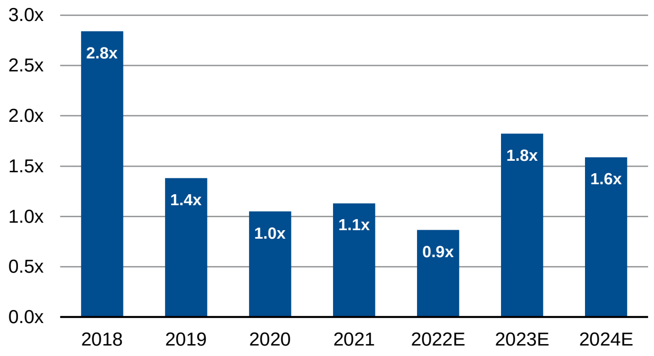
Sources: Veritasi, Scope estimates

Leverage to remain adequate in the next years

Despite fluctuations, leverage has been very low level thanks to the cautious financing policy. Even after the issuance of a commercial paper in 2022, Scope-adjusted debt/EBITDA remained below 1x. We anticipate leverage to remain below 2x over the next two years unless substantial changes led to higher construction and disposal risks.

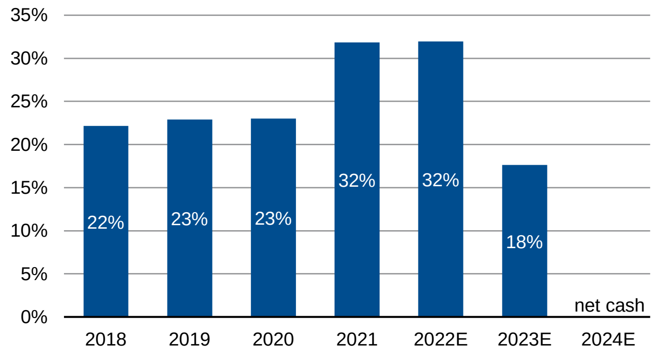
The loan/value ratio of below 30% on average leaves the company enough headroom to tap for external financing sources.

Figure 6: Scope-adjusted debt/EBITDA (x)



Sources: Veritasi, Scope estimates

Figure 7: Scope-adjusted loan/value (%)



Sources: Veritasi, Scope estimates

Strained liquidity

Liquidity is constrained by the short-term nature of the commercial paper, which is repayable yearly. Liquidity could also quickly come under pressure from cost overruns, customer payment delays and the fast-changing macro-economic environment. However, the possibility to sell at different project stages (serviced plots or finished units) provides some flexibility to quickly dispose of projects if needed. Liquidity could improve if Veritasi were to maintain a cautious expansion pace and/or replaced short-term with long-term financing at more favourable rates. Moreover, current undrawn facilities with local banks totalling NGN 1bn can supplement liquidity needs.

We note that holders of Series 3-5 commercial caper (NGN 6bn) issued by Veritasi benefit from an unconditional and irrevocable guarantee from Keystone Bank Limited.

Balance in NGN m	2021	2022E	2023E
Unrestricted cash (t-1)	195	533	643
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-1,543	-7,573	3,928
Short-term debt (t-1)	501	367	6,729
Coverage	**negative**	**negative**	**68%**

Supplementary rating drivers: -1 notch

The credit rating is also driven by the comparison with real estate development peers, which led to a one-notch downgrade based on Veritasi's low relative diversification, profitability, and experience in the highly volatile and cyclical industry. The peer comparison also reflects our view that Veritasi operates in a country with higher country risk, driven by the weak governance, political instability and high corruption and crime rates.

Short-term debt ratings

Short-term debt rating: S-4

We have assigned an S-4 rating to the short-term debt of Veritasi. The rating benefits from good banking relationships and the expectation that the commercial paper will be easily re-issued but is constrained by the less-than-adequate liquidity. We note that holders of Series 3-5 commercial paper (NGN 6bn) issued by Veritasi benefit from an unconditional and irrevocable guarantee from Keystone Bank Limited.

Appendix: Peer comparison

	Veritasi Homes & Properties Ltd.	Wingholding Zrt.	Kopaszi Gat Zrt.	Euroboden GmbH	SunDell Estate Nyrt.
	B/Stable	B+/Stable	B+/Stable	B+/Negative	B/Stable
Last reporting date	September 30, 2022 (9 months)	31 December 2021	30 June 2022	30 March 2022	31 December 2021
Business risk profile					
Scope-adjusted total assets (EUR m)	51	1,500	228	600	130
Portfolio yield	na	6.8%	na	na	na
GLA (thousand sq m)	na	600	439	na	na
Countries active in	1	3	1	2	1
Top 3 tenants (%)	na	10%	50%	na	na
Top 10 tenants (%)	na	17%	90%	na	na
Office (share NRI)	na	69%	55%	na	na
Retail (share NRI)	na	7%	0%	na	18%
Residential (share NRI)	na	0%	43%	na	82%
Hotel (share NRI)	na	3%	2%	na	na
Logistics (share NRI)	na	21%	0%	na	na
Others (share NRI)	na	0%	0%	na	na
Property location	‘B’	'B'	'B'	'A'	'B'
EPRA occupancy rate	na	86%	na	na	na
WAULT (years)	na	6.0	na	na	na
Scope-adjusted EBITDA margin	39%	29%	28%	21%	25%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	12.6x	4.3x	86.3x	1.4x	4.4x
Scope-adjusted debt/EBITDA	0.6x	9.0x	13.8x	20.8x	25%
Scope-adjusted loan/value ratio	31%	71%	67%	50%	5.6x
Weighted average cost of debt	16.5%	4.2%	5.7%	2.1%	3.5%
Unencumbered asset ratio	na	>100%	ca. 100%	145%	255%

Sources: public information, Scope

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