



RATING ACTION COMMENTARY

Fitch Assigns Arada Developments 'B+(EXP)' IDR; Outlook Stable

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Fitch Ratings - London - 16 May 2022: Fitch Ratings has assigned UAE-based property developer Arada Developments LLC (Arada) an expected Long-Term Issuer Default Rating (IDR) of 'B+(EXP)'. The Outlook is Stable.

The final IDR is contingent on the planned benchmark-size unsecured sukuk being issued, the proceeds of which will be used to repay current debt and fund future developments.

The rating is based on Arada's Standalone Credit Profile (SCP) of 'b' and a one-notch uplift for support from the Sharjah government (as assessed under Fitch's Government-Related Entity (GRE) criteria). Arada was established in 2017 to develop fully-integrated communities in Sharjah, which will benefit the Emirate. The Sharjah government provides support to Arada, particularly for land to develop Aljada, the largest community project ever in Sharjah. This included an initial government debt guarantee to buy the land and subsequently converting the debt into a 16-year payable.

The SCP reflects high geographical concentration and execution risk. Arada has delivered one project and two major projects are underway, all in Sharjah, UAE. Arada has moderate net debt/EBITDA, averaging 4.1x over the forecast period.

KEY RATING DRIVERS

Focus on Sharjah: Master-plan community development in Sharjah has been minimal, especially compared with Dubai and Abu Dhabi. Arada's projects include residential assets with extensive public parks, as well as commercial, retail, hospitality, leisure and education assets in areas where these facilities are limited. These projects will benefit residents as well as the wider community and should help attract home buyers from across UAE and elsewhere, diversify the economy and bring more direct investment.

Limited History: Arada has launched three community projects to date, one of which, Nasma Residences, comprising 1,117 townhouses and villas, was delivered on time. In September 2017, Arada launched Aljada, Sharjah's largest ever mixed-use development, covering 2.2 million square metres (sq m) with 14 build phases (four are underway). There will be around 25,000 apartments, townhouses and villas for some 70,000 residents with significant green space, as well as retail, commercial, education and other assets. Arada has delivered about 1,500 units, one school and some retail and leisure assets to date. The company's third project, Masaar, is an upscale forested community of 4,000 units on 1.8 million sq m launched in January 2021. While sales across the projects have been strong to date, Arada needs to deliver units to generate cash flows. Material delays will weaken financial metrics.

Bottom-up Rating Approach: As an integral part of Sharjah's development plans for the real estate sector, Arada benefits from government support. We view the history of support as strong, as evidenced by a past debt guarantee for Arada financial obligations. The government has also provided extended payment plans for the Aljada land acquisition, spreading payments over 16 years, helping Arada substantially increase its landbank. Under GRE criteria, we view status control and ownership, as well as socio-political implications of default, as 'moderate', but the financial implications of default as 'weak'.

Arada also receives support for municipal or regulatory approvals, reducing execution risks and costs. However, government support is for projects, rather than for the overall company, and the government is not obliged to support Arada for projects outside Sharjah or in the future. We therefore rate the company on a bottom-up basis, adding a one-notch uplift to the SCP.

Material Project and Geographic Concentration: Arada is almost entirely exposed to the small, developing, Sharjah market. Although it has a strong market position, having delivered around two-thirds of residential units in the Emirate over the past two years, significant development risk remains in Aljada and Masaar. Arada will expand geographically, having acquired a 25,000 sq m beachfront plot on Dubai's Palm Jumeirah for a high-end mixed-used project launching in 3Q22. There will be no government support.

Arada is small, especially compared with other UAE master-plan developers and while its market position in Sharjah is insulated by government support, competing outside of Sharjah will be challenging.

Retail and Other Businesses Developing: Arada intends to diversify its revenue by retaining projects' investment properties, which will generate recurring revenue. This will include retail and leisure assets, as well as schools and hotels that will be leased to operators. Arada owns several other businesses that will further diversify cash flows. Nonetheless, these will remain a small part of the business.

Development Model Reduces Risk: Unlike some UAE master builders, Arada was not granted land, but has mainly acquired it through deferred payments to reduce upfront costs. Arada aims to achieve minimum pre-sales of 60-65% before committing to construction (this has exceeded 75% to date) with about 25% of sales value collected, mainly through customer deposits (usually 10% of the purchase price). Buyers typically further pay based on building milestones with 70% collected when the unit is delivered. If a buyer defaults, Arada retains the payments and can then sell the unit.

Project contracts are lump sum and at a fixed price, and contractors must provide a performance bond of 10% of the contract sum. Unlike in Dubai, Sharjah developers are not legally required to use escrow accounts to manage project cash flows, but Arada uses them owing to banks' requirements. This will likely change once the planned sukuk is issued.

Corporate Governance Weak: As a private company, Arada has a comparatively weak corporate governance structure. The board comprises four members with no independents: the two shareholders, the CEO and one member who has been with the board since the company's founding. The company intends to develop and improve corporate governance, but this will take some time.

Moderate Leverage Metrics: As Arada is in a significant build-up phase, revenue and EBITDA at end-2021 were only AED1.29 billion (EUR334 million) and AED210 million (EUR54 million), respectively, and gross debt/EBITDA of 4.4x. The proposed sukuk will refinance all current debt (AED920 million), which is fully secured. Revenue is forecast to increase to AED2.2 billion, resulting in net debt/EBITDA of 4.4x, but only slowly reducing owing to the material building schedule. The average for the next four years is of 4.1x. We have treated government payables for the land as part of working capital.

Arada has an ESG credit relevance score of '4' for Governance Structure to reflect the structure of the board of directors, which is weak compared with many EMEA peers. The board comprises four members, including the two shareholders and the CEO with

no independents. All of the members sit on the four committees: audit, investment, remuneration and risk. The lack of an independent board has negative impact on the credit profile, and are relevant to the ratings in conjunction with other factors.

DERIVATION SUMMARY

Operating and regulatory environments vary significantly across EMEA, which limits comparability. Across Fitch's Housebuilder Navigator peers there are different risk profiles for different residential markets. In France, there is little upfront capital outlay for land, and purchaser deposits fund capex. In the UK and Spain, upfront land outlay and the bulk of the purchase price is paid upon completion. This is similar to UAE markets, although these tend to be more volatile than Western European markets.

Sharjah is smaller and less developed than Dubai or Abu Dhabi, but has experienced less volatility. There has also been limited community development in Sharjah, which is where Arada has a competitive advantage and is the rationale for Sharjah government support. Arada receives access to land through the government, which is critical in the UAE markets. However, outside of Sharjah, Arada competes with other UAE companies, including the much larger, established developers, such as Emaar (BBB-/Stable), Aldar and Damac.

As a community builder, the ability to compare Arada with other EMEA homebuilders is difficult, as they focus on building homes, with some mixed-use assets. There is some comparability with Emaar, a Dubai-based master-builder and one of the largest developers in UAE. Emaar is a conglomerate with significant recurring rents from malls, entertainment and hospitality assets and international operations. Emaar's revenue (through Emaar Developments) at end-2021 was AED15.6 billion, compared with a forecast AED2.2 billion at end-2022 for Arada, underlining the significant difference in magnitude. Emaar also has a strong international brand. However, Arada has a strong market position in Sharjah, which is protected through its relations with the government.

Arada is also smaller and less established than UK-based Castle UK Finco PLC (trading as Miller Homes, B+/Stable), or Spanish housebuilders AEDAS Homes, S.A., Neinor Homes S.A. and Via Celere Desarrollos Inmobiliarios, S.A. (all rated BB-/Stable). These companies all have relatively good geographic and project diversity compared with Arada, but do not have government support. Spanish and UK-based housebuilders' funding requirements are comparable, relying only on a small purchaser deposit (5%-10% for the UK and up to 20% for Spain) to fund land and development costs up to completion.

Arada's leverage of 4.4x at end-2021 is similar to Miller Homes' 4.9x funds from operations (FFO) gross debt leverage, which has increased following Apollo's acquisition of the company. AEDAS has leverage of 3.2x, and similar to Via Celere's 5.0x. Neinor's FFO gross leverage is around 6.0x, but this includes debt attributed to the company's growing build-to-rent portfolio.

KEY ASSUMPTIONS

Substantial new project launches in 2022-2025 yield revenue growth of 32.6% yoy

Stable EBITDA margin at 18.5%

Issuance of the planned benchmark-size sukuk instrument in 2022 and further funds raised in 2023-2024

Dividend pay-out of AED250 million on average for 2023-24

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Positive free cash flow (FCF) generation on a sustained basis

Sustained improvement in the financial metrics leading to gross debt/EBITDA below 3.5x

Improved corporate governance structure

Reduced execution risk

Improved liquidity position

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Change in government support, weakening Arada's business and financial profiles

Gross debt/EBITDA above 4.5x

Liquidity score sustained below 1x

Negative FCF on a sustained basis

Overall softening of Sharjah's real estate market resulting in low pre-sales levels and delayed project launches

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Weak Liquidity: As of 31 December 2021, the company had AED470 million of cash on the balance sheet, which sufficiently covered AED462 million of short-term bank debt due in 2022. The company does not have a liquidity facility. All debt is currently secured by mortgages, or in some cases receivables or other assets. The planned sukuk will refinance all the group's debt, improving the company's debt profile, as there will be no short-term debt with only the sukuk in place. Nevertheless, consistent negative FCF, reflecting significant working capital outflows as the company develops, mean the company's liquidity ratio will be below 1.0x.

ISSUER PROFILE

Arada is a master-plan community developer currently focusing on the Emirate of Sharjah, UAE.

DATE OF RELEVANT COMMITTEE

12 May 2022

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Arada Developments LLC has an ESG Relevance Score of '4' for Governance Structure due to the weak structure of the board of directors compared with many EMEA peers. The board comprises four members, including the two shareholders and the CEO with no independents. All of the members sit on the four committees: audit, investment, remuneration and risk. The lack of an independent board has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ↕

RATING ↕

Arada Developments LLC

LT IDR B+(EXP) Rating Outlook Stable

Expected Rating

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)
\(including rating assumption sensitivity\)](#)[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 15 Oct 2021\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

[Corporate Monitoring & Forecasting Model \(COMFORT Model\), v8.0.2 \(1\)](#)**ADDITIONAL DISCLOSURES**[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)

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Arada Developments LLC

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