

CREDIT OPINION

17 May 2022

New Issue

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RATINGS

Arada Developments LLC

| | |
|------------------|-----------------------------|
| Domicile | United Arab Emirates |
| Long Term Rating | B1 |
| Type | LT Corporate Family Ratings |
| Outlook | Stable |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Arada Developments LLC

New issuer

Summary

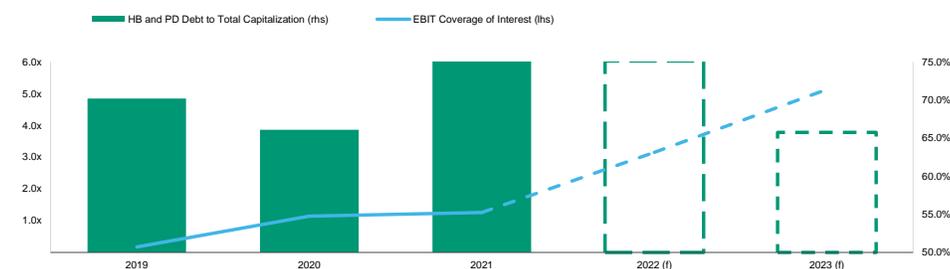
On 16 May 2022, we have assigned a B1 corporate family rating (CFR), and a B1-PD probability of default rating (PDR) to Arada Developments LLC (Arada or the Company), one of the leading homebuilders in the Emirate of Sharjah (Sharjah), United Arab Emirates (UAE). Concurrently, we also assigned a B1 instrument rating to the proposed benchmark-sized unsecured sukuk (the certificates) to be issued by Arada Sukuk Limited, a Cayman Islands special purpose vehicle established by Arada. The outlook on all ratings is stable.

The B1 CFR assigned to Arada incorporates the company's (1) unique market position in Sharjah (Baa3 negative), with our expectation that Arada will have long-term access to premium and well-located land plots; (2) strong track record of support from strategic and influential shareholders; (3) good profitability and revenue visibility in the current market, as a result of healthy demand for Arada's bespoke and good quality master development projects; and (4) improving liquidity profile following the sukuk transaction.

The rating also reflects Arada's (1) small scale and limited operating track record in developing and delivering properties through economic cycles; (2) business concentration, with only two projects that are currently launched (Aljada and Masaar), and the lack of geographic diversification outside Sharjah, which exposes the company to event risks; (3) relatively aggressive property development's funding policy, as Arada typically collects between 25%-30% of the total property's sales value during construction; and (4) exposure to the cyclical property sector and to potential changes in the regulatory environment.

Exhibit 1

Credit metrics to improve materially as the company executes on its project pipeline



All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's adjusted total debt include in 2019, 2020 and 2021 the addition of about AED1.0 billion, representing the present value of Aljada's AED1.6 billion bullet land payment due to the Government of Sharjah in 2029. Moody's forecasts (f) are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated.

Source: Moody's Investors Service

Credit strengths

- » Unique market position in Sharjah, with our expectation of long-term access to premium and well located land bank plots
- » Strong track record of support from strategic and influential shareholders
- » Good profitability and revenue visibility for the next 12-18 months

Credit challenges

- » Small scale and limited operating track record
- » Operational and geographical concentration in Sharjah
- » Aggressive property development's funding policy
- » Exposure to the cyclical property sector and to the potential changes in the regulatory environment

Rating outlook

The stable outlook reflects our expectation that Arada's financial performance will remain strong over the next 12-18 months and will continue to benefit from the recent positive trends in the UAE's property sector.

Factors that could lead to an upgrade

Arada's rating could be upgraded should the company significantly increase its scale, strengthen its business profile, and demonstrate over time, a robust operating track record in developing and delivering properties through economic cycles. Upward pressure would also require the company exhibiting strong credit metrics such that:

- » Moody's adjusted debt to book capitalization is sustained below 50%; and
- » Moody's adjusted EBIT to interest expense is sustained above 4.0x

Factors that could lead to a downgrade

Conversely, the rating could be downgraded if Arada's liquidity position remains weak or the operating environment in Sharjah deteriorates, which could cause revenue and gross margin declines. In addition, the rating could come under pressure if the company's credit metrics do not improve as forecasted by Moody's, such that:

- » Adjusted debt to book capitalization does not trend below 60%; and
- » Adjusted EBIT to interest expense remains sustainably below 3.0x

Key indicators

Exhibit 2

| | 2018 | 2019 | 2020 | 2021 | 2022 (f) | 2023 (f) |
|----------------------------------------------|-------|-------|-------|-------|----------|----------|
| Revenue (USD million) | \$43 | \$150 | \$303 | \$352 | \$654 | \$1,121 |
| Cost Structure (Pre-Impairment Gross Margin) | 29.9% | 24.3% | 25.1% | 27.1% | 34.2% | 34.9% |
| EBIT Coverage of Interest | -1.7x | 0.2x | 1.1x | 1.3x | 3.1x | 5.1x |
| HB and PD Debt to Total Capitalization | 92.3% | 70.2% | 66.1% | 76.4% | 75.1% | 65.7% |

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Source: Moody's Investors Service

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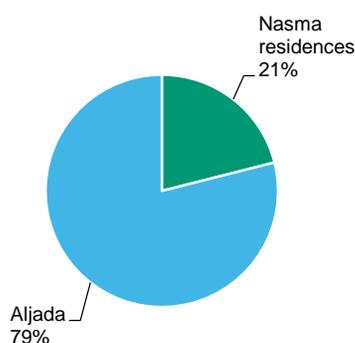
Profile

Arada was established in 2017 and in a short period of time has built a strong market position in developing and selling off-plan properties in Sharjah. During 2021, Arada delivered 1,565 units generating AED1.3 billion of revenue and AED143 million of Moody's adjusted EBIT. Arada's off-plan sales reached 2,493 units in 2021 representing a total property value of AED2.4 billion, while total off-plan sales backlog stood at AED3.3 billion as of YE2021. The company plans to deliver in 2022 about 5,000 units.

Arada is owned 60% by CORP KBW Investments LLC where HRH Khalid Bin Alwaleed Bin Talal is the ultimate beneficiary while the remaining 40% is owned by Basma Group LLC which is chaired by HH Sultan bin Ahmed Al Qasimi, the deputy ruler of Sharjah.

Exhibit 3

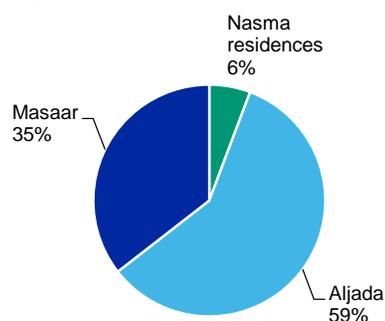
Revenue breakdown by project in 2021 Total revenue of AED1.3 billion



Source: Company reports

Exhibit 4

Sales-backlog by project as of YE2021 Total sales backlog of AED3.3 billion



Source: Company reports

Detailed credit considerations

Strong relationship with the government and influential shareholder

Arada's B1 CFR incorporates the historical and ongoing support provided from strategic and influential shareholders, and in particular support provided by the Government of Sharjah through (1) selling on account to Arada the Aljada's project land plots in 2017; (2) guaranteeing Arada's bank debt of AED1.0 billion in 2017; (3) transferring back to Arada in 2019 a total amount of AED1.6 billion representing the initial land proceeds that the Government had received from Arada in 2017 and 2018, which Arada used to repay its outstanding bank debt of AED1.6 billion; (4) replacing the initial 3 years short-term land payable agreement for the Aljada's development, with a 16 years long-term land payable agreement, to provide Arada with the financial flexibility it requires to achieve its growth plans; and (5) the various exemptions provided to Arada from certain property development's related cost, in order to support the company's sustainable growth.

The revised land payable agreement amounting to AED3.2 billion, provides the company with substantial financial flexibility, as the company is no longer required to pay in a short period of time the large amount of money for the land purchase. This improves the company liquidity profile as it reduces its short-term obligations and frees up some of its capital that can fund the ongoing capital investments in the projects under development, which otherwise would have been locked-in the land bank value until activated. In addition, about half the land payment amount has a variable component that helps mitigate Arada's development and execution risks.

The variable land payment component of AED1.6 billion is stretched over an extended period of time (2020 to 2035 / 16 years), which reduces the company's cash outflows, and are based on Arada's achievement of agreed off-plan sales targets.

The fixed land payment component consists of a single bullet payment of AED1.6 billion due in 2029. Given the supportive nature of the Government of Sharjah so far, we believe that the Government will show flexibility on this payment should Arada face liquidity stress closer to the maturity. We have taken the view that the fixed component has debt-like characteristics, and as such the present value amount of AED1.0 billion is reclassified to debt.

Arada's B1 CFR also incorporates the ongoing support provided from the shareholder, in the form of deferred land payment agreement for the Masaar development project, which provides Arada with further financial flexibility. In 2021, Arada established a long-term 10 years deferred land payable agreement with Tital Properties LLC a subsidiary of Basma Group. The agreement is similar to the variable component of the Aljada land payable agreement, with the Masaar's land payable obligation linked to the achievement of agreed off-plan sales targets.

Unique market position in Sharjah underpinned by good revenue visibility despite a relatively modest track record in developing and delivering properties through industry cycles

Arada has a unique market position in the Emirate of Sharjah. According to the company, its projects accounted for a substantial amount of the total off-plan residential sales transactions in Sharjah in 2020 and 2021 respectively.

Since it began operations in 2017, Arada has launched the following 3 projects:

- » Nasma residences: Total project value is AED1.5 billion and consists of +1,100 units. The project is almost completed with the remaining and final 133 units to be delivered in 2022. The construction on Nasma residences began in 2017 and the first homes were delivered in 2019.
- » Aljada: Total project value is AED24 billion and consist of +25,000 units. According to the company, Aljada is Sharjah's largest ever mixed-use development project and covers 2.2 square kms. Construction on Aljada began in 2018 and the first homes were delivered in 2021. As of YE2021, a total of 1,263 units were delivered out of 8,812 units launched, while Aljada's total off-plan sales backlog stood at around AED1.9 billion.
- » Masaar: Total project value is AED7 billion and consists of +4,000 units. Masaar is an upscale forested community where construction started in March 2022 and the first homes are expected to be handed over in 2023. As of YE2021, total off-plan sales stood at around AED1.2 billion.

Arada also enjoys healthy profitability, with a reported gross margin of around 27% in 2021. We expect margins to gradually increase over time as the construction of the Aljada and Masaar projects advance, with units being sold at higher price/square foot (sq ft) valuations than that of Arada's first project i.e. Nasma residences. In addition, Arada benefits from (1) early entrant advantage, as the Aljada development is one of the very few integrated master community developments in Sharjah; (2) increased demand for its bespoke designs and good quality projects; (3) ongoing support provided from the government of Sharjah, in the form of waiving certain property related cost fees; and (4) prudent construction cost management policies.

Arada sales backlog of AED3.2 billion as of YE2021 provides good revenue visibility, however this is offset by the company's limited track record in developing properties through economic cycles. As such, revenue realization is susceptible to the company's ability to achieve the respective construction milestones. The company is exposed to development and executions risk, which could derail revenue realization and negatively impact the company's financial metrics and liquidity. Since inception and up until 31 December 2021, Arada has delivered a total of 2,247 units, allocated between 984 units at Nasma residences and 1,263 units at Aljada.

The company has a diversified base of contractors. To minimize financial and execution risks, we understand that it signs turnkey construction contracts, at pre-agreed fixed cost, which helps to mitigate cost overruns. Although construction work is contracted to external parties, Arada maintains oversight over cost management and ensures quality standards are adhered to across the various construction phases.

Geographic concentration in Sharjah exposes the company to event risks

Geographic concentration in Sharjah exposes the company to event risks, as the two ongoing projects are both based in Sharjah. The company is expected to mitigate this risk by exploring other regional locations. More recently, in January 2022, Arada entered the Dubai real estate market by acquiring a land plot on the Palm Jumeirah for AED240 million. The plot is located on the Palm's East Crescent and is ideally located with views of the Burj Khalifa and Burj Al Arab to the east, and the rest of the Palm and Dubai Marina to the south and west. Design work on the mixed-use project (which will contain residential, leisure, food and beverage components) has already begun. The project is valued at AED1.2 billion, it will comprise 244 branded luxury residential units and the sales launch is planned for Q3-2022 with the first handover expected in the second half of 2025.

Sharjah real estate market is relatively more stable in terms of new supply and property price fluctuations, compared to the Emirates of Dubai and Abu Dhabi. However, the regulatory framework is not as investor friendly, as in the other abovementioned emirates. Currently, under the laws governing the real estate properties in Sharjah, non-GCC foreign nationals in the UAE do not have the right to own freehold property in the emirate and there are no regulations requiring developers to establish project specific escrow accounts where investor payments are deposited.

Credit metrics to improve over time despite increased capital spending and dividend distributions

Given the company's short operating history, Arada's credit metrics have historically been weak with Moody's adjusted debt to book capitalization of 76% and Moody's adjusted EBIT to interest expense of 1.3x as of YE2021. We expect these metrics to improve materially and reach about 66% and 5.0x by 2023 as the company executes on its project pipeline. Moody's adjusted leverage metrics include a portion of payments due to the Government of Sharjah as debt.

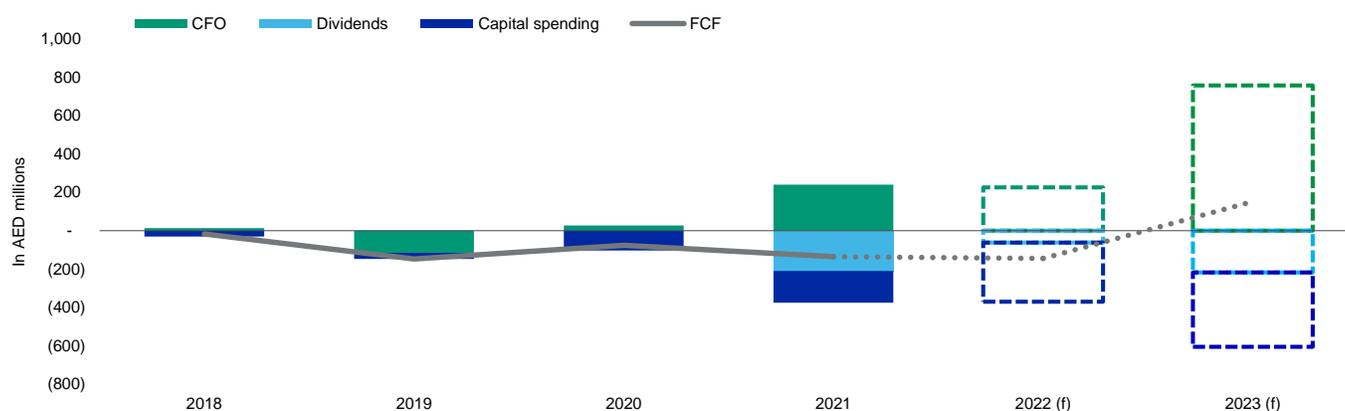
The company's free cash flow generation (FCF) generation is expected to turn positive in 2023 because of stronger operating performance and improved profitability, despite increased capital outflows in the form of negative working capital changes, higher capital spending and dividend distributions. There is a risk that a more aggressive and accelerated development plan however could lead to this expectation not being realized.

Arada's current property development funding policy can cause working capital swings that negatively impact its ability to generate FCF. Although the company targets a minimum pre-selling of 60% - 70% of the project before construction begins, construction linked payments are low with typically between 25% - 30% of the total property value collected. The remaining funding requirements to cover for the construction cost is sourced by Arada until the construction is completed. Once the property is handed over to the customer, Arada will collect the remaining 65% -70% of the property value. We understand that Arada currently has not provided post-handover payment plan options to customers.

Capital spending is expected to increase as the company rolls out its investment properties projects. Dividend distributions are expected to increase as well, in-line with Arada's updated dividend distribution policy of (1) 50% of prior year net profit; or (2) AED500 million, whichever is lower.

Exhibit 5

FCF generation is expected to turn positive in 2023 because of stronger operating performance despite increased capital outflows



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Source: Moody's Investors Service

ESG considerations

From a governance perspective, Arada is a closely held private company with its two shareholders able to influence the company's strategy and financial policies. The board of directors consist of four members (none of which are independent): the two shareholders, the CEO and a fourth member that has served as the general director for Basma Group and Tilal Properties LLC. While Arada has some defined financial policies including the aim to maintain net debt/EBITDA below 3.0x, the company is relatively new and therefore does not have an established track record of adhering to its leverage target. The company's exposure to environmental and social risks is low and in line with the overall industry. From a social perspective, Arada is an important strategic partner for the Government of Sharjah, as it aims to achieve sustainable development of new residential areas, help support the economy, and attract local and international investments into the property sector.

Liquidity analysis

Arada will have adequate liquidity following the issuance of the certificates. The proceeds from the issuance will be used to repay the entirety of the existing outstanding bank debt which stood at AED0.9 billion as of YE2021, while the remaining balance will be allocated towards ongoing capital investments. Moody's forecasts that for the next 18 months starting January 2022, Arada's cash balances of AED0.5 billion and funds from operations (FFO) of AED1.0 billion will be sufficient to cover changes in working capital of about AED0.4 billion, capital investments of AED0.5 billion and dividends of AED0.3 billion.

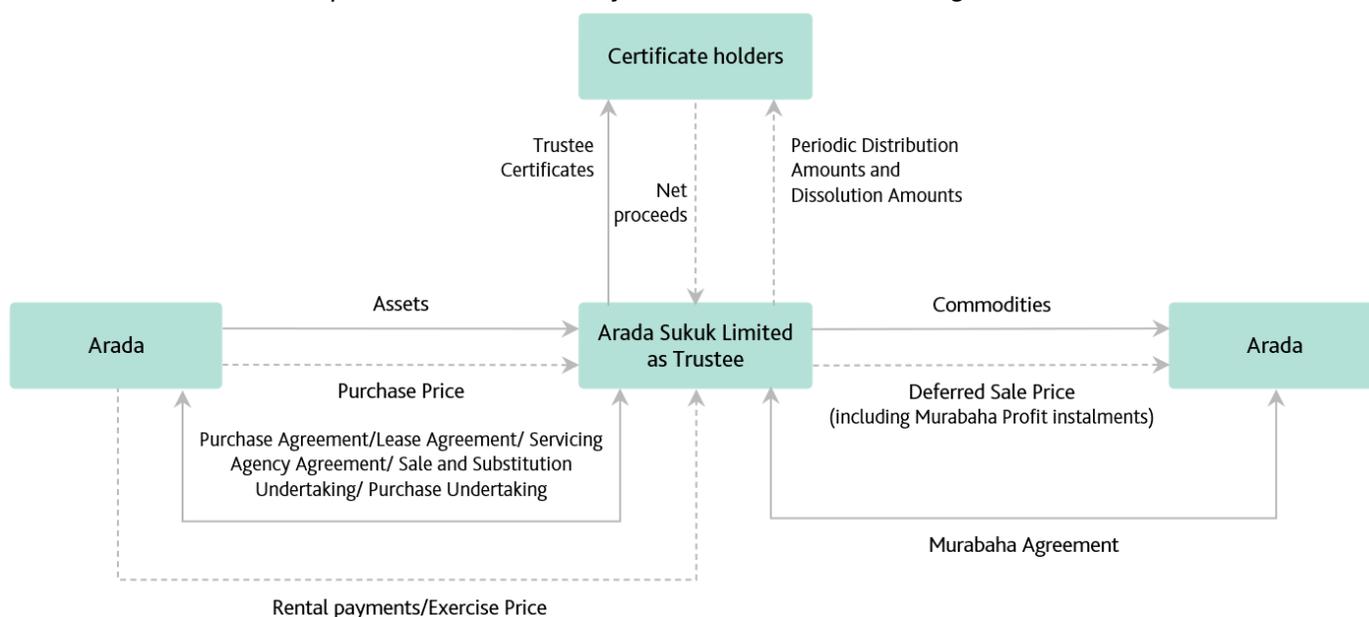
Structural considerations

The proposed senior unsecured sukuk has been assigned a B1 rating. The alignment of the sukuk's rating with that of Arada's B1 CFR is because certificate holders are effectively exposed to the creditworthiness of Arada for the periodic distributions (akin to coupon payments) and principal repayment of the sukuk. Certificate holders only have rights against Arada as defined under the sukuk transaction documents, and these rights rank pari passu with other senior unsecured obligations of Arada. Sukuk holders are not exposed to the performance risk of the investment portfolio related to the certificates and do not have any preferential claim or recourse over the relevant trust assets. The sukuk structure will consist of no less than 55% Ijara assets and the remainder being Murabaha assets.

The alignment of the sukuk ratings with the B1 CFR reflects the expectation of low proportion of secured debt to total assets over the coming years, thus reflecting significant unencumbered assets available to unsecured creditor claims.

Exhibit 6

Arada's Sukuk structure is a dual pool of no less than 55% of Ijara assets and the remainder being Murabaha assets



Source: Draft offering memorandum

Rating methodology and scorecard factors

We have applied the [Homebuilding and Property Development Industry rating methodology](#), published in January 2018, in assessing the ratings for Arada.

Exhibit 7

| Homebuilding And Property Development Industry | Current FY 12/31/2021 | | Moody's 12-18 Month Forward View | |
|------------------------------------------------------|--------------------------|-------|-------------------------------------|-------|
| | Measure | Score | Measure | Score |
| Factor 1 : Scale (15%) | | | | |
| a) Revenue (USD Billion) | \$0.4 | Caa | \$0.7 - \$1.2 | B |
| Factor 2 : Business Profile (25%) | | | | |
| a) Business Profile | B | B | B | B |
| Factor 3 : Profitability and Efficiency (10%) | | | | |
| a) Cost Structure (Pre-Impairment Gross Margin) | 27.1% | Ba | 33% - 35% | Baa |
| Factor 4 : Leverage and Coverage (30%) | | | | |
| a) EBIT Coverage of Interest | 1.3x | B | 3x - 5x | Ba |
| b) HB and PD Debt to Total Capitalization | 76.4% | Caa | 60% - 72% | B |
| Factor 5 : Financial Policy (20%) | | | | |
| a) Financial Policy | B | B | B | B |
| Rating: | | | | |
| a) Scorecard-Indicated Outcome | | B3 | | B1 |
| b) Indicative Rating assigned | | | | B1 |

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Source: Moody's Investors Service

Appendix

Exhibit 8

Peer comparison

| | Arada Developments LLC | | | Castle UK Finco PLC | | | Brookfield Residential Properties Inc. | | |
|----------------------------------------------|------------------------|-------|-------|---------------------|---------|-------|----------------------------------------|---------|---------|
| | B1 - STA | | | B1 - STA | | | B1 - STA | | |
| | 2019 | 2020 | 2021 | 2018 | 2019 | 2020 | 2018 | 2019 | 2020 |
| Revenue (USD million) | \$150 | \$303 | \$352 | \$997 | \$1,074 | \$853 | \$2,200 | \$1,900 | \$1,700 |
| Cost Structure (Pre-Impairment Gross Margin) | 24% | 25% | 27% | 26% | 25% | 23% | 22% | 21% | 20% |
| EBIT Coverage of Interest | 0.2x | 1.1x | 1.3x | 2.9x | 3.5x | 2.2x | 2.8x | 2.9x | 2.6x |
| HB and PD Debt to Total Capitalization | 70.2% | 66.1% | 76.4% | 69.2% | 62.3% | 61.5% | 47% | 40% | 41% |

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Source: Moody's Investors Service

Exhibit 9

Moody's-adjusted debt breakdown

| (In AED millions) | 2018 | 2019 | 2020 | 2021 |
|------------------------------|--------------|--------------|--------------|--------------|
| As Reported Debt | 1,600 | 221 | 389 | 964 |
| Pension adjustments | 1 | 3 | 5 | 7 |
| Non-Standard Adjustments | - | 926 | 994 | 1,061 |
| Moody's-Adjusted Debt | 1,601 | 1,149 | 1,388 | 2,032 |

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Source: Moody's Investors Service

Exhibit 10

Moody's-adjusted EBITDA breakdown

| (In AED millions) | 2018 | 2019 | 2020 | 2021 |
|--------------------------------|--------------|------------|------------|------------|
| As Reported EBITDA | 54 | 493 | 254 | 172 |
| Unusual adjustments | (155) | (518) | (190) | (77) |
| Pension adjustments | (1) | (2) | (3) | (2) |
| Non-Standard Adjustments | 0 | 67 | 49 | 67 |
| Moody's-Adjusted EBITDA | (102) | 40 | 110 | 160 |

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Source: Moody's Investors Service

Ratings

Exhibit 11

| Category | Moody's Rating |
|-------------------------------|----------------|
| ARADA DEVELOPMENTS LLC | |
| Outlook | Stable |
| Corporate Family Rating | B1 |
| ARADA SUKUK LIMITED | |
| Outlook | Stable |
| Senior Unsecured | B1/LGD4 |

Source: Moody's Investors Service

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