STANDARD & POOR'S

RatingsDirect®

September 1, 2009

Summary:

CJSC SSMO LenSpecSMU

Primary Credit Analyst:
Izabela Listowska, Frankfurt (49) 69-33-999-127; izabela_listowska@standardandpoors.com

Secondary Credit Analyst:
Varvara Nikanorava, Frankfurt (49) 69-33-999-135; varvara_nikanorava@standardandpoors.com

Table Of Contents

Summary:

CJSC SSMO LenSpecSMU

Credit Rating: B/Stable/B

Rationale

The ratings on Russia-based property developer CJSC SSMO LenSpecSMU (LSS) are constrained by the company's exposure to liquidity risks and continuing very weak demand for residential property in the Russian Federation (foreign currency BBB/Negative/A-3; local currency BBB+/Negative/A-2). Standard & Poor's Ratings Services believes this weakness is likely to continue at least through 2009 given the macroeconomic slowdown, low consumer confidence, and tight mortgage lending. Other negative rating factors are the country's lack of administrative transparency and predictability, and the company's dependence on property development in a single region of Russia.

Conversely, LSS' leading position in its core market, St. Petersburg and the surrounding region, an established track record of completing projects, and brand recognition moderate these risks. Based on information provided by the company, we believe that LSS' control of all the stages of a project's evolution should allow it to manage quality and costs adequately. The company is also able to effectively address key administrative and legal risks.

Key business and profitability developments

After benefiting from favorable demand conditions over the past few years, LSS' operations continue to be affected by a severe downturn in local housing markets since late 2008. We believe that LSS will continue to mitigate operating performance pressure by its demonstrated ability to scale back its development pipeline and by its fairly stable inflow of customer orders over the past several months, although they were significantly below 2008 levels. Housing orders are suffering only modest cancellation and default rates, but in our view they remain at risk in the current economic environment. Management information indicates that LSS' operations are fairly resilient to tight access to mortgage financing because mortgages fund only a small share of customer contracts. We estimate that LSS will maintain its good profitability measures in 2009, with an EBITDA margin at above 20%, because the drop in home prices and new orders will likely be largely offset by reduced construction costs, in particular for concrete and steel. On the negative side, any further potential depreciation of the Russian ruble against the dollar poses a risk for the company. This is because of the mismatch between dollar-denominated debt and largely ruble-denominated cash flows, although the company links housing contract prices to the dollar as far as possible.

Key cash flow and capital-structure developments

Like many of its peers, LSS entered the housing downturn with an aggressively leveraged balance sheet, owing to its ambitious largely debt-funded growth strategy over recent years. As of Dec. 31, 2008, total reported debt reached its peak of about Russian ruble (RUR) 6.6 billion, but it has since been repaid from internal cash resources. As of Aug. 31, 2009, based on the company's information, total reported debt was about RUR5.39 billion. Overall, LSS' financial profile is holding up well compared with some industry peers in Russia. The company's preliminary first-half 2009 results indicate that its credit ratios were above our guidelines for the ratings, with debt to EBITDA at about 1.3x and debt to capital at about 50%. However, these were appropriate given the company's weak liquidity profile and difficult market conditions.

Liquidity

LSS has made progress in better distributing its debt maturity profile over the past months. Despite this improvement, we regard LSS' liquidity as weak, according to our rating criteria, because we consider it to be dependent on external financing from currently difficult credit markets. Management information indicates that LSS' available liquidity does not cover its financial obligations (debt maturities and amortization payments) due within 12 months.

As of Aug. 31, 2009, the company had about $20 million of unrestricted cash balances and about $49 million availability under one credit facility with a regional bank, which can be utilized for lease-back transactions and similar funding schemes. This compares with $36 million of debt maturing this year, and $44 million and $25 million due for repayment in first and second quarters of 2010, respectively. We understand that LSS will accumulate cash for debt repayment purposes. However, we believe that internally generated cash flows may only partly bridge the funding gap, so the company will need to roll over its upcoming debt maturities and/or obtain additional funding from other sources. We believe these refinancing needs are likely to be manageable, owing to management's demonstrated proactive treasury management, established borrowing relationships, and historically good access to the Russian loan market. Company data suggests that LSS is the largest house builder in St. Petersburg and environs, which should also facilitate access to funding. We understand that LSS is in advanced discussions with potential lenders on several funding options, any of which, if closed, should be sufficient to cover most of its upcoming maturities.

The recent successful restructuring of credit-linked note obligations eliminated maintenance covenants and left the company subject only to incurrence financial covenants. We understand that there are currently no financial covenants in LSS' other bank and bond documentation.

Recovery analysis

The senior unsecured debt issued by Golden Ring Finance S.A. and guaranteed by LSS is rated 'B' in line with the corporate credit rating on LSS. This debt has a recovery rating of '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default. In addition, as of Aug. 31, 2009, LSS had RUR580 million outstanding under a RUR1.5 billion unsecured bond issue, which has an 'ruA' Russia national scale rating, and about $120 million in unrated bank debt.

For further information see the article "CJSC SSMO LenSpecSMU's Recovery Rating Profile," published on July 30, 2008, on RatingsDirect.

Outlook

The stable outlook reflects our view that despite the currently difficult credit markets, LSS will be able to refinance its short-term debt maturities. Furthermore, we believe that the management will stick to its financial discipline and prudent approach to a new development schedule in light of weak demand, which are essential factors in maintaining a credit profile commensurate with the ratings. We believe the company will be able to maintain adjusted debt to EBITDA of about 3.5x, which is consistent with its 'B' rating.

We would consider lowering the rating if LSS fails to adequately address the challenge posed by its short-term debt maturities or if its operating cash flows, which are susceptible to order cancellations and customer defaults, deteriorate significantly. Adverse developments in Russia's transitional regulatory and administrative environment could also trigger negative rating actions. Ratings upside is unlikely in the near term given the uncertainty about the company's business prospects.

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com