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Research Update:

Property Developer LenSpecSMU Outlook Now Stable On Potential Slowdown And Tighter Liquidity

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

Recovery Analyst:

Abigail Klimovich, London (44) 20-7176-3554; abigail_klimovich@standardandpoors.com

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Rationale

On Oct. 7, 2008, Standard & Poor's Ratings Services revised its outlook on Russia-based property development group CJSC SSMO LenSpecSMU to stable from positive. At the same time, we affirmed the 'B' long-term and 'B' short-term corporate credit ratings, and the 'ruA' Russia national scale rating.

The outlook revision reflects the weakened lending conditions in Russia due to the significant turbulence in the local equity and credit markets in recent weeks, with potential knock-on effects for real estate demand and prices. The consequent increased uncertainty surrounding the company's business prospects and tightened liquidity has diminished the likelihood of an upgrade in the near term.

The ratings continue to be constrained by the industry's cyclical nature, with heightened sensitivity to economic dynamics; uncertainty associated with Russia's evolving political and business climate; and the country's lack of administrative transparency and predictability. Other negative rating factors are the property development industry's risky profile, including high competition and volume and price cyclicity; property investors' penchant for speculation; the group's dependence on property development in a single region of Russia; and negative free operating cash flow (FOCF) owing to heavy working-capital needs heightened by rapid expansion.

Conversely, the group's leading position in its core market, St. Petersburg and its region, combined with an established track record and brand recognition, moderate these risks. LenSpecSMU's control of all the stages of a project's evolution allows it to manage quality and costs well. The company is also able to effectively address key administrative and legal risks.

LenSpecSMU has been able to improve its profitability because of dynamic trading activity in the St. Petersburg real estate market, which supported strong price appreciation for residential units, and management's increasing focus on managing risks and expanding economies of scale. As a result, the EBITDA margin strengthened to about 28% for the 12 months to June 30, 2008, up from 10% in 2006. We believe LenSpecSMU's still-sizable development pipeline, with a relatively high presold level for completion in 2009, gives good operating visibility in the near term. Nevertheless, operating margins are likely to contract if demand and property prices slow as a reflection of the weakened lending conditions and economic prospects.

The company has pursued an aggressive growth strategy with increased capital requirements. This resulted in an aggressively leveraged balance sheet because the group had to close the gap between investment needs on the one hand and available internal cash resources and cash streams from customer advances on the other. As of Sept. 1, 2008, LenSpecSMU had total debt of

Russian ruble (RUR) 6.2 billion (\$250 million), compared with RUR2.6 billion on Dec. 31, 2006. The company expects good growth in revenues and EBITDA in the second half of 2008, however, which should offset the high leverage and help to maintain credit measures in line with our expectations for the ratings. In the 12 months to June 30, 2008, total debt to EBITDA, asset coverage (total assets to total debt), and EBITDA interest coverage were about 2.5x, 6x, and 3.8x, respectively.

Liquidity

LenSpecSMU's liquidity has weakened. As of Sept. 1, 2008, LenSpecSMU had \$142 million available under credit lines, of which only \$22 million will expire by the end of 2009. Nevertheless, about half of total undrawn credit lines were granted by regional second-and third-tier Russian banks, which are considered less reliable in the current stress environment as opposed to top-tier, large, and state-controlled domestic banks. Also, there were cash balances of \$18 million (of which \$8 million was at the holding level) and about \$35 million short-term financial assets allocated to cover the potential put of the credit-linked notes (CLNs). Combined liquidity sources of \$173 million do not cover \$202 million in short-term maturities coming due in 2009, including the put option on the \$100 million CLNs. The latter is very likely to be exercised in April 2009 to an even greater extent than in the past. The medium-term (two or three years) nature of debt instruments currently negotiated with banks for future refinancing, with closings expected in fourth quarter 2008, should result in improvement of the debt structure, albeit at a much higher cost.

Liquidity is constrained by the group's negative FOCF and a subsequent strong dependence on the availability of external financing. External funding stemming from the inflow of new customer deposits and advances remains an essential component to LenSpecSMU's financial flexibility, as heavy working-capital needs are inherent to the property development sector. The relatively high presold level of developments for completion in 2009 bodes well for a healthy influx of prepayments in the near term. Nevertheless, if real estate demand slows, customer payments would be affected and would pose a risk to LenSpecSMU's liquidity.

We expect LenSpecSMU to continue to maintain adequate headroom within the guidelines of financial covenants under its CLN obligations, such as a debt-to-EBITDA ratio of less than 4x and an interest coverage ratio of more than 2.5x.

Recovery Analysis

The senior unsecured debt issued by Golden Ring Finance S.A. and guaranteed by LenSpecSMU is rated 'B', the same level as the corporate credit rating on the guarantor company, with a recovery rating of '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default. In addition, as of Sept. 1, 2008, the LenSpecSMU Group had RUR580 million outstanding under the RUR1.5 billion unsecured bonds issue rated 'ruA' on the Russia national scale, and about \$228 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.

For more information on the way we classify the world's legal jurisdictions with regard to creditor friendliness and our review of Russia's insolvency procedures, please see "Update: Jurisdiction-Specific Adjustments To Recovery And Issue Ratings," and "Debt Recovery For Creditors And The Law Of Insolvency In Russia," published on RatingsDirect on June 20, 2008, and May 7, 2007, respectively.

Outlook

The stable outlook reflects our expectations that despite the current stress environment, LenSpecSMU will be able to address its financing needs by prudently managing its operating costs, leverage position, and financial risk exposure, together with improving its liquidity position. At the current rating level we expect LenSpecSMU to maintain its debt to EBITDA at or below 3.5x.

We would consider a negative rating action if the company fails to successfully refinance its short-term debt, or experience material operational pressures stemming, for example, from a greater-than-expected market decline, significant project delays, or material cost overruns. Adverse changes in the evolving and still immature regulatory and administrative environment could also trigger negative rating actions.

Ratings upside is unlikely in the near term, due to the challenging market conditions and increased uncertainty surrounding the company's business prospects.

Ratings List

Outlook Action/Ratings Affirmed

	To	From
CJSC SSMO LenSpecSMU		
Corporate credit rating	B/Stable/B	B/Positive/B
Russia national scale rating	ruA	ruA

Ratings Affirmed

CJSC CUN LenSpecSMU		
Senior unsecured*	ruA	
Golden Ring Finance S.A.		
Senior unsecured*	B	
Recovery rating	4	

*Guaranteed by CJSC SSMO LenSpecSMU.

Additional Contact:

Industrial Ratings Europe;CorporateFinanceEurope@standardandpoors.com

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