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Summary:
CJSC SSMO LenSpetsSMU

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Summary:

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Corporate Credit Rating	B+/Stable/B	
Profile Assessments		
BUSINESS RISK	WEAK	Vulnerable — Excellent
FINANCIAL RISK	AGGRESSIVE	Highly leveraged — Minimal

Initial Analytical Outcome ("Anchor") And Rating Result

Our 'B+' long-term corporate credit rating on Russia-based residential real estate developer CJSC SSMO LenSpetsSMU is derived from:

- Our anchor of 'b+', based on our "weak" business risk profile and "aggressive" financial risk profile assessments for the company.
- The modifiers had no impact on the rating.

Rationale

Business Risk: Weak	Financial Risk: Aggressive
• Cyclical nature and capital intensity of the real estate development. • Full revenue concentration in Russia, where the economy is volatile and the regulatory framework is subject to unpredictable changes. • Strong market position in its local markets and track record of successfully selling apartments, especially in St. Petersburg where market conditions remains favourable.	• High volatility of cash flows and working capital arising from a long construction cycle. • Weak debt and coverage ratios, with funds from operations to debt below 20% and EBITDA interest coverage close to 2x. • Adequate liquidity and relatively good access to funding sources.

Outlook: Stable

Standard & Poor's Ratings Services' stable outlook on CJSC SSMO LenSpetsSMU (LSS; B+/Stable/B foreign currency; B+/Stable/B local currency; ruA+ Russia national scale) reflects its opinion that the company's operating performance over the next 12 months should benefit from consistent demand for apartments in St. Petersburg, and steady prices in the broader residential property segment. We assume that LSS's management will continue its prudent financial policy of tailoring cash outflows into ongoing construction to the cash inflows from committed and partly prepaid sales. We will also monitor working capital, which could rise in 2014. We expect LSS' debt to EBITDA to not exceed the company threshold of 4x and EBITDA interest coverage to remain close to 2x, in line with our definition of an "aggressive" financial risk profile.

Downside scenario

We would take a negative view of LSS abandoning its cautious strategy on phasing in new developments. Adverse developments in Russia's macroeconomic environment affecting demand for LSS' apartments more strongly than we currently anticipate could also lead us to consider a downgrade.

Upside scenario

Rating upside is contingent, in our view, on LSS' ability to maintain positive free operating cash flow (FOCF) over a more prolonged period than we currently anticipate.

Standard & Poor's Base-Case Scenario

We consider residential demand and GDP growth to be among the most important rent drivers for real estate developers in Russia. We view positively the socioeconomic trends in the cities where LSS operates and the sizable cash position the company maintains. This should translate into stable credit metrics at a level we view as commensurate with our "aggressive" financial risk profile assessment for the company.

Assumptions

- Lower revenue in 2013-2014, reflecting lower asset deliveries, partly offset by a 0%-5% increase in selling price.
- Stable debt metrics in 2013-2014, mirroring LSS' strong cash position, which mitigates negative free cash flow generation.

Key Metrics

	2012a	2013e	2014e
EBITDA (bil. RUB)	6.2	5.2-5.4	5.0-5.3
EBITDA margin (%)	24.9	23.0-26.0	22.0-26.0
FFO/debt (%)	23.1	16.0-17.0	11.0-13.0
EBITDA/interest (x)	6.0	1.8-2.0	1.7-1.9
Debt/(debt + equity) (%)	39.1	35.0-37.0	35.0-40.0

FFO--Funds from operations. RUB--Russian ruble. a--Actual. e--Estimate.

Business Risk: Weak

LSS's "weak" business risk profile is, in our opinion, constrained by the inherent volatility and long operating cycle of the property development industry, Russia's high country risk due to the lack of administrative transparency and predictability, and LSS' revenue concentration in a single region of Russia.

Although there is a structural demand for new homes in Russia, it remains highly correlated with GDP growth. We project Russia's GDP will increase by 2.2% in 2014. This is a slight rebound compared with 2013 (1.7%), although it should remain lower than the three-year historical average (3.4%). The supply of housing developments also relies greatly on the current low interest rates. These risks are moderated, however, by LSS' favorable and recently expanded position in St. Petersburg and the surrounding region, its core market, and gradually improving demand for residential property across Russia.

We believe that the company's established track record of completing projects and selling flats is additional support for the rating. We also believe that LSS' control of all the stages of property development should allow it to adequately manage quality and costs.

Financial Risk: Aggressive

Our view of LSS's "aggressive" financial risk profile is constrained by the inherent volatility of cash flows arising from a long operating cycle, given that LSS takes 30 months in the construction phase of its projects, on average, and the high working capital swings. We also note the analytical complexity associated with the company's completed-contract method of accounting, which creates a time gap between reported earnings and cash flow statement. However, this method reduces the risk of a downward revision of revenues. Furthermore, the financial risk profile is moderated by LSS high debt and coverage metrics with funds from operations (FFO) to debt below 20% and EBITDA interest coverage close to 2x. These ratios are calculated over a weighted average of five years (2011-2015) and commensurate with our "aggressive" financial risk profile.

Nevertheless, we believe that LSS' financial risk profile is partly softened by its high debt maturity (more than three years), low exposure to foreign currency risks (63.5% of financings were denominated in Russian rubles {RUB} as of Dec. 31, 2013) and diversified capital sources (50.1% financings came from debt capital market as of Dec. 31, 2013) relative to its peers in the region. This is underpinned by LSS' good access to bond market, as evidenced by its successful RUB5 billion (approximately €103 million as of the conversion rate at March 31, 2014) five-year bond issued on Dec. 18, 2012, and by its shares issued by its listed holding Etalon Group Ltd.'s (not rated).

Liquidity: Adequate

The short-term rating is 'B'. We classify LSS' liquidity as "adequate" under our criteria. We expect liquidity sources to meet needs by more than 1.2x in the next 12 months, as of Dec 31, 2013.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and short-term bank deposits of RUB7.5billion. • Availability under committed credit lines of RUB6.4 billion. • Estimate RUB2.2 billion of incoming FFO.	• Debt maturities of RUB3.1 billion. • Estimate working capital outflows of RUB5.0 billion, to be used for new real estate project developments. • Estimate capital expenditures of RUB520 million.

Convenants

In our view, LSS derives additional financial flexibility from its significant headroom on its covenants, which would allow the company to increase debt if needed.

Other Modifiers

No modifiers affect the rating.

Ratings Score Snapshot

Corporate Credit Rating: B+/Stable/B

Business risk: Weak

- Country risk: High
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Recovery Analysis

Key analytical factors

- The 'B+' issue rating and the '4' recovery rating on the senior unsecured debt is constrained by the unsecured nature of the notes, and the subordination of the rated instruments to various debts. The recovery rating is, however, supported by the company's tangible asset base.
- Under our hypothetical default scenario, we contemplate a default in 2016, mainly as a result of a deterioration in overall economic conditions across Russia. This would lead to a decline in residential real estate prices in St. Petersburg, which would eventually result in an interest payment default.
- We value LSS using our discrete asset valuation methodology. This approach stresses the expected book value of its properties at various discount levels, based on the type and stage of property development. Also, we apply a blended haircut of about 60% to the estimated inventory of the guarantor entity.

Simulated default assumptions

- Year of default: 2016
- Jurisdiction: Russia

Simplified waterfall

- Gross enterprise value at default: RUB18 billion
- Administrative costs: RUB1.3 billion
- Net value available to creditors: RUB16.7 billion
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- Secured debt claims: RUB7.1 billion*
- -- Recovery expectation: Not applicable
- Unsecured debt claims: RUB20.3 billion*§
- -- Recovery expectation: 30%-50%

*All debt amounts include six months' prepetition interest. §Including debt, trade and tax creditors, customer advances, and guarantees.

Related Criteria

- Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 03, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013

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