FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Arada's IDR at 'B+'/Stable; Senior Unsecured Rating at 'BB-'

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Fitch Ratings - London - 24 Oct 2024: Fitch Ratings has affirmed UAE-based property developer Arada Developments LLC's Long-Term Issuer Default Rating (IDR) at 'B+' with a Stable Outlook and its senior unsecured debt at 'BB-' with a Recovery Rating of 'RR3'. The latter also apply to Arada Sukuk Limited's and Arada Sukuk 2 Limited's instruments.

The affirmation reflects Arada's relatively high leverage and its project and geographic concentration. This concentration risk is somewhat mitigated by the prudent approach to development. Arada's trading performance is positive, benefiting from regional economic growth and residential demand. Gross debt/EBITDA at end 2023 was 5.9x and we expect it to reduce in the next two years when the major phases of current projects will be delivered.

Arada's 'B+' IDR is derived from its Standalone Credit Profile (SCP) of 'b' and a one-notch uplift for Sharjah government support, as assessed under Fitch's Government Related Entity (GRE) criteria.

KEY RATING DRIVERS

Leading Sharjah Developer: Arada is the largest master-plan developer in Sharjah with a 51% market share of off-plan home sales by volumes in 2023. The company mainly specialises in delivering villas and low-rise residential buildings within its master developments, while opportunistically building high-rise towers. Arada's newly-built communities typically comprise on completion a mix of residential units, schools, green spaces, shops and co-ordinated amenities. Since its inception in 2017, Arada has launched 14,900 units, 14,000 of which have been sold and 9,600 already delivered.

High Leverage: 2023 gross debt/EBITDA was high at 5.9x (2022: 3.1x). The operating margins in 2023 were negatively affected by higher marketing and sales costs despite year-on-year revenue increase of 11.5%. Fitch expects the EBITDA margin to consistently exceed 20% (2023 reported: 18.3%) over the next 24 months, as sales volumes are projected to increase. Gross debt/EBITDA should reduce to around 4.5x by end-2024, further declining by 2025 when most of the phases already launched in Aljada and Masaar will be delivered.

Buoyant Housing Demand: Demand for new, quality homes in Sharjah is robust. The local real estate market grew substantially in 1H24, with trade value surging by 35.6% compared with 2023, surpassing AED18.2 billion. Sales in the primary and secondary markets rose by 18% to 30%, depending on location and available offerings. There has been a significant change in buyer preferences, shifting from investors interested in smaller apartments to owner-occupiers looking for larger coastal apartments, townhouses, and villas. Sharjah's real estate market has traditionally benefited from rising prices in Dubai, as budget-conscious residents relocate.

Development Pipeline On-Track: Arada's new developments in Sharjah are progressing according to schedule and in 2023 the company delivered over 2,500 units. Arada's largest project - Aljada - initiated in 2017, spans 2.2 million square meters (sqm) and will feature 25,000 apartments, townhouses, and villas at completion in 2029. It will also include extensive green spaces, retail, schools, and various other amenities. 40% of the total units have been launched and 97% of these have been sold. Masaar, the upscale community encompassing 1.8 million sqm of villas and townhouses, 60% completed, is due for completion in 2026, with around 90% of units launched so far sold.

Limited Diversification Beyond Sharjah: Arada is extending its presence away from Sharjah, mostly into prime locations in Dubai. In late 2022, it introduced Jouri Hills at Jumeirah Golf Estates, which comprises 294 villas and townhouses and it is working on the upscale Armani Beach Residences at Palm Jumeirah (25% of units sold). A branded residential tower is in its design phase and will be launched in DIFC.

In August 2024, Arada set up a local branch in Australia where it has procured some land bank with the aim of launching new residential projects from 2025. Over the past three years, UAE buyers of Arada's properties have reduced to 8% from 47%, while buyers from regions outside GCC have grown to 77% from 30%, including expat residents.

Development Risk Mitigated: Arada acquired land in Sharjah through deferred payments to reduce upfront cash outlays. Before starting construction, Arada targets minimum pre-sales of 60%-65%. Buyers provide deposits (typically 10%), which together with instalments (based on building milestones) substantially fund all construction costs. Buyers pay the remainder (usually 70%) at handover. If a buyer defaults, Arada can keep the payments and sell the unit. Construction risk is mitigated by fixed-price, lump-sum contracts and 10% performance bonds from contractors. Unlike

Dubai, Sharjah does not require developers to manage cash-flows through escrow accounts.

Government Support Beneficial: Arada is an integral part of Sharjah's development plans for the real estate sector. It benefits from the support of the local government in accessing premium land and enjoying deferred land payment plans, as was the case for the land where the Aljada community is being built. Funded by a government-backed facility of AED1.6 billion, it has to be repaid in 16 years. Under our GRE criteria, we view government oversight and precedents of support as strong, therefore adding a one notch-uplift to Arada's SCP.

DERIVATION SUMMARY

Operating and regulatory environments vary significantly across EMEA, which limits comparability. Across Fitch's Homebuilder 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 the UAE tends to be more volatile than Western European markets.

Arada operates primarily in the Emirate of Sharjah, which is smaller and less developed than Dubai (where the company has also 4 projects) and Abu Dhabi, but less volatile. Arada is the primary master-plan developer in Sharjah, which has had little community development, and it has a strong competitive advantage there, particularly owing to government support from the Sharjah government. This includes access to land, which is critical in the UAE markets.

Arada is also developing projects in Dubai, helping reduce its high geographic concentration. However, it does not receive Sharjah government support for these projects and must compete with other UAE companies, including larger, established developers such as Damac Real Estate Development Limited, Binghatti Holding Ltd. (B+/Positive,) Emaar Properties PJSC (BBB/Stable), and Aldar Properties PJSC. The latter two are significant master-plan builders with material international operations. None of these developers has a material presence in Sharjah.

In contrast to Arada, Emaar and Aldar are conglomerates with significant portfolios of investment properties generating stable, recurring revenue. Arada's community projects include supporting assets, such as retail businesses and schools, which are retained and generate recurring revenue. Along with several other businesses owned by Arada, these are increasing and diversifying recurring cash flows, but these are expected to remain a small part of total revenue. Consequently, Arada will remain predominantly exposed to volatile development cash flows.

Arada is smaller and less established than UK-based Miller Homes Group (Finco) PLC (B+/Stable), or Spanish housebuilders AEDAS Homes, S.A. and Via Celere Desarrollos Inmobiliarios, S.A.U. (both rated BB-/Stable). These companies have relatively good geographic and project diversity compared with Arada, but do not benefit from government support and its related competitive advantages. However, Sharjah, and the UAE tend to experience more economic and real estate market volatility.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer:

- Significant revenue growth to over AED8 billion by 2026 supported by the deliveries of new and existing projects (Aljada and Masaar)

- Growing EBITDA margins at or above 25%

- Working capital requirements to average AED1.5 billion per year in the next three years. This includes discretionary land acquisitions

- Dividend distribution of AED150 million and AED250 million in 2024 and 2025, respectively

- Continuous negative free cash flow (FCF) during this expansion phase due to capex and working capital cash outflow

RECOVERY ANALYSIS

Recovery Assumptions

Fitch typically uses a liquidation approach for homebuilders, assuming that potential buyers for the company would be interested in valuable assets such as land and ongoing developments.

Using figures at end-September 2024, prior-ranking debt totalled AED535 million, composed of bilateral banking credit facilities.

The remaining unsecured debt (AED3.9 billion) mostly comprises sukuk instruments. The company has a committed AED50 million unsecured overdraft facility, which we assume to be fully drawn at default.

The standard advance rate of 50% applied to the inventory (AED3,986 million), accounts receivables (AED1,661 million) and net property, plant and equipment (AED2,207 million) is also used for other peers in the region.

After deducting 10% for administrative claims, our waterfall analysis generates a Recovery Estimate of 77% for the generic unsecured class of debt. As Arada's IDR is 'B+', the Recovery Rating is capped at 'RR3', resulting in a senior unsecured rating of 'BB-'/RR3 with a recovery output percentage capped at 70%.

RATING SENSITIVITIES

Arada's IDR

Factors That Could, Individually or Collectively, Lead To Positive Rating Action/Upgrade

- Positive FCF generation on a sustained basis

- Sustained improvement in 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

Sukuk Rating

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- The senior unsecured rating would not be upgraded if Arada's IDR was upgraded to 'BB-'

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- The rating could be downgraded if Arada's Long-Term IDR was downgraded

- Adverse changes to the roles and obligations of Arada under the sukuk's structure and documents

LIQUIDITY AND DEBT STRUCTURE

Capital Structure Actively Managed: In June 2024, Arada established a sukuk programme for up to USD1 billion and drew down USD400 million (AED1.5 billion) out of it. Later in September, the company tapped its sukuk programme and issued an additional USD150 million (AED550 million). Following these transactions, the gross debt mainly comprised senior unsecured sukuk totaling the AED3,800 million maturing between 2027 and 2029 and around AED500 million of secured bank facilities.

At 1H24 Arada's liquidity was satisfactory, with AED2,759 million of unrestricted cash. In 2023, the company completed a AED1,100 million (USD300 million) share capital increase to support the company's projects pipeline which was followed by an additional capital injection of AED200 million in September 2024.

ISSUER PROFILE

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

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

Arada has an ESG Relevance Score of '4' for Governance Structure due to the weak structure of the board of directors compared with most EMEA peers. The board comprises five members, including the two shareholders, one independent director and the CEO. The limited number of independent board members has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
Arada Sukuk Limited					
senior unsecured	LT	BB-	Affirmed	RR3	BB-
Arada Developments LLC	LT IDR	B+ Rating Outlook Stable	Affirmed		B+ Rating Outlook Stable
senior unsecured	LT	BB-	Affirmed	RR3	BB-
Arada Sukuk 2 Limited					

senior unsecured	LT	BB-	Affirmed	RR3	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Sukuk Rating Criteria (pub. 13 Jun 2022)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Government-Related Entities Rating Criteria (pub. 09 Jul 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Arada Developments LLC	UK Issued, EU Endorsed
Arada Sukuk 2 Limited	UK Issued, EU Endorsed
Arada Sukuk Limited	UK Issued, EU Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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