ICRA Lanka Assigns issuer rating of [SL]BBB to Liberty Holdings Limited

September 29, 2016

Instrument	Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB (Stable); assigned

ICRA Lanka Limited, Subsidiary of ICRA Limited, a Group Company of Moody's Investors Service has assigned an Issuer rating of [SL] BBB (pronounced S L triple B[1]) with stable outlook for Liberty Holdings Limited ("LHL"/ "the Company").

ICRA Lanka has taken a consolidated view on Colombo Land & Development Company PLC (CLAND), which is the parent company of LHL and LHL's subsidiary, Liberty Developers (Pvt) Limited (LDPL), given that the companies operate in the same line of business – owning and leasing of retail, commercial and residential assets – and as the cash flows from LDPL are expected to be available for LHL's debt servicing as per the proposed borrowing documents.

The assigned rating primarily factors in the brand name and the vintage of the single asset held by the Company - Liberty Plaza mall - with its status as Sri Lanka's oldest mall; strong promoter group with the holding company having representation from Urban Development Authority (UDA) of Sri Lanka, as well as foreign investors; and the expertise of a professional management. ICRA Lanka also takes into account the recent renovation of the Liberty Plaza mall and the development of the Liberty Plaza Retail Podium, adjoining the old mall, which have helped the mall to retain its position as one of Colombo's premier shopping destinations. Post the renovation, the company has signed lease agreements for almost the entire retail space available with retail majors and lifestyle brands. The rating factors in the healthy occupancy levels and the lease rental rates (signed with the clients), and the lock-in periods incorporated in a large number of client lease agreements which has provided revenue visibility and stability in the short to medium term.

These rating strengths are partly offset by the large capital expenditure that was incurred in the recent past towards the renovation of the property which had been funded through related party loans from the Group; the company proposes to refinance the debt through a borrowing program. The rating also considers the past high maintenance charges, which in turn strained LHL's profitability levels. Going forward, ICRA Lanka will continue to monitor the impact of maintenance charges on the profitability levels of the company. Notwithstanding the current higher occupancy levels witnessed in both Liberty Plaza and Liberty Plaza Retail Podium the company has signed short term lease agreements with certain clients, exposing the company to risk of future vacancies and less than optimal rental escalation. ICRA Lanka notes that the current competition is relatively low as the only comparable high end retail destinations in Colombo are the high streets; nevertheless, there are a few prime commercial properties under development and hence Liberty is expected to face elevated competitive intensity going forward. The rating also factors in the high revenue concentration given the large area taken up by few anchor clients. The rating further considers the cyclicality inherent in the real estate segment and the strong linkage of commercial/retail real estate performance to the country's economic outlook and macroeconomic indicators.

LHL proposes to refinance the debts availed from the parent through a borrowing program. The profits from LHL (rental income less expenses) and dividend income from LDPL will be channeled towards the coupon payments and capital redemptions. ICRA Lanka notes that the projected cash accruals from

[1] *For complete rating scale and definitions please refer to ICRA Lanka's Website www.icralanka.com or other ICRA Rating Publications*

operations, assuming current occupancy levels and lease rental rates, are fairly inadequate to cover the capital redemption requirements. Though the company is part of a larger group with easy access to markets for funding, the Group has other large development plans and hence the support to LHL for refinance might be limited. Hence the company is exposed to the market and refinancing risks; nevertheless, the stable cash flows projected beyond the proposed debt tenure, availability of multiple units-facilitating the ease of sale and the high valuation of the property are expected to aid the company in refinancing any shortfall.

Business and Competitive Position: Liberty Plaza shopping mall, located at Colombo, is a premium retail destination offering visitors a wide range of the consumer and electronic goods at very affordable prices. The total floor area of the Mall is 346,670 Sqr. Ft and has 335 units (of which, 139 units are owned by the Colombo Land Group). Roughly 85% of the total space is taken up by retail units whereas majority of the remaining space comprises of offices, apartments and parking. LHL owns around 65% of units (of the group), while the subsidiary (LDPL) and the parent (CLAND) own the rest.

The mall has recently been renovated with a newly developed section called Liberty Plaza New Retail Podium. The tenant portfolio of LDPL (which houses only the newly developed portions) includes international & local premium brands: Avirate, Coffee Bean, Basilur Tea, Paris Boutique, Shirt Works, Nike, Giordano, PEPE, Levi's, International Watch Station, Uptown Kandy & Burger King etc. The tenant portfolio of LHL (the renovated portions of the old mall), include Mobitel, Dialog, W.A. De Silva & Com, Hameedias, Torana Music, Albert Edirisinghe Opticians, Kapruka and etc.

The main revenue sources of the Company are rental revenue received from the clients and the advertising revenue from the media wall (LED screen + manual panels). Lease agreements with all the tenants are on the basis of monthly rentals to be paid during the agreement term - the maintenance fee, which is approximately LKR 65 per square feet is included in the monthly rentals. Under LDPL, more than 50% of the tenants have more than four years lease agreements, also under LHL the lease agreements which are more than four years, accounted up to 44%.

The current occupancy levels of the mall are very healthy with only very few small units yet to be leased. The company has also been able to command healthy rentals from the new lessees and hence the overall rental revenue has increased significantly in the recent past following the renovation. The rentals flow in from a large number of clients, the company faces some degree of concentration as the anchor store constitutes a major portion of the area leased and revenues. However, the anchor tenant -Uptown Kandy has signed the lease agreement for a period of 10 years thereby minimising the risk of revenue volatility.

Financial Position: LHL, on a standalone basis, has been recording rental income from the mall property over a number of years. The revenue growth was muted till FYE December 2015 (rental income of LKR 75.6 Mn as against LKR 70.5 Mn in FYE December 2014) as the renovation was not completed and the old tenants were paying lower lease rentals. However, post FYE December 2015, with the signing of new lease rentals, the rental income of LHL has increased substantially which would also result in higher profitability. Notwithstanding the periodic revaluations of the investment property resulting in healthy net worth, the company's debt structure with the proposed debt program, is expected to remain subdued at the standalone level.

LDPL was a subsidiary of the ultimate parent – Colombo Land & Development Company PLC (CLAND) – and had undertaken the renovation of the mall through funding from the parent. The Group has, however, been restructured during the current financial year and as a consequence, LDPL has become a wholly owned subsidiary of LHL. LDPL houses the newly constructed sections of the mall which have been leased to retail majors at high per square feet rates. The company started recording rental income only from FYE December 2015 and the growth in income is expected to be substantial as most of the units were occupied only in FYE December 2016. CLAND has transferred its related party loans (availed to LDPL), to LHL through a restructuring exercise in May 2016. Therefore, LHL's capital structure would remain relatively adverse until any additional capital proceeds are brought in at LHL level.

On a consolidated basis, ICRA Lanka estimates that LHL & LDPL would report operating income upwards of LKR 400 million in FYE December 2017. As detailed in the earlier section, the cash flows are expected to be applied towards proposed debt repayments. Albeit, the company's efforts to transferring LDPL income through a tax efficient way, the dividend distribution taxes (if passed on as dividends), would also impact the cash flows as profits from LDPL are proposed to be up streamed to LHL for debt servicing. Given the quantum of estimated profits and the proposed borrowing program to be issued, capital redemption of the proposed borrowing program could require part-refinance/roll over of the debt unless additional capital is brought in through a new capital raising exercise.

Company Profile;

Liberty Holding (LHL), is a 100% owned subsidiary of Colombo Land & Development Company PLC (CLAND). LHL is a real estate development company primarily engaged in leasing out property and developing investment properties in the country. After the restructuring of the group of companies, LHL holds 100% stake in Liberty Developers (Pvt) Ltd (LDPL). The Group owns and manages Liberty Plaza which houses nearly 335 commercial units consisting of retail outlets, office spaces and residential apartments extending to 346,670 sq.ft of which, 60% is owned by Colombo Land Group in the post restructuring exercise. The Group has recently revamped the existing building with an extension of floor area.

Liberty Developers (Pvt) Ltd (LDPL) was a 100% owned subsidiary of Colombo Land & Development Company PLC before the recent restructuring process. LDPL is a BOI registered company and has a tax holiday of 6 years. The Liberty Plaza Revamping Project was undertaken by Liberty Developers (Pvt) Ltd.

Group Restructuring Program;

The Group has recently undergone a restructuring exercise targeting to de-leverage at the holding company level (i,e. CLAND) and further enabling the Group's business performance. The recent restructuring program includes the following transactions; 1, capitalization of LKR 1.3 Bn payables to CLAND from LDPL by issuing additional shares of LDPL. 2, subsequently, transferring 100% of the shares held by CLAND in LDPL to LHL for LKR 2.03 Bn, which was partly settled by issuing additional shares and the balance cash consideration of LKR 1.4 Bn is payable to CLAND by LHL before CY 2016. 3, CLAND has invested close to LKR 5.2 Mn to increase its stake up to 100% in Agrispice Pvt Ltd and Anantya Global Solutions (Pvt) Ltd respectively, which were partly held by LHL.

On a standalone basis, for the FYE December-2015, LHL reported a net profit of LKR 226.1 Mn on a total income of LKR 380.2 Mn (including the revaluation of investment property of LKR 304.6 Mn) compared to a net profit of LKR 38.9 Mn reported on a total income of LKR 124.6 Mn in FYE December 2014.

LDPL has started its operation in CY2015 and on a standalone basis, for the FYE December 2015, LDPL reported a net profit of LKR 725.5 Mn on a total income of LKR 1,177.8 Mn (including revaluation of investment properties of LKR 1,130.6 Mn).

Group Overview:

Colombo Land and Development Company PLC is a real estate development company, primarily engaged in leasing out investment property under operating leases and the development of investment properties in Sri Lanka. The company was incorporated in 1981 as a joint venture between Urban Development Authority of Sri Lanka (UDA) and Clarisssa Private Ltd of Singapore to undertake urban development in the country. The Company was listed in 1986 and the share structure has changed after the company was listed and currently, the UDA ownership is 17.45%.

The company owns Sri Lanka's first shopping mall, Liberty Plaza, which has been recently renovated and extended to give it a modern shopping experience. A new building, with integrated multimedia and LED lighting wraps around the dated shopping podium block. The Pettah Commercial Development, which is currently under approval, proposes a complete urban renewal project.

On a consolidated basis, for the FYE December 2015, CLAND reported a net profit of LKR 1,356.8 Mn on a total income of LKR 2,237.3 Mn (including the revaluation of investment property of LKR 2,027.4 Mn) compared to a net profit of LKR 153.0 Mn reported on a total income of LKR 419.1 Mn (including the revaluation of investment property of LKR 269.5 Mn) in FYE December 2014.

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