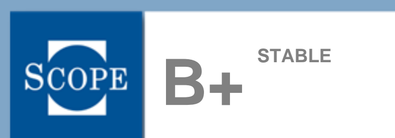
LP Portfolio Kft
Hungary, investment holdings



Corporate profile

LP Portfolio (LP) is a small Hungarian investment holding company. It is owned by Peter Lakics, one of the proprietors of family-owned Lakics Gepgyarto Kft, which also forms one leg of the three-division LP holding company. The holding company was founded in 2000 reflecting the proprietor's ambition to diversify his ownership in Lakics Gepgyarto (33%) by building exposure in solar energy and real estate. LP today is an unlisted holding company consisting of about 30 companies with around HUF 6.8bn (EUR 22m) in asset value.

The company's investment philosophy focuses on holding majority positions in three defined industrial sectors (engineering, solar energy and real estate). LP aims to develop the participations to dividend-paying status as part of its long-term 'buy-and-hold' approach.

Key metrics (based on holding company accounts)

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
Total recurring cost cover (x)	1.0	19.5	5.4	4.1
LTV (Scope-adj. debt/ portfolio market value) (%)	-	-	26	43
Liquidity (%)	>1,000	>1,000	>1,000	>1,000

Rating rationale

Scope Ratings affirms the issuer rating of B+/Stable to Hungary-based holding company LP Portfolio Kft (LP). The senior unsecured debt category is affirmed at BB-.

The ratings reflect our view on LP's robust financial risk profile in light of comparatively high recurring cost coverage rates. The ratings thus continue to be supported by the holding company's good recurring income generation going forward and its lean cost structure. The ratings also reflect our view of LP's conservative 'buy-and-build' investment approach around a somewhat diversified number of target sectors in largely non-cyclical industries (steel processing, solar energy, and real estate). The present coronavirus crisis does not appear to have impacted operations significantly so far, with the exception of some rental fee delays from smaller tenants in the new Kaposvar shopping center. Family ownership is another plus for the ratings as it implies a conservative financial policy and good transparency, in our view. The holding company's overall size is a restraining factor. LP placed a HUF 2.5bn bond under the MNB's Funding for Growth programme in early 2020. The issue of another HUF 1bn bond is envisaged later this year.

LP's investment strategy focuses on building diversified income streams in the long run around the 100% owner's (Peter Lakics) 33% interest in family asset Lakics Gepgyarto (heavy steel structures – engineering).

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB-

Analysts

Olaf Tölke
+49 69 6677389 11
o.toelke@scoperatings.com

Related Methodology

Corporate Rating Methodology

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Portfolio diversification – a very important ratings driver in our assessment of holding companies – has already benefited from the attractive investment environment for solar power plants in Hungary with regulated feed-in tariffs. We view the successful build-up of LP's solar energy position in particular as essential to lessen dependence on the owner's legacy family business. In addition, LP's real estate exposure has markedly improved in size over the past year, reflecting investments in the shopping centre mentioned above (Petöfi) as well as the acquisition of real estate in a Budapest hotel project to be developed by LP. This has addressed the former concentration on two segments (steel processing and solar energy), making the holding company's overall diversification across all group segments more balanced at the end of 2020.

The rating reflects no major expansion into additional – potentially cyclical – sectors. The issuance proceeds of the two bonds combined (HUF 3.5bn) has already and will continue to fund growth in the real estate and solar energy sectors. The rating also reflects the still comparatively limited amount of debt on LP's balance sheet after the bond issuances. The two bonds are likely to be the only financial debt on the balance sheet. Credit metrics continue to be relatively good in a holding company context. We focus on the total coverage of holding company costs by recurring income generated. This ratio is expected to be around 5x and 4x for 2020 and 2021, respectively. These comparatively high levels are explained by fairly large dividend income, chiefly from the solar sector companies – which already started paying dividends in 2019 – covering holding company cost structures which are still relatively lean.

We expect costs to increase in 2020, mainly reflecting the bond's coupon payments as well as fees and additional staffing expenses. However, we believe that LP can achieve the cost coverage ratios in our base case, reflecting high visibility of the energy sector's dividend income (the operational licenses and guaranteed feed-in tariffs for the 20 small solar energy power plants owned by LP are valid until 2041/42). The holding company's cost structure also benefits from no dividend payments to the owner. The rating incorporates our assumption that this will not change in the next two to three years at least.

We believe LP's liquidity situation is adequate, reflecting no short-term debt maturities and increased cash generation.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that LP's business and financial risk profiles will not change significantly in the next one to two years. It further reflects our view that total costs can be covered by recurring income of at least 1x on a sustainable basis. It also reflects the assumption that the usage of proceeds from the existing MNB bond as well as from a potentially new one, reflecting the only debt of the company, will continue to be for the expansion of LP's investment portfolio into real estate and solar assets. For a potential positive rating action, we would expect improvements in the holding company's business risk profile with improved concentration risks and significant growth of the investment portfolio. Rating downside could be triggered by total cost coverage dropping to 0.8x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Conservative buy-and-build strategy • Non-cyclical underlying industries • Strong cost coverage ratio	• Limited overall size • High dividend concentration • High domestic exposure • Key person risk

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in concentration risk	• Inability to maintain total cost coverage of 0.8x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
Total cost coverage from recurring income (x)	1.0	19.5	5.5x	4.4x
Total cost coverage including non-recurring income (x)	1.0	21.7	5.4	4.1
LTV (%)	-	-	26	43
Liquidity (%)	>1,000	>1,000	>1,000	>1,000
Cash flows (HUF m)	**2018**	**2019**	**2020e**	**2021e**
Recurring cash inflows	8.5	694	606	602
Non-recurring cash inflows	0	0	859	0
Balance sheet/ indebtedness (HUF m)	**2018**	**2019**	**2020e**	**2021e**
Net asset value	3,784	4,516	6,800	6,800
Gross financial debt	0	0	2,500	3,500
less: available cash	0	52.1	705	562
Guarantees and suretyships	0	0	0	0
Scope-adjusted debt (SaD)	0	-52.1	1,795	2,938

Business risk profile

Conservative investment approach

LP has a long-term, value-oriented 'buy-and-build' investment approach, involving operational control at subsidiary level. As a consequence, divestitures are rare but can be used opportunistically. This is also reflected by the company's targeting of majority positions which allow control. The holding company has used its own balance sheet in the past to fund and finance subsidiaries. The planned bond will be issued by LP to fund expansion into the real estate and solar energy segments.

LP is focused on generating dividend income from its main subsidiaries in the medium term. At present this is only the case for one company (Solar FM). While the likelihood of being able to upstream dividends from the 20 small (0.5 MW) power plants is low in the development phase, regulation allows for this to happen in later development phases. LP therefore has a phased 'dividend expectation' model, depending on the maturity and cash generation cycle of the individual project. On a group level, we continue to expect relatively strong dividend generation for the next few years. Sizeable Solar FM dividends of HUF 616m and HUF 500m were already received in 2019 and 2020. The other holdings are expected to contribute in the following years.

We assess LP's investment approach as conservative and less risky than a more timing-sensitive trading approach. The lean cost structure (no dividend payments to LP shareholders foreseen) makes adequate cost coverage relatively independent of the overwhelming part of dividends received.

Main portfolio companies

Steel processing

Lakics Gepgyarto Kft; Lakics Vagyonkezelö Kft; Acel 235 Kft. (33% ownership of the first two companies and 40% ownership of Acel; 2019 segment sales: HUF 6.9bn; EBITDA margin: 12%): Lakics Gépgyártó is a manufacturer of engines and generator housings, bearing shields, structural parts for tunneling equipment, and industrial drive housings. The split between serial and project-related production is around 50/50. Lakics Gepgyarto has three factories in Kaposvár, Komló, and Sántos (all located in Hungary). In 2018 the company employed 235 people. Lakics' products are used in the energy sector (around 95% of total revenues). The main customers are Siemens and General Electric.

Solar energy

Helios Solar Kft; Acel 02 Kft; Solar FM Kft. (100% ownership throughout, 2019 segment sales: HUF 3.2bn; EBITDA margin: 35%): Construction and operation of solar power plants; Acel and Helios own 20 0.5MW solar power plants.

Real estate

LPRE Commercial Kft; LP Broadway Kft; Broadway Portfolio Kft, Almassy Invest Kft (new) (100% ownership of the first two companies and 74% ownership of the third; 2019 segment sales: HUF 77m; EBITDA margin: 85%)

Credit-supportive industry mix in holdings portfolio

LP's exposure to three different industries supports its business risk profile. Solar energy (state-guaranteed uptake and tariffs) and commercial real estate are relatively non-cyclical sectors with low correlation. To some extent, this also applies to engineering (project background), which is not overly sensitive to underlying macro-economic developments. The majority of industries represented in the portfolio thus have low and medium cyclicality.

The company's largest exposure – by estimated asset value – was to the solar energy and engineering segments in 2019, with about 90% exposure. This has changed in 2020,

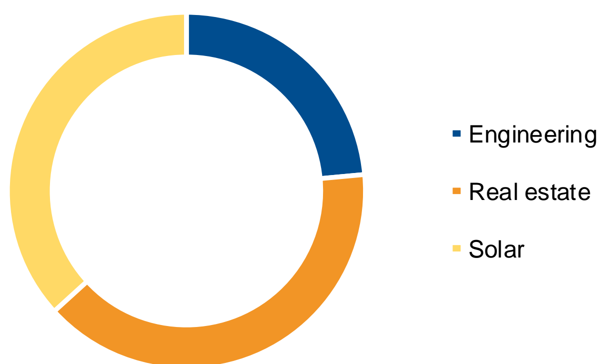
as expected, via investments in real estate. We expect the year-end 2020 split to be more balanced between the three divisions.

Given Hungary's chronically tight energy supply situation, the state has developed a protective subsidy system for renewable energy producers. In solar energy, LP therefore benefits from a protected domestic business model in Hungary, mandatory purchase system for existing solar plants (KAT) and guaranteeing power take-off under the METAR system (Renewable Energy Support Scheme), which came into force in January 2017. It consists of a guaranteed feed-in tariff, a 'green premium' granted without tendering for the small sizes LP has (0.5 to 1 MW). The eligibility period and maximum amount of eligible electricity generated are determined for each electricity producer individually by the Hungarian Energy and Public Utility Regulatory Authority. LP's solar energy assets have a remaining life span of about 21-22 years under the protective regulations. The guaranteed volume and pricing regulations will protect the holding company's income generation in the coming years.

The first licenses (25 years) were granted in 2016/17 but this window of opportunity closed in 2018. LP will bid for the new, additional licenses (15 years) up for tender from now.

A blended mix of A is representative of LP's current industry portfolio. The rating reflects no major expansion into additional – potentially cyclical – sectors

Figure 1: Segment breakdown 2020E (est. net asset value)



Source: LP

High concentration risk

We do not assess portfolio diversification purely in terms of a group's number of shareholdings. We also evaluate asset quality, underlying industry exposure, geographical exposure, concentration risk embedded in dividend exposure and net asset value.

Portfolio diversification – a very important ratings driver in our assessment of holding companies – has already benefited from the attractive investment environment for solar power plants in Hungary with regulated feed-in tariffs. We view the successful build-up of LP's solar energy position in particular as essential to lessen dependence on the owner's legacy family business. In addition, LP's real estate exposure has markedly improved in size over the past year, reflecting investments in the Petöfi shopping centre as well as the acquisition of real estate in a Budapest hotel project to be developed by LP. This has addressed the former concentration on two segments (steel processing and solar energy), making the holding company's overall diversification across all group segments more balanced at the end of 2020.

While LP's present exposure to comparatively stable and non-cyclical sectors (relative to GDP) supports the ratings, the holding company's still-limited scale does not. We

estimate that LP's net asset values are well below HUF 10 bn, including the planned investments enabled by the HUF 2.5bn bond proceeds under the MNB's Funding for Growth programme and the envisaged follow-on bond of HUF 1bn under the same programme. However, concentration risk remains very high with regard to dividend income. Solar energy company Solar FM has continued to provide all of 2020's expected dividend income, with other participations projected to start paying dividends in the following years.

This situation has culminated in 100% dividend concentration from Solar FM in the last two years. However, the dividend concentration issue is not overly severe for LP in our view, because its cost position is still lean enough to allow for about 1x coverage if the Solar FM dividend is excluded for 2020 (see financial risk profile section).

All of the holdings are unlisted companies. This may appear negative in terms of LP's ability to extract divestiture proceeds if needed. However, it also affords independence from market-timing requirements and potential stock price volatility. LP is thus not overly dependent on divestiture proceeds, given its comfortable cost coverage. At the same time, the owner has not excluded opportunistic divestitures if the need arises.

Neutral corporate governance

We assess corporate governance as neutral to the ratings. While Peter Lakics is the sole owner, we see the holding company as a typical owner-run, family-value company with a lack of traditional governance bodies like supervisory boards etc. We have not identified any governance concerns from a ratings perspective.

Financial risk profile

Solid credit metrics

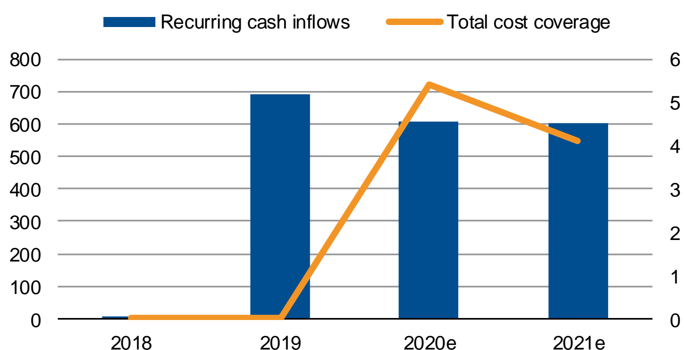
The rating continues to reflect the holding company's very strong cost coverage ratios. In the past, LP had a limited amount of debt on its balance sheet as most expansion was equity-funded. The HUF 2.5bn bond issued in early 2020 was therefore the first sizeable amount of debt in LP's history. Including this debt, credit metrics continue to be comfortable in a holding company context. We expect our key ratio of total coverage of holding company costs by recurring income generated to be around 5x and 4x for 2020 and 2021, respectively. The comparatively high levels continue to be generated by fairly high dividend income – chiefly from the solar sector companies, which already started paying dividends in 2019 – covering cost structures which are still quite lean.

We expect costs to increase in 2020, mainly reflecting the bond's coupon payments as well as fees and additional staffing expenses. However, we believe that LP can achieve the cost coverage ratios in our base case, reflecting the high visibility of the energy sector's dividend income (the operational licenses and guaranteed feed-in tariffs for the 20 small solar energy power plants owned by LP are valid until 2041/42). The holding company's cost structure also benefits from no dividend payments to the owner. The rating incorporates our assumption that this will not change in the next two to three years at least.

Given LP's high dividend concentration, we also performed a sensitivity analysis.

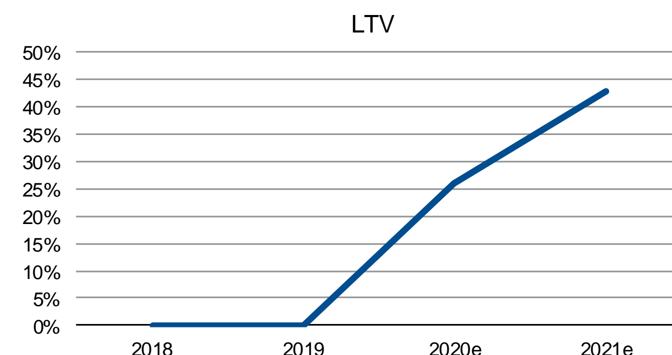
Total cost coverage without the Solar FM dividend (excluding the HUF 500m dividend from 2020 income) would result in a projected 2020 holding company income of about HUF 110m. Compared to projected holding company costs for the same year of about the same dimension, cost coverage would still be roughly 1x. Total costs are expected to increase in 2020 in a year-on-year comparison, mainly reflecting coupon payments for the newly placed bond as well as personnel expenses.

Figure 2: Improving recurring income



Source: Scope estimates

Figure 3: LTV projected to rise due to new bonds



Source: Scope

Projected LTV of about 40%

We forecast that the loan/value ratio (LTV) is likely to increase to about 40% in the coming years, reflecting larger debt positions (the placement of the additional HUF 1bn bond) plus growing cash derived from dividend income. We kept the portfolio's asset value constant at about HUF 7bn in this calculation.

Superior recovery prospects

As part of our recovery assessment, we calculated a liquidation value of about HUF 3.4bn in a hypothetical default scenario in 2021. This value is calculated by applying a 50% discount to the estimated net asset values of LP's participations, reduced by 10% for insolvency costs. This provides a recovery rate of more than 80% for the two combined HUF 3.5bn bonds, translating into a superior expected recovery for senior unsecured debt and qualifying the bond ratings for a two-notch uplift from the issuer rating. While this reflects LP's growing investment portfolio and the recoverability of existing solar plants (primarily equity-funded), which are operated under regulated tariffs, we have limited the bond ratings' upside to one notch (at BB-) given the issuer's low rating on an absolute scale amid overall size considerations.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

London

3rd Floor
111 Buckingham Palace Road
UK-London SW1W 0SR

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer

© 2020 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Analysis GmbH, Scope Investor Services GmbH and Scope Risk Solutions GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.

Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Guillaume Jolivet.