20 June 2022 Corporates

JSC Atsinaujinancios Energetikos Investicijos

Republic of Lithuania, Investment Holding Company

B+ STABLE

Key metrics

		Scope estimates		
Scope credit ratios	**2021**	**2022E**	**2023E**	**2024E**
Total cost cover	0.3x	0.2x	0.5x	1.5x
Loan to value	5%	26%	26%	21%[1]
Liquidity	No short-term debt	Negative	No short-term debt	No short-term debt

Rating rationale

The issuer rating of JSC "Atsinaujinancios Energetikos Investicijos" (AEI), a closed-end fund for informed investors, is well supported by its business risk profile. AEI's creditworthiness is supported by its indirect investments in renewable energy generation assets (solar and wind) in Poland and Lithuania through its shareholder loans to its portfolio companies. While the capacity of operated power generation assets held by the portfolio companies is small (67 MW) and not overly granular, the ramp-up of the portfolio to an expected total capacity of over 300 MW will likely provide more diversified cash streams and reduce concentration risks.

The issuer rating remains constrained by a financial risk profile that is weaker than the business risk profile, which we assess conservatively, particularly during the investment ramp-up phase. This is strongly driven by our view that AEI's total cost coverage will remain at 0.5x-0.8x, implying that recurring cash income, such as interest and dividends from main investments (shareholder loans to portfolio companies), cannot cover all costs at holding company level. We therefore expect AEI to remain reliant on its cash buffer, external funding and, potentially, asset sales over the next three years. Liquidity risks are limited during that period. Yet cliff risk regarding refinancing at holding company level at the end of 2025 is significant and would necessitate the sale of portfolio companies expected to be placed under the green bond programme.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation of a significant portfolio ramp-up through the construction of renewable generation assets within AEI's portfolio companies in Poland and Lithuania, backed by AEI's provision of shareholder loans. This will be accompanied by a significant increase in AEI's loan/value ratio (LTV) to up to 26%. Until 2024, we expect recurring cash income (from interest on shareholder loans and dividends) to be insufficient to cover costs at holding company level.

A negative rating action would be considered if AEI's total cost coverage remained at the lower end of the expected 0.5x-0.8x. This could be the result of lower-than-expected cash-interest income from portfolio companies, triggered by an underperformance of power-generating assets or construction delays that endanger the timely payment of interest to AEI. Moreover, a default of a portfolio company could trigger a cross-default, which could result in a significant deterioration of AEI's liquidity profile.

A positive rating action is possible if AEI's total cost coverage could be expected to improve above 0.8x on a sustained basis, bolstered by cash-interest income from shareholder loans or extraordinary dividends in cash from portfolio companies.

[1] This value has been amended on 23 June 2022. In the original publication the value was 26%.

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

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Related Methodology

Corporate Rating Methodology; July 2021

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Positive rating drivers	Negative rating drivers
• Supportive regulatory framework and favourable investment environment as Europe seeks to reduce dependence on Russian energy • Locally diversified projects in Poland to be enhanced as projects in Lithuania are finalised • Acceptable envisaged diversification in terms of projects that provide recurring revenues • No significant upcoming debt maturities over the next few years • Creditor protection through a detailed set of covenants, e.g. financial covenants, dividend restrictions • LTV during ramp-up of the investment portfolio expected at about 26%	• Cost coverage ratio from recurring cash income of below 1x in the significant portfolio ramp-up phase • Incomplete portfolio ramp-up, which limits transparency of the business and financial profile • Revenue of the shareholdings will derive mainly from unregulated power market prices or power purchase agreements • Potential cliff risk regarding debt refinancing at holding company level at the end of 2025

Positive rating-change drivers	Negative rating-change drivers
• Improved total cost coverage of more than 0.8x	• Total cost coverage persisting at the lower end of the anticipated 0.5x-0.8x • Default of a portfolio company that triggers early refinancing at the holding company and liquidity constraints

Corporate profile

AEI is a closed-end fund targeted at professional investors. It manages renewable energy assets, primarily solar and wind in Lithuania and Poland. The company was established in December 2020 and is managed by Lords LB Asset Management.

Lords LB Asset Management is an AIFM-licensed fund manager established in 2008. It manages 12 real estate funds, two investment companies, one private capital fund and one energy and infrastructure fund. Its total value of assets under management is EUR 730m as of December 2021. Part of AIE's long-term investment strategy is to increase renewable energy asset production capacity to 1,000 MW. Currently, AEI has projects in Lithuania and Poland in various stages of development.

Figure 1: Asset structure by development stage, December 2021

Source: AEI

AEI's investment strategy focuses on renewable energy, primarily ready-to-build or construction-stage solar and wind projects. The maximum target size of a single investment is EUR 20m with target leverage of 70%-75% per investment. Generated electricity is sold to government-backed schemes and investment grade off-takers via long-term fixed or partially fixed power purchase agreements.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Total cost cover (from recurring cash income)	0.4x	0.3x	0.2x	0.5x	1.5x
Total cost cover (including extraordinary cash income)	0.4x	0.3x	0.2x	1.9x	1.5x
Loan-to-value (Scop-adjusted debt/portfolio market value)	4%	5%	26%	26%	21%
Liquidity (%)	Negative	No short-term debt	Negative	No short-term debt	No short-term debt
Cash flows in EUR m					
Recurring cash inflows (dividends and cash-interest from shareholder loans)	0.1	0.6	1.9	7.2	8.6
Non-discretionary cash outflows (including net interest payments)	0.2	2.1	9.6	13.9	5.8
Portfolio market value in EUR m					
Net asset value	30	65	101	97	101
Gross asset value	32	69	136	131	128
Scope-adjusted debt in					
Reported gross financial debt	1.7	30.2	64.9	64.9	64.9
less: subordinated (hybrid) debt	0.0	0.0	0.0	0.0	0.0
less: cash and cash equivalents	-0.4	-26.5	-29.8	-30.7	-38.0
add: non-accessible cash	0.0	0.0	0.0	0.0	0.0
add: pension adjustment	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	**1.2**	**3.7**	**35.1**	**34.2**	**26.9**

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Environmental, social and governance (ESG) profile[2]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Investment in renewable energy assets

All of AEI's investments are channelled into portfolio companies that operate renewable energy assets in either Lithuania or Poland, countries with a chronic shortage of electricity generation capacities and a significant deficit in annual electricity generation (net importers). Poland particularly is catching up on the transition towards clean energy (credit-positive ESG factor). Overall, we expect tailwinds for AEI's business model and portfolio companies.

Attracting money flows that are directed into sustainable power generation

The focus on renewable energy generation assets has allowed the holding company to attract green bond funding and direct equity contributions, which support its growth and investment ambitions.

Weakness regarding provided transparency

While Scope understands that a closed-end fund's investment strategy is dynamic, aimed at an opportunistic, the transparency that AEI has provided to Scope on its budgeting and investment strategy has been sub-optimal. Nonetheless, we don't see a significantly credit-negative rating impact related to Governance factors that need to be flagged explicitly. But overall this led to a conservative assessment of the FRP and the issuer rating.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB-

Industry risk profile: BB

AEI's business remains completely exposed to regulated power generation secured in the form of Poland's 'contract for difference' auction scheme and Lithuania's feed-in tariffs. However, the assigned industry risk profile rating of BB already reflects a discount related to the strong future addition of unregulated generation capacities, which will be operated under long-term power purchase agreements or sold on the power exchange.

Favourable regulatory regimes for renewable energy in Lithuania and Poland

AEI's countries of operation, Poland and Lithuania, have set national targets for renewable energy to constitute between 21% and 51% of total energy consumption by 2030. In addition, the European Commission adopted in 2021 the EU's Clean Energy Package proposals, which set out climate, energy, land use, transport and taxation policies to reduce greenhouse gas emissions by at least 55% by 2030. As a result, Poland is financing renewable energy projects via various incentives and subsidies, such as extending its auction scheme to 2039 for the enlargement of the Renewable Energy Systems (RES). In terms of aggregate installed RES capacity, Poland expects a 20.1 GW rise (186% growth) and Lithuania a 2.3 GW rise (135% growth).

The regulatory regimes in Poland and Lithuania are beneficial for AEI. Poland's auction scheme secures a fixed income for the producer: the difference between the market price and the contract amount (auction price) of energy is covered by the government's Energy Regulatory Office if the market price is lower and by the producer if the market price is higher. This framework mitigates the risk of price changes for producers and reduces the cost of capital. This scheme is the basic and target support system for RES installations with capacity of at least 500 KW.

The feed-in tariffs in Lithuania guarantee a fixed income, provided by the government, from the sale of energy units, regardless of the market price. Consequently, AEI is not exposed to electricity price fluctuations for the duration of the feed-in tariffs. Regulations applicable in Lithuania are the Law on Renewable Energy Sources, including the Clean Energy Package from January 2022. Its main objective is to increase the share of electricity produced from RES to at least 38% of national consumption by 2025. The scheme is based on the fixed-price guarantee for certain quotas of specific RES, based on electricity generation capacities to be installed, allocated under an auction procedure. The feed-in tariff declared by the winning bidder is guaranteed for 12 years.

Poland's auction scheme applies for 15 years from the start of an asset's generation. Electricity under Lithuanian feed-in tariffs are valid until 2025 and cover a project's entire generation capacity. Only 'Saules energijos projektai', a 2.6 MW solar park, applies Lithuanian feed-in tariffs. The remaining assets under management will operate under power purchase agreements or will be sold on the power exchange through third-party energy traders. Part of the electricity produced by AEI's wind parks in 'Zaliosios investicijos' is sold under financial power purchase agreements with AXPO Nordic AS. Moreover, the company expects some of its development projects to sell electricity through long-term power purchase agreements.

Operating asset diversification focused on Poland

AEI's geographic diversification improves as new projects are ramped up or new ones started. For now, most of the investments are in Poland, which include 52 solar projects spanning seven administrative divisions (voivodeships) in northern and central Poland. Investments under development include 42 new solar projects in Poland, spread centrally from west to east, and 18 wind turbines in eastern Lithuania.

Figure 2: Operating projects in Poland

Source: AEI

Figure 3: Operating project in Lithuania[3]

Source: AEI

Figure 4: Projects in development in Poland

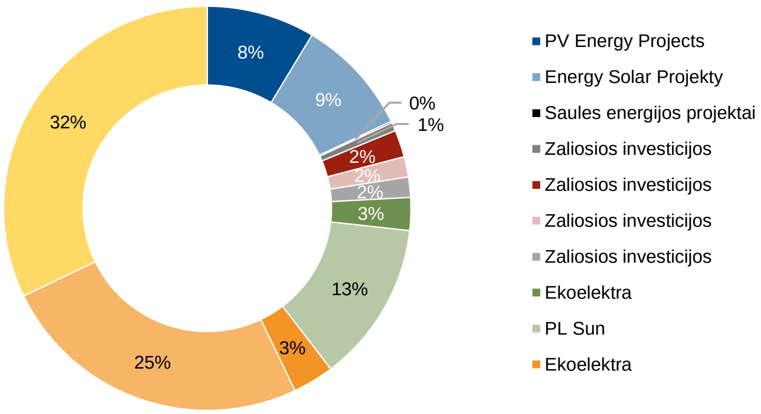
Source: AEI

Figure 5: Projects in development in Lithuania

Source: AEI

AEI's granulated power generation capacity is well diversified across Poland. This will improve with the addition of projects in Lithuania. As a result, AEI's presence in the two countries may lessen the potential negative impact of internal shocks such as from weather conditions or regulatory changes. However, AEI's diversification remains reliant on projects under development or in initial stages.

Figure 6: Capacity split by project



Sources: AEI, Scope estimates

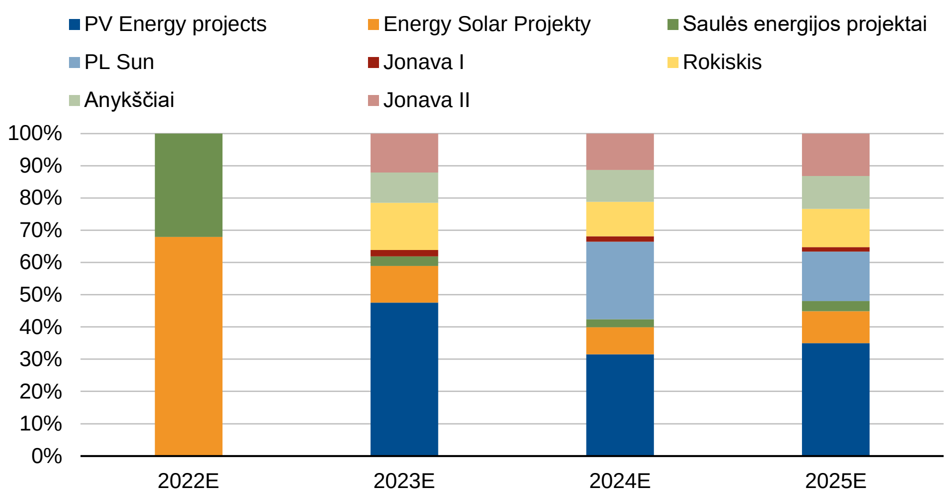
[3] This figure has been amended on 23 June 2022. In the original publication the solar icon was not included.

Concentration improves with expected portfolio ramp-up

AEI's portfolio is currently shaped by two fully operating shareholdings – Saules energijos projektai in Lithuania and Energy Solar Projekty in Poland – and three in different stages of development – Ekoelektra, Zaliosios investicijos and PV Energy Projects. However, new additions are not excluded if considered worthwhile. AEI's strategy is to create a renewable energy portfolio and sell it as a cash flow-generating infrastructure investment. Income to the holding company is provided through interest received from shareholder loans. One shareholding – Energy Solar Projekty – contributes most of the current gross asset value (40%) and interest income . As shareholdings develop, concentration risk will improve with the increased interest income (Figure 7).

Dividend income from portfolio companies is discretionary, also depending on the subsidiary and market conditions. A major source of future income is the interest received from shareholder loans. If loans are repaid, the company will consider other income streams. As shareholder loans were repaid for Saules energijos projektai, dividends were streamed up to AEI, which amounted to EUR 33,000 in 2021 and EUR 90,000 in 2020. In 2022, a dividend of EUR 950 000 is also expected from Energy Solar Projekty in Poland due to high energy prices.

Figure 7: Cash interest income 2022-2025



Sources: AEI, Scope estimates

Asset liquidity

All of AEI's shareholdings are unlisted companies with a dependence on market timing, taking into account the liquidation of AEI in 2026 or before. Unfavourable market conditions might delay the liquidation of the assets and AEI by two years, or result in only part of the portfolio being sold. This would be credit-negative in terms of liquidity. However, two aspects mitigate the lack of liquidity. Firstly, total cost coverage is not foreseen to be driven by frequent asset sales under AEI's 'buy/develop and sell' approach; asset sales are intended for covering debt maturities (liquidity). Secondly, although illiquid, renewable energy assets subject to regulated tariffs or contracted under power purchase agreements will likely find a market buyer, e.g. a utility, an independent power producer or investment fund/insurance. After the EU's implementation of its Clean Energy Package, member states have to increase their share of renewable energy use to 32% by 2030. Additionally, Europe is seeking to reduce dependency on Russian energy due to the Ukraine crisis.

Financial risk profile: B

Investment holding companies generate income from recurring dividends and non-recurring asset disposals. Our analysis of an investment holding company's financial risk profile focuses on total cost coverage, leverage as expressed by LTV, and liquidity. For details please refer to the appendix of this rating report.

AEI as a closed-end fund generates cash-income from:

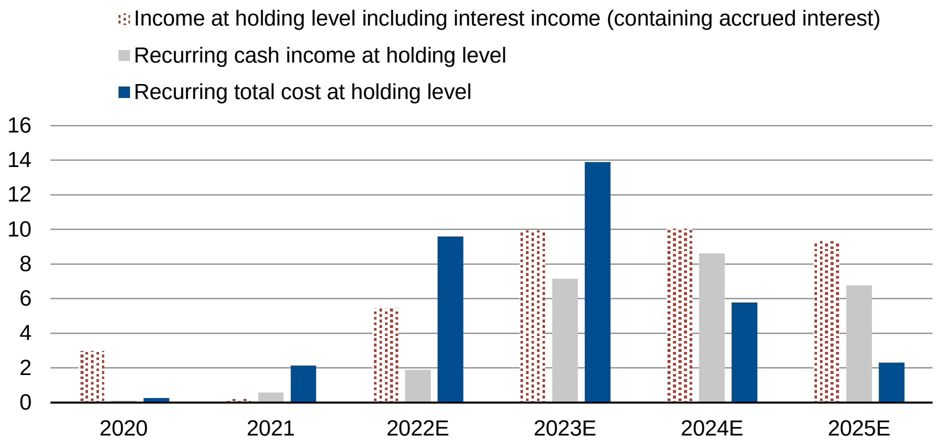
i) Interest received from shareholder loans to portfolio companies that operate renewable energy assets; and

ii) discretionary dividends if a portfolio company's results are stronger than expected.

Closed-end fund with limited lifetime

Moreover, AEI has a limited scheduled life, until 2026 with the option to extend by two years. Towards the end of this lifetime, all assets are scheduled to be sold to external parties (including other funds managed by LORDS LB Asset Management).

Figure 8: Expected cash-income to cover holding company costs after most portfolio projects finalised



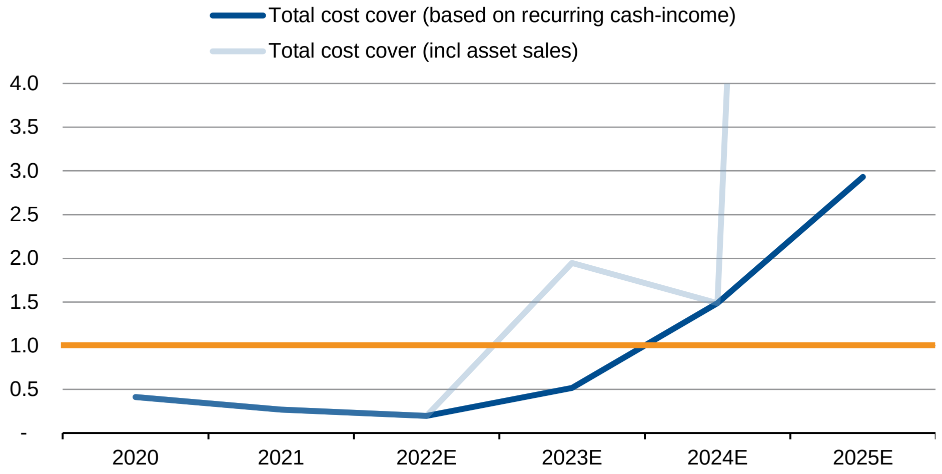
Sources: AEI, Scope estimates

Insufficient cash inflows during portfolio ramp-up

We believe that AEI will remain dependent on available cash buffers, interim asset sales before portfolio liquidation, and external funding until 2024. During this time, expected recurring cash streams related to interest and potential dividends are expected to cover only a fraction of the holding company's costs.

We do not expect full cost coverage during first few years of portfolio ramp-up. Total cost coverage based on recurring cash interest from shareholder loans and dividends will likely remain within 0.5x-0.8x over the next few years. Moreover, cost coverage is expected at the lower end of this range if AEI were to face significant cash outflows related to contingency payments resulting from a delayed start of renewable generation assets contracted under a power purchasing agreement. On a positive note, we recognise the restriction of dividend payments to AEI's shareholders in 2022 and 2023 as well as a dividend distribution that will only start in 2024 if financial covenants are met.

Figure 9: Sufficient cost coverage not ensured during first few years of AEI's lifecycle



Sources: AEI, Scope estimates

Asset sales could provide one-off cash inflows, strengthening the financial profile

The weak total cost coverage from recurring cash inflows is partially offset by the potential recognition of lump-sum cash inflows following a larger asset disposal envisioned for 2023 and 2025. However, as such asset disposals also depend on timing and achievable pricing, our rating case does not considered them recurring.

No full cost coverage expected before 2024

Total cost coverage will only reach above 1.0x from 2024 if i) the company is not facing the previously mentioned contingency payments; ii) much of the portfolio is ramped up; and iii) operating expenses related with the portfolio's development reduce. Total cost coverage will also improve in the last year of AEI's envisioned lifetime (2026) when most of the shareholder loans are expected to be redeemed following the asset disposals by the portfolio companies. However, the timing and scope of these non-recurring cash inflows remain uncertain as sales could be delayed or assets sold for less than anticipated.

Portfolio ramp-up accompanied by higher debt exposure

We expect AEI's leverage – as measured by the LTV – to increase significantly during the ramp-up phase. The holding company will use cash proceeds from external funding (e.g. capital market and equity funding) to reinvest in the shareholder loans. This is likely to cause total indebtedness in terms of Scope-adjusted debt to increase from EUR 3.7m at YE 2021 and peak to about EUR 35m at YE 2022, driven by constant payouts under the shareholder loans to facilitate the construction of new wind and solar assets. Total indebtedness can only be scaled back through asset disposals by portfolio companies and a corresponding redemption of shareholder loans (cash inflow at the holding level).

Medium-term LTV of about 26%

The expected rise in AEI's debt exposure will be accompanied by a significant increase in LTV, which we expect to grow from about 5% at YE 2021 to about 26% once the portfolio is ramped-up. We have taken the holding company's expected total asset value as a proxy for future portfolio market value, given the portfolio companies' illiquid nature and the infrequency of their market valuations. Impairments on total asset value (primarily, the shareholder loan exposure), which in turn would increase the LTV, are possible if portfolio companies cannot pay interest on their shareholder loans due to an underperformance of their operating power generation assets or lower-than-expected prices for sold electricity. However, we believe the downside risk is limited for now, with our view backed by the high energy prices in Poland and Lithuania due to chronic power shortages and the assets' expected operational performance of above the P50 value.

Financial covenants protecting against excessive leveraging

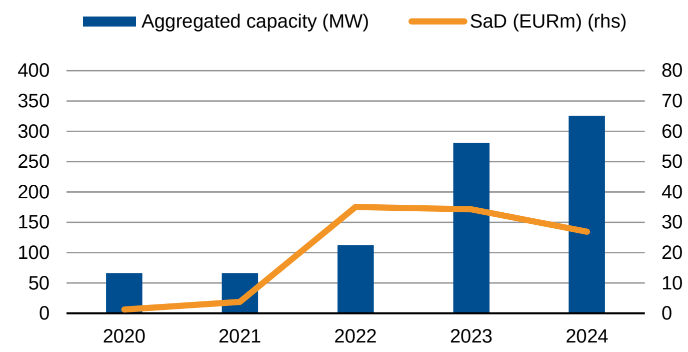
We view positively the limit on AEI's leverage through financial covenants under the Unsecured Fixed Rate Note Programme, aimed at enabling the company to raise up to EUR 100m through the placement of senior unsecured bonds. The covenants are:

- The equity ratio at the holding company level – measured as equity divided by total assets – must stay at a minimum of 50%.
- The leverage ratio must not exceed 75%, which takes into account debt of the portfolio companies and is measured as consolidated external financial debt (capital market debt plus bank loans at project level) divided by the sum of equity and consolidated external financial debt.

LTV expected to revert to 0% towards the end of the fund's envisioned lifecycle

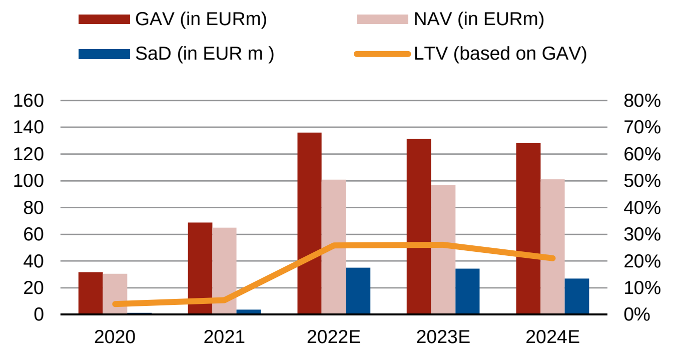
LTV is expected to improve drastically towards AEI's envisioned lifetime and the planned redemption of shareholder loans that follow the sale of portfolio companies. However, our rating case reflects the expected leverage between 2022 and 2024 because the current leveraged ramp-up phase will determine AEI's default risk and potential to breach covenants over the next few years.

Figure 10: SaD to grow with net capacity additions



Sources: AEI, Scope

Figure 11: Expected market value gearing



Sources: AEI, Scope

Strong impairment in portfolio market value needed before LTV deteriorates well beyond rating case

The holding's overall net indebtedness is expected to move in sync with the investment portfolio and expected portfolio market value, which poses limited risks regarding a significant deterioration of AEI's LTV. For the time being, impairments are low on the investment portfolio. Moreover, there is no chance of a significant increase on the holding's net debt exposure (SaD) that is not accompanied by growth in portfolio market value, given the holding's investment strategy. As such, LTV is unlikely to deteriorate to well above 50%.

No debt maturities until 2025 in the normal course of the company's development

No debt is set to mature in the short term, but the deeply negative free operating cash flow as a result of the significant portfolio ramp-up still requires external funding, planned via debt and equity. The minimum cash buffer of EUR 1.5m (under bond covenants) supports sufficient cost coverage rather than enabling the company to cover debt repayments.

Significant refinancing risk in 2025 prior to fund liquidation

While refinancing risk is limited during the ramp-up phase, cliff risk (tail risk) is significant regarding the financing of the assumed debt volume of about EUR 65m in 2025. Significant refinancing risks could arise if

i) portfolio companies cannot be sold on a timely basis and shareholder loans cannot be redeemed in full as expected before debt instruments used at holding company level mature; or

ii) the portfolio companies' selling prices and the associated redemptions of shareholder loans fall short of expectations.

While AEI can extend its lifecycle by two years (until 2028), it cannot defer the repayment of senior unsecured bonds it uses as primary funding. Consequently, AEI would need to seek bridge funding, e.g. through bank loans or an equity injection, if available funds are insufficient to cover the significant bond maturities in 2025. Such cliff refinancing risks will be clearer as the time to refinance nears.

Cross-default could trigger early refinancing on holding company level

A cross-default clause under the Unsecured Fixed Rate Note Programme sets out the triggers for early redemption of outstanding bond volumes (including accrued interest) at holding level. The triggering of such a scenario could result in portfolio companies being sold at a discount as part of a fire sale.

Adequate liquidity for the time being

For the time being, AEI's liquidity is adequate. Any early refinancing triggered by the cross-default clause – e.g. if portfolio companies perform significantly weaker than expected – and cliff refinancing risks will be more apparent as the fund's lifecycle progresses.

Position in EUR m	2021	2022E	2023E	2024E
Unrestricted cash (t-1)	0.4	26.5	29.8	30.7
Open committed credit lines (t-1)				
Free operating cash flow (t)	-31.3	-76.5	0.9	7.0
Short-term debt (t-1)	0.0	5.1	0.0	0.0
Coverage	**No short-term debt**	**negative**	**No short-term debt**	**No short-term debt**

Supplementary rating drivers: no rating impact

The issuer rating does not incorporate any impact from Lords LB Asset Management. Regular support in the form of equity injections is provided by investors for the ramp-up but no extraordinary support.

AEI's financial policy is neutral for the issuer rating. The financial policy includes: i) a free cash buffer of at least EUR 1.5m; ii) an equity ratio of at least 50%; iii) a leverage ratio limited at 75%; and iv) restrictions on dividend payments (dividends are not planned but are possible during the last two years of operations).

Long-term debt rating[4]

Above-average recovery expected

We expect an above-average recovery for senior unsecured debt issued by AEI (basically senior unsecured bonds issued under the Unsecured Fixed Rate Note Programme). We expect no debt to rank above unsecured debt at holding level. Our recovery assessment is based on liquidation value at a potential default, though the debt category rating reflects a conservative approach.

Senior unsecured debt at holding level to be recovered after senior secured debt of portfolio companies covered

In a liquidation scenario, project debt (bank loans) to special-purpose vehicles owned by portfolio companies and to which AEI has provided shareholder loans will be recovered first. Remaining proceeds from the disposal of operational and unfinished renewable energy power plants could be used to redeem the shareholder loans, which would support the recovery of senior unsecured debt at holding level.

One-notch uplift for senior unsecured debt

Our recovery analysis signals a robust, conservative advance rate for recoverable assets (e.g. 50% on expected property, plant and equipment), warranting a one-notch uplift for senior unsecured debt and leading to the BB- debt category rating.

[4] The title has been amended on 23 June 2022. In the original publication the word: "debt" was not included.

Appendix

For the assessment of an investment holding company's financial strength, we use financial data provided in the stand-alone (holding company) accounts as the source for calculating key financial credit metrics. Financial data from consolidated financials do not feed into our calculations of key credit ratios for the following reasons: i) cash flows or liquidity of portfolio companies as shown in consolidated accounts may not be accessible at the holding company level and; ii) an investment holding company may not have any influence over a portfolio company's dividend policy. We use the following key credit metrics to gauge the financial risk profile of an investment holding company:

- Total cost coverage;
- Leverage (loan-to-value, LTV);
- Liquidity.

We use total cost coverage as the key indicator. We define the total cost coverage ratio as cash inflows versus non-discretionary cash outflows at the holding company level.

Cash inflows at holding company level included in our calculation are:

- Cash inflows from portfolio companies such as dividends or cash payments triggered by profit-sharing agreements;
- Cash-interest inflows from treasury activities such as investment in debt securities;
- Distributions from other investments such as investment funds or money market funds;
- Any other recurring cash-effective payments received from portfolio companies such as management fees.

Cash proceeds from divestments in portfolio companies are only included as a cash inflow if we expect these to recur annually. Non-discretionary cash outflows included in our calculation are:

- Cash outflows from debt servicing (cash interest) and, if applicable, non-cash interest accruing on debt instruments.
- Dividend payments by the investment holding company to its shareholders. We are aware that the nature of dividend payments is more akin to a discretionary cash outflow. For the purpose of the total cost coverage calculation, we treat dividend payments as non-discretionary until the investment holding company publicly declares significant changes to its dividend payments.
- General holding costs such as administrative expenses, staff costs and taxes.

We calculate an investment holding company's leverage by taking into account the portfolio's market value relative to the adjusted debt position (Scope-adjusted debt) at the holding company level. The debt position not only includes short-term and long-term financial debt, but also adjustments for pension provisions, operating leases and other off-balance sheet items such as guarantees.

We use LTV as a supplementary ratio within the financial risk assessment. This is to avoid market prices of listed assets mechanically changing financial ratios, including the financial risk profile. We believe that changes in market prices of listed assets are only important if an investment holding company faces debt maturities over the course of the next 12-24 months. A pure focus on LTV can be misleading given that this ratio does not capture the dimension of an investment holding company's debt maturity profile. If an investment holding company can cover its non-discretionary cash outflows, as mentioned above, there is no need for additional funding. Therefore, the dependence and relevance of price changes on listed assets can only be judged with regard to debt maturities over the course of the next one to two years.

The liquidity of an investment holding company is assessed like for any other non-financial corporate, taking into account the holding company's ability to pay its short-term debt using free operating cash flow, unrestricted cash and marketable security positions, unused committed bank facilities, and unused committed factoring lines.

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