# Lexholding Zrt.
# Hungary, Investment Holding Company

SCOPE B+ STABLE

## Key metrics

| | | | Scope estimates | |
|---|---|---|---|---|
| Scope credit ratios | 2021 | 2022 | 2023E | 2024E |
| Total cost cover | 1.4x | 1.3x | 1.3x | 1.1x |
| Scope-adjusted loan-to-value ratio (LTV) | 38% | 41% | ~40.0% | |
| Liquidity | >100% | >100% | >100% | >100% |

## Key rating factors

Lexholding's issuer rating benefits from a well-balanced, diversified portfolio as well as stable management and service fees that keep interest cover robust.

The issuer rating is constrained by a limited gross asset value and a complex structure with different businesses, cross-ownerships and financing structures (credit-negative ESG factor). While we do not explicitly adjust for transparency issues in our supplementary rating drivers, we do consider them in our business and financial risk profiles assessments.

We have not made explicit adjustments for Lexholding's limited portfolio size in our supplementary rating drivers. However, we have included this factor in our overall assessment of the issuer's standalone rating by attributing significant weight to the business risk profile.

## Outlook and rating-change drivers

The Outlook is Stable and reflects our view that the company should maintain total cost cover at above 1.0x in the medium term.

A positive rating action might be warranted upon an improvement in portfolio sustainability and/or portfolio liquidity.

A negative rating action may be warranted if transparency remained limited in the medium term, mainly due to a complex organisational structure, and/or if total cost cover dropped to below 1.0x on a sustained basis. This could occur if the financial position of the dividend-paying undertakings deteriorated significantly, requiring a recovery programme and/or limiting their ability to pay dividends or management fees to Lexholding.

## Rating history

| Date | Rating action/monitoring review | Issuer rating & Outlook |
|---|---|---|
| 9 Jun 2023 | Affirmation | B+/Stable |
| 10 Jun 2022 | No Action | B+/Stable |
| 8 Jul 2021 | Affirmation | B+/Stable |
| 6 Jul 2020 | New | B+/Stable |

### Ratings & Outlook

| | |
|---|---|
| Issuer | B+/Stable |
| Senior unsecured debt | B+ |

### Analyst

Zurab Zedelashvili
+49 69 6677389 947
z.zedelashvili@scoperatings.com

### Related Methodologies/Research

General Corporate Rating Methodology; October 2023

Investment Holding Companies Rating Methodology; May 2024

### Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

## Rating and rating-change drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • Coverage of mandatory holding costs at above 1.0x, expected to be maintained in the medium term<br>• Expected increase in recurring cash inflows from management fees<br>• Majority shareholder position providing influence over dividend policies | • High concentration and limited diversification of income streams<br>• Complex corporate structure and inter-company transactions (credit-negative ESG factor)<br>• Low liquidity of undertakings |

| Positive rating-change drivers | Negative rating-change drivers |
|---|---|
| • Improvement in portfolio sustainability and/or portfolio liquidity | • Total cost cover ratio sustained at under 1.0x<br>• Limited transparency |

## Corporate profile

Lexholding Zrt. is an investment holding company majority-owned by Elek Nagy and his family. The company mainly invests in three areas: i) business services (pawnshops and art trading); ii) real estate; and iii) ground transportation (taxi operators).

The company has a long-term investment approach. This is reflected in the active role it plays on all of its investees' boards and the financial support it provides to them. However, this commitment does not rule out opportunistic disposals as Lexholding is mainly focused on recurring dividend streams from its undertakings.

The investment holding company generates significant revenue through service and management fees associated with the provision of various services to its core holdings. The services offered by Lexholding Zrt. are HR, controlling, marketing, IT, and internal auditing.

Lexholding's business model exhibits characteristics of both an investment holding company and a corporate group. The combination of minority and majority stakes in holdings as well as the receipt of dividend and management fees are characteristics of an investment holding company. On the other hand, the provision of shared services such as IT and HR indicates a corporate group structure.

We have used our investment holding methodology to assess Lexholding's credit quality. This is based on Lexholding's long-term investment approach for its strategic portfolio, with potential rotations of opportunistic assets such as commercial real estate, and a limited influence on management decisions at the level of portfolio companies.

## Financial overview

| | | | Scope estimates | |
|---|---|---|---|---|
| **Scope credit ratios** | **2022** | **2023P** | **2024E** | **2025E** |
| Total cost cover | 1.3 | 1.3 | 1.1 | 1.1 |
| Scope-adjusted loan/value ratio | 41% | 40% | 40% | |
| Liquidity | No short-term debt | No short-term debt | No short-term debt | No short-term debt |
| **Recurring cash income in HUF m** | | | | |
| Dividends form holdings | 1,331 | 1,358 | 725 | 725 |
| Interest received from shareholder loans | 459 | 692 | 643 | 643 |
| Management and service fees | 2,310 | 2,691 | 2,709 | 2,709 |
| **Recurring cash income** | **4,100** | **4,741** | **4,077** | **4,077** |
| **Total costs in HUF m** | | | | |
| Operating expenses | 2,095 | 2,738 | 2765 | 2793 |
| Taxes paid | 0 | 0 | 0 | 0 |
| Interest paid | 465 | 465 | 465 | 465 |
| Dividends paid | 500 | 500 | 350 | 500 |
| **Total costs** | **3060** | **3703** | **3580** | **3758** |
| **Scope-adjusted debt in HUF m** | | | | |
| Reported gross financial debt | 15,000 | 15,000 | 15,000 | 15,000 |
| less: cash and cash equivalents | -594 | -1,569 | -1,866 | -2,085 |
| Other items (guarantee) | 410 | 410 | 410 | 410 |
| **Scope-adjusted debt** | **14,816** | **13,841** | **13,545** | **13,327** |
| **Scope-adjusted gross asset value in HUF m** | | | | |
| Investments (as per balance sheet) | 25,593 | 26,460 | 26,660 | 26,760 |
| Short-term investments | 10,648 | 8,102 | 8,102 | 8,102 |
| **Scope-adjusted gross asset value** | **36,241** | **34,562** | **34,762** | **34,862** |

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## Environmental, social and governance (ESG) profile[1]

| Environmental | | 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)

### Corporate structure

The credit-negative corporate structure exhibits a lack of transparency driven by intra-company transactions, cross-ownerships and a complex organisational structure. While this has not led to any supplementary rating driver adjustment so far, it is reflected in our conservative assessment of the company's financial risk profile. This point is a credit-negative ESG factor for the rating.

[1] 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.

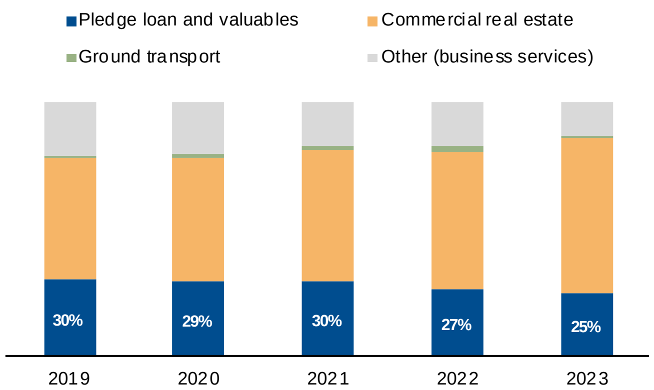
## Business risk profile: B

Lexholding's weighted average industry portfolio risk is mostly exposed to business services and real estate. Two subsidiaries of BÁV Zrt., namely BÁV Pénzügyi Zrt. and PERUN Zrt., are classified as financial enterprises2. However, we classify BÁV Zrt. as business services because it offers additional services (i.e. art trading and safe deposit box services) and operates as an umbrella of five corporates.

The weighted average industry risk based on gross asset value (60% of Lexholding's net investment value as of YE 2023) mainly reflects the mixed industry risk of commercial real estate developers (assessed at B) and that of commercial real estate (assessed at BB). This results in a high-to-medium cyclicality, medium entry barriers and high-to-medium substitution risk. These sectors primarily consist of businesses that are either directly or indirectly connected with tenant industries.

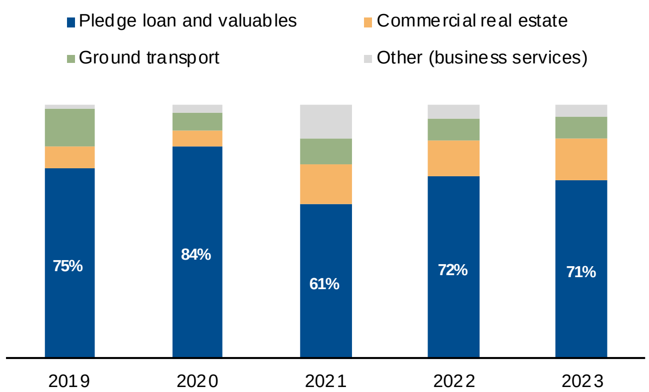
The weighted average industry risk based on income (about 71% of total cash inflows as of FY 2023) reflects characteristics of business services (assessed BBB) with medium cyclicality, medium entry barriers and medium substitution risk.

**Figure 1: Weighted average industry risk based on gross asset value**




Source: Lexholding, Scope estimates

**Figure 2: Weighted average industry risk based on income**




Source: Lexholding, Scope estimates

Lexholding's portfolio remains significantly concentrated as core holding BÁV Zrt. represents 71% of total income as of FY 2023. Our assessment of the portfolio's sustainability has focused on dividend-paying entities in order to capture the maturity of core holdings and their cash flow generation potential. Concentration by income is high as the main dividend-paying undertaking contributes over 80% of total dividend income.

The dependence of Lexholding's portfolio on BÁV-related ordinary dividends will remain significant (above 80%) in the next few years. This limits Lexholding's ability to offset the impact of a dividend not paid by one of the undertakings and hence poses the risk of volatile total cost cover.

Furthermore, Lexholding's portfolio sustainability is hindered by non-income-generating assets, primarily comprised of commercial real estate development projects. These assets offer little visibility regarding their cash generation potential, as their pipelines have long time horizons and their execution in the current market conditions is challenging.

[2] Under Act CCXXXXVII of 2013 on credit institutions and financial enterprises, financial services can only be provided by financial institutions, which include credit institutions (such as banks) and financial enterprises. The key distinction between credit institutions (banks) and financial enterprises is that the latter are not permitted to collect deposits, but they can engage in financial activities on a commercial scale.

The Hungarian commercial real estate market is experiencing increased prices and high inflation, further adding to the complexities faced by these projects.

**Figure 3: Cash income[3] by division**

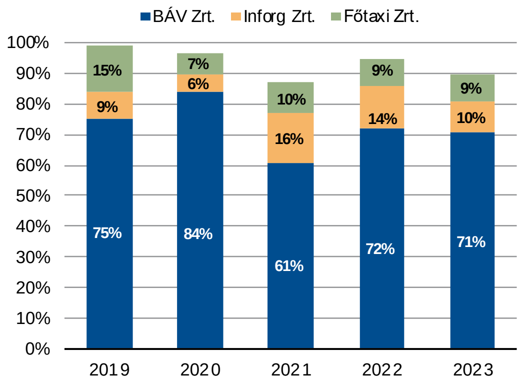
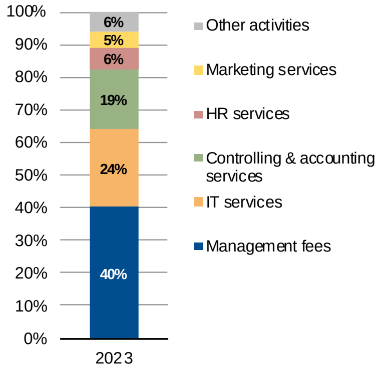
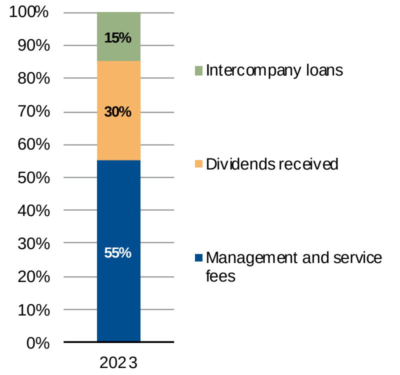



**Figure 4: Management fees and service income**




Source: Lexholding, Scope

**Figure 5: Income breakdown**




Source: Lexholding, Scope

In 2023, Lexholding came to an agreement with bondholders regarding a proposed change in the use of bond proceeds within the real estate division. The company redefined an investment strategy involving a portfolio of fully operational assets that are currently generating cash flow. The revised strategy was partially executed in 2023 via a HUF 1.5bn real estate acquisition (32,765 sqm of industrial property in Érd, Pest County) using HUF 1.25bn of invested bond capital, which enables immediate cash flow generation. Delayed investments from bond proceeds earmarked for real estate have been parked in the real estate fund for two years. This could signal a soft covenant breach.

In 2023, management fees and services constituted approximately 55% of Lexholding's cash income. The payment of management fees by the undertakings is mandatory and depends on their top-line performance rather than bottom-line profits. This provides some stability and predictability to Lexholding's cash flow. These fees are expected to further increase in the projected period as Lexholding intends to expand its provision of corporate functions to its undertakings.

Gross asset value concentration is modest. This is because the top three holdings (BÁV, INFORG and Arex fm Srl.) account for around 59% of total portfolio value and are one of the strongest component of the business risk profile.

The net investment value of the portfolio is expected to increase, with anticipated investments of approximately HUF 5.0bn in the commercial real estate sector. While this will result in a heavier dependence on the real estate sector within the portfolio, we do not expect it to lead to significant concentration.

The operations of Lexholding's core holdings are predominantly concentrated in the Hungarian market. This lack of geographical diversification exposes the company to risks associated with local economic conditions, regulatory changes and other market-specific factors, and weakens its business risk profile.

Lexholding's investment strategy includes a substantial focus on unlisted assets. Investing in such assets can present challenges in terms of liquidity. Unlisted assets typically have limited trading platforms, making it more difficult to sell or exit positions

[3] Including management and service fees, dividends and interest on intercompany loans

quickly. This lack of liquidity may hinder Lexholding's ability to adjust its portfolio or to address unexpected cash flow requirements.

The track record of Lexholding's portfolio value development is limited because the company reports under local generally accepted accounting principles using the book value of assets. This restricts our visibility on the company's ability to develop its portfolio value. Additionally, limited divestments during the analysed period means we are not able to fully assess management's competence and the company's ability to rotate assets.

## Financial risk profile: BB+

**Management fee income to increase further following high investee cost base**

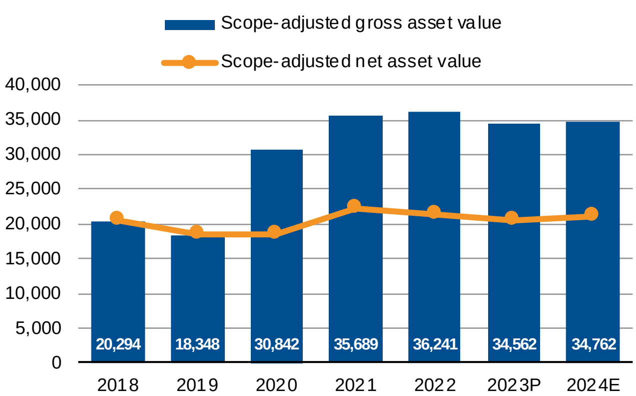
Cash income remained sufficient to cover operating expenses in FY 2023 because management and service fee income compensated for all service-related expenses at the holding level. In FY 2023, cash dividend inflows amounted to HUF 1.4bn. Of these, we only take into account inflows that are recurring, which mainly come from BÁV Zrt. and BAV Factor.

We estimate that total cost cover will remain above 1.0x over the next few years, supported by the relatively stable nature of management fees implemented at the level of core holdings. This is despite the fact that Lexholding did not fully pass on its increased costs in 2023 so as to support the subsidiaries' operations. The rise in cost-based service fees was attributed to inflation, leading to higher prices from external service providers and increased salaries. Further factors supporting cost cover are: i) broadly stable net interest on shareholder loans; ii) resumed dividend payments from core portfolio companies (i.e. pledged loans, ground transportation dividends already paid in 2024); and iii) no significant increase in dividend payouts shielded by bond covenants.

We have applied a 50% haircut to management's anticipated dividend payments from BÁV Zrt. going forward. This is based on the company's questionable ability to pay more than HUF 1.0bn of annual dividends based on its operating performance.

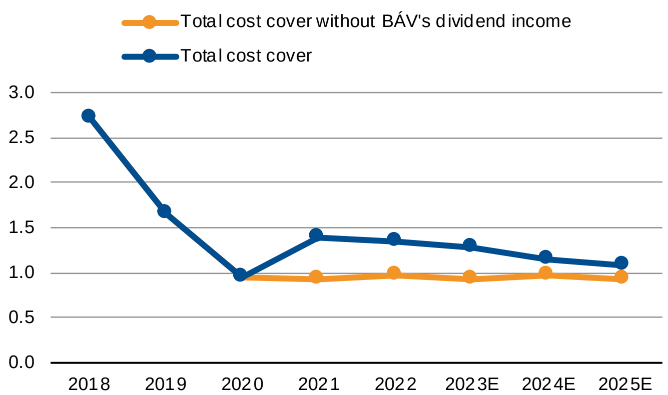
Holding costs (operating costs and dividends paid) are expected to increase as Lexholding intends to take over more of its undertakings' functions (compensated via a higher management fee).

**Figure 6: Asset value development in HUF m**




Source: Lexholding, Scope estimates

**Figure 7: Total cost cover**




Source: Lexholding, Scope estimates

**Modest leverage**

Lexholding's leverage as measured by its loan/value ratio (LTV) remains comfortable at 40% as of FY 2023 (41% in FY 2022). The LTV has decreased somewhat compared to the previous year due to a slight impairment loss in one of the holdings in the amount of HUF 100m. Almost 50% of cash proceeds from bonds still has to be spent on commercial real estate projects. With the gradual use of the bond proceeds, we expect Lexholding's

LTV to remain at around 40% over the next two years, depending on when the proceeds are used.

The rating is mainly constrained by the limited visibility on the net asset value of Lexholding's investments, as gross asset value appears to be stable without reflecting changes in the core holdings' underlying asset quality. However, we consider net investment values instead of market values, which is a more conservative approach to assessing the market value of Lexholding's core holdings. This conservative view excludes factors such as potential market volatility.

We do not forecast a major change in Lexholding's portfolio market value. Our sensitivity analysis indicates that market value would have to deteriorate by 40% to breach Lexholding's LTV target of 60% (at constant indebtedness).

Most core holdings, particularly the commercial real estate projects, do not rely on external third-party funding. Instead, they are supported by shareholder loans provided by Lexholding. This structure allows Lexholding to have direct control over the funding of its core holdings and reduces its reliance on external financing sources.

**Adequate liquidity**

Lexholding's liquidity continues to be adequate. Due to the absence of short-term debt, it benefits from positive free operating cash flow and a significant cash buffer of around HUF 1.4bn as of YE 2023. There are no refinancing risks that would necessitate the sale of any shareholdings.

| Balance in HUF m | 2024E | 2025E |
|---|---|---|
| Unrestricted cash (t-1) | 1,569 | 1,866 |
| Open committed credit lines (t-1) | 0 | 0 |
| Free operating cash flow (t) | 347 | 319 |
| Short-term debt (t-1) | 0 | 0 |
| **Coverage** | **>100%** | **>100%** |

We highlight that Lexholding's senior unsecured bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 15.0bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 90 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 0 notches. Given the limited rating headroom, the company must at least maintain its current credit profile to avoid triggering the rating-related covenant.

In addition to the rating deterioration covenant, the bond includes a dividend-related covenant (cap of 50% profit after tax and no dividend payout during the cure period) and an ownership-related covenant (if Elek Nagy's direct and indirect ownership drops below 50%+1 vote).

## Supplementary rating drivers: +/- 0 notches

**Credit-neutral financial policy**

There are no explicit adjustments for supplementary rating drivers. We highlight the lack of transparency and governance issues driven by cross-ownerships in the organisational structure.

In 2023, an intermediary trust fund was established between Lexholding and its shareholder. The primary purpose of creating the XLEK Alapitvany is to ensure the continuous operation of the holding company, particularly in the event of the owner's incapacity or during a potential generational transition.

## Long-term debt rating

**Senior unsecured debt rating: B+**

We have affirmed the senior unsecured debt rating at B+ including the HUF 15.0bn bond (ISIN HU0000359955). This reflects our expectation of a ‘superior’ recovery for senior unsecured debt in the hypothetical event of a company default. The recovery analysis is based on a hypothetical default scenario in 2025, which assumes outstanding senior unsecured debt of HUF 15.0bn with no senior secured loans.

More than half of the bond proceeds have been deployed already with a focus on investments in real estate (HUF 8.4bn); the rest has been invested in the open-ended real estate fund (HUF 6.6bn).

We highlight the limited visibility on the net asset value of core holdings. This is because current Hungarian accounting standards incorporate the cost of investments but do not capture the market value of these investments. This constrains our recovery assessment and therefore the debt rating.

Moreover, we limit the debt category rating to match the issuer rating due to the potential risk that Lexholding might issue higher-ranked debt, which could reduce the recovery prospects for senior unsecured debt holders.

## 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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

### Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

### Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

### Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

## Scope Ratings UK Limited

### London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
**www.scoperatings.com**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