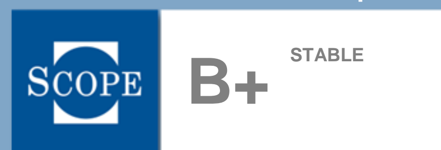
LP Portfolio Kft
Hungary, Holding Companies



Corporate profile

LP Portfolio Kft (LP) is a small Hungarian investment holding company owned by Peter Lakics, one of the proprietors of family-owned Lakics Gépgyártó Kft, which also forms one arm 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 Gépgyártó (33%) by building exposure in solar energy and real estate. Today, LP is an unlisted holding company, consisting of 15 companies with approx. HUF 5bn (EUR 15m) in asset value (calculated by using an EBITDA of about 3x).

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

Key metrics (based on holding accounts)

		Scope estimates		
Scope credit ratios	**2018**	**2019F**	**2020F**	**2021F**
Total recurring cost cover (x)	1.0	21.7	5.5	4.4
LTV (Scope-adj. debt/ portfolio market value) (%)	-	64	38	39
Liquidity (%)	>1,000	>1,000	>1,000	>1,000

Rating rationale

Scope Ratings assigns issuer rating of B+ to Hungary-based holding company LP Portfolio Kft (LP). The rating Outlook is Stable. Senior unsecured debt is rated BB-.

The ratings reflect a robust financial risk profile in light of comparatively high recurring cost coverage rates. This leads to rating support from improved recurring income generation going forward and a lean cost structure. The ratings also reflect our view of LP's conservative 'buy-and-build' investment approach around a slightly diversified number of target sectors in largely non-cyclical industries (steel processing, solar energy and real estate). Family ownership is another plus for the ratings, while the overall size of the holding company is a restraining factor.

LP's investment strategy focuses on building diversified income streams in the long run around the 33% interest in Lakics Gépgyártó (an engineering firm which makes heavy steel structures) of its 100%-owner Peter Lakics.

Portfolio diversification – a very important ratings driver in our assessment of holding companies – has benefited from the attractive investment opportunities for solar power plants in Hungary under regulated feed-in tariffs. We view the successful build-up of LP's solar energy position as essential to lessen dependence on the owner's legacy family business, particularly while the holding company's real estate exposure is still small. However, given LP's large concentration on two segments (capital goods and solar energy) its overall diversification is still evolving. While LP's present exposure to comparatively stable, non-cyclical sectors (relative to GDP) is positive, its limited scale is not. We believe that the holding company's estimated net asset values are well below HUF 10bn, including the new, planned investments made possible by the bond proceeds. Furthermore, concentration risk is still high, reflecting the strong weight of the two dominant sectors with regard to both asset values and dividend income.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB-

Analysts

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Related Methodology

Corporate Rating Methodology

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The rating reflects no major expansion into additional – potentially cyclical – sectors, while the intended bond issuance (HUF 3bn) later this year is earmarked to fund growth in the real estate (about 75%) and solar energy sectors. The rating also incorporates the limited amount of debt on LP's balance sheet, with most of its past expansion funded by equity. The envisaged HUF 3bn bond will be the first sizeable debt portion in LP's history. Credit metrics in a holding company context are relatively good. 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 due to larger dividend income, chiefly from the solar sector companies – which already started to make payments in 2019 – combined with relatively lean cost structures. Holding company costs are also expected to increase in 2020, mainly reflecting the bond's interest payments as well as fees and additional staffing. 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 (operational licenses and guaranteed feed-in tariffs for the 26 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 assumes that this will not change in the next two to three years at least.

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

In our recovery assessment, we calculated a liquidation value of about HUF 2 bn in a hypothetical default scenario. This value is calculated by applying a 50% discount to the estimated net asset values of LP's participations (using a 3x multiple on underlying EBITDA), reduced by 10% of insolvency costs. This leaves a recovery rate of about two-thirds for the HUF 3 bn bond, translating into an above-average recovery expected for senior unsecured debt, which receives a one-notch uplift above LP's issuer rating. This reflects LP's growing investment portfolio and the recoverability of existing solar plants (primarily equity-funded) which are operated under regulated tariffs.

Outlook

The Stable Outlook reflects our expectation that LP's business risk and financial risk profile will not change significantly in the next one to two years. The rating reflects our view of a total cost coverage by recurring income of at least 1x on a sustainable basis. It also incorporates our assumption that the National Bank of Hungary bond proceeds will be used to expand LP's investment portfolio into real estate and solar assets. A positive rating action could be warranted by an enhanced business risk profile with improved concentration risk and significant growth in LP's 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**	**2019F**	**2020F**	**2021F**
Total cost coverage from recurring income (x)	1.0	21.7	5.5x	4.4x
Total cost coverage including non-recurring income (x)	1.0	21.7	5.5	4.4
LTV (%)	-	64	38	39
Liquidity (%)	>1,000	>1,000	>1,000	>1,000
Cash flows (HUF m)	**2018**	**2019F**	**2020F**	**2021F**
Recurring cash inflows	8.5	650	615	520
Non-recurring cash inflows	0	0	0	0
Balance sheet/ indebtedness (HUF m)	**2018**	**2019F**	**2020F**	**2021F**
Net asset value	3,784	4,450	7,450	7,450
Gross financial debt	0	3,000	3,000	3,000
less: available cash	0	137	139	113
Guarantees and suretyships	0	0	0	0
Scope-adjusted debt (SaD)	0	2,863	2,861	2,887

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 group's targeting of majority positions which allow control. LP has used its own balance sheet to fund and finance subsidiaries in the past. The planned bond will be issued by LP to fund expansion in 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 potential for upstream dividends from the 25 small (0.5 MW) power plants is low in the development phase, regulation allows this to happen in later development phases. Consequently, LP has a phased 'dividend expectation' model, based on the maturity and cash generation cycles of individual projects. On a group level, we continue to expect relative strong dividend generation from 2019 – the Solar FM dividend of HUF 616m has already been received – while 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. It is accompanied by a lean cost structure (no dividend payments to LP shareholders foreseen), making adequate cost coverage relatively independent of the overwhelming majority of dividends received.

Main portfolio companies

Steel processing

Lakics Gépgyártó Kft; Lakics Vagyonkezelö Kft; Acel 235 Kft (33% ownership in the first two companies, 40% in Acel; 2018 segment sales: HUF 7.5bn; 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 Gépgyártó 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). Its main customers are Siemens and General Electric.

Solar energy

Helios Solar Kft; Acel 02 Kft; Solar FM Kft (100% ownership throughout, 2018 segment sales: HUF 2.5bn; EBITDA margin 27%): Construction and operation of solar power plants; Acel and Helios own 25 0.5MW solar power plants.

Real estate

LPRE Commercial Kft; LP Broadway Kft; Broadway Portfolio Kft (100% ownership in first two companies, 74% in the third, 2018 segment sales: HUF 759m; EBITDA margin: 56%.

Credit-supportive industry mix in the holding portfolio

LP's exposure to three different industries supports its business risk profile. We believe that solar energy (state-guaranteed uptake and tariffs) and commercial real estate are relatively non-cyclical sectors with little correlation. This is also partly true for 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.

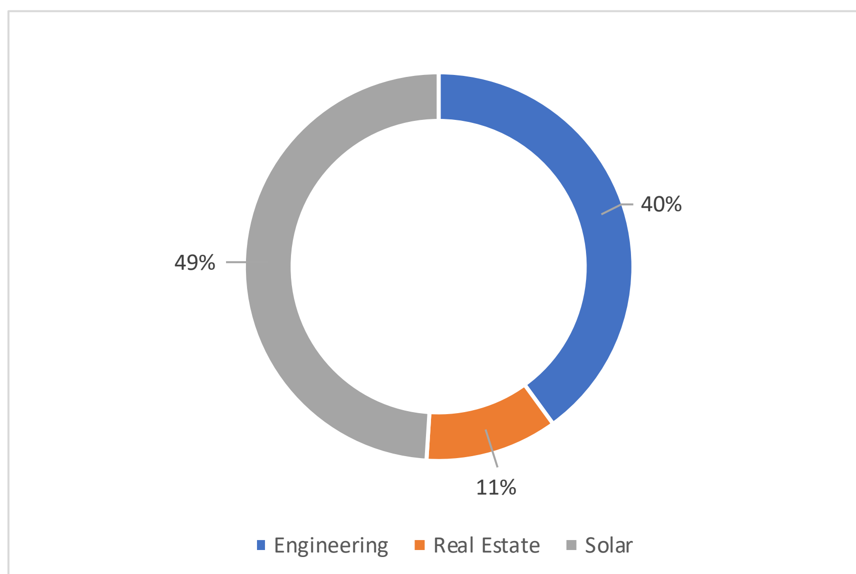
The group's largest exposure – by estimated asset value – is to the 'solar energy' and 'engineering' segments, with about 90% exposure. While this is likely to change over time, the holding company's industrial exposure is a mix of medium-rated real estate and highly rated solar energy exposure.

Given Hungary's chronically tight energy supply situation, the state has developed a protective subsidy system for renewable energy producers. In solar energy, LP benefits from a protected domestic business model in Hungary, guaranteeing power take-off under the METAR system (Renewable Energy Support Scheme) which came into force in January 2017. This consists of a guaranteed feed-in tariff, a 'green premium' granted without tendering for the small sizes which LP has (0.5 to 1 MW). The Hungarian Energy and Public Utility Regulatory Authority determines the eligibility period and maximum amount of eligible electricity generated for each electricity producer individually. 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.

While the first licenses (25 years) were granted in 2016/17 (this 'window of opportunity' expired in 2018), LP will participate in the new additional licenses (15 years) up for tender from now.

We believe that 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 (est. NAV)



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 benefited over time from the attractive investment opportunities for solar power plants in Hungary under regulated feed-in tariffs. The successful build-up of LP's solar energy position is essential to lessen dependence on the owner's legacy family business, particularly while the holding company's real estate exposure remains small. However, given LP's large concentration on two segments (capital goods and solar energy) overall diversification is still evolving.

This culminates in 100% dividend concentration from Solar FM in 2019. However, dividend concentration is not overly severe for LP in our view, because its cost position is

lean enough to allow for 1.2x coverage if the Solar FM dividend is excluded for 2019 (see financial risk profile section).

All of the holdings are unlisted companies. This may appear negative in terms of the 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 of LP. While Peter Lakics is the sole owner, we believe the holding company is a typical owner-run family-value company with a lack of traditional governance bodies like supervisory boards etc. However, in the context of the ratings we have not identified any concerns in this respect.

Financial risk profile

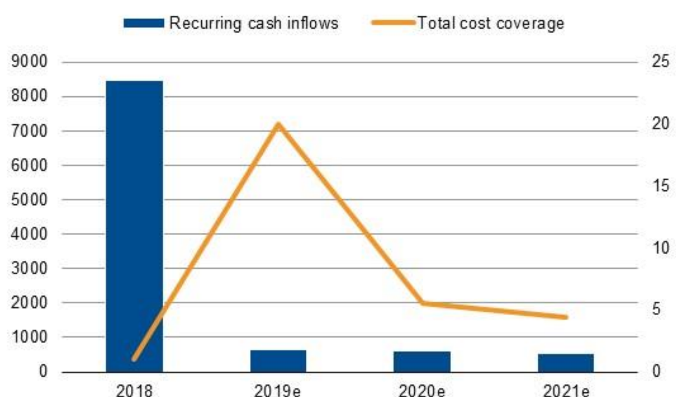
Solid credit metrics

The rating also reflects the limited amount of debt on LP's balance sheet as most past expansion has been equity-funded. The envisaged bond will be the first sizeable debt portion in LP's history. Credit metrics in a holding company context are relatively good. We focus on 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 due to larger dividend income, chiefly from the solar sector companies – which already started making payments in 2019 – combined with relatively lean cost structures. We expect holding company costs to increase in 2020, mainly reflecting the bond's interest payments as well as fees and additional staffing. However, we believe that LP can still achieve the cost coverage ratios in our base case, reflecting high visibility on the energy sector's dividend income (operational licenses and guaranteed feed-in tariffs for the 25 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 assumes that this will not change in the next two to three years at least.

Given high dividend concentration, we also considered a sensitivity scenario.

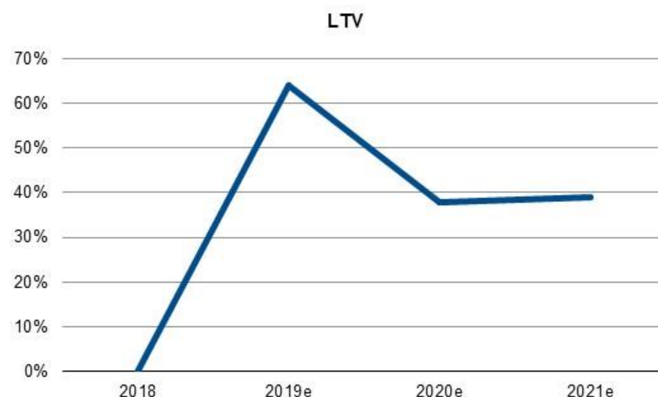
Total cost coverage without the Solar FM dividend: excluding the HUF 616m in 2019 income results in projected 2019 holding company income of about HUF 35m. Compared to projected holding company costs for the same year of about HUF 30m, cost coverage would still be above 1x. We expect total holding company costs to increase after 2019, mainly because of interest payments for the newly placed bond.

Figure 1: Improving recurring income



Source: Scope estimates

Figure 2: LTV projected to decline slightly



Source: Scope

Projected LTV of about 40%

We forecast that LTV will be about 40% in the coming years, reflecting unchanged debt positions (mainly the bond) plus increasing cash derived from dividend income. We kept the portfolio's asset value constant at about HUF 7bn in this calculation.

Above-average recovery

In our recovery assessment, we calculated a liquidation value of about HUF 2bn in a hypothetical default scenario. This value is calculated by applying a 50% discount to the estimated net asset values of LP's participations (using a 3x multiple on underlying EBITDA), reduced by 10% of insolvency costs. This leaves a recovery rate of about two-thirds for the HUF 3bn bond, translating into an above-average recovery expected for senior unsecured debt, which receives a one-notch uplift above LP's issuer rating. This reflects LP's growing investment portfolio and the recoverability of existing solar plants (primarily equity-funded) which are operated under regulated tariffs.

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