LP Portfolio Kft.
Hungary, Investment Holdings

SCOPE B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Total cost cover (x)	3.1	3.0	2.5	2.5
Loan-to-value (LTV, %)	37	39	40	
Liquidity (x)	>200	>200	>200	>200

Rating rationale

The ratings continue to reflect LP Portfolio's (LP) robust financial risk profile in light of comparatively high recurring total cost coverage. The ratings continue to be supported by our view on the holding's good recurring income generation capacity and its lean cost structure. The ratings also reflect our view of LP's conservative 'buy-and-build' investment approach around a slightly diversified number of core sectors in by and large resilient industries (steel processing, solar energy, real estate). Based on management's investments over the last twelve months, both portfolio diversification and value generation have benefited. We have therefore raised the business risk profile to B+, while at the same time we have introduced a negative notch to reflect the overall small size of the holding, which is still a restraining ratings factor in a peer group context. Net asset values are presently around HUF 12bn, compared to about HUF 8bn in 2020.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that both LP's business risk and financial risk profile will not change significantly in the next 1-2 years. The rating reflects our view of a total cost coverage by recurring income of at least 1x on a sustained basis. It also reflects that the funding of further growth of LP's investment portfolio will not be done via additional bank debt.

For a potential positive rating action we would expect improvements in the holding's business risk profile with regard to improved concentration risks or significant growth of its investment portfolio.

A downside trigger could be provided by total cost coverage dropping to 0.8x on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
08 AUG 2023	Affirmation	B+/Stable
17 AUG 2022	Affirmation	B+/Stable
17 SEP 2021	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

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Related Methodology

General Corporate Rating Methodology; July 2022

Rating Methodology: Investment Holding Companies; May 2023

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Conservative ‘buy and build’ strategy • Non-cyclical underlying industries • Continued strong total cost coverage • Exposure to solar power plants (ESG factor)	• Limited overall size • High dividend concentration • High domestic exposure • Key person risk (ESG factor)

Positive rating-change drivers	Negative rating-change drivers
• Lowered concentration risk and significant growth of the investment portfolio on an absolute scale	• Inability to maintain total cost coverage of 0.8x (sustained)

Corporate profile

LP is a small Hungarian investment holding company owned by Peter Lakics, one of the owners of family-owned Lakics Steel which also forms one leg of the three-division LP Holding company. The holding was founded in 2000, reflecting the owner’s ambition to diversify his ownership in Lakics Steel (33%) by building exposure in solar energy and real estate. LP today is an unlisted holding consisting of 44 companies with about HUF 12bn (EUR 30m) in asset value (EUR 18m three years ago – although this just reflects equity book values and can thus be deemed rather conservative).

The group’s investment philosophy focuses on holding majority positions in three defined industrial sectors (steel, solar energy and real estate). In its long-term ‘buy-and-hold’ approach, LP tries to develop the participations to dividend status – including opportunistic divestitures.

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

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)

ESG profile - neutral

LP is 100% owned by Peter Lakics. It is a typical owner-operated, family-value company with a lack of traditional governance bodies like supervisory boards. However, in the context of the ratings, we have not identified any concerns in this respect. The only 'technical' concern is provided by the company's perceived strong dependence on the CEO, categorised as key person risk. Our overall neutral stance on ESG reflects a positive assessment with regard to product innovation (E) regarding LP's large exposure to renewable energy, as well as negative assessments with regard to key person risk under management and supervision (G) and for stakeholder management (G) with regard to substantial payouts for portfolio companies.

[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.

Financial overview

				Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**
Total recurring cost cover (x)	3.6	3.1	3.0	2.5	2.5
Loan-to-value, LTV (%)	34	37	39	40	
Liquidity (%)	>200	>200	>200	>200	>200
Cash flows in HUF m					
Recurring cash inflows	553	547	703	577	605
Total recurring costs	156	174	236	231	238
Balance sheet/ indebtedness in HUF m					
Net asset value	**8,376**	**8,997**	**12,650**	**14,500**	**16,000**
Reported gross financial debt	3,600	5,400	5,400	5,400	5,400
less: accessible cash and cash equivalents	-724	-2,066	-417	-329	-242
add: cash non-accessible	0	0	0	0	0
Scope-adjusted debt	**2,876**	**3,334**	**4,983**	**5,071**	**5,158**

Business risk profile: B+

Note that the business risk assessment applies Scope's new Methodology for Investment Holding companies released in 2023 (see below):

Figure 1: Competitive positioning assessment

COMPETITIVE POSITIONING		
Weighted average industry portfolio risk	• Weighted average industry risk based on gross asset value	• Weighted average industry risk based on income

Portfolio sustainability	• Income-generating core holdings
	• Income-generating portfolio
		• Income concentration
		  • Top core holding
		  • Top three core holdings

Portfolio diversification	• Geographical diversification
	• Sector concentration
		• Gross asset value concentration
		  • Top core holding
		  • Top three core holdings

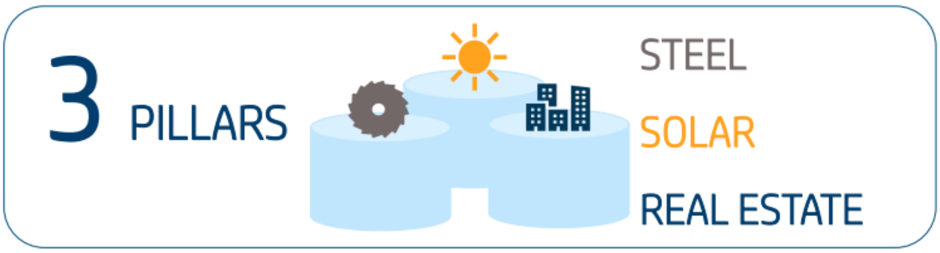
Portfolio liquidity	• Listed portfolio	• Ability to divest
Investment philosophy	• Portfolio value development	• Investment policy

Source: Scope

Industry risk: BB-

LP's industry risk assessment is a mix of its underlying industries' characteristics. While the solar energy division, a regulated segment with a 'AA' industry assessment, has a relatively high industry score, LP's exposure to the real estate development sector and the construction market (via Solar FM for the construction of the solar power plants) both have a B industry assessment. Overall, we assess LP's industry risk at 'BB-'.

Figure 2: LP Portfolio's activities



Source: LP

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)

2022 segment sales: HUF 9.9bn/ +13% year-over-year; EBITDA margin: 11%

Lakics Gépgyártó is a manufacturer of engines and generator housings, bearing shields, structural parts for tunnelling 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 in Hungary). Its products are used in the energy sector (around 95% of total revenues). The main customers are Siemens and General Electric (GE).

Solar energy

Helios Solar Kft; Helios Nova Kft; Helios Taszar Kft; Solar FM Kft (100% ownership throughout)

2022 segment sales: HUF 2.1bn; EBITDA margin: 30%

Construction and operation of solar power plants; The Helios companies own 17 0.5 MW solar power plants, one new 3.5 MW and one new 2 MW solar power plant.

Real estate

VRLD Invest Kft; LP Broadway Invest Kft; Almassy Invest Kft; Petöfi Center Kft (100% ownership throughout)

2022 segment sales: HUF 187m; EBITDA margin: 66%

Diversified real estate projects at various stages of maturity. Segment combines a mix of commercial and residential development projects as well as a City hotel development project in Budapest.

Credit-supportive industry mix in holdings portfolio

LP's exposure to four different industries (including lowly rated construction of solar power plants which has now been separated by us from the solar segment) 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 each other. To some extent, this also applies to engineering (project background), which is not overly sensitive to underlying macroeconomic developments. Most industries represented in the portfolio thus have low and medium cyclicality.

The company's largest exposure by asset values was to the real estate segment in 2022, with a close to 40% exposure, while it was only at about 20% three years ago. This reflects ongoing investments in new projects, such as Almassy Invest (residential, hotel) and IT Campus (recently renamed to EDU Campus) following new tenants signing in the education sector).

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 supportive domestic business model, a mandatory purchase system for existing solar plants (KAT) and guaranteed 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 20 years under the protective regulations. The guaranteed volume and pricing regulations will protect the holding company's income generation in the coming years.

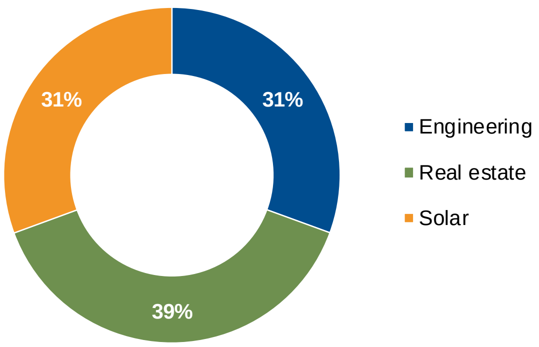
The first licences (25 years) were granted in 2016-17 but this window of opportunity closed in 2018. LP has recently started production on two larger solar power plants (2 MW in Taszar and 3.5 MW in Santos). That segment's pipeline also consists of one new 5.5 MW plant (METAR) and one 8.5 MW KAT project.

A blended ratings score of BB- is representative of LP's current industry portfolio. The rating reflects no major expansion into additional – potentially more cyclical – sectors. Diversification of investments across different sectors and asset classes helps mitigate the concentration risk and ensures the portfolio's balanced risk profile.

Improved portfolio sustainability

LP's portfolio sustainability and portfolio diversification – important rating drivers in Scope's investment holdings methodology – have benefited over the last 24 months from management's new investments aimed at reducing the formerly large dependence on the solar segment. Solar in 2019 provided by far the largest source of recurring income (100% of dividends received) and asset value (close to 50%) for the holding. This has changed during the past two years to a much more balanced exposure in terms of asset values (31%-39%-31% for engineering, real estate and solar, respectively). The real estate division in particular has markedly improved in size over the past years reflecting value generating investments mainly in the Budapest office park (EDU Campus, renamed from IT Campus) following recently increased occupancy rates, as well as in the Budapest hotel project (Almassy) under development by LP. The latest project is the Komlo Park steel manufacturing project whose investment phase should be completed in the last quarter of 2023. While we deem LP's present exposure to comparatively stable and resilient sectors (relative to GDP) a support from a ratings perspective, the holding's still limited scale is not. Additionally, income concentration risk remains very high, especially with regard to dividend income. The solar energy company Solar FM will continue to provide the bulk of present and forecasted dividend income for the next two years. While this is expected to change gradually going forward, also by relying not solely on dividend income for the holding, progress on portfolio sustainability (mature, non-cyclical assets, most companies contribute to recurring income generation) is relatively more evident.

Figure 3: Segment breakdown 2023E (est. net asset value)



Sources: LP, Scope

Portfolio diversification is also progressing

Portfolio diversification on the one side is constrained by LP's main exposure to the Hungarian market, as the dividend-paying undertakings generate all of their revenues there, which exposes these companies to the economic cycle of Hungary, limiting the ability to offset the negative impact from a downturn in this region. However, sector concentration as a percentage of asset values is actually rather balanced, providing at least a BB level, as is the case for the top (17%) and top 3 holdings per asset value (about 50%). Thus, after recent investments the group's dependence on individual sectors/companies has decreased. Just three years ago, the weight of the real estate segment in total NIV (Net Investment Value) was at about 50%.

Liquidity of holdings

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 total cost coverage. At the same time, the owner has not excluded opportunistic divestitures if the need arises.

Investment philosophy

LP's investment strategy continues to be focused on building diversified income generation in the mid-term around the owner's legacy steel processing stake. While there have been opportunistic divestitures historically, it is fair to assume the owner to continue focusing on buy and hold positions for his core holdings. This is now predominantly happening in real estate – following his success with new office and shopping centre projects while formerly the solar energy sector took precedence. The real estate segment was very small three years ago, but it gained in size significantly, expected to grow its asset value as a sector by about 40% the end of 2023, compared to 2020. While the shopping centre and the hotel project are already partly operational or under development, but delayed (hotel), the latest project (Komlo steel manufacturing project for solar parks) is expected to complete its investment phase in 2023. Projections are for the real estate segment to account for about 40% of LP's asset value by the end of 2023.

LP has a long-term, value-oriented buy-and-build investment approach involving operational control at the subsidiary level. Consequently, divestitures are rare but can be used opportunistically. This is reflected in the company's targeting of majority positions that enable control. The company has used its own balance sheet in the past for fund expansion. The three bonds issued by LP in 2020 and 2021 were used to finance and develop new real estate and solar energy projects.

We believe LP's investment approach is conservative and less risky than a more timing-sensitive active trading approach. While the overall size and number of divisions compares negatively to the larger rated peers, the strategy/investment philosophy is a support for the LP ratings. The ambition is to build a more sizeable holding over the next few years around the defined three segments in a balanced way.

Management appears committed to maintaining a strong cushion relative to the rating's requirements in terms of total cost cover. While ratings downside would occur if total cost cover dropped below 0.8x, LP's actual annual performances are recurringly much above this level. This is also safeguarded by waiving own dividend payments as again confirmed in our recent management meeting. In addition to that, this policy is also motivated by being able to: (i) develop its undertakings further; or (ii) to add new investments within the industries where LP is currently active (i.e. no expansion outside these sectors).

LP is focused on generating dividend income from its main subsidiaries in the medium term. Historically, this was only the case for one company, Solar FM. While the likelihood of being able to upstream dividends from the 17 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 that depends on the maturity and cash generation cycle of individual projects. In 2021, this has led to the first small dividends from the Helios subsidiaries and real estate assets. In addition, the steel processing companies paid dividends in 2022 following their increased operational performance. We continue to expect relatively strong dividend generation at the holding company level for the next few years.

Financial risk profile: BB

Financial risk profile providing ratings cushion

The rating reflects the still comparatively limited and stable amount of debt on the holding's balance sheet. The three bonds issued by LP with maturities in 2030 and 2031 continue to account for the only financial debt on LP's balance sheet. Credit metrics for a holding company continue to be on a very comfortable level in the context of the ratings, in our view, as LP maintains an ample cushion relative to its negative ratings trigger (total cost cover of 0.8x). This confirms our view that the portfolio of investment companies is comparatively non-cyclical and was not at all negatively influenced by the macroeconomic and geopolitical crises in the last two years.

We focus on coverage of recurring holding costs by recurring income generated. This ratio was at 3x in 2022 and is expected to be around similar levels in 2023 and 2024, respectively. These comparatively high levels continue to be generated by larger dividend income mainly from the solar sector companies – continuously received since 2019 – meeting still relatively lean cost structures in the holding. While holding costs have increased significantly during recent years, reflecting mainly the bonds' coupon payments as well as related fees and additional staffing expenses, the income side has expanded recently from gradual dividend diversification (from the engineering segment) and due to significantly increasing interest income on intercompany loans and on deposits.

On the other side, income generation is still held back by some investment companies not being allowed by their financing banks to pay dividends in the pre-cash generation phase (Almassy, most notably). This should improve gradually in the following few years, especially in the real estate segment, as there was good operational progress over recent quarters. However, we believe that LP can achieve the total cost coverage ratios projected in our base case reflecting high visibility of the solar sector's dividend income (operational licenses and guaranteed feed-in tariffs for the 17 small and for the two larger solar energy power plants owned by LP). The holding's cost structure also benefits from no dividend payments to the owner which was again confirmed to us. The rating assumes that this will not change in the next two to three years at least.

High level of total cost coverage maintained

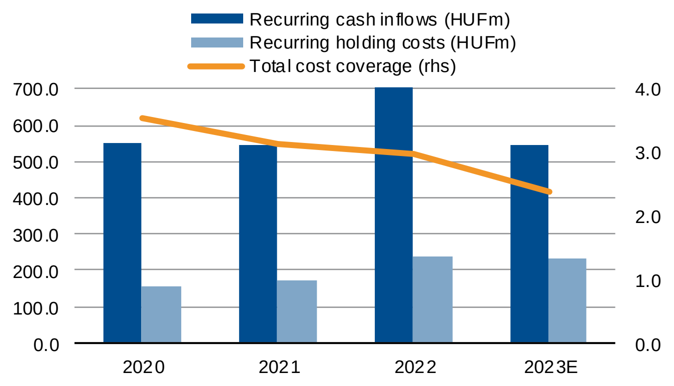
The total cost coverage ratio continued to be on a relatively high and stable level. The year-ago management guidance was fully met again, testifying to good business control. There was a significant increase in 2022 income levels, generated mainly from very high interest income (deposits, all intercompany loans) and also due to recovering dividend generation from the steel division). While the former intercompany loans carried an interest rate of 4%, the new ones are between 7-10%. Costs have also increased in 2022, mainly reflecting higher coupon payments due to the issuance of the second bond at the end of 2021.

The total cost coverage is forecasted to remain on a high level, although our projections are conservative (LP's guidance is for levels of about 2.8x for the next two years). LP's comparatively high total cost coverage thus looks still sustainable in our view despite significantly higher interest costs on the bonds and is due to: i) the absence of own paid dividends (Peter Lakics stated that he will not be asking for dividends); and ii) the holding's lean cost structure. There are only 4 FTEs working for the holding and the owner confirmed that this number will not change dramatically in the near future.

Leverage

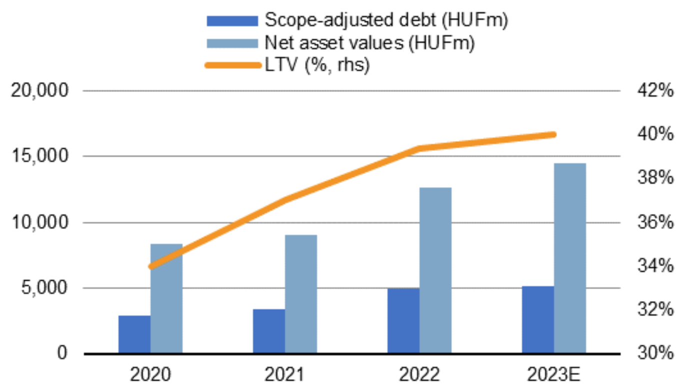
The first HUF 2.5bn bond was the first external debt raised for LP Portfolio, while its past expansion had been solely funded by equity. LTV 2022 had been projected at 40% and came in at 39%, reflecting both higher financial debt (the second bond issuance in November of 2021) and a stronger increase in asset values than initially forecasted. The main difference on asset values were from steel plant project Komlo which more than doubled compared to last-year forecasts. Overall there was not much deterioration in 2022 on the LTV as the asset side roughly expanded in parallel with financial debt. For the near future, the ratio is expected to decline based on strongly increasing asset values of 17% and 20% for 2023 and 2024, respectively. Drivers for this are mainly Komlo, EDU Campus and the new projects in Solar. Asset values continue to be calculated on a conservative basis, in our view, partly reflective of the equity side of predominantly private, non-quoted group companies. Some projects like the EDU Campus which have already benefited from higher occupancy achieved are also valued from third-party sources. We believe the project has valuation upside given the infrastructure developments in the region (BudaPart, tramline construction).

Figure 4: Total cost coverage providing cushion



Sources: LP, Scope (estimates)

Figure 5: LTV is more stretched, but also more stable



Sources: LP, Scope (estimates)

Balance in HUF '000	2022	2023E	2024E
Dividends	702,835	576,900	605,000
Open committed credit lines (t-1)	0	0	0
Short-term debt (t-1)	0	0	0
Coverage	**>200%**	**>200%**	**>200%**

Adequate liquidity

Based on no short-term debt at LP in 2023/2024, the company's liquidity profile continues to be sound. LP has a cash pooling arrangement with their leading bank KH which manages most of the cash generated via interest payments from investment companies. While this is unusual for a holding, we do not see this negatively from a ratings point of view for the time being (arrangement can be cancelled short term).

Supplementary rating drivers: - 1 notch

Our supplementary rating drivers assessment now includes a negative notch for the holding's small size in a peer context, in line with our recently published investment holding methodology.

Our overall neutral stance on ESG reflects a positive assessment with regard to product innovation (E) regarding LP's large exposure to renewable energy, as well as negative assessments with regard to key person risk under management and supervision (G) and for stakeholder management (G) with regard to substantial payouts from portfolio companies, which has partially been adopted.

Long-term debt rating

Senior unsecured debt rating: BB-

Our recovery analysis is based on significant asset haircuts of 50% on the HUF 15bn of gross asset values which management projects for 2024. They continue to be evaluated conservatively using partly book values (equity) as all of the subsidiaries are not quoted. The assessment indicates superior recovery rates for senior unsecured bond debt, which translates into two notches uplift for the instrument relative to the issuer rating. However, although the recovery rate is very high despite the increased debt and using only half of the assets (valued on a net basis, i.e. deducting their bank debt) as recoverable, we stick to our formerly adopted approach to limit the uplift to one notch.

Appendix: Peer comparison

	LP Portfolio Kft.	Lexholding Zrt.	Opus Global Nyrt.	Compactor Fastigheter AB	Franz Haniel & Cie. GmbH
	B+/Stable	B+/Stable	BB/Stable	BBB-/Stable	BBB-/Stable
Last reporting date	31 December 2022	31 December 2022	31 December 2022	31 December 2022	31 December 2022
Business risk profile	B+	B	BB-	BB	BBB
Financial risk profile	BB	BB+	BBB-	A-	BBB-
Total cover	>2x	1.3x	2.2x	>2x	>1x
Loan-to value	35%	40%	40%	10%	<10%
Asset values (EUR m)	40	150	850	1,200	5,500
Liquidity	No impact	No impact	No impact	No impact	No impact

Sources: Public information, Scope

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