LP Portfolio Kft.
Hungary, investment holding companies

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Total recurring cost cover (x)	3.6	3.1	2.8	2.7
LTV ratio (Scope-adjusted debt/ portfolio asset value; %)	34	37	40	34

Rating rationale

The ratings continue to reflect our view on LP Portfolió (LP)'s robust financial risk profile in light of comparatively high recurring cost coverage rates. The ratings thus continue to be supported by our view on the company's good recurring income generation capacity and 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 mostly non-cyclical industries (steel processing, solar energy, real estate). The various geopolitical crises around the world have not had a sizable negative effect on LP's credit quality so far. On the contrary, the steel business is presently benefitting from steel shortages and higher selling prices. The overall size of the company still restrains the ratings despite a significant increase in asset values during the last three years. Gross assets by book value are presently around HUF 9bn, about twice as high as in 2019.

LP's investment strategy is focused on building diversified income streams over the long run around the 100% owner (Péter Lakics)'s 33% interest in family asset Lakics Gépgyártó Kft (heavy steel structures – engineering).

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that LP's business risk and financial risk profiles will not change significantly in the next one to two years. The rating reflects our view of total cost coverage by recurring income of at least 1x on a sustainable basis. It also reflects the funding of further growth of LP's investment portfolio without additional bank debt.

For a potential positive rating action, we would expect improvements in the business risk profile with regard to lower concentration risk or significant growth of the 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
16 Aug 2021	Affirmation	B+/Stable
28 Sep 2020	Affirmation	B+/Stable
09 Oct 2019	Initial rating assignment	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

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Related Methodology

Corporate Rating Methodology; July 2022

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Positive rating drivers	Negative rating drivers
• Conservative ‘buy-and-build’ strategy • Non-cyclical underlying industries • Strong cost coverage	• Limited overall size • High dividend concentration • Key person risk (ESG risk)

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

Corporate profile

LP is a small Hungarian investment holding company owned by Péter Lakics. He is one of the owners of family-owned Lakics Steel, which also forms one part of the three-division LP. The holding company was founded in 2000 with the aim of diversifying Mr Lakics’ ownership stake in Lakics Steel (33%) by building exposure in solar energy and real estate. Today LP is an unlisted holding company consisting of 44 companies with about HUF 12bn (EUR 30m) in asset value (vs EUR 18m three years ago, although this figure only reflects equity book values and can thus be deemed rather conservative).

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

Scope’s Second-Party Opinion on LP Portfolió Kft. (https://www.scopegroup.com/dam/jcr:c21f466a-011c-4796-9455-36b98fb68cb2/Scope%20ESG_SPO%20LPP%20Green%20Bond%20Framework_2021Sep.pdf

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021**	**2022 E**	**2023 E**
Total cost coverage from recurring income (x)	19.5	3.7	3.1	2.8	2.7
Total cost coverage including non-recurring income (x)	21.7	3.7	3.7		
LTV ratio (%)		34	37	40	34
Liquidity (%)	>1,000	>1,000	>1,000	>1,000	>1,000
Cash flow in HUF m					
Recurring cash flows	694	553	547	634	621
Non-recurring cash flows	0	0	2	0	0
Total holding costs	36	156	174	228	228
Balance sheet/indebtedness in HUF m					
Net asset value	4,516	8,376	8,997	12,000	15,000
Gross financial debt	0	3,600	5,400	5,400	5,400
Less: available cash	15	724	2,066	462	398
Guarantees and suretyships	0	0	0	0	0
Scope-adjusted debt (SaD)	**-52**	**2,876**	**3,334**	**4,968**	**5,002**

Table of contents

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 position: key person risk

LP is 100% owned by Péter 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 other than the 'technical' issue provided by the company's perceived strong dependence on the CEO, categorised as key person risk. Our overall neutral ESG assessment also incorporates a positive assessment with regard to product innovation (ESG factor) regarding LP's large exposure to renewable energy, as well as negative assessments with regard to key person risk under management and supervision (ESG factor) and for stakeholder management (ESG factor) with regard to payout of substance for portfolio companies in the solar division.

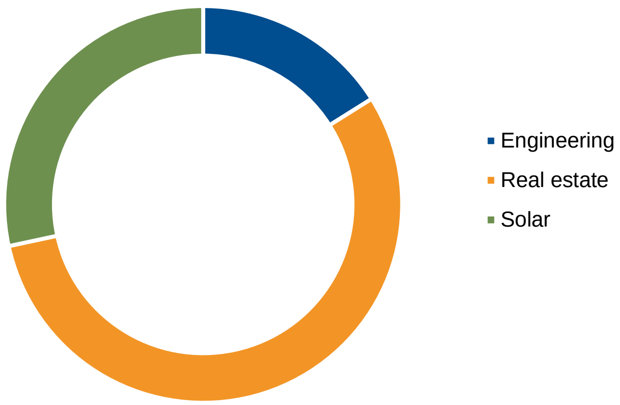
[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B

Industry risk profile: A

LP's high industry risk assessment is a mix of its underlying industries' credit-supportive characteristics. This especially true for the solar energy division, a regulated segment with a 'AA' industry assessment. As most of the dividends LP receives are from this division, the resulting contribution to the income-related assessment is high. Judged from the different industries' asset-value perspective, the outcome is lower. But it is still at 'BBB', reflecting the higher weight of the real estate segment, rated 'BB'. Overall, we assess LP's industry risk at 'A'.

Figure 1: Segment breakdown 2022E (est. net asset value)



Sources: LP

Conservative investment approach

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 to fund and finance subsidiaries. The three bonds issued by LP in 2020 and 2021 were used to fund expansion into the real estate and solar energy segments.

LP is focused on generating dividend income from its main subsidiaries in the medium term. Historically, this was only the case for one company, Solar FM. While the likelihood of being able to upstream dividends from the 20 small (0.5 MW) power plants is low in the development phase, regulation allows for this to happen in later development phases. LP therefore has a phased 'dividend expectation' model that depends on the maturity and cash generation cycle of individual projects. In 2021, this led to the first small dividends from the Helios subsidiaries and real estate assets. In addition, the steel processing companies are expected to pay dividends from 2022. We continue to expect relatively strong dividend generation at the holding company level for the next few years. The company has already received sizeable dividends of close to HUF 500m during the first seven months of 2022.

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

Main portfolio companies

Steel processing

Lakics Gépgyártó Kft.; Lakics Vagyonkezelö Kft.; Acél 235 Kft. (33% ownership of the first two companies and 40% ownership of Acél)

2021 segment sales: HUF 8.7bn; 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 in Hungary). The company employed 235 people in 2018. Its products are used in the energy sector (around 95% of total revenues). The main customers are Siemens, Flender and General Electric.

Solar energy

Helios Solar Kft.; Solar FM Kft.; Helios Solar Kft.; Helios Nova Kft.; Helios ASZI Észak and Dél.; Csesztreg; Misefa Kft. (100% ownership throughout)

2021 segment sales: HUF 1.2bn; EBITDA margin: 50%): Construction and operation of solar power plants; The Helios companies own 17 0.5 MW solar power plants and one 3.5 MW solar power plant.

Real estate

VRLD Invest Kft.; LP Broadway Invest Kft.; Almássy Invest Kft.; Petőfi Center Kft. (100% ownership throughout)

2021 segment sales: HUF 187m; EBITDA margin: 66%

Credit-supportive industry mix in holdings portfolio

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

The company's largest exposure – by estimated asset value – was to the real estate segment in 2021, with about a 60% exposure, while it was only at about 20% three years ago. This reflects ongoing investments in new projects, such as Almássy Invest (residential, hotel) and IT Campus (office).

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 (KÁT) and guaranteed power take-off under the METÁR system (Renewable Energy Support Scheme), which came into force in January 2017. It consists of a guaranteed feed-in tariff, a 'green premium' granted without tendering for the small sizes LP has (0.5 to 1 MW). The eligibility period and maximum amount of eligible electricity generated are determined for each electricity producer individually by the Hungarian Energy and Public Utility Regulatory Authority. LP's solar energy assets have a remaining life span of about 21-22 years under the protective regulations. The guaranteed volume and pricing regulations will protect the holding company's income generation in the coming years.

The first licences (25 years KÁT) were granted in 2016-17 but this window of opportunity closed in 2018. LP has since won three additional METÁR licenses (15 years guarantee) for a 3.5 MW solar power plant in Sántos, which is expected to begin production in 2023, a 2 MW plant in Taszár and another one in Sántos for 7 MW.

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

High concentration risk

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

Portfolio diversification, a very important ratings driver in our assessment of holding companies, has already benefited from the attractive investment environment for solar power plants in Hungary under regulated feed-in tariffs. We view the successful build-up of LP's solar energy position in particular as essential to lessening dependence on the owner's legacy family business. In addition, LP's real estate exposure has markedly improved in size over the past two years, mainly reflecting investments in the Petöfi shopping centre and the acquisition of real estate in a Budapest hotel project developed by LP. This has addressed the previous concentration on two segments (steel processing and solar energy), making the holding company's overall diversification across all segments more balanced during the past three years. New projects include the Komló steel manufacturing project and the comparatively large Sántos solar power plant (3.5 MW).

While LP's present exposure to comparatively stable and non-cyclical sectors (relative to GDP) supports the ratings, its still-limited scale does not. Despite the factual doubling of LP's net asset values since 2019, which was mainly enabled by applying bond proceeds, concentration risk with regard to dividend income remains very high for now. Solar energy company Solar FM continued to be the largest source of dividend income by far in 2021 (80% of LP's total income), and it is expected to continue to provide the bulk of 2022's expected dividend income (about a 60% contribution). Other holding companies such as Helios (solar) and real estate started to pay dividends for the first time in 2021, and the steel division is expected to do the same in the current year, based on that segment's much-improved operating conditions.

However, the dividend concentration issue is not overly severe for LP in our view. This is because its cost position is still lean enough to allow for about 1.5x coverage if the Solar FM dividend is cut in half for 2022 (see the financial risk profile).

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

Financial risk profile: BB

Continued solid level of credit metrics

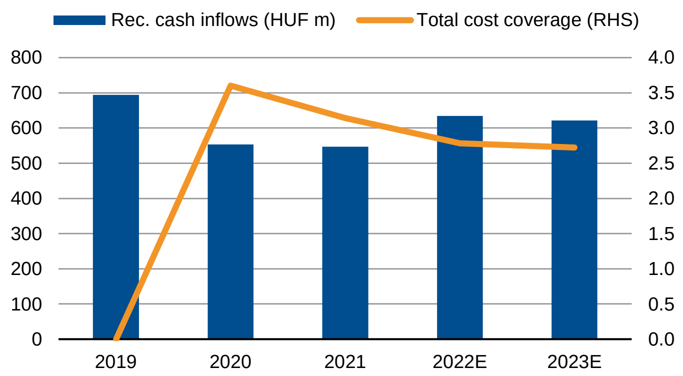
The rating continues to reflect the company's very strong cost coverage ratios. In the past, LP had a limited amount of debt on its balance sheet as most expansion was equity-funded. The HUF 2.5bn bond issued in early 2020 was therefore the first sizeable amount of debt in LP's history. Including this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

We expect costs to increase in 2022, mainly adding the new bond's coupon payments, fees and additional staffing expenses. However, we believe LP can achieve the cost coverage ratios in our base case, reflecting the high visibility of the energy sector's dividend income (the operational licenses and guaranteed feed-in tariffs for the 20 small solar energy power plants owned by LP are valid until 2041-42). LP's cost structure also benefits from no dividend payments to the owner. The rating incorporates our assumption that this will not change for at least the next two to three years.

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

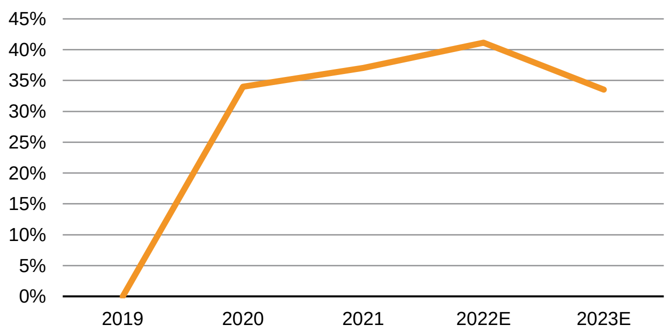
Total cost coverage without half of the Solar FM dividend would result in projected 2022 cost coverage of about 1.5x and thus well in line with present ratings.

Figure 2: Ample cost coverage



Sources: LP, Scope (estimates)

Figure 3: LTV ratio stabilising around 35%



Sources: LP, Scope (estimates)

Stabilising LTV ratio

We forecast that the loan/value (LTV) ratio will likely stabilise around 35% in the coming years, reflecting larger debt positions (adding the new HUF 1.8bn bond placed in the second half of 2021) plus growing cash derived from dividend income. We increased the portfolio's asset value in line with the planned investments at the holding companies. This is likely to result in net asset values of HUF 12bn in 2022 and HUF 15bn in 2023.

Adequate liquidity

Based on no short-term debt at LP, the company's liquidity profile continues to be sound.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	724	2,066	462
Open committed credit lines (t-1)	0	0	0
Short-term debt (t-1)	0	0	0
Coverage	-	-	-

Supplementary rating drivers: +/- 0 notches

Neutral corporate governance

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

Long-term debt ratings

Senior unsecured debt rating: BB-

As part of our recovery assessment, we calculated a liquidation value of about HUF 3.4bn in a hypothetical default scenario in 2023. This value is calculated by applying a 50% discount to the estimated net asset values of LP's participations, reduced by 10% for insolvency costs. This provides a recovery rate of more than 80% for the two combined HUF 3.5bn bonds, translating into a superior expected recovery for senior unsecured debt and qualifying the bond ratings for a two-notch uplift from the issuer rating. While this reflects LP's growing investment portfolio and the recoverability of existing solar plants (primarily equity-funded), which are operated under regulated tariffs, we have limited the bond ratings' upside to one notch (at BB-) given the issuer's low rating on an absolute scale amid overall size considerations.

Appendix: Peer comparison (as at last reporting date)

	LP Kft	Lexholding Zrt	Forrás Nyrt.	Opus Global Nyrt
	B+/Stable	B+/Stable	B+/Stable	BB/Stable
Last reporting date	31 December 2021	31 December 2021	31 December 2021	31 December 2021
Business risk profile	B	B	B	BB-
Competitive position	B	B	B	BB-
Financial risk profile	BB	BB	B+	BBB-
Total cost coverage (x)	3.1	2.5	1.3	3
LTV ratio (%)	37	25	35-65	30-40

Sources: Public information, Scope

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