26 August 2020

Corporates

OPUS GLOBAL Nyrt
Hungary, Holding Companies

SCOPE BB STABLE

Corporate profile

OPUS GLOBAL Nyrt is a Hungarian investment holding company. The group is the result of a merger between OPUS and Konzum in 2019. With about HUF 300bn (EUR 1bn) in market capitalisation, it is one of the largest entities on the Hungarian stock exchange.

The group's investment philosophy focuses on holding majority positions grouped into four industrial sectors (industrials, food processing, energy and tourism). As part of its long-term 'buy-and-build' approach, OPUS aims to identify undervalued situations and subsequently create growth and value by exercising tight operational control at its subsidiaries. The group presently holds eight sizeable individual participations in its four strategic investment fields, complemented by minority positions held in its asset management division.

Key metrics (based on holding accounts)

		Scope estimates		
Scope credit ratios	2018	2019	2020F	2021F
Total recurring cost cover (x)	0.6	6.9	3.0	3.5
LTV (Scope-adj. debt/ portfolio market value) (%)	38	35	<30	<30
Liquidity (%)	0	>200	>1.100	>500

Rating rationale

Scope Ratings affirms its issuer rating of BB/Stable on Hungary-based holding company OPUS GLOBAL Nyrt (OPUS). The senior unsecured debt category is affirmed at BBB- as is the company's HUF 28.6bn bond maturing in 2029 with a coupon of 2.8%.

The ratings continue to reflect our view on newly merged OPUS' strong growth, via the combination of (former) Opus and Konzum, as well as the positive operating potential of the industrial and food processing segments. The ratings are thus supported by the group's greatly increased recurring income generation capacity going forward. This, together with a lean holding company cost structure, means that OPUS' total cost coverage should continue to be far above the levels commensurate with the ratings. The ratings also reflect our view of OPUS' conservative and long-term 'buy-and-build' investment approach, focused on creating growth and value by exercising active operational control at the subsidiaries' level. We do not believe that management's present M&A transactions in the energy division (divestment of 55% stake in Status Power Invest Kft. [Matrai lignite plant] and potential replacement by Titasz) and the asset management division (4IG, Hotel Alpenblick, Apeninn, among others) are a departure from its investment philosophy.

We believe that the holding company continues to be relatively resilient to macroeconomic downturns, such as the present crisis triggered by coronavirus. With the exception of Hunguest, the effects on the holding company appear limited, as the other three core areas are non-cyclical and governed by long-term trends.

Ratings & Outlook

Corporate rating	BB/Stable
Senior unsecured rating	BBB-

Analysts

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Related Methodology

Corporate Rating Methodology

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In terms of portfolio diversification, OPUS is still largely concentrated on two segments (industrials – mainly construction, and food processing), which is a drag on the ratings. We thus continue to believe that diversification in the newly merged entity is not sufficiently balanced at present. In general, OPUS' exposure to four distinct, relatively non-cyclical and little-correlated sectors supports its business risk profile. In addition, most of the subsidiaries have significant growth potential, either from a high order backlog (as is the case for 51%-owned construction company Meszaros es Meszaros Kft (M+M) and R-Kord Kft.) or from substantial recent expansion and modernisation (food processing companies KALL and Viresol). We understand both segments benefitted from high growth rates in revenues and operating profitability in 2019 and the first half of 2020. However, concentration risk is still high, reflecting the weight of about 80% (by sales) of the two dominant sectors: industrials and energy.

The coronavirus crisis and related necessary refurbishment programme have delayed potential dividend payments at Hunguest by at least two years, in our view. Thus, portfolio diversification by income does not support the ratings at present. However, the situation by value is significantly better, as there is sizeable value in companies which are not paying a dividend at the moment.

The rating reflects the group's evolving form and structure, incorporating headroom for further investments, although we believe that the major building blocks were established after the merger. The rating also reflects the limited amount of debt on the holding company's balance sheet, consisting mostly of the 2019 bond (HUF 28.6bn). Both the bond issuance and the sale of Matrai have led to strong cash inflow to date. Excess liquidity was temporarily 'parked' in a HUF 10bn securities investment at the end of 2019. Year-end 2020 liquidity looks set to become even larger due to higher expected dividends (M+M, R-Kord) and the divestments of Matrai and others. We expect very comfortable cost coverage in 2019, based on recurring income, to come down in 2020, albeit to levels which are still more than in line with the ratings. We estimate that recurring holding income will cover costs by about 3x in the current year. This is based on some cost inflation – most notably accounted for by the coupon payments for the new bond – and likely higher taxes and M&A advisory fees. On the other hand, we also project higher recurring income as Mészáros Építőipari Holding Plc, a direct subsidiary of OPUS, has already paid a dividend of HUF 6bn to OPUS (HUF 5.1bn last year) and another HUF 2bn are potentially pending. The cost side continues to be supported by the fact that management is currently not paying dividends to OPUS shareholders.

While there continues to be no apparent cost coverage problem for OPUS, potential flexibility is provided by the portfolio being partly listed on the Budapest Stock Exchange. The rating benefits from the fact that OPUS will not be dependent on market timing factors should divestments become necessary to provide additional cost cover. Leverage as expressed by the loan-to-value ratio (Scope-adjusted debt to the portfolio's net asset value) is likely to be around 35%, adjusting for the low Hunguest valuation which is presently depressed by the coronavirus crisis.

We performed a recovery assessment for the senior unsecured debt category. For this assessment, we constructed a hypothetical default scenario, derived a liquidation value and then compared it with the bond volume in order to determine its recovery rate. We calculated a full recovery for the bond, mainly supported by very little secured bank debt ranking ahead, and the comparatively high market value of portfolio companies. Even discounting this value by 50% and adding guarantees and suretyships of about HUF 43bn, the bond is still likely to be fully recovered. We therefore assign the bond (senior unsecured debt category) a rating two notches above the issuer rating, reflecting superior recovery prospects.

Our assessment assumes no cross-default clauses in the portfolio companies' debt documentation.

Outlook

The Stable Outlook incorporates a broadly unchanged investment portfolio over the next one to two years, no material dividend payments to OPUS shareholders, a focus on developing the existing portfolio and no major M&A activity (other than the replacement for Matrai), as well as a cost coverage of above 1.0x.

A positive rating action could be warranted by an improvement in the holding company's business risk profile related to concentration risks. However, we do not foresee any material changes in this regard in the short to medium term. Rating downside could be triggered by total cost coverage dropping below 1.0x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Conservative buy-and-build strategy • Strong cost coverage ratio • No dividend payments	• Energy segment in transition • High dividend concentration • Coronavirus crisis negatively affecting Hunguest

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in dividend diversification	• Large debt-funded acquisition • Cost coverage of below 1x on a sustained basis

Financial overview

		Scope estimates		
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Total cost coverage from recurring income (x)	0.6	6.9	3.0x	3.5x
Total cost coverage including non-recurring income (x)	0.6	8.0	6.9	3.5
LTV (%)	38	35	34	34
Liquidity (%)	0.1	>200	>1.100	>500
Cash flows (HUF m)	**2018**	**2019**	**2020F**	**2021F**
Recurring cash inflows	285	6,476	8,437	8,587
Non-recurring cash inflows	74	1.478	15.400	0
Balance sheet/ indebtedness (HUF m)	**2018**	**2019**	**2020F**	**2021F**
Net asset value	172,142	164,546	157,000	180,000
Gross financial debt	10,958	32,868	31,200	31,200
less: available cash	-581	-12,466	-22,075	-6,202
Guarantees and suretyships	55,000	43,201	44,529	35,636
Scope-adjusted debt (SaD)	65,377	63,604	53,656	60,635

Business risk profile

Conservative investment approach

OPUS has a long-term, value-oriented 'buy-and-build' investment approach, involving tight control at subsidiary level. As a consequence, divestitures are rare. OPUS' active entrepreneurial approach is reflected in the group's targeting of majority positions which allow control. The group uses its own balance sheet to fund and finance subsidiaries. The planned bond will be issued by OPUS to refinance more expensive term debt at subsidiary level.

OPUS is focused on generating dividend income from its main subsidiaries in the medium term. At present this is only the case for a few group companies. Others, like food processing companies Viresol and Kall are going through capacity expansion and reorientation (with energy to be redirected towards renewables, away from lignite). Their ability to pay dividends is not certain as of now and is therefore not reflected in the rating.

We assess OPUS' 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 OPUS shareholders), making cost coverage relatively independent of the overwhelming part of dividends received.

OPUS also provides an increasing amount of management services to its subsidiaries as an additional element of income derived. The ratings thus reflect our view of OPUS' conservative and long-term 'buy-and-build' investment approach, focused on creating growth and value by exercising active operational control at subsidiary level.

Main portfolio companies

Industrials Segment (2019 sales: HUF 128.5bn, +22% vs 2018; EBITDA margin 12%):

- **Meszaros es Meszaros Kft.** (M+M; 51% owned indirectly): General contractor typically for large public procurement construction projects such as utilities (water, waste management, infrastructure), water and underground, as well as road and railways
- **R-Kord Kft.** (51% owned indirectly): General contractor for large public procurement projects in railway construction
- **RM International Zrt** (51% owned directly): holds a 50% participation in the consortium for the development of the high-speed railway connection between Budapest and Belgrade
- **Wamsler SE** (100% owned): German fireplace and stove manufacturer; largest player in CEE countries with a market share of about 7% (about a third in Hungary)

Food Processing Segment (2019 sales: HUF 32bn, +127% vs 2018; EBITDA margin 5%

- **KALL Ingredients Kft.** (83% owned): Corn processing with extensive product portfolio including isosugar and liquid sugars; just completed EUR 160m investment in modern plant
- **Viresol Kft.** (53% owned): Wheat processor with extensive product portfolio including starches, industrial alcohol, gluten and raw material for fodder

Energy Segment (2019 sales: HUF 77.6 bn, +5% vs 2018; EBITDA margin 2%)

- **Matrai Erömü Zrt.** (40% owned indirectly): Hungary's second largest power plant (mainly lignite); operates two lignite mines; to be redirected towards renewables

Tourism (2019 sales: HUF 26.9bn, +2.2%; EBITDA margin 18%)

- **Hunguest Hotels Zrt.** (100% owned indirectly): Hotel operator with 25 locations in Hungary, Austria, Montenegro and Romania. Strong acquisition activity in 2018 led to 62% growth

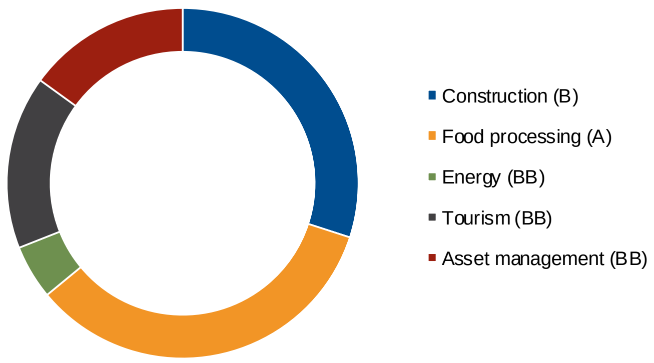
Underlying industries in portfolio have relatively little cyclicality

OPUS' exposure to four distinct, relatively non-cyclical and little-correlated sectors supports its business risk profile. The majority of industries represented in the portfolio have low and medium cyclicality. OPUS' construction subsidiaries have a large exposure to public projects such as railway infrastructure, telecoms and utility works, which is beneficial in the event of macroeconomic weakness.

In addition, most of the subsidiaries have significant growth potential, either due to a high order backlog (as is the case for M+M) or substantial, recent expansion capital expenditure (KALL and Viresol).

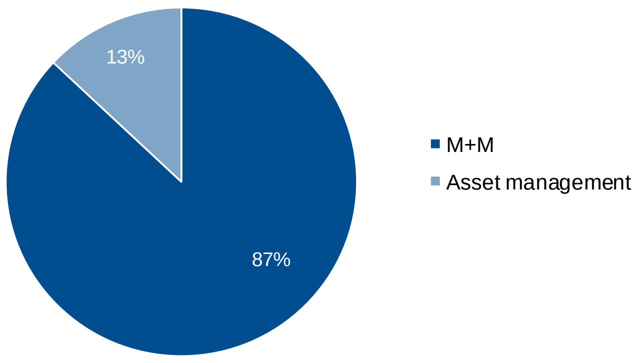
The group's largest exposure – by investment value and asset value – is to the 'Industrials' and 'Food Processing' segments, with about 70%-80% exposure. While this is likely to change over time, the holding company's industrial exposure is a mix of low-rated construction activities and highly rated food processing. We believe that a blended mix of BB is representative of OPUS' current portfolio of participations.

Figure 1: Two dominant industries (net asset value)



Source: OPUS

Figure 2: Dividend income 2019



Source: OPUS

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 equally from heavy investments in various participations over the past two years and from the merger. However, given still-large concentration on two segments (industrials – mainly construction, and food processing) diversification in the newly merged entity is not sufficiently balanced at present.

This culminates in an almost 90% dividend concentration from M+M and R-Kord. However, the dividend concentration issue is not overly severe for OPUS in our view, because the construction dividends appear sustainable given the companies' positive operating trend over the past 12 months.

The majority of OPUS' 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. OPUS is not overly dependent on divestiture proceeds, given its comfortable cost coverage. At the same time, it holds a flexibility reserve in the form of its asset management arm, which holds minority positions in three listed companies. However, due to divestitures in 2019 and further ones expected in 2020, we expect the segment to shrink significantly in value from the HUF 20bn a year ago.

Neutral corporate governance

We assess corporate governance as neutral to the ratings. There is no majority individual shareholder, although the Meszaros family has over 30% of the voting rights (directly, including the Konzum PE stake it is above 50%). OPUS' position as one of the largest quoted companies on the Budapest stock exchange means that it is subject to transparency and disclosure regulations. We therefore believe that existing structures at the newly merged company ensure adequate corporate governance. While we believe that disclosure transparency is comparatively high at OPUS, we note the abrupt departure of the former CEO within his first full year in office, which is unusual.

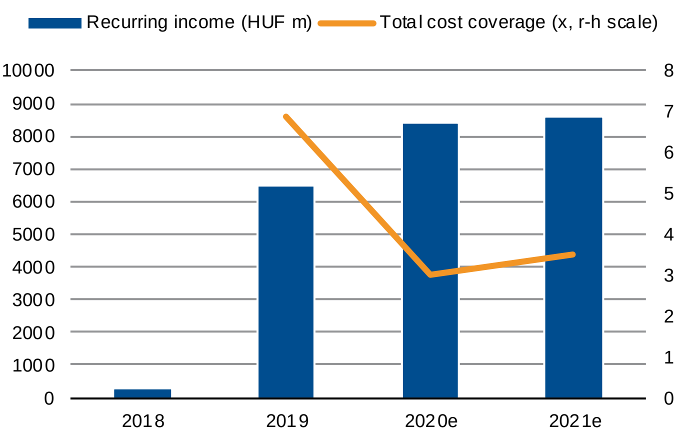
Financial risk profile

Solid credit metrics

We expect very comfortable cost coverage in 2019, based on recurring income, to come down in 2020, albeit to levels which are still more than in line with the ratings. We estimate that recurring holding income will cover costs by about 3x in the current year. This is based on some cost inflation – most notably accounted for by the coupon payments for the new bond – and likely higher taxes and M&A advisory fees. On the other hand, we also project higher recurring income for the holding as Mészáros Építőipari Holding Plc, a direct subsidiary of OPUS, has already paid a dividend of HUF 6bn to OPUS (HUF 5.1bn last year) and another HUF 2bn are potentially pending.

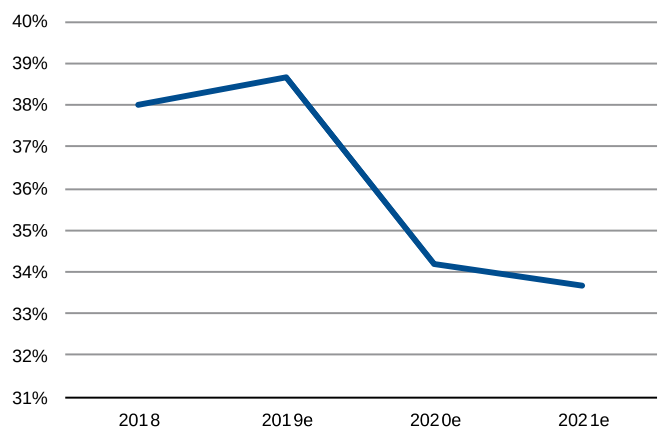
In line with the payment moratorium for bank debt incurred in Hungary to mitigate calls on cash generation driven by the coronavirus crisis, OPUS has also decided to apply a similar moratorium to its participations for 2020 and 2021. The cost side continues to be supported by the fact that management currently does not pay dividends to OPUS shareholders. In addition, the holding company is likely to derive more management fee income for services provided to group companies starting in 2020. As there are likely to be large cash proceeds from divestments (Matrai HUF 10bn and others) in 2020, the company's liquidity position should expand significantly at year-end 2020. This will then be expensed – probably in 2021 – for the targeted and pending energy transaction replacing Matrai in OPUS' energy segment.

Figure 3: Improving recurring income



Source: Scope estimates

Figure 4: LTV around 35%



Source: Scope

Projected LTV of about 30%

We forecast that LTV will stay at about 35% in the coming years, reflecting unchanged debt positions (mainly the bond) plus increasing cash derived from dividend income. The portfolio's asset value, adjusted for the presently low Hunguest valuation reflecting the impact of coronavirus on the company, as well as seemingly very conservative real estate book values, is commensurate with the rating.

Neutral financial policy

We believe that financial policy is not relevant to the ratings at present. This is because the new company and freshly introduced top management have not had time to establish a sufficient track record given the recent merger. We view the history of the two merger parties as positive, as both almost exclusively resorted to pure equity funding for portfolio expansion. However, it remains to be seen whether this will also hold true for the new entity. Management has stated that its conservative philosophy should not change in the near future, noting that further large acquisitions are unlikely because the focus will be on integration and deriving growth and profitability at subsidiary level.

Senior unsecured debt with superior recovery

In our hypothetical default scenario based on a liquidation approach, we continue to identify significant recovery value for the senior unsecured bond. We in fact calculated a full recovery for the bond, mainly supported by very little secured bank debt ranking ahead in an insolvency scenario as well as the comparatively large market value of portfolio companies. Even discounting this value by 50% and adding guarantees and suretyships of about HUF 35bn, the bond is still likely to be fully recovered. We therefore affirm both the senior unsecured debt category and bond ratings at BBB-, reflecting superior recovery prospects. Our assessment assumes no cross-default clauses in the portfolio companies' debt documentation.

Outlook

The Stable Outlook incorporates a broadly unchanged investment portfolio over the next one to two years, no material dividend payments to OPUS shareholders, a focus on developing the existing portfolio and no major M&A activity, as well as a cost coverage of above 1.0x.

A positive rating action could be warranted by an improvement in the holding company's business risk profile related to concentration risks. However, we do not foresee any material changes in this regard in the short to medium term. Rating downside could be triggered by total cost coverage dropping below 1.0x on a sustained basis.

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