Stelius Zrt.
Hungary, Holding Companies

B+ STABLE

Corporate profile

Stelius Zrt. is an investment holding company majority owned by Mr Elek Nagy and his family. Stelius' shareholdings are valued at about HUF 19bn as of December 2020. The company applies a long-term investment approach, reflected in its active role in all of its investees' boards and the financial support it provides to them.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Total cost coverage (x)	1.6x	1.0x	1.3x	1.3x
Loan-to-value (Scope-adjusted debt/portfolio's market value)	Net cash	38%	Depending on new investments	
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

The affirmation of the issuer rating is supported by the sufficient total cost coverage position and the balanced financing structure with only moderate external financial debt. The issuer rating is still constrained by the limited size of gross asset value and certain lack of transparency.

The cross ownerships within an already complex organisational structure result in a lack of transparency and limited visibility on future cash inflows. However, we believe Stelius' current transition phase, reflected in a partial portfolio reshaping, will simplify the group structure by the end of FY 2021, with holding activities centralised.

Stelius' portfolio will remain highly dependent on dividends from two holdings, BAV and Inforg, for the next few years (above 90%). This makes the portfolio vulnerable to any unpaid dividends and could make fixed-cost coverage volatile.

Though lower than expected, cash income has remained sufficient to cover operating expenses, with management and service fee income able to compensate for the Covid-induced dividend cuts at the shareholdings. We expect total cost coverage to remain above 1.0x over the next few years

Liquidity continues to be adequate. The absence of short-term debt, along with positive free operating cash flow and a significant cash buffer (around HUF 3.0bn as of FY 2020), means there are no refinancing risks that would necessitate the sale of shareholdings.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that the recurring coverage of mandatory holding costs will remain above 1.0x in the medium term. The Outlook also incorporates the successful structural reorganization envisaged for FY 2021.

A positive rating action might be warranted upon an improvement in diversification and concentration in terms of income streams and/or gross asset value.

A negative rating action may be warranted if limited transparency mainly related to complex organisational structure remained after 2021 and/or the total cost-coverage ratio (recurring) dropped below 1.0x on a sustained basis. This could occur if the financial position of the dividend-paying undertakings deteriorated significantly, requiring a

Ratings & Outlook

Corporate rating	B+/Stable
Senior unsecured rating	B+

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Related Methodology

Corporate Rating Methodology: July 2021

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recovery programme and/or limiting their ability to pay dividends or management fees to Stelius

Rating drivers

Positive rating drivers	Negative rating drivers
• Coverage of mandatory holding costs at above 1.0x, expected to be maintained after bond issuance • Expected increase in recurring cash inflows from management fees • Position as majority shareholder that affords influence over dividend policies	• High concentration and limited diversification of investments and income streams • Complex legal structure, though to be addressed via legal entity rationalisation envisaged for 2021 • Low liquidity of undertakings

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in diversification and/or concentration in terms of income streams and gross asset value	• Deterioration in diversification and/or concentration • Recurring total cost-coverage ratio of less than 1.0x on a sustained basis • Limited transparency

Financial overview

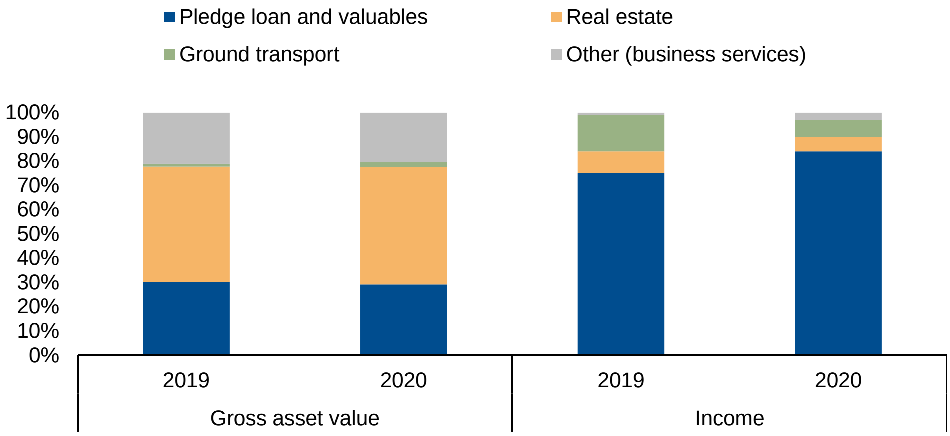
			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Total cost coverage (recurring)	1.6x	1.0x	1.3x	1.3x
Total cost coverage without dividend payments	2.0x	1.2x	1.7x	1.6x
Loan-to-value ratio (Scope-adjusted debt/portfolio market value)	Net Cash	38%	Depending on new investments	
Liquidity	>200%	>200%	>200%	>200%
Cash flows (HUF m)	**2019**	**2020**	**2021E**	**2022E**
Recurring cash inflows (dividends and profit transfers)	415	50.4	223	254
Non-discretionary cash outflows (including net interest payments)	217	225	223	223
Balance sheet/indebtedness (HUF m)	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted debt	Net Cash	12,041	12,032	14,286
Net asset value	18,348	31,633	31,583	34,758

Business risk profile: B

High concentration risk constrains business risk profile

High concentration risk remains the main constraint for Stelius' business risk profile. We do not expect this risk to ease over the next three years.

Figure 1 – Blended industry risk



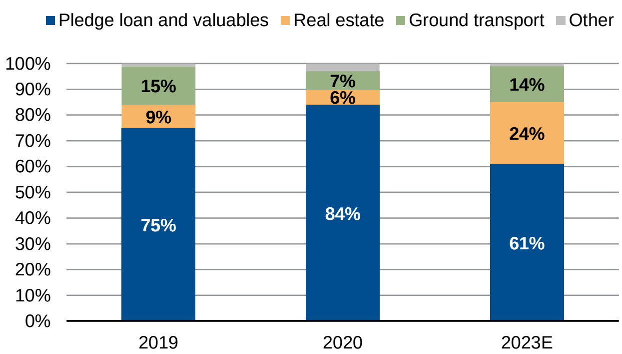
Source: Stelius, Scope

Stelius' portfolio will remain heavily dependent on dividends from two holdings, BAV and Inforg (above 90%), for the next few years. This makes the portfolio vulnerable to any unpaid dividends and could make fixed-cost coverage volatile. However, we hold a positive view of the effort to shift income sources away from dividends to less volatile sources such as recurring management and service fees which depends more on top line than the bottom line performance.

Limited asset diversification partially mitigated by global revenue streams

The limited diversification among dividend-generating assets persists. Five shareholdings contributed roughly 75% of gross asset value as of YE 2020, which we expect to further increase in the short to medium term. We also expect no additional diversification, as Stelius' strategy is to streamline investments in existing real estate projects, with the aim to increase rental income. This is despite the stronger investment headroom from bond proceeds and the HUF 3.8bn of extraordinary dividends from Pro-cash.

Figure 2 – Cash income[1] breakdown by division



Source: Stelius,Scope

Figure 3 – Management fees and service income as of Dec 2020

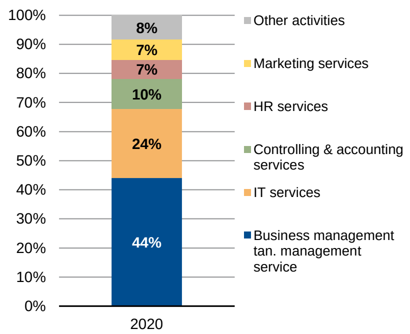
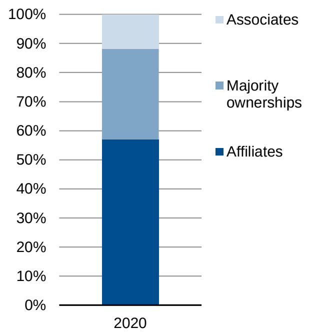


Figure 4 – Management fees and service income as of Dec 2020 by investment type



Source: Stelius, Scope

[1] including management and service fees, dividends and interest on intercompany loans.

Non-liquid portfolio due to high share of unlisted companies

Stelius' portfolio consisted entirely of unlisted companies as of YE 2020, which limits any potential divestiture proceeds. We believe its long-term investment approach is valid for the portfolio, as evidenced by the limited disposals in the past. However, Stelius places less emphasis on asset fungibility owing to its predictable cost structure and level of short-term securities.

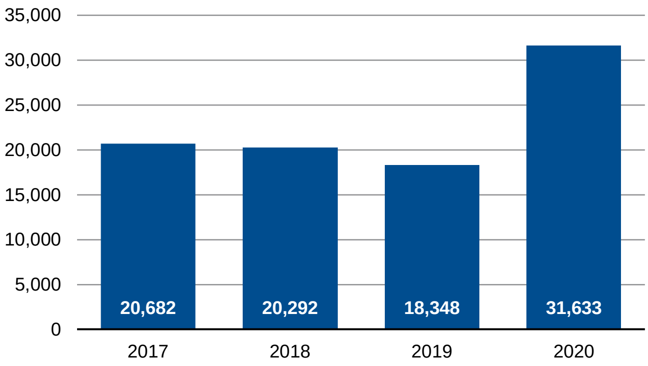
Financial risk profile: BB

Management fee income expected to further increase following elevated cost base of investees

Though lower than expected, cash income remained sufficient to cover operating expenses because management and service fee income could compensate for the Covid-induced dividend cuts at the shareholdings. We expect total cost coverage to remain above 1.0x over the next few years, supported by: i) the relatively stable management fees from investees from 2020; ii) the broadly stable net interest on shareholder loans; iii) the likely reduction of dividend payments from core portfolio companies to normal levels; and iv) no significant increase in dividend payouts, shielded by financial bond covenants.

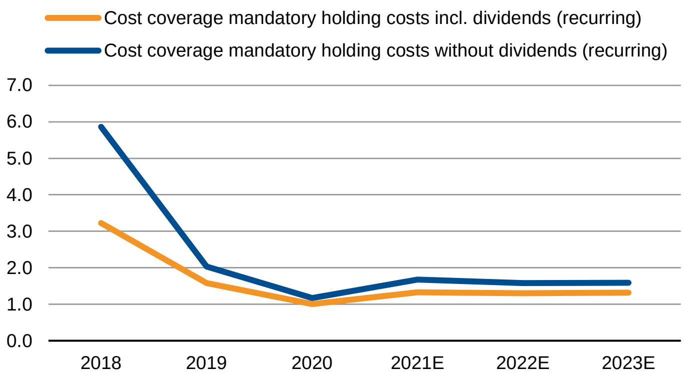
Management fees are expected to further increase in the forecast period. Stelius intends to provide more corporate functions to its undertakings, which will also result in higher cash expenses (operating costs) among the investees.

Figure 5: Gross asset value development



Source: Stelius, Scope estimates

Figure 6: Total cost coverage



Source: Stelius, Scope estimates

Modest leverage

Stelius' leverage as measured by its loan-to-value ratio remains comfortable at 38% as of FY 2020 (net cash as of YE 2019) despite the significant increase since last year. The loan to value has increased since the previous year with the issuance of the HUF 15bn bond. More than 75% of cash proceeds still has to be used towards modernising and renovating of real estate assets.

Adequate liquidity

Liquidity continues to be adequate. Due to the absence of short-term debt, along with positive free operating cash flow and a significant cash buffer of around HUF 3.0bn as of FY 2020, no refinancing risks would necessitate the sale of any shareholdings.

Supplementary rating drivers

There are no explicit adjustments for supplementary rating drivers. We highlight the lack of transparency, driven by cross ownerships in the organisational structure. However, we believe Stelius will have a simple group structure by FY 2021 with centralised holding activities after the current transition phase, reflected in the completed portfolio reshaping.

Long-term debt ratings

Senior unsecured debt affirmed at B+

In the third quarter of 2020, Stelius issued a senior unsecured corporate bond of HUF 15bn under the Hungarian National Bank's Bond Funding for Growth Scheme.

Long-term senior unsecured debt issued by Stelius Zrt. has been affirmed at B+, the same level as the issuer rating.

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