Lexholding Zrt
Hungary, Investment Holding

SCOPE B+ Stable

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Total cost coverage	0.94x	1.37x	1.22x	1.38x
Scope-adjusted loan-to value ratio (LTV)	40%	38%	~40.0%	
Liquidity	>100%	>100%	>100%	>100%

Key rating factors

Lexholding's business risk and financial risk profiles are in line with our base assumptions as outlined in the initial rating action in July 2021. There have been four notable events in the last 12 months: i) Stelius Zrt's change of name to Lexholding Zrt as of 1 December 2021; ii) the resignation of deputy CEO Béla Slánicz and the appointment of Sándor Móczár as CFO as the consequence of the current reorganisation of the company; iii) the spending of 40% of the bond proceeds, mainly on real estate and IT-related project developments as planned while the remaining bond proceeds remain invested in short-term deposits without any lock-up periods available for immediate deployment if required; and iv) ongoing structural reshaping as Procash Zrt merged with Lexholding Zrt and MB Elit Luxury Kft merged with Főtaxi Kft while a complex issuer structure remains. Incorporating a variety of different businesses, cross-ownerships, intra-company transactions and financing structures have resulted in a lack of transparency.

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.

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) persisted in the medium term and/or the recurring total cost-coverage ratio dropped below 1.0x on a sustained basis. This could occur if the financial position of the dividend-paying undertakings deteriorated significantly, requiring a recovery programme and/or limiting their ability to pay dividends or management fees to Lexholding.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
8 Jul 2021	Affirmation	B+/Stable
6 Jul 2020	New	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodology and Related Research

Corporate Rating Methodology; July 2021

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Bloomberg: RESP SCOP

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 to be addressed via legal entity rationalisation in the medium term (credit negative ESG factor) • Low liquidity of undertakings

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 under 1.0x on a sustained basis • Limited transparency

Corporate profile

Lexholding Zrt. is an investment holding company majority-owned by Mr Elek Nagy and his family. The company invests mainly in three areas: i) retail (pawnshops and art trading); ii) real Estate; and iii) ground transportation (taxi operators).

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. However, this commitment does not rule out opportunistic disposals, hence the company is mainly focused on recurring dividend-streams from its undertakings.

One of the key sources of income at the investment holding level (i.e. at Lexholding Zrt.) are service and management fees for services rendered for the various undertakings. Services provided by Lexholding Zrt for the undertakings are HR, controlling, marketing, IT and internal audit.

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Total cost coverage	0.94x	1.37x	1.22x	1.38x
Scope-adjusted LTV	40%	38%	~40.0%	
Liquidity	>100%	>100%	>100%	>100%
Total income in HUF m				
Dividends form industrial holdings	269	1,069	676	1,000
Income from financial holdings	0	0	0	0
Income from shareholder loans	39	191	459	560
Management and Service Fees	1,309	1,776	2,254	2,360
Recurring income	**1,617**	**3,036**	**3,389**	**3,920**
Total expenses in HUF m				
Operating expenses	-1,346	-1,450	-2,016	-2,069
Taxes paid	0	0	0	0
Interest paid	-135	-465	-465	-465
Dividends paid	-235	-300	-300	-300
Total expenses	**-1,716**	**-2,215**	**-2,781**	**-2,834**
Scope-adjusted debt in HUF m				
Reported gross financial debt	15,000	15,000	15,000	15,000
less: cash and cash equivalents	-2,959	-1,899	-1,633	-2,802
Other items (guarantee)	410	410	410	410
Scope-adjusted debt	**12,451**	**13,511**	**13,777**	**12,608**
Scope-adjusted gross asset value in HUF m				
Investments (as per balance sheet)	19,030	25,486	31,486	36,486
Short-term investments	11,812	10,203	5,203	203
Scope-adjusted gross asset value	**30,842**	**35,689**	**36,689**	**36,689**

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

Environmental	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)

Corporate structure

The credit-negative corporate structure is reflected in the lack of transparency driven by intra company transactions, cross ownerships and complex organisational structure. While this has not led to any supplementary rating driver adjustment so far, it is reflected in the conservative assessment of the company's financial risk profile. However, we believe Lexholding will adopt a simple group structure in the short-to-medium term with centralised holding activities after the current transition phase and the portfolio reshaping. We see this point as a credit-negative ESG factor for the rating.

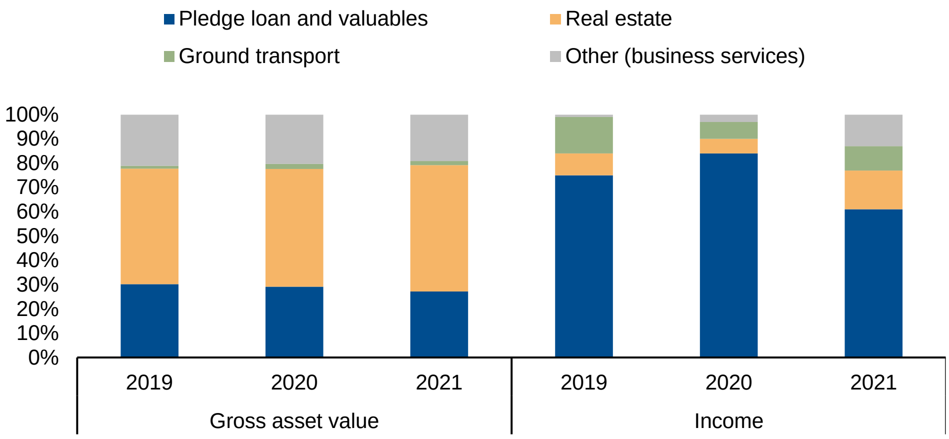
[1]These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B

Credit-neutral Industry risk

Lexholding's industry risk is assessed at BBB-, based on 60% of its net investment value being in BB rated commercial real estate at YE 2021, predominantly in businesses directly or indirectly exposed to tenant industries. By income, the exposure is 60%-80% to industries rated BBB as the real estate portfolio companies are still in early stages of development or need additional funds for renovation and do not yet contribute any material dividends.

Figure 1: Blended industry risk



Source: Lexholding, Scope

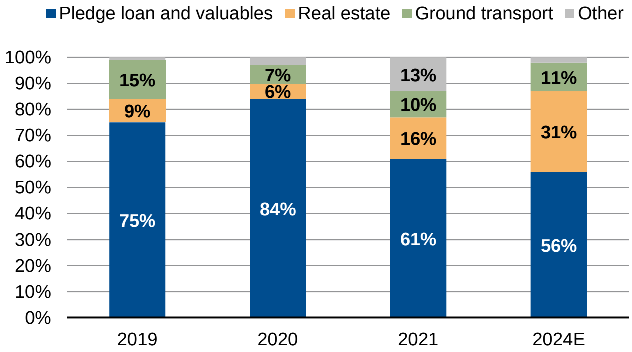
Limited asset diversification

Limited diversification among dividend-generating assets still persists. Five core shareholding contribute roughly 80% of gross asset value as at YE 2021, which is expected to further increase in the short-to-medium term after structural changes. Despite the strengthened investment headroom from bond proceeds (about HUF 8.5 available for deployment), we do not expect an increase in portfolio diversification as Lexholding's strategy streamlines investments in the existing real estate projects to increase rental income.

High concentration risk constrains business risk profile

The Lexholding's portfolio's dependence on BAV's dividends will also remain significant (above 70%) for the next few years, which limits Lexholding's ability to offset the impact of one of the undertakings failing to pay dividends and hence poses the risk of volatile fixed-cost coverage. We view positively the transition from dividends to management fees as an income source. Management and service fee income is less volatile than dividend income as payment by the undertakings is mandatory and depends on top-line rather than bottom-line performance. Management fees and services accounted for around 61% of total cash income in 2021 and are expected to further increase in the forecasted period as Lexholding intends to provide more corporate functions to its undertakings.

Figure 2: Cash income[2] breakdown by division



Source: Lexholding,Scope

Figure 3: Management fees and service income FY 2021

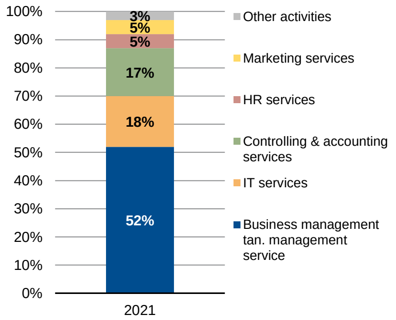
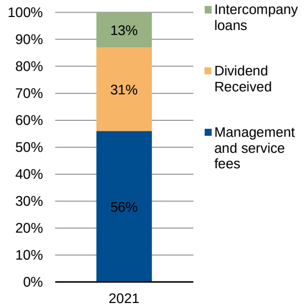


Figure 4: Income breakdown FY 2021



Source: Lexholding, Scope

Financial risk profile: BB

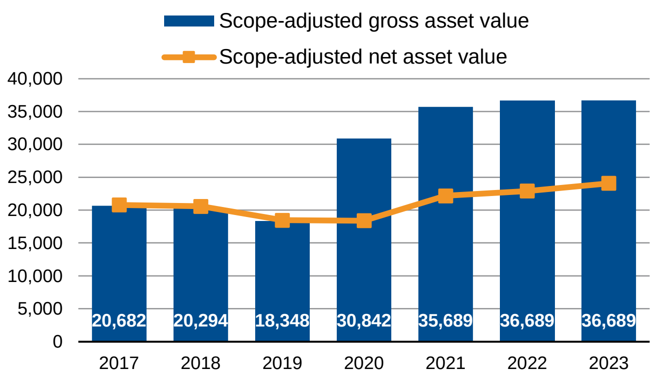
Management fee income expected to further increase following high investee cost base

Though lower than expected, cash income remained sufficient to cover operating expenses in FY2021 because management and service fee income could compensate for the Covid-19-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 nature of management fees implemented on the level of investees from 2020; ii) broadly stable net interest on shareholder loans; iii) the likely scaling-back of dividend payments to normal levels from core portfolio companies (i.e. ground transport, real estate); and iv) no significant increase in dividend payouts protected by financial covenants on bonds.

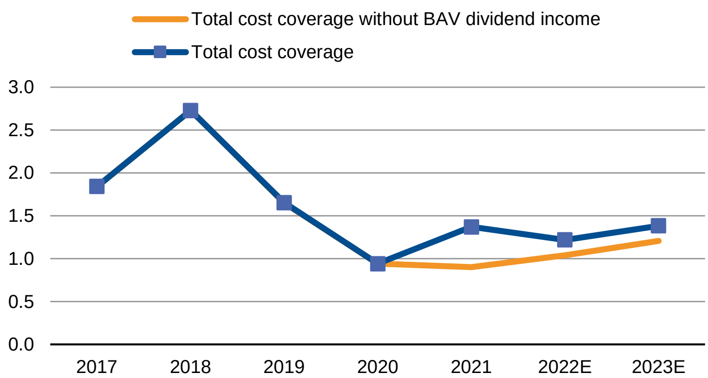
Management fees are expected to further increase in the forecast period. Lexholding intends to provide more corporate functions to its undertakings, which will also result in higher cash expenses (operating costs) among the investees.

Figure 5: Asset value development in HUF m



Source: Lexholding, Scope estimates

Figure 6: Total cost coverage



Source: Lexholding, Scope estimates

[2]Including management and service fees, dividends and interest on intercompany loans

Modest leverage

Lexholding's leverage as measured by its LTV remains comfortable at 38% as of FY 2021 (40% as of FY 2020). More than 60% of cash proceeds from bonds still has to be spent in accordance to the planned modernisation and renovation of real estate. With the gradual use of the bond proceeds, we expect the LTV to remain at around 40% within the next two years, depending on when the proceeds are used. The rating is mainly constrained by the limited visibility of the net asset value of Lexholding's investments, which makes its gross asset value stable without reflecting changes in the underlying asset quality of core holdings.

Adequate liquidity

Lexholding's liquidity continues to be adequate. Due to the absence of short-term debt, it benefits from positive free operating cash flow and significant cash buffer around HUF 2.0b as of YE 2021. There are basically no refinancing risks that would necessitate the sale of any shareholdings.

Balance in HUF m	2022E	2023E
Unrestricted cash (t-1)	1,899	1,633
Open committed credit lines (t-1)	0	0
Free operating cash flow (t)	34	469
Short-term debt (t-1)	0	0
Coverage	>100%	>100%

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

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 Lexholding will have a simple group structure in the short-to-medium term with centralised holding activities after the current transition phase, reflected in the reshaping of the portfolio.

Long-term debt rating

Senior unsecured debt rating: B+

We have affirmed the senior unsecured debt rating at B+ including the HUF 15.0b (ISIN HU0000359955) bond. This reflects our expectation of a 'superior' recovery for senior unsecured debt positions in the hypothetical event of a company default. The recovery analysis is based on a hypothetical default scenario in 2024, which assumes outstanding senior unsecured debt of HUF 15.0b with no senior secured loans. We highlight the limited visibility on the net asset value of core holdings as current Hungarian accounting standards incorporate the cost of a investments but does not capture the market value of investments.

Appendix:

In order to assess an investment holding company's financial strength, we use financial data provided in the standalone (holding company) accounts as the source for calculating key financial credit metrics. We do not include financial data from consolidated financials in our calculations of key credit ratios for the following reasons: i) cash flows or liquidity of portfolio companies as shown in consolidated accounts may not be accessible at the holding company level and ii) an investment holding company may not have any influence over a portfolio company's dividend policy. We use the following key credit metrics to gauge the financial risk profile of an investment holding company:

- Total cost coverage;
- Leverage (LTV);
- Liquidity.

We use total cost coverage as the key indicator. We define the total cost coverage ratio as cash inflows versus non-discretionary cash outflows at the holding company level.

Cash inflows at holding company level included in our calculation are:

- Cash inflows from portfolio companies such as dividends or cash payments triggered by profit-sharing agreements;
- Cash-interest inflows from treasury activities such as investments in debt securities;
- Distributions from other investments such as investment funds or money market funds;
- Any other recurring cash-effective payments received from portfolio companies such as management fees.

Cash proceeds from divestments in portfolio companies are only included as a cash inflow if we expect these to recur annually.

Non-discretionary cash outflows included in our calculation are:

- Cash outflows from debt servicing (cash interest) and, if applicable, non-cash interest accruing on debt instruments;
- Dividend payments made by the investment holding company to its shareholders. We are aware that the nature of dividend payments is more akin to a discretionary cash outflow. For the purpose of calculating total cost coverage, we treat dividend payments as non-discretionary until the investment holding company publicly declares significant changes to its dividend payments.
- General holding company costs such as administrative expenses, staff costs and taxes.

We calculate an investment holding company's leverage by taking into account the portfolio's market value relative to the adjusted debt position (Scope-adjusted debt) at holding company level. The debt position not only includes short-term and long-term financial debt, but also adjustments for pension provisions, operating leases and other off-balance sheet items such as guarantees.

We use the LTV ratio as a supplementary ratio within our financial risk assessment. This is to avoid market prices of listed assets mechanically changing financial ratios, including the financial risk profile. We believe that changes in the market prices of listed assets are only important if an investment holding company faces debt maturities over the course of the next 12-24 months. Purely focussing on LTV can be misleading because this ratio does not capture the dimension of an investment holding company's debt maturity profile. If an investment holding company can cover its non-discretionary cash outflows, as mentioned above, there is no need for additional funding. Therefore, the dependence and relevance of price changes for listed assets can only be judged with regard to debt maturities over the course of the next one to two years.

We assess the liquidity of an investment holding company in the same way as for any other non-financial corporate, taking into account the holding company's ability to pay its short-term debt using free operating cash flow, unrestricted cash and marketable security positions, unused committed bank facilities, and unused committed factoring lines.

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