TUESDAY, 29/03/2022 - Scope Ratings GmbH

Scope affirms BB/Stable issuer rating to OPUS Global Nyrt

The rating action reflects OPUS' resilient financial risk profile in light of potentially lower dividend income in the current year as well as improved asset diversification following transactions in the energy division.

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope Ratings GmbH (Scope) has today affirmed its BB/Stable issuer rating on OPUS Global Nyrt. Scope has also affirmed the company’s senior unsecured debt rating at BBB-.

Rating rationale

The ratings continue to reflect Scope’s view on OPUS’ strong financial risk profile and very sound total cost coverage at holding company level. This is supported by solid liquidity policy maintained in the holding’s recent phase of transition despite active M&A connected to the reorientation of the company’s energy segment. Scope deems the holding’s financial risk profile still strong, despite a likely deterioration in credit metrics in 2021 (final numbers are still outstanding), which was caused by the acquisitions of electricity distribution company Titasz as well as the takeover of gas distributor Tigaz both on a 50% basis (jointly executed with 50%-owned Status Energy Kft), for a total cash consideration of about HUF37 bn in 2021. The transactions were mainly funded by the new HUF 39bn bond placed under the Hungarian Central Bank’s (MNB) Funding for Growth scheme, but also by divestiture proceeds from solar project Buzsak sold to MET Holding AG. The expected credit metrics deterioration for 2021 is thus chiefly created by higher debt while the acquired companies do not yet contribute to OPUS’ dividend income. This might also be questionable both for the main entities of the food processing division (Kall and Viresol) as well as for Hunguest (tourism) reflecting both the effects of the Corona crisis (lockdowns, hotel refurbishments) as well as rising energy and raw material costs. Lockdown related project delays in the industrial division’s important railway construction arm might be very likely to have a negative consequence on the dividend level in 2022. As OPUS’ industrials segment continues to provide the main source of recurring dividend income for the holding this has a negative impact on expected 2022 credit metrics, most notably on total cost coverage. However, Scope believes that this will not be critical for the ratings as OPUS’ total cost coverage was historically much higher than the levels commensurate with the ratings. The ratings also reflect Scope’s 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.

Scope continues to believe that the holding company will continue to be relatively resilient to macroeconomic downturns such as the present one triggered by the coronavirus crisis. 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.

OPUS has improved its portfolio diversification. The significantly more sizable energy segment is now providing a more even spread of business in terms of asset values than before when the holding company’s portfolio was largely concentrated on the two segments of industrials and food processing. Scope therefore assesses diversification as having improved in the last 12 months, despite the fact that dividends continue to be generated exclusively by the industrials’ division. Scope believes that OPUS’ exposure to four distinct and relatively non-cyclical and little correlated sectors supports its business risk profile. In addition, most of the subsidiaries are characterised by significant growth potential, either derived from a large order backlog (as is the case for 51%-owned construction company M+M and R Kord Kft.) or from recent substantial expansion and modernisation (food processing companies KALL and Viresol, as well as tourism company Hunguest). Scope understands the food processing division’s profitability having been burdened by high input costs for energy and raw materials during 2021 which drove down the operating margin significantly in the full year, despite realization of significant sales growth. It remains to be seen whether the division’s entities can alleviate the situation by increasing their own selling prices during 2022. Thus, while the holding’s diversification by divisional exposure improved due to the addition of the energy companies as well as from the growth in the food processing division, concentration risk with regard to dividend income continues to be very high reflecting the non-industrial divisions’ inability to pay a dividend at least in the short term. This also applies to Hunguest, despite significant progress in terms of sales growth and EBITDA margin expansion in 2021, compared to the year ago.

The rating reflects the increased amount of debt on the holding’s balance sheet at the end of 2021 reflecting both the 2019 bond (HUF 28.6bn/ 10-year maturity, 2.8% coupon) as well as the second HUF 39bn bond issued in 2021 (10-

year maturity, 3.2% coupon). Both the bond issuances as well as the sale of subsidiaries have led to strong cash

generation at OPUS to date, even after cash used for acquisitions and intercompany loans (predominantly for Hunguest). This strong liquidity provision – also required by being eligible for a state subsidy of HUF 17bn at 30% intensity (ie 70% of OPUS' own money needs to be invested over time) - serves as a buffer in the short term but will also need to be expensed operationally (intercompany loans of in total HUF 16bn in 2022 for Hunguest, Kall and Viresol, after about HUF 31bn was passed on to the holding's participations in 2021, already). Scope notes that both large acquisitions of Titasz and Tigaz were structured in a way that preserves liquidity. This was enabled by a close joint-venture- like funding of both entities together with Status Energy Kft which is controlled by the Meszaros family (also the largest owner of OPUS Global). The Buzsak solar park transaction which OPUS sold to MET AG in 2021 for HUF 12.6bn is also supportive in this context.

While OPUS continues to have no apparent cost coverage problems, leverage as expressed by the loan-to-value ratio (Scope-adjusted debt to the portfolio's net asset value) is likely to have increased to about 40% in 2021, reflecting significantly increased debt levels compared to value (which was negatively impacted in 2021 by a HUF 7bn impairment for Kall due to this company's lower profitability). This does not constitute a "danger level" for the ratings, also due to OPUS' conservative LTV calculation based on book values. At the same time, Scope continues to focus on the total cost coverage ratio as the main driver for OPUS' financial risk profile which is likely to have continued on comparatively high levels of about 4x in 2021. For 2022, Scope expects some deterioration in the total cost coverage ratio, however, as the high dividend from the industrial segment might not be sustained in light of the division's likely delays emerging in the railway activities. As this dividend still constitutes the main source of income for OPUS, it has a direct impact on future cost coverage levels. Assuming a 40% cut in the industrial's dividend – with no mitigation from other group companies – total cost coverage is expected to be at about 2x, also reflective of higher interest charges for OPUS from the second bond. Holding companies are partly not permitted to pay back interest to OPUS due bank restrictions. Assuming a 'one-off' dividend cut from the industrials division, Scope's base case scenario reflects a recovering total cost coverage in 2023.

Outlook and rating-change drivers

The Stable Outlook incorporates a rating case of 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 total cost coverage of above 1.0x.

A positive rating action could be warranted by improvement in the holding's business risk profile related to concentration risks, especially with regard to dividend income. However, Scope does 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.

Long-term debt rating

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

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

APPENDIX: Scope's general view on an investment holding's relevant credit metrics

Scope uses the following key credit metrics to gauge the financial risk profile of an investment holding: Total cost coverage; Leverage (loan-to-value, 'LTV'); Liquidity. Scope uses total cost coverage as the key indicator. Scope defines the total cost coverage ratio as cash inflows versus non-discretionary cash outflows at the holding level. The ratio signals to which extent an investment holding covers all discretionary payments. An investment holding's leverage – measured as an LTV – only serves as a supplementary credit ratio, signalling the headroom of a company for additional external funding in case this is required in the context of covering upcoming debt maturities. However, as the LTV of an investment holding tends to be volatile due to the constant changes in the portfolio's market value Scope only focusses on this ratio in case of major debt repayments over the foreseeable future. The liquidity of an investment holding is assessed like for any other non-financial corporate.

Stress testing & cash flow analysis

No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodology used for these Credit Ratings and/or Outlook, (Corporate Rating Methodology, 6 July 2021), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services, while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:
With the Rated Entity or Related Third Party participation YES
With access to internal documents YES
With access to management YES
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, the Rated Entities' Related Third Parties and Scope Ratings' internal sources.
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Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.
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The Credit Ratings/Outlook were first released by Scope Ratings on 29 August 2019. The Credit Ratings/Outlook were last updated on 1 April 2021.

Potential conflicts

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