Forrás Nyrt.
Hungary, Investment Holding

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Total cost coverage	0.8x	1.6x	1.2x	2.2x
Scope-adjusted loan/value ratio	55%	57%	58%	57%
Liquidity	Negative	>100%	>100%	>100%

Rating rationale

The business risk profile of Forrás Nyrt. is supported by the portfolio's diversification, reflecting a well-balanced investment portfolio with limited concentration across sectors and gross asset value. The business risk profile is constrained by the limited geographical diversification (with the primary focus remaining on the Hungarian market) and the investment philosophy, which is still perceived as opportunistic, as evidenced by the rapid change in acquisition and divestment targets across years.

The financial risk profile benefits from the higher recurring cash income generation, which has a positive effect on total cost coverage (TCC), which is expected to be consistently above 1.0x in the medium term. Scope-adjusted loan/value (LTV) remains the weaker element of the financial risk profile, with the corporate guarantee behind the loans of Aquila New Energy and For-Five Kft. added to the Scope-adjusted debt, resulting in an LTV around 60%. The combination of no material financial debt maturities prior to 2027 (first year of bond amortization) at the holding company level and high levels of unrestricted cash on a sustained basis in our base case scenario results in adequate liquidity for the rated entity.

Outlook and rating-change drivers

The Outlook is Stable and encompasses the assumption that Forrás' credit metrics will develop in line with our base case forecast, resulting in total cost coverage consistently above 1.0x and an LTV ratio sustained below 60%. Our forecast does not include any acquisitions or divestments beyond 2024 due to limited visibility on the company's medium-term investment portfolio management strategy.

The upside scenario for the ratings and Outlook is: Providing better visibility of the medium-term strategy/investment philosophy and a rigorously established financial policy at the core investment level, while LTV decreasing below 50%

The downside scenarios for the ratings and Outlooks are (individually): (1) Total cost coverage deteriorating below 1.0x on a sustained basis; (2) LTV ratio rising above 70% on a sustained basis

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
18 Jun 2024	Affirmation	B+/Stable
22 Jun 2023	Upgrade	B+/Stable
27 Jun 2022	Downgrade	B/Stable
29 Jun 2021	Outlook change	B+/Negative

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodology and Related Research

General Corporate Rating Methodology; October 2023

Investment Holding Companies Rating Methodology; May 2024

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Multiple successfully executed acquisitions in the previous years, resulting in higher recurring cash income • Record of over 20 years in the sourcing, development and sale of manufacturing companies and real estate projects in different asset classes in Hungary • Hidden reserves in real estate and solar portfolio, partially mitigating the high LTV ratio and providing potential access to additional liquidity if needed • High cash level, earmarked for further M&A	• High LTV ratio due to Forrás acting as guarantor of subsidiary debt • Very small player with lack of scale compared to other European industrial and/or real estate players • Complex corporate structure, including a variety of business models, industries and holding structures • Lack of clear medium-term investment strategy reducing visibility and increasing cash-flow volatility

Positive rating-change drivers	Negative rating-change drivers
• Higher visibility regarding recurring cash income • LTV ratio below 50%	• Total cost coverage below 1.0x on a sustained basis • LTV ratio above 70%

Corporate profile

Forrás Nyrt. is a Hungarian investment holding company with current shareholdings in the commercial real estate, renewable energy and manufacturing sectors. Established in 1998, it has a long track record of investments in a wide range of industries from the past 20 years, including consumer goods, real estate and wholesale pharmacies. The shares of Forrás Nyrt are listed on the Budapest Stock Exchange (BÉT), with Arago Investment Holding as the majority owner (89%).

Financial overview

			Scope estimates		
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Total cost coverage	0.8x	1.6x	1.2x	2.2x	2.4x
Scope-adjusted LTV ratio	55%	57%	58%	57%	56%
Liquidity	Negative	>100%	>100%	>100%	>100%
Total cash income in HUF m					
Recurring cash interest and dividends received	842.4	2,131.4	1,112.3	2,134.3	2,308.3
Rental income and fees	7.7	2.5	2.7	2.7	2.7
Recurring income	**850.1**	**2,133.9**	**1,115.0**	**2,137.0**	**2,311.0**
Total expenses in Total cash income in HUF m					
Operating expenses	-237.7	-222.3	-231.2	-238.1	-245.2
Taxes paid	-8.9	-310.5	-17.3	-2.3	-2.5
Interest paid	-760.1	-776.8	-689.0	-689.0	-689.0
Cash dividend paid[1]	-30.0	-30.0	-30.0	-30.0	-30.0
Total expenses	**-1,036.7**	**-1,339.6**	**-967.5**	**-959.4**	**-966.7**
Scope-adjusted debt in HUF m					
Reported gross financial debt	31,677.8	24,959.4	26,387.7	25,911.4	25,482.7
Less: cash and cash equivalents[2]	-	-	-	-	-
Other items (guarantee)	898.0	9,952.3	9,952.3	9,952.3	9,952.3
Scope-adjusted debt	**32,575.8**	**34,911.7**	**36,340.0**	**35,863.7**	**35,435.0**
Scope-adjusted gross asset value in HUF m					
Non-solar long-term investments (as per balance sheet)	28,156.3	30,704.9	32,041.9	31,326.3	30,680.2
Solar portfolio (market value, based on valuation)	7,240.0	7,240.0	7,240.0	7,240.0	7,240.0
Short-term investments and cash earmarked for investments	23,731.6	23,345.9	23,412.4	24,551.6	25,818.6
Scope-adjusted gross asset value	**59,127.9**	**61,290.8**	**62,694.3**	**63,117.9**	**63,738.8**

[1] TCC calculation only includes cash dividend prescribed for priority shareholders
[2] Netting of cash: generally, this is only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible.

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Environmental, social and governance (ESG) profile[3]

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)

Management, supervision and complex group structure

The strong influence of main shareholder Arago (89% of voting rights) could be disadvantageous for external creditors like bondholders (and minority equity shareholders) in case of a dispute or liquidation. There is also key person risk as Arago's main shareholder, who is also member of the board of directors of Forrás Nyrt, makes all major operational decisions and sets the investment strategy at the holding company level, although a board of directors provides assistance. The company also operates with a complex corporate structure incorporating different businesses, consolidation forms and financing structures (ESG factor: credit-negative).

[3] 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.

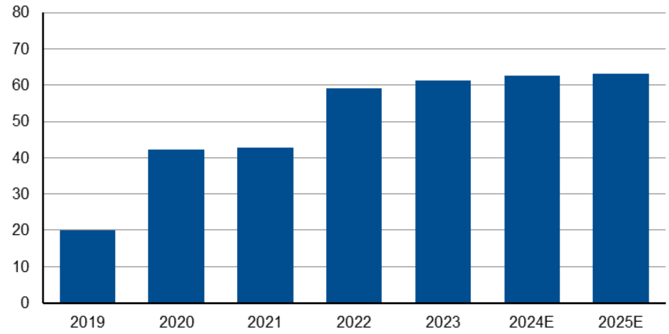
Business risk profile: B+

Weighted average portfolio risk driven by the real estate sector

Despite acquisitions in the capital goods sector (Kiss és Társa Kft., M-Technologies Kft) and the durable consumer products sector (Váll-Ker Kft.) in the previous years, Forrás' weighted average portfolio risk remains primarily driven by its real estate portfolio (41% of the net asset value [NAV] as of YE 2023) and its financial assets, including the shares of the investment fund Adventum, representing 23% of the NAV.

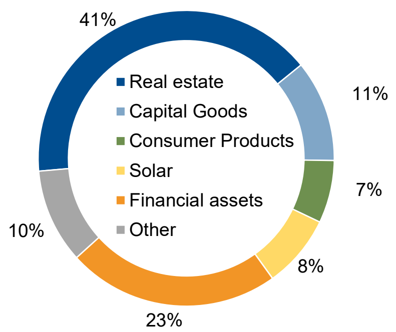
The weighted average industry risk based on gross asset value shows the mixed industry risk of commercial real estate (assessed at BB) capital goods (also BB) and durable consumer products (also BB), which are defined by high-to-medium cyclicality, medium barriers to entry and high-to-medium substitution risk.

Figure 1: Scope-adjusted gross asset value in HUF bn



Sources: Forrás, Scope estimates

Figure 2: Distribution of net asset value across sectors, YE 2023



Sources: Forrás, Scope estimates

Portfolio sustainability benefits from low recurring cash income concentration

While cash interest and dividend income in 2023 has been relatively concentrated (stemming from four subsidiaries and the yield of financial assets), a more favourable picture emerges when we consider the historical accounts, the prescribed but unpaid dividends on the subsidiary level.

Historically the largest cash-effective contributions to interest income from 2021 onwards have been from Studio V (interest on the shareholder loan provided to buy Magnetbank bonds) and Aquila New Energy. The latter has contributed the lion's share of recurring cash income upstreamed to the holding recently. In addition to interest income from the solar holding, the SPV's themselves are expected to pay less, but steady, interest on their shareholder loans. In a similar manner to 2023, Kiss és Társa Kft. is expected to continue paying HUF 500m cash dividend in the upcoming years. Váll-Ker, the other major manufacturing subsidiary of the holding is expected to pay dividend starting from 2025.

In 2023 the number of income generating core holdings (with Gross Asset Value above 5%) was lower compared to the previous years (two, Aquila New Energy and Kiss és Társa) but based on the management forecast this is going to return close to historical averages (six to seven companies) signalling a well-diversified investment portfolio, along with the high proportion of income-generating assets amongst the portfolio (close to 90%), making the cash income more resilient towards sector shocks, and reducing the dependency of the portfolio performance on individual companies. The top core holding, with the highest income concentration is Kiss és Társa Kft, responsible for approx. 23% of the recurring cash income in 2023.

Weak geographical diversification

Geographical diversification has remained limited - 95% of revenues come from the Hungarian market, exposing the investment portfolio to economic downturns and changes in the macroeconomic environment. However, Forrás indicated the potential expansion of the company's investment focus to Central and Eastern Europe and western Europe, predominantly in the German-speaking countries. This will benefit geographical diversification once acquisitions are completed.

As of YE 2023, Forrás holds the vast majority (around 61%) of its gross asset value in private/unlisted companies and real estate assets. We deem this credit-negative in terms of liquidity. In our view, a situation requiring urgent liquidation is rather remote. However, if a liquidation did become necessary, it would be caused by a severe downturn in the financial performance of the newly acquired industrial assets. In a hypothetical situation like this, we deem demand for such small (likely loss-making) industrial assets to be weak.

On the other hand, the diversified and largely unencumbered real estate portfolio (including a land bank in Budapest and hotel, retail, residential and agricultural assets) should provide some liquidity if needed, either via sales or secured lending. Additionally, the liquidity of the solar portfolio is seen as above average, benefitting from the high demand on the market for similar assets, which would enable the issuer to sell it quickly and without significant discount to the market price.

While smaller portion of Forrás's share portfolio has been sold, the issuer still holds a portfolio of Hungarian blue-chip shares (OTP and AKKO) with a total face value of HUF 3.3bn (as of YE 2023). Management states that they own this portfolio as an alternative to cash. However, due to highly volatile share prices, this portfolio's market value is subject to rapid, significant changes. We note that the Adventum investment funds are relatively liquid and can be sold in a short notice in case the core holding would require additional liquidity.

Lack of long-term investment strategy limits visibility

The Investment Holding Companies Rating Methodology takes into account the company's investment philosophy as an additional factor when assessing its business risk profile. Despite the company's strong track record of insourcing, developing and selling manufacturing companies and real estate projects in different asset classes in Hungary, we still consider its investment philosophy to be rather opportunistic, with acquisition and divestment targets changing rapidly. This results in limited visibility on medium-term cash flows at the investment holding company level.

Financial risk profile: B+

Total cost coverage expected to remain consistently above 1.0x

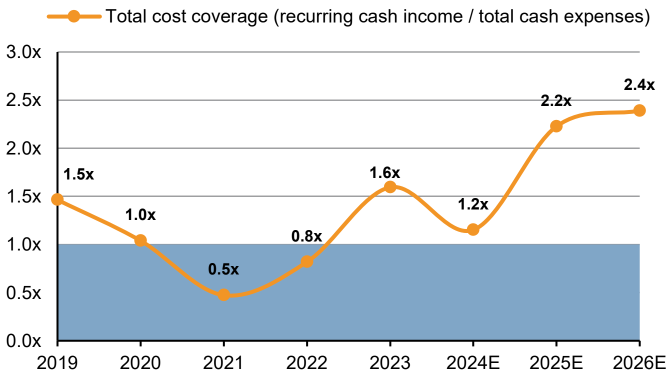
Recurring cash income in 2023 has increased to HUF 2.1bn (2022: HUF 0.9bn), primarily as a result of higher interest income on financial assets. Cash interest expenses remained flat (HUF 776m) benefiting from the fixed coupon of the bond and the low level of other financial liabilities on the holding level. Beyond 2024 TCC is forecasted to improve to above 2.0x as a result of the cash income from the manufacturing portfolio (Kiss és Társa Kft. and Váll-Ker are forecasted to pay HUF 500m cash dividend annually), increasing the recurring cash income to around HUF 2.1bn per year as per our financial forecast.

The cash interest received can be separated into two categories:

- Interest from shareholder loans, which consists mainly of the income from the solar portfolio (the SPVs and the portfolio's main holding entity pay yearly interest but no dividends) and
- cash income from the financial asset portfolio.

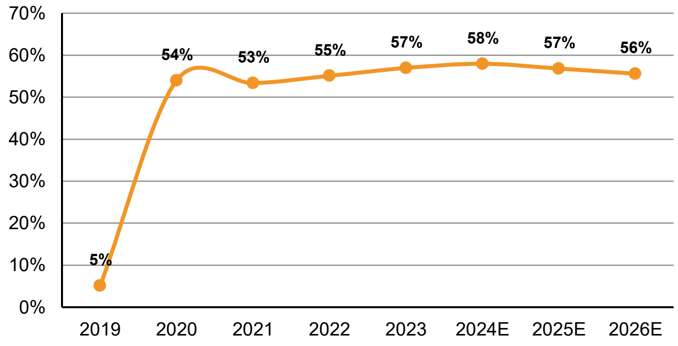
In a similar manner to the previous years, total cost coverage (Figure 3) only takes into account the issuing entity's recurring cash income after our discounts. The cash income after assets sales (in 2023, the selling of financial assets from the BÉT share portfolio) is not taken into account in the TCC calculation. Non-recurring items are also excluded from the TCC calculation, such as cash dividend related to a one-off asset sale (HUF 1.3bn), which Forrás is expected to realise in 2024.

Figure 3: Total cost coverage



Sources: Forrás, Scope estimates

Figure 4: LTV[4]



Sources: Forrás, Scope estimates

Guarantees on subsidiaries' debt have significantly increased the LTV ratio

The LTV remains the weakest link in the financial risk profile. The corporate guarantee behind the loans taken out by Aquila New Energy and For-Five increased Scope-adjusted debt by HUF 10bn as of YE 2023 on top of the HUF 21.7bn senior unsecured bond and HUF 3.3bn intercompany debt.

We note the fact that the majority of assets in the LTV calculation are kept at book value (valuation is available only for certain elements of the real estate portfolio and no valuation for the 23 MW PV plant). As Scope-adjusted debt is expected to remain stagnant (no short-term debt maturities, first amortization of the bond is in 2027) LTV is expected to develop in line with the gradually increasing total assets, assuming positive cash generation and stable market value for existing fixed assets.

We note that the computation of the LTV has been altered compared to the previous year to align it with the Investment Holding Methodology. Previously we have netted the cash in the Scope-adjusted debt calculation but excluded it from the Scope-adjusted total assets calculation. As cash is earmarked for acquisitions, in line with the methodology we include it in the Scope-adjusted total assets but exclude it from the Scope-adjusted debt calculation (issuer rating in the B category).

Adequate liquidity

The absence of material financial debt maturities on holding level until 2027 in combination with high level of unrestricted cash on a sustained basis in our base case scenario results in adequate liquidity for the rated entity.

[4] The LTV forecast does not include any acquisitions beyond 2024, and assumes stable market value of fixed assets

Additionally, the moderate indebtedness of the fully and or majority-owned property portfolio held via subsidiaries should leave sufficient possibilities for secured (mortgage-) lending on the subsidiary level, further mitigating liquidity concerns.

Balance in HUF m	2024E	2025E
Unrestricted cash (t-1)	12,500.4	12,566.9
Open committed credit lines (t-1)	0.0	0.0
Free operating cash flow	-2,912.7	-1,098.8
Short-term debt (t-1)	63.4	63.4
Coverage	**>200%**	**>200%**

We highlight that Forrás's senior unsecured bonds issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 21.7bn) if the debt rating of the bonds stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 30 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is zero notches. Given the limited rating headroom, the company must at least maintain its current credit profile to avoid triggering the rating-related covenant.

Supplementary rating driver

Limited predictive power of business plans limiting visibility

We point to the lack of reliability of Forrás's strategic planning, as evidenced by the limited predictive power of business plans provided by the management, with cash and non-cash income changing considerably between business years This factor significantly reduces visibility and may lead to a quick deterioration of credit metrics.

Long-term debt rating

Senior unsecured debt rating: B+

Forrás issued a HUF 21.7bn senior unsecured bond under Hungary's Bond Funding for Growth Scheme in October 2020. The bond's tenor is 10 years, with 10% of its face value to amortise from 2027. The coupon is fixed (3.2%) and payable yearly. Most of the bond proceeds were used to acquire assets in the renewable energy, manufacturing and real estate sectors, while the remaining proceeds have been invested in shares of companies listed on the Hungarian stock exchange.

Our recovery analysis is based on a hypothetical default scenario at year-end 2025. Corporate guarantees on the subsidiaries' loans are placed above senior unsecured debt in the waterfall of debt, as senior unsecured debt at the holding company level is structurally subordinated to debt at the subsidiary level. Thus, we rate senior unsecured debt at the same level as the issuer rating (B+).

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