OPUS GLOBAL Nyrt
Hungary, Holding Companies

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 the fifth largest entity on the Hungarian stock exchange.

The group's investment philosophy focuses on holding majority positions grouped in 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 holds 10 individual participations in its four strategic investment fields, complemented by minority positions held by its asset management division.

Key metrics (based on holding accounts)

		Scope estimates		
Scope credit ratios	**2018**	**2019F**	**2020F**	**2021F**
Total recurring cost cover (x)	0.6	3.4	4.1	4.5
LTV (Scope-adj. debt/ portfolio market value) (%)	38	30	<30	<30
Liquidity (%)	0	>300	>400	>600

Rating rationale

Scope Ratings assigns issuer rating of BB to Hungary-based holding company OPUS GLOBAL Nyrt (OPUS). The rating Outlook is Stable. The senior unsecured debt category is rated BBB-.

The ratings reflect our view on OPUS' strong growth, both in its two former units (OPUS and Konzum) and in the newly merged group. The ratings are thus supported by the group's greatly increased recurring income generation capacity going forward. As a consequence of this, together with a lean cost structure, we believe that OPUS' total cost coverage is likely to be above 6x in 2019, a very strong level in the context of 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 subsidiary level.

Portfolio diversification (a very important ratings driver in our assessment of holding companies) has equally benefited from heavy investment in various participations over the past two years and from the merger. However, given its still-large asset concentration on two segments – industrials (mainly construction) and food processing – diversification in the newly merged entity is not sufficiently balanced at present. We believe that OPUS' exposure to four distinct, relatively non-cyclical and little-correlated sectors supports the group's business risk profile. In addition, most of the subsidiaries have significant growth potential, either due to a high order backlog (as is the case for the 51%-owned construction company Meszaros es Meszaros Kft.– M+M, and R-Kord Kft.) or substantial, recent expansion capital expenditure (food processing companies KALL and Viresol).

Ratings & Outlook

Corporate ratings BB/Stable

Senior unsecured rating BBB-

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Related Methodology

Corporate Rating Methodology

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Conversely, concentration risk is still high at the moment, reflecting the weight of the two dominant sectors: industrials and energy (about 80% of consolidated sales). Concentration risk is even higher with regard to dividend income, with M+M and R.Kord likely to contribute about 90% of expected dividend income in 2019. This is likely to moderate over the following years, especially as food production companies Kall and Viresol are forecast to improve their profitability substantially. However, it is still too early to reflect this in the ratings, in our view, because it will probably take at least three years, following heavy investment programmes, for the two companies to reach dividend payment capability. Thus, while portfolio diversification by income does not support the ratings at the moment, diversification by value is much better because there is sizeable value in companies which are not paying a dividend. OPUS does not depend on the large HUF 5bn M+M dividend income from a cost coverage perspective (excluding it, total cost coverage is still expected to be at about 1.4x in 2019 and 2020) – a further mitigant to the group's high dividend concentration. This is thanks to OPUS' very lean cost structure after the merger, and also the fact that it currently does not pay dividends to its shareholders.

The rating reflects the group's evolving form and structure, incorporating headroom for further investments, although we believe that the major building blocks should have been established with the merger. The rating also reflects the limited amount of debt on OPUS' balance sheet because most past expansion was equity-funded. The envisaged bond issuance (HUF 28.6bn) later this year will represent the first sizeable debt portion for OPUS. We understand that most of the group's expansion has been completed and that management will concentrate on executing on the growth potential of the portfolio in the near future. While bolt-on acquisitions are still likely in the meantime, the possibility of any large portfolio addition is remote. Should a large acquisition be made, it is still likely to receive a sizeable equity funding contribution, in our view.

While OPUS has no apparent cost coverage problems, potential flexibility is provided by the portfolio's partial listing on the Budapest stock exchange. However, the rating benefits from OPUS' independence from market-timing aspects for any divestments which may be needed to provide additional cost cover. Leverage as expressed by the loan-to-value (LTV) ratio (Scope-adjusted debt to the portfolio's net asset value) is likely to be around 30% following the prospective bond issuance of about HUF 28.6bn. This will be the first time the group will take on long-term debt as its two founding parties were almost debt-free in the past few years, having funded investment programmes mainly via equity (OPUS and Konzum shares).

We have performed a recovery assessment for the senior unsecured debt category because the group plans to issue a HUF 28.6bn bond in the second half of 2019. 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. For OPUS, we calculated a full recovery of the bond, mainly supported by very little secured bank debt, and the comparatively large value embedded in the market value of portfolio companies. Even discounting this value by 50% and adding guarantees and suretyships of about HUF 33bn, the bond is still likely to be fully recovered. We therefore raise the debt category two notches above the issuer rating, reflecting superior recovery prospects.

Outlook

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 cost coverage of above 1.5x.

A positive rating action could be warranted by improvement in the holding's business risk profile related to concentration risks. 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.

Rating drivers

Positive rating drivers	Negative rating drivers
• Conservative buy-and-build strategy • Strong cost coverage ratio	• Newly-built structure • High dividend concentration

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improved diversification/ lower concentration rates	• Large debt-funded acquisition • Total cost coverage below 1.0x on a sustained basis

Financial ov erview

		Scope estimates		
Scope credit ratios	**2018**	**2019F**	**2020F**	**2021F**
Total cost coverage from recurring income (x)	0.6	3.4	4.1x	4.5x
Total cost coverage including non-recurring income (x)	0.6	6.4	4.1	4.5
LTV (%)	38	30	<30	<30
Liquidity (%)	0.1	>300	>400	>600
Cash flow s (HUF m)	**2018**	**2019F**	**2020F**	**2021F**
Recurring cash inflows	285	6,315	8,337	9,287
Non-recurring cash inflows	74	3.000	0	0
Balance sheet/ indebtedness (HUF m)	**2018**	**2019F**	**2020F**	**2021F**
Net asset value	172,142	200,232	200,232	200,232
Gross financial debt	10,958	31,957	31,957	31,957
less: available cash	-581	-4,728	-7,665	-12,792
Guarantees and suretyships	55,000	32,173	32,173	32,173
Scope-adjusted debt (SaD)	65,377	59,402	56,466	51,340

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 takes an active entrepreneurial approach. This is also reflected by 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

Meszaros es Meszaros Kft. (M+M; 51% owned indirectly; 2018 sales: HUF 51 bn): General contractor for typically 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, 2018 sales: HUF 36bn): General contractor for large public procurement projects in railway construction

Wamsler SE (100% owned, 2018 sales**:** HUF 7bn): German fireplace and stove manufacturer; largest player in CEE countries with a market share of about 7% (about a third in Hungary)

KALL Ingredients Kft. (83% owned, 2018 sales: HUF 9bn): Corn processing with extensive product portfolio including isosugar and liquid sugars; just completed EUR 160m investment in modern plant

Viresol Kft. (53% owned, 2018 sales: HUF 1bn): wheat processor with extensive product portfolio including starches, industrial alcohol, gluten and raw material for fodder

Matrai Erömü Zrt. (40% owned indirectly; 2018 sales: HUF 74bn): Hungary's second largest power plant (mainly lignite); operates two lignite mines; to be redirected towards renewables

Hunguest Hotels Zrt. (100% owned indirectly; 2018 sales: HUF 24 bn): hotel operator with 25 locations in Hungary, Austria, Montenegro and Romania. Strong acquisition activity in 2018 led to 62% growth

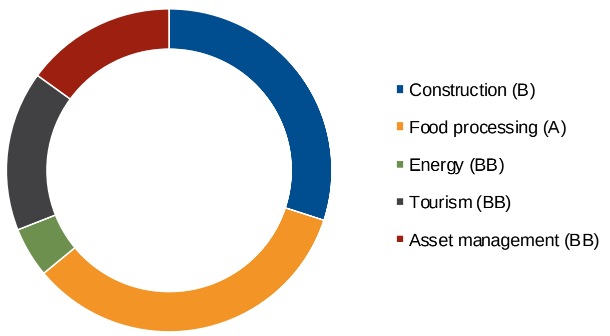
Underlying industries in portfolio have relatively little cyclicality

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).

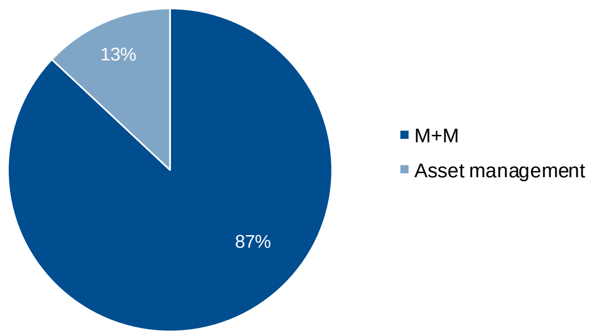
The group's largest exposure – by investment value and asset value – is to the 'Industrials' and 'Food Processing' segments, with about 70%-80% exposure. While this is likely to change over time, the holding company's industrial exposure is a mix of low-rated construction activities and highly rated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

Figure 1: Two dominant industries (NAV)



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 its cost position is lean enough to allow for 1.3x coverage if the M+M dividend is excluded (see financial risk profile section).

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. According to OPUS, the net asset value of this division is about HUF 20bn (about 10% of the group's overall value invested).

Neutral corporate governance

We assess corporate governance as neutral to the ratings of OPUS. There is no majority individual shareholder, although the Meszaros family has over 30% of the voting rights. 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.

Financial risk profile

Solid credit metrics

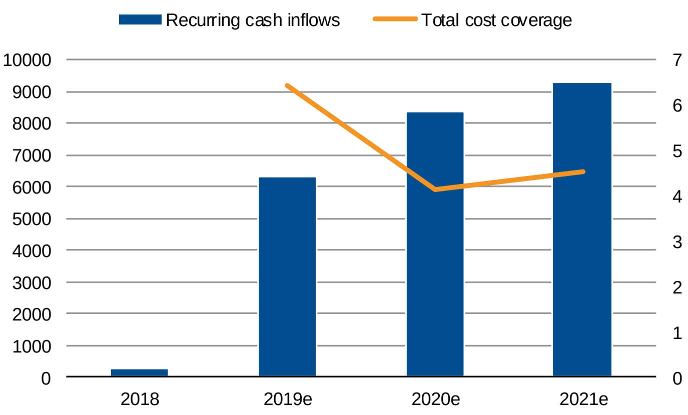
We expect credit metrics to be at a comparatively high level in 2019. This is the consequence of OPUS' significantly improved recurring income generation capacity. The M+M and R.Kord dividend is sizeable (about HUF 5bn has already been received in the first half of 2019) and further companies are likely to reach dividend status over the next five years. In addition, costs are still relatively low – reflecting the two members' lean approaches in the past – greatly helped by the fact that management does not pay dividends to OPUS shareholders currently. In addition, the holding company is likely to derive more management fee income for services provided to group companies. We therefore expect total cost coverage of about 4x. We project total costs to double in 2020, in a year-on-year comparison, reflecting interest costs on the new planned bond, while cost coverage at a projected 4x (from about 6x in 2019) still reflects a comparatively high level in the context of the ratings. We expect this to have a strong effect on costs from 2020, given the lower basis compared to income. At the same time, income will also be affected by the bond interest to be streamed back to OPUS, reflecting its funding role for subsidiaries.

We have not placed too much emphasis on our financial risk assessment up to 2018, as this still relates to the performance of the two stand-alone companies OPUS and Konzum. The first 'fresh' year of the merger is 2019.

Given high dividend concentration, we also considered two sensitivity scenarios:

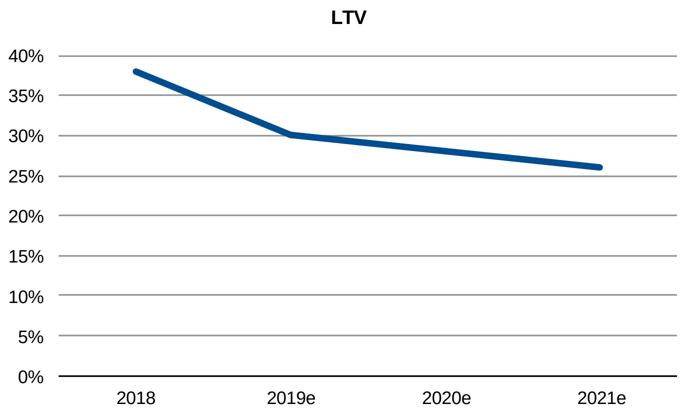
1. Total cost coverage without the M+M/ R.Kord dividend: excluding the HUF 5bn in 2019 income would result in a projected 2019 holding company income of about HUF 1.2bn. Compared to projected holding company costs for the same year of about HUF 1bn, cost coverage would still be above 1x.
2. Total cost coverage assuming a 50% payout ratio for OPUS in the medium term: this would increase costs to about HUF 5-6bn, compared to recurring income of HUF 9bn, resulting in cost coverage of above 1.5x.

Figure 3: Improving recurring income



Source: Scope estimates

Figure 4: LTV projected to decline slightly



Source: Scope

Projected LTV of about 30%

We forecast that LTV will gradually decline to below 30% in the coming years, reflecting unchanged debt positions (mainly the bond) plus an increasing cash derived from dividend income. We kept the portfolio's asset value constant at about HUF 200bn in this calculation.

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

We performed a recovery assessment for the senior unsecured debt category because the company plans to issue a HUF 28.6bn bond in the second half of 2019. For this assessment, we constructed a hypothetical default scenario and derived a liquidation value, which we then compared to the bond volume in order to determine its recovery rate. For OPUS, we calculated a full recovery of the bond, mainly supported by very little secured bank debt, and the comparatively large market value of portfolio companies. Even discounting this value by 50% and adding guarantees and suretyships of about HUF 33bn, the bond is still likely to be fully recovered. We therefore raise the debt category two notches above the issuer rating, reflecting superior recovery prospects. Our assessment assumes no cross-default clauses in the portfolio companies' debt documentation.

Outlook

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