Aker ASA
Norway, Investment Holding

SCOPE BBB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Total cost coverage	1.0x	0.8x	0.9x	1.0x
Scope-adjusted loan/value	14.5%	8.0%	~10%	

Rating rationale

Scope assigns first-time rating of BBB-/Stable to Aker ASA and holding companies.

Aker ASA and holding companies' (Aker) initial rating benefits from the liquidity of its predominantly listed holdings, which could provide cash inflows through partial liquidation if needed. It is also supported by its low loan-to-value (LTV) ratio of 7% as at Q1 2022, which is foreseen to remain at around 10% in the absence of a large debt-funded acquisition. The company's balanced cash inflows and outflows, resulting in a target total cost coverage of at least 1x, provide stability to the financial risk profile.

The rating is somewhat held back by the limited diversification, with only four core holdings representing 78% of gross asset value (GAV), and the company's modest geographic diversification with 94% of dividend income stemming from Norway. Aker's concentration of investments is relatively high, with core holding Aker BP contributing 92% of income.

Outlook and rating-change drivers

The Outlook for Aker is Stable and incorporates a continuation of the company's core long-term holdings Aker BP, Aker Solutions, Aker Horizons and Cognite. The Outlook relies on the fact that the company will balance its cash inflows and outflows and therefore achieve a total cost coverage of 1x or above for the foreseeable future. It further incorporates our expectation that the company will not engage in debt-financed increases in shareholdings, which would increase leverage as measured by the Scope-adjusted LTV to above 15% on a sustained basis, while we view temporary swings above this level as witnessed in the past as normal course of business.

A negative rating action would be possible if Aker's financial risk profile deteriorated, exemplified by a total cost coverage worsened below 1.0x on a sustained basis and/or the LTV increased significantly above 15%, while Scope does not gain confidence that such levels can be remedied by the company. This could be the result of its main holding Aker BP not being able to pay dividends at all, Aker and its holdings' dividend pay-out exceeding a balancing position and/or the company engaging in debt-funded increases in shareholdings.

A positive rating action may be warranted if the company diversified its income-generating holdings or achieved a total cost coverage of 1.3x or above on a sustained basis. Diversification could be the result of a more mature investment portfolio paying dividends to Aker and a better cost coverage could occur through increased income and adjusted dividend pay-outs accompanied by a change of financial policy restricting dividends.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
17 August 2022	Initial rating	BBB-/Stable

Ratings & Outlook

Issuer	BBB-/Stable
Short-term debt	S-2
Senior unsecured debt	BBB-

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Related Methodology(ies) and Related Research

Corporate Rating Methodology; July 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Highly liquid assets with 77% of GAV and 99% of income-contributing companies being listed • Modest LTV at 7%, which even under significant market volatility would not rise above 15% • Buy-and-hold strategy focusing on cash flows from recurring income in addition to capital appreciation from growth companies	• Limited diversification of holdings, with only four core holdings representing 78% of GAV • High concentration of income, with 92% coming from Aker BP, somewhat mitigated by the good asset/credit quality of the company and influence via board mandates • Weak geographical diversification with most recurring revenues from Norway

Positive rating-change drivers	Negative rating-change drivers
• Achieving a total cost coverage of at least 1.3x on a sustained basis • Diversification of its income-generating holdings	• Total cost coverage deteriorating below 1.0x on a sustained basis and/or the LTV increasing significantly above 15%

Corporate profile

Aker was founded in 1841 and taken over by Kjell Inge Røkke in 1996. It is a Norwegian industrial investment company with a portfolio concentrated in oil and gas, energy services, renewable energy and green technologies, industrial software, seafood and marine biotechnology sectors. Aker has an active ownership strategy but no operational integration with portfolio companies. The company is listed on the Oslo Stock Exchange and headquartered in Lysaker, Norway, with 45 employees.

Aker split its investments into two portfolios: industrial holdings that are managed with a long-term perspective and comprises what Aker considers as eight core holdings, and financial investments that include cash and investments into real estate, various listed equities, some unlisted equities and shareholder loans.

In late 2021, Aker established Aker Asset Management, a multi-strategy alternative investment firm with four departments: venture capital, private equity, infrastructure and listed equities. Active asset management will become a new core business area on par with industrial holdings from 2022 and aims for EUR 100bn in assets under management to be invested into the green transition.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Total cost coverage	1.0x	0.8x	0.9x	1.0x	1.1x
Cost coverage including sales gains	1.0x	2.5x	0.9x	1.0x	1.1x
Cost coverage without dividend payments	3.7x	2.9x	3.7x	3.4x	3.5x
Scope-adjusted LTV	14.5%	8.0%	~10.0%		
Liquidity	3.7x	No short-term debt	8.8x	4.1x	2.6x
Total income in NOK m					
Dividends from industrial holdings	1,996	1,870	2,261	2,406	2,554
Income from financial holdings	345	140	142	148	148
Income from shareholder loans	0	0	0	32	32
Interest received	193	6	16	26	20
Recurring income	**2,534**	**2,016**	**2,419**	**2,612**	**2,754**
Gains from asset sales	0	4,072[1]	**0**	**0**	**0**
Total income	**2,534**	**6,088**	**2,419**	**2,612**	**2,754**
Total expenses in NOK m					
Operating expenses	-270	-369	-310	-329	-349
Material costs	0	0	0	0	0
Taxes paid	0	0	0	0	0
Interest paid	-422	-325	-353	-428	-433
Dividends paid	-1,745	-1,746	-2,155	-1,750	-1,750
Total expenses	-2,437	-2,440	-2,818	-2,508	-2,532
Scope-adjusted debt in NOK m					
Reported gross financial debt	10,351	10,052	10,053	10,053	9,053
less: subordinated (hybrid) debt	0	0	0	0	0
less: cash and cash equivalents	-1,303	-4,025	-2,427	-1,731	-953
add: non-accessible cash	17	24	24	24	24
add: pension adjustment	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0
Other items	0	0	0	0	0
Scope-adjusted debt	**9,065**	**6,051**	**7,650**	**8,346**	**8,124**

[1] Sales proceeds from Ocean Yield and Aker BP shares amounted to NOK7,673m

Environmental, social and governance (ESG) profile[2]

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)	

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Standardised ESG reporting and increased transparency across portfolio companies

Aker has a sustainability framework and policy in place, including specific commitments and requirements. These include business development for long-term sustainable value creation. The policy also clearly sets out requirements for transparency, risk management and reporting, which it follows up with its portfolio companies.

Aker has set eight targets for 2025 that will be reported and followed up in future sustainability reports. The 2021 sustainability report was prepared in accordance with the Global Reporting Initiative standards and disclosures contained within the report are aligned with the World Economic Forum's Stakeholder Capitalism Metrics. The report covers material ESG impacts and the management approach adopted by Aker and its industrial holdings portfolio. Further, its principal adverse impact Indicators shed light on potential adverse negative impacts associated with Aker's business and investments.

Over the past few years, Aker’s exposure to climate solutions and renewable energy has grown from around zero to over 20% of total investments. At the same time, Aker has also reduced its exposure to oil and gas from 75% in 2019 to around 50% today. The establishment of Aker Asset Management in 2021 will further support Aker’s green investment ambitions.

Aker has showed a high level of transparency on the ESG topic lately. We also note that it has a green finance framework in place verified by DNV GL that enables Aker ASA, Aker Horizons ASA and Aker Horizons’ subsidiaries to issue Green Bonds and Green Loans to finance Green Projects.

[2] 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: BB+

Industry risk profile: BB

Aker's industry risk is assessed at BB, based on 80% of its net asset value (NAV) being in BB rated industries at Q1 2022, predominantly in businesses directly or indirectly involved in upstream energy and renewables and green technology. The largest exposure is to upstream oil and gas through the shareholding in Aker BP (52% of GAV at Q1 2022). Exposure in industries not rated BB is primarily in IT services (rated BBB) through the shareholding in Cognite and Aize (8.2% of GAV at Q1 2022).

By income, the exposure is almost 100% to industries rated BB as the IT businesses Cognite and Aize are growth companies that do not yet contribute any material dividends.

Figure 1: Industry risk assessment: Aker ASA and holding companies' portfolio

Industry As per Q1 2022	Mvalue/ GAV	Income based	Cyclicality	Market entry barriers	Substitution risk	Industry rating (blended)
E&P upstream	53.2%	92.0%	High	Medium	Low	BB
Energy Services	7.2%	1.4%	High	Medium	Low	BB
Aquaculture	4.8%	0.0%				BB
Renewables / Green Tech	12.4%	0.0%				BB
Industrial IT Services	8.2%	0.0%				BBB
Shipping	0.9%	5.3%				BB
Commercial RE	1.1%	0.0%	Medium	Medium	Medium	BB
Others	12.1%	1.3%				
Weighted industry risk	**BB**	**BB**				

Sources: Aker ASA, Scope

We do not only assess an investment holding's competitive positioning purely by the number of different shareholdings but rather on diversification in terms of the number of core holdings and income-generating assets as well as geographical outreach. Furthermore, we assess income (dividend, interest, others) protection by concentration of income-producing assets and the underlying industry exposure, while the liquidity of these investments provides us with a view on the companies' ability to quickly sell assets if needed.

Buy-and hold strategy with opportunistic disposals

Aker ASA and holdings generally pursues a buy-and-hold long-term investment approach for its core industrial holdings. The company is mainly focused on recurring dividend streams from its undertakings. However, this commitment will not rule out disposals as a central part of the company's long term funding and capital allocation strategy.

Aker exercises an active approach to the majority of its shareholdings through board room participation (e.g. influencing dividend payouts) and close ties to core holdings, with mostly a long-term perspective (no full exit strategy). This is made possible by its mix of minority and majority ownership stakes. The active approach extends to strategic direction, financing decisions and evaluation of M&A and restructuring cases, while the operations of its core holdings are ringfenced, limiting full control in the decision making process. Aker has in the past extensively and successfully used capital market transactions (M&A, IPO, etc.) and strategic partnerships in its portfolio companies to create value and allow for growth, and we expect this to continue. We see Aker's approach as mainly buy-and-hold but with some periodic disposals as an integral part of its investment strategy.

The portfolio is becoming increasingly diversified across several megatrends, such as rising energy demand, the energy transition, industrial digitalisation and healthy living. However, a large part of Aker's portfolio remains in its traditional cyclical industries, such as oil and gas. The current portfolio consists of roughly 65% of mature companies with predictable dividend streams, and 35% of growth companies focused on new megatrends not yet paying dividends.

Aker ASA's strategy rests on three pillars

Aker's investment strategy rests on three pillars:

1. Industrial holdings (long-term horizon): Aker BP (second largest exploration and production operator on the Norwegian continental shelf, post Lundin-transaction), Aker Horizons (renewables), Cognite (industrial software as a service), Aker Solutions (energy services and solutions), Aker BioMarine (marine biotech), Aker Energy (exploration and production in Ghana), Salmar Aker Ocean (offshore salmon production), Aize (IT services).

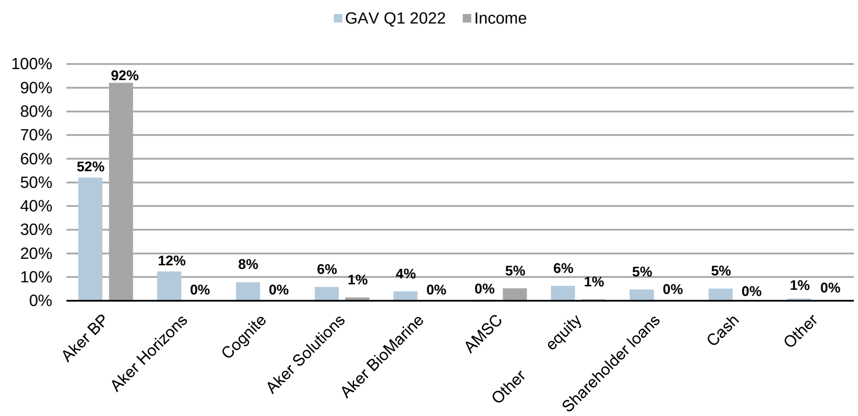
2. Financial holdings (short-term horizon): Aker Property Group (real estate development), Akastor (investment holding within energy), Philly Shipyard (shipbuilder), American Shipping Company (AMSC; ships on bareboat contracts), Solstad Offshore (offshore supply) and various equity investments, receivables (including shareholder loans) and other interest-free assets.

3. Aker Asset Management: Established in late 2021, aims to become a multi-strategy alternative investment firm (venture capital, private equity, infrastructure and listed equities) focusing on the green transition.

The four core holdings – holdings with a share in excess of 5% of the company's total GAV – represent 78% of Aker's total GAV (Q1 2022). The core holdings are dominated by Aker BP with 52.1% of total GAV, followed by Aker Horizons with 12.4%, Cognite with 7.9% and Aker Solutions with 5.9%. By extending the metric to recurring income, the core group goes down to two holdings representing 97% of total recurring income (dividends and interest), with Aker Horizons and Cognite dropping out (no dividends) and AMSC coming in with a 5% income share. In 2025 and beyond, we see the potential for Aker Solutions approaching the 5% income share, should the projected upswing in the oil services sector materialise while it is still set to broaden its income base in new green industrial segments. In addition, the company's cash contributes 5% to GAV, and group loans contribute 5%.

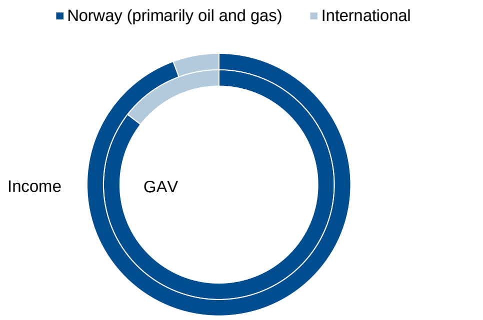
We believe Aker's comparatively limited diversification GAV leads to higher volatility of its LTV ratio, as a decline in the value of one of the core undertakings would have a significant impact.

Figure 2: Core investments by GAV Q1 2022 /income as of 2022e



Sources: Aker ASA, Scope

Figure 3: Geographic spread of dividend income from core holdings



Sources: Aker ASA, Scope

Moderate geographical diversification, mostly exposed to Norway

Aker's geographical diversification is moderate, as most of its dividend income comes from core holdings in Norway (94%). With regard to location of production, stock listings and domiciles, Aker is for the most part exposed to Norway, as all of Aker BP's production is on the Norwegian continental shelf and all listings of portfolio companies are on the Oslo Stock Exchange. This lack of geographical asset diversification is mitigated by Norway being a low-risk country. We note positively the global focus of core holding Aker Horizons, which has a portfolio of renewable assets across continents. In terms of revenue outreach of its holdings, Aker has a more global exposure, as the majority of its holdings operate in cross-border markets such as oil and gas upstream, energy services and industrial IT services. Its fifth largest shareholding, Aker BioMarine, has 91% of its 2021 USD 262m revenue outside Norway (Americas 53%; Europe, Middle East and Africa 20%; and Asia 18%). Further growth of its core holdings and especially a maturation through capacity to generate dividend income for Aker ASA will benefit the company's diversification.

High concentration, with Aker BP providing 92% of income

Concentration of investments is relatively high, with Aker's largest holding Aker BP contributing 92% of income (2022E), while accounting for 52.1% of GAV (Q1 2022). Helping to mitigate the top holding's income concentration is Aker BP's predictable payout capacity resulting from its low-cost assets, making its financial profile more resilient to market volatility. The cost-efficient production is illustrated by an expected production cost after the Lundin-transaction of below USD 7/bbl, and break-even prices of the most important assets, including Johan Sverdrup (42% of production) in the range USD 20-30/bbl, placing it among the top oil and gas peers rated by Scope.

Concentration risk mitigated by visibility on dividends, influence through board of directors and perceived credit quality of core holding

Aker BP plans to increase dividends by 5% per year at oil prices above USD 40/bbl, which with the current market outlook should limit downside risk in dividends over the coming years, supported also by Aker's strong influence in Aker BP's board of directors. The asset quality of Aker's core holding is supported by Aker BP's public investment grade rating, leverage as measured by NIBD/EBITDA below 1x and an interest cover of 30x in 2021, giving ample headroom to the 3.5x net leverage covenant and to the 3.5x interest coverage covenant. In Q1 2022 Aker BP stated that it will have capacity for extraordinary dividends or share buybacks at oil prices sustained above USD 65/bbl, providing a potential extraordinary income for Aker.

Next largest in terms of income (5%) is Aker's shareholding in American Shipping Company (19.1% directly; 49.9% total shareholding including two TRS agreements), which has historically provided stable dividends. While shipping is highly cyclical, AMSC's business model of leasing out its ships on fixed-rate long-term bareboat contracts has resulted in low cyclicality. The third largest in terms of income (1.4% in 2022, expected to grow to 3.5-5% in 2025E and beyond) is Aker Solutions, which historically has provided integrated engineering services to the offshore oil and gas sector, but as it plans to derive one-third of its revenue from renewables/green tech in 2025 and two-thirds in 2030, it should become more diversified.

Historically less concentrated

In the coming years, we expect Aker to exhibit higher income concentration than its historical levels: Aker BP had a share of income of only 76% in 2019-21, compared to 92% in 2022E. This is explained mainly by i) Aker BP paying a smaller average dividend in these years than what is expected from 2022 and ii) the sale of its 62% stake in Ocean Yield (ship-leasing company) to US private equity firm KKR, which contributed an average 15% of income to Aker in 2019-21.

Liquidity is a strength thanks to stock-listed holdings

The majority of Aker's financially relevant holdings in terms of GAV (77% at Q1 2022) or in terms of income contribution (99% of 2022E) are publicly listed companies in well-developed markets benefitting from high trading volumes, and as such could provide cash inflows through partial liquidation if needed. The remainder are for the most part shareholdings in majority-owned unlisted growth companies (by GAV) and cash and interest bearing receivables (by income).

After the merger with Lundin Energy's exploration and production business, Aker will be the largest shareholder of Aker BP (52% of GAV, 92% of income), with 21.2% ownership. BP and the Lundin family will own 15.9% and 14.4% respectively, while the remaining 48.6% will be free float. The ability and willingness to use core holding Aker BP to generate liquidity was evidenced in November 2021 when Aker sold NOK 3.2bn worth of Aker BP shares overnight through a trade sale.

Financial risk profile: BBB

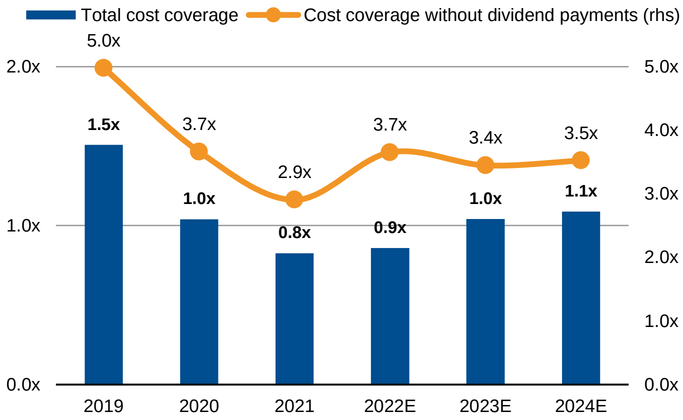
We use total cost coverage as the main indicator to assess the financial risk profile of an investment holding. We define the cost coverage ratio as the relation of cash inflows to non-discretionary cash outflows at the investment holding level. We believe that historic or normalised cost coverage ratios can be misleading as they might not be representative of the future due to portfolio changes and changes in the dividend policy of subsidiaries. Consequently, our analysis is forward-looking and incorporates the projected cash inflows relative to non-discretionary cash outflows.

No link between dividend policy (2-4% of NAV) and income…

…but a balance of cash inflows and outflows with target cost coverage of at least 1x

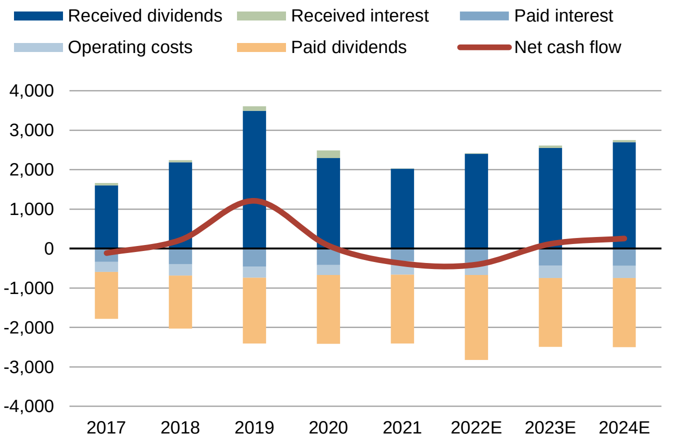
For an investment-grade rated holding, we expect total coverage from recurring income streams to be well above 1x. Aker averaged a total cost coverage of 1.1x over 2017-2021. Its recurring income stems mostly from dividends. Its costs are predominantly driven by the substantial dividends paid to its own shareholders and to a smaller degree interest expenses and operating expenses. The company has an official policy of paying its shareholders dividends of 2-4% of its net asset value, which is not representative of actual income. Embedded in this policy is the company's aim to balance cash inflows and outflows at all times, resulting in a target total cost coverage of at least 1x. We therefore expect a total cost coverage of 1.0x-1.1x going forward, with the paid dividend balancing swings in income.

Figure 4: Total cost coverage



Sources: Aker ASA, Scope (estimates)

Figure 5: Cash inflows and outflows (NOK bn)



Sources: Aker ASA, Scope (estimates)

Aker's flexibility in its dividend payments is also demonstrated by the company only committing at the AGMs (in April) to about half of the dividend per share to be paid throughout the year (this practice was introduced in 2020 to address the economic uncertainty following the covid-19 outbreak). In April 2022 it proposed that an ordinary dividend of NOK 14.50 per share be paid for 2021, and that the AGM authorise the board to disburse an additional dividend in 2022 based on the 2021 annual accounts. The potential second half would be paid out at the discretion of the board in November subject to a financial review assessing the solidity and liquidity of the company (as happened in previous years).

We calculate an investment holding's leverage, its LTV, by taking into account the market value of the portfolio of shareholdings, loans granted and fixed-income products relative to Scope-adjusted debt at the holding level. We note that such market gearing can be very volatile due to the volatility of share prices and changing valuation multiples depending on current market conditions.

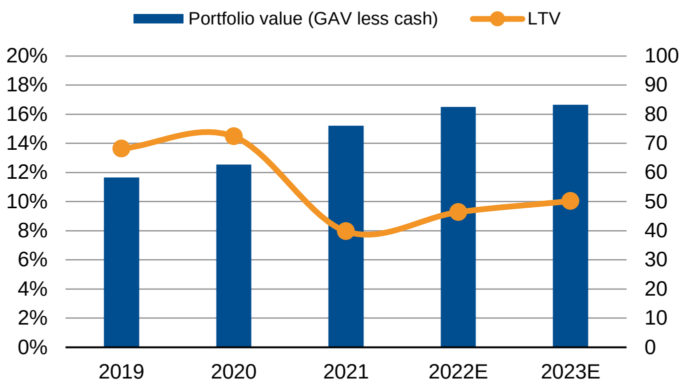
Aker's LTV at YE 2021 was 8.0% and 7.0% at 31st of March 2022. Such leverage is deemed adequate for a strong investment-grade financial profile. According to our calculations, Aker's LTV has been between 8.0% and 14.7% at year-end over the last five years, which demonstrates its conservative risk profile.

LTV of around 10% expected in absence of large debt-funded transactions

With regard to the decline in LTV compared to 2017-20, it should be noted that the oil and gas industry is volatile, and is currently in a positive cycle. We expect an LTV of around 10% in the short to medium term in the absence of any large debt funded transactions.

Aker's guidance is an LTV of below 20% through the cycle with a normalised target range of 10-15% or lower. The low LTV is credit-positive, particularly in the current environment. While the LTV remains strongly exposed to the volatility of its underlying holdings' share prices, our sensitivity analysis shows that share prices and GAV of unlisted holdings as at YE 2021 would need to decrease by more than 45% (debt unchanged) to take the LTV above 15%, which is still low.

Figure 6: LTV and portfolio market value (NOK bn)



GAV shown for 2022E and 2023E is the reported GAV as of Q1 2022

Sources: Aker ASA, Scope (estimates)

Figure 7: Sensitivity of Scope-adjusted LTV

Scope-adjusted debt (NOK bn)		Portfolio market value (NOKbn)							
		91.2	83.6	76.0	68.4	60.8	53.2	45.6	38.0
		20%	10%	0%	-10%	-20%	-30%	-40%	-50%
6.1	0.0%	6.6%	7.2%	**8.0%**	8.8%	9.9%	11.4%	13.3%	15.9%
6.8	12.5%	7.5%	8.1%	9.0%	9.9%	11.2%	12.8%	14.9%	17.9%
7.6	25.0%	8.3%	9.0%	9.9%	11.1%	12.4%	14.2%	16.6%	19.9%
8.3	37.5%	9.1%	9.9%	10.9%	12.2%	13.7%	15.6%	18.2%	21.9%
9.1	50.0%	9.9%	10.9%	11.9%	13.3%	14.9%	17.1%	19.9%	23.9%
9.8	62.5%	10.8%	11.8%	12.9%	14.4%	16.2%	18.5%	21.6%	25.9%
10.6	75.0%	11.6%	12.7%	13.9%	15.5%	17.4%	19.9%	23.2%	27.9%
11.3	87.5%	12.4%	13.6%	14.9%	16.6%	18.7%	21.3%	24.9%	29.8%

Portfolio market value of all listed and unlisted companies as of year-end 2021

Sources: Aker ASA, Scope (estimates)

Adequate liquidity

Liquidity is adequate given that i) the company is able to balance cash inflows and cash outflows; ii) committed credit lines increased in April 2022 through a refinancing to NOK 8bn (twice NOK 4bn) from NOK 4bn as at Q1 2022, approximately NOK 4.6bn of which is undrawn subsequent to the refinancing; iii) total cash position amounted to NOK 4.4bn at Q1 2022 and restricted cash stood at NOK 24m at YE 2021; iv) the ownership of 21.2% (post-transaction) in Aker BP is worth NOK 46bn (30.06.2022) in addition to other listed shareholdings; and v) the only short-term bond coming to maturity is worth NOK 1bn in 2022, followed by a NOK 2bn bond in 2023.

We assume those upcoming maturities to be refinanced with long-term unsecured bonds at the level of Aker ASA. The company's record of bond issuance and strong relationships with banks and investors, together with a low LTV and current strong oil and gas outlook, limits refinancing risk.

Balance in NOK m	2022E	2023E
Unrestricted cash (t-1)	4,025	2,427
Open committed credit lines (t-1)	4,600	4,000
Free operating cash flow (t)	1,757	1,854
Short-term debt (t-1)	999	2,000
Coverage	8.8x	4.1x

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

Following the refinancing in April 2022, Aker had NOK 5bn in senior unsecured bond debt in addition to EUR 100m (NOK 1bn) in Schuldschein and about NOK 3.4bn drawn on its senior unsecured RCF facilities (of NOK 8bn available), all ranked pari passu.

We rate senior unsecured debt at the issuer's level of BBB-.

Short-term debt rating: S-2

The S-2 short-term rating is supported by adequate liquidity, good banking relationships, and adequate access to diverse funding sources.

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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