Stelius Zrt.
Hungary, Holding Companies

SCOPE B+ STABLE

Corporate profile

Stelius Zrt. is an investment holding company majority owned by Mr Elek Nagy and his family. As of year-end 2019, Stelius' shareholdings were valued at about HUF 18bn in total. The company applies a long-term investment approach, reflected through its active role in all of its investees' boards and the financial support it provides to them.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Cost coverage ratio (x)	5.8x	2.0x	2.3x	1.6x
Loan-to-value (LTV) ratio in %	Net cash	Net cash	< 10%	< 10%

Rating rationale

Scope Ratings has assigned a first-time issuer rating of B+/Stable to Stelius Zrt. and a senior unsecured debt rating of B+.

The issuer rating of B+ reflects Stelius' majority ownership of its core investees, allowing it to influence their dividend policies. Our assessment is also supported by the increasing share of recurring management and service fee income, which is less volatile than dividend income, as payment by the undertakings is mandatory, and should reduce the volatility of the recurring cost-coverage ratio. The rating is likewise supported by our view that the recurring cost-coverage ratio should remain well above 1.0x in the medium term.

The rating is mainly constrained by the comparably high concentration of the company's investments, which makes its gross asset value (GAV) more vulnerable to changes in asset prices, with risks of a volatile leverage as measured by the loan-to-value (LTV) ratio. Moreover, the rating is constrained by the significant concentration of income sources, with the company's main dividend-paying undertaking expected to contribute 80%-90% of ordinary dividend income at the holding level.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that the company should maintain a recurring coverage of mandatory holding costs at above 1.0x in the medium term. Our Outlook also incorporates the successful issuance under the Hungarian National Bank's Bond Funding for Growth Scheme of a senior unsecured bond of up to HUF 15bn with a tenor of 10 years and an analytically assumed coupon of 4%.

A positive rating action might be warranted upon an improvement in diversification and concentration in terms of income streams and/or GAV.

A negative rating action might be warranted if overall diversification or concentration deteriorated. This could occur if the company sold some major undertakings and used the proceeds for discretionary purposes such as dividend payments.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	B+

Analyst

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Related Methodology

Corporate Rating Methodology

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Rating drivers

Positive rating drivers	Negative rating drivers
• Coverage of mandatory holding costs at above 1.0x, with level expected to be maintained after the planned bond issuance • Expected increase in recurring cash inflows from management fees • Position as majority shareholder of its undertakings, affording the company influence over their dividend policies	• High concentration and limited diversification of investments • High concentration and limited diversification of income streams • Complex legal structure, though to be addressed via legal entity rationalisation envisaged for 2021 • Low liquidity of undertakings • Increasing leverage (LTV) expected

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in diversification/concentration in terms of income streams and GAV	• Deterioration in diversification/concentration

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Total cost coverage (recurring)	5.8x	2.0x	2.3x	1.6x
Loan-to-value ratio (net debt/portfolio's market value)	Net cash	Net cash	< 10%	< 10%
Liquidity	>100%	>100%	>100%	>100%
Cash flows in HUF m	**2018**	**2019**	**2020F**	**2021F**
Recurring cash inflows (dividends, management fee and interest income)	4,314	2,148	2,461	3,152
Non-discretionary cash outflows (including net interest payments)	738	1,055	1,069	1,926
Balance sheet/indebtedness HUF m	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted net debt	Net cash	Net cash	135	2,005
Gross asset value (HUF bn)	20.3	18.3	23.3	31.5

Business risk profile: B

Blended industry risk profile of BB

Stelius' industry risk profile is rated BB, based on a blended assessment of the investees' underlying industry risks weighted by the amount of their dividend payments.

The main industries of Stelius' investees are i) Pledge Loan and Valuables (retail); ii) Real Estate; and iii) Ground Transportation (taxi services).

Commitment to long-term investment approach…

According to its management, Stelius is committed to a long-term investment approach focused on recurring dividend streams from its undertakings. However, this approach does not rule out opportunistic disposals.

… but opportunistic asset disposals not ruled out

The commitment to a long-term investment approach is shown by:

i) the company's efforts to become the majority shareholder in its undertakings. The share of its majority holdings increased to roughly 90% in 2018 from roughly 40% in previous years; and

ii) the active role taken by Stelius' representatives in the boards of its shareholdings.

Only a few dividend-paying undertakings

Diversification is limited, with only two investees expected to pay dividends in 2020. This limits Stelius' ability to offset the impact of a dividend not paid by one or more undertakings and hence poses the risk of a volatile fixed-cost coverage.

Significant concentration by GAV

Diversification in terms of GAV is likewise limited as the five main shareholdings contribute roughly 60% of GAV as of YE 2019.

Undertakings exposed to Hungarian economic cycle

In addition, diversification is weakened by the sole country exposure, as dividend-paying undertakings generate 100% of revenues in Hungary and are thus exposed to its economic cycle.

Concentration high

Concentration of investments is high as the main shareholding contributes roughly 30% of GAV as of YE 2019. Concentration by income is even higher as the main dividend-paying undertaking is expected to contribute 80%-90% of total ordinary dividend income. However, this is mitigated by the good coverage of mandatory holding costs, which remains above 1.0x even without the income from key dividend payer Pro-cash. Dividend risk is also somewhat mitigated by the underlying industries of the shareholdings, which we view to have medium cyclicality risks. Negative economic developments should also have a limited impact on the revenues and profits of the undertakings.

Financial risk profile: BB

Historically solid cost-coverage of above 1.0x

Stelius’ cost coverage has been solid with a recurring total cost-coverage ratio of above 1.0x in previous years. For 2019, however, only a preliminary cash flow statement was provided by the company.

Management fee income expected to increase

Stelius generates income through dividends as well as management and service fees paid by its undertakings in exchange for services provided (such as human resources, internal audit, information technology and marketing). Management fees are expected to increase in the forecast period as Stelius intends to provide more corporate functions to its undertakings.

In the forecast period, we also expect interest to become an additional income source because part of the proceeds from the planned bond issuance will be used for intercompany loans to undertakings.

Increasing cost base with functions moved to Stelius

The (recurring) cost base also benefits from Stelius’ tax strategy, which optimises taxable income and tax payments. Cash outlay (operating costs and dividends paid) among investees is expected to increase as Stelius assumes more functions in their organisations (resulting in a higher management fee received).

Dividend payments related to cash cushion and LTV target of 30%

Dividends to Stelius’ shareholders are discretionary and should be viewed in conjunction with the cash cushion planned by the management and owner as well as the LTV target of 30%. Therefore, the rating explicitly captures the commitment to this LTV target. Further, we expect that Stelius would adjust its dividend payouts accordingly if its policy to keep LTV below 30% was endangered.

LTV currently low

LTV is low as the company has no balance-sheet debt. With the gradual use of the prospective bond proceeds of HUF 15bn, we expect an LTV of less than 10% within the next two years, depending on when the proceeds are used.

Liquidity

Liquidity adequate

Due to the absence of short-term debt, we expect liquidity in the forecast period to be adequate in accordance with our methodology.

Senior unsecured debt

Senior unsecured debt rated at the same level as issuer rating

In the third quarter of 2020, Stelius plans to issue a senior unsecured corporate bond of up to HUF 15bn under the Hungarian National Bank’s Bond Funding for Growth Scheme. The bond is expected to have a 10-year tenor. Our base case assumes a 4% coupon on this instrument. The bulk of issuance proceeds are planned for the modernisation and renovation of real estate, with the remainder earmarked for the digitalisation of its Pledge Loan and Valuables and Ground Transportation businesses. We rate senior unsecured debt at the same level as the issuer rating.

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