THURSDAY, 14/03/2024 - Scope Ratings GmbH

Scope publishes BBB-/Positive issuer rating on Hungarian oil and gas company MOL

The rating is supported by a good financial risk profile but is held back the relatively weak business risk profile.

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 the existing subscription rating and has for the first time published its issuer rating of BBB- on MOL Magyar Olaj- és Gázipari Nyrt. (MOL Hungarian Oil and Gas plc or MOL) and its financing subsidiary MOL Group Finance Zrt. It has revised the Outlook to Positive from Stable. The S-2 short-term debt rating and BBB- senior unsecured debt rating have also been affirmed.

Rating rationale

The rating action reflects solid credit metrics amid high commodity prices and margins coupled with a decreasing vulnerability to energy supply disruptions from Russia and a gradual unwinding of regulatory interventions.

MOL sources more than half of its crude oil and indirectly a significant amount of gas from Russia. The Russia-Ukraine war has increased the risk of supply disruptions from damage to infrastructure or Russian retaliation against sanctions. Despite the European Commission's exemption from the embargo on Russian oil imports for some countries, this dependence makes MOL's Hungarian and Slovakian operations vulnerable to supply cuts from Russia. MOL is working on the diversification of oil supplies and made some progress in 2023. However, the pace of infrastructure upgrades is limited by continued uncertainty about the availability of EU funds. The situation in the European gas market is also improving, supported by additional supplies, reduced consumption and solid storage levels. At the beginning of March 2024, Hungarian and Slovakian gas storage facilities were around 70% full, a level sufficient to cover around half of the countries' annual consumption. Scope believes that these developments reduce the negative impact on MOL of potential Russian oil and gas supply disruptions.

MOL's business risk profile (assessed at BB+) continues to reflect its integrated business model, its competitive downstream portfolio and exposure to the regulated gas transportation business (midstream). Challenges include its dominant exposure to volatile energy prices, refining and petrochemical margins, small upstream operations, moderate geographical diversification, potential changes in environmental regulation and demand patterns (ESG: credit-negative environmental and social risk factors), ongoing regulatory interventions as well as some uncertainty regarding its ownership of the oil and gas company INA-Industrija nafte d.d.

MOL's oil and gas production reached 90,400 boe/d in 2023 compared with 92,000 boe/d in 2022. In the next couple of years, Scope expects production at around 90,000 boe/d with natural decline being largely offset by development activities, primarily in Azerbaijan, Hungary, Croatia and Kazakhstan.

In 2023, fuel demand growth supported Brent-based refining margins that were more than offset by lower YoY Brent-Urals spreads and a sharp increase in Brent-Urals taxation in December 2022. Demand for petrochemicals remained soft in 2023 and MOL group petrochemicals margin declined by around 40% YoY resulting in a negative EBITDA contribution. The overall downstream performance was also negatively affected by revenue-based taxes, CO2 taxes as well as increased maintenance and logistics costs. Scope expects refining and petrochemical margins to gradually stabilise to below multi-year averages.

As part of its sustainability strategy MOL is developing the waste management business and plans to report it as a separate segment from 2024 on. Scope notes, however, that the relevant projects could only be meaningful in the credit rating assessment once relevant cash flows reach a critical size, which is likely only in the medium or long term.

Despite moderating commodity prices and margins, ongoing regulatory intervention, record high income tax and dividend payments, MOL's Scope-adjusted debt grew only moderately in 2023. As a result, leverage, as measured by Scope-adjusted debt/EBITDA, remained at a very solid level (1.2x at YE 2023, up 0.5x YoY). While leverage and interest cover remained strong, cash flow cover, as measured by Scope-adjusted free operating cash flow/debt, fell to below 20%.

For 2024-2026, Scope expects Scope-adjusted debt/EBITDA to increase but remain below 2.0x based on its expectation of a gradual normalisation in oil and gas market fundamentals. In particular, Scope expects a Brent crude oil price of around USD 65-75 per barrel and moderately decreasing refining margins. Strong cash flow is likely to balance increased investment spending and shareholder remuneration. Scope expects the interest cover to remain at a comfortable level of well above 10x, mainly due to a moderate level of interest-bearing debt with largely fixed interest rates. The Scope-adjusted free operating cash flow/debt ratio is projected to fall below 15% in 2025, mainly driven by moderating commodity prices/margins and growth capex (around 30%-40% of total capex), which comes in addition to maintenance capex. This explains why Scope does not view this level of Scope-adjusted free operating cash flow/debt as worrisome.

While credit metrics are likely to stay solid in the next couple of years, they may be negatively affected by the supply disruption of hydrocarbons imported from Russia, regulatory interventions or significant worsening of the commodity price environment. While the regulatory interventions have been material in the past and remain difficult to predict, Scope believes that these are unlikely to jeopardise the financial stability of the company. Given the above uncertainties, Scope has maintained MOL's financial risk profile assessment at BBB+.

MOL's liquidity profile is adequate. For 2024-2025, Scope expects financial debt maturities (including financial liabilities related to transferred treasury shares with put and call option transactions) of around HUF 324bn and HUF 276bn respectively to be more than 110% covered by available cash and cash equivalents of around HUF 416bn as of YE 2023, committed undrawn credit lines of around HUF 964bn (maturing over 2025-2028) and positive free operating cash flow of around HUF 313bn and HUF 130bn respectively.

Regarding supplementary rating drivers, Scope notes that the Hungarian government (rated BBB/Stable by Scope) via MNV Zrt. continues to own the only series B voting preference share. According to the articles of association, no shareholder or shareholder group may exercise more than 10% of voting rights. While Scope believes that the Hungarian government does not control MOL, it can exercise significant influence supported by veto rights attached to the series B share.

However, Scope continues to assess the Hungarian government as having limited willingness and capacity to support MOL in the event of financial distress. Scope has therefore not adjusted the standalone credit assessment for parent support.

One or more key drivers for the credit rating action are considered an ESG factor.

Outlook and rating-change drivers

The Positive Outlook reflects Scope's expectation of a robust operating performance driven by supportive commodity prices, helping to maintain Scope-adjusted debt/EBITDA below 2.0x in the next few years. The Outlook also reflects MOL's decreasing vulnerability to energy supply cuts from Russia as well as a gradual reversal of regulatory interventions.

Scope would consider a positive rating action if the vulnerability to energy supply cuts from Russia decreased substantially and the company maintained its good credit metrics, with Scope-adjusted debt/EBITDA at around or below 2.0x on a sustained basis, e.g. as a consequence of supportive commodity prices/margins for a prolonged period.

A negative rating action (such as Outlook revision back to Stable) could be triggered by a deterioration in credit metrics, e.g. if expectations about a Scope-adjusted debt/EBITDA at or below 2.0x were not met on a sustained basis. This could be due to interrupted hydrocarbons supplies from Russia, weak commodity prices/margins for a prolonged period or material debt-financed M&A activities.

Long-term and short-term debt ratings

The rated debt is issued by MOL Nyrt. and its financing subsidiary MOL Group Finance Zrt. Debt issued by the financing subsidiary benefits from an unconditional and irrevocable guarantee by MOL Nyrt.

Senior unsecured debt is affirmed at BBB-, the same level as the issuer rating.

The affirmed short-term debt rating of S-2 reflects MOL's underlying issuer rating of BBB-/Positive and is backed by the company's solid short-term liquidity cover and conservative liquidity management. The rating is further supported by well-established banking relationships.

Stress testing & cash flow analysis

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

Methodology

The methodologies used for these Credit Ratings and/or Outlooks, (General Corporate Rating Methodology, 16 October 2023; Oil and Gas Rating Methodology, 22 December 2023), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
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 Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity 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 Outlooks and the principal grounds on which the Credit Ratings and/or Outlooks are based. Following that review, the Credit Ratings and/or Outlooks were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.
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The MOL's Nyrt. Credit Ratings/Outlook were first released by Scope Ratings on 3 May 2021. The Credit Ratings/Outlook were last updated on 20 March 2023.
The MOL's Group Finance Zrt. Credit Ratings/Outlook were first released by Scope Ratings on 20 March 2023.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

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ISSUERS **2**

INSTRUMENTS **4**