

FITCH AFFIRMS MOL HUNGARIAN OIL AND GAS COMPANY AT 'BBB-'; OUTLOOK STABLE

Fitch Ratings-Moscow/London-12 December 2018: Fitch Ratings has affirmed MOL Hungarian Oil and Gas Company Plc's (MOL) Long-Term Issuer Default Rating (IDR) at 'BBB-'. The Outlook is Stable. A full list of MOL's ratings is at the end of this commentary.

The affirmation reflects MOL's diversified and integrated business with assets in downstream, upstream, retail, and gas midstream, conservative leverage and strong competitive position in the company's core markets. The ratings are constrained by MOL's declining reserves and uncertainties over the company's stake in Croatia's INA - Industrija Nafte, d.d. (INA).

KEY RATING DRIVERS

Diversified Operations: MOL's integrated business model is a key credit strength, as the company operates across the entire oil and gas value chain and generates stable cash flows throughout the business cycle. MOL's small upstream production (100mboe/d in 3Q18, of which 52% were liquids) is concentrated in two countries - Hungary and Croatia, which account for 71% of the total output. MOL's more sizable downstream, which accounted for about half of the company's EBITDA in 2016-2017, drives profitability in periods of low oil prices. In addition, gas midstream and consumer services provide stable earnings and support MOL's overall creditworthiness.

Uncertainty around INA Remains: The decision of the United Nations Commission on International Trade Law (UNCITRAL) court in December 2016 to dismiss the claims of the Croatian government against MOL was followed by the announcement by the Croatian government of its intention to buy back MOL's 49.1% stake in INA. More recently, in April 2018, Croatia announced that it had engaged in discussion with a consortium of banks to advise it on the potential transaction.

Under such scenario, management plans to use the proceeds from the sale to replace the INA reserves via another acquisition. Although not our base case, such a development, combined with the company's current need to replenish its declining reserves would further increase the uncertainty around the upstream segment's future performance. In our opinion, the alternative option, where MOL keeps and operates INA, implies lower execution risk, particularly if MOL is able to optimise INA's downstream assets, which currently suffer from low utilisation and are not profitable.

Acquisitions to Drive Upstream Prospects: MOL aims to bring 350mmboe in new reserves by 2023 to avoid production decline thereafter. Given that its portfolio mainly consists of mature assets, inorganic growth is needed to meet this target. Although this entails some execution risk, we believe that MOL's robust balance sheet provides sufficient headroom to pursue acquisitions. Moreover, management's goal of a more internationally diversified upstream business would be an improvement on its current state and would support the company's credit profile.

MOL estimates that it can maintain upstream production at 105mboe/d-110mboe/d until 2023, up from its old guidance of 95mboe/d-105mboe/d, following positive developments on the company's fields in Iraq, the UK and Hungary. At-end 2017 2P reserves stood at 356 mmboe, which represent reserve life of nine years (5 years excluding INA).

Headroom for Strategy Execution: Under the Fitch base case, we project positive free cash flows (FCF), albeit at a lower level than in 2017-2018, and FFO adjusted net leverage below 1.0x over

2018-2021 (0.8x at end-2017). This assumes total capex of around USD1.9 billion over 2019 and 2020, associated primarily with the polyol project and provides sufficient headroom for upstream acquisitions without jeopardising MOL's credit profile.

Further Diversification into Chemicals: MOL plans to further expand into chemicals with its flagship polyol project, with expected completion by end-2021 and full ramp up by 2023. The plant is projected to contribute USD170 million of EBITDA under mid-cycle conditions. We view this expansion as positive for MOL's credit profile as it enhances downstream diversification with comparably lower margin volatility and superior growth prospects in petrochemicals than in fuel products.

Higher Contribution from Less Cyclical Segments: In 2017, MOL's relatively stable consumer services and gas midstream operations contributed 24% of total EBITDA, up from 18% in 2013. This has been driven by strong retail performance, whose EBITDA increased to USD358 million in 2017 from USD151 million in 2013.

Management plans further progress in the area by expanding MOL's non-fuel offering and new services, such as car-sharing and fleet management, with a goal to delivering USD500 million in EBITDA by 2023. We see higher contribution from more stable, less cyclical activities as positive for MOL's credit profile. Moreover, we view management's focus on the consumer services division as appropriate in light of the global transition to lower carbon economies.

DERIVATION SUMMARY

MOL's ratings are supported by vertical integration, some geographical diversification and low leverage, but are constrained by declining reserves and uncertainties over the company's 49.1% stake in Croatia's INA. In upstream, MOL's 2017 production (99mboepd without equity associates) was comparable to that of DEA Deutsche Erdoel AG (DEA, BB/Rating Watch Positive, 125 mboepd) and QEP Resources, Inc. (BB/Rating Watch Negative, 146 mboepd).

MOL's closest EMEA downstream peers are Polski Koncern Naftowy ORLEN S.A. (PKN, BBB-/Stable) and Turkiye Petrol Rafinerileri A.S. (Tupras, BB+/Negative). PKN's 689m bbl/d downstream capacity exceeds MOL's (417m bbl/d), and the gap is expected to widen to 500m bbl/d should PKN's planned acquisition of Grupa LOTOS S.A. (Lotos) go ahead. PKN's upstream remains small at 15mboepd at end-2017, potentially increasing to 40mboepd after the acquisition of Lotos, and is not a significant source of cash flow. Although MOL's business profile is stronger than Tupras's, the latter operates in a still deficit Turkish fuels market, despite the recent inauguration of the 10 mtpa capacity STAR refinery owned by State Oil Company of Azerbaijan Republic (BB+/Stable).

The Hungarian State owns a 25.2% stake in MOL. However, we rate the company on a standalone basis to reflect our assessment of low likelihood of support from the government due to weak-to-moderate strength of linkage and incentive to support.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer

- Crude oil price of USD72.5/bbl in 2018, USD65/bbl in 2019, USD62.5/bbl in 2020, USD60/bbl in 2021 and USD57.5/bbl thereafter
- Benchmark refining margin of USD5.4/bbl over 2018 - 2021
- Stable upstream production compared with 2017
- Capital expenditure in line with management's guidance
- 10% annual increase in dividend per share and no special dividends over 2019 - 2021

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Improved operational profile in the upstream and/or petrochemical segment; and
- Favourable resolution of the dispute with Croatian government regarding MOL's stake in INA;
- FFO-adjusted net leverage sustainably below 1.5x

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- FFO-adjusted net leverage above 2.5x on a through-the-cycle basis
- Upstream production falling significantly below 100mboe/d or 1P reserve life sustainably below five years
- Negative impact on MOL's financial profile from the dispute regarding the company's stake in INA

LIQUIDITY

Comfortable Liquidity: As of 30 September 2018 cash and cash equivalents of HUF352 billion covered short-term debt of HUF330 billion. MOL's liquidity is further supported by long-term undrawn committed facilities of around HUF874 billion and by our expectations of positive FCF generation over the next three years. MOL's liquidity is also supported by the company's demonstrated access to the bank and debt capital markets.

FULL LIST OF RATING ACTIONS

MOL Hungarian Oil and Gas Company plc

- Long-Term Foreign and Local Currency IDRs: affirmed at 'BBB-'; Outlook Stable
- Short-Term Foreign and Local Currency IDRs: affirmed at 'F3'
- Senior unsecured rating: affirmed at 'BBB-'

MOL Group Finance SA

- Senior unsecured rating: affirmed at 'BBB-'

Contact:

Principal Analyst

Vladislav Nikolov

Associate Director

+44 20 3530 1288

Supervisory Analyst

Maxim Edelson, CFA

Senior Director

+7 495 956 9986

Fitch Ratings Moscow

Business Centre Light House

6th Floor, 26 Valovaya St.

Moscow 115054

Committee Chairperson

Myriam Affri

Senior Director

+44 20 3530 1919

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email: adrian.simpson@thefitchgroup.com.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023785>

Government-Related Entities Rating Criteria (pub. 25 Oct 2018)

<https://www.fitchratings.com/site/re/10047173>

Sector Navigators (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023790>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.