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 689mbbl/d downstream capacity exceeds MOL's (417mbbl/d), and the gap is expected to widen to 500mbbl/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