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

Fitch Ratings-Warsaw/London-26 October 2017: 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 ratings of MOL reflect its integrated business profile with assets in refining, upstream, retail and petrochemical segments, a strong market position in central and eastern Europe, strong asset base in refining in Hungary and Slovakia and its low leverage. The ratings are constrained by its smaller size compared with European peers such as Repsol, S.A. (BBB/Stable), decreasing reserve size in the upstream segment and uncertainties over its ownership in Croatian-based INA, d.d..

In 2016 MOL generated USD2.2 billion (USD1.3 billion in 1H17) in current cost of supplies (CCS) EBITDA. It operates four refineries (one in Hungary, one in Slovakia and two in Croatia) with a total refinery capacity of 417 thousand barrels of oil equivalent per day (mboepd). MOL's 1H17 upstream production amounted to 110mboepd, mainly from mature assets in Hungary and Croatia, but also from greenfields in the North Sea, Kurdistan and other regions.

KEY RATING DRIVERS

Non-fuel Sales to Increase: MOL plans to invest in its petrochemical and chemical business as part of a long-term strategy until 2030 to diversify away from fuels. The company expects these measures will result in the share of non-fuel products in its refining output rising to more than 50% of sales from below 30% currently. It also transforms its traditional fuel retailing business into a broader consumer goods and services business.

Adapting to Changing Market Dynamics: MOL's plans are a response to the growing sales of electric vehicles (EVs), proliferation of low-carbon emission solutions and digitalisation of transport (eg, self-driving cars, sharing economy). The pace of adoption of battery-equipped cars is still uncertain. Yet, major car producers plan to introduce new, affordable models in 2019-2020, which will likely lead to higher sales. We view MOL's plans as positive for the company's business profile due to strong prospects for petrochemical product sales in the medium- to long-term.

Strong Refining Margins: MOL reported USD1.3 billion in CCS EBITDA in 1H17 (up 20% yoy) and a strong 9% growth in fuel sales. Refining margins were favourable in 3Q17, partly due to unforeseen events such as a fire in Shell's 404,000 bpd refinery in the Netherlands and hurricanes in the US Gulf Coast. We expect MOL will report strong financial results in 2H17. International Energy Agency expects healthy demand for oil to continue in 2018, while oil prices remain under USD60/barrel according to our price deck, which suggests that the macro environment for refiners should remain favourable in the short-term.

Low Leverage, Manageable Capex: MOL guides for capex of USD1 billion in 2017. We assume higher spending in the medium term due to planned investments in strategic projects. Recently, the company signed an agreement to design the propylene oxide value chain (polyol project) with an expected investment of USD1 billion in 2017-2021. MOL's funds from operations (FFO)-adjusted net leverage amounted to 1.3x in 2016. We expect the ratio to be below 2.0x until 2020, which leaves MOL with significant headroom for both organic and inorganic capex before reaching our negative rating sensitivity of 2.5x.

INA Situation Still Uncertain: In December 2016, MOL received the international arbitration award in the case launched by the Republic of Croatia against the company in January 2014. Pursuant to the award Croatian government's claims against MOL were dismissed. The arbitration proceeding launched by MOL is in progress. Based on publicly available information, we understand that the Croatian government plans to purchase back the 49.1% stake in INA from MOL.

INA represents 35% of upstream production and 47% and 43% of 1P and 2P reserves of MOL, respectively. Loss of INA will be negative for MOL's business profile. We assume, however, that in case of a disposal, the majority of proceeds will be used for inorganic growth, which will offset lost EBITDA contribution from INA.

Declining Oil & Gas Reserves a Risk: MOL's use of enhanced recovery techniques and cost-cutting measures resulted in a stable output and low production costs in the past few quarters despite low oil prices. MOL's oil and gas reserves declined in recent years and totalled 313.5mmboe and 459.4mmboe at end-2016 on 1P and 2P basis, respectively. This represented reserve life of eight and eleven years, respectively (six and 10 years excluding INA).

MOL estimates it will need to add inorganically up to 75mmboe of 2P reserves to maintain production at around 110mboepd until 2021 and an additional 100 mmboe-105mmboe of reserves to record a 100% reserve replacement rate. M&A transactions in the sector gathered pace in recent months and MOL's low leverage makes the company well placed to improve reserve base.

DERIVATION SUMMARY

MOL's closest peers are Polski Koncern Naftowy ORLEN S.A. (PKN ORLEN) (BBB-/Stable) and Turkiye Petrol Rafinerileri A.S. (Tupras) (BBB-/Stable). MOL's upstream segment is larger and more profitable than PKN ORLEN's. The latter company enjoys higher contribution to cash flows from its petrochemical segment, which has historically shown higher cash flow visibility than oil refining. Tupras's ratings are supported by the company's leading position in a growing Turkish market. We expect FFO-adjusted net leverage of under 2.5x for all three companies.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Brent price of USD52.5/bbl in 2018, USD55/bbl in 2019, USD57.5/bbl in 2020 andUSD57.5/bbl long-term;
- Stable refining margins over 2017-2020;
- Capex in line with management forecasts.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Improved operational profile in the upstream and/or petrochemical segment.
- Favourable resolution of the dispute with Croatian government regarding MOL's stake in INA.
- FFO-adjusted net leverage sustainably below 1.5x.

Future 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 100mboepd.
- Negative impact on MOL's financial profile from the dispute regarding management rights in INA.

LIQUIDITY

Healthy Liquidity: Short-term debt at end-June 2017 totalled EUR0.8 billion against cash and cash equivalents of EUR0.4 billion and available committed credit lines of EUR2.6 billion.

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
Jakub Zasada
Director
+48 22 338 6295

Supervisory Analyst
Maxim Edelson
Senior Director
+7 495 956 9901
Fitch Ratings CIS Limited
Valovaya Street, 26
Moscow

Committee Chair
Peter Archbold, CFA
Senior Director
+44 20 3530 1172

Media Relations: Adrian Simpson, London, Tel: +44 203 530 1010, Email: adrian.simpson@fitchratings.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. 07 Aug 2017)
https://www.fitchratings.com/site/re/901296

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. 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. 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 © 2017 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