FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms MOL at 'BBB-'; Outlook Stable

Thu 18 Jun, 2020 - 2:10 PM ET

Fitch Ratings - Warsaw - 18 Jun 2020: 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.

The affirmation and Stable Outlook reflects our view that MOL will be able to maintain its funds from operations (FFO) net leverage below 2.5x in 2020-2023, a level that is commensurate with the current rating. This is despite a more challenging macro backdrop and the completion of the Azeri-Chirag-Gunashli (ACG) acquisition in 2020. MOL entered 2020 with a low net leverage of 0.6x at end-2019, leaving ample headroom to weather the downturn.

MOL's rating is supported by a diversified and integrated business with assets in downstream, upstream, retail, and gas midstream; by low leverage and by a strong competitive position in the company's core markets. The rating is constrained by MOL's short reserve life compared with direct peers' and uncertainties over the company's stake in Croatia's INA - Industrija Nafte, d.d. (INA).

KEY RATING DRIVERS

Swift Response to Oil Price Slump: MOL recently announced plans to cut organic capex to a maximum of USD1.5 billion in 2020, down from a projected USD1.9 billion-USD2.1 billion earlier and to review operations to reduce its cost base. Dividend payment with respect to 2019 net profit is suspended pending normalisation of the coronavirus pandemic. Low leverage at end-2019, coupled with the cash flow-preservation measures swiftly announced by MOL should protect its financial profile from the economic fallout from the pandemic.

Good 1Q Results: Current cost-of-supply (CCS) EBITDA totalled USD622 million in 1Q20, up 21% yoy. Lower oil and gas prices resulted in upstream EBITDA dropping 35% to USD185 million, which was offset by a stronger result in the downstream segment with CCS EBITDA more than doubling on higher refining margins and stable demand prior to the coronavirus-related impact. Reported EBITDA excluding special items amounted to USD408 million, with a negative inventory effect of USD214 million.

Volatile Current Trading: Refining margins held up firmly until April 2020, buoyed partially by lower oil prices, but turned negative in May on overcapacity, lower demand but also on an increase in oil prices following curtailed supply after OPEC+ cuts. Deeper-than-average discounts of Urals to Brent in 4M20 recently turned into a premium on lower availability of sour crude blends. Retail and petrochemical segment results are less volatile, even under current difficult market conditions.

Weaker Results Expected in 2020: With demand for fuels recovering as lockdown is gradually being lifted, we expect the operating environment for oil and gas companies to normalise in 2H20, absent a second wave of coronavirus infections. MOL reported lower fuel demand of 35%-40% in April and we conservatively expect only a gradual recovery in 2H20 and significantly lower demand for 2020. Oil prices recently recovered to around USD40/bbl from below USD20/bbl in April. MOL's diversified business profile and low cash-breakeven upstream oil price of USD25/bbl should help smooth out cash flows over the current volatile period. Nevertheless, we forecast EBITDA to be 41% yoy lower for 2020, with downside risk from the pandemic and European GDP decline.

ACG Acquisition Rating-Neutral: The recently completed USD1.5 billion acquisition of a 9.57% stake in the ACG oil field, and an effective 8.9% stake in the BTC pipeline that transports crude to the Mediterranean port of Ceyhan increases MOL's upstream total 2P reserves by roughly 50% (120 million-140 million barrels of oil equivalent (mmboe)) and total annual production by a fifth (or 20,000 barrels of oil equivalent per day (boe/d)). The transaction alleviates some rating pressure on MOL related to a decreasing reserve base, while its financial profile will remain strong with FFO net leverage forecast to peak at 2.5x in 2020 before swiftly decreasing, leaving ample headroom for additional inorganic growth.

Mature Upstream Asset Base: MOL's upstream asset base remains mature compared with that of peers such as Compania Espanola de Petroleos, S.A.U (CEPSA, BBB-/Stable) or Aker BP ASA (BBB-/Stable). The ACG oil field reached plateau production in 2010 and its output has since steadily decreased. MOL's upstream asset base lacks prospective fields that can help raise production in the next three to five years.

Diversified Operations: MOL's integrated business model is a key credit strength with operations across the entire oil and gas value chain and generates more stable cash flows through the business cycle than pure refining or E&P companies. MOL's small upstream production is concentrated in two countries, Hungary and Croatia, which account for 64% of total output. Its more sizable downstream segment, which accounted for an average of 43% of EBITDA in 2016-2019, drives profitability in periods of low oil prices. In addition, gas midstream and consumer services contributed to an average of 23% of total EBITDA over the same period, providing stable earnings and supporting MOL's overall creditworthiness.

Further Diversification into Chemicals: MOL plans to improve downstream diversification through further expansion into chemicals with its flagship polyol project. The polyol plant, 60% completion at end-1Q20, is projected to contribute USD170 million of EBITDA under mid-cycle conditions. The completion date is end-2021, assuming no delays related to the coronavirus pandemic. We see further expansion in petrochemicals as positive for MOL's credit profile, due to lower margin volatility and superior growth prospects in the segment, compared with fuel products.

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 government's announcement to buy back the 49.1% stake in INA from MOL. Should this proceed, we expect MOL to monetise its stake at market prices and to use the cash to replace the INA reserves via another acquisition.

INA Sale May Raise Execution Risks: Monetising the INA stake, combined with MOL'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 retains and operates INA implies lower execution risk. This would allow MOL to further optimise INA's downstream assets, which currently suffer from low utilisation and are not profitable.

DERIVATION SUMMARY

MOL's ratings are supported by a integrated business model, some geographical diversification and low leverage, but are constrained by a mature upstream asset base and uncertainties over the company's 49.1% stake in Croatia's INA.

MOL's closest EMEA downstream peers are CEPSA and Polski Koncern Naftowy ORLEN S.A. (PKN ORLEN, BBB-/Stable). PKN ORLEN's 689mbbl/d downstream capacity exceeds MOL's (417mbbl/d), and the gap may widen to 500mbbl/d should PKN's planned acquisition of Grupa LOTOS S.A. go ahead. PKN's upstream segment remains small at 17mboepd in 2019, potentially increasing to 38mboepd after the acquisition of Lotos, and is not a significant source of cash flow. CEPSA has a slightly larger refining capacity (457mbbl/d) and similar oil and gas output to MOL of 93kboepd in 2019 (on a working interest basis), but larger 2P reserves.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Brent crude prices of USD35/bbl in 2020, USD45/bbl in 2021, USD53/bbl in 2022, and USD55/bbl in 2023

- TTF hub natural gas prices of USD2.5/mcf in 2020, USD3.75/mcf in 2021, USD5/mcf in 2022, USD5.5/mcf in 2023

- Refining margins of USD3.6/bbl in 2021, gradually recovering to USD6.5/bbl by 2023

- Generally stable baseline upstream production, with incremental volumes realised from ACG

- Polyol project contributing USD170 million of run-rate EBITDA in 2H22

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Improved operational profile in the upstream or petrochemical segment;

- Favourable resolution of the dispute with the Croatian government regarding MOL's stake in INA; and

- FFO net leverage sustainably below 1.5x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO 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; and

- Negative impact on financial profile from the dispute regarding the INA stake.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Healthy Liquidity: MOL has strong liquidity, comprising HUF766 billion of cash and a revolver availability of HUF423 billion in 1Q20, which fully cover near-term debt maturities, absent a refinancing, as well as modestly negative free cash flow in the near-term. This leads to strong liquidity scores above 2x in each forecast year (2020-2023), even under our conservative oil and gas price scenario.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
MOL Hungarian Oil and Gas Company Plc	LT IDR	BBB- Rating Outlook Stable	Affirmed
	ST IDR	F3	Affirmed
	LC LT IDR	BBB- Rating Outlook Stable	Affirmed
	LC ST IDR	F3	Affirmed
• senior	LT	BBB-	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 01 May 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

MOL Group Finance S.A.	EU Issued
MOL Hungarian Oil and Gas Company Plc	EU Issued

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