FitchRatings

RATING ACTION COMMENTARY

Fitch Revises MOL's Outlook to Negative; Affirms IDR at 'BBB-'

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Fitch Ratings - Warsaw - 08 Jun 2022: Fitch Ratings has revised MOL Hungarian Oil and Gas Company Plc's (MOL) Outlook to Negative from Stable while affirming its Long-Term Issuer Default Rating (IDR) at 'BBB-'.

The revision of the Outlook reflects the risks related to MOL's significant reliance on supplies of gas and oil from Russia mainly in its downstream division. While Hungary is exempt from the EU ban on Russian oil supplies and we do not currently assume that natural gas flows from Russia will be halted, geopolitical tension in Europe remains high. While we believe that MOL has a number of levers to shield its financial profile from the negative consequences of a potential halt of hydrocarbon supplies from Russia, the associated market volatility and risks related to refinancing and ongoing operations are difficult to predict at present.

KEY RATING DRIVERS

Reliance on Russian Natural Gas: Hungary consumes around 10bcm of natural gas annually, with nearly 80% primarily imported from Russia. Our base case assumes Russian natural gas flows to Hungary will continue, which if halted could have sizeable impact on capacity utilisation of MOL's downstream assets. In the extreme adverse scenario of the Russian gas and oil supplies being cut off with no substitutes found we still expect funds from operations (FFO) net leverage to remain manageable.

Uncertainty During Adjustment Period: We assume that Hungary, similar to other EU countries, would be able to gradually replace Russian supplies over two to three years but we see considerable uncertainty around the adaptability of MOL's operations and liquidity needs during this period, which is reflected in the Negative Outlook. MOL would also be more reliant on its upstream segment during the adjustment period.

Hungary Exempt from EU Oil Ban: The EU has recently agreed to ban Russian seaborn exports of oil and oil products. Currently around 64% of MOL's oil supplies are procured from Russia via the Druzhba pipeline, although those will be temporarily exempted from the ban (timing when the exemption expires is currently unknown). MOL estimates the investments required to diversify oil import infrastructure and overhaul refineries so that they could process lighter types of crude oil at USD500 million-USD700 million over two-four years. We reflected the capex in our forecasts, which is low relative to MOL's total investment spending.

Halt to Oil Supplies Unlikely: The EU agreement removes a risk that Russian oil supplies to Hungary would be halted. Nevertheless, we believe that in such a negative scenario MOL could increase supplies via the Adria Pipeline running from Croatia. While capacity utilisation at refining assets in such a scenario would temporarily reduce to 70%-80%, the impact on earnings would depend on the level of refining margins, which could improve further on the likely lower utilisation rate of other refineries in the CEE region.

Government Measures Impact Manageable: MOL's profitability is presently benefiting from significant discounts to Russian Urals' prices compared with other oil benchmarks and high oil and natural gas prices. This, coupled with high fuel retail prices, has prompted the Hungarian government to introduce certain measures to shield consumers and increase state revenue. We estimate the impact of the fuel price cap and windfall taxes will be manageable for MOL, with forecast FFO net leverage on average at 0.9x in 2022-2025.

Fuel Price Cap Shaves EBITDA: The Hungarian government recently extended the duration of the cap on main-grade gasoline and diesel prices at HUF480/l until 1 July 2022. We conservatively assume the price cap will run until end-September 2022, with an estimated impact of an EBITDA decrease of USD0.5 billion in 2022.

Windfall Tax Impact Unknown Yet: The Hungarian authorities have recently announced windfall taxes for companies that have benefited from higher energy prices, interest rates and banking fees, as well as more consumer spending in sectors such as telecommunications since the pandemic. While the decree of the new law has been just published and its impact needs to be analysed further, we have increased taxes by HUF250

billion in 2022 and HUF200 billion in 2023 in our forecasts, in line with the publicly available data and our own estimates.

DERIVATION SUMMARY

MOL is rated in line with its close EMEA downstream peers Compania Espanola de Petroleos, S.A.U (CEPSA, BBB-/Stable) and Polski Koncern Naftowy ORLEN S.A. (PKN, BBB-/Rating Watch Positive (RWP)). MOL and its closest peer CEPSA have a similar business profile characterised by vertical integration and comparable refinery capacities (MOL's 380kboe/d vs. CEPSA's 474kboe/d). MOL's larger upstream production scale of 101kboe/d, excluding JVs (CEPSA's 74kboe/d) is balanced by its lower reserve life. CEPSA recorded EBITDA of USD2.1 billion in 2021 compared with USD3.5 billion for MOL.

In comparison with PKN, MOL has a small operational scale of downstream activity and less diversified revenue stream especially after PKN's recent acquisition of Energa S.A and pending its expected mergers with Grupa LOTOS S.A (LOTOS), the second-largest Polish refiner, and Polskie Gornictwo Naftowe i Gazownictwo SA (PGNiG, BBB/Stable), a vertically integrated natural gas utility, in 2H22. PKN is currently on RWP, reflecting the expected expansion of its refinery capacity to 894kboe/d (assuming LOTOS is fully consolidated) and meaningful business diversification post mergers, growth in upstream production to 159kboe/d and a higher share of regulated earnings from electricity and natural gas distribution.

MOL has also demonstrated lower leverage and stronger liquidity than peers under its conservative financial policy. In addition, exemptions from the oil embargo granted to Hungary in June 2022 alleviates the risk of significant deterioration of refinery capacity at least in the short term.

KEY ASSUMPTIONS

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

- Oil and natural gas prices to 2026 in line with Fitch's base case price deck

- HUF/USD of 337.86 in 2022, 348.5 in 2023, 350 in 2024-2026

- Upstream production of around 90kboe/d from 2022 through 2026

- Refining throughput averaging 369kbbl/d from 2022 through 2026

- Refining margins averaging USD4/bbl from 2022 through 2026

- Capex of USD2 billion in 2022 and 2023, USD1.9 billion in 2024, and USD1.8 billion in 2025 and 2026

- Windfall tax of HUF250 billion in 2022 and HUF200 billion in 2023

- Price caps on wholesale and retail fuels remain in place until end-3Q22

- Annual dividends payment of HUF242 billion in 2022, HUF200 billion in 2023, and HUF150 billion in 2024-2026

RATING SENSITIVITIES

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

- As the rating is on Negative Outlook we do not expect positive rating action in the near term. However, reduced reliance on oil and gas from Russia or significantly reduced risk to supplies being halted may lead to the Outlook being revised to Stable

- 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 can lead to a positive rating action

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

- FFO net leverage above 2.5x on a sustained basis

- Upstream production falling significantly below 100kboe/d or 1P reserve life sustainably below five years

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

- Continuing problems in securing natural gas supplies leading to re-evaluation of MOL's business profile, an increase in leverage beyond the negative sensitivity or issues in rolling over debt maturities

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

Strong Liquidity: MOL has strong liquidity with a 1Q22 cash balance of HUF498.6 billion and HUF842 billion committed credit facilities which, alongside free cash flow generation, are expected to fully cover debt servicing over the medium term.

ISSUER PROFILE

MOL is a medium-sized integrated oil & gas company based in Hungary.

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

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

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
MOL Hungarian Oil and Gas Company Plc	LT IDR Affirmed	BBB- Rating Outlook Negative	BBB- Rating Outlook Stable

	ST IDR	F3	Affirmed	F3
	LC LT IDR Affirmed	BBB-	Rating Outlook Negative	BBB- Rating Outlook Stable
	LC ST IDR	F3	Affirmed	F3
senior unsecured	LT	BBB-	Affirmed	BBB-
MOL Group Finance S.A.				
senior unsecured	LT	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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

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