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Research Update:

MOL Hungarian Oil And Gas PLC Outlook Revised To Positive From Stable On Improved Credit Metrics; 'BB+' Ratings Affirmed

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Research Update:

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Overview

- MOL Hungarian Oil and Gas' improved its credit metrics on the back of higher-than-expected free cash flow generation and strong performance of its downstream business.
- We expect this trend to continue and now forecast that MOL's funds from operations (FFO) to debt will reach about 55% in 2017 and continue to strengthen in 2018.
- We are therefore revising the outlook on MOL to positive from stable and affirming the 'BB+' corporate credit rating.
- The positive outlook reflects the likelihood of an upgrade if MOL's strong performance enables the company to reach the rolling-12-months FFO/debt ratio of about 55%, further improving and maintained at about 60% on average through the cycle.

Rating Action

On July 20, 2017, S&P Global Ratings affirmed its 'BB+' long-term corporate credit rating on MOL Hungarian Oil and Gas PLC and revised the outlook to positive from stable.

We also affirmed our 'BB+' issue rating on MOL's senior unsecured bonds.

Rationale

The outlook revision to positive recognizes our assessment of MOL's strong performance, supported by above-average refining margins, and the company's success in rebalancing its costs. MOL's FFO/debt is currently close to 47%-48% and is set to strengthen further as the company generates positive cash flow after capital expenditures (capex) and dividends.

Importantly, MOL managed to prove the benefits of its integrated business model, having generated meaningfully positive free cash flow even in 2016 when oil prices remained weak and refining margins reduced by 30% compared to 2015. The company also delivered on its cost-optimization program, which we believe brings sustainable benefits for profitability, and increased the share of less volatile retail and petrochemicals segments.

As a result, we believe MOL's EBITDA should slightly increase in 2017-2018 even if refining margins remain flat. Although the company plans to invest significantly in its petrochemicals business, it should still allow for positive free cash flow generation of at least Hungarian forint (HUF) 100 billion and therefore allow for positive discretionary cash flow. This distinguishes MOL from the majority of larger peers, which still struggle with covering dividend and capex from operating cash flow.

We therefore believe that MOL's FFO/debt could strengthen further, aiming toward 55% by the end of the year and above 60% afterward. We believe that maintaining this ratio is important for a higher rating, as it provides significant headroom against volatility in refining margins, which are still at above-average levels in the cycle.

We don't rule out MOL to carry out investments and acquisitions in upstream over the next few years to address what we view as a weak 1P reserves-to-production ratio (8 times), which is a key constraining factor for MOL's business risk profile. We currently expect that such transactions would be prudently financed and that some deterioration in credit metrics may be offset by improvement in the business risk profile.

In our base-case scenario for MOL, we assume:

- A Brent oil price of $50 per barrel (bbl) for the rest of 2017 and 2018, and $55/bbl in 2018 and thereafter.
- Flat refining margins in 2017-2018 on average compared to 2016.
- Cash capex of Hungarian forint HUF400 billion-HUF450 billion in 2017-2018 ($1.5 billion-$1.7 billion).
- Dividends of HUF60 billion-HUF80 billion.

Based on these assumptions, we arrive at the following credit metrics for the company:

- FFO to debt of about 50%-60% in 2017-2018.
- Positive discretionary cash flow.

Our assessment of MOL's business risk profile as fair reflects the group's diversification across upstream activities, refining, petrochemicals and retail operations in Central and Eastern Europe. MOL's two main refineries are strategically located, highly complex, integrated plants. However, MOL is particularly exposed to Hungary and is materially smaller in terms of production than such peers as Repsol S.A. that have a stronger business risk assessment. Our assessment is also constrained by the ongoing dispute with the Croatian authorities over MOL's 49% owned subsidiary INA, which we view as important for the company given it has meaningful upstream reserves.

Under our criteria, we regard MOL as a government-related entity (GRE), but this is neutral for the rating. We assess MOL's role for and link with the Hungarian government as important and limited, respectively. This leads to our view of a moderate likelihood of timely and sufficient extraordinary support from the Hungarian government to MOL in the event of financial distress. The Hungarian government owns about 25% of MOL.

Liquidity

We assess MOL's liquidity as strong. We anticipate that liquidity sources will continue to exceed uses by more than 1.5x over the next 12 months and remain above 1x over the subsequent 12-month period. We assume that MOL will be able to obtain funding from international or local banks, if needed, and believe it will proactively refinance its committed bank lines well before they mature, as it has been doing so far.

Our base-case liquidity assessment includes the following liquidity sources and uses in the 12 months from March 31, 2017:

Principal Liquidity Sources:

- Cash and liquid investments of about HUF 285 billion on March 31, 2017.
- About HUF877 billion available under long-term committed bank lines, as well as about HUF96 billion under short-term bank lines. All long-term lines are subject to financial covenants of net debt to EBITDA of 3.5x, under which we believe MOL has strong headroom, as its net debt to EBITDA is about 1x currently.
- FFO of about HUF581 billion.

Principal Liquidity Uses:

- Short-term debt maturities of about HUF488 billion (including repayment of €750 million bond in April 2017)
- Capex of HUF407 billion.
- Dividends of HUF64 billion.
- Working capital outflows of about HUF8 billion.

Outlook

The positive outlook reflects the likelihood that we could raise the rating to 'BBB-' if MOL's credit metrics continue to strengthen on the back of robust performance and positive free cash flow generation. To support an upgrade we would also expect the company to maintain a conservative financial policy, with dividend payments not exceeding the amount of free operating cash flow.

Upside scenario

We could raise the rating if the rolling-12-months FFO/debt ratio improves to about 55% and is maintained at about 60% on average through the cycle, while the company continues to generate materially positive discretionary cash flow. Given that refining and petrochemicals margins are currently above our assumptions, we believe the company could be fairly close to this level already toward the end of 2017, which could unlock the upside potential.

An upgrade could also be achieved if we were to see MOL's business as stronger, which could happen if MOL were to address the issue of declining production post 2020 by acquiring additional reserves while maintaining solid credit metrics, such as FFO/debt of about 45% on average. Positive resolution of the conflict with Croatian authorities related to its subsidiary INA could also support achievement of this goal, although the terms of the potential agreement would be important.

Downside scenario

We could revise the outlook to stable if performance were to weaken because of deterioration of refining and petrochemicals margins, or if the company were to increase debt materially from the current level due to acquisitions or financial policy decisions not sufficiently compensated by related improvement in business risk. Although we currently see it as unlikely, if the resolution to the INA conflict is very unfavorable to MOL, such as the asset expropriation, this could also dilute the upside potential.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Positive/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)
- Likelihood of government support: Moderate (no impact)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Oil Refining And Marketing Industry, March 27, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013

- General Criteria: Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- EMEA Oil & Gas: A Mixed Picture In 2017, July 19, 2017

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
MOL Hungarian Oil and Gas PLC		
Corporate Credit Rating	BB+/Positive/--	BB+/Stable/--

Ratings Affirmed

MOL Hungarian Oil and Gas PLC	
MOL GROUP FINANCE S.A.	
Senior Unsecured	BB+

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.