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Research Update:

MOL Hungarian Oil and Gas Upgraded To 'BB+' On Expected Resilience; Outlook Stable

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Research Update:

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Overview

- MOL Hungarian Oil and Gas' recent performance has strengthened on the back of higher downstream margins and structural improvements in the refining business.
- We now forecast that MOL's credit metrics will remain stronger than we previously expected, with funds from operations to debt exceeding 45% on average.
- We are therefore raising our rating on MOL to 'BB+' from 'BB'.
- The stable outlook reflects our expectations that MOL's refining business will generate resilient cash flows even under our assumptions of 30% industry-wide decline in refining margins in 2016, while upstream performance will gradually improve in line with oil price growth.

Rating Action

On July 19, 2016, S&P Global Ratings raised its long-term corporate credit rating on MOL Hungarian Oil and Gas PLC to 'BB+' from 'BB'. The outlook is stable.

We also raised our issue rating on MOL's senior unsecured bonds to 'BB+' from 'BB'. In addition, we withdrew all our ratings on subsidiary Magnolia Finance Ltd. as per the issuer's request.

Rationale

The upgrade primarily reflects our expectations that MOL's credit metrics will be stronger than we anticipated due to the downstream division's better performance. We now forecast MOL's funds from operations (FFO) to debt, as adjusted by S&P Global Ratings, at 45% on average over 2016-2018, which we see as commensurate with an intermediate financial risk profile. We also think that with reduced capital spending, the company will likely generate positive discretionary cash flows even under our assumption of an industry-wide 30% contraction in refining margins in 2016.

Record high refining and petrochemical margins mainly drove the doubling of downstream EBITDA in 2015. That said, we recognize that a substantial part of the growth followed structural improvements in the refining business, which should support cash flow resilience even in a weaker market environment. We note that the company is progressing well with its efficiency improvement program, and its growth projects in petrochemicals (butadiene and

polyethylene) along with investments in retail should bring in about \$150 million in EBITDA per year.

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

- A Brent oil price of \$40 per barrel (/bbl) for the rest of 2016, \$45/bbl in 2017, and \$50/bbl in 2018 and thereafter.
- 30% weaker refining margins in 2016 compared with 2015.
- Cash capital expenditures (capex) of Hungarian forint (HUF) 350 billion-HUF400 billion (\$1.2 billion-\$1.4 billion).
- Dividends of HUF50 billion-HUF80 billion.

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

- FFO to debt of about 40% in 2016, improving to 45%-50% in 2017-2018.
- Positive discretionary cash flow in 2016-2018.

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 smaller in terms of production than peers 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 strategically important for the company.

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 (BB+/Stable/B) 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. We believe that MOL will be able to obtain funding from international or local banks, if needed, and proactively refinance its committed bank lines well before they mature.

Our base-case liquidity assessment includes the following liquidity sources in the 12 months from March 31, 2016:

- Cash of about HUF175 billion.
- HUF675 billion available under long-term committed bank lines. All lines are subject to financial covenants of net debt to EBITDA of 3.5x, under which we believe MOL has strong headroom.
- FFO of about HUF500 billion-HUF550 billion.

Our base case includes the following liquidity uses in the same period:

- Capex of HUF350 billion-HUF400 billion.
- Dividends of HUF50 billion-HUF80 billion.
- Short-term debt of about HUF264 billion.
- Moderate working capital outflows.

Outlook

The stable outlook on MOL balances our view on:

- The near-term challenging industry outlook under our oil price assumption of \$40-\$50/bbl over 2016-2018 and a 30% narrowing in refining margins in 2016; and
- Our expectation that the company's credit metrics will gradually improve on the back of cost optimization and material capex reduction, which should allow for positive free cash flow generation.

We expect that MOL's FFO to debt will stay at about 45% on average over 2016-2018, and likely somewhat short of this level in 2016. We think the company's previously made investments in refineries should support resilient cash flow generation, even under our assumption of reduced refining margins.

Downside Scenario

We could lower our rating on MOL if its performance weakened markedly, owing to an even sharper decline in downstream margins, or if the company's debt increase substantially from the current level due to acquisitions or financial policy decisions. Downside rating risk could materialize if FFO to debt decreased to sustainably below 40%.

Upside Scenario

We could raise the rating if we saw a pronounced improvement in MOL's business, particular on the upstream side. MOL could achieve such improvement if it positively resolved the conflict with Croatian authorities related to its subsidiary INA or it otherwise increased the scale of its upstream business. We could also raise the rating if MOL's credit metrics improved further, with FFO to debt at higher than 60%, although we see this scenario as unlikely in the next 12-18 months.

Upside rating potential also depends on MOL's ability to sustain a hypothetical default of Hungary, which we currently rate at the same level as MOL.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Fair

- Country risk: Fair
- 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 And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 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 - December 12, 2013
- General Criteria: Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008

Ratings List

Upgraded

	To	From
MOL Hungarian Oil and Gas PLC Corporate Credit Rating	BB+/Stable/--	BB/Positive/--
MOL Hungarian Oil and Gas PLC MOL GROUP FINANCE S.A. Senior Unsecured*	BB+	BB

Ratings Withdrawn

	To	From
Magnolia Finance Ltd. Corporate Credit Rating Junior Subordinated	NR NR	BB/Positive/-- B

*MOL Hungarian Oil and Gas PLC.

NR--Not rated.

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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.

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