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Research Update:

MOL Hungarian Oil and Gas Outlook Revised To Positive On Strong Operating Performance; 'BB' Rating Affirmed

Primary Credit Analyst:

Beatrice de Taisne, CFA, London (44) 20-7176-3938; beatrice.de.taisne@standardandpoors.com

Secondary Contact:

Simon Redmond, London (44) 20-7176-3683; simon.redmond@standardandpoors.com

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Overview

- MOL Hungarian Oil and Gas PLC's (MOL's) financial performance in 2014 and 2015 has been supported by a strong downstream contribution that has largely offset the effects of lower oil prices.
- We foresee a possible improvement in MOL's financial risk profile in the next 18 months as its oil production increases alongside our assumption of oil prices recovering. Its downstream division performance could be supported at current levels by an efficiency improvement plan and retail-growth strategy MOL is currently implementing.
- We are therefore revising our outlook on MOL to positive from stable, and affirming our 'BB' rating.
- We have revised our assessment of MOL's liquidity to "strong" from "adequate," reflecting the company's ample funding position.
- The positive outlook reflects our view that strong downstream margins, increased oil production, and the absence of credit-dilutive acquisitions could support operating performance such that adjusted funds from operations (FFO) to debt improves toward 40% in 2016 and 2017.

Rating Action

On July 17, 2015, Standard & Poor's Ratings Services revised its outlook on MOL Hungarian Oil and Gas PLC (MOL) to positive from stable. We affirmed our 'BB' long-term corporate credit rating on MOL.

We also affirmed our 'BB' issue ratings on MOL's senior unsecured debt instruments and our 'B' issue ratings on the group's junior subordinated debt.

Rationale

The positive outlook reflects our view that MOL's financial risk profile could strengthen over the next 18 months on the back of stronger performance than we currently expect in our base-case scenario.

MOL's financial performance in 2014, and so far in 2015, has been supported by a strong downstream contribution that has largely offset the impact of lower oil prices. Its plans for efficiency improvements in its downstream division and increase retail sales in its petrol stations will also support its financial performance. If successfully implemented, MOL's plans should result

in stronger cash flow generation, leading it to improve toward the stronger end of its current "significant" financial risk profile.

In our opinion, uncertainties around MOL's share of Croatia-based oil company INA-Industrija nafte, d.d. (INA) pose a potential risk because we regard MOL's ownership of INA as supporting MOL's business risk profile. The sale of INA would not lead us to revise our assessment of MOL's "fair" business risk profile, although it would increase its reliance on Hungary. INA constitutes roughly 36%-38% of MOL's combined reserves and production and also owns two refineries. Due to an ongoing disagreement between the Croatian government and MOL regarding strategic issues, we understand that MOL could consider selling its stake, although for MOL negotiation and agreement is the preferred option. If it did sell its stake, the negative impact on its business risk profile could be neutralized by what MOL does with the proceeds.

Our assessment of MOL's business risk profile as "fair" reflects the group's diversification across upstream activities, refining, 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.

We assess MOL's financial risk profile as "significant" under our criteria. This reflects its "intermediate" core credit ratios but weaker debt coverage ratios after capital expenditure (capex) and dividend payments (specifically discretionary cash flow to debt). This is in line with our assessment of most of MOL's peers.

Under our criteria, we regard MOL as a government-related entity (GRE) but this does not affect the rating. We assess MOL's role for the Hungarian government as "important" and its link as "limited," which leads to our assessment of a "moderate" likelihood of extraordinary government support. MOL is about 25% owned by the Hungarian state.

Our base case assumes:

- A slow recovery of upstream contributions from 2015 on a recovery in global oil prices and an increase in production.
- Continuous strong contribution of downstream operations amid supportive macroeconomic conditions and a cost-cutting program and retail-growth strategy.
- Ongoing dividend payments in line with historical levels.
- No material credit-dilutive acquisitions.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt sustainably above 30%, trending toward 40% by 2017.
- Sustained capex and dividend payments leading to low or negative free operating cash flow (FOCF) and discretionary cash flows.

Liquidity

We assess MOL's liquidity as "strong" under our criteria. 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, 2015:

- Cash of about Hungarian forint (HUF) 204 billion (€744 million).
- About HUF1,200 billion (about €4.4 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 HUF400 billion-HUF450 billion in calendar-year 2015.

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

- Capex of HUF400 billion-HUF500 billion.
- Dividends of HUF50 billion-HUF80 billion.
- Short-term debt of about HUF233 billion.
- Moderate working capital outflows.

Outlook

The positive outlook reflects our view that strong downstream margins, increased oil production, and the absence of credit-dilutive acquisitions could support operating performance such that adjusted funds from operations (FFO) to debt moves toward 40% in 2016 and 2017.

If MOL were to sell its share in INA, any rating action would depend on how MOL uses the proceeds of such a potential sale.

Upside scenario

We could raise the rating if MOL's financial performance improved such that FFO to debt trended toward 40% on good downstream performance and a recovery in its upstream contribution, showing some resilience to industry conditions.

Downside scenario

We could revise the outlook to stable if the financial profile does not improve--for example, if FFO to debt remains around 30%.

Rating pressure could arise if discretionary cash flow (FOCF minus dividends) turned sharply negative, leading to FFO to debt of less than 25% for a prolonged period.

Ratings Score Snapshot

Corporate Credit Rating: BB/Positive/--

Business risk: Fair

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

Financial risk: Significant

- Cash flow/Leverage: Significant

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 rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Key Credit Factors For The Oil Refining And Marketing Industry, March 27, 2014
- Key Credit Factors For The Oil And Gas Exploration And Production Industry , Dec. 12, 2013
- Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Related Research

- Standard & Poor's Revises Its Crude Oil And Natural Gas Price & Recovery Assumptions, March 26, 2015

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

*Research Update: MOL Hungarian Oil and Gas Outlook Revised To Positive On Strong Operating Performance;
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	To	From
MOL Hungarian Oil and Gas PLC Magnolia Finance Ltd. Corporate Credit Rating	BB/Positive/--	BB/Stable/--
Ratings Affirmed		
MOL Hungarian Oil and Gas PLC Senior Unsecured	BB	
MOL GROUP FINANCE S.A. Senior Unsecured*	BB	
Magnolia Finance Ltd. Junior Subordinated	B	

*Guaranteed by MOL Hungarian Oil and Gas PLC.

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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