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Summary:

MOL Hungarian Oil and Gas PLC

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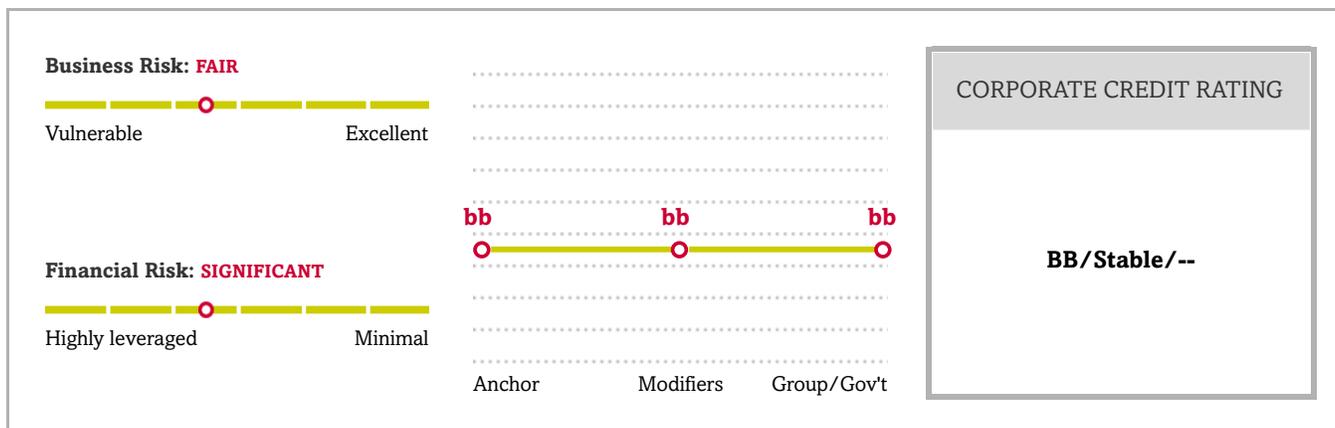
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Summary:

MOL Hungarian Oil and Gas PLC



Rationale

Business Risk: Fair	Financial Risk: Significant
<ul style="list-style-type: none"> • A significant country risk exposure, especially in terms of exploration and production (E&P) growth prospects with the company's interests in the Kurdistan region of Iraq. • Solid position in the downstream segment of MOL's core geographical markets, with a combination of high-complexity assets and a large filling-station network. • Ongoing disagreement between the Croatian government and MOL Hungarian Oil and Gas PLC (MOL) regarding strategic issues at Croatia-based oil company INA, in which MOL currently has a 49% stake. 	<ul style="list-style-type: none"> • Significant investments needed to keep the company's position in the upstream segment and maintain satisfactory profitability in downstream. • Large share of operating cash flows sourced from E&P with solid market fundamentals that will, in our view, support the company's growth initiatives. • Adequate liquidity supported by significant operating cash flow generation and large committed bank lines.

Outlook: Stable

The stable outlook on MOL reflects our view that, over our 18-month rating horizon, the group's operating performance will continue to be supported by elevated hydrocarbons prices, which will allow the group to maintain adjusted FFO to debt of more than 25%. The outlook also reflects our forecast that the group will maintain an "adequate" liquidity position and prudent financial policies, including cash flow-funded capital expenditure (capex).

Downside scenario

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 sustained period. We would also consider a downgrade if the company made major debt funded acquisitions or significant shareholder distributions above our base-case forecasts.

If we downgraded Hungary by one or two notches, this would not necessarily directly affect our ratings on MOL because our criteria allow for a rating differential of up to two notches between MOL and the sovereign. In the event of a downgrade of Hungary, we would look at the effect of domestic economic developments on MOL's profits and liquidity.

Upside scenario

We believe there are certain scenarios that could result in us upgrading MOL. For example, we could consider raising the ratings if MOL were to sell INA at market price and invest the cash from the disposal in new producing assets--potentially in areas with lower country risk than Hungary. Likewise, if MOL retains its stake in INA but continues to diversify its assets to improve its competitive position, both in upstream and downstream, we could consider an upgrade in the medium term.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics		
<ul style="list-style-type: none"> • A stabilization of declining exploration and production in 2014, on the back of new projects coming on stream. However, we see risks associated with the depletion of mature fields and the political uncertainty in Iraq. • Oil prices as per Standard & Poor's oil price deck: Brent price of \$110 per barrel for 2014, and \$105 for 2015. • A weak operating environment in downstream operations with regard to crack spreads and the Brent-Ural price differential. We anticipate that this will be somewhat offset by benefits from MOL's efficiency improvement program. • Capex of about HUF350 billion-HUF400 billion, with a large share of E&P spend targeted at high-risk areas such as the Kurdistan Region of Iraq, Kazakhstan, and Russia. • Potential acquisition spend in the range of US\$1 billion–US\$1.5 billion over the next two years, although this remains a key uncertainty to our forecasts. We highlight that total spend and type of assets acquired—and therefore EBITDA and cash flow contribution from those assets--depends on the opportunities that arise for the company. Therefore, our forecasts prudently do not include EBITDA generation from acquired assets. 	2013A 2014E 2015E		
	<hr/>		
	EBITDA margin (%) 9.3 8-9 8-9		
	FFO/Debt(%) 39 35-40 30-35		
<hr/> Debt/EBITDA(x) 2.1 2.2-2.7 2.5-3.2			
A--Actual. E--Estimate.			

Business Risk: Fair

We view MOL's business risk profile as "fair," reflecting the following key weaknesses:

- The company's exposure to the European refining market's structural overcapacity and challenging demand environment overall.
- E&P growth dependent on highly volatile regions such as the Kurdistan region of Iraq. Overall a somewhat higher country risk exposure than some peers, given its operations in Hungary, Croatia, Russia, and Iraq, notwithstanding a chunky portion of forecast production growth based in the North Sea following the recent acquisition.
- Depletion rates on Hungarian and Croatian assets are high, which makes it difficult for MOL to sustain production levels organically.
- Continued uncertainty relating to the ongoing disagreement between the Croatian government and MOL regarding strategic issues at Croatia-based oil company INA, in which MOL has a 49% stake and management control. INA constitutes approximately 36%-38% of MOL's combined reserves and production and also owns two refineries.
- Weakening reserve profile.

These weaknesses are partly offset by the following strengths:

- MOL's two main refineries are strategically located, highly complex, integrated plants.
- Diversification across upstream activities, refining, midstream, petrochemical, and retail operations in Central and Eastern Europe.
- Recent acquisition shows a new strategic way for MOL and further investments in low risk regions would support the business risk profile, especially if the assets have a significant impact on production levels both in the short and long run.

Financial Risk: Significant

We view MOL's financial risk profile as "significant," reflecting:

- Strong core credit ratios for the rating, with weaker debt coverage ratios, as is common in the oil and gas industry.
- Exposure to the volatile European refining market.
- Large capex and acquisition forecasts. We do, however, note that the company holds a large cash balance that tempers the risk of increased indebtedness linked to growth efforts.

Liquidity: Adequate

We assess MOL's liquidity as "adequate" under our criteria. We anticipate that liquidity sources will continue to exceed uses by comfortably more than 1.2x over the next 12 months. 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.

Our base-case liquidity assessment includes the following liquidity sources and uses in the 12 months from March. 31, 2014:

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • Cash of about HUF457 billion (€1.5 billion) on March 31, 2014. • About HUF760 billion (about €2.5 billion) available under long-term committed bank lines. All lines are subject to financial covenants. • FFO of about HUF390 billion–HUF400 billion in each full year 2014 and 2015. 	<ul style="list-style-type: none"> • Capex of HUF350 billion–HUF400 billion. • Dividends of HUF45 billion–HUF50 billion. • Short-term debt of about HUF300 billion. • Moderate working capital outflows. • Significant acquisition spend as per our base case forecast, albeit we believe that MOL could pull back on this if it were to experience liquidity issues.

Covenant headroom is ample

MOL has ample covenant headroom. Key tests are a group-reported net financial debt-to-EBITDA limit of 3x (the tightest test level) and a minimum tangible net worth of HUF600 billion. In the case of acquisitions, leverage can increase to 3.5x for up to one year. Covenant headroom was significant at the last test date on Dec. 31, 2014.

Other Modifiers

No modifiers affect the rating.

Government Influence

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.

Rating Above The Sovereign

Our 'BB' corporate credit rating on MOL remains in line with our rating on Hungary.

We believe that MOL could maintain sufficient liquidity to cover its commitments in the event of extreme stress on the sovereign. MOL's international operations provide a buffer for the group against potential weakness in its domestic operations. However, we would not rate MOL more than two notches above Hungary because we assess MOL's country risk sensitivity as "high," notably due to MOL's direct government ownership, our classification of MOL as a GRE, and its exposure to domestic economic cycles. Therefore, a downgrade of Hungary by more than two notches, or a downgrade of our transfer and convertibility assessment on Hungary to below 'BB' from 'BBB-' currently, would likely result in a downgrade of MOL.

In our view, a sale of INA would increase MOL's reliance on Hungary but would not lead us to revise our assessment of MOL's "fair" business risk profile. In such a scenario MOL would also receive a cash consideration for INA. This would, despite increased geographical concentration in Hungary in the short term, allow for other opportunities possibly in other regions. This is why we believe that in this scenario MOL would be able to maintain sufficient liquidity in a Hungarian sovereign stress situation.

Ratings Score Snapshot

Corporate Credit Rating

BB/Stable/--

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:** Adequate (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile

- **Related government rating:** BB
- **Likelihood of government support:** Moderate (no impact)

Related Criteria And Research

Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Business And Financial Risk Matrix						
Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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