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Research Update:

MOL Hungarian Oil and Gas 'BBB-' Rating Affirmed As Strong Profits Mitigate Political Risks; Outlook Stable

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Rating Action Overview

- MOL Hungarian Oil and Gas PLC faces political risks as the EU increases its sanctions against Russia, including an oil embargo, and as taxation increases on exceptional profits. A full embargo on importing Russian oil into Hungary would pose problems since more than 50% of crude processed by MOL is Urals and finding alternatives would take time and investment.
- We believe that the negative impact from these risks has been mitigated by robust cash flow generation as commodity prices remain elevated, strongly boosting upstream profits and supporting funds from operations (FFO) to debt well above 45%.
- We therefore affirmed our long-term rating on MOL at 'BBB-'.
- The stable outlook indicates that MOL should be able to cope with higher taxes and potential investments required to comply with restrictions on crude sourcing, while maintaining strong credit measures.

Rating Action Rationale

MOL is facing a number of uncertainties and risks that may affect performance and investments in the near to medium term. MOL is reliant on Russian crude oil for its refining operations, especially in Hungary and Slovakia. The EU embargo on Russian oil from the end of the year does not, for the moment, include oil delivered by pipeline to Hungary and Slovakia. The timeframe of this exemption will play an important role in MOL's ability to sustain current capacity utilization and cash flow generation at its refineries. If MOL needed to replace Russian crude, significant infrastructure and asset investments might be necessary. Hungary's landlocked position in Europe and currently unbalanced oil market further add to the complexity of the task for MOL. While the exemption will allow the company to continue buying strongly discounted Ural crude (we understand at least for two years), the benefit should be tempered by the windfall tax that will be put in place, especially in Hungary. Details of the latter are yet to be disclosed, but we understand the impact for MOL could be an additional Hungarian forint (HUF)250 billion ($750 million) tax payment in 2022.

Market conditions remain supportive with elevated oil and gas and refined product prices. In first-quarter 2022, the company generated high EBITDA of close to $900 million, given continued high oil and gas prices globally because of the Ukraine-Russia war. Despite high gas prices, a key energy cost for refining operations, the deficit in both diesel and gasoline in Europe continue to support prices and margins. We therefore anticipate the company will continue to generate significant free operating cash flows, continue to invest in its business evolution, and maintain FFO to debt close to 60%.

We continue to anticipate a prudent financial policy and strong credit metrics, while M&A is used to manage the asset portfolio. The spike in leverage during the pandemic in 2020, with reported net debt to EBITDA above 1.5x, was swiftly reduced back 0.6x-0.7x, reflecting the prudent approach to debt levels the company has maintained for many years. However, MOL retains flexibility to seize opportunities for M&A, with relatively high activity in 2022 already, as it sold higher-cost U.K. upstream assets and acquired more than 400 fueling stations in Central and Eastern Europe (CEE). MOL adjusted its dividends downward during the downturn, unlike some of its peers with less flexible shareholder distributions. Access to liquidity through cash on hand and undrawn credit facilities remains strong.

Outlook

The stable outlook reflects our view that, despite uncertainty and risks related to Russian crude sourcing and additional taxation on profits stemming from the large Urals-Brent Spread, MOL's business resilience and diversity, coupled with prudent balance sheet management, will limit the overall effect on credit metrics. We anticipate that FFO to debt will remain close to 60% over a five-year average, a level commensurate with the 'BBB-' rating.

Downside scenario

We could lower the rating in the next 12 months if an unexpected change in crude sourcing was to materially cut refined product production at the same time as the supportive prices were to decline. These scenarios could lead to FFO to debt falling below 45% on average without prospects for a quick recovery, which could lead us to downgrade MOL to 'BB+'.

Upside scenario

Given the increased risks, we think the upside is remote. We could raise the rating in two to three years if MOL's improving business mix and diversification, coupled with a markedly stronger market environment and conservative financial policies, lead to FFO to debt of above 60% through the cycle. This would also require cash flows after capital expenditure and dividends to be at least neutral and any risks to the crude sourcing to have been alleviated.

Company Description

MOL is a midsize integrated oil and gas company operating in CEE, headquartered in Budapest, Hungary. The company has annual oil and gas production of about 90,000 barrels of oil equivalent per day and has refining capacity of 417,000 barrels per day. The majority of oil and gas production still comes from Croatia and Hungary, complemented by the Middle East and Africa and the North Sea. Three out of four MOL refineries are regionally very competitive with high complexity characteristics. The company also has a large fuel retail network all over CEE and is also investing heavily in petrochemicals, with investments in a Polyol plant further deepening its exposure to chemicals. The company's market capitalization is currently close to $6 billion.

Our Base-Case Scenario

Assumptions

- Brent oil price of $100 per barrel (/bbl) for the rest of 2022, $85 in 2023, and $55 in 2024 and thereafter.
- Volatile but elevated refining margins in 2022 of $5/bbl or more (they were $12/bbl in first-quarter 2022), gradually diminishing toward $4/bbl in 2024. Petrochemical margins under pressure with high oil prices, normalizing at levels below €500/tonne after an exceptional 2021 with levels close to €1,000/ton.
- Stable oil and gas production of about 90,000 barrels of oil equivalent (boe) per day in 2022 and 2023 following divestment of the U.K. portfolio.
- Cash capital expenditure in 2022-2023 of slightly below $2 billion each year. Investments in downstream expansion are to continue as fuel-to-chemicals remains the key priority in organic spending.
- Dividend payments to be high in 2022 for fiscal 2021 at about HUF250 billion, moderately decreasing in coming years as we anticipate an EBITDA contraction from todays elevated levels.
- We do not include any additional mergers and acquisition (M&A) activity in our base case but understand the company will act opportunistically as it has with recent transactions.

Key metrics

- EBITDA of close to $3.5 billion in 2022, falling toward $3 billion in 2023, with upstream accounting for more than 50%. This compares with about $2 billion and $3.5 billion in 2020 and 2021, respectively.
- FFO to debt close to 60%-70% in 2022-2023. While we acknowledge the heightened risk environment, there is ample headroom at the current rating level to absorb significant EBITDA decline of $1 billion or more. In 2021, FFO to debt was just above 70%

Liquidity

We assess MOL's liquidity as strong, reflecting the company's solid cash cushion and our anticipation of positive free operating cash flow. We anticipate that liquidity sources will exceed uses by more than 1.5x over the next 12 months and remain above 1x over the subsequent 12-month period. We also favorably assess MOL's solid banking relationship, given the company's status as Hungary's largest corporate entity, and a track record of MOL proactively refinancing its committed bank lines well before they mature.

Our base-case liquidity assessment includes the following liquidity sources as of March 31, 2022:

- Cash and liquid investments of about HUF500 billion.
- About HUF750 billion available under long-term committed bank lines. Most lines are subject to financial covenants of net debt to EBITDA of 3.5x, under which MOL has strong headroom as its debt to EBITDA is below 1x.
- FFO of about HUF800 billion-HUF1,000 billion.

This compares with the following liquidity uses:

- Short-term debt maturities of about HUF175 billion.
- Capital expenditure of HUF550 billion-HUF600 billion.
- Dividends of HUF250 billion.

Issue Ratings--Subordination Risk Analysis

Capital structure

MOL's capital structure consists of senior unsecured debt issued at the parent level.

Analytical conclusions

The issue rating on MOL's senior unsecured debt is 'BBB-', in line with the issuer credit rating, as no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating	**BBB-/Stable/--**
Business risk:	Fair
Country risk	Moderately High
Industry risk	Moderately High
Competitive position	Fair
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)

Issuer Credit Rating	**BBB-/Stable/--**
Stand-alone credit profile:	bbb-
Related government rating	BBB
Likelihood of government support	Moderate (no impact)

ESG credit indicators: E-4, S-2, G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- General Criteria: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Ratings List

Ratings Affirmed	
MOL Hungarian Oil and Gas PLC	
Issuer Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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; or Stockholm (46) 8-440-5914