Fitch Ratings

15 JUN 2023

Fitch Affirms MVM at 'BBB'; Outlook Negative

Fitch Ratings - Warsaw - 15 Jun 2023: Fitch Ratings has affirmed Hungary's largest electricity and gas utility MVM Zrt.'s Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BBB' with a Negative Outlook. A full list of rating actions is below.

MVM's Long-Term IDRs are at the company's Standalone Credit Profile (SCP) of 'bbb'. Their Negative Outlook currently reflects the same on Hungary's sovereign 'BBB'/Negative rating, which was revised from Stable in January 2023.

Hungary's rating serves as a cap on MVM's ratings, driven by strong linkage between MVM and the state as per our Parent and Subsidiary Linkage Rating Criteria. This is the reason for not revising the Outlook to Stable despite MVM's 2022 results and leverage being considerably better than we had anticipated when we changed its Outlook to Negative from Stable in November 2022.

Key Rating Drivers

2022 Results Better Than Expected: MVM's financial performance in 2022 was better than our expectations, with funds from operations (FFO) net leverage at 2.5x versus our 7.5x forecast. This was because of stronger EBITDA and FFO largely due to higher margins in the wholesale and gas storage segment and full compensations received for losses on sale of electricity and gas to eligible customers.

In our updated projections, FFO net leverage will remain below our negative rating sensitivity of 3.5x in 2023-2024. Following the acceleration of capex, including two CCGT projects, FFO net leverage will peak at about 3.5x in 2025-2026 and then follow a declining trend when the projects start operating and contributing to EBITDA.

Large Net Debt Increase: MVM's net debt is subject to seasonal swings and is typically at a high point at end-December when gas inventories are close to their peak ahead of strong winter demand. At end-2022 this was exacerbated by the high cost of gas purchased for storage during 2022. As a result, MVM's debt rose to HUF1.5 trillion at end-2022 from HUF644 billion at end-2021. We estimate that at end-2022 most of MVM's debt was related to gas inventories.

More Exposed to Working-Capital Swings: MVM is more exposed to seasonality in working-capital needs than most regional peers, given its large gas inventories due to domestic legislative requirements and its crucial role in the security of gas supply in Hungary.

Retail Compensation: Fitch expects compensations from the utility protection fund to support MVM's profitability in the retail segment in 2023-2024. The fund, created by the government and available to MVM since September 2022, has compensated the company for the sale of gas and electricity to eligible customers, mostly households, under a universal service provision, at regulated prices, which in 2022 were substantially below market prices. The scheme is currently in place indefinitely but the selection of MVM by the state as a universal service provider at capped prices is valid until end-2024.

High Balancing Costs in 2022: MVM's infrastructure segment suffered from sharply increased balancing costs in 2022, which were covered at a considerably lower level by its tariff for the same year. Based on the existing regulatory framework the costs would be recovered through tariff increases with a two-year lag, but the regulator has reflected about a third of extra balancing costs in the tariff for 2022, instead of 2024, and factored in the high costs for 2022 in the 2023 tariff determination.

Gas Supplies from Russia: MVM has significant exposure to Russian gas imports as the off-taker in its long-term import contract with Gazprom. Russian gas continues to flow to Hungary through interconnectors with Austria and Serbia. Lower supplies through Austria in 2022 were compensated via the Serbian route.

Financial Policy Consistent with Rating: MVM's management targets net-debt-to-EBITDA of up to 2.5x in its current business plan until 2027, which is consistent with the 'BBB' rating. The plan was approved by the state as the sole shareholder. We assume the state will continue to provide extraordinary support to MVM given the latter's strategic role in maintaining energy security.

Moderately Strong State Links: Fitch applies its Government-Related Entities (GRE) Rating Criteria in its analysis of MVM's linkage with the Hungarian state. We assess status, ownership and control as well as support track record as 'Strong'. MVM has historically benefited from substantial tangible support from the state, most recently through large equity injections in the last three years, mainly related to acquisitions and investments.

Moderate Incentive to Support: We assess the socio-political implications of a default by MVM as 'Moderate' as we assume that most of its operations would likely continue following a default. We have changed the financial implications of a default to 'Moderate' from 'Weak' as we believe that non-payment of debt would have a moderate impact on funding access for the government and other GREs. This assessment results in a support score of 20 points, indicating moderately strong links with the state.

Strong PSL Linkage: We view the parent-and-subsidiary linkage between the state and MVM as strong under our PSL Criteria, with the subsidiary being stronger than the parent. Therefore, MVM's rating would be constrained by the sovereign IDR if the latter is downgraded. This is reflected in the Negative Outlook for MVM, mirroring that on the sovereign rating. Our overall assessment of legal ring-fencing and access and control factors is 'open', due to full state-ownership leading to effective control and open ring-fencing.

Leading Market Position: MVM's business profile benefits from its strong market position in Hungary, spanning electricity generation (57% market share), gas imports (off-taker in the main gas import contract), gas storage (70%), electricity transmission (100%), and electricity and gas distribution (23% and 34%, respectively). It is also the main supplier of wholesale and retail electricity and gas in Hungary.

Derivation Summary

MVM's central European peers are PGE Polska Grupa Energetyczna S.A. (PGE, BBB+/Stable), ENEA S.A. (BBB/Stable), TAURON Polska Energia S.A. (Tauron, BBB-/Stable) and Bulgarian Energy Holding EAD (BEH, BB+/Stable, SCP: bb).

MVM has better integration and business diversification than PGE, ENEA and Tauron, which are focused on a specific line of business, such as electricity generation or distribution, and also have higher exposure to coal.

BEH is more comparable to MVM in business diversification, as its activities include generation, transmission and supply of electricity, as well as transmission, transit and supply of gas, on top of lignite mining. However, BEH is a negative outlier in the peer group in cash flow predictability and corporate governance.

MVM's balance sheet and working capital are highly exposed to changes in gas inventories due to seasonality and changes in gas prices. This results in a higher volatility of MVM's leverage than peers'. Also, MVM's net debt and leverage at year-end is higher than during the course of the year when gas inventories are lower.

MVM's peers are all state-controlled (either by the Polish or Bulgarian governments). The Polish peers are rated at a standalone level without any uplift for state links, while the 'BB+' rating of BEH includes a one-notch uplift for links with the Bulgarian state.

Key Assumptions

Key Assumptions Within Our Rating Case for the Issuer:

- Generation EBITDA growth driven by stable contribution from nuclear power plants and renewables. High EBITDA from coal-fired assets in 2023 following CO_2 prices being hedged at low levels in 2023 and high market prices

- Strong EBITDA in infrastructure in the medium term due to high balancing costs accrued in 2022 being recognised in tariffs in 2023 and 2024 (one third of extra costs already reflected in 2022 tariff)

- High EBITDA in wholesale gas and electricity in 2023 due to higher electricity margins and better performance of gas storage, followed by more normalised EBITDA from 2024

- Total capex averaging about HUF800 billion per year in 2023-2027 with development capex focusing on decarbonisation (replacing coal-fired assets with gas-fired assets), as well as digitalisation and infrastructure development

- Capex partly funded by domestic and EU grants, averaging HUF115 billion per year in 2023-2027

- Dividend payments of HUF108 billion in 2023 followed by lower amounts in 2024-2027

- No equity injections by the state over 2023-2027

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- An upgrade of MVM is unlikely due to the Negative Outlook on the sovereign rating, which serves as a cap on MVM's ratings

- We would revise the Outlook to Stable if Hungary's Outlook is revised to Stable, provided leverage and interest coverage remain within our negative sensitivities

Factors That Could, Individually or Collectively, Lead to Downgrade:

- FFO net leverage above 3.5x and FFO interest cover below 6x on a sustained basis

- Substantial adverse change in the business profile, such as a material reduction in the share of regulated or quasi-regulated business in total EBITDA

- Negative rating action on Hungary would lead to similar rating action on MVM due to the sovereign cap

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Solid Liquidity: MVM has a solid liquidity position. At end-2022, it had unrestricted cash of HUF407.5 billion and undrawn committed facilities of HUF298 billion, of which HUF195 billion will expire within 12 months. In the year to date MVM has committed new loans totaling HUF644 billion. This liquidity is sufficient to cover debt maturities of HUF145 billion in 2023, and Fitch-projected negative free cash flow in 2023, driven by large negative changes in working capital and capex.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

MVM ratings are credit-linked to the ratings of Hungary.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Renata Dobrzynska, PhD
Director
Primary Rating Analyst
+48 22 103 3035
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce Krolewska 16, 00-103 Warsaw

Nataly Di Salvo
Analyst
Secondary Rating Analyst
+34 93 492 9519

Arkadiusz Wicik, CFA
Senior Director
Committee Chairperson
+48 22 103 3016

Media Contacts

Isobel Burke
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
MVM Zrt.	LT IDR	BBB	Affirmed		BBB
	LC LT IDR	BBB	Affirmed		BBB
• senior	LT	BBB	Affirmed		BBB

ENTITY/DEBT	RATING	RECOVERY	PRIOR
unsecured			

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⦿	◆
STABLE	⊙	

Applicable Criteria

Corporate Rating Criteria (pub.28 Oct 2022) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.30 Sep 2020)

Parent and Subsidiary Linkage Rating Criteria (pub.01 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub.12 May 2023)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

MVM Zrt.	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.