06 JUN 2024

Fitch Affirms MVM at 'BBB'; Outlook Negative

Fitch Ratings - Warsaw - 06 Jun 2024: 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 is fairly positioned in its Standalone Credit Profile (SCP) of 'bbb', while the Negative Outlook on its IDR reflects the same on Hungary's sovereign 'BBB' rating. Hungary's rating caps MVM's, due to their strong links under our Parent and Subsidiary Linkage Rating Criteria.

MVM's rating reflects its integrated position across various segments of the Hungarian electricity and gas markets. It also reflects a solid share of regulated and quasi-regulated business in MVM's EBITDA. We expect funds from operations (FFO) net leverage to remain commensurate with the rating in 2024-2026, despite an increase from 2023, as the company's EBITDA and FFO generation normalise, while the company increases its capex. The recently announced acquisition of a 5% non-operating interest in Shah Deniz (SD), one of the world's largest offshore gas and condensate fields, located in Azerbaijan, is rating- neutral, in our view.

Key Rating Drivers

Better-Than-Expected 2023 Results: MVM reported record EBITDA in 2023, doubling the level of 2022 to HUF910 billion, driven by lower transmission and distribution system operator costs as well as higher margins in its regional wholesale division and Czech merchant businesses.

Stabilising Infrastructure EBITDA from 2024: MVM's infrastructure segment was a major EBITDA contributor at HUF303 billion in 2023, due to lower costs of network losses. Volatile balancing costs led to EBITDA fluctuations between HUF49 billion in 2022 and HUF303 billion in 2023. To mitigate this volatility in the following years, the regulator has adjusted tariffs for 2024 and 2025, leading to Fitch-projected EBITDA of about HUF160 billion on average annually in those years.

Strong Wholesale Performance: The wholesale segment posted an exceptionally strong EBITDA of HUF392 billion in 2023 as MVM capitalised on highly volatile commodity prices and increased spreads between purchase and sale prices. We expect EBITDA in this segment to remain high in 2024, as MVM's sales were hedged at high prices in 2023, while EBITDA should normalise at around HUF120 billion in 2025-2028.

Negative EBITDA in Retail: The retail segment saw a loss of HUF37 billion in 2023, due primarily to temporary losses in its natural gas universal supply service, which are scheduled to be compensated in 2025 and 2026. In mid-2022 the government created a utility protection fund to compensate MVM for the sale of gas and electricity at regulated prices under a universal service provision.

Exposure 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. Following two years of exceptionally high cash absorption from working-capital (HUF1.9 trillion in 2022-2023), Fitch expects working capital inflows in 2024-2028, albeit at a limited amount.

Ongoing Exposure to Russian Gas: MVM has a large exposure to Russian gas imports as the off-taker in a long-term import contract with Gazprom. Russian gas continues to flow to Hungary through interconnectors with Serbia and to a limited extent from Austria.

Increasing Projected Leverage: FFO net leverage improved to 1.6x in 2023 from 2.4x in 2022 on higher EBITDA and FFO, with the latter reaching HUF800 billion, and despite net debt increase. Fitch expects FFO net leverage to increase to an average 2.9x in 2024-2028 as EBITDA normalises, while capex and investments rise, in line with MVM's updated strategy.

Financial Policy Consistent with Rating: MVM's management targets net-debt-to-EBITDA of up to 2.5x, 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.

Acquisition in Azerbaijan: The recently announced acquisition of a 5% non-operating interest in SD is rating- neutral. Following the acquisition MVM's leverage will increase by about 0.2x and average 2.9x in 2024-2028, remaining well within rating sensitivities. The acquisition is in line with MVM's strategy of diversifying away from Russian gas imports and targeting at least 25% of EBITDA from international markets in the long term.

Strong PSL Linkage: We view the linkage between the state and MVM as strong under our PSL Criteria, with the subsidiary stronger than the parent. Therefore, MVM's rating would be constrained by the sovereign IDR if the latter is downgraded. This is already reflected in the current Negative Outlook on 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.

GRE Analysis: Under the Government-Related Entities (GRE) Rating Criteria we have 'Strong Expectations of Support', backed by an overall support score of 25 points. This could be reflected in an uplift if MVM's SCP becomes weaker than the sovereign rating.

Responsibility to Support: Fitch assesses decision-making and oversight as 'Very Strong' because the Hungarian state is MVM's sole shareholder, approves its strategy and business plan and tightly controls MVM's operations. We view the government's precedents of support as 'Strong', due to support provided mostly in the form of equity injections.

Incentive to Support: We assess the preservation of government policy role as 'Strong', as MVM has a crucial role in the security of electricity and gas supply in Hungary, by implementing the government's strategy of diversifying gas supplies and decarbonisation of power generation. MVM also runs the country's main energy infrastructure, including gas imports, gas storage and electricity transmission. Fitch does not see material contagion risk, as a MVM default should not have major implications for the government's ability to issue new debt or its cost of funding.

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+/Positive, 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 with 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 corporate governance and has lower cash flow predictability resulting from the higher merchant exposure of its generation assets.

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 in MVM's leverage than peers'. Also, MVM's net debt and leverage at year-end is higher than during 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 BEH's 'BB+' rating 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 rising contribution from growing installed capacity in renewables with new gas capacities contributing to EBITDA from 2027

- Lower EBITDA in infrastructure segment in 2024-2025, at about HUF160 billion, after tariff adjustments due to lower balancing costs accrued in 2023, followed by normalised EBITDA at about HUF210 billion annually in the following two years

- High EBITDA to continue in wholesale gas and electricity in 2024 at HUF230 billion, due to high hedged prices for 2024, and with normalised EBITDA at around HUF120 billion from 2025 onwards

- Capex averaging HUF635 billion per year in 2024-2028, based on Fitch's assumptions, with development capex focusing on decarbonisation (replacing coal-fired assets with gas-fired assets), as well as network infrastructure development

- Capex partly funded by domestic and EU grants averaging HUF70 billion per year in 2024-2028

- Investments averaging HUF205 billion per year in 2024-2028, based on Fitch assumptions

- No equity injections by the state over 2024-2028

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 caps 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

- FFO net leverage below 2.5x on a sustained basis, supported by a more stringent financial policy, together with a stronger business risk profile, for instance, due to increased share of regulated and quasi-regulated businesses in EBITDA, may be positive for MVM's SCP

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- FFO net leverage above 3.5x and FFO interest cover below 5x on a sustained basis would be negative for the SCP, but not necessarily for the IDR

- 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

Liquidity and Debt Structure

Solid Liquidity: At end-2023, MVM had unrestricted cash of HUF246 billion and undrawn committed facilities of about HUF850 billion, of which HUF586 billion will expire within 12 months. In March 2024 MVM issued USD750 million bonds (HUF272 billion equivalent). These will cover debt maturities of HUF324 billion and Fitch-projected negative free cash flow (FCF), after acquisitions, divestitures and capex, of about HUF270 billion in 2024.

MVM maintains a solid liquidity position during the year, managing seasonal swings in working capital, especially the drain on liquidity at year-end.

Net Debt Increase: MVM's net debt rose to about HUF1.4 trillion at end-2023 from HUF1.0 trillion at end-2022, following high regular and advance dividend payments of HUF417 billion and negative working-capital changes of HUF486 billion with fairly stable capex of about HUF340 billion.

Issuer Profile

MVM is Hungary's largest electricity and gas utility. Its domestic operations span electricity generation (56% 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 32%, respectively). It is also the main supplier of wholesale and retail electricity and gas in Hungary.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

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

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.03 Nov 2023) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.13 Oct 2023) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.12 Jan 2024)

Parent and Subsidiary Linkage Rating Criteria (pub.16 Jun 2023)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.03 Nov 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

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