04 MAR 2024

Fitch Rates MVM's Planned Bonds 'BBB'

Fitch Ratings - Warsaw - 04 Mar 2024: Fitch Ratings has assigned MVM Zrt.'s (BBB/Negative) US dollar-denominated bonds a senior unsecured rating of 'BBB'.

The bonds' rating is at the same level as MVM's Long-Term Foreign-Currency Issuer Default Rating (IDR), as the bonds will constitute senior, unsubordinated, unconditional and unsecured obligations of MVM.

MVM intends to use the net proceeds from the bonds for general corporate purposes. The bond documentation includes a negative pledge, a change-of-control put option, redemption at the issuer's option for tax reasons and cross-default to any indebtedness of the issuer or any of its material subsidiaries with a EUR70 million threshold.

MVM's Long-Term IDRs are at the same level as its Standalone Credit Profile (SCP) of 'bbb'. The Negative Outlook currently reflects that on Hungary's sovereign ratings (BBB/Negative). Hungary's rating caps MVM's ratings, driven by strong linkage between MVM and the state as per our Parent and Subsidiary Linkage (PSL) Rating Criteria.

Key Rating Drivers

2023 Results Better Than Expected: According to MVM's unaudited preliminary estimates, its reported EBITDA almost doubled in 2023, reaching over HUF900 billion, mainly driven by higher margins in the Czech and Hungarian competitive markets, as well as the lower transmission and distribution system operator costs. Tariffs were set at a higher level, which will be balanced by the tariff methodology in the next periods.

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. According to MVM's preliminary data, debt rose to about HUF1.7 trillion at end-2023 from HUF1.5 trillion at end-2022, following high regular and advance dividend payments of about HUF400 billion and negative working capital changes with relatively stable capex.

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. 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.

Retail Compensation: Fitch expects compensation from the utility protection fund to support MVM's profitability in the retail segment in 2024, as it did in 2023. 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.

Balancing Costs in Infrastructure Segment: The results of MVM's infrastructure segment in the last two years have been affected by volatile balancing costs. Sharply increased balancing costs in 2022, which were covered at a considerably lower level by its tariff for the same year, resulted in weaker segment results in 2022. The situation reversed in 2023 when the regulator reflected the extra balancing costs for 2022 in the 2023 tariff determination.

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.

Strong PSL Linkage: We view the PSL 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 was downgraded. This is reflected in the 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.

Leading Market Position: MVM's business profile benefits from its strong market position in Hungary, spanning 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.

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 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 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 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 renewables.

- 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 the 2022 tariff)

- High EBITDA in wholesale gas and electricity in 2023 due to higher electricity, 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

- 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 caps MVM's ratings

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

Factors that could, individually or collectively, lead to negative rating action/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

Liquidity and Debt Structure

Solid Liquidity: MVM has a solid liquidity position. At end-2023, it had unrestricted cash of HUF226 billion and undrawn committed facilities of HUF851 billion. This liquidity is sufficient to cover debt maturities of HUF329 billion in 2024.

Issuer Profile

MVM is Hungary's largest electricity and gas utility.

Date of Relevant Committee

14 June 2023

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's ratings are credit-linked to Hungary's ratings.

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.

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 Marszalkowska 107, 00-110 Warsaw

Arkadiusz Wicik, CFA
Senior Director
Secondary Rating Analyst
+48 22 103 3016

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.					
• senior unsecured	LT	BBB	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria - Effective from 28 October 2022 to 3 November 2023 (pub.28 Oct 2022) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria - Effective from 9 April 2021 to 13 October 2023 (pub.09 Apr 2021) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria - Effective from 30 September 2020 to 12 January 2024 (pub.30 Sep 2020)

Parent and Subsidiary Linkage Rating Criteria - Effective from 1 December 2021 to 16 June

2023 (pub.01 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria - Effective from 12 May 2023 to 3 November 2023 (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

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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