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Research Update:

Hungarian Integrated Utility MVM Group Affirmed At 'BBB-' As Financial Performance Exceeds Expectations; Outlook Stable

May 4, 2023

Rating Action Overview

- MVM Energy Private LLC (MVM), the largest integrated utility in Hungary, posted strong results in 2022. Despite volatile energy markets, funds from operations (FFO) to debt reached 32%.
- We now expect FFO to debt to remain above 30% for the next two to three years, which is commensurate with the current rating. The Hungarian government has already agreed to extend the support it provided through the utility protection fund (UPF) until the end of 2024, but the scheme could be prolonged further.
- Although we anticipate that MVM's operating performance will remain stable, and its financial policy prudent, credit metrics are likely to remain volatile because the group's net debt is affected by seasonal swings. Debt peaks between October and December, when MVM's need for storage against the upcoming winter is highest.
- We therefore affirmed our 'BBB-' long-term ratings on MVM and its senior unsecured debt.
- The stable outlook indicates that we expect MVM to show gradual growth from 2024 on and that its credit metrics will remain commensurate with its 'bbb-' stand-alone credit profile (SACP).

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Rating Action Rationale

Despite turbulent energy markets, MVM posted strong results in 2022. The group realized stronger margins in its commercial segments because of the significant rise in commodity prices, causing overall EBITDA to rise by more than Hungarian forint (HUF) 229 billion (93%) to around HUF475 billion. Over the same period, the regulated segment underperformed because of the high balancing costs MVM incurred as a transmission system operator (TSO). S&P Global Ratings understands that the regulator has already taken action to mitigate this effect by adjusting tariffs for 2023-2026, instead of waiting for reimbursement until 2024 based on the t+2 recovery mechanism. This will result in more stable EBITDA going forward. In our view, this has positive

implications for our assessment of the regulatory framework and also suggests that the weaker performance will be only temporary.

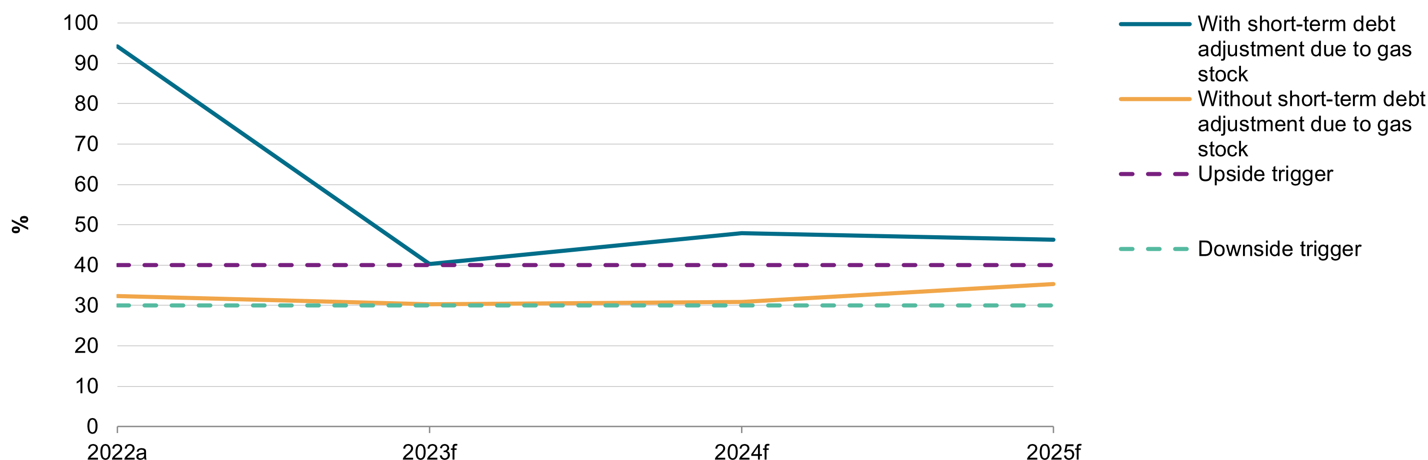
Net reported debt increased significantly, to about HUF1,185 billion at year-end 2022, as the volume of gas stock peaked. Given that gas consumption is seasonal, we expect debt levels to moderate as the year progresses before increasing again toward the end of 2023. The company is also investing in generation and networks, so that total investment spiked to HUF504 billion in 2022 from HUF238 billion in 2021, including carbon dioxide quotas.

Because of MVM's strong results, its FFO to debt stood at 32.4% in 2022, well above the 20%-25% we previously expected. Even though this does not give MVM a lot of headroom at the 'BBB-' rating level (and the 'bbb-' SACP), we do not expect downward pressure because MVM's credit metrics are at their tightest on Dec. 31. Net debt peaks at this time because MVM is obliged to fill its gas storage to a level set by the regulator (Hungarian Energy and Public Utility Regulatory Authority; MEKH). This is intended to secure the gas supply for universal service clients, most of which are residential users. The regulator sets the minimum gas storage level based on peak consumption over the past 10 years by universal service clients. The current minimum requirement, of 1.9 bcm, will also apply to the 2023-2024 winter season.

aHungary's gas storage capacity is one of the largest in the region. The total capacity is 6.33 billion cubic meters (bcm), of which MVM operates 70%. The group therefore plays a crucial role in maintaining the country's security of supply. At year-end 2022, net debt stood at HUF1,180 billion, of which HUF778 related to refilling gas inventories. FFO to debt would increase to 94% from 32.4% if we excluded the debt related to gas stocking. The need to maintain inventories ahead of the winter increases MVM's exposure to seasonality in its working capital needs, compared with some of its Central and Eastern Europe (CEE) peers. We understand that most of the gas stock is required to support the universal service provider (USP) segment, which is regulated by the government. In addition, the majority of the stock is likely to be sold before April, resulting in significantly lower net debt.

If the USP segment does not require the full stock volume, for example, due to mild weather, we understand that MVM CEEnergy Zrt., MVM's trading arm, is allowed to sell the excess on the market. The difference between the sales price and the stock value is also taken into consideration when setting regulated prices. Because both the regulation and the UPF ensure that MVM will realize the value of the gas stock stored to supply USP customers, we consider that the seasonal increase in debt carries limited risk for MVM.

Chart 1



FFO--Funds from operations. a--Actual. f--Forecast.

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The Hungarian government created the Utility Protection Fund (UPF) in September 2022 to compensate utilities in Hungary for any losses incurred as a result of their USP activities. The USP regulations protect entitled customers, most of which are residential customers, by obliging providers to supply utilities at a regulated price that is well below the current market price. MVM is the only universal service provider that supplies both gas and electricity. The mismatch between buying gas and electricity at spot market prices and selling it at a regulated tariff will cause MVM to incur losses--these are then covered by UPF on a monthly basis. The fund mirrors the pre-approved tool presented by the European Commission to support utilities while energy prices were at historical highs. Hence, there is no state-aid issue. The government compensated MVM for its losses from January 2022 and recently approved the extension of the scheme for an additional year, until the end of 2024, which we view as supportive. We understand that the government limited the extension to one year to comply with competition law and allow third parties to enter the Hungarian market as universal service providers, which would make them eligible for compensation from the UPF. That said, it could continue to extend the compensation scheme indefinitely.

We view as positive the Hungarian government's commitment to supporting MVM, for example, by allowing it to limit dividend distributions and providing a liquidity line. It could also inject additional capital, if needed. In 2022, the Hungarian government supported MVM through a capital increase. This took the form of:

- A HUF12 billion contribution in kind; and
- A HUF41 billion capital increase to support further capital expenditure (capex).

MVM is essential to the government's energy security and decarbonization agenda. As described above, the government has proven itself committed and willing to support MVM by making good the losses it incurred as a result of selling gas and electricity to households at lower tariffs. In 2022, the government also supported MVM by offering it a HUF460 billion revolving credit facility (RCF) to increase its liquidity reserves.

On the whole, the dividend pay-out is unlikely to change substantially. The Hungarian state, through the Ministry of Energy, as MVM's sole shareholder, has implemented a supportive financial policy that allows MVM to direct most of its cash flows toward funding its growth plan. Dividends are forecast to remain at HUF7 billion-HUF9 billion per year, except for in 2023. We expect MVM to pay a higher dividend of HUF108 billion in 2023 because of its strong performance in its wholesale segment.

We assess MVM as having a high likelihood of potential extraordinary government support, underpinned by:

- The group's strong link with the Hungarian state, which owns 100% of MVM and participates in strategic company decisions. The state supports the country's nuclear industry by bearing the full cost of asset retirement obligations and new builds. We expect the state to remain MVM's major shareholder; and
- MVM's very important role for the government. MVM is the No. 1 generator, No. 1 supplier, a key wholesaler and retailer for the electricity and gas universal service, and sole power TSO and dominant gas and power distribution system operator (DSO) in Hungary. MVM's operations are strongly aligned with the government's interests; particularly in ensuring Hungary's self-sufficiency in electricity. We expect the group's dividend policy to continue to allow it to accumulate and reinvest earnings. This affected our estimated metrics for 2022 and 2023, because MVM plans to finance capex largely from its own accumulated cash and to maintain stable dividends, with a conservative increase in 2023.

MVM's exposure to Russian gas imports is material but mitigated by its access to other sources of natural gas. About 85% of Hungary's gas supply comes directly or indirectly from Russia and MVM is Hungary's main natural gas importer. It signed a 15-year take-or-pay contract with Gazprom Export in September 2021 to deliver gas through Serbia (using the Balkan Stream pipeline) and Austria; this accounts for 4.5 bcm per year of MVM's natural gas supply. In 2022, MVM's volumes through Austria dropped by 29%, compensated for via an increase in volumes through Serbia. No reductions or interruptions have yet been observed in 2023. Nevertheless, Hungary has been working with MVM on a diversification plan that broadens MVM's ability to make gas purchases that are not dependent on Russian gas. It has:

- Secured long-term capacity bookings at the liquefied natural gas (LNG) terminal on the island of Krk until 2027 at 1 bcm a year;
- Started natural gas production in the southeast of Hungary through a 50/50 joint venture with Aspect Holdings; and
- Begun work on increasing LNG imports via Poland and Slovakia through the newly created Slovak-Polish Interconnector.

Half of MVM's capacity comes from the Paks nuclear power plant (NPP), which sources its nuclear fuel from Russia. We understand that there has been no interruption in the delivery of nuclear fuel. The fuel is supplied by TVEL (a subsidiary of Russian-based Rosatom) and MVM

agreed to receive additional stocks, partly delivered in 2022 and partly due for delivery in 2023. As a result, the fuel supply necessary for the full utilization of the Paks plant's capacity is secured at least until mid-2026. Moreover, due to regulatory requirements, the Paks NPP keeps two years' worth of nuclear safety stock onsite. This alleviates the risk of it running out of fuel. We understand that MVM is working on finding an alternative supplier for nuclear fuel.

An ambitious step up in investments during 2024-2027, to HUF780 billion-HUF820 billion, could result in negative cash flows. Although we view as positive the company's actions to expand its infrastructure and renewable generation, its plan to invest heavily and its increasing financial leverage constitute a credit weakness because it could lead to negative cash flow and increase debt. We expect MVM's capex to increase to HUF750 billion-HUF800 billion from 2024 and to stay elevated. As a result, we predict that free operating cash flow (FOCF) will be slightly negative to neutral on average over 2023-2026. It expects to use its own cash flow, European and government grants, and additional debt to fund growth. The existing business mix has a healthy positive operating cash flow.

Generation is transitioning toward a lower carbon dioxide-emitting fleet. This will be boosted by the decommissioning of the Matra 950 MW plant (884 MW coal and 66 MW gas), which is expected to occur in 2025. It could be slightly delayed as MVM aims to maintain the security of supply. The plant will be replaced by:

- 695 MW of highly efficient combined-cycle gas turbines (Matra and RDF);
- Two combined-cycle gas turbines with a capacity of 500 MW each at Tisza; and
- 200 MW of solar plants, partly funded by European and Hungarian government grants.

MVM is investing in infrastructure, digitalization, and renewables that should support the country's energy transition and its economy's electrification, as outlined in the Hungarian government's energy plan. The company's solar capacity plans are in line with Hungary's target of 6.5 GW capacity by 2030, from 2 GW in 2020.

Outlook

The stable outlook indicates that we expect MVM to achieve gradual growth and protect its credit metrics in line with our assessment of its 'bbb-' SACP. We expect FFO to debt to remain above 30% and debt to EBITDA below 3x for the next two-to-three years, and that it could receive ongoing and extraordinary government support. We believe that risks from volatile power and commodities prices will remain mitigated by the company's integrated position and strategy of hedging most of its open positions, and by relatively stable earnings from its regulated network.

Downside scenario

We could lower the rating because of diminishing state support (which is not our base case) combined with weakening stand-alone performance. For example, heavy capex could weaken FFO to debt below 30%.

Assuming no change in our expectation of a high likelihood of state support, we could downgrade MVM if its financial performance deteriorated enough to lead us to revise our assessment of its SACP to 'bb-' (from 'bbb-'), although we view this as remote. Similarly, a sovereign downgrade could trigger a downgrade of MVM, but we note that the outlook on our sovereign credit rating is

stable.

We could revise down our view of MVM's SACP to 'bb+' from 'bbb-' if the company were to post FFO to debt sustainably below 30% without any prospects for recovery; for example, because of poor availability in its generation fleet or a large loss of market share in its supply business, and if the company demonstrates poor capex execution under its strategic growth plan.

Upside scenario

We could upgrade MVM if its SACP improved such that FFO to debt rose above 40%. However, we consider this unlikely in the short term, largely because of the company's substantial capex plan.

Company Description

MVM is a 100% state-owned, vertically integrated energy company based in Hungary, and a leading natural gas trader in Czech Republic. Founded in 1948, it operates in power generation, transmission, distribution, wholesale, and retail, as well as gas storage, distribution, wholesale, and retail. In 2018 and 2019, MVM took control of NKM, Hungarian biggest gas retail company. The transaction was financed through a HUF13.4 billion capital increase provided by the government and made MVM the largest operating energy holding in Hungary. It has a presence in 18 countries. In 2022, the company reported EBITDA of about HUF453 billion, equivalent to about €1.167 billion.

The company has activities across the entire electricity value chain: it is the main power generator in Hungary, with installed capacity of 3.95 gigawatts (GW) at year-end 2022; and operates the Paks nuclear plant of 2.0 GW, the Matra coal plant, gas plants, and renewable energy sources. It also owns the only power TSO in Hungary, two of the six Hungarian power DSOs (representing 23% of the power DSO market), and the electricity supplier for universal service clients (at a regulated fixed price).

MVM is also integrated within the gas value chain (except transmission) because it owns 50% of the gas distribution network, 65% of the gas storage market, gas retail (both universal and liberalized), and 100% of gas wholesale universal service activities.

Our Base-Case Scenario

Assumptions

- There is no strong link between GDP and the issuer's EBITDA due to the low volatility of its contracted/regulated activities (TSO, DSO, contracted generation, and contracted wholesale).
- Wholesale Hungarian base load power price of €180-€220 per megawatt hour (/MWh) between 2023-2025.
- Title transfer facility (TTF) natural gas prices are assumed to be €68.42/MWh in 2023 and €62.2/MWh in 2024 and 2025.
- Prices for power and gas to be volatile due to the uncertainty over supply caused by the Russia-Ukraine conflict. We expect demand for energy to remain stable over the next two years.
- Regulated EBITDA represents an average of 25% over 2023-2026, which is in line with the 25% average over 2019-2021. There is a regulatory mechanism to compensate MVM for any losses incurred in its TSO and DSO activities (i.e., network losses and balancing costs) after a two-year

lag. The high balancing costs in 2022 will automatically be reimbursed in the tariffs in 2024; however, the regulator decided to allocate these amounts to the years 2024-2026 in order to provide stable TSO revenue.

- The rest of EBITDA comes from generation, supply, and trade.
- Stable operating performance across all generation and infrastructure subsegments; although coal was expected to be phased-out by 2025, there could be a delay.
- The utility is the sole retail provider in Hungary's universal service tariff over the period, and market shares in competitive supply to be stable. Wholesale to be slightly volatile, depending on gas inventories and hedged positions compared with the changing commodity prices.
- The Hungarian government to compensate MVM for losses incurred in its supply segment through UPF as long as energy prices remain above regulated prices.
- Capex of HUF416 billion in 2023, increasing to HUF716.8 billion in 2024 and HUF721.1 billion in 2025.
- Dividend distribution of HUF107.5 billion in 2023 and HUF7.5 billion between 2024-2026.

Key metrics

MVM Group--Key Metrics(1)

	--Fiscal year ended Dec. 31--				
Bil. HUF	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
EBITDA	246.4	475.5	650-700	670-720	800-850
EBITDA margin (%)	8.60%	6.2%	9-11	7.0-9.0	8.0-10.0
Funds from operations (FFO)	168.7	383.6	440-470	420-460	425-475
Net Capital expenditure	238.2	504.2	450-500	750-800	750-800
Free operating cash flow (FOCF)	406.9	Negative	Negative	Positive	Positive
Dividends (cash)	0.2	7.5	105-110	7-8	7-8
Debt to EBITDA (x)	0	2.5	2.0-2.5	2.0-2.5	1.7-2.2
FFO to debt (%)	N.M. (2)	32.4	28-32	28-32	>30

(1)All figures adjusted by S&P Global Ratings. (2)Due to large cash balance from margins received as of Dec. 31, 2021, net debt is close to 0. a--Actual. e--Estimate. f--Forecast.

Liquidity

We now assess the company's liquidity as adequate. We expect the group's large cash position, annual cash flow generation, and committed credit facilities to cover expected cash outlays--primarily capex, working capital, and dividends--by more than 1.2x over the next 12 months. We believe that, as a 100% state-owned entity in Hungary, MVM has adequate access to bank financing and the markets.

We note that MVM's short-term debt is currently very high, which weighs on the liquidity assessment. That said, we understand that MVM aims to refinance this in the short term.

Principal liquidity sources for the 12 months from March 31, 2023 include:

- HUF279 million in cash and liquid investments;
- Committed but undrawn bank lines of HUF893 billion; and
- Working capital inflows of about HUF1,092 billion (including proceeds from UPF).

Principal liquidity uses for the same period include:

- Debt amortization of HUF615 billion;
- Cash FFO outflow of HUF767 billion;
- Estimated capex of HUF300 billion; and
- Dividends of approximately HUF82 billion.

Covenants

We understand that the company has financial covenants on some of its loan agreements. We assume that MVM will continue to adhere to these covenants and take any appropriate measures to ensure adequate headroom should operating cash flow reduce more than anticipated. MVM will maintain the group's net debt to EBITDA below 4.5x.

MVM's financial debt, whether term loans, syndicated RCF, or overdraft facilities, are under three covenants:

- EBITDA interest coverage over 3x;
- Net debt/net assets under 0.9x; and
- Net debt/EBITDA under 4.5x

Environmental, Social, And Governance

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

ESG factors have an overall neutral influence on our credit rating analysis of MVM, since we perceive the entity as better positioned on climate transition risks than peers in the energy industry, which faces increasingly stringent greenhouse gas regulations.

The group's generation fleet is transitioning toward low carbon dioxide and no coal, in line with the Hungarian energy plan. About 30% of MVM's EBITDA is derived from its power generation activities. It has total installed capacity of about 3.95 GW, mostly nuclear (2 GW), fossil fuel-fired (1.4 GW: natural gas and oil 729 MW; coal, biomass, and waste 884 MW), and solar (0.2 GW).

All four units at the Paks nuclear power plant have had a 20-year life extension, from 2012-2017 until 2032-2037, and there is potential for a further extension. Nuclear is a very well-placed source of energy in Hungary's energy market, at the lower end of the merit order. Since nuclear is seen as a long-term strategic fit within Hungary's energy mix, the government supports the industry--as much as it is compatible with the internal market under the EU rules--and contributes accordingly to the heavy asset-retirement obligations linked to nuclear plants. A separate state-owned legal entity--not owned by MVM or its subsidiaries--has undertaken construction of new reactors at Paks 2.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/--
Business risk:	Satisfactory
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb-
Related government rating	BBB-/Stable/--
Likelihood of government support	High (no impact)

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: 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 Unregulated Power And Gas Industry , March 28, 2014
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013

- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating , Oct. 1, 2010

Related Research

- S&P Global Ratings Cuts 2023 European, U.S., And Canadian Gas Price Assumptions On Lower Demand, Feb. 23, 2023
- Hungary Downgraded To 'BBB-/A-3' From 'BBB/A-2' On Inflation And External Pressures; Outlook Stable, Jan. 27, 2023
- EMEA Utilities Outlook 2023: Eastern Europe | Credit Resilience Despite Increasing Affordability Concerns, Jan. 12, 2023

Ratings List

Ratings Affirmed	
MVM Energy Private LLC	
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

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