30 MAY 2023

Fitch Rates MVM's Planned Bonds 'BBB'

Fitch Ratings - Warsaw - 30 May 2023: Fitch Ratings has assigned Hungary's largest electricity and gas utility MVM Zrt.'s (BBB/Negative) planned 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 to finance and/or refinance eligible green projects, in whole or in part, in accordance with its green financing framework. 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.

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 compared with 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 is also lower than previously expected, remaining below our negative rating sensitivity of 3.5x in 2023-2024.

Negative Outlook Driven by Sovereign: MVM's Negative Outlook currently reflects the same on Hungary's sovereign 'BBB' 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 assessed under 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.

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 HUF1,451 billion 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.

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 fund has compensated retroactively losses from January 2022. 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, which were covered at a considerably lower level by its 2022 tariff. 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 a 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 MVM given the latter's strategic role in maintaining energy security.

Rated on Standalone Basis: MVM's Long-Term IDRs are at the company's Standalone Credit Profile (SCP) of 'bbb', but the Outlook is currently constrained by the Negative Outlook of the sovereign rating.

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.

We view the socio-political implications of MVM's default as 'Moderate', whereas the financial implications of a MVM default for the Hungarian government as 'Weak'. This assessment results in a support score of 15 points, indicating moderately strong links with the state.

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 (65%), 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. We assess BEH's links with the state as stronger than MVM's, but MVM's 'bbb' SCP is also much stronger than BEH's 'bb'.

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 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

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.

Issuer Profile

MVM is Hungary's largest electricity and gas utility.

Date of Relevant Committee

21 November 2022

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.

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

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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 (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 - Effective from 28 October 2022 to 12 May 2023 (pub.28 Oct 2022)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

MVM Zrt.	EU Issued, UK Endorsed

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