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Fitch Revises MVM's Outlook to Stable on Sovereign Action; Affirms at 'BBB'

Fitch Ratings - Warsaw - 12 Dec 2024: Fitch Ratings has revised the Outlook on MVM Zrt.'s Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to Stable from Negative and affirmed the IDRs at 'BBB'. A full list of rating actions is below.

The rating actions follow the revision of the Outlook on Hungary's Long-Term Foreign-Currency and Local-Currency IDRs to Stable from Negative on 6 December 2024 (see 'Fitch Revises Hungary's Outlook to Stable; Affirms at 'BBB'' at www.fitchratings.com) and MVM's stable credit profile after the publication of its 2024 mid-year results.

MVM's rating reflects its integrated position across various segments of the Hungarian electricity and gas markets. It also reflects the solid share of regulated and quasi-regulated business in EBITDA. We expect funds from operations (FFO) net leverage to remain commensurate with the rating in 2024-2026, despite increasing from 2023, as the company's EBITDA and FFO generation normalise, while the company increases its capex.

Key Rating Drivers

EBITDA and FFO to Normalise: We project the company's EBITDA and FFO generation to normalise in 2024-2026 following record results in 2023. Reported EBITDA in 1H24 decreased to a still healthy HUF450 billion from HUF513 billion in 1H23. The reduction was due mostly to the lower result of the natural gas universal service activity and the lower sales margin for gas retail and the Hungarian wholesale electricity market.

Increasing Projected Leverage: Fitch expects FFO net leverage to increase to about 3.3x in 2025-2026 from 1.6x in 2023 as FFO normalises, while capex and investments rise, in line with MVM's strategy. This leaves the company with limited rating headroom under our negative sensitivity of 3.5x.

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.

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 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, mainly through the interconnector with Serbia.

Strong PSL Linkage: We view the linkage between the state and MVM as strong under our Parent and Subsidiary Linkage (PSL) Rating Criteria, with MVM's 'bbb' Standalone Credit Profile (SCP) at the same level as Hungary's IDR. MVM's rating would be constrained by the sovereign IDR if the latter was rated lower than MVM's SCP. 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 our 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 its 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, 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 default of MVM 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 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, due to 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 higher volatility in MVM's leverage than peers. MVM's net debt and leverage at year-end is also 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:

- EBITDA and FFO generation to normalise in 2024-2026 following record results in 2023

- Capex averaging close HUF600 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 HUF60 billion per year in 2024-2028

- Acquisitions averaging HUF113 billion per year in 2024-2028, based on Fitch assumptions

RATING SENSITIVITIES

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

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

- 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. However, the IDR will be capped by the sovereign rating, due to strong linkage between MVM and the state assessed under the PSL Rating Criteria, unless Hungary's rating was upgraded.

Liquidity and Debt Structure

At end-June 2024, MVM had unrestricted cash of HUF384 billion and undrawn committed facilities of about HUF865 billion. In March 2024, MVM issued USD750 million bonds (HUF272 billion equivalent). Short-term debt at end-June 2024 was HUF124 billion. We project positive free cash flow (FCF) of about HUF265 billion in 2024 and negative FCF of about HUF270 billion in 2025.

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

Issuer Profile

MVM is Hungary's largest electricity and gas utility. Its domestic operations span electricity generation, gas imports, gas storage, electricity transmission, and electricity and gas distribution. 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.

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.06 Dec 2024) (including rating assumption sensitivity)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub.02 Aug 2024) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.09 Jul 2024)

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

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.06 Dec 2024)

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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