5 September 2022

Corporates

OPUS TIGÁZ Gázhálózati Zrt. Hungary, Utilities

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	7.9x	9.4x	10.7x	11.9x
Scope-adjusted debt/EBITDA	2.7x	2.9x	3.2x	3.0x
Scope-adjusted funds from operations/debt	29%	24%	24%	26%
Scope-adjusted free operating cash flow/debt	18%	8%	2%	5%

This publication does not constitute a rating action. For the most recent rating action on the issuer taken on 3 Aug 2022 please click **here**.

Rating rationale

The company's issuer rating is mainly supported by the issuers financial risk profile (assessed BBB+), reflecting OPUS TIGÁZ solid and recurring cash flow performance (resting on regulated income), which Scope expects to support full capex coverage with further potential to reduce leverage, and with leverage already trending towards the lower end of the range commensurate for the rating. The company's business risk profile (assessed BBB+) limits the upside potential slightly, mainly due to the limited geographical outreach, Hungary's high dependence on gas supplies from currently sanctioned Russia and the high revenue concentration of >90% with the state-owned gas supplier MVM, linking our counterparty risk assessment directly to the sovereign credit rating of Hungary (rated BBB+/negative by Scope).

Outlook and rating-change drivers

The stable outlook reflects Scope's expectation that OPUS TIGÁZ is able to maintain high and regulated free operating and discretionary cash flow levels over the medium-term, covering the budgeted capex levels to large extents. The outlook also incorporates our expectation that the shareholders will follow a credit-risk adjusted financial policy, notably in terms of dividend payments, shareholder loan repayments and discretionary spending, helping to keep Scope-adjusted debt/Scope-adjusted EBITDA below 4.0x over the long-term.

A negative rating action could result from a deterioration of SaD/EBITDA to >4.0x on a sustained basis notably with a view to the concentration of activities with state-owned gas supplier MVM. A negative rating action may also be warranted if the shareholders demonstrated less willingness to follow a credit-risk adjusted financial policy, or in the event of regulatory changes with an adverse impact on the expected operating cash flows (e.g. WACC / RAB regulation).

A positive rating action could be warranted in the case of significant growth in OPUS TIGAZ' size and improved diversification profile, contributing to less concentration risks, or should we see further improvements in credit metrics such as Scope-adjusted leverage of substantially less than 3.0x on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
3 Aug 2022	Upgrade (due to changes in methodologies)	BBB+/Stable
2 May 2022	Placement under review (changes in methodologies)	BB+
7 Sep 2021	Affirmation	BB+/Stable

Ratings & Outlook

Issuer	[BBB+/Stable]
Short-term debt	[S-2]
Senior unsecured debt	[BBB+]

Analyst

Matthias Peetz
+49 40 607781-212
m.peetz@scopehamburg.com

Related Methodologies

Corporate Rating Methodology; July 2022

European Utilities Rating Methodology; March 2022

Scope Hamburg GmbH

Ferdinandstraße 29 - 33
20095 Hamburg

Phone +49 40 607781 200

info@scopehamburg.com
https://scopehamburg.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Regulated gas distribution tariffs based on reliable and transparent sector regulation ensure highly predictable cash flows from operations • Largest natural gas distribution system operator (DSO) in Hungary with perpetual, territory-based gas distribution licence granted by the public utility regulator (MEKH) • Strong credit metrics based on recurringly high positive free operating and discretionary cash flow levels • High financial flexibility and exceptionally strong near-term liquidity position based on high accumulated cash balance, smooth long-term debt maturity profile and a broad external funding base with preferred and sustained access to new funding/ unutilized credit facilities • Strong operational benchmark scores among Hungarian gas distributors (6 other licensed gas distributors)	• Regulatory authority expected to narrow-down profit margins (WACC regulation) via tariff adjustments or revaluations of the regulated asset base looking forward • No geographical diversification and high revenue concentration of >90% with state-owned gas supply company; counterparty risk assessment directly linked to sovereign rating of Hungary • Concentration on single energy carrier (natural gas) which is indirectly affected by additional supply dependencies (imported from Russia)

Positive rating-change drivers	Negative rating-change drivers
• Improvement of credit metrics (e.g. SaD/EBITDA substantially < 3.0x on a sustained basis) • Significant corporate growth and improved diversification profile, contributing to less concentration risks	• Deterioration of credit metrics (e.g. SaD/EBITDA to >4.0x on a sustained basis) • Changes to financial policy or sector regulation with an adverse impact on discretionary cash flow

Corporate profile

OPUS TIGÁZ Gázhálózati Zrt. ("OPUS TIGÁZ") is the largest natural gas distribution system operator (DSO) in Hungary. OPUS TIGÁZ distributes over 2 billion cubic metres of natural gas annually (c. 32% of total domestic consumption) to 1.2 million customers (c. 36% of all connected households in Hungary). The 33,800 km-long pipeline network is owned outright by OPUS TIGÁZ and represents c. 42% of the national grid. The business operations are concentrated in the North-Eastern regions of Hungary serving customers in 1,092 municipalities, with two larger regional centres located in Gödöllő and Debrecen, and 15 operational centres plus 7 smaller technical basis spread across the distribution area. Almost the entire revenue stream of OPUS TIGÁZ (>99%) is generated from government-licensed activities based on regulated gas distribution tariffs. In 2021 the company employed a workforce of 979 (2020: 1,018) and generated net sales totalling HUF 39,375m (2020: HUF 35,272m).

OPUS TIGÁZ is jointly owned by the listed investment holding company OPUS GLOBAL Nyrt. and the private equity fund Status Energy Kft. (both Hungary). Status Energy PE Fund was launched and is managed by Opus Global Investment Fund Manager Zrt. (subsidiary of OPUS GLOBAL Nyrt). Direct holdings in OPUS TIGÁZ of less than one percent (minority stakes) remain attributable to private individuals and municipalities. OPUS TIGÁZ is part of OPUS GLOBAL consolidated accounts with Balázs Torda (Head of Energy Division) serving as CEO for OPUS TIGÁZ.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.9x	7.9x	9.4x	10.7x	11.9x	12.8x
SaD/Scope-adjusted EBITDA	3.9x	2.7x	2.9x	3.2x	3.0x	2.8x
Funds from operations/SaD	17%	29%	24%	24%	26%	28%
Free operating cash flow/SaD	8%	18%	8%	2%	5%	8%
Scope-adjusted EBITDA in HUF m						
EBITDA	13,825	17,343	17,429	16,346	16,753	17,168
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**13,825**	**17,343**	**17,429**	**16,346**	**16,753**	**17,168**
Funds from operations in HUF m						
Scope-adjusted EBITDA	13,825	17,343	17,429	16,346	16,753	17,168
less: (net) cash interest paid	-3,505	-2,192	-1,845	-1,610	-1,498	-1,426
less: cash tax paid per cash flow statement	-1,154	-2,012	-3,482	-2,085	-2,187	-2,277
Funds from operations	**9,166**	**13,139**	**12,102**	**12,652**	**13,068**	**13,465**
Free operating cash flow in HUF m						
Funds from operations	10,840	14,886	10,012	11,042	11,570	12,039
Change in working capital	-148	689	1,860	-558	-100	500
less: capital expenditure (net)	-6,205	-7,267	-7,785	-9,500	-9,000	-8,500
Free operating cash flow	**4,487**	**8,308**	**4,087**	**984**	**2,470**	**4,039**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-3,505	-2,192	-1,845	-1,610	-1,498	-1,426
Other items	0	0	0	0	0	0
Net cash interest paid	**-3,505**	**-2,192**	**-1,845**	**-1,610**	**-1,498**	**-1,426**
Scope-adjusted debt in HUF m						
Reported gross financial debt	57,345	56,806	57,456	55,956	54,456	52,956
less: cash and cash equivalents	-2,864	-10,751	-12,691	-10,674	-10,144	-11,184
add: debt-like liability (off-balance loan guarantee)	0	0	6,500	6,500	6,500	6,500
Other items	0	0	0	0	0	0
Scope-adjusted debt	**54,481**	**46,056**	**51,266**	**51,782**	**50,812**	**48,272**

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

ESG analysis is credit neutral

We did not identify any ESG-related rating driver which would have a relevant impact on our overall assessment on credit risk (neither positively nor negatively).

OPUS TIGÁZ has no dedicated ESG strategy, with most requirements either stemming from or directly implemented in gas consumers own ESG requirements. All governance factors are seen as neutral for the credit rating. The company is led by an executive team who makes business decisions in compliance with the board of directors and an independent supervisory board. The corporate governance structure does further entail several long-established policies, principles and regulations whose compliance is monitored via internal and external audit. Major external audits are being carried out on a regular basis with respect to accounting (PwC), ISO 9001/14001/45001 compliance (MSZT), IT-Security (Hunguard), HSE incidents (mining authorities) and regulatory compliance (HEPURA) with no further complaints during the course of 2020/21. The integrated financial planning and controlling systems adequately support internal transparency and external communication in our view.

However, we see a need for a more pro-active approach by OPUS TIGÁZ to address new kinds of ESG-related risks ahead: i) decarbonisation objectives (gas quality and the need for compliance to standards for the carbon footprint of injected blends of alternative gaseous fuels such as biogas, hydrogen and power to gas technologies); ii) regulatory risk (changing requirements for existing gas distribution infrastructure regarding energy efficiency and new decarbonised gases could lead to higher capex) and iii) risk of grid losses (especially due to leakages and their associated impact on carbon emissions).

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB+

Industry risk profile: AA

Gas distribution system operators are typically subject of highly regulated, protected, government-licensed activities which are characterised by extraordinary high market entry barriers and remunerated by regulated distribution tariffs. Due to usually constant, non-cyclical, gas consumption rates (seasonal swings depending on winter temperatures) and the indispensable nature of natural gas (or alternative gaseous fuels) for the European energy mix, the sector enjoys an overall low volatility in distributed volumes, strong visibility in revenues and sustainable operating cash flows. Overall, for regulated grid/network operators with comparatively low cyclicality, high entry barriers and low substitution risks, Scope assigns industry risks of AA.

Strong market position due to monopolistic market structures

OPUS TIGÁZ is the largest gas distributor in Hungary, operating more than 40% of the national gas distribution network while covering more than 30% of total domestic gas consumption. Currently six companies hold territory-based public gas distribution licences granted by the national energy regulatory authority. These entail the exclusive right and obligation to maintain and operate the gas distribution network in the assigned territory. The gas act prevents any other non-licensed companies from providing gas distribution services to the public. Potential acquisitions/mergers of gas distribution networks need to be approved or mandated by the regulatory body in order to keep the operator's distribution licence alive. Scope thinks, that due to the strict regulation and advanced sector consolidation since 2008, the entry of new market participants is unlikely which secures OPUS TIGÁZ' strong market position looking forward.

Economically modest service territory; very strong exposure to residential customers

Service operations are performed in an economically rather modest service territory in the north-eastern part of Hungary with a very strong exposure to residential customers (32% of all grid connected households in Hungary) and an overall noticeable trend of slightly declining demographics with shifts into the Budapest metropolitan area. Nevertheless, the services territory includes industrial areas surrounding the Debrecen regional centre with a certainly better economic outlook in our view.

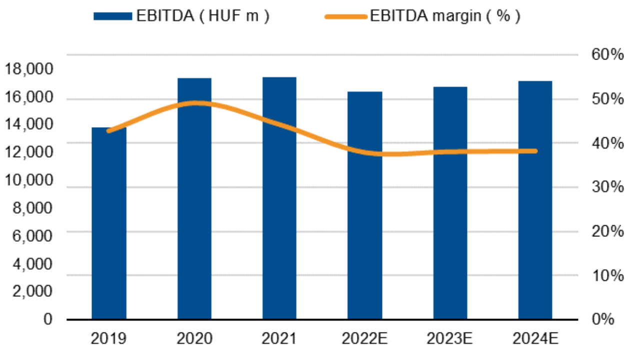
Diversification profile shaped by limited geographical outreach and high concentration risks

The company`s overall weak diversification profile constrains Scope`s business risk assessment with the main drivers being the limited geographical outreach on a European scale, Hungary's high dependence on gas supplies from currently sanctioned Russia and the high revenue concentration with the state-owned gas supplier MVM. Despite the concentration of activities on only one business segment (local gas distribution), Scope emphasis the regulatory nature of OPUS TIGÁZ' business model with no need to balance out other (potentially loss-making or cash-volatile) segments. Considerable concentration risks stem more from the fully state-owned gas supply company (MVM) in our view, where more than 90% of OPUS TIGÁZ' revenues are concentrated (other 10PP spread across c. 20 other gas suppliers). MVM bears the ultimate payment collection risk related to the actual end customers (outreach: c. 1.2 million customers) while gas distribution charges are being passed on. Scope's counterparty risk assessment for MVM is directly linked to the sovereign credit rating of Hungary (rated BBB+/negative by Scope).

High dependence on gas flows from Russia

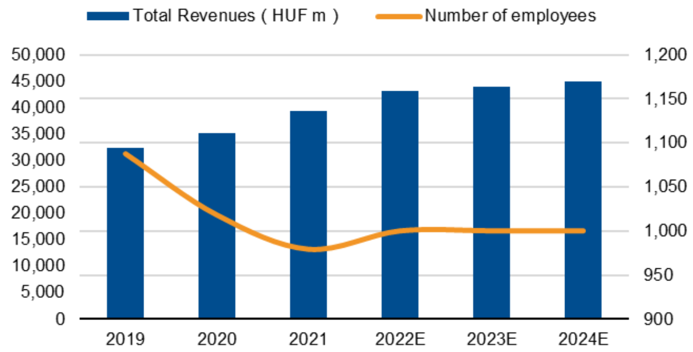
Furthermore, we note that Hungary sources more than 80% of natural gas supplies from Russia through long-termed (and recently extended) supply contracts between MVM and Russian supplier Gazprom, via several routes (mainly Turkstream) by-passing pipelines on Ukrainian territory. Geopolitical stress (Ukraine/Russia war) may trigger disruptions (e.g. Russian retaliation against EU sanctions) with a direct impact on distributed gas volumes and income for DSO's. Scope thinks, that the Hungarian government will be able to manage that risk, mainly due to somewhat closer ties with Russia and access to alternative pipeline routes (TurkStream, BalkanStream) bypassing conflicted Ukraine and major EU countries. However, potential implications of prolonged interruptions are likely to be material for the sector, but cannot be assessed reliably at present.

Figure 1: OPUS TIGÁZ EBITDA in HUF m



Sources: OPUS TIGÁZ, Scope (estimates)

Figure 2: OPUS TIGÁZ revenues in HUF m



Sources: OPUS TIGÁZ, Scope (estimates)

Strong operating profitability

OPUS TIGÁZ strong operating profitability drives our overall business risk assessment. Subject to largely constant, non-cyclical, gas consumption rates and regulated income levels, the companies track record benefits from a very stable profitability pattern at strong levels with EBITDA margins exceeding 40%. In Scopes view, OPUS TIGÁZ' operating profitability also benefits from rather low operating expenditures when benchmarked against the other regulated sector peers (e.g. cost per connection, leakages, maintenance costs per km etc.), mainly due to economy of scales and slightly lower FTE costs in Eastern Hungary. Furthermore, the company reports a low maintenance backlog for underground infrastructure with more than 90% of pipelines (>30tsd. km) aged less than 30 years (useful life c. 100 years). Nevertheless, we note that in the case of rising investment costs (e.g. 2021/22 meter replacements) the company is eligible to raise gas distribution tariffs accordingly as the tariff system allows for timely pass-through of increased costs (WACC regulation).

Exceptional improvements in operating profitability

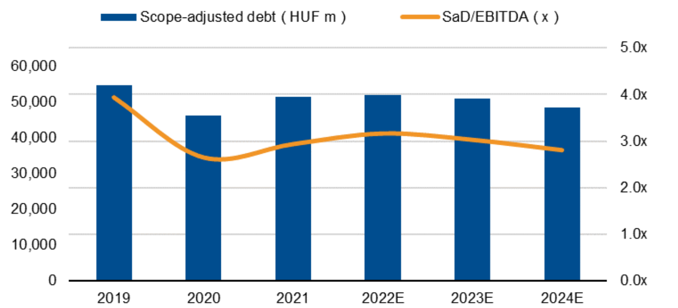
Following an ownership change in 2018 the new management initiated an operational excellence project with initiatives affecting the number of FTEs, network operations, material costs and CAPEX. By the end of 2020 all initiatives were accomplished and contributed to some exceptional improvements of the EBITDA margin (2020: 49.2%; 2021: 44.3%). Scope assess these quick wins with caution, as we think that sustained efficiency gains will be incorporated into the allowable tariff base while the regulator follows a statutory “lowest cost principle”. Nevertheless, on a long-term basis, we expect that OPUS TIGÁZ will maintain rather strong profitability levels with EBITDA margins not falling below 35%, resting on a solid operational track record and complying with future regulatory profit ranges.

Financial risk profile: BBB+

Low leverage at around 3x SaD/EBITDA

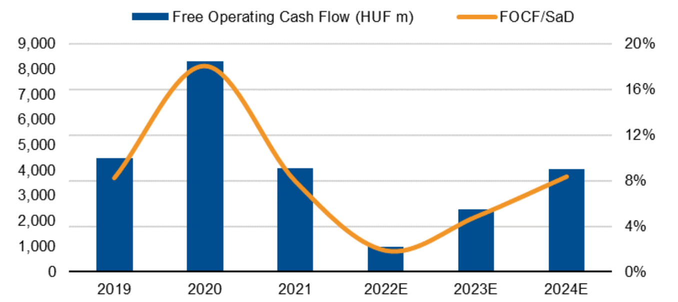
OPUS TIGÁZ very good financial risk profile reflects solid and recurring operating cash flow levels covering the company's capital expenditures in full with further potential to reduce leverage. However, leverage, as measured by Scope-adjusted debt/EBITDA, has improved significantly over the course of 2020/21 to low levels of around 3x. Besides slight reductions in gross financial debt, the current level is essentially a result of i) accumulated liquid sources (no dividend, capex postponements) which keeps the company's net debt measure low, and ii) the sharp improvement in operating results due to efficiency measures and exceptionally high gas distribution volumes (prolonged heating periods in 2020/21). Besides an anticipated steady reduction in interest-bearing debt, we believe that the shareholders will keep following a credit-risk adjusted financial policy, notably in terms of dividend payments, shareholder loan repayments and discretionary spending, helping to keep Scope-adjusted debt/Scope-adjusted EBITDA substantially below 4.0x over the long-term.

Figure 3: OPUS TIGÁZ Leverage in HUF m



Sources: OPUS TIGÁZ, Scope (estimates)

Figure 4: OPUS TIGÁZ FOCF in HUF m



Sources: OPUS TIGÁZ, Scope (estimates)

Interest coverage ratio to remain strong over the long-term

The company's strong EBITDA/interest cover ratio is likely to remain above 7.0x in our view mainly due to i) the comparatively high regulatory WACC rate among Hungarian utilities (period 2017/20 was 4.62% p.a., 2021/24 is 3.24% p.a.), which is expected to remain high as a result of national banks' rising base rate (monetary policy to fight inflation), ii) comparably low interest costs as a result of the 2021 long-term refinancing at very reasonable terms (HUF 50bn bond issue @ 2.80% p.a. fixed for ten years) and iii) an anticipated steady reduction in interest bearing liabilities via scheduled repayments.

Positive free operating cash flow across investment cycle

Compared to 2020 and 2021, Scope expects slight decreases in operating cash flow to levels of around HUF 10.5bn per year for 2022 (2020: HUF 15.6bn; 2021: HUF 11.9bn). Our expectation is mainly based on an assumed normalisation in gas distribution volumes (10 year avg.), tighter allowable profit margins for the regulatory period 2021-2024 and quickly rising operating costs (inflationary pressures). Nevertheless, we anticipate the company's high internal financing capacity to remain: The (regulated) asset base of OPUS TIGÁZ is mainly composed of non-current fixed assets representing the distribution pipeline system, related buildings and technical equipment such as gas meters or pressure control equipment. In terms of net CAPEX, a temporary increase to around HUF 10bn is planned in for 2022 before falling back again to regular levels of c. HUF 7-8bn annually by 2024. This is explained by the mounting demand for new connection claims which lifts the annual pipeline extension ratio temporarily. Also, the gas meter replacement process (due every 10 years) is expected to peak during 2022, since some of the above mentioned expenditures had to be postponed due to the COVID-19 pandemic. Overall, we expect annual net investments to remain fully covered by internally generated funds, leaving room for scheduled debt reductions and distributions to shareholders via positive free operating cash flow across the investment cycle.

Adequate liquidity

Scope assesses OPUS TIGÁZ' liquidity position as overall adequate as upcoming short-term debt maturities will remain comfortably and fully covered by available liquid funds without drawing on existing credit lines. Looking ahead, we expect a reduction of excess liquid sources as the company plans i) to pay out a dividend from 2022 (HUF 1.5m p.a.), ii) to further reduce financial liabilities (bond amortisation: HUF 1.5m p.a.; shareholder loan repayments on flexible terms) and iii) to temporally increase CAPEX during the period 2022 (see above).

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	12,691	10,674	10,144
Open committed credit lines (t-1)	3,330	3,330	3,330
Free operating cash flow	984	2,470	4,039
Short-term debt (t-1)	1,500	1,500	1,500
Coverage	**1,134%**	**1,098%**	**1,168%**

Supplementary rating drivers: +/- 0 notches

Financial policy: neutral

Scope thinks that OPUS TIGÁZ pursues an adequate financial policy with a positive alignment of shareholder interest and long-term business viability, covering the annual capex requirements in full from internally generated cash as a top priority. Furthermore, the company has a clear focus on a steady reduction in financial debt in accordance with the current debt repayment profile (corporate bond). Until 2021 the company applied a no-dividend policy as the company preferred to distribute free funds via the reduction of long-term shareholder loans on flexible terms. After reorganising the companies capital structure (HUF 50bn bond issue) and the 2021 ownership change, however, Scope will observe how financial policy might change. Overall we note, that the quick changes of the ownership structure during recent years, led to frequent appointments of new members to the board's and executive teams. During the transitionary period, we think that this situation can bear the risk of some disruption in the managerial style and moderate structural, strategic and operational challenges, as the newly appointed management aims for making OPUS Group's energy division a notable member of the domestic energy chain (collaboration with OPUS affiliate TITÁSZ; grid operator).

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB+

In 2021 OPUS TIGÁZ has issued senior unsecured bonds (HUF 50bn; ISIN: HU0000360292) under the Hungarian National Bank's Bond Funding for Growth Scheme. The bonds are structured as partially amortising balloon notes with a term of 10 years. Allocation and settlement took place on 24 Mar 2021. Since 18 Jun 2021 the bonds are registered with the Budapest Stock Exchange (BÉT Xbond). The net proceeds were used to fully replace all existing third-party financial liabilities and large parts of (subordinated) shareholder loans.

Reflecting Scope's view of OPUS TIGÁZ' ability to meet contractual and financial debt obligations as a going concern, on time, and in full out of its operating business, we rate senior unsecured debt issued by the company at BBB+, the same level as the issuer rating. Consequently, this translates into a BBB+ debt instrument rating for the HUF 50bn senior unsecured bonds, based on an assumed average recovery rate for investment grade issuers according to our Corporate Rating Methodology.

Short-term debt rating: S-2

The S-2 short-term debt rating reflects the company's liquidity profile and Scope's view on OPUS TIGÁZ' good access to external funding, if needed. Scope assesses OPUS TIGÁZ' short-term liquidity position as better than adequate as upcoming short-term debt maturities and capex are expected to be fully covered by internally generated operating cash flow. Besides, the company has built up a notable liquidity position over the course of 2020 and 2021 (30/06/2022: HUF 14.8 bn) as the shareholders agreed to suspend distributions as a response to the uncertainty around the pandemic situation, capex delays and the ownership change. We also acknowledge the existence of an additional working capital facility (EUR 9m; unutilised) provided by the shareholders, the maintenance of well-established banking relations and the successfully attraction of external funding by tapping capital markets (bond issue March 2021).

Scope Hamburg GmbH

Hamburg

Ferdinandstraße 29-33
20095 Hamburg

Phone +49 40 607781 200

info@scopehamburg.com
https://scopehamburg.com

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