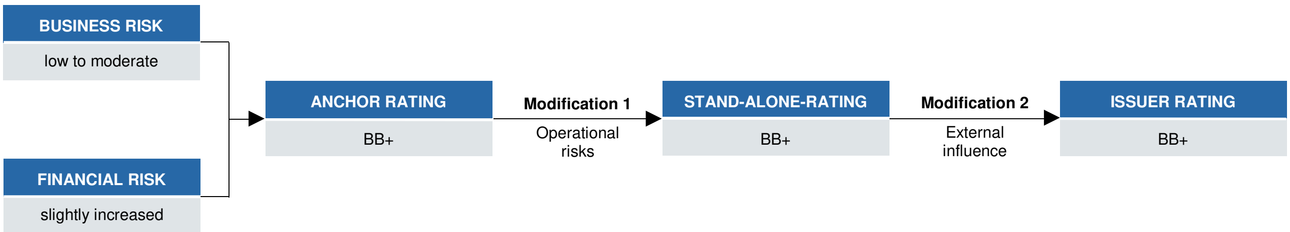
Issuer Rating (Short report)

TIGÁZ Földgázelosztó Zrt.		14 August 2019	BB+
		Issuer rating	
		Outlook	stable
Industry	Regulated Utility Companies	2018 Revenues	HUF 31,223m
		2018 Employees	1,174



BUSINESS RISK	low to moderate

- Perpetual, territory-based gas distribution licence
- Regulated gas distribution tariffs
- Reliable and transparent sector regulation
- Strong market position and sector benchmark scores
- Ongoing operational efficiency program

OPERATIONAL RISKS	+/- 0

- Operational risk profile consistent with the anchor rating; no modification required

FINANCIAL RISK	slightly increased

- Predictable and recurring cash flows
- Regulated, restricted earnings (WACC regulation)
- Consistently high financial debt levels
- Rather weak credit metrics
- Limited financial flexibility

EXTERNAL INFLUENCE	+/- 0

- Assessment of intra-group or public-sector relations causes no modification

Key financial ratios *	2016	2017	2018	FC 2019	2020e	2021e
EBITDA-Margin (%)	36.8	45.9	40.4	38.8	42.0	48.2
ROCE (%)	4.8	8.7	5.6	5.1	6.8	9.5
Equity ratio (%)	32.9	19.6	34.0	34.9	37.0	41.0
Leverage ratio (%)	62.5	75.5	58.8	58.2	55.5	50.9
Total liabilities / EBITDA	6.1	5.5	6.4	6.4	5.3	4.2
Net financial liabilities / EBITDA	5.0	4.1	4.7	4.8	3.9	3.0
EBIT interest coverage	4.9	26.4	3.2	1.8	2.8	4.1
EBITDA interest coverage	12.8	55.6	7.0	4.3	5.8	7.3

* adjusted on the basis of EHR's analytical methodology

Rating Rationale

Euler Hermes Rating assigns a BB+ issuer credit rating to TIGÁZ Földgázelosztó Zrt. The underlying factors are a combination of a low to moderate business risk profile and a slightly increased financial risk profile with no further modifications. We expect the rating to remain stable over the next twelve months.

Low to moderate business risks due to established market regulation and predictable operations

In our view TIGÁZ is subject to a low to moderate business risk profile. Due to its territory-based public gas distribution licence and mostly stable distribution volumes, TIGÁZ enjoys an overall strong visibility in revenues and sustainable operating cash flows. Our view is underpinned by well-established and reliable tariff-regulations within the Hungarian gas distribution sector, which mitigate volatility risks and allow TIGÁZ to recover all operating and capital costs incurred. Further supportive factors include the strong market position as the largest operator in Hungary, a well-maintained regulatory asset base, favourable sector-benchmark scores and low counterparty risks as >90% of sales are concentrated with the state-owned gas supplier NKM. Following an ownership-change in 2018, and a most recent buy-in of a second owner, the company faces moderate structural and operational challenges in our opinion, as the newly appointed management installed a complex and ongoing operational efficiency program accompanied by ambitious profitability expectations. Overall we think that TIGÁZ' risk-profile and corporate strategy are fairly aligned.

Slightly increased financial risks due to regulated earnings, high debt levels and limited financial flexibility

Regarding financial risks we think that TIGÁZ is subject to a slightly increased risk profile. Overall, we appreciate that TIGÁZ' business model allows for recurring, stable and positive earnings. Nevertheless, we expect the earning power of TIGÁZ' to remain at rather weak, industry-specific, levels over the long run. Our view is underpinned by the regulatory framework which incorporates efficiency gains and limits the rate of return on regulated assets (WACC). Factors constraining the stand-alone assessment are the consistently high debt levels. Together with the profit limitations, an exceptionally high interest burden and gradually rising investment needs we expect credit metrics on deleveraging or interest coverage to remain at rather weak levels. Despite this, we think that the highly predictable operating cash flows provide sufficient coverage for sustaining these high long-term debt levels. Furthermore, TIGÁZ is aiming to reduce the proportion of debt with the help of excess liquid sources. This may improve the credit metrics slightly over the long-term. Considering the high utilization of internally generated liquid funds and the still notable dependence on shareholder funding we assess TIGÁZ current financial flexibility as limited.

Assessment on operational risks and external influence requires no modification

In our opinion, TIGÁZ has adequate structures, processes and systems in place to control its operations and to handle its operational risks appropriately and in consistence with the anchor rating. A rating modification is not required. The further assessment of external factors which might have an impact on TIGÁZ' stand-alone rating, such as intra-group or public-sector relations, triggers also no modification according to our methodology.

Rating History

	14 August 2019
Issuer rating	BB+
Stand-alone rating	BB+
Outlook	stable

EULER HERMES Rating

Issuer

Largest gas distribution system operator (DSO) in Hungary

TIGÁZ Földgázelosztó Zrt. ("TIGÁZ Zrt." or "TIGÁZ") is the largest natural gas distribution system operator (DSO) in Hungary. 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 TIGÁZ and represents c. 42% of the national grid. TIGÁZ 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. With its almost 70-year history, TIGÁZ belongs to the most-established companies of Hungary's domestic energy sector. Almost the entire revenue stream of TIGÁZ (>99%) is generated from government-licensed activities based on regulated gas distribution tariffs. At the end of 2018, TIGÁZ employed a workforce of 1,174 and had generated revenues totalling HUF 31,223 million.

History of structural and regulatory changes

Since its privatisation in 1993 TIGÁZ went through several structural and regulatory changes mainly as an affiliate of the Italian based Eni group. Eni group indirectly acquired the majority of TIGÁZ in 1995 and increased its stake to c. 99% after the buyout of RWE's minority share (44.2%) in 2013. In 2007 TIGÁZ was required to separate its gas distribution activities from its gas retail activities in accordance with EU regulations, splitting it off into a 100% owned subsidiary (TIGÁZ-DSO Kft.). As a result of adverse market intervention the Hungarian gas retailers accumulated losses and TIGÁZ decided to discontinue its retail activities in 2016 and sold its retail portfolio to a state-owned gas supply company and its free-market portfolio to a subsidiary of RWE. Since 2017 TIGÁZ business is solely based on the government-licensed gas distribution activities, formally acknowledged in the merger of TIGÁZ-DSO Kft. back into TIGÁZ Zrt. as of 31 December 2018.

Jointly owned by Swiss-based energy company and Hungarian PE fund

Currently TIGÁZ is jointly owned by the Swiss-based energy company "MET Group" and "Opus Global Investment Fund" (Hungary), after MET acquired the c. 99% stake from Eni group in June 2018 and divested half of its holdings to Opus in July 2019. Minority stakes of less than one percent are attributable to private individuals and municipalities. The recent 50% divestment of MET only affects the company's ownership structure. TIGÁZ will remain within MET's consolidation with CEO Balázs Gábor Lehőcz (MET) continuing to serve as chief executive at TIGÁZ. Opus will appoint a deputy CEO (business development/strategy) and a new member to TIGÁZ's board of directors. The board is further comprised of former TIGÁZ executives and members of the asset management board at MET.

Appendix 1: Execution

Analysts

- Matthias Peetz, Senior Analyst / Project Lead
- István Braun, Senior Analyst

Rating committee

- Dörte Mählmann, Director
- Holger Ludewig, Director

Principal sources of information

- Reports on the consolidated financial statements for 2016, 2017 and 2018
- Financial Plan 2019-2021 and CAPEX budget 2019-2021
- Group Presentation and Business Plan
- Management interview
- Market research

Rating methodology

- Issuer rating of Euler Hermes Rating GmbH of 31 May 2016 (formally amended on 14 November 2017) (https://www.ehrg.de/en/about-us/our-methods/)

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Appendix 2: Rating categories

Category	Explanation
AAA	In the opinion of EHRG, AAA rated entities demonstrate an excellent credit quality and the lowest default risk.
AA	In the opinion of EHRG, AA rated entities demonstrate a very high credit quality with a very low default risk.
A	In the opinion of EHRG, A rated entities demonstrate a high credit quality with a low default risk.
BBB	In the opinion of EHRG, BBB rated entities demonstrate a medium credit quality with a moderate default risk.
BB	In the opinion of EHRG, BB rated entities demonstrate a medium-low credit quality with a slightly increased default risk.
B	In the opinion of EHRG, B rated entities demonstrate a low credit quality with an increased default risk.
CCC	In the opinion of EHRG, CCC rated entities demonstrate a very low credit quality with a high default risk.
CC	In the opinion of EHRG, CC rated entities demonstrate a very low credit quality, an event of default is very likely.
C	In the opinion of EHRG, C rated entities demonstrate a very low credit quality, an event of default is imminent.
D / SD	D rated entities have defaulted, as defined by the rating agency. The rated entity is assigned an SD rating (Selective Default) if it has only defaulted on certain debt obligations.
PLUS (+) **MINUS (–)**	Rating categories from AA to CCC are modified by a PLUS (+) or MINUS (-), where required, in order to show their relative position within the rating category.

Appendix 3: Definition of financial ratios

Earnings power

EBITDA margin

EBITDA margin
Numerator
EBITDA
Denominator
Total revenues

Returns

ROCE
Numerator
Adjusted operating result (= EBIT)
Denominator
Net debt + economic equity (= capital employed)

Return on total assets
Numerator
Adjusted operating and financial result + interest expense
Denominator
Adjusted total assets

Cash flow return on investment

Cash flow return on investment (Cash flow ROI)
Numerator
EBITDA
Denominator
Adjusted total assets

Capital structure

Indebtedness

Equity-to-total assets ratio
Numerator
Adjusted equity (= economic capital)
Denominator
Adjusted total assets

Leverage
Numerator
Net debt
Denominator
Net debt + economic equity (= capital employed)

Net debt

Net debt
Bonds
+ Liabilities to banks
+ Bill liabilities
+ Other interest-bearing liabilities
+ Operating lease liabilities
+ Adjustments for ABS/factoring transactions
- Cash and cash equivalents

Deleveraging potential

Total liabilities / EBITDA
Numerator
Total assets - economic capital (= total liabilities)
Denominator
EBITDA

Net debt / EBITDA
Numerator
Net debt
Denominator
EBITDA

Interest coverage

EBIT interest coverage
Numerator
Adjusted operating result (= EBIT)
Denominator
Interest expenses

EBITDA interest coverage
Numerator
EBITDA
Denominator
Interest expenses

Disclaimer

Magyar Nemzeti Bank (client) engaged Euler Hermes Rating GmbH to conduct a rating of TIGÁZ Földgázelosztó Zrt. (rated entity) on 18 June 2019. The rated entity was visited on 26 July 2019.

The Rating Committee of Euler Hermes Rating GmbH reviewed the rating process, issued the rating notation and approved the rating report in its current form on 14 August 2019. This rating report was given to the client on 22 August 2019, thereby concluding the rating process.

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Euler Hermes Rating GmbH

Hamburg, 22 August 2019