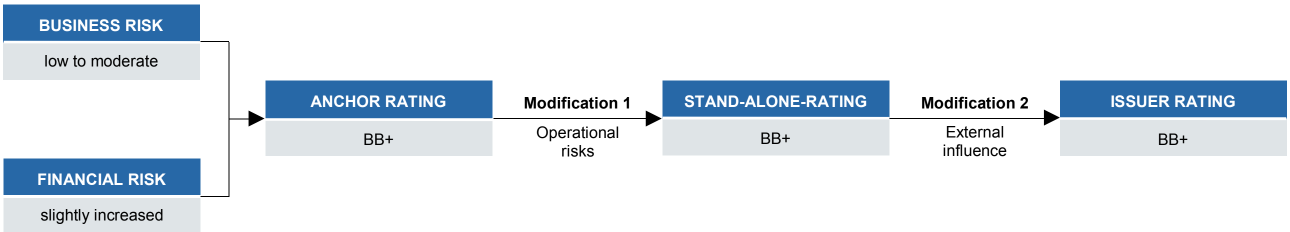
EULER HERMES Rating

Issuer Rating (Short report)

TIGÁZ Földgázelosztó Zrt.		07 September 2020	BB+
		Issuer rating	
		Outlook	stable
Industry	Regulated Utility Companies	2019 Revenues	HUF 32,459m
		2019 Employees	960



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
- Moderate credit metrics
- Moderate financial flexibility

EXTERNAL INFLUENCE	+/- 0

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

Key financial ratios *	2017	2018	2019	FC 2020	2021e	2022e
EBITDA-Margin (%)	45.9	40.4	47.2	50.5	53.8	52.0
ROCE (%)	8.7	5.6	8.2	10.5	10.5	11.4
Equity ratio (%)	19.6	34.0	35.0	36.8	41.3	46.4
Leverage ratio (%)	75.5	58.8	55.5	51.0	47.9	42.8
Total liabilities / EBITDA	5.5	6.4	5.3	4.6	4.0	3.7
Net financial liabilities / EBITDA	4.1	4.7	3.6	2.8	2.6	2.4
EBIT interest coverage	26.4	3.2	2.0	3.9	3.9	5.5
EBITDA interest coverage	55.6	7.0	3.8	6.8	6.9	8.6

* 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. The rating outlook is stable.

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 the buy-in of a second owner in 2019, 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 moderate 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 think that the earning power of TIGÁZ' will remain at rather constant, 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 rather expect a constant development of credit metrics on deleveraging or interest coverage. 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, adequate liquid funds and the still notable proportion to shareholder funding we assess TIGÁZ current financial flexibility as moderate.

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.

Upgrade / Downgrade Factors

Factors that could lead to an Upgrade

- Sustainable improvement of the operating cash flow as an effect of regulatory changes to the advantage of the allowable tariff base
- Sustainable improvement of the capital structure and the deleveraging potential (e.g. net debt/EBITDA < 3.0, EBIT interest coverage > 3.5 or leverage < 50%)
- Upgrade of Hungary’s sovereign credit rating

Factors that could lead to a Downgrade

- Substantial deterioration of the operating cash flow as an effect of adverse regulatory changes to the disadvantage of the allowable tariff base
- Substantial and lasting deterioration of the capital structure and deleveraging potential (e.g. net debt/EBITDA > 4.0, EBIT interest coverage < 2.0 or leverage > 60%)
- Downgrade of Hungary’s sovereign credit rating

Rating History

Company

Company

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 2019, TIGÁZ employed a workforce of 960 (2018: 1,174) and had generated revenues totalling HUF 32,459 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. TIGÁZ is part of MET's consolidated accounts with Balázs Gábor Lehőcz (Head of Asset Division) serving as CEO at TIGÁZ. Opus appoints the deputy CEO (business development/strategy) and a second member to TIGÁZ's board of directors. The board is further comprised of former TIGÁZ executives and members of MET's asset management board.

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Appendix 1: Execution

Analysts

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

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Rating committee

- Dörte Mählmann, Director
- Holger Ludewig, Director

Rating, Solicitation, Principal Sources of Information

- This credit rating has been issued in accordance with the CRA Regulation.

  [x] Solicited Rating
  [ ] Unsolicited Rating
    [ ] No participation of the rated entity or related third party
    [x] With participation of the rated entity or related third party
      [x] Access to internal documents
      [x] Access to management

- Prior to its publication the rating was disclosed to the rated entity. During this period, the rated entity had the opportunity to review the rating and to verify the underlying assumptions. Following this review, the rating was not amended.
- Principal sources of information:
  - Financial statements for 2017, 2018 and 2019
  - Interim reports (quarterly report Q1/2020, half year report 2020)
  - Financial budget 2020-2024 and CAPEX budget 2020-2024
  - Information on corporate strategy and corporate planning assumptions
  - Market research
  - Interviews with the management

Rating methodologies and definitions

- Methodology: Issuer Rating as of May 2016 (https://www.ehrg.de/seiten/Methodology_Issuer%20Rating_20171114.pdf)
- Basic principles for Assigning Credit Ratings and Other Services as of July 2020 (https://www.ehrg.de/seiten/Principles_200701.pdf)
- Guidance Regarding the Consideration of ESG Factors in Euler Hermes Rating Credit Ratings as of March 2020 (https://www.ehrg.de/seiten/ESG_2020.pdf)

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Appendix 2: Rating categories*

Category	Explanation
AAA	In the opinion of EHR, AAA rated entities demonstrate an excellent credit quality and the lowest default risk.
AA	In the opinion of EHR, AA rated entities demonstrate a very high credit quality with a very low default risk.
A	In the opinion of EHR, A rated entities demonstrate a high credit quality with a low default risk.
BBB	In the opinion of EHR, BBB rated entities demonstrate a medium credit quality with a moderate default risk.
BB	In the opinion of EHR, BB rated entities demonstrate a medium-low credit quality with a slightly increased default risk.
B	In the opinion of EHR, B rated entities demonstrate a low credit quality with an increased default risk.
CCC	In the opinion of EHR, CCC rated entities demonstrate a very low credit quality with a high default risk.
CC	In the opinion of EHR, CC rated entities demonstrate a very low credit quality, an event of default is very likely.
C	In the opinion of EHR, 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.

* For more explanations and definitions please refer to: Basic principles for Assigning Credit Ratings and Other Services (https://www.ehrg.de/seiten/Principles_200701.pdf)

Appendix 4: 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 review the rating of TIGÁZ Földgázelosztó Zrt. (rated entity) on 25 May 2020. The rated entity was visited on 26 August 2020.

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 07 September 2020. This rating report was given to the client on 11 September 2020, thereby concluding the rating process.

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The rated entity is solely and exclusively liable for any errors and omissions in the documents and information openly and willingly provided to us in response to our requests for information. The rated entity has reviewed the rating report and certified that all the information considered in the rating report is accurate and complete in all significant respects, no significant aspects have been concealed and any forward-looking statements are based on plausible, verifiable and current data and were prepared by the rated entity exercising reasonable and commercial care. The rated entity's representatives have issued a written certification of completeness to Euler Hermes Rating GmbH. However, the rated entity cannot be held liable if actual results differ from the forward-looking statements presented in this document, particularly the projections. Forward-looking statements and projections may be adversely affected by unforeseeable events and changes in the economic environment. Euler Hermes Rating GmbH assumes no liability for the accuracy of the information it considers when issuing a rating and extends no guarantee whatsoever that the information is explicitly or implicitly correct, timely, complete, suitable for the market or fit for any particular purpose.

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Euler Hermes Rating GmbH

Hamburg, 11 September 2020

