Rating Action: Moody's changes the outlook on OMV to negative; affirms its A3 ratings

16 Mar 2020

Frankfurt am Main, March 16, 2020 -- Moody's Investors Service, ("Moody's") has today changed the outlook to negative from stable on OMV AG ("OMV"). Concurrently Moody's has affirmed all the OMV's outstanding ratings.

The full list of the ratings is at the end of the press release.

RATINGS RATIONALE

Today's rating action has been driven by OMV announcing an acquisition of an additional 39% stake in its joint venture Borealis for around $4.7 billion. OMV already holds a 36% stake in Borealis, which it currently consolidates at equity. The increase of the stake to 75% would lead to OMV fully consolidating Borealis. While OMV has been solidly positioned in its rating category, this transaction, which Moody's assumes will be mostly debt funded, will initially exhaust the capacity OMV currently has under its A3 rating.

Moody's estimates that OMV's pro-forma RCF/net debt for 2019 (including purchase price and Borealis' net debt and debt-like liabilities, as well as Borealis' operating cash flows adjusted for dividend flows) would deteriorate to roughly low-thirties in % terms from around high-forties in % terms (Moody's estimate based on preliminary 2019 results). This would still largely be in line with the current A3 rating, even though at a lower end of the agency's expectation for it.

However, the current operating environment for oil and gas companies is challenging. Oil prices exhibited material contraction in the last couple of days and are currently trading well below Moody's medium term price range of $50 to $70 WTI per barrel. In addition to that, despite the fact that lower oil prices in the short term benefit downstream operations, as feedstock is cheaper, there is a risk that demand for many refined and chemical products will decline, which may ultimately put pressure on OMV's downstream earnings as well. If such a difficult environment continues for a prolonged period, there is a risk that OMV will not be able to deliver an improvement of its credit metrics 12-18 months after the acquisition, such as Moody's adjusted RCF/net debt at least to mid-thirties in % terms, which is the agency expectation for the current rating. This risk is reflected in the negative outlook.

The affirmation of the ratings reflects Moody's understanding that OMV plans to take measures to restore its capital structure towards its 30% gearing target (pre-IFRS 16) by the end of 2021. These steps would include (1) postponement of certain investments, such as the acquisition of Achimov project and final investment decision of the Neptune project; (2) disposals of various assets both in upstream and downstream operations worth up to EUR2 billion; and (3) strict investment discipline. An issuance of hybrids, which Moody's may not fully consider as equity, might also be considered. The affirmation of the ratings also reflects OMV's excellent liquidity position that would enable it to weather a period of a weaker operational performance.

In addition, notwithstanding initial increase in leverage Moody's believes that the increased stake in Borealis will improve OMV's business profile. Borealis enjoys a number of leadership positions in the polyolefin market that, albeit cyclical, enjoys a healthy underlying structural growth. The increased stake would also make it easier for OMV to realise operational synergies with its own operations, with OMV targeting EUR700 million synergies by 2025. A higher level of integration will also help to reduce volatility of earnings in the downstream operations.

OMV is 31.5% owned by the Government of Austria (Aa1 stable) and is rated according to Moody's methodology for government related issuers (GRI), which considers the company's fundamental credit quality as indicated by its BCA, and then factors in a level of government support and ratings uplift in the event of financial distress. OMV's ratings are based on the baa1 BCA and a one rating notch uplift. Today's transaction does not change this view.

Environmental considerations incorporated into the agency's credit analysis for OMV are primarily related to potential carbon dioxide regulations, but also include natural and man-made hazards. Social risks are primarily
related to demographic and societal trends and responsible production. These risks could influence regional moves towards less carbon-intensive sources of energy, which could reduce demand for oil, gas and refined products. The entire sector is exposed to rising litigation risk, which is an event risk related to climate change and related disclosures. Future laws and regulations that could accelerate the pace of energy transition or changes in technology that affect demand for hydrocarbons represent a material and growing risk for the company.

These risks also add to corporate governance considerations with respect to financial strategy and risk management. A strong business profile with a clear carbon transition strategy, healthy financial position and low financial leverage are important characteristics for managing these environmental and social risks.

WHAT COULD CHANGE THE RATINGS UP/DOWN

RCF/Net Debt falling to the mid-30s or less could lead to a downgrade of the baa1 BCA and a downgrade of the rating. Reduced ownership by the Austrian government or changes in Moody's support assumptions could result in a removal of the one notch rating uplift.

While there is limited potential for positive rating action in the mid-term, further growth of OMV's upstream production beyond its 2020 target alongside sustainable reserve replacement and a continued strong financial profile measured by a sustainable RCF/Net Debt metric of at least 50% could lead to a higher BCA and prompt a ratings upgrade.

LIST OF AFFECTED RATINGS:

..Issuer: OMV AG

Affirmations:

.... LT Issuer Rating, Affirmed A3
....Junior Subordinated Regular Bond/Debenture, Affirmed Baa2
....Senior Unsecured Medium-Term Note Program, Affirmed (P)A3
....Senior Unsecured Regular Bond/Debenture, Affirmed A3

Outlook Actions:

....Outlook, Changed To Negative From Stable

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Integrated Oil and Gas Methodology published in September 2019, and Government-Related Issuers Methodology published in February 2020. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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Martin Fujerik
Vice President - Senior Analyst
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Matthias Hellstern
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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