

A photograph of an industrial refinery or petrochemical plant at sunset. The scene is dominated by tall, vertical distillation columns and a complex network of pipes and metal walkways. The sun is low on the horizon, creating a strong orange and yellow glow that silhouettes the structures. In the background, several large white storage tanks are visible. The overall atmosphere is industrial yet serene due to the lighting.

THE QUIET REVOLUTION: **ENERGY IN THE CEE**

ACCEPT OR CHALLENGE?

At MOL Group we address the challenges of innovation, regulation and changing customer demand. We are leading the industrial transformation in Central and Eastern Europe by becoming the premier chemicals company, by diversifying our non-fuel products, and by being the first choice of those on the move.

SEE THE **INDUSTRY** OUR WAY



NEW DYNAMICS

The energy economics of Central and Eastern Europe are changing. One group, MOL, has recognised that there are opportunities among the difficulties, says Zsolt Hernadi, chairman and CEO



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Over the past 15 years, MOL has moved to a pre-eminent position in Central and Eastern Europe (CEE), becoming a truly international oil and gas company with market-leading positions across the core parts of our business. We committed ourselves to international growth and the efficient operation of our integrated business model, setting the pace in regional consolidation. In that period, our earnings have grown seven-fold and market capitalisation has grown five-fold.

Since well before the current downturn in global oil prices, MOL has endeavoured – successfully – to improve the efficiency of its downstream operations and grow its retail network, whilst optimising and intensifying upstream performance in the region. The oil price context since mid-2014 has merely proved that this was the correct path to take.

MOL faces the same challenge as its peers, however – how to evolve and continue growing in a lower carbon future, characterised by constant technological innovation and ever-shifting customer habits and needs. At MOL we see this time of change as a clear opportunity to improve ourselves, rather than a threat to be resisted. Using the capability, the financial means and the leading regional market position we have built up as a foundation, we want both to address this opportunity and to ensure that our business can respond dynamically to future trends.

It's true that with our resilient business model we are well-positioned to continue to deliver strong returns, but by no means will we bury our heads in the sand. Now is the time to lay down the foundations of operations that are sustainable in the long term.

MOL recently set out its new long term strategy, "MOL Group 2030 – Enter

Tomorrow", the objective of which is not only to sustain and strengthen our regional position in our core businesses, but also to once again drive the changes in CEE.

Demand for hydrocarbon-based motor fuels looks certain to decline in the long run. As MOL looks to diversify from motor fuels, we will further diversify and expand our petrochemicals portfolio with the aim of becoming a leading chemical company in CEE.

While the on-going drive for greater efficiency and profitability at MOL's refineries will continue, we are also looking to grow the share of non-motor fuel products, moving up the value chain to target those semi-commodity and speciality petrochemical products with a higher added value.

We believe that serving one million customers every day across our CEE retail network gives us insight into the needs of consumers – and these needs are changing. MOL is aiming for an evolution in retail similar to that in its petrochemicals business, so that customers use our network of service stations to do more than just fill up their cars.

Upstream will continue to play a key role, operating profitably and adding value even in a low oil price environment. This will mean maximising value from MOL's existing asset base, while sustaining our production at least at today's level.

I am confident that through the combination of our high quality assets, financial strength, growing markets, talented people and the right corporate culture, MOL will once again set the pace for the next 15 years, offering competitive returns to our shareholders and contributing to the long-term social and economic prosperity of the economies in the region. ■

THE QUIET REVOLUTION

As the energy infrastructure in the CEE develops across a number of projects, the political and economic sands are shifting – for the better



As the north-south gas corridor steadily approaches completion, it brings closer the EU's strategy of making Central Eastern Europe more energy independent. Of vital importance to Brussels in the wake of the gas crises of 2006 and 2009, the corridor will enhance regional interconnectivity with liquefied natural gas terminals located at each end of the system.

A significant bonus is that regional interconnectivity will enable liquid gas markets with gas-on-gas competition by giving access to LNG sources.

Much of the infrastructure is already in place. One of the first countries off the mark was Hungary, where two large gas storages have been built and interconnectors developed with most of the neighbouring nations.

However there's still work to be done. Although the Polish LNG facility has been completed at the northern end, the southern end needs extra infrastructure to reduce bottlenecks and boost flows. Just one example: there's still no reverse flow capacity

on the Hungary-Croatia interconnector into Hungary due to missing developments on the Croatian side, and the LNG terminal proposed for the Croatian island of Krk is at an early stage of development. It will require the support of the Croatian government and the EU in order to reach completion.

The delays have been particularly disappointing for Hungary which has been an early champion of an efficient, integrated gas market at both domestic and regional levels.

On a brighter note, a broad and high-level initiative has been formed to speed up gas integration in the wider region. Under the umbrella of the Central and South Eastern European Gas Connectivity (CESEC), it combines 15 nations with a vital interest in the creation of a gas network. Established in early 2015, CESEC is working to resolve interconnector delays by taking into consideration all relevant issues including those pertaining to regulation, technology and finance.

The results are already showing up. In

September CESEC signed off four important initiatives. The so-called BRUA project, one of the most important for the region, connecting Bulgaria, Romania, Hungary and Austria is gaining traction. Four countries – Greece, Bulgaria, Romania and Hungary – agreed to work together on the “vertical corridor” that would share gas between them. A memorandum of understanding was signed on achieving reverse flows on the trans-Balkan pipeline.

And Bulgaria and Romania declared themselves close to completing an interconnector that would also have the knock-on effect of facilitating more interconnections with neighbouring countries.

With all this going on, the CEE is now far better-placed in the diversification of its gas imports than it was a decade ago. At present Russia provides almost a quarter of Europe's natural gas but the CEE is much less dependent on this supplier than it was. And as Brussels is beginning to deploy funding for the further development of gas infrastructure,



An LNG tanker cruises toward Poland

Russia's influence on the region's energy needs will inevitably reduce.

Meantime think tanks such as the German Institute for Economic Research believe that existing infrastructure could be used more efficiently, but that would require more cooperation between Member States than there is at present. That view coincides with that of energy companies such as Hungary's MOL, which believes that small but essential add-ons to the existing networks, combined with scalable projects, offer the best bang for the buck.

The increase in LNG terminals will be important in gas integration in the region. The biggest such terminal in northern and central eastern Europe, Świnoujście in Poland, can now handle methane carriers with a capacity of between 120,000 cubic metres and, in the case of the Q-Flex class, 217,000 cm. And much of that gas can now be pipelined beyond Poland into other CEE countries. As Jan Chadam, president of terminal operator Polskie LNG, pointed out at the time of the

inaugural berthing: "The receiving terminal's potential makes us an important player in energy independence in the whole region."

Before that happens though, Poland needs to install missing infrastructure such as a Poland-Slovakia interconnector that would boost the flow of its LNG to the rest of the CEE. Gas experts also say Poland needs to develop its internal network.

The EU has earmarked a considerable budget to subsidise the financing of the CEE's pipelines.

Starting in 2009 with a sum of €4bn, the now-replaced European Energy Programme for Recovery (EEPR) saw its capex capability expand rapidly in the wake of the Ukrainian-Russian conflict, which jolted Brussels out of its complacency over the region's and Europe's energy independence. The current budget devoted to the expansion of Europe's gas network between now and 2025 is about €5.35bn.

The increase in the number and capacity of the pipelines, particularly those devoted to gas,

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MUCH HAS BEEN ACHIEVED IN THE LAST FEW YEARS IN OIL AND GAS SECURITY IN THE REGION, PARTICULARLY SINCE THE RUSSIAN INVASION OF EASTERN UKRAINE AND THE EARLIER GAS CRISIS OF 2009

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contributes to energy security right across the region because of the interlocking nature of the network. For instance, when the recently-announced €187m Baltic interconnector linking Finland and Estonia is activated in 2020, it will unite the eastern Baltic Sea region with the rest of the European energy market. In the event of a crisis such as occurred in 2009 when Russia turned off the pipeline through Ukraine, the new pipeline will take some of the pressure off the CEE.

Technically challenging, the pipeline will run 172km including 80km off shore. A two-way transmission system, it will transport 7.2m cubic metres of gas a day in both directions. But when the gas starts flowing, energy consultants point out that the benefit for Finland – until now heavily reliant on Russian gas – and the broader Baltic region will be historic. Thus the planned pipeline would have an important symbolic as well as practical value if built.

As smaller but essential developments take place, big-ticket projects are exercising a profound influence on gas supplies and will continue to do so.

For instance, Nord Stream 2. Germany appears committed to it in the face of concerted opposition.

As Russia attempts to decrease its exposure to Ukrainian transit to Central Europe, Germany has striven to take over the role of Europe's gas transit hub with the help of the Nord Stream pipeline that transports Russian natural gas to Western Europe underneath the Baltic Sea. This is a position Germany would cement if Nord Stream 2 were to go ahead.

The CEE is concerned about the project,



Poland's Świnoujście, one of the largest LNG terminals in Europe

mainly because it runs counter to the EU rulebook on energy.

Not only would it dramatically alter the gas transit axis and dominant flows, it would cause current gas transit income received by Poland and Slovakia to fall dramatically.

At the same time, warns the Central European Policy Institute (CEPI), it would undermine the efforts undertaken by CEE countries such as Hungary, with the backing and financial support of the EU, to diversify their gas markets.

In its support for Nord Stream 2, Germany also puts itself at loggerheads with Brussels. As CEPI explains, the pipeline would improve Germany's energy security at the expense of the economic and energy security of the CEE.

More recently, in late July Slovakia's Maroš Šefčovič, Vice President of the European Commission for energy, openly attacked the entire rationale for Nord Stream 2.

As he argued, the original basis for the pipeline has been undermined by the approximately 50% fall in the cost of seaborne LNG deliveries in the last few years

as well as by the mushrooming of receiving terminals around the Caspian Sea and the east of the Mediterranean, with yet more on the drawing board. "But in particular, gas is transported more and more by sea routes under liquefied form," he explained. "Prices are very competitive."

And although the South Stream pipeline across the Black Sea was cancelled in 2014 and supposedly buried after Russian President Vladimir Putin announced his country's withdrawal from the project in the teeth of opposition from Brussels, some believe it's still on the agenda.

In July 2016 Dušan Bajatović, head of Serbia's state-owned provider of natural gas Srbijagas, expressed his conviction that the project will eventually happen – because it has to.

"One way or another, the South Stream will be completed," Bajatović predicted on the basis that by 2035 Europe will require 150bn cm more natural gas per year than it currently imports.

Much has been achieved in the last few

years in oil and gas security in the region, particularly since the Russian invasion of eastern Ukraine and the earlier gas crisis of 2009. Generally, points out CEPI, gas infrastructure has been strengthened and several two-way cross-border pipelines have been switched on.

Poland, for instance, can now be supplied from western hubs and Gaz-System, the Polish operator, is implementing interconnections with Lithuania, Slovakia and the Czech Republic. Also, despite entertaining bigger ambitions, Slovakia now benefits from a two-way flow across its border with the Czech Republic. It has also boosted the Austrian-Slovak interconnector capacity and has a new interconnection with Hungary and Ukraine.

As the CEPI explains: "Compared to a few years ago, [the region's] energy security has improved, especially in gas."

Indeed experts have coined the phrase "quiet gas revolution" to describe the progress the CEE has made, admittedly after being shocked into action by the events of 2009 and 2014.

But there are a lot more projects on the horizon. According to CEE's Gas Regional Investment Plan (GRIP), a cooperative initiative launched by the European Network of Transmission System Operators for Gas (ENTSO-G), there's a busy programme to be completed between now and 2025. In all, 88 sizeable projects are planned in the region. Of these, 24 are already fully funded and 64 are under development.

One such landmark project is the gas interconnector between Poland and Lithuania, part-funded by €30m from Brussels. Due to be turned on in 2019, the interconnector will hook up several CEE countries to gas stored in a floating LNG terminal in Klaipėda on Lithuania's Baltic coast. The pipeline will, points out CEPI, "put an end to the [energy] isolation of the Baltic states."

In 2014 the European Commission conducted a stress test of the vulnerability of the CEE's gas supplies. The verdict, as those behind CESEC explained, was "extremely vulnerable" to the risk of a cut by its biggest, and in some countries, sole supplier. And compared with Central Western Europe, consumers were paying a lot more for their gas. CESEC concluded: "The main reasons were missing cross-border infrastructure and poor implementation of energy market rules that would allow reliable gas supplies from a diverse range of suppliers to be delivered at affordable prices to consumers."

Since then CESEC has overseen a rapid turnaround in gas integration. No longer is the CEE so vulnerable – and, as the organisation predicts, soon it will be even less so. As Šeščiavičius said in September: "In working together we can achieve heightened energy security and diversification in a region which has already experienced a severe vulnerability to its gas supplies."

Impressed by what it's been able to achieve, CESEC has lately embraced even bigger ambitions.

Its members have decided to extend their cooperation into renewable energy and energy efficiency by reducing their dependence on external suppliers, just as they've managed to do with gas. Next up, predicts Commissioner for Climate Action and Energy Miguel Arias Cañete, is the creation of a regional electricity market.

But companies in the region have not neglected the importance of oil supply diversification as a key element of the CEE's energy security. MOL, for instance, have invested in the Friendship I/Adria crude oil pipeline in order to be able to potentially fully supply its Danube and Bratislava refineries from the Adriatic. MOL plans to increase its

“IN ALL, 88 SIZEABLE PROJECTS ARE PLANNED IN THE REGION. OF THESE, 24 ARE ALREADY FULLY FUNDED AND 64 ARE UNDER DEVELOPMENT”

A border delivery station at the natural gas pipeline near Rozvadov, Czech Republic



crude intake from the Adriatic to 33% in the next few years to process the most profitable crude and to match the demand for its products.

Other oil companies are following suit in the pursuit of extra output, important in a region that is in the middle of what could be a long-term process of diversification in its source of oil. During 2016, crude from the Middle East – notably Iran, Saudi Arabia and Iraq – has been shipped into the CEE on a larger scale than before.

As with gas, the region has historically been supplied by Russia, mainly pipelined from the Urals, and the European Commission is concerned that the burden of supply does not fall on one country. Poland and Germany, for instance, are particularly dependent on Urals crude. That's why the berthing of the supertanker *Atlantis* in Gdansk in the summer with a cargo of Iranian crude was seen as symbolic.

Similarly, the opening of the Naftowy Północ oil terminal – also in Gdansk – in April has been greeted within the EU as another step forward in the region's energy diversification

because it provides Poland with another source of supply.

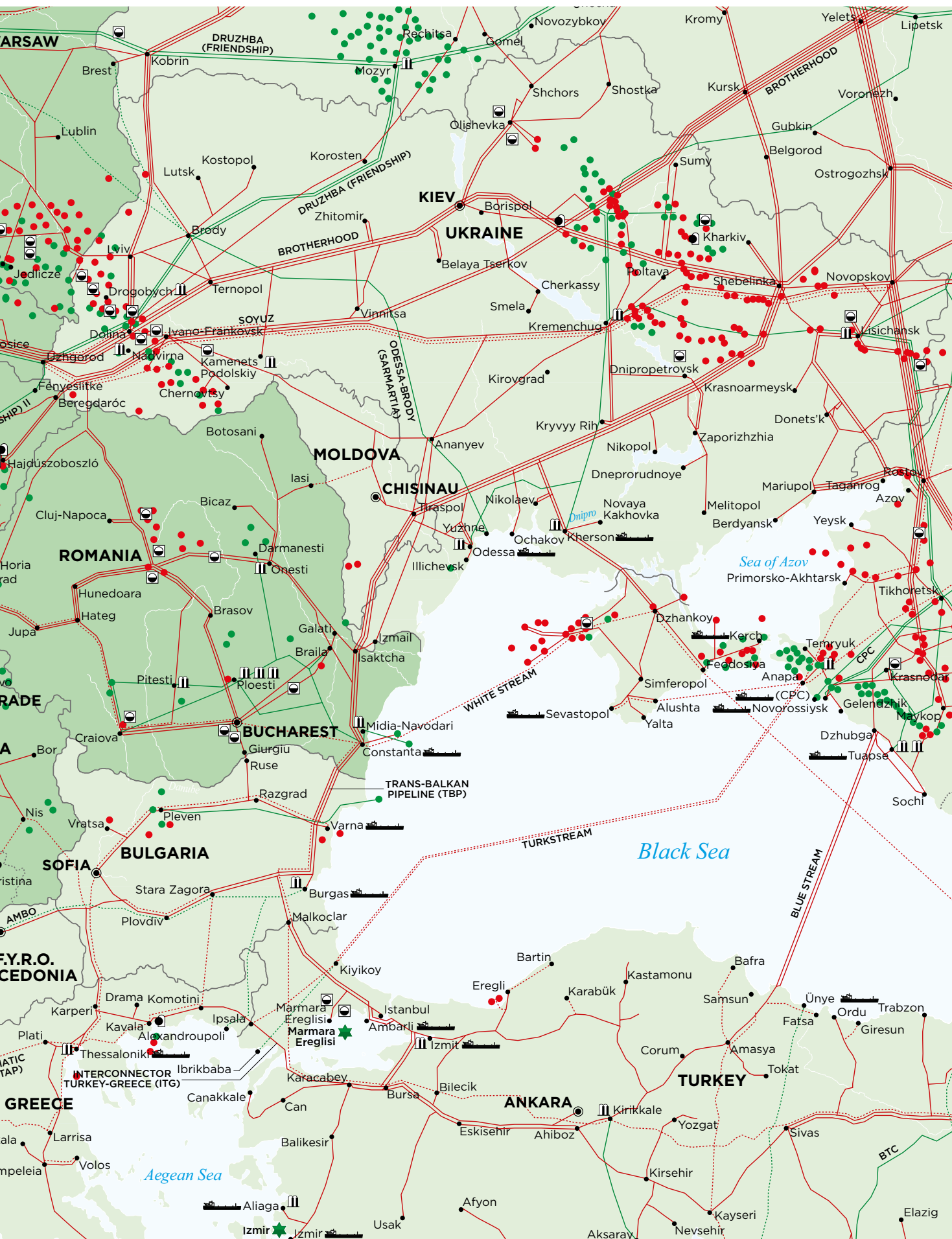
Both these developments follow Poland's PKN Orlen agreement of a long-term contract last year with Saudi Aramco – its first ever – for delivery of crude to the Polish outfit's refineries. PKN Orlen also has long-term contracts with Rosneft. Some of the Saudi oil will be moved to Lithuania and the Czech Republic.

Although, as oil experts point out, the continuation of Middle East-sourced crude depends significantly on favourable shipping rates and the volumes hardly put a dent in Rosneft's supplies, they do mark a milestone in the region's pursuit of energy security.

Meanwhile, the Czech Republic's Unipetrol – owned by PKN Orlen – is also in the market for Adriatic oil. The firm recently signed up to a three-year agreement for the transportation of crude oil to refineries in Kralupy and Litvinov, via the Adria pipeline. The agreement should provide the Czech Republic with greater crude supply security, mimicking the change towards a more stable energy market across the region. ■

MAPPING GROWTH: CEE OIL AND GAS INFRASTRUCTURE





ECONOMICS OF GROWTH

Regional finances are set for steady growth, but the CEE could benefit from wider geopolitical stability

It's just as well the oil and gas industry across the CEE is used to economic and political upheaval. For most of the last 20 years, it's had to deal with almost continuous change and it's become a way of life for commerce in general in the region.

As PWC Poland's senior economist Mateusz Walewski observed earlier this year, "international and local businesses have become used to continual reform over this period and executives say it has helped them to become more agile and less fragile."

And these nations have to be agile. "The majority of CEE countries are small, relatively open and heavily dependent on exports for growth, notably to other EU countries," Walewski adds. "This makes them highly sensitive to developments in advanced economies."

Economists generally divide the region's countries into three quite distinct camps. There are the smaller Baltic states, the next-biggest and export-focused economies such as the Czech Republic, Bulgaria, Romania, Hungary and Poland, and the troubled countries such as heavily indebted Slovenia. The nimbler

ones such as the Baltics are expected to grow at a rapid rate – up to 4% a year between now and 2020 – while the export-oriented countries with "reasonably friendly business environments", says Walewski, should achieve collective annual growth of between 2-3%.

Of the latter, Romania, Slovakia, the Czech Republic, Hungary and Poland are prime examples. They already serve as a vital element of the European supply chain in manufacturing, particularly in the automotive industry. Just two in fact, the Czech Republic and Slovakia turn out more cars than does France despite having just 16m people between them.

Ominously, they are increasingly applying their engineering know-how to the development of home-grown brands and competing in the wider European market in their own right. Clearly this will be important for the development of the region's energy sector. And it's why, estimates consultancy FocusEconomics in a recent forecast, Romania will be the region's fastest-growing economy in 2016 with a predicted rate of 4.5%, closely followed by Poland and Slovakia, both with

around 3.2%.

Although the CEE is seen as a cohesive region, most observers believe economic prospects will vary considerably, according to how capable their governments deal with current challenges including that of Brexit. "The Brexit decision will likely drag on confidence and might contribute to a further weakening of investment [in the region], which has already been declining due to lower inflows from EU funds," predicts FocusEconomics.

Energy outlook

The oil and gas industry has had a particularly turbulent period created by rock-bottom crude prices exacerbated by Iran's return to oil exporting after the ending of an international ban, the after-shocks of the attempted coup in Turkey that has already affected exports from several countries such as Romania, and the slowdown of Brussels-based investment.

The good news in all of this is low-cost feedstock.

With its ability to transcend national issues, the region's oil and gas industry is profiting





Rising Danube: regional economics are looking strong

from the ever-cheaper crude that is fuelling the downstream industry. “Taking advantage of cheap feedstocks, refiners have made the most of larger profit margins and producing higher value products,” points out the World Refining Association in its latest report on the region.

Rather than rely on the feedstock windfall though, industry in the CEE has launched its own initiatives. “There has also been a huge focus on driving efficiency, cutting costs and adapting to change,” adds the association. Only by creating efficient, value-driven supply chains have upstream companies been able to survive.

Although it adds to the turmoil, the lifting of sanctions from Iran in early 2016 may be helping the downstream industry. Despite the European market already being oversupplied to the tune of 1.5m barrels a day, the arrival of Iranian oil has served to further depress feedstock prices and encourage in the process deeper investment in petrochemical plants across the region.

According to the association, the industry’s biggest concern now is that feedstock prices

“**TAKING ADVANTAGE OF CHEAP FEEDSTOCKS, REFINERS HAVE MADE THE MOST OF LARGER PROFIT MARGINS AND PRODUCING HIGHER VALUE PRODUCTS**”

continue to stay at current levels. “The majority of respondents see the lifting of sanctions as having a positive affect for European refineries... Iranian crude offers a cheap feedstock for refiners in the CEE region who saw record margins in 2015 and would love to see this trend continue.”

And that’s considered likely because Iran looks like it will continue to pump crude into a saturated European market.

Making hay while the sun shines, oil and gas industry spokesmen report they are using fatter margins from downstream businesses to put aside funds for the sprucing up of ageing assets in their upstream activities.

The attempted coup in Turkey alarmed the region’s entire energy sector. As a vital energy

transit hub as well as an important and fast-growing outlet for CEE countries, its long-term stability is considered vital throughout the EU. For example Romania, for which Turkey is its biggest single export market, is already suffering from the economic fall-out of the coup.

On the bright side the region can only benefit from an end to the war in Syria and to conflicts with Islamic State that have destabilised the Turkish market.

Of the two major pipelines running through Turkey, the one originating from Kirkuk in northern Iraq has been severely affected by the fighting.

“Turkey plays a hugely influential role within the region and is seen as a major player in the downstream market,” points out the World Refining Association, citing its strategic location as a shipping hub and infrastructure such as the Star refinery under construction on the Petkim Peninsula.

If and when peace is restored, the CEE’s heavy current investments in their downstream activities could pay off handsomely in the coming years. ■

OPPORTUNITY IN DIVERSITY

Using the capability, the financial means and a leading regional market position in CEE, Hungary's MOL seeks to respond dynamically to future trends

Budapest-headquartered MOL Group can look back on a successful 15-year transformation, having achieved a series of targets. With production plants in eight countries and exploration assets in 13, it now runs four efficient refineries and two rapidly expanding petrochemical plants in its home region. "We're a highly integrated group between upstream and downstream. While a few years ago two-thirds of our earnings came from our upstream business, today the situation is basically the opposite. Downstream offsets the decline in profits from upstream," explains Ferenc Horvath, Executive Vice-President, Downstream.

And the board has just signed off on an even more challenging 15-year strategy that aims to reconfigure the company by 2030 into a flexible, more outward-looking, consumer-driven organisation. Although MOL believes demand will still exist for hydrocarbons in 2030, it is preparing itself now for a post-hydrocarbon world. In the 2030 strategy, besides the traditional businesses, new emphasis will be placed on high-margin petrochemicals and an expanding retail base as MOL embraces the coming era in private and public transport. The group is laying the foundation for a new age. "We want to become the first choice of customers, employees and investors," says Horvath, one of the architects of MOL's reconfiguration.

Echoing those views, Berislav Gaso, Executive Vice-President, Exploration and Production, underlines how integration is key: "There are very strong synergies on the financial side. MOL has very comfortable gearing, which gives us a strong cash flow

for the future." The refineries are in the vanguard of the makeover. On the one hand, MOL's goal is to keep its refineries among the most profitable in Europe. "There is still a lot of room for increasing our efficiency and competitiveness. Our internal programmes have delivered over \$700m EBITDA improvement in the past four years and we will continue with these efforts," says Horvath. On the other hand, within the next 15 years the group aims to take advantage of a number of opportunities. As the company plans to diversify its production away from motor fuels, MOL wants to boost feedstock to its petrochemical plants as well as to increase production of high value non-fuel products such as chemicals, jet fuel, lubricants and base oils, while simultaneously expanding its share of the liquefied petroleum gas market across CEE. Investments will be made into refineries in Hungary and Slovakia, making them more flexible producers of propylene and high value non-fuel products, as MOL increases the ratio of non-motor fuel products from 30% to 50%.

Higher-margin petrochemical products will be developed for the automotive, packaging, construction, furniture and electronics industries. Over the next five years the focus will be on propylene oxide-based polyols, highly favoured for a wide range of new products. MOL expects to be the only fully-integrated manufacturer of polyols in the region. "There is a shortage of polyols in CEE, we know the customers, have the knowledge and experience, and therefore we are well-positioned. And the fact that all the feedstock comes from our own value chain gives us an even greater advantage over our competitors",

explains Horvath. By 2030, MOL's objective is to be a leading chemicals company in CEE. To make it all happen, the company has earmarked future cash flows as capital expenditure. Up to \$4.5bn will be invested in five-year cycles. Of this sum, about \$2bn will be invested in the next five years.

With a forward integration strategy in place, MOL has ambitions for its retailing division on the back of a revamped corporate culture. "In the last 15 years we've been a rather centralised company," explains Horvath. "This will not be the case in the future as we enter a new era of mobility. We must become much more entrepreneurial. We have to manage our value chain with the understanding that markets will be driven by customers' habits and expectations. That means our thinking will start from the other end, from the customers' point of view. This is why our internal culture needs to be developed and we have to adjust our governance and processes for these challenges. We want to become a 'first mover', ahead of everybody else. No other company in the industry is doing this in the region."

As part of MOL's more outward-looking culture, it will seek new talent. "We will build stronger relationships with universities and academic institutions," he says. "This will support education and maintain a talent pool for the industry." Even now, almost a quarter of the managers at its headquarters are expatriates. "In my management team, six out of eight leaders are expats, which gives us additional experience and knowledge", adds Horvath. The company plans to employ big data to meet the needs of its current 10m customers as it expands its range of fast-



MOL's eco-friendly service station in Budapest



A rig in MOL-operated Tal-Block, Pakistan

moving consumer goods (FMCG). “There are tremendous opportunities for handling big data in an FMCG way,” enthuses Horvath. “It’s not rocket science, just a different way of thinking.”

The so-called ‘consumer services’ strategy is particularly bold. MOL sees itself meeting the requirements of a highly mobile population, for instance providing car-sharing, electric vehicles, fleet operations and even solutions for urban public transport. Between now and 2030, the group expects external factors to transform energy consumption around the world. Further embracing the transport revolution, MOL will offer alternative forms of power in its 2,000 service stations.

The group has already launched its retail transformation by modernising its service stations. By 2018, there should be over 700 service stations with the fast-food concept, Fresh Corner, in the CEE region. “We will sell our customers everything they need. Currently customers come primarily to refuel and make adjacent purchases. In the future we want to be the first choice of customers even if it is not about refuelling their cars,” says Horvath. As the consumer-facing businesses grow, the group expects them to deliver a third of EBITDA by 2030.

While MOL’s downstream businesses is a key focus for transformation, upstream won’t be neglected. “Upstream is a core pillar of the business,” Gaso says, explaining that his division must be self-funding and value generating even in a low oil price environment. “The world has changed. This oil crisis is different from previous ones. It’s not a demand-driven shock but a supply-

driven one.” MOL has been agile in adjusting to this new reality. “We had to move away from volumetric thinking and focus on our cash flow. In other words, as I like to put it to my colleagues, I really like barrels of oil – but I like dollars even more.” MOL’s steps to increase efficiency are clearly bearing fruit as MOL’s unit costs have decreased to the very competitive level of \$6 per barrel. “I want a portfolio of assets that creates value in the current low oil price environment. At present this is an efficiency game, but it will become more challenging later as we start to build up our reserves.”

He says the focus will be on small to medium-sized assets located in geographies that the group knows. “We aim to keep our production at least at the current levels [110,000 barrels of oil equivalent per day] and this will also require inorganic investments in reserves replacement, but these have to make financial sense in a low oil price environment.”

Meantime Gaso has a robust budget to develop MOL’s existing portfolio and he believes that the upstream business can generate \$3.5bn-4bn EBITDA between 2017 and 2021. MOL Upstream will invest \$2bn in organic capex during that period with an additional pre-tax \$500m earmarked for Norwegian exploration. About 20% of the \$2bn will be invested in exploration, notably in the CEE and Pakistan, and 55% for development projects in MOL’s home region, the UK, Pakistan, Kazakhstan and the highly profitable Baitugan field in Russia. As a result Upstream will generate around \$1bn post-tax free cash flow, which will allow MOL to sustain current production levels during the

next five years.

In MOL’s home region (Hungary and Croatia) the fields are mature, but the company has managed to reverse a production decline, with oil production growing by 20% in 2016 thanks to optimisation measures. “We know we’re really good at efficient onshore production and we employ the most advanced technology. And although the CEE region is a mature area, we will also focus strongly on further exploration,” Gaso adds. “We currently possess more than ten exploration licences and we will continue to participate in upcoming bid rounds. We also aim to revisit existing licences with 3D seismic to identify new geological plays.”

Although the group is not an operator in the hard-hit North Sea, Gaso is working with MOL’s partners to reduce costs. “It’s important that the North Sea returns to cost discipline,” he says.

“In the last five to eight years the entire UK upstream industry got lazy and now we need to find our way back to the old discipline. I believe substantial cost deflation is possible in the North Sea and together with Enquest on Scolty & Crathes, we have just proven that.”

Safety will remain a priority. “MOL has a solid record in safety but we’re aiming for zero incidents,” Gaso says. Similarly, the downstream division is setting its sights higher. “In sustainability we’re aiming to stay in the top 15% of companies,” hopes Horvath. “In safety there can be no compromises.”

As MOL embarks on its 15-year transformation into a more advanced group, observers are expecting much, following a period of sustained success. ■



CEE OIL & GAS COMPANIES EMBRACE ENERGY UNION

By working together, regional energy markets can feel the benefit of scale economics

As the CEE's oil and gas sector rapidly reduces its dependence on high-priced Russian supplies, it's moving closer into the European embrace through the so-called Energy Union that aims to create a self-sufficient, zero-carbon future.

In tandem with the linking up of pipelines in the Baltics, Central Europe and the Balkans, European Member States are adopting European regulatory systems to facilitate the completion of internal market functioning, and the flow of natural gas without administrative barriers. Energy community members like Ukraine are also aligning their legal systems so that national companies can harmonise more easily with the EU. "Many countries have recently undergone significant reforms or expect to implement them shortly," explains Nilüfer Evrenle, technical consultant to Azerbaijan's SOCAR Energy group.

As Miguel Arias Cañete, European Commissioner for Climate Action and Energy pointed out in October, there's a lot at stake. Thanks to a more efficient oil and gas sector, improved pipeline networks and lower prices, the EU as a whole saved \$27bn in imports in 2015 compared with the year before. The commissioner thinks the EU can do more provided regions such as the CEE continue to cooperate within the Energy Union, citing by way of example the "huge potential" waiting to be tapped in existing interconnectors.

"We will no longer tolerate a situation where bottlenecks are artificially pushed to the border, as is still the reality," he warned.

Meantime consumers are benefiting from lower prices. In the gas market, for instance, according to a recent European Commission report, the estimated import bill for the EU in the first quarter of 2016 plummeted to €14bn. That compares with the average quarterly bill of €18bn in 2015. And as the region is becoming better connected and LNG becomes accessible, prices should continue to fall further. In the first quarter of 2016, spot prices at European gas hubs fell to €12-15 per megawatt hour, the lowest in seven years. CEE-based consumers in particular are reaping the rewards. According to the European Commission, the price of imported

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natural gas in the Czech Republic fell late last year to the unprecedented point where it's only 4.5% higher than at the hubs in Germany.

However refineries in Europe are under pressure, not only to ramp up production but also to meet tougher standards in efficiency and pollution. Since 2008 EU refining capacity has decreased by 10%, according to the IEA. The oil refining fitness check – completed by the European commission in 2015 – evaluates how ten pieces of the most relevant EU legislation drawn from a variety of fields including environment, climate action, taxation and energy, influence the sector. The ten-point check list is by general agreement hurting margins and competitiveness, particularly against higher-producing refineries in North America and the Middle East. In July, the European Commission's own research conceded this was the case, noting that "the average cumulative cost resulting from the impact of legislation... is estimated to account for up to 25% of the total net loss of competitiveness of the sector in terms of the decline in the observed net margin."

But refineries shouldn't expect any reprieve. "The costs can be considered proportionate relative to the benefits achieved," argues the report, which also insists that regulatory costs have stabilised in the last four years.

There's no sign that the EU's energy czar will back down on fitness checks. Commissioner Cañete is on a mission to lead an "energy revolution", that converts the CEE and the rest of Europe into a carbon-free energy sector by 2050. ■

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