

## **MOL Group Position on Negotiations about the Future of INA**

A key driver in the evolution of MOL Group into the leading regional energy company has been the creation of long-term partnerships based upon shared values, objectives, and mutual trust with our partners, private or government.

We see that in any partnership it is essential for partners to talk to each other, especially at times when that partnership is challenged and when differences arise regarding adequate responses. In this spirit, we have been ready to talk with our largest partner in INA, the Government of Croatia (GOC), since 2010 on all important issues. The incumbent Minister of Economy at the time indicated after several rounds of correspondence that his Government was not ready to discuss and resolve outstanding issues with us, despite MOL being not only one of the largest foreign investors in the country but also having acted as a reliable, good partner to the GOC since its first investment in 2003.

By investing into INA, MOL has made one of the largest foreign direct investments in Croatia. Driven by the nature of our core business, this significant investment and presence makes us strongly interested in the development of the Croatian economy, on which INA's growth to a large degree depends. The last five years have been marked by the deepest and longest economic and financial crisis in recent history, creating a SUBSTANTIALLY changed environment for INA. Not only was demand reduced for key petroleum products and natural gas by around 20-25% in this period, but market competition also intensified both within and from outside of the region. Access to new markets, new opportunities and new funds became harder. Yet INA, through our joint effort, not only managed to survive the crisis and to complete its key jointly agreed projects, but was also enabled to turn again towards new regional and international growth opportunities.

We welcome the start of negotiations with the GOC on 18 September 2013 and we appreciate the Milanović Government's willingness to talk. However, since our first meeting, certain developments have added a new dimension. These include statements by senior Croatian government officials, some going as far as to claim that MOL has been a "bad partner" to the GOC in our joint ownership of INA – a charge amplified by the Croatian media – while failing to take adequate account of the many benefits derived by all shareholders, including the GOC, from INA's long partnership with MOL. These allegations are affecting MOL's well-established reputation as a responsible business partner and

investor, whose aim is to increase the value of INA in the best interest of all stakeholders. This has led our key shareholders, including the Government of Hungary and, at their suggestion, and after due consideration, our Board of Directors as well, to require us to take quick and decisive action to protect the value of our investment in INA.

During the first six years of our partnership, MOL was a supportive strategic investor with a 25% plus one share minority stake with no operative rights over business management, but always backing through its representatives the jointly agreed development plans. Since taking over management control, MOL has taken full responsibility for the operative management of the company, but always acted in agreement with the GOC and its representatives on strategic matters and fully complied with all obligations assumed in its contracts with the GOC. In the Annex we lay out facts which show that our co-operation was successful so far and that charges leveled against MOL have no merit.

It is our firm view that, given the circumstances and under present conditions, negotiations should proceed differently than originally planned, as before talking about operative details such as management models, the most fundamental question about the direction and future strategy of INA needs to be answered.

As we at MOL see it, there are essentially two paths ahead for the development of INA:

The first one is the private-sector path, leading to long-term growth and value creation for all shareholders. This is a model where operational decisions are made on the basis of market and business considerations and the overarching goal is to create long-term value for the owners. Investments are pursued if they are able to generate adequate returns and efficient use is made of material and human resources. The national provenance of company investors, leaders, employees, and contractors is not relevant and only their quality, competence and competitiveness counts. This model assumes a natural division of labor between the strategic investor, who takes operational responsibility for the company and other shareholders, including the Government, who profit from such value creation in proportion to their shareholding. This model also needs a supportive, investor-friendly business climate so that the time between a project plan and its implementation, with all the permitting it entails, is the shortest and easiest possible. Applied to INA, this model would create sufficient resources for INA to take on new opportunities in Croatia and elsewhere and to offer long-term, merit-based jobs and advancement for INA's skilled and competent employees.

The other path is the state-managed model where goals are mostly volumetric, not necessarily responding to market and economic realities. In this model value creation and returns may become secondary to other, mostly political considerations, and business efficiency and competitiveness to jobs preservation. Decisions about investments, managerial appointments, employment and contractor selection are influenced by arbitrary criteria and minority shareholders and stakeholders have an incentive to interfere with, block or delay operational and investment decisions. This model in the past has, as our joint experience also shows, proven inefficient and cost INA a loss of significant value creation potential, ultimately severely weakening the company. We believe that, in the current environment, returning even partially to such a path would result in the gradual marginalization of INA, leading to lower budget proceeds and putting more jobs at risk on the long-term.

MOL has always been committed to the first, private-sector path for INA. This was our understanding when we made our initial investment in INA when MOL had been selected as a strategic investor. Our approach was based on the INA Privatization Act of March 2002, which set out certain steps through which the GOC aimed to reduce its original controlling shareholding in INA to a qualified minority ownership of 25% plus one share and, what is more, and held out the promise that, after Croatia's accession to the EU, the remaining shares of the Republic of Croatia shall be privatized.

MOL therefore had every reason to trust that it could take management control and responsibility in INA within a reasonable period of time, and has made its original investment based on and conditioned upon these assumptions. We strongly believe that only a robust, efficient INA can serve the Croatian economy, secure Croatian energy supply and benefit all of INA's stakeholders, including the Government. While we see the short-term appeal of the second path for certain stakeholders, it is not the model MOL had anticipated when it invested in Croatia back in 2003 based on the spirit and letter of the INA Privatization Law and we can therefore only support the approach that is proven and likely to create value for shareholders.

The worst case if both models would be living within the company at the same time, as we have experienced already between 2003 and 2009. In our reading, the Government Decree of 1 August 2013 on the negotiating framework for the GOC indicates a move towards this direction, and as such, differs from MOL's approach.

The decision between the two paths, ultimately, is for Croatia and its Government to make. But the current situation, when its two largest shareholders appear to take INA in opposing directions, is detrimental and harmful for the company's future and for its shareholders as well.

Should the GOC choose to go down the first, private-sector path with us, as we hope, MOL is ready and open to continue with negotiations – but at a much more intensive pace and shorter timeframe than originally proposed by the Government. We are ready to secure all our available resources for such talks, with the understanding that nothing is agreed until everything is agreed. We propose to talk first about business objectives and strategy and only if and when we have agreed on these fundamentals should we turn to other details like what is the corporate governance structure that is most efficient to serve the agreed strategy. Our intention is to agree on all important points before the end of 2013.

We are obliged to do this as we have no time to lose, because INA has no more time to lose. Every day that goes by without an agreement between the two major shareholders and every political and regulatory obstacle INA is facing, it generates further direct losses and opportunity losses for INA and its shareholders (including the Government) amounting to several million Kunas per day and strengthens the position of INA's regional competitors. For the success of the negotiations, it will be important that the GOC declares its support for investments that have a clear potential to create value and to confirm that it will in any other respect abide by its legally assumed obligations and commitments for example by providing INA licenses necessary for its operations.

Naturally, we at MOL have also to accept if the GOC would, despite the advanced phase of the privatization of INA, still opt to pursue the second, state-managed path. In this case, MOL respectfully asks the Government to indicate this before the end of November 2013, together with an indication if it is willing to negotiate and agree on conditions of purchasing all the shares of INA held by MOL. In this case, we would see the most appropriate solution to enter into detailed negotiations with the GOC in accordance with applicable Stock Market regulations in Croatia and in a way that prevents speculation, impact on markets, or other possible adverse effects on all concerned parties, especially INA.

The Board of Directors of MOL Group

## Annex to MOL Group Position Paper

**We are pleased to present that MOL always acted in good faith in fulfillment of the obligations undertaken in valid contracts, including but not limited to the fact that its nominated members to the relevant corporate governance bodies exercised their voting rights to procure that INA maintains and develops both of the Sisak and Rijeka refineries in accordance with the Business Plans.**

**Growing profitability and cash generation capability:** since MOL took over operative control, the profitability and cash generation of the business was elevated from the previous HRK 2.5-3.0 bn EBITDA (operating cash result) range to the HRK 4.0-5.0 bn EBITDA level (without Syrian revenues and profits) producing one of the highest growth in our peer group by 2012 compared to 2008 (+83%).

**Improved efficiency and financial position:** In a period of strongly falling oil derivatives market demand in Croatia (with a decrease of almost 20%) and the broader region, we made the company more resilient to a weak economic environment and lower revenue base by a combination of substantial and **continuous internal efficiency improvement** (achieving HRK 2.2 bn yearly recurring operating cost and revenue improvement against the base of 2008) and **a sharp reduction of external debt**. We halved net debt from HRK 11 bn to around HRK 5 bn by today with respective gearing ratios reducing from 47% to 26%, thus enabling INA to consolidate its finances and consider new projects for future growth

**With strong and timely financial assistance of MOL** through shareholder loans and trade pre-financing totaling in a range of HRK 2.0-2.5 bn for more than a year, INA could maintain its operation, pay salaries and also complete its vital projects even in the most critical times.

**The viable long term profitability of INA is a must to ensure positive contribution to Croatian economy:** it can be best measured by contribution to GDP change. Via its efficiency improvement and higher economic value creation, in recent years INA contributed positively to the Croatian economy by adding positive contribution to the GDP and thus slowing down the GDP drop of Croatia (would INA not have adjusted its output from its refineries to lower

market demand and just push for higher volumetric production, it could have caused a potential loss of Croatian GDP up to 0.8% in the recent years).

Such efforts not only managed to restore the financial health of the company, but through **stable profitable operation created the fundamentals of new value creating investments, which are needed to put INA on a sustainable growth path** in the regional refining and marketing business and the international upstream arena, both of which are characterized by heavy investment need and strong competition.

**A number of strategic investments have been completed and new investment projects have been initiated in INA:** since MOL joined INA, continued development of activities in upstream, midstream and downstream in Croatia have been executed, with Initial Business Plan investment levels (set during the privatization process) overachieved in all segments, while yearly average value of INA's investments increased more than 2.5 times (from an average value of around HRK 1 bn to over HRK 2.7 bn) compared to the period prior the start of INA's privatization.

**MOL made its efforts to improve the competitiveness of the Croatian economy and strengthen the energy security of the country:** MOL, as a good partner of the Government of Croatia, also pursued own investments (e.g. building the Hungarian section of the gas interconnector between Croatia and Hungary) to increase the energy security of both Croatia in the short term and Hungary in the long term.

**INA became one of the most desired employers of Croatia after 2009:** people recognized the opportunities provided by the new INA, with more than 10,000 applications made for INA's open positions since.

**We are convinced that the above facts and results show that MOL has been and is committed to INA's continuous development that is also sustainable for the long term and MOL so far successfully supported INA to be able to meet these challenges.**