FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Tupras to 'B+'; Outlook Stable

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Fitch Ratings - Warsaw - 12 Oct 2023: Fitch Ratings has upgraded Turkiye Petrol Rafinerileri A.S.'s (Tupras) Long-Term Foreign-Currency Issuer Default Rating (IDR) and senior unsecured rating to 'B+' from 'B'. The Outlook is Stable. The Recovery Rating is 'RR4'.

The upgrade follows the strengthening of Tupras's credit profile and its record in maintaining offshore structural enhancements. The rating reflects our assessment of a one-notch uplift above the Turkish Country Ceiling of 'B' due to the increase in cash holdings and cash generation capabilities abroad via growing trading operations in the United Kingdom and the company's commitment to consistently apply this business practice. Tupras also had reached a net cash position as of end-June 2022, and we expect it to maintain a strong financial profile at least until 2026.

Tupras's rating is supported by the company's leadership in the Turkish refined product market, the operation of some of the most complex set of refineries in EMEA and its ability to access and process cheaper, heavier and sour crudes from several suppliers. However, the rating is limited by volatile refining margins, the company's focus on fuels production with limited business integration and domestic market and challenging operating environment in Turkiye. Tupras relies on uninterrupted access to local bank funding to support its liquidity, similar to other Turkish corporates.

KEY RATING DRIVERS

One Notch Above Country Ceiling: Tupras's offshore structural enhancements, including cash held in the UK's trading subsidiary, support a sufficient debt-service coverage ratio over the forecast horizon for the rating to be one notch above the Country Ceiling in line with Fitch's Corporates Exceeding the Country Ceiling Rating Criteria. We expect the offshore cash balance to remain relatively stable over the next three-five years and for the company to consistently apply its financial policy.

Strong Crack Spreads: European refining companies continue to have exceptionally high margins in 2H23. Shut-downs of refining capacity during the pandemic, lower availability of medium-sour Russian crude for European refiners and high temperatures during the summer affecting capacity utilisation have contributed to the current market situation. The recently announced ban of fuel exports from Russia may further tighten global markets.

Net Capacity Additions: Tupras estimates net global refining capacity additions of 400,000 barrels per day (bbl/d) in 2022 followed by an increase of 1.0 million bbl/d in 2023 and a stronger addition of 1.9 million bbl/d in 2024. The capacity additions may start to affect refining margins in 2H24.

Strong Financial Profile: We rate refining companies on a through-the-cycle basis given the inherent volatility of refining margins. Our forecasts, based on moderating refining margins to mid-cycle levels and dividend payments in line with the company's policy, still point to a very strong financial profile for Turpas with EBITDA net leverage below 1.0x in 2023-2026.

Low Capex, High Dividends: Tupras has a low maintenance capital expenditure (capex) of about USD200 million a year. Spending will increase due to the planned energy transition investments, but Tupras plans for a gradual transition, so we expect that overall capex will remain low compared with peers. Historically, Tupras has paid 80% of net profit in dividends, but dividends in 2020-2022 were effectively suspended due to market volatility. We expect dividend payouts at 80% of net profit from 2024, in line with the company's policy.

Carbon Neutral in 2050: Tupras's strategy assumes a focus on investing in biofuels, green hydrogen generation and renewables in response to long-term changes in demand. Tupras expects that a material amount of vehicle park will only begin running on electricity and hydrogen in Turkiye in late 2030. The company plans to spend an average of USD350 million a year on energy transition by 2030.

Fitch views Tupras's targets as less ambitious than its European peers', although demand dynamics for fuel in Turkiye are more positive than in Europe until 2040, supporting Tupras's more cautious investment plans.

DERIVATION SUMMARY

Tupras's closest EMEA peers are Compania Espanola de Petroleos, S.A.'s (CEPSA; BBB-/Stable) and MOL Hungarian Oil and Gas Company Plc (MOL; BBB-/Stable). The two peers have stronger credit profiles, benefiting from integrated and diversified businesses characterised by CEPSA's 41 thousand barrels of oil equivalent per day (kboe/d) and MOL's 83kboe/d upstream production and sizeable fuel marketing and petrochemical operations that provide countercyclical cash flow, while Tupras primarily focuses on the refining business.

However, this is counterbalanced by Tupras's larger refining capacity of 612kbbl/d exceeding CEPSA's 486kbbl/d and MOL's 380kbbl/d. In addition, unlike CEPSA and MOL, Tupras operates in a deficit fuel market, while the coastal location of its two principal refineries allows it to actively manage crude feedstock supplies. Tupras's leverage is currently lower than that of MOL thanks to the continued high refining margins since 2022. Tupras also has lower capital intensity than its peers, yet its rating is constrained by a lack of diversification, focus on domestic market and weak operating environment in Turkiye.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

-Brent oil price of USD80/bbl in 2023, USD75/bbl in 2024, and USD70/bbl in 2025, USD65/bbl in 2026, USD60/bbl in 2027.

-Refining margins trending towards mid-cycle level from 2024.

-Growing capex on increasing investment on ESG projects.

-Large dividend in 2023 based on the solid performance in 2022 and 80% of prior net profit distributed from 2024 in line with Tupras's financial policy.

Recovery Analysis Assumptions

Our recovery analysis is based on a liquidation value approach, which yields a higher value than a going-concern approach. It assumes Tupras will be liquidated in a bankruptcy rather than reorganised.

The liquidation estimate reflects Fitch's view of the value of balance-sheet assets that can be realised in a sale or liquidation conducted during a bankruptcy or insolvency proceedings and distributed to creditors.

-Fitch has applied a 100% discount to cash held.

-Fitch has applied a 25% discount to account receivables based on the analysis of Tupras's receivables portfolio and peer analysis.

-Fitch has applied a 25% discount to inventory, lower than the usual 50% discount as we consider commodities to be more readily marketable.

-Fitch has applied a 50% discount to net property, plant and equipment based on the quality of the company's assets and peer analysis.

-All loans and bonds are unsecured and rank pari passu.

-After a deduction of 10% for administrative claims, and taking into account Fitch's Country-Specific Treatment of Recovery Ratings Criteria, our waterfall analysis generated a waterfall-generated recovery computation (WGRC) in the 'RR4' band, indicating a 'B+' instrument rating. The WGRC output percentage on current metrics and assumptions was 50%.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

-Strengthening of Tupras's business profile

-EBITDA net leverage below 3.5x on a sustained basis

-Upward revision in Turkiye's Country Ceiling

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

-EBITDA net leverage consistently above 4.0x

-Worsening liquidity

-Consistently negative free cash flow (FCF)

-A lowering of Turkiye's Country Ceiling or deterioration of hard-currency debt service ratio below 1.5x on a sustained basis

LIQUIDITY AND DEBT STRUCTURE

Liquidity Subject to Bank Funding: At June 2023, Tupras's liquidity profile was primarily represented by its unrestricted cash balance of TRY39.6 billion, of which TRY38.6 billion are a time deposit with a maturity of less than a month. Fitch considers the liquid assets and solid FCF in 2023 as sufficient to cover Tupras's short-term debt of TRY11.5 billion, adjusted for the factoring of TRY1.4 billion.

ISSUER PROFILE

Tupras is the largest Turkish refiner with a capacity of 612kbbl/d, operating four plants across the country (in Izmit, Izmir, Kirikkale and Batman). The group's weighted Nelson complexity index of 9.5 is largely in line with EMEA peers. Its largest refinery in Izmit has completed a residuum upgrade project in 2014 and has a Nelson complexity index of 14.5, making it one of the most complex assets in Europe and the Middle East. Tupras is 53% owned by KOC Holding, an investment holding of the Koc family.

Apart from the refining assets, Tupras also holds a 42% stake in Opet, which is the second largest petroleum products distribution company in Turkiye in terms of sales volumes.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	RECOVERY ⬍	PRIOR ⬍

Turkiye Petrol Rafinerileri A.S. (Tupras)	LT IDR B+ Rating Outlook Stable Upgrade			B Rating Outlook Stable
	LC LT IDR B+ Rating Outlook Stable Upgrade			B Rating Outlook Stable
	Natl LT AAA(tur) Rating Outlook Stable Upgrade			A(tur) Rating Outlook Stable
senior unsecured	LT	B+ Upgrade	RR4	B

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

Corporates Exceeding the Country Ceiling Criteria (pub. 08 Dec 2022) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 03 Mar 2023)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 12 May 2023)

Climate Vulnerability in Corporate Ratings Criteria (pub. 21 Jul 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Turkiye Petrol Rafinerileri A.S. (Tupras)	EU Issued, UK Endorsed

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