FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Tupras's Outlook to Negative; Affirms 'BB-' Rating

Thu 16 Apr, 2020 - 12:51 PM ET

Fitch Ratings - Warsaw - 16 Apr 2020: Fitch Ratings has revised Turkiye Petrol Rafinerileri A.S.'s (Tupras) Outlook to Negative from Stable, while affirming the refinery company's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BB-'.

The revision of the Outlook results from a forecast increase in leverage due to lower demand for fuels caused by coronavirus-related lockdowns. We expect Tupras's funds from operations (FFO) net leverage to increase to 5.8x in 2020 from an already elevated 4.0x in 2019, before falling from 2021.

Tupras's rating is supported by the company's leadership in the Turkish refined product market, operation of some of the most complex set of refineries in EMEA and an ability to access and process cheaper, heavier and sour crudes from a number of suppliers. Similar to other Turkish corporates, Tupras is reliant on uninterrupted access to local bank funding to support its liquidity.

KEY RATING DRIVERS

Lower Demand due to Pandemic: The market for fuels in 2Q20 is highly challenging. European refiners are reporting a 50%-60% reduction in demand at retail stations due to restricted movement of people and closure of businesses aimed at curbing the spread of the coronavirus and we expect a similar level of decline to hit Tupras in its core domestic market. Some European, the US and Indian refiners have already announced reduction in capacity utilisation of 30% to 50%.

Recovery Expected in 2H20: We assume a gradual recovery in demand in 2H20 and no second wave of lockdowns. This should help more complex European refiners, such as Tupras, defend margins in 2H20. Nevertheless, we expect Tupras's EBITDA to decrease 49% yoy in 2020.

Healthy Margins in 1Q20: Tupras and its more complex European Fitch-rated peers have reported fairly strong margins in YTD2020. In January and February margins were on average stronger than a year ago when imports from the US had been particularly high in the Mediterranean region. In March 2020 the drop in oil prices lifted refining margins, which further strengthened in the second half of the month on lower competition as the US and Asian refiners reduced capacity utilisation following lockdowns in their domestic markets. Industrial consumption of fuels has been affected less than sales to retail customers. Correspondingly, diesel crack spreads were fairly strong while gasoline margins weak.

Difficult Year Ahead: We expect the overall impact of the pandemic will be materially negative for the sector due to a severe drop in demand. However, supply-and-demand imbalances in the market for fuels and the overcapacity in the oil market widening the differentials between heavy crude oil and Brent may, to a limited extent, help European refiners navigate market difficulties in 2020. The expected wider heavy crude differentials is especially important for Tupras, which can benefit from access to a variety crude oil types being located on the Bosphorus Strait, an important transportation route for crude oil to Europe.

Low Capex, No Dividends: Following the spike in capex in 2013-2015 due to investment in the residuum- upgrading project, Tupras's capex requirements are small at around USD200 million annually. Tupras has a policy of distributing large dividends, but in light of the weaker results we do not expect the company to pay dividends in 2020 and 2021. Despite the lower capital intensity and shareholder distributions, we expect Tupras to report elevated leverage metrics in 2020.

Higher Leverage: EBITDA in 2019 decreased 41% yoy to TRY3.7 billion, while FFO net leverage increased to 4.0x from 2.4x mainly due to lower refining margins and narrower differentials between heavier crude oil and Brent. Based on Fitch's assumptions for refining margins and fuel demand, we expect net leverage to spike to 5.8x in 2020, which may result in Tupras breaching its covenant. Should this happen, we would expect banks to grant Tupras waivers due to the temporary character of the breach as we expect its net leverage metrics to strengthen to 2.8x in 2021 with further deleveraging thereafter.

Operational Risks on the Rise: Tupras has a robust record in health and safety standards and implemented a number of measures to counter the risk of coronavirus spread among its employees. However, the pandemic may put additional pressure on operations of oil and gas companies. Limits to the transfer of people between countries and business interruption risk at refineries due to health-related concerns are an increasing risk for the industry.

FX Risk Managed: Tupras's debt and costs are predominantly in US dollars, while the majority of sales are denominated in Turkish lira. The resulting FX risks are mitigated by the natural hedge in the company's prices for refined oil products being ultimately US dollar-linked, albeit with a time lag. Any negative effects on Tupras's leverage ratios from FX changes should be temporary and are most likely to occur if there is significant lira weakening around the year-end. To further mitigate the effects of FX volatility Tupras maintains ample liquidity in US dollar- and euro-denominated deposits.

Sovereign Rating a Constraint: We do not view Tupras's Long-term Local-Currency IDR being above Turkey's Long-Term Local Currency IDR due to domestic operations and a policy of holding cash in Turkish banks. Weaker lira, lower growth and weaker domestic demand have had a limited impact on Tupras's results so far, but the spike in interest rates in 2019 significantly increased interest costs. A material, prolonged economic slowdown could have negative consequences on industrial activity and depress demand for fuels beyond what is currently expected from the pandemic. Weakening of the credit profiles of Turkish banks could also affect Tupras's access to liquidity sources.

High Complexity, Low Integration: Tupras maintains a leading position in the Turkish oil refining market and operates some of the most complex set of refineries in EMEA. Tupras remains focused on refining and has little vertical integration compared with MOL and PKN ORLEN, which are diversified into upstream, petrochemicals and retail. Tupras's 40% stake in Opet, Turkey's second-largest fuel retailer, partly mitigates this lack of integration, but increases Tupras's earnings volatility through the cycle.

DERIVATION SUMMARY

Tupras' closest EMEA peers are Polski Koncern Naftowy ORLEN S.A. (PKN, BBB-/Stable) and MOL Hungarian Oil and Gas Company (BBB-/Stable). PKN's 689 mbbl/d downstream capacity exceeds Tupras's (564 mbbl/d). Moreover, PKN ORLEN benefits from an integrated petrochemical segment, a large retail network and some exposure to upstream. MOL's downstream capacity (417 mbbl/d) is smaller than Tupras's, but the company's credit profile is stronger due to an integrated business profile with a 100 mbbl/d of upstream production that tends to provide countercyclical cash flows.

Unlike MOL and PKN ORLEN, Tupras operates in a deficit fuels market under normal market conditions, while the coastal location of its two principal refineries allows it to actively manage crude feedstock supplies. Tupras's leverage is higher than that of MOL and PKN ORLEN due to high historical and projected dividends, but the company has lower capital intensity than its peers.

KEY ASSUMPTIONS

- Fitch oil price assumption of USD35/bbl in 2020, USD45/bbl in 2021, USD53/bbl in 2022, and USD55/bbl thereafter.

- Volume to fall around 20% yoy in 2020, then by 5% in 2021 compared with 2019.

- Capex in line with management guidance.

- No dividend in 2020 and 2021.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- FFO net leverage consistently above 4.0x and/or FFO gross leverage above 5.0x on a sustained basis

- A downgrade of Turkey's sovereign rating, or a worsening operating environment in the country

- Slower-than-expected recovery in demand for fuels following the lockdowns.

The rating is on a Negative Outlook, therefore a positive rating action is unlikely in the short term. However,

Developments That May, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- FFO net leverage consistently below 4.0x and/or FFO gross leverage below 5.0x assuming Turkey's sovereign rating remains at 'BB-', which would lead to the Outlook being revised to Stable.

- FFO net leverage consistently below 3.5x and/or FFO gross leverage consistently below 4.5x along with a positive rating action on Turkey sovereign rating, which could lead to an upgrade.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Liquidity Subject to Bank Funding: As of end-2019 reported cash and cash equivalents of TRY8.8 billion (net of restricted cash) covered short-term debt of TRY7.2 billion, adjusted for factoring of TRY2.1 billion. Combined with Tupras's debt maturity profile over the next 24 months, the company's liquidity is therefore contingent on continued access to domestic banks. This is not uncommon among Turkish corporates but exposes the company to systemic liquidity risk. Tupras also keeps large deposits at a related-party bank Yapi ve Kredi Bankasi (B+/Negative), which amounted to TRY2 billion at end-2019. We also use gross leverage metrics as a rating sensitivity to reflect exposure to local banks and related-party bank.

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

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Turkiye Petrol Rafinerileri A.S. (Tupras)	LT IDR	BB-	Affirmed
	LC LT IDR	BB-	Affirmed
	Natl LT	AA+(tur)	Affirmed
• senior unsecured	LT	BB-	Affirmed

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Jakub Zasada
Director
Primary Rating Analyst
+48 22 338 6295
Fitch Polska SA Krolewska 16, 00-103 Warsaw

Wilhelm Mjaaland
Analyst
Secondary Rating Analyst
+44 20 3530 2605

Angelina Valavina
Senior Director
Committee Chairperson
+44 20 3530 1314

MEDIA CONTACTS

Adrian Simpson
London
+44 20 3530 1010
adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

National Scale Ratings Criteria (pub. 18 Jul 2018)

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

Sector Navigators-Addendum to the Corporate Rating Criteria (pub. 27 Mar 2020)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Turkiye Petrol Rafinerileri A.S. (Tupras)	EU Issued

DISCLAIMER

READ LESS

COPYRIGHT

nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any

security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Energy and Natural Resources Corporate Finance: Middle Markets

Corporate Finance Corporate Finance: Leveraged Finance Middle East

Asia-Pacific Europe Turkey