



## Fitch Assigns Tupras' USD-Denominated Bonds 'BBB-(EXP)' Rating

Fitch Ratings-London/Moscow-04 October 2017: Fitch Ratings has assigned Turkiye Petrol Rafinerileri A.S. (Tupras) planned dollar-denominated bond an expected foreign-currency senior unsecured rating of 'BBB-(EXP)'.

The final rating is contingent on the receipt of final documentation conforming materially to information already received and details regarding the amount and tenor.

Tupras has a Long-Term Foreign-Currency and a Long-Term Local-Currency Issuer Default Rating (IDR) of 'BBB-' and a National Long-Term Rating of 'AA+(tur)'. The Outlooks are Stable.

Fitch Ratings revised Tupras' Outlook to Stable from Negative in August 2017 reflecting Tupras' stronger operations following the completion of the Residuum Upgrade Project (RUP) in late 2015, better operating cash flows and our view that the company will maintain leverage broadly within our guidance on low capex intensity, albeit with high dividends. Turkish demand for refined oil products, in particular diesel fuel, remains strong and continues to grow. The political and economic situation in Turkey has stabilised and should not have a significant impact on Tupras.

### KEY RATING DRIVERS

**Projected Leverage Within Guidance:** Our forecasts show that Tupras should generate strong positive free cash flows (FCF) before dividends due to stable refining margins and low capital intensity, which gives it the flexibility to maintain leverage within our guidance for the 'BBB-' rating. In 2017-19, the company's capex-to-FFO should average 28%, compared to MOL's 83% and PKN's 71%. We expect that FFO adjusted net leverage will remain below 2.5x over this period despite its generous dividend policy. This level is broadly in line with the company's internal leverage targets.

Under Fitch's base case Tupras has little headroom to deviate from our expectations without the possibility of a negative rating action.

**Strong 1H17 Results:** Tupras reported strong 1H17 results due to favourable refining margins and the positive effect from the RUP, which remained idle for some time in 2016. In 1H17 Tupras' EBITDA reached TRY3 billion, up from TRY955 million 1H16. In 2H17 we expect margins to decrease and project EBITDA of around TRY4.9 billion in 2017 to moderate to around TRY4 billion per annum in 2018-20.

**High Complexity, Low Integration:** Tupras has a leading position in the Turkish oil refining market and operates some of the most complex set of refineries in EMEA. The RUP increased the company's yield and output of higher-margin "white" products, mainly diesel and gasoline. On the other hand, Tupras is focused on refining and has little vertical integration compared to MOL and PKN, which are diversified into upstream, petrochemicals and retail operations. This is partly mitigated by Tupras' 40% stake in Opet, the second-largest fuel retailer in Turkey. Lower integration increases Tupras' earnings volatility through the cycle.

**Rating Above the Sovereign:** In January 2017 we affirmed Tupras' IDR at 'BBB-' following the downgrade of Turkey's IDR to 'BB+' from 'BBB-'. The sovereign downgrade reflected primarily the country's political turbulence and slowing economy. Our decision to maintain Tupras' ratings above Turkey's was based on our observation that those developments had had a limited impact on the group's operations. We maintain this stance.

Higher lira volatility, a decrease in tourist arrivals, and slower GDP growth could weaken Tupras' results. However, domestic demand for oil products has so far proven resilient and performance has been supported by other key drivers such as prices for oil and refined oil products, and refining margins.

**FX Risk Limited:** Changes in fuel prices in Turkey reflect changes in foreign-exchange rates, which allow Tupras to pass most FX risk on to customers. Some risk remains, however, as a sharp deterioration in the Turkish lira towards the end of a reporting period may temporarily increase the company's leverage. To counter this, Tupras maintains ample liquidity, which should offset temporary leverage spikes.

**STAR Refinery Commissioning Credit Neutral:** The expected commissioning in 2019 of the SOCAR-led STAR refinery in Turkey should not have a material impact on Tupras' operations and is credit neutral. The Turkish market for diesel, Tupras' key product, should remain in deficit, so average realised product prices should not be adversely affected. The STAR refinery is constructed by

a consortium led by the State Oil Company of the Azerbaijan Republic (BB+/Negative) and is expected to have a capacity of 10m tpa.

Large Dividend Payouts Expected: In 2017-2020, we forecast dividends payments of 75% of net income calculated in accordance with IFRS, in line with the average for 2015-2016. This compares with Tupras' dividend policy of distributing up to 90% of net income (lowest of IFRS or local accounting) and assumes that the company will not return value to its shareholders to the detriment of its financial profile. In support of this view, Tupras did not pay dividends in 2015 as it was undergoing the capital-intensive RUP project and the company's results were impacted by falling oil prices due to the inventory effect.

Tupras' generous dividend policy constrains its rating, and much higher dividend payments leading to higher-than-expected leverage could result in a downgrade.

Shareholder Provides Flexibility: Tupras is controlled by Koc Holding, the largest industrial conglomerate in Turkey. Fitch does not rate Koc, and rates Tupras on a standalone basis. However, in our analysis we recognise that the shareholder may provide some flexibility to the company in case of necessity, eg through lower dividends and access to liquidity.

#### DERIVATION SUMMARY

Tupras has a leading position in the Turkish oil refining market and operates some of the most sophisticated refineries in EMEA following the completion of various capacity upgrade projects in 2015. Tupras has lower vertical integration than MOL Hungarian Oil and Gas (BBB-/Stable) or Poland's PKN Orlen (PKN, BBB-/Stable), but the coastal location of its two principal refineries allows it to actively manage crude feedstock supplies, contributing to higher and more stable margins. Tupras' leverage is higher than that of MOL and PKN due to high historical and projected dividends, but it has lower capital intensity than its peers.

#### KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for include:

- Mediterranean refining margins of USD3/bbl over the medium term, down from USD4/bbl in 2016-17, which is significantly below Tupras' expectations, ie, Med complex margin of USD4.5/bbl - USD5/bbl and Tupras' premium of USD1.5/bbl - USD2/bbl;
- USD/TRY exchange rate of around 3.7;
- low capital intensity following the completion of the RUP upgrade;
- dividend payout ratio at 75% of net IFRS profit;
- effective tax rate gradually increasing from 7% in 2016 to 15% by 2020 on utilisation of tax incentives.

#### RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

A positive rating action is unlikely as Tupras's rating is constrained by its lack of diversification into upstream/petrochemicals, and its asset concentration and focus on a single country.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

- FFO-adjusted net leverage consistently above 2.5x and FFO fixed charge cover well below 5x
- Consistently negative FCF
- Substantially higher capex or dividends leading to higher-than-expected leverage
- Turkey sovereign rating downgrade, or worse operating environment in the country

#### LIQUIDITY

Adequate Liquidity; Foreign-Currency Debt: At 30 June 2017, Tupras reported a cash balance of TRY4.4 billion (net of restricted cash) that covered short-term debt of TRY4 billion. This includes the EUR700 million (TRY2.5 billion at end-June 2017) Eurobond maturing in 2018. In addition, the company's liquidity is supported by multi-billion lira uncommitted credit lines from a number of Turkish and international banks and Fitch-forecast positive post-dividend FCF of TRY1.0 billion in 2017. The company has a track record of access to domestic and international banks and global capital markets.

Tupras' borrowings are predominantly denominated in dollars and euros, and only 12% are denominated in lira. The company manages the FX risk partly through natural hedges, with for example a large portion of its cash denominated in dollars and its raw material and refined product inventories are US dollar-linked, and partly through forward and other transactions with large international banks.

Large Related-Party Deposits: Tupras maintains large deposits with the related-party bank Yapi ve Kredi Bankasi A.S. (BBB-/Stable). These deposits amounted to TRY1.5 billion (35% of total) and TRY3.1 billion (62%) at 30 June 2017 and 31 December 2016, respectively.

Contact:

Principal Analyst  
Vladislav Nikolov  
Analyst  
+44 20 3530 1288

Supervisory Analyst  
Maxim Edelson  
Senior Director  
+7 495 956 9901  
Fitch Ratings CIS Ltd  
26 Valovaya Street  
Moscow 115054

Committee Chairperson  
Myriam Affri  
Senior Director  
+44 20 3530 1919

Date of Relevant Rating Committee: 14 August 2017

#### Summary of Financial Statement Adjustments -

- Accounts receivable factoring: we adjust Tupras' end-2016 debt by the amount of factored trade receivables of TRY1.6 billion (TRY0.8 billion at end-2015), deduct the difference in year-end balances from cash flows from operations and add it to cash flows from financing.
- Operating leases: we capitalise operating leases using a 5x multiple for Turkey. As a result, at end-2016 the company's adjusted debt increased by TRY99 million.
- Restricted cash: we classify TRY1.0 billion of cash as non-available or restricted.

Media Relations: Adrian Simpson, London, Tel: +44 203 530 1010, Email: [adrian.simpson@fitchratings.com](mailto:adrian.simpson@fitchratings.com).

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

#### **Applicable Criteria**

Corporate Rating Criteria (pub. 07 Aug 2017) (<https://www.fitchratings.com/site/re/901296>)

#### **Additional Disclosures**

Solicitation Status (<https://www.fitchratings.com/site/pr/1030195#solicitation>)

Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings)

(<https://www.fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM)

(<https://www.fitchratings.com>). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory) (<https://www.fitchratings.com/site/regulatory>). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE

FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2017 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the 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

#### **Solicitation Status**

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligator being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

**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 (<https://www.fitchratings.com/regulatory>) 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.