FitchRatings

RATING ACTION COMMENTARY

# Fitch Revises Tupras's Outlook to Stable from Negative; Affirms at 'B'

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Fitch Ratings - Warsaw - 14 Oct 2022: Fitch Ratings has revised the Outlook on Turkiye Petrol Rafinerileri A.S.'s (Tupras) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to Stable from Negative and affirmed the IDRs at 'B'.

The Outlook revision follows stronger credit profile of Tupras and the progress made in increasing export sales and cash holdings abroad. Tupras had reached a net cash position as of end-June 2022. Export sales accounts for 15% to 20% of its total sales and the UK trading subsidiary's cash holdings are increasing. The company's record of implementation of these financial and structural enhancements and conservative financial policy would support rating its Long-term Foreign-Currency IDR above Turkiye's Country Ceiling of 'B'. Currently, Tupras's Long-Term Local-Currency IDR of 'B' drives its Long-Term Foreign-Currency IDR.

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 ratings are volatile due to tight refining margins and the company's focus on fuels production with limited business integration. Similar to other Turkish corporates, Tupras relies on uninterrupted access to local bank funding to support its liquidity.

## KEY RATING DRIVERS

**Diesel Crack Spread Widens:** Tupras's diesel crack spread was USD35 a barrel (bbl) in 9M22, up from USD6/bbl in 9M21. The jet fuel crack spread rose to USD32/bbl from USD3/bbl, while the gasoline crack spread was USD22/bbl (USD11/bbl). Fitch believes that the diesel and jet fuel crack spreads are likely to remain elevated on lower export of products to Europe from Russia, which is to further decrease from February 2023 once EU sanctions on Russian fuel export come into effect. Higher refinery capacity utilisation and lower demand due to weaker GDP growth may be negative for gasoline and overall refining margins in the near term.

**Net Capacity Additions:** Following net global capacity closures of 300,000 bbl a day (bbl/d) in 2020 and 2021 combined, Tupras expects net additions of 400,000 bbl/d in 2022 followed by a stronger increase of 2.1 million bbl/d in 2023. Global refining market has been tight in 2022 on the back of increasing demand after the pandemic receded in most regions, earlier closures of refineries following a difficult 2020 and changes in global trade patterns due to the Russia-Ukraine war.

Fitch believes that additional capacity expected in 2023 is only likely to have more impact on global refining market balance in 2024 due to the likely delays and ramp-up issues in the new refineries given the complexity of starting a new plant.

**Turkish Market Still Growing:** Despite record high inflation and weak Turkish lira increasing pump prices, Turkish gasoline demand increased 17% yoy in 1H22. Jet fuel was up 48% and there was a fairly small 6% drop in sales of gasoline. The growing market is a key support for Tupras credit profile.

**Net Cash Position:** Good financial results in 1H22 and a cautious financial policy allowed Tupras to reduce leverage and move into a net cash position by end-June 2022. Fitch believes that with favourable results in 2H22, Tupras will maintain this net cash position for the rest of the year. We forecast that large dividend payment in 2023 from exceptional 2022 profits and normalisation of profitability in line with our rating through the cycle approach will see funds from operation (FFO) net leverage rising to average 3.0x in 2023-2025, albeit to still low levels for the rating.

**Low Capex, High Dividends:** Tupras has low maintenance 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 90% of net profit in dividends, but dividends in 2020-

2022 were effectively suspended due to market volatility. We expect dividend payouts to return to 80% of net profit from 2023, in line with the company's policy.

**Net Zero Emissions in 2050:** Tupras announced an update to its strategic plan in November 2021. It plans to 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 the targets as less ambitious compared to Tupras's European peers, while noting that demand dynamics for fuels in Turkiye appear to be more positive than in Europe until 2040 supporting Tupras's more cautious investment plans.

**Entek Acquisition Positive:** Tupras recently closed the acquisition of Entek Elektrik from related party Koc Holding. We view the transaction as long-term positive given Tupras's energy transition plans. The transaction was funded with new share issuance and therefore did not result in a cash outflow for Tupras. Entek's electricity is produced with natural gas (112MW), hydro (264MW) and wind generation (66MW) assets.

## DERIVATION SUMMARY

Tupras's closest EMEA peers are Polski Koncern Naftowy ORLEN S.A. (PKN) (PKN ORLEN; BBB-/Rating Watch Positive) and MOL Hungarian Oil and Gas Company Plc (BBB-/Negative). PKN's 894,000 bbl/d downstream capacity exceeds Tupras's 585,000 bbl/d. Moreover, PKN benefits from an integrated petrochemical segment, a large retail network and some exposure to upstream. PKN ORLEN plans to close its merger with Polskie Gornictwo Naftowe i Gazownictwo SA (PGNiG) (BBB/Stable) in November 2022, further increasing its scale and business diversification.

MOL's downstream capacity (417,000 bbl/d) is smaller than Tupras's, but its credit profile is stronger due to an integrated business profile with a 100,000 bbl/d of upstream production and sizeable fuel marketing and petrochemical operations that provides countercyclical cash flows.

Unlike MOL and PKN, 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 on a through the cycle basis is higher than that of MOL and PKN, but the company has lower capital intensity than its peers, as well as a lack of diversification.

## KEY ASSUMPTIONS

- Brent oil price of USD100/bbl in 2022, USD85/bbl in 2023, USD65/bbl in 2024, and USD53/bbl in 2025-2026.

- Strong refining margin in 2022 in line with 1H performance and normalised margin from 2023.

- Growing capex on increasing investment on ESG projects.

- No dividends in 2022 and 80% of net profit from 2023.

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 Rating 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:

-Longer record of maintaining structural enhancements in order to pierce Turkish Country Ceiling in line with Fitch's criteria.

-Maintenance of a conservative financial profile with FFO net leverage below 4.5x on a sustained basis.

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

-FFO net leverage consistently above 6.0x.

-Worsening liquidity.

-Consistently negative free cash flow (FCF).

## 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:** At end-2021, Tupras's liquidity profile was primarily represented by its unrestricted cash balance of TRY16.2 billion, of which TRY15.0 billion is time deposit with maturity less than a month. The liquid assets and solid FCF in 2022 are deemed sufficient to cover the short-term debt of TRY11.4 billion, adjusted for factoring and payable securitisation of TRY1.0 billion.

Nevertheless, the company's sizeable cash held at local banks in lira is contingent on credit risk of domestic banks and foreign-exchange transfer risk under the national economic crisis of Turkiye coupled with a highly unstable exchange rate. This is not uncommon among Turkish corporates but exposes the company to systemic liquidity risk. Tupras also keeps large deposits at a related-party, Yapi ve Kredi Bankasi A.S. (B-/Negative), of TRY7 billion at end-2021. We believe Tupras has not faced any difficulties in the past in accessing its liquidity buffer held in the 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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | RECOVERY | PRIOR |
|---|---|---|---|---|
| Turkiye Petrol Rafinerileri A.S. (Tupras) | LT IDR | B Rating Outlook Stable Affirmed | | B Rating Outlook Negative |
| | LC LT IDR | B Rating Outlook Stable Affirmed | | B Rating Outlook Negative |

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|---|---|---|---|---|---|
| | Natl LT<br><br>A(tur) Rating Outlook Stable<br><br>Affirmed | | | | A(tur) Rating Outlook Stable |
| senior unsecured | LT | B | Affirmed | RR4 | B |

VIEW ADDITIONAL RATING DETAILS

## FITCH RATINGS ANALYSTS

**Jakub Zasada**
Director
Primary Rating Analyst
+48 22 103 3022
jakub.zasada@fitchratings.com
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce
Krolewska 16, 00-103 Warsaw

**Jihwan Kim**
Associate Director
Secondary Rating Analyst
+49 69 768076 165
jihwan.kim@fitchratings.com

**Angelina Valavina**
Senior Director
Committee Chairperson
+44 20 3530 1314
angelina.valavina@fitchratings.com

## MEDIA CONTACTS

**Tahmina Pinnington-Mannan**
London
+44 20 3530 1128
tahmina.pinnington-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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## APPLICABLE CRITERIA

Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria (pub. 08 Jan 2021)

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

Corporate Rating Criteria (pub. 15 Oct 2021) (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), v8.0.3 (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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