FitchRatings

FITCH REVISES TUPRAS' OUTLOOK TO STABLE; AFFIRMS AT 'BBB-'

Fitch Ratings-London/Moscow-16 August 2017: Fitch Ratings has revised Turkiye Petrol Rafinerileri A.S.'s (Tupras) Outlook to Stable from Negative, while affirming its Long-Term Local- and Foreign-Currency Issuer Default Ratings (IDRs) at 'BBB-' and its National Long-Term Rating at 'AA+(tur)'. Tupras's USD700 million notes due in 2018 have been affirmed at 'BBB-'.

The Outlook stabilisation reflects 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 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.

We view Tupras' generous dividend policy as constraining 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 our rating case for the issuer 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's 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 hedge, eg, a large portion of its cash is 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.

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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.

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Additional information is available on 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