FitchRatings

Tagging Info

Fitch Affirms Tupras at 'BBB-'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-Warsaw/London/Moscow-15 January 2014: Fitch Ratings has affirmed Turkiye Petrol Rafinerileri A.S.'s (Tupras) Long-term local and foreign currency Issuer Default Ratings (IDRs) at 'BBB-' and its National Long-term rating at 'AA+(tur)'. Tupras's USD700m notes due in 2018 have been affirmed at 'BBB-'. The Outlooks are Stable.

The Stable Outlook reflects our forecast that in 2015 Tupras's credit metrics will return to levels commensurate with the 'BBB-' ratings, ie, funds from operations (FFO) net leverage of below 2.5x on a sustained basis. This is despite tight refining margins that should persist until at least 2015 and the adverse impact of the recent sharper-than-expected depreciation of the Turkish lira. We expect Tupras's credit metrics to have been stretched in 2013 and to remain so in 2014, ie, FFO adjusted net leverage of between 2.5x and 3x, as it completes the Residuum Upgrading Project (RUP) at the Izmit refinery, pays generous dividends and implements high capex until 2015, leaving limited rating headroom.

KEY RATING DRIVERS

Turkish Downstream Leader
Tupras's ratings are driven by its dominant downstream and marketing position in Turkey, where the company is presently the only oil refiner. It owns and operates all four existing oil refineries in Turkey (BBB-/Stable) and has a 59% share of Turkish oil products (2012 data). With its total refining capacity of 28.1 million metric tons (MT) at end-2012, the company is one of the largest downstream companies in Europe. In 2013, Tupras produced nearly 22.5MT of oil products, a 2.9% increase yoy, which are mainly supplied to the domestic market (80% of production volumes).

Tupras operates in the domestic fuel distribution market through its 40%-owned fuel distributor Opet Petrolculuk A.S. Its strong market position supports its financial profile. We expect that following the commissioning of the RUP in November 2014, Tupras will improve its EBITDA margins to about 4.5%, or levels reported in 2007-2011, from the 2.5%-3% forecast for 2013-2014. Refining is the main profit contributor for Tupras (88% of 2012 operating profit), with the remainder generated by the fuel distribution segment.

Foreign Exchange Risks until 2015
Tupras's RUP project loans are denominated in US dollars. A continued depreciation of TRY against the dollar could substantially worsen Tupras's credit ratios and may lead to a breach of loan covenants, in particular in 2014, when headroom under the covenants will be lowest. The 23% drop in the Turkish lira in 2013 to nearly 2.18 TRY for 1 USD highlights this risk. Fitch's updated sovereign forecast for TRY is 2.2 TRY for 1 USD in 2014 on average and 2.1 TRY for 1 USD in 2015 on average. We believe that Tupras's currency risk should diminish when the RUP becomes operational in 2015, ie, it starts generating US dollar-linked revenues and EBITDA.

Turkish Market Offers Growth Potential
Fitch sovereign analysts forecast Turkey's real GDP growth of 3.2% in 2014 and 3.8% in 2015, which we believe should translate into higher demand for oil products due to increasing domestic vehicle fleet and air travel.

Debt-Funded Capex
In 2008 Tupras began implementing the RUP to increase Izmit refinery's capacity to produce 3.5MT of light and

medium products that are compliant with Euro 5 standards. At end-3Q13, Tupras had spent USD2bn out of estimated USD2.7bn on the RUP, which was mainly funded by debt, and reported 85% overall project completion for the RUP. After the project completion, expected to be in November 2014, the Izmit refinery will increase the Nelson Complexity Index (a measure of refineries' technological sophistication) to 14.5 from 7.78 currently (based on design capacity). Tupras expects that the RUP will generate an additional USD550m per year in EBITDA at oil prices of USD85/bbl due to an improved product mix. We estimate Tupras's total capex in 2013-2016 at over TRY5.3bn, most of which is debt-funded.

Profit Margins and Working Capital Volatility
Tupras's refining margins have been under considerable pressure in 2012-2013, declining to about USD2.6/bbl in 9M13, from USD5.3/bbl in 2011. To mitigate the impact of declining margins, Tupras has extensively used vendor financing by agreeing more favourable payment terms with suppliers, in particular Iran, and utilising accounts receivable factoring on a non-recourse basis with the factoring companies of Turkish banks, thus decreasing its overall working capital needs. In our rating case, we expect that Tupras's refining margins will remain under pressure until at least 2015 when the RUP becomes fully operational. We also expect Tupras to continue optimising its working capital but until it can demonstrate consistent operational profitability, the ratings would see little upside.

Replacing Iranian Oil is no Longer a Priority
In November 2013, the US State Department extended six-month Iran sanctions waivers to Turkey, among other countries, in exchange for their reduced purchases of Iranian crude oil earlier this year. Under the Geneva accord signed that month, the U.S. and five other countries agreed to suspend efforts to further reduce Iran's crude oil sales, allowing consuming countries to continue buying their 'current average amounts of crude oil'. In 9M13, Iraq became Tupras's principal crude oil source by supplying nearly 28% of its crude oil, while Iran supplied 25% of Tupras's total crude, down from 45% in 2011. Tupras's favourable location and coastal refineries give it access to a variety of crude sources.

Impact of Receivables Factoring
Tupras's trade receivables subject to factoring were TRY1.7bn at end-3Q13, up from TRY1.5bn at end-2012. If the factoring amounts were included into Tupras's indebtedness, its FFO adjusted net leverage would have reached 2x in 2012 and about 4x in 2013-2014 before improving to under 2.5x in 2015. Tupras has factoring limits mainly with Yapi Kredi Factoring, a subsidiary of Yapi ve Kredi Bankasi A.S. (BBB/Stable), a related party 50/50 owned by Koc Holding A.S, Tupras's controlling shareholder, and UniCredit S.p.A. (BBB+/Negative), as well as with Garanti Factoring, a subsidiary of Turkiye Garanti Bankasi A.S. (BBB/Stable) and Is Factoring, a subsidiary of Turkiye Is Bankasi A.S. (BBB/Stable).

Large Dividends to Continue
Tupras's ratings are constrained by its generous dividend policy, which is unlikely to change over the rating horizon, despite negative free cash flow. Tupras pays out around 90% of its net profit or 100% of distributable income, or the maximum allowed under the Turkish law. Fitch expects Tupras to continue its generous dividend policy at least until 2014 because its 51%-shareholder Enerji Yatirimlari A.S. needs to repay the remaining USD331m (end-2013 data) of acquisition-related debt in 2014-2015.

RATING SENSITIVITIES

Negative: Future developments that could lead to negative rating action include:
-Failure to improve credit ratios to levels commensurate with the 'BBB-' ratings in 2015, ie, FFO-adjusted net leverage of below 2.5x and FFO fixed charge cover well above 5x
-Substantial delays in the RUP completion, even though we see this risk as less likely given that the RUP was 85% complete at end-2013
-Substantially higher capex due to an expansion into upstream in 2014, leading to slower-than- expected deleveraging
- Negative rating action on the sovereign and / or substantial further devaluation of Turkish lira beyond Fitch's expectations.

A positive rating action is currently unlikely given the company's constrained business profile as a pure downstream and marketing company and the limited leverage headroom at the current ratings.

LIQUIDITY AND DEBT STRUCTURE

Sufficient Liquidity
Tupras's end-3Q13 cash balances of TRY3.8bn more than covered TRY2bn in short-term debt. Tupras maintains significant amounts of deposits with related Yapi Kredi - TRY1.9bn at end-3Q13. Nearly 97% of Tupras's deposits were denominated in USD at end-3Q13.

USD-Denominated Borrowings
Tupras's debt consists mainly of three 2011 loans to finance the RUP and USD700m 4.125% coupon bonds due November 2018 (36% of total debt at end-3Q13). The USD1.1bn loan insured by CESCE and the USD624m loan insured by SACE have 12 years to maturity with no principal and interest repayments in the grace period of 2012-2016. The USD359m loan has seven years to maturity with no principal repayments in the first four years. In total, Tupras has drawn USD1.59bn at end-3Q13 to finance loan insurance payments and capex (nearly USD1.1bn at end-2012). RUP loans accounted for 46% of total debt at end-3Q13.

At end-Q313 Tupras had unused uncommitted credit facilities of USD8.7bn (excluding lines related to factoring).

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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 Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage', dated 5 August 2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage
2014 Outlook: EMEA Oil and Gas

Additional Disclosure
Solicitation Status