

## Fitch Affirms Tupras at 'BBB-'; Outlook Stable [Ratings](#) [Endorsement Policy](#)

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Fitch Ratings-London/Warsaw-12 January 2015: 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 2016 Tupras's credit metrics will return to levels commensurate with the 'BBB-' ratings on a sustained basis, ie, funds from operations (FFO) adjusted net leverage of below 2.5x. Tupras's credit metrics were stretched in 2013 and 2014 and are likely to remain elevated in 2015, ie, FFO adjusted net leverage of between 2.5x and 3x, as it completes the Residuum upgrading project (RUP).

### KEY RATING DRIVERS

RUP Completed in November 2014

In November 2014 Tupras completed the modernisation of the Izmit refinery with RUP consisting of a vacuum distillation, delayed coker and hydrocracker units, which will increase production of white products by 3.5 million tonnes. Tupras expects production from new units to start in 1Q15. We view the completion of the project in time and on budget as positive to the credit profile. The output of lower-margin products will be lower, while Tupras will increase production of white products generating higher margins. The completion of RUP also marks an end to a capex-intensive period. We expect investments of approximately USD0.2bn annually from 2015 and gradual deleveraging to ratios commensurate with the ratings from 2016.

### Turkish Downstream Leader

Tupras's ratings are driven by its dominant downstream and marketing position in Turkey, where the company is presently the sole oil refiner. It owns and operates all four existing oil refineries in Turkey (BBB-/Stable) and has a 59% share of Turkish oil products. With its total refining capacity of 28.1 million metric tons (MT), the company is one of the largest downstream companies in Europe. In 2014, Tupras produced nearly 20.1MT of oil products, a 5% decrease yoy, which were 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 the now completed RUP at the Izmit refinery will allow Tupras to improve its EBITDA margins to about 5%, as reported in 2007-2011, from 2.7% in 2013.

### Easing Margin Pressure in 2H14

Tupras's refining margins came under considerable pressure in 2013 and 1H14, declining to about USD1.1/bbl in 1H14 (down 40% yoy). This was due to the still high imports of fuel products into Europe from the US and overcapacity in the European refining sector, but increasingly also due to stronger competition from refineries in the Middle East, coupled with muted demand in China and India. Declining oil prices in 2H14 led to a sharp increase in refining margins and we expect Tupras to report improved performance in 2014 compared with 2013 (excluding the effect of inventory revaluation). Better profitability and working capital inflows due to lower oil prices will improve Tupras's leverage, although it would still have remained above our guidance in 2014.

### European Refining Sector

The structural problems of the European refining sector have yet to be fully addressed. The US, Russian and Middle Eastern refineries remain keenly competitive due to a mix of lower feedstock prices and/or beneficial taxation, and continue to expand capacity. At the same time improved engine efficiency and still weak GDP growth result in declining European fuel consumption. European refining capacity shrank 0.9mbbl/d in 2011-2013 and further closures are expected. Reduction of refining capacity in Europe is progressing more slowly than expected, making a return to supply-demand balance more distant.

### Lower Foreign Exchange Risks

Tupras's RUP project loans are denominated in USD. A depreciation of TRY against the USD worsens Tupras's credit ratios, especially in case of a sudden lira depreciation towards the end of its financial year period. We forecast TRY to average 2.25 for 1 USD in 2015 and 2.33 in 2016. We believe that Tupras's currency risk will be lower once the output from assets constructed under RUP adds US dollar-linked revenues and EBITDA. Tupras also plans to increase its TRY-denominated debt exposure by issuing up to TRY1bn in bonds and to hedge its foreign exchange exposure with forward and swap contracts.

### 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-2014, Tupras had spent USD2.9bn out of estimated USD3bn on the RUP, which was mainly funded by debt. Following the completion of RUP, 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 due to an improved product mix.

#### High Leverage

High capex was the primary reason for the deterioration in Tupras's credit metrics. If factoring amounts are included into Tupras's indebtedness (TRY2.3bn at end-2014, up from TRY1.6bn at end-2013), FFO adjusted net leverage is expected to have reached 3.8x in 2014. We had earlier expected Tupras to deleverage to below 2.5x in 2015; we expect it to be close to 2.5x in 2015 but not below it until 2016. The company was in compliance with covenants for its RUP loans in 1H14 and we expect this to have remained the same as of end-2014 following improved performance in 2H14. We also view the risk of a covenant breach as significantly lower as the output of higher value products contributes to EBITDA and cash flows.

#### 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 2016, ie, FFO-adjusted net leverage (adjusted for factoring of trade accounts receivables) of below 2.5x (2013: 3.9x) and FFO fixed charge cover well above 5x (2013: 4.1x)
- Substantially higher capex leading to slower-than- expected deleveraging
- Negative rating action on the sovereign and / or substantial further devaluation of the Turkish lira beyond Fitch's expectations
- Weaker-than-expected refining margins, for example, due to increased competition from Middle Eastern refiners and/or depressed global demand

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

Tupras's cash balances at end-3Q14 of TRY3.7bn more than covered TRY0.8bn in short-term debt. Tupras also maintained a large balance of available, unused credit lines, but these were mainly uncommitted. Approximately 44% of total cash at end-September 2014 related to USD-denominated balances and were held primarily in related-party Yapi ve Kredi Bankasi A.S. (BBB/Negative).

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Applicable criteria, 'Corporate Rating Methodology', dated 28 May 2014, are available at [www.fitchratings.com](http://www.fitchratings.com).

#### **Applicable Criteria and Related Research:**

[Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage](#)

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