

FITCH AFFIRMS TUPRAS AT 'BBB-'; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-28 January 2016: Fitch Ratings has affirmed Turkiye Petrol Rafinerileri A.S.'s (Tupras) Long-term local and foreign currency Issuer Default Ratings (IDRs) at 'BBB-' and National Long-term rating at 'AA+(tur)'. The Outlooks are Stable. Tupras's USD700m notes due in 2018 have been affirmed at 'BBB-'.

The affirmation reflects Tupras's leading position in the Turkish oil refining and marketing sector and favourable crude oil purchase costs and product slate, as well as the expected improvement in credit metrics following the completion of the Izmit refinery upgrade. The ratings are constrained by the refining sector cyclicity, the company's generous dividend policy and sales concentration in a single, albeit growing, market (Turkey, BBB-/Stable).

KEY RATING DRIVERS

RUP Completed and Operational

In November 2014, Tupras completed the modernisation of the Izmit refinery with the Residuum Upgrading Project (RUP) consisting of a vacuum distillation, delayed coker and hydrocracker units. New units became fully operational in May 2015 and are expected to increase production of higher margin white products by 3.5 million tonnes, which is positive for the company's credit profile. The completion of RUP also marks the end of a capex-intensive period. We expect investments of up to USD300m annually from 2016, which will help Tupras maintain leverage ratios within our guidance.

Favourable Refining Environment

Tupras's net refining margins in 9M15 increased to USD6.89/bbl (USD2.71/bbl in 9M2014), in line with the improved European refining environment, but also due to higher capacity utilisation (99.5% in 9M2015 vs. 72.6% in 9M2014) and a better product slate with white products accounting for 75% of total production (73% in 9M2014). Fitch expects refining margins to moderate in 2016 from the highs of 2015, but they are unlikely to revisit the lows of 2H13 and 1H14, due to depressed oil prices supporting demand for fuel and lower cost of oil for refineries' own consumption.

Oversupply in Europe to Return

The longer-term outlook for the Europe's refining sector is more uncertain. Excess refining capacity, structural decline in fuel consumption because of growing engine efficiency and environmental policies, and stronger competition from new refineries in the Middle East are likely to put pressure on the European refining sector in the medium to long term.

Competition in Crude to Benefit European Refiners

The lifting of the US ban on oil exports in December 2015 resulted in Brent-WTI differential collapsing, which improved the competitiveness of European refining companies versus their US peers. We expect the Brent-WTI differential to remain null on average over the rating horizon.

We forecast that thanks to the coastal location of two of its main refineries, Tupras will benefit from higher pricing differentials between various crude blends following lifting of Iranian sanctions. The company had been a large buyer of Iranian crude in the past, but was forced to scale down purchases between 2012 and 2015. In addition, higher competition for lower-grade crudes has already resulted in higher differentials, with Urals to Brent discount exceeding USD2.5/bbl in 4Q2015, compared with USD1-1.5/bbl over the past few years.

Growing Turkish Fuel Market

Tupras's ratings are supported by the growing Turkish fuel market. Sales of diesel, jet fuel and gasoline in 8M2015 increased by 17%, 11% and 9% yoy, respectively. We expect that growing vehicle park and air traffic will further support fuel market growth in Turkey over the rating horizon, while a diesel shortage will remain in place. In 2014, net diesel imports to Turkey were 12.7 million tons and therefore the additional production coming from Tupras and the new refinery currently constructed in Turkey by the State Oil Company of the Azerbaijan Republic (SOCAR, BBB-/Stable) post-2018 will not be enough to balance the market.

Leverage Back in Line with Guidance

The construction of RUP pushed Tupras's funds from operations (FFO) adjusted net leverage above our rating guidance of 2.5x in 2013 and 2014. We forecast that in 2015 the company's leverage was under 2.5x, and it will average 2.0x in the next four years as Tupras's RUP loans amortise over time and its capital intensity falls.

Manageable Foreign Exchange Risk

Tupras's foreign exchange risk is manageable. The company's dollar-denominated EBITDA and operating cash flows are not significantly affected by the USD/TRY exchange rate as domestic fuel prices are tied to the dollar. Tupras's debt, including the RUP loans, are also mainly in dollars. However, a sharp depreciation of TRY against USD may affect Tupras's credit ratios in a particular year, especially if it happens towards the year-end. We forecast USD/TRY at 2.9 in 2016 and at 3.15 in 2017-19.

KEY ASSUMPTIONS

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

- Mediterranean refining margins moderating from USD4.8/bbl in 2015 to USD3 in 2016 and USD2.5 in 2017-19.
- Improved profitability, refining complexity and throughput on the back of the RUP modernisation project completion in 2015.
- Falling capital intensity.
- Dividends sufficient to cover the parent Enerji Yatirimlari's acquisition loan with maturities in 2016 and 2017.

RATING SENSITIVITIES

Negative: Future developments that could lead to negative rating action include:

- FFO-adjusted net leverage (adjusted for factoring of trade accounts receivable) consistently above 2.5x (2015E: 2.1x) and FFO fixed charge cover well above 5x (2015E: 12x).
- Substantially higher capex and/or dividends leading to higher-than-expected leverage.
- Negative rating action on the sovereign.
- Weaker than expected refining margins (e.g. Mediterranean refining margins consistently below USD2.5/bbl).

Positive rating action is currently unlikely given the company's concentrated business profile and the limited leverage headroom at the current ratings.

LIQUIDITY

Uncommitted Credit Lines, Positive FCF Improve Liquidity

At end-September 2015 Tupras's cash balance TRY1.7bn (excluding blocked balances) just covered its short-term debt of TRY1.7bn. In addition, the company's liquidity is supported by a significant amount of uncommitted credit lines and our expectation of positive free cash flow (FCF) in 2016. The company has access to both domestic and international banks, as well as the international bond market.

Factoring Increases Leverage

Tupras's receivables factoring amounts are included into the company's indebtedness according to Fitch's methodology. At end-September 2015 the company's balance of factored trade receivables was TRY0.7bn (TRY2.3bn at end-2014), compared with its net balance sheet debt of TRY9.1bn.

Contacts:

Principal Analyst
Dmitry Marinchenko, ACCA
Associate Director
+44 20 3530 1056

Supervisory Analyst
Jakub Zasada, ACCA
Director
+48 22 338 6295
Fitch Polska SA
Krolewska 16,
00-103, Warsaw

Committee Chair
Maxim Edelson
Senior Director
+7 495 956 9901

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email:
peter.fitzpatrick@fitchratings.com.

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 (pub. 17 Aug 2015)

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