FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Tupras to 'BB-'; Outlook Stable

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Fitch Ratings - London - 01 Jul 2024: Fitch Ratings has upgraded Turkiye Petrol Rafinerileri A.S.'s (Tupras) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs), and senior unsecured rating to 'BB-' from 'B+'. The Outlooks on the Long-term IDRs are Stable. The Recovery Rating is 'RR4'.

The Foreign-Currency (FC) IDR exceeds Turkiye's Country Ceiling of 'B+' by one notch, reflecting Tupras's ample readily accessible offshore hard-currency liquidity. The company has also demonstrated a record in maintaining offshore structural enhancements.

The upgrade reflects Tupras's record of sustaining a conservative financial profile, a net cash position and low Fitch-projected leverage following solid results in 2022-2023, strong projected pre-dividend free cash flow (FCF) despite normalising margins, and a gradually improving operating environment in Turkiye. We forecast EBITDA gross leverage to fluctuate around 1x.

Tupras's business profile benefits from its leadership in the Turkish refined product market, the operation of some of the most complex sets of refineries in EMEA, and its ability to access and process cheaper, heavier, and sour crudes from several suppliers.

The ratings incorporate Tupras's focus on refining operations and the inherent volatility of refining margins, limited vertical integration, high exposure to the domestic market, and a still challenging operating environment in Turkiye. Similar to other Turkish corporates, the company is exposed to local bank funding. While Tupras continues to hold substantial cash balances offshore in foreign banks, a significant part of its accumulated cash balances is kept in local banks.

KEY RATING DRIVERS

Low Leverage, Strong Cash Flows: In 2023, Tupras generated very strong EBITDA (which Fitch calculates at USD2.7 billion) and post-dividend FCF of USD1.6 billion, and its cash balances were around twice as high as its total debt. We expect earnings to moderate as refining margins normalise. We forecast negative FCF generation for 2024 and 2025, due to large working capital (WC) outflows and, potentially, high dividends. However, we expect that Tupras will remain conservatively leveraged, with projected EBITDA gross and net leverage averaging 1.1x and 0.1x, respectively, in 2024-2027. Tupras's target of net debt below 2x EBITDA is also consistent with the rating.

Temporarily Weaker Interest Coverage: We project that Tupras's EBITDA interest coverage could temporarily fall below 4x in 2025 due to high interest rates in Turkiye, before it normalises at 4x-5x in 2026-2027. This projection is based on the assumption that Tupras will refinance a significant share of its short-term debt in the local market.

One Notch Above Country Ceiling: Tupras's offshore structural enhancements, represented by cash held abroad, support a sufficient hard currency debt-service coverage ratio for 2024-2027, allowing the FC IDR to be one notch above the Country Ceiling in line with Fitch's Corporate Rating Criteria (Exceeding the Country Ceiling section). We expect the offshore cash balance to remain fairly stable over 2024-2028 and for the company to consistently apply this financial policy.

Predominantly Domestic Sales: In 2023, Tupras sold around 80% of its oil products in Turkiye; its export capacity is fairly modest. It is the leading refiner in Turkiye. Prices in the domestic market closely follow international benchmarks and are hence effectively linked to the US dollar, though customers are billed in the local currency. Proceeds in liras, however, can almost be instantly exchanged into hard currencies, which the company uses to purchase crude oil. Our assessment of Tupras's credit profile considers a fairly weak operating environment in Turkiye and regulatory risks. Tupras is considering geographical diversification through a trading division in the UK and some power projects outside of Turkiye.

Focus on Refining: Tupras operates four refineries in Turkiye and has a total refining capacity of around 650 thousand barrels of oil per day (kbbl/d), which is higher than that of its similarly rated peers in North America. Its largest refinery in Izmit has a Nelson complexity index of 14.5, making it one of the most complex assets in EMEA. Tupras has access to various crude types and can process cheaper crudes, which positively affects its margins. However, Tupras lacks meaningful vertical integration and is more exposed to volatile refining margins than its integrated higher-rated EMEA peers.

Low Maintenance Capex: Tupras's maintenance capex requirements are low (less than USD200 million per annum). We assume Tupras's capex will stabilise at around USD350 million per annum in 2025-2027, including its energy-transition projects, after peaking at USD500 million in 2024, in line with the company's guidance. This compares with

Fitch-projected EBITDA of around USD1.2 billion per annum on average in 2024-2027 and suggests fairly strong pre-dividend FCF generation despite normalising margins.

High Dividends: Historically, Tupras has paid 80% of net profit in dividends, though dividends in 2020-2022 were effectively suspended due to market volatility before being resumed in 2023. We expect dividend payouts to be 80% of net profit from 2024, in line with the company's policy.

Refining Margins Could Moderate: European refining margins have been extremely strong since early 2022, though there are some signs of moderation that could intensify on the back of substantial global capacity additions in 2024-2025. Wide crack spreads were supported by the re-routing of Russian crude and oil products from Europe. We rate refining companies on a through-the-cycle basis and assume margins will moderate further, closer to their mid-cycle levels. We project Tupras's net unit margins (estimated as the downstream EBITDA to throughput) to moderate to around USD5/bbl in 2025-2027 from around USD13/bbl in 2022-2023.

DERIVATION SUMMARY

Tupras's closest peers in EMEA are Compania Espanola de Petroleos, S.A. (CEPSA; BBB-/Stable) and MOL Hungarian Oil and Gas Company Plc (MOL; BBB-/Stable). These two peers have stronger business profiles, benefiting from vertical integration into upstream, fuel marketing, and petrochemicals, which make their cash flows more stable through the cycle. CEPSA and MOL also operate in a better operating environment than Tupras and are more geographically diversified. Both are fairly conservatively leveraged.

Tupras's global peers include CVR Energy, Inc. (BB-/Stable) and Par Pacific Holdings, Inc. (B+/Stable), operating in North America. Both have lower downstream capacity compared with Tupras and lower projected through-the-cycle EBITDA but also operate in a better operating environment.

Tupras's projected net leverage is significantly lower than any of its peers' due to very strong refining margins in Europe in 2022-2023 and strong accumulated cash balances; however, Tupras's rating also reflects its weaker financial flexibility due to its traditional reliance on the domestic banking system and tightening coverage ratios on the back of high interest rates in Turkiye at present.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

-- Brent oil price in line with Fitch's price deck

-- Refining margins trending towards mid-cycle levels from 2024

-- Capex peaking at USD500 million in 2024, and moderating to USD350 million a year for 2025-2027

-- Large total dividend paid in 2024 based on the strong performance in 2023; 80% of net profit for 2024-2027 in line with Tupras's financial policy

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Strengthening of Tupras's business profile

-- EBITDA net leverage and EBITDA gross leverage consistently below 1x and 1.5x, respectively, supported by continued adherence to a conservative financial policy

-- EBITDA interest coverage above 4x on a sustained basis

-- Upward revision of Turkiye's Country Ceiling could be positive for the FC IDR, provided its hard currency debt service coverage ratio remains above 1.5x on a sustained basis, in combination with other factors

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

-- EBITDA net leverage and EBITDA gross leverage consistently above 2x and 2.5x

-- Evidence of a less conservative financial policy

-- EBITDA interest coverage below 3x

-- Worsening liquidity

-- Consistently negative FCF

-- A downward revision of Turkiye's Country Ceiling or a weakening of Tupras's hard currency debt service coverage ratio below 1.5x on a sustained basis could be negative for the FC IDR

LIQUIDITY AND DEBT STRUCTURE

Strong Immediate Liquidity: Tupras's immediate liquidity is strong. As of 31 March 2024, Tupras's cash balance, adjusted for the dividend paid out in April, was around USD2.2 billion versus reported short-term debt of around USD1.7 billion, including an USD700 million Eurobond due in October 2024. Tupras has the flexibility to either repay the bond from its accumulated cash balances or via refinancing.

Our assessment of Tupras's financial flexibility also takes into account its exposure to the local economy, given its traditional reliance on short-term funding provided by domestic banks.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍		RECOVERY ⬍	PRIOR ⬍

Turkiye Petrol Rafinerileri A.S. (Tupras)	LT IDR BB- Rating Outlook Stable Upgrade			B+ Rating Outlook Stable
	LC LT IDR BB- Rating Outlook Stable Upgrade			B+ Rating Outlook Stable
	Natl LT AAA(tur) Rating Outlook Stable Affirmed			AAA(tur) Rat Outlook Stable
senior unsecured	LT BB- Upgrade		RR4	B+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 14 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

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