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## Fitch Affirms Petroperu's Long-Term Foreign and Local Currency IDRs at 'BBB+'; Outlook Negative

Fitch Ratings - Chicago - 27 May 2021: Fitch Ratings has affirmed Petroleos del Peru - Petroperu S.A.'s (Petroperu) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDR) at 'BBB+'. The rating action affects USD3 billion of outstanding notes rated 'BBB+'. The Rating Outlook is Negative.

As a state-owned company, Petroperu's ratings are equalized with Peru's Sovereign Rating (BBB+/Negative). The ratings reflect its close linkage with Peru's ratings, due to its strong government ownership and control, and the very strong incentives to support the company, as it is one of the country's largest liquid fuels suppliers, and its strategic importance to maintaining the country's energy supply.

Fitch has revised Petroperu's Standalone Credit Profile (SCP) to 'b-' from 'b'. Absent the support and ownership from the Peruvian Government, the SCP reflects the long-term rating if the company were not owned by the state. The revision reflects Petroperu's slow deleveraged metrics derived from delays in the construction of PMRT's high complexity new refinery.

### Key Rating Drivers

**Government Support:** Petroperu's ratings reflect its close linkage with Peru's ratings, due to strong government ownership and control, and the very strong incentives to support the company, as it is one of Peru's largest liquid fuels suppliers. Petroperu has five refineries and approximately 100,000 barrels per day (mbpd) of throughput capacity. The government of Peru is currently Petroperu's only shareholder. The company's credit linkage to the sovereign is further evidenced by the explicit support it receives from the government through a financial guarantee for up to USD1 billion to assist Petroperu in case of financial distress as a result of PMRT's financing.

The ratings reflect the Peruvian government's strong incentives to support Petroperu in the event of financial distress. The company secures the oil supply at the national level, representing an approximate 45% market share in the domestic fuel market, combined with a strategic role in the energy supply chain to distribute and commercialize fuel nationwide.

**Low Stand-Alone Credit Profile:** Absent implicit and explicit Peruvian government support, Fitch assesses Petroperu's credit profile on a stand-alone basis, commensurate with a 'b-' rating category. As of December 2020, financial metrics deteriorated compared with YE 2019, Petroperu's gross debt/EBITDA reached to 33.5x from 11.8x, mainly explained by lower sales due to the pandemic restrictions,

combined with additional debt to finance PMRT's construction. Fitch estimates Petroperu will maintain a structural debt above USD5.0 billion over the rating horizon, with average leverage metrics in the range of 15.0x during 2021-2023, still high for the rating category.

**Operational Cash Flow Volatility:** Petroperu's cash flow generation is sensitive to changes in oil prices and certain operational interruptions to its transportation business. Fitch anticipates this trend will continue during 2021 until mid-2022, while the new Talara refinery is under construction and EBITDA margins improve after expected operations commence by the end of 2021, and gradually optimizing the refining process by the second half of 2022. Cash flow from operations (CFFO) is projected to be positive through the rating horizon, while FCF is expected to be negative following the company's aggressive capex investments. Once PMRT is completed with the latest timing and calibration guidelines, significant changes to Petroperu's cash flow generation profile are unlikely before 2022.

**Regulatory Risk:** The company is exposed to changes in the Peruvian Technical Decree, which is the primary catalyst for PMRT. During 2010, the prohibition of commercializing diesel with more than 50ppm of sulfur in Lima and Callao, was extended to other regions. This norm, combined with other factors, affected Petroperu's costs, reducing gross profit margins from around 15% to or below, 9% after the implementation of the regulation. Consequently, it became necessary for the company to invest approximately USD5 billion, primarily for PMRT's expansion into a high complexity new refinery.

Petroperu has an ESG Relevance Score of '4' for Governance Structure, due to its nature as a majority government-owned entity and the inherent governance risk that arise with a dominant state shareholder. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The score reflects its ownership by the Peruvian government, the company's strong strategic ties with the state, and its strategic importance to maintaining the country's energy supply. As a state-owned company, Petroperu's ratings are strongly linked with the credit profile of the Peruvian sovereign, and reflects the sovereign's incentive to provide financial support to the company, given its strategic importance for the country. The company is 100% owned by the Peruvian government, through the Ministry of Energy and Mines (60%) and the Ministry of Economy and Finance (40%).

## **Derivation Summary**

Petroperu's rating linkage to the Peruvian sovereign rating is in line with the linkage present for most national oil and gas companies (NOCs) in the region, including Empresa Nacional de Petroleo (ENAP; A-/Stable), YPF S.A. (CCC), Ecopetrol S.A. (BBB-/Negative) and Petroleo Brasileiro S.A. (Petrobras; BB-/Negative).

In most cases in the region, NOCs are of significant strategic importance for energy supply to their countries, and a default could have potentially negative social and financial implications at a national level. Similar to its peers, Petroperu has strong legal ties to the government, through its majority

ownership and strong operational control.

Petroperu's ratings also reflect the company's strong domestic market position, with 45% of the country's refining output. The ratings are constrained by Petroperu's weak capital structure and exposure to political interference risk.

## Key Assumptions

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

--Continuous implicit support, if needed, from the government given the company's strategic importance;

--Fitch's Brent oil price at \$58 per barrel (bbl) in 2021, and long-term prices at \$53/bbl;

--PMRT total cost of approximately USD5.7 billion (including financial expenses), considering an equity contribution from the Peruvian Government of USD325 million, and the remaining portion finance with debt;

--Roll over of short-term working capital facilities;

--PMRT completed by the end of 2021, with full calibration by mid-2022 reaching refining crack spreads in the range of USD11 to USD12 per barrel.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

A positive rating action on the Peruvian sovereign could lead to a positive rating action on Petroperu.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of Peru's sovereign rating;

--Additional overrun costs or significant delays from Fitch`s assumptions on PMRT's construction not met with Government support that would lower Petroperu's SCP to 'ccc' category from its current 'b-' level, will result in a negative rating action;

--A sustained deterioration of Petroperu's financial flexibility, combined with government inaction to support the company`s liquidity restricting the access to capital markets.

## Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade

scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## Liquidity and Debt Structure

**Adequate Liquidity:** Petroperu's liquidity position is supported by cash on hand and manageable short-term maturities, which are mostly related to uncommitted working capital financing for more than USD3.0 billion, of which the company has approximately USD2.3 billion available. As of December 2020, Petroperu reported cash on hand of USD84 million and short-term financial debt totaled USD1.01 billion, which Fitch expects will be rolled over. With the reopening of the 2047 notes for USD1.0 billion in February 2021, there is no expectation to require additional debt to finance the PMRT's capex.

## 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.

## ESG Considerations

Petroleos del Peru - Petroperu S.A. has an ESG Relevance Score of '4' for Governance Structure due to its nature as a majority government-owned entity and the inherent governance risk that arise with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

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### Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
Petroleos del Peru - Petroperu S.A.	LT IDR	BBB+	Affirmed	BBB+
	LC LT IDR	BBB+	Affirmed	BBB+
• senior unsecured	LT	BBB+	Affirmed	BBB+

### RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

### Applicable Criteria

[Corporate Rating Criteria \(pub.21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[Government-Related Entities Rating Criteria \(pub.30 Sep 2020\)](#)

[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub.30 Apr 2021\)](#)

## Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 [\(1\)](#)

## Additional Disclosures

[Solicitation Status](#)

## Endorsement Status

Petroleos del Peru - Petroperu S.A. EU Endorsed, UK Endorsed

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