

Research Update:

# Petroperu S.A. Rating Lowered To 'BB' From 'BB+' On Weaker Liquidity, Still On CreditWatch Negative

April 27, 2022

## Rating Action Overview

- In our view, Peruvian government-owned refiner and fuels supplier Petroleos del Peru S.A's (Petroperu or the company) liquidity and financial flexibility have weakened, and we expect them to remain under pressure in the short term as the plan to address the pending audit on its 2021 financial statements materializes and the government implements initiatives to support the company's liquidity.
- Therefore, on April 27, 2022, S&P Global Ratings lowered its global scale foreign currency rating on Petroperu to 'BB' from 'BB+', mainly reflecting that we revised downward our liquidity assessment to weak, which resulted in a revision of Petroperu's stand-alone credit profile (SACP) to 'b-' from 'b'. We also kept our view of the likelihood of government support as very high, which is a key rating component that provides four notches of uplift to the final rating.
- We kept the ratings on CreditWatch with negative implications, capturing our view that there's a chance we could downgrade the company multiple notches in the next 90 days depending on the execution of its plan to address the 2021 audit, which is ongoing. We also consider the need to obtain the waivers from the bondholders and Cesce and to secure the funds for the payment of the first installment for Cesce credit facility in June 2022, considering Petroperu's stretched liquidity.

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## Rating Action Rationale

**We revised our liquidity assessment to weak from less than adequate and removed our positive comparative ratings adjustment (CRA) that previously reflected Petroperu's higher financial flexibility than those of its peers in the same rating category.** On April 5, Petroperu announced the appointment of a new board and key management positions, including a new CEO and CFO. Following these changes, we reviewed topics such as liquidity, the audit process, and government support with the new management team and the Ministry of Finance.

Considering the latest developments, including the delay in the execution of the plan to address the still pending 2021 audited financials and the deterioration of the working capital balances resulting from shorter payment terms for oil imports in the first quarter, we concluded that

Petroperu's liquidity and financial flexibility have weakened since our last publication (refer to "Petroperu Rating Lowered To 'BB+' From 'BBB-' And Placed On CreditWatch Negative On Higher Governance Risk," March 15, 2022) and is no longer commensurate with our less than adequate liquidity assessment.

More importantly, we expect liquidity may remain under pressure in the short term while the plan to address the pending audit materializes, including the waiver negotiations, and while the initiatives to support the company's liquidity are effectively implemented (including, for example, securing the funds for the repayment to Cesce in June 2022).

Our previous rating action considered the company's liquidity as less than adequate given the availability of significant short-term facilities, the recovery of Petroperu's financial performance in 2021, the steady EBITDA expectations for 2022, and the support Petroperu has historically received from the financial community even during the pandemic. However, as of today, with no other audit firms lined up as alternatives and with the agreement with the auditor PricewaterhouseCoopers (PwC) still pending, we note that the company's uncommitted short-term facilities dropped to \$2.7 billion from \$3.0 billion between February 2022 and April 20, 2022. We also see a higher use rate of the facilities, which increased to 53% from 33%. This pressures our liquidity ratio, which shows a material deficit. (refer to Liquidity below for further details).

Finally, we removed the positive comparative rating adjustment. In the past, we included this positive adjustment on the rating to reflect the company's relative strength compared with regional peers due to the ongoing government support. We saw examples of support to Petroperu more frequently than for peers such as ENAP or ANCAP, the government-owned refineries in Chile and Uruguay, respectively. However, we now don't think that such a differential compared to peers is sufficiently justified. In our view, more effective ongoing support and oversight from the government would have prevented the events affecting Petroperu from happening. Therefore, we removed the positive CRA.

**The plan to address the audit remains in place, although it's been delayed by the appointment of new management.** The company expects to announce the agreement with PwC (the auditor) soon, but no other audit firms presented offers. However, at this stage the target date for Petroperu to release its audited statements is no longer on June 15 as initially proposed, but July 15 at the earliest or even early August, based on the latest information provided by the management team. Once the agreement is signed, we expect the company and its financial advisor to officially launch a consent solicitation to waive the breaches related to the bonds and Cesce documentation.

**We maintain our assessment of a very high likelihood of extraordinary support from the government.** In our view, there's still a very high likelihood that the company will benefit from extraordinary support from the government in the event of financial distress and to avoid a default in payment. We base this assessment on the company's very important role in Peru's energy matrix. We also think Petroperu has a very strong link to the government. The latter is involved in key investment decisions and gives authorization to conduct significant investments and approval to raise debt. In addition, in the past, the government did show signs of support, and currently has various initiatives to support Petroperu under consideration.

Petroperu's government shareholders have reaffirmed their intention to support the company, especially after the recent appointment of new management. They confirmed that Petroperu is a strategic asset for the country and fulfills a critical role in the fuel supply, which is why they plan to take the necessary measures to avoid a payment default of the company.

We will continue to monitor the relationship between Petroperu and the Peruvian government, including the latter's incentives, capacity, and tools to support the company, particularly in the uncertain global economic context and company-specific conditions, which at the moment are very stressed.

## **CreditWatch**

The CreditWatch negative reflects a 50% chance of a further downgrade in the next three months related to the uncertainties around the timely execution of the plan to address the 2021 audit. These uncertainties include the need to finally appoint an auditor (already delayed from the original plan), the need for a waiver consent to avoid a technical default, the uncertainty of effectively getting a clean and unqualified audit by July 15 at the earliest, and the pressure all this is putting on the company's liquidity.

We could lower the ratings on Petroperu if the company doesn't address the audit of its 2021 statements satisfactorily, further hurting liquidity. For example, if the company eventually incurs an event of default, it could potentially result in a debt acceleration, and its access to credit and capital markets would be further weakened. In this scenario, we could consider the company's capital structure as unsustainable, which could lead to a multi-notch downgrade.

We could also downgrade Petroperu to 'BB-' or below if the likelihood of government support diminishes while other credit factors remain unchanged. That could occur, for example, if we see the government pulling back from the stated clear intention to support Petroperu to avoid a payment default.

We could assign a stable outlook if the company presents to the market all necessary waivers to prevent an event of default from being declared, together with releasing its unqualified 2021 audited financial statements in line with its plan, while servicing the Cesce facility in June. In this scenario, we would also expect evidence of the maintenance of short-term credit facilities, which we typically consider a key part of our liquidity assessment for Petroperu.

Although unlikely at this stage, we could upgrade Petroperu if our view of the likelihood of extraordinary support increases, for example, if the company's role to the government--or link to it--rises. On the same grounds, we could also raise the ratings if we were to revise our liquidity assessment back to less than adequate or if we were to revise upward our management and governance assessment. The latter would require our view of a tangible track record that the company has strengthened its capacity to identify, anticipate, and more effectively control critical risks like the timely delivery of financial statements.

## **Liquidity**

We revised our liquidity assessment to weak from less than adequate because the company's sources to uses of cash indicates a material deficit in the next 12 months.

Our liquidity assessment also incorporates qualitative factors, like, for example, the need to get approval for a comprehensive covenants waiver and to secure the funds for the payment to Cesce in June 2022, as discussed above in our rating action rationale. In addition, we perceive that the company's standing in credit markets has further weakened during the last couple of months due to the context described above. This is despite that we acknowledge that there are initiatives from the government to gradually restore the company's liquidity.

Primary liquidity sources:

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- Cash and equivalents of \$240 million as of December 2021; and
- Funds from operations of \$220 million-\$240 million for the next 12 months.

### Primary liquidity uses:

- Short-term debt maturities of \$824 million that consist mainly of drawings under the short-term uncommitted credit facilities as of December 2021 and the first \$144 million payment due under the Cesce facility;
- Negative working capital changes estimated for 2022 of \$400 million-\$500 million that incorporates a reduction in average payables to capture working capital mismatches during the first quarter of 2022; and
- Total capital expenditures of about \$500 million (including a balance not executed in 2021 for the Talara refinery).

## ESG credit indicators: E-4, S-2, G-5

### Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

### Ratings List

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### Downgraded

	To	From
<b>Petroleos del Peru Petroperu S.A.</b>		
Issuer Credit Rating	BB/Watch Neg/--	BB+/Watch Neg/--

### Downgraded; CreditWatch/Outlook Action

	To	From
<b>Petroleos del Peru Petroperu S.A.</b>		
Senior Unsecured	BB/Watch Neg	BB+

	To	From
<b>Petroleos del Peru Petroperu S.A.</b>		
Analytical Factors	b-	b

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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