

**RATING ACTION COMMENTARY**

# **Fitch Downgrades Petroperu to 'BB+'; Maintains Rating Watch Negative**

Tue 06 Sep, 2022 - 15:53 ET

Fitch Ratings - New York - 06 Sep 2022: Fitch Ratings has downgraded Petroleos del Peru - Petroperu S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) to 'BB+' from 'BBB-'. Fitch has also downgraded Petroperu's senior unsecured notes to 'BB+' from 'BBB-'. The Rating Watch Negative (RWN) has been maintained.

The downgrade to 'BB+' and revised Standalone Credit Profile (SCP) to ccc- from ccc reflects a weakening in Petroperu's liquidity, persistent high leverage, insufficient government support, and uncertainty pertaining to its ability to maintain its credit lines. Petroperu has publicly disclosed in its unaudited financials a cash position of USD32 million, as of June 30, 2022, which Fitch deems to be inadequate.

Further, the company disclosed that USD1.2 billion of its USD2.9 billion of uncommitted revolving credit lines are under review with lenders; in June 2022, the government extended a USD750 million intercompany loan, which has a grace period to repay principal and interest through August 2024, to support the company. Fitch views this support as necessary but falls short in providing the liquidity buffer the company needs for working capital and debt service.

The RWN has been maintained to reflect uncertainty regarding the company's ability to provide audited financials for year-end 2021 by the end of September, and the uncertainty regarding its ability to maintain its USD1.8 billion of revolving credit lines, which Fitch's deems as crucial for the company.

## KEY RATING DRIVERS

**Government Related Entity:** Petroperu's ratings are linked with the sovereign's through Fitch's GRE criteria. The company is rated on a top-down-minus-two basis due to a lowering of its GRE assessment score from 35 to 27.5 as a result of the downward revision of the financial implications of a default from 'strong' to 'moderate' and support track record from 'strong' to 'moderate.' These factors coupled with a more than four notch differential between the SCP and that of the sovereign rating, resulted in a 'BB+' rating.

Status, Ownership and Control designation has remained as 'very strong.' Petroperu is 100% owned by the Peruvian government, through the Ministry of Energy and Mines (60%) and the Ministry of Economy and Finance (40%). The downward revision of the support track record to moderate reflects Fitch's view that recent government support was inadequate and did not strengthen the company's weak liquidity position and address its elevated leverage, both of which are deemed unsustainable. The government extended an intercompany loan with a grace period through August 2024, but this does not constitute strong support. Fitch views an equity injection, capitalization of its loan, and/or further government guarantee of Petroperu's debt as favorable and will likely strengthen the support and track record score.

**High Leverage:** Petroperu's gross debt/EBITDA is estimated to have declined to around 14.0x during 2021 from 24x in 2020, primarily due to a rebound in sales during 2021. Fitch estimates Petroperu will maintain a structural debt close to USD5.0 billion during the next two years. Gross leverage is projected to be close to 8.0x in 2022 before falling to around 5.3x during 2023 as the Talara Refinery ramps up.

**Operational Cash Flow Volatility:** Petroperu's cash flow generation is sensitive to changes in oil prices. Since Peru is a net importer of crude, elevated oil prices result in a compression of its profit margins. Operational interruptions to its transportation business, including disruptions related to the actions of local communities, further exacerbate cash flow volatility. Petroperu's cash flow volatility experienced in 2021 has continued into 2022. The completion of the Talara refinery will dramatically lower capex for the company past 2022; it will also increase operational efficiency, and predictable crack spreads should translate into stronger EBITDA margins over the rating horizon.

**Regulatory Risk:** Petroperu is exposed to changes in the Peruvian Technical Decree. In 2010 the prohibition of commercializing diesel with more than 50ppm of sulphur in Lima and Callao was extended to other regions. This restriction, 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. It became necessary for the

company to invest approximately USD5 billion, primarily for PMRT's expansion into a highly complex new refinery.

ESG - Financial Transparency: Petroperu has an ESG Relevance Score of '5' for Financial Transparency, reflecting the governance issues and weakness related to financial transparency as evidenced by the delay in the financial audit of YE statements, and its strained relationship with the auditing firm. ESG Relevance Scores of 5 are highly relevant credit considerations and impact the rating on an individual basis.

## **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. (BB+/Stable) and Petroleo Brasileiro S.A. (Petrobras; BB-/Stable).

In Latin America most 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. Like its peers, Petroperu has 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 35% of the country's refining output. The ratings are constrained by its weak capital structure and exposure to political interference risk.

## **KEY ASSUMPTIONS**

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

--Fitch's Brent oil price at \$105 per barrel (bbl) in 2022, \$85/bbl in 2023, \$65/bbl in 2024, and long-term prices at \$53/bbl;

--PMRT total cost of approximately USD5.3 billion (excluding 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 to be completed by mid-2022, fully operational by the end of 2022, and generating refining crack spreads in the range of USD10 per barrel.

## **RATING SENSITIVITIES**

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

-- A positive rating action of the Peruvian sovereign could lead to a positive rating action on Petroperu;

-- An upgrade can be considered if government does a capital injection, capitalizes its loans, and/or guarantees a greater portion of Petroperu's debt;

-- Fitch may consider a resolution of the RWN once the company provides 2021 year-end qualified audited financial statements and there is greater confidence pertaining to its ability to maintain lines of credit.

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

--A downgrade of Peru's sovereign rating;

-- A sustained deterioration of Petroperu's financial flexibility, combined with government inaction to support the company's liquidity, potentially resulting from continued negative FCF or a material reduction of cash on hand, credit facilities and restricted capital markets access.

## **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**

**Deteriorated Liquidity:** As of June 2022, Petroperu reported USD32 million in cash on hand, compared with the USD240 million registered during December 2021. The company has revolving credit lines for up to USD2.9 billion, out of which USD1.2 billion is currently under review by financial institutions, and short-term financial debt totaling USD 965 million.

## **ISSUER PROFILE**

Petroperu is a Peruvian state-owned petroleum company under private law and dedicated to transportation, refining, distribution and marketing of fuels and other petroleum-derived products.

## **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 '5' for Financial Transparency due to delay in providing audited financial statements, which has a negative impact on the credit profile, and is highly relevant to the rating, resulting in an implicitly lower rating, which in combination with other factors resulted in further decoupling from the sovereign rating and thus a rating downgrade. .

Petroleos del Peru - Petroperu S.A. has an ESG Relevance Score of '4' for Management Strategy 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.

Petroleos del Peru - Petroperu S.A. has an ESG Relevance Score of '4' for Group 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.

Petroleos del Peru - Petroperu S.A. has an ESG Relevance Score of '4' for Governance Structure due to the ongoing issues with the production of its audited financial statements, 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)

## **RATING ACTIONS**

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Petroleos del Peru - Petroperu S.A.	LT IDR    BB+ Rating Watch Negative  Downgrade	BBB- Rating Watch Negative
	LC LT IDR    BB+ Rating Watch Negative  Downgrade	BBB- Rating Watch Negative
senior unsecured	LT    BB+ Rating Watch Negative  Downgrade	BBB- Rating Watch Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

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

[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub. 15 Jul 2022\)](#)

**APPLICABLE MODELS**

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

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Petroleos del Peru - Petroperu S.A.

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