

RATING ACTION COMMENTARY

Fitch Downgrades Petroperu to 'B+'; Outlook Remains Negative

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Fitch Ratings - New York - 31 Jan 2024: Fitch Ratings has downgraded Petroleos del Peru - Petroperu S.A.'s (Petroperu) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B+' from 'BB+'. Fitch has also downgraded the rating of Petroperu's senior unsecured notes to 'B+' from 'BB+'. The standalone credit profile (SCP) remains at 'ccc-'. The Rating Outlook remains Negative.

The multiple notch downgrade reflects the change in the government-related entity (GRE) assessment score from 32.5 to 25, as a result of the Precedent of Support factor reassessment to Not Applicable from Strong. Per Fitch's Government-Related Entities Rating Criteria, Petroperu is now rated on a bottom-ups +5 basis compared to the previous TD-3, due to the lowering of the GRE assessment score coupled with the 10-notch rating differential between the sovereign rating and the SCP. The reassessment was triggered by Peru's (BBB/Negative) government explicit announcement that it will not support Petroperu in a manner that is sufficient to modify the company's weak capital structure. The Negative Outlook is aligned with that of the sovereign and further reflects concerns pertaining to the company's weak liquidity profile and capital needs in the next year.

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 bottom-ups +5 basis due to a GRE assessment score of 25- category D. These factors, coupled with a 10-notch differential between the SCP and the sovereign rating, resulted in a 'B+' rating.

The GRE criteria covers four factors. 1) Decision Making and Oversight, which was rated '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%), with robust and frequent oversight; 2) Precedents of Support, assessed as Not Applicable, which reflects how the government's record of assistance has only addressed immediate needs for the continuation of the company's operations, but not for the long-term improvement of capital structure; 3) Preservation of Provision of Public Service or Sovereignty or Strategic Assets, deemed Strong as a Petroperu default would have a direct material impact on national access to fuels; 4) Contagion Risk, rated as 'Strong' as Petroperu is high profile for its government, given its role and status; its default is likely to disrupt access to (or cost of) financing for the government or its other GREs.

Additional Government Support is Needed: Fitch does not expect the national government will support Petroperu in a way that is meaningful to its capital structural in the near term. In 2022, support was provided to address Petroperu's immediate liquidity needs, but none of these measures alleviated the structural issue of high indebtedness. Operational issues with the timing of the Talara Refinery and the cash demands of the ramp-up resulted in further cash needs for 2024, that the government will need to fund. However, the message thus far has been unclear with a request of USD2.5 billion by Petroperu followed by a non-committal government response.

Fitch believes that further support is needed, as high debt levels persist in an environment of compressing refining margins. Elevated leverage, which is deemed unsustainable, was not fully addressed as debt repayment is not expected with the funds provided, and the support from the government has been coming when the company faces severe liquidity constraints and needs imminent support.

High Leverage: Petroperu's projected gross debt/EBITDA for 2023 is estimated to be negative. Fitch estimates Petroperu will maintain structural debt averaging USD5.7 billion during at least the next two years. Absent government measures for debt repayment, gross leverage is projected to be 8.8x in 2024 before falling to around 7.0x during 2026 as the production of the Talara Refinery reaches favorable commercial and financially viable operations. The ramp-up proved costly, demanding a high volume of crude which, due to global market conditions, was imported at high prices impacting the company's already weak liquidity and leverage.

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. Petroperu's cash flow volatility experienced in 2021 and 2022 continued into 2023. The completion of the Talara Refinery should lower capex for the company past 2023, and will also increase operational efficiency. Predictable crack spreads should translate into stronger EBITDA margins over the rating horizon, but favorable operational metrics will be insufficient to drastically improve credit metrics given the heavy financial burden accumulated by Petroperu in the last two years.

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.

KEY ASSUMPTIONS

--Fitch's Brent oil price at USD82 per barrel (bbl) in 2023, USD80/bbl in 2024, USD70/bbl in 2025, and long-term prices at USD60/bbl;

--Domestic sales of 74 kbb/d in 2023, 93 kbb/d in 2024, and 115 kbb/d long term;

--Talara Refinery achieving commercial production in 2024, achieving crack spreads of USD10 per barrel in 2024, USD12 in 2025, and USD15 long term;

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

--Average capex of USD290 million per year through the rating horizon.

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 the government makes a capital injection that improves the company credit profile, capitalizes its loans, and/or guarantees a greater portion of Petroperu's debt to materially improve leverage metrics.

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.

LIQUIDITY AND DEBT STRUCTURE

Deteriorated Liquidity: As of November 2023, Petroperu reported USD55 million in cash on hand, compared with the USD89 million registered in December 2022, and USD71 million at the end of 3Q23. At December 2023, the company has revolving credit lines for up to USD3.5 billion, out of which USD865 is currently unavailable and under evaluation by different banks due to ESG concerns and USD410 million are under review. Out of bank lines, USD 1.1 billion are utilized, leaving availability of USD250 million.

ISSUER PROFILE

Petroleos del Peru S.A. (Petroperu) is a Peruvian state-owned petroleum company under private law and dedicated to oil production, transportation, refining, distribution and marketing of fuels and other petroleum-derived products. Refineries are located at Talara, Iquitos and Conchan.

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 Management Strategy due to its nature as a majority government-owned entity and the inherent governance risk that arises with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the rating[s] 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 arises with a dominant state shareholder, which has a negative impact on the credit

profile, and is relevant to the rating[s] in conjunction with other factors.

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 arises with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

Petroleos del Peru - Petroperu S.A. has an ESG Relevance Score of '4' for Financial Transparency due to a history of delayed delivery of audited financial statements, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

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 ↕			PRIOR ↕
Petroleos del Peru - Petroperu S.A.	LT IDR	B+ Rating Outlook Negative	Downgrade	BB+ Rating Outlook Negative
	LC LT IDR	B+ Rating Outlook Negative	Downgrade	BB+ Rating Outlook Negative
senior unsecured	LT	B+	Downgrade	BB+

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Adriana Eraso

Director

Primary Rating Analyst

+1 646 582 4572

adriana.eraso@fitchratings.com

Fitch Ratings, Inc.

Hearst Tower 300 W. 57th Street New York, NY 10019

Jose Ramon Rio

Director

Secondary Rating Analyst

+56 2 3321 2915

joseramon.rio@fitchratings.com

Saverio Minervini

Managing Director

Committee Chairperson

+1 212 908 0364

saverio.minervini@fitchratings.com

MEDIA CONTACTS

Jaqueline Carvalho

Rio de Janeiro

+55 21 4503 2623

jaqueline.carvalho@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

Government-Related Entities Rating Criteria (pub. 12 Jan 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)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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Petroleos del Peru - Petroperu S.A.

EU Endorsed, UK Endorsed

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