

RATING ACTION COMMENTARY

Fitch Affirms Petroperu's Ratings at 'BB+'; Outlook Negative

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Fitch Ratings - New York - 02 Mar 2023: Fitch Ratings has affirmed Petroleos del Peru - Petroperu S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) at 'BB+'. Fitch has also affirmed the rating of Petroperu's senior unsecured notes at 'BB+'. The Negative Rating Watch has been removed and the Rating Outlook is Negative.

Petroperu's ratings reflect its moderate linkage to Peru's (BBB/Negative) credit quality coupled with a weak Standalone Credit Profile (SCP), which Fitch believes is commensurate with a 'ccc-' SCP reflected by its persistently weak liquidity, higher working capital needs and high leverage estimated to average 4.8x over the rated horizon.

The Negative Watch was removed given the company published its audited financials for year-end 2021 and obtained a consent from bonds holders to avoid an event of default, due to its failure to provide audited financial, preventing an acceleration of its debt. The Negative Outlook mirrors that of the sovereign Outlook, given its ratings are tied to the sovereign.

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 GRE assessment score of 32.5. These factors, coupled with a more than four notch differential between the SCP and the sovereign rating, resulted in a 'BB+' rating.

The GRE criteria covers four factors. Status, Ownership and Control which was rated '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%). Support Track Record and Expectations was assessed as moderate, which reflects Fitch's view that despite recent actions from the government to support the company, the track record shows irregularity and action was taken only as a measure of last resort to ensure national energy security, and not to address balance sheet issues of the company long-term. Elevated leverage, which is deemed unsustainable, was not fully addressed as no debt was repaid with the funds made available, and the support from the government came as severe liquidity issues were imminent and the country's fuel supply was at risk. Socio-Political and Financial Implications of Default, factors and both were assessed as Strong reflecting the significance of the company as a provider of key economic and public service activity, and the impact on the credit quality of the sovereign in an event of default of the corporate.

Additional Government Support is Needed: The federal government took some actions in 2022 to support the company and address its immediate liquidity needs, but none of these measures alleviated the structural issue of high indebtedness. The government support amounted to USD2.4 billion, comprising of a USD1.0 billion capital injection, a guarantee of up to USD500 million for commercial letters of credit, USD150 million in refunds from the price stabilization fund, and the extension of a USD750 million intercompany loan, which has a grace period to repay principal and interest through August 2024.

Fitch views this support as positive, but still considers that further support is needed, as high debt levels persist. Elevated leverage, which is deemed unsustainable, was not fully addressed as no debt was repaid with the funds provided, and the support from the government came when the company faced a severe liquidity constrain and needed imminent support in order to procure fuel for the country, to avoid an energy shortage.

High Leverage: Petroperu's projected gross debt/EBITDA for 2022 is estimated to be negative. Fitch estimates Petroperu will maintain a structural debt close to USD5.0 billion during at least the next two years. Gross leverage is projected to be 7.0x in 2023 before falling to around 4.3x during 2024 as the calibration of the Talara Refinery concludes and it reaches favorable commercial and financially viable operations. Thus far, the calibration has proven costly, demanding a high volume of crude which, due to global market conditions, has been 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. 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 continued into 2022. The completion of the Talara refinery should lower capex for the company past 2023. It will also increase operational efficiency, and predictable crack spreads should translate into stronger EBITDA margins over the rating horizon.

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 Key Assumptions Within the Rating Case for the Issuer

--Fitch's Brent oil price at USD100 per barrel (bbl) in 2022, USD85/bbl in 2023, USD65/bbl in 2024, and long-term prices at USD53/bbl;

--Domestic sales of 102 kbbls in 2023, 115 kbbls in 2024, and 120 kbbls long term;

--PMRT achieving commercial production in 2023, achieving crack spreads of USD25 per barrel in 2024;

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

--Average capex of USD350 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;

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 December 2022, Petroperu reported USD89 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 USD868 million.

ISSUER PROFILE

Petroleos del Peru S.A. (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. 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 Financial Transparency, revised from a '5' as the issues with the delayed audited statements were resolved and the documents were delivered.

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

RATING ACTIONS

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

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

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

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub. 28 Oct 2022\)](#)

[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)

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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Petroleos del Peru - Petroperu S.A.

EU Endorsed, UK Endorsed

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