

Research Update:

Petroleos del Peru Petroperu S.A. Downgraded To 'B', Placed On CreditWatch Negative On Heightened Vulnerabilities

May 28, 2024

Rating Action Overview

- In May 2024, the board of directors of Petroleos del Peru Petroperu S.A. (Petroperu) released a statement underscoring the company's fragile operational and financial conditions and \$2.2 billion in support it has requested to the government. This comes after several years of support and persistent weakness in Petroperu as well as the announcement of an operational issue with the flexicoking unit at its Talara refinery, compromising the expected recovery in EBITDA in 2024. While we believe that the government will step in to avoid a default in the short term, we also believe the growing challenges in addressing Petroperu's difficulties weigh as a contingent liability, creating uncertainty about its future policies toward restoring the company's financial sustainability.
- In parallel, the company will negotiate with creditors on another waiver related to the potential delay of the audit on its 2023 financial statements, due on May 31, 2024 (excluding cure period). If the audit isn't waived or cured, this could result in an event of default and potential debt acceleration. This, together with the uncertainty around Talara's operations due to the stoppage of the flexicoking unit, resulted in a reduction by more than half of the company's original expected EBITDA for 2024, as well as further deterioration in our view of its liquidity.
- Therefore, S&P Global Ratings lowered its ratings on Petroperu to 'B' from 'B+' and placed the rating on CreditWatch with negative implications. We also revised downward the company's stand-alone credit profile (SACP) to 'ccc' from 'ccc+', reflecting further deterioration in expected cash flow. We also reassessed our view of the company's likelihood of government support to high from very high and its link to the government to strong from very strong, reflecting our belief that the latter has shifted negatively.
- The placement of the rating on CreditWatch negative captures our view that we could lower our rating on Petroperu to 'B-' or lower in the next three months, based on the company's need to obtain a waiver consent to avoid a technical default due to its delay in obtaining the audited statements.

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Rating Action Rationale

We revised our SACP downward to 'ccc', capturing the stand-alone deterioration and our expectation of lower cash flows generation. We believe Petroperu's operating and financial condition has weakened as a result of unexpected issues and a consequent stoppage at one of Talara's units. The company had stated that the refinery was fully operational by Dec. 31, 2023, but this unexpected stoppage of the flexicoking unit, announced in April 2024 and lasting until June 30, if not longer, has weakened EBITDA and cash flows for 2024. This has delayed to 2025 the so much expected recovery in EBITDA, exacerbating Petroperu's liquidity stress and compromising its already weak working capital position. We believe the 'ccc' SACP better reflects our view of the creditworthiness of the company on a stand-alone basis, which is now even more dependent on government support to avoid a default in payments over the next 12 months.

We have revised our assessment of extraordinary government support to high from very high. Recent developments have raised questions about the government's link with Petroperu, although at this stage we still expect the government to intervene to avoid a payment default. Our view is based on the track record of support, recent public confirmation from the Ministry of Finance (MEF), and our understanding that a default in the company would have material social, economic and reputational impacts for the Peruvian government.

The government has a track record of supporting the company, and we have noted the materialization of such support on various occasions since Petroperu's crisis began in early 2022. These measures were essential for maintaining business continuity and instrumental in preserving the country's fuel supply while avoiding a default. However, in our view, these measures haven't addressed the company's unsustainable capital structure, its operational deficiencies, or its scarce liquidity, and haven't restored market confidence. After more than two years since crisis erupted, we believe there is very little visibility on how Petroperu will address its crisis and on management's effectiveness in doing so.

Our view of the likelihood of support incorporates such qualitative factors as:

- Our belief that there are more uncertainties on the government's ability to implement sustainable corrective measures in a context of persistent vulnerabilities.
- Although Petroperu is fully owned by the government (Ministry of Energy and MEF), concerns about effective governance persist. The company is increasingly dependent on government support.
- Complicated politics around support, and injecting more money into the company widely perceived as inefficient in a context of a government with limited political capital and popular support.

We will continue to monitor the relationship between Petroperu and the government, including the latter's incentives, capacity, timing, and tools for supporting the company, particularly if there are complications in receiving a waiver for the audit or if the Talara stoppage persists through 2024.

If the information covenant isn't waived, it would constitute an EoD under the terms and conditions of the existing debts, which could result in debt acceleration. As in 2022 and 2023, in 2024 Petroperu will likely miss the deadline to release its previous-year audited financial statements (2023), as required by its bonds agreement and its credit agreement with Compañía Española de Seguros de Crédito a la Exportación (CESCE), which is 150 days from closing. The

company would negotiate a waiver to avoid a technical breach of the documentation covenant. If it doesn't obtain a waiver, this would represent an EoD on the two main funding sources for the Talara refinery project (the international bonds and the CESCE facility), which could potentially result in debt acceleration, also cascading to other short-term uncommitted bank facilities in case of nonpayment due to the cross-default clauses.

In the past, Petroperu managed to obtain the necessary waivers. However, at this stage, given the events commented in this report (noted above), the new setbacks at Talara (with the resulting much weaker performance in 2024), and new uncertainties surrounding the audit (e.g., timeliness, and the valuation of Talara), this exercise appears to be more challenging, as we believe the market's appetite for continuing to support the company has potentially eroded over the last two years.

CreditWatch

The placement on CreditWatch negative reflects that there's a chance we could lower our rating on Petroperu in the next three months. A lowered rating would be related to the company's need to obtain a waiver consent to avoid a technical default due to its delay in obtaining the audited statements. If, for any reason, the waiver is not granted, it could result in an EoD and debt acceleration. The placement on CreditWatch also reflects the possibility of a longer stoppage at Talara well into the second half of 2024, which could exacerbate the company's liquidity crunch.

We could also lower our ratings on Petroperu if we believe the company hasn't satisfactorily addressed the audit of its 2023 statements, and an EoD is therefore declared, causing a potential debt acceleration scenario. We could also lower our rating on the company if we revise downward our view of its likelihood of government support.

We could remove the rating from CreditWatch and assign a stable outlook if the company obtains the necessary waivers to prevent an EoD from being declared, along with it releasing its unqualified 2023 audited financial statements, and if our view of government support remains unchanged.

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Petroleos del Peru Petroperu S.A.		
Issuer Credit Rating	B/Watch Neg/--	B+/Stable/--
Petroleos del Peru Petroperu S.A.		
Senior Unsecured	B/Watch Neg	B+

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