FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Petroperu to 'CCC+'

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Fitch Ratings - New York - 21 May 2024: Fitch Ratings has downgraded Petroleos del Peru - Petroperu S.A.'s (Petroperu) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'CCC+' from 'B+'. Fitch has also downgraded the rating of Petroperu's senior unsecured notes to 'CCC+' from 'B+', and revised Petroperu's Standalone Credit Profile (SCP) to 'cc' from 'ccc-'.

The downgrade to a 'CCC+' rating is the result of a revision in the government-related entity (GRE) criteria, which was driven by two key developments: the revision of the SCP from 'ccc-' to 'cc', and the adjustment of the GRE score. Fitch's evaluation indicates that, when assessed on a standalone basis, default of some kind appears probable due to liquidity constraints, which supports its placement in the 'cc' rating category.

Additionally, the "Preservation of Government Policy Role" factor previously rated as 'strong' has been reclassified to 'not applicable,' which has led to a decrease in the GRE score from 25 to 15, moderate expectation of support. Consequently, this change has reduced the uplift derived from the GRE criteria from a previous +5 to a current +3.

This reassessment is underpinned by Petroperu's significant loss of market share, which plummeted from 45% to 25%. This decline underscores the availability of alternative sources for the country to obtain refined products, suggesting a reduced reliance on Petroperu for this purpose.

KEY RATING DRIVERS

GRE Criteria Application: Petroperu's ratings are linked with the sovereign's through Fitch's GRE criteria. The company is rated on a bottom-ups +3 basis due to a GRE assessment score of 15-category E, moderate expectation of support. These factors, coupled with a 11-notch differential between the SCP and the sovereign rating, resulted in a 'CCC+' rating.

The GRE criteria incorporates 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 (40%) and the Ministry of Economy and Finance (60%), with 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 as Not Applicable as the loss of market share from 45% to 25% has resulted in minimal disruption, contrary to expectations, and access to imported fuels continues to be a viable alternative; 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.

Constrained Liquidity: Petroperu faces a severe liquidity crunch as the cash forecasted to be generated within the year will not suffice to cover its debt repayments. Consequently, the company is compelled to depend extensively on external funding sources to prevent defaulting. Fitch has projected an EBITDA of $119 million for 2024 against debt repayments amounting to $175 million. According to Fitch's analysis, the company is experiencing a monthly cash burn rate of about $200 million during this period, while its refinery remains non-operational. This leads to an anticipated cash shortfall of $280 million, even after receiving an $800 million loan disbursed earlier in the year, evidencing a liquidity strain that could result in a default-like event reflective of a 'cc' rating.

Limited Visibility on Additional Government Support: Fitch does not anticipate substantial support from the national government for Petroperu's capital structure in the short term. While the government provided liquidity in 2022 to meet immediate requirements, these measures did not address the fundamental problem of high indebtedness. Operational challenges related to the completion timeline of the Talara Refinery and the cash demands of its ramp-up have led to further financial needs that the company will need to get fulfilled from external sources in 2024.

Petroperu has requested $2.5 billion from the government, which has been met with a tepid response—a loan of $800 million from Banco de la Nación and an increase in the existing guarantees to $1.0 billion from $500 million. These steps address immediate liquidity issues but do not resolve the structural deficiencies in the balance sheet.

Unsustainable Capital Structure: Without significant governmental support, Fitch forecasts Petroperu's gross debt/EBITDA ratio to approach 50x. With EBITDA estimated at $120 million and total debt predicted to surpass $5.6 billion, the structural debt is expected to average around $5.7 billion over the next two years. In the absence of government intervention for debt repayment, Fitch projects the gross leverage to reach 12x in 2025, potentially decreasing to approximately 9.5x in 2026 as the Talara Refinery begins to operate commercially and achieve financial viability. The ramp-up phase has been costly, necessitating the importation of high volumes of crude at elevated prices due to global market conditions, which further weakened the company's liquidity and leverage.

DERIVATION SUMMARY

Petroperu's rating linkage to the Peruvian sovereign rating is weaker than that of most national oil and gas companies (NOCs) in the region, including Empresa Nacional del 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/barrel (bbl) in 2023, USD80/bbl in 2024, USD70/bbl in 2025 and long-term prices at USD60/bbl;

--Domestic sales of 74,000 bbl/day in 2023, 93,000 bbl/day in 2024 and 115,000 bbl/day long term;

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

--Impact of FCK unit shut down of $200 million to EBITDA;

--Rollover 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

--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 Fitch-defined default process has commenced.

LIQUIDITY AND DEBT STRUCTURE

Deteriorated Liquidity: As of March 2024, Petroperu reported USD81 million in cash on hand, compared with USD41 million in December 2023. As of December 2023, the company had revolving credit lines for up to USD3.5 billion, USD865 million of which is unavailable and under evaluation by different banks due to ESG and government support concerns and USD410 million is under review. Out of bank lines, USD1.2 billion are utilized, leaving availability of USD75 million, per company's disclosure. Petroperu is currently negotiating a $100 million line and a $500 million with international banks. Both lines are for one year.

Government funding: In 2024 the company received a $800 million loan from Banco de la Nación guaranteed by the shareholder, plus an additional $500 million in letters of credit for import of crude and fuel. The government is assessing the company's request to capitalize a $750 million shareholder loan with maturity in December 2024, and the extension for one more year of the $1.0 billion letters of credit.

ISSUER PROFILE

Petroleos del Peru - Petroperu 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

Petroperu 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 ratings in conjunction with other factors.

Petroperu 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 ratings in conjunction with other factors.

Petroperu 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 ratings in conjunction with other factors.

Petroperu 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 ratings 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, visithttps://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Petroleos del Peru - Petroperu S.A.	LT IDR	CCC+	Downgrade	B+ Rating Outlook Negative
	LC LT IDR	CCC+	Downgrade	B+ Rating Outlook Negative
senior unsecured	LT	CCC+	Downgrade	B+

VIEW ADDITIONAL RATING DETAILS

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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

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Petroleos del Peru - Petroperu S.A.	EU Endorsed, UK Endorsed

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