

14 Jun 2019 | Affirmation

## Fitch Affirms Petroperu's Foreign Currency Rating at 'BBB+'

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Fitch Ratings-Chicago-14 June 2019: Fitch Ratings has affirmed Petroleos del Peru - Petroperu S.A.'s (Petroperu) Long-Term Foreign Currency (FC) Issuer Default Ratings (IDR) at 'BBB+' and Local Currency (LC) IDR at 'A-'. The rating action affects USD2 billion of outstanding notes rated 'BBB+'. The Rating Outlook is Stable.

Petroperu's ratings reflect its ownership by the Peruvian government, the company's strong strategic ties with the state, and its strategic importance to maintaining the country's energy supply. As a state-owned company, Petroperu's FC IDR is strongly linked with the credit profile of the Peruvian sovereign (FC IDR BBB+/ LC IDR A-; Outlook Stable). The government support has been evidenced by multiple recent actions including transferring all of the company's pension liabilities to the state, recovering some value added taxes, and capital injections for the Talara Refinery Modernization Project (PMRT). Additionally, government support can be seen in the Republic of Peru's approval of a financial guarantee of up to USD1 billion to support the financing of the Talara project, precise mechanism by which this guarantee would be activated has not been yet committed, pursuant to Law 30,130.

Petroperu's stand-alone credit profile (SCP) would be in line with a 'b' long-term rating if the company were not own by the state and the Peruvian government were not to provide financial support when needed.

### KEY RATING DRIVERS

**Government Support:** Petroperu ratings reflect its close linkage with Peru's ratings due to the strong government ownership and control and the very strong incentives to support the company is one of the largest liquids fuels suppliers. Petroperu has five refineries and approximately 100,000 barrels per day (mbpd) of throughput capacity. The government of Peru is currently Petroperu's only shareholder. The company's credit linkage to the sovereign is further evidenced by the explicit support of the government through a financial guarantee for up to USD1 billion to finance PMRT.

**Weak Capital Structure:** Absent implicit and explicit government support, Petroperu's credit

metrics are not consistent with the assigned rating but are in line with a 'b' SCP. As of LTM March 31, 2019, the company reported total debt of USD4.3 billion and high leverage as measured by total net debt-to-EBITDA of 19.2x. Gross leverage will continue to exceed 14x in the next 12 months, and is expected to start decreasing in 2021 and onwards after the company completes Talara's new refinery. Fitch expects Petroperu's capital structure to remain pressured and in line with its 'b' SCP after completion of the refinery and for its rating to continue to be supported by the company's linkage with Peru.

**Operational Cash Flow Volatility:** Petroperu's cash flow generation is sensitive to changes in oil prices and certain operational interruptions to its transportation business. Fitch expects this trend to continue while PMRT is still ongoing and for cash flow stability and EBITDA margins to improve after commencement of operations. CFFO is projected to be positive through the rating horizon. FCF is expected to be negative in light of the company's aggressive capex investments. Provided that PMRT is completed with the latest timing guidelines, significant changes to Petroperu's cash flow generation profile are unlikely before 2021.

**Regulatory Risk:** Petroperu is exposed to different changes in the Peruvian Technical Normativity, which is the primary catalyst for PMRT. During 2010, the prohibition of commercializing diesel with more than 50ppm of sulfur in Lima and Callao, and then extended to other regions. This norm affected Petroperu's costs, reducing gross profit margins from around 15% to/or below 9% after the implementation of the regulation. Consequently, it became necessary for the company to invest a capex of more than USD5 billion, primarily for PMRT, including the expansion of the refinery and the inclusion of the desulfurization unit.

**Talara Delay and Costs-overrun:** Petroperu has seen modest delays and cost-overruns with PMRT, which are not expected to affect the company's ratings as long as these are not exacerbated. Petroperu now expects its PMRT to commence operations by the end of 2020 and to have cost-overruns of between USD300 million-USD400 million, out of an initial budgeted construction cost of approximately USD4 billion.

#### DERIVATION SUMMARY

Petroperu's linkage to the sovereign is similar in nature to its peers, namely Petrobras (BB-/Stable) and Ecopetrol (BBB/Negative). It also compares with ENAP (A/Stable), Pemex (BB+/Negative) and PDVSA (RD). These companies all have strong linkages to their respective sovereigns given their strategic importance to each country and the potentially significant negative social and financial implication a default could have for their respective countries.

Petroperu's ratings reflect its close linkage to the government of Peru and the company's fiscal importance to the sovereign and strategic importance to the country. Petroperu's ratings also reflect the company's strong domestic market position, with 40%-50% of the country's refining output. The ratings are constrained by Petroperu's weak capital structure and exposure to political interference risk.

## KEY ASSUMPTIONS

### Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Petroperu's ratings assume the implicit support, if needed, from the government given the company's strategic importance;
- Long-term WTI oil prices trend towards \$55/bbl;
- 2019-2021 capex of USD1.5 billion mainly related to the modernization of the Talara refinery;
- Additional debt of approximately USD1 billion over the forecast horizon;
- PMRT completed by end of 2020.

## RATING SENSITIVITIES

### Developments That May, Individually or Collectively, Lead to Positive Rating Action

- An upgrade of Petroperu could result from an upgrade of the sovereign provided the company's SCP remains unaffected.

### Developments That May, Individually or Collectively, Lead to Negative Rating Action

- A negative rating action could be triggered by a downgrade of the sovereign's rating and/or the perception of a lower degree of linkage between Petroperu and the sovereign.
- A deterioration of Petroperu's SCP to 'ccc' from its current 'b' level.

## LIQUIDITY

Adequate Liquidity: Petroperu's liquidity position is supported by cash on hand and manageable short-term maturities, which are mostly related to working capital financing. As of March 31, 2019, Petroperu reported cash on hand of USD189 million and short-term financial debt totaled USD1.25 billion, which Fitch expects will be rolled over. The company still needs to raise approximately USD1 billion of capital to fund Talara's capex.

## FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings

Petroleos del Peru - Petroperu S.A.

--Long-Term Foreign Currency IDR at 'BBB+';

--Long-Term Local Currency IDR at 'A-';

--Senior unsecured ratings on notes due 2032 and 2047 at 'BBB+'.

The Rating Outlook is Stable.

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**Applicable Criteria**

[Corporate Rating Criteria \(pub. 19 Feb 2019\)](#)

[Government-Related Entities Rating Criteria \(pub. 29 Mar 2019\)](#)

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