FitchRatings

FITCH ASSIGNS INITIAL 'B' IDRS TO TURCAS PETROL; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-05 July 2012: Fitch Ratings has assigned initial Long-term local and foreign currency Issuer Default Ratings (IDRs) of 'B' and a National Long-term rating of 'BBB-(tur)' to Turcas Petrol A.S. (Turcas). The Outlooks on the Long-term ratings are Stable.

The ratings reflect Turcas' profile as a holding company investing in energy-related sectors (fuel distribution, power generation, refining, renewable energy and energy trading), the company's positive free cash flow after dividends (before investments in the projects) and sufficient liquidity.

Its main cash-generating investment is a 30% stake in leading Turkish fuel distributor Shell & Turcas Petrol A.S. (STAS), a 30%:70% joint venture with Royal Dutch Shell plc ('AA'/Stable) established in 2006. Fitch positively views Turcas' strategy of investing in oil- and power-related projects in Turkey in partnership with large foreign industry players having expertise in their respective sectors.

Turcas' ratings are negatively affected by the company's very ambitious investment plan for the next several years. Fitch expects that cash outflows related to two large investment projects in power generation and oil refining will substantially increase Turcas' funds from operations (FFO) adjusted net leverage in the next few years - to above 5x in 2012-2013 from a relatively high 2.3x in 2011. This projected leverage level is consistent with a weak 'B' rating given Turcas' business profile. Historically, Turcas had very little debt and a net cash position until end-2010.

In 2011, the company increased leverage in order to fund its 30% share in a 30%:70% joint venture with RWE AG ('A'/Negative) established to build and operate a 775 megawatt (MW) gas-fired power plant in south-western Turkey. Total project cost is EUR550m-EUR600m. Debt will continue to rise in 2012 as the company makes progress in the construction of the power plant, which is due to be operational in Q412. Fitch believes the gas-power plant project has attractive economics versus competitive plants due to its location, high efficiency and relatively low funding costs. However, the project's profitability is dependent on gas and power prices which tend to be volatile.

Fitch expects Turcas to increase its debt further in 2013-2015 as the company plans to fund its 18.5% equity share in the large Star refinery project with State Oil Company of the Azerbaijan Republic (SOCAR, 'BBB-'/Stable). SOCAR owns an 81.5% stake in the refinery project, which plans to build the 10 million tonnes refinery on the Turkish coast of the Aegean sea. The refinery is slated to be operational in 2016. This around USD5bn project is planned to be funded on a project-finance basis with a targeted 75%:25% debt to equity split. The SOCAR/Turcas jv plans to obtain long-term external funding for the project by end-2012.

Turcas expects to fund its USD231m share in the refinery's equity from a combination of free cash flow in 2012-2015 and external funding. Depending on the ongoing discussion with the refinery project's lending banks, Turcas will be making equity contributions to the refinery either gradually in 2012-2015 in line with the progress with refinery construction or up-front once the project funding is finalised probably by end-2012.

While the planned refinery investment will lead to a material increase in Turcas' debt, it should also enhance the company's business profile due to vertical integration of its existing operations in fuel distribution through STAS with refining through the jv with SOCAR. Nevertheless, Fitch views oil refining as a difficult and cyclical industry that reported weak margins in Europe in the past several years.

However, there are some risk mitigants for the refining project, including the presence of SOCAR as the majority-owner and an oil supplier to the refinery. In addition, the Star refinery's products will target the undersupplied domestic market with a large deficit of diesel and naphta rather than the oversupplied European market.

Turcas' main cash flow item is dividends from its 30%-owned associate STAS. This dividend accounted for 91% of 2011 FFO. Turcas benefits from a recurring dividend stream from STAS, which paid dividends each year in the past five years. Dividends and royalty payments received from STAS amounted to TRY258m (USD143m at the current FX rate) in 2007-2011, while Turcas paid dividends to its shareholders of TRY112m in this period. This means that Turcas reinvests more than 50% of the dividends received from STAS. However, Turcas does not have full control over dividend flows from this associate as dividends have to be agreed by both shareholders of STAS.

Asset sales are a secondary source of cash flows for Turcas and may support the company's cash flows if needed. For example, in December 2011 the company sold its 25% stake in SOCAR & Turcas Enerji A.S., the petrochemicals jv with SOCAR for USD44m (TRY83.8m) as it decided to exit the investment in the petrochemicals business.

Turcas' liquidity is adequate with TRY118m of cash and no current financial liabilities as of 31 December 2011. Total debt consisted of TRY212m of long-term bank loans, and with limited refinancing risk as its debt maturity extends to between 10 to 13 years. Turcas' potential liquidity includes undrawn uncommitted short-term credit lines amounting to USD209.5m at end-2011. The company had cash of TRY133m at end-March 2012.

Fitch positively assesses Turcas' policy to funds its long-term projects with long-term funding. The company's two main investment projects, the gas-fired power plant and the refinery project, are expected to provide sufficient cash flows for their debt service.

Negative pressure on Turcas' ratings would arise if FFO-adjusted net leverage approaches or exceeds 6.0x on a sustained basis. A requirement for Turcas to make equity contributions to the Star refinery up-front when the funding agreement with banks in closed (rather than gradual equity injections in 2012-2015) could also put pressure on the rating as it would result in a steep increase in Turcas' leverage in a short period of time. Cash on Turcas' balance sheet and funds already injected to the project somewhat mitigate this risk.

Positive rating pressure is likely in case of a reduced investment plan for the next several years.

Turcas has been listed on the Istanbul Stock Exchange since 1992 and is controlled by Aksoy Holding, a family-owned conglomerate that also has stakes in the hotel and construction businesses.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria; 'Corporate Rating Methodology' dated 12 August 2011 are available at www.fitchratings.com

Applicable Criteria and Related Research:
Corporate Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647229