FitchRatings

FITCH AFFIRMS TURKEY'S TURCAS AT 'B'; OUTLOOK STABLE

Fitch Ratings-London/Warsaw-01 July 2014: Fitch Ratings has affirmed Turkey-based Turcas Petrol A.S.'s (Turcas) Long-term foreign and local currency Issuer Default Ratings (IDR) at 'B' and its National Long-Term Rating at 'BBB-(tur)'. The Outlook is Stable.

Turcas's decision to divest its stake in the STAR refinery project, thereby avoiding high capital commitments, has addressed one of the company's key credit risks. We now forecast deleveraging to levels commensurate with a higher rating over the next two to three years from a funds from operations (FFO)-adjusted net leverage of over 8x at end-2013. Other factors supporting the ratings include Turcas's positive free cash flow after dividends, strong liquidity and long-dated debt maturity profile.

However, even with a much improved financial profile, Turcas's ratings will continue be constrained by the limited diversification of its revenue stream and by the implied average rating of the subordinated dividend income from its two main investments. As a result, we see the rating ceiling for Turcas at 'B+'.

Turcas is an investment holding company with minority stakes in JVs in energy-related sectors in Turkey (BBB-/Stable). Its main investments are a 30% stake the leading Turkish fuel distributor Shell & Turcas Petrol (STAS) and a 30% stake in Denizli, a gas-fired plant commissioned in 2013.

KEY RATING DRIVERS

Limited Income Stream Diversification
We expect STAS to remain Turcas's primary source of revenue in the next three years as weak gas and power prices will constrain Denizli's capacity to fully cover its shareholder loan repayments or contribute dividends. STAS, Turcas's JV with Royal Dutch Shell plc (AA/Stable), is Turkey's leading fuel distributor with 1,042 Shell-branded gas stations and a reported operating profit of TRY240m in 2013.

Fitch does not rate STAS but believes that, based on a comparison with other rated fuel retailers, its profile would warrant rating in the 'BB' category. This captures its limited geographical diversification and full exposure to Turkey's regulatory and economic environment, which are balanced by its strong financial metrics and leading position in the growing domestic market.

Reliable Dividend Flows from STAS
Turcas's lack of control over STAS's dividend distributions is strongly mitigated by the track record of recurring payments received over the past seven years. Income from STAS also includes management fees based on a pre-approved formula. In aggregate, cash inflows from STAS over 2007-2013 amounted to TRY363m, compared with TRY127m dividend paid by Turcas to its shareholders. Dividend payments from STAS reduced in 2011-2012 due to a regulatory reduction in contracts' length with dealers and the depreciation of the TRY.

Performance in 2014 will be affected by a two-month cap on fuel prices imposed by the energy regulatory authority in late March and by the weaker TRY/USD. Our forecasts assume dividends from STAS at a conservative level and stable distributions over the next three years.

Pressure on Denizli's Cash Flows

Although Denizli's newly commissioned 775 megawatt gas-fired power plant is one of the most efficient in Turkey, the economics of the project are now unlikely to meet pre-investment assumptions due to challenging conditions in the gas and power market. In our view, this, combined with Denizli's asset concentration and limited operational track record, would constrain its standalone rating in the 'B' category.

Turcas's debt consists of project loans raised to finance its 30% share in the construction of the plant. We had previously assumed that from 2015, the debt service of these facilities would be fully covered by payments from Denizli under a shareholder loan structured to mirror their terms. Our forecasts now project that Turcas will have to fund a shortfall in Denizli's repayments over the next three years.

Exit from STAR Credit Neutral
In May 2014, Turcas sold its 18.5% stake in the STAR refinery project to State Oil Company of the Azerbaijan Republic (BBB-/Stable) for USD59.4m. The decision to exit the project came after the estimated construction cost of the 10bn tonne refinery was revised to USD5.7bn from USD5bn. This would have translated into an increase of USD120m in Turcas's equity commitment to USD444m, with significant pressure on its external funding requirements and credit metrics.

While the disposal reverses these risks, it also has some implications for Turcas's operational profile, with no prospects for a more diversified revenue and asset base in the medium term. In mitigation, Turcas's financial ratios will now offer some headroom for investments in other new ventures.

Improving Credit Metrics
Turcas's credit metrics at end-2013 were weak for the ratings, with net FFO leverage at 8.7x, compared with the peak of 6.4x we had previously projected for end-2014. This reflected unfavourable FX trends and high capital commitments.

Our base rating case now forecasts a gradual reduction in net FFO leverage, to 2.0x by end-2016 and a strengthening in dividend/gross interest cover to 6.0x (4.0x at end-2013). This contrasts with our previous expectations of weakening leverage and coverage ratios and reflects the material reduction in Turcas's external funding needs and the positive effect of the cash proceeds from the disposal of its 18.5% stake in the STAR refinery project.

Strong Liquidity, Comfortable Maturities
At end-1Q14, Turcas's liquidity was adequate with TRY92m of cash and TRY58m in short-term debt. Cash flow generation was boosted in May 2014 by the USD59.4m proceeds from the sale of the stake in STAR. Total debt of TRY471m consisted of amortising project-related long-term loans denominated in EUR and USD. Free cash flow is forecast to be positive over 2014-2016.

RATING SENSITIVITIES

Positive: Future developments that may, individually or collectively, lead to positive rating action include:
- FFO adjusted net leverage consistently below 3x coupled with greater diversification of dividend income; or
- FFO adjusted net leverage consistently below 2x

Negative: Future developments that may, individually or collectively, lead to negative rating action include:
- FFO adjusted net leverage exceeding 6x on a sustained basis.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology', dated 28 May 2014 and 'Rating Investment Holding Companies', dated 25 March 2014, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393
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