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CREDIT OPINION

21 September 2020

Update

 Rate this Research

RATINGS

Koc Holding A.S.

Domicile	Turkey
Long Term Rating	B2
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Koc Holding A.S.

Annual update following Turkey sovereign rating action

Summary

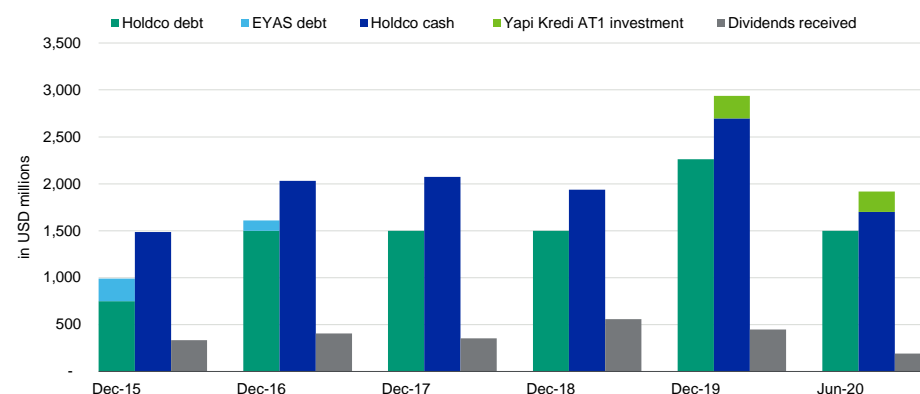
On 11 September 2020, the long-term issuer rating of the Government of Turkey was downgraded to B2 with a negative outlook from B1. Turkey's foreign currency bond ceiling was also downgraded to B2 from B1. As a result, on 17 September, several Turkish corporates were downgraded to B2 given their exposure to the country's political, legal, fiscal and regulatory environment. The corporate family rating of Koc Holding A.S. (Koc Holding) was also downgraded to B2 from B1 to as part of these developments.

Koc Holding's B2 corporate family rating continues to reflect the company's strong financial profile and balanced portfolio of investments in mature and high-growth companies, which have diversified the entity's dividend income. The holding company has a track record of maintaining a net cash position and follows a prudent approach in managing its investment portfolio. The company has a net cash position of \$206 million as of 30 June 2020 (\$419 million including YKB AT1 investment) and has maintained a net cash position (including marketable securities) between \$419 million and \$735 million over the past five years.

The rating takes into account the geographic concentration of investments to [Turkey](#) (B2 negative) and the volatility in the Turkish equity market. Koc Holding benefits from a degree of natural hedge against the depreciation of the Turkish lira because of the exposure of various operating companies to US dollar- and euro-linked cash flow.

Exhibit 1

Strong financial profile is supported by significant cash balances at holding level and steady dividends from a diversified investment portfolio



Note: Debt at intermediate EYAS SPV is non-recourse to Koc Holding and was fully paid in April 2017.

Source: Moody's Investors Service, Company data

Credit strengths

- » Diversified investments across sectors and companies, each having varying sensitivity to the Turkish economy through differences in cyclicity of business and capex needs
- » Highly transparent investment portfolio, with almost all core investments listed
- » Conservative approach to investments, with a track record of financial discipline and adherence to internal leverage targets

Credit challenges

- » High geographic concentration of investments, as all core companies are domiciled in Turkey with significant asset exposure to domestic market
- » Heightened regional geopolitical risks may make operating environment more difficult

Rating outlook

The negative outlook mirrors that of the Government of Turkey and reflects Koc Holding's exposure to the country's political, legal, fiscal and regulatory environment.

Factors that could lead to an upgrade

Given the credit linkages between the Koc Group's investments and the operating environment in Turkey, an upgrade of Koc Holding's rating is unlikely at this stage. The company's rating could be upgraded if Turkey's foreign currency ceiling is raised in combination with the Koc Group's investments continuing to display a strong financial profile.

Factors that could lead to a downgrade

Koc Holding's ratings could be downgraded as a result of a downgrade of the Government of Turkey's rating or of the foreign currency bond ceiling as well as signs of a deterioration in liquidity.

Key indicators

Exhibit 2

Koc Holding A.S. [1]

	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	YTD-20
Market Capitalisation (TL bn) [2]	31.4	27.7	35.0	46.9	36.0	51.5	37.5
Portfolio Value (TL bn) [3]	29.2	28.3	33.2	45.9	36.3	49.4	47.7
Cash (TL bn)	3.4	4.3	7.1	7.9	10.2	16.0	11.8
Market Leverage [4]	-4.1%	-5.7%	-4.9%	-4.7%	-6.2%	-5.2%	-3.0%
Asset Concentration [5]	50.3%	47.0%	44.4%	49.5%	49.3%	44.8%	45.1%
(FFO + Interest Expense)/Interest Expense [6]	13.8x	12.8x	10.6x	7.0x	10.4x	6.7x	6.7x

[1] Calculations are based on parent level (standalone) financials and include Moody's adjustments.

[2] Market cap of Koc Holding is as of year end except YTD-20 which is as of 4 September 2020.

[3] Portfolio value is based on market cap of listed investments and NAV of unlisted investments and excludes cash. All values are as of year end except YTD-20 numbers where listed investments are as of 4 September 2020 and unlisted investments are as of 30 June 2020.

[4] (Net Debt) / (value of investment portfolio); Net debt historically included non-recourse financial debt at EYAS level which was repaid in April 2017. For YTD-20, cash and debt is as of 30 June 2020, unlisted investments are as of 30 June 2020 while listed investments are as of 4 September 2020.

[5] (Top 3 investments) / (value of investment portfolio + cash at holding company level).

[6] FFO at parent level for Koc Holding is calculated as sum of management fees, dividend, interest, and rental income less opex, interest and tax paid. For YTD-20, Dec-19 data is used.

Sources: Moody's Investors Service, Company data, FactSet

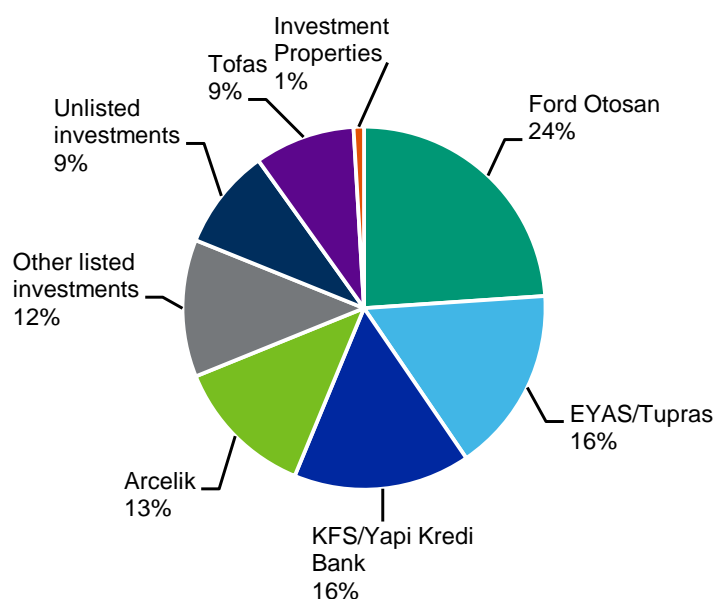
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Profile

Founded in 1926, Koc Group is one of Turkey's most prominent business groups, with investments in various sectors including energy, automotive, consumer durables and finance. Koc Holding A.S. was established in 1963 to house and centrally manage the group's diverse investment portfolio. The Koc family members directly and indirectly own 64.3% of the holding company while another 26.5% is listed on Borsa Istanbul.

Exhibit 3

Majority of investments are listed on Borsa Istanbul providing a high degree of analytical visibility



The above chart is based on total portfolio value split by listed and unlisted investments, excluding cash balances. Listed investments are based on market cap as of 4 September 2020 while unlisted investments and investment properties are based on Net Asset Value (NAV) as of 30 June 2020 from Koc Holding's earnings presentation. NAV is defined as assets minus liabilities for each investment. *For Tupras, the value includes the value of Opet, where Tupras has a 40% stake.

Sources: Moody's Investors Service, FactSet, Company presentation

For the six months ending 30 June 2020, Koc Holding reported consolidated revenue of TL74.0 billion and an operating profit of TL4.6 billion.

Detailed credit considerations

Exposure to Turkey is a key credit constraint

Koc Holding's group of investments are mostly concentrated in Turkey. Therefore, it is materially exposed to Turkey's political, legal, fiscal and regulatory environment. One such example is the elevated risk of government-imposed measures to preserve the country's foreign exchange reserves which could prevent the company from accessing its foreign currency cash deposits or servicing its foreign currency debt obligations. Unpredictable policy shifts of the government, such as the limit on company dividend payments to 25% of net income until December 2020 due to Covid-19, is another example. These risks constrain Koc Holding's rating at Turkey's foreign currency ceiling of B2.

While Koc Holding's revenue comprises mostly local currency denominated dividends, some of the companies in its investment portfolio generate international revenue (33% of combined 2019 revenue) and \$-linked revenue that provide access to foreign currency revenue. Moreover, around 80% of Koc Holding's dividend income is derived from portfolio companies that have foreign exchange (FX) or FX-linked revenue.

Strong financial flexibility at Holding company level

Functioning solely as an investment holding company, Koc Holding's cash requirements remain low and the company has no material requirements in terms of working capital or committed capex. Historically, the company's ability to cover operational expenses and

service debt has been strong and this remains the case, with recurring income generated from investment returns, management fees and interest income. Cash outflows over an investment cycle are primarily linked to principal and interest payments on financial debt, staff and operating costs and capital injections to existing investments. We calculate that Koc Holding's year to date market value leverage (MVL) is -3.0% (negative given net cash position) which we consider very strong translating into a Aaa rating MVL factor under our investment holding methodology. As of 30 June 2020, the company continued to hold high cash balances and maintained an adjusted net cash position of \$206 million (\$419 million including Yapi Kredi AT1 investment).

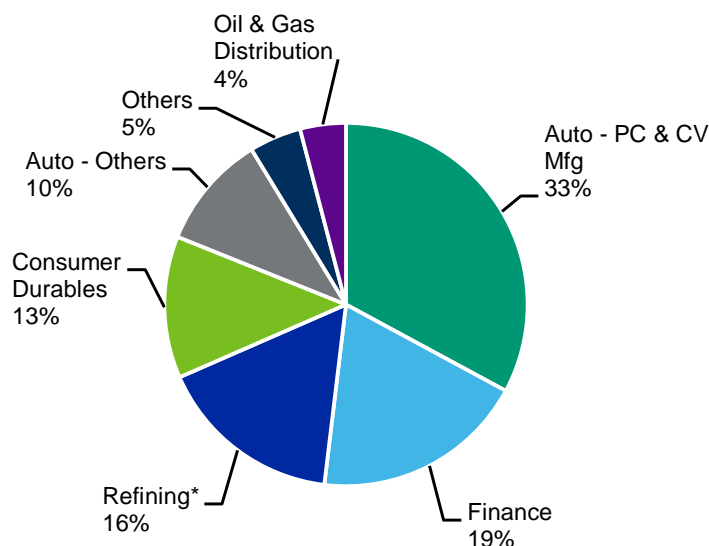
Through the supportive stance taken by the company's shareholders, both acquisition and investment outflows and dividend payments remain discretionary in nature. Koc Holding has a flexible dividend policy, which can be adjusted downward if necessary. This was demonstrated when Koc Holding lowered its dividend to TL 671 million from its 2019 net profit (compared to TL 1.2 billion from 2018 net profit) as a result of lower dividends received from its subsidiary companies, in particular no dividends from [Türkiye Petrol Rafinerileri A.Ş.](#) (Tupras B2 negative).

The sector diversification of the investment portfolio will generate, on average, a reliable dividend income stream, which is expected to continue growing as most of the investment programs at the level of key subsidiaries have been completed. However, given the COVID-19 adverse impact on subsidiary companies performance, dividend income for 2020 will be lower than normal. Tupras, Turkey's largest refining company, is a key dividend contributor to Koc Holding, representing close to half of total dividends received in 2019 but did not pay a dividend for financial year end 2019 because of weaker performance. As a result we expect the interest cover, as measured by $(\text{FFO} + \text{interest expense}) / \text{interest expense}$, to decline towards 2.5x for 2020 (Ba methodology sub-factor score) from 6.7x (Aa sub factor score) in 2019. The bulk of Koc Holding's dividends are received during the first quarter of the year and was not adversely impacted by the government of Turkey's directive to cap company dividends to 25% of net income initially until September 2020 and then extended to 31 December 2020. Should this be extended into 2021, Koc Holding dividend income will likely be lower than 2020 because of the dividend restriction. Koc Holding's high cash balance equivalent to \$1.7 billion provides good buffer to cover for any potential negative free cash flow.

Diversified investments across sectors but a degree of investment concentration risk remains

Koc Holding's investment portfolio is fairly balanced across the energy, automotive, consumer durables and finance business segments with various additional investments in other sectors (Baa for the Business Diversity sub-factor). We recognise that specific businesses within a given sector have uncorrelated characteristics, such as in the energy sector where the business profile is noticeably different between oil and gas distribution (Aygaz and Opet) and refining, Tupras. We also differentiate between the passenger and commercial vehicle manufacturers (Ford Otosan and Tofas) and the other automotive businesses (Otokar, Turk Traktor and Otokoc). At the same time, in assessing the various businesses, we also consider the materiality of the investment with respect to the total portfolio.

Exhibit 4

Diversified portfolio across multiple sectors

The above chart is based on total portfolio value split by industry. Listed investments are based on market cap as of 4 September 2020 while unlisted investments and investment properties are based on Net Asset Value (NAV) as of 30 June 2020 from Koc Holding's earnings presentation. NAV is defined as assets minus liabilities for each investment. *Refining sector corresponds to Tupras, which includes the value of Opet, where Tupras has a 40% stake.

Sources: Moody's Investors Service, FactSet, Company presentation

The portfolio exhibits a moderate degree of investment concentration, with the company's top three investments constituting around 45% of its invested portfolio plus holding company cash balances (Baa for the Asset Concentration sub-factor). Under our practice for calculating the portfolio value, we use the net asset value or book value of investment at the holding company level for unlisted companies and market-derived value for listed companies. This conservative approach undervalues Koc Holding's portfolio slightly as some of the unlisted investments have a very low cost basis and therefore does not reflect the fair value of the business.

The rating incorporates our expectation that Koc Holding will continue to invest in a meaningful manner when opportunities arise, such as its 9.02% increased stake in [Yapi ve Kredi Bankasi A.S.](#) (Yapi Kredi B2 negative) in the process giving Koç Group defacto control of the bank. Strategic growth would reduce the company's asset concentration risk and/or increase its geographic diversification, but Turkey will remain the group's largest market for the foreseeable future.

Limited geographic diversity of investments partially offset by high degree of international sales exposure to Europe

Koc Holding's rating is constrained as a result of its geographic concentration of investments in Turkey (B for the Geographic Diversity sub-factor). In addition, all of Koc Holding's core operating companies have high exposure to both the domestic market and to Europe (either directly or indirectly). Weak economic growth in Turkey and in Europe will be a headwind to growth for 2020 with a gradual recovery expected in 2021.

Moody's anticipates a slowdown of the Turkish economy as a result of COVID-19 with a real GDP growth rate expected to decline by 5% in 2020 with a 3.5% recovery for 2021 compared to the 0.9% growth recorded in 2019. A sustained macroeconomic environment deterioration would lead to a more difficult business and operating environment for the Koc Group. If economic activity and consumer confidence remains low, we believe that this may create uncertainty around overall demand on discretionary purchases, which Koc Holding is exposed to through its investments in companies such as Ford Otosan, Tofas and Arcelik. Koc Group's exposure to the Turkish market is partially mitigated by export-oriented companies particularly in the consumer durables and automotive segments. For the 6 months to 30 June 2020 total combined revenue amounted to TL 126.2 billion, of which we expect around 30% were derived from the international market. In addition, refined oil-product sales through Tupras are priced off international benchmarks and can be exported, making up a material portion (approx. 50%) of total group revenue that are less sensitive to domestic demand and currency movements.

Volatility in foreign exchange rates continues to be a risk for companies in Turkey that have structural currency mismatches between their financial assets and liabilities. For the 2019 financial year, the lira depreciated about 11.5% (2018: 28%) against the dollar with periods of volatility experienced since 2016 and has since depreciated further by 21.4% for the year to 18 September 2020. Active risk management measures employed by the Koc Group companies provide comfort that in periods of volatile currency markets, the group will prudently manage foreign exchange risk.

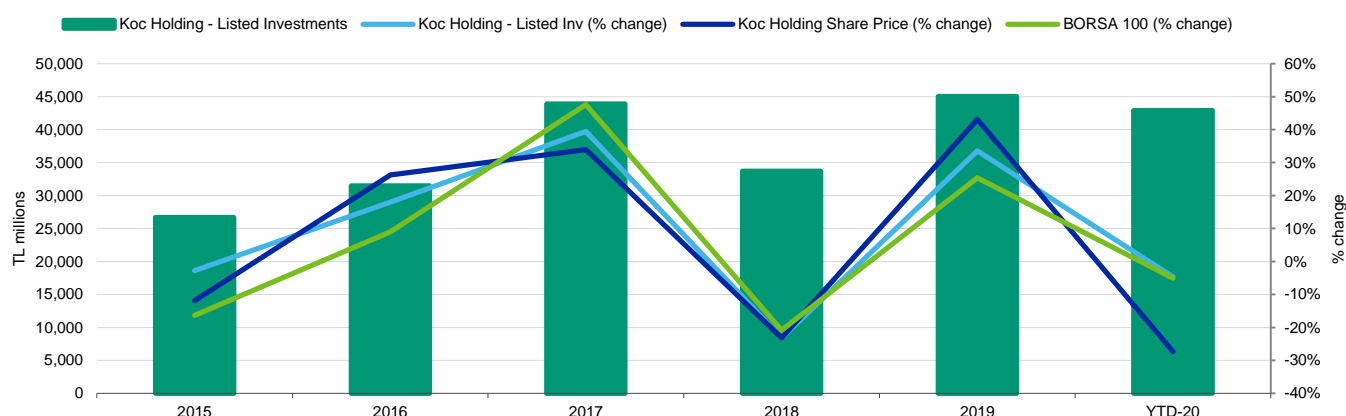
High portion of listed investments provides high degree of transparency on portfolio values

Koc Holding's listing on Borsa Istanbul, along with around 90% of its investment portfolio provides a high degree of transparency and is an important tool for assessing the quality of the company's underlying investments. Listed equity stakes help to assess the value of investments and are an additional source of liquidity for the holding company.

The sharp movements in share prices of Koc Holding and its operating companies over the past five years highlight the inherent volatility of the equity markets, as shown in exhibit 5. The current rating provides headroom for material volatility in asset values while incorporating our expectation that internal leverage targets will be adhered to.

Exhibit 5

Listed market values have heightened volatility



YTD-20 = Market capitalizations as of 4 September 2020

Source: Moody's Investors Service, FactSet, Company presentation

ESG considerations

Koc Holding has set proactive financial and risk management policies across its portfolio of companies to manage key business and credit risks. This oversight across its portfolio of companies is an additional layer of risk mitigation for the operating companies it has invested in and which we expect will strengthen the value of investments over the long term. In addition, event and execution risks associated with past acquisitions and investments are mitigated by the prudent approach the company has followed in managing its credit profile and avoiding financial over-leverage. We expect the company to maintain MVL below 15% and a normalised FFO interest coverage above 4.0x following any debt-financed acquisition.

Liquidity analysis

Koc Holding's liquidity profile over the next 12 months is expected to be good. As of 30 June 2020 Koc Holding had a cash balance of around TRY11.8 billion (TRY13.2 billion including YKB AT1 investment). We understand around 82% is held in foreign currency, both in domestic and international banks, which reduces its counterparty risk, in Moody's view, to the weaker credit quality of Turkey-based financial institutions.

Koc Holding's liquidity profile over the next 12 months is supported by projected cash inflows from dividend income, rental income, interest income on cash balances and management fees. Despite the lower dividend income we expect cash inflows will be sufficient to pay cash outflows from head office costs and interest expenses for 2020.

Rating methodology and scorecard factors

In determining Koc Holding's ratings, we have applied our [Investment Holding Companies and Conglomerates](#) industry methodology, published in July 2018. We view Koc Holding as having certain characteristics of a conglomerate, with the company as a shareholder remaining committed to its key investments while actively defining and managing the risk profile of individual operating companies by maintaining majority or joint control through joint venture partners. However, the decentralised approach to managing individual operations and the holding company's policy to clearly separate financing between the holding and operating company levels (with non-recourse debt and absence of guarantees) supports the investment holding methodology approach for our credit analysis.

The scorecard-indicated outcome for Koc Holding is A2 with a forward view of A3 because of the lower dividend income in 2020. The multi-notch difference to the actual assigned rating of B2 is due to the Turkey's foreign currency ceiling of B2.

Exhibit 6

Scorecard Factors				
Koc Holding A.S.				
Investment Holding Companies Industry [1]			Current LTM 6/30/2020	
			Moody's 12-18 Month Forward View As of 9/7/2020 [2]	
Factor 1 : Investment Strategy (10%)	Measure	Score	Measure	Score
a) Investment Strategy	Baa	Baa	Baa	Baa
Factor 2 : Asset Quality (40%)				
a) Asset Concentration	Baa	Baa	Baa	Baa
b) Geographic Diversity	B	B	B	B
c) Business Diversity	Baa	Baa	Baa	Baa
d) Investment Portfolio Transparency	A	A	A	A
Factor 3 : Financial Policy (10%)				
a) Financial Policy	A	A	A	A
Factor 4 : Estimated Market Value-based Leverage (MVL) (20%)				
a) Estimated Market Value-Based Leverage	Aaa	Aaa	Aaa	Aaa
Factor 5 : Debt Coverage and Liquidity (20%)				
a) (FFO + Interest Expense) / Interest Expense [3]	6.7x	Aa	2.5x	Ba
b) Liquidity	Aaa	Aaa	Aaa	Aaa
Rating:				
a) Scorecard-Indicated Outcome		A2		A3
b) Actual Rating Assigned				B2

[1] Ratios are based on holding level numbers and involves estimation of investment portfolio value.

[2] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

[3] FFO at parent level for Koc Holding is calculated as sum of management fees, dividend, interest, and rental income less opex, interest and tax paid.

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
KOC HOLDING A.S.	
Outlook	Negative
Corporate Family Rating	B2
Senior Unsecured	B2/LGD4

Source: Moody's Investors Service

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