Research Update:

Koc Holding Upgraded To 'BB' Following Positive Action On Turkiye; Outlook Positive

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One or more of the Credit Ratings referenced within this article was assigned by deviating from S&P Global Ratings' published Criteria.

Rating Action Overview

- On May 3, 2024, we raised our unsolicited long-term foreign currency sovereign rating on Turkiye to 'B+' from 'B' and revised our transfer and convertibility (T&C) assessment to 'BB-' from 'B+'. The outlook on the rating is positive.
- Koc Holding A.S. continues to meet our requirements to be rated a notch above the T&C assessment on Turkiye, and we still think the company can be rated two notches above the sovereign thanks to its positive track record in keeping a net cash position largely held at international banks and strong liquidity.
- We therefore raised our long-term issuer credit rating on Koc and our issue rating on its unsecured notes to 'BB' from 'BB-' and affirmed our 'B' short-term rating on the company.
- In addition, we revised our stand-alone credit profile (SACP) on Koc to 'bbb-' from 'bb+', reflecting the company's track record of minimal leverage and portfolio resiliency.
- The positive outlook on Koc mirrors that on Turkiye.

Rating Action Rationale

The upgrade follows a similar action on Turkiye. We continue to apply a criteria exception on our rating on Koc, based on our expectation that the holding company can maintain sufficient cash in U.S. dollars to repay its $750 million bond due in March 2025. As a result, Koc can be rated one notch above our 'BB-' T&C assessment on Turkiye, and at a maximum of two notches above our 'B+' sovereign credit rating on Turkiye (see "Turkiye Upgraded To 'B+' On Economic Rebalancing; Outlook Positive," published May 3, 2024, on RatingsDirect). The two-notch cap is because we view domestic investment holding companies, in general, as having high sensitivity to their home country's risk.

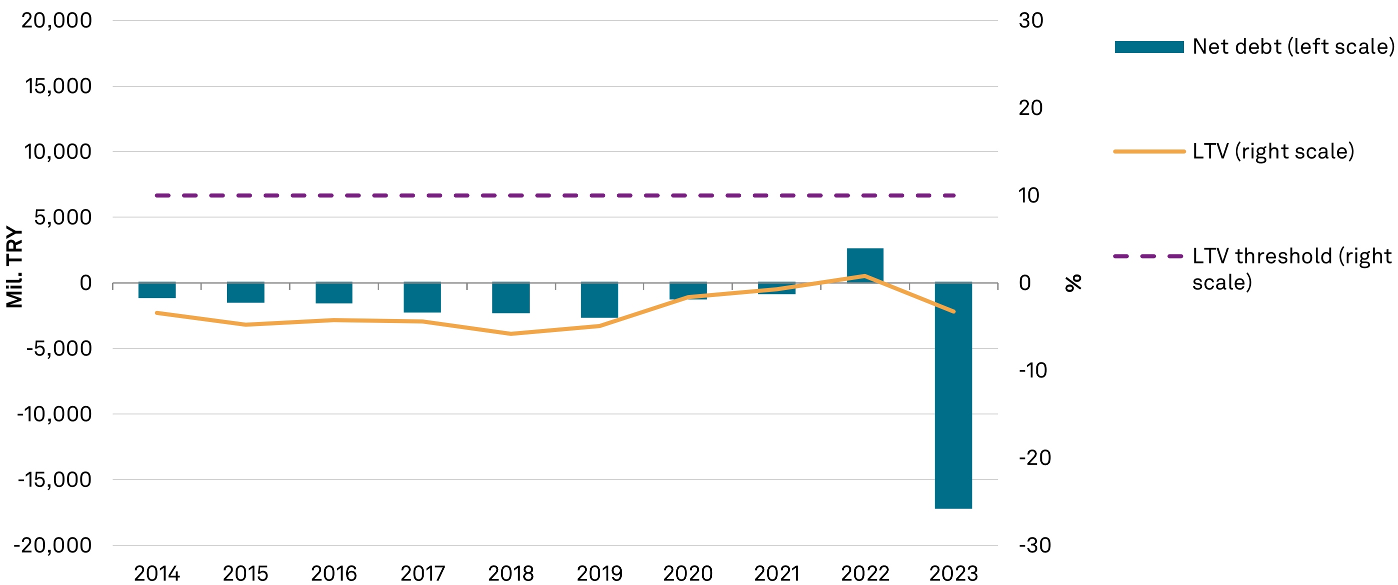
The criteria exception that enables us to rate Koc one notch above our T&C assessment on Turkiye reflects our expectation that the company can maintain sufficient cash in U.S. dollars at international banks to fully repay its U.S.-dollar-denominated debt and related interest. We would typically apply our T&C rating cap to companies such as Koc that are not exporters and generate more than 90% of their stand-alone cash flow in Turkiye, implying a rating of 'BB-'. In Koc's case, more than 90% of its income represents dividends from investments in the country. As of Dec. 31, 2023, the company's only financial debt liability pertains to its $750 million bond due in March 2025. We think Koc has enough U.S. dollars sitting offshore to repay its debt, and we do not anticipate this cash would be depleted for other reasons. In addition, the company has passed our sovereign stress tests, indicating that it would have enough liquidity resources to cover its obligations in the next 12 months, in the event of a sovereign default. We do not expect Koc's ability to use its U.S. dollar cash to pay U.S.-dollar-denominated debt to be restricted by exchange or repatriation controls. As a result of these factors, we are deviating from our criteria for rating above the sovereign by adding one notch, and therefore rate Koc one notch above our 'BB-' T&C assessment on Turkiye. We will continue to apply this criteria exception so long as:

- The company is able to meet our T&C stress test requirements;
- The amount of cash in U.S. dollars held offshore exceeds Koc's U.S. dollar liabilities; and
- We perceive no heightened risks of a repatriation of Koc's offshore U.S. dollar holdings.

These three factors, which are the conditions to be rated one notch above the T&C assessment, remain monitored on a quarterly basis. The company passed all our requirements as of the end of December 2023.

We raised our SACP on Koc to 'bbb-' from 'bb+' based on the company's track record of minimal leverage and portfolio resiliency. We estimate Koc's net cash position was about Turkish lira (TRY) 22.7 billion (or about $773 million) at Dec. 31, 2023, based on the portfolio value at the same date and pro forma the recent disposal of Tat Gida for about TRY2.2 billion, the redemption of Yapi Kredit's additional Tier 1 (AT1) instrument for $200 million (TRY6.3 billion) and the acquisition of Kemer Medical Center for about TRY2.9 billion. This in line with the company's track record of maintaining a net cash position or very low debt levels, with its adjusted loan-to-value (LTV) ratio staying well below our 10% maximum level for the 'bbb-' SACP since 2014. Under our base-case scenario, we anticipate that Koc will retain a net cash position, supported by a conservative financial policy and a sizable recuring dividend stream from its investee assets. For 2024, we estimate the company will receive dividends, fees, and interest income over TRY48 billion, up from TRY29.2 billion a year ago. This is supported by its key assets' solid operating results, with the exporting nature of companies such as Ford Otosan or Arcelik providing resiliency in case of weaker domestic market conditions. We estimate that about 50% of the revenue from Koc's investee assets was linked to hard currencies (U.S. dollars and euros for the most part) in 2023, including Tupras' sales, which are mostly settled in U.S. dollars. As a result, we view Koc's portfolio as relatively protected from Turkish lira depreciation. Overall, the holding has a track record of portfolio value creation thanks to steady asset value and dividend income growth. We estimate its pro forma adjusted portfolio value increased to about $17.2 billion as of Dec. 31, 2023, from about $10.2 billion as of Dec. 31, 2015. Therefore, we think Koc can maintain a net cash position for the foreseeable future. Even in a hypothetical Turkish sovereign default, we anticipate the company would retain a net cash position and a negative LTV ratio.

Koc Holding has maintained a very prudent LTV and cash position since 2014



TRY--Turkish lira. LTV--Loan to value. Source: S&P Global Ratings.

Koc's strong liquidity position and net cash position in hard currency are pivotal for our ratings. We view the company as having strong liquidity as of Dec. 31, 2023, and expect sources to exceed uses by 2.7x for the next 12 months and 1.6x for the subsequent 12 months, according to our estimates. In addition, about 96% of the company's gross cash held as of Dec. 31, 2023, was in U.S. dollars and predominantly held at international banks. In a hypothetical scenario in which the Turkish sovereign were to default, we think Koc would be able to continue to service its obligations. Under our stress test, which assesses the company's liquidity for a one-year period under a hypothetical sovereign default scenario, we estimate that Koc's liquidity sources would remain sound at about 1.4x of its uses, even including the repayment of its $750 million Eurobond and excluding dividend income. We notably estimate that the company's high share of cash denominated in hard currency would benefit from a devaluation of the lira and offset the potential lack of dividend income and higher operating and interest expense. In addition, our T&C stress test points to a continued positive liquidity ratio of foreign sources of cash to foreign uses of cash, because Koc's U.S. dollar cash balances held offshore are sufficient to cover its $750 million bond maturing in March 2025 and associated interest payment.

Outlook

The positive outlook on Koc mirrors that on Turkiye.

Downside scenario

We could take a negative rating action on Koc following a similar rating action on Turkiye, or if, during the coming quarters:

- Koc is unable to pass our T&C stress test;
- The company depletes its U.S. dollar cash balance abroad and can no longer cover its U.S.-dollar-denominated debt maturing in 2025; or
- Its U.S. dollar cash held abroad becomes subject to repatriation requirements or exchange controls.

Upside scenario

We could take a positive rating action on Koc following a similar rating action on Turkiye, implying a revision of the sovereign long-term rating by one notch to 'BB-' and of the T&C assessment to 'BB'. An upgrade will also require that the company meets our requirements to be rated up to one notch above our T&C assessment.

Company Description

Koc is an investment holding company listed on Borsa Istanbul since 1986 and whose operations began in 1926. On May 20, 2024, its market capitalization reached TRY623 billion ($19 billion). The company is closely controlled by the Koc family (63.4%).

Koc controls many listed (directly or indirectly) and unlisted companies operating in diverse sectors. According to our estimates, the holding company's pro forma portfolio value on Dec. 31, 2023, was TRY506.9 billion (about $17.2 billion). On the same date, Koc's portfolio included assets in the following sectors:

- Autos and auto suppliers (42.4% of the portfolio's value as defined above)--Tofas, Ford Otosan, and Turk Traktor, which are joint ventures with Stellantis N.V., Ford Motor Co., and CNH Industrial N.V., respectively; and Otokar and Otokoc. Combined reported revenue was TRY739.1 billion in 2023, with an operating margin of 9.5%.
- Energy (25.5%)--Tupras, Aygaz, Opet, and Entek. The segment's combined revenue was of TRY1,051.7 billion in 2023, with a reported operating margin of 9.0%
- Finance (18.1%)--Yapi and KocFinans, with combined revenue of TRY388.6 billion in 2023 and a reported operating margin of 24.7%.
- Consumer durables (7.1%)--Arcelik A.S. Reported segment revenue and operating margin were TRY297.2 billion and 4.5% in 2023, respectively.
- Other assets (6.9%).

Our Base-Case Scenario

Assumptions

- A conservative and proactive financial policy, through which Koc remains in a net cash position.
- Dividends, management fees, and interest income of TRY45 billion-TRY50 billion in 2024, compared with TRY29.2 billion in 2023.
- Operating expenses and taxes of about TRY8.0 billion-TRY9.0 billion in 2024, increasing from about TRY5.9 billion in 2023 due to domestic inflation.
- Annual interest expense of about TRY2.0 billion in 2024, up from TRY1.9 billion in 2023 due to the TRY devaluation.
- Dividend payments to Koc's shareholders of TRY20.3 billion in 2024, compared with TRY6.5 billion in 2023.
- No new investments or share buybacks.

Key metrics

Koc Holding A.S.--Key metrics*

	2019a	2020a	2021a	2022a	2023a	2024f
LTV (%)	(4.9)	(1.6)	(0.7)	0.8	(3.3)	Net cash
Cash flow adequacy (x)	3.5	1.5	2.6	2.1	3.7	4.0-5.0

*S&P Global Ratings-adjusted. LTV--Loan to value. a--Actual. f--Forecast.

Liquidity

We assess Koc's liquidity as strong and anticipate that sources of funds will exceed uses by 2.9x in the next 12 months, and by 1.7x in the subsequent 12 months according to our own estimates. This is further supported by our view of the company's extremely prudent cash management. Koc has one Eurobond outstanding of $750 million (or about TRY22.4 billion) due in March 2025, and its gross cash was of about TRY39.6 billion at Dec. 31, 2023. Moreover, having almost all its cash in U.S. dollars effectively neutralizes the foreign exchange risk attached to its U.S.-dollar-denominated bond.

Principal liquidity sources for the 12 months started Jan. 1, 2024, include:

- A cash balance of TRY39.6 billion;
- Unstressed dividend, interest income, and management fees of TRY45 billion-TRY50 billion per year;
- Proceeds of about TRY2.2 billion from the divestment of Tat Gida; and
- TRY6.3 billion from the redemption of the Yapi Kredi AT1 instrument.

Principal liquidity uses for the same period include:

- No debt maturities in the next 12 months, and debt repayments of about TRY22.4 billion in the subsequent 12 months, corresponding to the $750 million Eurobond due in March 2025;

- Operating and tax expense of TRY8 billion-TRY10 billion per year;
- Interest expense of TRY2.0 billion-TRY2.5 billion per year;
- Dividend payments of about TRY20.3 billion per year; and
- Contracted acquisition spending of about TRY2.9 billion in the next 12 months, stemming from the Kemer Medical Center acquisition.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Koc. This is because the company's portfolio has material stakes in companies exposed to high greenhouse gas emissions, such as Ford Otosan, Otokoc, Turk Traktor, Tofas, and Otokar. Also, Koc is exposed to refineries through its stake in Tupras. These assets make up close to 65% of the total portfolio value, with the remainder in less exposed sectors such as finance and consumer durables.

Koc's governance is exposed to high country risk in Turkiye, a negative factor compared with that of other investment holdings in Europe, but we view as positive that the group has an extensive strategic planning process, a track record of delivering on its strategy, and very comprehensive risk-management and performance-monitoring procedures.

Issue Ratings - Subordination Risk Analysis

Capital structure

At Dec. 31, 2023, Koc's capital structure comprises about $750 million of senior unsecured debt issued at the holding company level, with no significant priority debt outstanding or committed.

Analytical conclusions

The issue rating on Koc's senior unsecured notes is 'BB', in line with the issuer credit rating, because there are no significant elements of subordination risk in the capital structure and the leverage is low.

Ratings Score Snapshot

Issuer Credit Rating	BB/Positive/B
Business risk:	Weak
Country risk	High
Industry risk	Intermediate
Competitive position	Weak
Financial risk:	Modest
Cash flow/leverage	Minimal
Anchor	bb+
Modifiers:	

Issuer Credit Rating	BB/Positive/B
Liquidity	Strong (no impact)
Management and governance	Positive (+1 notch)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb-
Sovereign foreign currency rating	B+
Transfer and convertibility assessment	BB-
Rating above the sovereign	+2 notches

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Ford Otomotiv Sanayi A.S. Upgraded To 'BB' After Similar Action On The Sovereign; Outlook Stable, May 14, 2024
- Turkiye Upgraded To 'B+' On Economic Rebalancing; Outlook Positive, May 3, 2024

Ratings List

Upgraded

	To	From
Koc Holding A.S.		
Issuer Credit Rating	BB/Positive/B	BB-/Positive/B
Senior Unsecured	BB	BB-