

Research Update:

Koc Holding A.S. Ratings Affirmed At 'BB-'; Outlook Stable

March 11, 2020

Rating Action Overview

- During 2019, Koc Holding A.S. benefited from its dividend-generative and highly liquid portfolio--87% of its assets by value are listed. Koc has maintained a net cash position.
- That said, our rating on Koc is constrained by our 'BB-' transfer and convertibility (T&C) assessment for Turkey. Koc has a 'bbb-' stand-alone credit profile (SACP) assessment.
- We are affirming our rating on Koc at 'BB-'.
- The stable outlook primarily reflects the outlook on Turkey.

Rating Action Rationale

Koc has maintained a defensive net cash position and a highly liquid portfolio for a prolonged period. Koc benefits from a conservative financial policy, and we believe will maintain a loan-to-value (LTV) ratio below 20% under any circumstances, as demonstrated during the 2018 Turkish currency crisis. Moreover, it has ample financial flexibility sustained by its net cash position, which allows for potential new investments that would improve its portfolio diversity without jeopardizing its SACP. Offsetting this, Koc's highly liquid portfolio comprises assets of average credit quality. Most are in the 'B' category and our ratings on many of them are constrained by our T&C assessment for Turkey. Despite Koc's strengths, we consider that in a hypothetical default scenario for Turkey, Koc could face obstacles to paying foreign currency debt. Therefore, we cap our rating on Koc at 'BB-', in line with our T&C assessment on Turkey. Koc's stand-alone credit profile is 'bbb-'.

Koc's very prudent financial policy and strong balance sheet underpin the ratings. We expect Koc to remain committed to its financial policy. We understand that management has limited tolerance for net debt at the parent level, and the loan-to-value (LTV) ratio has been negative over the past six years. Despite the inherent volatility in the investment portfolio's value, and current equity market conditions in light of COVID-19, we believe the LTV ratio will remain well below 20% at all times. Furthermore, we expect cash flow adequacy to remain strong in 2020-2023, which we attribute to stable dividend income from its investee companies. These positives are tempered by

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volatility in asset values. The recent depreciation of the Turkish lira against the U.S. dollar has materially reduced Koc's investment portfolio in dollar terms. We estimate the portfolio was worth about \$8.8 billion as of Dec. 31, 2019 (TRY52.3 billion), at an exchange rate of TRY5.94/\$1, despite moderate increases in domestic share prices in 2019. We exclude net cash when calculating portfolio value and include Koc's Additional Tier 1 (AT1) securities investments in Yapi Kredi Bank. This compares with a valuation of about \$13 billion at year-end 2017, at an exchange rate of TRY3.77/\$1. Koc receives all of its material dividends within Turkey, although it derives most of its dividend income from companies with foreign exchange or foreign exchange-linked revenue.

Koc's investment position is supported by its diversity by sector and high proportion of listed assets. However, Koc's portfolio suffers from a degree of concentration in its three largest investments and is further constrained by the relatively low asset quality of its investee companies. Approximately 87% of Koc's assets by value are listed and are actively traded on the Borsa Istanbul. Additionally, Koc has invested in a wide range of sectors, including financial institutions, auto manufacturing, retail, consumer durables, and oil refining.

Koc's three largest assets--Tupras, Ford Otosan, and Yapi Kredi Bank--constitute about 55% of the portfolio. Following the downgrade of Yapi--in which Koc Group now has a 49.99% stake--to 'B+' earlier in 2018, and in view of the effect of the lower sovereign rating on some of Koc's other investee companies, we assess the weighted credit quality of Koc's investment portfolio as being in the 'b+' category. This is weaker than that of other investment holding companies, such as EXOR, Industrivarden, and Wendel.

We view management as conservative and expect the company to maintain strong liquidity.

Three Eurobonds totaling Turkish lira (TRY) 13.4 billion (\$2.25 billion) are outstanding at the parent level. This compares with year-end 2019 cash of TRY16 billion, 77% of which is denominated in hard currency. In March 2019, Koc issued \$750 million notes to prefinance an upcoming maturity in April 2020, which indicates prudent cash management on the company's part. Even if Koc had been unable to tap the Euromarket, we expect it would have met the April 2020 debt maturity because it keeps 77% of its TRY16 billion cash (\$2.7 billion) in hard currency deposits (as of Dec. 31, 2019).

Outlook

The stable outlook is in line with that on the Turkish sovereign, given the dependency on the T&C assessment.

Downside scenario

If we were to downgrade Turkey further, to below 'B+', or if Turkey were to impose capital controls causing us to lower our T&C assessment, we would likely lower our ratings on Koc.

Although we consider it unlikely, we could also lower our ratings on Koc if it failed to pass our sovereign stress test. This could happen if its debt maturity profile were to shorten and, at the same time, Koc held materially less cash in hard currencies. Because it passes the sovereign stress test at present, our rating on it may be up to two notches above that on the sovereign, capped at the T&C level.

Upside scenario

In our view, the ratings on Koc cannot be higher than our T&C assessment on Turkey (currently 'BB-') because the majority of investee companies, and therefore dividends, derive from Turkey. We could, therefore, upgrade Koc if we raised our rating and T&C assessment on Turkey.

Company Description

Koc has roots dating back to 1926 and has been listed on the Borsa Istanbul (Istanbul Stock Exchange) since 1986. The holding company controls a large number of listed and unlisted companies operating in the energy (Tüpras, Aygaz, Opet, and Entek), consumer durables (Arcelik A.S.; BB+/Negative/--), finance (Yapi ve Kredi Bankasi A.S.), and automotive industries (Tofas and Ford Otosan joint ventures with Fiat Chrysler Automobiles N.V. and Ford Motor Co.). Koc reported consolidated sales of TRY153.5 billion (\$27.1 billion) in 2019.

Our Base-Case Scenario

- GDP growth in Turkey of about 3.5% in 2020 and 3.3% in 2021, compared with 0.9% in 2019.
- Dividend, interest, and fee income of TRY2.5 billion-TRY 3 billion (\$0.40 billion-\$0.50 billion) in 2020.
- Operating expenses of about TRY580 million in 2020, a slight decrease in cash basis operating expenses, compared with about TRY600 million in 2019.
- Interest costs of about TRY600 million-TRY650 million in 2020, compared with TRY512 million in 2019.
- Dividend payments of about TRY1.2 billion per year, in line with 2019.
- No major acquisitions or disposals that would materially change our view of Koc's leverage.

Based on these assumptions, we arrive at the following credit metrics:

- A net cash position in 2020 and 2021 as it was in 2019.
- Cash-flow adequacy of 2.0x-2.5x in 2020, compared with 3.5x in 2019 (above 3.0x on a five-year weighted basis).

Liquidity

We assess Koc's liquidity as strong and anticipate that sources of funds will exceed uses by 3x, since the company has no short-term debt, beyond a \$750 million bond maturing in April this year, which we anticipate Koc will repay. Moreover, Koc's liquidity position remains strong in our stress test. We believe Koc has solid relationships with local and international banks--it is one of the largest investment holding companies in Turkey and has a large portfolio of listed assets on the stock exchange. In our view, Koc's financial risk management is very prudent. It includes a process that monitors foreign exchange exposure. Koc also aims to reduce the effect of currency depreciations by taking out loans in currencies that correspond with its revenue and its assets. The company is likely able to service its debt, even without dividend income or asset disposals, due to its strong cash position and long-dated debt maturity profile.

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Following the April maturity, Koc will have two bonds outstanding, each \$750 million, which are due in 2023 and 2025. We consider that Koc would likely be able to absorb any high-impact, low-probability events in the near term without additional financing. The company's ratio of sources to uses would qualify it for a higher liquidity assessment except that it keeps most of its cash at lower-rated domestic banks. In addition, its standing in international credit markets would likely be weakened if there were turmoil in Turkey.

We anticipate the company will have the following principal liquidity sources over the next 12 months from Dec. 31, 2019:

- Cash and cash equivalents of \$2.7 billion (TRY16 billion) mainly held at various domestic banks, with about 77% in hard currency, but no undrawn, committed credit facilities.
- Dividends, interest, and management fees from portfolio companies of TRY2.5 billion-TRY3.0 billion.

We anticipate the company will have the following principal liquidity uses over the same period:

- Upcoming bond maturity of \$750 million in 2020.
- Interest and operating expenses of about TRY1.2 billion.
- Dividends of about TRY1.2 billion.

Debt maturities

- \$750 million bond maturing in 2023.
- \$750 million bond maturing in 2025.

Rating Above The Sovereign

We consider that our rating on Koc could exceed the sovereign rating by two notches, but cap the rating at the level of our T&C assessment because most of Koc's investee companies (and consequently dividend inflows) are based in Turkey. This reflects our view of the likelihood that the government would restrict access to foreign exchange liquidity for Turkish companies.

We rate Koc above the 'B+' foreign currency rating on Turkey because it passes our sovereign default stress test, under which we assume that the value of investee companies declines by about 70%, Yapi Kredi Bank defaults, and Koc's cash is 10% lower. Under this scenario, we assume that Koc has no access to capital markets and the Turkish lira depreciates by 50% against the U.S. dollar.

Issue Ratings - Subordination Risk Analysis

Capital structure

Koc's capital structure consists of about \$2.25 billion of senior unsecured debt issued at the holding company level. We assess Koc's financial risk profile as modest.

Analytical conclusions

The issue rating on Koc's senior unsecured notes is 'BB-', the same as the issuer credit rating, because there are no significant elements of subordination risk present in Koc's capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/B

Business risk: Fair

- Country risk: High
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Modest

- Leverage/cash flow: Modest
- Funding and capital structure: Neutral

Anchor: bbb-

Modifiers

- Liquidity: Strong (no impact)
- Management and governance: Strong (no impact)
- Comparable ratings analysis: Neutral (no impact)
- Stand-alone credit profile: bbb-

Sovereign foreign currency rating: B+

- Sovereign transfer and convertibility: BB-
- Rating above the sovereign methodology: Capped at the level of the T&C assessment

Related Criteria

- General Criteria: Group Rating Methodology, July 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

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- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Koc Holding A.S.

Issuer Credit Rating	BB-/Stable/B
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Senior Unsecured	BB-
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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