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Ratings

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Koc Holding A.S.

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Koc Holding A.S.

Credit Highlights

Issuer Credit Rating
BB-/Stable/B

Overview

Key strengths	Key risks
Portfolio value of $8.8 billion (Dec. 31, 2019) with a high portion of liquid assets and more than 87% listed directly or indirectly and actively traded on the Borsa Istanbul.	The vast majority of Koc Holding A.S.'s (Koc's) investments are focused on Turkish companies with an average credit risk of 'B+'.
Prudent financial policy and cash management, with ample financial flexibility including a net cash position for six years and total cash balance of Turkish lira (TRY) 16.0 billion at year-end 2019.	Moderately concentrated investments, with the three largest assets, Tupras, Ford Otosan, and Yapi Kredi Bank, representing about 55% of the portfolio.
A material part of investee companies' combined revenues (approximately 55%) are in hard currency or foreign exchange linked, partially protecting Koc from potential lira devaluation.	Cash primarily held at domestic banks with lower credit quality than Koc.
S&P Global Ratings forecasts a continued net cash position in 2020 and 2021, as it was in 2019, and, strong cash flow adequacy ratio of 2.0x-2.5x in 2020 (from 3.5x in 2019), mainly supported by dividend inflows from, Tofas, Ford Otosan, and Arcelik.	Our view of Turkey's (B+/Stable/B) transfer and convertibility (T&C) assessment at 'BB-' acts as a cap for the ratings.
	The COVID-19 pandemic is currently not factored into our base case but large market value declines of assets and lower than expected dividends could occur as a result.

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 the COVID-19 pandemic, 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 volatility in asset values.

Koc's investment position is supported by its sector diversity and high proportion of listed assets, however, the top three assets represent about 55% of the portfolio with an average credit risk of 'B+'. Koc's portfolio suffers from a degree of concentration in its three largest investments, representing about 55% of its portfolio value, and is further constrained by the relatively low asset quality of its investee companies, in the 'B+' area. Approximately 87% of Koc's assets by value are listed and 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.

We view management as conservative and expect the company to maintain strong liquidity but the rating is capped by our 'BB-' T&C assessment for Turkey. Despite Koc's strengths, we consider that in a hypothetical default scenario for Turkey it 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-'.

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 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, are derived from Turkey. Therefore, we could upgrade Koc if we raised our rating and T&C assessment on Turkey.

Our Base-Case Scenario

Assumptions

- 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-TRY3.0 billion ($0.40 billion-$0.50 billion) in 2020.
- Operating expenses of about TRY580 million in 2020, a slight decrease on cash-basis operating expenses, compared with about TRY600 million in 2019.
- Interest costs of 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.

Key Metrics

	2019A	2020E
LTV (%)*	Below 0	Below 0
Cash-flow adequacy (x)	3.5	2.0-2.5

*S&P Global Ratings-adjusted. LTV--Loan to value. A--Actual. E--Estimate.

Company Description

Koc's roots date back to 1926 and it 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 auto industries (Tofas and Ford Otosan joint ventures with Fiat Chrysler Automobiles NV and Ford Motor Co.). Koc reported consolidated sales of TRY153.5 billion ($27.1 billion) in 2019.

Business Risk

Our assessment of Koc's investment position reflects its diverse portfolio, liquid assets, and management's investment discipline.

Our rating on Koc is supported by its investee companies, which export a significant part of their production, protecting dividends from currency depreciation. Among its investee companies, Ford Otosan, Tofas, and Arcelik derive about 85%,70%, and 68% of their revenue respectively from international sales, while refinery group Tupras' sales are U.S.-dollar linked. We believe this diversity will support Koc if the Turkish lira continues to depreciate against the U.S. dollar, and inflation pressure rises. In addition, these entities are active in industries that we believe carry only moderate sensitivity to country risk. Typically, all Koc's investee companies have low leverage. That said 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 the 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 and 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 sector diversity and high proportion of listed assets. 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,it has invested in a wide range of sectors, including financial institutions, auto manufacturing, retail, consumer durables, and oil refining.

Following the downgrade of Yapi--in which Koc 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 its investment portfolio in the 'B+' category. This is weaker than that of other investment holding companies (IHCs), such as EXOR, Industrivarden, and Wendel.

Peer comparison

Table 1

Koc Holding A.S.--Peer Comparison

	Koc Holding A.S.	Dogus Holding A.S.	JAB Holding Company S.a r.l.	Wendel	EXOR N.V.*
Rating as of March 18, 2020	BB-/Stable/B	trBB	A-/Positive/--	BBB/Stable/A-2	BBB+/Positive/A-2

Table 1

Koc Holding A.S.--Peer Comparison (cont.)					
	Koc Holding A.S.	**Dogus Holding A.S.**	**JAB Holding Company S.a r.l.**	**Wendel**	**EXOR N.V.***
Business profile	Fair	Vulnerable	Satisfactory	Fair	Satisfactory
Portfolio data as of	31-Dec-19	28-Oct-19	1-Dec-19	30-Sep-19	31-Dec-19
Portfolio size (adjusted; mil. $)	8,841	5,102	29,819	8,262	18,192
Weight of listed assets (%)	87	8.8	53.7	46.6	93.8
Largest asset (% of portfolio)	23.9	17.8	53.7	46.6	38.2
Three largest assets (% of potfolio)	56.1	46.7	89.1	75.7	88.7
Cash flow leverage	Modest	Highly Leveraged	Modest	Modest	Modest
Loan to value ceiling (%)	20.0	45.0	20.0	20.0	20.0
Loan to value (%)	(4.9)	22.7	17.7	7.0	(30.2)

Note: *EXOR N.V. data is pro-forma the PartnerRe divestment.

Financial Risk

The company has a long track record of managing leverage and cash flow. We base our analysis on Koc's stand-alone financial risk profile, meaning the parent company's group accounts, rather than the consolidated accounts. Our view of Koc's financial risk reflects the net cash position at the holding level. This results in a very robust ratio against the appraised value of the company's investment portfolio of TRY52.3 billion as of Dec. 31, 2019. We believe the group has a very conservative financial policy, given its long history of being in a net cash position. We therefore expect its LTV ratio to remain well below 20%, which provides ample headroom. Additionally, the group remains cash flow generative with cash flow adequacy ratios consistently above 2x. This is largely a result of stable dividend inflows and expenses.

Management's defensive cash management supports its strong liquidity. Three Eurobonds totaling TRY13.4 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 market, 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).

The company's has among the most comfortable LTV headroom in its peer group. In relation to peers, Koc has more headroom under its modest financial risk profile, given the net cash position. We also view Koc's financial policy as very prudent. However, in relation to its peers, Koc is more exposed to unstable country risk, given most of its investments are in Turkey. Although Koc was able to weather instability in Turkey in 2018 and 2019, we consider that the performance of investee companies may be affected in the future, which has the potential to decrease the company's cash flow, among other metrics. This could be the case particularly due to the COVID-19 pandemic, which we expect will reduce dividend inflows from investees.

Financial summary

Table 2

Koc Holding A.S.--Financial Summary						
(Mil. TRY)	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**
Portfolio as adjusted	52,251.0	38,555.0	48,897.0	35,321.0	30,385.0	31,170.0
Net debt as adjusted	(2,574.0)	(2,244.0)	(2,165.0)	(1,501.0)	(1,441.0)	(1,075.0)
Loan to value (%)	N.M.	N.M.	N.M.	N.M.	N.M.	N.M.
Dividend, fees, & interest received	3,984.0	3,765.0	2,019.0	1,850.0	1,337.0	1,051.0
Operating charges and tax paid	612.0	436.3	384.6	439.1	359.0	277.0
Interest paid	512.0	324.0	238.0	136.0	81.0	58.4
Cash flow cover (x)	3.5	5.0	3.2	3.2	3.1	3.1
Dividend paid	1,183.0	1,029.0	935.0	849.0	585.0	490.0

N.M.--Not meaningful (net cash position). TRY--Turkish lira.

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 it 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 IHCs 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 depreciation 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.

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.

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.

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
- 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 Detail (As Of March 18, 2020)*	
Koc Holding A.S.	
Issuer Credit Rating	BB-/Stable/B
Senior Unsecured	BB-
Issuer Credit Ratings History	
29-Aug-2018	BB-/Stable/B

Ratings Detail (As Of March 18, 2020)*(cont.)	
13-Jul-2018	BB+/Stable/B
02-Feb-2017	BBB-/Negative/A-3
15-Nov-2016	BBB-/Stable/A-3
22-Jul-2016	BBB-/Negative/A-3
24-May-2016	BBB/Stable/A-2
02-Mar-2016	BBB-/Positive/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.