Research Update:

Koc Holding Outlook Revised To Stable From Negative Following Similar Action On Turkiye

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One or more of the credit ratings referenced in this article was assigned by applying an exception to S&P Global Ratings' published criteria for rating above the sovereign.

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Rating Action Overview

- On Sept. 29, 2023, S&P Global Ratings revised its outlook on Turkiye to stable from negative and affirmed its unsolicited 'B/B' long- and short-term sovereign credit ratings on the country. The transfer and convertibility (T&C) assessment remained unchanged at 'B'.
- Since the end of June 2023, Koc Holding AS (Koc) has met our requirements to be rated a notch above the T&C assessment on Turkiye.
- We therefore revised our outlook on Koc to stable from negative and affirmed our 'B+' long-term issuer credit rating and 'B' short-term rating.
- The stable outlook on Koc mirrors that on Turkiye.

Rating Action Rationale

The outlook revision follows a similar action on Turkiye. The rating action on Koc follows a similar action on Turkiye (see "Research Update: Turkiye Outlook Revised To Stable From Negative On Policy Shift; 'B' Ratings Affirmed," published Sept. 29, 2023, on RatingsDirect). We also continue to apply a criteria exception on our rating on Koc, reflecting our expectation that the holding company can maintain sufficient cash in U.S. dollars to repay its $750 million bond due in March 2025.

The criteria exception that enables us to rate Koc one notch above our T&C assessment on Turkiye reflects our expectation that Koc can maintain sufficient cash in U.S. dollars at international banks to fully repay its U.S.-dollar-denominated debt. We would typically apply our T&C rating cap to companies, such as Koc, that are not exporters and that generate more than 90% of their cash flow in Turkiye, implying a rating of 'B'. In Koc's case, more than 90% of income represents dividends from investments in Turkiye. As of June 30, 2023, Koc's only financial debt liability pertains to its $750 million bond due in March 2025. We think the company 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, Koc 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 all 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 'B' 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 June 2023.

Koc has a sound net cash position and liquidity buffers. Based on portfolio value on June 30, 2023, and pro forma the completed sale of a 6.81% stake in Yapi ve Kredi Bankasi (Yapi; not rated) on July 27, 2023, for Turkish lira (TRY) 6.8 billion on a pre-tax basis, we estimate Koc's net cash position at about TRY11.5 billion, excluding additional tier 1 (AT1) instruments (about $200 million). In addition, around 98% of the company's gross cash held as of June 30, 2023, was denominated in U.S. dollars and predominantly held at international banks.

We consider Koc to have strong liquidity as of June 30, 2023, and expect sources to exceed uses by 5.1x for the next 12 months, and by 2.0x for the following 24 months. In addition, in a hypothetical scenario in which the Turkish sovereign were to default, we believe Koc would be able to continue to service its obligations.

Our stress test, which assesses the company's liquidity for a one-year period under a hypothetical sovereign default scenario, shows that Koc's liquidity sources would remain strong at nearly 6x thanks to its high share of cash denominated in hard currency, assuming no dividends. We think that, in this scenario, a devaluation of the lira would benefit Koc's gross cash position, and compensate the potential lack of dividend income and higher operating and interest expenses.

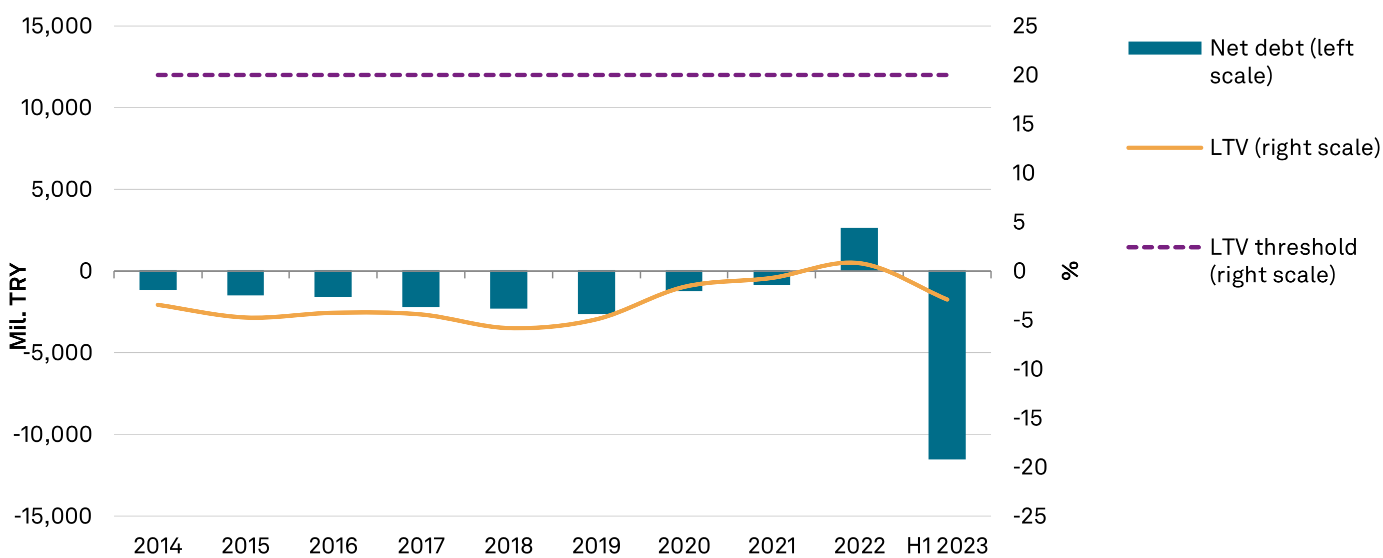
In addition, our T&C stress test points to a continued positive liquidity ratio of foreign sources of cash to foreign uses of cash, because Koc's current U.S. dollar cash balances held offshore are sufficient to cover its outstanding $750 million bond maturing in March 2025 and associated interest payments.

Koc's net cash position is pivotal for our rating. Under our base case, we anticipate that Koc will retain a net cash position, which could eventually be supported by dividends from its investee assets. For 2023, we estimate that Koc will receive dividends, fees, and interest income over TRY25 billion, up from TRY8.7 billion a year ago. This is supported by its key assets' solid operating results, largely because of their exporting nature. Moreover, 55% of Koc's portfolio is directly linked to U.S. dollars, so it is relatively protected from Turkish lira depreciation.

As a result, we think Koc can maintain a net cash position for the foreseeable future. Even in the hypothetical event of a default of the Turkish sovereign, we anticipate that Koc would retain a net cash position and a negative loan-to-value ratio. Koc has invested $200 million in Yapi's AT1 securities, which have a first call date in January 2024. If Yapi were to redeem this instrument, Koc would receive additional funds, which would further strengthen its already solid net cash position. At this stage, however, we do not account for this source of cash in our base case or liquidity calculations.

Chart 1

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.

Outlook

The stable 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; or
- 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, provided that Koc is able to meet our requirements to be rated up to one notch above our T&C assessment.

Company Description

Koc began operating in 1926 and has been listed on Borsa Istanbul since 1986. On Oct. 6, 2023, its market capitalization reached TRY403 billion ($14.5 billion). The company is closely controlled by the Koc family (63.8%).

Koc controls many listed (directly or indirectly) and unlisted companies operating in diverse sectors. According to our estimates, the holding company's portfolio value on June 30, 2023, pro forma the TRY6.8 billion Yapi stake sale, was TRY399.6 billion, or about $15.3 billion (our estimate of the gross portfolio value excludes net cash and includes Yapi's AT1 issuance). On the same date, Koc's portfolio included assets in the following sectors:

- Autos and auto suppliers (50.0% of the portfolio's value as defined above)--Tofas, Ford Otosan, and Turk Traktor; joint ventures with Stellantis N.V., Ford Motor Co., and CNH Industrial N.V., respectively; and Otokar and Otokoc. Combined revenue rose 125% to TRY312.9 billion in 2022, from TRY139.0 billion in 2021, on solid export contracts and a favorable product mix supported by currency tailwinds. The combined operating margin (as reported by Koc) deteriorated to 12.7% from 13.3% in 2021;
- Energy (16.2%)--Tüpras, Aygaz, Opet, and Entek. The segment's combined revenue more than doubled in 2022 to TRY713.7 billion from TRY229.6 billion in 2021, supported by robust net refining margins. The combined operating margin (as reported by Koc) was 7.0%, up materially from 1.5% in 2021;
- Finance (15.4%)--Yapi and KocFinans, in which we include the investment in Yapi's AT1 perpetual instrument. Revenue rose 129% to TRY168.7 billion in 2022 from TRY73.5 billion in 2021, supported by an improvement in margins and fees. The combined operating margin (as reported by Koc) increased to 41.0% from 18.3% in 2021;
- Consumer durables (9.1%)--Arcelik A.S. Combined revenue increased 100% to TRY153.7 billion in 2022 from TRY76.9 billion in 2021, supported by strong demand, both international and domestic, and contributions from acquisitions. The operating margin dipped to 6.4% in 2022 from 9.3% in 2021, owing to higher raw material prices; and
- Others (9.3%).

Our Base-Case Scenario

Assumptions

- A conservative and proactive financial policy, through which Koc remains in a net cash position over time.
- Our assumption of dividends, management fees, and interest income of TRY25 billion-TRY27 billion in 2023, compared with TRY8.7 billion in 2022.

- Operating costs of about TRY3.0 billion in 2023, increasing from about TRY2.5 billion in 2022 due to domestic inflation.
- Annual interest expense of about TRY1.6 billion in 2023, decreasing from TRY1.7 billion in 2022 due to the March 2023 bond repayment that offsets the TRY devaluation.
- Dividend payments of TRY6.5 billion in 2023, compared with TRY2.8 billion in 2022.
- No major new investments or share buybacks.

Key metrics

Koc Holding A.S.--Key metrics*

	2019a	2020a	2021a	2022a	2023f
LTV (%)	(4.9)	(1.6)	(0.7)	0.8	Net cash
Cash flow adequacy (x)	3.5	1.5	2.6	2.1	5.0-6.0

*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 5.1x in the next 12 months, and by 2.0x in the following 24 months. This is further supported by our view of the company's extremely prudent cash management. Koc has one Eurobond outstanding of $750 million due in March 2025, and we estimate its gross cash (pro forma the Yapi stake sale and excluding the AT1 instrument and other investments) at about TRY31.2 billion. 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 July 1, 2023:

- A cash balance of TRY31.2 billion pro forma the Yapi stake sale; and
- Unstressed dividend, interest income, and management fees of TRY25 billion-TRY26 billion per year.

Principal liquidity uses for the same period:

- Operating expenses of TRY2.5 billion-TRY3.5 billion per year;
- Interest expense of TRY1.5 billion-TRY2.0 billion per year; and
- Total dividend payment of about TRY6.5 billion per year.

Environmental, Social, And Governance

Environmental factors are a moderately 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 70% of the total portfolio value, with the remainder in less exposed sectors like 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

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

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.

Ratings Score Snapshot

Issuer Credit Rating	**B+/Stable/B**
Business risk:	Weak
Country risk	High
Industry risk	Intermediate
Competitive position	Weak
Financial risk:	Intermediate
Cash flow/leverage	Modest
Funding and capital structure	Negative
Anchor	bb
Modifiers:	
Liquidity	Strong (no impact)
Management and governance	Strong (+1 notch)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bb+
Sovereign foreign currency rating	B
Transfer and convertibility assessment	B
Rating above the sovereign*	(+1 notch)

*The final rating was obtained by applying an exception to our criteria for rating above the sovereign.

Related Criteria

- 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: Country Risk Assessment Methodology And Assumptions, 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Turkiye Outlook Revised To Stable From Negative On Policy Shift; 'B' Ratings Affirmed, Sept. 29, 2023
- Turkiye-Based Koc Holding Upgraded To 'B+' On Strong U.S. Dollar Net Cash Position; Outlook Negative, June 6, 2023

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Koc Holding A.S.		
Issuer Credit Rating	B+/Stable/B	B+/Negative/B
Koc Holding A.S.		
Senior Unsecured	B+	B+