S&P Global
Ratings

Research

Research Update:

Koc Holding Upgraded To 'BB-' Following Positive Rating Actions On Turkiye; Outlook Positive

December 14, 2023

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.

PRIMARY CREDIT ANALYST

Florent Blot, CFA
Paris
+ 33 1 40 75 25 42
florent.blot
@spglobal.com

SECONDARY CONTACT

Marta Bevilacqua
Milan
+ (39)0272111298
marta.bevilacqua
@spglobal.com

Rating Action Overview

- On Nov. 30, 2023, S&P Global Ratings raised its transfer and convertibility (T&C) assessment on Turkiye to 'B+' from 'B'. At the same time, we revised the outlook on our unsolicited 'B' long-term sovereign credit rating on Turkiye to positive from stable, and affirmed all our foreign and local currency ratings on the sovereign.
- Since the end of September 2023, Koc Holding A.S. (Koc) has met our requirements to be rated a notch above the T&C assessment on Turkiye, and we continue to think the company can be rated two notches above the sovereign, thanks to its positive track record in keeping a net cash position and a strong liquidity.
- We therefore raised our long-term issuer credit rating on Koc and our issue rating on its unsecured notes to 'BB-' from 'B+' and affirmed our 'B' short-term rating.
- The positive outlook on Koc mirrors that on Turkiye.

Rating Action Rationale

The upgrade and outlook revision follow a similar action on our T&C assessment and sovereign credit rating on Turkiye. We 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. As a result, Koc can be rated one notch above our 'B+' T&C assessment on Turkiye, and at a maximum of two notches above our 'B' sovereign credit rating on Turkiye (see "Turkiye Outlook Revised To Positive From Stable On Subsiding Twin Deficits; 'B' Ratings Affirmed," published Nov. 30, 2023, on RatingsDirect). The rating cap at two notches above the sovereign credit rating is because we view domestic investment holding companies as having high sensitivity to their home country's risk.

3102539

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 and related interests. 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 standalone 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 Sept. 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 September 2023.

Koc has a sound net cash position and liquidity buffers. Based on portfolio value on Sept. 30, 2023, we estimate Koc's net cash position at about Turkish lira (TRY) 11.7 billion, excluding additional tier 1 (AT1) instruments (about $200 million). In addition, about 94% of the company's gross cash held as of Sept. 30, 2023, was denominated in U.S. dollars and predominantly held at international banks.

We consider Koc to have strong liquidity as of Sept. 30, 2023, and expect sources to exceed uses by 5.2x 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 think 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 about 7x 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.

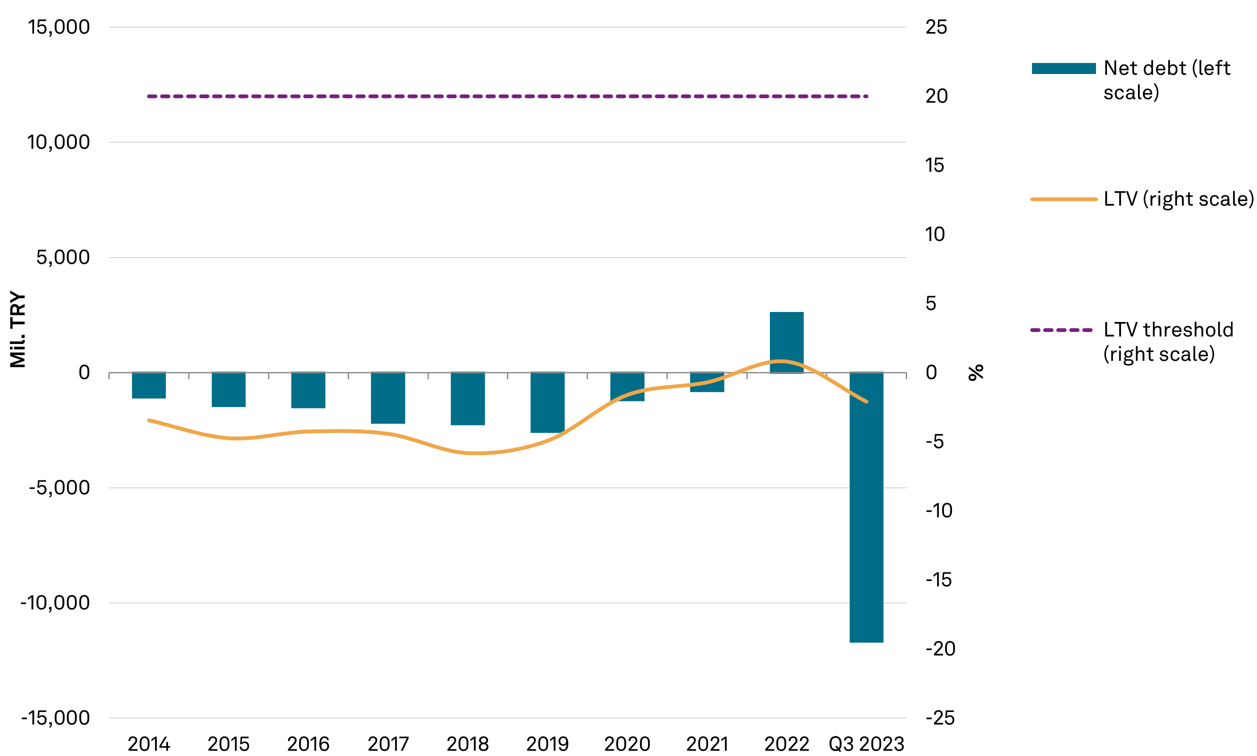
Koc's net cash position is pivotal for our rating. Under our base case, we anticipate that Koc will retain a net cash position, which could eventually be supported by dividends from its investee assets. For 2023, we estimate that Koc will receive dividends, fees, and interest income over

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. In the nine months to Sept. 30, 2023, about 50% of the revenue of Koc's investee assets was linked to hard currencies (including U.S. dollars), so we view Koc's portfolio as 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 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 'B+' as well as of the T&C assessment to 'BB-'. An upgrade will also require 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 Dec. 13, 2023, its market capitalization reached TRY347 billion ($12 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 Sept. 30, 2023, was TRY563.7 billion, or about $20.6 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 (44.3% 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 (26.4%)--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 (16.4%)--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 (8.1%)--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 (4.8%).

Our Base-Case Scenario

Assumptions

- A conservative and proactive financial policy, through which Koc remains in a net cash position over time.
- Dividends, management fees, and interest income of TRY25 billion-TRY27 billion in 2023, of which about TRY24 billion of dividends has already been cashed to date, 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 new investments or share buybacks.

Key metrics

Koc Holding A.S.--Key Metrics*

	2019a	2020a	2021a	2022a	2023f
Loan to value (%)	(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. a--Actual. f--Forecast.

Liquidity

We assess Koc's liquidity as strong and anticipate that sources of funds will exceed uses by 5.2x 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 at about TRY32.2 billion at Sept. 30, 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 Oct. 1, 2023:

- A cash balance of TRY32.2 billion; and
- Unstressed dividend, interest income, and management fees of TRY25 billion-TRY27 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 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 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 Sept. 30, 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:	Intermediate

Issuer Credit Rating	**BB-/Positive/B**
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*	(+2 notches)

*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: Methodology: Industry Risk, 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: Country Risk Assessment Methodology And Assumptions, 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 Positive From Stable On Subsiding Twin Deficits; 'B' Ratings Affirmed, Nov. 30, 2023

Ratings List

Upgraded

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

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.