Equity / Large Cap. / Conglomerate

Koc Holding

13.12.2016

OUTPERFORM

A rare mixture of thriving and stamina

Upside Potential 18%

Revised PT to TL15.3/share, maintained OUTPERFORM

We revised our 12M PT to TL15.3/share from TL14.6 owing to lower discretionary NAV discount attached to our TNAV at 5% (prev: 10%) as we believe Koc fits well to the current economic environment. Having a balanced and diversified portfolio, Koc bodes with a turbulent macro backdrop, poising to be a winner both in up and down markets. The current discount to its NAV is also flagging as a good entry point. We reiterate our OURPERFORM recommendation for the shares offering 18% upside potential to our PT.

Offers potential gains on discount front

The current NAV discount of the Holding stands at 6% compared to its 3M/1Y average discounts of 4%, respectively. Listed assets of Koc, making c.90% of its NAV is also a good precursor for its valuation. Currently Koc is trading at 8% premium to its listed current NAV vs. its 3M/1Y averages of 10%. In addition, its listed underlying assets also offer sizable appreciation potential which, in turn, suggests further gains on discount to NAV front. Six of subsidiaries under our coverage are rated as outperform offering sizeable upside potential with prospective near term catalysts while Tupras and Tofas remain to be crown jewels in our top recommended list.

Rendering an almost picture-perfect cocktail

The shares provide resilience against headwinds thanks to;

i) An optimum portfolio diversification to balance and minimize sector/ geography specific risks; including automotive (36%), energy (24%), consumer durables (16%), finance (15%) and cash&others (9%).

ii) Auto and consumer durable sectors have robust FX revenues. The Group's international revenues from exports and foreign operations account for c.30% of its combined revenues. Added Tupras to the list, the ratio rises to nearly half of the combined revenues.

iii) Timely downsizing the overall leverage to low levels. Its combined net debt/EBITDA ratio stands relatively low at 1.6x. The Holding carries combined adjusted net long FX position of US$225mn as of 9M16.

iv) The Holding's stand-alone net cash position stands at US$571mn (6% of NAV) as of 9M16, while its gross cash at hand stands at U$2.1bn, 75% of which is denominated in US$, while 25% is in TL. Its cash rich balance sheet provides a strong buffer to tackle short-term shocks while enabling to chase inorganic growth opportunities both in Turkey and abroad.

v) More room to increase dividend as the cap-ex need of the Group has significantly faded. Moreover, Tupras's dividends will fully flow to Koc starting from 2018 as the remaining debt (TL322mn) at the SPV level will be fully retired. We expect the dividend income of the Holding to reach TL1.3bn this year and to TL1.8bn in 2018 from TL0.9bn in 2015 which will likely lead to higher dividend yield for Koc Holding shareholders in upcoming years.

Key risks

Further deterioration in financing conditions and macro environment, weakness in refinery and banking margins and unfavorable regulatory changes in underlying sectors may have an adverse impact on Group's future growth and profitability, while value-enhancing corporate actions such as M&As may pose upside risks.

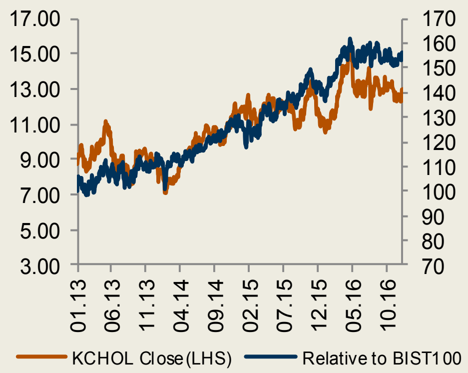
Ticker		KCHOL

Stock Data	TL	US$
Price at 12 12 2016	12.96	3.68
Target Price	15.30	4.42
Prev.Target Price	14.60	4.48
Mcap (mn)	32,865	9,327
Float Mcap (mn)	7,290	2,069
Avg.Daily Volume (3M, mn)	50.7	16.0
No. of Shares Outstanding (mn)		2,536
Free Float (%)		22.18

Multiples	2016E	2017E	2018E
P/E	10.4	8.1	7.0
P/BV	1.2	1.1	1.0
EV/EBITDA	8.1	5.4	4.8

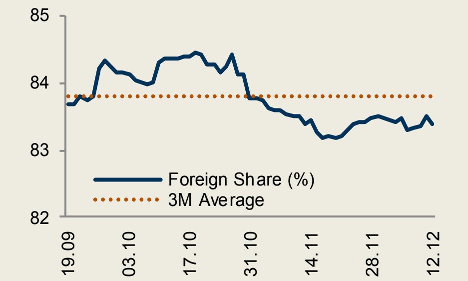
Price Perf. (%)	1 Mn	3 Mn	12 Mn
TL	5	2	19
US$	-3	-14	-1
Relative to BIST-100	3	1	9

Price / Relative Price



52 Week Range (Close TL)	11.28	15.14

Foreign Share (%)



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Valuation

We value Koc Holding shares based on the SOTP valuation. We attach a 5% discretionary holding discount in arriving to our target value. The discounts we apply to holding companies in our coverage universe ranges from 5% to 40%. The main reason for relatively lower discount applied to KCHOL can be cited as; sound asset composition (asset quality, diversification benefits), higher transparency, higher liquidity of shares, higher corporate governance, management control over major assets in the portfolio, and sound dividend contribution from subsidiaries. The successful track record of M&A activities and proactive disposals of the Holding are other factors behind the lower discount.

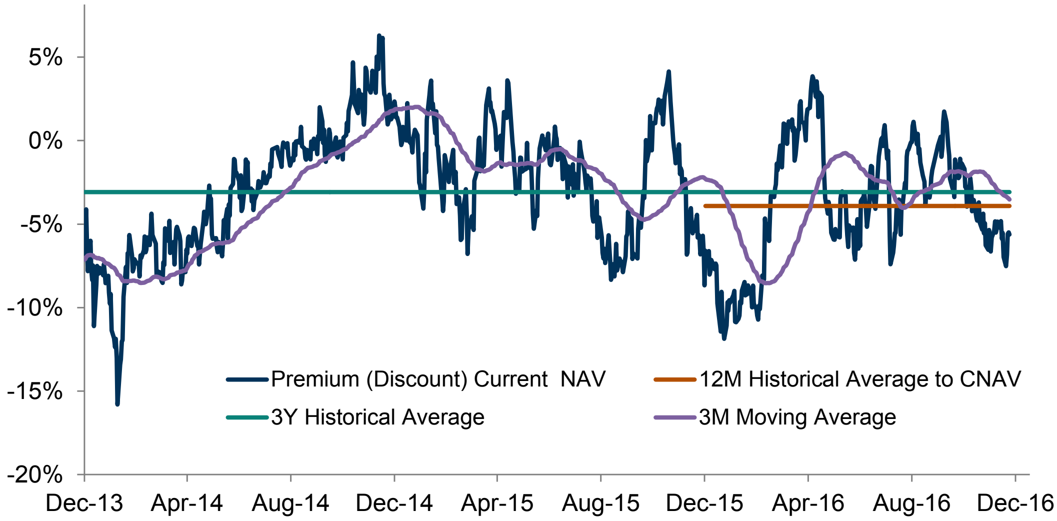
FIGURE 1: Koc Holding NAV Breakdown (US$ mn)

Business Segment/Company	Ticker	KCHOL's Stake	Current Valuation Method	Current Value	KCHOL's Stake	Weight in NAV	Target Valuation Method	Target Value	KCHOL's Stake	Weight in NAV
Automotive				**8,579**	**3,549**	**36%**		**9,238**	**3,795**	**34%**
Ford Otosan	FROTO	38.5%	Current Mcap	2,984	1,148	12%	Target Mcap	3,505	1,348	12%
Tofas Fabrika	TOASO	37.6%	Current Mcap	3,241	1,218	12%	Target Mcap	3,538	1,330	12%
Turk Traktor	TTRAK	37.5%	Current Mcap	1,116	419	4%	Target Mcap	1,260	472	4%
Otokar	OTKAR	44.7%	Current Mcap	829	370	4%	Target Mcap	496	222	2%
Otokoc	Unlisted	96.3%	0.3 x 2016E P/S	410	395	4%	0.3 x 2016E P/S * (1+CoE)	439	423	4%
Energy				**3,450**	**2,400**	**24%**		**4,135**	**2,864**	**26%**
Enerji Yatirimlari	Unlisted	77.0%	TUPRS's stake	2,490	1,917	19%	TUPRS's stake	2,981	2,295	20%
Tupras	TUPRS	39.3%	Current Mcap	5,092	2,000	20%	Target Mcap	6,055	2,378	21%
Aygaz	AYGAZ	40.7%	Current Mcap	960	391	4%	Target Mcap	1,154	469	4%
Entek	Unlisted	49.6%	1 x 1H16 P/BV	186	92	1%	1 x 1H16 P/BV * (1+CoE)	200	99	1%
Financial Services				**3,463**	**1,463**	**15%**		**4,706**	**1,989**	**18%**
Koc Finansal Services	Unlisted	42.2%	YKBNK's stake	3,421	1,445	15%	YKBNK's stake	4,662	1,969	18%
Yapi Kredi Bank	YKBNK	35.4%	Current Mcap	4,182	1,480	15%	Target Mcap	5,396	1,910	17%
Koc Tüketici Finans	Unlisted	44.5%	0.8 x 1H16 P/BV	42	19	0%	0.8 x 1H16 P/BV * (1+CoE)	45	20	0%
Consumer Durables				**4,147**	**1,617**	**16%**		**4,206**	**1,636**	**15%**
Arcelik	ARCLK	40.5%	Current Mcap	3,970	1,608	16%	Target Mcap	4,016	1,627	14%
Arçelik LG Klima	Unlisted	5.0%	2.6 x 1H16 P/BV	177	9	0%	2.6 x 1H16 P/BV * (1+CoE)	190	9	0%
Others				**740**	**339**	**3%**		**810**	**371**	**3%**
Koctas	Unlisted	37.1%	0.3 x 2016E P/S	118	44	0%	0.3 x 2016E P/S * (1+CoE)	126	47	0%
Tat Gida	TATGD	43.7%	Current Mcap	205	89	1%	Target Mcap	237	104	1%
Zer	Unlisted	39.0%	2.6 x 2016E P/S	176	69	1%	2.6 x 2016E P/S * (1+CoE)	189	74	1%
Altinyunus Cesme	AYCES	30.0%	Current Mcap	19	6	0%	Current Mcap * (1+CoE)	20	6	0%
Marmaris Altinyunus	MAALT	36.8%	Current Mcap	24	9	0%	Current Mcap * (1+CoE)	25	9	0%
Others			Book/Appraisal Value	198	123	1%	Book/Appraisal Value * (1+CoE)	212	132	1%
Total Value from Participations					**9,369**	**100%**	**Total Value from Participations**		**10,655**	**100%**
Listed					8,619	92%	Listed		9,852	92%
Unlisted					750	8%	Unlisted		803	8%
Net Cash (debt)					571	6%	Net Cash (debt)		571	5%
Current NAV					**9,940**		**Target NAV**		**11,226**	
Prem / (Disc) to Current NAV					**-6.2%**		**Prem / (Disc) to Target NAV**		**-16.9%**	
Historical Average Discount (one year)					**-4.0%**		**Historical Average Discount (one year)**		**-12.4%**	
Current Mcap					9,327		Target Mcap*		10,661	
							Target Share Price (US$)		**4.20**	
net cash (debt) is as of 3Q16							**Target Share Price (TL)**		**15.30**	
** after applying 5% holding discount*							**Upside Potential**		**18.1%**	

Source: Bloomberg, IS Investment

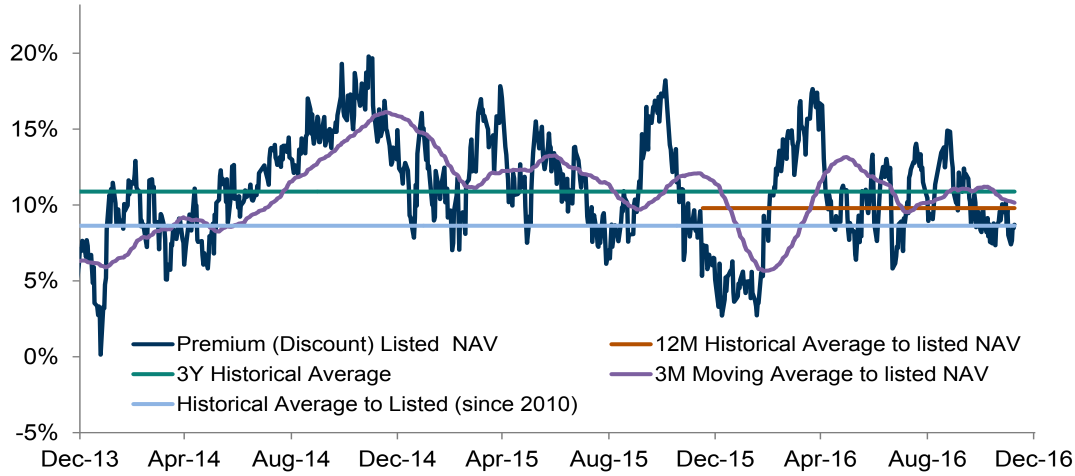
Trades at a lower discount than its historic averages. The shares trade at 6% discount to its current NAV, lower than its 3M, 1Y and 3Y average discounts of 4%, 4% and 3%, respectively.

FIGURE 2: KCHOL Premium/Discount to Current NAV



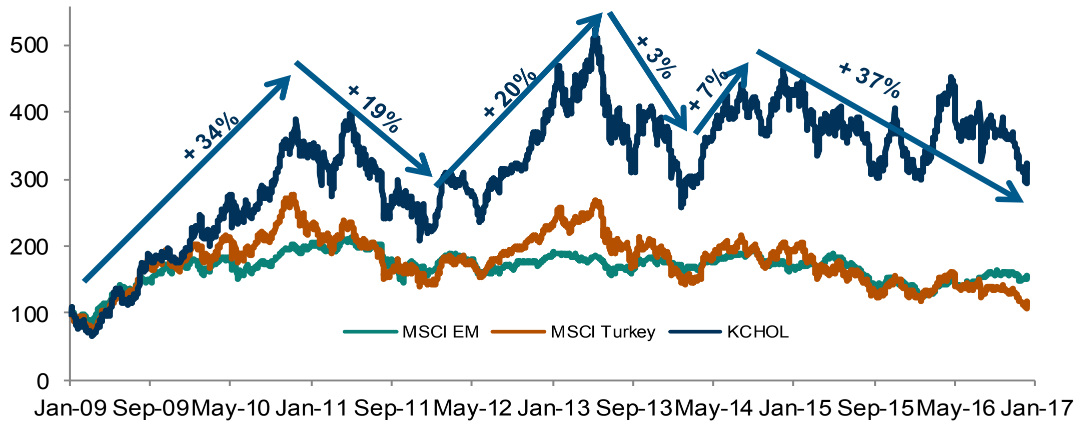
The current premium to its listed assets offers gains on discount front. The listed assets making c.90% of NAV are a good proxy for the share price of KCHOL. Currently, the shares trade at a 8% premium to its listed assets vs. its 3M, 1Y and 3Y averages of 10%,10% and 11%, respectively.

FIGURE 3: KCHOL Premium/Discount to Listed NAV



Koc shares have consistently outperformed the benchmark indices over the recent years. KCHOL shares over performed MSCI EM and MSCI Turkey by 181% and 102%, respectively since 2009, when the majority of the transformations in the portfolio were completed. KCHOL shares over performed MSCI Turkey in all major bull and bear markets since then.

Figure 4: Share Price Performance (US$, based 100 as of Jan 1, 2009)



Source: Bloomberg, IS Investment

Major subsidiaries also offer solid upside potentials. Six of subsidiaries under our coverage are rated as outperform offering sizeable upside potential along with catalysts. Tupras and Tofas are also included in our Most Recommended Stock List. According to our estimates Koc Holding trades at 8% premium with respect to its listed stakes versus its one year average of 10%.

FIGURE 5: Summary Tables of its Major Listed Subsidiaries

Ticker	Sector	Rating	TP	Upside	MCAP	FFMCAP	3M Ave. Volume	Foreign Ownership	Index Weights
TOASO	Auto	OP	25.75	12.8%	3,241	781	6.3	85%	2%
TTRAK	Auto	MP	85.90	16.6%	1,116	278	1.7	78%	1%
OTKAR	Auto	MP	75.25	-38.2%	829	227	7.4	13%	0%
FROTO	Auto	OP	36.35	21.3%	2,984	530	3.7	67%	1%
AYGAZ	Energy	OP	14.00	24.1%	960	231	0.7	75%	0%
TUPRS	Energy	OP	88.00	22.8%	5,092	2,490	30.0	81%	5%
YKBNK	Finance	OP	4.52	33.3%	4,182	745	28.6	50%	2%
ARCLK	Cons. Durables	MP	21.63	4.5%	3,970	994	5.7	89%	2%
TATGD	Food	OP	6.35	19.6%	205	85	1.0	41%	0%
MAALT	Tourism	NR	n.a.	n.a.	24	7	0.3	0%	0%
AYCES	Tourism	NR	n.a.	n.a.	19	1	0.0	0%	0%
KCHOL		OP	15.30	**18.1%**	9,327	2,069	16.0	83%	4%

TPs are denominated in TL, others in US$mn

Source: Bloomberg, IS Investment

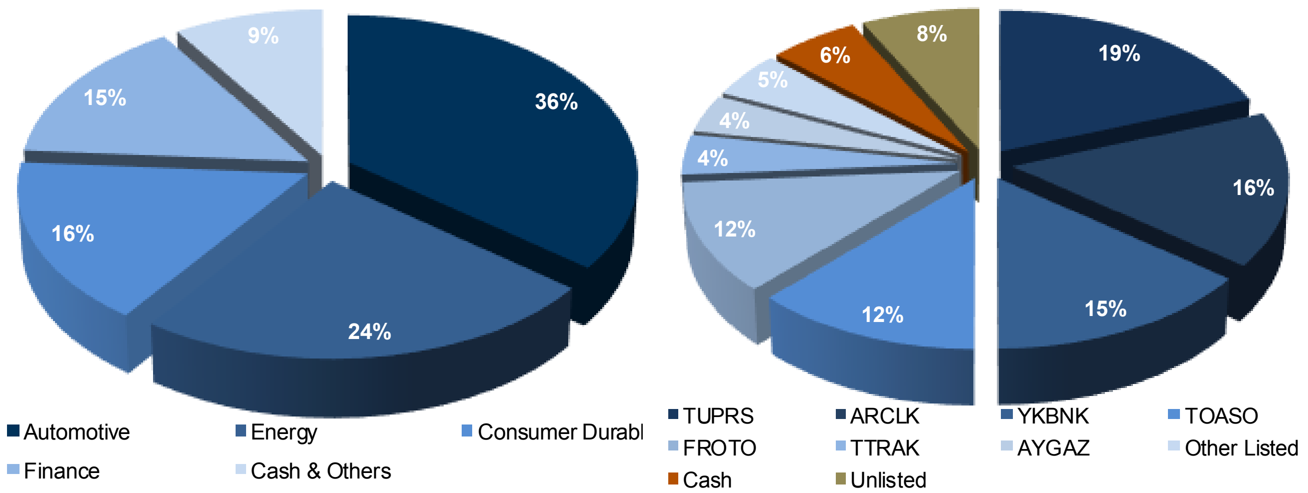
FIGURE 6: Koc Holding and its Subsidiaries Share Price Performances

Absolute Performance					Relative to ISE 100			
Ticker	1M	3M	1-year	3-year	1M	3M	1-year	3-year
TOASO	5%	0%	28%	93%	4%	2%	18%	88%
TTRAK	-5%	-12%	18%	44%	-6%	-10%	9%	40%
OTKAR	6%	13%	49%	112%	4%	16%	37%	106%
FROTO	4%	-5%	3%	33%	3%	-2%	-5%	30%
AYGAZ	4%	3%	24%	59%	3%	5%	14%	54%
TUPRS	10%	19%	14%	74%	9%	22%	5%	69%
YKBNK	2%	-8%	4%	-14%	0%	-6%	-4%	-16%
ARCLK	3%	-5%	44%	68%	2%	-2%	33%	63%
TATGD	-4%	-6%	2%	115%	-5%	-4%	-6%	109%
MAALT	-11%	63%	32%	-5%	-13%	67%	22%	-8%
AYCES	-5%	12%	10%	-25%	-6%	14%	1%	-27%
KCHOL	5%	0%	19%	45%	3%	2%	9%	41%

Source: Bloomberg, IS Investment

Well diversified value across sectors/assets. Koc offers an optimum portfolio diversification to balance and minimize asset/sector/geography specific risks consisting of defensive value assets with strong dividend prospects like Tupras, Aygaz Tofas and Ford Otosan and growth assets with exposure to Turkey's low penetrated sectors like Yapi Kredi and Arcelik. None of the assets has more than 20% share in NAV; TUPRS (19%), ARCLK (16%), YKBNK (15%), and TOASO (12%).

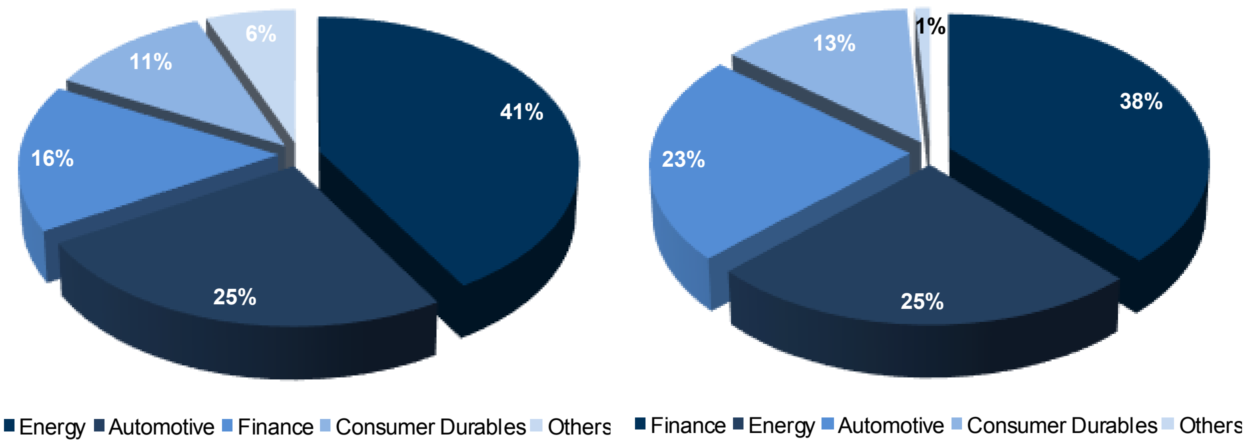
Figure 7: NAV Sector and Asset Diversification



Source: Company, IS Investment

Diversified revenue stream with significant FX generation. Non-cyclical energy segment with sizeable FX linked revenues (namely Tupras) and consumer segments (automotive and consumer durables) with significant FX revenues account for 41% and 36% of combined revenues respectively. The Groups international revenues (from exports and foreign operations) reached to US$11bn (mostly € and US$) in 9M16 making roughly 30% of the combined revenues. Including Tupras, FX linked revenues makes half of the combined revenues in 9M16.

Figure 8: Sectoral Diversification of Combined Revenues & Combined Operating Profits (9M16)



Source: Company, IS Investment

Wide-spread geographic diversification. In line with the strategy of geographical diversification, the Group has continued to further penetrate into new markets and increase its footing in existing markets in last decade. As a result, international revenues (from exports and foreign operations) have grown steadily in this period. The share of Asia, Africa and America in its total combined international revenues increased to c.1/3, while the share of Europe decreased to c.2/3. We deem the strategy of the Holding to further penetrate into new markets and enhance its operations in the existing markets like Africa, while reducing the exposure to Europe, as a long term positive since it will help the Holding to sustain its profitability and growth. The Group aims to further diversify its portfolio globally via organic and inorganic growth opportunities in its operating sectors or/and adjacent sectors and through very opportunistic plays in new sectors.

Figure 9: Summary of Key Financials (TL mn)

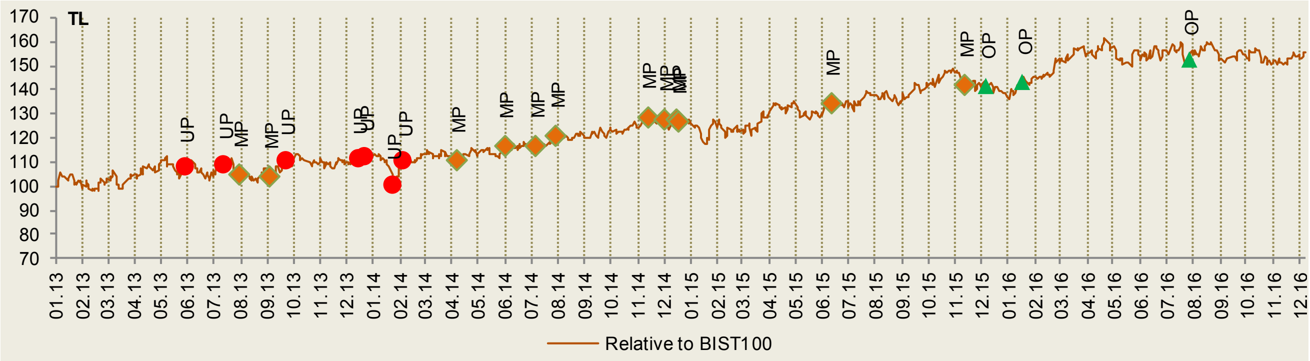
Income Statement (TL mn)	2014A*	2015A*	2016E	2017E	2018E
Revenues	68,622	69,492	67,449	94,323	113,291
EBITDA	2,922	6,393	5,643	8,415	9,521
Depreciation & Amortisation	958	1,266	1,443	1,577	1,747
EBIT	1,964	5,127	4,200	6,523	7,411
Other income (expense), net	(158)	(261)	120	167	201
Financial expenses, net	(565)	(1,401)	(1,743)	(1,562)	(1,157)
Minority Interests	1,504	2,262	1,531	1,955	2,264
Income before tax	3,181	5,557	4,738	7,007	8,440
Taxation on Income	1,033	272	(377)	(1,411)	(1,779)
Net income	2,710	3,568	3,165	4,042	4,680
Cash Flow Statement (TL mn)					
Net Income	2,710	3,568	3,165	4,042	4,680
Depreciation & Amortisation	958	1,266	1,443	1,577	1,747
Indemnity Provisions	54	67	37	52	62
Change in Working Capital	2,440	(4,409)	20	(2,495)	(1,140)
Cash Flow from Operations	6,163	493	4,546	3,007	5,149
Capital Expenditure	3,553	3,803	2,459	2,833	2,998
Free Cash Flow	2,610	(3,310)	2,087	174	2,151
Rights Issue	0	0	0	0	0
Dividends Paid	407	500	738	791	1,212
Other Cash Inflow (Outflow)	(3,933)	(263)	(1,518)	(485)	(253)
Change in net cash	(1,729)	(4,073)	(169)	(1,102)	685
Net Cash	(9,913)	(13,986)	(14,155)	(15,257)	(14,572)
Balance Sheet (TL mn)					
Tangible Fixed Assets	17,109	19,579	20,557	21,730	22,909
Other Long Term Assets	4,587	5,167	7,338	7,518	7,347
Intangibles	1,809	1,876	1,914	1,997	2,069
Goodwill	2,906	2,900	2,917	3,133	3,308
Long-term financial assets	12,299	13,470	13,971	15,575	17,410
Inventories	5,466	5,680	6,521	7,229	7,538
Trade receivables	6,792	9,712	10,269	12,053	13,036
Cash & equivalents	9,908	10,553	16,526	17,084	17,887
Other current assets	3,065	4,047	4,404	4,730	4,904
Total assets	63,941	72,985	84,452	91,094	96,463
Long-term debt	14,401	17,160	21,543	22,745	23,376
Other long-term liabilities	1,222	1,246	1,362	1,403	1,492
Short-term debt	5,420	7,379	9,138	9,596	9,083
Trade payables	9,138	7,864	9,281	9,278	9,430
Total Debt	19,821	24,539	30,681	32,341	32,459
Other short-term liabilities	4,456	5,657	5,683	6,561	6,933
Total liabilities	34,640	39,309	48,013	50,771	51,651
Minority Interest	8,953	10,541	11,982	13,937	14,246
Total equity	20,348	23,135	27,232	29,660	32,087
Paid-in capital	2,536	2,536	2,536	2,536	2,536
Total liabilities & equity	63,941	72,985	84,452	91,094	96,463
Ratios					
ROE (%)	14.1	16.4	12.6	14.2	15.2
ROIC (%)	6.5	13.5	9.4	13.3	14.0
Invested Capital	26,625	34,151	37,318	41,249	43,468
Net debt/EBITDA (x)	3.4	2.2	2.5	1.8	1.5
Net debt/Equity (%)	48.7	60.5	52.0	51.4	45.4
Capex/Sales (%)	5.18	5.47	3.65	3.00	2.65
Capex/Depreciation (x)	3.7	3.0	1.7	1.8	1.7
EBITDA Margin	4.3	9.2	8.4	8.9	8.4
EBIT Margin	2.9	7.4	6.2	6.9	6.5
Net Margin	3.9	5.1	4.7	4.3	4.1
Valuation Metrics					
EV/Sales (x)	0.4x	0.6x	0.7x	0.5x	0.4x
EV/EBITDA (x)	10.4x	6.5x	8.0x	5.4x	4.8x
EV/IC (x)	1.1x	1.2x	1.2x	1.1x	1.0x
P/E (x)	9.0x	7.2x	10.3x	8.1x	7.0x
FCF yield (%)	11%	-13%	6%	1%	7%
Dividend yield (%)	1.7%	1.6%	2.0%	2.4%	3.7%

*based on average Mcap during the year

Source: Company, IS Investment

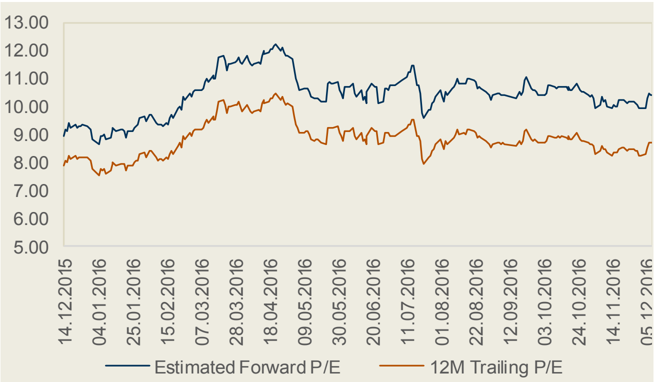
Koc Holding

Price / Recommendations



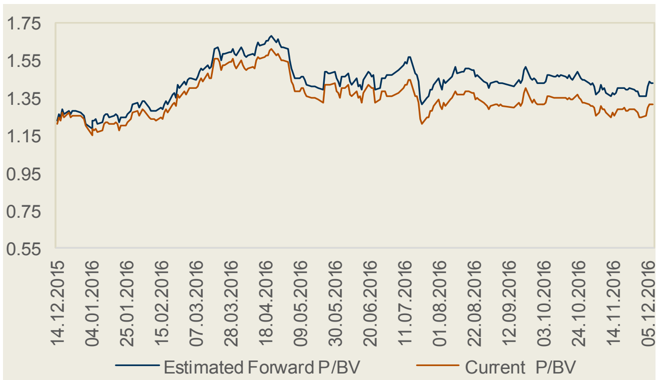
Source : BIST/ Is Investment Estimates

Estimated Forward P/E & 12M Trailing P/E



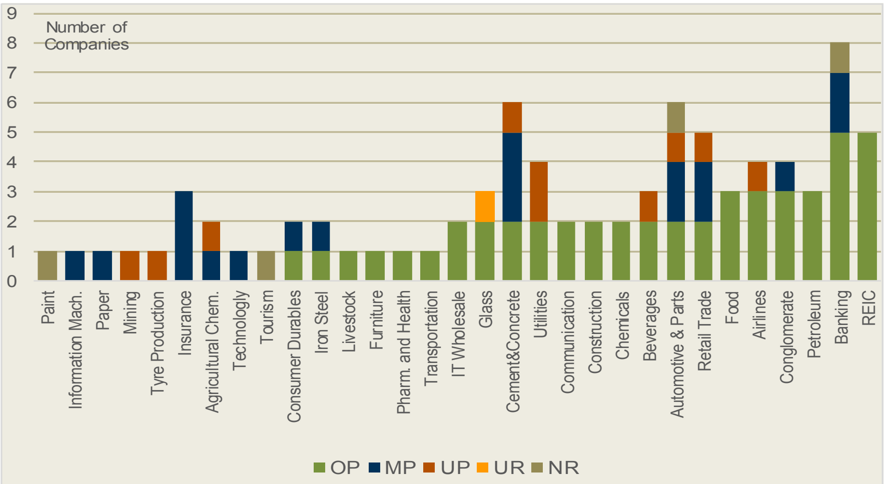
Source : BIST/ Is Investment Estimates

Estimated Forward P/BV & Current P/BV



Source : BIST/ Is Investment Estimates

Sectoral Recommendations



Rec. Breakdown for Coverage (%)