Koc Holding
Conglomerates

Neutral
Maintained

Provision blur better than expected margin

Price: TRY7.08
12m Target Price: TRY7.52

Koc Holding reported TRY310mn of net income in 4Q10, short of our own and the consensus estimate of TRY425mn. The deviation at the bottom line resulted from the TRY181mn tax penalty provisions booked by Tupras, the downstream oil subsidiary. We do not expect the earnings announcement to have a material impact on the shares, as subsidiaries' earlier earnings announcements had already offered a picture of Koc Holding's overall earnings. In sum, though, Koc Holding delivered a lower than originally expected top line, but a better EBITDA margin.

Energy and automotive contribute most to revenue growth

Koc Holding's consolidated top line expanded by 28% YoY to TRY14.0bn in 4Q10 thanks to the downstream oil and automotive segments. Revenues in the downstream oil segment climbed on a YoY basis due to higher oil prices, whereas automotive revenues improved in the back of higher unit sales. The consumer durable segment posted the top line performance, with a 1% YoY decline.

Margin contraction due to finance and consumer durables

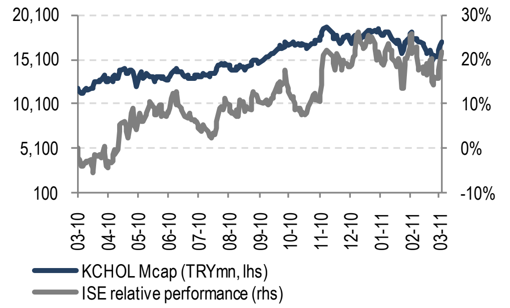
The Holding's consolidated EBITDA was up by 7% YoY in 4Q10, while the EBITDA margin contracted by 1.9 pp due to finance and consumer durables segments. Although the consumer durables was hit by steeper than expected hikes in raw material prices and the dilutive impact of the electronics business, provision expenses in the finance segment surged in 4Q10. On the other hand, EBITDA margins in the automotive segment improved thanks to higher volumes and new models.

Target price and Neutral rating maintained

We maintain our Neutral rating for Koc Holding based on our TRY7.52/share price target, which remains unchanged following the recent 10% price cut in Arcelik and incorporation of 2010YE holding-only net cash position. We like the Holding with its quality assets in a diversified portfolio, yet the Holding's non-financial underliers offer higher upside potentials. Koc Holding stock has outperformed the ISE-100 by 36% since beginning of 2010.

Stock data	
Bloomberg / Reuters	KCHOL TI / KCHOL.IS
12m expected total return	6%
52-week price range (TL/share)	4.56-7.78
Outstanding shares (m)	2,415.14
Mcap (TLm)	17,099
Mcap (US$m)	10,832
EV (US$m)	n.m.

Trading data	
ISE relative performance	
3m	2.4%
12m	24.9%
3m avg daily trading vol. (US$m)	19.1
Weight in ISE100	3.6%
Beta (on weekly returns)	1.12
Free float (%)	22%
Foreign ownership (% freefloat)	
Current	76.5%
12m ago	69.9%



Key financials (TRYmn)	4Q10	4Q09	YoY chg	3Q10	QoQ chg	FY10	FY09	YoY chg
Revenues	13,981	10,935	28%	12,627	11%	48,822	39,459	24%
Gross profit	2,496	2,164	15%	2,494	0%	9,192	8,876	4%
EBIT	1,110	1,012	10%	1,241	-11%	4,265	4,350	-2%
EBITDA	1,355	1,272	7%	1,487	-9%	5,233	5,275	-1%
Net profit	310	296	5%	659	-53%	1,734	1,429	21%
BV	12,574	11,170	13%	12,233	3%	12,574	11,170	13%

Key metrics	4Q10	4Q09	YoY chg (pp)	3Q10	QoQ chg (pp)	FY10	FY09	YoY chg (pp)
Gross margin	17.9%	19.8%	-1.9	19.7%	-1.9	18.8%	22.5%	-3.7
EBIT margin	7.9%	9.3%	-1.3	9.8%	-1.9	8.7%	11.0%	-2.3
EBITDA margin	9.7%	11.6%	-1.9	11.8%	-2.1	10.7%	13.4%	-2.7
Net margin	2.2%	2.7%	-0.5	5.2%	-3.0	3.6%	3.6%	-0.1

Source: Company financials.

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Figure 1: Koc Holding – Revenue Breakdown

TRY mn	4Q10	4Q09	Chg/YoY	3Q10	Chg/QoQ	FY10	FY09	Chg/YoY
Sales	15,338	12,184	26%	13,879	11%	53,813	44,832	20%
Energy	8,934	6,852	30%	8,341	7%	31,412	24,488	28%
Automotive	2,597	1,732	50%	1,780	46%	7,767	5,943	31%
Consumer Durables	1,804	1,822	-1%	1,796	0%	7,052	6,810	4%
Finance	1,357	1,199	13%	1,252	8%	4,990	5,382	-7%
Other	646	579	12%	711	-9%	2,592	2,209	17%
Non-Finance	13,982	10,985	27%	12,627	11%	48,823	39,450	24%
Share in consolidated sales								
Energy	58%	56%		60%		58%	55%	
Automotive	17%	14%		13%		14%	13%	
Consumer Durables	12%	15%		13%		13%	15%	
Finance	9%	10%		9%		9%	12%	
Other	4%	5%		5%		5%	5%	
Non-Finance	91%	90%		91%		91%	88%	

Source: Koc Holding

Figure 2: Koc Holding – EBITDA Breakdown

TRY mn	4Q10	4Q09	Chg/YoY	3Q10	Chg/QoQ	FY10	FY09	Chg/YoY
EBITDA*	1,099	937	17%	1,495	-26%	5,072	4,396	15%
Energy	323	412	-22%	535	-40%	1,653	1,701	-3%
Automotive	262	160	63%	189	39%	788	597	32%
Consumer Durables	176	165	6%	232	-24%	853	826	3%
Finance	324	147	120%	450	-28%	1,560	1,046	49%
Other	15	52	-72%	90	-84%	218	226	-3%
Non-Finance	776	790	-2%	1,045	-26%	3,513	3,350	5%
**Includes other operating income/expense*								
Share in consolidated EBITDA								
Energy	29%	44%		36%		33%	39%	
Automotive	24%	17%		13%		16%	14%	
Consumer Durables	16%	18%		16%		17%	19%	
Finance	29%	16%		30%		31%	24%	
Other	1%	6%		6%		4%	5%	
Non-Finance	71%	84%		70%		69%	76%	
EBITDA Margin	7.2%	7.7%		10.8%		9.4%	9.8%	
Energy	3.6%	6.0%		6.4%		5.3%	6.9%	
Automotive	10.1%	9.3%		10.6%		10.1%	10.0%	
Consumer Durables	9.7%	9.1%		12.9%		12.1%	12.1%	
Finance	23.9%	12.3%		35.9%		31.3%	19.4%	
Other	2.3%	8.9%		12.6%		8.4%	10.2%	
Non-Finance	5.5%	7.2%		8.3%		7.2%	8.5%	

Source: Koc Holding

Figure 3: Koc Holding – NAV Breakdown

Company / Project	Holding's Stake (%)	Valuation Basis	Share Price / Val.Multiple	Mcap ($m)	Holding's Stake ($m)	NAV (%)	12m Target Mcap ($m)	Holding's Stake ($m)	NAV (%)
Automotive					**3,293**	**23%**		**3,502**	**26%**
Tofas Fabrika	37.6%	Market Cap.	8.1	2,553	960	8%	3,357	1,262	9%
Ford Otosan	38.5%	Market Cap.	13.8	3,057	1,176	10%	3,516	1,352	10%
Otokar	44.7%	Market Cap.	24.0	365	163	1%	407	182	1%
Turk Traktor	37.5%	Market Cap.	28.7	970	364	3%	1,082	406	3%
Otokoc	96.3%	EV/EBITDA	6.7	359	346	3%	400	386	3%
Consumer Durables					**1,232**	**10%**		**1,479**	**11%**
Arcelik	40.5%	Market Cap.	7.1	3,031	1,228	10%	3,638	1,474	11%
Arcelik LG Klima	5.0%	Book Value	1.0	85	4	0%	95	5	0%
Food & Retail					**312**	**3%**		**384**	**3%**
Tat Konserve	43.7%	Market Cap.	3.4	293	128	1%	410	179	1%
Koctas	37.1%	P/SALES	1.0	472	175	1%	527	196	1%
Duzey	31.2%	Book Value	1.0	29	9	0%	32	10	0%
Finance					**3,867**	**33%**		**4,176**	**31%**
KFS	37.6%	Owns 82% of YKBNK		10,203	3,831	33%	11,014	4,136	31%
Koc Finans	44.5%	Book Value	1.0	81	36	0%	90	40	0%
Energy					**2,400**	**20%**		**2,820**	**21%**
EYAS	75.0%	TUPRS MCap.-Net Debt of SPV		2,316	1,737	15%	2,774	2,081	16%
Aygaz	40.7%	Market Cap.	8.6	1,631	663	6%	1,818	740	6%
Others					**123**	**1%**		**137**	**1%**
Altinyunus Cesme	30.0%	Market Cap.	11.3	119	36	0%	133	40	0%
Mares Altinyunus	38.4%	Market Cap.	17.8	62	24	0%	69	27	0%
Others		Book Value			63	1%		70	1%
Net Cash					**798**	**7%**		**798**	**6%**
Current NAV					11,740				
12m Target NAV								13,381	
Current/Target discount to NAV					-8%			-15%	
Current/12m Target mcap					10,832			11,354	

Source: Finansinvest

FinansInvest Rating System

We employ a relative scale in our rating system (i.e. Market **Outperform, Neutral, Underperform**) in order to better present relative value propositions and more actively pursue long vs. short ideas at the ISE. The relevant benchmark is the broader Turkish stock market, using the ISE-100 index as a basis. The ratings also incorporate a certain degree of relativity within the analyst's own stock coverage universe due to asymmetric return expectations among the industries under our ISE coverage. The rating system combines analysts' views on a stock relative to the sectors under coverage, and the sector call relative to the market, together providing a view on the stock relative to the market.

Individual ratings reflect the expected performance of the stock relative to the broader market over the next 6 to 12 months. The assessment of expected performance includes a function of near-term company fundamentals, industry outlook, confidence in earnings estimates and valuation, and other factors.

An essential element of our rating methodology involves benchmarking a 12-month expected return against the cost of equity. We set a required rate of return for each stock, calculated from our risk-free rate and equity risk premium assumptions. The price target for a stock represents the value that the stock is expected to reach or sustain over the performance horizon of 12 months, according to the view of the analyst.

We have separated the stocks under our coverage into two groups, mainly with respect to their liquidity (market cap, free float market cap and historical average daily trading volume) as small-cap stocks exhibit different risk/return characteristics to more-liquid large-caps. For the purposes of the relative stock rating, however, stocks within each group will be considered on an unweighted basis with regard to their market capitalization.

For a stock to be assigned an **Outperform** rating, the implied return *must* exceed the required rate of return by at least 5 percentage points over the next 12 months for our larger-cap stock coverage, or by 10 percentage points for the small-cap group. For a stock to be assigned an **Underperform** rating, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months. Stocks between these bands will be classified as **Neutral**.

When the potential upside of an *average* stock in our coverage exceeds its required rate of return (i.e. the market upside exceeding the implied average cost of capital), a greater number of stocks would fall into the aforementioned Outperform (Buy) category, illustrating the significance of the "relative return" concept (vis-à-vis absolute return) in picking better investment ideas with a positive alpha. The same holds true when the potential upside of an *average* stock in our coverage falls short of its required rate of return.

In this regard, as a supplemental methodology, we rank the stocks in our coverage according to their notional target price with respect to their current market price, and then categorise the top group (approximately 40-50% of the companies under coverage) as Outperform, the next 40-50% as Neutral and the lowest 10-20% (and no less than 10%) as Underperform.

It should be noted that the expected returns on some stocks may at times fall outside the relevant ranges of the applicable respective rating category because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges are permitted but becomes subject to review.

Also note that the analyst's short-term view may occasionally diverge from the stock's longer-term fundamental rating.

Outperform. We expect the stock to outperform the ISE-100 over the next 6 to 12 months.

Neutral (Market Perform). We expect the stock to broadly perform in line with the ISE-100 index over the next 6 to 12 months. (Although we would normally have a neutral assessment of stocks in this category, if a stock has gone through a period of market underperformance, it would be an indication that the stock may be expected to improve its performance relative to market averages in the coming period, and vice versa).

Underperform. We expect the stock to underperform the ISE-100 over the next 6 to 12 months.

N/R. Not Rated.

U/R. Under Review.

Analyst Certification

The following analysts hereby certify that the views expressed in this research report accurately reflect their own personal views regarding the securities and issuers referred to therein and that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report: Gaye Abidin.
Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

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