

Mid Cap
 Conglomerates
 Equity – Turkey

Neutral

Target price (TRY)	8.15
Share price (TRY)	7.16
Potential return (%)	13.8

Performance	1M	3M	12M
Absolute (%)	-6.0	-0.3	53.2
Relative ^A (%)	-1.8	8.3	25.4

Index^A ISTANBUL COMP

RIC KCHOL.IS
 Bloomberg KCHOL TI

Market cap (USDm) 10,814
 Market cap (TRYm) 17,292

Enterprise value (TRYm) nm
 Free float (%) 20

Note: (V) = volatile (please see disclosure appendix)

Koc Holding (KCHOL TI)

N: Keeping an eye on the last privatisation opportunities

- ▶ **More clarity on the state's roadmap for power generation privatisations needed as catalyst for stock; for now, Aygaz (OW(V)) is a more direct play on growth plans in energy**
- ▶ **We find Koc's valuation of current NAV discount of 10% versus our discount of 10% (lowered from 15%) close to fair**
- ▶ **Reflecting recent changes in subsidiary valuations in our NAV model, we raise our target price to TRY8.15 (vs. TRY6.0) and maintain our Neutral rating**

Waiting for more clarity on the state's timeline of generation asset sales: Koc's plans to grow in electricity generation are rather dependent on privatisations in the short term, in our view. So far, various state-owned plants, representing c20% of total generation capacity potentially available for sale, have been announced as first-phase privatisations. However, there is still no timetable and we believe that the launch of a clearer roadmap (identity and timeline of assets to be sold) is critical as a potential catalyst for Koc shares. However, even once announced, group company Aygaz (AYGAZ.IS, TRY8.54, OW(V), 40.7% owned by Koc) is a more direct play on Koc Group's energy growth prospects, in our view. This is due to the group structure that currently keeps Entek (the group's power generation unit) under Aygaz and the recent JV deal between Aygaz and US-based AES at Entek, although this structure could be altered for a big acquisition deal, in our view.

Already rewarded for its qualities: We think that Koc remains the best single-stock exposure to Turkish macro dynamics with a quality portfolio consisting of businesses with high and balanced profitability. Of the three key equity themes introduced in our recent country report titled "BBB or not BBB?" (2 February 2011), we see Koc as strongly positioned to benefit from the Investment Grade scenario for Turkey. It also scores well in terms of future dividend payments. The only potential weakness could be the group's high export exposure to Europe (c70% of total, exports c20% of total revenues) in the case of a slowdown in Europe (although Koc's "take-or-pay" agreements in autos and growing EM exposure in white goods may limit the risks here). Trading at a 10% discount to its current NAV (the last 12-month average and a lower discount level than peers), we think the market has already credited Koc to a great extent for its positive merits.

Revisions to estimates and NAV model raise our TP, Neutral maintained: As a result of our forecast changes (stemming from changes to currency forecasts and Q4 performances of underlying businesses, eg strong quarter for autos) and modifications to our NAV model (updated with changes to our valuation of the covered listed parts), our target price rises to TRY8.15 from TRY6.0. Given the portfolio's prospects under our three themes and the NAV discount trends, we also lower our fair conglomerate discount for Koc to 10% (applied on target NAV when deriving the target price) from 15%, also adding positively to our valuation. Our rating remains Neutral due to the limited 14% potential return.

7 February 2011

Cenk Orcan*

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Issuer of report: HSBC Yatırım
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Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Financials & valuation

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (TRYm)				
Revenue	44,832	53,033	57,231	62,638
EBITDA	4,396	5,500	5,691	6,195
Depreciation & amortisation	-925	-969	-989	-1,040
Operating profit/EBIT	3,471	4,531	4,702	5,155
Net interest	-312	-189	-276	-264
PBT	3,159	4,343	4,426	4,891
HSBC PBT	3,159	4,343	0	0
Taxation	-518	-800	-815	-901
Net profit	1,429	1,918	1,954	2,160
HSBC net profit	1,429	1,918	1,954	2,160

Cash flow summary (TRYm)

Cash flow from operations	2,620	-818	2,383	2,477
Capex	-1,444	-2,116	-2,271	-2,395
Cash flow from investment	-1,320	-1,965	-2,119	-2,254
Dividends	0	-310	-959	-977
Change in net debt	-5,813	1,731	-527	-769
FCF equity	1,077	-2,952	93	62

Balance sheet summary (TRYm)

Intangible fixed assets	4,838	4,838	4,838	4,838
Tangible fixed assets	21,898	25,480	28,463	31,732
Current assets	33,616	38,629	42,477	47,100
Cash & others	10,656	9,671	10,981	12,572
Total assets	66,386	74,982	81,812	89,704
Operating liabilities	31,484	36,208	40,399	45,457
Gross debt	14,920	15,666	16,450	17,272
Net debt	4,264	5,995	5,469	4,700
Shareholders funds	11,048	12,609	13,605	14,787
Invested capital	18,211	23,068	24,397	25,641

Ratio, growth and per share analysis

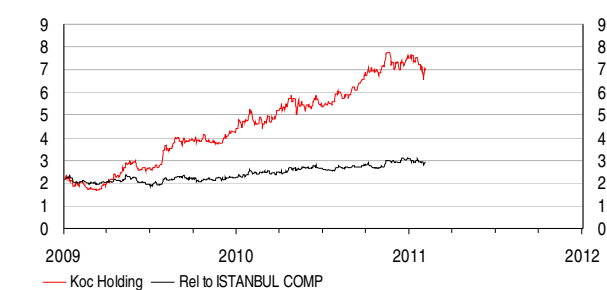
Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-19.5	18.3	7.9	9.4
EBITDA	-25.1	25.1	3.5	8.9
Operating profit	-31.3	30.6	3.8	9.6
PBT	-0.7	37.5	1.9	10.5
HSBC EPS	84.0	34.2	1.9	10.5
Ratios (%)				
Revenue/IC (x)	2.3	2.6	2.4	2.5
ROIC	15.0	17.9	16.2	16.8
ROE	13.7	16.2	14.9	15.2
ROA	6.7	7.4	6.8	6.8
EBITDA margin	9.8	10.4	9.9	9.9
Operating profit margin	7.7	8.5	8.2	8.2
EBITDA/net interest (x)	14.1	29.2	20.6	23.5
Net debt/equity	22.7	27.7	23.8	18.7
Net debt/EBITDA (x)	1.0	1.1	1.0	0.8
CF from operations/net debt	61.5		43.6	52.7
Per share data (TRY)				
EPS reported (fully diluted)	0.59	0.79	0.81	0.89
HSBC EPS (fully diluted)	0.59	0.79	0.81	0.89
DPS	0.00	0.13	0.40	0.40
Book value	4.57	5.22	5.63	6.12

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	0.3	0.3	0.3	0.2
EV/EBITDA	n.m.	n.m.	n.m.	n.m.
EV/IC	n.m.	n.m.	n.m.	n.m.
PE*	11.8	8.8	8.6	7.8
P/Book value	1.5	1.3	1.2	1.1
FCF yield (%)	11.2	-32.1	0.9	0.6
Dividend yield (%)	0.0	1.8	5.7	5.8

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 04 Feb 2011

Next catalyst: growth in power generation?

Awaiting announcement of full list of generation assets up for sale

With the privatisation process for electricity distribution grids almost over, all eyes are now on the generation privatisations in Turkey. Koc Holding may emerge as a player since energy comprises an important component of its growth strategy (as per management's publicly stated strategies). We believe there is a possibility Koc Holding could embark on greenfield investments or seek other acquisition opportunities apart from the privatisations. However, in our view Koc may prefer to wait for a clearer picture of what privatisations are available and when before looking at other options. To that end, we regard a clarification by the state on the timeline and identity of assets to be sold as the next potential positive catalyst for Koc shares, but for which visibility remains low. So far, there are four state-owned power plants in the initial pipeline, accounting for c20% of the total state-controlled capacity. Among these, the government aims to determine prequalified bidders for the Hamitabat plant but there is no timetable yet for the others.

First-phase generation asset privatisations

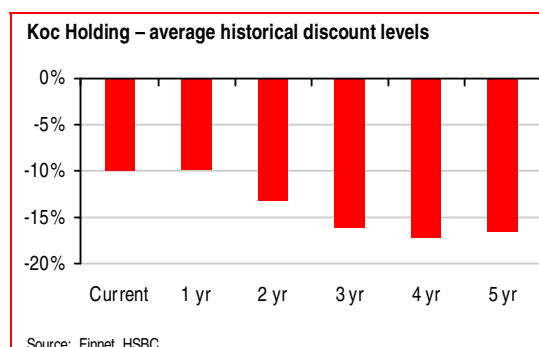
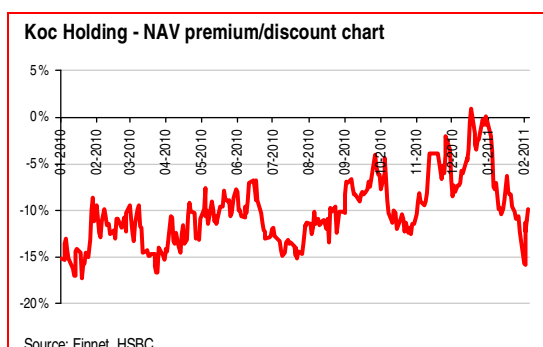
Asset	Type	Capacity (MW)
Hamitabat	natural gas	1,120
Soma A-B	lignite coal	1,034
Çan	lignite coal	3,20
Seyitomer	lignite coal	600
Total		3,074
Total generation capacity owned by state		16,160

Source: OIB

Aygaz could be a more direct play on Koc's energy growth plans

We believe it is reasonable at this stage to assume that Koc may pursue its growth plan in power generation through its unlisted subsidiary Entek. Entek operates two natural gas-based combined cycle plants with a total capacity of 302MW. Until December 2010, Aygaz, a Koc Holding group company, had a major stake in Entek (86.1% share), which changed after it signed a JV deal with US-based AES Electric Limited in that month. Based on the deal, Aygaz's 49.62% stake was sold to AES, creating a 50/50 JV between Koc and AES, called AES Entek. Aygaz now has a 36.5% stake in AES Entek (still the highest percentage stake among Koc's assets) with the remaining shares owned by other Koc Group companies.

Financially and from an expertise perspective, the partnership with AES clearly indicates Koc's keen focus on growing in power generation, in our view. AES operates 41,129 MW of generation assets in 29 countries and has 1,927 MW under construction, primarily in Chile, Bulgaria, the US and Panama, all of



which are planned to be completed by 2011. Its cumulative additions will total 3,270MW over 2009-11, if the expansions come through as planned. The JV announced its plan to increase its generation capacity ten-fold, to 3,000 MW through acquisitions and greenfield at an investment outlay of USD4-5bn. The fact that the deal has left Entek under Aygaz's ownership within the Koc Group) suggests that the primary beneficiary of planned growth should be Aygaz rather than Koc Holding.

Forecast changes

Our forecast changes stem mainly from changes to our macro team's currency forecasts since our previous note and adjustments to our sectoral expectations in the light of the forecast Q4 performances of the underlying businesses (eg Q4 2010 was a stronger-than-expected quarter for autos, while weaker-than-expected for white goods). Accordingly, as the table below shows, we expect Koc's 2010 results to reflect the strong domestic economy and anticipate some moderation in growth, parallel to the normalisation we expect in the country's GDP growth (yet to be announced). We expect the Q4 results to be out by mid-March 2011.

Forecast changes												
TRYm	2010e				2011e				2012e			
	old	new	new/old	yoy chg.	old	new	new/old	yoy chg.	old	new	new/old	yoy chg.
Revenue	52,306	53,033	1%	18%	60,356	57,231	-5%	8%	64,175	62,638	-2%	9%
EBITDA	5,064	5,500	9%	25%	5,583	5,691	2%	3%	6,395	6,195	-3%	9%
Margin	9.7%	10.4%	7%	6%	9.3%	9.9%	7%	-4%	10.0%	9.9%	-1%	-1%
EBIT	4,042	4,531	12%	31%	4,537	4,702	4%	4%	5,246	5,155	-2%	10%
Net profit	1,683	1,918	14%	34%	1,830	1,954	7%	2%	2,159	2,160	0%	11%
USD/TRY (year-end)	1.5150	1.5500	2%	4%	1.6300	1.4500	-11%	-6%	1.6500	1.5063	-9%	4%
USD/TRY (year-avg)	1.4984	1.5112	1%	-2%	1.6122	1.5138	-6%	0%	1.6000	1.5157	-5%	0%

Source: HSBC estimates

Valuation and risks

NAV discount suggests positives mostly priced in

We think Koc has a quality portfolio consisting of businesses with high and balanced profitability. It has high-beta (autos, durables) and low-beta (refining, LPG distribution) businesses and a bigger finance component (banking) than in the past, offering a better hedge against cyclical ups and downs as well as interest rate volatility. Overall, it remains the best single-stock exposure to Turkish macro dynamics, in our view. The only potential weakness may be a slowdown in Europe where most of the group exports (c70% of total) go. Otherwise, we see Koc as strongly positioned to benefit if Turkey achieves an investment grade rating (currently Turkey is one notch below IG by Fitch's criteria and two notches below by S&P and Moody's, while all agencies are maintaining a positive outlook) and also as a dividend play. We cited these factors in our recent country report titled "BBB or not BBB?" (2 February 2011).

However, we think the market has already credited Koc to a great extent for its positive merits (ie strong and profitable portfolio). We calculate that Koc currently trades at a 10% discount to its current NAV (which is close to the last 12-month average of 10%) and at a 21% discount to its target NAV. The current NAV discount band since the beginning of 2010 has ranged between -17% and 0% and appears currently close to the mid-point, at a level we deem represents a fair valuation.

We continue to value Koc Holding based on our NAV model and by applying a 10% conglomerate discount to our calculated target NAV. We have reduced our fair discount assumption for Koc from 15%

due to the latest trends in the discount level as well as our interpretation of the portfolio's positioning as a potential beneficiary of our key equity themes for the next three years: Investment Grade, EM Exposure, and Dividends (see our country note). Our forecast target NAV of USD13.7bn with the 10% discount applied gives as a new target price of USD5.1 or TRY8.15 from TRY6.0 previously. Based on the 14% potential return offered by our target price, which is inside the Neutral band for non-volatile Turkish stocks of 8.5%-18.5% under the HSBC model, our rating remains Neutral.

Risks

We see the key upside risks to our call as acquisitions at the parent company level (especially in power generation), a faster-than-expected economic recovery, better-than-expected domestic consumption, refinery and banking margins. The downside risks would be the opposite of these plus a possible decision by Koc family members (although the likelihood is low in our view) to register part of their non-floating shares for sale.

Valuation and risks for Aygaz (AYGAZ.IS, TRY8.54, OW(V))

Valuation: We are Overweight (V) on Aygaz with a 12-month target price of TRY9.15, based on SOTP valuation, driven by DCF. Our DCF model uses a WACC of 12.5% and a terminal growth rate assumption of 3%, which is derived using a risk-free rate of 9.5%, an equity risk premium of 5.5%, beta of 0.87, and cost of debt of 5.75%.

Risks: Any possible regulatory action to clamp down on distribution margins could hurt profitability. Significant risks to our valuation include contraction in auto-LPG demand, worse-than-expected distribution margins, and the Turkish lira's depreciation against the dollar (which could lead to lower net profit for Aygaz due to the short position of Tupras' SPV).

Koc Holding NAV Table

Segment	Koc Holding stake	Valuation method	Current NAV			Target NAV			
			Current value (USDm)	Stake value (USDm)	NAV (%)	Valuation method	Target value (USDm)	Stake value (USDm)	NAV (%)
Finance			13,509	4,168	34.7%		15,629	4,819	35.2%
YKB (via KFS)	30.7%	Market value	13,375	4,108	34.2%	DCF	15,495	4,759	34.8%
Koc Cons. Finance	44.5%	P/B 1.6x Banks	134	60	0.5%	P/B 1.6x Banks	134	60	0.4%
Automotive			7,301	2,892	24.1%		8,450	3,329	24.4%
Ford Otosan	38.5%	Market value	3,094	1,190	9.9%	DCF	3,731	1,435	10.5%
Tofas	37.6%	Market value	2,770	1,041	8.7%	DCF	3,283	1,234	9.0%
Turk Traktor	37.7%	Market value	908	342	2.9%	Market value	908	342	2.5%
Otokar	44.7%	Market value	378	169	1.4%	Market value	378	169	1.2%
Other (Otokoc)	99.1%	Peer comp. (DOAS)	150	149	1.2%	Peer comp. (DOAS)	150	149	1.1%
Consumer Durab.			3,448	1,397	11.6%		4,226	1,712	12.5%
Arcelik	40.5%	Market value	3,448	1,397	11.6%	DCF	4,226	1,712	12.5%
Energy			8,148	3,156	26.3%		8,450	3,274	23.9%
Tupras (via SPV Enerji Yat.)	38.3%	Market value	6,546	2,504	20.9%	DCF & peer comp.	6,734	2,576	18.8%
Aygaz	40.7%	Market value	1,602	652	5.4%	SOTP, DCF	1,717	698	5.1%
Food & Retail			531	219	1.8%		538	222	1.6%
Tat Konserve	43.7%	Market value	333	145	1.2%	DCF	340	148	1.1%
Koctas	37.1%	Peer comp (ISE retail)	198	74	0.6%	Peer comp (ISE retail)	198	74	0.5%
Other			449	178	1.5%		449	178	1.5%
Cesme Altinyunus	30.0%	Market value	139	42	0.3%	Market value	139	42	0.3%
Marmaris Altin.	36.8%	Market value	79	29	0.2%	Market value	79	29	0.2%
Other unlisted*		P/BV 1.5x ISE	232	107	0.9%	P/BV 1.5x ISE	232	107	0.8%
Total SOP			33,385	12,009	100.1%		37,743	13,534	99.0%
			Total listed	11,619	96.9%		Total listed	13,145	96.1%
			Total unlisted	390	3.2%		Total unlisted	390	2.8%
			Net cash (Koc Holding)	775	6.5%		Net cash (Koc Holding)	775	5.7%
			Net cash (SPV/Enerji Yat.)	-788	-6.6%		Net cash (SPV/Enerji Yat.)	-638	-4.7%
			Current NAV	11,996	100.0%		Target NAV	13,672	100.0%
			Current market cap	10,814			Current market cap	10,814	
			Prem./Disc.	-9.9%			Prem./Disc.	-20.9%	
							Target NAV @ 10% discount	12,305	
							TP in USD per share	5.10	
							TP in TRY per share	8.15	
							Current price	7.16	
							Potential return (%)	14%	

* Setur, Marine, Duzey, Ram, KocSistem

Source: Company data, HSBC estimates

Disclosure appendix

Analyst Certification

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Important disclosures

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

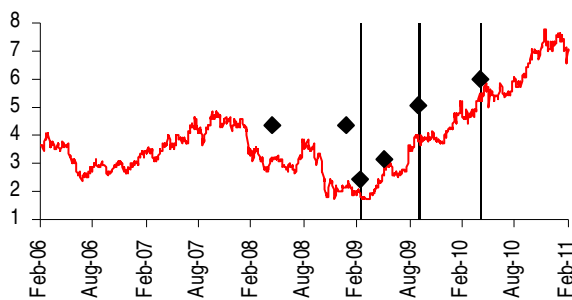
Rating distribution for long-term investment opportunities

As of 04 February 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	48%	(23% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(20% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Koc Holding (KCHOL.IS) Share Price performance TRY Vs HSBC rating history



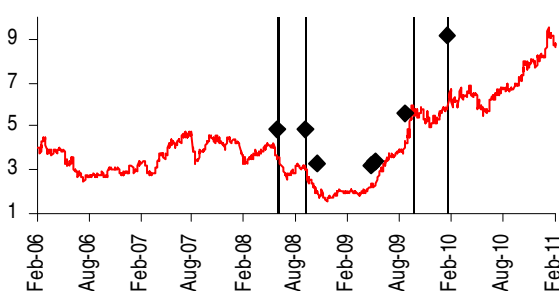
Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	13 February 2009
Neutral (V)	Overweight (V)	04 September 2009
Overweight (V)	Neutral	07 April 2010
Target Price	Value	Date
Price 1	4.35	14 April 2008
Price 2	4.35	29 December 2008
Price 3	2.44	13 February 2009
Price 4	3.17	12 May 2009
Price 5	5.10	04 September 2009
Price 6	6.00	07 April 2010

Source: HSBC

Aygaz (AYGAZ.IS) Share Price performance TRY Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	02 June 2008
Overweight	Overweight (V)	03 September 2008
Overweight (V)	Underweight (V)	25 September 2009
Underweight (V)	Overweight (V)	22 January 2010
Target Price	Value	Date
Price 1	4.85	02 June 2008
Price 2	4.85	03 September 2008
Price 3	3.30	17 October 2008
Price 4	3.20	30 April 2009
Price 5	3.40	12 May 2009
Price 6	5.60	25 August 2009
Price 7	9.15	22 January 2010

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
KOC HOLDING	KCHOL.IS	6.98	04-Feb-2011	1, 5, 6

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 31 December 2010 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
- 5 As of 31 December 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
- 6 As of 31 December 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
- 7 As of 31 December 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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Additional disclosures

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- 2 All market data included in this report are dated as at close 04 February 2011, unless otherwise indicated in the report.
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