S&P Global
Ratings

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Research Update:

Turkey-Based Soft Drinks Producer Coca-Cola Icecek Ratings Lowered To 'BB+' Following Same Action On Parent Company

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PRIMARY CREDIT ANALYST

Maxime Puget
London
+ 33(0)140752577
maxime.puget
@spglobal.com

SECONDARY CONTACT

Nikolay Popov
Dublin
+ 353 (0)1 568 0607
nikolay.popov
@spglobal.com

Rating Action Overview

- S&P Global Ratings downgraded Coca-Cola Icecek's (CCI's) parent company, Anadolu Efes (AEFES), to 'BB+' from 'BBB-' on Sept. 23, 2022. We see material risks that AEFES' large Russian beer operations face significant restrictions on its ability to extract cash to service debt outside Russia, and potential weaker credit metrics due to the potential buyout of ABInbev stake in the joint venture in Russia, which is still in discussion between the two parties.
- Given that CCI is assessed as a core entity of the AEFES group, we align the ratings on it with those on its parent company.
- However, CCI's stand-alone credit quality has remained solid, in our view, thanks to continued positive free operating cash flow (FOCF) and stable credit metrics overall with notably projected adjusted debt leverage of about 1.5x in 2022 and 1.0x-1.3x in 2023.
- We therefore lowered our long-term issuer credit rating on CCI and our issue ratings on the company's 2029 senior notes to 'BB+' from 'BBB-'.
- The negative outlook mirrors that of its parent.

Rating Action Rationale

Our downgrade to CCI mirrors that to parent AEFES. We lowered our ratings on the Turkey-headquartered beer bottler to 'BB+' from 'BBB-', with a negative outlook, because we anticipate its large Russian beer operations will face significant restrictions on their ability to extract cash to service debt outside Russia, and uncertainties on the financing of ABInbev joint venture in Russia. AEFES's could show weaker credit metrics following the buyout of ABInbev's stake in the joint venture in Russia, which is still being discussed. We view CCI as a core entity of the AEFES group because we think the parent would likely provide extraordinary support if needed, even if legally the two companies are legally separated. This is because we see CCI as a key asset for AEFES and due to potential reputation risk for AEFES should CCI found itself in a weak financial position. AEFES holds a majority stake (50.1%) and therefore effectively controls CCI, which is a major cash flow contributor (66% of group EBITDA in first-half 2022) and provides a significant stable dividend income. Both companies operate in consumer staples, and share a number of geographical markets and retail customers, but CCI brings important product diversification to beer bottling with a portfolio of very well-known licensed soft drinks brands (such as Coca-Cola, Fanta, and Sprite), has a long track record of profitable growth, and is not exposed to Russia.

We continue to see the group's stand-alone reporting of solid cash flow and credit metrics as credit positive. CCI continues to perform well despite a difficult economy (hyperinflation in Turkey, weak emerging market currencies versus the euro or U.S. dollar, and high operating cost inflation). In first-half 2022, volume increased 22% with net sales revenue increasing by 144% due to price increases to offset very high cost inflation in Turkey and Pakistan notably. On a trailing 12-month basis, CCI reported a stable profitability, with an adjusted EBITDA margin of about 20% (versus 22.5% last year), positive FOCF of Turkish lira (TRY) 1.2 billion (versus TRY2.3 billion), adjusted debt leverage of 1.4x (versus 0.7x), funds from operations (FFO) to debt of 50% (versus 114%), and EBITDA interest coverage of 6.7x (versus 9.1x). Our updated base-case projections for 2022-2023 assume continued high revenue growth mostly through price increase but also positive volume growth: revenue of TRY40 billion-TRY45 billion in 2022 and TRY60 billion-TRY65 billion in 2023, adjusted EBITDA of about TRY9 billion in 2022 (EBITDA margin of 19%) rising to TRY12 billion in 2023 (19%), and FOCF of TRY2 billion in 2022 rising to TRY3 billion in 2023. Adjusted debt leverage will be 1.5x in 2022 before declining to 1.0x-1.3x in 2023, with FFO to debt of 45%-50% rising to 65%-75% and EBITDA interest coverage of 5x-7x.

Volume growth should continue to mostly come from outside Turkey, with the continued penetration of sparkling beverages in the production and distribution in underpenetrated markets like Uzbekistan. We think profitability should hold up overall with CCI's track record in raising prices quickly and ability change the product and packaging mix to increase revenue per unit case. Finally, we account for the company's ability to realize operating cost savings. We see higher working capital needs in 2022 but believe part of it should decrease in second-half 2022 following prudent stocking up. Credit metrics should continue to see negative translation effect from the strong U.S. dollar versus the lira but CCI has partly hedged its 2024 bond, which should limit overall the effect. CCI is well hedged in 2022 for its main raw materials and energy costs but cost inflation means working capital and capital expenditure (capex) will also be higher, limiting FOCF growth in 2022 versus in 2021.

We continue to expect the group will pursue prudent treasury policies but think it will continue acquisitions to expand geographically. CCI continues to pursue its prudent funding policies by maintaining at all times large cash balances, mostly denominated in hard currencies (at end-June 2022, more than $400 million of denominated cash balances), which, together with our projection of positive FOCF in 2022 and 2023, should fund business needs despite expected higher working capital needs and higher capex from inflation and potential supply-chain disruptions. CCI continues to pass comfortably our stress tests to be rated above the foreign currency sovereign rating on Turkey (B+/Negative/B). We therefore believe that CCI, having already issued $500 million of senior notes in January 2022, faces no major near-term refinancing risks, with about $180 million of debt due in 2022, $174 million due (including about $120 million U.S. private placement [USPP]) in 2023, and $244 million (including about $300 million of remaining senior notes) in 2024. Also, there is strong (greater than 30%) headroom under the financial covenants on the USPP. Still, we believe the group will continue to look at acquisitions to expand its geographical reach and diversify outside Turkey. In 2021, the group acquired the Coke bottler in Uzbekistan, which we understand is on track to be fully integrated into the group in the next year. We believe the group could look to acquire Coke franchises in neighboring countries in Central Asia or the Middle East. We nevertheless believe the group will continue to careful in terms of adjusted debt leverage given the region's volatility. We also factor the group continuing to pay regularly a cash dividend with a gradually increasing payout within the policy of up to 50% of net income, but CCI has no history of paying extraordinary dividends or share buybacks.

Outlook

The negative outlook mirrors that of the parent, AEFES.

Downside scenario

We would lower the ratings most likely if we were to downgrade AEFES.

Upside scenario

We could revise our outlook to stable on CCI if we do the same to the parent.

Company Description

CCI is a soft drinks, juices, and water bottling company based in Turkey. It was founded in 2005 when AEFES' soft drinks business merged with the Coca-Cola bottler in Turkey. The company reported revenue of TRY21.9 billion (about €2.1 billion) and EBITDA of TRY4.7 billion (about €445 million) in 2021. CCI operates in 11 countries with its top three markets being Turkey (42% of volumes in 2021), Pakistan (21%), and Kazakhstan (12%). Its products are mostly produced under license from The Coca-Cola Co. (TCCC; A+/Stable/A-1) with sparkling beverages accounting for 81% of volumes in 2021.

CCI has 30 production plants with 146 productions lines, giving it a capacity to produce 1.8 billion units annually. Its market is about 430 million people across 11 countries. The company has about 870,000 sales points, with strong distribution channels and wide market reach.

CCI is 50.3% owned by AEFES, a Turkey-based bottler with large operations in Russia and central Asia. It is also 20% owned by TCCC, the largest soft drink maker globally, based in the U.S. About 28% of share capital is listed on the Istanbul stock exchange. Turkish group Ozgorkey Holding (not rated) owns 2% of share capital.

Our Base-Case Scenario

Assumptions

- Revenue growth of 100%-120% in 2022 and 30%-40% in 2023. In 2022, we assume Turkey revenue of close to 100% with volume growth of 8%-10%; international operations is assumed to grow by 110%-130%, with volume growth of 15%-20%. In 2023, we assume Turkey revenues of 30%-40%, with volume growth of about 3%; international operations is assumed to grow by

30%-40%, with volume growth of 8%-10%.

- An adjusted EBITDA margin of about 19% in 2022 and 2023. We factor in higher raw materials costs, including negative currency exchange effects, and higher energy and supply chain costs. This is offset by high price increases, changes in the packaging and product mix, and high operating efficiency.
- FOCF of TRY2.0 billion annually in 2022 and TRY3.0 billion-TRY3.5 billion in 2023. We account for negative working capital movements due to volume growth and inventory costs, and capex of 8.5%-9.0% of sales in 2022 and 2023.
- Adjusted net debt of TRY13.0 billion-TRY13.5 billion in 2022 and TRY12 billion 2023. This includes net debt, an assumed large negative foreign exchange effect of TRY8 billion, lease liabilities, and a net pension deficit. In 2022, we assume no acquisitions and cash dividends of TRY600 million. In 2023, we assume no acquisitions and dividends of about TRY2 billion.

Key metrics

- Adjusted debt to EBITDA of about 1.5x in 2022 and 1.0x-1.3x in 2023
- FFO to debt of 45%-50% in 2022 and 65%-75% in 2023
- EBITDA interest coverage of 5.0x-5.5x in 2022 and 6.0x-7.0x in 2023

Liquidity

We assess CCI's liquidity as adequate. We project that the group's sources of liquidity will likely cover its uses by more than 1.2x, and that its sources would cover uses even if forecast EBITDA declines more than 15% over the next 12 months. CCI has a prudent leverage, funding, and hedging policy overall despite most of its debt being in U.S. dollars. It holds large cash balances with at least 50% held in hard currency, mostly U.S. dollars. However, the very low debt level and strong headroom under financial covenants provide a cushion against currency-exchange volatility. We believe CCI has sound relationships with local and international banks, which is partly offset CCI being an infrequent issuer on the debt capital markets.

Principal liquidity sources for the 12 months starting from June 30, 2022 include:

- Unrestricted cash balances and liquid financial assets of TRY8.5 billion.
- Forecast cash FFO of about TRY 7.9 billion for the next 12 months.

Principal liquidity uses for the same period include:

- TRY5.6 billion of debt due within one year.
- Estimated maximum intra-year working capital outflows of TRY1.0 billion.
- Estimated maintenance capex spending of TRY3.0 billion-TRY3.5 billion annually.

Covenants

We project the group will maintain strong (more than 30%) headroom under its financial covenants in 2022.

CCI has two maintenance financial covenants linked to its USPP:

- Maximum net debt to EBITDA of 3.25x.
- Minimum net interest coverage of 4x.

These ratios are tested semiannually on a rolling-12-month basis. There are also default clauses and an event of default on the USPP if TCCC terminates any bottling agreement in Turkey.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors have a neutral influence overall on our credit analysis of CCI. We believe social risk factors are mitigated by the lower regulatory pressure and more positive consumer perception toward high sugar content beverages compared to mature markets. In addition, limited consumer affordability restricts the level of individual consumption.

The company's prudent treasury and debt leverage policies, with at least 50% of cash balances held at all times in hard currency, support our governance assessment.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Negative/-
Business risk:	Fair
Country risk	High
Industry risk	Low
Competitive position	Fair
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no effect)
Capital structure	Neutral (no effect)
Financial policy	Neutral (no effect)
Liquidity	Adequate (no effect)
Management and governance	Satisfactory (no effect)
Comparable rating analysis	Neutral (no effect)
Stand-alone credit profile:	bbb-
Group credit profile	bb+
Entity status within group	Core
Rating above the sovereign	B+

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: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Related Research

- Turkish Beverage Group Anadolu Efes Downgraded To 'BB+' On Rising Challenges Including Russia Exposure; Outlook Negative, Sept. 23, 2022

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Coca-Cola Icecek AS		
Issuer Credit Rating	BB+/Negative/--	BBB-/Watch Neg/--
Senior Unsecured	BB+	BBB-/Watch Neg