FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades CCI to 'BBB'; Outlook Stable

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Fitch Ratings - Milan - 26 Jun 2023: Fitch Ratings has upgraded Coca-Cola Icecek AS's (CCI) Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-'. The Outlook is Stable. A full list of rating actions is below.

The upgrade reflects CCI's continued strong operating profitability with successful execution of its expansion plan, leading to its revenues and EBITDA almost doubling in 2022 compared with 2021. This was supported by CCI's leading positions in its core markets, the resilient nature of the soft drinks business and CCI's strong capital structure. CCI's ratings continue to benefit from a single-notch uplift for strategic support from its parent, The Coca-Cola Company (TCCC; A/Stable) in line with Fitch's Parent and Subsidiary Linkage Criteria.

The rating remains constrained by the weak operating environment in a number of CCI's markets of operations. Inherent foreign-exchange (FX) risks related to hard-currency-denominated debt and some operating costs are key rating constraints.

KEY RATING DRIVERS

High but Manageable FX Risks: As of end-2022, about 92% of CCI's debt and 25% of its production costs were denominated in hard currencies, in contrast with revenue, which is mainly in emerging markets' local currencies. This results in high FX risks, which are managed by CCI via improving geographic diversification towards less volatile countries (2022: 64% of total revenue) and its policy of keeping a major part of its cash in hard currencies.

Strong Revenue Growth: We expect CCI to maintain a positive revenue trend, supported by organic growth across its end markets and a positive FX contribution. We expect revenues to increase by around 68% in 2023 and 32% in 2024 as a result of high single digit volume growth and higher average sales prices. We expect strong top-line growth from international emerging markets with a lower soft drinks market penetration, with more conservative growth projected for Turkiye.

Inflationary Challenges to Operating Profitability: We expect profitability will continue to be affected by inflationary pressures on raw materials, logistic and marketing costs over the next 12-18 months. We forecast a gradual recovery in EBITDA margin at 18.6% in 2023 and 19.3% in 2024, supported by the Anadolu Etap Icecek acquisition. The company has protected profitability by implementing proactive procurement, commodity hedging and a premiumisation strategy that results in a better product mix, as well as maintaining cost-reduction initiatives and internal efficiencies.

Strong Cash Flow Generation: Resilient operating profitability and capex forecast at 6%-8% of revenue in 2022-2025 should allow CCI to generate free cash flow (FCF) margins in the mid to high single digits. We continue to assume that CCI will adhere to its maximum dividend pay-out of 50% of net distributable income and to favour cash accumulation and deleveraging, with the aim of building up financial flexibility to maintain a low-risk balance sheet. This flexibility may also be deployed for potential M&A to grow the business in new geographies.

Conservative Capital Structure Intact: CCI's conservative financial policy targets EBITDA net leverage at below 2x (2022: 0.8x), albeit with tolerance for a temporary breach for value-enhancing M&A opportunities. Even with this conservative target, CCI acquired Coca-Cola Bottlers Uzbekistan and Anadolu Etap Icecek with ample leverage headroom and without a breach of the rating sensitivities. We project leverage ratios will remain well below target over the coming years, supported by sufficient FCF generation, resilient EBITDA and cash reserves to cover upcoming debt maturities.

One-Notch Uplift for TCCC Support: Fitch applies a 'bottom-up plus one notch' approach to CCI's 'bbb-' Standalone Credit Profile (SCP), reflecting our assessment of TCCC's 'Medium' operational and strategic incentives for supporting CCI. This is based on shared brands and marketing functions, as well as strategic, operational and innovation support provided by TCCC. We assess legal incentives as 'Weak'.

Overall, TCCC's moderate ownership of CCI at 20% constrains the uplift to a single notch. In our view, this level of ownership creates some uncertainty at the current rating about the extent of potential support to CCI in case of need, also given the existence of a majority shareholder, Anadolu Efes Biracilik ve Malt Sanayii A.S. (AEFES, BB+/Rating Watch Negative), and the company's public listing.

Insulated Ring-Fencing from AEFES: Under its Parent-Subsidiary Linkage methodology, Fitch views CCI's credit profile as insulated from that of its weaker parent, AEFES, which holds 50.3% of CCI's shares. This is because AEFES's ability to control CCI is constrained by important voting rights of the other shareholder, TCCC. Moreover, CCI's and AEFES's treasury functions and debt structures are fully ring-fenced from each other.

Weak Operating Environment: The operating environments in CCI's core markets (Turkiye, Pakistan, Uzbekistan and Kazakhstan), which we assess at 'bb-' and below, continue to moderately affect its ratings. These countries are characterised by historically high volatility in geopolitical events and macro-economic conditions, which tend to result in high inflation and FX fluctuations, We see these dynamics as a threat to consumer sentiment across the region, even though CCI has a strong record of operating under these challenging conditions.

Kazakhstan Country Ceiling: We apply Kazakhstan's 'BBB+' Country Ceiling to CCI's rating instead of that of Turkiye where CCI is incorporated. Given CCI's conservative capital structure with projected hard-currency interest expenses of around TRY900 million in 2023, we calculate that cash flows from Kazakhstan (2022: 26% of EBITDA) should continue to cover CCI's hard-currency interest charges with sufficient headroom. We expect this headroom to be maintained over the next four years.

Fitch assesses transfer and convertibility risks for Kazakhstan as low and we do not foresee any potential difficulties for CCI to upstream cash flows, either through dividends or intercompany loans, from Kazakhstan to Turkiye.

DERIVATION SUMMARY

CCI is among the 10 largest bottlers in the TCCC system in sales volumes, and one of the highest-rated corporates in Turkiye. Compared with its main peers, Coca-Cola Europacific Partners plc (CCEP; BBB+/Stable), and Coca-Cola FEMSA, S.A.B. de C.V. (A/Negative), CCI is smaller and operates in more volatile emerging markets and has greater exposure to FX risks. This is balanced by improved profitability, now in line with or exceeding its main peers, and by CCI's conservative capital structure with leverage metrics that are commensurate with the 'A' rating category, in line with Fitch's Sector Navigator for Non-Alcoholic Beverages.

CCI's ratings benefit from a one-notch uplift for potential support from TCCC. This is in line with Fitch's approach to CCEP, whose ratings also benefit from our assessment of TCCC's 'Medium' operational and strategic incentives for supporting CCEP.

At the same time, CCI's SCP reflects moderate pressure from a weak operating environment in the markets in which it operates, effectively capping its rating at the current level with the current quality of the operating environment.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer:

- Turkish lira/US dollar on average at 22.34 in 2023, weakening to 27.04 in 2024

- Turkish sales volumes growing in low single digits in 2023-2026. Given heightened inflationary pressure, we assume around 90% growth at the average selling price in 2023, reducing to around 30% in 2024 and 20% in 2025

- International sales volumes growing at high single digits in 2023, decreasing to low single digits over 2024-2026

- Consolidated EBITDA margin slightly improving to around 18.6% in 2023 (2022: 18.3%), driven by the Anadolu Etap Icecek acquisition, but remaining pressured by cost inflation, gradually recovering to around 20% in 2025 and 20.8% in 2026

- Capex at around 9% of net sales in 2023 and about 7% in 2023-2026

- Dividends of TL750 million and TL864 million in 2023 and 2024

RATING SENSITIVITIES

Factors That Could, Individually Or Collectively, Lead To Positive Rating Action/Upgrade

Any further upgrade would be constrained in the medium term by CCI's weak operating environment.

As we do not expect changes in the strength of ties with TCCC, an upgrade would depend on CCI's SCP, based on the following factors:

- EBITDA margin sustained above 20%

- Enhanced scale and geographic diversification, either organically or through M&A, without impairing the operating-environment score (currently bb-)

- Conservative financial structure with EBITDA net leverage remaining below 1.7x on a sustained basis

Factors That Could, Individually Or Collectively, Lead To Negative Rating Action/Downgrade

- Adverse impact of weaker operating and macro environments in CCI's core markets on credit metrics not accompanied by adequate cash-preservation measures, such as dividend and capex reduction

- Increased volatility translating into mid-single digit FCF (after capex and dividends)

- EBITDA net leverage above 2.5x

- EBITDA interest coverage below 6.5x (2022: 8.8x)

- EBITDA margin towards 16%

- Weakening linkages with TCCC

- A downgrade of Kazakhstan's Country Ceiling or the EBITDA generated in the country being insufficient to cover hard-currency interest expenses in the medium term would result in a downgrade of the Long-Term Foreign-Currency IDR

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: At end-March 2023, liquidity was supported by a cash balance of USD768million-equivalent, with about 67% in hard currencies, of which 95% is outside Turkiye.

Liquidity is also supported by USD1.2 billion-equivalent undrawn and uncommitted credit facilities in Turkiye, Pakistan, Kazakhstan, Turkmenistan and Azerbaijan, which can be utilised in hard currencies or local currency according to market conditions. However, Fitch does not include availability under uncommitted credit lines in its liquidity calculation.

ISSUER PROFILE

CCI is among the top-10 largest bottlers in the Coca-Cola system by sales volumes, operating mainly in the Middle East and Central Asia regions with the majority of sales generated in Turkiye, Kazakhstan, Pakistan and Uzbekistan. It is 50.3%-owned by Anadolu Efes Biracilik ve Malt Sanayii A.S. (BB+/Negative), 20.1% by TCCC with most of the remaining shares publicly traded on the Turkish stock exchange.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Coca-Cola Icecek AS	LT IDR	BBB Rating Outlook Stable Upgrade	BBB- Rating Outlook Positive
	LC LT IDR	BBB Rating Outlook Stable Upgrade	BBB- Rating Outlook Positive
	Natl LT	AAA(tur) Rating Outlook Stable Affirmed	AAA(tur) Rating Outlook Stable

senior unsecured	LT	BBB	Upgrade	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

Corporates Exceeding the Country Ceiling Criteria (pub. 08 Dec 2022) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 12 May 2023)

Exposure Draft: Climate Vulnerability in Corporate Ratings Criteria (pub. 09 Jun 2023) (including rating assumption sensitivity)

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Coca-Cola Icecek AS	EU Issued, UK Endorsed

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