MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns first-time Ba1 CFR to Turkish Airlines; stable outlook

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DIFC - Dubai, March 06, 2015 -- Moody's Investors Service has today assigned a Ba1 corporate family rating (CFR) and a Ba1-PD probability of default rating (PDR) to Turk Hava Yollari Anonim Ortakligi (Turkish Airlines). The outlook on the rating is stable.

"Our decision to assign a Ba1 CFR to Turkish Airlines balances the company's healthy financial profile and role as the national carrier against the execution risks associated with its high-growth strategy," says Rehan Akbar, an Analyst in Moody's corporate finance group and lead analyst for Turkish Airlines.

The Ba1 CFR on Turkish Airlines incorporates a one-notch uplift on its baseline credit assessment (BCA) of ba2, which is used to assess the underlying credit profile of a company. This uplift reflects its classification by Moody's as a government-related issuer (GRI) in view of its 49.12% ownership by the Government of Turkey (Baa3 negative).

RATINGS RATIONALE

Today's assignment of a Ba1 CFR to Turkish Airlines balances its strong business profile as the Turkish national carrier against the risks associated with the operator's significant expansion plans.

Turkish Airlines' healthy financial profile is underpinned by its low-cost structure and historical above-peer-average profitability metrics. The airline has a well-diversified passenger revenue base that is supported by the economic and tourism growth seen in Turkey, while Istanbul's geographic location allows the Ataturk International Airport to act as a hub for international transfer traffic.

As of the 12-month period through 30 September 2014, Turkish Airlines had a debt/EBITDA ratio of 4.4x and an EBIT/interest coverage ratio of 4.1x, under Moody's adjustments. However, these metrics are inflated to an extent as a result of foreign-exchange gains on financial liabilities. Excluding these gains, the debt/EBITDA and EBIT/interest coverage ratios are moderately weaker at 4.8x and 3.5x, respectively.

The Ba1 CFR also incorporates the challenges that Turkish Airlines faces, including exposure to an inherently cyclical industry and the risk of yield and margin pressure as the company executes on its high-growth strategy. In addition, the company has limited earnings diversification from other business segments such as MRO (maintenance, repair and overhaul) and catering. The material fleet expansion strategy also makes Turkish Airlines more sensitive to global and domestic economic weakness as well as foreign-currency volatility, particularly when competition is increasing as Middle Eastern carriers aggressively pursue capacity additions and as European carriers slowly consolidate.

The one-notch rating uplift reflects a balanced view that, although the government has not provided explicit support to Turkish Airlines and the ownership is held through the Turkish Privatization Administration, Moody's believes that the airline is an important contributor to the Turkish economy and plays a major role in promoting economic growth and tourism. Moody's also anticipates that the government will continue to hold its Class C golden share and remain the single largest shareholder, albeit the ownership stake could be partially reduced.

LIQUIDITY

Turkish Airlines has good liquidity under Moody's 12-18 months time horizon, particularly as a result of its healthy cash flow generation which is sufficient to support the company's upcoming financial obligations. As of year-end 2014, Turkish Airlines reported cash flow from operations of $1.1 billion, while cash and cash equivalent balances stood at $635 million. These amounts were sufficient to cover $471 million of capex and $131 million of aircraft pre-delivery payments (PDP). Fleet additions are funded through either finance or operating leases, with $697 million of financial lease liabilities and interest expense being paid in 2014.

Looking forward, Moody's anticipates that cash flows from operations will remain sufficient to cover maintenance and growth capex (excluding aircraft purchases) as well as existing lease payments. However, Turkish Airlines is dependent on external sources of financing for the foreseeable future to fund the purchase of new aircrafts.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Turkish Airlines will see steady industry demand with favourable passenger growth and healthy load factors during its fleet expansion phase.

The outlook also assumes that Turkish Airlines will continue to have an efficient cost base and above-peer-average profitability metrics through the economic cycle.

WHAT COULD CHANGE THE RATING UP/DOWN

The rating agency foresees little upward pressure on Turkish Airlines' ratings over the next few years because of the large aircraft order book and the company's plans to significantly grow capacity annually through 2017 and beyond, which could put pressure on yields and margins.

Nevertheless, an upgrade could follow if the company were to strengthen its credit metrics and maintain good liquidity while executing its growth strategy. More specifically, positive rating pressure could build if Turkish Airlines were to display a track record of debt/EBITDA below 4.0x and EBIT/interest coverage above 3.5x on a sustainable basis.

Conversely, negative rating pressure could develop if the company's liquidity were strained, potentially as a result of its large aircraft acquisition programme combined with weaker free cash flow generation. Any change in Moody's current GRI support assumptions or a downgrade of the Government of Turkey's sovereign rating could also negatively affect ratings. Downward pressure on the rating could also occur if Turkish Airlines' gross leverage were to remain above 5.0x for a sustained period and its EBIT interest coverage were to fall below 2.5x, for instance, as a result of a weaker operating environment.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Passenger Airlines published in May 2012. Other methodologies used include the Government-Related Issuers methodology published in October 2014. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Turkish Airlines is the national flag carrier of the Government of Turkey and is a member of the Star Alliance network since April 2008. Through the Ataturk International Airport in Istanbul acting as Turkish Airlines' primary hub, the passenger airline operates scheduled services to 218 international and 43 domestic destinations across 108 countries globally.

Turkish Airlines is 49.12% owned by the Government of Turkey while the balance is public on Borsa Istanbul. For the year ended 31 December 2014, Turkish Airlines reported consolidated revenue of $11.0 billion and a net profit of $845 million.

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