

Rating Action: Moody's downgrades Turkish Airlines to Ba3; negative outlook

Global Credit Research - 19 Aug 2016

Turkish Airlines-related Enhanced Equipment Trust Certificates also downgraded

DIFC - Dubai, August 19, 2016 -- Moody's Investors Service ("Moody's") has downgraded to Ba3 from Ba2 the corporate family rating (CFR) and to Ba3-PD from Ba2-PD the probability of default rating (PDR) of Turk Hava Yollari Anonim Ortakligi (Turkish Airlines).

Moody's also downgraded Turkish Airlines' Enhanced Equipment Trust Certificates (EETCs) to Baa1 from A3 (Bosphorus Pass Through Trust 2015-1A), to Baa1 from A3 (Anatolia Pass Through Trust 2015-1: Class A) and to Ba1 from Baa3 (Anatolia Pass Through Trust 2015-1: Class B). The outlook on the corporate and EETC ratings of Turkish Airlines is negative.

A complete list of affected companies and rating actions can be found at the end of this press release.

RATINGS RATIONALE

-- TURKISH AIRLINES' RATINGS DOWNGRADED, NEGATIVE OUTLOOK

Today's downgrade of the CFR and PDR reflects the downgrade of Turkish Airlines' baseline credit assessment (BCA), a measure of its standalone credit profile, to b1 from ba3.

The downgrade of the BCA reflects (1) the downward revision in our forecasts as a result of our expectation that Turkish Airlines' operating environment will remain weak entering into 2017; and (2) execution risks in the implementation of planned operational and strategic changes to address the currently challenging operating environment.

The ratings of Turkish Airlines incorporate a one-notch uplift of its BCA reflecting Moody's classification of the airline as a GRI and our moderate government support assumptions, which have not changed as a result of this rating action. Moody's classifies Turkish Airlines as a government-related issuer (GRI) because of the Government of Turkey's 49.12% ownership stake.

Passenger load factor has decreased to 73.7% for the January to July 2016 period from 78% a year earlier, driven by a decline in foreign visitors travelling to Turkey as well as less travelers passing through the Istanbul hub as a result of heightened security concerns in Turkey and Europe. This has been further exacerbated by the additions of new debt-funded aircraft into the airline's fleet, with available seat kilometres (ASK) increasing 14.1% for the January to July 2016 period from a year earlier. Although as of 31 March 2016 (LTM) the airline's adjusted debt to EBITDA (FX-adjusted) stood at 5.1x, Moody's forecasts adjusted leverage to be in excess of 7.0x by year-end 2016 and believes that, should operating conditions remain challenging over the near term, leverage could stay elevated above 6.0x in 2017.

Moody's notes that Turkish Airlines has begun to take proactive steps to improve its profitability, however it is unclear at this stage on the timing and success of some of these measures. A timely execution of capacity management measures, cost-cutting initiatives as well as revenue-enhancing steps could help to sustainably reduce leverage and improve profitability faster than what Moody's anticipates, which in turn could help stabilize the negative outlook.

-- TURKISH AIRLINES' EETC RATINGS DOWNGRADED, NEGATIVE OUTLOOK

The downgrade of the EETCs accompanies the downgrade of the ratings of Turkish Airlines.

EETC ratings are assigned by applying notching to an issuer's CFR, factoring in protective features such as (1) the importance of the aircraft collateral to the airline's network; (2) a legal framework that provides timely access to collateral following an insolvency where the airline no longer wants to use the aircraft; (3) liquidity facilities that fund a number of interest payments following the rejection of an EETC financing; and (4) the equity cushion.

The Bosphorus Trust (Series 2015-1) transaction is secured by three Boeing B777-300ER aircraft delivered new in 2015. The Anatolia Trust (Series 2015-1, JPY-denominated) is secured by three Airbus A321-200 aircraft delivered new in 2015. Moody's believes these aircraft models will remain integral to the airline's respective long-haul and medium-haul network over the remaining lives of the EETCs.

Some pressure on the values of B777-300ERs relative to expectations and the depreciation of the US dollar versus the Japanese yen since these transactions were issued have modestly lowered the equity cushions versus Moody's expectations, but not sufficiently to cause the rating agency to reduce notching relative to the CFR.

The ratings also reflect Moody's belief that Turkish Airlines would retain these aircraft under a reorganization scenario because of their relatively young age and the importance of these models to the network.

The negative outlook is aligned with the negative outlook on the rating of Turkish Airlines. Any combination of future changes in the underlying credit quality or ratings of Turkish Airlines, unexpected material changes in the market value of the aircraft and/or changes in the airline's network strategy that de-emphasize the subject aircraft models could cause Moody's to change its ratings of the EETCs.

The EETC ratings on the senior tranches might also be downgraded if the long-term local currency bond and deposit ceilings are downgraded below Baa1 when Moody's concludes its review of the ratings it assigns to Turkey. EETC ratings are capped by one notch above a country's long-term local currency bond and deposit ceilings. Moody's discusses the factors it considers when deciding whether to pierce Country Risk Ceilings in "[How Sovereign Credit Quality Can Affect Other Ratings](#)" and "[Local Currency Country Risk Ceiling for Bonds and Other Local Currency Obligations](#)" both linked here and available on Moodys.com.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects uncertainty around the recovery in passenger demand for Turkish Airlines at a time of heightened security concerns in Turkey and Europe, as well as the execution risks associated with a successful implementation of cost-saving initiatives.

The rating outlook could be stabilized should the operating environment for Turkish Airlines improve, with load factors trending above mid-70s%, and adjusted debt to EBITDA trending below 6.5x.

WHAT WOULD CHANGE THE RATING UP/DOWN

Given that Turkish Airlines' rating outlook is negative, a rating upgrade is unlikely in the near future. Nevertheless, the rating could be upgraded if Turkish Airlines sustainably maintains adjusted debt to EBITDA below 5.5x and EBIT interest coverage above 2.0x.

The rating could be downgraded if Turkish Airlines' gross leverage were to remain elevated around 7.0x or above for a sustained period, and its EBIT interest coverage were to remain weak at around 1.0x or below. Any change in Moody's current GRI support assumptions could also negatively affect ratings. In addition, a downgrade could also occur if the company's liquidity became strained, potentially as a result of its large aircraft acquisition programme combined with continued weak operating cash flows.

List of affected ratings:

Downgrades:

..Issuer: Turk Hava Yollari Anonim Ortakligi

.... Corporate Family Rating, Downgraded to Ba3 from Ba2

.... Probability of Default Rating, Downgraded to Ba3-PD from Ba2-PD

..Issuer: Anatolia Pass Through Trust

....Enhanced Equipment Trust, Downgraded to Ba1 from Baa3

....Enhanced Equipment Trust, Downgraded to Baa1 from A3

..Issuer: Bosphorus Pass Through Trust 2015-1A

...Enhanced Equipment Trust, Downgraded to Baa1 from A3

Outlook Actions:

..Issuer: Turk Hava Yollari Anonim Ortakligi

...Outlook, Remains Negative

..Issuer: Anatolia Pass Through Trust

...Outlook, Remains Negative

..Issuer: Bosphorus Pass Through Trust 2015-1A

...Outlook, Remains Negative

The principal methodology used in rating Turk Hava Yollari Anonim Ortakligi was Global Passenger Airlines published in May 2012. Other methodologies used include the Government-Related Issuers methodology published in October 2014.

The principal methodology used in rating Anatolia Pass Through Trust and Bosphorus Pass Through Trust 2015-1A was Enhanced Equipment Trust and Equipment Trust Certificates published in December 2015.

Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

Turkish Airlines is the national flag carrier of the Republic of Turkey and is a member of the Star Alliance network since April 2008. Through the Ataturk International Airport in Istanbul acting as the airline's primary hub, the passenger airline operates scheduled services to 240 international and 49 domestic destinations across 115 countries globally. As of June 2016, it operates 230 narrow-body, 83 wide-body and 11 cargo planes.

Turkish Airlines is 49.12% owned by the Government of Turkey through the Turkish Privatization Administration while the balance is public on Borsa Istanbul stock exchange.

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The person who approved Turk Hava Yollari Anonim Ortakligi credit ratings is David Staples, MD-Corporate Finance, Corporate Finance Group, Journalists 44 20 7772 5456, Subscribers 44 20 7772 5454. The person who approved Anatolia Pass Through Trust and Bosphorus Pass Through Trust 2015-1A credit ratings is Robert Jankowitz, MD-Corporate Finance, Corporate Finance Group, Journalists 212 553 0376, Subscribers 212 553 1653.

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