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RATING ACTION COMMENTARY

Fitch Publishes Ford Otosan's 'BB+' IDR; Outlook Stable; Rates Proposed Eurobond 'BB+(EXP)'

Thu 11 Apr, 2024 - 4:43 AM ET

Fitch Ratings - Barcelona - 11 Apr 2024: Fitch Ratings has published Ford Otomotiv Sanayi A.S.'s (Ford Otosan) Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'BB+' with a Stable Outlook. Fitch has also assigned the company's proposed Eurobond an expected senior unsecured rating of 'BB+(EXP)/RR4'. Final ratings are subject to the completion of refinancing and final documentation confirming to information already received.

The ratings and Outlook consider Ford Otosan's solid through-the-cycle financial profile, which Fitch views as largely in line with investment-grade automotive peers. The investment guarantee scheme embedded in the contract manufacturing agreement with Ford Motor Company (FMC, BBB-/Stable) helps protect Ford Otosan's revenue and margins from a market downturn and ensures complete capex recovery over the planned product cycle. We expect leverage metrics to closely follow the investment cycle and that the deleveraging path after the initial investment spike will be supported by healthy free cash flow (FCF) generation before dividend distribution.

Ford Otosan's business profile is characterised by its small scale and limited diversification compared with auto peers, which Fitch views as constraining the rating. The nature of being a contract manufacturer implies little brand value although Ford-branded light commercial vehicles (LCVs) produced by Ford Otosan have a leading market position in Europe. The internal synergy and ability to fund R&D needs without tapping into FMC network is limited.

KEY RATING DRIVERS

Leading Europe Segment Market Share: Ford-branded commercial vehicles (CVs) have a leading position in Europe, which is expected to grow together with new product launches. Transit, including its variants, is leading European van unit sales. This translated into Ford Otosan's export revenues significantly increasing between 2015 and 2023. CV registration in Europe has rebounded strongly since the start of 2023 from a low base in 2022, but it remains below the pre-pandemic level.

We expect demand for new CVs to remain strong as leisure and business services activities continue to recover, which will support high capacity utilisation levels of 80-90% at Ford Otosan's plants.

Solid Through-the-Cycle Financial Profile: Ford Otosan's financial profile is commensurate with Fitch's expectation for low investment-grade automakers. An EBIT margin between 5%-6% places it comfortably against the high investment-grade median (6%) in our rating criteria for auto manufacturers. We forecast the FCF margins to remain negative to neutral over the rating horizon and EBITDA net leverage to hover around 2x, driven by funding needs to roll out a four-year product pipeline. Ford Otosan has a record of healthy cash flow generation, which gives the company deleveraging capacity once mass production starts.

Investment Guarantee Scheme: As part of the contract manufacturing agreement, FMC provides Ford Otosan with an investment guarantee that secures a contractual volume despite actual sales volumes and enables Ford Otosan to recover upfront capex over the planned product cycle. The scheme also entails a cost-plus pricing mechanism that incorporates the full pass-through of the production expense and a profit mark-up. The investment guarantee scheme effectively serves as floor for Ford Otosan's revenue and earnings and offers some protection from a market downturn, which was evident by the resilient performance throughout the pandemic.

Scale, Diversification Constrain Rating: Ford Otosan is considered small compared with European vehicle manufacturers including Volkswagen AG and Mercedes-Benz Group AG that also feature a much broader spectrum of vehicle types, brands, and models and are well-diversified geographically. With expected production capacity above 900,000 by 2025, Ford Otosan is among the top producers when compared with the LCV/van segments of Renault, Stellantis N.V., and VW.

Consequently, we deem Ford Otosan a niche player despite its leading position in the covered markets and its size and scale constrain the rating at the current level. Additionally, Ford Otosan's engineering know-how and own intellectual property rights are largely associated with Ford branded trucks that do not have a meaningful market share outside Turkiye.

Appropriate Funding Structure: Around 10% of Ford Otosan's capital structure relies on short-term debt financing. This is common for Turkish corporates. We expect short-term bank lines will remain available. Ford Otosan has also access to factoring and trade lines that are not utilised. Its largest customer is Ford Deutschland Holding GmbH, which it derives around 80% of its annual sales, keeping receivable turnover to 14 days in Turkiye and 30 days in Romania. The high hard currency (HC) receivable collection rates support euro-denominated interest payments on its international borrowings, mitigating FX risks.

Margin Upside from Domestic Sales: Sales to the domestic market where Ford Otosan has discretion over pricing and distribution channels improve its profitability (EBITDA margin) although domestic unit sales have been volatile yoy and can contract fairly quickly in a worsening operating environment. Ford brands make up around 9% of the Turkish auto market share with a leading position in CVs. The passenger car (PC) market remains competitive and will remain dominated by Fiat and Renault, in our view. Despite the good margins from domestic sales, we expect group profitability to be lower as exports represent around 80% of sales.

Strategic Importance for Ford: Fitch believes that Ford Otosan is strategically important for its joint venture (JV) parent FMC, producing about two-thirds of Ford's CV unit sales and one-third of PCs in Europe and provides material cost advantage largely due to cheaper labour. Ford Otosan is likely to gain more importance while FMC is ramping down its manufacturing sites in Europe. Ford Otosan also plays a pivotal role in FMC's global CV strategy and electrification roadmap. It will manufacture six out of nine FMC's future electric models, including E-Transit, E-Custom, and the flagship LCVs is set to be a key pillar of its electric vehicle arm.

Rating Reflects Standalone Profile: As a JV, Ford Otosan's IDR currently reflects its Standalone Credit Profile (SCP). Fitch views the links between FMC and Ford Otosan as potentially supporting a one-notch rating uplift from Ford Otosan's SCP. This reflects our assessment using Parent and Subsidiary Linkage Rating Criteria (PSL) where we see operational and strategic incentives for FMC to support Ford Otosan, offset by the lack of debt guarantees or cross-default clauses.

We have not applied any additional notching to Ford Otosan's IDR under the PSL as this would lead to rating equalisation with FMC, which we do not deem appropriate due to the existing JV structure and proximity of credit profiles. The rating uplift could be applicable if Ford Otosan's SCP weakens, if FMC guarantees bulk of its debt, or if FMC's ratings were upgraded.

Country Ceiling Not Limiting Factor: Ford Otosan's IDR is not limited by a Country Ceiling because we apply the Romanian Country Ceiling of 'BBB+', reflecting its multi-country operations instead of Turkiye (B+) where the issuer is legally based. This stems from our estimate that Romania-originated EBITDA in euros from the contract manufacturing agreement with FMC (euro-denominated export sales) is more than sufficient to cover the HC (euro and US dollar) interest expenses.

DERIVATION SUMMARY

Ford Otosan's modest business profile is characterised by its comparatively smaller size that does not match higher-rated original equipment manufacturers (OEM) like FMC, or Renault SA, which have higher production volumes driven by their sizeable passenger car production capacities. Nevertheless, mirrored by FMC's leading CV market shares in Europe, Ford Otosan is a sizeable light/medium CV producer in Europe, with production capacity that matches or surpasses peers like Mercedes Vans or Renault CVs.

Ford Otosan's heavy/truck manufacturing capacity is smaller than truck manufacturers like AB Volvo (NR) and Iveco Group N.V. (BBB-/Stable). Ford Otosan's product diversification is also deemed limited, with the issuer's revenues dependent on a handful of Ford-branded models. Our forecast revenues for Ford Otosan are concentrated on four models including vans and Puma, which is one of the main reasons its business profile is constrained below investment-grade medians in our rating criteria for auto manufacturers.

The issuer has some geographic concentration to European market, with no exposure to APAC or the US. Nevertheless, we do not deem this as a major rating constraint. Its financial profile compares favorably with most investment-grade rated CV manufacturers and passenger car OEMs. We forecast an EBIT margin of around 6% for Ford Otosan, which is at the 'A' rating median and similar to that of FMC, and Volkswagen AG (A-/Stable).

The heavy investment cycle in new models will drive new debt issuance and push EBITDA net leverage to around 2x in the medium term, which is higher than peers, and above investment-grade medians in our sector criteria. We do not expect EBITDA net leverage to be below 1.0x in our four-year forecast period, which is the 'bb' rating median, flagging leverage as a constraint below investment-grade ratings. As the new models launch, and deliveries begin, we expect Ford Otosan's capital structure to improve rapidly. Nevertheless, this impact will be beyond our forecast period of four years.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Annual export unit sales reaching 700,000 by 2025

- EBITDA margins trending toward mid-single digit in 2027 from high single digit in 2024

- Capex in line with investment guarantee scheme

- 2024 net working capital change driven by inventory during model switch

- Successful placement of Eurobond

- Dividend pay-out ratio at 50%

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- An upgrade of FMC or strengthening of legal incentives for FMC to support Ford Otosan

- Net cash position

- Through-the-cycle FCF margin sustained above 4%

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- EBITDA margin sustainably below 6%

- Through-the-cycle FCF margin sustained below 1%

- EBITDA net leverage above 2.0x by 2025

- Multi-notch downgrade of FMC or adverse change to contractual sales to FMC

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: Ford Otosan had TRY5.0 billion of available cash as of end-2023, after Fitch's adjustment for restricted cash. Management targets maintaining a level of cash and credit commitments to meet 21 days of working capital outflows. The export receivables relate to a single counterparty, which is Ford Europe. The average receivable collection time at Turkish and Romanian plants are within 14 days and 30 days, respectively.

For domestic sales, a direct debit system is used for sales via dealers to mitigate credit risk. Ford Otosan uses letters of credit and trade lines for export sales, and has a EUR100 million revolver for working capital needs. We expect negative FCF in the rating horizon reflecting a capex spike and ongoing dividend payments.

Barbell Debt Maturity Profile Expected: Otosan's debt structure comprises both term loan A and term loan Bs. Most term loan Bs and the planned Eurobond are expected to have maturity between 2026 and 2028, reducing near-term liquidity needs after the planned refinancing. The short-term debt is refinanced on a rolling basis each year.

ISSUER PROFILE

Ford Otosan is a Turkish automotive manufacturing company that is specialised in light vehicle production, with leading market shares in Europe. The company is a joint venture between Koc Holding (41%) and Ford Motor Company (41%), rest of the shares are free float.

DATE OF RELEVANT COMMITTEE

04 April 2024

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY
Ford Otomotiv Sanayi A.S.	LT IDR	BB+ Rating Outlook Stable	Publish	
senior unsecured	LT	BB+(EXP)	Expected Rating	RR4

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Cigdem Cerit
Senior Director
Primary Rating Analyst
+34 93 467 8840
cigdem.cerit@fitchratings.com
Fitch Ratings Ireland Spanish Branch, Sucursal en España
Av. Diagonal 601 Planta 4 Barcelona 08028

Wendy Qian, CFA
Associate Director
Secondary Rating Analyst
+49 69 768076 278
wendy.qian@fitchratings.com

Josef Pospisil, CFA
Managing Director
Committee Chairperson
+44 20 3530 1287
josef.pospisil@fitchratings.com

MEDIA CONTACTS

Isobel Burke
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

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

Country Ceiling Criteria (pub. 24 Jul 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 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

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Ford Otomotiv Sanayi A.S.	-

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