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Research Update:

Turkish Appliance Manufacturer Vestel Affirmed At 'B-'; Outlook Stable

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Research Update:

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Overview

- Vestel has shown solid operating performance over the past 12 months, and we believe its full-year 2016 results will likely exceed our previous expectations.
- This is partly offset by the company's continued strong reliance on short-term financing.
- We are therefore affirming our 'B-' long-term rating on Vestel.
- The stable outlook reflects our view that the company is likely to reduce its short-term debt over time and that Vestel will generate positive free operating cash flow in 2016.

Rating Action

On Sept. 27, 2016, S&P Global Ratings affirmed its 'B-' long-term corporate credit rating on Turkey-based brown and white goods manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel). The outlook is stable.

Rationale

The affirmation reflects Vestel's solid operating performance over the past 12 months, driven by strong revenue growth in both its TV and white goods markets, combined with an expected EBITDA margin (as adjusted by S&P Global Ratings) of about 6.0% for 2016, up from 5.4% in 2015. However, this is offset by Vestel's continued reliance on short-term debt financing, in part due to sizeable intragroup lending (Turkish lira [TRY] 900 million [about USD 310 million] as of June 30, 2016) to its parent Zorlu Holding. About 82% of Vestel's gross financial debt of TRY3.1 billion was due within one year as of June 30, 2016, which exposes the company to refinancing risks. Although we expect Vestel's short-term debt will decline over the next 12 months, primarily due to working capital inflows and debt refinancing, we expect that its cash balances and operating cash flow will not fully cover short-term debt and capital expenditures (capex). As a result, we have revised our liquidity assessment to weak from less than adequate.

Our assessment of Vestel's business risk profile continues to reflect its volatile operating margins and cash flow generation, largely because of fierce competition and uneven demand in the consumer electronics sector. It also incorporates our view of high country risks in Turkey, such as economic, institutional, financial market, and legal risks that arise from doing business in or with Turkey. That said, Vestel's market share in liquid crystal

display (LCD) TV sales in Europe has increased over the past several years, and the company has become the largest B-brand producer of LCD TVs in Europe. Vestel has gradually increased its market share in the domestic white goods market, As of June 30, 2016, its market share stood at 15%, up from 13% in 2014. However, the company still largely depends on its key suppliers, which we see as another main weakness in Vestel's business risk profile.

Our assessment of Vestel's financial risk profile primarily incorporates its high S&P Global Ratings' adjusted gross debt to EBITDA and strong reliance on various forms of short-term financing. In addition, we expect the company's credit ratios and cash flow generation will remain highly volatile because it is exposed to demand swings and its margins and revenues are vulnerable to currency fluctuations. This is partly offset by our expectations of modest positive free operating cash flow (FOCF) and solid cash interest coverage ratios of between 2.5x and 3.0x in 2016-2017.

In our base case, we assume:

- Revenues growth at about 5% in 2017, compared with 11% for 2016, and 19% in 2015. In the first half of 2016, revenues received a boost from increasing sales before the Eurocup. However, we expect solid growth from Vestel's main products both domestically and abroad going forward, driven by the company's increasing market share in both TV and white goods markets and the relatively low penetration level of white goods and LCD TVs domestically.
- Gross profit margin to remain at about 21%-22% in 2016 and 2017 (21.2% in 2015), supported by continued low raw material and cell prices.
- Reported capex of about TRY400 million in 2016-2017.

Based on these assumptions, we arrive at the following credit measures:

- S&P Global Ratings' adjusted debt to EBITDA of about 6.0x-7.0x in 2016-2017.
- Positive FOCF up to TRY150 million in 2016 and 2017.

Liquidity

We have revised our assessment of Vestel's liquidity to weak from less than adequate. This reflects that the short-term debt reduction that we expected in our previous review has not materialized. Nevertheless, we recognize that Vestel has a long track record of relying on various forms of short-term funding, including bilateral loans and receivables factoring. We view this as an indication of aggressive liquidity management, since the company fully exposes itself to the volatility of the local capital markets.

We note, however, that reliance on short-term financing is a distinctive feature of many corporate entities operating in Turkey, where medium- and long-term financing is rare and expensive. Our current liquidity assessment also takes into account Vestel's solid relationships with its key lending banks, which we assume will continue to roll over the facilities provided they are covered by operating cash flow and the company continues to deliver satisfactory underlying operating performance.

We calculate that the company's liquidity sources will not fully cover its liquidity uses in the 12 months from June 30, 2016.

We believe that principal liquidity sources for the 12 months from June 30, 2016, include:

- Consolidated cash and equivalents of TRY776 million.
- Funds from operations of about TRY640 million.

We believe that principal liquidity uses for the same period include:

- Short-term debt of about TRY2.6 billion, of which TRY1.4 billion is related to the short-term portion of long-term financial liabilities.
- Annual capex of about TRY400 million.

We anticipate headroom of about 15% under the current liabilities ratio of the financial covenants under its loan agreement with the European Bank of Reconstruction and Development.

Outlook

The stable outlook on Vestel reflects our view that the company is likely to reduce its short-term debt over time, primarily following working capital improvements, active refinancing of short-term domestic bank loans, and reduced lending to Zorlu Holding. In addition, we expect Vestel will generate at least break even FOCF in 2016-2017.

Downside scenario

We could lower the rating if Vestel experienced declining revenues and margin prospects due to weaker demand or tighter availability of consumer financing in Turkey, adverse currency swings, or heightened competition. In particular, S&P Global Ratings' adjusted EBITDA margins sustainably below 4% and significantly negative FOCF for more than 12 months, coupled with a continued weak liquidity, could trigger a downgrade.

Upside scenario

A positive rating action on Vestel would hinge on an EBITDA margin consistently above 6%-7%, an adjusted debt leverage ratio of below 5x at year-end, and sustainably positive FOCF of more than TRY100 million per year. We do not see adequate liquidity as an absolute requirement for a one-notch upgrade, but the likely full coverage of liquidity uses, such as capex and short-term debt, throughout the fiscal year would be a key consideration for raising the rating.

Ratings Score Snapshot

Corporate Credit Rating: B-/Stable/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Negative (-1 notch)
- Liquidity: Weak (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Industrials: Key Credit Factors For The Technology Hardware And Semiconductors Industry - November 19, 2013
- Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Industry Risk - November 19, 2013
- Group Rating Methodology - November 19, 2013
- Corporate Methodology - November 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Country Risk Assessment Methodology And Assumptions - November 19, 2013
- Use Of CreditWatch And Outlooks - September 14, 2009

Ratings List

Ratings Affirmed

Vestel Elektronik Sanayi Ve Ticaret A.S.
Corporate Credit Rating B-/Stable/--

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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