Moody's Investors Service

Credit Opinion: Vestel Elektronik Sanayi Ve Ticaret A.S.

Global Credit Research - 21 Jul 2009

Istanbul, Turkey

Ratings

Category	Moody's Rating
Outlook	Negative
Corporate Family Rating	B3
Vestel Electronics Finance Ltd.	
Outlook	Negative
Issuer Rating	B3
Bkd Senior Unsecured	B3/LGD4

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Key Indicators

Vestel Elektronik Sanayi Ve Ticaret A.S.

Fiscal Year ending:	31/12/2006	31/12/2007
Revenue in thousands New Turkish Lira	**5,231,125**	**4,627,011**
EBITA Margin	**4.5%**	**2.8%**
EBIT/Interest expense	**1.2x**	**0.7x**
FCF/Debt	**-16.4%**	**9.9%**
Debt/Ebitda	**3.8x**	**4.4x**
Debt/Book Capitalization	**49.6%**	**47.2%**

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Vestel Elektronik Sanayi Ve Ticaret A.S. ("Vestel" or "the company") is one of the leading manufacturers and distributors of consumer electronics, white goods and digital products in Turkey. Manufacturing TV sets and white goods products for A-brand producers and retail chains, as well as for sale under its own name, Vestel is the leading OEM/ODM provider of TVs and white goods for the European market. Vestel-branded products are made available to consumers in Turkey and in other countries such as Russia, CIS countries, the Middle East, North Africa and South Asia. As of Q1 2009, Vestel was the fourth-largest player in the European LCD TV market in terms of sales, with a market share of 14.1%. In the 12 months to December 2008, the company reported US$3.63 billion in revenues (77% of which represent export revenues) and US$329 million in EBITDA (excluding net foreign exchange losses on a short foreign exchange position).

Initially, the company was almost exclusively focused on the manufacture and sale of cathode ray tube (CRT) TVs. However, the company has diversified into LCD TVs, white goods and other consumer electronics, resulting in a change in the composition of its sales. Although the proportion of TVs fell to 44% of total units sold in 2008 from around 80% in 2000, the TV business - generating roughly 56% of revenues - still represents the largest product category for the company. On the other hand, the white goods business accounted for 30% of units sold and 35% of revenues in 2008. From a profitability point of view, the gross profit margin in the domestic market is much higher compared to that in the export market. If we look at profitability by-products, the white goods business (export and domestic) is considered to be marginally more profitable than the TV business (export and domestic).

Given the market saturation of CRT TVs (units sold: down 49% y-o-y to 2.9 million in 2008), Vestel expects future growth to be mainly driven by LCD TV sales (units sold: up 19% y-o-y to 3.9 million in 2008) and white goods (units sales: remained broadly flat at around 4.7 million in 2008). The company sees the ongoing transition period in the TV business as an investment period in which its priority is the right market positioning in its export markets to fully capitalise on its OEM/ODM capabilities when LCD TV becomes commoditised. On the white goods front, the company increased its investment in its subsidiary, Vestel Beyaz Esya Sanayi Ve Ticaret A.S. ("Vestel White Goods" or "VWG"), so that Vestel now controls 72.6% of VWG. Vestel Elektronik's wholly-owned subsidiary Vestel CIS, which has refrigerator and washing machine plants with a production capacity of one million, carries out its production activities (currently at low capacity utilisation rates) at Alexandrow in Russia, targeting mainly CIS markets such as Russia, Ukraine, Belarus and Kazakhstan.

In 1994, Vestel was acquired by its current majority owner Collar Holding, which - following the rights issue in April 2009 - controls a 74.69% stake in the company, with the remainder floated on the Istanbul Stock Exchange. Collar Holding is owned by Ahmet Nazif Zorlu, who also owns equity interests in other businesses (e.g. textiles, energy) through Zorlu Holding. As of 21 July 2009, Vestel had a market capitalisation of US$176million.

Rating Rationale

Although the company benefits from a diversified customer base, its ratings are somewhat constrained by the mainly regional focus of its sales and the consequent exposure to the highly-competitive European consumer market for its products. More cautiously, the rating reflects Moody's concerns about the deteriorating trend in the company's operating environment amid weakening macroeconomic conditions and declining discretionary consumer spending in its markets, and the resulting potential impact on its financial risk and liquidity profile.

In Q1 2009, despite a 49% y-o-y increase in LCD TV unit sales (mainly thanks to Vestel's proximity to Europe, compared to its Far Eastern competitors, which, in today's market, is the customers' preference to ensure better inventory management), a sharp decline in LCD TV prices within the period (in line with a 50% y-o-y decline in panel prices) has taken its toll on Vestel's LCD TV revenues. In fact, together with a 74% y-o-y decline in CRT TV unit sales, Moody's believes the company's TV revenues in US$ terms were down around 38% in Q1 2009, y-o-y. Although panel prices in the sector started to recover in Q2 2009, Moody's is cautious that volatility in end-product pricing and the continuing decline in CRT TV sales could result in significant pressure on the company's TV revenues in 2009.

In the white goods (WG) segment, Vestel reported an 11% decrease in units sold in Q1 2009, due to the unsupportive macroeconomic outlook and sluggish consumer demand both in Europe and the domestic market. Together with a stronger US$ (the presentation currency) against the EUR (the functional currency of WG exports) in Q1 2009 compared to a year earlier, Moody's believes WG revenues were down around 27% in US$ terms within the period, y-o-y. Nevertheless, for 2009, Vestel anticipates it will deliver better performance than that of Q1 2009, taking into account: (i) the ongoing shift in demand to products in lower price segments in Europe; and (ii) the positive impact of the recently introduced Special Consumption Tax incentive on white goods in Turkey. As regards digital products, the sustained operational underperformance should pave the way for scaling down this segment going forward.

Moody's notes that, although the existing top-line pressure is beyond the level Moody's anticipated in October 2008 (when it downgraded Vestel's ratings to B3 from B2), the maintenance of the ratings at the existing levels currently reflects: (i) the majority shareholder's support of the business in today's challenging economic conditions, as demonstrated by the recent rights issue; and (ii) management's commitment to limiting the negative impact of top-line pressure on the company's negative free cash flow by focusing on working capital improvements, reducing capex to its minimum level (to US$40 million in 2009 from US$109 million in 2008) and by undertaking cost-cutting measures at the G&A expense level.

Moody's is nevertheless cautious and will continue to monitor the level of negative free cash flow in 2009. In that context, the rating agency notes that material deterioration in the cash burn compared to last year (which Moody's believes was around minus US$10 million), in the absence of additional support from the major shareholder, would warrant a downward rating action, particularly considering the lack of visibility in relation to the timing of a sustainable recovery in the company's operational environment.

Liquidity

In Moody's view, the cash balance (US$266 million at Q1 2009) and the US$100 million of proceeds from the recent rights issue (which are likely to be applied to debt reduction) should broadly enable the company to cover its short-term debt maturities of US$318 million (excluding letters of credit) and its negative free cash flow generation in the 12 months to March 2010. However, Moody's considers Vestel's liquidity profile to be vulnerable based upon its significant reliance on funding provided by letters of credit. If the availability of these credit lines were to decline in relation to an accelerating deterioration in the group's operating environment, any demand for faster payment to suppliers could hurt Vestel's cash flows. The potential risks associated with the company's lack of an adequate committed back-up facility contribute to Moody's liquidity concerns.

Rating Outlook

The negative outlook reflects (i) the sustained competitive pressure and the challenging operating environment in key segments, against the backdrop of a deteriorating macroeconomic environment; and (ii) Moody's view that the headroom under the covenants (around 4% under the fixed charge coverage ratio and 5% under the consolidated indebtedness to EBITDA ratio as of December 2008) are likely to remain tight at the next test (i.e. June 2009), despite the recent rights issue, mainly due to significant top-line pressure and the increasing borrowing costs in the financial markets.

What Could Change the Rating - Up

An upward revision of the rating would first require the outlook to be changed back to stable, which could result from a sustained recovery in the group's operating performance and higher visibility in revenues, profitability and the liquidity profile, together with an increase in the headroom under the covenants to comfortable levels.

What Could Change the Rating - Down

Sustained negative operational performance, a significant deterioration in cash burn compared to last year, further weakening in the liquidity profile and/or a breach of covenants set in the indenture of the notes could exert pressure on Vestel's ratings.