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Research Update:

Turkish Appliance Manufacturer Vestel Outlook Revised To Stable On Lower Expected Cash Flow; 'B-' Rating Affirmed

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Overview

- We do not expect that Turkish brown and white goods manufacturer Vestel will generate meaningfully positive free operating cash flow in 2012 and 2013.
- This is inconsistent with our previous expectation that its positive free cash flow generation could somewhat mitigate Vestel's very high exposure to short-term financing.
- We are revising our outlook on Vestel to stable from positive and affirming the 'B-' long-term rating.
- The stable outlook reflects our expectation that Vestel will adequately manage its high exposure to refinancing risk and will improve its cash flow generation in 2013.

Rating Action

On Nov. 30, 2012, Standard & Poor's Ratings Services revised its outlook on Turkish brown and white goods manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel) to stable from positive and affirmed the corporate credit rating at 'B-'.

Rationale

We revised the outlook to stable from positive because we no longer expect that Vestel will generate meaningfully positive free operating cash flow in 2012 and 2013, which we previously considered an important mitigant to the company's weak liquidity.

We now project that Vestel will report an at least twofold decline in Standard & Poor's adjusted EBITDA for 2012, because of negative foreign exchange dynamics and weakening trading conditions. We currently assume that, because of the EBITDA decline, the Standard & Poor's adjusted debt-to-BITDA ratio will exceed 7x at the end of 2012, up from about 3x in 2011. Given the EBITDA decline, significant working-capital swings, and persistently high capital spending, Vestel will not generate any meaningful positive free cash flow, which is inconsistent with our previous expectations.

The company's liquidity position remains "less than adequate", as its debt profile features a very high percentage of short-term maturities. These

primarily include various forms of working-capital financing, such as revolvers, letters of credit, and receivables factoring. We previously expected that Vestel's positive free cash flow generation (FOCF) in 2012 could somewhat mitigate its refinancing risk, which did not happen because of the weakened operating performance.

Nevertheless, in our base-case scenario for 2013, we assume that Vestel's operating performance will be on a positive trajectory, alongside with improving profitability and cash flow generation. Notably, we assume that the gross margin will improve from the current level of about 12% to about 13.5%, and that Vestel's working capital swings and capital expenditures will decline, supporting growth in cash flows.

The 'B-' rating reflects our assessment of Vestel's business risk profile as "weak" and its financial risk profile as "highly leveraged".

Vestel's business risk profile is constrained by its volatile operating performance, reflecting its exposure to uneven macroeconomic conditions in Turkey and Europe, working-capital swings, and volatility in foreign exchange rates. It also reflects the high competitiveness of the LCD (liquid-crystal display) TV market, where Vestel has to compete against larger and financially stronger global players, such as Samsung Electronics (A/Positive/A-1), LG Electronics Inc. (BBB-/Stable/--), or Sony Corp. (BBB/Negative/A-2). These weaknesses are only partially mitigated by Vestel's positioning as Europe's largest B-brands producer of LCD TVs, with a rising market share and increasing scale. We also assess Vestel's management and governance as "fair".

The company's financial profile is constrained by its high reliance on short-term funding, volatile debt leverage, and weak FOCF. These risks are only partly offset by support demonstrated by the shareholder, which, in our view, is a financially stronger entity than Vestel.

Liquidity

We assess Vestel's liquidity as "less than adequate", as defined by our criteria. This primarily reflects Vestel's continued reliance on various forms of short-term funding, including bilateral loans, receivables factoring, and letters of credit.

We calculate that the company's ratio of liquidity sources to uses was below 1x on Sept. 30, 2012, and we expect it to remain at this level, absent major refinancing.

In May Vestel repaid $250 million bond, using primarily new debt. We understand that most of the financing the company currently requires is for working capital financing, that is why the company primarily borrows on a short-term basis. We view this as indication of aggressive liquidity management, as the company fully exposes itself to the risk of volatility in the local capital markets.

We note, however, that reliance on short-term financing is a distinctive feature of many corporates operating in Turkey, where medium- and long-term financing is rare and expensive. Our "less-than-adequate" assessment of Vestel's liquidity factors takes into account Vestel's solid relationship with its key lending banks, which we assume will continue rolling-over the facilities on an ongoing basis.

Vestel's cash flow generation remains volatile, being dependent on trading conditions and currency swings. Therefore we do not expect FOCF to be an important source of financing in 2012 and 2013.

Outlook

The stable outlook reflects our expectation that Vestel's adjusted debt leverage will exceed 7x at the end of 2012 because of the drop in EBITDA and will reduce to about 4x at the end of 2013 thanks to improvements in profitability. It also reflects our assumption that Vestel's key lending banks will continue rolling over the short-term credit facilities they provide to the company.

We could raise the rating if Vestel were to demonstrate a meaningful turnaround in its operating performance, including a positive profitability trend and positive FOCF. Upside could also be driven by an improvement in Vestel's liquidity position, because of an extension of the maturity profile.

We could lower the rating on Vestel if its profitability were to remain at weak levels for a prolonged period of time, resulting in strongly negative FOCF. A negative rating action could also follow further weakening of Vestel's liquidity position, for example, if we saw more risk that key lenders would not roll over Vestel's short-term debt maturities.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Key Credit Factors: Methodology And Assumptions On Risks In The Global High Technology Industry, Oct. 15, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 14, 2008

Ratings List

CreditWatch/Outlook Action; Ratings Affirmed

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

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