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Research Update:

Turkey-Based Appliance Manufacturer Vestel Outlook Revised To Positive; 'B-' Rating Affirmed

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Overview

- Turkish appliance manufacturer Vestel's operating performance is improving, with more stable revenues and rising profitability, compared with our previous base-case expectations.
- We are therefore revising our outlook on Vestel to positive from stable, and affirming the 'B-' rating.
- The positive outlook reflects the likelihood of an upgrade over the next 12 months if Vestel outperforms our base-case profitability assumptions and generates meaningful positive free cash flow in 2015.

Rating Action

On Oct. 31, 2014, Standard & Poor's Ratings Services revised its outlook on Turkey-based brown and white goods manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel) to positive from stable. At the same time, we affirmed the 'B-' long-term corporate credit rating.

Rationale

The outlook revision reflects our view that Vestel's operating performance could exceed our base-case expectations in 2015 thanks to lower volatility in earnings, improving profitability, and lower working capital outflows.

In the first half of 2014, Vestel posted a gross margin of 22% and an EBITDA margin of 11%--both nearing all-time highs for the company. Although we expect profitability to weaken in the second half of 2014 due to seasonal effects, we think the company's EBITDA for the full year 2014 could materially exceed our base-case assumptions and lead to lower leverage and stronger free operating cash flow than we previously anticipated.

Although Vestel's liquidity remains "less than adequate," in our view, it will not be a constraining factor for a higher rating, assuming that the company's operating performance stays in line with or stronger than our base-case scenario. This is because we do not see meaningful risk that banks will not roll over their working capital facilities for Vestel. Furthermore, the company has recently raised some longer-term financing and is taking steps to increase the long-term portion of debt further.

Our assessment of Vestel's business risk profile as "weak" reflects its volatile profitability and cash flow generation, largely driven by the very

high competition in the consumer electronics sector. That said, Vestel's market share in LCD TV sales in Europe has increased substantially over the past several years, and Vestel has become the largest B-brands producer of LCD (liquid crystal display) TVs in Europe. Yet, the company is still largely dependent on its key suppliers, which we see as another key weakness in Vestel's business risk profile.

Our assessment of Vestel's financial risk profile as "highly leveraged" reflects its historically high debt in relation to its EBITDA and reliance on various forms of short-term financing. Although we expect that Vestel will start generating slightly positive free operating cash flow in 2015, this increment will not help Vestel meaningfully reduce its debt.

Under our criteria, the combination of our assessments of a "weak" business risk profile and a "highly leveraged" financial risk profile presents two possible anchor outcomes: 'b' or 'b-'. We assess Vestel's anchor at 'b-', based on our view that the company's financial risk profile is at the lower end of our "highly leveraged" category.

Under our base case, we assume:

- Mid-single-digit revenue growth in 2014, followed by a low-single-digit decline in 2015, which is driven primarily by the absence of major sports events. Revenues in 2014 were boosted by increasing sales before the FIFA World Cup in Brazil.
- A gross profit margin of about 18% in 2014-2015 as the company's strategy to exit from lower margin products starts to pay off.
- Capital expenditures of Turkish lira (TRY) 300 million (about $135 million) in 2014-2015.
- No dividend distribution, as in the previous years.
- Rollover of short-term credit facilities.

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

- A Standard & Poor's-adjusted debt-to-EBITDA ratio of about 4x-5x in 2015-2016 (compared with 10x in 2013).
- Slightly positive Standard & Poor's-adjusted free operating cash flow in 2015 and 2016.

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 liquidity sources will cover its liquidity uses at less than 1x, as of June 30, 2014, and we expect this ratio to remain at this level, without major refinancing. Although the company has decreased its share of short-term debt by raising medium-term loans, currently, most of the required financing is for working capital. That's why the company primarily borrows on a short-term basis. We view this as an indication of

aggressive liquidity management, since 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 corporate entities operating in Turkey, where medium- and long-term financing is rare and expensive. Our assessment of Vestel's liquidity as "less than adequate" takes into account Vestel's solid relationships with its key lending banks, which we assume will continue to roll over the facilities while they are covered by operating cash flow.

Outlook

The positive outlook on Vestel reflects our view that we could raise the rating if we see continued improvement in Vestel's operating performance, notably in terms of profitability, reduction of working capital outflows and positive free cash flow generation.

Upside scenario

A positive rating action would hinge on an EBITDA margin of consistently higher than 7%, an adjusted debt leverage ratio of 5x maximum, and positive free operating cash flow of more than TRY50 million per year. We do not see "adequate" liquidity as an absolute requirement for a one-notch upgrade, but we assume Vestel will continue improving its capital structure by replacing part of its short-term facilities with medium-term debt.

Downside scenario

We could revise the outlook to stable if Vestel's operating performance continues to be volatile, such as shown by an annual decline in revenues of more than 10% in 2015 or a decrease in the EBITDA margin to below 5%.

Ratings Score Snapshot

Corporate Credit Rating: B-/Positive/--

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

Financial risk: Highly leveraged
- Cash flow/Leverage: Highly leveraged

Anchor: b-

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Technology Hardware And Semiconductors Industry , Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

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

Additional Contact:
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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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.