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Research Update:

Turkish Appliance Manufacturer Vestel Outlook Revised To Negative; Rating Affirmed At 'B-'

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Overview

- Economic conditions in Turkey have weakened, and we consequently think that Vestel could be exposed to higher refinancing risks if its operating performance and credit metrics weakened further.
- Still, we understand that Vestel has recently taken actions to improve its debt maturity profile and liquidity.
- We are revising our outlook on Vestel to negative from stable and affirming our 'B-' long-term corporate credit rating.
- The negative outlook on Vestel reflects the potential for a downgrade in the next 12 months if its operating performance or liquidity weakens, or if its debt increases further.

Rating Action

On Feb. 3, 2017, S&P Global Ratings revised its outlook to negative from stable on Turkey-based brown and white goods manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel). At the same time, we affirmed our 'B-' long-term corporate credit rating on the company.

Rationale

The negative outlook reflects our view that Vestel could be exposed to higher refinancing risks, and that weaker economic conditions in Turkey could put a dent in the company's operating performance. In addition, although the recent sharp depreciation of the Turkish lira against the U.S. dollar and the euro has no material impact on Vestel's gross margins, it has led to an increase in the company's debt.

On Jan. 27, 2017, we revised our outlook on Turkey (see "Republic of Turkey Outlook Revised To Negative; Ratings Affirmed," published Jan. 27, 2017, On RatingsDirect). We now project GDP growth of around 2.4% in 2017, down from our previous projection of 3.2%. This is likely to dampen Vestel's domestic revenues, as 36% of the company's revenues are generated in Turkey.

Furthermore, we expect Vestel's leverage to increase as a result of the Turkish lira's depreciation, combined with increased intracompany lending to the main owner, Zorlu Holding (77.5% of capital). As of Sept. 30, 2016, Vestel reported financial net debt of the equivalent of about US\$806 million. Since then and until Feb. 2, 2017, the Turkish lira depreciated by 24% against the U.S. dollar and by 19% against the euro. In addition, intracompany loans to

Zorlu increased further from about Turkish lira (TRY) 900 million in June 2016 to about TRY1.1 billion a few months later at end-September. As a result, we now estimate that Vestel's adjusted debt to EBITDA could reach 9x or more in 2017 (compared with about 7x in our previous estimate).

The 'B-' rating continues to reflect our understanding that Vestel has taken significant actions to extend its maturity schedule, which was very short-dated as of Sept. 30, 2016. Furthermore, we anticipate that Vestel's liquidity position has improved over the past months due to strong working capital inflows upon completion of a large tender project worth TRY1 billion to provide smart boards for schools.

Our assessment of Vestel's business risk profile continues to reflect the company's volatile operating margins and cash flow generation, largely because of fierce competition and uneven demand in the consumer electronics sector. However, Vestel's market share in liquid crystal display (LCD) TV sales in Europe and in the domestic white goods market has increased over the past several years, and the company has become the Original Design Manufacturer (ODM) of LCD TVs in Europe. However, the company still depends heavily on its key suppliers, which we see as another main weakness in Vestel's business risk profile. Although we think that margins could be volatile, we assess that they are relatively protected against currency moves, given that both revenues and operating costs are predominantly denominated in euro and U.S. dollar.

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. 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 are vulnerable to raw material and cell prices. This is partly offset by our expectations of modest positive free operating cash flow (FOCF) and solid cash interest coverage ratios of between 2.0x and 2.5x in 2016-2017.

In our base case, we assume:

- Revenue growth at about 6%-8% in 2016 and 5% in 2017. After revenue growth above 20% in first half of 2016, which was supported in particular by strong sales in the TV segment prior to the Eurocup. We have revised down our revenue assumption for the second half of 2016 based on slowing domestic demand and strong competition in international markets.
- Throughout 2017, we expect international revenues will benefit from further depreciation of the lira. Gross profit margin to remain at about 20%-22% in 2016 (21.2% in 2015), supported by low raw material prices in White goods segment, but offset by increasing cell prices in TV segment. We expect slightly lower margins in 2017 based on an increase in raw material prices.
- Reported capital expenditures (capex) of about TRY400 million in 2016-2017.
- Cash inflow as full payment for the TRY1 billion tender project has been paid in full.

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

- S&P Global Ratings' adjusted debt to EBITDA of about 8.0x-9.5x in 2016-2017.
- Positive FOCF above TRY300 million in 2016 and at least break even in 2017.

Liquidity

We continue to assess Vestel's liquidity as weak. This reflects that Vestel's 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.

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 Sept. 30, 2016.

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

- Consolidated cash and equivalents of TRY759 million.
- Funds from operations of about TRY450 million.

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

- Short-term debt of about TRY2.7 billion, of which TRY1.4 billion is related to the short-term portion of long-term financial liabilities.
- Annual capex of about TRY400 million.

However, we note that since the latest reported figures, Vestel received payments from the larger tender project, which improved its cash balance. In addition, we understand that management has reduced its dependence on short-term debt financing by refinancing with debt maturing beyond 12 months.

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

Outlook

The negative outlook on Vestel reflects the potential for a downgrade in the next 12 months if the company's operating performance or liquidity weakens or if leverage continues to rise.

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 a downgrade could be prompted by S&P Global Ratings-adjusted EBITDA margins sustainably below 4% and significantly negative FOCF for more than 12 months, alongside persistently weak liquidity or further increases in leverage.

Upside scenario

We could revise the outlook to stable if the company markedly extends the maturity profile of its capital structure through continued active refinancing of short-term domestic bank loans, as this would result in the company's liquidity sources sustainably covering its liquidity uses. In addition, an outlook revision to stable would hinge on at least break-even FOCF.

Ratings Score Snapshot

Corporate Credit Rating: B-/Negative/--

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

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Technology Hardware And Semiconductors Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 01, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Outlook Action; Ratings Affirmed

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