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Research Update:

Turkey-Based Vestel Rating Cut To 'B' On Operating Pressures And Tight Liquidity; Outlook Neg

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Rationale

On Dec. 21, 2007, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Turkey-based consumer electronics and white goods manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. to 'B' from 'B+'. The outlook is negative.

At the same time, we lowered our senior unsecured debt rating on Vestel subsidiary Vestel Electronics Finance Ltd.'s \$225 million bond to 'B' from 'B+'.

At Sept. 30, 2007, Vestel had gross unadjusted debt of \$775 million.

The downgrade reflects the squeeze on Vestel's revenues and margins, particularly in critical TV exports to the EU, and the company's tight liquidity position. The rapid shift in demand to flat-screen (liquid crystal display, or LCD, and plasma) TVs away from cathode ray tube (CRT) based models has curtailed Vestel's volume growth, while the Turkish lira's current strength against the dollar and the euro is partly undermining Vestel's cost competitiveness.

TV volumes declined by 19% year on year in the nine months ended Sept. 30, 2007, while a 58% jump in flat TVs (where Vestel has about 11% market share in the EU) failed to offset a 36% drop, from a larger base, in CRT TVs (Vestel's market share is about 20% in the EU). TV sales were down by 12% year on year in dollar terms in the same period, despite the weaker dollar.

Growth in white goods remained satisfactory, with revenues and volumes up 26% and 13% year on year, respectively. White goods consequently contributed 33% of consolidated revenues, up from 26% in the nine months ended Sept. 30, 2006. Year-on-year domestic revenue growth swung back to 37% in third-quarter 2007, from minus 14% in second-quarter 2007, yielding overall good 12% year-on-year growth in the nine months ended Sept. 30, 2007. The company posted a \$22 million consolidated EBITDA loss in the nine months ended Sept. 30, 2007, however, with gross margin shrinking to 11%, down from 20% in the nine months ended Sept. 30, 2006.

The ratings continue to reflect Vestel's cost-efficient manufacturing, while remaining constrained mainly by the volatile Turkish macroeconomic environment and resulting currency swings; the company's significant, and largely short-term, debt burden; and the highly competitive nature of its end-markets. Vestel derived 74% of revenues from exports in the 12 months ended Sept. 30, 2007.

In late October 2007, Vestel signed a letter of intent with Whirlpool Europe Srl to create a 50/50 joint venture in white goods that will encompass the purchase of Vestel's 72.6% stake in Vestel White Goods. Although only limited details are available at this stage, the transaction could potentially

improve Vestel's near-term liquidity position but reduce the company's access to white goods profits, which have increased substantially in the past few years.

Liquidity

Vestel's liquidity remains tight, as a result of its significant short-term debt of \$407 million on Sept. 30, 2007 (including debt maturities of \$145 million), against cash and equivalents of \$380 million, and a very tight covenant position. Free cash flow generation is generally skewed toward the fourth quarter. Vestel repaid a €75 million bond from cash balances in December 2007.

Although capital expenditures have come down significantly to now represent about 2%-3% of revenues, we expect that Vestel's weak profitability will restrict near-term free cash flow generation.

At June 30, 2007, the company had very low headroom under the financial covenants included in the indenture of Vestel Electronics Finance Ltd.'s \$225 million bond. The margins under the 4x debt-to-EBITDA ratio and above the 2.25x fixed charge coverage ratio were 17% and 3%, respectively. Considering the operating pressures in consumer electronics, the December test also stands to be challenging.

Outlook

The negative outlook reflects our concerns about the company's weak margins and tight liquidity. We might lower the ratings if the company's liquidity position does not rapidly improve or its operating performance remains weak.

On the upside, the ratings could benefit from improvement in the company's operating performance, notably if margins widen and cash flow generation strengthens.

The rating impact of the possible white goods joint venture is difficult to assess at this point, given white goods' contribution to Vestel's profits, the uncertainties surrounding the transaction, and questions on Vestel's use of proceeds.

Ratings List

	To	From
Vestel Elektronik Sanayi Ve Ticaret A.S.		
Corporate credit rating	B/Negative/--	B+/Stable/-
Vestel Electronics Finance Ltd.		
Senior unsecured debt*	B	B+

*Guaranteed by Vestel Elektronik Sanayi Ve Ticaret A.S.

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