

FITCH AFFIRMS VESTEL AT 'B'; OUTLOOK STABLE

Fitch Ratings-London/Istanbul-04 February 2011: Fitch Ratings has affirmed Turkey-based Vestel Elektronik Sanayi Ve Ticaret A.S.'s (Vestel) Long-term foreign and local currency Issuer Default Ratings (IDR) at 'B'. The Outlook on both IDRs is Stable. Fitch has also affirmed the senior unsecured rating of Vestel Electronics Finance Ltd.'s guaranteed issue of USD225m 8.75% 2012 maturity notes at 'B'/RR4'.

The rating affirmations reflect the fact that Vestel's key credit metrics remain relatively comfortable for a 'B' range credit (both on a current and forecast basis), and that although liquidity and covenant headroom are relatively weak, they have not materially worsened over the past 12-18 months. This has been supported by management's focus on reducing gross debt levels (which fell by 20% during Q1-Q310) and decreasing balance sheet related FX risks through increased financial hedging. Assuming that end-market conditions and prevailing FX rates do not materially worsen, Fitch expects Vestel's credit profile to remain consistent with its current ratings.

The ratings continue to be supported by Vestel's low-cost manufacturing position, its healthy market share in the European TV and white goods markets, its proximity to the EU (which provides it with an advantage over Asian competition) and its strong economies of scale, including having Europe's largest production facility under a single roof.

However, despite these strengths, Vestel's credit profile remains relatively weak. Key weaknesses include the company's exposure to the mature and highly competitive TV and white goods markets, where technological change and over-capacity has led to intense price competition. Combined with Vestel's large FX exposure within its P&L (negative when the Turkish lira (TRY) appreciates), this can lead to significant swings in profitability.

Other factors limiting the ratings include Vestel's historically weak cash flow (it has generated positive free cash flow (FCF) only once in the past five years), and its opaque group structure, which includes a parent company (Zorlu Group) for which financial details are limited. Furthermore, Vestel suffers from a weak liquidity position, with a liquidity score (sources of liquidity/uses of liquidity over the next 12 months) of 1x; a score below 1x represents a significant concern. Liquidity suffers from Vestel's reliance on short-term debt, a lack of committed undrawn credit lines, a degree of FX exposure (with debt mainly in US dollars but cash flows in a mix of US dollars, euros and TRY), limited covenant headroom, and a large upcoming maturity 'lump' in the form of a USD225m bond, maturing in 2012.

The ratings also incorporate Vestel's recent trading performance, which was mixed during Q1-Q310. Although revenues have performed well (up 9% on an LTM basis) as demand for TVs and white goods has recovered following the 2008-09 downturn, profitability remains under pressure. EBITDA margins fell significantly to 7.1% in Q310 (on an LTM basis) from 12.8% in Q409 due to increasing price competition, rising input costs, the cessation of temporary tax incentives in Turkey, and a stronger TRY. Nevertheless, FCF has been slightly positive, thus allowing debt levels to fall. Key credit metrics remain consistent with the current ratings, with FFO adjusted leverage of about 2.6x as of Q310 (on an LTM basis) and FFO fixed charge cover of 3.9x. Fitch adjusts Vestel's credit metrics to reflect that Vestel does not have full access to the cash flows in its second-largest subsidiary, Vestel White Goods (VWG). Although Vestel fully consolidates VWG in its accounts, its access to VWG's cash flows is limited to purely annual dividend payments, which are also subject to a 27% leakage to minority shareholders.

Fitch believes there is little upside to Vestel's ratings at present, given that concerns about liquidity, FX exposure and a lack of transparency at the parent company level are unlikely to be resolved in the near term. Nevertheless, a significant improvement in credit metrics, such as FFO adjusted leverage below 1x, could create positive ratings momentum.

Conversely, the ratings could be downgraded if Vestel's liquidity position worsens, such as a liquidity score below 1x, evidence of an impending covenant breach, and/or a lack of meaningful progress within the next 12-14 months in refinancing its USD225m bond. A ratings downgrade would also be likely if key credit metrics were to sustainably worsen, such as FFO adjusted leverage (adjusted for ring-fenced VWG cash flows) to 3x or more, or FFO interest cover (adjusted for ring-fenced VWG cash flows) to 2x or less.

Vestel Electronics Finance Ltd.'s (VEFL) senior unsecured (SU) rating continues to be aligned with Vestel's IDR as Vestel fully guarantees VEFL's debt. Moreover, Fitch's bespoke recovery analysis indicates that VEFL's senior unsecured creditors would recover 30%-50% under a default scenario, equating to an 'RR4' recovery rating and thus zero notching between the SU rating and IDR, as per Fitch's methodology.

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Applicable criteria, 'Corporate Ratings Methodology', dated 13 August 2010, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Corporate Rating Methodology

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=546646

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