

RATING ACTION COMMENTARY

Fitch Downgrades Vestel's Local-Currency IDR to 'B+'; Affirms Foreign-Currency IDR at 'B+'

Thu 21 Nov, 2024 - 8:39 AM ET

Fitch Ratings - Dubai - 21 Nov 2024: Fitch Ratings has downgraded Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel's) Long-Term Local-Currency (LTLC) IDR to 'B+' from 'BB-'. The Outlook on the LTLC IDR is Negative. Fitch has also revised the Outlook on its Long-Term Foreign-Currency (LTFC) IDR to Negative from Positive, while affirming the rating at 'B+'. Vestel's USD notes are affirmed at 'B+'/'RR4'.

The downgrade reflects Turkiye's challenging market environment and high inflation, leading to declining demand and lower-than-expected sold volumes, including in its export markets. Consequently, Vestel's revenue and margins are under pressure, while working-capital outflow has increased reliance on short-term debt, leading leverage metrics to exceed its negative sensitivity.

The Negative Outlooks reflect risks related to Vestel's working-capital outflows, deleveraging trajectory, and general lower demand in Turkiye and other markets.

The IDR reflects Vestel's low-cost white goods and electronics manufacturing base in Turkiye with proximity to export markets in Europe that are its major revenue source. Rating constraints are domestic production concentration, limited pricing power, foreign-exchange (FX) risks and negative free cash flow (FCF).

KEY RATING DRIVERS

Challenging Market Conditions: Persistently high inflation and a tight monetary policy in Turkiye, alongside increased competition in European markets, have led to lower-than-expected sold volumes and a softer demand outlook. We expect domestic market weakness to persist into Q424, with a slow recovery beginning in 2025.

Vestel generates around 60% of its revenues from exports, mainly to Europe. Following some signs of improvement in European markets, ECB rate cuts should further support

the recovery. Overall, we expect Vestel's markets to fully recover during 2026, driven by stabilising macroeconomic conditions and gradual improvement in demand.

High Inflation Pressures Export Margins: Hyperinflation in Turkiye has driven up input costs, and Vestel is finding it challenging to fully pass on these costs to customers due to increased competition from Chinese exporters to European markets, particularly in TV and electronics. Vestel's revenues largely come from low-margin private-label manufacturing, which relies on cost competitiveness and thus limits its pricing power. Consequently, Vestel's ability to pass on cost increases has weakened in Europe but has remained broadly stable in Turkiye.

Cost Optimisation and Strategic Initiatives: Vestel has initiated a three-pillar strategy to navigate challenging market conditions, which we have only partially incorporated into our updated rating case forecast. It aims to achieve savings from logistics and procurement, expand its core business to the US and Asian markets, and focus on its mobility segment. This includes holding a stake in a leading domestic electric vehicle producer, which offers significant growth potential.

Significant Working-Capital Outflow: Changes to Vestel's supplier of white good raw materials - which are now procured from China instead of Turkiye - have led to significantly shorter average payment days but better pricing terms. Transportation times have also increased due to issues surrounding the Red Sea, necessitating an increase in inventory and leading to a large working capital outflow during 2024. We expect working-capital outflows to persist throughout our forecast horizon, although with a declining net working capital/revenue ratio.

Negative FCF: We expect Vestel to continue reporting negative FCF due to higher-than-expected working-capital needs and pressured earnings. This will limit financial flexibility and increase reliance on short-term funding, further raising leverage and interest costs. During 9M24, total reported debt increased to about TRY57 billion, from TRY29 billion at end-2023. This was due mainly to the USD500 million bonds issued during 1H24 and the additional issuance of short-term local bonds to fund the working-capital cash burn.

Increasing Leverage: We forecast Vestel's leverage to exceed our negative rating sensitivity and to remain high for a longer period than previously projected. We estimate Vestel's EBITDA leverage will reach 4.5x at end-2024 and 4.3x at end-2025, before returning to 3.5x at end-2027, underlining the downgrade and Negative rating Outlook.

Deteriorating Interest Cover: We forecast Vestel's EBITDA interest coverage to average 1.7x throughout our forecast period due to increased borrowings, higher local interest rates, and a decreased EBITDA forecast. As of end-9M24, the company had significant short-term debt totaling TRY37 billion, which is around 68% of total debt, with around 40% denominated in local currency, both higher than our prior expectation.

DERIVATION SUMMARY

Vestel's through-the-cycle EBITDA and EBIT margins of 12% and 9% per year on average are similar to that of higher-rated peers like Whirlpool Corp. (BBB-/Negative) and LG Electronics Inc. (BBB/Stable). However, this strength is offset by Vestel's weaker FCF margin, due to the sharp devaluation of the Turkish lira and unfavourable working-capital management from a longer payable cycle relative to receivables days.

Unlike Vestel, Arcelik A.S. (BB-/Negative), a Turkish-based peer, focuses solely on more profitable white goods and benefits from the geographical diversification of its production base. Additionally, Arcelik's stronger brand portfolio and pricing power explain the one-notch rating differential. Similar to Vestel, Uzbekistan-based Artel Electronics LLC (B/Stable) manufactures within its local market; however, it lacks the geographical sales diversification of Vestel and Arcelik.

Although Vestel's leverage metrics are not excessive compared with Arcelik's, financial flexibility is constrained by lower interest coverage, FX risk due to only partly effective hedging, short-term debt exposure and weak liquidity.

KEY ASSUMPTIONS

-Revenue to increase on average 20% for 2024-2028, reflecting improved sold volumes and pricing from 2024 levels

-Improving average EBITDA margin to 13% by end-2027, reflecting anticipated cost synergies and improved pricing ability

-Capex in line with management forecasts to 2027, with modest Fitch-assumed dividends

-FCF margin to remain negative until 2027, before turning modestly positive by 2028, driven by working capital outflows, albeit with a declining net working capital/revenue ratio

-Continued successful refinancing of upcoming short-term maturities, albeit at a higher interest rate

RECOVERY ANALYSIS

- The recovery analysis assumes that Vestel would be reorganised as a going-concern (GC) in bankruptcy rather than liquidated
- An administrative claim of 10% is used in line with the industry median and peer group
- The recovery analysis is translated into US dollars from Turkish liras (using our expected exchange rate for 2024) since the majority of the capital structure is in US dollars
- We assume a GC EBITDA of USD255 million in line with Fitch's previous assessment. This reflects a post-reorganisation EBITDA in Turkiye's challenging market environment and high inflation, leading to declining demand and lower-than-expected sold volumes
- An enterprise value (EV) multiple of 4.5x EBITDA is applied to the GC EBITDA to calculate a post-reorganisation EV, given Vestel's strong market position in Turkiye and flexible cost structure. However, this multiple is constrained by industry dynamics (including Turkish regulations), lack of geographical diversification (particularly in Asia and North America), lack of pricing power and the strength of competitors within the market
- The waterfall analysis is based on the new capital structure, which consists of factoring, senior unsecured USD500 million Eurobond at a fixed coupon of 9.75% and bank credit facilities. Debt issued by Vestel's subsidiary Vestel Beyaz Eşya Sanayi ve Ticaret A.Ş. ranks structurally senior to remaining debt instruments
- Factoring is not expected to remain available during bankruptcy following a more conservative approach than the previous assessment and is thus deducted from EV
- These assumptions result in a recovery rate for the senior unsecured instrument within the 'RR4' category. The principal and interest waterfall analysis output percentage on current metrics and assumptions is 50%

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Gross EBITDA leverage consistently above 4.5x
- EBITDA interest coverage below 1.5x
- Substantial deterioration in liquidity and consistently negative FCF margins

- Lack of ring-fencing and tighter links with parent Zorlu
- Business profile deterioration with loss of market share and pricing power

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Gross EBITDA leverage below 3.5x for a sustained period
- EBITDA interest coverage above 2.0x
- Positive FCF margin
- Stronger business profile with geographical diversification of production base and higher pricing power

LIQUIDITY AND DEBT STRUCTURE

Historically, Vestel has been dependent on short-term bank debt facilities to meet its financial requirements. The practice of continuously rolling over these uncommitted bank lines is typical in the Turkish corporate market and limits our liquidity assessment of Vestel even after the US dollar bond issue in 2024.

Long-term notes represent around 32% of Vestel's expected end-2024 debt, with short-term bank loans and domestic bonds making up the balance. We anticipate an increased reliance on short-term local funding, due to our forecast of continuing negative working-capital outflows.

ISSUER PROFILE

Vestel specialises in the manufacturing and sales of electronics, major household appliances, digital and e-mobility solutions in Turkiye.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

[Click here](#) to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector

key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT	RATING	RECOVERY	PRIOR
Vestel Elektronik Sanayi Ve Ticaret A.S.	LT IDR B+ Rating Outlook Negative Affirmed		B+ Rating Outlook Positive
	LC LT IDR B+ Rating Outlook Negative Downgrade		BB- Rating Outlook Stable
senior unsecured	LT B+ Affirmed	RR4	B+

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Parent and Subsidiary Linkage Rating Criteria \(pub. 16 Jun 2023\)](#)

[Country Ceiling Criteria \(pub. 24 Jul 2023\)](#)

[Corporate Rating Criteria \(pub. 03 Nov 2023\) \(including rating assumption sensitivity\)](#)

[Sector Navigators – Addendum to the Corporate Rating Criteria \(pub. 21 Jun 2024\)](#)

[Corporate Recovery Ratings and Instrument Ratings Criteria \(pub. 02 Aug 2024\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

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Vestel Elektronik Sanayi Ve Ticaret A.S.

UK Issued, EU Endorsed

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