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**Research Update:**

## Turkish Appliance Manufacturer Vestel Outlook To Positive On Potential For Improved Liquidity; 'B-' Rating Affirmed

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## Research Update:

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## Overview

- The operating performance of Vestel Elektronik Sanayi Ve Ticaret A.S. improved in 2011.
- We believe Vestel should be able to generate positive discretionary cash flow in 2012.
- We are revising our outlook on Vestel to positive from stable and affirming our 'B-' ratings.
- The positive outlook reflects the likelihood of an upgrade if, as we anticipate, Vestel's liquidity position strengthens.

## Rating Action

On Jan. 20, 2012, Standard & Poor's Ratings Services revised its outlook on Turkish home appliance and electronics manufacturer Vestel Elektronik Sanayi Ve Ticaret A.S. (Vestel) to positive from stable. The 'B-' long-term corporate credit rating on Vestel was affirmed.

At the same time, we affirmed our 'B-' issue rating on the \$225 million notes, due May 2012, issued by Vestel's subsidiary Vestel Electronics Finance Ltd. The recovery rating is unchanged at '4'.

## Rationale

The outlook revision reflects the likelihood that Vestel's liquidity will improve over the next 12 months, which could result in an upgrade.

In May 2012, Vestel will have to repay its \$225 million bond, which is now classified as short-term debt. The company has already repurchased close to \$126 million in bonds using bank debt, and plans to repay the remaining \$99 million of bond debt later in 2012. If Vestel refinances the bond with medium- or long-term debt, its liquidity position could improve sufficiently for us to consider raising the ratings.

The rating affirmation reflects the company's strong operating performance in 2011, including 21% growth in revenues in the first nine months of 2011 and an increase of the EBITDA margin to 10.6% from 8.8% for the full year 2010. We believe that this improvement is sustainable and the company will be able to maintain its profitability at this level over the next 12 months. The EBITDA

growth translated into improved debt ratios, including a reduction of adjusted debt to EBITDA to 2.4x as of Sept. 30, 2011, from 4.3x on Dec. 31, 2010. We believe Vestel might be able to deleverage further as we anticipate positive discretionary cash flow (DCF) for the company in 2012.

The ratings reflect our view of Vestel's high reliance on various forms of short-term funding, its volatile leverage, looming debt maturities, and volatile operating performance. These factors partly reflect uneven macroeconomic conditions in Turkey and foreign exchange rate volatility. The ratings also reflect what we consider to be weak and volatile cash generation, mainly fueled by working capital swings. These weaknesses are only partly mitigated, in our view, by the shareholders' demonstrated support, the group's cost-efficient manufacturing, a reducing debt burden, and Vestel's rising market share in the European TV market, after weathering the challenging transition to flat-screen TVs.

### **Liquidity**

We continue to assess Vestel's liquidity as "less than adequate," as defined in our criteria. This is despite significant improvement in its covenant headroom, its partial buyback of its bond and our anticipation of positive DCF in 2012. Our assessment primarily reflects Vestel's continued reliance on various forms of short-term funding, including short-term borrowings, receivables factoring, and letters of credit.

Consolidated short-term borrowings were Turkish lira (TRY) 628 million (about \$350 million) on Sept. 30, 2011, against consolidated cash and equivalents and assets held for trading of TRY237 million. This translates into a weak ratio of liquidity sources to uses of less than 1x.

Although we expect free operating cash flow generation to improve in 2012, it will likely remain volatile due to working capital outlays and currency swings. Vestel Electronics did not pay its parent company a dividend with regard to 2010 and we do not anticipate that it will pay one for 2011.

On June 30, 2011, Vestel complied with financial covenants in the documentation for Vestel Electronics' \$225 million bond due on May 31, 2012, Vestel's main long-term debt instrument. We calculate that leeway relating to the 4x debt-to-EBITDA covenant ratio and the 2.25x fixed-charge coverage ratio was in the 25%-30% range on June 30, 2011. We anticipate that these ratios will stay within this range in the near term.

### **Recovery analysis**

Vestel's outstanding \$225 million guaranteed notes are rated 'B-', with a recovery rating of '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default.

The recovery and issue ratings on the notes reflect, in our view, the estimated value available and accessible to creditors. This is assuming that

creditors of the operating subsidiary, Vestel White Goods, rank ahead of other group creditors. Our ratings also indicate our view of the likelihood of insolvency proceedings being adversely influenced by Vestel's Turkish domicile. In addition, the group has a complex capital structure and a significant proportion of short-term debt is rolled over periodically. We believe that the recovery and issue ratings are constrained by the unsecured nature of the notes. In addition, after Vestel's repurchase of \$126 million of the outstanding notes, about \$99 million remain outstanding. After deducting priority liabilities, we estimate recovery prospects for the unsecured issues in the 30%-50% range.

## Outlook

The positive outlook reflects the likelihood that we would raise the ratings on Vestel if its liquidity improves over the next 12 months. We believe Vestel's liquidity could improve if it refinances the bond maturing in May 2012 with medium- or long-term debt, which could reduce the company's exposure to short-term financing. However, an upgrade would also depend on the group's operating performance staying in line with our base-case scenario.

Our base-case assessment factors in positive DCF in 2012, rollover of various types of short-term debt facilities, and maintenance of covenant headroom of at least 15%-20%.

The upside rating potential could be diluted if the company refinanced the bond with short-term debt or if it is unable to generate positive DCF on a sustainable basis.

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

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

Ratings Affirmed

Vestel Electronics Finance Ltd.

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Senior Unsecured*	B-	B-
Recovery Rating	4	4

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

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://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.

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