Fitch Affirms Arcelik A.S. at 'BB+'; Outlook Stable

Fitch Ratings-Frankfurt/London-03 June 2016: Fitch Ratings has affirmed Arcelik A.S.'s Long-term foreign and local currency Issuer Default Ratings (IDR) at 'BB+' and National Long-term rating at 'AA(tur)'. The Outlooks are Stable. Fitch has also affirmed Arcelik's senior unsecured rating at BB+.

KEY RATING DRIVERS

Improved Leverage Metrics

Fitch forecasts Arcelik's receivable adjusted funds from operations (FFO) net leverage to come down to 1x at end 2016 from 1.8x at end 2015. The improvement will be mainly driven by the cash proceeds from the sale of Koc Financial Services shares totalling TRY558m, which will be used for short-term debt payments. Fitch believes that Arcelik will maintain a receivable adjusted FFO net leverage ratio below 1.5x in the medium term, driven by stable EBITDA margins around 10.5% and slightly positive free cash flow (FCF) generation driven by improvements in working capital (WC) needs.

Unwinding WC Needs

Recent measures taken by Arcelik's management has led to an unwinding in WC needs in the past year, bringing the WC/sales ratio down to 31% at end-2015 from 40% a year ago. Improved inventory management, and re-negotiations with domestic dealers has turned FCF positive in 2015 from -1% in 2014. Fitch forecasts slightly positive FCF generation, below Arcelik's positive rating sensitivities, and believes that a track record should be set before the change can be deemed structural. Despite the improvement in leverage metrics, Arcelik's FFO and FCF generation is still considered weak compared with its peers, and a sustainable improvement would be needed for positive rating action.

Strong Growth in International Markets

Arcelik has achieved strong top line growth in the past years outside Turkey, taking advantage of more price-conscious consumers in Western Europe as well as its previous marketing and distribution network expansion efforts. Further growth in developed markets in the short to medium term is likely as the company continues to capitalise on its present momentum and current market trends. However, this may place pressure on profitability as Fitch believes that margins in international markets tend to be lower than Turkey.

We believe that recent investment/expansion plans in the ASEAN region is a positive step towards further geographic diversification. Targeting markets where appliance penetration rates are lower than the rest of the world could also support strong revenue growth. The new refrigeration plant is expected to bring USD500m of extra revenues in the medium term and is likely to provide the first footprint for additional export opportunities in the region. However, Arcelik's exposure to emerging markets is higher than its close peers, which could lead to more vulnerability to FX movements, political risks and volatile macroeconomic conditions.

Improved Debt Maturity Profile and Diversification

Arcelik has been diversifying its funding base in the past two years with the issuance of USD500m 2023 and EUR350m 2021 eurobonds, taking advantage of the historically low interest rates. The issuances have improved Arcelik's debt maturity profile to approximately four years from less than two years in 2012. Fitch believes that diversifying the funding base away from short-term bank financing practices in Turkey is credit positive. Also, both Eurobonds are senior unsecured and have fixed interest rates, providing security for potential increase in interest rates in Turkey, and international markets in general.

KEY ASSUMPTIONS

- Single digit growth both in domestic and European markets.
- Profitability in-line with historical averages.
- No significant M&A.
- Normalised capex levels, in line with historical levels.

RATING SENSITIVITIES

Positive: Future developments that could lead to positive rating action include:

- Receivable-adjusted FFO net leverage ratio below 1.5x.
- FFO margins consistently above 10%.
- FCF margin above 2% on a sustainable basis.

Negative: Future developments that could lead to negative rating action include:
- Receivable-adjusted FFO net leverage ratio above 2.5x.
- FFO margin below 8%.
- Consistently negative FCF.

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SUMMARY FINANCIAL ADJUSTMENTS
- Fitch uses an adjusted leverage ratio for its guideline setting, one that takes into

consideration the customer financing activities of Arcelik in Turkey. Arcelik's reported leverage is negatively impacted by its higher than average working capital needs, as a significant portion of durable goods are sold on credit in Turkey, and this is partly financed by Arcelik. Given that Arcelik has historically seen few losses (less than 1% write offs) on its trade receivables (customer risk is transferred to the retailer), Fitch adjusts Arcelik's debt by netting off the debt portion of trade receivables, and deems 120 days of domestic receivables as customer financing, and considers the remaining portion as WC need for industrial operations. For 2015, the adjustment was around TRY1.6bn (120 days).
- Additionally, Fitch restricts 2% of revenues as minimum cash needed for operational needs.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
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