FitchRatings

FITCH AFFIRMS 4 TURKISH INDEPENDENT FACTORING COMPANIES; DOWNGRADES 1

Fitch Ratings-London-29 September 2016: Fitch Ratings has affirmed the National Long-Term Ratings of Kapital Faktoring A.S. (Kapital), Destek Faktoring A.S. (Destek), Eko Faktoring A.S. (Eko) and Optima Faktoring Hizmeteleri A.S. (Optima). Fitch has also downgraded the National Long-Term Rating of Lider Faktoring A.S. (Lider) to 'A-(tur)' from 'A(tur)'. The Outlook on Eko's rating is Negative. The Outlooks on the other entities' ratings are Stable.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

NATIONAL RATINGS

The National Long-Term ratings of Kapital, Destek, Lider, Optima and Eko are all driven by their standalone strength. The five factoring companies collectively controlled 15% of domestic receivables in Turkey's factoring sector at end-1H16. The ratings of each of the companies reflect their monoline business models, with recourse factoring making up nearly all of the companies' assets and revenues. This results in earnings sensitivity to economic cycles in Turkey. The ratings also factor in the potential instability of the companies' balance sheet ratios given the generally short-term nature of their assets and liabilities, as well as the wholesale-funding reliant debt structures.

The factoring sector remains small in Turkey, making up only 1.2% of total banking sector assets at end-1H16. The presence of bank-owned factoring subsidiaries, which enjoy better funding access and risk systems, has increased significantly in recent years. This has caused higher competition in target customer segments for independent players. The impaired factoring receivables to gross receivables ratio (end-1H16: 5.7%) is higher than the banking sector average (3.3%) and reflects the generally riskier customer base of factoring companies, weaker underwriting standards and more seasoned portfolios. The companies that are opting for factoring credit are usually unbanked micro-enterprises and SMEs that require liquidity in order to cover a range of cash, tax and working capital needs.

Kapital and Destek's higher ratings reflect their leading, independent franchises, solid capitalisation and track-record of sound financial metrics. Credit losses at Kapital and Destek have been low and the companies' impaired receivables ratio (overdue by 90+ days) reached a low 2.2% and 0.8% at end-1H16, respectively. Both entities' leverage and gearing ratios are comfortable for their ratings, with debt/equity ratios of 1.6x and 2.5x, respectively. A high profit retention rate and supportive shareholders have allowed the two companies to operate with high capital adequacy ratios (equity/assets: 38% and 32%, respectively, at end-1H16) and significant capital buffers should enable them to absorb unexpected losses.

Destek's rating also captures significant borrower concentration in factoring receivables, as the largest 25 borrowers accounted for a high 70% of total receivables at end-1H16 (equivalent to 2.2x equity). This reflects the company's strategy of targeting relatively larger corporate customers.

Eko's ratings are constrained by weak asset quality and the ensuing weak performance. The impaired receivables ratio reached a high 18% at end-1H16, significantly above the sector- and peer-average. The company is implementing a restructuring plan, which includes a shift in the target customer base towards larger SME and commercial companies to improve credit quality. Eko has also reduced the number of branches and personnel to improve cost efficiency.

The negative trends in Eko's performance are mitigated by a comfortable capital position; the debt-to-equity was a reasonable 3.5x at end-1H16, which means Eko has a significant capital buffer to absorb further losses. The Negative Outlook on Eko's rating reflects the potential weakening of its company profile as a consequence of its recent weak performance and its planned shift into new customer segments.

The downgrade of Lider's National Long-Term Rating primarily reflects its significantly higher leverage, with the debt-to-equity ratio reaching 8.4x at end-1H16 (end 2015: 6.2x, end 2013: 5.2x). The increase in leverage is related to large dividend payments in the last 18 months and a sharp (29%) increase in factoring receivables in 1H16. Facilities from minority shareholder Credit Suisse Group AG (A-/Stable; accounting for 13% of Lider's total debt at end-1H16) supports funding. The rating also considers Lider's moderate franchise, experienced management and its reasonable performance.

Optima's lower rating reflects its limited franchise, as it controlled a moderate 0.6% of domestic receivables at end-1H16. The company targets small, high risk customers, reflected in high margins, which supports profitability. Optima's return on equity (ROE) ratio reached 20% at end-1H16 and has been relatively stable over volatile interest rate and economic cycles. Asset quality metrics are reasonable for the business model.

The companies' ratings also capture their reliance on typically short-term wholesale funding from Turkish banks and local bond markets. Nevertheless, market access has been reasonable for all companies. However, the deterioration in Eko's asset quality could undermine funding access given a reduced stock of performing receivables that could serve as collateral. Optima's funding is less diversified than peers as it had not issued any bonds as at end-1H16.

RATING SENSITIVITIES

NATIONAL RATINGS

The ratings of all five factoring companies are sensitive to a material weakening in asset quality and leverage ratios. Their credit risk profiles mean that Fitch believes independent factoring companies are more vulnerable to asset quality deterioration than their bank-owned peers, which could lead to liquidity and performance pressures.

Kapital and Destek's ratings are unlikely to be upgraded given their already high ratings in the context of their business profiles. In addition, Destek's rating could be downgraded if there is a material increase in receivables concentration. However, a material strengthening of their franchise or a sustainable diversification of funding sources could create moderate upside rating potential.

Eko's rating could be downgraded if asset quality continues to deteriorate. Eko's rating could also be downgraded if the restructuring process does not result in a sustainable improvement in its performance and a stabilisation of the company's franchise. A liquidity squeeze would also be negative. Significant improvements in asset quality and performance could lead us to revise Eko's Outlook to Stable.

Lider's rating could be downgraded if there is a continued increase in leverage ratios. An improvement in leverage ratios and material strengthening of its franchise could lead to upside potential for Lider's rating.

Optima's rating could face downward pressure if its capitalisation and leverage position weakened significantly. Upward rating potential is unlikely given Optima's weaker franchise.

The rating actions are as follows:

Kapital Faktoring A.S. and Destek Faktoring A.S.
National Long-Term Rating affirmed at 'A+(tur)'; Outlook Stable

Lider Faktoring A.S.
National Long-Term Rating downgraded to 'A-(tur)' from 'A(tur)'; Outlook Stable

Optima Faktoring A.S.
National Long-Term Rating affirmed at 'BBB(tur)'; Outlook Stable

Eko Faktoring A.S.
National Long-Term Rating affirmed at 'BBB(tur)'; Outlook Negative

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Additional information is available on www.fitchratings.com

Applicable Criteria
Global Non-Bank Financial Institutions Rating Criteria (pub. 15 Jul 2016)
https://www.fitchratings.com/site/re/884128