Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Ekspo Faktoring A.S.

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Istanbul, Turkey

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Ba3
NSR Issuer Rating -Dom Curr	Baa1.tr

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Key Indicators

Ekspo Faktoring A.S.

	[1]2007	2006	2005	2004	2003	Avg.
Total Assets (US$ million)	195.01	135.88	96.61	91.57	78.31	[2]35.00
Shareholders' Equity (US$ million)	38.47	24.96	19.22	16.71	6.80	[2]49.68
Return on Average Assets	5.84	6.33	6.59	5.99	12.02	7.35
Recurring Earnings Power [3]	7.73	7.63	10.83	12.11	17.03	11.07
Net Interest Margin	12.06	12.45	11.24	11.07	14.74	12.31
Cost/Income Ratio (%) [4]	25.84	29.88	25.14	20.79	18.54	24.04
Problem Loans % Gross Loans	1.12	0.88	1.70	1.61	0.14	1.09
Shareholders' Equity % Assets	19.73	18.37	19.89	18.25	8.68	16.98

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets [4] Non-Interest Expense % Operating Income

Opinion

SUMMARY RATING RATIONALE

Moody's assigns local and foreign currency issuer ratings of Ba3 to Ekspo Faktoring A.S. The Ba3 ratings are constrained by the company's modest size, its relatively short track record of operation and its high reliance on domestic interbank funding. They are also constrained by uncertainty about the sustainability of the current profitability trends in the Turkish factoring industry. However, they are supported by the company's strong current profitability, capitalisation and asset quality metrics and its sound strategic positioning. Risk management and corporate governance practices are adequate.

The Ba3 issuer ratings do not incorporate any likelihood of systemic or shareholder support.

Credit Strengths

- Robust profitability and good efficiency metrics

- Strong capitalisation

- Sound asset quality, although not tested in adverse conditions

- Modest market risk appetite

Credit Challenges

- High reliance on market funding, though risks partly mitigated through active day-to-day liquidity management

- Need for further institutionalisation of corporate governance and risk management practices

- Considerable loan portfolio concentration to borrowers of modest credit quality, though risk is mitigated by the granularity of receivables

- Credit risk management practices have not been tested in a difficult economic environment

- Profitability trends in the factoring industry are uncertain over the medium term

Rating Outlook

The outlook on all of Ekspo's ratings is stable.

What Could Change the Rating - Up

The ratings are well-placed at their current level. However, they could potentially rise if a number of developments were all to occur, namely (i) the institutionalisation of corporate governance practices, (ii) further improvements in risk management practices, (iii) a further strengthening of the funding profile, and (iv) further consolidation and strengthening of the franchise.

What Could Change the Rating - Down

Downward rating pressure could materialise if (i) there is evidence of increasing risk appetite, if (ii) any deterioration in the credit risk environment in Turkey generates losses that put solvency at risk and jeopardise the company's current business model, or if (iii) if the company significantly increases balance sheet leverage, without simultaneously raising longer-term funding.

Recent Results and Developments

Ekspo posted unaudited first half 2008 net profits of YTL8.4 million (US$6.9 million), which suggests that the company is on course to exceed the YTL12.1 million net income generated in fiscal year 2007. This progression is driven primarily by higher net interest income, in line with asset growth, and through better leverage of operating expenses. This level of net income represents very strong profitability, generating a return on average assets of over 10%.

In the first six months of 2008 Ekspo grew its net factoring receivables by 23% to YTL151.3 million (US$123.7 million), total bank borrowings grew 28% to YTL96.6 million and equity (including first half earnings) was up 20% to YTL56.8 million. Leverage levels (total assets to equity) remain very conservative at 2.8:1.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Ekspo's currently assigned ratings are as follows:

Qualitative Factors

Factor 1: Franchise Value

Ekspo is a small, professionally run operator in a relatively young industry that is likely to become more competitive. It has established a meaningful market presence, consistently ranking amongst the ten largest companies. In 2007 it maintained its market share of 3-4%. Most of the larger competitors in the industry tend to be subsidiaries of Turkish commercial banks.

The company's core customer base is composed of middle-market Turkish companies with existing bank facilities to which it extends short-term finance secured by post-dated cheques. As a monoline business, with a strict focus on a corporate/commercial customer base, as opposed to a granular retail banking business, Ekspo's earnings stability is constrained, limiting its overall franchise value.

Ekspo is primarily present in the Marmara region of Turkey, surrounding Istanbul. Given that this region is the commercial hub of the country, accounting for more than 40% of GDP, the geographic scope of the company's operations is similar to that of small Turkish banks rated by Moody's.

Moody's assessment of Ekspo's franchise value also factors the sound strategic direction of the firm and its good execution. The firm's business model is founded on a number of core competences, including rapid decision-making, a good understanding of its customer base and good control of operating expenses. These strengths support the sustainability of the firm's franchise.

Moody's franchise value assessment also takes into account the uncertainty surrounding the factoring industry's medium-term profitability outlook. We consider market liquidity, strategic moves by bank-affiliated competitors and the evolving macroeconomic environment to be the main factors that will affect the structure and profitability of the factoring sector in Turkey.

Factor 2: Risk Positioning

Moody's assessment of Ekspo's risk positioning takes into account the firm's relatively simple risk management setup, its sound day-to-day liquidity management practices and modest market risk appetite. It is constrained, however, by a high reliance on market funding and the need for further institutionalisation of the corporate governance structure.

Moody's recognises the effectiveness of Ekspo's current corporate governance practices in maintaining adequate standards, but also notes the need to institutionalise principles and practices as the company grows further. More specifically, we would like to see the participation of truly independent members on the Board of Directors and explicit principles that would govern the firm's protection of creditor interests. The firm is capably managed by an experienced management team, headed by the younger generation of the Tumay family, supported by Mr Gurbuz Tumay, the founder of the firm, in his capacity as honorary chairman. The small size of the management team and the need for the personal engagement of the Tumay family in running the business represents an element of "key man risk".

The main risks to which Ekspo is exposed are credit risk and liquidity risk. Within this context, we consider that the company's risk management and control practices are generally effective. Ekspo employs comprehensive credit risk management policies, though we note that some of the risk assessment and management tools are fairly simple. The lack of a sufficiently long probability of default and loss given default dataset (is another constraint on the accurate assessment of credit risk appetite, though this is a broader issue for the Turkish banking sector as a whole.

In 2006 Turkish factoring companies presented accounts under IFRS for the first time. This has enhanced the comparability of Turkish factoring companies' financial reporting by providing extra information on risk positions. Notwithstanding this improvement, the quality of financial disclosure remains weaker than that of Turkish commercial banks.

Ekspo carries a significant level of loan portfolio concentration to borrower of relatively poor credit quality. Our concerns are largely mitigated, however, by the short maturity of Ekspo's exposure to these borrowers, its effective monitoring and the careful selection of and granularity of receivables.

Ekspo's liquidity profile is constrained by a very high reliance on market funding. The company mitigates liquidity risk through active day to day management and adherence to relatively conservative liquidity limits. The short maturity of Ekspo's receivables and low leverage are the main supporting factors in Moody's assessment of the firm's liquidity profile, however, the resilience of the bank's liquidity position has not been tested in difficult conditions.

Ekspo maintains a limited market risk appetite.

Factor 3: Regulatory Environment

Moody's considers that the regulatory and supervisory regime for factoring and leasing companies in Turkey is adequate, and improving, though generally weaker than that for banks. Less onerous regulations are generally balanced by the factoring firms' lower complexity. Leasing and factoring companies only came under the ambit of the Banking Regulation and Supervision Agency (BRSA) in 2006. It will take some time before regulatory and supervisory standards are fully upgraded.

Factor 4: Operating Environment

Moody's assessment for the operating environment in Turkey takes into account the following three factors: economic stability (measured by GDP growth volatility), integrity and corruption (as designated by the World Bank), and the effectiveness of the legal system (based on length of foreclosure on residential real estate).

Quantitative Factors

Factor 5: Profitability

Ekspo records very healthy profitability metrics founded on high interest margins, low credit costs and good control of operating expenses. In 2007 recurring earning power (Pre-provision Income (%) Average Total Assets) remained healthy at a high 7.73% (7.63% in 2006), while Return on Average Assets was also very strong 5.84% (6.33% in 2006).

High interest margins on Turkish lira intermediation are a prime reason for Ekspo's strong overall earning capacity.. Ekspo's profitability profile is also supported by its lean operating setup (see section on efficiency below) and its firm control on credit risks. Low credit costs are attributed to the current favourable economic environment and the asset-backed nature of the factoring business. In 2008 the company has experienced a significant increase in its funding costs, in line with higher Turkish Lira interest rates. It has managed to pass most of this increase to its customers.

Over the medium term, Ekspo's profitability will depend on the changing dynamics in the factoring industry. A lower level of real interest rates will obviously pressure interest margins, as will growing competition. Ekspo is also planning to expand its physical network and the extent to which it can leverage this with new business will also impact its efficiency metrics. Finally, the outlook for profitability will be affected by the evolution of Ekspo's credit costs, which in turn depend on the firm's developing risk appetite, any improvements in its credit risk practices and any changes in the quality of the operating environment.

Factor 6: Liquidity

Ekspo's liquidity profile is constrained by a very high reliance on short-term interbank funding. At the end of 2007, short-term funding was financing 62% of the firm's receivables. The primary concern with such funding is that it can become scarce or expensive in cases of firm-specific credit events and/or systemic liquidity crises. Because of this, Moody's maintains a cautious view on Ekspo's funding, notwithstanding a number of mitigating factors such as relatively diversified borrowings, the low rate of utilisation of its banking lines, fairly robust bank relationships, high capitalisation and the short-term nature of assets.

In view of the global credit crunch, and conscious of possible spillover in Turkey, Ekspo has secured some YTL80 million in six-month funding from a consortium of Turkish banks. We consider that further funding diversification, in particular longer maturities would provide support to our assessment of Ekspo's liquidity profile.

Factor 7: Capital Adequacy

The company has good capitalisation metrics founded on strong internal capital generation and retention. Turkish factoring companies are currently not subject to BIS-inspired capital adequacy requirements, other than a maximum ratio of total assets to equity of 30 times. Ekspo has set an internal maximum leverage limit of five times equity, which given the current risk appetite and high earnings retention is adequate. Moody's considers the current leverage of approximately 2.8 times for Ekspo provides a comfortable buffer for unexpected losses. The average for the sector is about seven times.

Factor 8: Efficiency

Ekspo is a lean operator with a cost-to-income ratio of around 26% (2006: 30%), reflecting a setup that features one head office and no branches. This low-cost business model reinforces the company's high profitability. On average two-thirds of the company's costs are allocated to personnel expenses.

Ekspo is planning an expansion of its physical network and expects to apply to the BRSA to open four branches around the Marmara region. At a later stage the firm may expand further eastwards with another four branches. The extent to which the firm can grow its assets to leverage this new infrastructure will determine how the efficiency profile will be affected. Another factor that will influence efficiency and overall profitability is the evolution of Ekspo's income-generating profile. This will be affected by the general level of interest margins in Turkey and by the firm's ability to leverage its customer bas by entering the leasing business.

Factor 9: Asset Quality

Asset quality indicators are shaped by the asset-based and short-term nature of the factoring business. The asset quality is currently strong, but has not yet been tested under adverse economic conditions. At the end of 2007, non-performing exposures accounted for 1.12% of total exposure, slightly up from 0.88% at the end of 2005. The non-performing loans are fully provisioned.

Although Moody's recognises that Ekspo's current asset quality metrics are strong, we note that the weak asset classification standards for factoring companies and the favourable economic environment of the last five years raise questions about the sustainability and comparability of these metrics. We do not believe that the introduction of new asset classification standards (taking effect in 2008) will lead to a deterioration in Ekspo's asset quality metrics, though this may be the case for some other factoring firms.

We consider that a possible weakening of the Turkish economy, as a result of a global credit squeeze and economic slowdown, will have a negative impact on Ekspo's asset quality, though the extent of asset quality deterioration is hard to predict. The short term nature of the company's receivables will give Ekspo the opportunity to quickly react, though such action may tarnish its franchise.

National Scale Rating

The Baa1.tr National Scale Rating (NSR) is derived directly from the Ba3 local currency issuer rating. Whereas the Ba3 issuer rating reflects the company's overall default risk, the NSRs rank Turkish issuers relative to each other and not relative to overall default risks. National scale ratings isolate systemic risks: they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the national scale.