Moody's Investors Service

Credit Opinion: Ekspo Faktoring A.S.

Global Credit Research - 21 Sep 2009

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]2008	2007	2006	2005	2004	Avg.
Total Assets (US$ million)	78.71	107.43	135.88	96.61	91.57	[2]0.10
Shareholders' Equity (US$ million)	36.66	38.63	24.96	19.22	16.71	[2]40.07
Return on Average Assets	12.66	7.72	6.33	6.59	5.99	7.86
Recurring Earnings Power [3]	17.01	10.22	7.63	10.83	12.11	11.56
Net Interest Margin	16.22	11.98	12.45	11.24	11.07	12.59
Cost/Income Ratio (%) [4]	22.94	25.84	29.88	25.14	20.79	24.92
Problem Loans % Gross Loans	3.47	2.03	0.88	1.70	1.61	1.94
Shareholders' Equity % Assets	46.58	35.96	18.37	19.89	18.25	27.81

[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. (Ekspo). 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 regarding the sustainability of 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 and continuing to improve.

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

Rating Drivers

- Continuing robust profitability, good efficiency metrics and strong capitalisation; however small size and business volumes, in absolute terms

- Moderate asset quality in a domestic environment that is currently difficult and remains potentially volatile

- High reliance on market funding, although risks are partly mitigated through the maturity match of assets and liabilities and high equity capital

- Considerable loan portfolio concentration to borrowers of modest credit quality, although risk is mitigated by the granularity of receivables and the developing risk management set-up

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, upward rating pressure could materialise if a number of developments were all to occur, namely (i) further institutionalisation of corporate governance practices, (ii) further strengthening of the funding profile and (iii) 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, (ii) the deterioration in the credit risk environment in Turkey generates losses that put solvency at risk and jeopardise the company's current business model, (iii) the company significantly increases its balance sheet leverage from its historical average, without simultaneously raising longer-term funding, or (iv) the franchise weakens.

Recent Results and Developments

Ekspo posted unaudited H1 2009 net profits of YTL8.13 million (US$5.31 million). This is in line with the YTL8.4 million net profits generated in H1 2008.

While Ekspo reported an approximately 30% reduction in its monthly average net factoring receivables in H1-2009 at YTL107.4 million compared with YTL158.9 million in H1-2008, the same level of profit was sustained in H1-2009 due to a healthy increase in the net interest margin, widening of the spreads and Ekspo's gross credit margin. This suggests that the company is on course to exceed the YTL15.475 million net income generated in fiscal year 2008. This progression is driven primarily by a still relatively high level of net interest income, planned asset growth and through better leverage of operating expenses. The level of net income represents very strong profitability, generating a return on average assets of over 10%.

The reduction in receivables was partly driven by the overall drop in demand (a 10% reduction in net receivables in factoring sector) and partly by Ekspo proactively reducing its portfolio due to its reassessment of the credit risk environment in Turkey. We consider this reduction in the balance sheet ahead of a projected significant increase in asset quality problems to be an appropriate response, although such actions may tarnish its franchise.

The company reported a very conservative leverage level (total assets to equity) of 1.74:1 at end-2008 vs. the sector's 3.28:1. Since year- end 2008, Ekspo has selectively grown its net factoring receivables by 29% to YTL126.95 million (US$82.6 million), total bank borrowings by 42% to YTL64.37 million and equity (including H1 earnings) by 9% to YTL66.6 million. The leverage level is a very conservative 1.97:1.

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 and is likely to become more competitive. Out of Turkey's total of 81 factoring firms, Ekspo has established a meaningful market presence, consistently ranking among the ten largest companies among the 47 members of the Factoring Association. In 2008, it maintained an average market share of approximately 2.2%. Most of the larger competitors in the industry tend to be subsidiaries of Turkish commercial banks, where the largest market share of a firm is approximately around 10% to 15%.

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 and assignments. As a mono-line 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.

Given that Ekspo is primarily present in the Marmara region of Turkey, which is the commercial hub of the country, accounting for more than 40% of GDP, with some presence in Aegean, Mediterranean and Inner Anatolia regions, 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 in the sound strategic direction of the firm and its good execution. The company'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 developing risk management setup, its sound day-to-day liquidity management practices and modest market risk appetite. It is constrained, however, by its 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 for the company to institutionalise principles and practices as it grows further. More specifically, we would like to see the participation of truly independent members on the board of directors and explicit principles to 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 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 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 and although we note that some of its risk assessment and management tools were fairly simple in the past, Ekspo's recent adaptation of a qualitative and quantitative risk rating model is a good example of how the company invests in its resources. The lack of an extensive historical probability of default and loss given default dataset, due to the young and developing nature of Turkey's factoring sector, the company's relatively short track record, and small customer base are a few of the constraints on the accurate assessment of credit risk appetite. As a result, the benefits of such risk assessment and management tools can only be seen over time, although this is an issue for the Turkish finance sector as a whole.

In 2006, Turkish factoring companies presented accounts under IFRS for the first time. This has enhanced the comparability of their 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. In addition, there is no requirement for quarterly or semi-annual audited reports, which constrains our overall assessments of the financial transparency of Turkish factoring companies. As a result, the availability of semi-annual (unaudited) financial statements in Ekspo's public domain is a positive step towards financial transparency.

Ekspo carries a significant level of loan portfolio concentration to borrower's of modest credit quality. However, our concerns are largely mitigated by the short maturity (averaging 70 days) of Ekspo's exposure to these borrowers, effective monitoring and careful selection and granularity of receivables.

Ekspo's liquidity profile is constrained by its very high reliance on market funding. The company mitigates liquidity risk by maintaining a profile that matches asset and liability maturities to a very large extent. 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 domestic environment is currently difficult, remains potentially volatile and may still lead to adverse ratios.

As of year-end 2008, Ekspo's top two factoring receivables by industry group were 23% in textile and 16% in construction. Due to Ekspo's low leverage, the largest industry concentration represents 41% of the firm's equity and therefore sector concentration is not an issue.

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, although 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

Trend: Weakening

The overall operating environment assessment for Turkey takes into account economic stability (GDP growth volatility), integrity and corruption scores (as calculated by the World Bank) and also an assessment of the effectiveness of the legal system (based on the ease with which property can be foreclosed). For more information, please refer to the Banking System Profile on Turkey.

The weakening trend for this factor is driven by the deep recession that is currently affecting Turkey, affecting the credit quality and asset performance in general. However this is partially offset by some banks pulling back, enabling the factoring companies to have access to new clients with better credits while requesting wider margins.

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 2008, its recurring earning power (pre-provision income as a percentage of average total assets) remained healthy at a high 17.01% (10.22% in 2007), while the return on average assets was also very strong, at 12.66% (7.72% in 2008).

High interest margins on Turkish lira intermediation are a prime reason for Ekspo's strong overall earning capacity. Furthermore, Ekspo's profitability profile is also supported by its lean operating set-up (see section on Efficiency, below), its firm control of credit risks, its current low funding costs, its increased credit margins and the asset-backed nature of the factoring business. In 2008, the company 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 on to its customers. In a similar fashion, in H1 2009, rate cuts on the funding side were also passed on to the newly originated receivables.

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 pressurise interest margins, as will growing competition. Ekspo is also planning to expand its physical network, which was initially scheduled for 2009 and had been postponed following the contraction in the economy, and the extent to which it can leverage this with new business will also affect 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 its very high reliance on short-term interbank funding. As of June 2009, short-term funding was financing 51% of the firm's receivables. Furthermore, 70% of this short-term funding was overnight; 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 (a consortium of 29 banks), the low rate of utilisation of its banking lines (currently at 23%, but historically at 50%), fairly robust bank relationships, high capitalisation and the short-term nature of its assets.

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 factoring receivables 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 (June 2009) of approximately 1.97 times for Ekspo provides a comfortable buffer for unexpected losses. The average for the sector is about 3.7 times.

Factor 8: Efficiency

Ekspo is a lean operator, continuing to report a low cost-to-income ratio of around 23% (2007: 26%), reflecting the current set-up 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 was planning an expansion of its physical network and expects to apply to the BRSA to open four branches around the Marmara region, which was initially scheduled for 2009 and has been postponed following the contraction of the economy. At a later stage, the firm may choose to resume its expansion plans eastwards when it perceives the economic conditions to be favourable. 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 base by entering the leasing business.

Factor 9: Asset Quality

Ekspo's asset quality indicators are shaped by the asset-based and short-term nature of the factoring business, providing opportunities for factoring companies to adjust their balance sheets quickly depending on economic conditions. The company's asset quality has weakened and is currently moderate, and the domestic environment is difficult and remains potentially volatile. Non-performing loans (NPLs) were at 4.5% as of end-March 2009, up from 3.6% at the end of 2008 and 2.0% at the end of 2007; the sector averages were 9.8%, 8.2% and 4.0%, respectively. The fact that Ekspo's NPL ratios are lower than those of the overall sector demonstrates the strength of the company's targeted segment, risk management and control practices. Due to 21% growth in the firm's total factoring receivables since March 2009 and the 6% reduction in its nominal NPLs (due to recent collections made), as of June 2009, Ekspo's NPL exposures accounted for 3.4% of its total receivables. NPLs are 100% covered by provisions.

The introduction of new asset classification standards (which took effect in 2008) brought more transparency and uniformity to the asset classification standards for factoring companies, increasing their comparability, although there are differences between the credit-spectrum factoring companies' targets. The introduction of the new asset quality classifications initially might have led to deterioration in the sector's reported asset quality metrics when they were first implemented, given that the sector's NPLs were previously reported in a non-uniform, voluntary fashion, but their impact on overall reported NPL trends should have normalised by now.

Weighted average seasoning/ageing in the Ekspo's NPL portfolio as of June 2009 was 3.5 months up from 1.5 from last year; this is a general trend in a weakening economy where the collections on loans can take longer due to workouts needed between the client and the originator or the increase in the demand for collections through judicial means.

National Scale Ratings

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.

CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.