Moody's Investors Service

Credit Opinion: Ekspo Faktoring A.S.

Global Credit Research - 15 Nov 2011

Istanbul, Turkey

Ratings

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

Contacts

Analyst	Phone
Arif Bekiroglu/Frankfurt am Main	49.69.707.30.700
Irakli Pipia/London	44.20.7772.5454
Carola Schuler/Frankfurt am Main	
Tarik Duyme/Frankfurt am Main	

Key Indicators

Ekspo Faktoring A.S. (Unconsolidated Financials)[1]

	[2]12-10	[2]12-09	[2]12-08	[2]12-07	[2]12-06	Avg.
Total Assets (TRY million)	224.0	152.6	119.6	124.8	191.5	[3]4.0
Total Assets (USD million)	145.5	101.8	77.5	106.5	135.2	[3]1.9
Tangible Common Equity (TRY million)	74.3	62.6	59.3	47.6	37.3	[3]18.8
Tangible Common Equity (USD million)	48.3	41.8	38.4	40.6	26.3	[3]16.4
Net Interest Margin (%)	8.6	13.7	15.5	9.5	7.2	[4]10.9
PPI / Avg RWA (%)	--	--	--	7.7	6.4	[5]7.1
Net Income / Avg RWA (%)	--	--	--	5.8	5.3	[5]5.6
(Market Funds - Liquid Assets) / Total Assets (%)	66.0	54.0	43.4	60.6	79.5	[4]60.7
Tier 1 Ratio (%)	--	--	--	20.9	19.4	[5]20.1
Tangible Common Equity / RWA (%)	--	--	--	21.0	19.5	[5]20.3
Cost / Income Ratio (%)	31.8	22.6	22.9	25.8	29.9	[4]26.6
Problem Loans / Gross Loans (%)	1.3	2.2	3.5	2.0	0.9	[4]2.0
Problem Loans / (Equity + Loan Loss Reserves) (%)	3.9	5.1	6.3	5.1	4.3	[4]4.9

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel I & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns local and foreign currency issuer rating of Ba3 to Ekspo Faktoring A.S. (Ekspo). The Ba3 ratings are supported by the company's robust profitability, strong capitalisation and asset quality metrics and its sound business model. Constraining rating factors include the company's modest size, its high reliance on domestic short-term bank funding and the young and developing nature of Turkey's small factoring sector as well as the uncertainty regarding the long-term sustainability of profits at current margins. Risk management, corporate governance practices and liquidity management are adequate for its size and operations and continue to improve.

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

Rating Drivers

- Small size and business volumes, in absolute terms in the evolving Turkish factoring sector

- Robust profitability, good efficiency metrics and strong capitalisation

- Satisfactory asset quality in a fast growing economic operating environment leading to high credit growth opportunities

- High reliance on market funding, though maturity risk is mitigated through partial matching of assets and liabilities, as well as high equity capital buffer

- Considerable loan portfolio concentration to borrowers of moderate credit quality within the Turkish operating environment, although risk is mitigated to some extend by the moderate granularity of receivables and the developing risk management set-up and controlling practices

Rating Outlook

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

What Could Change the Rating - Up

Upward rating pressure could materialise on occurrence of the following events: (i) continuing diversification and strengthening of the funding profile, (ii) further strengthening and improvement of the franchise, and (iii) further institutionalisation of corporate governance practices.

What Could Change the Rating - Down

Downward rating pressure could materialise if (i) there is evidence of increasing risk appetite, (ii) credit risk in Turkey generates losses that put solvency at risk and jeopardise the company's current business model, (iii) financial leverage significantly increases without simultaneously raising matched funding, or (iv) the franchise weakens.

Recent Results and Developments

Ekspo reported net income of TL11.7 million (US$7.5 million) for the financial year 2010. The 30% year-on-year decrease in net income was primarily driven by lower net interest income of TL 16.3 million versus TL 18.9 million the year before, which was a result of lower benchmark rates in a more benign operating environment, and higher competition. Consequently, the net interest margin (NIM) decreased to 8.61% from the exceptional peak 13.69% NIM reported a year earlier which is now again more in line with 9.50% and 7.15% reported in 2007 and 2006 respectively. Futher, the reduction in net fee and commission income to TL 5.0 million from TL 6.4 million - again reflecting the intensifying competition in the market - contributed to the decline in overall net income.

Despite the intensifying competition also from commercial banks, the factoring market in Turkey developed further. Ekspo's factoring receivables grew by a very strong 47% to TL226.6 million in 2010 which is in line with the growth rate of the system (47.7%), after the more cautious growth rate in 2009 with 35% compared to the system average of 50%.

Ekspo has good asset quality with non-performing loans at 1.3% down from 2.2% in 2009.

In 2010 the company reported a conservative financial leverage ratio of 2.01, while the sector average was 3.74. Bank borrowing, Ekspo's main funding source, increased by 79% to TL148.0 million (US$95.2 million), while at the same time total capital increased to TL74.3 million from TL62.6 million (18.6% increase).

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 and is ranked tenth out of a total of 64 factoring firms listed under the factoring association in Turkey. It has established a notable market presence, with an slight increase in market share (in total assets) to 1.6% in 2010 from around 1.5% in 2009. Most of the larger competitors in the industry tend to be subsidiaries of Turkish commercial banks, whereby the largest market share of a firm is approximately at 14% of total assets.

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 monoline business - with a strict focus on corporate and commercial customer base, as opposed to a more diversified banking loan book - Ekspo's earnings stability is constrained, thereby limiting its overall franchise value. Through recent collaboration with Korea Exim bank, a first for a non-bank in Turkey, Ekspo started to offer guarantee schemes for Turkish importers of Korea products as it continues to diversify its product range.

Our 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 competencies, 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.

Franchise value assessment also takes into account the uncertainty surrounding the factoring industry as well as its continuous evolution. Main factors affecting the structure of the Turkish factoring industry are market liquidity, strategic moves by bank-affiliated competitors and the evolving macroeconomic environment.

Factor 2: Risk Positioning

Our assessment of Ekspo's risk positioning takes into account the firm's developing risk management framework, its adequate day-to-day liquidity management practices and modest market risk appetite (mainly interest rate risk and contained foreign currency exposure - on a net basis it accounts for 1.2% of capital). The main constraints are the high reliance on short-term market funding (please refer to Liquidity section), the need for continuing investments into its systems and processes given the company's extraordinary and continued growth as well as the need for further institutionalisation of the corporate governance.

Ekspo employs comprehensive credit risk management policies and qualitative and quantitative risk rating models which ensure a better analysis of credit and counterparty risk. Accurate assessment of the company's credit risk appetite is constrained by the limited 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. As a result, the benefits of such risk assessment and management tools can only be seen over time.

Ekspo carries a significant level of receivables portfolio concentration to borrowers of moderate credit quality within the Turkish operating environment. However, our concerns are largely mitigated by the short maturity (averaging 60 days) of Ekspo's exposure to these borrowers, effective monitoring and careful selection and granularity of receivables. As of year-end 2010, the concentration in factoring receivables by industry group was 17% in textiles and 15% in construction which are prone to economical swings and volatility. Due to Ekspo's moderate leverage, the largest industry concentration represents 51% of the firm's equity.

Ekspo's corporate governance practices are adequate, but there is a need for the company to institutionalise principles and practices as well as the inclusion of a set of principles to govern the firm's protection of creditor interests as it grows further. Recent appointment of two independent board members in February 2011 is a positive development on this front. The firm's management team is experienced and is headed by Murat Tumay, the son of the founder Gurbuz Tumay. The small size of the management team and the need for personal engagement of the Tumay family in running the business, represents an element of "key-man" risk.

Ekspo adopted IFRS reporting for the first time in 2006. This has enhanced the comparability of their financial reporting by providing standardised accounting practices and ratios. The quality of financial disclosure remains weaker than that of Turkish commercial banks and constrains our overall assessments of the financial transparency of Ekspo.

Factor 3: Regulatory Environment

We consider 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 came under the ambit of the Banking Regulation and Supervision Agency (BRSA) in 2006. It will take some time for regulatory and supervisory standards to be fully upgraded.

Establishment of a central accounting system, in which all outstanding factoring agreements are collected and supervised was implemented in 2010. One benefit of this new central accounting system will be the prevention of sales of the same receivable to different factoring companies. In addition, BRSA adopted further regulatory measures in 2011 increasing the capital and regulatory threshold for market entrance to TL7.5 million from TL5 million.

Factor 4: Operating Environment

The evaluation of operating environment 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 detail, please refer to Moody's Banking Sector Outlook on Turkey.

Quantitative Factors

Factor 5: Profitability

Lower benchmark rates, and the more benign operating environment resulted in lower risk premiums, and higher competition which has pressurised margins to 8.61% in 2010 down from an extraordinary peak of 13.69% during 2009 which was a year of recession and higher risk aversion. Ekspo's recurring earning power (pre-provision income as a percentage of average total assets) decreased to 7.9% from a strong 14.9% reported in 2009 and 17.01% in 2008; but is more in line with 10.22% and 6.41% reported in 2007 and 2006 respectively. The 2008-09 high margins were primarily underpinned by the elevated risk perception during Turkey's recession where the factoring companies were able to charge higher premiums, at a time when some banks contracted their credit portfolios.

Healthy, though decreasing, interest margins on Turkish lira-denominated intermediation continues to support Ekspo's strong overall earning capacity (see section on Efficiency). Further factors are the firm control of credit risks, and the asset-backed nature of the factoring business.

Over the medium term, Ekspo's profitability will depend on the changing dynamics in the factoring industry as well as the development of interest rates and related cost of funding. In the short term, lower real interest rates will continue to pressure interest margins further, as will growing competition. The development of cost of funding will be the main driver for profitability outlook and will feature decisions on the firm's future risk appetite, as well as applicable credit risk practices.

Factor 6: Liqudity

The liquidity profile of Ekspo is constrained by its very high reliance on short-term bank funding and its low degree of liquid assets. In 2010, short-term funding financed about 65% of the firm's receivables. Furthermore, overnight funding accounted for 32% of this short-term funding; 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.

Positive developments on the funding side, were Ekspo's: (i) issuance of, for the first time, a TRY 20 million - 2 year floating rate bond in the domestic market (9% of its balance sheet), and (ii) utilization of US$15 million financing facility from US Ex-Im Bank, a first for a non-bank in Turkey; which contributed to the diversification and extension of the maturity profile of its funding base. The proceeds of the former were used towards funding credit to small and medium sized companies and the later were used for financing cotton imports of Turkish industrial companies. The bond issuance narrowed the maturity mismatch by 45 days to approximately 3 months versus the average maturity of its receivables at 4 months. Ekpso continues to have a very short term funding base and tries to manage its liquidity and interest rate risks through (i) a clause in its credit contracts enabling Ekspo to recall or adjust the rates of the extended loans at a written notice, and (ii) by maintaining numerous bank lines and (iii) a high level of capital.

Overall, we maintain a cautious view on Ekspo's funding, notwithstanding a number of mitigating factors such as relatively diversified borrowings (a consortium of 26 banks), unutilised banking lines (utilisation rate currently at 68%), established bank relationships, high capitalisation and the short-term nature of its assets.

Factor 7: Capital Adequacy

For the financial year 2010 the company reported a solid - though decreasing - capitalisation of 33% of total assets from 41% reported in 2009 which matched the duration gap of the funding profile. Although, shareholder's equity increased by almost 20% with capital inflow from retained earnings, it is still below the 47% growth in total assets, thereby decreasing the capitalisation ratio. Financial leverage is at 2 times and equity constitutes mainly "paid-in" capital and other core capital components. Ekspo has set an internal maximum leverage limit of five times equity, which would require a better matched duration gap of the funding profile with no liquidity gaps exceeding the total amount of capital at any point in time in order to be sustainable for the company and commensurate with the rating level. We regard the current leverage ratio as a comfortable buffer for unexpected losses, which compares favourably with factoring sector average of 4 times.

Factor 8: Efficiency

Ekspo is a lean operator, continuing to report a low cost-to-income ratio of around 32% at year-end 2010 from 23% in 2009, reflecting the current set-up that features one head office and no branches. This low-cost business model - whereby the main costs are allocated to personnel expenses - reinforces the company's profitability.

The company was initially planning an expansion of its physical branch network, which was postponed following the economic contraction in 2009. At a later stage, the firm may choose to resume its expansion plans eastwards or other main industrial cities when it perceives the economic conditions to be more favourable. The extent to which the firm can grow its assets in order 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, which will be affected by new businesses and by the general level of interest rates.

Factor 9: Asset Quality

Ekspo's asset quality indicators have gained strength since the end of 2008. Its non-performing loans (NPLs) were at 1.3% in 2010 and 2.2% in 2009, compared with a sector average of 4.1% and 6.3%, respectively. This demonstrates the company's strengths and developments in risk management and controls as well as the strength of the company's targeted customer segment. Nonetheless, the improvement in the NPL ratio is also attributable to the high growth in factoring receivables at 47% in 2010, following the 35% reported in 2009 and strong collections at time of strong economic activity in Turkey following 2009. We remain cautious of such high rate credit growth, as it could disguise future asset quality problems. We find comfort in the short-term nature of the factoring receivables as it enables Ekspo to monitor its credit portfolio's performance more readily. The NPLs are 100% provisioned for, and according to the company the factoring receivable portfolio is collateralised by approximately 1.6 times primarily in the form of cheques to which, however, we attribute no risk mitigant.

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.