Tear Sheet:

Arcelik A.S.

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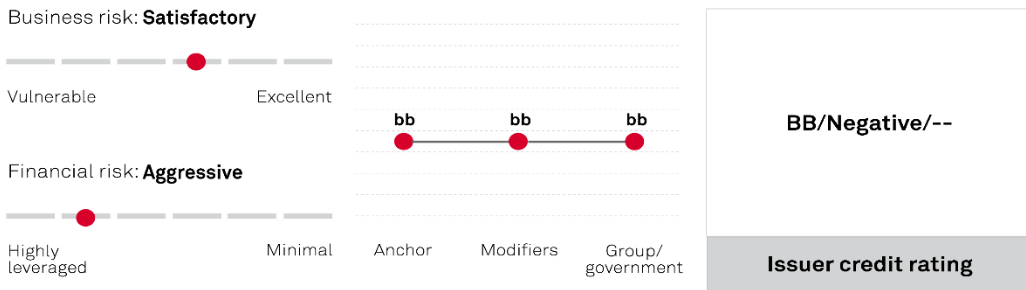
Arcelik's operational performance was affected by weaker consumer demand and higher borrowing costs in 2023 and first-quarter 2024. Revenue was stable in 2023, similar to 2022, reflecting weak demand in Western Europe, Asia Pacific, and the Middle East, and offsetting strong demand in Turkiye and impacts from recent acquisitions. Excluding the impact of inflation accounting, we estimate that nominal revenue grew by 92%. Arcelik achieved an S&P Global Ratings-adjusted EBITDA margin of 7.8%, down from 8.9% in 2022, reflecting the lower utilization of manufacturing capacity and cost inflation. Free operating cash flow (FOCF) was negative TRY28.8 billion driven by investments in manufacturing capacity in Egypt and Bangladesh and high working capital requirements. Arcelik achieved an S&P Global Ratings-adjusted debt-to-leverage ratio of 3.1x and EBITDA interest coverage of 2.3x, weaker than the 2.8x and 2.9x it achieved in 2022. These ratios deteriorated to 3.2x and 2.2x at the end of March 2024, further reducing Arcelik's headroom under its 'BB' rating. Arcelik issued two local currency short-term bonds in the first quarter of 2024 with a coupon rate of 44% and 47%, illustrating continued access to capital market debt, although at high cost.

Arcelik's interest coverage ratios will likely remain pressured in 2024 because of its reliance on short-term local currency debt, and reflecting currently high borrowing costs. We foresee nominal revenue growth of 65%-70% in 2024 thanks to higher prices and considering the contribution from the partnership with Whirlpool in Europe from April. Our forecasts consider volume growth in Turkiye in the first quarter and stable volumes in other markets because we anticipate consumer demand for high-unit-value home appliances will remain subdued. We see Arcelik generating a lower EBITDA margin of 6.0%-6.5%, from 7.8% in 2023, primarily because of the negative contribution from Whirlpool assets in Europe, which carry lower margins, albeit partly offset by lower raw material costs. Our forecasts factor in our estimate of about TRY3 billion-TRY4 billion in integration costs in 2023. We think Arcelik will remain supportive to its retail partners in Turkiye with specific payment terms, resulting in high working capital requirements that Arcelik can fund with local currency short-term debt. As such, we forecast Arcelik to achieve EBITDA interest coverage of 2.0x-2.2x in 2024, improving to above 2.5x in 2025, assuming higher profit margins and stable cost of debt. We forecast its S&P Global Ratings-adjusted debt to EBITDA will be 3.2x-3.5x in 2024 and 2.3x-2.7x in 2025.

The partnership with Whirlpool in Europe presents cost synergies and business diversification opportunities but entails execution risks, in our view. The partnership combines both companies' European manufacturing assets and brands under a newly established business, of which Arcelik owns a 75% stake. The transaction increases Arcelik's manufacturing capabilities because it adds factories across the U.K. and Continental Europe, which could drive cost synergies across procurement and footprint optimization and increase Arcelik's presence in Europe. However, Whirlpool's assets are less profitable than Arcelik's, as the 2023 0.8% EBIT margin shows. We believe this is partly due to its manufacturing assets being in countries where labor costs are higher. The transaction carries execution risks, in our view, given that the targeted cost synergies could take longer and require greater costs and capex than anticipated. That said, we note management's experience and good track record of integrating and extracting cost synergies from acquisitions, as seen in the successful integration of Hitachi, acquired in 2021.

Ratings Score Snapshot



Recent Research

- Industry Credit Outlook 2024: Consumer Products, January 9, 2024
- Research Update: Turkish Domestic Appliances Producer Arcelik A.S. Downgraded To 'BB' On Higher Cost Of Debt; Outlook Negative, March 21, 2023.

Company Description

Arcelik is a Turkiye-based producer of home appliances, including white goods (refrigerators, washing machines, ovens, and dishwashers, among others) and electronic products like televisions and tablets. It is the largest consumer goods companies in Turkiye and is listed on the Istanbul Stock Exchange. The group is majority owned (57.2%) by Koc Group and 17.6% by Burla group. The remaining shares belong to Arcelik (10.2%) and are free float (15%). In 2023, the group had revenue of TRY257 billion and S&P Global Rating-adjusted EBITDA of TRY20.15 billion.

The company owns a portfolio of well-regarded brands in their relevant markets, including Arcelik--the leading home appliance brand in Turkey--and Beko--a leading European free-standing major appliance brand in Europe. It also owns the Grundig brand, which helps the company address the premium home appliances market.

Arcelik generated the majority of its 2023 sales in Turkey (37%) followed by Western Europe (23%), and the Commonwealth of Independent States and Eastern Europe (16%). It also has an established footprint in South Africa, Pakistan, and Bangladesh.

Outlook

The negative outlook reflects the risk of rising short-term domestic debt costs in the next 12 months, resulting in a potentially more pronounced deterioration of Arcelik's debt-service coverage than we currently anticipate. Our current forecast is that Arcelik will continue to achieve solid operational performance and synergies from the recent partnership with Whirlpool in Europe, overall maintaining S&P Global Ratings-adjusted debt to EBITDA of 2.5x-3.5x and EBITDA interest coverage of 2.0x-2.2x in 2024, improving to above 2.5x in 2025.

Downside scenario

We could lower the rating on Arcelik if we see a significant rise in the cost of short-term corporate debt, combined with a greater-than-anticipated deterioration in consumer demand for household appliances in its main markets. Under this scenario, we anticipate EBITDA interest coverage would remain below 2.5x with no expectation of near-term recovery. Difficulties in refinancing the group's upcoming domestic or foreign currency short- and long-term debt maturities would also likely lead to a downgrade.

We could also lower the rating in case of material setbacks in the business partnership with Whirlpool in Europe, resulting in materially greater costs and capex requirements than anticipated, and leading to weaker debt-service coverage ratios and FOCF than forecast.

Upside scenario

We could revise our outlook on Arcelik to stable if we see tangible signs of lowering costs for local currency short-term debt, combined with improving consumer demand in its main markets. Under this scenario, we anticipate Arcelik's EBITDA interest coverage will sustainably approach 3.0x, with positive FOCF. A seamless realization of cost synergies from the partnership with Whirlpool in Europe would also support a stable outlook.

Key Metrics

Arcelik A.S.--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. TRY)	2020a	2021a	2022a	2023a	2024f	2025f	2026f	2027f
Revenue	40,872	68,184	133,916	257,104	436,060	548,202	589,966	624,832
EBITDA	5,558	6,898	11,962	20,153	26,388	37,030	45,085	49,062
Capital expenditure (capex)	1,735	2,515	5,893	13,791	14,390	18,090	19,468	20,619
Free operating cash flow (FOCF)	3,518	(4,396)	(3,316)	(28,772)	(20,153)	(3,354)	7,154	10,204
Debt	6,011	18,114	33,064	61,941	87,342	94,050	93,577	92,849
Adjusted ratios								
Debt/EBITDA (x)	1.1	2.6	2.8	3.1	3.3	2.5	2.1	1.9
EBITDA interest coverage (x)	4.1	3.7	2.9	2.3	2.1	2.8	3.4	4.0
Annual revenue growth (%)	28.0	66.8	96.4	92.0	69.6	25.7	7.6	5.9
EBITDA margin (%)	13.6	10.1	8.9	7.8	6.1	6.8	7.6	7.9

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. f--Forecast. TRY--Turkish lira.

Financial Summary

Arcelik A.S.--Financial Summary

Period ending	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	2018a	2019a	2020a	2021a	2022a	2023a
Display currency (mil.)	TRY	TRY	TRY	TRY	TRY	TRY
Revenues	26,904	31,942	40,872	68,184	133,916	257,104
EBITDA	2,831	3,241	5,558	6,898	11,962	20,153
Funds from operations (FFO)	1,874	1,656	3,991	4,906	8,218	11,032
Interest expense	1,035	1,580	1,358	1,841	4,111	8,605
Cash interest paid	852	1,435	1,400	1,494	2,971	8,308
Operating cash flow (OCF)	984	1,888	5,253	(1,880)	2,577	(14,981)
Capital expenditure	1,797	1,380	1,735	2,515	5,893	13,791
Free operating cash flow (FOCF)	(813)	508	3,518	(4,396)	(3,316)	(28,772)
Discretionary cash flow (DCF)	(1,248)	508	3,491	(7,124)	(6,908)	(32,000)
Cash and short-term investments	5,342	6,937	12,002	16,015	24,529	48,792
Gross available cash	5,342	6,937	12,002	16,015	24,529	48,792
Debt	7,387	8,610	6,011	18,114	33,064	61,941
Common equity	8,219	9,816	14,024	21,055	27,106	59,563
Adjusted ratios						
EBITDA margin (%)	10.5	10.1	13.6	10.1	8.9	7.8
Return on capital (%)	15.3	13.9	24.0	17.7	18.2	14.1
EBITDA interest coverage (x)	2.7	2.1	4.1	3.7	2.9	2.3
FFO cash interest coverage (x)	3.2	2.2	3.9	4.3	3.8	2.3
Debt/EBITDA (x)	2.6	2.7	1.1	2.6	2.8	3.1
FFO/debt (%)	25.4	19.2	66.4	27.1	24.9	17.8
OCF/debt (%)	13.3	21.9	87.4	(10.4)	7.8	(24.2)
FOCF/debt (%)	(11.0)	5.9	58.5	(24.3)	(10.0)	(46.5)
DCF/debt (%)	(16.9)	5.9	58.1	(39.3)	(20.9)	(51.7)

Rating Component Scores

Foreign currency issuer credit rating	BB/Negative/--
Local currency issuer credit rating	BB/Negative/--
Business risk	Satisfactory
Country risk	Moderately High
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Less than Adequate (-1 notch)
Management and governance	Neutral (no impact)
Comparable rating analysis	Positive (+1 notch)
Stand-alone credit profile	bb

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011