FitchRatings

Fitch Takes Rating Actions on 3 Turkish NBFIs

Fitch Ratings-London-17 December 2018: Fitch Ratings has affirmed the National Long-Term Ratings of Tacirler Yatirim Menkul Degerler A.S. (Tacirler Investment) at 'A(tur)' and of Kapital Faktoring A.S. (Kapital) at A-(tur)'. At the same time, Fitch has downgraded Destek Faktoring A.S.'s (Destek) National Long-Term Rating to 'BBB+(tur)' from 'A-(tur)' and removed it from Rating Watch Negative (RWN). The Outlook on all three independent non-bank financial institutions' (NBFIs) National Long-Term Ratings is Stable.

KEY RATING DRIVERS
NATIONAL RATINGS
The National Ratings of all three companies are underpinned by strong capital adequacy, acceptable profitability and manageable refinancing risk. The volatile operating environment remains a constraining factor as do funding limitations for the Turkish NBFI sector.

Fitch placed Destek's National Rating on RWN on 12 September 2018 and the downgrade (and removal from RWN) reflects its somewhat weaker capitalisation, incrementally higher refinancing risk and higher risk appetite compared with immediate peers. The rating also reflects its more concentrated funding profile and business model relative to many other rated Turkish financial institutions.

Independent NBFIs' funding access has weakened in 2H18, leading to increased liquidity pressure and higher refinancing risk. However, the companies under review benefit from a short-term asset base. Kapital and Destek were rapidly deleveraging their respective businesses in 2H18 and Tacirler in 4Q18. In Fitch's view, this was in response to funding constraints but also due to potentially higher credit risk in newly written business. Kapital and Destek demonstrated robust profitability and asset quality metrics despite shrinking their receivables books.

KAPITAL and DESTEK
Kapital and Destek - non-bank owned factoring companies- are among the largest in Turkey by domestic factoring receivables, and have a track record of sound financial metrics. However, in absolute terms both are small relative to Turkey's financial sector.

Both companies are exposed to a material refinancing risk due to recent market turbulence. This is mitigated by their low leverage and the short tenor of factoring receivables. Compared with Kapital, Destek's liquidity position is more dependent on market access given the longer maturities of its receivables book and greater use of short-term funding.

The companies did not report material credit losses in 9M18. Impaired receivables ratios (gross impaired receivables to gross receivables) increased to 2.6% at Kapital and to 1.0% at Destek at end-3Q18 (compared with 1.8% and 0.5%, respectively, at end-2017).

Kapital's capital adequacy peaked due to rapid deleveraging (at a 53% equity/assets ratio at end-10M18). Capitalisation was lower, but still strong at Destek, with a corresponding ratio of 25% at end-3Q18.

Fitch does not consider the currently very low leverage as sustainable and expects capital positions to weaken as the companies return to growth in 2019. However, we expect the companies to keep very strong capital positions, supported by robust internal capital generation (16% for Kapital and 23% for Destek in 9M18 on an annualised basis).

The solid capital buffer would allow Kapital to absorb potential credit losses of up to 52% of its factoring book as of end-10M18, before it breached the regulatory minimum (3% equity-to-assets). The same measure was weaker for Destek, but still strong at 32% at end-3Q18.

In 3Q18, Destek's management decided to open a strategic long position in foreign currency (US dollars) approximately the size of company's capital. Management's rationale for the open long position is largely to protect the value of Destek's capital base in foreign currency. However, Fitch views such a large open position as risky from a company's standalone perspective as it potentially increases volatility of the bottom line and could lead to volatility of its capital position. For instance, in October and November 2018, the Turkish lira strengthened against the US dollar by around 15% and we expect this to negatively affect Destek's financial performance in 4Q18.

TACIRLER INVESTMENT

Tacirler Investment's main business lines are margin lending and brokerage services. The 2018 market turmoil led to a reduction in its commission income but the company managed to offset this with an increase in interest income. Tacirler Investment's 3Q18 performance was negatively affected by realised FX risk driven by the company's speculative positions. Management informed us that it intends to keep a flat net strategic FX position to reduce earnings volatility. Cost efficiency, stemming from a low cost base, supports profitability.

Tacirler Investment's capitalisation is solid with a 34% equity-to-assets ratio at end-3Q18. This is sufficient to cover for hypothetical additional impairments up to 40% of investments and loans combined.

RATING SENSITIVITIES

NATIONAL RATINGS

The Stable Outlooks on the ratings reflect Fitch's expectation that potential weakening of the companies' profiles would be driven by systemic factors and thus would not affect their creditworthiness relative to other local issuers.

An upgrade of Tacirler Investment's and Kapital's National Ratings is unlikely in the medium term, given their already very strong financial metrics and would require either further meaningful diversification of their business model or a material decrease in their business volatility, which so far has largely been driven by external factors.

An upgrade of Destek's National Rating would require a longer track record of solid performance, strengthening its franchise as well as more moderate market risk exposure without a material increase of leverage.

The ratings of all three companies could be downgraded in case of reduced wholesale funding availability from their current core provider, Istanbul Takas ve Saklama Bankasi A.S. (BB/Negative) as well as in case of a significant increase in their risk appetite in form of either FX risk or more aggressive liquidity management.

Tacirler Investment's rating could be downgraded if the company materially leverages its business via materially higher exposure to riskier assets, e.g. domestic debt/equity instruments or riskier margin lending.

Kapital's rating could be downgraded in case of weaker capital adequacy for instance as a result of sharply higher impairment charges, aggressive growth (significantly above an internal capital generation) or sizable distributions to its shareholder.

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Applicable Criteria

National Scale Ratings Criteria (pub. 18 Jul 2018) (https://www.fitchratings.com/site/re/10038626)
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)
(https://www.fitchratings.com/site/re/10044407)

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