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Summary:
Wendel

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Summary:
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Credit Rating: BB/Negative/B

Rationale

The ratings on French investment holding company Wendel are constrained by its high financial gearing, concentration on three large investments, significant exposure to a structured investment in Compagnie de Saint-Gobain (Saint-Gobain; BBB/Stable/A-2) shares, and, in our opinion, the continued unpredictability of equity market conditions. These weaknesses are offset by the company's portfolio of listed equity investments, which provide financial flexibility and annual dividend inflows. In addition, we believe that the three largest investments have solid credit quality, and that Wendel's liquidity position remains adequate on the back of long average debt maturities and significant cash balances on hand.

Wendel's investment portfolio is concentrated on three listed assets--Saint-Gobain, Bureau Veritas (BV; not rated), and Legrand S.A. (BBB/Stable/A-2)--which represent over 90% of the portfolio value. These entities, however, have solid credit profiles and these shareholdings are highly liquid--factors that support credit quality. However, Wendel could be unwilling to sell shares in these entities because in doing so it may lose its control or significant influence. As a majority or controlling shareholder, Wendel has more influence over dividend policies at its core holdings.

Key cash flow and capital-structure developments

High gearing is a major rating constraint. The large debt-funded investment in Saint-Gobain in 2007 continues to weigh on Wendel's financial profile. The financing related to the transaction partly uses nonrecourse debt, subject to margin calls. Wendel has had to post significant amounts of additional collateral (cash as well as BV and Legrand shares) to retain its investment in Saint-Gobain since the substantial decline in the latter's share price. This has reduced Wendel's financial flexibility and increased its market value gearing (as market values have simultaneously fallen).

As of Aug. 26, 2009, we estimate Wendel's loan-to-value (LTV) ratio to be 56% (Standard & Poor's adjusted; excluding debt and shares protected by put options but including the nominal value of the put as an asset).

Dividend flow from investments will be lower in 2009 than 2008, mainly due to the adverse effect of the economic environment on the profitability of Wendel's holdings. Dividends and interest income are not likely to cover operating and interest expenses in 2009, which is a negative rating factor.

Key business and profitability developments

After a weak 2008 and first quarter of 2009, the share price of Wendel's main listed investments has recovered in line with a general stock market recovery. Wendel's unlisted, wholly-owned portfolio companies, however, have continued to struggle. Weak industry conditions and the generally high financial leverage of the unlisted entities have led to debt restructuring and/or the negotiation of new lending terms. Wendel has also supported some of these entities with fresh equity or other means of shareholder support, albeit to a limited extent. Consequently, the value of these assets has decreased significantly during 2009.

We take a positive view of the improved levels of transparency and disclosure at Wendel. We understand that the company will maintain its more cautious investment strategy in order to retain adequate financial flexibility and liquidity. To this end, Wendel has announced its intention to limit new investments in the near term on account of its weak financial position. The company has also completed asset disposals to strengthen its financial flexibility and reduce its debt levels. Nevertheless, we understand that Wendel does not intend to make any additional large divestments in the near term.

Liquidity

The short-term rating is 'B'. Wendel's liquidity remains adequate, in our view, underpinned by the medium- to long-term nature of the company's debt and ample cash balances. According to a public disclosure, Wendel had €1.4 billion of unpledged cash on Aug. 26, 2009. We understand the next bond maturity (€584 million) is due in 2011. But the company has debts relating to the Saint-Gobain transaction (largely protected by put options) maturing in 2010 and 2011 as well. On the positive side, Wendel has successfully extended a share (about €1.3 billion) of the Saint-Gobain related financing, which has improved its financial flexibility. We understand that Wendel is also looking to extend additional debt maturities.

Wendel has an undrawn €1.2 billion committed bank facility maturing in 2013. The use of this facility is restricted by covenants related to the market value gearing of its portfolio. The company was not in compliance with these covenants as of the end of June 2009. However, any action by Wendel to repair its balance sheet is likely to restore its covenant compliance.

We believe that Wendel will maintain adequate liquidity to cover any additional margin calls linked to the Saint-Gobain investment and to cover debts maturing in the medium to long term. Outstanding bonds are free of financial covenants, cross-defaults with its subsidiaries' debt, and ratings triggers. They do not benefit from any negative pledges.

Recovery analysis

The issue ratings on Wendel's €2.5 billion bonds and €1.2 billion revolving credit facility are 'BB', the same level as the corporate credit rating. The recovery rating on this debt is '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Underpinning our recovery assumptions is a stressed valuation of the company's investment portfolio of €4.25 billion, before taking into account an increase in the level of margin calls on the Saint-Gobain financing that would occur in this scenario. Our hypothetical path to default envisages deterioration in the company's financial position leading to difficulty refinancing debt maturing in 2011, both at the Wendel level and at the level of the holding companies that have issued the Saint-Gobain acquisition facilities.

The recovery rating is based on the existing portfolio and does not take account of asset rotations that may occur in the future due to the material uncertainties involved. Furthermore, we have not assumed any drawings on the revolving credit facility on the basis that covenants will limit access to the facility as the portfolio value declines.

As part of our recovery analysis we review the documentation for the company's main debt facilities. However, in this case we have not reviewed the documentation relating to the Saint-Gobain acquisition financing, which comprises a highly material element in the company's financing structure.

For our full recovery analysis, see "Recovery Report: Wendel's Recovery Rating Profile," published Feb. 12, 2009, on Ratings Direct.

Outlook

The negative outlook reflects our view that Wendel could struggle to achieve or maintain an LTV at a level that we would consider commensurate with the 'BB' rating. Specifically, we believe that Wendel could reduce its gearing so that its LTV ratio drops to less than 50% in 2009, and to less than 45% on a sustained basis at the beginning of 2010.

Equity market conditions and the share price development of Wendel's three large listed investments will in our view be particularly important for the company's credit profile in the near term. In addition, we will monitor Wendel's progress in extending its debt maturity schedule. Such extensions could favorably influence its credit profile.

A downgrade would be possible if Wendel did not restore the LTV ratio in the near term, or if equity valuations dropped significantly. Equally, the outlook could be revised to stable if Wendel were either to reduce or appear likely to reduce its gearing to within both our near- and long-term rating guidance (provided portfolio characteristics do not materially change).

Related Research

- Report Card: Equity Market Recovery Takes Pressure Off Rated EMEA Investment And Operating Holding Companies, Sept. 8, 2009
- Recovery Report: Wendel's Recovery Rating Profile, Feb. 12, 2009
- Rating Methodology for European Investment Holding and Operating Holding Companies, May 28, 2004

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