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April 11, 2012

Research Update:

French Investment Company Wendel Long-Term Rating Raised To 'BB' On Deutsch Group Sale; Outlook Stable

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Overview

- French operating holding company Wendel has completed the sale of electrical connections provider Deutsch Group SAS (Deutsch) to Switzerland-based electronics firm TE Connectivity Ltd.
- Following this transaction, we estimate that Wendel's loan-to-value ratio was about 40% on April 10, 2012. In addition, Wendel intends to use a sizable portion of the proceeds raised from the disposal of Deutsch to reduce debt.
- We are raising our long-term rating on Wendel to 'BB' from 'BB-' and affirming the 'B' short-term rating.
- The stable outlook reflects our expectation that the company's loan-to-value ratio will remain below 45%, or exceed it for only very short periods of time.

Rating Action

On April 11, 2012, Standard & Poor's Ratings Services raised its long-term corporate credit rating on France-based holding company Wendel to 'BB' from 'BB-'. At the same time, we affirmed the short-term credit rating at 'B'. The outlook is stable.

We also raised our issue ratings on Wendel's senior unsecured debt to 'BB' from 'BB-'. The recovery ratings are unchanged at '3', indicating our expectation of meaningful (50%-70%) recovery in case of a payment default.

Rationale

The positive rating action reflects management's continuous efforts to reduce debt since late 2009, and the more recent, significant drop in Standard & Poor's loan-to-value (LTV) ratio for Wendel to below 45%, a level commensurate with a 'BB' rating. This follows the completion of the sale of electronic connections provider Deutsch Group SAS (Deutsch) to Swiss electronics firm TE Connectivity Ltd. (BBB/Positive/A-2).

On April 10, 2012, Wendel's LTV ratio stood at about 40%. On that date, assuming no cash reinvested in the assets portfolio, it would have taken a 10% decline in asset values for our 45% LTV guidance to be reached. Because part of the debt that Wendel used to finance the acquisition of a stake in construction and engineered materials manufacturer and distributor Compagnie de Saint-Gobain (Saint-Gobain; BBB/Stable/A-2) is subject to margin calls, we consolidate this debt (€1.4 billion) in our LTV calculation, although it is technically nonrecourse to Wendel.

After the sale of Deutsch, and assuming unchanged unlisted asset value from March 12, 2012, when the last figures were made available, three listed assets currently represent close to 85% of Wendel's portfolio value: Saint-Gobain, in which Wendel holds a 17% interest; testing, inspection and certification company Bureau Veritas (not rated), of which it owns 52%; and low-voltage electrical fittings manufacturer Legrand S.A. (A-/Stable/A-2), in which it owns 6%. Large majority stakes in much smaller and more indebted unlisted corporate entities round out Wendel's portfolio. The strong creditworthiness of Saint-Gobain, Legrand, and Bureau Veritas and their listed, potentially liquid nature, support our ratings. We note that Wendel's willingness to reduce debt has been tested, as demonstrated through the sale of Legrand shares and of Deutsch in the past few months. While helping Wendel's financial profile, the disposals weaken the portfolio's credit quality to some extent as they increase its concentration on Bureau Veritas and Saint-Gobain.

We believe that Wendel's financial flexibility is still stretched and that the main rating constraint remains its aggressive financial risk profile. We note that cash burn remains significant at the holding level, with total coverage of fixed charges by dividends of only about 0.5x in 2009-2011. We also understand that Wendel will reinvest part of the Deutsch proceeds. We estimate that €100 million reinvested would increase LTV by almost 1%.

Liquidity

The short-term rating is 'B.' We assess Wendel's liquidity position as "adequate" under our criteria, with sources of liquidity to cover at least 1.2x of its needs in the near term, even in the event of unforeseen decline in dividends from portfolio companies. We factor into our assessment both near-term uses of funds and the longer-term available sources of liquidity at the company's disposal. Our assessment of the company's liquidity profile incorporates the following expectations and assumptions:

- In the next 12 months, sources of funds will include dividends from portfolio companies of close to €200 million. In addition, the company had about €1.5 billion in cash and equivalents as of April 10, 2012.
- Sources of financing include €950 million undrawn under Wendel's €1.2 billion syndicated revolving credit facility (RCF), of which €950 million is available until September 2013 and €250 million until September 2014. Based on share prices on April 10, 2012, we believe covenants on the facility leave adequate headroom. If asset values were to decline and jeopardize covenant compliance, the company could repay the €250 million drawdown if needed. This is because it also has about €1 billion undrawn under a number of Saint-Gobain financing-related facilities, of which €225 million is available until 2016, and €225 million until 2017. We understand from management that the documentation of these facilities would allow any utilization to refinance part of the currently unpledged

Saint-Gobain shares, which account for about two-thirds of the total.
- On March 21, 2012, Wendel had no short-term debt. Uses of funds in the next 12 months will include operating expenses of €45 million, dividend payments of €65 million, and interest expenses of about €210 million.
- Wendel will face large maturities in 2014, when €664 million in bonds, about €550 million of Saint-Gobain financing, and €250 million of its RCF come due. Our liquidity assessment incorporates our expectation that Wendel will tackle the refinancing of these maturities well in advance, as per its policy of maintaining well spread out debt maturities.

Recovery analysis

Wendel's €2.8 billion unsecured notes and €1.2 billion unsecured RCF are rated 'BB', the same level as the corporate credit rating. The recovery ratings on these instruments are '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default. In accordance with our criteria, although recovery prospects exceed the 50%-70% range, the recovery ratings on the unsecured notes are capped at '3'.

The recovery ratings are supported by our view of Wendel's portfolio, based on its three largest companies that we consider robust. Constraints are the possibility of prior ranking debt linked to the Saint-Gobain acquisition, and our opinion that France's jurisdiction is less friendly than other countries'. In particular, the recovery ratings on the unsecured debt, comprising the notes and the RCF, are also constrained by their unsecured nature. We assume that the notes and the RCF rank pari passu.

Recovery prospects are supported by our assumption that Wendel would be liquidated if it defaulted, given the good liquidity of its portfolio, more than 80% of which is composed of listed companies. To determine recoveries, we simulate a default scenario. Based on the assumptions below, Wendel would hypothetically default in late 2014, owing to its inability to refinance the second tranche of its unsecured RCF and its €664 million in unsecured bonds. Among other things, we envisage under our simulation that:

- Wendel will reinvest €250 million of the proceeds from the sale of Deutsch in new unlisted companies, and we assume that the company will use the remainder to repay part of its Eufor debt.
- The portfolio value will lose about 50% from the level reported on March 12, 2012, combined with a pronounced decrease in dividend inflows.
- The company, on the path to default, will partially use up its existing cash balances to meet cash flow shortfalls, additional equity investment requirements in existing portfolio companies, and the repayment of a tranche of its RCF in 2013.

Wendel is based and headquartered in France. We consider France to be a less creditor friendly jurisdiction for senior secured creditors than other countries. We estimate a stressed portfolio value at the point of default of about €4.2 billion including residual cash. After deducting priority liabilities of €820 million, comprising mainly enforcement costs and debt related to the acquisition of Saint-Gobain shares still outstanding at that time, we arrive at a net stressed value of €3.4 billion. At default, we assume around €3.0 billion of unsecured debt outstanding, including the unsecured notes, the second tranche of the RCF outstanding, and six months of prepetition interest. The recovery ratings on the unsecured debt are '3', indicating our expectation of average (50%-70%) recovery for debtholders in the event of a payment default. In accordance with our criteria, the recovery ratings on the unsecured debt instruments are capped at '3', although recovery prospects exceed the 50%-70% range. Under our criteria, for unsecured debt issued by corporate entities with a corporate credit rating of 'BB-' or higher, we generally cap recovery ratings at '3'. This takes into account the greater risk of impairment to our recovery prospects that would result from the issuance of additional priority loans, for example bank loans, as they are not covered by the negative pledge clause in the documentation or pari-passu debt prior to default.

Outlook

The stable outlook reflects our expectation that, based on current portfolio composition and assets flexibility, Wendel should be able to maintain an LTV ratio below 45%, and adequate liquidity.

Significant deterioration in the share prices of Wendel's key listed investments or a financial policy more aggressive than we currently expect could lead us to consider a negative rating action. Deteriorating liquidity to below our "adequate" category would put pressure on the ratings, although we consider this as an unlikely scenario for the near future.

We might consider a positive rating action, assuming broadly unchanged portfolio liquidity, quality, and diversity, if we saw that the company had established a track record of an LTV ratio below 40% and appeared able to maintain it. A further prerequisite would also be a significant reduction in cash burn at the holding level. We would also examine the operating performance of its main subsidiaries and would expect acquisitions to be pre-financed by disposals to a large extent.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Wendel, Jan. 24, 2012
- Debt Recovery For Creditors And The Law Of Insolvency In France, March 22, 2007

Ratings List

Upgraded

	To	From
Wendel		

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Corporate Credit Rating	BB/Stable/B	BB-/Negative/B

Upgraded

	To	From
Senior Unsecured		
EUR700 mil 4.875% bnds due 05/26/2016	BB	BB-
Recovery Rating	3	3
EUR400 mil 4.875% nts due 09/21/2015	BB	BB-
Recovery Rating	3	3
EUR300 mil 6.75% nts due 04/20/2018	BB	BB-
Recovery Rating	3	3
EUR1.2 bil multi-curr revolving credit fac bank ln due 09/12/2013	BB	BB-
Recovery Rating	3	3
EUR700 mil 4.875% bnds due 11/04/2014	BB	BB-
Recovery Rating	3	3
EUR700 mil 4.375% bnds due 08/09/2017	BB	BB-
Recovery Rating	3	3

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