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Research Update:

French Investment Company Wendel Upgraded To 'BB+' On Decreasing Loan-To-Value; Outlook Stable

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Overview

- We consider that the management of French holding company Wendel has reduced risk tolerance, which has led us to revise up our view of the company's financial risk profile to significant from aggressive.
- We believe that management is strongly committed to maintain permanently a loan-to-value (LTV) ratio commensurate with our view of Wendel's financial risk profile as significant.
- We are therefore raising our long-term rating on Wendel to 'BB+' from 'BB' and affirming our 'B' short-term rating on the company.
- The stable outlook reflects our view that the company's LTV ratio should remain sustainably below 40%, and its liquidity adequate.

Rating Action

On April 24, 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, the short-term credit rating was affirmed at 'B'. The outlook is stable.

We also raised our issue ratings on Wendel's €3.0 billion senior unsecured notes and €1.2 billion unsecured revolving credit facility (RCF), to be replaced by a new €0.4 billion RCF, to 'BB+' from 'BB'. The recovery rating on these instruments remains unchanged at '3,' indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Rationale

The upgrade reflects the drop in Standard & Poor's loan-to-value (LTV) ratio for Wendel to less than 40%, a level commensurate with our assessment of the company's financial risk profile as "significant" and the 'BB+' rating. We also take into account our opinion of management's strong commitment to maintain the LTV ratio below 40%.

On April 16, 2013, and assuming unchanged unlisted asset values compared with the last available figures in March 2013, three listed assets represented close to 85% of Wendel's portfolio value of €9.5 billion. The assets are building materials producer and distributor Compagnie de Saint-Gobain (28% of total assets), in which Wendel holds a 17% interest; testing, inspection and

certification company Bureau Veritas S.A. (54%), of which it owns 51%, and low-voltage electrical fittings manufacturer Legrand S.A. (5%), in which it owns 5%. Large majority stakes in much smaller and more indebted unlisted corporate entities round out the company's portfolio.

On April 16, 2013, Wendel's LTV ratio stood at about 37%. Assuming no cash reinvested in the asset portfolio, it would have taken an 8% decline in asset values to reach the 40% LTV guidance we deem commensurate with a "significant" business risk profile. While we acknowledge Wendel has limited flexibility versus our expectations for the current 'BB+' rating, we understand management is strongly committed and has the incentive to do what it takes to keep strengthening the capital structure in the long term, meaning if necessary to contain LTV to within our expectations for the ratings in the event of rising equity market turbulence.

The ratings on Wendel reflect our assessments of the company's financial risk profile as "significant," revised up from "aggressive," and its business risk profile as "satisfactory," as our criteria define the terms.

We believe that the main rating constraint remains Wendel's noninvestment-grade financial profile. A portion of the shares held in Saint-Gobain, Legrand, and Bureau Veritas are still pledged to secure €0.6 billion of Saint-Gobain-related bank debt. They are currently worth more than €0.6 billion according to our calculations. In addition, we note that cash burn remains significant at holding-company level, with total coverage of fixed charges by dividends of only about 0.6x in 2012.

Partially offsetting these weaknesses is the generally good creditworthiness of Wendel's larger portfolio companies, and their listed, potentially liquid nature. Management's ability to rotate assets, extracting value out of its investments to reduce leverage is also a critical positive.

Liquidity

The short-term rating is 'B.' We assess Wendel's liquidity as firmly established in our "adequate" category under our criteria, based on sources of liquidity that will cover needs well above 1.2x in the next 12 months, even in the event of an unforeseen decline in dividends from portfolio companies.

On March 18, 2013, Wendel's liquidity sources included:

- Net cash and cash equivalents of €0.7 billion;
- Dividends from portfolio companies of close to €230 million to be received in 2013, by our estimates; and
- €1,150 million undrawn under a number of Saint-Gobain financing-related facilities, of which €225 million is available until 2016 and €925 million until 2017. In addition, we understand the company is finalizing the terms of a new, €400 million RCF with a 2018 maturity. We understand that the documentation of these facilities would allow any utilization to refinance part of the currently unpledged Saint-Gobain shares, which account for about three-quarters of the total.

In the absence of short-term debt, sources favorably compare to uses of liquidity comprising:

- Operating expenses of below €50 million;
- Interest expense of some €200 million; and
- Dividend payments of €85 million, and some potential share repurchases.

Wendel will face large maturities toward the end of 2014, when €579 million in bonds and €250 million of its RCF come due. Our liquidity assessment incorporates our expectation that the company 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 €3.0 billion senior unsecured notes and €1.2 billion unsecured RCF, to be replaced by a new €0.4 billion RCF, are rated 'BB+', the same level as the corporate credit rating. The '3' recovery ratings on these instruments indicate our expectation of meaningful (50%-70%) recovery in the event of a payment default.

The recovery ratings on Wendel's debt are primarily underpinned by its portfolio of listed equity participations. However, they are constrained at the '3' level by prior-ranking debt linked to the Saint-Gobain acquisition, the unsecured nature of the debt rated, and our opinion that France's jurisdiction is less friendly to creditors than other countries'.

Recovery prospects are supported by our assumption that Wendel would be liquidated if it defaulted, given the good liquidity of its portfolio, a sizable portion of which (close to 85%) is composed of actively traded stakes. In order to determine recoveries, we simulate a default scenario, which stipulates that Wendel would hypothetically default in 2017, owing to its inability to refinance a €692 million bond maturing in August.

Among other things, we assumed that the portfolio would lose about 50% of its value, combined with a pronounced decrease in dividend inflows. The company, on the path to default, would use up its existing cash balances, replace its unsecured RCFs, and draw on the Saint-Gobain credit lines maturing in 2017 (to repay €200 million, €213 million and €213 million commitments due in 2015, 2016 and January 2017 respectively) to meet cash flow shortfalls, additional equity investment requirements in existing portfolio companies, and debt maturities (€829 million in 2014, €594 million in 2015, and €654 million in 2016).

On this basis, we estimated a stressed portfolio value at the point of default of about €4.6 billion including close to no residual cash. After deducting priority liabilities of about €800 million, comprising mainly enforcement costs and debt related to the acquisition of Saint-Gobain shares outstanding at that time, we arrived at a net stressed value of €3.8 billion.

At default, we assume about €2.4 billion of unsecured debt outstanding, including the unsecured notes, the RCF outstanding, and six months of prepetition interest. On this basis, the recovery expectations for this debt are numerically above 100%.

However, we cap the recovery rating on this debt at '3', which is equivalent to meaningful (50%-70%) recovery prospects for debt holders in the event of a payment default, in line with our criteria. They state that the recovery ratings on unsecured debt issued by corporate entities with corporate credit ratings of 'BB-' or higher are capped at '3' to factor our view that their recovery prospects are at greater risk of being impaired by the issuance of additional priority or pari passu debt prior to default.

Outlook

The stable outlook reflects our expectation that Wendel should be able to maintain an LTV ratio at about 40%, and adequate liquidity, based on its current portfolio composition, financial policy and asset flexibility.

A financial policy more aggressive than we currently factor into the rating, which we do not envisage at this stage, or significant deterioration in the share prices of Wendel's key listed investments--without an appropriate response from management to reduce net debt--could lead us to consider a negative rating action.

We could consider a positive rating action, assuming broadly unchanged portfolio liquidity, quality, and diversity, if we saw that the company had established for its LTV a sustainable track record of headroom versus the 35% we deem commensurate with an investment-grade rating and appeared to us able and keen to maintain it. Another prerequisite would also be a further reduction in cash burn at holding company level, with dividends received covering at least net interest expense. We would also examine the operating performance of Wendel's main subsidiaries and would expect acquisitions to be pre-financed by disposals to a large extent.

Related Criteria And Research

- Wendel, Jan. 15, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 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

Ratings List

Upgraded; Ratings Affirmed

	To	From
Wendel		
Corporate Credit Rating	BB+/Stable/B	BB/Stable/B
Senior Unsecured	BB+	BB
Recovery Rating	3	3

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