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Research Update:

France-Based Operating Holding Company Wendel Downgraded To 'BB-' On Persistently High Leverage; Outlook Stable

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Overview

- We view French operating holding company Wendel's leverage as continually high.
- We are lowering our long-term ratings on the company to 'BB-' from 'BB'.
- The stable outlook reflects our expectation that Wendel will likely restore its LTV ratio to 50% by early 2011.

Rating Action

On July 19, 2010, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on France-based operating holding company Wendel to 'BB-' from 'BB'. At the same time, we affirmed our 'B' short-term rating on the company. The outlook is stable.

We also lowered our issue ratings on Wendel's €2.6 billion bonds and €1.2 billion revolving credit facility to 'BB-' from 'BB', in line with the corporate credit rating. The recovery rating is unchanged at '3', indicating our expectation of meaningful (50%-70%) recovery in an event of payment default.

Rationale

The rating action reflects that Standard & Poor's adjusted loan-to-value ratio (LTV) for Wendel has exceeded levels commensurate with a 'BB' rating for an extended time period--namely 45% on a sustainable basis through the first half of 2010. At end-May 2010, Wendel's LTV ratio stood at around 54%. We think it remained above 50% as of end June and that it will likely continue above this mark in the third quarter. Despite asset disposals and a relative improvement in equity prices over the past 12 months, the LTV ratio remains persistently high and above that of Wendel's European peers. Still, we expect Wendel to take further actions to restore its LTV ratio to 50% by early 2011, bringing it in line with our 'BB-' rating based on the company's current portfolio composition.

Because part of the debt that Wendel used to finance the acquisition of its stake in France-based Compagnie de Saint-Gobain (BBB/Stable/A-2) is subject to margin calls (about €3 billion in gross debt), we consolidate this debt in our LTV computation although it is technically nonrecourse to Wendel. We do not consolidate, however, the €1.4 billion financing used for Saint-Gobain acquisition-related debt that is economically fully hedged through put options, as it is contractually nonrecourse to Wendel, not subject to margin calls, and protected by put options.

Wendel's investment portfolio mainly includes three listed assets representing over 80% of the portfolio's value at end-May 2010--Saint-Gobain, in which Wendel holds a 18% interest; Bureau Veritas (not rated), 52% owned; and Legrand S.A. (BBB/Stable/A-2, 25%-owned. A 46% interest in listed company Stallergenes (not rated) and large majority stakes in much smaller but highly leveraged unlisted corporate entities round out Wendel's portfolio.

The relatively strong creditworthiness of Saint-Gobain, Legrand, and Bureau Veritas and their listed nature--which makes these assets potentially liquid--support Wendel's credit quality.

High gearing and an aggressive financial risk profile remain the main rating constraints for Wendel, in our view. A substantial portion of the shares held in Saint-Gobain, Legrand, and Bureau Veritas are pledged to secure bank debt raised in 2007 to finance the acquisition of the Saint-Gobain stake at historically high share prices. The portion of this debt subject to margin calls matures over 2012-2015; the remainder without margin call matures during 2011-2012. Overall, it continues to weigh severely on Wendel's financial profile. Despite some recovery in share prices, we consider that Wendel's financial flexibility remains stretched. For Wendel to achieve an LTV ratio of 50% by early 2011, we would expect to see further asset disposals or a re-evaluation of its asset base.

In 2009, Wendel's unlisted, wholly-owned subsidiaries struggled under weak industry conditions, bearing the burden of their own significantly leveraged financial profiles on their performances. These difficulties led to substantial debt restructuring or the negotiation of new lending terms for three unlisted entities--Materis, Stahl, and Deutsch--and at the same time, the net equity value of these assets decreased markedly. As part of the debt restructuring plans, Wendel decided to inject new equity or provide other means of shareholder support for a combined effort of €160 million to these three subsidiaries.

A performance upturn in 2010, if this occurs, may provide a basis for some upward value adjustments for Wendel's unlisted assets.

Liquidity

The short-term rating is 'B'. Wendel's liquidity improved throughout 2009. We consider it adequate, based on the medium- to long-term nature of the company's debt, especially for that portion which is unsecured, and sizable cash balances. At end-May 2010, Wendel had €1.7 billion of cash, of which €1.0 billion not pledged.

The next bond maturity (€390 million, net of buybacks and the recent exchange offer) is due only in February 2011, while a large part of the company's banking debt relating to the Saint-Gobain transaction carries maturities spread between 2011 and 2015. The debt that is protected by put options--€1.4 billion-- falls due in 2011 and 2012.

Overall, debt maturing in 2011 is more than fully covered by cash. Other senior unsecured debt matures from 2014 and beyond.

Outstanding bonds are free of financial covenants, cross-defaults with its subsidiaries' debt, and rating triggers. They do not benefit from any negative pledge, however.
Wendel has an undrawn €1.2 billion committed bank facility maturing in 2013. Covenants related to the market value gearing of the company's portfolio restricts the use of this facility. Wendel has been in compliance with these covenants for over a year.

In addition, Wendel has €900 million available under the Saint-Gobain debt containing margin calls maturing between 2013 and 2015, which it could use to refinance or manage its Saint-Gobain exposure.

Recovery analysis

Wendel's €2.6 billion bonds and €1.2 billion revolving credit facility are rated 'BB-', the same level as the corporate credit rating. The recovery rating is '3', indicating our expectation of meaningful (50%-70%) recovery in an event of payment default.

Recovery expectations are underpinned by a stressed valuation of the company's investments, allowing for a decline in the portfolio value of about 45%-50% from the current level and an increase in the level of margin calls on the structured investment in shares Saint-Gobain.

For our full recovery analysis, see "Recovery Report: Wendel's Recovery Rating Profile," published Feb. 2, 2010.

Outlook

The stable outlook reflects our view that Wendel will take action to deleverage and bring its LTV ratio to 50% by early 2011.

A material deterioration in the share prices of Wendel's key investments could weaken its credit metrics beyond what we incorporate in the current ratings, however. This would in turn likely lead to a downgrade, barring any disposals that Wendel would potentially undertake to mitigate such negative share price movements.

Alternatively, sizable disposals associated with redeeming existing debt or a significant increase in asset value could lead to an improvement in Wendel's financial risk profile.

Related Criteria And Research

Rating Methodology for European Investment Holding and Operating Holding Companies, May 28, 2004

Ratings List

Downgraded

	To	From
Wendel		
Long-Term Corporate Credit Rating	BB-/Stable	BB/Negative
Senior Unsecured		
EUR471 mil 5% bnds due 02/16/2011	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
EUR1.2 bil multi-curr revolving credit fac bank ln due 09/12/2013	BB-	BB
Recovery Rating	3	3
EUR400 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

Ratings Affirmed

	To	From
Wendel		
Short-Term Corporate Credit Rating	B	B

Additional Contact:
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