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Research Update:

Outlook On France-Based Holding Company Wendel Revised To Negative On Increased Leverage; 'BB-/B' Ratings Affirmed

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Table Of Contents

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Overview

- French operating holding company Wendel is greatly exposed to equity market turbulence, which is undermining the value of assets in its portfolio.
- For the past few weeks, company's loan-to-value (LTV) ratio has fluctuated above our expectations for the current ratings.
- We are therefore revising our outlook on Wendel to negative from positive and affirming our 'BB-/B' corporate credit ratings on the company.
- The negative outlook reflects our view that Wendel's LTV ratio could continue to remain above our expectations.

Rating Action

On Oct. 10, 2011, Standard & Poor's Ratings Services revised its outlook on France-based operating holding company Wendel to negative from positive. At the same time, the 'BB-' long-term and 'B' short-term corporate credit ratings on Wendel were affirmed.

In addition, we affirmed our 'BB-' senior unsecured debt ratings on the company. The recovery ratings on this debt are unchanged at '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Rationale

The outlook revision reflects our view that Wendel's loan-to-value (LTV) ratio has been rising over the past few weeks because of equity market volatility. Since we revised our outlook on the company to positive at the end of July (see "France-Based Operating Holding Company Wendel Outlook Revised To Positive On Reduced Leverage; 'BB-/B' Ratings Affirmed," published July 29, 2011, on RatingsDirect on the Global Credit Portal), the share prices of Compagnie de Saint-Gobain (Saint-Gobain; BBB/Stable/A-2), in which Wendel has a 17% interest, and Bureau Veritas (not rated; 52% interest) have declined by about 35% and 10%, respectively. This is in spite of satisfactory results published for the first half of the year.

Given the quality, liquidity, and size of Wendel's asset portfolio, we consider that our current ratings on the company can accommodate an LTV ratio of up to 55%. This is a slight adjustment to our previous LTV ratio guidance of 50%, which we believe is justified due to the robust operating performance of key assets and what we expect to be a greater willingness on the part of management to sell assets in order to manage the capital structure. However, we estimate that Wendel's LTV ratio is now close to 60%--that is, above our revised 55% guidance for the 'BB-' rating. All other things being equal (no divestments and no change in unlisted asset valuations, for example), we calculate that it would take an equity market rebound of close to 10% to bring Wendel's LTV ratio back to within the confines of our leverage target for the current rating, as calculated on Oct. 5, 2011.

In the first half of 2011, Wendel's key subsidiaries performed well, reporting increased revenues and robust margins year on year. We note that Saint-Gobain confirmed its objectives for 2011 of robust organic growth and double-digit growth in operating income (at constant exchange rates), despite the rise in raw material and energy costs. We also note that Bureau Veritas unveiled its 2015 strategic plan, with average organic growth of 6%-8% per year and continued operating margin improvement. Since our economic forecasts are becoming increasingly negative (see "The Specter Of A Double Dip In Europe Looms Larger," published Oct. 4, 2011), we take a cautious stance on subsidiaries' operating performance over the next 18 months, and hence on the potential for a revaluation of their stock prices.

Today's rating action does not reflect a change in our assessment of Wendel's investment portfolio, which we believe continues to be satisfactory, underpinned by strong asset quality and adequate asset liquidity. We also believe that management's proactive stance remains a key support for the rating. Achievements in the past 12 months include sizable disposals, the reorganization of debt maturities, reduced exposure to margin loans, and the postponement of some of the outstanding put options sold on Saint-Gobain shares.

Liquidity

We view Wendel's liquidity profile as adequate under our criteria. We factor into our assessment both near-term uses of funds and the longer-term available sources of liquidity at the disposal of the company. On Aug. 22, 2011, Wendel had no short-term debt. The nearest debt maturity is in July 2013, when €266 million of Saint-Gobain financing matures. Wendel will face sizable maturities in 2014, at which time €700 million in bonds, about €600 million of Saint-Gobain financing, and a tranche of the revolving credit facility (RCF) come due.

Sources of financing include €700 million still undrawn under Wendel's €1.2 billion RCF, of which €950 million is available until September 2013 and €250 million until September 2014. Based on the current share prices of listed assets, we believe that covenants on the facility leave limited headroom. That said, we understand from management that Wendel could repay the €500 million drawdown if need be. This is because it also has about €700 million undrawn under Saint-Gobain financing (of which €225 million is available until 2016, and €225 million until 2017). We also understand from management that the documentation of these facilities would allow such utilization to refinance part of the currently unpledged Saint Gobain shares (about 60% of the total). In our view, there is a risk of liquidity becoming progressively less than adequate under these circumstances, since the amount of available undrawn facilities would be reduced from €1.4 billion to about €200 million. In addition, the company has about €1 billion in cash and equivalents as of Aug. 22, 2011.

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 rating on these instruments is '3', indicating our expectation of meaningful (50%-70%) recovery in an event of payment default.

The recovery ratings are supported by our view of Wendel's portfolio, which comprises three robust companies--Saint-Gobain, Legrand S.A. (BBB+/Positive/A-2), and Bureau Veritas--all of which have an investment-grade profile, in our opinion. The recovery ratings are constrained by the existence of prior-ranking debt linked to the acquisition of Saint-Gobain's shares, which could be triggered in our post-default waterfall under certain circumstances (by way of margin calls), and by the relatively creditor-unfriendly jurisdiction of France. In particular, the recovery ratings on the unsecured debt (comprising the notes and the RCF) are also constrained by those instruments' unsecured nature and very low documentary protection against further secured debt being raised. We assume that the notes and the RCF would rank pari passu at default, even though the RCF's documentation suggests higher protection through maintenance financial covenants. Recovery prospects for the rated debt are supported by our assumption that, in a default, Wendel would most likely be liquidated, since the bulk of the portfolio is listed.

In order to determine recoveries, we simulate a default scenario. Our hypothetical scenario includes a decline in the portfolio value of about 50% from the current level, combined with a marked decrease of dividend inflows to Wendel from subsidiaries. We calculate that this scenario would lead to a default in 2014, triggered by the group's inability to refinance its €700 million unsecured bonds maturing that year. Wendel is based and headquartered in France, a jurisdiction we consider to be relatively unfriendly for senior secured creditors (see "Debt Recovery For Creditors And The Law Of Insolvency In France," published March 22, 2007).

After simulating a 50% decline in asset value, we estimate the stressed portfolio value at the point of default would be about €3.6 billion. After deducting priority liabilities comprising mainly enforcement costs and margin loans, residual value available to unsecured debtholders would be about €1.8 billion. At default, we assume €2.8 billion of unsecured notes outstanding (including notes and six months of prepetition interest, and assuming the RCF will remain undrawn), leading to a recovery rating for the notes of '3'.

Outlook

The negative outlook reflects our view that while we anticipate the company will proactively reduce its gearing, we cannot ignore the execution risks and current equity price environment that could make such an exercise a difficult and/or prolonged process.

We would lower the rating if we do not see a near-term reduction in leverage toward 55%, either through actions taken by management or a correction in equity prices.

Based on the current characteristics of Wendel's portfolio, we could revise the outlook to stable if we see that the company is making strides to reduce its LTV ratio to below 55% on a sustainable basis.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

Related criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related research

- The Specter Of A Double Dip In Europe Looms Larger, Oct. 4, 2011
- France-Based Operating Holding Company Wendel Outlook Revised To Positive On Reduced Leverage; 'BB-/B' Ratings Affirmed, July 29, 2011
- Debt Recovery For Creditors And The Law Of Insolvency In France, March 22, 2007
- Rating Methodology For European Investment Holding And Operating Holding Companies, May 28, 2004

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Wendel		
Corporate Credit Rating	BB-/Negative/B	BB-/Positive/B

Ratings Affirmed

Wendel		
Senior Unsecured Debt	BB-	BB-
Recovery Rating	3	3

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.