

June 19, 2009

## Wuerth GmbH & Co. KG, Adolf

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## Major Rating Factors

### Strengths:

- World-leading player in the repair and construction distribution industry for low-ticket items, with a strong growth track record and brand name
- Market share protected by significant barriers to entry and established long-term relationships with customers in core markets
- Strong bargaining power and low price transparency for customers
- Broad diversification with little dependency on individual suppliers and customers

### Corporate Credit Rating

A/Stable/A-1

### Weaknesses:

- Concentration in the Western European market and particularly in Germany, which represent 59.4% and 41.5% of sales, respectively
- Exposure to cyclical and seasonal industries such as construction
- Fast-growing subsidiary network's inherent country and integration risks

## Rationale

The ratings on Germany-based Adolf Wuerth GmbH & Co. KG (Wuerth) are supported by the group's leading position in low-ticket items for the diverse global repair and construction industry, good distribution network, and strong bargaining power. Wuerth and its related subsidiaries distribute a broad range of low-ticket items used for the assembly segment and the less cyclical maintenance and repair segment by commercial, contractor, and, to a lesser extent, industrial customers.

The ratings are constrained by Wuerth's high exposure to mature Western European markets and weakening credit metrics after past significant spending coupled with the effects of the recession. Furthermore, because Wuerth is family-owned, this limits the group's access to equity markets and in turn its financial flexibility.

### Key business and profitability developments

As the world's largest player in this highly fragmented industry, Wuerth has proven quite resilient in its trading performance and maintained a strong financial position in past cyclical downturns. This was due to the group's broad and diverse product range, industries, and geographic operations as well as its strong exposure to the less sensitive renovation and maintenance end market. Nevertheless, Wuerth is not immune to the global recession.

Revenues in 2008 increased by 3.9% to €8.8 billion, reflecting largely organic growth, despite the downturn unfolding in tandem in most markets during the second half of 2008 following a very favorable first half.

In 2009, however, overall trading conditions are negative. A sharp output reduction and destocking effect were felt in many of Wuerth's key divisions, including Metal (17% of 2008 sales), Auto (15%), Construction (6%), Wood (12%), and Industry (8%). Difficult market conditions persist in most developed markets, especially the U.S., the

U.K., and Spain but also are weakening in Wuerth's home market Germany (41.5% of group sales). The sharp contraction in Eastern Europe will likely persist. At this stage, Standard & Poor's Ratings Services expects that market conditions could return to slightly positive territory in 2010. Overall, we anticipate a sales drop of about mid-teens for 2009 but pricing power to remain robust allowed by low price transparency.

Reported EBITDA margins fell from a record 10.7% in 2007 to 9.7% (the same as in 2005 and 2006), stemming from higher input costs (namely transportation) and rapid market declines. The group has demonstrated in the past its ability to stabilize profitability during a prolonged depression of end markets.

At this stage, we have factored into the ratings some further EBITDA margin contraction despite the group's ongoing cost-saving initiatives (overhead, short-time, and closure of unprofitable subsidiaries). We anticipate margins to remain at about high single digits in 2009 before a gradual recovery in 2010 given the benefits from restructuring measures and some moderate market improvement.

### **Key cash flow and capital-structure developments**

Funds from operations (FFO) to adjusted debt of 39.9% was broadly in line with the rating target at the end of 2008. Nevertheless, this is a significant reduction from past years' high level of about 60%. In our view, this weakening is stemming from a combination of two factors: a declining trading environment since the second half of 2008 and Wuerth's substantial spending, which resulted in Standard & Poor's-adjusted negative discretionary cash flow of €235.1 million. Spending included €415.8 million on capital expenditures, €98 million on acquisitions, and €233.3 million on increased dividends.

That said, we note that management is strongly focused on cash preservation and restoring a stronger balance sheet. We therefore believe that, among other elements, discretionary spending in 2009 and 2010 will be sharply reduced. We understand capital expenditure outlets could be cut to €140 million and dividends will be further reduced to €50 million from the €70 million previously expected. Wuerth's acquisition strategy has been put on hold for the time being.

In our view, this together with Wuerth's working capital saving program will not likely be sufficient to cushion anticipated lower operating cash generation in 2009. This will likely result in strongly deteriorated credit measures this year, with FFO to debt of about 30%. Even so, expected shrinking capital outlets should underpin positive discretionary cash flows in 2009 and 2010.

On this basis, we expect a rebound of credit metrics to FFO to debt of about 40% in 2010, which is more adequate for the rating level.

As part of our financial adjustments, we consider tax payouts of about €55 million in relation to the closed tax investigation in 2008 as exceptional. We deconsolidate Wuerth's 88.55% participation in Internationales Bankhaus Bodensee AG in line with our criteria.

### **Short-term credit factors**

The short-term rating is 'A-1'. Wuerth's liquidity is adequate, supported by unrestricted cash of about €190.9 million at Dec. 31, 2008, liquid securities investments of about €101 million, and €150 million of undrawn committed bank lines from a number of German and international banks maturing in 2013. This comfortably covers €150 million notes maturing in March 2010 and short-term uncommitted debt of €65 million.

Wuerth successfully issued a Swiss franc (CHF) 300 million note in June 2008 and a €150 million Schuldscheindarlehen in March 2008. The group's maturity profile is well spread over the coming years: Its next large debt maturities are €150 million notes on March 31, 2010, followed by a \$200 million U.S. private placement (USPP) in 2011, a €100 million and a CHF300 million bond in 2012, €100 million notes in 2013, and €300 million primary loan notes maturing in 2014.

We believe Wuerth should remain comfortable within its financial covenants' requirement of a maximum 3.25x net debt to EBITDA coverage for both its €150 million bank facility and the \$200 million USPP. We note, however, that covenant headroom under its USPP is likely weaker as only a consolidation of direct lenders' and guarantor's results are taken into calculation.

## Outlook

The stable outlook reflects our view of a sharp rebound in credit metrics in 2010 to FFO to debt of about 40% after management's focus on restoring balance sheet and cash flow measures. The stable outlook is furthermore supported by our view that Wuerth's strong business risk profile with considerable product and geographic diversity and an experienced management team will enable the group to restore its financial strength and flexibility to within the rating level quickly thereafter.

Nevertheless, given our expectations of a relatively weak financial performance for the 'A' rating level, we could revise the outlook to negative if we come to believe that the expected recovery in credit metrics is not likely to materialize or if credit measures weaken more than anticipated this year. That could be if we come to believe that FFO to debt would weaken below 30%. In addition, any adverse owner action such as aggressive dividend payouts, which we do not envisage at this stage, could put pressure on the ratings.

An outlook revision to positive seems unlikely at this time.

## Business Description

The family-trust-owned Wuerth group is the largest global distributor of assembly products in the maintenance, repair, and operations (MRO) industry to mainly small and midsize industrial companies. The group sells about 100,000 different products in its core business to the automotive, electrical components, metalworking, woodworking, and craft industries (Wuerth line). Acquired entities that maintain their individual brand name are combined under allied companies.

In 2007, the group structure changed, preparing Wuerth for a 2017 German inheritance tax payout by moving a modest share of its international operations into a newly founded family trust incorporated in Austria. Future acquisitions outside Germany are more likely to be listed in Austria than in Germany. The full completion of the new group structure is ongoing and not expected before the end of 2009. All companies are controlled by the Wuerth family foundations and have strong financial and operational links.

## Business Risk Profile: Strong, Supported By Sound Bargaining Power And Strong Market Positions

The major supports for the strong business risk profile are:

- The group's leading market position in the highly fragmented MRO market and strong brand recognition. Wuerth is currently estimated to have a share of less than 5% of the world market, but nevertheless is by far the largest and most diverse player. Berner GmbH (not rated), the largest German competitor, reported a turnover of about €869.6 million in the fiscal year ended March 31, 2008. Wuerth's largest European competitor is Liechtenstein-based, construction-focused Hilti AG (not rated), which posted sales of about CHF4.7 billion in 2008. International peers include U.S.-based and focused companies Grainger (W.W.) Inc. (AA+/Stable/A-1+) and WESCO Distribution Inc. (BB-/Stable/--).
- High barriers to market entry. Potential new entrants to this market are dissuaded by the high costs required to establish a branch-based network and supply a very broad base of products. Standard & Poor's believes this market arrangement will continue to prevail in Europe over the long term. Possible new entrants, however, could establish themselves in niche geographic areas not fully covered by Wuerth.
- Low price sensitivity. Most of Wuerth's proceeds are not subject to price pressures, owing to their low-ticket perception by customers and the related lack of transparency existing in the market.
- Strong diversification. Wuerth is well diversified by customer, product, and supplier. At the end of December 2008, the group had about 3 million customers in 86 countries, with an average order size of about €280 and more than 20,000 suppliers. The large number of customers, combined with the small size of orders, limits risks related to customer default, dependence on several key customers, and customer bargaining power. No single customer constitutes more than 1% of sales. The group maintains a wide presence in Germany (81 operating entities) and a strong position in the rest of Europe, and is also active in North America, South America, Asia-Pacific, and Africa. We expect the trend toward expanding internationally rather than through German operations to continue in the medium term.

These supports are partially offset by:

- The large revenue stake generated by operations in Germany and Western Europe. This exposes the group to a relatively unpredictable German construction market and cyclicity in fairly consolidated markets with moderate organic growth potential.
- Standard & Poor's opinion that overall, Wuerth's exposure to industry cycles is limited because of the broad variety of sectors served, including metalworking, automotive, woodworking, construction, and other allied companies, although the group is not immune to the current global economic downturn and recession in many of its key markets.
- Wuerth's quickly growing subsidiary network and ongoing acquisitions. Although Wuerth's proven market entry approach provides a competitive strength that supports a successful continuation of market consolidation in the long term, it exposes the group to new country risks, such as in some emerging markets, and integration risks. The group's aim is to supply the entire range of low-ticket items to its customer base in any given market.

## Financial Risk Profile: Modest, Underpinned By Sustainable Cash Flow Generation

The main strengths of the modest financial risk profile are:

- Wuerth's conservative financial policy. The group focuses on maintaining an equity base large enough to readily underwrite its growth initiatives, while also responding to management's interest in maintaining conservative financial policies. Shareholders remain committed to upholding Wuerth's status as a privately held group.
- The successful track record of the management and owners in preserving the balance sheet and cash flow generation when needed. This includes cutting discretionary spending and dividends, which should support sustainable cash generation.
- Wuerth's good working capital management, with low cyclicity over a business cycle.
- Our expectation that free operating cash flow will be sufficiently strong to accommodate Wuerth's operating requirements and small acquisitions in the medium term.

These strengths are moderated by:

- Past increased dividend payouts and tax investigation. We note that closed tax investigations have, among other drivers, led to increased cash payouts to shareholders, which have been more aggressive than we expected. We understand, however, that this should be nonrecurring and believe that the management and owners remain strongly committed to the group's financial strength.
- Our expectation that Wuerth will continue investing in bolt-on acquisitions as part of the group's growth strategy. Nevertheless, management has a strong track record of integrating those successfully.
- Debt funding that relies predominantly on capital markets, with €1,147.9 million of outstanding bonds at the end of 2008. Wuerth is reluctant to access equity markets as a family-owned group.

## Financial Statistics/Adjustments

Wuerth's consolidated financial statements are prepared in accordance with International Financial Reporting Standards. Standard & Poor's undertakes a number of analytical adjustments in arriving at its key ratios (see table 1).

Our most significant adjustments to Wuerth's reported figures are:

- Operating leases. The net present value of operating-lease commitments amounted to about €445.8 million in 2008 (about €440 million in 2007) and was added to the group's debt position.
- Surplus cash. For the purpose of calculating debt figures, we deduct the centrally available amount of cash and cash equivalents and highly liquid short-term investments, thereby excluding the cash amount tied to operations.
- Deconsolidation of Internationales Bankhaus Bodensee AG (IBB). Wuerth's capital structure weakened in 2006 due to the full consolidation of the 88.55% participation in IBB, a small local bank in southern Germany. We have deconsolidated related contributions to reflect the group's underlying financial performance in line with our criteria for corporation-owned financial institutions that are not considered captive finance units. In our analysis, we consider both the group's industrial and financial operations.

Table 1

**Reconciliation Of Wuerth GmbH & Co. KG, Adolf Reported Amounts With Standard & Poor's Adjusted Amounts\***

--Fiscal year ended Dec. 31, 2008--

**Wuerth GmbH & Co. KG, Adolf reported amounts**

(Mil. €)	Debt	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	2,063.4	853.0	853.0	575.1	103.2	488.7	488.7	415.8
<b>Standard &amp; Poor's adjustments</b>								
Operating leases	445.8	185.4	24.9	24.9	24.9	160.5	160.5	163.9
Postretirement benefit obligations	119.5	9.4	9.4	9.4	6.1	3.7	3.7	--
Surplus cash and near cash investments	(242.1)	--	--	--	--	--	--	--
Capitalized development costs	--	(4.7)	(4.7)	0.3	--	(4.7)	(4.7)	(4.7)
Deconsolidation/Consolidation	(612.7)	(21.5)	(21.5)	(15.4)	--	--	(6.4)	--
Reclassification of nonoperating income (expenses)	--	--	--	42.1	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	(74.9)	(74.9)	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	140.8	--
Minority interests	--	--	--	--	--	--	--	--
Total adjustments	(289.5)	168.6	8.1	61.3	31.0	84.6	219.0	159.2

**Standard & Poor's adjusted amounts**

	Debt	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	1,773.9	1,021.6	861.1	636.4	134.2	573.3	707.7	575.0

\*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Table 2

**Wuerth GmbH & Co. KG, Adolf Peer Comparison\***

	Wuerth GmbH & Co. KG, Adolf§	Grainger (W.W.) Inc.	WESCO Distribution Inc.¶
Rating as of June 19, 2009	A/Stable/A-1	AA+/Stable/A-1+	BB-/Stable/--
<b>(Mil. €)</b>			
<b>--Fiscal year ended Dec. 31, 2008--</b>			
Revenues		8,765.4	4,912.8
EBITDA		861.1	709.3
Net income from continuing operations		414.1	340.9
Funds from operations (FFO)		707.7	497.7
Cash flow from operations		573.3	394.4
Capital expenditures		575.0	168.0
Discretionary cash flow		(235.1)	139.2

**Table 2**

<b>Wuerth GmbH &amp; Co. KG, Adolf Peer Comparison* (cont.)</b>			
Debt	1,773.9	566.8	916.2
Equity	2,486.1	1,458.6	525.0
<b>Adjusted ratios</b>			
EBITDA/revenues (%)	9.8	14.4	6.4
Operating income (before D&A)/revenues (%)	11.7	14.1	6.7
EBIT interest coverage (x)	4.7	22.0	6.6
EBITDA interest coverage (x)	6.4	26.7	7.2
Return on capital (%)	15.6	30.8	16.6
FFO/debt (%)	39.9	87.9	22.0
Debt/EBITDA (x)	2.1	0.8	3.3

\*Fully adjusted (including postretirement obligations). †Fully adjusted. ‡Excess cash and investments netted against debt.

**Table 3**

<b>Wuerth GmbH &amp; Co. KG, Adolf Financial Summary*</b>					
<b>(Mil. €)</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Rating history	A/Stable/A-1	A/Stable/A-1	A/Stable/A-1	A/Stable/A-1	A/Stable/A-1
Revenues	8,765.4	8,445.8	7,714.2	6,913.9	6,203.2
EBITDA	861.1	905.7	754.6	701.5	610.9
Net income from continuing operations	414.1	409.4	299.0	330.9	259.5
Funds from operations (FFO)	707.7	774.4	755.9	692.5	530.1
Cash flow from operations	573.3	560.4	590.3	576.9	384.4
Capital expenditures	575.0	661.6	549.7	410.4	273.9
Free operating cash flow	(1.8)	(101.2)	40.6	166.5	110.5
Debt	1,773.9	1,352.5	1,167.7	1,055.0	1,044.6
Equity	2,486.1	2,368.6	2,247.1	2,048.7	1,715.1
<b>Adjusted ratios</b>					
EBITDA/revenues (%)	9.8	10.7	9.8	10.1	9.8
Operating income (before D&A)/revenues (%)	11.7	12.5	11.5	11.9	10.8
EBIT interest coverage (x)	4.7	6.9	6.9	7.8	6.7
EBITDA interest coverage (x)	6.4	8.9	9.0	10.4	9.3
Return on capital (%)	15.6	19.3	17.4	17.8	15.7
FFO/debt (%)	39.9	57.3	64.7	65.6	50.7
Debt/EBITDA (x)	2.1	1.5	1.5	1.5	1.7

\*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

**Ratings Detail (As Of June 19, 2009)\*****Wuerth GmbH & Co. KG, Adolf**

Corporate Credit Rating	A/Stable/A-1
Senior Unsecured (5 Issues)	A

**Corporate Credit Ratings History**

19-Jan-2000	A/Stable/A-1
22-Jul-1997	A-/Positive/--
25-Oct-1996	A-/Stable/--

<b>Ratings Detail</b> (As Of June 19, 2009)*(cont.)	
<b>Business Risk Profile</b>	Strong
<b>Financial Risk Profile</b>	Modest
<b>Debt Maturities</b>	
As of Dec. 31, 2008	
2009: €176.7 mil.	
2010-2013: €917.1 mil.	
Thereafter: €321.7 mil.	
*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.	

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