Franz Haniel & Cie. GmbH ('Haniel')
Reduced asset and dividend concentration from METRO demerger

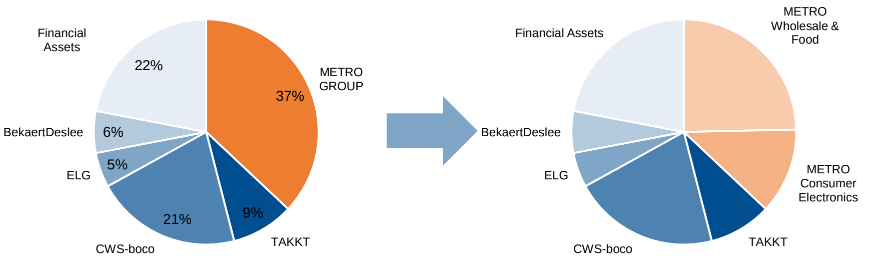
On 6 September METRO GROUP – one of Haniel's core dividend payers – shed more light on its demerger plans into two new entities. Scope therefore considers that a demerger into two independent entities – which are fungible and fully backed by Haniel – would strengthen the holding company's investment portfolio by making dividend streams more diverse and robust. Overall, Scope's rating case for Haniel's BBB- Corporate Issuer Credit Rating is supported by its improving cost coverage, thanks to recurring dividends from portfolio companies.

Reduced asset and dividend concentration for Haniel

METRO's demerger plans include splitting the group into two stock-listed entities: i) a wholesale and food specialist group comprising the 'cash and carry' and hypermarket business (METRO, MAKRO, Real); and ii) a consumer electronics group (Media-Saturn) – see appendix 1. The transaction would be closed mid-2017 at the earliest.

While METRO's demerger might not directly alter the total dividends to its shareholders in the short term, Scope expects Haniel's credit quality to benefit regardless. With currently five dividend-paying subsidiaries the holding company's comparatively low asset and dividend diversification is rather a constraining credit driver. As of March 2016 Haniel's asset concentration is high, with 37% of the portfolio's market value in METRO shares. A break up of METRO into two independent and uncorrelated entities will likely strengthen Haniel's asset and dividend diversification. Scope believes that asset concentration to the largest subsidiary can be reduced to below 25%. The demerger is particularly crucial to Haniel's dividend streams, as the two new entities differ in cyclicality and hence have different cash-flow patterns. While Scope regards the 'cash and carry' business as a robust and low-risk business that provides stable dividend streams to the holding (core dividend payer), the Media-Saturn business is more volatile, with a higher likelihood of dividend swings (additional dividends). The demerger could also prevent METRO again scrapping its entire dividend, as it did for 2014, which was due to weak financial performance and corporate restructuring.

Figure 1: Asset concentration (PMV) as of 31 March 2016 (left) and after the METRO demerger* (right)



* Future asset concentration depending on market developments and possible investments/divestments

Source: Scope Ratings

METRO exposure likely to be reduced further

Haniel's current exposure of 25% in METRO, hence the METRO subsidiaries, does not fully match the holding's investment strategy and portfolio focus (so-called 'Mittelstandsinitiative'). Scope understands that Haniel is likely to reduce its exposure to the METRO group in the long run. Firstly, the newly issued EUR 500m exchangeable bond could reduce the holding's exposure to METRO and its successor organisation CE CO (consumer electronics group) respectively. Secondly, the demerger would enhance liquidity in Haniel's portfolio as the two new fungible entities' shares can be sold independently. Such liquidity would allow Haniel to fund acquisitions of assets/companies that are better suited to its target portfolio, i.e. mature dividend-paying SMEs.

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Related Research

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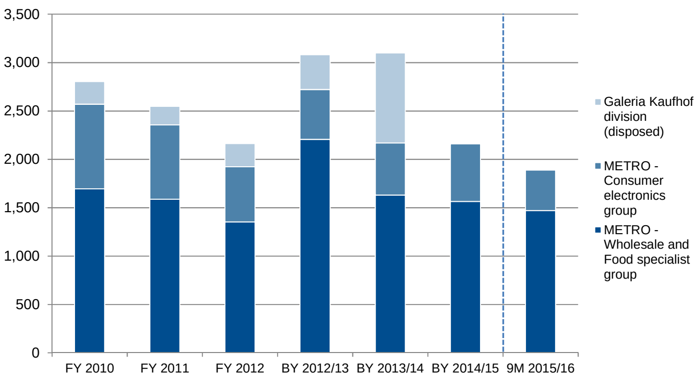
METRO in calmer waters with more robust dividend prospects

While METRO's dividend freeze for its BY 2013/14 was the main driver behind the dip in Haniel's total-cost coverage from recurring activities to 0.2x in 2014, Scope believes such a distortion is unlikely to be repeated over the next few years. METRO's credit profile has suffered slightly over the past years, which was due to the corporate restructuring necessitated by METRO's excessive expansion prior to 2013 and by the poor performance of Galeria Kaufhof, a retail company that METRO has since sold. Scope acknowledges that METRO has entered calmer waters following the disposal of Galeria Kaufhof and the consequent reduction of net debt by approximately EUR 2.7bn backed by the disposal proceeds, as well as by the re-investments in METRO's remaining business segments. Overall, the group's underlying operating performance has stabilised, despite the reduced business diversification following the disposals of Galeria Kaufhof and a few other non-domestic ventures within the 'cash and carry', Media-Saturn and Real units.

As a result, the dividend payment to METRO shareholders has again resumed, increasing from EUR 0.90 per share in 2015 to EUR 1.00 in 2016. This should be sustained by the stabilised underlying operating performance of the METRO divisions, reduced short-term refinancing needs as well as the remaining cash buffer of EUR 1.6bn on 30 June 2016.

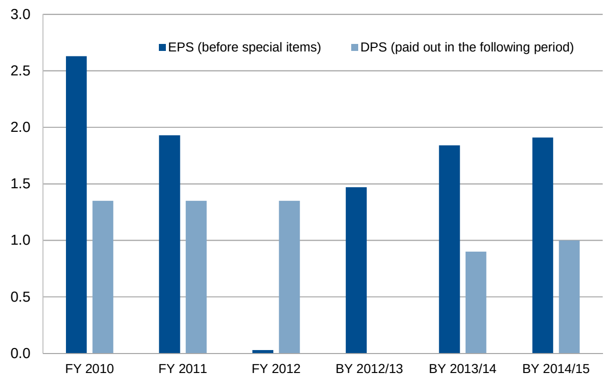
Moreover, METRO gave more guidance on the targeted credit quality of the two new entities. METRO intends to create capital structures with leverage ratios for the two newcos which are commensurate to investment grade ratings. This would imply the allocation of the larger portion of METRO's debt to the wholesale and food specialist group. While this concept needs to be proven, the intentions underpin that the two newcos are likely to provide robust and reliable dividend streams which will be less affected by pressure on the balance sheet.

Figure 2: EBITDA development of METRO segments (EUR m)



Source: METRO, Scope Ratings

Figure 3: METRO EPS and dividend development (EUR)



Source: METRO, Scope Ratings

Haniel H1 2016 results in line with rating case

Haniel's H1 2016 results, which show that all portfolio companies but ELG exhibit improving operating results, underpin Scope's expectations of Haniel's full cost coverage from recurring dividend payments becoming more robust. Particularly the increased dividends from METRO and TAKKT as well the first material dividend prospects from the most recent investment company, BekaertDeslee, support our expectations that Haniel's fixed-charge coverage (full cost coverage) will be at 1.0x in 2016, avoiding the need to tap the cash buffer or to force any asset sales.

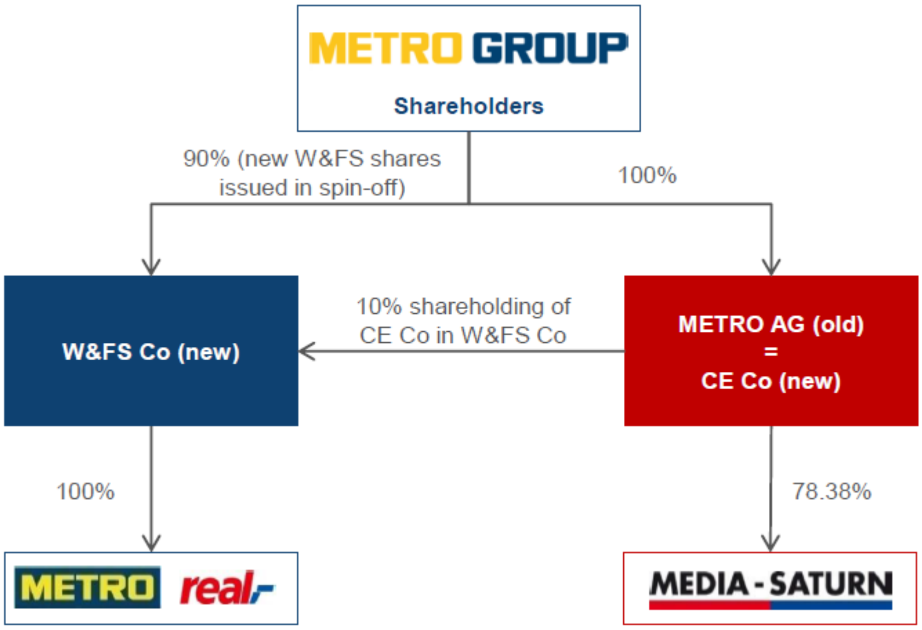
On 30 June 2016, Haniel's portfolio market value reached around EUR 6bn. With a net financial debt position of about EUR 1bn, the holding's LTV of 17% stands at a healthy level for the BBB- corporate rating. Scope highlights that the holding would be net cash, with net debt being fully offset by non-core disposable financial assets. The holding therefore has room for manoeuvre to either extend the investment portfolio if opportunities arise or reduce its gross debt position.

Nevertheless, Scope acknowledges that Haniel does not face immediate pressure to use up its potential financing volume of more than EUR 1bn for further SME acquisitions before reaching the communicated EUR 1bn net debt target.

Conclusion

Recent developments and the diversification effect from the execution of a METRO demerger underpin Scope's view on a sustainable total cost coverage above 1.0x which is the most important driver behind the BBB- corporate issuer credit rating. The increased diversification from the METRO demerger as well as from the most recent portfolio additions of Bekaert in 2015 and DesleeClama in 2016 in conjunction with the tight control on net debt is much welcome from our credit perspective.

APPENDIX 1: Simplified transaction structure of METRO demerger



Source: METRO

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