

Fitch: Negative Credit Outlook for W. European Construction & Homebuilding in 2009

Fitch Ratings-London-19 January 2009: Fitch Ratings says today that the 2009 credit outlook for western European (WE) construction and homebuilding companies appears increasingly negative as economic conditions worsen and access to finance remains difficult.

"The homebuilding sector remains of greatest concern to Fitch in terms of western European construction. The agency expects the sharp contraction in housing demand seen in 2008 to continue well into 2009, leading to further financial strains on the sector," says Ewan Macaulay, Associate Director in Fitch's EMEA Construction and Property team. "Conversely, Europe's large diversified construction majors have exhibited little sign of being affected by the global financial crisis to date, but negative pressures are expected to mount here also during 2009, although their ratings are supported by the stability and cash-generative nature of their non-construction units."

Fitch expects worsening economic conditions across the region to cause a fall in construction margins and volumes (with volumes forecast to fall 5% across WE on average in 2009, but with significant regional variation). Strong order books built up during the boom years of the mid-2000s will likely begin shrinking in 2009 and weaken future revenue generation prospects. Fitch is concerned that the speed and scale of the expected construction downturn during 2009 could be pronounced, especially for real estate construction.

Despite the weakening market conditions, the agency expects the credit profiles of its rated construction majors - Bouygues ('BBB+'/Stable), OHL ('BBB-'/(BBB minus))/Stable) and Vinci ('BBB+'/Stable) - to exhibit some resilience during 2009. Credit profiles will be supported by the diversified nature of these entities, which over recent years have moved into relatively stable infrastructure concessions, Public Private Partnerships (PPPs) and services. These non-construction activities tend to be strong cash generators and should help offset weakening construction cash flows. Furthermore, the rated majors have little direct exposure to the worst-affected construction segments in WE, notably homebuilding, tending instead to be more exposed to infrastructure construction. Fitch does not expect a major decline in demand for infrastructure in 2009 (with volumes forecast to fall in WE by about 1-2% yoy, compared to about 15% for homebuilding), supported by large-scale government infrastructure projects and boosted by recently announced national and EU stimulus packages.

Although lending, including bond issuance, to the construction sector will likely remain tightly rationed during 2009, refinancing risks remain relatively low for the majors given their good access to back-up liquidity, including cash and committed undrawn lines and continuing support from relationship banks. Nevertheless, if the rationing of credit persists well into 2009, this in combination with an expected drop in construction cash generation could increase downside pressure on ratings in the sector.

Of greater concern continues to be the WE housebuilding sector, where demand for new housing continues to fall sharply across most countries. Initially driven by a severe contraction in mortgage lending, and oversupply in certain countries such as Spain, the housing downturn has been compounded since mid-2008 by worsening macroeconomic conditions. Fitch expects the WE homebuilding downturn to persist into at least 2010, albeit with some country variation. As a result, many WE homebuilders are likely to face depressed earnings, falling asset values and weak operating cash flows during at least 2009 and 2010. This may lead to further pressure on financial covenants, a problem already seen during 2008, which in turn could create liquidity problems (such as debt prepayments or the removal of undrawn lines) if lenders are unwilling to reset these covenants. Taylor Wimpey plc's IDR (currently 'CCC'/Rating Watch Negative) was downgraded several times in 2008 due to covenant-related problems.

Fitch is also concerned that the expected deterioration in operating cash flow could create significant problems for highly levered housebuilders, with interest payments and debt amortisations becoming increasingly onerous. This could make debt servicing impossible for some homebuilders without a restructuring of debt or substantial equity injections. LBOs in the UK, France and Spain could be particularly prone to such a risk and could follow another LBO homebuilder - Martinsa-Fadesa of Spain - into default. Fitch currently rates a number of homebuilding LBOs on a non-public 'shadow' basis, with the vast majority currently rated 'CCC*' or lower.

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Note to editors: '*' suffix indicates that the shadow rating is not fully comparable in all regards with published ratings at that level. Please see the agency's public website (www.fitchratings.com) under "Resource Library" - "Ratings Definitions" for a formal description of Shadow Ratings.

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