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Weekly Credit Brief May 05 - May 11

The world's largest nuclear company seeks ways to survive

by Victor Liu

Areva SA, the world's largest nuclear-engineering company which is 87% owned by the French government, announced on May 7 that it plans to cut 6,000 jobs over the next three years. The layoff is part of the company's cost-cutting scheme, which indicates that the firm is aggressively seeking ways to turn around in the business headwind. This March, Areva just reported its fourth consecutive net loss of EUR 4.8bn, which was so high that it exceeded the company's market cap. The poor profit performance resulted from the company's failure to manage the risks inherent in large projects, the stagnation of the nuclear operations and a general slump of demand for new nuclear reactors after the Fukushima disaster in 2011. The RMI 1-year probability of default (PD) has well reflected Areva's business predicament. As shown in Figure 1, the company's RMI 1-year PD increased to 72bps on May 8, 2015 from 6bps at the end of 2013, in tandem with the 66% plunge in market cap during the same period.

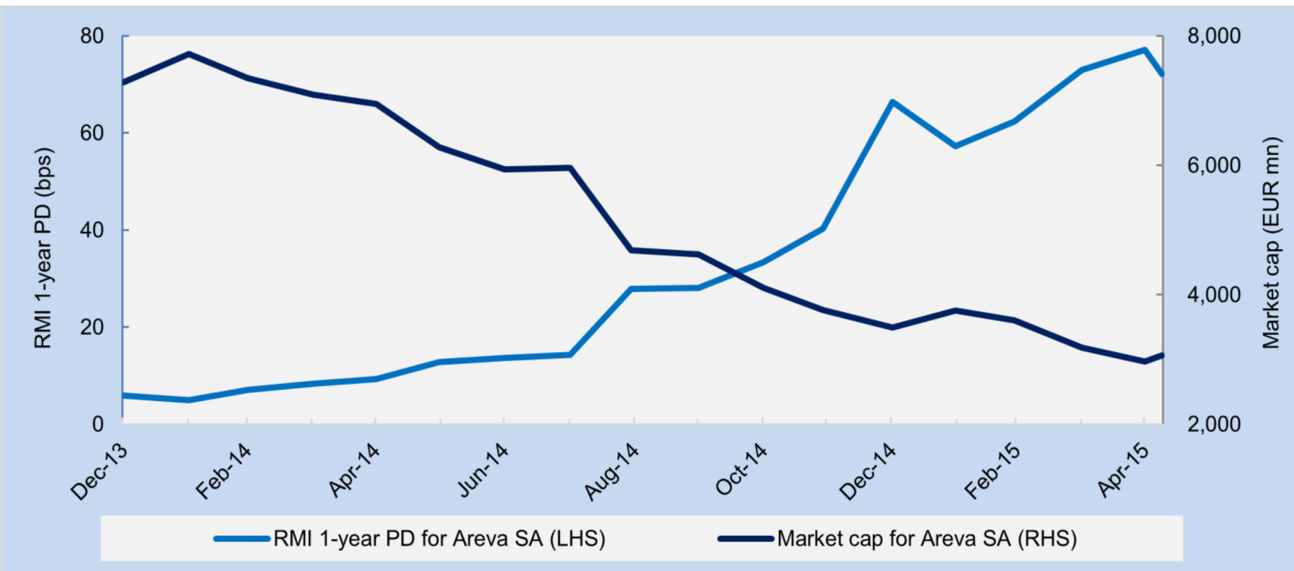

Figure 1: RMI 1-year PD and market cap for Areva SA. *Source: Risk Management Institute, Bloomberg*

Taking a closer look at the company's financial profile in Table 1, one can see that although the revenue simply dropped by 10% YoY in the challenging business environment, the net loss sharply widened by approximately 10 times the amount in 2013 and the operating cash flow shrank correspondingly. The huge cost overruns at its two largest projects in Finland and France and the impairment charges due to ill-timed investment in mining assets explained most of the net loss in 2014. As for the degree of leverage, the debt ratio increased from 84% to 101% in the past year. The larger-than-100% debt ratio means the debt level is higher than total asset; in other words, the huge net loss has made the company's net worth negative.

(EUR mn)	FY 2013	FY 2014
Revenue	9,240	8,336
Net income	-494	-4,834
Cash from operations	1,030	190
Total debt / total asset	84%	101%

Table 1: Financial data for Areva SA. *Source: Bloomberg*

Despite the fragile financial profile, the silver lining is that Areva has no liquidity problem in the short run. As shown in Figure 2, Areva still has EUR 1.7bn cash in hand at the end of 2014, which is quite enough to cover most of the debt repayment in the year of 2015 and 2016 unless the company continues to make huge losses and suffer operating cash outflows. Nevertheless, the liquidity problem remains in the long run. After Areva burns out the current cash level, it will be very difficult for the company to raise new debt due to its negative net worth and lack of profitability. According to the company, the only solutions could be selling part of the company's non-strategic assets, slashing costs and receiving possible capital infusion.

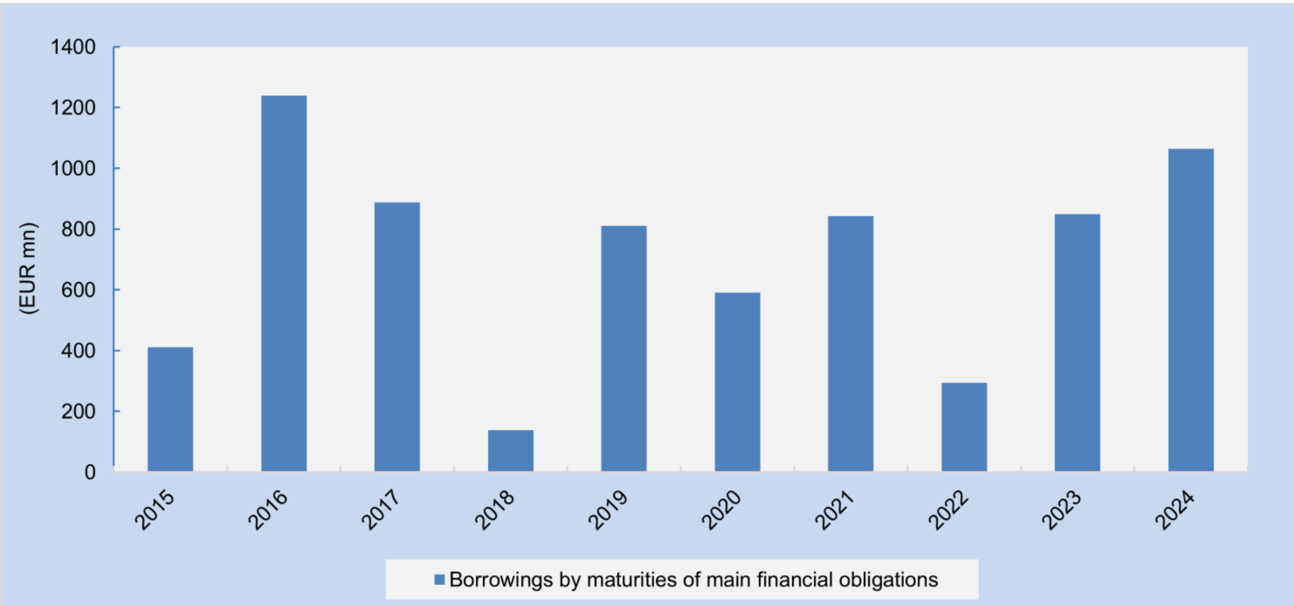

Figure 2: Borrowings by maturities of main financial obligations for Areva SA as of Dec 31, 2014. *Source: Company website*

Although the company has pledged to reduce capital expenditure to less than EUR 3bn between 2015 and 2017 and cut its costs by EUR 1bn by 2017, including talking with the union about the global layoff, it is not until the French government decides to inject capital and comes up with an effective rescue plan that Areva's financial tension could be relieved.

Credit News

IMF works with bank regulators on contingency plans for Greek default

May 11. The International Monetary Fund is working with national authorities in south eastern Europe on contingency plans for a Greek default, since Greek banks are big players in some of its neighbours' financial systems. The IMF has asked national supervisors to ensure that subsidiaries of Greek banks have enough assets that they can exchange for emergency financing at their own central banks. With these requirements, the IMF believes that subsidiaries of Greek banks in south eastern Europe should be able to withstand the failure of their parent companies. Meanwhile, the IMF has nevertheless urged national supervisors and governments to keep a close eye on the situation. (WSJ)

Sharp shares slump as panel maker considers cutting capital

May 11. Sharp Corp. plunged in Tokyo after the debt-saddled Japanese display maker said it's considering reducing capital and issuing preferred shares to shore up the balance sheet. It will cut its capital by more than 99% to JPY 100mn and issue preferred stock. Its shares slumped as much as 26%, the most since August 2012, to JPY 190. The main purpose of the move is to erase retained losses and makes the company able to distribute dividends again. It will also dilute common shareholders, reclassify Sharp as a small- to medium-sized company to lower its tax rate and eliminate accumulated losses. (Bloomberg)

Moody's warns UK credit rating could be hit if country leaves the EU

May 11. Moody's has warned the UK's credit rating could be downgraded if the country leaves the European Union. The ratings agency currently has Britain on an AA1 rating with a stable outlook. Kathrin Muehlbronner of Moody's said: "If Conservative plans to hold a referendum on European Union membership result in the UK's withdrawal, this could have further consequences for the whole economy. The sovereign rating could potentially be affected if the UK is not able to broadly replicate the benefits of membership." This warning will be issued in a report published after David Cameron's Conservative Party secured a majority in the general election. (International Business Times)

China rate cut to dominate market trading

May 11. China's third rate cut in six months is set to dominate trading in Asian markets. The People's Bank of China cut deposit and lending rates by 0.25% with the purpose of supporting the slowing economy and stimulating growth. The rate cut was not a surprise since economic conditions have continued to deteriorate, as economic growth in Q1 slipped to 7%, the slowest pace since 2009. Many economic analysts believe the central bank may not be finished with introducing easing measures, having cut interest rates and relaxed banks' reserve requirements five times in the past six months. (FT)

Low bad-debt rate belies credit crunch risk at China banks

May 9. According to the China Banking Regulatory Commission, the average non-performing loan ratio of banking sector was 1.39% by the end of March. This is much lower than what industry watchers such as DBS Vickers had expected. But the biggest risk to asset quality and a potentially severe credit crunch were not reflected in the ratio. Property-backed collateral loans have risen to 40% of total lending, an increase of 400% since 2008. In case the mainland property market sees an abnormal downturn, banks face the risk of a shrinking value in the collateral they hold. (SCMP)

Yellen cites 'potential dangers' in US stock valuations (Reuters)

Global bond selloff reaches Asia (WSJ)

Tesla posts wider loss, highlights energy storage demand (Reuters)

Australia walks budget tightrope (WSJ)

Regulatory Updates

Fed faces limits on lending powers during crises

May 11. The Federal Reserve's ability to give emergency loans to distressed institutions in a crisis would be restricted under legislation being prepared by lawmakers who want to stop "backdoor bailouts". The Fed contained panic during the crisis by offering emergency loans to institutions facing liquidity crunches. The bill could be introduced by the senators as early as May 12. Jerome Powell, a Fed governor, said in February that "it would be a mistake to go further than the Dodd-Frank amendments and impose additional restrictions." (FT)

Shelby said to weigh freeing banks from costly risk label

May 8. The head of the US Senate Banking Committee, Richard Shelby, is putting the final touches on a bill that could free about two dozen mid-size lenders, including US Bancorp and SunTrust Banks Inc., from the stringent capital requirements and tough oversight. This could be the biggest changes to the Dodd-Frank Act since its 2010 enactment. If the plan were to become law, regional banks might be able to avoid onerous capital and supervision standards imposed on institutions regarded as too-big-to-fail, such as JPMorgan and Bank of America. (Bloomberg)

Australian banks getting started on raising capital

May 8. National Australia Bank Ltd, Westpac Banking Corp and Australian & New Zealand Banking Group Ltd, Australia's top banks, have announced the largest collective fundraising since the global financial crisis. They revealed proposals to raise a combined AUD 8bn (USD 6.4bn) in capital to bolster their reserves against potential mortgage losses at home and to meet tougher global standards. More capital raisings are likely if regulators require the banks to set aside more capital and to lift capital ratios to higher global standards. (Business Times)

EBA publishes its final Guidelines on triggers for the use of early intervention measures

May 8. The European Banking Authority (EBA) published its final Guidelines on triggers for the use of early intervention measures. The Guidelines links the on-going supervision conducted by the Competent Authorities according to the Capital Requirement Directive (CRD) and by the early intervention powers set out in the Bank Recovery and Resolution Directive (BRRD). The purpose of the Guidelines is to promote convergence of supervisory practices. (EBA)

CBRC urges banks to increase lending to small businesses (Gulf Times)

Suspected rate rigging spurs probe of local companies (Taipei Times)

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