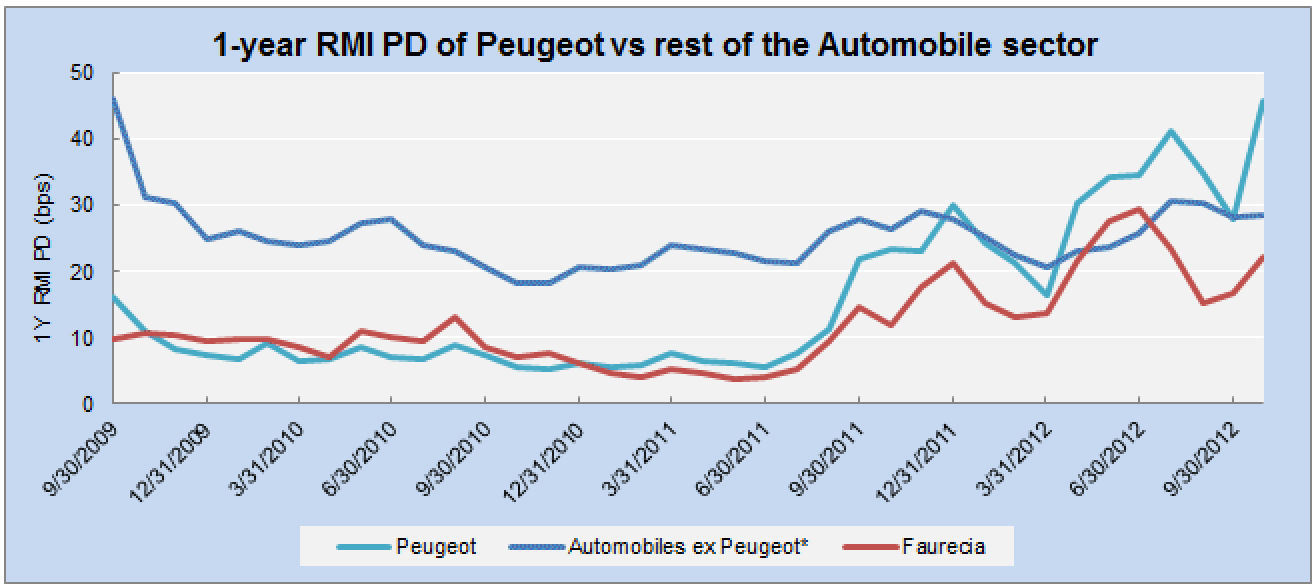
Weekly Credit Brief
Oct 23 - Oct 29 2012

Stories of the Week

Higher default probability seen for Peugeot

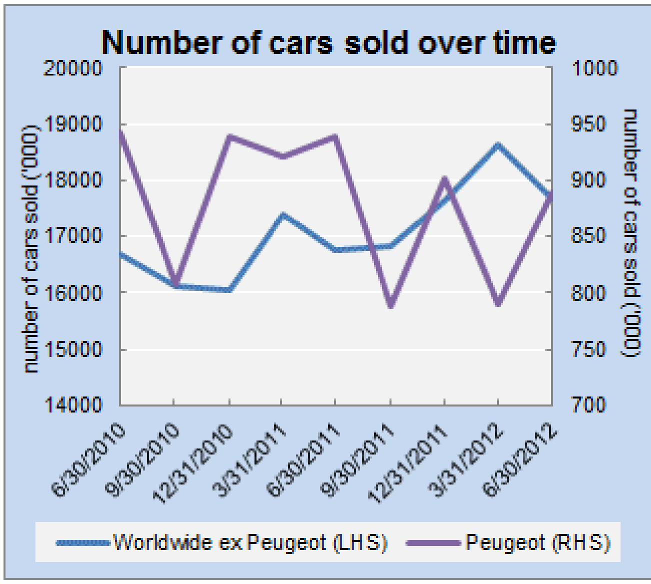
The French automobile industry is undergoing its worst period since the 2008 crisis. Peugeot, the holding company of PSA Peugeot Citroen Group, is facing its highest risk of default in years. The RMI 1-year probability of default (RMI PD) for the company has climbed significantly in recent months, and crossed the aggregate RMI PD for the Automobile sector* again last week after falling slightly during September. The RMI PD for Peugeot reached the highest level since March 2009 on October 29, reflecting a continued weakening in the firm's credit profile.

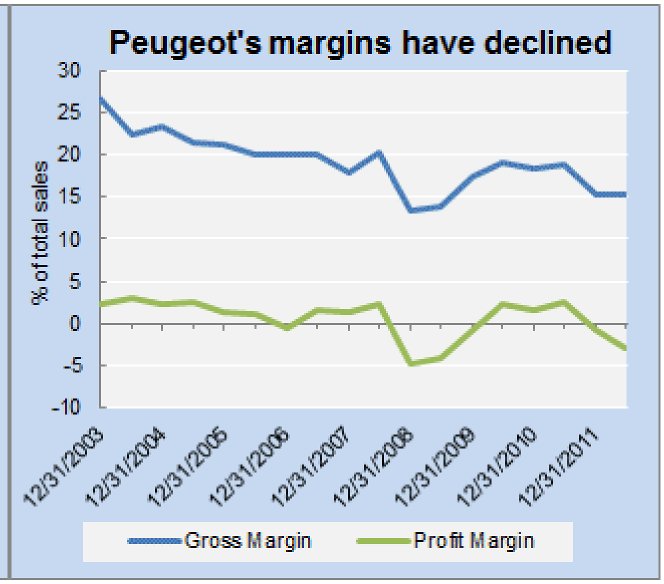
PSA Peugeot Citroen Group is a conglomerate operating a number of major business divisions. The Automotive Division is responsible for the design and manufacture of cars and light commercial vehicles. Gefco operates the transportation and logistics division, a unit OAO Russian Railways has agreed to buy. The Finance division, run by Banque PSA Finance provides retail and wholesale financing to Peugeot and Citroen customers and dealers. The group also has a controlling stake in Faurecia, which manages the automotive equipment division. The RMI PD of Faurecia, displayed below, has risen in tandem with the RMI PD for Peugeot.



European woes: Demand for automobiles across the 27 European countries fell 10.8% YoY in September. The debt crisis in the eurozone, sluggish economic growth, austerity measures, high unemployment and limited access to finance for consumers have combined to weaken automobile demand. The European Commission Economic Sentiment Indicator, an assessment of business and consumer expectations throughout the EU, reached the lowest level on record during September.

Misguided business strategies: Peugeot's business strategy of targeting middle class consumers in Europe appears to be poorly conceived. It lacks the required market diversification to survive the eurozone downturn. Europe accounts for 75.9% of Peugeot's overall revenues while emerging markets that have reported increasing sales over the last few quarters, like Asia and Latin America, account for only 4.7% and 9.2% respectively. Within Europe Peugeot faces stiff competition from South Korean rivals Hyundai and Kia while their growth strategy in emerging markets has been extremely sluggish. Their recent focus to move into the luxury car market is daunting with aggressive market players like Audi and BMW in the mix. Unlike General Motors and Toyota that have diversified customer bases and a wide spectrum of vehicles, Peugeot finds itself sandwiched between global competitors and luxury brands.





Strong competition hurting sales: Peugeot's global market share has fallen gradually as it went from the eighth largest player (with a 5.0% share) in Q3 2008 to the tenth largest in Q2 2012 (accounting for 4.1% of worldwide sales). The firm competes in an industry fiercely dominated by the largest four automobile companies: Toyota Motor Corp (12.8%), General Motors Co (11.7%), Volkswagen (11.1%) and Renault-Nissan (10%). Peugeot's financial statements suggest that auto sales at the group are following a gradual but highly fluctuating pattern. The number of cars Peugeot has sold per quarter has remained between 790,000 and 950,000 since 2010 while global sales at other companies have steadily increased quarter after quarter.

Too much leverage: Besides operating in a competitive environment, Peugeot's highly leveraged balance sheet meant that a small change in sales would translate into a large change in operating profit. Its Debt to EBITDA ratio is 10.09 times, more than twice the sectoral average of 4.7. The firm has undertaken drastic measures to shore up its balance sheet. To strengthen the business, Peugeot SA entered into a strategic alliance with General Motors (GM) which is expected to bring in about EUR 2bn annually over the next 5 years, funded partially by a EUR 1bn rights issuance. Additionally, the company agreed to sell its 75% holding in Gefco for EUR 800mn and is looking to save EUR 1.5bn through 2015 from cost cutting measures.

Banque PSA Finance: Peugeot's stake in the bank remains a concern amidst continued uncertainty in European financial markets. The bank's earnings could be affected by market volatility and loan defaults. During the first half of 2012, Banque PSA Finance borrowed EUR 800mn from the ECB through the long term refinancing operation (LTRO). The lender has found it difficult to access capital markets since yields on the company's 5-year 4.25% bond reached 7.13% on October 1. Last week, Peugeot resorted to state backing to boost confidence at the bank. The French state will guarantee as much as EUR 7bn in new bonds for the carmaker's finance arm, but its survival in the long term depends on its ability to restructure and deleverage aggressively.

* The aggregate RMI PD for the global automobile sector is an equally weighted average of 37 auto companies, excluding Peugeot for comparative purposes.

Sources:

France's quiet bank rescues top USD 78bn with Peugeot (Bloomberg)
Peugeot workers call fresh strike (Daily Mail)
Peugeot in talks to sell 75% Gefco stake (FT)
Report highlights Peugeot strategic errors (FT)
European car sales fall for 12 months in row (BBC)

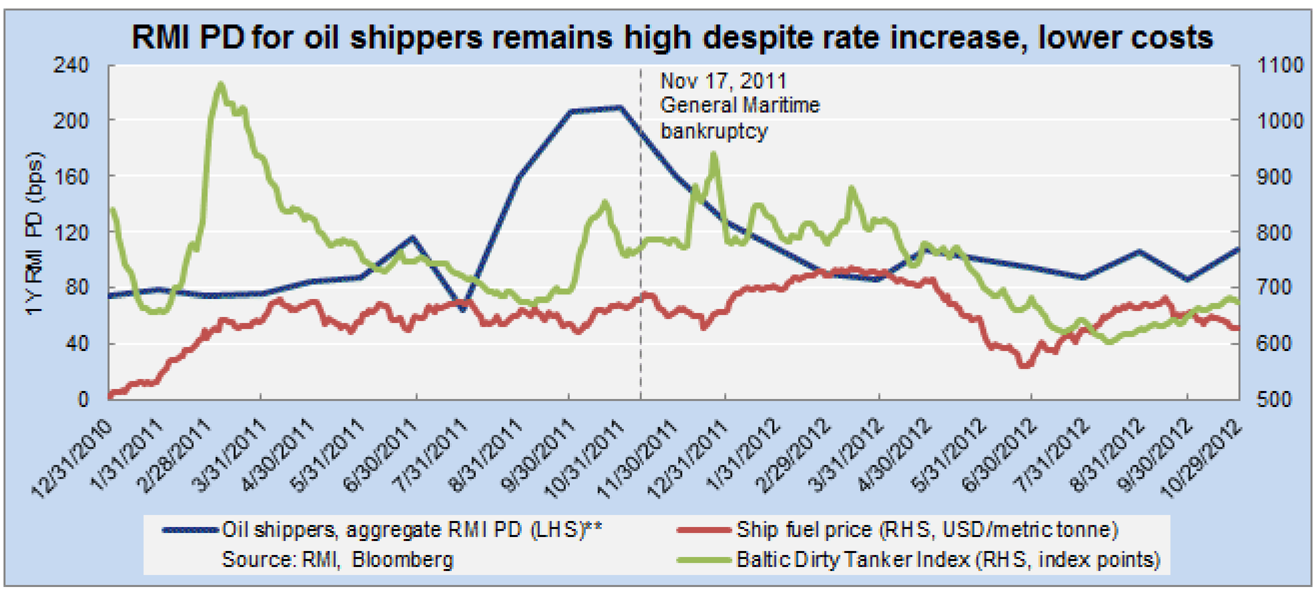
Overseas Shipholding Group nears failure, illustrating sectoral risks
By James Weston

US-based Overseas Shipholding Group (OSG) continues to illustrate the risks facing the global oil tanker industry, as the company's 1-year RMI probability of default (PD) soared above 60% last week. The largest US oil tanker company announced on October 22 that it could consider filing for Chapter 11 bankruptcy protection, among other strategic options, as the company continues to face a severe liquidity crisis.

A potential bankruptcy filing would make OSG the largest US-based shipper to seek creditor protection since General Maritime filed for Chapter 11 in November 2011. OSG said a tax issue arising from its US domicile and substantial international operations relating to provisions in a loan agreement meant its financial statements for the last four years can no longer be relied upon.

OSG continues to face a USD 100mn funding shortfall on a USD 1.5bn liquidity facility, which expires in Feburary. Two European lenders were said to be seeking a buyer for USD 150mn of OSG debt last week, believed to include the shortfall. This indicates the company's lenders believe reorganization is close, looking to offload claims on the company's assets to distressed debt firms. The company remains in negotiations with banks over a restructuring of its balance sheet; the company has recorded losses in every quarter since March 2009. The company also faces a slew of lawsuits filed last week by investors over possible securities law violations.

RMI has previously noted that significant industry overcapacity and lower demand for oil exports amid higher oil stockpiles in US markets have placed pressure on shipping rates. In combination with high fuel oil costs, tankers are losing money on a number of key routes. Although the Baltic Dirty Tanker Index has recovered some ground and the price of ship oil has eased since August, the aggregate sectoral RMI PD** continues to indicate a weakening in the industry's credit outlook.



The global oil tanker fleet is set to expand 6.8% this year, higher than 4.8% demand growth, according to estimates by Clarkson PLC, the largest shipbroker globally. One of every six very large crude carriers (VLCCs) in the global fleet are currently located in the Persian Gulf, driving down rates on the benchmark Saudi Arabia to Japan route. On October 29, VLCCs were losing USD 2,258 daily on the voyage. This figure does not reflect speed cuts aimed at saving ship fuel.

** The aggregate RMI PD for the global oil tanker industry is an equally weighted average of 36 tanker companies, and excludes OSG. Readers should note the aggregate RMI PD may differ slightly from those previously published due to monthly calibration.

RMI users with global access can access the RMI PD for OSG at rmicri.org

Sources:
Oil tanker operator OSG near to failure (FT)

In the News

Banks say regulators should rewrite Basel III capital rules

Oct 23. US financial industry groups have responded to the Basel III proposals set out by US regulators, stating that they would hurt both the economy and the competitiveness of the US banking system if implemented. In a letter addressed to the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit, bankers asked for softer guidelines including easier to follow rules regarding risk-weighted assets. Industry observers have also provided their inputs to the proposals. Some of them disagreed on the need for small banks to participate in the Basel III requirements while others said that the proposed rules for the banks were not aggressive enough. (Bloomberg)

Chinese, US and Russian rating firms set up a JV to rival the Big Three

Oct 23. China's Dagong Global Credit Rating, US-based Egan-Jones Ratings (EJR) and Russia's RusRating have set up a joint venture to challenge the current oligopoly of Fitch, Moody's and S&P. The three major ratings agencies have been criticized for their involvement in the world economic crisis by giving risky US mortgages investment grade ratings. European politicians also blame the agencies for creating added tension throughout the eurozone crisis by downgrading sovereign ratings and established institutions. The joint venture, called Universal Credit Rating Group aims to provide independent ratings that will not serve the interest of any country or group. (Russian Times)

Australia regulator plans 'simpler, safer' securitization market

Oct 22. The Australian Prudential Regulation Authority (APRA) is working on securitization reforms aimed at making the nation's market for debt securitization simpler, safer and more attractive to global investors. The rules, to be implemented by 2014, will ensure that securitization arrangements do not encourage lax lending or tempt market participants to take advantage of each other through excess complexity. APRA expects Australian 'A' notes to be among the safest and simplest securitization investments available globally. The reforms will also ensure that liquidity is properly managed by limiting the amount of assets banks can pledge for securitization, and monitoring mismatches between asset and liability tenors. (Bloomberg, APRA)

China property loans surge in Q3

Oct 22. Bank lending to China's real estate sector recovered strongly in Q3, suggesting that property prices in the country may be stabilizing. CNY 416.8bn of loans were issued over the three months, representing a 29% increase from the previous quarter. Outstanding mortgage loans and loans to property developers increased 12.6% YoY and 12.1% YoY, respectively. Regulators have stopped buyers from owning more than two properties in the overheated real estate market, which has caused home prices to fall from levels seen last year. (Reuters)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: James Weston