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Integrity investigations cast shadow over FIAT

by RMI-CRI staff

Fiat Chrysler Automobiles NV (FIAT), Italy's largest automobile manufacturer, has been recently haunted by integrity investigations conducted by several authorities. The US Securities and Exchange Commission and the US Department of Justice put a spotlight on the firm's sales reporting practices. Fiat was alleged to aggressively recognize its sales figures, with 75 consecutive months of sales growth before revising accounting practices in July. The revisions indicated that the sales streak should have ended three years earlier, a fact that did not affect its financial results. Also, Germany's Transport Ministry has asked the European Commission to investigate exhaust emissions of FIAT's vehicles for potential illegal manipulation devices, while the Fiat spokeswoman said that the company's cars conform to current emissions rules and do not contain defeat devices.

These integrity investigations have indeed damaged the reputation of the company and reduced investors' confidence in the company. The firm's net profit margin was 1.1% in Q2 2016 versus the industry average of 5.0%, while its total debt to total capital ratio was 63.4% versus the industry average of 45.5%. The increased risk of the firm is also reflected in the firm's RMI-CRI PD.

As shown in Figure 1, the RMI-CRI 1-year Probability of Default (PD) for FIAT has stayed constantly at 200bps, much higher than that of its peers since January 2016, when the emissions rules were brought up to the spotlight in the automobile industry due to the scandal involving Volkswagen.

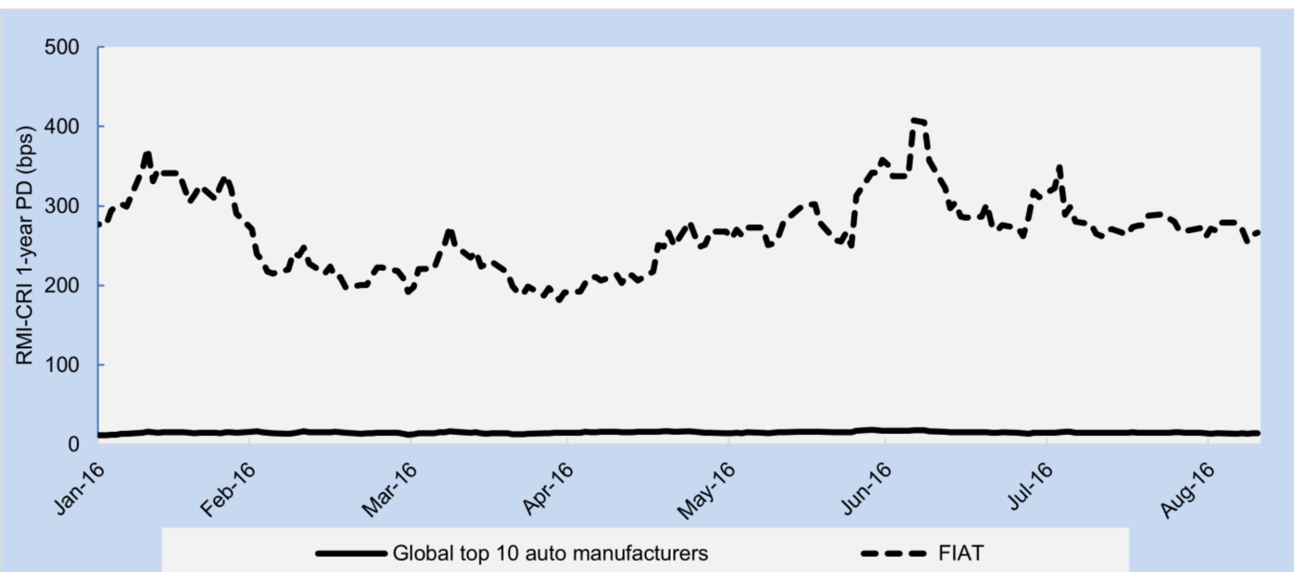

Figure 1: RMI-CRI 1-year PD for FIAT and the RMI-CRI aggregate PD (median value) for the world's top 10 automobile manufactures by revenue. *Source: RMI-CRI*

A closer look at the RMI-CRI PD variables in Figure 2 shows that the RMI-CRI Distance-to-Default (DTD), which is the volatility-adjusted leverage, for Fiat sees a downward trend and remains higher than the corresponding DTD for the world's top 10 automobile manufacturers. The RMI-CRI SIGMA, which measures the idiosyncratic volatility of the stock return relative to the market index, is also higher than that of its main industry peers. According to the academic studies, firms with higher volatility-adjusted leverage and idiosyncratic volatility have a higher risk of bankruptcy. Accordingly, although the results of integrity investigations are yet to be announced and the impact on the financial statements of FIAT remains uncertain, FIAT should be tightly watched by credit analysts based on the RMI-CRI PD model.

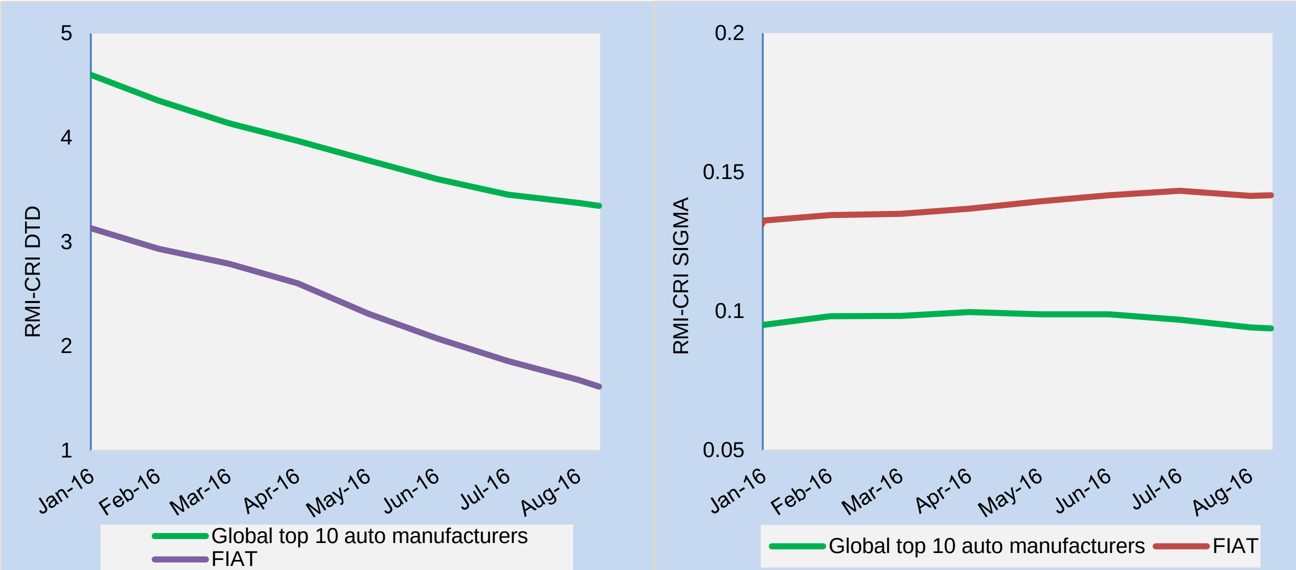

Figure 2: RMI-CRI Distance to Default (DTD) and idiosyncratic volatility (SIGMA). *Source: RMI-CRI*

Credit News

Oil impairments at Norway's banks set to rise, regulator says

Sep 11. In the face of an oil price slump, Norway's financial regulator said that banks exposed to the oil industry face a rise in impairments that will erode profits. Norwegian banks have seen loan losses increasing in the past year, writing down 0.34 percent of gross loans at the end of June. Norwegian banks, which operate in western Europe's biggest petroleum exporting nation, have a greater exposure to the oil-market crash that started about two years ago. Even so, banks are now in a better position to withstand the losses after accumulating more regulatory capital. (Bloomberg)

Two main creditors agree to help Oceanus stay afloat

Sep 9. Two main creditors of troubled seafood supply chain manager Oceanus Group have agreed to restructure Oceanus' debt significantly, alleviating its debt situation. The two main creditors, Ocean Wonder International and BW investment, had loaned a total of SGD 71.9mn, amounting to 80% of Oceanus' debt. Under the agreement, both creditors will convert SGD 54.2mn owed to them into new Oceanus shares ranging between 0.3 and 2.167 cents per share. However, Ocean King Group, the third key creditor has yet to agree to the debt-for-equity conversion. Executive director and chief executive Peter Koh mentioned that it "is a big step forward for Oceanus in our tireless efforts to clean up the group's books over the past year." (Straits Times)

Saudi Oger faces huge debt restructuring as rescue talks collapse

Sep 8. The Saudi Arabian Government has completed rescue talks with construction giant Saudi Oger, one of two major contractors charged with extensive infrastructure development plans across the kingdom. Due to the fall in oil prices leading to sharp cuts in state spending, the construction industry has been under strain. However, Saudi Oger, which is reliant on government contracts, has buckled under the backlog of government payments to Oger of USD 8bn which had left Saudi Oger struggling to meet its obligations. Saudi Oger faces a potential multi-billion-dollar debt restructure to prevent its collapse. (Reuters)

Cash piles at American companies are shrinking

Sep 6. In light of weakening profits and splurges on buybacks and dividends, the cash amount of American companies has started to deplete. The cash and equivalents of S&P 500 index members fell to a median of USD 860mn, the lowest level in three years. With S&P 500 companies recording negative growth for the past six quarters, the cash depletion is also exacerbated by increased buybacks and dividends. Pressure is now building at US companies that have chosen to return money to shareholders as investors are shifting towards companies with higher capital expenditures. (Bloomberg)

Saudi cost-cutting drive may cancel USD 20bn of projects

Sep 6. In an effort to repair finances affected by slumping oil prices, Saudi Arabia is reviewing plans to cancel over USD 20bn of projects and to cut ministry budgets by a quarter. According to people familiar with the review, the government expects the review to be completed with six months. The cancellation of projects would affect the budget for several years and might include transport, housing and healthcare projects. The Saudi Arabian government has already taken steps, such as delaying of payments owed to contractors and reducing fuel subsidies, to curb the budget shortfall which expanded to 16% of gross domestic product in the previous year, the highest among the world's biggest 20 economies. (Bloomberg)

Samsung slumps by USD 22bn as Note 7 safety warnings pile up (Bloomberg)

Many bondholders affected by Pac Andes liquidity crisis (Straits Times)

Nortel reports progress in bankruptcy settlement talks (WSJ)

Regulatory Updates

Canada regulator sets out stricter mortgage rules for banks

Sep 10. In the midst of the overheated housing market, Canada's financial regulator released proposed new mortgage rules that require the country's lenders to hold more capital to offset risks. According to the Office of the Superintendent of Financial Institutions (OSFI), the development reflects the changing risks in the Canadian mortgage market. OSFI floated the policy as part of revised Capital Adequacy Requirements (CAR), a set of rules governing federally-regulated banks, loan companies, and trusts and based on global requirements. The new CAR framework is expected to come in force as soon as November. (Bloomberg)

Taiwan mulls shielding insurers from callable corporate bonds

Sep 8. Taiwan's financial regulator is considering policies to protect local insurance companies from bond issuers paying off their debt early. Foreign issuers that sold callable notes in Taiwan have rushed to repay the securities before maturity to lock in lower financing costs. USD 6.7bn of foreign-currency notes were repaid early this year, up from USD 2.1bn in 2015. By limiting issuers from buying back notes early, the period mismatch between the insurance policy payout and bond payment can be minimized. However, limiting borrower's ability to issue callable bond will result in a higher issuance cost, making Taiwan less attractive for foreign bond issuers. (Bloomberg)

UK regulators are the most fin-tech friendly (FT)

Wells Fargo hit with record fine over secret accounts (FT)

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