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Weekly Credit Brief Sep 11 - Sep 17

Rallye & Casino Group's complex debt structure raises concerns amid share price rout

By Zhou Ye

Groupe Casino, or Casino Guichard Perrachon, a French mass retail listed on the Euronext Paris with operations over France, Latin America and Indian Ocean Region, is currently facing a market sell-off due to its complex debt structure which has caused concerns among its investors. In August, The RMI-CRI 1-year Probability of Default (PD) for Casino climbed to a high of 148 bps from 33 bps, as the market cap fell by 18.5%. Meanwhile, Casino's controlling shareholder, Rallye, also faced a similar fate with its RMI-CRI 1-year PD surging past 100 bps to over 300 bps, with market cap down over 12%. The similar trends indicate a close relationship between the two companies in addition to its parent-subsidiary relationship.

The reason behind this phenomenon is the closely-held ownership structure in which Casino's CEO, Mr Naouri, controls Rallye and Casino. Within this group, dividends from Casino are utilized to maintain Rallye's debt interest payment. The shares of Casino that are held by Rallye are pledged as collateral to banks in order to obtain more financing. The credit lines of Rallye is EUR 1.7bn but EUR 1.4bn of these are backed by Casino share pledges. Pressure on Rallye's credit line may build up when the market cap of Casino plunge which was what happened in August 2018.

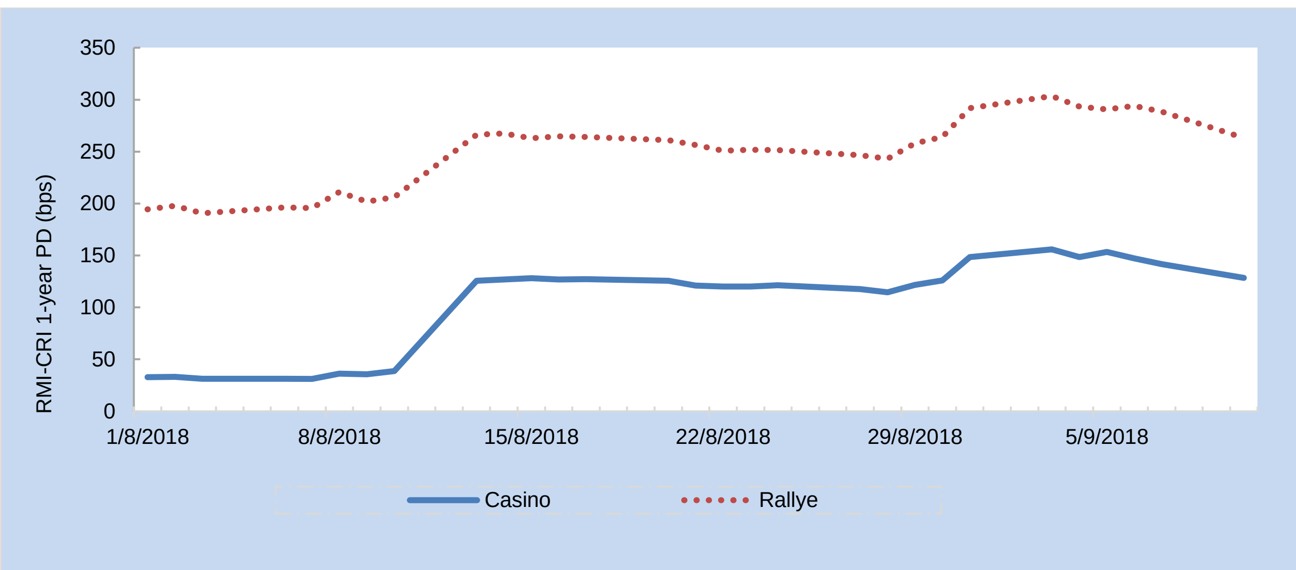

Figure 1: RMI-CRI 1-year PDs for Casino and Rallye. *Source: RMI-CRI*

In August 2018, the market witnessed a material drop in Casino's share price when a key finance entity – Casino Finance, who issues the company's bond, had not filed its 2017 annual accounts. The stock price slid further after S&P announced to cut Casino's credit rating into junk territory. Trading around EUR 27 per share, almost a 22-year low, Casino became the most-shorted stock in France despite the company attributing the late filing to a technical delay. Rallye has debt of EUR 700mn maturing in October 2018 and EUR 300mn maturing in March 2019. While Rallye has credit lines to refinance these upcoming debt, the plunging value of Casino's shares, which are pledged as collateral, raises liquidity concerns on the company. The sudden market cap drop of Casino further worsen Rallye's credit outlook.

The net debt/equity of Rallye shows a significant jump in 2017 and remained high in 2018 which may help to explain its relative higher credit risk as compared to previous years. Net income margin were negative for both companies in the first half year of 2018, which may due to the depreciation of its emerging market currencies in Brazil, dropping around 20% related to EUR this year, as 43% of Casino's revenue was from Latin America.

Rallye	2016 S1	2016 S2	2017 S1	2017 S2	2018 S1
Net Debt/Equity (%)	76.53	58.49	59.21	103.84	97.17
Net Income Margin (%)	7.07	-0.12	-0.72	0.2	-0.7

Table 1: Financial Figures of Rallye. Source: Bloomberg

Casino	2016 S1	2016 S2	2017 S1	2017 S2	2018 S1
Net Debt/Equity (%)	47.69	30.66	50.45	40.83	56.68
Net Income Margin (%)	15.23	0.6	-0.52	1.07	-0.35

Table 2: Financial Figures of Casino. Source: Bloomberg

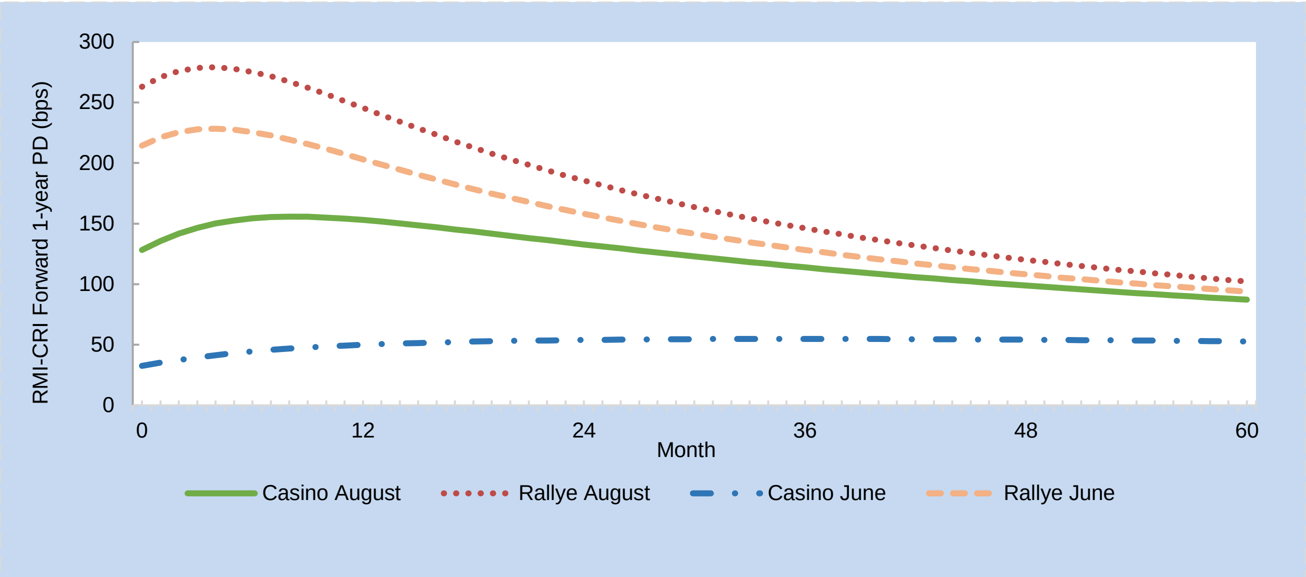

Figure 2: RMI-CRI Forward 1-year Corporate PDs for Casino and Rallye on Jun 01, 2018 and Aug 15, 2018. *Source: RMI-CRI*

Mr. Naouri has undertaken a debt-reducing strategy for Rallye and Casino through disposing its Brazilian and Asian Business. The RMI-CRI Forward 1-year PD (Forward PD) term structure in Figure 2 above shows how the shape and level of Forward PD changed from June 1 to August 15. The Forward PD works similarly to a forward interest rate. For instance, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months. The shift in term structures from June to August reflects the worsened credit outlook of both companies after the declining market cap in August in the face of upcoming debt maturities. The PD term structures for Casino and Rallye reach its peak in about 2 months and then falls. This may signal that if Rallye is able to improve its debt structure and manage its repayment over the next few months, its credit profile could marginally improve.

Credit News

ING to assess USD 600bn loan portfolio based on climate impact

Sep 17. Dutch bank ING will start assessing its lending portfolio based on climate impact to align with the emissions reductions required by the Paris climate agreement. After several unsuccessful attempts in choosing the right approach, ING settled on International Energy Agency's climate scenarios and applied them to each sector in its portfolio. It also incorporates data from 2 Degree Investing Initiative, a think-tank, to determine which companies have aligned them with a low-carbon economy. Even ING at this point will not use the climate assessment to direct individual decisions on whether or not to grant a specific loan, it hopes it will prompt its clients to "bring the discussion of this to a board level". (FT)

Chinese firms' debt-servicing firepower slumps to 2015 low

Sep 14. China companies' debt-servicing firepower slumps to a three-year low even as authorities move to support their financing. Thanks to the lingering effects of the crackdown in shadow financing and the rising trade tensions with the US, many companies' cash reserves are depleted as they have had to tap internal cash to repay debt. There have been over RMB 40bn in local bond defaults this year and even after the targeted steps China unveiled in July, defaults have yet to slow. However, local notes showed a sign of a recovery in recent months where net bond issuance was positive from June to August bouncing back from a negative figure in May. Lianxun Securities Co. stated that China's economic stimulus has raised expectations of a rebound in the real economy although credit risks will remain high due to the tight financial-markets regulations. (Bloomberg)

Euro zone banks adopt ECB rate after Euribor scandal

Sep 13. Euro zone's top lenders have decided to adopt the ECB's interest rate of overnight inter-bank lending (Ester) as their new benchmark to replace Eonia, the Euro Overnight Index Average. The short term rate is a gauge of how much banks charge for lending to each other for a day. The replacement is after a series of manipulation scandals for the Euribor series back in 2012. Eonia volumes have decreased to EUR 2bn from EUR 80bn at its peak in 2008. Ester is expected to go live by October and it will be based on transactions between 52 banks on a volume of EUR 30bn per day. (Reuters)

Fitch downgrades 4 Turkish banks

Sep 13. Fitch ratings agency has downgraded its credit ratings of four Turkish banks due to the increased risks caused by lira's slump and the higher chances of a "hard landing" for the Turkish economy. According to Fitch, the downgrades reflected "the increased risks to the banks' performance, asset quality, capitalization, liquidity and funding profiles following the recent market volatility". Fitch said this move took into account the deterioration of investor's sentiment, due to concerns regarding Turkey's financial stability amid the unpredictable policy framework and Turkey's large financing requirements. (Business Times)

Singapore's small construction firms seen facing debt problems amid property curbs

Sep 11. Singapore's small construction firms are likely to face greater difficulties in repaying debt as a clampdown on property speculation further deteriorates their liquidity profiles, in addition to other factors such as the rising interest rates on their borrowings and the delays in collections from customers. In July, the government implemented several cooling measures, including the increased stamp duties for developers. As a result, it is very likely that construction firms will be squeezed further by property developers in their attempt to maintain margins. (Straits Times)

Saudi Arabia raises USD 2bn with new Islamic bonds (Reuters)

Russia raises interest rates for first time since 2014 crisis (FT)

Takeda is said to weigh sale of Shire eye drug to cut debt (Bloomberg)

Regulatory Updates

China revamps USD 12tn bond market to lure foreign investors

Sep 14. Authorities in China have announced a set of new rules in the bond market in a bid to lure more foreign investment amidst threats to its economic growth as yuan's value slumps. The new rules will make Chinese bonds more attractive to foreigners in a time when China could use more capital inflows to stabilize the yuan and fund corporate borrowers. Some important changes include enabling overseas institutions to be exempted from paying certain taxes on interest gains and allowing them to conduct block trades through China's bond trading link with Hong Kong. Though more foreign participation could increase China's vulnerability to swings in global investor sentiment, analysts see that the new regulation could ease the downward pressure on yuan and diversify China's source of funding. (Bloomberg)

ECB reaffirms plan to halt bond-buying programme

Sep 13. The ECB confirmed that it would reduce the expansion of its quantitative easing (QE) programme, reducing monthly bond purchases to EUR 15bn from EUR 30bn from October till end of 2018 and highly likely to end thereafter. Despite the slower growth projection into 2019 and 2020, the expected strength in the region's labour market with stronger wage growth gave ECB the confidence to wind down its QE stimulus. However, monetary policy would remain loose with interest rates expected to remain at record lows at least into mid 2019 as uncertainty from the trade war between the US and China and the turmoil in emerging markets still remain. (FT)

Islamic banks face outdated property rules: industry body (Reuters)

Turkey's central bank faces test of independence (FT)

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