



European Credit Research

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Groupama's FY 2011 announcement neutral – We move from BUY to ADD on dated subordinated

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- **We change our recommendation on the Lower Tier 2 (7.875%) from Buy to Add on the basis of the gains already achieved, the comparative yields of other securities and the hard slog ahead in the recapitalisation of the group.**
- **Execution of disposals, asset mix shifts and the reporting of consistent operating profits in 2012 would once again make all these bonds more attractive.**

Background

- Groupama announced FY 2011 results on Thursday and released a presentation on Friday. It reported a loss of €1.7bn on the back of €3bn of impairments that were offset with exceptional gains and operating profits.
 - Due to the interest that has developed since we started coverage of Groupama given the low price of its bonds, we take this opportunity to summarise developments, even though without the benefit of detailed financial reports for the Combined and Consolidated perimeters we face limitations.
 - Groupama is a mutual organisation and financial reporting is not under the same time constraints as in listed companies, as most policyholders (owners) do not peruse reports and accounts before buying insurance. Groupama reports twice a year and the detailed report and accounts are published later than for listed companies. At the time of the announcement of results only a press release and a presentation were made available.
- 2011 due to the fall in share prices (Societe Generale's in particular) and the impending writedown of Greek debt.
- The fact that these agreements were made before year end hinted that they might be needed to meet solvency requirements and this was confirmed at the time of the announcement in March 2012, as the solvency ratio of 107% includes the effect of both transactions. We will not reproduce the same calculations from our 14 October report here, but at the time Groupama reported that its Solvency I requirement as of H1 2011 was €4.56bn.
 - In Appendix 6 of that report, we projected what the solvency would be given: 1) no growth, 2) average earnings and 3) the calling of the subordinated bonds. The projection showed that there would be a small excess over the requirements, including the bonds and taking into account some losses in 2011.
 - The fact is that instead of zero growth we will see the group shrink, so that is positive in solvency terms. As it turns out, the reported losses were larger than we had envisaged and that is negative but there were offsetting factors.
 - The investment mix of Groupama has begun to change and the liquidity of the portfolio is improving. Equities were reduced from 15.9% to 12.8% of assets and property from 9% to 8.1% Fixed income investments were also reduced from 71.4% to 66.9% and cash increased from 2.8% in 2010 to 10.6% at the end of 2011.

Operating performance highlights

Some of the highlights, in our opinion, are as follows:

Developments from October to December 2011

- Before the end of the year Groupama had announced two transactions: 1) an injection of €300mn into GAN Eurocourtage by Caisse des Dépôts (CDC) through an issue of preferred shares to CDC; and 2) the transfer of SILIC shares into a separate vehicle in which the property assets of SILIC and Icade would be combined and then listed (€0.5bn gain booked).
- Investors had speculated (rightly) that Groupama's solvency would have declined below 100% from H1
- The retention of most premium income with a decline for the group of just over 1% from the 2010 level. In France, P&C increased over 5% and life assurance fell by 7% both of which performances were better than for the market as a whole. Whether this was due to competitive pricing that may come to be reflected in future results remains to be seen, but the franchise appears to be intact.
- The potential decline in business volumes was a concern of some analysts and investors we spoke with in recent months, but we believe that the customer base of Groupama may not be as aware of its finances or its ratings as capital markets participants are.
- Abroad, diversification helped to keep volumes almost unchanged at €4.3bn, with Italy's and



Turkey's increases largely offsetting the declines in other markets of which Spain (-1.4%) and the UK (3.2%) are the largest in terms of volumes (Hungary, Greece, Romania and Portugal also reported declines).

- The reduction in the combined ratio of non-life insurance operations from 104.9% to 97.4% (driven fully by the loss ratio), represents a c.€700mn swing from deep losses to modest underwriting profits. Hopefully it was not all due to reserve releases.
- The life assurance and health insurance profit virtually evaporated, financial activities contributed little to the result and the holding company reduced its losses substantially.

Investment portfolio being de-risked

Investment portfolio of Groupama at end 2011

Asset class	%	€bn	Notes
Cash	11%	7.5	Significant increase
Bonds	67%	47.0	Of which
		28.2	Governments
		11.4	Financials
		6.2	Corporate
		1.2	Other
Equities	13%	9.0	Meaningful reduction
Property	8%	5.7	Minor reduction at the time
Other	2%	1.1	
Total	100%	70.3	

Source: Groupama presentation

- The entire bond portfolio of €47bn is composed of: €9bn in AAA rated securities, €13.1bn in AA, €16bn in A, €4.9bn in BBB and €4bn in non-rated and below investment grade securities.
- Of the financials portfolio of c.€11.4bn, we estimate that based on Groupama's presentation, Tier 1 represented €0.49bn, Tier 2 €2.46bn, with the rest being covered, secured and senior.
- Of the government bonds of €28.2bn, Groupama reported that France, Germany and The Netherlands accounted for €11.6bn and other eurozone countries for €15.2bn, with the rest of the world representing only €1.4bn. The exposure to GIIPS was €10.4bn at fair value and €12.8bn gross value. The unrealised losses net of profit sharing and taxes are estimated at €473mn excluding Greece, which show no further unrealised gains or losses after being written down. This represents less than 4% of the gross value of these bonds (roughly 20% from gross to fair value and 20% from gross unrealised loss to net).
- It is worth remembering that 70% of the assets are in the life funds.

Developments from end of 2011 to 1 March 2012

- Shareholders' funds fell from €7bn in 2010 to €5.3bn in 2011. Improvement in investments values in the

first two months of 2012 have helped the capitalisation of Groupama further from where it was reported at year end. In particular, the rise in the CAC 40 index and other equity markets and the fall in yields of Italian and Spanish government debt, but also the yield falls of other peripheral European countries and corporate bonds produced a €2.9bn swing in the unrealised gains position of Groupama, from a €1bn loss at the end of 2011 to €1.9bn positive at the beginning of March.

- Groupama's capitalisation is weak and is being managed at low levels, but it is recovering. Management's presentation shows a solvency margin goal of 140% by 2014, which confirms our view that the work is medium, not short, term.
- Management plans include cost reductions, better underwriting, a safer investment mix and improved risk management overall.

Regarding the potential IPO: abandoned

- The presentation states that, "the IPO project has been halted". With the recent operating performance of Groupama and the ongoing market instability, it has been clear that an IPO was unrealistic.
- Management had already communicated about this recently and the dates of 2014 or 2015 had been suggested as more likely, but still dependent on the above factors being favourable.
- Now the project has been stopped indefinitely. What matters is the capitalisation and the profitability of the group and these are being addressed. The upside is that without an IPO, the large dividends that are generally paid by listed companies will not be required and this will aid recapitalisation.
- We see the long, historic mutual status of Groupama, which underpins its franchise, as diametrically opposed to the aims of a listed company. We see it as virtually irreconcilable, although various companies have achieved the transition in the past.
- In the past we considered Achmea (formerly Eureko) and Talanx to be peers of Groupama with similar strategies. Achmea, which is a cooperative society akin to a mutual, also came to the conclusion some time ago, that the idea of an IPO would need to be abandoned indefinitely. In contrast to Groupama and Achmea, Talanx, the parent of Hannover Re and intermediate holding company within the German HDI Group, has long contemplated an IPO and remains committed to the goal.

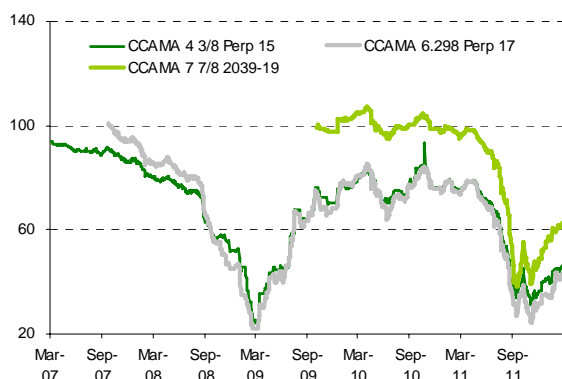
The bonds

- There is no active market on the CDS of Groupama.
- We see the 4.375% as Upper Tier 2, the 6.298% as Tier 1 and the 7.875% as LT2.
- The analysis needs to be made in the context of the fact that the bonds' prices ranged from 29 to 39



cents on 14 October 2011 and are now trading from 43 to 63 cents.

CCAMA – bond prices



Source: BNP Paribas Global Markets

- As we can see on the chart, the price of Groupama's undated subordinated bonds fell steeply (to low 20s) in 2009 and recovered to about 84 cents within a year. This time around, the recovery of the past four months has been positive and we expect a further rise in bond prices but recapitalisation will take time.

CCAMA – bond details

Coupon	Tier	Call	Step up	Price	Yield
7.875%	LT2	2019	3mE+536bp	63.5	16.7%
4.375%	UT2	2015	3mE+225bp	47.4	32.7%
6.298%	T1	2017	3mE+260bp	45.5	25.6%

Source: Bloomberg, BNP Paribas

- In October, we valued the bonds at between 77 and 94 cents if they are called; between 41 and 84 if they are not called, using high discount rates for the cash flows. The most recent prices are shown on the table. The LT2 is resilient and remains our preferred security; even if uncalled it has upside potential, whereas the value of the UT2 and T1 is only higher than the current prices if the bonds are called.
- Two differences between 2010 and 2012 are: 1) that the market now seems to be more aware of the financial position of the group; and 2) a segment of the investor base is absent due to the non-investment grade ratings of the bonds (S&P and Fitch).
- As usual, the market had moved ahead of the rating companies, with the prices beginning a rapid and prolonged (12 month) descent from November 2010 to October 2011 when we began coverage.

Thoughts about coupon deferrals and calls

- We believe that Groupama will continue to pay coupons on the subordinated bonds for the following reasons: 1) the amount of Groupama's debt – its gearing – is not its main problem and debt service can be covered from operating cash flows; 2) skipping coupons would not resolve the solvency

position; 3) as a mutual, Groupama has no access to equity markets and skipping coupons would only make it more difficult to secure support from debt markets in the future; and 4) if Groupama intends to do an IPO in the future, its record on paying obligations to capital providers generally must be impeccable.

- Regarding call dates (2015, 2017 and 2019), we expect Groupama to call the bonds on the first call date, keeping with market practice, which would value the bonds between 77 cents (Tier 1) and 94 cents (LT2), but clearly this will depend on the extent of recapitalisation which in turns depends on the operating performance of Groupama, the recovery on its capital position, the reduction of asset risks and the execution of disposals.
- In our opinion, Groupama has three years to deliver all of the above before the first call date arrives, particularly considering that Groupama needs to be strongly capitalised when Solvency II arrives and that is currently expected to be in early 2014.

Thoughts about 'Liability Management' (LME)?

- We believe that Groupama will not perform LME for the following reasons: 1) The emphasis is not on boosting core Tier 1 as is the case with banks; 2) the total amount of solvency capital would fall and recapitalisation through earnings would take time, so Groupama does not appear to be in a position to weaken its Solvency I position and much less to do that with Solvency II looming ahead; and 3) accessing debt markets now to refinance seems unrealistic.

The ratings

- Moody's does not rate Groupama.
- S&P rates Groupama BBB- for financial strength and BB for the Lower Tier 2. Ratings are on Creditwatch negative. S&P downgraded Groupama's LT2 in June 2010 from BBB+ to BBB, on a bond issued and rated only eight months before. Then from May to December 2011 S&P took five rating actions on the bonds of Groupama to lower them to BB.
- Fitch rates Groupama BBB for financial strength and BB for all subordinated debt. Fitch downgraded the LT2 from BBB to BBB- in August of 2011 and then a month later downgraded the bonds to BB.
- What is interesting is that 1) Groupama knew what the weaknesses were years ago and had planned to resolve them, but had not executed the necessary changes; 2) the rating companies waited until the H1 2011 results were announced to take action; and 3) Groupama changed management and is addressing the weaknesses.
- Thus at the time that Groupama's credit position is turning around, the Creditwatch and downgrades are being made and negative outlooks maintained.



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Type	Terminology	Horizon
Credit Trend (1)	Positive/ Stable/ Negative	6 months
Investment Recommendation (2)	Buy/ Add/ Hold/ Reduce/ Sell (*)	Up to 6 months

(1) Credit Trend is based on underlying Credit fundamentals, business environment and industry trends;

(2) Investment Recommendations are as follows:

(*) **BUY** – Maximise exposure based on improving financial profile and/or significant under-valuation.

ADD – Overweight exposure within industry sector/index, based on improving financial profile, and/or defensive characteristics and/or cheap valuation.

HOLD – Maintain position based on stable credit fundamentals and/or average expected return characteristics within peer group.

REDUCE – Underweight exposure within industry sector/index based on weakening financial profile, increased volatility and/or rich valuation.

SELL – Sell exposure/Maximise protection largely based on deteriorating credit fundamentals, negative headline/event risks and/or significant over-valuation.

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