Company Update

High Grade Credit | France | Insurance
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T2 bonds - we remain UW-30%

Jeroen Julius +44 20 7995 2283
Research Analyst
MLI (UK)
jeroen.julius@baml.com

Richard Thomas +44 20 7996 0128
Research Analyst
MLI (UK)
richard2.thomas@baml.com

Maciej Pisarek +44 20 7996 2539
Research Analyst
MLI (UK)
maciej.pisarek@baml.com

UW-30% despite valuation support

Following the announcement this morning by CCAMA that it will skip the upcoming coupon on its €6.298 17s Tier 1 bond due 22 October (more here), we have taken a closer look at the valuation support for the other two CCAMA subordinated bonds that we cover, namely the €4.375 15s and the €7.875 2039-19s. The former has optional coupon deferral language, but this is cumulative (unlike the €6.298 17s). The latter has the same language but will keep paying, we understand. Despite valuation support for both bonds, we remain UW-30% in each, due to: (1) poor CCAMA earnings and capital visibility; (2) Fitch Ratings downgrading CCAMA to non-investment grade; and (3) possible reputational damage.

Tier 1 coupon skip - why did CCAMA do it?

Since CCAMA had not paid dividends to its regional mutual shareholders this year (following the €1.76bn loss in FY11), it did not want to give favourable treatment to the holders of its €6.298 17s junior subordinated bonds. (Non-payment of dividends was a pre-condition for triggering the optional coupon deferral language of the T1 bond). CCAMA clearly differentiates between its T1 bonds (which it considers to be part of its equity) and its T2 bonds, as it confirmed that the next coupon of the €7.875s T2 bond (due 27 October) will actually be paid.

What about the reputational repercussions?

CCAMA did not believe that the reputational risks of a coupon skip on its T1 bond would be serious – '*funding markets are already closed to us anyway and we do not need to raise funding in the near term*'. We understand that this was a management decision and that the regulator did not get involved in it. In our view, the company may have under-estimated the repercussions for its market reputation - it could take a while to repair it, we think. Even if it does not need to raise subordinated debt in the near term, it will probably need to do so eventually. Today's coupon-skip decision will likely make a return to the markets more challenging.

Fitch downgrades CCAMA sub bonds and IDR

This afternoon, Fitch Ratings downgraded the CCAMA 7.875s, the 4.375s and the 6.298s sub bonds from 'BB' to 'B+', 'B-' and 'CCC', respectively. They remain on negative watch, which reflects Fitch's view of '*the risk of further coupon deferral*'. Simultaneously, the agency has '*downgraded Groupama S.A.'s and two of its core insurance subsidiaries, Groupama GAN Vie and GAN Assurances' Insurer Financial Strength (IFS) ratings to 'BB+' from 'BBB"* with a Negative outlook. The downgrade of Groupama's IFS ratings reflects Fitch concerns that '*the decision not to pay the coupon on its hybrid debt could negatively impact the company's reputation and that the group may face further challenges to its financial condition going forward*'. Recall that in June S&P already downgraded CCAMA to 'BB'.

Refer to important disclosures on page 4 to 6. Analyst Certification on Page 3. Link to Definitions on page 3.

€4.375 15s – fair value

This bond has cumulative coupon deferral language. CCAMA paid the most recent coupon on the 4.375s last July. In light of today's coupon skip on the T1 bond, however, there's considerable uncertainty with regards to the next few coupons of the 4.375s, we think. We therefore assume coupon deferrals until (but excluding) 2015. CCAMA could have restored its solvency ratio to 150% by that time, in our view, although visibility is poor. We note that the FY11 loss was primarily due to the impairment charges it took on its Greek government bond holdings. This should be a non-recurring feature. The recent rally in risk assets will also have helped CCAMA's solvency position somewhat. The underlying profitability of its Life & Health business appears decent, although its Property & Casualty segment has a combined ratio of around 104%.

We assume that the reaching of a 150% solvency ratio in 2015 would trigger the payment of the accumulated coupons (2013 and 2014) in 2015 (along with the 2015 coupon). Under this scenario, and when valued to perpetuity, we see the fair value of this bond at around €43. When valued to the first call date in 2015, we see fair value at around €86. When valued at 'call + 5', we see fair value at around €66, so about 17 points above today's close. (Recall that CCAMA did not call a bond in 2009, but then did call it in the subsequent year.) This is our base case. So there does appear to be considerable valuation support for this bond (even assuming two more years of coupon deferrals, the fair value would still be €63). We are nevertheless comfortable with our Underweight-30% rating, as (1) the visibility of the group's earnings and capital strategy is poor; (2) the company is now rated non-investment grade by both S&P and Fitch; and (3) investor sentiment towards the name has taken another hit today.

Cumulative coupons – when will they be paid?

When valuing the 4.375s under a coupon deferral scenario, we need to make an assumption regarding (1) the number of coupon deferrals; and (2) the timing of the payment of the deferred coupons. The clause describing this timing issue is the same for both bonds, namely Condition 3(h)(2).

Although '*Arrears of Interest may, at the option of the Issuer, be paid in whole or in part […] on any Optional Interest Payment Date*', all arrears of interest '*shall become due in full on whichever is the earlier of: (a) the next Interest Payment Date which is a Compulsory Interest Payment Date; or (b) the date on which the Notes are due to be redeemed (i) pursuant to any optional or mandatory redemption of the Notes in accordance with Condition 5 or (ii) otherwise by operation of law.*'

The Compulsory Interest Payment Date clause basically gets triggered when the solvency ratio exceeds 150% OR when the company (i) has declared/paid a dividend; or (ii) redeemed / bought back any of its share capital or senior/junior sub debt; or (iii) a '*relevant affiliated entity*' (the regional mutuals, Groupama Holding and the group) has made relevant payments. Condition 5 could be activated by a capital disqualification event, a tax event or in liquidation.

As CCAMA's Solvency I ratio was 113% at end-2Q12 (excluding recent gains/losses on disposals), the Compulsory Interest Payment clause seems unlikely to be triggered by a restored solvency ratio in the very near term. A dividend payment to/by its regional mutual shareholders could well be a more likely trigger, but it is hard to estimate the timing of this. Our two-year coupon deferral scenario described above is a more conservative approach, we think.

€7.875 2039-19s – no coupon deferrals

We understand that the next coupon of the €7.875s (due 27 October) will actually be paid, even though it has optional coupon deferral language, the 2013 coupon of the 4.375s seems uncertain and despite the coupon skip on the 6.298s this morning. Within its Tier 2 capital layer, therefore, the company does make a clear distinction between its dated bonds and its undated bonds. In our view, this is in line with the approach that other insurers (and probably regulators) take to their sub bonds (not that any of the other insurers under our coverage are currently skipping coupons). Therefore, we no longer expect that CCAMA will defer coupons on this bond, even though it does contain optional coupon deferral language. Assuming this bond is called in 2019, it would yield 13.8%. Assuming it remains outstanding until maturity, it would yield 11.2%. Under both scenarios, therefore, this bond appears to be attractively valued. As with the 4.375s, however, we are comfortable with our Underweight-30% recommendation for the reasons highlighted above (visibility, ratings downgrade to non-investment grade and investor sentiment).

Link to Definitions

Credit

Click here for definitions of commonly used terms.

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Security pricing

Groupama / CCAMA

Security	Amt (Millions)	Maturity date	Ratings Moody's/S&P/Fitch	Price	Price date	Yield (%)	Spread (Govt+bps)
6.298, Junior-Subordinated, EUR, Perp/2049:B	1,000	29-OCT-2049	N.A./B/BB	51.26	04-Oct-2012	23.92	2,184
4.375,TI,EURO, Perp/2049:B	500	29-JUL-2049	N.A./B/BB	51.55	04-Oct-2012	34.15	3,140
7.875, Subordinated, EUR, 2039:B	750	27-OCT-2039	N.A./B/BB	73.60	04-Oct-2012	13.99	1,224

Prices are as of date indicated and are from various sources, including BofA Merrill Lynch Global Fixed Income Indices and BofA Merrill Lynch trading desks. CDS spreads are sourced from the Markit Group Limited. Prices are indicative and for information purposes only.
B=Bond; CS=Capital Security (Not including Equity Preferred); CDS=Credit Default Swap; EP=Equity Preferred

Important Disclosures

Opinion history

Groupama / CCAMA

Security	Date^	Action	Recommendation
6.298, Junior-Subordinated, EUR, Perp/2049:B	30-Sep-2011		Underweight-30%
	13-Mar-2012	Extended Review	NA
	30-Aug-2012	Coverage Reinstatement	Underweight-30%
4.375,TI,EURO, Perp/2049:B	30-Sep-2011		Underweight-30%
	13-Mar-2012	Extended Review	NA
	30-Aug-2012	Coverage Reinstatement	Underweight-30%
7.875, Subordinated, EUR, 2039:B	30-Sep-2011		Underweight-30%
	13-Mar-2012	Extended Review	NA
	30-Aug-2012	Coverage Reinstatement	Underweight-30%

Table reflects credit opinion history as of previous business day's close. ^First date of recommendation within last 12 months. The BofA Merrill Lynch Credit Opinion key is contained below.
B=Bond; CS=Capital Security (Not including Equity Preferred); CDS=Credit Default Swap; EP=Equity Preferred

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Recommendation	Investor Action Points (Cash and/or CDS)	Primary Investment Return Driver
Overweight-100%	Up to 100% Overweight of investor's guidelines	Compelling spread tightening potential
Overweight-70%	Up to 70% Overweight of investor's guidelines	Carry, plus some spread tightening expected
Overweight-30%	Up to 30% Overweight of investor's guidelines	Good carry, but little spread tightening expected
Underweight-30%	Down to 30% Underweight of investor's guidelines	Unattractive carry, but spreads unlikely to widen
Underweight-70%	Down to 70% Underweight of investor's guidelines	Expected spread underperformance
Underweight-100%	Down to 100% Underweight of investor's guidelines	Material spread widening expected

Time horizon – our recommendations have a 3 month trade horizon

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