Is there value on Groupama's subordinated bonds?

If not insolvent, bonds need to be revalued

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Rafael Villarreal, Senior Credit Analyst

The backdrop

- Groupama has three subordinated bonds
  - CCAMA 7.785% dated 2039 with a call in 2019 (LT2)
  - CCAMA 4.375% undated with a call in 2015 (UT2)
  - CCAMA 6.298% undated with a call in 2017 (Tier 1)
- The prices of Groupama's subordinated bonds dropped to a range of 29 to 39 cents of par value in the recent past, which sent signals to distressed asset fund managers that valuations in insurance might be off kilter and offer high returns.
- Discussions with investors revealed that Groupama was no longer seen as a going concern, but that investors were trying to assess recovery values for each bond.
- While we have seen and reported the solvency of Groupama against our benchmark as comparatively weak in relation to other European insurers, we do not see it as running into insolvency and ultimately it is Solvency I which is the benchmark in force. Solvency II may not be implemented for another 2 years.
- This prompted us to review the actual financial position of the group, the bond features and the solvency benchmarks against which they are measured for the time being and to publish a note.

Possible drivers of the bond valuations

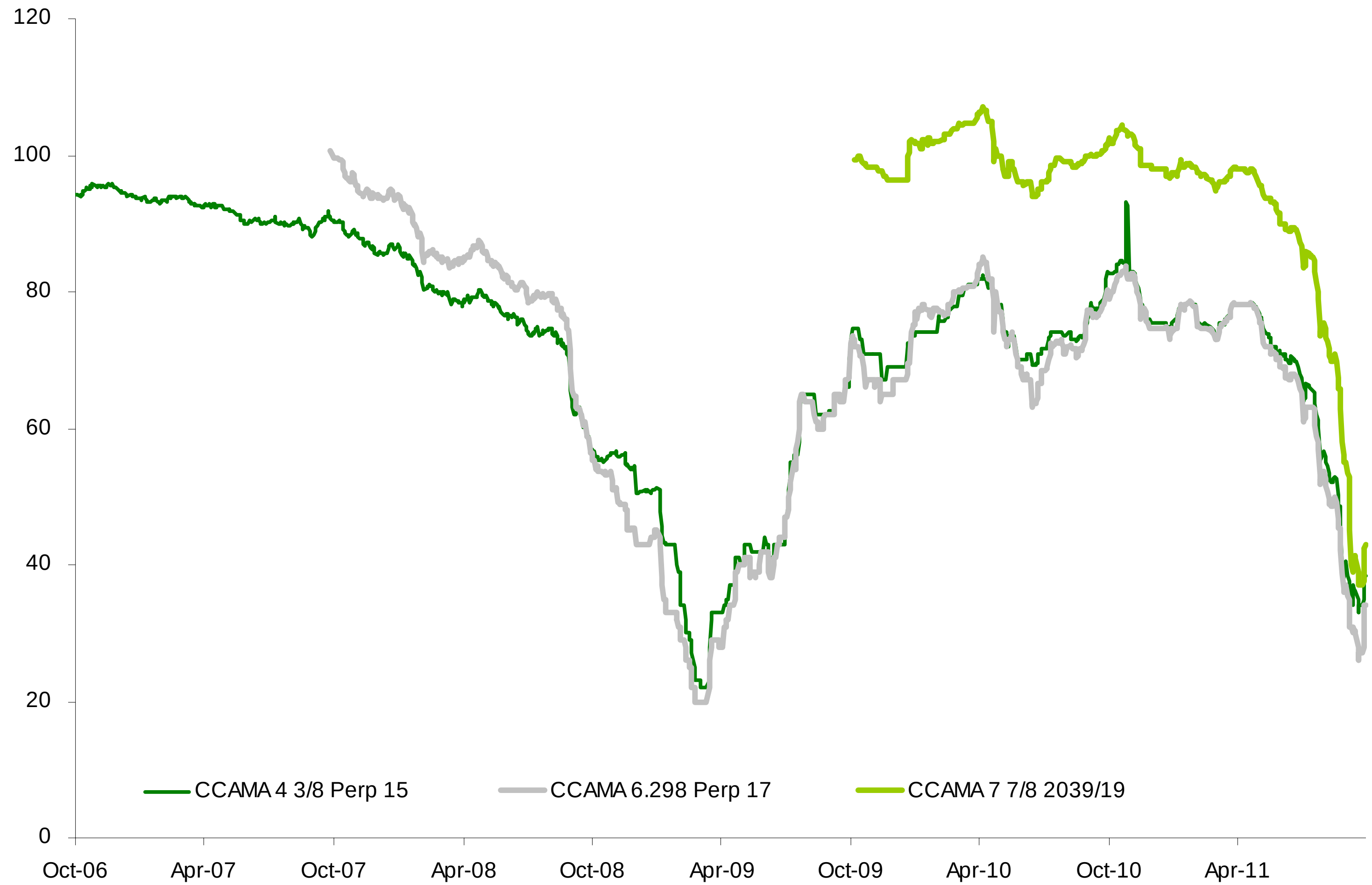
What the market seems to be saying:

- o Groupama is technically insolvent and soon will need to be seen as no longer a going concern
- o Groupama may stop paying coupons
- o Groupama may not call the bonds
- o All investment risks on strategic securities are for the account of the shareholders

What we believe to be the case:

- o Groupama is one of the largest insurers in France and among the largest in Europe and it is technically solvent but weakly capitalised
- o Groupama has paid all its coupons despite having the option to defer on one of the bonds and has a vested interest in abiding by market practice as it moves towards demutualisation
- o Groupama call its dated subordinated bond at the second call date (call 2009/ redemption 2010) and we expect it to continue to do so
- o 75% of the assets are backing the life insurance funds and it is logical that most investment risk will be borne by the policyholders over the life of the policies on the basis of their returns

The bonds: down but not for the first time



Source: BNP Paribas GlobalMarkets

The bonds: down but not for the first time

- ❑ The chart shows that the price on Groupama's bonds fell throughout 2008 and reached the same low levels as they have reached now.

- ❑ This was a time of low solvency levels due to the market's low valuations on many asset classes, not just driven by the equity or property investments that Groupama carries on the non-life insurance funds but also the fixed income portfolio.

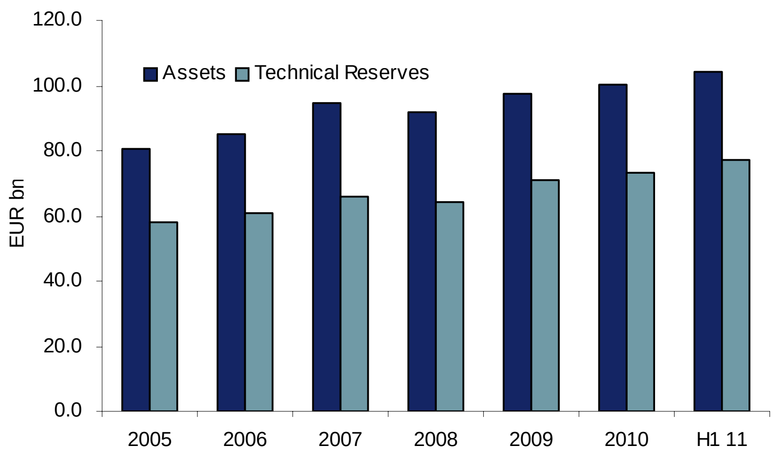
- ❑ The chart also shows that the recovery on the price was significant as asset values recovered and estimates of the interim solvency ratio rose.

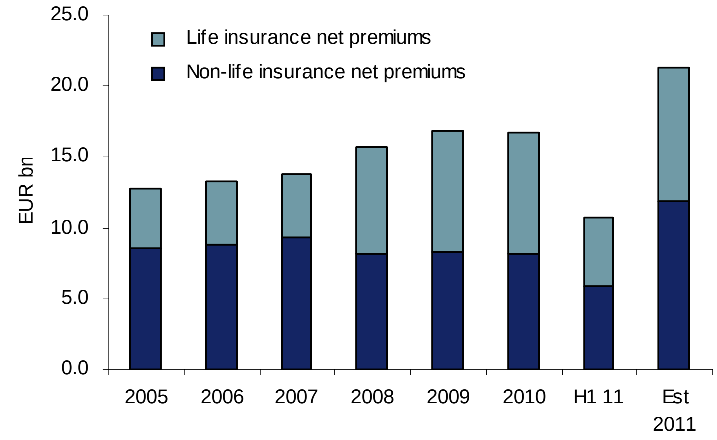
- ❑ By some measures, Groupama is in a better position in 2011 than it was in 2008 and 2009 (e.g. gearing, solvency).

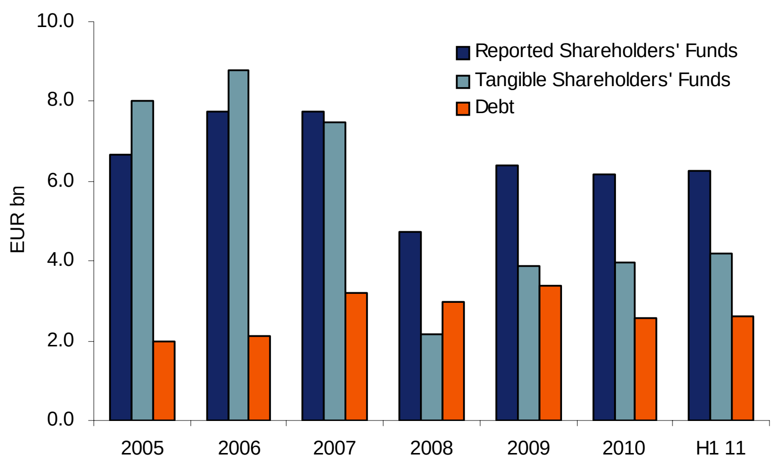
Group fundamentals

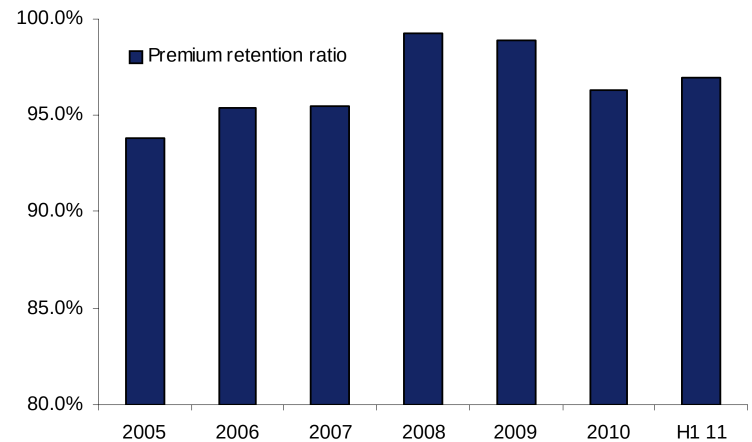
- One of the largest insurers in France and in Europe (15^{th} largest group in terms of premiums among the 30 groups we include in our *European Insurance Primer: Statistical Update*, October 2011)
- Among the largest in both non-life insurance and life/health insurance (positions vary by line of business)
- Comparative low risk profile of personal lines and SME
- Diversifying geographically and in terms of operations. Expansion seems unsustainable and a quiet period of recovery can be expected.
- Performance: scale, ROE and gearing not unlike those of peers
- Peers: comparable to these companies in terms of scale (assets and/or premiums)
  - Eureko
  - Swiss Life
  - Talanx
  - Aegon

Selected financial measures









Source: BNP Paribas GlobalMarkets

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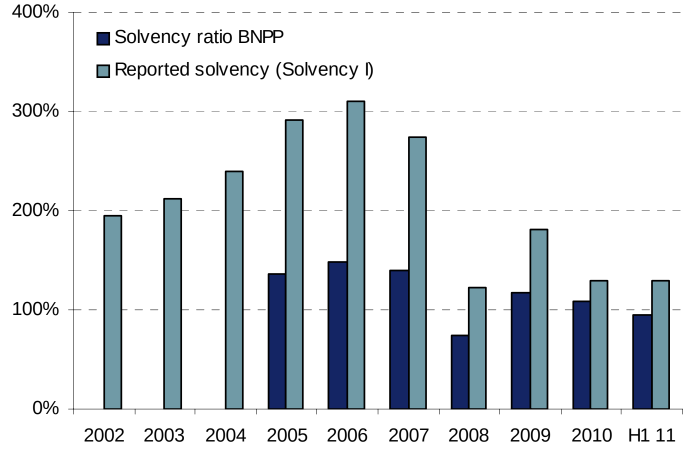

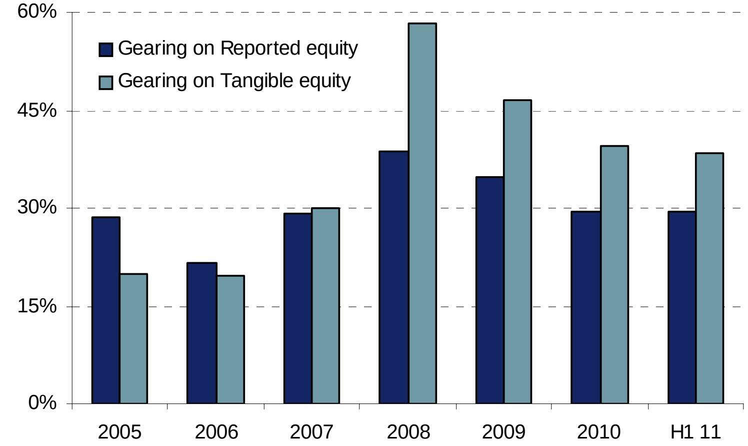

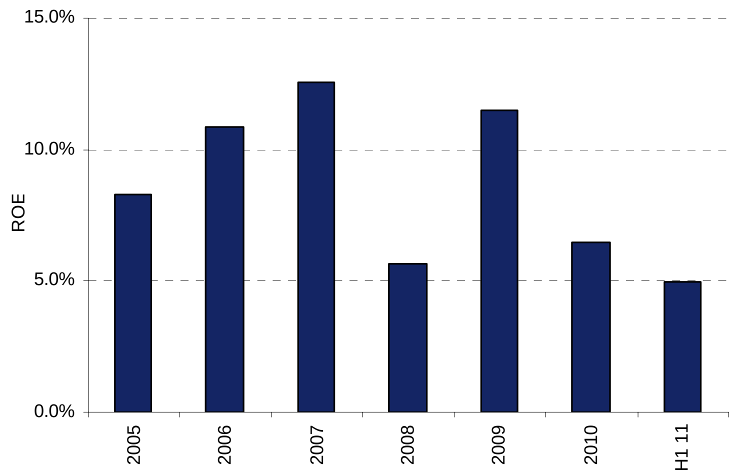

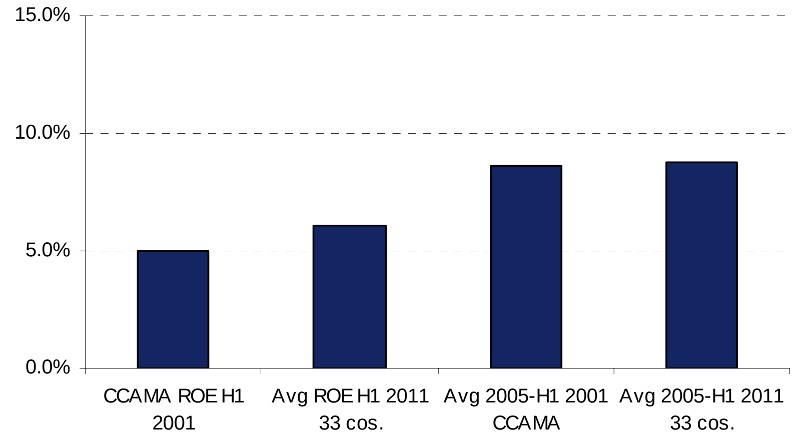

Source: BNP Paribas GlobalMarkets

Brief comments on group fundamentals

- There has been consistent growth
- International business is becoming more significant on the top line
- Scale is comparable to some of the largest groups in Europe
- Gearing is like that of peers, only slightly above average at the Combined scope and has fallen in the last three years
- Profitability – as measured by the ROE - was low in H1 2011, but so it was for the rest of the sector; the difference between Groupama and the sector average is not great either in the H1 2011 period or over the 2005-H1 2011 period
- Solvency is the key issue here and the benchmark we use accentuates this difference, but ultimately Solvency II is not yet implemented and the reference for the purpose of regulation and in relation to coupon deferral and loss absorption is Solvency I
- In addition to deducting goodwill and other intangible assets from the Reported Shareholders' Funds (RSF), we add unrealised gains on property investments for own account to the capital of Groupama, hence the Tangible Shareholders Funds (TSF) are in the early part of the 2005-H1 2011 period larger than Reported Shareholders' Funds
- It is the drop in the asset values of Groupama that weakens its Solvency ratios (most assets are classified as Available for Sale); risk reduction through changes in asset mix and hedging could reduce volatility

Capitalisation alternatives

1. Raise capital
   - ❑ Funds from mutuals / policyholders (not available)
   - ❑ Public or private placement of Tier 2 subordinated debt
   - ❑ IPO (2014-2015)
2. Reduce risks
   - ❑ Reinsurance
   - ❑ Disposals
   - ❑ Write a lower volume of business
   - ❑ Investment mix changes (e.g. reduction of equity and property investments for own account)
   - ❑ Place some hedges to limit the downside to the solvency of the group from investment market volatility

Bond valuation

Premises:

- The company is not insolvent
- The ROE is as high a discount rate as should be used to discount Tier 1; Tier 1 is actually far more protected than equity despite having (temporary) loss absorption and coupon cancellation
- We use the Consolidated ROE of c. 12% to discount Tier 1, rather than the Combined ROE of c. 8%-9% (but we show valuations at two different levels)
- Upper Tier 2 and Lower Tier 2 are further protected by the Tier 1 layer from loss, have cumulative coupons if deferred and therefore can be discounted at a significantly lower rate than equity and Tier 1

Groupama's bond values and investment return if called

Groupama bonds - if called

			LT2		UT2		Tier 1	
Principal			750		500		1,000	
Coupon			7.8750%		4.3750%		6.2980%	
Discount rate				9.0000%		10.0000%		12.0000%
Sum of PV of flows				703.30		410.85		765.57
as a % of par				94%		82%		77%
Amount paid				334		198		361
Price				0.45		0.40		0.36
Return on investment				**111%**		**107%**		**112%**
				Oct		Jul		Oct
				PV of CF		PV of CF		PV of CF
	0	2011	59.1		21.9		63.0	
	1	2012	59.1	54.2	21.9	19.9	63.0	56.2
	2	2013	59.1	49.7	21.9	18.1	63.0	50.2
	3	2014	59.1	45.6	21.9	16.4	63.0	44.8
	4	2015	59.1	41.8	21.9	356.4	63.0	40.0
	5	2016	59.1	38.4			63.0	35.7
	6	2017	59.1	35.2			63.0	538.5
	7	2018	59.1	32.3				
	8	2019	59.1	406.0				

Source: BNP Paribas

Groupama's bond values and investment return if called

Groupama bonds - if called (lower discount rate)

		LT2		UT2		Tier 1	
Principal		750		500		1,000	
Coupon		7.8750%		4.3750%		6.2980%	
Discount rate			7.0000%		8.0000%		9.0000%
Sum of PV of flows			789.19		439.97		878.79
as a % of par			105%		88%		88%
Amount paid			334		198		361
Price			0.45		0.40		0.36
Return on investment			136%		122%		143%
			Oct		Jul		Oct
			PV of CF		PV of CF		PV of CF
0	2011	59.1		21.9		63.0	
1	2012	59.1	55.2	21.9	20.3	63.0	57.8
2	2013	59.1	51.6	21.9	18.8	63.0	53.0
3	2014	59.1	48.2	21.9	17.4	63.0	48.6
4	2015	59.1	45.1	21.9	383.6	63.0	44.6
5	2016	59.1	42.1			63.0	40.9
6	2017	59.1	39.4			63.0	633.8
7	2018	59.1	36.8				
8	2019	59.1	470.9				

Source: BNP Paribas

Groupama's bond values and investment return if not called

Groupama bonds - if not called

		LT2		UT2		Tier 1	
Principal		750		500		1000	
Coupon		7.8750%		4.3750%		6.2980%	
Discount rate			9.0000%		10.0000%		12.0000%
Sum of the PV of flows			631.8		206.8		441.3
as a % of par			84%		41%		44%
Amount paid			334		198		361
Price			0.45		0.40		0.36
Difference			298.0		8.8		80.3
Return on investment			**89%**		**4%**		**22%**
Coupon step down		6.9180%		3.8060%		4.1580%	
			PV of CF		PV of CF		PV of CF
0	2011	59.1		21.9		63.0	
1	2012	59.1	54.2	21.9	19.9	63.0	56.2
2	2013	59.1	49.7	21.9	18.1	63.0	50.2
3	2014	59.1	45.6	21.9	16.4	63.0	44.8
4	2015	59.1	41.8	21.9	14.9	63.0	40.0
5	2016	59.1	38.4	19.0	11.8	63.0	35.7
6	2017	59.1	35.2	19.0	10.7	63.0	31.9
7	2018	59.1	32.3	19.0	9.8	41.6	18.8
8	2019	59.1	29.6	19.0	8.9	41.6	16.8
9	2020	51.9	23.9	19.0	8.1	41.6	15.0
10	2021	51.9	21.9	19.0	7.3	41.6	13.4

Source: BNP Paribas

Groupama's bond values and investment return if not called

Groupama bonds - if not called (lower discount rates)

			LT2		UT2		Tier 1	
Principal			750		500		1000	
Coupon			7.8750%		4.3750%		6.2980%	
Discount rate				7.0000%		8.0000%		9.0000%
Sum of the PV of flows				785.4		264.7		581.8
as a % of par				105%		53%		58%
Amount paid				334		198		361
Price				0.45		0.40		0.36
Difference				451.6		66.7		220.8
Return on investment				**135%**		**34%**		**61%**
Coupon step down			6.9180%		3.8060%		4.1580%	
				PV of CF		PV of CF		PV of CF
	0	2011	59.1		21.9		63.0	
	1	2012	59.1	55.2	21.9	20.3	63.0	57.8
	2	2013	59.1	51.6	21.9	18.8	63.0	53.0
	3	2014	59.1	48.2	21.9	17.4	63.0	48.6
	4	2015	59.1	45.1	21.9	16.1	63.0	44.6
	5	2016	59.1	42.1	19.0	13.0	63.0	40.9
	6	2017	59.1	39.4	19.0	12.0	63.0	37.6
	7	2018	59.1	36.8	19.0	11.1	41.6	22.7
	8	2019	59.1	34.4	19.0	10.3	41.6	20.9
	9	2020	51.9	28.2	19.0	9.5	41.6	19.1
	10	2021	51.9	26.4	19.0	8.8	41.6	17.6

Source: BNP Paribas

Conclusions

- ❑ The market has moved ahead and estimated losses to Groupama that could make it technically insolvent; on this basis, it has valued the bonds poorly
- ❑ We believe this is partly because the investment risks in strategic securities such as Societe Generale shares are being attributed to the shareholders when in fact 75% of the reserves (and the asset backing these reserves) belong to life insurance policyholders
- ❑ Groupama has not been able to improve its solvency position throughout the financial crisis but it has options available to either raise capital or reduce capital requirements
- ❑ We see the group as a weakened but viable organisation and this leads us to value the bonds as we would those of any other group
- ❑ Groupama has adhered to market practice and we expect it to continue to do so

Appendix – Exposure to peripherals core equity erosion: 50% write down

If shareholder participation is →	10%	20%	30%	50%	100%
Non –life insurers and reinsurers: AMLIN, RSA, LLYDIN. HANRUE, MUNRE, RUKNVX, SCOR	No loss	No loss	No loss	No loss	Only MUNRE €1.2bn (8%)
Combined groups: ALVGR, ASSGEN, AVLN, AXASA, CCAMA, DLNA, EUREKO, FSAIM, MAPSM, OLDMUT, SAMAFH, UNIIM, VIGAV, ZURNVX	FSAIM €0.4bn, UNIIM €0.1bn	ASSGEN, €2.2bn, CCAMA €0.4bn, FSAIM €0.9bn, UNIIM €0.4bn	ASSGEN, €4.4bn, CCAMA €0.9bn, FSAIM €1.4bn, MAPSM €0.1bn, UNIIM €0.6bn	ALVGR €0.5bn, ASSGEN €8.7bn, AVLN €0.1bn, AXASA, €1.1bn, CCAMA €1.8bn, FSAIM €2.4bn, MAPSM €0.6bn, UNIIM €1.1bn	ALVGR €6.5bn, ASSGEN €19.6bn, AVLN €1.8bn, AXASA, €6.4bn, CCAMA €4.1bn, DLNA €0.1bn, FSAIM €4.9bn, MAPSM €2.1bn, UNIIM €2.4bn, ZURNVX €0.8bn
Pure life insurers: AEGON, AGSBB, CNPFP, INTNED, LGEN, PRUFIN, RSLLN, SLHNVX, STALIF	AGSBB €0.3bn	AGSBB €0.7bn, CNPFP €1.1bn	AGSBB €1bn, CNPFP €2.2bn	AGSBB €1.6bn, CNPFP €4.4bn	AGSBB €3.3bn, CNPFP €9.8bn
Total aggregate loss of core equity	**€0.9bn**	**€5.7bn**	**€10.5bn**	**€22.4bn**	**€63bn**

Source: BNP Paribas

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