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Crédit Agricole SA puzzles investors

By David Brierley

If French banking is different, then no French bank is more different than Crédit Agricole SA.

The complexity of the banking structure surrounding Crédit Agricole SA has been underscored by a €651 million write-down incurred by the 39 regional mutual banks known as Caisses Régionales de Crédit Agricole Mutuel, or CRCAM, such as Crédit Agricole Alpes Provence.

These mutual banks together own SAS Rue La Boetie, which has 56% of Crédit Agricole SA; the mutuals have revalued this stake, which will result in a €651 million provision in the fourth quarter of 2012.

However, because Crédit Agricole SA also holds 25% of the regional mutuals, it too effectively takes a write-down on its own revaluation at a cost of €160 million. The structure is thus circular.

"It is effectively an incestuous structure but at the time of the IPO of Crédit Agricole, people thought that it would be good for Crédit Agricole to take a 25% stake in the regional banks [CRCAM] to reduce the 'volatility' of the results of Crédit Agricole," Christophe Nijdam, bank analyst at AlphaValue, explained to SNL. "It is the same thing at Natixis, which holds 20% of the Caisses d'Epargne and the Regional Banques Populaires, which in turn hold a majority stake in Natixis."

One sell-side bank analyst, who asked not to be named by SNL, said, "It is a situation that has baffled, confounded and driven to despair sell-side analysts for a generation," while describing Crédit Agricole entities as having "an abracadabra structure."

The question, he said, is "what equity and what capital would flow between the parents and the quoted entity sibling. The latter's capital is low by European standards."

There appears to be no appetite for a similar structure elsewhere in Europe.

Germany's sparkassen, for example, historically have held stakes in most of the landesbanken but these have not had stakes in the sparkassen. The quoted banks created out of the mutual banks of Austria and Italy were or are, in the main, partially held or controlled by charitable foundations, and controlled the mutuals themselves which were, thus, effectively subsidiaries of a listed group. This is a structure that is easy to understand.

In France, by contrast, the mutuals control the quoted company — that is, Crédit Agricole SA or Natixis — which has a minority stake in the mutuals. Moreover, this circularity sets up the possibility of a vicious spiral downwards, as seen at Crédit Agricole SA.

It is a common misconception that Crédit Agricole SA structurally resembles a landesbank. It is true that the landesbanken and Crédit Agricole SA conduct the trading risks and large-scale commercial business of smaller mutual entities. Crucially, however, the landesbanken do not own sparkassen. (Moreover, the landesbanken are partly state-owned and not quoted.)

The situation is rendered even more complex when one tries to consider the capital situation of the Crédit Agricole bank structure. The results and, indeed, the capital position of this structure are regularly presented to analysts and the press in terms of the holding company, Crédit Agricole Group. This ultimate holding embraces the local and regional banks as well as their subsidiary SAS Rue La Boetie, with its 56% stake in Crédit Agricole SA.

Abdoulaye Aboubakar, credit analyst at DZ Bank, told SNL that the structure of Crédit Agricole SA "lacked transparency because of the cross-holdings" and pointed to "almost incomprehensible" structures he saw invoked when capital was discussed.

Nevertheless, Aboubakar is confident that the interlinking of the regional mutuals and the quoted group is a strength. He pointed out that the rating agencies considered the mutual support structure credible and a source of increased stability. "If Crédit Agricole SA got into difficulties, it is reassuring for equity owners to know that the mutual regionals will sustain the bank. [Admittedly,] if both sides have problems, that could create difficulties," Aboubakar said.

Intertwined relationships

Slide 15 of a November 2012 presentation (repeated from an earlier presentation) appears to be the most recent attempt to explain the situation. It shows the relationship of mutual reliance between the regional banks and Crédit Agricole SA. The former have a "[potential liability amount[ing] to €50.3 billion at end-2011" toward the latter while "Crédit Agricole SA is required by the French Monetary and Financial Code to take all necessary measures to ensure that all of its affiliated members, inter alia the regional banks and Crédit Agricole Corporate and Investment Bank, maintain satisfactory liquidity and solvency."

The regional banks are strongly cash positive and generally take shares rather than cash as dividend from Crédit Agricole SA. There is an internal switch mechanism between the latter and the mutuals, which allows the transfer of assets and one assumes, under stress circumstances, capital. Exactly how the latter works is not made clear in the slide which does, however, state: "Regulators and rating agencies consider the group for solvency and liquidity issues."

Yet equity investors do not buy into Crédit Agricole Group but Crédit Agricole SA, whose capital position is significantly worse.

At the end of June 2012, under Basel 2.5, the former showed a core Tier 1 ratio of 11.3% and is committed to exceed 10% "fully loaded" under Basel III by the end of 2013. The latter showed 9.6% under Basel 2.5 at the same juncture; a figure and goal for Basel III were not named.

It seems that one buys a promise of loss-absorbing capital from mutual banks when investing in the equity of Crédit Agricole SA. However, on the slide cited, this is not entirely clear.

Prima facie, the quoted bank's structure does not appear to favor outside equity holders. The power of control and ownership and, indeed, capital resides with the regional mutuals. Admittedly, they are very sound, conservative and profitable retail banks.

"The system is way too complex. There is too much staked against your favor. It makes for a very high beta stock," the unnamed analyst said. He claimed that sell-side analysts who believe in fundamentals must consider that Crédit Agricole SA should bear a market discount. This, indeed, is reflected in the price-to-book ratio of the bank, which currently stands at 44.7% compared to 59.2% for Société Générale SA, according to SNL figures.

The shares of Crédit Agricole have soared in the last year, rising by 53.7% as market confidence returned and signs gathered that regulators were willing to be less stringent on capital issues.

"People who have been underweight [on fundamentals] have been shocked. France has very confidence-driven banks and Crédit Agricole SA is the most confidence-driven of all [and benefits] as evidence of regulatory forbearance comes through," the analyst said.

It must be said that Crédit Agricole SA has faced a very tough phase and looks set to emerge stronger. The bank has absorbed significant losses in Greece and is de-risking its business. Liquidity has improved so that "available liquidity reserves at Sept. 30, 2012, largely exceed net short-term debt," as CFO Bertrand-Pierre Delpit pointed out. In the summer of 2011, they did not when all of France's leading banks were confronted with a dollar liquidity crisis. This situation has, it must also be said, eased in recent times.

Aboubakar pointed out that 2012 was "a critical year and they managed that more or less successfully. Even if the French economy does not develop very well in 2013, even if the NPLs rise, I certainly do not see any catastrophic scenarios."

The 2012 figures will be a sea of red. Crédit Agricole SA is expected to show a €2.0 billion net loss for the full year, according to Inquiry Financial consensus figures, not least due to the losses on the sales of Emporiki Bank of Greece SA and Crédit Agricole Cheuvreux SA, the deconsolidation of Bankinter SA, and a goodwill impairment in consumer finance. While the bank is evidently trying to deal with past issues in 2012, as Aboubakar pointed out, 2013 should see a significant recovery to €2.7 billion net profit according to consensus.

The main worry for Crédit Agricole SA must be the state of the French economy and housing market. Many fixed-income fund managers are, according to a survey published Jan. 28 by S&P Capital IQ, skeptical of the future for France given the government's lack of spending cuts and commitment to reform. The unnamed analyst agreed with this pessimistic view of the macroeconomic situation and feared it might unsettle French bank investors, given that earnings were falling and price earnings ratios had risen sharply.