

Equities

16 June 2011 | 11 pages

French Banks

Alert: Moody's Review for Possible Downgrade

Moody's Review – On 15 June, Moody's placed the standalone financial strength ratings and long-term debt and deposit ratings of Credit Agricole SA (CASA), BNP Paribas, and Société Générale on review for possible downgrade. Primary focus is credit exposure to Greek government debt and Greek private sector.

Downgrade Would Still Rank French Banks Favourably – French banks' ratings 'starting point' is at a premium compared with their wholesale banks peer group (Figure 1). A one-notch downgrade would still put them at the top of the peer group in terms of Moody's ratings.

Short-Term Ratings Affirmed – French banks remain relatively highly dependent to short-term US\$ funding (Figure 2). However, Moody's has affirmed the Prime-1 ratings of the three French banking groups. Furthermore, SocGen has been diversifying US\$ funding via its MLT program as well as corporate deposit gathering, notably in Asia (see our note [French Banks: Feedback from Meetings](#), 31 May).

MLT Funding Programme on Track – French banks' look to be on track to meet their 2011 targets for medium and long-term funding at relatively attractive prices. Latest progress: BNP 58% as of end April (€20bn of €35bn), SocGen 77% as of May (c€20bn of €26bn), Credit Agricole 61% at end April (c€16bn of €27bn programme).

Greek Sovereign Exposure Reminder – Exposure of French banks' to Greek sovereign is €5.0bn for BNP Paribas (as of end 2010), €2.1bn for SocGen (as of May, to decrease by a further €0.7bn in August), €0.7bn for Credit Agricole (as of end 2010). BNP Paribas management previously guided that if this exposure was marked to market in capital, it would suggest a 'hit' of 'only' 15bps to the CET1 ratio.

Greek Direct Exposure – Direct exposure for SocGen (through subsidiary Geniki) represents c1% of group loans. Direct exposure for Credit Agricole (through Emporiki) represents c5% of group loans. As highlighted in our recent note ([First Check into Business Plan](#), 12 May), we are cautious on Emporiki's 2011 provisions and its LDR position (loan-to-deposit ratio of 204%, suggesting a €12bn funding 'gap').

French Banks Look Oversold – French banks look oversold in the context that policymakers are likely to 'kick the can down the road' on Greek sovereign debt. Our economists expect an agreement on the second Greek rescue package, although this will probably only be concluded at the EU Council meeting on Thursday/Friday next week. Our preferred French banks are BNP Paribas (Top 5 pick) as well as SocGen. We also believe that concerns over G-SIFI buffers are overdone with likely 'tiering', a less onerous approach to insurance business as well as potential use of T1/T2 capital instruments to meet the buffer.

(BNPP.PA; €51.30; 1M), (SOGN.PA; €38.78; 1M), (CAGR.PA; €9.90; 2M)

■ Industry Overview

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Figure 1. Wholesale Banks – Ratings by Moody's

	Short term	Senior unsecured	Long term
BNPP	P1	AA2	AA2
SocGen	P1	AA2*-	AA2
CASA	P1	AA1*-	AA1
DBK	P1	AA3	AA3
BARC	P1	(P)A1	A1
RBS	P1	A1*-	A1
JPM	P1	AA3	AA3
BoA	P1*-	A2*-	A2
GS	P1	A1*-	A1
MS	P1	A2	A2

Source: Bloomberg, Moody's

Figure 2. French Banks' Reliance on Top 10 US Money Market Funds

	% of Top 10 money market funds' assets	Top 10 US prime MMFs Exposure to Banks (US\$ bn)
BNP Paribas	3.6	26
SocGen	2.7	20
Credit Agricole	2.3	17
Other European banks	35.7	263

Source: Fitch

Note: Based on Top 10 money market funds (MMF), which hold €736bn assets. Total US prime MMF assets are €1,630bn

Credit Agricole SA

Valuation

We use a two-stage dividend discount model (DDM) to value CASA, including the present value of 2010-13E dividends and a terminal value assuming zero growth at the sustainable RoE. We use a Cost of Equity of 12.3% based on the company's business mix. We cross-check this valuation using: (1) justified price to book valuation, (2) comparable P/E valuation relative to the banks sector and (3) comparable P/E valuation relative to CASA's historical trading range and growth prospects. Our target price on this basis is €11.10.

Risks

Our risk rating on CASA is Medium Risk. The risk rating on the stock is derived after consideration of a number of factors. These factors include an assessment of industry-specific risk, financial risk and management risk. With regard to CASA, we would highlight in particular: complexity of the group and its financials, operational and financial leverage, and acquisition risk.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, the stock will likely have difficulty achieving/exceed our target price.

BNP Paribas SA

Valuation

We use a two-stage dividend discount model (DDM) to value BNPP, including the present value of 2010-13E dividends and a terminal value assuming zero growth at the sustainable RoE. We use a Cost of Equity of 11.3% based on the company's business mix. We cross-check this valuation using: (1) justified price-to-book valuation; (2) comparable P/E valuation relative to the bank sector; and (3) comparable P/E valuation relative to BNPP's historical trading range and growth prospects. We set our target price at €69 on this basis.

Risks

We rate BNP Paribas as Medium Risk based on our assessment of industry- and company-specific risks. The following risks may impede the shares from achieving our target price:

Credit risks are low, but BNPP financial performance would suffer if the credit risk cycle turned down again.

Wholesale banking accounts for approximately one-third of the revenues and capital of BNP Paribas, and the bank may be exposed to downturns in several of its key market segments.

Societe Generale

Valuation

We use a two-stage dividend discount model (DDM) to value SocGen, including the present value of 2009-13E dividends and a terminal value assuming zero growth at the

sustainable RoE. We use a Cost of Equity of 11.5% based on the company's business mix. We cross-check this valuation using: (1) justified price-to-book valuation; (2) comparable P/E valuation relative to the bank sector; and (3) comparable P/E valuation relative to SocGen's historical trading range and growth prospects. We set our target price at €60 on this basis.

Risks

We rate SG Medium Risk based on our assessment of industry and company-specific risk factors. For SG, the following risks may prevent the shares from achieving our target price: (1) the risks of a further sharp downturn in the CEE region where SocGen has significant exposure; (2) a more challenging capital markets environment especially in equity derivatives where SocGen has one of the leading franchises; and (3) more generally, a 'double-dip' in the macroeconomic environment.

Appendix A-1

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Ratings and Target Price History Fundamental Research

Analyst: Kinner Lakhani

Covered since June 17 2010

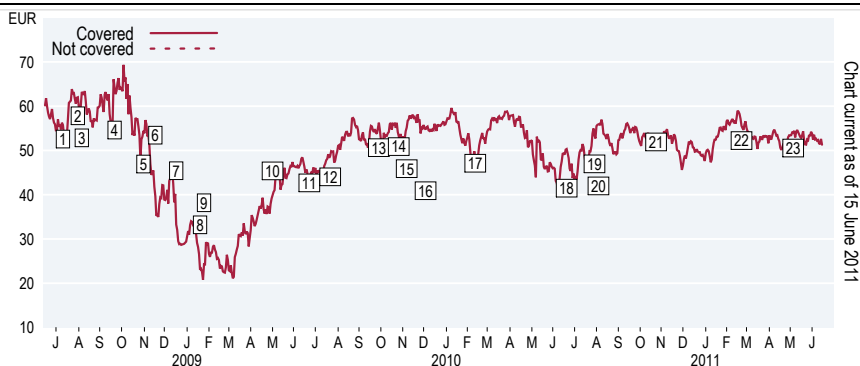


Chart current as of 15 June 2011

Date	Rating	Target Price	Closing Price
1 10-Jul-08	1M	*63.17	55.75
2 31-Jul-08	1M	*68.03	62.01
3 6-Aug-08	1M	*69.98	63.23
4 22-Sep-08	1M	*77.75	64.15
5 31-Oct-08	1M	*68.03	54.43
6 18-Nov-08	1M	*63.17	39.67
7 17-Dec-08	1M	*53.45	33.26
8 20-Jan-09	1M	*43.74	23.04

* Indicates change

Date	Rating	Target Price	Closing Price
9 26-Jan-09	*1H	*38.88	24.30
10 1-May-09	*1M	*48.59	39.12
11 23-Jun-09	1M	*53.45	42.67
12 22-Jul-09	1M	*58.31	48.79
13 29-Sep-09	1M	*60.00	56.27
14 27-Oct-09	1M	*65.00	53.24
15 6-Nov-09	1M	*68.00	55.17
16 3-Dec-09	1M	*70.00	54.73

Date	Rating	Target Price	Closing Price
17 11-Feb-10	1M	*65.00	48.50
18 21-Jun-10	1M	*60.00	50.32
19 29-Jul-10	1M	*62.00	53.40
20 4-Aug-10	1M	*66.00	55.89
21 25-Oct-10	1M	*64.00	52.84
22 22-Feb-11	1M	*67.00	55.56
23 5-May-11	1M	*69.00	53.98

Rating/target price changes above reflect Eastern Standard Time

BNP Paribas SA (BNPP.PA)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Kinner Lakhani

Covered since June 17 2010

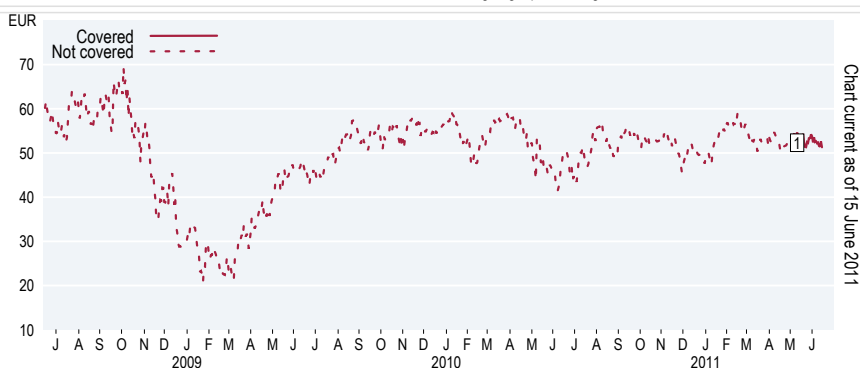


Chart current as of 15 June 2011

Date	Rating	Target Price	Closing Price
1 11-May-11	*ADD MP	-	54.62

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Credit Agricole SA (CAGR.PA)

Ratings and Target Price History Fundamental Research

Analyst: Kinner Lakhani

Covered since June 17 2010

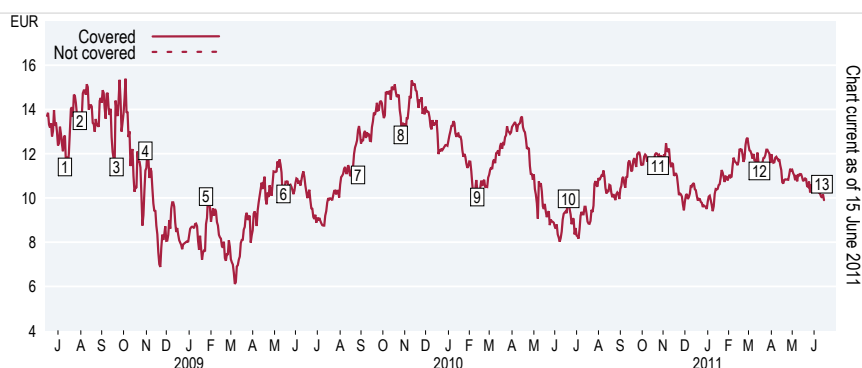


Chart current as of 15 June 2011

	Date	Rating	Target Price	Closing Price
1	10-Jul-08	2M	*13.50	12.82
2	31-Jul-08	2M	*13.00	13.77
3	22-Sep-08	2M	*15.00	13.91
4	31-Oct-08	2M	*13.00	11.24
5	26-Jan-09	*1M	*11.00	8.82

* Indicates change

	Date	Rating	Target Price	Closing Price
6	14-May-09	1M	*12.00	10.18
7	27-Aug-09	1M	*15.00	13.06
8	27-Oct-09	*2M	15.00	13.65
9	11-Feb-10	2M	*12.00	10.40
10	21-Jun-10	2M	*10.50	9.96

	Date	Rating	Target Price	Closing Price
11	25-Oct-10	2M	*11.50	11.91
12	16-Mar-11	2M	*12.00	11.29
13	13-Jun-11	2M	*11.10	10.01

Rating/target price changes above reflect Eastern Standard Time

Credit Agricole SA (CAGR.PA)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Kinner Lakhani

Covered since June 17 2010

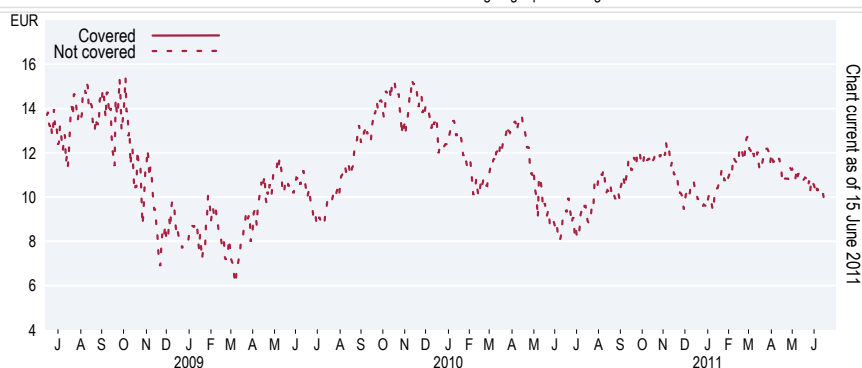


Chart current as of 15 June 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Societe Generale (SOGN.PA)

Ratings and Target Price History Fundamental Research

Analyst: Kinner Lakhani

Covered since June 17 2010

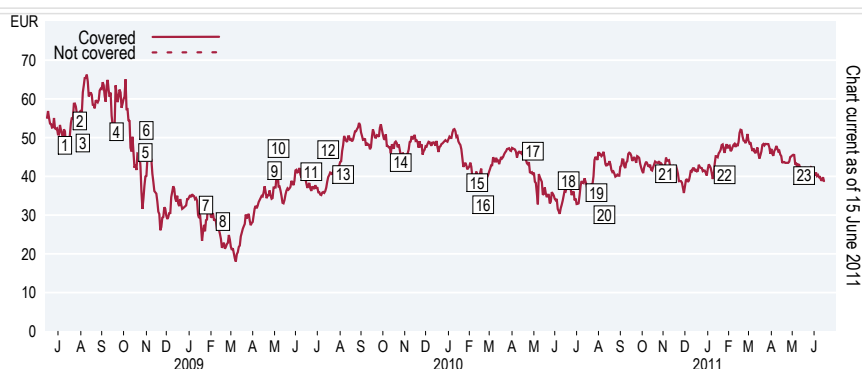


Chart current as of 15 June 2011

	Date	Rating	Target Price	Closing Price
1	10-Jul-08	3H	*47.39	51.66
2	31-Jul-08	3H	*49.29	56.72
3	5-Aug-08	3H	*55.92	61.70
4	22-Sep-08	*2H	*66.35	61.23
5	31-Oct-08	2H	*52.13	39.97
6	3-Nov-08	2H	*47.39	40.12
7	26-Jan-09	*1H	*37.91	28.68
8	18-Feb-09	1H	*28.43	22.13

* Indicates change

	Date	Rating	Target Price	Closing Price
9	1-May-09	*1M	*42.65	37.12
10	7-May-09	*2M	42.65	37.41
11	23-Jun-09	2M	*40.76	36.25
12	16-Jul-09	*1M	*44.55	39.85
13	6-Aug-09	1M	*52.13	48.05
14	27-Oct-09	1M	*55.00	45.33
15	11-Feb-10	1M	*50.00	40.26
16	19-Feb-10	1M	*48.00	39.70

	Date	Rating	Target Price	Closing Price
17	30-Apr-10	1M	*52.00	40.40
18	21-Jun-10	1M	*50.00	38.89
19	29-Jul-10	1M	*54.00	44.71
20	10-Aug-10	1M	*57.00	45.07
21	4-Nov-10	1M	*59.00	44.85
22	26-Jan-11	1M	*62.00	46.07
23	18-May-11	1M	*60.00	41.93

Rating/target price changes above reflect Eastern Standard Time

Societe Generale (SOGN.PA)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Kinner Lakhani

Covered since June 17 2010

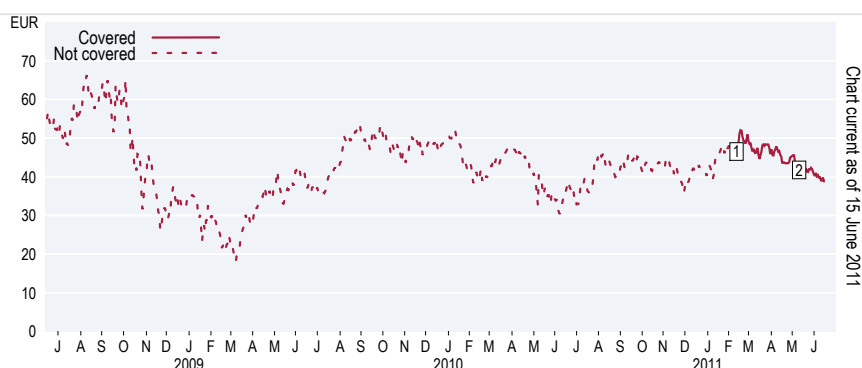


Chart current as of 15 June 2011

Date	Rating	Target Price	Closing Price
1 11-Feb-11	*ADD MP	-	48.40

* Indicates change

Date	Rating	Target Price	Closing Price
2 11-May-11	*REM MP	-	42.98

Rating/target price changes above reflect Eastern Standard Time

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French Banks

16 June 2011

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