

## Equities

10 May 2012 | 12 pages

# Monthly Default Data – April 2012

## Credit Cycle Tame, Remain Cautious on Outlook

### ■ Industry Overview

- **Global Default Rate Increases** — The global 12-month trailing issuer-weighted default rate of 2.6% was only up modestly from prior year levels and still near cyclical lows. Default rates in the US and Europe remain broadly similar – the US default rate increased modestly over the month to 3.0%, whilst the European rate decline marginally to 2.8%. This marks the fourth month in a row where the US default rate has fared worse than the European rate.
- **Three Bond Defaults, No Loan Defaults** — There were three new bond defaults recorded in April by two corporates, all in the US, with a total default amount of \$550m. The largest default was for \$440m – no European wholesale banks had a role in the issuance of the relevant securities, according to Dealogic.
- **Distressed Index Falls, Remaining Cautious on Default Rates** — The Distressed Index, which measures the share of speculative-grade issuers with debt trading at distressed levels, fell modestly for the sixth consecutive month to 17%. While Moody's forecasts the global 12-month trailing issuer-weighted default rate to modestly trend upwards to 3.1% by end-2012, we remain more cautious on this forecast for such a modest turn in the credit cycle. In our view, the current Distressed Index level remains more consistent with a default rate of 5% (see **Error! Reference source not found.**).
- **High Yield Issuance Challenged** — Worsening macro conditions in Europe have driven a steep drop in global high-yield debt issuance in 2Q12-to-date versus 1Q12, mirroring the effective closure of this market during 2H11. Should these conditions persist, low-rated corporates may have difficulty refinancing maturing bonds, increasing the likelihood of them defaulting (see **Error! Reference source not found.** and Figure 1).
- **Most Preferred Barclays, SocGen & HSBC** — Overall, we are more cautious than Moody's on default rates, but continue to expect a shallow worsening of the credit cycle, supported by improved liquidity conditions for banks, and expect peak default rates to fall far short of 2001-02 and 2008-09. Our Most Preferred stocks are Barclays, Societe Generale and HSBC.

#### Kinner Lakhani

+44-20-7986-4258  
kinner.lakhani@citi.com

#### Sentoor Kanagasabapathy

+44-20-7986-4203  
sentoor.kanagasabapathy@citi.com

#### Stefan Nedialkov

stefan.nedialkov@citi.com

#### Florent Nitu

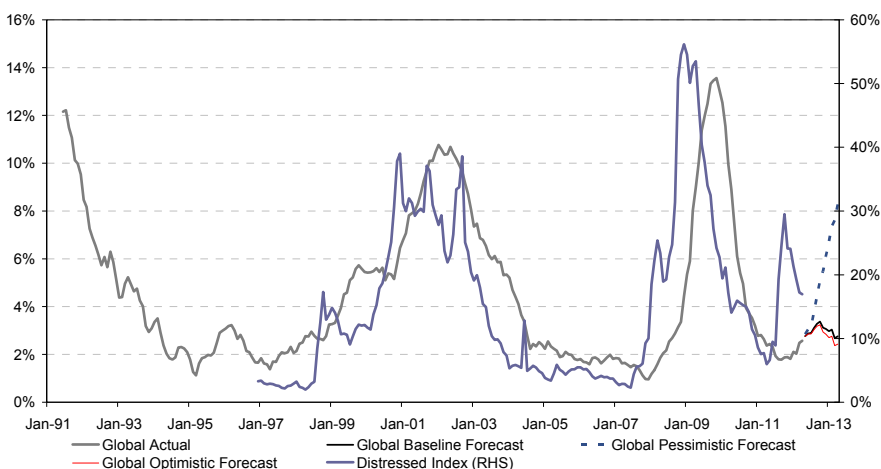
florent.nitu@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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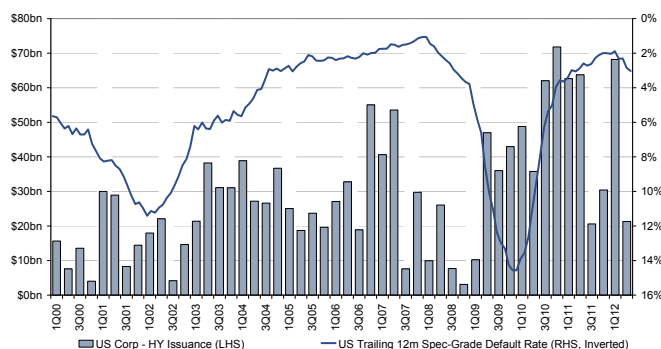
# Moody's Default Data – April 2012

Figure 1. Global Speculative Grade Default Rate vs. Distressed Index



Source: Moody's

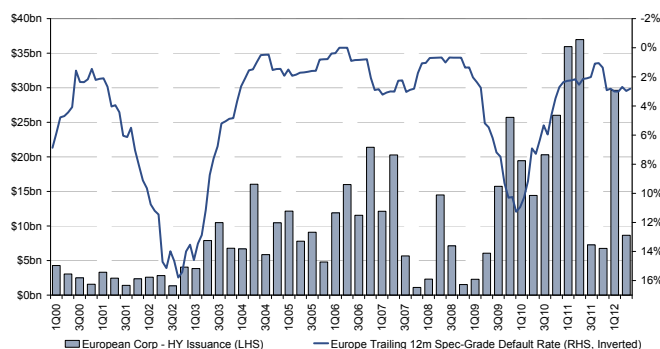
Figure 2. US Corporates – HY Issuance vs Default Rates



Source: Dealogic, Moody's

Note: Default rates defined as trailing 12m issuer-weighted spec-grade default rate

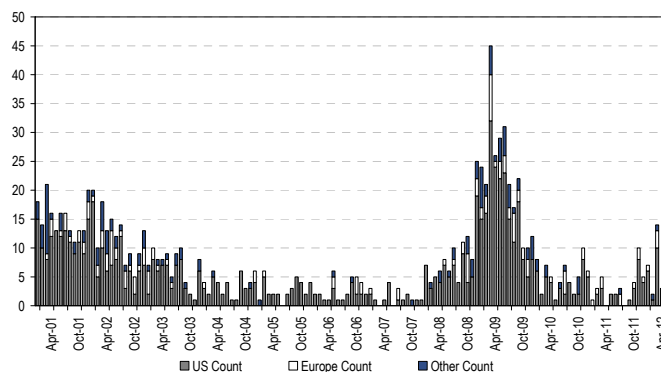
Figure 3. European Corporates – HY Issuance vs Default Rates



Source: Dealogic, Moody's

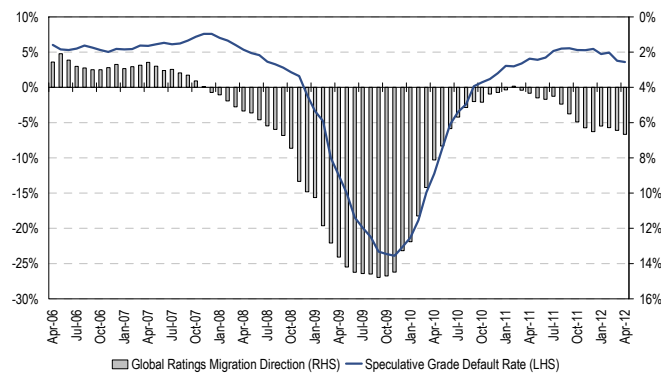
Note: Default rates defined as trailing 12m issuer-weighted spec-grade default rate

Figure 4. Default Count



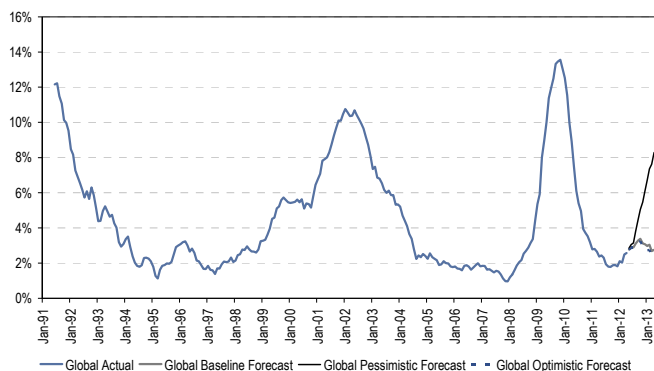
Source: Moody's

Figure 5. Global Ratings Migration



Source: Moody's

Figure 6. Global Speculative Grade Default Rate



Source: Moody's

Figure 7. European Speculative Grade Default Rate



Source: Moody's

## Default Events – April 2012

Figure 8. Initial Bond Default Events in April 2012

Company	Default Event	Default Amount (US\$m)	Specific Industry	Domicile	Ratings* At Default	1-Yr Prior
Dex One Corporation	Distressed exchange	\$98	Media: Advertising Printing & Publishing	United States	Ca	B2
Reddy Ice Corporation	Prepackaged Chapter 11	\$440	Beverage Food & Tobacco	United States	C	Caa1
Reddy Ice Holdings Inc.	Prepackaged Chapter 11	\$12	Beverage Food & Tobacco	United States	C	Caa2

\* Estimated senior unsecured bond ratings, which do not necessarily refer to the rating of a particular debt issue  
Source: Moody's

Figure 9. Initial Loan Default Events in April 2012

Company	Default Event	Default Amount* (US\$m)	Specific Industry	Domicile	Ratings** At Default	1-Yr Prior
None						

\* Defaulted loans in millions of US dollars. Guaranteed debts are only added to the issuers but not to the guarantors in order to avoid double counting

\*\* Most senior loan rating  
Source: Moody's

## Barclays PLC

(BARC.L; £2.04; 1)

### Valuation

We set our target price at 325p based on a two-stage dividend discount approach combined with a capital-adjusted warranted-equity valuation to calculate a terminal value. This target price represents 0.8x 2012E TBV per share, in-line with the European banks sector average, and a 2012E P/E of 11x, a small premium to the sector average.

### Risks

Barclays has exposure to higher-risk banking activities, such as derivatives, but this is offset by its lower-risk banking activities such as the UK mortgage market. There are several risks that could cause the share price to deviate significantly from our target price, including the risks of adverse regulatory changes, a significant UK economic double-dip recession, or a renewed bout of Eurozone sovereign concerns. If the impact of these risk factors is more/less negative than we anticipate, then the share price might fail to reach/rise above our target price.

## Societe Generale

(SOGN.PA; €17.20; 1)

### Valuation

We use a two-stage dividend discount model (DDM) to value SocGen, 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 12.0% 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 €30 on this basis.

## Risks

The key risks to our investment thesis on SocGen are: (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.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

## HSBC Holdings PLC

(HSBA.L; £5.53; 1)

## Valuation

We value HSBC using a peer group SOTP, a two-stage dividend discount model (DDM) and reference to its historical valuation multiples. Our target price of £6.50 is derived from these valuation methods.

1. **SOTP** - Based on 2011E regional peer PB and PE multiples, we derive a fair value of around £6.95.
2. **DDM** - Assuming a terminal ROE of 10.7% and a regionally weighted cost of equity of 10%, we derive a fair value of £6.62 (average of 2% and 4% terminal growth rate scenarios).
3. **Historical P/TB** - HSBC trades at 1.1x P/TB (and 0.9x P/B). Applying its 2000-10 average P/TB multiple of 2.5x gives us a fair value of £10.3.

## Risks

There are several risks that could cause the share to deviate from our target price:

**Market Revenues** - HSBC's Global Banking & Markets (GBM) division accounted for 32% of 2011 pre-tax profits and 24% of 2011 revenues. GBM activities are exposed to financial market volatility.

**Lower Returns** - Regulatory pressures could lead HSBC to hold more capital and incur greater costs than necessary and depress future profitability.

## Appendix A-1

### Analyst Certification

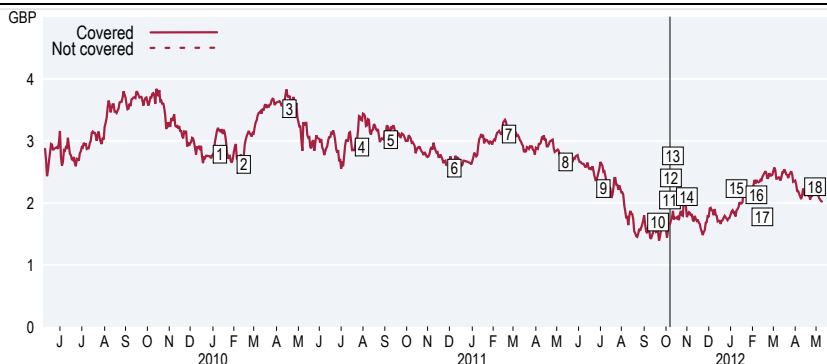
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### IMPORTANT DISCLOSURES

#### Barclays PLC (BARC.L)

##### Ratings and Target Price History Fundamental Research

Analyst: Andrew Coombs  
Covered since July 6 2011



Date	Rating	Target Price	Closing Price
1 12-Jan-10	*1M	*4.13	3.17
2 15-Feb-10	1M	*4.20	2.75
3 20-Apr-10	1M	*4.70	3.73
4 30-Jul-10	1M	*4.42	3.33
5 9-Sep-10	*2M	*3.50	3.23
6 8-Dec-10	2M	*2.94	2.64

\* Indicates change

Date	Rating	Target Price	Closing Price
7 23-Feb-11	2M	*3.38	3.19
8 13-May-11	*1M	*3.24	2.74
9 6-Jul-11	1M	*3.10	2.50
10 21-Sep-11	1M	*2.90	1.53
11 7-Oct-11	Stock rating system changed		
12 8-Oct-11	*1	2.90	1.65

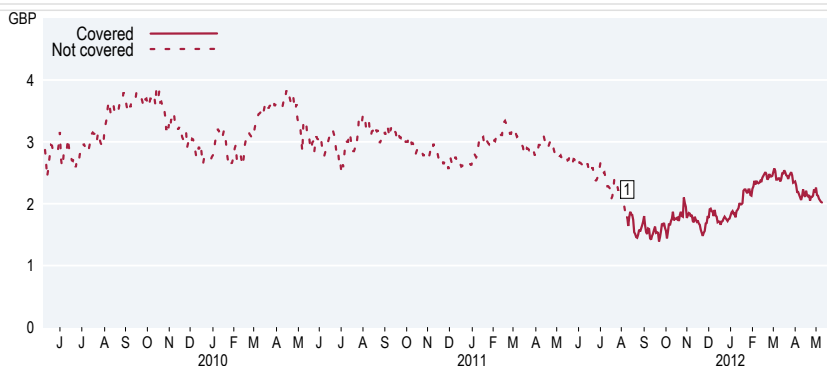
Date	Rating	Target Price	Closing Price
13 12-Oct-11	1	*2.25	1.87
14 1-Nov-11	1	*2.30	1.77
15 10-Jan-12	1	*2.45	1.88
16 7-Feb-12	1	*2.75	2.37
17 15-Feb-12	1	*3.00	2.42
18 30-Apr-12	1	*3.25	2.18

Rating/target price changes above reflect Eastern Standard Time

#### Barclays PLC (BARC.L)

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

Analyst: Andrew Coombs  
Covered since July 6 2011



Date	Rating	Target Price	Closing Price
1 9-Aug-11	*ADD MP	-	1.79

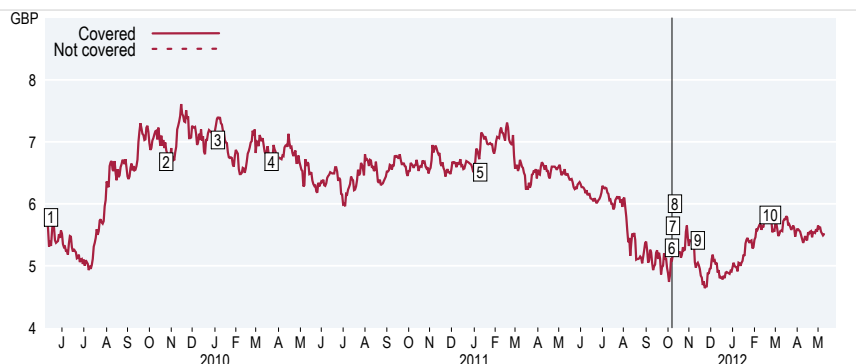
\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

## HSBC Holdings PLC (HSBA.L)

### Ratings and Target Price History Fundamental Research

Analyst: Ronit Ghose  
Covered since May 28 2009



	Date	Rating	Target Price	Closing Price
1	15-May-09	1M	*6.50	5.32
2	26-Oct-09	*2M	*7.00	6.86
3	6-Jan-10	2M	*7.50	7.40
4	23-Mar-10	2M	*7.00	6.76

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	11-Jan-11	*1M	*8.50	6.89
6	7-Oct-11	Stock rating system changed		
7	8-Oct-11	*1	8.50	5.09
8	12-Oct-11	1	*7.25	5.29

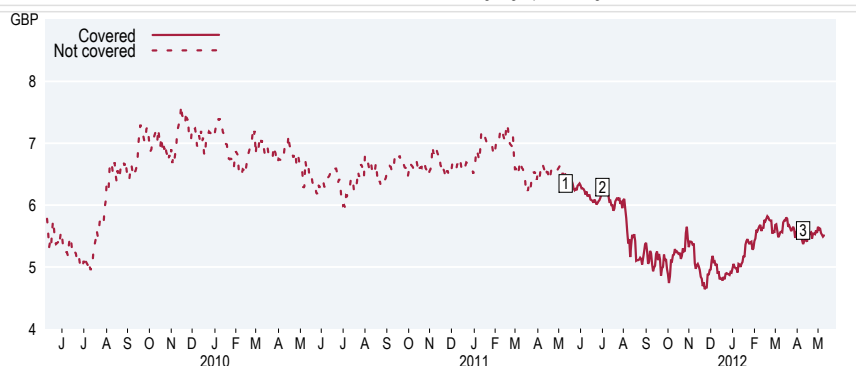
	Date	Rating	Target Price	Closing Price
9	14-Nov-11	1	*6.25	5.05
10	23-Feb-12	1	*6.50	5.75

Rating/target price changes above reflect Eastern Standard Time

## HSBC Holdings PLC (HSBA.L)

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

Analyst: Ronit Ghose  
Covered since May 28 2009



	Date	Rating	Target Price	Closing Price
1	11-May-11	*ADD MP	-	6.46

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	1-Jul-11	*REM MP	-	6.29

	Date	Rating	Target Price	Closing Price
3	10-Apr-12	*ADD MP	-	5.37

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



	Date	Rating	Target Price	Closing Price
1	23-Jun-09	2M	*40.76	36.25
2	16-Jul-09	*1M	*44.55	39.85
3	6-Aug-09	1M	*52.13	48.05
4	27-Oct-09	1M	*55.00	45.33
5	11-Feb-10	1M	*50.00	40.26
6	19-Feb-10	1M	*48.00	39.70
7	30-Apr-10	1M	*52.00	40.40
8	21-Jun-10	1M	*50.00	38.89

\* Indicates change

	Date	Rating	Target Price	Closing Price
9	29-Jul-10	1M	*54.00	44.71
10	10-Aug-10	1M	*57.00	45.07
11	4-Nov-10	1M	*59.00	44.85
12	26-Jan-11	1M	*62.00	46.07
13	18-May-11	1M	*60.00	41.93
14	4-Jul-11	1M	*56.00	41.87
15	28-Jul-11	1M	*55.00	35.61
16	4-Aug-11	1M	*50.00	27.70

	Date	Rating	Target Price	Closing Price
17	14-Sep-11	1M	*38.00	17.39
18	7-Oct-11	Stock rating system changed		
19	8-Oct-11	*1	38.00	20.51
20	28-Oct-11	1	*35.00	23.39
21	9-Nov-11	1	*33.00	18.20
22	16-Jan-12	1	*28.00	16.55
23	6-Feb-12	1	*32.00	23.55
24	18-Apr-12	1	*30.00	17.64

Rating/target price changes above reflect Eastern Standard Time

## Societe Generale (SOGN.PA)

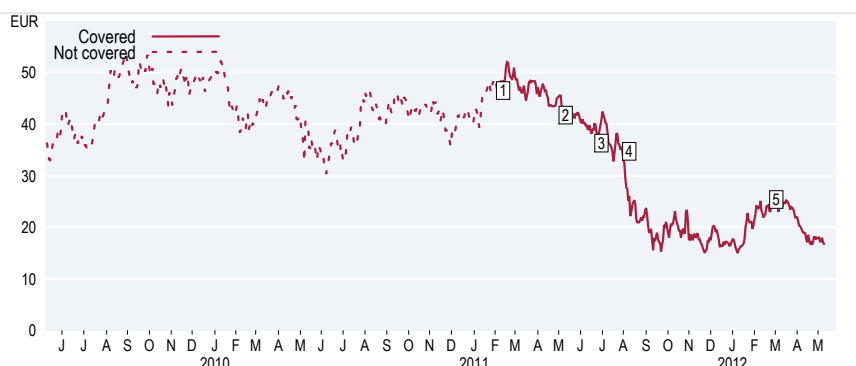
### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Kinner Lakhani

Covered since June 17 2010



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	48.40
2	11-May-11	*REM MP	-	42.98

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	30-Jun-11	*ADD MP	-	40.92
4	9-Aug-11	*REM MP	-	26.02

	Date	Rating	Target Price	Closing Price
5	2-Mar-12	*ADD MP	-	25.40

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 31 Mar 2012</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	10%	79%	10%
% of companies in each rating category that are investment banking clients	44%	42%	40%	47%	42%	43%

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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Kinner Lakhani; Sento Kanagasabapathy; Stefan Nedialkov; Florent Nitu; Andrew Coombs; Ronit Ghose

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