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Banco Popular weighed down by non-performing assets

By Yong Kit Siong

Banco Popular Espanol SA (BPE), Spain's seventh largest banks, announced an annual loss nearly the size of its market capitalization. The bank attributed the EUR 3.5bn loss due to a number of non-recurring items including a Q4 EUR 3bn provision related to non-performing assets. A landmark ruling also dealt a blow to the lender's net income. In December, the European Court of Justice ordered Banco Popular to return clients the money they made from "unfair" mortgage floor clauses introduced in 2009.

Apart from the latest financial loss, Banco Popular is a weak link in the Spanish banking sector due to its high exposure to troubled real estate assets. The RMI-CRI 1-year Probability of Default (PD) for Banco Popular shows that the bank has a higher default risk compared to the median measure of its banking peers (see Figure 1). Eight years after the ill-fated Spanish property boom collapsed, Banco Popular is still the lender with the largest exposure to problem loans with its clean-up of balance sheet being slower than peers.

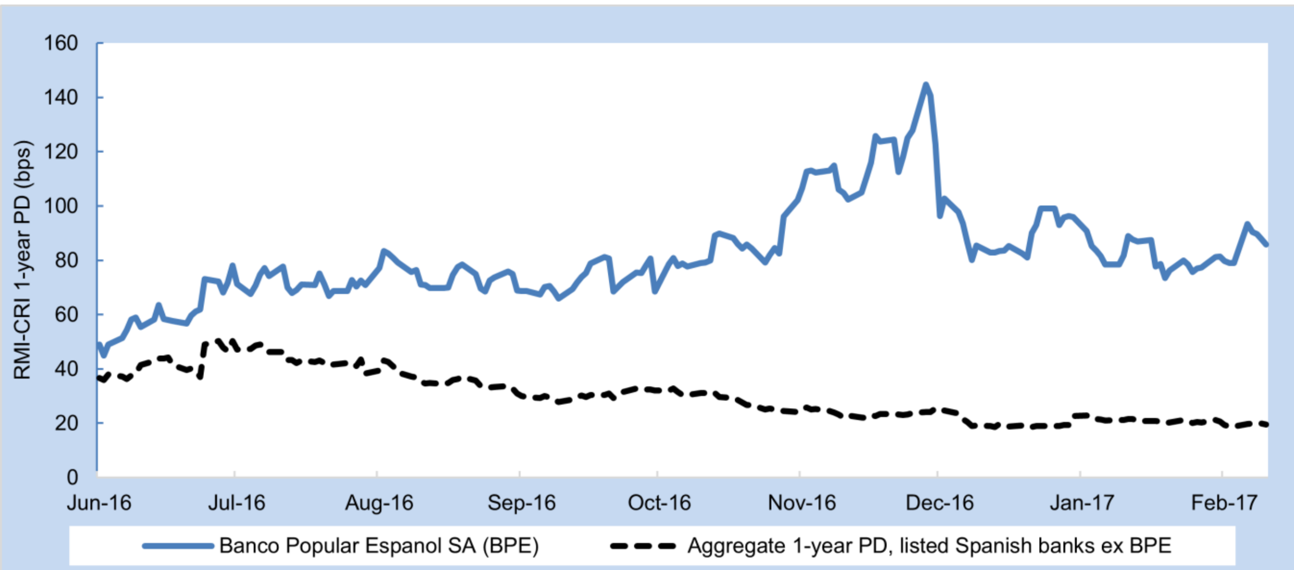

Figure 1: RMI-CRI 1-year PD for Banco Popular vs a simple median of 1-year PDs for six listed Spanish banks. *Source: RMI-CRI*

In Q4 2016, the firm's non-performing loans increased 7% YoY while most of its peers saw an improvement in asset quality. Nearly EUR 30bn of toxic real estate assets accumulated during the property boom years caused the bank's non-performing asset ratio to double the banking sector's average. After two highly dilutive capital increases in the last five years, Banco Popular's Common Equity Tier 1 ratio declined to 8.2%, which is lower than the Supervisory Review and Evaluation Process (SREP) requirement. Banco Popular is urgently selling its assets to boost its capital ratios.

Any future deterioration in asset quality could significantly affect the bank's credit performance. Popular's current coverage ratio, a measure of its ability to absorb potential losses from bad loans, is at 38%, which is lower than the Spanish banking sector average of around 56%. In addition, the bank's net interest income (NII) for the year dropped 7% YoY to EUR 2.1bn as competition for lending and historically low interest rates eroded margins.

Although the new management has pledged to clean up its balance sheet, it should take time for Popular to significantly strengthen its capital position and restructure its non-performing assets. Increasing demands by regulators for transparency in fee management could also increase costs and dampen profitability. How the bank's incoming President returns the firm to profitability and convince investors of its yearly positive outlook remains to be seen.

Credit News

Vallianz sees 35.4% fall in Q4 net profit, has waiver from default for 2 of 3 Swiber-related bank loans

Feb 13. Vallianz reported a 35.4% fall in net profit to USD 3.1mn for Q4 2016. Revenue from entities of controlling shareholder Swiber, which is under judicial management, fell substantially, accounting for 20.8% of the group's total revenue in FY 2016, compared to 34.6% in FY 2015. The company also reported a loss of USD 1.2mn from associate and joint ventures. Vallianz attributed the decline due to lower gross profit margins resulting in the downturn in the offshore marine industry. The company noted that it had not been served notices of any event of default on its 3 outstanding bank loans, which have corporate guarantees from Swiber. It further noted that it has waivers for event of default from two of the three loans, and is in active discussion with the third bank. (Straits Times)

Greek bond could set deadline on country's talks with creditors

Feb 10. Greece EUR 2bn bond maturity in July will likely serve as a hard deadline for the country to get money from its creditors. Trading of the bond has been volatile, with yields reaching 15% before declining to 10.4% last Friday after the IMF and Greece's European creditors came to terms on agreeing a common stance of negotiations with the country. Elections in other countries, including the Netherlands, Germany and France will likely cloud the picture – with German politicians not wanting to appear as letting Greece of the hook. Many investors believe a last-ditch agreement right before the bond matures as likely. (WSJ)

Agrokor's debt structure in focus as PIK "time-bomb" grows

Feb 10. A growing payment-in-kind (PIK) loan is threatening Croatian retailer Agrokor – as investor's confidence in the company's ability to repay dwindles. Although the debt is held at the holding company level, Agrokor's 2020 EUR 325mn senior bonds have collapsed to 75 cents on the dollar. The collapse means that Agrokor's bonds now yield over 20% across its capital structure. However, the PIK debt was raised outside a restricted group of bonds, meaning that it should not impact senior bondholders. The company has three senior notes outstanding – a EUR 300mn bond due in 2019, and two notes valued at EUR 325mn and USD 300mn, both maturing in 2019. (Reuters)

Cell C defaults on payments, gets downgraded to lowest junk rating

Feb 7. South African mobile operator Cell C had its long-term corporate credit rating downgraded from 'SD' to 'D' by S&P, after missing interest payments on its ZAR 5.7bn senior secured notes due in 2018. The credit rating agency noted that the decision to miss interest payments constitutes a default, and delays in concluding its restructuring agreement constrains its liquidity. The company has not sought bankruptcy protection, and is expected to continue its operations and non-debt obligations. Cell C is in the process of restructuring its debt in an acquisition deal involving Blue Label Telecoms, and will have its downgrade reviewed if any deal materializes, says S&P. (Business Tech)

China's zombie province shows what's wrong with its bond market (Bloomberg)

Bank for International Settlements warns of looming debt bubble (Forbes)

Regulatory Updates

Europe vows to maintain post crisis financial rules, despite Trump deregulation

Feb 10. In a speech, vice-president at the European Commission Valdis Dombrovski stated "what is in the hands of the EU is to preserve recent reforms and firmly uphold our prudential framework". The statement came on the back of the pledges by new US President Donald Trump to roll back the 2010 Dodd-Frank act, which is a sharp change in the manner US oversees its financial system and raises the prospect of creating a gulf between the US and Europe after years of attempts at close coordination. Although the European commission has yet to adopt a formal stance on Brexit or President Trump's financial services policies, Mr Drombrovski's speech reflects overall European concerns that the bloc may lose its prominence as a financial center if other jurisdictions begin to deregulate and put EU banks at a competitive disadvantage. (WSJ)

PBOC crusade against leverage seen curbing bank debt spree

Feb 9. China's stance against leverage has grown to encompass short-term debt that smaller lenders have used to boost growth. The People's Bank of China has pushed up money market rates in the past three months and according to China Securities Co., it's "totally possible" regulators will force lenders to add negotiable certificates of deposits (NCDs) to their measures of interbank, prompting them to slow down on issuance. Concerns that weaker smaller lenders could face cash crunches has surfaced. According to a Singapore-based economist at Commerzbank AG, "Small banks have expanded their assets much faster than big banks thanks to the funding from the interbank market" and "PBOC tightening is now making it very painful to them." (Bloomberg)

Banks to propose a more flexible, realistic debt rejig scheme (Economic Times)

EBA publishes final draft technical standards on exclusion from CVA of non-EU non-financial counterparties (EBA)

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