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Ratings

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Research Update:

FE Investments Ltd. Ratings Lowered To 'CCC/C'; Outlook Developing

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Overview

- On Dec. 6, 2019, FE Investments Group Ltd. (FEIG) published its half-year results in which auditors raised uncertainties around the value and recoverability of material loan receivables. We are now factoring this information into our ratings.
- In our view, FE Investment Ltd. (FEI) may need to write down the value of large loan receivables, materially weakening its capitalization and potentially triggering liquidity challenges.
- We are lowering our ratings on FEI to 'CCC/C' from 'B/B'.
- The developing outlook reflects FEI's progress made to restructure its Tomizone exposure and the completion of hotel development projects, the potential near-term sale of three property development exposures, and what we believe is sufficient liquidity to deal with near term pressures. In addition, the upside scenario in our developing outlook recognizes capital available at the FEIG level, which could be down streamed to FEI should it be required to meet regulatory capital or debenture covenant requirements.

Rating Action

On Dec. 20, 2019, S&P Global Ratings lowered its long-term and short-term issuer credit ratings on FE Investments Ltd. (FEI) to 'CCC/C' from 'B/B'. The outlook is developing.

Rationale

On Dec. 6, 2019, FE Investments Group Ltd. (FEIG) published half-year results that raised uncertainties around the value and recoverability of material loan receivables. We are now factoring this new information into our ratings. These loans are sizeable and relate to Tomizone Ltd. (NZ$11 million) and two hotel developments (totaling NZ$17 million).

The company has announced it is restructuring its Tomizone exposures--converting debt to equity. Tomizone itself is dealing with solvency challenges and the need to raise additional capital. This information leads us to believe that FEI may need to write down Tomizone exposures, which, given the size of the exposure relative to FEIG's NZ$17 million capital base, would result in a material weakening of FEIG's capital position.

Concerning FEI's two hotel exposures, we see a risk of further construction delays, a blow out in development costs, or the sale of the hotels at less than the amount required to repay all creditors, which could impact the quality of these exposures. Furthermore, FEI is subordinated in the debt structure.

Should these exposures (Tomizone and the two hotels) face additional credit costs, FEI could be at risk of breaching its regulatory capital requirement or its debenture trust deed covenant requirements without an immediate capital injection. Such breaches could prohibit the company from raising new debentures or rolling over maturing ones, resulting in a liquidity stress.

We note that the external auditor's report on the review of the half-year financial report contained a "Disclaimer of Conclusion" as they were unable to obtain sufficient appropriate review evidence to provide the basis for the review conclusion. This primarily related to the exposures highlighted above. In the half-year financial report, the directors of FEI also considered that the financial statements can be prepared on a going-concern basis.

Outlook

The developing outlook reflects our view that elements of FEI's credit profile remain delicately balanced, stemming from risks associated with the restructure of Tomizone and the hotel development project exposures.

Downside scenario

We are likely to lower our long-term ratings on FEI within the next 12 months if we form the view that additional provisions or write-offs are needed, which would weaken capitalization. In the absence of an immediate capital injection, this could see the company breach its regulatory capital or debenture covenant requirements that could trigger a liquidity stress.

Upside scenario

We could raise our ratings on FEI if we form a view that the entity will sustainably meet its regulatory requirements, debenture covenant obligations, and have sufficient liquidity to remain a going concern. To this point, we note that FEIG raised an additional A$3 million in equity, which could fund further capital injections into FEI should it be at risk of breaching regulatory capital requirements or debenture covenant requirements. An upgrade would also require positive developments on a number of other fronts, such as:

- A successful debt-to-equity restructure of the Tomizone exposure, including Tomizone raising new capital;
- Substantial progress in the construction of FEI's hotel exposures or the sale of these properties without loss; or
- The sale of FEI's three property development exposures.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
FE Investments Ltd.		
Issuer Credit Rating	CCC/Developing/C	B/Stable/B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.