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PANORAMA ROMANIA INSOLVENCIES

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The number of newly initiated insolvency procedures in 2014 it significantly dwindled last year (-28%, according to Coface estimates), down to 21,815 initiated procedures. Coface reckons that the significant decrease in insolvencies registered in 2014 year-over-year is relevant strictly from the statistical perspective, with this trend occurring due to a basic effect, as well as to the decrease in the number of insolvencies among very small companies. Moreover, by the estimated number of insolvencies, Romania, alongside Serbia, remains among the countries with the highest

incidence compared to the average number of insolvencies per 1,000 active companies in the region. The construction industry, the textile, waste, HORECA and food sectors are the top 5 sectors with the highest number of insolvencies at every 1,000 active enterprises, for 2014.

The geographical distribution of insolvent enterprises has undergone significant changes vs. previous year. If newly filled insolvency cases during 2014 has seen similar contraction at regional level vs previous year, Bucharest is the only exception, where the number has remained constant.

JANUARY 2015

SUMMARY

Based on the data published by the IPB and Coface methodology, 18,913 insolvency cases were reported during 2014, with 32% reduction vs. previous time last year, when a number of 27,924 were registered. **These are preliminary data, while final numbers will be reported end of Q1 of current year.** Based on own calculations, Coface estimates that the real number of insolvencies in 2014 amounts to 20,000, thus the real decrease vs previous year being approximately -28%.

Despite this fact, approximately 95% of the contraction is due to the reduction in the number of insolvent enterprises with a turnover less than 500 K EUR, with approximately 80% of these recording a turnover less than 100 K EUR. At the same time, the decrease in the number of insolvencies is due to a significant base (by comparison with a 2013 historical record), and the number of insolvency procedures initiated during 2014 is with 11% above the long term trend (the last ten year's average has been of 18.180 insolvency cases). Moreover, Romania continues to report a 6 times higher than the regional average insolvency incidence for every 1,000 active enterprises, with namely 66 insolvent enterprises of 1,000 active enterprises, and is, next to Serbia, the only country that exceeds the 50 threshold for this indicator. Consequently, we appreciate that the reduction in the number of insolvencies for 2014 is relevant from a statistical viewpoint only, without spreading any positive effect in the payment discipline between undertakings.

From a sectorial distribution standpoint, the construction industry, the textile, waste, HORECA and food sectors are the top 5 sectors with the highest number of insolvencies at every 1,000 active enterprises, for 2014.

Amid a decrease compared to the same period last year, with 28% and 15% respectively, in the number and value of direct debit rejected payments in the first 11 months of 2014, the average rejected for payment value amount has hit a new maximum of 71 K RON, 5 times higher than the level recorded in 2008 (before the global financial crisis effects were felt locally). This dynamic does not confirm an improvement in the payment discipline because the value contraction of rejected payment instruments is due to a reluctance of enterprises to accept such instruments amid decreasing business confidence levels during 2014. According to the latest data provided by the National Bank of Romania, the transacted value of payment instruments has decreased to 9% and their number reduced with 14%, while the % of refused payment instruments reached 15%, 3 times more than in 2008.

For a deeper understanding of the causes of 2014 filled insolvencies, Coface has made an analysis of the financials statements of these enterprises for the period 2008 - 2013. The retrospective analysis for the period 2008 - 2013 of the financial statements of the 2014 insolvent enterprises, has revealed the following observations regarding the evolution of these companies:

- The majority of additional debt (6.6 B RON) was attracted to cover equity decrease (reported losses increasing with 1.9 B RON and additional dividends cashed in of 1.8 B RON), increase in receivables (2.4 B RON), stock (0.9 B RON) and -0.2 B RON reduced treasury, in the context in which additional book value of fixed assets by 100 M RON was reported during the covered period (the amortization value should not be disregarded, with an estimated value during the covered period of 3.9 BN RON already reflected in equity through the reported values of net result, the latter being diminished by the corresponding value of the expense);
- The enterprises attracted mostly short term capital from suppliers, and their weight in the total short term debt increased from 35% (2008) to 55% (2013);
- More than half of the investments were long term oriented and proved to be unprofitable, with increasing loss during the period under analysis;
- The constant increase of the average DSO indicates an inadequate credit risk policy, the average DSO increasing with 82 days during the interval under analysis, from 85 days (2008) to 167 days (2013);

VOCABULARY

- BNR** = Romanian National Bank
- IBP** = Insolvency Proceedings Bulletin
- ECE** = Europa Centrala si de Est
- MPF** = Ministry of Public Finance
- CIP** = Payment Incident Database, BNR
- IPB** = Insolvency Proceedings Bulletin
- DSO** = Days Sales Outstanding
- DIH** = Days of Inventories on Hand
- DPO** = Days of Payables Outstanding
- CCC** = Cash Conversion Cycle
- P&L** = Profit & Loss Account
- II** = Individual Enterprise
- ONRC** = National Registry of Commerce
- PFA** = Authorized Private Individual

- Slower payment to suppliers, the average DPO having increased with 168 days, from 79 days (year 2008) to 247 days (2013);
- The average DSO doubled during the period under analysis while the average DPO has more than tripled during the same period. Under these conditions, for the enterprises that filled for insolvency during 2014, the average cash conversion has recorded an almost 2 months contraction during 2008 - 2013;
- Under these conditions we notice a new business practice wherein outgoing payments to suppliers are prioritized by rotation, according to factors such as transactional volume, business relation historic, future strategic interests or simply the power of negotiation or and strategic importance of each supplier.

Coface calculated the „bill” generated by the enterprises filling for insolvency in 2014, who the payers are and what the impact has been for each business partners category. Section 5 „Evolution in time of the insolvent enterprises and their impact on the economy” further details and splits

the conclusions drawn into two timing stages (2009 - 2011 and 2012 - 2013), the final figures being:

1. **Vendors/ Suppliers:** 7 B RON
2. **Banks:** 4.4 B RON
3. **Shareholders:** 2 B RON (not a direct cost, but rather the opportunity cost)
4. **Government Fiscal Authorities (the state):** 1.3 B RON

Considering as well the other types of interruption of activity, besides insolvency, such as suspension, dissolution, a total number of 120,149 enterprises interrupted their activity in 2014, a decrease with 16% vs previous year. Despite this fact, the number of newly registered enterprises in the first 11 months of 2014 shows and even more abrupt descending trend, with 19% namely, compared to the same period of previous year.

Consequently, we notice a gradual but painstakingly slow recovery of the payment behavior amid the reduction of insolvent companies and defaulted payment instruments. The business framework captures also a relatively unfriendly economic landscape, for both private investors and entrepreneurship initiative.

2 SECTORIAL AND PERIODICAL DISTRIBUTION OF INSOLVENT COMPANIES

Coface Romania has issued a new report regarding the evolution of the number of newly recorded insolvency cases in Romania during 2014 with the Insolvency Proceedings Bulletin⁽¹⁾.

Based on the data published by the IPB and Coface methodology in 2014, 18,913 new insolvencies were

filled, 32% lower vs same period previous year, when 27,924 new insolvencies had been filled. These are preliminary data, while final numbers will be reported end of Q1 of current year. Based on own calculations, Coface estimates that the real number of insolvencies in 2014 amounts to 21,815, thus the real decrease vs previous year is approximately -28%.

Table 1: Monthly evolution of newly filled insolvencies over last 5 years

Month	2010	2011	2012	2013	2014 (Preliminary Data)
January	1,897	1,709	2,159	2,101	2,091
February	1,903	1,849	2,420	2,441	2,210
March	1,887	2,160	2,560	2,368	2,211
April	1,506	1,847	2,340	2,690	2,059
May	1,544	2,097	2,396	1,945	2,118
June	1,880	2,127	2,343	2,310	2,173
July	852	811	1,322	1,517	1,151
August	575	658	1,007	1,050	1,047
September	2,021	2,061	2,444	2,313	1,284
October	1,932	2,202	2,724	4,070	1,421
November	2,222	2,379	2,504	2,976	1,148
December	1,431	1,599	1,623	2,143	2,902
TOTAL	19,650	21,499	25,842	27,924	21,815
Annual Variation		9%	20%	8%	-28%

Source: IPB, Data processed by Coface

(1) See Methodological Remarks at page 19

Chart 1: Number of Insolvencies Evolution between 2010 - 2014

Source: Data processed by Coface

The significant decrease of the insolvency cases recorded in 2014 compared to previous year is relevant strictly from a statistical viewpoint only given that this dynamic was recorded based on a base effect as well as due to the decrease in the number of small enterprises insolvencies. Thus, 36% from the decrease of insolvency cases is represented by

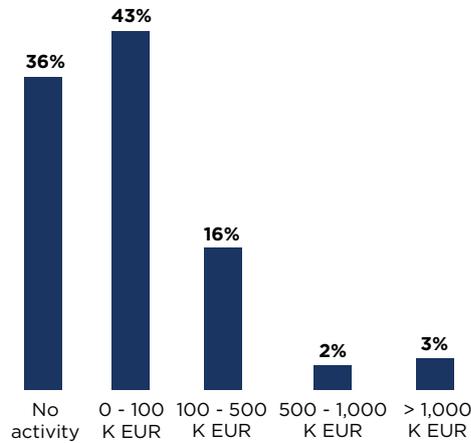
enterprises that were not in any case carrying any activity (2013 turnover was equal to zero), while 43% is represented by enterprises that recorded in 2013 a turnover of less than 100 K EUR. Moreover, only 5% from the decrease in the number of insolvency cases is represented by enterprises with a turnover higher than 500 K EUR during 2013.

Table 2: 2013 and 2014 newly filled insolvency cases dynamics structure

Turnover Category	2014 (Preliminary Data)	2013	Absolute Dynamics	% Dynamics
Total Insolvencies	18,913	27,924	-9,011	-32%
Have submitted their financial statements to MPF for the fiscal year prior to the insolvency filling year	9,381	13,816	-4,435	-32%
% from Total	50%	49%		
Turnover Distribution of these companies				
No activity	3,466	5,070	-1,604	-32%
0 - 100 K EUR	3,782	5,662	-1,880	-33%
100 - 500 K EUR	1,174	1,895	-721	-38%
500 - 1,000 K EUR	327	432	-105	-24%
1 - 5 M EUR	476	561	-85	-15%
5 - 10 M EUR	79	112	-33	-29%
10 - 50 M EUR	66	67	-1	-1%
50 - 100 M EUR	8	10	-2	-20%
Over 100 M EUR	3	7	-4	-57%
Total Annual Deviation			- 4,435	-32%

Source: IPB, MPF, Data processed by Coface

Chart 2: Insolvency Cases Dynamics Structure based on Turnover



Source: Data processed by Coface

Among the factors that determined this decrease we mention the following:

- Favorable base effect - 2014 dynamics is compared to historical records. The decrease in 2014 is recorded in general in comparison to a huge volume of insolvencies registered in the fourth Quarter of 2013, increasing trend that can be attributed to:
 - The negative chain effect of the insolvency of medium and large size enterprises, causing a rapid and amplified financial and social shock in the private economy;
 - The announcement at that time over the introduction of the new insolvency code procedure, imposing additional eligibility criteria on the debtor side. Thus, there have probably been enterprise administrators that have filed for insolvency rather earlier than later, in order to take advantage of the previous insolvency law.
- During 2010 - 2013 only, approximately 95,000 of insolvency proceedings cases have been recorded, generally with enterprises with increasing life span. The revival of the private sector is setting in even though Romania continues to significantly lack in entrepreneurial capabilities, impacting the registration of new profitable businesses.

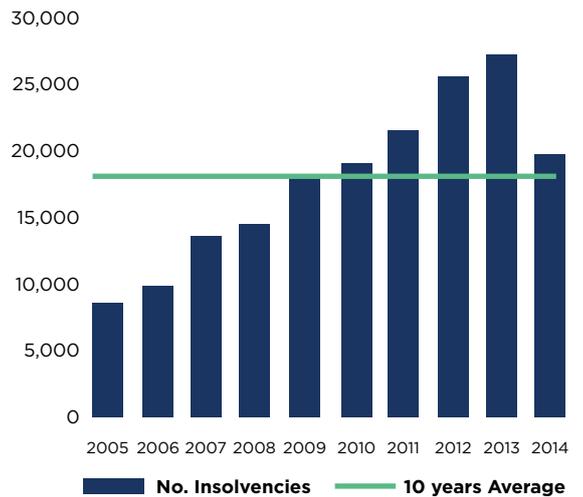
Despite the decrease in the insolvencies filled in 2014 compared to previous year, the level of insolvency proceedings initiated in 2014 records an increase on the long term (the last 10 years average), as it can be observed in the figures presented in Table 1 and Chart 3.

Table 3: The Evolution of Insolvencies in 2005 - 2014

Year	No. Insolvencies	Ten Years Average	Deviation vs Ten Years Average
2005	9,230	18,180	-49%
2006	10,431	18,180	-43%
2007	14,104	18,180	-22%
2008	14,483	18,180	-20%
2009	18,421	18,180	1%
2010	19,650	18,180	8%
2011	21,499	18,180	18%
2012	25,842	18,180	42%
2013	27,924	18,180	54%
2014	20,216	18,180	11%

Source: IPB, Coface studies on the evolution of the insolvency cases during 2005 - 2013

Chart 3: The Evolution of Insolvencies in the Last Ten Years



Source: IPB, Coface studies on the evolution of the insolvency cases during 2005 - 2013

In comparison with the dynamic recorded in similar countries in the Central Eastern region, Romania records a very high incidence of insolvencies compared to the number of active enterprises. According to the data presented in Table 4 (from the Coface study on insolvency in the ECE), Romania and Serbia are the only ones that have recorded a number of above 50 insolvency cases every 1000 active enterprises. Although Romania is recording share of approximately 7% from the total active enterprises in the ECE region, our country generated during 2014 approximately 40% of the insolvencies recorded at regional level.

Even if these figures are valid for 2013 and during 2014 the number of insolvencies recorded in Romania reduced with 32% (based on preliminary data), or 28% respectively (based on Coface estimation), the contraction is not sufficient to cover the significant difference recorded between Romania and the ECE average. Consequently, our estimations are that Romania next to Serbia is in the top 2 countries in the ECE region regarding the newly filled insolvency cases for 2014.

The comparison between the data provided by the IPB and the MPF reveals an increasing degree of transparency identified about the enterprises that have filed in for insolvency. If in 2010 and 2011 respectively, less than 40% of the enterprises that filed in for insolvency had submitted their financial statements, this indicator increased to 47% in 2012 and to nearly 50% in 2013 and 2014. In consequence, we can state that, in average, one in two insolvent enterprises submits their financial statements in the year prior to the year of insolvency filing.

Table 4: Central and Eastern Europe – Insolvencies 2013

Country	Total Insolvencies 2013	Total Insolvencies 2012	Total Active Enterprises	Insolvencies: 1,000 active enterprises
Serbia	8,498	8,333	111,700	76.1
Romania	27,924	25,842	421,900	66.2
Hungary	13,489	22,840	595,000	22.7
Croatia	3,186	3,033	150,000	21.2
Lithuania	1,517	1,400	90,800	16.7
Czech	10,653	8,045	1,471,000	7.2
Slovenia	994	980	185,500	5.4
Estonia	514	495	139,000	3.7
Latvia	818	883	229,600	3.6
Bulgaria	834	601	400,000	2.1
Slovakia	507	452	540,000	0.9
Poland	883	877	1,795,000	0.5
Average ECE	69,817		6,129,500	11.4

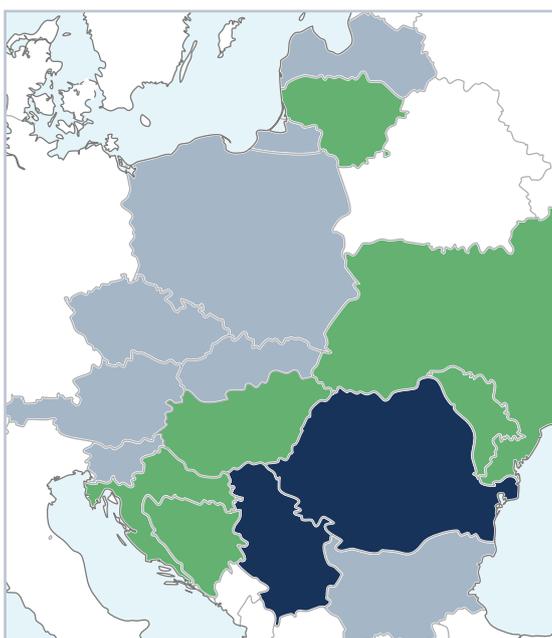
Source: Data processed by Coface

Table 5: Insolvent enterprises - financial statements submitted to the Ministry of Public Finance

Total insolvencies 2014	15,575
submitted the financial statements to MPF	7,696
Percentage	49.41%
Total insolvencies 2013	27,924
submitted the financial statements to MPF	13,816
Percentage	49.48%
Total insolvencies 2012	25,842
submitted the financial statements to MPF	12,021
Percentage	46.52%
Total insolvencies 2011	21,499
submitted the financial statements to MPF	8,153
Percentage	37.92%
Total insolvencies 2010	19,650
submitted the financial statements to MPF	7,902
Percentage	40.21%

Source: MPF, IPB

Chart 4: ECE - Insolvencies per 1,000 active enterprises



Source: Data processed by Coface

Based on the financial statements submitted in the year prior to the insolvency filing year and the main object of activity indicated by the principal NACE code, Coface has distributed the insolvent enterprises based on their industry sector as follows.

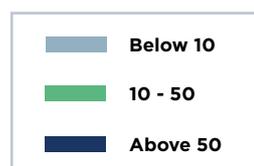


Table 6: Sectorial distribution of insolvencies over the last 2 years⁽²⁾

Field of activity	Insolvencies 2014	Insolvencies 2014 % Total	Insolvencies 2013	Insolvencies: 1,000 enterprises
Retail	4,029	23%	6,096	66
Wholesale and Distribution	3,232	17%	4,748	70
Construction	2,861	15%	3,998	104
Other service activities provided to enterprises	1,558	9%	2,268	42
Hotels and restaurands (HORECA)	1,324	7%	1,938	86
Transport	1,165	6%	1,827	73
Agriculture	573	3%	831	57
Manufacture of wood and wood products	558	3%	976	53
Manufacture of textiles, clothing and footwear	476	3%	766	95
Food and beverages	441	2%	639	74
Metallurgical industry	421	2%	620	72
Real Estate	337	2%	477	45
Other service activities	270	2%	479	36
Recreational, cultural and sporting activities	266	1%	342	70
Manufacture of machinery and equipment	212	1%	273	43
Manufacture of chemicals and chemical products	189	1%	249	55
IT	189	1%	362	22
Financial intermediation	187	1%	356	43
Asanarea si indepartarea gunoaielor; salubritate si activitati similare	185	1%	198	87
Production and supply of electric and thermal energy, gas and water	171	0%	77	236
Post and telecommunications	105	0%	176	50
Health and social care	89	0%	117	15
Mining and quarrying	77	0%	111	93
Total	18,915	100%	27,924	65

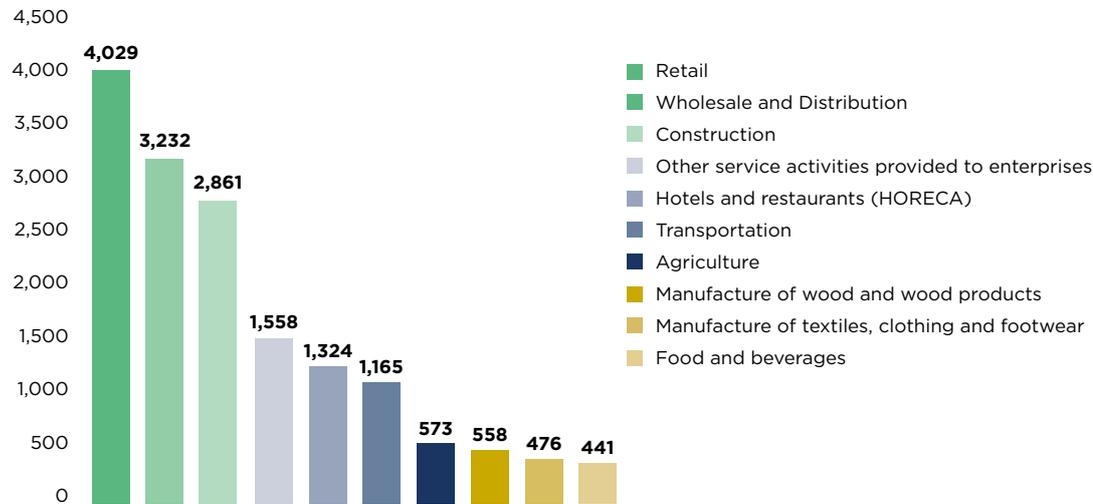
Source: IPB, MPF

Even though we do not possess information on the NACE code in the case of all the enterprises that filed in for insolvency during the period under analysis⁽³⁾, there are 2 reasons why we consider that the sectorial distribution at the level of the entire portfolio is similar to the one at the level of the sample we have analyzed:

- The sample ratio is statistically significant, for both years;
- The sectorial distribution ratio within the sample records similar values with the distribution at the level of the entire portfolio recorded in the studies made by Coface in the last 3 years.

(2) By extrapolation of the enterprises that have submitted their financial statements in the year prior to their insolvency filing year, the enterprises with the highest number of insolvencies for every 1,000 active enterprises are written in blue (for active enterprises we have considered enterprises with a turnover of more than 1,000 EUR/ month during 2013).

(3) This data can be calculated for approximately half of the insolvent enterprises.

Chart 5: Top 10 Industry Sectors in terms of the Insolvency Cases Number during 2014

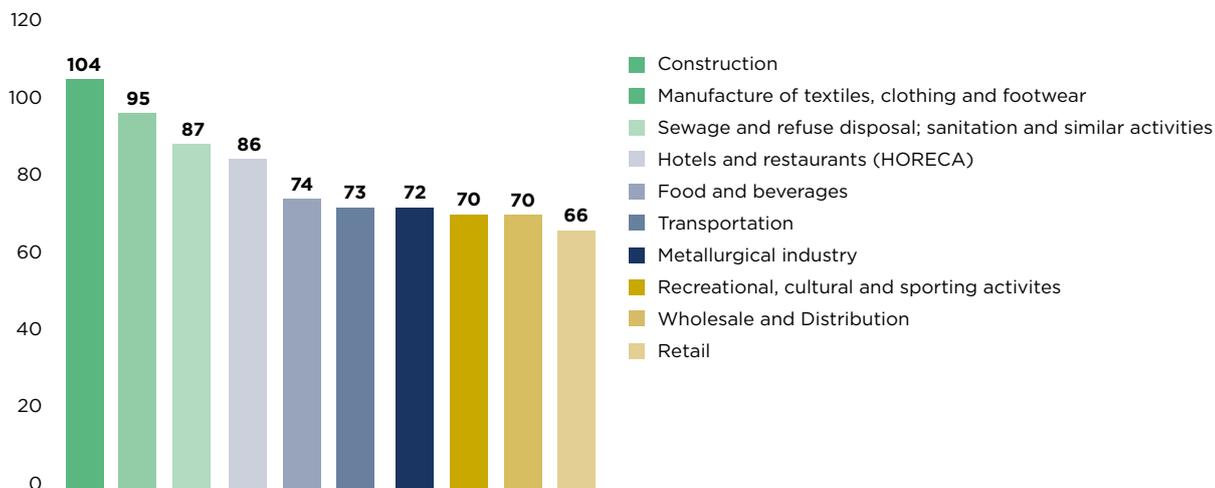
Source: IPB, MPF, Data processed by Coface

In most of the reports issued by Coface regarding the evolution of insolvencies, the top 10 sectors experiencing the highest number of insolvency cases remain unchanged, with max 1 or 2 position shifts in the top.

The analysis of the evolution of the insolvency cases during the last 5 years reveals a tendency for the first 3 to 5 top sectors to concentrate most of the insolvency cases volume. Thus, the percentage of the top 3 sectors recording the highest number of insolvency cases in absolute amounts has varied in the last 5 years between 50% - 54% and for the first 5 sectors, between 65% - 70%.

These percentages are not accidental but are determined by structural factors such as the sectorial distribution of all active enterprises at national level. Thus, the top 5 sectors recording the highest number of insolvencies cover a similar percentage in terms of total active enterprises. Having considered this structural factor, it is important that we analyse the total number of insolvencies in comparison to the total number of active enterprises from the respective sector.

The top ten sectors that record the highest values for this indicator are listed in the next chart. We notice that 4 sectors in the chart show values higher than 80, which means that 8% of the active companies in the respective sector are insolvent.

Charts 6: Top 10 Industry Sectors with highest Insolvency Cases Number per 1,000 active Enterprises

Source: IPB, MPF, Data processed by Coface

(4) Have been included in the category "Active Enterprises" only enterprises with a turnover > 1,000 EUR/ month during the year 2013.

3 PROFILE OF INSOLVENT COMPANIES

From the total of 18,913 insolvent enterprises during 2014, a number of 9,381 have submitted their financial statement for prior year. Based on this information, preliminary indicators have been calculated, both at the level of the entire portfolio and for each turnover range. The results are shown in the next table and

can confirm that the consolidated financial result deteriorates as the size of the enterprise decreases. Thus, enterprises with turnover less than 1 M EUR record highest debt levels, net loss, DSO, the latter being 2 times larger than that of the enterprises with turnovers above 10 M EUR.

Table 6: Insolvent enterprises in H1 2014 - Financial Indicators

TOTAL INSOLVENT ENTERPRISES DURING 2014 - BASED ON 2013 FINANCIALS		
PRELIMINARY FINANCIAL INDICATORS:	DYNAMIC FINANCIAL INDICATORS	
<ul style="list-style-type: none"> 9,381 enterprises with an average turnover of 2.04 M RON Total debt ratio of 99% Net loss of -12% Percentage of total fixed assets from total assets of 43% 82% debt covered through turnover Average DSO of 166 days 	<ul style="list-style-type: none"> 3 out of 10 enterprises recorded an increased turnover in 2013 vs 2012 2 out of 10 of them recorded a positive financial result for the year 2013; 4 out of 10 enterprises did not have any fixed asset in their balance sheet 4 out of 10 enterprises recorded increased DSO in the period 2012 - 2013, for most of these the extended credit terms was supported by the receivables stagnation while the turnover decreased with 21% during the period under analysis 	
OUT OF WHICH:		
ENTERPRISES WITH A TURNOVER LESS THAN 1 M EUR	ENTERPRISES WITH A TURNOVER BETWEEN 1 - 10 M EUR	ENTERPRISES WITH A TURNOVER OVER 10 M EUR
<ul style="list-style-type: none"> 8,749 enterprises representing numerical percentage of 93% Turnover percentage weight of only 14% Debt ratio of 138% Net result of -34% Average DSO of 281 days 	<ul style="list-style-type: none"> 555 enterprises representing 6% number weight Turnover percentage weight of 36% Debt ratio 91% Net result of -13% Average DSO of 177 days 	<ul style="list-style-type: none"> 77 enterprises representing 1% number weight Turnover percentage weight of 50% Debt ratio 84% Net result of -5% Average DSO 127 days

Source: IPB, MPF, Data processed by Coface

Based on the financial data of the insolvent enterprises correlated with the macroeconomic context and the business practices observed between enterprises, the following have contributed to the insolvency risk for the case of the enterprises under our analysis:

- The Increasing significance of the supplier credit in the context of an increasing percentage in receivables in current assets;
- The extension of credit terms amid an aggressive increase of receivables in comparison with the turnover dynamic. This indicates more permissive crediting conditions between private

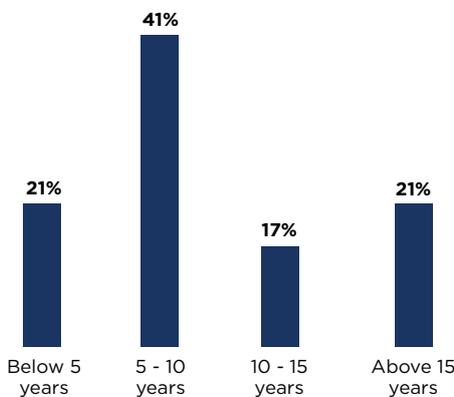
enterprises by starting business with partners that carry higher risk. Thus, the enterprises filing for insolvency in 2014 have recorded a turnover decrease of 21% during 2013, compared with 2012, while the value of the receivables has remained unchanged during the period under analysis;

- The high level of arrears and the negative impact that these have had on the enterprises that work with the state;
- The deteriorated financial situation and the poor self-financing resources that have persisted during the last 3-4 years.

Another important aspect with respect to the insolvent enterprises is their average life time. Thus, if in the period 2012 - 2013 the average lifetime of insolvent enterprises records between 7 - 8 years, the enterprises that have filled in for insolvency during 2014 recorded an average lifetime of 11 years, level similar to enterprises that filled for insolvency during 2009 - 2010. The analysis of the distribution of insolvent enterprises in the first 9 months of current year shows that the weight of the enterprises that had over 10 years of activity was 38%, while their value weight (based on turnover) amounts to 53%. The insolvent enterprises active for up to 5 years represent a numerical and value weight of 21% out of the total number of insolvent enterprises during 2014.

period of last year, 757 enterprises, respectively. Despite this, 68% of this dynamics is due to the decrease in the number of insolvencies among enterprises with a turnover between 1 - 5 M EUR, the incidence of insolvencies among enterprises with a turnover higher than 10M€ remains though a worrying element (the average recorded in 2014 is comparable with the average recorded during 2011 - 2012). Thus 77 enterprises with a turnover above 10 M EUR filled for insolvency in 2014, a level comparable to the cumulated level of the period 2011 - 2012. Similarly, the number of the insolvency proceedings initiated in 2014 among enterprises with a turnover of above 1 M EUR is with 8% over the last 6 years average, 585 enterprises annually for this enterprise segment.

Chart 7: The distribution of insolvent enterprises - lifetime - numerical weight



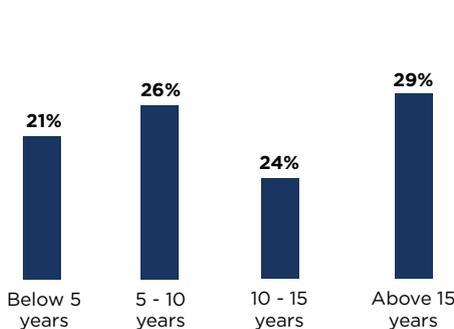
Source: IPB, Data processed by Coface

Table 8: The distribution by turnover of insolvent enterprises during 2014

Turnover Range	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1-5 M EUR	468	402	383	561	476
5-10 M EUR	65	45	57	112	79
10-50 M EUR	31	33	37	67	66
50-100 M EUR	2	2	5	10	8
Over 100 M EUR	3		3	7	3
Total Insolvencies TO > 1 M EUR	569	482	485	757	632

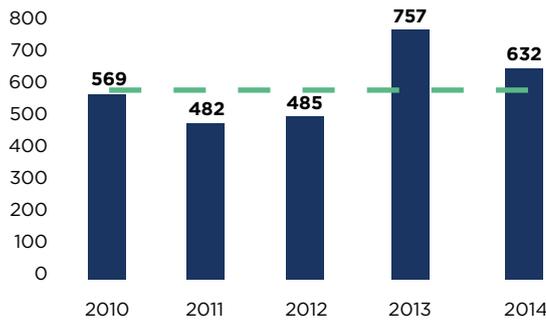
Source: IPB, MPF, Data processed by Coface

Chart 8: The distribution of insolvent enterprises - lifetime - value (turnover) weight



Source: IPB, Data processed by Coface

Chart 9: Distribution of over 1 M EUR Turnover Insolvent Enterprises



Source: IPB, Data processed by Coface

A worrying element signaled by Coface in the last reports on the subject of the insolvency is represented by the increasing number of insolvent enterprises with a turnover of over 1 M EUR. Based on data published by IPB and the analysis made by Coface, the year 2014 signals a decrease in this phenomenon. Thus, the number of insolvencies recorded among enterprises with a turnover of more than 1 M EUR during 2014 decreased to 632 companies, a contraction of 17% compared with the level reported in the same

The number of insolvencies recorded among enterprises with a turnover of more than 1 M EUR during 2014 decreased to 632 companies, a contraction of 17% compared with the level reported in the same period of last year, 757 companies, respectively.

Chart 10: Number of insolvent enterprises with a turnover > 1 M EUR (6 months mobile sum)



Sursa: IBP, Data processed by Coface

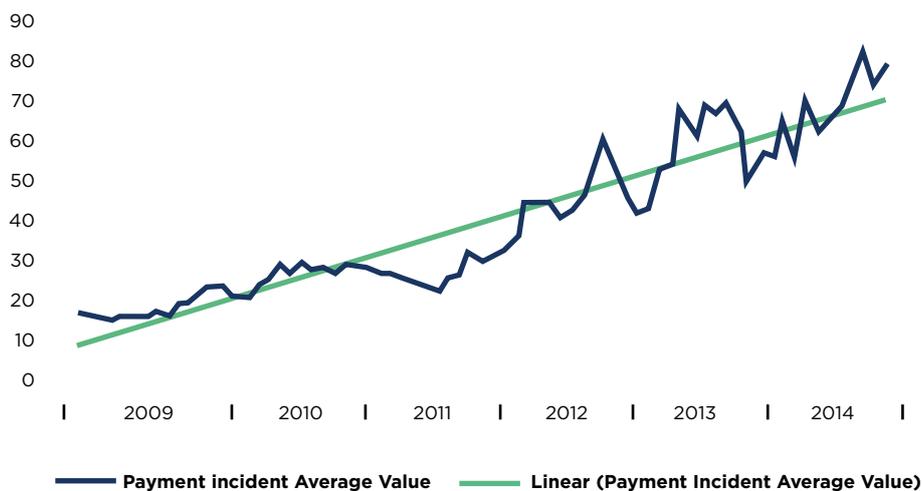
Based on data made available through CIP, for the first 11 months of 2014, the total amount of transactions by direct debit that have come rejected for payment was of 7,38 B RON, smaller by 15% as compared to the same period last year. While the payment incidents number has decreased with 28% in the same period, the average value of payment incidents has increased with 19%. Thus, the average payment incidents recorded during January - September 2014 has reached a maximum level of 71 K RON. We notice the fact that the first 11 months of the current year records a level in the value of payment incidents 2 times higher than that of same period of 2008, while the number of payment incidents is 2 times smaller. Thus, in the period 2008 - 2014, the average value of a payment incident has increased 5 times.

Table 9: Payment incidents evolution based on data made available by BNR

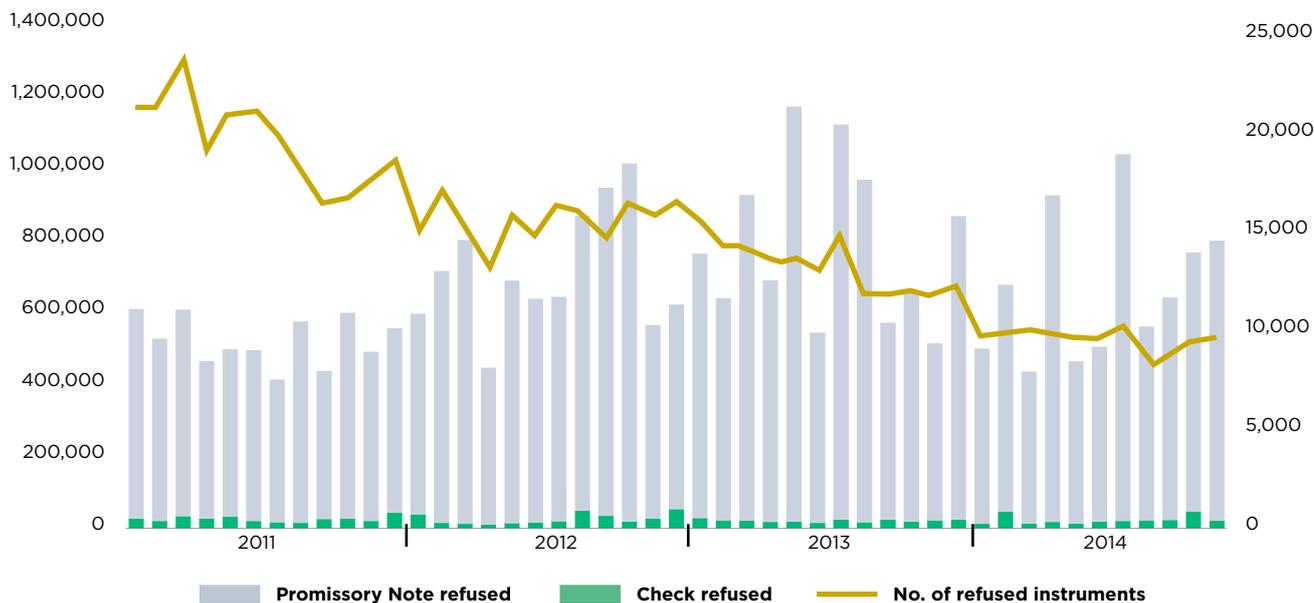
January - November	Total Payment rejected Amounts (K RON)	Incident Number	Incident Average Value (K RON)
2014	7,387,410	104,475	71
2013	8,654,763	145,657	59
2012	8,000,695	169,590	47
2011	5,779,567	214,688	27
2010	8,792,309	324,815	27
2009	8,526,167	451,008	19
2008	3,724,866	244,632	15

Source: BNR (CIP), Data processed by Coface

Chart 11: Average Value CIP (K RON)



Source: BNR (CIP), Data processed by Coface

Chart 12: Number of payment incidents and amounts rejected, K RON

Source: BNR (CIP), Data processed by Coface

Despite this fact, it is premature to interpret this dynamic as a confirmation of payment discipline improvement, given that the total of transacted amounts at national level of 2014 is yet not known (the figures are expected to be made public at the end of current year). Thus, the contraction in the value of refused payment instruments can be due as well to a reluctance of enterprises in the use of these instruments (drafts or checks), amid a decreasing trust level among business partners during 2014. The scenario of a contraction in the use of payment instruments at national level is quite probable, given the trend between 2010 - 2013. Based on the latest data made public by the National Bank of Romania, the amounts transacted through drafts or checks has had a constant decrease in the last years, the total cumulated level for 2013 amounting to 65,683 M RON, less with 9% vs 2012 and with 27% vs 2008. Similarly, the number of such transactions at national level has decreased even more during

2013, with 14% vs 2012 and 46% vs 2008. Thus, even if the rejected payment instruments value recorded a contraction in 2014, it is highly probable that we will witness an increase of the rejected payment instruments value vs the total value of payment instrument amounts transacted at the level of the entire economy. This sense, we can clearly see an ascending trend in the refusal rate, the percentage increasing from 5% in 2008 to up to 13% in 2013. During 2013 there were two times less payment instruments used at the level of the entire economy in comparison to 2008, that have generated transacted amounts 27% less vs the same year, but the value of the rejected transactions dwindled as a consequence of a refusal rate that tripled. We estimate a similar trend for 2014, in the context of decreasing number and value of refused payment instruments and amid a general contraction in the number of payment instruments employed and the level of the entire economy.

Table 10: Total transacted instruments at national level

Year	Amounts transacted with payment instruments (M RON)	Number of transactions (M)	Amounts refused for payment (M RON)	Refusal Percentage %
2008	90,458	10.75	4,446	5%
2009	61,165	9.01	9,422	15%
2010	91,691	10.86	9,570	10%
2011	74,142	7.16	6,342	9%
2012	72,445	6.83	8,629	12%
2013	65,683	5.85	9,531,00	15%

Source: BNR (CIP), Data processed by Coface

4 EVOLUTION IN TIME OF INSOLVENT COMPANIES AND THEIR IMPACT ON THE ECONOMY

For a deeper analysis of the causes that have determined the insolvency of enterprises in 2014, Coface has made an analysis of the financial statements of these enterprises for the period 2008-2013. Thus, out of the 18,913 insolvent enterprises in 2014, a no of 9,381 have submitted their financial statements for the year 2013. Out of these, 4,640 enterprises have submitted their financial statements

to the Ministry of Public Finance for each year in the period 2008 - 2013, these enterprises being as well the most representative, as they generate a weight (turnover) of 84% of the total range under analysis. The preliminary financial indicators for the period 2008 - 2013 corresponding to the 4,640 enterprises are summarized in the following table:

Table 11: Financial indicators of insolvent companies in 2014, based on the activity carried between 2008 - 2013

Indicator	Financials 2013	Financials 2012	Financials 2011	Financials 2010	Financials 2009	Financials 2008
Average Turnover (M RON)	2.9	3.6	3.7	3.5	3.2	3.4
Net Result	-13%	-3%	-3%	-1%	-2%	1%
Debt Ratio	95%	85%	80%	77%	74%	70%
TO/ Debt	81%	105%	120%	130%	131%	161%
Fixed Assets/ Assets	45%	45%	48%	51%	54%	54%
DSO	167	138	117	104	102	85
DIH	76	68	60	53	54	44
Supplier Rotation/ CA	247	174	137	112	106	79
Operational Cycle	243	206	177	157	156	130
CCC ⁽⁵⁾	-4	32	40	44	50	51

Source: IPB, MPF, Data processed by Coface

The analysis of the financial indicators' evolution in the past 6 years reveals several structural elements that have put pressure on the liquidity and have caused payment incapacity.

Thus:

- **Profit & Loss Account (P&L)** - except 2013, the P&L does not represent a worrying element. The average turnover has remained relatively stable during 2008 - 2013, varying between 3.2 - 3.7 M RON. The revenue decrease of 21% during 2013 has been decisive amid 4 times higher losses. The constant loss for the last 4 years (more so, the increased deterioration of the same during 2013) amid a gradual increase of debt without a strong enough capitalization, have pushed these enterprises closer to an end.
- **Balance Sheet** - several structural issues could be identified, which, amid performance challenges signaled in the P&L, have amplified the difficulties of these enterprises:
 - **Current asset lengthy rotation:** Amid a turnover decrease of 21% in 2013 compared with previous year, receivables have remained stable. This dynamic, corroborated with the decrease in the income recorded in advance

(which would have represented additional liquidity) indicates a deterioration of income amid a rapid non-monetary base increase. Thus, the DSO has recorded a constant increase during the period under analysis, from 85 days in 2008 to 167 days in 2013. The enterprises that have recorded the most abrupt deterioration from this perspective are the enterprises with a turnover below 1 M EUR, which have recorded a DSO of 281 days. Moreover, the DPO has increased in the period under analysis from 79 days in 2008 to 247 days in 2013. Thus, the average DPO has extended with 168 days during 2008 - 2013, two times more than the average DSO, the latter having increased during the period under analysis with 82 days. This dynamic could signal a risk of default in settling the supplier's invoices on due date, in the sense in which the insolvent enterprises in 2014 have attracted during the last years more short term financial resources from suppliers and banks than what they would have required to finance their working capital (receivables and inventory). Obviously, an important question is to determine how these surplus resources have been ultimately used, aspect we will be analyzing next.

(5) CCC = DSO + DIH - DPO (see Vocabulary, page 2)

- **Unsustainable debt ratio increase:** The debt ratio⁽⁶⁾ has increased for the entire portfolio under analysis from 70% in 2008 to 95% in 2013. Obviously, this dynamic was recorded amid a decreased capitalization ratio, a sign that shareholders have not covered the loss from the last 6 years through similar capital increase.

What was the cash circuit from 2008-2013? Who has lost and what are the lessons learned?

As it can be noticed in the next table, the financial situation of the enterprises that have become insolvent in the 1st nine months of 2014 looked completely different in 2008 compared to 2013. Table 12 points out and comments on the main differences between the 2 moments.

Table 12: The general situation of the insolvent enterprises in 2014 at 2 key moments – 2008 vs 2013

2013	2008
Average turnover of 2.9 MIL RON, 16% nominal decrease vs 2008. After adjustment with the buying power, real sales have decreased with 1 third between 2008 - 2013	Average turnover of 3,4 M RON
Net loss has risen to -13%	Net result vs. turnover was at +1%
Debt ratio has increased to 95% reaching a critical level amid constant loss as a consequence of poor capitalization	Average debt ratio at 70% - although close to recommended value, it did not represent a significant worrying level provided that the operating return of the enterprises would have exceeded the financing cost
Amid increasing debt and decreasing turnover (most important contraction recorded in 2013, -21% respectively), the annual turnover covering only 81% of the total debt value	Annual turnover exceeded with 161% total debt level
Although the fixed assets book value has remained unchanged during 2008 - 2013 (7.8 B RON, amid the covering of amortization through investment and maintenance services or of debatable positive revaluations of asset value), the weight of fixed assets from total assets have decreased to 45% compared to 54% in 2008, amid 49% increase of current assets during the period under analysis (because of receivables increase by 64% and inventories up by 44%)	The percentage of fixed assets from total assets was of 54%. Maybe the only alarm signal for the enterprises under analysis: modest capitalization considering long term significant investment allocation
Average DSO has increased in the period 2008 - 2013, reaching to 167 days in the last year (amid nominal contraction of revenues by 16% and with receivables increase by 64%)	Average DSO was at 85 days, a level considered optimal and close to the national average for that period
The DPO increased constantly during 2008 - 2013, reaching 247 days in the last year	Average DPO was in 2008 at 79 days. Cash conversion cycle was positive at 51 days, indicating that payments to suppliers were settled by 51 days faster as compared to operating cycle (total length of receivables collection and selling of inventories). Considering the equity ratio of 30% recorded during 2008, this indicates a short term working capital financing balance

Source: Data processed by Coface

(6) Total debt (short term + long term) vs total assets

Table 12 captures a generalized situation among private enterprises, often found in the market in the last six years. Amid growing restrictive banking financing conditions starting with the year 2009, private enterprises were forced into depending more and more on the supplier credit. Non-payment risk was amplified during 2008 - 2013 because:

- The phenomenon was one amplified on the revenue chain, as the request for pay terms extension was being propagated on the supplier chain;
- The phenomenon increased the interdependency between enterprises, more and more enterprises justifying their temporary payment incapacity through non collection of receivables from key customers;
- The cash conversion cycle increased, while the pressure of converting expenses into payments as well increased, amplifying the pressure on the liquidity of the enterprises;

- The phenomenon was a generalized one, many enterprises promoting same behavior simultaneously.

Given the fact that the insolvent enterprises in 2014 have constantly postponed payments to suppliers more than it would have been necessary to finance their receivables that were collected more and more slowly, the following essential question becomes obvious: **Why? How have these resources been used in the meantime?**

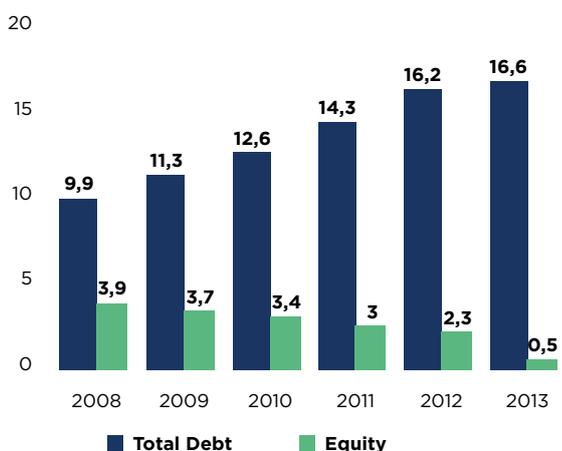
To answer this question, table 13 summarizes for the case of the insolvent enterprises the total balances of financing sources (debt and own capital) compared with the total long and short term investment balances, for each interval of 2008 - 2013. We can thus distinguish between the following intermediary phases that the insolvent enterprises during 2014 with reference to the 2008 - 2013 financial statement exercise.

Table 13: Balance between Financing, Investment and Receivables Due Date (in BN RON)

Year	Debt	Equity	Fixed Assets	Current Assets	Receivables	Stock	Net Result
2008	9.9	3.9	7.7	6.3	3.8	2.0	0.2
2009	11.3	3.7	8.2	6.9	4.1	2.2	-0.3
2010	12.6	3.4	8.4	7.7	4.7	2.4	-0.2
2011	14.3	3.0	8.6	9.0	5.5	2.8	-0.5
2012	16.2	2.3	8.6	10.2	6.4	3.1	-0.5
2013	16.6	0.5	7.8	9.4	6.2	2.8	-1.7

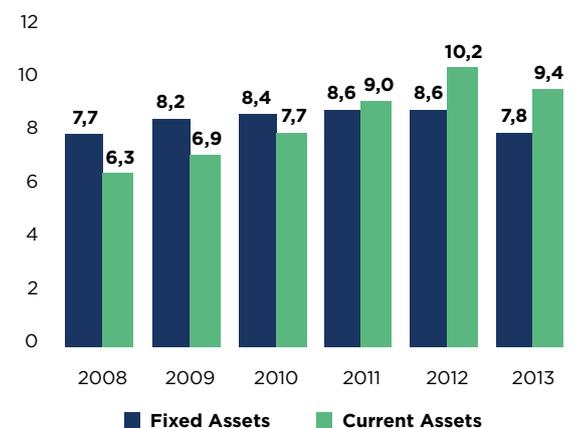
Source: Data processed by Coface

Chart 13: Insolvent Enterprises Equity Structure between 2008 - 2013 (B RON)

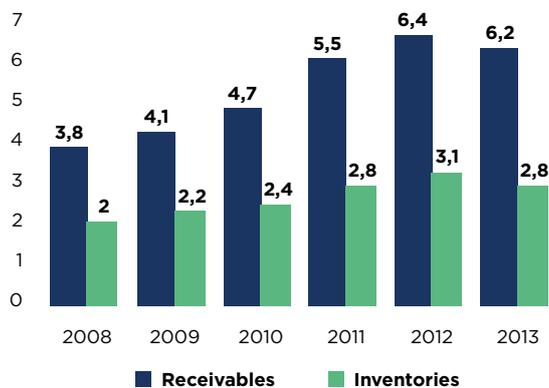


Source: IPB, MPF, Data processed by Coface

Chart 14: Investment Horizon 2008 - 2013 (B RON)



Source: IPB, MPF, Data processed by Coface

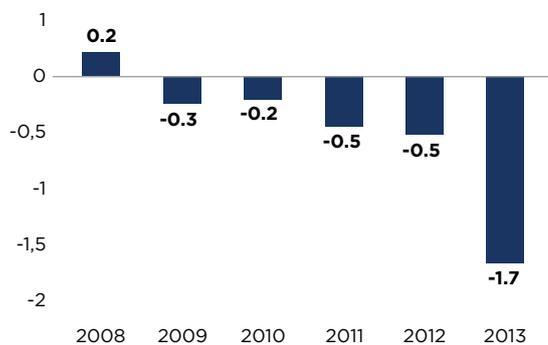
Chart 15: Receivables and Stock Dynamics 2008 - 2013 (B RON)

Source: IPB, MPF, Data processed by Coface

We can thus distinguish between the following intermediary phases that the insolvent enterprises during 2014 experienced, which could be split between 2009 - 2011 and 2011 - 2013.

Phase I: 2009 - 2011 characterized by: capital structure destabilization, loss not covered through social capital, long term investment with negative results financed through short term resources and the extension of credit terms.

- **The year 2009:** additional debt of 1,300 M RON was incurred in order to cover 200 M RON capital deterioration (caused by consolidated loss above 500 M RON and reserves from reevaluation in increase with 300 M RON), 200 M RON fixed asset investment (fixed asset increase with 500 M RON in the context of asset reevaluation of 300 M RON in a year with generalized asset depreciation) and another 900 M RON in inventories and receivables;
- **The year 2010:** additional debt of 1,300 M RON was incurred in order to cover 300 M RON deterioration of capital (caused by dividend payments of 400 M RON in estimated value, amid a decrease in net loss of up to 100M Ron vs previous year), 200 M fixed assets investments and another 800 M RON in current assets (3 thirds in receivables, the rest in stock). In other words, in order to sustain the consolidated turnover increase of 10%, which fueled a similar increase in receivables, the enterprises under analysis have re-directed part of the long term investment (fixed assets) towards short term (receivables);
- **The year 2011:** additional debt of 1,700 M RON was contracted in order to cover a 400 M RON capital deterioration (caused by additional consolidated losses of 300 M RON and 100 M RON paid in dividends), the difference

Chart 16: Net Result Evolution during 2008 - 2013 (B RON)

Source: IPB, MPF, Data processed by Coface

being allocated to finance fixed assets with 200 M RON and current assets with 1,100 M RON (>80% in receivables).

Conclusions: in these 3 years, the enterprises under analysis attracted additional debt of 4,3 B RON, to cover additional loss of 700 M RON (which normally would have been covered through social capital increase), in order to invest on a long term fixed assets of 600 M RON (the balance of fixed assets having increased with 900 M RON in the timeframe under analysis as a consequence of reevaluations amounting to 300 M RON) and 2.500 M RON in current assets (2/3 receivables, 1/3 quarter inventory) and 500 M RON dividend payments. We notice 3 additional factors that have destabilized the financial structure of the respective enterprises:

- Receivables have increased by 47%, much faster than the increase in the turnover, 6% respectively;
- Additional debt mostly on short term and from suppliers. Long term investment was not beneficial, given that:
 - The average turnover increased with only 6% (basically sales have decreased in real values)
 - Operating loss of the enterprises have been amplified with 700 M RON, the deterioration of capital was hidden under a suspicious reevaluation of fixed assets at a consolidated value of 300 M RON, in a context in which the assets depreciated in average with 40% in the timeframe under analysis.
 - Fixed assets investment did not generate real terms additional sales and loss consolidated. This is an important indication that fixed assets investments were directed towards domains of activity that do not generate strong synergies with the main type of activity of the enterprises under analysis.

- The consolidated debt ratio reached at the end of 2011 80%, average DSO increased with approximately 1 month (from 85 days in 2008 to 117 in 2011) while DPO increased with nearly two months (from 79 days in 2008 to 137 in 2011).

Phase II: 2012 - 2013 was characterized by sales decrease, increasing loss and lengthening of the average DSO.

- **The year 2012:** additional debt of 1,900 M RON was contracted in order to cover 700 M RON capital deterioration (caused by dividend payments, amid constant value of reported loss, 500 M RON), the difference being allocated to financing the increase of receivables (+900 M RON) and stock (+300 M RON) while the book value of fixed assets was flat. In that year the consolidated turnover figure decreased by 1%, receivables increased with 17%, and the debt ratio reached over 85%;
- **The year 2013:** additional debt of 400 M RON (which mostly represented increasing balance suppliers, thus unpaid invoices) was attracted to finance a consolidated loss of 1.2 B RON, in the context of income decrease with 21%. Equity deteriorated in marginal terms by 1.8 B RON (amid total dividend payments of 600 M RON), the difference of 1.4 B RON was covered through the sale of fixed assets (800 M RON), collection of open receivables balance (200 M RON), stock sale (200 M RON) as well as treasury reduction with 200 M RON.

Conclusions: The sales decrease in 2013 with -22% caused a 4 times increase of the consolidated loss, while expenses were not adjusted proportionally. Debt ratio reached 95%, given that loss was not covered by additional social capital.

Drawing some final conclusions over the financials of companies that went insolvent during the first nine months of the current year based on backward-looking data during 2008-2013, we observe that:

- The majority of additional debt (6,6 B RON) was attracted to cover equity decrease (reported losses increasing with 1,9 B RON and additional dividends cashed in of 1,8 B RON), increase in receivables (2,4 B RON), stock (0,9 B RON) and -0,2 B RON reduced treasury, in the context in which additional book value of fixed assets by 100 M RON was reported during the covered

period (the amortization value should not be disregarded, with an estimated value during the covered period of 3.9 B RON already reflected in equity through the reported values of net result, the latter being diminished by the corresponding value of the expense);

- The enterprises attracted mostly short term capital from suppliers, and their weight in the total short term debt increased from 35% (2008) to 55% (2013);
- More than half of the investments were long term oriented and proved to be unprofitable, with increasing loss during the period under analysis;
- The constant increase of the average DSO indicates an inadequate credit risk policy, the average DSO increasing with 81 days during the interval under analysis, from 85 days (2008) to 167 days (2013);
- Slower payment to suppliers, the average DPO having increased with 168 days, from 79 days (year 2008) to 247 days (2013).
- The average DSO double during the period under analysis while the average DPO has more than tripled during the same period. Under these conditions, for the enterprises that filled for insolvency during 2014, the average cash conversion has recorded an almost 2 months contraction during 2008-2013;
- Under these conditions we notice a new business practice wherein outgoing payments to suppliers are prioritized or are advised by rotation, according to factors such as transactional volume, business relation historic, future strategic interests or simply the power of negotiation or and strategic importance of each supplier.

Who assumed the cost of these decisions?

Most probably the message carried out to suppliers during 2009-2013 by the enterprises filing in for insolvency in 2014 was that they cannot pay their invoices because of long collection time on their side as well. This is a true fact but it represents only one of reasons for the payment indiscipline. The use of the financial resources coming from late supplier payment for long term investment, proved later to be unprofitable, was, to a similar extent, a cause to payment indiscipline. By analyzing the consolidated balance sheet of enterprises going into insolvency during the 1st nine months of 2014 at 2 key moments, 2008 and 2013 respectively, we can answer to the question: Who assumed the cost of these decisions?

Thus:

- The marginal interest of shareholders of the insolvent enterprises recorded at the end of 2008 was at 3,9 B RON, representing the total value of equity. Except the situations where this was fueled by fictive evaluation of fixed assets, this amount could have been monetized to a considerable extent by distribution of dividends. By extracting the estimated value of 1,8 B RON paid in dividends during the past five years, we can state the opportunity cost of shareholders at 2 B RON⁽⁷⁾;
- The total debt balance at the end of 2013 was of 16.6 B RON. If 50% of the total fixed asset value could be recovered through the insolvency

procedure (optimistic scenario if we consider the average of 30% recorded at national level), total debt of 12.7 B RON remain uncovered (loss). Out of these, 55% is allocated against suppliers, 30% to banks and 10% remain outstanding obligations to the state budget.

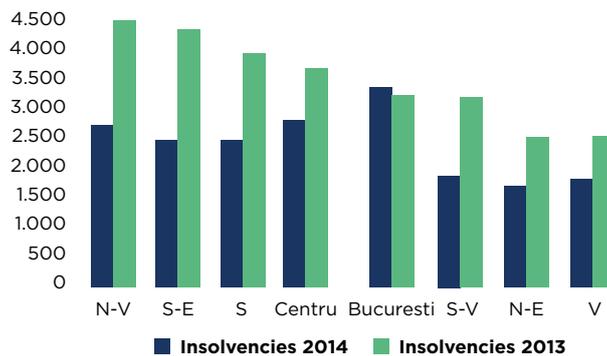
In conclusion, the final net loss caused to business partners and creditors by the companies that went insolvent during 2014, is distributed as follows:

1. Private suppliers: 7 B RON
2. Banks: 4.4 B RON
3. Shareholders: 2 B RON

5 GEOGRAPHICAL DISTRIBUTION OF INSOLVENT COMPANIES

The geographical distribution of insolvent enterprises has undergone significant changes vs. previous year. Thus, if newly filled insolvency cases during 2014 has seen similar contraction at regional level vs previous year, Bucharest is the only exception, where the number has remained constant. Likewise, from a point of view of the number of insolvency cases filed in during 2014, the South-East region occupies the 4th position from a number of 8 regions, while same time last year it occupied the 1st position. In the case of Bucharest the situation is opposite, with the highest number of newly recorded insolvencies this year as compared to rank 5 out of 8 positions last year.

Chart 17: Insolvency cases by region during 2014 & 2013



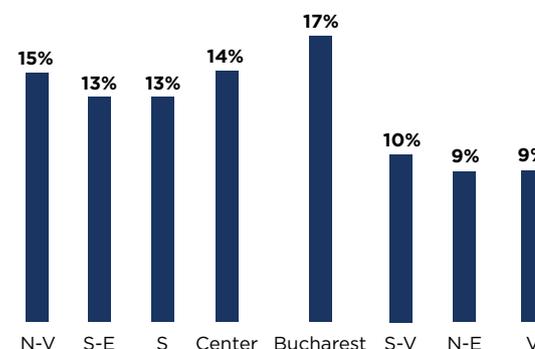
Source: IBP, Data processed by Coface

Table 14: Distribution of insolvent enterprises by region

Region	Insolvencies 2014	Insolvencies 2013	Deviation Insolvencies 2014 - 2013
Bucharest	3,257	3,245	0%
N-V	2,762	4,488	-38%
Center	2,737	3,718	-26%
S-E	2,471	4,408	-44%
S	2,463	3,880	-37%
S-V	1,839	3,199	-43%
V	1,730	2,491	-31%
N-E	1,654	2,495	-34%
Total	18,913	27,924	-32%

Source: IBP, Data processed by Coface

Chart 18: Distribution by region of newly recorded insolvencies in 2014



Source: IBP, Data processed by Coface

(7) Disregarding the level of minimum return on equity, that might vary between 10% - 15% depending on the sector specificity (implied level of risk) and the model used to estimate the cost of capital.

6

PRIVATE SECTOR - WHERE NEXT?

There are different theories⁽⁸⁾ that promote the beneficial aspect of competitiveness in eliminating non performing players in the markets. The technological progress together with innovation will determine that the less competitive business get eliminated from the market and be replaced by new, competitive ones. In this way, the private business environment is in a continues dynamic, the so called «creative destruction».

The applicability of this theory for Romania will have to address:

- The analysis of the number of enterprises that have ceased their activity (not only that have filed in for insolvency) vs. newly registered enterprises, for a given period of time;
- The comparison in terms of the financial and social size of the enterprises ceasing activity vs. newly registered ones.

It is important that all forms of activity interruption are captured: insolvency, suspension, radiation, dissolution.

A. The evolution of newly registered enterprises

Based on data made available by the National Registry of Commerce, the number of newly

registered enterprises in 2014 has decreased by 19% vs. prior year. Ilfov is the only district where the number of newly recorded enterprises has seen an increase of 3%, while the most significant decrease was recorded in Bistrita Nasaud (-54%), Gorj (-48%), Alba (-47%).

The decrease in the number of newly registered enterprises was significantly impacted by the contraction in the number of PFA (-33%) and II (-26%), whereas the number of newly registered Ltd decreased by 7%.

B. The evolution in the number of enterprises that ceased their activity

Based on data published by the National Registry of Commerce⁽⁹⁾, a number of 1,067,417 agents were registered at the end of 2013. After the elimination of PFA and II, 719,258 enterprises are left of which 621.000 submitted their financial statements for the year 2013.

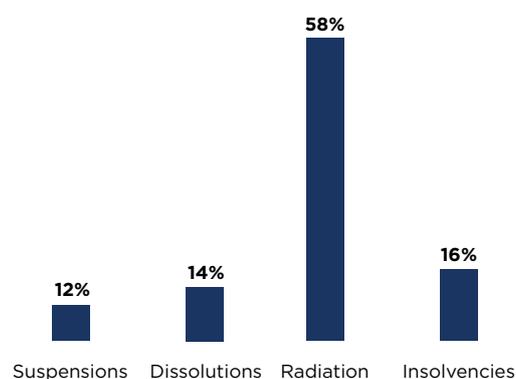
Based on data published by the National Registry of Commerce a number of 120,149 enterprises ceased their activity in 2014, less with 16% vs. same period last year when 143,177 ceased their activity. The distribution in the number of insolvencies by root cause is shown in the chart below:

Table 15: Cease of Activity 2013 & 2014

Type of Interruption	January - November 2014	January - November 2013
Suspensions	14,512	20,374
Dissolutions	16,912	21,427
Radiation	69,812	73,452
Insolvencies	18,913	27,924
Total	120,149	143,177

Source: ONRC, Data processed by Coface

Chart 19: Cease of activity 2014



Source: Data processed by Coface

METHODOLOGICAL REMARKS

This report considers the total number of insolvencies recorded during the last five years, based on data published by the IPB. As an example, all the enterprises that filed in for insolvency during the period January to December 2014 (according to IPB) and that do not show up as active at the beginning of Jan 2015 (according to ONRC), were considered to have been

newly declared insolvencies in 2014.

The analysis of the financial indicators pertaining to enterprises that filed in for insolvency were carried out based entirely on the financial statements information submitted by the same enterprises with the Ministry of Public Finances.

(8) The most known is promoted by Joseph Schumpeter, in his work Capitalism, Socialism and Democracy, 1942.

(9) http://www.onrc.ro/documente/presa/comunicat_30_01_2013/6-active-1.pdf

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