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The paradox of insolvencies in Romania

- **A minimum level of insolvencies correlated with a maximum of losses caused to the business environment**
- **Increasing revenues for companies which, however, have a high degree of indebtedness**
- **Liquidity in the business environment at a historic high, but an increase in the value of the instruments refused for payment by almost 50% in the first half of the current year compared to the same period of the previous year**
- **The sectors with the highest number of insolvencies: Construction and Trade**

Although the number of insolvencies in the first semester of 2017 is similar to that of the last year, namely 4,442 new proceedings, the companies with a turnover of more than 1 M EUR which became insolvent in the time interval analyzed increased by almost 20%, reaching 180 companies.

The number of insolvencies in the first half of the current year is at the minimum of the last ten years, but the losses generated to the creditors are at the highest level in the period analyzed. The paradox, namely a minimum of insolvencies correlated with a maximum of losses caused to the business environment, is explained by the profile of the companies. More specifically, of the total insolvent companies in the first semester of the current year, 20 companies had revenues higher than 10 M EUR in the previous year, out of which 11 carried out distribution, trade or energy supply activities. These companies have a low level of fixed assets and a very high degree of indebtedness, which may predispose the creditors to significant losses.

The degree of indebtedness of the companies which subsequently became insolvent has constantly increased, from 72% in 2008 to approximately 97% in 2016. This dynamics was determined by the accumulation of losses which have eroded the level of equity, the low capitalization contribution from the shareholders and the need for supplementing the debts in order to manage the liquidity pressures.

Of the 4,442 insolvent companies in the first semester of 2017, 2,244 companies submitted their financial returns for the activity carried out in 2016. According to the Coface analysis, **one of the main causes which fueled the risk of becoming insolvent was the accelerated increase of the debts well above the advance of revenues, coupled with the accumulation of increasing losses.**

However, an evolution of the companies' revenues was noticed in the years before the insolvency.

"The level of the companies' revenues significantly increased in the past 3-4 years before becoming insolvent mainly as a result of significant investments. The average turnover in 2016 was of 4,57 M RON, more by 26% compared to the previous year and almost twice more than

that in 2008. However, the companies did not use all the resources to become efficient, accumulating increasing losses. This dynamics was registered as a result of the evolution of the degree of indebtedness, which generated an increasingly important financial burden”, said Eugen Anicescu, Country Manager, Coface Romania.

Also, the increase in the value of instruments refused for payment by almost 50% in the first half of the current year compared to the same period of the previous year also seems to be paradoxical given that the liquidity registered at the level of the business environment is at a historic high. According to the study, the added value of the treasury of the companies from the active business environment in Romania has constantly evolved since the impact of the financial crisis at the local level, reaching 128 B RON at the end of 2016 compared to 78 B RON in 2007.

“If there are companies which benefit from cash, and the insolvencies in the first semester of the current year remain at a historic low, why do we register an increase in the value of the instruments refused for payment? This apparent paradox is explained by the increase of the phenomenon of polarization of revenues, profits and liquidity among large companies. According to data, the first largest 1% of the active companies in Romania, approximately 5,000 concentrate 58% of the liquidity of the entire business environment at the end of 2016, compared to only 43% at the end of 2007. In conclusion, the consolidated cash in the entire business environment register indeed an increase, but the surplus is concentrated among the large companies. The concentration of the cash among the large companies is generated by the increase of the polarization phenomenon from the perspective of revenues and profits of the active companies in Romania”, said Iancu Guda, Services Director, Coface Romania.

“Thus, the largest 1,000 companies generated a share of 50% of all the companies’ revenues at the end of 2016, a less visible phenomenon in the countries of the region. More exactly, 6 out of 10 active companies in Romania register profit, out of which 75% is concentrated in the largest 10% companies. On the other hand, 4 out of 10 active companies register losses while only 42% are concentrated in the largest 10% companies”, added Iancu Guda.

What mistakes the companies which became insolvent have made

Analyzing the evolution of the financial situation registered in the period 2008-2016 by the companies which became insolvent in the first semester of the current year, we point out some of the most common mistakes:

- The lack of alignment of the horizon of assets and liabilities by financing long term investments from resources attracted on short term;
- The money conversion cycle has constantly registered positive values, and the financing sources have not been sustainable;
- The constantly registered losses have eroded the treasury of the respective companies;
- The structure of the cash flow was not sustainable whereas the operational cash was negative, and the treasury was replenished by loans contracted from credit institutions;
- The investments were not efficient because they determined the increase of the revenues, but the companies have constantly registered losses. The return obtained was below the financing cost.

The sectors with the highest number of insolvencies: Construction and Trade

In the majority of studies made by Coface, the first 10 sectors which register the highest number of insolvent companies have mainly remained unchanged, the only changes being at the level of order in the top, but with variations of one or maximum two positions. Nevertheless, it is for the first time in the last five years when the wholesale or retail trade is not in the first position from the perspective of the absolute number of newly opened insolvencies.

The most insolvencies opened in the first semester of the current year were in the constructions field, namely 746, which seems to pass through an unfavorable period, the volume of works decreasing by 8% in the first six months of the current year, compared to the same period of the previous year. The above mentioned sector is followed by the retail trade (705 insolvencies in semester I 2017), the wholesale trade and distribution (660 insolvencies).

Territorial distribution of insolvencies

The territorial distribution of the insolvency cases in the first semester of 2017 did not undergo important changes compared to the existing situation in the same period of the previous year. The **Bucharest, S-E and S** areas have remained the first three regions where the highest number of insolvencies is registered, while the **W, S-W and center** areas remain in the last positions from this point of view.

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