

Friday, July 05, 2019 | special comment

Corporate Bankruptcies Rise In Q2

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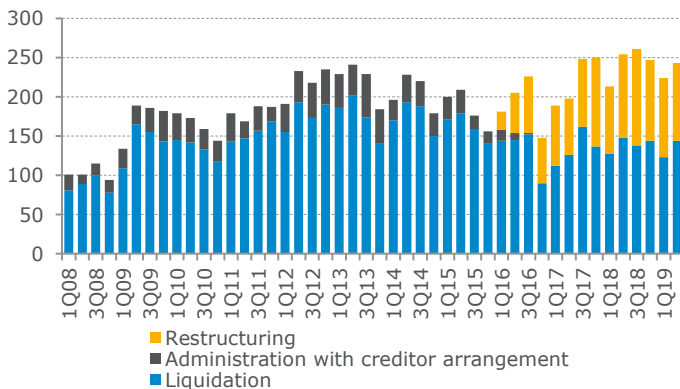
According to a study by Coface, at 243, the number of pending corporate bankruptcy cases in the second quarter of 2019 was down 4.3% from the same time last year, but relative to the quarter before it increased by 8.5%.

By type of proceedings, the number of businesses in liquidation was down 2.7% q/q but up 17% y/y, and administration cases were down 6.6% y/y and 2.0% q/q.

By industry, compared to Q2 2018, the biggest increase in filings (+11) was recorded in the transportation sector, followed by retailers and producers of chemicals and rubber (+4 each). It is worth noting the sharp fall in filings by construction firms, down to a level not seen since Q1 2016, alongside fewer filings by food producers (-7) and metal companies (-4).

The overall rise in insolvencies is a worrying trend in our view given Poland's positive economic outlook forecast for this year. Moreover, the seeming deterioration in the financial standing of retailers and transportation companies is potentially problematic for lenders who have large exposures to these two sectors. One example is Bank Handlowy, in whose case the retail industry accounted for as much as 28% of the total loan exposure at the end of 2018. Finally, note that Coface's study is consistent with the latest central bank data on cost of risk, indicating that in Q2 2019 the average CoR in the Polish banking sector increased by about 4bp to roughly 70bp.

Insolvencies by type of filing



Source: Coface, Dom Maklerski mBanku

Labor costs ruin carriers

There were 25 filings by transportation companies pending in Q2 2019, the highest number since statistics began in Q1 2013. Coface associates the industry's insolvency issues (reflected in payment delays of 140 days on average compared to 60 days across all other industries) with an increase in labor costs to a point where doing business is no longer sustainable. The situation in transportation is all the more troubling to Coface analysts that the industry is viewed as a yardstick for other sectors of the economy.

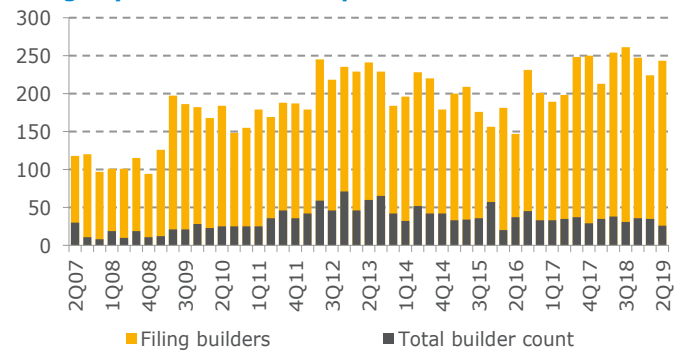
More and more retailers go bust

68 retail firms had filed for bankruptcy as of 30 June 2019, with one cases added since the end of March, a number well above the quarterly average of 52 recorded in the last five years. The factors that drive retailers out of business have been the same, and they include intense competition and pay pressures on top of payment bottlenecks, with delays stretched to 44 days on average from 15 days in the past.

Construction bounces back

Filings by construction companies decreased by 12 y/y in Q2, and at 26 the number of cases was the lowest since Q1'16 and well below the quarterly average for the last five years.

Filings by construction companies



Source: Coface, Dom Maklerski mBanku;

Manufacturing recovers

There were 53 filings by manufacturing companies in Q2, down by 6 from Q2 2018 but up by 5 relative to the previous quarter. Branches where the situation had most noticeably improved compared to last year included food producers (-7) and metallurgical companies (-4). On the other hand there were four more filings in Q2 2019 than in the same period in 2018 by producers of chemicals and rubber.

Bankruptcies by size and age

Of the filings made in H1 2019, the majority (56%) were by companies with annual sales between PLN 5m and PLN 50m (56%), followed by those with less than PLN 5m (29%) and those generating more than PLN 50m (15%). The single biggest case in terms of annual turnover was the meat producer ZM Henryk Kania. Other notable cases included Pol-Mot Auto S.A., QUMAK S.A., Marspol Grupa S.A., Rosa-Bud S.A., CONBELTS S.A., Krakowski Kredens S.A., EXDROB S.A., and Sobsmak Sp. z o.o..

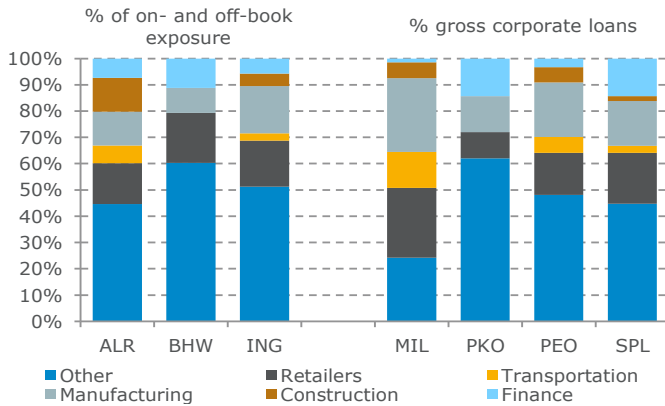
By age, 45% of the insolvent firms have been in business for less than 10 years. The oldest firm on the list is the rolling stock repairer ZNTK w Oleśnicy S.A., est. 1913.

Bank exposures

Retailers represent a major part of the on-and off-book risk exposures of the banks in our coverage universe. Of these, the retail sector makes up the largest portion (26.9%) of the corporate loan portfolio of Bank Millennium, while in the case of PKO BP the proportion is the smallest at 11.61%.

The exposure to credit risk from the transportation industry is much smaller in our banking universe, with these companies making up 13.9% of the 2018 year-end loan book of Millennium.

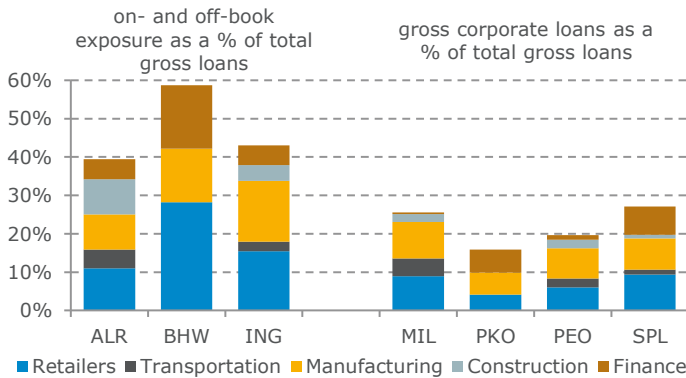
Corporate credit risk exposures* of rated banks by industry



Source: Banks, Dom Maklerski mBanku; *as of year-end 2018

Keep in mind that there are differences between banks in terms of internal risk and loan categorization and reporting of on- and off-book assets. When measured as a proportion of gross loans, the bank with the largest risk exposure to the retail industry at 28% is Handlowy, which probably carries a substantial amount of off-book and conditional receivables. For Millennium, the exposure as a ratio of gross loans drops to 9%, a figure which tallies well with the Bank's much larger portfolios of mortgages and consumer loans. Exposure to transportation companies as a ratio of the total gross exposures of rated banks does not exceed 5%.

Industry credit risk exposures vs. gross loans

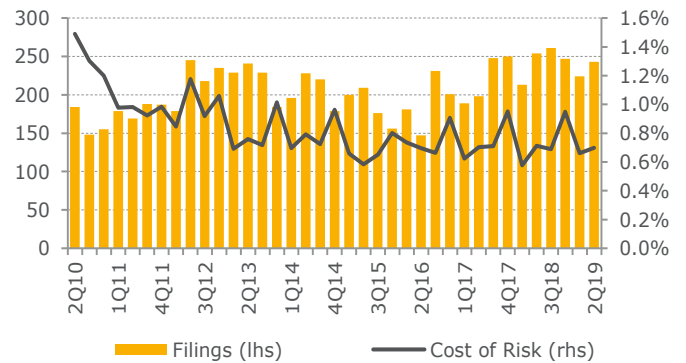


Source: Banks, Dom Maklerski mBanku

Banks tighten credit for corporate borrowers

A central bank survey of credit policies conducted at the beginning of the second quarter revealed that many Polish banks had tightened their lending criteria for businesses this year, placing increased restrictions on long-term loans offered to large corporations and on short-term lending to small and mid-sized businesses. The restrictions include higher margins, lower amounts offered, and shorter payback periods. The reasons given included heightened market risks for different industries, particularly the construction industry. The banks surveyed indicated they were planning to continue tightening access to financing for businesses in the second quarter, and said they were expecting slightly fewer loan applications from SMEs in the period.

Bankruptcy filings vs. cost of risk to banking



Source: Coface, NBP, Dom Maklerski mBanku; CoR in Q2'10 spans 2 months

Insolvency filings in Poland by industry

	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	Q/Q	Y/Y
Industrials	56	71	73	65	67	40	95	56	61	5	-6
Manufacturing	52	63	68	56	59	39	78	51	53	2	-6
Metal products	12	10	10	13	14	14	12	6	10	4	-4
Food & Beverages	7	12	13	6	12	6	12	8	5	-3	-7
Machinery & Equipment	7	2	4	9	5	2	8	3	4	1	-1
Rubber and plastics	2	4	8	5	3	0	8	7	7	0	4
Printing	0	6	3	3	2	1	3	0	4	4	2
Chemicals	3	0	0	1	1	-2	0	0	5	5	4
Paper	1	1	0	1	3	0	1	0	4	4	1
Clothing & Textiles	3	5	3	3	2	2	3	5	2	-3	0
Furniture	0	0	6	0	2	1	7	4	3	-1	1
Wood (ex. Furniture)	6	6	4	6	6	8	4	5	6	1	0
Other nonmetallic mineral products incl. building materials	5	4	5	2	2	2	6	0	2	2	0
Other manufacturing	6	13	12	0	14	5	14	13	1	-12	-13
Consumer	51	65	57	46	70	59	59	67	68	1	-2
Wholesale	30	38	45	27	49	40	32	38	47	9	-2
Retail	11	22	10	17	13	13	23	24	17	-7	4
Construction	35	37	29	35	38	31	36	35	26	-9	-12
Transportation	5	10	17	7	14	14	21	11	25	14	11
Other	51	65	74	60	65	117	36	55	32	-23	-33
Total	198	248	250	213	254	261	247	224	243	19	-11

Source: Coface, Dom Maklerski mBanku

List of abbreviations and ratios contained in the report:

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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