Central and Eastern Europe

Changing Credit Risk Environment in Europe's Emerging Markets

Robert Kovacs

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Content

- Basic Facts on CEE
- CEE Country Risk
- Sector Risk
- Payment Default Risk
- Risk of Insolvency
- Companies' View
- Credit Agency's View

CEE – Basic Facts

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CEE – geopolitics

- **Central and Eastern Europe – 16 (17) independent national states**
  - Poland, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Albania
  - Baltic states – Estonia, Latvia, Lithuania
  - Former Yugoslavia – Slovenia, Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Republic of Macedonia, (Kosovo)
- **Area: 1.35 million km2**
- **Population: 124 million inhabitants**
- **CIS countries**
  - Belarus (10 million inhabitants)
  - Moldova (4 million inhabitants)
  - Ukraine (46 million inhabitants)
  - Russia (142 million inhabitants)
  - And adjacent territories (Caucasian and Central Asian countries)

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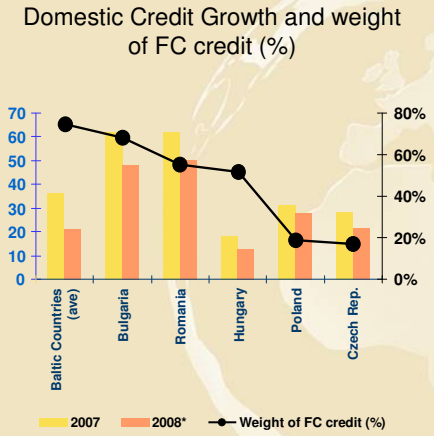
CEE – transformation processes

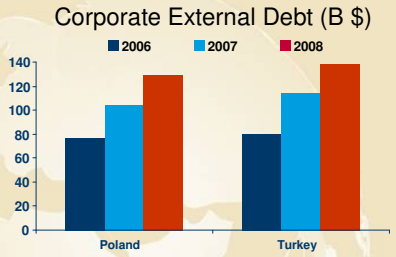
- **Political and economic transformation since 1989**
- **Process of formation of national states**
  - Between 1989 and 2006 (2008)
- **EU Accession process**
  - 2004: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia
    - Increase of EU population by 20%, increase of GDP by 5%
  - 2007: Bulgaria, Romania
- **Adoption of the EUR**
  - Slovenia: 2007
  - Slovakia: 2009

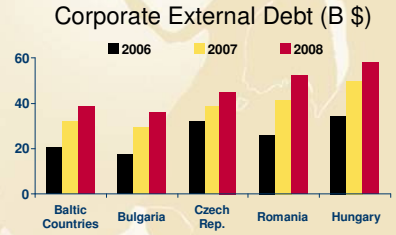
  (Montenegro, Kosovo)

CEE – Country Risk

CEE – credit growth and corporate external debt







Source: Coface Economic Research, Jan 2009

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CEE – macroeconomic indicators - Oct '08

	GDP (yoy, %)			FDI (% of GDP)			Ind. output (yoy, %)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
• Bulgaria	6.2	6.3	4.2	22.6	15.5	10.0	9.0	8.0	7.3
• Czech Rep.	6.6	4.0	3.2	5.2	4.6	6.2	9.0	4.0	4.0
• Hungary	1.3	2.5	3.3	4.0	3.6	3.8	8.1	6.9	7.8
• Latvia	10.3	0.5	0.4	8.0	5.3	4.6	0.5	-3.5	0.5
• Poland	6.6	5.2	4.2	4.4	3.2	3.3	9.7	5.3	3.8
• Romania	6.0	8.0	4.8	5.9	6.0	4.5	5.6	6.0	5.0
• Russia	8.1	7.4	6.0	4.1	3.7	3.7	6.3	5.7	5.5
• Serbia	7.1	7.0	5.3	5.5	6.7	7.1	3.7	4.0	4.0
• Ukraine	7.6	6.3	4.2	6.6	5.9	3.8	10.2	6.2	5.0

Source: UniCredit Group, CEE Research Network – Closing date: Oct 3,2008

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CEE – macroeconomic indicators - Feb '09

	GDP (yoy, %)			GDP (yoy, %)		
	2008	2009	2010	2008	2009	2010
• Bulgaria	6.3	4.2	4.5	6.0	0.8	2.0
• Czech Rep.	4.0	3.2	4.0	4.2	1.0 (-2.0)	6.2
• Hungary	2.5	3.3	4.0	0.8	-3.0	0.3
• Latvia	0.5	0.4	3.6	-1.8	-8.0	-1.0
• Poland	5.2	4.2	4.4	4.8	1.5 (0.5)	2.3
• Romania	8.0	4.8	4.7	7.8	-1.0	3.0
• Russia	7.4	6.0	5.5	6.0	1.0 (-0.3)	3.8
• Serbia	7.0	5.3	5.6	5.7	0.0	3.0
• Ukraine	6.3	4.2	5.1	2.3	-6.0 (-8.0)	1.5

Source: UniCredit Group, CEE Research Network – Closing date: Oct 3, 2008

Source: The Economist Intelligence Unit, Corporate Network – Closing date: Feb 2009

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CEE – Country Ratings Coface

→ **Comparable Country Ratings**

- A1 neg. Germany, Belgium, France
- A2 United Kingdom, Italy, US
- A3 India
- A3 neg. South Africa
- A4 Brasil
- B neg. Vietnam
- C Argentine, Kenya
- C neg. Pakistan, Ecuador

Source: Coface Economic Research, Jan 2009; Coface Country Ratings are on a scale of A1, A2, A3, A4, B, C, D with pos. or neg. trend indicators

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CEE – Sector Risk

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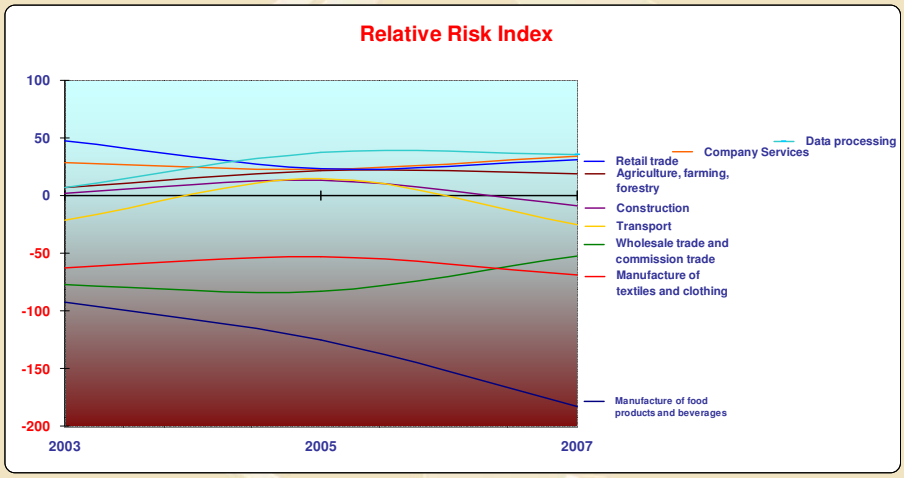
CEE – sector risk analysis – anticipating trends



Source: Coface Central Europe Sector Risk Analysis 2007, May 2008

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CEE – negative trends before 2008 crisis

Sector	Relative risk index 2003	Relative risk index 2005	Relative risk index 2007
Manufacture of food products and beverages	-92	-125	-183
Wholesale trade and commission trade	-77	-83	-53
Manufacture of textiles and clothing	-63	-53	-69
Construction	2	13	-9
Transport	-21	15	-25
Agriculture and farming, forestry, fishing	7	21	19
Company services	29	23	34
Retail trade	47	24	31
Data processing and data warehousing	7	38	35

Source: Coface Central Europe Sector Risk Analysis 2007, May 2008

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CEE – currently most vulnerable sectors

- **Wholesale trade and retail sale**
  - It is the high number of insolvencies that will always show this sectors on top of the negative list
  - On average between 35% and 45% of all insolvencies
- **Construction and related sectors**
  - High number of secondary insolvencies
- **Transport and freight forwarding**
  - Like the construction industry among the fastest growing segments
- **Wood processing industry**
  - In markets were this industry was previously strongly established
- **Specifically, the automotive industry and its supply chain**
- **Machine building industry**
- **Insolvencies with high impact can be found in almost all sectors**
  - Exceptions: petrochemical industry, energy suppliers, telecommunications, pharmaceutical industry, IT (some subsectors)

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CEE – Payment Default Risk

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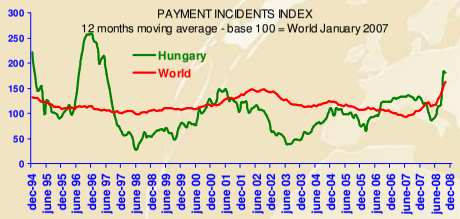
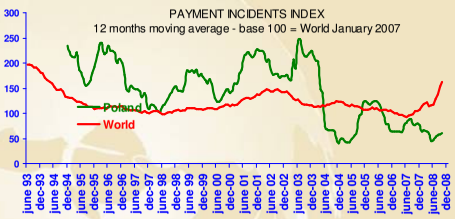
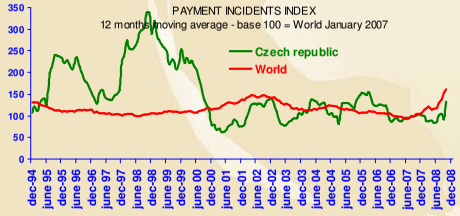
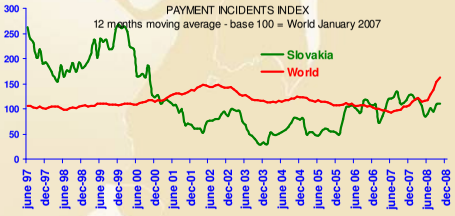
CEE – Coface payment incident indices









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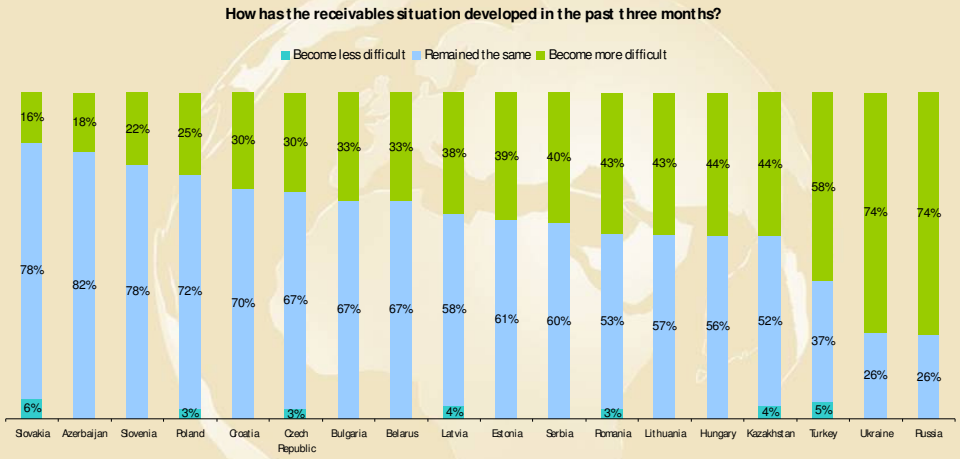
CEE – receivables situation



Source: Economist Intelligence Unit, Corporate Network; Express Benchmarking Survey for 2009- Summary Survey Results, Feb 18, 2009

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CEE – Risk of Insolvency

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CEE – insolvency statistics 2007/2008

2008

	Bulgaria	Croatia	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	Ukraine
(a) Judicial Compositions	n.a. 1.)	n.a. 1)	7	0	15	n.a. 2.)	n.a. 2.)	63	658	0	49	27
(b) Bankruptcies	80*	131	3.059	101	11.515	1.250	928	348	13.825	266	383	597
(c) Bankruptcies revoked due to lack of assets	n.a. 1.)	276	477	240	n.a. 2.)	n.a. 2.)	n.a. 2.)	n.a. 2.)	n.a. 2.)	301	1	n.a. 2.)
(a)+(b)+(c) Total Insolvencies	80	407	3.543	341	11.530	1.250	928	411	14.483	567	433	624

2007

	Bulgaria	Croatia	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	Ukraine
(a) Judicial Compositions	n.a. 1.)	n.a. 1.)	12	3	20	n.a. 2.)	n.a. 2.)	70	45	0	63	24
(b) Bankruptcies	240	171	1.814	166	9.635	1.028	604	377	6.161	225	402	464
(c) Bankruptcies revoked due to lack of assets	n.a. 1.)	281	676	158	n.a. 2.)	n.a. 2.)	n.a. 2.)	n.a. 2.)	209	566	95	n.a. 2.)
(a)+(b)+(c) Total Insolvencies	240	452	2.502	327	9.655	1.028	604	447	6.415	791	560	488

1.) Not published in public sources
2.) Not published separately in public sources
** figures for first half of 2008, full year figures not yet available*

Insolvency rates 2008

	Bulgaria	Croatia	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	Ukraine
Total number of active companies*	240.000	77.000	720.000	120.000	489.000	172.000	146.000	3.500.000	570.000	549.000	160.000	1.230.000
Insolvency rate	0,0%	0,5%	0,5%	0,3%	2,4%	0,7%	0,6%	0,01%	2,5%	0,1%	0,3%	0,1%

**expert organisations' estimation, average*

Deviations (2007/2008)

	Bulgaria	Croatia	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	Ukraine
(a) Judicial Compositions	-	-	-42%	-100%	-25%	-	-	-10%	1362%	-	-22%	13%
(b) Bankruptcies	-	-23%	69%	-39%	17%	22%	54%	-8%	124%	18%	-5%	29%
(c) Bankruptcies revoked due to lack of assets	-	-2%	-29%	52%	-	-	-	-	-	-47%	-99%	-
(a)+(b)+(c) Total Insolvencies	-	-10%	42%	4%	17%	22%	54%	-8%	126%	-28%	-23%	28%

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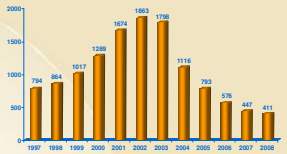
CEE – insolvency statistics – "highlights"



- **Poland: another drop of 8%**
  - Strong increase of notifications of overdue amounts
  - Worsening payment habits in construction
- **Baltic states: increase between 22% and 54%**
  - Most significant increase in construction
- **Czech Republic: 42% increase**
  - 3 insolvencies of companies with more than 100 million EUR turnover, all in the second half of 2008
- **Hungary: 17% increase in bankruptcies**
  - Same average increase as in past 3 years, but higher proportion of frauds
- **Romania: incredible increase of 126% to 14,500 insolvencies**
  - "Crisis effect" intensified by very low "entry barriers" for creditors (2,500 EUR outstanding amount in 30 days)
- **Ukraine: 28% increase**
  - Both bankruptcy and judicial composition proceedings are rsing

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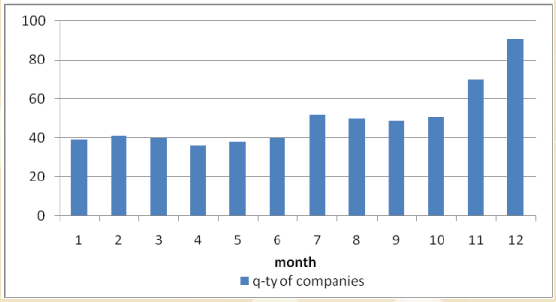
CEE – insolvency statistics – last quarter 2008

- **Romania:**
  - Number of opened insolvencies was 63% higher in the last quarter of 2008 than in the previous 9 months on average
- **Ukraine:**
  - Still comparatively low insolvency rate, but opened insolvency cases doubled within 2 months



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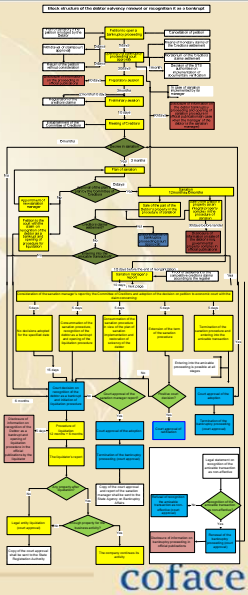
CEE – insolvency procedure – legal framework

- **Legal framework regulating insolvency proceedings have a strong influence in statistics**
  - Fuelling negative trend additionally (Romania)
  - Turning a noticeable negative trend into a decrease (Slovakia)
- **Complex structures and ineffectiveness of courts lead to long delays**
  - Acceptance of insolvency proceedings is low in some countries
- **Authorities make "methodological changes" in registering and reporting insolvencies**
- **Nevertheless Coface CE receives information about all opened insolvencies (and to a great extent also petitions of insolvencies – 80% in Poland) within a maximum delay of 1 week**



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CEE – Companies' View
(Economist Corporate Network Survey)

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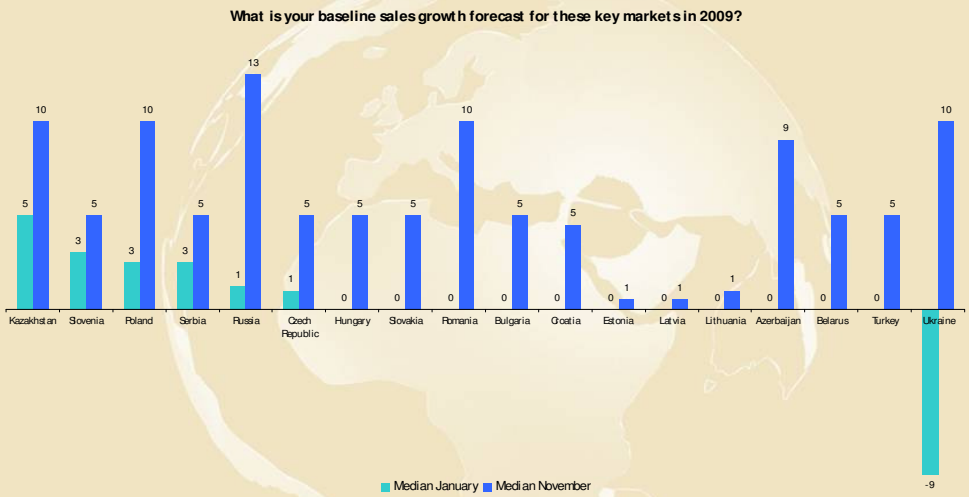
CEE – Economist baseline sales growth forecast



Source: Economist Intelligence Unit, Corporate Network; Express Benchmarking Survey for 2009- Summary Survey Results, Feb 18, 2009

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CEE – Economist market sentiment rankings

Jan Rank	Change	Nov Rank	Country	Jan Score	Change in score Nov to Jan	Nov Score
1	↑	4	Slovakia	54.3	-9%	59.7
2	↓	1	Azerbaijan	54.2	-6%	57.9
3	↑	10	Slovenia	52.7	-7%	56.3
4	↑	13	Turkey	51.1	-8%	55.5
5	↑	11	Bulgaria	51.0	-8%	55.5
6	↑	12	Croatia	50.9	-6%	54.2
7	↓	6	Serbia	50.9	-4%	52.7
8	↔	8	Czech Republic	49.3	-5%	51.8
9	↓	2	Poland	49.3	-3%	50.6
10	↓	7	Kazakhstan	48.1	-4%	50.0
11	↓	9	Belarus	46.4	-6%	49.3
12	↓	5	Romania	46.1	-7%	49.3
13	↓	3	Russia	41.7	-12%	47.5
14	↑	18	Hungary	41.2	-12%	47.0
15	↑	16	Latvia	40.7	-12%	46.4
16	↓	14	Lithuania	37.5	-19%	46.3
17	↔	17	Estonia	34.6	-25%	46.2
18	↓	15	Ukraine	22.9	-47%	43.0

Source: Economist Intelligence Unit, Corporate Network; Express Benchmarking Survey for 2009- Summary Survey Results, Feb 18, 2009

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CEE – Credit Agency's View

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CEE – predictability of defaults

- **Constant monitoring of the predictive power of the 32 scoring models in CEE**
- **Ongoing revaluation of assessment models based on**
  - 3.2 million financial statements with 159 mio individual financial data sets
  - more than 65,000 new pieces of information on defaults added each year
  - current and historical insolvency information on 135,000 companies
  - updated each year with an additional 320,000 individual research inquiries

GINI coefficients	BG*	CZ	HR	HU	PL	RO	SI	SK
Static valuation	0,37	0,29	0,42	0,24	0,28	0,21	0,37	0,33
Small @rating Score		0,55	0,78	0,58	0,64	0,57	0,74	0,44
Large @rating Score		0,60	0,73	0,68	0,70	0,63	0,66	0,66

CEE – short-term crisis measures

- **Business information:**
  - Get more up-to-date information and data in a more speedy manner
    - Coface Central Europe collected 6 times more financials in the first two months of 2009 than during the same period last year
    - Refusal to share information becomes an increasingly negative indicator
  - Increase the share and weighting of sector information in the evaluation model
  - Enhance systematic press monitoring
  - Provide straightforward risk monitoring and portfolio analysis features
  - Reinforce exchange of negative information with other credit rating agencies
- **Debt collection:**
  - Increase direct contact with debtor
    - Phone call within 24 hours after receipt of file
    - Making street collection an indispensible part of the collection workflow
  - Reduce collection period before “potential of recovery assessment”
    - Adapting the automated workflows to the changed environment

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