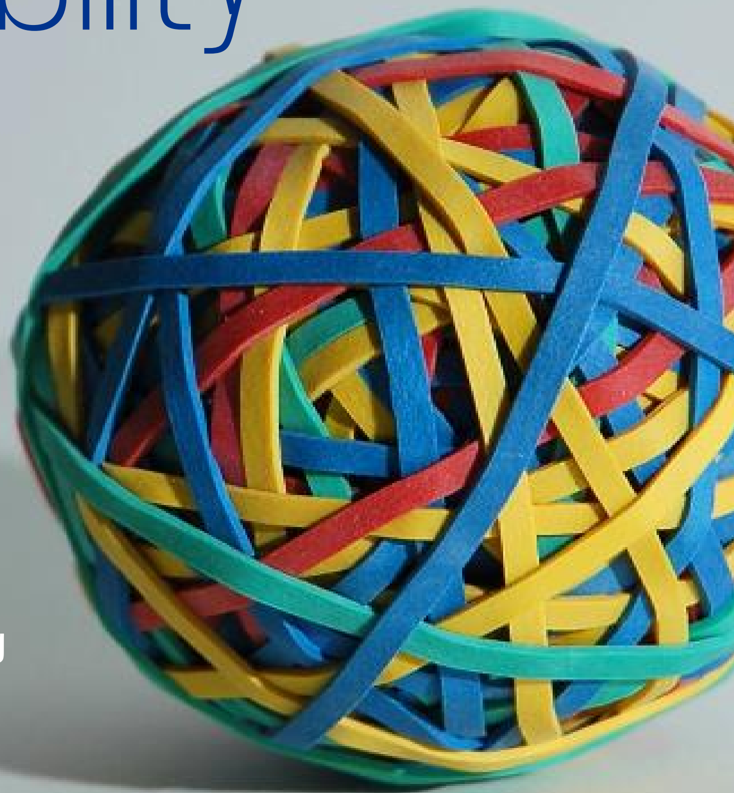
Corporate viability - case study



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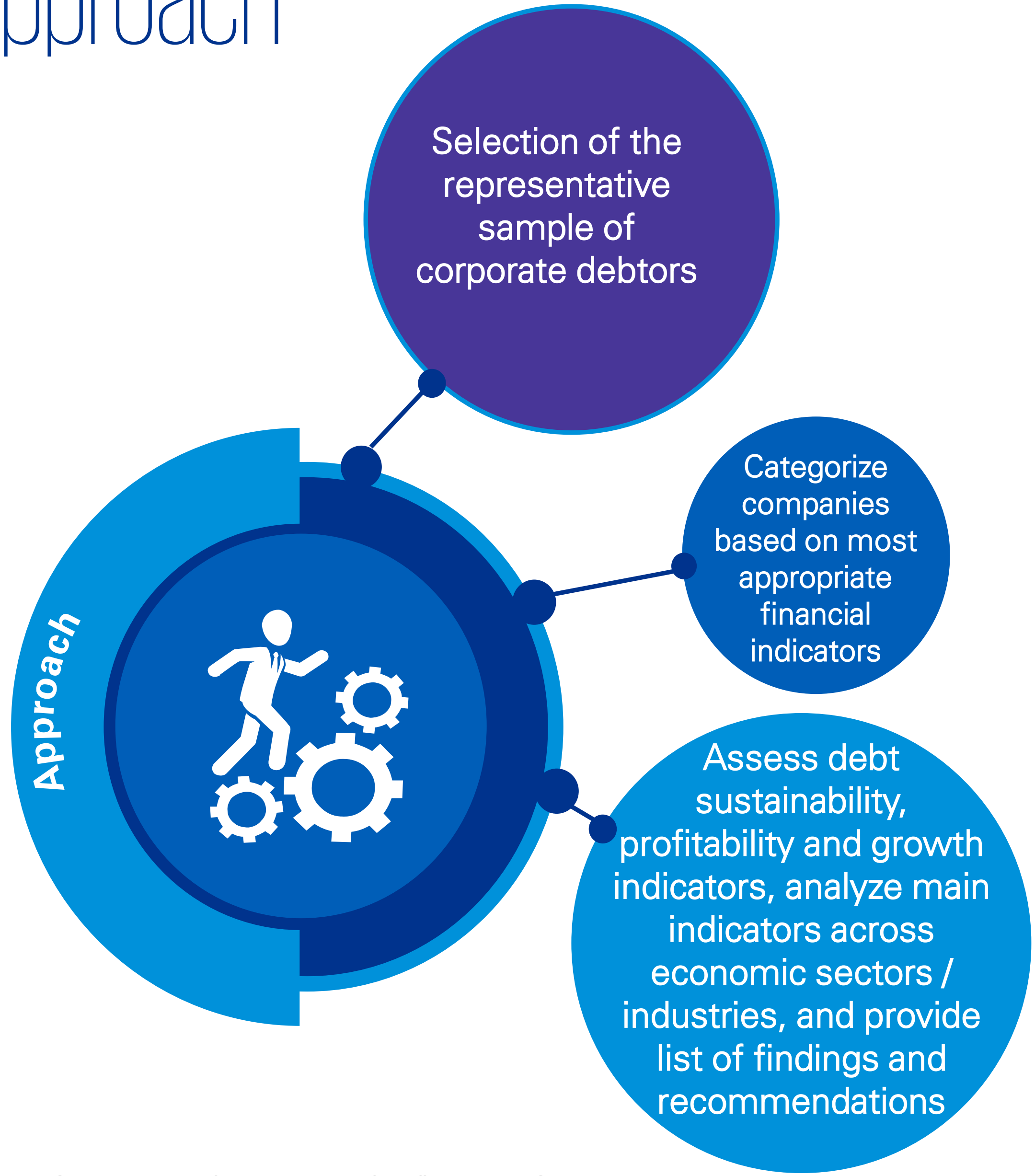
Context and the study approach

Context

- Non-performing loans are an obstacle to further economic prosperity in any economy
- As such, one of the most important pillars of any program to combat NPLs would be the establishment of the framework which would enable the prevention of formation and accumulation of new NPLs.
- Viability – ability or capacity to work successfully.
- Corporate viability studies are an assessment of entire economies in such manner.
- Several studies in a similar manner have been performed by KPMG in last 3 years in order to assess corporate indebtedness and to serve as a basis for prevention of future NPLs.



Sampling

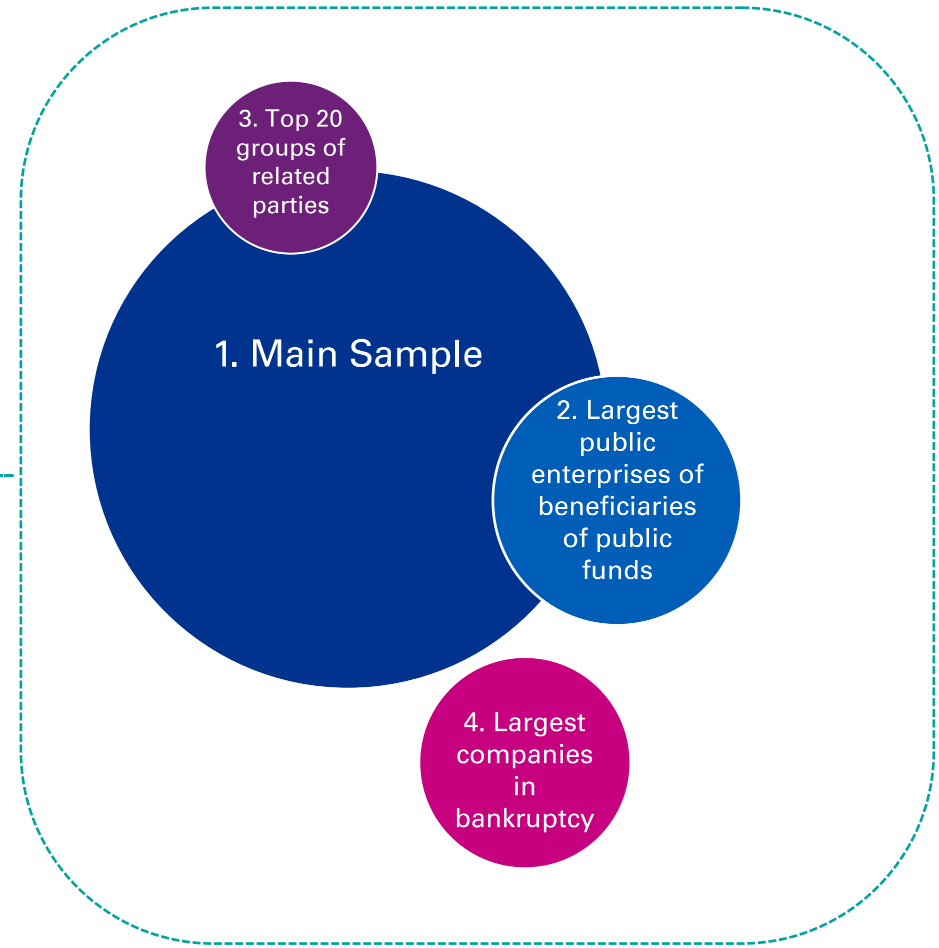
Overview:

1. **Main Sample.** Top 1,000 active companies by Total Revenue, however also taking into account Assets and Equity (aiming for >50% coverage)

2. **Public companies.** Largest Public enterprises & beneficiaries of public funds by Total Revenue.

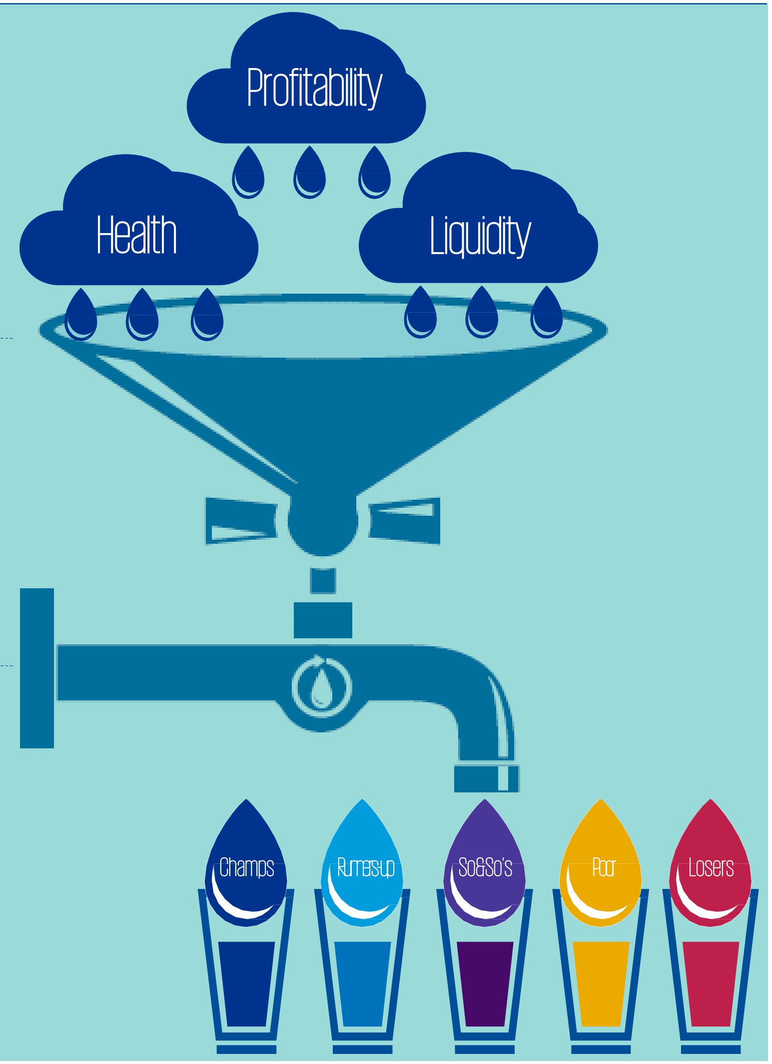
3. **Groups of related parties.** Top groups of related parties were separately analyzed with particular focus on intercompany relationships and debt.

4. **Largest companies in bankruptcy.** Top Companies in bankruptcy or liquidation by Total Assets have been observed with the ultimate goal of determining the efficiency of the liquidation process as well as identifying trapped assets and debt in these cases



Indicators | definitions and limits

	Indicator	Description	Limits
Overall health	**Net debt/ EBITDA**	The net debt-to-EBITDA ratio is a measurement of leverage - how many years it would take for a company to pay back its debt if net debt and EBITDA are held constant.	• Lower limit is 2 (and EBITDA > 0); • Upper limit is 5.
	DSCR	DSCR - measures the company's ability to pay their current debt obligations.	• Lower limit is defined at: 0.9
Profitability	**ROA**	ROA - shows the percentage of profit a company earns in relation to its overall resources.	• Lower limit 0% • Upper limit is 5%
	EBITDA	EBITDA - measure of a company's profit as well as overall financial performance.	• Lower limit is defined at 0.
Liquidity	**Liquidity ratio**	Liquidity ratio - ability to pay debt obligations and its margin of safety.	• Lower limit is 1:1 • Upper limit is 2:1
	Acid test	The quick ratio - ability to meet its short-term obligations with its most liquid assets.	• Lower limit is defined at 1



The process and scoring

Step I

Selection of financial ratio indicators is based on **literature** and **practical experience**. In the each area (profitability , overall health and liquidity) two of the most relevant ratio indicators are selected - main ratio and corrective ratio.

Depending on the value of those ratio indicators, to the each area is given a score.

Step II

The main ratio in each of the aspects/areas has upper and lower thresholds, thus allowing the segmentation to one of three groups: Champs / So & So's / Losers, while Corrective ratios, the ratios with a single threshold (e.g. EBITDA – positive or negative), are further adjusting and contributing to the final score. Depending on the value of those ratio indicators, each area is given a score (1-5).

Step III

The final score is calculated by summing individual area scores (profitability, overall health and liquidity). The least possible value is 3 and the highest is 15.

The final score in this step is weighted according to the following rule:

Overall health rating * x% + profitability rating * y% + Liquidity rating * z%

Step IV

On the basis of the **final score**, entity categorization has been performed :

- ✓ *5 – Champs (score ≥x)*
- ✓ *4 – Runners-up (x ≤score <y)*
- ✓ *3 – So & So's (x ≤ score <y)*
- ✓ *2 – Poor (x≤ score <y)*
- ✓ *1 – Losers (score <x)*

Financial performance over the years

Big picture

Assessment of overall health, profitability and liquidity per observed average realized ratios in the observed years

Obtaining a general picture about solvency of the economy and general trends in the observed years

Assessed separately for private and public

Figures presented for Illustrative purposes

		2016	2017	2018	2019	2020
Overall health	**Net debt/EBITDA**	4.2	4.1	3.5	4.4	3.9
	DSCR	1.07	1.07	1.17	1.07	1.16
Profitability	**ROA**	4.7%	4.3%	4.6%	5.4%	4.2%
	EBITDA	x.y bn	x.y bn	x.y bn	x.y bn	x.y bn
Liquidity	**Liquidity ratio**	1.85	2.17	2.08	2.11	1.99
	Acid test	1.19	1.47	1.38	1.44	1.29

KPMG

Who drives the economy and who is a drag on growth?

Deeper dive

Assessing which company groups, by the observed categories are driving the growth and contribute the most and which represent the drag on growth.

Common conclusions:

- Champs usually are the biggest value creators
- Runners-up and so-so's tend to be more efficient in use of debt, i.e. EBITDA generation
- Poor and Losers – stuck with debt and unable to create value to repay it

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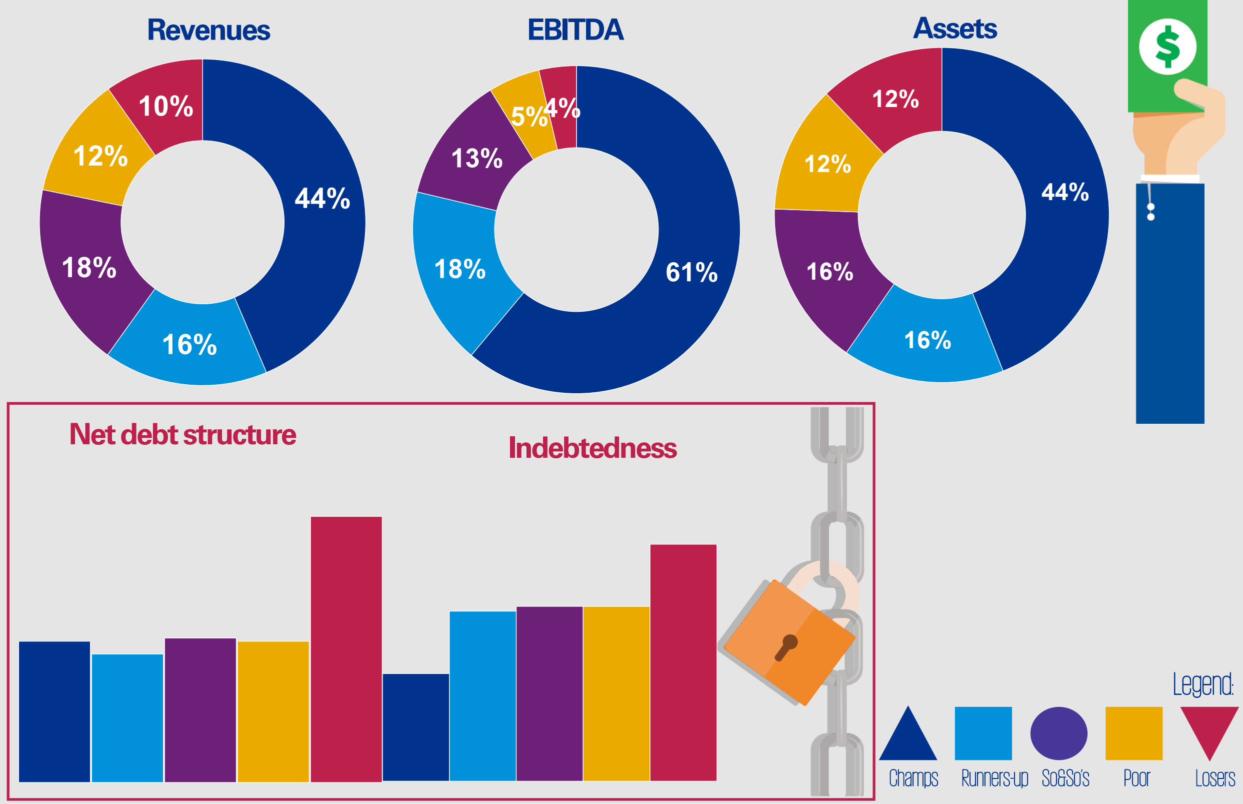

Transition analysis

Often - No major movements

Assessment of transition of companies across observed categories tends to put more light and quite often reveal in fact that there are:

- No significant improvements
- No significant deterioration
- Gap between good and bad widening

Implying – problem still exists and requires more structured approach

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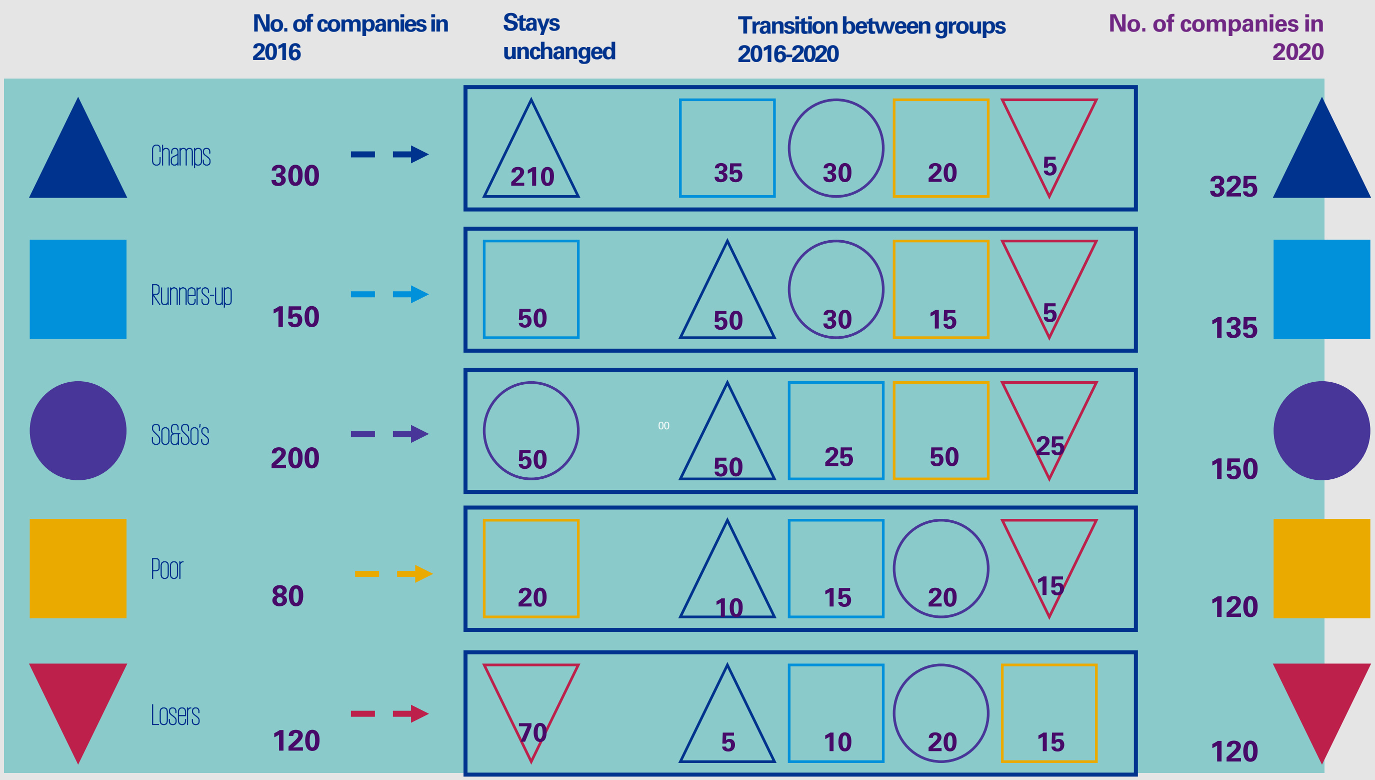

Profitability and efficiency

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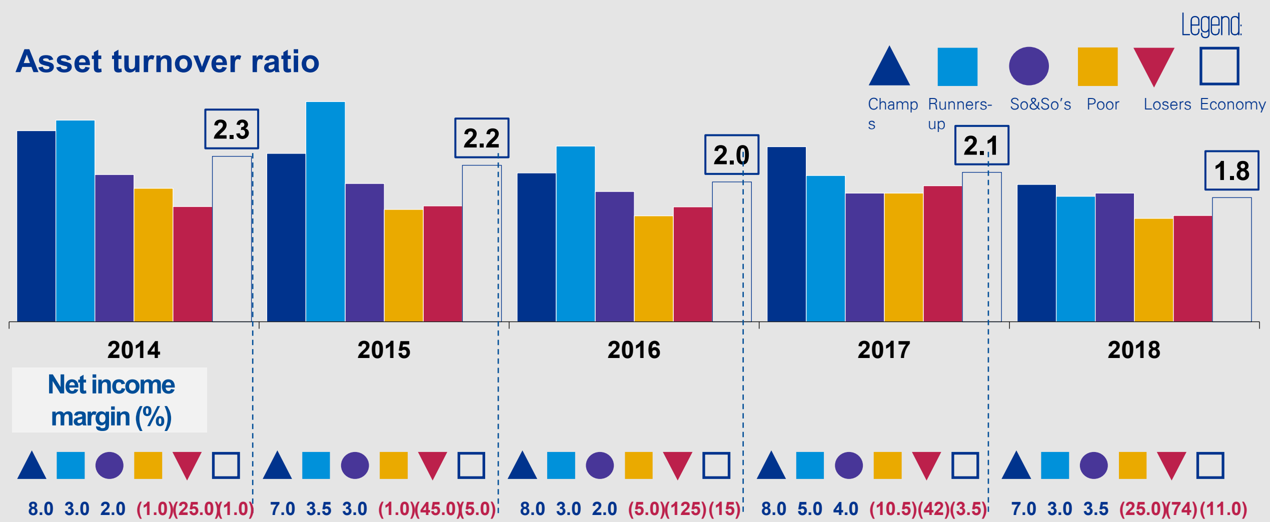
Best are more efficient in the exploitation of assets

Champs clearly best; where losers are loss making.

Also, Champs tend to be less asset intensive than runners-up



Focus on debt

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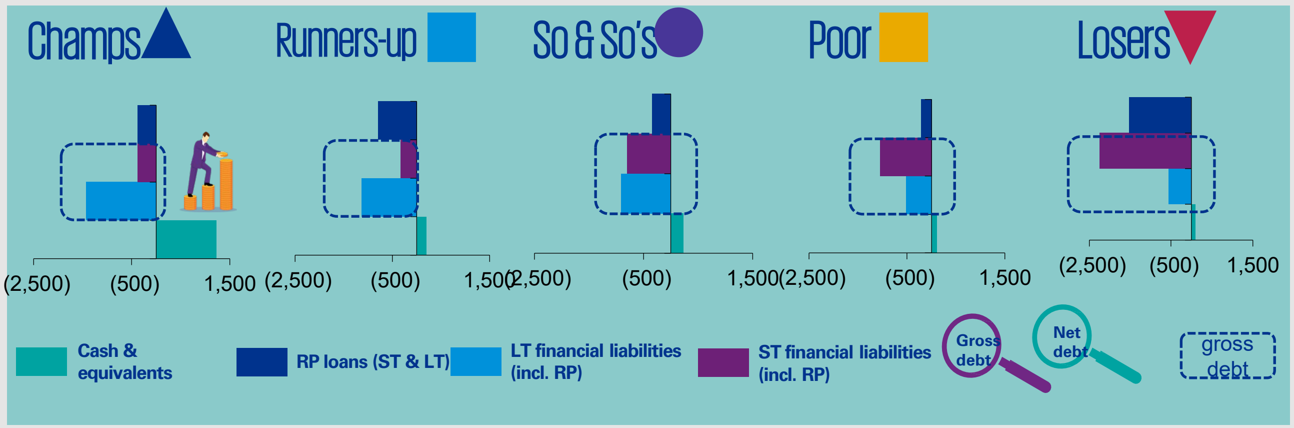
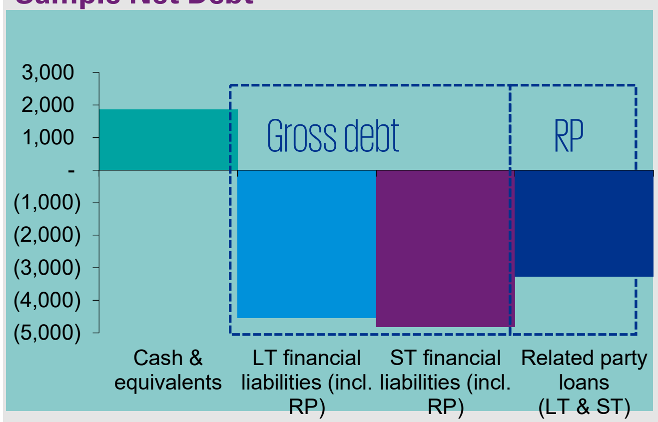
Deep dive in puts more light on the debt structure and inability to repay for numerous companies

Moving from left to right (champs to losers) – more short than long term; more debt; less cash; more related party loans



Sample Net Debt



average	Champs	Runners-up	So & So's	Poor	Losers
RP loans/ Gross debt	10%	15%	10%	15%	20%
Indebtedness %	40%	60%	65%	65%	85%

Liquidation process

Inefficiency of the liquidation processes

Assessment of the liquidation process tends to reveal what's expected:

- Inefficiency of the process and in addition
- Value leakage in costly liquidation processes that annually consume value and generate costs

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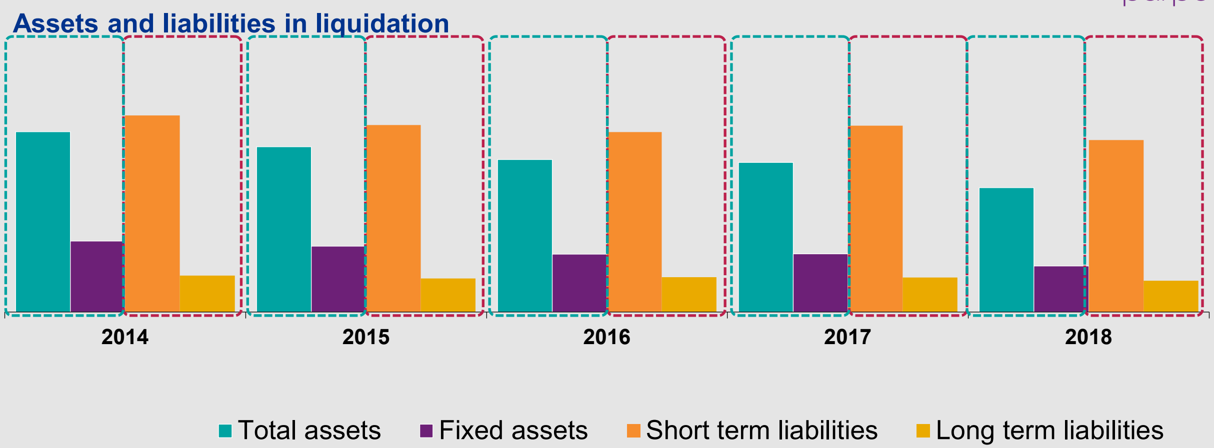

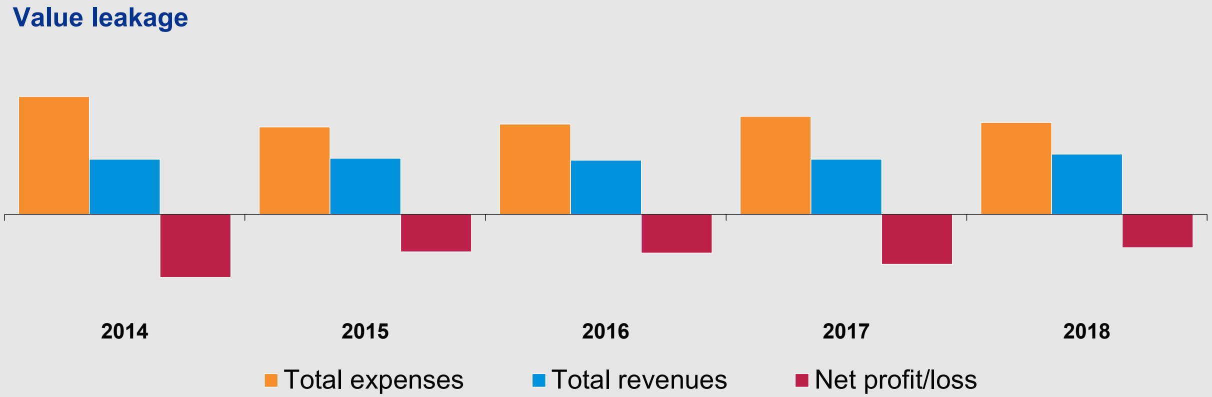

Doubtful debt assessment

Making the debt sustainable

Assessment of the amount of debt that needs to be restructured or written off in order for debt to be sustainable in the sampled companies

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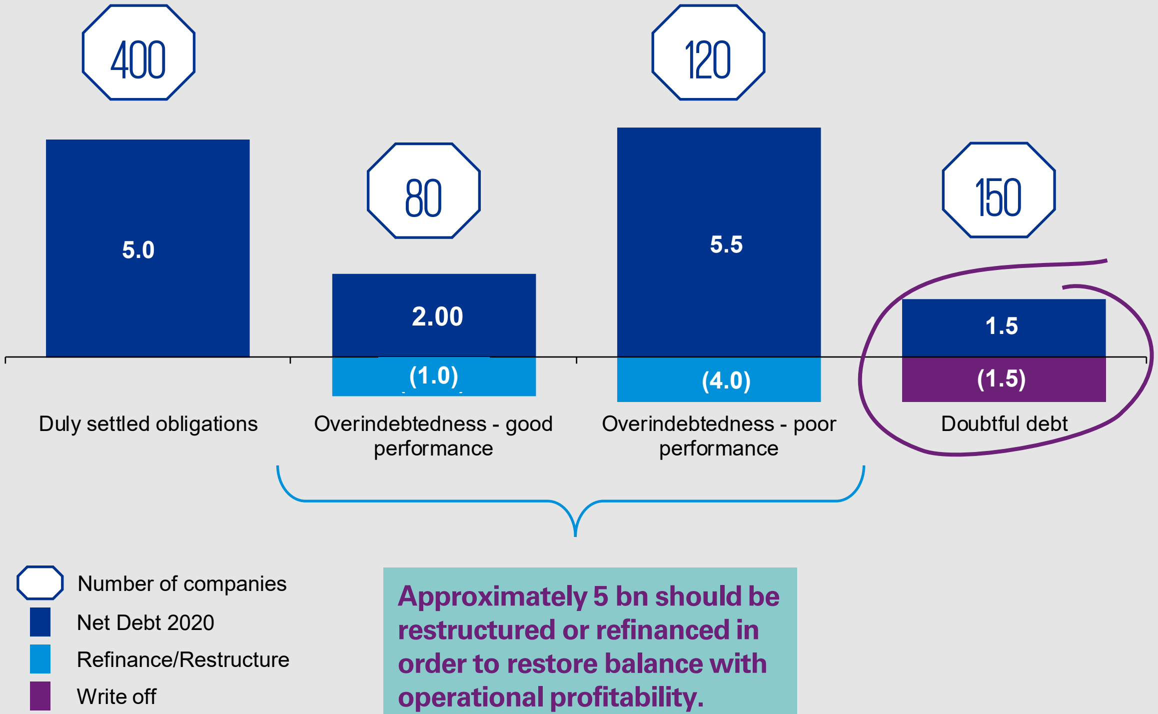

Approximately 5 bn should be restructured or refinanced in order to restore balance with operational profitability.

Main challenges and key points

Overview of main challenges:

- Data issues and necessity of data collection, cleansing and harmonization prior to an assessment
- Multiple stakeholders with a range of interests that can be contradict
- Alignment with stakeholders and getting the full support in the process

Key potential benefits:

- "Unboxing" the NPL issue;
- Identifying sectors and their specific issues that require application of appropriate measures;
- Assessment of the liquidation process, its weaknesses and basis for more concrete measures in order to improve efficiency;
- Solid basis for restructuring framework.

Thank you

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