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Poland insolvencies Focus: Are restructuring proceedings the remedy?

Business proceedings aimed at insolvencies and restructuring have been on rise in Poland this year. Over the course of the first three quarters of 2017 they increased by 14% compared to the same period last year. Most of the sectors in Poland experienced an increase in the number of proceedings. In contrast, the country's macroeconomics have been performing well. GDP growth strengthened to 4.0% y/y in the first half of 2017. Economic activity is being driven by household consumption, which remains the main growth engine. Household consumption has benefitted from a further fall in the unemployment rate, which has broken previous record lows. Polish households are also enjoying fair growth in wages and the lowest central bank interest rates in history. Unsurprisingly, within this positive economic environment, consumer confidence indicators are high. Slowly, but gradually, fixed asset investments are becoming more evident and are positively contributing to Polish growth. After last year's contraction (due to a switch to the new EU budget), investments have started to be fuelled again by infrastructural projects and increasing business capacities. As a result, domestic demand - along with stronger exports supported by strengthening global trade dynamics - is secure enough to keep Poland's GDP growth at solid levels over the following quarters. This positive economic activity will continue to support companies in Poland, but the first signs of an overheating economy (such as supply constraints and labour shortages) will bring challenges for companies and the pace of expansion. Coface forecasts that GDP growth will reach 3.9% this year, before weakening to 3.5% in 2018. The favourable macroeconomic environment has been supporting Polish businesses. The cross-sector average shows that, during the first half of 2017, companies were able to generate both higher revenues (+9.6%) and profits (+5.4%). Nevertheless, profitability indicators have not been overly impressive. The intense competition present in many sectors is hampering attempts to increase margins, despite growing demand and revenues. The retail sector is an illustration of this trend. Although retail has been benefitting from increased consumer spending, the sector experienced a 59% increase in insolvencies and restructuring procedures during the first three quarters of this year.



The amended legal regulations that were implemented at the beginning of last year are still affecting the statistics on proceedings. Separated acts on bankruptcy and restructuring laws have given priority to company restructuring procedures, with the aim of helping businesses return to effective operations. As expected, restructuring procedures have become even more frequently used this year. Whereas the share of restructuring within the total number of proceedings reached 23% during the first three quarters of 2016, it surged to 37% in the same period of 2017. Restructuration procedures will remain popular among businesses suffering from liquidity problems. Coface forecasts that the total number of insolvency and restructuring proceedings will be 8% higher at the end of 2017 than in 2016. They will then decrease by 0.7% during the course of 2018. A rebound in investments is creating momentum for the construction sector's recovery, although improvements in its profitability and liquidity will be gradual for some time. Retailers will continue to benefit from solid household spending, but intense competition and pressure on margins will affect many entities, especially the smaller ones. Although the trade sector enjoys a favourable environment, thanks to robust private consumption, it will also remain a fixture in the insolvency and restructuring statistics.

Accelerating economy activity

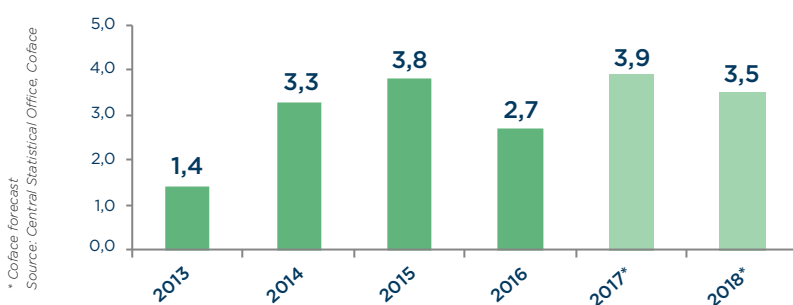
Poland's corporate sector is benefitting from the acceleration in economic activity. This is a reversal of last year's situation, when the pace of economic growth was weaker. This was due to a slow start to the new programming period for EU funds, which contributed to a slump in fixed asset investments. A similar phenomenon was experienced by other CEE economies, where growth was dragged down by lower investments. Poland recorded GDP growth of 3.8% in 2015, before slowing to 2.7% in 2016. GDP growth is now regaining strength and reached 4.0% y/y in the first half of 2017. Investments have started to rebound, supported by EU co-financed projects and increased corporate capacity - although household consumption remains the biggest driver. Poland is enjoying another year of improvements in the labour market. The unemployment rate is continuing to break previous record lows and fell to 4.7% in August 2017. This is significantly lower than the EU average of 7.6%. Wages are also continuing to rise. Since 2014, wages had already attained a solid growth rate of at least 3% a year. Salary dynamics have now sped up further, to reach 6.6% y/y growth in August 2017. Supported by the lowest interest rates in Poland's history and peaking consumer sentiment indicators, private consumption is a crucial growth component. Nevertheless, further boosts from household consumption will be somewhat limited by the increase in inflation and subsequent weaker growth in real wages than recorded in the previous two years. It should be noted that Poland's inflation remains in line with the central bank's corridor band target, but it does represent a reversal of the two-year deflationary period which continued until late-2016. Poland has the biggest population in the CEE region, but businesses are not only focusing on the domestic market. Exports represent an important share of business activities

for many Polish companies, accounting for over 52% of nominal GDP last year. Polish companies have become more active exporters - and not only to the Eurozone, the country's core market, but also to new destinations. Although Polish exports were affected by weak global trade dynamics in 2016, during the first 8 months of 2017, the country's exports surged by nearly 10% compared to the same period last year. Polish companies are taking advantage of the Eurozone's stable recovery, as well as rebounding economies in emerging economies such as Russia (which remains one of the biggest foreign markets for the country's exports). World trade is expected to rally strongly this year and continue with solid growth next year¹. Although this scenario fits well with exporters' ambitions, Polish GDP growth will only partially benefit from this, as net exports (the difference between exports and imports) are taken into account when calculating the GDP growth rate. Polish households and businesses have not only increased purchases of domestic goods, but imported ones as well and the rate of import growth is even higher than export growth. Net export contributions to GDP growth are therefore likely to be negative in 2017 and 2018.

Insolvencies and restructuring are still on the rise, despite the robust economy

The positive macroeconomic environment has been supportive of Polish corporates. During the first half of 2017, aggregated net revenues of companies in Poland rose by 9.6% compared to the same period last year. The gain in financial results was lower, but still at a solid level of 5.4%. Nevertheless, the strengthening economy was not sufficient to bring insolvency and restructuring proceedings down to lower levels than last year and they in fact increased by 14% y/y over the first three quarters of 2017. These statistics were affected by changes to legislation that were introduced last year. As from 1st January 2016, there are separate laws to cover insolvencies and the restructuring of companies experiencing payment problems. These new regulations were introduced to encourage greater use of restructuring procedures - particularly as recovery tools for companies faced with temporary liquidity problems. The main goal of the revised legislation was to enable debtors to restructure their businesses and thereby avoid liquidation. This support for the continuity of businesses should help to preserve employment and allow the uninterrupted execution of contracts. Companies experiencing financial difficulties are entitled to use various proceedings for restructuring.

CHART 1
Poland's GDP growth rate (%)



1 - The World Trade Organization (WTO) assumes in its latest forecast that growth in world merchandise trade volume will increase from 1.3% in 2016 to 3.6% in 2017 and then 3.2% in 2018 (https://www.wto.org/english/news_e/pres17_e/pr800_e.htm).

These include the “procedure of approval of a plan after creditors’ votes”, “accelerated arrangement procedures”, “ordinary arrangement procedures” and “rehabilitation proceedings”. As illustrated in *chart 2*, there were a total of 635 proceedings during the first three quarters of 2017. Compared to the previous year, there is a slight decrease in the number of insolvencies, while restructuring has nearly doubled. Companies only started to become familiar with the new regulations in the first months of 2016 and during this time the use of restructuring proceedings was still relatively low. They have gradually gained popularity as a solution for companies suffering from liquidity problems. Whereas the share of restructuring in the total number of proceedings was 23% in the first three quarters of 2016, it surged to 37% during the same period in 2017. Among the different types of restructuring proceedings, expedited arrangements were the most popular. This fast and easy solution for restructuring accounted for 58% of all remedial procedures during the first nine months of 2017. Reorganisation proceedings, which are a hybrid between insolvency and restructuring (with, for example, employee redundancies or the cancelling of unprofitable contracts), took second place with a 26% share. These were followed by arrangement proceedings and proceedings for approval of an arrangement. There were no judicial compositions this year, as these no longer exist under the new legislation. Several such proceedings were recorded in 2016, but only as a result of applications filed in late 2015 which were announced later.

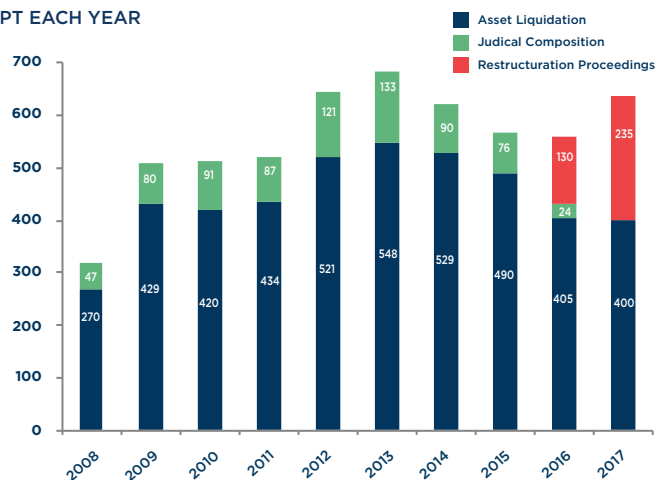
The rise in popularity of restructuring is the main reason for the overall rise in proceedings, as seen in *chart 2*. Nevertheless, Poland still enjoys the lowest insolvency rate in the CEE region. The new legislation may have led to an increase in the total number of proceedings, but the rate² is still relatively low compared to many other CEE countries. Although Poland has a large economy compared to other CEEs, with over 1.8 million active companies, it only recorded 760 company insolvencies and cases of restructuring last year. This translated into an insolvency rate of just 0.04% - the lowest level in the CEE region³. Nevertheless, the full scale of Polish companies’ liquidity problems is much larger. Cases of liquidation, suspension of activities and going out of business without conducting official insolvency proceedings, are all much more commonplace. The new legislation clearly focuses on encouraging restructuring procedures as the preferred solution for companies with liquidity problems.

Most sectors recorded increases in proceedings

The sectorial breakdown shows that nearly all sectors experienced a greater number of proceedings during the first three quarters of 2017. The rising popularity of restructuring procedures recorded on a general level this year can also be applied to sectors. Although the macroeconomic environment is robust, there are a number of companies in Poland that have fallen into a liquidity crisis and consequently used restructuring proceedings as a remedial tool. Insolvencies still constitute the bulk of proceedings and their rate of decline has slackened in recent quarters. The highest number of insolvencies and restructuring proceedings occurred among production⁴ companies, whose share accounted for almost 28% of all those recorded. These production companies were mainly manufacturers and among these, producers of metals and fabricated metal products took the greatest share. Although **the steel sector** has benefitted from a rebound from the low prices recorded last year, this rapid increase in prices has made buyers take a cautious approach.

CHART 2
Polish company insolvencies and restructuring procedures

JAN-SEPT EACH YEAR



JAN-SEP 2017

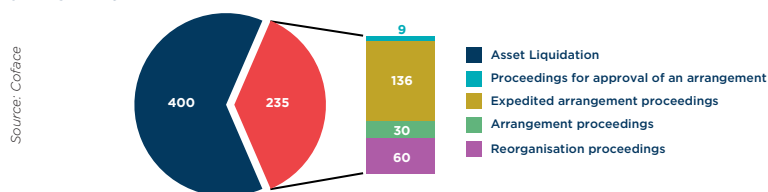


CHART 3
Company insolvencies by sectors, January-September 2017

	Insolvencies in Q1-Q3 2017	Change y/y	Share
PRODUCTION, including:	177	36%	27.9%
Manufacturing including, but not limited to:	128	14%	20.2%
Production of metals and fabricated metal products	34	42%	5.4%
Production of food products and beverages	22	-15%	3.5%
Production of wooden products excluding furniture	18	64%	2.8%
Production of machinery, equipment and electrical devices	14	17%	2.2%
Production of rubber and plastic products	10	67%	1.6%
Production of goods from other non-metal natural resources (including construction materials)	10	43%	1.6%
Production of clothing and textiles	8	33%	1.3%
Production of paper and paper products	3	200%	0.5%
Production of furniture	3	*	0.5%
Other manufacturing	29	107%	4.6%
TRADE including, but not limited to:	162	13%	25.5%
Wholesale	95	7%	15.0%
Retail	51	59%	8.0%
CONSTRUCTION	105	3%	16.5%
TRANSPORT	23	53%	3.6%
Other sectors	168	-1%	26.5%
TOTAL	635	14%	100.0%

* There were no proceedings in the production of furniture in the previous period - Source: Coface

Prices of some merchandise produced within the steel sector, such as HEB beams, have fluctuated recently. Insolvencies and restructuring among producers of metals and fabricated metal products rose by 42% y/y during the first three quarters of this year. Manufacturers of fabricated metal products were particularly affected. However, the relatively high share of restructuring among all proceedings (58%) in the entire sector, does bring hope that some of these businesses will resume normal business operations. The steel sector will benefit from the rebound in fixed asset investments in Poland and increased activity in the construction sector, but challenges still remain. According to the World Steel Association, global consumption of steel will decline in 2018, following a peak this year. Dynamics in the European Union are expected to remain positive, although weaker than last year. Poland’s steel industries are heavily dependent on the performance of **the construction sector**. As previously mentioned, the construction

2 - Share of insolvencies in the total number of active companies.

3 - More information on insolvencies in CEE countries in 2016 can be found in the Coface Focus “Central and Eastern Europe: Less business insolvencies despite temporary headwinds in the construction sector”, September 2017 (<http://coface.com/content/download/156469/2580141/file/FOCUS+CEE+insolvencies+07092017.pdf>)

4 - Includes sections: mining and quarrying, manufacturing, electricity, gas, steam and air conditioning, water supply; sewerage, waste management and remediation activities

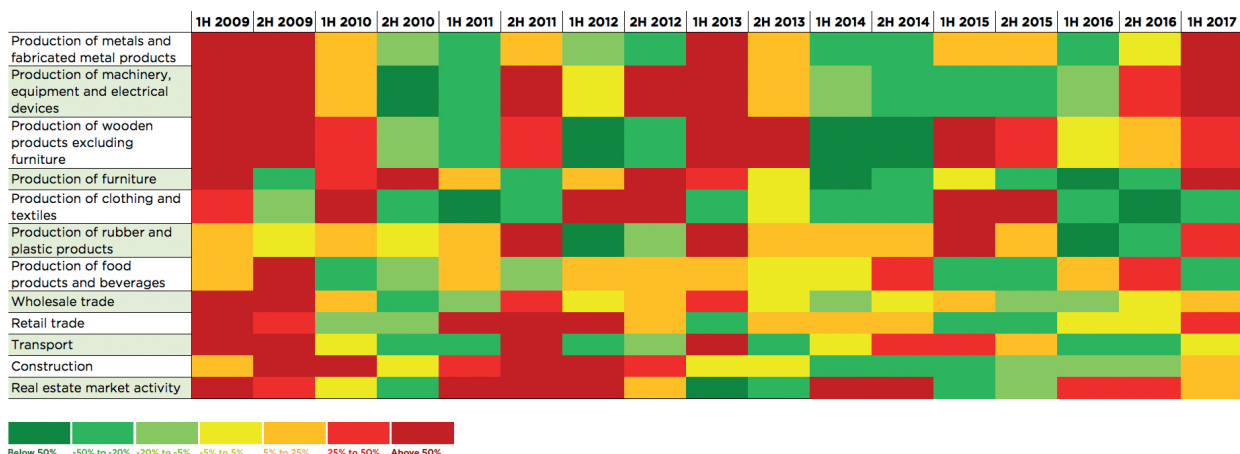
sector is benefitting from a rebound in fixed asset investments this year, following a contraction in 2016 – particularly with regards to components for buildings and structures. This was linked to the switch to the new EU budget which entailed a slow adoption of local regulations and guidelines into the new financing programme. Since the first quarter of 2017, the contribution of fixed asset investments is no longer dragging down Poland's GDP growth rate. Nevertheless, the process is relatively slow and improvements in terms of better liquidity for construction companies are not yet noticeable. Construction entities continue to be widely represented in the insolvency statistics. The total number of insolvency and restructuring proceedings among construction companies was 3% higher in the first three quarters of this year than in the same period in 2016, while its share of all proceedings reached nearly 17%. The portion of restructuring procedures was higher than the cross sectorial average, reaching 46%. The second half of this year shows more visible improvements for the sector. Robust economic growth and new investments made by Polish companies are among the positive contributing factors. Furthermore, various infrastructural projects co-financed by EU funds are generating higher demand for construction materials and services. Public investments mainly rely on tender procedures, which mean that there is a relatively long time period from the decision to conduct a particular project through to construction companies actually recording profits from them. Improvements in the profitability and liquidity of the construction sector will therefore be somewhat delayed and gradual. During the first nine months of 2017, there was a substantial rise in the number of insolvency and restructuring proceedings among companies in **the trade sector**. These constituted a share of nearly 26% of all proceedings – and were particularly pronounced among retail companies. At first glance, this comes as some surprise, as the Polish economy is enjoying solid growth which is mainly fuelled by household consumption (which accounted for three-quarters of the country's GDP growth in the first half of 2017). The Poles are benefitting from a favourable situation on the labour market, with falling unemployment rates and rising wages. Their spending is further supported by high levels of consumer sentiment indicators. Nevertheless, this increased demand cannot completely compensate for the intense competition which is affecting the sector's margins. Smaller entities in particular are finding it more difficult to be competitive, as their larger counterparts benefit from their stronger ability to negotiate. The financial results recorded by many trade companies during the first half of 2017 have confirmed that increasing turnover does not always mean increasing profits.

Despite this, the stable demand from household consumption should continue to foster a favourable macroeconomic environment for the trade sector.

Heading towards stabilisation

The amended legislation that separates insolvencies and restructuring proceedings has now been in force for almost two years. These legal updates have prioritised restructuring proceedings, but it is still too early to evaluate the positive effects for Polish corporates. There have, however, already been instances where restructuring proceedings have succeeded in returning companies to effective business operations. Coface's research shows that these cases mainly concerned companies who had recourse to expedited arrangement proceedings (which also accounted for the highest number of restructuring procedures). Over the next few quarters, statistics will continue to be affected by the legal changes implemented last year. Coface forecasts that the total number of insolvency and restructuring proceedings will be 8% higher at the end of 2017 than in 2016. The economic environment will be supportive for companies. The robust GDP growth rate will be fuelled by a stable increase in household consumption, a rebound in fixed asset investments and the business activities of Polish companies on foreign markets. Over the course of next year, the number of restructuring procedures will show a slight increase, while insolvencies will continue on a downward trend. The total number of proceedings will stabilise and solid economic activity should be supportive of a further decrease. Nevertheless, the fall in the number of proceedings will not be significant, as insolvencies and restructuring procedures, the entry into the market by new companies and the suspension of business activities by others, are still experienced even during recovery periods. Moreover, dynamic economies often encourage entrepreneurs to set up new businesses which are unable to survive when faced with real market challenges. Coface expects that the total number of insolvency and restructuring proceedings will decrease by 0.7% during the course of 2018. In addition to challenges such as intense competition in a number of sectors, labour shortages are also a growing problem. These labour shortages have become a serious barrier to expansion for companies in many of the sectors. Difficulties in filling vacancies are starting to hamper the conclusion of new business deals and even the execution of fixed contracts. In extreme cases, this could even add to the risk of suspending operating activities for some companies, leading to liquidity problems and insolvency risks.

CHART 4
Heat map of total proceedings (insolvencies and restructuring procedures)
by selected sectors, per semester (dynamics, y/y)



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