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ROMANIAN STATE-OWNED ENTERPRISES: CHALLENGES AND REFORM PRIORITIES[1]

Core Questions and Findings

- **How are inefficient state-owned enterprises (SOEs) holding back performance of the economy**?

  SOEs play a notable role in the economy, particularly in the transport and energy sectors—key network industries to accelerate growth—but service delivery has been poor. Profitability of many SOEs has been weak and they have been unable to generate resources for urgently needed investment. SOEs account for almost all arrears in the state-sector and have also been a drain on the public purse, albeit financial performance has recently improved in some SOEs.

- **How can SOEs become better in public service delivery and more profitable**?

  Key policies should center on creating incentives for performance, strengthening corporate governance, and improving public oversight. Steadfast restructuring of loss-making SOEs needs to be implemented.

- **What has held back SOE reforms**? **Can the obstacles be overcome**?

  Political economy considerations and lack of political will seem to have been the main reasons for weak reform implementation. While institutional arrangements can mitigate political involvement, well functioning institutions require strong ownership to overcome impediments to reforms.

- **What are further reform priorities**?

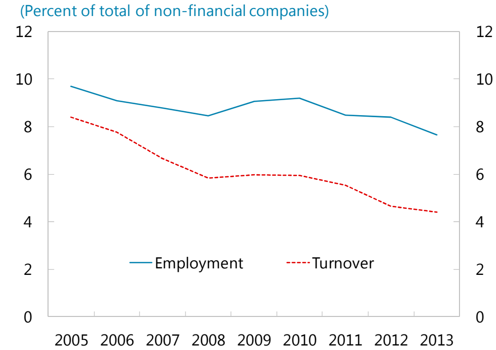
  Continue with greater private sector involvement in SOEs (IPOs and strategic majority investors) and energy market deregulation. Improve the SOE corporate governance framework and exercise political will to implement provisions of the new framework. Restructure non-viable SOEs or liquidate them to ensure efficiency and improved resource allocation.

A. An Overview of SOEs in Romania's Economy

1. State-owned enterprises (SOEs) play a notable role in the Romanian economy. There are more than 1,000 SOEs in Romania, with about 250 majority-owned by the central government and the remainder – by local governments.[2] SOEs range in size from very small enterprises with a few employees to the largest employers in the economy like the post office with more than 25,000

SOE Employment and Turnover

(Percent of total of non-financial companies)



Sources: Ministry of Public Finance, Romanian Fiscal Council; and IMF staff estimates.

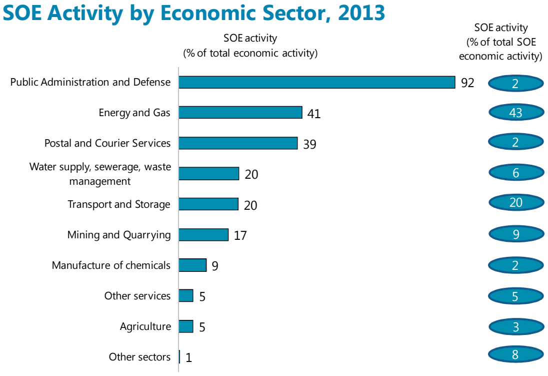
[1] Prepared by Vahram Stepanyan and Georgia Babici.

[2] Only central government SOEs are included in program conditionality under the 2013 Stand-By Arrangement (SBA).

employees. In aggregate, SOEs constitute around eight percent of non-financial companies' total employment and account for around 4 percent of their annual turnover. The Romanian SOE universe is far from being homogenous as the top 20 enterprises account for about two-thirds of the turnover and half of the employment in the SOE sector. Five SOEs generate the bulk of profits, while another handful account for the large part of losses and for about half of SOE arrears.

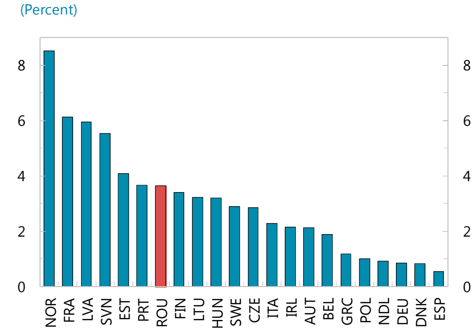
2. **SOEs dominate in key economic sectors**. SOEs constitute more than 40 percent of the energy and gas sector, around 40 percent of postal and courier services, and more than 20 percent of the transport sector turnover in Romania. While existence of natural monopolies or externalities may justify state ownership and intervention, the large presence of state-owned enterprises in sectors where market forces can and do operate in many other countries, such as energy and transport sectors, indicates that Romania's SOE sector remains relatively large (IMF, 2012). The SOEs role also seems large when compared to many EU member countries.

SOE Activity by Economic Sector, 2013



Sources: Ministry of Public Finance; Romanian Fiscal Council; and IMF staff estimates.

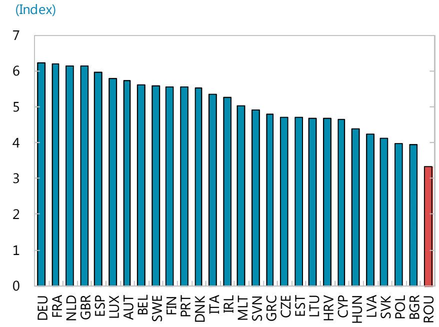
Share of SOE Employment in Total Employment, 2013 1/
(Percent)

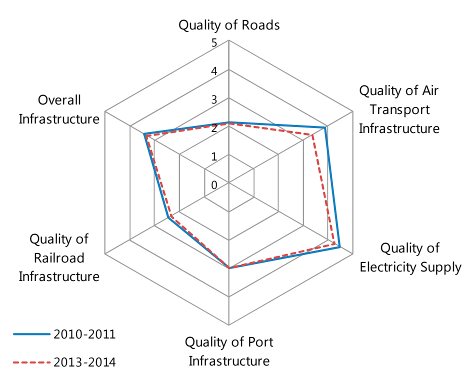


1/ Majority government-owned SOEs.
Sources: OECD, Ministry of Public Finance; and IMF staff estimates.

3. **Romanian SOEs are not efficient providers of high quality infrastructure**. Romania has ranked consistently low in terms of satisfaction with the state of its infrastructure. In particular, the World Economic Forum's assessment of the quality of infrastructure, based on surveys of business executives, ranks Romania lowest in the EU. The quality remains very low, especially in the road and railroad infrastructure. The SOEs operating in these sectors are amongst the largest arrears holders and loss-makers.

Quality of Infrastructure 1/
(Index)





1/ A higher score corresponds to better infrastructure.
Source: The Global Competitiveness Report, 2013–2014.

4. Inefficient SOEs weigh on the overall performance of the economy. Profitability of many SOEs has been weak and they have been unable to generate resources for urgently needed infrastructure improvements. The poor infrastructure is due partly to the dominance of inefficient SOEs in the transportation and energy sectors. Poor governance of these SOEs is reflected in their relatively low labor productivity. In particular, according to the European Commission (EC) estimates for 2011, Romania ranks in the bottom four countries with the lowest labor productivity in the transport sector. Interestingly, in the same year Romania's gross investment in the transport sector was one of the highest as a percent of GDP (European Commission, 2014).

B. State-Owned Enterprise Performance

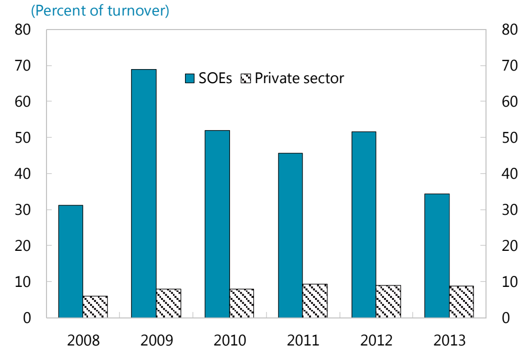
5. Romanian SOEs have generally low profitability and many operate at loss creating large arrears. With the exception of a few energy companies, the majority of Romanian SOEs have been operating for years at low profitability or making losses. Losses have been concentrated in the transport and energy sectors, in particular, in the three rail companies, the national air carrier and the coal-based energy producers. A stark example of a highly inefficient SOE is the rail freight operator CFR Marfa (Box 1). During 2008–12, cumulative SOE losses amounted to around 2 percent of 2012 GDP. In addition, SOEs account for the bulk of arrears in the Romanian state sector and are a drain on public finances in the form of foregone tax revenues, dividends and, to a lesser extent, subsidies. The transport sector has been the largest recipient of subsidies and transfers from the state budget, albeit the bulk of those are payments for the public sector obligations.

SOE Arrears and Budget Subsidies and Transfers
(Percent of GDP)

	Arrears under SBA 1/	Total Arrears 2/	Subsidies and Transfers 3/
2010	3.9	5.3	1.0
2011	3.1	4.7	0.7
2012	2.1	4.3	0.8
2013	1.1	2.8	0.7
2014	0.5	…	…

1/ Only central government-owned solvent SOEs.
2/ Includes all SOEs except those under liquidation.
3/ 2008–09 data covers only central government SOEs.
Sources: Romanian authorities; and IMF staff estimates.

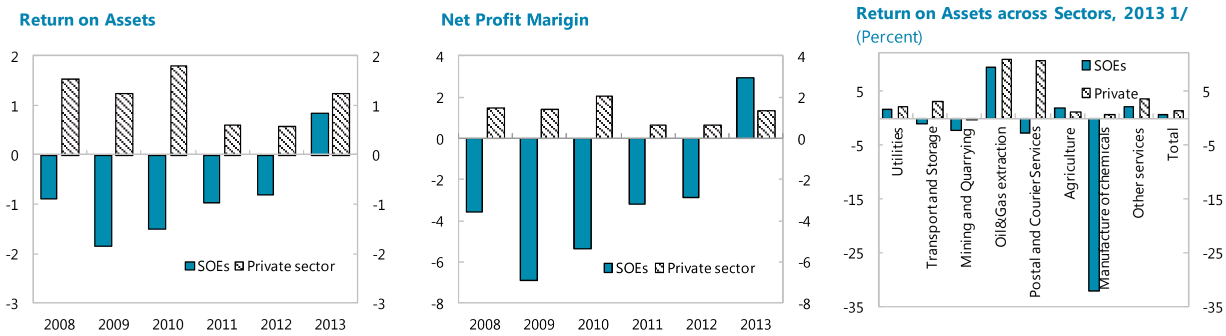
Arrears
(Percent of turnover)



Source: Ministry of Public Finance, Romanian Fiscal Council; and Fund staff estimates.

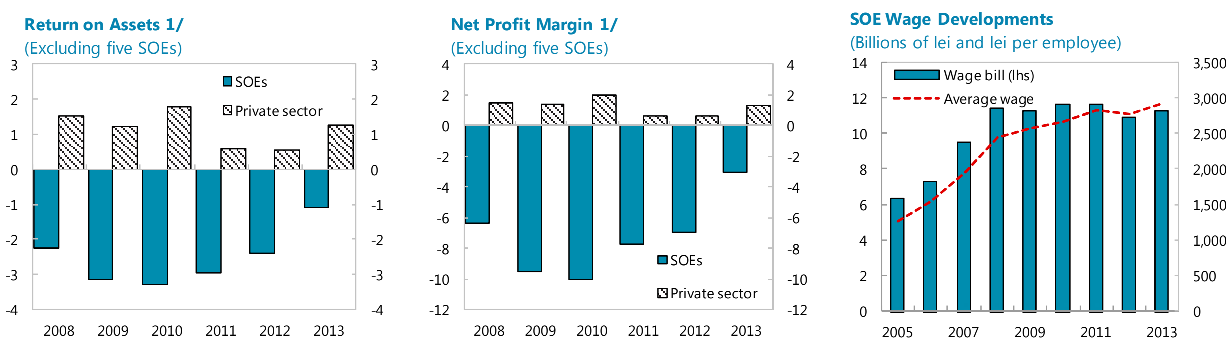
6. In 2013, the aggregate SOE sector became profitable following several years of losses.[3] In aggregate, it even surpassed the private sector in terms of net profit margins. Sectoral distribution shows that SOEs operating in the oil and gas sector were particularly profitable.

[3] The analysis is based on the Romanian tax authority (ANAF) and Fiscal Council databases that contain information from unaudited financial statements. It excludes central government-owned SOEs under liquidation.



1/ Data covers central government-owned SOEs and local government-owned SOEs with turnover over 100 million lei.
Source: Romanian authorities; and IMF staff estimates.

7. **However, a closer look reveals that when five SOEs are excluded from the analysis the picture changes drastically**. These are the state-owned gas, nuclear and hydroelectricity producers which benefited from deregulation in 2013, the gas transportation network which enjoys monopolistic conditions, and the Road Company which acts more like a project implementation unit. The remaining SOE sector was still loss making, albeit with a declining trend. The total SOE wage bill did not change much since the global financial crisis while the average wage increased, pointing to the fact that a notable labor shedding took place.

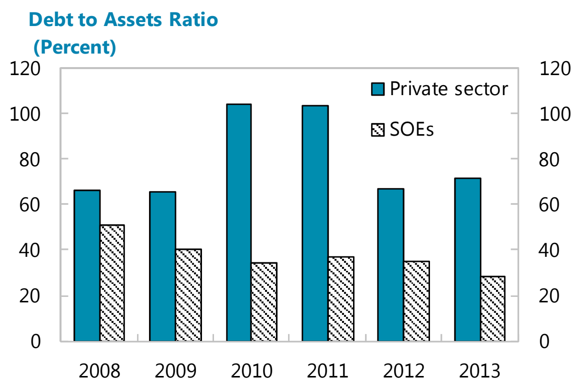


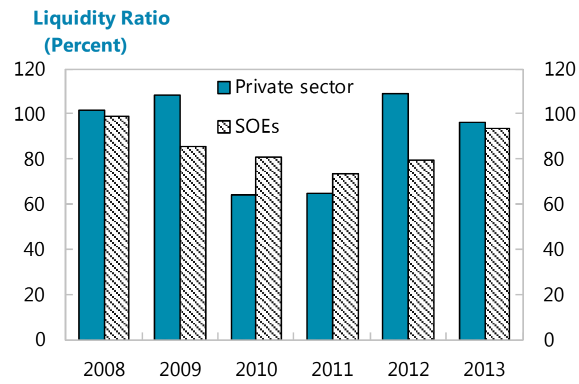
1/ Excludes Romgaz, Hidroelectrica, Nuclearelectrica, Transgaz, and Road Company.
Source: Ministry of Public Finance, Romanian Fiscal Council; and IMF staff estimates.

8. **The improved performance of the SOE sector can be attributed to reforms in regulatory and pricing frameworks as well as some progress in the governance of the SOEs**. The latter started to materialize following the approval of Government Emergency Ordinance 109 on SOE governance in 2011. While the progress under this reform effort has basically stalled and at times partially reversed, the changes in governance practices still seem to have born some positive impact on financial performance of several large SOEs during the 2012–13 period. The overall SOE performance has improved also due to putting loss-making SOEs Compania Nationala a Huilei (a large coal producer) and SC Termoelectrica SA (an energy company) into liquidation.

9. **SOEs relatively low debt level and adequate liquidity situation suggest that systemic risk related to debt repayment is moderate**. This of course varies from one SOE to another and the low level of debt can partly be explained by reluctance of creditors to provide longer-term

funding to many SOEs. While the debt and liquidity situation does not change much when the highly profitable SOEs are excluded, there is a caveat—some of SOEs' assets, in particular, accounts receivables, are of low quality which usually is not reflected in the unaudited financial statements.





Sources: Ministry of Public Finance, Romanian Fiscal Council; and IMF staff estimates.

10. SOE arrears have declined substantially during the last three years (Box 2). However, some SOEs still have large and increasing arrears. This may have detrimental effects on the business environment, in particular by exacerbating the burden of already financially constrained firms which can ultimately push them out of business (European Commission, 2014). Arrears also help perpetuate a culture of non-payment and may contribute to the rise of nonperforming loans of the banking system. In case of Romania, the direct impact of SOEs arrears accumulation is largely born by the public sector as more than 70 percent of arrears are owed to the consolidated budget and other SOEs (creating a risk of being considered as state aid (European Commission, 2015), less than 1 percent to banks and the remaining—to other creditors. Hence, reducing arrears can generate valuable public resources for much-needed investment and contribute to restoring financial health of businesses, especially small- and medium-sized enterprises.

C. Reasons for Poor Performance

11. Many SOEs have not faced hard budget constraints. Management compensation is generally not linked to the performance and non-wage payments in the form of various benefits continue to be implemented in many SOEs despite their precarious financial situation. Also, line ministries have usually been reluctant to initiate liquidation or insolvency procedures even in cases where it is evident that the SOE operations are not financially sustainable. In cases, where SOEs have been put under insolvency, the process has often been dragged on without addressing the fundamental problems of inefficiency. A notorious example is the case of chemical company Oltchim which can be contrasted with that of energy producer Hidroelectrica (Box 3).

12. SOEs in general lack professional management both at the executive level and at the level of boards. Appointments have often reflected political affiliations and connectedness to line ministries (Dochia, 2014). The situation might have been somewhat different in SOEs where

Government Emergency Ordinance 109/2011 on corporate governance was implemented. However, even in those cases, the process of selection of candidates for the management positions was not always fully exempt from line ministries' interference and many appointments were subsequently reversed. Notorious examples include several SOEs operating in the transport sector where implementation of GEO 109 started in late 2012. In CFR Infrastructura, the management was dismissed three times since then, every time coinciding with the new transport minister appointment. In SOE Tarom, the composition of the board changed four times during two years.

13. **There is no clearly defined SOE ownership policy and the tutelary authority interference is extensive**. This creates a potential for conflicts of interest in the SOEs governance framework as the line authorities (usually line ministries) that exercise ownership role in SOEs are also responsible for establishing sectoral strategies, implementing government's policies and conducting privatizations. Consequently, they often have conflicting interests over various issues and may sacrifice good corporate governance objectives over other priorities including political expediency. In such cases, line ministries' interference, especially when done through the issuance of ministerial orders, can be quite disruptive for SOEs effective management (Dochia, 2014).

14. **Monitoring of SOEs performance has not been effective**. Even though an SOE monitoring unit has been established, developing a framework for assessing SOE performance remains a work in progress. SOEs performance has not yet been properly assessed. The monitoring unit collects detailed SOE financial data but the reports it produces need to be enriched with more analytical depth and recommendations. It is not empowered to call for remedial actions or initiate actions that would hold SOEs and relevant line ministries accountable for poor financial performance. Reporting by SOEs is another issue. Only a few SOEs publish financial reports based on International Financial Reporting Standards (IFRS). The audits of many SOEs financial statements may not be conducted in line with the international standards. Even if they are, the audit reports often contain numerous material qualifications which remain unaddressed from year to year.

D. Impact of Implemented Reforms

15. **Progress with reform efforts that target improved SOEs performance and more efficient use of resources in the economy has been mixed**. The government's approach to achieve these goals has included: (i) SOEs Initial Public Offerings (IPO) and privatization; (ii) improved monitoring of SOEs financial performance and arrears reduction; (iii) professionalization of SOEs boards and management (GEO 109); (iv) restructuring or liquidation of unviable SOEs; and (v) energy market deregulation. There have been both achievements and setbacks virtually on all fronts.

16. **IPOs implementation so far has focused on the energy sector**. Under the current SBA arrangement, there have been three successful IPOs including a majority IPO of the electricity distribution company Electrica and a landmark IPO of Romgaz, the main gas producer in Romania. However, IPOs of two other large energy companies, Hidroelectrica and Oltenia, have been delayed. Hidroelectrica has been under insolvency from which it is expected to exit during 2015. Meanwhile, it has undergone substantial restructuring that promises to make it another successful IPO

candidate once the insolvency process is over. Oltenia's performance, on the other hand, has deteriorated reflecting in part inefficient management, bad accounts receivables and highly depreciated assets, and calls for a long overdue restructuring.

17. Majority privatization attempts of SOEs have usually not been pursued successfully. This seems to be partly due to political economy reasons and partly to inefficient organization of the process. A recent example is the case of rail freight company Marfa. Marfa's privatization attempt failed in late 2013 as it was not concluded before the expiration of the deadline set in the government decision approving the transaction. Since then, the government committed to an aggressive restructuring of Marfa; however, tangible restructuring measures did not start until mid-2014 when a substantial reduction (over one fourth) in the number of its staff happened.

18. SOE monitoring has improved and arrears have been reduced substantially. The government has moved from quarterly data collection to monthly collection and reporting of financial indicators on all central government-owned SOEs. It also started collection of data on the age profile of the SOEs liabilities including that of arrears. While the quality of reporting needs further improvement as the reporting entities often revise substantially the preliminary data, these are major steps towards better monitoring and ensuring timely action. SOEs arrears have been reduced under the program, albeit the measures and the pace of reduction have fallen short of the original plans (Box 2).

19. The adoption of the Government Emergency Ordinance (GEO) 109 in 2011 was a major step in the right direction to provide good principles for SOE governance. The legislation contains necessary provisions for depoliticization and professionalization of SOE governance through procedures for the selection, appointment, and functioning of SOE boards and managers. It provides for increased transparency and information disclosure to help enhance SOEs' accountability to the Romanian public. Minority shareholders' protection in SOEs is also integrated in the ordinance.

20. However, implementation of GEO 109 has been weak. The selection and appointment of professional management under the GEO 109 was implemented only in 33 SOEs. For various reasons, the majority of the newly appointed boards in those SOEs were dismissed and, as a result, only a handful of SOEs out of about 250 central government-owned SOEs at present have boards appointed according to GEO 109 (Dochia, 2014). Dismissed board members were replaced with interim members who were not selected through procedures prescribed under GEO 109. Several factors have led to difficulties in implementation, including misplaced expectations, the lack of an institution charged with overall monitoring of implementation, the absence of an effective state owner to hold SOEs accountable for results as well as weaknesses and gaps in the GEO 109.

21. The government has recently set up a High Level Commission (HLC) tasked with ensuring proper implementation of GEO 109. This Commission is intended to monitor, implement and assess the effects of the application of the provisions of the GEO 109. The SOE monitoring unit at the Ministry of Public Finance (MoPF) has been tasked to act as a supporting unit for the HLC.

However, so far there has been no tangible action on the part of the HLC and its effectiveness remains to be seen as it seems to lack ownership and enforcement tools.

22. There have been very few cases of tangible restructuring of SOEs and at the same time the government has been highly selective in initiating insolvency or liquidation. Large energy sector SOEs like Hunedoara and Oltenia as well as several rail sector SOEs and their subsidiaries are not likely to become financially sustainable if they continue their current mode of operations. Furthermore, delaying the necessary adjustment often exacerbates the situation leading to even larger losses for the state as the main shareholder and often the largest creditor. The example of Hidroelectrica suggests that it is possible to restructure an SOE through insolvency if there is a credible plan and effective administration.

23. The government has made important progress on energy market deregulation, but the reform agenda is unfinished. Electricity sales to non-residential consumers are now fully sourced from competitive markets and those to residential consumers have been so far deregulated according to the roadmap (still leaving 60 percent sourced from non-competitive market). Regarding the gas price deregulation, after a delay in the second half of 2014, the prices have been fully deregulated for non-residential consumers as of beginning of 2015. However, for residential consumers, the government decided to postpone the gas price deregulation and extend the deadline until 2021. A new roadmap still remains to be approved.

E. Further Reform Priorities

24. Move ahead steadfastly with the IPO and privatization agenda. The HLC should ensure that the unit responsible for privatizations fully employs already existing expertise of the successful IPOs and is provided with needed additional resources. While the way private ownership is brought into SOEs is important, it should not be the main focus of the efforts as the end objective is to improve SOEs operations and resource allocation in the economy. Circumstances can and do change and SOEs that were slated for IPOs may now have better chances to attract private ownership through a majority privatization and vice versa. Energy SOE Oltenia and rail freight SOE Marfa are cases in point.

25. Assess SOEs performance against clearly set targets and performance indicators and report transparently. These targets and indicators should include general indicators such as profitability as well as sector-specific indicators and must be reviewed and set on a timely basis to allow for due preparation and approval of SOEs budgets. Increased SOE governance transparency is also important to enable proper public oversight and provide for additional accountability for improved performance. In this regard, the OECD provides helpful guidance on accountability and transparency for state ownership (OECD, 2010). The government, through the SOE monitoring unit, needs to make sure that SOEs annual reports are published on a timely basis.

26. Swiftly submit the revised draft legislation on SOE corporate governance for parliamentary approval. The revised draft should adequately reflect the suggestions provided by partner international institutions. These suggestions, amongst other things, focus on appointment and dismissal of SOEs board members, their mandate contracts and administration/management plans, SOEs annual budgets, as well as on the MoPF's oversight role.

27. Exercise political will to implement provisions of the new legislation as improved legislation alone will not ensure progress. While the government has reiterated its commitment to improved SOE corporate governance in line with good international practice, it is time for concrete action to achieve firm progress on this important reform agenda and to make headway against public disappointment with the reform becoming entrenched. To this end, the HLC could play an important role by ensuring regular monitoring and assessment of SOE corporate governance through requesting from tutelary authorities of SOEs progress reports on corporate governance legislation implementation as well as on SOEs financial performance against targets. The HLC could also review and propose a reduction in the scope of ministerial orders that interfere with SOEs management functions and promote stability of the management boards which is important for business planning and implementation.

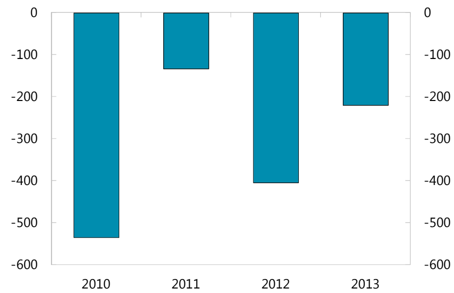
28. Restructure loss-making SOEs, put them into insolvency or liquidate them to ensure improved resource allocation. A number of loss-making SOEs, in particular in the energy and transportation sectors, need immediate restructuring. Restructuring is likely to involve substantially downsizing of operations and hence should be well planned with public resources budgeted as needed to mitigate social costs. In cases, where it is clear that the company is not financially viable, insolvencies should not be used as a vehicle to keep SOEs operational for prolonged periods of time.

29. Establish an ownership policy to complement the framework for SOE governance with clear separation of government's functions of ownership, governance, and monitoring. Centralizing the ownership function may deliver separation of ownership interests and policy objectives thus constraining the line ministries' influence on SOEs governance. However, experience, such as that of Greece's Asset Development Fund (IMF, 2014), suggests that without political will the institutional setup alone cannot ensure such a separation. The HLC could potentially play the role of an ownership coordinating entity.

30. Continue with the energy market deregulation. The government needs to continue with the implementation of the electricity market deregulation roadmap for households to achieve full competitive market sourcing by end-2017. A new roadmap for gas price deregulation for household consumers needs to be adopted, while at the same time strengthening the support for the most vulnerable consumers.

Box 1. Rail Freight SOE CFR Marfa's Performance

CFR Marfa, with its rigid business and management culture, has not been able to adjust to changing market conditions. Its market share shrank by almost 50 percent during the last decade due to competition from private rail freight operators as well as road freight. CFR Marfa has been making losses since 2008, and despite significant cuts in staffing and costs, it has been facing the prospect of bankruptcy. According to the World Bank (2013), the company's labor productivity had essentially halved, as had locomotive and rail car productivity. In 2013, CFR Marfa managed to somewhat improve its performance, but it still retained far more staff and assets than its operations justified. This low productivity is also evidenced in the table below which compares CFR Marfa to its regional peers, also state-owned companies, and to a domestic operator.



Source: Ministry of Public Finance.

Under these circumstances, privatizing CFR Marfa is the only viable option. This would give the company commercial freedom and opportunity to aggressively restructure in order to achieve radical improvements in productivity and asset utilization. CFR Marfa's privatization has been on the government's agenda since 2012 and the government approved a decision to privatize CFR Marfa in February 2013. However, the process has not been successful so far with one attempt failing to materialize in October 2013. In 2014, after protracted preparations of a restructuring plan and delays with its implementation, the company managed to reduce its staffing by almost 30 percent. This was a major step and in order to make CFR Marfa more attractive for potential private investors the restructuring needs to continue along with the preparations for another attempt to privatize it during the course of 2015. In particular, the restructuring should focus on: (i) improving the management of the company by appointing professional management and implementing sound corporate governance principles; (ii) rationalization of services with possible re-pricing to limit loss-making operations; (iii) further reduction in staffing; and (iv) disposal and scrapping of non-utilized assets.

Selected Indicators for Rail Freight, 2012

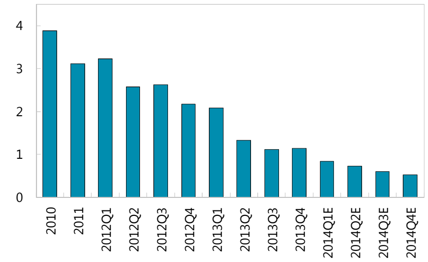
	Global traffic, thousand tonnes	Average number of employees	Tonnes per employee
CFR Marfa	31,282	8,411	3,719
PKP Cargo (Polish)	126,745	28,100	4,510
CD Cargo (Czech)	73,188	8,900	8,223
GFR SA (private Romanian)	12,000	2,368	5,068

Source: International Union of Railways Database; Companies' websites; and IMF staff calculations.

Box 2. Details on SOE Arrears[1]

SOE arrears have declined substantially during the last three years. The EU-IMF supported program targets a reduction in arrears with a view to bringing them to a de minimis level (<0.2 percent of GDP); however, progress in this direction has become increasingly challenging. The authorities missed the end-December 2013 indicative target on arrears by a substantial margin. As a prior action for the combined first and second reviews the authorities implemented specific measures including budgetary transfers, placement of several SOEs into voluntary liquidation and insolvency procedures, and implementation of restructuring measures to reduce SOE arrears significantly. As a result, end-June 2014 arrears declined to RON 4.8 billion or 0.7 percent of GDP, however, the target was missed again. At end-2014, arrears fell further to RON 3.5 billion.

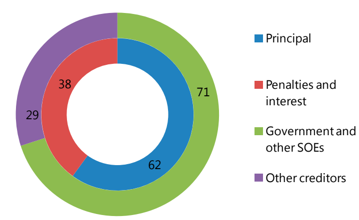
SOE Arrears 1/
(Percent of GDP)



1/ Central government-owned solvent SOEs.
Source: Ministry of Public Finance; and IMF staff estimates.

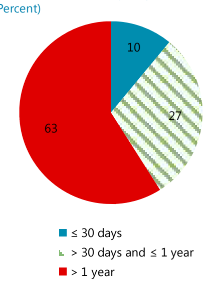
The large share of accrued penalties and interest is a challenge for further reduction. Out of total arrears, around 40 percent are accrued penalties and interest. Since they keep accruing on outstanding stock of arrears, the total stock of arrears may increase even if there is no increase or there is only a modest decrease in principal. Thus, without a major reduction in principal, it would be hard to achieve a tangible reduction in the total stock of arrears. In case of SOEs deemed viable, this could happen through refinancing or budget transfers (including through capital increases) and arrears write-off. The former is difficult to arrange because of the high risk for potential creditors, while the latter is constrained by the fiscal framework and the EU rules on state aid as around 70 percent of arrears are due to the general government and other SOEs. Given these constraints, the authorities should focus efforts on steadfast implementation of SOE restructuring and privatization plans and on liquidating unviable SOEs to achieve a sustainable improvement in SOEs finances and to put arrears on a firmly downward path.

Composition of SOE Arrears, end-2014
(Percent)



Most arrears have been overdue for more than one year. SOE arrears under the program include all payments past due date since until recently no data on age profile was available. New monthly data show that around 10 percent of the arrears are less than 30 days past due and around 30 percent are more than 30 days but less than one year overdue.

Arrears Profile by Age, end-2014
(Percent)



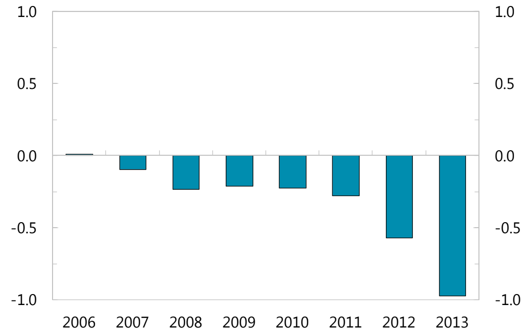
Source: Ministry of Public Finance; and IMF staff estimates.

The situation with local government-owned SOE arrears is worrisome. While not part of the program conditionality, the monitoring of these arrears reveals that they have increased since end-2013 (to around 1 percent of GDP). The latest data shows that around two thirds of the local government-owned SOE debt is overdue payments. Again, as in the case of central government-owned SOEs, most of the arrears are due to the general government and other SOEs and addressing these requires similar measures as listed above for the central government-owned SOEs.

[1] Central government-owned SOEs. Excludes arrears of those SOEs that are under insolvency or liquidation.

Box 3. Oltchim and Hidroelectrica: A Tale of Two Insolvencies

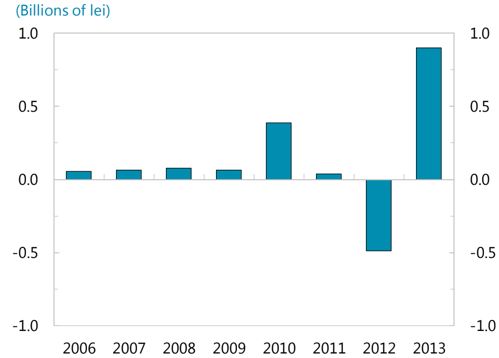
Oltchim Gross Results
(Billions of lei)



Source: Ministry of Public Finance

Oltchim is a majority state-owned petro-chemical manufacturer with more than 2,000 employees. It has been under insolvency since January 2013. During 2001–13, there were eight attempts to privatize the company, all failing as either the process was put on hold by the authorities or contracts with winning bidders were cancelled. Lately, there has been a lack of investor interest. The company has been loss making for the past seven years and has debt close to equivalent of €800 million most of which is overdue. The company has also continued to accumulate arrears to the state budget. Such a dire financial situation is the result of highly inefficient operations and poor management of the company. During 2009–12, when revenues dropped by more than 30 percent, the wage bill increased by around 40 percent despite the fact that the total number of employees decreased by more than 10 percent. At the same time, the company seems to have entered into a number of ineffective contracts, some of them reportedly with connected parties. The situation has worsened further during the insolvency. Under these circumstances, unless the insolvency administrator radically changes its approach to managing Oltchim's operations, its liquidation seems to be the only solution to stop further losses and allow for the possibility of some asset recovery for its creditors.

Hidroelectrica Gross Results
(Billions of lei)



Source: Ministry of Public Finance

Hidroelectrica is one of Romania's largest energy producers, supplying up to a third of Romania's domestically produced electricity. However, poor corporate governance, characterized by heavy political interference in management and operating decisions, made it one of the least efficient and least profitable hydro power producers. The government placed Hidroelectrica into insolvency procedures for the first time in June 2012 in view of its deteriorating financial position. Under insolvency procedures, Hidroelectrica is being restructured, while it continues to operate. The judicial administrator has made notable progress in improving Hidroeletrica's financial performance. The administrator cancelled or renegotiated all non-commercial bilateral energy contracts, which absorbed well over half of its output and cost the company an estimated €1.1 billion in lost revenue. The cancellations also eliminated the need for Hidroelectrica to buy more expensive electricity from other state-owned producers and sell it at a loss to meet contracted volumes. Moreover, the administrator managed to achieve substantial cost savings throughout the company's operations. Continued progress will be key for the success of the company's planned IPO.