

EUR100BN EQUITY GAP FOR FRENCH AND ITALIAN SMEs

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On top of emergency liquidity measures provided to European SMEs to fight Covid-19, we estimate that Italian SMEs need EUR70bn of recapitalization, French SMEs EUR30bn and German SMEs EUR3bn — after excluding pre-existing zombies. While state-guaranteed loans have so far helped companies avoid a liquidity crisis, European SMEs are facing excessive debt levels, deteriorated profitability and undercapitalization, a bad combination for medium-run solvency, with French and Italian SMEs being most at risk. French non-financial corporations' debt is expected to have reached more than 81% of GDP in Q2, much above Germany's levels of 43% and the Eurozone average of 63%. This comes against the backdrop of below peer equity ratios¹ (37% of total assets, see Figure 1) and strongly deteriorating profitability: French non-financial corporations' margins have lost more than -7pp since the start of the year and stand at the lowest level among EU-27 countries. While the debt issue is less of a concern in Italy (65% of GDP) in a context of a higher resilience of margins, equity ratios of Italian SMEs also stand below 40% level considered as adequate.

Figure 1 – Equity gap, EURbn

	Equity ratios (SMEs, 2018)	Share of zombie SMEs in total assets	Total assets (SMEs excl. zombie, EURbn)	Total equity (SMEs excl. zombie, EURbn)	Total equity targeting 40% equity ratio (EURbn)	Equity gap in 2020, EURbn
Germany	39%	10%	301.6	117.6	120.6	3
France	37%	11%	875.6	321.2	350.3	29
Italy	33%	20%	941.9	306.7	376.8	70

Sources: Euler Hermes, Bank of France, Allianz Research.

Note that the equity gap excludes what we considered as pre-existing zombies, as identified with the following criteria. We apply these three criteria below to around 150,000 SMEs in Euler Hermes proprietary database for Germany, France and Italy in order to be able to retreat the BACH SME database to calculate total assets and equity ratios for "healthy" companies only².

	France	Italy	Germany
Profitability (ROCE)	<6%	<0.2%	<7%
Capitalization (equity/ total assets)	<23.2%	<15.6%	<20.6%
Interest coverage (EBIT/ interest expenses)	<1.1x	<0.5x	<0.8x

¹ Total equity to total assets² Read our report: https://www.eulerhermes.com/en_global/news-insights/economic-insights/covid19-crisis-in-europe-puts-13000-corporates-at-risk.html

Which sectors are the most at risk? Excluding zombie SMEs, and looking at the pre and post Covid-19 state of equity ratios, the accommodation and catering sector in France is most at risk, followed by transportation and storage services. The accommodation and catering sector represents 38% of the increase in the equity gap foreseen in France, i.e. EUR11bn, but this sector is also far from immune in Italy (EUR3.9bn) – see Figure 2. Machinery equipment and trade (combining retail and wholesale) in Italy are next on the ‘watch list’, with an almost similar additional equity gap (EUR7.5bn and EUR7.3bn, respectively). We expect the ‘other transportation and storage services’ sector to remain high on the list in both France and Italy (EUR5.5bn and EUR2.6bn, respectively). More globally, Italian sectors are over represented in the ‘watch list’ since they all appear to be undercapitalized compared to their German and even French counterparts, with several sectors posting a below 35% equity ratio prior to the Covid-19 outbreak (notably wearing apparel, wood and wood products, structural metal, construction, land transport). In France, the equity gap is concentrated in a much more limited number of undercapitalized sectors. The transportation sector, including both maritime and air transport, highly impacted by the Covid-19 crisis, is one of them, with equity gaps at a record EUR3.4bn and EUR1.9bn, respectively. Those two sectors are the only ones to watch in Germany, where all the other sectors had above 40% equity ratios prior to the crisis.

Figure 2 – Equity gap by sectors (excluding zombie SMEs)

France	Pre-covid Equity ratio	2020 increase in equity gap (EUR bn)	Share of the total
Oil & natural gas extraction	36%	0.4	1%
Electricity, gas & air conditioning	31%	5.0	17%
Water, sewerage & waste management	29%	1.6	6%
Accommodation & catering	38%	11.1	38%
Water transport	38%	3.4	12%
Air transport	34%	1.9	7%
Other transportation & storage services (inc. warehousing & postal)	38%	5.5	19%
Total		29.0	100%

Germany	Pre covid Equity ratio	2020 increase in equity gap (EUR bn)	Share of the total
Water transport	32%	0.8	26%
Air transport	29%	2.2	74%
Total		3.0	100%

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Italy	Pre covid Equity ratio	2020 increase in equity gap (EUR bn)	Share of the total
Textiles	38%	0.5	1%
Wearing apparel & furs	30%	1.9	3%
Leather goods	35%	2.4	3%
Wood & wood products	31%	0.6	1%
Paper & printing	33%	0.6	1%
Rubber & plastics	37%	2.4	3%
Non-metallic minerals	36%	1.3	2%
Basic metals	37%	3.5	5%
Structural metal incl. tanks, boilers & weapons	34%	4.5	6%
Electrical machinery & apparatus	36%	2.0	3%
Mechanical engineering	36%	7.5	11%
Motor vehicles & parts	35%	4.5	6%
Air, space, rail, ships & other transport equipment	32%	1.3	2%
Furniture manufacturing	33%	1.2	2%
Electricity, gas & air conditioning pre-scaled	32%	4.5	6%
Water, sewerage & waste management pre-scaled	31%	1.5	2%
Construction	30%	4.7	7%
Retail & wholesale distribution	34%	7.3	10%
Accommodation & catering	28%	3.9	6%
Land transport & transportation via pipelines	30%	3.7	5%
Air transport	37%	0.4	1%
Other transportation & storage services (inc. warehousing & postal)	32%	2.6	4%
Information & communication	33%	0.7	1%
IT Programming, consultancy & information services	34%	0.5	1%
R&D, leasing, legal, professional & maintenance services	39%	3.3	5%
Arts, recreation, unions, personal services	16%	2.2	3%
Total		70.0	100%

Sources: Oxford Economics, Euler Hermes, Allianz Research

These assessments are, as always, subject to the disclaimer provided below.

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