

**DECISION OF THE COMPETITION COUNCIL**  
**no. 151 of 04.07.2006**  
**concerning the state aid notified by**  
**the Authority for the Recovery of State Assets**  
**to be granted to SC HIDROMECHANICA SA Brasov**

**THE COMPETITION COUNCIL,**

With regard to the provisions of the European Agreement establishing an association between Romania, on one hand, and the European Communities and their Member States, on the other hand, ratified by Law no. 20/1993, published in the Romanian Official Gazette no. 73, Part I, of 12.04.1993,

With regard to the provisions of the Competition Law no. 21/1996, republished in the Official Gazette no. 742, Part I, of 16.08.2005,

With regard to the provisions of the State aid Law no. 143/1999, republished in the Official Gazette, Part I, no. 744 of 16.08.2005,

With regard to the provisions of the Regulation on State aid for rescue and restructuring firms in difficulty, published in the Official Gazette, Part I, no. 1215, of 17.12.2004,

With regard to the provisions of the Regulation regarding the form, contents and other details of the notification of a State aid, published in the Official Gazette, Part I no. 82 of 25.01.2005;

With regard to the provisions of the Regulation on the state aid for small and medium size enterprises, published in the Official Gazette, I Part, no. 340 on 19 April 2004,

With regard to the provisions of the Decree no. 57/2004 on the appointment of the Competition Council's members,

**Based on the following,**

**1. PROCEDURE**

(1) By address no. VP4/2736/08.05.2006, filed with the Competition Council no. RS-AS 83/10.05.2006, the Authority for the Recovery of State Assets (hereinafter AVAS) has notified, in the name of all grantors, based on art. 15 from Law no. 143/1999 on state aid, republished, the individual state aid for the restructuring of SC HIDROMECHANICA SA Brasov within the privatization process.

(2) The Competition Council requested to AVAS additional information by address no. DAAS/730/12.06.2006. AVAS transmitted its answer to the requested information by address no. VP4/2948/16.05.2006, filed with the Competition Council no. RG 4126/17.05.2006. The notification became effective on 17.05.2006.

## **2. DESCRIPTION OF THE STATE AID MEASURES**

### **2.1. Legal basis for granting the aid**

- Law no. 137/2002 regarding certain measures for accelerating the privatization process, with its subsequent amendments and completions;
- GD no. 577/2002 on approving the Methodological norms for EGO no. 88/1997 regarding the privatization of the commercial companies, with its subsequent amendments and completions and for Law no. 137/2002 regarding certain measures for accelerating the privatization process;
- EGO no. 26/2004 regarding certain measures for completing the privatization of the companies in AVAS' portfolio and consolidating some privatizations, approved by the Law no. 442/2004;
- GO no. 95/2003 regarding the undertaking by AVAB of some budgetary debts in order to recover and return them to FNUASS;
- EGO no. 26/2005 regarding the abrogation of the legal provisions concerning the granting of facilities for the payment of the remaining budgetary obligations,
- Law no. 244/2005 for approving EGO no. 26/2005 regarding the abrogation of the legal provisions concerning the granting of facilities for the payment of the remaining budgetary obligations.

### **2.2. Beneficiary of the measures – SC HIDROMECHANICA SA Brasov**

(3) The State aid beneficiary is SC HIDROMECHANICA SA Brasov<sup>1</sup> (hereinafter HIDROMECHANICA). The company was set up as joint-stock company in 1990 through the reorganization of the former state company Hidromecanica. Hidrotehnica was set up during 1964 from the plant Strungul.

(4) HIDROMECHANICA was privatized in 2001, but the new owner didn't fulfill the conditions from the sale-purchase agreement and the precarious management generated the company's decapitalization, the loss of an important number of specialized staff, a substantial accumulation of debts towards the local and state budget, together with the failure to pay the suppliers and the employees. In 2003 the privatization contract was annulled, the state became again the company's owner and the company entered under special administration and financial supervision. During 2002 – 2004 the company's activity regressed and there were accumulated further substantial losses.

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<sup>1</sup>At the date of signing the privatization contract, the company had a share capital of RON 6,471,397.5 divided in 2,588,559 shares with a FACE value of RON 2.5; the company is registered at the Trade Register under no.: J08/26/1991, CUI: 1088974 fiscal attribute R, headquarters in: Brasov, 78 15 Noiembrie Avenue, Brasov county, postal code 500097;

(5) On the background of this negative financial situation (accumulated losses of RON 40 millions and historical debts of approximately RON 46 millions towards the budgets, suppliers and employees) the company was privatized for the second time in December 2004 by signing the share sale-purchase agreement no. 87/23.12.2004, concluded between AVAS and Mr. Gibarcea Neculae Lucian (Romanian natural person). The shareholders structure after privatization is presented in table no. 1. The share ownership transfer took place on 07.01.2005.

**Table no. 1 Ownership structure at HIDROMECHANICA after privatization**

SHAREHOLDERS	EQUITY HOLDINGS	
	Number of shares held	Percentage from the social capital (%)
Gibarcea Neculae-Lucian	1,319,299	50.96654
SIF Transilvania	1,170,304	45.21064
Actionari PPM	98,956	3.82282
<b>TOTAL</b>	<b>2,588,599</b>	<b>100.0000</b>

Source: AVAS Notification

(6) The company's main activity according to NACE classification – 2911 – is the production of engines and turbines (excepting engines for planes, auto vehicles and motor-cycles).

(7) The company's main groups of products are the following:

- hydrokinetic transmissions;
- rotary blowers for Diesel motors supercharge;
- hydraulic couple converters and fluid flywheels;
- hydraulic transmission;
- special transmissions THM 5-800;
- spare parts for auto and agriculture;
- castings, forged pieces and die parts which are used exclusively by the company and are not sold to third persons.

(8) Economic- financial results of HIDROMECHANICA based on balance sheet data prior to the privatization are the following:

**Table no. 2 Economic-financial results , based on balance sheet data**

2002	2003	2004
<b>Turnover (RON)</b>		
26,395,676	20,987,105	21,897,473
<b>Turnover realized in Romania (RON)</b>		
19,175,411	14,863,505	14,341,820
<b>Loss (RON)</b>		
8,035,454	12,912,133	15,060,967

Source: AVAS Notification

It can be noticed a substantial decrease of the company's activity volume (with 17%), especially based on the production for the internal market (with 25%); on the external market the company registered a moderate increase of 5% mainly determined by the exchange rate growth comparing with RON. As it results from the data presented, before the privatization, the company registered losses.

(9) HIDROMECHANICA is a large enterprise, since its number of employees exceeds the limits imposed by the Regulation on State aid for SMEs, with the subsequent amendments and completions. Thus:

- 50.97% of HIDROMECHANICA equity is held by Gibarcea Neculae-Lucian – Romanian natural person, who also owns shares of SC LUCFOREST SRL Brasov and SC CORAL SA Brasov; therefore, HIDROMECHANICA and these companies are related companies within the meaning of Art. 2 (7) of the Regulation on State aid for SMEs, with the subsequent amendments and completions;
- The number of employees and financial values are the following:
  - The average number of employees of HIDROMECHANICA at the end of 2004 is 989, and that of the companies related through the majority shareholder, is 39 for SC LUCFOREST SRL Brasov and 29 employees for SC CORAL SA Brasov;
  - The turnover made by the company is RON 21,897,473, those realized by SC LUCFOREST SRL Brasov is RON 6,312,162 and the turnover realized by SC CORAL SA Brasov is RON 999,128.

### **2.3. Financial position of HIDROMECHANICA before privatization**

(10) Prior to privatization, HIDROMECHANICA was in a difficult economic-financial situation shown by:

- decrease of cash flow due to a low recovery of receivables and payment of debts which do not ensure available cash to carry out the current business;
- increase of company debts due to lack of liquidity;
- increase of financial burdens, shown by intermediate liquidity, which is much below the minimum limit of the admissible margin of 0.5; this fact confirms the company's incapacity to generate the necessary liquidities for making the payments from the current activity

(11) Among the causes that led to the difficulties that the company is confronted with, one can enumerate:

- exploitation of obsolete technology, leading to continuous productivity decline;
- severe lack of investment funds which impeded the replacement of obsolete technology;
- migration of the specialized, qualified labor force because of the delays from the wages payment, situation that led to increasing the scraps, and, implicitly, the production costs, as well as to the contractual terms inobservance;
- the blockage in the Romanian economy as a whole which also affected the revenues of HIDROMECHANICA, situation that caused as a chain effect payments delay of the budget obligations and for the social insurance budget.

(12) Taking into consideration this difficult situation, AVAS decided to privatize HIDROMECHANICA and to grant some facilities conditioned by the implementation of some restructuring measures. According to the information from the notification, the privatization presentation file informed the potential investors of the facilities for the payment of overdue budgetary payments.

## 2.4. Financial support measures for HIDROMECHANICA

(13) Thus, at privatization, the company was granted fiscal facilities consisting of exemption and payment scheduling of the payment of the overdue debts towards the state consolidated budget, local budget, AVAB and AVAS, with a total value of RON 47,303,372.4, respectively: [...]<sup>2</sup>

## 2.5. Relevant markets

(14) HIDROMECHANICA is active on the following relevant markets:

- market of metal constructions and metal products (forged parts of steel for machines, equipment and vehicles, general mechanics operations and thermal treatments);
- market of parts for machines and equipments (tractor parts and spare parts, rotary blower and components, special transmissions, converters, couples and components, hydro mechanical transmissions and components);
- market of road transports parts and accessories (parts and accessories for town cars);
- market of parts and accessories for transports except road transports (parts and accessories for railway transports).

The company commercializes its products on the internal and external market.

(15) The company has attached to the restructuring plan a „Market study for SC HIDROMECHANICA SA Brasov”. The market study has been drawn up by SC DARIAN ROM SUISSE SRL and presents mainly the following aspects:

- an analysis of the relevant markets on which the company operates;
- analysis of the competition on the relevant markets;
- perspectives for the development of the markets on which the company operates during 2005-2009.

(16) According to this market study, the size of the internal markets on which the company operates and the market shares are the following:

**Table no. 3 Size of the relevant markets and market shares held by HIDROMECHANICA**

<b>Groups of products</b>	<b>Market size (Thousands RON)</b>	<b>Market share held by HIDROMECHANICA (%)</b>
Metal constructions and metal products	4,679,580	0.23
Parts for machines and equipments	5,468,830	0.10
Road transports parts and accessories	4,809,590	0.07
Parts and accessories for transports except road transports	3,253,100	0.01

*Source: Market study*

(17) HIDROMECHANICA's main competitors on the internal market are the following:

- for parts for machines and equipments: CLARK-SUA, CLARKHURTH-Belgium, ZF Germany, CATERPILLAR-SUA, RENK-Germany, HOLSET-Anglia, KKK-Germany, ABB-Switzerland, SULZER-Switzerland, VOITH-Austria, SC MECANICA Vaslui;

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<sup>2</sup> Confidential data

- for parts for machines and equipments, road transports parts and accessories, as well as parts and accessories for transports except road transports: DACIA Pitesti, MECANICA Codlea, TRACTORUL Brasov, ROMAN Brasov, BPT Canada;
- for metal constructions and metal products: small commercial companies workshops type.

(18) The main customers of the company are undertakings from the car building industry, agriculture, defense industry, shipbuilding industry, rail building industry, mines, oil industry, land improvements, food industry, etc.

(19) The company exports parts for machines and equipments (rotary blower and components, hydraulic transmissions and components, hydro mechanical transmissions and components) and auto parts and parts for agriculture. The exports are realized in Canada, Egypt, Germany, Austria, Switzerland, Italy and Kazakhstan. On the external market , HIDROMECHANICA holds an insignificant market share, way below 0.1%.

(20) The market study points out for the future an increase tendency of the internal market of the company's products, in close correlation with the general tendency of the industries in which activate its clients. The internal market will also have an ascendant trend; the company is about to extend the traditional co-operation especially with firms from the Egyptian and Canadian markets.

## **2.6. Description of the privatization process**

(21) [...] <sup>3</sup>

(22) [...] <sup>4</sup>

(23) [...] <sup>5</sup>

(24) [...] <sup>6</sup>

(25) [...] <sup>7</sup>

(26) [...] <sup>8</sup>

## **3. DESCRIPTION OF THE RESTRUCTURING PROGRAM**

(27) The company has drafted a comprehensive restructuring plan for the period 2005-2009, comprising organizational, technological, environmental and financial measures. The

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<sup>3</sup> Confidential data

<sup>4</sup> Confidential data

<sup>5</sup> Confidential data

<sup>6</sup> Confidential data

<sup>7</sup> Confidential data

<sup>8</sup> Confidential data

restructuring plan has been drawn up by the company together with the buyer, and was approved by AVAS.

(28) The restructuring plan submitted by AVAS contains both the causes which led to HIDROMECANICA's difficulties and measures to ensure the long term viability of the company. AVAS estimates that by implementing the measures comprised in the restructuring plan, the company will become profitable and will secure its own financial resources in order to properly conduct business without debts to the consolidated budget of the state or to AVAS.

(29) In brief, the restructuring program entails the following measures:

**Table no.4 Summary of the restructuring measures for HIDROMECANICA BRASOV**

- RON -

No.	Measures	Assessment of implementation costs			
		Total cost	Own sources	Investor sources	State aid
1.	Organizational restructuring measures	2,615,500	1,175,500	1,440,000	-
2.	Technological restructuring measures	22,749,500	-	22,749,500	-
3.	Environmental restructuring measures	3,154,050	52,500	3,101,550	-
4.	Financial restructuring measures	68,571,321	457,948	20,810,000	47,303,373
	<b>TOTAL RESTRUCTURING COST</b>	<b>97,090,371</b>	<b>1,685,948</b>	<b>48,101,050</b>	<b>47,303,373</b>

Source: Restructuring plan of HIDROMECANICA

The implementation of the restructuring plan requires a financial effort of RON 97,090,371, of which RON 48,101,050 are committed by the investor, RON 1,685,948 are committed by the company while the State contributes to the company's financial restructuring with RON 47,303,373. This plan is expected to restore the viability of the company in 2009 (at the end of the restructuring period).

### 3.1. The organizational restructuring

(30) The organizational restructuring of the company implies a financial effort of RON 2,615,500 that will be entirely borne by the company and the buyer. In brief, the organizational restructuring is the following:

**Table no. 5 Measures regarding the organizational restructuring of HIDROMECANICA**

- RON -

Measure	Deadline	Implementation effort	Financing sources		State aid
			Company sources	Investor sources	
Reorganization of the productive activity on a single platform situated in Brasov industrial area	2006	330,000	330,000	-	-
Improving the working conditions	2007	1,440,000	-	1,440,000	-
Development of the marketing activity, certification of the Quality Management System in compliance with the ISO 9001-2000 Standard	2008	185,500	185,500	-	-
Reduction of the production	2006	175,000	175,000	-	-

capacities by some equipments cassation					
Reduction of the production capacity by capitalization of those which have functional technical characteristics	2008	485,000	485,000	-	-
<b>TOTAL</b>	<b>-</b>	<b>2,615,500</b>	<b>1,175,500</b>	<b>1,440,000</b>	<b>-</b>

Source: Restructuring plan of HIDROMECHANICA

### 3.2. Technological restructuring

(31) The proposed technological restructuring measures refer to:

**Table no. 6 Measures regarding the technological restructuring of HIDROMECHANICA -RON -**

Measure	Deadline	Implementation effort	Financing sources		State aid
			Company sources	Investor sources	
Investments for ensuring the maintenance and for modernizing the technological equipments from the endowment	2008	2,280,000	-	2,280,000	-
Investments for increasing the activity efficiency in the warm sectors (buying installations and equipments)	2008	19,625,500	-	19,625,500	-
Acquisition of equipments for lifting and loading	2006	284,000	-	284,000	-
Acquisition of an integrated software system for the company management (MFG PRO) and of the corresponding hardware equipments; acquisition of telecommunication equipments	2007	560,000	-	560,000-	-
<b>TOTAL</b>	<b>-</b>	<b>22,749,500</b>	<b>-</b>	<b>22,749,500</b>	<b>-</b>

Source: HIDROMECHANICA BRASOV's restructuring plan

The total implementation costs of these measures are of RON 22,749,500 which are totally ensured by the investor.

### 3.3. Restructuring measures for environmental protection

(32) Investments in environmental protection amount to RON 3,154,050 and are briefly presented in table no. 7. These investments are aimed at complying with the environmental obligations and the measures in the compliance program for the Environmental permit.

**Table no. 7 Restructuring measures for environmental protection -RON-**

Measure	Deadline	Implementation effort	Financing sources		State aid
			Company sources	Investor sources	
Investments in the energetically resources areas	2008	1,260,250	-	1,260,250	-



(design again the warm system, the endowment with meters in order to measure the energetic consume, the compressors acquisition with high technological performance)					
The modernise of the dyeing atelier	2007	316,800	-	316,800	-
Dismantling sandblasting installations with electrocorindon and purchase of a monorail sandblasting installation OMSG Germany	2006	474,500	-	474,500	-
The reduction and the control of the water, air and soil pollution (the replacement of the polluting Technologies with per formant and "clean" Technologies at the Atelier of the surface coverage and at the Station of saturated the residual water)	2007	1,050,000	-	1,050,000	-
The unrig of the Nuclear Unit functional for industrial radiogram and the replacement of the un-destructive controlling method to detect the defects based on gamma radius, with rectifier apparatus (NDT) with X-ray with ways of measure and control compatible with Standard requirement of the beneficiaries	2006	52,500	52,500	-	-
<b>TOTAL</b>	<b>-</b>	<b>3,154,050</b>	<b>52,500</b>	<b>3,101,550</b>	<b>-</b>

Source: HIDROMECANICA restructuring plan

### 3.4. Financial restructuring

(33) At privatization, the company needed financial restructuring for the normal functioning of the production activity, besides other restructuring measures assumed through the restructuring plan.

(34) In the case of HIDROMECANICA, the financial restructuring involves a total cost in amount of RON 68,571,321 and contains the following measures:

**Table no. 8 Financial restructuring measures**

Measures	Deadline	Implementation effort	Financing		-RON- State aid
			Company own sources	Company own sources	
Granting payment facilities for overdue obligations towards AVAS and AVAB,	2006	28,219,115	-	-	47,303,373

the State budget and the local budget					
The financing of the company activity through ensuring work capital <sup>9</sup>	2009	20,810,000	-	20,810,000	-
The capitalization of fixed assets approved to be quashed (special construction, office equipment, furniture, fixed assets as inventory objects) and the capitalization through selling ferrous/un-ferrous waste <sup>10</sup>	2006	424,608	424,608	-	-
The capitalization of the stock raw materials, materials, products which exceed the level of the security stock	2009	27,840	27,840	-	-
The debts recovery by cession/compensate debts overdue 120 days	2006	5,500	5,500	-	-
<b>TOTAL</b>	<b>-</b>	<b>68,571,321</b>	<b>457,948</b>	<b>20,810,000</b>	<b>47,303,373</b>

Source: *HIDROMECHANICA restructuring plan*

The restructuring plan, through its financial component, gives the possibility to increase cash flow, to secure a stable cash flow, which will relieve and facilitate the financial activity of the company.

#### 4. STATE AID ASSESSMENT OF THE MEASURES

##### 4.1. The State aid character of the notified measures

(35) [...] <sup>11</sup>

(36) [...] <sup>12</sup>

(37) [...] <sup>13</sup>

(38) [...] <sup>14</sup>

(39) [...] <sup>15</sup>

<sup>9</sup> The Buyer provides working capital required to finance current company activity, as well funds for for the payment of some debts to creditors.

<sup>10</sup> Reorganization of the company's production activity on a single platform imposes the dismantling of premises in the central part of the city where previously carried out. Thus, buildings, special constructions (pipes, fittings, heating and ventilation networks, platforms), storage constructions, furniture and office related equipment sold as scrap iron and non-ferrous waste.

<sup>11</sup> Confidential data

<sup>12</sup> Confidential data

<sup>13</sup> Confidential data

<sup>14</sup> Confidential data

<sup>15</sup> Confidential data

(40) [...] <sup>16</sup>

(41) Granting financial support to HIDROMECANICA sets the premises for a possible distortion of the competition on the relevant markets, since it allows the company to continue on these markets. Moreover, there is no doubt that the financial support granted to HIDROMECANICA may affect trade with the Member States of the European Union, since the products manufactured by the company may compete with similar products manufactured in the European Union.

(42) To conclude, the financial facilities granted to the company at privatization are considered to represent State aids and fall under the scope of the Law no. 143/1999 on State aid, republished.

#### **4.2. Compatibility with the State aid legal framework**

(43) Art. 2 of the Law no. 143/1999 on State aid, republished, it foresees that State aids granted by the State or from State resources that distort or threaten to distort competition and affect trade with the Member States are incompatible with a normal competitive environment.

(44) The State aid objective is the restructuring of HIDROMECANICA in order to restore its viability at the end of the restructuring period.

(45) The Competition Council evaluates the State aid granted to HIDROMECANICA, in accordance with the criteria stipulated in the Regulation on State aid for rescuing and restructuring firms in difficulty, published in the Official Gazette no. 1215/17.12.2004, issued in application of the Law no. 143/1999 on State aid, republished. To be considered compatible with a normal competitive environment, the State aid must fulfil the criteria set in the above-mentioned Regulation.

(46) The restructuring aid is conditioned by the implementation of a viable and coherent restructuring plan, demonstrating the long-term viability of the company. To this effect, the Regulation states that the restructuring usually involves one or more of the following elements: the company's re-organization and rationalization on a more efficient base, generally implying the retreat from actions that are generating losses, the restructuring of the existing activities that may become again competitive and sometimes the diversification towards new and profitable activities. In general, the industrial restructuring must be accompanied the financial restructuring (capital injections, reduction of debts degree, etc.).

(47) The facilities granted upon the privatization of HIDROMECANICA is considered as state aid for restructuring and is to be granted based on a restructuring plan for 2005-2009, drafted by the company together with the buyer and AVAS, the main objective being the restoration of the company's viability until the end of the implementation period

(48) The Competition Council assesses the state aid granted to HIDROMECANICA according to criteria provided in the Regulation on state aid for rescuing and restructuring firms in difficulty, as follows:

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<sup>16</sup> Confidential data

- eligibility of the company - company in difficulty;
- restoring the company's long term viability;
- avoid undue distortion of competition;
- aid limited to the minimum necessary (proportionality of the aid);
- observing the "first time, last time" principle;
- ensuring the fulfilment of the restructuring plan and permanently monitoring its progress;
- affiliation to a group of companies.

#### 4.2.1. Eligibility of HIDROMECANICA – firm in difficulty

(49) In order to benefit from State aid in accordance with the Regulation on State aid for rescuing and restructuring firms in difficulty, the company must be in difficulty. According to the Regulation, the Competition Council considers that a company is in difficulty when it is not able to cover its losses either from its own financial resources or from other sources that it may obtain from owners/shareholders or creditors, and which, in the absence of external intervention of the State will almost certainly lead to the company's demise.

(50) According to art. 2 para. (3) from the Regulation on state aid for the rescue and restructuring of firms in difficulty, if none of the requirements provided in para. (2) are not met, a firm may still be considered to be in difficulties, in particular where the usual signs of a firm being in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value.

(51) The reasons to establish whether HIDROMECANICA is eligible or not to receive state aid for restructuring being a firm in difficulty are the following:

##### *a) Evolution of turnover*

**Tabel nr. 9 Evolution of turnover of HIDROMECANICA between 2002-2004** - RON-

	2002	2003	2004
Turnover	26.395.676	20.987.105	21.897.473
Consumer price index	117,8	114,1	109,3
Turnover in 2002 prices	26.395.676	18.893.606	17.558.531

Source: Notification AVAS

In the analyzed period, there is a decreasing evolution of the turnover expressed in comparable prices.

##### *b) The company makes losses*

**Table no. 10 Losses of HIDROMECANICA between 2002-2004** - RON-

	2002	2003	2004
Gross result of exercise	-8,035,454	-12,912,133	-15,060,967
Operating result	-7,667,592	-12,177,071	-14,456,037

Source: Notification AVAS

In the analyzed period the company makes losses on the entire activity, most of them operational.

*c) The gross operating margin, as operating profit/turnover*

**Table no. 11**      **Gross operating margin for HIDROMECANICA between 2002-2004**      - RON-

	<b>2002</b>	<b>2003</b>	<b>2004</b>
Operating result	-7,667,592	-12,177,071	-14,456,037
Turnover	26,395,676	20,987,105	21,897,473
Profit ratio (%)	-29.04	-58.02	-66.02

*Source: Notification AVAS*

As it can be noticed, the gross operating margin is negative, losses from the core business growing from one year to another, highlighting the company's difficulty and generating debts unlikely to be sustained by own sources.

*d) Acid test ratio*

**Table no. 12**      **Acid test ratio for HIDROMECANICA in 2002-2004**      - RON-

<b>Indicator</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Current assets	16,067,836	16,050,233	14,363,804
Inventories	11,737,612	11,584,805	10,218,749
Current liabilities	25,043,794	36,602,763	46,185,591
Acid test ratio <sup>17</sup> = (Current assets - Inventories)/ Current liabilities	0.17	0.12	0.09

*Source: Notification AVAS*

The "acid test ratio" recorded values below normal levels in the analyzed period, showing that the company did not benefit of required liquidity for current payments.

(52) It can be concluded from the above indicators that during the analyzed period, the company registered the decrease of turnover, increase of losses, acid test ratio much below normal levels, all these showing a decline of the economic and financial activity. As a result, the Competition Council notes that the criteria provided by art. 2 (3) of the Regulation on state aid for the rescue and restructuring of firms in difficulty are met so as HIDROMECANICA to be considered „firm in difficulty”.

#### **4.2.2. Restoring the long term viability of the company**

(53) Difficulties confronting HIDROMECANICA led to the drastic reduction in its business activities, coupled with the accumulation of debts to the state budget and AVAS that attracted increment and delay penalties higher than overdue debts.

(54) Subsequent to the privatization in 2004, a restructuring plan for 2005-2009 has been drawn up. The summary of the measures included in the company's restructuring plan has been presented in chapter 3.

<sup>17</sup> The acid test ratio must be situated between 0.5 – 1.0 to consider that a company has a stable financial position.

(55) The assessment of the restructuring plan and of the way in which it leads to the restoration of the company's long-term viability has in view the provisions of article 13 of the Regulation on State aid for rescuing and restructuring firms in difficulty.

(56) According to above-mentioned article, the granting of a restructuring State aid is conditioned by the implementation of a restructuring plan. The evaluation of the State aid by the Competition Council is based on the restructuring plan. The restructuring plan, which must be as short as possible in time, must include the abandonment of loss making activities and to offer the company long term viability, thereby allowing it to function with its own resources. The restructuring plan must be based on a realistic appraisal of market conditions, the restoring of viability having to result mainly from internal measures as well as from taking into consideration external factors such as price and demand over which the company has no substantial influence.

(57) The restructuring plan of HIDROMECHANICA starts from the financial and economic data that reflects the company's activities in the period prior to privatization. This plan was elaborated as a result of a diagnosis that shows the strong and weak points of the company as well as the circumstances that led to the difficulties the company faces.

(58) The strategy of HIDROMECHANICA aims at preserving the strong points, respectively: the company has an integral plank (casting, processing, installing, testing) and qualified personnel, which is adaptable at a complex structure of the production. At the same time, the company's strategy aims at limiting and counteracting with adequate measures the weak points, i.e. the obsolete and outdated of the production equipments, the high operating expenses and the weak marketing activity.

(59) The implementation of the measures provisioned by the restructuring plan financed both by the majority shareholder of the company, its own infusion, and the state through the facilities granted to the company for the payment of budgetary obligations. It is foreseen to improve the financial - economic indicators in the period 2005-2009<sup>18</sup>, as follows:

**Table no. 13 Estimates of the economic and financial indicators subsequent to the implementation of the restructuring measures**  
- RON-

Indicators		2005	2006	2007	2008	2009
<b>1</b>	<b>Total revenues, of which:</b>	<b>26,120,500</b>	<b>52,219,115</b>	<b>37,900,000</b>	<b>40,900,000</b>	<b>43,000,000</b>
	Operating revenues	26,020,000	52,219,115	37,900,000	40,900,000	43,000,000
	Turnover	23,000,000	27,500,000	34,000,000	37,000,000	40,000,000
	Financial revenues	10,500	-	-	-	-
	Extraordinary revenues	-	-	-	-	-
<b>2</b>	<b>Total expenses, of which:</b>	<b>33,862,200</b>	<b>38,199,342</b>	<b>38,146,663</b>	<b>37,079,862</b>	<b>39,826,225</b>
	a) operating	33,162,200	37,899,342	37,896,663	36,829,862	39,626,225
	b) financial	700,000	300,000	250,000	250,000	200,000

<sup>18</sup> The fact that the restructuring plan ensures the company viability it is proved also by the improvement of the main economic and financial indicators starting with the first restructuring year. Thus, in 2005, the company realized a turnover of RON 21.021,7 thousand and losses of RON 7.770,2 thousand (approx. 2 times smaller than previous year). Thus, indicators for the first restructuring year confirm projections of the restructuring plan (Table no. 9).

	c) extraordinary	-	-	-	-	-
3	Gross profit (+) / Loss (-)	-7,741,700	19,348,457 <sup>19</sup>	-1,130,054	2,522,697	2,205,663

Source: HIDROMECHANICA restructuring plan

(60) As a result of accomplishing the measures provisioned by the restructuring plan, at the end of the restructuring period the company forecasts to reach the following target indicators:

**Table no. 14** The targeted economic and financial indicators

1. Net profit	RON	5,608,850
2. Turnover	RON	42,000,000
3. Employees	persons	680
4. Equity	RON	82,511,605
5. Receivables collection period	days	27
6. Debt payment period	days	68
7. Indebtedness ratio	%	9.7
8. Return on assets	%	5
9. Return on equity	%	5.4
10. Cash flow	RON	440.000

Source: HIDROMECHANICA restructuring plan

(61) Taking into account the above data, the Competition Council considers that the proposed restructuring plan will lead to the restoration of the long-term viability of HIDROMECHANICA.

#### 4.2.3. Preventing any excessive distortion of the competition (compensatory measures)

(62) According to the provisions of the Regulation regarding State aid for rescuing and restructuring of firms in difficulty, in order to minimize as much as possible the negative effects that the State aids granted have on the competition on the relevant markets, compensatory measures are needed. These measures will be proportional with the distorting effects caused by the aids and especially with the size and relative importance of the company on the relevant markets. The reduction of the company's presence on the market will be set based on the market research attached to the notification, as well as on any other relevant information, and will be included in the restructuring plan.

(63) Through the restructuring plan the company will close and unrig the non-viable capacities that represent 12% from the production capacity. This capacities reduction are not considered compensatory measures in the meaning of the Regulation regarding State aid for rescuing and restructuring of firms in difficulty, because, according to the information submitted by AVAS, these reductions contribute to the elimination of the activities that generate losses, being absolute necessary the restoration of the viability. Thus, the company will unrig a number of 820 machines, equipments, work equipments and technological equipments.

(64) The reduction of the capacities production viable proposed by the grantor of the state aid as compensatory measures in order to reduce the distorting effect of the granting state aid on the competition are the following:

<sup>19</sup> Estimated profit for 2006 is just an accounting profit, generated by the record in company's books of the granting of fiscal facilities. It is estimated that from operating activity the company will make a loss.

**Table no. 15 Capacity utilization before and after HIDROMECANICA restructuring**

Services	MU <sup>20</sup>	Capacity in 2004 (before restructuring)	Capacity in 2009 (end of restructuring)	Reductions of production capacities (%)
Metallic constructions and products	EUC	400	380	5
Replacements for machines and equipments	EUC	2,290	1,462	37
Parts and accessories for the road transportation	EUC	72	60	17
Metallurgical products	EUC	1,800	1,170	35

*Source: HIDROMECANICA restructuring plan*

These capacity reductions are irreversible and are an integral part of the restructuring plan. Thus, the company will unrig 286 machines, outfits and equipments as boring machines, lathes, equipments for the metal weld, compressors, machines and outfits for the processing of the products from the un-ferrous metallurgy, accumulator batteries, outfits and equipments for the separation process and clarifying tanks, etc.

(65) According to the market study on which the restructuring plan is based, HIDROMECANICA holds on the markets on which it operates, small shares, respectively:

- 0.23% on the market of metallic constructions and products;
- 0.10% on the market of replacements for machines and equipments;
- 0.07% on the market of parts and accessories for the road transportation;
- 0.01% on the market of parts and accessories for the transportation, except the road one.

(66) According to provisions of art. 14 from the Regulation regarding State aid for rescuing and restructuring of firms in difficulty, stipulating that compensatory measures will be proportionate with the distorting effects of the state aid over the competition and considering the market share held by the company on the relevant markets, the Competition Council considers that in the case of HIDROMECANICA, reductions of production capacities proposed through the restructuring plan are sufficient.

(67) In light of the above, the Competition Council notes that the State aid shall be used exclusively for restoring the company's viability, not allowing the beneficiary, while implementing the restructuring plan, to extend its production capacity.

#### **4.2.4. Aid limited to the minimum necessary (proportionality of the aid)**

(68) In accordance with art. 15 of the Regulation on the rescue and restructuring of firms in difficulty, the State aid intensity and quantum is limited to the minimum necessary in order to allow restructuring according to the existing financial resources of the company and of shareholders. The State aid beneficiary must significantly contribute to the restructuring programme, using own resources, including the sale of unessential assets or external loans obtained under normal market conditions. According to art. 15 (2) of the Regulation, for large undertakings a contribution of at least 50% is considered adequate.

<sup>20</sup> The unit measure is EUC – equivalent units of capacity



(69) The total restructuring cost of HIDROMECHANICA is RON 97,090,371 and is composed of:

- Organisational restructuring cost	RON 2,615,500
- Technological restructuring cost	RON 22,749,500
- Environmental restructuring cost	RON 3,154,050
- Financial restructuring cost	RON 68,571,321

(70) The total restructuring cost of HIDROMECHANICA, in amount of RON 97,090,371, is supported from the following sources:

- own sources of the Buyer	RON 48,101,050
- company's own sources	RON 1,685,948
- State aid	RON 47,303,373

(71) According to information submitted by AVAS, the own contribution of the Buyer and of the company in amount of RON 49,786,998 (51.3% of total restructuring costs) is provided from the following sources:

- capital injection in amount of RON 48,101,050 of the majority shareholder<sup>21</sup>;
- revenues from the selling of the waste products resulted from the annulment/dismemberment of the non-performance/non-viable equipments and other fix assets that do not serve directly to the main object of company activity (waste selling contract no. 5261/09.09.2005 close with SC TEHNOINVEST SRL Brasov) in amount of RON 1,370,000;
- revenues from the selling of raw materials, materials and products stock<sup>22</sup>, in amount of RON 315,948.

(72) The State aid intensity, calculated as a ratio between the amount of State aid and the whole restructuring cost, is 48.7%.

(73) Given the above, the Competition Council notes that the own financing sources are certain and considers sufficient the own contribution of 51.3% to the restructuring costs, this showing trust in the practical value of the restructuring and the fact that the amount and intensity of the state aid were strictly limited to allow restructuring according to the existing financial resources of the company and the Buyer. Therefore, the ability of the company to apply any liquidity surplus for aggressive activities, with the possible distortion of the market, is reduced.

#### **4.2.5. Observing the „first time, last time” principle**

(74) After the first privatization, in 2001, it was authorized a State aid<sup>23</sup> for HIDROMECHANICA. This contract was annulled and the company re-enter in the State property, in 2003, because the new owner did not fulfil the privatization contract conditions, and the precarious way of its administration generated the company decapitalization, accumulation the substantial debts to the state and local budget, supplier and employees.

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<sup>21</sup> The Buyer provides working capital in amount of RON 19,000,000 additional to the amount assumed through the privatization agreement (RON 1,810,000 respectively Euro 500,000. The obligation was assumed through a statement certified by a public notary.

<sup>22</sup> According to the order and the invoices situation, these amounts were cashed.

<sup>23</sup> The Competition Council Decision no. 242/2002

Because of its difficult situation, HIDROMECANICA has not dispose of the necessary funds in order to respect the payment schedules of the deferrals interest and, therefore the facilities from the payments of the residual budgetary debts authorized were annulled. The debts were relayed in the company charge<sup>24</sup>. Therefore, the company has not benefited from the authorized state aid.

(75) Taking into consideration these exceptional circumstances generated by the failing of the company first privatization, the Competition Council considers that, by granting notified State aid for restructuring it is not an infringement of the art. 24 provisions from the Regulation on the rescue and restructuring of firms in difficulty, which provides that the restructuring State aid must be granted only once.

#### **4.2.6. Affiliation to a group of companies**

(76) According to the provisions of art. 2 (5) of the Regulation regarding State aid for rescuing and restructuring of firms in difficulty, a company belonging to a group is not normally eligible to receive State aid for rescuing and restructuring, except for the case when it can be proved that the financial difficulties belong to the company itself and they are not the outcome of an arbitrary allocation of costs within the group and that the respective difficulties are much too serious to be handled by the group itself.

(77) The fiscal facilities intended to be granted to HIDROMECANICA refer to historical debts – consequence of the economic results obtained in the years preceding the sale of the majority share package, so they are the company's own.

(78) Followed the company privatization process and the signed selling-buying of shares contract, the new owner of HIDROMECANICA is Mr. Lucian Neculae Girbacea – Romanian natural person – who owns 50.97% from the register capital. He also controls the companies as SC LUCFOREST (100% from the register capital) and SC CORAL SA Brasov (59.69% from the register capital).

(79) AVAS submitted to the Competition Council data on the economic-financial situation of these companies. According to their balance sheets, these two companies owned by Mr. Lucian Neculae Girbacea obtained at the end of 2004 a net profit in amount of RON 120,618.

(80) [...] <sup>25</sup>

(81) Therefore, the Competition Council considers that Mr. Lucian Neculae Girbacea could not have coped with the financial difficulties of HIDROMECANICA and the restructuring of the company without a consistent intervention of the State, the company's debts to the consolidated State budget and to AVAS being in total amount of RON 28,219,115. Taking into consideration the data mentioned above the Mr. Lucian Neculae Girbacea contribution at the HIDROMECANICA restructuring is significant compared with the financial resources of the later.

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<sup>24</sup> These amounts were included in the amount of overdue obligations to the state consolidated budget according to the Certificate of budgetary obligations issued by the General Department of Public Finance Brasov no. 5885/17.02.2005.

<sup>25</sup> Confidential data

#### **4.2.7. Monitoring and annual reporting**

(82) In accordance with article 18 from the Regulation on State aid for rescue and restructuring firms in difficulty, the Competition Council permanently monitors the implementation of the restructuring plan so that the company will not fail in fulfilling the objectives established.

(83) The Competition Council will monitor the implementation of the restructuring plan until the end of the period to assure itself that increases of the production capacities are not registered, major deviation from the achievement of restructuring measures and that the State aid will not lead to the creation of complementary liquidities to be used for other activities than the ones contained in the restructuring program.

### **5. CONCLUSIONS**

(84) Having in view the above-mentioned aspects, the Competition Council concludes that the individual State aid intended to be granted to HIDROMECHANICA is compatible with a competitive normal environment and does not significantly affect the trade with the Member States of the European Union.

### **DECIDES**

**Art. 1.** The financial support measure notified by the Authority for the Recovery of State Assets for SC HIDROMECHANICA SA Brasov represents a State aid according to article 2(1) of the Law no. 143/1999 on State aid, republished.

**Art. 2.** Based on the provisions of article 21 (2) letter c) corroborated with art. 23 (1) e) of the Law no. 143/1999 on state aid, republished, the restructuring aid that is going to be granted to SC HIDROMECHANICA SA Galati at privatization, is authorized with the condition to observe the provisions of articles 3 and 4 of the present Decision

**Art. 3.** The company is compelled to fully implement the assumed restructuring plan.

**Art. 4.** The company shall reduce the production capacities until 2009, according to the assumed restructuring plan.

**Art. 5.** If the conditions imposed by the present decision are not observed, the provisions of article 22 of the Law no. 143/1999 on State aid, republished shall apply.

**Art. 6.** The amount of the State aid that is going to be granted is of RON 47,303,372.4.

**Art. 7.** The present decision becomes applicable as of communication.

**Art. 8.** In accordance with the provisions of article 32 of the Law no. 143/1999 on State aid, republished, the Authority for State Assets Recovery shall submit to the Competition Council information on the State aid granted in order to inventory and monitor. In addition, the Authority for State Assets Recovery shall submit to the Competition Council the annual reports on the implementation of the restructuring plan. The first report shall be submitted within 6 months from the issuance of the decision. The following reports must include the necessary

data on the (physical and value) stage of implementation of the restructuring plan. At the same time, information on the enforcement of compensatory measures related to the production capacities imposed by the present decision will be submitted.

**Art. 9.** In accordance with article 46 of the Law no. 143/1999 on State aid, republished, the present decision can be appealed by interested parties at the Court of Appeals, the Administrative Litigation Section within 30 days from its communication.

**Art. 10.** The present decision shall be communicated by the General Secretary of the Competition Council to:

- The Authority for the Recovery of State Assets, 50 Cpt. Av. Alexandru Serbanescu street, sector 1, Bucharest;
- The Ministry of Public Finance, Str. Apolodor nr. 17, sector 5, Bucharest;
- Local Council Brasov County, str. Dorobantilor nr. 4, Brasov, cod postal 500009;
- SC HIDROMECHANICA SA Brasov, 78 November 15 Boulevard, Brasov county, postcode 500097.

**PRESIDENT**

**MIHAI BERINDE**