CRITICS REGARDING THE USE OF DEGREE OF FINANCIAL LEVERAGE IN THE EVALUATION OF COMPANY'S FINANCIAL RISK

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Abstract: Financial risk has been traditionally evaluated using two kinds of tools: degree of financial leverage and the break-even point. In this paper, we carried a study regarding the limits and the terms of using the degree of financial leverage when evaluating the financial risk. In this aim, we first proposed a new set of indicators that could be used to assess this type of risk. In order to demonstrate the relevance of new measures proposed, we carried out a survey on several companies listed on Bucharest Stock Exchange. The period of analysis was 2007 - 2010. For the companies selected, we calculated both the traditional measures and the new set proposed. The results showed the disadvantages and the terms of using the traditional measures when evaluating the financial risk. We also found out that some of the measures proposed within this paper provide better results in this respect.

JEL classification: G32, G33

Key words: financial risk, degree of financial leverage, coefficient of sensitivity, financial expenses, operating profit, net income

1. INTRODUCTION

Financial risk should reflect the firm's ability to cover the interest on bank loans. The degree of financial leverage (DFL), by the way it is built, reflects the financial risk indirectly, through the effects it has on shareholders' earnings and not in terms of generating causes, i.e. fixed interest expenses. Thus, it compares the changes in net profit with the changes in operating profit, but it doesn't reflect the changes in interest expenses. The latter one is found, however, indirectly, in the change in net profit. But the net result is also influenced by financial revenues, so the impact of interest expenses on the net profit is lower. Due to this, the degree of financial leverage has certain limitations.

This study aims to highlight the limits of DFL and to propose alternative tools for assessing the financial risk, based on the causes that generate it. To this end, a study was conducted on six Romanian industrial companies. The period of analysis was 2007-2010. For the companies selected, there were calculated both the degree of financial leverage and the proposed indicators. Finally, a comparison was made between these tools on their ability to point out the right level of financial risk.

2. CONCEPTS AND METHODOLOGY

In order to assess the financial risk, the traditional indicator, the degree of financial leverage, was primarily used, calculated using the formula:

$$\text{Degree of financial leverage DFL} = \frac{\Delta\%\text{Net income}}{\Delta\%\text{Operating profit}}.$$

Besides this, the following indicators were proposed:

a) $\text{Coverage ratio of financial expenses} = \frac{\text{Financial expenses}}{\text{Operating profit}}$ - it shows the extent to which the operating covers the financial expenses of a company;

b) $\text{Overall coverage ratio of financial expenses} = \frac{\text{Financial expenses}}{\text{Operating profit} + \text{Financial revenues}}$ -it shows the extent to which the operating and the financial revenues cover the financial expenses of a company. This ratio is especially important for the firms having large financial revenues which can be used to cover some of the financial charges.

c) $\text{Coefficient of sensitivity} = \frac{\text{Percentage variation in financial expenses}}{\text{Percentage variation in operating profit}}$ - compares the dynamics of financial expenses with the dynamics of operating profit. The bigger this coefficient, the bigger the financial risk.

d) $\text{Overall coefficient of sensitivity} = \frac{\text{Percentage variation in financial expenses}}{\text{Percentage variation in operating profit} + \text{financial revenues}}$ - compares the dynamics of financial expenses with the cumulate dynamics of operating profit and financial revenues.

e) $\text{Safety margin} = \text{Percentage variation in financial expenses} - \text{Maximum allowable percentage variation in financial expenses}$

where:

$$\text{Maximum allowable percentage variation in financial expenses} = \frac{OP_1 - I_0}{I_0} \times 100,$$

OP_1 – operating profit in current year;

I_0 – interest expenses in previous year;

f) $\text{Overall safety margin} = \text{Percentage variation in financial expenses} - \text{Maximum allowable percentage variation in financial expenses}^*$

where:

$$\text{Maximum allowable percentage variation in financial expenses}^* = \frac{(OP_1 + FR_1) - I_0}{I_0} \times 100,$$

FR_1 – financial revenues in current year.

Coverage ratio of financial expenses and overall coverage ratio of financial expenses were calculated for the period 2007 - 2010. All the other indicators, due to their calculation, were determined only for the period 2008 to 2010. Based on these indicators, there were made assessments on the financial risk of the firms studied and there were raised limits and advantages of their use.

3. RESULTS

The degree of financial leverage for **Condmag** is given in Table below:

Table no. 1

Indicators	2007	2008	2009	2010
Operating result	7,419,975	14,419,005	21,977,644	13,984,891
Net income	4,666,245	8,890,127	18,384,271	11,786,731
Percentage variation in operating result	-	94.33%	52.42%	-36.37%
Percentage variation in net income	-	90.52%	106.79%	-35.89%
Degree of financial leverage	-	0.96	2.04	0.99

The operating result has quite large increases in 2008 and 2009 (+94.33% and +52.42%). In 2010, the decrease is large (-36.37%) and is probably due to the economic crisis. The net result has an evolution similar to the operating result, as it increases by 90.52% in 2008 and by 106.79% in 2009, then it decreases by 35.89% in 2010. In 2009 we notice different percentage changes in the two profit indicators. In the other years, the percentage changes are quite close. The degree of financial leverage has low values in 2008 and 2010 (0.96 and 0.99), signifying a low financial risk. In 2009, DFL has a level of 2.04, meaning a slightly higher financial risk against the rest of the years.

In Table 2 there are presented the financial expenses ratios and the coefficients of sensitivity recalculated according to the methodology presented in the previous paragraph.

Table no. 2

Indicators	2007	2008	2009	2010
Financial expenses	2,513,130	4,845,844	2,814,027	4,439,018
Operating result	7,419,975	14,419,005	21,977,644	13,984,891
Financial revenues	886,923	782,430	2,349,579	4,770,449
Operating result + Financial revenues	8,306,898	15,201,435	24,327,223	18,755,340
Coverage ratio of financial expenses	33.87%	33.61%	12.80%	31.74%
Overall coverage ratio of financial expenses	30.25%	31.88%	11.57%	23.67%
Percentage variation in financial expenses	-	92.82%	-41.93%	57.75%
Percentage variation in operating result	-	94.33%	52.42%	-36.37%
Percentage variation in operating result+financial revenues	-	83.00%	60.03%	-22.90%
Coefficient of sensitivity K	-	0.98	-0.80	-1.59
Overall coefficient of sensitivity K*	-	1.12	-0.70	-2.52

Coverage ratio of financial expenses has acceptable values in the period under review. In 2007, 33.87% of the operating profit goes to cover the financial expenses. In 2008, both the operating profit and the financial expenses increase a lot, but with similar percentages, so the coverage ratio of financial expenses remains at about the same level. In 2009, the operating profit increases, but the financial expenses decrease, so the ratio drops to 12.80%. In 2010, the operating profit decreases and the financial expenses grow and the rate becomes 31.74%.

The overall coverage ratio of financial expenses has a dynamics close to the coverage ratio of financial expenses. Moreover, in the first three years, the levels of the two ratios are quite close, as the financial revenues are not very high. In 2010, the financial revenues increase up to 4.7 million lei, so the overall coverage ratio of financial expenses increased by only 8 percent to 23.67%.

The coefficient of sensitivity has a positive value only in 2008. In the last two years, the variations in different directions for financial expenses and operating profit resulted in negative levels of the coefficient of sensitivity, so it has no economic significance. The situation is similar for the overall coefficient of sensitivity. On this basis, we can say that the degree of financial leverage ensures better results in assessing the financial risk than the coefficients of sensitivity.

Table three shows the safety margins of the changes in financial expenses:

Table no. 3

Indicators	2008	2009	2010
Percentage variation in financial expenses	92.82%	-41.93%	57.75%
Maximum allowable percentage variation in financial expenses	473.75%	353.54%	396.97%
Safety margin	-380.93%	-395.47%	-339.22%
Percentage variation in operating result+financial revenues	83.00%	60.03%	-22.90%
Maximum allowable percentage variation in financial expenses*	504.88%	402.02%	566.49%
Overall safety margin	-412.06%	-443.95%	-508.75%

In 2008, the percentage change in financial expenses was 92.82%. The maximum value they could increase was 476.75%, thus the safety margin is -380.93%, which is favorably appreciated. Safety margin is also negative in the coming years, which means that the company had a consistent reserve to increase the financial expenses, which could be covered by the operating profit. The situation is similar for the overall safety margin, which has higher values than the safety margin. Assessed by these two indicators, the financial risk assumed by the company is quite low.

The tools that correctly assess the financial risk are the coverage ratio of financial expenses, the overall coverage ratio of financial expenses, the degree of financial leverage, the safety margin and the overall safety margins, while the coefficients of sensitivity were not relevant.

For **OMV Petrom**, the situation is as follows:

Table no. 4

Indicators	2007	2008	2009	2010
Operating result	1,964,598,430	1,309,233,231	1,197,278,464	3,201,693,547
Net income	1,778,042,301	1,022,387,463	1,368,127,631	1,799,154,602
Percentage variation in operating result	-	-33.36%	-8.55%	167.41%
Percentage variation in net income	-	-42.50%	33.82%	31.50%
Degree of financial leverage	-	1.27	-3.95	0.19

The operating result decreases in 2008 and 2009 and increases sharply in 2010. The net income drops in 2008, in 2009 grows (although the operating profit decreases), and in 2010 increases, but much less than the operating result. The degree of financial leverage has a low value in 2008 (1.27), then becomes negative in 2009 (-3.95) and has no economic significance, while in 2010 reaches the value of 0.19, meaning, also a low financial risk. We notice the high volatility of the two indicators of profit, affecting the ability of DFL to correctly point out the financial risk.

The financial expenses ratios and the coefficients of sensitivity are as follows:

Table no. 5

Indicators	2007	2008	2009	2010
Financial expenses	313,268,366	1,635,431,821	619,138,262	1,896,557,792
Operating result	1,964,598,430	1,309,233,231	1,197,278,464	3,201,693,547
Financial revenues	498,296,964	1,931,761,930	1,119,379,543	910,503,264
Operating result + Financial revenues	2,462,895,394	3,240,995,161	2,316,658,007	4,112,196,811
Coverage ratio of financial expenses	15.95%	124.92%	51.71%	59.24%
Overall coverage ratio of financial expenses	12.72%	50.46%	26.73%	46.12%
Percentage variation in financial expenses	-	422.05%	-62.14%	206.32%
Percentage variation in operating result	-	-33.36%	-8.55%	167.41%
Percentage variation in operating result+financial revenues	-	31.59%	-28.52%	77.51%
Coefficient of sensitivity K	-	-12.65	7.27	1.23
Overall coefficient of sensitivity K*	-	13.36	2.18	2.66

The low level of financial charges in 2007 determined a low level for the coverage ratio of financial expenses, of 15.95% only. In 2008, the financial expenses increase greatly, exceeding the operating profit, so the ratio becomes 124.92%. In 2009, the financial expenses decrease again greatly and the ratio becomes 51.71%. The ratio increases slightly in 2010, reaching 59.24%. Over the period analyzed, in 2007 we can say that the financial risk is lower, while the worst situation is found in 2008.

The overall coverage ratio of financial expenses shows a completely different situation than the previous ratio. The extreme values are reached in the same years as described above, meaning the maximum in 2008 (50.46%) and the minimum one in 2007 (12.72%). However, in this case we see a much lower financial risk, due to financial revenues, which covers much of the financial expenses.

The large variations in financial expenses and in operating profit cause large oscillations for the coefficient of sensitivity. Thus, in 2008 it has a value of -12.65, in 2009 it is 7.27 and in 2010 is 1.23. As compared to DFL, it has a lower capacity to reflect the financial risk. Instead, the overall coefficient of sensitivity shows a different situation. Its level is 13.36 in 2008 (compared with the negative level of the coefficient of sensitivity K) and 2.18 in 2009, showing a lower financial risk than the previous coefficient. In 2010, it has a slightly higher value, of 2.66, but it doesn't reflect a financial risk much higher than the coefficient of sensitivity K.

The safety margins of the financial expenses are given in the table below:

Table no. 6

Indicators	2008	2009	2010
Percentage variation in financial expenses	422.05%	-62.14%	206.32%
Maximum allowable percentage variation in financial expenses	317.93%	-26.79%	417.12%
Safety margin	104.13%	-35.35%	-210.80%
Percentage variation in operating result+financial revenues	31.59%	-28.52%	77.51%
Maximum allowable percentage variation in financial expenses*	934.57%	41.65%	564.18%
Overall safety margin	-512.52%	-103.80%	-357.86%

The safety margin shows a worse situation in 2008 when the financial expenses vary more than the maximum allowed. Instead, the situation is recovering in 2009 and in 2010 a low financial risk is reached. The overall safety margin shows a low financial risk in each year analyzed. It is correlated with the overall coverage ratio of financial expenses, which shows a similar situation.

The tools that correctly highlight the financial risk are the overall coverage ratio of financial expenses and the overall safety margin.

For **Dafora**, the level of DFL is shown in Table 7.

Table no. 7

Indicators	2007	2008	2009	2010
Operating result	30,826,793	28,849,682	22,638,736	23,795,669
Net income	17,831,198	1,075,512	1,456,107	8,146,877
Percentage variation in operating result	-	-6.41%	-21.53%	5.11%
Percentage variation in net income	-	-93.97%	35.39%	459.50%
Degree of financial leverage	-	14.65	-1.64	89.91

The degree of financial leverage has a low capacity to assess the financial risk. In 2008, the operating profit decreases by 6.41% and the net profit by 93.97%. In these circumstances, DFL becomes 14.65, which means a major risk. In 2009, it has a negative value as the operating profit drops and the net profit increases. In this case, DFL has no economic significance. In 2010, the operating profit increases by 5.11% and the net profit by 459.50%, which determines the level of DFL of 89.91 (a major financial risk). The values of DFL in 2008 and 2010 are high and mean, theoretically, a high risk for the company. However, without comparing the financial costs with the operating profit, we can not say with certainty whether or not the company can cover the financial costs, which affect the relevance of this coefficient.

The financial expenses ratios and the coefficients of sensitivity are as follows:

Table no. 8

Indicators	2007	2008	2009	2010
Financial expenses	15,166,486	31,004,325	25,319,597	31,059,144
Operating result	30,826,793	28,849,682	22,638,736	23,795,669
Financial revenues	5,122,174	4,450,846	4,435,563	16,500,864
Operating result + Financial revenues	35,948,967	33,300,528	27,074,299	40,296,533
Coverage ratio of financial expenses	49.20%	107.47%	111.84%	130.52%
Overall coverage ratio of financial expenses	42.19%	93.10%	93.52%	77.08%
Percentage variation in financial expenses	-	104.43%	-18.34%	22.67%
Percentage variation in operating result	-	-6.41%	-21.53%	5.11%
Percentage variation in operating result+financial revenues	-	-7.37%	-18.70%	48.84%
Coefficient of sensitivity K	-	-16.28	0.85	4.44
Overall coefficient of sensitivity K*	-	-14.17	0.98	0.46

The financial expenses are pretty high in 2008 - 2010, when they exceed the operating profit (the coverage ratio of financial expenses is greater than 100%). In 2007

only, their level is lower, leading to a level of coverage ratio of financial expenses less than 100%. All this leads to a high financial risk for the company. The overall coverage ratio of financial expenses is below 100% in all years analyzed, indicating a more favorable situation than in the previous case. However, the levels are quite high, leading to a great financial risk for the company. The coefficients of sensitivity do not accurately reflect the financial risk. In 2008, their values are negative and, in next period, only the coefficient K has a higher level (4.44).

The safety margin and the overall safety margin have the following levels:

Table no. 9

Indicators	2008	2009	2010
Percentage variation in financial expenses	104.43%	-18.34%	22.67%
Maximum allowable percentage variation in financial expenses	90.22%	-26.98%	-6.02%
Safety margin	14.21%	8.65%	28.69%
Percentage variation in operating result+financial revenues	-7.37%	-18.70%	48.84%
Maximum allowable percentage variation in financial expenses*	119.57%	-12.68%	59.15%
Overall safety margin	-15.14%	-5.66%	-36.48%

The two margins show a completely different situation. The safety margin is positive, meaning a great financial risk. The overall safety margin is negative, indicating that the financial costs are covered by the operating profit and the financial revenues and thus the financial risk is lower. However, the level of this margin is not very low and shows some profitability problems for this company.

For Dafora, the indicators which accurately reflect the financial risk are the overall coverage ratio of financial expenses and the overall safety margin.

The situation of degree of financial leverage for **Electroputere** is as follows:

Table no. 10

Indicators	2007	2008	2009	2010
Operating result	-52,846,991	65,116,740	-22,860,048	10,089,525
Net income	-57,425,381	41,119,567	-39,557,448	-7,335,555
Percentage variation in operating result	-	-223.22%	-135.11%	-144.14%
Percentage variation in net income	-	-171.61%	-196.20%	-81.46%
Degree of financial leverage	-	0.77	1.45	0.57

The degree of financial leverage has low values and seems to indicate a low financial risk. In 2007, the company has both operating and net loss. In 2008, it goes on profit, which is quite high. In 2009, it posts losses again (operating and net), and after that in 2010 it has a positive operating result and a net loss. The different direction of variation of profits from one year to another makes DFL meaningless, as the company seems to face a financial risk already occurred.

The financial expenses ratios and the coefficients of sensitivity are presented in the table below:

Table no. 11

Indicators	2007	2008	2009	2010
Financial expenses	4,992,498	25,429,330	30,901,649	39,153,543
Operating result	-52,846,991	65,116,740	-22,860,048	10,089,525

Indicators	2007	2008	2009	2010
Financial revenues	414,108	1,432,157	14,232,916	21,771,463
Operating result + Financial revenues	-52,432,883	66,548,897	-8,627,132	31,860,988
Coverage ratio of financial expenses	-9.45%	39.05%	-135.18%	388.06%
Overall coverage ratio of financial expenses	-9.52%	38.21%	-358.19%	122.89%
Percentage variation in financial expenses	-	409.35%	21.52%	26.70%
Percentage variation in operating result	-	-223.22%	-135.11%	-144.14%
Percentage variation in operating result+financial revenues	-	-226.92%	-112.96%	-469.31%
Coefficient of sensitivity K	-	-1.83	-0.16	-0.19
Overall coefficient of sensitivity K*	-	-1.80	-0.19	-0.06

It is noted from this table, the high financial costs in 2008-2010, as well as the strong growth in 2008 as compared to 2007. In 2007, the operating result is negative and does not fully cover the financial expenses. In 2008, the operational profit becomes positive and the coverage ratio of financial expenses amounts to 39.05%, which means a moderate financial risk. In 2009, operating result is negative and does not allow covering the increased financial expenses. In 2010, the operating result is positive, while the coverage ratio of financial expenses is 388.06%, which means a financial risk already occurred, because the company can not fully cover the financial expenses

In the first two years, the overall coverage ratio of financial expenses is close to the coverage ratio of financial expenses because the financial revenues are reduced. In the last two years, the financial revenues significantly increase and allow covering a large proportion of financial expenses, but in 2009, the operating loss reduces this capacity. In 2010, however, the operating profit and the financial revenues manage to cover a large part of the financial expenses, but not entirely (the overall coverage ratio of financial expenses reaches 122.89%). This level, though higher than one, is considerably lower than the coverage ratio of financial expenses, due to the financial revenues.

The coefficients of sensitivity have no economic significance as they are negative throughout the period studied, in both variants.

In Table 12 the level of safety margins is presented.

Table no. 12

Indicators	2008	2009	2010
Percentage variation in financial expenses	409.35%	21.52%	26.70%
Maximum allowable percentage variation in financial expenses	1204.29%	-189.90%	-67.35%
Safety margin	-794.94%	211.42%	94.05%
Percentage variation in operating result+financial revenues	-226.92%	-112.96%	-469.31%
Maximum allowable percentage variation in financial expenses*	1232.98%	-133.93%	3.10%
Overall safety margin	-823.63%	155.45%	23.60%

Safety margin shows a situation similar to coverage ratio of financial expenses. In 2008, the company can cover financial expenses without problems, because their percentage change is one third of the maximum allowed variation. In 2009 and 2010, the company can not cover any more the financial expenses, which is pointed out by the

positive level of margin. The overall safety margin shows a similar meaning as the safety margin.

For this company, the best tools to emphasize the risk are the coverage ratios (in both versions) and the safety margins (in both versions).

For **Foraj Sonde Craiova,** the DFL during the period of analysis is as follows:

Table no. 13

Indicators	2007	2008	2009	2010
Operating result	7,028,761	33,232,012	8,333,185	3,291,097
Net income	6,053,749	24,414,393	5,722,451	2,061,764
Percentage variation in operating result	-	372.80%	-74.92%	-60.51%
Percentage variation in net income	-	303.29%	-76.56%	-63.97%
Degree of financial leverage	-	0.81	1.02	1.06

For this company, the operating result and the net result go in the same direction, with percentages close enough. Both the operating and the net result are positive throughout the period studied. Also, the oscillations of operating profit affect the net result as well, which leads to a reduced DFL (0.81 in 2008, 1.02 in 2009 and 1.06 in 2010). This means a low financial risk for the company.

The coverage ratios and the coefficients of sensitivity have the following values:

Table no. 14

Indicators	2007	2008	2009	2010
Financial expenses	95,835	5,088,486	4,567,709	5,276,338
Operating result	7,028,761	33,232,012	8,333,185	3,291,097
Financial revenues	245,115	1,272,358	3,513,700	4,786,278
Operating result + Financial revenues	7,273,876	34,504,370	11,846,885	8,077,375
Coverage ratio of financial expenses	1.36%	15.31%	54.81%	160.32%
Overall coverage ratio of financial expenses	1.32%	14.75%	38.56%	65.32%
Percentage variation in financial expenses	-	5209.63%	-10.23%	15.51%
Percentage variation in operating result	-	372.80%	-74.92%	-60.51%
Percentage variation in operating result+financial revenues	-	374.36%	-65.67%	-31.82%
Coefficient of sensitivity K	-	13.97	0.14	-0.26
Overall coefficient of sensitivity K*	-	13.92	0.16	-0.49

The coverage ratio of financial expenses has reduced values in the first two years (1.36% and 15.31%), signifying a low financial risk. The company can easily cover the financial expenses from the operating profit. In 2009, the ratio is 54.81% and shows an increased risk, which is of medium intensity. In 2010, the company can not fully cover the financial costs from the operating profit and the ratio becomes higher than one (160.32%), signifying a high risk. The significance of this ratio is affected by several issues, which however, are taken into account by the overall coverage ratio of financial expenses. Thus, the financial revenues are high in 2008-2009 and help covering a major part of financial expenses. However, in 2008 the operating profit is very high (33 million), which contrasts with the values in other years, which makes us believe that is due to sale of assets and no to operating current operations. In 2009, the financial revenues have a significant value compared to operating profit, so that the overall coverage ratio of financial expenses is smaller, meaning a less financial risk. In

2010, the financial revenues are higher than the operating profit, which is reflected in the overall coverage ratio of financial expenses, which becomes 65.32%, much lower than the coverage ratio of financial expenses (160.32%).

The two coefficients of sensitivity have values close enough. In 2008, they have high and positive levels (which theoretically means a major financial risk), in 2009 they have very low values (low financial risk), and in 2010 they are negative and have no economic significance. In relation to the above, we can say that these indicators do not fairly reflect the financial risk.

The safety margins are as follows:

Table no. 15

Indicators	2008	2009	2010
Percentage variation in financial expenses	5209.63%	-10.23%	15.51%
Maximum allowable percentage variation in financial expenses	34576.28%	63.77%	-27.95%
Safety margin	-29366.65%	-74.00%	43.46%
Percentage variation in operating result+financial revenues	374.36%	-65.67%	-31.82%
Maximum allowable percentage variation in financial expenses*	35903.93%	132.82%	76.84%
Overall safety margin	-30694.30%	-143.05%	-61.32%

The safety margin is negative in 2008 and shows a low financial risk. In 2009, its level is -74% and indicates an increased risk, but the company can still cover the financial expenses from the operating profit. In 2010, the positive level of the ratio signifies an occurred risk. The overall safety margin expresses better the company's financial risk. This is negative throughout the period analyzed and shows a low financial risk including last year.

In conclusion, for this company, the tools that reflects the best the financial risk are DFL, the overall coverage ratio of financial expenses and the overall safety margin.

For **Electroargeş**, the degree of financial leverage has the following levels:

Table no. 16

Indicators	2007	2008	2009	2010
Operating result	2,536,422	4,036,367	4,160,786	9,116,088
Net income	1,036,217	2,044,910	2,687,105	7,583,271
Percentage variation in operating result	-	59.14%	3.08%	119.10%
Percentage variation in net income	-	97.34%	31.40%	182.21%
Degree of financial leverage	-	1.65	10.19	1.53

The operating profit and the net profit grow continuously in the period analysed. However, the rates of change are different, resulting in an increased volatility for DFL. Thus, in 2008, its level is 1.65, meaning a reduced financial risk. In 2009, the operating profit increase by 3.08% and the net profit by 31.40%, resulting in a DFL of 10.19, which means a major financial risk. In 2010, the degree of financial leverage is 1.53, which also signifies a low financial risk. From the table above, we notice a positive aspect, namely the profit increases during the period analyzed. As well, we see the very large increase from last year, especially for the net profit.

The covergae ratios and the coefficients of sensitivity have the values:

Table no. 17

Indicators	2007	2008	2009	2010
Financial expenses	989,126	10,707,499	12,167,191	1,870,029
Operating result	2,536,422	4,036,367	4,160,786	9,116,088
Financial revenues	4,522,652	9,088,336	11,200,602	1,767,558
Operating result + Financial revenues	7,059,074	13,124,703	15,361,388	10,883,646
Coverage ratio of financial expenses	39.00%	265.28%	292.43%	20.51%
Overall coverage ratio of financial expenses	14.01%	81.58%	79.21%	17.18%
Percentage variation in financial expenses	-	982.52%	13.63%	-84.63%
Percentage variation in operating result	-	59.14%	3.08%	119.10%
Percentage variation in operating result+financial revenues	-	85.93%	17.04%	-29.15%
Coefficient of sensitivity K	-	16.61	4.42	-0.71
Overall coefficient of sensitivity K*	-	11.43	0.80	2.90

The coverage ratio of financial expenses has acceptable values in 2007 and 2010 only. In the other two years, it has levels well above 100%, which means that the operating profit is insufficient to cover the financial expenses. Yet, this financial ratio is not representative for the financial risk's analysis as the company posts high financial revenues. The overall coverage ratio of financial expenses is less than 100% in each year, which shows a lower financial risk than the previous rate. However, in 2008 and 2009 the levels are high (around 80%), indicating that the company has a high pressure for covering the financial expenses.

The coefficient of sensitivity is 16.61 in 2008, due to the much higher grow of financial expenses against the operating profit. In 2009, the coefficient of sensitivity is 4.42, and in 2010 is -0.71. The level and the evolution of this coefficient don't point out the correct size of financial risk. The overall coefficient of sensitivity has lower values in 2008 and 2009 and the level from 2010 is positive. It assesses the financial risk more accurately than the coefficient of sensitivity.

To analyze the safety margins, we use the following data:

Table no. 18

Indicators	2008	2009	2010
Percentage variation in financial expenses	982.52%	13.63%	-84.63%
Maximum allowable percentage variation in financial expenses	308.07%	-61.14%	-25.08%
Safety margin	674.45%	74.77%	-59.55%
Percentage variation in operating result+financial revenues	85.93%	17.04%	-29.15%
Maximum allowable percentage variation in financial expenses*	1226.90%	43.46%	-10.55%
Overall safety margin	-244.38%	-29.83%	-74.08%

The safety margin shows a comfortable situation of the financial risk in 2010 only. In 2008, the financial expenses should have increased by up to 308.07%, instead of +982.52%. In 2009, the financial expenses should have decreased by 61.14% in order to be covered by the operating profit, while the real change was +13.63%. All these show that the company faces a major financial risk in 2008 and 2009. The overall safety margin assesses more accurately the financial risk because the firm has higher financial revenues. This shows that the financial expenses are covered in each year by

the operating profit and the financial revenues. The best situation is encountered in 2008.

For Electroargeş, the indicators that allow an accurate assessment of the financial risk are the overall coverage ratio of financial expenses şi overall safety margin.

4. Conclusions

The main conclusions of this paper are:

- the coverage ratio of financial expenses is correlated with the safety margin and the overall coverage ratio of financial expenses with the overall margin of safety. If one of them is relevant, then the other one it is;
- the coefficients of sensitivity K and K* show a very high and different volatility of financial expenses and operating profit, which resulted in a lack of economic significance for them;
- some of the indicators of assessing the financial risk proposed in this article require some benchmarks for making comparisons and assessments;
- the indicators of financial risk's assessment based on the dynamic between two consecutive years have a reduced capacity to evaluate the financial risk;
- the financial risk assessment tools are based on the likelihood that the company can not cover the financial expenses in the future. If the financial risk has already occurred, these tools do not give satisfactory results;
- turnover, operating profit and net profit are oscillating for Romanian companies, which affects the ability of traditional instruments to accurate asses the financial risk.

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