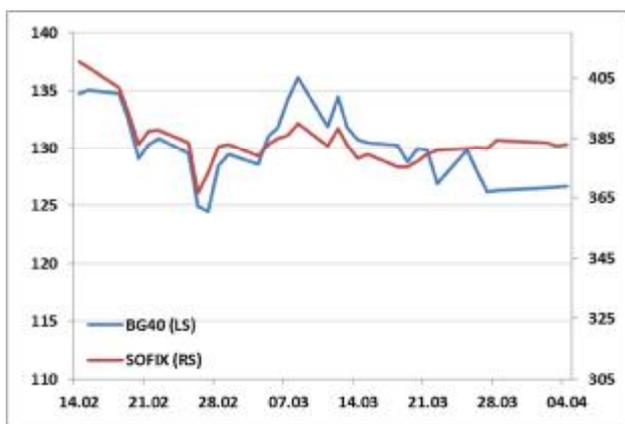


Before the Parliamentary elections

The stock market's tensions calmed during March as events in the political life of Bulgaria followed their logic. The President appointed a new Cabinet of Ministers that will conduct the Parliamentary elections in May, 12. Indices were stable last month but not due to positive factors like economic recovery or improved business and investor confidence.



Investors are in wait-and-see stance. The stable prices of leading stocks are a consequence of the lack of supply at current prices, rather than rising market demand. The market bias is not deep on the negative and the first impulse for sell diminished gradually. Indices lost more than 10% after the resignation of the Cabinet, which is relatively small when comparing to the current negative economic and political news.

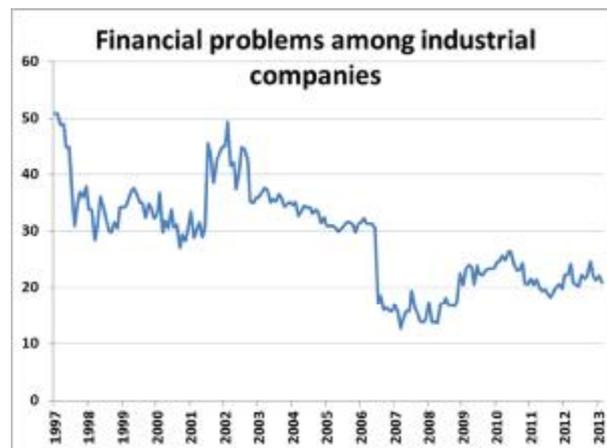
The situation in Bulgaria, concerning the formation of new Cabinet, is unclear. Sociological researches are pointing to difficult formation of the government after the vote. Bulgarian investors are aware of this fact but are not very concerned regarding a future deterioration of Government budget.

Economic situation in Bulgaria

The stagnation in the economy is not only a consequence of the crisis in Europe, which undoubtedly has negative impact on the business activity. The financial crisis in 2008 also influenced the credit market in Bulgaria and is the main reason for the cool down in the property markets. However, the view that the Bulgarian economy is only a function of the conditions on its main export markets is missing the most important aspects of the problems. The economic stagnation is a consequence of hard process of restructuring, which is following, of course, the global changes. This is including the loss of many jobs in small and medium-sized indus-

trial companies. They will recover slowly and painfully. Bulgaria lost the markets of its SME because of the declining demand in Europe. Many enterprises ceased operations or decreased substantially their output. They also lost permanently their advantages of low wages and low costs of production as they are unable to maintain full capacity utilization. Moreover, many companies are facing rising interest payments on credits.

The recovery of export will require long period of economic boom in Europe, which is unrealistic in near future. Large industrial companies are performing much better, but they cannot compensate the job losses and the aggregate decline of income comparing to 2007. This is the reason to expect high unemployment in Bulgaria, whereas the consumer demand will be subdued. The economic policy should aim at creating advantages to Bulgarian companies to maintain their market positions abroad or to expand their export. These measures will support employment and consumer demand, along with the tax revenues and indirectly the credit activity.



The share of industrial companies with financial difficulties is low. Around 20% of respondents in the business confidence surveys are reporting facing them. It is likely that the financial situation will improve overtime. However, managers are reporting better current situation than the period of growth between 2003 and 2006. At the same time the industry is suffering from the much worst economic situation in the country. Plausible explanation is that companies are making large cuts of new investments, costs, including wage costs, whereas the most problematic companies went into bankruptcy. The improvement of the business climate is requiring at least three years, following the trend of improvement during the last several years.

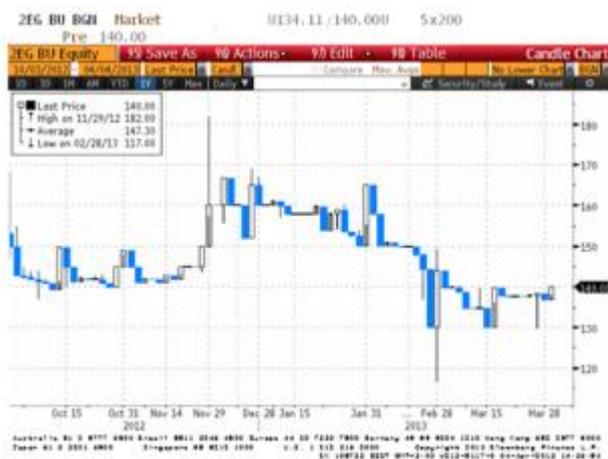
Too early for credit boom

Financial problems in construction sector are substantially higher than among industrial companies. Enterprises in service sectors and retail are also under heavy burden of financial difficulties. This is resulting to decrease in the credit quality and balance sheets of Bulgarian banks. Moreover, future loans are likely hard to service. The recovery of credit activity requires not only economic improvement, but also better balance sheets of banks and more risk taking appetite. Factors for this improvement are not yet available and we expect that loans will increase gradually until end-2013. Banks will not be the active part in the economic recovery as they will wait for improvement of business climate.

Stocks on focus

The electricity distribution companies are under the selling pressure from different type of investors. It is not similar to the risk aversion that is seen to other Bulgarian stocks after the resignation of the Cabinet in February, when political factors are more important for investors.

Energo-Pro Grids



The pressure on the stock renewed in the middle of March, although the volumes were substantially lower as compared to the previous month. The change in the regulated price of electricity had little impact on the stock as investors ignored the most important fundamental reason – its effect on profits. The stock stabilized at the price level of BGN 140. Energo-Pro is expecting that its gross profit will decrease by BGN 24 million, which will hurt substantially the EPS.

The stock is interesting due to the low liquidity that it is limiting the decline of share price. However, the

price gains will lag the eventual increase of the other utility stock, following a new price regulation in the sector. The political risk is much lower when considering Energo-Pro's companies. Investors that are buying the stock at current levels are counting the most on a future tender offer from the majority owner but the price is unlikely to be much higher than the current. The time horizon of price recovery is at least six months as the energy sector needs an audit and a change in the pricing.

CEZ Distribution



The market reacted more negatively when regarding the shares of CEZ companies. CEZ Distribution recovered only temporarily on the news of license revocation and the stock slowly fell to its lows of BGN 1200. The market priced in much negative news – audit from the regulator and the prosecution, along with the changes in price of electricity. Investors are expecting to see more pressure on the stock, which is regarded as main reason for high electricity bills by the society.

The long-term price increase of CEZ shares should be lower than Energo-Pro. However, short-term price gains are possible due to the low liquidity but they require significant change in the regulation. Current support level of BGN 1200 is very strong and we considering it as bottom price.

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BUY	More than 5% higher as compared to SOFIX and BG40 performance
HOLD	Market performance, +/-5% as compared to SOFIX and BG40
SELL	More than 5% lower as compared to SOFIX and BG40 performance

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