

Searching for the market bottom

The indices stabilized, despite the permanent downward pressure which was seen in June on some of the companies with the highest liquidity. The SOFIX increased slightly above its recently achieved bottom level, however the market activity did not show any rise in terms of market participants. Block deals were prevailing. The market attention was rather turned to the events in Europe and the elections in Greece.



The investors in Bulgaria are worried about negative outcome in the Eurozone, which will worsen the crisis and deepen the already existing recession. Or at least, this is the popular explanation for the decline of local stocks. The positive news however, had to distract these worries, which in fact did not happen – the market in Bulgaria is weak even after the positivism coming from the recovery of the foreign bourses. There are two explanations for this.

Crisis in Bulgaria plus low liquidity

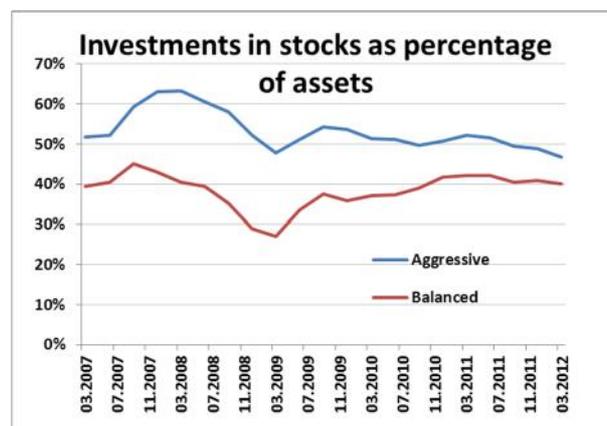
Despite the good economic picture in Bulgaria, compared to Greece or the major decline in Europe, the small businesses and the incomes of households were the most sharply affected. They had significant contribution to the market liquidity but the current outflows are mainly due to the lack in prospective growth of stock prices and improvement in the corporate governance. The portfolio liquidation is usually performed by market sell-off, if volumes can absorb up to 5-10% fall in prices. The second reason for the downward trend of the stock exchange is the change in the attitude towards Bulgarian companies. These are mainly the companies that are included in the indices, with relatively high liquidity and large free-float. Investors are losing confidence in the ability of companies to achieve good profitability margins and strong growth of revenues, while maintaining good corpo-

rate governance. The revenues of many companies recovered to the pre-crisis levels but their profit margins stayed low. This is due to the inflationary pressure and the lack of profits generation from other than the main business activity. High proportion of results of companies with holding structure usually comes from financial profits. This however, is not very helpful, and the market capitalization of Chimimport is a good example – it exceeds the profit of the company by 20% only. Assets are disregarded for the valuation of the companies – investors focus on the return on assets at a particular moment rather than on their absolute value, until and if they are liquidated and distributed to shareholders. The valuation of Bulgarian stocks is usually much higher than their current market prices. This discrepancy continues for years and there are no evidences for a change. In fact, this tendency could continue for long term. Stocks are undervalued, not because there is an outflow of money from the stock exchange, after all the volume of every sale corresponds to a purchase at an equal volume. Buyers have no reason to rush to invest in shares. Investors do not miss out anything but possible losses, if they do not put their money in the stock exchange.

This situation is absolutely the opposite of 2007, when the market was apparently too expensive, but the hot money did not want to miss the gains. The contrary to the boom is actually the bottom, which we experience at the moment. The precise time frame of both is actually unclear.

Mutual funds and stocks

The Bulgarian mutual funds are not avoiding shares of local companies. Their proportion in the structure of the portfolios remains unchanged despite the huge price slump and the rising uncertainties.



Source: Bulgarian National Bank

Assets of aggressive and balanced investment schemes decreased by nearly a quarter during the last year. Fund managers maintained the proportion of investments in stocks, which means that they did not change their attitude toward the Bulgarian market. They tend to avoid risk as it is seen by the decline of stocks in aggressive funds. For a comparison, the fall in SOFIX for the last year is about 30% or less than the assets in funds.

Stocks in focus

Taking into account the negative bias at the moment, Bulgarian stocks are not expected to record any significant increase in their prices. Corporate news as well as current valuations don't provide boost for prices. Therefore our companies at focus are those with specific news.

Orgachim (5ORG)

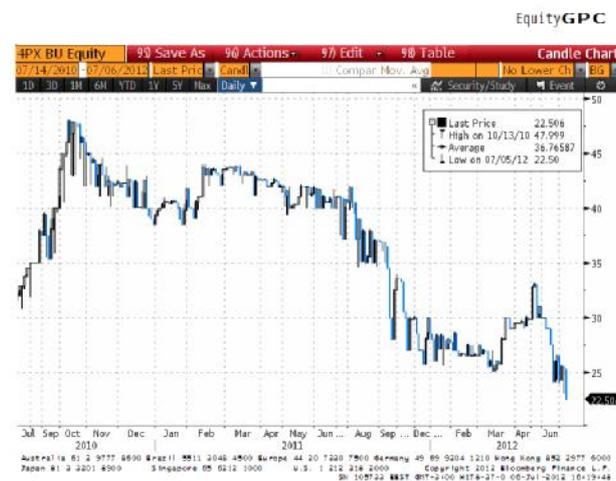


The Financial Supervision Commission banned temporarily the issuance of tender offer to minority shareholders of chemical company Orgachim. A month and a half ago the company announced that its major shareholders own 95% of the shares, which allows them to perform a squeeze out at the price of the previous auction offer.

The price is BGN 90 per share and the rest of the securities are quite likely to be purchased at the same price and the company to be delisted. Investors can sell their securities for BGN 90 at the moment as majority shareholders is constantly bidding. The daily turnover is relatively low and probably there will be bid offers at that level, similarly to the period from September on.

Sales on the market will allow shareholders to receive the cash at the regular settlement and to avoid the long procedure of the squeeze out.

Yuri Gagarin (4PX)



There is no positive side of the news for this company, after the changes in the legislation which banned the production of cigarette cartridges. They contribute to 20% of the production of the company and 80% of them are for export. The annual turnover of this market segment is BGN 7.3 million, or about 13% of the yearly revenues.

The EU has not required these changes in the legislation and many other European companies will continue to produce and sell such products. The company made significant investments in the already 'illegal' production. Their share price will be falling until the effects of this situation on the revenue and the profit of the company become clear or the ban is rejected.

Effects should be seen in the financial reports for the second half of the year. It is a common policy of many Bulgarian companies to not disclose detailed information about their operational activity and investment plans, thus speculations will probably continue to determine the share 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
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