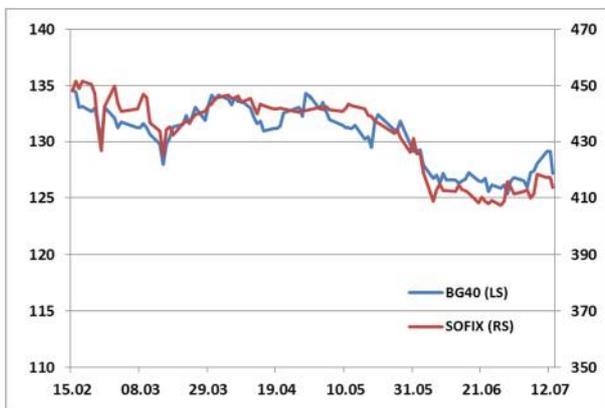


## The expected cool down

Bulgarian stock exchange continued to move on its logic and without connection to the international markets. Indices were relatively unchanged after the early-June decline. The selling pressure faded out but no catalyst for growth emerged. The market found its equilibrium point for the moment and even the Greek solvency turmoil was unable to change it. Moreover, Greek investors were not selling. SOFIX weakened 4% for the month, whereas BG40 declined 2%.



The 10% correction was not threatening the market with further weakness as it was not deep enough to trigger additional margin calls from REPO-operations. Moreover, investors are substantially less leveraged than three years ago.

Trading volumes improved in June. However, the increase was mainly due to the transfer of nearly 50% of the capital of ELARG REIT. The activity with top positions was meager and block deals formed the largest part of their turnover. Individual investors were very passive. All those factors are clearly the signs of summer lethargy that is usual for the period and is preceding the low-volumes rallies that are also usual for the period.

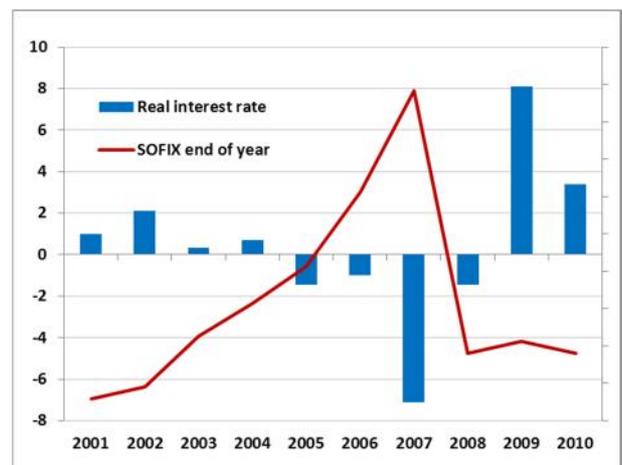
## Catalyst for growth

Soon or later, the lethargy is turning into impulsive movement of stock prices. The pessimism is not prevailing on the market and the risks of substantial price decline are very low. The budget problems of Greece did not have implications on Bulgarian stocks,

although some selling through Greek banks that are intermediaries of foreign investors pushed down prices of liquid stocks like Chimimport and Central Cooperative bank. However, the 10% correction is the late market reaction to the strong growth from the beginning of the year. The historical pattern is favorable for the stock gains during the summer months due to the low liquidity. Corporate reports are not important for the positive bias of investors as their implications on prices were meager during the last two years. Summer rallies were ignited mainly by the individual investors. Any comparison with the trend on international markets is just showing the coincidences.

## The inflation could support risk assets

Consumer prices in Bulgaria are rising steadily. The inflation has the potential to turn into the biggest factor behind long term support of the capital market. Bank deposits are very high and we expect that interest rates will continue to decline as liquidity is ample and credits are restrained by the low quality rating of debtors. Deposits are exceeding substantially the free-float of liquid Bulgarian stocks. Part of those capitals will search for higher return when real interest rates drop further this year. At the moment, the risk aversion is high.



The graph is presenting the connection between index SOFIX and the interest rate on one-year deposit minus inflation. The period of negative interest rates coincided with the economic and market boom. The capital market benefited from the decline of real

interest rates in 2003 as other factors also contributed positively. Savings are just one of the possible market catalysts. They are concentrated in narrow group of individuals, whereas deposits of companies are likely to remain aside of the market for some time.

### Privatization hopes

The Privatization Agency chose the intermediaries for the sale of government stakes in the electricity distribution companies. The privatization of the 33% stakes in the companies is the source of many hopes for the future development of the stock exchange. This stance could be overoptimistic as comparing to the positive example of the telecommunication company's privatization in 2004. The differences are many. The first is the scale of offering. The distribution companies are much larger than the capability of the market to offer capitals. The offerings could not be absorbed only by financial investors and new stakes are well above the resources of domestic funds and individuals. Therefore strategic investors should be searched to buy stakes. In this case the market will receive the shares of large and illiquid companies that will not change the situation. The logic dictates that investors should restrain from selling their current holdings to participate in the privatization. On the contrary, they should look to buy stocks that are under pressure.

The second important difference is the method of payment. The privatization of the telecom has been paid with vouchers that were already traded at the stock exchange. Thus capital inflows remained partially on the accounts of domestic investors or moved to mutual funds. This time the capitals are going straight to the government.

### Stocks in focus

The privatization of Bulgartabac Holding (57B) is the second biggest issue that has the potential to support the market. The stock did not reacted to the latest news as only one of the global tobacco producers that bought tender documents continued the procedure.

The successful privatization could wake-up the stock market. If the new majority owner

decides to delist the companies, this will result to substantial capital inflows for investors. As market participants currently are long term investors that will reallocate capitals to other stocks. The capitals will provide positive background for price increase and will attract additional funds from abroad as foreign investors are following the good performance of the market. For now, this is just a scenario that depends mainly on the privatization.

### Bulgartabac Holding (57B)



The capital increase of BACB (5BN) has been approved by the shareholders on an extraordinary meeting in the beginning of July. The share price of the bank continued to weaken after the news and dipped below BGN 4.50. This is close to the issue price of new shares and it is possible that the stock will remain under pressure until the capital increase.

### Bulgarian American Credit Bank (5BN)



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

**Frequency of Recommendations:** No schedule of recommendations is available. The frequency of recommendations depends on specific factors to individual companies and the opinion of the analyst(s) for the necessity of minor or major changes.

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