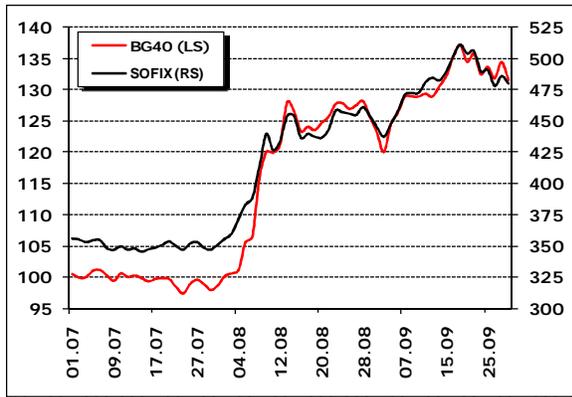


## Hot, But Not Red Hot Yet

September began with some profit-taking for the liquid positions but quickly returned to the growth path. The last several sessions for the month were on the downside as the weakness of international markets has negative influence on Bulgarian stocks.



Bulgarian stocks also began to diverge from other regional indices and the correlation to developed markets decreased. Share prices of liquid positions lost between 5 and 10% during the last week of September. The main reason for the steeper decline was the broadening of the bid-ask spread during the last stage of the rally. The market showed its first signs of overheating in September as the number of deals increased and shares were driven mostly by individual investors. The long-term confidence among investors is returning. However, institutional investors were reluctant to buy at the way they did it several months ago. Pension funds will probably support the market after more prolonged correction, whereas the capital inflows toward mutual funds are well below the levels of 2006 and 2007.

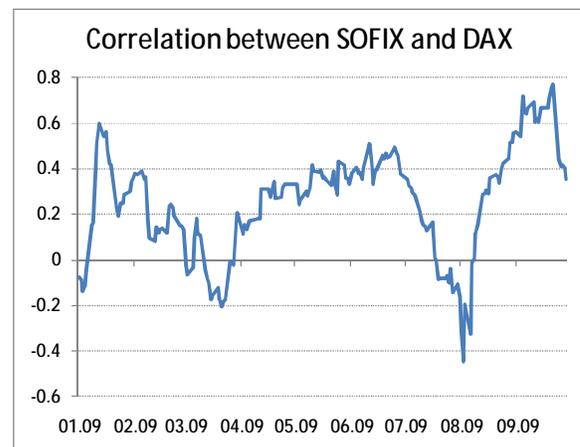
Nevertheless, we can expect that the demand will increase much faster than the supply from short-term investors and from the capital increases of Bulgarian public listed companies. The IPO market will remain quiet for some time but the large issue of preferred shares of Chimimport in June was a success and will be followed by other Bulgarian companies. However, the crisis changed significantly the investment policy of many non-public companies in the country and

their need of capital is more related to the current operations than the expansion of capacity.

## Is A Correction Looming?

We don't think that the Bulgarian market is too overpriced to start a large correction and to diverge significantly from rising international markets. On the contrary, the current valuation of most liquid shares is fair when comparing to East European markets. The P/B and P/S ratios are significantly lower than average for US stocks. The risks for additional decrease of financial results on yearly basis are diminishing but could influence the ratios after the third quarter earnings reports. Bulgarian companies started to feel the crisis during the fourth quarter of 2008. However, the Bulgarian market was too stretched on the upside and is under a normal pull-back.

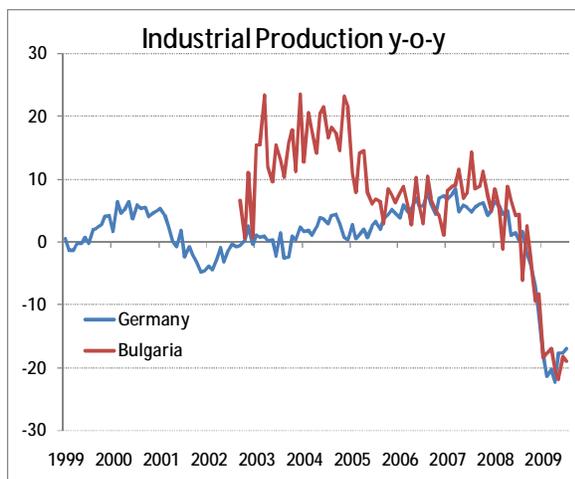
The first stage of the correction of Bulgarian stocks is on its way – liquid positions were under some profit-taking as most of them were already 100% above the February lows. Volumes were improving during the sessions with decline, whereas gains are accompanied with lower demand than a month ago. We can expect that this stage could continue even if international markets remain in tight range and even if they gain several percents from current levels. In this case Bulgarian stocks will decrease the spreads between bid and ask prices and the market will have additional time to investors to get used to the current price levels.



The correlation between SOFIX and DAX decreased in September after reaching its peak of almost 0.80. Bulgarian stocks started the correction a bit earlier than the developed markets. This divergence was also supported by the solid increase of share prices in August and September and was a result of the 100% gains of most blue chips since March. The correction is imminent and SOFIX could be under short-term pressure even if European markets experience only mild losses in October. Bulgarian stocks could underperform due to the low liquidity but we expect that SOFIX will find support at the levels around 400 points. Foreign investors were reluctant to sell during the first weeks of the correction and without serious deterioration of the global economic growth during the fourth quarter it will be unlikely that Bulgarian stocks will test their 2009 lows. We expect that the current correction will form the base for the next leg up and SOFIX will move to 700 points in 2010.

### The Macro News

The lower correlation to developed markets is more a consequence that investors are worried for the recovery of the global economy than a sign for overheating. The economic news showed only small improvement of the industry and the export. The next graph is presenting the yearly change of the industrial production of Bulgaria and Germany.



The period of higher growth between 2003 and 2005 was due to the recovery from lower base from the crisis of the previous decade. Since 2005 the industrial production of Bulgaria is following the percentage of yearly change in Germany. The Bulgarian economy is also negatively affected by the global slump. The connection to the export-oriented German economy is supported by the international trade and foreign investments from the largest European economy. Although we need to see the correlation in time of robust economic growth, there is no reason to expect that Bulgarian industrial production will fall behind the global up trend.

### Stocks In Focus

#### Bulgarian-American Credit Bank



The bank was among the best-performing positions in both August and September. Shares jumped to one-year high but remained below the pre-Lehman levels. The bank announced bad loans of more than 8% of total credit portfolio in its half-year report but the news had low impact on the market price. Moreover, the market seemed in comfort with the figure that is above the average for the banking system. Large banks are refinancing the credits with difficulties to decrease the pressure on their clients and to lower the percentage of defaults.

**Enemona**



The engineering company announced some of the details of the forthcoming warrant issue. The number of the warrants would be 5 966 800 or twice lower than the current number of ordinary shares. The issue will be converted in ordinary shares after six years at the price of BGN 18.50 per share. The conversion price is 65% higher than the current but is lower than the all-time highs above BGN 20.00 seen last year. The warrants will be a cheap way to play on the long side for long-term investors as their price is BGN 0.17.

**Chimimport**



The ordinary shares of Chimimport were unable to post a new high in September. Moreover, they fell below BGN 2.50 that ended the consolidation from the previous two months. This is another confirmation that the market is in correction. The large and liquid company is driven mainly by institutional

investors, whereas the gainers during September were mainly small-caps.

**Eurohold Bulgaria**



The correction erased the previous gains of Eurohold Bulgaria but the price remained 40% above the July lows. The position was very volatile as volumes decreased. The company is trading at P/B of 0.50, which is among the lowest in SOFIX.

**Devin**



Shares of the bottling company jumped after the newspaper report of the change in ownership at significantly higher value than the market price. However, the denial of the information from the company's management settled down the price to the level of BGN 3.00. The deal should be finalized during the coming weeks and the price will be announced afterwards. The information for the deal so far included a range between BGN 3.06 and 3.17.

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<b>Outperform</b>	More than 5% higher as compared to SOFIX and BG40 performance
<b>Market Perform</b>	Market performance, +/-5% as compared to SOFIX and BG40
<b>Underperform</b>	More than 5% lower as compared to SOFIX and BG40 performance

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