

INDUSTRIAL HOLDING BULGARIA
INDUSTRY: DIVERSIFIED HOLDINGS
THE TURNAROUND

INDUSTRIAL HOLDING BULGARIA REPORTED AN IMPROVEMENT OF SALES OF MACHINES IN Q1 AND STABLE REVENUES FROM CHARTERING SERVICES DESPITE THE DECLINE OF FREIGHT RATES. THE LOSS WAS DUE TO THE APPRECIATION OF THE US DOLLAR AND THE LARGE DOLLAR-DENOMINATED DEBT OF THE HOLDING. THE SHIPPING SECTOR WILL RECOVER IN THE SECOND HALF OF 2015 BUT WE EXPECT ANOTHER ROUND OF WEAK RESULTS IN Q2.

BOTTOMING OUT?

The first quarter was weak due to the appreciation of the US dollar and its negative effect on the dollar-denominated debt of Industrial Holding Bulgaria. When excluding the financial losses, the Holding reported an improvement of its operating profit on yearly basis. It is a consequence of the slow recovery of the main segments. The revenues were 2.5% higher. These results are suggesting that the Holding bottomed out in terms of its quarterly performance. 2015 should become the year of turnaround.

SHIPPING SECTOR REMAIN ON FOCUS IN 2015

Industrial Holding Bulgaria was pressured down from the lower freight rates in the shipping sector, while the difficulties of the manufacturing segment came from the lower demand in Russia and Ukraine. The first segment is experiencing a turnaround in the middle of 2015. The retirement of ships is at record high. The monthly average for the first six months in 2015 is 3.3m dwt, as compared to 1.3m dwt for the same period of 2014. As a result, Baltic Dry Index, the main gauge of the freight rates, doubled since February. The shipping companies will benefit from the higher rates and the low fuel costs as oil price again fell below 50 USD per barrel. The growth of freight rate will not continue at the current pace as shipbuilders are reporting an increase of order book after five years of declining demand.

What to expect during the second quarter?

The negative news are already priced in a month before the announcement of Q2 earnings. The next report, however, will not come with positive surprises on revenues. The low level of Baltic Dry Index persisted until June and the revenues from chartering services will remain subdued. The sales of the Holding, however, are less volatile as part of them are rents of the ships. Regarding the other segments, we expect a confirmation of the slow improvement in sales of machines due to the weak euro and the growth of industrial demand in Europe. The market conditions are not suggesting better margins.

VALUATION: Our price target is BGN 1.16 per share which is above the current market price. The valuation is based on a DCF model that assumes a moderate growth of revenue and a return to a net profit. The loss during the first quarter has negative impact on the value of the stock but the change is not substantial to lead to a revision of the HOLD recommendation.

RESULTS ANALYSIS

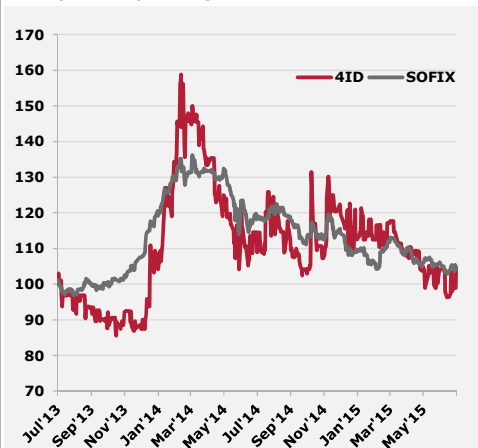
PREVIOUS RATING: HOLD
ONE YEAR PRICE TARGET: BGN 1.16
 (JANUARY 7, 2015)
CURRENT PRICE: BGN 0.95

EXCHANGE RATES

EUR/BGN (FIXED): 1.95583
USD/BGN: 1.7850

MARKET DATA

Shares Outstanding:	77.4m
Share Capital:	BGN 77.4m
Free-float:	36.63%
Treasury Shares	1.43%
Market Cap.:	BGN 73.5m
Avg. Daily Vol.:	BGN 15,000
52 Weeks Range:	BGN 0.83-1.55
BSE Ticker	4ID
Bloomberg	4ID BU

PRICE PERFORMANCE


in kBGN, excl. ratios	3Q 2013	4Q 2013	1Q 2014	2Q 2014	3Q 2014	4Q 2014	1Q 2015
REVENUES	23,248	31,129	20,400	22,011	23,431	31,073	20,909
EBITDA	5,858	3,302	3,492	3,348	4,660	13,928	174
EBIT	2,588	(180)	133	(9)	1,331	10,586	(3,051)
NET PROFIT	971	(2,247)	(919)	(652)	177	9,270	(5,106)
EQUITY	243,615	254,175	253,307	252,171	247,680	250,403	242,675
ROE	15.25%	7.08%	1.13%	-1.14%	-1.45%	3.14%	1.49%
ROA	43.83%	20.36%	3.93%	-3.67%	-4.18%	7.68%	3.14%
EBITDA MARGIN	41.68%	31.53%	22.56%	16.53%	15.26%	26.24%	22.69%
NET PROFIT MARGIN	25.11%	14.01%	2.76%	-2.94%	-3.75%	8.13%	3.79%
EPS	0.02	-0.04	-0.01	-0.01	0.00	0.12	-0.07
DEBT/EQUITY	0.54	0.49	0.48	0.47	0.49	0.48	0.49
P/E	1.63	3.25	24.36	-25.42	-19.34	9.78	20.52
P/B	0.25	0.23	0.27	0.29	0.28	0.31	0.31
EV/EBITDA	3.01	4.52	8.21	11.73	12.76	7.54	8.61

ANALYST'S COMMENT

Shipping stocks are not among the favorite ones of investors nowadays. This is not a surprise regarding the headwinds for the sector. China's economy is losing steam and the decline of commodity prices suggests slower demand of shipping services. It offset the recovery of European economies and the stable growth in USA as the freight rates substantially depends on the raw materials trade.

The expectations of a cool down in China were not confirmed by the statistical data. According to Commodore Research, Chinese iron ore fixtures hit an all-year-high in mid-May. Most of supplied resources came from China's main supplier Australia, but the shipments out of Brazil also hit year-high levels. Demand was very strong, which supported the quick recovery of Baltic Dry Index. It measures the rates for chartering ships that transport iron ore, coal and grain. The index moved to 1,100 points in July after averaging 576 points from February to May this year.

The demand side is only part of the equation that lifted the freight rates. It would not have been possible without the support coming from a decreasing fleet size. The ship demolition during the first half of the year was 3.3m dwt per month on average, while the monthly average was 1.3m dwt during the same period of 2014. April 2015 saw 5.36m dwt being retired from active service, which was the highest on record ever for a single month. The record came on the back of continued poor earnings and deteriorating market conditions in dry bulk shipping. In 2012, which is the largest demolition year on record with 33.4m dwt leaving the fleet, the monthly average was 2.79m dwt. The preliminary amount of dry bulk tonnage being demolished during the first half of 2015 is 20m dwt as compared to 18m dwt for the six months of 2012. This suggest a new record high year for ship demolition. The increase of Baltic Dry Index, however, will have positive impact on the shipping sector and should decrease the demolition activity. Nevertheless, it remains high and will improve the business conditions in the sector.

The ship repair operations of the Holding were not hurt by the recent trends in chartering. On the contrary, the subsidiary Bulyard reported an increase of ship repair orders due to the higher technical requirements of ships. The company is focused in ship repair and reconstructions as well as the building of ship sections. It also reported that it is in process to conclude contracts for the construction of sections for another four ships, which will use the current capacity until March 2016.

The first quarter saw the lowest oil prices for the past several years. The expenditures of Industrial Holding Bulgaria declined, most notably the material costs. This, however, was not the improvement in margins we expected to see on yearly basis but when excluding the financial losses the operating profit increased. The Holding's revenues did not contracted in the same way the freight rates did. These results at the back of the worst market conjuncture in the shipping sector are suggesting a turnaround for the Holding. The foreign exchange loss during the first quarter was due to the revaluation of dollar-denominated debts. Bank loans were USD 34.8m.

The second important segment of the Holding, the production of lathes and machines, also reported a small improvement during the quarter. The export to EU countries, including Germany, France and Italy, managed to offset the large decline in deliveries to Ukraine and Russia. The Holding put efforts into diversification of markets, which was followed by the rising sales to countries like Poland and Turkey.

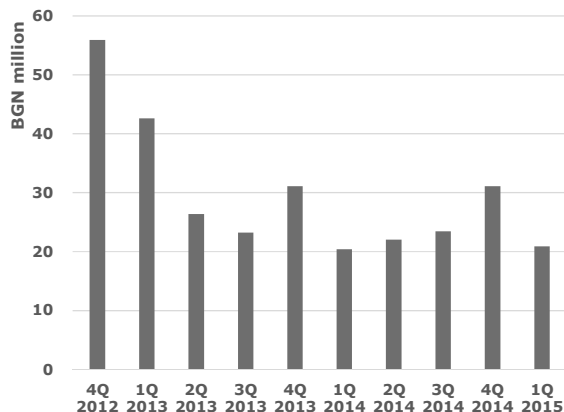
The new convertible bond issue of Industrial Holding Bulgaria was a success and attracted BGN 49.99m at the beginning of April. The purpose of the new bonds was to cover the payment on the issue that matured on April and to invest in subsidiaries. Part of the bond holders of previous issue, however, decided to convert to ordinary stocks. The total number of shares was increased by 9.4m with converted bonds, which represented one third of the previous bond issue. The average stock price during the first quarter was BGN 1.10 but fell below the conversion price of BGN 1.00 per share afterwards.

The new issue has 3 years to maturity and 5% coupon. The previous one was 2-year with 6.5% coupon. Both issues have conversion price of BGN 1.00.

We consider the stock undervalued in terms of its assets, while we have moderately positive expectations for its financial performance this year. The financial loss during the first quarter will have negative effect on the yearly results. The EPS will further erode from the conversion of bonds.

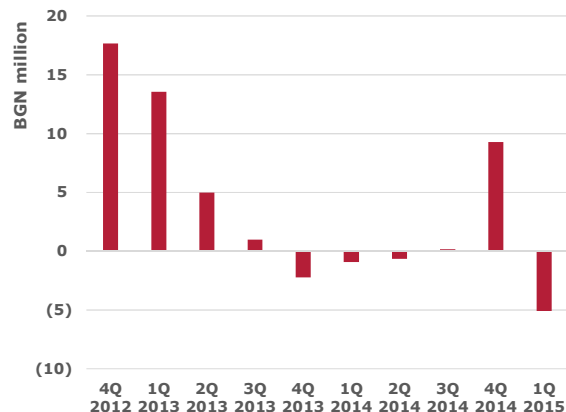
Our recommendation is HOLD and is based on the negative expectations for the performance in 2015. The local investors are focused on the net profits and dividend yields of Bulgarian companies. Therefore, shares of Industrial Holding Bulgaria will lag behind other blue chips. We see signs of long-term improvement in the performance of the Holding aside of foreign currency fluctuations.

QUARTERLY REVENUE



Source: Company data

QUARTERLY PROFIT



Source: Company data

QUARTERLY DATA (UNAUDITED)

Income Statement ('000 BGN)	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	1Q 2015
Revenue	55,902	42,615	26,363	23,248	31,129	20,400	22,011	23,431	31,073	20,909
Operating Expenses	39,067	24,438	21,996	21,827	32,361	20,043	20,987	20,727	26,104	19,252
Change in Inventories	30,129	(1,370)	(182)	(2,690)	993	(1,797)	(727)	(1,067)	787	(1,546)
Cost of Material	(16,541)	8,645	8,047	8,087	8,254	8,204	7,677	7,044	8,164	6,890
Cost of Labor	4,858	5,510	5,567	5,550	6,036	5,382	5,364	5,425	5,956	5,806
Cost of External Services	7,168	5,001	5,127	5,504	5,497	4,012	4,731	5,128	6,059	3,893
Depreciation and Amortization	5,490	3,208	3,244	3,270	3,482	3,359	3,357	3,329	3,342	3,225
Net Book Value of Assets Sold	(632)	298	1,112	(682)	(462)	97	33	260	190	78
Other Costs	30,129	(1,370)	(182)	(2,690)	993	(1,797)	(727)	(1,067)	787	(1,546)
Operating Income	20,663	16,359	6,918	2,588	(180)	133	(9)	1,331	10,586	(3,051)
Interest Expense	1,917	1,772	1,764	1,634	1,803	1,533	1,465	1,519	1,691	1,513
NET INCOME	17,678	13,565	4,987	971	(2,247)	(919)	(652)	177	9,270	(5,106)

Balance Sheet ('000 BGN)	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
Cash & Near Cash Items	5,210	6,090	6,980	5,783	5,210	1,870	2,647	3,180	4,676	4,833
Accounts & Notes Receivable	5,693	12,075	6,251	5,648	5,693	5,892	6,859	7,203	29,181	6,624
Inventories	18,903	22,133	20,456	20,904	18,903	18,890	19,372	21,282	19,514	19,629
Total Current Assets	31,631	42,064	35,291	33,177	31,631	29,298	30,753	33,568	55,218	32,900
Net Fixed Assets	376,258	366,958	367,322	366,116	376,258	374,461	373,624	372,408	380,106	378,023
Other Long-Term Assets	17,199	16,097	15,535	15,423	17,199	16,867	16,473	16,161	24,683	23,902
Total Long-Term Assets	393,457	383,055	382,857	381,539	393,457	391,328	390,097	388,569	404,789	401,925
Total Assets	425,088	425,119	418,148	414,716	425,088	420,626	420,850	422,137	460,007	434,825
Accounts Payable	8,648	32,961	11,395	9,961	8,648	8,512	12,130	14,757	36,642	30,371
Short-Term Borrowings	58,663	87,729	61,270	59,561	58,663	58,190	87,549	91,605	92,369	96,346
Other Short-Term Liabilities	1,953	3,454	2,250	1,638	1,953	1,921	1,990	2,288	2,364	1,396
Total Current Liabilities	69,264	124,144	74,915	71,160	69,264	68,623	101,669	108,650	131,375	128,113
Long-Term Borrowings	65,972	43,139	73,115	71,176	65,972	63,069	30,438	29,965	26,944	23,069
Other Long-Term Liabilities	16,369	6,675	14,265	14,257	16,369	17,203	19,201	19,135	31,633	33,089
Total Long-Term Liabilities	82,341	49,814	87,380	85,433	82,341	80,272	49,639	49,100	58,577	56,158
Total Liabilities	151,605	173,958	162,295	156,593	151,605	148,895	151,308	157,750	189,952	184,271
Total Equity	254,175	236,516	241,216	243,615	254,175	253,307	252,171	247,680	250,403	242,675
Total Liabilities & Equity	425,088	425,119	418,148	414,716	425,088	420,626	420,850	422,137	460,007	434,825

Cash Flow Statement ('000 BGN)	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
Cash From Operations	15,126	1,634	5,557	7,481	15,126	2,645	6,218	11,038	16,681	1,918
Cash From Investing Activities	2,030	1,250	4,967	4,717	2,030	(9)	(719)	(2,031)	(3,675)	11,807
Cash from Financing Activities	(20,896)	(5,767)	(12,509)	(15,385)	(20,896)	(5,448)	(8,094)	(11,071)	(13,579)	(13,544)
Net Changes in Cash	(3,740)	(2,883)	(1,985)	(3,187)	(3,740)	(2,812)	(2,595)	(2,064)	(573)	181
End-of-period cash	5,249	6,106	7,004	5,802	5,249	2,437	2,654	3,185	4,676	4,833

COMPANY OVERVIEW

COMPANY PROFILE

The largest industrial holding on the Bulgarian stock exchange and one of the biggest conglomerates in the country. It is owner and the operator of five ships with total capacity of 162,000 dwt. Chartering services represent 56% of total revenues, a substantial increase from the 21% level in 2010. The Holding is the owner of the largest shipyard in Bulgaria but the negative market conjuncture forced it to cease shipbuilding operations and to use its assets for repair. Industrial Holding Bulgaria has long lasting traditions in construction of lathes, electric motors and hydro generators for water power plants. Subsidiaries are owned through ZMM Bulgaria Holding, established in 2001. Major markets are Germany, Italy, USA, Russia and Turkey, Middle and Far East, Central and South America. Major clients are Linde, Siemens, Thyssen Krupp, Bosch, Fiat and Man. The segment generated 30% of revenues in 2014. The production of generators reported an increase of orders and the Holding managed to enter new markets.

FUNDAMENTAL STORY

The challenging market conditions in all sectors of the Holding resulted to a lag in its financial performance during the global recovery since 2009. Freight rates are low but the steep decline of oil price decreases fuel costs of chartering companies. The positive effect on profits, however, is limited by the competition and the free capacity. The profitability of Industrial Holding Bulgaria improved during the fourth quarter of 2014, despite the lower revenues of the main segments. We expect growth of margins to continue in near future. The Holding sold one of its smallest ships in December. The profit from the deal and the appreciation of US dollar suggest that the value of assets substantially exceeds the market capitalization of Industrial Holding Bulgaria. The liquidation of assets, however, is not on the agenda. The new convertible bond issue provides additional funds for investments.

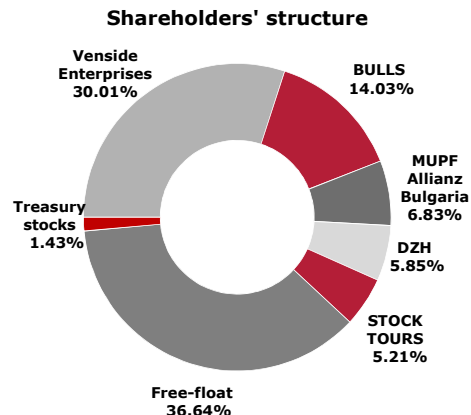
STRENGTHS AND OPPORTUNITIES

- Diversified holding with activities and assets in areas that should benefit from global growth of industrial production and trade
- The decline of oil price has a positive effect on the profitability of shipping companies
- The value of ships exceeds the market capitalization of the Holding, while additional assets in manufacturing and shipbuilding make the stock cheap
- Transformation from shipbuilding to ship repair due to the global oversupply of ships, while the Company maintains its capability to return to the core operations

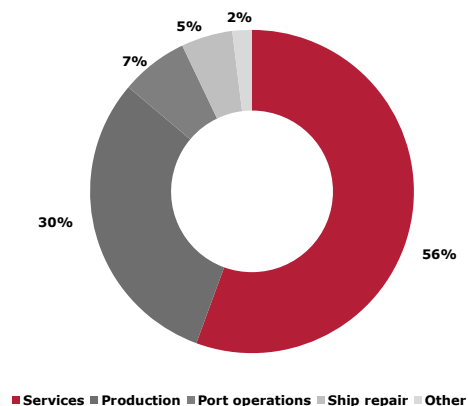
WEAKNESSES AND THREADS

- The oversupply of ships pressures down freight rates to record lows
- Decrease of demand from foreign markets, including Turkey, due to slowdown of economies or foreign currencies fluctuations

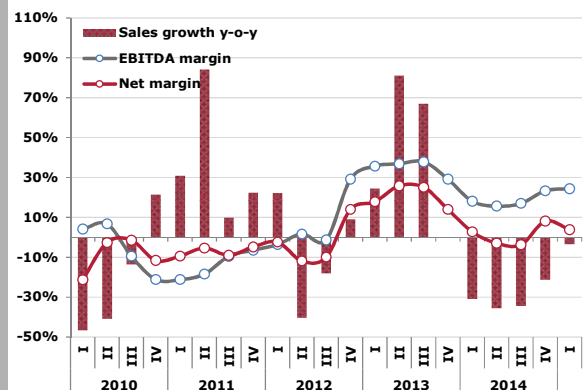
SHAREHOLDERS' STRUCTURE



SALES BREAKDOWN IN 2014



MARGINS



Source: Company data; 12 months trailing data

PRICE TRIGGERS

- Further improvement of profitability due to lower costs and increase of revenues in manufacturing segment
- Favorable conditions on the Bulgarian Stock Exchange and expansion of multiples

YEARLY DATA

STATEMENT OF INCOME (IN '000 BGN)	2011	2012	2013	2014
SALES	113,148	94,034	123,424	97,109
OPERATING EXPENSES	129,349	103,269	100,622	87,861
CHANGE IN INVENTORIES	(2,316)	(23,046)	(3,249)	(2,804)
COST OF MATERIAL	62,957	58,886	33,033	31,089
COST OF LABOUR	23,971	23,998	22,663	22,127
COST OF EXTERNAL SERVICES	25,747	21,406	21,129	19,930
DEPRECIATION AND AMORTIZATION	8,876	10,689	13,204	13,387
NET BOOK VALUE OF ASSETS SOLD	866	5,662	266	580
OTHER COSTS	9,248	5,674	13,576	3,552
OPERATING INCOME	(16,201)	(9,235)	22,802	9,248
INTEREST EXPENSE	4,980	6,802	6,973	6,208
FOREIGN EXCHANGE LOSSES (GAINS)	7,813	(3,300)	(3,329)	3,334
NET NON-OPERATING LOSSES (GAINS)	(4,409)	(1,598)	518	(6,127)
PRETAX INCOME	(18,977)	(11,027)	18,784	5,833
INCOME TAX EXPENSE	(1,224)	1,814	2,963	804
INCOME BEFORE XO ITEMS	(17,753)	(12,841)	15,821	5,029
EXTRAORDINARY LOSS NET OF TAX	0	0	0	0
MINORITY INTEREST	(12,266)	(7,030)	(1,455)	(2,847)
NET INCOME	(5,487)	(5,811)	17,276	7,876
EARNINGS PER SHARE IN BGN	(0.08)	(0.09)	0.25	0.12
BALANCE SHEET (IN '000 BGN)	2011	2012	2013	2014
CASH AND NEAR CASH ITEMS	11,075	8,494	5,210	4,676
SHORT-TERM INVESTMENTS	0	969	1,426	1,247
ACCOUNTS AND NOTES RECEIVABLE	7,976	7,202	5,693	29,181
INVENTORIES	67,023	24,086	18,903	19,514
OTHER CURRENT ASSETS	2,992	779	399	600
TOTAL CURRENT ASSETS	89,066	41,530	31,631	55,218
LT INVESTMENTS AND LT RECEIVABLES	25,056	6,802	3,115	1,063
NET FIXED ASSETS	321,091	371,234	376,258	380,106
OTHER LONG-TERM ASSETS	10,899	13,323	14,084	23,620
TOTAL LONG-TERM ASSETS	357,046	391,359	393,457	404,789
TOTAL ASSETS	446,112	432,889	425,088	460,007
ACCOUNTS PAYABLE	24,316	32,953	8,648	36,642
SHORT-TERM BORROWINGS	23,413	88,598	58,663	92,369
OTHER SHORT-TERM LIABILITIES	21,320	21,862	1,953	2,364
TOTAL CURRENT LIABILITIES	69,049	143,413	69,264	131,375
LONG-TERM BORROWINGS	127,993	43,684	65,972	26,944
OTHER LONG-TERM LIABILITIES	6,862	6,796	16,369	31,633
TOTAL LONG-TERM LIABILITIES	134,855	50,480	82,341	58,577
TOTAL LIABILITIES	203,904	193,893	151,605	189,952
TOTAL PREFERRED EQUITY	0	0	0	0
MINORITY INTEREST	13,673	16,094	19,308	19,652
SHARE CAPITAL & APIC	67,978	67,978	67,207	67,202
RETAINED EARNINGS & OTHER EQUITY	160,557	154,924	186,968	183,201
TOTAL EQUITY	228,535	222,902	254,175	250,403
WORKING CAPITAL	8,942	(110,377)	(42,843)	(80,833)
NUMBER OF SHARES:	67,978,543	67,978,543	67,978,543	67,005,277
PRICE IN BGN - PERIOD END:	0.60	0.70	0.84	1.08
MARKET CAP IN '000 BGN - PERIOD END:	40,787	47,585	57,034	72,366

CASH FLOW STATEMENT (IN '000 BGN)	2011	2012	2013	2014
NET INCOME	(5,487)	(5,811)	17,276	7,876
DEPRECIATION & AMORTIZATION	8,876	10,689	13,204	13,387
OTHER NON-CASH ADJUSTMENTS	(20,117)	(103,345)	52,180	(42,572)
CHANGES IN NON-CASH CAPITAL	17,274	119,319	(67,534)	37,990
CASH FROM OPERATIONS	546	20,852	15,126	16,681
DISPOSAL OF FIXED ASSETS	1,117	852	2,670	517
CAPITAL EXPENDITURES	(58,040)	(29,095)	(4,937)	(5,826)
INCREASE IN INVESTMENTS	(1,985)	(1,179)	(222)	0
DECREASE IN INVESTMENTS	3,811	16,366	0	0
OTHER INVESTING ACTIVITIES	8,112	(2,785)	4,416	1,567
CASH FROM INVESTING ACTIVITIES	(46,821)	(15,525)	2,030	(3,675)
DIVIDENDS PAID	(311)	(311)	(376)	(167)
CHANGE IN SHORT-TERM BORROWINGS	2,211	65,185	(29,935)	33,706
CHANGE IN LONG-TERM BORROWINGS	117,055	(84,309)	22,288	(39,028)
INCREASE IN CAPITAL STOCKS	9,987	0	8,320	0
DECREASE IN CAPITAL STOCKS	0	0	(790)	(5)
OTHER FINANCIAL ACTIVITIES	(80,498)	12,022	(20,403)	(8,085)
CASH FROM FINANCING ACTIVITIES	48,444	(7,413)	(20,896)	(13,579)
NET CHANGES IN CASH	2,169	(2,086)	(3,740)	(573)
END-OF-PERIOD CASH	11,075	8,989	5,249	4,676
CASH PER SHARE	0.16	0.13	0.08	0.07

FINANCIAL AND PERFORMANCE INDICATORS	2011	2012	2013	2014
VALUATION				
PRICE/EARNINGS (P/E)	(7.43)	(8.19)	3.30	9.19
PRICE/BOOK (P/B)	0.18	0.21	0.22	0.29
PRICE/SALES (P/S)	0.36	0.51	0.46	0.75
EV (IN '000 BGN)	181,118	171,373	176,459	187,003
EV/EBITDA	(24.73)	117.86	4.90	8.26
PROFITABILITY				
RETURN ON COMMON EQUITY	-4.09%	-2.57%	7.24%	3.12%
RETURN ON ASSETS	-2.09%	-1.32%	4.03%	1.78%
RETURN ON INVESTED CAPITAL	-5.79%	-1.34%	5.91%	2.77%
EBITDA MARGIN	-6.47%	1.55%	29.17%	23.31%
OPERATING MARGIN	-14.32%	-9.82%	18.47%	9.52%
NET INCOME MARGIN	-4.85%	-6.18%	14.00%	8.11%
DIVIDEND				
DIVIDEND YIELD				
DIVIDEND PER SHARE				
LIQUIDITY				
CURRENT RATIO	1.29	0.29	0.46	0.42
QUICK RATIO	0.28	0.12	0.18	0.27
CREDIT				
LT DEBT/EQUITY	0.56	0.20	0.26	0.11
TOTAL DEBT/EQUITY	0.66	0.59	0.49	0.48
TOTAL DEBT/TOTAL ASSETS	0.34	0.31	0.29	0.26
EBIT/INTEREST EXPENSE	(3.25)	(1.36)	3.27	1.49

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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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