The Bulgarian Equity Market: Ready for a New Takeoff

Photo: Lockheed Martin (www.lockheedmartin.com)

Note: Bulgaria has purchased 8 new F-16 Block 70 fighter jets for US$ 1.26 bn to be delivered in 2023

I. EXECUTIVE SUMMARY

Positive political and economic outlook…

- As a NATO member since 2004 and an EU member since 2007, Bulgaria is enjoying political and economic stability
- Debt/GDP at 22% and falling, 3rd lowest in the EU
- GDP growth is 3-4%, salaries are rising by 41% over 4 years (in EUR terms)
- Budget surpluses since 2016, current account surpluses since 2013
- Record-low unemployment at 4.2% as of July 2019
- Investment grade rating of the sovereign debt
- Accelerating real estate prices
- A stable banking sector, strong credit growth with falling NPLs (non-performing loans)
- Joining of the ERM-II mechanism expected by 2020, joining of the Eurozone by 2023
- Government 9-yr EUR-denominated Eurobonds trading at a 0.27% yield – extremely low

… but a cheap and sleepy equity market

- SOFIX, the main Bulgarian equity index, has fallen by -21.8% for the last 2 years (since 16 August 2017). The S&P 500 has risen by +25.6% in EUR terms, and the neighbouring Northern Macedonian market by +60% for the same period. The neighbouring Greek market has been up by +50.5% since December 2018.
- The average (aggregated) P/E for the 15 stocks in SOFIX is 9.6x (12-mo trailing), while P/B is 0.66x – among the lowest valuations for the CEE region

We believe this is about to change. A Macro Play. We see +25% upside in 6-12 months

- With the start of the new autumn business season, we expect the stock market to wake up again and rise by +25% in 2020. Our target level for the index is 715, from the current level of 571.80 (as of 3 September 2019)
- One of the triggers should be Bulgaria's expected ERM-II membership within a few months, followed by a potential Eurozone membership in a few years
- An ERM-II membership, combined with continuing prudent fiscal policies, should lead to a 2-notch improvement in the credit ratings. For the first time, they might start with the letter 'A' soon

Buying the Bulgarian index ETF is the easiest way to play the market

- Expat Capital created the Bulgarian index ETF in 2016, Expat Bulgaria SOFIX UCITS ETF
- It has been listed on the Bulgarian Stock Exchange (in EUR and BGN), on the Frankfurt Stock Exchange (in EUR), and on the London Stock Exchange (in EUR)
- Ticker: BGX
- Investments or divestments in/from the ETF of EUR 10 mln a day are achievable

II. POLITICAL STABILITY

Bulgaria is enjoying political stability, at least relative to many countries in Europe and elsewhere. Consider the following examples:

- The UK is facing the unpredictable consequences of Brexit
- The governments in Italy and Romania have just lost their parliamentary majorities
- In Romania, the Czech Republic, and Russia, there have been mass political protests
- Turkey has recently suffered a currency crisis, and the future is generally uncertain
- Poland and Hungary occasionally have unresolved issues with the European Commission

Compared to this, Bulgaria is quiet. The main ruling party, GERB – a member of the European People's Party, center-right, not populist, but at the same time not reformist enough – is continuing to win parliamentary and European elections. The only elections which the party has lost since 2007 are the 2016 presidential elections won by Rumen Radev, the socialist candidate.

Boyko Borisov is running his third mandate as prime minister since 2009. The first and the second were stopped prematurely as he called early elections and won on both occasions.

GERB's coalition partner, the Patriotic Front, consists of three parties which have frequent internal contradictions. Should they withdraw their support for the government, GERB could rely on the support of other fractions in the parliament, and the cabinet is likely to serve its full term till 2021.

Table 1.: Results of the Elections for the European Parliament, 26 May 2019

No.	Party (Political Family)	% of the Votes	Mandates
1	GERB (EPP)	31.07%	6
2	BSP (Socialists)	24.26%	5
3	DPS (Turkish ethnic, Liberals)	16.55%	3
4	VMRO (mild nationalists, Conservatives)	7.36%	2
5	Democratic Bulgaria (EPP, right-wing)	6.06%	1
	Other	14.70%	-
Total		**100.00%**	**17**

Source: European Parliament

Our forecast: We expect GERB to continue winning all future elections in the next several years, including the local elections on 27 October 2019.

Implications for the stock market: On the one hand, most governments since 1990, except one, have not considered capital markets a priority. On the other hand, putting party preferences aside, the status quo seems more beneficial for the market development than a political turnaround to the left. Thus, the lack of surprises at the local elections would be good news.

III. POSITIVE MACROECONOMIC PICTURE

Summary

Bulgaria went through a deep economic crisis in 1996-97, after which it started major economic reforms: a successful IMF programme – now long forgotten; large-scale privatization; reduction of direct taxes; development of capital markets. For the last 22 years, the country has seen just one year of recession – 2009, in line with the global trend. Poland seems to be the only economy in Europe which has not had a single year of recession since the early 1990s. Starting from a very low base, Bulgaria has had two decades of strong income growth, probably the highest in Europe. Only neighbouring Romania can boast similar or better income growth.

Bulgaria became a member of NATO in 2004 and of the EU in 2007 (the accession agreement was signed in 2005) – soon after the countries of Central Europe, and six years earlier than Croatia. From a historical perspective, this has been a pretty good achievement, accompanied by a general transformation of the economy and the institutions in line with EU standards.

The economy has picked up nicely in the last 4 years, although growth at 3-4% is still far away from the 'golden years' of the previous decade. Unemployment is at a record low of 4.2%, the budget has been in a surplus for four years in a row (compare this to the fiscal problems of many countries in the EU and the world in general). FDI is a bit disappointing in terms of quantity, but the structure has improved – much of the new investment goes into auto parts manufacturing and other exporters, as well as into the IT sector. These are more high-value-added and knowledge-intensive sectors than real estate.

Table 2.: How Do We Estimate and Evaluate the Macro Indicators, 2019E

No.	Indicator	2019E	Our Score and Comment	
1	Real GDP Growth	3.5%	+++	Moderate
2	Budget Surplus	+0.5%	++++	Very good
3	Debt/GDP	21%	+++++	Excellent
4	Currency Regime	Currency Board vs EUR	+++++	Excellent
5	Forex Reserves	c. EUR 25.2 bn	++++	Very good
6	FDI	EUR 2.2 bn	++	Not great, not terrible
7	Inflation	+3.0%	+++	Not an issue
8	Unemployment (year-average)	4.5%; (July only: 4.2%)	+++++	Excellent
9	Salary Growth (YoY)	+12%	+++++	Very high
10	Current Account Surplus (% GDP)	+4%	+++++	Excellent
11	Sovereign Credit Rating	BBB- S&P, Baa2 Moody's	+++	Should improve with ERM-II

Source: Expat Capital

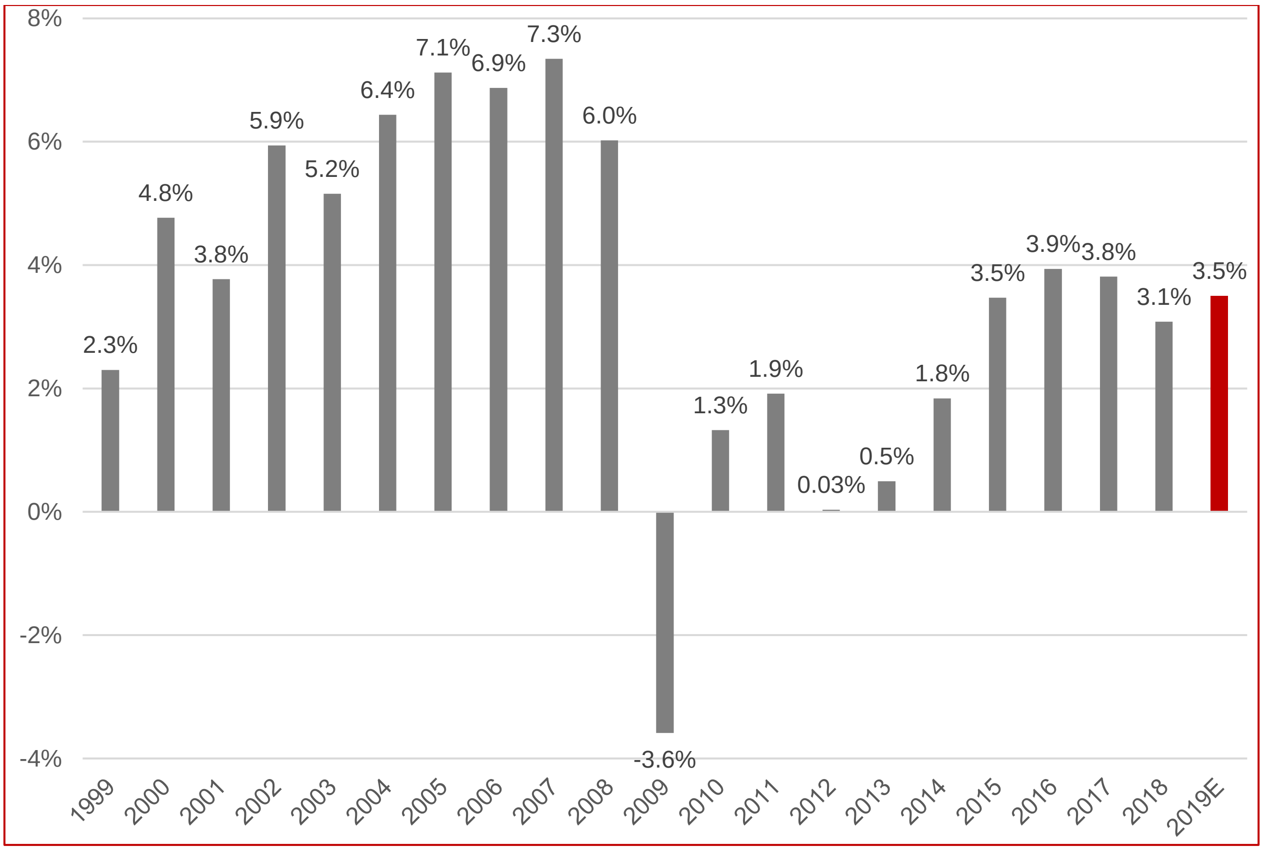
Note: These are our forecasts. Some of them might differ slightly from other institutions' forecasts in the charts below.

A) Growth – good, not stellar

The period since 1997 can be divided into several cycles:

- 1998-2001: moderate growth after the local banking crisis and hyperinflation
- 2002-2008: the 'golden decade' of high growth
- 2009-2014: moderate growth after the global crisis
- 2015-2019: economy accelerating

Chart 1.: Real GDP Growth, YoY, %



Source: National Statistics Institute

Looking forward, we see no risks for economic growth apart from an external shock caused by a potential new global crisis. If there is no such shock, GDP should continue growing by the not so impressive 3.5-4.0% per year. Such a growth rate, combined with a future Eurozone membership, should sustain higher income growth, thus fueling consumption and supporting asset prices. Bulgaria will slowly move towards the EU average GDP/capita numbers.

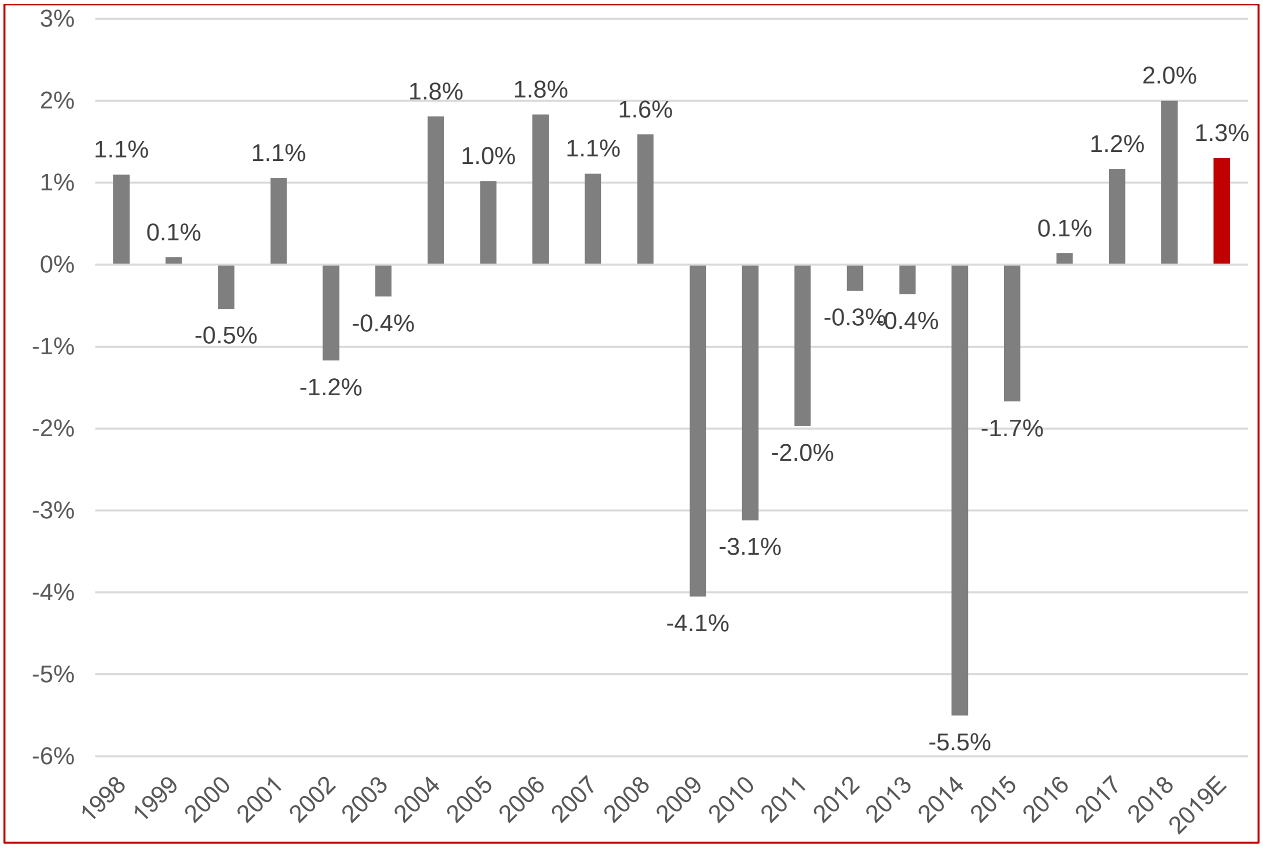
Our forecast: GDP growth of 3.5-4.0% going forward as long as the global economy does not fall into a recession.

B) Budget Surpluses – Bulgaria can be an example for many richer countries

After the economic mismanagement of 1990-97, Bulgaria has learned the lesson the hard way. Since 1998, there have been more years with surpluses than with deficits. Few non-oil-producing countries in Europe and in the world can demonstrate a similar achievement. Prudent fiscal policies, combined with the currency board, have led to a virtuous cycle: falling debt levels, low inflation and interest rates, improving credit ratings.

If we used the methodology 'on a cash basis', the numbers would be even better – there would be a large cumulative budget surplus for the last 22 years. The numbers in the chart below reflect the 'accruals' methodology, we believe. Thus, the numbers are less stellar, but still good.

Chart 2.: Budget Surplus (+) / Deficit (-), % GDP, on an 'Accrual Basis'



Source: Eurostat

We expect the conservative fiscal policies to continue. We see no danger of extravagant budget deficits regardless of any domestic political developments.

C) Debt/GDP – Bulgaria has the EU bronze medal

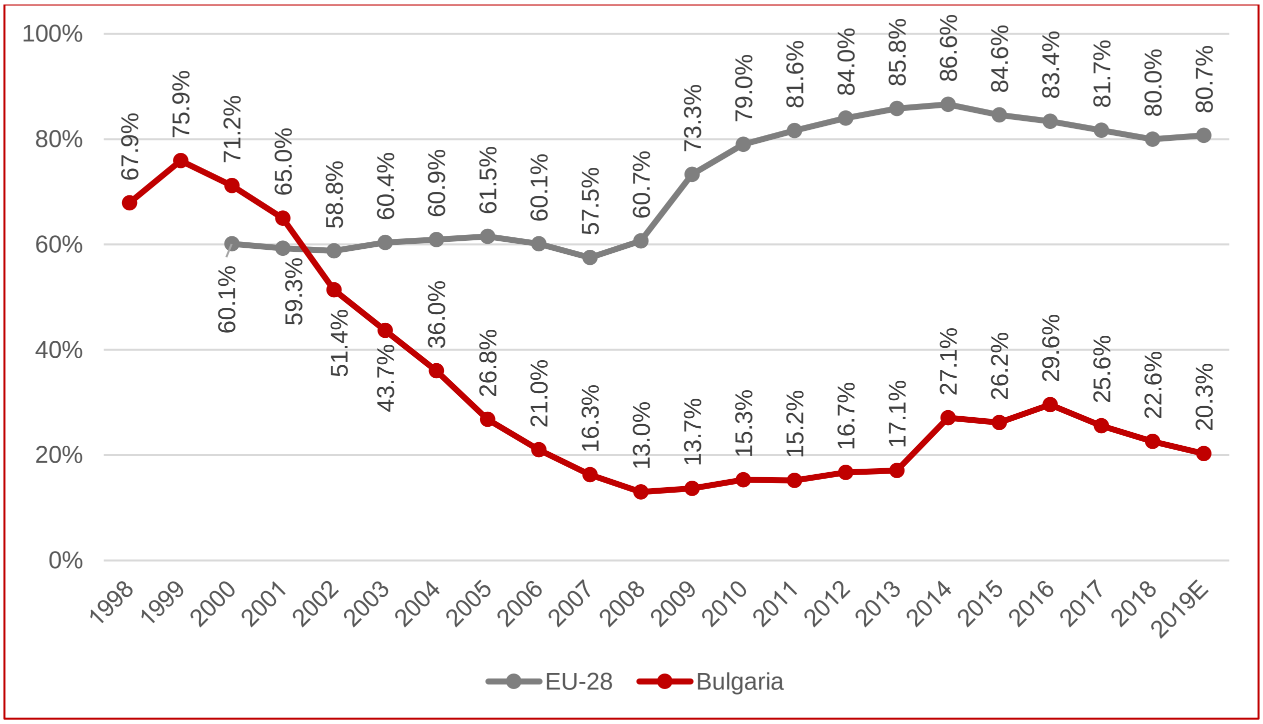
At the height of the financial crisis in 1996-97, Bulgaria was a rather indebted country with Debt/GDP in the area of 75-100%. We are giving this unusually wide range due to the hyperinflation and the fast depreciation of the local currency. On any given date in early 1997, the

Debt/GDP ratio might have been below or above 100%. The important point is – Bulgaria was highly indebted then.

Since the currency board was introduced on 1 July 1997, the trend has changed dramatically. Bulgaria has probably set a world record for the fastest reduction of its indebtedness. Within a short period of 11 years (1998-2008), Debt/GDP fell from 70% or so to 13%, the second lowest in the EU after Estonia. Please note, however, that Estonia started its post-communist transition with no debt, while Bulgaria was highly indebted in the late 1980s.

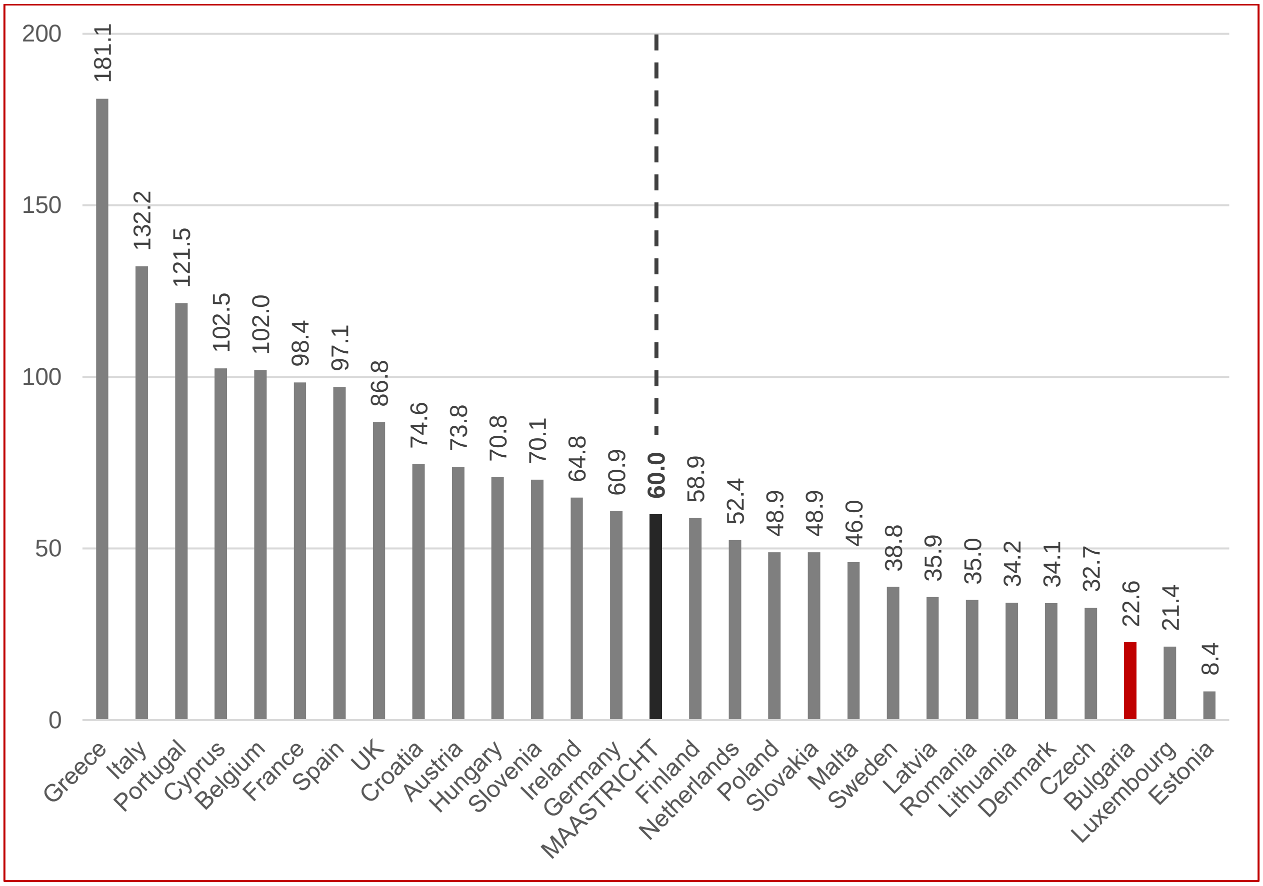
After the economic crisis of 2009, Bulgaria had years of moderate budget deficits, raising the debt level. Since 2016, new budget surpluses have brought down the debt again. If this trend continues, Bulgaria might regain the EU silver medal within a couple of years, surpassing Luxembourg.

Chart 3.: Bulgaria vs the EU-28, Public Debt/GDP, Year-End, %



Source: Eurostat

Chart 4.: Public Debt/GDP of the EU Countries for 2018, Year-End, % GDP



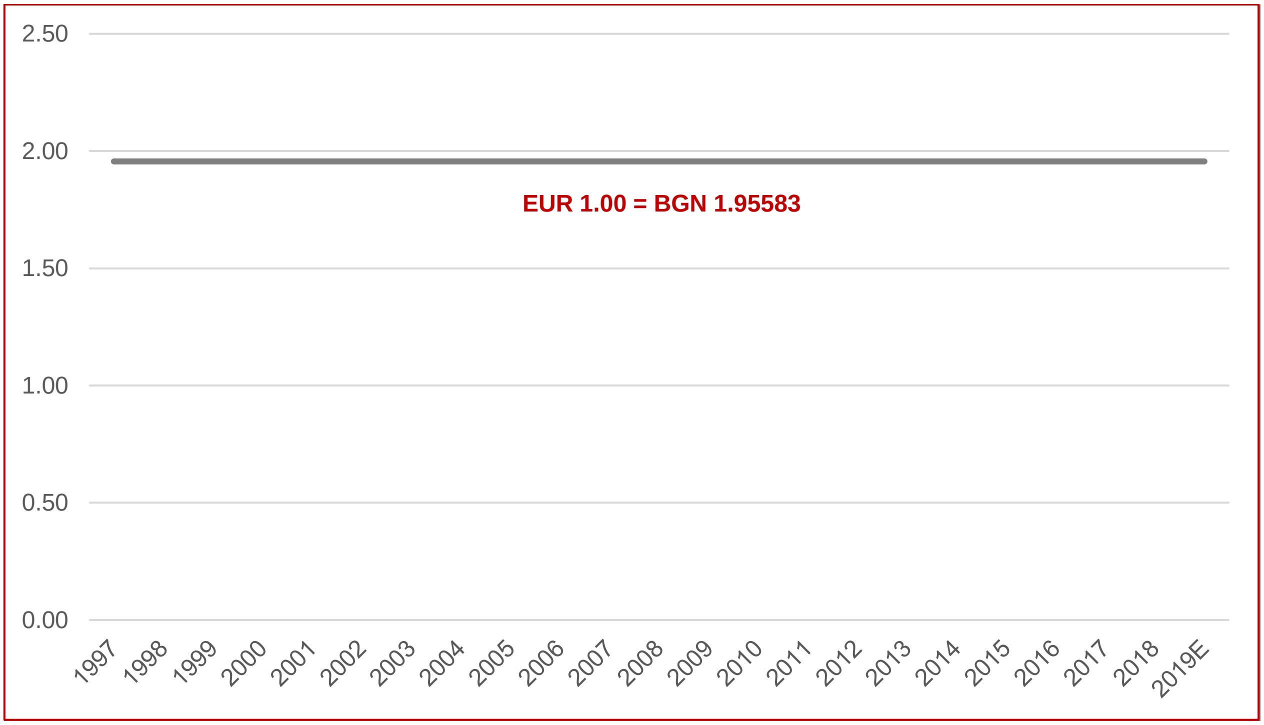
Source: Eurostat

In the chart above, please note that most Eurozone members do not meet the Maastricht criterion of 60%.

D) Currency Board • EUR 1.00 = BGN 1.95583 • DEM 1.00 = BGN 1.00

This is the most boring paragraph and the most boring chart in this report. Bulgaria introduced a currency board on 1 July 1997. The exchange rate was initially set at DEM 1 = BGL 1,000 – the [old] Bulgarian lev was fixed to the old Deutsche Mark. A denomination of three zeros followed two years later when the new lev (BGN) was equal to one Deutsche Mark. With the introduction of the euro, the rate was not changed, just re-calculated using the DEM/EUR conversion rate. For two decades, Bulgaria has enjoyed a fixed exchange rate towards the EUR. The definition of the currency board means that the forex reserves of the Bulgarian National Bank are always higher than the whole money supply. The latest ‘currency board coverage ratio’ published is above 150%. Thus, we see no risks to the fixed exchange rate whatsoever.

Chart 5.: BGN/EUR Exchange Rate, 1997-2019



Source: BNB

Our forecast: Bulgaria is expected to join the ERM-II mechanism soon, and the Eurozone within several years at today's exchange rate. No exchange rate risk.

E) Forex Reserves and the Sovereign Credit Rating

Paradoxically, the prudent fiscal/debt/reserve policies over the last 22 years have led to a situation where Bulgaria might choose to repay all of its public debt overnight and still be left with forex reserves of around 20% of GDP. We are not saying it should, but, unlike most countries, it can. Nice.

Then, our next question is: Why does Bulgaria's credit rating not start with an 'A'? Our answers are:

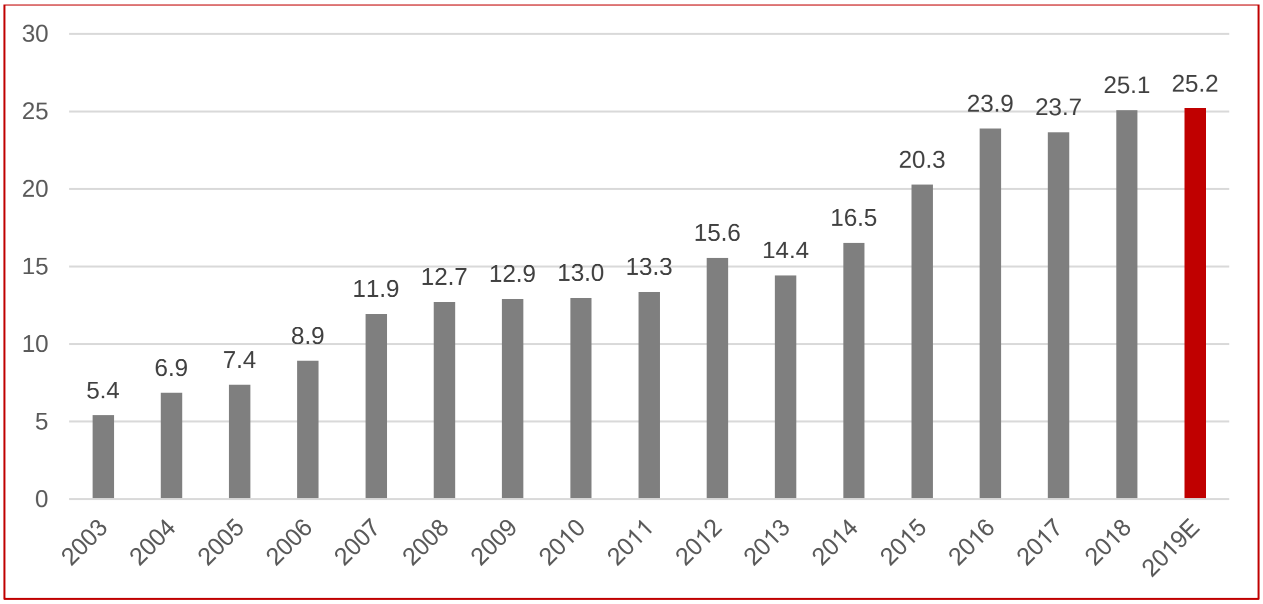
- It takes decades to improve a country's international image. Bulgaria suffered two financial crises in the 1990s. This still impacts the 'political risk' factor in its ratings.
- The rating agencies might be partially worried about the stability of the financial sector. The latest banking stress tests and asset quality reviews administered by the ECB (as part of the ERM-II accession process) have been positive. However, the 4th largest bank failed rather unexpectedly in 2014, leaving EUR 2 bn in economic damage behind.
- Bulgaria's economy is quite small, the nominal GDP/capita is rising fast, but is still well below the EU average. This prevents the country from getting a developed country status. Poland has been the first in the region to achieve this status a few months ago. Ceteris paribus, emerging markets have lower credit ratings.

- Bulgaria is still not a member of the Eurozone, the Schengen Agreement, and the OECD. The country is expected to join the ERM-II Mechanism soon, and to adopt the euro in several years. Should the ERM-II accession happen, we expect the credit ratings to improve automatically by two notches and really reach A-. This would be well deserved.

Our forecast: An A- rating by Standard & Poor's and A3 by Moody's by 2023. Rising forex reserves by >EUR 1 bn per year on average.

The chart below demonstrates that the Bulgarian National Bank's foreign exchange reserves have increased sharply. They are about 50% of GDP.

Chart 6.: Forex Reserves of BNB, Year-End, EUR bn



Source: BNB (Bulgarian National Bank)

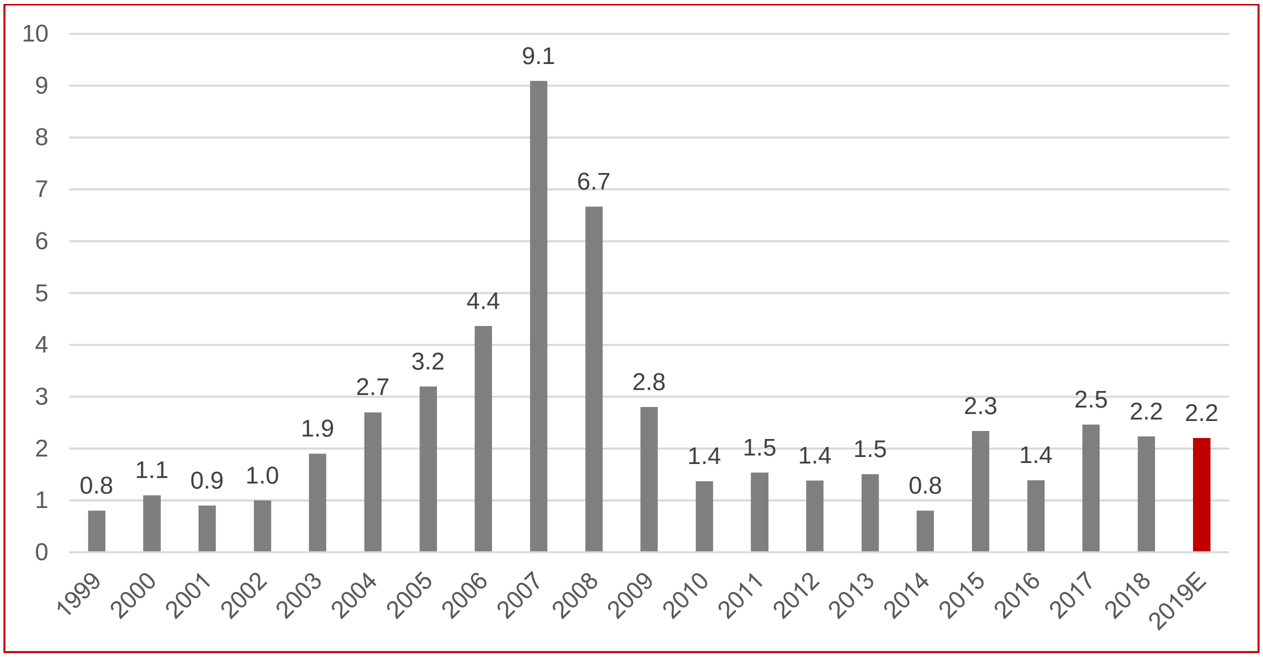
F) FDI Was Astronomical a Decade Ago, Less Satisfactory Now

During the 'golden years' of the previous decade, foreign direct investment (FDI) into Bulgaria was very strong, peaking above EUR 9 bn in 2007 when the country joined the EU. That accounted for over 30% of GDP, the third highest result in the world and by far the highest among all OECD/EU/CEE countries. Impressive.

The situation changed with the global crisis of 2009 and has not recovered since. As nominal GDP has increased sharply, FDI today is only 4-5% of GDP, similar to the chaotic 1990s. One of the reasons for this is the gradual outflow of large foreign investors who are selling their assets to local business groups – in the banking, insurance, energy, real estate and media sectors. In our view, this is a worrying trend.

On the positive side, much of the current FDI goes into high-value-added and export-oriented sectors such as auto parts manufacturing and IT. The government has been working hard to attract automobile producers to open a large assembly plant. The most likely suspects are Volkswagen and Hyundai. The outcome remains to be seen.

Chart 7.: FDI, EUR bn



Source: BNB

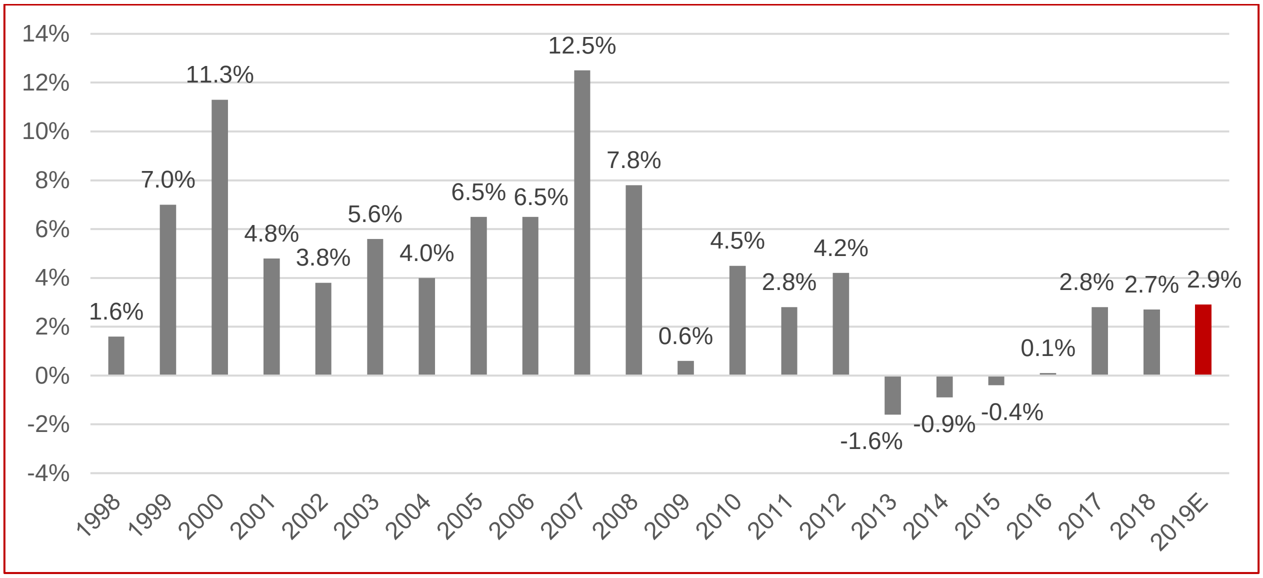
G) Inflation – Not Interesting

With the fixed exchange rate against the euro, Bulgaria has experienced a decade of very low inflation or deflation. On a cumulative basis, the price level has not moved too much for 10 years. Good. Over the last year, inflation has picked up to 2.9% per year for the following reasons:

- rising fuel prices
- very strong nominal income growth – by over 40% for 4 years
- accelerating real GDP growth

We do not consider inflation to be a risk or a problem. We even view the recent increase in inflation as a good sign of improving economic activity and consumption. This should also raise corporate earnings.

Chart 8.: Inflation (Consumer Price Index), Year-End, %



Source: National Statistics Institute

Our forecast: Inflation of 2-3% going forward. Not interesting.

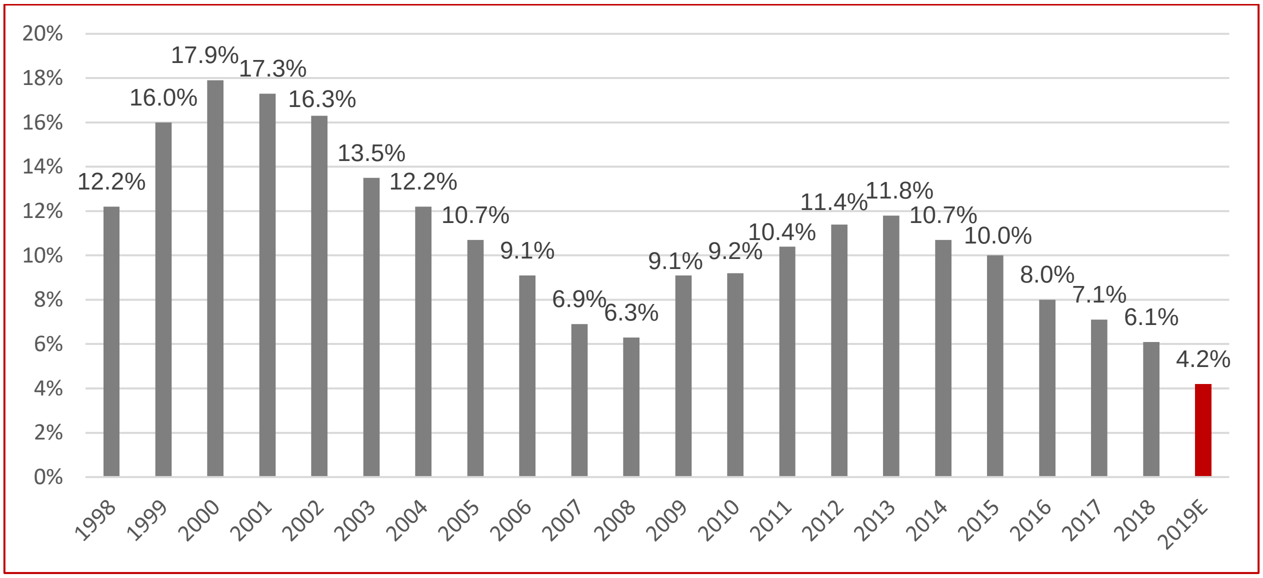
H) Unemployment – at Record Lows

At the height of fiscal austerity and after a decade of restructuring, unemployment reached a historic peak of 19.3% in February 2001. It then fell to below 6% within 8 years. This might qualify for some kind of an international record. After the global crisis of 2009, unemployment rose again to above 11%. We have now reached an all-time low of 4.2% as of the summer of 2019. Here are the factors for the hot labour market:

- The stronger economy since 2015.
- The emigration of younger and educated people from CEE to the West has led to a general shortage of skilled as well as unskilled labour across the region. Labour demand is higher than the supply, leading to strong wage growth.
- The influx of numerous outsourcing and other companies to the capital Sofia and to other large cities has created dozens of thousands of skilled jobs for university graduates speaking foreign languages. This has depleted the labour pool for the remaining sectors. Wages have doubled within a decade.

Please note our view that these outsourcing companies do not account for large FDI – they are labour-intensive but their actual equity investment is granular. Hewlett-Packard and its related entities, for example, are employing c. 5,000 people in Bulgaria, while their FDI contribution is probably similar to the price of a luxury house in Sofia – negligible. Still very positive for the economy.

Chart 9.: Unemployment, Year-Average, %



Source: National Statistics Institute

Our forecast: Unemployment of 4-5% going forward as long as the global economy does not fall into a major recession.

I) Salary Growth – Accelerating

Due to the same factors discussed in the unemployment section above, salaries have grown fast. On the one hand, this is positive for the economy for the following reasons:

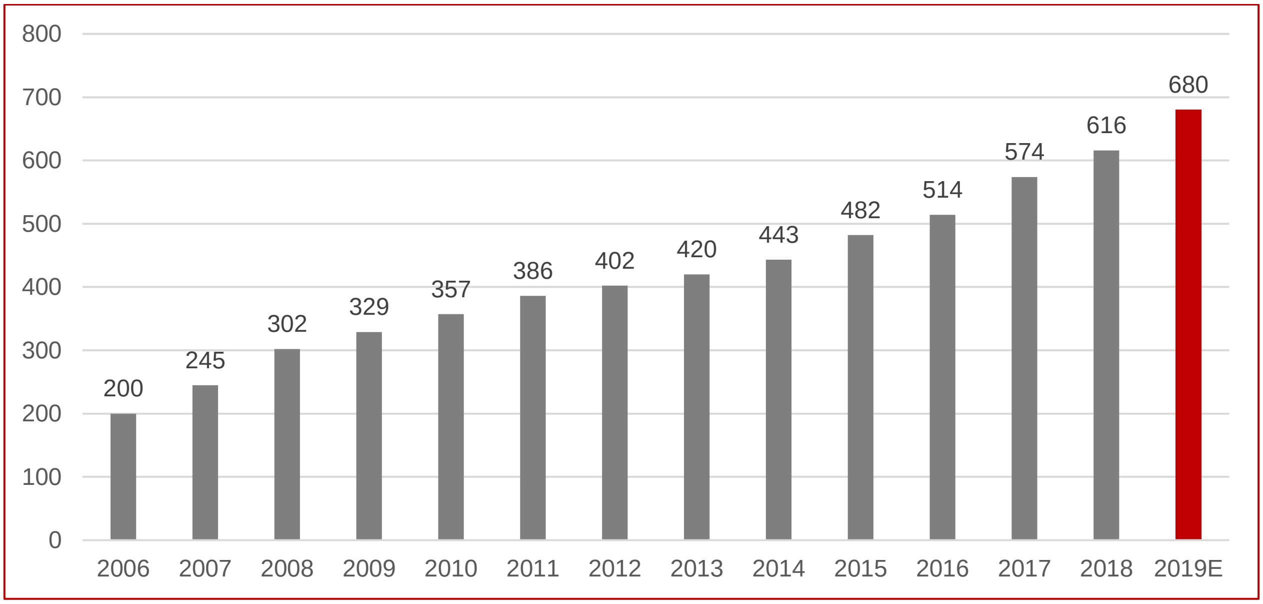
- growing consumption
- rising asset prices
- higher salaries stimulate more people to remain in the country, and some to come back from emigration

On the other hand, there might be negative effects:

- negative pressure on corporate earnings in labour-intensive sectors
- negative pressure on the international competitiveness of the Bulgarian economy

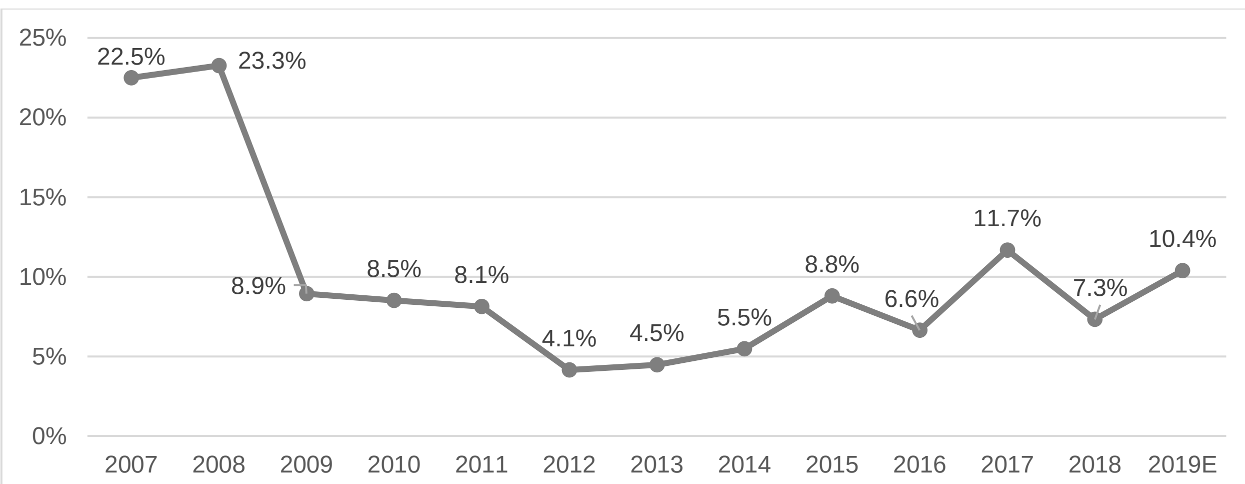
However, exports continue increasing fast, and faster than imports. The current account balance is positive. Productivity is rising, although not as fast as the salaries.

Chart 10.: Average Monthly Salary, EUR



Source: National Statistics Institute

Chart 11.: Annual Increase of the Monthly Salary, Year-End, %



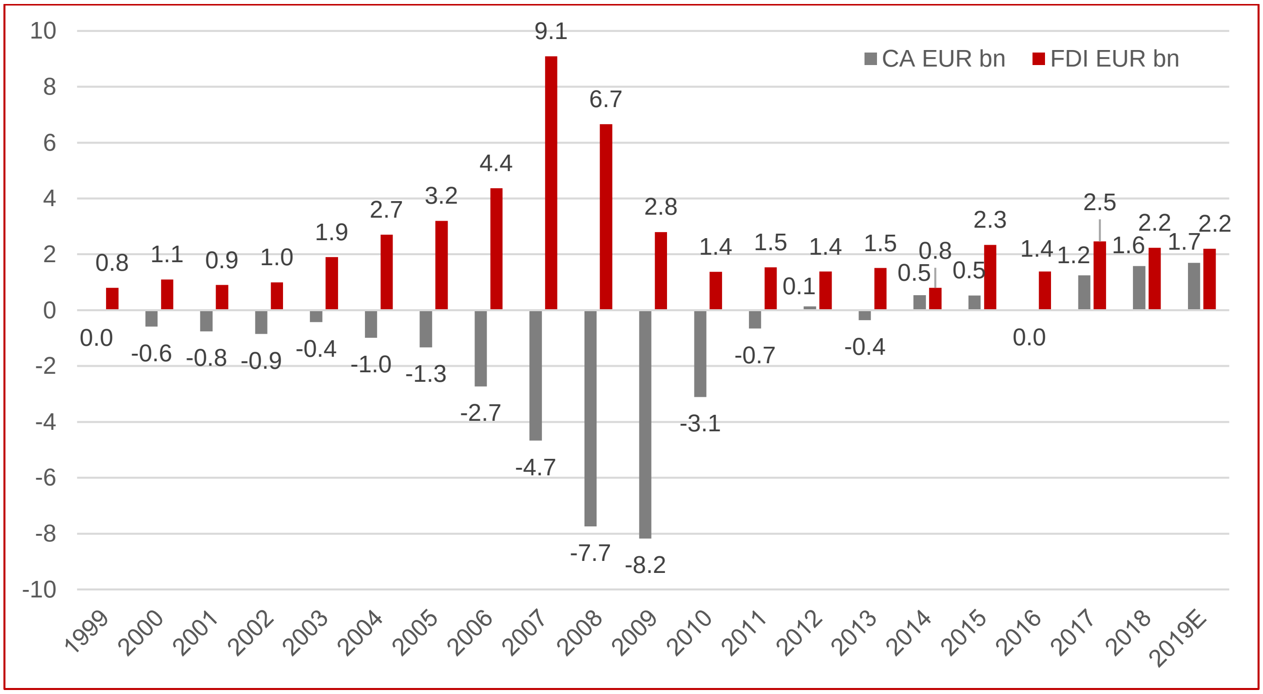
Source: National Statistics Institute, Expat Capital

Our forecast: Salaries should continue growing by 7-10% per year over the next several years.

J) Current Account – Years of Surpluses

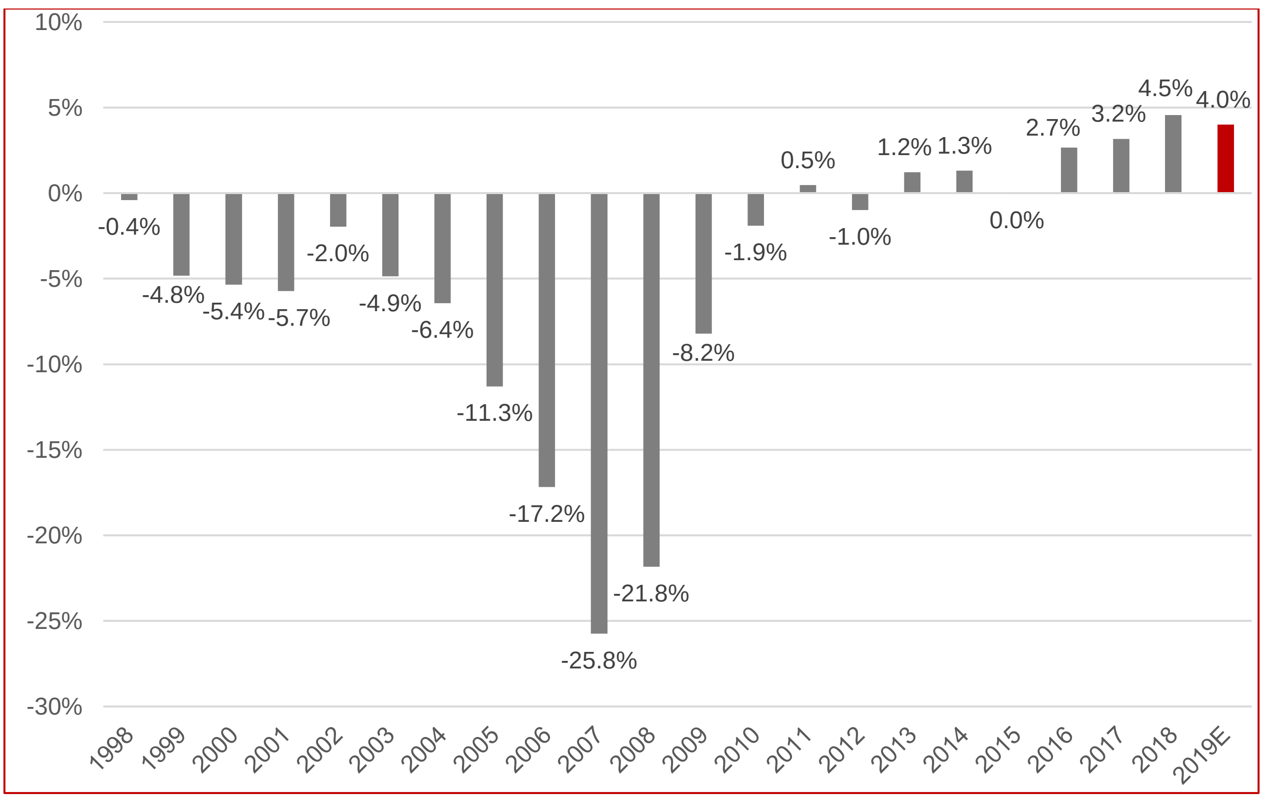
During the 'golden years' of the previous decade, FDI was astronomical, but so was the current account deficit. Bulgaria apparently had the 3rd largest FDI/GDP ratio and the 3rd largest negative CA/GDP ratio in the world. We were among the people who considered the latter to be a major risk. Others disagreed, pointing to the 'mirror effect' – the higher the FDI, the higher the imports of machinery, etc., leading to a larger CA deficit. This 'mirror effect' can be observed in the chart below.

Chart 12.: Current Account Balance vs FDI, EUR



Source: Bulgarian National Bank; World Bank

Chart 13.: Current Account Balance, % GDP



Source: World Bank

Since 2013, the current account has clearly improved for the healthiest reason: high exports growth. Excellent. Rising exports, and exports rising faster than imports mean:

- improving international competitiveness
- deeper economic integration with the EU – Bulgaria’s largest exports market
- larger investments in export-oriented sectors

Our forecast: Current account surpluses of 2-4% of GDP over the next several years.

IV. COMPOSITION AND PERFORMANCE OF THE SOFIX INDEX

Table 3.: The Composition of the SOFIX Index, 3 September 2019; Valuations

No.	Company Name	Sector	Weight in SOFIX	P/E Ratio	P/B Ratio
1	Sopharma	Pharmaceuticals	14.98%	14.64x	0.85x
2	Eurohold	Insurance	10.73%	23.06x	2.26x
3	Chimimport	Industrials/Conglomerates	10.39%	6.00x	0.28x
4	Advance Terrafund REIT	Real Estate	9.09%	15.34x	0.66x
5	Holding Varna	Real Estate	8.75%	127.07x	1.28x
6	Gradus	Consumer Goods/Food	7.16%	28.00x	1.27x
7	M+S Hydraulic	Industrials/Conglomerates	6.10%	18.75x	3.79x
8	Stara Planina Hold	Industrials/Conglomerates	5.87%	14.43x	1.09x
9	Bulgarian Real Estate Fund REIT	Real Estate	5.21%	3.39x	0.31x
10	Industrial Holding Bulgaria	Industrials/Conglomerates	5.08%	8.07x	0.33x
11	First Investment Bank	Banks	4.99%	1.60x	0.37x
12	Doverie United Holding	Financials	3.34%	6.75x	0.71x
13	Central Cooperative Bank	Banks	3.21%	5.40x	0.39x
14	Elana Agrokredit	Real Estate/Financials	2.65%	17.18x	0.98x
15	Sirma Group Holding	IT	2.45%	5.71x	0.46x
	TOTAL (Aggregate)		**100.00%**	**9.60x**	**0.66x**

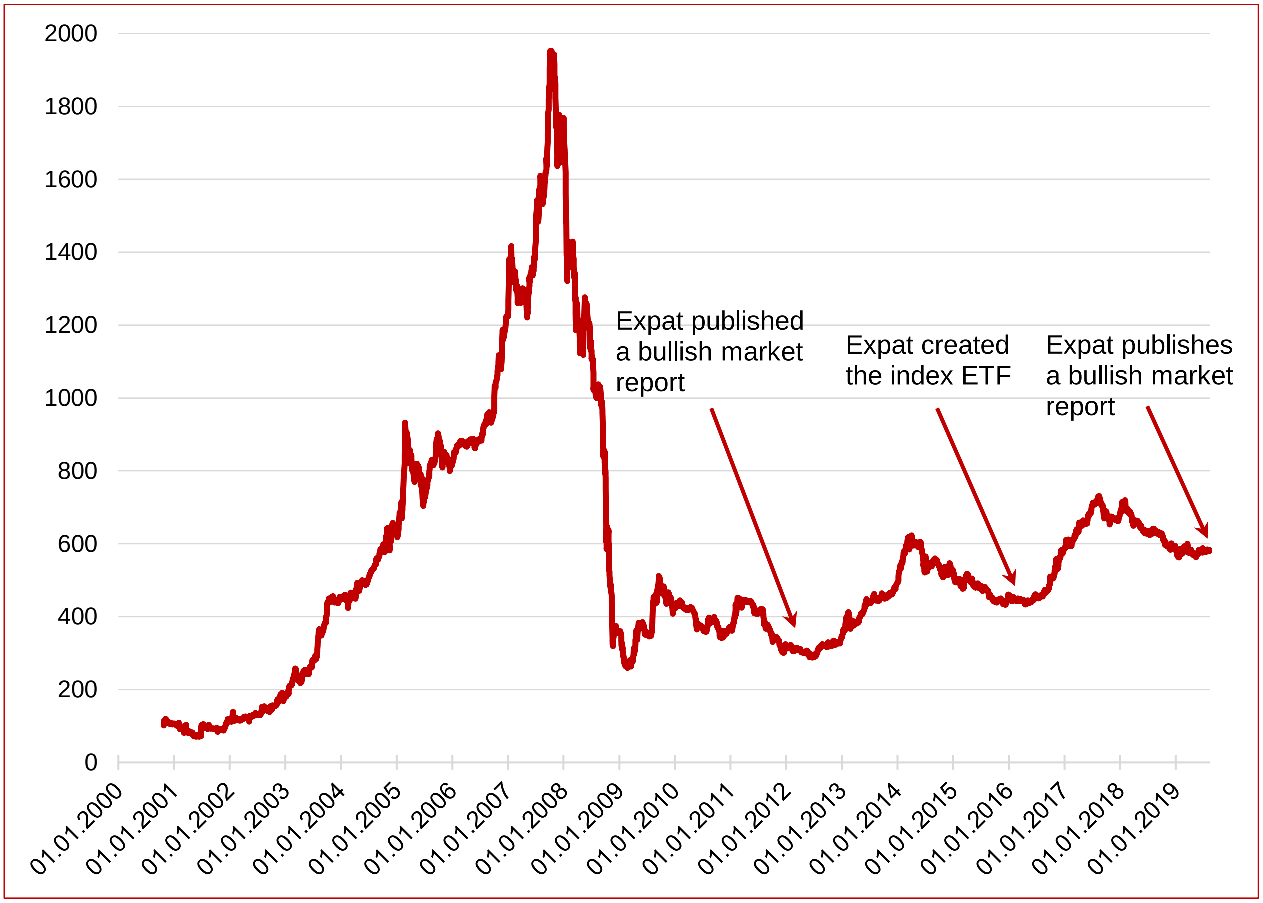
Source: Bulgarian Stock Exchange; Bloomberg; Expat Capital

The index consists of 15 companies. It represents relatively broadly the sectors of the Bulgarian economy: pharmaceuticals, banks, insurance, IT, various industrials, real estate, conglomerates. In comparison, several of the main indices in Central and Eastern Europe (CEE) have a smaller number of stocks in them.

Concentration of the Stocks in the Index

Compared to other indices in the region, the SOFIX index is not dominated by a couple of stocks. The largest stock has a weight of below 15%. The smallest stock is above 2.3%. As an operator of 11 ETFs, we find it easier to replicate the SOFIX index than many other indices, namely Hungary, Serbia, Slovakia, Greece. In addition, the number of stocks is not excessive like in Greece where it is difficult to buy and sell 60 stocks. Thus, the SOFIX is a very convenient index for us to follow.

Chart 14.: Performance of the SOFIX Index since Inception



Source: Bulgarian Stock Exchange

The period of 20 years since the creation of SOFIX can be divided into periods. A 'naked eye' would see 3 large periods:

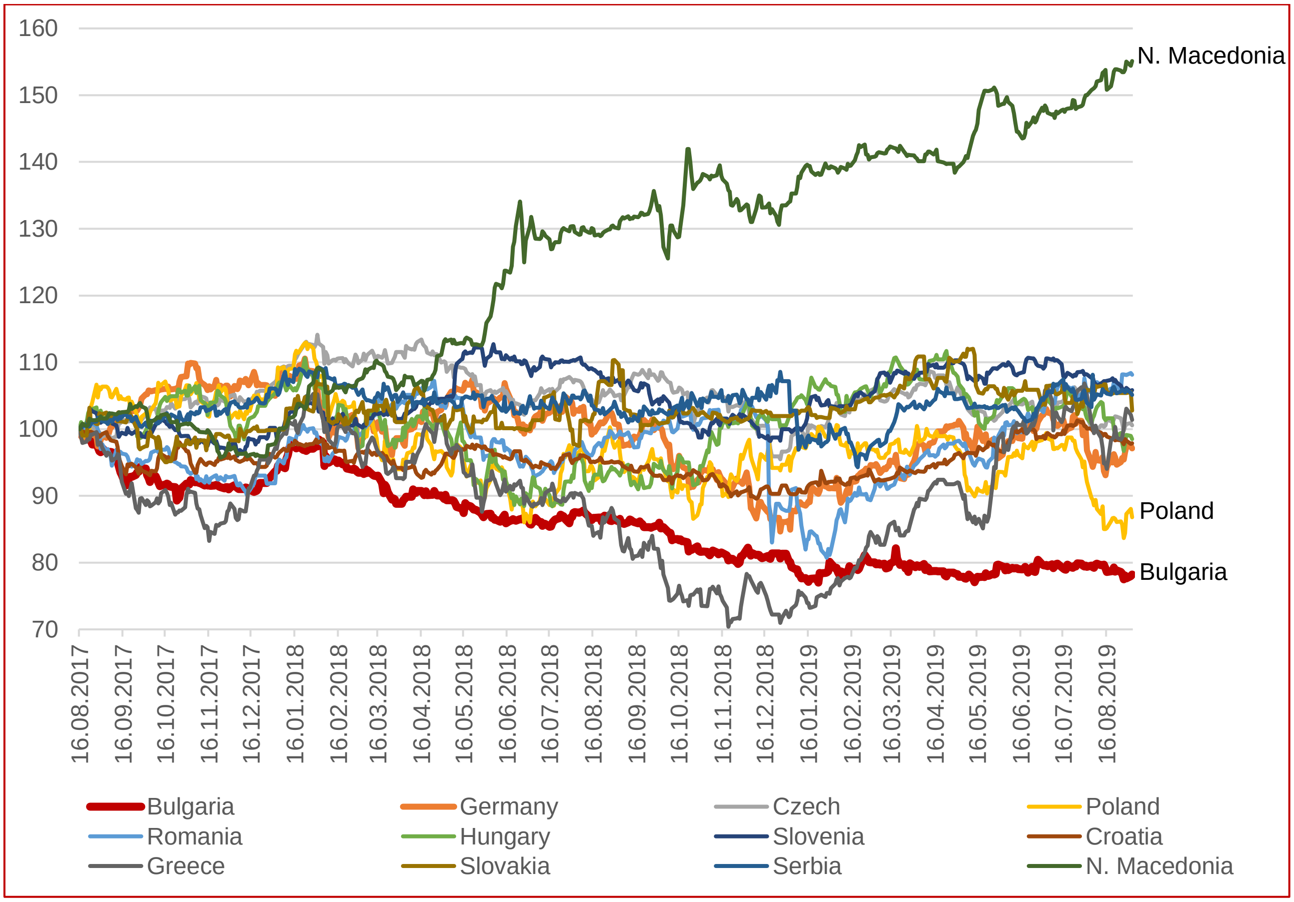
- Stellar growth till 2007
- A strong drop in 2008
- Moderate growth since 2010

With more knowledge of the market, we would separate the last 22 years into more periods:

- 1997-2001 (during much of this period, the SOFIX index did not exist; there was another index): Several years of boredom, similar to 2019
- 2001-2007: The index rose over 27 times (>2600%) in EUR terms and over 40 times (>3900%) in US$ terms (the US$ weakened during those years). This might be a world record for the period
- 2007-2009: A sharp drop by -85%. The Bulgarian market was one of the worst-performing in the world, together with Greece. However, Bulgaria did not go through a Greek-style crisis. We can say that the market overshot on the upside and then on the downside
- 2010-2012: A 'dead-cat-bounce' followed by two years of boredom

- 7 August 2012 – March 2014: Expat Capital identified a good investment opportunity and published a 38-page bullish research report on the Bulgarian equity market. The index went up by almost +100% within 19 months of our report
- 2014-2016: Another two years of boredom
- 2016: Expat Capital created the Bulgarian index ETF
- 2016-2017: The market rose by +60% within a year
- 2017-2019: Another two years of boredom
- September 2019: Expat Capital publishes a bullish report on the Bulgarian equity market
- Our forecast: +25% upside in 2020
- Target level for SOFIX: 715

Chart 15.: Relative Performance of the CEE Indices since August 2017, Normalized



Source: Bloomberg; Expat Capital

Conclusions from the Chart Above

- It can be clearly seen that Northern Macedonia has been the only well-performing CEE market for the last two years, +55%
- The biggest underperformer is Bulgaria, -22%
- Greece initially lost -30%, but has been the best performer in 2019
- The other markets have been moving in a pack

What Would +25% Upside Mean for the Bulgarian Market?

- If the Bulgarian market rises by +25%, it will still be down -2% since August 2017
- In that case, Bulgaria would still be among the worst markets in CEE
- A bit paradoxically, if the Bulgarian market rises by +25%, it might get noticed by international investors. New inflows might follow, and the market might go up further. This is exactly what we expect to happen.

V. VALUATIONS

Table 4. The Size and Valuations of the 11 Markets in the Region for Which Expat Has ETFs

No.	Country	Index Name	Index P/E	Index P/B	Market Cap of the Index, EUR bn
1	Poland	WIG20	12.09x	1.16x	82.02
2	Czech Republic	PX	11.72x	1.34x	43.38
3	Slovakia	SKSM	17.75x	0.94x	2.12
4	Hungary	BUX	9.65x	1.21x	23.57
5	Slovenia	SBITOP	7.84x	0.89x	6.04
6	Croatia	CRO	15.55x	1.10x	7.45
7	Serbia	BELEX15	2.65x	0.66x	2.00
8	Northern Macedonia	MBI	11.21x	1.49x	2.15
9	Romania	BET	7.95x	1.11x	18.05
10	**Bulgaria**	**SOFIX**	**9.60x**	**0.66x**	**1.70**
11	Greece	ASE	23.10x	0.72x	51.72
	Total/Aggregated		**12.05x**	**1.03x**	**240.20**

Source: Bloomberg

The table above compares the 11 markets in CEE where Expat has created ETFs. We draw the following conclusions:

- The Bulgarian market is the smallest in terms of the market capitalization of the index. Nothing to be proud of.
- The Bulgarian market has a lower P/E than the aggregate for the region, and the lowest P/Book ratio (together with Serbia) among the 11 countries. This makes the market relatively cheap and attractive.

Our conclusion: +25% rise of the market would bring Bulgaria closer to the average ratios for the region.

VI. EVENTS TO WATCH. RISKS

Over the next several weeks and months, investors should monitor the following events which might have an effect on the SOFIX index:

Positive Expected Developments

1. Kristalina Georgieva (Bulgarian), currently Executive Director of the World Bank, is expected to become Managing Director of the International Monetary Fund. Such a development would raise the profile of the country in the international financial circles and might accelerate Bulgaria's entry into ERM-II and the Eurozone:

- This would be a strong continuation of Ms. Georgieva's career. Previously, she had a long career at the World Bank, including Director for Russia and Executive Director; Vice President of the European Commission; a candidate for Secretary General of the United Nations.
- The Bulgarian government has been more active internationally in the last several years, especially in relation to the Western Balkans. Ms. Georgieva's appointment would be considered major success for the country's diplomacy.
- For the first time the Managing Director of the IMF would not represent one of the richer, 'lender' countries (France, etc.) but one of the [former] borrowing nations. It is not a coincidence that such a country is Bulgaria. In the history of the IMF programmes, Bulgaria has been a star performer. It was bailed out with a small loan (repaid in full a long time ago) in the magnitude of US$ 1 bn in 1997 – nothing similar to the US$ 57 bn for Argentina. Unlike some of the other borrowers, Bulgaria has recovered quite well and does not need the IMF anymore. Hence, it is ready to head the IMF itself.

2. Joining of the ERM-II Mechanism

- The ECB is expected to issue a positive opinion on the application of Bulgaria to join ERM-II by the end of 2019. Actual accession of to the currency mechanism is expected in early 2020.
- This will set a clear roadmap for the country to join the Eurozone. This is expected by 2023, as the currency board system in Bulgaria excludes any currency rate fluctuations and the ERM-II waiting period is just a technical step.

3. The Concession of Sofia Airport

- In the summer of 2019, five major West European airport operators submitted their bids.
- A consortium led by Munich Airport (Germany), together with a French investment fund, has been selected as a winner.
- The other four participants have appealed. Thus, the procedure will be delayed, but is underway.
- If a concession contract is finally signed, the winner is expected to pay a one-off concession fee of EUR 280 mln into the budget, pay large annual concession fees, and build a new terminal and a new runway within a decade. As a result, the airport should be in a much better shape.

4. A Possible New Large Automobile Assembly Plant in Bulgaria

- Volkswagen is expected to announce in the autumn whether it will build its large new EUR 1.4 bn plant in Turkey or in Bulgaria. We see the two countries' chances as 50:50.

- Even if Turkey wins, Bulgaria is lobbying hard to invite Hyundai and other large manufacturers to build a similar factory near Sofia.
- Any such piece of news would be a major contributor to growth, while the lack of such news is just the current status-quo.

Risks to Our Bullish Forecast for the Bulgarian Equity Market

1. The largest risk we see is actually external. Should a global recession or a global equity meltdown occur, the Bulgarian market might not perform as well as we expect it. There are some mitigating factors, however:

- The correlation between the Bulgarian market and the global equity markets is weak. The degree of foreign ownership of Bulgarian shares is small, much lower than before 2008.
- The Bulgarian market has strongly underperformed most other markets in the last two years – for no apparent reason. Thus, with global markets flat, we just see a positive correction of +25%.

2. An unexpected political turnaround in the country. If GERB loses badly the October local elections, especially in the capital Sofia, that might trigger early parliamentary elections and a shift to the less market-friendly left. However, this is not our forecast as of today.

3. The third risk we see is that although the Bulgarian market has underperformed and is cheap, it is not mainstream and is too small to be noticed. Still, the index ETF, Expat Bulgaria SOFIX UCITS ETF, listed on the Bulgarian Stock Exchange (in EUR and BGN), on the Frankfurt Stock Exchange (in EUR), and on the London Stock Exchange (in EUR) provides global investors an easy access to and exit from the market.

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RISK DISCLOSURE