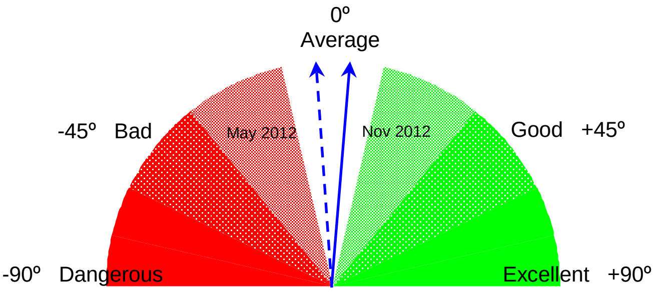
Issue 11 November 2012

expat compass

22 November 2012

EXPAT CURRENCY BOARD WATCH



OUTLOOK: STABLE

We are not worried about the currency board and see no immediate danger of devaluation. Compared to last time, there have been some improvements on the budget side.

GUEST COMMENTS

ARTICLES

EDITORIAL COMMENT

We are upgrading our rating due to several macro improvements over the last few months:

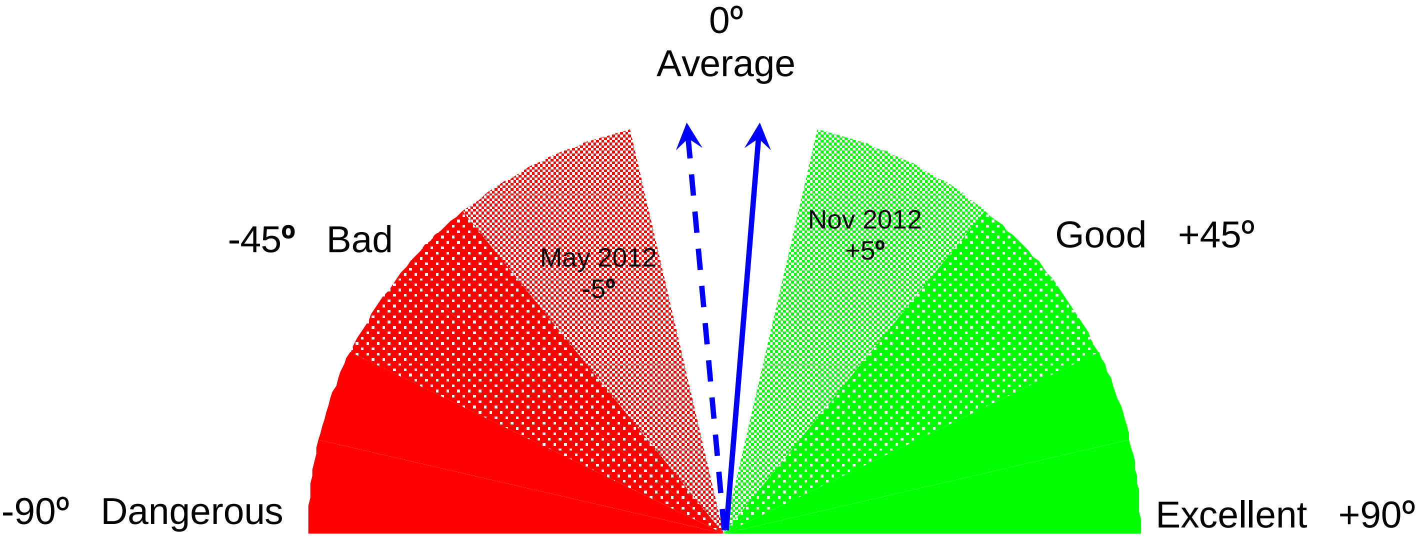
1. The **budget** reached a **surplus** of BGN248m for Jan-Sept 2012. Excellent, compared to other countries.
2. A new **Eurobond** issue brought EUR950m at a low rate of 4.436%. In the consecutive trading, the yield has fallen to c. 3% – impressive, compared to Italy.
3. As a result of the Eurobond, the **fiscal reserves** have risen above BGN7bn (Sept). Much better than before, although they should fall again due to:
   - the expected excessive spending before year-end
   - the repayment of the old Eurobonds in early 2013
4. The government has temporarily or permanently forgotten its intentions to spend much of the Silver Fund for buying government debt. Please note that we have deliberately said *spend* and not *invest.*

However, there have been negative economic policy developments:

1. A **10% tax on interest from bank deposits** is being introduced from 2013 – for the first time in Bulgaria. We disapprove – see the articles on p. 17 and 23. We hope that there will be no new taxes on capital gains and other similar income.
2. There have been oral suggestions about changes to the second pillar of the pension system to the detriment of the **private pension funds.** No danger (yet).
3. The **renewable energy sector** (mostly solar) has been surprisingly hit again by a 40% fee (tax) on revenues. That can kill the whole sector. This policy decision might not be final, though, because its opposition is strong.

EXPAT CURRENCY BOARD WATCH

OUTLOOK: STABLE



In the last year, the main issue of concern for the business community in Bulgaria and globally has been the debt crisis, including in Greece, Western Europe, and the US. Bulgaria has not been directly hit by these tremors. While high economic growth cannot be expected in the country soon, here is our conclusion – positive as usual:

We are not worried about the currency board and see no immediate danger of devaluation. However, we are worried about the lack of economic growth and about the strange shifts in the economic policy of the country.

In the future months and years, we will continue constantly monitoring the development of the relevant economic indicators in order to assess the health of the currency board and to potentially predict any negative events, should they ever occur.

It is becoming more difficult to draw all the arrows and the dates in the picture. That is why we are also providing a table with all the historical data. The measure is angular degrees (º). The reading of the Compass can change between +90º (horizontal to the right, Excellent) and -90º (horizontal to the left, Dangerous). 0º is a neutral (vertical upwards, Average) reading.

Date	Reading of the Compass (Angular Degrees)	Change	Comment
2005	**+64º**		Currency board very stable
2008	**+44º**	**-20º**	Deterioration due to current account concerns
Jan 2010	**+20º**	**-24º**	Deterioration due to budget and recession concerns
Mar 2010	**+9º**	**-11º**	Deterioration due to budget and reforms concerns
Jun 2010	**0º**	**-9º**	Deterioration due to budget and reforms concerns
Oct 2010	**+4º**	**+4º**	Improvement due to exports growth
Feb 2011	**+8º**	**+4º**	Improvement in many economic indicators
May 2011	**+10º**	**+2º**	Smaller concerns about the budget
Aug 2011	**+12º**	**+2º**	Small budget and trade deficits
Dec 2011	**+14º**	**+2º**	Conservative 2012 budget, some pension measures
Feb 2012	**+20º**	**+6º**	Troubles in the Eurozone; good 2012 budget
May 2012	**-5º**	**-25º**	Sharply falling fiscal reserves. Intentions to spend the Silver Fund
Nov 2012	**+5º**	**+10º**	Successful Eurobond; good budget; Silver Fund forgotten

How to assess the stability of the currency board and to predict any danger of devaluation? We suggest the following check-list of 16 questions and provide our answers:

ISSUE	OLD	NEW	COMMENTS
I. Political issues			
1. Does the government support the currency board?	+++	+++	Yes
2. Does the Central Bank support the currency board?	+++	+++	Yes, absolutely
3. Do the European institutions (EC, ECB) support Bulgaria in joining the ERM II and the Eurozone?	--	--	Not much
II. Budget and debt			
4. Budget balance	-/+	+	Surplus year-to-date
5. Budget spending	+++	+	Among the EU's lowest, rising
6. Government debt	++	++	Very low, rising
7. Foreign liabilities of the private sector	--	--	High, falling
8. Fiscal reserves	-	-/+	Have risen recently
III. Economic cycle related issues			
9. GDP growth	-	-	Just above zero
10. Inflation	++	+	Moderate, rising
11. Unemployment	--	--	Average, rising
12. Strength of the banking system	+	+	Average
IV. External balances			
13. Current account deficit, trade deficit	-	-	Back to negative
14. Foreign direct investment	--	-	Low-to-average, rising
15. Revenues from international tourism	++	++	Moderate
16. Foreign exchange reserves	++	++	High

Legend: Good Bad

This time, good budget news

1. The **budget** has had a **surplus** in Jan-Sept 2012 of BGN248m (+0.3% of the annual GDP). Excellent. Based on economic considerations alone, the year might even finish with a surplus. However, at year-end, governments typically spend large amounts which are difficult to estimate. Thus, we are lowering our 2012 budget deficit forecast from -2% to -1.2%. A surprise on the positive side (i.e., a lower deficit, of course) is possible.
2. The **fiscal reserves** have risen by over BGN2.5bn to above BGN7bn in Sept, most of which has come from the new Eurobond issue which brought EUR950m. In early 2013, however, BGN2bn will be used to pay back the old Eurobonds. After that, we expect the fiscal reserves to fall back to BGN4.5bn. The news to follow is the typical December budget spending, e.g. Christmas pension bonuses, transfers to municipalities. This extra spending might be as large as BGN1bn – not negligible.
3. **FDI** is rising from very low levels. We expect EUR2.5bn in 2012 vs EUR1.7bn in 2011.

The higher spending is due to the forthcoming elections in 2013

Traditionally, we prefer budget spending as % of GDP to be lower. Lower spending corresponds to a more dynamic private sector, to a lower tax burden. It also stimulates the government to make deeper reforms in the public sector – not the case in Bulgaria. In the 2013 budget, spending is set at 38.8% of GDP – quite low by European standards (let us not admit this too loudly ☺), but higher than in most of the years since 2005.

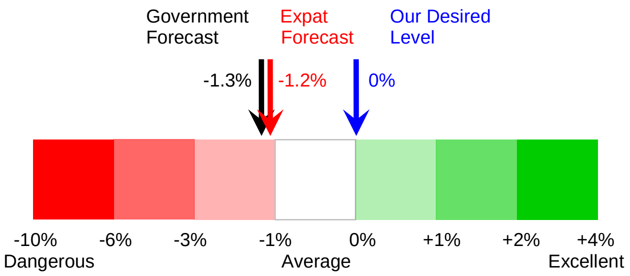
We are improving our Expat Currency Board Watch reading from the all-time low of -5º to +5º

How does the situation compare to 2 years ago when the reading was similar?

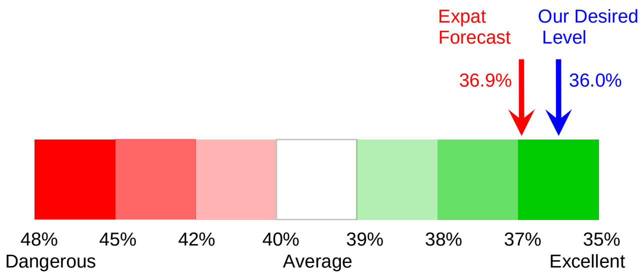
- The budget and the current account are in a better shape
- However, the lack of reforms, the fiscal reserves, and the banking system are worse
- Years have been wasted with no major improvements to the pension system and healthcare. The economic policy record has been mixed

INDICATORS, 2012

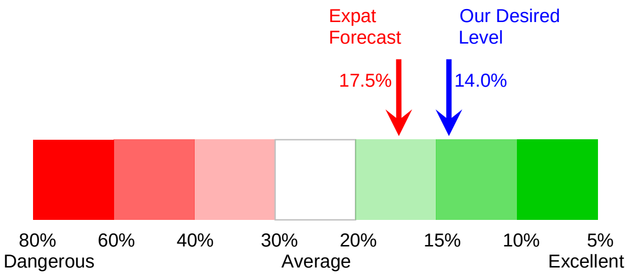
I) Budget Surplus/Deficit, % GDP, 2012



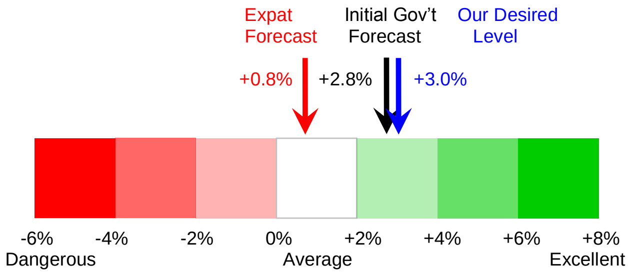
II) Budget Spending, % GDP, 2012



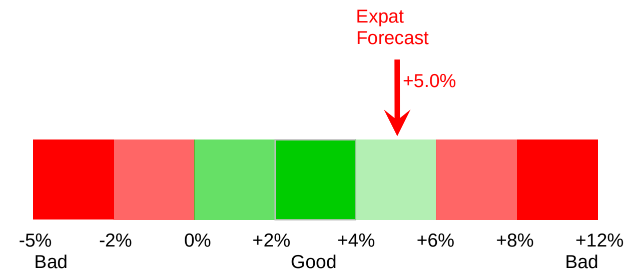
III) Government Debt, % GDP, 2012, Year-End



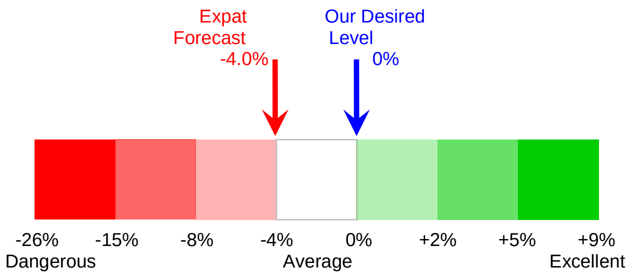
IV) Real GDP Growth, %, 2012



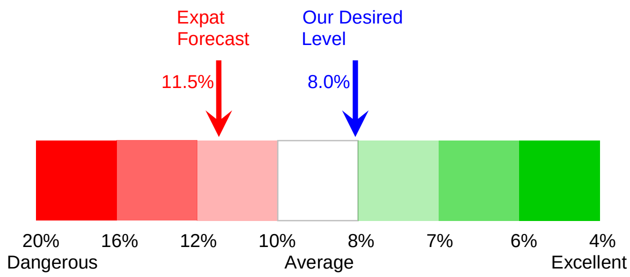
V) Inflation, %, 2012, Year-End



VI) Current Account Deficit, % GDP, 2012



VII) Unemployment, %, 2012, Year-End*



** The changed methodology results in lower reported unemployment numbers*

THE 2013 BUDGET – A MIXED PICTURE

The 2013 budget is the last one for this government before the elections. Let us comment on some of its most important parameters.

1. Budget deficit – low [+], but still a deficit [-]

The planned deficit is -1.3% of GDP. On the positive side, it is by no means very large, especially when compared to the rest of the world. It is also well within the EU's limit of -3% and the Bulgarian limit of -2%. There is no danger to the country's indebtedness in the foreseeable future – low by any standards at some 15-18% of GDP (depending on how we take into account the old and the new Eurobonds). On the negative side, however:

- We are not impressed that the country has had deficits, albeit small-to-medium, in each of the years 2009-2013. This follows a decade when 3 governments had balanced budgets (1997-2003) or very large surpluses (till 2008). Running budget deficits is becoming a habit with consequences well known from Washington through Athens all the way to Tokyo. Let us remind you that we favour a balanced budget policy.
- The 2013 budget numbers seem too optimistic. The growth rate of 1.9% might not be achieved, while the planned revenues seem too high.
- The parliamentary elections are expected in mid-2013. Typically, every outgoing government tends to overspend before the elections, leading to a difficult Q4 after a new government is formed. Thus, we fear a larger-than-planned deficit for 2013, -2.0%.

2. Level of government spending – rising [-]

With its BGN32bn of expenditures, this will be the largest budget in the history of the country. While all sectors feel they deserve more funding, we would not call the current situation 'austerity'. At 38.8% of GDP, the level of government spending in 2013 will be higher than in all of the years since 2005. This reflects the lack of notable reforms in the public sector. The BGN32bn could have been spent more efficiently, had the pension system, healthcare, and the state administration been reformed.

3. Pensions are rising by c. 9.3% on average – a typical pre-election move

Traditionally, we have NOT been proponents of excessive pension increases. Not because we do not like the pensioners, but because:

- Pension spending rose from c. 8.3% of GDP in 2007 (a more sustainable level which we liked) to 11-12% in 2009 (an unsustainable level).
- The deficit of the National Insurance Institute (the first pillar of the pension system) has increased about 10 times in the last decade – dangerous for the public finances and for the economy in the long run.
- Unemployment is rising, while Bulgaria's demography is one of the worst in the world. The birth rate has deteriorated since 2009.
- In addition, the partial nationalization of c. 3% of the assets of the private pension funds (the second pillar) in 2010 set a bad precedent. Later, the move was declared unconstitutional by the Constitutional Court.

Is the 9.3% increase justified by an expected rise of social security revenues? No. Is the increase excessive? It depends on the point of view. Pensioners would consider a 30% rise insufficient. Reformist economists would have preferred a lower number.

In all the previous issues of *Expat Compass,* we supported the policy of *no increases or decreases* of pensions and public sector salaries since mid-2009. This is clearly a pre-election move, but the overall income policy during this mandate has been conservative. Not bad.

4. A new tax of 10% on interest from bank deposits – we strongly disapprove

Please see the articles on p. 17 and 23.

In order to secure higher budget revenues to fund the increase of pensions and other spending in an election year, the government surprisingly introduced a new tax on interest from bank deposits. While the rate is not excessive and is in line with the low flat 10% income tax rate in the country, we see the following problems:

- The new tax was introduced surprisingly, without any discussion, and after the Ministry of Finance had publicly said it was not considering such a move.
- Bulgaria has traditionally been one of the several countries in Europe with no tax on bank deposits. This has stimulated the propensity to save, has helped stabilize the banking system, and has reduced the interest rate margins.
- Now, the high growth of the level of deposits might be reversed. The banks might be pressed to extend fewer credits.

Overall, we expect the problems to exceed the planned budget revenues of BGN100-150mln in 2013.

While this government has managed not to increase the low tax rates in the country [good], it is the first government which has introduced a new direct tax [bad].

BULGARIAN ECONOMY OVERVIEW – GOOD MACRO STABILITY, LOW GROWTH

On the positive side, we have:

- No recession
- Very low public debt: 14-18% of GDP in recent years
- Budget surplus in Jan-Sept 2012
- Very stable currency board against the euro since 1997
- Improved external balances
- Stable banking system with the highest capital adequacy ratio in the EU: 16.7% Q1 2012
- Low or moderate inflation: +5% 2012E (Expat forecast)
- The lowest direct taxes in Europe: 10% on income and profits, 0% on capital gains

However, on the negative side we see:

- Low GDP growth: 0.8% 2012E (Expat forecast)
- Rising unemployment: 11.5% 2012E year-end (Expat forecast)
- FDI much lower than before 2008: EUR2.5bn 2012E (Expat forecast)
- The fiscal reserves have fallen since 2008, but have risen lately
- Boring capital markets – SOFIX down -83% since 2007, which presents an investment opportunity
- Relatively slow reforms (pension system, healthcare, education and science, privatization, concessions, capital markets)

We should also note the impressive achievements

Since 1997, Bulgaria might have set a few world records. Even if there is a country with a higher achievement, try to comprehend these facts:

- **Debt/GDP** fell from 303% in 1996 (possibly a world all-time high) to 13.7% in 2008. Compare this to the debt crisis elsewhere
- **Unemployment** fell from 19.3% in Feb 2001 to below 6% in mid-2008. Over 13 percentage points in 7 years
- **SOFIX,** the stock market index, rose >27 times in EUR terms and >40 times in US$ terms in June 2001 – Sept 2007
- The **current account** improved from a deficit of -25.2% of GDP in 2007 (probably the 3rd largest deficit globally) to a surplus in 2011
- **FDI** reached EUR9.1bn in 2007, 30% of GDP (probably number 3 in the world)
- **Direct taxes** are among the lowest in the world: 10% flat on profits and personal income, 0% on capital gains

EXPAT REFORM WATCH

In our view, most of the necessary reforms in Bulgaria have been stopped or significantly delayed. Namely:

1. Pension reform (--)

(-) A rare opportunity to reform the model was missed after 2009
(+) The retirement age is being increased…
(-) … but only slowly – by 4 months per year
(+) Pensions were not increased in 2010-2012 – brave and positive…
(-) … but will increase by 9.3% from April 2013 – pre-election

2. Healthcare reform (---)

(---) No such reform

3. State administration (+/-)

(+) The number of employees might have decreased a bit…
(-) … but we have not seen any official numbers – there might be no real decrease
(-) We do not consider the attempts to relocate some administrations away from the capital a 'reform'. We do not approve of this process

4. Education and science (-)

(-) Apologies, if we have missed something, but we do not remember any reforms after 2009
(-) The relations between the Bulgarian Academy of Sciences and the government have been tense and unproductive, but no real changes have been implemented

5. Privatization and concessions (-)

(+) Bulgartabac was finally privatized (although the buyer is unknown)
(+) As well as the minority stakes in the 3 electricity distribution companies
(-) Almost nothing else (energy, stock exchange) – disappointing
(+) A concession deal for the Port of Burgas
(---) Almost nothing else (airports, ports, railway stations, highways, water companies) – disappointing
(--) No notable public-private partnerships – disappointing

6. Traffic control (+++)

(+++) One of the few areas with major improvements since 2009. The number of casualties has fallen by 1/3 due to the: 1) somewhat better roads, 2) fear of the police, 3) more efforts by the police, 4) investment in technology, e.g. road cameras

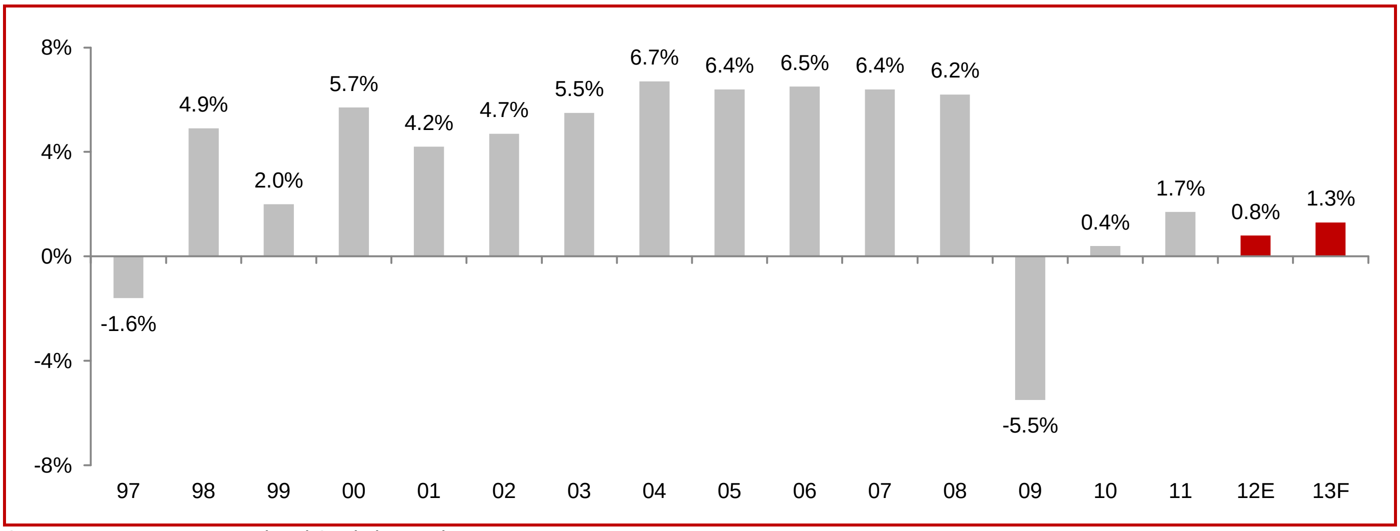
MACROECONOMIC INDICATORS

** The 2012 and 2013 data are Expat Forecasts and Estimates*

1. GDP Growth

After a decade of high growth, Bulgaria was hit by the crisis in 2009. Since then, growth has been positive but low. Our forecast for 2012 is +0.8%, and +1.3% for 2013.

Graph 1. GDP Growth, % of GDP



Source: BNB, Eurostat, National Statistics Institute

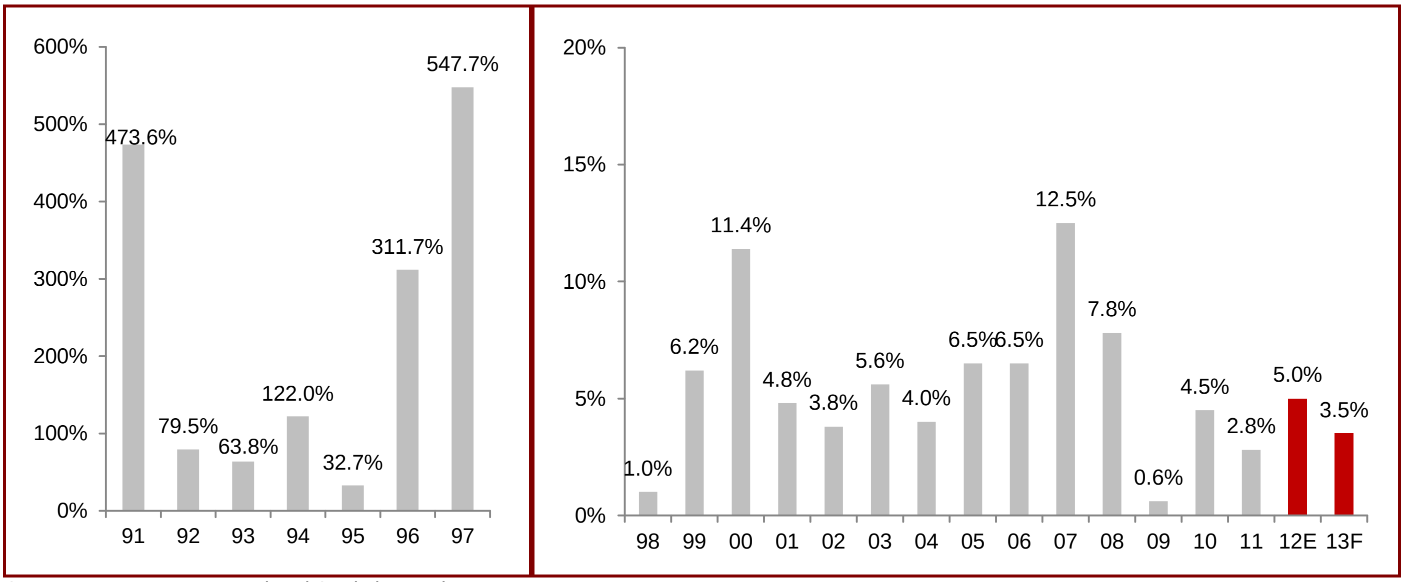
2. Currency

After the hyperinflation in 1997, the lev (BGN) was pegged to the DEM (now EUR) through a currency board which has worked well. Since then, the lev has been extremely stable, and we see no risks for the BGN/EUR exchange rate.

3. Inflation

Bulgaria had high inflation till 1997 but, with the currency board, it has been brought down. Lately, inflation has picked up due to rising fuel and food prices. However, with the fixed exchange rate, we are not worried about inflation, and our forecast for 2012 is +5%, and +3.5% for 2013.

Graph 2. Inflation Rate, %, Year-End

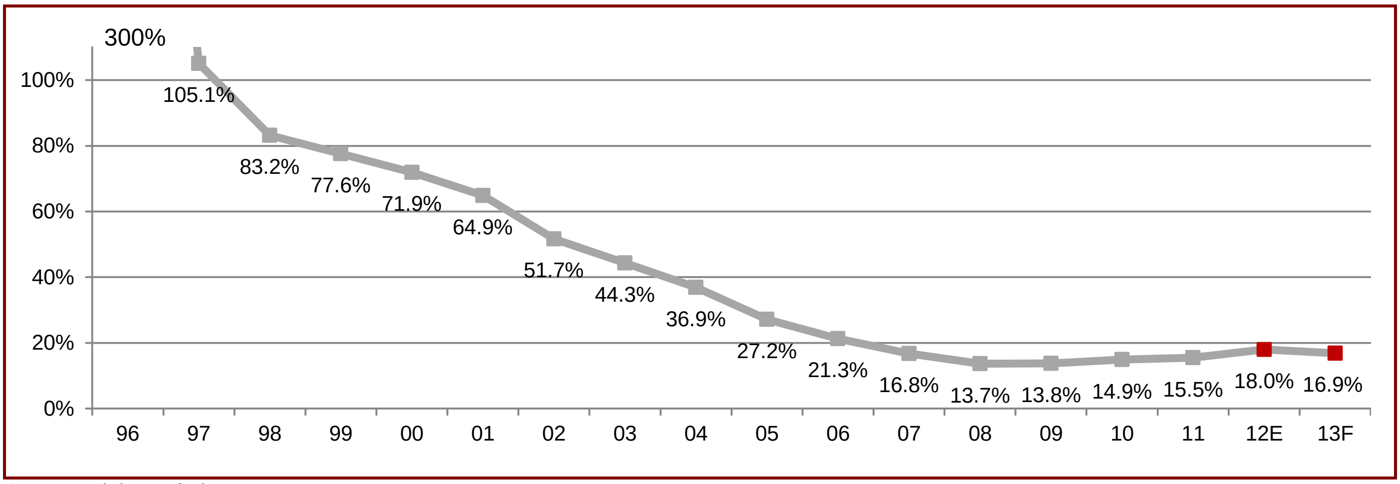


Source: BNB, Eurostat, National Statistics Institute

4. Public Debt

After a default in 1990 and a restructuring deal in 1994, Bulgaria has been a star performer since. In 1996, the debt/GDP ratio temporarily jumped to >300% due to the hyperinflation, the skyrocketing interest rates, and the low nominal GDP in US$ terms. Public debt/GDP has fallen from over 100% in the 1990s to 14-18% lately. A 5-year Eurobond for EUR950m was issued in mid-2012 at a low yield of 4.436%. This has increased the fiscal reserves. Later, the yield fell to around 3%.

Graph 3. Public Debt, % of GDP

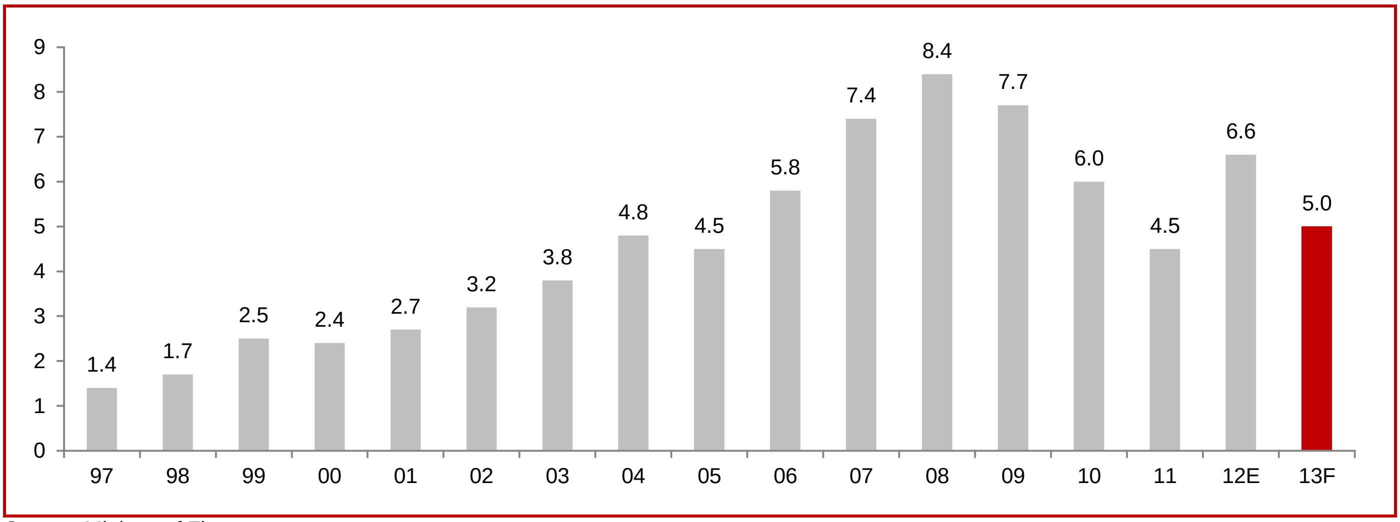


Source: Ministry of Finance

5. Fiscal Reserves

Fiscal reserves grew steadily from 1997 and reached a peak in mid-2008 at above BGN12bn. As the crisis hit, they started falling and reached a dangerously low level of BGN4bn in H1 2012 – due to the 2009-2011 fiscal deficits. The 2012 Eurobond has topped up the reserves. However, some BGN2bn will be used in early 2013 to repay the old Eurobonds. In our view, the level of reserves is low. In addition, due to the future fiscal deficits and the lack of privatizations, we do not expect it to rise.

Graph 4. Fiscal Reserves, BGN bn, Year-End

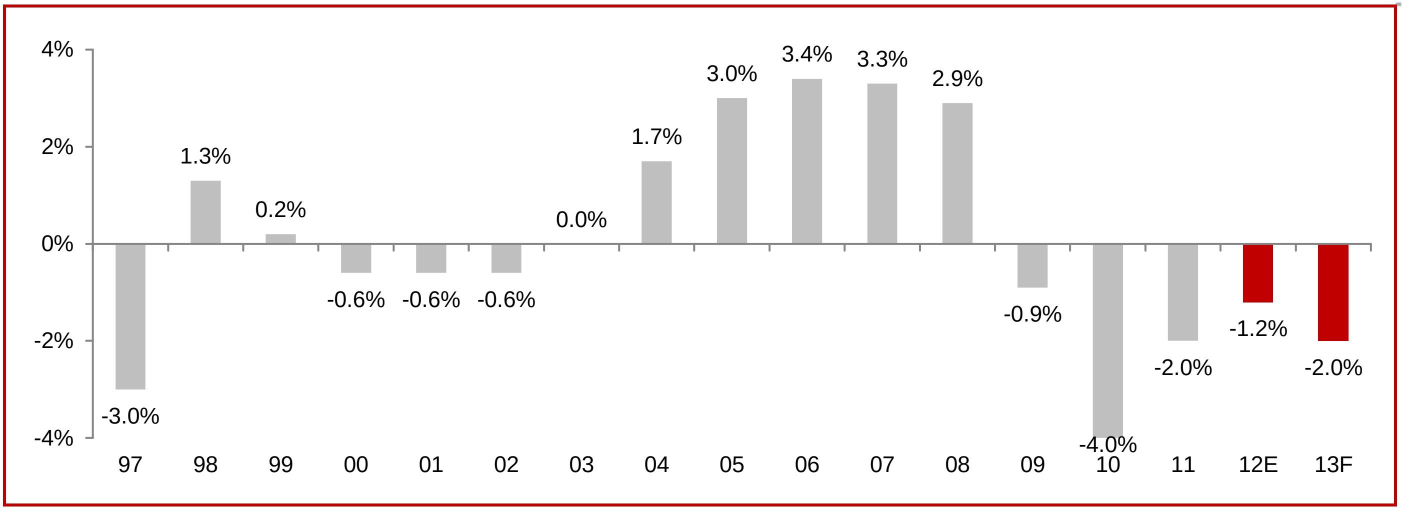


Source: Ministry of Finance

6. Budget Deficit/Surplus

Before 1997, public finances were a mess. With the currency board introduced in 1997, Bulgaria had low deficits or surpluses till 2003 (+/-1% of GDP). This was followed by years of high surpluses above +3%. Since 2009, the current government has allowed low deficits. However, we favour balanced budgets. On the positive side, there is a budget surplus for Jan-Sept 2012. We expect moderate deficits of -2% of GDP going forward. Again, we prefer zero deficits.

Graph 5. Budget Surplus/Deficit, % of GDP

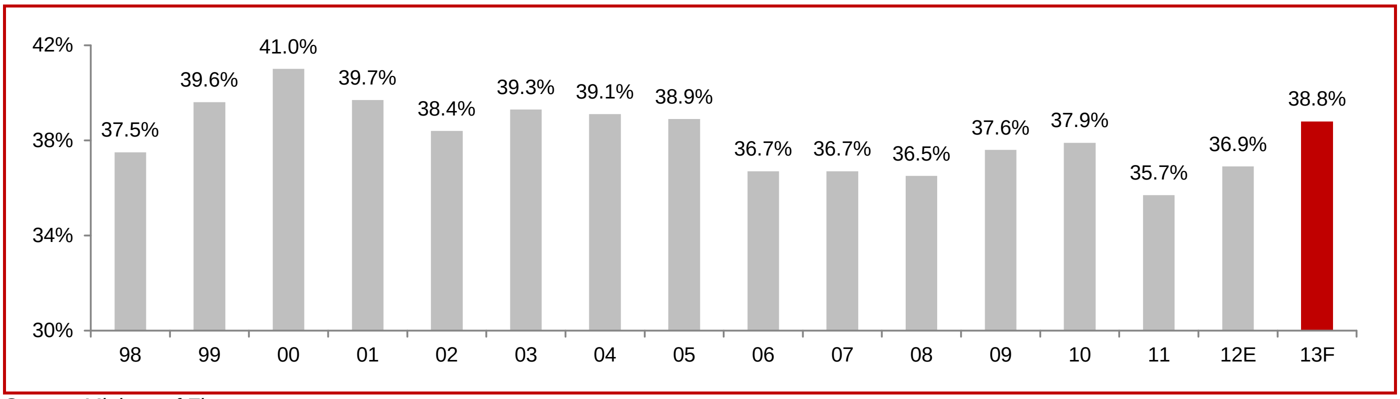


Source: BNB, Eurostat, National Statistics Institute

7. Public Spending

Traditionally after 1990, Bulgaria has had relatively low public spending as % of GDP. Combined with the low GDP per capita, this has resulted in a poor quality of public services. On the other hand, we favour the low-tax and low-spending policy as it benefits business and investment. It led to above-average GDP and income growth in 1998-2008. Spending as % of GDP recently reached a low of 35-37% – probably the lowest in the EU (good) but it is rising in 2013 to 38.8% due to the elections (not good).

Graph 6. Public Spending, % of GDP

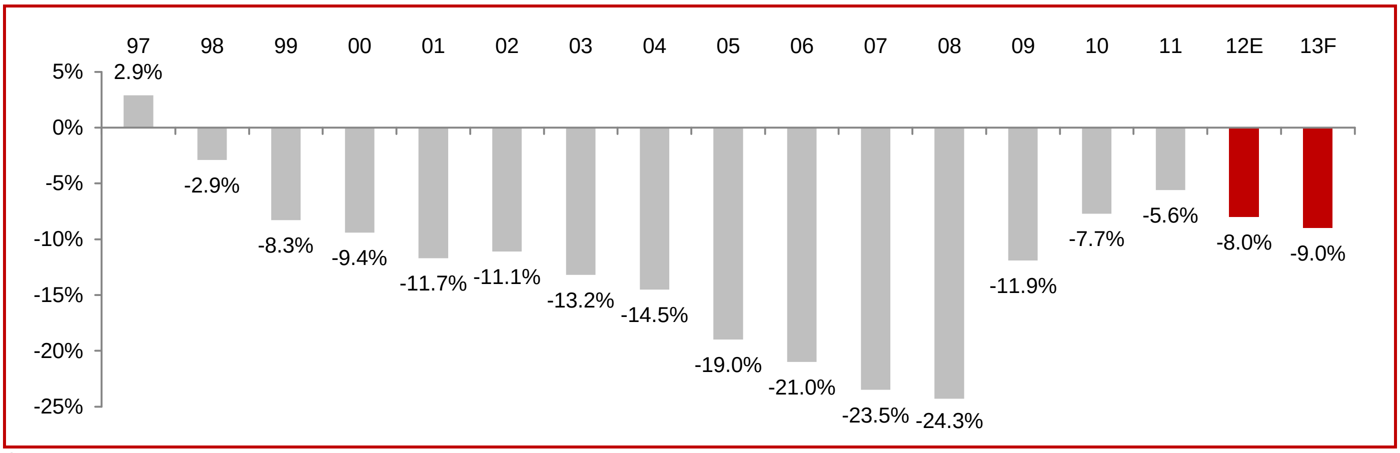


Source: Ministry of Finance

8. Trade Balance

Bulgaria was running very large trade deficits for a decade. The peak was in 2008 at -24.3% of GDP, or EUR-9bn. After the crisis hit, exports fell sharply, but imports decreased even more due to the fall in FDI-related imports of equipment, as well as due to lower domestic consumption. In 2010-2011, exports grew strongly, and faster than imports. This significantly reduced the trade deficit to more sustainable levels.

Graph 7. Trade Balance, % of GDP

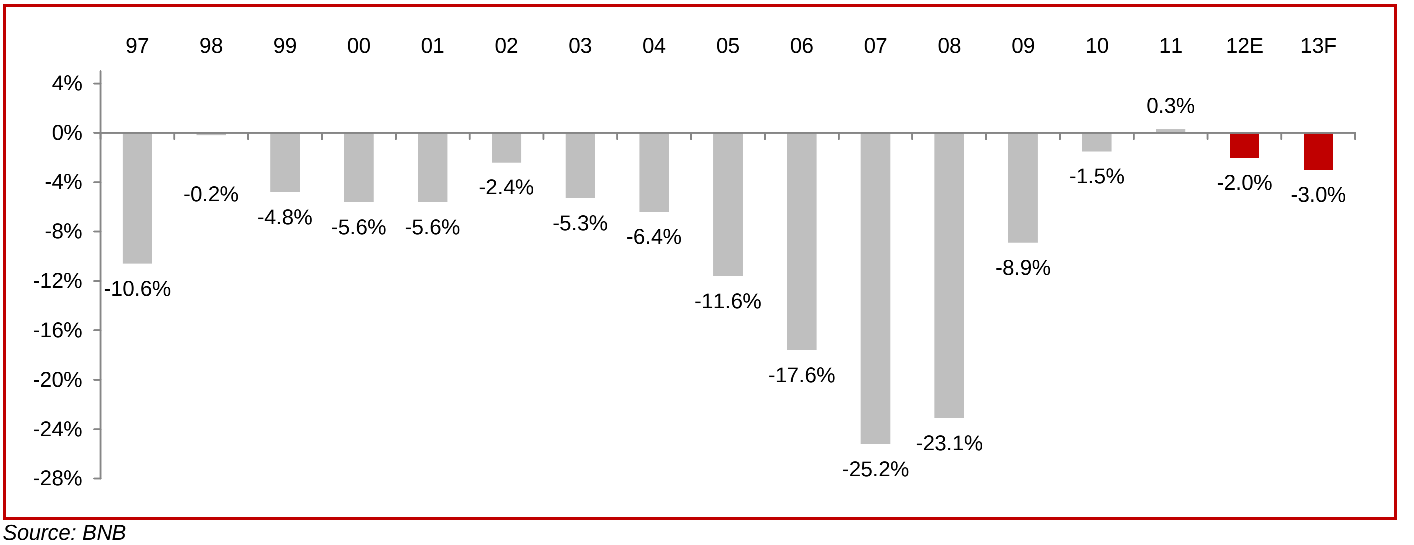


Source: BNB

9. Current Account Deficit

The conclusions are the same as with the trade deficit. The current account numbers are in the chart below. Please note the -25.1% deficit in 2007 (probably the 3rd largest in the world) and the surplus in 2011. A strong improvement.

Graph 8. Current Account Balance, % of GDP

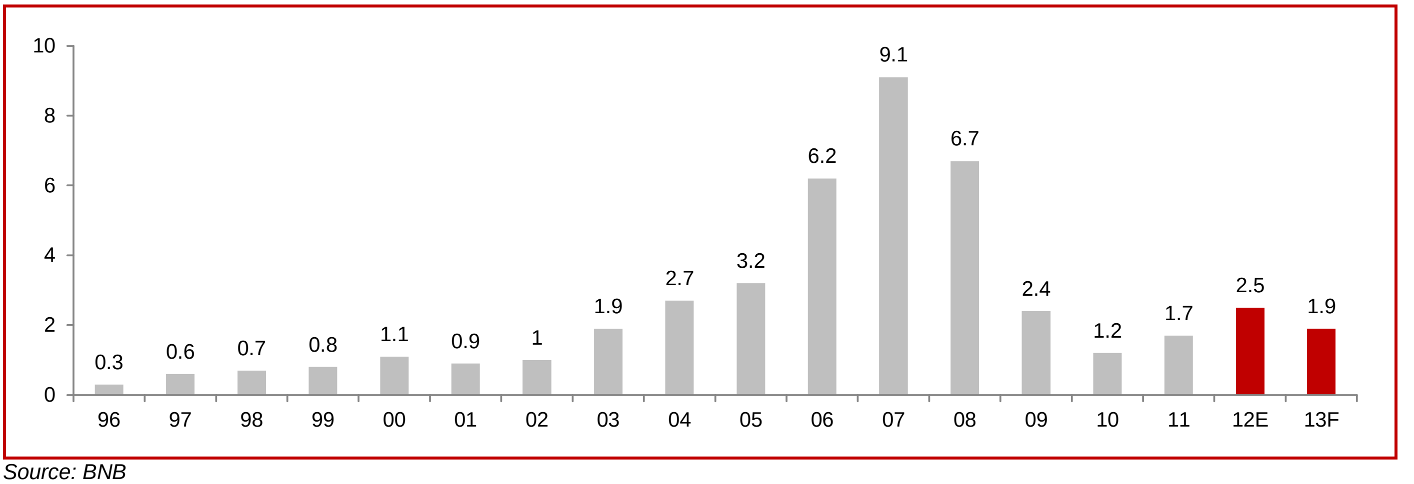


Source: BNB

10. Foreign Direct Investment

FDI was very low before 1997 due to the lack of reforms and partially due to the wars in former Yugoslavia. Then, for a decade, cumulative FDI was above EUR30bn – an enormous amount for this small economy. FDI peaked in 2007 at EUR9.1bn, or 30% of GDP. In terms of FDI as % of GDP, Bulgaria was a star performer globally for a few years. FDI dropped sharply after 2009 due to: 1) the crisis, 2) the not very friendly policies vis-à-vis foreign investors. Namely, investors in energy distribution, renewable energy, and private pension funds have been hurt by negative rhetoric and by unexpected regulatory changes. Not as much as in Hungary, though.

Graph 9. FDI, EUR bn

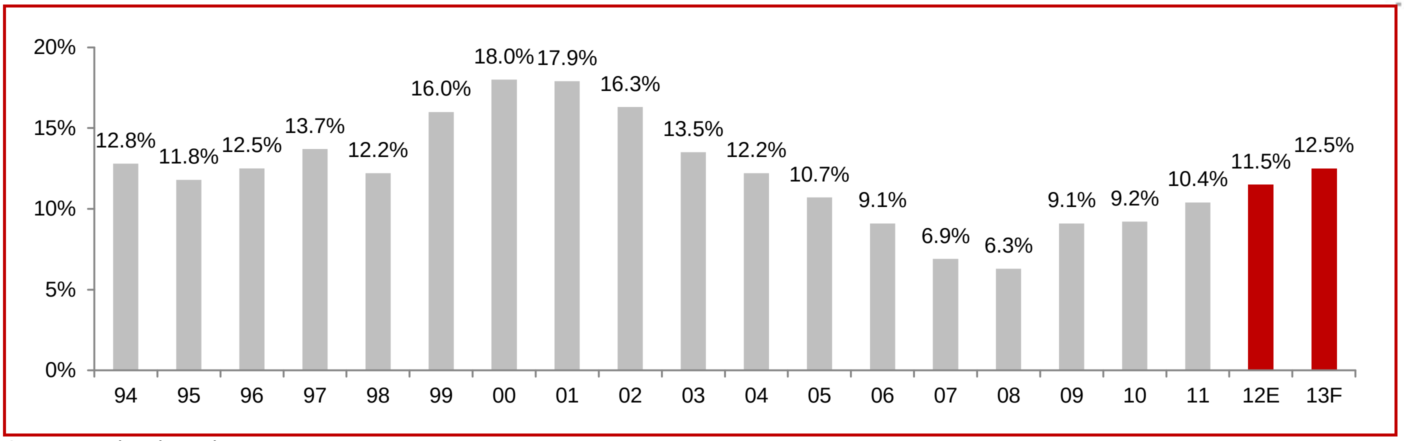


Source: BNB

11. Unemployment

Unemployment was high throughout the 1990s due to the restructuring of the old planned economy and the low growth, and peaked in early 2001 at 19.3%. From 2001 to 2008, it fell by 2/3 – probably a European record. There were several reasons: 1) a decade of high GDP growth and rising investment; 2) business-friendly policies, including moderate liberalization of the labour market; 3) low direct taxes and lower social security contributions. Since 2009, unemployment has doubled due to the crisis, and we expect it to reach 11.5% by end-2012 and to rise further by 1-2%. Please note that the reporting methodology of the Employment Agency has been changed in a way which makes the unemployment numbers look lower by at least 1 percentage point.

Graph 10. Unemployment, %, Year-end



Source: National Employment Agency

12. Direct Taxes

After a decade of tax reductions, Bulgaria has introduced the lowest direct tax rates in Europe. In our view, these low tax rates have been very beneficial for economic growth, for stimulating savings and investments. There is some danger that the Europe-wide disease of tax increases might contaminate Bulgaria in the future. Watch the mid-2013 parliamentary elections.

Table 1. Direct Taxes in Bulgaria

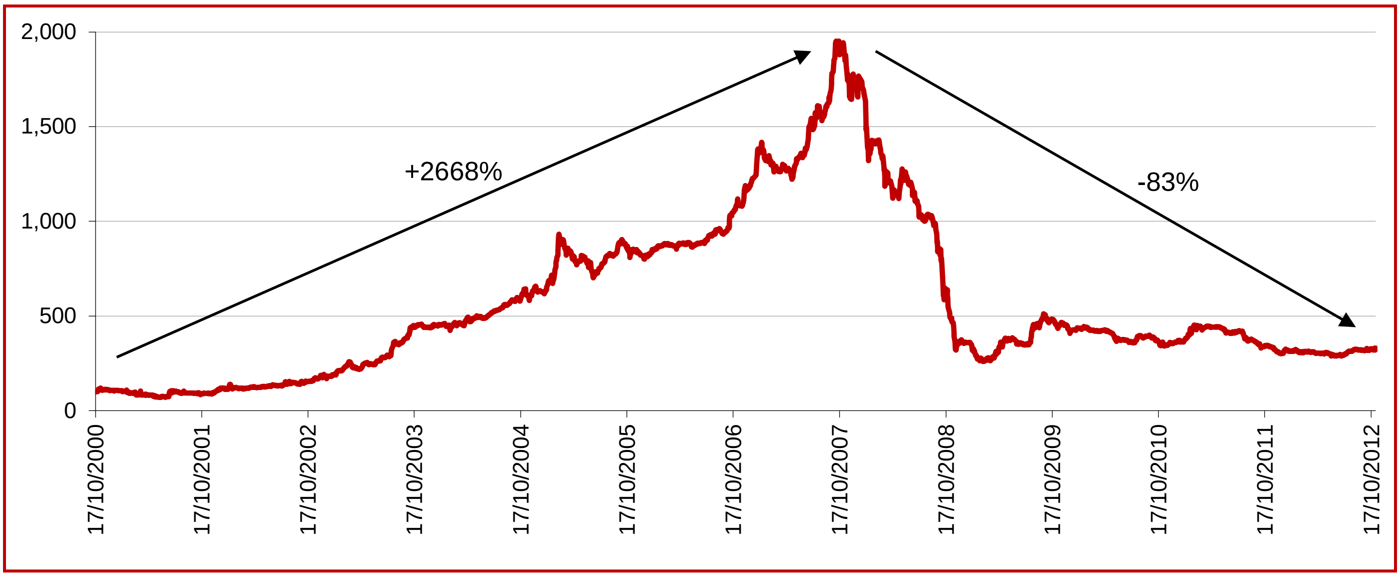
Flat personal income tax rate	10%
Tax on corporate profits	10%
Dividend withholding tax	5% (0% to legal entities)
Tax on the interest from bank deposits	0%. *Rising to 10% in 2013 – we disapprove*
Capital gains from stocks/bonds/mutual funds	0%
Profit tax for REITs (Real Estate Investment Trusts)	0%

13. Stock Market

The history of the Bulgarian stock market can be divided into 3 distinctive periods:

1. Before 2001: boring. Low volumes, falling prices
2. 2001-2007: SOFIX rose over 27 times in EUR terms, or over 40 times in US$ terms. Many new listings, high volumes
3. After 2007: back to the boring 1990s. Low volumes and prices. SOFIX has fallen by -83%. This presents a good opportunity for investments in undervalued Bulgarian equities.

Graph 11. The SOFIX Index



Source: Investor.bg

THE MYTH ABOUT 'THE PAST TIME'

NIKOLAY VALKANOV, IME

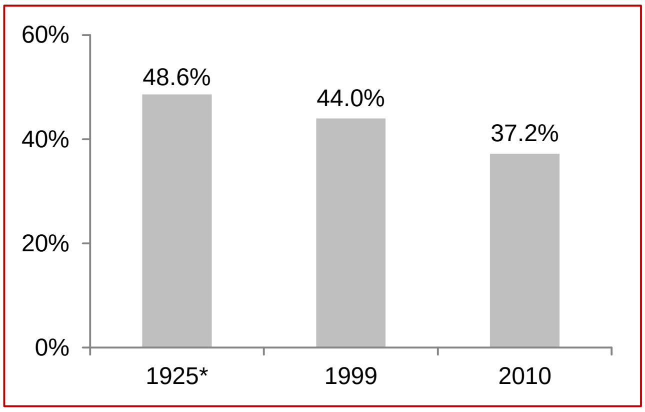
Nikolay Valkanov is an Economist at the Institute for Market Economics. He is currently working on a project analyzing the farming sector, sponsored by the America for Bulgaria Foundation. Prior to that, he worked as a business consultant for South East Europe Research Corporation, as well for the newspapers Capital, Pari, and others.

Nikolay graduated in European Studies from Sofia University Sv. Kliment Ohridski with Economics and Law majors.

This article was published in the newsletter of the Institute for Market Economics

In case you are tired of arguing whether the standard of living in Bulgaria is improving or not, following published data by Eurostat in relation to the GDP at purchasing power parity, we offer you an alternative view on the development of the country. It is not about income and prices. There are other indicators which measure the wellbeing of a society, and one of them is the budget of a household and the way it is spent. For that reason, let us take a look at the food expenditures as a percentage of the household budget and the change in the structure and the quantities of food consumption. We use data of the National Statistics Institute (NSI) about household budgets in 1999-2010 and in a randomly chosen year in the past – 1925. In fact, 1925 is the first year for which we found statistics for household budgets.

Graph. 12. Spending on food and nonalcoholic beverages as a percentage of the total household expenditures

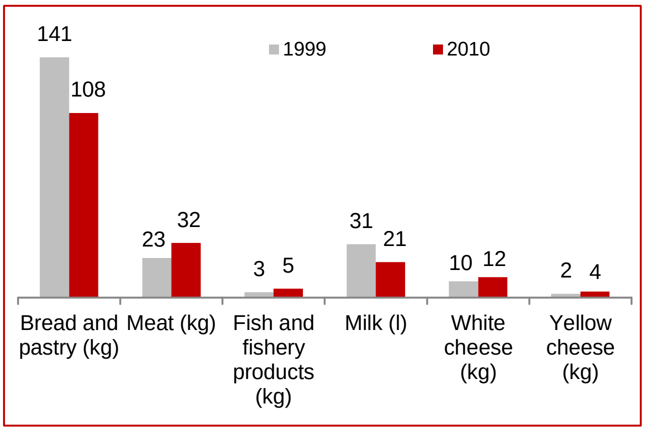


Source: NSI (National Statistics Institute)

** The data for 1925 are not totally comparable with the ones from 1999 and 2010. The reason is that the former ones are based on a sample of 691 households of civil servants, counting 3,143 members living in their own houses. 43.4% of the expenditures of households renting their housing was spent on food. The data for 1925 were rather representative for the urban population which formed 20% of the population of the country. In 2010, household expenditures on food were 36.4% of total expenditures.*

The decline in food spending as a share of the total household expenditures is one of the evident indicators for increasing the well-being of the households, when this decline is not due to price decreases. Regardless of the whole relativity of the comparison with 1925 (see the comments under the graph), the wellbeing of the urban households has been improving faster in the last 12 years, compared to the previous 74 years. A clear downward trend in the consumption of food high in carbohydrates can be seen, accompanied with an increase in protein-rich food consumption (raw and processed). Bread and flour consumption decreased by 23% and 33%, respectively, in 1999-2010, whereas meat consumption increased by almost one third. In general, we see a gradual switch to healthier and more nutritious food. There is a substantial increase in the consumption of fish (by 60%), poultry meat (by more than 75%), vegetables (by 18%), white cheese (by 25%), and yellow cheese (by 56%). At the same time, there is a steep decline in the consumption of canned meat, lard, bacon, sheep meat, hogget meat, goat meat, jams, and canned fruits.

Graph. 13. Consumption of some of the main products, comparison between 1999 and 2010



Source: NSI

In other words, Bulgarian households today eat much better food compared to 1999, spending a much smaller share of their expenditures on that.

However, if we take a look back at 1925, we may see a very interesting comparison which shows that the urban households consumed more meat and fish in that period than in 1999. 85 years ago, the general menu consisted of bread and milk. The consumption of rice and eggs seems to be fairly constant.

Table 2. Quantity of primary products consumed by households (average per person)

	1925	1999	2010	2010 – in cities
Bread and pastry (kg)	258.0	140.6	108.0	95.6
Rice (kg)	6.0	5.5	7.0	6.6
Meat (kg)	27.6	23.3	32.0	32.1
Fish (kg)	3.6	3.3	5.3	5.3
Milk (l)	50.8	31.4	20.9	20.4
White cheese (kg)	7.0	9.6	12.0	12.0
Yellow cheese (kg)	1.1	2.3	3.6	3.8
Eggs (number)	125.8	133.0	137.0	131.0

Source: NSI and own calculations of the IME

Let us take an alternative perspective on this topic. This time, we compare the purchasing power of the average salary/wage in the country in the selected years – 1912, 1925, 1972, 2010, to several essential food products. Those periods are chosen on purpose. 1912 because during that year the so-called 'Bulgarian economic miracle' from the beginning of the 20th century came to an end, and the period of wars started; 1925 because that year marked the pick of the economic boom after the wars, and shortly afterwards the economy fell into a new depression; 1972 as an approximate flourishing point of socialism; 2010 – the year in which the economic boom from the beginning of 21st century came to an end, and household incomes had already been affected by the current crisis.

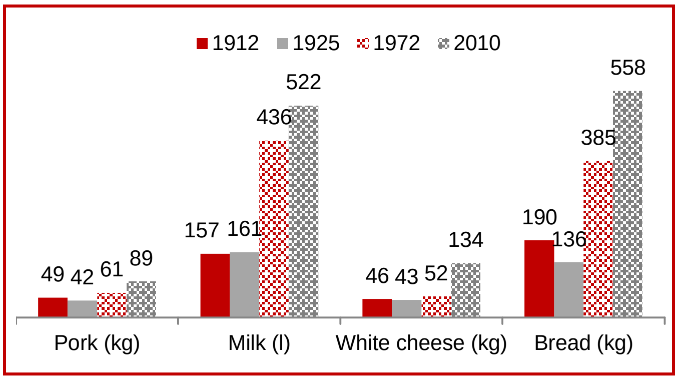
We use data from NSI for the average daily wages of workers in 1912 and 1925 equated to monthly salaries on the basis of 22 working days per month; the average annual salary in 1972 divided by 12; and the average monthly salary in 2010.

The purchasing power of the salaries is calculated on the basis of the average prices of four essential food products, assuming that the entire salary is spent on buying one of those four products.

Table 3. Average monthly salary in the country and prices of some primary food products, in BGN

Year	Equated monthly salary (BGN)	Pork (for kg)	Milk (for l)	White cheese (for kg)	Bread (for kg)
1912	55.0	1.1	0.4	1.2	0.3
1925	1,553.0	37.3	9.7	36.0	11.5
1972	131	2.1	0.3	2.5	0.3
2010	642	7.3	1.2	4.8	1.2

Graph 14. Purchasing power of the monthly salary, measured in basic food products



Sources: Statistical Yearbooks of the Bulgarian Kingdom, 1912 and 1925, Statistical Yearbook of People's Republic of Bulgaria, 1972; Average prices and quantities of essential food and non-food products purchased by households, 2001-2010, NSI.

The data shows that no matter which indicator is used (type of food product), several conclusions could be drawn in general:

- The growth of the well-being in the period after the World War I had already been not enough to compensate the lagging behind during the war period. In 1925, the purchasing power of the population was still below that of 1912.
- The socialist regime managed to provide a much higher standard of living in comparison with the Bulgarian Kingdom. The price of this improvement is another question which does not fall in the scope of the current article.
- The data clearly refutes the myth that the standard of living during the socialist regime was higher than it is today, even if we compare the flourishing years of socialism with the period of crisis and falling revenues which we observe today. Even if we exclude the white cheese as a measure (this would refute all kinds of attacks such as: 'Today white cheese is made of palm oil, whereas before it was made of real milk') and use only bread, milk and fresh pork meat as indicators, we still get a 20-45% higher purchasing power today compared to 1972.

THE HUNGER OF THE SOCIALLY WEAK PEOPLE

VLADIMIR KAROLEV, CFA

Vladimir Karolev is a Bulgarian economist with extensive experience in the field of privatisation advisory, mergers and acquisitions, business development, corporate finance. He is managing partner at Balkan Advisory Company. Previously, he worked for KPMG, Europa Capital Management, and the Bulgarian Post Privatisation Fund.

Mr. Karolev has a Master's Degree in Economics from the University of National and World Economy (Sofia), a PhD in Industrial Economics from the University of Chemical Technology and Metallurgy (Sofia), and an MBA from the University of Alberta (Canada).

The article was published in www.forumat-bg.com

The strongest argument against the leftist political wave in Europe is the cruel reality of the empty bank account. While we were all betting on which developed European economy will run out of money first, David Cameron did the impossible – concisely and in plaintext he justified his measures to reduce social spending with its counter-productivity. For example, fewer and fewer people have the motivation to find a job or to study, as they see their neighbours living a normal life, relying solely on social aid.

In the UK, the misunderstood image of the European social country had long ago reached scary dimensions. Prime Minister Cameron has pointed out that about 5,000-10,000 continuously unemployed people do not intend to search for a job and plan to live their lives by relying only on social aid. Approximately 400,000 low-paid or unemployed young people receive GBP90 per week in order to leave their parents' home without there being any reason for that. Great Britain spends twice as much as the Bulgarian annual budget to assist British people under the age of 35 to settle in private accommodations. A lonely parent with 4 children, paying rent, would get social aid amounting to GBP25,000. This is more than the resources which a working family of 2 economically active parents lives on. Anyone who has visited the UK knows that in that country there is a so-called 'mother' profession – women who plan to live at least half of their lives on social aid without working.

Solidarity under the social contract is supposed to establish a safety net which should catch the most vulnerable groups before they fall below the 'morally acceptable' standard of living. The richer a country is, the higher this 'morally acceptable' standard should be. But as Einstein said – everything is relative. However, it is obvious that a powerful social system as the British one is turning from a safety net into a comfortable nap hammock. Socialists would immediately argue that actually people do not become lazy, but they just do not have no job. Let us leave this cliché dispute for a while and take a look from a different perspective. Even if there are no jobs now, what happens when there are job opportunities?

The world in the 21st century is a 'bit' different than the one dating 2000 years B.C., when the majority of the work in ancient Egypt consisted of mechanically moving resources, be it in construction or agriculture. Even at that time there were crises. But after every crisis the Pharaoh just pointed at a new empty place and mobilized the workforce to move stones, to build temples, pyramids, agricultural warehouses, irrigation canals, etc. All the Egyptians just got down to work and started moving resources under the proficient surveillance of a handful of engineers. Things are a little bit different now. Today, the majority of jobs require skills which are not innate but acquired. Even if we assume that for the moment the people on social aid will not find a job, no matter how hard they are looking for one, their falling into deadlock and their passive waiting for Godot proves to be fatal for their abilities to find a job at any future point. That situation creates structural unemployment.

In other words, the 'sleeping' British people receiving social aid are not developing any skills and are not acquiring any new knowledge which could make them appropriate for a new job position when it potentially becomes available (here we still rely on the socialists' assumption that there are no job opportunities for the present). What would stimulate a young woman with several children to acquire new knowledge and skills when she feels more than comfortable with her social aid package? After a certain age, she will just continue receiving not family benefits but unemployment benefits, and afterwards a social pension. Meanwhile, she will always continue complaining that she does not possess the necessary knowledge and skills to occupy the offered job positions. Well, how can she get those skills? After all, we do not live in ancient Egypt where everybody who can carry stones could immediately find a job at a construction site or a cornfield.

And no, you are not the only one who thinks that the situation with the Roma people in Bulgaria is the same. No matter whether there is or there is no crisis, there are always no job opportunities for them, and they always receive social aid. Even if the job websites were full of offers, a Roma person would always tell you that there is no job. In fact, there could be a job, but especially for him – there is really none. The reason is that he is incapable of doing anything else than mechanically moving resources. He has even no stimulus to acquire new skills. The worse thing is that as the other people observe this lifestyle, they may not even ask themselves 'Why should I work like crazy, and they could live out of my taxes?', but would certainly ask 'Why shall I work like crazy, when I could live off somebody else's taxes as they do?' Long ago, Margaret Thatcher answered these questions, but, unfortunately, nobody heard her: 'The problem with socialism is eventually you run out of other people's money.'

THE GOVERNMENT LAYS WASTE TO RENEWABLES INVESTMENTS

SEBASTIAN NOETHLICHS, MANAGING DIRECTOR OF N-VISION ENERGY

Sebastian Noethlichs is Managing Director of N-vision Energy, the Bulgarian office of the renewable energy business of the Noethlichs family. Sebastian joined the family business in Germany full time in 2005. In 2007, he established N-vision Energy and moved to Sofia.

Sebastian is the first CEO of the Bulgarian Wind Energy Association. He is Member of the Board of the German Chamber of Commerce, where he also chairs the working group on energy. Prior to this, Sebastian was an electricity and emissions options trader for Goldman Sachs in London. He holds a Bachelor's Degree in Management from the London School of Economics.

The recent regulation amounts to retro-active tariff cuts which threaten the financial survival of the majority of all investments in renewable energy projects in Bulgaria.

Despite months of harsh anti-renewable energy rhetoric from the government, things had become calm over the summer in the renewable energy sector in Bulgaria. While sharp reductions in the electricity tariffs for future projects made sure that virtually not a single new wind or solar project has been connected since the July 1st, the owners of current wind and solar projects got to enjoy a summer of exceptional solar production and a very good wind yield. But this calm period of good returns on their investments, it turns out, was just the calm before the storm.

A loss a long time in the making

While renewable energy investors and the banks which financed their investments saw their business plans validated, trouble was brewing elsewhere. On July 1st, the energy regulator had hiked end-consumer electricity prices by the more-than-unpopular 13%. Though blame for the increase was squarely laid at the feet of renewable energies, it really was a necessary increase to address a structural deficit which has been undermining Bulgaria's electricity sector for years. With consumer prices – the lowest in the EU – below the cost of electricity generation from conventional and renewable sources alike, the national electricity company (NEK) had been piling up debt at an alarming rate.

By the middle of July, however, it appeared that as sharp and politically toxic as the consumer tariff increase had been, it was still not enough to cover the structural deficit. With another consumer tariff increase out of the question for at least another year – when it would be only months away from the next general election – and thus a solution to the problem out of sight, the problem was instead shifted from NEK to the three electricity distribution companies (EDCs): CEZ, EnergoPro, and EVN.

Until July, the EDCs collected income from the green premium on electricity bills, passed the income on to NEK, and NEK then redistributed the income to the EDCs and itself in proportion to how much renewable energy each of the companies had bought from projects connected to its grid. But, from July on, this straight-forward approach was replaced by a novel invention. Since then, NEK has still been collecting the income but redistributing it to the EDCs not based on their actual purchases of renewable electricity but on forecasts of expected installed capacity and production. The trick here is that these forecasts date from the beginning of the year, and one of the forecasts – EVN's – turned out badly wrong to the tune of underestimating the installed solar capacity by 400MW. That is half of all the installed solar capacity in Bulgaria missing from the forecasts.

The first one to go over the cliff?

Effectively, this means that NEK ends up redistributing only half of the green premium income that it collects from the EDCs, and it keeps the rest. As bizarre and effective of a short term fix to NEK's problems as this new methodology turned out to be, it caused panic among the EDCs and most of all EVN with its 400MW forecast error. EVN announced a loss of more than BGN80mln which it suffered in just two – very sunny – months from this new methodology. The loss, EVN complained, threatened the very survival of the operator of Bulgaria's second largest distribution grid. EVN's complaints were heard and, on September 14th, the regulator stepped in. Determined not to let EVN go over the cliff, the regulator, in a repeat of its earlier relocation of the structural deficit, took EVN's losses and dropped them onto renewable projects.

Retro-active tariff reductions up to 39%

Under the pretense of newly invented 'grid access fees' payable by renewables projects to the EDCs, the regulator retro-actively cut the feed-in tariff received by renewable energy projects. Since the middle of September, all wind projects have been losing a threatening 10% of their revenue, while solar projects have lost a devastating 20 to 39% of their revenues. By shifting the structural losses of the electricity sector as a whole onto its smallest component – renewables – the regulator is causing an unparalleled willful destruction of investment that undermines the economic foundations of the entire country.

Investors fight back

With the retro-active reductions in place, renewable energy investors are now fighting for the survival of their investments. Project loans cannot be repaid anymore – debt-service-cover ratios cannot absorb a 20 or 39% income reduction – corporate guarantees are being called, and in the case of many small investors property given as collateral is on the line. With billions of euro of investments on the line and more so with their own home on the line for many small investors, the Supreme Administrative Court has received hundreds of claims against the regulator's decision. The wind and solar associations alone gathered over 300 claimants for cases being heard in November. At the same time, the filing desks of the EDCs have seen lines form around the block of people filing objections and complaints. But while the immediate impact and damage inflicted on renewable energy investors must have been clear to the regulator and government, the full set of ramifications has drawn much wider circles.

Damage far beyond renewables

Since the regulator's controversial decision, the government has on all levels been hearing one and the same message: the retro-active change of investment incentives for renewable energy will have disastrous consequences for Bulgaria as an investment destination for all sectors, and it may tip the country's banking system into crisis. No less than fifteen Ambassadors from the EU, China, Korea, and Turkey told the government as much. The Chinese Development Bank, with over EUR400mln in renewables financing in Bulgaria, and the Japanese Bank for International Co-Operation have both threatened no less than the freezing of any future financing to Bulgaria until the matter is resolved.

Both banks are invested in Bulgaria in excess of a billion EUR each. They have been joined by the EBRD which has already sent its vice president to Bulgaria to take the government to task over the matter. And lastly, on the home front, the association of commercial banks in Bulgaria has joined the ranks of affected lenders. Its chairman – Levon Hampartzoumian, the head of UniCredit Bulbank and the biggest domestic lender to renewables – sees as much as BGN2bn of Bulgarian bank loans at stake, an amount sufficient to create a home-grown credit crisis.

A solution?

The enormity of the challenges of the electricity sector and the severity of the consequences of the haphazard steps by the regulator have been laid bare loudly and clearly. And the EDCs, the banks, and the investors seem eager to find and implement a sustainable solution. The government, however, with polls worsening and less than a year to go, seems to shy away from tackling the problem, leaving instead, for now at least, the regulator to hang. It remains for investors, banks, and anyone with a stake in the development of Bulgaria to hope that the message gets through to the government before the damage done becomes irreversible.

A DIFFERENT PERSPECTIVE ON THE DEPOSITS INTEREST TAX

NICOLA YANKOV, MANAGING PARTNER AT EXPAT CAPITAL

Nicola Yankov is Managing Partner and Chairman of the Board of Expat Capital. Between 2003 and 2005, he was Deputy Minister of Transport and Communications. Prior to that Mr. Yankov served as Deputy Minister of Economy (2001-2003). He has held a number of senior private sector management positions. Mr. Yankov has a BS degree in Consumer Economics from Cornell University, USA.

If we look beyond the political rhetoric and more calmly analyze the proposal for a tax on the deposits interest rates, it may turn out that the idea will not have the widely predicted apocalyptic dimensions. Moreover, in addition to the fiscal benefits, it may have a positive effect on economic growth. However, there are some ‘local’ features that must be taken into serious consideration.

The good news

In Bulgaria, the government and the central bank do not have lots of instruments to influence the interest rates in the economy. The Bulgarian National Bank cannot provide cheap (in fact, any) loans to the banks, neither does it have the resources or the practice to buy large quantities of government bonds from the market in order to pour liquidity. The Ministry of Finance traditionally has not taken any actions through sales or purchases of government bonds to influence liquidity and interest rates in the economy. The Ministry can easily raise interest rates, if it issues a large amount of high-yield government bonds, but it will hardly be able to reduce them in any way. There is a consensus among economists and the business community that in times of recession, interest rates should be reduced in order to stimulate investments, consumption, the capital markets, and thus induce growth. This, of course, has been practiced by all the central banks around the world for several years – or at least in the countries without a currency board system. In Bulgaria, there is a lot of political and public speaking about reduction of interest rates, but there have been practically no actions on that issue. There are attempts by representatives of political parties and government members to ‘intimidate’ the banks. These representatives make hints about withdrawal of state business from those banks who do not reduce interest rates, or warn about possible antitrust lawsuits against the major banks in the country. Such statements, however, meet the strong resistance of the Central Bank which, in addition to being a bank regulator, has recently been acting also as the main defender of the interests of the banking sector. Consequently, there are no actual results – there is no economical or legal mechanism that could bring the interest rates in the country down, and the public noise about the problem, expectedly, does not scare anybody and produces no results. Until now.

For the first time since the introduction of the currency board system in Bulgaria, the Minister of Finance is trying to interfere with the interest rates and the distribution of the capital flows in the economy through regulation (in this case through taxation). The proposal is simple, easy and cheap to administer. And, most importantly, it does not contradict the restrictions imposed by the currency board arrangement. In addition, there will certainly be some positive effects on the public finances. The tax on bank deposit interest (it is important to emphasize the word ‘bank’ because there have been taxes on the other types of interest income for a long time, and nobody has been complaining about that) is a measure with immediate economic effect – another important advantage over alternative methods of intervention that may take longer to produce results. Although it is an income withholding tax, it has the effect similar to an indirect tax – i.e. something that is only paid by the end-user of the particular good or service and not borne by the one who produces or sells it. This tax resembles the excise taxes on fuel and cigarettes, for example. It does not reduce the profits of the banks but takes value from the end-user – in this case the saver who has invested in a bank deposit. As any indirect tax, this one will also have a negative effect on the consumption of the taxed good or service – in this case, on investing in bank deposits.

Surely, no one would disagree that it is good to encourage people to save because the accumulated capital in Bulgaria after the period of hyperinflation is still insignificant compared to other developed countries. Neither would anybody disagree that it is good for the banks to have sufficient liquidity and access to financing. However, there are other not less important principles which are also hard to argue against. Bank lending is not at an adequate level, and the vast majority of Bulgarian companies – especially small and medium enterprises which should be the backbone of the economy and a priority for all political parties – have insurmountable difficulties in securing bank credit at the moment. Providing funding for many of those companies is not simply a matter of growth but a matter of survival. And their survival directly impacts the economic cycle of the country.

Banks have become more cautious and conservative after the surge of bad loans in their portfolios over the past few years. This, however, is rather a positive trend. Banks cannot be blamed that they want to reduce risk and stop losing money. The reason for the reduced bank lending now is exactly the overleveraging and the excessive risk-taking during the economic boom. Thus, many of the companies that had easy access to bank financing during those years preferred it over other forms of raising capital and got into serious difficulties during the crisis years. Bulgarian companies in general do not have enough equity and have too much debt. This is the main reason, besides the deteriorated environment and the reduced consumption, why banks are very cautious when lending money. Therefore, the way to increase bank lending is not to pour more money into the banks (in the form of deposits), as this will not lead to reduced risk and increased quality of the borrowers. The way is to take measures which will stimulate investments in equity. That is, part of the accumulated capital in the form of bank deposits, which will not be invested in the economy as corporate loans, should be invested in equity stock so that those companies would get bank lending easier afterwards. Then things will start falling into place.

Currently, the bulk of the local savings (although it is difficult to find serious studies on the subject) is in the form of bank deposits and a very small portion is invested in other capital instruments. This is not the case in the developed economies where the long-term savings of the people are tied through different products (mainly mutual funds, private pension funds, life insurance products, and personal investment accounts) to the capital markets, and to a much lesser extent to bank deposits. In order for the Bulgarian economy to be stronger, this should change. The statement that putting money in banks is good, but putting money into equities is bad, because people's money should only stay in banks, is shortsighted and wrong.

The lending interest rates will not rise because this tax is not an expense for the banks but for their customers with deposits. The deposit interest rates will not rise either because banks in Bulgaria nowadays have difficulties not in attracting funds but in finding quality borrowers to loan those funds to. Banks have excess liquidity caused by the increasing deposits they have to pay interest on. Those interest costs, in turn, cannot be compensated with interest income generated by performing loans. Therefore, the interest rates on deposits will fall in the long-term with or without a tax on them.

The interest tax effect will be similar to the effect of a minimum decrease in the interest rates because the economic benefits for the investors will slightly decrease, and this may lead to some changes in their future investment decisions. The tax proposed by the Ministry of Finance has a chance to slightly change the deposits-to-equity investments ratio. That would be good in the long term both for the banks (because it will progressively produce better-capitalized borrowers and will reduce the overall credit risk) and the economy as a whole. The measure will not harm the banks.

The horrific scenarios about massive withdrawals of deposits will not happen because: 1) the difference between 5.0% and 4.5% annual interest rate is not enough of an incentive for someone to terminate an investment, especially if a future general decline in rates is expected; 2) people in Bulgaria do not currently have many alternatives for small-size investments with a state-guaranteed principal (the average size of an individual's deposit in the country is below BGN5,000), and will not withdraw their money from the banks to put them in a pot or under the mattress, where it could be easily stolen, destroyed or just progressively devalued by inflation; and 3) this tax will not make people spend their savings on consumer goods because the propensity to consume more is influenced by completely different factors – inflation expectations, increased disposable income, optimism about the future, etc. – all things too far from the issue of new taxes.

It is unrealistic to expect a significant effect on the total amount of deposits in the banking system (currently, between BGN35bn and BGN40bn). Even if a small proportion (say, 5%, or about BGN2bn) leak towards alternative investment opportunities, that would cause a real financial revolution in a small country like Bulgaria, and would provide vitally needed equity capital to hundreds of small and medium business projects, that will gradually cause economic growth, reduce unemployment and pull the country out of the recession. Government spending does not have and cannot have such an effect. Increasing private investments (especially in the small and medium business segment) is what our economy needs right now.

The banking system statistics are quite accurate so it would be easy to measure the effect of the tax introduction in the next year. If it turns out that the effect on the overall amount of deposits is minimal at a 10% tax rate, then the rate may rise (to 20%, for example) in the next budget cycle, in order to mobilize revenues for the budget and indirectly stimulate the shift of households' savings to alternative instruments, including those related to the capital markets. This paradoxically may turn out to be the only policy undertaken by a Bulgarian government in the last eight years in support of the capital markets, despite the fact that the rhetoric of the Minister of Finance regarding other taxes on capital transactions does not suggest such initial ideas. The tax on bank deposits interest may prove to be the only possible regulator of capital flows under the conditions of a currency board system. It may not be bad if the government starts using this instrument to make real monetary policy.

The tax on bank deposits interest is not a tax on capital, such as the property tax, for example. It does not take away wealth from investors and does not redistribute wealth from one social stratum to another. In this sense, this is not a 'leftist' tax. A 'leftist' redistributive tax, for example, would be a one-time 10% tax on the value of the deposits over BGN1mln. This is not the case by far, and the tax on bank deposits interest is a small step to the right direction.

And now, the bad news

There are probably no more than 1,000 people who have significant amounts in bank deposits (let us say over BGN1mln) in Bulgaria. Besides being wealthy, these people probably have the best lawyers and tax consultants, and it is improbable that their bank savings are of problematic origin and from untaxed income. Most of them are hard-working and talented people who have built their own businesses over the years with a lot of hard efforts and a little bit of luck. However, after the introduction of the tax, banks might provide information about the account balances of all citizens to the tax administration, and, suddenly, these customers will be exactly the ones to focus the attention of the whole government machine. Hardly anyone doubts that if the Prime Minister or the Minister of Interior requests information from the Minister of Finance about the bank accounts status of a particular Bulgarian citizen, the latter will refuse to give the information on the grounds that it is a tax secret. Or that it will be very difficult to purchase from an anonymous tax official a USB drive with the bank balances of the wealthiest individuals in the country.

The question is what the result will be from this effective revocation of bank secrecy in Bulgaria. To be more precise, what would be the consequences not for a person with a BGN4,750 deposit with DSK Bank, but for someone who has BGN3,500,000 with UniCredit Bulbank, for example. The state of the judiciary and the law enforcement system in the country is still such that anyone can be accused of tax evasion, his reputation can be irreparably tarnished, and his business destroyed in no time, before he could defend himself and prove his innocence in court. And even if he could prove it later, he cannot recover his business reputation and his career (not to mention the attorney costs). The risk of criminal assaults and extortion or ransom demands on these is also not negligible. This is known both to the rich people in Bulgaria and those who will soon get information from the banks about the wealth of those rich people.

It will be naive to leave the fortune and the future of one's family at the mercy of Bulgarian bureaucrats and magistrates, or of malicious third parties. And most rich people in Bulgaria are not naive. There is no way for anyone, no matter how rich and powerful one is, to overcome the state machine, especially when one is targeted by it. There are many such examples, especially in countries like Russia. Therefore, it is normal to expect that those Bulgarian depositors who are the wealthiest part of society and the business elite will most quickly and painfully react through withdrawing their bank deposits and moving them to alternative investment channels.

After the introduction of the tax, banks might provide information about the account balances of all citizens to the tax administration, and, suddenly, these customers will be exactly the ones to focus the attention of the whole government machine.

The impact of these reactions on the overall level of bank deposits and for each individual bank remains to be seen. Whether this money would automatically go to other Bulgarian capital instruments is also doubtful, as these movements are not entirely voluntary and a product of a conscious decision but rather a result of circumstantial necessity. This will happen not because a 10% tax rate on deposits interest is high, but because the risk that these people would be exposed to is of totally different and more dangerous nature. This is not a financial risk that can be hedged. It is a risk that in certain cases could lead to 100% loss of not only the bank deposits, but of everything else those families own in Bulgaria as well. This is the political risk of our country which, in many respects, still stands somewhere between the European Union and the Soviet Union. In this sense, the bank deposits interest tax is not a good idea. Not in Bulgaria, not today. Not yet.

INVESTMENT OPPORTUNITIES IN THE BULGARIAN STOCK MARKET

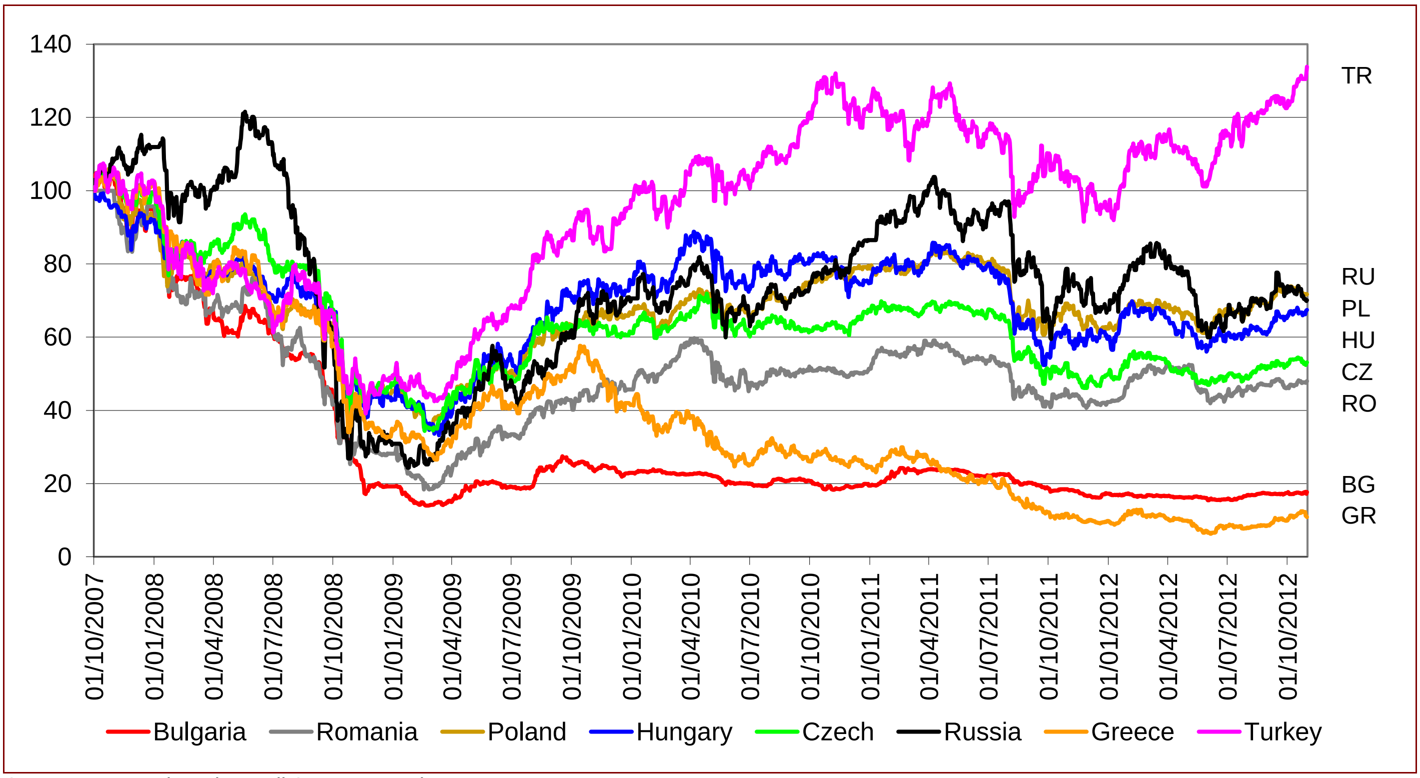
MARIA PANAYOTOVA, HEAD OF RESEARCH AT EXPAT CAPITAL

At Expat Capital, Maria Panayotova is responsible for the research on public companies, stock markets, and financial instruments. Prior to that, she worked as a Research Analyst at the Norwegian financial services company Edge Capital where she analyzed real estate companies in Germany, Switzerland, and Austria and issued investment recommendations for mutual funds and discretionary accounts. Her professional career in finance started in New York where she was an intern at Merrill Lynch Wealth Management and a summer analyst in Equity Research and Fixed Income Strategy at JP Morgan. Maria holds a Bachelor's Degree in Mathematics and Economics from Vassar College, New York. In 2008, she participated in an exchange program at London School of Economics. She has successfully passed the Level I exam of the CFA programme.

The SOFIX, the most widely followed Bulgarian stock market index, rose by 2668% between mid-2001 and October 2007, outperforming equity indices around the world. However, the spreading debt crisis drove investors away from risky assets into safer havens. This trend led to greater stock market losses in Emerging Europe compared to Developed Europe.

In the graph below, we show the performance of the major stock indices in Central and Eastern Europe since 2007, when all of them reached their peaks and subsequently declined with the deepening of the financial crisis. The SOFIX appears to be significantly lagging in its recovery compared to other regional benchmarks.

Graph 15. CEE Market Indices*



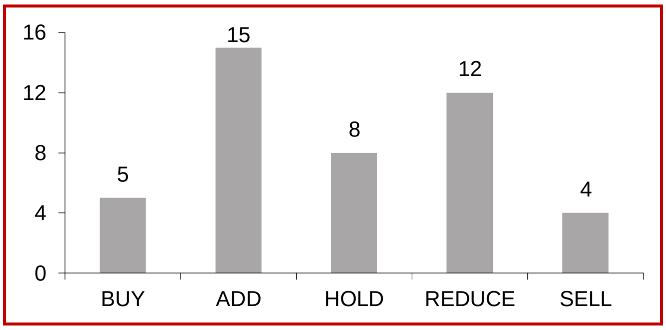
Source: Investor.bg, The Wall Street Journal

** Country stock indices: Bulgaria – SOFIX; Romania – BET; Poland – WIG; Hungary – BUX; The Czech Republic – PX; Russia – RTS; Greece – ATHEX; Turkey – XU100*

The Expat Research team has analysed the 44 largest and most liquid companies on BSE – Sofia, excluding the banking stocks. The cumulative market cap of these 44 shares is EUR1.16bn, or 17% of the overall market, as of November 2012. The group is trading at P/B of 0.47x and P/E of 8.22x (2012E). Overall, we think that Bulgarian stock market valuations are low but we do not recommend investing in all stocks and sectors across the board. We only like certain stocks.

We use a five-scale rating system and assign the highest rating BUY to stocks whose expected upside potential in the next 12 months is more than +25%. The most attractive companies are those with below-average P/B (Price to Book) and P/E (Price to Earnings) ratios, improving earnings, low leverage, and high quality of management. All of the factors for assessment that we use, with the exception of management quality, are objective. Our current rating distribution is slightly scaled towards the positive direction, as there are 20 out of 44 stocks with ratings above HOLD (Graph 16).

Graph 16. Rating Distribution (number of Companies)



The most attractive companies according to our valuation model are: Sopharma (3JR), Yuri Gagarin (4PX), Agria Group Holding (A72), Albena (6AB), and Albena Invest Holding (5ALB), all with a BUY recommendation. We further think that Bulland Investments REIT (5BD), Neochim (3NB), Bulgarian Real Estate Fund (5BU), Expat Beta REIT (E7P), and Advance Terrafund REIT (6A6) present a good investment opportunity at the moment (Table 4).

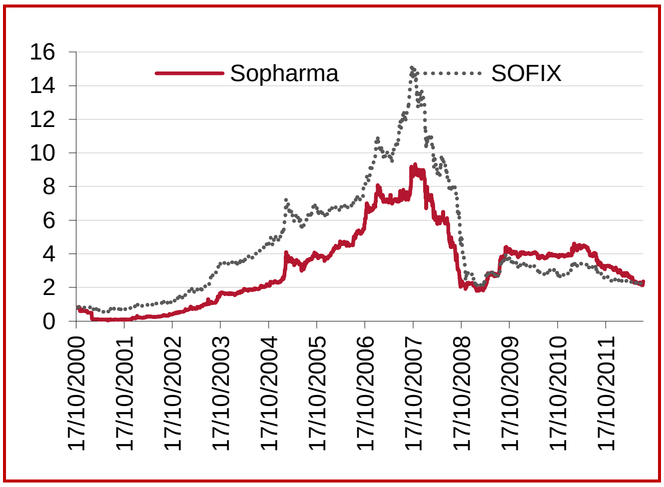
Table 4. Recommended Shares by Expat Capital

Company	Sector	Current Price (BGN)	Upside	2012E P/E	2012E P/B	Rating
Sopharma	Pharmaceuticals	2.22	35%	7.51	0.88	BUY
Yuri Gagarin	Paper & Related Products	24.50	30%	3.07	0.36	BUY
Agria Group Holding	Agriculture	3.02	30%	4.30	0.40	BUY
Albena Invest Holding	Real Estate	4.82	25%	17.35	0.25	BUY
Albena	Hotels & Resorts	40.00	25%	10.26	0.49	BUY
Bulland	REITs	0.97	20%	8.89	0.65	ADD
Neochim	Chemicals	28.00	20%	14.02	0.67	ADD
BREF	REITs	0.52	20%	21.92	0.42	ADD
Expat Beta REIT	REITs	1.10	18%	neg.	1.10	ADD
Advance Terrafund	REITs	2.16	15%	6.80	0.85	ADD

We briefly introduce the companies in which we see the highest upside potential in the next 12 months.

In our view, the recent sharp decline in the stock price of **Sopharma** presents a rare buying opportunity. The share price has fallen by -48% in the past 16 months, and the shares are currently trading at a P/E of 7.51x and P/B of 0.88x, while historically the P/E and P/B ratios have been around 12.0x and 1.6x, respectively. Our 12-month price target for Sopharma is BGN 3.00, which corresponds to a +35% upside. We think there are several factors that psychologically undermined confidence in the stock. Fundamentally, however, Sopharma remains operationally sound and profitable, and it is a matter of time for the share price to reflect that.

Graph 17. Historical Performance: Sopharma (BGN/share) vs. SOFIX

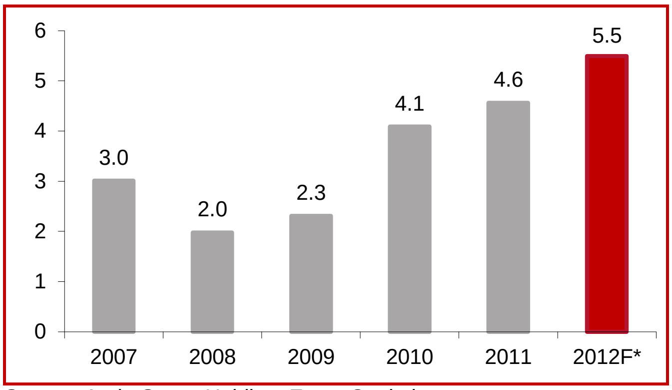


Source: Investor.bg

The share price of **Yuri Gagarin** is 25% lower than it was at the beginning of 2011 due to a change in the tobacco law which now forbids the production and sale of cigarette filter tubes. Only 22% of Yuri Gagarin's revenues come from this business segment. We think the current share price does not reflect the stability of the other company business lines and the potential relocation of the cigarette filter business abroad. Our rating is BUY, with a 12-month price target of BGN 31.85, reflecting an expected return of +30%. The shares are trading at a P/B of 0.36x, the lowest in five years. We have adjusted 2012 earnings downwards to reflect the income loss from cigarette filter tubes sales and still, the P/E ratio is attractively low at 3.07x.

The share price of **Agria Group Holding** has fallen near historic lows last seen in 2009, while the underlying business has improved. The company operates through 8 subsidiaries in the business of agricultural land development, production of high-quality milling wheat, its storage and sale. Its business has been expanding rapidly through steady investments and strategic acquisitions. Agria Group's profits have been rising for the last 4 years, surpassing pre-crisis levels, and are up a total of 131% from their low point in 2008 (Graph 18). In our view, the prevailing market negativity, the high debt-to-equity ratio, and the no-dividend policy are the reasons for the share price decline. While the price has fallen, however, the scale and quality of the group's business have improved. Our model shows an attractive upside potential of +30% in the next 12 months.

Graph 18. Net Income (BGN mln)



Source: Agria Group Holding, Expat Capital
** Expat Capital forecast*

We think the shares of **Albena Invest Holding** are strongly undervalued. The current P/B ratio is 0.25x, one of the lowest in our Bulgarian coverage group. Albena Invest Holding has a diversified portfolio, consisting of 15 companies in 6 sectors. Diversification is quite valuable in challenging economic times. The company earnings remained positive in every year after 2007, except for 2010. In 2012, we expect them at BGN0.7mln, unchanged from 2011. We think the shares offer a good opportunity for a short-term capital gain. We recommend buying Albena Invest Holding and exiting the position at a price level of BGN6.03, which would imply a return of +25%.

Albena is the biggest hotel company in Bulgaria and is focused on seaside tourism. It owns and manages over 40 hotels, restaurants, balneological and sports centres. The company has assets of EUR241mln, as of June 2012. The current market capitalization is EUR85mln. The share price has fallen by 33% in the past 12 months due to expectations of a weaker summer season. The company already announced unconsolidated earnings for the first nine months of 2012 which showed a 57% annual increase in net income. The results indicated that fewer tourists visited the resort but the spending per tourist increased. Also, the costs per tourist were reduced significantly. In our view, the positive development should affect the share price in the next 12 months. We expect tourism in Bulgaria to develop favourably in the medium term. The shares of Albena are currently trading at a P/B ratio of 0.49x. Our targeted price for Albena is BGN50, which indicates an expected return of +25%.

In conclusion, 2012 seems a good moment to reinvent the Bulgarian stock market which has been severely punished by investors since 2007. While most of the other markets in the region have doubled since 2009 (Turkey has tripled), Bulgaria has been boring and flat. One day, probably after a government change next year, the market could even double from its current levels without a change in fundamentals at a corporate level. It is all a question of sentiment. The same happened a decade ago. The market was boring and neglected between 1997 and 2001. Then, with a government change it skyrocketed. The same might happen again. It would be good for investors not to miss out on such a development.

THE HAZARDOUS GAME WITH THE TAX ON BANK DEPOSITS

NIKOLAY VASSILEV, CFA

In September, the government first proposed and 24 hours later abandoned the idea to introduce a 10% tax on interest from bank deposits. In October, the Council of Ministers surprisingly accepted the introduction of the new tax. There are two big damages from these actions. First – the idea itself is nonsense. And second – the way it is done is not appropriate.

The zero tax has helped the financial system

Bulgaria is one of the few countries in Europe which has never had a tax on interest income. I do not agree with the idea that we need to introduce such a tax because it exists in other countries. In France, the maximum income tax rate is suggested to be 75%. Should we copy that, too? In Bulgaria, the zero tax rate has contributed to the stability of the banking system and has stimulated savings which are vital to the whole economy. I have always been against taxing deposits. The damages will far outweigh the benefits.

What will be the generated revenues?

In a static world where depositors simply pay the tax, the revenues will be, say, BGN150mln. With the reduction of interest rates, this amount will decrease. The Ministry of Finance would say: no matter how much the amount is, it is still above zero, so the tax is worth it. However, the side effects would be dangerous because the world is not static. What do you think will happen to the amount of bank deposits? Many people would hardly feel stimulated to save money in banks because they will not want to pay a tax, or because deposits will not be advantageous. Others will send their money abroad, including to exotic destinations. Foreign citizens have quite sizable deposits in our country now. What will happen to them?

Why do we need more revenues? Are we taking them from the right people?

If someone believes that the 'budget pizza is vegetarian', i.e. small, I disagree. The expenditures planned for 2013 of nearly BGN32bn are the largest amount ever in the history of the country. It is 38.8% of GDP – even the previous government was spending less during the golden years of the global economy, while the current government was supposed to decrease this proportion. I think it would be proper to reduce expenses through reforms in the public sector, rather than to look for new sources of revenue.

If it is about getting more revenues for the Treasury through increased controls and anti-smuggling measures, that is OK. This way, the burden would fairly fall on the offenders. Savings, however, are one of the most important factors in the economy. They support the banks. They finance credits and investments, and create stability. The whole global crisis in the recent years was caused by the high amount of credits and the lack of savings. If we introduce a tax on interest, we will take money from the people who save in order to spend it on those who do not save. Let me remind you that most of the pensioners also have bank deposits.

What will happen to the banks and the interest rates?

Insufficient bank lending is one of the main problems of the economy. With the new tax, we will strike an additional blow to banks and loans: the amount of deposits is likely to decrease; in order to partially minimize the effect, banks will have to compensate the new tax by increasing interest rates; then, the interest rates on credits will increase, too – woe to manufacturers; and, if there are no new deposits, there will be no way to find money for new loans. These trends are the opposite of what we need.

It is strange to say that 'money from deposits will flow into the economy'

When money is in the banks, is it out of the economy? We are probably forgetting the money flow: deposits – loans – investment – production, etc. If it is not good for the money to stay in deposits, why do we not just remove this instrument and 'pour all the money into the economy'? It is more likely, however, that money will 'pour' to foreign economies where at least the risk of unpredictable changes in the business environment looks smaller.

Should the non-banking institutions be happy?

I have heard colleagues from the financial sector welcoming the introduction of a tax on bank deposits because in that way more money would be invested in stocks, bonds, mutual funds, pension accounts. That may be so, but malice might also be short-lived. It would not be a surprise if these instruments got taxed, too. *I will stop here because I do not want to give any bad ideas…*

Let us not forget that all non-bank financial institutions, in one way or another, also work with banks. They make deposits; invest in companies with bank loans. The banking sector is not isolated, and it is more likely for the whole business environment to worsen additionally.

The image of the country, the success of the economy, and even of an individual company depend primarily on trust – in institutions, in the normal environment, in tomorrow. The image is very difficult to build and easy to destroy. Bulgaria had just introduced some of the lowest direct taxes in the world, which undoubtedly gave good results prior to the crisis and will again after the economy recovers. It would be foolish to start raising taxes now and destroy the confidence created.

Tax policy should be stable and predictable

The government constantly proposes new and often harmful suggestions for changes, and later on abjures them. 'Well – some would say – there is nothing wrong in probing the public opinion with different proposals and implementing only the good ones.' But is it that simple? Imagine what would happen if the Ministry of Defense proposed an attack against a neighbouring country and officially drew back on the following day. Or if seismologists predicted a major earthquake and later denied it. Or if a big bank announced bankruptcy and later it turned out to be a bluff. Or if President Obama resigned and then said that it was a mistake… We may only guess what the consequences would be, but they would not be harmless.

WHERE WILL GROWTH COME FROM?

NIKOLAY VASSILEV, CFA

We know the formula from the economics textbooks:

GDP = consumption + investment + net exports + government spending

This is where the frequent recipes for growth by politicians and populists come from:

1) Let us stimulate consumption by raising incomes
2) Let us have larger budget spending
3) Let us force banks to make more loans at lower interest rates in order to stimulate investment

These medicines are not working with the current debt and budget crisis in the world. Just the opposite, exactly these wrong medicines caused the crisis. It is like curing a dental caries with chocolate. Look at the US, Japan and most of the European countries – in the last decade, their governments were spending recklessly, incomes were rising faster (Hungary is an excellent example). Then, why did things get this far? For the last four years, there have been record budget deficits in the world – why are we not coming out of the crisis? Because the treatment is wrong. A coffee before an exam would help, but ten cups of coffee would lead to a more serious problem – this time a health problem. Similarly, large government spending could be a short-term solution for achieving growth, but long-term deficits lead to colossal debts which cause cataclysms.

In the boom years, banks were lending more than it was reasonable. Now, they have a large number of bad loans – both because of their own mistakes, and because of the failure of the same business people who expect more funding today and who are angry with the 'bad' banks.

The real problem is the lack of trust

The economy does not need artificial stimulation of consumption but restoration of the lost trust.

- Investors do not believe in the governments' will to reduce budget deficits and national debts
- Business does not believe in the future of the tax system and in the profit opportunities
- No one has illusions about the transparency of public procurement and the speed of the legal procedures
- No one is sure about her/his job and future income
- Banks do not believe that most projects will be successful, and, thus, do not extend loans
- Nobody believes in the generous pension systems, meanwhile everyone is afraid of the worsening demographic processes
- Neither the euro, nor the yen, nor the US dollar seem a safe haven – there is no currency which we can run to
- Not to mention taboo words such as wars, conflicts, natural disasters

Another formula for growth – to restore trust

The formula should not be copied from François Hollande's preelection programme – deadly high taxes, common European bonds, a European pseudo-credit agency, and nobody knows what kind of measures to boost growth at the expense of stability.

In the current situation, Bulgaria needs some orthodox (i.e. classical) reforms and actions: 1) macroeconomic stability (available), 2) low direct taxes (availible), 3) good business environment (no improvement), 4) working capital markets (worsening), 5) reduction of inter-company indebtedness (there are no ideas), 6) more effective legal procedures to protect the creditors and not the debtors, 7) more privatizations and concessions, better management of the companies still owned by the state (none), 8) attraction of concrete investments and completion of major projects (none).

1. Macro stability

I recommend the prohibition of budget deficits to be written in the Constitution, preferably in all the countries on the continent. This may be politically painful, but it will lead to a great improvement in trust – raised credit ratings and reduced interest rates. Here, the glass of the ruling party is half full. The Minister of Finance's idea to restrict the deficit to 2% is better than the situation in Greece, but the correct solution is not to have any deficit at all.

The currency board has been working perfectly for 15 years now, and it should simply not be touched.

2. Keeping the low direct taxes

We have the lowest direct taxes in Europe, which, thank God, this government has not raised (except for the tax on interest from bank deposits to be introduced in 2013). And the low direct taxes are one of our few competitive advantages.

3. Business environment and competition

There has been no significant simplification of regulatory regimes since 2005. Public procurement is not more transparent. The competitive environment in entire sectors such as media and fuel is not favourable. Bulgaria has shamefully fallen down in global rankings such as the perception of corruption, economic freedom, competitiveness, freedom of the media. This fact and the generally poor image of the country do not encourage Bulgarian or foreign business to invest here. The opposite, more and more successful Bulgarian businessmen are selling their business and moving abroad with their families.

4. Capital markets

The situation is as sorrowful as it was in 2000. The government is not listing enough shares of large companies, the private sector is not active. Most Bulgarian companies do not need loans which they cannot and should not get. They need shareholders' equity but they cannot attract it either from the Stock Exchange or from the investment fund industry which is also in a poor condition. Zero ideas from the government.

5. Inter-company indebtedness

We have to act quickly on this topic, otherwise, for many years, we will have to deal with inherited issues instead of developing new projects. This happened in Japan – after the burst of the real estate bubble in 1990, for two decades Japan has been fighting with bad credits and cannot come out of the recession and deflation trap. For this period, the Japanese have been catastrophically overtaken by booming China.

Companies need fresh resources but in the form of equity capital. In Bulgaria, the government and the municipalities do not pay on time and are part of the problem. Triangular or polygonal schemes could be invented in order to clear the obligations. Securitization of the obligations is also possible (conversion into tradable instruments – bonds or shares). But, apparently, not during this government's mandate.

6. Court procedures

If you are collecting your receivables in court, I am not sure in how many years you will succeed. The same applies to insolvency and liquidation procedures. The speed of emblematic criminal cases is often a topic for discussion, but the commercial cases are hundreds of times more. Yet, there is no will for change.

7. Privatization, concessions, management of state companies

During this term, progress is disappointing. What is happening with Sofia Airport, Bulgarian State Railways – Freight Services, the Bulgarian Stock Exchange – Sofia, the whole energy sector? I doubt there is still anyone who has illusions that the railways, the post company, the energy sector, or the hospitals will make any progress in the hands of the state – torn between the mismanagement by the politicians, populism, and the lack of investments. In the last 20 years, growth has come from the private sector. The public sector mainly keeps accumulating debts.

Let us hope there will be no significant bankruptcies.

8. There are no major projects

Our government is like an exhausted cinematic team which produces some films (in fact, when it comes to 'movies' and media performances, we are the best), but nothing worthy of an Oscar. This mandate will not be remembered for any significant business project, leaving aside the undeniable success with the highways. It is easy to spend public resources, but it is difficult to attract private investments. Until 2008, Bulgaria was a record holder for investments as % of GDP, now the decrease is very steep.

The 'tango' with Belene is a typical example of helplessness and indecisiveness. New hundreds of millions have been spent since 2009, we got embarrassed in front of the Russian partners so many times, and yet, there is still no NPP. And this decision may again not be final.

The list could go on

More active steps to stimulate exports and tourism are necessary. The picture with the EU funds is clear – the more, the better. The pension model should be changed in the direction of reducing the pension expenditures as % of GDP. Savings (incl. for pensions) and investments in securities and in businesses should be stimulated. Consumption (such as cars and appliances) should not be a priority for its own sake, because it would simply increase the trade deficit. It will grow on its own, if there are more private sector investments, more jobs, and increased confidence in the future. We are falling behind in education – especially in higher education, science, and innovations – all these topics are being constantly repeated, but no action has been taken.

We need vision and direction

The current government has not destroyed many of the achievements of the past but it has no brilliant success stories either. In sports, as well as in the economic competition among countries, one of the ways to move forward is when the others fail and fall behind. At least, Bulgaria has no debt crisis and no deep recession. However, we have a lack of good management ideas and determination. In an election year, one would hardly have the courage to sit on the dentist's chair. We would rather be fooled with a piece of chocolate.

A FAIRY TALE ABOUT THE REFERENDUM

NIKOLAY VASSILEV, CFA

In one family, the parents argued for a long time whether to buy an apartment in a building under construction or not. The wife supported the deal because she knew the buyer well, while the husband was sometimes against, sometimes for it, but the family friends never understood his arguments. On several occasions, they paid the builders a large downpayment, but after each payment they continued to hesitate whether they were making the right decision and they did not want to take responsibility for their children and grandchildren. And so life was passing by. In the end, they decided to gather the family council, so that all the members would make a collective decision. They asked the following question: 'Shall we ensure the future of our family by buying this apartment?'

- The daughter Ani was going to vote For because she liked her future pink curtains
- The grandmother Penka was also supporting the purchase because her neighbour Maria told her that it was a good idea
- The aunt was Against because as a habit she was always against the opinion of Grandma Penka
- The grandfather heard on TV that real estate investments were always profitable, so he was For
- The father was Against because he had to find the money for the deal, which was not an easy task at all during those times
- The mother was For because she hoped that her cousin's company would be hired for the finishing works
- The father's brother – an economist working at a housing construction company – was probably the only one in the family who was competent on the subject but nobody wanted his opinion. He decided not to participate in the referendum because he did not understand the question. He did not have information about the parameters of the deal, and without them what was he supposed to base his decision on?

Still, the uncle participated in the discussion and stated:

- If the price is 400 euro per sq.m, let us buy it, but if it is 1,400 euro per sq.m – it is not advantageous
- If we can count on the neighbours (who would be our partners) – let us do this, but if they are not reliable, it is better to give up
- If the loan is with an interest rate of 3%, it is worth it, but if it is 12%, it is not

Eventually, with 4 votes For, 2 votes Against, and 1 abstention the family council gave green light for the purchase. But then the problems appeared. The seller started to get greedy and doubled the price because he knew that after the vote there was no way back – the deal would happen. Bad neighbours appeared but it was already too late. At last, the uncle started to think what would happen if, despite the family decision, they refused to buy the apartment. How much would they lose from all the deposits paid so far, and who would pay the price for the changed decision?

Let us multiply the woes of this family 100,000 times and we will get the case of the nuclear power plant Belene.

When is it reasonable to have a referendum?

The referendum would be appropriate when a clear question with answers of only Yes and No could be posed. The topics of the referendum should be more global, strategic and a question of values, not technical. For example, questions about NATO and EU accession, revoking the death penalty, the form of government. Inappropriate questions would be whether pilots should land more steeply or more gradually; whether doctors should operate for over or under 4 hours (without clarifying the type of the operation); and whether the national football team should play more defensively or not.

The wide public cannot be competent on medical or aviation matters. Even if we spend whole days watching movies such as 'Airplane' and 'House, M.D', we would not be able to learn how to fly a Boeing 747 or to distinguish bird flu from multiple sclerosis. Even if we observe arguments among doctors for months, we would still not be able to decide whether they should do a heart surgery or not. Then why ask us exactly?

It is ostensibly different with football. Everybody is a 'specialist' and shouts in front of the TV. But how to answer Yes or No when it is not the same thing if the opponent next year is Germany or Andorra?

Are we more competent about nuclear energy than about medicine?

If you think that you are, then answer the following questions:

- What distinguishes the VVER-type reactor from the recent French developments? What about the Czech and the American ones?
- When was the last time you entered a nuclear power plant?
- What is the temperature in the reactor, and what is the voltage of the electricity produced? If you err by less than two zeroes, then you are on the right track…

Probably, only a few thousand people in Bulgaria know the answers, but I, just like most of the others, am not one of them.

Are we competent about investments?

This is like with football – everyone is somewhat an expert. But how many people in the country have made a (successful) investment of 10,000 euro? Or 10 million? What about 10 billion? How many people know how to evaluate a pastry shop with a 20,000 levs turnover, not to mention a nuclear power plant worth 6 zeroes more? How many people know what IRR is? What about NPV? I know these things at least. But having in mind that most people do not, then how will they vote at a referendum where some will say that no one loses money from energy (which is not true), and others will argue that we are signing a blank check (which may be true)?

I do not know how to vote at such a referendum

In order to make a competent and responsible decision, I have many questions, including:

- Who will be the investor? If it is the state – I am against it. If it is a leading (western) company from the sector – I am for.
- What will be the state's share? I would like only the private investor to take the risk.
- Where will the nuclear fuel come from, and will there be more than one supplier?
- Where will the radioactive waste be stored?
- Will there be guarantees for purchasing the electricity, for how many years, and at what price? I would prefer there not to be any of these.
- How much will the plant cost, and how will the construction be financed? If it is 20 billion euro, I am against.
- How much will the electricity cost? If it is more expensive than solar power, I am against.
- In which century will the plant be completed? I have the right to ask because the construction started 31 years ago.
- Will there be seismic or radiation risks?
- What is the opinion of the Prime Minister and the ministers, if there is any?

The whole saga with Belene is an embarrassment for the country

My questions about Belene are more than the answers, but there are few things I am certain about:

- It is not normal that for several decades Bulgaria has not been able to make a clear decision whether to build this plant or not. The blame falls on a dozen governments.
- It is not reasonable that we have spent hundreds of millions more during this government's mandate, and, in the end, we still do not have a nuclear power plant. Then, why have we spent it?
- Why are we making such fools of ourselves in front of the foreigners?

Apparently, this government, too, is incapable of making the right decision and defending it. That is why, they are passing the ball around to the parliament and the people. Since many would not feel prepared to make a decision without enough information, the result of the referendum would depend on Ani's pink curtains and Grandma Penka's neighbour. Obviously, there is no pilot in the plane, but we will have to pay the bill with eleven zeroes.

EXPAT NEWS

MR. NIKOLAY NIKOLOV BECAME ASSOCIATED PARTNER AT EXPAT CAPITAL

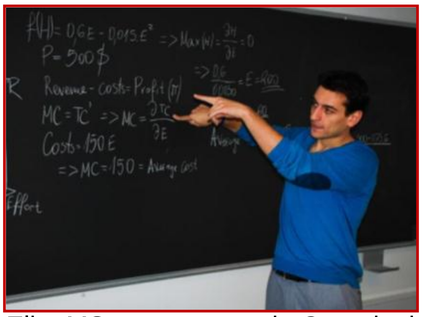
Effective September 2012, Mr. Nikolay Nikolov has joined Expat Capital as Associated Partner.

Prior to joining Expat, Nikolay had been involved in the inception and development of a number of start-up businesses. Since 2009, Nikolay has been focusing his efforts on originating, funding and developing renewable energy projects in South East Europe, as founding director of Island Renewable. Nikolay is a former Executive Director and board member of Mobiltel AD, Bulgaria's leading mobile telecommunications company. He oversaw the leveraged buyout of Mobiltel in 2004 by a large group of renowned private equity investors among which Citigroup Venture Capital, ABN Amro Capital and Sandler Capital for a total consideration of EUR1.2bn. Mobiltel was further sold to Telekom Austria in 2005 for an Enterprise Value of EUR1.6bn. Nikolay is a former Deputy Minister of Transport and Communications, a former member of the Bulgarian parliament and Board Chair of the incumbent fixed line telecom BTC.

Nikolay serves as a board member on a number of small technology businesses. He is also Chairman of the Supervisory Board of the Bulgarian Wind Energy Association.

Nikolay is an Economics and Business Administration graduate of the American University in Bulgaria. He was on the Board of Trustees of the American University in Bulgaria for 6 years.

EXPAT CAPITAL'S INTERN BORIS GEORGIEV WITH A WORLD AWARD



Out of more than 50 participants from different universities around the world, Expat Capital's 2012 intern Boris Georgiev took second place in the 2012 Best Undergraduate Paper competition.

In the prestigious international competition organized by the International Atlantic Economic Society, Boris presented his paper on 'Implications of Public Debt on Economic Growth and Development' written under the supervision of Professor Nabanita Gupta from Aarhus University, Denmark.

Boris interned with Expat Capital in the summer of 2012. He holds a BSc in Economics and Business Administration from Aarhus University and enrolled in the Elite MSc programme in Quantitative Economics at the same university. As of today, he is also a Teaching and Research Assistant at the Department of Economics and Business of Aarhus University.

Expat Capital's team is proud of Boris's performance and wishes him the best in all his future endeavours.

THE TEAM

THE EXPAT COMPASS TEAM

Authors:

Nikolay Vassilev, CFA
Managing Partner, Expat Capital

Nicola Yankov
Managing Partner, Expat Capital

Maria Panayotova
Head of Research at Expat Capital

Guest Contributors:

Nikolay Valkanov

Vladimir Karolev

Sebastian Noethlichs

EXPAT CAPITAL

1000 Sofia, Bulgaria
96A Georgi S. Rakovski Str.
E-mail: compass@expat.bg
Tel.: +359 2 980 1881
Fax: +359 2 980 7472
Web: www.expat.bg

Editors and Translations:

Natalia Dimitrova, PR & Advertising Manager, Expat Capital

Maria Divizieva, Managing director at Expat Group

Maria Panayotova, Head of Research, Expat Capital

Viktoria Rangelova, Executive Assistant, Expat Capital

Boris Georgiev, Intern, Expat Capital

Dimitar Bogoev, Intern, Expat Capital

Konstantin Dimitrov, Intern, Expat Capital

Design:

Natalia Dimitrova, PR & Advertising Manager, Expat Capital

Economic Data:

Nadezhda Gogova, External Expert