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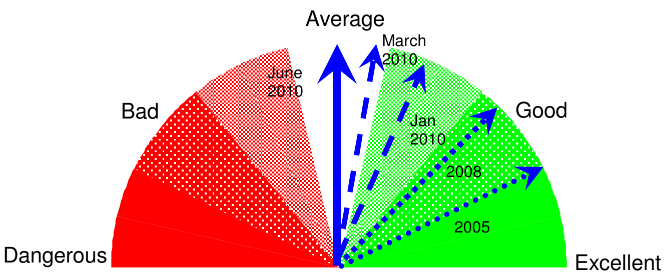
EXPAT CURRENCY BOARD WATCH



OUTLOOK: WORSENING FASTER THAN EXPECTED

Our proprietary indicator – the **Expat Currency Board Watch** (page 2) – summarizes in one chart our views about the lev/euro exchange rate. In this issue, **we are moving the pointer leftwards again, i.e. in the negative direction** due to the rising budget deficit and the falling fiscal reserves.

SVETLA KOSTADINOVA:

A SIMPLE, CLEAR AND FEASIBLE IDEA FOR BULGARIA'S PENSION SYSTEM

At the center of the new pension system is the individual who should be able to plan for his/her retirement, and thus have a greater responsibility.

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INITIAL COMMENT

In this third issue of the Expat Compass, we are moving the arrow of the Expat Currency Board Watch leftwards, i.e. **in a negative direction again.** Two months ago the reason for the downgrade was the high budget deficit in January and February. This time there are two reasons. First, the government has abandoned its priority to join the ERM II and the Eurozone. Second, the government is now amending the 2010 budget to allow for a significantly larger deficit and for a lower fiscal reserve. In our view, the necessary deep spending cuts are not likely to take place, with some positive but insufficient exceptions.

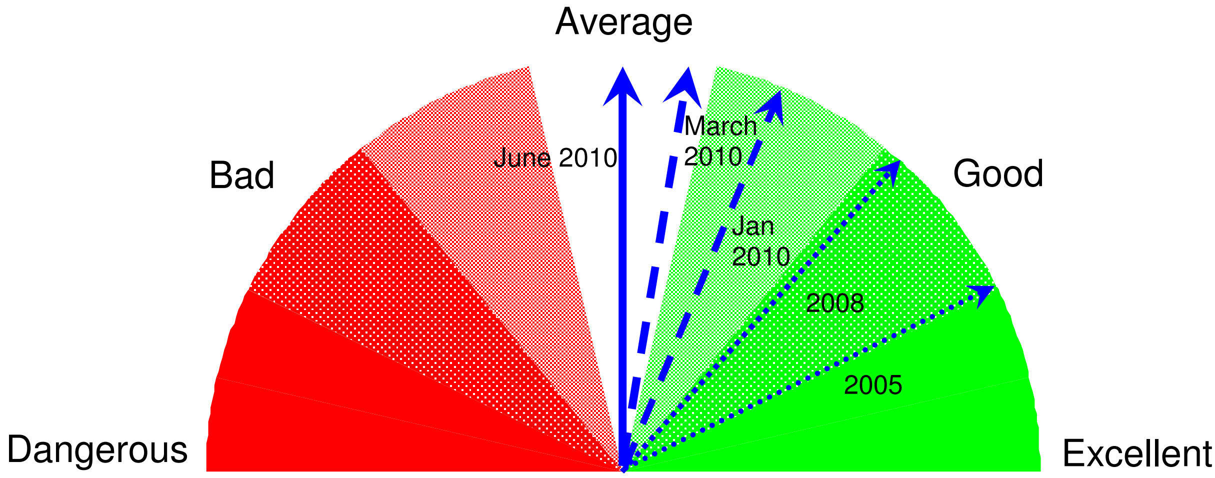
On the one hand, there is still no immediate danger for the stability of the currency board. The country could survive without major reforms and with the fixed exchange rate by eating up its reserves and/or taking on new debt. On the other hand, we are more worried about the lack of political will to start the unpopular but necessary reforms of pensions and healthcare, as well as by the lack of privatization and concession deals.

On page 8, we ask the *Question of the month:* If the government has a choice to reduce pensions or to abandon the currency board, what will it do? We do not provide a definite answer… See also the article about pensions on page 9.

The economy shows an unimpressive picture. There have been some positive readings in the exports growth, industrial production, and unemployment numbers. The budget numbers have been better in the second two months, which should be considered a success. However, Bulgaria is still deep in recession, and foreign capital is not flowing in.

EXPAT CURRENCY BOARD WATCH

OUTLOOK: WORSENING FASTER THAN EXPECTED



When we first published the Expat Compass on 4 February, we got some angry comments about why we did not give three green pluses to the government's commitment to the currency board and why we gave one red minus and a 'Not much' assessment of the support of the European institutions. We were also asked why the European Commission was mentioned there at all, as it should not have anything to do with the Eurozone. We disagreed, as we felt and still feel that whether a country joins the Eurozone is also a political decision – look at the case of Greece.

Well, the April events explain our caution. The government revised the 2009 budget deficit from -1.9% to -3.9% on an accrual basis (the deficit is much lower on a cash basis at -0.8%, the lowest in the EU) and surprisingly dropped its ambitions to pursue an entry to the ERM II and the Eurozone soon. This is why we are taking away one of the pluses.

As a result of the Greek crisis, the European Central Bank has more urgent priorities than accepting Bulgaria into the ERM II and later into the Eurozone. This is why we are adding a second minus there.

ISSUE	OLD	NEW	COMMENTS
I. Political issues			
1. Does the government support the currency board?	++	+	Yes, but less so
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	--	--	Deficit, rising very fast
5. Budget spending	--	--	Excessive
6. Government debt	+++	+++	Very low
7. Foreign liabilities of the private sector	--	--	High
8. Fiscal reserves	+	-	Expected to fall further
III. Economic cycle related issues			
9. GDP growth	--	--	Recession
10. Inflation	+++	+++	Low
11. Unemployment	-	-	Stable, seasonally falling
12. Strength of the banking system	+	+	Good but worsening
IV. External balances			
13. Current account deficit, trade deficit	-	-	High but falling
14. Foreign direct investment	+	---	Negative **for the first time**
15. Revenues from international tourism	+	+	Moderately high
16. Foreign exchange reserves	++	++	High

Legend: Good (green) Bad (red)

ANALYSIS

I) OUR VIEW ON THE ERM II AND THE EUROZONE

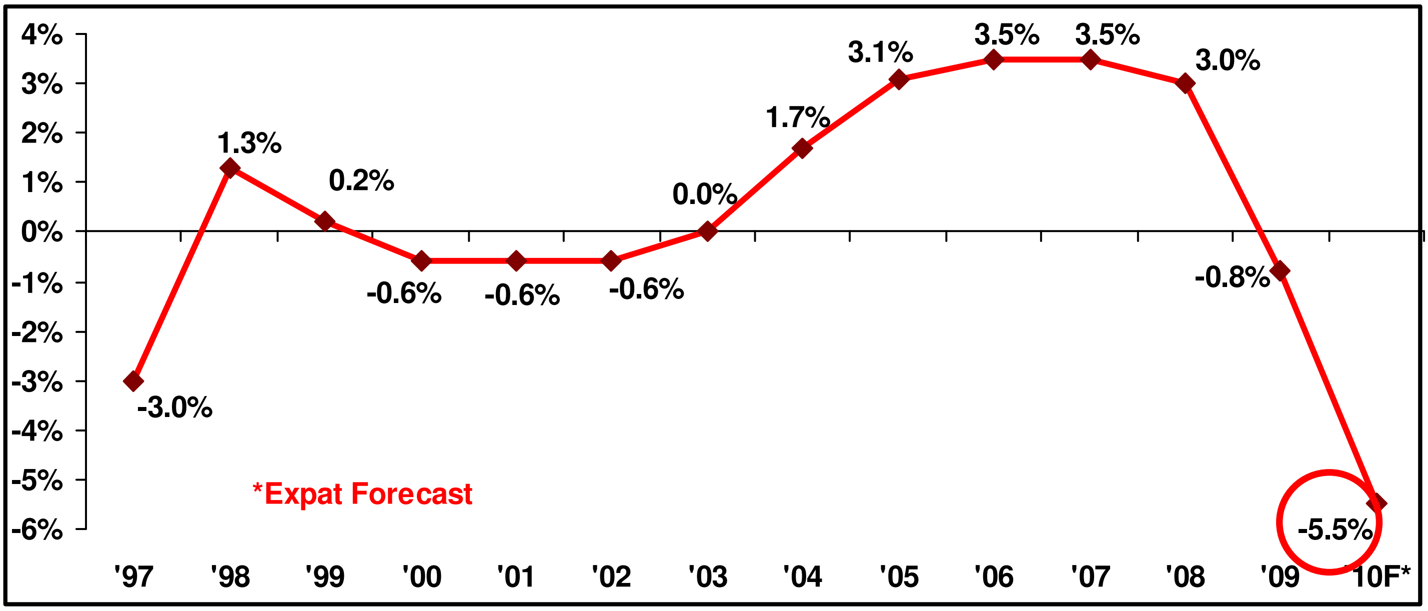
Until April, the government was saying that joining the ERM II and the Eurozone was Bulgaria's main foreign policy priority, and we still support that view. However, January and February produced a very high budget gap of BGN 1.4 bn or 2.2% of GDP – much higher than the -0.9% deficit envisaged for the whole 2010 year. Instead of tightening the belts in 2010, the government surprisingly chose to… revise the 2009 budget deficit to -3.9% of GDP on an accrual basis and blame it on the previous government. Even more surprisingly, the government informed the European institutions and the public that Bulgaria would not apply for a membership in the ERM II and the Eurozone as it was not meeting the budget deficit criterion.

In our view,

1. The -3.9% number for 2009 might be slightly exaggerated, and a future revision towards a smaller deficit should not be ruled out.
2. Although we strongly favour a balanced budget policy, the revised 2009 deficit is by no means fatal or too large in comparison to the rest of Europe, especially in an election year. Thus, blowing a very loud whistle that Bulgaria has major budget problems is like shooting oneself in the foot, unnecessarily adding more uncertainty, risk perceptions, and negative international financial and political repercussions to an already very difficult economic environment.
3. Whatever the previous year's deficit, we still think that joining the ERM II and the Eurozone at the current exchange rate should be Bulgaria's top priority. No temporary difficulties should distract Bulgaria from striving to achieve this goal.

II) THE 2010 BUDGET – WORSENING OUR DEFICIT FORECAST AGAIN

Chart 1. Budget Surplus (+)/Deficit (-), % GDP – on a cash basis



Source: Ministry of Finance, Bulgarian National Bank, Expat Capital

In the second edition of the Expat Compass of 30 March 2010, we worsened our 2010 budget deficit forecast from -2.0% to -3.2% of GDP. We are now further downgrading the number to -5.5%. This is not because the March and April numbers are bad. On the contrary, the March deficit was lower at BGN 270 mln, while in April we had a surplus of BGN 370 mln (most of which came from BNB's dividend payment to the budget). We expect a deficit below BGN 100 mln for May. However, we feel that the political will to keep a low deficit is evapourating. The government is amending the Budget Law to allow for a deficit larger than the initial plan for -0.9%. Before the news came out on 25 May, we had expected a number from -2.9% to -3.3% on a cash basis – just around the -3.0% Maastricht criterion. We were hit by the more reckless -4.8%.

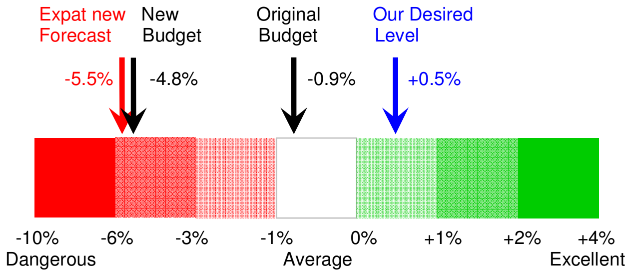
The minimum level for the fiscal reserve is to be lowered from BGN 6.3 bn to BGN 4.5 bn. We view this as dangerous and as a lack of determination to cut spending. Let us remind you again that this would be a second amendment of the budget for the last six months. There had been no budget amendments since 1996.

The major problem are the lower revenues – understandable due to the crisis. However, a secondary problem is that spending in many sectors would even be increased instead of decreased: social spending, road and railroad infrastructure, tobacco subsidies, healthcare. Just to remind you, the Q1 budget spending was higher than in Q1 2009 by BGN 955 mln. Whatever the revised deficit in the Law, we see no reason to think that there would not be another amendment in December. Hence, our current forecast of -5.5%.

Diagnosis: deeper into the "red" (i.e. negative) zone

Implications for the currency board: worsening

Budget Surplus/Deficit, % GDP, 2010



ANALYSIS

III) THE NEW PHENOMENON OF NEGATIVE FDI

For the last 15 years, Bulgaria was one of the countries in Europe and the world which attracted very significant Foreign Direct Investment (FDI) compared to the small size of the economy (see the charts). Investments flowed into a diversified list of sectors, and the countries of origin were also varied, with the EU states leading the rankings. Most of the FDI came in 2003-2008, and coincided with Bulgaria's joining NATO (2004) and the EU (2007). In the peak year alone, 2007, FDI as % of GDP reached almost 30%, one of the highest numbers in the world.

Even in the hyperinflation and crisis years (1996-97), FDI amounted to hundreds of millions of dollars. Since reliable data exist, there had been no single quarter without positive FDI. That is why, the statistics for Q1 2010 showing negative net FDI of EUR -41.2 mln caused a surprise. The number means that no new investment is coming in, while old investment is fleeing the country. We see several reasons for this:

- The unfavourable international environment including the Greek crisis
- The perception that Bulgaria has entered a vicious circle of recession, lack of bank credit, weak financial markets, budget troubles, and lack of reforms
- Controversial statements by the government causing some foreign investors to feel uncomfortable doing business in the country
- Controversial postponement of the large energy projects such as the Belene nuclear power plant, the gas and oil pipelines

In the second issue of the *Expat Compass,* we made a positive comment about the 2009 FDI of almost EUR 3 bn, and made a lower forecast of EUR 2 bn for 2010. To be honest, a negative number for Q1 caught us by surprise. Having in mind that the preliminary Q1 estimates might later be revised in any direction, it is very difficult to make a meaningful forecast for 2010. Our new one is lower at EUR 500 mln of inflows. *Note: Before this issue was finished, the data for the first several months of 2010 were revised and are now above zero.*

Chart 2. FDI, EUR mln

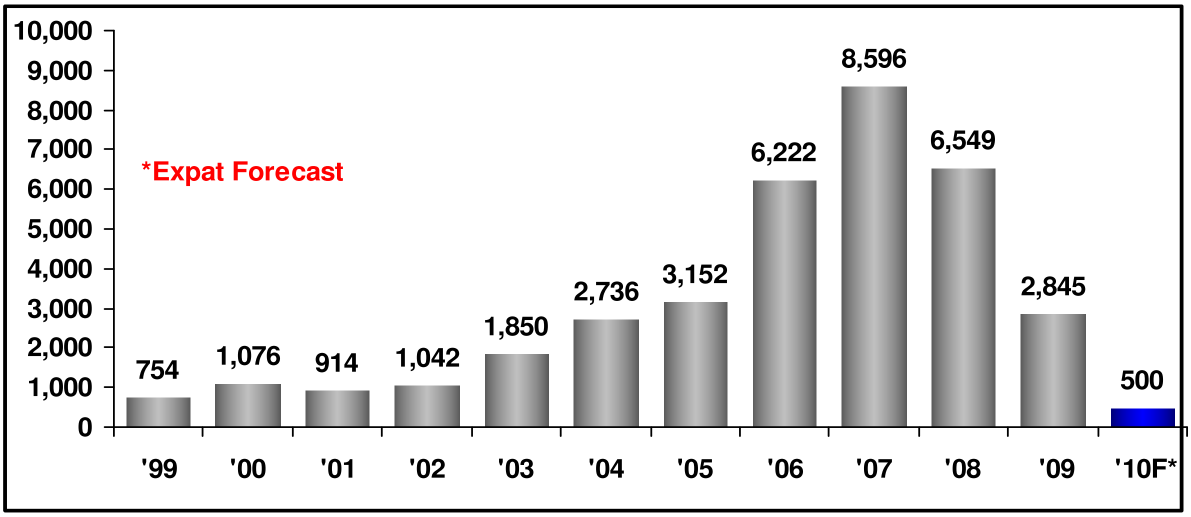
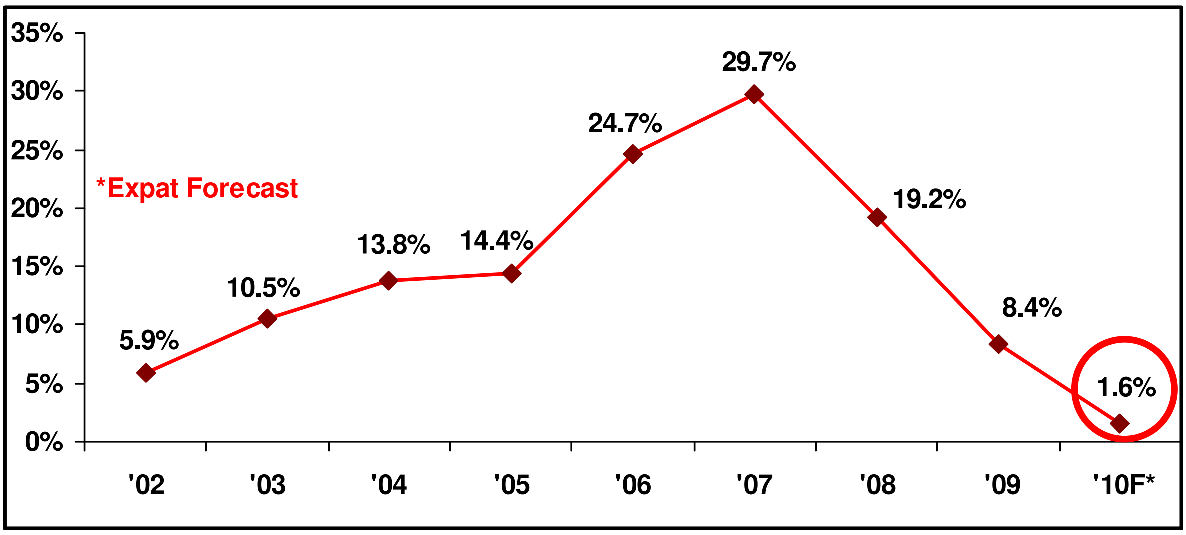


Chart 3. FDI, % GDP



Source: Bulgarian National Bank, Ministry of Finance, Expat Capital

IV) THE BOREDOM OF THE BULGARIAN STOCK MARKET IN 2010

We can divide the history of the Bulgarian stock market into at least four distinctive periods:

1990-1995: barely existent

1996-2001: some but insufficient institutional progress; hundreds of listed companies due to the mass privatization; low liquidity and falling stock prices

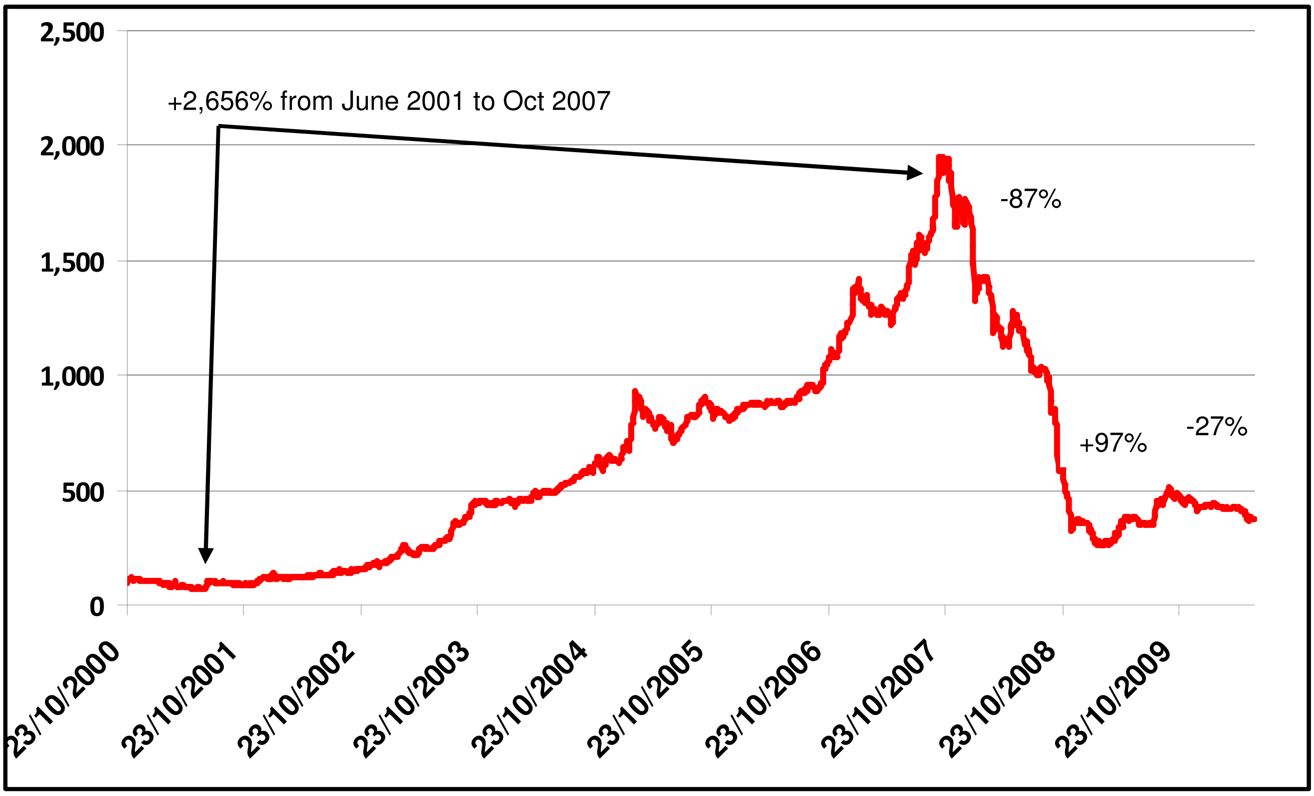
2001-2007: the golden period. Deep legal and institutional reform. The SOFIX rose over 27 times in BGN (EUR) and over 40 times in US$ – probably the highest in the world for that period. Many new IPOs, larger trading volumes. The asset management and the brokerage industry flourished. Some privatizations through the stock market.

Oct 2007-2010: back to the boredom of the 90s. Few new listings, low volumes. The SOFIX first fell by almost 87%, and Bulgaria is one of the few markets which have not recovered much. Since September 2009, the index is down by 27% with low trading volumes.

Another worrying phenomenon are the several defaulting corporate bonds.

Looking forward, the negative period for the market might continue for some time. The debt troubles of neighbouring Greece and the weakness of the Euro do not help. The situation resembles that of 10 years ago when the market was very undervalued but not many foreign investors looked at it. As the sentiment improved, stock prices exploded. Could this be partially repeated? Possibly, especially if the financial stability in Bulgaria is maintained.

Chart 4. SOFIX



Source: Bulgarian Stock Exchange – Sofia

V) THE APRIL REFORM PACKAGE – A MIXED AND UNCONVINCING PICTURE

You might remember that we published the previous issue of the Expat Compass just before the government was to announce a second reform package. We were afraid that the austerity budget measures and reforms might be so deep that our analysis would become outdated within days. Well, they weren't, and it didn't.

Half a year ago, the government announced some initial measures which do not seem to have produced measurable results. The largest item in monetary terms were the expected revenues of BGN 500 mln from the sale of carbon emissions. We have seen none of that, and the EC recently took away Bulgaria's accreditation to trade in these instruments. There have also not been any notable privatization or concession deals.

In April, the government came up with another 60 measures. Most of them are in fact positive: some spending cuts, although not large enough; some privatizations – no delivery yet. However, there are at least two steps in the opposite direction. First, some new expenses were announced, e.g. for social policies, defense, tobacco subsidies, and possibly healthcare. Second, excessive concessions have been made to the trade unions such as a broader introduction of mandatory sectoral collective labour contracts.

On balance, we are not convinced that the April package would even have a BGN 300-500 mln effect on the 2010 budget. We would have rather welcomed measures worth BGN 2-3 bn.

Cuts in the state administration – a good step forward

One of the few measures which are likely to get at least partially implemented is a reduction in the state administration, or the expenses thereof, by 20%. This might save the budget up to BGN 900 mln. While we strongly support this reform, we do not expect these cuts to fully take place. Firstly, we have seen no numbers from the 10% cut announced in the autumn of 2009. We cannot be sure whether at least a third of that was actually implemented. Secondly, the discussions with the corresponding ministries show that the '20%' should be read as 'between 0 and 20%'. Some will aim at 20% but might deliver less, others promise 10%, other three 0%, and one ministry is actually planning to increase staff. Thus, our forecast is for a weighted average of below 7%.

Other reforms are struggling

The government has started some changes in the Bulgarian Academy of Sciences. Any step forward there would be positive. Nothing major seems to be happening in the health sector in terms of closure of hospitals and spending cuts. On the contrary, the sector seems to understand the word 'reform' as spending more, and not less. Minor steps have been suggested in the pension system – an increase in the retirement age for the military and the police. We view this as positive, but it would only affect some 3% of all future pensioners. Thus, we see this as achieving 1% of what is needed in the pensions area.

The VAT tango

The VAT discussion in 2010 is a typical example of the back-and-forth policies of the government which are more driven by public opinion than by a clear and decisive vision. Within just three months, it was announced that in the middle of this year (although taxes should normally be fixed for the whole year):

- VAT would fall from 20% to 18%
- VAT would rise to 22-24%
- VAT would rise first and fall later
- VAT would not be changed

The same can be said about at least a dozen other policy decisions such as the pension reform, closure of hospitals, changes at the Bulgarian Academy of Sciences, policies regarding genetically modified organisms, introduction of a 'luxury tax' – whatever that means, introduction of a maximum salary in the public sector, all the energy projects, etc.

ANALYSIS

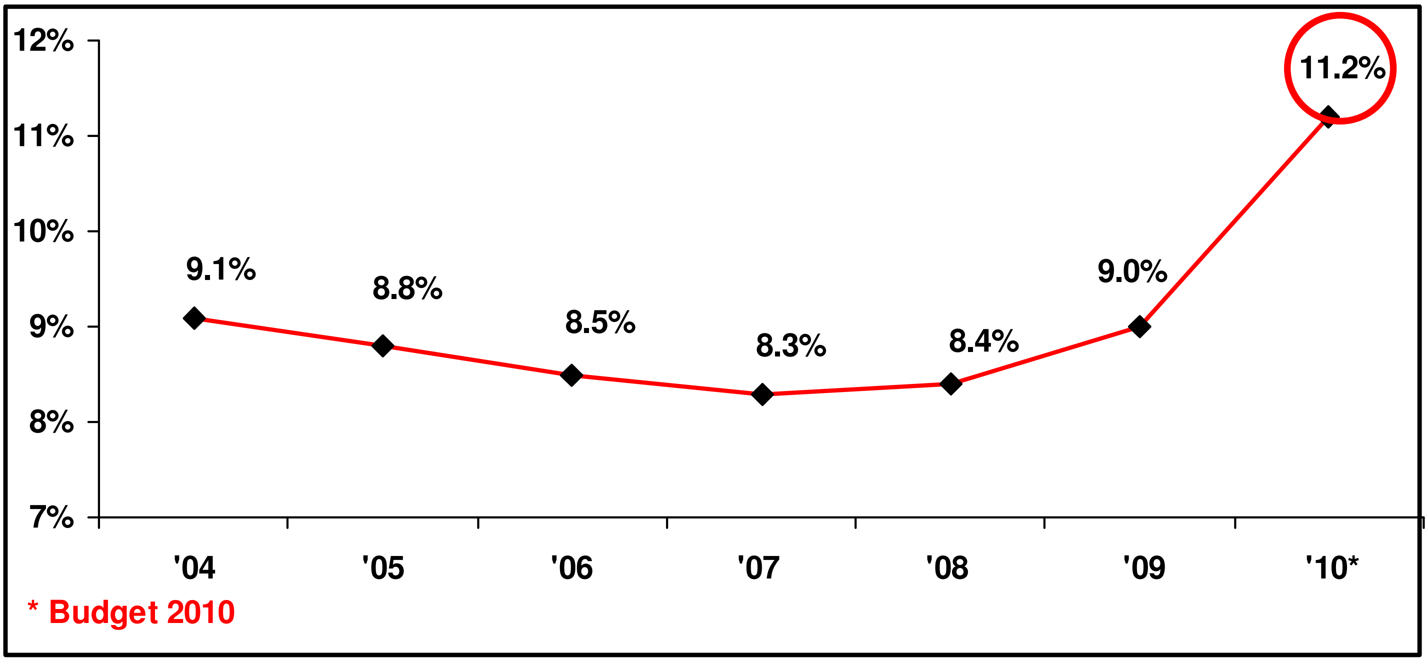
VI) PENSION REFORM

QUESTION OF THE MONTH: If the government has a choice to reduce pensions or to abandon the currency board, what will it do?

Your guess can be as good as ours. We cannot provide a definite answer…, which should tell you a lot.

We hope the government never faces such a dilemma. However, this might be a very real situation in the foreseeable future (see the chart below). Look at both our EU neighbours. Romania has no currency board, but is planning to reduce nominal pensions by 15% and public sector salaries by 25% in order to maintain fiscal stability. The developments in Greece have been well publicized. So far, Bulgaria has chosen not to touch nominal incomes including pensions. This of course is one of the options available to the decisionmakers. However, in order for this to be sustainable, other severe spending cuts are necessary, but they are still missing.

Chart 5. Pension Spending, % GDP



Source: Ministry of Finance

THE PENSIONERS' BIGGEST ENEMY IS NOT TO REFORM THE PENSION SYSTEM

NIKOLAY VASSILEV

I have decided to devote an article to the most important issue in my view – the lack of will to reform the pension system. I am happy that Svetla Kostadinova – one of the best economists in Bulgaria – has also chosen this topic for her guest commentary. The truth might not bring votes in elections, but hiding one's head in the sand, or worse – devaluation and hyperinflation – would also be devastating at future elections.

As an economist, I have consistently argued against excessive increases of pensions. This is one of the most difficult reforms all over the world – no matter how much you increase pensions, it is never enough, while it is almost impossible to lower them. The reasons are political and pragmatic: pensioners are a huge proportion of potential voters and an even larger proportion of the people who actually vote. There is no correlation between pensions and election results. In our country, no government has ever been reelected anyway. Pensions were increased before the elections in 2001 and rose sharply after 2007 – this has apparently not helped the corresponding parties.

What is the truth about pensions?

Complicated. The pensioners are convinced that they are the poorest in the EU (this is true), that they are among the biggest losers of the transition (partially true), and that they are among the main victims of the current crisis (this is absolutely not true). The business community and the active part of the population think that social security contributions in Bulgaria are still high. The employees declare lower incomes for tax purposes, but later complain that their pensions are low. Everyone asks whether the so-called 'point system' would be abolished, meaning whether it would be simultaneously possible: 1) to work for fewer years, 2) not to pay contributions regularly and not to declare the full income, 3) to lower the retirement age, and 4) to receive a higher pension.

All of us love our parents. We have heard the question 'How can you possibly live with 200-300 levs?'. But we have forgotten that 9 years ago the question was about 40-80 levs, and 13 years ago it was 2-3 dollars. In 2020, the Bulgarian citizens will probably ask 'How can you possibly live with 500 euro?'. And no one understands why the London pensioners with 1000-2000 pounds and the Cuban pensioners with 10-20 euro are almost equally unhappy. And hardly many people are aware that in Japan – the country where the richest several dozen million pensioners live – there is no state pension system at all, and everyone saves individually for retirement. The average savings per capita might be above 1-2 million dollars.

The whole population would wholeheartedly support a new increase of pensions. But do you know when pensions in Bulgaria rose the most? During the 1996-97 crisis – by hundreds of percents! Who suffered the most from the 1996-97 crisis? The bankers and the politicians? I don't think so. They were among the best informed about the changes in the exchange rate. For the socially weak, the crisis was a catastrophe. Does anyone think that then pensioners were the richest? In fact, then they were the poorest for the last century. Ask economists when the Bulgarian pensioners have been the best-off since Khan Asparuh founded the country in 681. You will not like the answer – TODAY. In 2009, the inflation was 0.6%, while pensions rose by almost 20%. Do you know many working people or businesspeople who are 20% better-off today than in 2008? I do not know a single one.

The biggest risk to the financial stability is the growing budget deficit. Who would suffer the most if the currency board fails and the lev collapses? Trust me, the socially weak and the pensioners. Pensions are the spending item which is growing the most recklessly. I.e., what is the pensioners' biggest enemy? The imprudent growth of pensions.

In the good year of 2007 the pension spending was 8.3% of GDP, 4.5 billion levs. In 2008 – 8.4%. In my view, an optimal level for that period. Pensions had risen by 10-15% annually for a decade. From 2007 to 2010, nominal GDP has risen by 12%, while pension spending has increased by 54% and has reached 11.3% of GDP. Unless there is pressure for a further increase during the year. This luxury costs additional 2 bn levs. Annually. You might say that this is still completely not enough for the pensioners. Well, then let us increase pensions even more? If you have a job, you and your kids will pay the bill. With higher taxes and contributions today or with a larger public debt tomorrow – Greek-style.

Problems of the pension system

1. A sharply deteriorating demographic picture due to: a low birth rate, emigration of younger people, growing unemployment, rising grey economy.

2. Social security contributions are high according to employers (I agree) but are extremely low in order to support the current level of pensions. However, if contributions are raised, their evasion would increase, and revenues might decrease.
3. The maximum pension limit has not been abolished, which does not stimulate people to declare high incomes.
4. The solidarity “pay-as-you-go” system is failing and unfair. The current workers are not saving for their own retirement but are paying for the current pensioners, who in turn ask where their own money has gone. There is a weak link between current contributions and future pensions. The state guarantees an ever higher minimum pension, thus decreasing the stimuli to pay higher contributions.

What are the possible solutions?

The goal is to design a sustainable model for financing the pension expenses and to lower them as % of GDP – in my view, to below 9%.

Here are three ‘good’ solutions:

1. Reform the economy in order to achieve high growth. Thus, the denominator (GDP) in the pensions/GDP ratio would rise.
2. Implement acute measures for the long-term improvement in the demographic picture – measures to increase the birth rate (including in vitro programmes) and to stimulate the Bulgarian citizens to live and work in Bulgaria instead of emigrating. Thus, pensioners would not become 50% of the population soon.
3. Improve the long-term return of the pension funds in order to accumulate more money for distribution.

Here are four ‘bad’ solutions:

1. Lower the pensions in nominal terms. A correct but extremely unpopular solution. Latvia did it under severe pressure, now watch our neighbours Greece and Romania.
2. Increase the retirement age. Many countries are doing it, including Germany. Also unpopular but correct.
3. Raise taxes and social security contributions in order to collect more budget revenues. Also unpopular and incorrect. The result would be more grey economy, lower investment, and slower growth.
4. Chronic budget deficits. A real danger of devaluation and hyperinflation. The pensioners would be the main victims. That is the worst scenario.

The role of private pension funds

They have several advantages. First, the accounts are individual. If you double your contributions, you would double your pension. Second, the professionals from the financial industry are expected to invest our savings more successfully than state officials. The role of the private pension funds has to increase sharply. We should invest more in them and contribute less to the state social security system.

The role of the Silver Fund

The Silver Fund should be allowed to invest in Bulgarian securities a part of the accumulated assets (not all the assets, however, for the sake of diversification). This would be positive for the Bulgarian capital market and for the Bulgarian economy.

Is there a good moment for the pension reform?

When a politician tells you that the retirement age will be increasing between 2015 and 202X, what would you think? Again no one is taking the responsibility to do something, the garbage is again swept under the carpet. It would have been better if the reforms had happened in 2005, but 2010 is still better than 2020. Otherwise, by then pension spending might reach 15% of GDP. There will be elections almost every year, but each wasted year would mean steps in the wrong direction and missed opportunities. The government is popular now, the opposition is weak. The society is expecting reforms. What are we waiting for?

A SIMPLE, CLEAR AND FEASIBLE IDEA FOR BULGARIA'S PENSION SYSTEM

SVETLA KOSTADINOVA

Executive Director, Institute for Market Economics (www.ime.bg)

Svetla Kostadinova is one of the most prominent young economists in Bulgaria. She was born in 1977 in Varna, Bulgaria. She graduated from the University of National and World Economy in Sofia with a Master's degree in Finance. Svetla joined the renowned economic think-tank Institute for Market Economics (IME) in 2001 as an economist and in 2007 was elected as executive director. She has numerous articles and media appearances on topics such as government policy, administration reform, tax reform, impact assessment of regulations, and labor market. She is a member of the Bulgarian Macroeconomic Association.

Photo: Ikonomika.org

Bulgaria is not an exception among EU countries when we talk about the public pension system crisis. The estimations show that the population will shrink drastically by 2050 and will soon reach the point when one worker will have to support one pensioner and all this – coupled with additional transfers from the state budget. The reality is low pensions close to poverty levels, totally unrelated to contributions; workers trying to avoid pension contributions that reach 16% of salaries; and a chronic deficit of the state pension budget. The real pension savings are at marginal levels, and the responsibility of who pays the pensions is unclear. The politicians decide how much the pensions will be, they define the retirement age and all other criteria that change over time, thus making everything uncertain and unclear in the long-term perspective.

Knowing that, it is crucial that measures are taken. The state budget will not sustain the current situation especially during hard crisis times, and exactly now it is the time to act.

The good news is that the current government stated from the very beginning that it would focus on the pension reform and make real changes in order to make the system sustainable and pensions higher. The bad news is that after a year of internal discussions no real reform has been proposed. The current debate organized by the official Consultative Pension Reform Council established by the Ministry of Labor and Social Policy (includes labor unions and employers' organizations) is going nowhere. Among the discussed ideas are changes in the pay-as-you-go system that already proved to be a failure – raising the retirement age, limitations of the criteria for receiving a pension, etc. and these would be very difficult to implement. What is still missing is the clear acknowledgment that the system is so flawed that no parametric changes will make it work, not to mention providing decent pensions and creating an incentive for people to contribute and participate actively. The side effects of the collapsed system are a continuously large grey sector, a high tension of the budget, and old people who can easily be manipulated by populist political promises.

There is a group of people, however, who have a vision of how the pension system in Bulgaria can be changed in order to create the right incentives, get rid of the political strings and introduce the logic of savings for pensions. This group has created an Alternative Pension Reform Council in February 2010 and consists of 8 economists who revealed a vision of what the future pension system should be. The announced pension model will be based on the following ideas:

- Everyone in working age is saving a part of his/her salary in a personal pension account
- The state's role is to regulate the system – avoidance of imprudence risks, imposing high transparency and release of information

- The state will support people who have not managed to save enough for retirement but with strict limitations and to a limited extent
- Each worker will choose by him/herself when to retire, and that would predetermine how much and how long he/she has to save for retirement.

As it can be seen, the state has its important role in the proposed model but it is more of a guarantor for the majority of people who will be saving, and of social assistance for a limited group. It will not make promises it cannot fulfill and will not subordinate the entire pension system to a false solidarity principle.

At the center of the new pension system is the individual who should be able to plan for his/her retirement, and thus have a greater responsibility.

The effects for the economy are expected to be substantial and diverse. The personal pension accounts will increase the private savings so much needed after the shrink of FDI in the last year, and will foster the capital market development through the private pension funds. The labor market will be more flexible, employment will increase, and most of the working people will no longer have an incentive to hide the real earnings, so the informal economy will contract. All of the above, coupled with higher disposable incomes due to lower pension contributions in comparison to the current levels will lead to economic growth that we so much need.

The idea is not new – numerous countries around the world have the personal pension accounts at the center of their pension systems, and others are considering to increase the personal responsibility element. This is something that Bulgarian politicians find hard to understand when discussing the future of the Bulgarian pension model.

EXPAT NEWS

Expat Beta REIT plans to invest in high-quality distressed assets

June 2010

Expat Beta REIT is ready to make the first investment within weeks after the capital increase, Mr. Nicola Yankov and Mr. Nikolay Vassilev, managing partners at Expat Capital, announced. Over 250 guests in Sofia and 150 in Varna came at the Expat beta presentation about the IPO and the opportunities for investments in distressed assets.

The public offering of shares started on 21 May 2010. The issue is to the amount of 43,428,900 ordinary shares with an issue price of BGN 1 per share. With this capital increase the share capital could reach BGN 47,771,790.

If the capital increase is successful, the REIT could play a key role on the distressed assets market in Bulgaria. After the real estate and construction bubble in 2002-08, there are many good new developments in distressed situations. Because of the recession we expect a wave of foreclosures and liquidations. Expat Beta REIT aims to be among the very few buyers with cash.

Currently the REIT is evaluating a solid pipeline of a dozen projects, matching the investment criteria – prime locations, investment-grade building quality, no development risk, project in financial distress.

Expat Beta has three rules of thumb:

- Acquire new developments at or below loan value for leveraged projects (50-75% of investment cost)
- Acquire commercial properties to let, at a price allowing a 20% rental yield. Sell at lower yields aiming at doubling the initial investment within a 2-3-year horizon
- Acquire distressed properties with a hold-and-sell strategy aiming at doubling the initial investment within a 2-3-year horizon

Every current investor gets 1 tradable right per each share, which entitles him to buy 10 new shares. The current investors can either exercise their rights or sell them in the stock market. The rights will be traded on the stock market from 31 May to 28 June 2010. An open tender for the unexercised rights will be held on 7 July, the new shares can be bought till 21 July. The expected time for the start of the trading of the new shares is at the end of August.

Expat Beta REIT, managed by Expat Capital, is listed on the Bulgarian Stock Exchange – Sofia. This is one of the few stocks in Bulgaria whose market price has not fallen during the crisis. Some of the reasons are that the fund has zero bank debt and owns prime quality assets.

Related documents:
Investment presentation
Summary of the Prospectus for the public offering of shares

EXPAT CAPITAL

1000 Sofia, Bulgaria
96A Georgi S. Rakovski Str.
Tel.: +359 2 980 1881
Fax: +359 2 980 7472
Web: www.expat.bg
In order to subscribe or make comments, please write to us at compass@expat.bg

THE EXPAT COMPASS TEAM

Author:

Nikolay Vassilev, CFA
Managing Partner, Expat Capital

Guest Contributor:

Svetla Kostadinova
Executive Director,
Institute for Market Economics

Editors:

Iva Popova
Research Analyst, Expat Group

Maria Divizieva
Managing Director,
Expat Group

Design:

Natalia Dimitrova
PR & Advertising Manager,
Expat Capital

Economic Data:

Nadezhda Gogova
Senior Expert