

Bulgaria's public finance is the catalyst for growth

One of the leading brokerages in Bulgaria portrays the country as a tax-efficient and low-debt stable economy to invest in. Mr Georgi Konyov highlights the non-commensurate weak liquidity vis-à-vis strong potential of the markets.



Georgi Konyov, General Manager of
First Financial Brokerage House

Why do you think Bulgaria has a strong base for capital markets?

Bulgaria is clearly standing out in the Balkans with its strong macro figures. With debt to GDP ratio of 26.9% as of 2014, Bulgaria remains the third least indebted country in the European Union. The surge in exports in the last several years has helped to balance the current account and the Balance of payments in general which added to the macro stability. The flat 10% tax rate for both individuals and corporations together with the competitive labor market are providing further opportunities for foreign investments. The peg of the Bulgarian Lev (BGN) to the Euro is effectively removing currency risk, thus reducing costs related to international investments. All these suggest that Bulgaria is a must go place for all kind of investors looking to benefit from stable macro environment, low taxes and attractive labor market.

What are the major challenges?

As a frontier market BSE-Sofia is still facing many challenges. Liquidity remains a major concern as the lack of more complex financial instruments is ruling out any arbitrage

opportunities, which eventually decreases the overall activity. Most of the investors had become much more sensitive to the liquidity figures after the financial crisis and they may turn out to be one of the most significant factors to consider while choosing the investment universe. Corporate governance is frequently discussed as an issue in undeveloped markets. Bulgaria is no exception although the overall transparency has been constantly improving. However, well known practices worldwide like earnings calls, results guidance, electronic GSM voting are yet to be implemented.

How do you compare involvement of individuals vs of institutions in trading?

Institutional investors are definitely dominating in trading. The local pension funds are major players as their assets have grown to about EUR 4.5bln and the constant inflows make them hungry for new quality ideas. Foreign institutional investors already have a long history of investing in Bulgaria either as part of their geographic coverage of Eastern Europe and the Balkans or as part of the frontier markets universe. Individuals' importance in trading

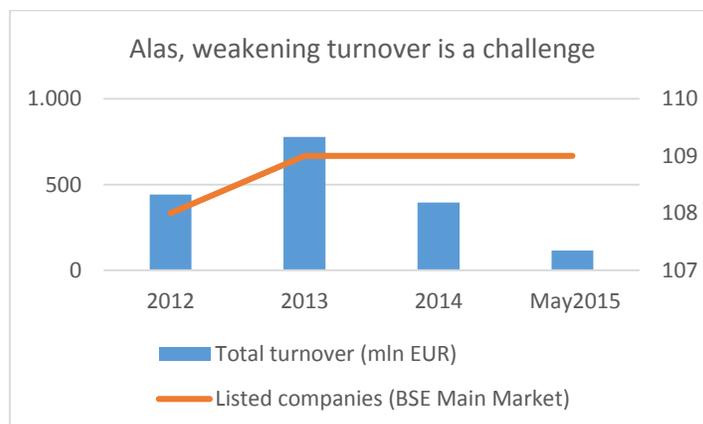
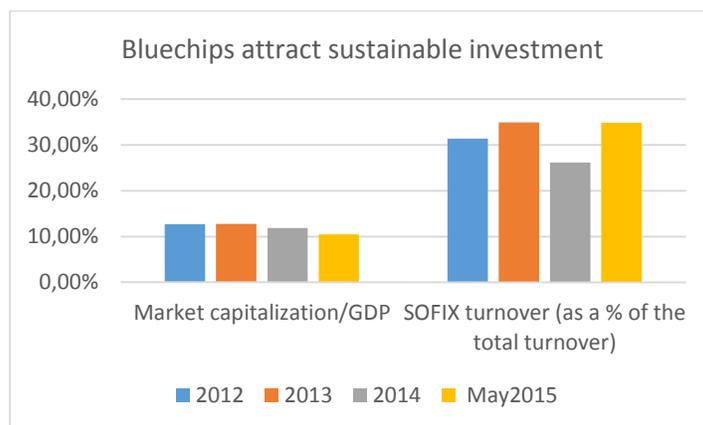
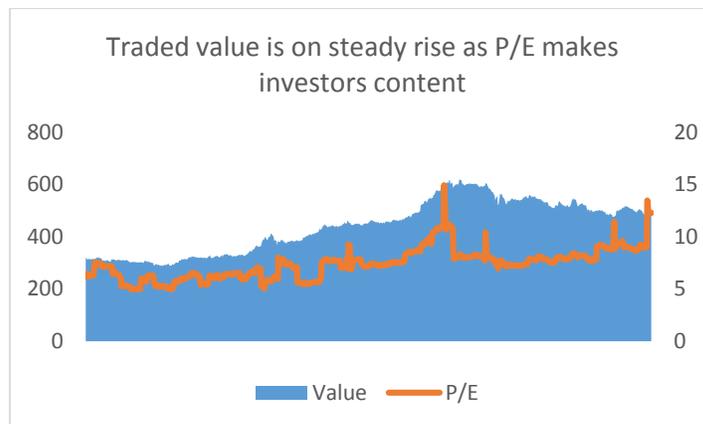
have been increasing in the recent years as the total personal savings have been growing steadily. Currently retail deposits are standing at about EUR 30bln, which is more than 6 times the total market capitalization and about 75% of GDP. Declining deposit rates should eventually lead to more demand for income generating investments.

Why should investors add Bulgarian securities into their portfolios?

Bulgarian equities are often overlooked by investors, because of the relatively small size of the market. However, attractive valuations in many stocks present opportunities that wait to be exploited. Country specific sectors like agriculture, tourism and industrials provide diversification benefits and strong growth prospects. Bulgaria has something to offer to any investor who is looking to benefit from an economy built on strong fundamentals, without country specific currency risk, within a legal framework that closely matches a developed market. Research coverage by the leading local brokers is giving additional leverage to foreign investors.

Are the Bulgarian markets accessible from around the world?

BSE is easily accessible via a broad network of international and local brokers. So far, DMA access hasn't been implemented within the industry's well known electronic trading solutions, but several electronic platforms for retail investors do exist. The cost of settlement for foreign institutional investors remains relatively high, but it is directly related to the segregated account structure in the Bulgarian Central Depository, which improves the transparency of the securities ownership.



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Marketplace matters to depth and liquidity

We ask the head of Bulgaria Stock Exchange on how local markets fare against full-fledged infrastructure, regulations and corporate governance practices. He resonates to our questions openly.



Ivan Takev, CEO of Bulgaria Stock Exchange

What markets do you maintain on the Bulgaria Stock Exchange?

Bulgarian Stock Exchange is the only exchange operator in the country since 1997. We provide state-of-the-art trading infrastructure to all market participants and play a key role in the ongoing development of the local capital markets. We rely on our flexibility for meeting customer needs and our adaptability when it comes to providing tailored solutions.

The core business of the exchange is the cash market at which equities, corporate and municipal bonds, subscription rights and company-issued warrants are traded. Local blue-chips are listed on the Premium segment, where certain quantitative and qualitative requirements are in place. All Premium companies are obliged to disclose price-sensitive information to the public simultaneously in both Bulgarian and English. Issuers that do not meet minimum liquidity requirements or do not disclose information according to the terms specified are transferred to the Bulgarian Alternative Stock Market, BaSE.

Driven by the desire to follow the best practices in transparency and corporate governance in general as well as to be an example for potential issuers the exchange filed for a listed company in late 2010 and its shares have been traded on the market since early January 2011.

Please tell us about the rules of corporate governance.

One of the key characteristics of most emerging and frontier markets is the immaturity of listed companies. Such markets are frequently examples of practices that are at least not well accepted at their well-developed peers.

These practices are not necessarily intentional; many of them originate from the inability of companies' managers to properly assess the consequences of their actions. Here comes the importance of constantly promoting corporate governance among listed companies.

Of course, it is very difficult, if not impossible, to transform every single listed entity into a model for governance. That is the why, to what extent the market in general can be insulated from individual negative influences depends the level of acceptance of the best corporate governance principles by its blue chips.

Bulgarian Stock Exchange identified corporate governance as a key pillar of the local financial industry long ago and since then has been relentless in its efforts to continuously promote it among listed companies. In that sense, we were a pioneering trading venue in this part of Europe in developing our own corporate governance code as early as in 2006. Starting from September 2011 the Exchange has been a calculation agent with respect to an index of the companies complying with the best corporate governance standards called CGIX. For its entire existence CGIX has systematically beaten the exchange market-wide index and even its blue-chip index, SOFIX. Just as an example, over the course of the past two years, CGIX has gained more than 33%, while SOFIX's return has been 14.4%. It is also worth mentioning that BSE, being a listed company, has been proud to be one of the constituents for the past three years.

An EBRD sponsored project to connect South East European markets is a highly expected one to consolidate liquidity in regional markets. Bulgaria, Zagreb and Macedonia stock exchanges have joined forces to leverage on pooled liquidity.

How do you consider efficiency in post-trading services?

In order to secure a smooth transition throughout the entire lifecycle of each bid or ask order, from entry through execution till settlement, not just a robust electronic trading environment is needed but also an efficient and investor-friendly clearing and settlement infrastructure. Even a state-of-the-art trading solution like the one that we have been running on may remain unutilized if the daily clearing and settlement routines are cumbersome from trading members' perspective.

Central Depository AD, the clearing and settlement institution in Bulgaria, one year ago immersed itself in a

massive overhaul of the technology that had been in use as well as total reconsideration of the business rules in place. Following the replacement of core technology, our CSD provides a full set of post-trading services even though it doesn't operate as CCP which is essentially not allowed by the EU regulatory framework. As a result of that, with the introduction of the new clearing and settlement platform in December 2014 almost all of the setbacks for fluent and fully automated settlement were eliminated. In addition, from listed companies' perspective, certain services like corporate actions processing have become much more meaningful, streamlined and easy to use.

“Partnerships such as SEE Link, our participation in the global Xetra family, potential joint regional clearing initiatives and the sale of the state-owned stake at the exchange is also on our agenda for success.”

What are the projects to strengthen depth and liquidity in the capital markets?

In 2014 we launched a very ambitious project ultimately aiming at more listings on the exchange in the mid-run. We have developed internally a very comprehensive project for studying and screening thousands of private companies. By analyzing all available sources of public data about all major non-listed business enterprises in Bulgaria we have managed to select those that may reasonably need non-banking financing for their activities. After a careful review of the shortlisted potential issuers, we have conducted detailed financial and non-financial analysis of the target companies, to which management in person we could present the growth potential for their companies via capital market's funding.

We have been going through the second round of our IPO project for the past few months meeting top-level management. As we went through a similar process back in 2011, we can rather easily say that this time the results are more positive than before although market's conditions have not changed much since then. This gives us some comfort as in the mid run we may expect some fresh inflow of listings.

In 2015 we have launched a new project together with 19 of the stock exchange members, aiming at improving the

investment culture and increasing the knowledge of equity instruments as a form of investment. The initiative, called Equity Day provides for retail investors the opportunity to trade free of all charges for up to 15 executed orders, EUR 1000 each. This year it was held on June 10th and was a major success. The number of executed orders increased more than twice in comparison with the YTD daily average, much of which could be attributed precisely to individual investors. Given the broad support that we received from our members and its good acceptance by the investors, we plan to hold an Equity Day every year.

Are you involved in any cooperation projects with your peers in the region?

In 2014 BSE, together with Macedonia and Zagreb stock exchanges started a joint project to create a regional infrastructure for enhancing the cross border trading of the securities listed on each of the three markets. The goals of the project called SEE LINK are to develop an order routing vehicle that has the potential to build sufficient critical mass at each trading venue by further increasing its trading volumes and improving liquidity.

The idea behind this initiative is to integrate regional equities markets without merger or other types of corporate integration using only technology that will enable participating stock exchanges to remain independent yet complementing each other's efforts in providing investors

with easier and more efficient access to those markets through a local broker. The platform will aggregate order flow from the multitude of trading members of each exchange and route it to the relevant exchange's members using their own systems and straight through trades' processing environment.

In order to give the whole project a formal framework necessary for successful completion, Bulgarian, Macedonian and Zagreb stock exchanges established in May 2014 a same-name joint stock company headquartered in Macedonia with three partner exchanges holding an equal share of ownership. The SEE LINK project is financed by the three exchanges and by the European Bank for Reconstruction and Development that provided a grant for the establishment of the electronic order-routing platform.

Following a successful tendering procedure that was completed in April 2015 a software vendor was selected. It is expected that at the end of the year the system will be open for testing and, upon a positive acceptance test, it will go live in the beginning of 2016. After its launch the System will be opened for other exchanges in the region if they wish to join it.

What are the long-term goals you are aiming at?

Bulgarian capital market as well as many other markets in Southeastern Europe has been suffering from very low investors' activity during the post-crisis years which naturally results in low overall liquidity.

Contrary to the common understanding that exchanges should rely on international investors to regain what was lost in the global financial crisis, our belief is that, as a small market with limited investability from abroad, BSE's recovery can come only from the inside. It is not that we have stopped reaching out for foreign portfolio investments over the years but one should not reasonably expect rivers of capital from abroad while the domestic investors shy away from the home equity markets. That is why successfully meeting domestic supply and demand should serve as a stepping stone for additional international capital inflows. In this sense, keeping our local focus and reaching our short- and mid-term goals discussed above is of critical importance for exchange's long-term performance and its lasting credibility.

It is not a secret that there are a lot of investable funds in Bulgaria which strive for perspective listed business. Given listed companies' relatively small size and low free float, our top priority is to increase the overall investability of the market by bringing more listings onto the exchange which, in its turn, will gradually improve the balance between the ample supply of capital and the limited demand.

On top of that, BSE is determined to continue its participation in multilateral projects in the region as well as globally. Partnerships such as SEE Link, our participation in the global Xetra family, potential joint regional clearing initiatives and the sale of the state-owned stake at the exchange is also on our agenda for success.



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