

# BACB

5 February 2010

## Building reserves

<b>Banks</b>		<b>Current price</b>	BGN 17.3		<b>Buy</b>			
<b>Bulgaria</b>		<b>Fair value</b>	BGN 23.2		Rating reiterated			
<b>Performance over</b>	<b>1m</b>	<b>3m</b>	<b>12m</b>	<b>FY/e 31.12 (€ m)</b>	<b>2008A</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>
<b>Absolute</b>	2%	1%	100%	<b>Net interest income</b>	40.7	39.0	38.1	39.5
<b>Rel. to MSCI index</b>	-5%	-15%	-7%	<b>Non-interest income</b>	2.2	0.9	1.0	1.2
<b>12m Hi/Lo</b>	BGN 21.5 / 7.6			<b>Non-interest expense</b>	6.0	6.9	7.4	8.4
<b>Reuters</b>	BACB.BB			<b>Operating profit</b>	37.0	33.0	31.6	32.4
<b>Bloomberg</b>	5BN BU			<b>Net income**</b>	26.5	10.8	9.4	19.5
<b>Market Cap</b>	US\$ 155.8 m			<b>Cost / income (%)</b>	14.0	17.4	19.0	20.5
<b>Free float</b>	19.1%			<b>ROE (%)</b>	30.1	10.7	8.4	15.5
<b>Next corporate event</b>				<b>P/E (x)</b>	4.2	10.3	11.9	5.7
-				<b>P/B (x)</b>	1.2	1.0	1.0	0.8

Source: KBC Securities

\*\*Net attributable income, \*priced at COB 4/2/2010

BACB reported a net loss of € 1.5m for 4Q09 on swelling net provisioning costs, reflecting mainly an increase in the NPL coverage ratio. This translates into € 10.8m for full year 2009, down 59.1% y/y and well below our expectations for € 14.8m. Even though NPLs retreated to 9.6% in 4Q09, from 10.0% in 3Q09, we have revised our net earnings estimates downwards by 36.1% to € 9.4m (-13.3% y/y) for 2010 and by 9.2% to € 19.5m (+108.3% y/y), on a concern that Bulgaria's economic recovery is likely to be delayed until 2011. This has resulted in a 2.3% cut in our fair value estimate to BGN 23.2 per share, implying 34.4% upside. We reiterate our Buy recommendation.

### Buy rating maintained

- NPL formation to slow down:** A surge in the cost of risk to 781bp of gross loans in 3Q09 and 898bp in 4Q09, wiped out most of the bank's earnings in the 2H09, leading to negative earnings revisions. But with a decline in NPLs in the last quarter (9.6% of gross loans down from 10.0% in 3Q09) and the massive increase in provisioning reflecting an increase in the coverage ratio (up from 79.4% in 1Q09 to 91.8% in 4Q09) we forecast the cost of risk to retreat to 559bp (-13bp y/y) in 2010, which should restore confidence in the bank.
- Most resilient to deterioration in asset quality:** Due to its wide margins and unrivalled efficiency (cost-to-income of 17.4% in 2009), enabling a pre-provision operating profit to average gross loans of 9.0%, BACB is highly profitable in good times but resilient in a difficult operating environment. However, with expectations for further margin pressure (-23bp in 2010F) and still high cost of risk (559bp in 2010F), earnings are forecast to decline by additional 13.3% y/y in 2010, before recover by 108.3% y/y in 2011.
- Reliant on wholesale funding:** Loans-to-deposits reached 333.1% in 4Q09, when the bank lost 15.5% q/q of its deposits. However, regardless of a relatively high reliance on wholesale funding, we view rollover risk as very limited given the already proven support of AIB and long-term structure of funding. But with difficult access to wholesale markets and new funds, we believe that BACB will be forced to cut on growth, and therefore, we forecast lending to grow by 1.3% y/y in 2010 and 8.2% y/y in 2011, well below the market.
- Still cheap:** After a correction in overdone risk aversion, BACB has emerged as the best performing bank in Bulgaria in 2009 (up 42.4%). On a 2011F P/E of just 5.7x, BACB trades at a broad discount to CEE banks on 10.3x and Bulgarian banks on 8.7x. While a discount is justified due to the bank's high exposure to sectors that are vulnerable in the downturn, we believe the gap is likely to narrow as confidence in the recovery builds.

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EBITDA = EBIT + amortization and depreciation EPS = Net profit / No of shares outstanding

DPS = Dividend per Share

NBV per share = Net Book Value / No of shares outstanding

EBITDA margin = EBITDA / Revenue

EBIT margin = EBIT / Revenue

CFPS = Cash flow / No of shares outstanding

Net Financial Debt = Financial debt – Cash equivalents

ROE = Net profit / Average Equity

EV = Market Capitalization + Net Financial Debt

P/E = Stock Price / EPS

P/CF = Stock Price / (Net Profit + amortization and depreciation)

P/BV = Stock Price / NBV per share

P/S = Market Capitalization / Revenue

Gross Dividend Yield = Dividend per share / Stock

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**BUY** – total return is expected to appreciate 10% or more

**HOLD** – total return is expected to be between 10% and –10%

**SELL** – total return is expected to depreciate 10% or more

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