

Why is there an IPO boom in Bulgaria?

“Trace Group issues stocks for more than 32 mln leva”, reads an article from today’s issue of Dnevnik. Two years ago, such an event would have been simply unbelievable, but in the second half of 2007 we see an absolute boom of Initial Public Offerings. What is more, Bulgarian companies have managed to raise through the stock exchange approximately 350 mln leva for a period of around three years (information from Investor.bg, 23.10.2007). The companies to go public range from well-established banks such as First Investment Bank and Corporate Commercial Bank, to the construction materials company Kaolin, and the mineral water bottling company Devin.

All these numbers seem to carry a lot of positive information, but the questions is what exactly has driven Bulgarian managers to seek alternative ways to raise capital. An important argument is that IPOs are a useful way for a private company to get a market valuation or determine its upside potential. One way to do that is through the price to earnings ratio (P/E), but what we notice in Bulgaria, however, is that P/E for SOFIX securities is above 30, having in mind that the expected company revenues are no more than 15%, we will ultimately see an over-valuation of the market, which ultimately leads to “stocks infatuation”.

Another factor is the increasingly appealing investment environment that the Bulgarian market offers to private and institutional investors. A soon-to-be corporate tax of 10%, a large pool of well-educated cheap labor force and developed infrastructure bring a huge stream of foreign capital. Together with an increasing number of mutual funds, pension funds, and investment banks, creates a situation in which a potential of financial resources is aimed at a small number of securities – this may overheat the market. One way to solve this problem is by implementing IPOs, which acts as a life-belt that will disperse this large pool of capital among a larger number of stocks.

Companies have mainly relied until recently on bank loans, but as they grow bigger they have to reduce their dependence on banks and find an alternative way to raise large amount of cash in order to expand. The price of raising capital through the stock exchange is smaller than that of getting a bank loan. Statistics show that the cost of larger issues can reach up to 3-5% of the amount of the raised capital. Also, an increasing number of investment intermediaries means greater competition, which ultimately leads to decreasing underwriting costs.

Another interesting reason for the observed IPO boom is that founders of smaller companies have seen IPOs as a useful exit strategy so that they can start doing something else and leave the management in the hands of stockholders and professionals.

The underlying causes for the increasing trend of Bulgarian companies going public can be many, but one thing is for sure that a liquid secondary market is a major prerequisite for more and more firms seeking alternative ways to raise capital. A greater number of IPOs, in turn, means a chance for companies to expand, which ultimately incorporates a nice, healthy pace of economic growth and increasing living standards.