RECENT EVOLUTIONS ON ROMANIAN CAPITAL MARKET

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Abstract: As Romania became member of the EU, its financial markets are operating more and more like those of a developed capitalist country and the firms have to take into consideration all the advantages and to face all the challenges regarding the new financing sources such as: the public capital market, the private equity funds.

Key words: capital market, private equity funds, integration,

Introduction

The legal framework for the Romanian capital market was set up in 1994, establishing the National Securities Commission (CNVM) as the regulatory authority, followed by the launch of trading on the Bucharest Stock Exchange (BSE) in November 1995. One year later, the over-the-counter RASDAQ market started its operations.

Over the last three years, there were several changes in the capital market legislation, with the aim of bringing legal provisions in line with the EU directives. The main step in this regard was the issue in 2004 of a new Capital Market Law, containing in a single act, provisions for the capital market institutions, intermediaries and issuers of securities.

Due to the limited offer of trading instruments (currently only shares, municipal and corporate bonds and since recently - preemptive rights are traded), and the limited number of large and well performing companies on the market, the average daily turnover in the first six months of 2006 was around EUR 10 mil.[1]. This ranks the BSE among the smallest exchanges in the Central European region.

The BSE official listing is structured into three segments: domestic stock; bonds and other debt securities; foreign securities.

The domestic stock segment is organized into the following tiers, based on the "quality" of the traded stock:

- First Tier (with 21 shares listed on July 2006);
- Second (Base) Tier (with 44 shares listed);
- the premium Plus Tier, introduced in 2001 for the most transparent listings.

The Plus Tier includes shares traded on both First and Base tiers which meet additional transparency and corporate governance criteria required by the exchange. The admission of shares to the Plus Tier has no impact on their preservation in the Base or First tiers. Currently, only one stock is listed on this tier. Apart from the Base and First tiers, the BSE runs the so-called "unlisted market" which trades stocks which have been delisted from the main market and for which the exchange does not impose any

[1] Bucharest Stock Exchange, http://www.bvb.ro/

requirements of information disclosure or daily variance in price. The unlisted market is open only two hours a day and has low trading volume.

Listing of municipal bonds started in 2001 and at the end of July 2006 there were 12 such securities listed on the exchange. Apart from the municipal bonds, the BSE also trades 6 corporate bonds (one on the Base Tier and five on the unlisted market), of which three were issued by banks, two by leasing companies and one by an industrial firm.

Public offerings are regulated by the Capital Market Law as well as by specific CNVM rules. Making an Initial Public Offering (IPO) allows firms to expand their business, as well as bringing indirect benefits through giving them a higher public profile, which can be a particular boost to a company's image if the shares perform well.

In order to carry out a selling public offer, an issuer must prepare and submit a prospectus providing detailed information on the company and the conditions of the offer to CNVM for approval. According to the Capital Market Law, CNVM has to make a decision on the approval of the public offer in 10 days, but this term may be prolonged in case of any additional information requirements. The validity period of a prospectus is 12 months from the date of CNVM's approval.

Evolutions on Romanian capital market

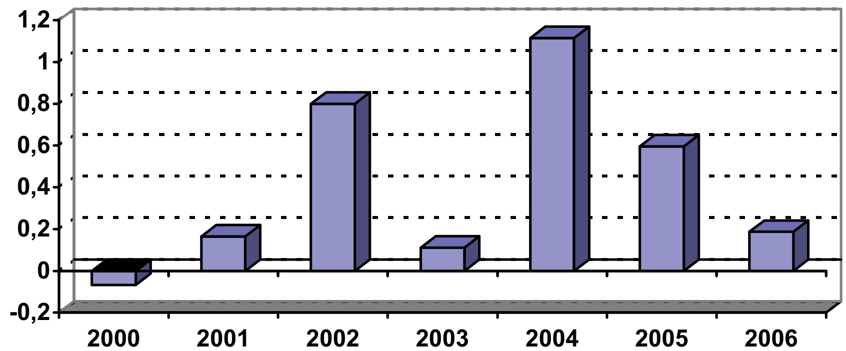
As Romania's economy continues to grow, EU accession approaches and the activity on the Bucharest Stock Exchange increases, more and more companies are coming to see the advantages of making the public offering. This has proved a very useful way for these firms to raise financing for new investments, with many advantages over other alternative sources of funding such as bank loans. However, listing on the stock market imposes certain prerequisites on the company, requiring greater transparency and continuous compliance with the regulatory environment. The company needs a history of long serving and competent management, as well as to be financially stable, showing earnings growth and future potential.

A publicly listed company allows becoming more visible and enabling the free trading by investors, who can buy and sell shares, and this brings further advantages besides the initial influx of capital. It can increase a company's ability to obtain more and possibly cheaper finance through issuing either additional shares or bonds.

Despite the advantages, listings are a relatively recent occurrence on the Romanian exchanges. Only a few companies went public this way over the last years. In 2005, there were five new listings of shares on the BSE, all on the Second Tier, of which two were stocks transferred from the RASDAQ market, and three were first time listings. As of July, there was only one new listing in 2006, Transelectrica.

The year 2005 also registered three municipal bond listings, the first listing on the BSE of corporate bonds issued by a non-financial company (Hexol Lubricants) and two listings of preemptive rights (Impact and Petrom). From January to June 2006 there were two more municipal bond listings (Bistrita and Navodari).

In 2003, the BSE and RASDAQ started negotiations for a merger with the intention of strengthening the Romanian capital market, by increasing the daily volume and attracting the interest of investors. The merger was agreed to in August 2005 and formally completed in November 2005. Several hundred of the RASDAQ listed shares are already being traded using the more advanced trading platform of the BSE. The historical performance of BSE measured by the progress of the official BET index (including the top ten shares in terms of market capitalization and liquidity listed on the First Tier) ranked the exchange among the best performing markets in the region in 2005. It was 2004, however, that was the year of highest returns, when the BET index advanced by 111.5% (figure 1).



Source: Bucharest Stock Exchange

Figure 1. Yearly BET index performance (2000-July 2006)

The total capitalization of the Romanian capital markets (BSE and RASDAQ) as of July 2006 stood at EUR 19.6 billion. The stocks traded on the BSE accounted for 88% of this capitalization. Capitalization increased more than ten times over the last four years as a result of the escalation in the market value of the companies in the First Tier.

Table 1. Bucharest Stock Exchange - liquidity and capitalization history

Year	Liquidity (Euro mil.)	Capitalization (Euro mil.)
1999	84	313
2000	93	451
2001	149	1,361
2002	222	2,646
2003	269	2,991
2004	598	8,819
2005	2,152	15,311
2006	2,603	17,171

Source: Bucharest Stock Exchange

A breakdown of market capitalization in 2006 shows that the energy sector accounted for more than half (53%) of the value, followed by the financial sector (35%), materials (5%), equipment (3%), pharmaceuticals (3%) and chemicals (1%) stocks. As far as turnover is concerned, the financial sector (comprising a few banks and five investment funds) accounted for 71% of trades, while trades of energy stocks accounted for only 13%, chemicals 7%, pharmaceuticals 5% and equipment 4%[1].

The low daily liquidity of the market, even in the best traded stocks was in the past a strong deterrent for large institutional investors. The average daily turnover

[1] Bucharest stock Exchange, www.bvb.ro

exceeded EUR 1 mil. for the first time in early 2003, and grew to EUR 2.4 mil. in 2004, EUR 8.7 mil. in 2005 and EUR 10,1 mil. in the first six months of 2006.

Liquidity on the bond market has been very low (EUR 35.3 mil. during 2005). This is due to the relatively small size of the issues (the largest issue of municipal bonds did not exceed EUR 6 mil.) and the investors' preference to keep such instruments until maturity (as a result of the yields on these bonds, significantly higher than the ones offered by the alternative long-term bank deposits). The primary offers of municipal bonds were mostly subscribed by banks and investment funds and therefore there is a concentration of the issues in the hands of a few bondholders, which has reduced liquidity further.

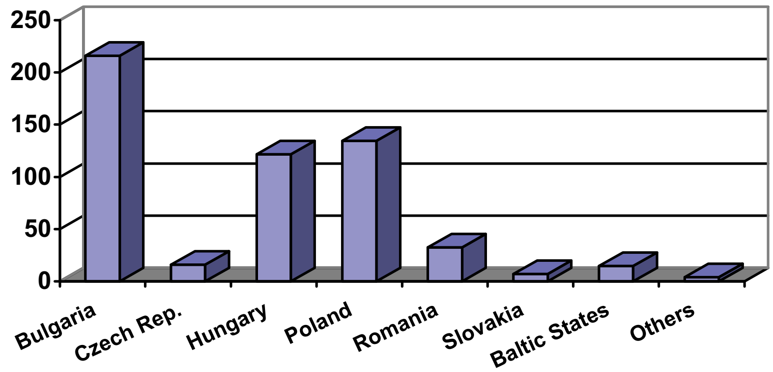
Local institutional investors account for the lion's share of investment on the Romanian stock exchanges. The main categories of buyers on the capital market are the mutual funds, the five financial investment companies (SIFs) and the banking and insurance sectors. Fueled by the sharply falling interest rates on bank deposits, the demand for alternative investment opportunities has been constantly increasing. In the last half of 2005, eight new mutual funds were launched, of which five are focused on capital market investment. The close establishment of the private pension funds will critically increase the supply of investment capital on the market and put additional pressure on the stock exchange. Another stream of investment capital comes from foreign investors, attracted by the country's growth prospects following the accession to the EU. In 2005, the share of purchases of nonresidents on the BSE was over 30%.

Private equity funds (PE)

Private equity (PE) financing in the form of an injection of capital, in exchange for a minority (or majority) stake in the business is available for a limited number of well performing companies, that are in the growth stage of their life cycle, have proven the capacity of their management team and have outstanding growth prospects. The investment cycle of PE funds lasts for a period of 3-4 years and always includes an exit provision generally, through stock exchange listing or private placement.

The main reasons quoted by the managers of PE funds to explain their prior reluctance to invest in Romanian targets were the unavailability of professionally skilled management teams and the limited alternatives on exit (which could only be made through a private transaction due to the underdeveloped capital market). The country's advances in preparation for the accession to the EU, the steady economic growth over the last five years accompanied by the rushing demand for growth capital in many sectors of the economy and the recent progress of the stock market, have caused the acceleration of activity of the PE funds. This is reflected in the increase in invested capital. Judging from the value of the deals, over the last three years there was growing activity in terms of both investments and exit. The European Private Equity and Venture Capital Association (EVCA) reported the PE investments in Romania at EUR 32.5 mil. in 2005 (figure 2), not including additional EUR 51 mil. in transfers among PE investors.

Taking into account the size of the country's GDP, PE investment level in Romania, which stood at 0.06% of GDP in 2005 was still below the CEE average of 0.1% and much below the general European average of 0.32%, according with the European Private Equity and Venture Capital Association (EVCA).



Source: The European Private Equity and Venture Capital Association (EVCA)

Figure 2. Private Equity volume (2005) – Euro mil.

The most dynamic economic sectors in 2005 - retail and the related consumer finance, real estate and IT were among the preferred targets of the PE funds. In retail, two of the three top players in the white goods segment - Domo and Flanco obtained financing against minority participations in the business. Both companies have set up consumer finance firms, also with participation of private equity funds. The large supermarket/hypermarket retail chains (such as Metro, Carrefour, Cora, Mega Image) have available financing from their parent companies, but the smaller, privately owned players in need of funding such as Aritma and La Fourmi were also approached by the PE funds.

In the IT sector, Intercapital and Enterprise Investors took over a 32.5% stake in Siveco (a software producer), while other two top companies Romsys and Softwin are also in view of PE investors. Among the largest private equity deals in 2005, two were transfers among PE funds. In the largest deal, Enterprise Investors acquired 100% of the supermarket chain Aritma jointly held by the SEAF Trans Balkan Romania Fund and a private investor and expressed its intention to list the company on the capital market. In the other deal, Total Soft (a software company) was taken over by the Greek PE fund Global Finance.

The year 2005 was also remarkable by its wave of successful exits. Several PE funds which entered the market in the late nineties or in the early years of this decade, reached the end of their investment cycle and successfully sold their holdings to strategic investors or in a few cases to other PE funds. In 2005, three exits alone (AIG-CET Capital Investment and Enterprise Investors sold 23% stake in Orange, AIG New Europe Fund sold 25% in Astral Telecom and GED Capital Development and Global Finance sold 51% stake in Sicomed) gathered over USD 720 mil.

The returns earned by PE investors in Romania were significantly higher than the average such returns in the EU. For instance, Oressa Ventures, mentions 35% pa return from its recently sold investment in Credisson, Enterprise Investors earned four times its entry price in Orange five years ago, GED Capital Development reported 20-25% return on a group of eight investments in Romania, while SEAF Trans Balkan Romania Fund sold Aritma for more than 2.5 times the acquisition price paid in 2002.

To raise financing with a PE fund, a company has first to fulfill the eligibility criteria related to the size of investment, quality of management, profitability and growth prospects, prepare a detailed and argumented business plan for its activity and try to contact as many as possible fund management companies targeting its economic sector, a search that can be made directly or intermediated by a financial advisory firm.

Conclusion

As Romania became member of the European Union, its financial markets are operating more and more like those of a developed capitalist country and the firms have to take into consideration all the advantages and to face all the challenges regarding the new financing sources.

Listing on the Bucharest Stock Exchange and other markets has proved a very useful way for the firms to raise financing for new investments, with many advantages over alternative sources of funding such as bank loans. A publicly listed company allows becoming more visible and enabling the free trading by investors, who can buy and sell shares, and this brings further advantages besides the initial influx of capital. It can increase a company's ability to obtain more and possibly cheaper finance through issuing either additional shares or bonds (loans).

Private equity financing in the form of an injection of capital, in exchange for a minority (or majority) stake in the business is available for a limited number of high performing companies. In order to raise financing with a private equity fund, a company has first to fulfill the eligibility criteria related to the size of investment, quality of management, profitability and growth prospects, prepare a detailed and argumented business plan for its activity and try to contact as many as possible fund management companies targeting its economic sector.

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