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Erste Bank Analysts: Austria and Poland are the best places within the CEE Equity markets to await better weather in Q2

- **Markets expected to still remain volatile and to take quick profits on yesterday's gains**
- **CEE markets still hold substantial growth differentials to western markets, key advantage in a US decoupling scenario**
- **Within SEE, Romania expected to be first one benefiting from any broader recovery**

Erste Bank analysts say their forecasts for Q1 have been realized and 2007 reporting has resulted in some financial institutions giving a clearer picture on the full damage of the US sub-prime crisis. They say this "reporting effect" could be seen as fading out, even though indications are that first quarter figures are still showing some existing difficulties. However, they say recession talk in the US and fears on spill-over on real economy globally will take over headlines.

"Our view is that markets have yet to bottom out and we still expect volatility for some time, together with quick profit taking on yesterday's gains. However, nervousness should start to faded. In the best case, a decoupling from the US economy becomes a reasonable theme for markets", says Henning Esskuchen, Co-Head of CEE Equity research at Erste Bank. *"We continue to believe that CEE markets still have substantial growth differentials to western markets on the cards and this card could be played well within a decoupling scenario,"* adds Esskuchen.

Erste Bank analysts say recent the ZEW/Erste Bank sentiment indicator yielded a fairly positive view on the current situation, while survey participants had an improving view on economic expectations for both, Eurozone and CEE. While most participants expect some slowdown in activity, still 20% see accelerating M&A activities. Romania and Poland were mentioned as the most attractive targets, while on the investor side Germany was in the leading position closely followed by Austria, confirming the seamless integration of Austria into the CEE growth story.

Erste Bank analysts are expecting markets to bottom out, but no immediate take-off afterwards is seen. They say some more sideward movements should prevail into the second quarter and they recommend sticking to liquidity and size, although some positioning for calmer markets in the second half of the year should already be considered. *"Austria and Poland are seen as the best places to wait for better weather. Within SEE we would remain cautious, but see Romania as the first one to benefit from any broader recovery, once investors are willing to tap smaller markets again. For Russia and Turkey risk aversion will need to improve considerably before these markets become more favorable again",* says Esskuchen.

CEE markets expected to experience some slow down in growth, but mostly in line with maturing business cycles. Austrian and Polish markets rated with overweight.

- **Austria's** 12M forward P/E (10) is significantly below its historical average (12.9) and the current spread between benchmark yield and earnings yields (5.9) is much above the historical average of 3.4, asking for a bit overdone risk premium for Austrian equities. CEE growth channeled into the Austrian market will remain appealing.
- Compared to other CEE markets, **Poland** might appear a bit "expensive" on a P/E of 15.4 on 2008 earnings and also risk premiums for equities are at about the historical average. Under current cir-

cumstances liquidity and size remain strong arguments and Poland remains second after Austria with an average daily turnover of EUR 253mn (single counted) in 2007. Assuming a bottom in 2H, the depth of the market could be another argument, in a way that it offers sound second line ideas among small and mid-caps.

- Given the kind of turn-around nature of the entire market, **Hungary** would be rated as an overweight, but current environment calls for prudence.
- A low weighting for **Czech** market appears to be justified within the current market environment, when volatile markets recommend remaining rather in big size.
- **Slovenia** together with **Croatia** remain the most demandingly valued markets. Local liquidity should be able to lift prices occasionally again, but within the current environment of risk aversion investors are recommended to stay away, even though a few stock picking opportunities prevail (Krka, Gorenje).
- For **South East European** markets selective stock picking opportunities remain, but the market overall has still a lot of vision priced in and vision does not sell well these days.
- Notoriously expensive **Romanian** market has given back a lot of its premium and trades now at P/Es of 13.2 and 9.5 on 2008 and 2009 earnings, respectively. Admittedly the country runs risks (with regards to CA deficits, corresponding impacts on currency etc.); however, these risks seem acceptable for a market in this stage of development and would have been accepted in any other environment. FDI greatly cover the CA deficit and will contribute to profitability increases and exports in the mid to long-term.
- The low valuation of the **Turkish** market has to be seen relative to growth and the accumulated negative expected return for the market. In total, market to be called a neutral weight.
- **Russia** is pretty similar to Turkey: more neutral weight. The change in presidency went smoothly and the political program recently announced sounds business friendly. As long as uncertainty remains, investments in commodities might remain an option (assuming that recession fears do not massively steer sentiment).

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