

TREND

## monitor

Weekly Service on Slovak Economy in English



## Focus: Penta, sexta, etc.

Private equity group is changing

Restructuring debts of Czech lottery firm Sazka might sound boring. Yet, private equity group Penta offered two to three billion Koruna (€80-120 million) for the indebted company with the aim of overtaking it. This way, Penta could chain its gaming holding Fortuna with the prospective lottery giant in Slovakia's western neighbor. Similar and highly profitable restructuring deal had been done by Penta with a regional Czech water management company some time ago.

Long-term profitability of Penta can be documented by the growth in its net assets value (NAV). In 1996, the NAV stood at less than €2 million. Last year, the group posted a net value of its assets at €859 million, managing altogether as much as €2.7 billion. The group's investment strategy has been formed after 2000, when it restructured wire manufacturer in Hlohovec (now Bekaert) and aluminum producer in Žiar nad Hronom (ZSNP, now Slovalco). Later, Penta entered the health care as well as

the real estate business. Its analysts carefully assess the potential of the group managing this or that firm and increasing its value – the core of the private equity business. By selling the firm later, Penta's aim is to earn a 25% annual yield on each of such restructuring. Now its firms employ almost 30 thousand workers. Penta has been named after its five founders. Yet, one of them announced he's quitting and two others are to join the leading team.

In health care, Penta serves as an insurer to 1.4 million clients, acquired several hospitals, laboratories as well as pharmacy chain. The group sees an expansion potential in Poland, as well as in the aging demographic trend, creating more and more demand for health care. Penta is also ambitious in the banking sector, where it has smaller specialized Privatbanka and recently bought local branch of Dexia banka.

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### IN BRIEF

**DECEMBER 27.** Mining company Siderit should re-launch its operations. Minister of Economy Juraj Miškov told the SITA press agency that in early 2011, the way to save the local 600 jobs should be found.

**DECEMBER 28.** Price impact of compulsory purchases of

energy produced from renewable sources will be partly mitigated. President Ivan Gašparovič signing an amendment to the law on state support of renewable resources.

**DECEMBER 29.** Zvolen-based company Bučina, one of the largest woodchip boards producer in Slovakia, stopped its production due to the lack of wood.

**JANUARY 1.** The basic value added tax (VAT) rate increased by one percentage point to 20%. Lower 6% rate has been abolished. 10% rate remains to be levied on health care products and books.

- Households will pay more for energies in 2011. Electricity price should increase by 4.8% on average. Natural gas will be on average 4.5% more expensive. The prices

of heat should increase by six percent on average.

**JANUARY 3.** Two new water power plants should be erected in the Levice and Stará Ľubovňa districts - western and eastern Slovakia. The first one is to cost roughly €150 million. It should be built on river Litava by Pow-en company. Firm Slor aims to build the other power station on river

Poprad for €2.3 million.

**JANUARY 4.** The state railway company ŽSR is soon to decide on cutting five percent of its train connections. The cuts stem from the lower orders of state in personal railway transportation. Apart from fewer lines, the railways want to improve its finances and attract more people into train transport.

# GUARDING THE JUSTICE

Tim Evans is the president of the UK Libertarian Alliance and talks about the role of the private sector in areas usually dominated by the state, such as police, justice and health care.

**» Why did you accept the position of an advisor to Slovak Prime Minister in 1991?**

That was a period of change. The government machinery was transforming from socialist to democratic. Ján Čarnogurský wanted an apolitical advisory team and asked me to form it from international experts. The first aim was to find and train young Slovaks to have local advisors in a two years' time.

**» What is your current opinion on Slovakia?**

Trust, transparency and legally consistent rules are still challenges to your country. The people should understand that justice or police do not have to be necessarily provided by the state. In Britain, 20 percent of legal suits are solved by private courts. I

would welcome a discussion on the role of the private sector in justice. Competition increases quality standards.

**» Is crisis a market failure?**

This crisis is not a market failure. In 1991 I suggested not to have a Slovak central bank. The euro is a socialist project; we should prefer a system of competing currencies. According to the Austrian school of economics, there would be no crisis if there were no central banks. And the deficit fiscal financing. That is a state failure, not a market one. The more new regulation we implement the worse the situation will be. The current banking system is a pyramid. Imagine we lived only in this room, have everything we need, only must not walk through the doors. In the case of fire, we either burn or open the door. This crisis makes us opening the door we never believed to walk through.

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## AIDED INVESTMENTS

### *Stimuli for business*

Slovak governments have approved investment incentives of nearly €1.18 billion since 2002. The 108 state-aided corporate investment projects worth over €6.1 billion in eligible capital expenditures, which were supposed to create more than 40 thousand new jobs, were promised to gain one-fifth of the investment costs on average. The companies have drawn slightly over a half of the allowance according to the report of the Ministry of Economy. Twenty of the projects worth €446 million in capital expenditures and tied to 3475 new jobs will not be realized. The largest foreign direct investments given a state aid were the carmakers PSA and Kia that decided to build their factories in Slovakia. The Cabinet approved 44 percent of all state aid applications in late 2006.

The most frequently used incentive form of aid were grants for acquiring capital assets, of where companies used over €393 million of the approved volume of €547.5 million. The least drawn aid so far was the tax break. The investors only used €90 million of the total €439 million approved by the governments so far. A similar amount was drawn for the purpose of job creation and trainings, even though the approved amount was much smaller: €140 million. **page 8**

# RIGHT TIME FOR REFORMS

**N**ow is the right period for reforms, says the Institute of Financial Policy (IFP) at the Ministry of Finance. That is also the message from most of the Slovaks to the Cabinet of Prime Minister Iveta Radičová. Part of the society supporting the reformist effort, even including tax increases, IFP states.

The IFP analysts refer mostly to the Eurobarometer research from September, finding that 83 percent of the respondents agree that reforms are necessary for Slovakia. Compared to the previous year, the support has increased by 5 percentage points. IFP's statement does not match the other finding of the research - that there is low trust in the ability of the government to fight the economic crisis. The people in Slovakia trust the EU's competence (32 percent), followed by the G20 economies and the International Monetary Fund. The Government was ranked at the fourth place with a 10 percent support.

Impacts of the economic crisis forced the Cabi-

net of Mrs. Radičová to introduce its fiscal austerity measures. According to the approved state budget, the income and expenditure changes should lower the fiscal deficit by €1.7 billion this year, which is 2.5 percent of GDP. The fiscal healing may slow the reforming effort down according to the IFP. On the other hand, the analysts expect a positive impact of the economic and election cycle on the reformist atmosphere. "The most suitable time for reforms is the second year after recession and the first two years after [parliamentary] elections," IFP adds.

Compared to 2009, the research refers to higher acceptance of deficit's decrease by tax increases among Slovaks. As in 2009, only 14 percent of the respondents admitted such option. Last autumn it was 20 percent. Even higher support of nearly one-third of respondents got the option of fiscal consolidation via cuts in public expenditures.

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## MACRO SUMMARY

- ✦ Index of economic sentiment reached its after-crisis maximum in December. According to the Statistical Office, the indicator improved by two points to reach a value of 94.8. The long-term average stands yet three more points higher however. Business confidence in industry jumped to the highest level since summer 2007, owing most probably to the economic growth in Germany.
- ✦ Registered unemployment rate slid slightly in November to 12.2%, the Office for Labor, Social Affairs and Family reported. Unemployment rate calculated from all job applicants, including those not able to start an employment immediately, stayed at 13.9%.
- ✦ Central state budget deficit reached €4.4 billion (6.7% of GDP) in 2010. According to the figures of the Finance Ministry, the deficit was slightly lower than expected thanks to cash transfers from state-owned companies.

## Brief Statistical Overview

(Slovakia)

	2009	3.7	Current Period		Forecast
<b>GDP</b>	-4.7	3.7	(Q3 2010)	↓	3.3 (Q4 2010)
<b>Consumer Inflation (%)</b>	0.5	1.0	(Nov 2010)	↓	1.3 (Dec 2010)
<b>Producer Prices (%)</b>	-4.9	-1.0	(Nov 2010)	↓	-0.1 (Dec 2010)
<b>Unemployment (%)</b>	12.1	14.1	(Q3 2010)	↓	14.4 (Q4 2010)
<b>Current Account (% HDP)</b>	-3.2	-3.0	(Jan-Oct 2010)	↓	-3.1 (2010)

Notes: Unemployment according to Labor Force Survey. Forecasts based on prognoses of bank analysts and TREND Analyses.  
SOURCES: Statistical Office, National Bank of Slovakia

## FORESTS GOING ONLINE

The state-owned forest company Lesy SR (Forests of the Slovak Republic) was in the past misused for various speculations and deals beneficial for people close to the former government. Many deals were signed based on large volumes of timber and low prices. These contracts valid for several years are now blocking Lesy SR from better deals and profitability. Old contracts mean that in 2012 the company will not be able to auction 2 million cubic meters of raw wood, almost half of its production. In 2020 around 0.5 million will be still blocked due to long-term contracts. But the new management of Lesy SR is confident to fulfill these contracts with the current price based on new internet auctions. Internet auctions are to raise the price of raw wood upwards and decrease the room for corruption and harsh bargains. But local wood-processing companies are afraid of large exports of Slovak wood abroad and higher prices will mean rising costs for them and result in stumbling export of Slovak wooden products.

However, Lesy SR are focusing on higher prices of raw wood, because Slovak wood is currently the cheapest in the region. For example price of coniferus roundwood is by €10 per cubic meter lower compared to the Czech, Austrian and German prices. For example, the very first e-auction done in December resulted in 35% increase of the starting price. So far 150 prospective buyers joined the e-auctions.

For extended exports of raw wood, Lesy SR will establish two types of e-auctions: closed and open. Whereas to open auctions anyone can join, to the closed ones only Slovak wood processing companies will be allowed to join. Slovak wooden companies are negotiating about the volumes and share of closed auctions. According to their needs, closed auctions will represent around 70 percent of all auctioned volumes. This protectionism will not be punished by the EU, as the same system is used in many EU countries.

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## PANASONIC LAYING OFF

### *Productivity taking toll*

Krompachy-based DVD and Blu-ray players and recorders manufacturer Panasonic will lay off 162 people in February. Out of this number, 150 are blue-collar workers. Last year the factory was employing 900 people, but the sales of DVD recorders slowed. Blu-ray players, despite volume growth, witnessed decreasing prices. On top of that, expanding Blu-ray production is much easier for assembling and thus they do not require so many workers in the factory. Last year Panasonic manufactured 60 thousand fewer products than in 2009, when it reached one million units. The firm's revenues dropped by over ten percent to €148 million. This year a drop in revenues is also expected, with a slight increase in manufactured volume. In March 2010 Panasonic started to manufacture also 3D Blu-ray players. The factory is supplying the whole EU market with DVD recorders and Blu-ray players. There is no fear about keeping the factory in Krompachy. The CEO of Panasonic Europe Laurent Abadie confirmed that Slovak plants of Panasonic have its solid place in the company structure. Besides Panasonic AVC Networks Slovakia, there are two more manufacturing sites of Panasonic - located in Trstená and Stará Ľubovňa.

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## AUDITORS MERGING

Since January 1, a new consulting company appeared on the Slovak market. VGD Avos was established by a merger of Piešťany-based group under the brand Avos and Bratislava subsidiary of Belgian VGD. Both companies are focused on accountancy, tax advisory and salary administration. These activities represent 70 percent of their revenues; the rest is performed by the auditing department. Each company is having yearly revenues around € 1 million. With the joined revenues of € 2.1 million, VGD Avos will not compete with the Big Four represented by Deloitte, PricewaterhouseCoopers, Ernst & Young and KPMG. But it will become one of the top ten on the Slovak market. Thus Slovakia will be the third country after Belgium and the Czech Republic where VGD is in the top ten consulting companies. Avos' contribution to the new merged company is its local experience. VGD was aiming to acquire new Slovak companies and be helpful al-

so for the international clients. VGD does not yet have partners from Slovakia. It wants to further expand to regions of Slovakia distant from Bratislava. The CEO of VGD Bart Waterloos admitted there are plans for further expansion of their services in Slovakia. On the contrary, for Avos the international presence of VGD as well as its participation in Nexia - organization which joins accountancy and consulting companies around the world for over thirty years - is crucial. Avos' clients are international as well as Slovak.

VGD was founded 30 years ago in Belgium. In 1994 it entered the Czech market, where it merged with NBG Consulting and Podzimek a Šuma. In 2002, VGD Audit SK was established in Bratislava. One of its top clients is Slovak national lottery Tipos, Slovak subsidiary of McKinsey & Company and Spanish automotive supplier Grupo Antolin.

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### CORPORATE INVESTMENTS

#### GERMANS IN SUČANY.

In April, construction of Volz Luftfilter plant for manufacturing air-conditioning and industrial filters will be launched in Sučany. German investor via its Slovak subsidiary Volz Filters is already assembling filter systems in rented premises.

es. The project is estimated to cost €13 million, several million euro will be necessary also for equipment, technology and machines. Volz will first assemble filters from imported parts, mostly from Germany. Later also production processes present in Volz factories in German Horb and English Manchester might be moved to Sučany. Around 300 jobs will be created.

#### STARTING IN AUGUST.

Investments into infrastructure and galvanizing technology are planned in Zvolen-based factory of Continental Automotive Systems Slovakia. Since 2006, brakes and brake components are manufactured in this plant for many car-producers. The expansion of the plant took place in 2009; the new galvanizing line will be launched in August 2011.

#### BIOGAS COOPERATIVE.

Sporiteľné Družstvo Lužianky is the next investor in Čab industrial park near Nitra. Costing €15 million, it will put up a new biogas power plant. Electricity and heat will be produced there from the food leftovers of households, restaurants and shops. The production of electricity from bio-waste ought to be launched next year.

#### HONEYWELL FURTHER.

American Honeywell International, supposedly, decided to put up its new factory for turbochargers for car engines in Slovakia. The initial investment of €38 million in Prešov will create 446 jobs. According to its volumes, this investment qualifies for state investment stimulus. The final sum of subsidy and tax relief will be decided by the Slovak government.

# SLEEPING APARTMENTS

The developer of a large 400-apartment complex in High Tatras, British Letterstone, has offered its clients to pay back half of the first installment, with the other half being subtracted from the purchase price once the complex is finished. If it is finished at all. The project called Silver Resort was put on hold, with few buildings standing. The developer plans to continue construction once the demand picks up. That's why there is now a possibility of getting half the money back. Silver Resort is the largest of the planned recreational projects in Slovakia. Some of the recreation apartment stories are even worse, with no solution and no money back. The whole sector of recreation building has been struck by crisis the hardest. The developers miscalculated the demand and there are now many empty buildings and bungalows along Donovaly or Hrabovo. According to Lexxus property agency more than 2 500 such apartments were vacant this summer,

which is half their total number. The demand starts picking up though.

In the years of boom many have started to build the recreational apartments, often for sale rather than own use. Some of the developers guaranteed the owners that they will provide lease of the apartments, thus saving a part of the purchase price. But the bust that came didn't help getting clients into the apartments.

Currently the demand is slowly rising, but the clients are also pickier. They are looking at the possibilities of relax near their apartments and choose localities that have a lot to offer. Which is good for the market, as it makes the developers compete in the services and amenities sectors. Still, there are many projects that have been stopped half way, some of them have even been executed and auctioned off.

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## VAT in Banks

Increase in VAT from 19 to 20% will be felt in banking fees as well. Yet most of the services in banks are VAT-free. The services that do fall into VAT category include managing foreign securities, lease of security boxes, consulting and advisory services or banking information requested by a client. The new fees have been amended into the price lists of banks since January 1<sup>st</sup>. The fees themselves have not changed, only the VAT has increased them a bit. The common retail client will feel it in different notes required for mortgage. But only those requested by the client. | page 54

# RISKY AND RISKIER

Last year TREND predicted that the credibility of financial markets will slowly rise. The confidence was returning in different ways: the stock market attracted investors with good results of strong companies. State bond market, on the other hand, was much more shaky: the bond market was not considered risk-free anymore. The conservative Slovaks stuck with their usual guns and chose to save their money mostly in bank products. That's despite very low interest rates. They have been investing in mutual funds a bit more than before, but were choosing mostly conservative investments, i.e. those with bonds. This year the interests on deposits should rise a bit, which will keep banking deposits an interesting option especially due to legal deposit protection. The shares will draw more clients, while state bonds will remain a questionable investment, despite governments trying hard to instill the air of non-risk in them again.

In 2010 the deposits were once again on the rise, after the outflow of 2009. In the first ten months of 2010 the banks received a net inflow of €600 million. This was mostly in the form of current accounts, long-term deposits were not the instruments of choice. For those wanting to deposit their money for longer-term, the multi-year products had better interests, leading to the outcome that longer than one year deposits now prevail.

Mutual funds predict that the most important thing will be handling the state debt in the EU and the USA. They believe that the clients will be withdrawing money from bond funds and either putting them more in shares and commodities or in other financial instruments, such as longer-term deposits. Commodities are an alternative investment of choice: the predictions say that e.g. price of oil can surpass USD 100 per barrel.

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## Funds to Watch

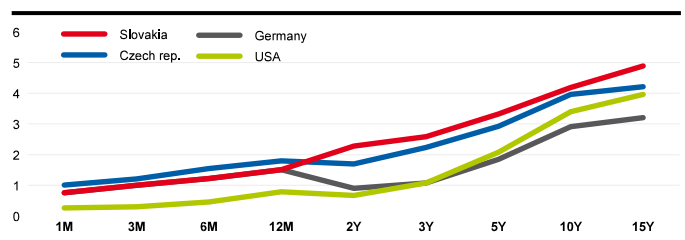
TREND asked several investment experts how would they invest their savings this year. The main event that will influence their decision is the expected increase in the key interest rate of the ECB. Currency and bond funds will be glad if they beat the inflation this year, which is expected to reach 3.3 percent in Slovakia. Currency and bond funds will be negatively influenced by the increase of the key rate. At least 30% of the experts advise to go for riskier investments. Commodities such as wheat, oil or precious metals are in high demand and ever shorter supply, meaning a long-term return of 5 to 8 percent a year. The other option is to look at regional funds in prospective regions. | page 55

## PENSION HIGHWAY

Ministry of Transport is now working on an analysis that should lead to the possibility of investing pension savings into highway construction. The current estimates say that approximately €700 million could go for this goal, with additional €150 million each year. Ministry of Labor is currently preparing a new set of investment rules that will allow pension managers to buy such bonds. The highway bonds should offer interesting yields and be guaranteed by the state. Similar funds in different countries allow such investments, but in much lower ration. In Ireland, for example, only 1 percent of all pension savings is set aside for infrastructure investment. The current investment rules force the managers to put money into highly conservative short-term instruments, this has to be changed in order to buy the highway bonds.

## Yield Curves

(central banks' reference rates and government bond yields as of January 7, 2011, in % p.a.)



SOURCE: Bloomberg

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