Opportunities and Risks of Austrian Corporates in Central and Eastern Europe – An Empirical Analysis of the ATX Prime

Presentation at the OeNB

On March 7, 2008, the Oesterreichische Nationalbank invited Peter Szopo, head of Sal. Oppenheim's equity research, to present a recent study by Sal. Oppenheim Austria on "Opportunities and risks of Austrian corporates in CEE – An empirical analysis of the ATX Prime."

The Austrian equity market is highly exposed to Central and Eastern Europe (CEE). Based on the regional split of the companies' top lines we estimate the current CEE exposure of the ATX Prime, which is composed of 58 shares, at 42%. In other words: More than 40% of the aggregate market valuation can be derived from the companies' operations in CEE. This figure is higher than both the market's dependence on the domestic economy (29%) and on the rest of Europe (23%).

In contrast to its bold move into CEE, Austria's corporate sector has been lagging those of e.g. Switzerland, Scandinavia or the Netherlands in its expansion outside Europe. Austria's listed sector, in line with the broader economy, is Europe-centered. For the overall market, the exposure to non-European markets is less than 10%; for non-financials just 11%. In a way, the reliance on the fast-growing economies in CEE compensated the Austrian economy and the listed corporate sector for the (on average) poor presence in the other growth regions of the world, like East Asia, and more recently, Latin America.

We expect to see a further rise in the market's CEE exposure for several reasons: First, recent investments in the region are simply not yet fully reflected in current figures, either because the projects are still not completed or the new operations are still too small or too recent to be consolidated. Second, almost all core players with significant operations in the region plan to strengthen their CEE presence (by expanding in countries where they are already on the ground, adding new markets or taking over competitors). Third, a number of companies that have not been very active in CEE so far are now entering the region. Finally, and possibly most importantly, the superior growth outlook for CEE relative to Western Europe is likely to increase the share of CEE business for most companies, even without any further shift in capital expenditure toward the region.

There are reasons to assume that the increased economic integration with CEE has been highly beneficial for Austria and its corporate sector, listed and unlisted. Macroeconomic simulations by the Austrian Institute of Economic Research (WIFO) show that the Eastern opening has been adding 0.15 percentage points annually to real GDP growth, has supported employment growth (although estimates vary widely), and has contributed to Austria's strong productivity gains over the past decade. In our view, the corporate sector has benefited in several ways: (a) The opening of CEE was a key catalyst for many Austrian companies to start any international expansion at all. (b) CEE was also crucial in allowing many companies to achieve scale effects that would have been unattainable in the domestic market alone. (c) The CEE expansion not only brought access to new and much bigger, but also more rapidly-growing, markets than the domestic ones. (d)

Austrian companies, which tend to be small or mid caps in a global context, have often managed to be among the market leaders in CEE – something they would typically not have achieved in Western Europe. (e) There is some evidence that CEE operations tend to be more profitable than the domestic or Western European business, either because of better margins, or because the expansion into the region allowed companies to move into more profitable business segments. (f) Finally, the CEE expansion provided companies with a broader risk diversification because – despite rising integration – the business cycles between mature Western economies, new EU members, and CIS economies are unlikely to become fully correlated anytime soon.

The market's high CEE exposure may partly explain why the Austrian stock market underperformed other European stock markets toward the end of 2007. Investors seemed to be increasingly nervous about what they saw as mounting risks in the region. The main argument in this context is that, due to external imbalances which characterize many of the CEE economies as well as the private sector's high foreign exchange exposure, the region may be harder hit by an international credit crunch than other parts of the world. We feel that the market has overreacted, particularly after the recent correction: First, the macro concerns just mentioned only apply to some countries (Balkans, Baltic states) while the biggest economy in the region, Russia, is not affected at all; also, Poland and the Czech Republic are in good health. Second, even in those economies with a credit boom and a surging domestic absorption, growth seems to reflect "normal" convergence rather than a fundamentally irrational boom. Growth is likely to slow down, but will stay ahead of Western European growth.

The ensuing discussion centered primarily on the ongoing global financial market turbulence, particularly how secondary effects might turn out after primary effects of the crisis have been contained, whether we have been observing a downward overshooting reaction in equity markets, and the likelihood of contagion – especially with respect to CEE. In this context, there was also some debate on the optimal timing of market entry as – according to Peter Szopo – a number of Austrian equities have fallen well below the level justifiable by fundamentals so that they currently offer a good opportunity to go long.