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Strong market has regional pull

A large local economy, thriving stock market and reliable regulation make the city attractive to finance, says **Jan Cienski** who wrote this report

About 22 years after the end of Communist party rule, Warsaw is creating an international role for itself in finance.

Two decades ago, anyone suggesting that Warsaw would have any sort of future as a financial hub would have been laughed out of the handful of modern offices that then existed in the Polish capital.

With no stock exchange, no system of regulation, banks that did not lend money, real estate transactions concluded with cash-filled shopping bags, and business dominated by inefficient state-owned enterprises, Poland had none of the muscles and sinews of a functioning market economy.

At a time when brokers and bankers in places such as New York and London met at swish restaurants and health clubs to do deals, Warsaw lacked any decent restaurants or even grocery shops, and finding a roll of sandpapery toilet paper represented a shopping triumph.

The reformers who took power in 1989 were well aware of how far behind the country had been left by the experience of the second world war and the more than four decades of communism that followed it, and they had no illusions about Poland trying to rebuild capitalism on its own.

From the very beginning, the idea was to take well functioning systems from the developed world and transplant them.

In the case of capital markets, a group of academic economists with very little real-life experience of capitalism toured stock exchanges and regulators across western Europe, the US and Japan to gain ideas for building the stock market and securities and exchange commission.

"We have clear rules of the game," says Stanislaw Kluza, head of the Financial Supervision Authority, Poland's unified financial service regulator.

Built on a foundation of solid regulation, the Warsaw Stock Exchange has boomed, becoming central Europe's largest capital market with a capitalisation of more than €142bn.

In recent years, the WSE has started to attract non-Polish companies, and now lists enterprises from the Czech Republic, Hungary, Ukraine and other countries from around emerging Europe.

"Foreign companies are here because of the size of the stock market and of the Polish economy and because we provide an opening to the whole region," says Ludwik Sobolewski, WSE president.

The stock exchange created a class of Polish retail investors, who account for about 20 per cent of the market's turnover. It also built up local investment funds and attracted foreign investors, responsible for 47 per cent of volume.

"If you want to do an IPO for a company active in central Europe, the WSE is the only option," says Jaroslav Hascak, partner at Penta Investments, a

Continued on Page 4

Reflections on history: A statue of former mayor Stefan Starzynski in front of the Blue Skyscraper in Warsaw's Bank Square

Dreamstime

Inside this issue

Fiscal problems limit the flow of pension money

Funds

Privatisations are fuelling interest from investment banks and private equity

Poland's capital markets are a symbol of the country's enormously successful transformation from socialism to capitalism.

However, ut in spite of the muscular adoption of free markets, the government continues to play an important role.

Government involvement has had both positive and negative effects. The most obvious impact is from the treasury ministry's privatisation programme.

This is regarded as being vital to keep the country's public debt from overshooting the self-imposed legal threshold of 55 per cent of gross domestic product.

This year, the government plans on earning 15bn zlotys through the sale of assets.

The biggest revenues are likely to come from the sale of shares in the country's largest bank, state-controlled PKO BP, which could raise 13bn zlotys before the end of the year.

Also on the block is JSW, a hard-coal mining company that is slated for an initial public offering on the Warsaw Stock Exchange by the end of the year.

A host of smaller government-owned companies are also expected to list on the stock market.

The year's largest likely non-privatisation transaction – the sale of Polkomtel, a mobile telephone operator, for about 18bn zlotys – also has a government angle: most of the largest shareholders are government-controlled groups, such as refiner PKN Orlen, power generator PGE and copper miner KGHM, which have all decided to sell their stakes in the company to raise funds for their own needs.

Transactions such as these are likely to fuel continued interest in the WSE, as well as attract investment banks and private equity funds – some of which are bidding for Polkomtel.

"These transactions are pulling in a completely different class of player," says Jacek Radziwilski, chief executive of UniCredit CAIB, a unit of the Italian bank, which is one of the most active investment banks on the Polish market.

"Without the supply from the treasury, none of them would be here."

Aleksander Grad, the treasury minister, is particularly keen to sell companies through the WSE, because it tends to be much less problematic politically than offering companies directly to investors.

This was clearly demonstrated by the botched sale of Enea, Poland's third largest power generator.

The ministry is also pleased at the high valuations on the WSE, something the government has also played a role in bringing about.

That is because among the most significant participants on the WSE – accounting for 7 per cent of turnover – are private pension funds, created following the reform of the retirement system in 1999.

Until this year, 7.3 per cent of workers' salaries was diverted to the funds, 40 per cent of which can be invested in the stock market.

However, faced with growing fiscal problems, the government this year slashed the share of salaries flowing to the funds to 2.3 per cent, although it has promised to allow the funds to gradually invest more in equities, rising to 62 per cent of their portfolio by 2020.

> 'If you reduce the role of the pension funds, someone has to take up the slack – that will probably be foreign funds'

"The changes could make funds less active on the local market," says Ewa Radkowska-Swieton, board member in charge of investment for ING PTE, part of the Polish subsidiary of the Dutch bank, with 55bn zlotys under management.

"If you reduce the role of the pension funds, someone has to take up the slack – that will probably be foreign funds, which increases the risk of volatility."

However, the funds currently have more than 85bn zlotys invested in stocks, and they are unlikely to sell quickly, so the government's changes are unlikely to create a short-term vacuum on the market.

Any shortfall in interest from the pension funds could be made up by classic investment funds, which have most of their assets in stocks, albeit not just Polish ones.

The government is also promoting them as a way of getting Poles to save more.

After seeing a significant increase in redemptions, following the onset of the stock market crisis in 2007, investors have been returning to investment funds – which reported a strong 2010, thanks to a recovery on the WSE.

Last year, an additional 23bn zlotys flowed into investment funds, a 24 per cent increase on 2009.

"There is a growing understanding that investments are aimed not just as spectacular short-term gain, but can be used for the long term," says Malgorzata Gora, the head of Union Investment TFI, with 8.4bn zlotys under management.

Broker sees city as regional centre

Profile
Wood & Company

EU accession was a 'game changer' for the bourse and its traders

Wood & Company got its start as a brokerage during the controversial privatisation programme launched by the Czech Republic in 1993, just after the collapse of communism.

But although the company's headquarters are still in Prague, in an office overlooking the building where Czechoslovakia declared its freedom in 1918, its centre of gravity has shifted to Warsaw, the region's business centre.

"We still have back-office operations, and the history of the company is in Prague, but Warsaw and London are our profit centres," says Sebastian Siejko, Wood's head of equities, and one of a host of top level professionals hired by the firm, as it has rapidly expanded its Warsaw office by poaching talent from its brokerage and investment bank rivals.

'This region is our bread and butter, and Warsaw is the market where we have the greatest possibility for growth' – Sebastian Siejko

Wood is one of the largest forces on the Prague Stock Exchange, where it accounts for about a quarter of daily secondary equity market trading. However, Prague only has 15 listed shares, with a daily trade volume of about Kcs1.4bn ($84m).

The Prague exchange had a tumultuous birth, with hundreds of tiny companies listing as part of the privatisation scheme, before the exchange withdrew 1,300 stocks in 1997 because of the lack of liquidity and was forced into a reorganisation.

By contrast, Warsaw started slowly. The exchange has always been conservative when it comes to regulation, allowing only properly vetted companies to list.

As a result, it grew steadily and with ever-increasing momentum. In recent years, it has rivalled the London Stock Exchange for the number of new listings.

Last year, Warsaw had 112 IPOs on its regulated and alternative markets while Prague had none.

Wood tried to penetrate Warsaw in the late 1990s, but shut down its office after failing to generate enough volume. It returned after Poland, the Czech Republic and other countries from the region joined the European Union in 2004.

"It was a game changer," says Jan Sykora, one of the company's four managing partners.

Last year, Wood decided to expand its Warsaw operation much more aggressively. It has seen its market share rise from 2 per cent of trades to 5 per cent and Mr Sykora wants it to hit 10 per cent this year.

"The current ambition of Wood is in a way a response to management's view of Warsaw's future as a regional financial centre," says Pawel Tamborski, the head of investment banking in central and eastern Europe, formerly a senior official with UniCredit CAIB, one of the region's leading investment banks.

He adds: "Poland is going to be the locomotive of the business."

Wood has rapidly scaled up its operation in Warsaw, growing from seven people to 30, and in the process becoming one of the region's largest integrated investment banks.

The goal is to continue to play a growing role in equities trading, as well as helping arrange the IPOs of companies from across the region who want to list on the WSE.

Warsaw is an increasingly popular listing choice for companies from Ukraine to the Czech Republic and Bulgaria, an area that Wood wants to capitalise on, thanks to its regional network.

In addition, the firm is hoping to break into the growing mergers and acquisitions market, where €100m deals – a rarity elsewhere in the region – are becoming increasingly common.

There is also the prospect of winning a slice of the government's privatisation programme: the treasury ministry is planning on selling 15bn zlotys ($5.3bn) in government assets this year, and the ministry has made it clear that investment banks without a presence in Warsaw are not welcome to take part.

"This region is our bread and butter, and Warsaw is the market where we have the greatest possibility for growth," says Mr Siejko, gazing out at a view of the fast-changing Warsaw skyline from his perch at a table in a restaurant on the 22nd floor of a new office tower.

Growth market: brokers and traders welcome the increasingly international focus of the WSE Bloomberg

Bourse pursues foreign groups as it vies to lead central Europe

Stock exchange

There is still plenty of scope for expansion

Changes in the make-up of the Warsaw Stock Exchange's WiG20 blue-chip index are not usually big news. However, the recent addition of Kernel Holding was an exception, because it is the first Ukrainian company on the list.

"This event brings Kernel and Ukraine under the spotlight of the international investment community," Andrey Verevskyy, the company's chairman, said in a statement after the change was announced. Kernel was the second Ukrainian company to list on the WSE, debuting in 2007.

Its presence is a sign of the importance the WSE places on attracting foreign companies. The exchange is also planning to set up a Ukrainian index shortly, reflecting the growing number of companies from Poland's eastern neighbour choosing to list on the WSE.

"We want to be an object of interest not only for Polish companies," says Ludwik Sobolewski, the exchange's president. "Ukraine is the most important market for us."

Kernel is the second foreign company on the WiG20; it was preceded five years ago by CEZ, the Czech energy conglomerate. Last month, the WSE saw the first listing by a Lithuanian company, Avia, which provides air services. It already includes MOL, a Hungarian oil and gas group, while Nova KBM, a bank from Slovenia, is planning an IPO this year.

The wide range of foreign companies is part of Mr Sobolewski's strategy of making Warsaw central Europe's leading bourse. With a market capitalisation of more than €142bn ($205bn) it has passed putative rival Vienna – with a market capitalisation of €94bn – and has left Prague and Budapest far behind.

Now, Warsaw is aiming to pass such exchanges as Istanbul and Oslo, where market capitalisation is more than €200bn.

The WSE's strength rests in its key role in the Polish economy, the largest in post-communist central Europe. Unlike other emerging European bourses, the WSE was always strictly regulated and professionally run, which kept out dubious companies that ruined the reputations of some smaller exchanges.

The Warsaw bourse has long been one of the most important market institutions in Poland – a symbol of the success of the country's transition from communism to capitalism. It began trading in 1991 on the top floor of the old Communist Party headquarters, trading only five shares for a turnover of $2,000. Daily turnover is now more than €250m and there are more than 400 companies listed.

The WSE has proved to be a popular way for the government to sell off shares in state-controlled companies – ranging in recent years from PKO BP, the country's largest bank, to PGE, its largest energy company, and Bogdanka, a coal miner. More government companies such as JSW, another coal company, are preparing IPOs this year.

> Being listed has become a rite of passage for growing companies to a much greater extent than in the rest of central Europe

The exchange is also crucial to the private sector. Being listed has become a rite of passage for growing companies to a much greater extent than in the rest of central Europe. Open Finance, a financial advisory firm owned by Leszek Czarnecki, a banking entrepreneur, recently raised 480m zlotys ($174m; €121m, £106m).

"The stock exchange has been the main source of competition for private equity funds," says Robert Feuer, who leads the emerging European investment activities of Warburg Pincus, a private equity firm. The company recently bought a 307m zlotys minority stake in Amrest, a Warsaw-listed restaurant operator with businesses in Russia, much of central Europe, the US and Spain.

Over the years, the WSE has broadened its offering. It now has an alternative exchange for small companies called New Connect, bond trading, futures, a new energy trading exchange, and exchange-traded funds.

One concern, as the number of listings and platforms expands, is the level of analysis, which Mr Sobolewski acknowledges will have to improve in volume and quality if the WSE is to continue to attract outside investors.

A crucial development was last year's privatisation of the WSE, which had been 98 per cent owned by the state treasury. Although the government has long maintained an arms-length relationship with the exchange, being owned by the state did hamper its expansion plans.

Like most other European exchanges, the bourse has made a good recovery from the depths of the crisis – the WiG20 index recently crossed the 2,900-point threshold for the first time since the collapse of Lehman Brothers. During the depths of the crisis two years ago the index had dropped as low as 1,349 points. At its peak in 2007, it reached 3,917.

As the WSE grows, Mr Sobolewski is keen to increase the level of activity by foreign investors, who account for about 47 per cent of the exchange's trading volume.

That would ensure the WSE does not suffer any consequences from the government's recent decision to reform the pension system by transferring less money to private pension funds. The worry is that the funds, responsible for about 7 per cent of the WSE's turnover, would cut back their stock investments, which could hit company valuations.

Despite such concerns, the exchange still has much room to grow – its market capitalisation accounts for only about 35 per cent of Poland's gross domestic product, less than half of the level common in more developed countries.

Counting the zlotys: as the economic environment improves, the banking sector expects double digit increases in profits Reuters

Lending is back in vogue

Banking

Consolidation opportunities have made the market look attractive again

Polish television is showing something that had long been absent – not the latest soap opera but advertisements enticing customers to take out loans. The ads are a sign of the return to health of the banks, which reported a strong revival in profits last year – with net earnings rising 41 per cent to 11.7bn zlotys ($4.2bn), and the banking regulator expects profits to rise at a double-digit rate this year.

"Last year was good for banks. Profits improved sharply," says Janusz Dedo, president of the management board of HSBC Polska.

The immediate causes of the rise in profits were strong economic growth – 3.8 per cent in 2010 – and the repricing of risk, as large provisions had been set aside in 2009 and in early 2010, while non-performing loans – currently 8.8 per cent of outstanding credit, up from 2.1 per cent at the end of 2008 – are not rising unduly.

Going into the crisis in late 2008, there were fears that the banking sector, which is 72 per cent foreign-owned, would run into severe trouble, because of the credit boom sparked by accession to the European Union in 2004.

Some pessimists worried that the central European affiliates of western banks would need such an enormous amount of support from their parent companies that they would end up dragging down some of western Europe's banks.

A particular worry was mortgages denominated in foreign currency, mainly Swiss francs, which created risks for banks' balance sheets. In addition, many companies had dabbled in currency hedges, taking what they thought were one-way bets on the appreciation of the zloty which turned sour when the currency plunged following the onset of the crisis.

Happily, the region performed much better than expected and problem loans ended up being less of an issue than had been feared. The largest deterioration in credit was for consumer loans and corporate lending, where exporters were hit by stagnation in western Europe.

By contrast, mortgage loans barely budged, with only 1.8 per cent of such loans endangered – proof that Poles have been fiercely dedicated to repaying their mortgages.

> 'Volumes are returning to pre-crisis levels but the use of [financial] products is different'
>
> **Lukasz Bystrzynski, PwC**

"Poland had no recession, no big loss of jobs, and unemployment remained relatively low, which made it possible for people to continue repaying their debts," says Piotr Siciak, director of the financial services advisory with PwC, the consultancy.

Having passed through the crisis in 2009, banks are again beginning to lend. However, in part as a result of prodding from the Financial Supervision Authority, the regulator, and partly because of caution on the part of borrowers, foreign currency loans now make up less than a third of new loans.

"There needs to be an exceptionally good reason to lend in a currency other than that in which a customer earns a salary. It is not good for customers and creates balance sheet problems," says Mr Dedo.

The level of foreign currency loans in the overall household loan book has been steadily falling – from 69 per cent at the end of 2008, to 62 per cent at the end of February 2011.

Lending to smaller businesses is showing signs of reviving, although lending to larger corporates is flat.

Polish companies slashed their costs when the crisis hit, and are now able to increase output without having to invest more, although spare capacity will soon be used up.

"We are seeing the first signs of small and medium-sized businesses looking for working capital," says Malgorzata Kolakowska, president of the management board at ING Bank Slaski.

The chastening experience of the crisis has made both banks and customers warier. For example, real estate developers now need to show at least 40 per cent of a project as pre-leased before a bank will make money available. Before 2008, financial institutions were much more eager to finance speculative projects. Vehicles such as hedging, rather than being used as a way of making money, are now insuring against currency risk – a real danger with the zloty's wild fluctuations.

"Volumes are returning to pre-crisis levels but the use of products is different. Before, some of them were used for speculation; now, banks are being more careful to ensure these instruments lower risk, not raise it," says Lukasz Bystrzynski of PwC.

Banks are also willing to finance mergers and acquisitions again, particularly in the light of large transactions such as the impending sale of Polkomtel, one of the country's leading mobile operators, thought to be worth more than 18bn zlotys.

The treasury ministry is also planning to sell about 15bn zlotys worth of assets this year.

"The scale of transactions will be completely different from the situation in 2010, which in turn was a breakthrough year for M&A in Poland," says Jacek Radziwilski, chief executive of UniCredit CAIB.

Last year, Poland saw $19bn in mergers and acquisitions activity, up from $4.6bn in 2009, according to Bloomberg.

The increasingly lucrative banking market is attracting interest from abroad, particularly now that there are buying opportunities, often because troubled parent banks are being forced to sell their Polish operations in order to shore up their balance sheets.

The largest such transaction was the sale of Bank Zachodni WBK, Poland's fifth largest, to Spain's Santander by Allied Irish Banks for €4bn.

Other recent transactions include the €490m purchase of Polbank by Austria's Raiffeisen and Getin Bank's €35m acquisition of Allianz Bank Polska.

"Inevitably there will be more consolidations, but the pace of growth is so high that banks can fulfil their balance sheet expectations," says Alan Jarman, chief executive of HSBC Polska.

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WSE seeks a leading role in power market

Energy trading

Poland is the only EU country with competing platforms, says **Adam Easton**

The Warsaw Stock Exchange, already the largest in the region, is continuing its expansion policy and seeking to become a centre for energy trading.

In December last year, the WSE launched its own power exchange, POEE WSE Energy Market, in direct competition with the Polish Power Exchange (PolPX), which has been in operation since 1999.

Poland is now the only country in the European Union with competing power exchanges.

Ludwik Sobolewski, chief executive of WSE, says the company wants to broaden its base from trading financial instruments to commodities, especially energy products, and cites exchanges such as NYSE Euronext, Deutsche Börse and Toronto, which have already done so.

"We want to be the only important platform and market venue in Poland, as this is good for the price discovery and valuations on the local market, and will prepare us for international competition," Mr Sobolewski says.

"It also explains why we concentrate at present on consolidation within the boundaries of the Polish market.

"Whether we achieve this through acquisitions, or in another way, remains to be seen and solved."

Mr Sobolewski did not want to discuss WSE's plans to acquire PolPX, but the Puls Biznesu daily wrote last month that talks with PolPX's shareholders were continuing.

One market participant told the FT that the WSE is active in trying to win over PolPX's shareholders – comprising the state treasury as well as domestic and foreign power companies – to sell their stock, and that it has drawn up a draft purchase contract.

The government appears to be backing the takeover and Aleksander Grad, treasury minister, has said he is willing to sell the ministry's 22 per cent stake in PolPX to the WSE.

At his office in a business park near Warsaw airport, Grzegorz Onichimowski, the chief executive of PolPX, says he is not surprised by the WSE's interest in his company.

PolPX has become much more liquid since a legal requirement obliging power producers to sell between 15 and 100 per cent of their production on the open market was introduced last August.

In 2010 the total volume of electricity traded on PolPX increased 20-fold.

Before the amendments were introduced, more than 90 per cent of energy in Poland was traded through fixed-term 12-month bilateral contracts, often between producers and distributors belonging to the same capital group.

Mr Onichimowski says: "The result is far, far beyond everybody's expectations, including mine. We had a lot of luck too. The legal obligation provided the basis, but the power companies also realised they needed more transparency and they decided the success of this story."

He says that PolPX plans to defend itself by offering a better service with lower fees and opening new market niches. Market participants have long complained about a lack of smoothness and user-friendliness in its operations.

PolPX plans to offer new products such as coal, gas and biomass, with the latter starting in a few weeks.

PolPX has also been cultivating international alliances. That is something that might be difficult for the WSE to do, given its rivalry with the Vienna Stock Exchange, which controls or has stakes in central European exchanges such as PXE, the Austrian energy exchange, and EXAA, a central European energy exchange covering the Czech Republic, Slovakia and Hungary.

PolPX launched market coupling with Scandinavia's Nord Pool Spot last December and has signed a preliminary integration agreement with EXAA and PXE.

'Cross-border flows are shaping the future,' says Ludwik Sobolewski

Mr Onichimowski says: "The WSE has the tremendous advantage of having a diversified business. It may finance one business through its others for a limited time, while we don't have this advantage.

"On the other hand, we are here and we have our liquidity and story already. I think we are accepted and appreciated by our members."

Neither man believes that two competing power exchanges in Poland can survive, especially if the European Union pushes ahead with its plans to create a single energy market by 2014.

The European Commission's third package of gas and power market reforms aims to break down national barriers to gas and power trading and force national monopolies to compete at the EU level.

Mr Onichimowski says: "I don't think there will be just one Polish exchange; the future is regional exchanges. It might be located in Poland; we'll have to see."

Mr Sobolewski says the WSE is aware that in future competition may not just be domestic but regional.

"Cross-border flows are shaping the future," he says.

Regulation Solid capital markets environment acts as spur to investors

The Polish bureaucrat's pedantic attachment to the rules has been enough to drive many frazzled business people to distraction, but it has helped in one aspect of business: setting up well-regarded capital and banking market regulation, a key to Warsaw's increasing regional financial power.

Communism did not leave Poland particularly well equipped with the rules and regulations needed to create a functioning market economy.

When a group of experts was preparing to launch the Warsaw Stock Exchange 20 years ago, they looked to western Europe, the US and Japan for models on how to regulate capital markets.

Unlike other central Europeans, who created only stock exchanges, the Poles created both a stock exchange and a securities commission to monitor the market.

"We were advocates of free markets, but the invisible hand had to be constrained by regulation," says Jacek Socha, deputy chairman of PwC in Poland, and from 1994 to 2004 the head of Poland's Securities and Exchange Commission.

Warsaw has settled on modern solutions, such as having no physical securities.

The commission also brought in rigorous standards on information policy, pressing companies to prepare proper prospectuses before listing, and cracking down on insider trading.

Warsaw was so successful that when Germany was setting up its own securities commission under pressure from the EU it sent people to Warsaw to see what solutions the Poles had come up with, says Mr Socha.

The solid capital markets regulatory environment has been a big spur to both domestic and to foreign investors, who account for about 47 per cent of the trading on the WSE.

The Polish securities commission was folded into the Financial Supervision Authority (KNF), a unified financial industry regulator created in 2006 on the British model, which oversees banks, capital markets, insurance and investment funds.

The KNF's formation was controversial, particularly the decision to remove bank supervision from the National Bank of Poland and hand it to the KNF. At the time the decision was highly political, as the central-bank governor was Leszek Balcerowicz, a doctrinaire economic liberal who was seen as a foe by the populist government of Jaroslaw Kaczynski, leader of the rightwing Law and Justice party.

Removing bank supervision was seen as a move against Mr Balcerowicz. However, when he was replaced in 2007 by Slawomir Skrzypek, a Kaczynski loyalist, the government changed its mind and tried unsuccessfully to return bank supervision to the National Bank.

Despite the wild gyrations as to the functions of the KNF, the authority's chief, a low-key economist named Stanislaw Kluza, managed to steer the institution through the shoals of the economic crisis.

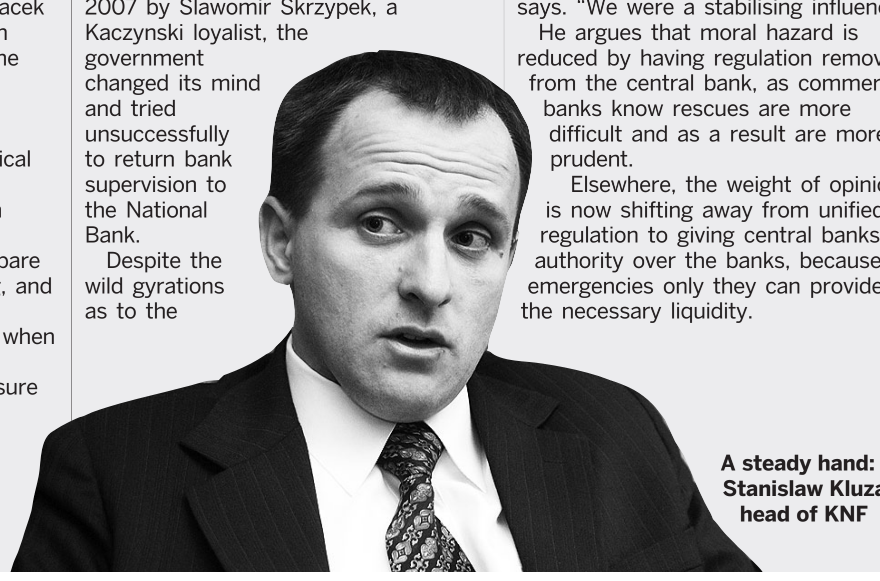
The regulator was already worried about the growing appetite for foreign currency loans as far back as 2006, drafting a regulation that tightened up lending standards, which is credited with helping preserve the banking system from the kinds of troubles experienced in Hungary, which also saw a lot of foreign-currency lending.

During the crisis the KNF successfully pressed banks to retain their profits in order to build up capital bases. In addition, many foreign-owned banks received capital injections from their parents, meaning that the Polish authorities did not have to bail out any financial institutions.

Mr Kluza remains an enthusiastic backer of unified regulation. "Poland handled the crisis well, thanks in part to having an integrated regulator," he says. "We were a stabilising influence."

He argues that moral hazard is reduced by having regulation removed from the central bank, as commercial banks know rescues are more difficult and as a result are more prudent.

Elsewhere, the weight of opinion is now shifting away from unified regulation to giving central banks authority over the banks, because in emergencies only they can provide the necessary liquidity.



A steady hand: Stanislaw Kluza, head of KNF

Opportunities emerge from crisis

Profile
Leszek Czarnecki

The entrepreneur explains why his bank is still growing

Leszek Czarnecki has had a very good economic crisis, which is something that most bankers around the world would have a very difficult time saying.

"Getin was one of the few banks in Poland not to have a single month of losses during the crisis," says Mr Czarnecki, Poland's third-wealthiest man according to a list compiled by Forbes.

The results have surprised market watchers because, going into the crisis, Mr Czarnecki's Getin Noble Bank was seen as one of the most vulnerable institutions to a downturn.

The bank, which he bought in 2003 and developed rapidly, was one of first and most aggressive to lend for mortgages in Swiss francs. Just before the crisis, two-thirds of its loans were not denominated in zlotys.

Unlike the international banks that dominate the Polish market, Getin had no foreign parent to rely on, and was financing himself on the interbank market. As the crisis broke in late 2008, the serial entrepreneur had in mind that in early 2009 he had to repay a €500m Eurobond followed by a 400m zlotys ($143m) bond.

However, even before Lehman Brothers collapsed, Mr Czarnecki executed a sharp change of policy, halting all foreign currency lending – which now makes up only 46 per cent of Getin's portfolio.

"At the first sign of trouble, we stopped all such loans," he says. "We never lost our common sense."

He also began to gather deposits aggressively; they jumped last year by 31 per cent to 37bn zlotys. The bank's loan-to-deposit ratio fell from 114 per cent before the crisis to 90 per cent now.

As rival banks began to restrict the availability of credit, Mr Czarnecki bucked the trend, continuing to supply zloty loans. Last year, Getin's lending grew by 31 per cent to 33.5bn zlotys.

Getin repaid both of its bonds in 2009, and its core tier one capital never dropped below 11 per cent throughout the crisis. Unlike many of its rivals, Getin was not pushed to raise new capital.

Although non-performing loans have risen to 10 per cent of the bank's portfolio, higher than the industry average, provision coverage is 70 per cent, and Mr Czarnecki is confident the worst is now over.

Despite the slowdown in the Polish economy, which grew by only 1.7 per cent in 2009 before rebounding last year, Getin made a solid return in 2009, recording a 12 per cent increase in net profit to 170m zlotys. Last year its net profit came to 450m zlotys.

Having survived and prospered during the crisis, Mr Czarnecki is hunting for acquisitions to help accelerate growth. Over the past two years, he has bought two banks, GMAC and Allianz, after their owners reassessed their presence on the Polish market.

GMAC is being transformed into IDEA, a bank aimed at small and medium-sized business, becoming one more of the portfolio of financial companies, from insurance to leasing, real estate and advisory companies that Mr Czarnecki owns through Getin Holding, the listed parent company, in which he owns a 56 per cent share.

He expects to find more to buy in the next year, as western banking groups continue to lick their wounds in the aftermath of the crisis. He also thinks Polish affiliates will be more timid despite the country's solid growth prospects.

"The risk appetite of a lot of those banks has fallen," says Mr Czarnecki. "They would simply like to hang on to what they have now, which creates the possibility of very fast growth for banks such as Getin." He expects Poland's banking market to grow more than 8 per cent a year – one of the fastest rates in Europe.

He is also expanding to the east, with banks in Belarus, Russia and Ukraine. That is something that most of his rivals are not doing – as members of larger international groups whose parents already own foreign operations, there is no need for Polish subsidiaries to do so – which also creates interesting opportunities for Mr Czarnecki.

So far his venture into banking has paid off handsomely. His initial €100m investment is now worth more than €3bn, but he shows no sign of slowing down.

"We're not doing too badly," he says with an enormous grin.

'The risk appetite of a lot of banks has fallen. They would simply like to hang on to what they have now'

Leszek Czarnecki: 'We never lost our common sense'

Strong market has regional pull

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Czech and Slovak investment fund.

Warsaw's nascent capital market and the size of the economy – with 38m people, Poland accounts for more than half the population of the countries admitted to the European Union in 2004 – have helped the capital to become a centre for private equity funds as well.

Initially, the funds – often working with foreign donors – concentrated on investing in the domestic economy. But with time, they have bought companies from across the region. One of the largest, Enterprise Investors, has bought into Polish companies including Zelmer, a white goods maker, as well as a Czech Republic-based antivirus software producer and a Romanian building materials company.

"When it comes to private equity, Warsaw plays the role of a hub for the entire region," says Przemyslaw Szczepanski, founding partner of Syntaxis Capital, a specialist mezzanine capital provider. "When you look at the private equity houses which were first set up in Warsaw, over time many of them reached a scale that allowed them to cover the rest of the region."

Poland's banks also looked abroad for help in building a modern financial system. The size of the market and its potential drew in investors ranging from the US to Portugal and Italy, and now 72 per cent of the sector is in foreign hands.

The restaurants are now world class, transactions use bank transfers, and the toilet paper is a soft two-ply

That has created a nimble domestic banking sector, which was quickly able to respond to the looming crisis by restricting foreign currency loans, and with occasional help from foreign parents, had little trouble in surviving the crisis and is again growing strongly.

However, one result of the high level of foreign ownership is that most Polish banks have no aspiration to play a regional role, as their parent corporations already have operations in other countries.

Poland's largest bank, state-controlled PKO BP, bungled its expansion by waiting too long and now has missed its chance to become a regional force.

Only Leszek Czarnecki, an aggressive serial capitalist who owns Getin Noble Bank, the country's 10th largest, has big hopes for expanding in Ukraine, Belarus and Russia.

Polish foreign investment has also lagged behind the international nature of the country's capital markets and investment funds. The country's largest foreign investment is the ill-starred $3.6bn purchase of Lithuania's Mazeikiu oil refinery, which has been a source of conflict between Poland and Lithuania and a drain on the Polish company's finances.

There have been other investments. Comarch, a business software maker, has some production in western Europe, and Solaris buses ply the streets of many European cities. Nonetheless, most Polish companies are still concentrating on the large and growing domestic market.

The difficulties over Mazeikiu also point to another potential problem for Poland: a lot of its neighbours are suspicious of its grandiose regional ambitions – something that a smaller country such as Austria, which itself hopes to become central Europe's financial hub, does not provoke.

While international expansion is still limited, Poland continues to attract interest both because of the size of its economy and because of how well the country did during the crisis. It was the only EU country not to fall into recession in 2009, and the economy grew by 3.8 per cent last year, one of the highest rates in the EU.

"2009 was a signal to the world that something interesting is happening in Poland," says Adam Pietruszkiewicz, head of the Polish operations of Riverside, a global private equity firm.

With Poland's claim to being a regional financial hub based in large part on the success of its capital market, the coming year looks to be a strong one.

The government plans to raise 15bn zlotys ($5.3bn) this year through the sale of state assets, and another 10bn zlotys in 2012.

There are also big upcoming transactions such as the sale of Polkomtel, one of the three leading mobile operators, which has attracted interest from local companies and foreign investment funds, including KKR and Bain Capital.

Although there are some fears that changes to the pension system – rushed through this spring to prevent the country breaching its self-imposed public debt limit of 55 per cent of GDP – could slow the flow of funds to the stock exchange, most market watchers are confident the WSE will continue to grow.

As Warsaw's status as a financial centre grows, the city provides an increasingly sophisticated level of services, with law firms, accounting companies, advisory and investment consultants housed in gleaming office towers in the business district, although for the largest and most complex deals, specialists from New York and London are still needed.

The restaurants are now world class, real estate transactions are completed with bank transfers, and the toilet paper tends to be a soft two-ply.