

Prospects for long-term gains

BSE Ticker:	SO5
Bloomberg:	SO5 BU
Sector:	Health Care
Industry:	Health Care Providers and Services
Stock price:	BGN 4.65
Free-float:	24.10%
Market capitalization:	BGN 153 mln EUR 78.2 mln
Avg daily turnover:	BGN 120 000 EUR 61 000
1 year change:	+114%
1 year range:	2.18-4.79

Sopharma Trading is interesting investment opportunity. It is subsidiary of the leading Bulgarian pharmaceutical company Sopharma and is specialized in the distribution of medicines and equipment in the country. **Sopharma Trading has better profit growth and lower valuation ratios than its parent company. This is the reason to prefer it as exposure in the dynamic sector of health care in the country.**

Local investors have very positive attitude toward the pharmaceutical group Sopharma. This also applies to Sopharma Trading as the stock jumped more than 100% for the last twelve months. **We expect to see further growth of the stock price, albeit after period of consolidation.**

Valuation

	2012	2013	2014E
EPS	0.22	0.29	0.40
P/E	7.97	11.11	11.48
P/B	1.78	1.80	1.88

The pharmaceutical market grew by 6.3% in 2013 to BGN 2.3 billion, led by the solid 13.7% increase of sales from hospitals. **Sopharma Trading is the largest distributor with 23% market share since the beginning of the year.** Its presence is most notable on the deliveries for hospitals with more than one-third of supplies.

One year performance



Profit growth in 2013 was sizable (29%), which was due to the positive effects from the distribution of medical equipment along with the rising productivity and economies of scale. The growth during the first quarter accelerated to 38% and reported BGN 3.4 million profit before tax.

Five years performance



We have positive expectations to the financial performance of Sopharma Trading and we give **BUY recommendation.** At the same time, the stock will continue to be one of the best performing positions on the market. **Our target price is BGN 6.10,** which is the average from the comparison to peer group and the discounted cash flows.

We consider the stock of Sopharma Trading as **good long-term investment that will benefit from the rising expenditures for health care in Bulgaria.** Therefore, the current period of consolidation could be used for accumulation of larger stakes.

COMPANY OVERVIEW

Leader on the distribution of medicines in Bulgaria

Sopharma Trading is a leader in the distribution of pharmaceutical products on the Bulgarian market. Its portfolio includes medical products and consumables, sanitary-hygienic materials, vitamins, food supplements, cosmetical products, medical equipment and articles. The company is subsidiary of the well-known generic drug producer Sopharma, which is public listed and one of the most liquid Bulgarian stocks.

The distributor covers 100% of the country through its five regional distribution and logistics centers. It can provide deliveries for maximum of four hours. Its warehouse area is 17 500 sq. m.

The company supplies to pharmacies and hospitals. Sopharma Trading meets all the international and European standards and is the first Bulgarian distributor of medicinal products which fully meet the requirements of the international standard ISO 9001:2008.

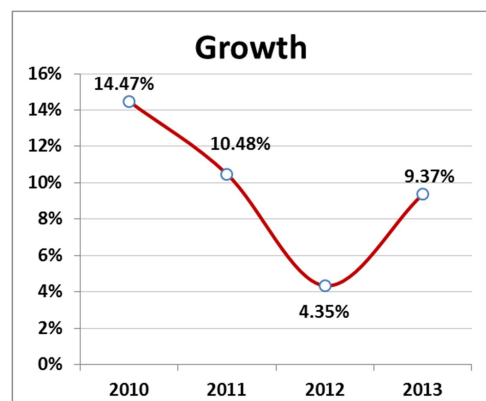
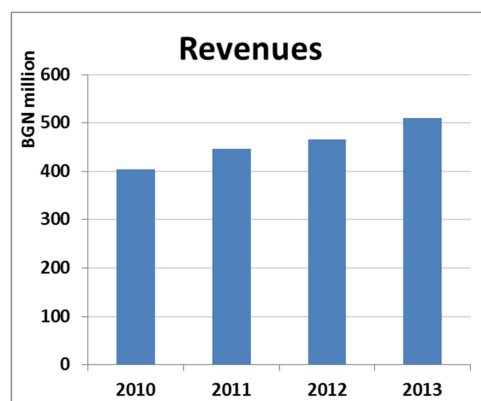
MARKET POSITION

Largest distributor with 23% market share

The company's operations are in direct relations with the health care system in the country. Various researches are pointing that the Bulgarian pharmaceutical market has the largest potential for growth among countries in Central and Eastern Europe. The pharmaceutical market grew by 6.3% in 2013 to BGN 2.3 billion, led by the solid 13.7% increase of sales from hospitals. Pharmacies generated 85% of sales but hospitals continued to generate larger increase during the first two months of the year. Overall growth for the period was 9% and the acceleration is due to the larger government and personal spending for health care.

The distribution of medicines is highly concentrated. Latest data reveal that the fourth largest companies in the sector has 82% market share. Sopharma Trading is the largest distributor with 23% market share since the beginning of the year. Its presence is most notable on the deliveries for hospitals with more than one-third of supplies.

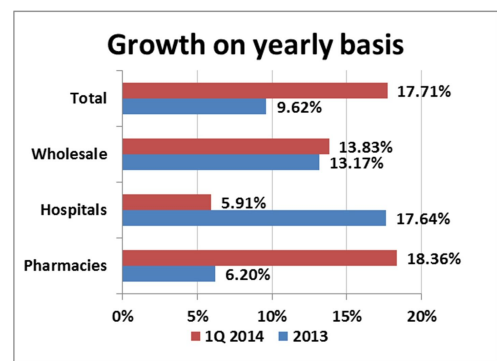
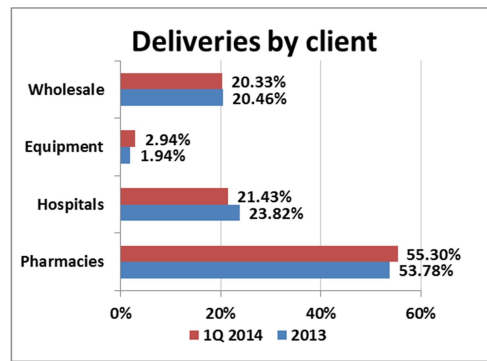
Deliveries and growth by segment of Sopharma Trading



Growth is again accelerating on 2013

Sopharma Trading grew faster in 2013 and the acceleration was due to the higher deliveries to hospitals. Liabilities of hospitals increased to half billion leva or 20% higher during the last year. This is opportunity for Sopharma Trading as the company has access to capital at low interest rates.

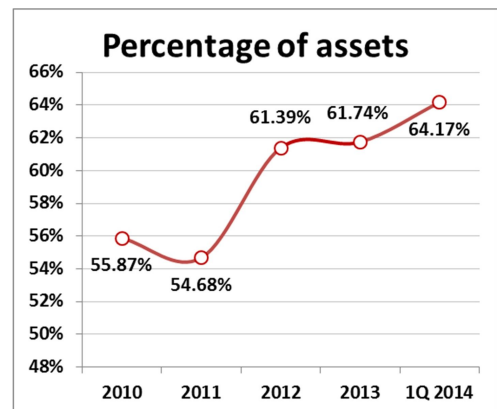
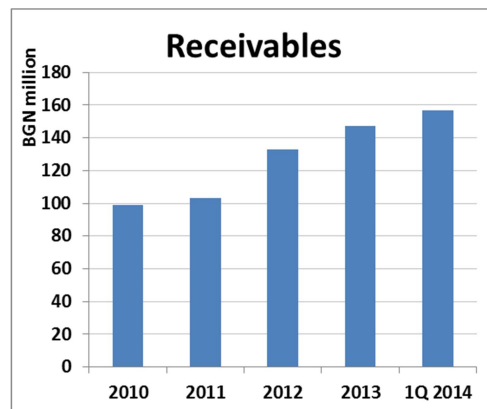
Deliveries and growth by segment of Sopharma Trading



Deliveries to pharmacies are jumping

The beginning of 2013 is marked with higher growth of deliveries to pharmacies. This contributed to significantly higher growth of revenues and stable level of receivables as percentage of assets.

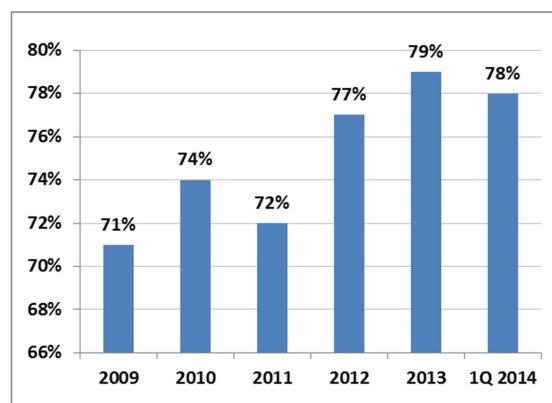
Total receivables and percentage of assets



Receivables are following the growth of revenues

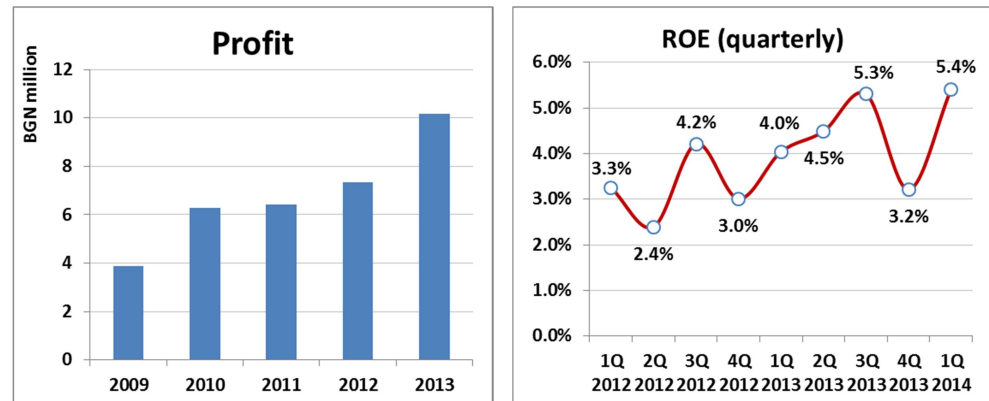
Receivables represented 61% of assets at the end of the previous two fiscal years. First quarter's increase to 64% is in line with the average since the beginning of 2012 and data are not worrisome. The nominal growth is due to the rising revenues. Our model for valuation includes the presumption of maintaining receivables of 63% of assets. It is not rational at the moment to assume that the government financed health care system will be able to repay substantial part of hospitals' debts.

Share of imported products



Sopharma Trading is mainly selling imported products. They represented 78% of total sales. The company is following the general market trend and is maintaining trade relationships with all producers. As expected, Sopharma is the largest supplier for Sopharma Trading and has 12% share of revenues.

Profit and return on equity



Positive trend of return on equity

Profit growth in 2013 was sizable (29%), which was due to the positive effects from the distribution of medical equipment along with the rising productivity and economies of scale. The growth accelerated to 38% during the first quarter and the company reported BGN 3.4 million profit before tax. Return on equity is steadily improving during the last two years and we expect that the positive trend will continue. Health care costs as percentage of GDP will rise and the company has leading position on the distribution market. Moreover, its investments and close relation with Sopharma are suggesting that RoE will increase further.

FORECASTS

Double-digit growth of revenues

Our estimations for the company's performance during the next several years are presented in the table. Revenues are expected to increase by 12% annually for 2014-2015 and further by 15% in 2016. Our presumptions are based on the acceleration of health care expenditures in the country, although they will remain very low as percentage of GDP. We also assume the continuation of profit margin improvement due to growing scale of operations. Interest expenses should rise faster as the company increased its bank loans. Nevertheless, we expect to see further growth of net profit.

Forecasts

Statement of income (000 BGN)	2011	2012	2013P	2014E	2015E	2016E	2017E	2018E
Net Sales	447 193	466 635	510 342	571 583	640 173	736 199	809 819	882 703
Costs of goods sold	415 022	430 800	470 987	525 856	588 959	673 622	738 960	803 259
Sales and administrative costs	12 540	12 715	13 685	15 147	16 805	19 215	21 055	22 068
EBITDA	10 850	12 060	15 379	20 005	22 406	27 607	30 368	33 101
Depreciation and amortization	2 256	2 400	2 222	2 572	2 881	3 313	3 239	3 531
EBIT	8 594	9 660	13 157	17 433	19 525	24 295	27 129	29 571
Interest expenses	1 444	1 479	1 861	2 792	3 071	2 303	2 533	2 787
Net profit	6 416	7 349	10 166	13 178	14 809	19 792	22 136	24 106

VALUATION

The table presents the main valuation multiples of Sopharma Trading, calculated with the annual reports for 2012 and 2013 and the data for the last 12 reported months.

Multiples

	2012	2013	12M
Last Price	1.78	3.21	4.65
Number of Shares	32 905 009	32 905 009	32 905 009
Market Capitalization	58 570 916	105 460 554	153 008 292
Net Profit	7 349 000	9 490 000	10 415 000
P/E	7.97	11.11	14.69
Equity	58 702 000	59 369 000	62 762 000
P/B	1.00	1.78	2.44
Sales	466 635 000	510 342 000	532 100 000
P/S	0.13	0.21	0.29
EV	113 920 494	151 785 916	199 035 554
EBITDA	12 060 000	14 663 000	15 966 000
EV/EBITDA	9.45	10.35	12.47
RoE	12.52%	15.98%	16.59%
RoA	3.39%	4.05%	4.27%

Multiples increased as stock price jumped

The stock price is rising faster than the profit since the beginning of 2014, which resulted to higher valuation ratios. Sopharma Trading is currently traded at P/E ratio of 14.70. The relatively high value is due to the nature of stock price increase in the beginning of 2014. Investors have been buying the stock with the expectations of solid improvement of financial results. Although this is stable long-term trend, the market is pricing in positive news and we expect that the stock will trade in tight range during the next few months. EV/EBITDA is high due to the large debt of the company that is used to finance the supplies to Bulgarian hospitals.

Comparison to peer group

Multiples	P/E	P/B	P/S	EV/EBITDA
Median	15.09	1.26	0.29	8.24
Market Capitalization	157 119 149	79 000 444	155 512 610	37 993 941
Price	4.77	2.40	4.73	1.15
Weight	35%	15%	35%	15%
Current Price		4.65		
Fair Price		3.86		
Premium (Discount) to Current Price		-17.02%		

The rally looks overextended when comparing to peer group

We are valuing the stock by comparing it to companies of health care distribution sector. The specifics of local pharmaceutical market are forcing us to give lowest weight of EV/EBITDA ratio as the high debt is temporarily factor and will decrease when the state sponsored hospitals improve their financial situations. Although this is not plausible in near future, we are confident that Sopharma Trading will not occur any financial losses from bad loans to hospitals. The comparison by multiples is resulting to 17% lower fair value as compared to the latest stock price. The two important multiples P/E and P/S are pointing to higher stock price of Sopharma Trading and we don't consider the gap of 17% as worrisome for the valuation of the company. However, this is another sign for stock

price consolidation in near term. Higher weight of P/E and P/S ratios is justified by the prospects for growth and the profitability.

Discounted cash flows

Sopharma Trading											Terminal
BGN'000	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Year
EBIT	17 439	19 532	24 303	27 138	29 580	34 331	37 077	42 031	44 133	45 898	47 504
EBIT(1-T)	15 695	17 578	21 872	24 424	26 622	30 898	33 369	37 828	39 719	41 308	42 754
Add: D&A	2 573	2 882	3 314	3 240	3 532	3 815	4 120	4 367	4 585	4 769	4 936
Less: Investments	1 715	1 921	2 209	2 835	3 090	3 815	4 120	4 367	4 585	4 769	4 936
Less: Change NWC	4 423	5 489	7 685	5 892	5 833	883	5 722	4 635	4 094	3 439	3 129
FCF	12 130	13 050	15 292	18 938	21 231	30 015	27 648	33 193	35 625	37 869	39 625
PV FCF	11 027	10 785	11 489	12 935	13 183	16 942	14 188	15 485	15 109	14 600	
Sum of PV FCF	135 743										
PV of Continuing Value	235 030										
Total PV Free Cash Flows	370 774										
Less: Outstanding Debt	100 399										
Plus: Financial Assets	6 824										
PV of Equity	277 199										
Number of Shares	32 905										
Price Per share	8.42										

	SA	Growth Rate				
		2.0%	3.0%	3.5%	4.0%	5.0%
WACC	8.0%	11.05	12.91	14.15	15.70	20.35
	9.0%	8.78	9.99	10.76	11.68	14.23
	10.0%	7.08	7.91	8.42	9.02	10.57
	11.0%	5.78	6.37	6.73	7.13	8.14
	12.0%	4.75	5.18	5.44	5.72	6.41

Positive expectations support higher fair value

Discounting the cash flows resulted to high fair price of Sopharma Trading. Our forecasts are positive as the company managed to improve its market positions. However, the growth of revenues will be based on the rising health care costs and personal income in Bulgaria. Gaining market share is not our primary scenario, although improvement of profitability will come from the rising scale of operations and investments. As a result, the intrinsic value of Sopharma Trading is BGN 8.42.

RECOMMENDATION AND PRICE TARGET

Recommendation: BUY
Target Price: BGN 6.10
Increase: 30%

We have positive expectations to the financial performance of Sopharma Trading and we give **BUY** recommendation. At the same time, the stock will continue to be one of the best performing positions on the market. **Our target price is BGN 6.10**, which is the average from the both models and represents the positive market bias to the stock.

INVESTMENT IDEA

We consider the stock of Sopharma Trading as good long-term investment that will benefit from the rising expenditures for health care in Bulgaria. Therefore, the current period of consolidation could be used for accumulation of larger stakes. We don't expect profit taking that is induced by negative corporate news or overall market weakness. Risk is low, while we expect the stock to add 30% to its value until the end of the year. Current shareholders should maintain their positions.

Financial Data

Statement of Income (in '000 BGN)	2011	2012	2013	1Q 2013	1Q 2014
Sales	447 193	466 635	510 342	123 494	145 252
Production expenses	425 185	442 868	483 887	117 452	137 319
Personnel expenses	12 540	12 715	13 685	3 183	3 525
Net income from financial activities	1 382	1 008	1 893	651	405
Other revenues and expenses	0	0	0	0	0
EBITDA	10 850	12 060	14 663	3 510	4 813
Depreciation	2 256	2 400	2 222	645	673
EBIT	8 594	9 660	12 441	2 865	4 140
Interest expense	1 444	1 479	1 861	397	747
Pretax income	7 150	8 181	10 580	2 468	3 393
Taxes	734	832	1 090	0	0
After-tax income	6 416	7 349	9 490	2 468	3 393
Minority interest	0	0	0	0	0
Net income	6 416	7 349	9 490	2 468	3 393
Earnings per share in BGN	0.19	0.22	0.29	0.08	0.10

Balance Sheet (in '000 BGN)	2011	2012	2013	1Q 2013	1Q 2014
Total Assets	188 799	216 493	234 563	225 475	243 943
Equity subscriptions receivable	0	0	0	0	0
Fixed assets	20 737	24 619	28 804	23 129	28 301
Tangible fixed assets	19 794	20 744	25 322	22 347	24 787
Financial investments	0	3 102	2 256	0	2 256
Current assets	168 062	191 874	205 759	202 346	215 642
Inventory	56 132	55 458	55 039	44 896	51 931
Receivables	103 235	132 737	147 124	148 837	156 543
Financial assets	2 626	0	0	2 980	0
Cash and cash equivalents	5 998	3 507	3 395	5 253	6 824
Total liabilities + equity	188 799	216 493	234 563	225 475	243 943
Equity	56 576	58 702	59 369	61 105	62 762
Registered capital	32 905	32 905	32 905	32 905	32 905
Capital funds	17 169	18 244	16 691	18 178	16 691
Earnings	6 502	7 553	9 773	10 022	13 166
Liabilities	132 223	157 791	175 194	164 370	181 181
Long-term payables	573	536	269	534	267
Long-term bank loans	1 113	3 976	7 037	5 274	6 713
Short-term bank debt	35 778	47 066	89 573	50 082	93 686
Short-term payables	94 759	106 204	78 306	108 471	80 506
Other liabilities	0	9	9	9	9
Working capital	37 525	38 604	37 880	43 793	41 450

Cash Flow Statement (in '000 BGN)	2011	2012	2013	1Q 2013	1Q 2014
Net income	6 416	7 349	9 490	2 468	3 393
Depreciation	2 256	2 400	2 222	645	673
Changes in Working capital	1 837	1 079	(724)	5 913	(2 343)
Other operating cash flow items	7 653	(20 876)	(41 311)	(9 352)	(1 708)
Net cash from operating activities	18 162	(10 048)	(30 323)	(326)	15
Capital expenditures	(1 128)	(1 964)	(8 273)	(2 256)	(243)
Other investing cash flow items	(462)	159	205	(262)	131
Net cash from investing activities	(1 590)	(1 805)	(8 068)	(2 518)	(112)
Issuance/ Retirement of Stock, Net	0	0	0	0	0
Issuance/ Retirement of Debt, Net	(8 899)	15 050	45 675	4 717	3 826
Dividends paid	(4 886)	(5 464)	(6 510)	0	(94)
Other financing cash flow items	(527)	(224)	(886)	(127)	(206)
Net cash from financing activities	(14 312)	9 362	38 279	4 590	3 526
Net change in cash	2 260	(2 491)	(112)	1 746	3 429
Beginning-of-period cash	3 738	5 998	3 507	3 507	3 395
End-of-period cash	5 998	3 507	3 395	5 253	6 824
Cash per share	0.18	0.11	0.10	0.16	0.21

Number of shares:	32 905 009	32 905 009	32 905 009	32 905 009	32 905 009
Price in BGN - period end:	1.66	1.78	3.21	2.12	4.65
Market cap in BGN - period end:	54 622 315	58 570 916	105 460 554	69 758 619	153 008 292

Financial and Performance Indicators	2011	2012	2013		TTM
Valuation Ratios					
Price/Earnings (P/E)	8.51	7.97	11.11		14.53
Book Value (BV)	1.72	1.78	1.80		1.91
Price/Book (P/B)	0.97	1.00	1.78		2.41
Sales Per Share	13.59	14.18	15.51		16.17
Price/Sales (P/S)	0.12	0.13	0.21		0.28
Price/Cash per share	6.30	6.01	9.00		11.95
EV (in BGN)	85 515	106 106	198 676		244 938
EV/Sales	0.19	0.23	0.39		0.46
EV/EBITDA	7.88	8.80	13.55		15.34
EV/EBIT	9.95	10.98	15.97		17.86
Liquidity					
Current ratio	1.29	1.25	1.23		1.24
Quick ratio	0.86	0.89	0.90		0.94
Debt Management					
Debt to total assets	0.70	0.73	0.75		0.74
Interest coverage	5.95	6.53	6.69		6.20
LT Debt/Equity	0.03	0.08	0.12		0.11
Total Debt/Equity	2.34	2.69	2.95		2.89
Asset Management					
Inventory turnover	7.97	8.41	9.27		10.25
Days sales outstanding	83	102	104		106
Fixed asset turnover	21.56	18.95	17.72		18.80
Total asset turnover	2.37	2.16	2.18		2.18
Profitability					
Profit margin on sales	1.4%	1.6%	1.9%		2.0%
EBITDA margin	2.4%	2.6%	2.9%		3.0%
Basic earning power	4.6%	4.5%	5.3%		5.6%
Return on assets	3.4%	3.4%	4.0%		4.3%
Return on equity	11.3%	12.5%	16.0%		16.6%
Return on investments	11.0%	11.6%	14.2%		14.9%
Dividend Information					
Dividend Yield	10.24%	11.24%			
Dividend per share	0.17	0.20			

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BUY	More than 5% higher as compared to SOFIX and BG40 performance
HOLD	Market performance, +/-5% as compared to SOFIX and BG40
SELL	More than 5% lower as compared to SOFIX and BG40 performance

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