

SOPHARMA (3JR BU)

INDUSTRY: PHARMACEUTICALS

A COMPANY OF GROWTH

24.5% REVENUE CAGR FOR THE LAST DECADE. STABLE GLOBAL PHARMACEUTICALS MARKET GROWTH OF 3-4% AND LOCAL MARKET GROWTH OF 5% IN 2012 AND 7% IN 2013. MAJOR PROFIT-DRIVERS ARE THE EXPECTED 80% INCREASE IN GOVERNMENT HEALTHCARE SPENDING IN ORDER TO REACH THE EU AVERAGE AND THE AGING DOMESTIC POPULATION.

LARGE-SCALE INVESTMENT PROGRAM IMPLEMENTED IN THE LAST 5 YEARS

Increased capacity to answer higher pharmaceutical products demand. 15 modernized factories in Bulgaria conforming to GMP, two in Serbia, and one in Ukraine, to provide full-scale coverage on EE and SEE markets. But still the domestic market remains the main sales generator with 62.1% of the consolidated sales in 2013. EE and SEE markets are expected to grow and Sopharma to intensify its presence in Russia and Poland.

WELL-DIVERSIFIED PORTFOLIO

210+ own products and over 10,000 in the distribution portfolio. Highest achievers are Tabex, Tribestan, Analgin and Carsil. In order to answer the increasing demand from aging population, the Group has focused on therapeutic areas such as cardiology, gastroenterology, pain relief, neurology and psychiatry, and urology.

WIDE DISTRIBUTION NETWORK COVERING THE WHOLE DOMESTIC MARKET

Sopharma Trading (SO5 BU), the distribution arm of the Group, is the domestic distribution market leader with 23% market share. Apart from the distribution business line, Sopharma Trading provides turnkey solutions for hospital construction. In addition, the company provides complete logistics solutions for import, storage and distribution of goods to end customers, and marketing and advertisement services for penetrating products in the Bulgarian market.

ACKNOWLEDGED FOR PROFESSIONAL MANAGEMENT

Several companies of the Group are highly placed by local media for the quality of the corporate governance and their financial performance. Sopharma is well-respected by both institutional and individual investors and praised for the stock's high liquidity and low volatility.

EASY ACCESS TO EU FINANCING

Sopharma enjoys preferential terms of financing from EU financial institutions. That factor not only positively influences final results, but plays huge role in its ability to penetrate hospitals' delivery market, characterized with significantly longer payment terms.

VALUATION/RISKS

VALUATION: Our BGN 5.82 per share is derived on the grounds of sum-of-the-parts method, with excluded dividends income. **RISKS:** Deteriorating business environment in Ukraine and highly competitive domestic market.

in kBGN, excl. ratios	2013	2014F	2015F	2016F
REVENUES	769,802	831,386	889,583	951,854
EBITDA	74,304	79,813	85,400	91,378
EBIT	48,085	53,475	58,099	62,762
NET PROFIT	29,248	35,107	38,954	41,971
EQUITY	358,598	383,173	390,938	399,848
ROE	8.16%	9.16%	9.96%	10.50%
ROA	3.74%	4.27%	4.65%	4.84%
D/E	75.77%	70.52%	68.27%	68.44%
EBITDA MARGIN	9.65%	9.60%	9.60%	9.60%
NET PROFIT MARGIN	3.99%	4.22%	4.38%	4.41%
EPS	0.24	0.28	0.31	0.33
P/E	16.10	15.09	13.60	12.62
P/B	1.38	1.38	1.36	1.33
EV/EBITDA	9.95	9.65	9.13	8.65
PAYOUT RATIO	0.30	0.30	0.30	0.30
DIVIDEND YIELD	1.79%	1.99%	2.21%	2.38%

BUY
ONE YEAR PRICE TARGET: BGN 5.82
CURRENT PRICE: BGN 4.15

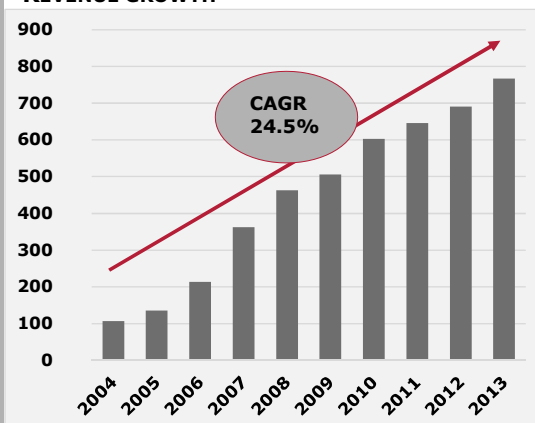
EXCHANGE RATES

BGN/EUR (FIXED): 1.95583
USD/BGN: 0.69556

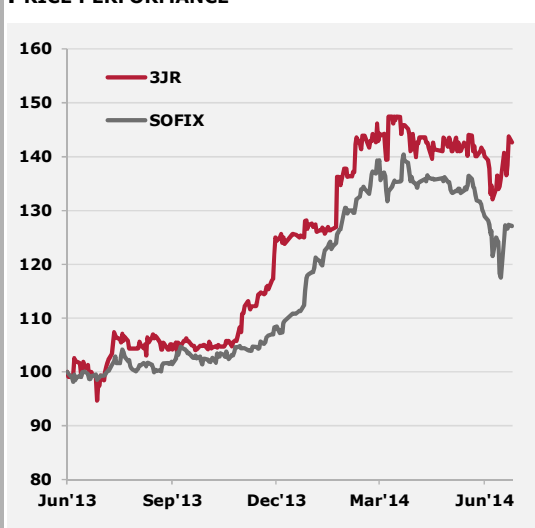
MARKET DATA

Shares Outstanding:	127.0m
Share Capital:	132.0m
Free-float:	32.4%
Treasury Shares	3.8%
Market Cap.:	BGN 530.0m
Avg. Daily Vol.:	BGN 317,000
52 Weeks Range:	BGN 2.95-4.66

REVENUE GROWTH



PRICE PERFORMANCE



EXECUTIVE SUMMARY

WE CONFIRM THE BUY RATING OF SOPHARMA JSCO. WITH ONE YEAR PRICE TARGET OF BGN 5.82 WHICH IS A 38% RETURN OVER THE NEXT 12 MONTHS. OUR RECOMMENDATION REFERS TO BOTH SOPHARMA AND SOPHARMA TRADING SHARES AS THE LATTER OUTPERFORMS THE HOLDING.

THE COMPANY

Sopharma JSCO. (Sopharma, the Group) is one of the biggest Bulgarian group of companies and one of the few of that size which are still locally owned. The Company is a leading producer, exporter and local distributor of pharmaceutical products with a strong presence in Eastern and South-Eastern Europe, offering a wide range of prescription medicines and OTC products.

The Group operates in the following areas:

- Production of pharmaceutical products including medicines, primarily generics, herbal-based substances and food supplements;
- Distribution of pharmaceuticals, medical supplies, sanitary materials, vitamins, food supplements and cosmetics;
- Production and distribution of non-pharmaceutical products, primarily medical supplies such as syringes and other disposables used in medicine.

The revenues in Bulgaria contribute 62% to the consolidated sales revenue in 2013, which is about the level of their historical share for the last ten years.

Sopharma is one of the key players in the local pharmaceutical market. The company is the second largest domestic producer with 4% market share by value and 13% by units sold. Among its main advantages is the compliance with EU standards and industry developments. Selected companies of the Group are among winners in different categories for corporate governance and financial performance, ranked by Bulgarian newspapers. We consider the Group as one of the best managed among listed companies in Bulgaria.

The Group is specialized in the production of generic pharmaceutical high quality products on competitive prices. Its portfolio consists of several original phyto-based products. One of them is Tabex, a smoking cessation drug that is substantially cheaper than its analogs. Generic products are likely to gain even larger market share as it is expected that the Bulgarian government will increasingly focus on cost-containment measures.

Sopharma's shares are listed on the Bulgarian Stock Exchange (Premium shares segment) and on the Warsaw Stock Exchange. They are considered one of the Blue Chips in Bulgaria, whose performance usually dominates the local stock exchange index - SOFIX. Sopharma is a part of that index, which is construed by the prices of 18 companies.

THE COUNTRY AND THE MARKET

The country is under a Currency board arrangement and the Bulgarian lev is pegged to the Euro at 1.95583.

We expect a modest economic increase in 2014 (around 1.8% of GDP) from a subdued rate last year, driven by stabilizing domestic demand and higher absorption of EU funds. Nevertheless, unemployment will remain high. Ongoing improvement of the economic environment both in Bulgaria and neighboring countries will support the holding business and lower the risk of Group's activity slow down.

Despite the difference of opinion between the two leading parties, politicians have agreement about the main political lines, such as currency board stability, further reduction of administrative burden, and country's competitiveness via low tax levels.

The Bulgarian pharmaceutical industry is one of the fastest growing sectors in recent years, and its market volume will continue to increase by 5% - 7% per year in the next few years. These expectations surpass the forecast for the growth of the overall economy (2% - 3% GDP growth). Increased share of the chronic diseases, combined with growing domestic demand and aging population, provide opportunities for growth.

THE VALUATION

We use the sum of the parts methodology to value Sopharma. The non-consolidated results are the base for the valuation of its main production facilities. It is the primary profit generating asset, even after the exclusion of future income from dividends. The investments in modernization and capacity increase are turning into positive cash flows.

We value the stock of Sopharma at BGN 5.82 per share or 38% above the current market prices

SOME RISKS

Revenues resulting from Ukrainian export decline by double-digit percentage annually. That country is the second largest export market of Sopharma holding a 14% stake from the revenues. Strong rivalry on the domestic pharmaceutical market, including heavy price competition between retailers and pharmacies, which lead to low margins. Increased indebtedness of hospitals, which raises the impossibility of discharging the obligations to suppliers. Payment delays deter investments in the sector.

Relatively limited size of the market due to the population size, as it is susceptible to shocks caused by funding shortfalls and other one-off factors. Limited potential for high value products due to low per-capita consumption and income in comparison with other markets in the region.

Increased political instability, after the ruling Socialists from BSP did poorly in the European Parliament elections and a junior coalition partner MFR withdrew support for the government. Inefficient government institutions, which may delay some business projects. Change in regulation, as the government controls reimbursed drug prices through the Ministry of Health's Drug Pricing Committee.

Corruption remains relevant in many political and economic institutions and has a negative impact on the quality of public services. Slow recovery of the Bulgarian economy, leading to lower than expected demand of Group's products and services.

COMPANY OVERVIEW

The pharmaceutical company Sopharma is the second largest Bulgarian pharmaceutical producer in terms of sales volume. The Group is vertically integrated and includes both production and distribution. The Group operates 15 pharmaceutical factories in Bulgaria, all in compliance with GMP (Good Manufacturing Practices), one in Ukraine, and two in Serbia. Sopharma's products portfolio consists of more than 210 products, mainly generics. It includes 15 original products, of which 12 are phyto-based. The original products, in particular Carsil and Tempalgin, are key contributors to the revenues from export markets. Meanwhile, the most important products for domestic sales are generic pharmaceuticals with a leading drug called Analgin.

Producer of more than 210 medicines, mainly generics

The products' portfolio of Sopharma is focused on the following therapeutic areas: cardiology, gastroenterology, pain relief, cough and cold, immunology and dermatology, respiratory and asthma, neurology and psychiatry, urology and gynecology. The most important pharmaceutical products in terms of their contribution to revenues are:

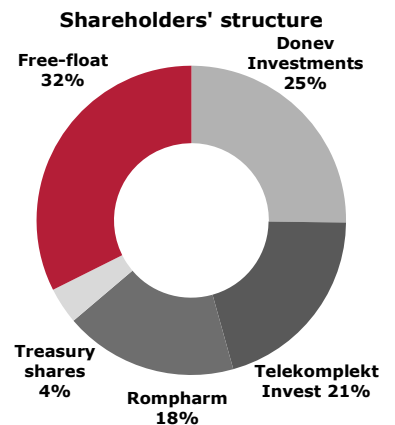
- Carsil – original phyto-based product used to treat gastrointestinal diseases (liver diseases);
- Sedal M – generic analgesic (painkiller);
- Tempalgin - original analgesic (painkiller);
- Analgin - generic analgesic (painkiller);
- Broncholytin - original phyto-based product used to suppress cough;
- Methylprednisolone - generic drug for cases of severe allergies and certain life-threatening conditions;
- Tabex – original phyto-based anti-smoking drug;
- Tribestan – original phyto-based drug used for stimulation of the male reproductive system.

SHAREHOLDERS' STRUCTURE

Three large shareholders hold a majority stake in Sopharma. They are also involved in the management of the company. The shareholders structure suffered a significant change as compared to year ago. That was the entry of Rompharm, a Romanian pharmaceutical group with Bulgarian owners that bought the stake of another major shareholder. Both companies, Sopharma and Rompharm, will seek ways for cooperation.

Number of shares outstanding - 126.7m

Sopharma is one of the favorite stocks of the Bulgarian institutional and individual investors. It has a significant free-float percentage and is subject of regular buy-back programs. One of its goals is to accumulate shares that can be used as a payment for the acquisition of its production subsidiaries during vertical mergers. Their support of the stock price levels during declines in the last few years was utilized as an exit strategy from some investors. The number of shares outstanding is currently 126.7 million from the total of 132 million share capital.



Donev Investments and Telekomplekt are companies associated with the CEO and major shareholder Mr. Ognian Donev. He is a well-respected public figure and a manager, who, among many activities, is also the chairman of the Confederation of the Employers and Industrialist in Bulgaria (the biggest and well-presented organization of local employers).

GROUPS' SUBSIDIARIES SUMMARY

Most of the main production facilities of the Group are owned by Sopharma Jsc. The consolidated results include 28 subsidiaries under direct or indirect control and three associated companies. The facilities in Bulgaria are utilized mostly by subsidiaries of the Group, which are also its suppliers and heavily depend on Sopharma for their sales.

The Group consist of Sopharma and 28 subsidiaries

The biggest and most important subsidiary is the distribution unit Sopharma Trading (also a listed company). It holds a 23% market share on the Bulgarian drugs wholesale market. The company's portfolio includes more than 7,000 drugs, medical equipment and appliances, vitamins, cosmetics and food additives. Sopharma Trading's contracts more than 400 partners and 3,870 clients. The distribution network includes pharmacies and hospitals and covers 100% of the country's territory through its five regional distribution and logistics centers. Its delivery term can be less than four hours. The total disposable warehouse area is 17,500 sq. m.

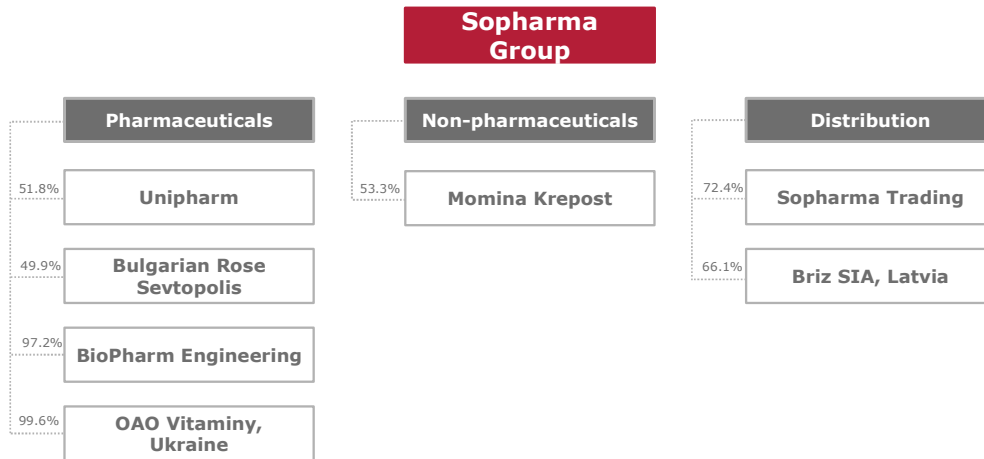
Unipharm is a drug producer, which size is in the small and medium enterprises category with an annual turnover between BGN 16m and BGN 20m in the last few years. Primarily, Unipharm's revenues come from the Bulgarian market. However, it also exports to Russia, Ukraine, Georgia, Poland and others. 39% of its total sales in 2013 are formed by its major

client Sopharma.

Bulgarian Rose Sevtopolis (BRS) produces drugs only for Sopharma as that company does not possess any brands and industrial properties. That does not allow any direct sales on domestic or foreign markets. BRS operates under Sopharma's brand and has signed a long-term contract until 2019. BRS's portfolio includes Carcil and Analgin. In addition, phyto-substances were well represented in its total sales in 2013 - 26%. Sopharma is in the process of all-stock acquisition of Sevtopolis through capital increase.

Momina Krepost is a small company for medical products from plastics, cloths and goods for household use. The company has broad distribution network in Bulgaria, but also exports to 15 countries. The Group's investment in Momina Krepost is part of its strategy to cover all medical segments. Last year's results showed growth of revenues by 11% and 3.2% net profit margin.

Exhibit 1: Major business lines with their key subsidiaries



POTENTIAL CATALYSTS

GROWING DOMESTIC MARKET: The share of healthcare costs in government budget is 4.1% as compared to 7.3% on average for EU. Therefore, the expected increase in government spending towards reaching the average EU spending is considered a catalyst for the Bulgarian pharmaceutical market growth. Furthermore, the quality of health-care services should improve, which will be consequence of larger government spending and rising personal income.

Perspectives for growth of expenditures for health-care

IMPROVING FINANCIAL RESULTS: 2013 results of the Group were influenced by the accumulated loss from public stocks trading. This one-time item affected negatively the annual net profit. We expect that the new tablet plant and the growing domestic market will result in higher Group's profits in 2014 and 2015. External investors' confidence is expected to rise following better results in the coming years.

TABEX – THE ANTI-TOBACCO DRUG: This drug for smoking cessation is phyto-based and is the cheapest alternative in the pharmaceutical market among this type of products. Tabex contains cytisine, a natural alkaloid that has strong binding affinity for the nicotinic receptor. It was first marketed in Bulgaria in 1964. A 2013 meta-analysis of eight studies demonstrated that cytisine has similar effectiveness to other smoking cessation drugs already licensed in the USA. Sopharma is in a process to register the drug in the FDA and to offer it to the US market as the cheapest smoking cessation product. Although, the exact timing of drug release is currently unknown, we consider that release in the near future as a possible catalyst for increase of revenues.

PHARMACEUTICAL SECTOR OVERVIEW

GLOBAL PHARMACEUTICAL SECTOR

The global pharmaceutical market is expected to grow around 3% - 4% per year and to reach USD 1.2 trillion in 2016 and USD 1.5 trillion in 2020, according to the research by IMS Health. Emerging markets will continue to increase their share, as their annual growth is expected to be around 10% - 13%.

Emerging markets will lead the growth

The aging populations will be the growth engine in rich countries, while in developing countries the population will become wealthier. Therefore, the latter is expected to experience chronic diseases, typical of wealthier societies (such as hypertension and diabetes). Be-

sides growth in demand, we expect to witness also an increased pressure on drug prices. The overall growth of health care costs leads to increased use of cheaper generic drugs. Their share of the global pharmaceutical market is expected to rise to 36% in the next few years, compared to 27% currently. Generics' share in developing economies is expected to reach 63%.

LOCAL PHARMACEUTICAL SECTOR

The pharmaceutical industry is one of the leading and fastest growing sectors of the Bulgarian economy. Since country's EU accession in 2007, the Bulgarian pharmaceutical legislation has been harmonized with the EU regulations in that field. Due to the EU requirements in this sector, local manufacturers have heavily invested in modernization of their production facilities. Many of the country's leading manufacturers have been privatized and multinational activity has become increasingly significant for the development within the sector.

EU accession stimulated investments

Pharmaceutical industry in Bulgaria is mostly generic. In addition to the major manufacturers such as Actavis and Sopharma, there are many other international companies such as Roche, Bayer, Pfizer etc. The production capacity of plants in Bulgaria to produce generics is 21 bn tablets and capsules, 200 m ampoules, syrups and ointments, 125 tons substances. About 80% of the overall production is exported to EU and third countries, and only 20% is sold on the Bulgarian market. The average price of a drug, produced in Bulgaria, is between BGN 3 - 4.

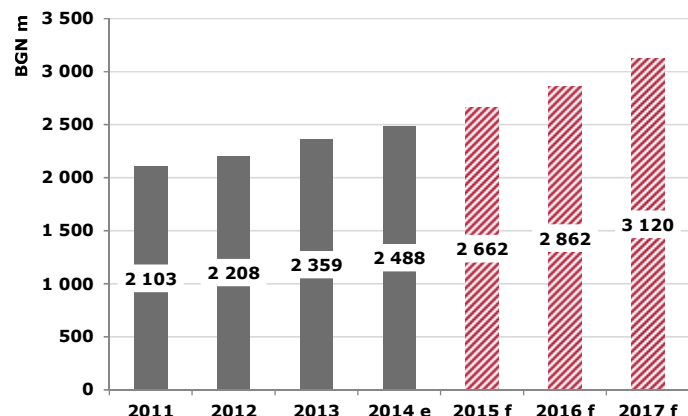
After several years of double-digit growth, factors such as reduced solvency of patients, due to the economic crisis, and cuts to reimbursement spending, affected sales. The annual market growth decelerated to slightly above 5% in 2012. According to IMS Health, the growth remained single-digit also in 2013 (6.8%), as the market for drugs and supplements reached BGN 2.39 bn. The 2014 expectations are that the drug market will continue to grow moderately (between 5% - 7%), as more sizable growth could be observed only after a significant increase in public funds or in disposable income of the population.

The drugs for treatment of diseases of the Cardiovascular system have the largest share in sales in terms of value (23.9% of total sales), followed by diseases of the Alimentary and metabolism (12.7%). The share of drugs for treatment of diseases of the Nervous system declined during the last few years, mainly due to an expiration of patent protection of the major ingredients, which led to their replacement with generic analogues at prices three to ten times lower.

For another consecutive year there are no new players in the wholesale sector, as five major distributors cover more than 90% of medicines, medical devices, equipment, and food supplements. The four largest distributors - Sopharma Trading, Sting, Farmnet and Libra - Fyoniks hold around 20% market share each, as their turnover is around BGN 0.5 bn each. The market of pharmaceuticals distribution remains highly competitive. Distributors rely on income from other activities such as marketing, services, exclusive representation, and etc. to improve their financial flows.

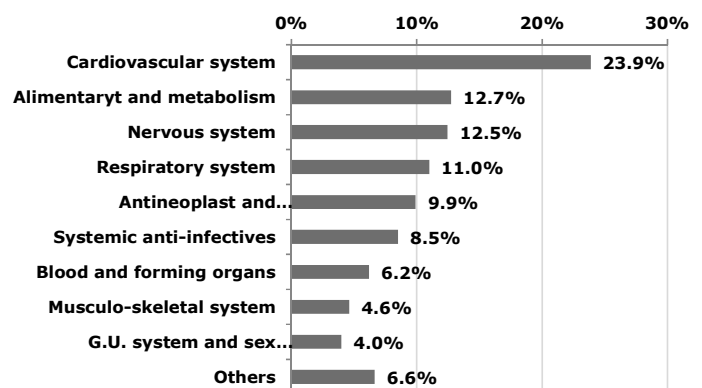
The observed growth of sales in value at a relatively constant amount of sold packs shows that drug prices have been growing faster than the consumption of drugs. Nevertheless, the drug prices in Bulgaria remain relatively low, compared to other EU countries. However, the VAT (20%) for drugs is one of the highest ones in the EU. Margins are legally regulated and they could not exceed 7% for drugs' wholesale, covered by public funds. This is the lowest percentage rate, according to IMS Health.

Exhibit 2: The market is expected to continue to increase gradually during the next few years



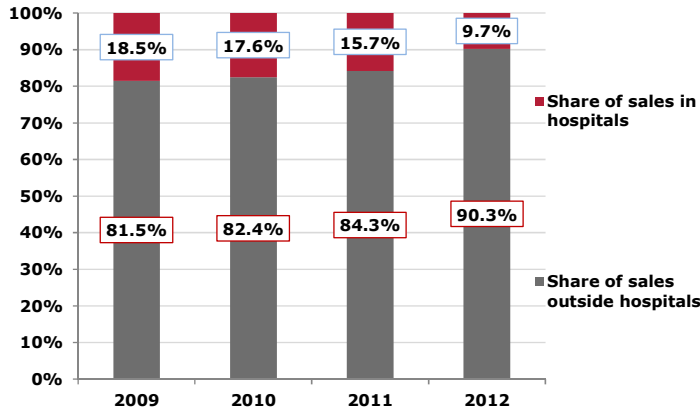
Source: IMS Health

Exhibit 3: Main treatment groups by total sales



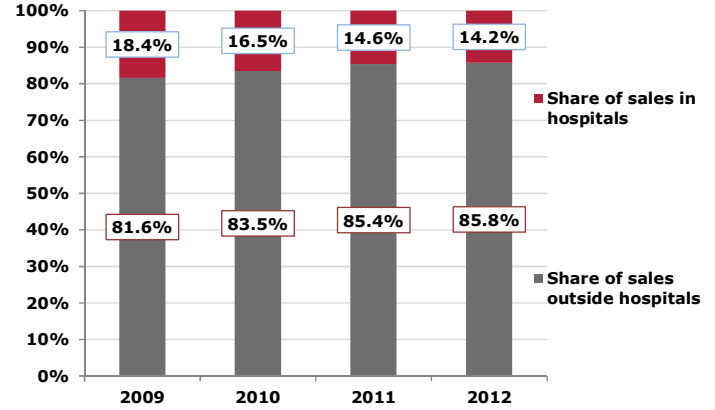
Source: Bulgarian Drug Agency

Exhibit 4: Domestic sales in units sold remains dominated by sales outside hospitals, as their share increased by almost 9 p.p. for the last four years



Source: Bulgarian Drug Agency

Exhibit 5: The share of sales volume outside hospitals grew by slightly above 4 p.p. for the same period



Source: Bulgarian Drug Agency

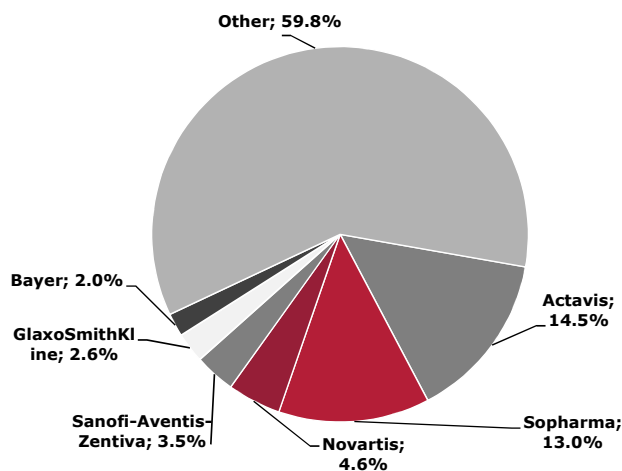
SOPHARMA'S MARKET PRESENCE

Sopharma's portfolio includes many generic medicines that are substantially cheaper than imported analogs. This contributes for the leading position of the company by market volumes. Sopharma had the sixth larger market share by value on the domestic market. Its top selling drug during the first quarter was Carsil, original phyto-based product used to treat liver diseases. Carsil had leading positions on the export markets of Russia, Ukraine and the Baltics. The 5 top drugs represented 53% of non-consolidated revenues. Although the concentration is big, we don't consider it as risky for the revenues of Sopharma due to the well-known brands and competitive prices of medicines. Sopharma is popular brand on the local market with its pain-killer medicines.

Russia was the largest market for the production of Sopharma in 1Q 2014 with 37% of non-consolidated sales. Reported growth on yearly basis was 7%. The second largest export market was Ukraine with 16% of non-consolidated sales and 27% growth y-o-y. Sopharma reported preliminary data for revenues during the first half of the year, including 2% growth of the domestic market and 8% decrease of export. Lower sales were consequence of the situation in Eastern Ukraine, where the company was unable to deliver its products. Falling national currency and personal income in Ukraine were also negative factors. Sopharma requires payment immediately from its Ukrainian partners and lowers the risks.

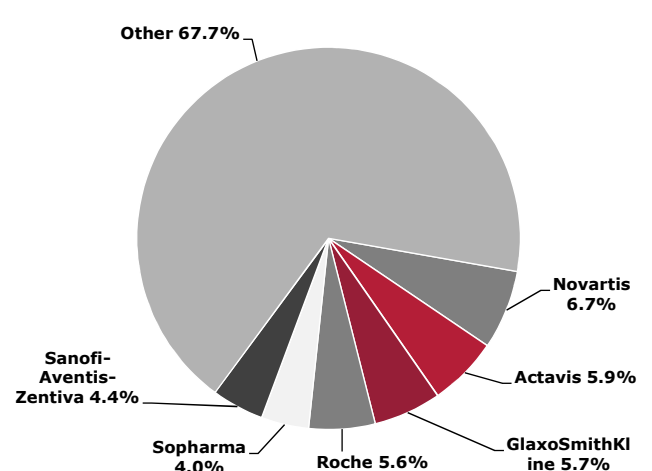
The distribution unit Sopharma Trading supplies equipment and provides complete decisions for hospitals. Revenues from deliveries of equipment represented 3% of total during the first quarter of 2014. Considering the small level of government investments in hospitals, we assume that share of sales of equipment will remain 3% of total in 2014.

Exhibit 6: Sopharma is among the two leading companies on the Bulgarian pharmaceutical market by volume



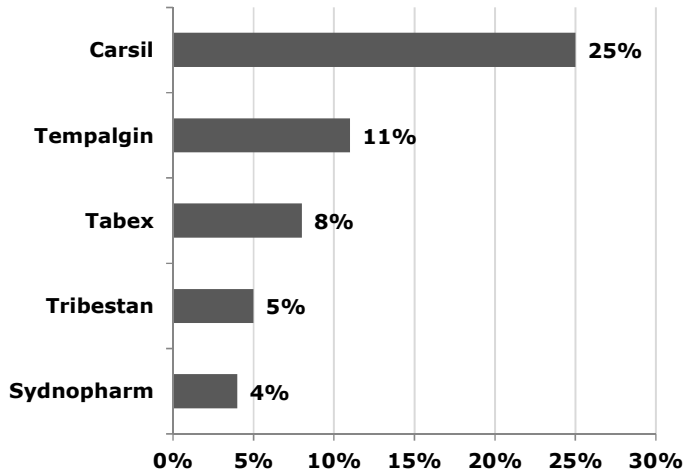
Source: Sopharma, 1Q 2014

Exhibit 7: It is also among top six companies by value, as there is no clear market leader



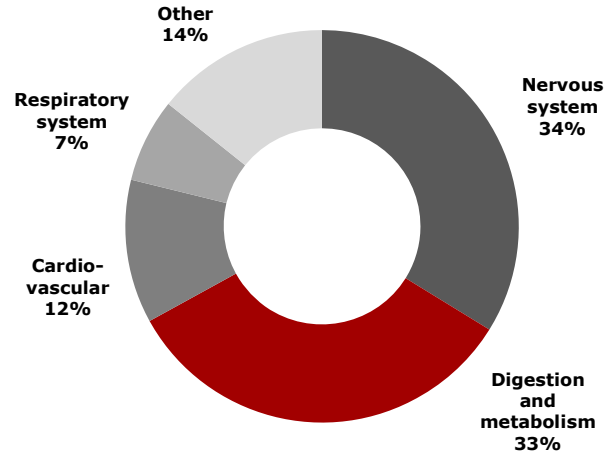
Source: Sopharma, 1Q 2014

Exhibit 8: Top 5 medicines by share in revenues of Sopharma represent 53% of sales



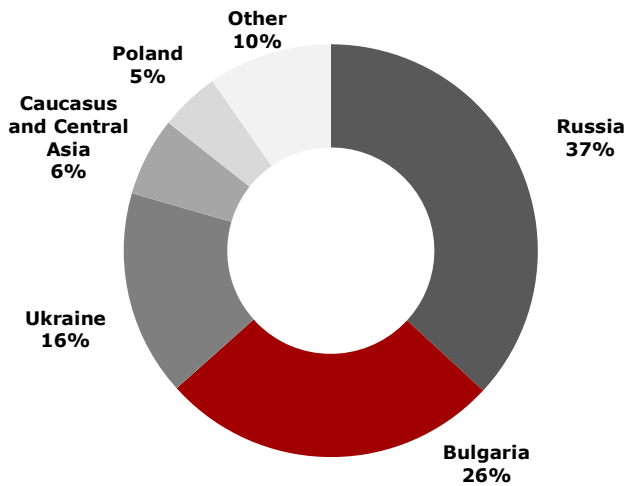
Source: Sopharma, 1Q 2014

Exhibit 9: Sopharma produces mainly medicines to treat diseases of nervous and digestion systems



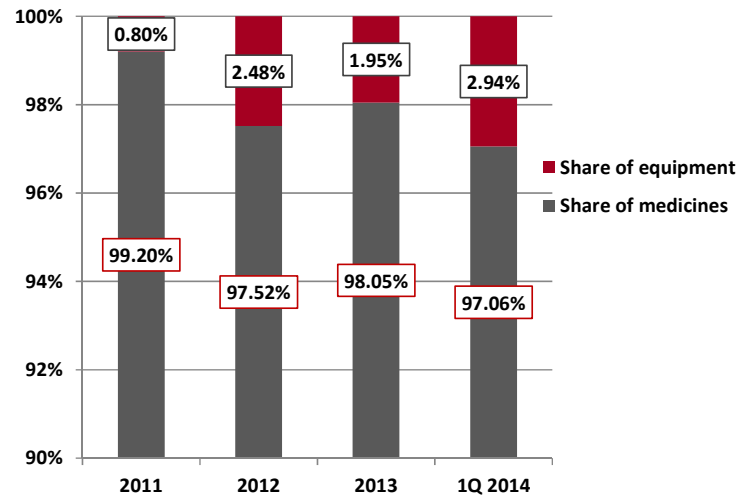
Source: Sopharma, 1Q 2014

Exhibit 10: Risks of large exposure on Ukraine are compensated by the growth of other main markets



Source: Sopharma, 1Q 2014

Exhibit 11: Sale of equipment had low share of Sopharma Trading's revenue



Source: Sopharma, 2013

ACQUISITION BULGARIAN ROSE - SEVTOPOLIS

Based on the strategy to consolidate most production facility into Sopharma, the Company announced a merge with its subsidiary Bulgarian Rose – Sevtopolis. Sopharma will issue new shares that will be distributed among the shareholders of the transferring company Bulgarian Rose – Sevtopolis, except the shareholder Sopharma. The capital of the receiving company will be increased from 132 million to 134 530 820 ordinary share. Against one share of Bulgarian Rose – Sevtopolis each shareholder shall receive 0.419404 shares of the capital of Sopharma.

The Company submitted for approval the signed merger agreement and all accompanying documents to the Financial Supervision Commission on 3 July 2014.

FINANCIAL ANALYSIS AND VALUATION

Sopharma is a solid company/holding utilizing its vertical integration and strong presence on the Bulgarian pharmaceutical market. The wholesale unit Sopharma Trading, the Group's biggest subsidiary, is a high revenue and low level of profitability company compared to the remaining units. Therefore, we use the sum-of-the-parts method for valuation purposes and discard the peers' method. The consolidated results multiples are presented in the next table. P/E ratio with value of 15 on the expected profit for 2014 is slightly higher than the average P/E on the Bulgarian stocks. However, strong presence on several EE markets and the anticipated revenues growth in Bulgaria result in an attractive long-term investment with low price volatility.

Stable performance, expected to further improve

	2012	2013	12M	2014E
Current Price	2.10	3.92	4.18	4.18
Number of Shares	128,146,215	126,324,658	126,762,779	126,762,779
Market Capitalization	269,107,052	494,561,036	529,868,416	529,868,416
Net Profit	35,308,000	30,720,000	25,674,000	35,107,214
P/E	7.62	16.10	20.64	15.09
Equity	345,879,000	358,598,000	370,468,000	383,173,050
P/B	0.78	1.38	1.43	1.38
Sales	694,027,000	769,802,000	797,218,000	831,386,160
P/S	0.39	0.64	0.66	0.64
EV	523,737,052	739,123,036	746,452,416	746,028,818
EBITDA	72,720,000	74,304,000	70,783,000	79,813,071
EV/EBITDA	7.20	9.95	10.55	9.35
RoE	10.21%	8.57%	6.93%	9.16%
RoA	4.74%	3.92%	3.21%	4.27%

SOPHARMA INDIVIDUAL ANALYSIS AND VALUATION

Individually, Sopharma's results represent mainly the production part of the Group and it is the most profitable part. However, during the last three years, its annual revenues growth was insignificant (1%-1.5%) due to the lack of production capacity. Therefore, the consolidated revenues growth was considerably higher as it included distribution and sale of outside producers' goods. The investment program during the last three years included the construction of new tablet facility for EUR 36 million. Its annual capacity is 4 billion tablets for more than 100 different products. The tablet production capacity utilization was 50-60% during the first half of 2014, whereas ampule production capacity utilization was 80%. Moreover, the building of tablet facility was designed with additional free space for more machines and equipment. Sopharma can increase its capacity further without sizable investments. We don't estimate that the company will make large investments in its core production during the next three year. Sopharma increased its presence in Belarus and the Baltics with the acquisition of apothecaries, a warehouse and wholesale trader in its subsidiary Briz.

Rising demand in Bulgaria and higher export to Russia, Poland and other countries

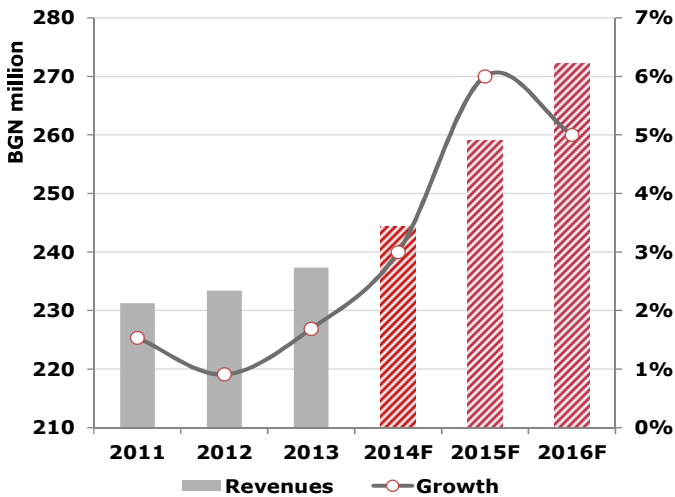
Following the implementation of an adequate investment program, we expect that the sales growth will additionally accelerate during the next two year, also supported by the increased usage of generic medicines in Bulgaria and other countries in Eastern Europe. Based on the Q1 results and the available capacity, we expect a 3% increase of non-consolidated revenues of Sopharma solely for 2014. *(The forecasts exclude the forthcoming merger with Bulgarian Rose - Sevtopolis).*

Sopharma enjoys preferential terms (incl. interest rates) on its debt financing, supported by its access to big EU banks. The beneficiary of these funds is usually the Group's distribution arm Sopharma Trading. These privileges allow the distributor to gain deeper penetration in the hospitals supply market, which is characterized by longer payment terms.

The result of that redirection of acquired debt is that bank loans and receivables are closely related in the balance sheet of Sopharma. Last year's financial income from loans amounted almost BGN 4 million (more than BGN 5 million for 2012) and we expect steady receivables levels in the following years.

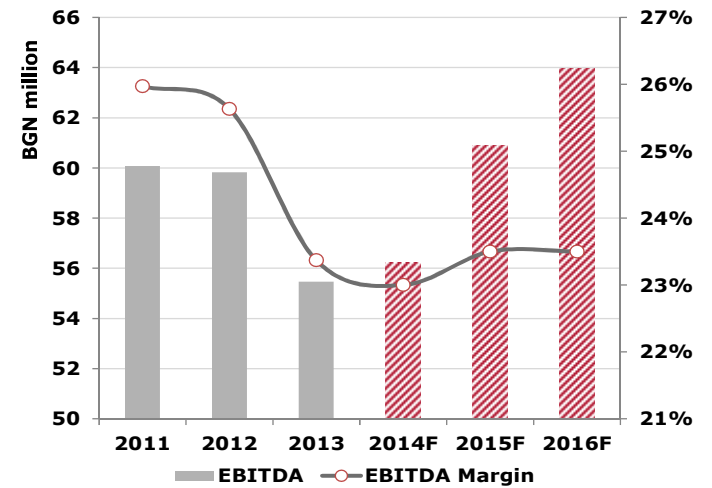
In terms of risks involved, we consider the declining export to Ukraine a considerable one. That country is the second largest export market for Sopharma and that destination is currently experiencing double-digit percentage decrease in sales.

Exhibit 12: Forecasted growth of sales following higher export expectations



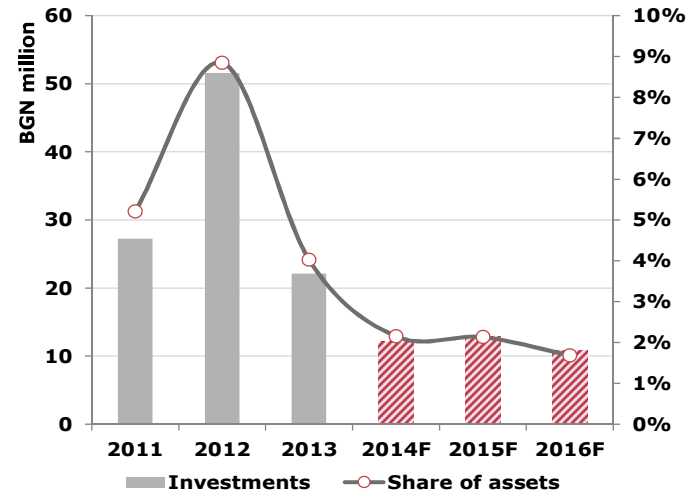
Source: Elana Trading estimates, company data

Exhibit 13: Decrease of EBITDA margin, following increased staff cost and higher expenses with free capacity; margins could surprise on the upside



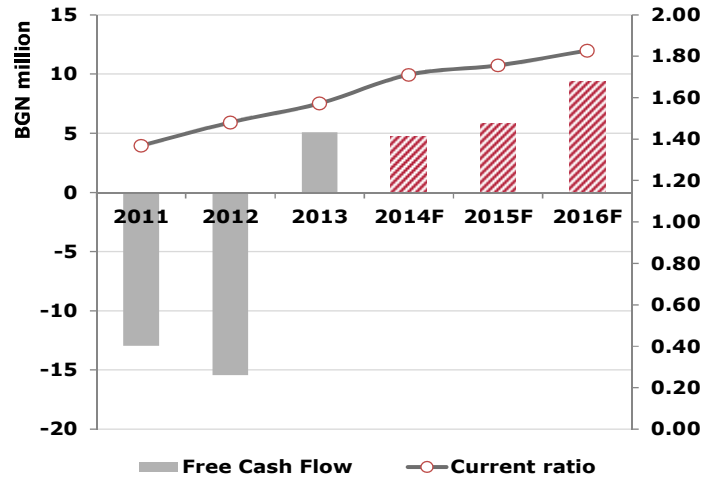
Source: Elana Trading estimates, company data

Exhibit 14: Investment program in new capacity and modernization is completed



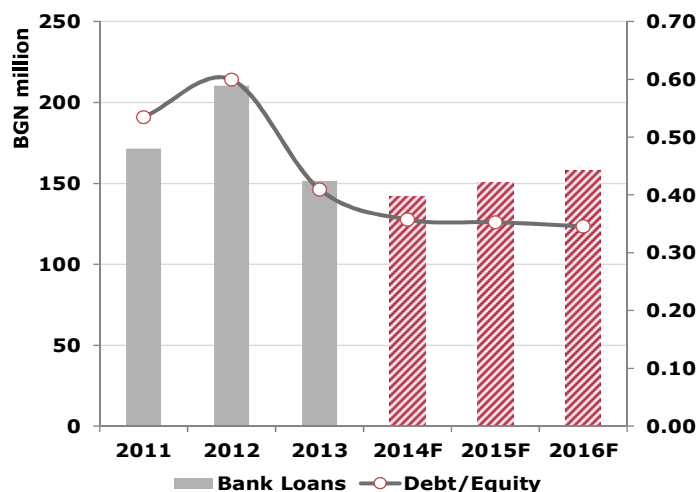
Source: Elana Trading estimates, company data

Exhibit 15: Sopharma demonstrates excellent liquidity and will continue to generate positive cash flows



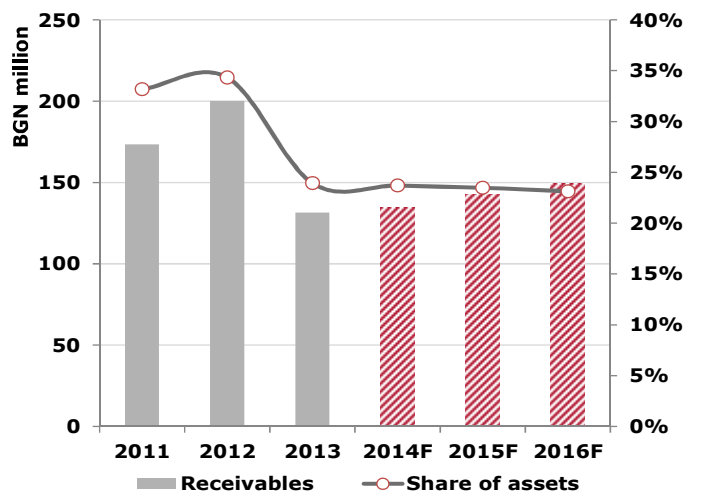
Source: Elana Trading estimates, company data

Exhibit 16: Decreased loan levels as we expect average 0.35 debt-to-equity ratio



Source: Elana Trading estimates, company data

Exhibit 17: Receivables and bank loans are linked and depend on the amounts of subsidiaries' loans



Source: Elana Trading estimates, company data

Our forecasts and DCF calculations are adjusted to exclude the dividend income from subsidiaries as we add their value under the sum-of-the-parts method.

We value Sopharma by its individual report at BGN 4.71

Bloomberg returns a beta of Sopharma below 1 (0.77). Sopharma's shares provide high liquidity and lower volatility compared to the main market index (SOFIX). However, the stock's direction is susceptible to the market volatility despite the non-cyclical production of the Group. We utilize Bloomberg's beta level as we expect that the stock will be less volatile than SOFIX but will follow the general market trend. We expect that the cost of equity will exceed 10% due to the gradual increase of risk-free rate. Simultaneously, the Group will maintain its low cost of debt correlated to the euro rates. Overall, we suggest that WACC is increased gradually to 9.3%.

The discounted cash flows model is adjusted to exclude the dividends from subsidiaries income and represents the value generated by the production facilities of Sopharma. The model does not account for the forthcoming merger with Bulgarian Rose Sevtopolis. We imply 3% revenues increase in this year alone, followed by accelerated 6% in 2015. EBITDA margin forecasts are as follows: 23% in 2014 and 23.5% in 2015 and 2016. All estimation and forecasts include a margin of safety due to the risks of additional decline in sales in Ukraine and our decision to exclude dividends from the individual report. The investments level forecasts are matched to depreciation due to the already completed projects for capacity increase.

The intrinsic value of Sopharma's share is BGN 4.71. This is the value of main production segment of the company, which excludes the lucrative assets in distribution and other activities.

WACC CALCULATION

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	TERMINAL YEAR
RISK FREE RATE	2.26%	2.50%	3.00%	3.50%	3.50%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
EQUITY RISK PREMIUM	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
BETA	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77
COST OF EQUITY	8.42%	8.66%	9.16%	9.66%	9.66%	10.16%	10.16%	10.16%	10.16%	10.16%	10.16%
COST OF DEBT	3.75%	3.75%	4.00%	4.50%	4.50%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
EFFECTIVE TAX RATE	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
AFTER-TAX COST OF DEBT	3.38%	3.38%	3.60%	4.05%	4.05%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
WEIGHT OF EQUITY	74%	74%	74%	80%	85%	85%	85%	85%	85%	85%	85%
WACC	7.09%	7.28%	7.73%	8.54%	8.82%	9.31%	9.31%	9.31%	9.31%	9.31%	9.31%

DISCOUNTED CASH FLOWS

BGN'000	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	TERMINAL YEAR
EBIT	45,226	49,235	51,697	54,023	57,940	60,257	62,668	64,861	67,131	69,481	71,912
EBIT(1-T)	40,703	44,311	46,527	48,621	52,146	54,232	56,401	58,375	60,418	62,533	64,721
ADD: D&A	11,001	11,661	12,244	12,795	11,885	12,360	12,855	13,305	13,770	14,252	14,751
LESS: INVESTMENTS	12,223	12,957	10,884	11,373	11,885	12,360	12,855	13,305	13,770	14,252	14,751
LESS: CHANGE NWC	2,303	3,740	3,304	3,122	3,263	3,031	3,152	2,868	2,969	3,073	3,291
FCF	37,178	39,275	44,584	46,920	48,883	51,201	53,249	55,507	57,449	59,460	61,430
PV FCF	34,716	34,125	35,656	33,809	32,036	30,012	28,554	27,229	25,782	24,411	
SUM OF PV FCF	306,330										
PV OF CONTINUING VALUE	434,000										
TOTAL PV FREE CASH FLOWS	740,330										
LESS: OUTSTANDING DEBT	147,245										
PLUS: FINANCIAL ASSETS	4,275										
PV OF EQUITY	597,360										
NUMBER OF SHARES	126,763										
PRICE PER SHARE	4.71										

SENSITIVITY ANALYSIS

Exhibit 18: Terminal growth

	2.0%	3.0%	3.5%	4.0%	5.0%
WACC 7.0%	6.26	7.46	8.33	9.48	13.50
8.0%	5.06	5.79	6.28	6.88	8.71
9.0%	4.24	4.71	5.01	5.37	6.36
10.0%	3.64	3.97	4.16	4.39	4.99
11.0%	3.20	3.43	3.56	3.72	4.11

Source: Elana Trading estimates

Exhibit 19: Terminal EBIT margin

	17.0%	18.0%	19.0%	20.0%	21.0%
WACC 7.0%	7.38	7.76	8.14	8.52	8.90
8.0%	5.60	5.87	6.14	6.41	6.68
9.0%	4.51	4.71	4.91	5.11	5.31
10.0%	3.77	3.93	4.09	4.24	4.40
11.0%	3.26	3.38	3.50	3.63	3.75

Source: Elana Trading estimates

SOPHARMA TRADING

Sopharma Trading's operations are heavily influenced by the health care system in the country. Its product portfolio mainly (78%) consist of imported products. The company follows the general market upwards trend while maintaining excellent trade relationships with all producers. Regardless of how diversified its portfolio is, the parent company is still the largest supplier for Sopharma Trading which corresponds to 12% share of revenues.

Leading distributor in Bulgaria with more than 23% market share

Various researches state that the Bulgarian pharmaceutical market has the largest growth potential among all countries in Central and Eastern Europe. That market accounted to BGN 2.3 billion in 2013, a 6.3% increase compared to the previous year. Furthermore, the health care government spending as percentage of GDP is projected to rise.

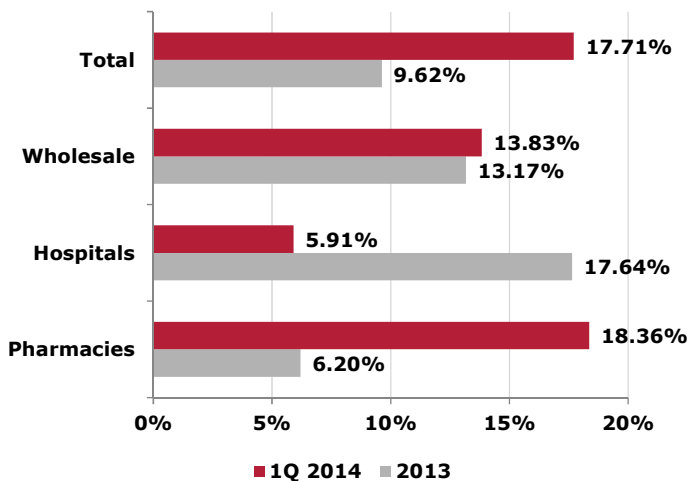
Sopharma Trading is the market leader with more than 23% of this highly competitive market. Deliveries to hospitals is that company's strongest suit where it is responsible for more than one-third of the supplies. In addition, the first quarter of 2014 reports a solid growth in deliveries to pharmacies.

Sopharma Trading's receivable increase steadily and reach 28% of sales during the last two years. Assumptions that the government financed healthcare system will be able to repay substantial part of hospitals' debts are currently not rational. Therefore, the access to cheap financing from the parent company allows Sopharma Trading to maintain its 1.6 debt-to-equity ratio, without risk of insolvency or decline of profits.

A sizable profit growth of 29% is observed in 2013. That was mainly a result from the positive effects from the distribution of medical equipment along with the rising productivity and economies of scale. The first five months of 2014 returned even higher profit growth of 43% due to the same factors.

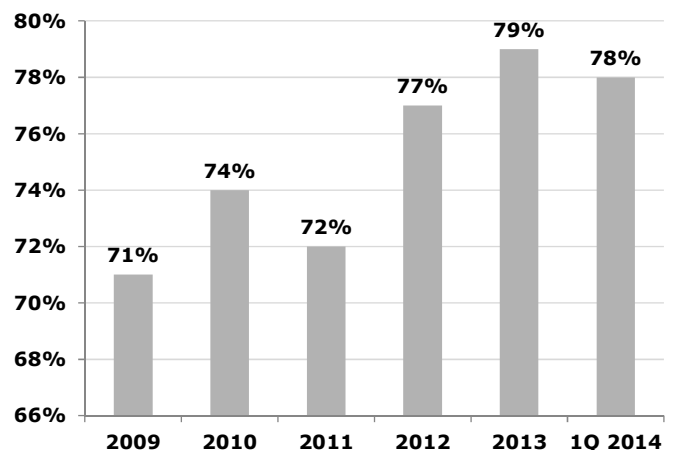
A steady improve on return on equity is visible during the last two years as we expect the positive trend to continue.

Exhibit 20: Sopharma Trading reports solid revenues increase by segments

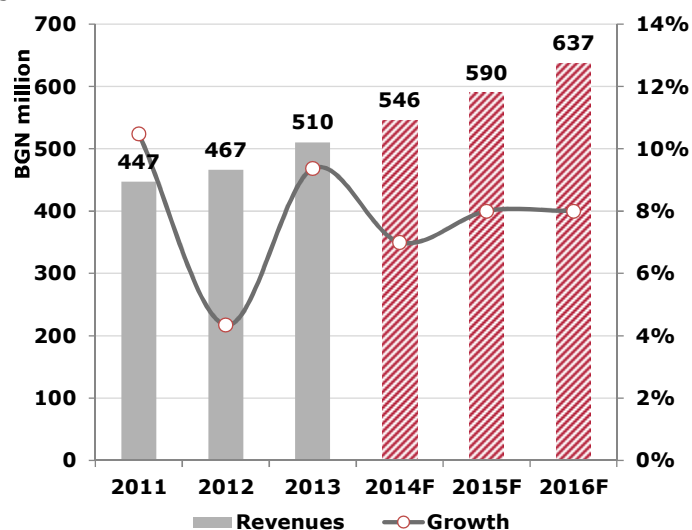


Source: Company's data

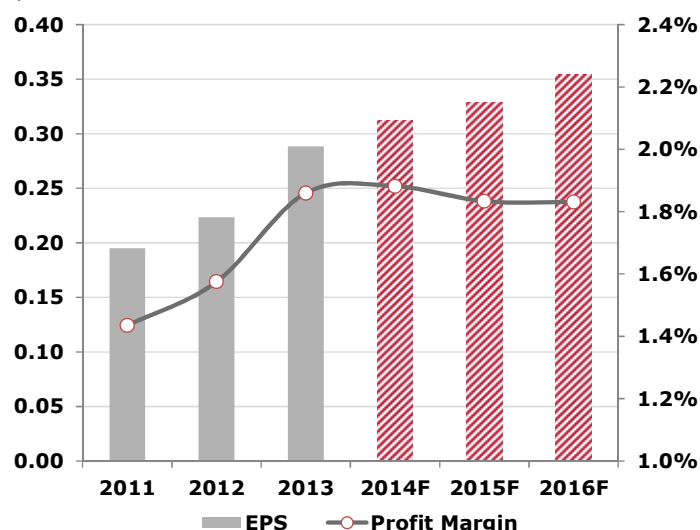
Exhibit 21: Almost 80% of sales are imported goods



Source: Company's data

Exhibit 22: Expected moderate growth of revenues from the growth of the domestic market


Source: Elana Trading estimates and company's data

Exhibit 23: Slight decrease of profit margin to reflect the possible increase of debt costs


Source: Elana Trading estimates and company's data

The current price of Sopharma Trading is BGN 5.00 per share, or capitalization of BGN 164 million. This price can be justified only when comparing to average P/E ratio of medicine distribution companies. Our discounted cash flows model is pointing to substantially higher value of the stock, mainly due to the low cost of capital and the expected profit increase. Therefore, we use the current market price in defining Sopharma Trading market capitalization.

VALUATION OF SUBSIDIARIES

We evaluate the remaining subsidiaries by their equity, applying 50% discount for non-public listed and 25% for public listed companies. This will reflect their smaller contribution to the net profit and lower liquidity. Value of other assets will be included in the final calculation under the SotP method.

VALUATION OF THE GROUP

We use the sum of the parts model to value the shares of Sopharma. The list includes the main subsidiaries. The value of Sopharma under this method is BGN 5.82 per share.

	MARKET CAP	SHARE	ELANA NAV	VALUE	DISCOUNT	VALUE
SOPHARMA - INDIVIDUALLY		100.00%	597,359,943	597,359,943	0%	597,359,943
SOPHARMA TRADING	164,525,045	72.42%	164,525,045	119,149,038	25%	89,361,778
BRIZ - LATVIA				22,270,000	50%	11,135,000
UNIPHARM	18,000,000	49.99%		19,448,000	25%	14,586,000
BULGARIAN ROSE SEVTOPOLIS		49.99%		8,729,000	25%	6,546,750
BIOPHARM ENGINEERING		97.15%		16,380,000	50%	8,190,000
VITAMINE - UKRAINE		99.56%		6,187,000	50%	3,093,500
OTHER STAKES				14,023,000	50%	7,011,500
TOTAL VALUE OF SOPHARMA:						737,284,471
CURRENT MARKET CAP:						529,868,416
PREMIUM/(DISCOUNT):						39.14%
FAIR PRICE PER SHARE:						5.82

RECOMMENDATION AND PRICE TARGET

The intrinsic value of Sopharma’s stock is higher than the market quotes. The favourable market and the Group’s position in that market, which ultimately will result in growth and enhanced profits, are some of the factor to contribute to Sopharma’s management attempts to increase shareholders’ value.

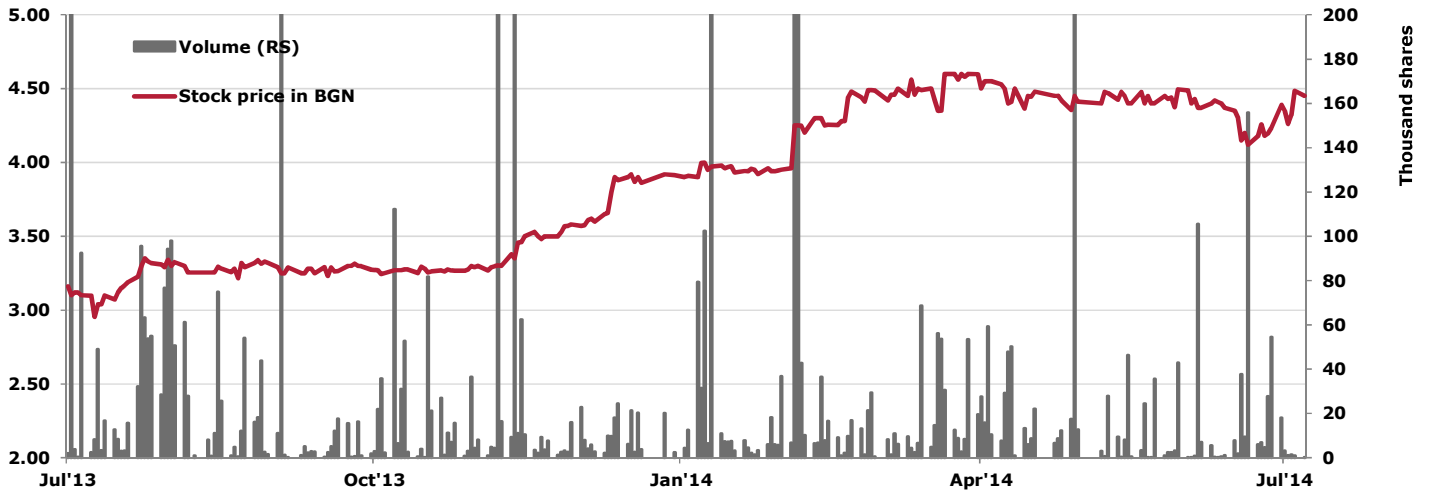
*Recommendation: BUY
Target Price: BGN 5.81
Increase: 38%*

We maintain our **BUY** recommendation with price target that is more than 30% higher than the current quotes.

In terms of significant investors involved in our stock market, we share the following observations:

- Foreign investors prefer Sopharma shares for their higher liquidity and low volatility. These factors will continue to attract buyers that look for exposure in Bulgarian pharmaceutical market
- Bulgarian institutional investors are not active currently on the buy side. However, they are expected to sustain their present portfolio and will not provide excess volumes for either Sopharma’s or its subsidiaries’ shares in following months.
- Domestic private investors view the stock as stable and perspective for longer-term holding, rather than short-term speculation with high return.

STOCK PRICE DYNAMICS



FINANCIAL DATA

STATEMENT OF INCOME (IN '000 BGN)	2011	2012	2013	TTM	3M 2013	3M 2014
SALES	649,572	694,027	771,832	797,218	189,872	217,288
PRODUCTION EXPENSES	515,097	554,472	618,091	637,797	145,555	169,465
PERSONNEL EXPENSES	65,200	68,972	74,852	76,709	17,276	19,326
NET INCOME FROM FINANCIAL ACTIVITIES	,614	1,518	(7,527)	(13,311)	1,307	(3,743)
OTHER REVENUES AND EXPENSES	,439	,619	,573	1,382	,97	,170
EBITDA	70,328	72,720	71,935	70,783	28,445	24,924
DEPRECIATION	18,139	21,995	23,549	28,421	5,410	7,612
EBIT	52,189	50,725	48,386	42,362	23,035	17,312
INTEREST EXPENSE	8,608	7,719	8,701	9,239	1,751	2,194
PRETAX INCOME	43,581	43,006	39,685	33,123	21,284	15,118
TAXES	4,964	4,934	6,021	4,626	2,674	2,121
AFTER-TAX INCOME	38,617	38,072	33,664	28,497	18,610	12,997
MINORITY INTEREST	(,227)	2,764	2,789	2,823	,930	,363
NET INCOME	38,844	35,308	30,875	25,674	17,680	12,634
EARNINGS PER SHARE IN BGN	0.29	0.28	0.24	0.20	0.14	0.10

BALANCE SHEET (IN '000 BGN)	2011	2012	2013	TTM	3M 2013	3M 2014
TOTAL ASSETS	683,362	745,418	787,028	799,158	791,870	799,158
EQUITY SUBSCRIPTIONS RECEIVABLE	0	0	0	0	0	0
FIXED ASSETS	293,902	354,751	388,771	384,073	368,695	384,073
TANGIBLE FIXED ASSETS	237,751	292,074	309,154	304,109	302,826	304,109
FINANCIAL INVESTMENTS	20,043	24,007	9,080	10,433	26,332	10,433
CURRENT ASSETS	389,460	390,667	398,257	415,085	423,175	415,085
INVENTORY	126,247	130,950	140,722	140,484	126,712	140,484
RECEIVABLES	228,973	242,431	228,597	246,665	270,314	246,665
FINANCIAL ASSETS	0	0	0	0	0	0
CASH AND CASH EQUIVALENTS	32,377	15,767	27,155	26,606	24,795	26,606
TOTAL LIABILITIES + EQUITY	683,362	745,418	787,028	799,158	791,870	799,158
EQUITY	321,690	345,879	360,096	370,468	363,670	370,468
REGISTERED CAPITAL	120,780	118,406	113,005	114,394	118,000	114,394
CAPITAL FUNDS	162,066	189,513	213,427	49,850	190,030	49,850
EARNINGS	38,844	37,960	33,664	206,224	55,640	206,224
LIABILITIES	361,672	399,539	426,932	428,690	428,200	428,690
LONG-TERM PAYABLES	10,228	13,244	18,533	17,558	13,915	17,558
LONG-TERM BANK LOANS	23,496	56,844	56,556	53,949	60,466	53,949
SHORT-TERM BANK DEBT	151,798	203,994	209,743	216,584	233,930	216,584
SHORT-TERM PAYABLES	131,694	79,983	88,092	81,012	70,483	81,012
OTHER LIABILITIES	0	0	0	0	0	0
WORKING CAPITAL	105,968	106,690	100,422	89,553	92,613	89,553

NUMBER OF SHARES:	132,000,000	128,146,265	126,324,658	126,762,779	127,966,149	126,762,779
PRICE IN BGN - PERIOD END:	3.18	2.10	3.92	4.18	2.38	4.60
MARKET CAP IN BGN - PERIOD END:	419,760,000	269,107,157	494,561,036	529,868	304,431	582,982

CASH FLOW STATEMENT (IN '000 BGN)	2011	2012	2013	TTM	3M 2013	3M 2014
NET INCOME	38,844	35,308	30,875	25,674	17,680	12,634
DEPRECIATION	18,139	21,995	23,549	5,378	5,410	7,612
CHANGES IN WORKING CAPITAL	(18,298)	,722	(6,268)	(23,980)	3,209	(3,060)
OTHER OPERATING CASH FLOW ITEMS	10,207	(52,292)	4,553	48,648	(23,149)	(10,812)
NET CASH FROM OPERATING ACTIVITIES	48,892	5,733	52,709	103,680	3,150	6,374
CAPITAL EXPENDITURES	(37,141)	(63,432)	(36,453)	(33,313)	(11,943)	(8,299)
OTHER INVESTING CASH FLOW ITEMS	(24,027)	3,594	11,845	19,494	(5,002)	2,472
NET CASH FROM INVESTING ACTIVITIES	(61,168)	(59,838)	(24,608)	(13,819)	(16,945)	(5,827)
ISSUANCE/ RETIREMENT OF STOCK, NET	(6,741)	(2,131)	(5,629)	(3,311)	(341)	1882
ISSUANCE/ RETIREMENT OF DEBT, NET	21,415	52,645	(1,882)	(27,838)	24,001	(1,992)
DIVIDENDS PAID	(12,790)	(11,672)	(10,942)	(11,047)	(3)	(108)
OTHER FINANCING CASH FLOW ITEMS	(2,767)	(1,205)	1,740	1,574	(834)	(883)
NET CASH FROM FINANCING ACTIVITIES	(883)	37,637	(16,713)	(40,622)	22,823	(1,101)
NET CHANGE IN CASH	(13,159)	(16,468)	11,388	1,280	9,028	(554)
BEGINNING-OF-PERIOD CASH	44,384	32,235	15,767	24,795	15,767	26,633
END-OF-PERIOD CASH	31,225	15,767	27,155	26,079	24,795	26,079
CASH PER SHARE	0.24	0.12	0.21	0.21	0.19	0.21

FINANCIAL AND PERFORMANCE INDICATORS	2011	2012	2013	TTM
VALUATION RATIOS				
PRICE/EARNINGS (P/E)	10.81	7.62	16.02	22.71
BOOK VALUE (BV)	2.44	2.70	2.85	2.92
PRICE/BOOK (P/B)	1.30	0.78	1.37	1.57
SALES PER SHARE	4.92	5.42	6.11	6.29
PRICE/SALES (P/S)	0.65	0.39	0.64	0.73
PRICE/CASH PER SHARE	7.37	4.70	9.09	10.78
EV (IN BGN)	562,677	514,178	733,705	826,909
EV/SALES	0.87	0.74	0.95	1.04
EV/EBITDA	8.00	7.07	10.20	11.68
EV/EBIT	10.78	10.14	15.16	19.52
LIQUIDITY				
CURRENT RATIO	1.37	1.38	1.34	1.39
QUICK RATIO	0.93	0.91	0.86	0.92
DEBT MANAGEMENT				
DEBT TO TOTAL ASSETS	0.53	0.54	0.54	0.54
INTEREST COVERAGE	6.06	6.57	5.56	4.59
LT DEBT/EQUITY	0.10	0.20	0.21	0.19
TOTAL DEBT/EQUITY	1.12	1.16	1.19	0.73
ASSET MANAGEMENT				
INVENTORY TURNOVER	5.15	5.30	5.48	5.67
DAYS SALES OUTSTANDING	127	126	107	111
FIXED ASSET TURNOVER	2.21	1.96	1.99	2.08
TOTAL ASSET TURNOVER	0.95	0.93	0.98	1.00
PROFITABILITY				
PROFIT MARGIN ON SALES	6.0%	5.1%	4.0%	3.2%
EBITDA MARGIN	10.8%	10.5%	9.3%	8.9%
BASIC EARNING POWER	7.6%	6.8%	6.1%	5.3%
RETURN ON ASSETS	5.7%	4.7%	3.9%	3.2%
RETURN ON EQUITY	12.1%	10.2%	8.6%	6.9%
RETURN ON INVESTMENTS	10.9%	8.5%	7.1%	5.8%
DIVIDEND INFORMATION				
DIVIDEND YIELD	2.20%	3.33%	1.79%	
DIVIDEND PER SHARE	0.07	0.07	0.07	

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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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