

SOPHARMA

INDUSTRY: PHARMACEUTICALS

CAPITALIZING ON INVESTMENTS

SOPHARMA TOOK A SERIOUS HIT FROM RUSSIA IN Q2'16 AS SALES TO THAT MARKET DROPPED BY ALMOST A QUARTER. NEVERTHELESS, THE COMPANY CAPITALIZED ON INVESTMENTS WITH DIVIDEND INCOME AND PROFIT FROM THE SALE OF A SUBSIDIARY SAVING THE BOTTOM LINE AS COST OPTIMIZATION WAS NOT ENOUGH TO DEAL WITH THE HIT FROM RUSSIA.

TOP LINE TROUBLE INTENSIFIES AGAIN

After somewhat stable two quarters, in Q2'16 Sopharma took another hit on the top line. This time from Russia where sales retreated 23.7% y/y in H1'16 to BGN 24.2m while domestic market sales declined 3.36% to BGN 32.7m. Overall, sales in H1 2016 are down 10.3% to BGN 78.9m, which is in line with regional peers but considerably below our expectations despite positive development in Ukraine. Sales in Q'16, alone, dropped 21.2% q/q to BGN 37.4m due to Russia, making it the second worst top line quarter over the last 13 quarters.

OPERATING PROFITS ON THE LINE DESPITE COST OPTIMIZATION

With the new developments on the top line, operating profitability is obviously already on the line including with the massive cost optimization on operating level. External service costs were slashed by 32% y/y while labor cost retreated 7% y/y. Nevertheless, EBITDA was flat at BGN 21.3m while EBIT was up 3.6% y/y to BGN 14.3m. These results were largely thanks to better Q1'16 performance as Q2'16 standalone operating profit numbers are among the weakest ever since the Russian-Ukraine issue started. EBITDA slid by half q/q to BGN 4.8m while EBIT declined 77% q/q to BGN 1.4m.

CAPITALIZING ON INVESTMENTS

Still, the Company saved the bottom line for yet another year as it capitalized on investments. In May 2016, it sold its 51% stake in Serbian subsidiary Ivancic and Sons for BGN 18.5m, booking a BGN 12.4m profit on it or 2.2x initial investment made in 2008. In addition, it booked another round of hefty dividend income from Sopharma Trading (SO5 BU) and Unipharm (59X BU) thus, securing the bottom line for Q2'16, H1'16 and potentially FY2016. Accordingly, the net income is up 30.4% to BGN 33.8m which is considerably above our expectations.

DIVIDEND REINSTATEMENT AND SHARE BUYBACK RELAUNCHED

Despite a tough Q2'16, Sopharma reinstated dividend payments and shareholders approved in June a BGN 0.07 DPS, yielding 2.6% at current market quotes. Dividend payment to start August 3rd. Additionally, the Company relaunched its share buyback program to support the stock, acquiring approx. 228k shares (0.17% of the share capital) in July 2016 which . As of July 27th, 2016, Sopharma owns 5.45 million of its own shares or 4.04% of the share capital.

VALUATION/RISKS

VALUATION: The worse than expected Q2'16 urges us to lower our FY 2016 top line expectations. Yet, the company's ability to profitably capitalize on its investments and the buyback support on the stock, makes us comfortably stick to our BUY recommendation. **RISKS:** We remain on the lookout for Russia and any dramatic developments in Ukraine.

In kBGN, excl. ratios	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Revenues	45 012	51 466	40 498	47 501	34 413	51 391	41 497	37 433
<i>Growth y/y</i>	<i>-3.00%</i>	<i>-11.92%</i>	<i>-20.78%</i>	<i>-11.80%</i>	<i>-23.55%</i>	<i>-0.15%</i>	<i>2.47%</i>	<i>-21.20%</i>
EBITDA	10 052	5 375	11 738	9 615	6 513	11 820	16 498	4 820
EBIT	6 414	656	7 951	5 863	2 929	8 394	12 985	1 325
Net profit	5 580	-2 849	7 216	18 667	2 118	-2 647	11 711	22 047
Equity	387 616	393 013	389 706	413 613	432 516	434 568	443 362	456 343
ROE (TTM)	8.63%	7.18%	6.35%	7.28%	6.24%	6.14%	7.06%	7.62%
ROA (TTM)	5.69%	4.84%	4.33%	5.03%	4.37%	4.38%	5.14%	5.71%
EBITDA	22.33%	10.44%	28.98%	20.24%	18.93%	23.00%	39.76%	12.88%
Net profit	12.40%	-5.54%	17.82%	39.30%	6.15%	-5.15%	28.22%	58.90%
EPS	0.04	-0.02	0.06	0.14	0.02	-0.02	0.09	0.17
Debt/equity	0.40	0.39	0.35	0.33	0.31	0.30	0.25	0.24
P/E (TTM)	15.78	18.04	18.11	13.04	12.88	13.44	11.68	10.18
P/B (TTM)	1.32	1.25	1.13	0.90	0.75	0.78	0.79	0.74
EV/EBITDA	13.00	15.47	14.43	13.74	13.63	11.85	10.17	10.94

RESULTS ANALYSIS

BUY
ONE YEAR PRICE TARGET: BGN 3.09
CURRENT PRICE: BGN 2.75

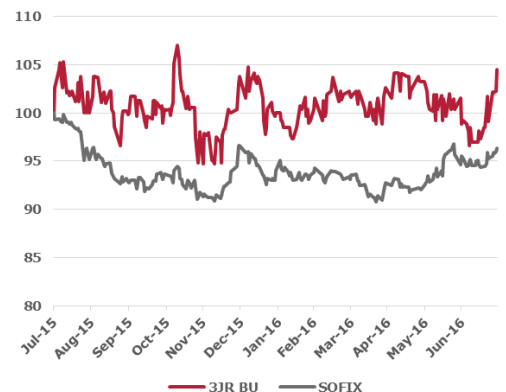
EXCHANGE RATES

EUR/BGN (FIXED): 1.95583
USD/BGN: 1.75995

MARKET DATA

Shares Outstanding:	127.0m
Share Capital:	134.0m
Free-float:	33%
Treasury Shares	4.04%
Market Cap.:	BGN 363 m
Avg. Daily Vol.:	BGN 21 000
52 Weeks Range:	BGN 2.44 – 2.75
BSE Ticker	3JR
Bloomberg Ticker	3JR BU

BUY BACK SUPPORT EVIDENT



Source: Bloomberg

SOPHARMA'S INDIVIDUAL RESULTS REVIEW

It seems the positive Q1'16 sentiment was short-lived as Russia-Ukraine consequences hit Sopharma again in Q2'16

Revenue breakdown: The top line deteriorated yet again, 21% q/q and 10.3% y/y as the Russian economy and purchasing power weaknesses hit sales as early as March. As it seems FY 2016 will be the year of Russian problems after 2014 and 2015 were of Ukraine. Sales to Russia retreated 23.7% y/y in H1'16 to BGN 24.2m while domestic market sales declined 3.36% to BGN 32.7m. Sales in Ukraine inched up, the Company revealed in its management report, yet no immediate details available as the country's share in Sopharma's revenue is already very small.

We still do not consider the Russian economy to perform as dismal as the numbers this far suggest but the deterioration is too significant to be easily overcome over the course of 2016. It will be difficult to overcome as the top line diversification measures Sopharma is taking are not short-deliverers. As the CEO Ognyan Donev put it recently, expanding into other markets like Serbia or smaller markets like Vietnam is possible but could hardly overcome Russia any time soon. Yet, Donev said the bottom has been hit in Ukraine that used to be Sopharma's third largest market pre-Crimea crisis.

Profitability review: Even prior to latest Russian troubles, cost cutting all over the place has been on the agenda. External service costs slid by more than a third with rents, consulting services and advertising expenses slashed considerably. Labor

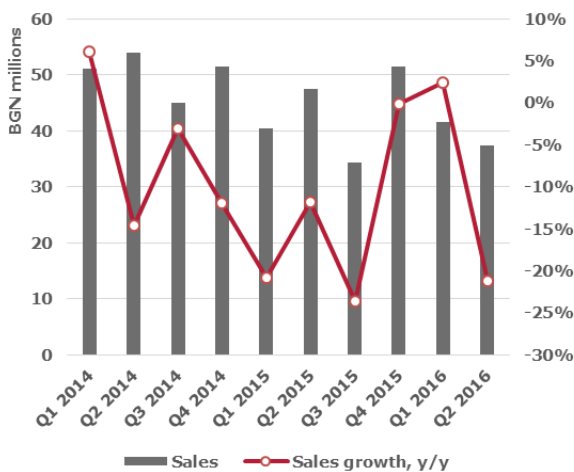
costs were down 7% y/y. This helped Sopharma's operating profitability in Q1'16 and further added in Q2'16. Accordingly, H1'16 EBITDA remained almost unchanged to BNG 21.3m while EBIT added 3.6% y/y to BGN 14.3m.

However, Q2'16 results alone were pretty dismal, among the worst quarterly performance in 13 quarters. Accordingly the Company's bottom line was saved by one offs and dividend income from subsidiaries. In May 2016, Sopharma sold its 51% stake in Serbian Ivancic and Sons for BGN 18.5m, booking a BGN 12.7m profit on the investment it made in 2008. It also booked another nice chunk of dividend income from its main dividend paying subsidiaries - Sopharma Trading (S05 BU) and Unipharm (59X BU).

Accordingly, overall financial revenue is up 48% y/y to BGN 22.8m, thus helping achieve a 30.4% y/y rise in net income to 33.8m. These should support the Company's cash position allowing to consider M&A activity to help resolve the top line trouble partially.

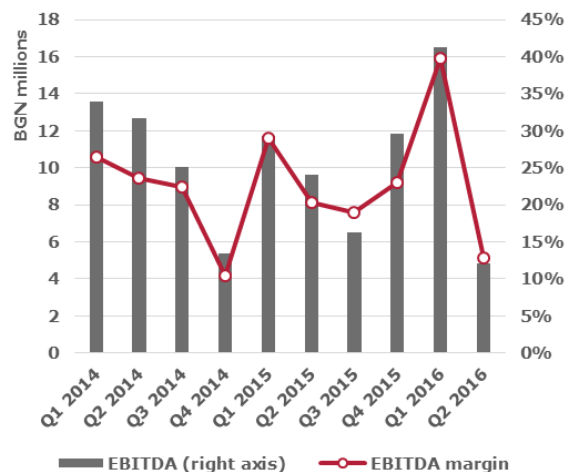
The continuing deleveraging of the Company is also a positive sign with debt/equity already at our FY2016 target of 20%. Thus, we revise our leverage expectations as well our top and bottom line performance for the year. We slash our sales growth expectations from a 1% rise to a 10% y/y drop on latest developments, but raise our bottom line estimate to encompass return on divestments.

Exhibit 2: Sales growth did not withstand in Q2'16



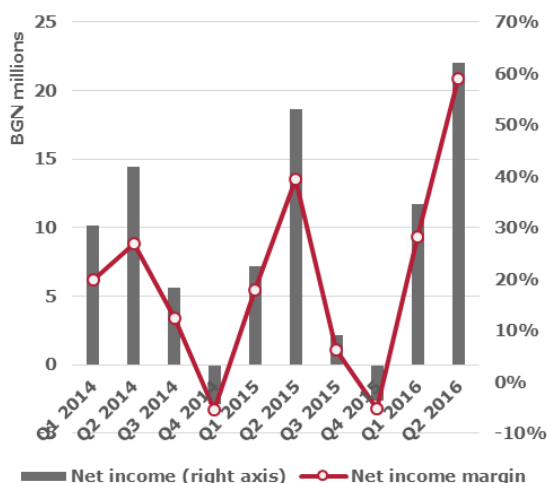
Source: Company data

Exhibit 3: Operating profits take a hit in Q2'16...



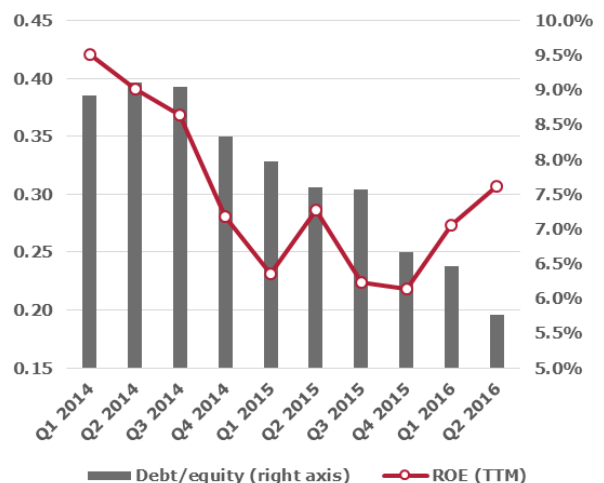
Source: Company data

Exhibit 4: ... with financial profits to save the annual bottom line



Source: Company data

Exhibit 5: ...and ROE



Source: Company data

INDIVIDUAL FINANCIAL DATA

Income Statement ('000 BGN)	2011	2012	2013	2014	2015	2016F
Sales	209 847	210 291	216 054	201 461	173 803	156 564
Other operating income	3 823	4 143	3 079	3 973	3 651	4 361
Change in Inventories	4 341	1 113	-7 006	14 039	6 667	1 566
Cost of Material	-57 460	-59 002	-54 932	-73 920	-61 619	-54 797
Cost of External Services	-68 972	-65 710	-59 659	-56 396	-41 275	-31 313
Cost of Labor	-34 051	-34 859	-32 328	-37 605	-35 331	-31 313
Other Operating Expenses	-5 104	-6 219	-8 059	-9 902	-6 210	-4 697
Total Operating Expenses	-161 246	-164 677	-161 984	-163 784	-137 768	-120 554
EBITDA	52 424	49 757	57 149	41 650	39 686	40 370
Depreciation and amortization	-8 454	-8 941	-11 716	-16 989	-14 549	-12 525
EBIT	43 970	40 816	45 433	24 661	25 137	27 845
Impairment on non-current assets	-875	-975	-193	-3 252	-8 567	-4 697
Financial revenues	11 443	11 757	9 987	13 001	17 922	23 485
Financial costs	-9 444	-6 451	-17 338	-4 690	-6 312	-3 601
Financial income (loss)	1 999	5 306	-7 351	8 311	11 610	19 884
EBT	45 094	45 147	37 889	29 720	28 180	43 032
Income taxes	-4 409	-4 262	-4 349	-2 429	-2 826	-2 348
Net Income	40 685	40 885	33 540	27 291	25 354	40 683

Balance Sheet ('000 BGN)	2011	2012	2013	2014	2015	2016F
Inventories	50,916	54,482	51,249	57 360	61 701	62 626
Receivables from related parties	135,104	167,113	103,350	99 505	78 035	93 938
Trade Receivables	29,383	22,539	22,155	23 397	21 466	17 222
Other receivables	10,333	11,560	7,241	11 901	6 881	7 045
Cash & Cash Equivalents	18,038	2,595	8,198	4 076	3 745	2 709
Current Assets	243,774	258,289	192,193	196 239	171 828	183 541
Property, Plant & Equipment	135,048	186,861	198,158	211 056	211 943	209 796
Intangibles	3,386	3,973	3,661	3 210	2 507	2 348
Investment property	19,170	19,391	22,555	22 368	22 160	20 353
Investments in subsidiaries	88,462	92,932	101,207	101 449	132 899	137 776
Investments available for sale	16,792	19,472	6,862	4 439	5 510	6 263
Receivables from related parties	16,069	1,183	25,649	33 150	20 505	20 353
Other receivables	272	922	17	6	3 257	313
Non-Current Assets	279,199	324,734	358,109	375 678	398 781	397 203
Total Assets	522,973	583,023	550,302	571 917	570 609	580 743
Share Capital	132,000	132,000	132,000	132 000	134 798	134 797
Treasury Stock	(10,036)	(12,156)	(18,105)	-17 203	-17 597	-17 203
Reserves	157,913	189,928	220,935	246 243	284 227	310 671
Retained Earnings	40,791	41,060	36,022	45 484	30 198	40 770
Shareholders' Equity	320,668	350,832	370,852	406 524	431 626	469 035
Short-term Bank Loans	112,008	152,778	98,878	90 761	68 961	51 666
Current Portion of LT Bank Loans	40,735	5,888	3,822	7 431	7 380	6 263
Liabilities to Related Parties	16,544	3,782	7,836	4 154	3 070	4 462
Account Payables	5,236	7,090	4,973	7 909	8 014	4 540
Tax Liabilities	262	208	1,243	938	965	783
Liabilities to Employees & Soc. Sec.	2,748	3,684	3,736	4 564	4 769	2 662
Other Current Liabilities	598	1,006	975	1 151	1 508	6 263
Current Liabilities	178,131	174,436	121,463	116 908	94 667	76 638
Long Term Bank Loans	18,737	51,779	48,723	37 972	30 819	26 616
Deferred Taxes	3,864	3,815	3,826	4 124	4 697	3 914
Liabilities to Employees on Retirement	1,269	1,479	1,855	2 387	2 426	1 096
Financial Leases	304	682	49	34	3	313
Other Long Term Liabilities	0	0	3,534	3 968	6 371	3 131
Non-Current Liabilities	24,174	57,755	57,987	48 485	44 316	35 070
Total Liabilities	202,305	232,191	179,450	165 393	138 983	111 708
Shareholders' Equity & Liabilities	522,973	583,023	549,136	571 917	570 609	580 743

Source: Company IFRS Financial Statements Audited; Elana Trading Estimates

QUARTERLY FINANCIAL DATA

Income Statement ('000 BGN)	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Sales	45 012	51 466	40 498	47 501	34 413	51 391	41 497	37 433
Other operating income	1 207	494	521	1 298	1 097	735	923	1 186
Change in Inventories	2 745	4 224	5 672	-807	2 634	-832	7 029	-2 748
Cost of Material	-13 431	-29 544	-15 574	-15 455	-13 503	-17 087	-16 452	-13 297
Cost of External Services	-16 610	-2 371	-11 116	-10 746	-9 462	-9 951	-7 036	-7 827
Cost of Labor	-8 003	-11 564	-9 539	-10 104	-7 891	-7 797	-8 820	-9 426
Other Operating Expenses	-868	-7 330	1 276	-2 072	-775	-4 639	-643	-501
Total Operating Expenses	-39 805	-51 304	-33 068	-42 936	-32 581	-43 732	-29 435	-37 294
EBITDA	10 052	5 375	11 738	9 615	6 513	11 820	16 498	4 820
Depreciation and amortization	-3 638	-4 719	-3 787	-3 752	-3 584	-3 426	-3 513	-3 495
EBIT	6 414	656	7 951	5 863	2 929	8 394	12 985	1 325
Impairment on non-current assets	0	-3 252	0	0	0	-8 567	0	0
Financial revenues	1 000	1 020	861	14 576	1 775	710	591	22 216
Financial costs	-1 190	-1 252	-828	-959	-1 059	-3 466	-702	-1 182
Financial income (loss)	-190	-232	33	13 617	716	-2 756	-111	21 034
EBT	6 224	-2 828	7 984	19 480	3 645	-2 929	12 874	22 359
Income taxes	-644	-21	-768	-813	-1 527	282	-1 163	-312
Net Income	5 580	-2 849	7 216	18 667	2 118	-2 647	11 711	22 047

Balance Sheet ('000 BGN)	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Inventories	56 751	54 047	62 966	61 816	65 998	57 292	66 894	62 978
Receivables from related parties	118 214	99 505	74 653	93 946	83 364	80 063	76 041	96 186
Trade Receivables	26 559	23 268	20 300	27 339	27 955	21 457	16 058	16 232
Other receivables	10 587	11 024	11 617	6 999	6 234	6 520	7 489	7 409
Cash & Cash Equivalents	2 316	2 935	3 697	3 343	2 843	3 911	9 954	4 741
Current Assets	214 427	190 779	173 233	193 443	186 394	169 243	176 436	187 546
Property, Plant & Equipment	192 926	192 728	208 947	211 606	209 654	210 620	210 969	209 665
Intangibles	2 968	2 442	3 076	2 912	2 516	2 303	2 420	2 362
Investment property	22 555	22 368	22 368	22 365	22 365	22 160	22 160	22 160
Investments in subsidiaries & assoc.	105 462	110 083	130 032	130 313	131 866	133 810	144 001	138 448
Investments available for sale	7 797	4 439	4 477	4 636	5 924	5 425	5 609	5 941
Receivables from related parties	32 773	33 150	33 547	26 937	32 283	20 505	12 001	12 089
Other receivables	8	6	5	5	3 038	3 258	3 114	3 540
Non-Current Assets	364 489	365 216	402 452	398 774	407 646	398 081	400 274	394 205
Total Assets	578 916	555 995	575 685	592 217	594 040	567 324	576 710	581 751
Share Capital	132 000	132 000	134 798	134 798	134 798	134 798	134 798	134 798
Treasury Stock	-17 060	-17 203	-17 378	-17 398	-17 597	-17 597	-17 603	-17 602
Reserves	246 841	246 243	255 065	284 209	284 678	284 143	284 042	300 828
Retained Earnings	31 232	28 666	41 128	30 907	32 689	27 113	42 125	38 319
Shareholders' Equity	393 013	389 706	413 613	432 516	434 568	428 457	443 362	456 343
Short-term Bank Loans	107 315	90 761	92 357	90 659	92 229	68 961	69 047	54 596
Current Portion of LT Bank Loans	3 765	7 391	7 330	7 329	7 363	7 380	7 153	7 153
Liabilities to Related Parties	7 789	7 929	3 108	2 990	3 078	1 609	1 834	3 607
Account Payables	5 129	6 553	5 821	6 131	5 322	8 051	5 584	5 913
Tax Liabilities	781	902	578	464	1 077	1 821	355	830
Liabilities to Employees & Soc. Sec.	4 715	4 213	5 016	5 835	4 990	4 618	5 310	6 046
Other Current Liabilities	3 187	969	1 269	1 430	1 328	1 502	1 489	5 837
Current Liabilities	132 681	118 718	115 479	114 838	115 387	93 942	90 772	83 982
Long Term Bank Loans	43 333	37 972	36 175	34 379	32 582	30 819	29 200	27 436
Deferred Taxes	4 347	3 988	4 021	4 046	5 100	5 161	4 639	5 277
Liabilities to Employees on Retirement	2 099	2 219	2 469	2 602	2 701	2 571	2 491	2 598
Financial Leases	44	34	25	18	9	3	0	-
Other Long Term Liabilities	3 399	3 358	3 903	3 818	3 743	6 371	6 246	6 115
Non-Current Liabilities	53 222	47 571	46 593	44 863	44 135	44 925	42 576	41 426
Total Liabilities	185 903	166 289	162 072	159 701	159 522	138 867	133 348	125 408
Shareholders' Equity & Liabilities	578 916	555 995	575 685	592 217	594 090	567 324	576 710	581 751

Source: Company IFRS Financial Statements

SOPHARMA Overview

COMPANY PROFILE

Sopharma is one of the biggest Bulgarian groups of companies. It is a leading producer, exporter and 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 is vertically integrated and includes both production and distribution. It operates 15 pharmaceutical factories in Bulgaria, all in compliance with GMP (Good Manufacturing Practices), one in Ukraine, and two in Serbia. It is also the owner of the leading healthcare product distributor in Bulgaria – Sopharma Trading (SO5 BU) and the majority shareholder in a leading distributor and owner of a large pharmacy chain in the Baltics and Belarus – Briz, Latvia.

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. The most important products for domestic sales are generic pharmaceuticals with the leading painkiller drug Analgin.

FUNDAMENTAL STORY

Sopharma is a key player on the domestic pharmaceutical market: 2nd largest domestic pharma producer with 13% market share in unites sold. Second in volumes and 6th in value in Bulgaria.

Its main advantages are the compliance with EU standards and industry developments. In the last 5 years it underwent a large scale investment program in new facilities and modernization. Thus increased capacity to answer rising demand.

Generic products are likely to gain even larger market share as the Bulgarian government is more and more focused on cost-containment measures.

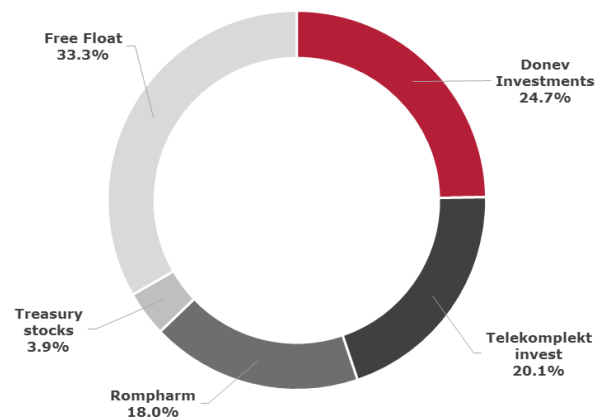
Original products are expected to add significantly to bottom line. Highest achievers are Tabex, Tribestan and Carsil. In order to answer the increasing demand from aging population, the Group has focused on therapeutic areas such as cardiology, gastroenterology, pain relief, neurology and psychiatry, and urology.

Key top line contributor in Bulgaria is the Group’s distribution arm – Sopharma Trading (SO5). It’s a market leader with 23% market share by offering a wide range of medical products and turnkey hospital solutions.

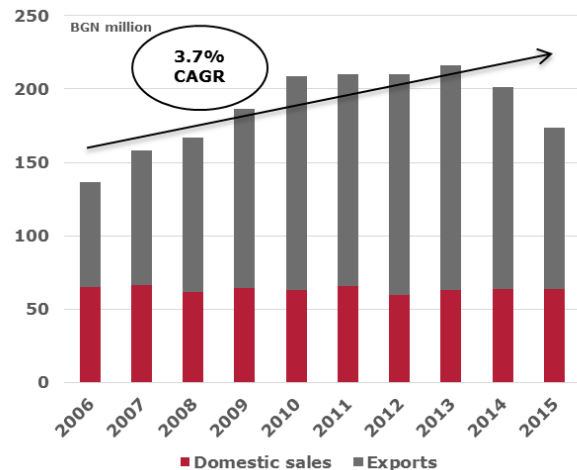
STRENGTHS & OPPORTUNITIES

- Excellent corporate governance
- Well diversified portfolio
- Wide distribution network covering the whole domestic market
- Strong domestic position
- Strong balance sheet and ease of access to EU financing

SHAREHOLDERS’ STRUCTURE



INDIVIDUAL SALES GROWTH



WEAKNESSES & THREATS

- Heavy exposure to Russia & Ukraine
- Strong rivalry among domestic players
- Weak financial performance of the Bulgarian healthcare institutions and hospitals due to state budget dependence and poor management

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Recommendations: Analyst(s) recommendations are based on the specific factors for the company, sector, country and global developments, as compared to market indices. Recommendations and opinions reflect ELANA Trading's expectations over the 12-month period following publication from the perspective of long-only investment clients. ELANA Trading reserves the right to express different or contrary recommendations and opinions for different timescales or for other types of investment client. Except as otherwise noted, expected performance over next 12 months vary for different recommendations for Bulgarian stocks as follows:

BUY	Target price is more than 10% above current quotes
HOLD	Target price in +/-10% range of the current quotes
SELL	Target price is more than 10% below the current quotes

Frequency of Recommendations: No schedule of recommendations is available. The frequency of recommendations depends on specific factors to individual companies and the opinion of the analyst(s) for the necessity of minor or major changes.

Q4 2015 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	9	47%	SKK BU
HOLD	7	37%	
SELL	0	0%	
Under review	3	16%	

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