

SOPHARMA
INDUSTRY: PHARMACEUTICALS
ABOVE EXPECTATIONS

SOPHARMA BOOKED A STRONG 3Q16 AND IS HEADING FOR A BETTER THAN EXPECTED FY2016 PERFORMANCE. RECENT MARKET IMPROVEMENTS IN RUSSIA AND UKRAINE COULD BE THE INFLECTION POINT FOR THE COMPANY'S DISAPPOINTING RESULTS OVER THE LAST TWO YEARS. OPERATING PROFITS CAME ABOVE EXPECTATIONS ON COST OPTIMIZATION MEASURES WHILE ONE OFFS BOOSTED EPS

A NEW TURNING POINT

After two years of disappointing performance due to heavy exposure to Russia and Ukraine, Sopharma's latest results signal an inflection point into better times. 3Q16 top line and operating profitability improved considerably. The results came close to pre-crisis levels with a 16% y/y rise in sales to BGN 40m and 90% y/y rise in EBIT to BGN 5.6m. As management put it, Russia remains unpredictable, but the Company managed to soothe the drastic sales decrease in 1H16 with better exports in 2H16. Overall 11M16 top line preliminary data reveal only 5% drop in sales which is considerably better than we expected.

OPERATING PROFITS IMPROVED CONSIDERABLY ON COST OPTIMIZATION

Profitability improved considerably as well despite top line remaining in the negative growth zone. Key reason is cost optimization efforts paying off. Unconsolidated EBIT is up 18% y/y to BGN 19.9m for the 9M16 due to slashed external service expenses by 26.7% y/y, 14% y/y drop in material costs and 5.4% y/y decrease in labor costs. Overall EBIT and EBITDA margins for the 9M16 add 3 p.p. y/y to 16.7% and 25.5%, respectively. The latter returned to normalized pre-crisis levels.

MAJOR BOTTOM LINE SURGE ON ONE-OFFS

Net profit surged 32% y/y to BGN 37m for 9M16, best in six years, on major one off positive effects from financial revenues. The Company booked BGN 23m in financial revenue, up 36% y/y, on profitable disposal of a subsidiary in Serbia and dividend income from major subsidiaries like Sopharma Trading (SO5 BU) and Unipharm (59X BU). Normalized results (excluding also a one off receivables write off), finished with a final bottom line improvement of 22% y/y.

STOCK PERFORMANCE YET TO CATCH UP MARKET RALLY

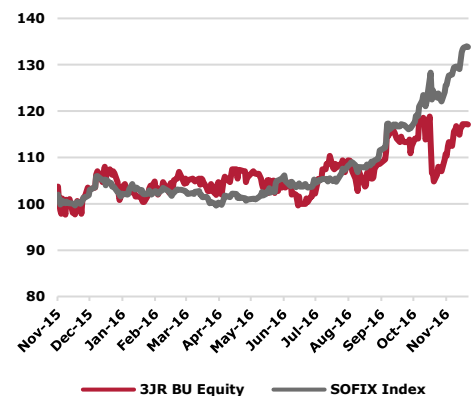
Nevertheless, Sopharma's stock performance is yet to catch up the markets 33% y/y rally. The Company's market cap has expanded 16% y/y even below fundamental improvements, thus offering room for further capital appreciation. Valuation wise the stock trades below average market multiples especially with the considerable 32% y/y EPS expansion.

VALUATION/RISKS

VALUATION: With the latest core Sopharma financial performance we are more comfortable to raise our conservative expectations both on the top and bottom line performance. Additional deleveraging over the year provides comfort for the upcoming dividend. Accordingly, we raise upward our one year price target from BGN 3.09 to BGN 3.46 per share and keep our BUY recommendation. **RISKS:** We remain on the lookout for Russia and any dramatic developments in Ukraine.

RESULTS ANALYSIS
BUY
ONE YEAR PRICE TARGET: BGN 3.46
CURRENT PRICE: BGN 2.98
PREVIOUS PRICE TARGET: BGN 3.09
EXCHANGE RATES
EUR/BGN (FIXED): 1.95583
USD/BGN: 1.84582
MARKET DATA

Shares Outstanding:	129.2m
Share Capital:	134.7m
Free-float:	33%
Treasury Shares	4%
Market Cap.:	BGN 404 m
Avg. Daily Vol.:	BGN 77 000
52 Weeks Range:	BGN 2.44 – 3.04
BSE Ticker	3JR
Bloomberg Ticker	3JR BU

EVIDENT CATCH UP POTENTIAL


Source: Bloomberg

In kBGN, excl. ratios	Q4 2014	Q1 2015	Q2 2016	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Revenues	51 466	40 498	47 501	34 413	51 391	41 497	37 433	39 915
<i>Growth y/y</i>	-11.92%	-20.78%	-11.80%	-23.55%	-0.15%	2.47%	-21.20%	15.99%
EBITDA	5 375	11 738	9 615	6 513	11 820	16 498	4 820	9 027
EBIT	656	7 951	5 863	2 929	8 394	12 985	1 325	5 582
Net profit	-2 849	7 216	18 667	2 118	-2 647	11 711	22 047	3 257
Equity	393 013	389 706	413 613	432 516	434 568	443 362	456 343	458 507
ROE (TTM)	7.18%	6.35%	7.28%	6.24%	6.14%	7.06%	7.62%	7.72%
ROA (TTM)	4.84%	4.33%	5.03%	4.37%	4.38%	5.14%	5.71%	5.94%
EBITDA margin	10.44%	28.98%	20.24%	18.93%	23.00%	39.76%	12.88%	22.62%
Net profit margin	-5.54%	17.82%	39.30%	6.15%	-5.15%	28.22%	58.90%	8.16%
EPS	-0.02	0.06	0.14	0.02	-0.02	0.09	0.17	0.03
Debt/equity	0.35	0.33	0.31	0.30	0.25	0.24	0.20	0.19
P/E (TTM)	18.04	18.11	13.04	12.88	13.44	11.68	10.18	11.24
P/B (TTM)	1.25	1.13	0.90	0.75	0.78	0.79	0.74	0.84
EV/EBITDA	15.47	14.43	13.74	13.63	11.85	10.17	10.94	11.16

SOPHARMA'S INDIVIDUAL RESULTS REVIEW

After a serious top line shock in 2Q16, the leading generic pharma producer in Bulgaria, Sopharma, posted a much more balanced 3Q16. Unconsolidated results improved considerably both on the top and the bottom line with operating profits in check and net profits boosted by one offs.

Revenue breakdown: 3Q16 was the strongest quarter in two years for Sopharma with a 16% y/y expansion in sales to BGN 39.9m and 90% y/y rise in EBIT to BGN 5.6m.

9M16 results also came up better than expected with a 2.9% y/y drop in sales to BGN 119m and 18.8% y/y rise in EBIT to BGN 19.9m.

The top line stabilized on stronger domestic sales as well as better exports to Ukraine, the Baltics, Romania and other smaller markets. Russia remained on the negative growth zone and as management put it remains unpredictable despite some market improvement in 3Q16. It remains second biggest market for Sopharma, thus will be a considerable unknown factor as shown in preliminary sales numbers for October and November. The Company announced 11M16 preliminary numbers signaling 5% y/y slip in sales. The latter is better than our expectations which were in the conservative double digit drop range.

9M16 data signal sales from Russia slipped 7% y/y. We expect some further deterioration by the end of the year, yet allowing us comfort to revise upwards our top line decline estimates from 10% to 6% y/y.

Positive development is seen on Sopharma's domestic market which is also the biggest market for the Company. Revenues from Bulgaria added 1.2% y/y during the 9M16 to BGN 47.2m and accelerate growth for the 11M16 pre wholesale discounts that may come up in December.

Yet, the latter together with a recovering Ukraine lead to some top line stabilization after the two year shock. No immediate data on Ukraine, yet, our estimates are for the market to have started growing albeit from a very low base. We estimate Ukraine is among the five most important markets for Sopharma despite being somewhere in between 70% to 75% off its pre-crisis levels.

Profitability review: Despite another volatile top line year, we are positively surprised by the ongoing operating profits improvements due to cost cutting measures. The latter were mostly in external services expenses that slashed 26.7% y/y for the 9M16. Material costs expectedly decreased 14% y/y while

labor costs shed 5.4% y/y.

Accordingly, operating profit improved considerably, 18.8% y/y to BGN 19.9m for the 9M16. Yet, EBIT remains below normal pre-crisis levels despite adding 3pp to 16.7% in terms of margins in 9M16.

Net income, on the other hand, surged 32% y/y to BGN 37m in 9M16 on considerably one offs. In May 2016, Sopharma booked a 2.2x profit on its investment in a Serbian pharma company. This resulted in a one off financial profit of BGN12.4m. In addition, the Company collected yet again hefty dividends from subsidiaries like Sopharma Trading (SO5 BU) and Unipharm (59X BU). The latter secure Sopharma's dividend payout in 2017.

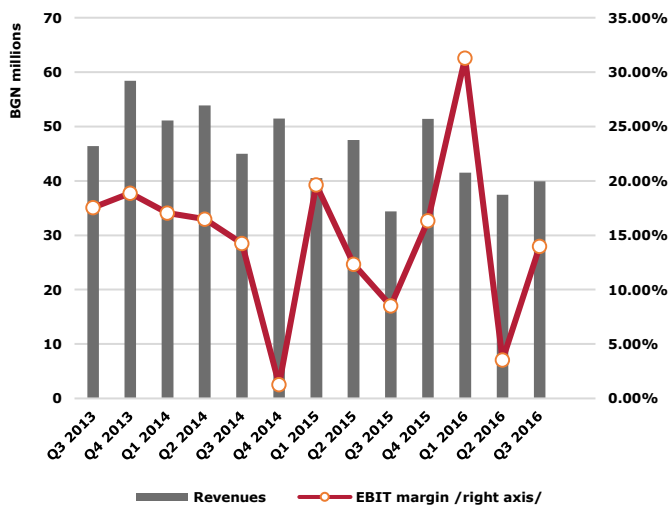
Normalizing net income, excluding both the extra financial revenue and a one off write off on a receivables in 2016, yields a 22% y/y EPS improvement.

The latter was also supported by the ongoing deleveraging process with D/E ratio of 0.19, lowest in 6 years. This should positively affect midterm profitability as Sopharma has finished its major investment cycle in capacity expansion. Going forward we expect the Company to continue consolidation of its subsidiaries, a strategic move that has begun a couple of years ago. In 4Q16, Sopharma announced it is to acquire a small local antiseptics producer Veta pharma. It also increased its stake in Unipharm to 77%, tender offer imminent.

All in all, based on the latest unconsolidated financial performance together with the latest sock development of listed Sopharma's subsidiaries we raise our fair value. The new valuation estimates include slightly better FY2016F to line performance but a more cautious FY2017F.

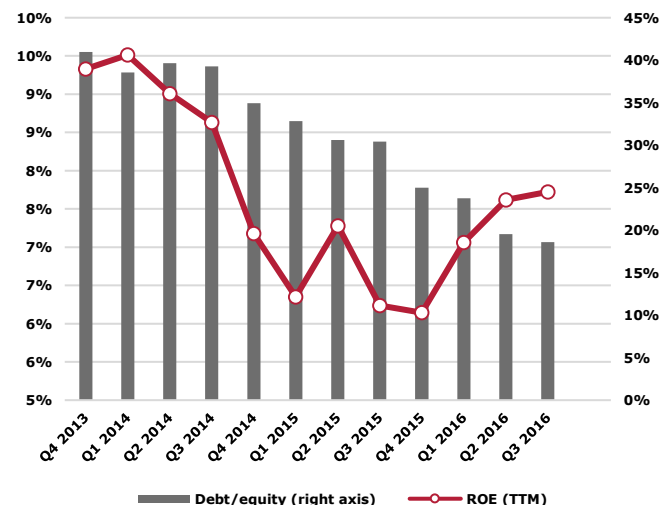
We further optimize our cost structure estimates as well as our cost of capital. We also include a precautionary provisions on any further write offs in receivables or investments if Russia or Ukraine worsen again. Nevertheless, all the latter measure yield a higher one year target price and support our BUY recommendation. We also see room for further valuation expansion as the Company's stock performance has to catch up overall market rally. It also trade at lower than average market multiples.

Exhibit 2: Top and bottom line stabilize...



Source: Company data

Exhibit 3: ...with deleveraging offering comfort



Source: Company data

INDIVIDUAL FINANCIAL DATA

Income Statement ('000 BGN)	2013	2014	2015	9M 15	9M16	TTM	FY2016F	FY2017F
Sales	216 054	201 461	173 803	122 412	118 845	170 236	163 522	166 793
Other operating income	3 079	3 973	3 651	2 916	2 985	3 720	4 361	4 579
Change in Inventories	-7 006	14 039	6 667	7 499	-2 493	-3 325	-3 270	-1 668
Cost of Material	-54 932	-73 920	-61 619	-44 532	-38 273	-55 360	-52 327	-53 374
Cost of External Services	-59 659	-56 396	-41 275	-31 324	-22 973	-32 924	-32 704	-33 359
Cost of Labor	-32 328	-37 605	-35 331	-27 534	-26 049	-33 846	-35 975	-35 026
Other Operating Expenses	-8 059	-9 902	-6 210	-1 571	-1 697	-6 336	-3 270	-3 336
Total Operating Expenses	-161 984	-163 784	-137 768	-97 462	-91 485	-131 791	-127 547	-126 763
EBITDA	57 149	41 650	39 686	27 866	30 345	42 165	40 336	44 609
Depreciation and amortization	-11 716	-16 989	-14 549	-11 123	-10 453	-13 879	-13 899	-13 343
EBIT	45 433	24 661	25 137	16 743	19 892	28 286	26 436	31 266
Impairment on non-current assets	-193	-3 252	-8 567	0	0	-8 567	-2 453	-1 668
Financial revenues	9 987	13 001	17 922	17 212	23 420	24 130	24 528	8 340
Financial costs	-17 338	-4 690	-6 312	-2 846	-3 118	-6 584	-3 761	-3 503
Financial income (loss)	-7 351	8 311	11 610	14 366	20 302	17 546	20 767	4 837
EBT	37 889	29 720	28 180	31 109	40 194	37 265	44 751	34 435
Income taxes	-4 349	-2 429	-2 826	-3 108	-3 179	-2 897	-4 475	-3 443
Net Income	33 540	27 291	25 354	28 001	37 015	34 368	40 276	30 991

Balance Sheet ('000 BGN)	2013	2014	2015	9M 15	9M16	TTM	FY2016F	FY2017F
Inventories	51 249	57 360	61 701	65 998	59 110	59 110	55 598	55 042
Receivables from related parties	103 350	99 505	78 035	83 364	88 917	88 917	89 937	90 068
Trade Receivables	22 155	23 397	21 466	27 955	19 231	19 231	17 987	16 679
Other receivables	7 241	11 901	6 881	6 234	12 019	12 019	7 359	7 506
Cash & Cash Equivalents	8 198	4 076	3 745	2 843	1 686	1 686	6 413	16 405
Current Assets	192 193	196 239	171 828	186 394	180 963	180 963	177 293	185 700
Property, Plant & Equipment	198 158	211 056	211 943	209 654	208 956	208 956	209 309	205 155
Intangibles	3 661	3 210	2 507	2 516	2 387	2 387	2 453	1 668
Investment property	22 555	22 368	22 160	22 365	22 160	22 160	22 076	21 683
Investments in subsidiaries	101 207	101 449	132 899	131 866	138 589	138 589	143 900	140 106
Investments available for sale	6 862	4 439	5 510	5 924	5 839	5 839	6 541	5 004
Receivables from related parties	25 649	33 150	20 505	32 283	12 240	12 240	21 258	20 015
Other receivables	17	6	3 257	3 038	3 507	3 507	327	334
Non-Current Assets	358 109	375 678	398 781	407 646	393 678	393 678	405 863	393 965
Total Assets	550 302	571 917	570 609	594 040	574 641	574 641	583 156	579 664
Share Capital	132 000	132 000	134 798	134 798	134 798	134 798	134 797	134 797
Treasury Stock	-18 105	-17 203	-17 597	-17 597	-18 637	-18 637	-17 203	-17 203
Reserves	220 935	246 243	284 227	284 678	300 744	300 744	310 406	330 550
Retained Earnings	36 022	45 484	30 198	32 689	41 602	41 602	40 118	34 196
Shareholders' Equity	370 852	406 524	431 626	434 568	458 507	458 507	468 118	482 341
Short-term Bank Loans	98 878	90 761	68 961	92 229	52 417	52 417	53 962	45 034
Current Portion of LT Bank Loans	3 822	7 431	7 380	7 363	7 153	7 153	6 541	4 170
Liabilities to Related Parties	7 836	4 154	3 070	3 078	770	770	4 660	4 587
Account Payables	4 973	7 909	8 014	5 322	4 029	4 029	4 742	3 336
Tax Liabilities	1 243	938	965	1 077	609	609	818	834
Liabilities to Employees & Soc. Sec.	3 736	4 564	4 769	4 990	5 470	5 470	2 780	2 835
Other Current Liabilities	975	1 151	1 508	1 328	5 798	5 798	6 541	6 672
Current Liabilities	121 463	116 908	94 667	115 387	76 246	76 246	80 044	67 468
Long Term Bank Loans	48 723	37 972	30 819	32 582	25 640	25 640	26 164	21 683
Deferred Taxes	3 826	4 124	4 697	5 100	5 554	5 554	4 088	4 170
Liabilities to Employees on Retirement	1 855	2 387	2 426	2 701	2 703	2 703	1 145	1 168
Financial Leases	49	34	3	9	0	0	327	334
Other Long Term Liabilities	3 534	3 968	6 371	3 743	5 991	5 991	3 270	2 502
Non-Current Liabilities	57 987	48 485	44 316	44 135	39 888	39 888	34 994	29 856
Total Liabilities	179 450	165 393	138 983	159 522	116 134	116 134	115 038	97 324
Shareholders' Equity & Liabilities	549 136	571 917	570 609	594 090	574 641	574 641	583 156	579 664

Source: Company IFRS Financial Statements Audited; Elana Trading Estimates

INDIVIDUAL QUARTERLY FINANCIAL DATA

Income Statement ('000 BGN)	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Sales	51 466	40 498	47 501	34 413	51 391	41 497	37 433	39 915
Other operating income	494	521	1 298	1 097	735	923	1 186	876
Change in Inventories	4 224	5 672	-807	2 634	-832	7 029	-2 748	-6 774
Cost of Material	-29 544	-15 574	-15 455	-13 503	-17 087	-16 452	-13 297	-8 524
Cost of External Services	-2 371	-11 116	-10 746	-9 462	-9 951	-7 036	-7 827	-8 110
Cost of Labor	-11 564	-9 539	-10 104	-7 891	-7 797	-8 820	-9 426	-7 803
Other Operating Expenses	-7 330	1 276	-2 072	-775	-4 639	-643	-501	-553
Total Operating Expenses	-51 304	-33 068	-42 936	-32 581	-43 732	-29 435	-37 294	-35 209
EBITDA	5 375	11 738	9 615	6 513	11 820	16 498	4 820	9 027
Depreciation and amortization	-4 719	-3 787	-3 752	-3 584	-3 426	-3 513	-3 495	-3 445
EBIT	656	7 951	5 863	2 929	8 394	12 985	1 325	5 582
Impairment on non-current assets	-3 252	0	0	0	-8 567	0	0	0
Financial revenues	1 020	861	14 576	1 775	710	591	22 216	613
Financial costs	-1 252	-828	-959	-1 059	-3 466	-702	-1 182	-1 234
Financial income (loss)	-232	33	13 617	716	-2 756	-111	21 034	19 271
EBT	-2 828	7 984	19 480	3 645	-2 929	12 874	22 359	4 961
Income taxes	-21	-768	-813	-1 527	282	-1 163	-312	-1 704
Net Income	-2 849	7 216	18 667	2 118	-2 647	11 711	22 047	3 257

Balance Sheet ('000 BGN)	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Inventories	54 047	62 966	61 816	65 998	57 292	66 894	62 978	59 110
Receivables from related parties	99 505	74 653	93 946	83 364	80 063	76 041	96 186	88 917
Trade Receivables	23 268	20 300	27 339	27 955	21 457	16 058	16 232	19 231
Other receivables	11 024	11 617	6 999	6 234	6 520	7 489	7 409	12 019
Cash & Cash Equivalents	2 935	3 697	3 343	2 843	3 911	9 954	4 741	1 686
Current Assets	190 779	173 233	193 443	186 394	169 243	176 436	187 546	180 963
Property, Plant & Equipment	192 728	208 947	211 606	209 654	210 620	210 969	209 665	208 956
Intangibles	2 442	3 076	2 912	2 516	2 303	2 420	2 362	2 387
Investment property	22 368	22 368	22 365	22 365	22 160	22 160	22 160	22 160
Investments in subsidiaries & assoc.	110 083	130 032	130 313	131 866	133 810	144 001	138 448	138 589
Investments available for sale	4 439	4 477	4 636	5 924	5 425	5 609	5 941	5 839
Receivables from related parties	33 150	33 547	26 937	32 283	20 505	12 001	12 089	12 240
Other receivables	6	5	5	3 038	3 258	3 114	3 540	3 507
Non-Current Assets	365 216	402 452	398 774	407 646	398 081	400 274	394 205	393 678
Total Assets	555 995	575 685	592 217	594 040	567 324	576 710	581 751	574 641
Share Capital	132 000	134 798	134 798	134 798	134 798	134 798	134 798	134 798
Treasury Stock	-17 203	-17 378	-17 398	-17 597	-17 597	-17 603	-17 602	-18 637
Reserves	246 243	255 065	284 209	284 678	284 143	284 042	300 828	300 744
Retained Earnings	28 666	41 128	30 907	32 689	27 113	42 125	38 319	41 602
Shareholders' Equity	389 706	413 613	432 516	434 568	428 457	443 362	456 343	458 507
Short-term Bank Loans	90 761	92 357	90 659	92 229	68 961	69 047	54 596	52 417
Current Portion of LT Bank Loans	7 391	7 330	7 329	7 363	7 380	7 153	7 153	7 153
Liabilities to Related Parties	7 929	3 108	2 990	3 078	1 609	1 834	3 607	770
Account Payables	6 553	5 821	6 131	5 322	8 051	5 584	5 913	4 029
Tax Liabilities	902	578	464	1 077	1 821	355	830	609
Liabilities to Employees & Soc. Sec.	4 213	5 016	5 835	4 990	4 618	5 310	6 046	5 470
Other Current Liabilities	969	1 269	1 430	1 328	1 502	1 489	5 837	5 798
Current Liabilities	118 718	115 479	114 838	115 387	93 942	90 772	83 982	76 246
Long Term Bank Loans	37 972	36 175	34 379	32 582	30 819	29 200	27 436	25 640
Deferred Taxes	3 988	4 021	4 046	5 100	5 161	4 639	5 277	5 554
Liabilities to Employees on Retirement	2 219	2 469	2 602	2 701	2 571	2 491	2 598	2 703
Financial Leases	34	25	18	9	3	0	-	0
Other Long Term Liabilities	3 358	3 903	3 818	3 743	6 371	6 246	6 115	5 991
Non-Current Liabilities	47 571	46 593	44 863	44 135	44 925	42 576	41 426	39 888
Total Liabilities	166 289	162 072	159 701	159 522	138 867	133 348	125 408	116 134
Shareholders' Equity & Liabilities	555 995	575 685	592 217	594 090	567 324	576 710	581 751	574 641

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.

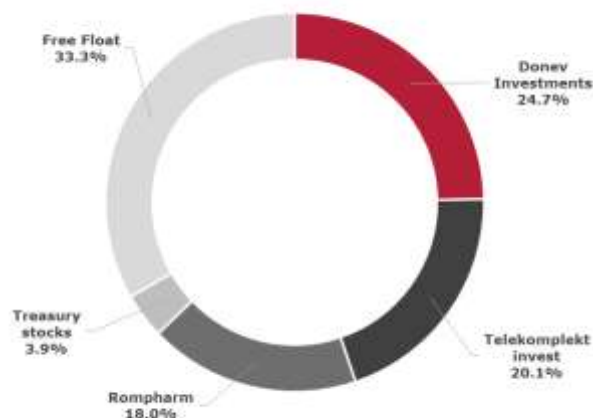
Original products are expected to add significantly to bottom line. Highest achievers are Tabex, Tribestan and Carsil. In order to answer the increasing demand from aging population, the Group has focused on therapeutic areas such as cardiology, gastroenterology, pain relief, neurology and psychiatry,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

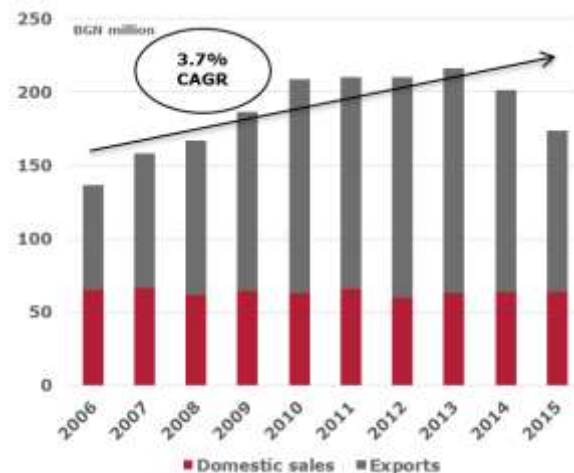
STRENGTHS & OPPORTUNITIES

- Excellent corporate governance
- Well diversified portfolio
- Wide distribution network covering the whole domestic market
- Strong domestic position

SHAREHOLDERS' STRUCTURE



INDIVIDUAL SALES GROWTH



WEAKNESSES & THREATS

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

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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.

Q3 2016 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	8	42%	SKK BU
HOLD	8	42%	
SELL	0	0%	
Under review	3	16%	

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