

SOPHARMA

INDUSTRY: PHARMACEUTICALS

FINALLY TAILWINDS

SOPHARMA DELIVERED GOOD FY2016 RESULTS IN LINE WITH OUR ESTIMATES. UKRAINE KEEPS BOTHERING THE BOTTOM LINE, BUT OPERATING PROFITS ARE WELL SUSTAINED. PRELIMINARY Q1'17 TOP LINE RESULTS SIGNAL TAILWINDS MAY HAVE FINALLY ARRIVED AND THE COMPANY IS HEADED FOR A LIGHTER PERIOD. THIS GIVE US THE COMFORT TO RAISE OUR EXPECTATIONS

SALES IN LINE WITH EXPECTATIONS

After losing a ¼ of its operations due to Russia/Ukraine, in 2016 Sopharma stopped the negative surprises trend and delivered steady performance in line with our estimates. Top line contracted 5.7% y/y to BGN 163.8m with 7.6% y/y decline in exports and 2.6% y/y drop in domestic sales. H2'16 witnessed considerable top line contraction deceleration with Q3'16 offering strong expansion. The Company reported renewed growth in Ukraine, albeit on a low base.

RUSSIA SIGNALING A COMEBACK, PUTTING AN END ON THE NEGATIVE CYCLE

Russia also stabilized at the end of 2016. Preliminary Q1'17 results point to a turning point post 2014 crisis as the Company announced 12% y/y rise in sales on strong exports, especially Russia. Management even guided on continuing upward trend in the following months. If realized, it would put an end to the three year negative cycle for Sopharma.

OPERATING PROFITS IN CHECK, BOTTOM LINE SURGE ON ONE-OFFS

With top line contraction in rein, cost optimization sustained operating profits while profitable one off divestments delivered an excellent bottom line. EBITDA added 1.4% y/y to BGN 40.3m while net income surged 49% y/y to BGN 37.8m, best in three years. Considering also the continuing deleveraging, we are comfortable for the upcoming dividend.

STOCK ON A RALLY

Sopharma's stock caught up quickly with the local market's rally at the end of 2016. Improving market conditions for the Company acted as a catalyst. The share price is up almost 50% y/y and currently trades at a 3 year high after bottoming out in Sept'16. Demand remains considerable from local investors with institutional ones adding exposure early in 2016.

NEW OPPORTUNITIES ON THE HORIZON

Sopharma awaits further development with its smoking cessation drug Tabex in the US. The rights to market the latter were sold in 2015 and current right owners are advancing well in their attempts to test and register the drug with the US FDA. Significant development expected as early as 2018. We do not price it in our valuation, yet the market reacts to any news on the matter.

VALUATION/RISKS

VALUATION: After taking into account Sopharma's latest positive financial performance we are comfortable to revise upward our expectations. However, considering Sopharma's M&A activity we introduce a holding discount to our SoTP valuation. Still, we up our one year price target from BGN 3.46 to BGN 4.82 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 4.82
CURRENT PRICE: BGN 4.03
PREVIOUS PRICE TARGET: BGN 3.46

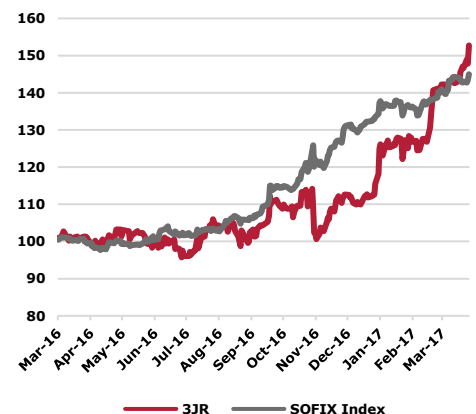
EXCHANGE RATES

EUR/BGN (FIXED): 1.95583
USD/BGN: 1.83164

MARKET DATA

Shares Outstanding:	129.6m
Share Capital:	134.7m
Free-float:	33%
Treasury Shares	4.20%
Market Cap.:	BGN 539 m
Avg. Daily Vol.:	BGN 105 000
52 Weeks Range:	BGN 2.54 – 4.03
BSE Ticker	3JR
Bloomberg Ticker	3JR BU

AT A 52 WEEKS HIGH



Source: Bloomberg

In kBGN, excl. ratios	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Revenues	40 498	47 501	34 413	51 391	41 497	37 433	39 915	44 982
<i>Growth y/y</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>	<i>15.99%</i>	<i>-12.47%</i>
EBITDA	11 738	9 615	6 513	11 820	16 498	4 820	9 027	9 908
EBIT	7 951	5 863	2 929	8 394	12 985	1 325	5 582	6 442
Net profit	7 216	18 667	2 118	-2 647	11 711	22 047	3 257	755
Equity	389 706	413 613	432 516	434 568	443 362	456 343	458 507	462 875
ROE (TTM)	6.35%	7.28%	6.24%	6.14%	7.06%	7.62%	7.72%	8.37%
ROA (TTM)	4.33%	5.03%	4.37%	4.38%	5.14%	5.71%	5.94%	6.58%
EBITDA margin	28.98%	20.24%	18.93%	23.00%	39.76%	12.88%	22.62%	22.03%
Net profit margin	17.82%	39.30%	6.15%	-5.15%	28.22%	58.90%	8.16%	1.68%
EPS	0.06	0.14	0.02	-0.02	0.09	0.17	0.03	0.01
Debt/equity	0.33	0.31	0.30	0.25	0.24	0.20	0.19	0.17
P/E (TTM)	18.11	13.04	12.88	13.44	11.68	10.18	11.24	13.72
P/B (TTM)	1.13	0.90	0.75	0.78	0.79	0.74	0.84	1.12
EV/EBITDA	14.43	13.74	13.63	11.85	10.17	10.94	11.16	14.95

SOPHARMA'S INDIVIDUAL RESULTS REVIEW

The leading generic pharmaceutical company in Bulgaria – Sopharma, booked a 2016 performance in line with our expectations. Top line negative surprises seem fading away, operating profits sustained on cost optimization and profitable divestments made the bottom line.

Revenue breakdown: FY2016 unconsolidated sales slid 5.7% y/y to BGN 163.8m in line with our estimates after another bumpy H1'16 and much better H2'16. 3Q16 was the strongest quarter in two years for Sopharma with a 16% y/y expansion in sales on rising exports. Q4 slid again on both domestic and foreign sales volatility.

Top line volatility is something of a new normal for the Company. Ukraine and Russia hit Sopharma hard in 2014 and especially in 2015 on market share, price and volumes erosion. 2016 could be described as more mild with Ukraine returning to growth, albeit from a low base. Russia also showed some positive signs in Q3 and continued so in Q1'17. Preliminary Q1'17 results, published by the Company, reveal 12% y/y rise in sales, best Q1 performance in three years, on well progressing sales in Russia. Management guided it expects the upward trend in Russia to continue in the following months.

The latter could mean tailwinds have finally arrived for Sopharma and the negative surprises cycle may have turned.

Profitability review: The turn is definitely seen in Sopharma's profitability. Operating profits are sustained with EBITDA up 1.4% y/y to BGN 40.3m, in line with our estimates and EBIT up 4.8% y/y to BGN 26.3m.

The latter is due to considerably cost reduction. External service costs are down 19% y/y to BGN 33.3m, costs for materials declined 10.5% y/y to BGN 55m and labor costs dropped 2.6% y/y to BGN 34.4m.

Further down the income statement, financial costs slid almost 50% y/y to BGN 3.2m while interest expense alone is down almost 60% y/y to BGN 2m as Sopharma continued deleveraging. Total debt exposure is down 26% y/y to BGN 79m.

Combining these results with a major divestment profit (2.2x on investment or BGN 12.7m) on the sale of the stake in the Serbian company Ivancic and Sons, net profit surged 49% to BGN 37.8m.

Additionally, the Company collected yet again hefty dividends from subsidiaries like Sopharma Trading (SO5 BU) and Unipharm (59X BU), with dividend income up 16% y/y to BGN 9.2m.

The latter results secures Sopharma's dividend payout in 2017. However, the bottom line did take in another write off on Ukraine of c.BGN 5m (above our expectations).

We believe Ukraine will remain a negative drag on the bottom line in the midterm as the situation in the country remain difficult despite some sales improvement. Thus, we raise our Ukraine provisioning expectations. Russia will also remain a potential drag despite latest positive developments due to price erosion and consumer purchase power instability.

M&A activity: Continuing organization restructuring, M&A and new markets initiative, however, to balance out the negative effect in the mid to long term.

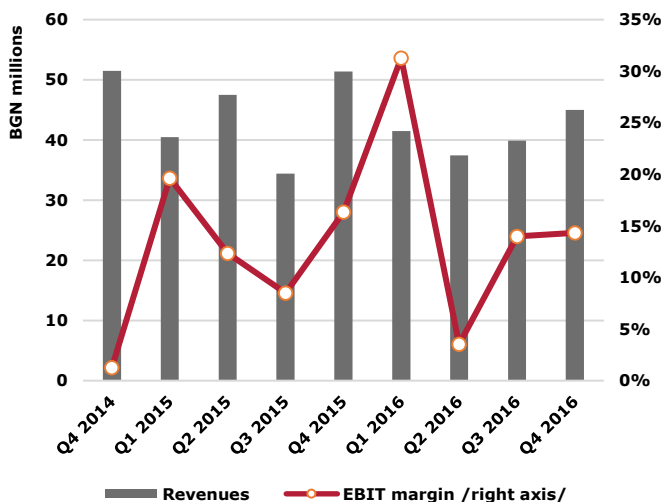
Sopharma continues buyouts of pharma and medical companies to diversify the above risks. At the end of 2016, It acquired a 68% stake in non-sterile medical products manufacturer Veta Pharma for BGN 6.6m. The Company also increased its stakes in bandages producer Medica (5MA BU) to 98% as well as in generic drug producer Unipharm (59X BU) to 78%. It plans to merge the latter two and is currently in a pending tender offer for Unipharm.

Lastly, it has recognized as an associated company the ex-privatization fund Doverie United Holding (5DOV BU) and may consider additional share acquisitions as a diversification and a synergy offering option with Doverie's two health insurance funds and one hospital in its portfolio.

New markets potential: Sopharma is also looking into positive developments on an old project to register its smoking cessation drug Tabex for sale in the US. In 2015, the Company sold Tabex marketing rights to a US based drug development specialists. The latter have joined forces with OncoGenex Pharmaceuticals (NASDAQ:OGXI) on the cytosine based product non-clinical studies and new drug application with the FDA. The partners are advancing well in their plans to get the drug approved (including collaboration with the National Institute of Health) but any significant development expected as early as 2018.

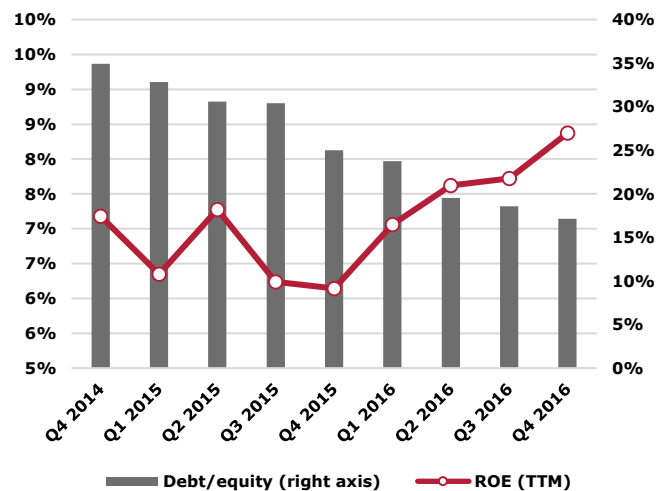
We do not incorporate the cytosine drug development in our valuations. Based on latest top line and operating profit performance we raise our initial cautious expectations for 2017-2018. However, we raise our WACC and incorporate a holding discount to our fair value estimate as Sopharma has intensified its M&A activity in line with management guidance.

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	2016	2017F	2018F
Sales	216 054	201 461	173 803	163 827	168 733	178 857
Other operating income	3 079	3 973	3 651	4 193	4 579	4 808
Change in Inventories	-7 006	14 039	6 667	360	-1 687	-1 789
Cost of Material	-54 932	-73 920	-61 619	-55 172	-53 994	-55 446
Cost of External Services	-59 659	-56 396	-41 275	-33 297	-33 747	-35 771
Cost of Labor	-32 328	-37 605	-35 331	-34 414	-33 747	-33 983
Other Operating Expenses	-8 059	-9 902	-6 210	-5 244	-5 062	-5 366
Total Operating Expenses	-161 984	-163 784	-137 768	-127 767	-128 237	-132 354
EBITDA	57 149	41 650	39 686	40 253	45 075	51 310
Depreciation and amortization	-11 716	-16 989	-14 549	-13 919	-12 655	-11 626
EBIT	45 433	24 661	25 137	26 334	32 420	39 685
Impairment on non-current assets	-193	-3 252	-8 567	-5 627	-5 062	-5 366
Financial revenues	9 987	13 001	17 922	24 158	8 437	8 943
Financial costs	-17 338	-4 690	-6 312	-3 176	-2 531	-2 468
Financial income (loss)	-7 351	8 311	11 610	20 982	5 906	6 475
EBT	37 889	29 720	28 180	41 689	33 263	40 794
Income taxes	-4 349	-2 429	-2 826	-3 919	-3 326	-4 079
Net Income	33 540	27 291	25 354	37 770	29 937	36 714
Balance Sheet ('000 BGN)	2013	2014	2015	2016	2017F	2018F
Inventories	51 249	57 360	61 701	56 807	60 744	62 600
Receivables from related parties	103 350	99 505	78 035	71 076	64 118	59 023
Trade Receivables	22 155	23 397	21 466	22 479	23 623	25 040
Other receivables	7 241	11 901	6 881	7 304	7 593	7 154
Cash & Cash Equivalents	8 198	4 076	3 745	4 343	6 139	20 842
Current Assets	192 193	196 239	171 828	162 009	162 216	174 658
Property, Plant & Equipment	198 158	211 056	211 943	209 326	204 167	202 108
Intangibles	3 661	3 210	2 507	2 177	1 687	1 789
Investment property	22 555	22 368	22 160	22 840	22 779	22 357
Investments in subsidiaries	101 207	101 449	132 899	152 802	150 172	159 182
Investments available for sale	6 862	4 439	5 510	5 229	5 062	5 366
Receivables from related parties	25 649	33 150	20 505	11 011	20 248	21 463
Other receivables	17	6	3 257	3 714	337	358
Non-Current Assets	358 109	375 678	398 781	407 099	404 452	412 622
Total Assets	550 302	571 917	570 609	569 108	566 669	587 281
Share Capital	132 000	132 000	134 798	134 798	134 797	134 797
Treasury Stock	-18 105	-17 203	-17 597	-18 809	-18 809	-18 809
Reserves	220 935	246 243	284 227	304 403	329 865	353 729
Retained Earnings	36 022	45 484	30 198	42 483	33 749	33 143
Shareholders' Equity	370 852	406 524	431 626	462 875	479 603	502 860
Short-term Bank Loans	98 878	90 761	68 961	48 291	37 121	37 560
Current Portion of LT Bank Loans	3 822	7 431	7 380	7 185	4 218	4 471
Liabilities to Related Parties	7 836	4 154	3 070	497	1 687	1 789
Account Payables	4 973	7 909	8 014	4 712	3 375	3 398
Tax Liabilities	1 243	938	965	609	844	894
Liabilities to Employees & Soc. Sec.	3 736	4 564	4 769	5 363	2 868	3 041
Other Current Liabilities	975	1 151	1 508	1 514	6 749	7 154
Current Liabilities	121 463	116 908	94 667	68 171	56 863	58 307
Long Term Bank Loans	48 723	37 972	30 819	23 844	21 935	19 674
Deferred Taxes	3 826	4 124	4 697	5 703	4 218	3 041
Liabilities to Employees on Retirement	1 855	2 387	2 426	2 649	1 181	1 252
Financial Leases	49	34	3	0	337	358
Other Long Term Liabilities	3 534	3 968	6 371	5 866	2 531	1 789
Non-Current Liabilities	57 987	48 485	44 316	38 062	30 203	26 113
Total Liabilities	179 450	165 393	138 983	106 233	87 066	84 420
Shareholders' Equity & Liabilities	549 136	571 917	570 609	569 108	566 669	587 281

Source: Company IFRS Financial Statements Audited; Elana Trading Estimates

INDIVIDUAL QUARTERLY FINANCIAL DATA

Income Statement ('000 BGN)	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Sales	40 498	47 501	34 413	51 391	41 497	37 433	39 915	44 982
Other operating income	521	1 298	1 097	735	923	1 186	876	1 208
Change in Inventories	5 672	-807	2 634	-832	7 029	-2 748	-6 774	2 853
Cost of Material	-15 574	-15 455	-13 503	-17 087	-16 452	-13 297	-8 524	-16 899
Cost of External Services	-11 116	-10 746	-9 462	-9 951	-7 036	-7 827	-8 110	-10 324
Cost of Labor	-9 539	-10 104	-7 891	-7 797	-8 820	-9 426	-7 803	-8 365
Other Operating Expenses	1 276	-2 072	-775	-4 639	-643	-501	-553	-3 547
Total Operating Expenses	-33 068	-42 936	-32 581	-43 732	-29 435	-37 294	-35 209	-39 748
EBITDA	11 738	9 615	6 513	11 820	16 498	4 820	9 027	9 908
Depreciation and amortization	-3 787	-3 752	-3 584	-3 426	-3 513	-3 495	-3 445	-3 466
EBIT	7 951	5 863	2 929	8 394	12 985	1 325	5 582	6 442
Impairment on non-current assets	0	0	0	-8 567	0	0	0	-5 627
Financial revenues	861	14 576	1 775	710	591	22 216	613	738
Financial costs	-828	-959	-1 059	-3 466	-702	-1 182	-1 234	-58
Financial income (loss)	33	13 617	716	-2 756	-111	21 034	-621	680
EBT	7 984	19 480	3 645	-2 929	12 874	22 359	4 961	1 495
Income taxes	-768	-813	-1 527	282	-1 163	-312	-1 704	-740
Net Income	7 216	18 667	2 118	-2 647	11 711	22 047	3 257	755

Balance Sheet ('000 BGN)	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Inventories	62 966	61 816	65 998	57 292	66 894	62 978	59 110	56 807
Receivables from related parties	74 653	93 946	83 364	80 063	76 041	96 186	88 917	71 076
Trade Receivables	20 300	27 339	27 955	21 457	16 058	16 232	19 231	22 479
Other receivables	11 617	6 999	6 234	6 520	7 489	7 409	12 019	7 304
Cash & Cash Equivalents	3 697	3 343	2 843	3 911	9 954	4 741	1 686	4 343
Current Assets	173 233	193 443	186 394	169 243	176 436	187 546	180 963	162 009
Property, Plant & Equipment	208 947	211 606	209 654	210 620	210 969	209 665	208 956	209 326
Intangibles	3 076	2 912	2 516	2 303	2 420	2 362	2 387	2 177
Investment property	22 368	22 365	22 365	22 160	22 160	22 160	22 160	22 840
Investments in subsidiaries & assoc.	130 032	130 313	131 866	133 810	144 001	138 448	138 589	152 802
Investments available for sale	4 477	4 636	5 924	5 425	5 609	5 941	5 839	5 229
Receivables from related parties	33 547	26 937	32 283	20 505	12 001	12 089	12 240	11 011
Other receivables	5	5	3 038	3 258	3 114	3 540	3 507	3 714
Non-Current Assets	402 452	398 774	407 646	398 081	400 274	394 205	393 678	407 099
Total Assets	575 685	592 217	594 040	567 324	576 710	581 751	574 641	569 108
Share Capital	134 798	134 798	134 798	134 798	134 798	134 798	134 798	134 798
Treasury Stock	-17 378	-17 398	-17 597	-17 597	-17 603	-17 602	-18 637	-18 809
Reserves	255 065	284 209	284 678	284 143	284 042	300 828	300 744	304 403
Retained Earnings	41 128	30 907	32 689	27 113	42 125	38 319	41 602	42 483
Shareholders' Equity	413 613	432 516	434 568	428 457	443 362	456 343	458 507	462 875
Short-term Bank Loans	92 357	90 659	92 229	68 961	69 047	54 596	52 417	48 291
Current Portion of LT Bank Loans	7 330	7 329	7 363	7 380	7 153	7 153	7 153	7 185
Liabilities to Related Parties	3 108	2 990	3 078	1 609	1 834	3 607	770	497
Account Payables	5 821	6 131	5 322	8 051	5 584	5 913	4 029	4 712
Tax Liabilities	578	464	1 077	1 821	355	830	609	609
Liabilities to Employees & Soc. Sec.	5 016	5 835	4 990	4 618	5 310	6 046	5 470	5 363
Other Current Liabilities	1 269	1 430	1 328	1 502	1 489	5 837	5 798	1 514
Current Liabilities	115 479	114 838	115 387	93 942	90 772	83 982	76 246	68 171
Long Term Bank Loans	36 175	34 379	32 582	30 819	29 200	27 436	25 640	23 844
Deferred Taxes	4 021	4 046	5 100	5 161	4 639	5 277	5 554	5 703
Liabilities to Employees on Retirement	2 469	2 602	2 701	2 571	2 491	2 598	2 703	2 649
Financial Leases	25	18	9	3	0	-	0	0
Other Long Term Liabilities	3 903	3 818	3 743	6 371	6 246	6 115	5 991	5 866
Non-Current Liabilities	46 593	44 863	44 135	44 925	42 576	41 426	39 888	38 062
Total Liabilities	162 072	159 701	159 522	138 867	133 348	125 408	116 134	106 233
Shareholders' Equity & Liabilities	575 685	592 217	594 090	567 324	576 710	581 751	574 641	569 108

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), and one in Ukraine. 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 drugs, 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. It is second in volumes and 6th in value in Bulgaria.

The Company’s 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 focused on cost-containment measures.

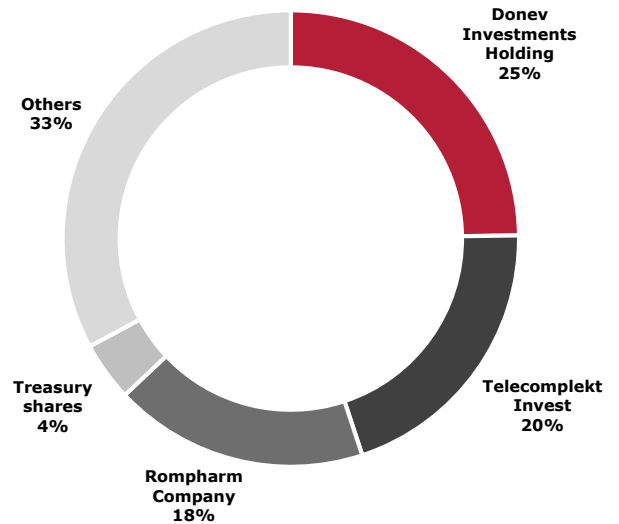
Original products are expected to add significantly to bottom line. Highest achievers are Tabex, Tribestan and Carsil. In order to answer the increasing demand from aging population, the Group has focused on therapeutic areas such as cardiology, gastroenterology, pain relief, neurology and psychiatry,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

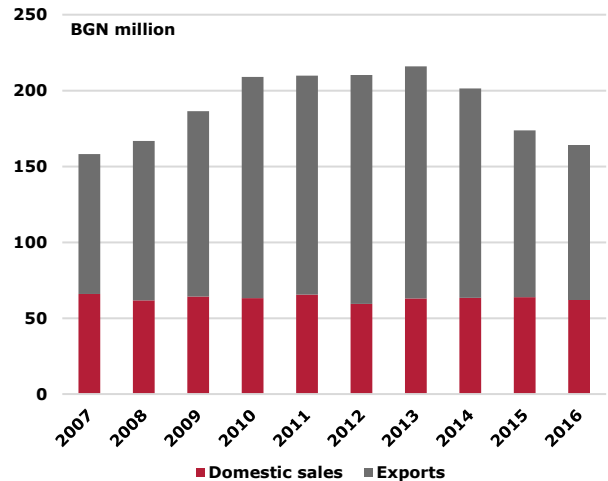
STRENGTHS & OPPORTUNITIES

- Good corporate governance
- Well diversified portfolio
- Wide distribution network in Bulgaria
- 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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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 2016 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	7	37%	SKK BU
HOLD	9	47%	
SELL	0	0%	
Under review	3	16%	

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