

SOPHARMA TRADING

INDUSTRY: PHARMACEUTICAL WHOLESALE

SKY IS THE LIMIT

WITH 8.2% CAGR FOR THE LAST 10 YEARS AND 7% AVERAGE DY IN THE LAST 7 YEARS, SOPHARMA TRADING FIRMLY LEADS THE BULGARIAN PHARMACEUTICALS WHOLESALE MARKET. FOLLOWING STRONG ACQUISITION SPREE ON THE LOCAL AND EXPORT MARKETS IN 2017, THE COMPANY IS ALL SET FOR A MAJOR EXPANSION TO NEARLY DOUBLE IN SIZE IN NEXT 5 YEARS

VERTICALLY INTEGRATED LEADING FULL-VALUE HEALTHCARE SOLUTIONS PROVIDER

Sopharma Trading, part of the biggest generics pharmaceutical group in Bulgaria, Sopharma (3JR BU), provides full-value healthcare solutions to 3000+ customers. It offers a diversified portfolio of 10K+ products – medicines, consumables, medical equipment and devices. Excellent local network and exclusive partnerships with global leaders like GE Healthcare and Abbott. Profiting on both high-growth pharmacy market and high margin hospital market.

MARKET LEADER WITH CONSTANT INCREASE IN REVENUES SINCE INCEPTION

Sopharma Trading shows an outstanding performance, achieving 8.2% CAGR in the past 10 years, keeping healthy c.2% net income margins in a highly regulated and competitive sector. The Company is also an undisputable market leader in Bulgaria with 21% overall market share, holding the leadership position on the hospital segment with 31% share of the latter.

MOVING TOWARDS ESTABLISHING A NATIONWIDE PHARMACY NETWORK

Sopharma Trading has been developing its own branded pharmacy operator SOPharmacy since 2015, with 27 pharmacies across Bulgaria's biggest cities. In 2017, the Company acquired local #4 in terms of sales pharmacy operator Pharmastore adding 19 pharmacies to its portfolio. This, coupled with the Company's full country coverage logistics network with four regional distribution centers in Bulgaria's major cities, sets the ground for the establishment of the 2nd largest national pharmacy network.

M&A-DRIVEN EXPORT EXPANSION

M&A-intense 2017 saw the Company acquiring 70% in Serbian peer Lekovit, opening the gate to the USD 1.1bn Serbian market. Lekovit currently holds 7% of the overall market and 20% of the small pharmacies segment. Lekovit is the fastest growing Serbian company in its sector with 25-30% annual growth, 4% net income margin. Sopharma Trading's expansion strategy envisions Lekovit to reach 25%+ market share within the next 3-5 years.

GOOD CORPORATE GOVERNANCE AND STABLE DIVIDENDS

Following Sopharma's example, Sopharma Trading has good corporate governance and is among the highest dividend paying companies in Bulgaria with a 7YR average dividend yield of 6.8% and dividend payout of above 80%.

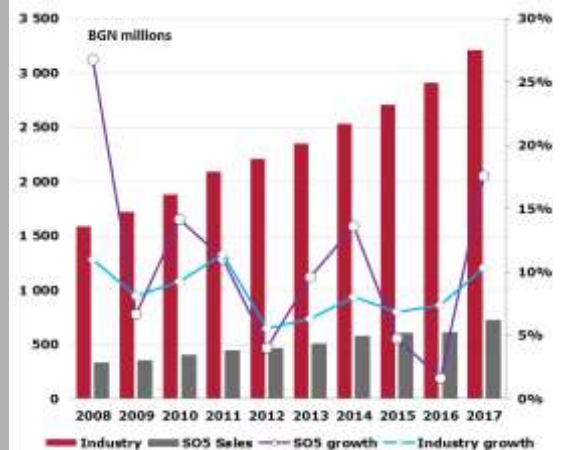
VALUATION/RISKS

VALUATION: Our BGN 8.25 per share target price is derived from discounting the Company's cash flows and performing a peer valuation, thus we keep a HOLD rating. **RISKS:** Local healthcare system imbalances; Overregulated market; fierce rivalry; currency risk from operation on the Serbian market

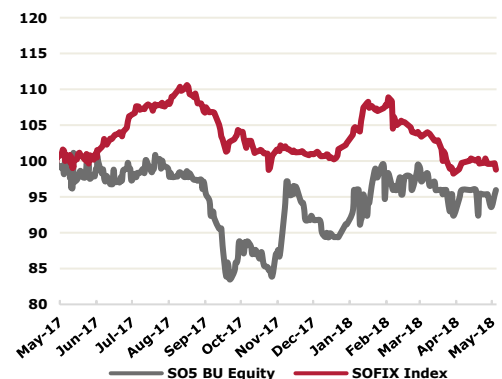
in '000 BGN, excl. ratios	2015	2016	2017	2018F
Revenues	603 410	613 130	721 118	908 609
EBITDA	16 733	14 337	16 441	18 899
EBIT	13 406	10 328	11 202	14 356
Net profit	12 164	10 872	10 578	13 738
Equity	66 349	65 763	74 093	77 960
ROE	18.87%	27.68%	14.28%	17.62%
Gross Profit Margin	7.49%	7.61%	7.95%	8.00%
EBITDA margin	2.77%	2.34%	2.28%	2.08%
Net profit margin	2.02%	1.77%	1.47%	1.51%
EPS	0.37	0.33	0.32	0.42
Debt/equity	1.66	1.70	2.00	2.28
P/E	14.20	19.07	24.89	19.16
P/B	2.60	3.15	3.55	3.38
EV/EBITDA	16.67	22.07	25.58	23.09
Payout ratio	81%	91%	93%	72%
Dividend yield	5.71%	4.76%	3.75%	3.75%

HOLD
ONE YEAR PRICE TARGET: BGN 8.25
CURRENT PRICE: BGN 8.00
PREVIOUS PRICE TARGET: BGN 6.03
EXCHANGE RATES
EUR/BGN (FIXED): 1.95583
USD/BGN: 1.63408
MARKET DATA

Shares Outstanding:	32.9 m
Share Capital:	32.9 m
Free-float:	27.3%
Treasury Shares	0%
Market Cap.:	BGN 265 m
Avg. Daily Vol.:	BGN 32,600
52 Weeks Range:	BGN 7.00-8.49
BSE Ticker	S05
Bloomberg Ticker	S05 BU

OUTPACING THE INDUSTRY


Source: Company data

PRICE PERFORMANCE VS. THE MARKET


Source: Bloomberg

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EXECUTIVE SUMMARY

WE REITERATE OUR HOLD RECOMMENDATION OF SOPHARMA TRADING BUT UPGRADE OUR ONE YEAR PRICE TARGET TO BGN 8.25 PER SHARE WHICH PROVIDES FOR A 3% UPSIDE IN THE NEXT 12 MONTHS.

THE COMPANY

Sopharma Trading (the Company) is the biggest pharmaceuticals wholesaler in Bulgaria. It is part of Sopharma Group (3JR BU), which is one of the leading local generics producers and one of the biggest corporate groups in Bulgaria.

Sopharma Trading was established from the merger of five regional wholesalers in Bulgaria in 2007. Since then, the Company has almost tripled its revenue and net profit. It has also built up its market presence from a cumulative 16% market share in 2007 up to the current leading position with a 21% market share.

Diversification and expansion: Since its inception in 2007, the Company has successfully diversified its operations from being a simple medicine distributor to a full service healthcare provider offering 10,000+ products - medicines, consumables, medical equipment and devices. It also provides turnkey hospitals re-equipment services as well as complete logistics solutions.

The Company services 3,000+ customers in Bulgaria and has an excellent partnership network with 400 local and international partners, including exclusive contracts with global leaders such as GE Healthcare, Abbott, Eucerin, etc. The Company's diversified business model enables it to keep its revenues growing and net margins at healthy levels, as it is not entirely dependent on any segment. Thus, it can compensate thin net income margins from pharmaceuticals wholesale by tapping on double digit margins from the sale of medical equipment, consumables, devices and non-medicine products.

To further boost size, Sopharma Trading has been expanding both locally and internationally. Started developing own-branded SOpharmacy retail pharmacy network in Bulgaria, acquired 4th largest local pharmacy chain in terms of sales - Pharmastore and added leading Serbian wholesaler Lekovit to tap the Serbian market. These will enable the Company to build on its retail grasp, narrowing the wholesale gap in net margins through exclusive product offerings and increased marketing revenue.

Operations: The Company **works with both pharmacies and hospitals**, with the former generating 59% of revenues in 2017 and the latter - 24%. The pharmacy segment contributes the most to the Company's top line but offers little margins as stringent healthcare overregulation squeezes distributors' markups to 7% max by law (one of the lowest margins in the EU according to IQVIA). The latter aided by fierce market competition makes net profit margins hard to expand.

The hospitals' segment, on the other hand, is divided into four subgroups: medicines, wholesale, medical consumables and devices, and medical equipment. The latter two subgroups provide both high growth and high margin potential, especially given the Company's Bulgarian exclusivity over certain equipment and consumables manufacturers. Sopharma Trading has exclusive contract with GE in supplying the latter's imaging equipment e.g. MRIs, ultrasound equipment, etc. During the last ten years, it managed to increase its gross profit margin from 6.4% to 7.95% by selling those high margin medical equipment and consumables. Recently, the Company has also been aggressively focusing on its retail segment, expecting increases in revenues and net income margins from its exclusive products portfolio and product marketing with the development of its pharmacies network.

Working with Bulgarian hospitals, however, has significant shortcomings. Due to the chronic liquidity problems in the Bulgarian healthcare system, hospitals delay their payments with 200, sometimes even 300 days, thus urging pharmaceutical wholesalers to indirectly provide for the financial gap in the system. As a result, few wholesalers have the potential to work on the market unless they have access to cheap financing. Until 2013, Sopharma Trading took advantage of its vertical integration with Sopharma as the latter provided it with better-than-the-market financing terms. This enabled it to offset financial costs from hospitals unable to meet payments on time with financial revenues generated from interest charges on delayed payments. However, with the Company's expansion and strengthened financial position, it has outgrown its reliance on the parent company and is able to attract cheap financing and manage its funds more efficiently.

Corporate Governance: Sopharma Trading has an excellent management team and good corporate governance. It is among the top 10 best dividend paying companies on the market with an average 7 year dividend yield and dividend payout of 6.8% and 80%+, respectively.

THE COUNTRY AND THE MARKET

Bulgaria is under a currency board and the Bulgarian Lev is pegged to the Euro at fixed rate of 1.95583. Joining the Eurozone is a midterm strategic goal for the country with expectations to start the preliminary process as early as within one year.

The current political situation is stable as Bulgaria took over the presidency of the Council of Europe on Jan 1st, 2018.

The Bulgarian economy booked 3.6% y/y real GDP growth in 2017, slightly decelerating from 2016 levels, driven by domestic demand and investments. 2018 consensus estimates point to 3.8% GDP growth. The unemployment rate is at its lowest level in 9 years with disposable income rising fast.

The Bulgarian pharmaceutical market has been steadily outpacing global pharma growth with 10% y/y rise in 2017 and 5%-7% CAGR expected in the midterm. Increased share of chronic diseases, combined with growing domestic demand and aging population both in Bulgaria and neighboring countries to provide opportunities for growth.

THE VALUATION

We use the discounted cash flow method and peer valuation to value Sopharma Trading. Thus, we value the stock of the Company at BGN 8.25 per share or 3% above the current market price.

SOME RISKS

Overregulation due to government's attempts to artificially lower medicine prices; Significant market imbalances due to lack of healthcare reform; Imminent budget deficits may lead to temporarily lower healthcare spending, thus further increasing state hospitals' indebtedness and rising their insolvency potential; Fierce pharmaceutical market rivalry; Limited market due to population size; lower disposable income for high value medical products; currency risks from operations on the Serbian market. .

COMPANY OVERVIEW

Sopharma Trading is the leading pharmaceutical wholesaler in Bulgaria. Established in 2007 from the merger of five regional distributors, the Company has been aggressively increasing revenues growing at 8.2% CAGR in the past 10 years.

It distributes a wide range of healthcare products, 10,000+ items, from basic medicine to special medical cosmetics, medical consumables, equipment and devices. Additionally, it offers pre-wholesale services to other distributors and/or pharmaceutical producers.

It operates 17,500 sq. m. of warehouse space in four of the major cities in Bulgaria – Sofia, Varna, Plovdiv and Veliko Turnovo. The majority of its warehouse space (75%) operates under an innovative state-of-the-art fully automated warehouse management system, implemented from the specialized Austrian company KNAPP. The modern technology limits human mistakes and allows faster customer order processing. A robot collects and compiles orders with human personnel responsible for double checking and special orders only.

Sopharma Trading is the first Bulgarian company to be certified as per ISO 9001:2008 for international Good Distribution Practice (GDP) standard. The standard provides for the best practices in storing, transporting, selling and reporting the distribution of medical products.

Following the latest regional and global trends, the Company has been focused on the establishment of a new concept revolving around the pharmacy as a one stop shop, where customers can get not only their prescribed medicines, but also take advantage of medical consultations, tapping on a wide range of OTC products, food supplements and medicine cosmetics. So far, the Company has opened 27 pharmacies operating under this model branded as SOpharmacy, and added 19 new pharmacies (Pharmastore's acquisition) to be gradually rebranded and start functioning under the SOpharmacy concept.

Supplies more than 10,000 medical products

Established the innovative SOpharmacy retail concept

SHAREHOLDERS' STRUCTURE

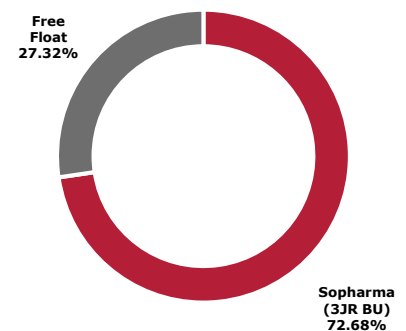
Sopharma Trading is part of the one of the biggest Bulgarian pharmaceutical groups – the Sopharma Group. Its registered capital is BGN 32.905m distributed in 32 905 009 number of outstanding shares.

Sopharma owns 72.68% of the Company's outstanding shares. The rest is free float, traded on the local market and distributed among many institutional and individual investors. The Company has 25,000 small individual investors.

The Company's Chairman of the Board, Mr. Ognyan Donev, is also Sopharma's leading shareholder together with his partner - the Bulgarian lawyer Mr. Ventsislav Stoev. Despite the fact that Mr. Donev is the leading controlling shareholder, his management role in Sopharma Trading's operations is more of a supervisory type rather than executive.

Sopharma Trading's chief executive officer is Mr. Dimitar Dimitrov.

32.9 million shares outstanding



POTENTIAL CATALYSTS

EXPANSION ON THE SERBIAN MARKET: Sopharma Trading stepped into the Serbian market in 2015 with an exclusive portfolio which in 2017 was upgraded by acquiring 70% of Serbia's fastest growing pharma wholesaler Lekovit. The latter showing 25-30% CAGR for the past 4 years as well as ~4% net income margins. The Company's Serbian plan envisions a two-stage fast expansion strategy- initially, focusing on the wholesale segment, including entering the country's hospital sector, followed by a retail expansion, to finally reach 25-30% overall market share. Midterm target to become Serbia's #2 wholesaler.

LOCAL MARKET BOOST: Since 2015, Sopharma Trading has been developing its innovative SOpharmacy concept, focused on the positioning of the pharmacy as a one stop shop for products and services. So far, the Company has opened 27 pharmacies across the country's biggest cities; envisions to add 10-12 new pharmacies every year in the midterm. With the acquisition of 19 new pharmacies in 2017, most of which fully-operational, Sopharma Trading is set to build the 2nd biggest nationwide pharmacy network, rivaling country's #1 Mareshki network with 300+ pharmacies operating across Bulgaria.

SERVICE AND PRODUCTS DIVERSIFICATION: Sopharma Trading is focused on diversification to be boosted by its exclusive products portfolio, encompassing both pharmaceutical and non-pharmaceutical products, medical consumables and devices. This coupled with its developed partnerships with local hospitals will help the Company achieve growth and up its net income margin through sales and exclusive products marketing.

HEALTHCARE SECTOR OVERVIEW

GLOBAL & CEE PHARMACEUTICAL SECTOR

The global pharmaceutical sector is expected to grow by 2%-5% per year until 2020 and reach USD 1.5 trillion by 2021, according to research data published by IQVIA. The latter projects that spending on medicine will grow by 4%-7%, primarily driven by newer medicines in developed markets and increased volume in emerging markets. However, developed countries are expected to offset the increased costs from new medicines with the use of generic drugs. For Europe, IQVIA projects a rather modest 0.8% annual growth.

Global market expected to grow at 2-5% until 2020

The aging population will be the growth engine in rich countries. Due to the increase of net income in developing countries, the latter started to experience health issues that used to be typical for developed economies. These include both communicable and chronic diseases, among which diabetes, chronic heart disease, Alzheimer's disease. Besides growth in demand, we expect to witness also an increased pressure on drug prices.

Central Eastern Europe to grow at 8.7% CAGR in 2016-2021

The overall growth of healthcare costs leads to increased use of cheaper generic drugs. The generic drug market is expected to reach approximately USD 380bn by 2021, growing at a CAGR of around 10.8% between 2016 and 2021, according to IQVIA. According to BMI Research, the CEE region is expected to grow at an 8.7% CAGR in the 2017-2021 period. Growth to be driven almost equally by original and generic products, the former adding 49% and the latter 51% in 2017, according to data from IQVIA.

Special attention should be paid to Serbian market, as the latter is to become one of Sopharma Trading's main growth drivers in the midterm. Serbian pharma market is rather underdeveloped, with a total value of approx. USD 1.1bn estimated for 2018. It experiences regular medicine shortages, more than 50% of consumption goes to state-controlled prescription drugs, with relative per capita spending on medicines expected to improve in the long term. The market is dominated by prescription drugs, the latter constituting 89.7% of market's total value. Generic drugs make up 69% of prescription drug sales and 62% of market's total value. Patented drugs expected to gain share in the midterm.

Generics take up 62% of Serbian market's total value

Currently, the biggest Serbian wholesaler is Phoenix with 30% market share. The latter owns national pharmacy chain operator Benu and works with independent Serbian pharmacies under its cooperation program BETTY. Thus, Phoenix manages more than 200 pharmacies. Other significant players are Serbian Lilly Drogerie operating pharma corners and newly entered Czech Dr. Max pharmacies.

LOCAL PHARMACEUTICAL & PHARMACEUTICAL WHOLESALE SECTOR

The pharmaceutical industry in Bulgaria has been steadily on the rise 10% y/y growth in 2017 which is the highest pace since 2014, according to IQVIA. The growth in 2017, however, was rather unbalanced, with original products surging 14%+ y/y, generics growing at below 9% rate, while food supplements - by only 7% y/y. Generics added only 29% to the growth in 2017, while original products added 71% in 2017. The latter is a serious deviation from CEE average, where originals and generics add almost equal to growth.

Local market expected to grow 11% y/y in 2018

IQVIA forecasts an 11% y/y market growth in 2018, with original products growing by 14%, food supplements - by 10% and generics - by 9%. Major drivers will be the increased national budget for the National Health Insurance Fund in 2018 (the increase coming mainly from increased health contribution due to higher salaries), as well as the new pharmaceuticals added to the reimbursement list. It should be noted that vicious re-export practice will also be driving growth up unless restrictive measures are taken.

Currently, Bulgaria spends 3.5% of the state budget on health compared to the EU average of 7.1%. At the same time due to chronic underfunding hospitals significantly delay payments to suppliers. Additionally, due to budget deficits the state often tries to lower drug prices even though drug prices are well below EU average and smaller domestic wholesalers find it profitable to re-export imported drugs. At the same time whole parts of the industry are almost unregulated i.e. no central tendering for special medical consumables, devices and equipment, thus offering profitability potential.

According to IQVIA, Bulgaria has the highest VAT on drugs (20%) while regulated wholesale markup capped at 7% for drugs covered by public funds is one of the lowest in the EU.

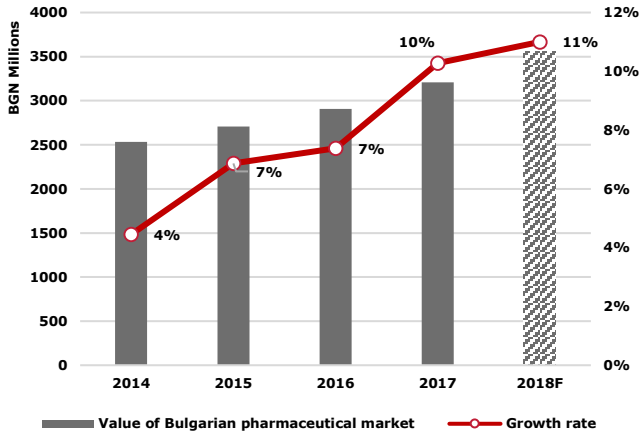
Currently, roughly 80% of the market is dominated by international drugs with the rest locally produced by the two leading generic manufacturers - Sopharma and Actavis. However, it is difficult for international players to gain significant part of the wholesale market.

Four major players dominate the wholesale market

The wholesale is dominated by four players with Sopharma Trading on the lead. Second largest, in terms of value, is German Phoenix wholesaler with 20.9% share. The third place is taken by the ex-Actavis wholesaler Pharmnet, currently owned and run by local businessman Veselin Mareshki. The latter also controls the biggest pharmacy chain in the country but has been often accused of improper market practices by competitors. On fourth place is the locally owned distributor - Sting. All four account for 82% of the market.

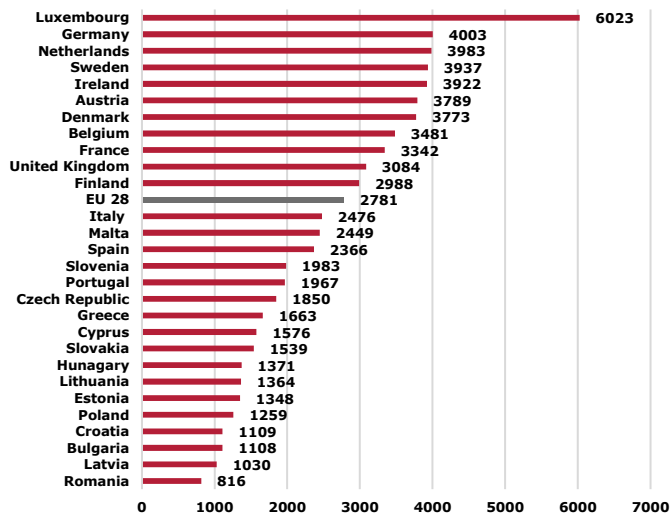
Competition is fierce with Pharmnet dominating the pharmacy market. Sopharma Trading dominates the hospitals market with its easy access to cheap financing. Thus, to get margins distributors rely on other activities - marketing, services, exclusive partnerships, etc.

Exhibit 2: Local market has been steadily on the increase...



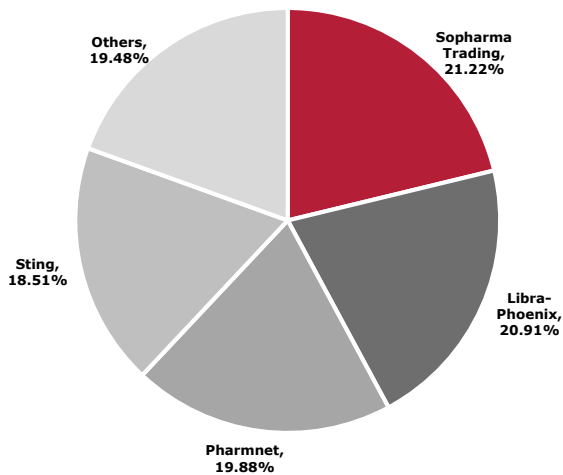
Source: IQVIA

Exhibit 4: Total health care expenditures per capita in Bulgaria among the lowest in the EU...



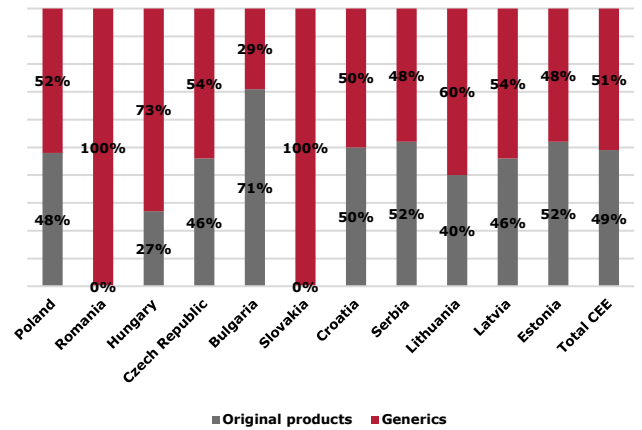
Source: OECD Health Data 2015; Eurostat Statistics Database (in EUR millions)

Exhibit 6: Fierce rivalry, but Sopharma Trading on the lead ...



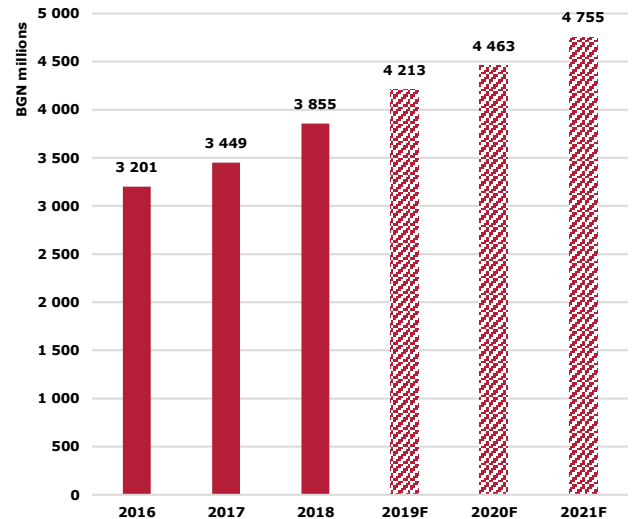
Source: Company's financial statements; 4Q'17

Exhibit 3: ...with generics driving the growth in 2017



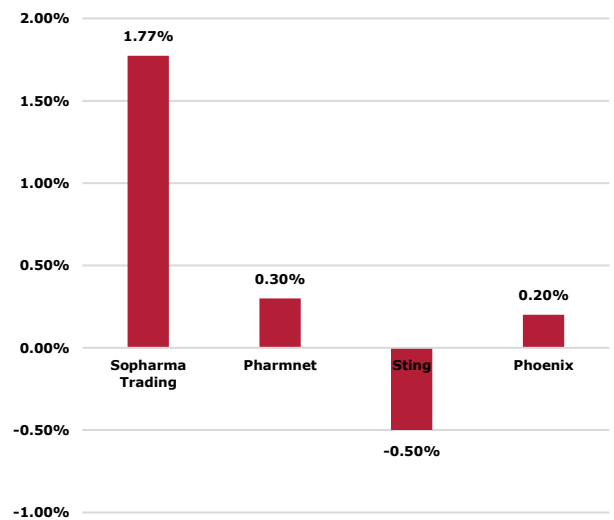
Source: IQVIA

Exhibit 5: ... steadily increasing budget for the National Health Insurance Fund to boost growth



Source: Ministry of Finance

Exhibit 7: ... delivering much higher net profit margins ...



Source: Companies financial statements; FY 2016

SOPHARMA TRADING MARKET PRESENCE

Sopharma Trading is the leading pharmaceutical wholesaler in Bulgaria with a 21% market share. It has kept this position during the last five years with solid market presence and diversified portfolio of products and services, achieving 8+% CAGR for the past 10 years.

The Company works with pharmacies, wholesalers and hospitals, generating 59%, 17% and 24% of its 2017 revenues, respectively. The hospitals' segment is divided into four subgroups: medicines, wholesale, medical consumables and devices, and medical equipment. The pharmacy segment and the medicine subgroup of the hospital market contribute the most to the Company's top line but offer little margins due to overregulation of drug prices and tough competition. Medical consumables and equipment provide both high growth and high margin potential, especially due to the Company's exclusivity over the marketing of certain products in Bulgaria, such as GE Healthcare devices, for example.

Since 2017, the hospital segment has been decelerating in growth, yet the Company has managed to keep its 30+% market share. The trend is expected to persist in the midterm. In order to strengthen its overall position, Sopharma Trading has been focusing on its retail division, emphasizing OTC, cosmetics and food supplements. Retail revenues are also to boost its wholesale segment in the long term. SOPharmacy chain and recently acquired #4 in terms of sales Pharmastore, have strong positions in the country's biggest cities – Sofia, Plovdiv and Burgas. Online retail channel www.sopharamcy.bg although not main distribution channel, offers an additional option for customers and adds to brand recognition.

The Company's entrance into the Serbian market in 2015 and its 2017 acquisition of wholesale Lekovit gives it current 7% overall market share and 20% market share in the small pharmacies segment in the country.

The Company's business with related parties represents less than 12% of sales in 2017 and is declining. According to Sopharma Trading's management, in terms of transfer pricing Sopharma treats its wholesale subsidiary as any other wholesaler it works with i.e. it sells to Sopharma Trading at prevailing wholesale prices.

Lastly, more than 80% of the products Sopharma Trading sells are imported.

Geographic expansion – Sopharma Trading's gateway to growth

Exhibit 10: Revenue breakdown by segments, nominal

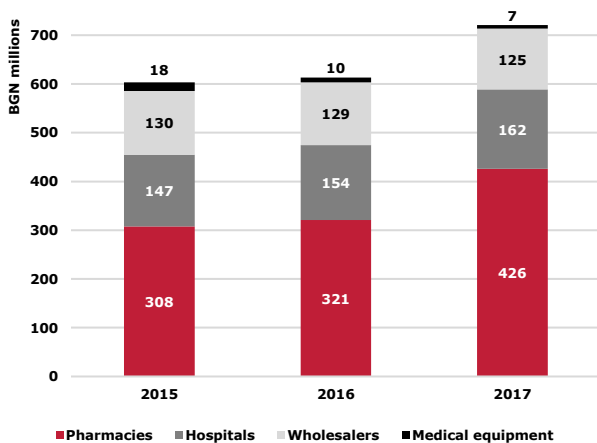
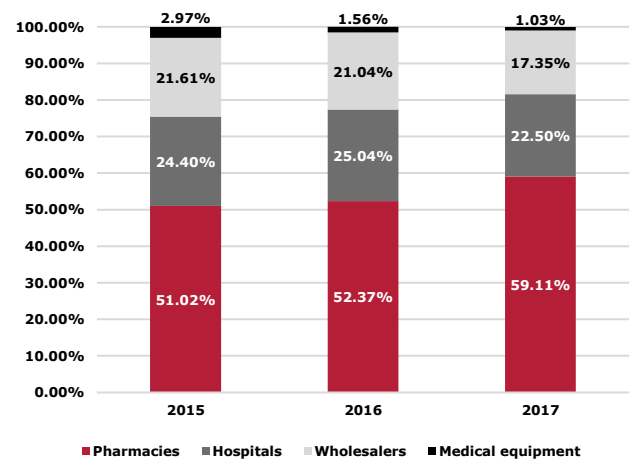


Exhibit 11: Revenue breakdown by segments, % of sales



Source: Company data

Source: Company data

Exhibit 12: Revenue breakdown by product place of origin

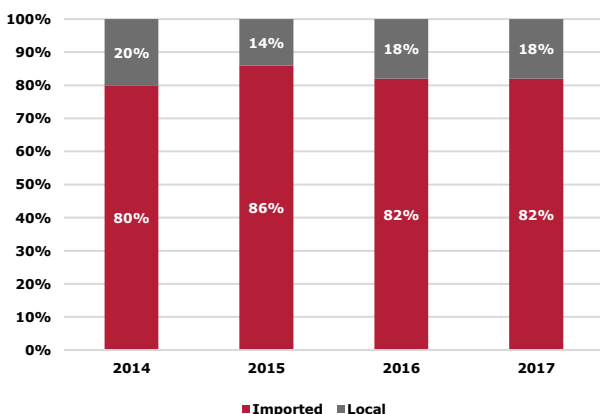
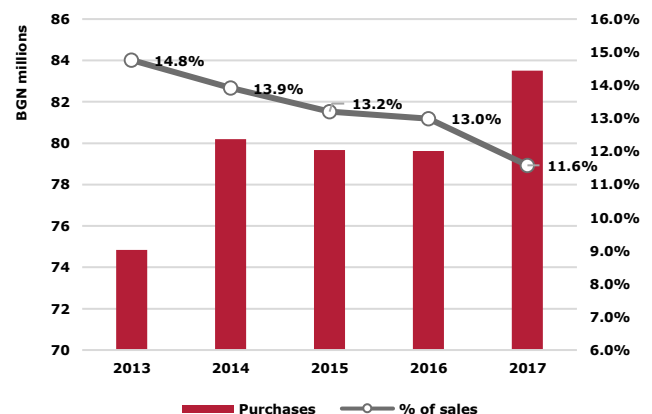


Exhibit 13: Purchases from related parties



Source: Company data

Source: Company data

FINANCIAL ANALYSIS AND VALUATION

Sopharma Trading is a solid company with excellent presence on the Bulgarian pharmaceutical market. The Company gradually outgrew its dependence on parent company Sopharma in terms of financing, and has diversified its operations to gradually position itself as a solid market player on both wholesale and retail markets. As the Company is independent from Sopharma in terms of cash generation, we use the discounted cash flow model coupled with peer valuation to determine its intrinsic value.

Stable performance, expected to further improve

<i>in '000 BGN, except for ratios</i>	2015	2016	2017	2018F
Current Price	5.25	6.30	8.00	8.00
Number of Shares	32 905 009	32 905 009	32 905 009	32 905 009
Market Capitalization	172 751 297	207 301 557	263 240 072	263 240 072
Net Profit	12 164	10 872	10 578	13 738
P/E	14.20	19.07	24.89	19.16
Equity	66 349	65 763	74 093	77 960
P/B	2.60	3.15	3.55	3.38
Sales	603 410	613 130	721 118	908 609
P/S	0.28	0.33	0.36	0.29
EV	278 860	316 484	420 581	436 329
EBITDA	16 733	14 337	16 441	18 899
EV/EBITDA	16.67	22.07	25.58	23.09
ROE	18.87%	27.68%	14.28%	17.62%
ROA	4.72%	3.88%	2.65%	3.27%

SOPHARMA TRADING PERFORMANCE ANALYSIS

Sopharma Trading has been steadily increasing its revenues for 11 consecutive years since inception, with 8+% CAGR for the period, and 2x+ its profit over the same period. The Company has been outpacing the overall market in six of the past ten years. Up until 2014, Sopharma Trading was registering double digit growth both on the pharmacy and the hospital segments. After having developed a balanced and well-diversified business model, the Company slowed down its growth in 2015-2016 period.

Retail to drive growth and add to profitability

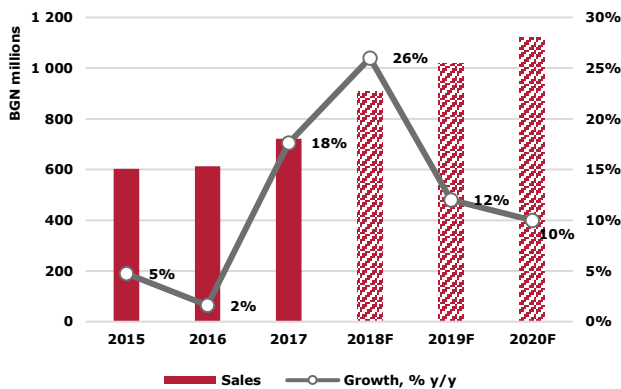
In 2017, it had a high acquisition season, acquiring 70% of Serbian peer Lekovit and local pharma chain Pharmastore. Since 2015, the Company has been focusing on its own branded SOpharmacy network. The pharmacy orientation in the past two years depressed Sopharma Trading's bottom line, as the Company opened 24 pharmacies (as at the end of 2017), which are yet to break-even.

The Company's portfolio diversification has helped it improve profitability despite the eroded regulative wholesale markup. However, with fierce rivalry and shrunk hospital market, diversification and excellent partner relationships are the way to growth and higher profits.

Gross profit has registered 9% CAGR over the last four years to BGN 57m in 2017. Additionally, after several years of working below 7% gross profit margin, thanks to diversification, since 2013 the Company surpassed the 7% barrier and in 2017 it reached 8%. We expect this positive trend to continue and with Sopharma Trading focusing on higher margin OTC products, cosmetics and exclusive products, our estimations are that gross profit margin will reach 8.3% in 2022.

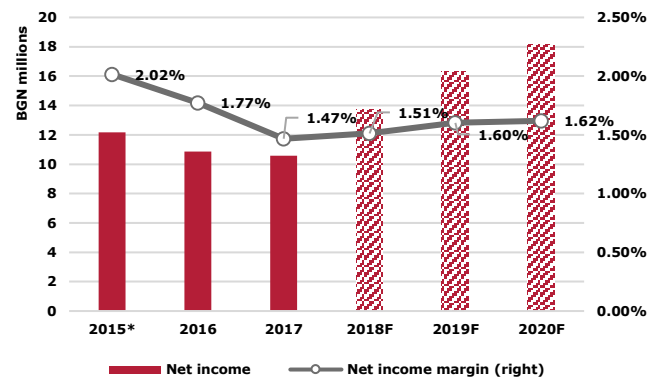
Net income has been steadily rising until 2015 when it reached BGN 12.2m, and dropped to BGN 11m in 2016 and 2017 due to the opening of a large number of pharmacies, which are expected to start adding to the Company's bottom line in 2018-2019, aided by Sopharma Trading's wholesale expansion in Serbia through Lekovit. Our estimations are that net income will grow at 12% CAGR during the next 5 years, with net income margin reaching 2% in 2022.

Exhibit 14: Double digit growth on local and export expansion



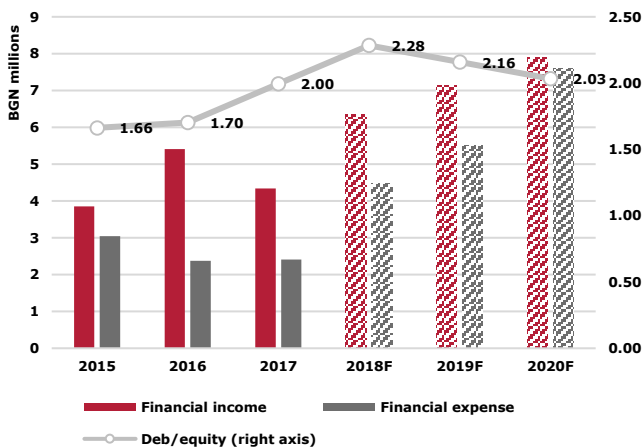
Source: Elana Trading estimates, company data

Exhibit 15: Steady net income margin in the midterm



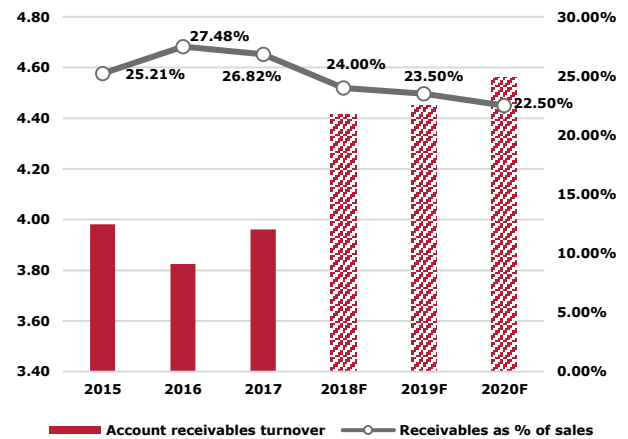
Source: Elana Trading estimates, company data
*On individual level. In 2015, the Company started building its own-branded pharmacy network S0pharmacy, which is loss generator at end-of 2016 and 2017

Exhibit 16: ... even despite rising debt as financial income will outpace interest expense growth



Source: Elana Trading estimates, Company data

Exhibit 17: Receivables turnover to improve on re-focus to retail and exclusive product portfolio



Source: Elana Trading estimates, company data

Working with hospitals in Bulgaria has its shortcomings. In this case Sopharma Trading is trading off higher revenue and margins with higher debt level. The Company is basically financing delayed payments by hospitals and in a way financing hospitals themselves. Moreover, up until 2012, some of this financing has been co-shared with the parent company Sopharma, but since 2013 Sopharma stepped aside allowing Sopharma Trading to deal with the market specifics independently. Additionally, the Company took a BGN 30m long-term debt to finance its two acquisitions in 2017, thus substantially increasing its debt exposure. Its debt costs, however are averaging around 1.5% due to the currently extremely low interest rate levels. The latter, however, are expected to rise in the midterm. In addition, Sopharma Trading will increase its working capital in order to finance its wholesale and retail expansion in Bulgaria and Serbia. Still, we don't expect these two factors to affect negatively its financial position in the midterm, as interest expense will be compensated with reciprocal financial income stemming from hospitals' delayed payments collections.

We also expect CAPEX investments to gradually rise in the next two-to-three years as the Company is planning to open about 10 new pharmacies per year, the latter needing equipment.

Debt levels to follow Company's revenue growth

SOPHARMA TRADING VALUATION

We use the discounted cash flow model as well as peer valuation in order to determine Sopharma Trading's intrinsic value and it returns a BGN 8.25 per share.

When valuing the Company using the discounted cash flow method, we incorporate a sharp revenue growth from 18% in 2017 to 26% in 2018 on added acquisitions. The latter pace is to be followed by more moderate growth of 12% and 10% in 2019 and 2020, respective-

We value Sopharma Trading's at BGN 8.25 per share

ly, mainly due to expected gradual local and Serbian expansion in both retail and wholesale segments. Following 2020, we project gradual slowdown in growth rates to 7.5% and 5.5%, respectively and 1.5% perpetual growth in terminal year. We expect profit margins to increase to almost 2% by 2022.

When calculating the Company's weighted average cost of capital we foresee a gradual increase in the risk free rate as Bulgaria's cost of financing will rise on rising global interest rates and possible budget deficits. Additionally, we expect 2018 to be the last low-interest-rate year, with interest rates starting to gradually rise. This will translate into higher corporate debt cost as well. Sopharma Trading will also leverage its Lekovit subsidiary, which currently enjoys very low debt levels. Accordingly, we arrive at a weighted average cost of capital of 4.84% for the forecasted period.

To arrive at a fair value for the stock we also take into account the Company's standing to its peers in Central and Eastern Europe. It looks overvalued when compared to peers' P/E and P/S multiples which we feel being the most representative for the specifics of the companies' operations.

By applying an equal weight to the stock's value as per cash flow and peer analysis, we arrive at a final weighted fair value of BGN 8.25 per share.

KEY DCF ASSUMPTIONS

BGN'000	2015	2016	2017	2018F	2019F	2020F	2021F	2022F	TERMINAL YEAR
Sales	603 410	613 130	721 118	908 609	1 017 642	1 119 406	1 203 361	1 269 546	1 288 589
y/y growth	4.74%	1.61%	17.61%	26.00%	12.00%	10.00%	7.50%	5.50%	1.50%
EBITDA	16 733	14 337	16 441	18 899	21 167	23 284	26 233	29 580	31 313
EBITDA margin	2.77%	2.34%	2.28%	2.08%	2.08%	2.08%	2.18%	2.33%	2.43%
D&A	3 327	4 009	5 239	4 543	4 071	3 358	3 610	3 174	3 221
% of Sales	0.55%	0.65%	0.73%	0.50%	0.40%	0.30%	0.30%	0.25%	0.25%
Investments	5 520	4 898	3 913	7 269	8 141	5 597	4 813	3 809	3 866
% of Sales	0.91%	0.80%	0.54%	0.80%	0.80%	0.50%	0.40%	0.30%	0.30%
EBIT	13 406	10 328	11 202	14 356	17 096	19 925	22 623	26 407	28 091
EBIT margin	2.22%	1.68%	1.55%	1.58%	1.68%	3.00%	3.00%	3.00%	3.00%
NWC	32 853	31 793	19 889	27 349	30 631	29 216	32 009	36 944	40 075
% of Sales	5.44%	5.19%	2.76%	3.01%	3.01%	2.61%	2.66%	2.91%	3.11%
Change NWC	-3 810	-1 060	-11 904	7 460	3 282	-1 415	2 793	4 934	3 131

WACC CALCULATION

	2018	2019	2020	2021	2022	TERMINAL YEAR
RISK FREE RATE	1.50%	1.50%	2.00%	2.50%	3.00%	4.00%
EQUITY RISK PREMIUM	7.27%	7.27%	7.27%	7.27%	7.27%	7.27%
BETA	0.90	0.90	0.90	0.90	1.00	1.00
COST OF EQUITY	8.04%	8.04%	8.54%	9.04%	10.27%	11.27%
COST OF DEBT	2.50%	3.00%	4.00%	4.50%	5.00%	5.50%
EFFECTIVE TAX RATE	10%	10%	10%	10%	10%	10%
AFTER-TAX COST OF DEBT	2.25%	2.70%	3.60%	4.05%	4.50%	4.95%
WEIGHT OF EQUITY	19%	19%	20%	21%	22%	25%
WACC	3.33%	3.73%	4.59%	5.11%	5.80%	6.50%

DISCOUNTED CASH FLOWS

BGN'000	2017	2018	2019	2020	2021	2022	TERMINAL YEAR
EBIT	11 202	14 356	17 096	19 925	22 623	26 407	28 091
EBIT(1-T)	10 082	12 920	15 387	17 933	20 361	23 766	25 282
ADD: D&A	5 239	4 543	4 071	3 358	3 610	3 174	3 221
LESS: INVESTMENTS	3 913	7 269	8 141	5 597	4 813	3 809	3 866
LESS: CHANGE NWC	-11 904	7 460	3 282	-1 415	2 793	4 934	3 131
FCF	23 312	2 734	8 034	17 109	16 365	18 197	21 506
PV FCF	23 312	2 608	7 309	14 846	13 545	14 366	
SUM OF PV FCF	52 674						
PV OF CONTINUING VALUE	508 096						
TOTAL PV FREE CASH FLOWS	560 770						
LESS: OUTSTANDING DEBT	175 713						
PLUS: FINANCIAL ASSETS	18 372						
PV OF EQUITY	403 429						
NUMBER OF SHARES	32 905						
PRICE PER SHARE	12.26						

DCF SENSITIVITY ANALYSIS

Exhibit 18: Terminal growth

	0.5%	1.0%	1.5%	2.0%	2.5%
2.84%	21.22	27.81	39.34	64.58	164.05
3.84%	13.08	15.94	20.01	26.30	37.27
4.84%	8.70	10.24	12.26	14.96	18.83
5.84%	5.98	6.93	8.10	9.58	11.50
6.84%	4.12	4.75	5.51	6.42	7.53

Source: Elana Trading estimates

CENTRAL AND EASTERN EUROPEAN PEER COMPARISON

Company	Country	Mkt Cap (EUR m)	P/E	ROE	P/S
SOPHARMA TRADING	Bulgaria	135.44	26.83	14.77	0.37
MEDIKA DD	Croatia	65.17	10.65	18.83	0.16
SALUS DD	Slovenia	55.51	14.41	7.57	0.24
NEUCA SA	Poland	348.19	15.01	15.37	0.19
SELCUK ECZA DEPOSU TICARET V	Turkey	422.31	7.14	14.71	0.20
PROTEK PJSC	Russia	691.55	8.67	18.22	0.21
Median		241.81	12.53	15.07	0.21

Source: Bloomberg

	P/E ttm	P/S ttm
Median peer multiple	12.53	0.21
Sopharma Trading's fair value '000 BGN based on the peer multiple	132 553	149 199
Fair value per share based on peer multiple	4.03	4.53
Weight of multiple fair value	60%	40%
Fair value per share	4.23	

FINAL VALUATION

	DCF	Peer Comparison
Fair Value per Model (in BGN)	12.26	4.23
Weight of Model	50%	50%
Final Fair Value per Share (in BGN)	8.25	

RECOMMENDATION AND PRICE TARGET

The intrinsic value of Sopharma Trading's stock is higher than the current market prices despite the stock's appreciation over the last year. The favorable market and the Company's position on that market are some of the factors to contribute to Sopharma Trading's management efforts to increase shareholders' value.

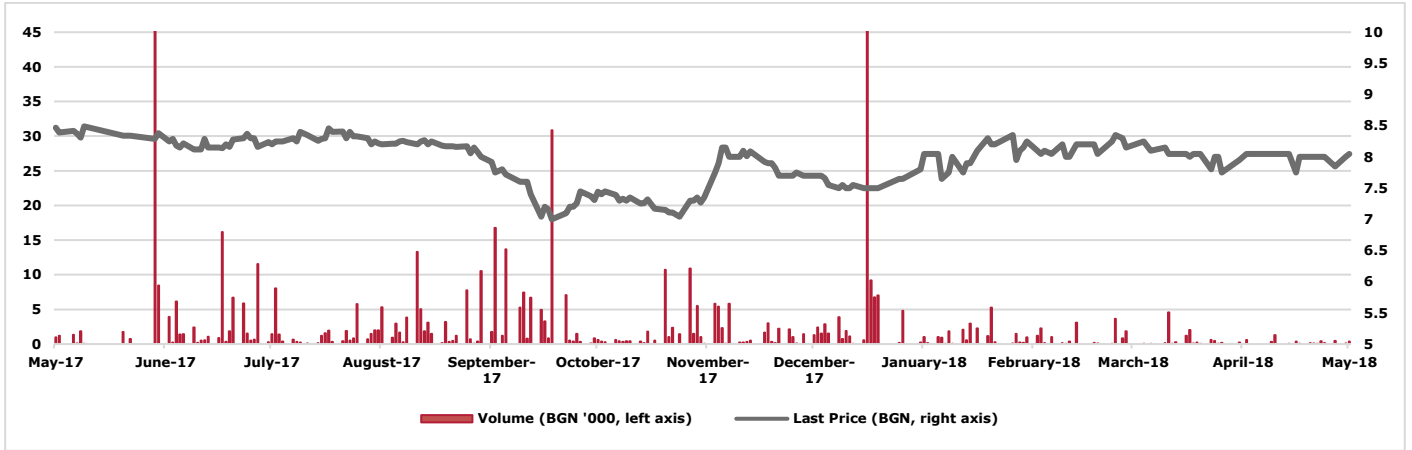
However, we reiterate our HOLD recommendation as the price target offers only 3% upside potential to current quotes and we keep a more conservative look on the expected big expansion whose success is subject to a number of factors that are yet to unfold.

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

- Bulgarian institutional investors prefer Sopharma Trading's stock due to solid market position and stable dividend policy. They are expected to increase their portfolio positions if the price consolidates below current levels and sustain positions at current price levels.
- Domestic private investors view the stock as stable and perspective for longer-term holding even if dividends per share are frozen at current level due to the ongoing market expansion.
- Foreign investors are opening up to Sopharma Trading due to higher liquidity and stable dividend policy.

Recommendation: HOLD
Target Price: BGN 8.25
Upside potential: 3%

STOCK PRICE DYNAMICS



Source: Bloomberg

ANNUAL FINANCIAL DATA (AUDITED, EXCL. FORECASTS)

INCOME STATEMENT (IN '000 BGN)	2014	2015	2016	2017	2018F	2019F
Sales	576 100	603 410	613 130	721 118	908 609	1 017 642
Other operating income	4 794	5 518	6 152	8 096	7 087	7 938
Change in Inventories	0	0	0	0	0	0
Cost of Materials	3 364	3 061	3 326	4 254	5 452	6 106
Cost of External Services	7 918	11 142	11 095	15 080	18 172	18 318
Cost of Labor	15 578	17 562	21 195	26 920	34 527	37 653
Other operating expenses	2 570	2 194	2 869	2 745	4 543	5 088
COGS	535 625	558 236	566 460	663 774	835 920	934 195
Total Operating Expenses	568 009	595 522	608 954	718 012	901 340	1 008 483
EBITDA	15 839	16 733	14 337	16 441	18 899	21 167
Depreciation and Amortization	2 954	3 327	4 009	5 239	4 543	4 071
EBIT	12 885	13 406	10 328	11 202	14 356	17 096
Financial revenue	2 522	3 856	5 407	4 336	6 360	7 123
Financial expense	3 546	3 701	3 318	3 076	5 452	6 106
Interest Expense	2 998	3 040	2 371	2 407	4 475	5 495
EBT	11 861	13 561	12 417	12 462	15 265	18 114
Income Taxes	1 222	1 397	1 545	1 884	1 526	1 811
Net Income	10 639	12 164	10 872	10 578	13 738	16 303
BALANCE SHEET (IN '000 BGN)	2014	2015	2016	2017	2018F	2019F
Inventories	62 877	60 785	67 207	109 122	113 576	117 029
Receivables from related parties	2 232	3 447	1 017	2 822	3 634	4 071
Trade Receivables	151 058	152 105	168 499	193 404	218 066	239 146
Other receivables and prepaid expenses	866	3 895	6 068	2 805	4 543	5 088
Cash & Cash Equivalents	3 948	4 212	2 863	18 372	5 907	2 572
CURRENT ASSETS	220 981	224 444	245 654	326 525	345 727	367 906
Property, Plant & Equipment	21 825	20 977	24 319	24 559	24 532	22 388
Intangibles	3 312	6 730	9 947	48 082	48 065	47 829
Investments in subsidiaries	0	2 684	0	0	0	0
Investments available for sale	2 412	2 396	72	72	91	102
Receivables from related parties	0	404	1 017	0	909	1 018
Other receivables	258	283	124	368	273	305
NON-CURRENT ASSETS	27 807	33 474	35 479	73 081	73 870	71 642
TOTAL ASSETS	248 788	257 918	280 175	399 606	419 597	439 548
Share Capital	32 905	32 905	32 905	32 905	32 905	32 905
Reserves	17 111	18 834	20 663	22 315	23 689	25 319
Retained Earnings	12 589	14 610	12 195	10 851	13 344	18 145
Minority Interest	0	0	0	8 022	8 022	8 022
SHAREHOLDERS' EQUITY	62 605	66 349	65 763	74 093	77 960	84 391
Short-term Bank Loans	105 218	103 872	106 585	107 481	140 834	157 734
Current Portion of Long Term Bank Loans	1 788	2 574	2 553	6 712	9 995	6 106
Liabilities to Related Parties	28 097	30 127	41 526	41 074	45 430	45 794
Account Payables	38 872	45 744	53 107	95 907	104 490	111 941
Tax Liabilities	3 241	2 798	4 299	4 376	4 997	5 597
Liabilities to Employees & Social Security	1 356	1 473	2 207	3 278	2 726	3 053
Other Current Liabilities	1 798	791	721	29 436	3 998	4 478
CURRENT LIABILITIES	180 370	187 379	210 998	288 264	312 471	334 702
Long Term Bank Loans	3 837	3 875	2 907	32 084	27 258	18 318
Deferred Taxes	0	0	42	3 167	91	102
Liabilities to Employees on Retirement	316	0	0	399	273	305
Financial Leases	1 651	0	0	1 567	909	1 018
OTHER LONG TERM LIABILITIES	9	315	465	32	636	712
NON-CURRENT LIABILITIES	5 813	4 190	3 414	37 249	29 166	20 455
Total Liabilities	186 183	191 569	214 412	325 513	341 637	355 157
Shareholders' Equity and Liabilities	248 788	257 918	280 175	399 606	419 597	439 548
NUMBER OF SHARES:	32,905,009	32,905,009	32,905,009	32,905,009	32,905,009	32,905,009
PRICE IN BGN - PERIOD END:	5.50	5.25	6.30	8.00	8.00	8.00
MARKET CAP IN BGN - PERIOD END:	180 977 550	172 751 297	207 301 557	263 240 072	263 240 072	263 240 072

FINANCIAL AND PERFORMANCE INDICATORS	2014	2015	2016	2017	2018F	2019F
Valuation						
Price/Earnings (P/E)	17.01	14.20	19.07	24.89	19.16	16.15
Price/Book (P/B)	2.89	2.60	3.15	3.55	3.38	3.12
Price/Sales (P/S)	0.31	0.28	0.33	0.36	0.29	0.26
EV (in 000' BGN)	289 524	278 860.30	316 484	420 581.07	436 329	443 843.20
EV/EBITDA	18.28	16.67	22.07	25.58	23.09	20.97
Profitability						
Return on common equity	17.44%	18.87%	27.68%	14.28%	17.62%	19.32%
Return on assets	4.28%	4.72%	3.88%	2.65%	3.27%	3.71%
EBITDA margin	2.75%	2.77%	2.34%	2.28%	2.08%	2.08%
Operating margin	2.24%	2.22%	1.68%	1.55%	1.58%	1.68%
Net income margin	1.85%	2.02%	1.77%	1.47%	1.51%	1.60%
Dividend						
Dividend yield	4.91%	5.71%	4.76%	3.75%	3.75%	3.75%
Dividend per share	0.27	0.30	0.30	0.30	0.30	0.30
Liquidity						
Current ratio	1.23	1.20	1.16	1.13	1.11	1.10
Quick ratio	0.88	0.87	0.85	0.75	0.74	0.75
Credit						
LT debt/equity	0.06	0.06	0.04	0.43	0.35	0.22
Total debt/equity	1.80	1.66	1.70	2.00	2.28	2.16
Total debt/total assets	0.75	0.74	0.02	0.81	0.81	0.81
EBIT/interest expense	4.30	4.41	4.36	4.65	3.21	3.11

Source: Elana Trading estimates and company data

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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.

Q1 2018 Recommendation Review

Recommendation	#	Share	Market Maker Services
BUY	5	31%	SKK BU; 4KX BU
HOLD	11	69%	
SELL	0	0%	

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