Sopharma Group

Sell

Initiation of coverage

Price: BGN 3.15
Price target: BGN 3.00

It's a capital management issue

We initiate coverage of Sopharma Group, a Bulgarian holding with investments in pharma wholesale and manufacturing, with a SELL recommendation and a 12M price target (PT) of BGN 3.00/share (c.5% downside). The company is a leading wholesaler in Bulgaria, but inordinately inefficient working capital management, compared to peers, has resulted in high gearing (3.7x at end-1Q20) and returns on capital employed (ROCE) consistently below the company's cost of capital. Management also deploys capital well outside the core business (e.g., Doverie Holding); together, these factors constrain Sopharma's ability to grow at its full potential, we believe. Also, while there are synergies between the core Bulgarian manufacturing and wholesale units, we are unable to say that this is true across all businesses (e.g., in Belarus and Ukraine). We could change our view if Sopharma tames its working capital, cuts leverage, streamlines the business, and improves the reporting of operational data. At this juncture, however, we lack confidence that this process will start in the next 12 months.

Sopharma Group is best described as a holding structure, encompassing Sopharma AD – the core pharma business – BSE-listed drug wholesaling business Sopharma Trading (SO5 BU), distribution in the Baltics and Belarus, and non-pharma related investments (e.g., Doverie Holding). The complicated structure is a M&A legacy issue and, while there is a level of disclosure for the core domestic businesses, the reporting of most local subsidiaries and businesses abroad – which we estimate accounts for c.30% of gross turnover and a similar amount of PP&E – is opaque to us.

Earnings outlook: we forecast 2020E net profit of BGN 50.1m (-42% yoy) on revenues of BGN 1,374m (+7% yoy) and EBITDA of BGN 101.3m (-2% yoy). Due to COVID-19, we expect better growth on the (low margin) wholesale side of the business, but relatively weaker demand for Sopharma's own products. In the mid-term, we expect a 2019-23E revenues CAGR of 6.0% and a 2019-23E EBITDA CAGR of 4.0%. In our modelling, the main factors contributing to the modest margin erosion over the next few years are the cost of goods sold and employee benefits.

Valuations: on our 2020E estimates, the business trades at an EV/EBITDA of 8.2x (a c.4% premium vs. peers) and a PER of 7.9x (a c.33% discount). On our 2021-22E earnings, the stock trades at an average c.8x EV/EBITDA, or a c.10% premium, and a c.11% discount on PER (c.9.6x vs. the median of 10.8x for our peer group).

Triggers. We would expect a material earnings boost if Sopharma's American partner obtains approval for Sopharma's smoking cessation drug on the US market; however, in view of the long delays, the absence of guidance and the potential funding issues facing its partner, we do not include this in our modelling. The wholesale/pharmacies parts of the business could be an interesting target for one of the big European players, we believe, but any potential takeover would depend on the owners' willingness to break up the current holding structure.

Expected events

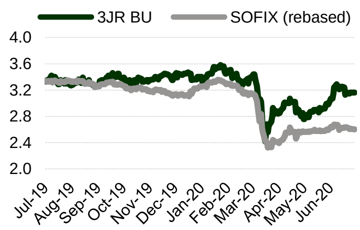
Stand-alone 2Q20 results	30 July 2020
Consolidated 2Q20 results	31 August 2020
Stand-alone 3Q20 results	30 October 2020
Consolidated 3Q20 results	5 November 2020
Stand-alone 4Q20 results	1 February 2021
Consolidated 4Q20 results	1 March 2021
FY20 results	30 April 2021

Key data

Market Cap (EUR m)	217m
Free float	54%
Shares outstanding	134.8m
Major Shareholders	
Donev Investments	25.42%
Telecomplect invest	20.68%
6M ADTV	EUR 36k
Reuters Code	3JR.BB
Bloomberg Code	3JR BU
SOFIX Index	452.5

Price performance

52-w range	BGN 2.42-3.58
52-w performance	-5.4%
Relative performance	16.6%



Year	Sales	EBITDA	Net profit	EPS	EPS	DPS	P/E	EV/EBITDA	P/CE	Div yield
	BGN m	BGN m	BGN m	BGN	% yoy	BGN	(x)	(x)	(x)	%
2017	1,017	85.9	40.0	0.31	87%	0.11	13.4	9.8	7.3	2.7%
2018	1,179	72.3	28.3	0.23	-27%	0.05	18.0	12.1	17.1	1.2%
2019	1,282	103.7	87.0	0.69	207%	0.12	4.9	8.3	5.9	3.5%
2020E	1,374	101.2	50.1	0.40	-43%	0.12	7.9	8.2	10.2	3.8%
2021E	1,453	107.1	39.1	0.31	-22%	0.11	10.2	8.1	6.2	3.4%
2022E	1,542	114.2	43.7	0.35	12%	0.12	9.1	7.8	6.7	3.9%

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EQUITY RESEARCH

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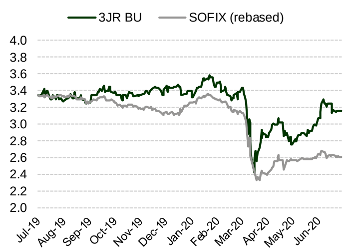
Closing Prices as of 02 July 2020

Company snapshot – SELL, PT BGN 3.00

SELL

Bloomberg ticker	**3JR BU**
Closing price (BGN)	**3.15**
Price target (BGN)	**3.00**
Upside to PT	**-4.7%**
Shares outstanding (m)	**134.8**
MCAP (EUR m)	**217**
Free float	**53.9%**
ADTV (EUR k)	**36.0**
52 W Range (BGN)	**2.42-3.58**



COMPANY DESCRIPTION

Sopharma AD is a Bulgarian based company that researches, manufactures, and trades drugs and chemical pharmaceutical preparations. The company produces and sells a broad spectrum of medicines, phytochemical products, and synthetic drug forms. SOPHARMA AD is located in Sofia, Bulgaria. It is a producer and exporter, with a strong regional presence. The product portfolio of the company consists of more than 200 products. The company produces and markets medicinal substances and dosage forms; and conducts research, engineering and implementation activities in the field of phytochemistry, chemistry and pharmaceuticals. Sopharma AD provides services related to production, as well as to ancillary and service activities. Sopharma AD is a subsidiary of the Sopharma Group, which is a leading producer and distributor of health-related products. The business model is vertically integrated, running through the whole value chain.

RATIOS

PER SHARE RATIOS	2017	2018	2019	2020E	2021E	2022E
EPS	0.31	0.23	0.69	0.40	0.31	0.35
CFPS	0.56	0.24	0.58	0.31	0.51	0.47
BVPS	3.49	3.77	4.27	4.30	4.32	4.34
DPS	0.11	0.05	0.12	0.12	0.11	0.12

FINANCIAL RATIOS	2017	2018	2019	2020E	2021E	2022E
Gross margin	33.1%	30.0%	31.5%	30.5%	30.5%	30.4%
EBITDA margin	8.4%	6.1%	8.1%	7.4%	7.4%	7.4%
EBIT margin	5.5%	3.3%	4.7%	4.1%	4.0%	4.1%
Net margin	3.9%	2.4%	6.8%	3.6%	2.7%	2.8%
ROE	8.3%	5.8%	16.0%	8.7%	6.7%	7.5%
ROCE	7.8%	5.2%	8.0%	6.3%	6.3%	6.7%
Net debt/EBITDA	2.9x	4.1x	3.7x	4.0x	4.1x	4.0x
Net debt/(cash) to equity	0.5x	0.6x	0.7x	0.7x	0.7x	0.8x

VALUATION RATIOS	2017	2018	2019	2020E	2021E	2022E
P/E	13.4x	18.0x	4.9x	7.9x	10.2x	9.1x
EV/EBITDA	9.8x	12.1x	8.3x	8.2x	8.1x	7.8x
P/CF	7.3x	17.1x	5.9x	10.2x	6.2x	6.7x
P/BV	1.2x	1.1x	0.8x	0.7x	0.7x	0.7x
EV/Capital Employed	1.3x	1.3x	1.2x	1.1x	1.0x	1.0x
EV/Sales	0.8x	0.7x	0.7x	0.6x	0.6x	0.6x
EV/EBIT	15.0x	22.4x	14.5x	14.9x	14.9x	13.9x
Cash flow- Ops, BGN (m)	73	30	72	39	64	59
EV, BGN (m)	840	878	863	832	862	886
FCF, BGN (m)	44.9	-11.0	10.1	-3.0	5.7	11.4
FCF yield	8.4%	-2.2%	2.4%	-0.8%	1.4%	2.9%
Dividend yield	2.7%	1.2%	3.5%	3.8%	3.4%	3.9%

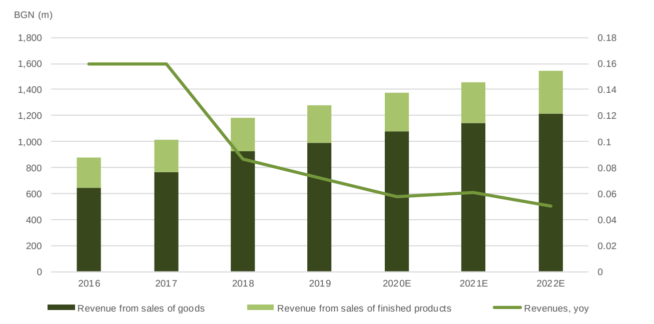
COMPANY FINANCIALS

INCOME STATEMENT, BGN (m)	2017	2018	2019	2020E	2021E	2022E
Sale of Goods	768	928	993	1,078	1,140	1,211
Sale of Finished Products	250	251	289	296	313	330
Revenues	1,017	1,179	1,282	1,374	1,453	1,542
COGS	-680	-826	-879	-955	-1,010	-1,073
Gross profit	337	354	403	419	443	469
Operating expenses	-251	-281	-299	-318	-336	-354
EBITDA	86	72	104	101	107	114
Depreciation and Amortization	-30	-33	-44	-45	-49	-50
Operating profit	56	39	60	56	58	64
Finance Costs (net) and Other	-7	-9	27	-24	-19	-20
Profit before tax	52	35	88	44	49	55
Tax	-7	-5	-4	-6	-6	-7
Minority interest	6	2	-3	-11	4	4
Net profit	40.0	28.3	87.0	50.1	39.1	43.7

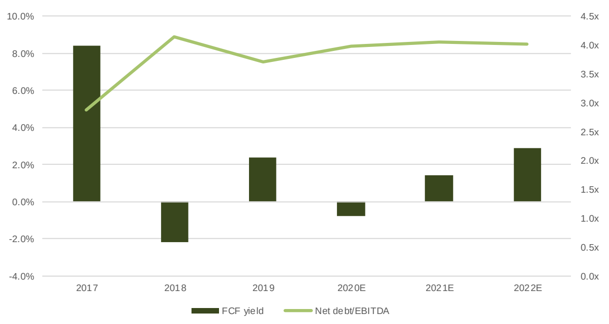
CASH FLOW, BGN (m)	2017	2018	2019	2020E	2021E	2022E
Revenue from contracts with custom	1,058.6	1,201.7	1,215.4	1,323.5	1,422.9	1,506.5
Payments to suppliers	-950.6	-1,142.1	-1,144.0	-1,282.5	-1,356.3	-1,438.2
Payments for wages and social secu	-94.3	-110.7	-120.3	-128.3	-136.7	-144.9
Taxes paid (profit tax excluded)	-57.2	-56.2	-62.1	-65.3	-69.1	-73.3
Other	-8.6	-8.4	-9.0	-17.2	-12.0	-13.1
CF from Operations	-58.3	-123.8	-128.4	-176.6	-158.5	-171.2
CAPEX	-17.3	-27.2	-39.0	-37.6	-58.2	-47.6
CF from Investments	-76.8	-41.2	-104.2	-22.4	-58.2	-47.6
Change in debt	38	40	49	15	32	22
Proceeds from Factoring	131	154	201	216	222	230
Interest Paid	-3	-2	-2	-2	-2	-2
Dividends Paid	-15	-23	-3	-19	-19	-18
Cash from financing activities	135.4	166.5	235.9	194.0	218.6	217.7

BALANCE SHEET, BGN (m)	2017	2018	2019	2020E	2021E	2022E
Current Assets	512	530	549	597	630	666
Cash and equivalents	33	26	28	22	24	23
Receivables	235	236	256	286	304	325
Inventories	218	236	230	245	259	275
Other	26	33	36	44	44	44
Long Term Assets	468	481	626	602	612	609
PP&E	318	325	379	376	389	390
Intangibles	63	62	43	38	34	30
Investments in JV	20	20	63	64	64	64
Other	68	74	142	125	125	125
Total Assets	981	1,011	1,175	1,199	1,242	1,275
Total Current Liabilities	398	433	484	514	556	598
Trade payables	135	124	116	124	131	139
ST loans	209	258	292	314	348	381
Other	54	51	76	75	76	77
Total Non-current Liabilities	80	69	115	106	103	92
Long-term debt	51	41	57	49	47	35
Other	21	28	59	57	57	57
Total shareholders' equity	470	509	576	580	583	585
Minority interests	33	33	19	4	4	4
Total liab. & equity	981	1,044	1,195	1,203	1,246	1,278
Net Debt	247	299	384	403	434	458
Net Working Capital	344	380	405	450	475	503
Capital Employed	631	677	751	789	822	847
Total Debt	259	299	348	363	395	417

REVENUE FORECASTS



NET DEBT AND FCF



Investment case

We initiate coverage of Sopharma Group, a Bulgarian holding with investments in pharma wholesale and manufacturing, with a SELL recommendation and a 12M price target (PT) of BGN 3.00/share (c.5% downside). The company is a leading wholesaler in Bulgaria, but inordinately inefficient working capital management, compared to its peers, has resulted in high gearing (3.7x at end-1Q20) and returns on capital employed (ROCE) consistently below the company's cost of capital. Management also deploys capital well outside the core business (e.g., Doverie Holding); together, these factors constrain Sopharma's ability to grow at its full potential, we believe. Also, while there are synergies between the core Bulgarian manufacturing and wholesale units, we are unable to say that this is true across all businesses (e.g., in Belarus and Ukraine). We could change our view if Sopharma tames its working capital, cuts leverage, streamlines the business and improves the reporting of operational data. At this juncture, however, we lack confidence that this process will start in the next 12 months.

Sopharma Group is best described as a holding structure, with businesses located in Bulgaria, Serbia, the Baltics and Belarus. It is built around its two main Bulgarian units: Sopharma AD (production) and Sopharma Trading (the wholesale unit that was partly spun off in 2006). It has achieved a relatively high level of vertical integration in its home market, but it is our impression that the businesses abroad operate autonomously. It reports revenues in two main groups: 1) sales of goods (e.g., wholesale and retail pharmacies); 2) and sales of finished products (e.g., pharma and related items produced within the group). The company also invests opportunistically, with minority investments in non-pharma related businesses, the most significant being BSE-listed Doverie Holding (5DOV BU). The complicated structure is a M&A legacy issue and, while there is a level of disclosure for the core domestic businesses, the reporting of most local subsidiaries and businesses abroad – which we figure accounts for c.30% of gross turnover and a similar amount of PP&E – is opaque to us.

Sopharma's largest shareholders are the company's long-time CEO, Ognian Donev, and Ventsislav Stoev, a local lawyer, through their respective investment vehicles. At end-1Q20, CEO Donev owned a 25.4% stake and Mr. Stoev 20.68% via his company, Telecomplect Invest. The two key owners are active investors in Bulgaria, including a business (SCS Franchise) operating three pharmacy chains, reportedly totalling over 150 units (this March, Sopharma applied for anti-trust approval to acquire SCS Franchise). The next largest shareholder is Rompharm, a privately held drug producer based outside Bucharest, which holds 6.76% currently. In 2013-14, Rompharm had built up a stake of over 18%; but, by the end of 2017, it had sold c.60% of the position; its current stake has remained more or less unchanged since. The company holds c.6.8% of its own shares in Treasury. The single largest institutional holder is the Alianz Bulgaria pension fund, with c.5%. Retail investors own 7.3%.

Earnings outlook: we forecast 2020E net profit of BGN 50.1m (-42% yoy) on revenues of BGN 1,374m (+7% yoy) and EBITDA of BGN 101.3m (-2% yoy). Due to COVID-19, we expect better growth on the (low margin) wholesale side of the business, but relatively weaker demand for Sopharma's own products. In the mid-term, we expect a 2019-23E revenues CAGR of 6.0% and a 2019-23E EBITDA CAGR of 4.0%. In our modelling, the main factors contributing to the modest margin erosion over the next few years are the cost of goods sold and employee benefits.

Our estimates reflect flat gross margins in the trade business over the coming years, where we are generally cautious on the overall outlook, for several reasons. Firstly, on an industry-wide basis, the growth of pharma markets in value terms is driven by three therapeutic areas – oncology, autoimmune diseases and diabetes – which are dominated by expensive biologicals. This should certainly be reflected in Sopharma's revenues growth, but not necessarily in margins; we note that the regulated allowed mark-up for wholesalers in the core Bulgarian market for the highest-priced drugs is capped (at BGN 30 currently). Secondly, as management notes, competition on the wholesale level is fierce, and we see no reason for this to change in the mid-term. Thirdly, Sopharma's push into retail pharmacies is a logical move to enhance margins along the whole value chain, but would require it to spend more on capex, and opex in the mid-term, we believe.

Inefficient working capital management. Sopharma's businesses seem to consume, compared to its sector peers, an inordinate level of working capital as the business grows, which the company finances both through short-term working capital loans and a factoring agreement with one local financial institution. Part of the reason for this is the company's commercial policy of extending payment terms for public hospitals – on which it does charge interest – so a comparably high level of trade receivables. Sopharma's ability and willingness to help finance drug supplies to public-sector hospitals make it a more attractive partner, which can be seen in the company's above-average market share in the hospital segment (29.5% last year vs. 21.3% for the Bulgarian market as a whole). Another is a low level of trade payables compared to its sector peers (Sopharma prepays to lock in some suppliers of goods; in the case of oncology drugs for the hospital sector, the manufacturers require pre-payment for supplies). Sopharma's comparably high working capital would be less of an issue, in our view, if the company were generating a superior return on the cash invested; however, compared to its sector peers, this does not generally seem to be the case.

In our view, the company's apparently inefficient working capital management is an issue for the business as a whole, tying up cash, while generating a below-average return and forcing the business to run at a level of gearing – 3.7x last year and around 4.0x for the next several years, on our estimates – that investors may not be comfortable with. More importantly, the stress on the balance sheet could limit the company's growth potential, crowding out potentially value-accretive investments or M&A.

Reporting of operational data and KPIs could be better, in our view. In comparison with many other companies in the region, we believe that Sopharma could provide more insight into the structure of revenues, either by region or by key products, as well as regular (i.e., quarterly), detailed segmental reporting. A close reading of reports for stand-alone business (not all in English) provides more insight but, overall, the reporting is not sufficiently granular for us to understand where and how the different units generate revenues, nor their profitability.

Valuations: on our 2020E estimates, the business trades at an EV/EBITDA of 8.2x (a c.4% premium vs. its peers) and a PER of 7.9x (a c.33% discount). On our 2021-22E earnings, the stock trades at an average c.8x EV/EBITDA, or a c.10% premium, and a c.11% discount on PER (c.9.6x vs. the median 10.8x for our peer group).

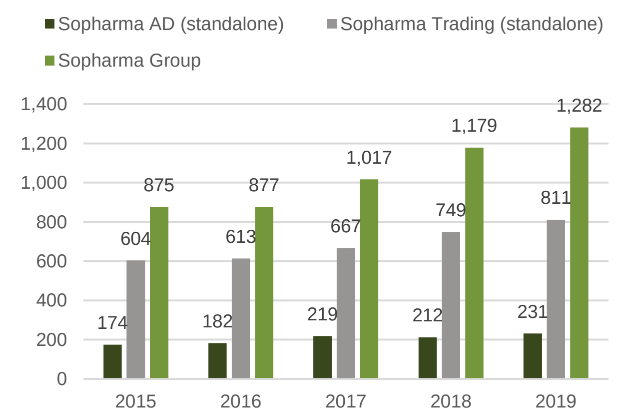
Potential NDA filing of Tabex (cytisinicline) in the US. Tabex is Sopharma's third-bestselling drug in its pharmaceuticals portfolio, a traditional plant-based smoking cessation drug based on the alkaloid cytisinicline. Cytisinicline is structurally similar to nicotine and has appeared to be effective in reducing the severity of nicotine withdrawal symptoms. Tabex is available already as an OTC drug in the majority of Sopharma's markets, but it has also been working on a patentable form of the drug, for the US market in particular. In principle, this could be a game-changing development for the company – there are only approved two smoking cessation drugs in the US currently: the largest, Pfizer's Chantix, generated global sales of USD 1.1bn last year, of which USD 899m, or 82%, in the US (the other is bupropion, an atypical antidepressant available as a generic).

Sopharma and its US partner began work towards filing a new drug application (NDA) for Tabex around 2010. Its partner – Achieve Life Sciences (ACHV US) – still aims to move the drug into PIII trials. We also note, however, that Achieve had cash on its balance sheet of just USD 12.1m and a market cap of just c.USD 16m at end-1Q20. Inasmuch as large-scale clinical trials cost in the neighbourhood of USD 40-50m, it seems unlikely, in our view, that a trial will be starting soon. We are not aware if Achieve has imminent plans to raise new capital, but it is the likely next step to moving the project forward, in our view. In our experience, running a PIII trial can take two-to-three years, plus another year to file the NDA. Accordingly, it is unlikely to expect results on the drug before 2024E.

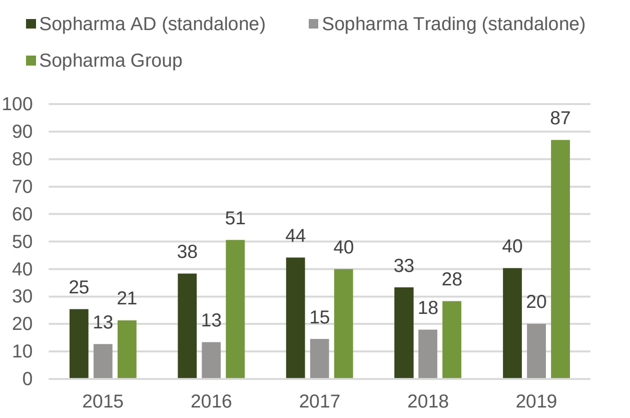
Company description

Sopharma Group is best described as a holding structure, with businesses located in Bulgaria, Serbia, the Baltics and Belarus. It is built around its two main Bulgarian units: Sopharma AD (production) and Sopharma Trading (the wholesale unit that was partly spun off in 2006). It has achieved a relatively high level of vertical integration in its home market, but it is our impression that the businesses abroad operate autonomously. It reports revenues in two main groups: 1) sales of goods (e.g., wholesale and retail pharmacies); 2) and sales of finished products (e.g., pharma and related items produced within the group). It also generates limited revenues from services to third parties, and rental income. The company also invests opportunistically, with minority investments in non-pharma related businesses, the most significant being BSE-listed Doverie Holding (5DOV BU).

Revenues (BGN m)



Net profit (BGN m)



Source: Company data, WOOD Research

Wholesale business

Wholesale and retail pharmacies are, by nature, high turnover/low margin businesses, so they dominate the structure of the revenues: last year, c.77% of the total consolidated revenues, but c.35% of the gross profit. The three main revenue generating units are: 1) Sopharma Trading, in Bulgaria; 2) Sopharma Trading, in Serbia (formerly Lekovit); and 3) businesses in the Baltics and Belarus, controlled via its 68% stake in SIA Briz. The first two are controlled via Sopharma's 74.2% stake in the listed Sopharma Trading business (S05 BU) and the latter is owned by the parent company. The Bulgarian retail pharmacy business (61 stores) is consolidated under Sopharma Trading and the pharmacies in Belarus (over 200 stores) are owned through SIA Briz. Last year, we estimate that the Bulgarian operations accounted for c.78% of the segment's consolidated turnover, followed by Serbia, with 14%, and the remaining 8% in the Baltics and Belarus.

Sopharma provides detailed operational data only for the Bulgarian business. We can get a feeling of the revenues in Serbia through the consolidated Sopharma Trading financials (only in Bulgarian), with a country split on an annual basis, but no commentary on the business trends. There is practically no operating information on the Baltics and Belarus operations. Despite their apparent strategic importance, especially in Bulgaria, the company does not disclose any information on the pharmacies as a stand-alone segment, so we do not know any operational KPIs.

Bulgarian wholesale

Sopharma's Bulgarian business was the second-largest wholesaler by turnover last year, with a market share of c.21.3% (it was overtaken by German-based drug wholesale major Phoenix, with a market share of 22.1%). Like almost all European countries, the market is highly consolidated and competitive; Bulgaria is dominated by four main players, each with around one-fifth of the market (smaller players account for the remainder). Wholesaler mark-ups are regulated and businesses compete on scale and the breadth of their product portfolio, value-added services and, particularly over the past couple of decades, by moving into retail pharmacies (either directly, or by creating virtual networks, i.e., one-stop supply and business support agreements with independent pharmacy owners). In Bulgaria, for example, Sopharma owns retail pharmacies directly, while Phoenix has a virtual network through its partnership network, operating locally under the trade name Betty.

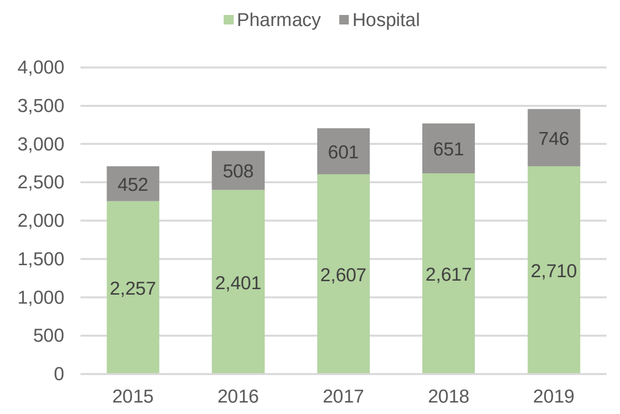
As in all the countries in the region, both the wholesale and retail margins in Bulgaria are regulated. In the case of wholesalers, the maximum allowed mark-up is a percentage of the price, starting at up to 7% for goods up to BGN 10 and falling to up to 4% for goods over BGN 30 (with the mark-up capped at

BGN 10). On the retail side, the mark-up on drugs up to BGN 10 is up to 20%, falling to up to 16% on goods over BGN 30 (capped at BGN 25). These is an exception, however, on drugs that are 100% reimbursed by health insurance (e.g., for the long-term treatment of chronic diseases), where the mark-up is capped at BGN 2 per prescription. Price regulation is applicable to all medicines, regardless of whether they are prescription or over-the-counter (OTC) products, and subject to reimbursement or not.

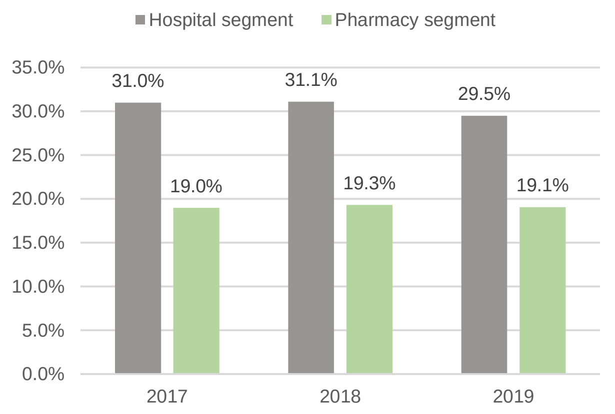
Additionally, wholesalers are also allowed to offer a range of value-added services, e.g., drug registration, marketing support or pre-wholesaling (logistical services for manufacturers, consisting mainly of the warehousing and transportation of pharmaceutical products from the manufacturer to wholesalers, hospitals and, in some instances, pharmacies). Sopharma offers marketing and pre-distribution, as well as logistics services for companies performing clinical trials.

Compared to its peers, Sopharma's business has a strong niche in the hospital market, which has been a fast-growing segment of the market over the past five years (a 2015-19 CAGR of 13.4% vs. 4.7% for sales to pharmacies). According to IQVIA data (an American multinational company serving the combined industries of health information technology and clinical research), the Bulgarian hospital market accounted for 22% of total turnover drug market last year and Sopharma's share of the hospital market was 29.5%, vs. a 19.1% share in the pharmacies segment. According to the company, this was driven by the less-than-reliable financing for state-owned hospitals – starting with late payments from the state monopoly, the National Health Insurance Fund (NHIF) – and Sopharma's ability and willingness to finance overdue receivables from the sector.

Bulgarian pharmaceuticals market (BGN m)

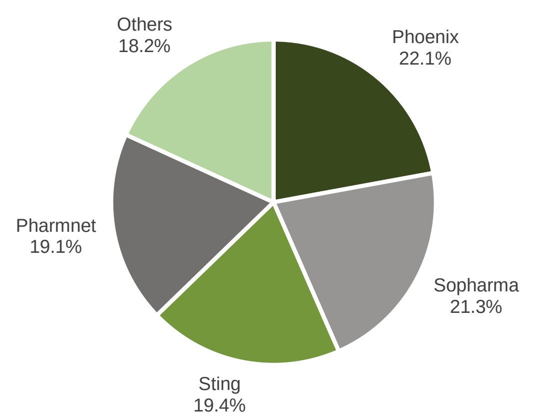


Sopharma Trading – BG market share by segment

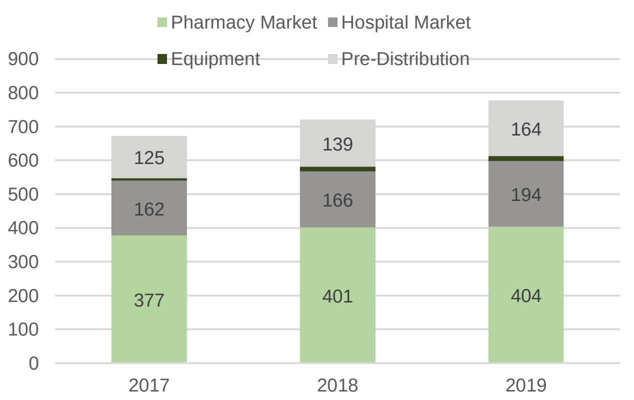


Source: Company data, WOOD Research

BG wholesalers by market share (2019)



Sopharma Trading – revenues by segment (BGN m)



Source: Company data, WOOD Research

Serbian wholesale

Serbia is almost identical to Bulgaria in terms of population – each with c.7m inhabitants – but the Serbian pharma market is c.60% of the size of its eastern neighbour. Sopharma entered the market in 2015, distributing its exclusive brands, and it acquired a 70% stake in privately-held Lekovit (later renamed Sopharma Trading d.o.o.) for BGN 24.4m in 2017; it bought the remaining 30% from the company's founder in January 2019. According to reports at the time of the initial deal, Lekovit's total market share was 7% (but 20% of the small pharmacies segment) and management's three-to-five year target was to grow this to around one-quarter, to become the #2 wholesaler. It envisioned focusing first on the wholesale business – including launching sales to hospitals – and then expanding on the retail market.

Similarly to Bulgaria, the Serbian market is largely consolidated. The market leader, Phoenix, has a market share of 36% (according to the company's website) and the top-three full-line wholesalers cover around 70% of the total market (according to IQVIA data). As in Bulgaria, the state hospitals rely on wholesalers for financing, as do the state-owned pharmacies (the latter accounting for c.25% of retail pharmacy sales, according to IQVIA data).

The regulated wholesale mark-ups are somewhat more attractive, we believe. The wholesale margin is 6% (of the wholesale price, reimbursement price or tender price, whichever is higher), the retail margin on reimbursed drugs is 12% and the margin on non-reimbursed prescription drugs starts at 25%, falling to 12% (capped at EUR 8.12 per prescription).

Retail pharmacies

Sopharma formally entered the retail pharmacy business in Bulgaria in 2015, currently with 61 locations, and the company announced in March 2020 that it would seek antitrust approval to acquire the pharmacies of SCS Franchise for an undisclosed consideration. SCS started in 2007 and operates three pharmacy chains, reportedly totalling over 150 units. Its owners are Sopharma's CEO, Ognian Donev, and Ventsislav Stoev, who are also Sopharma's two largest controlling shareholders. By extending its business into retail, Sopharma is moving in the same direction as its larger peers – the top-three European distributors, Phoenix, McKesson and Walgreens Boost Alliance, together manage chains totalling c.23,800 pharmacies – and should help counterbalance the low profitability of pure wholesale.

The SOpharmacy concept itself appears to have been well-executed, including an e-shop and a wide range of own-branded products. By the current number of stores, it ranks in the top-five pharmacy chains, the largest being Apteka Mareshki, with 301 stores, and SCS Franchise (the total number of pharmacies in the country is c.4,200). The SCS Franchise deal, if approved by local antitrust regulators, would go some way to consolidating what is otherwise a still fragmented market. Also, we do not rule out that Sopharma may seek to consolidate the market further. We note that the market is still dominated by local players; to-date, none of the big European or regional players (e.g., Phoenix, Walgreens Boots Alliance, Dr. Max) has entered the market with their own stores, although we note that, since 2014, Phoenix has been present indirectly, with its pharmacy partnership under the name Betty (the platform provides independent pharmacies with services such as white label goods, promotional materials and a loyalty programme).

We are not aware if Sopharma is currently developing a retail strategy for the Serbian market, although this is its stated aim and would be a logical extension of the business. The Serbian pharmacy market appears to be more institutionalised; Phoenix acquired a large local chain there in 2017 and now operates c.370 units, including its Benu brand; while Dr. Max (a Czech-owned pharmacy chain) operates another c.130. The largest locally-owned chain, Lilly, with 183 stores, could be a potential target for Sopharma, in our view, although the company's balance sheet could be an issue (see below).

Through its investment in SIA Briz, the company entered the retail pharmacy business in Belarus in the first half of the 2010s. According to the company, it owns over 200 stores in the country currently.

Manufacturing business

Sopharma owns a number of manufacturing companies, producing both OTC and prescription drugs, as well as other healthcare products. Last year, the business generated gross revenues (i.e., before eliminations through consolidation with the wholesale business) of BGN 387.6m on a consolidated basis. The stand-alone sales of own goods from the parent company was BGN 228.9m last year, or c.60% of the consolidated total, a proportion that has been basically unchanged for the past three years. Last year, the business accounted for 23% of group turnover and c.62% of the gross profit. At the end of last year, in the Bulgarian market, the company ranked seventh in terms of overall pharmaceuticals sales and second in the OTC segment.

Sopharma's core manufacturing business is its Bulgarian parent company, where the product portfolio is dominated by its 15 traditional OTC drugs, of which 12 are phytopharmaceuticals, i.e., plant-based. The company does not provide a breakdown of sales by product – and only a broad breakdown by region, which we use for forecasting purposes – but, according to its management report, the most important drugs in terms of their contribution to revenues are:

- ✓ **Carsil:** contains silymarin, derived from milk thistle, for the treatment of liver disease.
- ✓ **Tempalgin:** metamizole, a traditional pain relief drug.
- ✓ **Tabex:** cytisine, an alkaloid derived from the *Citisus laborinum* plant for smoking cessation.

- ✓ **Tribestan:** *Tribulus terrestris*, a dietary supplement marketed for its ability to increase testosterone levels.
- ✓ **Broncholitin:** a herbal cough suppressant syrup.
- ✓ **Analgin:** metamizole, a generic pain relief drug.
- ✓ **Nivalin:** galantamine, an alkaloid derived from *Galanthus nivalis* for ailments of the peripheral nervous system.
- ✓ **Methylprednisolone:** a prescription corticosteroid drug used to suppress the body's immune system and reduce inflammation.
- ✓ **Vitamin C.**
- ✓ **Valerianae:** a herbal sleep aid derived from *Valeriana officinalis*.

According to the company, Analgin is its top-selling drug in the domestic market, while Tabex, Carsil and Tempalgin are major contributors to its export revenues. Comparing Sopharma's most important drugs last year to the list presented in the 2015 management report, we note that, for the first eight, neither the names nor their order on the list has changed.

In addition to the parent company, Sopharma has several subsidiaries, which together generate the other c.40% of turnover. Other production units include:

- ✓ **Biopharm Engineering (Bulgaria):** infusion solutions and other products for human and veterinary use.
- ✓ **Vitamini (Ukraine):** vitamins and other OTC products.
- ✓ **Phyto Palauzovo (Bulgaria):** the production and trade of herbs and medicinal plants.
- ✓ **Veta Pharma (Bulgaria):** disinfectants, tinctures, cosmetics, food additives.
- ✓ **Momina Krepos (Bulgaria):** syringes and other medical and non-medical plastic products.
- ✓ **Aromania (Bulgaria):** a Sofia-based start-up active in the development and marketing of nutrition supplements.

Sopharma only discloses the turnover data for the subsidiary companies, with material non-controlling interests that, with one exception, are all on the wholesale side of the business. On the production side, we are able to see that the 2019 revenues at Momina Krepos stood at BGN 2.18m. The latest sales we could find for Vitamini were for 2018, at UAH 296.2m (c.BGN 21.3m).

Non-pharma investments (e.g., Doverie Holding)

In addition to the pharma-related businesses above, Sopharma is invested in businesses that operate outside of the sector, with the most significant being Doverie Holding (5DOV BU). Doverie is a BSE-listed holding invested in a broad range of businesses, including insurance, healthcare, DIY stores and industrials. In late-2016, Sopharma announced that it had acquired a c.30.22% stake – a decision that may have been driven by Doverie's exposure to health insurance and hospitals, in our view – for BGN 2.4m and made a friendly offer for the remaining 69.78% in February 2017, but this was subsequently withdrawn later in the year. Since 2017, Sopharma's CEO Donev has served as a member of Doverie's supervisory board, and Telecomplect Invest (Sopharma's second-largest shareholder) owns c.9% of the company.

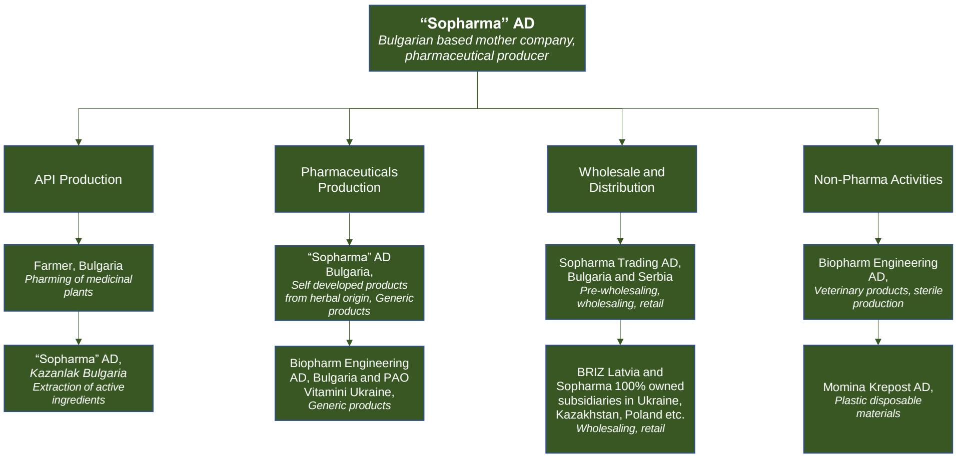
For Sopharma's shareholders, the Doverie investment became topical again late last year, when the company acquired a 63.89% stake in Moldovan Moldindconbank in a public tender by the National Bank of Moldova (NBM) for a reported BGN 76.3m (a P/B of c.0.5x). Several years back, the bank was caught up in the "Russian Laundromat" scandal and was subsequently taken over by the NBM, restructured and recapitalised. Following a mandatory tender offer to the minorities, Doverie subsequently increased its stake in the bank to 77.62% for an additional BGN 15.8m.

It is Sopharma that lent Doverie the money to pay for the bank: BGN 68m at first, but later increased to BGN 81.9m. The loan is due at the end of 2025 and carries an interest rate of 3%. It also reduced its stake in Doverie to below 25% to avoid any issues with the Moldovan central bank (by doing so, it could no longer be considered a controlling shareholder). Doverie's bargain purchase of the bank also triggered significant non-cash gains both for itself and Sopharma; in 4Q19, Sopharma booked a gain of BGN 44.5m from its stake in the company – this represented c.50% of its total pre-tax earnings for FY19.

In 2Q20, Doverie Invest AD (100% owned by Doverie Obedinen Holding AD) repaid BGN 22m of the loan, funded by a new loan from Unicredit Bulbank. The entire amount of the credit line granted to Doverie Obedinen Holding AD is BGN 30m, and another BGN 8m was repaid directly by Doverie Obedinen Holding AD to Sopharma. According to our understanding, Doverie will repay another

BGN 10m this year, with the rest to be returned over time, funded by Moldindconbank dividends. We note that the NBM suspended bank dividends this year due to COVID-19, but it is expected to lift the restriction starting in 2021E. Going forward, in view of potential issues with the NMB, we do not expect Sopharma to increase its stake in Doverie further. Rather, we expect to either to sell down, on an opportunistic basis, or to allow itself to be diluted in the event that Doverie raises new capital to fund the banking business.

Simplified corporate structure



Source: Company data, WOOD Research

Financial forecasts

For 2020E, we forecast net profit of BGN 50.1m (-42% yoy) on revenues of BGN 1,374m (+7% yoy) and EBITDA of BGN 101.3m (-2% yoy). Compared to last year, we expect better growth dynamics on the wholesale side of the business – much of it COVID-19-led demand for drugs and medical equipment – but relatively weaker demand for Sopharma's own products. Unlike some other regional drugs producers, the company did not see a particularly strong 1Q20 uptick in finished product sales – its portfolio contains few of the modern prescription drugs for chronic diseases that patients stockpiled ahead of the regional lockdown – and it may be more exposed to the overall weaker demand environment.

The relative weakness of product sales versus wholesale should lead to a lower EBITDA margin for the year, we expect an EBITDA margin of 7.4% vs. last year's 8.1%, but profitability will also be tempered by the sharp depreciation of eastern European currencies (c.21% in the case of the Belarus ruble (BYN) and c.15% for both the UAH and KZT; these only partly recovered in 2Q20), and modest margin compression in gross margins for the wholesale business (11.4% vs. last year's 11.54%).

In the mid-term, we are looking for a 2019-23E revenues CAGR of 6.0% vs. the 2015-19 CAGR of 10%, of which about one-quarter, we estimate, was driven by acquisitions. We expect a 2019-23E EBITDA CAGR of 4.0% (vs. the 2015-19 growth of 10.4%, excluding the impact of IFRS-16). In our modelling, the main factors contributing to the modest margin erosion over the next few years are the cost of goods sold and employee benefits. Specifically, we assume that COGS remains flat, at 11.4%, i.e., at the average level for 2016-19, and for employee benefits to grow by 6.4% (vs. the 6.9% CAGR for 2015-19).

While we pencil in flat gross margins in the trade business over the coming years, we are generally cautious on the overall outlook, for several reasons. Firstly, on an industry-wide basis, the growth of pharma markets in value terms is driven increasingly by three therapeutic areas – oncology, autoimmune diseases and diabetes – which are dominated by expensive biologicals. Double-digit growth in these indications more than offsets the price compression for higher-volume drugs for chronic diseases. This should certainly be reflected in Sopharma's revenues growth, but not necessarily in margins; we note that the regulated allowed mark-up for wholesalers in the core Bulgarian market for the highest-priced drugs is capped (at BGN 30 currently).

Secondly, as management notes, competition on the wholesale level is fierce, and we see no reason for this to change in the mid-term. Thirdly, Sopharma's push into retail pharmacies is a logical move to enhance margins along the whole value chain, but will require additional opex in the mid-term, we believe. For example, acquiring SCS Franchising's retail pharmacies would add store numbers; however, to achieve the maximum benefits of scale, we should we would first expect the company to undertake a re-branding exercise, supported by marketing campaigns. We also note that, as both SCS and Sopharma Trading already share a common owner, it would be logical to assume that Sopharma Trading has already been benefiting from SCS's volumes; acquiring chains that trade primarily with competing wholesalers would have a greater impact, in our view.

Modelling assumptions

Our revenues forecast for 2020E, at BGN 1,374m (+7.2% yoy), assumes revenues from sales of goods of 8.6%, at BGN 1,078m, and 2.6% growth of finished goods sales, at BGN 296m. We believe that the group's 1Q20 numbers – sale of goods +18.7% yoy and finished good sales +9.6% – were affected materially by pre-lockdown buying at the retail level, which brought forward demand, and which is likely to largely correct as we move through the rest of the year. We can see this already on the wholesale side in the stand-alone 5M sales figures for the Bulgarian business, where growth decelerated to 11% vs. 19% in 1Q20. implying flat sales in April and May, at best.

We note that, in line with the company's guidance, the demand for products from the stand-alone portfolio was not affected particularly by COVID-19; the stand-alone company does not make drugs for chronic diseases (e.g., hypertension, depression), which patients stockpiled, nor does it contain any antivirals that may have benefited from panic buying. Product revenues for the stand-alone business fell 3.8% in 1Q20 (the 5M sales recovered to +2% yoy). Revenues at the subsidiaries outperformed in 1Q20 but, lacking any real insight into the product portfolio or the sale drivers last quarter, we can only assume that the sales throughout the rest of the year are likely to suffer from demand destruction. Based on what we have observed at other regional drug producers, we assume a sharp deceleration in 2Q20E, followed by below-trend sales growth for the rest of the year.

In the mid-term, we assume a 2019-23E CAGR for the wholesale business of 6.3%, of which we assume a 6.4% CAGR from the Bulgarian business and 6.2% growth for the rest of Europe (e.g., SIA Briz and the business in Serbia). Serbia, we assume, should benefit from heavy ongoing investments; after the small 3.2% contraction in 2019, we assume a 2019-23E CAGR of 7.7%. Revenues growth at SIA Briz is more difficult to estimate. We believe that the business generated an average c.10.5% revenues growth for the 2015-19 period, although we note that this includes several acquisitions in 2017-19, the impact of which is unclear. Through to 2023E, we assume revenues growth of this part of the business at c.5% annually.

Revenues by segment

BGN m	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E	2015-19 CAGR	2019-23E CAGR
Bulgaria	86	97	95	95	101	102	105	108	111	4.1%	2.3%
Europe	141	113	129	133	166	170	182	195	209	4.1%	6.0%
Other	20	22	26	23	22	24	26	27	29	2.3%	7.4%
Finished products	**247**	**232**	**250**	**251**	**289**	**296**	**313**	**330**	**349**	**4.0%**	**4.9%**
Bulgaria	531	541	593	657	715	772	820	872	916	7.7%	6.4%
SIA Briz	97	104	116	132	144	147	156	165	173	10.5%	4.7%
Serbia	0	0	54	139	135	160	165	174	181	n.m.	7.7%
Goods	**628**	**645**	**768**	**928**	**993**	**1,078**	**1,140**	**1,211**	**1,270**	**12.1%**	**6.3%**
Total	**875**	**877**	**1,017**	**1,179**	**1,282**	**1,374**	**1,453**	**1,542**	**1,619**	**10.0%**	**6.0%**

Source: Company data, WOOD Research

Operating costs. By far, Sopharma's biggest cost – c.71-72% of its total opex – is the cost of goods sold in the wholesale and retail business. The implied average gross margin for this segment has been running at 11.1-11.5% over the past four years, or an average of 11.4%, and we assume the same 11.4% margin through to 2023E. As we note above, we are we are generally cautious on the overall outlook for profitability in this part of the business, and a flat gross margin is, in our view, a good compromise between a growing share of retail pharmacy sales and the competitive margin pressure on the wholesale side.

Sopharma's second-largest cost line item is employee benefits, which have averaged at c.10% of the group's revenues over the past five years; here, we assume some slight margin pressure going forward. The 1Q20 numbers imply c.6.6% growth in average wages and we assume 6% for FY20E. For the next three years, through to 2023E, we assume an average c.5% growth, which works out to a 2019-23 CAGR of 6.4% (together with a c.1% annual increase in headcount), vs. 6.0% growth on the top line.

Offsetting this, we expect to see continued solid containment of materials and third-party costs (together, these have been running at 14-15% of total revenues over the past five years). Active pharmaceuticals ingredients (APIs) (including plant-based inputs) and packaging materials represent the largest part of materials costs, and we are not seeing any cost pressures on this side. Similarly, Sopharma has been good at managing its third-party costs, of which 20-30% is marketing costs. Going forward, we expect this line to grow by c.5.6% annually over the next four years, but we note that this includes no assumptions about the potential acquisition of the SCS Franchising retail pharmacies, nor the potential re-branding and additional marketing costs that this business by its nature, we believe, would require.

The other operating cost line is mostly: 1) travel and entertainment; and 2) asset impairments and provisions. Net of impairments and provisions, costs here have mostly grown in line with revenues (0.82%, on average) and we assume the same going forward. Impairments and provisions have (again, on average) added another c.BGN 4m annually, which we assume remains unchanged.

Financial costs/income. In the past two years, Sopharma's gearing has grown to 3.7x (versus covenants for the large majority of loans at 4.0x), driven primarily, we believe, by the financing needs of the wholesale and retail pharmacy business. The group funds itself and its associated business with a mix of (mostly) short-term working capital loans, through the factoring of receivables and leasing. Working capital loans represent the bulk of the company's gross financing liabilities, and stood at c.BGN 315m (up yoy by c.BGN 52m) at end-2019, c.76% of the total. Sopharma also appears to have used its short-term loans and credit lines to partially fund a long-term loan of BGN 81.9m to Doverie, due at the end of 2025. In contrast, investment purpose loans totalled just c.BGN 30m. Similarly, in the past two years, interest and bank fees on working capital loans have grown to c.85% of the total bank interest, c.BGN 9m last year, and we expect this to rise to c.90% by 2023E.

A large part of the problem, we understand, is in the state financing of Bulgarian hospitals and Sopharma's outsized exposure to the hospital market. Simply put, public funding for the sector is insufficient, so hospitals turn to distributors like Sopharma to act as their creditors. In return, it is able to charge hospitals interest on this portion of receivables, specifically on the average BGN 70m the company carries on the balance sheet as "past due but not impaired". We note that Sopharma Trading's exposure to the hospital drug market is generally rising, but not dramatically so. Last year, its share of the hospital market was 26% vs. 22.4% for the market as a whole, or 440bps higher. We note that the company also wants to grow its market share in Serbia by addressing the hospital market there in the same fashion. With few concrete signals that state financing should improve in the region – on the contrary, we expect COVID-19 to strain budgets further – for now, we assume the *status quo*.

Last year, the company booked net financial expenses of just BGN 1.44m – of which c.BGN 12.4m was financial costs and c.BGN 11m financial gains – but this was affected heavily by one-off gains (including a c.BGN 4m gain on securities trading), which are not likely to be repeated. For 2020E, we estimate a net financial loss of BGN 12.4m, driven by: 1) an increase in interest expenses on loans and leasing of BGN 2.53m; 2) unchanged interest income from past due trade receivables and loans granted; 3) a c.BGN 5m decline in other financial gains (of which BGN 4m was securities trading); and 4) a c.BGN 3.1m negative revaluation of FX loans (BGN 4.4m in 1Q20, driven by the depreciation of the Belarus ruble (BYN), but which should partly reverse in 2Q20E).

For the 2021-23E period, we expect net financial expenses to run at around BGN 10m, with growth in interest-type expenses to finance working capital, mostly offset by higher interest gains of overdue receivables with the hospitals, and for this to start to decline gradually afterwards, as the company will have finished the current capex cycle in Serbia.

Financial revenue and expenses

BGN m	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Interest type income	6.6	6.5	5.2	3.8	5.7	5.7	5.9	6.3	6.6
Interest type expenses	-9.3	-11.0	-8.5	-8.4	-12.4	-14.9	-15.7	-16.5	-16.4
Revaluation of FX loans	-4.6	-1.1	-2.9	-0.6	0.0	-3.1	0.0	0.0	0.0
Other Income	0.3	0.5	3.1	0.3	5.3	0.3	0.3	0.3	0.3
Other expenses	-7.7	-0.7	-0.2	-0.7	0.0	-0.4	-0.4	-0.4	-0.4
Net financial expense	**-14.8**	**-5.7**	**-3.3**	**-5.7**	**-1.4**	**-12.4**	**-9.8**	**-10.3**	**-10.0**

Source: WOOD Research; note: from 2019, interest-type expenses include the interest on leases per IFRS 16

Sopharma's gearing could improve more quickly when Doverie starts repaying its loans from the company. We understand that it intends to repay from dividends from the bank. We are not confident, however, in assuming either: 1) when the Moldovan central bank will allow the banks to restart dividend payouts; or 2) what those levels might be. For the purpose of our modelling, we simply assume that Doverie repays the loan in full at term, i.e., at the end of 2025E.

Corporate income tax. The nominal tax rate in Bulgaria is 10%, which is materially lower than in the other countries in which the company operates (the nominal CIT rate in Serbia is 15%; in Ukraine and Belarus, it is 18%). Over the past few years, the effective nominal tax rate has averaged at 13% of taxable income and this is the rate we assume in our model for 2020E through to the end of our forecast horizon.

Dividends. Sopharma says that it generally tries to pay out 30-40% of its stand-alone earnings – under Bulgarian law, only the stand-alone business distributes dividends, not the group – which, over the past five years, has more or less been the case. In this time, the stand-alone earnings have equalled c.90% of the adjusted group level; therefore, for modelling purposes, we assume a c.35% payout of our forecast group earnings. This means a forecast DPS of BGN 0.14 from its 2020E earnings, a yield of 4.3%, dipping to BGN 0.11 and BGN 0.12 from its earnings in 2021E and 2022E, respectively, then rising gradually thereafter as we expect some gradual deleveraging.

Working capital. Sopharma's wholesale and, we assume, the retail pharmacy businesses seem to consume, compared to its sector peers, an inordinate level of working capital as the business grows, which the company finances both through short-term working capital loans and a factoring agreement with one local financial institution. Part of the reason for this is the company's commercial policy of extending payment terms for public hospitals – for which it does charge interest – so a comparably high level of trade receivables; another is a low level of trade payables compared to its sector peers. Sopharma's ability and willingness to help finance drug supplies to public-sector hospitals make it a more attractive partner, which can be seen in the company's above-average market share in the hospital segment. At the end of last year, Sopharma held net working capital (current assets less cash less trade payables) of BGN 405m, or net working capital (NWC) days of 112. For Sopharma trading, the pure-play Bulgarian and Serbia wholesale business, NWC days were 104. Compared to Phoenix Group – the most applicable peer in terms of its exposure to the Balkans region, we believe – NWC days have been running in the mid-20s. The largest US-based wholesalers are even more efficient, with single-digit NWC days. Even its less efficient peers manage with working capital levels at half or one-third of Sopharma's.

Pharma wholesalers: net working capital (NWC) days

	Ticker	2015	2016	2017	2018	2019
Sopharma Group	3JR BU	135	136	121	112	112
Sopharma Trading	5SO BU	105	113	113	104	104
Phoenix Group	2590Z GR	24	28	27	24	22
McKesson Corp	MCK US	13	11	6	4	3
Wallgreens Boots Alliance	WBA US	23	16	12	10	9
AmerisourceBergen	ABC US	-7	-9	-8	-7	-7
Cardinal Health	CAH US	10	7	10	8	4
Owens & Minor	OMI US	41	39	44	51	61
Dermafarm Holding	DMP GR	115	106	128	83	106
Oriola	OKDBV FH	-27	-17	-16	-28	-33
Sigma Healthcare	SIG AU	54	52	34	37	39
Selcuk Ecza	SELEC TI	62	57	52	50	34
Neuca	NEU PW	6	4	4	5	5
Median		**23**	**16**	**12**	**10**	**9**

Source: Companies data, Bloomberg, WOOD Research

Sopharma's cash conversion cycle (below) has improved somewhat over the past couple of years – to 105 days last year vs. c.118 days in 2015-17. This is thanks to the better management of trade receivables; specifically, we believe, its increasing use of factoring, which brought in c.BGN 216m of cash in 2019 vs. an average c.BGN 140m in 2016-18, as well as the improved management of inventories (specifically, it has been holding lower stocks of its own finished products). However, as we note above, there is also the issue of the falling level of trade payables, which is an unusually low level compared to sector peers, at 33 days last year (at Sopharma Trading, payable days in the low-30s, we note, has rather been the rule, not the exception). For peers like Phoenix or other "majors", like Wallgreens Boots Alliance or McKesson, trade payable days are more like 50-plus days; for listed local players like Selcuk Ecza (Turkey) or Neuca (Poland), the figure is around 100 days.

We note that, last year, according to management, trade payables were lower due to the higher sales of oncology (cancer) drugs, as the major suppliers of these products require prepayments for delivery. The company also prepaid in order to reserve supplies of other goods. Given Sopharma's prominent role as a supplier (and creditor) to the domestic hospital market, and the growth of the oncological drug segment – in the top-5 EU markets, by 10-13% annually, according to IQVIA, vs. 1-4% growth for the pharma market as a whole – we believe that the former issue with oncology drugs, at least, is unlikely to change soon. For this reason, in part, we assume in our forecasting that Sopharma's working capital days remain at last year's levels and that the businesses' working capital need grow in line with turnover.

Cash conversion cycle and NWC (BGN m)

Days	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Inventory days	68	71	78	73	65	65	65	65	65
Trade receivable days	86	90	84	73	73	73	73	73	73
Trade payable days	-36	-38	-49	-39	-33	-33	-33	-33	-33
Cash conversion cycle	**117**	**123**	**114**	**107**	**105**	**105**	**105**	**105**	**105**
Net working capital (BGN m)	**323**	**328**	**344**	**380**	**405**	**450**	**475**	**503**	**523**

Source: Company data, WOOD Research

Finally, we note that Sopharma's comparably high working capital would be less of an issue, in our view, if the company were generating a superior return on the cash invested; however, compared to its sector peers, this does not seem to be the case generally. Using net operating profit after tax (NOPAT), divided by average net working capital as a measure of "cash ROIC", this has averaged c.13% for the period 2016-19, including higher margin earnings from the production businesses; for Sopharma Trading, the figure is c.4.5%. For its sector peers, the levels vary, but the cash ROIC generated by the "majors" ranges from mid-single digits at Phoenix to a low-20s return at McKesson, and an average of c.130% at Wallgreens Boots Alliance. Regional peers Selcuk Ecza and Neuca generate c.30% and c.115%, respectively. We note that Germany's Dermapharm Holding – which has both wholesale and production – carries a level of net working cash similar to Sopharma's, but the return, in terms of NOPAT generated – around 50%, on average – is c.4x higher than the return generated by Sopharma at the group level.

Pharma wholesalers – NOPAT as % of average net working capital

	Ticker	2016	2017	2018	2019
Sopharma Group	3JR BU	13.5%	15.6%	10.0%	15.2%
Sopharma Trading	5SO BU	5.7%	5.1%	4.3%	4.8%
Phoenix Group	2590Z GR	16.0%	9.8%	6.3%	4.2%
McKesson Corp	MCK US	43.4%	122.1%	24.1%	19.3%
Wallgreens Boots Alliance	WBA US	84.3%	102.0%	140.1%	122.4%
AmerisourceBergen	ABC US	n.m.	n.m.	n.m.	n.m.
Cardinal Health	CAH US	61.1%	48.7%	15.4%	67.0%
Owens & Minor	OMI US	11.8%	8.7%	-27.3%	4.1%
Dermafarm Holding	DMP GR	64.4%	53.8%	50.3%	48.3%
Oriola	OKDBV FH	n.m.	n.m.	n.m.	n.m.
Sigma Healthcare	SIG AU	10.9%	14.4%	14.3%	10.7%
Selcuk Ecza	SELEC TI	20.0%	23.0%	26.9%	37.4%
Neuca	NEU PW	118%	124%	113%	116%
Median		**43.4%**	**48.7%**	**24.1%**	**37.4%**

Source: Bloomberg, Companies, WOOD Research; note: AmerisourceBergen and Oriola have negative working capital; for 2019, we adjust Phoenix's NOPAT for impairments of intangible assets

In our view, the company's apparently inefficient working capital management is an issue for the business as a whole, tying up cash, while generating a below-average return and forcing the business to run at a level of gearing – 3.7x last year and around 4.0x for the next several years, on our estimates – that investors may not be comfortable with. More importantly, the stress on the balance sheet could limit the company's growth potential, crowding out potentially value-accretive investments or M&A.

Capex and FCF. Over the past couple of years, we have seen capex accelerate sharply vs. the 2015-17 levels – to BGN 62m last year vs. an average run-rate of c.BGN 29m – mostly on the wholesale side of the business. We expect it to remain elevated for the next three years, as the company spends to expand its Serbian wholesale and Bulgarian pharmacies business. For the wholesale segment, we pencil in 2020-23E capex of c.BGN 29m, of which c.70% for Serbia, and the remainder in Bulgaria and the Baltics/Belarus (i.e., SIA Briz). For Serbia, the company is budgeting c.BGN 9.8m for this year, c.BGN 31m in 2021E and c.BGN 20m in 2022E (for 2023E-onwards, capex falls to maintenance levels).

On the production side, we assume the capex in Sopharma's stand-alone business at c.BGN 14m for 2020E-onwards, which is a maintenance level of expenditure, plus the completion of the Biopharm Engineering and Momina Krepost projects. In recent years, the company has had plans to expand its capacity with a new lyophilics plant and a cytisine production facility, but both seem to have been postponed indefinitely. The cytisine plant would be back on the table if Achieve is successful in launching Tabex on the US market, but this is not in our base case assumptions currently (below).

On this basis, we see that the FCF generation has fallen to plus/minus breakeven over the past two years, down from an average of BGN 39m in 2015-17. On our forecasts, the business should be around breakeven on the FCF line for the next two years, rising to c.BGN 11m in 2022E and returning to robust levels only from 2023E-onwards, generating a low teens FCF yield.

Capex and FCF

in BGN m	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Capex	-33.3	-26.4	-28.0	-40.8	-62.3	-42.0	-58.2	-47.6	-28.5	-29.2
FCF	34.0	37.2	44.9	-11.0	10.1	-2.8	5.7	11.4	52.0	47.7
FCF yield	9.9%	11.7%	9.4%	-2.3%	2.4%	-0.7%	1.4%	2.9%	13.0%	11.9%

Source: Company data, WOOD Research

Potential NDA filing of Tabex (cytisinicline) in the US

Tabex is Sopharma's third bestselling drug in its pharmaceuticals portfolio, a traditional plant-based smoking cessation drug based on the alkaloid cytisinicline. Cytisinicline is structurally similar to nicotine and has appeared to be effective in reducing the severity of nicotine withdrawal symptoms. Tabex is available already as an OTC drug in the majority of Sopharma's markets, but it has also been working on a patentable form of the drug, for the US market in particular. In principle, this could be a game-changing development for the company – there are only approved two smoking cessation drugs in the US currently: the largest, Pfizer's Chantix, generated global sales of USD 1.1bn last year, of which USD 899m, or 82%, in the US (the other is bupropion, an atypical antidepressant available as a generic).

In 2009 and 2010, Sopharma and its partner at the time – currently Achieve Life Sciences (ACHV US) – signed licencing and supply agreements, respectively, with the aim of launching Tabex on the markets not covered already by Sopharma – including most of Western Europe and the US. In May 2015, the two parties extended the terms of the licensing agreement until May 2029, as well as reducing the terms of the royalty payments to Sopharma from the mid-teens to the mid-single digits. In July 2019, the licensing agreement was extended further, until 2037, with Sopharma securing exclusivity for cytisinicline supplies. Additionally, Achieve has a licence agreement with the University of Bristol for exclusive rights to all intellectual property regarding all human medicinal uses of cytisinicline across all therapeutic categories.

Achieve still aims to move the drug into PIII trials, with the aim of filing a new drug application (NDA) with the FDA. We also note, however, that the company had cash on its balance sheet of USD 12.1m and a market cap of just c.USD 16m at end-1Q20. As large-scale clinical trials cost in the neighbourhood of USD 40-50m, it seems unlikely, in our view, that a trial will be starting soon. We are not aware that Achieve has imminent plans to raise new capital, but it is the likely next step to moving the project forward, in our view. In our experience, running a PIII trial can take two-to-three years, plus another year to file the NDA. Accordingly, it is unlikely to expect results on the drug before 2024E. Barring a decision by Sopharma to fund the trials itself, or for it or Achieve to find a new partner for the project, we would rather not attach any value to a US launch of Tabex at this time.

Valuation

DCF

We value Sopharma using a 10Y DCF model, with a multiples valuation as a sanity check. On this basis, we arrive at a DCF-based 12M PT of BGN 3.00/share, or downside of c.5% to the current level. The key assumptions in our DCF model include:

- ✓ A WACC of 9.7%, starting with a risk free rate of 5% for Bulgaria and an equity risk premium of 6.0%. We use 6.0% vs. our usual 5.5% for Balkan countries, to reflect Sopharma doing a material share of its business in riskier markets (Moody's rates Bulgaria at Baa2, but Serbia is Ba3, and Ukraine and Belarus are rated B3).
- ✓ We apply a levered beta of 1.86x, starting with an unlevered beta from the Damodaran sector beta database of 1.05x for emerging market drug producers and 0.80x for emerging market healthcare support services. We use a 60/40 weighting for the drug producer and healthcare support services betas, in line with Sopharma's reported gross margin mix.
- ✓ We calculate the terminal value as the average of: 1) the perpetuity with a 1% terminal growth rate; and 2) an exit EV/EBITDA of 7.0x.

DCF valuation

BGN m	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
EBIT	56.0	58.1	63.8	72.1	79.0	85.7	93.5	101.7	110.4	119.6
NOPLAT	48.7	50.5	55.5	62.7	68.7	74.6	81.3	88.5	96.1	104.1
Depreciation	45.2	49.0	50.3	49.0	46.9	44.5	41.9	39.1	36.0	32.7
Change in NWC	-45.0	-24.4	-28.9	-19.8	-20.6	-19.5	-18.0	-17.6	-18.2	-18.9
Capex	-37.8	-58.2	-47.6	-28.5	-29.2	-29.9	-30.5	-31.2	-32.0	-32.7
FCF	**11.2**	**16.9**	**29.4**	**63.5**	**65.8**	**69.8**	**74.7**	**78.7**	**81.9**	**85.2**
PV of FCF	**11.2**	**15.4**	**24.4**	**48.1**	**45.4**	**43.8**	**42.7**	**41.0**	**38.9**	**36.9**

	I. Perpetuity (g=1%)		II. Exit EV/EBITDA (7x)		
Sum of PV	348		348	**Risk-Free Rate**	5.0%
PV of Terminal value	421		458	Levered Beta	1.88
Total EV	**769**		**806**	Risk premium	6.0%
Net Debt (2019A)	-387		-387	**Cost of Equity**	**16.3%**
Minority interest	-19		-19	Cost of Debt	3.5%
Provisions	-6		-6	Tax Rate	13.0%
Dividend paid	-6		-6	**Effective Cost of Debt**	**3.0%**
Equity value	**350**		**387**	Weight of Equity	50.6%
Price target (BGN)	2.60		2.87	Weight of Debt	49.4%
Average		2.73		**WACC**	**9.7%**
12M price target		**3.00**			

Source: WOOD Research

PT sensitivity to WACC and terminal growth rate

WACC/terminal growth	-1.0%	-0.5%	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%
7.7%	3.9	4.1	4.4	4.7	5.1	5.5	6.0	6.6	7.4
8.2%	3.4	3.6	3.9	4.2	4.5	4.8	5.2	5.7	6.3
8.7%	3.0	3.2	3.4	3.7	3.9	4.2	4.6	5.0	5.4
9.2%	2.7	2.8	3.0	3.2	3.4	3.7	4.0	4.3	4.7
9.7%	2.3	2.5	2.6	2.8	3.0	3.2	3.5	3.7	4.1
10.2%	2.0	2.1	2.3	2.4	2.6	2.8	3.0	3.2	3.5
10.7%	1.7	1.9	2.0	2.1	2.3	2.4	2.6	2.8	3.0
11.2%	1.5	1.6	1.7	1.8	1.9	2.1	2.2	2.4	2.6
11.7%	1.3	1.3	1.4	1.5	1.7	1.8	1.9	2.1	2.2

Source: WOOD Research

Peer valuation table

Name	Country	Price	Mkt Cap	PER			EV/EBITDA			EBITDA margin		
		(LCU)	(EUR)	20E	21E	22E	20E	21E	22E	20E	21E	22E
SOPHARMA AD SOFIA	**BP**	**3.15**	**217**	**7.9**	**10.2**	**9.1**	**8.2**	**8.0**	**7.8**	**7.4%**	**7.4%**	**7.4%**
Healthcare Service Providers				**13.4**	**12.0**	**10.4**	**8.8**	**7.6**	**7.2**	**2.4%**	**2.5%**	**2.6%**
MCKESSON CORP	US	153.3	22,081	10.4	10.7	9.0	7.7	7.9	7.2	1.8%	1.6%	1.6%
WALGREENS BOOTS ALLIANCE INC	US	42.1	32,769	7.7	7.1	6.7	7.1	6.5	6.3	5.4%	5.6%	5.5%
AMERISOURCEBERGEN CORP	US	99.9	18,048	13.4	12.2	11.1	8.8	7.4	6.7	1.3%	1.3%	1.3%
CARDINAL HEALTH INC	US	52.3	13,567	9.9	9.6	8.8	7.1	6.7	6.1	1.8%	1.8%	1.8%
OWENS & MINOR INC	US	7.59	425	15.4	12.0	10.4	8.8	7.6	7.4	2.4%	2.5%	2.5%
SIGMA HEALTHCARE LTD	AU	0.63	408	48.1	25.0	19.5	16.3	11.8	10.2	1.7%	2.3%	2.6%
JOINTOWN PHARMACEUTICAL-A	CH	19.0	4,477	15.9	13.3	11.0	10.3	11.1	9.8	3.9%	4.2%	4.2%
CHINA NATIONAL MEDICINES-A	CH	39.4	3,732	2.5	2.2	2.0	10.9	9.4	8.3	5.4%	5.6%	5.6%
ORIOLA CORP -B	FI	2.02	368	15.7	12.6	11.3	6.3	5.6	5.2	3.4%	4.5%	4.6%
Pharmaceutical producers				**12.5**	**11.7**	**11.0**	**7.8**	**6.8**	**6.1**	**26%**	**26%**	**27%**
PERRIGO CO PLC	IR	55.1	6,676	13.6	12.6	11.7	11.0	9.9	8.9	18%	19%	19%
LANNETT CO INC	US	7.45	267	7.2	6.0	5.1	6.4	6.1	5.5	26%	26%	27%
DERMAPHARM HOLDING SE	GE	44.8	2,414	23.2	19.8	17.9	13.9	12.2	11.3	25%	27%	27%
KRKA	SV	82.8	2,715	11.3	10.8	10.5	6.3	5.9	5.9	26%	26%	25%
RICHTER GEDEON NYRT	HU	6,490	3,420	14.4	12.5	11.4	7.7	6.5	5.5	24%	26%	27%
HIKMA PHARMACEUTICALS PLC	JO	27.2	6,934	17.2	15.7	14.3	9.8	8.9	8.0	28%	29%	29%
MYLAN NV	US	16.1	7,407	3.7	3.6	3.5	5.4	4.4	3.8	30%	31%	31%
TEVA PHARMACEUTICAL-SP ADR	IS	12.2	11,889	4.9	4.6	4.4	7.9	7.1	6.4	29%	29%	30%
Peers median				**11.9**	**11.2**	**10.4**	**8.0**	**7.5**	**6.9**			
Sopharma vs peer median				-33%	-10%	-13%	2%	7%	12%			

Source: Bloomberg, WOOD Research

As a sanity check for our DCF valuation, we look at Sopharma's three-year forward earnings on median peer multiples both for healthcare service providers – here, primarily drug distributors – and pharmaceuticals producers. For the latter group, we have tried to select from peers that have a similar production portfolio to Sopharma (e.g., Perrigo, Dermapharm), are similar in terms of region (e.g., Krka), or that produce a broad spectrum of non-proprietary drugs (e.g., Mylan). In the end, we see that the median multiples for both groups are rather similar – EV/EBITDA multiples in a range of 6-8x – regardless of the very disparate levels of profitability, in terms of EBITDA multiples, that characterise the two different sectors.

On this basis, not applying any trading premia or discounts, we would see a fair value for Sopharma on forward PER multiples of BGN 3.68/share, or c.17% higher than the current level and 23% higher than our 12M PT of BGN 3.00/share. Conversely, on forward EV/EBITDA multiples, we would see a fair value for the stock of CZK 2.87/share, or 9% below the current share price. The average of the two is BGN 3.3/share, which is 10% higher than our 12M PT, and 5% upside to the current share price.

Peer multiples valuation

	PER	EV/EBITDA
Peer group avg. multiples 2020-22E	11.2	7.5
Trailing 3Y premium/(discount)	0%	0%
Average 2020-22E earnings forecast	44	107
EV		**806**
Net debt (2019)		-387
Minority interest		-19
Provisions		-6
Dividend paid		-6
Equity value	**496**	**387**
Price target (BGN/sh)	3.68	2.87
Weight	50%	50%
Weighted price target (BGN/sh)	**3.30**	

Source: Bloomberg, WOOD Research

Risks

- ✓ Sopharma has significant working capital needs, which the company finances both through short-term working capital loans and a factoring agreement with one local financial institution. The company's gearing is already high (3.7x at end-1Q20) and close to the 4.0x gearing covenants for most of its loans. In this situation, additional access to financing could be difficult, and limit its ability to invest and grow.
- ✓ Sopharma's product portfolio, which is dominated by plant-based OTC drugs and older generics, leaves the company less well-positioned than older generics producers, which invest heavily in more modern drugs and formulation (e.g., fixed dose combinations).
- ✓ In terms of drug exports, Sopharma has significant exposure to countries (e.g., Ukraine, Russia, Kazakhstan) with a history of currency volatility, which could lead to significant FX losses/gains. It is in a similar situation regarding exposure to pharmacies and wholesale in Belarus.
- ✓ Wholesale and retail pharmacy mark-ups, in markets where Sopharma has these operations, are regulated, which means that earnings would be affected materially by changes in the regulatory regimes. In Bulgaria and Serbia, at least, the drug wholesale markets are also largely consolidated and very competitive, limiting Sopharma's ability to improve margins on pricing alone.
- ✓ The Bulgarian pharmaceuticals market suffers from delayed payments along the supply chain – from the state-controlled national health insurance house to pharmacies, distributors and producers – which raises the companies' risk of encountering liquidity issues. Moreover, at present, Sopharma's commercial policy is to finance drug deliveries to state-controlled hospitals, further exposing it to credit risk.
- ✓ Sopharma's shareholder Rompharma, with a 6.76% stake currently, could resume selling down its position in the company, which would then represent a material overhang risk.
- ✓ Sopharma's largest shareholders, CEO Donev and Mr. Stoev, are active investors in healthcare-related businesses in Bulgaria (e.g., pharmacy chains controlled by their companies, SCS Franchises, Sopharma Properties REIT or Sofprint Group), and transactions between the key shareholders and the company, from the perspective of minority investors, could represent a unacceptable conflict of interest.
- ✓ Sopharma's auditor, Baker Tilly, flagged in its 2019 auditor's report, as a key audit matter, that assessment potential credit losses of trade receivables, receivables from related parties and loans granted to third parties entail significant complexity and rely on the input of key estimates and judgements from management.
- ✓ At the present time, the repayment of Sopharma's loan to Doverie Holding appears to be tied to Moldindconbank resuming dividend payments, which were suspended this year by the National Bank of Moldova (NBM) in view of the COVID-19 crisis. If dividends are not resumed (expected in 2021), then Doverie could have difficulties servicing the loan.

Financials

Income statement

BGN m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Revenue from sales of goods	645.4	767.6	928.3	993.1	1,078.2	1,140.4	1,211.3	1,270.1
Revenue from sales of finished products	231.7	249.5	250.8	288.5	296.2	312.8	330.5	349.3
Revenue from contracts with customers	**877.1**	**1,017.1**	**1,179.1**	**1,281.6**	**1,374.3**	**1,453.2**	**1,541.8**	**1,619.4**
Other operating income/(losses), net	9.5	6.7	11.8	12.4	9.6	11.2	11.8	12.1
Changes in inventories	-1.0	8.7	8.8	-3.5	1.0	0.0	0.0	0.0
Materials	-82.9	-90.2	-91.3	-93.2	-94.7	-99.1	-103.6	-108.4
Third party services	-56.4	-63.5	-75.9	-75.2	-81.9	-86.6	-91.8	-96.3
Employee benefits	-87.2	-101.4	-119.4	-127.1	-136.5	-145.4	-154.1	-162.6
Carrying amount of goods sold	-571.1	-680.0	-825.6	-878.5	-955.3	-1,010.4	-1,073.2	-1,125.9
Other operating expenses	-14.3	-11.5	-15.3	-12.8	-15.3	-15.9	-16.6	-17.1
EBITDA	**73.7**	**85.9**	**72.3**	**103.7**	**101.2**	**107.1**	**114.2**	**121.2**
Depreciation and amortisations	-28.7	-30.1	-33.1	-44.0	-45.2	-49.0	-50.3	-49.0
Profit from operations	**45.0**	**55.8**	**39.1**	**59.7**	**56.0**	**58.1**	**63.8**	**72.1**
Other impairment of non-current assets	-1.0	-0.7	-0.2	-18.9	0.0	0.0	0.0	0.0
Finance income	7.0	8.4	4.0	11.0	6.0	6.2	6.6	6.9
Finance costs	-12.7	-11.6	-9.7	-12.4	-18.4	-16.1	-16.9	-16.8
Finance income / (costs), net	-5.7	-3.3	-5.7	-1.4	-12.4	-9.8	-10.3	-10.0
Gain from associates and joint ventures, net	9.0	0.4	2.1	44.7	0.9	1.0	1.0	1.0
Gain on acquisition and disposal of subsidiaries	14.9	0.0	0.0	4.4	0.0	0.0	0.0	0.0
Profit before income tax	**62.1**	**52.4**	**35.3**	**88.4**	**44.5**	**49.2**	**54.6**	**63.1**
Income tax expense	-7.2	-6.6	-4.7	-4.1	-5.8	-6.4	-7.1	-8.2
Non-controlling interests	4.3	5.8	2.3	-2.6	-11.4	3.8	3.8	3.9
Net profit to equity holders	**50.6**	**40.0**	**28.3**	**87.0**	**50.1**	**39.1**	**43.7**	**51.0**
Average shares for EPS	129.1	125.8	125.8	125.9	125.9	125.9	125.9	125.9
EPS	**0.39**	**0.31**	**0.23**	**0.69**	**0.40**	**0.31**	**0.35**	**0.41**
DPS	**0.10**	**0.11**	**0.05**	**0.12**	**0.12**	**0.11**	**0.12**	**0.14**
EV/EBITDA	**7.3**	**8.9**	**11.2**	**8.0**	**8.2**	**8.1**	**7.8**	**7.1**
PER	**6.3**	**12.3**	**16.9**	**4.8**	**7.9**	**10.2**	**9.1**	**7.8**
Dividend yield	4.1%	2.9%	1.3%	3.7%	3.8%	3.4%	3.9%	4.5%
Revenues, yoy	0%	16%	16%	9%	7%	6%	6%	5%
EBITDA, yoy	17%	17%	-16%	43%	-2%	6%	7%	6%
Operating profit, yoy	23%	24%	-30%	52%	-6%	4%	10%	13%
Net profit, yoy	138%	-21%	-29%	207%	-42%	-22%	12%	17%
EBITDA margin	**8.4%**	**8.4%**	**6.1%**	**8.1%**	**7.4%**	**7.4%**	**7.4%**	**7.5%**
Operating margin	5.1%	5.5%	3.3%	4.7%	4.1%	4.0%	4.1%	4.5%
Net margin	5.8%	3.9%	2.4%	6.8%	3.6%	2.7%	2.8%	3.1%

Source: Company data, WOOD Research

Balance sheet

BGN m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Property, plant and equipment	321.2	317.6	324.5	378.6	375.6	389.1	390.5	373.9
Intangible assets	34.6	63.4	62.2	42.8	38.4	34.1	30.0	26.0
Goodwill	9.9	23.1	23.5	15.9	15.7	15.7	15.7	15.7
Investment properties	9.5	9.8	10.4	10.9	13.0	13.0	13.0	13.0
Investments in associated and joint companies	18.7	19.5	20.4	63.0	63.5	63.5	63.5	63.5
Other long - term equity investments	5.7	8.0	8.6	10.1	13.0	13.0	13.0	13.0
Long-term receivables from related parties	10.0	20.6	23.1	91.8	70.0	70.0	70.0	70.0
Other long-term receivables	4.1	4.9	6.4	2.4	11.2	11.2	11.2	11.2
Deferred tax assets	2.8	1.3	1.6	10.7	1.9	1.9	1.9	1.9
Non-current assets	**416.6**	**468.4**	**480.7**	**626.2**	**602.3**	**611.5**	**608.8**	**588.3**
Inventories	171.8	218.1	235.8	229.9	244.7	258.8	274.6	288.4
Trade receivables	215.6	235.2	235.9	255.7	286.1	303.6	324.7	337.7
Receivables from related parties	15.0	4.7	9.9	7.1	7.9	7.9	7.9	7.9
Assets held for sale	0.0	0.0	0.0	1.5	1.5	1.5	1.5	1.5
Other short-term receivables and assets	17.7	21.0	22.7	27.5	34.2	34.2	34.2	34.2
Cash and cash equivalents	22.5	33.3	25.6	27.5	22.4	24.2	23.1	15.7
Current assets	442.6	512.4	529.9	549.1	596.8	630.2	666.0	685.3
Total assets	**859.2**	**980.7**	**1,010.6**	**1,175.3**	**1,199.1**	**1,241.8**	**1,274.8**	**1,273.6**
Share capital	134.8	134.8	134.8	134.8	134.8	134.8	134.8	134.8
Reserves	62.7	53.6	55.7	61.0	61.0	61.0	61.0	61.0
Retained earnings	260.0	281.5	285.1	360.7	380.0	383.1	385.8	401.1
Equity attributable to equity holders of the parent	**457.5**	**469.9**	**475.6**	**556.4**	**575.8**	**578.9**	**581.6**	**596.8**
Non-controlling interests	**33.7**	**33.2**	**33.0**	**19.3**	**4.0**	**3.8**	**3.6**	**3.5**
Long-term bank loans	25.9	50.5	41.1	56.8	49.1	46.9	35.2	31.2
Deferred tax liabilities	11.8	13.7	11.8	8.2	8.1	8.1	8.1	8.1
Long-term liabilities to related parties	0.0	0.0	0.0	3.0	2.5	2.5	2.5	2.5
Long-term payables to personnel	4.5	5.5	6.0	6.6	6.4	6.4	6.4	6.4
Finance lease liabilities	2.6	2.0	2.5	25.8	25.2	25.2	25.2	25.2
Government grants	0.0	0.0	7.5	10.9	10.4	10.4	10.4	10.4
Other non-current liabilities	0.0	0.2	0.3	4.0	3.9	3.9	3.9	3.9
Non-current liabilities	**53.8**	**80.1**	**69.2**	**115.4**	**105.6**	**103.4**	**91.7**	**87.7**
Short-term bank loans	170.8	194.2	242.9	274.8	296.2	326.2	369.2	349.2
Short-term part of long-term bank loans	9.5	14.5	14.9	16.7	17.8	21.8	12.2	12.2
Trade payables	92.1	135.2	124.5	116.4	124.3	131.4	139.4	146.4
Payables to related parties	0.6	0.8	0.5	7.7	8.8	8.8	8.8	8.8
Factoring agreement liabilities	20.0	19.4	21.8	24.8	24.5	25.3	26.2	26.7
Short-term part of leasing obligations	0.0	0.0	1.2	10.0	10.2	10.2	10.2	10.2
Payables to personnel and social security	10.1	12.9	14.2	15.4	16.1	16.1	16.1	16.1
Tax payables	5.9	7.4	6.7	7.2	10.7	10.7	10.7	10.7
Other current liabilities	5.1	13.3	6.4	11.0	5.1	5.1	5.1	5.1
Current liabilities	**314.2**	**397.6**	**432.9**	**484.1**	**513.7**	**555.6**	**597.9**	**585.5**
Total liabilities	**368.0**	**477.6**	**502.1**	**599.5**	**619.3**	**659.1**	**689.6**	**673.2**
Total liabilities and equity	**859.2**	**980.7**	**1,010.6**	**1,175.3**	**1,199.1**	**1,241.8**	**1,274.8**	**1,273.6**
Net Debt	**206.3**	**247.2**	**298.7**	**384.5**	**403.1**	**433.9**	**457.5**	**441.6**
Net debt/EBITDA	*2.8*	*2.9*	*4.1*	*3.7*	*4.0*	*4.1*	*4.0*	*3.6*
Capital employed	**617.3**	**630.9**	**677.2**	**750.5**	**788.7**	**821.6**	**846.8**	**845.5**
ROCE	*6.3%*	*7.8%*	*5.2%*	*8.0%*	*6.3%*	*6.3%*	*6.7%*	*7.4%*
Net working capital	**328.0**	**343.9**	**379.9**	**405.2**	**450.2**	**474.6**	**503.5**	**523.2**
NWC days	*136*	*121*	*112*	*112*	*114*	*116*	*116*	*116*

Source: Company data, WOOD Research

Cash flow statement

BGN m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Revenue from contracts with customers	906.9	1,058.6	1,201.7	1,215.4	1,323.5	1,422.9	1,506.5	1,595.0
Payments to suppliers	-819.2	-950.6	-1,142.1	-1,144.0	-1,282.5	-1,356.3	-1,438.2	-1,496.7
Payments for wages and social security	-81.5	-94.3	-110.7	-120.3	-128.3	-136.7	-144.9	-152.8
Taxes paid, net	-58.3	-57.2	-56.2	-62.1	-65.3	-69.1	-73.3	-77.0
Profit tax paid, net	-5.6	-6.1	-8.2	-8.5	-6.7	-7.4	-8.2	-9.5
Paid interest and bank fees on WC loans	-7.2	-5.4	-6.2	-8.0	-9.1	-10.0	-11.1	-11.5
Exchange rate differences, net	-0.5	-1.3	-0.9	0.2	-1.8	0.0	0.0	0.0
Other proceeds/(payments), net	-3.3	-2.0	-1.3	-1.2	-6.3	-2.0	-2.0	-2.0
Net cash flows used in operating activities	**-68.8**	**-58.3**	**-123.8**	**-128.4**	**-176.6**	**-158.5**	**-171.2**	**-154.5**
Purchase / disposals of PP&E and intangible asset, net	-17.5	-17.3	-27.2	-39.0	-37.6	-58.2	-47.6	-28.5
Purchase / disposals and dividends from equity investments, net	0.4	-0.8	-1.3	-1.3	-4.2	0.0	0.0	0.0
Purchase / disposals subsidiaries, net	14.4	-44.2	-1.3	7.3	0.0	0.0	0.0	0.0
Purchase / disposals of associated and JVs, net	-2.5	-1.4	-0.2	4.6	0.0	0.0	0.0	0.0
Transactions with non-controlling interests, net	-21.9	-9.8	-2.1	-5.7	-0.2	0.0	0.0	0.0
Change in loans to related parties	18.4	-2.0	-7.6	-66.3	21.8	0.0	0.0	0.0
Change in loans to third parties, net	-0.4	-2.5	-2.3	-6.2	-0.2	0.0	0.0	0.0
Interest received on loans and deposits	2.5	1.2	1.0	2.7	0.1	0.0	0.0	0.0
Other proceeds/(payments), net	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Net cash flows used in investing activities	**-6.9**	**-76.8**	**-41.2**	**-104.2**	**-22.4**	**-58.2**	**-47.6**	**-28.5**
Change in short-term banks loans	-26.6	11.6	48.9	32.2	21.4	30.0	43.0	-20.0
Change in long-term banks loans	-13.1	27.0	-8.8	17.3	-6.6	1.9	-21.3	-4.0
Change in loans from third parties	0.6	-0.5	-0.2	-0.2	0.0	0.0	0.0	0.0
Proceeds from factoring	132.4	131.3	153.6	200.8	215.6	222.4	230.1	235.0
Interest and taxes for factoring paid	-0.9	-0.3	-0.3	-0.4	-0.5	-0.5	-0.5	-0.5
Interest and bank fees on investment purpose loans	-2.3	-2.6	-1.3	-1.4	-1.5	-1.5	-1.3	-1.0
Finance lease payments	-2.2	-1.7	-2.2	-13.1	-14.7	-14.7	-14.7	-14.7
Purchase of treasury shares	-0.9	-17.0	-0.9	-0.8	-0.5	0.0	0.0	0.0
Dividends paid	-12.1	-15.5	-22.6	-3.5	-19.1	-19.0	-17.6	-19.3
Other	0.0	3.2	0.2	5.0	0.0	0.0	0.0	0.0
Net cash flows from financial activities	**74.9**	**135.4**	**166.5**	**235.9**	**194.0**	**218.6**	**217.7**	**175.5**
Increase / decrease in cash and equivalents	**-0.8**	**0.3**	**1.5**	**3.2**	**-5.0**	**1.9**	**-1.1**	**-7.5**
FCF	**37.2**	**44.9**	**-11.0**	**10.1**	**-3.0**	**5.7**	**11.4**	**52.0**

Source: WOOD Research

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CEZ	5
CME	5
Dino	5
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Electrica	5
Erste Group Bank	5
Eurobank	4
Eurocash	4, 5
Fortuna	5
Fondul Proprietatea	4, 5
Graphisoft Park	5
ING BSK	5
Kazatomprom	5
Kernel	5
Kety	5
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Kofola CS	5
Komercni	4, 5
Kruk	5
Lotos	5
MedLife	4
MONETA Money Bank	5
O2 Czech Republic	1, 4, 5
OMV Petrom	5
Orange PL	5
Pekao	4, 5
PGE	5
PGNiG	5

Philip Morris CR	**5**
PKN Orlen	**5**
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