

Pilulka Lekarny

Hold

Initiation of coverage

Price: CZK 1,050

Price target: CZK 1,120

Blowing with the e-commerce wind

We initiate coverage of Pilulka Lekarny (Pilulka), with a HOLD rating and a 12M price target (PT) of CZK 1,120/share, implying 6.6% upside. Pilulka is an e-pharmacy company, operating in Czechia, Slovakia, and Romania. The online channel is limited to consumer healthcare (CHC) and personal care products, with prescription (Rx) sales made via its smaller bricks & mortar retail footprint. Pilulka benefited greatly from the pandemic (2019-21 revenues CAGR of 39%), but we anticipate a slowdown in top-line growth to 17% yoy for 2022E, in line with the revised management guidance, due to the deceleration of the local e-commerce market. The online segment should still benefit from rising e-commerce penetration in the medium-to-long term: our sales CAGRs of 17.8% (2021-25E) and 14.2% (2025-29E) reflect the normalised mid-teens growth expectations of the online retail market. While we appreciate Pilulka's long-term potential, at this juncture we rate it a HOLD, as it is clear that growth should decelerate sharply, and we are sceptical about its ability to exceed expectations in the current climate. It trades on a par with DACH-based e-pharmacy peers Zur Rose and Shop Apotheke (on 2022-24E EV/sales), but lacks the trigger of online Rx in Germany in the near future.

Pilulka has found success by positioning itself as a mainstream e-pharmacy. Its online presence is relatively large compared to its peers, with a substantially bigger bricks & mortar footprint: it was second to Dr. Max and above BENU last year. It also stands out in the last mile, benefiting from: i) its position as the #3 bricks & mortar retail chain (c.160 units); ii) its own delivery service; and iii) partnering with the country's largest parcel locker operator.

We expect a gradual improvement in profitability. With an EBITDA margin of 1.5% by 2024E (vs. an adjusted 0.5% in 2021), and convergence towards its regional e-pharmacy peers, the company should break even in 2024E, on our figures. Softer operating margins and elevated capex mean that FCF should not turn positive until 2026E. To fund itself, it could raise new debt later this year.

Czech e-commerce penetration is among the highest in the EU (c.15%). It still lags in the CHC (11%) and OTC (6%) segments by about half vs. developed markets like Germany, however, which suggests room for convergence, in our view. In the long term, the local e-commerce association expects total penetration to rise to 25% by 2030E.

Catalysts. Deregulation of Rx, expansion into new markets, alternative revenue lines (e.g advisory services) and private-label products. If successful, these may justify further upside.

A candidate for the PSE Prime market. A move to the main market, which we anticipate may be feasible in the next 12-24 months, if Pilulka decides to, should improve liquidity and reporting standards, and provide greater visibility.

Valuation. Pilulka trades at our 2022E EV/sales of 1.0x, and average 2022E-24E of 0.81x, in line with its e-pharmacy peers, which have a similar revenue growth outlook despite their larger size. **Risks.** International expansion, logistics capacity, persistent inflation, purchasing power with wholesalers.

Expected events

PSE Autumn START Day	October 2022
PSE Spring START Day	May 2023
Preliminary 2022 revenues	January 2023
Consolidated 2022 results	April 2023

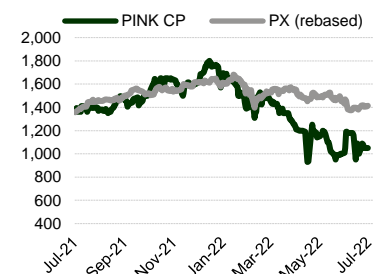
Key data

Market cap	EUR 107m
Free float	32%
3M ADTV (EURk)	16.3
Shares outstanding	2.5m
Major shareholders:	P&M Kasa (32%) All Star Holdings (17%)
Reuters code	PINK.PR
Bloomberg code	PINK CP
PX index	1246

Price performance

52-w range	CZK 930-1800
52-w performance	-23%
Relative performance	-27%

Pilulka 12M share price performance (CZK)



Year	Sales	EBITDA	Net profit	EPS	ND/EBITDA	EV/Sales	EV/EBITDA	P/E
	CZK m	CZK m	CZK m	CZK	(x)	(x)	(x)	(x)
2019	1,239	-24	-45	-23	-2.8	0.7	n.m	n.m
2020	1,780	25	-22	-9	-4.2	0.8	53.2	n.m
2021	2,380	29	-25	-10	-1.7	1.4	113.7	n.m
2022E	2,775	13	-26	-10	1.7	1.0	205.7	n.m
2023E	3,333	36	-8	-3	1.5	0.8	73.8	n.m
2024E	3,929	60	6	2	1.2	0.7	44.6	n.m

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Closing Prices as of 26 July 2022

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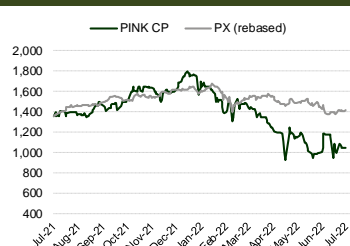
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Company snapshot - HOLD, PT CZK 1,120/share

HOLD

Bloomberg ticker	PINK CP
Closing price (CZK)	1,050
Price Target (CZK)	1,120
Upside to PT	6.6%
Shares outstanding (m)	2.5
MCAP (EUR m)	107
Free float	32.0%
ADTV (EUR ths)	16.3
52w range (CZK)	930-1800



COMPANY DESCRIPTION

Pilulka Lekarny a.s is a multichannel pharmacy, consumer health and personal care retailer. It was founded by Martin and Petr Kasa, both pioneers in the Czech e-commerce world. Previously they launched Kasa.cz, an online platform selling electronics, white goods, appliances, and household items, eventually selling the business to HP Tronic in 2010. The brothers leveraged their experience in the e-commerce sector, by launching an online pharmacy concept in 2013 in Czechia, together with a brick-and-mortar presence. Currently, it mainly operates in Czechia, Slovakia and to a smaller extent in Romania. Its online segment (77% of sales in 2021) is supported by a relatively smaller offline retail chain (17% of sales in 2021). In Czechia, it is the third largest offline retail chain (c.160 branded units) after leaders Dr Max and BENU.

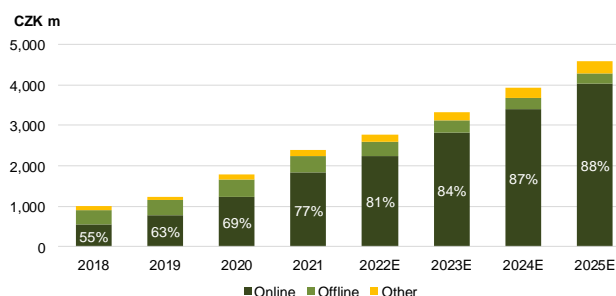
RATIOS AND OPERATING KPI'S

PER SHARE RATIOS (CZK)	2019	2020	2021	2022E	2023E	2024E	VALUATION RATIOS (x)	2019	2020	2021	2022E	2023E	2024E
EPS	-23	-9	-10	-10	-3	2	EV/Sales	0.7	0.8	1.4	1.0	0.8	0.7
CFPS	0	-1	0	-1	-2	-3	EV/EBITDA	n.m	53.2	113.7	205.7	73.8	44.6
BVPS	19	91	82	71	68	71	P/E	n.m	n.m	n.m	n.m	n.m	n.m
FINANCIAL RATIOS							P/CF	n.m	n.m	n.m	n.m	n.m	n.m
Gross margin	10.3%	11.1%	10.0%	10.1%	10.2%	10.2%	P/BV	55.7	11.5	12.8	14.7	15.4	14.9
EBITDA margin	-1.9%	1.4%	1.2%	0.5%	1.1%	1.5%	EV/EBIT	-20.4	1282.2	-235.5	-117.8	-973.6	193.7
EBIT margin	-3.6%	0.1%	-0.6%	-0.8%	-0.1%	0.4%	EV, CZK (m)	915	1,355	3,294	2,647	2,678	2,695
Net margin	-3.7%	-1.2%	-1.1%	-0.9%	-0.2%	0.1%	OPERATING KPI'S						
ROE	-120.7%	-16.5%	-11.8%	-13.4%	-4.5%	3.3%	Active customers (ths)	380	576	750	845	992	1,139
ROA	-13.2%	-5.2%	-4.7%	-4.1%	-1.1%	0.7%	Average basket size (CZK)	1,080	1,069	1,308	1,413	1,483	1,542
Net debt/EBITDA	-2.8x	-4.2x	-1.7x	1.7x	1.5x	1.2x	Order frequency (x)	1.9	2.0	1.9	1.9	1.9	1.9
							Total orders (ths)	721	1,150	1,400	1,585	1,898	2,212

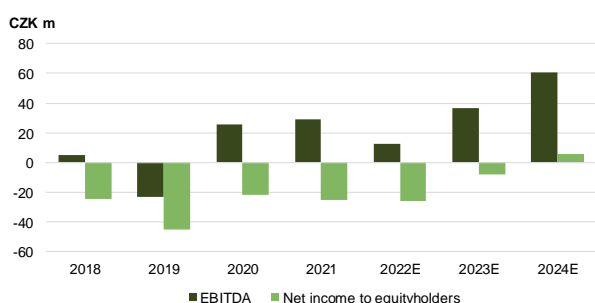
COMPANY FINANCIALS

INCOME STATEMENT, CZK (m)	2019	2020	2021	2022E	2023E	2024E	BALANCE SHEET, CZK (m)	2019	2020	2021	2022E	2023E	2024E
Revenues	1,239	1,780	2,380	2,775	3,333	3,929	PP&E	33	35	62	84	85	86
Cost of sales	-1,112	-1,582	-2,143	-2,494	-2,992	-3,527	Intangible assets	50	54	83	113	150	191
Gross profit	127	198	238	281	341	402	Cons. differences & other	30	28	30	30	27	25
Personel Expenses	-146	-167	-224	-268	-304	-341	Non-current assets	113	117	175	227	263	302
Other operating income/expense	-5	-9	7	0	0	0	Inventories	77	91	155	198	230	261
EBITDA	-24	25	29	13	36	60	Receivables	139	155	185	202	238	275
D&A	-19	-19	-23	-33	-37	-44	Cash and cash equivalents	10	132	72	19	27	30
Other	-2	-5	-20	-2	-2	-2	Current assets	226	378	412	419	495	566
Operating profit	-45	1	-14	-22	-3	14	Prepayments and accrued as	6	4	2	2	2	2
Other adjustments	0	0	0	0	0	0	Total Assets	345	498	589	648	760	870
FX gains/(losses)	-4	-24	-11	0	0	0	Share capital	177	392	393	393	393	393
Net interest expenses	-4	-3	0	-3	-5	-7	Retained earnings	-94	-142	-163	-189	-214	-222
Profit before tax	-52	-25	-25	-25	-7	7	Current year net profit	-45	-22	-25	-26	-8	6
Income tax	1	-1	-1	-1	-1	-1	Cons. Differences	0	0	0	0	0	0
Minorit interest	-5	-4	0	0	0	0	Shareholders Equity	38	228	204	179	171	177
Net profit	-45	-22	-25	-26	-8	6	Minority	-6	-10	0	0	0	0
CASH FLOW, CZK (m)							Total Equity	32	218	204	178	171	176
Profit before tax	-52	-25	-25	-25	-7	7	Long term payables	42	3	21	21	21	21
D&A	19	19	23	33	37	44	Short Term payables	270	271	348	430	547	651
Other items	-2	12	20	5	7	9	Trade payables & other	194	246	326	389	467	551
Net cash from operating activities (before WC)	-35	6	19	13	36	61	Debt	76	25	21	41	80	100
WC changes	13	4	6	3	13	16	Accruals and deferred income	0	0	1	1	1	1
Net interest and income tax paid	0	-3	0	-3	-5	-8	Provisions	0	6	15	17	19	21
Net cash from operating activities	-22	7	25	13	44	69	Liabilities	313	280	385	469	589	694
Capex	-49	-28	-82	-85	-75	-86	Total liabilities and equity	345	498	589	648	760	870
Other	0	0	0	0	0	0	Net debt/(cash)	67	-107	-50	22	53	70
Net cash from investing activities	-49	-28	-82	-85	-75	-86							
Change in debt	6	-52	-3	19	39	20							
Change in equity and other	62	194	0	0	0	0							
Net cash from financing activities	67	142	-3	19	39	20							

REVENUES BY CHANNEL (ONLINE AS %OF TOTAL)



PROFITABILITY



Investment case

We initiate coverage of Pilulka Lekarny (Pilulka), with a HOLD recommendation and a 12M price target (PT) of CZK 1,120/share, offering a 6.6% upside. Pilulka is a Czech-based e-pharmacy and online retailer of consumer health and personal care products. It operates mainly in Czechia and Slovakia and, to a smaller extent, in Romania. Its online segment (77% of sales in 2021) is supported by a relatively smaller bricks & mortar retail chain (17% of sales in 2021). Based on company comments on the sales performance so far this year, and local e-commerce specialists' expectations of slower growth, we anticipate a softer top-line in 2022E. Pilulka has downgraded its original guidance for revenues this year (which we also reflect in our 2022E assumptions), to c.18% yoy growth (from 25%). Nevertheless, we believe the guidance is attainable, given the non-discretionary nature of the business and the underlying inflationary environment, which should be supportive. In the medium-to-long-term, our forecasts reflect local market consensus thinking on local e-commerce growth: our revenue CAGRs of 17.8% (2021-25E) and 14.2% (2025-29E) reflect the normalised trend expectations from the Czech Association of E-commerce (APEK), of c.15% p.a. On our numbers, the company trades at a 2022E EV/sales of 1.0x, and a 2022-24E average of 0.81x: on par with the median EV/sales of the European e-pharmacies (Zur Rose and Shop Apotheke). While we appreciate Pilulka's long-term potential, we rate the stock a HOLD at this juncture, as it is clear that growth should decelerate sharply, and we are sceptical about its ability to exceed expectations in the current market climate. It trades on a par with its DACH based e-pharmacy peers, Zur Rose and Shop Apotheke, on its 2022-24E EV/sales, but lacks the rigour of online Rx in Germany in the near future.

We believe that 2022E should see a softer year in sales. Our expectation reflects a cooldown vs. the pandemic boom period, and expectations of slower overall growth for local e-commerce players. In the medium-to-long-term, continued local e-commerce penetration should drive the company's online segment, and thus its top line, in line with market estimates. Anecdotal 1Q22 data suggests a tough beginning to the year for local online retailers. We expect 2022E online segment sales to reach CZK 2.24bn (+22% yoy vs. 2020-21 average of 53%), with total revenues of CZK 2.8bn (+17% yoy), in line with Pilulka's downwardly-revised guidance, published this April. In the medium and long term, our forecasts reflect local market consensus thinking on local e-commerce growth. Our revenue CAGRs of 17.8% (2021-25E) and 14.2% (2025-29E) reflect APEK's normalised medium-to-long-term growth estimate of 15%. High-teens top-line growth for 2022E for Pilulka seems reasonable. Without a specific breakdown of the guidance by the company, we believe that, given the non-discretionary nature of pharmacies, the high underlying inflationary environment and the company's low ticket sizes, the target should be plausible to reach.

E-commerce penetration in Czechia is among the highest in Europe. It is well above the EU and CEE average, resembling its north-west European (NWE) peers. Underlying e-commerce penetration is currently at around 15% (depending on the source), and APEK believes that this could potentially reach 25% by 2030E. Looking at the consumer healthcare (CHC) and OTC segment, there is still room to grow as e-commerce penetration in these markets lags significantly behind NWE, by more than a half in some cases.

In our model, the key drivers in the online segment are: i) active customers; ii) the average basket size; and iii) order frequency. During 2023-25E, we expect c.75% of Pilulka's online revenues growth to stem from the expansion of active customers, c.18% from basket growth and the balance from order frequency. Growing e-commerce penetration should drive new active customer acquisitions (a normalised 2021-25E CAGR of 14.4% vs. a 2018-21 CAGR of 35.9%). With limited visibility on segment KPIs, our forecasts for the basket size are purely inflation driven (2021-25E CAGR of c.5% for headline inflation in the CEE) and we pencil in low-single-digit growth in order frequency. We note that there is a potential upside beyond our estimates, depending on how well the company manages to upsell to its customers (to increase basket size) and the success of its loyalty efforts (to improve order frequency).

Bricks & mortar presence to be scaled down. We expect bricks & mortar revenues to decline in the next three-to-four years (2021-25E CAGR of -10.7%), in line with Pilulka's decision to transition its own-operated bricks & mortar pharmacies to franchise partners. In the long term, Pilulka intends to maintain a small physical presence, which we reflect in our model. We note that Pilulka has c.160 branded pharmacies in Czechia currently, of which c.130 are operated by franchisees, and is the #3 player after Dr. Max (c.460 units) and BENU (c.315). Together, the top three retail pharmacy chains account for c.40% of total public pharmacy units in Czechia (2.5k), with the remaining market being fragmented.

Capex is predominantly geared towards IT and software development. Pilulka's ability to improve the monetisation of its online customer base lies in its tech capabilities, so we believe the main capex requirements will be in IT and software development. Looking forward, we pencil in 2022-24E average capex/sales of 2.5%, of which c.75% should be geared towards IT and software development. Our total

2022E capex estimate is CZK 85m, in line with management's guidance, and we forecast CZK 75-95m of run-rate capex in the medium term. As Pilulka is still at the growth stage, softer operating margins and continued investments in IT development means that it would not generate positive FCF until 2026E.

We expect Pilulka to turn to debt financing this year. It has been depleting the remaining balance from the IPO proceeds. Consequently, to fund itself and its required capex needs, we expect it to raise debt later this year. We estimate net debt/EBITDA at 1.7x in 2022E (from -1.7x last year), with a step up in net interest expenses, reflecting the higher debt financing environment locally.

We expect Pilulka to become profitable on net income in 2024E. Pilulka has been generating a gross margin of 10% which, on a comparable basis, is materially lower than the high-teens figures of its peers. Due to limited visibility on its cost structure, we assume a flat gross margin across our forecast horizon, as margins have been stable historically. Over time, Pilulka's EBITDA margin should improve and converge gradually towards its EU e-pharmacy peers. On our numbers, we expect a 2021-25E EBITDA CAGR of 35%, and the EBITDA margin to reach 1.5% by 2024E (from an adjusted EBITDA margin of 0.5% last year). On the back of the improved profitability, the expected convergence towards its EU peers, higher D&A expenses and elevated financing costs, we forecast Pilulka to generate positive net earnings only from 2024E-onwards.

Regional expansion is on the radar. Pilulka has reiterated its ambitious plans to expand into the neighbouring countries: Austria and Hungary by end-2022E, and Germany in 2023E. Such an international expansion is common for the major Czech e-commerce players, which is understandable, in view of the limited size of the domestic market. Similar e-pharmacy concepts exist in these markets already, however, with Zur Rose and Shop Apotheke already having an established online presence in the DACH region. We have limited information on the expansion strategy, and are thus unable to gauge the required investment value and expected returns.

Risks. The Prague START market, where Pilulka is listed, has less strict reporting requirements than the Prime and Standard markets. Moreover, Pilulka is competing in segments that are dominated by privately-held players, so it may choose not to disclose information and metrics it deems "commercially sensitive". Nonetheless, the stock could be a candidate for a PSE Prime market listing. Moving to the main market, which we consider may be feasible in the next 12-24 months, should the company decide to do so, should improve liquidity and reporting standards, and provide greater visibility to investors. Further risks include international expansion, a persistent inflationary environment, and logistics and distribution capacity issues. The stock is relatively small in size, trades with low liquidity, and the free float is held by local retail investors. These factors may limit the ability of institutional investors to enter and exit the stock, or build a meaningful position, without significantly affecting the price.

Further upside, in the case of deregulation and a successful expansion execution. Our forecasts do not model Pilulka's international expansion plans explicitly. Neither do we reflect the de-regulation of online prescription drug (Rx) sales in Czechia, which is a potential trigger in our view. Moreover, the company is venturing into alternative revenue lines (e.g. advisory services) and private label products. These are not significant contributors to the top line at present, but depending on the success of the execution, they could offer more upside to our forecasts and valuation.

Valuation. We rate Pilulka a HOLD, with a 12M PT of CZK 1,120/share, implying 6.6% upside. We derive our 12M PT from a DCF valuation (with a WACC of 10.6%), with the terminal value as the average of: i) the perpetuity (a TGR of 3%), and exit EV/EBITDA and EV/sales of 7.5x and 0.85x, respectively. On our numbers, Pilulka trades at a 2022E EV/sales of 1.0x, and a 2022-24E average of 0.81x: on a par with the median EV/sales of the European e-pharmacies (Zur Rose and Shop Apotheke), and thus we consider it fairly valued at the current price.

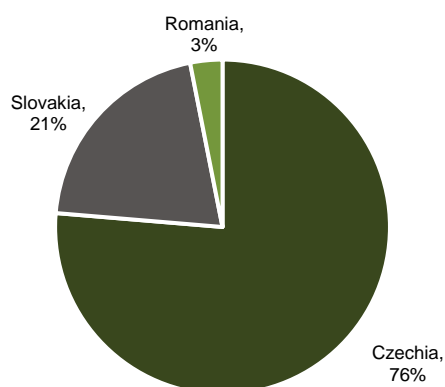
Company description

Introduction

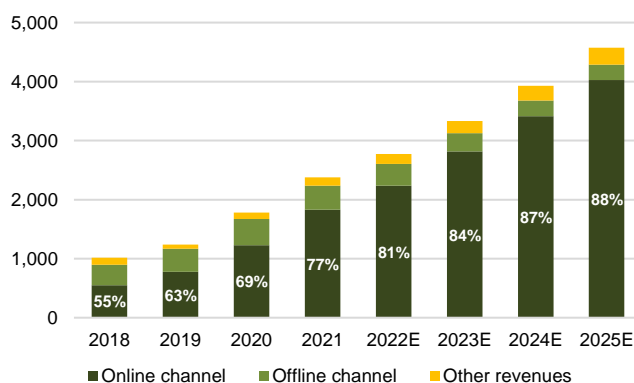
Pilulka Lekarny a.s. is a multi-channel pharmacy, consumer health and personal care retailer operating in the Czech Republic, Slovakia and Romania. It was founded by Martin and Petr Kasa, both pioneers in the Czech e-commerce sphere. Previously, they launched Kasa.cz, an online platform selling electronics, white goods, appliances and household items, before selling the business to HP Tronic in 2010. The brothers then leveraged their experience in the e-commerce sector by launching an online pharmacy concept in 2013 in Czechia, together with a bricks & mortar presence.

Pilulka's largest online presence is in Czechia (71% of online sales in 2021). It expanded into Slovakia shortly after its inception (25% of online sales in 2021), and then into Romania (4% of online sales in 2021) in 2018. Romania is currently a smaller market for Pilulka, as it is establishing a foothold there. Last year, the overall online segment grew 50% yoy in terms of revenues, driven by the Czech market (61% yoy), followed by Romania and Slovakia (53% yoy and 23% yoy, respectively). At this stage, its active customer base is growing in line with its Western peers (+30% yoy with three-year average growth of 35%), and stood at 750k last year. It has delivered c.1.4m total orders in the past year, and has stated that every tenth household in Czechia ordered from Pilulka.cz. To be able to service its customers, Pilulka has three distribution centres, but is planning on adding one more this year to alleviate the urgent capacity issues in the Czech market.

Total sales mix by region, 2021



Sales per channel, CZKm



Source: Company data, WOOD Research

Pilulka opened its first bricks & mortar pharmacy in 2015. There are c.160 Pilulka-branded pharmacies in Czechia, of which 27 are owned and operated by the company, with the remainder being franchises. This makes Pilulka the third-largest physical retail pharmacy chain in Czechia in terms of units, behind Dr. Max (c.460) and BENU (c.315). The physical branches act as a key source of marketing and brand awareness for Pilulka, and are an important channel for delivery, as many customers in Czechia still prefer the click & collect method. Pilulka does not require franchise fees from its partners, so this is not an important revenue stream. Expanding its franchise network does, improve its purchasing power with the drug wholesalers, however. At this stage, being relatively small and without any integration with a drug wholesaler (unlike Dr. Max and BENU), offering franchising solutions should benefit Pilulka with regard to its cost of inventories, due to scale. According to the company, it plans to shift its own-operated brick and mortar stores across to franchisees, but maintain some level of physical own-brand presence, which we reflect in our model.

Structure and organisation

Management

The company continues to be led by the founding brothers, who are supported by a management team which includes executives experienced in local online retail business (such as Zoot, a Czech online fashion retailer), and last-mile/delivery businesses. It intends to hire one top-level manager per year to expand its talent pool and attract new quality executives.

- ✓ **Petr Kasa, Chief Executive Officer.** Mr P Kasa has wealth of experience in the tech field, and in sales and business development. He began his career as an area manager at GSMobile Group, but later transferred to Nokia. There, he eventually led the Czech and Slovak operations as general manager. In 1999, together with his brother, he co-founded and operated Kasa.cz, an online

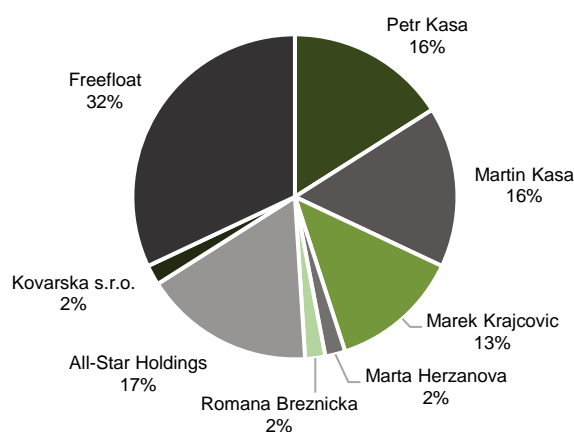
e-commerce platform. This was sold eventually to HP Tronic, a local holding company focusing on retail electronics and home appliances. He is a graduate of the Faculty of Civil Engineering of the Czech Technical University in Prague.

- ✓ **Martin Kasa, Chief Strategy Officer.** Mr M Kasa was originally a programmer, working in the tech field as an entrepreneur and investor. He is experienced in supporting tech start-up firms.
- ✓ **David Stanek, Chief Financial Officer.** Mr Stanek began his career at HP, in the sales and finance departments. He has experience with e-commerce platforms, for example at Zoot, as group financial operations director.

Ownership structure

The indicative post-IPO shareholding structure in Pilulka's issue prospectus shows that the Founders, Petr and Martin Kasa, each control a c.16% stake. Martin Kasa also controls another 2%, via Kovarska s.r.o. The next-largest shareholder is All-Star Holdings, a Malta-listed company associated with the shareholders of WOOD & Co. Another 17% is controlled by private Czech individuals, including Marek Krajcovic, a member of the Supervisory Board with over 20 years of experience in FMCG and retail pharmacy in CEE and Western Europe. At present, the company states that Kovarska s.r.o and Romana Breznicka are no longer shareholders but that the ownership structure has not changed materially since the IPO.

Shareholder structure, post IPO shareholding structure



Source: Company data, WOOD Research

Opportunities and sources of growth

- ✓ **Pilulka intends to expand into neighbouring countries, specifically Hungary and Austria (by end-2022E), and Germany (in 2023E).** It has taken steps to set up local logistics and processes, and has appointed a specific manager for the expansion. It should begin to service Austria and Hungary from its warehouses in Slovakia and Czechia by the end of this year. If it finds appropriate opportunities for inorganic growth and M&A, it may look to acquire possible local targets to establish a foothold. It is also actively investing in, and developing, its secondary markets (Romania and Slovakia). Foreign sales comprise less than 30% of its total sales currently, but Pilulka is aiming for this to reach 40% by 2024E.
- ✓ **As a self-described tech firm,** the company uses data analytics, business intelligence and advanced automated inventory systems in its warehouses to support its logistics operations and last-mile services (for example, same-day delivery). Moreover, data collection through its fitness and mobile apps (as well as on its website) provides a great amount of useful customer data. Over time, its tech-driven approach and significant investments in IT and software development should improve its ability to monetise consumer data.
- ✓ **In 2020, Pilulka launched its private label, known locally as “Aporosa”.** Private labels are a profitable segment for retail pharmacies, as they usually generate higher margins and establish a loyal customer base. For example, over the past decade, Dr. Max has established a popular private brand in the country “Dr. Max”, offering a wide range of products like OTC, dermo-cosmetics and food supplements. According to a press release, this is a significant product segment for Dr. Max: in 2021, private-label sales accounted for a quarter of the total OTC turnover. Thus far, Pilulka is only selling private-label food supplements, not OTC products. It has c.70 unique products in this category but plans to expand the range to c.100 by end-2022E. In 2021, the private label generated CZK 7m in sales, and the company targets around CZK 20m in 2022E. In the medium term, we

note that Pilulka is seeking to focus its efforts towards establishing a well-known private brand, similar to “Dr. Max”. If it manages to launch this segment successfully, it may begin to see improvements in its margins, expand its customer loyalty base and gain a competitive advantage over its peers.

- ✓ **Pilulka’s franchising conditions do not require any fees.** Instead, it focuses on the benefits that franchising provides with respect to wholesale purchases of goods. Pilulka achieves purchasing volume bonuses for its own and partners’ network pharmacies from distributors and should continue to expand its franchise partners.
- ✓ **New revenue opportunities.** Pilulka is looking to develop alternative business lines, focused on the digitalisation of the health care system. Branded as ‘Plus Care’, Pilulka aims to provide contract-based advisory services and solutions to health care enterprises and corporate organisations. One such way is to connect health care providers with corporate employers by developing a digital platform for health-related services to end-users, i.e. the employees.

Czech e-commerce market and penetration

The Czech e-commerce market is one of the fastest-growing in Europe, resembling the trajectory of developed economies like Germany and the Netherlands. Looking forward, the market consensus trend for e-commerce players is 15% p.a. growth, which we use as our medium-to-long-term assumption (vs. the Czech e-commerce market CAGR of c.20% in 2015-21). Czech e-commerce penetration is among the highest in Europe, and well above the EU and CEE average, resembling its NWE peers. Underlying e-commerce penetration is currently c.15% (depending on the source), and APEK believes that this could potentially reach 25% by 2030E. Looking at the CHC and OTC segment, there is still room to grow, as e-commerce penetration in these markets lags significantly behind its NWE peers by more than a half. Overall, we believe the Czech Republic resembles the markets of NWE more closely than those of CEE and given the lower e-commerce penetration in the CHC and OTC segments, we believe there is potential for convergence.

According to various market data sources, the size of the Czech e-commerce market was a little over CZK 200bn in 2021 (c.EUR 8.4bn). The consensus estimates, which are broadly similar, suggest that the online market e-commerce market saw a 2015-20 CAGR of c.20%. The latest data for 2021 (APEK, Euromonitor) show a slowdown in growth, however: the APEK estimates imply 14% yoy and Euromonitor 19%, with the median being 16%. Looking forward, market analysts believe the long-term trend of the e-commerce market should be below the historical trend (2015-20 CAGR of c.20%). The head of APEK, Mr. Vetyška, believes the market should continue to grow c.15% in the long term, while Euromonitor suggests a reasonable 2021-26E CAGR would be 11%.

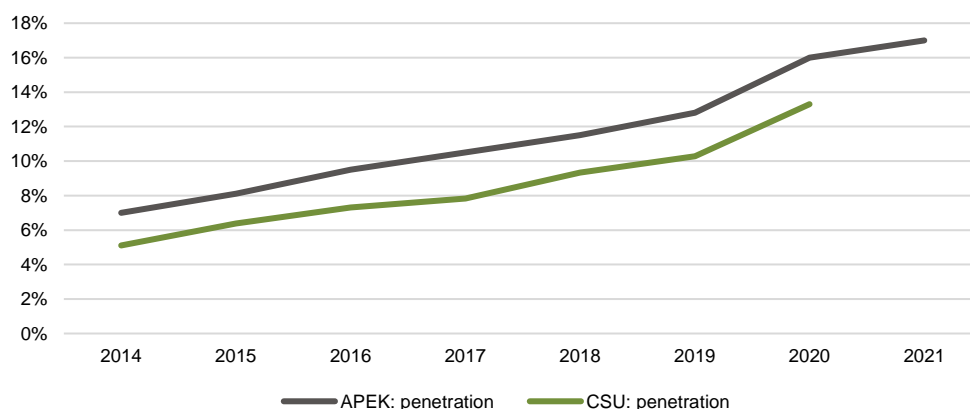
Czech e-commerce market size estimates

CZKbn	2015	2016	2017	2018	2019	2020	2021	2015-21 CAGR
APEK	81	98	115	135	155	196	223	18%
Euromonitor	62	78	91	107	127	161	193	21%
Czech Statistical Office	64	75	87	109	127	167	n.a	n.a
Median	64	78	91	109	127	167	208	22%
Median (EURbn)	2.4	2.9	3.6	4.3	5.0	6.4	8.4	24%

Source: APEK, CSU, Euromonitor, WOOD Research

Data from the Czech Statistical Office (CSU) shows the accelerated trajectory of e-commerce penetration in Czechia during the pandemic, at 13% in 2020, vs. from 10% in 2019, and double the levels in 2015-16. APEK's estimates are above the CSU's by c.2-3%. It estimates that last year, e-commerce penetration was 17%. Mr. Vetyška believes the online retail market could account for a quarter of the total retail market in Czechia by 2030E. This would imply c.1% e-commerce penetration growth p.a.

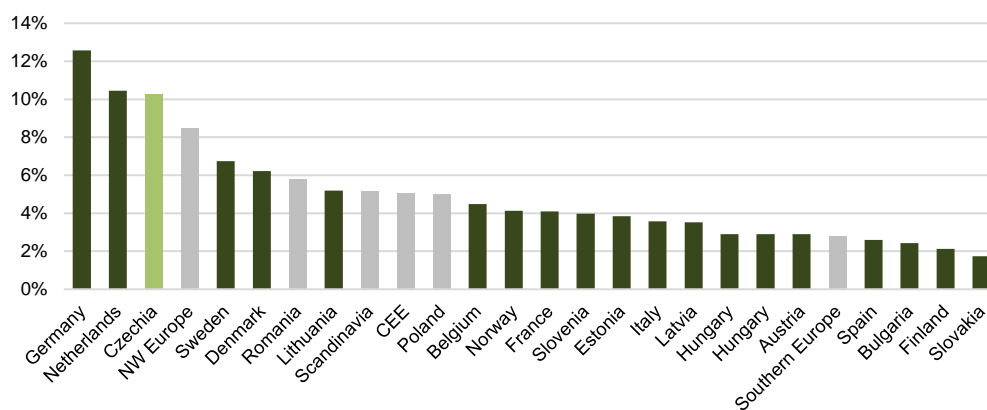
E-commerce penetration estimates: APEK and CSU data



Source: APEK, CSU, WOOD Research

Actual transaction data backs this up. According to the latest detailed Eurostat data (from 2019), Czech retail purchases via the internet or mail order, as a share of total retail goods and services, was the third-highest in Europe, at 10.3%, trailing only Germany (12.6%) and the Netherlands (10.4%), and well above the EU average of 6.2%. From this data, Czechia's e-commerce penetration is also well above its CEE peers and resembles the NWE countries. The laggards are Southern Europe, which still has plenty of room to grow and, surprisingly, Slovakia.

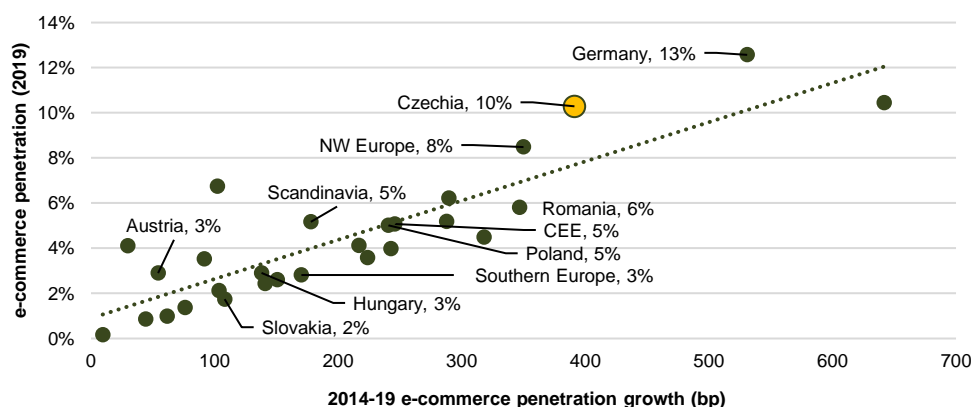
Share of internet and mail order (NACE 47.19) in retail goods & services (NACE 47), 2019



Source: Eurostat, WOOD Research

The rate of growth in Czech e-commerce penetration has also been among the most rapid in the recent past, rising c.390bp vs. 2015 and trailing only the Netherlands and Germany (c.530bp and c.650bp, respectively). We note also the very positive dynamics for Pilulka's newest market, Romania (relatively low penetration, but higher growth). On the other hand, Slovakia and Austria lag in both penetration and growth, despite being developed economies in Europe. The long-term horizon for Pilulka in these regions, based on historical trends, suggests slower growth in the e-commerce market, and thus in its ability to outperform local online retail market growth.

e-commerce penetration: 2019 vs. 2014-19 penetration growth (bp)



Source: Eurostat, WOOD Research, Czechia's e-commerce penetration growth is 2015-19 due to missing data for 2014.

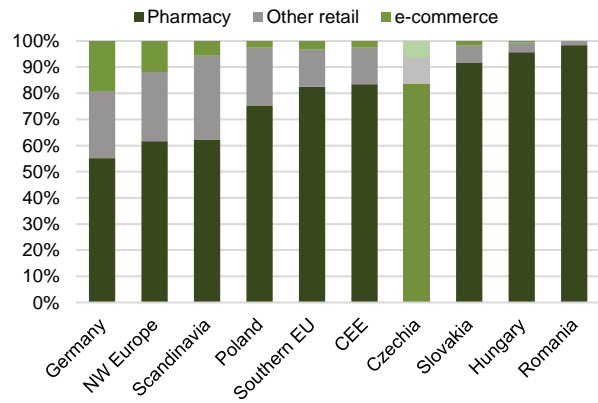
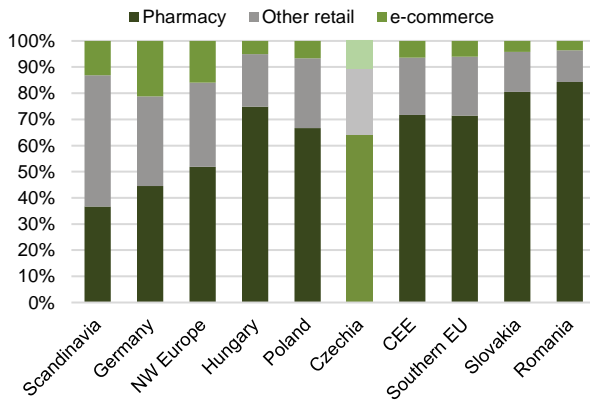
The degree of e-commerce penetration differs widely across different market segments, however. Statistical Office data is not helpful in identifying e-commerce penetration by segment: it tracks sales by type of shop (e.g. pharmacies), but not by product type, and e-commerce turnover is similarly aggregated, regardless of the type of goods or services. We note also that the data includes, for instance, plane tickets and online hotel bookings. Based on Euromonitor data, however, we can highlight some of these differences.

In the Czech Republic, about two-thirds of turnover in CHC products in 2020 was in pharmacies, while online channels generated 11%. In this respect, online penetration trails Germany and Austria (22% and 15.6%, respectively), and the Scandinavian countries (at 14.8%), but is well above the CEE average of 6.2%. In Slovakia and Romania, the figures were 4.1% and 3.7%, respectively.

In the case of OTC drugs, specifically, in the Czech Republic, bricks & mortar pharmacies generate c.83% of sales vs. c.6% online, and the balance is split roughly equally between drugstores (parapharmacies) and grocery stores. Again, e-commerce penetration is well behind Germany and the average for NWE (19% and 12%, respectively), but is in line with Scandinavia (c.5.4%) and well ahead of the CEE average (2.4%).

Consumer healthcare turnover by channel, 2020

OTC turnover by channel, 2020



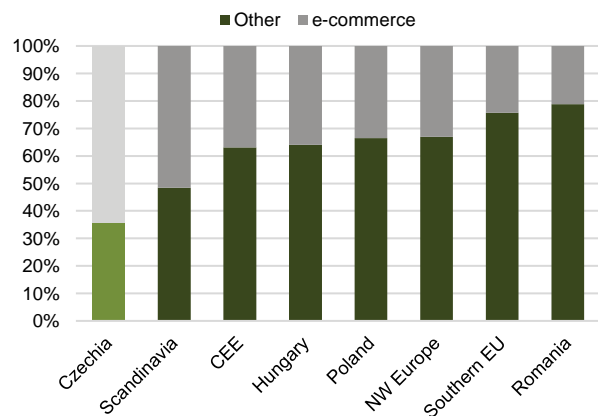
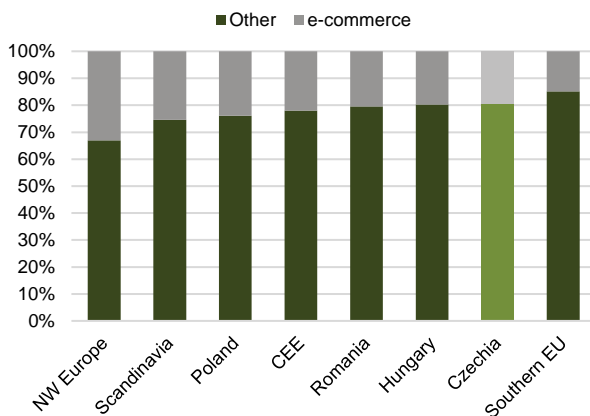
Source: Euromonitor, WOOD Research

For the sake of comparison, we have also looked at e-commerce penetration in two other segments: apparel/footwear and consumer electronics. Both markets are mature, we assume, like CHC with well-developed bricks & mortar networks, but where dedicated e-commerce players entered the market earlier, and where retailers chose (or were driven) to develop their own e-commerce channels. They also sell a good mix of both branded and commodity products. As such, they could be a good leading indicator of how a country's e-commerce consumer healthcare penetration might develop.

In the case of consumer electronics, the data suggest that nearly two-thirds of Czech transactions are conducted online, among the highest in the EU, and we notice quite similar trends for white goods sales. In the case of clothing, the figure is c.20%, or c.200bp below the EU median: a middling figure, broadly in line with its CEE peers.

Apparel/footwear turnover by channel, 2020

Consumer electronics turnover by channel, 2020



Source: Euromonitor, WOOD Research

After looking at e-commerce penetration in these additional segments, we believe that the Czech Republic most resembles the markets of NWE (Germany and France), as opposed to Scandinavia or the CEE as a whole. The very high Czech penetration rates for consumer electronics is the outlier, rather than the rule and, adjusting for this, average penetration rates are around three-quarters of the current (but growing) NWE median. Consumer healthcare e-commerce penetration, at roughly half of NWE, is still at the lower end of the range, which suggests potential for convergence to higher levels, in our view.

Financial forecasts

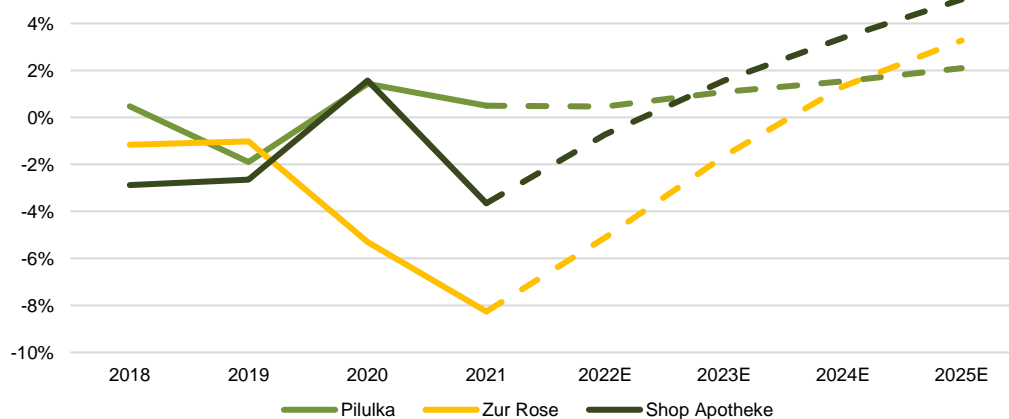
Our assumption for the e-commerce market for Czechia is that 2022E will be a softer year vs. 2021. This is based on anecdotal 1Q22 data: local e-commerce specialists described a tough 1Q for online retailers, with yoy growth ranging from -25% to 9%, depending on the source, and indicated continued slower growth overall for 2022E. Pilulka also decided to cut its revenue guidance by c.10% to CZK 2.8bn for 2022E in April 2022, vs. the April 2021 guidance of CZK 3.1bn. The revised guidance was based on its performance in the first several months of 2022, which recorded a weak start vs. the previous year, albeit from a high base, according to Pilulka.

In the medium and long term, the underlying driver of our forecasts is continued growth in e-commerce penetration, which stands at c.15% currently (according to local market estimates). Local e-commerce specialists believe that penetration could reach 25% by 2030E, which should drive e-commerce market growth. Our medium- and long-term revenue CAGRs of 17.8% (2021-25E) and 14.2% (2025-29E) also reflect the long-term outlook for the size of the e-commerce market, with c.15% p.a. growth according to APEK. This is a slowdown vs. the 2015-21 CAGR of c.20% (accelerated by the pandemic), but still represents a healthy pace, in our view. We do not assume the deregulation of prescription drugs online in the Czech Republic in our modelling; nor do we model its international expansion plans explicitly.

For 2022E, we forecast revenue growth of 17% to CZK 2.8bn (vs. 34% yoy in 2021), in line with the company's new guidance, driven predominantly by a 22% expansion in the online segment, which should comprise 81% of revenues in 2022E. We expect bricks & mortar revenues to fall to CZK 366m this year (-8% yoy), as Pilulka aims to shift its own-operated bricks & mortar channel across to franchise partners. High-teens top-line growth for Pilulka for 2022E seems reasonable, in our view. Without a specific breakdown of the guidance by the company, we believe that, given the non-discretionary nature of pharmacy, the high underlying inflationary environment and the company's low ticket sizes, the target should be plausible to reach.

Assuming a flat gross margin yoy and a jump in personnel costs of c.20% yoy, due to expansion in hiring for its new warehouse this year, we expect the EBITDA margin to remain flat at 0.5% in 2022E (adjusted for a one-off write-off and impairments in 2021). In the medium term, however, as the company scales up, we expect improved profitability, which should converge towards its e-pharmacy peers.

EBITDA margin: historical and WOOD forecast



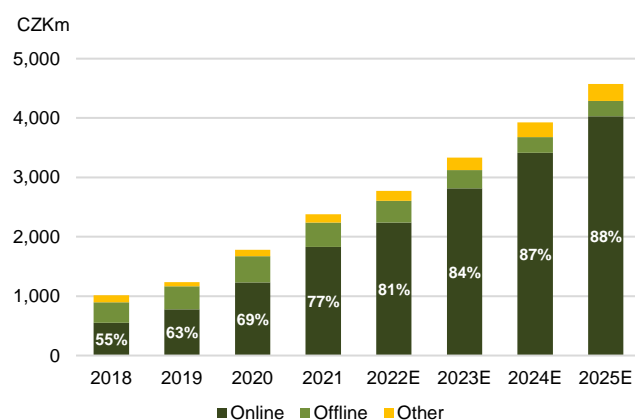
Source: Bloomberg, WOOD Research consensus estimates for Zur Rose and Shop Apotheke, 2021 EBITDA adjusted for Pilulka

Revenues by segment

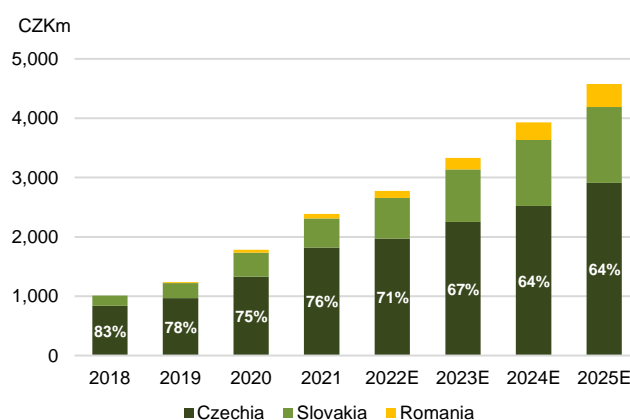
Online

We expect the online segment to achieve revenues of CZK 2.24bn (22% yoy) in 2022E, up from CZK 1.83bn in 2021. Most of the online sales should continue to be generated predominantly in Czechia (66% of online sales in 2022E), but we expect this region to normalise from a very high base. In Czechia, we forecast revenues of CZK 1.5bn, 14% yoy growth vs. the previous year's +60% yoy. We expect Romania and Slovakia, its secondary markets, to continue to post high growth (from a low base) in the next two-to-three years, as it is establishing a foothold in these markets. By 2025E, we expect Czechia to contribute to online sales to a lesser c.60%, while Slovakia should be c.30% and Romania at 10%.

Sales forecast per channel, online as % of total



Sales forecast per region, Czechia as % of total



Source: Company data, WOOD Research

Online sales forecast by region

Online sales (CZKm)	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Czechia	375	536	810	1,302	1,483	1,799	2,096	2,474
Slovakia	175	243	374	459	643	835	1,044	1,201
Romania	0	19	46	70	112	181	272	354
Online total	550	798	1,230	1,831	2,238	2,815	3,413	4,029
Czechia yoy		43%	51%	61%	14%	21%	17%	18%
Slovakia yoy		39%	54%	23%	40%	30%	25%	15%
Romania yoy		n.a	138%	53%	61%	61%	51%	30%
Total yoy		45%	54%	49%	22%	26%	21%	18%

Source: Company data, WOOD Research

From a modelling perspective, our key drivers in the online segment, are: i) the number of active customers (e-commerce penetration); ii) the average basket size; and iii) the order frequency of an active customer.

COVID-19 has had an interesting impact on Pilulka's customer behaviour. In 2020, almost all the online segment growth was driven by new active customer acquisitions (compared to 70% in 2019). Although, the order frequency increased in 2020, to a small extent, people spent less per basket. In 2021, with partial reopenings in the country and the lifting of lockdowns, consumers returned to bricks & mortar purchases, especially in 2H21, we believe. New active customers contributed to online sales growth to a lesser extent in 2021 (71% vs. 97% in 2020), and moreover, the order frequency declined while basket sizes grew.

Looking at 2022E, we expect a relatively smaller contribution from active customers in online revenues: with the pandemic over, fewer new customers should be purchasing online, we believe. With the persisting inflationary environment, ticket sizes should drive c.35% of online revenue growth in 2022E. By 2023E, growing e-commerce penetration (as seen in new active customer acquisitions) should drive the online top line. In 2023-25E we expect an increase in active customers to drive c.75% of Pilulka's online revenue growth, c.18% from basket growth and the balance from order frequency.

The number of active customers of Pilulka, defined as customers who have made at least one order during the year, stood at 750k in 2021, up from 300k in 2018 (2018-21 CAGR of 36%). Speaking with Pilulka, c.30% of active customers were new users, historically, i.e. those who made one order, while the remainder (c.70%) were returning. We assume a 2021-25E CAGR of 14% in new active customer acquisitions, which drives the total active customer base in our modelling. Our forecasts imply a c.14% 2021-25E CAGR for active customers, vs. c.36% for 2018-21. In the long term, this should normalise to c.10% 2025-29E CAGR.

The average basket size stood at CZK 1,308 in 2021, up from CZK 1,069 in 2018 (a 2018-21 CAGR of 10%). Given the current inflationary outlook, and from our conversations with the company, management is confident that it can pass on the increasing prices to end-users. Without more detail on how Pilulka aims to grow the average ticket per customer, our forecasts for the basket size are purely inflation driven, based on our short-to-medium-term assumptions for headline inflation in the CEE. We assume a c.5% 2021-25E CAGR in average basket size, on our inflation estimates, vs. a nearly 10% CAGR in 2018-21, most of which was driven during the second year of the pandemic. We note, however, that there is a potential upside, depending on how well the company manages to upsell to its customers.

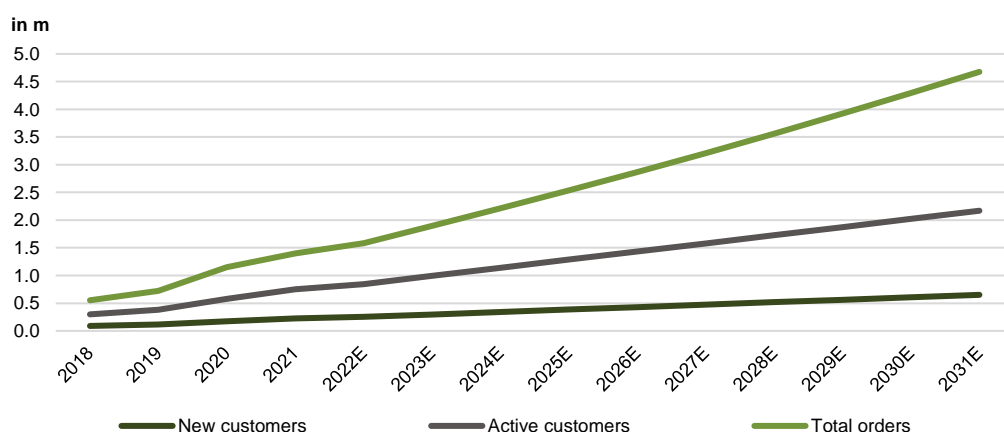
Online segment forecast: key value drivers

	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Total orders (000)	553	721	1,150	1,400	1,585	1,898	2,212	2,536
Yoy	n.a.	30%	60%	22%	13%	20%	17%	15%
Active customers (000)	299	380	576	750	845	992	1,139	1,286
yoy	n.a.	27%	52%	30%	13%	17%	15%	13%
Average basket size (CZK)	995	1,107	1,069	1,308	1,413	1,483	1,542	1,589
yoy	n.a.	11%	-3%	22%	8%	5%	4%	3%
Orders per active customer	1.85	1.90	2.00	1.87	1.88	1.91	1.94	1.97
Online revenues	550	798	1,230	1,831	2,238	2,815	3,413	4,029
yoy	n.a.	45%	54%	49%	22%	26%	21%	18%
Variance analysis								
Active customers	n.a.	170	418	425	251	418	441	461
Order frequency	n.a.	16	40	-98	10	47	44	53
Average basket	n.a.	62	-27	275	146	112	113	102
Online revenues (yoy in CZKm)	n.a.	248	432	602	407	577	598	616

Source: Company data, WOOD Research

Last year the company delivered c.1.4m orders, approximately 2.5x more than 2018 (a 2018-21 CAGR 37%). The order frequency per active customer stood at 1.9x in 2021, similar to historical levels. Once again, we do not have enough information on how the company intends to increase order frequency, so we assume 50bp growth for 2022E and 2ppt in our medium-to-long-term horizon (a 2021-25E CAGR of 1.4% vs. a flat c.1.9x vs. 2018-21), with potential upside depending on the success of the company's loyalty efforts.

New active customers drive the total orders



Source: Company data, WOOD Research

Bricks & mortar & other

Physical presence to scale down gradually. We expect bricks & mortar revenues to decline in the next three-to-four years (2021-25E CAGR of -10.7%), in line with the company's decision to transition its own-operated bricks & mortar pharmacies to franchise partners. We expect a fall in bricks & mortar revenues of c.10% in 2022E, estimating that it transfers five own-branded pharmacies both this year and next. This should be offset, however, by the improvement in sales per pharmacy, which are driven by our inflation estimates.

Revenues in bricks & mortar and other segments

CZKm	2018	2019	2020	2021	2022E	2023E	2024E
Bricks & mortar total revenues	348.0	387.7	443.5	408.0	366.7	309.4	266.6
Own pharmacies (#)	32	32	32	27	22	17	15
Revenues per unit	11	12	14	14	15	16	17
Revenues yoy	0.0%	11.4%	14.4%	-0.2%	8.2%	6.0%	5.0%
Other revenues	116.0	72.4	107.2	141.2	169.9	208.3	249.4
Rebates from vendors	-	56.5	74.6	89.0	112.8	136.0	162.0
Delivery fees	-	10.1	25.0	40.5	51.2	67.3	83.1
Rx dispensary fees	-	5.8	7.6	6.7	5.9	5.0	4.3
Other	-	n.a.	0.0	5.0	0.0	0.0	0.0

Source: Company data, WOOD Research

Gross margin

Pilulka has been generating a gross margin (the cost of inventories plus the cost to achieve sales, including services and consumables) of 10% historically (2018-21). For 2021, it was 10% on the consolidated business and 11% for the stand-alone Czech business, which is materially lower than the high-teens figures generated by the market-leading retail chains, Dr. Max and BENU (c.20%), but a touch better than its primarily online peer Lekarna.cz (c.9%). Compared to its Western-based international peers, Shop Apotheke and Zur Rose, this is also c.15% and 5% lower, respectively.

Pilulka has not offered the granularity that would allow us to parse its cost structure, and compare it with its international peers on a like-for-like basis. For modelling purposes, we assume a flat gross margin trend across our forecast horizon, as margins have been stable historically.

Gross margin: cost of goods for resale/inventories, services and consumables to achieve those sales

	2018	2019	2020	2021
Pilulka (consolidated)	10.2%	10.3%	11.1%	10.0%
Pilulka (standalone CZ)	25.6%	18.3%	12.7%	10.8%
Dr. Max	18.4%	20.0%	20.2%	19.9%
BENU	19.1%	19.1%	19.8%	n.a
Lekarna.cz	9.3%	9.9%	9.3%	n.a
Median	14.3%	14.7%	15.5%	14.9%
Zur Rose*	15.8%	15.4%	16.3%	15.1%
Shop Apotheke **	18.4%	19.6%	22.7%	25.1%
Median	17.1%	17.5%	19.5%	20.1%

Source: Company data, Bloomberg, commercial registry, WOOD Research. * Zur Rose's gross margin is revenues less the cost of goods sold (cost inventories held for resale + packaging materials + inventory allowance), ** Shop Apotheke's gross margin is revenues less the cost of sales (cost inventories held for resale + inventory allowance and provisions + contributions by suppliers through bonuses and discounts).

Based on management figures, the margin generated on goods purchased for resale, i.e., excluding services and consumables, was 26.3% last year. While this figure is not available from its consolidated results, the comparable figures for Dr Max and BENU were 30.8% (2021) and 30.2% (2020), respectively. Historically, Pilulka's stand-alone business in the Czech Republic has generated gross margins more than 100bp higher than the consolidated business.

Realised margin on inventory

	2018	2019	2020	2021
Pilulka (consolidated)	24.1%	25.7%	27.4%	26.3%
Pilulka (standalone CZ)	25.6%	26.9%	30.0%	27.6%
Pilulka (other)	23.5%	25.3%	19.9%	22.2%
Dr Max	29.4%	30.3%	30.9%	30.8%
BENU	28.8%	29.0%	30.2%	n.a
Lekarna.cz	26.3%	22.8%	20.5%	n.a
Median	27.5%	27.4%	28.8%	28.6%

Source: Company data, commercial registry, WOOD Research

Personnel

Headcount transitioning from pharmacists to warehouse employees. Pilulka ended 2021 with c.360 employees (c.340 excluding management), of which c.260 were based in Czechia. Approximately one-third of its Czech employees work as pharmacists, one-third are warehouse employees and the remainder are in offices. Along with Pilulka's shift to reduce its own-branded pharmacies, we pencil the bricks & mortar staff to fall by c.20 this year (c.3-4 employees per pharmacy), but this is offset by the expected recruitment of c.40-50 employees for its new warehouse in Olomouc. Looking forward, we pencil in personnel growth of in 10-20 p.a. for Pilulka in the medium term, as it is growing rapidly. In the long term, we believe the personnel mix should gradually be skewed towards the online operations.

Historically, management salaries have grown faster rate than those of its employees (i.e. pharmacists and warehouses employees). In line with management guidance that salary expectations for employees should remain constant vs. the previous year, we keep salary growth for employees at 2%, while management wage growth tracks our inflation forecasts for the CEE. We expect total personnel costs in 2022E of CZK 270m (+20% yoy) and grow by c.10% p.a. on average over the next 3Y.

Working capital

Pilulka has demonstrated sound working capital management, historically, in particular with regards to inventory days outstanding (how many times the inventory is sold and replaced; a lower number indicates tighter stock management). On the 2018-21 data, the inventory days outstanding was about five days

better than our local peer group, which all have a materially larger base of physical outlets (except for Lekarny.cz), nearly all of which stock a full complement of Rx drugs. Sales days outstanding were less efficient than its peers in 2018-20, but are converging quickly with the median. In terms of the payable days outstanding, which tracks the average time it takes Pilulka to pay its creditors, the average was c.50 days, shorter than both Dr. Max and BENU.

Days inventories, days sales and days payables outstanding: Pilulka vs. its peers

	Inventory days outstanding				Sales days outstanding				Payable days outstanding			
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
Pilulka	22.1	23.6	19.3	20.9	42.3	39.8	29.5	25.6	49.5	52.8	44.4	44.7
Dr. Max	32.2	31.9	32.4	n.a	19.2	17.6	16.6	n.a	75.6	73.7	73.3	n.a
BENU	38.2	37.5	33.0	n.a	22.1	22.5	22.4	n.a	58.9	63.6	61.6	n.a
Lekarna.cz	21.4	15.2	10.1	n.a	34.1	29.0	26.0	n.a	34.8	36.7	34.3	n.a
Zur Rose	23.1	22.3	24.1	23.1	26.7	29.5	29.9	26.1	28.5	27.9	27.4	28.1
Shop Apotheke	34.5	32.4	33.6	40.9	14.4	12.7	10.7	10.0	21.4	19.6	20.3	29.8
Median	27.7	27.7	28.3	23.1	24.4	25.7	24.2	25.6	42.1	44.7	39.4	29.8

Source: Company data, WOOD Research, Bloomberg, commercial registry

We also typically look at net working capital days, which incorporate not only inventory and receivables management but also payables, i.e. its ability to use suppliers to bear its cost of holding stock. Here, Pilulka is the only business operating with negative NWC, although Dr. Max is quite close. Pilulka does not specifically break out short-term liabilities (payables) on a consolidated basis, as according to the company, they are essentially all trade payables. On an unconsolidated basis, trade payables represented c.88% of the 2021 short-term liabilities.

NWC days

	2018	2019	2020	2021
Pilulka	16.9	-1.6	-5.9	-0.9
Dr. Max	0.7	2.5	1.3	4.7
BENU	17.2	25.0	20.2	n.a
Lekarna.cz	34.1	29.0	26.0	n.a
Zur Rose	31.1	35.3	35.9	26.8
Shop Apotheke	56.8	60.5	42.3	36.9
Median	24.1	27.0	23.1	15.7

Source: WOOD Research, Bloomberg, commercial registry

Capex

We assume 2022E capex of CZK 85m, in line with the management guidance. This should be used predominantly for intangibles, i.e. in-house software and IT development (CZK 50m), with the balance for PP&E (CZK 35m). Management has indicated expansion and investment into the warehouses in its existing markets, but has not gone into specific details, so we assume similar capex needs for PP&E as in previous years. Its ability to improve the monetisation of its online customer base lies in its tech capabilities, so we believe the main capex requirements should be in IT and software development, which we pencil in at 1.8% of sales for 2022-24E (total capex should be c.2.5% of sales).

Balance sheet

We assume that the company begins to start financing itself with debt in 2022E. We believe Pilulka should turn to debt financing this year, to meet its capex needs and fund its operations. We pencil in a debt capacity of CZK 80-110m in the medium term, and net financial expenses of c.CZK 3-8m p.a. in the next five years, reflecting the higher cost of financing environment. This should turn net debt/EBITDA positive, hovering around 1.7x this year (from -1.7x in 2021) and falling to 1.2x by 2024E. Consequently, the debt/equity leverage ratio should increase to c.20% this year and 57% by 2024E, up from average of the past two years of c.10%.

The company runs with a very low amount of debt, currently. Its liabilities to credit institutions are predominantly revolving credit facilities (with less than 5Y maturity), denominated in CZK at the 1M or 3M local interbank rate, with a c.5% spread for the most recent year. Bank loans at the end of 2021 stood at CZK 21m, similar to 2020. The revolving credit facilities are secured by inventories, trade receivables and third-party guarantees. On the asset side, we note that c.47% of non-current assets are intangibles, representing its software, while c.36% are PP&E.

Profitability and FCF

The company should turn profitable on the bottom line in 2024E. We expect the EBITDA margin to remain flat this year at 0.5% (after adjusting for a one-off write-off and impairments in 2021) but then rise gradually to 1.5% by 2024E, converging towards its e-pharmacy peers. Thus far, it has generated negative FCF, as it is in the growth stages. Its softer operating margins and continued investments in IT development mean that it should not generate positive FCF until 2026E. Below the EBITDA line, we forecast the D&A and financing costs to rise, due to the higher investment requirements. On these assumptions, the company should break even by 2024E.

Income statement: summary

CZKm	2018	2019	2020	2021	2022E	2023E	2024E
Revenues	1,009	1,239	1,780	2,380	2,775	3,333	3,929
Online	550	779	1230	1831	2238	2815	3413
Bricks & mortar and other	464	460	551	549	537	518	516
Gross profit	103	127	198	238	281	341	402
EBITDA	5	-24	25	29	13	36	60
Net financial expense	-4	-7	-26	-11	-3	-5	-7
Taxes	0	1	-1	-1	-1	-1	-1
Minority interest	-1	-5	-4	0	0	0	0
Net income to equity holders	-25	-45	-22	-25	-26	-8	6
Gross margin	10.2%	10.3%	11.1%	10.0%	10.1%	10.2%	10.2%
EBITDA margin	0.5%	-1.9%	1.4%	1.2%	0.5%	1.1%	1.5%
Online channel growth	n.a.	41.6%	57.9%	48.9%	22.2%	25.8%	21.2%

Source: Company data, WOOD Research

E-commerce in 2022E

Anecdotal data suggests a tough 1Q22 for e-commerce retailers in Czechia and indicates slower growth overall for 2022E. According to the local e-commerce specialists, growth in 1Q22 was slower than the previous year, albeit from a high base. Thus far, speaking with retailers in CEE and based on statistical data on the local consumer retail market, we believe that demand remains solid, even with looming signs of economic downturn.

Shoptet.cz, a local e-commerce solutions/platform provider, has published its 1Q22 e-commerce update, based on proprietary data from the companies that its services (around half of the 55k e-shops in the Czech Republic). According to this data, 1Q22 e-commerce turnover rose 9%, albeit from a still-high pandemic base, from CZK 54bn in 1Q21 to CZK 59bn in 1Q22. The growth was driven primarily by the first two months of the year (c.11% yoy), after which the conflict in Ukraine decreased the pace to 5% yoy. In a more recent newspaper interview, Shoptet.cz's CEO, confirmed the tougher start for e-commerce in the Czech Republic.

According to Heureka, one of the largest price comparison platforms in the CEE (c.23m users p.m.), 1Q22 e-commerce turnover declined sharply vs. the previous year. The contraction was 25% yoy (from 80% yoy growth in 1Q21), due to the high base in 2021, accelerated by weaker consumer sentiment on rising prices and the Ukraine conflict. Compared to pre-pandemic levels, however, turnover grew, according to Heureka's CEO, Tomas Braverman.

The head of APEK, Mr. Vetyška, also commented that 2H21 experienced a growth deceleration, as lockdowns were lifted, and sees slower 2022E growth of "above 10%", below the long-term trend outlook of 15%.

Separately, according to monthly transaction data published by the CSU, the first five months of 2022 recorded a decline in retail purchases via the internet and mail order. The greatest drop in the recorded turnover for online retail was during March and April, at 19% and 14% respectively, with a total 1Q decline of c.14%. The fall is also attributable to the high base in 2021, as severe lockdowns in the country forced consumers to turn online.

The 2Q22 results

After explosive growth during the pandemic, Pilulka has continued to record solid sales so far in 2022E, albeit with signs of a deceleration. The 2Q22 sales grew +30% yoy, to CZK 0.69bn (from CZK 0.53bn in 2021), posting a solid quarter and recovery vs. the previous quarter. We believe this is due to Pilulka's efforts to increase its active customer base, i.e. organic growth in the online segment, rather than inflation driven. Speaking with the company, price adjustments on its inventory have been implemented to reflect the inflationary environment, but not drastically so far. We note that the 1Q22 results were affected negatively by the high base in 1Q21, due to the pandemic-related lockdowns, and by the start of the Ukraine conflict in February, which caused a sudden drop in sales. Consequently, 1Q22 sales dropped in both yoy and qoq terms.

2Q22 results

CZKm	2Q22	1Q22	4Q21	3Q21	2Q21	1Q21	1H22	1H21
Total Sales	690	630	680	500	530	670	1,320	1,200
qoq	10%	-7%	36%	-6%	-21%	22%		
yoy	30%	-6%	24%	24%	33%	56%	10%	45%
EBITDA margin	n.a	n.a	n.a.	n.a.	-0.3%	4.9%	n.a	2.6%

Source: Company data, WOOD Research

Total 1H22 sales (ex. franchise sales) were CZK 1.3bn (from CZK 1.2bn in 2021). This represents c.10% growth yoy, compared to the previous year's +45% yoy. The lfl sales growth in 1H22 was around 30% yoy so sales remained solid, excluding the strong impact of the COVID-19 portfolio in 1H21, albeit still decelerating.

In its press release, the company confirmed our view on the decelerating e-commerce market locally, and slower sales for Pilulka, which we believe are trending towards normalisation. The company issued revised 2022E sales guidance of CZK 2.8bn in April this year. This implies 18% yoy growth, which, although positive, represents a slowdown vs. the pandemic boom. The deceleration is not surprising, in our view, as the local e-commerce market is cooling off.

In our conversations with the company, it reiterated its guidance that the target is achievable, taking into account the second half of the year, which is stronger for Pilulka traditionally. Assuming flat 2H22E results, the revised target implies that the remaining half-year should grow at a fairly-robust c.20% yoy. In our view, this is plausible, given the non-discretionary and non-cyclical nature of the business, and the underlying inflationary environment, which should be supportive.

Valuation

DCF

We value Pilulka using a 10Y DCF model, which generates at a 12M PT of CZK 1,120/share, or 6.6% upside to the current level. Our key assumptions in our DCF model include:

- ✓ A WACC of 10.6%, starting with a risk-free rate of 4.5% for the Czech Republic and an equity risk premium of 5.0%.
- ✓ We apply a levered Beta of 1.22, starting with the unlevered Beta from the Damodaran sector database of 1.24 for European online retailers.
- ✓ We calculate the terminal value as the average of: 1) the perpetuity with a 3% TGR; 2) an exit EV/EBITDA of 7.5x; and 3) an exit EV/sales of 0.85x.

DCF

CZKm	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
Sales	2,775	3,333	3,929	4,576	5,295	6,067	6,898	7,793	8,755	9,789
EBIT	-22	-3	14	41	82	130	187	256	326	402
NOPLAT	-23	-3	11	33	67	105	152	207	264	325
Depreciation	33	37	44	52	61	70	80	89	101	114
Change in NWC	3	13	16	9	10	11	11	12	13	14
Capex	-85	-75	-86	-94	-101	-108	-114	-119	-124	-127
FCF	-72	-28	-14	1	36	78	129	189	255	327
PV of FCF	-69	-24	-11	1	23	44	65	86	104	120

	I. Perpetuity (g=3%)	II. Exit EV/EBITDA 7.5x	III. Exit EV/sales 0.85x		
Sum of PV	357	357	357	Risk-free rate	4.5%
PV of Terminal value	1,668	1,497	3,205	Levered Beta	1.22
Total EV	2,025	1,854	3,562	Risk premium	5.0%
Net cash (2021)	50	50	50	Cost of equity	10.6%
Equity value	2,075	1,905	3,612	Cost of debt	7.5%
Fair value (CZK/share)	830	762	1,445	Tax rate	16.1%
Average (CZK/share)	1,007			Effective cost of debt	6.3%
12M PT (CZK/share)		1,120		Weight of equity	99.2%
Upside/(downside)		6.6%		Weight of debt	0.8%
				WACC	10.6%

Source: WOOD Research

Peer group valuation

As a sanity check for our DCF valuation, we consider Pilulka's forward earnings on the median peer multiples for European e-pharmacies (Zur Rose and Shop Apotheke). On this basis, applying a 0% trading premia, we see a fair value for Pilulka on the forward EV/sales multiples of CZK 1,104/share. On the forward EV/EBITDA multiples, we have chosen to look only at 2024E, as by this time we expect Pilulka's earnings to have converged towards its EU e-pharmacy peers. On this basis, applying a 0% premia for EV/EBITDA, we see a fair value of CZK 752/share. Applying weights of 80/20, we reach a fair value of CZK 1,034/share, 8% below our 12M PT, and 2% below the current share price.

Peer multiples valuation

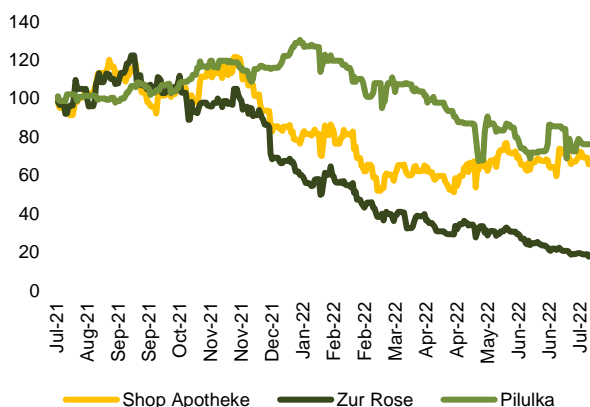
	EV/sales	EV/EBITDA*
Median 2022-24E peer group multiples	0.8	30.3
Premium/(discount)	0%	0%
Average 2022-24E forecasted earnings	3,346	60
EV	2,710	1,830
Net cash (2021)	50	50
Equity value	2,760	1,880
Fair value (CZK/share)	1,104	752
Weight	80%	20%
Weighted fair value (CZK/share)		1,034

Source: Bloomberg, WOOD Research; *for EV/EBITDA multiples sanity check, we look at the 2024E EBITDA earnings and the 2024E peer median group multiple

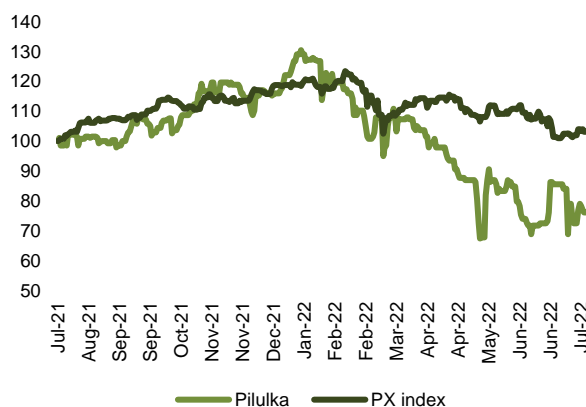
Sector performance and valuation

Pilulka's share price rallied to a peak in January 2022 at CZK 1,800, implying a c.+220% gain since its IPO. Since then, however, it has de-rated, losing c.40% of its peak value, currently, although it still trades at double the IPO price. Comparable peers like Shop Apotheke and Zur Rose also have de-rated since their LTM peaks: Shop Apotheke trades currently at a 45% discount to the peak, while Zur Rose is at a c.85% discount. We believe the share price weakness of Zur Rose and Shop Apotheke can be explained partially due to the slowdown in the rollout of the eRx system in Germany, moderating sales expectations in the short-to-medium term. An improved outlook on the implementation of Rx sales online may be a trigger going forward, which is not available to Pilulka in the near term. If we compare the price trends, Pilulka's share price drop has been less than its peers in the last 12M, while it has underperformed compared to the PX index, and trades at c.50% discount on a LTM basis.

Share price performance vs. peers



Share price relative to the local market index



Source: Bloomberg, WOOD Research

On our estimates, Pilulka trades at an average 2022-24E EV/sales multiple of 0.81x, a c.60% premium to the EU e-commerce retailers in our peer group (2022-24E EV/sales of 0.52x). There are still differences among our EU e-commerce retail peers basket however. We look more closely at the pure e-pharmacies such as Zur Rose and Shop Apotheke, which have de-rated significantly over the past 12 months.

Zur Rose and Shop Apotheke were trading at a median of c.2.5x EV/sales in the latter half of 2021 (a 60% premium vs. Pilulka at 1.4x), but have dropped steeply since, and are now at c.1.0x, a c.60% discount to the 2021 average and at similar to pre-pandemic levels. We believe that on top of the market-wide sell-off in e-commerce stocks, the de-rating of the Swiss and German-based e-pharmacies was also due to the slower-than-expected roll-out of the eRx system in Germany, which has hampered sales expectations in German e-pharmacy. Pilulka now trades on a par with the 2022-24E EV/sales of Zur Rose and Shop Apotheke.

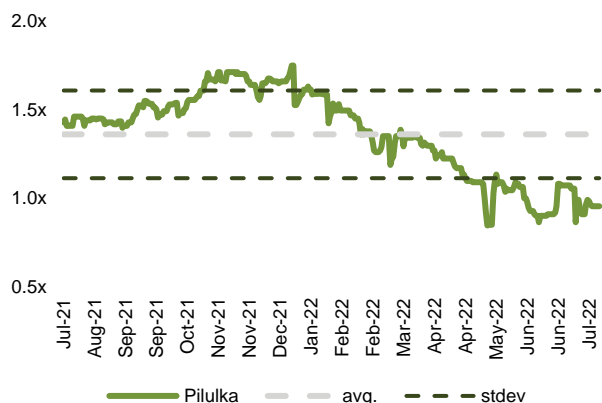
Looking at online retailers of a discretionary nature, such as the clothing segment (Asos, Boohoo, Zalando), these trade at median 2022-24E EV/sales of c.0.35x, a significant discount vs. pre-pandemic levels and our median EU e-commerce peer basket. We believe this is due to the lower median growth outlook for sales for the fashion/clothing retailers (2021-24E revenues CAGR of 10%) compared to those of Pilulka and its peers with non-discretionary businesses like Ocado, HelloFresh and Zooplus, which have median 2021-24E revenue CAGRs of c.15% and trade at 2022-24E c.1.0x EV/sales.

Pilulka trades at a similar level to its EU e-commerce retailers, in general, compared to its global peers (which, in addition to retail, also include business lines including SaaS, logistics and entertainment, which generate higher earnings as they grow in scale). It is also at a similar level to the US healthcare companies with a large established retail pharmacy presence, and an online presence, but lower median growth outlook due to other mature business segments, like health insurance and pharmaceuticals.

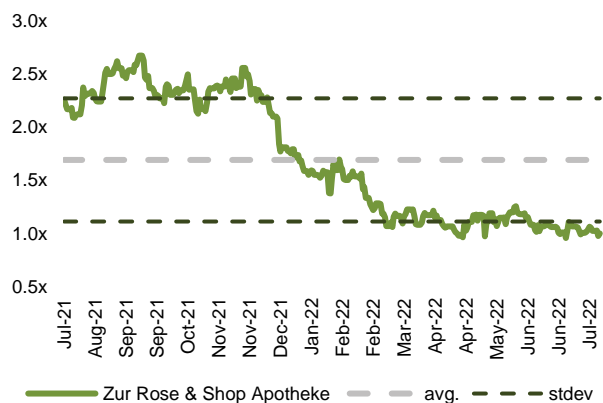
We expect improved profitability for Pilulka by 2024E which, we believe, should have converged towards the expected profitability of our e-pharmacy peers. On the back of this improved profitability, which it is yet to be seen whether Pilulka can deliver, our forecast implies a 2021-25E EBITDA CAGR of 27.7%, similar to the median of its e-pharmacy peers (2021-24E CAGR of 21.2%). Pilulka trades at a 2024E EV/EBITDA of 45x, compared to its e-pharmacy peers with 2024E median of 30.3x.

LTM EV/sales (based on 2021 and 2022E)

Pilulka



Zur Rose and Shop Apotheke (median)



Source: Company data, Bloomberg, WOOD Research. The chart above presents the EV/sales, based on actual reported historical figures for 2021. For 2022, we use the Bloomberg consensus estimates for the peers and our forecasts for Pilulka.

Looking at EV/sales trends in the past 12 months, we see pressure on valuations for e-pharmacies as all three companies have de-rated significantly. The average LTM EV/sales for Zur Rose and Shop Apotheke stood at 1.8x: they trade currently at one standard deviation below the average, at 1.0x. Pilulka, which has traded c.20% below its peers in the LTM on EV/sales is also at c.1.0x: again, one standard deviation below its trailing 12M average

Peer valuation multiples

	Mcap (EURm)	ADTV (EURm)	EV/sales						EV/EBITDA					
			2019	2020	2021	2022E	2023E	2024E	2019	2020	2021	2022E	2023E	2024E
Pilulka	107	0.02	0.7	0.8	1.4	1.0	0.8	0.7	n.m.	53.2	113.7	205.7	73.8	44.6
Zur Rose	864	12.7	0.9	1.7	2.5	0.6	0.5	0.5	n.a.	n.a.	n.a.	n.a.	n.a.	36.4
Shop Apotheke	1,749	9.9	1.0	1.8	2.7	1.3	1.0	0.8	n.a.	117.3	n.a.	n.a.	66.2	24.1
Asos	1,127	9.5	1.1	1.1	1.1	0.3	0.3	0.2	27.9	12.9	13.1	6.2	4.3	3.4
Boohoo	875	9.1	3.2	3.0	1.9	0.6	0.4	0.4	37.8	31.7	21.2	17.3	8.9	6.3
HelloFresh	5,862	44.8	1.0	1.7	2.2	0.5	0.5	0.4	131.4	13.4	26.7	8.5	6.2	4.3
Ocado	8,049	25.4	5.4	6.5	6.7	2.6	2.4	2.0	205.8	88.8	158.0	337.2	51.2	27.1
Showroomprive	142	0.3	0.2	0.1	0.4	-0.1	0.2	0.1	n.a.	2.3	7.0	n.a.	3.4	2.6
Zalando	6,753	51.0	1.5	1.9	2.2	0.6	0.5	0.5	26.6	26.7	34.5	13.7	10.2	7.3
Zooplus	2,760	0.0	0.5	0.5	1.1	0.9	0.8	n.a.	66.6	14.3	149.3	26.7	21.3	n.a.
EU e-commerce retail	1,438	9.7	1.0	1.7	2.2	0.6	0.5	0.4	52.2	20.5	26.7	15.5	9.6	6.8
<i>Pilulka vs. median</i>			-27%	-56%	-36%	60%	49%	64%	n.m.	160%	326%	1225%	671%	557%
CVS. Health	120,833	477.0	0.6	0.6	0.6	0.5	0.5	0.5	8.1	7.4	8.4	8.5	7.7	7.0
Walgreen Boots	31,976	278.8	0.5	0.6	0.6	0.3	0.3	0.3	9.4	13.0	8.8	7.0	6.9	6.8
Rite Aid	396	29.6	0.2	0.3	0.3	0.3	0.1	0.1	n.a.	6.5	7.0	10.5	6.8	6.9
US pharmacies	16,707	154.2	0.5	0.6	0.6	0.5	0.5	0.4	9.4	7.4	8.4	10.5	6.9	6.8
<i>Pilulka vs. median</i>			42%	33%	143%	77%	64%	64%	n.m.	624%	1259%	1857%	965%	552%
Alibaba	325,259	2,505.8	8.2	8.1	4.2	1.7	1.8	1.5	32.9	29.4	20.7	11.4	10.0	8.0
Allegro	6,048	18.9	n.a.	22.3	12.4	3.5	2.8	2.3	n.a.	56.2	33.3	14.0	11.9	9.6
Amazon	1,145,182	9,962.1	3.3	3.6	3.7	2.3	2.0	1.8	23.3	26.0	26.2	17.0	13.3	11.1
Etsy	10,747	411.0	9.0	6.9	12.1	4.8	4.2	3.6	52.1	24.4	51.4	18.1	15.0	12.2
Global e-commerce	168,003	1,458.4	8.2	7.5	8.1	2.9	2.4	2.0	32.9	27.7	29.7	15.5	12.6	10.4
<i>Pilulka vs. median</i>			-91%	-90%	-83%	-67%	-66%	-66%	n.m.	92%	282%	1227%	484%	330%

Source: Company data, Bloomberg, WOOD Research

Peer growth, profitability, and gearing metrics

	2021-24E CAGRs			EBITDA margin				Net debt/EBITDA		
	Revenues	EBITDA	Net	2021	2022E	2023E	2024E	2022E	2023E	2024E
Pilulka	18.2	27.7	n.m.	1.2	0.5	1.1	1.5	1.7	1.5	1.2
Zur Rose	17.9	n.m.	n.m.	-8.3	-5.1	-1.7	1.3	n.m.	n.m.	17.0
Shop Apotheke	24.4	n.m.	n.m.	-3.7	-0.4	1.6	3.4	n.m.	3.0	1.3
Asos	8.7	-0.2	-10.3	8.4	4.6	5.8	6.5	0.6	0.4	0.3
Boohoo	9.2	-4.3	0.0	8.8	3.2	4.6	5.9	0.6	0.1	0.2
HelloFresh	16.9	18.0	17.2	8.2	6.4	7.3	8.4	-0.4	-0.8	-1.1
Ocado	15.3	40.1	n.m.	4.2	0.8	4.6	7.5	42.4	9.5	5.7
Showroomprivé	1.1	-9.1	-18.7	6.2	43.8	4.4	4.5	-0.7	-1.5	-2.0
Zalando	10.4	10.2	12.3	6.4	4.3	5.3	6.4	-1.2	-0.6	-0.6
Zooplus	n.m.	n.m.	n.m.	0.7	3.5	3.8	n.a.	-0.9	-1.1	n.a
EU e-commerce retail	12.8	5.0	0.0	6.2	3.5	4.6	6.1	-0.4	-0.3	0.2
<i>Pilulka vs. median</i>	42%	454%	n.m.	-80%	-87%	-76%	-75%	-508%	-657%	435%
CVS. Health	5.2	3.2	0.0	6.9	6.4	6.5	6.6	2.1	1.7	1.3
Walgreen Boots	1.9	-8.7	18.6	6.5	4.7	4.5	4.7	1.5	1.3	1.6
Rite Aid	-0.4	-23.8	n.m.	4.3	2.5	2.0	1.9	9.7	5.9	6.0
US pharmacies	1.9	-8.7	9.3	6.5	4.7	4.5	4.7	2.1	1.7	1.6
<i>Pilulka vs. median</i>	878%	-420%	n.m.	-81%	-90%	-76%	-67%	-18%	-15%	-27%
Alibaba	13.0	11.1	1.9	20.1	15.1	17.7	19.1	-3.9	-1.9	-1.9
Allegro	32.5	14.4	12.2	37.2	24.7	23.1	24.0	2.0	1.4	0.9
Amazon	14.1	18.6	20.7	14.1	13.5	15.0	16.0	0.5	0.5	0.6
Etsy	12.9	22.0	13.8	23.5	26.4	27.9	29.4	0.0	0.0	0.0
Global e-commerce retail	13.5	16.5	13.0	21.8	19.9	20.4	21.5	0.2	0.3	0.3
<i>Pilulka vs. median</i>	34%	68%	n.m.	-94%	-98%	-95%	-93%	623%	472%	250%

Source: Company data, Bloomberg, WOOD Research

The Czech retail pharmacy and health and beauty markets

The publicly-available statistics for the overall Czech pharmacy market are imperfect, as they focus either narrowly on the sales channel, i.e., bricks & mortar stores excluding e-shops, or on prescription and registered OTC drugs, but excluding other CHC goods sold commonly at pharmacies. We can say, however, that the turnover of the pharmacies through the bricks & mortar channel was around CZK 65.5bn in 2020, according to the CSU. Of this, Rx and registered OTC drugs accounted for c.CZK 50.3bn, according to the Czech Institute of Health Information and Statistics (UZIS), or c.77%.

In 2020, total spending on medicines was CZK 88.2bn, according to the latest available data from UZIS. Of this, c.43% was generated by the country's c.100 hospital pharmacies, and c.57% by the c.2.5k public pharmacies (the applicable market segment for Pilulka and its peers). Among the public pharmacies, Rx generated c.CZK 42bn of turnover and the remaining CZK 8.4bn was for OTC drugs.

The Czech pharma market is mature, like much of Europe, with 2011-20 revenue CAGRs of 4.2% for Rx and 2.9% for OTC (OTC sales were impacted negatively in 2020). In the case of Rx, this was driven by: increased use of expensive (usually biological) cancer drugs (typically hospital drugs) and an increase in the number of new hospitals and clinics. UZIS does not comment on the OTC market drivers but the pre-pandemic 2017-19 CAGR was 10.8%, vs. a 2011-17 CAGR contraction of 2.2%, on a *per capita* basis. We speculate that this is part of the broader trend towards healthier lifestyles, for example.

Turnover of medicines at Czech pharmacies

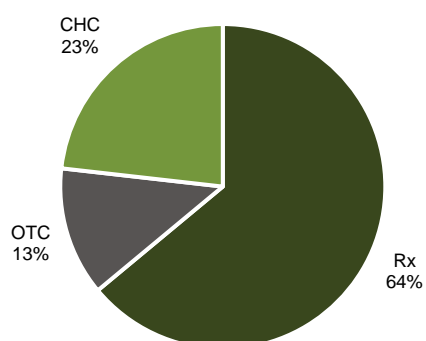
CZKbn	2017		2018		2019		2020		2017-20 CAGR
	CZKbn	% of total	CZKbn	% of total	CZKbn	% of total	CZKbn	% of total	
Total revenues	71.6	100.0%	75.8	100.0%	80.6	100.0%	88.2	100.0%	7.2%
Hospital pharmacies	28.2	39.4%	31.5	41.5%	32.7	40.6%	37.9	43.0%	10.3%
Rx	27.8	38.8%	31.0	40.9%	32.3	40.0%	37.5	42.5%	10.5%
OTC	0.4	0.6%	0.5	0.6%	0.4	0.6%	0.4	0.4%	-3.0%
Public pharmacies	43.4	60.6%	44.3	58.5%	47.9	59.4%	50.3	57.0%	5.0%
Rx	35.6	49.7%	36.0	47.4%	38.7	48.0%	41.9	47.6%	5.6%
OTC	7.8	10.9%	8.4	11.1%	9.2	11.4%	8.4	9.5%	2.4%

Source: UZIS, WOOD Research; note: figures exclude medical equipment

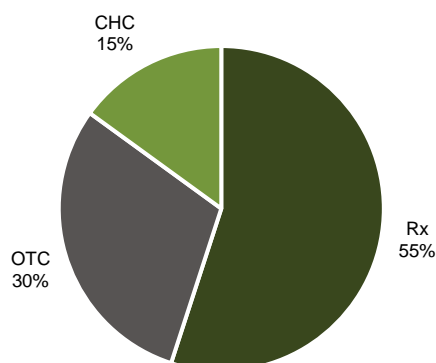
We note that OTC expenditures are defined narrowly by UZIS, i.e., registered medicinal products sold without prescriptions, identifiable by the fact that they include an informational leaflet, like prescription drugs. It excludes nutritional supplements and infant foods, which are generally considered as CHC, as well as cosmetics and other health and beauty goods.

Taking the CZK 65.5bn turnover for bricks & mortar pharmacies from UZIS and stripping out the figures for Rx and registered OTC drugs, we reach CZK 15.2bn, or c.23% of the turnover, which is primarily other CHC products, we believe. As a sanity check, we compare this with the reported sales mix of Pilulka's bricks & mortar units, and can see that they are broadly comparable.

Typical bricks & mortar pharmacy sales mix

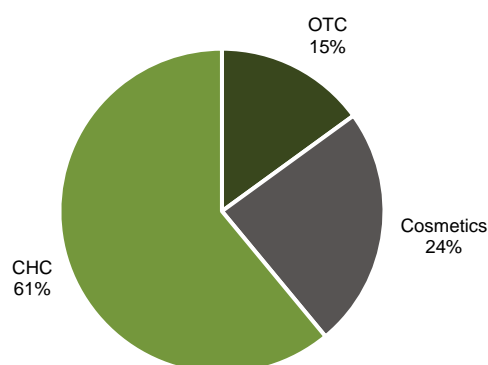


Pilulka's bricks & mortar pharmacy sales mix



Source: Company data, CSU, UZIS, WOOD Research

Online, however, we see that Pilulka's most popular categories of products are CHC and beauty & cosmetics, while OTC lags at 15%. We speculate that one of the reasons for this is that consumers still prefer to consult with pharmacists when purchasing OTC drugs.



Source: Company data, WOOD Research

On a per-unit basis, the country's c.2.5k public pharmacies generated average revenues on pharmaceutical and medical equipment of c.CZK 21m (UZIS data) in 2020, or just over CZK 27m including CHC, based on CSU data. The former figure compares with average sales of c.CZK 350m for c.100 hospital pharmacies, nearly 17x higher. The main reasons for this, in our view, are above all: 1) the much higher cost of typical hospital drugs (including biologicals, typically cancer treatments vs. drugs dispensed directly to patients); 2) purchases of typical "consumables" used in the routine delivery of care; and 3) the very large number of sub-scale "mom and pop" public pharmacies.

Average turnover per bricks & mortar pharmacy (Czechia)

	Pilulka	Dr. Max	BENU CR	Czechia (ave.)	Germany (ave.)
Units	27	463	186	~2,500	18,753
Physical sales per unit (CZKm)	19.2	44.9	33.3	21.0	69.9
Physical sales per unit (EURm)	0.8	1.8	1.3	0.8	2.8

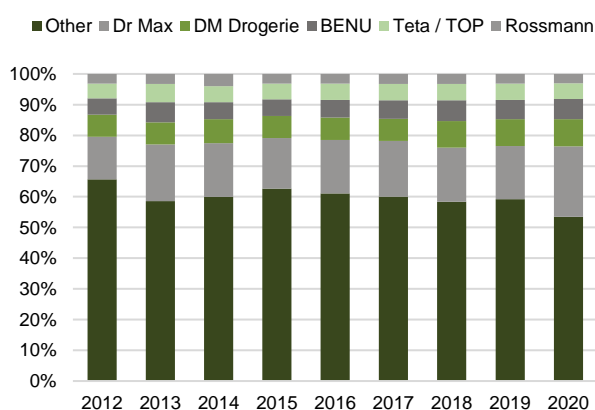
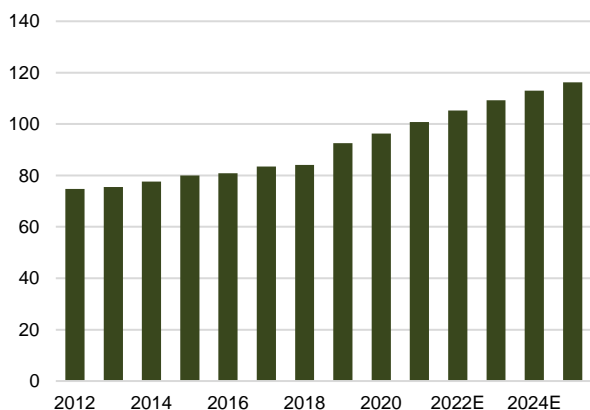
Source: Company data, CSU, UZIS, ABDA, WOOD Research. Physical sales are calculated as total sales minus online sales. The number of units was collected from press releases and media outlets for 2021.

The large pharmacy chains, on the other hand, perform materially better on this metric. In 2021, while Pilulka's own (small) 27 bricks & mortar pharmacy network generated an average turnover per store of CZK 19.2m in Czechia, market leader Dr. Max, generated nearly CZK 45m and #2-ranked BENU CZK 33.3m (bearing in mind that bricks & mortar are both their core businesses, unlike for Pilulka). For the sake of comparison, the 2021 average for Germany's c.19k public pharmacies was c.EUR 2.8m according to data from the Federal Union of German Associations of Pharmacists (ABDA). This should be taken with a pinch of salt, however, as there are significant differences when comparing individual pharmacies in Germany. According to ABDA, about 60% of pharmacies do not reach the average sales amount whereas some individual, large pharmacies greatly exceed it.

Health and beauty market

The retail pharmacy business is not just about prescription and registered OTC drugs. It overlaps with broader CHC (registered OTC, but also supplements, for example) and infant and personal care. Pharmacies commonly stock some or all of these FMCG, just like drugstores (e.g., parapharmacies, with no dispensaries) or supermarkets, as they represent a way to grow the basket size for the same footfall, and can typically generate better margins, especially when the mark-ups on the majority of their turnover, Rx drugs, are regulated.

Looking at the broader group of health and beauty specialist retailers (i.e. pharmacies and drugstores), these generated turnover in the country of CZK 96.3bn in 2020, according to data from Euromonitor, or roughly 1.5x the turnover of public pharmacies alone. This is, again, a mature market, dominated increasingly by five top players - the DM Drogerie, Teta/TOP and Rossmann drugstore chains, in addition to Dr Max and BENU - with a 2012-20 CAGR of 3.2%. Also, like OTC drugs, we can see that the growth has accelerated noticeably in the past few years. After a period of flat turnover in 2014-17, sales accelerated to c.5% p.a. from 2018. According to Euromonitor forecasts, the segment should continue to grow by c.3.8% p.a. through to 2025E, somewhat above the long-run trend,.



Source: Euromonitor, WOOD Research, 2020 data from Euromonitor.

Retail pharmacy

Competitive landscape in Czechia

The Czech pharmacy market is split largely between chains owned or operated by the large drug wholesalers on the one hand, and independently owned and operated pharmacies on the other. Between them are a few mid-sized players, like Pilulka and Lekarna.cz, which differentiate themselves through their large online presence.

The three major retail chains operate about 40% of the total public pharmacy units in Czechia (2.5k units, stable historically). The rest of the segment can best be described as fragmented, where the majority of pharmacies are operated by single-pharmacy owners or owners with two-to-five outlets, according to the Czech Chamber of Pharmacists.

The top-three retail chains in order of pharmacy units (including franchise pharmacies) in Czechia currently are Dr. Max (c.460), BENU (c.315), Pilulka (c.160), followed by Sanovia (c.40). Because of the fragmented and saturated market, existing chains find it difficult to establish own-branded pharmacies, and thus often revert to franchising solutions. This affects BENU and Pilulka predominantly, as they have significant franchise segments. Dr. Max, on the other hand, is the only top pharmacy that does not offer franchise solutions and has found success without it. Finally, there is one “pure-play” e-pharmacy that we are aware of: Lekarna.cz, founded in 2003 and owned by Dr. Finsterle. Comparing the online segment in Czechia, Lekarna.cz recorded higher sales than Pilulka in 2020.

Basic financial results of the top Czech pharmacies

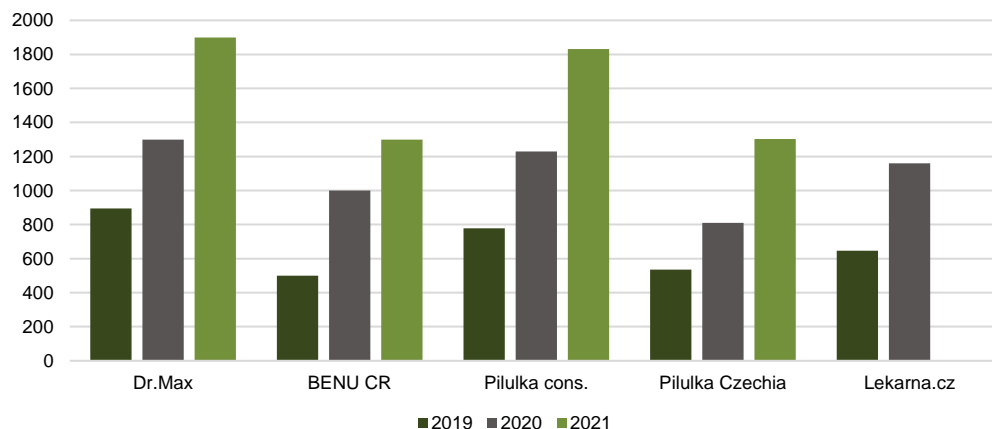
CZKbn	Sales			EBITDA			EBITDA Margin			Net income margin		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Dr. Max (CLH)	20,015	21,098	22,566	1,376	1,475	1,517	6.9%	7.0%	6.7%	2.4%	2.5%	2.6%
BENU CR	6,230	7,581	8,700	408	567	n.a	6.6%	7.5%	n.a	3.6%	4.5%	n.a
Pilulka (consolidated)	1,239	1,780	2,380	-24	22	21	-1.9%	1.3%	0.9%	-3.7%	-1.2%	-1.1%
Lekarna.cz	720	1,272	n.a	18	46	n.a	2.4%	3.6%	n.a	1.0%	2.6%	n.a

Source: Commercial registry, WOOD Research. EBITDA for Pilulka is excluding changes in provisions and provisions for impairment to be able to compare to other peers. EBITDA calculation for Pilulka includes the amortisation of positive/negative consolidation difference.

Based on revenues, the Czech retail pharmacy market is dominated by Dr. Max and BENU CR. Both chains are integrated with large wholesalers: Dr. Max with ViaPharma (both are owned by local private equity group Penta); and BENU with Phoenix (both are owned by Germany’s Phoenix Group). They are also more profitable, posting c.6-7% EBITDA margins in the past three years and c.2-4% on net margins. Pure-play e-pharmacy Lekarna.cz, also posted positive margins, albeit at about half the level of Dr. Max and BENU.

Dr. Max’s sheer size also makes it the largest in terms of online sales (in absolute terms) among the local (e-)pharmacies, but Pilulka is not far behind. In 2021, Pilulka posted c.CZK 1.8bn in the online segment, close to Dr. Max’s c.CZK 1.9bn. When comparing pure Czech online sales, however, Pilulka’s online presence more closely resembles BENU CR. We note that the data for online sales for its peers are approximate (gathered from press reports), so we do not know their exact figures or breakdown, unlike for Pilulka.

Online sales of goods by Czech pharmacies



Source: Company data, various media outlets (E15, Forbes, Seznam), company press releases, commercial registry, WOOD Research

Other drug wholesalers, like Alliance Healthcare and Ceska Lekarnicka also have organised groups of independently-owned pharmacies: Alliance under the brand name Alphaega (c.300 partners), and Ceska Lekarnicka with Moje Lekarna (c.400 partners, as well as c.40 units owned by a subsidiary, Sanovia).

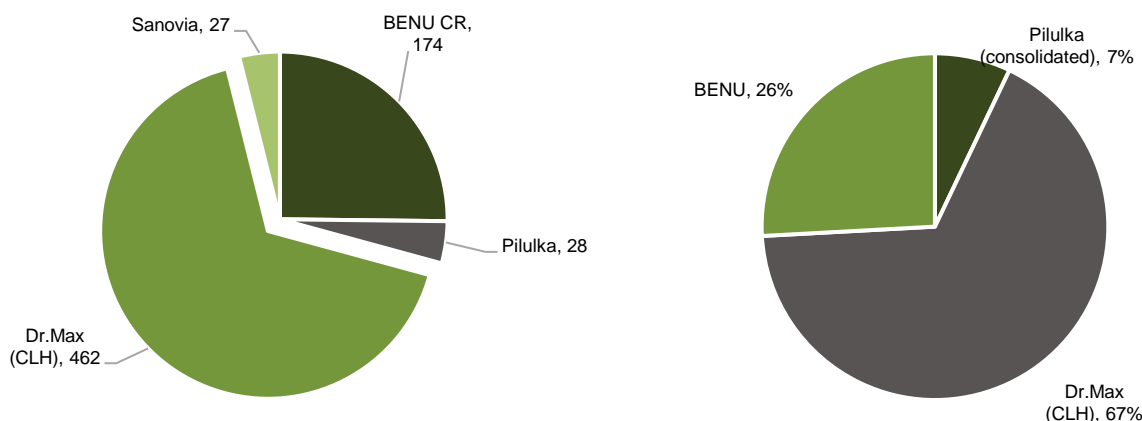
Key local pharmacy players

Dr. Max Group is owned by Penta, a CEE-based private equity group. The Dr. Max Group, a healthcare holding company, operates one of the largest retail pharmacy chains in the CEE. Its presence spans the CEE region and Italy, with a total of c.2.3k pharmacies (of which c.460 are in Czechia) under the Dr. Max brand. The group's retail pharmacy chain also has the benefit of being integrated with one of Penta's drug wholesalers, ViaPharma. Under the Dr. Max umbrella, the group began producing and rolling out a private label catalogue in 2011, offering food supplements, OTC and non-prescription medical devices. Venturing into private label is a growing and profitable market segment for pharmacies, especially those with lower purchasing power and integration with a wholesaler: the advantages being greater margins, improved customer loyalty and brand awareness. The turnover of its private label was c.CZK 1.8bn (+11% yoy) in 2021, or c.10% of its total sales (25% in the OTC category according to a press release). Dr. Max is also expanding its efforts in the online segment, generating impressive growth in the past five years, with a 2017-21 CAGR of 60%. In 2021, revenues in the online segment were c.CZK 1.9bn (+c.50% yoy), c.50% higher than Pilulka's online sales in Czechia.

BENU is owned by the Phoenix Group. The Phoenix Group is a leading healthcare provider in Europe which operates several retail pharmacy chains across 14 European countries. It has more than 2.8k pharmacies, predominantly under its largest and most popular brand, BENU (c.1.5k). In Czechia, there are c.315 BENU-branded pharmacies. Like Dr. Max, BENU also benefits from the integration with a wholesaler, which is owned by the Phoenix Group.

Lekarna.cz operates a fully online pharmacy business model across the Czech Republic. It is, to our knowledge, the only 'pure' e-pharmacy in Czechia. It is owned by Dr. Finsterle, who founded the company in 2003.

Top pharmacies' owned-operated units, Czechia, 2020 Top three retail chains: market share by sales, 2021

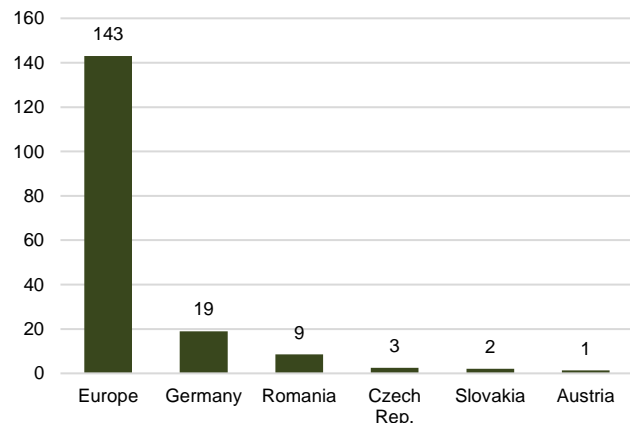


Source: Czech Chamber of Pharmacists annual report 2020, Company data, Commercial registry, key local and regional market players, WOOD Research

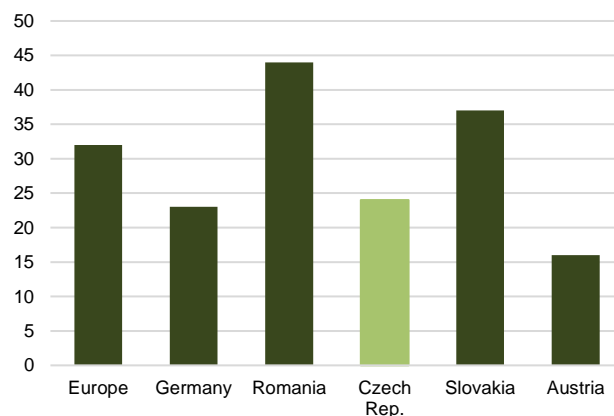
Regional context

There were c.143k pharmacies in Europe in 2021, according to the study compiled by ABDA. In the CEE countries, where Pilulka currently operates, the largest number of bricks & mortar pharmacies was in Romania, with c.8.6k, followed by Czechia at 2.5k, and Slovakia at 2.0k. *Per capita*, the greatest density of pharmacies was in Romania, with 44 pharmacies per 100k inhabitants. In Slovakia it was 37 and in the Czech Republic, 24. The EU average, in comparison, was 32 pharmacies per 100k inhabitants.

Number of pharmacies in Europe, 000



Density of pharmacies per 100k residents



Source: WOOD Research, Federal Union of German Associations of Pharmacists

In Central Europe, there are four primary retail pharmacy chain owners: PENTA (the Dr. Max brand), Phoenix Group (the BENU brand), Walgreens Boots Alliance (the Alphega and Boots brands) and Vilnius Prekyba (the Euro-Apteka brand). Together, these firms operate c.6.5k pharmacies, according to IQVIA report in 2021.

Pharmacy operators in Europe

PENTA

Dr.Max chain



VILNIUS PREKYBA

Euro-Apteka chain



PHOENIX group

Benu own chain
Benu own & PHOENIX virtual chain
PHOENIX virtual chain



Walgreens Boots Alliance

Boots own chain

Boots own & Alphega virtual chain
Alphega virtual chain



Source: IQVIA

Key regional e-pharmacy players

There are two major e-pharmacy players, Zur Rose and Shop Apotheke, which operate predominantly within the DACH region and are the most relevant publicly-listed peers to compare with Pilulka. Germany is slowly rolling out a fully-fledged eRx system, allowing mail order or online purchases of prescription drugs. Although the initiative has met some delays and is in the testing stage, the companies are confident that the full rollout should get underway in 2022E and be implemented by 2023E. To prepare for this, both Zur Rose and Shop Apotheke have invested heavily into the infrastructure for online sales of Rx.

Swiss-listed Zur Rose is the largest e-pharmacy in Europe, by sales. It operates primarily in Germany, under the leading Doc-Morris brand, and recorded a consolidated 12.4m active customers in 2021. Other than its core market, it is also present on a smaller scale in France and Spain, and is a

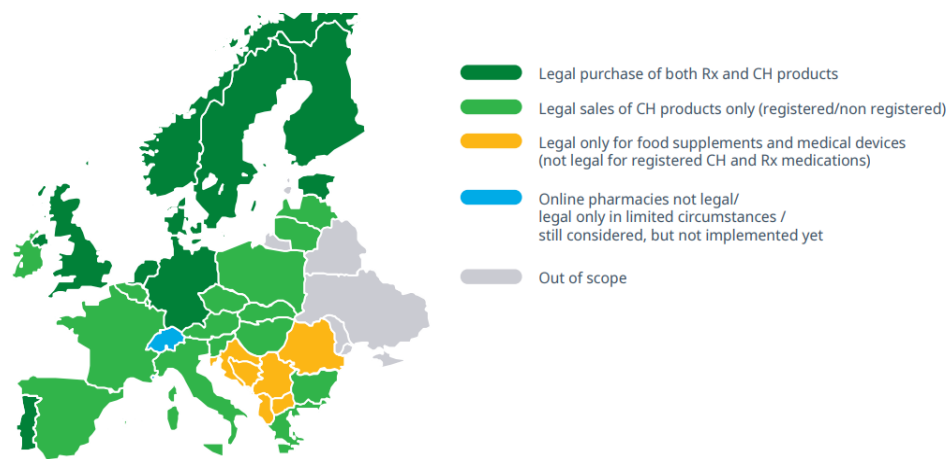
leading drug wholesaler in Switzerland. Zur Rose is actively developing a healthcare eco-system, leveraging its e-commerce business to build a digital health umbrella for customers, beginning from awareness of health issues to diagnosis, treatment and monitoring.

Dutch-based Shop Apotheke Europe is the second-largest e-pharmacy in Europe, focused on the DACH region, the Netherlands, Belgium, France and Italy. The e-pharmacy recorded almost 8m active customers across its regional portfolio in 2021, including its core market: Germany. The pure online retailer aims to build the leading e-pharmacy platform in Europe.

Regulatory environment

The sale of prescription pharmaceuticals and consumer healthcare products, in general, is subject to a relatively-high level of national regulation. The main difference between member states is in the sale of prescription drugs; and, to a lesser extent, the sales channels allowed for regulated OTC products. Within the EU-27, countries primarily in Scandinavia and NWE allow the sales of Rx drugs via e-shops or mail order. In the rest, including the Czech Republic, Rx drugs are available only from registered pharmacies. Most of the rest of Europe allows the sales of registered OTC products via pharmacies, but not other e-shops. Some countries, including the Czech Republic, make exemptions for some registered OTC drugs to be sold outside of pharmacies or specialised e-pharmacies: in parapharmacies, grocery stores or fuel stations, for instance. In the Czech Republic, at least, this range is limited, and the share of total sales through these channels is marginal (mid-single digits).

Pharmaceuticals sales online: channels allowed



Source: IQVIA Czech Republic; Rx = prescription, CH = consumer health

Online Rx sales are not in the current government's programme

As the penetration of e-commerce has grown in the country, there have been efforts in the Czech Republic to permit online sales of Rx drugs, as well as OTC. Pilulka, and other pharmacy chains like Dr. Max, expect the law to be amended, at some point, and that pharmacies would be allowed to dispense Rx drugs by mail order and/or sell online.

Former Health Minister Adam Vojtech (of the current opposition party, ANO) first proposed the idea of allowing online sales of Rx drugs in 2019, at the urging of, and with support from, the National Council of Persons with Disabilities. At that time, the draft failed to gain traction with the ruling coalition. The Health Minister proposed a similar draft amendment to the Act on Addictive Substances in March 2021, which would have allowed bricks & mortar pharmacies to dispense (most) prescription drugs by mail order, but this was rejected in the final parliamentary reading. In the end, it had support from only 40% of MPs in the ruling coalition, and was rejected by all the MPs from the opposition parties, including the Pirates and ODS, as well as the far-right SPD and the Communists.

A new coalition government took office in late 2021, formed by the liberal-conservative SPOLU group (ODS, KDU-CSL and TOP-09) and the PirStan group (Pirates, STAN). Pirates leaders support the idea of mail-order sales in principle, but voiced concerns that the Health Ministry's proposal failed to protect independent pharmacies sufficiently (a point raised also by other traditional, small business-leaning parties, e.g., ODS), as well as "patient safety". Other parties, like TOP-09, have voiced concerns regarding the safety of end-users when buying Rx drugs online. In general, there has been no recent legislative push towards allowing online sales of Rx through mail order by the current coalition. Moreover, we have not seen any indication that it is in the current legislative programme. Overcoming these concerns is likely to be the largest political hurdle for legislative change, in our view.

The Czech Chamber of Pharmacists, which represents the views of mainly independent pharmacies, is open to a discussion but its agreement is conditional on, *inter alia*: 1) the remuneration of pharmacy care; and 2) settling on a platform for the continuity of patient-pharmacist contact.

Last mile

The biggest Czech pharmacies, Dr. Max, BENU, Pilulka and Lekarna.cz, all offer typical last-mile options. These include: i) to-door delivery, either through Czech Post or third-party logistics operators and couriers (like PPL, DPD); ii) pick-up points at their own or partner pharmacies; and iii) parcel lockers

and pick-up, drop-off points (PUDO). Customers in Czechia prefer to collect orders themselves, as opposed to to-door delivery, according to a 2021 survey. Thus, partnering with an established last-mile operator, like Zasilkovna (Czechia's largest operator of parcel lockers and PUDO points), is important, as it improves the proximity for Pilulka's customers, which could potentially drive more sales.

According to a survey published in mid-2021, about half (48%) of Czech e-commerce customers now prefer to collect orders themselves. The survey, commissioned by APEK and Nielsen Admosphere, found that e-commerce customers in Czechia prefer to pick up orders at either one of the e-shop's own pick-up points, lockers or PUDO points, as opposed to home delivery. This represents a fairly substantial shift from when APEK ran the survey in 2018, when 66% preferred home delivery (45% in 2021), while personal pick-up was preferred by only 23% of respondents. When asked for their preference for pick-up points, 27% of 2021 respondents said that they preferred third-party locations (their local post office, or a Zasilkovna partner), vs. 19% in 2018. Another 15% preferred to use an e-shop's own pick-up points (which, in the case of e-pharmacies, also includes the bricks & mortar shops themselves) vs. 4% in 2018, and 6% preferred lockers (which were still relatively rare in the Czech Republic four years ago). The pandemic played its part in this shift - 22% of respondents said that it was a factor in choosing pick-up points vs. home delivery - but the growing availability of new locations was another reason.

We believe that expanding the network of pick-up points is important for e-shops like Pilulka to expand the customer base and improve proximity/accessibility to collect orders. Through own-brand or third-party channels, Pilulka could potentially encourage the usage of these last-mile options and consequently drive more sales. We believe that due to the growing preference for in-person collection, there is increasing demand for pick-up locations as a flexible and affordable solution for end-users, ensuring that the delivery of the product fits their schedule and preferences. This implies an expanding importance for e-shops to partner with third-party providers like Zasilkovna, to increase the number of dispensing points and serve the growing demand for pick-up locations, without the need to invest heavily into a proprietary network.

With the exception of Dr. Max, all the top pharmacies offer last-mile deliveries through Zasilkovna. The *Status of E-commerce in Czech Republic 2022* project, which tracks e-commerce trends on its platforms, shows that 42% of orders have been delivered through Zasilkovna so far in 2022. According to Zasilkovna, it owns about half of the 3.5k parcel lockers in Czechia. Meanwhile, it is strengthening its network with self-servicing lockers (Z-boxes) in attractive and high-traffic locations, such as shopping centres, railway ticket offices and supermarkets. BENU has partnered with Rohlik.cz (one of the largest local e-grocers), offering its product catalogue on the Rohlik.cz platform. Dr. Max, interestingly, does not deliver through Zasilkovna or any other parcel locker operator, currently. According to press reports, it intends to pilot its own-branded new self-service parcel locker network.

Currently, Pilulka operates c.25 Pilulka Boxes, mainly in Prague. By the year-end, it aims to have c.50 across the Czech Republic and Slovakia. In the trial phase, these were situated in Pilulka stores, but new boxes are being added in high-traffic locations, which both extend customers' last-mile options and increase the company's visibility.

Pilulka also offers a delivery service, Pilulka Auto. It highlights Pilulka Auto (a fleet of c.15 vehicles) as a standout product offering same-day delivery. The survey by APEK and Nielsen also indicated that 67% of respondents would prioritise an e-shop that offers same-day delivery, which is positive for Pilulka. The delivery service is limited so far, operating only in key regional cities. According to Pilulka, c.20% of all orders are delivered to-door by this service, with c.70% sent through Czech Post, third-party couriers or parcel lockers, and the remainder picked up at Pilulka points (including own/franchise pharmacies and Pilulka boxes). The company's long-term vision is to expand its delivery service to the major regional cities of the Czech Republic. The main strategy of continuing with expanding and Pilulka Auto is to promote its brand offering as a value-added service for customers throughout the process of purchasing through Pilulka.

Product offerings of local e-commerce players

The retail pharmacy business does not just comprise prescription and OTC drugs. It overlaps with the broader CHC, infant, personal care and beauty/cosmetics categories. Local pharmacies commonly stock some or all of these product, just like in a supermarket or a drugstore (e.g. a pharmacy, with no dispensaries). Pilulka offers a wide range of product categories online, from veterinary/animal goods to electronics for personal care. Its local pharmacy peers sell practically the same items (other than OTC), as do local marketplaces. To differentiate itself and attract more sales, the most important factor it considers is pricing strategies between the local competitors in the online segment (e.g. loyalty programmes and discount strategies).

Other key ways to gain new active customers are to focus on: i) the overall customer experience ordering through Pilulka online; ii) health tie-ins; iii) private label products; and iv) last-mile factors like delivery costs and proximity to pick-up points.

By offering a wide range of products, e-pharmacies like Pilulka can act as a one-stop-shop for consumer health-related purchases. To illustrate this, on Pilulka.cz, a customer may purchase fever relief drugs (OTC), washing detergent, toilet paper, toothpaste/mouthwash and vitamin supplements: i.e. the basic home cleaning and personal health items needed for the average person or family on a regular basis. By increasing the product base, e-pharmacies like Pilulka may be able to upsell to its customers, increasing the basket size and frequency of orders, as customers would be inclined to shop on one platform for their needs.

We looked at the 13 product categories that Pilulka offers, and cross-checked their availability with the local e-shops: i) pharmacies like Dr Max, BENU, Lekarna.cz, and dm.cz (a drugstore); ii) pure-play e-commerce sites/platforms Alza and Mall; and iii) online supermarkets Rohlik.cz, Kosik.cz and iTesco.

Practically all the e-shops offer the same FMCGs, to some extent: toiletries (like personal cleaning products), personal hygiene/care products (including dental care), special health food/beverages (e.g. keto, paleo, gluten-free), and mother and infant care items. Food and nutritional supplements, like vitamins and minerals, are also offered by all the players, and is a popular category, reflecting the increasing demand for preventative healthcare and general wellness. Interestingly, animal care products have also become widespread in e-pharmacies, including animal food/nutrition, treatment solutions/creams and toys/equipment. The local pharmacies also all offer cosmetics and beauty products, geared especially towards specialised dermo-cosmetics, with a subset of beauty products dedicated to decorative cosmetics and beauty.

BENU also benefits from offering OTC drugs on a partner platform, through local e-grocer Rohlik.cz. The online grocery store started listing BENU's product catalogue after approval by the local regulator in 2018.

Categories	Pharmacies/drugstores					E-commerce		E-grocers		
	Pilulka	Dr. Max	BENU	Lekarna.cz	Dm.cz	Alza.cz	Mall.cz	Rohlik.cz	Kosik.cz	iTesco
OTC	✓	✓	✓	✓				✓*		
Beauty & cosmetics	✓	✓	✓	✓	✓	✓	✓			
Dietary/food/nutrition suppl.	✓	✓	✓	✓	✓	✓	✓	✓*	✓**	✓
Toiletries/hygiene/personal care	✓	✓	✓**	✓	✓	✓	✓	✓	✓	✓
Specialist health food/beverages	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mother and infant	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Source: WOOD Research, *Through BENU partnership, ** limited offerings

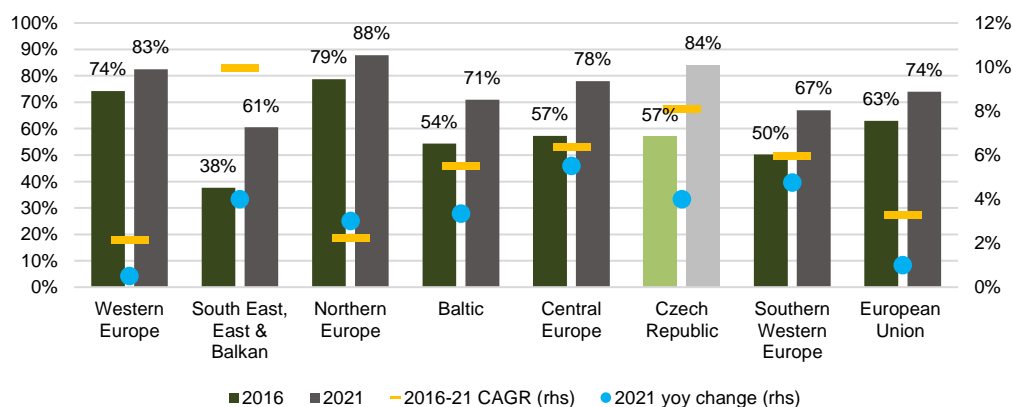
When it comes to groceries (food and beverages), local e-pharmacies offer a limited selection, mostly products categorised as 'healthy' and/or 'organic/bio', in categories such as oils, dried fruits and nuts, herbal teas and coffees, and some grains and pasta. Additionally, e-pharmacies have begun to offer a wider selection of specialised sports nutritional products and electronics related to personal care, such as electric razors/shavers and hairdryers, as well as household items like coffee makers and food mixers.

A typical Czech e-commerce consumer in a European context

Overall, the typical Czech e-consumer is very similar to their EU counterpart. According to a 2020 survey by Eurostat, responses from Czechs indicate that they buy beauty/cosmetics/wellness products, cleaning & personal hygiene goods and medicines (excluding Rx) online - segments where Pilulka is active - more often than the average EU consumer. Most of the aforementioned product categories are driven, understandably, by women. The results of the Eurostat survey came to similar conclusions to one conducted by APEK.

Czechia ranks among the highest countries in the EU in terms of internet users who shop online, according to a 2021 Eurostat survey. About 84% of internet users in Czechia said that they shopped online in 2021, up from 57% in 2016. Its current e-consumer penetration is similar to its peers in both Northern Europe (i.e. Sweden, Finland, Norway and Iceland, where c.90% of respondents shopped online), and Western Europe. Unlike the west or north, where e-consumer penetration is relatively mature (2016-2021 CAGR of 2%), the share of consumers shopping online in Czechia has continued to grow at a considerably faster rate in the past five years, with a 2016-21 CAGR of 8%. This was higher than the EU average but lower than the growth experienced in the South-East, East and Balkan regions (2016-21 CAGR of 10%) where a considerable portion of the population that does not shop online. The EU average, meanwhile, was 74%, up from 63% in 2016 (a 2016-21 CAGR of 3%).

Eurostat survey: % of internet users who purchased online in 2021 (e-consumer penetration)

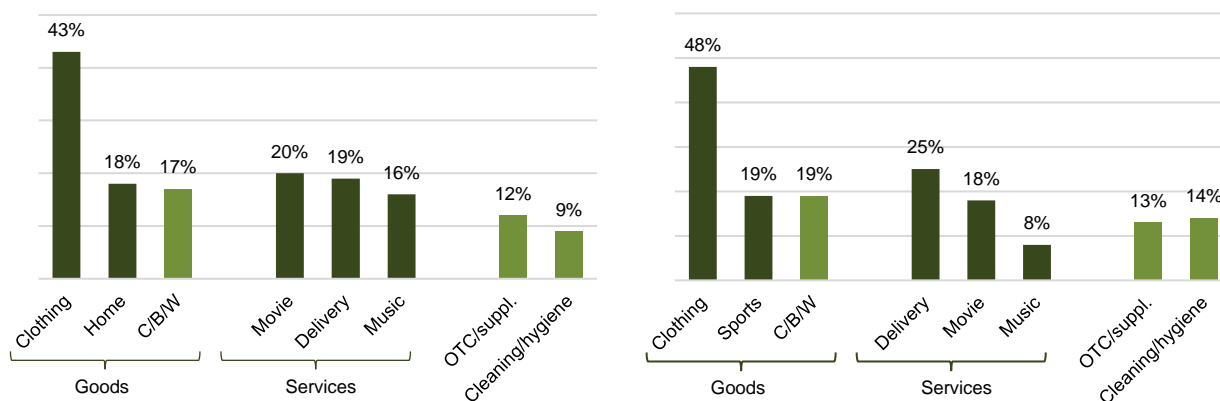


Source: WOOD Research, Eurostat

Clothing and footwear were the most popular goods bought in the EU, and streaming services were the most popular services purchased. On average, the survey indicates that approximately 43% of EU internet users purchased clothing and footwear in 2021, slightly below the ratio in Czechia, which stood at 48%. Among goods purchases in the EU, the top three were clothing/footwear (43%), home furniture/accessories (18%), and cosmetics/beauty/wellness products (17%). Czech consumers have similar preferences, except that the second most popular products are sporting goods (19%), rather than home furniture/accessories. As for services, in no particular order, the top EU and Czech consumer purchases were film and music streaming, and food delivery.

As mentioned above, Pilulka also operates in the wider beauty and cosmetics segment, as well as the CHC/personal care segment. The segments where Pilulka is active - cosmetics/beauty/wellness - rank among the top three purchases in both EU and Czechia. More Czechs buy FMCG like personal hygiene and cleaning products online than the EU average (14% vs. 9%), while the purchase of OTC and dietary supplements (where Pilulka is active with its private label) are at similar levels.

Eurostat survey: top purchase categories in 2021 - goods, services, consumer healthcare, beauty/cosmetics EU Czechia



Source: WOOD Research, Eurostat, C/B/W is cosmetics, beauty, wellness.

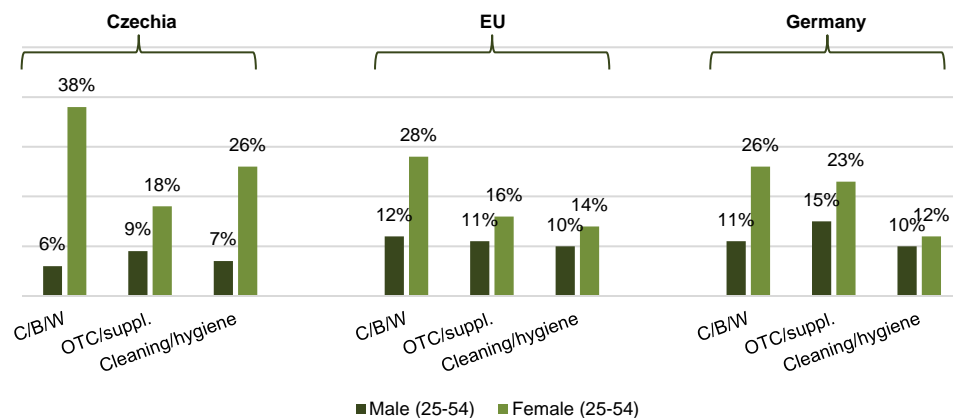
A survey conducted by APEK in 2020 came to similar conclusions. It confirmed broadly that e-consumer (or e-shopper) penetration was high in Czechia, at c.90% of internet users over the age 15. The second-most purchased categories after clothing (61%) were beauty/cosmetics and CHC/personal care. Combined, these were purchased by 47% of internet users, while OTC drugs and nutritional/dietary supplements (including bio/organic products) stood at 35% and 29% respectively. The penetration for the aforementioned categories, on average, has grown c.15-20% in the past decade.

When we break down the online shopping behaviour between genders, Pilulka's core demographic, women aged 25-45, drives most of the consumer purchase behaviour in the broader consumer/personal healthcare FMCG and OTC/dietary supplement categories. Czechia, according to the Eurostat survey, boasts higher e-consumer penetration when it comes to women purchasing online compared to both the

EU average, and its next-door neighbour Germany, where the online retail market is developed and mature.

The Eurostat survey indicated that 38% of female internet users aged 25-54 purchased cosmetics/beauty and wellness products online, significantly higher than the EU and German average (26-28%). Additionally, 18% indicated that they purchased medicines and dietary supplements in 2021. The 2021 surveys suggest that Czech consumers exceeded the EU in terms of e-consumer penetration in these categories in 2021. Even looking at Czechia's neighbouring countries with a more developed and mature e-commerce market, Germany still trails in online shopping penetration in the aforementioned categories.

Eurostat survey: share of internet users purchasing consumer health care products, by gender, 2021



Source: WOOD Research, Eurostat, C/B/W is cosmetics, beauty, wellness.

Risks

Pilulka is listed on the PSE START market, which has less strict reporting requirements compared to the Prime and Standard markets. Importantly, it is not required to produce either full quarterly or semi-annual financial reports for investors, or financials according to IFRS. Instead, it is obliged to provide “necessary cooperation” to an authorised analyst, who should publish company updates on a regular basis. Pilulka is required to provide the exchange with such a report within four weeks of publishing its annual report. It is required to attend the exchange’s START Days, which are currently organised in the spring and the autumn, and to present “up-to-date information related to its financial situation and the development of the its business”.

In addition to more lax disclosure obligations, Pilulka is a publicly-listed company, competing in markets that are dominated by privately-held players. As such, the company may choose not to disclose information and metrics it deems “commercially sensitive”. Nonetheless, the stock could be a candidate for a PSE Prime market listing. Moving to the main market, which we anticipate may be feasible in the next 12-24 months, if the company decides to do so, should improve liquidity and reporting standards, and provide greater visibility to investors.

Purchasing power and integration with a wholesaler. Pilulka still lacks the purchasing power of its larger peers as, unlike them, it is not integrated with a major regional wholesaler. As a result, it may find it challenging to compete effectively with its peers solely on price, without a material impact on its earnings

Logistics. Pilulka works with most of the major ‘last-mile’ logistics providers, and is looking to differentiate itself with its own one-day delivery and locker network. Nonetheless, it lacks the extensive bricks & mortar network that its larger competitors rely upon and, given its size, it could find it difficult if the larger peers decide to invest heavily in their own logistics, which has not been the case up to now.

International expansion and capacity. Pilulka is established in the Czech market and is focusing on Romania in the near term. Additionally, it has plans to expand into Austria, Hungary and Germany. Such international expansion is common for the major Czech e-commerce players, which is understandable, in view of the limited size of the domestic market. Similar e-pharmacy concepts in these markets do exist, as does competition from the established retail chains, like Dr. Max in Romania, which may have superior brand recognition and knowledge of local customers’ preferences, as well as better relations with suppliers and business partners. Zur Rose and Shop Apotheke have already established an online presence in the DACH region.

Pilulka’s international expansion is likely to involve significant investments, especially in the near term, if the expansion plan is executed, but it may not deliver the anticipated returns. Moreover, expansion into Austria and Hungary, initially, would be serviced through Pilulka’s warehouses in Slovakia and Czechia, which could put more strain on its logistics and distribution capacity, and may be reflected in higher opex.

Overhang risk. There was no lock-up for Pilulka’s main shareholders following the IPO: they are free to divest their position at any time. Moreover, Pilulka’s free float is held predominantly by local retail investors, which means a different trading dynamic compared to stocks where the free float is held largely by institutional investors.

Inflationary pressure. Although it is primarily a consumer staples business, we believe the discretionary spending of Pilulka’s customers, e.g. in the CHC and beauty & cosmetics segments, may be impacted adversely in a persistent inflationary environment. Speaking with the company, packaging, delivery, utility and energy costs are rising fast: by double-digits so far. Although the company intends to pass the cost pressures onto its end-users, it may not be able to do so to the full extent, which would start to erode margins and have an adverse impact on Pilulka’s ability to compete in pricing.

Financials

Profit and loss

CZKm	2018	2019	2020	2021	2022E	2023E	2024E
Sales of goods	893	1,166	1,673	2,239	2,605	3,125	3,679
<i>Online channel</i>	550	779	1,230	1,831	2,238	2,815	3,413
<i>Bricks & mortar channel</i>	348	388	444	408	367	309	267
Other revenues	116	72	107	141	170	208	249
<i>Rebates from vendors</i>	n.a.	57	75	89	113	136	162
<i>Delivery fees</i>	n.a.	10	25	40	51	67	83
<i>Rx dispensary fees</i>	n.a.	6	8	7	6	5	4
<i>Other</i>	n.a.	n.a.	0	5	0	0	0
Total sales	1,009	1,239	1,780	2,380	2,775	3,333	3,929
Cost of sales	-905	-1,112	-1,582	-2,143	-2,494	-2,992	-3,527
Gross profit	103	127	198	238	281	341	402
Personnel expense	-109	-146	-167	-224	-268	-304	-341
Other income/(expense)	-2	-5	-9	7	0	0	0
EBITDA	5	-24	25	29	13	36	60
D&A	-14	-19	-19	-23	-33	-37	-44
Amortisation of consolidation difference, net	-1	-2	-2	-12	-2	-2	-2
Provisions and impairments	-12	0	-3	-8	0	0	0
EBIT	-22	-45	1	-14	-22	-3	14
Net interest expense	-2	-4	-3	0	-3	-5	-7
FX gains/(losses)	-2	-4	-24	-11	0	0	0
Other financial income/(expense)	0	0	0	0	0	0	0
Net financial expense	-4	-7	-26	-11	-3	-5	-7
Pre-tax income	-26	-52	-25	-25	-25	-7	7
Taxes	0	1	-1	-1	-1	-1	-1
Net Income	-26	-51	-26	-26	-26	-8	6
Minority interest	-1	-5	-4	0	0	0	0
Net income to equity holders	-25	-45	-22	-25	-26	-8	6

Source: Company data, WOOD Research

Growth and margins

	2018	2019	2020	2021	2022E	2023E	2024E
Gross margin	10.2%	10.3%	11.1%	10.0%	10.1%	10.2%	10.2%
EBITDA margin	0.5%	-1.9%	1.4%	1.2%	0.5%	1.1%	1.5%
Operating margin	-2.2%	-3.6%	0.1%	-0.6%	-0.8%	-0.1%	0.4%
Net margin	-2.5%	-3.7%	-1.2%	-1.1%	-0.9%	-0.2%	0.1%
Revenues growth	52.0%	22.8%	43.7%	33.7%	16.6%	20.1%	17.9%
<i>Online channel</i>	n.a.	41.6%	57.9%	48.9%	22.2%	25.8%	21.2%
<i>Bricks & mortar channel</i>	n.a.	11.4%	14.4%	-8.0%	-10.1%	-15.6%	-13.8%
<i>Other revenues</i>	4.1%	-37.6%	48.1%	31.7%	20.3%	22.6%	19.7%

Source: Company data, WOOD Research

Balance sheet

CZKm	2018	2019	2020	2021	2022E	2023E	2024E
PP&E	29	33	35	62	84	85	86
Intangibles	63	50	54	83	113	150	191
Long-term investments	0	0	0	4	4	4	4
Consolidation difference (net)	33	31	28	26	26	23	21
Securities held	0	-1	0	0	0	0	0
Non-current assets	125	113	117	175	227	263	302
Inventory	67	77	91	155	198	230	261
Receivables	134	139	155	185	202	238	275
Cash	13	10	132	72	19	27	30
Current assets	215	226	378	412	419	495	566
Prepayments and accrued assets	7	6	4	2	2	2	2
Total assets	347	345	498	589	648	760	870
Share capital	2	2	3	3	3	3	3
Share premium	114	175	389	390	390	390	390
Retained earning	-24	-94	-142	-163	-189	-214	-222
Current year net profit	-26	-45	-22	-25	-26	-8	6
Consolidation differences	1	0	0	0	0	0	0
Equity	67	38	228	204	179	171	177
Minority share	-1	-6	-10	0	0	0	0
Long-term payables	36	42	3	21	21	21	21
Short-term payables	240	270	271	348	430	547	651
Trade payables and other	154	194	246	326	389	467	551
Liabilities to credit institutions	85	76	25	21	41	80	100
Accruals and deferred income	5	0	0	1	1	1	1
Provisions	0	0	6	15	17	19	21
Liabilities	281	313	280	385	469	589	694
Total equity and liabilities	347	345	498	589	648	760	870
Net debt to EBITDA (x)	15.1	-2.8	-4.2	-1.7	1.7	1.5	1.2
Net debt	72	67	-107	-50	22	53	70

Source: Company data, WOOD Research

Cash flow statement

CZKm	2018	2019	2020	2021	2022E	2023E	2024E
PBT	-26	-52	-25	-25	-25	-7	7
Depreciation and amortisation	14	19	19	23	33	37	44
Other	62	-2	12	20	5	7	9
Operating cash flow before W/C changes	50	-35	6	19	13	36	61
Receivables and prepayments	0	-8	-15	-28	-17	-36	-37
Payables and accruals	0	30	33	99	63	80	85
Inventory	0	-10	-14	-65	-43	-31	-31
Operating cash flow after W/C changes	50	-22	10	25	16	49	77
Interest received/paid	0	0	-3	0	-3	-5	-7
Income tax paid	0	0	0	0	-1	-1	-1
Operating cash flow	50	-22	7	25	13	44	69
Capex	-45	-49	-28	-82	-85	-75	-86
Other	0	0	0	0	0	0	0
Cash flow from investment	-45	-49	-28	-82	-85	-75	-86
Change in debt	2	6	-52	-3	19	39	20
Impact of changes in equity on cash	-9	62	194	0	0	0	0
Other financing deposits	0	0	0	0	0	0	0
Cash flows from financing activities	-8	67	142	-3	19	39	20
Cash BoP	16	13	10	132	72	19	27
Net change in cash	-2	-4	122	-60	-53	9	2
Cash EoP	13	10	132	72	19	27	30

Source: Company data, WOOD Research

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29/07/2022	HOLD – initiation of coverage	29/07/2022	CZK 1,120

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