

1 September 2020

Sopharma AD

SELL

| | |
|----------------------|--------|
| BBG Ticker | 3JR BU |
| Market Cap (USD mil) | 253 |
| Price | 3.08 |
| Price target | 3.00 |
| Upside | -2.6% |

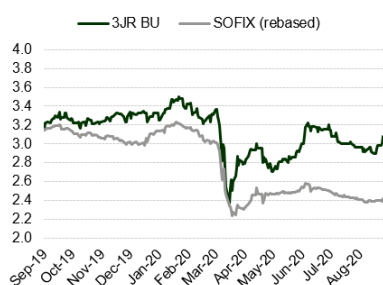
Sopharma: 2Q20 results support our FY20E earnings outlook

Sopharma's consolidated 2Q20 results came in broadly in line, we believe, with revenues growth on the wholesale side slowing after the unusually high, COVID-19 related demand in the first quarter, and finished goods sales slowing to a mid-single digit pace. By the end of June, the company had delivered 49% of our estimated FY20E revenues and 48% of our estimated EBITDA (last year, the figures were 48% and 48%, respectively), which suggests that our full-year expectations of slightly accelerating growth in wholesale and a deceleration in the growth of finished products remain largely intact. Similarly, we expect some compression of the EBITDA margin – due to the higher share of wholesale in the revenues mix – which is also borne out by the 1H20 numbers.

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While the capex slowed in the quarter, under the influence of COVID-19, we also saw a drop in FCF generation, albeit driven more by lower cash from operations (a working capital impact, we believe). Inasmuch as we see capex being driven by the expansion of its Serbian wholesale business and into the pharmacy chain, two businesses that should not suffer overall from the ongoing pandemic, we believe that it is still realistic that it will accelerate in 2H20E. In this case, the near-term trend should also be in the direction of lower FCF generation, at least until Sopharma winds up its investment cycle in Serbia (by end-2022E, we expect). On our forecasts, the stock trades currently at a 2020E EV/EBITDA of 8.1x, or fully in line with its peers, and at an average 2021-22E EV/EBITDA of 7.8x, or a c.10% premium. At this stage, we do not see a reason to trigger a positive surprise for our forecasts, so we maintain our SELL recommendation on the stock.

Yesterday (31 August), Sopharma reported 2Q20 consolidated net profit of BGN 9.8m (+36% yoy) on revenues of BGN 313m (+4.8% yoy) and EBITDA of BGN 21.3m (unchanged yoy). The 2Q20 revenues from the sale of goods (i.e., wholesale) and finished products (i.e., the pharma businesses) rose by 4.9% and 4.5% yoy to BGN 248m and BGN 65m, respectively. Sopharma does not provide a quarterly sales split by geographical region on the consolidated level, but we note that, on a stand-alone basis, the domestic sales of the production business domestic fell by 39% yoy (-19% in 1H20), while exports in Europe grew by 39% (+13% in 1H20), led by Russia and Ukraine. Sopharma Trading's 2Q20 domestic sales increased by 2.5% yoy and we attribute the higher growth on the consolidated level to the Serbian business.

Sopharma: 2Q20 earnings review

| BGN m | 2Q20 | 1Q20 | 2Q19 | yoy | qoq | 1H20 | 1H19 | yoy |
|---------------------------------------|--------------|--------------|--------------|-------------|-------------|--------------|--------------|------------|
| Sale of goods | 247.5 | 294.8 | 235.9 | 4.9% | -16% | 542.3 | 484.4 | 12% |
| Sale of finished products | 65.5 | 71.2 | 62.6 | 4.5% | -8% | 136.7 | 127.6 | 7% |
| Total revenues | 313.0 | 366.0 | 298.6 | 4.8% | -15% | 679.0 | 611.9 | 11% |
| Opex | -291.6 | -338.9 | -277.3 | 5.2% | -14% | -630.5 | -562.6 | 12% |
| EBITDA | 21.3 | 27.2 | 21.2 | 0.4% | -22% | 48.5 | 49.4 | -2% |
| EBITDA margin | 8.6% | 9.2% | 9.0% | | | 8.9% | 10.2% | |
| Operating profit | 10.4 | 16.4 | 10.6 | -2% | -37% | 26.7 | 28.1 | -5% |
| Finance income / (costs), net | -1.0 | -6.0 | -1.8 | -45% | -84% | -7.0 | -2.6 | 171% |
| Associates and joint ventures, net | 2.0 | 0.5 | -0.6 | n.m. | 265% | 2.5 | 1.9 | 35% |
| Gain on purchase/sale of subsidiaries | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | |
| Pre-tax profit | 11.4 | 10.9 | 8.3 | 38% | 5% | 22.3 | 27.4 | -19% |
| Minorities | 0.5 | -2.4 | -0.2 | n.m. | | -1.9 | 1.6 | n.m. |
| Net profit to equity holders | 9.8 | 10.8 | 7.2 | 36% | -9% | 20.6 | 22.6 | -9% |

Source: Company data, WOOD Research

Opex rose slightly faster than revenues, driven by materials (+25% yoy) and the cost of goods for resale (+8% yoy), meaning that the EBITDA was flat yoy, at BGN 21.3m, and we saw a slight compression of the EBITDA margin to 8.6% vs. 9% in the quarter preceding. Below the operating line, the group benefited from lower net interest costs of c.BGN 0.8m, which came primarily from a partial reversal of the FX revaluation losses on FX loans (adding BGN 1.8m), while the interest costs on bank loans rose by BGN 0.9m, to BGN 3.2m. Earnings from associates contributed BGN 2m in the quarter vs. a BGN 0.6m loss in 2Q19, thanks to its stake in Doverie Holding. As a result, pre-tax earnings grew by 38% yoy, to BGN 11.4m. The minority interest was a positive BGN 0.5m, as the Belarussian pharmacy business moved back to profitability in the quarter.

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In 2Q20, Sopharma generated a cash flow outflow from operations (including the proceeds from factoring) of BGN 11.0m vs. an inflow of BGN 6.1m in the base period. Cash from factoring grew by 20% yoy, to BGN 54.4m; in our view, the difference seems to have been driven by an increase in working capital – specifically, higher inventories (by BGN 11.5m yoy) and a bigger qoq drop in trade payables (by BGN 19.4m, vs. BGN 4.1m in the base period, but largely a seasonal impact). The capex for the quarter fell by 33% yoy, to BGN 9.9m; nevertheless, the FCF burn more than doubled, to BGN 20.9m, vs. BGN 8.8m in the base period (the FCF for the whole first half was a negative BGN 29m vs. the positive BGN 4.7m in 2019). The net debt stood at BGN 378m, or c.2% lower than end-2019, and the gearing ratio was unchanged, at 3.7x.

| Year | Sales BGN m | EBITDA BGN m | Net profit BGN m | EPS BGN | EPS % yoy | DPS BGN | P/E (x) | EV/EBITDA (x) | P/CE (x) | Div yield % |
|-------|----------------|-----------------|---------------------|------------|--------------|------------|------------|------------------|-------------|----------------|
| 2017 | 1,017 | 85.9 | 40.0 | 0.31 | 87% | 0.11 | 13.4 | 9.8 | 7.3 | 2.7% |
| 2018 | 1,179 | 72.3 | 28.3 | 0.23 | -27% | 0.05 | 18.0 | 12.1 | 17.1 | 1.2% |
| 2019 | 1,282 | 103.7 | 87.0 | 0.69 | 207% | 0.12 | 4.9 | 8.3 | 5.9 | 3.5% |
| 2020E | 1,374 | 101.2 | 50.1 | 0.40 | -43% | 0.12 | 7.7 | 8.1 | 9.9 | 3.9% |
| 2021E | 1,453 | 107.1 | 39.1 | 0.31 | -22% | 0.11 | 9.9 | 7.9 | 6.0 | 3.5% |
| 2022E | 1,542 | 114.2 | 43.7 | 0.35 | 12% | 0.12 | 8.8 | 7.7 | 6.5 | 4.0% |

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|------------|-------------------------------|------------|----------|
| 06/07/2020 | SELL – initiation of coverage | 06/07/2020 | BGN 3.00 |

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